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Serial No.....

## Institute of Certified Management Accountants of Sri Lanka

### Managerial Level October 2017 Examination

**Examination Date :** 29<sup>th</sup> October 2017      **Number of Pages :** 08  
**Examination Time:** 9.00 a.m. – 1.00 p.m.      **Number of Questions:** 10

#### **Instructions to Candidates**

1. Time allowed is **four (4) hours.**
2. Total: **200 Marks.**
3. Answer **any four (4)** questions in Section A, **all** questions in Part I and any **three (3)** questions from Part II in Section B.
4. **Section A:** Corporate Law and **Section B:** Advanced Taxation
5. Candidates are allowed to use non-programmable calculators.
6. The answers should be in **English Language.**

<b><u>Subject</u></b>	<b><u>Subject Code</u></b>
<b>Corporate Law &amp; Advanced Taxation</b>	<b>(CLT / ML 4 - 304)</b>

#### **SECTION A: Corporate Law**

Answer **any four (4)** questions

#### **Question No. 01 (25 Marks)**

- (a) Corporate theory has certain principles which practitioners and academics have struggled to define. Some of these principles seem somehow unsuitable for strict and permanent delineations, given that their construction often changes with time (Karasz 2012). The case of *Salomon V. Salomon and Co. Ltd* which has formed the basis of company law globally is one such example.

Discuss the principles of Separate Legal Personality with reference to the above case.

**(11 Marks)**

- (b) A Partnership Agreement is a written agreement between two or more individuals who join as partners to form and carry on a business with an aim of earning profits. You as an Accountant is required to advise your client the contents that should be included into a partnership agreement. Advise.

**(08 Marks)**

- (c) A private company is a company with private ownership. As a result, it does not need to meet the Securities and Exchange Commission's (SEC) strict filing requirements for public companies. Private companies may issue stock and have shareholders, but their shares do not trade on public exchanges and are not issued through an initial public offering (IPO). In general, the shares of these businesses are less liquid.

State the Characteristics of a Private Company which could be formed under the Companies Act No. 7 of 2007.

**(06 Marks)**

**(Total 25 Marks)**

**Question No. 02 (25 Marks)**

- (a) Board of Directors of ABC (Pvt) Limited which is into import of wrist watches recently decided to change its business name to Romeo (Pvt) Limited to obtain a brand name from their proposed name. You as the Company Secretary is required to inform the Board of Directors what steps the company should follow under the Companies Act, No. 7 of 2007 to change its name. (10 Marks)
- (b) Directors as agents of a Company are responsible to look after overall interests of all stakeholders of the Company. Under legal principles we consider this duty as a fiduciary duty where the director has to act as a trustee of the business. On the other hand the directors have some specific duties spelled by the Companies Act such as duty of care and skill. Discuss the provisions available in the Companies Act on duty of care and skill. Justify your answer with reference to decided cases. (07 Marks)
- (c) Arun and Ravi two of the directors at AR (Pvt) Limited decided to appoint Navin as an executive director of the Company to involve in day to day business. Arun and Ravi seek your opinion as to whether there are any restrictions under the Companies Act as to disqualifications of appointing directors to a Company. Advise Arun and Ravi. (08 Marks)
- (Total 25 Marks)**

**Question No. 03 (25 Marks)**

Write short notes on the following by applying the legal principles under Company Law and case law.

- (a) Share Capital is funds raised by issuing shares in return for cash or other considerations. Debenture funds are money received from debt obligation backed strictly by the borrower's integrity. State the difference between a Share and a Debenture.
- (b) A prospectus, in finance, is a disclosure document that describes a financial security for potential buyers. In the context of an individual securities offering, such as an initial public offering, a prospectus is distributed by underwriters or brokers to potential investors. Discuss the required information in a prospectus prepared for a share or debenture issue.
- (c) The doctrine of *Ultra Vires* played an important role in the development of corporate powers. The doctrine remains in full force for government entities. An *Ultra Vires* act is one beyond the purposes or powers of a company under the available provisions of the Companies Act, of 2007.
- Discuss the relationship between the Company objectives and its relationship to *Ultra Vires*.
- (d) General amalgamation is the process of combining or uniting multiple entities into one form. State the Steps that a Company should follow in a Short Form Amalgamation.
- (e) An off-shore company is a company that is registered in Sri Lanka, but does its business abroad. Any company whether it is incorporated in Sri Lanka or it is incorporated abroad may make an application to the Registrar of Companies to be registered as an Off-Shore Company.

