

Strategic Level Exam -December 2024

Corporate Taxation – Target Paper 01

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SECTION 1

Question 01

(a) Sukiyo Company Ltd (SCL) incorporated and a resident company in South Korea. Company engaged in the business of manufacturing, and installation service of aluminum structures. Pacific Beta (Pvt) Ltd (PBL) a company incorporated in Sri Lanka and approved by the Board of Investment of Sri Lanka. PBL is constructing a manufacturing plant in the BOI export processing zone at Biyagama. PBL has entered into a separate agreement for installation of the building with SCL. This is for the installation of prefabricated aluminum building structures at the building project. Total cost quoted by SCL is for the service of the installation was Rs. 250,000,000/- (USD equivalent LKR value).

Total Quoted price for the setting up the building was Rs. 800,000,000/-. SCL is manufacturing aluminum building structure at their plant in South Korea and imported to (prefabricated building structures) Sri Lanka. Separate agreement was entered by PBL with SCL for the purchases of prefabricated aluminum structures and total price quoted for the aluminum structures was Rs. 350,000,000/- (USD equivalent LKR value).

SCL has brought Three (3) machines for Rs. 100,000,000/- (USD equivalent LKR value) which are specially use in the building installation projects. As per the terms and conditions, employees specially having expertise in operating this machinery has sent by SCL for this type of project and total remuneration cost paid was Rs. 75,000,000/- (USD equivalent LKR value). This was remitted to employee's bank account directly by SCL. Other administration cost of Rs. 70,000,000/- and maintenance cost of Rs. 45,000,000/- (USD equivalent LKR value) incurred by SCL for the project, respectively. The employees stayed at the building site and their activities

were completed within a period of 50 days. Further, a consultant who is also from South Korea was recruited by SCL for supervision of function of machinery and the project

SCL has stated the project on 01st August 2023 and completed the project within a period of 182 days. After the completion of the project, the building was duly handed over to PBL.

Required:

- i. Discuss whether SCL is required to pay income tax in Sri Lanka for Y/A 2023/24 and if required compute the income tax liability of SCL 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 SCL 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 tax liability of machine operators located in Sri Lanka in relation to installation services.

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

(5 marks)

(b) Mr. Chai Yeng, the consultant recruited by SPL received a consultancy fee of Rs. 30,000,000/- (USD equivalent LKR value) during the consultation service provided in Sri Lanka. This cost is declared under the maintenance cost in the financial statements. Mr. Chai has made an investment of Rs. 20,000,000/- in shares of few companies listed in the Colombo stock exchange. In the month of December 2023, he received a dividend (Gross) of Rs. 2,000,000/- for this investment. He has sold all shares for Rs. 35,000,000/- in January 2024.

(c) Further SPL has purchased a security control system to the plant. All equipment and software were purchased from Combia Lector Pvt Ltd (CLPL) a company incorporated in Cambodia. This system and software were installed by employees of CLPL. They came to Sri Lanka and stayed at the project office for a period of 3 months. This is to setup the control system, installation of the software and monitor the function of software, As per the contract, total cost including annual license fee of Rs. 25,000,000/- to be paid for the security system.

Mr. Chai Yeng and Mr. Sekio Peng the managing director to CLPL 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 2023/24.

Required:

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

(5 marks)

- ii. Advise Mr. Sekio Peng 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 CLPL.

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 2023/24. The following information was identified with respect to value-added tax (VAT) for the taxable period ended, March 2024.

Description	Rs.
Turnover	
• Laboratory testing services to exporters – Registered for SVAT as RIP	40,000,000/-
• Laboratory testing services to local manufacture of Garments – registered for VAT.	20,000,000/-
• Quality assurance diploma course fee to local candidates	20,000,000/-
• Quality assurance diploma course fee to foreign candidates	20,000,000/-
VAT paid on importation and local purchases.	
• Imports of testing materials – VAT deferment scheme	2,000,000/-
• Imports of machinery used for testing service – VAT deferment scheme.	1,800,000/-
• Purchase of equipment and accessories used for quality assurance diploma courses.	1,500,000/-
• Purchases of other materials for diploma courses – SVAT suppliers	1,200,000/-
• Building rent – Lab	1,150,000/-
• Building rent – Diploma course	1,100,000/-
• Expenditure incurred by administration office	1,000,000/-

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. 1,800,000/- during the above period. Further there was fire at the Lab Testing building. Insurance claim of Rs. 3,600,000/- was received during the month of February 2024.

