

INCOME TAX LIABILITY OF RESIDENT COMPANY

Strategic Level – CA Sri Lanka
Corporate Taxation (SL 3)

Resource Person:

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Assessable Income from Business - Tutorial 02



9. Deductions which are specifically allowed

9.3 Allowance for Trading Stock (Cost of Sales) – (Sec. 13)

The deduction for the allowance for trading stock is allowed and for determining the allowance for trading stock it needs to follow the generally accepted accounting principles. A formula has been given in section 13.

| | |
|---|-------------|
| The opening value of trading stock of the business for the Y/A | XXX |
| Add: | |
| Expenses incurred during the year that are included in the cost of trading stock of the business (<i>Purchases</i>) | <u>XXX</u> |
| Less: | |
| Closing value of trading stock of the business for the year | <u>(XX)</u> |
| Allowance for trading stock (Cost of Sales) | <u>XXX</u> |

9. Deductions which are specifically allowed

9.4 Research and development expenses and agricultural startup expenses (Sec. 15)

Research and development expenses and agricultural startup expenses **can be deducted irrespective of the fact that they are capital nature or not**. However, if such expenses incurred are **included** in the cost of an asset, then it is **to be excluded**.

“**Agricultural startup expenses**” means expenses in

- opening up any land for cultivation or for animal husbandry,
- cultivating land with plants,
- the purchase of livestock or poultry to be reared on land or maintaining tanks or ponds or the clearing or preparation of any inland waters for the rearing of fish and the purchase of fish to be reared in such tank, pond or inland waters.

9. Deductions which are specifically allowed

“**Research and Development expenses**” means expenses incurred by a person in

- a) carrying on any scientific, industrial, agricultural or any other research for the upgrading of the business **through any institution in Sri Lanka** (or for any innovation or research relating to high value agricultural products, **by the person or through any research institution in Sri Lanka**) or
- b) the process of developing the business and improving business products or process, which should be beneficial to Sri Lanka.

As per the 6th Schedule, a person is entitled to an additional deduction equal to 100% of the total amount of research and development expenses deducted for the year, for **five** years of assessment after the commencement of the Act No. 24 of 2017 (w.e.f. 01.04.2018) (i.e. 2018/19 to 2022/23).

9. Deductions which are specifically allowed

| Description | In-house | Through an institution in Sri Lanka | Through an institution outside Sri Lanka |
|--|-----------------|-------------------------------------|--|
| Revenue/ Capital nature expense on scientific, industrial or other research for upgrading business | - | Additional 100% | - |
| Revenue/ Capital nature expense on innovation or research relating to high value agricultural products | Additional 100% | Additional 100% | - |
| Process of developing the business and improving business products or process | Additional 100% | Additional 100% | Additional 100% |
| Other R&D expenses | - | - | - |
| Total | - | - | - |

9. Deductions which are specifically allowed

9.5 Capital Allowances and balancing allowances (Sec. 16)

Capital allowances can be deducted under the 2nd, 4th or 6th Schedules and balancing allowances (loss from disposal of depreciable assets) can also be deducted.

Capital allowance is granted on **depreciable assets (Sec. 195)**, if it is **owned** and **used in the production of the income** from a business and **at the end of the year of assessment asset is available** in the statement of financial position of the business.

- It should be calculated according to the **straight-line method** on the **depreciation basis**.
- Full capital allowances will be granted for the **year of acquisition**.
- Capital allowance should **not be deferred** to a later year of assessment.
- Capital allowance is not granted in respect of **road vehicles** other than a **commercial vehicle** (*a road vehicle designed to carry loads of more than half a tonne or more than 13 passengers or vehicles used in a transportation or vehicles used in a rental business*), **a bus or minibus, a goods vehicle or a heavy general purpose or specialized truck or trailer, motor bicycle**.
- Capital allowance will **not be granted** for the **year of disposal**.

9. Deductions which are specifically allowed

- If the depreciable asset is **partly used** in the production of income from a business at the end of the year of assessment, the **cost** of and **consideration received** for the asset **shall be apportioned** according to the **market value** of that part of the asset that is used in the production of income from that business and that part not.

“**Depreciation basis**” is the sum of;

- a) the depreciation basis of the asset at the end of the previous year of assessment and,
 - b) amounts added to the depreciation basis of the asset during the year of assessment including the excess expense of repair and improvements referred to in section 14 for which a deduction shall not be allowed as a result of the limitation.
- The Formula for calculating capital allowance is **A/B**
A - the **depreciation basis** of asset at the end of the year of assessment
B - **number of years** (provided in the fourth schedule) remaining

9. Deductions which are specifically allowed

Class of the Asset, Description and number of years are as follows:

| Class | Depreciable Assets | Years |
|-------|---|-------|
| 01 | Computers and data handling equipment together with peripheral devices. | 5 |
| 02 | Buses and minibuses, goods vehicles; construction and earthmoving equipment, heavy general purpose or specialized trucks, trailers and trailer-mounted containers; plant and machinery used in manufacturing. | 5 |
| 03 | Railroad cars, locomotives, and equipment; vessels, barges, tugs, and similar water transportation equipment; aircraft; specialized public utility plant, equipment, and machinery; office furniture, fixtures, and equipment; any depreciable asset not included in another. | 5 |
| 04 | Buildings, structures and similar works of a permanent nature | 20 |
| 05 | Intangible assets, excluding goodwill | * |

* The **actual useful life** of the intangible asset, or where the intangible asset has an **indefinite useful life**, then it is **20 years**.

9. Deductions which are specifically allowed

| Class | Depreciable Assets | Years |
|-------|--|-------|
| 06 | Milking Machines (with latest technology, used to manufacture local liquid milk related products). W.e.f. 01 April 2021. | 2 |

Transitional Provision

The allowance for depreciation in respect of any-

- Capital asset** acquired prior to April 1, 2006, **any qualified building*** constructed or **any building** acquired prior to April 1, 2006; or
- Capital asset** acquired on or after April 1, 2006, but prior to April 1, 2018, **any qualified building** constructed, or **any building** acquired on or after April 1, 2006, but prior to April 1, 2018,

should be computed in accordance with the respective provision of the Inland Revenue Act, No. 10 of 2006 and be deducted.

