

# **BUSINESS TAXATION**

2015-16 Semester III

## **STUDY TEXT**

**EXECUTIVE DIPLOMA IN BUSINESS AND ACCOUNTING  
BUSINESS SCHOOL – CA Sri Lanka.**

The Institute of Chartered Accountants of Sri Lanka  
No. 30A, Malalasekera Mawatha, Colombo 07, Sri Lanka.

Prepared by

**Damith Gangodawilage**

Desha Shakthi, Lanka Puthra, Vishwa Abhimani.  
MBA (USQ) (Aus.), PGD (BFA), EDBA, ATII, HNDA  
FMAAT, ACPM, AIPFM (UK).

damithlk@gmail.com

+94 773 597884

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# **Business Taxation Syllabus.**

Executive Diploma in Business & Accounting (EDBA).

Academic Year 2015/16 – Semester III.

## **1. Principles of taxation.**

Economic and social function of taxation. | Difference between accounting profit and taxable profit. | Principles of taxation. | Difference between direct tax and indirect tax. | Different source of statutory provisions.

## **2. Profits and income chargeable with tax.**

Chargeability of income tax. | Sources of profits and income chargeable with income tax.

## **3. Taxation of unincorporated entities.**

Ascertainment of profits and income of an individual. | Aggregation of child's income. | Ascertainment of Statutory income of an individual. | Ascertainment of Assessable income of an individual. | Ascertainment of Taxable income of an individual. | Legal status of partnership. | Ascertainment of profits and income of Partnership. | Ascertainment of profits and income of clubs, charitable institutions and association.

## **4. Taxation of Companies.**

Definitions of corporate bodies. | Tax structure of a Company. | Resident and Non-resident Company. | Basic understanding of Thin Capitalization and Transfer Pricing. | Distribution Rules. | Director's responsibilities and liabilities. | Remittance tax. | Computation of Tax Liability of a Company.

## **5. Indirect taxes.**

### **5.1. Value Added Tax.**

The Scope. | Imposition of VAT. | Registration. | Calculation of VAT payable. | Introduction to SVAT & FVAT.

### **5.2. Nation Building Tax.**

The Scope. | Imposition of NBT. | Registration. | Calculation of NBT payable.

## **6. Tax planning.**

Introduction to tax planning. | Assessments on undisclosed income. | Deferred taxation. | ECS.

## **7. Statutory Compliances.**

Anti – Avoidance provisions. | Statutory provisions and judicial precedents| self-Assessment System. | PAYE Scheme. | Tax Incentives and concessions.

## **8. Introduction to International taxation.**

Causes for double Taxation. | Tax havens and Treaty Shopping. | Introduction to tax treaties (UN & OECD Model).

## **9. New Trends in Taxation.**

E-commerce. | Digital Taxation.

# Assessment.

Assessment of EDBA semester III consists of,

- **Self-assessment questions**

Some modules are included self-assessment questions for you to assess the level of knowledge of the subject area gathered in the classroom. **These questions are not form part of your final assessment.** If you attempt them diligently it will help you to achieve the desired result expected from this course.

- **Group Assignments**

This consist of two parts, case analysis report and presentation of the findings. Hardcopies of your assignments should be submitted to your course coordinator at the Business School and the softcopies to be submitted to damithk@gmail.com on or before the due date. Late submission will not be considered for marking.

- **Examination**

At the end of semester there will be a written exam. Question paper consists with three sections with maximum of five or six questions for 100 marks.

**Section A** consists with 10 MCQs and two marks allocated for each question. All questions of this question is compulsory to answer.

**Section B** consists with two or three questions to test the practical understanding of tax computation. This section questions will carry 60 marks.

**Section C** questions cover module 6 to 9. There are one or two questions in this sections and allocated 20 marks.

## Details of Assessment

| Assessment type      | Marks | Wtg % | Pass mark | Due date                   |
|----------------------|-------|-------|-----------|----------------------------|
| Case analysis report | 100   | 35    | 25%       | 10 <sup>th</sup> June 2016 |
| Presentation         | 100   | 15    |           | 18 <sup>th</sup> June 2016 |
| Examination          | 100   | 50    | 25%       | 09 <sup>th</sup> July 2016 |

## Group Assignment

| Type of the Assignment   | Marks | Length                          |
|--------------------------|-------|---------------------------------|
| Compliance Report        | 35%   | 2,500 words max.                |
| Presentation of findings | 15%   | 8-10 slides max. for 15 minutes |

Assume that your team is planning to start a business in Sri Lanka. Business can be carried out in different forms. It can be a corporate entity or unincorporated entity. Depending on the business entity, types of compliance and tax liability will be varied. Compare and contrast the compliance structure of different types of business entries exist in Sri Lanka and identify the ideal business type fit for your business with the proper reasoning.

### Your compliance report should cover the following areas.

1. Executive summary.
2. Table of contents.
3. Introduction (state why the report has been prepared and how the report is structured).
4. Overview of the Company (background of the business, Vision & Mission, organizational structure, Key business operations etc..).
5. Different business types exist in Sri Lanka.
6. Compliance dashboard of each business type.
7. Compare and contrast the compliance structure of different types of business.
8. Business type fit for your business and reason for selection.
9. Evaluate the compliances to be adhered by your business.
10. Conclusion.
11. List of references.
12. Appendices.

### General Information:

- The report should have a cover page to include a meaningful title, Name of your group, date, course name and Semester, Subject and the lecture, Word count etc.
- Evaluation Criteria should be included in the second page.
- Group members detail should be provided in the third page.
- Harvard referencing system should follow to cite your source. A full list of references in alphabetical order must be included.
- You may include any additional supporting information in the appendices. Information in the appendices should only be included if it is relevant and referred in the report.
- Report should be used Times New Roman 12 point font with double line spacing.

## Evaluation Criteria:

| Marking Criteria  |   | Maximum Marks  | Marks Obtained |  |
|---|---|--|----------------|--|
| <b>Compliance Report</b>  | <p><b>Understand the Firm and its operations.</b><br/>Students should provide enough information to enable the reader to understand what the business is and its operations.</p>  | 8  |                |  |
|   | <p><b>Compare and contrast the compliance structure of different business types.</b><br/>The level of understating of different business types and compliances they need to adhere.</p>   | 12   |                |  |
|   | <p><b>Identify and evaluate the compliance structure of the selected business</b><br/>Find out the suitable business types and applicable compliance and regulatory requirements and understanding of compliance dashboard.</p>   | 10   |                |  |
|   | <p><b>Structure of the Report and Referencing</b><br/>Your list of references should adhere to the Harvard referencing style. Use of current materials and facts related to the business, Clear headings and subheadings, Correct labelling of tables, diagrams and appendices.</p> | 5  |                |  |
|   | <b>Presentation of findings</b>   | <p><b>Organising PowerPoint presentation</b><br/>The content of the presentation should be organised in a logical manner and interesting sequence, that is easy to follow.</p>                     | 3              |  |
|   |   | <p><b>PowerPoint slide design and layout</b><br/>Each slide should present one central idea with supporting facts, and is visually pleasing and not overloaded.</p>                                | 3              |  |
|   |   | <p><b>Delivery</b><br/>Presenter should convey a clear, cogent and coherent argument to support your evaluation and findings.</p>  | 5              |  |
|   |   | <p><b>Conclusion and recommendations</b><br/>The conclusion should summarise the key points of your presentation. The recommendations should highlight the findings and leanings you gathered.</p> | 4              |  |
|   | <b>Total (I) =</b>  |  | <b>50</b>      |  |
|   | <b>Penalties</b>  | <ul style="list-style-type: none"> <li>• Evidence of plagiarism or collusion</li> </ul>  |                |  |
| <ul style="list-style-type: none"> <li>• Spelling and grammatical errors</li> </ul> |   |  |                |  |
| <ul style="list-style-type: none"> <li>• Late submission</li> </ul>                 |   |  |                |  |
| <b>Total (II) =</b>   |   | <b>(Max. – 50)</b>   |                |  |
| <b>Final Marks (I) – (II) =</b>   |   |  |                |  |
| <b>OVERALL COMMENTS:</b>  |   |  |                |  |

## Study Schedule

| Session | Date              | Module   | Activity                     | Reading  | Assignment                              |
|---------|-------------------|--|------------------------------|--|---|
| 1       | 12.03.2016        | Module 1: Principles of taxation.                    | Lecture                      | Social implication and functions of tax in market economy conditions. Glukhov V.V., Rozhkov Y.V, 2014                        |   |
| 2       | 19.03.2016        | Module 2: Profits and income chargeable with tax.    | Lecture                      | Some preliminary observations on the law of income tax in Sri Lanka. M.S.M. Samaratunga, Sri Lanka TAX RAVIEW Vol. 14 No. 01 |   |
| 3       | 26.03.2016        | Module 2: Profits and income chargeable with tax.    | Lecture                      |  |   |
| 4       | 02.04.2016        | Module 2: Profits and income chargeable with tax.    | Lecture                      |  |   |
| 5       | 09.04.2016        | Module 3: Taxation of unincorporated entities.       | Lecture                      |  |   |
| 6       | 23.04.2016        | Module 3: Taxation of unincorporated entities        | Lecture                      |  |   |
| 7       | 30.04.2016        | Module 4: Taxation of Companies.                     | Lecture                      |  |   |
| 8       | 07.05.2016        | Module 4: Taxation of Companies.                     | Lecture                      |  |   |
| 9       | 14.05.2016        | Module 5: Indirect taxes.                            | Lecture                      |  |   |
| 10      | 28.05.2016        | Module 6: Tax planning                               | Lecture                      |  |   |
| 11      | 04.06.2016        | Module 7: Statutory Compliances.                     | Lecture                      | IRD Circular no. SEC/2014/05 & 06  |   |
| -       | <b>10.06.2016</b> | <b>Group Assignment Report</b>                       | <b>Assignment</b>            | <b>Report Writing. Comm. Skill Hand Book, 3e</b>   | <b>Assignment is due for submission</b> |
| 12      | 11.06.2016        | Module 8: Introduction to International taxation.    | Lecture                      |  |   |
| 13      | 18.06.2016        | <b>Module 9: New Trends in Taxation.</b>             | <b>Lecture/ Presentation</b> |  | <b>Group presentation</b>               |
| -       | <b>09.07.2016</b> | <b>Semester end written test – Business Taxation</b> | <b>Exam</b>                  | <b>9.00am – 12.00pm</b>  |   |



**Section A**  
**Module 1 - 4**

# Module 1: Principles of taxation.

Outline:

- Economic and Social Functions of Taxation.
- Difference between Accounting Profit and Taxable Profit.
- Principles of Taxation.
- Basis of recognition of profits and income
- Residential status
- Difference between direct and indirect tax.

## 1.1 Introduction

Tax is central to all business decisions. Ever-increase body of legislation, precedent and practices demand professionals to have technically correct and commercially sound knowledge in taxation.

## 1.2 What is Tax?

There is no universally agreed definition for tax. Tax is a price paid by the citizen for their wellbeing and civilization. It is a compulsory charge imposed by the government. Tax may not have direct benefit but indirectly it is benefited to the public at large.

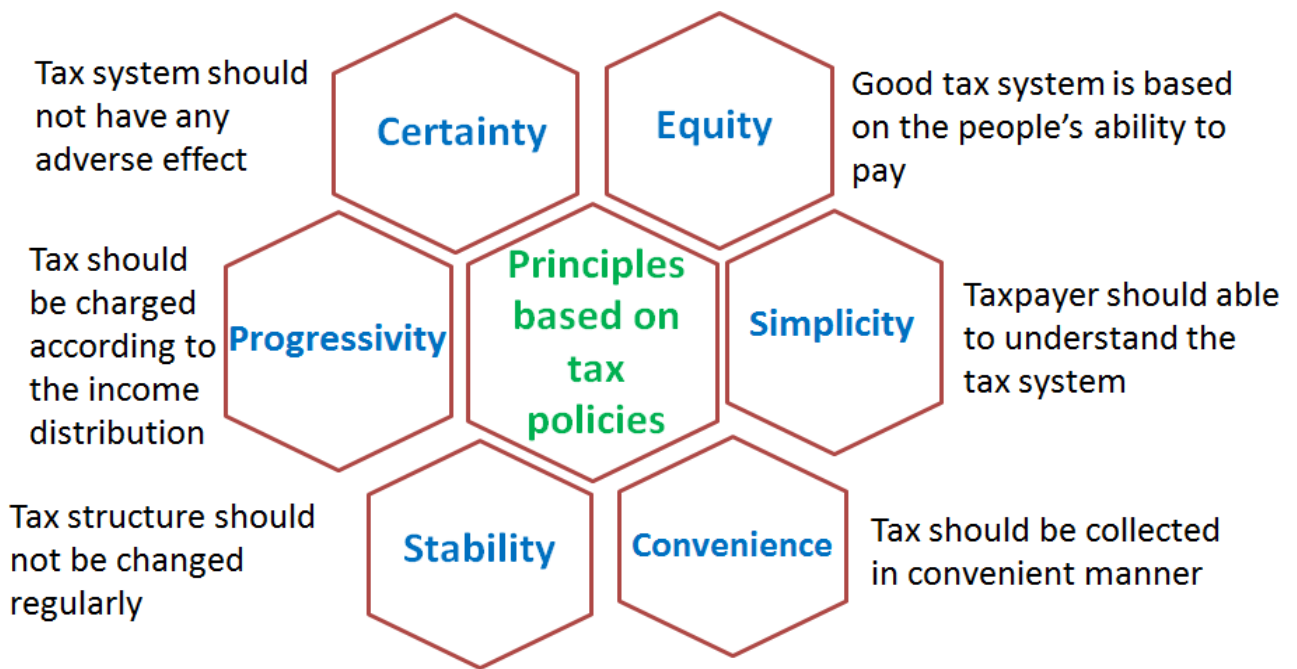
## 1.3 Economic and Social Functions of Taxation.

Government is facing the following fiscal pressure in the 21st Century. The main objective of collection of taxes to spend for various economic and social activities and infrastructure development of the country.

- Ageing population
- Pressure to support for education and social welfare
- Pressure for Infrastructure
- Pressure to reduce taxes
- Transition from manufacturing based economy to services based economy

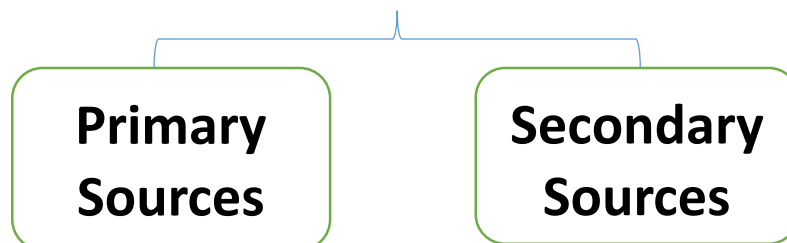
## 1.4 Functions of Taxation.

Tax is a personal obligation of the people. People should tax according to their ability to pay. Therefore, tax policies are framed based on certain principles. They are equity, certainty, simplicity, progressivity, convenience and stability.



## 1.5 Sources of Statutory Provisions.

To understand Income Tax, we need to have an understanding of the sources of tax law in the Country.



### Primary Sources of tax law

- Statutory Sources
  - Inland Revenue Act
- Administrative Sources
  - Revenue Ruling
  - Gazette Notifications
  - Interpretation of provisions
- Judicial Source

### Secondary Sources

Secondary sources are not themselves the law but provide commentary on a particular subject.

