



Proposed amendments to the Inland Revenue Act

April 2021

**KPMG**

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For clients of KPMG in Sri Lanka

The Bill to amend the Inland Revenue Act No. 24 of 2017 ("the Act") was gazetted and issued on 18th March 2021. The Bill is yet to be passed by the Parliament for legal enactment.

In this Tax Alert, we have provided a synopsis of the key amendments proposed to the Act. Please note that the Bill is subject to change via Committee stage amendments and would become law only once certified by the Speaker of Parliament.

You may click on the link below to access the bill published in the website of the Department of Government Printing:

http://www.documents.gov.lk/files/bill/2021/3/37-2021_E.pdf

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Employment Income

Exclusions – benefits not considered for tax

1. Dental, medical or health insurance benefits

An exclusion was granted in calculating employment income for any discharge or reimbursement claimed by the person from the employer for dental, medical or health insurance expenses. However, in terms of the provision in the Act, such exclusion was available subject to the condition that such benefit should have been available to all full-time employees on equal terms.

Since in practice employees of an organization would enjoy the above benefits on equal terms based on their grade, this requirement could not be satisfied. Hence, the DIR issued a Public Ruling (Ref: PR/IT/2019/02) to clarify that the above exclusion could be applied if the said benefits were available to all full-time employees in the same grade on equal terms. The Bill provides for the amendment of the aforementioned provision in the Act to be in line with the said Public Ruling.

2. Contributions to approved gratuity funds

The Bill provides for an exclusion for contributions made by the employer on behalf of the employee to a gratuity fund approved by the CGIR, in computing employment income for a year of assessment.

Deductions in ascertaining income

General deductions

1. Contributions to approved gratuity funds

As per the prevailing law, a deduction for contributions to a gratuity fund is not available when calculating profits unless such contribution is included in calculating the income of the employee. The Bill proposes to grant a deduction for contributions made by such person as an employer to a gratuity fund approved by the CGIR subject to any specified conditions.

Effective date: 1st April 2018

2. Expenses for entertainment

As per the prevailing law, entertainment expenses are disallowed in calculating a person's income from business. The term "entertainment" was defined to mean "the provision to any person of food, beverages, tobacco, accommodation, amusement, recreation or hospitality of any kind". The Bill proposes to revise such definition so that a deduction is granted for expense incurred in relation to the provision of food and beverages (excluding liquor) to any person, to the extent the same has been incurred in the production income of such person.

Effective date: 1st April 2021

3. Cost of funds incurred on loans provided to new businesses carried out by individuals with vocational education

As per the budget proposals announced last November, loans of LKR 500,000 are intended to be provided to new business ventures of individuals who have completed vocational education. Such loans were proposed to be provided at a reduced rate of 4% with a five-year tenure and a grace period of one-year for both interest and capital.

The Bill proposes to deem the cost of funds incurred by financial institutions, which provide such loans, as expenditure incurred in the production of income of such financial institutions, subject to the following conditions,

- a) The loan should be provided to new businesses which commence on or after 1st April 2021;
- b) The business should be carried out by any individual who has successfully completed vocational education from any institution which is,
 - standardized under Technical and Vocational Education and Training ("TVET") concept; and
 - regulated by the Tertiary and Vocational Education Commission.

We note that the inclusion of the said provision, intends to re-emphasize that the cost of funds incurred by financial institutions in providing stated loans at a reduced interest rate and cost of funds incurred during the grace period, are deductible expenses in calculating the profits and gains from business of the financial institutions.

Effective date: 1st April 2021

Deductions in ascertaining income

Specific deductions

1. Repairs and improvements

As per the prevailing law, a restriction is imposed in the form of a ceiling on same that can be deducted as repair or improvement expenses in relation to depreciable assets. The Bill proposes to limit such restriction only to expenses for improvements of depreciable assets. Accordingly, from 1st April 2021, repair expenses incurred on depreciable assets will be fully deductible during the year of assessment in which such expenses are incurred.

Furthermore, for the above purpose, the term “improvement” is defined to mean “the expenditure incurred to make additions or alterations to a depreciable asset which enhances the value of such asset but excludes the expenditure incurred to maintain or repair a depreciable asset which temporarily enhances the value of such asset”.

Effective date: 1st April 2021

2. Marketing and communication expenses

• Capital costs

The Bill proposes to deem a deduction for marketing and communication expenses incurred by a person in the production of income from business during the year of assessment, irrespective of whether such expenses are of a capital nature or not. For this purpose, the term “ Marketing and Communication expenses” has been defined to mean any expense incurred by any person in -

- a) carrying out a market research by such person or any institution in Sri Lanka on his behalf;
- b) the development or production of marketing, advertising and communication campaign to the extent that such development or production is carried out in Sri Lanka;
- c) advertising on mainstream media or social media including television, radio, print or as outdoor advertising;
- d) product launches or campaign activation carried out by such person or by any local institution on his behalf;
- e) development and printing of point of- sale material by such person or by any local institution on his behalf.

We note that based on the prevailing law, a deduction can be claimed for marketing and communication expenses to the extent such expenses are incurred in the production of income from business and provided such expenses are not of a capital nature.

Deductions in ascertaining income

Specific deductions (Cont.)

2. Marketing and communication expenses (Cont.)

• Double deduction

An additional deduction of 100% for aforementioned marketing and communication expenses has been proposed to be granted as a temporary concession during the years of assessment 2021/22, 2022/23 and 2023/24 under the Sixth Schedule to the Act, subject to meeting the following conditions:

- a) payment is made to a person who is not an associated person of the taxpayer;
- b) internal marketing expenses, salaries of marketing staff, expenditure on maintaining an internal marketing department, expenditure on corporate social responsibility initiatives and foreign travel expenses shall not be considered for the above purpose;
- c) expenditure shall be attributable to goods and services with 65% of local value addition, the mode of calculation of which shall be as specified by the CGIR;
- d) the total additional deduction shall not exceed Rs. 500,000,000 in any year of assessment;
- e) the CGIR shall specify the requirements to maintain records, source documents and underlying documents for the above purpose, in addition to the requirements of other provisions of the Act.

