

Imposition of Income Tax

Chartered Accountancy Strategic Level Corporate Taxation (TAX)

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1. IMPOSITION OF INCOME TAX

1.1.Charging Section

Section 2 of the Inland Revenue Act No. 24 of 2017, imposes the liability to pay income tax on every person;

- (i) who has a taxable income for that year
- (ii) who receives a final withholding payment during that year

This section is the main charging section of the Act. This section will provide answers for the following questions;

- Who is liable to pay income tax?
- When does income tax have to be paid?
- On what is the tax liability imposed?
- At what rate does the tax have to be paid?

Who is liable to pay income tax?

It is important to clarify and understand as to who is liable to pay income tax. The law clearly specifies “a person” is liable to pay income tax.

Therefore, it is necessary to determine who falls within the meaning of “person” for the imposition of income tax. The word “person” is defined as follows.

“Person” means an individual or entity and includes a body of persons corporate or unincorporated, an executor, non-governmental organization and charitable institution”

The words “Entity” and “body of persons” are defined as follows;

“entity”	means a company, partnership or trust, but excludes an individual.
“Body”	means a company, partnership, trust or other body of persons whether formed in Sri Lanka or elsewhere.”
“company”	(a) means a corporation, unincorporated association or other body of persons; (b) includes - (i) a friendly society, building society, pension fund, provident fund, retirement fund, superannuation fund or similar fund or society; and (ii) a government excluding the Sri Lankan government, a political sub-division of a government, or a public international organization; but (c) excludes a partnership or trust; and (d) the following shall be deemed to be a company:- (i) a partnership in which at least twenty of the partners have limited liability for the debts of the partnership; and

	(ii) a unit trust or mutual fund to which section 59 applies;
“partnership”	means an association of two or more individuals or corporations carrying on business jointly for the purpose of making profit, irrespective of whether the association is recorded in writing;
“trust”	means an arrangement under which a trustee holds assets;

When does income tax have to be paid?

Year of assessment (Sec 20)

The year of assessment means the period of twelve months commencing on the first day of April of any year and ending on the thirty first day of March in the immediately succeeding year.

In terms of section 20(2) of the IRA, where the following persons are unable to submit the accounts for the period of twelve months of the year of assessment as provided above, such person may apply to the CGIR requesting for the accounts based on an alternative period of twelve months be used to compute the income tax payable for a given year of assessment;

1. A trust
2. A company

Section 203(3) of the IRA of 2006 allowed companies to maintain accounts for an accounting period for a period of 12 months other than the year ending 31st March. Such persons can continue to use the approved accounting period to ascertain their tax liability for a year of assessment. (Public Ruling No. PR/IT/2019/01).

Change of year of assessment/accounting year

The CGIR has issued an approval to ABC (Pvt) Ltd to maintain its books of accounts for the year ending 31st December in each year under section 28 of the IRA of 2006.

Advise ABC (Pvt) Ltd whether they need to prepare separate books of accounts for the year ending 31st March 2022 when filing the Return for the year of assessment 2021/22.

Tax payments (Chapter VIII)

Income tax should be paid in the following methods (Sec 82)

1. Tax payable by withholding
2. Tax payable by instalment
3. Tax payable on assessment
4. In any other case – on the date stated in a notice for payment

Tax payable by withholding

The IRA imposes tax payments by withholding when making the following payments;

1. Withholding by employer – section 83A
2. Withholding from investment returns – section 84A
3. Withholding from service fees and contract payments to non-residents – section 85 (1A)

- **Withholding by employers – Advance Personal Income tax (APIT)**

The IRA requires an employer to deduct an Advance Personal Income Tax w.e.f. 01st April 2020 on any payment that is made to an employee on his employment income if such employee;

- Is a resident and citizen of Sri Lanka - if such employee has given his consent
- Is a non-resident or non-citizen of Sri Lanka - mandatory deduction

The CGIR provides the tax tables based on which the employer is required to deduct tax when making monthly payments to the employees.

- **Withholding from investment returns**

Where any person pays an amount as winnings from a lottery, reward, betting or gambling then such person needs to withhold tax at the prescribed rates.

Advance Income tax (AIT)

A taxpayer who is resident in Sri Lanka may make a request to the withholding agent to deduct Advance Income Tax (AIT) from the following payments which has a source in Sri Lanka;

- Dividend
- Interest
- Discount
- Charge
- Natural resource payment
- Rent
- Royalty

- Premium
- Or similar periodic payment

When a withholding agent receives such a request, the Advance Income Tax shall be deducted as specified by the CGIR.

