

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE3 – Fundamentals of Taxation & Law

March 2015

Part A
Taxation
SECTION 1

Answer 01

1(a)

1.1

Relevant Learning Outcome/s: 4.1.1
Correct answer: C

1.2

Relevant Learning Outcome/s: 1.1.2
Correct answer: B

1.3

Relevant Learning Outcome/s: 4.5.2
Correct answer: B

1.4

Relevant Learning Outcome/s: 5.1.1
Correct answer: A

1.5

Relevant Learning Outcome/s: 5.2.1
Correct answer: C

[Total marks for 1(a) (MCQs) 2 x 5 = 10 marks]

1(b)

1.6

Relevant Learning Outcome/s: 2.4.3		
Gross income Tax Liability		1150000
Tax Credits		
PAYE	400000	
Self-Assessment Payment	<u>120000</u>	<u>(520000)</u>
Balance income tax payable		<u>630000</u>
<p>Tax deducted on Interest and Dividend is final tax. Hence, WHT cannot be taken as a tax credit.</p>		

1.7

Relevant Learning Outcome/s: 2.4.4		
Divisible Profit	7,570,000	
Net Rent	<u>1,350,000</u>	
	8,920,000	
Partnership Tax free Allowance	(1,000,000)	
Liable Profit	<u>7,920,000</u>	
Tax @ 8%	<u>633,600</u>	

1.8

Relevant Learning Outcome/s: 3.1.1	
Applicable Tax rate is 28%	
<p>Sri Toys (Pvt) Ltd. is a subsidiary company. Hence lower rates on quantum of turnover or taxable income is not applicable.</p>	

1.9

Relevant Learning Outcome/s: 5.1.3

Any two articles stated in the part one of the first schedule of the NBT Act

Examples – Any article exported by the manufacturer, fertilizer,

Any other item mentioned in the study text or PART I of the first schedule of the NBT Act is acceptable.

1.10

Relevant Learning Outcome/s: 5.2.2

When a supply is zero rated, it means that the supply is liable to tax, but the rate applied is zero. If a supply is exempted, the supply is not liable to VAT.

In the case of zero rated supplies, the person is entitled to claim input taxes born by him whereas in the case of exempted supplies person cannot claim the input taxes as he cannot charge VAT on his supplies.

[Total marks for 1(b) 2 x 5 = 10 marks]

SECTION 2

Answer 02

Relevant Learning Outcome/s:	2.2, 2.3, 2.4
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Mr. Peter		
Computation of gross income tax and balance income tax payable		
For year of assessment 2013/14		
	Rs.	
<i>Employment income</i>		
Gross salary (250,000 *12)	3,000,000	
Vehicle allowance (105,000 *12) 1,260,000		
Less: exempt 50,000 per month (600,000)	660,000	
Entertainment allowance 20,000 x 12	240,000	
Reimbursement of telephone bills 172,000 x 50%	86,000	
Contribution made by employer to the approved provident fund	-	
		3,986,000
Net Dividend - does not form part of the Statutory income		-
Profit on Sale of listed shares is exempt (share transaction is paid)		-
<i>Rent Income</i>		
Gross rent received (140,000 x 12)	1,680,000	
Less: rates	<u>(32,000)</u>	
	1,648,000	
Less: 25% for repairs	<u>(412,000)</u>	
Net Rent	1,236,000	
NAV = RA - repair allowance = 160,000 - 40,000 = 120,000		
Net rent is more than NAV		1,236,000
<i>Business Income</i>		
Net profit as per Accounts	1,742,000	
Add: Disallowable items		
Overseas travelling	689,000	

Entertainment expenses	67,000		
Book depreciation - computers	160,000		
Book depreciation – photo copy machine	75,000		
	2,733,000		
Capital allowance on computers 480,000 x 25%	<u>(120,000)</u>		
Adjusted profit from business			2,613,000
Total Statutory Income			7,835,000
Less: deductions under section 32			
Interest paid on a loan taken to purchase an apartment - allowed			(850,000)
<i>Note : (Nothing can be deducted from employment income. However, he has enough other source of income , and therefore, interest payment can be deducted)</i>			
Assessable income			6,985,000
Less: qualifying payments			
Qualifying payment on employment income			(100,000)
EPF contribution – not a qualifying payment			-
Life policy premium Rs.150,000 (Limited to lower of Rs.75,000 and 1/3 of AI)			(75,000)
Capital repayment of the loan is not a qualifying Payment			-
Personal allowance			(500,000)
<i>Note: (Nothing can be deducted from employment income. However, he has enough other sources of income , and therefore, life insurance policy premium can be deducted)</i>			
Taxable income			6,310,000
Gross Income Tax Payable			
	500,000	4%	20,000
	500,000	8%	40,000
Business income	2,613,000	10%	261,300
	500,000	12%	60,000
	500,000	16%	80,000
	1,000,000	20%	200,000
	<u>697,000</u>	24%	<u>167,280</u>
	<u>6,310,000</u>		<u>828,580</u>
Gross income tax payable			828,580

Less: tax credits		
PAYE	841,800	
Self-Assessment Payments	150,000	
		(991,800)
Balance tax payable /(refund claimed)		(163,220)

(Total 20 marks)

Part B
Legal Fundamentals

SECTION 1

Answer 1

1(a)

1.1

Relevant Learning Outcome/s: 1.3.1.