* *Qualified building means a building constructed for the purpose of a trade, business, profession or vocation other than for use as a dwelling (occupied/residence) house by an executive officer”.*

9. Deductions which are specifically allowed

9.6 Enhance Capital allowance (2nd Schedule)

Apart from the capital allowances mentioned above, enhanced capital allowances are allowed (in addition to the normal capital allowance) subject to the amount of investments mentioned in the 2nd Schedule in **view of encouraging investments** in Sri Lanka. This enhance capital allowance is **not available for expansion of an existing business**. The amount of investments and the appropriate rate for claiming the capital allowance are as follows:

| Criteria | Limitation | % |
|--|------------------------------|---|
| Depreciable assets used in Sri Lanka other than the Northern Province | USD 3 million to 100 million | 100% |
| | Exceeding USD 100 million | 150% |
| Depreciable assets used in the Northern Province | Exceeding USD 3 million | 200% |
| On assets or shares of a state owned company used in a part in Sri Lanka | Exceeding USD 250 million | 150% allowed to the state owned company |

9. Deductions which are specifically allowed

9.7 Enhance Capital allowance - Temporary Concessions (6th Schedule)

Further to the above provisions, a capital allowance of **100%** for expenses incurred on **depreciable assets** is granted if the investment is **up to USD 03 million** and if such depreciable assets are used in a part of Sri Lanka **other than the Northern Province**.

If it is **in the Northern Province**, the capital allowance of **200%** of expenses incurred is granted. This enhance capital allowance is **not available for expansion of an existing business**.

In order to enjoy this Enhanced Capital Allowance, the cost to be incurred during the first **six** years of commencement of this Act. (i.e. **2018/19 to 2023/24**)



9. Deductions which are specifically allowed

9.8 Improvement expenses (Sec. 14) – w.e.f. 01 April 2021

Expenses incurred in respect of the improvement of **depreciable assets** can be deducted if the **asset is used for the production of income** for any year of assessment, irrespective of whether the expenses are of a capital nature or not. (This provision is not applicable for an investment asset because it is not a depreciable asset).

However, it is restricted to the **lower of actual cost** or

- a) in the case of improvement to a **Class 4 depreciable asset** (buildings, structures etc.), **5% (20 years) of the written down value** of the asset at the end of the previous year,
- b) in all other cases, **20% (5 years) of the written down value** of the asset at the end of the previous year.

The excess expense for which a deduction has **not been allowed** as a result of the limitation is **to be added to the depreciation basis** of the asset.

9. Deductions which are specifically allowed

Example:

- During the year of assessment -2020/2021, the Cost of improvement 400,000
- Written down value of the Asset as at the end of previous year 600,000

Required: (Assuming that this is not a class 4 depreciable asset)

- i. Allowable improvement cost $(600,000 \times 20\%) = 120,000$
- ii. Excess improvement cost to be added to the depreciable basis $(400,000 - 120,000) = 280,000$
- iii. Calculate the capital allowance for the Y/A 2021/2022

| Year of Assessment | Depreciation basis | No of Years | Depreciation for the year |
|--------------------|-----------------------|-------------|---------------------------|
| 2018/2019 | 1,000,000 | 5 | 200,000 |
| 2019/2020 | 800,000 | 4 | 200,000 |
| 2020/2021 | 600,000 | 3 | 200,000 |
| 2021/2022 | $(400 + 280)$ 680,000 | 2 | 340,000 |
| 2022/2023 | 340,000 | 1 | 340,000 |

9. Deductions which are specifically allowed

Improvement cost is allowed **based on the WDV** at the end of the previous year of assessment. In respect of **new assets** purchased during the year or assets which were **not put to use** during the year of assessment, **no improvement cost is allowed since there is no WDV** at the end of the previous year of assessment. In the subsequent year of assessment, **capital allowance is given** on such improvement cost.

9.9 Lease-hold assets purchased **prior** to 01st April 2018

As per regulation 8 of the gazette notification issued on Transitional provisions, any profit, loss, receipt or payment in respect of **any finance lease agreement** entered into, **prior to April 1, 2018**, is to be computed in accordance with the respective provisions of the Inland Revenue Act, No. 10 of 2006 as explained below.

9. Deductions which are specifically allowed

- a) In case of **lease rentals paid** for **assets other than IT equipment** (vehicles, furniture, machinery, etc.), the amount in **excess of 1/5th of the total lease value p.a.** is disallowed.

Example:

If a person acquires a lorry on a three-year lease on 01 April 2016 and pays a lease rental (including interest) of Rs. 50,000 per month, he would have paid Rs. 600,000 during the year.

Required:

- i. Calculate allowable deduction as lease allowance

| | |
|--|---------|
| Lease rentals paid during the year (Rs. 50,000 x 12) | 600,000 |
| 1/5th of the total lease value [(rs. 50,000 x 36) x 1/5] | 360,000 |
| Deduction allowed (whichever is lower) | 360,000 |

9. Deductions which are specifically allowed

- b) In the case of **lease rentals paid** on **information technology (IT) equipment**, the amount in excess of **1/4th of the total lease value** is **disallowed**.
- c) **Lease interest or stamp duty** charged on such lease asset to the profit is **not allowed**, since the instalment payment of rental is including the interest part as well.

9.10 Lease - hold assets purchased after 01st April 2018

- The lessee is treated as the **owner** of the leased asset.
- The lessee is treated as having **acquired the asset** at the commencement of the lease.
- Lessee is **entitled to claim capital allowance** on the cost
- Interest cost can be claimed **subject to the restriction** in Sec. 12 and Sec. 18.

9. Deductions which are specifically allowed

Tax Treatments for Right to used assets / Operating Lease

| | (+) | (-) |
|------------------------------------|-----|-----|
| Profit before tax | xxx | |
| Add: Dep charge to P&L | xxx | |
| Add: Interest charge to P&L | xxx | |
| Less: Actual Rent Expense | | xxx |

Tax Treatments for Finance Lease

| | (+) | (-) |
|---|-----|-----|
| Profit before tax | xxx | |
| Add: Dep charge to P&L | xxx | |
| Add: Interest charge to P&L (Allowed, subject to Thin Cap) | xxx | |
| Less: Capital Allowance | | xxx |

9. Deductions which are specifically allowed

9.11 Disposal of assets

Where a depreciable asset of a person is realized, an **assessable charge** is to be included (**profit**) or a **balancing allowance** (Sec. 16 and 4th Schedule) is to be granted (**loss**) in calculating the person's income.

