



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JANUARY 2019

(AA35) CORPORATE AND PERSONAL TAXATION

- **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.**

27-01-2019
Afternoon
[1.45 – 5.00]

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

SECTION A

Four (04) compulsory questions

(Total 20 marks)

Question 01

As per the Inland Revenue Act No. 10 of 2006, the word “Person” includes a company or a body of persons or any government.

You are required to:

(a) **State** three(03) persons that can be included under the term “a body of persons”. (03 marks)

(b) **State** two(02) main tax authorities in Sri Lanka. (02 marks)

(Total 05 marks)

Question 02

Sagaree (Pvt) Ltd. was incorporated on 01st July 2017 and commenced its business operations on the same day. As per the financial statements for the year ended 31st March 2018, the company has incurred an accounting loss and also there was no taxable income.

Directors of the company seek your advice on the following:

- Registration of the company with the Department of Inland Revenue.
- Furnishing of the return of income for the year of assessment 2017/18.

You are required to:

State the provisions applicable for each of the above situations under the Inland Revenue Act.

(05 marks)

Question 03

- (A) **Sarath** is a resident individual. His income for the year of assessment 2017/18 consists of employment income and interest income on fixed deposits. Further, PAYE has been deducted on his employment income by the employer and withholding tax (WHT) has been deducted on the interest income received from fixed deposits. He did not have any other income for the year of assessment 2017/18.

You are required to:

Explain whether **Sarath** is required to file the return of income with the Department of Inland Revenue. (03 marks)

- (B) “Any individual who satisfies any four requirements out of the specified five (05) requirements during any year of assessment shall submit the return of income to Commissioner General of Inland Revenue not later than one month after the fulfillment of such requirements.”

You are required to:

State any two (02) specified requirements that should be fulfilled to be eligible to submit the return of income as stated above. (02 marks)

(Total 05 marks)

Question 04

Health care (Pvt) Ltd. is engaged in a pharmaceutical business managed by three brothers. **Mr.Dias** being the Managing Director who actively participated in the day to day business operations, had to undergo foreign medical treatment. Therefore, the other two brothers gave a special bonus from the company to **Mr.Dias** to bear his medical cost considering his exceptional service to the success of the company.

The Assistant Commissioner of Department of Inland Revenue has assessed the bonus received from the company as part of the employment income of **Mr.Dias**.

You are required to:

Explain whether the bonus received from the company for the medical treatment would be considered as employment income of **Mr. Dias** for tax purposes by referring to the decision given in the case of *Crib vs. Commissioner of Income Tax (CIT)*. (05 marks)

End of Section A

SECTION B

Three (03) compulsory questions

(Total 30 marks)

Question 05

Pathumi who is a retired teacher, commenced a business of plant nursery in January 2014. In 2016, **Sithumi**, a friend of **Pathumi** joined the business as a partner and started a partnership as **Sithu Pathu Growers**. **Pathumi** and **Sithumi** agreed to share profits and losses in the ratio of 2:1 respectively.

The income statement of the partnership for the year ended 31st March 2018 is given below:

	Rs.
Gross Profit	12,426,000
Add: Other Income	
Interest income on savings account – Gross [withholding tax (WHT) was not deducted]	7,500
	12,433,500
Expenses:	
Salaries	(3,800,000)
Depreciation on assets	(432,000)
Electricity, Water and Telephone	(144,500)
Interest on loan provided by Sithumi	(45,000)
Stationery	(14,000)
Net Profit	7,998,000

The following additional information is also provided:

- (1) Salaries include the following:
 - Rs.720,000/- paid to **Pathumi** as her annual salary.
 - Rs.500,000/- paid to **Sithumi's** daughter for book keeping of the partnership.
- (2) Interest was paid to **Sithumi** for the loan provided by her to **Sithu Pathu Growers**.
- (3) Depreciation allowance on assets for tax purposes for the year of assessment 2017/18 was Rs.168,000/-.

You are required to:

- (a) **Calculate** the divisible profit of the partnership. (04 marks)
 - (b) **Calculate** the income tax liability of the partnership. (03 marks)
 - (c) **Prepare** the statement of distribution of profits and other income of the partners arising from the partnership. (03 marks)
- (Total 10 marks)

Question 06

Avotek Technologies Ltd. is a company registered for Value Added Tax (VAT) purposes and engages in the business of importing and selling of computers, software development and other related services:

The following information for the quarter ended 31st March 2018 was extracted from the books of the company:

- (1) Income (exclusive of VAT)

	Rs.
Sale of computers	5,200,000
Network cabling and installation	3,900,000
Maintenance services provided to SVAT registered persons	1,350,000
Foreign currency income earned from a software developed to a foreign buyer to be used in India (USD 1 = Rs.150/-)	4,000,000
Total	14,450,000

- (2) Input VAT paid by the company:

	Rs.
On imported network cables	320,000
Input VAT paid on transport of computers sold to Jaffna	17,000

- (3) The excess input VAT brought forward from the previous quarter amounts to Rs.52,000/-.
(4) The company has received Simplified VAT Credit Vouchers (SVCV) on SVAT sales.

