

# Strategic Level Exam -December 2023

## Corporate Taxation – Target Paper 01

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Taxation – PIM USJP

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### SECTION 1

#### Question 01

(a) Maxima Co.,Ltd (MaCo) incorporated and a resident company in Vietnam. Company engaged in the business of manufacturing, installation, and service of aluminum structures. Company has been offered a contract to install aluminum structures at a Housing scheme constructed by Sky Residence Jawaththa (Pvt) Ltd (SRJ) a company incorporated in Sri Lanka. Total cost estimated by MaCo is for the service of the installation was Rs. 250,000,000/- (USD equivalent LKR value) and this includes total installation cost. Quoted price for the installation of building project was Rs. 800,000,000/-. MaCo has manufactured aluminum building at their plant in Vietnam and imported to (prefabricated building structures) Sri Lanka. Separate agreement was entered by SRJ with MaCo for the purchases of prefabricated aluminum structures and total price quoted for the aluminum structures was Rs. 350,000,000/- (USD equivalent LKR value).

MaCo has entered into an agreement with Tong Fu (Pvt) Ltd (Ton Fu), a resident company incorporated in Vietnam and engaged in the business of supply of installation services. Ton Fu provided Three (3) machines which are specially use in the building installation projects. As per the terms and conditions, a fee for machines is to be paid based on the number of hours used. Therefore, MaCo has entered into a royalty agreement with Ton Fu for the usage Those are machinery specially used for this type of project and total fee agreed was Rs. 175,000,000/- (USD equivalent LKR value). Ton Fu has sent their expert employees who can operate those machineries. Salaries for the employees are paid by the Ton Fu. Total salary and other cost incurred by Ton Fu for the project was Rs. 80,000,000/- and Rs. 45,000,000/- respectively (USD equivalent LKR value). The employees stayed at the building site and their activities were completed within a period of 45days.

MaCo has stated the project on 01<sup>st</sup> July 2022 and completed the project within a period of 182 days. After the completion of the project, the building was duly handed over to SRJ.

**Required:**

- i. Discuss whether MaCo is required to pay income tax in Sri Lanka for Y/A 2022/23 and if required compute the income tax liability of MaCo in Sri Lanka for Y/A 2022/23.

Support your answer citing statutory provisions of the Inland Revenue Act No. 24 of 2017, as amended (IRA) and the double tax agreement between Sri Lanka and Vietnam.

Your answer should include an analysis of the following.

- Permanent establishment exposure of MaCo in Sri Lanka
- Whether the full contract value that includes income from the following is liable to tax in Sri Lanka
  1. Supply of prefabricated building
  2. Rendering installation services

(10 marks)

- ii. Assess the requirement for the deduction of withhold tax when remitting the payment in relation to installation services to Ton Fu in Vietnam.

Support your answer citing statutory provisions of the IRA and any relief that may be invoked pursuant to the DTA with Sri Lanka and Vietnam.

(5 marks)

(b) Mr. Saigon, employee to Ton Fu received a salary of Rs. 30,000,000/- (USD equivalent LKR value) during the employment period in Sri Lanka and has made an investment of Rs. 10,000,000/- in the Commercial Bank (Ceylon) PLC a listed company in the Colombo stock exchange. In the month of December 2022, Commercial Bank (Ceylon) PLC has distributed a dividend (Gross) of Rs. 5,000,000/- for this investment. He has sold all shares for Rs. 15,000,000/-.

(c) Further SRJ has obtained a software for the control of electricity used by the housing scheme form Elector Vietnam Ltd (EV) a company incorporated in Vietnam. This is a fully owned subsidiary company of Ireland company. This software was installed by an employee of EV. As per the contract, annual license fee of Rs. 25,000,000/- to be paid for the software.

Mr. Saigon and Mr. Diagon, the managing director to EV approach you for tax consultation. They are seeking your advice on the Income tax and other tax liability in Sri Lanka on the transaction entered by them, during the year 2022/23.

**Required:**

- i. Advise whether Mr. Saigon is required to pay income tax in Sri Lanka for Y/A 2022/23 and if required compute the income tax liability of Mr. Saigon in Sri Lanka for Y/A 2022/23.

(5 marks)

- ii. Advise Mr. Diagon the requirement for the payment of income tax in Sri Lanka including the requirement of deduction of withhold tax when remitting the payment in relation to installation services to EV in Vietnam.