Required:

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

(15 marks)

- (b) According to company policy, Bio Tech Laboratory (Pvt) Ltd (BTL) provides company vehicles to employees in top management positions. The company's depreciation policy for these vehicles spans five years. Upon the completion of this five-year period, employees are entitled to acquire ownership of the vehicles they have used, at the net book value. Following a request from an employee, the company is considering selling the vehicle used by the respective employee to an external party. Employee is requesting the cash proceeds.

Required:

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

SECTION 2

(based on the common pre-seen)

Question 03

In addition to the information provided in the common pre-seen in relation to Ecom Logistic PLC (ELP), 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 ELP for the year ended 31 March 2024 is as follows.

Description	Note	Amount (LKR) 'Mn
Revenue	01	447,352
Cost of sales	02	(371,302)
Gross profit		76,050
Other Income	03	3,853
Selling and distribution expenses	04	(5,634)
Administrative expenses	04	(44,418)
Profit from operating activities		29,851
Finance cost	05	(983)
Finance income	06	67
Share of profit from associate (Net of tax)		(61)
Profit before tax		28,874
Income Tax expenses		(7,466)
Profit for the year		21,408

Note: - 01 - Revenue

Description	Amount (LKR) Mn
Air import	53,190
Sea import	166,670
Air export	29,500
Sea export	197,992

Note: - 02 - Cost of sales

Description	Amount (LKR) Mn
Air import	42,240
Sea import	133,000
Air export	32,360
Sea export	163,702

Note: 03: - Other Income

Description	Note	Amount (LKR) Mn
Creditors written back		150
Warehouse Management Fee (Gross)		1,540
Vehicle Rent (Net)	(i)	1,800
Container Rent (Net)	(ii)	360
Sundry Income		3

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

Note 04: - Extract of some of the expenses recorded under Selling and distribution expenses.

Description	Note	(Rs.) 'Mn
Business promotion expenses	(i)	135
Advertising	(ii)	6
Courier charges		2
Cash allowances	(iii)	1,020
Foreign Travelling Charges	(iv)	2,400
Business Intelligence	(v)	63
Donation expenses	(vi)	30
Sales commission		1,700
Impairment provision for Trade Receivable		200
Customer Registration Expenses		5
Discounts		65
Visa fees	(vii)	10

- (i). The total cost represents the sponsorship fee paid to an event organized by the Freight Forwarders and Logistics Association.
- (ii). This includes the advertising expenses incurred for employee recruitment and business promotion.
- (iii). This expense pertains to the cash payment made to a temporary employee as the monthly salary for December 2023. The employee was engaged specifically for resolving customs matters and having worked only in December, received the total payment in cash.
- (iv). The foreign travel cost amounts to Rs. 1,600,000, incurred by the marketing team for visiting foreign customers. The remaining balance was spent on the director's family tour expenses.
- (v). This represents the cost incurred by the company for staff members responsible for the logistics team who were enrolled in a degree program at the University of Sri Lanka Sagara Vishwavidyalaya. As this was related to business activities, no benefits were recognized for the APIT computation.
- (vi). Cash was donated to the Ministry of Education for a government-conducted project.

(vii). Visa fees for visa obtained by directors for their family tour.

Note 05: - Extract of some of the expenses recorded under administrative expenses.

