

## Chapter IX

Special Provisions regarding computation of business income

Country	(i) Restriction on certain business expenses e.g.			
	Entertainment	Donations to Political parties	Charities etc.	Managerial remuneration etc.
Australia	Entertainment expenses incurred after 19 Sept. 1985 are not deductible except in very limited circumstances. This prohibition extends to entertainment in the form of food, drink or recreation.		Every person, whether an individual, the trustee of a trust estate or super-annuation fund, a partnership or a company and whether a resident or non-resident of Australia, is entitled to a deduction from his or its assessable income for gifts of A\$ 2 or more each made during the year to certain nominated funds, institutions or bodies or classes of them, subject to certain conditions.	There is no limit on payments to local or foreign employees as such. If the company is a private company for Australian income tax purposes, the Commissioner has a discretion to reduce salaries that are paid to directors, shareholders, or their relatives to an amount that he considers reasonable. The excess over this amount is treated as a dividend that is not deductible to the corporation and is assessable to the employee as a dividend. This treatment applies equally

to resident and non-resident employees of private companies.

<b>Belgium</b>	<p>Entertainment expenses are deductible when they are reasonable and duly justified. Expenses relating to hunting, fishing, yachting and country houses are usually disallowed.</p>	<p>The total deductible amount of gifts to political parties may not exceed BF 350,000 per political party.</p>	<p>Gifts paid in cash to universities, to organisations for aid to developing countries, and to certain other recognised charitable institutions are allowed for tax purposes to the extent of 5% of the taxable income, with a maximum of BF 20 million.</p>	
<b>Denmark</b>	<p>Various entertainment expenses are deductible upto 25% of the expenses.</p>		<p>Donations to charitable institutions as designated by the Inland Revenue Directorate are deductible up to an amount of DKr. 1,000 per annum.</p>	<p>There are no tax limits on remuneration of employees, whether resident in Denmark or abroad.</p>
<b>Federal Rep. of Germany</b>	<p>Expenses of entertaining business friends to the extent that the amount or the business reasons cannot be proved or appear unreasonable, are disallowed.</p>	<p>Contributions to political organisations are deductible for corporation income tax to the extent, in the aggregate, (together with donations to charitable, religious, etc.</p>	<p>Contributions made to charitable, religious or scientific organisations are deductible as in the case of those to political organisations.</p>	<p>No limits on payment of remuneration to foreign employees working full time.  Unduly high salary or other compensation paid to an officer who is a</p>

organisations) of 5% of the net taxable income before deduction of such expenses, or 0.2% of the sum of the total payroll and turn over.

shareholder is regarded as hidden distribution of profits and disallowed as a deduction in arriving at taxable income.

**Indonesia** Expenses incurred by the company for entertainment of business clients and connections are deductible, as long as they are not considered luxurious or excessive.

Contributions to charitable organisations are not deductible for corporate income tax purposes.

There are no limits on payments to foreign employees, as long as they are for services actually rendered and income tax is withheld.

**Japan** Tax deductions for entertainment expenses are limited to Y.3 million for firms capitalized at Y.10-50 million, to Y.4 million for firms with paid up capital of Y.10 million or less, and are not available to firms with capital of more than Y.50 million.

In the case of donation to political organisations which satisfy certain conditions the excess of 10,000 yen is deductible subject to a ceiling for all contributions and donations. This ceiling is 25% of the gross total income.

Of the various kinds of expenditure called contributions, some may be deductible as expenses on the basis of the generally accepted accounting principles and others may not. Hence, it is stipulated that a corporation may deduct as expenses part of contributions up to the amount equal to the sum of 1.25% of its income and 0.125% of the

The portion of directors' remuneration, retirement allowances and bonuses, exceeding a reasonable level is excluded from expenses for tax purposes.

Entertainment expenses not supported by vouchers are not usually deductible.

paid-in capital in the case of ordinary corporations.

Contributions to certain public organisations, established by special law and listed in cabinet orders, which are related to the main business of the corporations are entitled to deduction of an additional 1.25% of income and 0.125% of the paid-in capital.

Contributions to the national or local government and to those designated as public welfare organisations by the Minister of Finance are fully deductible.