You are required to:

Assess the balance payable / (overpaid) of Value Added Tax (VAT) for the quarter ended 31st March 2018. (10 marks)

Question 07

Sunimal Enterprises which is engaged in the business of manufacturing and selling of ceramic products as core business activity, is also engaged in wholesale and retail trade of imported paints and other building material. The following information was extracted from the books of accounts of **Sunimal Enterprises** for the quarter ended 31st March 2018:

- (1) Sales of the company were as follows:

	Rs.
Sale of ceramic products manufactured by the company	4,360,000
Sale of paints and other building material imported by the company	5,200,000
Total	9,560,000

- (2) Interest income from fixed deposits for the quarter ended 31st March 2018 was Rs. 250,000/-.
(3) The amounts of Nation Building Tax (NBT) paid by the company were as follows:

	Rs.
On machinery imported to manufacture ceramic products	140,000
On imported raw material to manufacture ceramic products	62,000
On imported paints and other building material	22,000

- (4) Rs.25,000/- has been paid as monthly installments of NBT for the quarter ended 31st March 2018.

You are required to:

Assess the balance amount of Nation Building Tax (NBT) payable for the quarter ended 31st March 2018. (10 marks)

SECTION C

Two (02) compulsory questions.

(Total 50 marks)

Question 08

Maliga Constructions (Pvt) Ltd. (MCL) is a resident company engaged in construction industry. During the year ended 31st March 2018, the company was carrying out several projects in Sri Lanka. As at 31st March 2018, issued share capital and total reserves of the company were Rs.20,000,000/- and Rs.5,000,000/- respectively.

The following information was extracted from the financial statements of **MCL**:

- (1) Turnover and net profit before income tax of the company for the year ended 31st March 2018 were Rs.876,400,000/- and Rs.16,250,000/- respectively.
- (2) Other income comprised of the following:

	Rs.
Interest income on fixed deposits [Withholding Tax (WHT) has been deducted by bank]	240,000
Interest income on listed debentures (invested in August 2016)	1,456,000
Insurance claim	300,000
Total	1,996,000

- (3) The net profit was arrived at after charging all the expenses, including the following:

	Rs.
Depreciation	5,028,000
Entertainment	134,000
Foreign travelling expenses (Note 01)	474,000
Penalties (Note 02)	1,903,600
Donations (Note 03)	1,250,000
Legal and consultancy fees (Note 04)	115,000
Advertising in media	765,000
Gratuity (Note 05)	8,500,000
Lease interest	60,750
Interest paid to parent company (Note 06)	3,000,200

Note 01 - Foreign Travelling expenses:

- Cost of air ticket of Chief Executive Officer (CEO) for travelling abroad to inspect a new machinery was Rs.120,000/-.
- Chief Engineer of the company has been sent to Maldives for negotiations of a prospective project. Cost of the tour was Rs.354,000/-.
- Statutory income from trade for the year of assessment 2016/17 was Rs.14,880,000/-.

Note 02 - Penalties:

	Rs.
Additional tax paid on an assessment	1,276,000
Penalty on additional tax	127,600
Liquidated damages paid for delaying completion	500,000

Note 03 - Donations:

	Rs.
Cash donation to a children's home which is an approved charity	1,000,000
Scholarships for staff members' children	250,000

Note 04 – Legal and consultancy fees:

	Rs.
Fees for settlement of tax assessment	65,000
Fee for filing the tax return	50,000

Note 05 – Gratuity:

Gratuity represents the gratuity provision for the year ended 31st March 2018 and no gratuity payments were made during the current year.

Note 06 – Interest paid to parent company:

The company has obtained a loan of Rs.112,000,000/- from its parent company **Easy Life PLC**. The company has paid Rs.3,000,200/- as interest on this loan obtained from its parent company during the year.

