MEMO

TO : THE MANAGEMENT OF WWPL

FROM : FINANCE MANAGER

DATE : 11TH JUNE 2022

SUBJECT : PENAL PROVISIONS APPLICABE TO RIPs AND RISs

The Extraordinary Gazette No. 1986/9 dated 27th September 2016 has prescribed the regulations that are applicable on the operation of Simplified VAT scheme (SVAT). This regulation provided the obligations of those registered as RIPs and RISs.

Registered Identified Purchases (RIPs)

- Not issuing SVAT credit vouchers to RISs
- Not submitting the specified forms to the CGIR on time
- If the CGIR is given sufficient evidence/complaints from suppliers regarding non-submission of credit vouchers on time, then the CGIR can issue assessments.
- Not approving the SVAT form 04 on time
- Not submitting schedule SVAT 06 on time

Registered Identified Suppliers (RISs)

- No suspended invoices to be issued for exempt supplies
- Negligence in issuing suspended tax invoices, updating SVAT 04 AND SCHEDULE svat 05, 05a, 05b and SVAT 07 to the CGIR on time.

Investment of Rs. 240 million

The IRA does not provide any tax exemptions or tax holidays for the industry that WWPL operates in. However, the Second schedule to the IRA provided certain investment incentives in the form of enhanced capital allowances.

The proposed investment is Rs. 240 Million which is approximately, USD 685,000. The second schedule only provides investment incentives for investments of more than USD 3 million. Therefore, the investment made by WWPL will not be entitled to the investment incentives provided under the second schedule.

However, the Sixth schedule on Temporary concessions provide that an investment up to USD 3 million will qualify for enhanced capital allowances of 100% for expenses incurred on depreciable assets that are specified and are used in a part of Sri Lanka, other than the Northern province. If the assets are used in the Northern province, then the enhanced capital allowances will be at 200%. The depreciable assets that are specified for this purpose are;

- Class 1 – Computers and data handling equipment together with peripheral devices

- Class 4 – buildings, structures and similar works of a permanent nature

In order to qualify for the above enhanced capital allowances, the entire investment has to be in acquiring the above specified depreciable assets and the enhanced capital allowances will only be available for these assets.

The schedule also specifies that the investment will not be available for the expansion of an existing business. Therefore, WWPL will have to consider making the investment through a newly incorporated company and it should not be an expansion of its existing business.

The above concessions are only available up to 07 years from the date of operation of the IRA No. 24 of 2017 as per section 201.

Use of the concessionary rate of 14% as an exporter

The IRA in the First schedule provides the tax rates that are applicable to a company. In this schedule, concessionary rate of 14% is available for the year of assessment 2018/19 for any company engaged predominantly conducting a business of exporting goods and services. "predominantly" has been defined to mean 80% or more calculated based on gross income. Based on the turnover reported by WWPL the % from turnover is as follows;

	Turnover	%
Direct export sales	113,000	11.66
Indirect exports – SVAT sales to exporters	454,000	46.83
Indirect exports – SVAT sales to indirect exporters	268,400	27.69
Local sales	134,000	13.82
TOTAL SALES	**969,400**	

Section 195 defines, 'export' includes specified undertaking. The definition of specified undertaking includes production or manufacture, and supply to an exporter of non-traditional goods. Therefore, the SVAT sales to exporters can be considered as "exports" but the SVAT sales to indirect exporters cannot be treated as "export'. Therefore, the total turnover from "export' as defined for WWPL for the Y/A 2018/19 is only 58.49%. This is less than the 80% threshold. Therefore, WWPL cannot claim the concessionary rate of 14% given to exports.

WWPL can consider doing its local sales through a different entity which will help the company to reach the threshold. However, it has to calculate the impact of this decision considering other factors like, liability for VAT, additional administrative effort, transfer pricing implications etc. However, w.e.f. 01st January 2020 the predominantly rule has been abolished. Therefore, the 14% concessionary rate for exports can be applied proportionately to the turnover generated from exports and sales to exporters. The balance taxable income will be subject to income tax at the normal corporate income tax rate of 24%.

REVISION – NON RESIDENT

- The Inland Revenue Act No. 24 of 2017 ("IRA") in section 4 specifies that a non resident person will be liable for income tax in Sri Lanka to the extent that the income arises in or is derived from a source in Sri Lanka.

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- Section 73 provides a list of payments that have a source in Sri Lanka which includes amounts received in respect of activity conducted or forbearance from conducting activity in Sri Lanka in relation to a non-resident person, to the extent attributable to a Sri Lankan permanent establishment or any other activity.
- Section 195 defines a "Sri Lankan Permanent establishment" to mean "any business connection or fixed place of business through which the business of the enterprise is wholly or partly carried out, irrespective of the number of days of such business being carried out in Sri Lanka."
- Since employees of Ambal will be in Sri Lanka providing services under the TTA it can be considered that Ambal is carrying out its business in Sri Lanka. Therefore, Ambal will be liable to pay income tax in Sri Lanka under the IRA.
- Sri Lanka has entered into a double tax agreement with India. And section 75 provides that the DTA will supersede the domestic law.
- Article 7 on business profits state that an enterprise will be liable to income tax in the other State only if it creates a permanent establishment in that other State and only so much of the profits that are attributable to that permanent establishment.
- Article 5 on Permanent establishment states that

  > "The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose constitutes a Permanent Establishment, but only where activities of that nature continue (for the same or connected project) within the Contracting State for a period or periods aggregating more than 90 days within any 12-month period."
- Based on the facts, employees of Ambal will be present in Sri Lanka from May 2021 to February 2022. Therefore, since the employees will be in Sri Lanka for more than 90 days in a 12 month period, Ambal will be treated as creating a PE in Sri Lanka and it will be liable to tax in Sri Lanka on the profits attributable to the PE.
- Initial set up fee will be liable for income tax in Sri Lanka.
- Article 12 (4) on Royalties specify that where the beneficial owner of royalties has a PE in the other contracting State, the royalties will be treated as attributable to the PE and taxed as business profits.
- Therefore, running royalties and brand use charges will be taxed as business profits attributable to the PE.

