

Strategic Level Exam -December 2024

Corporate Taxation – Target Paper 02

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

SECTION 1

Question 01

(a) Korea Engineering [Pvt] Limited (KEL) is incorporated in the Republic of Korea (South Korea) and is primarily engaged in selling high-tech construction machinery. Over the past few years, KEL has successfully entered markets in several countries through local partnership. Encouraged by this track record, KEL has decided to expand its business to Sri Lanka, starting in May 2023. Notably, KEL currently lacks any legal presence in Sri Lanka. As part of its preparations for entering the Sri Lankan market, KEL is evaluating a business model.

Under this model, KEL will manufacture machinery in Korea and will be directly shipped to Sri Lanka and sold to customers in Sri Lanka. KEL will directly enter into an agreement with customer. Agreement will be executed outside Sri Lanka. Installation and operating services will be provided through a company incorporated in Sri Lanka. A Company will be incorporated in Sri Lanka under the name of Mlanka Construction Services (Pvt) Ltd (MCS). It will provide the installation and operating services to customers, and KEL will reimburse a cost-plus 5% mark-up, at USD 20. The fee charged from the customer as the service fee for the same will be USD 30. KEL will train the employees of MCS and provide detailed instructions and manuals to provide the support services. MCS will be prohibited from providing these services to any other party in Sri Lanka. Machine can only be used after the installation and operating services provided by the MCS.

Required:

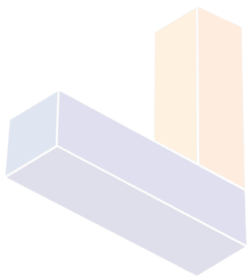
- i. Discuss whether KEL is required to pay income tax in Sri Lanka for Y/A 2023/24 and if required compute the income tax liability of KEL in Sri Lanka for Y/A 2023/24.

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 South Korea.

Your answer should include an analysis of the following.

- Permanent establishment exposure of KEL in Sri Lanka
- Whether the full contract value that includes income from the following is liable to tax in Sri Lanka
 1. Supply of Machinery
 2. Customer service fee

(15 marks)



JMC vLearning
"your virtual learning partner"

(b) KEL is seeking opportunities in India market. The business model set up for Sri Lanka will be the model applied for India. However, installation services will be provided by MCS. MCS will not set up a separate entity in India. However, Consultants will be engaged for technical support services. Consultant of MSC will be located at project site in india. Payment will be made by MCS from Sri Lanka to those consultants.

(c) Profit on the services provided by MCS at the india project will be remitted to Sri Lanka. There will be a TDS deducted by India on the remittance. Net amount will be remitted to Sri Lanka.

They are seeking your advice on the applicability of Income tax in Sri Lanka on the payments to consultant engaged in india project.

Required:

- i. Advise whether MCS is required to deduct withholding tax in Sri Lanka on the payment of service fee to consultants.

(5 marks)

- ii. Advise whether the income/profit received by MCS is liable for Income Tax in Sri Lanka and possibility of claiming credit for Tax paid (TDS) in India

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

(5 marks)

Question 02

APS Business solution Ltd is a company incorporated in Netherland and having a branch office in Sri Lanka, the enterprise is providing business process outsourcing services to customers in Sri Lanka and other countries. Following information has been provided for the taxable period ended 31st March 2024.

| Description | Rs. |
|---|---------------|
| Turnover | |
| • Services to exporters – Registered for SVAT as RIP | 60,000,000/- |
| • Services to local manufacture – registered for VAT. | 40,000,000/- |
| • Services to Foreign clients | 120,000,000/- |
| VAT paid on importation and local purchases. | |
| • Imports of Computers – VAT deferment scheme | 4,000,000/- |
| • Imports of other accessories – VAT Paid. | 1,200,000/- |
| • Payment to consulting companies. | 3,500,000/- |
| • Building rent | 1,200,000/- |
| • Expenditure incurred by administration office. | 750,000/- |
| • Insurance – office staff | 875,000/- |
| • Insurance – computer and accessories | 1,950,000/- |

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

- Services were provided to foreign client via internet and service fee has been collected by the company in foreign currency.
- Insurance claimed of Rs. 1,180,000/- was received to employee who got injured during the travelling for service. Insurance claimed of Rs, 2,360, 000/- received on computers, which damaged during the transportation.
- Company has collected all the SVAT credit vouchers.
- Company has sold scrap material to a local party and collected Rs. 472,000/- during the above period.

Required:

- i. Assess the VAT liability/overpayment for the taxable period ended 31.03.2024.

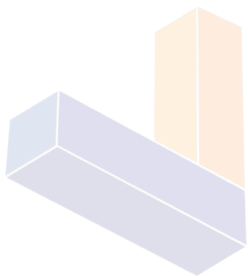
(15 marks)

- (a) Company is planning to set up a service office in Bangladesh. This office is monitored by the branch office in Sri Lanka. Service will be provided by staff located in Bangladesh and income will be recorded under Sri Lanka Branch office.

Required:

- i. Advise the management on the applicability of Value Added Tax on above business model.

(10 marks)



JMC vLearning
"your virtual learning partner"

SECTION 2

Question 03 (based on the common pre-seen)

Question 03

a) In addition to the information provided in the common pre-seen in relation to Ocean Shipping Line (Pvt) Ltd (OSL), the following additional information in relation to the company for the year ended 31 March 2024 is made available.

