

UNIVERSITY OF COLOMBO, SRI LANKA
FACULTY OF MANAGEMENT AND FINANCE

Bachelor of Business Administration

Level II – Semester VI Examination, December - 2017

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 Lakmal owns a textile business and he is also employed as a Senior Internal Controls Officer in Thajima Garments Plc. The employment benefits derived from Thajima Garments Plc for the year of assessment 2016/17 are listed below:
 - a) Monthly salary of Mr. Lakmal amount to Rs. 250,000 which includes 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. 55,000 per month as the traveling allowance.
 - b) Mr. Lakmal has been provided a company vehicle with fuel and a driver. Engine capacity of the vehicle is 1499 cc.
 - c) Mr. Lakmal received a bonus of Rs. 150,000 in December, 2016.
 - d) Telephone bills of Rs. 75,000 have been reimbursed by the company.
 - e) Mr. Lakmal resides in a fully furnished house provided rent free by his employer. The rating assessment of the house is Rs. 100,000 and municipal rates are payable at 30% of the rating assessment. The monthly rent paid by the employer is Rs. 15,000.
 - f) The company has a group insurance scheme. During the year of assessment 2016/17, Mr. Lakmal was paid by the employer Rs. 200,000 in order to settle the hospital bill of his wife who was admitted to a private hospital.

- g) Mr. Lakmal's life insurance premium and medical insurance premiums amounting to Rs. 50,000 were reimbursed by the employer.
- h) Mr. Lakmal has invested in the share market and earned a net dividend income of Rs. 500,000 during the year of assessment.
- i) Mr. Lakmal possesses fixed deposits in Sampath Bank and earned a net interest income of Rs. 100,000 during the year of assessment.
- j) Mr. Lakmal has donated Rs. 30,000 to an approved charity which provides institutional care for the sick and needy people.
- k) Mr. Lakmal commenced a textile business in October, 2013. He is engaged in designing, manufacturing and selling clothes. Income Statement of the business prepared for the year ended 31.03.2017 is as follows:

	Rs.		Rs.
Management fees	74,000	Gross profit	10,589,000
Wages	236,000	Tailoring charges	406,000
Gratuity payment	192,000	Charges on material	145,000
Electricity	60,000		
Postage	16,300		
Depreciation	233,000		
Travelling	72,000		
Bad debt and provisions	12,000		
Legal expenses	33,000		
Foreign travel expenses	156,000		
Telephone	44,500		
Advertisement	14,000		
Penalty on NBT	2,600		
Rent of the shop	86,000		
Salaries	1,240,000		
Loss on office theft done by an employee	3,500		
Accountancy fee	7,200		

Maintenance expenses	48,000		
Net profit	8,609,900		
	11,140,000		11,140,000

Notes:

i) Provision for gratuity account could be illustrated as below

Provision for Gratuity

Cash	100,000	B/B/F	200,000
		I/S	192,000
B/C/F	292,000		
	392,000		392,000

- ii) The management fees illustrates the accrued management expenses. The yearly turnover of the business is Rs. 15,000,000 and management fees approved by the Commissioner General of Inland Revenue is Rs. 80,000.
- iii) Out of the 33,000 legal expenses, Rs. 10,000 was allocated for the legal fees paid to recover trade debts. The rest of the legal charges was for a law case against Mr. Warnakulasuriya who used to be a partner in the business 3 years ago.
- iv) Traveling expenses include expenses of operating a motor coach of Rs. 12,000 and traveling expenses incurred by executive officers to promote finished garments locally of Rs. 60,000.
- v) The trade debts set off for the year of assessment amount to Rs. 6,000. Bad debt recovered during the year of assessment amount to Rs. 2,000. The bad debt provision illustrated a special provision for Mr. Samarasekara which is unlikely to be recovered.
- vi) The expenses included under the item "Foreign travel expenses" illustrate the air fare and other expenses incurred to meet a foreign customer in India in order to negotiate exports. The trip was successful and this business deal would generate additional revenue of Indian Rupees 2,000,000 next year. The exchange rate is 1 Indian Rupee = 2.5 Sri Lankan Rupee.
- vii) The advertisement expenditure consists of Rs. 10,000 incurred on neon sign board and Rs. 4,000 incurred on the preparation of advertising booklet for the export promotion in India.

viii) The information related to the fixed assets are given below:

Cost (Rs.)

