



# Corporate Level

## Corporate Taxation

### (Pilot Paper)

#### **Instructions to candidates**

(1) Reading time: 15 minutes

Time allowed for writing : 3 hours

(2) All questions should be answered

(3) Answers to questions should be in the answer booklet provided to you.  
Begin each answer on a separate page.

(4) All answers should be in English.

K

C

3

June 2015

## SECTION 1

### Question 01

Mr. Senevirathna is a businessman engaged in the business of selling hardware and building construction materials in Colombo. He commenced this business as a proprietorship in 1980. He is an income tax payer since 1986. Mr. Senevirathna used to file his return of income tax on time from the day he become a tax payer. However, for the year of assessment 2013/14 he was unable to submit his return of income tax on the due date.

Mr. Senevirathna has not registered for VAT and NBT yet. According to the financial information extracted from the accounts of his business for the financial year ended in 31.03.2015,-his turnover details are as follows:

Buying and selling hardware items	Rs. 16 Mn
Hiring of lorries	Rs. 9 Mn

According to the returns of income tax filed, Mr. Senevirathna has paid income tax for the past five years of assessment as follows:

Year of assessment	Tax paid (Rs.)
2012/13	1,250,000
2011/12	978,000
2010/11	380,000
2009/10	260,000
2008/09	250,000

On perusal of the tax payments, it was noted that Mr. Senevirathna had paid his income tax on a quarterly basis on the due date as stipulated in the Inland Revenue Act.

Mr. Senevirathna left for Australia in May 2014 for his daughter to pursue her higher education there. He returned to Sri Lanka in June 2015.

According to Mr. Senevirathna, the only pending matter connected with his income tax is the assessment which was issued for the Year of Assessment 2010/11 by the Department of Inland Revenue. This assessment was issued in connection with the transport income of his business. Upon receipt of the assessment, Mr. Senevirathna had appealed against the said notice of assessment issued for the Y/A 2010/11-within 30 days as stipulated in the Inland Revenue Act. According to Mr. Senevirathna the appeal had been handed over to the relevant unit which handles his income tax file and a copy of the appeal has been stamped "Received on 10<sup>th</sup> March 2012.

After handing over the appeal he did not receive any correspondence in connection with the appeal submitted except the 'Tax in Default' notices issued by the Department of Inland Revenue from time to time. Each time Mr. Senevirathna received such a notice, he informed the Commissioner General that he had already made an appeal. In March 2015 4 Mr. Senevirathna received a notice under Section 179(1) of the Inland Revenue Act, informing him that action will be taken to recover the tax in default for the year of assessment 2009/10.

You are required to:

**1. Analyse** the position of Mr. Senevirathna with regard to the notice of assessment issued for the Y/A 2010/11.

**(8 marks)**

**2. Discuss** the benefits available to Mr. Senevirathna as an income tax payer under the Finance Act.

**(4 marks)**

**3. Advise** on any VAT and NBT liability that may have arisen. (Your advice should be supported with computations).

**(5 marks)**

**4. Analyse** whether the change of residency status of Mr. Senevirathna has any effect on the tax free allowance under Section 33 of the Inland Revenue Act for the Y/A 2014/15.

**(4 marks)**

**5. Advice** Mr. Senevirathna on the consequences of a delay in filing his return of income tax

**(4 marks)**

**Total 25 marks**

## **Question 02**

Alphine Industries (UK) Ltd. (AI), a company resident in the United Kingdom, manufactures agricultural tools and equipment. AI currently supplies high quality agricultural tools and equipment to the European market. AI is now seeking to consolidate their position in Asian markets. In the year 2012 AI set up a branch office in Sri Lanka to sell their products. Before the Sri Lanka branch was set up, AI's customers in Sri Lanka placed their orders directly with AI (UK) Ltd. However, after the establishment of the local branch most customers in Sri Lanka place their orders through the branch with the exception of a few customers who still place their orders directly with AI (UK) Ltd. According to the statistics available for the year of assessment 2014/15, AI (UK) Ltd has supplied Rs. 60Mn worth of goods to Sri Lankan customers who placed orders directly with them.