The detailed for unaudited income statement of OSL for the year ended 31 March 2024 is as follows.

| Description | Note | Amount (LKR) 'Mn |
|---|------|------------------|
| Revenue | 01 | 6,877 |
| Cost of sales | 02 | (4,920) |
| Gross profit | | 1,957 |
| Other Income | 03 | 472 |
| Administrative expenses | 04 | (352) |
| Earning from operation before depreciation | | 2,077 |
| Depreciation | | (177) |
| Profit from operating activities | | 1,900 |
| Finance cost | 05 | (1,686) |
| Share of profit from associate (Net of tax) | | 40 |
| Profit before tax | | 254 |
| Income Tax expenses | | (72) |
| Profit after tax for the year | | 182 |

Note: - 01 - Revenue

| Description | Amount (LKR) Mn |
|-------------|-----------------|
| Air import | 2,190 |
| Air Export | 1,520 |
| Sea import | 1,677 |
| Sea Export | 1,490 |

Note: - 02 – Cost of sales

| Description | Amount (LKR) Mn |
|-------------|-----------------|
| Air import | 1,360 |
| Air Export | 780 |
| Sea import | 1,065 |
| Sea Export | 1,115 |

Note: 03: – Other Income

| Description | Note | Amount (LKR) Mn |
|-------------|------|-----------------|
|-------------|------|-----------------|

| | | |
|---|-----|-----|
| Reversal of the provision for Fair value loss | | 72 |
| Vehicle Rent (Net) | (i) | 280 |
| Treasury bill interest income (Gross) | | 120 |

(i). Customer has deducted relevant tax and paid to the Inland Revenue.

Note 04: - Extract of some of the expenses recorded under administrative expenses.

| Description | Note | (Rs.) 'Mn |
|--|--------|-----------|
| Salaries and wages | | 120 |
| EPF & ETF | (i) | 18 |
| Contribution to retirement benefits fund | (ii) | 72 |
| Director's fee | (iii) | 10 |
| Staff welfare | (iv) | 5 |
| Repair expenses | (v) | 82 |
| Subscription | (vi) | 4 |
| Fines and penalties | (vii) | 7 |
| Legal fees | (viii) | 2 |
| IT service cost | (ix) | 11 |
| Internet and e-mail | | 7 |
| Consultancy fee | (x) | 14 |

- i. EPF 12% and ETF 3% has been made for all staff these funds are approved funds for tax purposes.
- ii. The gratuity represents the contribution made to the retirement benefits fund maintained by the Company. During the year, a gratuity payment of Rs. 20 million was disbursed from the fund to staff members whose employment was terminated. This fund was an approved fund. Additionally, an ex-gratia payment of Rs. 7.5 million was made to a non-executive director. No advance income tax was deducted on the ex-gratia payment.
- iii. This cost pertains to director fees paid to executive directors for their participation in board meetings. As these are participation fees, no advance income tax was deducted.
- iv. Staff welfare expenditure includes the costs associated with the annual staff entertainment event.
- v. Repair costs for the dry dock amounted to Rs. 14 million, with the remaining balance allocated for improvements to the office building constructed in 2017.
- vi. Subscription costs represent the fees paid by the company to the Sri Lanka Logistics Association.
- vii. There was a dispute regarding the payment of EPF/ETF for staff members. The company reached a settlement for this dispute. Fines and penalties were incurred due to delayed payments of EPF and ETF.
- viii. A legal fee of Rs. 3 million was paid to a lawyer for the settlement of the EPF/ETF dispute.

- ix. Software licensing and maintenance costs paid to an Indian vendor are included in this expense. A relevant withholding tax of 10% was deducted at the time of remittance. However, per the agreement with the vendor, the tax cost is absorbed by the company.
- x. Fees paid to independent consultant is included under consultancy fee costs. The service was obtained for the clarification of shareholders rights and obligations.

Note 5: - Finance costs.

- a) Interest on loan obtained for construction of vessel dry dock is Rs. 686Mn.
- b) Interest paid on long term borrowing was Rs. 800Mn. This was used for working capital purpose.
- c) Loan interest on facility obtained for investment in associates were Rs. 45Mn
- d) Exchange conversion loss was Rs. 155Mn

Note 8: - Property, plant and equipment acquired during the year is as follows:

| Description | Year | Cost Rs. 'Mn |
|---|---------|--------------|
| Office Building – Constructed | 2016/17 | 1,200 |
| Motor vehicles – Cars – executive director's | 2018/19 | 800 |
| Motor vehicles – Logistic | 2023/24 | 350 |
| Computer equipment | 2018/19 | 250 |
| Computer equipment | 2019/20 | 125 |
| Computer equipment | 2023/24 | 600 |
| Computer software – ERP with 8-year warranty period | 2018/19 | 400 |

During the year company has disposed Three trucks purchased in the year 2019/20 for Rs. 160 Mn. Cost of theses trucks was Rs. 200Mn.

Further computer purchased in the year 2019/20 for Rs. 25 Mn has been disposed for Rs. 8Mn during the year.

Capital allowance have been fully claimed for all other assets remaining as at 01.04.2023.

The Tax loss B/F from the year 2022/23 was Rs. 12,500,000/-

Unless otherwise stated all the expenses are incurred to produce income. The information and details are given for the purpose of the examination that will be held on December 2024

Required:

Assess the balance income tax payable, by Ocean Shipping Line (Pvt) Ltd (OSL) n respect of the Y/A 2023/24.

(30 marks)

- b) A member of the Board of Directors engaged an independent consultant to provide services aimed at resolving conflicts among the board members.

Required:

Advise the possible tax implication on the above to the company. You may refer to the provision of tax law and legal precedents.

(10 marks)

- c) A member of the Board of Directors has proposed to divest one of the associates and use the proceeds to settle the loan acquired for the investment in associates. Further, it is proposed to capitalize the interest paid on loan obtained for the construction of the vessel dry dock

Required:

Advise the possible tax implication on the above proposal to the company. You may refer to the provision of tax law and legal precedents.

(10 marks)

