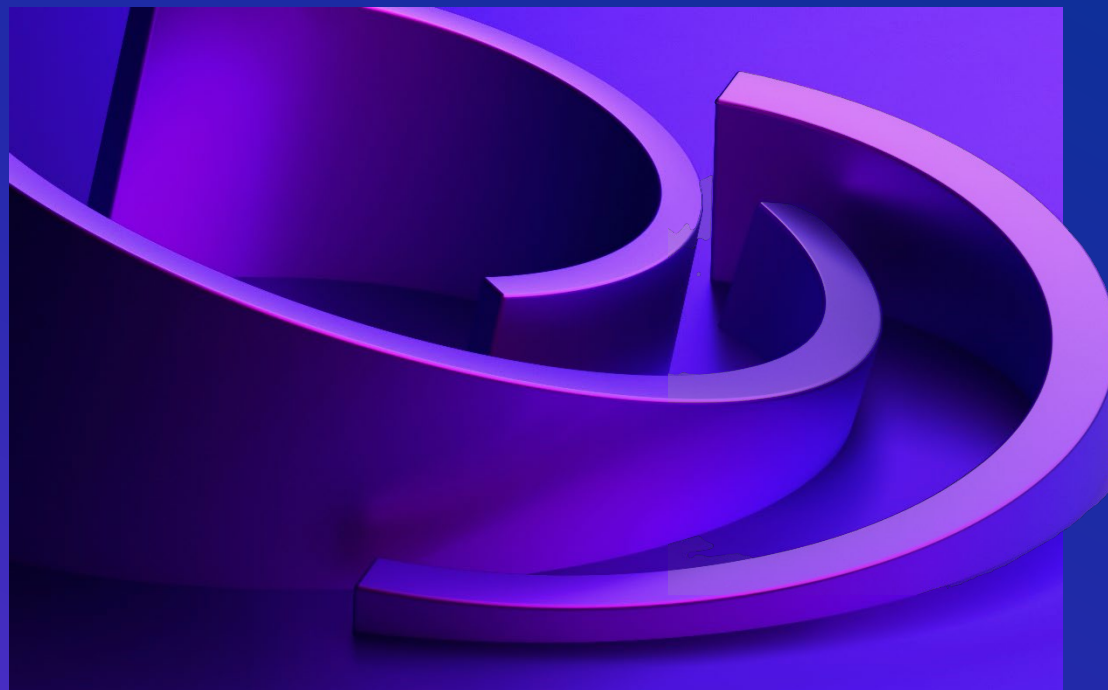


# Tax Alert

## Inland Revenue (Amendment) Act No 45 of 2022

December 2022

KPMG Sri Lanka



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**01**

# **Corporate Income Tax**

# Corporate Income Tax

The Inland Revenue (Amendment) Act No 45 of 2022 was certified by the Speaker on 19<sup>th</sup> December 2022. The Act will come into operation with effect from specific dates referred to under specific sections.



## Standard Income Tax Rate

The standard rate of Income Tax is increased to 30% from 24% w.e.f. 1<sup>st</sup> October 2022.

The increase in income tax rate to 30% in mid year would result in two tax rates being applicable for the Year of Assessment 2022/23. The company may compute the tax payable on a pro rata basis (i.e. 50% for first six months and balance 50% for second six months) for the Year of Assessment 2022/23.



## Concessional Tax Rates

The concessional rate of 14% and 18% applicable on identified gains and profits is increased to 30% w.e.f. 1<sup>st</sup> October 2022.



