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Serial No.....

## Institute of Certified Management Accountants of Sri Lanka

### Managerial Level May 2012 Examination

**Examination Date :** 19<sup>th</sup> May 2012      **Number of Pages :** 08  
**Examination Time:** 1.00 p:m. – 5.00 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. The answers should be in the **English Language**.

<u>Subject</u>	<u>Subject Code</u>
<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)**

Explain what is meant by the expression “the doctrine of separate legal entity”, the consequences of treating the company as a separate person and the drawbacks of this corporate form.

**(Total 25 Marks)**

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

Drinks Ltd was formed in 2009 to manufacture non-alcoholic beverages. In 2012 the board of directors was convinced that, to combat falling profitability, the company must develop new businesses. Tasty Drinks Ltd started importing medical products that were used for slimming. The company entered into a contract with Equip Ltd. for supply of office equipment to use for the new venture. Equip Ltd. knew that the company intended to use the office equipment for its new business. Now the company however does not want to proceed with the contract and seeking to escape from the equipment purchase contract. Now Equip Ltd. wishes to sue the company. Kamal, a shareholder, holding 5% of the shares in the company, expressed concern about this new venture and opposed the import business due to health hazards, that he envisaged. However, Kamal’s protests were ignored by the management. Kamal wishes to know the options available to him to enforce his statutory rights.

Equip Ltd. and Kamal have come to you for advice as to the best course of action about the above situations. Advise them with reference to decided cases and statutory provisions.

**(Total 25 Marks)**

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

- (a) Lilan, a director of Finco Ltd., is the properly appointed finance director for a period of 5 years, in terms of a contract outside the articles. The articles provide that the finance director, subject to his/her contract with the company, can be removed in the same manner as the other directors, and that if he/she ceases to be a director, he/she should also cease to be the finance director. The articles also provide that the company could remove a director before the expiration of the period of office. Lilan's attendance at board meetings has become erratic and he is often unprepared. When he attends, he makes inappropriate comments and disrupts the board meetings. Lilan still has three years of his appointment to run. Now, the company wishes to alter the articles so as to remove Lilan from office as the finance director before the expiration of the 5 year period stipulated in the contract.

Consider the validity of the contract entered into between Lilan and the Finco Ltd and explain whether the board can remove Lilan from office. **(15 Marks)**

- (b) Ansett Ltd is a company which operates a chain of estate agents. It has a subsidiary, Home Loan Ltd. which offers financial services to home buyers. Carson, a director of Ansett Ltd, ask Home Loan Ltd. to lend Carson Rs. 1 Million to enable him and his wife to purchase a holiday home.

Home Loan Ltd. seeks your advice about this request. Advise the company. **(10 Marks)**  
**(Total 25 Marks)**

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

- (a) Laura and her husband Mike are running a small garment business. They are seeking to expand the business and form a company limited by shares. They seek your advice as to the required procedure in setting up a new company.

Advise them. **(15 Marks)**

- (b) What qualifications do company auditors need and how are they appointed. **(10 Marks)**  
**(Total 25 Marks)**

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

- (a) Ranil, a minority shareholder wishes to bring an action against two directors, Edward and Suki of Pessu Ltd. alleging that they have misappropriated money belonging to the company. However, at a general meeting, the majority of shareholders of Pearl Company Ltd. resolved that such a proceeding should not be taken.

Advise Ranil. **(15 Marks)**

- (b) What do you mean by the 'major transactions' as defined in the Companies Act No.7 of 2007? **(10 Marks)**  
**(Total 25 Marks)**  
End of Section A

## SECTION B: Advanced Taxation

### Part I

Answer all questions

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

Electro Plates Ltd. is a Resident Company incorporated in Sri Lanka in the year 2006 and it is a subsidiary of Electro Ltd. Issued share capital of the Company is Rs.5,000,000/- and the company has been listed company in the year of assessment 2007/2008. Electro Plates Ltd. manufactures spare parts for racing motor cars and sales are exclusively made in the local market. Total reserves as at 31/03/2011 are Rs.3,654,000/- The summarized profit and loss account for the year of 2010/2011 and related notes are given below.

	Rs.	Rs.
Gross profit from trading	38,225,000	
Gross rental income	660,000	
Net Dividend received	730,000	
Treasury bill interest	630,000	
Fixed deposit interest – net	200,000	
Other income	<u>900,000</u>	
<i>Total Income</i>		41,345,000
Less: Administration cost	13,127,000	
Selling and distribution cost	5,580,000	
Legal and professional cost	1,020,000	
Finance cost	<u>8,041,000</u>	
<i>Total Expenses</i>		<u>27,768,000</u>
<b>Net Profit</b>		<u><u>13,577,000</u></u>

Breakup of the above expenses is as follows.

