LIST OF INTERPRETATIONS

(In a generalized and summarized form)

Committee for Interpretation of Tax Laws
Department of Inland Revenue
October 2014

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(In a generalized and summarized form)

Set II

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October 24, 2014

Interpretation of Tax Laws – Set II

This is **Set II** of the List of Interpretations issued by Department of Inland Revenue under the Committee appointed by the Commissioner General of Inland Revenue. Interpretations **Set I** was issued in November 2013 which consisted of Interpretations issued up to that period.

As stipulated in section 208A of the Inland Revenue Act, No. 10 of 2006, [which was introduced by the Inland Revenue (Amendment) Act, No. 22 of 2011] , the Committee (comprising senior officials) is statutorily empowered for the interpretation of provisions of any enactment administrated 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 the relevant provisions in line with the interpretations Issued.

Accordingly, 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 revenue enactments. Therefore, such interpretations which could be summarized in a manner, that the secrecy with regard to the affairs of the respective taxpayers is preserved, are given in a generalized form entailing the respective **interpretation number** and the **section** of the relevant enactment.

Certain clarifications given by the Secretariat on specific issues based on the facts of the case, explaining the Departmental viewpoint on respective issues, and to ensure consistency in the application of the law, are also incorporated with the reference number of the connected source file.

Any officer of IRD requiring more information may discuss with the Senior Commissioner (Tax Policy), the Commissioner (Secretariat) or the Secretary to the Interpretation Committee. Any of the interpretations or rulings may be released to any concerned party as per the process of issuing interpretations given by the Committee, in the generalized form and summarized manner to the stakeholders on request make on that regard.

Apart from that explanatory notes on amendments made to the relevant Acts have also been issued parallel to the Interpretations and clarifications given in this document.

D.G.P.W. Gunatilaka
Senior Commissioner (Tax Policy)
Chairperson – Committee for Interpretation of Tax Laws

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Interpretations under

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

[hereinafter referred to as "IR Act"]

01. Whether the income tax exemption is applicable to interest earned by any co- operative society registered under the Co-operative Societies Act, No. 5 of 1972 from 2011 and whether such exemption is eligible to be applicable to any co-operative society registered under Co-operative Societies Ordinance No. 16 of 1936 as amended by Act, No.21 of 1949 and Act, No. 17 of 1952?

Section 7(h) of the IR Act was first introduced in 2008 by the IR (Amendment) Act, No. 9 of 2008 [closing the provisions under paragraph (b) (xvii) of section 7] which provided exemption for the profits and income of co-operative societies registered under the Co-operative Societies Act, No. 5 of 1972 for a period of 5 years commencing from April 1, 2008 (until March 31, 2013).

Section 7(h) was subsequently amended in 2011 [IR (Amendment) Act, No. 22 of 2011] by removing the time restriction of 5 years and expanding the said exemption to co-operative societies registered under the other respective statutes enacted by a Provincial Council and Lak Sathosa Ltd etc.

Accordingly, the exemption including income from interest is continuously being exempted from April 1, 2008 onwards to co-operative societies registered under the Co-operative Societies Act, No. 5 of 1972.

The present section 7(h) of the IR Act reads as follows:

> *"the profits and income of any registered society within the meaning of the Co-operative Societies Law, No. 5 of 1972 or under the respective Statute enacted by a Provincial Council providing for such registration and the profits and income of Lak Sathosa Limited registered under the Companies Act, No. 7 of 2007."*

Based on the above provisions,

(1) With effect from April 1, 2008, the profits and income of co-operative societies registered under Co-operative Societies Law, No. 5 of 1972 is exempt from income tax including income from interest or dividends.

(2) With effect from April 1, 2011, such exemption is extended to any co- operative society registered under the respective statutes enacted by a Provincial Council providing for such registration and the profits and income of Lak Sathosa Limited registered under the Companies Act, No. 7 of 2007.

However, there is no evidence that co-operative societies registered under Co-operative Societies Ordinance No 16 of 1936 as amended by the Act, No. 21 of 1949 and Act, No. 17 of 1952 are covered either within the provisions of the Co-operative Societies Law No 5 of 1972 or under the respective statutes enacted by a Provincial Council. As such the present provisions do not permit the aforesaid exemption for such societies.