Effective date: 1st April 2021

3. Capital Allowance

The Bill proposes to grant accelerated capital allowances over the period of two years, in respect of milking machines with latest technology used to manufacture local liquid milk related products.

Effective date: 1st April 2021

Furthermore, the Bill proposes to deem motorcycles to be eligible for claim of capital allowance.

Effective date: 1st April 2018

Deductions in ascertaining income

Specific deductions (Cont.)

4. Thin capitalization rule

- **Adjustment to base**

The Bill proposes to introduce a revised formula for computing the limit for deduction of financial costs by a company. Accordingly, a company can claim a deduction for financial costs during the year of assessment up to the limit calculated based on the following formula:

$$\frac{\text{Financial cost of the year}}{\text{Value of financial instruments on which the financial cost incurred during the year}} \times \left(4 \times \text{total of the issued share capital and reserves of the company as at the end of the year} \right)$$

As per the prevailing law, the limits specified for deduction of financial costs differ between a manufacturing entity and other types of entities. The revised formula removes this discrepancy.

Furthermore, there was ambiguity in the prevailing law as to the date on which issued share capital and reserves need to be considered within the formula. The revised formula addresses this issue.

- **Special relief for year of assessment 2021/22**

Additionally, the Bill proposes to grant a full deduction for the financial costs incurred during the year of assessment 2021/22 (other than financial costs brought forward from previous years), regardless of the formula specified above, in the form of a temporary concession under the Sixth Schedule of the Act. However, such year of assessment will not be considered as falling within the unutilized period out of the 6-year period granted for claiming brought forward financial costs.

Effective date: 1st April 2021

Deductions in ascertaining income

Specific deductions (Cont.)

5. Deductibility of brought forward business losses by an SME

As per the prevailing law, an entity could claim losses which arose from an activity taxed at a concessionary rate, against profits arising from an activity which is taxed at the same concessionary rate, lower concessionary rate or which is exempt.

An SME is subject to tax at a concessionary rate of 14%. Furthermore, a company is required to evaluate whether it falls within the scope of an SME for each year of assessment against specified criteria. As a result of the limitation set out above, a company would not be in the position to deduct brought forward losses that were incurred during the years in which it was deemed to be an SME, against profits which are taxed at a higher rate.

The Bill proposes to disregard the above rule in deducting losses brought forward from previous years of assessment during which a company operated as an SME. We note that this proposal addresses the practical difficulties faced by companies in claiming brought forward losses due to the changes in their SME status year-on-year.

Effective date: 1st April 2021

Method of Accounting

Approval for varying accounting period

The prevailing law contains provisions enabling a company or a trust to seek approval from the CGIR to change its year of assessment. However, in practice, the DIR has not accommodated requests to allow change in the year of assessment of a company/ trust, but has approved requests for computing tax liability based on accounts prepared for accounting periods ending other than on 31st March of a year.

The Bill proposes to remove the option of seeking approval to change the year of assessment, and proposes to grant the option of seeking approval to compute the tax liability based on accounts prepared for an alternative 12-months period, for a company/ trust. However, an approval granted for such change in the basis of computing tax liability will not impact the deadlines for tax payments.

Effective date: 1st April 2018

Calculation of gains/ losses on realization

Ascertaining gains/ losses on realization of common assets used in businesses taxed at different rates

It has been proposed to apportion the gains/ losses arising on the realization of assets commonly used in different business activities of a person, which are liable to tax at different rates, based on the market value of the proportionate part of the asset.

Assessed value of an investment asset

It has been proposed to deem the consideration received on the realization of an investment asset to be the higher of the amount received/receivable or the assessed value. For this purpose, the term “assessed value” has been defined to mean the value at the time of the realization, certified by a professionally qualified valuer in a valuation report.

Provisions are also proposed to be made to enable a tax official to determine a different value to that of the assessed value, if in his opinion such assessed value is not reflective of the market value of the asset.

Effective date: 1st April 2021

Calculation of gain/ loss on realization of assets on which enhanced capital allowance has been claimed

The gain/ loss arising on realization of a depreciable asset was previously required to be calculated according to the provisions of the Second or Fourth Schedule to the Act. However, the reference to the Second Schedule (under which enhanced capital allowances are granted) in the said provision has been proposed to be removed due to the lack of clarity in the method specified in the Second Schedule for calculating such gain/ loss.

Effective date: 1st April 2018

The Fourth Schedule has also been proposed to be amended to include provisions to specify the method for calculating the gain/ loss arising on the realization of depreciable assets on which enhanced capital allowances have been claimed in accordance with the Second or Sixth Schedule of the Act. However, such amendment has been proposed to be effective from 1st April 2021. We note that such effective date should ideally be rectified to be in line with the above change.

Taxation of partnerships

Tax on partnership

Under the prevailing law, a partnership was excluded from chargeability to income tax, other than withholding tax and tax on gains from realization of investment assets. The partners were liable to tax in respect of their share of income from the partnership. Allocation of profits to partners was subject to withholding of tax at 8%.

It has been proposed to make every partnership liable to income tax with effect from 1st January 2020 at the tax rate of 6%, separately from its partners.

Furthermore, all partners are responsible for performing any duty or obligations imposed by the Act with regard to the income tax payable by the partnership.

Effective date: 1st January 2020

Claim of tax credit by partners for partnership tax paid

A partner will be entitled to claim a tax credit for such tax paid by the partnership if the applicable installment of tax payable has been duly settled by the partnership. However, a refund cannot be claimed by the partners for any excess share of income tax paid in respect of the partnership income. Nevertheless, any such excess tax paid is allowed to be carried forward to the next succeeding year, but is not permitted to be carried forward to any year thereafter.

Effective date: 1st January 2020/ 1st April 2020

Taxation of Companies

Basis of taxation

Profits liable to tax at different rates whether same be an activity or a source, would be considered different businesses/ sources. Previously, all activities carried on by a company were considered a single company business.

