



Institute of Certified Management Accountants of Sri Lanka

**Intermediate Stage
March 2010 Examination**

Examination Date : 3rd April 2010 **Number of Pages :** 05
Examination Time: 1.30 p.m. 4.30 p.m. **Number of Questions:** 05

Instructions to candidates:

- (v) Time allowed is **three (3) hours.**
- (vi) Answer **all** questions.
- (vii) Answers should be entirely in the **English** language.

<u>Subject</u>	<u>Subject Code</u>
Taxation	(TAX / 605)

Question No. 1 (35 Marks)

Watertex Ltd, a company manufacturing bottled water for the local market sends the following details relevant to the year of assessment 2008 / 2009. Compute the Statutory Income, Taxable Income and the tax payable for the year of assessment 2008 / 2009.

The company commenced operations in the year of assessment 2003 / 2004. All assets, other than those where it is clearly stated otherwise, were purchased in the year of assessment 2003 / 2004.

- (i) Net profit before tax amounted to Rs.30,000,000/-.
- (ii) The following expenses have been charged in the profit and loss account before arriving at the net profit:

	Rs.
a) Loss on sale of car	80,000
b) Advertisements	490,000
c) Entertainment	300,000
d) Donations	260,000
e) Legal expenses	40,000
f) Provision for bad debts	600,000
g) Depreciation charged to the profit and loss a/c	1,602,000
h) Rent paid for the residence provided to the Managing Director	720,000
i) Lease rent on motor cycle used by Mr. Silva, an Executive Officer	50,000

- (iii) The following income have been accounted in the profit and loss account before arriving at the net profit:

	Rs.
(i) Interest on Treasury Bills – net	180,000
(ii) Dividends received from a resident company, net of withholding tax	54,000
(iii) Profit on sale of a machine	40,000

(iv) Assets

Cost	Balance 1/4/08 (Rs.)	Additions (Rs.)	Disposals (Rs.)	Balance 31/3/09 (Rs.)
Buildings	10,000,000	3,000,000	0	13,000,000
Machinery & Equipment	7,000,000	1,200,000	800,000	7,400,000
Motor Vehicles	4,000,000	2,000,000	1,000,000	5,000,000
Furniture	980,000	0	0	980,000
Computers	400,000	110,000	0	510,000
Computer Software	300,000	60,000	0	360,000

Depreciation	Balance 1/4/08 (Rs.)	Charge for year (Rs.)	Disposals (Rs.)	Balance 31/3/09 (Rs.)
Buildings	2,300,000	500,000	0	2,800,000
Machinery & Equipment	3,400,000	770,000	450,000	3,720,000
Motor Vehicles	1,650,000	550,000	650,000	1,550,000
Furniture	980,000	0	0	980,000
Computers	400,000	20,000	0	420,000
Computer Software	300,000	<u>12,000</u>	0	312,000
		<u>1,852,000</u>		

- (a) The buildings were purchased in the year in which the business commenced. Additions during the year represent office premises being constructed. The company expects to shift the office to the new building in October 2009.
- (b) A machine was sold and replaced during the year.
- (c) All the motor vehicles other than the car used by the Managing Director had been purchased in the year 2003 / 2004. The Managing Director's car was purchased in the year 2005 / 2006. This vehicle was sold and replaced with a new jeep. The Managing Director is paid a salary of Rs.2,000,000/- per annum.
- (d) The computer software has been developed in Sri Lanka.
- (v) A motor cycle was taken on lease in October 2008. The total lease rental payable over a 3 year period amounted to Rs.300,000/- including on the lease amounting to Rs.75,000/-.

(vi) Advertisements.

	Rs.
Advertising for vacancies in the company in local newspapers	150,000
Advertising of products in the local newspapers	190,000
Advertising of products in Foreign Magazines	150,000

(vii) Entertainment.

	Rs.
Entertainment of all directors in a 5 star hotel	140,000
Entertainment of business customers	160,000

(viii) Donations.

	Rs.
Donations of bottles of water to an elder's home	260,000

- (ix) Legal expenses were incurred in a case where the company driver was charged in court for not observing road rules. The driver was found not guilty.

(x)

Provision for Bad Debts Account			
Bad debts written off	380,000	Opening balance – General	200,000
Closing provision		Bad debts recovered	80,000
General	400,000	P/L account	600,000
Specific	<u>100,000</u>		
	<u>500,000</u>		
	<u>880,000</u>		<u>880,000</u>

- (a) The specific provision is in respect of a company which has closed down business as it has incurred heavy losses.
- (b) All bad debts written off are uncollectible debts.
- (c) Out of the bad debts recovered Rs.50,000/- are from debts, which had been disallowed by the Assessor at the point of write off.

(Total 35 Marks)

Question No. 2 (30 Marks)

Mr. Thevarapperuma, a surveyor retired from government service on 30th September 2008, on reaching the age of 60 years. Thereafter he commenced employment in Survex Ltd, a private company, on 1st October 2008.