State the documents that must be added to the application to register an off-shore company.

**(5 × 5 Marks = Total 25 Marks)**

**Question No. 04 (25 Marks)**

- (a) Discuss the activities where a company shall be deemed to have satisfied the solvency test and the responsibilities of the Board of Directors in satisfying the solvency test. **(07 Marks)**
- (b) Define the term “Major Transaction” and discuss the ways a company could enter into a Major Transaction. **(08 Marks)**
- (c) Section 154(1) of the Companies Act, No. 7 of 2007 provides that a company shall at each Annual General Meeting, appoint an auditor to hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

Discuss the process that a company should follow when appointing new auditors at the time of forming the company and subsequent auditors thereafter at an Annual General Meeting.

**(10 Marks)**

**(Total 25 Marks)**

**Question No. 05 (25 Marks)**

- (a) **Liquidators and voluntary administrators are given powers to resolve financial problems in companies where debts are not paid. Discuss the powers** of liquidators and administrators in such situations. **(12 Marks)**
- (b) The Central Depository System (Pvt.) Ltd. (CDS) acts as the depository for all securities traded at the Colombo Stock Exchange (CSE). The CDS is a fully owned subsidiary of the CSE. The CDS offers a range of depository services to Member Firm Participants, Custodian Banks, Account Holders and Listed Companies.

List such services provided by the CDS.

**(08 Marks)**

- (c) Corporate Governance is an important focus in commercial world. Especially the regulated companies such as banks, listed companies are governed by the corporate governance principles introduced by their own regulators.

State different types of Corporate Governance Mandatory rules applicable for regulated companies and their common gaps that need further development.

**(05 Marks)**

**(Total 25 Marks)**

End of Section A

**SECTION B: Advanced Taxation**

**Part I**

Answer **all** questions

**Question No. 06 (40 Marks)**

Pandula and Puhilan are Engineers in profession formed a Partnership in 2005, with 50:50 profit sharing to provide Civil Engineering consultancy services. After identifying the growth prospects, they decided to expand the business by providing the construction services too. Accordingly, they converted the partnership into a Private Limited Company on 01<sup>st</sup> April 2016 as P&P Private Limited and the additional funds required for their expansion was funded through a Mutual Fund by taking 60% stake in the company's shareholding. Since Pandula and Puhilan do not have any accounting background, the company does not maintain proper accounts. However, the accounts clerk Binura has given you the following information and asked you to advise them on the income tax for the year ended 31<sup>st</sup> March 2017.

1. The gross revenue earned by the Company for the year was Rs.505,000,000/-. Gross profit is Rs.202,000,000/-.
2. In addition, the company has earned following other income;
  - Sundry income earned from scrap sale was Rs.35,000/-.
  - Net Interest income earned though Fixed Deposit Rs.180,000/-. The bank has deducted Rs.20,000/- as Withholding Tax.
  - Sale proceed from old equipment disposal is Rs.1,100,000 /-.
3. As per Binura's scratch records, P & P has incurred the following administrative expenses.
  - Cost of incorporation was Rs.150,000/-.
  - The management fee paid to the Mutual Fund was Rs.5,400,000/-. During the year a research and development programme was successfully completed incurring a cost of Rs.3,400,000/-. This was to innovate new construction methods.
  - P&P bears the school fees of Pandula and Puhilan's kids. School fee per month is Rs.200,000/- for kids and not considered for PAYE purposes of Pandula and Puhilan.
  - The total salary and wages paid by the company during the year was Rs.72,000,000/-. This includes the salaries paid to Pandula and Puhilan Rs.24,000,000/-. P&P's contribution to EPF & ETF within the year is Rs.1,440,000/-.
  - Under the CSR activities carried out , P&P constructed a new ward which facilitate for 50 patients at the Nachchaduwa Primary Government Hospital incurring Rs.5,000,000/-.
  - Pandula and Puhilan was given two cars for their office and personnel traveling and fuel and other related cost for those two cars are born by the company. Within the year total of such cost was Rs.1,800,000/-.
4. The distribution expense includes the following;
  - As a result of a massive expansion plan executed in the year under review, they have recruited 30 employees for few job roles. The expense incurred for the paper advertisements was Rs.460,000/-. In addition, the advertisement expense incurred to promote the company is Rs.1,100,000/-.
  - Other distribution expenses, which are fully allowed for tax purposes is Rs.40,700,000/-
5. Binura has given the following summary of the property plant and equipment of P&P.
  - Additions of properties during the year of assessment are as follows;

