LIST OF INTERPRETATIONS

(in a generalized and summarized form)

Set I

Committee on Interpretation of Tax Laws
Department of Inland Revenue

November 2013

Ref: SEC/IC/2013-1 31.12.2013

To: All officers

Interpretation of Tax laws

As stipulated in Section 208A of the Inland Revenue Act No.10 of 2006, [which was introduced by the Amendment Act No. 22 of 2011], the Committee (comprising senior officials) appointed thereunder by the Commissioner General, is statutorily empowered for the interpretation of provisions of any enactment administered by the Department of Inland Revenue, notwithstanding anything to the contrary in such enactments. In addition, the Committee is required in terms of such mandate, to issue all necessary guidelines and instructions, to ensure uniformity in the application of such provisions in line with such interpretation.

Accordingly, as it is considered necessary that the Revenue Officers, Taxpayers as well as the Tax Practitioners, need to be apprised of the interpretations given by the Committee with respect to provisions of the relevant enactments. Therefore, such interpretations which could be summarized in such a manner, that the secrecy with regard to the affairs of the respective taxpayers is preserved, are given in **PART I** in a generalized form entailing the respective **interpretation number** and the **section** of relevant enactment.

The **PART II** sets out a modified version of rulings, given earlier on respective matters by the Secretariat, then CCIR or under the hands of CGIRs, with appropriate adjustments made by the Committee, where relevant, to be in line with the present context of respective laws.

Any of these summarized interpretations or rulings may be released to any concerned party. The process of issuing interpretations given by the Committee, in a generalized form and summarized manner, to the stakeholders, will continue in the future as well.

H.B.A. Seneviratne
Chairman [Committee for Interpretation of Tax Laws]
Senior Deputy Commissioner General, IRD

CONTENTS

PART - I

Page

PART - II

PART - I

Interpretations of certain provisions of tax laws, which could be summarized into a generalized form in a manner that the secrecy with regard to the affairs of the respective taxpayers is preserved, are given in this PART entailing the respective **section number of relevant enactment** (in the ascending order) and the relevant **interpretation number**.

Interpretations under

(A). INLAND REVENUE ACT NO.10 OF 2006

[**hereinafter referred to as "IR Act"**]

01. Taxation of Remunerations and the other receipts of Showroom Managers

Showroom Managers of certain companies receive, in addition to remunerations, sums by way of commissions and incentives for managing and carrying on the showroom (under an agreement entered in to with the employer company). Whether such commissions and incentives etc. received by such Showroom Managers fall within the meaning of profits from employment, or from trade or business?

In terms of said Agreements (i.e. generally entered in to between the two parties, in a situation like this), Showroom Managers are expected to manage the showroom by employing their own staff, etc. and bound by other statutory obligations in that regards. As such, they are required to manage the showroom, out of the commissions/incentives received from the employer, in the same manner as other traders do.

Accordingly, any such sale commission or incentive should be treated as receipts of such Managers from a trade or business, and liable to income tax, or any other tax.

Nevertheless, even in such a situation all inclusive consolidated salaries and allowances of any such Showroom Manager constitutes his "profits from employment", and liable to tax deduction under PAYE scheme.

[Generally, commissions or incentives; etc. received by an employee, in the course of an employment, form part of his employment income. However, the large commissions received by insurance agents or sales representatives who are in receipt of small salaries; the gross remuneration of sub-post masters or guarantee Shroffs; or such receipts in a situation like aforementioned Showroom Managers, are treated not as profits from employment, but as receipts from trade or business.]

[IC/2012/44] **[Section 3, and 4]**

02. Benefits under a "worldwide save for shares scheme"

Under the scheme named as "worldwide save for shares scheme", every employee of a Company could opt to participate in the scheme and those who opted so are required to save money in their own bank accounts monthly. Then, they become eligible to reserve shares of the Company at the prevailing share price, based on the amount of such savings for a specified period, while earning interest thereon.

Under this arrangement, the respective employees do not acquire shares or make any payment for shares (other than mere reservation), but at the end of the specified period they receive a benefit equal to the excess of the value of shares on that date over the value of such shares at the time of reservation.

Whether such a benefit received by employees of the Company under the said scheme, is liable to income tax?

This benefit cannot be viewed none other than from the employment of respective employees, and accordingly, should form part of remunerations of the respective employees, and the tax deduction requirement under PAYE scheme will also be applicable on such benefits.

[IC/2011/50] **[Section 4]**

03. Reimbursement of medical expenses under Contributory Medical Scheme

Whether the reimbursement of medical expenses under a Contributory Medical Scheme operated by a Company amounts to a taxable benefit as contemplated under section 4 of the IR Act and the Gazette Notification No. 1706/18 dated 20 May 2011?

The employer (company) does not make any monthly contribution to the Medical Scheme, but hold the pool funds contributed by each employee to be utilized for medical expenses of any employee when a claim is made.

In the event of hospitalization, the employer reimburses the actual cost irrespective of the amount of contribution made by relevant employee. The monthly contribution by any employee is apparently very nominal and in any case the company does not maintain separate contribution schedules for each employee.

Under these circumstances, the medical expenses (hospitalization cost) reimbursed by the Company to any employee should form part of his employment income.

[IC/2012/45] **[Section 4]**

04. Applicability of interest exemption on investments made in Quoted debt securities

In terms of Section 9(o) of IR Act, as amended by the Act No. 18 of 2013, the interest or discount accruing or arising to any person for any year of assessment commencing on or after April 1, 2013, from any investment made on or after January 1, 2013 in any quoted corporate debt security, is exempt from income tax.

This exemption is applicable to interest accruing or arising to any person from any such investment in such securities, irrespective of whether that investment is made at the time of primary issue, or by purchasing such securities from the secondary market. Further, as per Section 135 of the IR Act, as amended by Act, No. 18 of 2013, the withholding tax also should not be deducted from the interest or discount in relation to such exempt securities effective from April 1, 2013.

Furthermore, for any year of assessment commencing on or after 01.04.2013, the profits and income from any investment made on or after 01.01.2013, in such corporate debt securities are also exempt from income tax under Section 13 (xxxxxxx) of IR Act. However, expenses incurred in relation to such exempt profits will not be deductible in the computation of other profits and income.

[IC/2013/09] **[Sec 9(o), 13(xxxxxxx), 135]**

05. Exemption of dividends and fees received in foreign currency, under Sections 10(1)(j) and 13(ddd) of IR Act, respectively.

A company resident in Sri Lanka is engaged in the investment activities overseas, and the provision of technical and marketing support services to such investee Companies. In return, the Company receives dividends, technical fees and marketing fees, in foreign currency through a Bank.

Under the provision of section 10(1)(j) of the IR Act, any dividend distributed by a non-resident company to a resident company is exempt from income tax, if such dividend is remitted to Sri Lanka through a bank. However, when such dividends are distributed by the Sri Lanka Company, in turn, to its shareholders, such dividends will be liable to income tax.

Further, the section 13 (ddd) of IR Act will be relevant in determining the liability to income tax, of profits and income derived, in foreign currency by any resident Company for any service rendered to persons outside Sri Lanka, on or after April 1, 2011. Accordingly, the fees for such technical and marketing support services (other than any commission, discount or other similar receipt), earned by the Company in foreign currency (without any business connection) and remitted to Sri Lanka through a bank, will be exempt from income tax.

[IC/2011/33] **[Sec 10(1)(j) and 13(ddd)]**

06. Liability of a Company on dividends distributed out of Off-shore profits

IR Act (No.10 of 2006), or the Act, No.38 of 2000 contains no provision to exempt any dividend from income tax, for the mere reason that such dividend was distributed out of profits exempt from income tax.

A dividend is liable to income tax, whether distributed out of profits liable to tax or not, unless such dividend is specifically exempted.

[IC/2012/03] **[Sec 10(2)]**

07. Applicability of Exemption on Rental Income

Whether the lease rent from leasing an apartment to a Company, prior to 01.04.2008, to be used as a residence of an employee of that Company is exempt from Income Tax, for the specified period, under Section 11(2)(a) of the IR Act, as amended by Act, No. 09 of 2008?

An apartment (the floor area of which is not more than 1500sq feet) in a condominium unit constructed by the developer prior to 31st March, 2008, which was purchased (by an individual), has been leased out to a Company for the use as a residence of an employee of the Company.

In this circumstances, irrespective of the fact that the house is leased out to a commercial entity or otherwise, the income accruing to the owner (lessor) of that house will be exempt from income tax for **the period as specified** in section 11(2) (a) of the IR Act, so long as it is not used for any purpose other than residential purpose.

[IC/2011/59] **[Sec 11(2)(a)]**

08. Exemption from income tax, of earnings from professional services provided to a person outside Sri Lanka.

A Company in Sri Lanka providing professional services to an enterprise of Sri Lanka's treaty partner Country, earned income from fees for such services, which are remitted to Sri Lanka through a bank. In the meantime, the overseas enterprise established with effect from April 1, 2011, an office (a Permanent Establishment) in Sri Lanka.

Income earned by the Sri Lanka Company for the year of assessment 2010/11, from providing services to an enterprise outside Sri Lanka, will be exempt from Sri Lanka income tax, under section 13(dddd) of the IR Act, as such earnings were remitted to Sri Lanka (and presumably, the other conditions are also satisfied).

But, commencing from 01.04.2011, as the outside enterprise has a Permanent Establishment (PE) in Sri Lanka, the Sri Lanka Company **will not be eligible for such an exemption** due to the existence of a PE in Sri Lanka for such outside enterprise.

It is evident from the existence of PE in Sri Lanka, that the overseas enterprise is not actually a person fully outside Sri Lanka.

[IC/2012/12] **[Sec 13(dddd), 13(ddd)]**

09. Exemption of interest on certain loans given by banks [Section 13(x) of the IR Act]

Whether the exemption referred to in Section 13(x) could be applied for interest received by a bank on a loan granted to a BOI undertaking which is relocated, but not satisfying certain conditions stated in in Section 21(2) of the IR Act, before the stipulated date?

The exemption under said section 13(x) of IR Act is applicable to banks even in relation to any such loan given to a BOI undertaking which is relocated having fulfilled the conditions specified in Section 21 of the said IR Act. One of the conditions to be so fulfilled is that the undertaking should have been relocated in any of the respective district and continued to carry on commercial operations commencing from a date not later than March 31, 2010. This condition has not been fulfilled by the aforementioned BOI undertaking.