# Corporate Income Tax (Contd.)



## Synopsis of Concessionary Tax Rates

| Gains & profits from                                                                                                       | Current Tax Rate   | New (w.e.f 01 <sup>st</sup> Oct 2022) Tax Rate |
|----------------------------------------------------------------------------------------------------------------------------|--------------------|------------------------------------------------|
| Small & Medium Enterprise                                                                                                  | 14%                | 30%                                            |
| Export of goods for which payment received in foreign currency                                                             | 14%                | 30%                                            |
| Specified undertaking                                                                                                      | 14%                | 30%                                            |
| Educational services                                                                                                       | 14%                | 30%                                            |
| Promotion of tourism                                                                                                       | 14%                | 30%                                            |
| Construction services                                                                                                      | 14%                | 30%                                            |
| Health care services                                                                                                       | 14%                | 30%                                            |
| Agro processing                                                                                                            | 14%                | 30%                                            |
| Gems & Jewellery                                                                                                           | 14%                | 30%                                            |
| BOI registered Export company which sells health protective equipment and similar products to identified Govt institutions | 14%                | 30%                                            |
| A company that lists its shares in the CSE during 01.01.2021 to 31.12.2021                                                 | 14%<br>(for 3 Y/A) | 30%                                            |
| Supply of electricity to national grid generated using renewable energy resources                                          | 14%                | 30%                                            |
| Manufacturing                                                                                                              | 18%                | 30%                                            |

# Corporate Income Tax (Contd.)



## Capital Gain Tax (CGT)

The CGT rate applicable on the realisation of investment assets by a company is increased to 30% w.e.f. 1<sup>st</sup> October 2022.

Since the Law is effective retrospectively, further guidelines may be issued by the Department of Inland Revenue for the collection of additional CGT during the interim period.

## Transfer of assets to an associate or for no consideration

The Law provides for a deferment in the tax payable, where a person realizes an asset, being trading stock, a depreciable asset, an investment asset or a capital asset of a business, by way of transfer of ownership of the asset to an associate of the person subject to certain conditions.

The Act seeks to bring a new condition to qualify for the deferment where the tax rate applicable on the person's gain from the realization of an asset is equal or less than the tax rate which is applicable on the gain of the associate from realization of such asset, in addition to the existing conditions with effect from 1<sup>st</sup> April 2021.



## Limitation of tax concession available to Agri business

A person in the business of agro farming and agro processing qualifies for a 25% deduction on the tax payable subject to certain criteria. This concession has been restricted to Y/A 2021/22 and Y/A 2022/23.



## Source of Payment

The Act seeks to expand the source of payment liable to tax in Sri Lanka. If interest, charges, annuities, a royalty, technical service fee, or similar payment is paid by the Government of Sri Lanka, including such payments made by any institution on behalf of the Government of Sri Lanka with effect from 1<sup>st</sup> April 2018 would be considered having a source in Sri Lanka .



# Corporate Income Tax (Contd.)



## Deduction Rules

### Disallowable Expenses

The taxes or levies that are not allowed in calculating the Assessable Income is extended to cover any tax or levies which are specified in the respective written laws as not an allowable deduction in computing the Assessable Income with effect from 1<sup>st</sup> April 2021.

### Deduction for improvements

Where an improvement is carried out on a depreciable asset during a Year of Assessment and the tax written down value of such depreciable asset is zero, the cost incurred for the improvement could be eligible to claim capital allowance in the following manner in ascertaining the Assessable Income of the company with effect from 1<sup>st</sup> April 2022.

| Nature of the Asset                                       | No of Ys/A |
|-----------------------------------------------------------|------------|
| Building, structures and similar work of permanent nature | 12         |
| Other depreciable assets                                  | 3          |

### Loss Claim – with effect from 1 April 2018

- Business Losses – where a person has incurred business losses when such person is qualified for a concessional tax rate and the tax rate is subsequently increased, such losses shall not be considered as being taxable at a reduced rate thereby the company would be allowed to deduct such losses incurred during the tax concessional period against any profits arising under the amended such higher tax rate.
- Investment Losses - Any unrecovered investment losses incurred in any Year of Assessment would be limited for the succeeding six (6) Years of Assessment
- Gains from realization of investment assets cannot be reduced by any losses

### Marketing and Communication Expenses

The additional 100% expense deduction granted for marketing and communication expenses has been limited to two years only (Y/A 2021/22 and Y/A 2022/23).

# Corporate Income Tax (Contd.)



## Deduction Rules

### Debt Claim of Banking Business

A person conducting a banking business is permitted to claim specific provision of a debt claim in accordance with the Gazette issued by the Commissioner-General along with the relevant directives made by the Central Bank of Sri Lanka.

