

CIRCULAR TO THE CLIENTS - 16th April 2020

INCOME TAX UPDATES

Pending legalization of the amendments, based on the directions issued by the Ministry of Finance, the IRD has published several public notices including the notices of 18th February 2020, 08th April 2020 and of 15th April 2020 regarding certain amendments proposed to the tax laws of Sri Lanka and issued several circulars to the parties concerned. This document contained a summary of such changes published by the IRD from November 2019 to date. However, it is to be noted that there is no legal validity of these proposed amendments until passed by the Parliament as Amendment Act/s.

1. A SUMMARY OF THE PROPOSED INCOME TAX CHANGES

1.1 PAYE (W.E.F. 01.01.2020)

1.1.1 **Resident Employees Remuneration** - With effect from 01.01.2020 **remuneration** (other than on terminal benefits) of any resident employee is not subject to WHT (PAYE).

Accordingly, any WHT (including PAYE) deducted on such payments during the period from 01st January 2020 to 5th February 2020 to be refunded to the related service provider by the agent.

W.e.f. 01.04.2020, at the request of an employee whose gross remuneration exceeds Rs. 250,000 p.m. or Rs. 3 million a Y/A, an **advance personal income tax** could be deducted.

REMARKS - *This implies the importance of re-introduction of PAYE deduction system.*

Furthermore, as per the Notice of 15.04.2020 (attached), with the consent of respective employees, by deducting or otherwise, the employers are allowed to make the payment of tax on employee remuneration for the **period 01.01.2020 to 31.03.2020** under the PAYE Scheme.

1.1.2 **Non-resident Employees Remuneration** - The **remuneration** which has a source in SL of a non-resident employee (SL citizen or otherwise) continues to be liable to WHT and the rate there on is 14%, subject to the provisions of relevant double tax avoidance agreement (DTAA).

1.1.3 **Any Employee Terminal Benefits (both resident and non-resident)** – Any employee's **employment terminal benefit income** (other than CGIR approved or regulated Provident Fund, capital sums paid as compensation or gratuity in relation to injuries suffered by the person or the death of another person, pension or any retiring benefit paid by the Government/Government Department of SL) from SL is liable to WHT as follows;

(i) On commuted pension, retiring gratuity, compensation on loss of office/employment paid under a scheme uniformly applicable to all employees and approved by the CGIR, receipts from ETF excluding the share of Fund investment income earned after 31.03.1987;

○ No tax on first Rs. 5 million, while the excess of Rs. 5 Million tax @ 12%

(ii) Compensation on loss of office/employment paid under a scheme not approved by the CGIR, Provident Fund not been approved by CGIR or not been a regulated, non-cash retirement benefits, any other payment;

○ Without any exemption liable @ 18%

The tax so withheld under (i) & (ii) above be hold for 90 days of retention allowing the employee to obtain a direction from the PAYE Audit Branch of the IRD. If no such direction is submitted by the employee within 90 days such monies be remitted by the employer to the IRD. However, this WHT been not a final WHT, the employee shall claim a credit of it in his personal tax return.

1.2 OTHER WHT (W.E.F. 01.01.2020) –

1.2.1 Payments to Resident Persons

With effect from 01.01.2020 following payments to residents are exempted from WHT;*

- (i) **Payments to residents** including dividends, interest, discounts, charge, natural resource payment, rent, royalty, premium or retirement payments and on the service fee paid on services rendered by an individual (other than of winnings from a lottery, reward, betting or gambling, sale of gems and on employment terminal benefits and ETF).

W.e.f. 01.04.2020, if any of those payments are regular fixed payments, at the request of the recipient, an **advance income tax** could be deducted by the payer of such payment. To activate this, the payer has to be a person registered as a withholding Agent.

REMARKS–

This implies the importance of re-introduction of certain WHTs such as on interest, dividends etc. preferably as final WHT.

- (ii) **Share of profit** allocated by a partnership **to a resident partner**.

It is to be noted that 8% WHT on non-resident partners is also abolished, as under the capture of “taxing of partnerships”, it is mentioned that the 8% WHT on any partner’s share of partnership income is replaced with a tax on partnership w.e.f. 01.01.2020.

