Question 1

MSG Packaging (Pvt) Ltd (MSG) was incorporated on 1 April 1994. It manufactures packing materials and at present more than 50% of its shareholding is owned by MSG Holdings (Pvt) Ltd.

Currently the company caters only to the domestic market. The CEO of MSG is having a strategic plan to enter into a new business line to provide packaging for the international markets in the future. With that intention the following arrangements were done by the company.

- A foreign investor has invested USD 5 million in Sri Lanka in MSG and has set up a joint venture with MSG.
- In the year of assessment (Y / A) 2021 / 22, an investment of Rs. 54 million was made in machinery which are to be used for the production in the future.
- A new factory building is currently being constructed in Koggala, and as at the end of Y / A 2021 / 22 the value of its work-in-progress was stated as Rs. 56,000,000.
- The commercial operations of the new factory will commence in January 2025.
- Expenses of several foreign visits made by the directors were as follows:

(i) Rs. 989,000 on visits to negotiate with prospective customers.
(ii) Rs. 272,000 on visits to inspect new machinery for the new business.
These expenses were included under foreign travel expenses.

An extract of the income statement of MSG for the year ended 31 March 2022 and related notes are given below.

Summary income statement

	Rs.
Revenue	678,563,000
Cost of sales	(562,611,000)
Gross profit	115,952,000
Other income	10,002,000
Administrative expenses	(72,458,000)
Selling and distribution expenses	(14,256,000)
Operating profit	39,240,000
Finance cost	(4,747,000)
Finance income	692,000
Profit before tax	35,185,000

Additional information

(i) Break-up of other income

	Rs.
Profit from sale of motor lorry	5,352,000
Insurance receipt	3,500,000
Dividend received	430,000
Ground rent received	720,000
Total	10,002,000

- 50% of the dividend received is from foreign companies and the balance 50% is from local companies.

(ii) The company has made investments in Fixed deposits, and the interest received during Y/A 2021/22 is as follows.

	Type of security and time to maturity	Interest income Rs.
Investment made in 2019	Fixed Deposit: 5 years	422,000
Investment made in 2020	Fixed Deposit: 5 years	270,000
Total		692,000

(iii) Administrative expenses included the following.

	Rs.
Entertainment expenditure	725,000
Amortisation of non-refundable key money for building	250,000
Loss on sale of air conditioner	22,000
Book depreciation of property, plant and equipment	1,425,000
Foreign travel expenses	1,261,000

- Entertainment expenditure includes the entertainment allowance of Rs. 320,000 paid to executive employees.
- Non-refundable key money amounting to Rs. 500,000 was paid in Y/A 2021/22 to the owner of the building that was taken on rent by the company for 5 years.
- An air conditioner (AC), which was fixed at the residence of the finance director, was replaced with a new AC at a cost of Rs. 112,000 within two weeks from the date of disposal of the old AC. The old AC was sold to one of the employees for Rs. 5,000 and this sale incurred a book loss of Rs. 22,000.

(iv) Selling and distribution expenses included the following.

- A donation of Rs. 300,000 to a government hospital, and a donation of Rs. 200,000 to an approved charity (in money) established for the provision of institutionalised care for the sick or needy.

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- Advertising expenses of Rs. 452,000, in relation to the maintaining of a roundabout in the heart of the city.

(v) Property, plant and equipment

- The company has incurred the following costs during Y/A 2021/22.

	Rs.
Work-in-progress of new building	56,000,000
Furniture to be used in new building	3,000,000
New van purchased in August 2021	4,000,000
Computers	100,000

- A motor lorry disposed of during Y/A 2021/22 was purchased in Y/A 2018/19 for Rs. 9,000,000. It was sold for Rs. 5,352,000.
- An old van, which was purchased in 2018, met with an accident, and MSG received an insurance claim of Rs. 3,500,000 in the month of May 2021.
- Allowance for depreciation has been granted in full for all the other assets held as at 1 April 2021.

(vi) Personal income tax paid by the company in respect of the executive directors for Y/A 2021/22 was Rs. 656,000.

(vii) All other expenses are allowable for the purpose of taxation.

(viii) Taxes paid on self-assessment basis for Y/A 2021/22 were Rs. 3,500,000.

Required:
Assess the income tax liability, tax credits and balance tax payable of MSG for Y/A 2021/22.

Advise the company on any incentives/benefits available under the Inland Revenue Act for the investment made in the new business.

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Question 2

Electro Techno Distributors PLC (ETD PLC)

Brief history

In the early 1970s David Fernando was a lawyer carrying out his practice in Colombo. He was a young member of a prestigious business club in Colombo and met a lot of professionals, businessmen, government officials and diplomats who visited there. As a result he was able to build good contacts with various kinds of people who had high living standards.

The government of Sri Lanka stopped all kinds of imports and tried to encourage local industries during the period 1970 – 1977 when a closed economy was practiced. David saw the opportunity that was created by this policy of the Sri Lankan government. He discussed this with his close associates when he met them at the club and they were impressed. He thought of starting a new business Electro Techno Trading Company as a partnership in Kollupitiya with his close friend Joseph Emmanuel who was a retired diplomat. Both of them collected second-hand used electronic and electrical equipment/appliances such as radios, washing machines, and luxury imported items from influential people who left the country for migration after completing their tenures in Sri Lanka. With this humble initiative they successfully created demand for those items in the domestic market and earned a good profit. Immediately after the general election in 1977, an open economy was introduced and most of the import restrictions were lifted. David and Joseph both agreed to convert the partnership into a limited liability company under the name Electro Techno Distributors (Pvt) Ltd (ETD) in 1978 and expanded the business to acquire agencies of prestigious brands for electronic and electrical appliances. They opened their second showroom in Bambalapitiya for both second-hand and brand new items such as radios, washing machines, grinders, ovens and other convenient gadgets.