Support your answer citing statutory provisions of the IRA and any relief that may be invoked pursuant to the DTA.

(5 marks)

## Question 02

(a) Bio Tech Laboratory (Pvt) Ltd (BTL) is engaged in the business of providing laboratory services for fabric and garment testing services to local clients. Income received from laboratory service represents more than 70% of the total turnover of the company. BTL is registered as a Registered Identified Purchaser (RIP) as well as a Registered Identified Supplier (RIS) under the Simplified value-added tax (SVAT) scheme.

The management of BTL has started diploma course for merchandisers and quality assurance for personnel in garment industries during the Y/A 2022/23. The following information was identified with respect to value-added tax (VAT) for the taxable period ended, December 2022.

Description	Rs.
Turnover	
• Laboratory testing services to exporters – Registered for SVAT as RIP	50,000,000/-
• Laboratory testing services to local manufacture of Garments – registered for VAT.	10,000,000/-
• Quality assurance diploma course fee from local candidates	3,000,000/-
• Quality assurance diploma course fee from foreign candidates	7,000,000/-
VAT paid on importation and local purchases.	1,000,000/-
• Imports of testing materials – VAT deferment scheme	800,000/-
• Imports of machinery used for testing service – VAT deferment scheme.	500,000/-
• Imports of equipment and accessories used for quality assurance diploma courses.	200,000/-
• Purchases of other materials for courses – SVAT suppliers	150,000/-
• Building rent – Lab	100,000/-
• Building rent – Diploma course	700,000/-
• Expenditure incurred by administration office	

Following additional information provided by the company for the above taxable period.

- The diploma course is recognized by the ministry of education and the university grant commission as high national diploma.
- Foreign candidates joined for the course virtually and examination or evaluation process also made via internet.
- Course fees to be paid at the beginning of the course.
- Company has collected all the SVAT credit vouchers.
- Company has sold scrap packing material to a local party and collected Rs. 345,000/- during the above period.

**Required:**

- i. Assess the VAT liability/overpayment for the taxable period ended 31.12.2022.

(15 marks)

- (b) As per the company policy Bio Tech Laboratory (Pvt) Ltd (BTL) is providing company vehicles for its employees at top management. Depreciation policy of the company is five years for these vehicles. After the expiration of a five (5) year period employee is entitled to get the ownership of the motor vehicle used by them at the net book value.

Tax authority has requested information from the company and their argument is profit earned by the company shall be treated for capital gain tax. Management seeks your advice on the possible tax exposure on the above scheme.

**Required:**

- i. Advise the management on the applicable taxes for the company on the above scheme.

(10 marks)

## SECTION 2

### Question 03 (based on the common pre-seen)

#### Question 03

In addition to the information provided in the common pre-seen in relation to Sunshine Manufacturing (Pvt) Ltd (SML), the following additional information in relation to the company for the year ended 31 March 2023 is made available.

(i) The detailed for unaudited income statement of SML for the year ended 31 March 2023 is as follows.

Description	Note	Amount (LKR) 'Mn
Revenue	01	3,000
Cost of sales	02	(1,800)
<b>Gross profit</b>		<b>1,200</b>
Other Income	03	50
Administration, Distribution, and other expenses	04	(304)
Profit from operating activities		946
Finance Income	05	100
Finance cost	06	(918)
<b>Profit before tax</b>		<b>128</b>
Income Tax expenses		60
<b>Profit for the year</b>		<b>188</b>

#### Note: - 01 - Revenue

During the year company has recorded export turnover of Value-added Concrete products of Rs. 1,000,000/-

#### Note: - 02 - Cost of sales

	(LKR) 'Mn
Opening inventory	250
Purchase	1,400
Labour Charges and other direct cost	300
	1,950
Closing Inventory	1500
Cost of sales	1,800

#### Note: 03: - Other Income

- a) Renting and hiring machineries Rs. 50,000,000/-.

