

Chapter Review Exercises

Chartered Accountancy Strategic Level Corporate Taxation (TAX)

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(a)

(i)

- Section 4 of the IRA specifies that a non-resident person is liable to pay income tax in Sri Lanka on the profits and income arising in or derived from a source in Sri Lanka.
- Section 73 of the IRA specifies the payments that have a source in Sri Lanka. This includes payments “received in respect of activity conducted or a 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 (including sales in Sri Lanka of goods and merchandise) of the same or similar kind as that conducted by the non-resident person through a Sri Lanka permanent establishment.”
- Section 195 defines a ‘Sri Lankan permanent establishment’ as, “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;”
- HHR is a company incorporate in Bermuda and Sri Lanka does not have a double tax treaty with Bermuda.
- Therefore, based on the facts, employees of HHR visited Sri Lanka in January 2020 for a 40-day period in order to streamline the operations in HLanka. Therefore, since employees of HHR have been physically present in Sri Lanka and has done work in Sri Lanka, it can amount to creating a PE in Sri Lanka, if the business was wholly or partly carried out through these employees.
- HHR appoints the general manager to oversee the operations of HLanka. Although the general manager was employed by HLanka, all the instructions to him were given by HHR and he is closely supervised by HHR. Therefore, even though he is employed by HLanka, he can be considered as an employee of HHR who is running the operations of the business in Sri Lanka based on the instructions of HHR. Therefore, HHR can be considered as carrying on business in Sri Lanka and creates a Sri Lankan permanent establishment.
- Therefore, HHR will be liable to pay income tax in Sri Lanka.

(b)

(i)

- Any individual who is considered as a resident of Sri Lanka will be liable to pay income tax in Sri Lanka on his/her global income.
- Any individual who is non-resident for income tax in Sri Lanka, will only have to pay income tax on the profits and income arising in or derived from a source in Sri Lanka.
- According to section 69, an individual will be considered as a resident if the individual;
 - Resides in Sri Lanka OR
 - 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.

- According to the facts, the individuals were only present in Sri Lanka for 40 days. Therefore, they will not be considered as resident for income tax since they have not crossed the 183 days threshold.
- Therefore, these individuals will be liable to income tax in Sri Lanka on the profits and income arising in or derived from a source in Sri Lanka.
- These individuals have employment income from Sri Lanka.
- The Double Tax Treaty with Seychelles in Article 15 of the DTA provides that a non-resident individual will only be taxed in Seychelles on his employment income, if the employment is exercised in Sri Lanka subject to the following conditions;
 - The employee is present in Sri Lanka for a period not exceeding 183 days within any 12 month period
 - The remuneration is paid by or on behalf of an employee who is not a resident of Sri Lanka
 - The remuneration is not borne by a permanent establishment which the employer has in Sri Lanka
- However, since the salary of these officials were paid by HHR, and since HHR has a PE in Sri Lanka as explained above, all of the 3 conditions specified above will not be satisfied.
- Therefore, the individuals will be liable to pay income tax in Sri Lanka on their employment in Sri Lanka from Sri Lanka.

(c)

(i)

- HHR as explained above is considered as a non-resident for income tax purposes in Sri Lanka.
- Therefore, HHR will be liable to income tax in Sri Lanka only on the profits and income arising from a payment that has a source in Sri Lanka.
- Section 73 lists the payments that have a source in Sri Lanka, and this includes; “payments made in respect of the acquisition of a domestic asset, incurring of a domestic liability or realisation of such an asset of liability”
- Accordingly, where there is a realization of a domestic asset, income tax has to be paid by a non-resident person in Sri Lanka.
- A domestic asset has been defined in Section 195 as follows;
 - “domestic asset” means -
 - (a) 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;
 - (b) an interest in land or a building situated in Sri Lanka; and
 - (c) shares in a resident company;
 - (d) 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;
- Accordingly, a domestic asset is where a person has membership interest of more than 50% of its value, either directly or indirectly through one or more entities from land or building in Sri Lanka.
- Section 195 defines “land or buildings” to include the lease of lands or buildings.

- According to the facts provided, HLanka has entered into a 99 year lease for the plot of land in which it has constructed its hotel.
- Therefore, more than 50% of the value of the shares of HSeey is attributable to such leased land in Sri Lanka, the indirect transfer of shares will result in a realisation of a domestic asset.
- In such case, the gain will be liable to income tax in Sri Lanka based on Consideration minus cost. The tax rate will be 10% if the asset was considered as an investment asset by HHR and at the rate of 24% if the asset was considered as a capital asset of the business by HHR.

(d)

- HHR and Hlanka will be considered as associated enterprises. Therefore, any transactions between these two entities should be at arm's length price.
- Hlanka makes management fee payments and royalty fee payments to HHR. Therefore, the pricing for these should be determined using one of the 5 TP pricing methodologies which is most appropriate based on the functional analysis.
- HHR sends employees to Sri Lanka. These employees should be treated as seconded employees and there should not be any mark-up on the expenses charged on behalf of these employees. (cost-to-cost)



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