THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SRI LANKA

SUGGESTED SOLUTIONS

KC 3 - Corporate Taxation

June 2016

Answer 01

(a)

Relevant Learning Outcome/s:
4.4. Managing VAT in a business

Suggested Detail Answer:

Output tax			
	Value of Supplies (Rs.)	**Rate**	**Tax (Rs.)**
Taxable Supplies-Rent	1,000,000	11%	110,000
VAT Suspended Taxable Supplies	48,586,000	11%	5,344,460
Zero rated Supplies	902,750,000	0%	-
Excluded Supplies	108,000,000	-	-
Total Output taxes			**5,454,460**

Information Related to other supplies				
	Numbers/Kgs	**Value of Supplies(Rs.)**	**Rate**	**Tax(Rs.)**
Local supplies of Garments	3,200	3,252,000	Rs.25	80,000
Local supplies of Fabrics	900	1,050,000	Rs.40	36,000

Input tax		**Rs.**		**Rs.**
Imports on which VAT is not Charged	Exempt	522,471,000	-	-
VAT Suspended Purchases		198,252,000	-	-
Local Purchases-VAT registered Persons		4,565,000	11%	502,150
Local Purchases- on which VAT is not charged		489,000		-
				502,150
Disallowable inputs on purchases				(340,000)
Allowable Input tax				**162,150**

Input tax applicable without restriction			
Input relating to Exports and Suspended supply			
Exports + Suspended supply x Allowable Input Tax	951,336,000	X 162,150	161,980
Total supply excluding exempt and Excluded Supplies	952,336,000		
Input tax restricted to 100% of output tax			
Input related to other supplies (162,150-161,980)			170
Total allowable Input Tax			162,150
Tax payable (Output-Allowable Input)			5,292,310
Deductions			
SVAT Credit Vouchers			(5,344,460)
Refund Due			(52,150)

(b)

Relevant Learning Outcome/s:
4.3.2. Outline significant features of the Simplified VAT Scheme.

Suggested Detail Answer:

As per the Guidelines Issued by Gazette no.1910/2, The RIPs are requested to make purchases from RISs.

Refunds are made only under the following circumstances.

- any upfront payment made to the Director General of Customs and VAT paid in any situation mentioned.
- excess input (if any) where goods or services obtained from any other VAT registered person who is not a RIS. (However, if it appears that the VAT component has not been remitted to the CGIR by such supplier to whom the VAT is paid, the CGIR may hold such claims of refunds till such VAT component is recovered.)

The company has to claim a refund of Rs. 52,150 as this was paid to a VAT registered person.

(c)

Relevant Learning Outcome/s:
3.3. Application of Statutory Provisions & Case Law

Suggested Detail Answer:

To : The Chairman
From: Mr. X-Tax consultant

The sum paid to Bimal on retirement is made in order to prevent him taking any legal action which will cause publicity injurious to the company. The accountant stated that this is not a payment of capital nature. It is similar to a payment of remuneration which he could have earned as a life director for a long period of time. The accountant stated that a similar situation was discussed in the case MITCHELL -V- NOBLE LTD (11TC372).

In the above case the installments of the sum of £19,200 payable by the company to the retiring director under the agreement, were allowed as a deductions in arriving at its profits for Income Tax purposes.

However it has to be considered whether the same principle can be applied for the present case since the environment and the law has changed. As per the Inland Revenue Act it is not sufficient that the expense is of revenue nature. As per section 25 of the Inland Revenue Act a deduction can be made for the purpose of ascertaining the profit and income when it is incurred in the production of the income.

An expense should be directly relating to the income generating activity and not remotely connected. Therefore in my opinion the principle in the decided case stated by the accountant cannot be applied in this case as it is not incurred for the production of income in the years the installments are paid. Hence it is not deductible**.**

(d)

Relevant Learning Outcome/s:
1.3. Personal taxation

Suggested Detail Answer:

Yes, this is chargeable for income tax in the hands of the recipient. The source of income is "annuity" or "other Income", because it is a periodical payment, and cannot be considered as a retiring benefit. Furthermore if it is treated as an annuity it is not exempted under section 13(w)

(e)

Relevant Learning Outcome/s:
5.2.Transfer pricing

Suggested Detail Answer:

(i) The importing of fabric from Sun Textiles Limited in Australia may have a transfer pricing exposure since it is the sole supplier of fabric to SMPL. If certain other conditions are fulfilled it may become an associated undertaking as per the regulation issued under the Inland revenue Act as describes below.

