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ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JULY 2016

(AA35) CORPORATE AND PERSONAL TAXATION

17-07-2016
Afternoon
[1.45 – 5.00]

No. of Pages : 09
No. of Questions : 09

- **Instructions to candidates** (Please Read Carefully)**:**
  - (1) ***Time Allowed:*** *Reading : 15 minutes*
    Writing : 03 hours
  - (2) ***All questions should be answered.***
  - (3) ***Answers*** *should be in* ***one language****, in the* ***medium*** *applied for, in the* ***booklets*** *provided.*
  - (4) *Submit all workings and calculations. State clearly assumptions made by you, if any.*
  - (5) *Use of Non-programmable calculators is* ***only*** *permitted.*
  - (6) ***Action Verb Check List*** *with definitions is attached. Each question will begin with an* ***action verb****. Candidates should answer the questions based on the* ***definition*** *of the verb given in the Action Verb Check List.*
  - (7) *100 Marks.*

SECTION A

Four (04) compulsory questions

(Total 20 marks)

Question 01

The government imposes taxes with the primary objective of raising funds for public expenditure. Taxation system of a country is normally based on a set of tax principles. Those are formal guidelines which are widely accepted and should be considered when tax laws are proposed and implemented:

Explain any five(05) principles of taxation. (05 marks)

Question 02

State the activities chargeable with Value Added Tax (VAT) according to the provisions of the Value Added Tax Act. (05 marks)

Question 03

Agri Seed (Pvt) Ltd. is a leading seed production company. The company produces seeds in Sri Lanka as well as imports seeds from foreign countries. **Agri Seed (Pvt) Ltd.**, had an adjusted tax loss in the previous year of assessment and the following information is relevant to the quarter ended 31st March 2015:

	Rs.
Sale of Seeds - produced by the company	54,650,000
Sale of Seeds – imported	12,650,000
Sale proceeds on office equipment	2,225,000
Interest income	750,000
	70,275,000

You are required to,

Assess Economic Service Charge (ESC) payable by **Agri Seed (Pvt) Ltd.** for the quarter ended 31st March 2015. (05 marks)

Question 04

Papers (Pvt) Ltd. is engaged in the business of wholesale and retail sale of paper items. In December 2014, goods worth Rs.500,000/- were damaged due to floods that affected the stores of the company. The loss was reduced to Rs.200,000/- by the insurance claim of Rs.300,000/-. The company claimed the net loss of Rs.200,000/- as a deduction when calculating the income tax liability. The assessor has assessed this amount as a disallowable item.

You are required to,

Explain whether the Assessor's decision is correct according to the provisions of the Inland Revenue Act (Support your decision with reference to any decided cases in this connection).

(05 marks)

End of Section A

SECTION B

Three (03) compulsory questions

(Total 30 marks)

Question 05

On 01st April 2014, **Suresh** and **Naresh** started a pastry shop as a partnership business. They agreed to share profits and losses in the ratio of 1 : 1. Income statement of the partnership for the year ended 31st March 2015 is given below:

	Rs.	Rs.
Gross Profit		1,740,000
Add: Other Income		
Interest Income Received on Savings Account	8,000	8,000
		1,748,000
Less: Expenses		
Rent Paid to **Naresh**	120,000	
Depreciation	20,000	
Salaries - **Suresh**	192,000	
Salaries - **Naresh**	192,000	
Other Expenses	378,000	902,000
Net Profit		**846,000**

The following additional information is also provided:

(1) The business is carried in a building owned by **Naresh** and a rent of Rs.10,000/- per month has been paid to him.

(2) Equipment costing Rs.90,000/- were purchased at the commencement of the business.

(3) No withholding tax was deducted on interest income.

(4) No disallowable expense is included in other expenses.

Based on the above information,

You are required to,

(a) **Calculate** the Divisible Profit of the Partnership. (04 marks)

(b) **Calculate** Income Tax Liability of the Partnership. (02 marks)

(c) **Prepare** Statement of Distribution of Profits and Other Income of the partners arising from the partnership. (04 marks)

(Total 10 marks)

Question 06

Spicy World (Pvt) Ltd. is a company engaged in the business of manufacturing spices and food items. The following information for the quarter ended 31st March 2015 were extracted from the books of the company:

(1) Value of supplies (excluding Value Added Tax [VAT]) made by the company during the quarter ended 31st March 2015:

Supplies Made	Value
Direct Exports (US $ 1 = Rs.130)	US $ 12,500
Sales made to Exporters as Suspended Supplies	Rs.845,000
Sales to the Local Market	Rs.2,850,000

(2) The company has paid Rs.144,600/- as input VAT on local purchases.

(3) The company has received a tax credit note from a local supplier which shows a VAT amount of Rs.16,500/-.

(4) The excess input VAT brought forward from the previous quarter amounts to Rs.74,000/-.