Remittance Tax

It has been proposed to grant an exemption from remittance tax on profits repatriated by a Sri Lankan permanent establishment of a non-resident person, subject to meeting the following conditions:

- a) The total income earned in any year of assessment commencing on or after 1st April 2021 via the Sri Lankan permanent establishment should be retained for a minimum period of three years commencing from the first day of the immediately succeeding year of assessment in which the income is earned;
- b) The retained income should be invested in Sri Lanka,
 - to expand its business; or
 - to acquire shares or securities from the CSE; or
 - to acquire any treasury bill, treasury bond or Sri Lanka International Sovereign Bond issued on behalf of the Government of Sri Lanka.

Effective date: 1st April 2021

Taxation of Companies

Financial institutions

1. Taxation of reversals of specific provision for debt claims

As per the prevailing law, there is no specific requirement to deem reversal of provisions made for debt claims as income.

The Bill proposes to provide clarification on the treatment of the reversal, reduction or payment of a debt claim by a financial institution, in relation to which a specific provision was made previously and which was permitted to be deducted for tax purposes in accordance with the relevant directives made by the Central Bank of Sri Lanka. Accordingly, the amount of such reversal, reduction or payment received during the year would be included in calculating the income of the financial institution.

Effective date: 1st April 2018

Furthermore, it has been proposed to make it mandatory for financial institutions to prepare and retain the records in respect of specific provision for a debt claim. For this purpose, the form in which such records should be prepared and retained would be specified by the CGIR.

Effective date: 1st April 2021

Transfer Pricing

Permanent Establishment

It has been proposed to revise the definition of the term “Permanent Establishment” for the purpose of transfer pricing by limiting the application of such definition to a non-resident from a country with which Sri Lanka has entered into a Double Tax Avoidance Treaty. Previously, the meaning of the term extended to cover Permanent Establishment of a person resident in a country with which Sri Lanka does not have a Double Tax Avoidance Treaty..

Effective date: 1st April 2018

Withholding tax/ APIT

Withholding tax

1. Withdrawal of PAYE Tax

It has been proposed to remove the obligation for withholding of tax by an Employer from payments made to employees (i.e. PAYE Tax) with effect from 1st January 2020, and introduce a scheme called APIT in lieu of same with effect from 1st April 2020.

We note that the DIR had previously issued instructions requiring withholding of tax on payment of any terminal benefits as per the guidelines issued in Circular No. SEC/2020/02 dated 18th February 2020. However, such requirement has not been included in the Bill.

Effective date: 1st January 2020/ 1st April 2020

APIT

1. Application of APIT

It is mandatory for Employers to deduct APIT from employment income of non-resident or non-citizen employees.

In relation to resident citizen employees, it will be mandatory for Employers to deduct APIT only if such employee has given consent for such deduction.

APIT is treated as a withholding tax for purposes of the Act.

Effective date: 1st April 2020

2. Credit for APIT deductions

APIT deducted by the employer could be claimed as a tax credit by the resident or citizen employee when calculating self-assessment income tax payments to be made on a quarterly basis.

For non-resident non-citizen employees, the APIT deducted would be a final tax on such employment income since such payment which has been subject to APIT would be considered a final withholding payment in the hands of such employee.

Effective date: 1st April 2020

Withholding tax/ APIT

Requirement to register for tax and file return of income

As per the provisions of the prevailing law, there was no requirement for a resident employee to register for tax and file a return of income if his taxable income comprised only of employment income which was subject to withholding tax. With the removal of withholding tax and introduction of APIT on employment income, it has been proposed to remove such exception.

Accordingly, the above system of deduction of APIT by the employer does not relinquish the requirement for a resident or citizen employee to register for Income Tax and file a return of income, if such employee has a taxable income for the year of assessment.

Effective date: 1st April 2019

Withholding tax/ AIT

Payments to residents

It has been proposed to abolish the requirement for withholding of tax by the payer, in relation to payment of any dividend, interest, discount, charge, natural resource payment, rent, royalty, premium or retirement payment to a resident person, or payment of specified service fees to a resident individual, where the payment has a source in Sri Lanka.

Effective date: 1st January 2020

However, the requirement to withhold tax on payment of amounts as winnings from a lottery, reward, betting or gambling would continue. Such payments would be considered final withholding payments in the hands of the recipient.

Furthermore, the requirement to withhold tax on the sale price of any gem sold at an auction conducted by the National Gem and Jewellery Authority would also continue.

Introduction of AIT

In lieu of the above withholding tax, an AIT Scheme is proposed to be introduced under which a payer is required to deduct AIT on periodic payments of the above types of returns to resident persons, if the payer has received a request from the recipient for such deduction. Such AIT will be treated as a withholding tax for purposes of the Act.

AIT deducted would be treated as a tax credit which is deductible in calculating self-assessment income tax payments to be made on a quarterly basis by the recipient of the income.

Effective date: 1st April 2020

Payments to non-residents

The requirement to withhold tax on specified payments made to non-residents with a source in Sri Lanka would continue (subject to provisions of the relevant Double Tax Avoidance Treaty). Accordingly, payment of interest/ discounts is liable to withholding Tax at a rate of 5% and any other payment is liable to withholding tax at the rate of 14%.

Such payments subject to withholding tax would be considered final withholding payments in the hands of a recipient who is a non-resident non-citizen, or a non-resident entity (other than payments derived through a Sri Lankan Permanent Establishment).

Payments to non-residents (Cont.)

Interest derived by an individual who is a non-resident citizen would be considered a final withholding payment in the hands of such individual. However, any amount of interest falling within the relief threshold of LKR 3Mn will not be considered a final withholding payment. We note that this provision enables non-resident citizens to benefit from the relief of LKR 3Mn granted to them, since a credit for any tax withheld on such interest not considered as a final withholding payment could then be claimed as a tax credit.