REMARKS

- (i) **However, following payments to residents continue to be liable for WHT [Sec. 85(1)(a)];**

- Winnings from a lottery, reward, betting or gambling @ 14%
- Sale price of gems sold at an auction conducted by National Gem & Jewelry Authority @ 2.5%

- (ii) **Interest and dividends** which were subjected to final tax (@ 5% and 14% respectively) on certain tax payees are also now to be included into the Assessable Income (AI) and tax at the rate/s as applicable to that taxpayer.

- (iii) Any person who is having a taxable income but not yet registered for income tax, shall open a IT file, make quarterly self-assessment tax payments (i.e. by on or before 15th of July, November, February, May respectively and the final by on or before 30th November) and file the duly filled IT Returns by the due date (i.e. on or before 30th November).

- (iv) Any WHT deducted during the period from 01.01.2020 to 05.02.2020 on payments subsequently made exempted from WHT w.e.f. 01.01.2020, to be refunded to the related recipients by the WHT agents.

1.2.2 Payments to Non-resident Persons

The **dividend** payments to any person, including non-residents, are fully **exempted** from WHT.

All other payments to non-residents (excluding exempted interest) are liable to WHT as follows;

Non-exempted Interest;

- On Non-resident SL citizen individuals' total interest (on the excess of Rs.3mn P/Allowance p.a.) **@ 5%**
(Personal allowance for the period from 01.01.2020 to 31.03.2020 is Rs.750,000)
- On other Non-residents **@ 5%**

Services fee in respect of land, sea, air transport or telecommunication [**Sec. 85(2)**] **@ 2%**

Any other payment **@ 14%**

REMARKS

- The **remuneration of a non-resident**, whether SL citizen or not, is subject to WHT **@ 14%**.*
- All deduction of WHT on **payments to non-residents** are to be subjected to the provisions of relevant double tax avoidance agreement (**DTAA**).*

1.3 PROPOSED INCOME TAX EXEMPTIONS;

1.3.1 The gain and profit earned or derived by any person from;

- (i)** The sale of produce of an undertaking for **agro farming** of such person without subjecting such produce to any process of production or manufacture. (w.e.f. 01.04.2019).
- (ii)** Providing IT and enabled services as may be prescribed. w.e.f. 01.01.2020.
- (iii)** Any service rendered in or outside SL to any persons to be utilized outside Sri Lanka to receive payments in foreign currency through a bank to SL. (w.e.f. 01.01.2020).
- (iv)** Any foreign source, other than referred to in (iii) above where such gains and profits earned or derived in foreign currency and remitted to SL through a bank (w.e.f. 01.01.2020).

1.3.2 **Interest** earned on any foreign currency account deposits **by any person** (w.e.f.01.01.2020).

1.3.3 **Interest** earned by **any person** outside SL (overseas lenders) on any loan provided to any person in Sri Lanka or to Government of SL (w.e.f. 01.04.2018).

1.3.4 **Any income earned by a non-resident person** by way of **interest, discount or realization of any gain** on any Sovereign Bond denominated in local or foreign currency (w.e.f. 01.04.2018).

1.3.5 **Interest or discount** paid or allowed to **any person** on any foreign currency Sovereign Bond, including SL Development Bonds (w.e.f. 01.04.2018).

1.3.6 **Any sum received** on or after 01.04.2018 by **any Public Corporation** out of the funds voted by Parliament from the Consolidated Fund or out of any loan arranged through the Government.

- 1.3.7** A dividend paid by a resident company to a member out of dividend received by that resident company directly or through another resident company.
- 1.3.8** Dividends paid by a resident company to any non- resident person (w.e.f. 01.01.2020).
- 1.3.9** A dividend paid by a resident company which is engaged in any one or more of the following businesses in accordance with the provisions of the Part IV of the Finance Act No. 12 of 2012 and within the meaning of an agreement entered into with the Board of Investment of Sri Lanka established under the Board of Investment of Sri Lanka Law; ((w.e.f. 01.01.2020)
- (i) Entrepot trade involving import, minor processing and re-export,
 - (ii) Offshore business where goods can be procured from one country or manufactured in one country and shipped to another country without bringing the same into SL.
 - (iii) Providing front end services to clients abroad,
 - (iv) Headquarters operations of leading buyers for management of financial supply chain and billing operations,
 - (v) Logistic services such as bonded warehouse or multi-country consolidation in SL.
- 1.3.10** Dividends from and gains on the realization of shares in a non-resident company where derived by any person with respect to a substantial participation (holding 10% or more shares / control 10% or more voting power) in the non-resident company. (w.e.f. 01.01.2020).
- 1.3.11** Amounts derived by any non-resident person from laboratory services or standards certification services (w.e.f. 01.01.2020).
- 1.3.12** Amounts received by any religious institution registered with the Ministry in-charge by way of grants and donations (w.e.f. 01.01.2020).

