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Chapter 02
Imposition of Income Tax

Inland Revenue Act provides the legal authority to charge, levy, collect and recover the income tax on the profits and income of every person or partnership.

2.1 Basis for Chargeability of Income Tax

The scope of the income tax is spelled out in the Section 2 of the Inland Revenue Act No. 10 of 2006. Unless a person brought within the charge imposed by Section 2 cannot be taxed. Therefore, the profits and income of any person arises or derive for any year of assessment is chargeable with tax is the subject matter for Income Tax.

2.2 Measurement of Profits and Income

Profits or income means net profit or income from any source for any period calculated in accordance with the provisions of the Act. Therefore it is understood that the gross receipt is not the amount liable for tax. The net amount computed after giving the credit for certain expenses allowed under the provisions of the Act is the profit or the income measured for the tax purpose.

2.3 Receipts do not constitute as profit or income

Profits and income from different sources consider for the purpose of tax purpose. However, any receipts not fall within the definition of profits and income from any of the sources is outside the scope.

- Capital Receipts
  Any receipt which is a capital nature is not profit and income chargeable with tax.

- Gift
  Presently gift is not liable for tax in Sri Lanka.

- Donation
  Donation is not consider as profit and income is Sri Lanka. Therefore donation is not taxable.

- Profits of Casual and Non-Recurring Nature
  Any profits in the nature of casual and non-recurring nature are excluded from profits and income.
2.4 Incident of Income Tax

In respect of a person who is deemed to be resident in Sri Lanka is chargeable with income tax in respect of his income from Sri Lanka and income derived by him from outside Sri Lanka. The liability to income tax therefore extends to his global income. A person who is deemed to be non-resident in Sri Lanka is chargeable with income tax in respect of only on the profits and income, arising or derived from Sri Lanka.

Profits and income arising or derived from Sri Lanka is include all profits and income derived from services rendered in Sri Lanka or from property in Sri Lanka, or from business transacted in Sri Lanka, whether directly or through an agent.

The words “arising or deriving” is an important wards to understand since it gives the effect to charges the tax on the profits and income.

2.5 Place where the profits and income arising in or deriving from.

It is a question of fact that the profits and income is a result of particular transaction arise or derive from one place or another place.

If he has rendered a service or engaged in an activity such as the manufacturing of goods, that profits will have arisen or derived from the place where the service was rendered or the profits making activity carried. But the profit was earned by the exploitation of property assets by letting property, lending of money or dealing in commodities or securities by buying and reselling at a profit, the profits will have arisen in or derived from the place where the property was let, the money was lent or the contract of purchase and sale was effected.

Lord Bridge in Hang Seng bank Ltd (1 AC 306, 1991)

2.6 Types of Profits and Income

The types of profits and income arising in Sri Lanka chargeable for income tax includes;

- Service rendered in Sri Lanka
  Profits and Income arise at the place where the services are rendered and not the place where the contact of, or for services is concluded. The rendered implies that the place where the actually perform the services.
    - Eg: employment, professions, vacation, carried on in Sri Lanka

- Property in Sri Lanka
  Property defined to include any interest in any movable or immovable property.
    - Eg: rent from house, dividends, interest.
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- Business transacted in Sri Lanka whether directly or through and agent. Business is defined in the act to include, an agricultural undertaking, the racing of horses, the letting or leasing of any premises including any land by a company or forestry. The trade is defined to include, every trade and manufacture and every adventure and concern in the nature of trade.
  o Eg: agriculture, industrial or other business carried on in Sri Lanka.

2.7 Profits and income arising in or derived from Sri Lanka

With reference to the persons other than the person resident in Sri Lanka is liable to pay the tax on the profits and income arising in or derived from the sources in Sri Lanka.

The word arise means, to spring up, originate, to come into being or notice, to come operative…. (Black’s Law Dictionary, 6th Edition) Therefore profits and income must accrue for the benefit of a person to charge.

The word derive means, to receive from a specific source, proceeds from property….. (Black’s Law Dictionary, 6th Edition)

2.8 Person chargeable with income tax

A person chargeable with income tax is included a Company or a body of persons or any Government. Accordingly, the following persons are chargeable with income tax.

  a. An individual
  b. A Company
  c. A Trust
  d. A Charitable Institution
  e. A co-operative Society
  f. A Hindu undivided Family
  g. An Executor or Administrator
  h. An Association or Club or a Society
  i. Any Local or Public Authority
  j. Government