Effective date: 1st January 2020

Rates of Tax

Resident and Non-Resident individuals

1. Normal Tax rate

The previous progressive tax rates applicable to individuals, ranging from 4% to 24%, and the applicable tax slabs of Rs. 600,000 each, are to be revised with effect from 1st January 2020. The revised tax rates and the tax slabs applicable on taxable income of an individual, with effect from 1st January 2020 (subject to the different tax rates on specified terminal benefits, capital gains, profits from gem and jewellery and income from business of betting and gaming, liquor or tobacco) are tabulated below:

Taxable income per year of assessment	Tax rate
First Rs. 3 Million	6%
Next Rs. 3 Million	12%
On the balance	18%

Table A

In arriving at the taxable income of a resident individual or a non-resident citizen of Sri Lanka, the applicable reliefs as detailed in Page 36 of this Alert can be deducted.

2. Terminal Benefits

The following concessionary tax rates will be applicable with effect from 1st January 2020 on specified terminal benefits from employment, i.e. commuted pension, retiring gratuity, ETF or compensation for loss of office or employment approved by the CGIR:

Total terminal benefits per annum	Tax Rate
First Rs. 10 Million	0%
Next Rs. 10 Million	6%
On the balance	12%

Table B

Moreover, any compensation for loss of office which has not been approved by the CGIR, any payment from a provident fund which is not approved by the CGIR, or any other retirement payments including non-cash benefits, are subject to tax as specified in the Table A above.

Effective date: 1st January 2020

Resident and Non-Resident individuals (Contd.)

3. Business of betting and gaming, liquor or tobacco

The higher tax rate of 40% applicable to individuals on income from following businesses will continue:

- a) Business of betting and gaming;
- b) Business of manufacture and sale, or import and sale, of any liquor or tobacco products.

4. Gains on realization of investment assets

We note that gains on realization of investments assets (other than any exempt gains) derived by an individual will continue to be taxed at the rate of 10%.

5. Gains and profits from gems and jewellery

It has been proposed to tax an individual's gains and profits from the consideration received in respect of gems and jewellery at the maximum rate of 14%.

Effective date: 1st April 2020

Partnerships

It has been proposed to make partnerships chargeable to income tax at the tax rate mentioned below, with effect from 1st January 2020:

Taxable Income per year of assessment	Tax Rate
First Rs. 1 Million	0%
On the balance	6%

Effective date: 1st January 2020

Gains on realization of investments assets (other than any exempt gains) derived by a partnership will continue to be taxed at the rate of 10% to the partnership.

Rates of Tax

Trusts

It has been proposed to tax the taxable income of a trust at the rate of 18% with effect from 1st January 2020.

The taxable income of a unit trust or a mutual fund that does not conduct an eligible investment business will be taxed at the rate of 24% with effect from 1st January 2020.

Effective date: 1st January 2020

However, gains on realization of investments assets (other than any exempt gains) derived by the above trusts will continue to be taxed at the rate of 10% .

NGO

The taxable income, and the deemed profits of 3% of amounts received by way of grants, donation, contribution or in any other manner of an NGO will be taxed at the rate of 24% with effect from 1st January 2020.

Effective date: 1st January 2020

However, gains on realization of investments assets (other than any exempt gains) derived by an NGO will continue to be taxed at the rate of 10% .

Rates of Tax

Companies

1. Standard tax rate

The standard tax rate applicable to a company is revised to 24%, with effect from 1st January 2020.

2. Concessionary tax rates

A concessionary tax rate of 14% is granted on the following gains and profits of a company, with effect from 1st January 2020:

- a) Business of an SME (excluding profits from a business of betting and gaming or from sale of liquor);
- b) Conducting a business of sale of goods or merchandise including export of goods, where the payment for such sale or export is received in foreign currency and remitted through a bank to Sri Lanka;
- c) Specified undertaking (as defined in Section 195 of the IR Act);
- d) Provision of educational services;
- e) Undertaking for promotion of tourism;
- f) Provision of construction services;
- g) Agro processing;
- h) Provision of healthcare services;
- i) Dividends received from a resident company;
- j) Gains and profits from consideration received by any export company registered with the Board of Investment of Sri Lanka, in respect of health protective equipment and similar products supplied to the Ministry of Health, Department of Health Services, Sri Lanka Army, Sri Lanka Navy, Sri Lanka Air Force, Sri Lanka Police and COVID Centre.

Effective date: 1st January 2020

For the above purpose, definitions to the terms “manufacture” and “agro processing” have been introduced, and the prevailing definitions of the terms “SME” and “specified undertaking” have been revised (refer Annexure).

Companies (Cont.)

2. Concessionary tax rates (Cont.)

The following concessions on the tax rate/ liability have been afforded to specified companies, with effect from 1st April 2021:

- a) On gains and profits of any company which lists its shares in the CSE between 1st January 2021 and 31st December 2021
 - A 50% reduction of income tax payable (other than on Capital Gains) for the year of assessment 2021/22; and
 - Concessionary tax rate of 14% is applicable for a period of three years of assessment commencing from 1st April 2022
- b) Gains and profits from consideration received by a company in respect of gems and jewellery is liable to a concessionary tax rate of 14%.

Effective date: 1st April 2021

Furthermore, a concessionary tax rate of 18% is granted for gains and profits from the business of manufacturing.

Effective date: 1st January 2020

Previously, a similar concessionary tax rate system was available for companies engaged in specified businesses, if such company was engaged predominantly in the specified business (i.e. if income from the specified business amounted to 80% or more of the gross income of the company). If the company met such criteria, the company was eligible to claim the concessionary tax rate of 14% on the entire taxable income of the company.

We note that the revised scheme provides for concessionary tax rates only to the specified gains and profits derived by a company, and the remainder of the taxable income would be liable to tax at the standard tax rate of 24%.

Companies (Cont.)

3. Business of betting and gaming, liquor or tobacco

The higher tax rate of 40% applicable to companies on gains and profits from the following businesses will continue:

- a) Business of betting and gaming;
- b) Business of manufacture and sale, or import and sale, of any liquor or tobacco products.