As this BOI undertaking is otherwise (if it were not a BOI undertaking) not eligible for the exemption under Section 21, then the exemption of interest referred to in Section 13(x) will not be applicable to the respective bank in respect of any loan granted (to such BOI undertaking).

[IC/2013/18] **[Sec 13(x)]**

10. Liability on the profits from manufacturing "black tea" [applicability of (exemption) under Section 16 of IR Act]

Is the manufacture of tea exempt from income tax, with the amendment made to section 16(2)(b) of IR Act, by Act No.19 of 2009?

'**An undertaking for the manufacture of tea**' had been excluded from the scope of the definition of undertaking referred to in the paragraph (b) of Section 16(2) of the IR Act, in view of the specific situation referred to in section 16(3) for the tea industry, and not to make green leaf liable to tax even if any of the primary process referred to in that paragraph (b) is carried out.

The effect of the amendment made to paragraph (b) of subsection (2) and subsection (3) thereof, by the Act No.19 of 2009, is to extend the same relief (as for tea), to manufacturers of any product [other than products specified under paragraph (c) of subsection (2), which are exempt in any case] manufactured by using **any produce** referred to in Sec 16 (2) (a).

The "black tea" is a distinct product for the market made out of green leaf. Therefore, the profits arising from the manufacture of black tea [except items specified by gazette order under paragraph (c)] is not exempt under section 16(2)(b) of the aforesaid IR Act.

[IC/2011/58] **[Sec 16(2)]**

11. Applicability of exemption under Section 16 of the IR Act in relation to "Dairy Products"

'**Dairy produce'** referred to in Section 16(2)(a) of IR Act, for the purpose of the definition of "agricultural undertaking", should mean the fresh milk, and not any product made out of fresh milk.

Further, the undertaking referred to in Section 16(2)(b) of the Act does not include any process by which the character of any produce referred to in said section 16(2)(a) is changed. The products made out of dairy produce, being distinct products for the market, do not qualify for this exemption.

As such, the profits and income in relation to the products such as Cheese, Gee, butter, cream, etc. are not exempt under Section 16 of the aforesaid IR Act.

However, as provided under Section 16(2)(c), any product made by conversion of any agricultural produce referred to in section 16(2)(a) which is specified by notice published in the Gazette would qualify for this time bound exemption. (only 'tea bags' weighing not more than 4 Grams, Yoghurt, curd, chili powder and ready to drink milk have been gazetted for this purpose).

[IC/2012/32] **[Sec 16(2)]**

12. Applicability of Section 16 or 17 of IR Act, in relation to a milk based product.

A Company is engaged in the manufacture of fresh milk based **ice cream** and other dairy products. In that, not only fresh milk, but also powdered milk [which is already a processed product and not an agricultural produce referred to in Section 16(2)(a)] is used by the Company for such manufacture.

In the process of manufacturing 'ice cream' and other dairy products, even if the fresh milk only is used, the character of the fresh milk is changed into another product. In other words, it is a process of converting one type of produce into another, and such products are distinct products made out of fresh milk. Therefore, the Company cannot be considered as engaged in an undertaking referred to in section 16(2)(b) of the IR Act.

Further, as the milk powder is not an agricultural produce, but a product already made (or processed) out of fresh milk (being an agricultural produce), the ice cream made mainly out of milk powder does not qualify for exemption under section 17 of IR Act, either.

The profits and income of the company are, therefore, not exempt either under Section 16(2) (b) or 17 of the IR Act.

[IC/2012/33] **[Sec 16 or 17 of IR Act]**

13. Applicability of section 17 of IR Act, in relation to import and sale of electronic goods.

A Company is engaged in the import and sale of electronic goods. Is the company engaged in an undertaking specified under Section 17 of the IR Act, and eligible for the exemption on its profits from the sale of such electronics, if the required level of investment has been made?

The exemption under aforesaid Section 17, in relation to electronics, is applicable only for an undertaking engaged in the manufacture or processing of electronics. The said Company is engaged only in the sale of (imported or locally purchased) electronics, and hence, the exemption under section 17 will not be applicable to this Company, even if the other conditions are satisfied.

[IC/2011/38] **[Sec 17]**

14. Applicability of section 17A of the IR Act, for the contractor engaged in a construction project.

The Section 17A, in relation to a construction contract, is applicable to the person who made the capital investment in such construction work. Generally, the contractor does not make a capital investment therein, but only provides a service to the other party (the developer) by constructing respective buildings; etc.

Furthermore, the developer and the contractor both cannot enjoy tax benefits under the respective Section (i.e. Section 17A) on the same investment.

However, if the investment criteria and the other conditions are fulfilled separately by the contractor, then this exemption would be applicable to the contractor as well.

[IC/2012/18] **[Sec 17A]**

15. Applicability of exemption under section 17A of IR Act, in relation to a project of a Company.

Whether a project of a Company could be treated as an undertaking specified under section 17A of the IR Act, as last amended by Act No 18 of 2013, if the respective investment criteria is satisfied?

For the eligibility of exemption under the aforesaid section, the Company should have established a new undertaking with the respective investment and engaged in the respective activities as specified, on or after April 1, 2011. A new undertaking (of a company) means an undertaking functioning as if a separate company (though in fact it is not).

A project of a Company to be treated as a new undertaking for the purposes of the aforesaid Section, such project should be capable of functioning as an independent unit. Any asset or employee should not be kept or used in common between such project and the company or any of its other undertaking, if it is to be considered a new undertaking. Profits and income of such new undertaking should be derived only from the new capital invested on such new undertaking.

Any project of a Company not satisfying such requirements could not be considered as eligible for the exemption under section 17A of the IR Act.

[IC/2012/22] **[Sec 17 A]**

16. Allowance for depreciation in respect of any plant or machinery used in the business of construction work on or after April 1, 2011.

As per paragraph (c) of the proviso to section 25(1)(a) of IR Act (as amended by Act, No. 08 of 2012), the rate for the allowance of depreciation, in respect of any plant or machinery used in any business of construction work, is:

- **twenty five** per centum of the cost of acquisition, if the acquisition is on or after April 1, 2007, but prior to April 1, 2011;
- **thirty three and one third per centum** of the cost of acquisition or assembly, if the acquisition is on or after April 1, 2011

[IC/2012/14] **[Para (c) of proviso to sec 25(1)(a)]**

17. Capital allowance in respect of a motor vehicle used exclusively for demonstration purposes

A company dealing in motor vehicles uses one of the motor vehicles in the trading stock, exclusively for demonstration purposes. Is the company eligible to deduct capital allowance under section 25 of the IR Act, in respect of that motor vehicle?

The said motor vehicle represents a part of the stock in trade of the company, and is not a capital asset used in the business. Therefore, the company is not eligible to deduct any depreciation allowance (or capital allowance) in respect of that vehicle, unless it is capitalized and used as a qualified asset.

[IC/2011/12] **[Sec 25(1)(a)]**

18. Capital Allowance on buildings

Question is whether a building is eligible for deduction of depreciation allowances under section 25(1)(a)(v) of the IR Act, on its cost of acquisition **including the land value?**

The value of land in which the building erected should not form a part of the cost for the purpose of computing the allowance for depreciation in respect of constructing the building, as the allowance is due only on the cost of construction.

Where a building is purchased, and which is qualified for deduction of depreciation allowance, then a reasonable percentage of the cost of acquisition should be excluded from the composite cost of land and building. The allowance should be deducted only on the cost of acquisition of the building arrived at on such percentage basis.

[IC/2011/41] **[Sec 25(1)(a)(v)]**

19. Meaning of the phrase "aggregate Debts Outstanding" as referred to in the proviso to section 25(1)(eee) of IR Act

As referred to in paragraph (eee) of section 25(1) of the Inland Revenue Act (as amended by Act No.10 of 2007), for the purpose of allowing doubtful debts of a bank or financial institution ……, such sums so considered reasonable shall not exceed one per centum of the ***aggregate debts outstanding*** at the end of that period".

The aforementioned phrase "aggregate debts outstanding" as referred to therein, for quantifying the maximum quantum of allowable doubtful debts of a bank or financial institution (as at any particular date), could only be comprised of debts of such bank or financial institution as at that date, being any debt having a possibility of becoming bad only.

Accordingly, the phrase should be interpreted as not including any item of debt which is not having any possibility (or probability) of becoming bad.

[IC/2011/39] **[Proviso to Sec 25(1)(eee)]**

20. Taxation of proceeds from the disposal of a property (land & building) owned by a company (under liquidation), and the deductibility of its liquidation expenses.

The proceeds from the disposal of a property (land & building) owned by a company which is under liquidation have been shown separately for the land and the building, by the liquidators. Further, the liquidation expenses related to the land and building have been deducted from the proceeds related to the building only.

If the valuations of the land and the building could be accepted as accurate, such values could be treated separately for the purpose of taxation. Accordingly, the proceeds related to the land, being a profit of a casual and non-recurring nature, will not be taxable while the proceeds related to the building, in respect of which the allowance for depreciation has been granted, is liable to tax.

As per the section 25(1)(l), the expenditure incurred in the formation or liquidation of a company could be deducted in ascertaining its profits and income. However, in that, any expenses which could not be clearly identified as incurred in the production of profits and income liable to income tax, is not deductible.

[IC/2012/61] **[Sec 25]**

21. The meaning of interest deductible from the total statutory income.

As defined in paragraph (a) of Section 32 (5) of the IR Act, for the purpose of that paragraph, the interest means any 'interest' paid on a loan, the proceeds of which are utilized for construction or purchase of any building or for the purchase of any site for the construction of any building;……". The Sinhala text also gives this same meaning as it does not use the words "එක්කෝ..... නැතහොත්".

මෙහිදී "හෝ" යන අර්ථයෙන් "නැතහොත්" යොදා ඇත.

Accordingly, the deductible interest could be any interest paid on any loan, the proceeds of which are utilized

- for the construction of any building;
- for the purchase of any building; or
- for the purchase of any site for the construction of any building.

It should be noted that the interest paid is deductible on any number of such loans, the proceeds of which are utilized for any or all of such activities.

[IC/2012/41] **[Sec 32(5)(a)]**

22. Whether the return furnishing requirement is applicable to an employee who is receiving, in addition to the remuneration from the current employment, a pension from a past employment, and interest from bank deposits.

