

UNIVERSITY OF COLOMBO, SRI LANKA

FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration, Level II – Semester VI Examination, December - 2018

MOS 2308 – Taxation

Three (03) Hours

Answer All Questions

**Workings and assumptions, if any, should be clearly stated
Use of calculators is permitted**

1. Mr. Raja is 50 years old and earns income from several sources. Mr. Raja owns a business of modifying and selling garments which is known as Fashion Garments. He is also working as a Senior Business Analyst at Wickrama Garments Plc. He further serves as a part time Accountant in Swarna Garments Plc. and as a full time Financial Consultant at Thurya Garments. The employment benefits derived from different sources for the year of assessment 2018/19 are listed below:

a) **Wickrama Garments Plc:** Mr. Raja is employed as a Senior Business Analyst in Wickrama Garments Plc. His monthly basic salary amount to Rs. 250,000. He also receives a cost of living allowance of Rs. 50,000, entertainment allowance of Rs. 30,000 and meal allowance of Rs. 40,000. Further he is paid Rs. 60,000 per month as the traveling allowance. Mr. Raja has been provided a company vehicle with fuel and a driver. Engine capacity of the vehicle is 1499 cc. Mr. Raja received one month basic salary as bonus in December, 2018. Mr. Raja and his family reside in a furnished house in Rajagiriya which is belonged to Wickrama Garments Plc.

b) **Swarna Garments:** Mr. Raja is employed as a part time Management Accountant in Swarna Garments and received monthly payments as below:

January, 2018	Rs. 40,000
February, 2018	Rs. 50,000
March, 2018	Rs. 30,000

April, 2018	Rs. 90,000
May, 2018	Rs. 70,000
June, 2018	Rs. 30,000
July, 2018	Rs. 80,000
August, 2018	Rs. 60,000
September, 2018	Rs. 70,000
October, 2018	Rs. 90,000
November, 2018	Rs. 70,000
December, 2018	Rs. 50,000
January, 2019	Rs. 20,000
February, 2019	Rs. 60,000
March, 2019	Rs. 40,000

- c) **Thurya Garments:** Thurya Garments is a newly established clothing store which is engaged in the business of designing and selling bridal garments. Mr. Raja provides ideas and suggestions for Thurya Garments to search new avenues in developing the business. Accordingly, he earned Rs. 150,000 monthly salary for working as a Business Advisor for Thurya Garments.
- d) Mr. Raja has donated Rs. 20,000 to a charitable institution which provides institutional care for the sick and needy people and Rs. 30,000 to an approved charity. Further, he has donated Rs. 50,000 to the Api Wenuwen Api Fund.
- e) Mr. Raja commenced a business of buying, modifying and selling garments for high end customers under the brand name Fashion Garments. Mr. Raja commenced his business in October, 2012. The Income Statement of the business prepared for the year ended 31.03.2019 is as follows:

	Rs.		Rs.
+ Opening Stock	10,000,000	Sales	20,000,000
+ Purchases	4,500,000		
- Closing Stock	<u>(5,500,000)</u>		
Cost of Sales	9,000,000		

Gross Profit	<u>11,000,000</u>		
	<u>20,000,000</u>		<u>20,000,000</u>
Interest	80,000	Gross profit	11,000,000
Wages	326,000		
Utility Expenses	352,000		
Depreciation	500,000		
Travelling expenses	364,000		
Bad debt and doubtful debt provisions	25,000		
Management Fees	35,000		
Advertisement	120,000		
Penalty on NBT	6,000		
Rent of the factory	600,000		
Salaries	1,340,000		
Loss on office theft done by an employee	11,500		
Maintenance expenses	78,000		
Packaging machine repairs	500,000		
Net profit	6,662,500		
	11,000,000		11,000,000

Notes:

- i) Interest expense of Rs. 80,000 includes interest paid on a personal loan obtained by Mr. Raja which amounts to Rs. 30,000 and the interest paid for a business loan taken to buy a sewing machine accounts for the rest. The reserves amount to Rs. 6,000,000 which includes Rs. 2,000,000 revaluation reserves and Rs. 2,000,000 of capital reserves and Rs. 2,000,000 other reserves, issued share capital amount to Rs. 2,000,000. The personal loan taken was Rs. 1,000,000 and the business loan obtained was Rs. 800,000.
- ii) Bad and doubtful debt provision includes Rs. 11,000 provision made for doubtful debt and Rs. 14,000 set off as bad debt. Out of the set off bad debt Rs. 4,000 was received within the year of assessment 2018/2019.

iii) A breakdown of the traveling expenses is illustrated below:

