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Assessable Income - Business

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CHAPTER CONTENT

1.0 Definition of a Business

The business is defined in the interpretation section (Section 195) of the Inland Revenue Act No.24 of 2017, as follows.

"Business",

(a) Includes,

(i) A trade, profession, vocation or isolated arrangement with a business character however short the duration of arrangement;

(ii) A past present or prospective business, but

(b) Excludes an employment.

Trade

Characteristics for a trading nature are as follows.

- ✓ Whether a person has purchased some commercial quantities of items which are more than enough for him,
- ✓ If such articles are held for a short period,
- ✓ Transactions are repetitive,
- ✓ Any such motivation to make profits, etc.

Ex: Manufacturing, buying & selling of goods

Profession

Any person engaged in professional activity with his special skills and knowledge, it is his profession. He may have obtained such skills from an institution following a course or program.

Ex : Chartered Accountant, Doctor, Lawyer

Vocation

Occupation to which a person is specially drawn or for which she or he is suited, trained or qualified.

Ex: Singer, Actor

Isolated arrangement with a business character however short the duration of arrangement

Ex: Seasonal business

Question 1

Confirm the category of business income (trade, profession, vocation or isolated arrangement) as per the interpretation section of the Inland Revenue Act.

(a) Mr.Perera is a doctor who is working in general hospital. In addition to above, he visits to Asiri medical.

(b) Mr.kasun is a singer.

(c) X PLC engages in manufacturing activities of toys.

(d) ABC (Pvt) Ltd main business activity is buying & selling of liquors.

(e) Ms.Senani is a chartered accountant. She is working as a finance manager in A PLC. In addition to above, she is the managing partner of her own tax consultancy firm.

(f) Mr.X & Y are engaged with selling of decoration items for new year and Christmas periods only.

2.0 What constitute a Business?

A person's income from a business for a year of assessment shall be the person's gains and profits from conducting the business for the year.

In calculating a person's gains and profits from conducting a business for a year of assessment the following amounts derived by the person during the year of assessment from the business shall be included;

- service fees;
- consideration received in respect of trading stock;
- gains from the realization of capital assets and liabilities of the business as calculated under Chapter IV; (Section 17)
- amounts required to be included by the Second or Fourth Schedule to this Act on the realization of the person's depreciable assets of the business; (Section 16)
- amounts derived as consideration for accepting a restriction on the capacity to conduct the business;
- gifts received by the person in respect of the business;
- amounts derived that are effectively connected with the business and that would otherwise be included in calculating the person's income from an investment; and
- other amounts required to be included under this Act.

In calculating a person's gains and profits from conducting a business for a year of assessment the following shall be excluded:

(a) exempt amounts and final withholding payments; and

(b) amounts that are included in calculating the person's income from an employment.

3.0 Computation of Gains & Profits from Business

In order to arrive at the assessable income from business, the following format should be followed.

	+	-
Net profit before taxation	Xx	
Less : Exempt income/ final WH payments/ other sources of income		Xx
Add: Disallowable expense	Xx	
Less: Allowable expenses		Xx
Assessable income from business	Xxx	

4.0 Allowable & Disallowable Expenses

Generally, deductions of the Act fall in to three main categories.

- General Deductions – Disallowable Expenses (Sec.10)
- Main Deduction (Sec.11)
- Specific Deductions (Sec.12-19)

Section – 12 – Interest Expense

Section – 13 – Allowance for Trading Stock

Section – 14 – Repairs & Improvements

Section – 15 – Research and Development Expenses and Agricultural Startup Expenses.

Section – 16 – Capital Allowances & Balancing Allowances

Section – 17 – Losses on Realization of Business Assets & Liabilities

Section – 18 – Deductible Amount of Finance Cost

Section – 19 – Business or Investment Losses

4.1 General Deductions (Sec.10)

The following deductions shall not be made in calculating a person's income:-

(i) domestic expenses incurred by the person (section 197);

(1) Where an individual incurs expenditure in respect of himself, the expenditure shall be domestic expenditure to the extent that it is incurred –

(a) in maintaining the individual, including in providing shelter as well as meals, refreshment, entertainment or other leisure activities;

(b) in the individual commuting from home;

(c) in acquiring clothing, including shoes, for the individual, other than clothing that is not suitable for wearing outside of work;

(d) in educating the individual, other than education that is directly relevant to a business conducted by the individual and that does not lead to a degree or diploma; or

(e) in paying any personal debts, including credit card debts, of the individual.