[IC/2014/12] **[Section 7(b) & 7(h)]**

02. Whether the interest on a loan obtained by a resident company from a bank outside Sri Lanka, which has a branch in Sri Lanka and since the branch of the foreign bank is not in a position to grant the loan due to the single borrower limit as specified by the Banking Act, the facility is obtained from the foreign bank, could be exempt under section 9(a) of the IR Act?

The requirement for the exemption is that the proceeds of the entire loan evidently flown to Sri Lanka from abroad and the exemption is applicable to the foreign bank (and not to the branch in Sri Lanka) .

Accordingly, the interest **accruing to the foreign bank** from any loan granted to a resident company in Sri Lanka is exempt from income tax, if the proceeds of **the entire loan evidently flown to Sri Lanka from abroad notwithstanding the facts that such foreign bank has a** local branch or a business connection, so far as it is a direct loan agreement between the local party with the foreign bank (not through the branch).

[IC/2013/17] **[Section 9(a)]**

03. Applicability of the exemption under section 13(ddd) of the IR Act by an undertaking currently paying income tax at the rate of 15% as per an agreement entered into with Board of Investment of Sri Lanka (BOI) after the expiry of the tax holiday

In terms of section 48C of the IR Act, where the taxation of profits and income of any BOI undertaking in accordance with the respective agreement, after the expiry of the tax exemption period under such BOI agreement is more burdensome than the taxation under the applicable provisions of IR Act, then such company **is chargeable with income tax** in accordance with the provisions of the IR Act. This could be extended even to cover exemption applicable under the IR Act **(even not chargeable to income tax)** on profits and income of any such undertaking, notwithstanding any rate applicable under the BOI agreement.

However, the application of the exemption under section 13(ddd) depends on the facts of the case on which the recipient of services should actually and completely be out of Sri Lanka.

[IC/2012/68] **[Sections 13(ddd) & 48C]**

04. Applicability of income tax exemption under section 13(ddd) of IR Act, on profits and income of a company where an agent of relevant foreign company exists in Sri Lanka

As provided in paragraph (ddd) of section 13 of the IR Act, the exemption is applicable to the profits and income earned in foreign currency by **any resident company**, any resident individual or any partnership **in Sri Lanka**, from any service rendered in or outside Sri Lanka **to any person or partnership outside Sri Lanka**, other than any commission, discount or similar receipt for any such service rendered in Sri Lanka, if such profits and income (less such amount, if any, expended outside Sri Lanka as is considered by the Commissioner-General to be reasonable expenses) are remitted to Sri Lanka through a bank.

For the application of exemption under section 13(ddd), the recipient of the services should actually and completely be out of Sri Lanka. If part of the services are provided through an agent in Sri Lanka such part would not fall within the provision of the section 13(ddd).

However, any services provided directly to persons out of Sri Lanka based on the agreement entered in to with them and such services are received by such recipient out of Sri Lanka for payment in foreign currency would be exempted from income tax subject to the conditions specified in that section.

[IC 2013/92] **[Section 13(ddd)]**

05. Applicability of income tax exemption under section 13 (ddd) of the IR Act, on profits and income of a registered travel agent under Sri Lanka Tourism Development Authority, acting as the destination management company for reputed travel agents of a foreign country

A registered travel agent under Sri Lanka Tourism Development Authority; a resident company incorporated in Sri Lanka earns profits and income by acting as the destination management company for reputed travel agents in a foreign country. The said travel agent provides tourist packages to their clients (tourists) and **if such tourists wish to visit Sri Lanka, they are directed** to the agent to facilitate their tour in Sri Lanka. Being the destination management company of those travel agents in foreign country, the company fulfills a part of such travel agent's business. Therefore, the company could be treated as a dependent agent satisfying requirements for a Permanent Establishment of each such enterprise (Travel Agents) of the foreign country under the Double Tax Avoidance Agreement between Sri Lanka and the other country.

