

# Discussion on Inland Revenue Act

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# Transitional provisions

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- ▶ The transitional provisions have been published by the Gazette dated April 01, 2018 and it provides for the following:
  - Profits and income which are fully or partly exempt from income tax under the provisions of Sections 16C, 16D, 16E, 17, 17A, 18, 20, 24A of the Inland Revenue Act, No. 10 of 2006 (“previous IR Act”) or subject to a reduced rate under the provisions of Sections 59D, 59I, 59J, 59K, 59L, 59M of the previous Act, for a period as specified under those provisions, will continue to be treated as such, until the specified period is complete.
  - Profits and income, which are fully or partly exempt from income tax or subject to a reduced rate under BOI agreements entered prior to April 1, 2018 based on Section 17 of the BOI law, for a specified period and such period has not expired by 31 March 2018, will continue to be treated as such, until the specified period is complete.

# Transitional provisions (cont'd)

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- Any unabsorbed losses (as at March 31, 2018), which were carried forwarded under the provisions of the previous IR Act, will be deemed to be treated as losses incurred for the Y/A commencing on or after April 01, 2018 under the Inland Revenue Act, No. 24 of 2017 (“new IR Act”) and will be deductible in accordance with the provisions of new IR Act.
- Any unclaimed qualifying payments (as at March 31, 2018), which were provided under Section 34 of the previous Act, will be deductible from the Y/A commencing on or after April 01, 2018, subject to any conditions as specified in said Section.
- Capital allowances in respect of qualified assets, which acquired and used in the business prior to April 01, 2018, will continue to be computed in accordance with the previous IR Act and can be deducted.
- Any profit, loss, receipt or payment in respect of any finance lease agreement entered into, prior to April 01, 2018, will be computed in accordance with the provisions of the previous IR Act.

# Transitional provisions (cont'd)

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- ▶ Any unclaimed notional tax credit, which was carried forwarded under Section 138 (2) of the previous Act, can be carried forwarded to be setoff against the income tax liability within three consecutive years of assessment commencing from the Y/A 2018/2019.
- ▶ In case of any dividend paid to be shareholder of any company prior to April 01, 2019, out of any such dividend received by that company from any other company on which tax had been deducted prior to April 01, 2018 in accordance with the provisions of the previous IR Act, such dividend will not be subject to tax under the provisions of the new IR Act.
- ▶ In case of any non-resident person whose profit from any project in Sri Lanka has been ascertained by the CGIR, in accordance with the section 83 of the previous IR Act, prior to April 01, 2018, as a percentage of the sum receivable from trade or business of such person, such percentage of the sum receivable from that project shall be continued for any Y/A commencing from April 01, 2018.

# Withholding tax on dividends

# Withholding taxes on dividends

Item	Previous provision	Current provision
Basis of taxation	Final WHT	Same (final for residents)
Definition	<p>Distribution of profit by a company to its shareholders, in the form of;</p> <ul style="list-style-type: none"> <li>▶ Money or of an order to pay money</li> <li>▶ Shares in any other company</li> <li>▶ Debentures in that company or any other company</li> <li>▶ Scrip dividend or dividend in specie</li> <li>▶ The excess of the market value relating to shares buy-back</li> <li>▶ Reduction of capital within six years of a bonus issue.</li> </ul>	<p>Dividend</p> <p>a) means a payment derived by a member from a company, whether received as a division of profits, in the course of a liquidation or reconstruction, in a reduction of capital or share buy-back or otherwise;</p> <p>b) Includes a capitalization of profits (bonus share)</p> <p>c) Excludes a payment to the extent to which it is</p> <ul style="list-style-type: none"> <li>▶ matched by a payment made by the member to the company;</li> <li>▶ debited to a capital, share premium or similar account; or</li> <li>▶ otherwise constitutes a final withholding payment or is included in calculating the income of the member.</li> </ul>

# Withholding taxes on dividends (cont'd)

Item	Previous provision	Current provision	Change
Chargeability	The company is liable to pay dividend tax. Such tax can be recovered from the shareholders.	The company has no liability to dividend tax other than as a withholding agent.	The dividend is income of the shareholder.
Dividends	Liable @ 10%	Liable @14%	Rate increased by 4%
Exemptions	Certain exemptions given under Section 10	Dividend received by a non resident is exempt if the paying company has invested more than US\$ 1,000 Mn on depreciable assets	



