

Strategic Level Exam -December 2023

Corporate Taxation – Model Paper 02

Prepared by:- Prabath Weerasinghe BB Mgt (HRM) SP, ACA, MAAT, ACMA, ATII, MBA Taxation
– PIM USJP

SECTION 2

Question 03

a) The Trendywear (Pvt.) Ltd (TW) is an apparel manufacture for exports market. More than 60% of raw materials used for the manufacturing purposes are from imports. Parent company of TW is Trend House Ltd (THL), a company incorporated in India. The company, TW automated the manufacturing process during the year 2022/23. Company has invested Rs. 70Mn on the process improvement under the automation project and this process introduced the latest apparel manufacturing process to the company which is used by China. Further, during the year 2022/23 company has installed solar panels to its manufacturing locations this is a new initiative and solar system is connected to national grid.

Company holds 15% of the equity capital of a Hong-Kong Company. Further TW has invested in shares of few local companies. The following additional information in relation to the company for the year ended 31 March 2023, is made available.

Issued share capital of the company is Rs. 20 Mn and reserve Rs.15Mn as of 31st March 2023.

The detailed unaudited income statement of Trendywear (Pvt.) Ltd for the year ended 31 March 2023 is as follows. Company's reporting currency is USD and exchange rate used for the year is as follows:

Average Exchange rate is 1 USD = LKR 318.56

Year-end spot rate is 1 USD = LKR 320.18

Description	Note	Amount (LKR) '000
Revenue	01	1,000,000
Cost of sales	02	(600,000)
Gross profit		400,000
Other Income	03	3,500
Administration, Distribution, and other expenses	04	(229,000)
Profit from operating activities		174,500
Finance Income	05	4,000
Finance cost	06	(7,000)
Profit before tax		171,500
Income Tax expenses		(51,450)
Profit for the year		120,050

Note: - 01 - Revenue

Exports of apparel Rs. 1,000,000,000/-

Note: - 02 – Cost of sales

- a) Opening Finished goods Rs. 50,000,000/- . Manufacturing cost of Finished garments 650,000,000/- . Closing Finished goods Rs. 100,000,000/- .

Note: 03: – Other Income

- a) Local Sale of reject/second grade garments – Rs. 500,000/- . Solar Income Rs. 2,500,000/- . Machinery Rent income Rs. 200,000/-
- b) Dividend income from foreign subsidiary company Rs. 100,000/- . This was received in the month of October 2022.
- c) During the year company has disposed the equity holding with Hong-Kong subsidiary and profit from the disposal was Rs. 200,000/- .

Note 04: - Extract of some of the expenses recorded under administrative, distribution and other expenses

Description	Note	(Rs.) '000
Salaries and wages		75,000
EPF & ETF	(i)	1,545
Provision for retirement benefits	(ii)	5,750
Provision for Bad and doubtful debts	(iii)	500
Medical expenses	(iv)	116
Staff welfare	(v)	100
Machine Repair expenses	(vi)	700
Advertising and promotion	(vii)	2,500
Marketing expenses	(viii)	6,200
Donation	(ix)	5,000
Depreciation		48,739
Fines and penalties	(x)	4,000
Legal fees	(xi)	1,550
Consultancy fees	(xii)	7,300
Automation expenses	(xiii)	70,000

- i. EPF 12% and ETF 3% has been made for all staff.
- ii. Gratuity provision represent the provision for retirement benefit. During the year Gratuity payment of Rs. 2,000,000/- was made factory staff engaged with tool manufacturing.
- iii. Write off amount of staff debtors is Rs. 200,000/- and balance represents the bad debt provision made for trade debtors.
- iv. Medical expenditure represents the compensation paid for factory staff who got injured at an accident at the process of factory machine moving.

- v. Staff welfare expenditure shows tea and water provided to factory staff.
- vi. Lubricant used for machines are included in the repair cost
- vii. Advertising and promotion expenses are related to payment of Rs. 2,500,000/- made to local advertising firm for product launch
- viii. Marketing expenses is for the promotion campaign made at foreign market.
- ix. Donation represented the garments donated to children's village. This is an approved charity
- x. Tax authority has issued an assessment for the year 2019/20. Company lodged an administrative review. Tax authority and the company came for an agreement. Fine and penalties are related to the Income tax and penalties paid at the settlement.
- xi. Legal fee was made to tax consultants for the settlement of above tax matter.
- xii. Consultancy fee of Rs. 4,300,000/- has been paid for training program conducted for factory staff during the month of January 2023. This was paid to training institute which is a partnership established in Sri Lanka. No withholding tax has been deducted from the fee payment. Balance fee represent the annual maintenance cost incurred for solar panels
- xiii. Total cost other than capital nature expenditure incurred in the automation project are included.

Note 5:- Finance income

- a) Interest Income – RFC Rs. 3,000,000/- (USD equivalent value)
- b) Exchange gain – Transaction Gain Rs. 1,500,000/- . Translation gain Rs. 2,500,000/-

Note 6:- Finance costs

Interest on imports loan obtained for raw material used for the business is Rs. 6,000,000/- (Loan balance as of 31.03.2023 is Rs. 30Mn)

Lease interest on Right of use assets Rs. 1,000,000/-

Note 7:- Property, plant and equipment acquired during the year is as follows:

Description	Cost Rs. '000
Leased Land	75,000
Factory Building	150,000
Plant and machinery	30,000
Motor vehicles – Cars – executive director's	20,000
Computer equipment	5,000
Computer software – ERP with 5-year warranty period	40,000
Total	

Cost incurred for the installation of solar panels was Rs. 10Mn included in the plant and machinery cost.

Capital allowance have been fully claimed for all other assets remaining as at 01.04.2022

Note 8:- Property, plant and equipment recognized as right of used assets acquired during the year is as follows:

Description	Cost Rs. '000
Leased Land and building	75,000
Total	75,000

Depreciation charged on the above assets has been included in the depreciation. Payment of lease rental to lease creditor is Rs. 5,000,000/-

Unless otherwise stated all the expenses are incurred to produce income. You may assume that expenses are incurred propionate to generate the respective business income. The information and details are given for the purpose of the examination that will be held on June 2023

Required:

Assess the balance income tax payable, by Trendywear (Pvt.) Ltd (TW) in respect of the Y/A 2022/23.

- b) Board of directors of TW has made a dividend distribution in the month of September 2022 and in the month of January 2023 for the year and they are seeking your advice on the distribution of dividends for the year 2022-23.

Required:

Advice the possible tax implication and procedure to follow for the distribution of dividends, by Trendywear (Pvt.) Ltd (TW) in respect of the Y/A 2022/23.