Assessable charge or balancing allowances are to be calculated in respect of depreciable assets **realized (sold)** during a year of assessment if capital allowances have been granted in that year of assessment or an earlier year of assessment in accordance with the provisions of the 2nd, 4th or 6th schedules to this Act on such assets.

$$\text{Assessable Charge} = A - B$$

(Taxable profit on disposal of depreciable asset)

$$\text{Balancing Allowance} = B - A$$

(Taxable loss on disposal of depreciable asset)

“A” - is **consideration received (Sale proceed)** by the person during the year of assessment for the asset

“B” - is the **written down value (WDV)** of the asset at the time of realization (sale) of the asset

9. Deductions which are specifically allowed

Example 01:

ABC PLC purchased a Machinery on 01.04.2019 at Rs. 1,000,000/- and used in the same Y/A. ABC has sold the same on 31.12.2020 at Rs. 900,000/-.

Required;

- i. Calculate **assessable charge** or **balancing allowance** on the Machinery sold.
- ii. If **accounting profit** on disposal of such machinery has charged to P&L Rs. 20,000/-, present the required tax adjustment in (+)/(-).

Example 02:

ABC PLC purchased a Machinery on 01.04.2019 at Rs. 800,000/- and used in the same Y/A. ABC has sold the same on 31.12.2020 at Rs. 500,000/-.

Required;

- i. Calculate **assessable charge** or **balancing allowance** on the Machinery sold.
- ii. If **accounting loss** on disposal of such machinery has charged to P&L Rs. 100,000/-, present the required tax adjustment in (+)/(-).

9. Deductions which are specifically allowed

9.11 Disposal of assets (Contd.,)

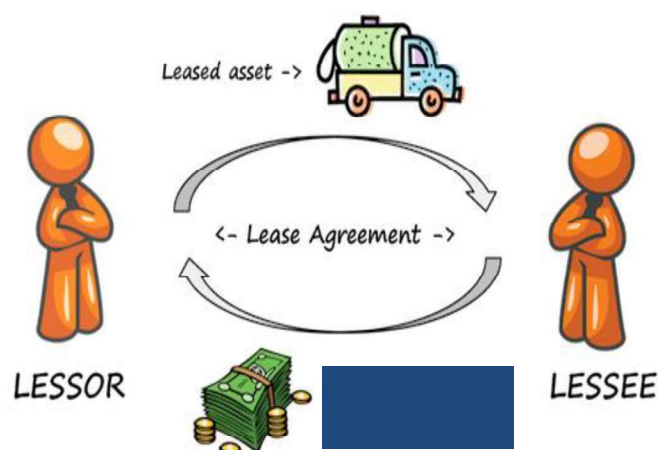
| | (+) | (-) |
|--|-----|-----|
| Profit Before Tax | xxx | |
| Add/Less: Accounting profit/loss on disposal of depreciable assets | xxx | xxx |
| Add: Assessable charge (Taxable profit on disposal of depreciable asset) | xxx | |
| Less: Balancing allowance (Taxable loss on disposal of depreciable asset) | | xxx |

Assessable charge (profit from the disposal) is to be **added** or **balancing allowance** (loss from the disposal) is to be **deducted** at the tax computation in respect of depreciable assets realized during the year of assessment.

9. Deductions which are specifically allowed

9.13 Disposal of Lease-hold assets purchased **after** 01st April 2018

- Since lease assets are **qualified to be claimed for capital allowance**, tax treatment is **similar to the tax treatment** applicable for assets on which depreciation is claimable.



10. Special Provisions

10.1 Disclaim of any income to be received or write off a debt as bad

When an accrual basis is adopted in calculating the income of a person, he includes an amount as income whether received or receivable. However, later if he disclaims the entitlement to receive the amount or if he write off the debt as bad debt, Sec. 24 specifically says that he **cannot deduct** the amount **disclaimed** or **written off** unless he **takes reasonable steps** in pursuing (following) the amount and the person reasonably believes that the entitlement or debt claim will not be satisfied.

If any amount **written off** is **allowed** and **later recovered**, that amount is **required to be included** for the **period in which it is recovered**.



10. Special Provisions

10.2 Specific provisions relating to banking business

With regard to the banking business, special industry provisions are applicable to make specific provisions on loan portfolio too, in addition to other bad debt provisions referred to in section 24.

The **specific provisions are allowed** as per the Central Bank Guidelines issued to the banks or financial institutions subject to the approval of the CGIR (Gazette notification No. 2064/57 dated 01st April 2018). For this purposes in which the application of the Central Bank Guidelines are subject to the following restrictions,

No specific provision be allowed in respect of:

- lease debtors of which facilities granted prior to 01 April 2018
- potential risk of credit facilities
- pawning debtor
- loans given to associates
- loans given to persons outside Sri Lanka



10. Special Provisions

10.2 Specific provisions relating to banking business (Contd.,)

| | (+) | (-) |
|--|-----|-----|
| Profit Before Tax (PBT) | xxx | |
| Add: Provision for trade debtors (Accounting) | xxx | |
| Less: CBSL provision on trade debtors | | xxx |



11. Loss or unrelieved loss from Business income

In calculating the person's income from the business for a year of assessment, there could be a loss due to the excess of amounts deducted under the Act over the amounts included in calculating that income. When the loss that has **not been deducted** in calculating a person's income, it is known as unrelieved loss.

| | (+) | (-) |
|---|--------------|----------------|
| Profit Before Tax (PBT) | 1,000 | |
| Less: exempt income/ final withholding payments, Other amounts that are included in the employment | | 200 |
| Add: Disallowable expenses | 600 | |
| Less: Allowable expenses | | 1,800 |
| Total | 1,600 | (2,000) |
| Unrelieved loss from business | | (400) |

11. Loss or unrelieved loss from Business income

11.1 Business Losses - Section 19

In calculating the income of a person from a business, the following should be deducted:

- a) an unrelieved loss of the person for the year from **any other business**; and
- b) an unrelieved loss of the person for any of the **previous six years of assessment** from the **business or any other business**.