Asset	Balance as at 01.04.2016	Additions	Disposals	Balance as at 31.03.2017
Building	1,000,000	-	-	1,000,000
Computers	900,000	84,000	-	984,000
Sewing machines	6,000,000	22,000	-	6,022,000
Cutting machines	4,000,000	50,000	25,000	4,025,000
Total	10,900,000	156,000	25,000	12,031,000

Cutting machine worth of Rs. 25,000 used by the company from the inception of the business has been sold for Rs. 35,000 in August 2016. The total capital allowance on this machines has already been claimed. Similar machine was purchased in February 2017 for Rs. 50,000. Computers worth Rs. 84,000 and sewing machines worth Rs. 22,000 have been bought during the year of assessment 2016/17.

Calculate the taxable income and tax liability of Mr. Lakmal for the year of assessment 2016/17.

(30 Marks)

2. Esteem Manufacturers is a partnership operating a business of plastic manufacturing for local market. Ananda and Nalanda are the partners who share profits and losses equally. The Income Statement for the year ending on 31.03.2017 is as follows:

	Rs.	Rs.
Turnover		74,700,000
Less: Cost of sales		62,700,000
Gross profit		12,000,000
Add: Other income		
Interest on fixed deposit (net)		360,000
Rent income		900,000
		13,260,000
Administration Expenses		
Salaries paid to partners		
Ananda - 900,000		

Nalanda - 600,000	1,500,000	
Salaries to other staff	5,600,000	
Expenses on training	450,000	
Depreciation - building	600,000	
Other Expenses	<u>672,000</u>	<u>(8,822,000)</u>
Selling and Distribution Expenses		
Bad debts written off	330,000	
Entertainment	290,000	
Delivery charges	<u>616,000</u>	<u>(1,236,000)</u>
Financial Cost		
Interest paid to a partner on a loan taken	140,000	
Overdraft Interest	684,000	
Interest on capital		
Ananda - 200,000		
Nalanda - 100,000	<u>300,000</u>	<u>(1,124,000)</u>
Net profit		<u>2,078,000</u>

Notes:

- a) A new building was purchased for Rs. 5,000,000 during this year of assessment from another partnership in order to re-establish the factory. The depreciation has already charged in respect of this building.
- b) Motor lorry which was under leased assets had a lease value of Rs. 3,900,000 and was sold on 07.11.2016 for Rs. 4,500,000 after claiming all lease rentals from the profits of previous years of assessment and paying Rs. 1,000 to the leasing company as the nominal value of the asset.
- c) Bad debt written off was related to a loan given for an employee.
- d) Marketing executive was sent abroad for training and his expenses were included under expenses on training (this includes air passage expenses of Rs. 62,000). Profits and income from the business for the previous year of assessment was Rs. 2,680,000.

- e) During this year of assessment, repairs have been made to the building given on rent, and its cost amounting to Rs. 200,000 is included in the other expenses.
- f) Economic Service Charge paid on behalf of the partnership is Rs. 50,000 for the year of assessment 2016/17.
- g) All other expenses are allowable for the purpose of taxation.

You are required to:

- i. Compute divisible profit/loss of Esteem Manufactures.

(12 Marks)

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

(08 Marks)

(Total 20 marks)

3. Mr. Thilakasiri owns five properties in Colombo and details of each of these properties are as follows:

House 1 - This house was constructed by Mr. Thilakasiri in 2001 and given on rent to a foreign official of a multinational company at a monthly rent of Rs. 40,000. This house is fully furnished and monthly charge for furniture of Rs. 10,000 is included in rent. The following expenses are incurred during this year in respect of this property.