- Guidelines
- Commentaries
- Text books /Handbooks
- Legal dictionaries

## 1.6 Difference between Accounting Profit and Taxable Profit.



**Accounting Profit** is the amount reported in accordance with accounting standards.



**Taxable Profit** is the Net Profits & Income derived from any sources for any year of assessment.

### 1.6.1 Define the Profits & Income.

IRD Act does not define what is profit and income. It is merely described the sources of profits and income and prescribed the methods of computing income.

Income and capital is not necessarily conclusive. What is paid out of the profits may not always be income. One has to look at all the relevant circumstances and reach a conclusion according to the general tenor and combined effect.

*[Lord Mac Dermot, Harry Ferguson Motors Ltd Vs. CIR (33 TC 15)]*

The name given to transaction does not necessarily decide the nature of the transaction. The question always what is the real character of the payment and not what the parties call it.

*[I.R Vs. Wesleyan General Assurance Society (30 TC 11)]*

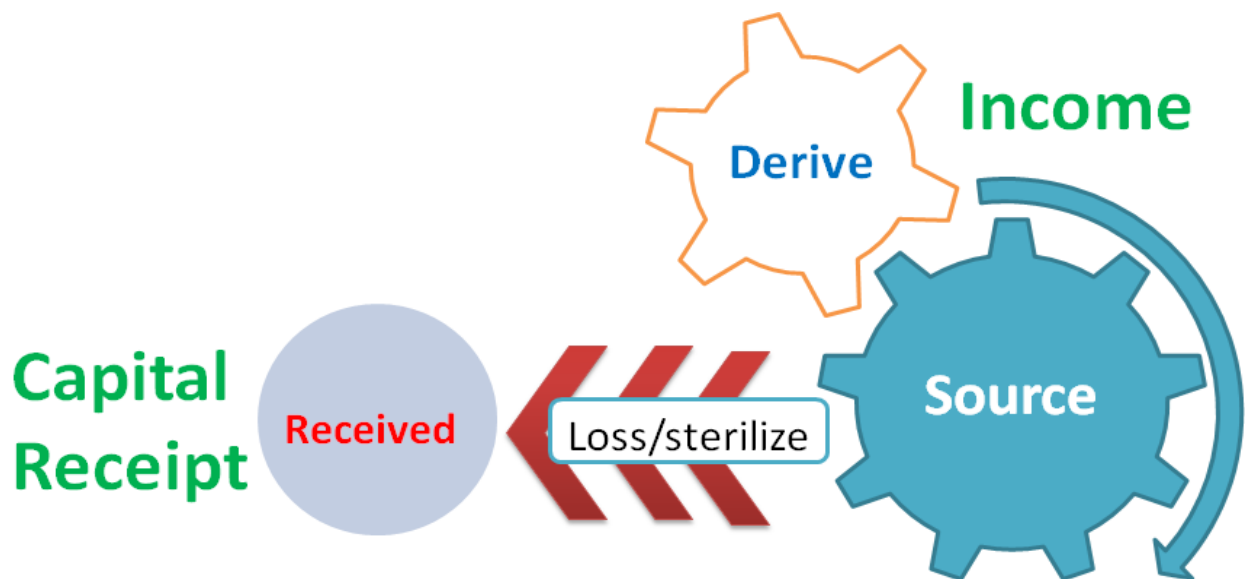
The words Profit and Income are clearly not synonymous. They are not to be used interchangeably or indiscriminately.

*[Soertuz J, Ceylon Financial Investments Ltd Vs. CIT (1 CTC 206, pg 252)]*

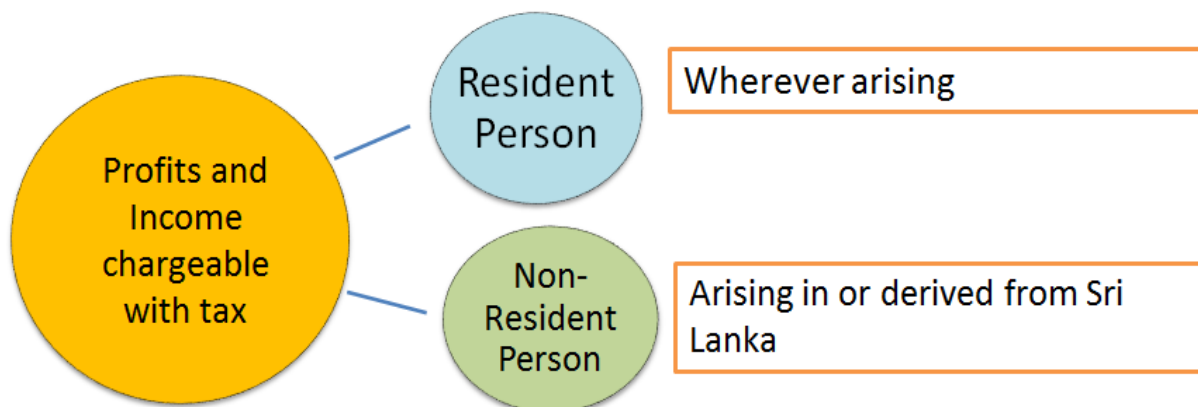
Anything in the nature of capital accretion is excluded as being outside the scope and meaning of the act.

*[Rowlatt J, Ryall Vs. Hoare (8 TC 521)]*

## 1.6.2 Income & Capital Receipt.



## 1.7 Basis of recognition of Profits and Income.



[S2(1)/2006-10]

### 1.7.1 Component of Profits & Income:

- Profits from Trade, Business, Profession or vocation.
- Profits from employment.
- Net Annual Value (NAV).
- Occupier's Income.
- Dividends, Interest or discounts.
- Charges or Annuity.
- Rents, Royalties or Premium.
- Winning from a Lottery, Betting or Gambling.
- Money received by a NGO.
- Profits from any other sources

[S3/2006-10]

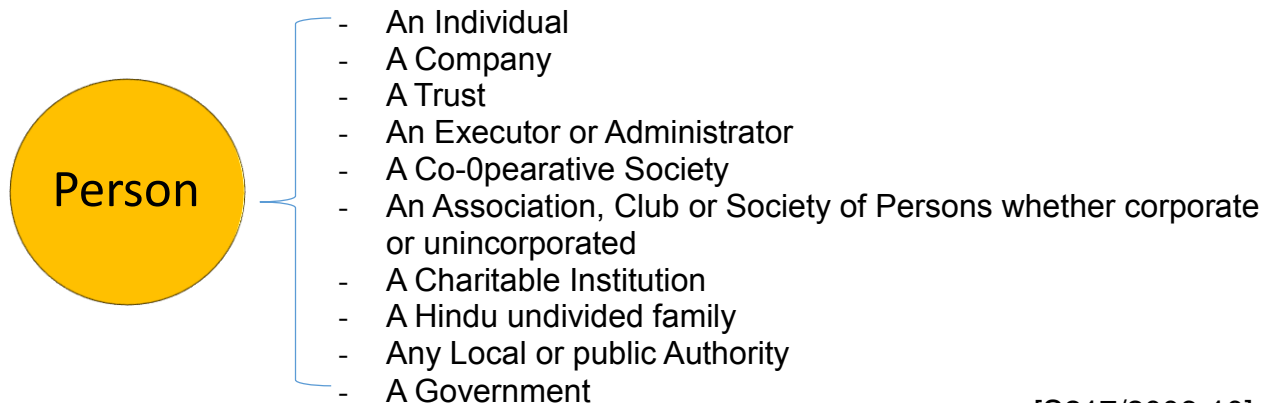
## 1.7.2 Measurement of Profits & Income

Profits or Income means the net profit or income from any source for any period calculated in accordance with the provisions of the Inland Revenue Act.

[S217/2006-10]

## 1.8 Residential Status.

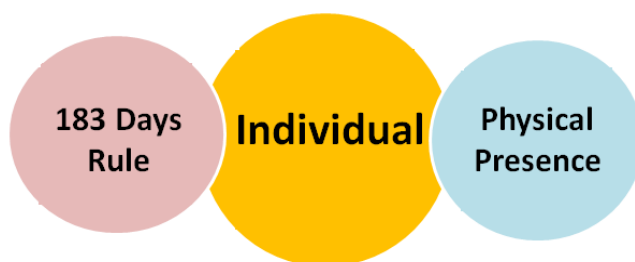
Tax is levied on person. Person includes a Company or body of persons or any government.



[S217/2006-10]

### 1.8.1 Residential Status of Individual.

Residential status important in taxing individuals in Sri Lanka.



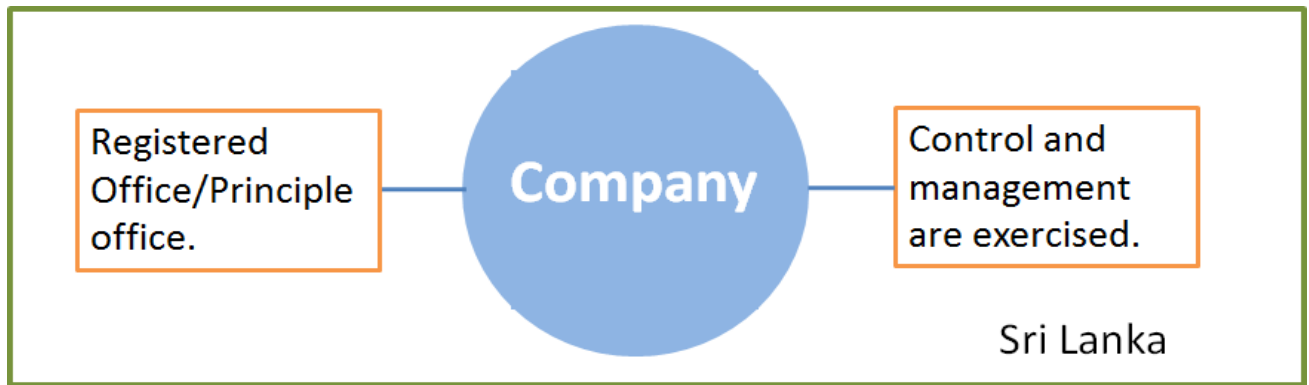
[S79 (2)-(6)/2006-10]

### 1.8.2 Residential Status of a Company or Body of Persons.

Company means, any Company incorporated or registered under any law in force in Sri Lanka or elsewhere and includes public corporation.

Public Corporation means, any corporation, board or other body which was or is, established by or under, any written law, other than the companies Act, No 7 of 2007, with capital wholly or partly provided by the Government, by way of grant, loan or other form.

[S217/2006-10]



[S79 (1)/2006-10]

### 1.8.3 Year of Assessment (YA).

Income tax is charged on a current year basis. A Year of Assessment is the 12 months period commencing from Residential 1st April to 31st March in the following year.

All accounts of trade, business, profession or vocation are to be made up for the period specified above.

[S28 (2)/2006-10]

CGIR may allow taxpayer to deviate from the general rule but not legally empowered to revoke such decision.

[S28 (3)/2006-10]

## 1.9 Direct Tax & Indirect Tax

**Direct Tax** is a tax that is paid directly by an individual or organization on whom it is imposed. Direct tax cannot be shifted to another individual or entity. The individual or organization upon which the tax is levied is responsible for the fulfilment of the tax payment. Indirect taxes, on the other hand, can be shifted from one taxpayer to another but direct tax cannot be passed on to others. In Sri Lanka Income Tax is the main Direct Tax.

**Indirect Tax** is the tax that increases the price of a good so that consumers are actually paying the tax along with the price of the goods. Indirect tax is most often not born by the person on whom is levied. It is shifted from one taxpayer to another, by way of an increase in the price of the good. VAT, NBT are the indirect tax in Sri Lanka.

## 1.10 Practice Questions

### **e** 1.1

Mr. Sunimal's movements during the YA 2013/14 & 2014/15 are as follows,

| <u>Arrival</u> | <u>Departure</u> | <u>Period of stay in SL</u> |
|----------------|------------------|-----------------------------|
| 01.05.2013     | 25.06.2013       | 56 days                     |
| 18.08.2013     | 20.11.2013       | 95 days                     |
| 22.12.2013     | 13.01.2014       | 23 days                     |
| 24.03.2014     | 05.05.2014       | 43 days                     |
| 31.07.2014     | 28.12.2014       | 151 days                    |
| 15.10.2015     | -                |                             |

**You are required to assess the residence status of Mr. Sunimal for the YA 2013/2014 & 2014/2015.**

### **e** 1.2

Date of arrivals and departure of Ramalin are as follows.

| <u>Arrival</u> | <u>Departure</u> |
|----------------|------------------|
| 10.06.2013     | 10.08.2013       |
| 15.09.2013     | 15.12.2013       |
| 25.01.2014     | 10.03.2014       |
| 05.04.2014     | 30.09.2015       |
| 25.01.2016     | 05.02.2016       |
| 10.02.2016     | 25.02.2016       |
| 02.11.2016     | -                |

**You are required to assess the residence status of Ramalin.**

### **e** 1.3

Where a company has its registered office in Sri Lanka or principle office in Sri Lanka and the control and management of its business are exercised outside Sri Lanka deemed to be a resident company in Sri Lanka.

- 1). The above statement is correct.
- 2). The above statement is incorrect.
- 3). No relevance to tax law.
- 4). Described the non-resident company.



# Module 2: Profits and income chargeable with tax.

Outline:

- Basis for Chargeability of Income Tax
- Types of profits and Income
- Sources of Profits and Income.
- Measurement of Profits and Income

## 2.1 Basis for Chargeability of Income Tax

Unless a person brought within the charge imposed by Section 2 cannot be taxed.

The profits and income of any person has been arisen or derived for any year of assessment is chargeable with tax is the subject matter for Income Tax.

The Income Tax Act..... impose a territorial limit; either

- (1). That from which the taxable income is derived must be situated in the United Kingdom, or
- (2). The person whose income is to be taxed must be resident there.

[Lord Herschell in *Coloquhoun Vs. Brooks* (2 TC 490)]

### 2.1.1 Incident of Income Tax

Income tax shall, subject to the provisions of this Act, be charged at the appropriate rates ....., for every year of assessment ..... in respect of the profits and income of every person .....

- (a) wherever arising, in the case of a person who is resident in Sri Lanka...; and
- (b) arising in or derived from Sri Lanka, in the case of every other person.

[S2/2006-10]

### 2.1.2 Arising in or Deriving from Sri Lanka.

The word arise means, to spring up, originate, to come into being or notice, to come operative....

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]

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

The word derived implies that the source of the profits or income must be from Ceylon..... In my opinion these two words “arise” and “derive” were meant to include the case of the Ceylon Company when it makes any profits or gets any income for anything done in Ceylon.....

[Akbar J. in Anglo Persian Oil Co. Ltd Vs. CIT (1 CTC 82)]

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)]

## 2.2 Types of profits and Income

Profits and income arising or derived from Sri Lanka is include,

- a). Services rendered in Sri Lanka
- b). Property in Sri Lanka
- c). Business Transacted in Sri Lanka

[S2/2006-10]

### **a). Services 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

### **b). Property in Sri Lanka**

Property defined to include any interest in any movable or immovable property (S163/206-10).

Eg: rent from house, dividends, interest.

..... the two ships.... belongs to the appellant were not passing through Sri Lanka but were in Sri Lanka water from 1985 to September 1986. .... take the view that..... clearly established that the appellant's ship constitute property in Sri Lanka.....

