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## GHANA REVENUE AUTHORITY

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**Practice Note on  
Limitation on Deduction of Financial Costs  
under the Income Tax Act, 2015 (ACT 896)**

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## **1.0 TAX LAW**

The Commissioner-General of the Ghana Revenue Authority is empowered under paragraph 2 of the Seventh Schedule of the Income Tax Act, 2015 (Act 896) to issue Practice Notes setting out the interpretations placed on provisions of the Act. Accordingly, this Practice Note is issued in respect of Section 16 of the Act, which provides for the limitation of the deduction of financial cost in calculating the chargeable income of a person.

## **2.0 INTERPRETATION**

In this Practice Note the word “Act” means the Income Tax Act, 2015 (Act 896).

Definitions and expressions used in this Practice Note have the same meaning as they have in the Act.

## **3.0 PURPOSE OF THIS PRACTICE NOTE**

This Practice Note is issued to provide direction and guidance to officers of the Ghana Revenue Authority, Tax Practitioners, Consultants, Taxpayers and the general public on the acceptable treatment of the limitation on deduction of financial costs in calculating the chargeable income of a person under section 16 of the Act in order to achieve consistency in the administration of the Act.

## **4.0 APPLICATION OF THE LAW**

The Act provides the following rules in respect of deduction of financial cost:

- (i) The quantum of financial cost that can be deducted is limited to -
  - a) the sum of financial gain derived in the year of assessment; and
  - b) 50% of the “adjusted chargeable income” from business or investment.

*‘Adjusted Chargeable Income’* is the Chargeable Income from the business or investment without including a financial gain derived by the person or deducting a financial cost incurred by the person.

- (ii) Financial cost that has not been allowed as a deduction in a year of assessment as a result of the limitation in (i) above may be carried forward and treated as incurred for any of the next five years of assessment
- (iii) Financial costs that are carried forward shall be applied in the order in which they are incurred;
- (iv) Financial cost in this instance does not include interest;

**5.0 FORMAT FOR THE DETERMINATION OF 50% OF ADJUSTED CHARGEABLE INCOME FROM BUSINESS OR INVESTMENT**

		<b>GHS</b>	<b>GHS</b>
	Net Profit before tax		xxxxx
	Add back:		
	Disallowable deductions		xx
			xxxxx
	Less:		
	Allowable deductions		xx
<b>A</b>	<b>Adjusted profit</b>		<b>Xxxx</b>
	Less		
	Capital allowance		xx
<b>B</b>	<b>Chargeable Income</b>		<b>xxx</b>
	Add financial cost		xx
			zzz
	Less financial gain		yy
<b>C</b>	<b>Adjusted Chargeable Income (after adjusting for financial gain and financial cost)</b>		<b>zzzz</b>

Computation of 50% of Adjusted Chargeable Income (C) = **zzzz \*50%**  
 = **zz**

Allowable Financial cost = **Financial gain + zz**

## 6.0 DETERMINATION OF ALLOWABLE FINANCIAL COST

### 6.1 Illustration 1

Where the financial cost is more than the financial gain plus 50% of the chargeable income

	GHS
Profit before tax	22,000.00
The following were included in arriving at the net profit before tax:	
Depreciation	7,000.00
General bad debt written off	1,500.00
Realised loss	2,000.00
Total Financial Gain	7,000.00
Total Financial Cost	50,000.00
Capital allowance	12,000.00

Required:

Determine the chargeable income after adjusting for financial gain and financial cost.

Compute the allowable financial cost.

Compute the tax payable.

Solution.