- **Withholding from service fees and contract payments to non-residents**

When any person pays a service fee with a source in Sri Lanka to a non-resident person, withholding tax has to be deducted at the prescribed rates.

Tax payable by installments

The following persons are required to pay tax by installment if he derives or expects to derive assessable income during a year of assessment;

- a. From a business or
- b. From an investment or
- c. From other income or
- d. From employment where the employer is not required to withhold tax

The above persons are required to pay tax by quarterly instalments

For the year of assessment ending on 31st March

1st installment – on or before 15th August

2nd installment – on or before 15th November

3rd installment – on or before 15th February

4th installment – on or before 15th May

Tax payment due dates

Paarami (Pvt) Ltd. is a company incorporated in Sri Lanka. The estimated income tax liability for the year of assessment 2021/22 is Rs.36,000,000/-.

- (a) Identify the due dates for the payment of income tax for the year of assessment 2021/22, under self assessment
- (b) State the minimum tax payable for each quarter

On what is the tax liability imposed?

Income tax payable by each person for a year of assessment will be as follows;

Tax on taxable income	xxx
Tax on final withholding payment	<u>xxx</u>
Total tax payable	<u>xxx</u>

Every person is liable to income tax on taxable income. The law prescribes that taxable income of a person shall be equal to the total of the person's assessable income arising from the following sources.

1. Employment
2. Business
3. Investment
4. Other sources

Income tax on taxable income is calculated by applying the tax rates specified in the First schedule to the IRA.

Section 2(3)(b) provides certain deductions to be made from the tax payable as follows;

Taxable Income x tax rates as per First Schedule	xxxx
Less : Any Foreign tax credits under section 80	(xxx)
Any other tax credits allowed under the Act	<u>(xxx)</u>
Balance tax payable	<u>xxxx</u>

Foreign Tax credits

Any tax paid in another country can be deducted as a foreign tax credit as per section 80 of the IRA, irrespective of whether there is a double tax agreement with that country or not.

Other tax credits

The IRA allows the following to be deducted as tax credits in computing the balance income tax payable;

- Withholding tax credits
- Tax paid by instalments

Economic Service Charge paid by the person under the ESC Act can also be deducted from the income tax liability.

Computing Balance tax payable

Cinnamon Homes (Pvt) Ltd has computed its taxable income to be Rs. 65 Million for the year of assessment 2021/22. The company is liable to income tax at the rate of 24%. The following information has been provided by the company;

- Self assessment payments made amounting to Rs. 2 million.
- Economic Service Change b/f to the year Rs.3 million

Compute the Balance income tax payable for the year of assessment 2021/22.

At what rate does the tax have to be paid?

The persons are liable for income tax at the rates specified in the First schedule to the Act. There are two types of rates available under the Act as follows;

1. Normal tax rates
2. Special tax rates

Tax rates applicable to a company

The normal corporate income tax rate will be 24%. However, such part of the gains and profits of a company is entitled to be taxed at the following rates;

Description	Tax rate
Small and medium enterprises excluding business of betting and gaming or from the sale of liquor (other than in a business where sale of liquor is merely incidental to another business)	14%
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	14%
Specified undertaking	14%
Providing educational services	14%
An undertaking for the promotion of tourism	14%
Providing construction services	14%
From agro processing	14%
Providing health care services	14%
Dividends received from a resident company	14%
Derived by any export company which is registered with the BOI from the consideration received in respect of health protective equipment and similar products supplied to the Ministry of health, Tri-forces and Police and COVID Center	14%
A company which lists its shares on or after January 1, 2021, but prior to December 31, 2021 in the Colombo Stock	14%

Exchange – for 3 years of assessment commencing from April 1, 2022	
Consideration received in respect of gems and jewellery	14%
From the supply of electricity to the national grid generated using renewable energy resources by a company (w.e.f. April 1, 2021)	14%
From manufacturing (subject to the above)	18%
Conducting betting and gaming	40%
From the manufacture and sale or import and sale of any liquor or tobacco product	40%

The tax liability computed as per the above tax rates, can be further reduced as follows;