[Somawansa J in Trust Union Shipping Corporation Vs. CGIR (3 SLR 43, 2003)]

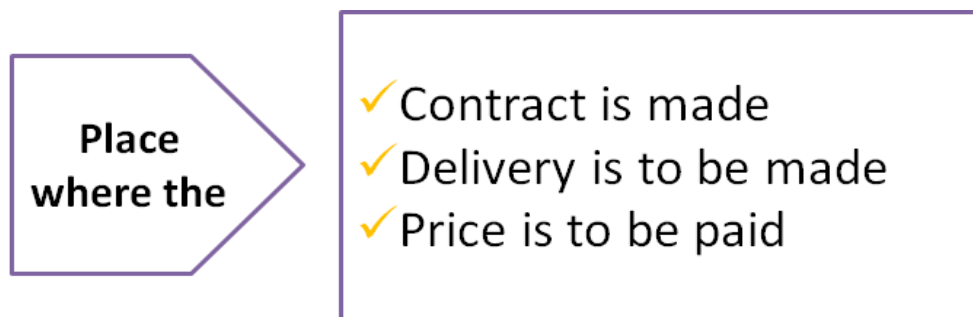
### c). Business Transacted in Sri Lanka

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.

Eg: agriculture, industrial or other business carried on in Sri Lanka.

#### 2.2.1 Determine the place where the business transacted



### 2.3 Profits and Income.

Profits and income of any person in respect of the tax is chargeable is the net profit and income from every source calculated in accordance with the provisions of the Act [S217-10/2006]. In the other hand the profits and income calculated in accordance with the provision of the Act is constituted as the statutory income.

#### 2.3.1 Sources of Profits and Income.

Section 3 of the Inland Revenue Act No. 6 of 2006 enumerated the sources of profits and income chargeable with tax.

- 1). Profits from any trade, business, profession or vocation
- 2). Profits from any employment
- 3). Profits from immovable property
- 4). Income from interest
- 5). Income from dividends
- 6). Charges or Annuities
- 7). Royalties
- 8). Profits from Lottery, Betting or Gambling
- 9). Sums Received by NGO
- 10). Income any source other than casual and non-recurring nature.

### 2.3.2 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.

There shall be deduction for the purpose of ascertaining the profits or income of any person from any source, all outgoings and expenses incurred by such person in the production thereof.....

Profits and Income outside the scope

- Capital Receipts
- Gift
- Donation
- Profits of casual and non-recurring nature

### 2.3.3 Memorandum for Computation.

#### Profits and Income:

|                                      |  |                    |
|--------------------------------------|--|--------------------|
| Statutory income from employment     |  | XXXX               |
| Statutory income from dividend       |  | XXXX               |
| Statutory income from interest       |  | XXXX               |
| Statutory income from trade etc..... |  | <u>XXXX</u>        |
| <b>Total statutory income</b>        |  | <b><u>XXXX</u></b> |

#### Less: Permitted deductions

|                          |             |                     |
|--------------------------|-------------|---------------------|
| Annuity                  | XXXX        |                     |
| Ground rent & Royalty    | XXXX        |                     |
| Interest                 | XXXX        |                     |
| Losses                   | <u>XXXX</u> | (XXXX)              |
| <b>Assessable income</b> |             | <b><u>XXXX</u></b>  |
| Less: Tax Free Allowance | XXXX        |                     |
| Qualify payment          | <u>XXXX</u> | (XXXX)              |
| <b>Taxable income</b>    |             | <b><u>XXXXX</u></b> |

### 2.3.4 Total statutory income.

The statutory income is the income of every taxable source arose, derived or accrued to any person during a year of assessment. However, income tax liability is computed on the taxable income of a person.

Total statutory income is the aggregated amount of the statutory income from every taxable source.

### **Profits and Income:**

|                                      |                    |
|--------------------------------------|--------------------|
| Statutory income from employment     | XXXX               |
| Statutory income from dividend       | XXXX               |
| Statutory income from interest       | XXXX               |
| Statutory income from trade etc..... | <u>XXXX</u>        |
| <b>Total statutory income</b>        | <b><u>XXXX</u></b> |

### 2.3.5 Assessable income.

Assessable income is the residue of the total statutory income after deducting aggregate amount of the deduction specified in S32.

#### **Annuity:**

Not defined in the act. It is fixed sum received annually under a legal obligation as a recurring or capable of recurring but not in capital nature.

#### **Ground rent:**

It is known as a rent charged. The regular payment made by the owner of a leasehold property to the freeholder under a lease agreement.

#### **Royalty**

Payment made by one party to another for the right to use of an asset. Such as patent, copyright, trade mark, industrial design, license for the manufacturing process.

#### **Interest**

Interest paid on a loan obtained for the construction or purchase of any building or purchase of a land to construct a building, to utilize in trade business profession or vocation and paid under legal or contractual obligation to any licensed bank or any registered finance company.

Other person recognized by the CGIR (i.e a person who declared such interest as income)

### 2.3.6 Losses:

Loss arise from the statutory source

- Deemed loss
- Loss arise from the statutory source

Loss is the loss ascertain as per the manner provided in the Act for the ascertainment of the profits and income. There may be,

- Loss incurred during the YA
- Loss B/F from previous year

#### **Deemed loss**

The excess of the any sum paid by way of annuity, ground rent, royalty or interest over the total statutory income is treated as loss incurred in a trade.

However, the deduction of loss is limited to 35% of the total statutory income [S32 (5) (b)].

### 2.3.7 Taxable income.

Taxable income is the residue of the assessable income after deducting the aggregate amount of tax free allowance and qualifying payment.

Taxable income of resident individual and charitable institution shall be the residue after deducting the aggregate amount of tax free allowance and qualifying payment.

However, taxable income of every other person shall be the assessable income after deduction of qualifying payment [S33 (2)].

### 2.3.8 Qualify payment:

The certain payment and expenses allow to deduct from assessable income to encourage the people [S34(2)].

- Donation to approved charity
  - Life Insurance premium paid annually >3 year
  - Medical Insurance premium paid for other than incurable disease
- } 1/3 of SI or 75,000  
} Whichever is lower
- Donation to government funds
  - Insurance premium paid for incurable diseases
- } no limit and  
} balance can be C/F
- Expenditure on government plan - limit to 25000 and balance can be C/F
  - Expenditure on film production, construction and equipping of a cinema and up gradation of cinema.
  - Expenditure on community development project
- # In economically marginalize village - Limited to 1,000,000
  - # Investment not less than 50Mn in FA in the expansion of certain undertaking - Max 25% per year
  - The profit of the employment income in excess of 500,000/- or 100,000/- whichever is lower.
  - Repayment of housing loan obtained by professional - not exceed 600,000/-

Once the taxable income calculated, the relevant tax rate to be applied in computing the gross tax liability of a person.

- Normal rate (4 – 24 percent progressive rate)
- Reduced rate
- Higher rate

|                   |                             |   |                    |
|-------------------|-----------------------------|---|--------------------|
| Gross tax payable | = taxable income X tax rate | = | XXXX               |
| Less: Tax credits |                             |   | <u>(XXX)</u>       |
|                   | <b>Balance tax payable</b>  |   | <b><u>XXXX</u></b> |

### Tax Credits:

- PAYE Tax
- WHT on royalty, annuity or management fees
- Tax deducted on dividends
- Self-assessment payment
- ESC
- Double tax relief

## 2.4 Profits from Immovable Property.

Income arising from the ownership of land & improvements thereon are the subject matter for charge the tax on the owner. [S.5,6].

- 1). Net Annual Value (NAV)
- 2). Rent Income
- 3). Occupier's Income

### 2.4.1 Net Annual Value (NAV):

The Net Annual Value of lands and improvements thereon occupied by the owner or on behalf of the owner for the purpose other than trade, business..... Is chargeable with income tax. [S3(c)].

The NAV is a hypothetical or a notional income from property chargeable with income tax. Which is not an income received in monetary terms.

When the owner occupies or someone else occupies on behalf of the owner, NAV is treated as income to the owner.

However, any premises use by the owner for trade, business, profession or vocation is not chargeable with tax as a source.

### 2.4.2 Determination of NAV:

NAV is determined by deducting 25% of the Annual Value - i.e. the value assessed by the local authority for payment of rates- for repair and other expenses. [ S5(2) & S26(3)].

|   |                   |
|---|-------------------|
| <b>Annual Value / Rating Assessment</b> | <b>XXX</b>        |
| <b>Less: 25% Allowance for Repairs</b>  | <b>(XX)</b>       |
| <b>NAV</b>                              | <b><u>XXX</u></b> |

In case of unrated area, the NAV is determined on the basis of rate which a tenant might reasonably be expected to pay. Generally, Revenue determine NAV of such property at 5% of its capital value.

### 2.4.3 Rent Income: [S3(g)]

Where the property is let, the NAV will not be assessed as income to the owner as the property is not occupied or deemed occupied by the owner. The only source of such property would be the rent income.

However, any income received for using any premise for trade, business, profession or vocation is not the income under source of rent (S217).

Determination of Rent income: [S6]

|  |                   |
|--|-------------------|
| <b>Gross Rent</b>                      | <b>XXX</b>        |
| <b>Less:</b> Rates borne by the Owner  | <u>(XX)</u>       |
|  | <b>XXX</b>        |
| <b>Less:</b> 25% Allowance for Repairs | <u>(XX)</u>       |
| <b>Net Rent Income</b>                 | <u><b>XXX</b></u> |

Where the net rent is less than the NAV, then NAV is considered as the income from rent for payment of tax. However, NAV should not be higher than the gross rent receivable. If the NAV is higher than gross rent, then income liable for tax is limited to the gross rent.

### 2.3.4 Furnished House:

Where the owner resides furnished house or bungalow permanently, even it is vacant, is considered as occupied by him. In such situation income from these houses would be the NAV.

However, such house is rented out then there will be income from,

- Unfurnished rent (NAV).
- Profit from furnished.

|   |                    |
|---|--------------------|
| <b><u>Unfurnished rent (NAV).</u></b>   |                    |
| <b>Rental Value (Rating Assessment)</b> | <b>XXXX</b>        |
| <b>Less:</b> Rates Paid                 | <u>(XXX)</u>       |
|   | <b>XXXX</b>        |
| <b>Less:</b> 25% allowance for Repair   | <u>(XXX)</u>       |
| <b>Unfurnished Rent / NAV</b>           | <u><b>XXXX</b></u> |

|   |                    |
|---|--------------------|
| <b><u>Profit from Furnished.</u></b>  |                    |
| <b>Rent Received</b>  | <b>XXXX</b>        |
| <b>Add:</b> Rental value of the period occupied/<br>deemed to be occupied by the owner    | <u>XXX</u>         |
|   | <b>XXXX</b>        |
| <b>Less:</b> Furniture up keeping, Agent's commission,<br>Advertising & Cost of inventory | (XXX)              |
| Rental Value for the year   | <u>(XXX)</u>       |
| <b>Profit from furnishing</b>   | <u><b>XXXX</b></u> |

Income from Rent



NAV/rent income is exempted from tax in respect of the house is used solely for the residential purpose.

- Once place of residence of an individual.  
When there are two or more premises, then the highest NAV is exempted.
- House constructed on or after 01.04.2008.  
FA <500 sqft - Year of construction completed + 4 years.
- House converted into two or more place of residence.
  - FA < 1000 sqft - Year of conversion + 5 years.
  - 2000 < FA > 1000 sqft - Year of conversion + 3 years.
- Property owned by a body of person for promotion of sports.
- Any place of public worship
- Any premises owned and occupied by charitable institution for its purpose.

## 2.5 Occupier's Income:

Occupier's income is the benefit accrued to a tenant. Such situation arises where the gross rent paid by tenant is less than the NAV of the Property.

|   |                     |
|---|---------------------|
| <b>Occupier's Income:</b>                     |                     |
| <b>Net Annual Value</b>                       | <b>XXXX</b>         |
| <b><u>Less:</u> Rent paid by the occupier</b> | <b><u>(XXX)</u></b> |
| <b>Occupier's income</b>                      | <b><u>XXXX</u></b>  |

In the following circumstances, occupier's income does not arise.

- Person occupies in a trade, business, profession or vocation.
- Person occupies on behalf of the owner.
- Person occupies the house provided by an employer.

## 2.6 Profits from any employment

A profit from employment is a source of income chargeable with tax: [S. 3(b)].

The basis of assessment is the profits arising out from the employment during the year of assessment.

- There must be an employer employee relationship
- Payment made for service of employment

### Conclusive Test:

- Master-Servant relationship.
- Periodicity of payment.
- Contract of employment/Service.

..... It is observed that the kinds of receipts ..... with the item wages and going down to perquisite are receipts in respect of a person's service as employee....

The statute requires that these receipts must be payments “which an employee receives in the course of his employment” ..[Wimalasundera J. Kanagasabapathy vs. CGIR (4CTC131)].

Profits from employment is defined to cover wages, salary, allowance, leave pay, ..... in money which an employee receives in the course of his employment. [S.4(1)(a)(i)].

### 2.6.1 Employer: [S. 131].

An employer for the purpose of PAYE means any person, partnership, body of persons or any organization, other than any Government Institution referred to in Chapter XV:

- for whom an individual perform services as an employee;
- paying any profits from employment within the definition “profits from employment”;
- paying any pension or other remuneration to a former employee or to any other person, for the past service of such employee.

It is important to understand whether an individual is carrying on an employment or profession or vocation.

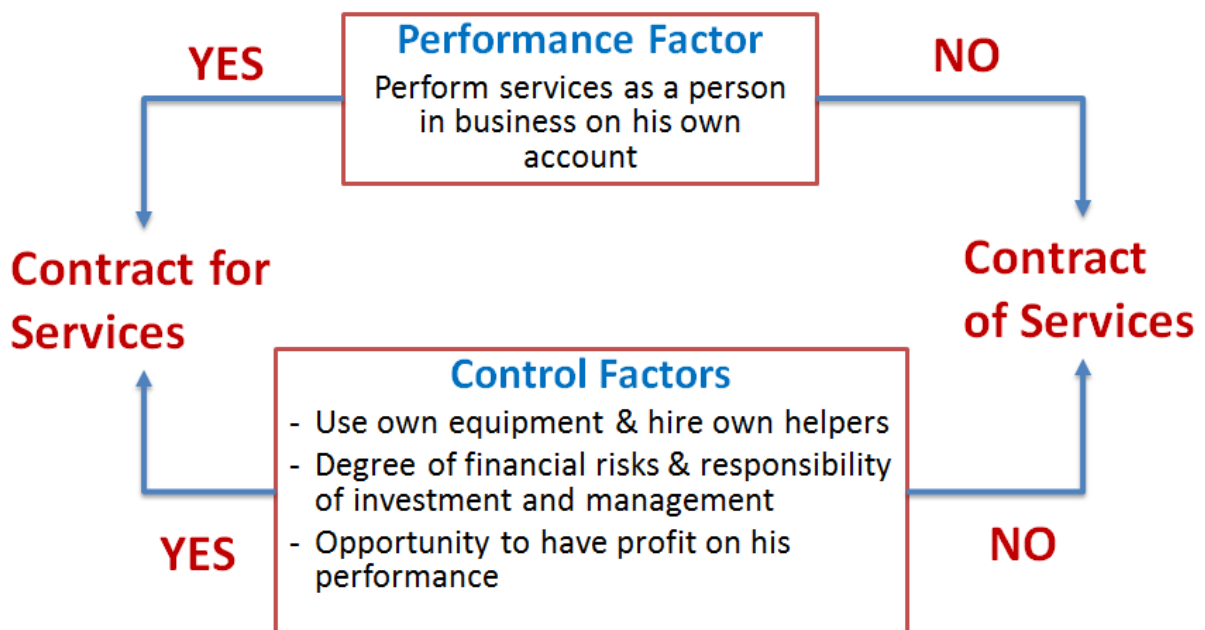
.... series of engagement and moving from another could not be considered an employment .....