Section 32(3)(*i*) of IR Act (as amended by Act No.22 of 2011), provides that where income tax is deducted at source from the employment income of an individual under section 114, such tax represents final tax thereon if such individual has no any other income other than income from which tax is deducted at source as a final tax.

However, in parallel to that, the section 117A of that Act provides that, where an employer pays any remuneration (or provides any benefit) to any employee who is also an employee of another employer and such other employer deduct income tax on the remuneration under PAYE provisions as such employee's main employer, then such first

mentioned employer is required to deduct income tax on aggregate of such payments and the value of such benefits:

- at 16%, if such aggregate per month exceeds Rs. 25,000/=; or

- at 10%, if such aggregate per month does not exceed Rs. 25,000/=

Accordingly, **if income tax has been deducted as aforesaid** for any year of assessment commencing on or after April 1, 2011 **[**under PAYE Tax Table 1,2, ….or 7(at 10% or 16%)], such employee is not required to furnish a return under section 106 (1) of the said Inland revenue Act.

[IC/2012/67] **[Sec 32(3)(*i*), 114, 117A and 106(1)]**

23. Deductibility of donations made in kinds, to a Govt. Hospital

Any donation (whether in money or otherwise) made to a Government Hospital (whether national or provincial) is fully deductible from the assessable income of the donor in the respective year of assessment in which such donation is made, under Section 34(2)(b)(i) of the IR Act.

Any balance can also be carried forward to the following year of assessment and so on, and deducted from the assessable income, until such sum is fully deducted.

However, as a confirmation of the donation made, the receipt issued by the Director of the respective Hospital, needs to be produced.

[IC/2011/54] **[Sec 34 (2) (b) (i)]**

24. Whether electrical insulations fall within the meaning of construction of building

As defined in the Section 45(2)(c) of the IR Act, the construction of any building falls within the meaning of an undertaking for construction work.

However, the electrical insulation could only be a part of construction work and that alone could not be an undertaking for construction work.

Therefore, the concessionary rate referred in the fifth schedule, for the purpose of Section 45(2)(c), will not be applicable in relation to a person engaged in electrical insulation alone.

[IC/2012/78] **[Sec 45(2)(c)]**

25. Applicable Income Tax Rate for a Non-resident Company engaged in an undertaking for Construction work (as defined in Sec 45).

Profits from any undertaking for "**construction work**" carried on by a Company resident in Sri Lanka is taxable at a concessionary rate of 12%. It means that a non-resident company is not eligible to apply this rate of 12%.

However, if such Company (contractor) is a resident of Sri Lanka's tax treaty partner Country, then under the provisions of Non-discrimination Article of the Double Taxation Avoidance Agreement (Tax treaty) between Sri Lanka and that Country, in the absence of any provision to the contrary in the respective treaty, such non-resident Company as well becomes entitled to apply 12% rate on the profits from that undertaking for construction work, if other conditions stipulated in Section 46 are satisfied.

[IC/2012/62] **[Sec 46]**

26. Applicability of Section 59B of the IR Act, in relation to professional services.

Whether the 10% concessionary tax rate under Section 59B of the IR Act is applicable to profits from services of professionals such as Doctors, Lawyers, Chartered Accountants etc., and whether such rate (of 10%) is a flat rate?

The profits from services of a professional do not fall within the scope of Section 59B, as such profits could not be from an undertaking carried on by the professional, even though he is eligible to deduct certain expenses incurred in the production of his professional income. An undertaking always refers to a kind of business, but not to a profession which is practiced independently through his professional and intellectual excellence.

Further, the rate mentioned in the Section 59 B is a flat rate for an undertaking carried out by any person for the year of assessment 2011/12. However, a revision has been made effective from the Y/A 2012/13, for such rate to be a maximum rate under the progressive rate schedule in case of any individual, and a flat rate in case of any other person (except holding company, a subsidiary company, or an associate company of a group of companies for which the provision of Section 59 B has no application).

[IC/2012/20] **[Sec 59B]**

27. Applicability of Section 59B of IR Act, in relation to healthcare services.

Whether the section 59B of the IR Act (effective from April 1, 2011), is applicable in relation to the profits and income of a practicing doctor deriving income from his private dispensary.

The profits and income from professional services such as indoor/outdoor channeling (private practices) do not fall within the scope of Section 59B, as such profits could not be from an undertaking carried on by a Doctor even though he is eligible to deduct certain expenses incurred in the production of his professional income.

An undertaking always refers to a kind of business, but not to a profession which is practiced independently through his professional and intellectual excellence.

Nevertheless, the profits from a dispensary or nursing home etc. carried on by a doctor or any other individual would be from an undertaking, and could be taxable at 10% if the other conditions specified in the section 59B is satisfied.

However, in terms of item No 38 of the Fifth Schedule to the IR Act, as amended by the Act No.08 of 2012, the rate of income tax applicable to profits and income of a person from the **provision of health care services** (which include even professional services of a practicing doctor) is as per the First Schedule to the Act but subject to maximum of 12%, effective from the Year of Assessment 2012/13.

[IC/2013/05] **[Sec 59B]**

28. Taxation of the allowance paid to an employee for services rendered to a project.

An employee of an institution serves for a project functioned under such institution. A monthly allowance is paid under the project for such services in addition to the normal remunerations paid by the institution (employer).

In such a situation, Income tax may be deducted by the institution as per the PAYE Tax Table No.01 and No.2 (if relevant) or No.5 on the total remuneration paid to such employee by the institution and the allowance for the services to the project, as regular profits of such employee.

However, any allowance or other remuneration paid by the project to any individual who is employed under any other employer (other than the institution to which the project belongs) being his main employer, income tax should be deducted therefrom under section 117 A of IR Act (i.e. PAYE Tax Table No.07).

[IC/2012/48] **[Sec 114]**

29. Deduction of income tax under PAYE, as per sections 114 117A of the IR Act, from the remuneration of employees in certain situations.

(i) An individual is employed under more than one employer, drawing a monthly remuneration of Rs. 55,000/- from one employer, and a monthly payment of Rs. 25,000/- from the other employer (second employment). How tax is to be deducted?

If the employer paying Rs.55,000 per month is specified by the employee as his main employer, then such employer should deduct income tax from such remuneration under PAYE (Tax Table 1). The other employer should deduct income tax in accordance with Section 117A, i.e at the rate of 10%.

(ii) If an employee who is employed under two employers, drawing a monthly remuneration of Rs. 25,000/- from one employer and another Rs. 25,000/- from the other employer. Is the employee liable for tax deduction under PAYE scheme from either remuneration, in spite of that his total monthly income does not exceed Rs.50,000/-?

The main employer (as stated by the employee) should not deduct tax, as the remuneration does not exceed the liable limit. However, the other employer should deduct tax from the remuneration (of 25,000/-) paid by him, as per Section 117A, i.e. at the rate of 10%.

[IC/2012/34] **[Sec 114, 117A]**

30. Income Tax liability of a Company Director who is functioning as Director for 3 other Companies.

An individual is a director for 4 private companies receiving remunerations from all, and one company deducts tax as per PAYE Tax Table No 01, and the other 3 companies deduct tax under Section 117A (as per Tax Table No 07). He has no any other income.

Section 32(3)(*i*) of IR Act, (as amended by Act, No.22 of 2011) provides that where income tax is deducted at source from the employment income of an individual as per Section 114 read with section 116, such tax represents final tax thereon, if such individual has no any other income other than any income from which tax is deducted at source as a final tax.

Accordingly, the tax deducted from the employment income of the aforesaid director is the final tax thereon, and such income is not subjected to any further taxation, if the respective deductions are correctly made by applying the rate on the correct income.

[IC/2013/31] **[Sec 116(2) and section 117A]**

31. Upfront Tax deduction from Corporate Debt Securities (issued at floating rate of interests).

In terms of section 135 of the IR Act (as amended by Act No. 22 of 2011), effective from 01.04.2013, tax (WHT) should be deducted upfront from corporate debt securities for the respective full period of the security. However, where such security is issued with floating rate of interest, a practical difficulty could arise in determining the quantum of interest for such upfront deduction.

Therefore, where any debenture or other security is issued on the basis of floating rate of interest, the tax deduction there from may be made upfront of each renewal period based on the interest rate prevailing as at the first date of each such period of renewal.

However, it should be noted that whether the security is issued at fixed rate of interest or with floating rate of interest, WHT should be deducted on the respective full interest, and not on the discounted interest.

(Inland Revenue Act includes above provisions, effective from 01.04.2013)

[IC/2011/29] **[Sec 135]**

32. Reduction or waiver of penalty accrued for non-payment on time.

Whether the penalty for tax in default in relation to an assessment which was under appeal and was determined by the Tax Appeals Commission, as per Tax Appeals Commission Act, No. 23 of 2011, could be reduced or waived by the Commissioner General of Inland Revenue.

Section 7 of the Tax Appeals Commission Act, No. 23 of 2011 stipulates that a person aggrieved by the determination given by the Commissioner General of Inland Revenue, in respect of any matter relating to imposition of any tax, levy, charge, duties or penalty under the provisions of any of the enactments may appeal to the Commission.

With regard to any income tax appeal preferred to the Commission, the determination of the Commission may be in relation to a particular source of income; or the taxable income; or the tax; or penalty for default; or any other penalty, depending on the issue involved.

The Commissioner General has the power to reduce or waive off penalties (in terms of Section 173 of Inland Revenue Act), if it appears to him such reduction or waiver of penalty is just and equitable being any penalty accrued on tax in default.

Accordingly, such power could be exercised even in relation to an appeal against an assessment determined by the Tax Appeals Commission, if such matter or issue determined is not in relation to a penalty for non-payment of tax on due dates.

[IC/2013/22] **[Sec 173]**

33. The rate of Income Tax on the supply of Security Services

Can the services provided by security firms be treated as supply of labour and the concessionary income tax rate of 10% specified under item 31 of the First Schedule to the IR Act, as amended by Act, No. 22 of 2011, be applied on the profits therefrom?

The aforesaid item 31 states that the income tax rate applicable to any undertaking carried on in Sri Lanka for the operation and maintenance of facilities for storage, development of software or **supply of labour** is as per First Schedule, but subject to a maximum of 10 per centum for an individual, and 10 per centum for a Company.