(2) Where another person incurs expenditure in making a payment to or providing any other benefit for an individual, the expenditure shall be domestic expenditure (except to the extent that –

(a) the payment or benefit shall be included in calculating the income of the individual;

(b) the individual provides consideration of an equal market value for the payment or benefit; or

(c) the amount of the expenditure is so small as to make it unreasonable or administratively impracticable to account for i).

(ii) <u>tax payable</u> under this Act & others;

The following taxes are disallowable under general deductions.

- Income tax payable under IRD Act
- Economic Service Charge
- VAT/NBT on Financial Services
- Crop Insurance Levy
- Supper Gain Tax, Mansion Tax

NBT expense for the year is allowable.

(iii) <u>interest, penalties and fines</u> payable to a government or a political subdivision of a government of any country for breach of any written law;

Ex : Penalties for taxes, EPF & ETF surcharge

(iv) expenditure to the extent incurred by a person in deriving <u>exempt amounts or final withholding payments;</u>

(v) <u>Retirement contributions</u>, unless they are included in calculating the income of an employee or consist of a contribution by an employer to a pension, provident or savings fund or a savings society, which is approved by the Commissioner-General subject to any specified conditions;

(vi) <u>dividends</u> of a company;

(vii) outlays or <u>expenses for entertainment;</u>

Ex : Foods to suppliers & customers

(viii) an amount that a person has transferred, in his financial accounts, to a reserve or provision for expenditures or losses not yet incurred but expected to be incurred in a future year of assessment;

Ex: Gratuity provision, bad debt provision

(ix) amounts incurred on lotteries, betting or gambling, other than amounts incurred from conducting a business of lotteries, betting or gambling;

Ex : Expenses related to lotteries

- **No Deduction for Payment until WHT has been Paid (Sec. 10(2))**

  Where a person is allowed a deduction for a payment from which the person is required to withhold tax under Division II of Chapter VIII (section 83, 84 and 85), the deduction shall not be allowed until the tax withheld has been paid to the Commissioner General.

  Ex: PAYE not deducted salary, WHT not deducted rent expense

- **No Deduction for Expenditure unless the Deduction is Expressly Permitted in the Act (Sec. 10(3))**

  A person shall deduct an expense only if the deduction is expressly permitted in the Act. If a deduction of an expense is not expressly permitted in the Act, then, such deduction shall not be allowed under this section.

- **Most Specific rule shall be applied in case of more than one Deduction Applies (Sec. 10(4))**

  Where more than one deduction applies, the most specific deduction shall be applied even if that results in the denial of a deduction.

Question 02

A company which is engaged in the business of manufacture of articles has incurred the following expenditures during the year of assessment 2018/2019. Advise the company whether these expenses are allowable or not, based on section 10.

(a) Penal interest paid for outstanding overdraft facility obtained from a bank of Rs. 230,000.

(b) Surcharge paid on EPF of Rs. 75,000.

(c) Penalty paid to Inland Revenue due to the delay in payment of nation building tax (NBT) of Rs.110,000. The expense of nation building tax of Rs. 16,800,000.

(d) Interest paid of Rs.25,000,000 includes the dividend payable to preference shareholders of Rs. 8,500,000.

(e) Cost incurred in providing food and beverages to the customers in a hotel of Rs. 3,000,000.

(f) Provision for gratuity of Rs. 6,300,000. The company has paid a sum of Rs. 1,500,000 as gratuity during the year.

(g) The company has failed to deduct relevant withholding tax at the rate of 10% under section 84 of the Act in relation to payment of rent of Rs. 5,400,000 in respect of showrooms used in its business.

(h) Company has charged unrecovered economic service charge (ESC) of Rs. 3,000,000 during the year.

(i) Expenses to maintain a company car used by CEO of Rs. 1,000,000. The company has considered a monthly amount of Rs. 80,000 as his personal benefit in his employment income.

(j) Payment of rent of Rs. 800,000 to a landlord for an apartment given to its marketing manager. The company has considered a sum of Rs. 50,000 as his monthly benefit in his employment income.

