

Taxation of Individuals and Companies

AAT Level III Corporate & Personal Taxation (CPT)

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CHAPTER 07

GROSS INCOME TAX & BALANCE TAX PAYABLE - INDIVIDUAL

1.0 Computation of gross income tax liability

The taxable income of a person is determined by two main steps, namely the total assessable income & taxable income.

Total assessable income of a Company is the aggregate of following elements;

- Assessable income from Employment
- Assessable income from Business
- Assessable income from Investment
- Assessable income from any other sources

$\text{Income tax liability} = \text{Taxable Income} * \text{Tax Rates}$ (Individual)

2.0 Tax Rates

The following tax rates are applicable for individuals, when calculating income tax liability.

- Normal Rates
- Lower rates on retirement benefits under employment income
- Rate on gains from the realization of investment assets
- Rate for the businesses related to betting & gaming, liquor or tobacco

2.1 Normal Rates

Taxable Income	Rates	Tax
1st	600,000	4% 24,000
2nd	600,000	8% 48,000
3rd	600,000	12% 72,000
4th	600,000	16% 96,000
5th	600,000	20% 120,000
On Balance		24%

2.2 Employment Income at Reduced Rates

Following types of income shall be tax at the reduced rates,

- Amount Received in commutation of pension
- Amount Received as a retiring gratuity

- Amount received as compensation for loss of office or employment under scheme which the Commissioner General considered to be uniformly applicable to all individuals employed by the employer.
- Withdrawal from provident fund approved by the CGIR
- Withdrawal from Employees trust Fund (ETF)

The aggregation of above benefits tax at reduced rates as,

If period of Contribution / Employment 20 years or less,

	<u>Retirement Benefits</u>	<u>Rates</u>
On First	2,000,000	NIL
Next	1,000,000	5%
On	Balance	10%

If period of Contribution / Employment more than 20 years,

	<u>Retirement Benefits</u>	<u>Rates</u>
On First	5,000,000	NIL
Next	1,000,000	5%
On	Balance	10%

2.3 Income from realization of Investment Assets.

However, where an individual's taxable income includes gains from the realization of investment assets shall be taxed at the rate of 10%.

2.4 Income from Betting and Gaming, Liquor and Tobacco - 40%

3 Computation of Balance Tax Payable

Balance tax payable or refund due is calculated as follows;

Tax on Taxable Income	xxx
Less; Tax Credits	(xx)
Balance Tax Payable/ (Refund Due)	xxx

The following can be deducted from the gross tax liability in determining the balance tax payable.

- Income tax paid on self-assessment basis
- Pay As You Earn (PAYE) tax deducted from primary employment
- WHT deducted on secondary employment

- WHT on investment income & service income
- WHT on partnership based on the share of profit
- Economic Service Charge Paid & Brought forward from previous Y/A

ESC Paid during the Y/A & ESC B/F from Previous Y/A can be claimed against income tax.

- ESC Paid from Y/A 2016/17 can be carried forward to paid year plus another two years. (1+2 Years)
- ESC Paid up to Y/A 2016/17 can be carried forward to paid year plus another four years. (1+4 Years)

REVISION QUIZ

Q 1

Rangana is a Chartered Accountant, who works as the Chief Financial Officer of Double Q (Pvt) Ltd a leading apparel manufacturing company in Sri Lanka. The following information relating to Rangana is provided in respect of the Y/A 2018/19.

Income from employment

- Gross salary: Rs. 400,000 per month.
- The company has provided him a motor car (engine capacity: 1700cc) along with fuel.
- Under the Employment Share Option Plan, an option had been given to Rangana to purchase 10,000 shares at Rs. 60 per share whereas the market value of a share is Rs. 120. He exercised this option during this Y/A.
- Rs. 420,000 had been reimbursed by the company on foreign visits made by Rangana to meet a business partner in Singapore.
- Contribution made by the employer to a provident fund which is a fund approved by the Commissioner General of Inland Revenue was Rs. 300,000.
- The employer had deducted Rs. 256,000 as PAYE for the Y/A.
- Rangana had also been appointed as a director of a subsidiary company of Double Q (Pvt) Ltd, which had paid him a director's fee of Rs. 22,500 (net of tax) per month. The company had issued the T10 certificate relating to the tax deducted by the company.

Income from business

In addition to his employment, Rangana provides investment advisory services to both local and foreign customers as an independent investment advisor. The draft income statement prepared for the year ended 31 March 2019 is given below.