Supply of labour means the supply of manpower, temporarily or otherwise, to another person to work under superintendence and control of the supplier, though the recipient party is free to assign any work to such labourers suitable to their capacity. The services provided by security firms relate to the security of any property or person in any manner. The providing security personnel is only a part of such service and the superintendence or control of such security personnel is vested with the security firms as per the terms and conditions of the Agreement generally entered into with the service recipient party. The service recipient party cannot manage such security personnel or engage them in any other purpose other than the pre-determined work agreed with the security firms (i.e. security of the property or person).

As such, the security firms do not fall within the meaning of an undertaking for operation and maintenance of facilities for the supply of Labour, and therefore are not entitled to apply concessionary tax rate of 10% in item 31 to the First Schedule of IR Act, (as amended by Act, No. 22 of 2011).

[IC/2013/38] **[First Schedule]**

34. Article 10(3) of the Convention for Avoidance of Double Taxation between Sri Lanka and the United Kingdom

Interpretation sought is whether **a dividend** declared by a company resident in Sri Lanka to a Company in United Kingdom is exempt from income tax and no additional tax is applicable in terms of the above treaty provision?

Article 10(3) of the Convention between the two Countries states that,

> "*a dividend derived and beneficially owned by a Company which is a resident of the United Kingdom from a Company which is a resident of Sri Lanka shall be exempt from Sri Lanka tax other than the Sri Lanka tax on the Company which pays the dividend and also the additional tax imposed by Section 26 (4) of the Sri Lanka Inland Revenue Act. No.4 of 1963 in so far as this provision is in force on the date of signature of this Convention or has been modified only in minor respects so as not to affect its general character.*"

As a corresponding section for Section 26(4) of the Inland Revenue Act, No. 04 of 1963 or Section 37 of the Inland Revenue Act, No. 28 of 1979 has not been included in the Inland Revenue Act, No.10 of 2006, the aforesaid dividend is exempt from Sri Lanka income tax (other than the tax on the Company), and no additional tax as referred to in the said treaty provision could be charged.

[IC/2011/14] **[Article 10(3) of DTAA with UK]**

(B). ECONOMIC SERVICE CHARGE ACT NO. 13 OF 2006

[hereinafter referred to in as "ESC Act"]

35. Whether the Telecommunication levy forms part of Relevant Turnover for ESC?

In terms of Section 2(3) of the ESC Act, the "**relevant turnover**" in relation to any person or partnership, and to any relevant quarter, means the aggregate turnover for that relevant quarter from every trade business profession or vocation carried on or exercised by such person or partnership.

In terms of the Telecommunication levy Act, No. 21 of 2011, the Telecommunication service providers are required to collect the levy for the Government, and therefore, such part of the levy collected by such service providers, on account of the Government, could not be treated as part of receipts for services. Accordingly, the Telecommunication levy collected by service providers will not form part of their turnover liable for ESC.

[IC/2011/13] **[Sec 2(3)]**

36. ESC liability of a BOI Company during the period of tax holiday.

As per the proviso to Section 2(3)(a) of the ESC Act, as amended by the Act No 11 of 2012, ESC is not payable by any person on the respective turnover from any trade, business, profession or vocation for any year of assessment, if that person has a taxable income for the year of assessment immediately preceding that year of assessment, from that trade, business, profession or vocation assessed under the provisions of IR Act.

However, if any profits or part thereof is exempt from income tax for any year of assessment, ESC is payable for that year of assessment on the turnover relevant to such exempt profits or part.

Therefore, the Company, being a BOI Company and the profits & income thereof are exempt from income tax, the Company is liable to pay ESC on the relevant turnover.

However, the interest, being a separate source of income is not liable for ESC, unless derived in the course of that trade or business resulting in a loss in the preceding year, or exempt from income tax as a receipt from that trade or business.

[IC/2012/26] **[Proviso to Sec 2(3)(a)]**

(C). VALUE ADDED TAX ACT NO.14 OF 2002

[hereinafter referred to as "VAT Act"]

37. Extension of the period approved for the purposes of Sec. 22 (7) of the VAT Act No. 14 of 2002.

The period of approval granted to a project, in terms of section 22(7) of the VAT Act, before the end of which the project is required to make taxable supplies therefrom, could be considered for extension in certain circumstances.

For instance, where a project (of a BOI company) being a project to be engaged in the business of radio or television transmission, which is approved under the aforementioned section 22(7), has not commenced the commercial operations but receiving some revenue from auxiliary activities such as further licensing of its rights with regard to certain specific channels to their competitors, with a view to reduce the project cost.

Then, in such a situation, if

- the BOI has granted approval for the extension of the project implementation period; and
- the company undertakes to pay VAT on the revenue from aforesaid auxiliary activities,

the extension of the said period for making taxable supplies (by the project) could be considered for a further period not extending beyond the project implementation period of the project.

[IC/2011/16] **[Sec 22(7)]**

38. VAT liability on charges for Printing of Text Books.

If the printers' own materials, labour and machinery are used for the printing (manufacture of) books, and the supply of such books could be treated as a supply of an article, which is exempt from VAT under item (a)(v) of Part II, First Schedule of the VAT Act

However, if the supply is made by using the materials provided by the customer, but using own machinery and labour of the printer, such supply could be considered as supplying of a service, and is not exempt from VAT.

[IC/2011/09] **[Item (a)(v) of Part II, First Schedule]**

39. VAT Liability on the Supply, to the local market, of residue of fish processed for export.

The main business of the Company is exporting processed fish. Certain residues of fish, processed for export in the course of that business, are sold in the local market.

The local supply of the said Company, being the residue of such fish, could be treated as unprocessed fishing products exempt from VAT as per Part II of the first Schedule to VAT Act, as amended by the Act, No. 15 of 2008.

[IC/2011/36] **[Part II of the first Schedule to VAT Act]**

40. VAT on the subscriptions made by Apartment Owners to the Management Committee (MC).

Whether VAT is payable by the owner of an apartment (in a condominium property) on the subscriptions made to the Management Committee (MC) appointed in terms of Condominium Act No. 39 of 2003?

Under the provisions of VAT Act, VAT is chargeable on the value of taxable supply of goods or services made by a registered person in the course of carrying out a **taxable activity** in Sri Lanka. As defined in the said VAT Act, the "taxable activity" means,……., the provision of facilities to its members or others for consideration and the payment of subscription in the case of a club, association or organization.

All apartment owners are required to subscribe to a fund maintained by the MC for the maintenance of common amenities in the condominium, such as security, electricity, water, cleaning, insurance or repairs; etc. for the benefit of members (owners of residential units). The provision of these facilities by the MC to the members falls well within the definition of taxable activity, and the total collection on account of those services is liable to VAT. It is immaterial whether the MC provides those services in the course of a business or otherwise, and this chargeability is in line with the policy perspectives of VAT.

[IC/2011/60] **[Sec 2]**

41. Requirement to set up an Investment Fund Account under the provision of the VAT Act

Whether a Company providing financial services, but not engaged in giving loans, is required to invest in the Investment Fund Account (IFA)?

In terms of Section 25C of VAT Act, as amended by the Amendment Act, No. 9 of 2011, **eight** (8) per centum of the value addition as specified in section 25C(1) is required to be invested, in the investment fund established by the respective institution on the basis of the guidelines issued respectively by the Central Bank of Sri Lanka and the Commissioner General of Inland Revenue (based on the respective provisions of VAT and Inland Revenue Acts), for a period of three years commencing from January 01, 2011 (or from the commencement of business thereof).

The Company is an institution providing financial services as defined in the VAT Act, and paying VAT on such financial services. Therefore, the Company is required to deposit money on the respective dates at the specified rate, in the IFA, even though the institution is not giving loans. Such funds of the IFA, in that case, could be utilized in other areas as per the guidelines (CB).

[IC/2012/07] **[Sec 25C]**

42. Liability of VAT (and NBT) on license fees, maintenance charges and service charges, in relation to locally developed software.

Whether the license fees, maintenance charges or service charges, in relation to locally developed software are liable to VAT and NBT?

If the original agreement of sale covers the license fee, any charge or fee for maintenance or any other fee, such fees or charges become part and parcel of the price of the locally developed software, and therefore, such sums will be exempt from VAT [and also from NBT] under item (xxxiii) in Part II of First Schedule of Value Added Tax Act [and item (xxix) in Part II of First Schedule of Nation Building Tax Act], with effect from January 1, 2011.

Such exemptions, however, are not applicable in the case of fees for renewal of such license, maintenance or any other service.

[IC/2012/17] **[Part II, First Schedule]**

43. VAT on leasing of Prime Movers.

In terms of PART II of the First Schedule of VAT Act, No. 14 of 2002 as amended by VAT(Amendment) Act, No. 9 of 2011, provision of leasing facilities for lorries, trucks…. are exempted from VAT with effect from 01.01.2011. Further, in terms of item (xxii) of the VAT Act, as amended by VAT (Amendment) Act, No. 7 of 2012, supply or importation of lorries, trucks…. are exempted from VAT with effect from 01.01.2012.

Prime Movers are distinguished from Lorries and Trucks as they are under separate HS Code. Further, for the purpose of above exemption, the HS code number for Prime Movers has not been identified. Therefore, the exemption for the provision of leasing facilities on Lorries & Trucks was not applicable for Prime Movers.

However, as per item (iii) of sub-paragraph (A) of paragraph (b) of the PART II, in the First Schedule of the VAT Act, as amended by Act No.17 of 2013, the supply of leasing facilities in respect of road tractors for semi-trailers falling within H.S. code 8701.20.10 (under which Prime Movers are covered), is exempt effective from January 1, 2013.

[IC/2012/80] **[Part II, First Schedule]**

44. VAT on Financial Services, in relation to benefits from Employee Share Option Plans (ESOP).

As stipulated in section 25C (1) of the VAT Act, the value addition, for a particular period, of a financial institution should include the net profits (or loss) before payment of income tax on such profits computed in accordance with accepted accounting standards, subject to adjustments for economic depreciations and the emoluments payable to all the employees of such institution.

If the value accruing to employees under a ESOP has no impact on the profits (of the bank) computed in accordance with accepted accounting standards for any period, such value may be excluded from the value base for VAT on financial services for that period.

(However, under SLFRS the value of benefits to employees under an ESOP has an impact on the profits of the employer)

[IC/2011/07] **[Sec 25C (1)]**

45. Value Added Tax on sale proceeds from auctioning un-redeemed pawned articles.

As per PART II of First Schedule of Value Added Tax Act, No. 14 of 2002 as amended by Value Added Tax Act, No. 15 of 2009, the supply of locally manufactured jewellery is exempt from VAT, however, the supply of jewellery manufactured outside Sri Lanka is liable to VAT at the standard rate of 12%.