[Rowlatte J. in Davies vs. Barithwaite (18TC198)].

### 2.6.2 Fundamental Test:

It is a test to be applied in distinguishing between a contract of service and a contract for services.

[Cooke J. Market Investigators Ltd vs. Minister of Social Security, 1969: 2QB173)].



### 2.6.3 Consideration and Motive

The mere fact that the payment is made to the employee as a result the employment is not enough to make liable for tax.

Where there is no consideration but merely to motivate, the payment made in view of the exceptional past services is a personal gift and not liable for tax.

[Craib Vs. CIT, 1CTC138]

### 2.6.4 Profits from employment includes: [S.4(1)].

- Payments for services whether received from the employer or others.  
Eg: Any wages, salary, allowance, leave pay, fee, commission etc
- The value of any benefit received by the employee or spouse, child or parent.  
Eg: Free medical benefits, meals, fuel, electricity, transportation etc..
- Any payment made to any other person for the benefit of the employee or spouse, child or parent.  
Eg: Payment of IT, insurance premium, loan repayment, rent, lease rental etc.
- Payment received by the employee on termination of service.  
Eg: Pension, retiring gratuity, compensation for loss of office, ETF withdrawals etc.
- Payments for services whether received from the employer or others.
- The payment received from an employment include anything in money or money worth.
- Regular cash benefits:  
Eg: Salary | Allowance | Leave pay | Commission | Bonus

The value of any benefit received by an individual is determined

- at the market value
- Cost incurred

#### **Conveyance:**

Motor vehicle provide to an employee for private use is a profit from employment.

|                         | <b>Cylinder Capacity</b> |                     |
|-------------------------|--------------------------|---------------------|
|                         | <b>&gt; 1500CC</b>       | <b>&lt; 1500 CC</b> |
| Driver and Fuel         | 50,000                   | 35,000              |
| Fuel without Driver     | 35,000                   | 25,000              |
| Driver without Fuel     | 30,000                   | 20,000              |
| Without driver and fuel | 15,000                   | 10,000              |

Motor bicycle provide to an employee for private use is a profit from employment.

|                       |           |
|-----------------------|-----------|
| Provided with fuel    | Rs. 5,000 |
| Provided without fuel | Rs. 3,000 |

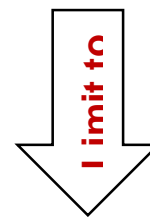
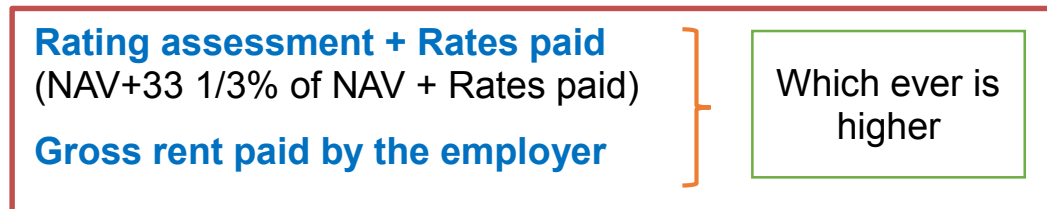
Records for private usage is maintained,

|               |               |
|---------------|---------------|
| Motor vehicle | Rs. 15 per km |
| Motor bicycle | Rs. 3 per km  |

## 2.6.5 Rental Value:

When the employer provided an accommodation to an employee for rent free or at lesser rent then the benefit to be taxed,

- Rent free – Rental value is the benefit to be taxed
- Lesser rent - Excess of the rental value over the rent



| Aggregate Profits | Rental Value |
|-------------------|--------------|
| < Rs. 1.8 Mn      | Rs. 120,000  |
| >Rs. 1.8 Mn       | Rs. 180,000  |

In the case of provision of a furnished house, the value of furnished house is to be calculated as follows,

- 2.5% of the gross remuneration or
- Rs. 18,000/- per annum

Benefit from furnished house is limited to Rs. 18,000/-.

### Estate Bungalow:

- 7.5% of the GR
  - Rs. 2,000/- per month
- Which ever is higher

## 2.7 Trade, Business, Profession or Vocation

The profits of any trade, business, profession or vocation is a source chargeable with tax even short a period such trade, business, profession or vocation was carried out or exercised.

Therefore, it is important to understand the meaning of these phrases.

Section 217 of the Act defined the meaning of trade and business. However, the word profession and vocation are not defined in the Act.

## 2.7.1 What is Trade?

The definition of trade includes every trade and manufacturing and every adventure and concern in the nature of trade [1217].

It implies that the trade or business must be systematically carried on or exercised and cannot apply to isolated transactions (Grainger & Son Vs. Gough, 3TC462). Repeated and systematic transactions may lead to the conclusion that a trade is being carried on (Pickford Vs. Quirke, 13TC251).

Trade normally involves the exchange of goods for rewards. It must be with someone and bilateral.

However, trade cannot be precisely defined, but certain characteristics can be identified  
[Lord Wilberforce in Ransom Vs. Higgs, 50TC1].

The decided cases guide to understand what constitute an adventure in the nature of trade.

### **Adventure and concern in the nature of trade or isolated transaction:**

#### **Profit motive**

Taxpayer entered into an agreement to purchase a tea state by paying an advance. Further, he agreed to complete the transaction within a short period of time. Since they did not have sufficient finance they procure only the part of estate as a source of green leaf for their tea factory and the part was sold at a profit.

It was clear that the purchase of estate not for themselves. And, held that the transactions were an adventure or concern in the nature of trade.

[DS Mahavitharana Vs. CIR (3CTC156)]

#### **Sufficient finance resources**

Assessee's wife was entered into an agreement to purchase 433 perches land adjoining St. Bridget's Convent. However, they didn't have sufficient money and even the deposit was paid by borrowed money.

Soon after the agreement they block out the land and number of blocks were sold at a profit.

Assessee argued that the dominant interest to live near St. Bridget's Convent was to facilitate the children's education.

It was held that, assessee did not have sufficient funds and the land to be sold to pay the balance due to landlord.

It was decided that it was an adventure in the nature of trade.

[Ram Ishwara Vs. CIR (3CTC184)]

## Isolated Transaction

The assessee's wife owned a block of land and undivided shares in surrounding lands. These lands had been requisitioned during the war and the Navy had erected hangers and building. These building given back free of charge to assessee along with land. Later, hangers and building was sold and make a profit.

*Supreme Court held that:*

Buying and selling to constitute as trade, there should be some amount of repetition in the act of buying and selling. Therefore the transaction was an isolated one and not have the characteristic of an adventure in the nature of a trade since it does not involve the repletion of activity

[CIR Vs. De Zoysa (1CTC524)]

### 2.7.2 What is Business?

In Section 217, Business defined to include an agriculture undertaking, the raising of horses, the letting or leasing of any premises including any land by a Company and the forestry.

According to the decided case trade or business must be systematically carried on or exercised and cannot apply to isolated transactions. We can identify some factors in determining that whether the transaction is an adventure in the nature of trade.

- Intention to re-sell (profit making motive)
- Alteration to the subject matter
- Repetition and systematic transaction
- The length of ownership
- Financial Resources

### 2.7.3 Profession or Vocation

Profession or vocation has not been defined in the act. It is a question of fact whether an individual is carrying on a profession or vocation.

A profession is an occupation that requires either purely an intellectual skill or manual skill controlled by the intellectual skill of the operator (CIR Vs. Maxse, 12TC41). Eg: medicine, law, engineering, auditing and tax practice etc.

It is an important fact that, a membership of a professional body with a standard of conduct is a leading factor for deciding whether the profession is exercised, but it is not conclusive factor (Durant Vs. CIT, 12TC249).

However, all profession are business and all business are not profession. A profession requires professional qualities and qualifications and a company is incapable of acquiring the necessary qualification and qualities (Esplen Sons & Swanston Ltd Vs. CIR, 1919KBB731).

A vocation is an occupation which a person is specially drawn or for which he or she is suited, trained or qualified. In this case the formal qualification is not required. Eg: Singers, players, actors and musician etc.

## 2.7.4 Ascertain Profits and Income

The profits and income chargeable with tax is the net profits or income. Unlike other sources, in ascertaining the profits and income all outgoings and expenses incurred in the production of income including certain specified expenditure are allowed (\$25(1)).

In ascertaining profits and income it is important to consider;

- Allowable Expenses (\$25)
- Disallowable Expenses (\$26).

### 2.7.4.1 Allowable Expenses \$25.

General rule is that expenses and outgoings must be deductible only if they are incurred in the production of income.

Loss considered as an outgoing.

The company was carrying on the business of buying and exporting commodities has suffered a loss of money kept in the safe for the purpose of purchased rubber.

The money in the safe was indented to replenish stock in trade and thus its loss would be equivalent to a loss of stock-in-trade. The loss was out of circulating capital of the Company. Thus, the loss incurred was something incidental to the business and would deduct in order to ascertain its net profits.

[Hayley and Co. Ltd Vs. CIR (3CTC115)]

### 2.7.4.2 Capital Allowance \$25(1)(a)

The allowance for depreciation by wear and tear of any qualified capital assets use in any trade, business, profession or vocation at a fixed rate on the cost of acquisition or construction or assembly permitted to be deducted.

| <b>Asset</b>   | <b>Up to<br/>YA<br/>2010/11</b> | <b>From<br/>YA<br/>2011/12</b> |
|--|---------------------------------|--------------------------------|
| Information technology equipment and calculating equipment including accessories and software                                  | 25%                             | 25%                            |
| Any software developed in Sri Lanka  | 100%                            | 100%                           |
| Any motor vehicle or furniture   | 20%                             | 20%                            |
| Machinery or equipment and any plant   | 12.50%                          | 33 1/3%                        |
| Any bridge, railway track, reservoir, electricity or water distribution line and toll roads                                    | 6 2/3%                          | 6 2/3%                         |
| Any qualified building constructed   | 6 2/3%                          | 10%                            |
| Any plant or machinery used in any business of carrying out construction work (after April 1,2007 but prior to April 1, 2011 ) | 25%                             | 33 1/3%                        |

|   |         |         |
|---|---------|---------|
| Any plant or machinery used in any business of providing health care, printing on paper, gem cutting and polishing, packaging of any commodity for commercial purposes, rice milling or such other business as may be prescribed by the Commissioner- General | 33 1/3% | 33 1/3% |
| Any high tech plant, machinery or equipment use for energy efficiency purposes *  | 12.50%  | 50%     |

\* Where high tech plant machinery or equipment acquired on or after April 1, 2013 and used in any trade or business meets more than thirty per centum of the total requirement of the power generation of that trade or business out of alternative energy sources - one hundred per centum on the cost of acquisition.

Alternative energy source means any source other than the National Grid that generates power.

Where any plant or machinery or equipment is acquired and used in any business on or after April 1, 2013 for technology upgrading purposes or introducing any new technology - fifty per centum of the cost of acquisition.

Where any plant, machinery or equipment is acquired and used on or after April 1, 2013 in any Stock Broker Company for the upgrading of information technology infrastructure to be in compliance with the requirements of the Colombo Stock Exchange licensed by the Securities and Exchange Commission, in relation to the Risk Management System, - one hundred per centum of the cost of acquisition

Where any plant, machinery or equipment acquired and used on or after April 1, 2013, in any trade or business and where at least sixty per centum of the turnover of such trade or business is from export - fifty per centum of the cost of acquisition

#### 2.7.4.3 Disposal of capital assets (\$25(3))

When a capital asset on which depreciation allowance claimed is disposed, the profits and income arising on such disposal to be taken in ascertaining the profits and income.


Adjustment arise;

- a). Depreciation allowance equal to the cost of acquisition has been claim - Total proceeds of the disposal is treated as profits
- b). Allowance for depreciation claimed is less than the cost of asset - Profit or loss is the deference between the disposal proceeds and the tax written down value if such capital asset not replaced.
- c). Asset on which the capital allowance claimed is disposed and the proceeds used within one year in replacing such assets - Profit not recognized to charge the tax. The amount of the profits is reduced from the cost of acquisition of the replaced asset. Therefore, the cost of new asset for depreciation purpose is calculated.



Profits/Loss on disposal of capital assets;

$$DP = SP - TWDV$$


$$(C - CAC)$$

Depreciable value of new asset on replacement;

$$DV = C - DP$$

- Intangible Assets §25(1)(b) - 1/10th of the cost of acquisition.  
Intangible assets include copyright, patent, designs, trademarks etc. But, goodwill not a qualify asset for claim the allowance.
- Payment for License §25(1)(b) - 1/4th of the license fee paid  
License fee paid in favour of manufacturing process is an allowable expenses.
- Renewal Allowance §25(1)(c) - for tools and utensil if no allowance for depreciation is deductible.
- Repair Expenses §25(1)(d) - Initial repair expenses is not allowed (Law Shipping Vs. CIR, 12TC621).  
However, in the case of repair expenses of letting premises by a Company is limited to 25%.
- Tax Payable §25(1)(h) - Any statute enacted by a Provincial Council. Eg: Stamp duty on transfer of property.
- Bad debts §25(1) (e) - (eeee)  
Any debts other than trade debts not deductible. Any bad debts written off or allowed recovered subsequently treated as income in the year of receipt.

General deduction is not deductible from profits. Specific provision is allowed. Where the debts are identifiable and provision made with the satisfaction of CGIR is deductible as specific.

- Interest paid or payable §25(1)(f)  
Interest paid on working capital, project load, OD interest is deductible. Interest cannot be claim in computing the profit from the source may be claimed from statutory income.
- Contribution to approved fund (provident, pension or saving fund). §25(1)(g)
- Research Expenses §25(1)(i) - 200%  
Any scientific, industrial, agricultural or any other research for upgrade of any trade, business profession or vocation through the institute in Sri Lanka - 300%
- Travelling expenses §25(1)(k), §26(1)(a)(b)(c)

No deduction shall be allowed;

- Vehicle used partly for business and partly for private purpose
- Vehicle used for official purpose and for domestic or private purpose by executive office to non-executive director unless the value consider for PAYE.

- Provision of second vehicle
- Vehicle given to outside person (non-employee or non-service provider)
- Lease rental, other rental or cost of capital of vehicle use to travel between residence and place of work.

However, employees travel between residence and place of work by a motor coach is allowed.

Travel outside Sri Lanka - promotion of exports, provision of service for payment in foreign currency, design or product development, product innovation, operating any hotel for tourist is limited to 2% of the profits of preceding year.

- Training Expenses \$25(1)(q)

Allow to deduct such training is,

- directly relevant to perform the duties
- essential for upgrading the skills or performance of such employee
- Improve the efficiency and performance of the business
- Gratuity payment, annual payment to any fund approved by the CGIR
- Accreditation expenses
- Cost of acquisition of internationally recognized intellectual property.
- Royalty or ground rent.
- Lump sum payment in connection with letting or leasing of commercial premises.  
Eg: Key Money. The deduction should be made during the period covered in the agreement.

