

KE3 - FUNDAMENTALS OF TAXATION
Suggested Answers and Marking Guide

SECTION 1

Question 01

Section 1(a)

1.1.

Learning Outcome:
1.1.1 State the economic and social functions of taxation

Correct answer: A

Equity, progressivity, simplicity, certainty

1.2.

Learning Outcome:
2.2.3 Calculate the statutory income from other sources of income (including rent, net annual value, interest, dividends, royalties, annuities, winnings from lottery, betting or gambling and income from any other source)

Correct answer: C

Rs. 1,800,000 being net rent received from his residential house in Kandy.

1.3.

Learning Outcome:
3.1.4 Compute gross income tax liability and balance tax liability for a small- or medium-sized company.

Correct answer: D

40%

1.4.

Learning Outcome:
4.4.1 Explain the liability to settle income tax on a “self-assessment” basis, including due dates.
4.1.1 State the circumstances under which an individual or a company is required to furnish a “return” with due dates.

Correct answer: C

On or before 30th September 2016 & 30th November 2016

1.5.

Learning Outcome:
5.2.1 Explain the applicability of NBT to small and medium-sized businesses, and the registration threshold.

Correct answer: A

Rs. 3,800,000

Section 1(b)

1.6.

Learning Outcome:
1.2.1 State the role of the following tax authorities in Sri Lanka. (Department of Inland Revenue, Provincial Departments of Revenue, Sri Lanka Customs and Department of Excise).

1. Department of Inland Revenue
2. Provincial Departments of Revenue
3. Department of Customs
4. Department of Excise

1.7.

Learning Outcome:
2.2.3 Calculate statutory income from other sources of income (including rent, net annual value, interest, dividends, royalties, annuities, winnings from lottery, betting or gambling and income from any other source).

1. Statutory rent income = Rs.180,000

Working.

Gross rent	25,000 x 12	=Rs. 300,000 (¼ mark)
Less: Rates	200,000 x 30%	=Rs. (60,000) (¼ mark)
		=Rs. 240,000
Less: Allowance for repair	240,000 x 25%	=Rs. (60,000) (¼ mark)
Net Rent		=Rs. 180,000 (¼ mark)
Rating Assessment		=Rs.200,000 (¼ mark)
Less: Allowance for repair	200,000 x 25%	=Rs. (50,000) (¼ mark)
Net Annual Value		=Rs. 150,000 (¼ mark)

Taxable Rent income is Rs. 180,000 (Net Rent) (¼ mark)

1.8.

Learning Outcome:
2.2.1 Calculate “statutory income” from a small or medium-scale “trade, business, profession or vocation”, taking into consideration “allowable and disallowable expenses, allowance for depreciation (capital allowances)” and disposal of capital assets.

Profit/(Loss) on disposal = Rs. 120,000

Working (Rs.)

Profit	= (Selling price – Tax W.D.V.)
Selling price	= 520,000 (½ mark)
Tax WDV	= 2,000,000 - (2,000,000 x 20% x 4yrs) (1 mark)
	= 400,000
Profit	= 520,000 - 400,000 (½ mark)
	= 120,000

1.9.

Learning Outcome:
4.4.5 List recovery actions available under the Inland Revenue Act.

1.

- a. Appoint a tax collector and recover tax by seizure and sale of movable property.
- b. Take action before a Magistrate who can collect the tax as a fine.
- c. Prevention from leaving Sri Lanka by issuing a direction to Inspector General of Police through the Magistrate Court.

(1 mark each for any 2= 2 marks)

1.10.

Learning Outcome:
5.1.2 Compute tax payable for a given straightforward, non-complex scenario.

VAT Payable for the quarter: Rs. 247,500

Output tax

Sale of product of Alfa (4,500,000 x 11% (**¼ mark**)) = 495,000 (**¼ mark**)

Sale of product of Beta (Exempt from VAT)(**¼ mark**) = 0 (**¼ mark**)

Total output tax = 495,000

Less:

Claimable input tax (360,000(**¼ mark**)-30,000(**¼ mark**)) x 4.5/6(**½ mark**)

= (247,500)

Balance payable = 247,500

Marking Guide
Each question carries 2 marks.
Total 10 marks.

SECTION 2

Question 02

Learning Outcome:
3.1.1 Identify various types of companies in relation to application of different rates of income tax.
3.1.2 Explain specific adjustments applicable to the computation of statutory income of a company, from rent, interest, dividend and profit from trade or business (other than adjustments applicable to intercompany transactions).
3.1.3 Compute total statutory income, assessable income and taxable income of a company, by making relevant statutory deductions.
3.1.4 Compute gross income tax liability and balance tax liability for a small or medium-sized company.