The deduction for loss from business income is subject to the following limitations:

- Where a loss can be deducted against business income, same has to be deducted.
- Where a person makes a **loss** and if the loss were a **profit** and the profit would be taxed at a **reduced rate**, the loss should be deducted only in calculating income taxed at the same **reduced rate**, a lower reduced rate or **exempt amount***

** Though the law refers to offset of losses against exempt amounts, same is not applicable, since exempt income does not form a part of income tax is liable to tax.*

11. Loss or unrelieved loss from Business income

11.1 Business Losses - Section 19 (Contd.,)

- Unrelieved losses from a business may be deducted in calculating income from an investment
- Unrelieved losses from an investment shall be deducted only in calculating income from an investment (Cannot be deducted from Business Income).
- Gain from realization of an investment asset shall not be deducted by any loss on the disposal of another investment asset.
- If enhanced capital allowance result in an unrelieved loss for a person, it **can be carried forward for 10 years** (2nd Schedule).

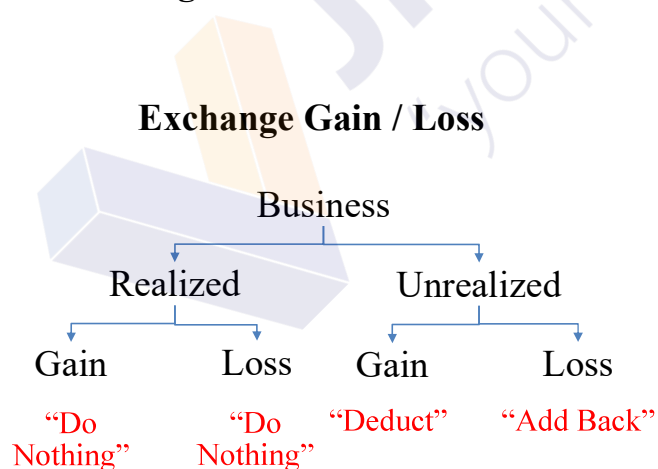
10. Loss or unrelieved loss from Business income

10.1 Business Losses - Section 19 (Contd.,)

| | Business Losses | | Investment Losses |
|--|-----------------|----------------|-------------------|
| | 14% | 24% | 24% |
| B/F Losses from Y/A 2019/20 | (500) | (2,500) | - |
| Losses During the Y/A 2020/21 | - | - | - |
| Total Losses | (500) | (2,500) | - |
| Gains & Profits During the Year | 1,000 | 1,000 | 500 |
| Losses transfer from Higher Rate to Lower Rate | (500) ← | (500) | - |
| Losses transfer to Investment | - | (500) → | (500) |
| Losses utilized under same category | (500) | (1,000) | - |
| Specific Losses (ECA) | - | - | - |
| Total Loss Deductible | (1,000) | (2,000) | (500) |
| Assessable Income | - | - | - |

10. Loss or unrelieved loss from Business income

10.2 Exchange Gain / Loss



11. Loss or unrelieved loss from Business income

11.4 Transitional Provisions on Losses

- Any unabsorbed loss available as at 31st March 2018 under the Inland Revenue Act, No. 10 of 2006 is **deemed to be a loss** for the year of assessment commencing on or after 1st April 2018 (Y/A 2018/2019) under the Inland Revenue Act, No. 24 of 2017 and be deductible in accordance with the Inland Revenue Act, No. 24 of 2017. Such unabsorbed loss could be claimed **subject to the maximum of six (6) years**.



12. Marketing and Communication Expenses

With the 2021 amendments under Sixth Schedule to the Act, during 3 years of assessment **commencing from 01 April 2021**, any person shall be entitling to an additional deduction when calculating assessable income from business, equal to 100% of the total amount of marketing and communication expenses. This is irrespective of nature but subject to following conditions;

- Payment should not be made to a person who is not an associated person of the taxpayer,
- Internal marketing expenses, salaries of marketing staff, maintain expenses of internal marketing division, expenses on corporate social responsibility, internal or foreign travel expenses, shall not be considered for this purpose,
- Expenses should be attributable to goods and services with 65% of local value addition, the mode of calculation of which shall be as specified by the Commissioner General,
- The total additional deduction under this section shall not exceed Rs. 500,000,000 in any year of assessment
- The Commissioner General shall specify the requirements to maintain records, source documents and underlying documents.

13. Calculate Assessable income from investment

Assessable Income from Investment



13. Calculate Assessable income from investment

“Investment” means (Sec. 195);

- a) the owning of one or more **assets**, including one or more assets of a similar nature or that are used in an integrated fashion, and*
 - i. **includes** a past, present or prospective investment; but*
 - ii. **excludes** a business or employment; or*
- b) a game of chance, including lotteries, betting or gambling.*

“Asset” includes (Sec. 195);

a tangible or intangible asset, currency, goodwill, know-how, property, a right to income or future income, a benefit that lasts longer than twelve months and a part of an asset.



12. Calculate Assessable income from investment

Calculating Investment Income (Sec. 7(1))

A person's income from an investment for a year of assessment shall be the person's gains and profits from that investment for the year.

| | (+) | (-) |
|--|-----|-----|
| Add: | | |
| Interest Income | xxx | |
| Dividend Income | xxx | |
| Gain on realization of Investment in quoted shares | xxx | |
| Gain on realization of Investment in unquoted shares | xxx | |
| Realized / Unrealized exchange gain on investment assets and liabilities | xxx | |

12. Calculate Assessable income from investment

| | (+) | (-) |
|---|------------|------------|
| Less: Exempt | | |
| Gain on realization of Investment in quoted shares | | xxx |
| Less: Non-Taxable Income | | |
| Unrealized exchange gain on investment assets and liabilities | | xxx |
| Less: Allowable deductions | | |
| Realized exchange losses on investment assets and liabilities | | xxx |
| Total | <u>xxx</u> | <u>xxx</u> |
| Assessable income from Investment | <u>xxx</u> | |

12. Calculate Assessable income from investment

Inclusions (Additions) (Sec. 7(2))

In calculating gains and profits from an investment for a year of assessment, the following amounts received or derived by a person from the investment during the year of assessment shall be included.