(d)

- Employees of Ambal are present in Sri Lanka from May 2021 to February 2022.
- Article 15 of the DTA will decide whether the employees will be liable to income tax in Sri Lanka.
- The employees will be liable to income tax only in India if the following criteria are satisfied;
  (a) the recipient is present in that other Contracting State for a period or periods not exceeding in the aggregate 183 days in any twelve month period commencing or ending in the fiscal year concerned ; and
  (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of that other Contracting State ; and
  (c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in that other Contracting State.

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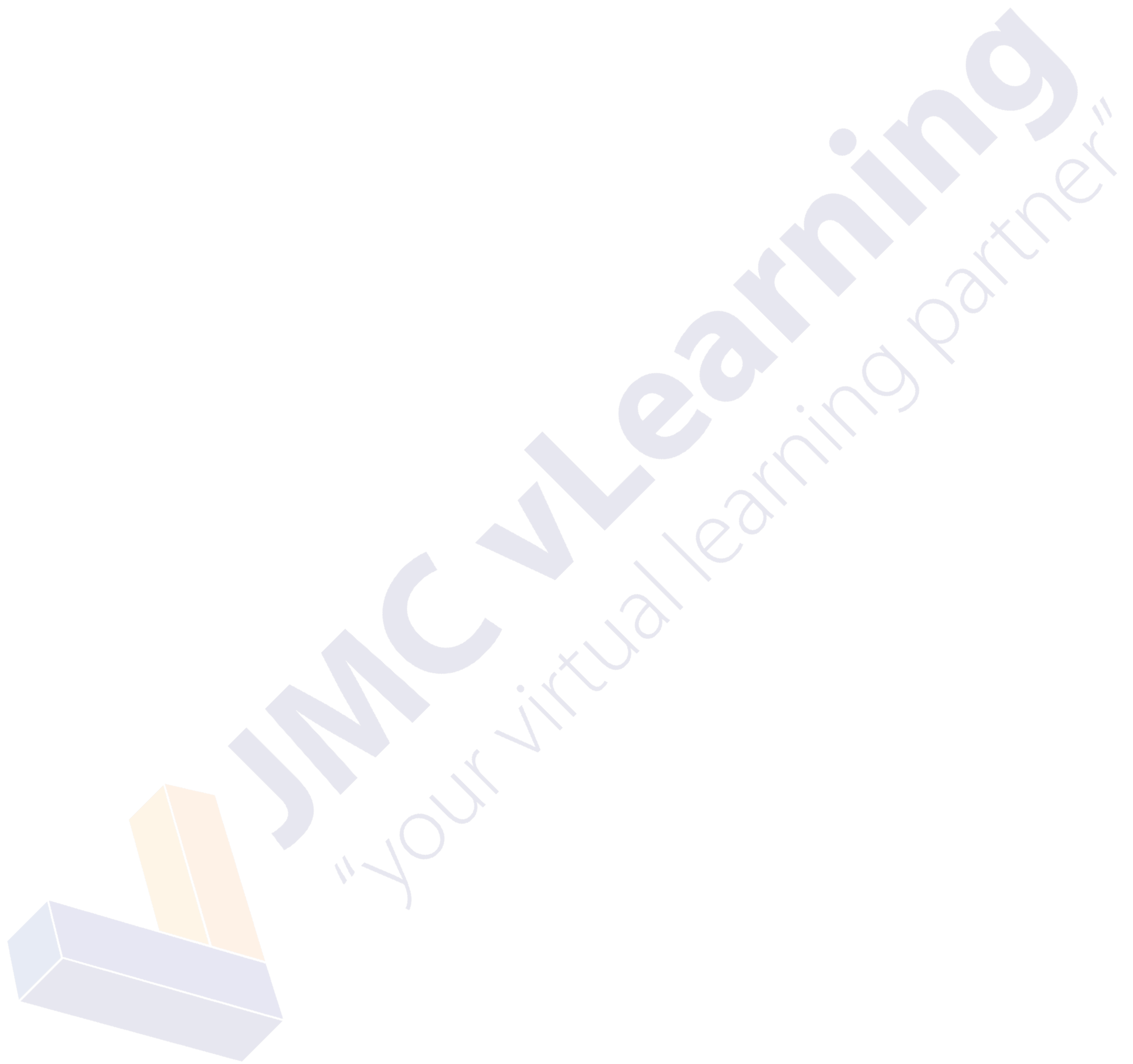
- Since the employees of Ambal have been present in Sri Lanka for more than 183 days, the first condition is not satisfied. Therefore, they will be liable to income tax in Sri Lanka on their employment income from Sri Lanka.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