4. Export-oriented Multi-National Companies

Income tax payable on gains and profits from dividend by any multi-national company is to be reduced by 25% for the year of assessment 2021/22 and by 50% for the next immediately succeeding two years of assessment, if the multi-national company meets one of the following conditions:

- a) Should have achieved an increase in exports (other than specified undertakings) by 30% in the year of assessment 2021/22 compared to the year of assessment 2020/21; or
- b) Should have achieved an increase in exports (other than specified undertakings) by 50% in the year of assessment 2022/23, compared to the year of assessment 2020/21, and maintains such status in the subsequent year of assessment.

Effective date: 1st April 2021

5. Gains on realization of investment assets

We note that gains on realization of investments assets (other than any exempt gains) derived by a company will continue to be taxed at the rate of 10%.

Rates of Tax - Special sector

Persons engaged in agro farming together with agro processing/ manufacturing

It has been proposed to grant a reduction of 25% on the income tax payable by a person who produces agro farming produce and utilizes same wholly or partly in his agro processing/ manufacturing business activity in Sri Lanka.

The reduction is granted only on the portion of income tax payable relating to the agro processing activity, which utilized the agro farming produce.

Such portion of tax payable is to be calculated as that amount which corresponds to the proportion of the agro farming produce produced by the person to the total farming produce utilized in such agro processing/ manufacturing activity.

Effective date: 1st April 2021

Investment Incentives - Second Schedule

Enhanced capital allowances

It has been proposed to grant enhanced capital allowance to the investor, on investment made into buildings, structures or similar work of a permanent nature constructed on leasehold land.

Effective date: 1st April 2021

Exemption on employment income

It has been proposed to grant an exemption on employment income of expatriate employees of a company subject to the following conditions:

- a) The company has incurred more than USD 250Mn on depreciable assets (other than intangible assets) in Sri Lanka;
- b) Exemption is available during the period in which the payment is made out of profits sheltered by enhanced capital allowances granted to the company, or during the period of 5 years from the commencement of commercial operations, whichever is higher; and
- c) The number of expatriate employees at any time during that period does not exceed 20.

Effective date: 1st April 2021

Exemptions

It has been proposed to amend the IR Act to facilitate the granting of exemptions under the Strategic Development Projects Act No. 14 of 2008.

The following new exemptions have been proposed to be granted with effect from the corresponding dates stated below:

Source	Exemption	Effective Date
Retirement benefits	<ul style="list-style-type: none"> Amounts received on retirement by an employee from a regulated provident fund. 	1 st April 2018
Gains on transfer of immovable properties to SLREIT	<ul style="list-style-type: none"> Any gain made by a person on sale/ exchange/ transfer of land or building to a SLREIT. 	1 st April 2021
Interest income	<ul style="list-style-type: none"> The interest accruing to or derived by any person outside Sri Lanka on any loan granted to any person in Sri Lanka or to the Government of Sri Lanka. 	1 st April 2018
	<ul style="list-style-type: none"> The interest accruing to or derived by any person on moneys lying to his credit in foreign currency in any foreign currency account opened by him or on his behalf, in any commercial bank or in any specialized bank, with the approval of the Central Bank of Sri Lanka. 	1 st January 2020
	<ul style="list-style-type: none"> Interest accruing to or derived by any person from a term deposit account titled as "Special Deposit Account" opened and maintained on or after 8th April 2020 in any designated foreign currency or in Sri Lanka Rupees, with an authorized dealer in Sri Lanka as prescribed by regulations made by the Minister under section 29 read with section 7 of the Foreign Exchange Act No. 12 of 2017 (excluding the subsequently renewed accounts). 	8 th April 2020
	<ul style="list-style-type: none"> Interest accruing to or derived by any welfare society. <p>"Welfare society" has been defined to mean a fund or a society which has been set up or formed for the welfare of its members or their respective families and contributions are made by its members, including benevolent fund which promotes the savings of members, but other than any company which is incorporated or registered under any law in force in Sri Lanka or elsewhere and a partnership.</p>	1 st April 2021

Exemptions

Source	Exemption	Effective Date
Interest income (Contd.)	<ul style="list-style-type: none"> Interest accruing to or derived by a Multi-National Company from foreign currency deposits opened and maintained in any domestic bank, if such deposit is maintained to cover the its import expenditure for that year of assessment. 	1 st April 2021
Interest, discount and gains on realization	<ul style="list-style-type: none"> Interest, discount or any gain on realization of any sovereign bond denominated in local or foreign currency, issued by or on behalf of the Government of Sri Lanka, derived by any non-resident person (other than a Sri Lankan permanent establishment). 	1 st April 2018
	<ul style="list-style-type: none"> Interest or discount derived by any person on any sovereign bond denominated in foreign currency, including Sri Lanka Development Bonds, issued by or on behalf of the Government of Sri Lanka. 	1 st April 2018
	<ul style="list-style-type: none"> Gain on realization of Sri Lanka international sovereign bond issued by or on behalf of the Government of Sri Lanka and received or derived by a commercial bank or authorized dealer whose aggregate investment in to such bonds on or after 1st April 2021 is not less than USD 100Mn. 	1 st April 2021
	<ul style="list-style-type: none"> Interest or discount accruing to or derived by any Samurdhi community-based banks established under the Department of Samurdhi Development, from security or treasury bonds under the Registered Stocks and Securities Ordinance (Chapter 420) or treasury bills. 	1 st April 2021

