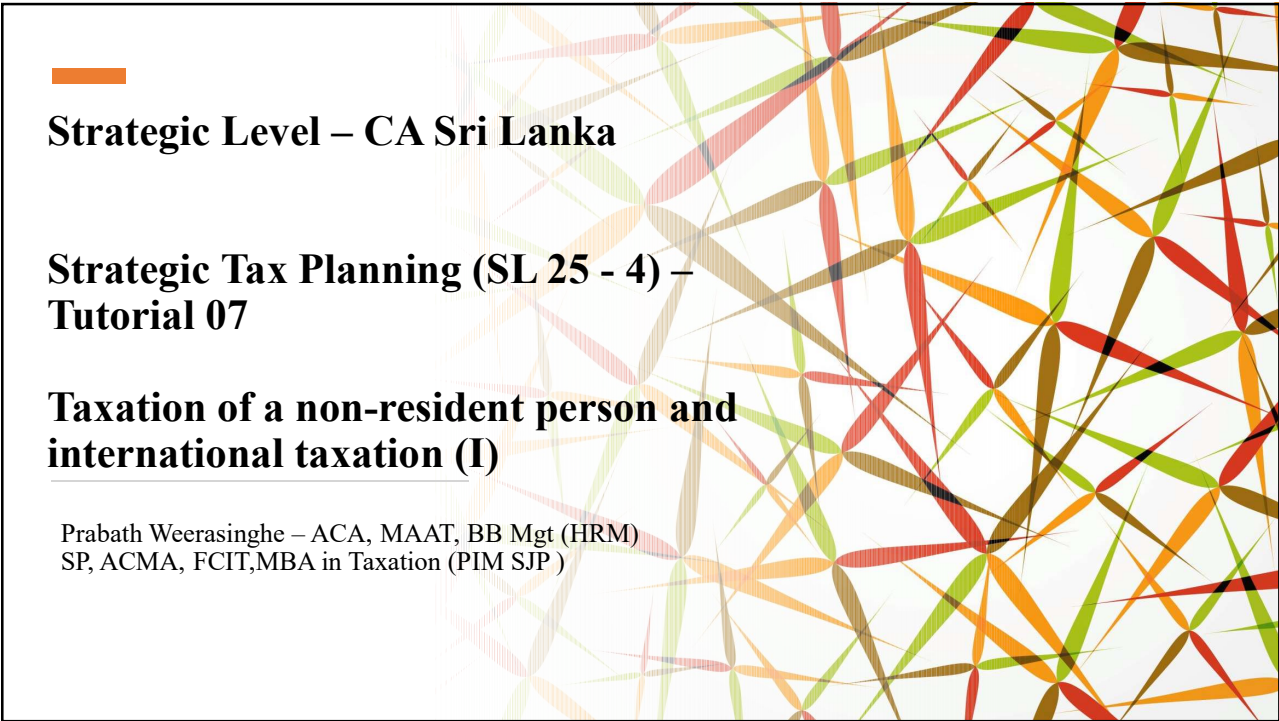




Strategic Level – CA Sri Lanka

Strategic Tax Planning (SL 25 - 4) – Tutorial 07

Taxation of a non-resident person and international taxation (I)

Prabath Weerasinghe – ACA, MAAT, BB Mgt (HRM)
SP, ACMA, FCIT, MBA in Taxation (PIM SJP)

Taxation of non-resident and international taxation

Key learning outcome

- **Assessing income tax liability of a non-resident person**

- Resident status of an individual and company
- Income arising in or derived from a source in Sri Lanka
- Assessable Income from income sources for a non-resident
- Taxable income and tax payable by a non-resident
- Liability of an agent of a non-resident

- **Remittance tax**

- Liability of a non-resident company for remittance tax
- Ascertaining the remittance tax liability

Taxation of non-resident and international taxation

Key learning outcome

- **Double tax avoidance agreement** (Tax treaties)
 - Overlapping tax jurisdiction and method of avoiding double taxation
 - OECD Vs UN Model
 - Principles of operation of Double tax avoidance agreement

Taxation

Objective of taxation

- Primary objective – Raising Revenue to the country
- Economic objective – Direction of the Economy
- Social objective – Promotion of Good Governance and Best Practices



Taxation

Domestic taxation

1. Domestic activity - State (Sovereignty) imposes taxes – domestic law/legal framework
2. Cross border activity - Globalization – capital, goods and technology are transferred across national boarder [M&A, Resource mobilization, JV, Franchising, Licensing, e-commerce]

Legal framework taxation

Income Tax Act No. 24 of 2017 (Gazette, Circular, ruling, caselaw etc..)