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

<b>Description</b>	<b>Note</b>	<b>(Rs.) 'Mn</b>
Salaries and wages		35.0
EPF & ETF	(i)	5.25
Provision for retirement benefits	(ii)	27.5
Provision for Bad and doubtful debts	(iii)	30.0
Other exports expenses	(iv)	20.0
Staff welfare	(v)	10.0
Machine Repair expenses	(vi)	30.0
Advertising and promotion	(vii)	2.5
Marketing expenses	(viii)	6.2
Donation	(ix)	5.0
Depreciation and impairment–Factory and machinery		48.8
Fines and penalties	(x)	4.0
Legal fees	(xi)	1.5
Training cost	(xii)	7.3
Product innovation development expenses	(xiii)	70

i.

- i. EPF 12% and ETF 3% has been made for all staff these funds are approved funds for tax purposes.
- ii. Gratuity provision represent the provision for retirement benefit. During the year Gratuity payment of Rs. 20,000,000/- was made for staff members who got terminated their employment during the year.
- iii. Amount represents the bad debt provision made for trade debtors.
- iv. Exports related expenses for value added products.
- v. Staff welfare expenditure shows tea and water provided to factory staff.
- vi. Lubricant used for machines at the plant was Rs. 15,000,000/- and which is included in the repair cost. Balance amount is for improvement cost made to machinery purchased in the year 2005.
- vii. Advertising and promotion expenses are related to payment of Rs. 2,500,000/- made to local advertising firm for new product launch
- viii. Marketing expenses is for the promotion campaign made at foreign market.
- ix. Donation represented the cash donated to government school. This is an approved donation.
- 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 of Rs. 500,000/- was made to tax consultant for the settlement of above tax matter. Balance fee has been made in the month of January for consultation obtained form a lawyer for the preparation of agreement entered with foreign clints. Company has not deducted WHT from both fees.

- xii. Training cost of Rs. 7,300,000/- 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 company established in Sri Lanka. No withholding tax has been deducted from the fee payment.
- xiii. Total cost other than capital nature expenditure incurred in the development of innovative concrete products through the R & D institution established under the university of Moratuwa.

**Note 5:-Finance income**

- b) Interest Income – RFC Rs. 70,000,000/- (USD equivalent value)
- c) Exchange gain – Transaction Gain Rs. 15,000,000/-. Translation gain Rs. 15,00,000/-

**Note 6:- Finance costs**

Interest on export loan obtained and used for the value added product business is Rs. 908,000,000/- (Loan obtained and balance as of 31.03.2023 is Rs. 3000Mn)

Overdraft interest Rs. 10,000,000/-

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

Description	Cost Rs. '000
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

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

**Note 8:-** Bank overdraft has been used for the business: Balance as of 31.03.2023 was. Rs. 100,000,000/-.

**Note 9:-** Tax loss brought forwarded from the year 2021/22 is Rs. 25,000,000/-

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 December 2023

**Required:**

**Assess the balance income tax payable, by Sunshine Manufacturing (Pvt) Ltd (SML)in respect of the Y/A 2022/23.**

**(30 marks)**

client. Accordingly, concrete products can be manufactured at the plant at their country and expertise knowledge shall be shared by the Sunshine Manufacturing Company (Pvt) Ltd All the logistic arrangement is made by the client including supply of required raw materials. Profit will be shared between the two party equally.



**Required:**

**Advice the possible tax implication to the Sunshine Manufacturing (Pvt) Ltd (SML) in respect of the above business arrangement.**

**(10 marks)**

- c) Rs.20 million worth of Cement stock was damaged due to a bad weather during the year of assessments 2022/23 and Rs. 8 million were recovered through the insurance claim. Balance amount of Rs. 12 million was charged as an expense by the company and claimed for income tax purposes.

**Required:**

**Advice the possible tax implication to the Sunshine Manufacturing (Pvt) Ltd (SML) by explaining the stock loss which was not recovered through the insurance. You may refer to the provision of tax law and legal precedents.**

**(05 marks)**

- d) As per the agreement entered with Sunshine Real Estate and Residency (Pvt) Ltd, company enjoyed a tax exemption period of 10 years and after the expiration of the tax exemption period company is liable for income tax at a concessional rate of 15%. Board member has informed to the audit committee that, with the changes to inland Revenue law company will be liable for tax at a higher tax rate. Audit Committee chairman seeks your advice on the possible tax exposure on the changes to tax law.

**Required:**

**Advice the possible tax implication to the Sunshine Estate and Residency (Pvt) Ltd (SRERL) in respect of the amendments made to Inland Revenue Law.**

**(05 marks)**