

10. The Ascertainment of Taxable Income

10.1 Taxable Income

The taxable Income of a person is his assessable income after deducting qualifying payments and specified tax free allowance.

(a) Tax free allowance

The following are the tax free allowances:

An individual citizen of Sri Lanka whether	
Resident or non-resident	Rs. 500,000
Non resident individual who is	
not a citizen of Sri Lanka	Nil
Companies	Nil
Charitable institution	500,000
Clubs, trade associations	Nil
Trustee, executor or liquidator	Nil

(b) Deduction of qualifying payments

Qualifying payments are deductible from the assessable income in arriving at the taxable income.

An individual shall not be entitled to deduct any part of any allowance in respect of qualifying payment against employment income included in his assessable income. *Sec 33(A11)*

Qualifying payments and the limits that are claimable are listed in Appendix III

Where the total statutory income of any child for any year of assessment is aggregated with that of his parent, any qualifying payment made by that child in that year of assessment shall be deemed to be a qualifying payment made by such parent. *Sec 34(3)*

Deductions in arriving at the taxable income are made in the following order -

- (1) tax free allowance
- (2) qualifying payments not eligible to be carried forward
- (3) other qualifying payments

Formats are given below for calculating the amount of the claim to be made by individuals and by companies. The alphabetical codes of paras in the formats refer to the sub-sections of Section 34(2).

10.2 Tax Payable

The tax payable is calculated by applying the appropriate rate on the taxable income.

10.3 Deductions from Tax Payable.

The deductions that have to be made from the tax payable to arrive at the balance tax payable *include*:

- (i) WHT deducted and notional credit on sources of income included in the assessable income.

A notional credit, in respect of any interest from secondary market transactions in dealing with any security, Treasury Bill, Treasury Bond or any Central Bank Security, deposit in a bank or financial institution from which tax at 10% has been deducted, can be claimed against income tax payable. Any excess not thus set off can be carried forward to be set off against future income tax but no refund is made of the excess. When claiming a certificate from auditors should be attached.

- (ii) Self assessment payments made, PAYE deducted

- (iii) ESC deductible.

ESC payments made for any year of assessment can be used to set off against the income tax payable for relevant year of assessment and for **four** subsequent years of assessment.

- (iv) Other credits such as relief due on double taxation etc

- (v) Unabsorbed VAT input credit remaining at 31.12.2010

In the case of a VAT registered person who has no taxable supplies after this date and such person is liable to pay income tax, the unabsorbed amount may be set off against the tax payable after 01.01.2011. The set off shall not exceed 10% of the unabsorbed input credit at 31.12.2011 or 5% of the relevant tax imposed for that particular month whichever is less until fully absorbed. (Budget 2012- the 5% restriction is removed) .

Qualifying payments –Budget 2012

Expenditure incurred by any person under any community development project carried out in most difficult villages as identified and published in the Gazette by the CGIR, will be a qualifying payment deductible subject to a upper limit of Rupees one million in the case on an individual and Rupees ten million in the case of a company .(Budget 2012)

10.4 QUALIFYING PAYMENTS - INDIVIDUALS

	Rs.	Rs.	Rs.
Description	total	claim	c/f
(a) <i>Donation made to Approved Charities-institutionalized care for the sick and needy</i>			
(g) Life Insurance premia paid in Sri Lanka on a life insurance policy (not being a pure endowment policy) - premia payable over a period not less than 3 yrs (gg excluded Aggregate of a & g Maximum lower of Rs. 75,000 or 1/3 of A.I . - no c /f			Nil
(b) <i>Donations to Government etc. Sec 34</i>			
Balance b/f (if any)			
Donations made during the year			
Total of (b) - balance not set-off can be c/f indefinitely			
(c) <i>Investment made in a Project of Government's Development Plan</i>			
Balance b/f (if any)			
Investment made during the year			
Rs.25,000 or (c) whichever is less - no time limit for c/f			
(gg) <i>Premia on special health insurance covering incurable disease</i>			
Fully claimable - no c /f			Nil
(h) <i>Investment in Producing Films</i>			
Balance b/f of films produced after 01.04.2007, (if any)			
Expenditure in producing a new film costing not less than Rs5mil during the year			
Maximum Rs.35mn per film produced – balance can be c/f			
(k) <i>50% of cost of Investment in Shares of Venture Capital Companies</i>			
Maximum 1/3 of A.I. – no c/f			Nil
(x) <i>Un-deducted balance of investment in the purchase of shares, prior to 01.04.2000 in a BOI company- 1/3 rd A.I -there is c/f</i>			
(n) <i>Expenditure in construction and equipping new cinema</i>			
Limited to Rs. 10m. c/f indefinitely			
(o) <i>Expenditure in upgrading existing cinema</i>			
Limited to Rs. 10m. c/f indefinitely			
(q) <i>Expenditure incurred in constructing houses for low income families – fully claimable.- can be c/f indefinitely</i>			

The alphabetical codes of paragraphs refer to the sub-sections of Section 34(2)..