#### 2.7.4.5 Disallowable Expenses \$26.

- Entertainment Expenses or entertainment allowance.
- Capital expenses - Legal fees for purchase of property.
- Cost of improvements - eligible for capital allowance
- Cost of provision of residence to employee
  - i. Remuneration < 600,000 per annum
    - $\frac{1}{2}$  of the excess of any expenditure over rental value
  - ii. Remuneration > 600,000 per annum
    - $\frac{3}{4}$  the excess of any expenditure over rental value
- Finance lease rental
  - i. Information technology equipment and calculating equipment including accessories and software - 1/4 max
  - ii. Any motor vehicle, furniture, plant, machinery or equipment - 1/5 max

- Management fees - excess of 2 million or 1% of the annual turnover which ever is lower.
- Transfer to reserve or provision
  - Provision for depreciation
  - Provision for gratuity
  - Provision for bad debts
  - Provision for obsolete stock
  - Provision for repairs
- Loan granted to employee written off
- Advertisement cost            - 1/4
  - The restriction not applicable for advertising outside Sri Lanka;
  - Export trade of any goods or service
  - Provision of any services
  - Approved sponsorship for international sport event
- Asset given to employee at free of charge or at concessionary price
- Income tax of employee
- Interest expenses
  - Loan from holding company
    - If subsidiary is manufacturing company - interest above 3 time of issued share capital or reserves of the subsidiary.
    - If subsidiary is non-manufacturing company - interest above 4 time of issued share capital or reserves of the subsidiary.
  - Loan from subsidiary
    - If holding company is manufacturing company - interest above 3 time of issued share capital or reserves of the holding company.
    - If subsidiary is non-manufacturing company - interest above 4 time of issued share capital or reserves of the holding company.

## 2.8 Taxation of NGO

Non-Governmental Organizations are not for profit oriented entities, therefore they are not engaging on trade or business.

Section 3 (i), grants, donation or contribution received by a NGO is considered to be profits and income chargeable with tax.

However, these institution may have income from interest, dividend are liable to tax at normal rate.

### 2.8.1 Definition of NGO

A NGO means,

- any organization or association whether corporate or un-incorporate
- formed by a person or a group of persons on a voluntary basis

And which is non-governmental in nature, ddepend on grants, donations, contributions or any other form of money received and established and constituted for the provision of relief and services of a humanitarian nature to the poor and destitute, the sick, orphans, widows, youth, children or generally for providing relief to the needy.

However, the following organizations are not considered as a NGO.

- An approved charity.
- Any society or organization is carrying on its activities on membership fees received by its members.
- Any approved charity use the funds, donation or contribution received solely for the purpose of institutionalized care for the sick and needy.

[S102(2)-10/2006]

### 2.8.2 Deemed Profits and Income

Profits and income of a non-governmental organization chargeable with income tax shall be an amount equal to 3% of such money received by way of grants, donations, and contribution or any other means after deducting from any money received from the Government of Sri Lanka.

[S102(1)-10/2006]

The rate of tax on deemed profits and other income will be charged at 28%.

### 2.8.3 Reduction or removal.

The CGIR may reduce or remove the tax payable by a NGO on the satisfaction that such NGO is solely engaging in,

Rehabilitation and the provision of infrastructure facilities and live hood support to displaced person in any area identified by the Government

Any other activity approved by the minister as being of humanitarian in nature, taking into consideration the nature and gravity of the disaster

## 2.9 Practice Questions:

### **e** 2.1

Mrs. Shiromi is an owner of the house located in Kurunegala. The local authority of Kurunegala was assessed the property at an annual value of Rs. 75,000/-. She paid Rs. 5,625/- as the rates for the year 2015.

Calculate the NAV.

### **e** 2.2

A house of Mr. Kamaladasa in Wellawatte was rented out for Rs. 35,000/- per month. The annual assessment value of CMC for the year 2014 was Rs. 350,000/-. Mr. Kamaladasa paid the rates to CMC at 35%.

Calculate the income from rent

### **e** 2.3

House is rented out at Rs. 60,000/- per annum. Local authority assesses the property at Rs. 85,000/- and the rate paid for the year is Rs. 12,750/-. Occupier's income would be;

1). Rs. 35,438    2). Rs. 28,312    3). Rs. 63,750    4). 3,750

### **e** 2.4

A house which has been constructed in January 2009 and purchased by Mr. Hettiarachchi in March 2010, was rented for Rs.65,000/- per month from April 2010. The rating assessment of the house is Rs.90,000/-. Rates are paid at 30% and the square area of the house is 3,000 square feet.

Calculate the Statutory Income.

### **e** 2.5

Sirimewan own house which is in Homagama was rented for Rs.50,000/- per month from January 2012. The construction of this house was completed in June 2004 and floor area of the house is 2,500 square feet. Rating assessment of this house is Rs.200,000/- and rates paid for the year was Rs.60,000/-. During the year, he had incurred Rs.70,000/- for repairs of the house.

Calculate the Statutory Income

**e** 2.6

Mr. Thumilan rent his property located in Dehiwal at an annual rent of Rs. 65,000/-. Dehiwala Mount-lavenia MC assess the property at Rs. 85,000/- and rates paid by Mr. Thumilan for the year 2014 was Rs. 12,750/-.

Calculate the rent income, NAV and occupiers income if any.

**e** 2.7

Apartment purchased in 2009 given on rent. Total rent collected from the tenant during the year was Rs. 1,750,000/-.

Rates paid for the year Rs. 52,500/-. This is a 15% of the rating assessment.

Advertising to find a tenant Rs. 15,000.

She has constructed a house with the floor area of 2,600sqft and rented out for monthly rent of Rs. 95,000/-. The house was constructed on bank loan obtained from NSB. This property has valued by the local authority for Rs. 95,600/-. The rate payable is at 12%.

She is living in a house at Maharagama. The rating assessment of this house is Rs. 58,500/-. MMC charges the rates at 8% on rating assessment.

Calculate the Statutory Income.

**e** 2.8

Mr. Sumanadasa Perera owns house in Wellawatte and the house kept for rent. This house was rented out in 2013 April for Rs. 120,000/- per month. Tenant vacate the house on 31st January 2015. The rating assessment of the house is Rs. 450,000/- and the rate has been paid at 25%. The following expense has been incurred by Mr. Perera.

|                  | 2013/14 | 2014/15 |
|------------------|---------|---------|
| Repair expenses  | 145,000 | 276,750 |
| Furniture upkeep | 325,250 | -       |
| New furniture    | -       | 125,250 |
| Advertisement    | 15,650  | -       |

This house is constructed from the loan taken by Commercial bank during the year 2009 and the floor area of the house is 2,750sqft. Mr. Perera paid interest on housing loan for Rs. 325,425 in 2013/14 and 317,625 in 2014/15.

Calculate the Statutory Income.

### **e** 2.9

Mr. Amarapala is working as a Manager – Admin in Admonton Pvt. Ltd. His gross remuneration for the YA 2014/15 was Rs. 2,400,000/- and he was provided with free accommodation during the year. The house was assessed by CMC for rate purpose to Rs. 300,000/-. Employer has paid Rs. 600,000/- as rent to the owner. Assume that the rate is 30%.

### **e** 2.10

Mr. Kamal Saparamadu was an army commander. He retired from the service at the age of 50 and joined with Vidulaka Pvt. Ltd in April 2011 as a Head of Human Resource.

During the YA 2014/15, Mr. Saparamadu was earned following profits and income from his employment.

- Monthly consolidated salary is Rs. 115,000/-.
- Allowance for conveyance is Rs. 50,000/- per month.
- He was provided with a 1700CC jeep with driver.
- Performance bonus of Rs. 425,000/- paid in July 2014.
- Family health and surgical insurance premium is Rs. 98,500/- per annum.

Company paid Rs. 75,000/- per month as a rent to the land lord for the house provided to Mr. Saparamadu. The rating assessment of the house is 500,000/- and 35% rates to be paid.

You are required to calculate the total employment income liable for the tax.

### **e** 2.11

Wasala Rathnayake is a Manager – Logistics at a reputed company. During the year he was paid the following income by his employer.

- Basic Salary Rs. 87,800/- and Fixed Allowance Rs. 112,000/-
- He eligible for 2.5% commission on clearing the goods from cargo. During the year he cleared Rs. 25,145,856/- worth of cargo.
- He was paid a conveyance allowance of Rs. 50,000/- per month and eligible to claim 200Lts of fuel every month.
- Company maintains car is provided to him for his official purposes. However, he uses this car for his personal matters as well.
- Company policy is to pay three time basic as bonus for the year 2014/15. Company process the bonus in July every year.
- Wasala was provided a family health and surgical insurance facility. Premium for the YA 14/15 was Rs. 84,500/-
- During the year son of Wasala was admitted to Asiri Surgical for an operation. Company has reimbursed the medical bill amounting to Rs. 425,625/-

- Wasala living in a house provided by the company. Company paid Rs. 65,000/- per month as a rent to the land load. The rating assessment of the house is Rs. 235,600/- and the rates to be paid at 11%.

You are required to calculate the total employment income liable for the tax.

## **e** 2.12

Mr. Wimal De Cruz is working as a Head of Logistics at Manhattan Shipping Co. Pvt. Ltd. During the year of assessment 2014/15 he was earned the following income from his employer.

- Basic Salary Rs. 92,850/- and Fixed Allowance Rs. 115,675/-.
- He is eligible for 2.5% commission on clearing the goods from cargo. During the year he has cleared Rs. 23,215,259/- worth of goods.
- He was paid a conveyance allowance of Rs. 50,000/- per month. In addition to the conveyance allowance he is eligible to claim 150Ltrs of fuel on every month.
- Company provides a car to him for his official purposes. However, he uses this car for his personal business as well.
- Company policy is to pay two times basic as a performance bonus for the year 2013/14. Company process the bonus in July every year.
- Mr. Wimal was provided a family health and surgical insurance facility. Premium for the YA 2014/15 was Rs. 94,250/-
- During the year, son of Mr. Wimal was admitted to Asiri Surgical for an operation. Company has reimbursed the medical bill amounting to Rs. 115,625/-
- Mr. Wimal is living in a house provided by the company. Company paid Rs. 95,000/- per month as a rent to the land load. The rating assessment of the house is Rs. 62,600/- and the rates to be paid at 12%.

You are required to calculate the total employment income liable for the tax.



## Module 3: Taxation of unincorporated entities.

Outline:

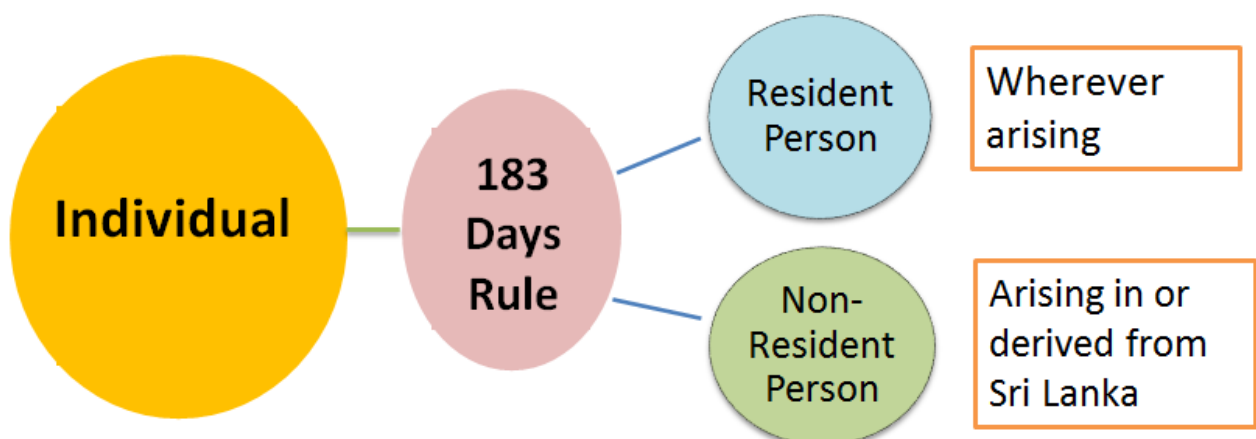
- Ascertainment of profits and income of an individual.
- Aggregation of child's income.
- Ascertainment of Statutory income of an individual.
- Ascertainment of Assessable income of an individual.
- Ascertainment of Taxable income of an individual.
- Legal status of partnership.
- Ascertainment of profits and income of Partnership.
- Ascertainment of profits and income of clubs, charitable institutions and association.

### 3.1 Ascertainment of profits and income of an individual.

Profits and income of any person in respect of the tax is chargeable is the net profit and income from every source calculated in accordance with the provisions of the Act

[S217-10/2006]

Profits and income calculated in accordance with the provision of the Act is constituted as the statutory income. The statutory income is the income of every taxable source accrued to any person during a year of assessment. And, the income tax liability is computed on the taxable income of a person.



### 3.1.1 Furnish a Return of Income.

Satisfy any four requirements then within one month submit the return.

#### **Requirements:**

- Monthly residential electricity bill exceeds Rs. 10,000.
- Monthly credit card bill exceeds Rs. 25,000.
- Monthly residential telephone bill exceeds Rs. 10,000.
- Purchase a air ticket to travel aboard.
- Owning a motor vehicle for travelling.

#### *Exceptions:*

- Profits from employment chargeable with tax.
- Dividends chargeable with tax.
- Income from interest chargeable with tax.

### 3.1.2 Total statutory income

The statutory income is the income of every taxable source is accrued to any person during a year of assessment whether the source is ceased to possess or sources is ceased to produce the income (S28(1)).

Total statutory income is the aggregated amount of the statutory income from every taxable source for which the tax is charged (S30).

#### **Profits and Income:**

|                                      |                    |
|--------------------------------------|--------------------|
| Statutory income from employment     | XXXX               |
| Statutory income from dividend       | XXXX               |
| Statutory income from interest       | XXXX               |
| Statutory income from trade etc..... | <u>XXXX</u>        |
| <b>Total statutory income</b>        | <b><u>XXXX</u></b> |

### 3.1.3 Husband and Wife.

Husband & wife consider as separate individuals under tax purpose. Therefore,

- Pay tax due under self-assessment.
- Business between Husband & Wife
- Liable to tax on their share of profits from partnership business.
- Intention is not to reduce the tax liability.
- Service rendered by one spouse to another will be the profit of another spouse.

### 3.1.4 Income of a Child

Under the tax law income of one person is not aggregated with the other person for charging the tax. However, under the aggregation rule, income of a child is aggregated

with the income of his/her parents for charging the tax where parent is a resident individual (S31).



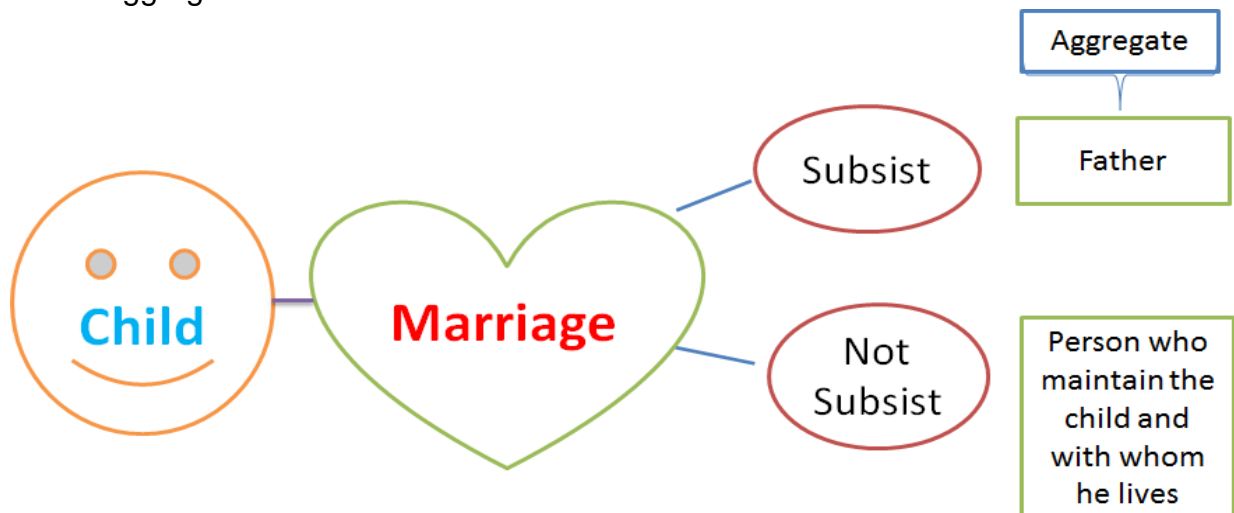
Child < 18 years of age and include a child adopted under the Adoption of children Ordinance, and

Where that the individual is not citizen of Sri Lanka, a child adopted under the law of the country of which the individual is subject or citizen (S217).