#### a) Determination of adjusted chargeable income and computation of allowable financial cost

	GHS
Net Profit before tax	22,000.00

Add back:	
Depreciation	7,000.00
General bad debt written off	<u>1,500.00</u>
	30,500.00
Less:	
Realised loss	<u>2,000.00</u>
<b>A Adjusted profit</b>	<b>28,500.00</b>
Less	
Capital allowance	<u>12,000.00</u>
<b>B Chargeable Income</b>	<b>16,500.00</b>
Add financial cost	<u>50,000.00</u>
	66,500.00
Less financial gain	<u>7,000.00</u>
<b>C Chargeable Income after adjusting for financial gain and financial cost</b>	<b><u>59,500.00</u></b>

**b) Allowable financial cost:**

$$\begin{aligned} &= \text{Financial gain} + 50\% \text{ of the adjusted chargeable income} \\ &= 7,000.00 + \{(50\% * (59,500)\} \\ &= 7,000.00 + 29,750 \\ &= 36,750.00 \end{aligned}$$

The amount of GHS36,750.00 represents the allowable Financial cost for the year of assessment.

The excess financial cost of 13,250.00 (50,000.00 – 36,750.00) that is not allowed as a deduction may be carried forward for the next 5 years of assessment.

**Computation of chargeable income and tax payable by the company.**

	GHS	GHS
Net Profit before tax		22,000.00
Add back:		
Depreciation		7,000.00
General bad debt written off		1,500.00
Financial cost		<u>50,000.00</u>
		80,500.00
Less:		
Realised loss	2,000.00	
Allowable financial cost	<u>36,750.00</u>	<u>38,750.00</u>
<b>A Adjusted profit</b>		<b>41,750.00</b>
Less:		
Capital allowance		<u>12,000.00</u>
<b>B Chargeable Income</b>		<b>29,750.00</b>
Tax thereon @ 25%		<u>7,437.50</u>

### 6.2 Illustration 2

Where the financial cost is less than the financial gain plus 50% of the adjusted chargeable income.

	GHS
Profit before tax	22,000.00
The following were included in arriving at the net profit before tax:	
Depreciation	7,000.00
General bad debt written off	1,500.00
Realised loss	2,000.00
Total Financial Gain	10,000.00
Total Financial Cost	5,000.00
Capital allowance	12,000.00

Required:

- a) Determine the chargeable income after adjusting for financial gain and financial cost.
- b) Compute the allowable financial cost.
- c) Compute the tax payable.

**6.2.1 Solution**

**a) Determination of adjusted chargeable income and computation of allowable financial cost**

	GHS	GHS
Net Profit before tax		22,000.00
Add back:		
Depreciation		7,000.00
General bad debt written off		<u>1,500.00</u>
		30,500.00
Less:		
Realised loss		<u>2,000.00</u>
<b>A Adjusted profit</b>		<b>28,500.00</b>
Less		
Capital allowance		<u>12,000.00</u>
<b>B Chargeable Income</b>		<b>16,500.00</b>
Add financial cost		<u>5,000.00</u>
		21,500.00
Less financial gain		<u>10,000.00</u>
<b>C Chargeable Income after adjusting for financial gain and financial cost</b>		<b>11,500.00</b>

**b) Allowable financial cost** = Financial gain +50% of Adjusted Chargeable Income

$$\begin{aligned} &= 10,000.00 + \{50 \% * 11,500\} \\ &= 10,000.00 + 5,750.00 \\ &= 15,750.00 \end{aligned}$$

Since the financial cost (GHS5,000.00) is less than the financial gain plus the 50% of the adjusted chargeable income (GHS15,750), the entire financial cost (GHS 5,000.00) is deductible. Hence no adjustment is made to the reported profit in respect of the financial cost.

**c) Computation of chargeable income and tax payable by the company.**

	GHS	GHS
Net Profit before tax		22,000.00
Add back:		
Depreciation		7,000.00
General bad debt written off		<u>1,500.00</u>
		30,500.00
Less:		
Realised loss		<u>2,000.00</u>
<b>A Adjusted profit</b>		<b>28,500.00</b>
Less:		
Capital allowance		<u>12,000.00</u>
<b>B Chargeable Income</b>		<b>16,500.00</b>
Tax thereon @ 25% (16,500.00 x 25%)		<u>4,125.00</u>

**6.3 Illustration 3**

Where the company recorded financial cost without financial gain.