The Act seeks to expand the scope of the directives made by the Central Bank to include the directives issued for classification, recognition and measurement of credit facilities under the powers conferred by, section 46(1), section 46A and section 76J(1) of the Banking Act, No. 30 of 1988 with effect from 1 April 2022.

### Enhanced Capital Allowance on Investment Incentives

The Act seeks to introduce a three-year project implementation period from the first date of the investment on a depreciable asset, if the investor has not made the intended total investment in order to qualify for enhanced capital allowance.

The Act specifies that capital allowance shall be deducted in that year of assessment in which total intended investment is completed, but before the expiration of such project implementation period (3 years). This will be effective from 1<sup>st</sup> April 2022.

## Advance Income Tax (AIT)

Mandatory AIT deductions would be applicable on the payment of dividend, interest, discount, charge, natural resource payment, rent, royalty or premium which has a source in Sri Lanka at the following rates from 1<sup>st</sup> January 2023.

| Nature of payment                                                      | AIT rate          |
|------------------------------------------------------------------------|-------------------|
| Rent equal or exceeding Rs.100,000 per month made to a resident person | 10% on total rent |
| Interest or discount                                                   | 5%                |
| Dividend                                                               | 15%               |
| All other payments                                                     | 14%               |

## Final withholding payment

Dividend paid by a resident company would be considered as a final withholding payment with effect from 1<sup>st</sup> January 2023. Hence the recipient of such dividend is not liable to pay further taxes.

# Corporate Income Tax (Contd.)

## Withholding tax on service payments

The following service fee payments would be subject to mandatory withholding tax with effect from 1<sup>st</sup> January 2023 and the applicable withholding tax rates are as follows:

1. Payment of a service fee or an insurance premium with a source in Sri Lanka to a non-resident – withholding tax applicable at the rate of 14% (final tax)
2. Service fee payments mentioned below with a source in Sri Lanka exceeding Rs.100,000 per month to a resident individual (who is not an employee of the payer) – withholding tax applicable at the rate of 5% (not a final tax)
  - a) Service fee for teaching, lecturing, examining, invigilating or supervising an examination
  - b) Service fee as a commission or brokerage to a resident insurance, sales or canvassing agent
  - c) Service fee paid to an individual providing services in the capacity of independent service provider such as doctor, engineer, accountant, lawyer, software developer, researcher, academic or any individual service provider as may be prescribed by regulation



## Introduction of Exemptions

- The dividend income received by a member is exempt, if such dividend is paid by a resident company from the dividend received by such resident company or another resident company which has been subject to Advance Income Tax
- Gain from realization of capital asset used in business or investment or a liability by an entity fully owned by the Government of Sri Lanka (GOSL) is exempt, if such gain was made due to any decision by the GOSL which is deemed essential for the economic development of Sri Lanka and subject to the prior written approval of the Minister w.e.f. 1<sup>st</sup> April 2022



## Withdrawal of Exemptions - w.e.f. 1 October 2022

The following exemptions have been removed:

- Gain from realization of land or building arises from sale, exchange or transfer to a SEC listed and licensed real estate investment trust (REIT)
- Dividend and gains on the realization of units or amounts derived as gains from the realization of capital assets of a business or investment by a unit holder, from SEC listed & licensed REITs
- Dividend paid by a resident company to a non-resident person – Although the Act states the effective date is 1<sup>st</sup> October 2022, as per the Budget 2023, the removal of exemption will be effective from the date of the commencement of the Amending Act, and not 1<sup>st</sup> October 2022. However, such amendment proposed in the Budget 2023 is not reflected in the Amending Act. CGIR may have to issue a clarification in order to rectify the ambiguity

# Corporate Income Tax (Contd.)



## Withdrawal of Exemptions - w.e.f. 1 April 2023

- **Information technology and enabled services**

The gains and profits from information technology and enabled services was granted an exemption from 1<sup>st</sup> January 2020. The Act seeks to remove such exemption from 1<sup>st</sup> April 2023 thus allowing the exemption to be enjoyed till end of Y/A 2022/23.