Under the taxation, the following persons are not considered as a child:

- Child adopted any other law
- A married child
- An illegitimate child

#### 3.1.4.1 Aggregation Rule



Marriage is non-subsist: If the spouse is living separately,

- Under the judgement given by the court or a deed of separation
- in such circumstances separation is likely to be permanent.

#### 3.1.5 Assessable income

Assessable income is the residue of the total statutory income after deducting the following expenses (S32).

- Income does not form part of assessable income.
- Deductions permitted under section 32.

|  |                   |
|--|-------------------|
| <b>Total Statutory Income</b>                  | <b>XXX</b>        |
| Less:  |                   |
| Income does not form part of assessable income | (XX)              |
| Deductions permitted under section 32          | <u>(XX)</u>       |
| <b>Assessable Income</b>                       | <b><u>XXX</u></b> |

### **Income not form part of assessable income**

1. Interest income from deposits subject to WHT (S133).
2. Interest income from government securities (Treasury Bills/ Treasury Bonds) subject to WHT (S134).
3. Interest income from corporate debt securities subject to WHT (S135).
4. Dividend income subject to WHT at 10% (S65).
5. Rewards or share of fine subject to WHT at 10% (S157)
6. Lottery prize or winning from gambling or betting subject to WHT at 10% (S157)
7. Interest on compensation subject to WHT at 10% (S36)
8. Interest from Rupee TB purchased out of TIREA.
9. Sale of gem subject to 2.5% tax (S161A).
10. Profits from employment subject to PAYE.

### **3.1.6 Permitted Deductions (S32).**

The following expenses are permitted to deduct in arriving the assessable income.

- Annuity, ground rent, royalty or interest.
- Loss incurred in any trade, business, profession or vocation.
- Business commencement expenses.

No deduction is permitted from employment income. Therefore, the amount of assessable income cannot be less than the profits from employment income.

Ground rent and royalty removed from S32 and allow under S25.c

#### **Annuity:**

Not defined in the act. It is fixed sum received annually under a legal obligation as a recurring or capable of recurring but not in capital nature.

- paid under an order of court by way of alimony or maintenance.
- paid to spouse under a deed of separation
- paid in return for full consideration in money or money's worth.

#### **Ground rent:**

It is known as a rent charged. The regular payment made by the owner of a leasehold property to the freeholder under a lease agreement.

#### **Royalty**

Payment made by one party to another for the right to use of an asset. Such as patent, copyright, trade mark, industrial design, license for the manufacturing process.

## **Interest**

Interest paid on a loan obtained

- For the construction or purchase of any building or purchase of a land to construct a building
- To utilize in trade business profession or vocation

And paid under legal or contractual obligation

- To any licensed bank or any registered finance company
- Other person recognized by the CGIR (i.e a person who declared such interest as income)

### **3.1.6 Losses:**

#### **Loss arise from the statutory source**

Loss is the loss ascertain as per the manner provided in the Act for the ascertainment of the profits and income. There may be,

- Loss incurred during the YA
- Loss B/F from previous year

#### **Deemed loss**

The excess of the any sum paid by way of annuity, ground rent, royalty or interest over the total statutory income is treated as loss incurred in a trade.

However, the deduction of loss is limited to 35% of the total statutory income [S32(5)(b)].

### **3.1.7 Taxable income**

Taxable income is the residue of the assessable income after deducting the tax free allowance and qualifying payment (S33).

Taxable income of,

- Resident individual and
- Charitable institution

Shall be the residue after deducting the tax free allowance (i.e. Rs. 500,000/-) and qualifying payment.

However, taxable income of every other person shall be the assessable income after deduction of qualifying payment [S33(2)].

#### **Qualify payment: (Individuals)**

The certain payments and expenses allow to deduct from assessable income to encourage the people [S34(2)].

- Donation to approved charity
  - Life Insurance premium paid annually >3 year
  - Medical Insurance premium paid for other than incurable disease
  - Donation to government funds  
Government, local authority, funds established by the government, provincial council or local authority, any university, sevana fund, Api Wenuwen Api Fund.
  - Insurance premium paid for incurable diseases
- 1/3 of AI or 75,000 whichever is lower
- 100% and balance can be C/F
- Expenditure on government plan - limit to 25000 and balance can be C/F
  - Expenditure on film production, construction and equipping of a cinema and up gradation of cinema
  - Expenditure on community development project in economically marginalize village
  - Investment not less than 50Mn in FA in the expansion of certain undertaking
  - The profit of the employment income in excess of 500,000/- or 100,000/- whichever is lower
  - Repayment of housing loan obtained by professional - not exceed 600,000/-
  - Construction and sale of house <500sqft for low income families approved by the UDA or NHA - 100% and balance can be C/F

Once the taxable income is calculated, the relevant tax rate to be applied in computing the gross tax liability of a person at,

- Normal rate,
- Reduced rate, or
- Higher rate.

|   |                    |
|---|--------------------|
| Gross tax payable (taxable income X tax rate) | XXXX               |
| Less: Tax credits                             | <u>(XXX)</u>       |
| <b>Balance tax payable</b>                    | <b><u>XXXX</u></b> |

**Tax Credits:**

- PAYE Tax
- WHT on royalty, annuity or management fees
- Tax deducted on dividends
- Self-assessment payment
- ESC
- Double tax relief

### 3.1.8 Individuals are taxed at progressive rate.

| Taxable income bracket |           | Tax rate on income in bracket | Total tax on income below bracket |
|------------------------|-----------|-------------------------------|-----------------------------------|
| From LKR               | To LKR    | Percent                       | LKR                               |
| 0                      | 500,000   | 4                             | 0                                 |
| 500,001                | 1,000,000 | 8                             | 20,000                            |
| 1,000,001              | 1,500,000 | 12                            | 60,000                            |
| 1,500,001              | 2,000,000 | 16                            | 120,000                           |
| 2,000,001              | 3,000,000 | 20                            | 200,000                           |
| 3,000,001              | Over      | 24                            | 400,000                           |

## 3.2 Taxation of Partnership

Partnership is the relationship between persons to carry on business in common with the view to profit.

It is a question of fact that the enterprise fall within the definition of Partnership.

- Relation of Agency
- Community in loses and profits
- Participate for the share of capital

[CIR V. Williamson (14TC365)]

### 3.2.1 Legal Status of Partnership

Partnership is an arrangement through which individuals carry on a trade, business, profession or vocation. Therefore, Partnership is not a legal person.

However,

Under the Prevention of Frauds Ordinance requires the partnership to establish by written agreement when the capital is over and above Rs. 1,000/-.

If the name of the business is different from that of the partners, then it should be registered as per Business Name Ordinance.

As the Partnership does not have the legal personality, Precedent Partner is liable to attend all the matters to be done by Partnership (\$191(1)).

### 3.2.2 President Partner:

Active partner who is resident in Sri Lanka,

- The person whose name in the first place in the agreement;
- The person whose name or initials precedent to the other partners in the name of partnership;
- The first name in the business registration.

### 3.2.3 Imposition of Income Tax

Under Section 2 of the IRD Act, profits and income charged from a person. But in the definition of person, partnership is excluded.

Even the charging section not cover the partnership to liable for tax, IRD Act No. 38/2000 introduced special provision to bring the partnership in the tax net.

Income tax is imposed on partnership under a section 78 of the Act. Accordingly, the method of computation of tax liability is different from a normal person.

Partnership is chargeable with income tax in respect of,

- Divisible profit and,
- Other income (rent, interest, dividend, annuity, royalty & discount etc.)

are in excess of Rs. 1,000,000/- at the rate of 8%.

[S78 – 10/2006]

### 3.2.4 Divisible Profit.

Divisible profit/loss is the profit/loss calculated in accordance with the provisions in the Act relating to the ascertainment of profits and income of person.

However, there is a special provision that no deduction should be allowed towards remuneration and interest paid to partners in computing the adjusted profits.

[S76 – 10/2006]

#### **Computation of Divisible Profits:**

|  |             |                    |
|--|-------------|--------------------|
| <b><i>Adjusted profits from trade, business<br/>Profession or vocation</i></b> |             | <b>XXXX</b>        |
| <b><u>Less:-</u></b>   |             |                    |
| Annuity and/Interest paid  |             | <u>(XXX)</u>       |
| <b><u>Add:-</u></b>  |             |                    |
| Remuneration paid to partners  | XXXX        |                    |
| Interest on partners' capital  | <u>XXXX</u> | <u>XXXX</u>        |
| <b>Divisible Profit</b>  |             | <b><u>XXXX</u></b> |

### 3.2.5 Distribution of Profits

Profit arising from partnership are the profit of the individual partners who carry on the business in the form of partnership. Therefore, income tax liability of partners are not limited to 8% tax paid by the partnership.



### **Distribution Rule:**

- Divisible profits – profit sharing ratio (this should be treated as profit from trade, business, profession or vocation).
- Other income - profit sharing ratio (this should be treated as profit from other source).
- Divisible loss - profit sharing ratio (this should be treated as loss arising from trade, business, profession or vocation).
- Qualifying payments - profit sharing ratio.
- Tax paid - profit sharing ratio.

### **3.2.6 Income of spouse in Partnership.**

Under section 25 (6) of the Act, profits and income received by one spouse for service rendered in a partnership of which other spouse is a partner shall be deemed to be the profits and income of that other partner.

Accordingly, the payment made by the partnership to a spouse of a partner is construed as an expenses incurred in the production of profits and income of partnership is deductible in arriving at the divisible profit of the partnership. However, such payment is to be considered as the income of the relevant partner whose spouse is received the payment for service rendered.

### **3.2.7 Sub Partnership**

Act does not defined what constitutes a partnership. However, according to section 217 partnership shall not include any disposition, trust, grant, covenant, agreement, assignment, settlement, or other arrangement by which the share of the divisible profits or the divisible loss of a partner of any partnership, is shared with any other person or partnership.

The above definition expects to exclude of creating a sub-partnership to share the profits of a partner within a partnership.

The reason behind this enactment was not to allow the sub-partnership considered as a valid partnership in the case of A.A. Davoobhoy vs. CGIR (4CTC122).

The taxpayer, Abasbhoy Davoobhoy was one of five partners of a firm carrying on business under the name of “Abdul Hassen Davoobhoy” and was entitled to one fifth share of its profits. He entered into a agreement with his children to share only the one fifth of the profits he received from the partnership.

Agreement and the rights claimed under the agreement were rejected by the Assessor and subsequent to that the case was heard by the Court of appeal and answered against the tax payer. The taxpayer appeal to Supreme Court,

It was held that,

- The agreement is not artificial and fictitious. And the agreement cannot be rejected under the law.
- Sub-partnership is a convenient name used in law and in commercial circle to describe a partnership is depend on another partnership. Therefore, such agreement is perfectly valid in civil law and therefore, attract the IRD provisions.

[A.A. Davoobhoy vs. CGIR (4CTC122)]

### 3.3 Taxation of Club & Trade Association

A club is an association of two or more people united by a common interest. Therefore a club is owned by members who carry out activities collectively.

A trade association is known as an industry trade group, business association or sector association. Many associations are not for profit oriented organizations governed by the officers who are members. Therefore, trade association also owned by members.

Club and trade associations are considered as a body of person is chargeable with income tax under section 2 of the IRD Act.

#### 3.3.1 Basis of Liability

The liability to tax of a Club or Trade Association (CTA) depend on the circumstance that,

- Deemed not to carry on a business.
- Deemed to carry on a business.

Where the CTA is not to carry on business will be liable to tax only on its investment income. However, if it is deemed to be carry on business will be liable to income tax on both investment income and business income.

##### 3.3.1.1 Deemed not to carry on a business

A Club or similar institution is liable to income tax on its investment income in the circumstances in which it is not deemed to carry on business.

A Club is not deemed to carry on business where it receives from its members not less than three-fourth of its gross receipts on revenue account including entrance fees and subscriptions

[S101(1)].

In such situation, CTA is chargeable with income tax only on its investment income,

- Income from property. Such as rent and NAV etc.,.
- Interest income
- Dividends

### 3.3.1.2 Deemed to carry on a business.

A Club is deemed to carry on business where it receives less than three-fourth of its gross receipts from members on revenue account including entrance fees and subscriptions

[S101(1)].

When a club is deemed to carry on business, the whole of the income arising from transaction both with members and others shall be considered as receipts from business and liable to pay tax on both its profits and investment income.

### 3.3.2 Gross receipts on revenue account

The gross receipts from members on revenue account include the followings,

- Entrance fees
- Subscriptions
- Donation from members
- Any other receipts from members

Income arising from transactions with members and others are,

- Entrance fees
- Subscription
- Receipt in respect of business transaction
- Receipt from fund raising activities. Eg. Carnival
- Benefit show

### 3.3.3 Computation of income tax of club

Whether the club is carrying out a business or not whole profits and income should be aggregated in computing total statutory income.

The assessable income of a club is derived after deducting the income not form a part of assessable income and deduction permitted under S32.

Taxable income of a club is the amount arrived after the deduction of qualifying payments from assessable income.

Taxable income of a club is liable to pat tax at 10%.

### 3.3.4 Computation of income tax of a Trade Association

The tax liability of a trade association, a chamber of commerce or similar institution depend on the institution is deemed to carry on business or not during the Y/A.

It is deemed to carry on business where more than half of its receipts by way of entrance fees and subscriptions are from persons who claim or would be entitled to claim as allowable deduction under section 25.

Where a trade association is deemed to carry on business, it will be liable to tax on the higher amount of,

- Business income
- Investment income

#### 3.3.4.1 Business income.

Business income is the profits and income computed in accordance with the provision of the Act. In computing the profits of the business, the whole of the income arising from transactions both with members and others including entrance fees and subscriptions will be deemed to be the receipts of such business.

Members in relation to club or trade association mean, those persons who are entitled to vote at a general meeting of the body which exercises effective control over its affairs.

### 3.4 Practice Questions

#### **e** 3.1

1. The following statements are given for your review:
- (i) "Business" includes the letting or leasing of any premises by a company.
  - (ii) "Child" includes an illegitimate child.

According to the definitions provided in the Inland Revenue Act No. 10 of 2006, which of the above statements is/are correct?

- A. Both (i) and (ii) are correct.    B. Both (i) and (ii) are incorrect.  
C. Only (i) is correct.                D. Only (ii) is correct.

#### **e** 3.2

Identify the income or the receipt given below which does not constitute a source of income of a resident person, under Section 03 of the Inland Revenue Act.

- A. Singapore Dollars 1,000 being interest on a fixed deposit maintained with a bank in Singapore.
- B. Rs. 420,000 being interest (net of withholding tax at 8%) on a fixed deposit maintained with a bank in Sri Lanka.
- C. Rs. 1,800,000 being net sale proceeds of his residential house in Kandy.
- D. Rs. 900,000 being a prize won at a lottery conducted by the National Lotteries Board.