"Ninety per cent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one undertaking, are supplied by the other undertaking, or by persons specified by the other undertaking, and the prices and other conditions relating to the supply are influenced by such other undertaking**."**

(ii) Comparable uncontrolled price method and Resale price method or Two of any prescribed methods or any other method prescribed in the gazette.

(Total 25 marks)

Answer 02

(a)

Relevant Learning Outcome/s:
2.1. Assessing income tax liability of a non-resident person

Suggested Detail Answer:

In terms of section 79(1), where a company or a body of persons has its registered or principal office in Sri Lanka, or where the control and management of its business are exercised in Sri Lanka, such company or body of persons shall be deemed to be resident in Sri Lanka.

When it comes to Sri Lankan operations of Macro (India) there is no principal office in Sri Lanka and it is only a project office. Since Macro (India) is incorporated in India and its business activities are controlled and managed from India, it is considered as a non-resident person for the purposes of Income Tax in Sri Lanka. Hence the operation of this office can be taxed as a non-resident person in Sri Lanka. All the considerations made by the accountant are not relevant criteria to decide on the residency status.

Sri Lanka has a Double Tax Avoidance Treaty with India and the business profits derived from Sri Lanka will be liable to Income Tax in Sri Lanka if such profits are attributable to a permanent establishment in Sri Lanka. As Macro India operates a project office in Sri Lanka / employees are staying a longer period hence it is a PE in Sri Lanka.

(b)

Relevant Learning Outcome/s:
2.1.Assessing income tax liability of a non-resident person

Suggested Detail Answer:

Taxable income for the year of assessment 2015/16.

Operating profit	14,526,000	
Head office expenditure USD 3972 x 145	575,940	
Oversees travelling 35000 x 12 =420,000 Since the service income is not received in foreign currency, foreign travel expenditure is disallowed to 2% of the statutory income could be deducted. 420,000 - (5,600,000 + 1,400,000)x 2%)=280,000	280,000	
Non-citizens and Sri Lankans visited the Maldives project – cost of air ticket - Rs.1,690,000. Allowed		
Subsistence and Accommodation expenses paid is Rs. 3,252,000. Allowed		
Local travelling expenditure is allowed since it has been taken into account when preparing the PAYE T6 form		
Rent paid for residence 140,000 x 3 x 12 = 5,040,000 Rental value considered for PAYE purpose 180,000 x 3 = 540,000 4,500,000 75% is to be disallowed 4,500,000 x 75% =3,375,000	3,375,000	
Tax under PAYE has been undertaken by the project – it is disallowed	4,600,000	
Statutory income of the business	**23,356,940**	
Less 10% of the SI or actual head office whichever is lower. (2,123,358 or 575,940)	(575,940)	
Taxable Income	**22,781,000**	

(8 marks)

(c) (i) Compute the remittance tax

Relevant Learning Outcome/s:
2.2.2. Compute remittance tax payable by a non-resident company.

Suggested Detail Answer:

During the year of assessment 2015/16, the project office in Sri Lanka has remitted to Macro (India) as follows.

		Rs.
From profits 2014/15	USD 10,000 x 145	1,450,000
From profits 2015/16	USD 6,000 x 145	870,000
Funds brought to Sri Lanka	USD 8,000 Not liable to remittance tax)	-
Reimbursement of head of expenses	USD 3,972 (Not liable to remittance tax)	-
Directly remitted to India by Maldives office	USD 5,900 x 145	855,500
Total remittance liable to tax		**3,175,500**

Remittance tax thereon = 3,175,500 x 10%
= **<u>317,550</u>**

(d)

Relevant Learning Outcome/s:
3.1. Statutory Provisions

Suggested Detail Answer:

In order to be eligible for exemption under section 13 (ddd) the service should be rendered to a non-resident person and the money should be remitted to Sri Lanka through a commercial bank.

The Assistant Commissioner's view is correct since this service was rendered to a person in Sri Lanka although it has a branch outside Sri Lanka, and the currency received is rupees in Sri Lanka.

However, instead of giving those reasons the Assistant Commissioner has given his conclusion. Therefore the company can appeal the assessment on the same ground as reasons were not properly communicated**.**

(e)

Relevant Learning Outcome/s:
4.4.Managing VAT in a business

Suggested Detail Answer:

Total amount received is not chargeable for VAT since it is considered as supply of service. When the supply is consisting of "customized locally development of software" it should be treated as services. This service is exempted under item no (xxxiii) Part 11 of the first Schedule.