**Korea** Deductibility of entertainment expenses is limited under the tax law. Entertainment expenses include "confidential expenses" [see under Chapter V-(c)] as well as gratuities for services rendered and other similar expenses that are disbursed by a

A corporation can deduct contributions and donations for the purpose of public benefit, as specified, up to 10 per cent of taxable income plus 2 per cent of paid-in capital (with a maximum limitation of W 5

There is no statutory limit on employee remuneration, which includes salaries, wages, stipends, bonus, retirement payments, pensions, cash, meal and housing allowances, and all other kinds of sub-

corporation in connection with its business.

Reimbursement of business expenses including social membership costs and entertainment expenses incurred by an employee for business purposes, are non-taxable elements of employee income.

billion of paid-sidies, pay- in capital). ments and com- Any amount over pensation. such limitation Remuneration of is not deducti- foreign emp- ble for tax loyees is purposes unless limited to these contri- their engage- butions were ment contracts. made to the government, disaster victims and/or organi- sations speci- fied by law.

**Sri Lanka** Entertainment expenses incurred by an assessee, his employee or on his behalf in connection with any trade, business, profession or vocation are deductible.

Entertainment allowances paid by an employer to his non-executive staff are deductible by the employer; those paid to his executive officer are not deductible.

Donations made:-  
(a) in money to an approved charity;  
  
(b) in money or otherwise to the Govt. of Sri Lanka or local authority or any approved higher educational and other institutions will qualify for deduction from assessable income subject to the ceiling of one-third of assess- able income or Rs. 150,000 whichever is less.

**U.K.** Expenditure on business entertain- Political contri- butions are not ment including deductible. gifts, may not be deducted, except where the expendi- ture relates to

Charitable con- tributions are not deductible, except (i) donations to a charity which has a sufficient limit that pay- There are no tax limits on employee remuneration pay- ments other than the general limit that pay-

employees (including directors) or to oversees customers or clients and their agents and is reasonable in amount.

connection with the business carried on, (ii) covenanted donations to charity, provided they are payable under an irrevocable contract over a period which must be capable of exceeding three years. ments must be wholly and exclusively laid out for the purposes of the company's trade.

A new relief "gift aid" applies to single gifts to charities by individuals and companies of Pounds 600 or more, up to a limit of Pounds 5 million a year per donor, beginning in October 1990.

## U.S.A.

Effective for tax years beginning after Dec. 31, 1986, only 80 per cent of otherwise allowable meal and other entertainment expenses is deductible by taxpayers. A meal expense only qualifies for deduction if there is a substantial and bonafide business discussion relating to the

Political contributions are not deductible.

A deduction limited to 10 per cent of the corporation's taxable income may be claimed for contributions to certain types of charitable organizations created or organised in the U.S. or its possessions. Contributions in excess of the 10 per cent

taxpayer's active  
trade or business  
during, directly  
preceding or  
directly following  
the meal.

limitation may  
be carried  
forward and  
deducted over  
the next five  
years.

Charitable  
contributions  
are deductible  
for individuals  
as itemised  
deductions only,  
up to a limit.

Computation of Business Income (Contd.)

Country	(ii) Capital/investment allowance	(iii) Treatment of pre-incorporation & other preliminary expenses
<b>Australia</b>	The investment allowance has been terminated for expenditure incurred under contracts entered into after 30th June 1985.	Expenses incurred prior to the commencement of business are not deductible. The cost of incorporating a company or other structure to conduct business is a capital expense and not deductible.
<b>Belgium</b>	<p>In certain development areas, during a maximum of three consecutive tax periods, an annual depreciation that is equal to twice the normal straight-line depreciation is permitted. This provision relates to investment in equipment, tools and associated industrial buildings that are acquired for the promoted operation. Investment deductions are also granted.</p> <p>From the tax year 1983 onward, investment deduction (replacing the investment tax incentives) is allowed, which reduces the taxable basis and consequently the tax payable. The investment deduction is computed on the tax depreciable acquisition value of new tangible or intangible assets acquired or made and of new intangible assets when such tangible or intangible assets are used for industrial, commercial, agricultural or other income-producing activities of the taxpayer in Belgium.</p>	
<b>Denmark</b>	An investment allowance was introduced again effective from 1.1.1981 and expired on 31.12.1983.	



The allowance was granted on net additions of certain machinery and equipment relating primarily to manufacturing companies. The allowance was computed at 5% (2.5% in 1983) of net purchases (purchases less sales proceeds) and can only be granted in the year of acquisition as a deduction in the taxable income. The allowance does not reduce the depreciation basis.