#### **Administration:**

Salaries	8,640,000	
Director's Remuneration	1,480,000	
Postage and Printing	272,000	
Overseas Travel	430,000	
Depreciation of Office Equipment, etc...	255,000	
Business Entertainment	288,000	
Other Expenses	1,100,000	
Repairs to the building	232,000	
Rent	<u>430,000</u>	<u>13,127,000</u>

#### **Selling and Distribution:**

Advertising	1,543,000	
Sales Commissions	536,000	
Trade Discount	245,000	
Depreciation for Motor Vehicle	1,925,000	
Donation	200,000	
Other Expenses	<u>1,131,000</u>	<u>5,580,000</u>

**Legal and Professional Cost:**

Legal Cost – debt recovery case	245,000	
– labour disputes	346,000	
– tax appeal	83,000	
Professional Cost – Accountancy fees	246,000	
– Auditor’s fee	<u>100,000</u>	<u>1,020,000</u>

**Financial Cost:**

Interest paid to its holding company	7,120,000	
Interest paid to banks	<u>921,000</u>	<u>8,041,000</u>

**Notes**

- (1) Gross profit is 15% of the turnover.
- (2) Part of the building has been rented out for commercial purposes.
- (3) Repairs to the building given on rent is Rs.232,000/-.
- (4) Rent paid in respect of a residence, which has a rental value of Rs.330,000/-, provided to the Managing Director is Rs.430,000/-. The total annual remuneration of the Managing Director is Rs.2,500,000/-.
- (5) Other income has arisen from the profit on disposal of a lorry which has been purchased during the year of assessment 2007/2008. The cost of acquisition was Rs.2,800,000/- and it was sold for Rs.2,600,000/- on 14/11/2010. A new lorry was purchased during the year of assessment for Rs.3,200,000/- to replace the one sold.
- (6) **Overseas travel**  
One of the Directors had visited China to inspect a machine which the company intends to purchase.
- (7) **Depreciation of office equipment**  
During the year of assessment 2006/2007, four computers and two printers have been purchased at a cost of Rs.420,000/- and Rs.60,000/- respectively. During the current year of assessment company purchased office furniture and a photo copy machine costing Rs.440,000/- and Rs.200,000/- respectively.
- (8) **Depreciation on motor vehicles**  
The cost of the motor car which was purchased for the Managing Director during the current year of assessment was Rs.4,500,000/-. The balance of the depreciation charge relates to the lorry.
- (9) **Advertising**  
This includes Rs.120,000/- which is the cost of construction of a sales outlet.
- (10) **Donation**  
Donation made to the Maharagama Cancer Hospital to purchase surgical equipment amounted to Rs.160,000/- and Rs.40,000/- worth grocery items were given to an approved charity.
- (11) The total loans obtained from the holding company as at the end of the year of assessment is Rs.48,000,000/-.
- (12) Company has distributed dividends amounting to Rs.2,000,000/- during the above year of assessment (**Please disregard the calculation of deemed dividend tax**).
- (13) Economic Service Charge (ESC) has been paid on the liable turnover.

**You are required to compute** the income tax liability of the company, any tax credits available and the balance tax payable for the year of assessment 2010/2011. **(Total 40 Marks)**

End of Part I

## Part II

Answer **any three (3)** questions

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

- (a) For each of the scenarios illustrated below, identify the sources of income liable to income tax and compute such liable income for the purposes of tax in respect of the year of assessment 2010/2011. If any income is exempt, the reasons must be clearly stated.
- (i) Mr Roshan Weerakody is an employee of a mercantile firm receiving a gross salary of Rs.130,000/- per month. Further, he has been provided a vehicle which has been leased out by the firm. Lease rental payable by the firm is Rs.34,000/- per month. Engine capacity of this vehicle is 1800 cc. **(04 Marks)**
- (ii) Ms. Manel Ganesharaja has let a house which has a floor area of 2800 sq.ft. for Rs.30,000/- per monthly rent. The house was constructed during the year of assessment 2005/2006. Rating assessment of this house is Rs.200,000/- and rates payable are 20%. **(04 Marks)**
- (iii) Mr. Priyankara Fernando has a savings account in a commercial bank. During the year of assessment 2010/2011, the bank has paid Rs.36,500/- as interest on which no withholding tax has been deducted. However, when he was paid Rs.380,000/- interest on fixed deposit held by him in the same bank, withholding tax has been deducted. **(02 Marks)**
- (b) Ceylon Paper Products Ltd paid income tax for the year of 2009/2010 at the rate of 35%. Further, dividend tax was paid at the rate of 10% on the distribution made within 18 months from the commencement of the year of assessment and such tax is Rs.53,000/-.

The book profits of the company for the year of assessment 2009/2010 is Rs.58,432,100/-. Its book profit included a notional profit of Rs.972,000/- on revaluation of a land at Mirihana. The company has not purchased any assets during the year of assessment. Taxable income for year of assessment 2009/2010 is Rs.32,950,000/-.