#### **e** 3.4

Ruwan (MBBS, MD), is a medical doctor attached to a private hospital in Sri Lanka (his main employer). He has another contract of employment with another private hospital (second employer) to work three nights per week in the emergency treatment unit. Apart from that, he does his private practice (medical dispensary) till 9.30 p.m. at a rented premises for another three days a week. The following information is available for the year of assessment 2014/15.

(1) (i) Employment income from the main employer

- Basic salary: Rs. 135,000 per month.
- Ruwan uses his own vehicle for official travelling as well as private travelling. Reimbursement on private travelling during a month is approximately Rs. 40,000. The total of such reimbursements for the above year of assessment was Rs. 480,000.

- His residential telephone bill and mobile bill are also reimbursed. Such reimbursements made to him during the year of assessment were Rs. 38,000.
- As per the hospital service contract, Ruwan's spouse and two of his family members are entitled to obtain medical treatment from the hospital. At the end of the year of assessment, the cost will be reimbursed subject to a maximum amount of Rs. 200,000.

During the year of assessment, his wife was hospitalised, and the total bill was Rs. 314,000. Other than that, no other medical treatment was obtained from this hospital.

- Contribution made by the employer to a provident fund which is a fund approved by the Commissioner General of the Inland Revenue was Rs. 194,400.
- PAYE deduction made by the main employer during the year of assessment was Rs. 91,000.

(ii) Employment income from the second employer

Each month Ruwan was paid more than Rs. 80,000 for the work done at night in the emergency treatment unit. During the year of assessment he was paid Rs. 924,000 after deducting withholding tax.

(2) The following is a summary of the income statement and other information of the medical dispensary prepared for the year ended 31 March 2015.

|   | Rs.              |
|---|------------------|
| Receipts                                  | 3,733,000        |
| Receipt from sale of blood pressure meter | 2,000            |
|   | <b>3,735,000</b> |
| Salaries paid to a dispenser (wife)       | 175,000          |
| Foreign travel (Note 1)                   | 177,000          |
| Cost of drugs                             | 370,000          |
| Rent                                      | 360,000          |
| Stationery                                | 35,000           |
| Purchase of medical equipment (Note 2)    | 75,000           |
| Water                                     | 36,000           |
| Electricity                               | 240,000          |
| Other expenses (Note 3)                   | 490,000          |
| <b>Net profit</b>                         | <b>1,777,000</b> |

Note 1: Ruwan participated in a medical seminar held at the University of Chittagong in Bangladesh. The cost related to the airfare was Rs. 54,000. The cost of accommodation and other expenses were Rs. 123,000. Profit and income adjusted for tax purposes of the dispensary for the previous year of assessment was Rs. 1,872,000.

Note 2: The cost of purchase of medical equipment includes Rs. 21,000 spent on the purchase of a new blood pressure meter. This new pressure meter was purchased within two weeks from the date of sale of the old blood pressure meter which was purchased in 2003 for Rs. 8,000. No depreciation allowance was claimed on the old blood pressure meter.

There are no other qualifying assets on which allowances are claimable.

Note 3; 'Other expenses' are allowable for tax purposes.

(3) Ruwan has made the following payments during the year of assessment:

- Rs. 230,000 as interest on a loan taken for the wedding of his daughter. Capital repayment of this loan was Rs. 360,000.
- Rs. 80,000 has been paid as a premium on his life insurance policy and Rs. 75,000 has been paid on a medical insurance policy obtained for an incurable disease.

(4) Self-assessment payments made for the year of assessment 2014/15 were Rs. 20,000.

**Compute the gross income tax liability, balance tax payable/(refund due) by/to Ruwan for the year of assessment 2014/15.**

### **e** 3.5

Piyathilaka is an Engineer serves as a lecturer of a Private university. In addition to lecturing, he provides professional services to his clients.

The following information provided in respect of the year of assessment 2014/15.

(1) Gross monthly salary is Rs.125,000/- and he was paid a bonus of Rs.245,000/- during the year. In addition to these, he was paid a travelling allowance of Rs.50,000/- per month by the university.

(2) Net profit for the year from his private professional services was Rs.1,250,000/- which was arrived at after deducting the following expenses:

- (i) Depreciation on his car (he had purchased his car on 01st April 2013 for his personal use) – 850,000/-
- (ii) Book-keeping charges, to his wife - Rs.12,000/- per month

(3) He lives with his family in a house inherited from his parents. Floor area of the house is 2,500 Square feet and rating assessment is Rs.95,000/-. The House was entirely renovated in the year 2013.

(4) Construction of his new house in Colombo was completed in January 2013, and it was rented for Rs.85,000/- per month from April 2013. Rating assessment is Rs.95,000/- and rates are paid at 30%. Floor area of the house is 2,000 square feet.

(5) (i) Interest received by him on an investment in Treasury Bills was Rs.125,000/-.

(ii) Interest Income on a fixed deposit in a finance company was Rs.250,000/-. WHT was not deducted.

(6) He received a dividend from Central PLC, and the following particulars were stated in the dividend warrant counterfoil.

Dividends out of profits liable for tax: Net dividend 144,000

Dividends paid out of exempt profits 72,000

(7) Piyathilake has paid an Interest of Rs.75,000/-, and capital of Rs.100,000/- on a loan obtained from Sampath Bank to renovate his old house.

(8) He has donated Rs.50,000/- to poor students at the University.

(9) Annual premium paid by him on a policy of life insurance was Rs.75,000/-.

(10) PAYE deduction for the year was Rs.72,000/-.

(11) Self-assessment income tax payment for the year of assessment 2014/15 was Rs.350,000/-.

**You are required to compute**

(a) Statutory Income from each source of income (b) Total Statutory Income

(c) Assessable Income (d) Taxable Income

(e) Gross Income Tax payable and balance Income Tax Payable / Refund due for the Year of Assessment 2014/15.

**e** 3.6

Rumesh and Umesh carrying out a partnership with equally share the profits & income. The net profit of the business for the YA 2014/15 was Rs. 5,675,125/-. Profit was calculated after considering the following transactions.

- Royalty 475,000.
- Salary paid to Rumesh 1,850,000 and to Umesh 925,000.
- Interest paid on capital contribution to Umesh was 225,000 and to Rumesh 425,000.
- Interest on bank deposits 300,000.

**Required:**

Determine the divisible profit for the YA 2014/15 and tax payable.

**e** 3.7

Using the above example,

- Determine the profits of each partner from partnership.
- Determine the tax credit available for the partners.



### **e** 3.8

You are a tax consultant of Kusum Peiris. She disclosed the following details to you and request to compute her tax liability for the YA 2014/15.

1. An apartment purchased by her given on rent and the total rent collected was Rs. 2,400,000/-.

- a. Rates paid (30% of the rating assessment) Rs. 60,000/-
- b. Advertising Rs. 15,000

2. She has constructed a house with the floor area of 2,600sqft and let for monthly rent of Rs. 85,000/-. This was constructed on bank loan obtained from NSB. This property has been valued by the local authority for Rs. 300,000/-. The rate payable is at 20%.

3. She occupied a house at Maharagama. The rating assessment of this house is Rs. 128,500/-. MMC charges the rates at 12% on rating assessment.

4. She has invested in some quoted public companies and received the dividend (net) Rs. 345,896/-.

5. She incurred following expenses during the year

- a. Interest payment for housing loan Rs. 328,745/-
- b. Apartment repair charges Rs. 245,968/-

6. Kusum Pieris is a partner of Wewala Enterprise. She receives 1/3rd of the profit from partnership. The following information extracted from the partnership for the YA 2014/15.

- Adjusted profit for tax purpose Rs. 2,654,325/-
- Partners were paid interest on capital
  - a. Kusum Rs. 85,456
  - b. Nelum Rs. 47,856
  - c. Waruni Rs. 65,456
- Salaries were paid to Kusum and Waruni amounting to 1,500,000/-
- Interest received on fixed deposit account Rs. 300,000/-

**You are required to,**

- a) Calculate the divisible profit of partnership, distribution of profit between two partners and the tax payable by partnership.
- b) Taxable income of Mr. Sudarshan and the balance tax payable for the YA 2014/15.

### **e** 3.9

Mr. Sudarshan Kumaraswami is a partner of Kumar Auto Traders. Mr. Sudarshan & Mr. Ajanthan are carrying on this partnership business sharing the profits and loss equally.

During the year of assessment 2014/15 partnership recorded Rs. 4,475,895/- net profits after charging following income and expenses.

1. Salaries paid to partners:  
Mr. Sudarshan - 1,800,000/- Mr. Ajanthan - 1,800,000/-
2. Depreciation on motor car - Rs. 940,000/-.
3. Advertisement expenses - Rs. 285,000/-.
4. Interest on capital:  
Mr. Sudarshan - 250,000/- Mr. Ajanthan - 250,000/-
5. Interest paid for short term loan (STL) - Rs. 675,000/-
6. Interest on Fixed Deposit – Rs. 150,725/-

Further, Mr. Sudarshan Kumaraswami is having profits from following activities;

- Net dividend on the investment made in public quoted companies amounting to Rs. 327,525/- .

- Interest from the deposit in Bank of Ceylon was Rs. 768,500/-. This was subjected to WHT.

- He owns two houses, one is at Nuwara Eliya and the other one is at Down South. He purchased a Nuwara Eliya house in 2009 and the Down South house was constructed in 2012.

Nuwara Eliya house was given on rent with the furniture at a monthly rent of Rs. 95,000/-. Rating assessment is Rs. 250,000/- and the rates paid at 25%.

Down South house use by Mr. Sudarshan and his family during their vacation. This house was constructed on bank loan obtained from BOC. The property is valued by the local authority for Rs. 450,000. The rates should be paid at 30%.

He incurred following expenses during the year.

Interest paid for bank loan obtained to construct the house is Rs. 575,125/-

Repair expenses for Nuwara Eliya house is Rs. 385,965/-

Furniture maintenance for Nuwara Eliya house is Rs. 245,625/-

**You are required to,**

- a) Calculate the divisible profit of partnership, distribution of profit between two partners and the tax payable by partnership.
- b) Taxable income of Mr. Sudarshan and the balance tax payable for the YA 2014/15.

### 3.10

The income and expenditure account of Food Ball Club for the year ended 31.03.2015 is as follows.

| <b>Income</b>         | <b>Rs.</b> | <b>Expenses</b>        | <b>Rs.</b> |
|-----------------------|------------|------------------------|------------|
| Subscription          | 12,000.00  | Office salary          | 10,000.00  |
| Entrance fee          | 3,000.00   | Rent & rates           | 5,000.00   |
| Donation from members | 8,000.00   | Postage and Stationery | 2,500.00   |

|                                   |                  |                       |                  |
|-----------------------------------|------------------|-----------------------|------------------|
| Profit from benefit show          | 9,000.00         | Upkeep of furniture   | 500.00           |
| Liquor sales                      | 5,000.00         | Telephone             | 1,000.00         |
| Interest                          | 9,000.00         | Audit fees            | 1,000.00         |
| Donation from others              | 25,000.00        | Donation              | 10,000.00        |
| Dividend (net)                    | 10,200.00        | Gift to poor children | 5,000.00         |
|                                   |                  | Purchased furniture   | 10,000.00        |
| Excess of income<br>over expenses | 36,200.00        |                       |                  |
|                                   | <b>81,200.00</b> |                       | <b>81,200.00</b> |

Other information:

- a) Office furniture purchased during the year.
 

|                |       |
|----------------|-------|
| Writing table  | 4,000 |
| Steel cupboard | 6,000 |
- b) Donation made during the year to Ceylon Cancer Society. Which is an approved Charity.
- c) Tax deducted on dividend at 10% is Rs. 1,133/-
- d) No tax has been deducted on interest.

**You are required,**

1. Determine whether Foot Ball Club is carry on business.
2. Calculate Deemed profit, if any.
3. Calculate Business profits, if any.
4. Calculate statutory income from other source.
5. Calculate total statutory income, assessable income, and taxable income.
6. Calculate tax payable of Foot Ball Club for the Y/A 2014/15.

# Module 4: Taxation of Companies.

Outline:

- Definitions of corporate bodies.
- Tax structure of a Company.
- Resident and Non-resident Company.
- Basic understanding of Thin Capitalization and Transfer Pricing.
- Distribution Rules.
- Director's responsibilities and liabilities.
- Remittance tax.
- Computation of Tax Liability of a Company.

## 4.1 Definition of a Company

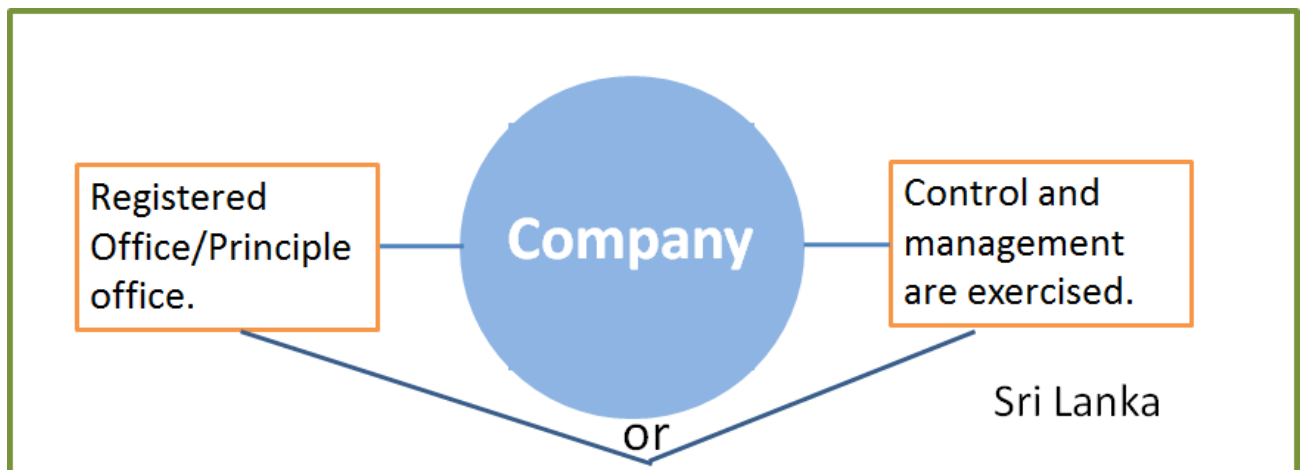
A company is a form of business organization recognized in law as a legal person with separate identity from its owners.

Company means, any Company incorporated or registered under any law in force in Sri Lanka or elsewhere and includes public corporation.

Public Corporation means, any corporation, board or other body which was or is, established by or under, any written law, other than the companies Act, No 7 of 2007, with capital wholly or partly provided by the Government, by way of grant, loan or other form.

[S217/2006-10]

## 4.2 Residential Status of a Company



[S79(1)/2006-10]

### 4.3 Thin Capitalization Rule

The implication of thin capitalization rule arise on the income arising from investment in equity and loan capital in corporate entity.

The associate company receives the interest is subjected to tax in full amount of the interest income. However, there is a limitation for the deductibility of the interest in the hands of associated companies in the case of loan obtained from a holding company by a subsidiary or holding company from a subsidiary company.

#### **Manufacturing company (3:1)**

Interest above 3 time of issued share capital and reserves (equity).

