



Tax update

Guidelines on advance income tax and withholding tax

May 2020

# Guidelines on advance income tax and withholding tax

The Department of Inland Revenue (DIR) issued guidelines effective from 01 April 2020, to banks and financial institutions (*vide circular no. SEC/2020/03*), and withholding tax agents (WHA) (*vide circular no. SEC/2020/04*) on deducting advance income tax (“AIT”) from payments liable for withholding tax (WHT).

The guidelines have been uploaded on the DIR website ([www.ird.gov.lk](http://www.ird.gov.lk)).

This tax update explains the tax implications and compliance requirements arising for individuals and entities pursuant to these guidelines.

## 1. Deduction of AIT

### 1.1 Resident person

On receiving the consent, AIT can be deducted by the bank, financial institution, or WHA in respect of dividend, interest, discount, charge, natural resource payment, rent, royalty, premium, or similar payment made to a resident person (as applicable).

If consent is not provided, the bank, financial institution or WHA is not permitted to deduct AIT on the payment made to the resident person.

The declaration format is provided in the annexures under the respective circular notices (*refer annexure summary for reference*).

#### Deduction rates

The rates applicable for deduction of AIT will be based on the declaration made to the bank, financial institution, or WHA.

#### Resident individuals

Payment (LKR)		Tax rate
Annual declarations (Y/A)	Monthly deductions	
First 3 million	First 250,000	6 percent
Next 3 million	Next 250,000	12 percent
Balance	Balance	18 percent

#### Resident persons other than individuals

Entity type	Tax rate	Amount of payment* (LKR)
Partnership	6 percent	
Dividend to resident company	14 percent	
Charitable institution	14 percent	
Employee trust fund, provident fund, pension fund, or terminal funds	14 percent	
Other resident entities, including resident companies	24 percent	

\* The declarant must specify the amount of payment for which AIT is to be deducted. Exempt amounts can be excluded for this purpose.

## 1.2 Non-resident person

A bank or financial institution does not require the consent of the non-resident person for the deduction of AIT on interest or similar payments made to a non-resident person.

However, for a **non-resident individual who is a citizen of Sri Lanka**, WHT on interest will be deducted by the bank or financial institution only if aggregate interest income from the bank or financial institution exceeds LKR 250,000 per month or LKR 3 million for any year of assessment.

For this purpose, the bank or financial institution will need a declaration from the respective individual or his/her duly authorised agent/attorney that the assessable income for that individual has not exceeded LKR 3 million for that year of assessment.

The declaration format is provided under **Annexure 1** of **DIR circular no. SEC/2020/03**.

If the individual does not provide the declaration, WHT will be deducted on gross interest payment. However, if the declaration is provided, WHT will be deducted only on interest amount as stated in the declaration to the bank or financial institution.

## 2. Payments liable for WHT

WHT will apply as follows in respect of payments (excluding exempt payments\*) having a source in Sri Lanka.

Payment	WHT rate	*
Payment of interest (excluding exempt interest) by a bank or financial institution or discounts and income received from an Islamic financial institution	5 percent	
Payment of interest (excluding exempt interest) and discounts that have a source in Sri Lanka, paid or payable to any non-resident person	5 percent	
Winning from lottery, reward, betting, or gambling (exceeding LKR 500,000)	14 percent	
Sale price payable to the seller of any gem sold at an auction conducted by the National Gem and Jewellery Authority	2.5 percent	
Payments of amounts by a resident person as charge, natural resource payment, rent, royalty, premium, retirement payment, or other similar payment (excluding exempt amounts), which has a source in Sri Lanka, paid or payable to any non-resident person	14 percent	
Payments by a resident person to a non-resident person with respect to land, sea, air transport, or telecommunication service (subject to the double tax avoidance agreement)	2 percent	

*Exemptions on WHT will apply as provided under the Inland Revenue Act No. 24 of 2017 ("IRA") read together with the amendments proposed to the IRA vide DIR notice [PN/IT/2020-03 (Revised)] issued 8 April 2020. The formal amendment to the IRA in respect of these amendments is expected to follow in due course.*

**A declaration, statement, or certificate provided to a bank or financial institution is treated as a statement made to a tax official under Section 181 of the IRA. A penalty will be imposed for any false or misleading information of material particulars.**

## 3. Application of the double tax avoidance agreement (DTAA) for payments to non-residents

If the DTAA rate is lower than the domestic law payment, the lower rate in the DTAA could be availed in respect of that payment to a non-resident.

