Tax on corporate transactions in Sri Lanka: overview

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A Q&A guide to tax on corporate transactions in Sri Lanka.

This Q&A provides a high level overview of tax in Sri Lanka and looks at key practical issues including, for example, the main taxes, reliefs and structures used in share and asset sales, dividends, mergers, joint ventures, reorganisations, share buybacks, private equity deals and restructuring and insolvency.

To compare answers across multiple jurisdictions, visit the tax on corporate transactions *Country Q&A tool*.

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Tax authorities

1. What are the main authorities responsible for enforcing taxes on corporate transactions in your jurisdiction?

The Department of Inland Revenue (DIR) is the main authority responsible for enforcing taxes on corporate transactions in Sri Lanka.

Pre-completion clearances and guidance

2. Is it possible or necessary to apply for tax clearances or obtain guidance from the tax authorities before completing a corporate transaction?

Companies making outward remittances must obtain a tax clearance from the DIR, except for the following outward remittances:

- Sale proceeds of quoted shares owned by non-residents in companies resident in Sri Lanka.
- Dividends paid to non-resident shareholders.
- Foreign investments made by resident companies.
- Transportation expenses in relation to freight forwarding, courier services and airline services involving carriage of passengers and goods, subject to the submission of an annual clearance certificate.
- Payments to employees.
- Remittances by export companies in respect of services in relation to advertising (subject to periodical clearance from the DIR), sales promotion, marketing and trade fairs performed outside Sri Lanka.
- Remittances by export companies in respect of trade mark registrations outside Sri Lanka.
- Annual subscriptions for membership of professional bodies, or periodical subscriptions for journals, magazines and other publications.
- Remittances made in respect of visa expenses, medical expenses, air travel expenses and expenses on hotel accommodation abroad.
- Capital repayment of foreign loans obtained by resident companies.
- Payments made from one country to another, other than Sri Lanka (except where the account holder is resident in Sri Lanka) on instructions directly from clients outside of Sri Lanka.
- Payments for the import of any tangible goods.
- Payments relating to participation in foreign seminars, conferences and delegations. including registration fees.

Further, a tax clearance must be obtained when winding-up or liquidating a company.

However, due to the Covid-19 pandemic, the circular under which the payer is required to obtain a tax clearance is currently suspended by way of a public notice issued by the DIR, until further notice. Accordingly, persons in Sri Lanka are permitted to remit the gross amounts or net amount after deducting withholding tax (if applicable) set out in that public notice through commercial banks/authorised dealers.

Under the Inland Revenue Act No. 24 of 2017 (Inland Revenue Act), the taxpayer is given the opportunity to apply for a private ruling from the Commissioner-General of the Inland Revenue (CGIR) concerning the application of the provisions of the Inland Revenue Act to a transaction entered into, or proposed to be entered into, by that taxpayer. Private rulings are not binding on the taxpayer, but private rulings are binding on the CGIR as against that particular taxpayer (although they are not binding as against any other taxpayer).

Disclosure of corporate transactions

3. Is it necessary to disclose the existence of any corporate transactions to the tax authorities?

Circumstances where disclosure is required

Corporate transactions are not required to be disclosed at the outset. However, under the general powers, certain officers of the DIR are empowered to request any information by way of a written notice. Hence, in order to allow the CGIR to determine whether a company has entered into a tax avoidance scheme or arrangement, the CGIR may require a company to disclose details pertaining to any action, trust, grant, agreement, arrangement, understanding, promise, plan, proposal or undertaking made by the company.

A company liable to pay capital gains tax on the gain from the realisation of an investment asset is required to furnish a return of capital gains tax.

Details of profits and income from other corporate transactions will be disclosed to the DIR by way of a return of income (*see Question 5*). Further, companies carrying out controlled transactions with associated enterprises are required to submit information regarding such transactions to the DIR.

Manner and timing of disclosure

The CGIR may request the disclosure of details pertaining to any corporate transaction undertaken by a company. The manner and timing of such disclosure will be outlined in the CGIR's letter requesting such disclosure.

A return of capital gains tax in prescribed form must be submitted to the DIR no later than one month after the date of such realisation.

An annual transfer pricing disclosure form must be submitted to the DIR along with the return of income. Other specified documentation on transfer pricing must also be provided to the DIR within stipulated timelines or 30 days of the written request to do so being duly issued by the CGIR.