- a) dividends, interest, discounts, charges, annuities, natural resource payments, rents, premiums and royalties.
- b) gains from the realization of investment assets as calculated under Chapter IV of the Act;

“investment asset” means (Sec. 195);

- i. a **capital asset** held as part of an investment, but-
- ii. **excludes** the principal place of residence of an individual, provided it has been owned by the individual continuously for the three years before disposal and lived in for at least two of those three years.

12. Calculate Assessable income from investment

“Capital Asset” means (Sec. 195);

each of the following assets but excludes trading stocks and depreciable assets:

- i. *land or buildings;*
 - ii. *a membership interest in a company (i.e. shares), partnership or trust;*
 - iii. *a security or other financial asset;*
 - iv. *an option, right or other interest in an asset.*
- c) amounts derived as consideration for accepting a restriction on the capacity to conduct the investment - *sometimes a person may receive some amount for agreeing not to do a investment.*
 - d) gifts received by the person in respect of the investment.

“gift” means (Sec. 195);

a transfer without consideration or a transfer with consideration to the extent that the market value of the property exceeds the market value of the consideration;

12. Calculate Assessable income from investment

- e) winnings from lotteries, betting or gambling; and
- f) other amounts required to be included under this Act.

Exclusions (Sec. 7 (3))

In calculating a person's gains and profits from an investment the following shall be excluded:



- a) exempt amounts (3rd schedule) and final withholding payments; and
- b) amounts that are included in calculating the person's income from an employment or business.

12. Calculate Assessable income from investment

12.1 Dividend, Interest and etc

| | Rate/Exempt |
|---|-------------|
| Dividend received from a resident company | 14% |
| Dividend paid by a resident company to a member to the extent that such dividend payment is attributable to, or derived from, gains and profits from dividend received by that resident company | Exempt |
| Dividend paid by a resident company to a non-resident person | Exempt |
| Dividend paid by a resident company which is engaged in hub services under the Finance Act, No. 12 of 2012 and which has entered into an agreement with the Board of Investment of Sri Lanka | Exempt |
| Dividend from a non-resident company derived by any person with respect to substantial participation | Exempt |
| Dividend falling within category of foreign sourced income earned or derived in foreign currency and remitted to Sri Lanka through a bank | Exempt |
| Dividend from a Real Estate Investment Trust (REIT) | Exempt |

12. Calculate Assessable income from investment

12.1 Dividend, Interest and etc

| | Rate/Exempt |
|--|-------------|
| Any interest payment is not subject to withholding tax due to the fact that the payer is an individual who is not conducting a business, or the payer is non-resident and not specifically exempted, then such interest income is liable to income | 24% |
| On interest, discount, charge, natural resource payment, rent, royalty, premium, service fee or an insurance premium with a source in Sri Lanka to a non-resident person | 14% |
| Further, the interest other than those exempted and paid to non-residents continued to be subject to final withholding tax at 5%. (Eg. Interest on normal rupee deposits with financial institutes continued to be liable to 5% WHT) | 5% |
| Interest paid or derived by any person outside Sri Lanka, on loans granted to a person in Sri Lanka or to the Government of Sri Lanka. | Exempt |
| Income derived by any non-resident person (other than a Sri Lankan permanent establishment) as interest, discount or realization of any gain, on any sovereign bond denominated in local or foreign currency. | Exempt |

12. Calculate Assessable income from investment

12.1 Dividend, Interest and etc

| | Rate/Exempt |
|--|-------------|
| Income derived by any person as interest or discount paid or allowed, on any sovereign bond denominated in foreign currency, including Sri Lanka Development Bonds. | Exempt |
| Interest income derived from any foreign currency account approved by the Central Bank of Sri Lanka (w.e.f. 01.01.2020) | Exempt |
| Interest income earned by any person from the term deposit titled as “Special Deposit Accounts” maintained with authorized dealers of foreign currency as specified and at the instructions of the Central Bank of Sri Lanka either in foreign currency or in local Currency (w.e.f. 01.01.2020) | Exempt |
| Interest accruing to or derived by any multi-national company from the deposit opened by utilizing the foreign sources and maintained such deposit in foreign currency in any domestic bank, if such deposit is maintained to cover its import expenditure for that year of assessment. | Exempt |

12. Calculate Assessable income from investment

12.1 Dividend, Interest and etc

| Interest Income (Contd.,) | Rate/Exempt |
|---|-------------|
| Interest or discount accrued or derived by any Samurdhi community-based banks established under the Department of Samurdhi Development from the Sri Lanka Government treasury securities. | Exempt |



13. Tax holidays and other tax incentives

The original Act [Inland Revenue Act No. 24 of 2017 (IRA)] does not grant any tax holidays. However, it provides for investment incentives by way of Enhanced Capital Allowance & Concessionary Tax Rates. The Inland Revenue Amendment Act No. 10 of 2021 provides several income tax holidays (exemptions) as summarized below;

| Income Tax Holidays on Business Income - Industry | To Whom | Effective Date | Exemption period |
|--|---------|----------------|------------------|
| Realization Gain on land or building sold to REIT | R & NR | 01.04.2021 | Open |
| Non-resident's certain service income from the SL Airlines Ltd | NR | 01.04.2018 | Open |
| Agro-farming | R & NR | 01.04.2019 | 5 Years |
| IT & Enabled Services | R & NR | 01.01.2020 | Open |
| Local/foreign services to be utilized outside SL | R & NR | 01.01.2020 | Open |
| Vocational Educational Institute expansion (doubling students) | R & NR | 01.04.2021 | 5 Years |