Nomad Manufactures (Pvt) Ltd Computation of Income tax Liability Year of Assessment 2015/2016	Rs.	Rs.	Rs.	Marks
Statutory Business Profit			100,000,000	1/4
Interest Income				
Interest on Fixed Deposit Add: WHT deducted $180,000 \times 1/9$ Gross Interest Income on Fixed Deposit	180,000 <u>20,000</u> <u>200,000</u>	200,000		3/4
Interest on Treasury bills Add: Notional tax deducted $45,000 \times 1/9$ Gross Interest Income on Treasury bills	45,000 <u>5,000</u> <u>50,000</u>	50,000		3/4
Statutory interest income		250,000	250,000	1/4
Dividend Income				
Net Dividend Received (Final Tax Deducted)	90,000	Not taxable		1/4
Dividend exempt from income tax	50,000	Exempted		1/4
Statutory Dividend income		-	-	1/4
Total Statutory Income			100,250,000	1/4
Less: Deductions under Section 32				1/4
Loan Interest Paid on construction of Factory Building		1,200,000		1/2
Share trading loss - Not Allowed since capital loss		-		1/2
Total Deductions under Section 32		1,200,000	(1,200,000)	1/4
Assessable Income			99,050,000	1/4
Less: Deductions under Section 33				1/4
Allowance for Qualifying Payments	Limit	Allowance		
a) Cash Donation to Approved Charity 750,000	Lower of 1/5 of A.I. or 500,000	500,000		1/2
b) Donation to "Api Wenuwen Api Fund" 400,000	N/A	400,000		1/2
Total Deductions under Section 33		900,000	(900,000)	1/4

Taxable Income			98,150,000	1/4
Computation of Tax Liability				
On export profit 98,150,000 x 40,000,000 / 100,000,000	39,260,000	@12%	4,711,200	1/2
On Balance Taxable Income	58,890,000	@28%	16,489,200	1/4
Tax on Taxable Income	98,150,000		21,200,400	1/4
Tax on Dividend declared	5,000,000	@10%	500,000	1/4
Gross Income Tax			21,700,400	1/4
Less: Tax Credits				1/4
WHT deducted on interest on FD (180,000 x 1/9)		20,000		1/4
Notional tax Credit on interest of TB 45,000 x 1/9		5,000		1/4
Self-Assessment Tax Paid		18,000,000		1/4
Dividend tax paid		500,000		1/4
Total tax credits		18,525,000	(18,525,000)	1/4
Balance Tax Payable			3,175,400	1/4

SECTION 3

Question 03

Learning Outcome:
2.2.1 Calculate “statutory income” from a small or medium-scale “trade, business, profession or vocation”, taking into consideration “allowable and disallowable expenses, allowance for depreciation (capital allowances)” and disposal of capital assets.
2.2.2 Calculate employment income (including all cash and non-cash benefits, excluding terminal benefits).
2.2.3 Calculate statutory income from other sources of income (including rent, net annual value, interest, dividends, royalties and annuities, winnings from lottery, betting or gambling and income from any other source).
2.2.4 Identify the “miscellaneous exemptions” under the Inland Revenue Act (Sec. 13) applicable to an individual and capital gains.
2.3.1 Compute the total statutory income, assessable income and taxable income taking into consideration relevant statutory deductions and aggregation of child’s income.
2.4.1 Identify rates of income tax applicable to an individual, (including of tax rates” introduced from time to time).
2.4.2 Compute gross income tax liability for an individual.
2.4.3 Compute the balance tax payable, taking into consideration the various types of tax credits.

Mr. Uthpala Perera Computation of Income Tax Liability Year of Assessment 2015/2016	Rs.	Rs.	Rs.	Marks
Employment income				1/4
Net Salary	1,340,000			1/4
Add: EPF Deduction from Mr. Perera’s salary 180,000/12 x 8	120,000			1/2
PAYE Deduction	<u>40,000</u>			1/4
Gross Salary	1,500,000	1,500,000		1/4
<i>Note: Employer’s Contribution to EPF taxable as retirement benefit and from 01.04.2011 it is exempt from tax.</i>				1/4
Festival Allowance		50,000		1/2
Medical bills reimbursed		60,000		1/2
Housing Benefit				
(a) Rental Value 200,000 + (200,000 x 20%)	240,000			1/2
(b) Gross rent paid to owner (25,000 x 12)	300,000			1/2
Whichever is higher	300,000			1/4
<i>Note: Gross remuneration does not exceed 1.8 million Therefore value of benefit limited Rs. 120,000</i>			120,000	1/4
Statutory income from Employment income		1,730,000	1,730,000	1/4
Profession – Consultancy Service				