You are provided with the following information for the financial year ended 31 December 2021.

The detailed accounts of ETD PLC for the year ended 31 December 2021 are as follows.

	Note	31st December 2021 Rs.'000
Revenue	Note 1	3,217,152
Cost of sales		(2,422,727)
Gross Profit		794,425
Other operating Income	Note 2	35,245
Administrative expenses	Note 3	(355,258)
Selling and distribution expesenes	Note 4	(161,452)

Operating Profit		312,960
Impairment of related party receivables		(24,068)
Finance cost	Note 5	(158,460)
Finance income	Note 6	7,210
Profit before income tax		137,642
Income tax expenses		(20,211)
Profit/(loss) for the year		117,431

Notes

Note 1 – Revenue

	Rs' 000
Gross revenue	3,217,152

Note 2 – Other operating income

	Rs' 000
Commission income	7,500
Dividend income received from ET Electricals (Pvt) Ltd	4,000
Writing back of payables	8,783
Royalty income	3,500
Reimbursement of expenses (intercompany)	8,992
Reversal of provision for slow-moving stock	2,470
	35,245

Note 3 – Administrative expenses

	Rs' 000
Salaries and wages	159,000
Director fees	18,500
Travelling	6,503
EPF and ETF	23,850
Provision for gratuity	12,990
Audit and accounting fees	2,000
Donations	1,750
Rent	9,050
Entertainment expenses	670
Depreciation	95,775
Building maintenance	5,215
Other	19,955
	355,258

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Note 4 – Selling and distribution expenses

	Rs' 000
Advertising / business promotion	40,000
Royalty	10,000
Fall in value of investment properties	1,399
Amortisation of leasehold land	3,100
Amortisation of intangible assets (5 years)	6,860
Collective impairment of debtors (General provision)	25,000
Foreign travelling	2,000
Research expenses	1,000
Vehicle maintenance	9,185
Warranty provision	3,200
Commission	14,935
Motor vehicle insurance	6,128
Other expenses	38,645
	161,452

Note 5 – Finance cost

	Rs' 000
Interest paid on loan obtained to invest in ET City Developer (Pvt) Ltd	100,000
Imputed interest cost relating to purchases made from ET Electricals (Pvt) Ltd	20,000
Bank interest	38,460
	158,460

Note 6 – Finance income

	Rs' 000
Interest from fixed deposits (gross)	3,210
Interest from unlisted debt securities (Gross)	4,000
	7,210

Other information

(i) Writing back of payables includes the following:

- Service fees payable to ET Electricals (Pvt) Ltd: Rs. 6,200,000
- The balance represents the writing back of the temporary loan provided by ET Electricals (Pvt) Ltd in Y / A 2019 / 20.

(ii) Intangible assets of ETD PLC include a manufacturing license acquired by it in Y / A 2020 / 21 for Rs. 15 million on behalf of ET Electricals (Pvt) Ltd. The license is being amortised over five years together with the other intangible

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assets of ETD PLC (which are also amortised over 5 years) for accounting purposes.

(iii) The royalty expense represents the trademark fees paid / payable to foreign suppliers for Y / A 2021 / 22.

(iv) Research expenses represent the amount paid to a leading market research agency to obtain a market intelligence report on the fashion and footwear business in Sri Lanka, as the company is contemplating on moving into the fashion and footwear industry as well.

(v) Foreign travelling includes the following:

- Rs. 800,000 – cost of the air tickets provided to joint venture partners from Hex Shang Ltd to come to Sri Lanka for a discussion.
- Rs. 1,200,000 – cost of visits to foreign manufacturers to inspect the quality of imported goods by the marketing team.

(vi) Donations represent the following:

- Death donation made to the immediate family member of a deceased employee: Rs. 150,000.
- Donation made to an approved charity for institutionalized care for the elderly: Rs. 1,600,000.

(vii) Movement of the warranty provision account is as follows:

	Rs. '000
Opening balance as at 1 January 2021	26,565
Add: Provision for the year	3,200
Less: Warranty claim during the year	(14,539)
Closing balance as at 31 December 2021	15,226

(viii) The cost of assets acquired during the year of assessment 2021 / 22 is as follows;

Description	Cost Rs. '000
Buildings	140,000
Generators	30,000
Motor vehicles - Lorries - Motorcycles	34,000 16,000
Software (useful life is 3 years)	12,000
	232,000

(ix) Depreciation allowance claimed for Y / A 2020 / 21 was Rs. 7,900,000. None of the assets were fully tax depreciated at the end of Y / A 2021 / 22.

(x) Income tax receivables as at 31 December 2021 of Rs. 14,285,000 represent the quarterly self-assessment payments made for the Y / A 2021 / 22.

Required:

(a) Assess the balance income tax payable by ETD PLC on 30 September 2022, if any, in respect of Y / A 2021 / 22.