House repair expenses of Rs. 30,000

Furniture maintenance expenditure of Rs. 10,000

Rates paid for the year of Rs. 18,000

Rating assessment of Rs. 60,000

Care taker's salary of Rs. 30,000

Expenditure on fixing an air conditioner of Rs. 60,000

House 2 - Mr. Thilakasiri has rented out a house since January 2010 for Rs. 5,000 per month. The owner of the property is Mr. Zahirul. With the permission of Mr. Zahirul, Mr. Thilakasiri has done some renovation amounting to Rs. 40,000. Then, it was let to an executive of a firm for Rs. 7,500 per month. The owner of the house is not an income tax payer. Owner does not bear repairs but he pays rates of Rs. 10,000 which is the rating assessment, at 20%.

House 3 - This house was constructed in May 2004 and the floor area is 1,200 sq.ft. and it has been given on rent to a company to use as its office. Monthly rent is Rs. 30,000. The non-

refundable key money has been collected in June 2014 which was Rs. 500,000. The rating assessment of this house is Rs. 40,000. Rates are payable at 10%.

House 4 – Mr. Thilakasiri was living in a property which belongs to his wife who died in 2005. Rating assessment was Rs. 60,000 and rates paid at 30%. He has entered in to a rent agreement to let this house from 01.04.2016 at Rs. 30,000 per month and received an advance of Rs. 180,000 in February 2016.

Shopping Mall – A shopping mall is under construction in Narahenpita. Rs. 15 million has been spent so far and Mr. Thilakasiri expects to complete it by January 2018. He has collected non-refundable key money from prospective tenants as follows:

January 2016 - Rs.5.0 Million

December 2016 - Rs. 2.0 Million

Calculate Mr. Thilakasiri's income from the above properties for the year of assessment 2016/17.

(20 Marks)

4. Ms. Kimron & Co. Ltd is engaged in whole sale and retail business and at the same time, it is engaged in manufacturing jewelry and providing apartments for rent. Further, it exports non-traditional and traditional commodities. The company has commenced its business on 01.01.2012. The company turnover and profits for the year ended 31.03.2017 are as follows:

- Income from export of commodities Rs. 16,000,000
- Detail breakdown of Income from export of commodities is given in the table below:

Export Commodity	Rs.
Export of fresh coconut	4,000,000
Export of crepe rubber	8,000,000
Export of dried coconut pieces	1,000,000
Export of coconut milk powder	1,000,000
Export of lemon flavored tea drink	2,000,000
Total Income	16,000,000

- Income from export of handmade Jewelry Rs. 200,000,000
- Income from wholesale and retail business in the local market Rs. 80,000,000
- Sales proceeds from a discarded plant Rs. 5,000,000

- Rental Income Rs. 1,000,000
- Dividend income (net) Rs. 90,000
- Adjusted Business profits 75,000,000 (including Rs. 500,000 profits of discarded plant and Rs. 9,000,000 profits from exporting jewelry)

Calculate the tax liability of Ms. Kimron & Co. Ltd for the year ended 31.03.2017.

(15 Marks)

5. i. ABC (Private) Limited, is a VAT registered person, and has liable supplies as well as exempt supplies for the quarter ended 30th September 2017 as follows:

Liable supply	- Rs. 80,500,000
Exports	- Rs. 12,000,000
Exempt supply	- Rs. 34,250,000

In respect of purchase of goods and services, Rs. 5,226,000 was paid as VAT to other persons. Out of this input tax Rs. 152,000 is not allowable as per the provisions of the VAT Act. You are required to calculate the output tax and the input tax that could be claimed against VAT output tax for the quarter ended 30th September 2017.

(06 Marks)

ii. a. A person who carries on a business of manufacturing has not obtained a VAT registration. What is the threshold for registering for VAT if he has made supplies in the year 2017?

(02 Marks)

b. What is the time of supply under the VAT Act in the case of a service is performed?

(03 Marks)

c. XYZ (Private) Limited is a VAT registered person engaged in the manufacturing of garments. The Company purchased a land in 2012 for Rs. 1,000,000 and constructed a building on the land for Rs. 500,000. The Company sold this land and building in September 2017 for Rs. 5,000,000. The market value of the land and building at the time of sale was Rs. 3 million and Rs. 2 million, respectively. Calculate the value of land and improvement and the VAT liability.

(04 Marks)

(Total 15 marks)