From the following particulars applicable to the year of assessment 2008 / 2009, compute his Statutory Income, Assessable Income, Taxable Income and the balance tax payable for the year of assessment 2008 / 2009. Any income exempt from tax or excluded from statutory income should be clearly stated.

	Rs.
(i) Salary from the Government upto 30 th September 2008	180,000
Incentive allowance from the Government	60,000
Pension from the Government	150,000
	Rs.
(ii) Salary from the company for 6 months	420,000

The company provided him with a house, free of rent, as he had to live outside Colombo. The company paid a rent of Rs.240,000/- for the 6 months period. The rating assessment of this house was Rs.20,000/- and rates were paid at 10%.

The company has also provided him with a car with an engine capacity of 2000cc for his travelling.

The company during the year reimbursed him with Rs.40,000/-, an amount he had incurred on entertaining company clients at his residence.

- (iii) He has rented out his house in which he resided to a foreigner from 1st October 2008 at a gross rent of Rs.40,000/- per month. The rates paid by Mr. Thevarapperuma for this house amounted to Rs.8,000/- for the whole year. The repair expenditure incurred by him for the year amounted to Rs.50,000/-. This house which he had purchased in the year 2000 has an annual value of Rs.40,000/-.
- (iv) The interest paid by him for the year to the bank on a loan utilized to purchase this house amounted to Rs.20,000/-. He paid an interest amounting to Rs.10,000/- on a loan taken to repair this house.
- (v) Income received from fixed deposits during the year were

		Rs.
National Savings Bank		180,000 (gross)
Sampath Bank	40,000	
Less : 10%	<u>4,000</u>	36,000

- (vi) He contributes 8% of his salary to the Employees' Provident Fund. The employer contributes 12% on behalf of the employee.
- (vii) He donated 100 packets of Lakspray milk powder costing Rs.200/- each and a cash donation of Rs.40,000/- to an approved charity.
- (viii) His PAYE deduction for the period amounted to Rs.5,000/-.

(Total 30 Marks)

Question No. 3 (16 Marks)

- (a) State the criteria under which a person who carries on a taxable activity should register for VAT for the period commencing 1st January 2009.
- (b) Compute the VAT payable for the month of January 2009 according to the following details provided by a business.
All amounts shown below other than sales to non registered persons are excluding VAT, where applicable. The sales to non registered persons are inclusive of VAT.

	Rs.
Sales at luxury rate	1,500,000
Sales at standard rate	2,800,000
Sales to non-registered persons at standard rate	600,000
Purchase of machine at standard rate	2,000,000
Purchases at standard rate	2,500,000
Expenses at standard rate	800,000
Purchases from non-registered suppliers	900,000

- (c) Can any amount of VAT paid during the month be carried forward to the following month? If so what is the amount?

(Total 16 Marks)

Question No. 4 (13 Marks)

Mr. Dharmawansa, who is hoping to commence a business of buying and selling building materials, wishes to obtain advice from you on tax matters before setting up the business. He expects to commence the business in January 2009.

He provides the following information.

- (i) He intends to introduce a capital of Rs.2,000,000/-. In order to finance this he hopes to sell his house in Kurunegala for Rs.1,500,000/-. He constructed this at a cost of Rs.750,000/- in 1990.
- (ii) He expects the sales for a month to be over Rs.600,000/-.
- (iii) (a) He will employ his wife, who has a qualification in accountancy at a salary of Rs.45,000/- per month.
(b) He will employ 3 salesmen at salaries ranging from Rs.15,000/- to Rs.25,000/- per month.
- (iv) He will carry on business in a building owned by his wife, which he got as dowry. He will pay her a rent of Rs.40,000/- per month. He will pay the rates and bear any repair expenses on this building. Rates amount to Rs.15,000/- per year. The building has not been given out on rent during the year.
- (v) He will buy 2 computers for business use in January 2009, when he commences the business.

He wishes to have advice on the following matters (the answers should be based on the law applicable to year of assessment 2008 / 2009).

- (i) Is he liable to tax on the profit he makes on the sale of the house? Explain your answer.
- (ii) Is the wife liable to tax on her salary? Give reasons.
- (iii) Has he to register for pay as you earn tax in respect of his salesman employees? Give reasons.
- (iv) Can he claim the rent paid to his wife as a business expense?
- (v) What will be the wife's statutory income from rent for year of assessment 2008 / 2009, assuming he commences the business in January 2009? Explain your answer.
- (vi) Since he is purchasing the computers in January 2009, can he maintain accounts on a calendar year basis? Explain your answer.
- (vii) Is he liable to pay Value Added Tax? Give reasons.

(Total 13 Marks)

Question No. 5 (06 Marks)

How is the "Divisible Profit" of a partnership computed according to the provisions of Section 76 of the Inland Revenue Act?

(Total 06 Marks)

End of Question Paper