# Withholding taxes on dividends (cont'd)

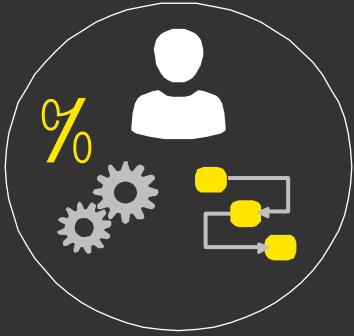
Item	Previous provision	Current provision	Change
Dividends distributed out of dividends received	Not liable for WHT	Same	No Change
Foreign dividends	Exempt	Exempt if there is a participation of at least 10% of the value of shares in the foreign Company	New conditions imposed for exemption
Dividends distributed out of dividends (foreign) received	Exempt if declared within 3 months	Liable @ 14%	Increased to 14%

The background of the slide is a dynamic, abstract image featuring a dense field of bright orange and yellow sparks or light trails. These trails are most concentrated on the right side, where they form a large, glowing, circular shape that resembles a fireball or a large-scale spark display. The overall effect is one of intense energy and movement, with the colors ranging from deep orange to bright yellow and white at the points of light.

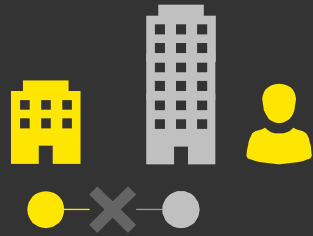
# Investment income and taxation of capital gains

# Investment income

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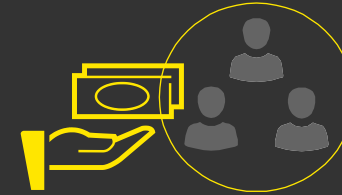
Dividend,  
interest,  
royalties,  
annuities, rent  
etc.



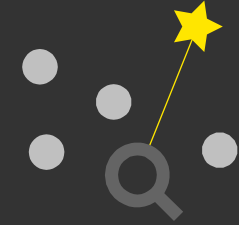
Gains from the  
realization of  
investment assets  
(capital gain)



Consideration for  
accepting a restriction  
on the investment  
asset



Gifts received in  
respect of the  
investment



Winnings from  
betting and  
gambling

# Investment assets

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- ▶ An investment asset is a capital asset held as part of an investment.
- ▶ A capital asset is defined to mean
  - ▶ Land or building
  - ▶ A membership interest in a company or partnership
  - ▶ A security or other financial asset
  - ▶ An option, right or other interest in the above assets
  - ▶ But excludes trading stock or a depreciable asset
- ▶ Therefore an investment asset is any of the above assets held as part of an investment and not as an asset connected to the business.

# Realization of investment assets

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- ▶ Realization of an asset means when the owner of that asset parts with the ownership of that asset by
  - ▶ Sale, Transfer, exchange, distribution, cancellation, redemption, destruction, loss, expiry, expropriation or surrender
  - ▶ When a person ceases to exist including the death of an individual there would be a realization of that asset immediately before
  - ▶ This would include gifting of an asset

# Gains from realization of assets

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- ▶ How is the gain computed

$$\text{Gain} = \text{Consideration} - \text{Cost of the asset}$$

- ▶ Applicable tax rate on such gain - 10%
- ▶ Applicable rate on other assets effectively connected with a business would be the rate at which the respective company or individual is liable.
- ▶ Cost of an investment asset held as at September 30, 2017, shall be equal to the market value at that time.

# Gains from realization of assets (cont'd)

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- ▶ Cost of the asset includes
  - ▶ Expenditure to acquire
  - ▶ Expenditure on construction
  - ▶ Expenditure in altering, maintaining and repairing
  - ▶ Advertising
  - ▶ Transfer taxes
  - ▶ Duties
  - ▶ Expenditure in preserving or defending title
  - ▶ Service fees for retaining accountants, lawyers for the above purposes

# Gains from realization of assets (cont'd)

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## Consideration

- ▶ Does consideration have to be the market value?
- ▶ The consideration is defined to mean the amount received or receivable for the asset.
- ▶ Only where consideration is given in kind-the market value must be considered.
- ▶ Exempt amounts shall be excluded from the consideration.