Tax Act No. 24 of 2017 - Charging Provision.

Sec 2 (1) Income tax shall be payable for each year of assessment by –

- (a) a person who has taxable income for that year; or
- (b) a person who receives a final withholding payment during that year.

Taxable income

Sec 03 (1) The taxable income of a person for a year of assessment shall be equal to the total of the person's assessable income for the year from each employment, business, investment and other sources

Sec 03 (2) In arriving at taxable income of a year of assessment qualifying payments and reliefs for that year under section 52 (Qualifying payments and reliefs) shall be deducted.

Sec 03 (3) The taxable income of each person and the assessable income from each source shall be determined separately.

Legal framework taxation

Deductibility of Qualifying payments and reliefs

Sec 52 (1) In arriving at the taxable income of **an individual or entity** for a year of assessment under section 3, the aggregate qualifying payments referred to in the Fifth Schedule to the Act shall be deducted.

Sec 52 (2) In arriving at the taxable income of an **individual who is resident in Sri Lanka** for a year of assessment under section 3, the aggregate reliefs referred to in the Fifth Schedule to the Act shall be deducted.

Sec 52 (3) In arriving at the taxable income of an individual **who is not resident in Sri Lanka** for a year of assessment **but is a citizen of Sri Lanka** under section 3, the relief referred to in paragraph 2(a) of the Fifth Schedule to the Act shall be deducted.

(Refer Fifth schedule to the Act)

Legal framework taxation- Taxation of non-resident

Assessable income

Sec 04 The assessable income of a person for a year of assessment from employment, business, investment or other source shall be equal to:-

- Sec 04 (a) in the case of a resident person, the person's income from employment, business, investment or other source for that year, wherever the source arises; and
- Sec 04 (b) **in the case of a non-resident person, the person's income from the employment, business, investment or other source for the year of assessment, to the extent that the income arises in or derived from a source in Sri Lanka.**

Sri Lanka bases its income tax on the usual dual jurisdictions of residence and source

- Resident person - wherever the source arises
- Non-resident person - to the extent that a source in Sri Lanka

Individual – Tax residence

Residence and Sources

Sec 69 (1) An individual shall be a resident in Sri Lanka for a year of assessment if the individual

Individual's residency is decided based on two **Primary Test** and two **Residual Test**

(a) resides in Sri Lanka;

Primary Test [qualitative] - Resides in Sri Lanka [Permanent home , location of individual's family]

(b) is present in Sri Lanka during the year and that presence falls within a period or periods amounting in aggregate to one hundred and eighty-three days or more in any twelve-month period that commences or ends during the year;

Primary Test [quantitative] – Physical presence in Sri Lanka

(c) is an employee or an official of the Government of Sri Lanka and his spouse is posted abroad during the year; or

Residual Test

(d) is an individual who is employed on a Sri Lanka ship, within the meaning of the Merchant Shipping Act, during the period the individual is so employed.

Residual Test

Individual – Tax residence

Residence and Sources

Sec 69 (1) An individual shall be a resident in Sri Lanka for a year of assessment if the individual

(b) is present in Sri Lanka during the year and that presence falls within a period or periods amounting in aggregate to one hundred and eighty-three days or more in any twelve-month period that commences or ends during the year;

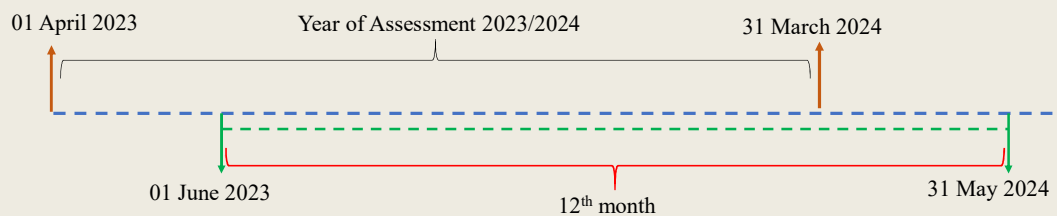
Sec 70 (1) An individual who is resident in Sri Lanka only by reason of paragraph (b) of subsection (1) of section 69, shall be so resident from the start of the one hundred and eighty three day period.

