Sri Lanka
Tax Profile

Produced in conjunction with the KPMG Asia Pacific Tax Centre

Updated: September 2014
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## 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 to maintain documentation, and such documentation would have to be submitted to the Tax Authorities in the event of a tax audit. |
| **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 and in the event research and development is conducted through an institution, a 300 percent deduction is permitted.

Other incentives

- Incentives for new undertakings
  Where a company wishes to invest in a new undertaking with a minimum investment of LKR 50 million into acquisition of fixed assets, such undertaking would qualify for exemption subject to fulfilment of the requisite criteria. The investment however should be made on or before 1 April 2015.

- Incentives for small and medium-sized companies
  Companies involved in any business other than buying & selling are entitled to a lower tax rate of 12 percent (with effect from 1 April 2014) provided the annual turnover of the company does not exceed LKR 500 million.

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

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

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 could 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.
## Income Tax Treaties for the Avoidance of Double Taxation

### In Force

<table>
<thead>
<tr>
<th>Australia</th>
<th>Korea</th>
<th>Saudi Arabia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>Kuwait</td>
<td>Seychelles</td>
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<td>Belarus</td>
<td>Luxembourg</td>
<td>Singapore</td>
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<td>Belgium</td>
<td>Malaysia</td>
<td>Sweden</td>
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<td>Canada</td>
<td>Mauritius</td>
<td>Switzerland</td>
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<td>China</td>
<td>Nepal</td>
<td>Thailand</td>
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<td>Denmark</td>
<td>Netherlands</td>
<td>United Arab Emirates</td>
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<td>France</td>
<td>Norway</td>
<td>United Kingdom</td>
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<td>Finland</td>
<td>Oman</td>
<td>United States</td>
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<td>Germany</td>
<td>Pakistan</td>
<td>Vietnam</td>
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<td>Hong Kong</td>
<td>Palestine</td>
<td>Bahrain</td>
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<td>India</td>
<td>Philippines</td>
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<td>Indonesia</td>
<td>Poland</td>
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<td>Iran</td>
<td>Qatar</td>
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<tr>
<td>Italy</td>
<td>Romania</td>
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<tr>
<td>Japan</td>
<td>Russia</td>
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</table>

**Negotiated or signed, but not yet in force at time of publication**

Bahrain
## 3 Indirect Tax

<table>
<thead>
<tr>
<th><strong>Value Added Tax (VAT)</strong></th>
<th>Consumption tax</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard Rate</strong></td>
<td>Standard rate of consumption tax is 12 percent and applies to every taxable supply of goods and services supplied in Sri Lanka other than exempt supplies.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Nation Building Tax (NBT)</strong></th>
<th>Turnover tax</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard Rate</strong></td>
<td>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.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Economic Service Charge (ESC)</strong></th>
<th>Turnover tax</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Standard Rate</strong></td>
<td>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 1 a company is exempt from income tax, therefore it would be required to pay ESC. In year 2, the company becomes liable to income tax. In this case the ESC paid in year 1 could be set off against the income tax liability for year 2. ESC paid could be set off against the income tax within a period of 5 years.</td>
</tr>
</tbody>
</table>

**Further Information**

For more detailed indirect tax information across various countries, refer to:

[KPMG’s VAT/GST Essentials](#)
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, 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.

**Further information**

For more detailed personal taxation information, refer to:

KPMG’s Thinking Beyond Borders
## 5 Other Taxes

<table>
<thead>
<tr>
<th>Tax</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Customs duty</strong></td>
<td>Customs duty is levied on goods entering Sri Lanka. The rates vary by product type.</td>
</tr>
<tr>
<td><strong>Excise duty</strong></td>
<td>Excise duty is imposed on tobacco, liquor and other excisable articles.</td>
</tr>
<tr>
<td><strong>Stamp duty</strong></td>
<td>Stamp duty is imposed on specified instruments such as shares, deeds, insurance policies, etc. The levy is based on the value of the instrument.</td>
</tr>
<tr>
<td><strong>Property transfer tax</strong></td>
<td>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.</td>
</tr>
<tr>
<td><strong>Port and Airport Development Levy</strong></td>
<td>This is a tax imposed on all imports into Sri Lanka</td>
</tr>
<tr>
<td><strong>Cess</strong></td>
<td>Cess is a levy imposed on all imports into Sri Lanka and the rate of the tax levied varies by product type.</td>
</tr>
</tbody>
</table>
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)
## 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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