Correct answer: C

The Supreme Court is the only court which has the power to hear and determine a fundamental rights application in Sri Lanka.

1.2

Relevant Learning Outcome/s: 3.1.1

Correct answer: C

A contract of sale can also be formulated by word of mouth, by the implied conduct of the parties, and partly in writing and partly by word of mouth.

1.3

Relevant Learning Outcome/s: 4.3.1

Correct answer: B

The mere fact that the holder has reason to believe that the bill will be dishonoured on presentment, does not dispense with the requirement to present the bill for payment.

1.4

Relevant Learning Outcome/s: 5.3.1

Correct answer: A

The agent has a duty, not to delegate his authority to anyone, unless he has been so authorized by the principal.

1.5

Relevant Learning Outcome/s: 8.1.1

Correct answer: D

The Act is applicable, only to acts done within Sri Lanka, and not to acts done outside of Sri Lanka.

[Total marks for 1(a) (MCQs) 2 x 5 = 10 marks]

1(b)

1.6

Relevant Learning Outcome/s: 1.4.1 / 1.4.2

The regulatory role played by the Institute of Chartered Accountants of Sri Lanka and its main functions, are as follows:

- The registration control and maintenance of professional standards and discipline by the members of the Institute.
- The regulation of the auditing and accounting professions in the country.

1.7

Relevant Learning Outcome/s: 2.1.1

The main requirements, which are essential to form a legally binding contract are as follows:

- (a) There must be a valid offer;
- (b) There must be a valid acceptance;
- (c) The parties must have an intention to create legally binding relations;
- (d) The terms of the contract, should be certain;
- (e) The performance of the contract should be possible;
- (f) There must be a genuine consent or agreement of the parties to the contract;
- (g) The parties should have capacity to contract;
- (h) The objective of the contract should be legal.
- (i) Consideration / Justa Causa (based on whether it is English law or RD Law that is applicable to the particular contract)
- (j) Should comply with the form stipulated by the relevant statute.

1.8

Relevant Learning Outcome/s: 4.1.2

The main characteristics of a negotiable instrument are as follows:

- (a) The title to the negotiable instrument passes on delivery (if it is a bearer instrument), and on delivery and endorsement (if it is an order instrument);
- (b) The holder of the negotiable instrument for the time being, can sue in his own name ;
- (c) No notice of assignment is required to be given to the person liable thereon;
- (d) A bona fide holder for value, takes free from any defect in the title of his predecessors

1.9

Relevant Learning Outcome/s: 6.1.1

The main differences between a contract of insurance and a contract of wagering, are as follows:

- (a) Insurance is taken to protect “what is yours”; but in gambling you try to make a bargain or winning;
- (b) In insurance, you must have an “insurable interest” in the thing you insure; but in gambling, you can bet on anything;
- (c) Courts will enforce a contract of insurance; but not a gambling contract;
- (d) Except for life insurance, generally you cannot insure the same thing or risk, with two insurers, but in gambling you can place bets with more than one bookmaker for the same item.
- (e) In insurance one cannot make a profit. But one of the main motives of wagering is to make a profit; or
- (f) Any other valid difference.

1.10

Relevant Learning Outcome/s: 7.1.3

Given below are some of the instances, where an employee can withdraw the funds lying to his/her credit in his/her EPF account.

- Upon reaching the age of retirement, and on termination of employment.
- After a female employee ceases to be employed, in consequence of marriage.
- After the member ceases to be employed, by reason of a permanent and total incapacity for work, and being certified medically unfit.
- On taking up permanent residency abroad.
- After the member ceases to be employed in a covered employment, and takes up pensionable employment in the public service or in the local government service.
- An employee in a public corporation or government-owned business undertaking, can withdraw the total amount lying to his/her credit in the event of being retrenched from service.

[Total marks for 1(b) 4 x 5 = 20 marks]

SECTION 2

Answer 02

Relevant Learning Outcome/s: 2.4

The law of contracts, provides for a contract to be discharged due to frustration.