10.5 QUALIFYING PAYMENTS – COMPANIES

Description	Rs. Total	Rs. Claim	Rs. c/f
(a) <i>Donation made to Approved Charities (established for the provision of institutionalized care for the sick or needy)</i> Rs.500,000 or a or 1/5 of A.I. whichever is less - no c /f			Nil
(b) <i>Donations to Government etc.</i> Balance b/f (if any) Donations made during the year Fully claimable. There is c/f indefinitely			
(c) <i>Investment in a Project of Government's Development Plan</i> Balance b/f (if any) Investment made during the year Up to lesser of 1/5 th A.I. or Rs25,000 - c/f indefinitely			
(gg) <i>Premia on special health insurance covering incurable disease</i> Fully claimable - no c /f			Nil
(h) <i>Investment in Producing Films</i> Balance b/f of films produced after 01.04.2005, (if any) Investment in producing a new film, during the year Limited to Rs. 35mn - c/f indefinitely			
(k) <i>50% of Investment in Shares of Companies enjoying tax holidays</i> - Amount Invested during the year Total up to 1/5 of A.I. - no c/f			Nil
(x) <i>Un-deducted balance of investment in the purchase of shares, prior to 01.04.2000, in a BOI company - up to 1/5th A.I.</i> - there is c/f			
(n) <i>Expenditure in construction and equipping new cinema</i> Limited to Rs. 25m. c/f indefinitely			
(o) <i>Expenditure in upgrading existing cinema</i> Limited to Rs. 10m. c/f indefinitely			
(q) <i>Sum invested in an undertaking for the construction and sale of houses for low income families</i> can be claimed fully - c/f indefinitely.			
(l) <i>Investment in a new undertaking located in any area outside the administrative districts of Colombo and Gampaha.</i> cLimited to Rs.100mn. c/f indefinitely.			
(m) <i>Expenditure in relocating undertaking in the administrative districts of Colombo and Gampaha.(section 21(2)) expenditure not less than Rs.100m.)</i> - fully claimable -c/f			
(p) <i>Expenditure in relocating undertaking under Section 21(2)(A)(A08) outside the administrative districts of Colombo and Gampaha -expenditure not less than Rs.100m)</i> up to 1/5 A.I. no c/f			

The following donations made on or after 1st April 2011 **do not qualify** as qualifying payments

- (i) the Industrial Technology Institute
- (ii) the Sri Lanka Foundation Institute
- (iii) the Tower Hall Theatre Foundation
- (iv) the Sri Lanka Inventors Commission,
- (v) the S W R D Bandaranaike National Memorial Foundation,
- (vi) the Institute of Fundamental Studies, Sri Lanka,
- (vii) the International Winged Bean (Dambala) Institute,
- (viii) the Sri Lanka Institute of Printing,
- (ix) the Arthur C. Clarke Institute for Modern Technologies
- (x) the Institute of Policy Studies of Sri Lanka;
- (xi) the J R Jayawardena Centre,
- (xii) the Institution of Engineers, Sri Lanka,

Illustration

Year of assessment 2011/12

The assessable income for y/a 2011/12 of Mr.Perera is	Rs.1,100,000
(1) Contributed to approved provident fund	50,000
(2) Donation to City Development Fund established by C.M/C.	10,000
(3) Donated to Tower Hall Theatre Foundation	12,000
(4) Donated to S.L. Cancer Society	25,000
(5) Donation to Government	200,000
(6) Donation to Govt b/f	700,000
(7) Donation paid in cash to approved charity established for Institutionalized care of the sick & needy	100,000
(8) Premia paid on a whole life insurance policy, premia payable annually for seven years in Sri Lanka	45,000
(9) Premia paid in Sri Lanka on a medical policy covering incurable disease	150,000

Answer

Items (1) , (3), (4) are not qualifying payments:

