



Sri Lanka Tax Profile

Produced in conjunction with the
KPMG Asia Pacific Tax Centre

Updated: July 2016

Contents

1	Corporate Income Tax	1
2	Income Tax Treaties for the Avoidance of Double Taxation	5
3	Indirect Tax	6
4	Personal taxation	7
5	Other Taxes	8
6	Free Trade Agreements	9
7	Tax Authority	10



1 Corporate Income Tax

Corporate Income Tax	Corporate tax
Tax Rates	<p>The standard tax rate is 17.5 percent. (Pending enactment)</p> <p>Tax rates of 28 percent and 40 percent also apply to profits from specific businesses.</p>
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	<p>Sri Lanka has a self-assessment system for Income Tax payments.</p> <p>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 each year).</p> <p>The final tax payment is due on or before the 30th of September immediately following the end of year of assessment.</p> <p>Non-filing of returns or non-payment of taxes by due dates will result in penalties being imposed.</p>
International Withholding Tax Rates	<p>Withholding tax is imposed on payments such as dividends, royalties and technical fees paid to non-residents. The following are the Sri Lankan domestic tax rates. Rates may be reduced where there is an applicable tax treaty.</p> <ul style="list-style-type: none">▪ Dividends: 10 percent▪ Royalties/ technical fees: 20 percent <p>Interest payments to non- residents are exempt from Income Tax.</p>
Capital gains	Capital gains are out of scope of Income Tax in Sri Lanka. The Government of Sri Lanka has indicated that tax on capital gains will be re-introduced.



Tax Losses	<p>Losses can be set-off up to 35 percent of Total Statutory Income for a given year.</p> <p>Losses can be carried forward indefinitely until such losses are utilised.</p> <p>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.</p>
Tax Consolidation / Group relief	N/A
Transfer of shares	Capital gains arising on transfer of shares are out of scope of Income Tax in Sri Lanka.
Transfer of assets	Gains arising on transfer 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	<p>The arm's length principle applies to transactions with related companies within Sri Lanka and/or outside Sri Lanka.</p> <p>There is a statutory requirement for reporting and for maintenance of documentation.</p>
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, or any other subsidiary within the group. 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	A 10 percent deduction over 10 years is available on the cost of acquisition of any intangible asset. Further, the cost of acquisition of any internationally recognised intellectual property used in business is considered as revenue expenditure.

R&D Incentives

Companies are permitted to deduct tax of 200 percent of expenditure, including capital expenditure, on research and development activities. In the event 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

- Hub service

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

- Incentives for new undertakings

Where an existing company engaged in manufacturing expands into any province, other than the 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 company registered 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.

There is a proposal to withdraw the above concession and introduce the following. However, such amendments have not yet been brought into law.

- A new company engaged in the business of manufacturing or provision of any services and which is set-up in a lagging region with a minimum investment of US Dollar 10 million or 500 new employment will have a 50% reduction on the tax payable for a period of 5 years. This concession would be extended to 8 years if new employment opportunities exceed 800, and up to 10 years if the investment is for the business of a Theme park.
- A new company incorporated especially for MICE (Meetings, Incentives, Conferences and Exhibitions) will have a 50% reduction on tax payable for a period of 5 years.
- 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.

Hybrid Instruments

There are no special rules applicable to hybrid instruments.

Hybrid entities

N/A



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 the 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.

Accounting and Reporting

Financial statements are prepared in accordance with Sri Lanka Financial Reporting Standards (SLFRS) and Lanka Accounting Standards (LKAS). These standards are similar to International Financial Reporting Standards and International Accounting Standards.

A quoted public company, a company which is a member of a group of companies where at least one company is a quoted public company or other companies having an annual turnover of not less than Rs.250,000,000/-, or net profit of not less than Rs.100,000,000/- for a year, are required to submit audited financial statements to the Department of Inland Revenue. However administratively, the Department of Inland Revenue requests companies to submit audited financial statements irrespective of the turnover or the net profit derived for the year by such company. The audited financial statements have to be submitted at the time of filing the income tax return for the relevant Year of Assessment.



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 (Value Added 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 or imported into Sri Lanka, other than exempt supplies or zero rated supplies. It is proposed to increase rate to 15 percent.
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 tax effectively at 1 percent of turnover, or 0.5 percent of turnover, if a distributor
Economic Service Charge (ESC)	Turnover tax
Standard Rate	Tax is imposed on turnover at the rate of 0.50 percent provided turnover for a quarter exceeds LKR 50 million. ESC is available as a tax credit for a period of 3 years. Advanced payment of ESC is imposed on imports (CIF value) which are subject to Special Commodity Levy. ESC is paid disregarding the registration threshold of LKR 50 million per quarter. The advance ESC paid could be set-off against the ESC liability arising on turnover in that year. No refunds are provided.
Further Information	For more detailed indirect tax information, refer to: KPMG's 2016 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 tax, 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 the 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.

Private Sector Establishments and State Corporations with more than 15 employees are required to pay gratuity to its employees with more than 5 years of service at the time of retirement. The method of calculating gratuity is prescribed by law.

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 Instrument and the value of the instrument.
Property Transfer Tax	Outright transfer of property to foreign nationals/ foreign companies is prohibited
Port and Airport Development Levy	This is a tax imposed on all imports into Sri Lanka at 7.5 percent unless same has been exempted.
Cess	Cess is a levy imposed on all imports into Sri Lanka and the rate of tax varies by product type.
Special Commodity Levy	Special Commodity Levy is a composite levy on certain items imported in lieu of the amount chargeable on such commodity items as a tax, duty, levy or cess or any other charge.

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

Shamila Jayasekara
Head of Tax & Regulatory
KPMG in Sri Lanka
T +94 11 5426 503
E sjayasekara@kpmg.com

www.kpmg.com/lk

This profile was provided by professionals from KPMG's member firm in Sri Lanka.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2016 KPMG International Cooperative ("KPMG International"), a Swiss entity. Member firms of the KPMG network of independent firms are affiliated with KPMG International. KPMG International provides no client services. No member firm has any authority to obligate or bind KPMG International or any other member firm vis-à-vis third parties, nor does KPMG International have any such authority to obligate or bind any member firm. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.

