

ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

(AA35) CORPORATE AND PERSONAL TAXATION

As per New Inland Revenue No. 24 of 2017

PILOT QUESTION

ABC (Pvt) Ltd., is a resident company incorporated in 2000, engaged in manufacturing coconut fibre related products. As at 31st March 2019, issued share capital and total reserves of the company were Rs.12,000,000/- and Rs.1,850,000/- respectively.

The summarized income statement of **ABC (Pvt) Ltd.** for the year ending 31st March 2019 is given below:

	Note	Rs.'000
Revenue - exports		632,000
- local sales		84,000
		716,000
Cost of sales		(486,000)
Gross profit		230,000
Other income	1	6,598
Administration expenses	2	(134,500)
Distribution expenses	3	(54,450)
Finance cost	4	(7,654)
Net profit before income tax		39,994

(1) **Note 1 – Other income:**

	Rs.'000
Rent income (gross)	480
Dividend income received (net)	215
Profit from disposal of Land	5,000
profit from disposal of Quoted shares	468
Interest Income on fixed deposit (gross)	435
	6,598

(2) **Note 2 – Administration expenses:**

Administration expenses include the following:

- (2.1) Accounting depreciation charged for the year was Rs.5,436,000/-.
- (2.2) The company has incurred an accounting loss of Rs.120,000 from the sale of motor lorry used for business.
- (2.3) Gratuity provision for the year was Rs.1,876,000/-.
- (2.4) Director fees paid during the year was Rs.2,400,000/- and it has not considered for PAYE purposes.
- (2.5) Entertainment expenses was Rs.135,000/-.
- (2.6) During the year, the company has paid Rs.250,000/- to the pradeshiya sabha as fines for violating health regulations.
- (2.7) The company has donated Rs.1,000,000/- to the Cancer Hospital to purchase medical equipment. (the hospital has issued a receipt in this regard) and Rs.200,000/- worth of grocery items to an approved charity that maintains inmates in the home.
- (2.8) A research was carried by the company to improve the quality of their products by incurring a cost of Rs.2,500,000/-. This cost included laboratory equipment worth Rs.1,000,000/-, which was purchased for the purpose of carrying out the research.
- (2.9) A sales team of the company has been sent to Singapore for negotiations with prospective buyers. Cost of air tickets purchased for the team was Rs.248,000/-. Further, Rs.600,000/- incurred on a foreign tour organized to entertain the managing Director and his family.
- (2.10) The company has incurred Rs.145,000/- for painting of the building given on rent.
- (2.11) In December 2018, the company has paid Rs.750,000/- to a lawyer who represents the company in labour court. The company has not paid relevant Withholding Tax on such payment.

(3) **Note 3 – Distribution expenses:**

include the following:

- (3.1) Remaining loan balance of Rs.50,000/- from an employee has been written off. In addition to that, the company has made a general provision of Rs.120,000/- for doubtful debts from trade debtors. Further, a trade debt of Rs.15,000/- was estimated to have become doubtful during the year.
- (3.2) Cost of TV commercials of Rs.1,520,000/- and the cost of Rs.25,000/- for paper notices published to recruit new workers were included in advertising expenses.

(4) **Note 4 – Finance cost:**

include the following:

- (4.1) Economic Service Charge written off due to lapse of claimable period for tax credit was Rs.1,057,000/-.
- (4.2) Loan interest paid on bank loan obtained for working capital purposes was Rs.6,483,000/-.
- (4.3) On 01st July 2018, 5 laptop computers were obtained under a finance lease agreement for a period of 36 months. Monthly installment of the lease was Rs.31,200/-. The company has paid 9 installments during the year. Lease Interest charged to Income statement was Rs.114,000/-.