13. Tax holidays and other tax incentives

| Income Tax Holidays on Business Income - Industry | To Whom | Effective Date | Exemption period |
|--|---------|----------------|------------------|
| Gold, gems, jewellery exports & gem processing for export | R & NR | 01.04.2021 | Open |
| Non-resident's laboratory & standards certification services | NR | 01.01.2020 | Open |
| Recycling & sale of such recycled construction materials | R & NR | 01.04.2021 | 10 Years |
| Businesses commenced after successful vocational education | N & NR | 01.04.2021 | 5 Years |
| Boat and ship building | R | 01.04.2021 | 7 Years |
| Solar or wind power projects not less than 100 MW | R & NR | 01.04.2021 | 7 Years |
| Construct communication towers & install appliances | R | 01.01.2021 | 5 Years |
| Letting out bonded warehouses for offshore businesses | R & NR | 01.04.2021 | Open |

14. Qualifying payments

Qualifying payments (Sec. 52 & 5th Schedule)

- 1) a donation made by an entity in money to an approved charitable:
 - a) a charitable institution established for the provision of institutionalized care for the sick or the needy; and
 - b) declared by the Minister as an approved charitable institution, subject to a maximum of –
 - i. The claimable amount in respect of donations made in money to Approved Charities is restricted to lower of $\frac{1}{5}$ th of the taxable income or Rs. 500,000
 - ii. Unclaimed amount, if any, cannot be carried forward

14. Qualifying payments

Qualifying payments (Sec. 52 & 5th Schedule)

- 2) Donations made in **money** or **otherwise** to the **Government** and to **certain prescribed Institutions** is claimable at 100%, but **unclaimed amount, if any, cannot be carried forward**.
- a) a local authority;
 - b) any Higher Education Institution established under the Universities Act or Buddhist and Pali University of Sri Lanka or any Higher Educational Institution established under the Buddhist and Pali University of Sri Lanka Act;
 - c) a fund established by the Government of Sri Lanka;
 - d) a fund established by a local authority or by a Provincial Council and approved by the Minister;
 - e) the Sevana Fund of the National Housing Development Authority
 - f) the Api Wenuwen Api Fund ;
 - g) National Kidney Fund.

14. Qualifying payments

Qualifying payments (Sec. 52 & 5th Schedule)

- 3) **any sum paid to the Consolidated Fund or to the President's Fund** established by the President's Fund Act, No. 7 of 1978 by a public corporation as required by the law by or under which such corporation is established.
- 4) Transitional Provisions on qualifying payments (Para 6)
As per the transitional provisions gazette notification No. 2064/53 dated April 1, 2018, any unclaimed balance of qualifying payment as at March 31, 2018 which has been claimed as per section 34 of the Inland Revenue Act, No. 10 of 2006 is deductible as an allowance in ascertaining the taxable income of any person for any year of assessment commencing after April 1, 2018 subject to any conditions specified in the provisions of the new IRA.

14. Qualifying payments

Amount B/F from Y/A 2017/2018 (Regulation under Sec. 194)

| E Limited to 1/5 th of Assessable Income and balance if any, can be C/F ^{*2} | | | | | | | | | | | | |
|--|-------|--|--|--|--|--|--|--|--|--|--|--|
| Qualifying Payment B/F from last year | 60.10 | | | | | | | | | | | |
| 1/5 th of Assessable Income | 60.11 | | | | | | | | | | | |
| Amount Deductible (lower of 60.10 or 60.11) [Enter to cage 60.12.A] | 60.12 | | | | | | | | | | | |
| Amount C/F to next year (60.10 – 60.12) | 60.13 | | | | | | | | | | | |

^{*2} Expenditure incurred for Government Development Plan

| G Donation to the Government or Specified Institutions, 100% deductible and balance if any, can be C/F | | | | | | | | | | | | |
|--|-------|--|--|--|--|--|--|--|--|--|--|--|
| Qualifying Payment B/F from last year | 60.27 | | | | | | | | | | | |
| Amount Deductible | 60.28 | | | | | | | | | | | |
| Amount C/F to next year (60.27 – 60.28) [Enter to cage 60.28.A] | 60.29 | | | | | | | | | | | |

15. Calculation of Income Tax Payable

The Calculation of Income Tax Payable shall be computed as follows.

| | |
|---|-------------------|
| Assessable income from “business” | XXX |
| Assessable income from “investment” | XXX |
| Assessable income from “other sources” | <u>XXX</u> |
| Total Assessable Income | XXX |
| Less: Qualifying payments and reliefs under section 52 (5 th Schedule) | <u>(XX)</u> |
| Taxable Income | <u>XXX</u> |
| Taxable income x tax rates as per 1 st Schedule | XXX |
| (-) Tax Credits: | |
| Any other tax credit allowed under the Act | <u>(XX)</u> |
| Balance Tax payable | <u>XXX</u> |

15. Calculation of Income Tax Payable

ABC Limited

COMPUTATION OF INCOME TAX

| | Rs. |
|---|-----|
| Exempt Amounts | - |
| Computation of Taxable Income | |
| Business Income | - |
| Investment Income - Dividend | - |
| Investment Income - other than dividend | - |
| Assessable Income | - |
| Less: Qualifying Payments | |
| Donation to the Government | - |
| Donation to an approved charity | - |
| Taxable Income | - |

15. Calculation of Income Tax Payable

Computation of Income Tax Payable

| | Taxable Income Rs. | Rate @ | Tax Rs. |
|--|-----------------------|-----------|------------|
| Tax on realization of investment assets | - | 10% | - |
| | - | | - |
| Tax on Remittance | - | 14% | - |
| | - | | - |
| Tax on profits from dividend | - | 14% | - |
| Tax on taxable income at special rates | - | 14% | - |
| Tax on taxable income at special rates | - | 18% | - |
| | - | | - |
| Tax on balance taxable income at normal rate | - | 24% | - |
| Total Tax Payable | - | | - |

