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Sri Lanka Tax Profile

Produced in conjunction with the KPMG Asia Pacific Tax Centre

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Contents

1 Corporate Income Tax

Corporate Income Tax	Corporate tax
Tax Rates	The standard tax rate is 28 percent. Tax rates from 10 percent to 40 percent also apply to profits from specific businesses.
Residence	A Sri Lankan resident company is a company that has its registered or principal office in Sri Lanka, or where the control and management of business is exercised in Sri Lanka. Resident companies are taxed on worldwide income, whereas a non-resident company is taxed only on income derived from Sri Lanka.
Compliance requirements	Sri Lanka has a self-assessment system for Income Tax payments. Income tax returns are filed annually on or before the 30th of November of every year immediately succeeding the end of every year of assessment. (Year of assessment is a period of 12 months from 1 April to 31 March of every year). The final tax liability payment is due on or before the 30th of September immediately following the end of year of assessment. Non-filing of returns or non-payment of taxes by due dates will result in penalties.
International Withholding Tax Rates	Withholding tax is imposed on payments such as dividends and royalties paid to non-residents. The following are the Sri Lankan domestic tax rates. Rates may be reduced where there is an appropriate tax treaty. ▪ Dividends: 10 percent ▪ Royalties: 20 percent Interest payments to non-residents are exempt from Income Tax.
Capital gains	Capital gains are out of scope of Income Tax in Sri Lanka.

Tax Losses	Losses can be set-off against up to 35 percent of Total Statutory Income for a given year. Losses can be carried forward indefinitely until such losses are utilised. Special restrictions apply in the case of finance leasing businesses and life insurance businesses, i.e. losses from such businesses cannot be set off against any other income.
Tax Consolidation / Group relief	N/A
Transfer of shares	Capital gains arising on transfers of shares are out of scope of Income Tax in Sri Lanka.
Transfer of assets	Gains arising on transfers of assets used in business are liable to tax as a trade profit. Exemptions are available on conversion of sole proprietorship or partnership to a company.
CFC rules	N/A
Transfer Pricing	The arm's length principle applies to transactions with related companies within Sri Lanka and/or outside Sri Lanka. There is a statutory requirement for reporting and to maintain documentation.
Thin Capitalisation	The thin capitalisation regime restricts the deductibility of interest payable by a parent to a subsidiary or by a subsidiary to its parent. The safe harbour debt to equity ratio is 3:1 in the case of manufacturers and 4:1 in the case of service providers.
Rulings	A written advance ruling system is prevalent in Sri Lanka. Rulings do not apply to all transactions/circumstances (e.g. cases based on hypothetical facts and cases where the main purpose is a tax saving). Rulings are generally made public. However, rulings issued to specific companies are not made public.
Intellectual Property Incentives	The cost of acquisition of any intangible asset is entitled to a 10 percent deduction over 10 years. Further, the cost of acquisition of any internationally recognised intellectual property used in business is considered as revenue expenditure.

R&D Incentives

Profits and income from research activities are entitled to a lower tax rate of 20 percent.

Companies are permitted a tax deduction of 200 percent of expenditure including capital expenditure on research and development activities. In the event that such research and development is conducted through an institution, or if research relates to high value agricultural products and is conducted by a person via a research institute, a 300 percent deduction is permitted.

A 300 percent deduction is permitted on expenditure incurred in promoting local brands internationally.

Other incentives

- Large scale projects

  Projects which are identified as being of strategic importance to the country can be afforded incentive/ exemption from a number of taxes up to a period of 25 years.

- Hub service

  Entrepot trade, logistics services, etc have been recognised as hub services and are entitled to concessions from a number of taxes and regulations.

- Incentives for new undertakings

  Where an existing company engaged in manufacturing expands into any province other than western province, the profits and income of such company would be liable to tax at a concessionary rate for five years, up to a maximum of LKR 500 million of taxable profits subject to fulfilment of the requisite criteria. A minimum investment of LKR 300 million in fixed assets should be made prior to 1 April 2017.

  Any registered company with the Inland Revenue Department of Sri Lanka on or before 31 December 2015 which commits to an investment of LKR 500 million in any manufacturing activity will be awarded a concessionary rate of tax for seven years on tax profits, subject to fulfilment of the requisite criteria.

- Incentives for investments

  Profits arising to a unit trust from investments made after 1 January 2015, in US dollar deposits or US dollar denominated securities in any foreign exchange will be exempt. Other Concessions

  Profits from exports, agriculture, tourism, construction and SMEs enjoy a concessionary tax rate of 12%.

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Hybrid Instruments	There are no special rules applicable to hybrid instruments.
Hybrid entities	N/A
Special tax regimes for specific industries or sectors	Exports/ agriculture/ tourism/ construction industry – concessionary tax rate of 12 percent.
Related Business Factors	*Forms of legal entities typically used for conducting business* Businesses may be conducted through public limited companies, private companies and branch offices of foreign companies. *Requirements for establishing a legal entity* Legal entities are established in line with provisions of the Company Law in Sri Lanka. In general, there are no capital requirements specified, except for the establishment of a branch which requires a minimum investment of USD200,000. *Foreign Exchange Control rules* The Foreign Exchange Control Regulation provides rules on inbound and outbound investment and commercial transactions between residents and non-residents.