Adjustment of Net Profit for Tax Purposes	+	-		
Net Profit	600,000			1/4
Salaries paid to spouse is an allowable expenditure, Added to Statutory Income of Mr. Perera	-	-		1/4
Printing and stationary – Fully allowed	-	-		1/4
Advertising Expenses				
Staff Vacancy Notice 12,000 Fully allowed				1/4
Commercial Advertising 48,000 x 25% D/A	12,000			1/2
Purchase of Computer – Capital Expenditure D/A	80,000			1/4
Entertainment Expenses - Not deductible	20,000			1/4
Accounting Depreciation	32,000			1/4
Electricity & Telephone – 80,000 x 80% Personal	64,000			1/2
Allowance for Depreciation				
Furniture (2013/2014) 60,000 x 20%		12,000		1/2
Computer (2015/2016) 80,000 x 25%		20,000		1/2
	808,000	32,000		1/4
	(32,000)			
Statutory income from profession			776,000	1/4
Interest Income				
Interest on Fixed Deposit (Final With Holding Tax Deducted)	276,000	Not Taxable	-	1/2
Interest on Treasury bills (Final With Holding Tax Deducted)	90,000	Not Taxable		1/2
Statutory interest income			-	1/4
Income from sale of shares				
Profit on Sale of Shares	300,000	Not a taxable source of income	-	1/2
Rent Income				
Gross Rent 50,000 x 12	600,000			1/4
Less: Rates paid 200,000 x 30%	<u>(60,000)</u>			1/4
	540,000			1/4
Less: Allowance for repair & maintenance 540,000 x 25%	<u>(135,000)</u>			1/4
Net Rent	<u>405,000</u>			1/4
Rating Assessment	200,000			1/4
Less: 25% Allowance for repair & maintenance 200,000 x 25%	<u>(50,000)</u>			1/4
Net Annual Value	<u>150,000</u>			1/4
<i>Note: Since the Net Rent > Net Annual Value, Net Rent is treated as Taxable Rent income</i>	405,000			1/4
Statutory rent income			405,000	1/4
Dividend Income				
Dividend from Namal Unit Trust	25,000	Exempted		1/4
Net dividend from Toyota Lanka PLC	45,000	Not Taxable		1/4
<i>Note; 10% Final With Holding Tax paid not a part of assessable income.</i>				
Statutory Dividend Income	0	0	0	1/4
Salaries paid to Spouse			150,000	1/4
Aggregation of Child's Income				

Interest Income (Gross)			45,000	1/4
Total Statutory Income			3,106,000	1/4
Less: Deductions under Section 32				
Housing Loan Interest Paid		123,000		1/4
Credit Card Interest - Not Allowed		-		1/4
<i>Note: Deduction limited to non-employment income of (3,106,000 - 1,730,000) Rs.1, 376,000.</i>				1/4
Total Deductions under Section 32		123,000	(123,000)	1/4
Assessable Income			2,983,000	1/4
Less: Deductions under Section 33				
Tax Free Allowance		500,000		1/4
Allowance for Qualifying Payments	Limit			
c) Donation to Govt. School	100,000	N/A	100,000	1/4
d) Donation to Approved Charity	80,000	Lower of 1/3 of A.I. or 75,000	75,000	1/4
e) Premia on Insurance Policy for Incurable Diseases		N/A	48,000	1/4
f) Qualifying Payment on Employment Income		N/A	250,000	1/4
<i>Note: Deduction for Q/Payments other than (d) is limited to balance Non-employment income of (1,376,000 - 123,000) Rs. 1,253,000</i>				1/4
Total Deductions under Section 33		973,000	(973,000)	1/4
Taxable Income			2,010,000	1/4
Computation of Tax Liability				
On 1 st	500,000	@ 4%	20,000	1/4
On next	500,000	@8%	40,000	1/4
On next	500,000	@12%	60,000	1/4
On Balance Professional income	510,000	@12%	61,200	1/4
Gross Income Tax	2,010,000		181,200	1/4
Less: Tax Credits				
PAYE Deductions		40,000		1/4
Self-Assessment Tax Paid		40,000		1/4
Total tax credits		80,000	(80,000)	1/4
Balance Tax Payable			101,200	1/4