- **Exemptions granted from 1<sup>st</sup> April 2021 on Gains and profits derived from following business activities has been removed with effect from 1<sup>st</sup> April 2023:**

- ✓ Any vocational education programmes of any Vocational Education Institution
- ✓ Any business of export of gold, gems or jewellery or from the business of cutting and polishing of gems which are brought to Sri Lanka and re-exported, where such gains and profits earned in foreign currency are remitted through a bank to Sri Lanka

- **The tax holidays granted with effect from 1<sup>st</sup> April 2021 for the gains and profits from business of the following new undertakings has been removed with effect from 1<sup>st</sup> April 2023:**

- ✓ the sale of construction materials recycled in a selected separate site established in Sri Lanka
- ✓ manufacturing of boats or ships in Sri Lanka by a resident person
- ✓ undertaking commenced by an individual on or after 1<sup>st</sup> April 2021, after successful completion of vocational education from any Vocational Education Institution

- ✓ any renewable energy project established with a capacity to produce not less than 100 Mega Watts of solar or wind power
- ✓ construction and installation of communication towers and related appliances using local labour and local raw materials in Sri Lanka by any resident person on or after 1<sup>st</sup> January 2021
- ✓ letting bonded warehouses or warehouses related to the offshore business in the Colombo and Hambanthota Ports



## Administrative Provisions

### Segregation of Tax Accounts

Where a person incurs expenses in common or commonly used any assets on all business or investment activities, and such expense or deduction cannot be separately identified for the calculation of tax accounts, it is permitted to divide such expenses or deductions on a proportionate basis (i.e. turnover or asset usage).

### Amendments to the Return of Income

Any amendments to self-assessment Returns should be made within 12 months from the date on which the self-assessment Return was filed from any Year of Assessment commencing 1<sup>st</sup> April 2022.

**02**

# **Personal Income Tax**

# Individual Income Tax



## Tax Rates & Tax Slabs

### Tax Rates

Effective from 1<sup>st</sup> January 2023, the progressive personal income tax rates would be 6%, 12%, 18%, 24%, 30% and 36%.

The increase in personal income tax rates from 01<sup>st</sup> January 2023, would result in different tax rules being applied for the 1<sup>st</sup> nine months and the 2<sup>nd</sup> three months of the Year of Assessment 2022/23.

### Tax Slabs

Tax slabs has been reduced from Rs. 3 mn to Rs. 500,000 w.e.f. 1<sup>st</sup> January 2023.

**Personal income tax rates for the first 9 months period of the Year of Assessment commencing from 1<sup>st</sup> April 2022**

| Taxable Income (LKR) | Tax Rate |
|----------------------|----------|
| First Rs. 2,250,000  | 6%       |
| Next Rs. 2,250,000   | 12%      |
| On the balance       | 18%      |

**Personal income tax rates for the second 3 months period of the Year of Assessment commencing from 1<sup>st</sup> April 2022**

| Taxable Income (LKR) | Tax Rate |
|----------------------|----------|
| First Rs. 125,000    | 6%       |
| Next Rs. 125,000     | 12%      |
| Next Rs. 125,000     | 18%      |
| Next Rs. 125,000     | 24%      |
| Next Rs. 125,000     | 30%      |
| On the balance       | 36%      |

**Personal income tax rates effective from 1<sup>st</sup> April 2023**

| Taxable Income (LKR) | Tax Rate |
|----------------------|----------|
| First Rs. 500,000    | 6%       |
| Next Rs. 500,000     | 12%      |
| Next Rs. 500,000     | 18%      |
| Next Rs. 500,000     | 24%      |
| Next Rs. 500,000     | 30%      |
| On the balance       | 36%      |

# Individual Income Tax (Contd.)



## Concessionary Tax Rates applicable to Individuals

Effective from 1<sup>st</sup> January 2023, the maximum rate of 14% applicable on profits and income derived by an individual on following has been removed and the personal income tax rates will apply.

- consideration received in respect of gems and jewelry
- amounts received on the supply of electricity to national grid generated by using renewable energy resources by any individual



## Capital Gains Tax Rate

The tax on realization of investment asset by an individual will continue to be taxed at 10%.

The gain arising from the realization of an “investment asset” cannot be reduced by any loss.



## Tax on Terminal Benefits

There is no changes to the tax on terminal benefits.

