

# Strategic Level Exam -December 2023

## Corporate Taxation – Model Paper 03

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### SECTION 2

#### Question 03

a) The Sudu Araliya (Pvt.) Ltd (TSA) is incorporated company in Sri Lanka and Tourist board approved hotel. It provides Ayurvedic treatments for foreign tourists. Company has employed qualified doctors and staff for Ayurvedic treatments. Also provides tropical Sri Lankan foods and beverages which are supported with medical treatments. Company has established fully owned subsidiary, Frangipani Boutique Ltd (FBL) in Thailand. The company, TSA has invested Rs. 200Mn during the year 2022/23 on the new equipment and upgraded the room facilities of the hotel. Those rooms have been built in the year 1995 and after upgrading this will be available for use in the year 2025. As per the government economic plan the Sri Lankan tourist industry will expected to be expanded in the year 2025. Hotel will be ready to cater the demand with the expected boom in the Sri Lankan tourist market. Further, during the year 2022/23 company has installed solar panels and solar system, this will be connected to national grid during the year 2024.

Company promotes Sri Lankan ayurvedic treatment at Thailand. Agreement was entered with the Thailand companies to share knowledge on ayurvedic treatment. Further TSA has invested in shares of few Thailand 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. 250 Mn and reserve Rs.75Mn as of 31<sup>st</sup> March 2023. The detailed unaudited income statement of The Sudu Araliya (Pvt.) Ltd (TSA) for the year ended 31 March 2023 is as follows.

Description	Note	Amount (LKR) '000
Revenue	01	1,250,000
Cost of sales	02	(800,000)
<b>Gross profit</b>		<b>450,000</b>
Other Income	03	4,500
Administration, Marketing, and other expenses	04	(229,000)
Profit from operating activities		225,500
Finance Income	05	3,500
Finance cost	06	(27,500)
<b>Profit before tax</b>		<b>201,500</b>
Income Tax expenses		(60,450)
<b>Profit for the year</b>		<b>120,050</b>

**Note: - 01 - Revenue**

Room Income Rs. 300,000,000/-

Treatment income Rs. 450,000,000/-

Food and beverage income Rs. 500,000,000/-

**Note: - 02 – Cost of sales**

This includes the direct cost incurred to generate the income, comprises cost of Ayurveda materials, foods and direct salaries. More than 90% of materials are sourced from domestic market.

**Note: 03: – Other Income**

- a) Laundry service – Rs. 500,000/-.
- b) Dividend income from foreign subsidiary company is Rs. 900,000/-. This was received in the month of September 2022 (USD equivalent amount).
- c) Fee income for knowledge sharing with Frangipani Boutique Ltd was Rs. 3,100,000/- (USD equivalent amount). Cost incurred by the treatment team is Rs, 1,100,000/- which is recorded in direct salary cost.

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

Description	Note	(Rs.) '000
Salaries and wages		65,000
EPF & ETF	(i)	9,750
Provision for retirement benefits	(ii)	15,750
Provision for Bad and doubtful debts	(iii)	500
Medical expenses	(iv)	125
Staff welfare	(v)	100
Repair expenses	(vi)	1,700
Advertising and promotion	(vii)	8,700
Donation	(viii)	5,000
Depreciation	(ix)	75,250
Fines and penalties	(x)	1,000
Legal fees	(xi)	2,150
Consultancy fees	(xii)	5,300
Other expenses	(xiii)	47,475

- i. EPF 12% and ETF 3% has been made for all staff including direct salary.

- ii. Gratuity provision represent the provision for retirement benefit. During the year Gratuity payment of Rs. 12,000,000/- was made staff engaged with hotel room service.
- iii. Write off amount of staff debtors is Rs. 500,000/-.
- iv. Medical expenditure represents the staff offers.
- v. Staff welfare expenditure shows tea and water provided to staff.
- vi. Room repair cost included in the repair cost
- vii. Advertising and marketing expenses are related for the promotion campaign made at foreign market.
- viii. Donation represented the money donated to Government hospitals.
- ix. This represented the Depreciation and amortization of hotel assets
- x. Fine and penalties are related to the charges paid to environmental authority on the breach of environmental regulations at the hotel improvement project.
- xi. Legal fee was made to a legal consultant in drafting fee agreement with foreign subsidiary.
- xii. Consultancy fee of Rs. 5,300,000/- has been paid for medical doctors who provides special Ayurveda treatment on the request of customers. This was made during the month of January 2023. No withholding tax has been deducted from the fee payment.
- xiii. General administration and establishment cost are included.

**Note 5:-Finance income**

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

**Note 6:- Finance costs**

Interest on loan obtained for hotel improvement project is Rs. 200Mn and Interest cost incurred for this loan was Rs. 25,500,000/-. (Loan balance as of 31.03.2023 is Rs. 170Mn)

Lease interest on Right of use assets Rs. 2,000,000/-

**Note 7:- Property, plant and equipment are as follows:**

Description	Cost Rs. '000
Leased Land	25,000
Land – Investment property	30,000
Building	150,000
Equipment and machinery	30,000
Motor vehicles – Cars	25,000
Computer equipment	3,000
Computer software	20,000
WIP – Upgrading project	125,000

Cost incurred for the installation of solar panels was Rs. 10Mn included in the Equipment cost. All other equipment has been acquired in the year 2015.

Motor cars were purchased during the year 2023/24. These cars are used for picking the tourist from airports at the arrival and facilitating for excursion etc..

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	25,000
Total	25,000

Depreciation charged on the above assets has been included in the depreciation. Payment of lease rental to lease creditor is Rs. 3,000,000/-

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

**Required:**

**Assess the balance income tax payable, by a) The Sudu Araliya (Pvt.) Ltd (TSA) in respect of the Y/A 2022/23.**

- b) Board of directors of The Sudu Araliya (Pvt.) Ltd plan to issue bonus shares in the month of April 2024. The board is evaluating option available for the said share issue. As proposed by one board member it can be made from the profit earned for the year 2022/23, retained income or disposal gain on the land recognized under the investment property, which is not used in the business. They are seeking your advice on the alternative option of issuing bonus share.

**Required:**

**Advice the possible tax implication and procedure to follow for the issuing bonus shares , by The Sudu Araliya (Pvt.) Ltd).**