(Total 25 marks)

Answer 03

RUHUNU PUTRA ENERGY PLC
YEAR OF ASSESSMENT 2015/2016
INCOME TAX LIABILITY

				Rs.000'
Adjusted Profit from Trade or Business	- Liable	**Note 1**		1,298,881
Interest	- Liable			45,411
Profit on disposal of Land	Not taxable			
TOTAL STATUTORY INCOME				1,344,292
Income not a part of total Statutory Income				
Dividends received from companies in Sri Lanka			86,400	
Not Taxable				
ASSESSABLE INCOME				1,344,292
Less: Qualifying Payments				
Donation to Pradeshiya Saba (fully allowed)			2,700	
On Expansion(16-c)		**Note 2**	69,750	
				(72,450)
TAXABLE INCOME				1,271,842
CALCULATION OF TAX PAYABLE				
Tax on Taxable Income	1,271,842	28%	356,116	
Dividend Tax	580,500	10%	58,050	
Income Tax Payable for the Year of Assessment 2015/2016				414,166

RUHUNU PUTRA ENERGY PLC
YEAR OF ASSESSMENT 2015/2016
ADJUSTED PROFIT FROM TRADE OR BUSINESS

		Rs.000'	Note 1 Rs.000'
		+	-
Net Profit as per Statement of Comprehensive Income		1,663,620	
Income Considered Separately			
Dividend Income			86,400
Finance Income			45,411
Profit on disposal of Land			199,362
Fair Value Adjustment			35,575
Allowable			
Research Expenses - 300% Deductible (15,000 x 3) - (15,000)			30,000
Research Expenses - 200% Deductible (10,000 x 2) - (10,000)			10,000
Written off development expenses- impairment		7,000	
Development Cost-Considered incurred during the Year As 200% Deductible (7,000 x 2)			14,000
Disallowable Expenses			
Accounting Depreciation		250,622	
Entertainment		12,000	
Advertisement 96,000 25% Disallowed		24,000	
Specific provision for bad debts - Trade 16,000 Allowed		-	
Provision for Inventories		14,250	
Provision for Gratuity		8,130	
Penalties		780	
Ground Rent-Allowed only Paid = (300/12) x 2 months - Disallowed		50	
Donations to Pradeshiya Saba		2,700	
Donations to Others		7,700	
Staff donation is considered as welfare to staff - Allowed			
Legal Charge-Labour		-	
Legal Charge-Land		3,900	
Surveyor Charge-Land (Capital Expenditure)		3,600	
Depreciation Allowances	Annexure 1		278,281
Gratuity Payment			442
		1,998,352	699,471
Adjusted Profit from Trade or Business		1,298,881	

YEAR OF ASSESSMENT 2015/2016

DEPRECIATION ALLOWANCES **Annexure 1**

Item Description	Year of Acquisition/ Construction	Cost	Rate %	Claim for the year Rs.
Land	No Depreciation	50,000		
Building	2013/14	100,000	7%	6,667
Improvement	No Depreciation	1,000		-
Plant & Machinery	2013/14	80,000	33.33%	26,667
	2015/16	140,000	33.33%	46,667
Storage Tanks	2015/16	250,000	33.33%	83,333
Cylinders	2015/16	58,452	33.33%	19,484
Furniture & Fittings	2013/14	4,000	20%	800
	2014/15	10,000	20%	2,000
	2015/16	17,000	20%	3,400
Motor Vehicle	2014/15	330,000	20%	66,000
	2013/14	20,000	20%	4,000
Cars	Not claimed	25,000		
Computer	2015/16	70,000	25%	17,501
Computer Software	2015/16	1,763	100%	1,763
				278,281

Details of qualifying Payments **Note 2**

Purchase of the land	50,000,000	
Purchase of the building	100,000,000	
Improvement cost of the building	1,000,000	Not an investment in acquisition
Cost of machinery and equipment	80,000,000	
Furniture	4,000,000	
Motor vehicles -lorry and trucks	20,000,000	
Motor vehicles - Cars	25,000,000	
Working capital	20,000,000	Not eligible-Not a Fixed assets
	300,000,000	
Less: Working capital	(21,000,000)	
Total investment in fixed assts	279,000,000	
Claimed in 14/15 25%	69,750,000	
Claimable in 15/16 25%	69,750,000	
Balance For 16/17 1nd 17/18	139,500,000	

Note 5- It is not mentioned that any part of the dividend received has been redistributed

(b)

Relevant Learning Outcome/s:
6.2. Financial reporting and taxation

Suggested Detail Answer:

Subject: Report on the Investment Property
To: Board of Directors
From: Tax Consultant

With regard to two concerns made by the Board relating to accounting and disclosures on "Investment property" I made the following observations based on the regulations issued by the tax authorities under Gazette notification no. 1857/8 of 2014 on the adoption of Sri Lanka Accounting Standards.