#### **You are required to compute:**

- (i) The distributable profit based on the information given for the year of assessment 2010/2011.
- (ii) The minimum dividend to be distributed before 30<sup>th</sup> September 2010.
- (iii) Compute the Deemed Dividend Tax Liability if any for year of assessment 2010/2011.

**(10 Marks)**

**(Total 20 Marks)**

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

- (a) Briefly explain the difference between the zero rated supply and exempt supply. **(04Marks)**
- (b) What is the time of supply in relation to provision of services? **(04 Marks)**
- (c) Star Light Garment Ltd. is engaged in the manufacturing of garments and it has standard rated supplies, suspended supplies and zero rated supplies. The raw materials required for its manufacturing are mainly imported and VAT is paid upfront since deferred facility is not available for the company. The company furnishes its return on a quarterly basis.

The following are the transactions taken place during the month of December 2011.

<b>Supplies:</b>	Standard rated supply	Rs. 43,350,750
	Suspended supply	Rs. 23,240,000
	Zero rated supply	Rs. 6,257,000

<b>Imports:</b>	Raw materials	Rs.36,146,350
	Machine	Rs. 8,275,000
	Motor car	Rs. 4,500,000

**Local Purchase:**

Other materials and accessories from registered persons	Rs.27,110,300
: From non-registered persons	Rs. 5,431,000

All purchases are shown excluding VAT.

**Other expenses**

Telephone bill	Rs. 1,230,750
Electricity bills	Rs. 3,560,000

Brought forward input tax from the period after 01/01/2011 and as at 30/09/2011 is Rs.2,231,000/-.

**You are required to compute** the following relating to the quarter ending on 31/12/2011.

- (i) Output tax
- (ii) Input tax
- (iii) Disallowable input tax
- (iv) VAT payable
- (v) Carry forward input (if any) to the quarter ending with 31/03/2012. **(12 Marks)**

**(Total 20 Marks)**

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

- (a) “The government took several measures to simplify the tax system and improve revenue generation from taxes through ‘Budget 2011’ ”.

What were those measures taken?

**(10 Marks)**

- (b) Sri Lanka Handicrafts Corporation is a public corporation where more than 75% of its capital has been provided by the Government of Sri Lanka other than by way of a loan. Its adjusted profit for the year of assessment 2010/2011 is Rs.64,950,000/-.

After considering income from other resources, deductions allowable under Sections 32 and allowances for qualifying payments, the corporation has to pay Rs.14,270,000/- as income tax under section 61(1)(a) of the Inland Revenue Act No.10 of 2006 for the above year of assessment .

The aggregate amount of dividends distributed in that year of assessment is Rs.8,000,000/-.

**You are required to compute the income tax liability of the corporation. (05 Marks)**

- (c) Explain the provision relating to employment income which is covered in International Double Tax Relief Agreements.

**(05 Marks)**

**(Total 20 Marks)**

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

- (a) Mr. Perera has ascertained his profits and income from all sources of income for the year of assessment 2010/2011 and the taxable income is Rs.1,267,000/-. However, he was unable to furnish the return of income and pay the tax per the return of income by due dates. He received an estimated assessment considering his assessable income as Rs.2,000,000/-. He is not satisfied with the assessment and therefore he wants to make an appeal. In order to make a valid appeal, what advice would you give Mr. Perera?

**(05 Marks)**

- (b) ABC is a software company incorporated and managed in India. It has a branch in Sri Lanka and operations are controlled from India but managed by a Sri Lankan management team. The company gets orders from Sri Lanka as well as from outside Sri Lanka and it performs services for payment in foreign currency. Sometimes, proceeds for provision of services outside Sri Lanka are not remitted to Sri Lanka but directly paid to the head office in India.

When examining the books of accounts, the Assessor has found that Rs.6,000,000/- has been remitted to its head office in the year of assessment 2010/2011. Further, it has remitted 6,000 US dollars to its head office out of the dividends received from Sri Lankan resident companies. It has been confirmed that one US dollar is equal to Rs.108/- for the relevant period.

On filling the half yearly returns on remittances, the company has submitted a “NIL” returns. Now the company has received an assessment on remittance tax amounting to Rs.600,000/-.

**You are requested to give comments on this assessment.**

**(05 Marks)**

- (c) Mr. Sarath Senadeeera has made quarterly payments in respect of income tax payable for the year of assessment 2010/2011 as given below:

Quarter	Date of Payment was made	Amount Paid (Rs.)
1	12/07/2010	40,500
2	14/10/2010	40,500
3	12/02/2011	40,500
4	16/04/2011	40,500

Total income tax paid for the year of assessment 2009/2010 was Rs.180,000/- and

total income tax payable for the year of assessment 2010/2011 is Rs.210,000/-.

**You are requested to compute the final payment which had to be made on or before 30<sup>th</sup> September 2011 (Ignore the penalty provisions). (05 Marks)**

- (d) An assessment could be issued under various grounds. Discuss such grounds. **(05 Marks)**  
**(Total 20 Marks)**

End of Part II

End of Section B

End of Question paper

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