Overview of Tax System

Taxation

Sri Lankan businesses, except enterprises that qualify for BOI incentives under Section 17 of the BOI Act and special concessions under the Inland Revenue Law, are generally liable to tax. This section introduces the general tax environment.

Corporate Income taxes Resident and Non-resident companies are liable to corporate

“Companies are liable to corporate income tax at 35%”

income tax at 35%. This is similar to the rates seen in other fast developing Asian economies and is the result of reductions introduced in recent years by the government. Non-resident companies are those with their head office located overseas, or are controlled from abroad. Such companies pay an additional tax of 1/3 of remittances abroad or 1/9 of taxable profits, whichever is less. Remittances exclude dividends for this purpose.

Dividends

Dividends declared out of tax exempt profits during the tax holiday period and one year thereafter are tax free in the hand of shareholders. A withholding tax of 15% on dividends applies to all companies other than quoted public companies. This can be credited against the individual income tax of the shareholders. Quoted public companies have to deduct the 15% withholding tax on dividends paid to non-resident shareholders. Resident companies pay an Advance Company Tax (ACT) of 27% of gross dividend at the time of declaring a dividend. The ACT can be set off against the tax liability of the company up to 50% of income tax payable. Any excess can be carried forward to the following year.

Personal Income taxes Resident individuals pay personal income tax on a sliding rate scale up to a maximum of 35% of income. The first slab of Rs. 100,000 per annum is exempt.

Non-citizens of Sri Lanka who are employed in qualifying BOI enterprises are eligible for a flat concessionary tax at 15% of Sri Lanka-source income. This benefit, except in the case of BOI approved “flagship” projects, is restricted to the expatriate’s first five years of employment.

Indirect Taxes

Sri Lankan indirect taxes comprise turnover tax, excise duties and stamp duty.

Turnover tax is a multi-stage tax applied on the manufacture, sales and import of goods and on services. The rates vary between 2% and 20%, depending upon the type of commodity or service. The tax is generally payable every quarter. Manufacturers have the benefit of a system of credits on turnover taxes paid at time of import and on local procurement of inputs. The government has

“A withholding tax of 15% on dividends applies to all companies other than public quoted companies”

“Sri lanka has concluded Double Tax Relief Agreements with 25 countries”

announced its intention of replacing the turnover tax with a more simple goods and services tax (GST) shortly.

Products made in Sri Lanka for export, raw materials imported for export production, items imported duty free under Section 19 A of the Customs Ordinance and items sold to BOI firms are exempt from turnover tax.

Excise duties apply on liquor, tobacco and some types of luxury or semi-luxury goods. Stamp duty is levied on a variety of instruments: the transfer of property, issue and transfer of shares and on some types of financial instruments.

A National Security Levy of 2% is levied on all imported capital goods. Exemptions from this levy will be granted on

- imports used in the manufacture of exports, including consumables
- articles brought into the country for temporary use, for repair and re-export or for display at exhibitions or for repair and reimported
- items of plant and machinery shipped abroad for repair and reimported
- gold imports for sale at Duty Free shops

All other imported or manufactured articles are subject to a National Security Levy of 4.5%. Exported articles are not subject to the levy. BOI approved ventures are subject to this levy as described above.

Tax Treaties

Double Tax Relief Agreements signed between Sri Lanka and other countries provide for reduced tax rates on dividends, interest and royalties. Recently concluded agreements include special provisions to ensure that foreign investors receive the benefits arising from the various tax incentives. The countries having tax treaties with Sri Lanka are the following: Australia, Bangladesh, Belgium, Canada, Czechoslovakia, Denmark, Finland, France, Germany, India, Italy, Japan, Korea, Malaysia, Netherlands, Norway, Pakistan, Poland, Romania, Singapore, Sweden, Switzerland, Thailand, The United Kingdom, USA and Yugoslavia.