For the application of exemption under section 13 (dddd) [or section 13(ddd) after March 31, 2011] the recipient of services should actually and completely be out of Sri Lanka. The existence of any business connection or Permanent Establishment in Sri Lanka, of an enterprise of any other country, would be evidence that such enterprise is not a person completely outside Sri Lanka. **In the case of travel agent the services are provided in Sri Lanka, as such, services are not actually and completely be outside Sri Lanka.**

Accordingly, the profits and income earned by company, would not be exempt from income tax under section 13 (dddd) or 13 (ddd) of the aforesaid IR Act.

[IC/2013/08] **[Sections 13(ddd) & 13(dddd)]**

06. Applicability of income tax exemption on interest earned from loans given out of funds raised from abroad in the hands of DFCC Bank under section 13 (xxxxxxxx) of the IR Act

In terms of the section 13 (xxxxxxxx) of the IR Act, the interest earned by the DFCC Bank from moneys lent, out of funds raised from outside Sri Lanka, to small and medium scale enterprises, plantations, construction industry or other manufacturing industries is exempt from income tax.

The receipts of the bank from lending money constitute profits referred to in section 3(a) of the IR Act, and hence aforesaid exemption is applicable to the profits and income from lending of aforesaid funds, computed in accordance with the said Act. Accordingly, any expense which could be recognized as incurred in the production of such profits and income (interest) cannot be deducted in computing the profits and income of the bank liable to tax.

Further, the exemption is applicable for the interest accrued on or after April 1, 2013 to the DFCC Bank on such loans given out of funds raised from outside Sri Lanka to small and medium enterprises.

[IC/2013/ 91] **[Section 13 (xxxxxxxx)]**

07. Identifying of new undertaking of an existing company engaged in infrastructure project as defined under section 17A (2) (a) (x) of IR Act

To consider a project of a company to be treated as a new undertaking for the purposes of section 17(A) of the IR Act, the undertaking should be able to function as an independent unit in which new assets (to the undertaking) are put up (including technology), and thereby itself is capable of production of goods or

provision of services independently of the existing business of the company. Profits and income of such new undertaking should be derived **only** from the new capital invested on such new undertaking. Further, any employee or asset of the company should not be employed or used in common between such project and the company or it's any other undertaking if it is to be considered a new undertaking.

Further, the expenses such as, consultancy fees (or costs) etc. cannot be treated as investment for the purpose of aforesaid section.

Accordingly, subject to the other conditions specified in section 17 A (2) (a) (x) of IR Act, together with the above requirements being satisfied, could be treated as a new undertaking engaged in infrastructure project qualifying for the exemption under the said section.

[IC/2012/54] **[Section 17A]**

08. Whether the rice milling products could be treated as 'edible products manufactured out of locally cultivated agricultural products" for the purposes of section 17A of the IR Act?

Section 17 A of the IR Act as amended by the IR (Amendment) Act, No. 08 of 2012 refers to the exemption from income tax of the profits and income from any new undertaking engaged in any activity specified therein as qualified activities for the exemption and under that, edible products manufactured out of locally cultivated agricultural products qualify for the exemptions subject to the fulfillment of conditions specified therein.

The term "edible products manufactured out of locally cultivated agricultural products" means a product readily suitable for eating which resulted in certain process of manufacturing. (Eg- serial made out of grains). The product which is manufactured in a rice

mill is used for the manufacture of edible product but such product itself is not an edible product.

Accordingly rice milling project does not possess characteristic described above and not qualify for the exemption under section 17A.

[ACT 4/17] **[Section 17A]**

09. Whether the payments made to Sri Lanka Tea Board as "levy for tea promotion and marketing strategy" could be treated as an expense disallowable under section 26(l) (iii) of the IR Act

As stipulated in the section 26(l) (iii), no deduction shall be allowed in the ascertainment of profits for income tax purposes, in respect of any prescribed tax or levy.

Payments made in accordance with the Gazette Notification No, 1677/14 dated 27.10.2010, to the Director General of Sri Lanka Tea Board, has not been prescribed for the purpose of income tax under section 26(l) of the IR Act.

Therefore, a proportionate part of payments made to the Director General of Sri Lanka Tea Board as per the above Gazette Notification, as attributable to the liable profits of the company from exports, could be deducted for the purpose of ascertaining profits and income, as such part of expense is incurred in the production of profits liable to tax.

However, in any instance of refunding such levy, fully or partly, to the company, such amount of refund should be treated as a receipt from the business of the company.