Exemptions

Source	Exemption	Effective Date
Dividends	<ul style="list-style-type: none"> A dividend paid by a resident company to a member who is a non-resident person. 	1 st January 2020
	<ul style="list-style-type: none"> A dividend paid by a resident company to a member to the extent that dividend payment is attributable to, or derived from, gains and profits from dividend received by that resident company (i.e. pass-through dividends) is exempt. <p>For the above purpose, “gains and profits from dividend” means the dividend received by that company after the deduction of expenses or losses, if any, subject to the provisions of the Act and income tax paid or payable on such dividend received by that company.</p>	1 st January 2020
	<ul style="list-style-type: none"> A dividend paid by a resident company which is engaged in any one or more of the following businesses in accordance with the provisions of the PART IV of the Finance Act No. 12 of 2012 and which has entered into an agreement entered into with the Board of Investment of Sri Lanka: <ol style="list-style-type: none"> entrepot trade involving import, minor processing and re-export; offshore business where goods can be procured from one country or manufactured in one country and shipped to another 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 including bonded warehouse or multi- country consolidation in Sri Lanka. 	1 st January 2020
Dividend and gains on realization	<ul style="list-style-type: none"> Dividends, gains on realization of units and gains on realization of capital assets of a business/ investment derived by a unit holder from a SLREIT. 	1 st April 2021
	<ul style="list-style-type: none"> Dividends from, and gains on the realization of, shares in a non-resident company where derived by any person with respect to a substantial participation in the non-resident company. <p>“Substantial Participation” means holding 10% or more of the value of shares in the company, excluding redeemable shares, together with control, either directly or indirectly, of 10% or more of the voting power in the company.</p>	1 st April 2018

Exemptions

Source	Exemption	Effective Date
Profits from business of Agro Farming	<ul style="list-style-type: none"> Any gains and profits derived by any person from the sale of produce of "Agro Farming" of such person will be exempt for a period of 5 years commencing from 1st April 2019. <p>For the above purpose, the term "Agro farming" has been defined (refer Annexure).</p> <p>Where the person utilizes his agro farming produce in his activities of agro processing/ manufacture, the agro farming produce will be deemed to be sold at the market price to the agro processing/ manufacture activity, and the profits of agro farming thus calculated will be exempt during the said period.</p>	1 st April 2019
Profits from business of providing Information Technology and enabled services	<ul style="list-style-type: none"> The gains and profits earned or derived by any person from providing Information Technology and enabled services as may be prescribed is exempt from income tax. <p>We note that the DIR has not yet prescribed the scope of "Information Technology and enabled services" for above purpose.</p>	1 st January 2020
Profits from Business of gold, gem and jewellery	<ul style="list-style-type: none"> Gains and profits derived by any person from following businesses, where the gains and profits earned in foreign currency are remitted through a bank to Sri Lanka, would be exempt: <ol style="list-style-type: none"> export of gold, gems or jewellery; or cutting and polishing of gems which are brought to Sri Lanka and exported after such cutting and polishing. 	1 st April 2021
Profits from business of export of services	<ul style="list-style-type: none"> The gains and profits earned or derived by any person from any service rendered in or outside Sri Lanka to any person to be utilized outside Sri Lanka, where the payment for such services is received in foreign currency and remitted through a bank to Sri Lanka. 	1 st January 2020
Other foreign sources of income	<ul style="list-style-type: none"> The gains and profits earned or derived by any person from any foreign source [other than gains and profits referred to under "Profits from business of export of services" above], where such gains and profits are earned or derived in foreign currency and remitted through a bank to Sri Lanka. 	1 st January 2020

Exemptions

Source	Exemption	Effective Date
Profits derived by Vocational Education Institutions	<ul style="list-style-type: none"> Gains and profits earned or derived by any Vocational Education Institution which is standardized under TVET concept and regulated by Tertiary and Vocational Education Commission will be exempt for a period of 5 years commencing on 1st April 2021, subject to specified conditions. 	1 st April 2021
Grants or donations received by religious institutions	<ul style="list-style-type: none"> Grants or donations derived by any religious institution which is registered with the Ministry in charge of the subject of religious affairs. 	1 st January 2020
Laboratory or standards certification services	<ul style="list-style-type: none"> Any amount derived by any non-resident person from laboratory services or standards certification services. 	1 st January 2020
Service providing to Sri Lankan Airlines Limited	<ul style="list-style-type: none"> Any amount derived by any non-resident person as any payment for aircraft, software licenses or as for other related services from Sri Lankan Airlines Limited 	1 st April 2018
Sums received by a Public Corporation	<ul style="list-style-type: none"> Any sum received by any Public Corporation out of the funds voted by Parliament from the Consolidated Fund or out of any loan arranged through the Government. 	1 st April 2018

Exemptions

Exemptions have been proposed to be granted from 1st April 2021, on the profits from business of the following new undertakings, other than any gains from realization of capital assets and liabilities of the business:

Source	Exemption	Effective Date
Profits from business derived by a new undertaking for recycling of construction materials	<ul style="list-style-type: none"> 10 year tax exemption for an undertaking which sells construction materials recycled in a selected separate site in Sri Lanka, which has been established to recycle the materials that have been already used in the construction industry. <p>In the event, the recycled material are used by the same person for the provision of construction services, the exemption can be claimed on the profits from the undertaking of recycling ascertained based on the market price.</p>	1 st April 2021
Profits from business of a new undertaking of an individual who completed vocational education	<ul style="list-style-type: none"> 5 year tax exemption for any business commenced by an individual after successful completion of vocational education from any Vocational Education Institution which is standardized under TVET Concept and regulated by the Tertiary and Vocational Education Commission. 	1 st April 2021
Profits from business of operating bonded warehouses	<ul style="list-style-type: none"> An undertaking for letting bonded warehouses or warehouses related to the offshore business in the Colombo or Hambantota Ports, for investments on or after 1st April 2021. 	1 st April 2021
Profits from business of manufacture and sale of boats and ships	<ul style="list-style-type: none"> 7 year tax exemption for an undertaking commenced by a resident person for manufacture and sale of boats or ships. 	1 st April 2021
Profits from business of a renewable energy project	<ul style="list-style-type: none"> 7 year tax exemption for any renewable energy project supplying power to the national grid, with a capacity to generate not less than 100MW solar or wind power. 	1 st April 2021

Exemptions

Source	Exemption	Effective Date
Profits from business of constructing and installing communication towers and related appliances	<ul style="list-style-type: none">5 year tax exemption for an undertaking commenced by a resident person on or after 1st January 2021 for constructing and installing of communication towers and related appliances using local labour/ raw materials in Sri Lanka, or providing required technical services for such construction/ installation.	There is an ambiguity as to when the exemption is effective, i.e. whether on 1 st January 2021 or 1 st April 2021

