

# Chapter Review Exercises

## Chartered Accountancy Strategic Level Corporate Taxation (TAX)

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## Question 2 - Chapter Review exercises

- Section 4 of the IRA specifies that a non-resident person should pay income tax in Sri Lanka only on the income that arises from or is derived from a source in Sri Lanka.
- PEL (UK) is a company incorporated in UK and according to section 69, it will be considered as a non resident person income tax purposes.
- EPL is a company incorporated in Sri Lanka and it canvasses for orders from students and teachers in Sri Lanka, delivers books on the orders received, holds stocks on behalf of PEL (UK) in Sri Lanka, and receives new stocks according to the orders received.
- EPL provides these services exclusively to PEL (UK), and on the instructions received by PEL (UK). The transactions are entered into and the invoices are issued in Sri Lanka by EPL on behalf of PEL (UK).
- Section 195 defines a “Sri Lankan permanent establishment” as

“Sri Lankan permanent establishment” means any business connection or fixed place of business through which the business of the enterprise is wholly or partly carried out, irrespective of the number of days of such business being carried out in Sri Lanka;”;

- PEL (UK) is doing business in Sri Lanka through an agent and therefore creates a Sri Lankan permanent establishment as it is doing business in Sri Lanka. Therefore, it will be liable to pay income tax in Sri Lanka.
- Section 75 of the IRA specifies that where Sri Lanka has entered into a double tax agreement with another State, such DTA will supersede the domestic law. Since Sri Lanka has entered into a DTA with UK, the provisions in this DTA will apply in this case.
- Article 7 on Business Profits specifies that an enterprise will only be taxable in the other State, where it carries on business through a permanent establishment (PE). Further, only so much of the profits attributable to such PE will be liable to income tax in that other State.
- Article 5 defines a PE. This includes a person acting on behalf of the enterprise in the other contracting State, which is deemed to be a PE if such person has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise.
- Based on the facts provided, the activities carried on by EPL on behalf of the PEL(UK) will be deemed to be a PE of PEL(UK) in Sri Lanka and therefore, it will be liable to income tax in Sri Lanka on the profits attributable to such PE.
- In the case of *Chivers & Sons Ltd*, it was held that where a person is instrumental in selling the goods and in canvassing for orders and maintaining stocks, it will be considered that the non-resident person will be doing business in Sri Lanka. Therefore, based on the case law, PEL (UK) will be liable to pay income tax in Sri Lanka.

(c)

- According to section 62, remittance tax is payable on “remitted profits”. The IRA defines “remitted profits” as “amounts remitted or retained abroad out of the profits and income of the non-resident person that are subject to income tax in Sri Lanka, and any amount received outside Sri Lanka by or on behalf of the non-resident person from conducting business in Sri Lanka that is subject to income tax

in Sri Lanka, excluding dividends paid by a resident company to the non-resident person”.

- Therefore, remittance tax is payable on amount falling within the above definition and not on all remittances made by the non-resident company.

### Question 3 - Chapter Review exercises

- IRA in Section 4 specifies that a non-resident person has to pay income tax in Sri Lanka on the profits and income arising in or derived from a source in Sri Lanka.
- KYC being a company incorporated in India will be considered as a non-resident person and therefore will be liable to pay taxes arising in or derived from a source in Sri Lanka.
- Section 75 specifies that where there is a DTA, the DTA will supersede the IRA. Sri Lanka has entered into a DTA with India and the Articles of the DTA will apply to this transaction.
- Article 7 on business profits of the DTA specifies that an enterprise will be liable to pay tax in the other State where it conducts business through a permanent establishment. (PE)
- Article 5 of the DTA explains what will constitute a PE. And this includes;  
“The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose constitutes a Permanent Establishment, but only where activities of that nature continue (for the same or connected project) within the Contracting State for a period or periods aggregating more than 90 days within any 12- month period.
- Based on the facts, KYC will be providing services in Sri Lanka through its employees, where five employees will be present in Sri Lanka from June 2021 to August 2021 and two employees visited Sri Lanka for about 4 to 5 days a month from September 2021 to March 2022. Therefore, it can be assumed that employees of KYC have been present in Sri Lanka for more than 90 days within a 12 month period. Therefore, KYC will be considered to have a PE in Sri Lanka.
- Therefore, KYC will be liable to pay income tax in Sri Lanka on the profits and income it earns from its operations in Sri Lanka.

(ii)

- The DTA in Article 23 provides that where a resident of one country pays tax in the other country, the tax paid can be considered as a tax credit in the first State. Therefore, any taxes paid in Sri Lanka by KYC can be claimed as a tax credit against its tax liability in India under the DTA.

(c)

- Section 85(1A) of the IRA specifies that a service fee paid to a non-resident person will be subject to WHT at the rate of 14%. Therefore, any services fee paid to KYC will be subject to WHT.
- However, the DTA specifies that KYC will only be liable to pay income tax in Sri Lanka, if it creates a PE in Sri Lanka.
- Since KYC creates a PE in Sri Lanka, the service fee will also be subject to income tax in Sri Lanka as its business income.

(d)

- Section 20 (2) provides that where a company is unable to submit the accounts for the period of twelve months of the year of assessment as provided in the Act, such company may apply to the Commissioner-General requesting that the accounts based on an alternative period of twelve months be used to compute the income tax payable for a given year of assessment.
- Therefore, KYC needs to make an application under section 20(2) requesting that the CGIR grants approval for KYC to prepare accounts for an alternative period of 12 months.



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