

December 2021 - Q1

(i)

- The Inland Revenue Act No. 24 of 2017 (“IRA”) in section 4 provides that a non-resident person is required to pay income tax in Sri Lanka on the profits and income arising in or derived from a source in Sri Lanka.
- Section 73 lists the payments that have a source in Sri Lanka and include providing services in Sri Lanka.
- Section 75 states that where Sri Lanka has entered into a double tax treaty with another country, such clauses in the DTA will supersede the domestic law.
- Since Sri Lanka has entered into a DTA with Germany, the clauses in this DTA will apply in the case of Spadau Germany in determining whether it will be liable to pay income tax in Sri Lanka.
- Article 7 of the DTA provides that the profits of an enterprise will be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein.
- Article 5 lists the instances where a permanent establishment (“PE”) maybe created.
- Article 5 specifies that a PE will be created where there is a fixed place of business in which the business of the enterprise is wholly or partly carried on. It includes, “an office”.
- Spandau Germany has registered a representative office in Sri Lanka and employees of Spandau Germany visits Sri Lanka and since it will be having a fixed place of business in Sri Lanka through which it carries on its business, Spandau Germany will be treated as creating a PE in Sri Lanka.
- Article 5(3) specifies instances where a PE is deemed not to be created. This include maintenance of a fixed place of business solely for the purpose of supply of information.
- Based on the facts provided, Spandau Germany RO is not solely engaged in collection and supply of information, but it also carries out quality control activities and coordinate with independent specialist consultants. Therefore, it will not be entitled to claim the exclusion under Article 5(3).
- Therefore, Spandau Germany will create a PE in Sri Lanka through its RO and it will be liable to pay income tax in Sri Lanka.
- However, Article 7 specifies that tax will only have to be paid on the profits attributable to the PE.

(ii)

- The finance manager has suggested to reserve some workspace for Spandau Germany employees at the Pamera Lanka office without registering a RO in Sri Lanka to avoid creating a PE.
- Article 5 of the DTA requires an enterprise to have a fixed place of business and it does not require such enterprise to either own or rent/lease such premises. As long as the workspace has some level of permanency, it will be treated as a fixed place of business. Only requirement is that such space should be at the disposal of the

employees of Spandau Germany and the business activities of the enterprise should be carried on in that space.

- Based on the facts provided, the activities in Sri Lanka have been carried on for 9 months and the fact that a workspace has been allocated to Spandau Germany in the premises of Pamera Lanka would still amount to creating a PE in Sri Lanka.
- Therefore, avoiding the creation of a PE as suggested by the finance manager is not possible.

(iii)