(4) Details of Property, Plant and Equipment are as follows:

Cost

Assets	Balance as at 01 st April 2017 (Rs.)	Additions (Rs.)	Disposals (Rs.)	Balance as at 31 st March 2018 (Rs.)
Land	8,000,000	-	-	8,000,000
Buildings	2,500,000	-	-	2,500,000
Machinery	25,670,000	3,450,000	-	29,120,000
Motor vehicles	10,450,000	-	2,400,000	8,050,000
Office Equipment	1,546,000	348,000	-	1,894,000
Computers - Leased	-	800,000	-	800,000
Total	48,166,000	4,598,000	2,400,000	50,364,000

Depreciation

Assets	Balance as at 01 st April 2017 (Rs.)	Charge for the year (Rs.)	Disposals (Rs.)	Balance as at 31 st March 2018 (Rs.)
Buildings	1,000,000	125,000	-	1,125,000
Machinery	15,402,000	3,080,400	-	18,482,400
Motor Vehicles	4,702,500	1,149,500	2,400,000	3,452,000
Office Equipment	463,800	162,500	-	626,300
Computers - Leased	-	192,000	-	192,000
Total	21,568,300	4,709,400	2,400,000	23,877,700

- In December 2017, a truck used in a project met with an accident and it was fully condemned. The insurance company has paid Rs.300,000/- as the insurance claim and it was recorded in other income. This truck had been purchased in the year of assessment 2013/14.
- Five laptop computers, each costing Rs.160,000/- were acquired under a Finance lease agreement, commencing from 01st June 2017 and the term of the lease was 30 months. Monthly installment of the lease was Rs.45,000/- and 10 installments were paid during the current year.
- Unless otherwise stated, all property, plant and equipment as at 01st April 2017 were fully depreciated for tax purposes.

(5) Economic Service Charge (ESC) payments for the year of assessment 2017/18 was Rs.4,382,000/-.

You are required to:

Assess the following for the year of assessment 2017/18:

- Total Statutory Income,
- Assessable Income,
- Taxable Income,
- Gross Income Tax Payable, and
- Balance Tax Payable.

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

Question 09

Mrs.Silva is 64 years old. She is a chartered accountant employed as the Finance Director of **Easy Tour (Pvt) Ltd.** which is a leading travel agency company in Sri Lanka. The following information relating to **Mrs.Silva** is provided in respect of the year of assessment 2017/18 (*hereinafter referred to as the 'year'*):

- (1) During the year she received the following from the company:
 - Gross salary – Rs.240,000/- per month.
 - The company has provided her a Motor car (Engine Capacity of 2,000 CC) with fuel and driver for both private and official use and she did not pay the employer for the private usage. The company did not maintain running records for this car.
 - During the year, she participated at a conference conducted by the Travel Agency Association in Dubai and the cost of the air ticket and accommodation fee of Rs.720,000/- were borne by the company.
 - During the year, the company has reimbursed her telephone bills for the year amounting to Rs.291,000/-.

- (2) Director fee of Rs.84,000/- per month (net of tax) has been paid to her by a subsidiary of **Easy Tour (Pvt) Ltd**. She was informed that the relevant tax on director's fee has been deducted from that amount and she was not considered as an employee of the subsidiary.
- (3) **Mrs.Silva** lives in her own apartment in Rosmead Place which was bought in May 2017. The rating assessment of this house was Rs.1,500,000/- and rates were paid at 30%.
- (4) She has a house in Kandy which she inherited from her parents, and her brother is living in that house from January 2018. Rating assessment of this house is Rs.120,000/- and rates were paid at 20%. The house was given on rent for Rs.100,000/- per month to a neighbor until December 2017 prior to her brother's shifting to that house.
- (5) **Mrs. Silva** has a Fixed Deposit of Rs.5,200,000/- at the People's Bank on which she received an interest of Rs.420,000/- during the year. Withholding Tax (WHT) was not deducted on this interest income by the bank.
- (6) During the year, she has obtained a housing loan of Rs.5,500,000/- from the Bank of Ceylon and that money was invested to purchase the apartment in Rosmead Place. She has paid Rs.304,000/- and Rs.280,000/- for the year as interest and capital repayment of this loan respectively.
- (7) During the year, she has donated Rs.90,000/- to an approved children's home which provides care for abandoned children.
- (8) PAYE deduction for the year was Rs.200,000/- by **Easy Tour (Pvt) Ltd**.
- (9) During the year, she has paid income tax of Rs.25,000/- on the self-assessment basis.

From the foregoing information,

You are required to:

Assess the following for **Mrs.Silva** for the year of assessment 2017/18.

- (a) Taxable income,
- (b) Gross income tax payable,
- (c) Balance tax payable, and,
- (d) Exempt income, if any. (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.