- The aggregate income tax payable by any company (other than gains on realization of investment asset) which lists its shares on or after January 1, 2021 but prior to December 31, 2021 in the Colombo Stock Exchange licensed by the Securities and Exchange Commission of Sri Lanka, shall be reduced by 50% for the year of assessment commencing from April 1, 2021
- Where a multi-national company satisfies the following conditions;
 1. An increase in exports (other than specified undertakings) by 30% in the year of assessment from April 1, 2021 compared to the immediately preceding year of assessment (first year)
 2. An increase in exports (other than specified undertakings) by 50% in the year of assessment commencing from April 1, 2022 compared to the first year and maintains such status in the subsequent year of assessment

Income tax payable on the gains and profits from dividends by any multi national company shall be reduced as follows;

- by 25% - for the year of assessment commencing from April 1, 2021
- by 50% - for the 2 years of assessment immediately succeeding that year of assessment

The following definitions are important in deciding the applicable tax rates of a company;

“Small and medium enterprises”	means 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) subject to paragraph (d), the person does not have an associate that is an entity; and (c) the person’s annual gross turnover is less than Rs. 500,000,000;
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	(d) the person's or his associate's aggregate annual gross turnover is less than Rs. 500,000,000, if such associate is an entity or entities
"export"	includes specified undertaking;
"specified undertaking"	<p>means an undertaking which is engaged in –</p> <p>(a) entrepot trade involving import, minor processing and re-export;</p> <p>(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;</p> <p>(c) providing front end services to clients abroad;</p> <p>(d) headquarters operations of leading buyers for management of financial supply chain and billing operations;</p> <p>(e) logistic services such as bonded warehouse or multi-country consolidation in Sri Lanka;</p> <p>(f) transshipment operations;</p> <p>(g) freight forwarding;</p> <p>(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;</p> <p>(i) production or manufacture, and supply to an exporter of non-traditional goods; and</p> <p>(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;</p> <p>(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;</p> <p>(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-</p> <p>(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</p>

	<p>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</p> <p>(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 April 1, 2021;</p> <p>(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;</p>
undertaking for the promotion of tourism	<p>means an undertaking for the operation of-</p> <p>(a) any hotel or guest house approved by the Ceylon Tourist Board;</p> <p>(b) any restaurant graded by the Ceylon Tourist Board as being in "Class A" or "Class B";</p> <p>(c) any business of travel agent who provides travel management services for domestic travel in Sri Lanka;</p> <p>(d) any business of transporting tourists only; or</p> <p>(e) any business approved by the Ceylon Tourist Board for providing facilities for recreation or sports;</p>
Agro processing	<p>means 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;</p>
Manufacturing	<p>means a change in a non-living physical object, article or thing-</p> <p>(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</p> <p>(b) bringing into existence of a new and distinct object, article or thing with a different chemical composition or integral structure;"</p>

Tax rates applicable to a company

Determine the tax rate applicable in each of the following situations;

1. A company which is engaged in the business of canning pineapples cultivated in Sri Lanka with an annual turnover for the year ended 31.03.2022 amounting to Rs. 900 million.
2. A company which does not have an associate is engaged in the manufacture of consumables with turnover for the year ended 31.03.2022 amounting to Rs. 450 million.
3. A company has a turnover of Rs. 600 Mn from the business of providing educational services for the year ended 31.03.3022.
4. A company is engaged in selling goods to exporters as ra material. The invoices are issued in USD and the payment is received in USD though a bank in Sri Lanka.
5. A company which does not have an associate is engaged in the business of selling imported foods with turnover for the year ended 31.03.3022 amounting to Rs. 400Mn.
6. A company being a subsidiary company has a total gross income from washing garments amounting to Rs. 150 Mn. The parent company which is engaged in the business of buying and selling garments in the domestic market has a turnover of Rs. 200 Mn for the year ended 31.03.2022.
7. A company which is engaged in the business of freight forwarding with a turnover of Rs. 750 Mn for the year ended 31.03.2022
8. A company being a subsidiary company which is engaged in the business of transporting tourists with a turnover of Rs. 225 Mn for the year ended 31.03.2022. The parent company has a turnover of Rs. 600 Mn.
9. A company engaged in the business of manufacture of consumables for export and local market, where the export turnover is 60% of the total income.
10. A company being a subsidiary company is engaged in providing construction services with a turnover of Rs. 575Mn.

Tax concessions

Tax concessions fall into two categories;

1. Exemptions
2. Reduced tax rates

Exemptions

The income which is specifically exempt as specified in the Third schedule to the Act will be excluded from liability for income tax, even though such income will fall within any one of the sources of income. Such exemptions are discussed under each source of income in the relevant chapters.