15. Calculation of Income Tax Payable

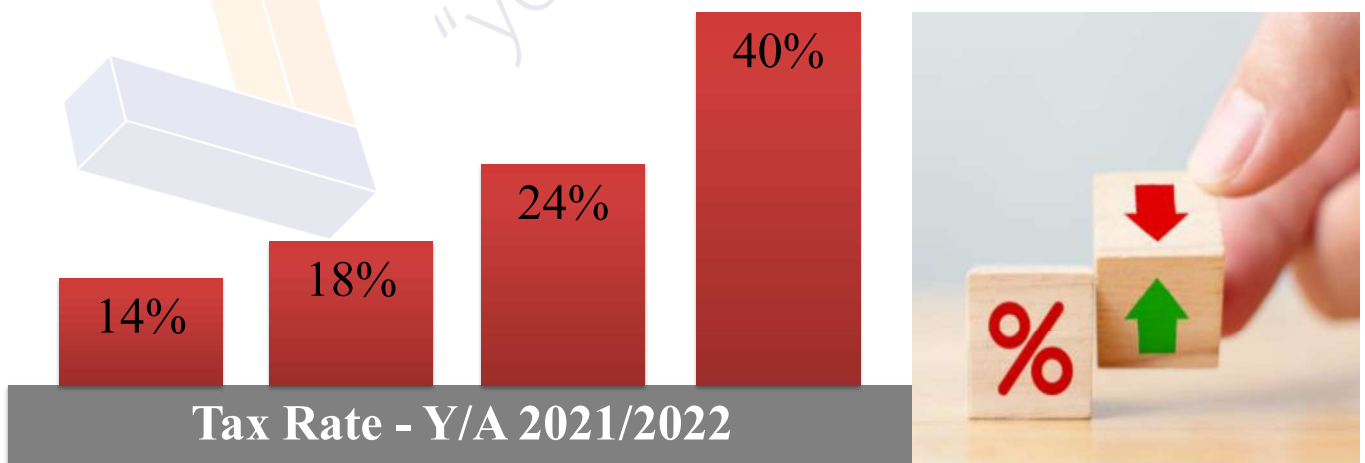
Less: Tax Credits

| | Rs. | |
|---|-----|----------|
| Economic Service Charge | - | |
| Notional Tax Credit | - | |
| Remittance Tax | - | |
| Withholding Tax | - | |
| Quarterly Installments | - | |
| Refunds | - | - |
| Balance Tax Payable / (Refund due) | | - |

15. Gross income tax and balance tax payable

15.1. Tax rates

The 1st Schedule of the IRA provides **four rates** of taxes on the taxable income.



15. Gross income tax and balance tax payable

The first schedule of the IRA provides the different income tax rates applicable to all taxpayers and on different taxable incomes. Accordingly, in the case of companies there were four (4) different rates applicable for the period from 01st April 2018 to 31st December 2019 while there are five (5) different rates with effect from 01st January 2020 as summarized below;

| | Up to 31.12.2019 | From 01.01.2020 |
|---|---------------------|--------------------|
| On Capital Gains (Gain on realization of investment Assets) | 10% | 10% |
| On Taxable Income taxing at Concessionary Rate | 14% | 14% |
| On Taxable Income representing manufacturing undertakings | - | 18% |
| On Taxable Income taxing at Standard Rate | 28% | 24% |
| On Taxable Income taxing at Higher Rate | 40% | 40% |

15. Gross income tax and balance tax payable

15.1.1. Standard rate

Up to 31st December 2019 any company not entitled to the reduced tax rate of 14% and also not liable to the higher tax rate of 40% were taxing at the standard rate of 28%. However, with the Amendment Act, with effect from 01st January 2020 the standard rate has been reduced to 24% while introduction of a new rate of 18% for manufacturing.

15.1.2. Reduced rate

The following companies are entitling to apply reduced tax rate of 14% for the period from 01.04.2018 to 31.12.2019 subject to the conditions provided in the IRA.

- i. Small and Medium Enterprises (SMEs)
- ii. A company **predominantly** conducting a business of **exporting goods and services**
- iii. A company **predominantly** conducting an **agricultural business**
- iv. A company **predominantly** providing **educational services**

15. Gross income tax and balance tax payable

v. A company **predominantly** engaged in an undertaking for **promotion of tourism**

vi. A company **predominantly** providing **information technology services**

“Predominantly” means; 80% or more calculated based on gross income.

The reduced tax rate of 14% is applicable on following gains and profits with effect from 01 January 2020;

| Tax rates for companies | Rate |
|---|-------------|
| Small and Medium Enterprise (excluding betting and gaming and liquor) | 14% |
| Sale of goods including exports for foreign currency | 14% |
| Entrepot trade | 14% |
| Offshore business without bringing goods to Sri Lanka | 14% |
| Front end services to clients abroad | 14% |

15. Gross income tax and balance tax payable

| Tax rates for companies | Rate |
|--|-------------|
| Headquarter operations of leading buyers for management of financial supply chain | 14% |
| Logistic services such as bonded warehousing | 14% |
| Transshipment operations | 14% |
| Freight forwarding | 14% |
| Supply of services to an exporter of goods or services or to foreign principle for payment in foreign currency - including agent of a ship operator | 14% |
| Manufacture and supply to an exporter of non-traditional goods | 14% |
| Bunkering services | 14% |
| Income generated from the supply of health protective equipment and similar products by BOI companies on the request of Ministry of health, Department of health services, Tri Forces, Sri Lanka Police and COVID centre | 14% |

15. Gross income tax and balance tax payable

| Tax rates for companies | Rate |
|--|-------------|
| Ship repair/refurbishment of marine cargo containers for payment in foreign currency | 14% |
| Provision of computer software, programs or systems or recording computer data for payment in foreign currency | 14% |
| Sale of gem or jewelry in foreign currency made in Sri Lanka | 14% |
| On gains and profits from the consideration received in respect of gems and jewellery | 14% |
| Gains and profits from providing educational services | 14% |
| Gains and profits of an undertaking for the promotion of tourism | 14% |
| Gains and profits from providing construction services | 14% |
| Agro Processing (Agro Farming - Exempt, w.e.f. 01.04.2019 only up to 5 years) | 14% |
| Gains and profits from providing health care services | 14% |