Type	Date of Purchase / Completed	Amount (Rs.)
Office building constructed	31 <sup>st</sup> December 2016	50 million
Machinery Purchased	30 <sup>th</sup> April 2016	35 million
Cars for Pandula and Puhilan	15 <sup>th</sup> April 2016	10 million

  - The cost on Machinery includes the travelling cost of Rs.500,000/-, on visit to Germany by Puhilan to inspect the machinery and the Value Added Tax (input tax) paid at the time of Importation Rs.4,500,000/-. P&P is not registered for VAT yet.
  - Statutory income from trade in the previous year of assessment was Rs.30Mn.
  - Capital Allowances have granted in fully for all other assets other than addition during the year.
6. OD interest for the year is Rs.2,400,000 /-.
7. Further the company pays the personal loan installment of Pandula and. installment paid amounts to Rs.600,000 /- and interest portion is Rs.360,000 /-.and has not considered for PAYE purposes of Pandula.

**Based on the above information, you are required to calculate:**

- (a) **Adjusted taxable business profit** of P&P for the year of assessment 2016/2017.  
(Hint: you are advised to use the top bottom approach starting from the revenue) **(25 Marks)**
- (b) **Gross Income Tax Liability, Applicable Tax Credits and Balance Tax Liability** of P&P for the year of assessment 2016/2017. **(06 Marks)**
- (c) **State the** tax administrative requirements with regard to the following,
- (i) Due date to make the final income tax payment and due date to submit the income tax return for the year of assessment 2016/2017. **(02 Marks)**
- (ii) Penalty charged for none submission of income tax return duly. **(01 Mark)**
- (iii) Details to be included in the income tax return. **(02 Marks)**
- (d) **Pandula and Puhilan**, plan to distribute dividend of Rs 80,000,000. **Advise** on the following;
- (i) **Calculate the Dividend** tax payable on the above distribution. **(03 Marks)**
- (ii) State before when such distribution has to be made to avoid tax on distributable profit of the Y/A 2017/2018. **(01 Mark)**

**(Total 40 Marks)**

End of Part I

## **Part II**

Answer **any three (3)** questions

### **Question No. 07 (20 Marks)**

- (a) Amal works for Winken Ltd as the Finance Manager. As a part of employment benefit, Amal was given a rent free house. Total rent for the house is born by the company and pays Rs.65,000/- per month as the rent to the owner of the house Parakrama. Following information is also given.

- Monthly salary of Amal Rs.170,000/-.
- Rating assessment of the house is Rs.500,000/- and Parakrama pays Rs.80,000/- as Rates.

**You are required to assess the following;**

- (i) Rental value to be included under profits from employment for Amal.
- (ii) Rent Income of Parakrama.
- (iii) Deductible rent expenditure for Winken Ltd for tax purposes.