## 4. Time of deduction

The tax will be deducted at the time the relevant amount is paid, credited, re-invested, accumulated, capitalised, or made available to the person by the bank, financial institution, or WHA.

## 5. Certificate of deduction

Every bank, financial institution, or WHA who has deducted WHT or AIT, is required to issue a certificate of WHT or AIT deduction to the respective person in the specified format (refer annexure summary for reference).

The certificate must cover a calendar month and must be served within 30 days after the end of the month.

## 6. WHT - Other considerations

Consideration	Interest payments by banks and financial institutions	Payments by other WHA
Amount considered for WHT	Gross interest (other than repayment of capital under a debt obligation)  Sum referred to as “excess” over the original payment (in case of certificate of deposit), discount or profit from an Islamic financial transaction	Gross amount excluding VAT
Payment to non-residents	If remitting the total amount of the due payment (before deducting WHT), such amount will be considered as net amount.  WHT will apply on the amount grossed up for taxes.	
Application of currency exchange rate on payments	Selling exchange rate published on the central bank website relevant to the date of remittance, to convert the foreign exchange amount into LKR	
Joint Investments	Relevant payment will be apportioned between joint owners, in proportion to their interest in the investment  If the interest of the joint owners cannot be ascertained, the relevant payment will be considered equal.	

## 7. Considerations for banks, financial institutions, and WHA

- WHT deducted must be remitted to the DIR within 15 days from the end of the calendar month. As provided under circular no. SEC/2020/04 (the WHA circular), WHA will be informed about the collection of the WHT on payments to non-residents, under circulars to be issued in due course, in connection with the furnishing of tax clearance certificates to banks for outward remittances.
- The bank, financial institution, or WHA deducting WHT or AIT, must be registered as a WHA with the DIR. Registration should be obtained from the DIR not later than 30 days before the commencement of deduction of WHT or AIT.
- Deduction of AIT can be done under the registration of a WHA.
- The documentation (including declarations received) must be maintained per the circulars, and should be furnished at the tax official’s request or for the inspection by the tax official.
- The schedules to the annual statements should be submitted for the WHT or AIT deducted. Such schedules are required to be furnished in an electronic form. However, if the number of taxpayers liable for WHT or AIT deduction is fewer than 20, hard copies may be submitted.

## Annexure summary

The summary of the reference to the respective annexures under the circulars issued for WHT/AIT is given below.

Circular	Annexure o.	Annexure reference
Banks and financial institutions (circular no. SEC/2020/03)	<b>1</b>	Declaration by non-resident, Sri Lankan citizens to banks or financial institutions
	<b>2 (a)</b>	Declaration by resident individuals to banks or financial institutions
	<b>2 (b)</b>	Declaration by resident entities to banks or financial institutions
	<b>3 (a)</b>	Certificate of AIT deduction
	<b>3 (b)</b>	Certificate of WHT deduction
	<b>4</b>	WHT/AIT deduction schedule for interest payments to non-residents
Withholding tax agents (WHA) (circular no. SEC/2020/04)	<b>1 (a)</b>	Declaration by resident individuals
	<b>1 (b)</b>	Declaration by resident entities
	<b>2 (a)</b>	Certificate of AIT deduction
	<b>2 (b)</b>	Certificate of WHT deduction
	<b>3</b>	Schedule for deduction of WHT that includes payments made to non-residents (excluding import of tangible goods) that are not subject to WHT



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