	Rs.
Revenue - consultancy fees	5,465,000
Less: expenses	
Salaries and wages	(2,850,000)
Stationery	(167,000)
Entertainment expenses	(120,000)
Donation	(175,000)
Income tax instalment payments	(150,000)
Foreign travelling	(135,000)
Other expenses	(924,500)
Net profit	943,500

- During the Y/A he earned USD 9,000 in foreign currency from Maldives and this amount had been included in the revenue. (USD 1 = LKR 170).
- Cash donation of Rs. 175,000 was made to "National Kidney Fund".
- He had paid Rs. 150,000 as income tax instalment payments for the Y/A 2018/19.
- During the Y/A, Rangana visited Maldives to meet some prospective clients. The cost of the tour is included under foreign travelling.
- In June 2018, Rangana purchased furniture for his office amounting to Rs. 450,000. No depreciation has been recognized in the income statement with respect to this.
- Other expenses include a penalty paid to the Department of Inland Revenue for delay in making tax payments amounting to Rs. 5,400. All other expenses were incurred in the production of income.

Income from investments

- Rangana purchased a luxury house situated in Wadduwa and it had been rented out to a company to be operated as a holiday resort. Monthly rent was Rs. 40,000 and the tenant bears the rates of Rs. 75,000. The company had deducted WHT from rent payment and remitted it to Inland Revenue Department.
- He had earned Rs. 104,500 as net interest income during the Y/A on a fixed deposit in a bank, and the bank had remitted WHT to Inland Revenue Department.
- During the Y/A, Rangana sold the shares of AB PLC, a listed company at a profit of Rs. 56,000.

Required: Compute the income tax liability, tax credits and balance tax payable/receivable by Rangana for the Y/A 2018/19.

CHAPTER 08

GROSS INCOME TAX & BALANCE TAX PAYABLE - COMPANY

1.0 Computation of gross income tax liability

Gross Income Tax Liability = Tax on Taxable Income + Tax on Dividends Declared

1.1 Tax on Taxable Income

The taxable income of a person is determined by two main steps, namely the total assessable income & taxable income.

Total assessable income of a Company is the aggregate of following elements;

- Assessable income from Employment
- Assessable income from Business
- Assessable income from Investment
- Assessable income from any other sources

Tax on Taxable Income = Taxable Income * Rates

1.2 Tax on Dividends Declared

Tax on gross distribution of dividends is to be paid as withholding tax. When calculating the gross dividend, dividend received from another resident company is to be excluded.

Company is responsible to deduct withholding tax from the dividend distributed to the shareholders and remit deducted WHT to the Department of Inland Revenue on or before 15th of following month.

Tax on dividends distributed = Gross dividends * 14%

2.0 Tax Rates

The following tax rates are applicable for individuals, when calculating income tax liability.

- Lower rate @ 14%
- Normal Rate @ 28%
- Rate on gains from the realization of investment assets @ 10%
- Rate for the businesses related to betting & gaming, liquor or tobacco @ 40%

2.1 Lower Rate @ 14%

The taxable income of a company for a year of assessment shall be taxed at the following rates:—

- in the case of an Small and Medium Enterprises - 14%;
- in the case of a company predominantly conducting a business of exporting goods and services - 14%;
- in the case of a company predominantly conducting an agricultural business - 14%;
- in the case of a company predominantly providing educational services - 14%;
- in the case of a company predominantly engaged in an undertaking for the promotion of tourism- 14%;
- in the case of a company predominantly providing information technology services-14%.

Important Notes ;

- providing information technology means;
 - software development services; or
 - the provision of information technology services under a business process outsourcing arrangement or a knowledge process outsourcing arrangement;
- undertaking for the promotion of tourism means an undertaking for the operation of-
 - (a) any hotel or guest house approved by the Ceylon Tourist Board;
 - (b) any restaurant graded by the Ceylon Tourist Board as being in “Class A” or “Class B”;
 - (c) any business of travel agent who provides travel management services for domestic travel in Sri Lanka;
 - (d) any business of transporting tourists only; or 204 Inland Revenue Act, No. 24 of 2017
 - (e) any business approved by the Ceylon Tourist Board for providing facilities for recreation or sports;
- “predominantly” means 80% or more calculated based on gross income

2.2 Normal Rate @ 28%

The taxable income of a company for a year of assessment shall be taxed at the rate of 28%.

3.3 Income from realization of Investment Assets @ 10%

However, where an individual’s taxable income includes gains from the realization of investment assets shall be taxed at the rate of 10%.

3.4 Income from Betting and Gaming, Liquor and Tobacco - 40%

4 Computation of Balance Tax Payable

Balance tax payable or refund due is calculated as follows;

Gross Tax Liability	xxx
Less; Tax Credits	<u>(xx)</u>
Balance Tax Payable/ (Refund Due)	<u>xxx</u>

The following can be deducted from the gross tax liability in determining the balance tax payable.