(5) **Note 5 – Property, Plant and Equipment:**

(5.1) Acquisitions made during the year:

(Rs.'000)

Type of asset	Cost
Generators	2,000
Office furniture	450
Motor Car for Managing Director	2,800
Motor Lorry	4,360
Locally developed software (estimated useful life time of 8 years)	420
Computers (obtained under finance lease term)	840

(5.2) The following assets were as at 31st March 2018: (Rs.'000)

	Cost	Acquired in Y/A
Buildings	12,465	2015/16
Machinery	2,400	2016/17
Motor Lorries	5,400	2016/17
office Equipment	225	2017/18

(5.3) Disposal made during the year:

- (i) A motor Lorry which was purchased in Y/A 2016/17 for Rs.2,800,000/- has been sold for Rs.1,750,000/- on 30th June 2018. A new lorry was purchased at a cost of Rs.4,360,000/- on 01st July 2018 to replace the old one.
- (ii) The company owned land in Nugegoda. This land was purchased in 2014 for Rs.25,000,000/- with an old building at no cost. The management retained the land as an investment asset in order to gain from capital appreciation in the long run. The building was rented out until such time the land is sold. Rent received during the year has been recorded under other income. This land was sold for Rs.30,000,000/- on 31st December 2018. The market value as at 30th September 2017 was Rs.28,000,000/-.

(5.4) All assets have been fully depreciated for tax purposes, other than those specifically mentioned above.

(6) As at 31st March 2019, following liabilities were in the books of the company:

	Rs.
Bank Loan	41,700,000
Lease Creditor	680,000
	42,380,000

(7) Rs.1,345,000/- has been paid as gratuity for retired employees during the year.

(8) Taxable business loss brought forward from the year of assessment 2017/18 was Rs.16,500,000/-.

(9) Economic Service Charge (ESC) payments for the year of assessment 2018/19 was Rs.3,580,000/-.

(10) The company has paid Rs.1,000,000/- as quarterly installments for Y/A 2018/19.

(11) Withholding tax has been deducted on income from interest, rent and dividend at relevant rates.

(12) As per the return of income for 2017/18, Notional tax credit carried forward was Rs.560,000/-.

You are required to:

Assess the balance income tax payable by **ABC (Pvt) Ltd.** for the Y/A 2018/19.

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ANSWER

ABC (Pvt) Ltd.
Notes to the Computation of Income Tax
Year of Assessment 2018/2019

Computation of Business Income	Note Ref.	Rs.	Rs.
		+	-
Profit/(Loss) Before Tax		39,994,000	
Add:			
Accounting depreciation on PPE		5,436,000	
Accounting loss on disposal of motor lorries		120,000	
Provision for Gratuity		1,876,000	
Director fee - Disallowed as it is not considered for PAYE purpose - U.S 10 (2)		2,400,000	
Entertainment expenses		135,000	
Fines and penalties		250,000	
Donations (Expenses not incurred in the production of income)		1,200,000	
Research & Development expenses - Lab Equipment - Disallowed U.S 15 & Claimed Capital allowance		1,000,000	
Foreign Travel - sales team - allowed		0	
Foreign Travel - Managing Director - Disallowed		600,000	
Repair and improvements - related to investment income		145,000	
Payment to lawyer- WHT not deducted		750,000	
Staff loan written off		50,000	
Provision for doubtful debts - Specific		15,000	
Provision for doubtful debts - General		120,000	
Advertising - allowed		0	
Unclaimable Economic service charge		1,057,000	
Loan Interest	1.1	6,483,000	
Lease Interest	1.1	114,000	
Assessable charge (disposal profits) on realization of depreciable assets	1.3	70,000	
Less: Allowable Deductions			
Capital allowances on depreciable assets	1.2		4,224,000
<u>Research and development expenses:</u>			
Additional 100% can be claimed under six schedule - Transitional provision			1,500,000
Gratuity paid			1,345,000
Allowable Finance cost	1.1		6,467,800
Less: Investment Income			
Rent income			480,000
Interest income			435,000
Dividend income			215,000
Gain on disposal of investment in quoted shares			468,000
Gain on disposal of land			5,000,000
		61,815,000	20,134,800
		41,680,200	
Less: Business losses brought forward		(16,500,000)	
Business Income		25,180,200	