Identification whether any item of Jewellery is manufactured in Sri Lanka is up to the supplier and the method of such identification should be reliable and justifiable. Necessary documents and records with regards to the sale of these jewellery needs to be maintained.

[IC /2012/04] **[Part II, First Schedule]**

46. VAT liability of a Company in Sri Lanka providing services to its Parent Company abroad, in promoting a software (developed by the Parent Company)

A Sri Lanka Company provides services to its parent Company abroad by way of promotion of the software developed by the parent Company, for travel agents in Sri Lanka to facilitate their business of making flight reservations.

The said travel agents make payments to the relevant airlines for the tickets issued, which were reserved using the said software and the Sri Lanka Company receives commissions from its parent Company, based on respective payments, for promoting their software in Sri Lanka. However, the conditions for application of zero rate are not satisfied in this case even though the commissions are paid by the parent company overseas.

Thus, it is clear that the Sri Lanka Company provides services (in Sri Lanka) for promoting software with the view to enhancing its clientele in Sri Lanka. Accordingly, the commissions received by Sri Lanka Company are liable to VAT at the normal rate of 12%.

[IC/2011/01] **[Part II, First Schedule]**

(D). NATION BUILDING TAX ACT NO. 09 OF 2009

[hereinafter referred to as "NBT Act"]

47. Liability to Nations Building Tax - Gems Mining Industry

Whether the sale proceeds of Gems derived through auction sale or direct sale, in the Gem Mining Industry, is liable to NBT? Further, who is liable to pay this tax? Is it the Gem Mining Licensed holder or any partner of the mining partnership?

The Nation Building Tax should be paid at the time of sale of such gems, irrespective of the manner of sale thereof. The individual or partnership who sold such gems is liable to pay NBT.

[IC/2013/56] **[Sec 2]**

48. Nation Building Tax (NBT) liability of BOI companies, on the local sale of permitted quantum of garments

The issue is whether the local sale of permitted quantum of garments by BOI companies is exempt from NBT as well, if Rs.25/- per piece sold is paid, which presumably covers all indirect taxes including Customs Duty, PAL, CESS, SRL and VAT etc.

The levy of aforesaid Rs.25/-, as imposed under the Finance Act No. 11 of 2002, is in place of Customs Duty, PAL, CESS, SRL and VAT only. The imposition of NBT was even some years later. As such, NBT payable on the sale of such garments will not be automatically exempt for the mere payment of that Rs.25/= per piece, in the absence of specific provisions.

[IC/2011/10] **[Part I, First Schedule]**

49. Whether a public corporation could be an undertaking fully owned by the Government, and exempted from NBT?

Where an institution is established under an Act of Parliament with funds, fully or partly, provided by the Government, such institution falls specifically within the definition of "public Corporation".

As per the item (xxx) of Part II of the First Schedule to the NBT Act, as amended by Act No.10 of 2011, the services provided by any Government Department, Ministry or any undertaking fully owned by the Government are exempt from NBT with effect from January 1, 2011.

This exemption is not applicable to any public corporation, as it is not a Ministry (or Department) of the Government or an undertaking fully owned by the Government. It is a person to be assessed as a Company (in terms of the definition of Company in section 217 of IR Act), and will not be exempt from the Nation Building Tax (NBT).

[IC/2012/30] **[Item (xxx) of Part II - First Schedule]**

50. Whether a "Securitized Transportation Service" could be considered as transportation of goods or passengers and exempted from NBT?

A Company is engaged in the business of delivering secured packages belong to its clients. The Company has, in this regard, obtained 'cash in transit insurance policy' to cover up the risk in the process and employed armed security guards in the transportation as per conditions specified in that cover.

In this case, the component of payment for the service of armed security personnel forms a major part of the service fee, as claimed by the company, for providing that "Securitized Transportation Service". Therefore, such a service should be regarded as distinct from the service of transport of goods or passengers under normal circumstances.

Accordingly, the securitized transportation service is not an excepted service falling within the description of item (v) of part II of the First Schedule to the NBT Act.

[IC/2012/31] **[Item (v) of part II - First Schedule]**

51. Liable Turnover for NBT purposes

The rate of NBT is 2% on the "liable turnover". It can be presumed that the liable turnover entails essentially a sum on account of NBT payable on such turnover, by the person liable to pay NBT.

A person liable to pay NBT in relation to any good or service, may in pricing thereof, increase the price determined without considering NBT payable by him, by 2.041% thereof to arrive at the price to be charged and invoiced.

[IC/2011/34] **[Sec 3]**

52. Liable turnover for NBT purposes and the applicability of 25M threshold for a person engaged in the manufacture of food items

A person is engaged in the manufacture of food items in its bakery and all such items (products) are sold at the restaurants owned by that person, together with the other food stuffs and beverages.

Confirmation sought by that person is whether the threshold of Rs.25M per quarter as referred to in Section 3(4)(iv)(a) of the Nation Building Tax Act, No. 9 of 2009 would be applicable on the basis that the person is engaged in a business similar to a hotel, guest house or restaurant.

If a person manufactures food items in own bakery and sells all such items at their own restaurants etc, such person could be considered as a person operating a business similar to that of a hotel, guest house or restaurant.

Accordingly, that person is eligible for the threshold of Rs. 25 million per quarter in respect of turnover of the business.

[IC/2012/70] **[Sec 3(4)(iv)(a)]**

53. NBT on the wholesale and retail trading Sector.

Whether the term **distributor** (of any product) defined in the NBT Act confined only to wholesalers (appointed by the manufacturer of such product, for the sale at the price fixed by such manufacturer), or it applies to persons (or partnerships) engaged in the distribution of such products in the **wholesale market as well as in the retail market?**

Such a distributor may sell respective products not only in the wholesale market, but also in the retail market, and accordingly, if other conditions are satisfied, such person would be entitled to the exemption of specified quantum (i.e.75%) of the liable turnover on the goods sold by him in the wholesale market.

[IC/2012/81] **[Sec 3]**

54. NBT on Leasing of movable properties

Whether the operating leases in relation to movable properties, could be regarded as **excepted services** within the meaning of NBT Act?

The aforesaid provision is intended to be for businesses of providing finance leasing facilities (under the Finance Leasing Act, No.56 of 2000) in relation to movable properties, under which the ownership of the property is ultimately transferred to the customer.

Accordingly, the business of renting out of vehicles on leasing agreements could not be interpreted as falling within the exemption under item No.(vi) of Part II of the Nation Building Tax Act.

[IC/2013/25] **[Item (vi) of Part II -First Schedule]**

(E). STAMP DUTY (SPECIAL PROVISIONS) ACT NO. 12 OF 2006

[hereinafter referred to as "SD (Special Provisions) Act"]

55. Stamp Duty in respect of share certificates on the Transfer of Shares from the Trustee to Beneficiaries

As stipulated in section 4 of the SD (Special Provisions) Act, the "*share certificate on new or additional issue or on transfer or assignment*" is a "**specified instrument"** in respect of which stamp duty is payable.

No provision has been made by, or under, the aforesaid SD Act to exempt share certificates on the transfer or assignment of shares by the trustee (of a Trust) to the beneficiaries, though the trustees held shares on behalf of the beneficiaries (and no change in the beneficial ownership).

The meaning of share certificate is as given in the SD Act, No. 43 of 1982.

[IC/2011/30] **[Sec 4]**

56. Stamp duty in respect of share certificates on the transfer of shares to beneficiaries modifying the rights attached to shares.

Whether the share certificate issued upon the change made to the Articles of Association of the company modifying the rights attached to shares (converting preference shares into ordinary shares) and in lieu of existing share certificate, is liable to stamp duty?

As per the Gazette Notification No 1465/20 dated 05.10.2006, published under the aforesaid Act, "*Any Share certificate issued in lieu of share certificate lost or destroyed, or new share certificate for a greater or less number of shares in lieu of existing share certificates but not exceeding in value of the existing share certificates"*, is exempt from Stamp duty.

To be eligible for this exemption, the new share certificates should be for a greater or lesser number of shares in lieu of existing share certificates (not exceeding in value of the existing share certificates). However, in this situation of converting preference shares into ordinary shares, there would be no addition to or deduction from the number of shares in the stated capital, but change in rights. Therefore, the aforesaid exemption will not be applicable in this situation.

Accordingly, the share certificates issued modifying the rights attached to shares is liable to stamp duty.

[IC/2011/57] **[Sec 4]**

(F). BETTING AND GAMING ACT NO.40 OF 1988

["**B&G Levy Act**"]

57. Meaning of 'gross collection' from the business of bookmaker or gaming, referred to in the B&G Levy Act (as last amended by Act No.19 of 2013)

As defined in Section 2(10) of the B&GL Act, the "gross collection" for a month means "**the total amount recovered** from the business of bookmaker or business of gaming in respect of that month. The "**amount recovered**" from the business of……in this context, needs to be interpreted on the basis of policy perspectives surfaced in that and the other similar enactments.

The VAT Act, defines 'the value of supply', for the taxation of lotteries or wagering contracts or similar businesses (for VAT), as the amount of money receivable in respect of such supply less the consideration of prices or winnings awarded.

As reflected in the Casino Control Act of Singapore, the "gross gaming revenue" in relation to a casino operator is determined based on the aggregate of the amount of net wins received on all games conducted by the casino operator or conducted within the casino premises of such operator. The "net win" in relation to a casino operator, in respect of any game or type of game where the casino operator is a party to a wager, has been defined to mean the difference between the amount of bets received by the casino operator on the game and the amount paid out by the casino operator as winnings on the game, derived by such method or formula as may be prescribed in respect of that game or type of game.

Accordingly, the "total amount recovered" as referred to in the definition for "gross collection" should be interpreted as the aggregate of total collection received from the business of bookmaker or gaming at the end of the day, after deducting therefrom the amount paid as winnings on that day. Any other expenditure should not be considered for deduction.

Further, it should be noted that as per Section 157 of the IR Act, any person or partnership paying winnings from gambling or betting to any person or partnership, as the case may be, the payer is required to deduct at the time of payment of such winnings from gambling or betting, income tax at the rate of 10% on such gross payment, if such payment exceeds the specified limit.

[IC/2013/52] **[Sec 2(10)]**

PART - II

This PART sets out a modified version of earlier rulings, given on respective matters by the Secretariat, then CCIR or under the hands of CGIRs, having reformulated by the Committee with appropriate adjustments, to be in line with the present context of respective laws.