- Income tax paid on self-assessment basis
- WHT on investment income & service income
- Ex: WHT on interest & rent
- Notional tax credit on T-Bills & T-Bonds
 As per the transitional provisions any unclaimed notional tax credits can be claimed within three consecutive Y/A commencing from Y/A 2018/19.
- Economic Service Charge Paid & Brought forward from previous Y/A
 ESC Paid during the Y/A & ESC B/F from Previous Y/A can be claimed against income tax.
 - ESC Paid from Y/A 2016/17 can be carried forward to paid year plus another two years. (1+2 Years)
 - ESC Paid up to Y/A 2016/17 can be carried forward to paid year plus another four years. (1+4 Years)
- Dividend tax paid

REVISION QUIZ

Q 1

Stella Beach Hotel (Pvt) Ltd (SBH) was incorporated as a subsidiary of Stella Beach Management (Pvt) Ltd (SBM) in 2012 and operates a hotel business, with the approval of the Ceylon Tourist Board. An extract of the income statement of SBH for the year ended 31 March 2019 is as follows.

	Rs. '000
Revenue	108,000
Cost of sales	<u>(75,200)</u>
Gross profit	32,800
Other income	17,600
Administrative & general expenses	(28,400)
Selling & distribution expenses	(11,300)
Finance cost	<u>(4,800)</u>
Profit before taxation	<u>5,900</u>

An extract of the equity and liability position as at 31 March 2019 is shown below:

Equity & liabilities	Rs. '000
Stated capital	2,000
Reserves	16,000
Long term loan	80,000

Additional information:

Break up of revenue

	Rs. '000
Food & accommodation income	74,400
Tourist transport income	24,000
Bar income	21,600
Gross revenue	120,000
Less: Tourism Development Levy (TDL)	(12,000)
Net revenue	108,000

Break up of other income

	Rs. '000
Rent income (gross) - Note 1	12,000
Interest income - treasury bills	1,900
Dividend income (net)	3,000
Cash prize awarded by Hotels Corporation identifying SBH as the best hospitality service provider during the year	700
	17,600

Note 1:

- Part of the hotel premises has been given on rent temporally, to a shopping arcade at a monthly rent of Rs. 240,000, to facilitate tourists, and relevant withholding tax (WHT) had been deducted by the payer.
- A building recorded under 'investment property' had been given on 10 years lease term at a monthly rent of Rs. 760,000 to operate a ticketing agency, for which WHT had been deducted.

Administrative & general expenses include the following

- Book depreciation of Rs. 6,250,000 and gratuity provision of Rs. 5,200,000 had been provided.
- During the year Rs. 8,000,000 had been paid as management fees to SBM for the hotel management services provided by them.
- Rs. 1,800,000 had been incurred on facilities provided in the hotel for the guest entertainment (music and other) and Rs. 500,000 had been spent on a tour arranged to entertain the selected team in the catering division.

- Staff training included Rs. 900,000 incurred on a hospitality management diploma followed by the front office manager.
- Repairs & maintenance expense represent the following. -
 - Rs. 350,000 had been incurred to paint the ticketing agency building which was fully depreciated for tax purposes.
 - Rs. 480,000 had been incurred for office maintenance

Selling & distribution expenses include the following.

- Rs. 1,700,000 had been paid as director’s remuneration to George who is the director of SBH, and for which WHT had not been deducted by the company.
- Rs. 360,000 had been incurred during the year for Cutlery, Crockery and Glassware items, and these items are replaced after every three months period, as per SBH policy.
- SBH had donated Rs. 1,434,000 to the ministry of tourism

Finance cost represents

- Rs. 4,800,000 loan interest made on the bank loan obtained for working capital requirements.

Details of the assets acquired are as follows.

Description	Cost Rs.	
	Acquired in 2018/19	Acquired in 2017/18
Kitchen equipment - Note 2	2,900,000	2,400,000
Motor cars for tourist transport	6,000,000	nil

Note 2

- Rs. 1,500,000 worth of kitchen equipment has still not been used by the company.
- Except for the above, all other assets have been depreciated fully for the purpose of income tax.
- Brought forward tax losses from the previous Y/A were Rs. 2,834,000.
- The company has paid a total of Rs. 200,000 as quarterly instalment of income tax for Y/A 2018/19 and ESC paid for the Y/A 2018/19 is Rs. 600,000.

Required:

Assess the income tax liability, tax credits and balance tax payable/(refund due) by SBH for the Y/A 2018/19.