15. Gross income tax and balance tax payable

| Tax rates for companies | Rate |
|--|-------------|
| Supply of electricity using renewable energy | 14% |
| A company list its shares in Colombo Stock Exchange during the period from 01.01.2021 to 31.12.2021, for year of assessment 2022/2023 to 2024/2025 | 14% |
| Gains and profits from dividends received from a resident company | 14% |
| Gains and profits from manufacturing (if 14% provided for same income, it can be applied ex: SME, Exports, etc.) | 18% |
| Gains and profits from conducting betting and gaming | 40% |
| Gains and profits from the manufacture and sale or import and sale of any liquor or tobacco product | 40% |
| Information technology and enabled services as prescribed (After 01.01.2020) | Exempt |

15. Gross income tax and balance tax payable

| Tax rates for other bodies | Rate |
|---|------|
| Partnerships - on income exceeding Rs. 1,000,000 | 6% |
| Charitable institutions | 14% |
| Employee Trust Funds, provident, pension or gratuity funds and termination funds | 14% |
| Trusts | 18% |
| Unit trusts or mutual funds that does not conduct an eligible investment business | 24% |
| Non-governmental organizations | 24% |

15. Gross income tax and balance tax payable

Small and Medium Enterprises (SMEs)

“Small and Medium Enterprise” means a person who satisfies the following conditions (*As amended w.e.f. 01.04.2020*):

- a) The person who conducts business solely in Sri Lanka other than an individual who is engaged in providing professional services individually or in the partnership being an individual who is professionally qualified;
- b) the person does not have an associate that is an entity; and
- c) the person’s annual gross turnover is less than Rs. 500 Million;

Associated companies are treated as SME, if the aggregate turnover of such group of persons does not exceed the turnover threshold of Rs.500 Million.



15. Gross income tax and balance tax payable

15.2 Business of exporting goods and services

A company conducting a business of **exporting goods and services** is entitled to the reduced rate of **14%**.

Exports includes **specified undertaking**:

“Specified undertaking” means (Sec. 195); an undertaking which is engaged in:

- a) Entrepot trade involving import, minor processing and re-export;
- b) Offshore business where goods can be procured from one country or manufactured in one country without bringing the same into Sri Lanka;
- c) Providing front end services to clients abroad;
- d) Headquarter operations of leading buyers for management of financial supply chain and billing operations;
- e) Logistic services such as bonded warehouse or multi-country consolidation in Sri Lanka;

15. Gross income tax and balance tax payable

- f) Transshipment operations;
- g) Freight forwarding;
- h) Sale of gem and jewelry for foreign currency;
- i) Supply of services to any exporter of goods or services or to any foreign principal of such exporter directly, being services which could be treated as essentially related to the manufacture of such goods or provision of such services exported by such exporter either directly or through any export trading house, including any service provided by an agent of a ship operator to such agent's foreign principal, and the payment for such services are made by such exporter or foreign principal to such person in Sri Lanka in foreign currency;
- j) Production or manufacture, and supply to an exporter of non-traditional goods; and
- k) The performance of any service of ship repair, ship breaking repair and refurbishment of marine cargo containers, provision of computer software, computer programs, computer system or recording computer data, or such other services as may be specified by the minister by notice published in the Gazette, for payment in foreign currency”;

15. Gross income tax and balance tax payable

15.3 Providing information technology services

For this purpose, the providing information technology means (1st Schedule);

- a) software development services; or
- b) the provision of information technology services under a business process outsourcing arrangement or a knowledge process outsourcing arrangement;

15.4 An undertaking for promotion of tourism

For this purpose, the undertaking for promotion of tourism means (1st Schedule); 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 (inbound) in Sri Lanka;

15. Gross income tax and balance tax payable

- d) any business of **transporting tourists** only; or
- e) any **business approved** by the Ceylon Tourist Board for providing facilities for recreation or sports;

15.6 Agro farming

“agro farming” means-

- a) the tillage of the soil and cultivation of land with plants of any description, cultivation in green house, bee-keeping, rearing of fish, shrimp farming or animal husbandry, poultry farms, hatchery, veterinary or artificial insemination services;
- b) the cleaning, sizing, sorting, grading, cutting or chilling of any produce produced out of any activity referred to in paragraph (a) by any person who is engaged in any such activity, in preparation of such produce for the market but excludes the agro or food processing;

15. Gross income tax and balance tax payable

15.6 Agro processing

Agro-processing means the processing of any locally produced agricultural, fishing or animal product and includes an undertaking for the dehydrating, milling, packaging, canning for the purpose of changing the form, contour or physical appearance of such product in preparation for the market but excluding an undertaking of deep-sea fishing or manufacturing.



15. Computation of tax payable and balance tax payable

Tax rates are applied on the taxable income, in computing gross income tax liability of a company for a year of assessment. The **tax credits are deducted from the gross tax liability** to arrive the balance tax payable.

| | |
|--|--------------------|
| Taxable income x tax rates as per 1st Schedule | xxx |
| (-) Tax Credits; | |
| Any other tax credit allowed under the Act | <u>(xx)</u> |
| Balance Tax payable | <u>xxx</u> |

15. Computation of tax payable and balance tax payable

The following tax credits are generally applicable for a company;

| Tax Credits | Description |
|--|---|
| Economic Service Charge (ESC) | Paid during the year and unutilized and unexpired ESC brought forward from prior years of assessment. |
| Income Tax Quarterly Installments (self-assessment payments) | The computed income tax liability is to be discharged to the Department of Inland Revenue quarterly under the self-assessment basis . |
| Withholding Tax | withholding tax deducted under section 84 in respect of investment income is deductible as a tax credit provided such investment income is not a final withholding payment . |

15. Computation of tax payable and balance tax payable

The following tax credits are generally applicable for a company;

| Tax Credits | Description |
|---------------------------|--|
| Notional Tax Credit (NTC) | As per the para 10 of the Transitional Provision Gazette; The carried forward NTC as per section 138(2) of Inland Revenue Act, No. 10 of 2006 may be carried forward to be set off against the income tax liability within three consecutive years of assessment commencing from the year of assessment 2018/2019 (up to 2020/2021). |
| Remittance Tax (RT) | A non-resident person who carries on business in Sri Lanka through a Sri Lankan permanent establishment shall pay tax at the rate of 14% on the remitted profits earned within the year of assessment (Sec. 62). |
| Refunds | Any finalized refund available for a company. |