ABC (Pvt) Ltd.
Computation of Income Tax
Year of Assessment 2018/2019

			Note Ref.	Rs.
Business Income				25,180,200
Investment Income			2	2,770,000
Assessable Income				27,950,200
Less: Qualifying Payments and reliefs				
Donation to the Government				(1,000,000)
Donation to approved charity - in kind - not claimable				-
Taxable Income				26,950,200
Computation of Income Tax Payable				
	Note Ref.	Taxable Income	Rate	Tax
		Rs.	@	Rs.
Gain on realization of Investment Assets	2.1	2,000,000	10%	200,000
Balance Taxable Income	3	24,950,200	14%	3,493,028
Total Tax Payable		26,950,200		3,693,028
Less: Tax Credits				
		Rs.		
Economic Service Charge		3,580,000		
Notional Tax Credit Brought Forward		560,000		
Withholding Tax on interest (435,000 x 5%)		21,750		
Withholding Tax on Rent (480,000 x 10%)		48,000		
Quarterly Installments		1,000,000		5,209,750
Balance Tax Payable / (Refund due)				(1,516,722)

ABC (Pvt) Ltd.
Notes to the Computation of Business Income
Year of Assessment 2018/2019

(1.1) Finance Cost

Finance cost	B	6,597,000
Thin capitalization adjustment under Section 18 of the IR Act		
Issued Share Capital		12,000,000
Reserves		1,850,000
	A	13,850,000
Finance Cost attributable to financial instruments		
Amount due on financial instruments	C	42,380,000
Maximum financial cost claimable	$D = [(A \times 3) / C] \times B$	6,467,800
Disallowed financial cost c/f to next year		129,200

Added back

(1.2) Capital allowances on depreciable assets:

Type of Assets	year of purchase	Depreciation Basis or WDV B/F (Rs.)	No. of years	Charge for the year (Rs.)
Lab Equipment	2018/19	1,000,000	5	200,000
Generators	2018/19	2,000,000	5	400,000
Office furniture	2018/19	450,000	5	90,000
Motor Car for Managing Director	2018/19	2,800,000	not entitled, not a road vehicle	
Motor Vehicles	2018/19	4,360,000	5	872,000
Locally developed software	2018/19	420,000	8	52,500
Computers - leased	2018/19	840,000	5	168,000
Buildings	2015/16	12,465,000	10%	1,246,500
Machinery	2016/17	2,400,000	33.33%	800,000
Motor Vehicles	2016/17	5,400,000		
Less: Disposals		(2,800,000)		
		2,600,000	20%	520,000
Office Equipment	2017/18	225,000	33.33%	75,000
				4,224,000

(1.3) Assessable Charge and Balancing Allowance on depreciable assets:

Description	Cost of the Asset	Year of Acquisition	Consideration	Written Down Value	Assessable Charge
Motor Vehicles	2,800,000	2016/2017	1,750,000	1,680,000	70,000

ABC (Pvt) Ltd.
Notes to the Computation of Business Income
Year of Assessment 2018/2019

2. Computation of Investment Income:

	Note Ref.	Rs.	Rs.
Rent income		480,000	
Less: expenses - painting		(145,000)	
		335,000	
Interest Income		435,000	
Dividend Income		215,000	
Gain on disposal of Investment in quoted shares		468,000	
Gain on disposal of land	2.1	2,000,000	3,453,000
Less: Exempt/final WHT payments			
Dividend Income		215,000	
Gain on disposal of Investment in quoted shares		468,000	(683,000)
Investment income			2,770,000

(2.1) Gain or loss on realization of investment assets:

Description	Cost/ Market Value as at September 30, 2017 (Rs.)	Consideration (Rs.)	Gain / Loss (Rs.)
Land	28,000,000	30,000,000	2,000,000

3. Business Income Tax at Lower Rate:

The taxable income of a company predominantly conducting the business of exporting goods and services is taxed at the rate of 14% under the Inland Revenue Act No. 24 of 2017.

Description	Rs.
Export Revenue	632,000,000
Local Revenue	84,000,000
Other Income	6,598,000
Gross Income	722,598,000
Export revenue as a percentage of gross income	87%

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