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THE INSTITUTE OF  
**CHARTERED** ACCOUNTANTS  
OF SRI LANKA

# **SUGGESTED SOLUTIONS**

**KE3 (A) – Fundamentals of Taxation**

**March 2019**

# SECTION 1

## Answer 01

1(a)

1.1

**Learning outcome/s: 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).

Study text reference: Pages 62 and 63

**Correct answer: A**

1.2

**Learning outcome/s: 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).

Study text reference: Page 38

**Correct answer: D**

1.3

**Learning outcome/s: 4.4.4**

Explain the "Notice of Tax Default" and submission of an "objection" against such notice.

Study text reference: Page 113

**Correct answer: C**

1.4

**Learning outcome/s: 4.5.2**

Explain the PAYE scheme and obligations of an employer under this scheme.

Study text reference: Page 115

**Correct answer: B**

1.5

**Learning outcome/s: 5.2.1**

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

Study text reference: Page 136

**Correct answer: D**

**(Total: 10 marks)**

1(b)

1.6

**Learning outcome/s: 1.1.2**

State the principles of taxation and the difference between direct taxes and indirect taxes.

Study text reference: Pages 4 and 7

(a) To raise funds for government expenditure, or in other words to finance public expenditure.

(b) Broad base – Wide Tax Net

1.7

**Learning outcome/s: 2.1.3**

Explain the meaning of "person", "year of assessment", "sources of profits & income", and "residence rule".

Study text reference: Page 21

Departure from Sri Lanka	Arrival in Sri Lanka	Days outside Sri Lanka
28.04.2017	28.06.2017	60
01.08.2017	15.10.2017	74
05.01.2018	05.03.2018	<u>59</u>
		<u>193</u>

Days spend in Sri Lanka (365-195) = 170 days.

No. of days physically present in Sri Lanka is less than 183 days. Therefore, he is a non-resident in Sri Lanka for income tax purposes.

1.8

**Relevant Learning Outcome/s: 4.5.3**

Explain the concept of final tax.

Study text reference: Page 63

Interest income of Rs. 36,923

Lottery winning of Rs. 1 million.

} Since final WHT payment made.

1.9

**Learning outcome/s: 5.1.2**

Compute tax payable for a given straightforward, non-complex scenario.

Study text reference: Page 126

	<b>Taxable supply</b>	<b>Rate</b>	<b>Tax</b>
Villa rental income	4,150,000	15%	622,500
Guest transport income	2,320,000	15%	<u>348,000</u>
Total			970,500
Less: Input tax			
- on local purchases			(126,000)
- on insurance of motor car			(18,000)
<b>VAT payable</b>			<b><u>826,500</u></b>

1.10

**Learning outcome/s: 5.2.4**

Explain the due dates of payment and submission of returns.

Study text reference: Pages 136 and 140

Silk Road Partners is not liable to pay NBT for the quarter ended 31 March 2018, as the quarterly turnover was below Rs. 3 million.

However, the NBT return for the quarter ended 31 March 2018 has to be filed on or before 20 April 2018.

**(Total: 10 marks)**

## SECTION 2

### Answer 02

#### Learning outcome/s: 3.1

Basic understanding of income tax liability of a resident company (non-complex straightforward scenario).

Study text reference: Chapter 6

#### Computation of gross income tax liability and balance tax payable by Coco (Pvt) Ltd for the year of assessment 2017/18.

	Rs.
<b>Income</b>	
Adjusted profit from trade (schedule 01)	1,894,000
<b>Total statutory income</b>	<b>1,894,000</b>
Less: Statutory deductions	Nil
<b>Assessable income</b>	<b>1,894,000</b>
Less: Qualifying payments	
Donation to a government school -100% claimable	(620,000)
<b>Taxable income</b>	<b>1,274,000</b>
Tax liability @ 12% (export business)	152,880
<b>Less : Tax credit</b>	
Self assessment payment made	(125,000)
<b>Balance tax payable</b>	<b>27,880</b>