4.2 Main Deductions (Sec.11)

➢ **Expenses Incurred in the Production of Income from a Business or Investment shall be Deducted (Sec. 11(1))**

In calculating a person's income from a business or investment for a year of assessment, expenses to the extent they are incurred during the year by the person and in the production of income from the business or investment, shall be deducted.

Ex: Salary to workers and advertisements cost are incurred for the production of income. But donations and gifts re not incurred for the production of income.

An expense shall be deducted if it is incurred during the year in the "production of income from the business or investment". An expense which satisfies one of the following requirements be treated as incurred in the production of income.

(a) Incidental expense - An expense which is incidental to the business or investment is deductible, whether an expense is incidental or not depends on the nature of the business or investment and the manner in which it is carried on or carried out.

(b) Direct purpose of earning the income - Identifying the activity relating to income from business or investment is essential to deduct an expense. An expense which is incurred for direct purpose of earning such income is deductible.

(c) Closely connected - It is not enough to establish that an expense is connected to the business or investment. It is required to prove an expense is closely connected to the business or investment for the deduction. An expense which is remotely connected is not deductible.

Question 03

Advise whether the following expenses incurred by a company which is engaged in the provision of management consultancy services fall within the meaning of "expenses incurred in the production of income"

(a) Employees remuneration including bonus

(b) Charity and donation

(c) Gifts and compliments

(d) Cost of advertisement

(e) Foreign travelling for business purposes

- **Capital Expenditure not Allowed (Sec. 11(2))**

  No deduction shall be allowed under this section for an expense of a capital nature.

  "Expense of a capital nature" includes an expense that secures a benefit capable of lasting longer than twelve months.

4.3 Specific Deductions (Sec.12- 19)

4.3.1 Interest Expense (Sec. 12)

For the purposes of section 12, the interest incurred by a person during a year of assessment under a debt obligation of the person shall be deemed to be incurred in the production of income to the extent that –

(a) where the debt obligation was incurred in borrowing money, the money is used during the year or was used to acquire an asset that is used during the year in the production of income;

and

(b) in any other case, the debt obligation was incurred in the production of income.

Question 04

Advise whether the following interest expenses incurred by a company are deductible for the year of assessment 2018/2019.

(a) Interest paid on a loan obtained during the year of assessment 2016/2017 to construct a factory building and the building is used during the year of assessment 2018/2019 in its production.

(b) Interest paid on a loan obtained during the year 2018/2019 to purchase a machinery.

(c) Interest paid on overdraft facilities obtained.

(d) Interest paid on a loan to construct a showroom. The construction is not complete as at 31.03.2019.

(e) Interest paid on a lease obtained to purchase the car of Managing Director (Personal Vehicle).

Question 05

An individual has acquired an apartment which was given on rent for a monthly rent of Rs. 300,000. He has paid interest of Rs. 1,300,000 during the year on a loan obtained to purchase this apartment.

Advise him whether he can deduct the interest cost in calculating his income from rent.

4.3.2 Deductible Amount of Financial Cost (Sec. 18)

4.3.2.1 Maximum deductible financial cost (Sec. 18(1))

The amount of financial costs deducted in calculating an entity's income, (other than a financial institution) from conducting a business or investment for a year of assessment shall not exceed the amount of financial costs attributable to financial instruments within the limit as given in the following formula.

$$A \times B$$

Where:

A' is the total of the issued share capital and reserves (other than revaluation reserve) of the entity;

B' is –

(a) in the case of a manufacturing entity, the number 3; and

(b) in the case of an entity other than a manufacturing entity, the number 4.

4.3.2.2 Treatment for excess financial cost

Financial costs for which a deduction is denied as a result of above formula, may be carried forward and treated as incurred during any of the following six years of assessment, but only to the extent of any unused limitation for the year.

Question 06

ABC (Pvt) Ltd has following details for the Y/A 2018/19.

Share Capital – Rs.1,000,000

Reserves – Rs.750,000 (This includes revaluation reserve of Rs.250,000)

Finance cost as per the financial statement – Rs.500,000

Loan balance as at 31.03.2019 – Rs.5,000,000

Determine the tax implication, if the entity become a;

(a) A manufacturer

(b) A service provider

Question 07

XYZ (Pvt) Ltd is providing consultancy services and having following details for the Y/A 2018/19. Determine the tax implication for disallowable finance cost if any.

