



Tax update: Income tax
Implementation of proposed amendments

April 2020

Income tax–Implementation of proposed amendments

The Department of Inland Revenue (DIR) has issued a revised notice (PN/IT/2020-03 (Revised)) on 8 April 2020 for implementation of amendments to the Inland Revenue Act No.24 of 2017 (IR Act) with effect from 1 January 2020.

These amendments have been made on the instructions of the Ministry of Finance issued on 31 January 2020 and 5 March 2020.

These proposals will be implemented from **1 January 2020**, unless otherwise stated. Formal amendment to the IR Act is expected to follow in due course.

The DIR implementation notice has been summarised below.

1. Withholding tax (WHT) on payments to resident persons

WHT is abolished for the following payments to resident persons:

Removal of WHT on interest income for residents

The effect of this amendment will make interest income (for whom it was a final tax earlier) a part of the taxpayer's assessable income.

Removal of WHT on specified fee paid to residents

WHT on service-fee payments to non-residents will continue. However, amounts derived by any non-resident person from laboratory or standards certification services will be exempt.

Removal of WHT on dividends, discount, charge, natural resource payment, rent, royalty, premium, or retirement payments made to residents*

The effect of this amendment will make dividend income, the tax on which was considered a final tax earlier, a part of the taxpayer's assessable income.

** However, with effect from 1 April 2020, if any of above payments are regular fixed payment (interest, rent, etc.) on the recipient's request, an advance income tax (which can be claimed as a tax credit) could be deducted by the withholding tax agent (WHA) at the point of making such payment, per declaration made to the WHA. The DIR is expected to issue a separate guideline in this regard.*

Removal of WHT on partners' shares

The taxable income of the partnership exceeding LKR 1 million per annum will be subject to the partnership tax at the rate of 6 percent.

2. WHT on payments to non-resident persons

Non-resident persons will be subject to WHT, provided the payments have a source in Sri Lanka.

The WHT rates below will be subject to the provisions of the respective double tax avoidance agreement as applicable.

Payment	Rate
Dividends	Exempt
Interest (excluding exempt interest)	5 percent
In case of a Sri Lankan citizen who is a non-resident, the WHT will apply only if the aggregate interest income from a bank or financial institution exceeds LKR 250,000 per month or LKR 3 million per annum	
Land, sea, air transport or telecommunication service	2 percent
Service fee and insurance premium	14 percent
Any other payment	14 percent

3. Pay as you earn (PAYE) tax

PAYE has been removed from employment income for resident employees.

The effect of this amendment will make employment income a part of the taxpayer's assessable income, shifting the compliance obligation to the employee.

Accordingly, employees earning an aggregate income from all sources (including interest dividends etc.), of more than LKR 250,000 per month or LKR 3 million per annum will be required to file a return of income.

With effect from 1 April 2020, an employee whose gross remuneration for a month exceeds LKR 250,000 per month or LKR 3 million for a year of assessment, can request the employer to deduct an advance personal income tax, which can be claimed as a tax credit. The DIR is expected to issue a separate guideline in this regard.

4. Terminal benefits

The income tax rate has been revised on terminal benefits (i.e., amounts received in commutation of a pension, retiring gratuity, loss of office, and ETF) as below.

Though PAYE has been abolished on the employment income of a resident person, the employer must retain tax on terminal benefits paid including ETF per the instructions published under DIR Circular No. SEC/2020/02 dated 18 February 2020. An employee will have to obtain a direction from the DIR as earlier.

The tax liability will be calculated as follows.

Criteria to determine terminal benefit rate	Applicable rate
Compensation for loss of office is under a uniform scheme	Concessionary rate First LKR 10 million - Exempt Next LKR 10 million - 6 percent Balance - 12 percent
Compensation for loss of office under a scheme that has not been approved by the Commissioner General	Standard rate i.e., the normal rates applicable for individual income tax