**(3 × 2 Marks = 06 Marks)**

- (b) XYZ International is incorporated in China XYZ Lanka Limited is a company incorporated in Sri Lanka and that distribute the XYZ International goods in Sri Lanka and XYZ Lanka Limited do this service exclusively to the XYZ International as per instructions given by XYZ International. For the year of assessment 2016/2017 XYZ International reported a USD 10 Billion profit while XYZ Lanka Limited contributes 1% to the XYZ International profit. (USD/LKR = 150)

**Determine whether XYZ International is required to pay income tax in Sri Lanka for the activities carried out by XYZ Lanka Limited and assess the liable profit out of which they should pay taxes to the Sri Lankan government.** **(04 Marks)**

P.T.O...

- (c) You are the Finance Manager of Indigo Pvt Limited. Company holds an excess cash of Rs.100 million and the management plans to invest the money for a period of 12 months starting from 01<sup>st</sup> April 2016. They considers two options;

<b>Option 01</b>	Invest the money in unit trusts and Unit Trust has guaranteed an annual yielding at 8% and yield is paid semiannually to unit holders
<b>Option 02</b>	Deposit in a Fixed Deposit in a commercial bank at 10% annual interest

**You are required to advise** the management of Indigo Pvt Limited by quantifying the best investment option that would offer them the highest net tax return. **(06 Marks)**

- (d) Navada Pvt Limited is a leading apparel company in Sri Lanka. As a policy company maintain medical insurance scheme for its core workers and the Company pays Rs.1,500,000/- premium per annum as a block contribution. There are 100 core workers in the company. Further, they maintain separate insurance policies for its CEO and CFO for which the Company pays Rs.125,000/- and Rs.70,000/- as annual insurance premiums respectively.

**Assess** the taxable medical benefit for each person (Sisira and Kalansooriya) under each scenario for the Year of Assessment 2016/2017 justifying the reason.

- (i) Sisira is a core worker of Navada Pvt Limited. On 16<sup>th</sup> October 2016, he injured while operating a machine and he was hospitalized. The hospital bill was Rs.500,000/- and the bill was reimbursed by the insurance company. **(02 Marks)**
- (ii) On 31<sup>st</sup> January 2017, Mr. Kalansooriya, the CEO of Navada was hospitalized due to a heart attack and he was recommended to do a Bypass surgery. Total medical bill was Rs.1,500,000/- and it was reimbursed by the insurance company. **(02 Marks)**

**(Total 20 Marks)**

### **Question No. 08 (20 Marks)**

Mr. Upul Tharanga works for a reputed quoted company as the Chief Financial Officer (CFO). You are provided with the following information in relation to his sources of income. Employment Income.

- In the capacity of CFO, he was paid a monthly salary of Rs.500,000/-. In addition, he was provided with a BMW car (engine capacity 2000 cc) with a driver and fuel Company pays Rs.30,000/- per month to the driver and also paid Rs.20,000/- per month to the home maid of Mr. Tharanga.
- On 30<sup>th</sup> April 2016, Mr. Tharanga was allotted 150,000 of Company's shares at free under a Share Benefit Scheme and the market value of a share at that time was Rs.50/-. Company policy is to distribute dividends quarterly. Details of the interim dividend distributions (net of dividend tax) are as follows;

<b>Dividend</b>	<b>Date</b>	<b>Dividend per share (Rs.)</b>
1 <sup>st</sup> Interim	18 <sup>th</sup> July 2016	0.45
2 <sup>nd</sup> Interim	06 <sup>th</sup> October 2016	0.90
3 <sup>rd</sup> Interim	01 <sup>st</sup> February 2017	1.35
4 <sup>th</sup> Interim	30 <sup>th</sup> May 2017	2.25

- Tharanga entitled for ½% of the profits of the company as bonus, under his employment contract. Accordingly, he received Rs 1.5 Mn in May 2016 after finalizing the accounts for the year ended 31<sup>st</sup> March 2016.
- PAYE deducted for the year of assessment 2016/17 was Rs.255,000/-.

P.T.O...

