



The Institute of Chartered Accountants of Sri Lanka

TAXATION

Certificate in Accounting and Business II (CAB – II)

Supplement for Study Text

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The Study Text in Taxation for CAB – II level (Revised Edition - 2013) has been compiled on the basis of year of assessment 2012/2013. According to the present examination policy of the Institute questions in income tax for September 2014 and March 2015 examinations will be set based on the year of assessment 2013/2014. The purpose of this publication is to provide necessary updates to the present study text for the students preparing for September 2014 and March 2015 Examinations.

Chapter 01 – Income Tax

Page 2 – Charging Section

Sixth amendment to the Act

Inland Revenue (Amendment) Act No. 18 of 2013

Meaning of Resident Person

An individual who is physically resident in Sri Lanka for 183 days or more during any year of assessment is deemed resident in Sri Lanka through that year.

Page 5 – Table of Depreciation Rates

New categories effective from 2013

- a) High Tech Plant and Machinery meets more than 30% of the total power requirement of that business out of alternative energy sources (any source other than National Grid) – 100%
- b) Plant and Machinery for technology upgrading purposes or introducing new technology – 50%
- c) Plant and Machinery used in a business with at least 60% of turnover is from exports – 50%

(Applicable for assets under these categories, acquired on or after April 1, 2013)

Page 11 – Allowable expenses

Paragraph “O” to be amended as follows (effective from 2013/2014)

O. Double deduction for research and development expenses including expenditure in capital nature. If such research is carried out through any institution in Sri Lanka a deduction equal to three times of the expenditure will be allowed.

Page 13 – Deduction not allowed

Paragraph (i) to be amended as follows (effective from 2013/2014)

- i. One fourth (1/4) of cost of commercial advertisement incurred in Sri Lanka.

Note that cost of public notices including advertising vacancies in the business and sponsorship of international sport events approved by the Minister of Sports will not come under disallowable expenditure.

Cost of advertisement outside Sri Lanka incurred are fully allowed if such expenses are;

- i. Solely in connected with the export of any article or goods or
ii. The provision of any service for payment in foreign currency

Page 19 – Employment income exempt from tax

Paragraph “g”

This exemption is not applicable for the year of assessment 2013/2014. Instead a deduction equivalent to this value is granted as a qualifying payment (See paragraph 02 of page 33)

Page 21 – Computation of employment income

Answer to be amended as follows

| | | Rs. |
|--|---|-----------|
| Salary | 120,000 x 12 | 1,440,000 |
| Contribution to EPF by employer | Not taxable | 0 |
| Entertainment allowance | 15,000 x 12 | 180,000 |
| Bonus on cash basis | 120,000 x 3 | 360,000 |
| Director fees | Net 216,000 WHT @ 10% <u>24,000</u> | 240,000 |
| Vehicle benefit – 1800cc car with driver | Rs. 50,000 x 12 = 600,000 (one vehicle exempted) | 0 |
| Official expenses reimbursed | Not taxable | 0 |
| Family medical bills | Taxable benefit | 75,000 |
| Subscription to Professional Institute | Taxable benefit | 25,000 |
| Grant for daughters achievement | Personal gift – Not taxable | 0 |
| Residential telephone bills | Rs. 60,000 x 50% | 30,000 |

| | | |
|---|---|------------------|
| Gross remuneration | | 2,350,000 |
| Housing benefit | Rental value $120,000 + 25,000 = 125,000$ Rent paid to owner $20,000 \times 12 = 240,000$ Higher of that = 240,000 As the gross remuneration exceeds Rs. 1.8mn taxable value limited Rs. 180,000 | 180,000 |
| Statutory income from employment | | 2,530,000 |

Note

Since his employment income exceeds Rs. 600,000 he is entitled for a deduction of Rs. 100,000 under qualifying payments.

Page 25 – Dividend Income

1. Definition;

Following paragraph to be added as” e”.

- e. Any excess paid to shareholder over the market price, in a buyback arrangement of shares by a company from its shareholders.

Page 26 – Exempted interests

Following paragraph to be added as “d”

- d. Interest or discount accruing to any person from any investment made on or after January 1, 3012, in any quoted Corporate Debt Security (Debenture) or Municipal Bond issued by any Municipal Council with the approval of Secretary to the Ministry of Finance.

Page 29 – Miscellaneous Exemptions

Following paragraph to be added as “18”

18. Where a citizen of Sri Lanka, employed abroad returns on or after January 1, 2013 and invests his earnings from employment abroad to commence any business of manufacturing any product other than liquor or tobacco, or provision of any service, the profits and income such business will be exempted for a period of five years.

Page 34 – Qualifying Payments

Following paragraph to be added as “(l)” immediately after the paragraph (k)

- (l). Where the profits from employment of any individual, (other than lump sum receipts at retirement referred to in paragraph 1.g under employment income) exceeds five hundred thousand rupees,
 - a) such part of profit in excess of five hundred thousand rupees or
 - b) one hundred thousand rupeeswhichever is lower

Note (3) of the same page to be amended as follows

- (3) An individual shall not be entitled to deduct any part of allowance for qualifying payments described from (a) to (k) above, from any employment income which is included in the assessable income.