Otherwise, a person who is resident in Sri Lanka during a year of assessment shall be treated as a resident for the whole of the year

Individual – Tax residence

Residence and Sources

Sec 69 (1) (b)



Company – Tax residence

Residence and Sources

Sec 69 (4) A company **shall be 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

However, as per the domestic law if the company is incorporated or formed under the laws of Sri Lanka it shall be treated as a resident company unless there is a specific reason to decide.

Non-resident company- Not satisfy above criteria [**Effective management**]

Italy Tax authority vs Agusta Holding BV – dispute is tax residence of the company. Tax Court held that the place of effective management was at the State, where board meetings physically took place and where the company had dedicated premises on which management activities were conducted.

Company – Tax residence



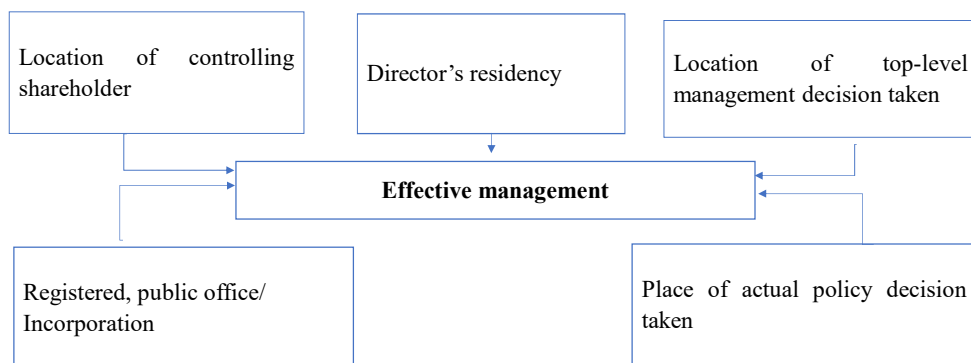
RESIDENCE



**EFFECTIVE
MANAGEMENT**

Company – Tax residence

Effective management – determinant factors



Company – Tax residence

Effective management

The residence of a company is to be determined by its actual place of management and control, based on the actual circumstances of the company and not through the interpretation of the constitution or by-laws of the company.

The decision-making body of a company is the board of directors. Where there is more than one decision-making body in a company, the management and control of the business of that company held with the body having the paramount authority (having the supreme power) on major questions of policy (a course or principle of action adopted or proposed by an organization).

Although the management and control of a company generally held with the board of directors of the company, such management and control may be usurped (by force) by an outsider, such as the holding company, where the company's board of directors stand aside from their directorial duties and do not purport (appear) to function as a board of management.

However, the control and management of a company is not usurped by an outsider who instructs the board of directors on what to do, so long as the board exercises its discretion when making decisions and would have refused to carry out an improper or unwise transaction.

Partnership – Tax residence

Sec 69 (2)

A partnership shall be resident in Sri Lanka for a year of assessment if –

- a) it was formed in Sri Lanka; **or**
- b) at any time during the year the management and control of the affairs of the partnership are exercised in Sri Lanka.

Trust – Tax residence

Sec 69 (3)

trust shall be resident in Sri Lanka for a year of assessment if –

- a) it was established in Sri Lanka;
- b) at any time during the year a trustee of the trust is resident in Sri Lanka; or
- c) at any time during the year a person resident in Sri Lanka directs or may direct senior managerial decisions of the trust, whether the direction is made alone or jointly with other persons or directly or through one or more interposed entities

Taxation of a non-resident

Source in Sri Lanka

Sec 72 (1) There are two broad categories of amounts that may be included in calculating income as having a source in Sri Lanka:

Sec 72 (1) (a) those amounts relating to the realisation or disposal of domestic assets and liabilities; and

Sec 72 (1) (b) other types of payments that has a source in Sri Lanka.

