

Imposition of Income Tax

Chapter – 02 (II)

Business Taxation - EDDBA

Business School

CA Sri Lanka

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Chapter Outline

- Chargeability of Income Tax.
- Difference Source of Statutory Provisions.
- Sources of Profits and Income chargeable with income tax.

Imposition of Income Tax

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**

**Secondary
Sources**

Imposition of Income Tax

Sources of Statutory Provisions.

Primary Sources

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

Imposition of Income Tax

Sources of Statutory Provisions.

Secondary Sources

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

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

Imposition of Income Tax

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.

Imposition of Income Tax

Chargeability of Income Tax.

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**

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

*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)].*

..... It is observed that the kinds of receipts with the item wages and going down to perquisite are receipts in respect of a persons service as employee.... The statue requires that these receipts must be payments “which an employee receives in the course of his employment”.: [Wimalasundera J. Kanagasabapathy vs. CGIR (4CTC131)].

Conclusive Test:

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

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Employee:[S.131]

An employee is any **individual who is in receipt of profits from employment** and include,

- a. any **director** of a company or corporation;
- b. any **working partner** of a partnership;
- c. any **person receiving remuneration** for past service performed by him or performed by any other person;
- d. any **person who receives a remuneration in cash or kind:**[S. 114(1)].

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

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:

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

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

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)].

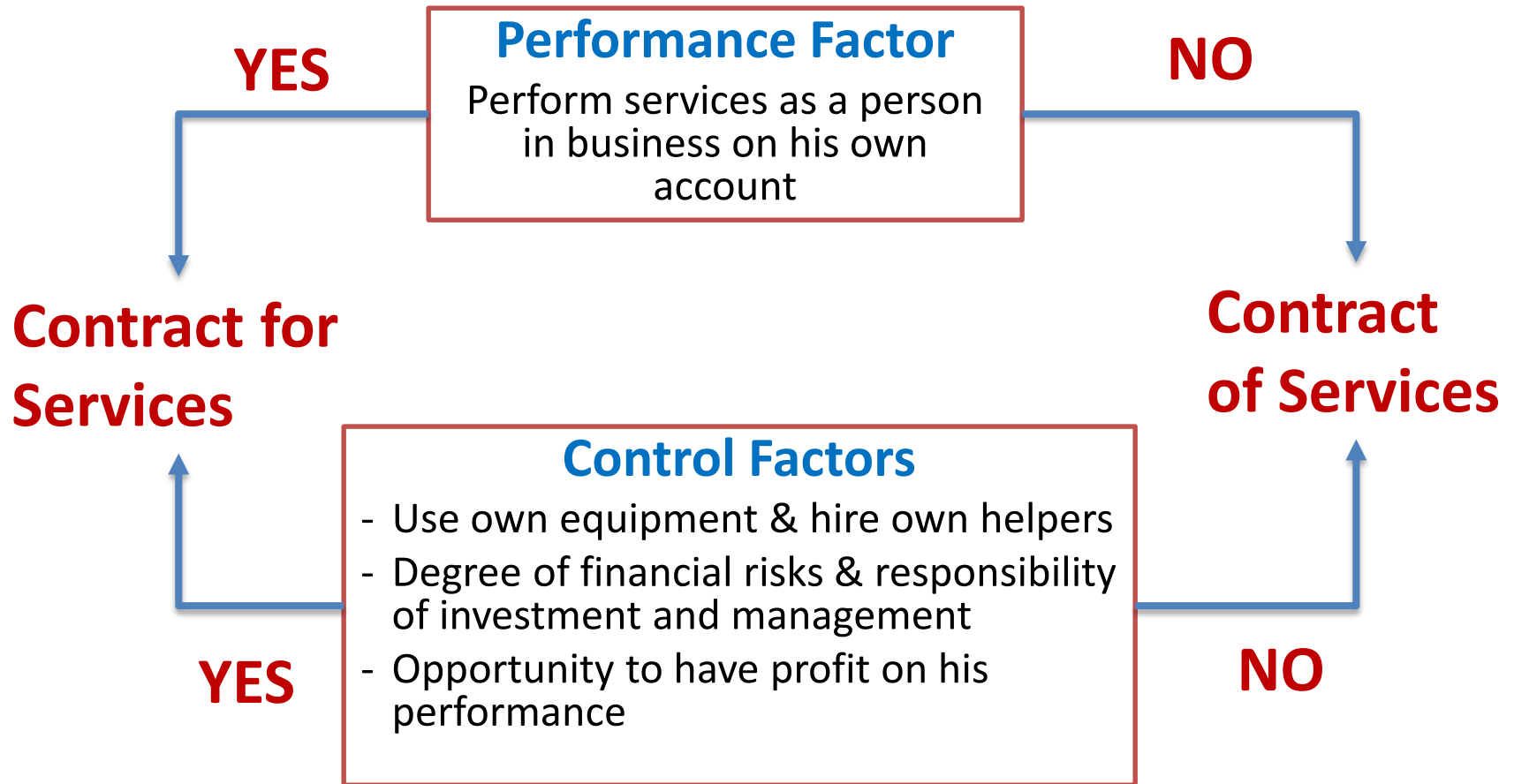
Fundamental Test:

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

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

Imposition of Income Tax

Contract of Service and Contract for Services.



Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Consideration and Motive

The mere fact that the payment is made to the employee as a result of 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]

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

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

- a. **Payments for services** whether received from the employer or others.
- b. **The value of any benefit** received by the employee or spouse, child or parent.
- c. Any **payment made to any other person** for the benefit of the employee or spouse, child or parent.
- d. Payment received by the employee on **termination of service.**

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

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:

Salary | Allowance | Leave pay | Commission | Bonus

The reimbursement of official expenses to an employee cannot be made liable for tax.

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Taxation of Remunerations of Showroom Managers

Showroom managers of some companies receive commission and incentive in addition to remuneration.

Such commission or incentive should be treated as receipt from trade or business for tax purpose.

However, the instances where all inclusive consolidated salary and allowances constitute as profit from employment.

IC/2012/44 | S3&4/2010-6

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

The value of any benefit received by the employee or spouse, child or parent.

The value of benefit received by an individual is determined

- at the market value
- Cost incurred

Conveyance | ESOP | Medical | Telephone | Rental Value | Perquisite

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Conveyance:

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

	Cylinder Capacity	
	> 1500CC	< 1500 CC
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

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Conveyance:

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

- Provided with fuel 5,000
- Provided without fuel 3,000

Records for private usage is maintained,

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

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

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

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Rental Value:

Rating assessment + Rates paid
(NAV+33 1/3% of NAV + Rates paid)

Gross rent paid by the employer

Which ever is
higher

Aggregate Profits

< Rs. 1.8 Mn

>Rs. 1.8 Mn

Rental Value

Rs. 120,000

Rs. 180,000

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

e 2.1

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%.

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

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

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Any **payment made to any other person** for the benefit of the employee or spouse, child or parent.

Any payment made to a third party for the benefit of employee or his spouse, children or parent is the profit from employment.

Contribution to ETF & EPF | Payment of Income Tax | School Fees

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Payment of Income Tax:

Where an employee receives a salary with free of income tax, then the income tax liability of the employee absorbed by the employer is the profit from employment.

In such situation, the amount chargeable with income tax is the gross amount of the salary.

[Hartland vs. Diggins 10 TC 247]

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

e 2.2

Mr. Panditharathne is a Head of Operation in Heartlands Pvt. Ltd. His employment contract provides for monthly tax free take home as Rs. 75,000/-.

Compute the income tax payable of Mr. Panditharathne for the YA 2014/15.

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Payment received by the employee on **termination of service.**

The payment received by an employee at the time of termination of employment considered to be profits from employments.

Gratuity | Pension | Compensation for loss of office | withdrawal from ETF & EPF

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Gratuity:

Under the payment of Gratuity Act, it the obligation of employer to pay the gratuity to an outgoing employee where the retirement take place after five years from the date of appointment.

Retiring gratuity is taxed at concessionary rate.

	Period of employment / contribution			
	< 20 years		> 20 years	
on the first	Rs. 2 Mn	NIL	Rs. 5 Mn	NIL
on the next	Rs. 1 Mn	5%	Rs. 1 Mn	5%
on the balance	-	10%	-	10%

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Compensation for Loss of office:

Compensation received by an employee in respect of termination of his employment is taxable on the hands of employee.

If, such payment is not in uniform basis then such amount is tax at the normal rate subject to a max. limit of 16%.

Imposition of Income Tax

Chargeability of Income Tax.

Profits from any employment.

Withdrawal from ETF & EPF:

Withdrawal of the money from ETF established by the ETF Act No. 46 of 1980 is treated as profits from employment. However, any sum paid from a provident fund approved by the CGR not a profit from employment after 01.04.2011.

The amount so paid from ETF consisted with employer contribution and interest. Interest earned up to 31.3.1987 is taxable in addition to the contribution.

Imposition of Income Tax

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Profits from any employment.

Other Exemptions:

- An allowance granted to an employee in respect of travel outside Sri Lanka in connection with his employment.
- Pension paid to employee under S8(1)(b)
- 50% of the cost of telephone usage
- 75% of the hotel charges for expat employees during first 3 months
- Rental value of one place provided to Government and semi Government employees
- Up to the Rs. 100,000/- in excess of Rs. 500,000/- per annum
- Free transport by motor coach between office and residence