Share Capital – Rs.1,500,000

Reserves – Retained earnings Rs.750,000, General reserve Rs.250,000 & revaluation reserve of Rs.350,000

Finance cost as per the financial statement – Rs.1,200,000

Loan balance as at 31.03.2019 – Rs.6,000,000

4.3.3 Capital Allowances & Balancing Allowances (Sec. 16)

4.3.3.1 Capital Allowances

For the purposes of calculating a person's income from a business for a year of assessment, the capital allowance shall be deducted.

- Capital allowances are granted in respect of depreciable assets owned and used by a person at the end of a year of assessment in the production of the person's income from a business; and calculated in accordance with the provisions of the Second or Fourth Schedule to this Act.
- The phrase "depreciable asset";

(a) means an asset to the extent to which it is employed in the production of income from a business and which is likely to lose value because of wear and tear, obsolescence or the passing of time;

but

(b) excludes goodwill, an interest in land, a membership interest in an entity and trading stock;

- Capital allowances granted with respect to a particular year of assessment shall be taken in that year and shall not be deferred to a later year of assessment.
- Full Capital allowance will be granted for the year of acquisition (irrespective of date of acquisition).
- Capital allowance is not granted for the year of disposal.
- Deduction of capital allowances on the assets acquired under the finance leasing (Sec. 49(2)). Where an asset is leased under the finance lease, the lessor shall be treated as transferring ownership of the asset to the lessee. Accordingly, the lessee is entitled to deduct capital allowance in relation to the assets obtained under finance leasing.
- Capital allowance for a year of assessment for each depreciable asset shall be calculated according to the straight-line method using the following formula:

  Depreciation basis of asset at the end of the year of assessment (A)

  Number of years referred to applicable to that asset (B)

- Depreciation basis of depreciable asset

  The depreciation basis of a depreciable asset of a person at the end of a year of assessment is shall be 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 in respect of additions to the cost of asset.

- Classification of depreciable asset

Class	Depreciable Asset	No of Years
1	computers and data handling equipment together with peripheral devices	5
2	buses and minibuses, goods vehicles; construction and earthmoving equipment, heavy general purpose or specialised trucks, trailers and trailer-mounted containers; plant and machinery used in manufacturing.	5
3	railroad cars, locomotives, and equipment; vessels, barges, tugs, and similar water transportation equipment; aircraft; specialised public utility plant, equipment, and machinery;	5

	office furniture, fixtures, and equipment; any depreciable asset not included in another class.	
4	buildings, structures and similar works of a permanent nature	20
5	intangible assets, excluding goodwill.	The actual useful life of the intangible asset, or where the intangible asset has an indefinite useful life, 20.

- No Capital allowance shall be granted to a person in respect of a road vehicle, other than–

  (a) a commercial vehicle;

  (b) a bus or minibus;

  (c) a goods vehicle; or

  (d) a heavy general purpose or specialized truck or trailer.

- For the purposes of this paragraph, "commercial vehicle" means–

  (a) a road vehicle designed to carry loads of more than half a ton or more than 13 passengers; or

  (b) a vehicle used in a transportation or vehicle rental business.

Special Note

Where a depreciable asset owned by a person is only partly used in the production of income from a business at the end of a 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. (Fourth Schedule – 1(2))

Question 08

Calculate the capital allowances in respect of following assets used by a company for the year of assessment 2018/2019.

Additions during the year of assessment 2018/2019.

(a) Machinery of Rs. 60,000,000 which include a sum of Rs. 10,000,000 obtained under finance leasing

(b) Equipment of Rs. 2,500,000

(c) Office furniture of Rs. 2,400,000

(d) Computers and accessories of Rs. 1,300,000

(e) Building constructed of Rs. 15,000,000

(f) Patent purchased of Rs. 1,500,000 (Actual useful time – 15 years)

Question 09

A newly incorporated company has acquired following assets (classified as motor vehicles) during the year of assessment 2018/2019. Advise the company whether it can deduct capital allowances in relation to these motor vehicles.