Page 35 – Example 1.13.1

Compute the taxable income of Mr. Perera for the year of assessment 2013/2014

| | Rs. | Rs. |
|--|----------------|------------------|
| <u>Employment income</u> | | |
| Salary and allowances | 920,000 | 920,000 |
| <u>Business</u> | | |
| Adjusted Profit | | 880,000 |
| <u>Winning from lottery</u> – final tax deducted Rs.900,000 | Not taxable | 0 |
| Total statutory income | | 1,800,000 |
| <u>Deductions under Sec. 32</u> | | |
| Annuity paid – alimony | 80,000 | |
| Housing loan interest | <u>120,000</u> | (200,000) |
| Assessable income | | 1,600,000 |
| Tax free allowance | | (500,000) |
| <u>Allowance for qualifying payments</u> | | |
| • Donation in money to Victoria Home | 40,000 | |
| • Life insurance premium | <u>48,000</u> | |
| Total | <u>88,000</u> | |
| Allowance for above is limited to Rs. 75,000 | 75,000 | |
| • 50% of Venture capital investment Rs. 600,000 Allowance limited to 1/3 rd of assessable income | 500,000 | |
| • Donation to Api Wenuwen Api Fund | 100,000 | |
| • Deduction on account of employment income | <u>100,000</u> | (775,000) |
| Taxable income | | 325,000 |

Note; Following payments / donations are not allowed

Housing loan – capital Rs. 200,000

Car loan interest Rs. 60,000

Donation to YMBA Colombo - in money Rs. 25,000

Donation to Victoria Home for Disabled - goods worth Rs. 10,000.

Living expenses Rs. 600,000

Page 37 – Computation of Income Tax

Paragraph b, c and d to be amended as follows

- b. Profits and income from following activities are taxable as per rates given in paragraph (1) above subject to a maximum of 10%. (Not applicable to profit on disposal of capital assets.)
- Operation & maintenance of storage facilities,
 - Development of software,
 - Supply of labour (man power),
 - Educational services,
 - Agricultural undertakings,
 - Any undertaking with an annual turnover not exceeding 500 million other than buying and selling activities.
- c. Profits and income from following activities are taxable as per rates given in paragraph (1) above subject to a maximum of 12%, where the annual turnover exceeds Rs. 500 Million. (Not applicable to profit on disposal of capital assets.)

Promotion of tourism

Hotel or guest house approved by Ceylon Tourists Board

Restaurant graded Class A or B by Tourists Board

Business of travel agent

Business of transporting tourists

Business providing facilities of recreation or sports for tourists approved by Tourists Board.

Undertaking for construction work

Construction of any building, road and bridges, water supply and drainage or sewerage system

Qualified exports including deemed (indirect) exports.

Non traditional goods manufactured, produced or purchased

Export of services including

Ship breaking and repair,

Refurbishment of marine cargo containers,

Computer software and recording computer data,

Other service gazetted by minister.

Traditional exports are black tea in bulk, crape rubber, sheet rubber, scrap rubber, latex or fresh coconut and basic agricultural produce.

- d. Profits and income from following activities are taxable as per rates given in paragraph (1) above subject to a maximum of 16%.
- Employment income of a pilot of an air line licensed under the Air Navigation Act
 - Employment income out of exempted foreign currency income of employer (under Sec. 13) from provision of services in or outside Sri Lanka to a person outside Sri Lanka.

Page 40 – Answer for example 1.14.4

Revised Table of Gross Income Tax

| | | |
|------------------|------------------|---------|
| First | 500,000 X | 20,000 |
| 4% | | 40,000 |
| Next | 500,000 X | 80,000 |
| 8% | | 4,800 |
| Export profit | 800,000 X | |
| 10% | | |
| Balance | <u>40,000 X</u> | |
| 12% | | |
| | <u>1,840,000</u> | |
| Gross income tax | | 144,800 |

Chapter 2 - Partnerships

Page 2 - (2.3) Partnership Tax

Paragraph 1 to be amended as follows

1. Every partnership is required to pay a tax at 8% on the aggregate amount of divisible profit and other statutory income of the partnership, exceeding Rs. 1,000,000.
Accordingly the tax is payable on the excess over Rs. 1,000,000.

Page 6 – Computation of Partnership Tax Payable

c. Revised Computation

| | |
|-------------------------------|--------------------|
| Divisible profit | 1,342,000 |
| <u>Other statutory income</u> | |
| Rent income | 217,500 |
| Interest income | <u>0</u> |
| Total | 1,559,500 |
| Less; Tax free allowance | <u>(1,000,000)</u> |
| Taxable income | 559,500 |
| Tax @ 8% | 44,760 |

e. Tax credit available to each partner

(Based on the % of total share of profit)

| Partner | Share | % | Tax Credit |
|---------|-----------|-----|------------|
| Arthur | 711,000 | 53 | 23,723 |
| Bertie | 631,000 | 47 | 21,037 |
| Total | 1,342,000 | 100 | 44,760 |

Chapter 3 – Administrative Provisions

Page 4 - (3.6) Time Bar for Assessment

Paragraph to be amended as follows

- 1) If a person has duly made a return on or before Thirtieth day of November of the succeeding year of assessment, no assessment can be made after the expiry of
 - two years from that date (due date for submission of return), for any year of assessment commencing prior to April 1, 2013.
 - eighteen months from that date (due date for submission of return), for any year of assessment commencing on or after April 1, 2013.
- 2) If the return is not furnished on or before due date, statute bar is four years,
- 3) If there is a fraud, or willful default the statute bar does not operate.

Chapter 4 – Value Added Tax

Page 2 – c. Registered Person

Paragraph to be amended as follows

Any person who falls in to following categories shall register for Value Added Tax with the Commissioner General of Inland Revenue.

- Where the value of supplies for a period of three months in one calendar year of any person who carries on a wholesale or retail trading activity, exceeds rupees five hundred million or;
- Where the value of taxable supplies of any other taxable activity carried on in Sri Lanka exceeds rupees three hundred million for a period of three months or twelve million for a period of twelve months,

Page 5 – 4.03. Retail and wholesale activities

Paragraph to be amended as follows

Effective from January 1, 2013, where the value of supplies for a period of three months in one calendar year of any person who carries on a wholesale or retail trading activity, exceeds rupees five hundred million, such person is required to register for VAT.