(G). INCOME TAX [Inland Revenue Act]

01. Off-Shore Companies

(a) Where the business is transacted?

In terms of the Companies Act, off-shore companies cannot do business in Sri Lanka. However, for purposes of income tax, mere fact of registration as an off-shore company will not be conclusive evidence that the business is not transacted in Sri Lanka. This would depend on the actual activities of the company.

(b) Residence

A company registered as an off-shore company will be treated as a **non-resident company** for tax purposes if it was not incorporated in Sri Lanka, and

(i) its registered or principal office is not in Sri Lanka, and

(ii) the control and management of its businesses are exercised outside Sri Lanka.

A company which has registered an office in Sri Lanka for the purpose of Sections 261 and 262(of the company Act No.7 of 2007) will not, on that account alone, be treated as a resident company, if it was incorporated outside Sri Lanka and its principal office is situated outside Sri Lanka.

(c) Tax Liability

In the case of an off-shore company which is treated for tax purposes as a non-resident company, the business of which consists solely of the purchase and sale of goods, there would be no liability to income tax in Sri Lanka, if no sales are effected in Sri Lanka.

[ACT 5/17] **[Sec 2]**

02. Tax liability of certain profits or gains.

(a) Sale of Nadun Trees in an estate

Nadun trees in a rubber estate form part of the capital of the land. Accordingly, its sale proceeds cannot be treated as normal agricultural income, such as sale proceeds of old, uprooted trees in a rubber estate or gunnies in a paddy mill. But, whether it is a receipt from an adventure in the nature of trade, or it is of a casual and non-recurring nature, depends on the circumstances of each case.

(b) Exchange Gains

Un-realized exchange gain appearing in the accounts should be considered as a business receipt for tax purpose in computing the profits and income. If this profit has been generated by exempt undertaking by engaging the relevant activity, undertaking is entitled to claim the exemption.

[ACT 3/3 (1995)] **[Sec 3]**

03. Promotional Shares.

Value of Promotional shares issued to a promoter will be exempt from income tax in the hands of the promoter, unless

- such promoter is engaged in such promotional activities as a business; or
- such activities are of a casual and non-recurring nature.

[Rul/2005/IT/06] **[Sec 3]**

04. Value of employment benefit from the use of Motor Vehicles owned by the employer.

The value of private use of any vehicle, where accurate records of traveling is maintained by the employer, is calculated as specified under item (d) of the Gazette notification No.1706/18 dated May 20, 2011.

Accordingly, where the vehicle is owned by the Employer and is used by the Employee for private purposes as well, and in relation to the use of such vehicle accurate records of traveling is maintained by the employer, the benefit for tax purpose should be calculated in the following manner.

If the Employee,

- reimburses the employer, the cost of private travel at a rate not less than the rate specified under item (d) of the Gazette, the value of the benefit is Nil;
- reimburses at a lesser rate specified under aforesaid item (d), then the difference is treated as value of the benefit;
- does not reimburse the Employer, the value of the benefit is computed according to the respective rate given in the said item (d) of the Gazette.

[Rul/2005/IT/08] **[Sec 4]**

05. NRFC Gift Scheme “Ran Kahawanu Wasana”

No provision in the Inland Revenue Act to accord exemption from withholding tax on lottery prices received under the “Ran Kahawanu Wasana” Gift Scheme, conducted by the Bank of Ceylon.

[Rul/2005/IT/13]

06. Meaning of the word 'paid' referred to in Section 10.

For the purpose of exemption under Section 10, the dividends should be paid within the period stipulated therein. The word 'paid' means that the company declaring the dividends should part with funds equal in amount to such dividends. Crediting the amount of the dividends to the shareholder's account in the books of this company is a mere book entry and does not amount to such dividend having been 'paid' within the meaning of Section 10.

[ACT3/3] **[Sec 10]**

07. Exemption of income from land and improvements

Where a house, the income of which is exempt is sold, the new owner is entitled to the exemption. The exemption is available to the owner of the house and not to the builder.

Where a person purchases a house in the course of the period for which the rent income from that house is exempt, then that person is entitled to the exemption for the balance part of such period.

[ACT 7/4, ACB 75] **[Sec 11(2)]**

08. Exemption on income from Re-export of cut and polished Gems and Diamonds

The export of gems/diamonds after cutting and polishing of rough gems/diamonds sent on No Foreign Exchange (NFE) basis is treated as export of gems and diamond, and not a provision of service. Accordingly, the exemption on exports of gems/diamond is applicable.

[Rul/2005/IT/14] **[Sec 13]**

09. Deductibility of Expenses

(a) Expenses incurred by a lawyer in the purchase of books

Lawyer's books can be treated as "plant" (as held in Munby vs Furlong – 40 TC 491) and 33 1/3% depreciation rates can be applied in terms of Section 25(1)(a)(iii) if they are not replacements.

[ACB 75] **[Sec 25]**

(b) Stamp duty paid on the execution of the legal document

Stamp duty paid on the execution of the legal document with a bank on the hypothecation of stocks in obtaining a loan that is required as working capital of a business is an allowable deduction.

[ACT 4/25] **[Sec 25]**

(c) Purchase of Trade Mark

The expenditure incurred on the purchase of trademark is of a capital nature, and therefore cannot be deducted in computing profits and income. However as trade mark rights are intangible assets, such assets could be qualified for an allowance specified under section 25(1)(b)(ii) of the IR Act.

[ACT 3/3 (1995)] **[Sec 25(1)]**

(d) Losses on Forward Booking of Foreign Exchange

Any loss incurred by forward booking of foreign exchange by exporters is an allowable deduction, as it is an expense in the production of income.

[ACB 75]

(e) Expenditure in the Production of Films

Where the production of a film commences in one year of assessment and its exhibition is in a subsequent year of assessment, the expenses of production should be carried forward as work-in-progress for set off against receipts from its exhibition in a subsequent year. The expenses of production cannot be treated as a "loss" and set off against other income of that year.

[ACT 3/3 (1988)]

(f) License Fees

The license fee paid annually to the Government Agent by a tavern keeper to obtain license to carry on the business is an allowable deduction. It is not a capital payment to acquire a right or create an enduring benefit.

[ACB 75]

(g) Start-up expenses

Certain start-up expenses which are incurred prior to the actual commencement of business in Sri Lanka will be treated as referable to the operations after the commencement of business and allowed as a deduction.

These expenses are:

(i) expenses of hiring staff in advance of opening of the branch for purposes of training, some of which would take place outside Sri Lanka;

(ii) administrative overheads of maintaining a temporary office while the branch premises are being prepared for the opening;

(iii) transfer expenses of any staff assigned to the Branch prior to the opening.

[ACT 4/25]

(h) Contributions made to Mill Development Fund

The contributions made by the desiccated coconut millers to the Mill Development Fund administered by the Coconut Development Authority are not outgoings and expenses incurred in the production of income.

[ACT 3/3]

(i) Expenses deductible by Approved Pension Funds

Approved pension funds are not entitled to deduct any management expenses, as their sources of income is interest, dividends, etc.

[ACT 4/10 (1997)]

(j) Capital Allowances

(i) Video cassettes

Video Cassettes used as apparatus in carrying on the business of hiring will qualify for the allowance for depreciation.

[ACT 4/4 (1988)]

(ii) Machinery used in a hiring business

A person who carries on the business of hiring plant, machinery and fixtures to other persons, will be entitled to capital allowances in respect of such plant, machinery and fixtures, purchased by him and used in the business of hiring.

To be entitled to these allowances, it must be established that the person concerned is carrying on a business and not merely receiving income from rent.

[ACT 4/4]

(iii) Transformer installed for the supply of electricity to a consumer Taxpayer.

Is the transformer an asset acquired by the consumer taxpayer? Does he qualify for depreciation allowance?

The payments made by the consumer-taxpayer are only in respect of cables, sub-station, compensation for trees etc and also includes a Protective Deposit. The payments are not towards the cost of the transformer which remains the property of the Board. The consumer taxpayer does not qualify for the depreciation allowance as he is not the 'owner'.

[ACT 4/4] **[Sec 25 (1)]**

(k) Company Formation Expenses

Company formation expenses include;

(i) cost of drawing up and printing, memorandum and articles of Association and of registration fees.
(ii) share issue expenses
(iii) stamp duty on issue of shares
(iv) legal and professional charges (as are incurred in connection with the formation of the Company)
(v) cost of prospectus, brokerage and other expenses in connection with public issue of shares.
(vi) value of free issue of shares to promoters

[However, the expenses similar to (ii), (iii), (iv), (v) and (vi) incurred by a company already in existence, in connection with the fresh issue of shares, are not allowable].

Company formation expenses does not include,

(i) Expenses of foreign collaborators who visit Sri Lanka for consultation in connection with the formation of the Company;
(ii) Cost of feasibility and project report;
(iii) Other pre-commencement expenses such as staff recruitment staff training, staff remuneration and setting up of accounting system.

[Expenses referred to in (i), (ii) and (iii) are not deductible and cannot be carried forward. Such expenses cannot be taken into account even in the first year of operation of the business]

[ACT 4/7 (1980)]

(l) Meaning of Deductible expenses

The broad rule regarding deduction of expenses is that they must be "incurred by such person in the production" of income. Any expenses to be deductible must first qualify under this rule in Section 25 (1) which then goes on to give certain types of such expenses specifically to be allowed, like salaries payable and so on. Secondly, none of the expenses, even if they qualify under Section 25, should be allowed if specifically excluded as under Section 26.

The phrase "incurred by such person" has two connotations. On the one hand, it means that legal liability has arisen to that person in respect of that expenses. On the other hand, it also means that the money in respect of that expense must be actually expended 'by such person'. Therefore, where, for example, a Government Department pays the Nation Building Tax on behalf of a company that company does not 'incur' any expense by way of NBT and, therefore, notwithstanding the provisions of Section 25, the company is not entitled for a deduction in respect of tax.

[ACT 3/3] **[Sec 25 & 26]**

10. Profit on sale of fixed assets

Sale proceeds from the change of ownership of a motor vehicle used in a business, in respect of which no allowance for depreciation has been granted, will not be liable to income tax. However, gains arising from the sale of an asset such as a lift used in business and even in respect of which no depreciation allowance is granted, would be liable to income tax.