- Lorry purchased for transporting of goods
- Car purchased for marketing director for his official travelling
- Car purchased for rental business

Transitional Provisions – Depreciation Allowance for assets acquired up to 31st March 2018

Depreciation allowance for the Assets acquired up to Y/A 2017/18 should be computed in accordance with the repetitive provisions of the Inland Revenue Act No.10 of 2006.

Accordingly, depreciation allowances applicable under No. 10 of 2006 Act is as follows.

	Acquired prior to 2004/05	**ACQUIRED WITHIN THE YEAR OF ASSESSMENT**						
		2004/05	2005/06	2006/07	2007/08	2008/09 2009/10 2010/11	2011/12 & 2012/13	2013/14 onwards & prior to 01.04.2018
I.T. & calculating Equipment and Imported Software	100%	25%	25%	25%	25%	25%	25%	25%
Locally Developed Software	100%	25%	100%	100%	100%	100%	100%	100%
Motor vehicle (qualified) & furniture	25%	20%	20%	20%	20%	20%	20%	20%
Energy efficiency Plant, Machinery & Equipment	50%	12 ½ %	12 ½ %	$33^1/_3\%$	$33^1/_3\%$	$33^1/_3\%$	50%	50%
High tech power generating Plant, Machinery & Equipment>30% of own power requirement	50%	12 ½ %	12 ½ %	$33^1/_3\%$	$33^1/_3\%$	$33^1/_3\%$	50%	100%
Plant & Machinery & Equipment for technology upgrading/introducing new technology	50%	12 ½ %	12 ½ %	$33^1/_3\%$	$33^1/_3\%$	$33^1/_3\%$	$33^1/_3\%$	50%
Plant & Machinery used in health care, printing, packaging, gem cutting and rice milling businesses	50%	12 ½ %	12 ½ %	$33^1/_3\%$	$33^1/_3\%$	$33^1/_3\%$	$33^1/_3\%$	$33^1/_3\%$

Machinery used in construction industry	50%	12 ½ %	12 ½ %	12 ½ %	25%	25%	$33\frac{1}{3}$%	$33\frac{1}{3}$%
Plant & Machinery & Equipment by trade/business exporting >60% turnover	50%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$33\frac{1}{3}$%	50%
Ships (owned or chartered)			$12\frac{1}{2}$%	$12\frac{1}{2}$%	$33\frac{1}{3}$%	$33\frac{1}{3}$%	$33\frac{1}{3}$%	$33\frac{1}{3}$%
Plant, Machinery & Equipment by stock brokering companies for upgrading IT	100%	25%	25%	25%	25%	25%	25%	100%
Plant, Machinery & Equipment of an undertaking manufacturing for export with ≥US$ 2 m. investment commenced 01.04.2015 or after	N/A	N/A	N/A	N/A	N/A	N/A	N/A	100% W.E.F. 1.4.2015
Other Plant, Machinery & Fixtures	50%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$12\frac{1}{2}$%	$33\frac{1}{3}$%	$33\frac{1}{3}$%
Qualified Buildings (Own Constructed);								
-Constructed during 01.04.1993 to 31.03.2011	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	N/A	N/A
-Constructed after 31.03.2011						N/A	10%	10%
Acquired qualified buildings constructed after 31.03.2011						N/A	10%	10%
Purchase of any commercial unit of a condominium property	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%					
Hotel building including hotel building complex			$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	10%	10%
Industrial building / complex acquired from a person who has used such building in any trade or business								
Any bridge Railway track, reservoir, electricity/water line & toll roads (constructed/purchased	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%	$6\frac{2}{3}$%
Acquisition cost of Intangible Assets other than goodwill			10%	10%	10%	10%	10%	10%

- Full Depreciation allowance will be granted for the year of acquisition (irrespective of date of acquisition).
- Depreciation allowance is not granted for the year of disposal.

Question 10

Calculate the depreciation allowance for the Y/A 2018/2019.

a) Acquisition of software developed in Sri Lanka in May 2017 of Rs. 1,800,000
b) Building purchased in August 2015 of Rs.5,000,000
c) Computer purchased in June 2016 of Rs. 500,000
d) Machine Purchased in January 2018 of Rs.3,000,000
e) Machinery purchased in January 2018 Rs. 10,000,000 obtained under finance leasing
f) Car purchased in the Y/A 2017/18 for Rs.3,500,000

Leasehold assets purchased prior to April 01st April 2018

According to the transitional provisions, in respect of any finance lease agreement entered into, prior to April 1, 2018, is to be computed in accordance with the repetitive provisions of the Inland Revenue Act No.10 of 2006.