# Gains from realization of investment assets (cont'd)

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## Exemptions

- ▶ No tax will be imposed if it's the principle place of residence if it is owned continuously for 3 years before disposal and lived in for at least 2 years.
- ▶ Gains by a resident individual from the realization of investments assets that does not exceed Rs 50,000/- per asset and does not exceed Rs 600,000/= per annum in total.
- ▶ Gains from the realization of assets consisting of shares quoted in any official list published by any stock exchange licensed by the SEC Sri Lanka.

# Gains from realization of investment assets (cont'd)

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## Exclusions

- ▶ In the following cases the Act deems that there would be no capital gain from the realization of an asset as it deems the amount realized from the transfer to be the net cost of the asset.
  - ▶ Transfer of an asset to a spouse or former spouse due to death or part of a divorce settlement (where the spouse specifically asks for this exclusion to apply in writing).
  - ▶ Transfer on death – the realization of any asset upon the death of an individual.

# Capital gains from realization of investment assets

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- ▶ Transfer to an associate – where the associate is defined to include the individuals

child, spouse, parent, grand parent, grandchild, sibling, aunt, uncle, nephew, niece or first cousin including by way of marriage or adoption

and where the asset is

an interest in land or building.

# Losses from realization of assets

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- ▶ Unrelieved losses from a business may be deducted in calculating investment income.
- ▶ Unrelieved losses from an investment can be deducted only in calculating income from investments.
- ▶ A gain from the realization of an investment asset cannot be reduced by a loss on the disposal of another investment asset.

# Investment incentives

# Investment incentives

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- ▶ No tax holidays
- ▶ Tax incentives are provided through enhanced capital allowances for new companies in addition to the normal capital allowances.
- ▶ Any unrelieved loss arising on this claim should be claimed within 10 years. Further, If a person has incurred more than US\$ 1000 mn on the qualified assets, any unrelieved loss, arising on this claim should be allowed within 25 years.

# Investment incentives (cont'd)

Investment criteria	Expenses should be incurred on	Location criteria	Enhanced capital allowance
Exceeds US\$ 3 Mn	Depreciable assets (other than intangible assets)	Northern province	200%
Exceeds US\$ 3 Mn, but not exceed US\$ 100 Mn	Depreciable assets (other than intangible assets)	Other provinces	100%
Exceeds US\$ 100 Mn	Depreciable assets (other than intangible assets)	Other provinces	150%
Exceeds US\$ 250 Mn	Assets or shares of a state owned Company	State owned Company	150%

# Temporary concessions



# Temporary concessions (for three years)

Investment	Location	Qualified assets	Rate
Up to US\$ 3 Mn	Northern Province	Computers, data handling equipment, specified plant or machinery buildings, structures	200%
Up to US\$ 3 Mn	Other Province	Computers, data handling equipment, specified plant or machinery buildings, structures	100%

- ▶ Enhanced capital allowances for new companies in addition to the normal capital allowances.
- ▶ Applicable to a person who incurs expenses on the above depreciable assets.
- ▶ The depreciation allowance has to be claimed in the year of assessment.

# Temporary concessions (contd.)

Category	Conditions	Tax Rate	Applicable years of assessment (after the commencement of the Act)
<u>Life Insurance</u> The portion of gains and profits (surplus distributed) of a life insurance company		14%	Three
<u>Headquarters Relocation</u> Headquarters or regional head office as specified by the CGIR	Established in Sri Lanka on or after 1-10-2017	0%	Three
<u>Renewable energy</u> Any person	Entered into standardized power purchase agreement on or before 10-11-2016 with the CEB	14%	Three

# Temporary concessions (contd.)

Person	Entitled for additional deduction	Conditions	Applicable years of assessment (after the commencement of the Act)
Company providing information technology(IT) services	35% of the total amount of employee benefits considered for employees' taxable income other than benefits of the company's directors	<ul style="list-style-type: none"> <li>▶ should have 80% of gross income from the business of providing IT services.</li> <li>▶ at least 50 employees during the whole year; and</li> <li>▶ include those employees in the annual statement.</li> <li>▶ Not entitle to deduct enhanced capital allowance.</li> <li>▶ Any unrelieved loss can not be deducted in any succeeding year of assessment.</li> </ul>	five
<b><u>Research &amp; Development Expenses</u></b> Any person	100% of total R&D expenses deducted under section 15 from business income		Three