Main taxes on corporate transactions

Transfer taxes and notaries' fees

4. What are the main transfer taxes and/or notaries' fees potentially payable on corporate transactions?

Stamp duty

Key characteristics. Stamp duty is imposed on specific instruments which are executed, drawn or presented in Sri Lanka, as well as specific instruments that are executed outside Sri Lanka in relation to property situated in Sri Lanka which are presented in Sri Lanka. The rates at which the stamp duty is imposed are announced/published in the *Official Gazette of the Government of Sri Lanka* in relation to these instruments. Stamp duty is generally calculated as a percentage of the value of the instrument.

Triggering event. Stamp duty is payable at the point of execution of specific instruments identified by the regulations, such as:

- An affidavit.
- A policy of insurance.
- A periodic licence to carry on a trade, business, profession or vocation.
- A claim or demand from a credit cardholder for payment on account of usage of the card.
- A mortgage for a definite sum of money which affects any property.
- A promissory note.
- A lease or hire of any property.
- A receipt or discharge given for any money or other property.
- Any other instrument specified by the Minister by Gazette Order.

In addition, any deed of conveyance including transfers in relation to immovable property in Sri Lanka is subject to stamp duty.

Stamp duty is chargeable on the instrument and not on the transaction.

Liable party/parties. Stamp duty is paid by the person drawing, making or executing the instrument, except in relation to the following instruments:

- A policy of insurance: stamp duty is paid by the person effecting the insurance policy.
- A lease: stamp duty is paid by the lessee (in practice, stamp duty is shared by both parties, if agreed).
- A claim to the service provider from the holder of a credit card: stamp duty is paid by the credit cardholder.
- A licence: stamp duty is paid by the applicant.
- A deed of conveyance: stamp duty is paid by the buyer.
- A mortgage bond: stamp duty is paid by the mortgagor/borrower (in practice).

Applicable rate(s). Stamp duty is calculated as a percentage of the value of the instrument, which will vary based on the type of instrument or the fixed value on such instruments.

Share transaction levy

Key characteristics. Under the Finance Act No. 5 of 2005, a share transaction levy is charged on share trading transactions that take place on the stock exchange.

Triggering event. The share transaction levy is payable on a share trading transaction conducted through the stock exchange.

Liable party/parties. Both the seller and the buyer pay the share transaction levy on the turnover of the share trading transaction.

Applicable rate(s). The applicable rate is 0.3% of the turnover of the share trading transaction.

Notaries' fees

Key characteristics. Under the Notaries Ordinance, a notary can charge a fee for services rendered and duties performed.

Triggering event. The notaries' fees will become payable upon the services being rendered to a person.

Liable party/parties. The person receiving, or who has received, the notary's services is liable to pay the notary's fee.

Applicable rate(s). In practice, the maximum rate chargeable by the notary is 3% of the transaction value.

Corporate and capital gains taxes

5. What are the main corporate and/or capital gains taxes potentially payable on corporate transactions?

Corporate income tax

Key characteristics. Under the Inland Revenue Act, a company resident in Sri Lanka is liable to pay corporate income tax on its taxable income, which is calculated as the total worldwide assessable income for the year from business, investment and other sources. Non-resident companies in Sri Lanka are only liable to pay corporate income tax on the profits and income arising in, and derived from, a source in Sri Lanka.

The following companies are considered to be tax resident in Sri Lanka and therefore subject to corporate income tax on the aggregate of its worldwide taxable income:

- A company either incorporated in, or formed under the laws of, Sri Lanka.

- A company registered in Sri Lanka or which has its principal office in Sri Lanka.
- A company whose management and control of the affairs of that company are, at any time during the tax year, exercised in Sri Lanka.

Triggering event. All companies generating profit and income from their activities are required to make quarterly income tax payments. A statement of estimated tax payable is required to be submitted to the CGIR along with the first instalment of income tax. The year of assessment runs from 1 April in one year to 31 March of the subsequent year. A return of income pertaining to the year of assessment must be filed by companies on or before eight months from the end of the year of assessment. The same process applies to non-resident companies generating income in Sri Lanka.

Liable party/parties. The resident or non-resident company is liable to pay corporate income tax. In the event of default, the DIR may take action to recover any amounts due. Such default will attract penalties.