Sec 72(1)(a) realisation or disposal of domestic assets and liabilities specifically comprise the following :

Consideration received in respect of domestic trading stock of a business, Sec. 6(2)(b);

Gains as calculated under Chapter IV from realization of

- (i) capital assets and liabilities of a business, sec. 6(2)(c);
- (ii) investment assets, sec. 7(2)(b); and

Amounts to be included by the Fourth Schedule on realization of depreciable assets of a business, Sec. 6(2)(d).

Other types of payments - Payments with a source in Sri Lanka. Sec. 72(1)(b) are set out in an exhaustive list under Sec. 73(1).

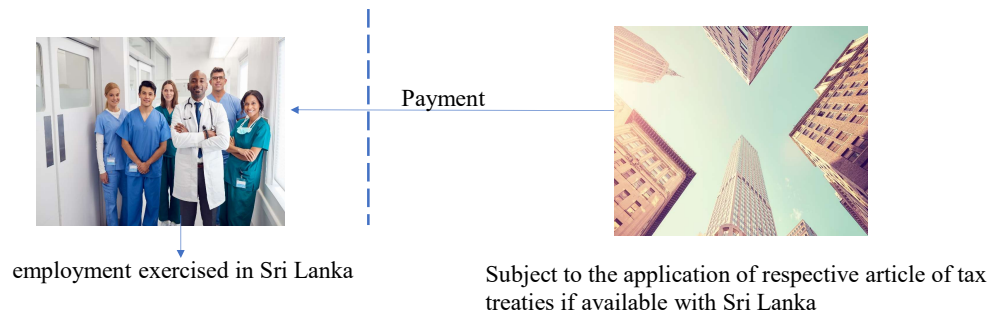
Taxation of a non-resident

Source in Sri Lanka

Some of the main types of payments deemed to have a source in Sri Lanka under Sec. 73(1) include:

Sec. 73(1)(a) payments received in respect of employment

- to the extent derived in respect of employment exercised in Sri Lanka, regardless of where they are paid,

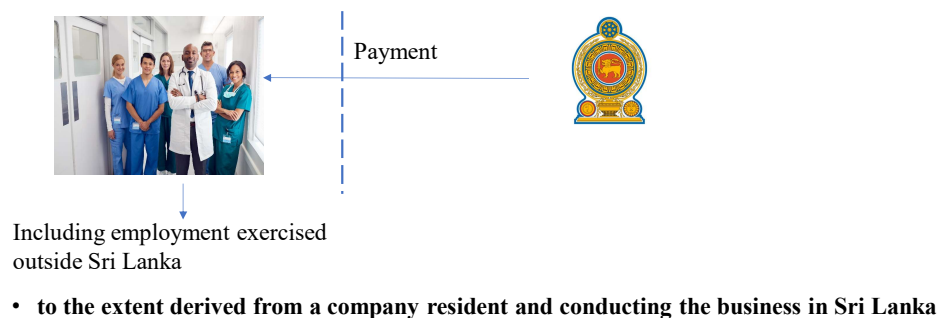


Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1)(a) payments received in respect of employment

if paid by or on behalf of the Sri Lanka Government, regardless of where employment is exercised; or



Taxation of a non-resident

Source in Sri Lanka



Payment



- derived from a company resident and conducting the business in Sri Lanka

Employment income exemption

the income of an individual entitled to privileges to the extent provided for by –
a diplomatic immunities law or a similar law;

an Act giving effect to the Convention on the Privileges and Immunities of the United Nations and the Convention on the Privileges and Immunities of the Specialised Agencies of the United Nations; or

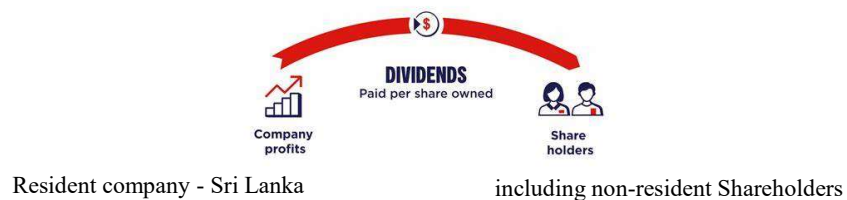
regulations made under this Act relating to an international organisation, or a law or Act