1.4 RELIEFS & QUALIFYING PAYMENTS

- (i) Any sum paid to the Consolidated Fund by a public corporation as required by the law by or under which such corporation is established. (w.e.f. 01.04.2019).
- (ii) Personal relief for the residents or non-resident but citizens for each year of assessment Rs. 3 million. (w.e.f. 01.01.2020).
- (iii) W.e.f. 01.01.2020, individuals are entitled to a total qualifying payment up to Rs. 1.2 million on following payments;
 - Health expenditure including medical insurance
 - Educational expenditure incurred locally (own education of children's' education)
 - Interest on housing loans
 - Contribution to an approved pension scheme
 - Expenditure on purchase of equity/security.

1.5 A SUMMARY OF APPLICATIONS & EFFECTS TO DIFFERENT PERSONS (TAX PAYEES)

1.5.1 Individuals

- Interest and dividends

Interest and dividends which were subjected to final tax (@ 5% and 14% respectively) are now (w.e.f. 01.01.2020) to be included into the Assessable Income (AI) and tax at the rate/s as applicable to that taxpayer. Depending on the level of income, low income earning individuals may be benefited while high income earners will be badly affected (*As an example, the effective tax rate on such interest and dividend income of an individual having more than Rs. 9 million annual income for Y/A 2020/21 is 18%*).

REMARKS

The Government might reconsider to reintroduce the WHT on senior citizens' interest income exceeding personal allowance of Rs 3 million to mitigate the tax burden on their interest income.

- Employment income (remuneration)

W.e.f. 01.01.2020, remuneration is not subject to WHT (PAYE) and hence no need of recognizing as primary employment or as secondary employment.

No amendments are proposed to the employment allowance (relief) of Rs. 700,000 p.a. and hence the said relief may continue.

W.e.f. 01.01.2020, the tax concessions on **terminal benefits** (whether resident/non-resident) are expanded and taxing as follows;

(i) Commuted Pension, Retiring Gratuity, EPF or Approved Compensation

Taxable terminal benefits (Approved/regulated)	Tax Rate
First Rs. 10 million	0%
Next Rs. 10 million	6%
Balance	12%

(ii) Compensation for loss of employment which has not been approved by CGIR, provident funds which are non-regulated or non-approved by CGIR, other payments and non-cash benefits –

These are to be taxed at the standard tax rates as applicable to the individual. (i.e. 6%, 12%, 18%)

- **Senior citizens tax relief of Rs. 1.5 million on interest income** will continue until 31.03.2020.
- W.e.f. 01.01.2020 individuals are entitled to a total qualifying payment up to Rs. 1.2 million on payments detailed in item (iii) of paragraph 1.4 above;
- **The personal tax-free allowance (relief) for individuals for 2019/20 is to be computed as follows;**

- First 9 months	Rs. 375,000	(No final WHT deducted incomes <u>be included</u> into the AI)
- Last 3 months	Rs. 750,000	(<u>Interest & dividends also to be included</u> into AI)
- Total	Rs. 1,125,000	

- **The personal tax slabs & rates of individuals for 2019/20 are as follows;**
 - First 9 months - Five slabs of Rs. 450,000 each @ 4%, 8%, 12%, 16% & 20% and excess @ 24%.
 - Last 3 months - Two slabs of Rs. 750,000 each @ 6% and 12% each and the excess @ 18%.

Accordingly, the assessable income & taxable income of first 9 months and the balance 3 months of 2019/20 to be computed separately and compute the income tax there on separately which leads to lot of practical difficulties.

