



ASSOCIATION OF ACCOUNTING TECHNICIANS OF SRI LANKA

AA3 EXAMINATION - JANUARY 2017

(AA35) CORPORATE AND PERSONAL TAXATION

- **Instructions to candidates** (Please Read Carefully):

(1) **Time Allowed:** Reading : 15 minutes
Writing : 03 hours

22-01-2017
Afternoon
[1.45 – 5.00]

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

- (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

Section 2 of the Inland Revenue Act states that Income tax shall, subject to the provisions of this Act, be charged at the appropriate rates for every year of assessment in respect of the profits and income of every person for that year of assessment:

- wherever arising, in the case of a person who is resident in Sri Lanka in that year of assessment; and,
- arising in or derived from Sri Lanka, in the case of every other person.

You are required to:

Define the following terms:

- (a) Person.
- (b) Year of assessment. (05 marks)

Question 02

Sarasi Fashions (Pvt) Ltd. which is engaged in manufacturing of garments is currently having around 100 employees. Recently, you are appointed to handle the payroll system of the company.

You are required to:

State five(05) obligations of an employer in operation of the PAYE system. (05 marks)

Question 03

Sunimal is a retired teacher. One day **Sarath**, one of **Sunimal's** friends met him and asked him to purchase his rubber estate of 200 acres for Rs.40 million since he is migrating to Australia in 3 months' time. Though **Sunimal** wishes to buy it, he did not have sufficient money. However, he managed to collect Rs.30 million from some prospective purchasers, with an agreement to transfer 70% of that estate for the amount collected. **Sunimal** paid an advance of Rs.25 million agreeing to complete the transaction within two months. At the end of two months, he purchased the estate and transferred 70% of the estate to the purchasers for the money that was collected in advance. He was able to sell the entire land over a period of six months, keeping 10 acres for himself. He made a net profit of Rs.5 million on this transaction. This is the first time he has engaged himself in a transaction of this nature. He considered this profit to be a capital gain, which is not liable to tax.

However, the assessor issued an assessment on him after including this **profit as an income from a trade**.

You are required to:

Explain to Sunimal why the assessor has come to this conclusion.

(Support your answer with reference to the case law "Mahawitharana Vs Commissioner General of Inland Revenue) (05 marks)

Question 04

Amarasa (Pvt) Ltd. is engaged in the manufacturing of sweets for the local market. The following information is extracted for the quarter ended 31st March 2016:

| | Rs. |
|---|-----------|
| Sales (exclusive of VAT) | 3,500,000 |
| Sale Proceeds from disposal of a packeting machine (inclusive of VAT) | 166,500 |
| Input VAT paid on local purchases | 260,000 |
| Input VAT paid on purchase of an air-conditioner for the factory | 85,000 |
| The following VAT payments have been made during the quarter as installments: | |
| 20 th January 2016 | 12,625 |
| 20 th February 2016 | 15,000 |
| 20 th March 2016 | 10,000 |

You are required to:

Assess the balance amount of Value Added Tax (VAT) payable for the quarter ended 31st March 2016 of **Amarasa (Pvt) Ltd.**

(Consider the applicable VAT rate as 11%)

(05 marks)

End of Section A

SECTION B

Three (03) compulsory questions

(Total 30 marks)

Question 05

Sumanaweera has not paid income tax for the year of assessment 2014/15. As per the income return submitted by him, amount of tax payable is Rs.1,500,000/- which is now in default. A notice in writing has been sent by the Department of Inland Revenue for the recovery of taxes in default.

You are required to:

- (a) **Explain** three(03) methods available to recover the taxes in default. (06 marks)
- (b) **List** four(04) persons who can be “an authorized representative” under the Inland Revenue Act. (04 marks)
- (Total 10 marks)

Question 06

Jubilee Foods (Pvt) Ltd. is a company engaged in the business of manufacturing and buying and selling of food items. The following information was extracted from the books of the company for the quarter ended 31st March 2016:

- (1) Turnover of the company is as follows:

| | Rs. |
|---|------------------|
| Products Manufactured by the company | 1,250,000 |
| Products locally purchased by the company | 3,895,000 |
| | 5,145,000 |

- (2) The company has paid Nations Building Tax (NBT) amounts as follows:

| | Rs. |
|---------------------------|------------|
| On imported raw materials | 11,250 |
| On office expenses | 6,540 |

- (3) Rs.26,000/- has been paid as monthly installments of NBT for the quarter ended 31st March 2016.