[IC/2013/11] **[Section 26(1) (ii)]**

10. Clarification of the meaning of the term "reserves" as to whether a negative balance can be fallen within the meaning of reserves

For the purpose of income tax, adjustments are made based on the provisions of the IR Act, to the Audited Financial Statements prepared in accordance with generally accepted accounting principles and the accounting standards laid down by the Institute of Chartered Accountants of Sri Lanka and the requirements of Companies Act, No. 7 of 2007.

Hence, for the purpose of income tax, the items which should have been disclosed under "reserves" in accordance with the aforesaid principles, accounting standards and the Companies Act, could be regarded as "reserves". Consequently, negative balances, such as accumulated losses could be fallen within the meaning of reserves.

[IC/2013/07] **[Section 26(1)(o)]**

11. Tax treatments of a BOI registered company such as, tax treatment in post BOI tax exemption period, brought forward losses during the tax exemption period, self-assessment payments of taxes [including set off of Economic Service Charge (ESC)], deduction of royalty payments during the tax exemption period etc.

(i) Whether the company is entitled for deductions of brought forward business loss arose during income tax liable period (prior to the commencement of the tax exemption period but after signing the Agreement) and royalty payment in order to arrive at the income tax liability of the company?

In this particular case, the exemption under the BOI agreement (entered into prior to 01.04.2011 under the BOI Law) shall be commenced in the year of assessment in which the enterprise commences to make profits in relation to its transactions in that

year, or any year of assessment not later than five (05) years reckoned from the date of its commercial production or operation, whichever is earlier.

As stipulated in section 32(5) (b) of the IR Act, a loss to be a deductible loss (for income tax purposes), it would have been taxable if it was a profit. As such, if the loss for any year of assessment were a profit (instead of a loss) the period of tax exemption would have been commenced from that year of assessment. It means that the said requirement would not be satisfied.

Hence, the losses incurred prior to the commencement of tax exemption period are not deductible for tax purposes.

(ii) Whether the royalty paid in relation to their business by a BOI company which is exempt from income tax for a specific period, is qualified for deduction under section 32 of the IR Act?

During the tax exemption period, the BOI Company is not eligible to make adjustments required to be made under the IR Act, as the provisions of the IR Act relating to the imposition of income tax in respect of the profits and income of the company is not applicable. Therefore, any statutory adjustment is not relevant with regard to the profits of the company during the period of tax exemption. Hence, the company is not entitled to deduct royalty from the total statutory income; as such amount has already been deducted (or should have been deducted) in arriving at the accounting profits of the company.

(iii) Whether the company is entitled to set off ESC against the income tax payable at 2% on the turnover of the company?

Income tax payable at 2% of the turnover is the tax payable for the purpose of the IR Act which is agreed upon for the

purposes of the BOI agreement. Hence, ESC paid can be set off against the income tax payable.

(iv) Whether the company is liable to pay quarterly income tax during financial year soon after the expiry of the tax holiday on the basis that business profit is exempted during the previous financial year?

As the tax exemption period was ceased on December 31, 2012 (in this particular case), the company is required under proviso (ii) (B) to section 173(3) of the IR Act, to pay quarterly installments taking into consideration of any income tax which would have been payable by the company, had such profits and income been taken into account in computing the assessable income for the previous year of assessment i.e. 2011/2012.

[IC/2013/02 & [IC/2013/71] [Sections 32(5) (b) &173(3)]

12. Whether the qualifying payment on the expansion of an existing undertaking under section 34 (2) (s) of the IR Act could be entitled to a BOI registered company which is subject to tax at the rate of 2% on the turnover after the expiry of the tax holiday under the said BOI agreement?

Whether the company is eligible to deduct qualifying payments is a matter which has to be decided based on the facts considering whether the activities carried on by the company could fall under the specified activities referred to in section 16C or 17A of the IR Act and whether the new investment could result in an expansion of the existing business.

Since the company pays tax on 2% of the turnover there is no assessable income ascertained by the company for tax purposes. As such, the relevant provisions relating to qualifying payments cannot be applied by the company.