Frustration of a contract occurs when the following factors are present:

- The event which leads to the frustration of the contract is beyond the control of the parties to the contract;
- If the parties try to perform the contract even after the occurring of the event which led to the frustration, then the contract so performed will be a totally different one to that which the parties initially intended to enter into;
- The event which led to the frustration of the contract occurred due to no fault of the parties to the contract.
- The destruction of a particular object, which is necessary for the performance of the contract.

In the given scenario, the hall which is the subject matter of the contract and which is necessary for the performance of this contract of hire, has been destroyed.

Further this hall has been destroyed due to the fault of neither party.

Therefore, it could be said that the contract to hire the hall, has been discharged due to frustration.

This results in the parties to the contract being discharged from their obligations under the contract.

Therefore, Alex is not entitled to claim damages from Melmon, on the expenses incurred by him on this concert.

The facts of the scenario are similar to the case of Taylor vs Caldwell (1983) 122 ER 309.

(Total: 10 marks)

Answer 03

Relevant Learning Outcome/s: 3.3

The facts of the scenario are similar to the case of Greenwood vs Bennett (1973) 1 Q.B. 195. / and also in the case of Rowland vs. Divall.

This scenario relates to a sale by a person who is not the owner of the subject matter.

Based on the given scenario, there is nothing to imply or suggest that Alloy by his conduct, had authorized Moddy to sell this car to anybody.

The general rule is that, when a person who is not the owner of particular goods, without the consent or authority of the owner, sells such goods to a buyer, the buyer gets the same title to that goods as the seller had.

Since Moddy never become the owner of this Volkswagen car, he is not in a position to pass the ownership of this car, to Scrappy, and hence Scrappy never became the owner of this car at any given point.

Therefore it could be said that based on the given facts, the ownership of this car still remains with Alloy and therefore Alloy can get the possession of the car.

Further since Scrappy was an innocent purchaser who thought that Moddy was the actual owner, and since Moddy had no title to sell Scrappy is entitled to recover the cost he incurred to modify the car amounting to Rs. 200,000. Since it was Alloy, as the owner who got the benefit of this modification, it is from Alloy that Scrappy has to claim this sum of money from.

Also Scrappy can claim the sales price of Rs. 500,000 he paid to Moddy, from Moddy, and Moddy will have to pay it back to Scrappy.

(Total: 10 marks)

Answer 04

Relevant Learning Outcome/s: 5.4

As per the facts given in this scenario, Mr. Pentor as the agent, seems to have failed to perform / breached the following duties, for the reasons given therein:

- The duty of following the principal's instructions.

This duty was breached, as Mr. Pentor was given specific instructions to buy chairs made from teak, which he failed to do so.

- The duty of applying a special skill, he professes to have, has also been breached by Mr. Pentor.

The reason being that as a professional carpenter, it is implied that he should have the skill to identify the type of wood the chairs were made from.

- The duty to disclose a material fact which was in his possession, has been breached by Mr. Pentor.

The reason being, that he knew that the chairs were not made from teak, but still did not disclose such fact to Skewl.

- The duty to exercise due diligence and care has been breached by Mr. Pentor.

The reason being that the principal wanted teak chairs, but Mr. Pentor without even checking on the availability of teak chairs, purchased non-teak chairs from the first shop he went into. Here it could be said that Mr. Pentor had acted negligently, as well.

- The duty to act in the best interests of the principal fiduciary duty too has been breached by Mr. Pentor.

The principal specifically wanted teak chairs, for a reason known best to the principal. Therefore by Mr. Pentor, not obtaining teak chairs, he has failed in this duty.

(Total: 10 marks)

Answer 05

Relevant Learning Outcome/s: 6.3

The failure to pay a lease instalment as per the lease agreement, amounts to a substantial failure or breach on the part of the lessee (Crazy Cricket Club).

Such a failure or breach is called a “default of payment” of the lease rentals agreed in the agreement by the lessee.

Therefore in this scenario, the failure to pay the 3rd instalment by the lessee, Crazy Cricket Club, can be treated as an event categorized as a “default of payment”, in law relating Leasing in terms of the Finance Leasing Act (No. 56 of 2000).

In the event of a default by the lessee, certain remedies are available to the lessor, Mr. Cre Kett.

These remedies are as follows:

- To require the lessee to make **accelerated payment** of the monies due under the lease.
 - If the lessee fails to make such accelerated payments, the lessor can after **servicing notice by registered post** to the lessee, **terminate/repudiated** the lease, and either ;
 - **Recover possession** of the leased asset, either without a court order or through a court order;
- OR
- **Recover damages**, as would place the lessor in the position he would have been if not for the breach by the lessee.

(Total: 10 marks)

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