Schedule 01		Rs.	Rs.
<b>Calculation of adjusted profit from trade</b>		<b>+</b>	<b>-</b>
Net profit as per accounts		1,219,900	
Less: Unit trust redemption income	Exempt		1,400,600
Profit on disposal of assets			150,000
Depreciation		1,950,000	
Royalty paid – allowed		-	
<u>Adjusted profit on disposal of assets</u>			
Sale proceed	<u>1,900,000</u>		
Cost	2,700,000		
Depreciation allowance claimed @ 33.33%	<u>(900,000)</u>		
Tax written down value	<u>1,800,000</u>		
Profit on disposal of asset	100,000	100,000	
Donation	disallowed	620,000	
Depreciation allowance on motor coach – 2,226,500 x 20%			445,300
		3,889,900	1,995,900
<b>Adjusted profit from trade</b>		<b>1,894,000</b>	

**(Total: 10 marks)**

## SECTION 3

### Answer 03

**Learning outcome/s: 2.2, 2.3 and 2.4**

2.2 Statutory income form sources of profits & income listed in the Inland Revenue Act.

2.3 Total statutory income, assessable income and taxable income.

2.4 Gross income tax and balance tax payable.

Study text reference: Chapter 04

		Rs.	Rs.
<b><u>Employment income</u></b>			
Gross salary	175,000 * 12	2,100,000	
Bonus		280,000	
Insurance premium paid by employer	8,000 * 12	96,000	
Value of free transport facility	Exempt		
<b><u>Income received from second employment</u></b>			
- Net salary	50,400		
- Tax deducted at 16% (50,400/84) x 16	9,600		
Gross salary	60,000	720,000	
<b>Total employment income</b>			<b>3,196,000</b>
<b><u>Interest income</u></b>			
Interest income (of which WHT deducted by the bank is the final tax)			-
<b><u>Business income</u></b>			
Net profit per accounts		1,476,500	
<b><u>Add/deduct disallowable/allowable expenses</u></b>			
Replanting subsidy received from the Coconut Development Board	Exempt	(900,000)	
Lease rental paid	Disallowed	590,000	
Land filling cost	Allowed	-	
Bank loan interest		80,500	
<b><u>Lease allowance</u></b>			
Lease rental value (59,000 * 24)	1,416,000		
<sup>1</sup> / <sub>5</sub> of total lease value	283,200		
Rental paid during the year	590,000		
Maximum amount that can be claimed is <sup>1</sup> / <sub>5</sub> of the lease value or rental paid, whichever is lower		(283,200)	
<b>Adjusted profit from business</b>			<b><u>963,800</u></b>
<b>Statutory income</b>			<b>4,159,800</b>
<b><u>Add: Child income</u></b>			
Rent income (35,000 * 12)	420,000		
Less: Rates	<u>(24,000)</u>		

		396,000	
Less: 25% repair allowance		<u>(99,000)</u>	
Net rent (NR)		<u>297,000</u>	
NAV = 280,000 - 70,000 = 210,000			
NAV < NR			<u>297,000</u>
<b>Total statutory income</b>			<b>4,456,800</b>
Less: Statutory deductions – Section 32			
- Interest paid on land purchased			<u>(80,500)</u>
<b>Assessable income</b>			<b>4,376,300</b>
Less: Qualifying payments			
Life insurance premium paid (8,000 * 12)		96,000	
Limited to 1/3 of AI or 75,000, whichever is less		75,000	(75,000)
Insurance premium paid to special health insurance scheme deductible	(3,000 * 12)		(36,000)
Tax-free allowance			(500,000)
Employment income allowance			<u>(250,000)</u>
<b>Taxable income</b>			<b><u>3,515,300</u></b>
<b>Tax liability</b>			
- First	500,000	4%	20,000
- Second	500,000	8%	40,000
- Business income	963,800	10%	96,380
- Next	500,000	12%	60,000
- Balance employment income	<u>1,051,500</u>	16%	<u>168,240</u>
	<b>3,515,300</b>		<b>384,620</b>
<b>Total tax liability</b>			
Less: Tax credits			
- PAYE on primary employment			(124,160)
- PAYE on secondary employment	9,600 * 12		(115,200)
- Self-Assessment payments			<u>(90,000)</u>
<b>Balance tax payable</b>			<b><u>55,260</u></b>

(Total: 20 marks)



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