Terminal benefits are taxed as follows:

- **Commutated pension, retiring gratuity, ETF or Approved compensation**

| Tax Slab        | Tax Rate |
|-----------------|----------|
| First Rs. 10 Mn | 0%       |
| Next Rs. 10 Mn  | 6%       |
| On the balance  | 12%      |

- **Compensation for loss of office not approved, provident fund not CGIR approved, Retirement non-cash benefit**

The tax would be based on the progressive tax rates applicable to an individual effective for the period 1<sup>st</sup> April 2018 to 31 December 2019.

# Individual Income Tax (Contd.)



## Qualifying Payments and Reliefs

### Personal relief

Effective from 1<sup>st</sup> April 2023, the personal relief available to resident and non-resident citizen individuals would be Rs.1.2 mn.

For the 1<sup>st</sup> nine months of the Y/A 2022/2023, the personal relief would be Rs.2,250,000 while for the 2<sup>nd</sup> three months, the personal relief would be Rs.300,000.



### Expenditure relief

The expenditure relief of Rs.1.2mn available to resident individuals has been removed w.e.f. 1<sup>st</sup> January 2023.

The expenditure relief was introduced effective from 1<sup>st</sup> January 2020 (by way of Inland Revenue (Amendment) Act No.10 of 2021), a resident individual was entitled to deduct the following expenditure subject to a maximum deduction of Rs.1,200,000/-:

- health expenditure including contributions to medical insurance
- vocational education or other educational expenditure incurred locally by such individual or on behalf of such individual's children
- interest paid on housing loans
- contributions made to any local pension scheme, other than for a scheme under the employer or on behalf of the employer, by an employee
- expenditure incurred for the purchase of shares, or any other financial instrument listed in the Colombo Stock Exchange and licensed by the Securities and Exchange Commission of Sri Lanka or treasury bonds under the Registered Stocks and Securities Ordinance (Chapter 420) or treasury bills under the Local Treasury Bills Ordinance (Chapter 417)



For the 1<sup>st</sup> nine months of the Y/A 2022/2023, the expenditure relief would be Rs.900,000 while for the 2<sup>nd</sup> three months no deduction would be available.

# Individual Income Tax (Contd.)



## Advance Income Tax (AIT)

### Investment returns received by an individual

The applicable AIT on investment returns paid to individuals is mandatory deduction effective from 1<sup>st</sup> January 2023. (refer page 08 for the applicable AIT rates).

### Final withholding payments

On or after 1<sup>st</sup> January 2023, Dividend paid by a resident company is considered as a final withholding payment.



## Withholding Tax (WHT)

### Service Fees received by an individual

Effective from 1<sup>st</sup> January 2023, withholding tax at the rate of 5% has been reintroduced on service fee payments which has a source in Sri Lanka and paid to a resident individual who is not an employee of the payer of such service fee. The withholding obligation would arise if the service fee payment exceeds LKR 100,000/- per month.

### Payments received by a non-resident person

As per the prevailing Law the payment of service fee or an insurance premium with a source in Sri Lanka to a non-resident would be subject to a withholding at the rate of 14%.

The amount received would be considered a final withholding tax payment and there would be no further tax exposure on the non-resident person.

# Individual Income Tax (Contd.)

## Advance Personal Income Tax (APIT)

Effective from 1<sup>st</sup> January 2023, mandatory APIT deduction will apply on employment income received by employees. CGIR will have to issue the revised APIT Tables.



### Exclusions

#### Income excluded from “employment income”

Effective from 1<sup>st</sup> April 2022, income excluded from “Employment Income” has been widened to cover an individual’s retirement payments, where the contribution have already been considered for income tax purposes by the employee.



## Tax Accounts

### Segregation of tax accounts

Effective from 1<sup>st</sup> April 2022, where a person has expenses incurred in common or commonly used any assets on all business or investment activities, and such expense or deduction cannot be separately identified for the calculation of tax accounts, it is permitted to divide such expenses or deductions on a proportionate basis (according to the proportion of turnover or proportion of asset usage).



## Administrative provisions

### Opening an Income Tax file

Effective from 1<sup>st</sup> April 2022, individuals whose income comprises exclusively of income from employment and same has been subjected to APIT, is excluded from opening an Income Tax file.



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