Company shall be a manufacturing company where more than 50% of the turnover is from the sale of products manufactured by such company.

$$\frac{\text{Loan} - (3x \text{ Equity})}{\text{Loan}} \times \text{Interest} = \text{Disallowable Interest}$$

#### **Non-manufacturing company (4:1)**

Interest above 4 time of issued share capital and reserves (equity).

$$\frac{\text{Loan} - (4x \text{ Equity})}{\text{Loan}} \times \text{Interest} = \text{Disallowable Interest}$$

[S26 (x), (y)/2006-10]

#### **Income not form part of assessable income.**

1. Interest income from corporate debt securities subject to WHT.
2. Rewards or share of fine subject to WHT at 10%.
3. Lottery prize or winning from gambling or betting subject to WHT at 10%.
4. Interest on compensation in respect of a property vested from the government or land reform commission or public corporation is subjected to WHT at 10%.
5. Interest from Rupee TB purchased out of TIREA.
6. Sale of gem subject to 2.5% tax.

### 4.4 Permitted Deductions (S32).

The following expenses are permitted to deduct in arriving the assessable income.

- Annuity, ground rent, royalty or interest.
- Loss incurred in any trade, business, profession or vocation.
- Business commencement expenses (non-capital nature).
- Ground rent and royalty removed from S32 and allow under S25.c

## 4.5 Qualifying Payments (S34).

| Type of QP  | Limit  | C/F                                  |
|---|--|--------------------------------------|
| Donation to approved charity  | 1/5 <sup>th</sup> of AI or 500,000                                 | -                                    |
| Donation in money or otherwise to Government, local authority, funds established by the government, provincial council or local authority, any university, sevana fund, Api Wenuwen Api Fund. | 1/5 <sup>th</sup> of AI  | Unlimited                            |
| Approved expenditure on Government development plan   | 1/5 <sup>th</sup> of AI  | Unlimited                            |
| Production of a film at a cost not less than 5Mn  | 1/5 <sup>th</sup> of AI or 10Mn from 01.04.2007<br>35Mn 01.04.2008 | Succeeding<br>Two years<br>Unlimited |
| Expenditure not exceeding 25Mn in the construction and equipping Cinema   | 25Mn   | Unlimited                            |
| Relocation expenses of section 21A (2)  | -  | -                                    |
| Investment in an undertaking referred to S. 13 (zzz)  | 1/5th of AI  | unlimited                            |
| Expansion of any undertaking referred to S. 16C & 17A   | 25% of the investment  | Three years                          |
| Investment in an undertaking referred to S. 16D   | 25% of the investment  | Three years                          |
| Expenses on acquisition or merger of bank or finance companies  | 1/5th of AI  | -                                    |
| Expenditure not exceeding 10Mn for upgrading Cinema   | 10Mn   | Unlimited                            |
| Gazetted community development project  | 10Mn   | -                                    |

## 4.5 Tax Rates

Once the taxable income is calculated, the relevant tax rate to be applied in computing the gross tax liability of a person at,

- Normal rate,
- Reduced rate, or
- Higher rate.

|   |                    |
|---|--------------------|
| Gross tax payable (taxable income X tax rate) | XXXX               |
| Less: Tax credits                             | (XXX)              |
| <b>Balance tax payable</b>                    | <b><u>XXXX</u></b> |

| <b>Company</b>  | <b>Rate</b> |
|---|-------------|
| Holding Company, Subsidiary or associate  | 28%         |
| Companies other than group companies  | 28%         |
| - Taxable income exceed 5Mn   | 12%         |
| - Taxable income not exceed 5Mn   |             |
| Turnover not exceed 500Mn (other than whole sale and retail an group companies)             | 10%         |
| Educational Services  | 10%         |
| Manufacture, import, sales of any liquor, tobacco products and lottery, betting or gambling | 40%         |

#### **Tax Credits:**

- WHT on royalty, annuity or management fees
- Self-assessment payment
- ESC
- Double tax relief

## 4.6 Tax on Dividend.

When a company distributes its profits to shareholders are liable to withheld 10% on such distribution as dividend tax.

The following dividend are not liable for dividend tax:

- Dividend distributed out of the dividend received
- Dividend distributed to persons referred to S. 7 (a), (c) and (h)
- Dividend distributed to approved unit trust or mutual fund
- Dividend distributed to Api Wenuwen Api Fund
- Dividend distributed to persons referred to S. 10

## 4.7 Deemed Dividend Tax.

Company distributes dividends to its shareholders out of the profits earned in preceding year, such profit called as distributable profit. The dividend should be distributed within 18 months not less than 10% of the distributable profit.

If the company fails to distribute dividend as specified above will be subjected to tax at 15% on the excess of 33 1/3 % of the distributable profit of the preceding year.

In computing distributable profit of YA 2014/15, it is required to find out whether the company has distributed as least 10% of the distributable profit for the YA 2013/14 on or before 30.09.2014.

### Computation of distributable profit:

|                                       |            |                    |
|---------------------------------------|------------|--------------------|
| Book Profits                          |            | XXXX               |
| Less: Tax on taxable income           |            |                    |
| Cost of acquisition of Capital Assets | XXX        |                    |
| Re-valuation profits charged to P&L   | <u>XXX</u> | <u>(XXX)</u>       |
|                                       |            | XXXX               |
| Add: Depreciation on capital assets   | XXX        |                    |
| Re-valuation loss charged to P&L      | <u>XXX</u> | <u>XXXX</u>        |
| <b>Distributable Profits</b>          |            | <b><u>XXXX</u></b> |



## 4.8 Practice Questions

### **e** 4.1

Apparel Manufactures Pvt. Ltd incorporate in June 2011 and engages in manufacturing of garments and selling to local market and export to EU market. The following information are extracted from the books of Apparel Manufactures Pvt. Ltd for the year 2013/14.

1. The PBT for the year ended 31.03.2014 was Rs. 4,375,000.
2. Total turnover is Rs. 94,750,605 and out of which 40% earned from the export sales to EU market.
3. Other income credited to income statements includes,
  - a. Interest income on LKR denominated FD (gross) 325,000
  - b. Interest on Treasury Bond (net) 235,000
  - c. Profit on sale of dying plant 475,000
  - d. Dividend 97,500
  - e. The expense charged to income statement includes the following.
4. Donation made to Cancer Hospital Rs. 250,000
  - a. Foreign training expenses Rs. 625,000. This was spend to train the employee to operate new embroider machine imported from German during the year for Rs. 2,750,000.
  - b. Advertisement of Rs. 427,500.
  - c. Rs. 47,500/- spend in respect of recruiting new technical manager
  - d. Interest paid on finance leasing Rs. 185,000
5. Company purchased delivery van on lease for a period of four years on 01.07.2012 for a monthly installment of Rs. 37,000. During the year company has paid 10 installment.
6. Depreciation charged to income statement is Rs. 1,575,235.
7. Provision made for gratuity Rs. 1,250,000.
8. Entertainment expenses Rs. 125,250.
9. Fixed assets as at 31.03.2014 are as follows.

| Description            | 01.04.2013       | Addition         | Disposal         | 31.03.2014       |
|------------------------|------------------|------------------|------------------|------------------|
| Sewing machine         | 2,750,125        |                  |                  | 2,750,125        |
| Dying plant            | 1,500,000        | 2,000,000        | 1,500,000        | 2,000,000        |
| Embroider machine      | -                | 2,750,000        |                  | 2,750,000        |
| Furniture and Fittings | 750,000          | 125,000          |                  | 875,000          |
| Computers              | 450,000          | 225,000          |                  | 675,000          |
|                        | <b>5,450,125</b> | <b>5,100,000</b> | <b>1,500,000</b> | <b>9,050,125</b> |

10. There is a B/F trading loss of Rs. 2,654,378.

You are required to compute the taxable income Apparel Manufactures Pvt. Ltd for the YA 2014/15. You may give the realistic assumption whenever you think is necessary.

## e 4.2

Telco Pvt. Ltd is a Company incorporated in Sri Lanka in 2010 and engages in international telecommunication. The following details are extracted from the books of the Company for the YA 2014/15. 75% of the turnover of the Company comes from the customers in outside Sri Lanka.

1. Share capital of the company is 10,125,896/- (10/- each).
2. Gross profit of the company is Rs. 15,165,350/-.
3. The gross profit margin is 35% and the net profit margin is 12%.
4. The Company declares Rs. 12,650,789/- as the statutory income in the last year annual return.
5. The details of the other income are given below.
  - Dividend received Rs. 125,000/-
  - Interest income from Fixed Deposits in USD Rs. 312,500/-
  - Profit from sale of telecom equipment Rs. 245,658/-
6. The following expenses are charged to the income statement;
  - Entertainment expenses Rs. 643,000/-.
  - Company has spend Rs. 632,425/- towards advertising and business promotion. Out of which Rs. 275,365/- spend towards recruitment of employees.
  - During the year Company paid 2,568,471/- as gratuity for the employee who resigned during the year. The gratuity provision in the books is Rs. 8,74,985/-.
  - Oversea training expenses is Rs. 2,356,487/-.
  - Donation to the approved charity Rs. 500,000/-.
7. Movements of the property, plant and equipment.
  - Gross block of the assets as at 01.04.2014.

|                      |            |
|----------------------|------------|
| Furniture & Fittings | 875,965    |
| Telecom Equipment    | 11,456,893 |
| Plant & Machinery    | 6,758,145  |
  - During the year company has disposed telco equipment purchased in 2010 at Rs. 625,789/-.
  - Assets reported on 01.04.2014 are purchased during the year 2010.
8. Company depreciates its fixed assets as follows.

|                      |     |
|----------------------|-----|
| Furniture & Fittings | 25% |
| Telecom Equipment    | 25% |
| Plant & Machinery    | 12% |
9. All other expenses correctly charged to the income statement for the income tax purpose.
10. Company distributed Rs.6.50/- dividend per share during the year.
11. The self-assessment payment made during the year was Rs. 1,650,158/-.

You are required to compute the adjusted profit of the company and the balance tax payable for the YA 2014/15.

### **e** 4.3

You are provided with the following summarized Income Statement of Kingrose (Pvt) Ltd.

#### Kingrose (Pvt) Ltd. Income Statement for the year ended 31st March 2015

|   |                   |
|---|-------------------|
| Turnover                                  | 140,800,000       |
| Gross Profit                              | 27,456,000        |
| <b>Add: Other Income</b>                  |                   |
| Profit on disposal of Machine             | 412,500           |
| Interest income received                  | 375,000           |
|   | <b>787,500</b>    |
| <b>Less:</b>                              |                   |
| Administration Expenses                   | (8,363,250)       |
| Distribution Expenses                     | (2,988,775)       |
| Finance and Other Expenses                | (1,932,500)       |
|   | (13,284,525)      |
| <b>Net Profit /(Loss) Before Taxation</b> | <b>14,958,975</b> |

Net profit before taxation for the year ended 31st March 2015 is arrived at after charging all the expenses including the following:

|   |           |
|---|-----------|
| Depreciation                              | 2,386,692 |
| Entertainment expenses                    | 191,250   |
| Lease Interest                            | 118,825   |
| Provision for bad and doubtful debts      | 370,500   |
| Provision for gratuity                    | 765,000   |
| Donations                                 | 250,000   |
| Advertising - Staff recruitment           | 67,500    |
| - Others                                  | 850,000   |
| Foreign travelling                        | 843,000   |
| Legal fees                                | 132,000   |
| Rent paid for factory Manager's residence | 216,000   |
| Stamp duty paid on lease agreement        | 20,700    |

(1) The building in which the operations are carried out was constructed during the year of assessment 2012/13.

(2) The company has sold a sewing machine on 01st May 2014 and a new sewing machine was purchased on 01st September 2012.

(3) Opening balance of motor vehicles consists of Lorries used for the purpose of transport of raw material and finished goods. During the year, the company has purchased a car for the use of the Managing Director for Rs.2,500,000/-.

(4) A cutting machine was obtained under a finance lease agreement for a period of 48 months from 15th June 2013. Monthly installment of the lease is Rs.25,500/-. The company has paid 10 installments during the year.

(5) Unless stated otherwise, all items of Property, Plant and Equipment as at 01st April 2014 have been acquired in the year of assessment 2011/12 when the company commenced its operations.

(6) (i) The bad debts of Rs.68,000/- had been provided as doubtful debts earlier, written off during the year. In addition to that, a trade debt of Rs.75,000/- was estimated to have become a bad debt during the year.

(ii) The company has recovered Rs.248,000/- during the year from Amco (Pvt) Ltd. which had been provided for in the previous year as a doubtful debt. This amount has been credited to provision for bad and doubtful debts account.

(7) During the year, company has donated plastic waste bins worth of Rs.200,000/- to the Pradeshiya Saba and cash donation of Rs.50,000/- was made to the company's employees welfare society.

(8) The company has paid Rs.425,000/- for air tickets of Managing Director who visited China to inspect a new sewing machine. Balance of foreign travelling expenses was incurred in respect of participation to a trade fair in Germany.

(9) During the year, legal fees of Rs.72,000/- has been incurred for a labour case in District Court. In addition to that, the company has paid Rs.60,000/- to a Consultant in respect of an appeal made against an additional assessment of income tax.

(10) The company has paid Rs.216,000/- for the year to owner of the house in respect of rent free residence provided to the Factory Manager, who was employed throughout the year and received a salary of Rs.100,000/- per month.

(11) Movement of PPE

| <b>Cost</b>             | <b>As at 01.04.2014</b> | <b>Additions</b>    | <b>Disposals</b>   | <b>As at 31.03.2015</b> |
|-------------------------|-------------------------|---------------------|--------------------|-------------------------|
| Building                | 2,325,000               |                     |                    | 2,325,000               |
| Furniture & Fittings    | 635,500                 |                     |                    | 635,500                 |
| Sewing machine          | 2,550,000               | 1,440,000           | 1,275,000          | 2,715,000               |
| Computer                | 406,000                 |                     |                    | 406,000                 |
| Factory Equipment       | 360,000                 | 900,000             |                    | 1,260,000               |
| Motor Vehicles          | 3,650,000               | 2,500,000           |                    | 6,150,000               |
| <b>Leasehold Assets</b> |                         |                     | -                  |                         |
| Cutting Machine         | -                       | 840,000             |                    | 840,000                 |
|                         | <b>9,926,500</b>        | <b>5,680,000</b>    | <b>1,275,000</b>   | <b>14,331,500</b>       |
| <b>Depreciation</b>     | <b>As at 01.04.2014</b> | <b>For the year</b> | <b>on Disposal</b> | <b>As at 31.03.15</b>   |
| Building                | 50,000                  | 51,667              |                    | 101,667                 |
| Furniture & Fittings    | 285,975                 | 95,325              |                    | 381,300                 |
| Sewing machine          | 1,530,000               | 543,000             | 765,000            | 1,308,000               |
| Computer                | 243,600                 | 81,200              |                    | 324,800                 |
| Factory Equipment       | 270,000                 | 67,500              |                    | 337,500                 |
| Motor Vehicles          | 2,190,000               | 1,380,000           |                    | 3,570,000               |
| <b>Leasehold Assets</b> |                         |                     | -                  |                         |
| Cutting Machine         | -                       | 168,000             |                    | 168,000                 |
|                         | <b>4,569,575</b>        | <b>2,386,692</b>    | <b>765,000</b>     | <b>6,191,267</b>        |

(12) No payment has been made as gratuity during the year.

(13) Interest income is the net interest received on treasury bills.

(14) Taxable business loss brought forward from the year of assessment 2013/14 was Rs.6,223,500/-.

**You are required to compute:**

(a) Statutory Income from each source of income, (b) Total Statutory Income, (c) Assessable Income, (d) Taxable Income, (e) Gross Income Tax Payable, (f) Loss to be carried forward, if any