Applicable rate(s). The standard corporate income tax rate is 24%. The concessionary rate of 14% is available for companies on gains and profits from the following businesses:

- Small and medium enterprises (as defined in the Inland Revenue Act).
- Specified undertakings (as defined in the Inland Revenue Act, which includes operations such as freight forwarding and logistic services).
- Conducting a business of sale of goods/merchandise where the payment for the same is received in foreign currency and remitted to Sri Lanka through a bank.
- Agro-processing undertakings.
- Educational services.
- Undertakings for the promotion of tourism.
- Construction services.
- Healthcare services.
- Dividends received from a resident company.

A small and medium enterprise is defined to be a company which:

- Conducts business solely in Sri Lanka (other than an individual who is engaged in providing professional services individually or in partnership, being an individual who is professionally qualified).
- Does not have an associate that is an entity.
- Has an annual gross turnover of less than LKR500 million.

In addition, gains and profits of a company from the following industries will be subject to the following income tax rates:

- Manufacturing: 18%.

- Betting and gaming: 40%.
- Manufacture/import and sale of any liquor or tobacco products: 40%.

Profits and income from certain activities such as information technology and enabled services as prescribed are exempt from income tax.

(These changes to the applicable income tax rates and exemptions are implemented with effect from 1 January 2020 by way of a decision made by the Cabinet of Ministers of Sri Lanka, published in a public notice issued by the DIR, although the formal amendments to the Inland Revenue Act are currently pending.)

Capital gains tax

Key characteristics. The Inland Revenue Act re-introduces capital gains tax on gains derived from the realisation of investment assets and liabilities (that is, certain assets held as part of an investment which are not used in the production of the company's business income).

Triggering event. The following events constitute the realisation of an asset or liability which trigger capital gains tax:

- Parting with ownership of an asset (including when the asset is sold, exchanged, transferred, distributed, cancelled, redeemed, destroyed, lost, expired, expropriated or surrendered), including when a person transfers ownership of an asset to an associate or any other person by way of a gift.
- When a debt claim is written off as a bad debt.
- Where the sum of consideration received from owning the assets (except trading stock or depreciable assets) exceeds the cost of such asset.
- When a person begins to employ trading stock, a depreciable asset, a capital asset of a business or an investment asset in such a way that it ceases to be an asset of any of those types.
- When a person resident in Sri Lanka ceases to be resident in Sri Lanka, certain assets owned by that person are deemed to be realised.
- In the case of assets of a person who ceases to exist, immediately prior to the death or cessation of its owner. This is a deemed transfer (or rather a deemed realisation) where the legislation treats an asset as transferred to a successor immediately before the death/cessation of the owner, even though no actual transfer has taken place before death/cessation.
- Where rights or obligations with a duration of more than 50 years relating to an asset owned by a person are assigned to another (including by way of a lease of that asset).
- When a person provides an asset under a finance lease or an instalment sale.

Liable party/parties. Liability for the payment of capital gains tax lies with the company realising the asset/liability. In the event of default, the DIR may take action to recover any amounts due. Such default will attract penalties.

Applicable rate(s). The applicable rate of capital gains tax is 10%.

Value added and sales taxes

6. What are the main value added and/or sales taxes potentially payable on corporate transactions?

Value added tax (VAT)

Key characteristics. VAT is charged at the time of supply on every taxable supply of goods and services made during a taxable period, by a registered person in the course of carrying on, or carrying out, a taxable activity in Sri Lanka, and on the importation of goods into Sri Lanka by any person. A taxable activity is defined to include any activity carried on as a business, trade, profession or vocation, or every action in the nature of a trade and anything done in connection with the commencement or cessation of such activity.

Triggering event. VAT is payable when a company reaches a certain turnover threshold, at which time it must obtain VAT registration. The current VAT registration turnover threshold (with effect from 1 January 2020) is LKR75 million per quarter or LKR300 million per annum. (These changes are implemented under a decision made by the Cabinet of Ministers of Sri Lanka, published by way of a public notice by the DIR, and the formal amendments to the relevant legislation are currently pending.) For a company engaging in wholesale and retail trade, the applicable VAT registration turnover threshold is LKR12.5 million per quarter. When a company reaches these turnover thresholds, it must obtain VAT registration and charge VAT on the taxable supplies made by the company.