Traveling Expenses	Rs.
Travelling expenses of Mr. Raja from residence to work place	100,000
Traveling expenses incurred by the distribution manager to distribute finished garments in Kandy	42,000
The Air ticket expense of Mr. Raja for visiting his brother in Japan	132,000
Mr. Raja's air fare to India in order to meet a foreign exporter to commence a business contract. The contract was successful and accordingly, Mr. Raja is having a plan of importing materials from the Indian supplier	90,000
Total	364,000

iv) Salaries and wages are composed of the payments made for the factory staff, administrative staff, the executive level employees and managers.

v) The advertisement expenditure consists of expenditure on neon sign board which amounts to Rs. 12,000. Rest of the expenditure was incurred in order to prepare an advertising booklet targeting the prospective customers and to advertise on television.

vi) Mr. Raja had an extra sewing machine which was newly bought for the business. But later he thought that the existing machine capacity is enough to carry on with the production. Therefore he rented the new machine to Mr. Sumanasiri, another finished garments producer. Accordingly, Mr. Sumanasiri pays a monthly rental of Rs. 40,000 to Mr. Raja as the rental fee of the sewing machine.

vii) Mr. Raja is planning to buy a new material cutting machine for his business. Accordingly, he has kept a fixed deposit as a collateral in the bank and planning to obtain a loan in order to buy the machine. This fixed deposit has already reached maturity and as a result Mr. Raja received an interest of Rs. 60,000 in June 2018.

viii) Utility expenses include electricity bills, water bills, and postal expenses incurred on behalf of the factory

ix) Mr. Raja holds several assets in his business. The information related to the respective fixed assets are given below:

Cost (Rs.)

Asset	Balance as at 01.04.2018	Additions	Disposals	Balance as at 31.03.2019
Building	1,000,000	-	-	1,000,000
Computers	900,000	84,000	-	984,000
Sewing machines	2,000,000	2,000,000	-	4,000,000
Packaging machines	3,000,000	2,000,000	-	5,000,000
Cutting machines	4,000,000	1,000,000	1,000,000	4,000,000
Total	10,900,000	5,084,000	1,000,000	14,984,000

Building and Computers:

The building was bought when Mr. Raja commenced his business. In addition to the computers bought in 2018 all the other computers were bought in June 2016.

Sewing Machines:

The opening balance of Rs. 2,000,000 illustrates a machine which was bought in June 2016. Further a new sewing machine was bought in May 2018.

Packaging Machines:

Two packaging machines were bought in August, 2015 and May, 2016 which cost Rs. 2,000,000 and Rs. 1,000,000, respectively. For the packaging machine which was bought in 2015 a repair expense of Rs. 500,000 was borne in 2018/2019 to increase its capacity.

Cutting machines:

The two cutting machines which were bought in December, 2015 and November, 2014 which cost Rs. 2,000,000 each. Another cutting machine was bought in November, 2018 and the cutting machine which was bought in 2014 was sold for Rs. 2,500,000.

Calculate the taxable income and income tax liability of Mr. Raja for the year of assessment 2018/19.

(40 Marks)

2. Mr. Rathnakumara is 55 years old and obtains income from several sources. He is employed at Prabodha Pvt (Ltd) and also derives income from several investment sources.
- a) Mr. Rathnakumara works as a Senior Finance Manager at Prabodha Pvt (Ltd). Accordingly he earns a monthly salary of Rs. 450,000 which includes a cost of living allowance of Rs. 50,000, transport allowance of Rs. 40,000 and an entertainment allowance of Rs. 30,000.
- b) Mr. Rathnakumara purchased a land in Wellawatta for Rs. 16,000,000 on 01.10.2010 with the intention of selling it. Subsequently he filled the land and improved it spending Rs. 2,000,000. Mr. Rathnakumara decided to sell the land and incurred an advertising expense of Rs. 100,000 and a lawyer fee of Rs. 300,000. The market value of the land as at 30.09.2017 is estimated as Rs. 20,000,000. Mr. Rathnakumara managed to sell the land for Rs. 31,000,000 in 2018 December.
- c) Mr. Rathnakumara is married and does not have any children. His wife passed away in May, 2018. Since his wife was the only child of her family a furnished house in Negombo which was under the name of his wife was transferred to the name of Mr. Rathnakumara. He sold the land to Mr. Chandrakumara in 2018 December for Rs. 20,000,000. The Net cost of the asset is estimated to be Rs. 12,000,000. The market value of this house in December, 2018 amounts to Rs. 21,000,000.
- d) Mr. Rathnakumara earned the following interest income for the 2018/19 Y/A:
- Interest from a fixed deposit at BOC (interest earned at maturity) – Rs 100,000 (net)
 - Interest from a fixed deposit in Sampath Bank – Rs. 50,000 (net)
- e) Mr. Rathnakumara received the following dividend income for the 2018/19 Y/A:
- Rs. 400,000 worth dividend received from Smart Plc which is a foreign company.
 - Rs. 86,000 worth dividend (net) received from Mihiliya plc
 - Rs. 200,000 worth dividend was received by Mr. Rathnakumara from Victoria plc. This dividend was distributed from the dividend received from Ramco plc.
- f) Mr. Rathnakumara owns the following properties and earns rental income
- A building in Nugegoda – rented to Sumathi Plc for a monthly gross rent of Rs. 30,000
 - A house in Pagoda – rented to a family for a monthly gross rent of Rs. 20,000

You are required to:

- i. Calculate capital gain and capital gain tax related to above (b) and (c).