Qualifying Payments and Reliefs

It has been proposed to grant deductions for the following new qualifying payments or reliefs in ascertaining taxable income of an eligible person, with effect from the corresponding dates specified below:

Eligible person	Qualifying payment	Effective Date
Public corporation	<ul style="list-style-type: none"> Any sum paid to the Consolidated Fund or to the President's Fund. 	1 st April 2019
Resident individual	<ul style="list-style-type: none"> Contribution made in money or otherwise to establish a shop for a female individual who is from a Samurdhi beneficiary family as recommended and confirmed by the Department of Samurdhi Development. 	1 st April 2021
Financial institution	<ul style="list-style-type: none"> Expenditure incurred by any financial institution by way of cost of acquisition or merger of any other financial institution where such cost is ascertained by considering all the facts on case-by-case basis and as confirmed by the Central Bank of Sri Lanka, subject to the following restrictions: <ul style="list-style-type: none"> The expenditure will be apportioned in equal amounts over a period of 3 years of assessment and be deducted from the assessable income of the financial institution in each such year of assessment commencing from the year of assessment during which the expenditure is incurred; Any amount which was not deducted during the 3 years period due to the total assessable income in a year being less than the above permitted deduction, should be deducted in the year of assessment immediately after the 3 years period and so on. 	1 st April 2021
Any person	<ul style="list-style-type: none"> Expenditure incurred for the following in relation to the film industry upto 1/3 of the taxable income of the year (with permission to carry forward and claim any excess): <ul style="list-style-type: none"> In production of film at a cost of (including promotional expenses) not less than LKR 5Mn. In the construction and equipping of a new cinema at a cost not exceeding LKR 25Mn as certified by the National Film Corporation of Sri Lanka; In the upgrading of a cinema at a cost not exceeding LKR 10Mn as certified by the National Film Corporation of Sri Lanka. 	1 st April 2021

Qualifying Payments and Reliefs

Eligible person	Relief	Effective Date
Sri Lankan citizens	<ul style="list-style-type: none"> • A personal relief of LKR 3Mn per year of assessment. <p>This has been granted in lieu of the previous general relief of LKR 500,000 granted to citizens of Sri Lanka, the relief of LKR 700,000 granted against employment income to resident individuals, and the relief of LKR 1.5Mn granted against interest income to senior citizens.</p>	1 st January 2020
Resident individuals	<ul style="list-style-type: none"> • A relief up to LKR 1.2Mn in relation to the following expenditure incurred by such individual during a year of assessment: <ol style="list-style-type: none"> a) Health expenditure including contributions to medical insurance; b) Vocational education or other educational expenditure incurred locally by such individual or on behalf of his/her children; c) Interest paid on housing loans; d) Contributions made to any local pension scheme other than for a scheme under the employer or on behalf of employer, by an employee; e) Expenditure incurred for the purchase of shares or any other financial instrument listed in the CSE or treasury bonds or treasury bills. 	1 st January 2020
Resident individuals	<ul style="list-style-type: none"> • Expenditure incurred on acquisition of solar panels or on amounts paid to a bank in respect of any loan obtained to finance such acquisition, where such solar panels have been acquired to fix on his premises and connected to the national grid, upto LKR 600,000 per year of assessment. 	1 st April 2021

Temporary Concessions – Sixth Schedule

It has been proposed to modify/ grant the following temporary concessions under the Sixth Schedule to the Act, with effect from the dates specified below:

Source	Details of exemption	Effective Date
Enhanced Capital allowance	<ul style="list-style-type: none"> The validity period of the temporary concession granted in the form of enhanced capital allowances for investments up to USD 3Mn has been extended by an additional period of 3 years (i.e. to expire on 1st April 2024). 	1 st April 2018
Research and Development Expenses	<ul style="list-style-type: none"> The validity period of the temporary concession granted in the form of an additional deduction for Research and Development Expenses in calculating a person's income from business has been extended by an additional 2 years (i.e. to expire on 1st April 2023). 	1 st April 2018
Interest on underpayment/ late payment of taxes	<ul style="list-style-type: none"> Interest will not be charged by the DIR for any delays in payment of tax by a person which were due during the period from 1st March 2020 to 30th September 2020. 	1 st March 2020
Marketing and communication expenses	<ul style="list-style-type: none"> An additional deduction of 100% for marketing and communication expenses incurred by a person subject to conditions has been proposed to be granted as a temporary concession (refer Page 7 for details). 	1 st April 2021

Administrative provisions

Statutory deadline for filing Capital Gains Tax return

It has been proposed to revise the due date by which a person is required to file a Capital Gains Tax return, whereby such return should be filed within thirty days after the end of the relevant calendar month in which the realization of the asset occurred. The payment of Capital Gain Tax also should be made within such revised period.

Accordingly, a single Capital Gains Tax return can be filed for all transactions during a particular month.

Use of TIN in all correspondence

It has been proposed to make it mandatory for taxpayers to use the TIN in all tax related correspondence and source documents/ underlying documents of the taxpayer.

E-filing of tax return

It has been proposed to make it mandatory for filing of tax returns electronically via the use of a computer system or mobile electronic device for resident and non-resident companies, and for public corporations.

Appeals to Tax Appeals Commission

It has been proposed to extend the time period for the CGIR to communicate his decision on a request for administrative review. Accordingly, an appeal can be made to the Tax Appeals Commission only after a decision from the CGIR has been received or after the lapse of 7 months (previously 90 days) since the request for administrative review was made.

Effective date: 1st April 2021

Administrative provisions

Preparation of financial statements

A company is required to maintain and prepare separate financial statements for the different activities and sources via which it derives taxable income taxed at different rates.

Interest on refundable amounts

It has been proposed to extend the grace period enjoyed by the DIR for payment of interest on refundable amounts to a taxpayer. Accordingly, the DIR is not required to pay interest on refunds processed within 6 months (previously 60 days) of the filing of the claim for refund.