Assessable Income	1,100,000	
Less: Qualifying payments		
Contribution to approved Charity established for institutionalised care of the sick & needy	100,000	(conditions satisfied)
Premia pd on whole life	<u>45,000</u>	(conditions
satisfied)		
	145,000	

Limited to lower of	1/3 rd 1,100,000		
	or Rs.75,000	75,000	
Donation to fund of local authority			
City Dev Fund –C.M.C	10,000	10,000	(allowable in full)
Premia on medical policy(incurable disease)		150,000	(conditions satisfied (allowable in full)
Donation to govt.			
b/f	700,000		
this year	<u>200,000</u>		
	900,000		
Claimed	<u>720,000</u>	720,000	
c/f	180,000	-----	<u>1,100,000</u>
Taxable income			<u>nil</u> =====
The order of set off is :	no c/f		
	then c/f only for a limited period, order of years		
	then c/f indefinitely		

10.6 Taxation of Resident Individuals

(1) Tax Payable

Tax payable is calculated on the taxable income as follows:

- (i) Individuals by applying the tax slabs on the taxable Income: -

Year of assessment **2011/12** -**First Schedule**

On the first Rs.500,000 of taxable income at	4%
On the next 500,000	8%
On the next 500,000	12%
On the next 500,000	16%
On the next 1,000,000	20%
On the balance	24%

- (ii) Special rate of tax applicable to certain undertakings carried on by an **individual** are, inter-alia,-

- a. in respect of the following, the tax rate is as per First Schedule (given above) subject to **a maximum rate of 10 %**

- Profits and income from an undertaking for the manufacture of any product for export, or deemed export, the product having domestic value addition greater than 65% and S.L brand name patent rights reserved in S.L. Sec 59A
- any undertaking engaged in the manufacture of any article or in the provision of any service, with T.O for y/a not exceeding Rs.300 mil, other than buying & selling activities Sec 59B

- any undertaking carried on in Sri Lanka for operation and maintenance of facilities for storage, development of software, or supply of labour *Sch V 31*

- Profits and income from educational services *Sch V 32*

- b. on such part of **taxable income** attributable to the manufacture and sale or import and sale of any liquor or tobacco product **40%** *Sch V 29*

Further reference regarding rates etc. may be made to-

Tax holidays and Concessions – Chapter 16

Rates of Taxes in Appendix and Schedule V of the Act.

(2) Deductions against Income Tax Payable - Individuals

(a) Dividends and interest received by an *individual* on which final tax has been deducted

- (i) Dividends and interest received on which final tax has been deducted will not be included in the assessable income. No credit against tax payable is available for the WHT deducted.
- (ii) Interest received on secondary market operation will not be included in the assessable income. Credit should **not** be taken for the notional interest against the tax payable.

(b) Foreign dividends and interest received

Where foreign dividends are received and included in the assessable income, such dividends are liable to tax at 10% on the gross amount and subject to a credit for the tax deducted abroad up to an amount of tax payable on the dividends if there is a double taxation treaty with that country and on the net amount received if there is no treaty and no set off of tax deducted abroad..

Self Test

Dr. Subashini an employee in a private hospital asks clarification on the following matters pertaining to year of assessment 2011/12. Her monthly salary is Rs75,000. She is provided with a car of 1500cc for her private use. She contributed to EPF Rs.60,000.

1. Her employer sent her to represent the medical profession in Japan spending Rs.850,000.
2. She paid the following.

Interest on credit card	12,000
Interest on car loan	120,000
Interest on private loan	12,000
Repayment during the year in respect of 2 nd house	
Capital	70,000
Interest	24,000
3. Her donations for the year amounted to donation to approved charities (normal)

Bed mattress for patients	Rs.100,000
Cash	17,500
4. She has given her 2nd house on rent for residential purpose for Rs.25,000 per month which was constructed by her during 2006/2007. The floor area is 1450 sq ft. She paid annual rates Rs.5,000 and repairs amounted to Rs.4,000.
5. Hospital paid her bonuses of Rs.100,00 in May 2011 and of Rs.140,000 in May 2012 based each on the profits of the previous year results of the hospital. PAYE deducted for the whole year is Rs.44,000.
6. Hospital provided her with a free residence in Colombo 4 for which the hospital pays a rent of Rs.30,000 a month. They gave her a servant whose wages paid by the company was Rs.15,000 per month. The owner maintains the house. The rating assessment is Rs.200,000 and rates are 30%.
7. She has rented her 1st house constructed in 2002/2003 for Rs.15,000 per month and the tenant bears the rates and repairs.