[ACT 4/1 (1980)] **[Sec 25]**

11. Capital Allowances

Where, upon conversion of any partnership, into a company, any asset of that partnership is transferred, to that company, the cost of acquisition by such company of such asset is equal to the cost of acquisition by the partnership of that asset reduced by the total allowance for depreciation granted to the partnership in respect of that asset. In other words, in computing the depreciation allowance for the company, the rate of depreciation (i.e. the rate applicable to the partnership) should be applied on the written down value of assets of the partnership at the time of transfer.

[ACT 3/3] **[Sec 25]**

12. Foreign Travel Expenditure – Travel Agents

Expenditure on foreign travel incurred by travel agents and tour operators would be allowed as a deduction only if it could be related to "the provision of any service for payment in foreign currency". The relationship should be direct if the expense is to be tax deductible.

[ACT 4/25]

13. Entertainment Expenses

(a) The expenses incurred on food and liquor (mostly at hotels), by money brokering business to influence or solicit business from bankers are entertainment expenditure, even though it is labeled as business promotion expenses.

(b) Following expenses incurred by export oriented companies are disallowed in terms of Section 26.

(i) Board and lodging expenses on foreign buyers.

(ii) Expenditure incurred in arranging special functions to welcome or bid farewell to foreign buyers or in entertaining foreign buyers.

14. Deduction in arriving at Assessable Income

(a) Deductions of interest on joint loans

The deduction for the interest payment made on a joint loan taken by husband and wife should, without apportioning between husband and wife, be allowed in the hands of that spouse who makes the payment.

[ACT 4/25]

(b) Interest paid on overdrawn funds by a person in the capacity of an "attorney" while operating the account of his "principal"

Interest paid on overdraft obtained by a person (say Mr. 'X') who holds a power of attorney (for his personal use), from an account of the "principal" cannot be deducted in ascertaining his (i.e. Mr. 'X's) assessable income. This ruling is in accord with the legal position that all acts performed by a person qua attorney are in law performed by the "principal". Therefore, any loan taken by Mr. X in his capacity as attorney and any interest paid thereon are legally attributable to the "principal".

[ACT 3/3]

(c) Interest on loans

For the purpose of paragraph 32(5)(a)(iv) of the proviso, 'loan' includes 'overdraft'.

[ACT 3/3]

(d) Deduction of interest for personal taxes

Where any person who carries on the business of buying and selling of shares, obtains any loan/overdraft for the financing of such purchases, and pays any interest on such overdraft, then such interest is deductible under Section 25 in computing the statutory income of such business. Such interest is not deductible under Section 32. Where the loan/overdraft is utilized for the purchase of shares to be held as long term investments any interest payable on the loan/overdraft is deductible under Section 32 in computing the assessable income.

[ACT 3/3]

(e) Annuity to wife, In Return for full Consideration in money or money's worth

The words "in return for full consideration in money or money's worth" excludes capital payments or return of capital.

[ACB 75]

(f) Annuity

Deductions under Section 32 will be permitted only in respect of an annuity paid under an order of Court by way of payment of alimony or maintenance and do not include:

(i). the payment of a lump sum after the order Nisi is made absolute; and

(ii). the payment of any further lump sums (to be deposited in the Bank) in the names of the children of the marriage.

[ACT 3/3]

(g) Adjustment to a loss

The adjustments to a loss can be made at any time notwithstanding the provisions of Section 163(5), so long as such adjustments do not result in the assessment of income.

[ACT 3/3 (1996)]

(h) Limitation of Deduction of Losses to 35% of Total Statutory Income

In terms of Section 32 of the Inland Revenue Act, any interest accruing to any company should be taken into account when computing its statutory income, if it is not exempt under Section 9 of the Act. Further, the limitation of deduction of losses to 35% of the total statutory income, with regard to a company, is calculated on the basis of such statutory income.

[Rul/2005/IT/19]

(i) Deduction of Interest

A loan taken from a Bank to repay a housing loan previously obtained from another Bank could be treated as a loan the proceeds of which are utilized for the purchase or a construction of a house or the purchase of any site for the construction of any building, if it is proved that the money has been transferred direct from Bank to Bank together with relevant security documents.

[Rul/2005/IT/0012] **[Sec 32]**

15. Taxation of Provident and Pension Funds

(a) Investment income of a provident fund includes **–**

i. Interest derived from

- Fixed deposits in banks and financial institutions
- Government securities
- Loans advanced to members of the Fund

ii. Dividends (other than exempt dividends).

iii. Rental income from –

- part of office premises rented out
- other premises

iv. Gains arising on disposal of

- Shares
- Other assets

(b) No deduction in respect of management expenses is allowable in computing the investment income of a provident or pension fund, derived from investments made by it.

[ACT 4/2] **[Sec 36]**

16. Companies/Pre-incorporations Profits

Pre-incorporation profits of a Company are liable to tax, not on the Company but on the owner or owners of the undertaking, prior to such undertaking being acquired by the company

[ACT 4/7 (1980)]

17. Withholding tax on Dividends Payable to Non-Residents of Treaty Countries

The tax of 10% on the gross dividends distributed by a resident company is a charge under Section 61(1) on the resident company distributing the profits.

Section 97(1) is a relief section in respect of persons who are liable to taxation in Sri Lanka as well as in the home country on income derived from Sri Lanka. It does not remove the liability to tax under 61(1).

[ACT 3/3] **[Sec 61 (1)]**

18. Dividends Tax at Source

The provisions of Section 65(1) apply to a BOI company which opts to pay income tax at 2% or any other, of the turnover. The taxable income of the company is the turnover which is deemed to be its profits.

[ACT 4/7] **[Sec 65]**

19. Liability on the sale of shares

The application of concessionary rate of 15% on the profit (including gains) from the sale of any share, in relation to which the share transaction levy is not payable (and sold within 2 years) referred to in section 44 of the Inland Revenue Act, has no application with effect from April 1, 2007 (as per the amendment to the Inland Revenue Act made by the Amendment Act No 10 of 2007).

Accordingly, the profits or income from the sale on or after April 1, 2007, of private company shares, may not be liable to income tax unless such profits could be treated as profits or income from any source referred to in section 3 of the Inland Revenue Act.

[Rul/IT/2008/07] **[Sec 44]**

20. Assessment on a partnership

Where an assessment is made on a partnership, it is not valid to make it in the name of the precedent partner. The notice of assessment must be in the name of the business. For example the Narammala Arrack Tavern.

[ACB 75] **[Sec 76 (1)]**

21. Income tax on dividends not distributed

(a) Capital assets for the purpose of calculating distributable profits

(i) Plant and machinery can be considered as capital assets, only if such assets form part of the fixed assets of the company. The value of items shipped (goods in transmit) does not form part of the fixed assets until the assets are physically acquired.

(ii) A building is a capital asset for this purpose, but only after its completion. The work in progress is not treated as a capital asset for that purpose.

(iii) The assets given on finance lease by a leasing company can be treated as capital assets of the company, if such assets form part of the fixed assets of the company.

(iv) A land acquired for business purposes is a capital asset for the purpose of section 61(1)(b)(ii).

(v) Whether an intangible asset falls within the purposes of the above section depends on its nature and relevant facts.

[ACT 12/1] **[Sec 61(1)(b)(ii)]**

(b) Applicability of Section 61(1)(b)(ii) to BOI Companies

Tax refers to in section 61(1)(b)(ii) of the Inland Revenue Act is an income tax imposed on a company. Accordingly, if the BOI Company is exempt from income tax on any profits (or rather, when the provisions of Inland Revenue Act relating to impositions of income tax are not applicable), then the 15% tax specified in section 61(1)(b)(ii) is also not applicable in relation to such profits of the company.

[ACT 2/2006/9] **[Sec 61(1)(b)(ii)]**

22. Miscellaneous

(a) Refunds of partnership tax overpaid under self-assessment system

The 8% partnership tax is payable for any year of assessment on the divisible profits and other income for that year of Assessment. Any excess of partnership tax paid based on the liability of the previous year, is not treated as such partnership tax, and accordingly, is refundable (if there is any excess) through the respective partners'

[Rul/2006/IT/02] **[Sec 78]**

(b) Taxation of Co- ownership

A co-ownership does not generally constitute a person for the purpose of taxation of income. It has been the established practice of the Department that the co-ownerships are taxed on the same footing as that of partnerships. However, the concept of partnership applies only in relation to a business. It means that, the partnership provisions are applicable (covering any other income as well) in relation to a co-ownership, only when there is any business presence.

Accordingly, for instance, where the profit of a co-ownership is a rent income, such income may not be chargeable with 8% partnership tax, unless any part of which could be treated as business income.

[Rul/IT/2008/01] **[Sec 78]**

(c) Set off of withholding tax (WHT) paid against Partnership Tax payable

WHT paid on Specified Fees prior to 01.04.2011 (at 5%) is an advance against income tax. The 10% partnership tax is also an income tax and as such, the WHT can be permitted to be set off against partnership tax payable as well. However, the quantum of 10% partnership tax remained same even though settled or paid through WHT or otherwise. Hence, the partners are not entitled to refunds from such tax distributed among the partners up to the respective shares of partnership tax.

[ACT 12/1] **[Sec 78 & Sec 153]**

23. Liability of Non-resident persons

Where a person acts on behalf of a non-resident person and by his instrumentality, the non-resident person is able to make a successful tender for the supply of goods, either to the Government of Sri Lanka or to a government sponsored Corporation or Institution, the non-resident person becomes liable to tax. However, if the non-resident person tenders successfully, on a principal to principal basis for the supply of goods, either to the Government of Sri Lanka or to a government sponsored Corporation or Institution without the aid of a local Agent, no liability to Sri Lanka tax will arise in respect of that non-resident person.

[ACT 4/21 (1974)] **[Sec 82]**

24. Residence

Residence of Individuals

Section 79(2) of the Inland Revenue Act reads as "An individual who is physically present in Sri Lanka for one hundred and eighty three days …….. shall be deemed to be resident in Sri Lanka ……"

Accordingly, when counting one hundred and eighty three days for determining individual's status of residence the date of arrival as well as the date of departure is required to be taken into account since such individual has been physically present in Sri Lanka in both days.

[Rul/2005/IT/02] **[Section 79]**

25. Royalties

Any payment made for the use of designs, drawings or manufacturing process of any proprietary product is a royalty in character. The character remain the same even when the payment is a lump sum payment.