	GHS
Profit before tax	22,000.00

The following were included in arriving at the net profit before tax:

Depreciation	7,000.00
General bad debt written off	1,500.00
Realised loss	2,000.00
Total Financial Gain	-
Total Financial Cost	50,000.00
Capital allowance	12,000.00

Required:

- Determine the chargeable income after adjusting for financial gain and financial cost.
- Compute the allowable financial cost.
- Compute the tax payable.

### 6.3.1 Solution

#### a) Determination of adjusted chargeable income and computation of allowable financial cost

	GHS	GHS
Net Profit before tax		22,000.00
Add back:		
Depreciation		7,000.00
General bad debt written off		<u>1,500.00</u>
		30,500.00
Less:		
Realised loss		<u>2,000.00</u>
<b>A Adjusted profit</b>		<b>28,500.00</b>
Less		
Capital allowance		<u>12,000.00</u>
<b>B Chargeable Income</b>		<b>16,500.00</b>
Add financial cost		<u>50,000.00</u>

	66,500.00
Less financial gain	-
<b>C Chargeable Income after adjusting for financial gain and financial cost</b>	<b>66,500.00</b>

**b) Allowable financial cost**

Financial gain +50% of chargeable income

$$= \text{Nil} + \{(50\% * (66,500))\}$$

$$= 33,250$$

Only GHS33,250 representing 50% of the adjusted chargeable income of GHS 66,500 is deductible as financial cost. The remaining amount of GHS16,750.00 of the financial cost that is not allowed as a deduction may be carried forward for the next five years of assessment.

**Computation of chargeable income and tax payable by the company**

	GHS	GHS
Net Profit before tax		22,000.00
Add back:		
Depreciation		7,000.00
General bad debt written off		1,500.00
Financial cost		<u>50,000.00</u>
		80,500.00
Less:		
Realised loss	2,000.00	
Allowable financial cost	<u>33,250.00</u>	<u>35,250.00</u>
<b>A Adjusted profit</b>		<b>45,250.00</b>
Less:		

Capital allowance	<u>12,000.00</u>
<b>B Chargeable Income</b>	<b>33,250.00</b>
Tax thereon @25% (33,250.00 x 25%)	<u>8,312.50</u>

#### 6.4 Illustration 4

Where financial gain is nil and there is no positive chargeable income (excluding financial cost), then there should be no deduction for financial cost.

	GHS
Profit before tax	5,000.00
The following were included in arriving at the net profit before tax:	
Depreciation	7,000.00
General bad debt written off	1,500.00
Realised loss	2,000.00
Total Financial Gain	Nil
Total Financial Cost	50,000.00
Capital allowance	12,000.00

Required:

- Determine the chargeable income after adjusting for financial gain and financial cost.
- Compute the allowable financial cost.
- Compute the tax payable.

#### 6.4.1 Solution

- Determination of adjusted chargeable income and computation of allowable financial cost**

	GHS	GHS
Net Profit before tax		5,000.00
Add back:		
Depreciation		7,000.00
General bad debt written off		<u>1,500.00</u>
		13,500.00
Less:		
Realised loss		<u>2,000.00</u>
<b>A Adjusted profit</b>		<b>11,500.00</b>
Less		
Capital allowance		<u>12,000.00</u>
<b>B Chargeable Income</b>		<b>(500.00)</b>

**b) Allowable financial cost**

From the solution, the financial gain is nil and there is a negative chargeable income of (GHS500). In view of this there would be no deduction for financial cost.

The entire financial cost (GHS50,000) may be carried forward for the next 5 years of assessment.

**Computation of chargeable income and tax payable by the company.**

	GHS	GHS
Net Profit before tax		5,000.00
Add back:		
Depreciation		7,000.00
General bad debt written off		1,500.00
Financial cost		<u>50,000.00</u>
		63,500.00
Less:		

Realised loss	<u>2,000.00</u>
<b>A Adjusted profit</b>	<b>61,500.00</b>
Less:	
Capital allowance	<u>12,000.00</u>
<b>B Chargeable Income</b>	<b>49,500.00</b>
Tax thereon (49,500.00 x 25%)	<u>12,375.00</u>

Signed .....  
Date ..... 06/10/2016

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