Accordingly, allowable lease rentals is calculated as follows;

a) Lease rentals paid in excess of the following amounts are disallowable.

Disallowable Excess Amount % of Total Rentals

On IT and calculating equipment, accessories & software - 25% p.a.

On Motor vehicles, furniture, plant, machinery & equipment - 20% p.a.

Question 11

Determine the amount of rental to be allowed under the section 26 for the Y/A 2018/19 in respect of the following finance leasing agreements entered in to by individual businessmen for his business.

(a) Lease of lorry in May 2017 for a period of 4 years at a monthly rental of Rs.150,000.
(b) Lease of computer equipment including accessories in April 2017 for a period of 5 years at a monthly rental of 25,000.
(c) Lease of machinery from June , 2017 for period of 4 years at a monthly rental of Rs.500,000.

Leasehold Assets purchased after April 01, 2018

- The lessee is treated as the owner of the leased asset so can claim capital allowance on the asset.
- Interest cost is allowable subject to thin capitalization rule.

4.3.3.2 Balancing Allowances (Sec. 16)

For the purposes of calculating a person's income from a business for a year of assessment, the balancing allowances shall be deducted.

Balancing allowances are –

(a) made in respect of depreciable assets -

(i) realized during a year of assessment; and

(ii) in respect of which Capital allowances have been granted in that year or an earlier year; and

(b) calculated in accordance with the provisions of the Second or Fourth Schedule to this Act.

<u>Balancing allowances and assessable charges</u>

(a) an assessable charge is included in calculating the person's income for the year calculated in accordance with the following formula:

$$A - B$$

(b) a balancing allowance is granted to the person for the year calculated in accordance with the following formula:

$$B - A$$

where –

'A' is consideration received by the person during the year of assessment for the asset; and

'B' is the written down value of the asset at the time of realization of the asset.

For the purposes of this paragraph, "written down value" of an asset at the time of realization of the asset means the expenses incurred by a person in acquiring the asset reduced by all Capital allowances granted to the person in respect of the asset.

Question 12

Advise the company on the tax adjustments in relation to realisation of following assets during the year of assessment 2018/2019.

a. A machine sold for Rs.8,000,000 was acquired by the company on 14.09.2016 for Rs.12,000,000.

b. A lorry sold for Rs. 1,000,000 was purchased by it on 19.08.2015 for Rs. 4,000,0000.

4.3.4 Repairs and Improvements (Sec. 14)

Expenses for the repair or improvement of depreciable assets and meeting the requirements of section 11(1) of a person for any year of assessment shall be deducted irrespective of whether they are of a capital nature or not.

Maximum deduction

(a) shall not exceed –

(i) in the case of repair or improvement to a Class 4 depreciable asset, 5% of the written down value of the asset at the end of the previous year (Fourth Schedule);

(ii) in all other cases, 20% of the written down value of the asset at the end of the previous year (Fourth Schedule); and

(b) shall be allowed in the order in which the expenses are incurred.

Treatment for the excess;

- Excess expense for which a deduction shall not be allowed as a result of the above limitation shall be added to the depreciation basis of the asset year (Fourth Schedule).
- Capital Allowance can be claimed from next Y/A.

Question 13

Advise the disallowable amount of following costs of repair and improvements of a company for the year of assessment 2018/2019.

Assets	WDV as at 31.03.2018 (Rs)	Costs (Rs)
Machinery	25,000,000	4,000,000
Building	30,000,000	2,500,000

Question 14

A company has acquired a machinery for a sum of Rs. 5,000,000 during the year of assessment 2018/2019. A company incurred Rs.1,000,000 repair cost in the Y/A 2019/2020.

Determine the tax implication.

Question 15

An individual has acquired an apartment which was given on rent for a monthly rent of Rs. 250,000. He has incurred repair expense of Rs.150,000 during the year.

Advise him the applicable provisions available to him to deduct the repair cost in calculating his income from rent.