However, as stipulated in section 48(c) of the IR Act, in a case of a BOI registered company which is subject to a concessionary rate of tax after the expiry of the tax holiday and the applicable tax rate is more burdensome than the taxation under the provisions of the IR Act, the provisions of the IR Act can be applied. In this case the option is available to the company to go back to the concessionary rate applicable under the IR Act at the rate of 12% on the taxable profits of export income. In such circumstances, only the qualifying payment could be deducted as there is an assessable income ascertained in arriving at the taxable income.

The qualifying payment is not deductible with the application of concessionary rate by payment of tax at 2% of the turnover.

[ACT 6 /21] **[Section 34 (2) (s)]**

13. Interpretation on '<u>monthly salary or wages</u>' for the computation of the specified part of retiring gratuity, for which the concessionary tax rates under section 35(2) (b) of the IR Act are applicable

As per section 4 of IR Act, profits from any employment include, inter alia, 'any wages, salary, allowance, which an employee receives in the course of his employment. Accordingly, wages, salary and allowance have been separately identified as components of profits from employment.

Accordingly, salary or wage is distinguished from any allowance or other payment or benefit. However, even though the salary or wages is considered for relief, such relief is almost two times the minimum payment required to be made by the employer under the Payment of Gratuity Act, No.12 of 1983.

In terms of the section 6 (2) of the said Payment of Gratuity Act, No. 12 of 1983, "a workman …… is entitled to receive as gratuity a sum equivalent to –

(a) half a month's wage or salary for each year of completed service, computed at the rate of wage or salary last drawn by the workman, in the case of a monthly rated workman ; and

(b) in the case of any other workman, fourteen days' wage or salary for each year of completed service computed at the rate of wage or salary last drawn by that workman:

Provided, however that, in the case of a piece-rated workman, the daily wage or salary shall be computed by dividing the total wage or salary received by him for a period of 3 months immediately preceding the termination of his employment, by the number of days worked by him in that period."

Therefore, the monthly salary or wage for the purpose of section 35(2) (b) (ii), should be interpreted as the aggregate of-

(a) the basic salary or wage; and

(b) any allowance or payment taken in to account by the employer, in computing the respective contributions for any Provident Fund (PF) and Employees' Trust Fund (ETF), and for the payment of gratuity.

[IC/2013/81] **[Section 35(2)(b)(ii)]**

14. Liability to tax for payments to be made in local currency for local sales effected by BOI registered export oriented companies and request to treat such sales income as deemed export income (import substitution / import replacement)

As provided in section 56A of the IR Act,

Such part of the profits and income of an export oriented company which has entered in to an agreement with the Board of Investment

of Sri Lanka under section 17 of the Board of Investment of Sri Lanka Law, No. 4 of 1978, for any year of assessment commencing on or after April 1, 2013, from the sale of goods manufactured in Sri Lanka, up to the quantity approved by the Board of Investment as import replacement,

(a). any company which has entered into an agreement with the Board of Investment of Sri Lanka under section 17 of the Board of Investment of Sri Lanka Law, No. 4 of 1978, enjoying tax holiday under section 16C, 16D or 17A of the IR Act or under the Strategic Development Projects Act, No.14 of 2008 and which is permitted to import project related goods or raw materials on duty free basis under the provisions of such agreement, during the project implementation period; or

(b). any person eligible to import specific goods on duty free basis under any Government Authority

shall notwithstanding anything to the contrary in any other provisions of the IR Act, be deemed to be profits and income from exports and be chargeable with income tax at the appropriate rate specified in the Fifth Schedule to the Act (and the rate specified in the Fifth Schedule is 12%).

Based on the above, the procedure is subject to the following:

(i) The percentage of sales to the local market is a matter to be agreed upon with BOI based on the Government Policy. The percentage approved to be supplied to the local market in such manner is the total consisting of the sales referred to in both sections 56A and / or 56D (locally manufactured garments, bags made out of fabric, linen, curtains or any other similar goods).

(ii) Out of the total local sales, the sales fall in the category of section 56A (import replacement) could be treated as deemed exports to be considered for the calculation of the

minimum export criteria for export oriented BOI companies for the purposes of fulfillment of the requirement of the BOI agreement entered into. However, such part is liable to income tax at the rate of 12% as the application of this provision is **notwithstanding anything contrary to other provisions of the IR Act**. It should also be noted that the local sales qualified for the concessionary rate under section 56D would not be treated as deemed exports but the rate applicable is the concessionary rate of 12% as specified in the Fifth Schedule to the IR Act.