(5) Suspended VAT Credit Vouchers (SVCV) amounting to Rs.92,950/- were received on suspended supplies.

(6) VAT of Rs.80,000/- for the quarter ended 31st March 2015 has been paid as installments.

You are required to,

Assess the balance amount of VAT payable for the quarter ended 31st March 2015. (10 marks)

Question 07

Siriwardana is the owner of **Siri Tours**. He has several other sources of income also. He has not yet submitted the return of income for the Year of Assessment 2014/15. You are the Tax Consultant of **Siriwardana**.

You are required to,

(a) **State** the due date for submitting the return of income for the Year of Assessment 2014/15. (02 marks)

(b) **Explain** the benefits of submitting a return of income on or before the due date. (03 marks)

(c) **State** two(02) actions that can be taken by the Commissioner General of Inland Revenue on failure to furnish a return of income. (02 marks)

(d) **Explain** the instances where the Commissioner General may reduce or waive off penalties in respect of failure to furnish a return on the due date. (03 marks)

(Total 10 marks)

End of Section B

SECTION C

Two (02) compulsory questions.

(Total 50 marks)

Question 08

Glass Deco (Pvt) Ltd. which is a resident company incorporated in 2010 is engaged in the business of manufacturing decorated glassware for the European market. The company's parent undertaking is **Deco Global Ltd.**, which was incorporated in India.

The following information has been extracted from the financial statements of **Glass Deco (Pvt) Ltd.** for the year ended 31st March 2015:

(1) **Note 1 -** Net profit before taxation for the year ended 31st March 2015 was Rs.17,489,450/-. The following expenses were charged when arriving at the net profit.

Note 1.1 – Foreign Travelling

During the year, the production manager of the company has travelled to India, to study new production techniques which can be used to improve the quality of products. Cost of his tour was Rs.265,000/-.

Marketing team of the company participated in a trade fair in Germany and cost of that tour was Rs.540,000/-.

Note 1.2 – Advertising

The company has incurred the following advertising expenses during the year:

	Rs.
Paper advertisement to sell a Machinery	15,000
Advertisements in Foreign Media	1,200,000
Total	**1,215,000**

Note 1.3 – Research and Development Expenses

During the year, a research was carried out by a research institution with the aim of improving the quality of products. The company has paid Rs.1,000,000/- for this purpose to the research institute.

Note 1.4 – Royalty

During the year, the company has paid a royalty of Rs.1,000,000/- to its parent company.

Note 1.5 – Donation

The company has donated Rs.600,000/- to the Ministry of Health to be used for construction work in National Hospital, Colombo.

(2) **Note 2 -** Other Income includes the following:

	Rs.
Export Development Rebate received from Export Development Board	500,000
Profit on disposal of a Machinery	180,000
Interest income received from Foreign Currency Banking Unit (FCBU)	265,000

(3) **Note 3 -** Details of Property, Plant and Equipment are as follows:

Cost

Assets	Balance as at 01st April 2014 Rs.	Additions Rs.	Disposals Rs.	Balance as at 31st March 2015 Rs.
Land	2,000,000	-	-	2,000,000
Buildings	12,000,000	-	-	12,000,000
Furniture	860,000	-	-	860,000
Plant and Machinery	8,540,000	2,400,000	1,250,000	9,690,000
Computers	435,000	-	-	435,000
Office Equipment	236,000	42,000	-	278,000
	24,071,000	**2,442,000**	**1,250,000**	**25,263,000**

Depreciation

Assets	Balance as at 01st April 2014 Rs.	Charge for the year Rs.	Disposals Rs.	Balance as at 31st March 2015 Rs.
Buildings	4,800,000	1,200,000	-	6,000,000
Furniture	688,000	34,400	-	722,400
Plant and Machinery	6,832,000	341,600	1,000,000	6,173,600
Computers	348,000	17,400	-	365,400
Office Equipment	188,800	9,440	-	198,240
	12,856,800	**1,602,840**	**1,000,000**	**13,459,640**

Note 3.1

The company sold an old machinery on 01st May 2014 and a new machinery was purchased on 01st September 2014 to replace the old one.

Note 3.2

Assume all items of Property, Plant and Equipment as at 01st April 2014 have been acquired in the year of assessment 2010/11 when the company commenced its operations.

(4) **Note 4 -** Other relevant information:

Note 4.1

Adjusted business profit of the company for tax purposes for the year ended 31st March 2014 was Rs.12,500,000/-.

Note 4.2

Taxable business loss brought forward from the year of assessment 2013/14 was Rs.2,435,000/-.

Note 4.3

Self-assessment tax payment for the year of assessment 2014/15 was Rs.750,000/-.

You are required to,

Assess the following for the year of assessment 2014/15:

(a) Total Statutory Income,

(b) Assessable Income,

(c) Taxable Income,

(d) Gross Income Tax Payable and

(e) Balance Tax Payable.