# Tax exemptions

# IT exemptions (corporates)

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- ▶ Gain from realization of asset consisting of shares quoted in any official list published by SEC in Sri Lanka.
- ▶ Gain from realization of shares in a non –resident Company if there is a participation for at least 10% of the value of shares of foreign Company.
- ▶ Interest income from sovereign bonds denominated in foreign currency to non resident persons or licensed Commercial Bank in Sri Lanka.
- ▶ Dividend paid out of dividend received on which WHT has been deducted as per Section 84 (2).
- ▶ Any amount derived from sale of any gem on which WHT has been deducted under Section 84 (2) of the new IR Act.

# Current exemptions abolished

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- ▶ Export of services (Section 13 ddd)
- ▶ Services performed outside Sri Lanka (Section 13 bb)
- ▶ Redemption of units in a Unit Trust
- ▶ Interest and gain from sale of Sri Lanka development bonds
- ▶ Buying from one country and exporting to another country
- ▶ Subsidies given to plantations

# Tax rates

# Tax rates

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14%

SMEs, exports, education, agriculture, promotion of tourism and IT

28%

Standard rate of 28% for all other industries, including banking, finance, insurance, leasing and related services, trading and unincorporated bodies

40%

Higher rate applicable to betting and gaming, liquor and tobacco

**Three tier structure effective from 1 April 2018**



# Tax rates

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Concessionary rate of 14% will be applicable for companies predominately (80%) engaged in the business of exports, education, agriculture, promotion of tourism and IT.

Export means export of goods and services including the following specified undertakings –

- ▶ Entrepot trade involving import, minor processing and re-export;
- ▶ Offshore business where goods can be procured from one country or manufactured in one country without bringing the same into Sri Lanka;
- ▶ Providing front end services to clients abroad;
- ▶ Headquarters operations of leading buyers for management of financial supply chain and billing operations;
- ▶ Logistic services such as bonded warehouse or multi-country consolidation in Sri Lanka;

# Tax rates

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- ▶ Transshipment operations;
- ▶ Freight forwarding;
- ▶ Sale of gem and jewelry for foreign currency;
- ▶ Supply of services to any exporter of goods or services or to any foreign principal of such exporter directly, being services which could be treated as essentially related to the manufacture of such goods or provision of such services exported by such exporter either directly or through any export trading house, including any service provided by an agent of a ship operator to such agent's foreign principal, and the payment for such services are made by such exporter or foreign principal to such person in Sri Lanka in foreign currency;

# Tax rates

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- ▶ Production of manufacture, and supply to an exporter of non-traditional goods; and
- ▶ The performance of any service of ship repair, ship breaking repair and refurbishment of marine cargo containers, provision of computer software, computer programs, computer system or recording computer data, or such other services as may be specified by the minister by notice published in the Gazette, for payment in foreign currency”;

# Tax rates

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Promotion of tourism means;

Undertaking for the promotion of tourism means an undertaking for the operation of-

- ▶ any hotel or guest house approved by the Ceylon Tourist Board;
- ▶ any restaurant graded by the Ceylon Tourist Board as being in “Class A” or “Class B”;
- ▶ any business of travel agent who provides travel management services for domestic travel in Sri Lanka;
- ▶ any business of transporting tourists only; or
- ▶ any business approved by the Ceylon Tourist Board for providing facilities for recreation or sports.

# Tax rates

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## Information Technologies (IT)

Providing IT means;

- ▶ Software development services or
- ▶ The provision of IT services under a Business Process Outsourcing arrangement or a knowledge process outsourcing arrangements

# Tax rates

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Small Medium Enterprises means;

- ▶ The person conducts business solely in Sri Lanka other than an individual engages in providing professional services individually or in partnership being an individual who is professionally qualified;
- ▶ The person does not have an associate that is an entity; and
- ▶ The person's annual gross turnover is less than Rs.500 million.

# Key sectors where the rate of tax is increased from 10% or 12% to 28%

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- ▶ Construction services
- ▶ Healthcare services
- ▶ Warehousing
- ▶ Agro processing, animal feed and fishing
- ▶ Clubs and associations