You are required to:

- (a) **Assess** the balance amount of Nation Building Tax payable for the quarter ended 31st March 2016. (08 marks)
- (b) **State** the due date for submitting Nation Building Tax return for the quarter ended 31st March 2016. (02 marks)
- (Total 10 marks)

Question 07

Sithumini, an architect and **Muthumini**, an engineer commenced a partnership named, **Sithmuthu Partners** on 01st April 2015. **Sithmuthu Partners** purchases small lands and constructs houses according to clients' requirements. When forming the partnership, they agreed on the following conditions:

- **Sithumini** and **Muthumini** are entitled to receive a professional fee of Rs.4,000,000/- and Rs.2,000,000/- per annum respectively.
- In addition to the professional fee, **Muthumini** is entitled to receive Rs.50,000/- per month as salaries.

Income Statement of the partnership for the year ended 31st March 2016

| Description | Rs. '000 | Rs. '000 |
|-------------------------------------|----------|---------------|
| Turnover | | 75,000 |
| Cost of Sales | | (50,850) |
| Gross Profit | | 24,150 |
| Expenses: | | |
| Salary | 7,200 | |
| Professional Fee: | | |
| Sithumini | 4,000 | |
| Muthumini | 2,000 | 6,000 |
| Partner's Salary - Muthumini | 600 | |
| Office rent | 480 | |
| Electricity expenses | 84 | |
| Depreciation on assets | 120 | |
| Telephone expenses | 60 | 14,544 |
| Net Profit | | 9,606 |

Depreciation allowance on assets for tax purposes for the year of assessment was Rs.180,000/-.

You are required to:

- (a) **Calculate** the Divisible Profit of the Partnership. (05 marks)
- (b) **Calculate** the 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. (03 marks)
(Total 10 marks)

End of Section B

SECTION C

Two (02) compulsory questions.

(Total 50 marks)

Question 08

Golden (Pvt) Ltd. is engaged in the business of manufacturing and selling of leather footwear to the local market.

- (1) Summarized Comprehensive Income Statement for the year ended 31st March 2016 is given below:

| | | Rs. |
|-------------------------|------------|-------------------|
| Turnover | | 172,450,675 |
| Cost of Sales | | (102,460,000) |
| Gross Profit | | 69,990,675 |
| Other income | | 108,000 |
| Administration Expenses | 26,437,000 | |
| Distribution Expenses | 7,450,525 | |
| Finance Expenses | 1,506,000 | (35,393,525) |
| Net Profit | | 34,705,150 |

- (2) Other Income consists of interest received from Treasury Bills.
- (3) Administration expenses include the following:

| | Rs. |
|---------------------------|------------|
| Depreciation | 2,625,000 |
| Gratuity provision made | 834,000 |
| Penalty (Note 1) | 276,000 |
| Legal fee (Note 2) | 50,000 |
| Rent (Note 3) | 1,500,000 |
| Donation (Note 4) | 600,000 |

Note 1

During the year, the company had to pay a penalty of Rs.276,000/- due to non-payment of income tax on time.

Note 2

Rs.50,000/- has been paid to a tax consultant for negotiating with the Inland Revenue Department to reduce the penalty.

Note 3

The Chief Executive officer (CEO), who was employed throughout the year received a salary of Rs.200,000/- per month and given a rent-free residence by the company. The company has paid Rs.318,000/- for the year as rent in respect of the rent-free residence provided to CEO and it is included in rent expense.

Note 4

The company has donated Rs.600,000/- to an elders' home which is an approved charity established for the provision of institutionalized care for displaced elders.