4.3.5 Losses on Realization of Business Assets and Liabilities (Sec. 17)

For the purposes of calculating a person's income from a business for a year of assessment, a loss of the person from the realization during the year of assets and liabilities shall be deducted.

The loss shall be calculated under Chapter IV.

The assets and liabilities are –

(a) capital assets of a business to the extent to which the assets were used in the production of income from the business; and losses on realization of business assets and liabilities.

(b) liabilities of a business to the extent to which –

(i) in the case of a liability that is a debt obligation incurred in borrowing money, the money was used or an asset purchased with the money was used in the production of income from the business; and

(ii) in the case of any other liability, the liability was incurred in the production of income from the business.

The phrase "capital asset";

(a) means each of the following assets:

(i) land or buildings;

(ii) a membership interest in a company, partnership or trust;

(iii) a security or other financial asset;

(iv) an option, right or other interest in an asset referred to in the foregoing paragraphs; but

(b) excludes trading stock or a depreciable asset;

- Calculation of gain/(loss) on realization of business asset = Sales proceed – Cost

Question 16

Advise the company on the tax adjustments in relation to realisation of following assets, which are used for the business during the year of assessment 2018/2019.

(a) Land 01 – Situated in Colombo had sold for Rs. 7,000,000 was purchased by it on 19.08.2016 for Rs. 4,000,0000.

(b) Land 02 - Situated in Kandy sold for Rs. 5,000,000 was purchased by it on 2017 for Rs. 4,000,0000.

Question 17

A PLC had sold following assets during the year of assessment 2018/2019. Determine the tax implication.

(a) Land 01 - Used as the factory stores had sold for Rs. 6,000,000 was purchased by it on 2015 for Rs. 3,000,0000.

(b) Land 02 – Used as the investment property sold for Rs. 7,500,000 was purchased by it on 2010 for Rs. 2,000,0000.

For above sales transaction following incidental expenses were incurred.

Land 01 – Survey charges Rs.50,000 & sales commission Rs.150,000

Land 02 – Valuation charges Rs.100,000 & sales commission Rs.250,000

4.3.6 Allowance for Trading Stock (Sec. 13)

For the purposes of calculating a person's income from a business for a year of assessment, the allowance in respect of trading stock of the business shall be deducted.

The phrase "trading stock" is defined under section 195 as follows;

"trading stock" means assets owned by a person that are sold or intended to be sold in the ordinary course of a business of the person, work in progress on such assets, inventories of materials to be incorporated into such assets and consumable stores;

Calculation of allowance (Sec. 13(1))

(a) the opening value of trading stock of the business for the year of assessment; plus

(b) expenses incurred by the person during the year that are included in the cost of trading stock of the business; less

(c) the closing value of trading stock of the business for the year.

The opening value of trading stock for a year of assessment shall be the closing value of trading stock at the end of the previous year of assessment.

The closing value of trading stock of a business for a year of assessment shall be the lower of;

(a) the cost of the trading stock of the business at the end of the year; or

(b) the market value of the trading stock of the business at the end of the year.

4.3.7 Research and Development Expenses (Sec. 15)

Research and development expenses meeting the requirements of section 11(1) may be deducted irrespective of whether they are of a capital nature or not.

"research and development expenses" means expenses incurred by the person in –

(a) carrying on any scientific, industrial, agricultural or any other research for the upgrading of the person's 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 person's business and improving business products or process,

which shall be beneficial to Sri Lanka, but shall exclude expenses incurred that are otherwise included in the cost of an asset under this Act.

➢ **Additional deduction for research and development for three years from 01.04.2018 (Temporary concession under Sixth Schedule)**

A person is entitled to an additional deduction when calculating the person's income from business for a year of assessment equal to 100% of the total amount of research and development expenses deducted for the year under section 15, for three years of assessment after the commencement of this Act. (Up to Y/A 2020/21)

Question 18

A company has incurred a sum of Rs. 4,500,000 in relation to industrial research through an institution in Sri Lanka. It has also incurred a sum of Rs. 1,000,000 in improving its business process.

Advise the amount to be deducted by the company in calculating its business income.

➢ **Agricultural Start up Expenses (Sec. 15)**

Agricultural start up expenses meeting the requirements of section 11(1) may be deducted irrespective of whether they are of a capital nature or not.