Requirement for signing the tax return

It has been proposed to make it mandatory for a person who has assisted to prepare or fill a tax return for a payment, to sign such tax return.

Punitive provisions in relation to auditors and tax consultants

Punitive provisions have been proposed to be introduced for intentional disregards/ misinterpretation of the law and fraudulent preparation/ certification of information by auditors and tax practitioners.

Effective date: 1st April 2021

Tax relief measures due to Covid-19

- The following tax reliefs have been proposed to be granted to facilitate post Covid-19 economic recovery:
 1. The CGIR to write off any income tax arrears payable by an SME (considered SME for the year of assessment 2019/20), if same has arisen due to any assessment made up to the year of assessment 2018/19 (other than assessments made for tax payment as per the return excluding penalties), which is outstanding as at 26th June 2020, subject to the deduction of any tax refunds (including refunds from other taxes administered by the CGIR) duly claimed by such person from such income tax arrears.
 2. No assessments will be raised for SMEs who have filed the tax return and paid the tax declared in the return for the year of assessment 2019/20, unless the DIR deems that there is fraud or willful neglect involved.
 3. The CGIR will not impose any penalty or initiate criminal proceedings against a person who has filed his tax return for the year of assessment 2019/20 before 30th June 2021, and made the final payment of tax (which was due by 30th September 2020) before 30th June 2021.

Annexure - Definitions

Agricultural business

The term “Agricultural business” has been defined to mean “the business of agro farming or agro processing, but excludes farming of, or processing of liquor or tobacco produces or products, as the case may be”.

1. Agro farming

The term “Agro farming” has been defined to mean:

- “the tillage of the soil and cultivation of land with plants of any description, cultivation in green house, bee-keeping, rearing of fish, shrimp farming or animal husbandry, poultry farms, hatchery, veterinary or artificial insemination services;
- the cleaning, sizing, sorting, grading, cutting or chilling of any produce produced out of any activity referred to in paragraph (a) by any person who is engaged in any such activity, in preparation of such produce for the market but excludes the agro or food processing”.

2. Agro processing

The term “Agro processing” has been defined to mean “the processing of any locally produced agricultural, fishing, or animal product and includes an undertaking for the dehydrating, milling, packaging, canning for the purpose of changing the form, contour or physical appearance of such product in preparation for the market but excludes an undertaking of deep-sea fishing or manufacturing”.

Effective date: 1st April 2019

Manufacture

The term “Manufacture” has been defined to mean “a change in a non-living physical object, article or thing-

- a) resulting in transformation of such object, article or thing into a new and distinct object, article or thing having a different name, character or use; or
- b) bringing into existence of a new and distinct object, article or thing with a different chemical composition or integral structure”

Effective date: 1st January 2020

Annexure - Definitions

SME

The term “Small and Medium Enterprise” has been defined to mean “a person who satisfies the following conditions:

- a) the person who conducts business solely in Sri Lanka other than an individual who is engaged in providing professional services individually or in partnership being an individual who is professionally qualified;
- b) the person does not have an associate that is an entity unless such person’s and associate’s aggregate annual gross turnover is less than Rs. 500, 000,000; and
- c) the person’s annual gross turnover is less than Rs. 500,000,000”.

Effective date: 1st April 2020

Specified undertaking

The term “Specified undertaking” has been defined to mean “an undertaking which is engaged in –

- a) entrepot trade involving import, minor processing and re-export;
- b) offshore business where goods can be procured from one country or manufactured in one country and shipped to another country without bringing the same into Sri Lanka;
- c) providing front end services to clients abroad;
- d) headquarters operations of leading buyers for management of financial supply chain and billing operations;
- e) logistic services such as bonded warehouse or multi-country consolidation in Sri Lanka;
- f) transshipment operations;
- g) freight forwarding;
- h) 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;

Annexure - Definitions

Specified undertaking (Cont.)

- i) production or manufacture, and supply to an exporter of non-traditional goods; and
- j) the performance of any service of ship repair, ship breaking repair and refurbishment of marine cargo containers, provision of computer software, computer programmes, computer systems or recording computer data, or such other services as may be specified by the Minister by notice published in the Gazette, for payment on foreign currency;
- k) sale for foreign currency, of any gem or jewellery, being a sale made in Sri Lanka by any person authorized by the Central Bank of Sri Lanka to accept payment for such sale in foreign currency;
- l) sale of goods manufactured in Sri Lanka by an export-oriented company which has entered into an agreement with the Board of Investment of Sri Lanka under section 17 of the Board of Investment of Sri Lanka Law No. 4 of 1978, to-
 - i. any company which has entered into an agreement with the Board of Investment of Sri Lanka under section 17 of the Board of Investment of Sri Lanka Law No. 4 of 1978 including a company enjoying tax holidays under the Strategic Development Projects Act No. 14 of 2008 and which is permitted to import project related goods or raw materials on duty free basis under the provisions of such agreement, during the project implementation period; or
 - ii. any person eligible to import specific goods on duty free basis under any Government Authority,but, up to the quantity approved by the Board of Investment of Sri Lanka as import replacement within the three years period commencing on 1st April 2021;
- m) bunkering services provided for the supply of marine fuel, including the supply of marine fuel to local bunker suppliers within a specified port premises

Effective date: 1st April 2021

Glossary

Advance Income Tax	AIT
Advance Personal Income Tax	APIT
Colombo Stock Exchange	CSE
Commissioner General of Inland Revenue	CGIR
Department of Inland Revenue	DIR
Million	Mn
Multi-National Corporation	MNC
Non-Governmental Organization	NGO
Pay-As-You-Earn Tax	PAYE Tax
Real estate investment trust listed in the Colombo Stock Exchange and licensed by the Securities and Exchange Commission of Sri Lanka	SLREIT
Securities and Exchange Commission of Sri Lanka	SEC
Small and Medium Enterprise	SME
Technical and Vocational Education and Training	TVET



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