Exemptions applicable to companies

i. Providing information technology and enabled services as may be prescribed

A company providing information technology and enabled services will be exempt from income tax.

providing information technology means -

(a) software development services; or

(b) the provision of information technology services under a business process outsourcing arrangement or a knowledge process outsourcing arrangement;

Enabled services has been provided by Extra ordinary gazette No. 2234-6 dated 29th June 2021.

ii. Services rendered to persons outside Sri Lanka

Where a company provides any services 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 will be exempt.

iii. Any foreign source income

Any foreign source income where such gains and profits are earned or derived in foreign currency and remitted through a bank to Sri Lanka is exempt from income tax.

iv. Sale of produce from agro farming

The gains and profits from the sale of produce from agro farming of a company within a period of 5 years of assessment commencing from April 1, 2019 will be exempt.

“agro farming” means-

(a) 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;

(b) 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;

Agro farming and Agro processing

Where a company engaged in production of agro farming produces and utilizing such produce to agro processing or manufacture of any product, such produce shall be deemed to have been sold for the agro processor or manufacturer at the market price prevailing at the time of such deemed sale, and the gains and profits computed on the basis of such deemed sale in relation to the agro farming shall be considered as exempt gains and profits within the period of five years of assessment commencing on April 1, 2019;

v. Interest income

- On money in foreign currency in any foreign currency account opened in any commercial bank or specialised bank, with the approval of the Central Bank of Sri Lanka
- From a term deposit account titled as "Special Deposit Account" opened and maintained with an authorized dealer in Sri Lanka
- Any multi-national company on any deposit opened and maintained in foreign currency in any domestic bank, if such deposit is maintained to cover its import expenditure for that year of assessment, on or after April 1, 2021

("multi-national company" means a company that is part of a group of associated companies, with business establishments in two or more countries")

vi. Dividend income

- Paid by a resident company from dividend received by that company
- Paid to a non-resident shareholder
- Paid by a resident company which is engaged in any one or more of the following businesses
 - o Entrepot trade involving import, minor processing and re-export;
 - o 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;
 - o providing front-end services to clients abroad;
 - o headquarters operations of leading buyers for management of financial supply chain and billing operations;
 - o logistics services including bonded warehouse or multi-country consolidation in Sri Lanka

Reduced rates

There are instances where certain income is liable to income tax at reduced rates. Such instances are also discussed under each source of income in the relevant chapters.

1.2. Taxable Income (Section 3)

Taxable income = Total of the person's assessable income for the year of assessment
- (Qualifying payments and reliefs)

The IRA specifies that the taxable income of each person and the assessable income from each source is to be calculated separately.

Section 52 has listed out the Qualifying payments and reliefs that are allowed as a deduction when calculating the taxable income of a person. The specific qualifying payments and the reliefs have been listed in the Fifth schedule to the IRA.

A. For individual or entity (section 52(1))

The aggregate qualifying payments referred to in the Fifth schedule shall be deducted in arriving at the taxable income.

1. The qualifying payments referred to in section 52 shall be as follows:

(a) a donation made by an individual or entity in money to an approved charitable institution that is:

(i) a charitable institution established for the provision of institutionalized care for the sick or the needy; and

(ii) declared by the Minister as an approved charitable institution for the purposes of this sub-paragraph, subject to a maximum of –

(iia) in the case of an individual, one-third of the taxable income of the individual or Rupees seventy five thousand, whichever is less;

(iib) in the case of an entity, one-fifth of the taxable income of the entity or Rupees five hundred thousand, whichever is less;

(b) a donation made by an individual or entity in money or otherwise to the following:-

(i) the Government of Sri Lanka;

(ii) a local authority;

(iii) any Higher Education Institution established or deemed to be established under the Universities Act, No. 16 of 1978;

(iv) the Buddhist and Pali University of Sri Lanka or any Higher Educational Institution established by or under the Buddhist and Pali University of Sri Lanka Act, No. 74 of 1981;

(v) a fund established by the Government of Sri Lanka;

(vi) a fund established by a local authority and approved by the Minister;