(05 Marks)

- ii. Calculate the taxable income and income tax liability of Mr. Rathnakumara for the year of assessment 2018/19.

(10 Marks)

(Total 15 marks)

3. Mr. Weeratunga, Mr. Kulatunga and Mr. Samaratunga are partners of Wikum Groceries. They are performing a partnership with a 2:1:2 profit sharing ratio. As they agreed, Mr. Weeratunga and Mr. Kulatunga received Rs. 25,000 and Rs. 30,000 monthly salaries respectively. Mr. Samaratunga has arranged his son to work as the Financial Manager of the firm on behalf of Mr. Samaratunga and he receives Rs. 30,000 monthly salary. The brought forward capital balances of the partners as at 01.04.2018 are as follows:

Mr. Weeratunga	Rs. 120,000
Mr. Kulatunga	Rs. 100,000
Mr. Samaratunga	Rs. 120,000

All the partners receive 10% interest on their amount of capital at the beginning of the year.

The Income Statement for the year ended on 31.03.2019 is as follows:

Gross profit for the year		2,000,000
Interest income (net)		40,000
Interest on drawings		10,000
Rental Income		110,000
		2,160,000
Less: expenses		
Interest on capital	34,000	
Commission Expenses	15,000	
Salaries for workers	307,000	
Legal expenses	5,000	

Salary (Mr. Samaratunga's son)	360,000	
Interest on loan – Mr. Weeratunga	30,000	
Interest on bank OD	30,000	
Transportation Expenses of goods	122,000	
Royalty payment	20,000	
Salaries for partners	660,000	
Furnishing expenses	10,000	
Income tax	60,000	1,653,000
Net profit		507,000

Additional information:

1. Legal expenses are related to a trade debt recovery.
2. Salaries for March, 2019 of Mr. Weeratunga and Mr. Kulatunga have not been paid yet.
3. Partnership has rented out their one story of its two-storied building for business purpose for a monthly gross rent of Rs. 10,000. However the last month's rental has not been received yet.
4. Income tax paid Rs. 60,000 out of partnership profits reflects income tax paid on behalf of Mr. Kulatunga.

You are required to:

- iii. **Compute divisible profit/loss of the partnership.**

(12 Marks)

- iv. **Prepare a statement to allocate the above profit/loss among partners.**

(08 Marks)

(Total 20 marks)

4. i) Mr. Premathilaka, an Architect (who is a registered person) goes to Australia in order to draw a building plan to an Australian firm and to attend to other matters connected with that service. Is this service liable to VAT? Provide reasons for your answer.

(02 Marks)

- ii) A registered person purchased a van for his transport business. He used its 60% of the time for the taxable activity and 40% of the time for private use. Cost of the van is Rs. 1

million and VAT paid is Rs. 150,000 (i.e., at 15%). During the same taxable period he spent Rs. 115,000 on insurance which includes VAT. Compute the input credit available to him?

(03 Marks)

iii) X Limited, a VAT registered person, had the following supplies in a taxable period.

- Liable supply - Rs. 10,200,000
- Exports - Rs. 1,800,000
- Exempt supply - Rs. 3,000,000

In respect of purchase of goods and services, Rs. 750,000 was paid as VAT to other registered persons. Calculate the output tax and the input tax that could be claimed against VAT output tax for the taxable period.

(04 Marks)

iv) Y Limited is a VAT registered person engaged in a taxable activity. The Company purchased a land in 2015 for Rs. 10 million and constructed a building on the land for Rs. 15 million. The Company sold this land and building in the 3rd quarter of 2018 for Rs. 30 million. The market value of the land at the time of sale was Rs. 13 million. Calculate the value of land and improvement and the VAT liability at the rate of 15%.

(03 Marks)

v) a) What is the time of supply under the VAT Act in the case of taxable goods are supplied by a registered person?

(02 Marks)

b) Mention the persons liable for Nation Building Tax?

(01 Mark)

(Total 15 marks)

5. i. Describe the hierarchy of decision making bodies in examining a tax appeal.

(04 Marks)

ii. State the methods of recovery of default tax.