[Ref ACT 7/14] **[Sections 56A &56D]**

15. Issues relating to the application of the concessionary rate of tax (10% subsequently increased to 12%) under section 59B:

(i) Whether the provision of architectural services carried out by a partnership could be considered under section 59B?

The profits and income derived from the partnership would be **from an undertaking**, and could be taxable at the concessionary rate, if the other conditions specified in section 59B of the aforesaid IR Act, are satisfied.

(ii) Whether the leasing of the rooftop of the building owned by an individual (a partner of the same partnership) would form part of the profits which could be taxed under the same rate applicable to profits of the undertaking taxed under section 59B?

The said building is a personal asset. The leasing income derived from the leasing of said rooftop has been declared as a separate source. This income is not an income arising to the partnership. Further, such income could not be treated as from an individual business of him for the mere reason that it is arising under an agreement without any characteristics of

business. (If the letting or leasing the space by a company, it is by way of a business by definition) Hence, the source is rent and therefore, tax treatment is under section 6 of the IR Act.

[IC/2013/75]

(iii) Whether the concessionary rate is applicable on income from interest on deposits which forms part of the total statutory income of an undertaking?

The concessionary rate is applicable only for business profits. Interest income is a separate source for which the concessionary rate is not applicable.

(iv) Whether the turnover could be separated for the application of section 59B, where the total turnover consists of turnover from the business of providing services, manufacturing activity, sales without any processing (import and sale or local buying and selling for which the provisions of section 59B has no application), turnover of business on which the profit and income is exempt from income tax etc.?

The concessionary rate is applicable only on the profits from the business of manufacturing of articles and provision of services. The turnover of the undertaking means, the total turnover of the undertaking consisting of all the activities and, if the total turnover from all the activities (separate undertakings under one entity or separate activities of one entity) does not exceed Rs.300Mn (subsequently increased to Rs.500Mn) the 10% rate is applicable to the profit and income from provision of services and manufacturing of goods for any year of assessment commencing prior to April 1, 2014 (subsequently increased to 12% for any year of assessment commencing on or after April 1, 2014).

[IC/ 2013/82]

(v) Whether the concessionary rate is applicable to income derived from leasing few lots of land owned by an individual to use as a car park?

The concessionary rate of 10% is applicable on profits and income derived from any undertaking which is always referred to a kind of business. Therefore, profit and income declared under paragraph (a) of section 3 would be qualified for the above concession.

The leasing income derived from leasing merely few lots of bare land could not be considered as an undertaking for the purpose of section 59B of the IR Act. Leasing income has to be considered under section 6 of the IR Act in which the source of income is rent/ground rent (ground rent on which expenditure is not deductible except rates if the owner pays such rates). Accordingly, as such leasing income could not be from an undertaking it does not fall within the scope of section 59 B.

[IC/2014/22]

(vi) Clarification with regard to the meaning of the words, Holding Company and a Subsidiary Company referred to in section 59B of the IR Act as amended by the IR (Amendment) Act, No. 8 of 2012

Even though an inclusive definition has not been provided to the words, "Holding Company" and a "Subsidiary Company" for the purpose of aforesaid section 59B, Part B of the Second Schedule to the IR Act, as amended by the IR (Amendment) Act, No. 22 of 2011 provides that the aforesaid terms shall have the same respective meanings assigned to them in the Companies Act, No. 7 of 2007.

Therefore, the expressions, "Holding Company" and a "Subsidiary Company" referred to in section 59B of the IR Act carries the same meaning as is defined in relation to aforesaid

Second Schedule of the IR Act [as introduced by the IR (Amendment) Act, No. 22 of 2011].

Since the meaning assigned to such words have been widened, with effect from 01.04.2014, the ***holding company or a subsidiary of any company*** incorporated or registered outside Sri Lanka also could be treated as within the ambit of group of companies under aforesaid definition.

[IC/2014/13]

(vii) Whether the concessionary income tax rate is applicable on the income derived by an Attorney-At-Law, by providing professional service through a Chamber?