"agricultural start up expenses" means expenses incurred by the person in-

(a) opening up any land for cultivation or for animal husbandry;

(b) cultivating land referred to in paragraph (a) with plants;

(c) the purchase of livestock or poultry to be reared on land referred to in paragraph (a);or

(d) 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 as the case may be.

4.3.8 Business or Investment Losses (Sec .19)

4.3.8.1 Deduction of business loss (Sec. 19(1))

In calculating the income of a person from a business for a year of assessment, the following shall 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 section 19(6) defines the terms "loss" and "unrelieved loss" as follows.

"loss" of a person for a year of assessment from a business or investment shall be calculated as the excess of amounts deducted in accordance with this Act (other than under this section or section 25(5)) in calculating the person's income from the business or investment over amounts included in calculating that income.

"unrelieved loss" means the amount of a loss that has not been deducted in calculating a person's income under this section or section 25(5).

The person may choose the income calculation or calculations in which an unrelieved loss or part of the loss is deducted. However, where a loss can be deducted, it shall be deducted.

4.3.8.2 Deduction of business losses from the operation taxable at reduced rate (Sec. 19(3))

Where a person makes a loss and if the loss were a profit it would be taxed at a reduced rate, the loss shall be deducted only in calculating income taxed at the same reduced rate, a lower reduced rate or exempt amounts.

4.3.8.3 Deduction of business losses from exempt operation (Sec. 19(3))

If the losses were a profit and the profit would be exempt, the loss shall be deducted only in calculating exempt amounts.

4.3.8.4 Deduction of losses from the investment income (Sec. 19(4))

(a) unrelieved losses from a business may be deducted in calculating income from an investment;

(b) unrelieved losses from an investment shall be deducted only in calculating income from an investment.

4.3.8.5 Restriction in deducting of loss on the disposal of investment asset from a gain from realization of another investment asset (Sec. 19(5))

Subject to section 194 (regulation by the Minister), a gain from the realization of an investment asset shall not be reduced by any loss on the disposal of another investment asset.

Note;

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 Y/A commencing on or after April 1,2018 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 years.

Question 19

A company has incurred business loss of Rs. 10,000,000 from its manufacturing operations during the year of assessment 2018/2019. However, it has generated business income (profit) of Rs.18,000,000 from the business of trading operation. Company is contemplating to set off the said loss from manufacturing business from income from the trading operation.

Advise the company whether it can set off under the Inland Revenue Act.

Question 20

A company has incurred business loss of Rs. 10,000,000 from its manufacturing operations during the year of assessment 2018/2019. Company is contemplating to set off the said loss from its rent income.

Advise the company whether it can set off under the Inland Revenue Act.

Question 21

A company has incurred business loss of Rs. 10,000,000 from its manufacturing operations during the year of assessment 2018/2019. Company has realized a gain from investment asset of Rs. 5,000,000. Company is contemplating to set off the said loss arose from the manufacturing business from the gain on the realization of investment asset.

Advise the company whether it can set off under the Inland Revenue Act.

Question 22

As per the income tax computation for the year of assessment 2017/2018 of a company, it has a loss carried forward to the year of assessment 2018/2019 amounting to Rs. 25,000,000.

Advise whether the company can deduct this loss for the year of assessment 2018/2019.

Question 23

XYZ (Pvt) Ltd has following details for the Y/A 2018/19. Calculate the total assessable income.

Business income	–	Rs.3,000,000
Rent Income	–	Rs.1,500,000
Business loss C/F from Y/A 2017/18	–	Rs.3,500,000

Question 24

ABC (Pvt) Ltd has following details for the Y/A 2019/20. Calculate the total assessable income.

Business income	–	Rs.2,500,000
Rent Income	–	Rs.3,500,000

Business loss C/F from Y/A 2018/19 – Rs.1,500,000 & Investment loss C/F from Y/A 2018/19 – Rs.4,000,000

Question 25

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	(75,200)
Gross profit	32,800
Other income	17,600
Administrative & general expenses	(28,400)
Selling & distribution expenses	(11,300)
Finance cost	(4,800)
Profit before taxation	**5,900**

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 Hotel 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**	**nill**

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.