Official emoluments of any individual who is employed by Asia Development Bank

Taxation of a non-resident

Source in Sri Lanka

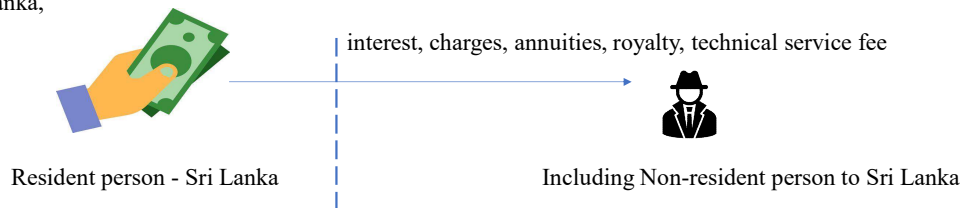
Sec. 73(1)(b); dividends paid by a resident company,



Taxation of a non-resident

Source in Sri Lanka

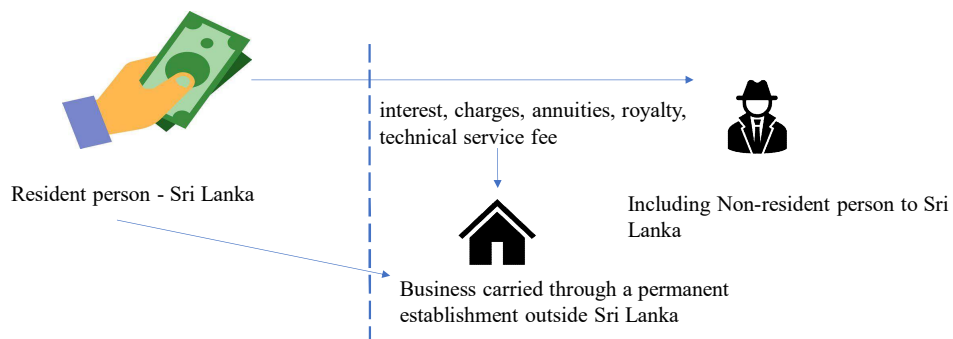
Sec. 73(1)(c); interest, charges, annuities, royalty, technical service fee*¹ or similar payment paid by:
a resident person, except where it is an expense of a business carried on through a permanent establishment outside Sri Lanka,



Taxation of a non-resident

Source in Sri Lanka

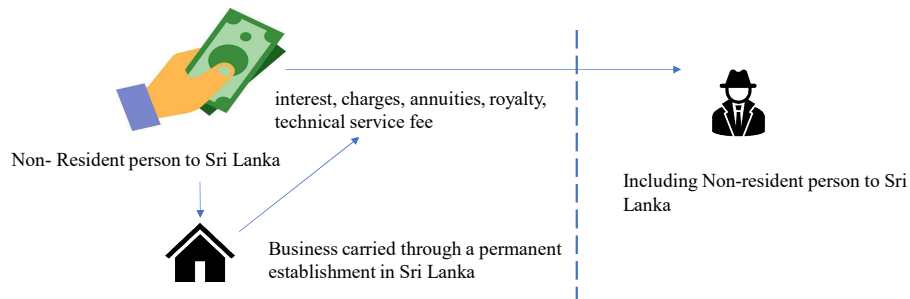
Sec. 73(1)(c); interest, charges, annuities, royalty, technical service fee*¹ or similar payment paid by:
a resident person, **except where it is an expense of a business carried on through a permanent establishment outside Sri Lanka,**



Taxation of a non-resident

Source in Sri Lanka

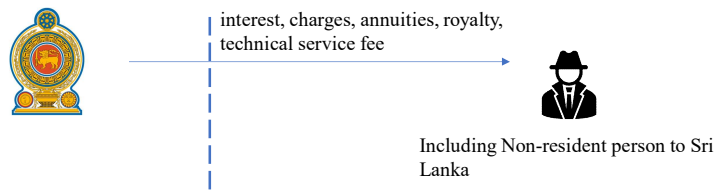
Sec. 73(1)(c); interest, charges, annuities, royalty, technical service fee*¹ or similar payment paid by:
a non-resident person as an expense of a business carried on through a permanent establishment in Sri Lanka,



Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1)(c); interest, charges, annuities, royalty, technical service fee*¹ or similar payment paid by:
Paid by the Government of Sri Lanka, including such payments made by any institution on behalf of the Government of Sri Lanka



*¹“technical service fee” means a service fee for managerial, technical, or consultancy services, including a fee for the provision of services of technical or other personnel.

Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1)(d); winnings from lottery, betting, or gambling relating to a game of chance held in Sri Lanka;



Game of chance held in Sri Lanka

winnings from lottery, betting, or gambling



Including Non-resident person to Sri Lanka

Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1)(e); natural resource payments made in respect of or calculated by reference to natural resources taken from land or the sea situated within Sri Lanka or its territorial waters;



Natural resources taken from land, or the sea situated within Sri Lanka or its territorial waters

Natural resource payments

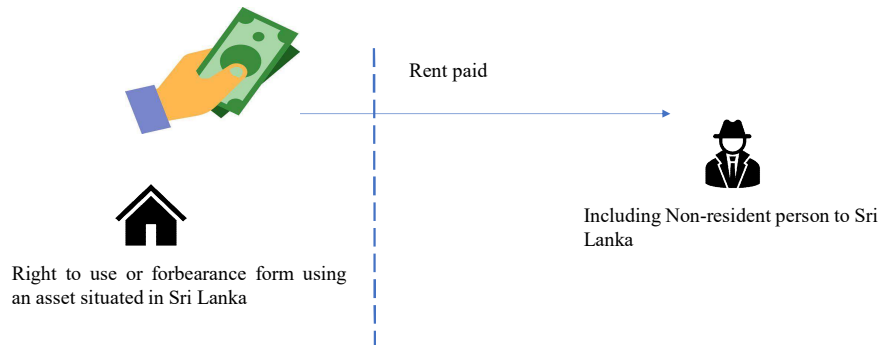


Including Non-resident person to Sri Lanka

Taxation of a non-resident

Source in Sri Lanka

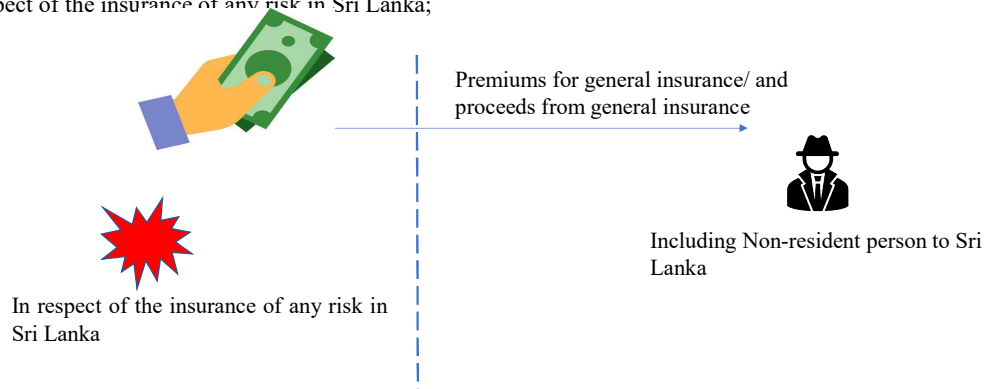
Sec. 73(1)(f); Rent paid for the use of, right to use or forbearance form using an asset situated in Sri Lanka,



Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1) (g); Premiums for general insurance paid to and proceeds from general insurance paid by a person in respect of the insurance of any risk in Sri Lanka;



Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1) (h); payments received by a person who conducts a relevant transport business*² in respect of –
the carriage of passengers who embark or cargo, mail or other moveable tangible assets that are embarked in Sri Lanka, other than as a result of transshipment; or

rental of containers and related equipment which are supplementary or incidental to carriage referred to above

*²“relevant transport business” means a business of land, sea or air transport operator or charterer carrying passengers, cargo, mail or other moveable tangible assets



Passengers/assets that are embarked in Sri Lanka

Payments received by a person who conducts a relevant transport business



Including Non-resident person to Sri Lanka

Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1) (i); payments received by a person who conducts a business of transmitting messages by cable, radio, optical fibre or satellite or electronic communication in respect of the transmission of messages by apparatus established in Sri Lanka, whether or not such messages originate in Sri Lanka



Apparatus established in Sri Lanka

Payments received by a person who conducts a telecommunication or electronic communication business