**Federal  
Rep. of  
Germany**

No investment credits or allowances are available. A special 10-20% depreciation allowance is available on new investments for small and medium-sized enterprises; it is possible to postpone its use for two years.

Expenses directly connected with the formation of business must be treated as deductible business expenses in the year they are incurred.

**Indonesia**

Investment allowance on certain investment expenditure, enjoyed as a tax incentive by foreign and domestic investors were eliminated with the introduction of new taxation laws from January 1, 1984.

The removal of tax incentives is compensated for by lower tax rates and accelerated rates of depreciation for fixed assets.

Costs of setting up business and issuing the capital of an enterprise will be amortized using the written down value method at a rate of 50 per cent per annum. However, where these costs are considered a normal business expense, they may be claimed in full in the year the expenditure is incurred.

**Japan**

Initial expenses in opening the business, incorporation expenses may be at the option of the taxpayer, expensed in the accounting period in which they are incurred. They may also be capitalised and deducted in the following years.

**Korea**

Investment credits are available on purchases of certain assets used in certain manufacturing or mining

Pre-incorporation expenses (including registration fees paid for registration

industries. The credit equals 10 per cent of the gross value of machinery purchased domestically and generally 3 per cent for imported machinery. There is also a 10 per cent to 20 per cent credit available for the development of technology and manpower.

Investments approved under the Foreign Capital Inducement Law enjoy a five-year tax holiday from corporate income, dividend, interest, royalty, defence and certain other taxes.

#### Sri Lanka

of incorporation), initial operating expenses (namely, expenses other than organisation expenses paid for preparation of starting the business from the time of incorporation of the corporation to the date of commencement of the business), stock issuing fees and other expenses expended directly for the issuance of stocks, are expenses which decrease the net assets of the corporation and are deductible.

Deduction is allowed for expenditure incurred in the formation of a company

#### U.K.

There is no investment deduction in UK except the allowances of the kind described below.

Company formation expenses are not tax-deductible from business income.

Allowances are granted for capital expenditure incurred in providing new or second-hand plant and machinery for the purposes of a trade or (unless the plant is for use in a dwelling house) for the purposes of leasing. Qualifying plant must have a degree of durability (a minimum life of 2 years generally is sufficient). Certain expenditure on buildings is treated as if it was expenditure on plant, namely, expenditures for:

- 1) fire safety;
- 2) thermal insulation of existing industrial buildings;
- 3) sports ground safety.

First-year capital allowances, in the limited situations where they are still available, may be carried back up to three years.

Generous depreciation (capital) allowances include 75 per cent initial allowance on industrial buildings and a 100 per cent first-year allowance on the cost of machinery and equipment.

U.S.A.

A variety of credits ranging from 10 to 15 per cent are available for investments in certain energy or energy related properties, e.g., solar energy, geothermal, ocean thermal, biomass, through 1987 or 1988.

A credit is allowed for alcohol (other than that produced from petroleum, natural gas, coal or peat) used as a fuel of a type suitable for use in an internal combustion engine where the excise tax exemption for alcohol fuels does not apply.

A special deduction is allowed for the costs of organising or starting up a trade or business. A corporation may elect to amortize such costs on a straight-line basis over a period of not less than 60 months, beginning with the month in which the corporation began business. Expenditures connected with issuing or selling securities do not qualify for this election.

Computation of Business Income (Contd.)

Country	(iv) Treatment of deferred revenue expenditure	(v) Treatment of business loss-provisions regarding carry-over and carryback of such losses
<b>Australia</b>		<p>If, in a particular year, the total deductions exceed the total assessable income, there is a loss for that year and the loss can be carried forward to a subsequent year. A loss in a year of income cannot be carried back to a prior year.</p> <p>In the case of a loss from a business of agricultural production, there is no limit to the number of years the loss can be carried forward and it is deductible from all types of income and not merely agricultural production income. A loss from all other types of business can be carried forward for the seven income years succeeding the year in which the loss is incurred, if incurred before 1 July 1989; if the loss is incurred after this date, it may be carried forward indefinitely. If there are two or more losses brought forward, the loss incurred first is deducted first.</p>
<b>Belgium</b>	<p>Provisions set up to cover the following are deductible:</p> <p>(i) Items covered by indemnities already collected with respect to damages, expropriations, requisitions, or similar events.</p>	<p>From assessment year 1991 onwards, all the losses can be carried forward unlimited in time. Losses may not be carried back.</p>

(ii) The proportionate share of overhaul and heavy repairs to buildings, machinery and equipment, and to ships, if such assets are subject to overhaul at regular intervals not exceeding 10 years.