A manager and assistants have been employed for the purpose of canvassing business for AI. The branch in Sri Lanka accepts orders on behalf of the Company. The branch keeps proper records of all the goods ordered through them. Payments for goods sold by the branch are received both by the branch and the head office in the UK. Generally, customers are advised to make payments direct to the head office in respect of bulk purchases. AI has employees in their UK office to handle orders and other administrative matters.

During the year of assessment 2014/15 head office expenses connected with the Sri Lankan branch were Rs. 14 Mn. During the year the branch remitted Rs. 50 Mn to the head office in UK and invested part of its excess funds in government securities (Treasury bills). During the year Rs. 9 Mn was received as interest and Rs. 2 Mn. as dividends.

During the year ended 31.3.2015 4 the branch had the following profits and income in Sri Lanka.

	<u>Rs.</u>
Sale of goods by the Sri Lanka branch	200,850,000
Cost of goods sold in Sri Lanka	101,000,000
Gross profit	99,850,000
Other income	11,000,000
Less: Expenses	
Salaries and administration expense of the branch office	3,150,000
Entertainment expenses of the branch	700,000
Advertising	2,000,000
Net profit of the branch before head office expenses	105,000,000
Head office expenses	14,000,000
Net profit after head office expenses	91,000,000

The branch had purchased Rs. 5 Mn worth of computers and related equipments in the Y/A 2013/14 and depreciation charges of Rs. 500,000 are included in the above salaries and administration expenses.

According to the double tax treaty between Sri Lanka and the United Kingdom, the Company is entitled to claim a credit in respect of tax paid in Sri Lanka against the tax payable in the UK on the same income.

You are required to:

1. **Prepare** a report specifying direct and indirect taxes applicable to AI in respect of their operations connected with the branch established in Sri Lanka.  
**(7 marks)**
2. **Compute** income tax liability of AI in Sri Lanka for the year of assessment 2014/15 under the Inland Revenue Act.  
**(10 marks)**
3. **Outline** the taxes which qualify for relief in the UK and the extent of relief under the double tax treaty.  
**(4 marks)**
4. **Discuss** the responsibility of a non-resident company on account of remittances made by such non-resident company (OR Returns to be filled by non-resident company.)  
**(4 marks)**

**(Total 25 marks)**

## Section 2

### Question 03

(based on pre-seen information).

In addition to the pre-seen information in connection with Migaya Ceramics Lanka PLC (MCLP) you are provided the following additional information for the financial year ended 31<sup>st</sup> March, 2015:-

i) Extract of Income Statement for the year ended 31.03. 2015

	<b>(Rs. 000)</b>
Turnover	2,750,000
Cost of sales	2,020,000
Gross profit	730,000
Other income	2,000
Investment income	13,800
Distribution expenses	(285,300)
Administrative expenses	(192,500)
Finance cost	(167,000)
Profit before tax	101,000
Income tax expenses	(12,120)
Net profit after tax	88,880

- ii) MCLP commenced its business of manufacture and export of tiles prior to 10<sup>th</sup> November 1993.
- iii) MCLP is a globally marketed brand name. Part of its exports is purchased from its subsidiary company, Migaya Porcelain (Pvt) Ltd at the ready-to-export price and exported without a profit margin to MCLP. During the year under review MCLP has purchased Rs. 230 Mn worth of tiles from Migaya Porcelain (Pvt) Ltd.
- iv) MCLP adopted SLFRS in the financial year 2012/13. The revaluation gain of Rs. 18 Mn recognized in the first year of adoption has been reversed during the financial year 2014/15. This adjustment and a sum of Rs. 180,000 paid as valuation charges are included in administrative expenses.
- v) The Company has constructed a warehouse on a leasehold land obtained from Migaya Porcelain (Pvt) Ltd with the right to build. MCLP has paid Rs. 750,000 as lease rentals and charged this to the distribution cost. The construction cost

incurred amounting to Rs. 272 Mn has been capitalized under the caption of 'Building'.