N.B: The reasons for allowing or disallowing any expenses should be clearly stated. (25 marks)

Question 09

Ranasinghe is a resident individual, working as a Production Manager of a leading Biscuit Manufacturing Company in Sri Lanka. The following information relating to **Ranasinghe** is provided in respect of the year of assessment 2014/15 (hereinafter referred to as the 'year').

(1) He has received a monthly salary of Rs.100,000/-. One month's salary was paid to him in January 2015 as a production incentive.

(2) The company has provided him a Motor car (Engine Capacity - 2,000cc) with fuel and no running records were maintained for usage.

(3) He is living in a rented house at Moratuwa. Rent of the house is borne by him and monthly rent of the house is Rs.40,000/-. He received Rs.50,000/- per month from the company as an allowance for residence.

(4) During the year, his son passed grade 5 scholarship examination and he received a gift of Rs.100,000/- from the company. That money was deposited in a minor's savings account.

(5) He has a house in Kandy which was inherited from his parents and it was rented for Rs.20,000/- per month from January 2014. Rating assessment of this house is Rs.90,000/- and rates are paid at 20%.

(6) During the year, the following Interest income were received:

On Fixed Deposits : Rs.69,000/- (net of WHT at 8%)
On Minors' Savings account : Rs.3,000/-

(7) During the year, he obtained a personal loan of Rs.500,000/- from the Bank of Ceylon and that money was invested in quoted shares. He has paid Rs.52,000/- and Rs.190,000/- for the year as interest and capital repayment of this loan respectively.

(8) Summary of dividends received during the year is given below:

	Gross Dividend Rs.	**Withholding Tax Rs.**	**Net Dividend Rs.**
Paid out of dividend received from other companies	18,000	1,800	16,200
Paid out of profits and income	7,000	700	6,300
Total	**25,000**	**2,500**	**22,500**

(9) Details of shares disposed by **Ranasinghe** during the year are as follows:

Company	**No. of Shares**	**Cost (Rs.)**	**Sale Proceeds (Rs.)**	**Profit (Rs.)**
ABC PLC	10,000	186,000	220,000	34,000
PQR PLC	6,000	245,000	300,000	55,000
XYZ PLC	2,000	80,000	65,000	(15,000)
		511,000	**585,000**	**74,000**

(10) He has donated Rs.20,000/- to an approved charity which was established for the provision of institutionalized care for differently abled persons. Further, he has donated Rs.100,000/- to "Api Venuwen Api Fund".

(11) PAYE deducted for the year was Rs.96,000/-.

(12) He has paid income tax of Rs.10,000/- on the self-assessment basis.

From the foregoing information,

You are required to,

Assess the following for **Ranasinghe** for the year of assessment 2014/15.

(a) Taxable income,

(b) Gross income tax payable, and,

(c) Balance tax payable.

N.B: The reasons for allowing or disallowing any expenses should be clearly stated. (25 marks)

End of Section C

ACTION VERB CHECK LIST

Knowledge Process	Verb List	Verb Definitions
Level 01 **Comprehension** Recall & explain important information	**Define**	Describe exactly the nature, scope, or meaning.
	Draw	Produce (a picture or diagram).
	Identify	Recognize, establish or select after consideration.
	List	Write the connected items one below the other.
	Relate	To establish logical or causal connections.
	State	Express something definitely or clearly.
	Calculate/Compute	Make a mathematical computation
	Discuss	Examine in detail by argument showing different aspects, for the purpose of arriving at a conclusion.
	Explain	Make a clear description in detail revealing relevant facts.
	Interpret	Present in an understandable terms.
	Recognize	To show validity or otherwise, using knowledge or contextual experience.
	Record	Enter relevant entries in detail.
	Summarize	Give a brief statement of the main points (in facts or figures).

Knowledge Process	Verb List	Verb Definitions
Level 02 **Application** Use knowledge in a setting other than the one in which it was learned / Solve closed-ended problems	**Apply**	Put to practical use.
	Assess	Determine the value, nature, ability, or quality.
	Demonstrate	Prove, especially with examples.
	Graph	Represent by means of a graph.
	Prepare	Make ready for a particular purpose.
	Prioritize	Arrange or do in order of importance.
	Reconcile	Make consistent with another.
	Solve	To find a solution through calculations and/or explanation.

Knowledge Process	Verb List	Verb Definitions
Level 03 **Analysis** Draw relations among ideas and compare and contrast / Solve open-ended problems.	**Analyze**	Examine in detail in order to determine the solution or outcome.
	Compare	Examine for the purpose of discovering similarities.
	Contrast	Examine in order to show unlikeness or differences.
	Differentiate	Constitute a difference that distinguishes something.
	Outline	Make a summary of significant features.