Liable party/parties. The VAT registered company sets off the input tax credits made against the output VAT received. The excess must be paid to the DIR on a monthly basis.

Applicable rate(s). The standard VAT rate is 8%. However, there are certain supplies which are considered to be exempt supplies, zero-rated supplies (such as the export of goods and services) or VAT chargeable on differential rates.

Nation building tax (NBT)

NBT has now been abolished with effect from 1 December 2019, under a decision made by the Cabinet of Ministers of Sri Lanka, although the formal amendments to the relevant legislation are still pending.

Other taxes on corporate transactions

7. Are any other taxes potentially payable on corporate transactions?

There are no other taxes potentially payable on corporate transactions. The economic service charge that was previously applicable has now been abolished with effect from 1 January 2020 under a decision made by the Cabinet of Ministers of Sri Lanka, although the formal amendments to the relevant legislation are currently pending.

Taxes applicable to foreign companies

8. In what circumstances will the taxes identified in *Questions 4* to *7* be applicable to foreign companies (in other words, what "presence" is required to give rise to tax liability)?

Corporate income tax

The following foreign companies are considered to be tax resident in Sri Lanka and therefore subject to corporate income tax on the aggregate of its worldwide taxable income:

- A company either incorporated in, or formed under the laws of, Sri Lanka.
- A company registered in Sri Lanka, or which has its principal office in Sri Lanka.
- A company whose management and control of the affairs of that company are, at any time during the tax year, exercised in Sri Lanka.

However, foreign companies which do not meet the above criteria will be treated as non-resident for tax purposes and will be subject to income tax to the extent that the income arises in, or is derived from a source, in Sri Lanka. Further, a non-resident company carrying on business in Sri Lanka through a Sri Lankan permanent establishment is required to pay remittance tax on the remitted profits at the rate of 14%.

VAT

Foreign companies making taxable supplies in Sri Lanka exceeding the turnover thresholds are liable to charge VAT at a rate of 8% on its supplies (*see Question 6, Value added tax (VAT)*).

Capital gains tax

Capital gains tax is payable by foreign companies on gains derived from the realisation of investment assets located in Sri Lanka (*see Question 5, Capital gains tax*).

Stamp duty

Stamp duty is payable by foreign companies executing instruments in Sri Lanka which are subject to stamp duty (*see Question 4, Stamp duty*).

Dividends

9. Is there a requirement to withhold tax on dividends or other distributions?

No: dividends are not subject to withholding tax in Sri Lanka.

However, with effect from 1 April 2020, a company paying dividends to a resident person is required to deduct advance income tax from such dividends paid, provided that the recipient has consented to such a deduction by way of a declaration made to the company. The rate of the deduction will vary based on the type of recipient (that is, an individual, a company or a partnership) and the income declared by such recipient.

(These changes are implemented under a decision made by the Cabinet of Ministers of Sri Lanka, published by way of a public notice and circulars by the DIR, and the formal amendments to the relevant legislation are currently pending.)

Share acquisitions and disposals

Taxes potentially payable

10. What taxes are potentially payable on a share acquisition/share disposal?

Corporate income tax

If a company engages in acquiring and disposing of shares as a business, the proceeds received from such activities will be taxed as part of the taxes due under corporate income tax.

VAT

Companies engaged in acquiring and disposing of shares as a business are subject to VAT as a financial service. Profits derived from such business activity are subject to VAT on financial services at a rate of 15%.

Capital gains tax

If a company derives a gain from the disposal of shares of companies other than listed companies which are held as an investment by the company, that gain will be subject to capital gains tax at a rate of 10%.

Share transaction levy

Under the Finance Act No. 5 of 2005 a share transaction levy is charged on share transactions taking place on the stock exchange. The applicable rate is 0.3%, which is imposed on both the seller and the buyer on the turnover of every share trading transaction.

Exemptions and reliefs

11. Are any exemptions or reliefs available to the liable party?

Capital gains tax

Capital gains tax will not be applied to:

- Gains arising from the disposal of listed shares (that is, an asset consisting of share quoted in any official list published by any stock exchange licensed by the Securities and Exchange Commission of Sri Lanka).
- Gains on the realisation of shares of a non-resident company derived by a person with respect to a substantial participation in the non-resident company. A "substantial participation" means holding 10% or more of the value of shares in the company (excluding redeemable shares) together with control, directly or indirectly, of 10% or more of the voting power in the company.