- (vii) the Sevana Fund created and administered by the National Housing Development Authority established by the National Housing Development Authority Act, No. 17 of 1979;
 - (viii) a fund established by a Provincial Council and approved by the Minister;
 - (ix) the Api Wenuwen Api Fund established by the Api Wenuwen Api Fund Act, No. 6 of 2008;
 - (x) National Kidney Fund established under the National Kidney Foundation of Sri Lanka (Incorporation) Act, No. 34 of 2006;
- (c) profits remitted to the President's Fund established by the President's Fund Act, No. 7 of 1978 by a public corporation as required by the law by or under which such corporation is established.
- (d) with effect from April 1, 2021, contribution made by a resident individual 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;
- (e) with effect from April 1, 2021, 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. Such deductible

expenditure shall be apportioned in equal amounts over a period of three years of assessment and be deductible from the assessable income of that financial institution in each such year of assessment commencing from the year of assessment where the expenditure is incurred:

Provided however, any amount which was not deducted during the three years period, by reason of the total assessable income in a year has not exceeded the above permitted deduction, shall be deducted in the year of assessment immediately after the three years period and so on;

- (f) expenditure incurred on or after April 1, 2021, by any person-
- (i) in the production of a film at a cost of (including promotional expenditure of such film) not less than five million rupees;
 - (ii) in the construction and equipping of a new cinema at a cost of not exceeding twenty-five million rupees;
 - (iii) in the upgrading of a cinema at a cost of not exceeding ten million rupees:

Provided that, the deduction under this subparagraph shall be restricted

to one third of the taxable income of the year of assessment, and any amount which is not deducted in current year may be carried forward and deducted in the next succeeding year and so on, subject to the same restriction.

"film" means any audio-visual presentation of the moving image

produced on any form or format whatsoever and which is intended

primarily to be exhibited by projection on a screen in a cinema; and the expenditure on construction and equipping or upgrading a cinema shall be certified by the National Film Corporation of Sri Lanka established by the National Film Corporation of Sri Lanka Act, No. 47 of 1971 as being equipped with digital technology, Digital Theatre Systems and Dolby Sound Systems.

Qualifying Payments

Assess the taxable income in the following situations;

1. A company has made donation of Rs. 500,000 in cash to an approved charitable institution established for orphans and provided beds to the orphanage amounting to Rs. 350,000. The company has also donated Rs. 1 Mn to the Sevana Fund. The taxable income of the company for the year of assessment 2021/22 is Rs. 7.5 Mn.
2. A company has made a donation to the Government during the year of assessment 2021/22 amounting to Rs. 7.5 Mn. The company does not have any taxable income during the year of assessment 2021/22.

B. For an individual who is resident in Sri Lanka (section 52(2))

The aggregate reliefs referred to in the Fifth schedule shall be deducted in arriving at the taxable income.

The reliefs referred to in section 52 shall be as follows:

1. Rs. 3,000,000, for each year of assessment commencing on or after January 1, 2020, except that an individual who is a trustee, receiver, executor or liquidator shall not be entitled to deduct this personal relief as such trustee, receiver, executor or liquidator, and the relief shall not be deducted against gains from the realisation of investment assets;
2. in the case of an individual with rental income from an investment asset, an amount equal to 25 percent of the total rental income for the year of assessment, being a relief for the repair, maintenance, and depreciation relating to the investment asset, but shall only be allowed to the extent no deduction or cost is claimed for any actual expenditures incurred by the taxpayer for the repair, maintenance, and depreciation of the investment asset;
3. in the case of a resident individual, following expenditure up to a total sum of Rs. 1,200,000, incurred for a year of assessment on or after January 1, 2020: -
 - (i) health expenditure including contributions to medical insurance;

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

4. in the case of a resident individual who has acquired solar panels to fix on his premises and connected to the national grid, Rs. 600,000 for each year of assessment, up to the total expenditure on such solar panels or up to the amounts paid to a bank in respect of any loan obtained to acquire such solar panels.

1.3. Assessable Income (Section 4)

A person's assessable income will arise from the following sources.

Employment Income	xxx
Business Income	xxx
Investment Income	xxx
Income from other sources	<u>xxx</u>
TOTAL ASSESABLE INCOME	<u>xxx</u>

Assessable Income of a person for a year of assessment from each source is based on such person's residence status.

Resident and Non-resident persons

For income tax purposes, a person will be recognized as;

- a. A resident person
- b. A non-resident person

A **resident person** is liable for income tax in Sri Lanka on the income of that person, wherever the source arises. This means that such person is liable for income tax on the sources of income in Sri Lanka and outside Sri Lanka.

A **non-resident person** is liable to income tax on the income of such person to the extent that the income arises in or is derived from a source in Sri Lanka.