State how you will deal with the above in the preparation of her tax computation for the year of assessment 2011/12.

Answer to Self Test

1. The expenditure incurred by her employer in sending her to represent the medical profession in Japan is not profit from employment.

The benefit arising from the use of one vehicle provided by the employer is exempt.
2. The following payments will not be allowed as a deduction

Interest on credit card	12,000
Interest on car loan	120,000
Interest on private loan	12,000

 Interest of Rs. 24,000 paid on a housing loan is allowable as a deduction in arriving at her A.I.

Any repayment of the loan is in respect any house constructed **does not qualify** as a qualifying payment from 01.01.2011.

3. Contributions to EPF and to approved charities (normal) are not qualifying payments
4. Her 2nd was *constructed* on or after 01.04.2005 and prior to 01.04.2008 and the floor area does not exceed 1,500 sq ft. The rental income is exempted for the year of assessment of completion of construction and for next 6 years. Therefore the rent that she received is exempt from tax.
5. Bonus is assessed in the hands of the recipient in the year of assessment in which it is received. The bonus paid in May 2011 will be assessable in y/a 2011/12
6. The profits arising out of the house provided rent free is Rs.120,000 since her employment income is less than Rs.150,000 p.m.
The servant's wage of Rs.180,000 paid by the hospital is profits from employment.
- 7 Since the occupier is bearing the rates and repairs, the gross amount received of Rs.180,000 will be income from rent. There is no deduction due.

Her computation assuming she has no other income is

Salary	900,000
Servant's wage	180,000
Bonus paid in 2011/2012	100,000
Residence provided rent free	120,000
Vehicle provided	---

Statutory Income - employment	1,300,000
- rent	180,000

Total Statutory Income	1,480,000
Less Interest – housing loan	<u>24,000</u>
Assessable income	1,456,000
Less Tax free allowance 500,000	
Qualifying payment -	<u>500,000</u>
Taxable Income	<u>, 956,000</u>

Tax Payable:

On 500,000 @ 4%	20,000	
456,000 @ 8%	<u>36,480</u>	56,480
Less: PAYE deducted		<u>44,000</u>
Balance Payable		<u>12,480</u>

Example

Mr. Alice, a lawyer and an entrepreneur residing in Panadura had the following income from undertakings separately maintained and accounted as separate units in respect of the year ended 31st March 2012:

	Annual T.O.	Profit
1. Profits from his undertaking for providing legal services	6mn	Rs.1,000,000
2. Profits from a departmental store In Panadura	200mn	Rs. 6,000,000
3. Profits from manufacture and sale of candles	350mn	10,000,000
4. Profits from the manufacture and Exports of products of domestic value addition > 65% with SL brand name patented in SL	650mn	20,000,000
5. Profits from manufacture and sale of articles	120mn	<u>3,000,000</u>
		<u>40,000,000</u>

Calculate the taxes payable by him for the year of assessment 2011/12

Answer

The following will be taxed at the maximum rate of 10%

			Section
1. Profits from his undertaking for providing legal services	6mn	Rs.1,000,000	59B
4. Profits from the manufacture and Exports of products of domestic value addition > 65% with SL brand name patented in SL	650mn	20,000,000	59A
5. Profits from manufacture and sale of articles*	120mn	<u>3,000,000</u>	59B
		<u>24,000,000</u>	

The following do not qualify to be assessed at a maximum rate of 10% under Section 59A or 59B

2. Profits from a <u>departmental store</u> ** In Panadura	200mn	Rs. 6,000,000
3. Profits from manufacture and sale of candles	<u>350mn</u> * *	<u>10,000,000</u>
		<u>16,000,000</u>

**** Items that fail to qualify** under section 59A & 59B for a maximum rate of 10%

The tax payable by him will be calculated as follows:

Total Statutory Income /Assessable Income			40,000,000
Less: Tax free allowance			500,000
Taxable Income			39,500,000
Tax Payable			
On first	500,000	@ 4%	20,000
next	500,000	8%	40,000
	500,000	12%	60,000
	500,000	16%	80,000
	1,000,000	20%	200,000
	12,500,000	24%	3,000,000
	15,500,000		3,400,000
	24,000,000	10%	2,400,000
	39,500,000		5,800,000