Further, a gain made by a resident individual from the realisation of an investment asset that does not exceed LKR50,000, and total gains made during the year of assessment that do not exceed LKR600,000, will be exempt from capital gains tax.

Tax advantages/disadvantages for the buyer

12. Please set out the tax advantages and disadvantages of a share acquisition for the buyer.

Advantages

The buyer is not subject to taxes on the share acquisition, except in relation to quoted shares.

Disadvantages

The buyer cannot claim capital allowances.

Tax advantages/disadvantages for the seller

13. Please set out the tax advantages and disadvantages of a share disposal for the seller.

Advantages

Any trading losses arising out the business of a share transactions (including disposals) can be set off against future business profits of the company when calculating its corporate income tax liability.

Disadvantages

The seller is not eligible for any relief on capital allowances, and the responsibility for the payment of corporate income tax or capital gains tax on the disposal of shares which are investment assets is on the seller.

Transaction structures to minimise the tax burden

14. What transaction structures (if any) are commonly used to minimise the tax burden?

There are no particular structures used to minimise the tax liability on share acquisitions or disposals.

Asset acquisitions and disposals

Taxes potentially payable

15. What taxes are potentially payable on an asset acquisition/asset disposal?

Corporate income tax

Any gain arising on a disposal of assets used in a business is liable to corporate income tax as it constitutes business income.

Capital gains tax

Any gain arising on a disposal of an investment asset, such as land or buildings which are considered as investment assets, is liable to capital gains tax at a rate of 10%.

Stamp duty

A transfer of immovable property in Sri Lanka is subject to stamp duty on the value appraised by the relevant revenue officer of the provincial council, which is payable by the buyer to the provincial council of the relevant province where the property is situated, at the following rates:

- For the first LKR100,000 (or part thereof): 3%.
- For the balance: 4%.

VAT

Acquisition and/or disposal of assets will be subject to VAT at the rate of 8%.

Exemptions and reliefs

16. Are any exemptions or reliefs available to the liable party?

Capital gains tax

Gains on the realisation of sovereign bonds issued by, or on behalf of, the Government of Sri Lanka denominated in local or foreign currency, derived by any non-resident persons (other than a Sri Lankan permanent establishment) are exempt from capital gains tax. (This change is implemented with retrospective effect (that is, with effect from 1 April 2018) under a decision made by the Cabinet of Ministers of Sri Lanka, published by way of a public notice by the DIR, and the formal amendments to the relevant legislation are currently pending.)

There are no other exemptions available for corporates.

The following types of gains made by a resident individual will be exempt from capital gains tax:

- Gains from the realisation of an investment asset that do not exceed LKR50,000, and the total gains made during the year of assessment that do not exceed LKR600,000.
- Gains from the realisation of his or her principal place of residence, which was owned by the individual continuously for three years before being realised, and was lived in by the individual for at least two of those three years.

Tax advantages/disadvantages for the buyer

17. Please set out the tax advantages and disadvantages of an asset acquisition for the buyer.

Advantages

The buyer can claim capital allowances on the acquired asset used in the production of income from its business.

Disadvantages

If the buyer is not registered for VAT and/or the VAT on such a purchase is disallowed in terms of the provisions of the VAT Act No. 14 of 2002 (as amended), VAT paid by the buyer will be an expense to the buyer.

Tax advantages/disadvantages for the seller

18. Please set out the tax advantages and disadvantages of an asset disposal for the seller.

Advantages

There are no particular advantages for the seller on an asset disposal.

Disadvantages

The seller will lose any relief from capital allowances on the asset.

Transaction structures to minimise the tax burden

19. What transaction structures (if any) are commonly used to minimise the tax burden?

There are no particular structures used to minimise the tax liability on asset acquisitions or disposals.

Legal mergers

Taxes potentially payable

20. What taxes are potentially payable on a legal merger?

Income/capital gains tax

As the Inland Revenue Act has recently been implemented, there are currently no specific regulations concerning the application of income/capital gains tax to the involuntary realisation of assets (for example, securities) as a result of a merger, or demerger, of a company.

Exemptions and reliefs

21. Are any exemptions or reliefs available to the liable party?

No exemptions or reliefs have yet been identified (*see Question 20*).