Including Non-resident person to Sri Lanka



Taxation of a non-resident

Source in Sri Lanka

Sec. 73(1) (j); payments, including service fees, of a type not mentioned for or attributable to service rendered or a forbearance from rendering service –

- i. in Sri Lanka, regardless of the place of payment; or
- ii. where the payer is the Government of Sri Lanka, irrespective of the place of exercise, rendering or forbearance

Sec. 73(1) (k); proceeds of life insurance and retirement, termination and pension payments not falling within employment income if

- i. paid by a resident person, other than as an expenditure of a business carried on by the resident person through a permanent establishment outside Sri Lanka;
- ii. paid by a non-resident person as an expenditure of a business carried on by the non-resident person through a Sri Lankan permanent establishment; or
- iii. paid by, or on behalf of, the Government of Sri Lanka;

Sec. 73(1) (l); gifts and other ex gratia payments to the extent received in respect of business or investment conducted with domestic assets:



Taxation of a non-resident

Source in Sri Lanka

“asset” includes a tangible or intangible asset, currency, goodwill, know-how, property, a right to income or future income, a benefit that lasts longer than twelve months and a part of an asset;

“domestic asset” means –

- an asset owned by a resident person (other than foreign land or buildings or an asset held by a foreign permanent establishment of the person) or held by a Sri Lankan permanent establishment;
- an interest in land or a building situated in Sri Lanka; and
- shares in a resident company;
- a membership interest in a body, if more than fifty *per cent* of the value of the interest is derived, directly or indirectly through one or more interposed bodies, from land or buildings in Sri Lanka;

Taxation of a non-resident

Source in Sri Lanka

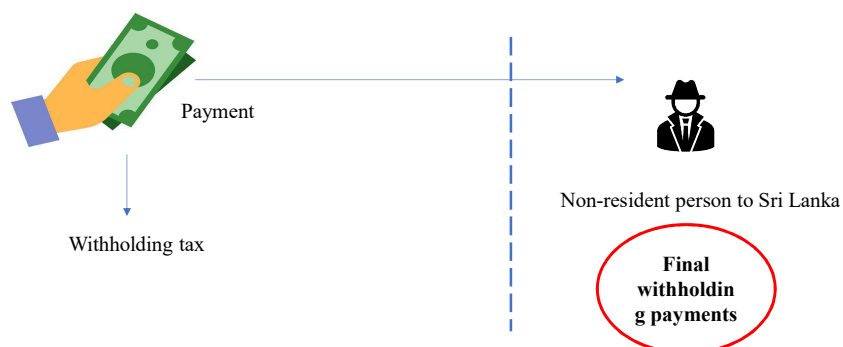
Sec. 73(1) (m); payments not mentioned in the above –

- i. made in respect of the acquisition of a domestic asset, incurring of a domestic liability or realisation of such an asset or liability;
- ii. received in respect of activity conducted or a forbearance from conducting activity in Sri Lanka –
 - (iia) except, in relation to a resident person, to the extent attributable to a foreign permanent establishment; and
 - (iib) in relation to a non-resident person, to the extent attributable to a Sri Lankan permanent establishment or any other activity (including sales in Sri Lanka of goods and merchandise) of the same or similar kind as that conducted by the nonresident person through a Sri Lankan permanent establishment; or
- iii. made to any foreign entertainer or artist for activity relating to Sri Lanka.

Taxation of a non-resident

Application of withholding tax and Final withholding payments

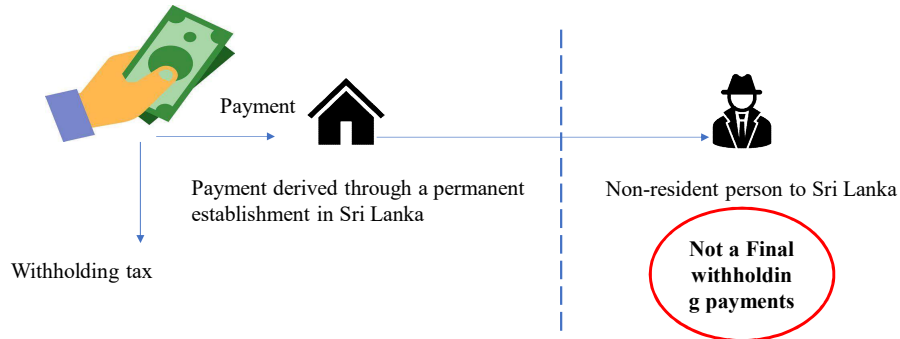
Payments made to non-resident persons that are subject to withholding, other than payments derived through a Sri Lankan **permanent establishment**.