2 Income Tax Treaties for the Avoidance of Double Taxation

In Force	Australia	Italy	Poland
	Bangladesh	Japan	Qatar
	Belarus	Korea	Romania
	Belgium	Kuwait	Russia
	Canada	Luxembourg	Saudi Arabia
	China	Malaysia	Seychelles
	Denmark	Mauritius	Singapore
	France	Nepal	Sweden
	Finland	Netherlands	Switzerland
	Germany	Norway	Thailand
	Hong Kong	Oman	United Arab Emirates
	India	Pakistan	United Kingdom
	Indonesia	Palestine	United States
	Iran	Philippines	Vietnam
Negotiated or signed, but not yet in force at time of publication	Austria	Egypt	South Africa
	Bahrain	New Zealand	
Under discussion	Finland (Revised Agreement)		

3 Indirect Tax

Consumption Tax	Consumption tax
Standard Rate	Standard rate of consumption tax is 11 percent and applies to every taxable supply of goods and services supplied in Sri Lanka other than exempt supplies.
Nation Building Tax (NBT)	Turnover tax
Standard Rate	Standard rate on turnover is 2 percent and companies involved in wholesale or retail sales are liable to pay tax effectively at 1 percent of turnover.
Economic Service Charge (ESC)	Turnover tax
Standard Rate	Tax is imposed on turnover at the rate of 0.25 percent provided turnover for a quarter exceeds LKR 50 million. Companies liable to Income Tax are exempt from the levy. ESC is available as a tax credit for a period of 5 years. For example: In year one a company is exempt from income tax, therefore it would be required to pay ESC. In year two, the company becomes liable to income tax. In this case the ESC paid in year one could be set off against the income tax liability for yeartwo2. ESC paid could be set off against the income tax within a period of five years.
Further Information	For more detailed indirect tax information, refer to: KPMG Asia Pacific Indirect Tax Guide

4 Personal taxation

Income Tax

Withholding scheme

Top Rate

The income tax rate for an individual in Sri Lanka is between 4 percent and 24 percent, depending on the level of profits and income earned in a given year of assessment.

For employees, the employer is required to deduct tax under a withholding scheme, termed 'PAYE' (Pay As You Earn). Where a person is in receipt of only employment income subject to PAYE the tax withheld is limited to a maximum of 16 percent and this is considered a final tax.

Social Security

The employers and employees contribute to Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF). The minimum contribution should be 8 percent by employees and 12 percent by employers in the case of EPF and 3 percent by employers in the case of ETF.

Mansion Tax

Mansion tax of LKR 1 million per annum will be levied on every individual owning a mansion with effect from 01 April 2015. Mansion for this purpose will be residential property constructed on or after 1 April 2000, exceeding 10,000 square feet in floor area or exceeding LKR 150 million in value on 1 April of any year.

Further information

For more detailed personal taxation information, refer to:

KPMG's Thinking Beyond Borders

5 Other Taxes

Customs duty	Customs duty is levied on goods entering Sri Lanka. The rates vary by product type.
Excise duty	Excise duty is imposed on tobacco, liquor and other excisable articles.
Stamp duty	Stamp duty is imposed on specified instruments such as shares, deeds, insurance policies, etc. The levy is based on the value of the instrument.
Property transfer tax	Outright transfer of property to foreign nationals/ foreign companies is to be prohibited. Leasing of property is to be subject to a minimum tax of 15 percent.
Port and Airport Development Levy	This is a tax imposed on all imports into Sri Lanka.
Cess	Cess is a levy imposed on all imports into Sri Lanka and the rate of the tax levied varies by product type.

6 Free Trade Agreements

In force

- Indo-Sri Lanka Free Trade Agreement (ISFTA)
- Pakistan – Sri Lanka Free Trade Agreement (PSFTA)
- SAARC Preferential Trading Arrangement (SAPTA)
- Asia-Pacific Trade Agreement (APTA)
- South Asian Preferential Trading Arrangement (SAPTA)
- SAARC Agreement on Trade in Services (SATIS)
- Generalized System of preferences (GSP)
- South Asia Free Trade Agreement (SAFTA)

7 Tax Authority

Tax Authority Department of Inland Revenue

Tax audit activity There are no official rules on frequency of tax audits. In practice, it is understood that larger and profitable companies tend to have tax audits more frequently than smaller or loss-making companies.

A typical tax audit commences with an advance notice to a taxpayer. The tax officials investigate various documents and conduct interviews with the taxpayer on the taxpayer's site. They may also visit business partners of the taxpayer if sufficient information is not gathered from the taxpayer.

The Tax Authority has recently focused on related party transactions that give rise to transfer pricing issues.

Appeals Every person who is dissatisfied with an assessment can make an appeal to the Commissioner General of Inland Revenue. If a tax payer is dissatisfied with the determination of the Commissioner General, he can proceed with litigation processes, which include three steps:

(i) Appeal to the Tax Appeals Commission,

(ii) Appeal to the Court of Appeal,

(iii) Appeal to the Supreme Court.

Contact us

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