- (4) Entertainment expense of Rs.435,000/- is included in Distribution expenses.
- (5) Finance expenses include the following:

| | Rs. |
|--------------------|------------|
| Lease Interest | 270,000 |
| Overdraft Interest | 524,000 |

- (6) No payment has been made as gratuity during the year.
- (7) All other expenses are allowable for tax purposes.
- (8) Details of Assets acquired during the year are given below:

| Asset | Cost (Rs.) |
|----------------------------------|-------------------|
| Furniture (Note 5) | 860,000 |
| Machinery | 7,370,000 |
| Computers | 435,000 |
| Motor vehicles (Note 6) | 2,736,000 |
| Motor vehicles – leased (Note 7) | 1,800,000 |
| | 13,201,000 |

Note 5

Furniture includes a sofa purchased for the residence of CEO, which costs Rs.150,000/-.

Note 6

Motor vehicles consist of motor bikes used by non-executive staff, except a car used for business travelling, which costs Rs.2,250,000/-.

Note 7

A delivery van was obtained under a finance lease agreement for a period of 5 years on 01st May 2015. Monthly installment of the lease was Rs.44,000/- and 10 installments have been paid during the year.

- (9) Depreciation allowances for tax purpose on assets as at 01st April 2015 were fully claimed.
- (10) The company has a brought forward Economic Service Charge (ESC) excess payment of Rs.800,000/- from the previous year of assessment.

You are required to:

Assess the following for the year of assessment 2015/16:

- (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

Hettige, who is a resident individual and a qualified Pharmacist has been employed by **Suwa Sahana Private Hospital** since his retirement from the public service in 2013. The following information relating to **Hettige** is provided in respect of the year of assessment 2015/16 (hereinafter referred to as the 'year').

- (1) Pension received from the government of Sri Lanka is Rs.540,000/- per annum.
- (2) He has received a monthly salary of Rs.120,000/- from **Suwa Sahana Private Hospital**. Further, one month's salary was paid to him in December 2015 as a bonus.
- (3) A commission of Rs.135,000/- has been paid to him for the promotion of drugs under identified brands during the year.
- (4) During the year, he was sent to Pakistan for a two day medical conference and he was paid 250 US dollars (US \$) per day for accommodation by the hospital. The air ticket was also provided and the cost was Rs.75,000/- (US \$ 1 = Rs.142/-).
- (5) He is living in a house at Nugegoda, which was purchased by him long years back. Net Annual Value of that house is Rs.150,000/-.
- (6) He has another house in Matara Town which was inherited from his parents and it was rented for a monthly rent of Rs.60,000/- for a well-known restaurant chain from 01st April 2014. Rating assessment of this house is Rs.180,000/- and rates were paid at 30%.
- (7) He has a land in Kurunegala. He is planning to shift his residence to Kurunegala, after retiring from his current job in 2018 at **Suwa Sahana Private Hospital**. During the year, he has constructed a house having 490 square feet in that land and total cost of construction was Rs.650,000/-. He has obtained a housing loan from Peoples' Bank for the construction of this house. He has paid Rs.27,000/- and Rs.32,000/- during the year as interest and capital repayment of this loan respectively. Net Annual Value of this house is Rs.75,000/-.

- (8) He has sold his private Motor Car which was purchased in 2006 for a cost of Rs.1,400,000/- during the year. Sale proceeds of Rs.1,600,000/- were utilized to purchase a new Motor Car.
- (9) **Hettige** has a Fixed Deposit of Rs.1,500,000/- at the People's Bank on which he received an interest of Rs.105,000/- during the year. No taxes were deducted on this interest income by the bank.
- (10) The following dividends were received during the year:

| | Rs. |
|--|---------------|
| Dividends – from profit exempt from tax | 36,000 |
| Dividends – received from other companies which have been subject to 10% withholding tax | 9,000 |
| | 45,000 |

- (11) **Hettige** got divorced from his wife 10 years back. As per the court order, Rs.15,000/- per month is payable to his ex-wife. During the year, he has paid Rs.180,000/-.
- (12) Annual premium paid by him on a policy of life insurance was Rs.84,000/-.
- (13) PAYE deducted for the year was Rs.55,600/-.
- (14) He has paid an income tax of Rs.10,000/- on the self-assessment basis.

From the foregoing information,

You are required to:

Assess the following for **Hettige** for the year of assessment 2015/16.

- (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. |