5. New exemptions – Income tax

		Effective date
a)	Interest accruing to or derived by any person outside Sri Lanka, on any loan granted to any person in Sri Lanka or to the government of Sri Lanka	1 April 2018
b)	Interest income earned by any person on foreign currency accounts opened in any commercial or specialised bank in Sri Lanka, with the approval of the Central Bank of Sri Lanka	1 January 2020
c)	Funds received by any public corporation out of the funds voted by the Parliament from the consolidated fund, or out of any loan arranged through the government	1 April 2018
d)	Any income (i.e., interest, discount or realisation of any gain) earned by a non-resident (other than a permanent establishment) on any sovereign bond denominated in foreign or local currency	1 April 2018
e)	Interest or discount paid or allowed to any person on sovereign bond denominated in foreign currency (including Sri Lanka Development Bonds)	1 April 2018
f)	A dividend paid by a resident company to a member to the extent that dividend payment is attributable to, or derived from, another dividend received by that resident company or another resident company	1 January 2020
g)	Dividend paid by a resident company engaged in any one or more of the following businesses, in line with 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, No.4 of 1978) will be exempt in the hands of the recipient. (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 them into Sri Lanka (iii) Providing front-end services to clients abroad (iv) Headquarters operations of leading buyers for management of financial supply chain and billing operations (v) Logistics services, such as bonded warehouse or multi- country consolidation in Sri Lanka	1 January 2020

		Effective date
h)	<p>Dividends from and gains on the realisation of shares in a non-resident company, derived by any person with respect to a substantial participation* in the non-resident company</p> <p>* "Substantial participation" is defined in paragraph (r) of the third schedule to the IR Act as below.</p> <p>i. Holding 10 percent or more of the value of shares in the company, excluding redeemable shares; together with</p> <p>ii. Control, either directly or indirectly, of 10 percent or more of the voting power in the company</p>	1 January 2020
i)	Gains and profits earned or derived by any person from the sale of produce of an undertaking for agro farming without subjecting such produce to any process of production or manufacture	1 April 2019
j)	Gains and profits earned or derived by any person from IT and enabled services as may be prescribed	1 January 2020
k)	<p>Gains and profits earned or derived by any person from:</p> <p>services rendered in or outside Sri Lanka, to any person, and used outside Sri Lanka, where the payment for such services is received in foreign currency and remitted through a bank to Sri Lanka</p> <p>Any other foreign source where such gains and profits are earned or derived in foreign currency and remitted through a bank to Sri Lanka</p>	1 January 2020
l)	Grants and donations received by religious institutions registered with the relevant ministry	1 January 2020

6. Qualifying payments and new reliefs

Qualifying payments	Effective date
Personal relief of LKR 3 million per annum for resident individuals and non-residents who are citizens	1 January 2020
Payments made to the consolidated fund by any public corporation	1 April 2019

New relief	Effective date
<p>Permitted deductions in calculating personal income tax (subject to a maximum of LKR 1.2 million per annum) include the following:</p> <ul style="list-style-type: none"> • Health expenditure, including contributions to medical insurance • Education expenditure incurred locally for such individuals or on behalf of their children • Payment of interest on housing loans • Contribution to an approved pension scheme • Expenditure incurred for the purchase of equity or security 	1 January 2020

7. Revision of income tax rates

a) Individuals

Personal income tax: Resident and non-resident* individuals

Taxable income from 1 January 2020 to 31 March 2020	Taxable income from 1 April 2020 (per annum)	Income tax rate
First LKR 750,000	Next LKR 3 million	6 percent
Next LKR 750,000	Next LKR 3 million	12 percent
Balance	Balance	18 percent

* In case of non-resident individuals, these tax rates apply on the income, which is not subject to final tax for non-residents.

Tax rate of 40 percent applies on businesses engaged in betting and gaming, manufacture and sale, or import and sale of any liquor or tobacco products

b) Companies

Industry	Corporate income tax rate
Standard rate for companies	24 percent
Small and medium-sized enterprises Export of goods (where the payment for such sale is received in foreign currency and remitted through a bank to Sri Lanka) Specified undertaking Educational services Promotion of tourism Construction services Agro processing Healthcare services Dividends received from a resident company	14 percent
Manufacturing	18 percent
Betting and gaming	40 percent
Manufacture and sale or import and sale of any liquor or tobacco products	40 percent

c) Partnership

Taxable income	Tax rate
First LKR 1 million	0 percent
Exceeding LKR 1 million	6 percent on the excess of LKR 1 million
Gains on realisation of investment assets	10 percent



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