Transaction structures to minimise the tax burden

22. What transaction structures (if any) are commonly used to minimise the tax burden?

Legal mergers may be considered to be tax neutral as the changes are effected by operation of law. However, in order to mitigate any tax risk, the parties may consider obtaining a private ruling from the DIR, prior to the merger.

Joint ventures

Taxes potentially payable

23. What taxes are potentially payable on establishing a joint venture company (JVC)?

Corporate income tax

A JVC established in Sri Lanka will be considered as either a tax resident or a non-resident in Sri Lanka (based on the rules of residency) and subject to corporate income tax accordingly (*see Question 5, Corporate income tax*).

Capital gains tax

Capital gains tax is payable by JVCs on gains derived from the realisation of investment assets (*see Question 5, Capital gains tax*).

VAT

A JVC making taxable supplies in Sri Lanka exceeding the turnover thresholds will be liable to VAT at a rate of 8% or differential rates (based on the type of supply) on its supplies (*see Question 6, Value added tax (VAT)*).

Exemptions and reliefs

24. Are any exemptions or reliefs available to the liable party?

There are no specific reliefs or exemptions applicable to JVCs.

Transaction structures to minimise the tax burden

25. What transaction structures (if any) are commonly used to minimise the tax burden?

Since the tax treatment of resident JVCs is similar to those of other resident companies in Sri Lanka, there are no commonly used structures to minimise the tax burden.

Company reorganisations

Taxes potentially payable

26. What taxes are potentially payable on a company reorganisation?

Income/capital gains tax

As the Inland Revenue Act has only relatively recently been implemented, there are currently no specific regulations concerning the application of income/capital gains tax to the involuntary realisation of assets (for example, securities) as a result of a company reorganisation.

However, the taxes discussed above will be applicable to any reorganisation, based on the manner in which it is carried out.

Exemptions and reliefs

27. Are any exemptions or reliefs available to the liable party?

There are no specific reliefs or exemptions applicable.

Transaction structures to minimise the tax burden

28. What transaction structures (if any) are commonly used to minimise the tax burden?

We have not identified any structure which is used to minimise the tax burden.

Restructuring and insolvency

29. What are the key tax implications of the business insolvency and restructuring procedures in your jurisdiction?

There are no specific underlying tax implications of business insolvency and restructuring. As part of the liquidation procedure, the company must obtain a tax clearance from the DIR.

Share buybacks

Taxes potentially payable

30. What taxes are potentially payable on a share buyback? (List them and cross-refer to *Questions 4* to *7* as appropriate.)

Withholding tax/advance income tax

A share buyback constitutes a dividend distribution by a company, and therefore the tax treatment applicable to dividends will be applicable to a payment derived by a member from a company (*see* Question 9).

Exemptions and reliefs

31. Are any exemptions or reliefs available to the liable party?

There are no specific exemptions or reliefs available for share buybacks. However, the exemptions or reliefs that apply to dividends may be applicable.

Transaction structures to minimise the tax burden

32. What transaction structures (if any) are commonly used to minimise the tax burden?

We have not identified any particular structures which are used to minimise the withholding tax/advance income tax payable on share buybacks.

Private equity financed transactions: MBOs

Taxes potentially payable

33. What taxes are potentially payable on a management buyout (MBO)?

There is no specific tax treatment for MBOs. An MBO will be treated as a share acquisition of the company. Hence, the tax treatment will be similar to a share transaction (*see* Question 10).

Exemptions and reliefs

34. Are any exemptions or reliefs available to the liable party?

There are no specific exemptions or reliefs available for MBOs. However, the exemptions or reliefs applicable to share dealings will be applicable (*see Question 11*).

Transaction structures to minimise the tax burden

35. What transaction structures (if any) are commonly used to minimise the tax burden?

There are no particular structures used to minimise the tax liability on share acquisitions or disposals.

Reform

36. Please summarise any proposals for reform that will impact on the taxation of corporate transactions.

The Inland Revenue Act came into effect on 1 April 2018 and proposed amendments to the same are currently being implemented based on decisions made by the Cabinet of Ministers of Sri Lanka, and published by way of public notices issued by the DIR. The formal amendments to the Inland Revenue Act, and the relevant regulations and procedures that need to be followed by taxpayers, are currently pending.

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