Description	Note	(Rs.) 'Mn
Salaries and wages		24,400
EPF & ETF	(i)	3,660
Provision for retirement benefits	(ii)	2,275
Bonus	(iii)	1,330
Staff welfare	(iv)	100
Repair expenses	(v)	300
Donation	(vi)	50
Depreciation and impairment		11,680
Fines and penalties	(vii)	48
Legal fees	(viii)	300
Cash loss	(ix)	200
Training cost	(x)	75

- i.
- i. Contributions of 12% to the Employees' Provident Fund (EPF) and 3% to the Employees' Trust Fund (ETF) have been made for all staff members. These funds are approved for tax purposes.
 - ii. The gratuity provision represents the retirement benefit provision. During the year, gratuity payments totaling Rs. 2,200 million were made to staff members whose employment was terminated. Additionally, Rs. 75 million was paid to a senior managerial person who resigned from the company as a non-competing commission payment, which is in addition to his gratuity entitlement.
 - iii. The balance in the Bonus Provision Account was Rs. 2,030 million as of March 31, 2023, and Rs. 1,360 million as of March 31, 2024.
 - iv. Staff welfare expenditure includes the provision of tea and water to warehouse staff.
 - v. The cost of lubricants used for vehicles amounted to Rs. 180 million and is included in the repair costs. The remaining amount pertains to improvement costs for vehicles purchased in 2006, all of which are used for the transportation of goods.
 - vi. The donation represents cash donated to a government school, which is an approved donation.
 - vii. Following an investigation by the port authority, a penalty was imposed for non-compliance with document maintenance requirements. The fines and penalties are related to the settlement payment.
 - viii. A legal fee of Rs. 300 million was paid to a lawyer for the settlement of customs duties and charges arising from a preventive investigation conducted by a customs officer and imposed on a major customer. As this customer is critical to the company, the cost was incurred for the settlement.
 - ix. Additionally, there was a cash loss due to fraud committed by a staff member. Cash loss represented the cash fraud made by a non-executive staff member.

- x. Training costs amounting to Rs. 73 million were paid for a training program conducted for staff in January 2024. This payment was made to a training institute established in Sri Lanka, and no withholding tax was deducted from the fee payment. Others are related for cost incurred for staff participation for awareness session conducted by Custom tariff seminars.

Note 6:- Finance costs

- a) Interest on loan obtained for construction of new warehouse is Rs. 450,000,000/-. The construction has completed on 31.03.2024 and warehouse was used for the business from 01.04.2024. Loan obtained and balance as of 31.03.2023 is Rs. 2,000Mn.
- b) Leases interest Rs. 300Mn paid to leasing company for the acquisition of new logistic vehicle fleet introduced by 01.04.2023. Lease creditor as of 31.03.2023 was Rs. 4,000 Mn,
- c) Interest paid on right of use assets was Rs. 200Mn.
- d) Foreign Exchange conversion loss recognized to financial statement was Rs. 33Mn

Note 7:- Finance income

- a) Interest Income – RFC Rs. 50Mn (USD equivalent value)
- b) Dividend (net) Rs. 17Mn

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

Description	Cost Rs. 'Mn
Warehouse – Constructed	2,000
Motor vehicles – Cars – executive director's	350
Motor vehicles – Logistic	4,350
Computer equipment	600
Computer software – ERP with 4-year warranty period	400

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

Note 9:- Right of uses assets

Description	Rental paid Rs. Mn	Cost Rs. 'Mn
Warehouse	125	400
Vessels, carriages	350	1,900
Motor vehicles – Logistic	143	873

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 Ecom Logistic PLC (ELP) in respect of the Y/A 2023/24.

(30 marks)

- b) The Board of Directors has unanimously approved the proposed payment to a key senior staff member who resigned from the company. This payment acknowledges his long-term service and includes a non-compete agreement concerning business contacts. The total termination fee amounted to Rs. 75 million.

Required:

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

(5 marks)

- c) During the assessment year 2023/24, the company incurred a loss of Rs. 250 million due to cash fraud perpetrated by a non-executive staff member. An amount of Rs. 50 million was recovered through an insurance claim. The remaining balance was recorded as an expense by the company and claimed for income tax purposes.

Required:

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

(5 marks)

- d) The company is currently evaluating the expansion into a new business line, targeting a customer base that has not been previously served. The company is also in a position to attract a foreign investor for this venture.

Required:

Foreign investor is seeking any tax concession in setting up the new business with the company. Advice the possible tax concession, that could be helpful the company to attract the foreign investor.

(10 marks)