- (a) Mr. Tharanga owns following two houses;

	NAV (Rs.)
House in Nugegoda	300,000
House in Matara	225,000

He lives in Nugegoda house with his family. On 28<sup>th</sup> September 2016, he sold his Matara house at a price of Rs.9 Mn and his parents occupied in six months in the Y/A 2016/2017. He deposited the proceed in various sources and the interest and other benefits received are as follows;

Investment Source	Interest / Dividend Income for the year (Rs.)
Sampath Bank (FD)	120,000 (Net Interest)
NSB (Savings)	40,000 (Gross interest)
Peoples Bank (Savings)	45,000 (Net interest)
ABC PLC (in Shares)	27,000 (Net Dividend )

In addition, Mr. Tharanga do a retail shop with his wife, Wimala overlook the business activities of shop. Net profit after deducting allowable expenses for taxation for the Year of Assessment was Rs.1,270,000/-. Mr. Tharanga has three kids named Ruwan, Supuni, and Mahesh. Details are as follows.

Name	Age	Occupation	Annual Income (Rs.)
Ruwan	26	Accountant	1,200,000
Supuni	18 (reached 18 on 31 June 2016)	Student	450,000
Mahesh	14	Student	150,000

- (b) Following donations have been made during the year of assessment 2016/2017 by Mr. Tharanga.

	Rs.
Cash paid to an approved charity engaged in religious activities	56,000
Donation of Medicine to the Cancer Hospital - Maharagama	100,000
Books offered to University of Sri Jayewardenepura	76,000

**You are required to compute the Gross tax payable, applicable tax credits and Balance Income Tax Liability of Mr. Upul Tharanga for the Year of Assessment 2016/2017.**

**(Total 20 Marks)**

**Question No. 09 (20 Marks)**

- (a) Economic Service Charge (ESC) is an Advance payment of Income Tax liability of a Company. Explain. **(03 Marks)**
- (b) Abbas Limited is a BOI registered company and currently enjoying a tax holiday. The revenue of the company for the year of assessment 2016/2017 is given bellow. Calculate ESC payable by the company for the year of assessment 2016/2017. **(04 Marks)**

Quarter ending	30 <sup>th</sup> June 2016	30 <sup>th</sup> Sep. 2016	31 <sup>st</sup> Dec. 2016	31 <sup>st</sup> March 2017
Revenue (Rs. Million)	60	45	100	15

- (c) List **four (4)** main categories of persons to whom the Nation Building Tax (NBT) Act is applicable, as per Section 2 of the NBT Act. **(04 Marks)**

P.T.O...

- (d) Mr. Sumanapala, is an Auditor in Profession and he is a VAT registered person. He wants you to advise him on the following matters relating to his profession.
- (i) He has provided audit service for a Quatrain client based in Sri Lanka and received a payment in US dollars to his bank account in Sri Lanka. Is he liable to pay VAT on this? **(03 Marks)**
  - (ii) He has visited Maldives several times to give accounting and auditing related advice to his clients in Maldives and received payment in US dollars. Should he pay VAT on such payments received? **(03 Marks)**
  - (iii) Recently he imported a Car from Japan. At the time of import he paid VAT on the CIF price of the car. Is this tax paid is claimable against his output tax? **(03 Marks)**
- (Total 20 Marks)**

**Question No. 10 (20 Marks)**

- (a) State **two (2)** circumstances under which a refund may arise to a taxpayer. **(02 Marks)**
- (b) Sri Lankan Government plans to remove the protection given via imposition of import taxes on most of the goods at the point of importation.  
**Evaluate** the impact pointing the pros and cons of such initiative in the perspective of the economy, the general public as well as of the local players in those industries. **(08 Marks)**
- (c) The main reason, Sri Lanka to have a low tax income (around 13% of the GDP) is the inadequacy of the tax income earned through Direct Taxes. Direct Tax contributes is averagely 20% of the overall tax revenue.  
**Propose** suggestions to increase the Direct Tax revenue in Sri Lanka. **(06 Marks)**
- (d) Explain the statutory rules in the Inland Revenue Act applicable to the recovery of tax from the assets of a partnership in circumstances in which the tax payable by a partner is in default. **(04 Marks)**

**(Total 20 Marks)**

End of Part II  
End of Section B  
End of Question paper