Deductions from total statutory income when arriving to assessable income

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Introduction

South Asia (PVT)Ltd is a family owned business and registered under the companies act No 07 of 2007 as a private limited company. This company also registered as a BOI company as well. The main business of this company is providing consultancy service for landscaping. Since this is a BOI approved company in terms of the BOI agreement a tax holiday period of 3 years has been granted to South Asia (PVT) Ltd commencing from the 2 years from the commencement of operation or from the year of assessment in which company makes profit whichever is earlier.

Discussion of the issue

The company operations commenced in the year of assessment 2006/07. From the commencement of the operation the company profit and loss schedule is as follows.

2006/07	Loss	2007/08	Loss
2008/09	Profit	2009/10	Profit
2010/11	Profit	2011/12	Profit
2012/13	Profit		

According to the Inland Revenue Act of 2006 South Asia (PVT) Ltd can enjoy a tax benefit for the year of assessment 2008/09 to 2010/11. The year of assessment 2006/07 and

2007/08 the company did not earn any profit (Pre Tax Holiday Period). However year of assessment 2008/09 to 2010/11 tax holiday could be enjoyed. No tax losses were incurred during the tax holiday period. When calculating taxable income in year of assessment 2011/12 for tax purpose they have deducted the tax losses incurred year of assessment 2006/07 and 2007/08 subject to 35% of Total Statutory Income. An assessment has been issued by Commissioner General of Inland Revenue against the income tax return filled by the company for the year of assessment 2011/12 mentioning that South Asia (PVT) Ltd has deducted brought forwarded tax losses which are not eligible for deducting as tax losses.

Conclusions and Recommendations

According to the paragraph (b) of subsection 5 for the Inland Revenue Act, the losses which are eligible to deduct as tax losses have been clearly mentioned.

As per above section, the loss is deductible from the total statutory income subject to the 35% of total Statutory Income , if it would have been a profit such profit would have been taxable under the act. Therefore according to this section only the losses which are liable to income tax if it had been a profit is entitle, to be deducted. However in this case had this company loss become profit such profit in not liable as company is enjoying a tax holiday under BOI agreement with Board of Investment Sri Lanka. The company's view was that recognized loss was not within the tax holiday period; it was happened before commencing the tax holiday period. Therefore deduction of such losses is not accepted because company had made a profit in the very first year and that profit was exempted and tax holiday of the company should have commenced from that year. Therefore there was no logic whether the loss was incurred before commencing the tax holiday or during the tax holiday period.

Not only that, another ruling has issued by Department of Inland Revenue in Sri Lanka relating to the tax losses which are eligible for tax losses. It is "Ruling issued by CGIR on 14.05.1996.

According to this rule the loss incurred prior to the commencement of tax holiday of any undertaking (other than an undertaking referred to in section 29(3A)) is not deductible from the total statutory income of that undertaking of any period after the termination of the tax holiday period. Not clear of this statement

Hence recommendation for this issue is the tax losses incurred prior to commencement of tax holiday period cannot be deducted as tax losses even after the tax holiday period. Therefore company should prepare correct income tax return and submit immediately to the Inland Revenue Department.