(iii) Expenses and charges relative to activities or to events that took place during the financial year provided that such charges are allowable for tax purposes.

If the provision could not be justified at the end of a financial year, the provision or excess will be treated as a taxable item for that financial year.

**Denmark**

Generally, a loss as computed for tax purposes including capital losses may be carried forward and utilized against taxable income of the following five years. No carryback of tax losses is available.

Losses from the sale of securities may not be carried forward.

**Federal  
Rep. of  
Germany**

A taxpayer may only set up a provision for future pensions (under section 6(a) of the income tax law) if he has entered into a firm obligation in writing to pay old-age pensions. Such pension provisions are deductible for tax purposes in any one year.

Provisions for certain liabilities may be set up - e.g. litigation expenses, damage claims, surety obligations, etc.

Losses upto DM 10 million as agreed for corporation tax purposes must be carried back and offset against the portion of taxable income of the two preceding years that was subjected to tax at the full rate, reduced by the grossed-up dividends for those years upto a certain maximum. Any portion of the loss that cannot be carried back may be carried forward and offset against taxable income of the subsequent five fiscal years.

- For municipal trade income tax purposes, losses may be carried forward for five years; they may not be carried back.
- Indonesia**
- Losses sustained by a corporation from 1984 onward may be carried forward for a maximum of five years. In the case of companies operating in the areas of mining or plantations that produce hard crops (i.e., crops with a growth period of more than one year), losses may be carried forward for up to eight years. Loss carry backs are not permitted.
- Japan**
- The corporate tax-loss carryback is one year, and the carryforward is five years.
- There is no loss carryback for enterprise and inhabitants taxes but a five year carryforward is permitted.
- Korea**
- A reserve for special repair of vessels, boats or smelting furnaces is allowable for tax purposes. The amount is determined by considering the amount and period of prior special repairs. If such data is not available, a reserve of up to 5 per cent of the acquisition cost (0.1 per cent for vessels) is permitted.
- A liability reserve and an emergency reserve are permissible for tax purposes.
- Losses are generally deductible when the loss is incurred. Loss of inventory that is discovered at the time a physical inventory is conducted is deductible; however, these deductions are limited to standards that are set by the tax authorities. Losses from natural calamities are deductible to the extent that they are not covered by insurance. Losses from business operations may be carried over for five years. There are no loss carry-back provisions.
- [According to tax reforms which became effective as from 1 January, 1989, the carry-forward of losses has been extended from 3 to 5 years for losses incurred

- in years for which a corporate tax return is filed on or after 1 January 1989.]
- Sri Lanka** According to sub-section (r) of Section 23(1) of the Inland Revenue Act No. 28 of 1979, a person who intends to obtain a deduction in the computation of income should set up a fund for the purpose of payment under the Payment Gratuity Act No. 12 of 1983, of gratuities to employees on the termination of their services, and get that fund approved by the Commissioner General of Inland Revenue.
- (i) A loss incurred by a person in a trade, business, profession or vocation is deductible from the statutory income. (Statutory income of a person for a year of assessment from a source of income is the profits or income which were derived by him or arose or accrued to his benefit from that source during that year of assessment).
- (ii) If the loss exceeds the statutory income of that year, the excess is carried forward to be set off against the statutory income of the next year and so on.
- (iii) On the cessation of a trade, business, profession or vocation, the loss may be carried back for three years.
- U.K.** Provisions which may be deducted include those against allowable liabilities which have accrued fully and which can be estimated with reasonable accuracy.
- In general, trading losses can be carried back against other income and capital gains for one accounting period and carried forward indefinitely. A loss incurred in the last year of trading can be set off against trading profits of the 3 prior years.
- U.S.A** Contributions to qualified deferred employee compensation plans are deductible (within limits) in the year of contribution.
- A net operating loss may generally be carried back three years and forward fifteen years. A net operating loss attributable to a product liability loss may be carried back ten years. Losses must be applied in chronological sequence, starting with the earliest carryback year.