- **The personal tax slabs & rates of individuals for 2020/21 onwards are as follows;**

Taxable Income		Tax Rate
1 st	Rs. 3,000,000	6%
2 nd	Rs. 3,000,000	12%
On the balance		18%

However, the business consisting of betting & gaming, manufacture and sale or import and sale of any Liquor or tobacco products tax @ **40%**. (Effective date may be 01.01.2020)

REMARKS/ADVICE:

- The Government might reconsider to reintroduce the WHT (PAYE) on employment income exceeding personnel allowance of Rs 3 million to secure the Government tax collection.
- With the current situation all individuals including employees having more than Rs. 250,000 total monthly assessable income (AI) should;
 - open personal tax files immediately,
 - pay quarterly income tax, (i.e. 4th Quarter by 15.05.2020) and
 - file individual tax returns (By 30.11.2020).

1.5.2 Partnerships

Current WHT of 8% on any partners share of partnership profit is removed w.e.f. 01.01.2020.

W.e.f. from 01.01.2020, the partnership's taxable income is to make liable to income tax as follows;

Taxable Income	What part of taxable Income	Tax Rate
Gains on realization of investment assets, if any	Gains on realization of investment assets	10%
Balance taxable income	Not exceeding (up to) Rs. 1,000,000	0%
- Do -	Exceeding Rs. 1,000,000	6% (on excess of Rs. 1,000,000)

1.5.3 Companies

With the new proposals the Income tax rates of companies would be as follows (Effective date ?);

14% - Tourism, Education, Healthcare, Constriction Services and Agro-processing^{*1},

14% - Specified Undertakings as defined in Sec. 195 [• entrepot trade, • offshore business, • front end services to overseas clients, • headquarters operations, • international trading related logistic services, • transshipment operations, • freight forwarding, • supply of services (being services which could be treated as essentially related to the manufacture of such goods or provision of such services exported by the exporter directly or through export trading house)(including services providing by a

shipping agent to its foreign principal) to any exporter of goods or services or directly to any foreign principal of such exporter, • production or manufacture of non-traditional goods • supply of non-traditional goods to an exporter exporting such goods, • some specified services connected with ships & container repair, braking & refurbishing, IT & computer data and services specified by the Minister, • sale of gems & jewellery for foreign currency],

14% - SME as defined in Sec. 195

14% - Business of sale of goods or merchandise where the proceeds in foreign currency is remitting through a bank to Sri Lanka *2.

14% - Dividends received from a resident company

18% - Manufacturing

40% - On conducting Betting & Gaming

40% - On manufacture & sale or import & sale of any Liquor or Tobacco products

10% - Capital Gains (continues @ 10%)

24% - On any other taxable income of a company

REMARKS

As per the above proposals;

- *1 *Health care, construction and agro-processing tax rate has come down from 28% to 14%.*
- *2 *Any export (even traditional) including local sale to a party remitting proceeds in foreign currency through a bank to SL is also attracts the concessionary tax rate of 14%.*
- *Manufacturing sector attract a lower tax rate of 18%.*
- *Trading, banking, finance and insurance sectors tax rate has come down from 28% to 24%.*
- *The concessionary rate of 14% given in the Act on **exporting of goods & services** is omitted in the latest IRD Notice.*
- *It is to be noted that the **agro farming (without any process of production/manufacture)** made exempted on the hand of all taxpayers w.e.f. 01.04.2019. However, agricultural produces (harvests) are generally perishable in nature and hence blocking the tax concessions on basic mandatory processing activities is not practical as it does not match with the intentions of offering tax concessions.*

For clarifications, you may contact;

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RANAWEERA ASSOCIATES
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16th April 2020

FURTHER REFERENCES:

- *Inland Revenue Act No. 24 of 2017*
- *IRD Notices of 18th February 2020 [Ref. No. PN/IT/2020-03 (Amended)], of 08th April 2020 [Ref. No. PN/IT/2020-03 (Revised)] & of 15th April 2020 [Ref. No. PN/PAYE/2020-01]*
- *CGIR's Circular of 08th April 2020 under the reference No. SEC/2020/02*