[ACT 5/2]

26. Non-resident shipping companies

A non-resident company is liable to pay income tax on the profits and income at the rate specified in the Second Schedule and on remittances at the rate specified in Section 57 of Act No 38 of 2000. Since 2.5% percent in the Second Schedule was an additional amount on account of Human Resources Endowment Fund (HREF) and such collection could subsequently be transferred to that Fund, the tax relief under the Double Taxation Relief Agreement should be calculated after excluding this 2.5% tax. However, remittance tax should be calculated on the balance profits and income after deducting income tax including HREF contribution.

[Rul/2005/IT/03] **[Sec 57]**

27. Lease of Aircraft -Double Tax Avoidance Treaties

Where a non-resident company, having no permanent establishment in Sri Lanka, derives income by way of rent or lease of aircraft, it is the Article on "Royalties" which would be applicable in taxing the lease rent in question in the absence of special treatment under the respective Double Tax Treaty. The term 'royalties' is generally defined in Double Tax Agreements to mean "consideration for use of, or the right to use industrial, commercial or scientific equipment ……..". An aircraft constitutes an equipment.

[ACT 4/9]

28. Payments of Quarterly Tax

The "quarterly instalment" of income tax referred to in Section 113 in relation to any quarter means the excess of,

- $1/4^{th}$ of the income tax for the year calculated by the application to the taxable income of the relevant tax rate/rates specified in the relevant schedule to the Act,

  over

- The aggregate of taxes withheld (such as PAYE tax, withholding tax on interest, dividends, ACT etc.) in that quarter.

[ACT 3/3] **[Sec 113]**

29. Requirement for furnishing a Return – Clubs or Similar Institutions.

In terms of Section 106(1) and Section 106(2) respectively of Inland Revenue Act, any person, in relation to an year of Assessment, who is chargeable with income tax or to whom a return is issued by a Deputy Commissioner, or ……..is required to furnish a return of income on or before November 30th of the following Year of Assessment or within the time specified in the notice.

However, the exemption stipulated in the proviso to subsection (1) of that section, is applicable to individuals only. Clubs or similar institutions are required to furnish a return under the said Section 106 of the Inland Revenue Act, even though interest is the sole income of such Institution.

[Rul/2005/IT/07] **[Sec 106]**

30. Refunds to non-resident shareholders

If the deduction by the resident company in respect of a dividend is in excess of the rate specified in the respective Double Tax Treaty, a refund of the excess of the tax deducted under Section 65 can be made in respect of any dividend paid to a non-resident shareholder.

[ACT 3/3] **[Sec 200(6)]**

(H). ECONOMIC SERVICE CHARGE

[ESC Act No.13 of 2006]

31. Clubs or associations referred to in the section 101 of the Inland Revenue Act.

The interpretation of the word "business" of the ESC Act has the same meaning assigned to it in the Inland Revenue Act. However, with regard to the meaning of **business** in relation to a club or association, a specific meaning is given in section 101 of the Inland Revenue Act. Hence, it should be applicable to ESC as well.

Accordingly, in the case of a club or association, the deeming provisions referred to in the section 101 of the Inland Revenue Act are relevant in deciding whether a business is carried on by for the application of ESC.

[ACT 2/2004/6] **[Sec 3]**

32. Government assisted private schools

The educational services provided by a Government approved private schools (administrated under a General Manager appointed by the Secretary to the Ministry of Education), do not fall within "the business of providing any services" for the purposes of NBT Act or ESC Act, if the following conditions are fulfilled by such schools:

i. No fee is charged for educational services, other than receiving donations to meet the running expenses of the respective schools;

ii. The salaries of registered approved teachers of those schools are paid by the Government

The receipts of such schools by way of donations are not liable to ESC or NBT, if any running expenses of respective schools, including salaries of other teachers (not registered), coaches, etc. are met out of donations received.

However, the turnover from other activities such as swimming pool charges, hall (hiring) charges or any other activity is liable to ECS as well as NBT if other requirements are satisfied.

[ACT 12/1] **[Sec 3]**

33. Deductibility of ACT from ESC payable.

In terms of Section 3 of the Finance Act No. 11 of 2004, Economic Service Charge paid can be set off against income tax payable, subject to conditions stipulated in subparagraph (2) and (3) therein and Section 4.

However, the Inland Revenue Act includes no provision to set off any income tax paid against Economic Service Charge payable. Accordingly, any Advance Company Tax (ACT) paid cannot be set off against ESC since ACT is an income tax paid in advance. Further, ACT cannot be refunded and it can only be set off against income tax.

[Rul/2005/ESC/03]

34. Entrepot Trade.

The turnover from entrepot trading cannot be treated as commission income but is the turnover from such entrepot trading for the purpose of Economic Service Charge.

[Rul/2005/ESC/01] **[Sec 3]**

35. Change of Accounting year

If a person has been granted approval for changing the accounting year under Section 28 of the Inland Revenue Act, in relation to any trade, business, profession or vocation carried on by such person, he is entitled to declare for income tax purposes the statutory income from such trade, business, profession or vocation on the basis of an accounting year ending in that year of assessment.

For the purpose of determining the liable turnover, in relation to Economic Service Charge, the same basis as for income tax, can be adopted.

[Rul/2005/ESC/02] **[Sec 3]**

36. Relevant Turnover in relation to Export of articles made from raw-materials imported on No Foreign Exchange (NFE) Basis and payment received as a service charge.

The activity carried on by a person or partnership in making an article using raw-materials supplied by a foreign buyer on NFE basis and for which payment is received as a service charge (value addition) is treated as carrying on of a business of export of articles and not a provision of services.

ESC is payable on FOB (Free on Board) value of the export (up to 31.03.2007), and on the basis as Gazetted for the subsequent period.

[Rul/2/2006/8] **[Sec 3]**

(I). VALUE ADDED TAX

[VAT Act No.14 of 2002]

37. Zero rated supplies

"Aero Bridge Service" provided inside the Airport, could be treated as falling within the category of **ground handling services** under international transportation, and is zero-rated for VAT purposes.

[Rul/2006/VAT/02] **[Sec 7]**

38. Input VAT on Tax Debit Notes.

The additional claim of input credit, on a 'tax debit note' by way of an adjustment to the input tax already claimed, is allowable only if such adjustments are connected to an input credit already claimed on an original 'tax invoice'. The adjustments on a tax debit note tax/credit note is subject to restrictions specified in Section 25.

[Rul/2005/VAT/10] **[Sec 25]**

39. Withholding tax charged by the Western Province Provincial Council.

The withholding tax charged by the Western Province Provincial Council under the provisions of the Western Province Provincial Financial (Amendment) Statue No 02 of 2010, in relation to certain goods sold for resale, will not form part of the value of supply of such goods for VAT purposes.

[ACT 17/9] **[Sec 5]**

40. Fees, subscriptions etc. collected by Management Corporations of condominium properties

The provision of facilities to its members or others for consideration and payments of subscriptions in the case of a club, association or organization is defined to be a taxable activity.

Accordingly, the management corporation of any condominium property is treated as carrying on a taxable activity, and liable to collect and pay VAT thereon.

[ACT 17/9] **[Sec 83]**

41. International Transportation

Supplies referred to in item 10 of the Gazette Notification No.1267/5 dated 17.12.2002, which specifies services which are zero rated for the purposes of Section 7 of the VAT Act, are applicable only in relation to shipping lines.

This has not been extended to 'airlines'.

[Rul/2005/VAT/03] **[Sec 7]**

42. Exemption of VAT on supplies made to Diplomatic Mission

The identification of goods or services referred to in item (viii) of paragraph (b) of PART II of the First Schedule to the VAT Act is applicable to any Diplomatic Mission as well as Diplomatic Personnel of such Mission.

The provision of the Act does not permit to split the Diplomatic Mission and Diplomatic personnel in order to apply the requirement of identification of goods or services by the Commissioner General of Inland Revenue, to apply only to Diplomatic personnel of the Mission.

[Rul/2005/VAT/04] **[First Schedule]**

43. The value of supply of Fertilizer, the cost of which is partly subsidized by the Government.

The price of fertilizer has been fixed by the government. It would, therefore, be the price on which fertilizer could be sold in the open market. Hence, determining Market Value of such Fertilizer by adding government subsidy (or grant) may not be a realistic value of such supply. Therefore, the open market value of fertilizer should be the price fixed by the Government.

Further, the subsidy (or grant) paid by the government is not connected either to a good, or to a service supplied to the government. Hence, it may not be possible to connect such payment to a taxable activity of the supplier, with the Government

Accordingly, it is more appropriate, to disallow input tax credit on the subsidy (or grant) given by the Government, on import or manufacture of fertilizer, instead of adding the subsidy to the value of supply.

Further, it could be justifiable since the cost of such part of Fertilizer which is subsidized by the Government is not incurred by the supplier.

Therefore,

i. treat the value of Government subsidy (or grant) on fertilizer, as an excluded supply; and
ii. disallow input tax credit attributable to the value of such subsidy or grant paid by the Government.

[Rul/2005/VAT/2005] **[Sec 5]**

44. Liability to VAT (Services provided by a person in Sri Lanka to a person outside Sri Lanka)

In terms of paragraph (c) of subsection (1) of Section 7 of the VAT Act,

Services provided by any person in Sri Lanka to a person outside Sri Lanka, to be consumed outside Sri Lanka, shall be Zero rated, provided that payment for such services has been received in full from outside Sri Lanka, and in foreign currency through a bank in Sri Lanka.

If the supply of service originates in Sri Lanka and finally such services are utilized in the course of carrying on or carrying out a business in Sri Lanka by a foreign principle, then such services are not treated as consumed outside Sri Lanka.

The utilization of services will depend on the fact that the place where the taxable activity is carried out. If the person outside Sri Lanka does a business in Sri Lanka through a person in Sri Lanka, such services are not treated as services utilized outside Sri Lanka, even though the recipient of the services is not physically present in Sri Lanka, to utilize such services.

[Rul/2005/IT/15]

45. VAT Exemption on import of project related Articles

After the completion of the project implementation period, if any company has entered in to a Supplementary Agreement with the BOI, then it means that it continues the project under the same Agreement, the project implementation period of which is already completed and such project is liable to pay VAT. The input tax in respect of the supply of goods or services, whether import or local purchases, could be claimed as a deduction against the output tax payable, so far as such imports or purchases are connected to such liable supplies.

[Rul/2005/VAT/06] **[Sec 5]**