1. ***Adjustment to be made in the ascertainment of profits or income for tax purposes***
   - Gain or loss that may be charged to the statement of comprehensive income on Investment Property measured at fair value shall be disregarded (added back).

   - Balance of tax written down value (TWDV) existing before transferring to Investment property shall continue to be entitled for allowance for depreciation.

2. ***Information required by the tax authorities***
   - A schedule of Investment Property shall be accompanied with the tax return.
   - The rationale used in apportioning or separating the cost of land and building with certified value's report shall be furnished by the entity.

I also wish to clarify that, if the above information is declared in the financial statements or the annual report, the company can make the references to those disclosures instead of reproducing the same.

(c)

Relevant Learning Outcome/s:
5.3. Tax Planning

Suggested Detail Answer:

As per information given in the pre-seen material, the Board has taken a decision to go ahead with an expansion project in 2013. They may have planned their taxes and business strategies based on the law prevailing at that time (Inland Revenue (Amendment) Act no. 8 of 2012).

As per that act it was a qualified for allowance if the investment made in fixed assets was before 1 April 2015. Therefore the investment may have been made within that period.

However by Inland Revenue (Amendment) Act no 9 of 2015 this has been amended and as per the new act, the investment should have been made before 1 April 2014. As such the company is **not entitled to claim the qualifying payment** on the fixed assets purchased in June 2014.

(d)

Relevant Learning Outcome/s:
5.4. Providing tax advise

Suggested Detail Answer:

Advice RPE on the matters raised by the CGIR in the intimation letters issued in relation to:

(i) Rejection of the income tax return for the Y/A 2014/15 with reference to the applicable case laws if any. The following reason has been communicated as a reason for rejection of the return. "Fuel tanks cannot be treated as "Plant" under the provisions of the Inland Revenue Act and therefore the allowance claimed for depreciation will be disallowed."

Company cannot agree with the position taken by the CGIR. According to the "THORNHILL Vs COMMISSIONER OF INCOME TAX" case it has been held that Word "Plant" cannot be made to include the building or shell which contains plant."

The fuel tanks are neither building nor shell which contains a plant. In the above mentioned case judge "SOERTSZ" has said that "plant" might be regarded as that without which production could not go on.

Further the section 25(1)(a), an allowance for depreciation is entitled on plant, machinery and fixtures, equipment etc. Even though the fuel tanks are considered not to be a plant, it could be considered equipment use for the production of income. Therefore allowance for depreciation shall be allowed.

(ii) Rejection of VAT returns filed for the taxable periods

As per the value added tax act supply of premises for commercial purposes is liable to VAT. Further as per the value added tax, the time of supply is the earliest occurrence of the following:

- Performance of the service
- Receipt of payment for the service rendered
- Payment is due for the services rendered or future services
- Invoice is issued

In this case the “service” has already been performed as the land and building was occupied during that period. Therefore the company has to pay output VAT on the supply of land and building together with penalties for the default.

(e)

Relevant Learning Outcome/s:
3.3. Application of statutory provisions and case law

Suggested Detail Answer:

As per the pre seen information, the tax authorities has raised the issue as to why no distribution of dividend was made out of profit in 2014/15 by RPT.

To: Board of Directors
From: Tax Consultant
Subject: Report on inquiry on non-distribution of profit

As per the section 61(ii) of the Inland Revenue Act, the minimum equivalent to 10% of the distributable profit has to be distributed within a period of eighteen months immediately succeeding the commencement of that year of assessment. If not the company is liable to pay tax 15% of 1/3 of distributable profit. When the distribution is made the company should remit 10% WHT. This may be the reason for the inquiry from the Department of Inland Revenue.

Even though the company makes profits, dividend can be distributed only when the company is solvent as per the company’s Act.

- When we look at the balance sheet of RPT its current liabilities exceed the current assets. This indicates the company is not solvent; hence dividend cannot be distributed.

- When considering the method of computing the distributable profit, the company can deduct the cost of capital assets acquired during that year in arriving at the distributable profit. As per the pre seen information it appears that the company had purchased capital assets and that amount was higher than its profits made in 2014/15. Therefore there were no distributable profits**.**

The above two matters have to be communicated along with the return of income 2015/16.

(Total 50 marks)

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