vi) Turnover of the Company is made up as follows:

	<b>(Rs. 000)</b>
Export turnover	2,000,000
Local sales	750,000
Total turnover	2,750,000

vii) At the annual stock verification of the Company, the auditors have identified stock losses due to breakages and damage amounting to Rs. 17.5 Mn. This amount has been debited to the stock losses account and included in the finance cost.

viii) The following is an extract of the expenses included under distribution and administration expenses:

	<b>(Rs. 000)</b>
Depreciation	138,000
Entertainment	3,032
Advertising outside Sri Lanka	88,000
Advertising in Sri Lanka	12,000
Foreign travel expenses for trade fairs and exhibitions	3,100
Provision for slow moving stocks	4,250
Provision for retirement benefits	6,250
Research and development charges paid to SLIT	1,800

ix) The Company has set up a new production line for manufacture of ceramic tiles. The investment in machinery in the financial years 2013/14 and 2014/15 was Rs. 40 Mn and Rs. 80 Mn respectively. The new production line was commissioned in February 2015 .

(ix) Details of property, plant and equipment are as follows:

	<b>(Rs. 000)</b>
Opening balance (BWDV) as at 01.04.2014	1,852,000
Add: Cost of additions	352,000
Less: Depreciation for the year	(138,000)
Impairment adjustment	(18,000)
Book written-down value of disposals	(2,600)
Closing balance (BWDV) as at 31.03.2015	2,045,400

(x) Analysis of provision accounts:

<b>Provision account</b>	<b>As at 31.03.2014 3 (Rs. 000)</b>	<b>As at 31.03.2015 4 (Rs. 000)</b>
Retirement benefits	48,027	51,277
Slow moving stocks	14,750	19,000

(xi) Other income of the Company represents the profit on sale of fixed assets. The tax written-down value of the asset disposed was Rs. 3 Mn.

(xii) Investment income includes interest income of Rs. 5.4 Mn received on Treasury bonds and the balance represents net dividend income received from subsidiaries.

(xiii) Except for the purchase and disposal of fixed assets stated above, no other assets have been purchased or disposed. On all assets other than additions which are clearly indicated, allowance for depreciation has been claimed in full.

The policy of the Company is to depreciate buildings and machinery at 10% and 12% respectively, irrespective of the date of purchase.

(xiv) In December 2013, the Company made a bonus issue of shares amounting to 193.5 Mn. The market price of a Company share at the date of the bonus issue was Rs.15.60. Stamp duty paid on the bonus issue is included in the finance cost.

(xv) The excess VAT input tax brought forward to the year of assessment 2014/15 amounts to Rs. 87 Mn. This excess is mainly due to input VAT credit on account of tiles purchased from Migaya Porcelain (Pvt) Ltd.

Assume that you are the Finance Controller of the Company and you are given the following tasks.

1. To **assess** the income tax liability of the Company for the year of assessment 2014/15.

**(25 marks)**

2. "The objective of the bonus issue was to please the shareholders as the Company did not wish to declare any dividend for the year 2014/15." **Convince** the Managing Director of the company(MCLP) the tax implications of this decision.

**(08 marks)**



3. **Advice** the Managing Director on the course of action that the Company should take on the matter mentioned in the intimation letter issued for the Y/A 2013/14 and to clarify whether the reason given in the intimation is adequate. Support your advice wherever possible with references to decided Case Law.

**(12 marks)**

4. **Analyse** actions available to the group in order to reduce the cash flow burden of paying and claiming VAT input tax on the tiles purchased from Migaya Porcelain (Pvt) Ltd under the Value Added Tax Act.

**(05 marks)**

**(Total 50 marks)**