The Act in section 73 lists the payments that have a source in Sri Lanka. This includes;

- Payments received in respect of employment to the extent derived in respect of employment in Sri Lanka or paid by the Government of Sri Lanka
- Dividends paid by a resident company
- Interest, charges, annuities, a royalty, technical service fee or similar payment paid by a resident or paid by a non-resident as expenses of a business having a permanent establishment in Sri Lanka
- Winnings from lottery, betting, or gambling relating to a game of chance held in Sri Lanka
- Natural resource payments made in respect of natural resources taken from land or sea situated within Sri Lanka or its territorial waters
- Rent paid for the use of, right to use or forbearance from using an asset situated in Sri Lanka

Any payments that do not have a source in Sri Lanka will be treated as foreign sourced.

Resident status of a company

In determining the tax liability of a company it is important to determine if such company is a resident or non resident of Sri Lanka.

A company will be considered to be a resident in Sri Lanka for a year of assessment if;

- (a) it is incorporated or formed under the laws of Sri Lanka;
- (b) it is registered or the principal office is in Sri Lanka; or
- (c) at any time during the year the management and control of the affairs of the company are exercised in Sri Lanka.

A resident company will be liable to pay income tax on its "global income" wherever arising, whereas a non resident company will only be required to pay income tax on income arising in or derived from Sri Lanka.

Residency status of a company

Assess the income of which the following entities will be liable to pay income tax in Sri Lanka;

1. A company resident in Sri Lanka has provided consultancy services via its branch in Maldives. The total fee income for the year of assessment 2021/22 is USD 100,00.
2. A non-resident company situated in India, has carried out business in Sri Lanka through a permanent establishment in Sri Lanka and the profit from the business in Sri Lanka is USD 150,000.

1.4.Final Withholding payments (section 88)

Tax on final withholding payments = Final withholding payment x tax rate

The following payments have been specified as final withholding payments;

- (a) amounts paid as winnings from a lottery, reward, betting or gambling, other than amounts received in conducting a business consisting of betting and gaming;
- (b) payments made to a non-resident person who is not a citizen of Sri Lanka or to a non-resident entity that is subject to withholding under this Division, other than payments derived through a Sri Lankan Permanent Establishment; and
- (c) interest paid to or treated as being derived by a non-resident individual who is a citizen of Sri Lanka:

Provided however, the following interest amounts shall not be deemed as final withholding payments to such non-resident individual who is a citizen of Sri Lanka: -

- (i) such amount of interest paid and falling within the relief threshold in paragraph 2(a) of the Fifth Schedule to this Act; or
- (ii) such amount calculated by deducting the total of other sources of assessable income (total assessable income other than interest) from the relief threshold if the total of assessable income from other sources does not exceed the relief threshold.

Tax rates

The First Schedule to the IRA has specified the following tax rates

- Winning from lottery, reward, betting or gambling 14%
- Payment to non resident person - based on the type of income and/or the applicable double tax treaty
- Interest or discount paid - 5%
- All other payments - 14%

Where the tax has been withheld by the withholding agent on any final withholding payment specified above, it will relieve the withholder from any further tax liability on such income.

Where a withholding agent fails to withhold tax, the withholder shall be jointly and severally liable with the withholding agent for the tax.

The IRA in section 195, provides the following definitions;

“withholder” means a person receiving or entitled to receive a payment from which tax is required to be withheld under this Act; and

“withholding agent” means a person required to withhold tax from a payment under this Act.

CHAPTER REVIEW EXERCISES

1. As per the Inland Revenue Act No. 24 of 2017, the word "Person" includes a company or a body of persons or any government.

State three (03) persons that can be included under the term "a body of persons"

2. Taxable income of a person for a year of assessment comprises with the four main sources of income as per the provisions of the Inland Revenue Act No. 24 of 2017.

Identify the four (04) main sources of income as per the Inland Revenue Act.

3. ABC Inc. is a multinational company based in New Zealand. It has a subsidiary company in Sri Lanka, which was registered on 01st December 2017 under the Companies Act No. 07 of 2007.

Explain the resident status of that subsidiary company for taxation purposes in Sri Lanka.

4. Perera has estimated his income tax liability for the year of assessment 2021/22 as Rs.750,000/-. He has paid Rs.300,000/- for first and second installments.

- (a) Calculate the amount of income tax to be paid as third installment payment.
- (b) State the due date for the payment of third installment payment.