Taxation of a non-resident

Application of withholding tax and Final withholding payments

Payments made to non-resident persons that are subject to withholding, **other than payments derived through a Sri Lankan permanent establishment.**



Taxation of a non-resident

Sri Lankan permanent establishment Sec 76 (2) b

“Permanent establishment”

If double taxation avoidance agreement available , a permanent establishment defined in an agreement for the relief of double taxation where an agreement is in force between the Government of Sri Lanka and the Government of any territory in which any person and their agencies, branches or establishments in Sri Lanka is resident

If no double taxation avoidance agreement available 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

Foreign permanent establishment means a fixed place of business of a resident person situated in a foreign country where the business is conducted continuously for at least six months, but excludes any place at which only activities of a preparatory or auxiliary nature are conducted;



Taxation of a non-resident

Computation of income tax liability

The computation of assessable income from employment, business, investment or other sources, relevant provision of the inland Revenue Act no. 24 of 2017 is applicable for a non-resident person as well.

Specific tax treatment for Individual

Non –resident individual including non-citizen employees are not entitled for tax free allowance (However non-resident but citizens of Sri Lanka are entitled for tax free allowance)

Specific tax treatment for business

Sec. 76 (1) Any business organization that has a permanent establishment in Sri Lanka shall be deemed to be a person for the ascertainment of the income, gains or profits arising in or derived from or any loss incurred in Sri Lanka from such permanent establishment.

Sec. 76 (2) any income, gains or profits arising, derived or accruing from, or any loss incurred in any transaction between a permanent establishment and its head office or other related branches in Sri Lanka or elsewhere , in which case the permanent establishment shall be treated as a distinct and separate entity from its head office and related branches, shall be ascertained having regard to the arm's length price

Taxation of a non-resident

Computation of income tax liability

Specific tax treatment for business

Remittance tax

A non-resident person who carries on business in Sri Lanka through a Sri Lankan permanent establishment shall pay tax on the remitted profits earned within the year of assessment. This is in addition to tax on gains and profit from business.

A non-resident person who has earned remitted profits shall pay a final tax on the gross amount of the remitted profits to the Commissioner-General at the rate of **14%** on or before the **thirtieth day succeeding the date of making such remittances**:

“remitted profits” means amounts remitted or retained abroad out of the profits and income of the non-resident person that are subject to income tax in Sri Lanka, and any amount received outside Sri Lanka by or on behalf of the non-resident person from conducting business in Sri Lanka that is subject to income tax in Sri Lanka, excluding dividends paid by a resident company to the nonresident person.

Taxation of a non-resident

Computation of income tax liability

Specific tax treatment for business

Remittance tax

Provided however, if a non-resident person retained the total income earned in any year of assessment commencing on or after April 1, 2021 in Sri Lanka 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 and invested the same in Sri Lanka to expand its business or to acquire shares or securities from the Colombo Stock Exchange licensed by the Securities and Exchange Commission of Sri Lanka or to acquire any treasury bill, treasury bond or Sri Lanka International Sovereign Bond issued on behalf of the Government of Sri Lanka, the tax rate on remittances of such retained income invested **shall be zero percent**.

Taxation of a non-resident

Computation of income tax liability

Specific tax treatment for business

Sec. 79 No deduction shall be allowed for an amount incurred by a non-resident person as an expenditure of a business carried on by the non-resident person through a Sri Lankan permanent establishment that represents head office expenditure where the amount would exceed **ten per cent** of the person's assessable income.

In case of any non-resident person whose profit from any project in Sri Lanka has been ascertained by the Commissioner General of Inland Revenue, in accordance with the section 83 of the Inland Revenue Act, No. 10 of 2006, **prior to April 01, 2018**, as a percentage of the sum receivable from trade or business of such person, such percentage of the sum receivable from that project shall be continued for any year of assessment commencing from April 01, 2018 [Extra Ordinary Gazette No. 2064/53 – dated 01.04. 2018].