(04 Marks)

iii. Briefly explain how refundable tax amounts could be treated.

(02 Marks)

(Total 10 marks)

එකවර ගෙවීම් (ප්‍රසාද දීමනා ගනාදීම) / தொகைக் கொடுப்பனவுகள் (மிகை ஊதியம் போன்றவை) / Lump Sum Payments (Bonus etc.) = 0.50 සාමාන්‍ය මාසික ආදායම (සාමාන්‍ය) / සාමාන්‍ය මාසික ආදායම (සාමාන්‍ය) / Average Monthly Profits (Income) From employment					
දළ මාසික ආදායම් මුදල (සාමාන්‍ය) / Gross Monthly Income (Average) / රු./මුදා./රු.	එකවර ගෙවීමේ වටය / Rate Applicable to Lump Sum Payments / %	දළ මාසික ආදායම් මුදල (සාමාන්‍ය) / Gross Monthly Income (Average) / රු./මුදා./රු.	එකවර ගෙවීමේ වටය / Rate Applicable to Lump Sum Payments / %	දළ මාසික ආදායම් මුදල (සාමාන්‍ය) / Gross Monthly Income (Average) / රු./මුදා./රු.	එකවර ගෙවීමේ වටය / Rate Applicable to Lump Sum Payments / %
96,000	0.00				
96,001 - 96,236	0.25	195,910 - 196,410	10.25	299,986 - 336,826	20.25
96,237 - 96,478	0.50	196,411 - 196,913	10.50	336,827 - 337,672	20.50
96,479 - 96,721	0.75	196,914 - 197,420	10.75	337,673 - 338,523	20.75
96,722 - 96,965	1.00	197,421 - 197,928	11.00	338,524 - 339,377	21.00
96,966 - 97,211	1.25	197,929 - 198,440	11.25	339,378 - 340,236	21.25
97,212 - 97,457	1.50	198,441 - 198,954	11.50	340,237 - 341,100	21.50
97,458 - 97,705	1.75	198,955 - 199,471	11.75	341,101 - 341,968	21.75
97,706 - 97,955	2.00	199,472 - 199,990	12.00	341,969 - 342,840	22.00
97,956 - 98,205	2.25	199,991 - 240,590	12.25	342,841 - 343,717	22.25
98,206 - 98,457	2.50	240,591 - 241,194	12.50	343,718 - 344,598	22.50
98,458 - 98,710	2.75	241,195 - 241,802	12.75	344,599 - 345,484	22.75
98,711 - 98,964	3.00	241,803 - 242,413	13.00	345,485 - 346,374	23.00
98,965 - 99,220	3.25	242,414 - 243,026	13.25	346,375 - 347,269	23.25
99,221 - 99,477	3.50	243,027 - 243,643	13.50	347,270 - 348,169	23.50
99,478 - 99,736	3.75	243,644 - 244,263	13.75	348,170 - 349,073	23.75
99,737 - 99,995	4.00	244,264 - 244,886	14.00	349,073 -	
99,996 - 144,354	4.25	244,887 - 245,512	14.25		
144,355 - 144,717	4.50	245,513 - 246,142	14.50		
144,718 - 145,081	4.75	246,143 - 246,774	14.75		
145,082 - 145,448	5.00	246,775 - 247,410	15.00		
145,449 - 145,816	5.25	247,411 - 248,050	15.25		
145,817 - 146,186	5.50	248,051 - 248,692	15.50		
146,187 - 146,558	5.75	248,693 - 249,338	15.75		
146,559 - 146,932	6.00	249,339 - 249,987	16.00		
146,933 - 147,308	6.25	249,988 - 288,708	16.25		
147,309 - 147,685	6.50	288,709 - 289,433	16.50		
147,686 - 148,065	6.75	289,434 - 290,162	16.75		
148,066 - 148,446	7.00	290,163 - 290,895	17.00		
148,447 - 148,830	7.25	290,896 - 291,631	17.25		
148,831 - 149,216	7.50	291,632 - 292,371	17.50		
149,217 - 149,603	7.75	292,372 - 293,115	17.75		
149,604 - 149,993	8.00	293,116 - 293,863	18.00		
149,994 - 192,472	8.25	293,864 - 294,615	18.25		
192,473 - 192,956	8.50	294,616 - 295,370	18.50		
192,957 - 193,442	8.75	295,371 - 296,129	18.75		
193,443 - 193,930	9.00	296,130 - 296,892	19.00		
193,931 - 194,421	9.25	296,893 - 297,660	19.25		
194,422 - 194,914	9.50	297,661 - 298,431	19.50		
194,915 - 195,410	9.75	298,432 - 299,206	19.75		
195,411 - 195,909	10.00	299,207 - 299,985	20.00		