Any person including an Attorney-At-Law maintaining a Chamber to provide professional services could be considered as an undertaking for the purpose of section 59B of the IR Act. Hence such services are chargeable to income tax at the concessionary rate of 10% for any year of assessment commencing prior to April 1, 2014 and 12% for any year of assessment commencing on or after April 1, 2014 as specified in item 33 of the Fifth Schedule to the IR Act as amended by the IR (Amendment) Act, No. 8 of 2014 on satisfying the other conditions specified therein.

[IC/2014/29] **[Section 59B]**

16. Meaning of the terms "issues by way of initial public offering" and "general public" respectively, referred to in section 59D of the IR Act as amended by IR (Amendment) Act, No.18 of 2013

As stipulated in the aforesaid section 59D, the company is required to list its shares in the Colombo Stock Exchange and issue by way of Initial Public Offering (IPO) not less than 20% of its shares to the **general public**, to be eligible for relief in terms of reduced tax

rate as specified therein. The company is also required to maintain such percentage of **public holding** (i.e. not less than 20% of total shareholding) to sustain such relief.

It is agreed that, an IPO could be via issuing new shares by the company to the public for subscription, or offering shares already issued (by the company) for public subscription to facilitate broadening of shareholding. Accordingly, and in line with its meaning followed by the Securities and Exchange Commission the wording "**issues by way of initial public offering"** referred to in the section 59D (1) of the IR Act carries the same meaning as is followed in relation to Clause 2.4 of the Listing Rules.

For the purposes of said section 59D, the subsection (2) thereof defines "**shares held by the general public**" and this is similar to the "**Public Holding (s)**" as defined for the purposes of Listing Rules. Accordingly, that the reference to "**general public**" in both subsections (1) and (2) of section 59D, could be construed to mean "**public holding(s)**" as referred to in such Listing Rules.

[IC/2013/113] **[Section 59D]**

17. Whether the dividend distributed by a subsidiary in Sri Lanka of a resident company in Japan is subject to tax in terms of the Double Taxation Avoidance Agreement between Sri Lanka and Japan?

As per section 61(1) of the IR Act, every company resident in Sri Lanka is required by statute to pay income tax not only on taxable income of the company but also on the dividends distributed by it out of its taxed profits.

In terms of Article VI of the Double Tax Agreement with Japan, dividends paid by a company shall be exempt from all Sri Lanka tax **other than Sri Lanka income tax.** As explained above, tax on dividends distributed forms part of the income tax payable by the company.

Hence, the subsidiary is required to pay 10% income tax of the relevant part of the aggregate amount of the gross dividends since it is part of the income tax payable by such company.

[IC/2013/94] **[Section 61(1)]**

18. Whether the income tax on the undistributed part of distributable profits that would have been distributed to reach the minimum quantum (Deemed Dividend tax) specified in section 61(1) (b) (ii) of the IR Act, is applicable to a company during the period of its tax exemption in terms of an Agreement entered into with the BOI, and how the sections 10(1) (d) and 10(2) (a) are effective in such circumstances?

Tax referred to in the aforesaid section 61(1) (b) (ii) of the IR Act is an income tax imposed on a company. Hence, the 15% tax specified in that section 61(1) (b) (ii) is not applicable to the company, during the period of such tax exemption under the said BOI agreement (other than the agreement entered in to with BOI in which the income tax exemption is provided within the provisions of the IR Act).

Further, the above mentioned sections 10(1) (d) and 10(2) (a) are not relevant to the liability on distributable profits of the company, as those sections deal with income tax exemptions accorded to shareholders on dividends distributed.

As shareholders are not exempt under sections 10(1) (d) and 10(2) (a) on the dividends distributed by the company, even during the period of tax holiday of the company, income tax is payable by the shareholders on such dividends at normal rates, unless tax from such dividends are deducted by the company. Nevertheless, if the company has deducted tax at 10%, from such dividends, without any obligation, but with a view to provide relief to shareholders,

the company is bound by section 65(4) of the IR Act, to remit such tax to the Department.

[IC/2013/ 68] [Sections 61(1) (b) (ii), 10(1)(d) & 10(2)(a)]

19. Whether the Treasury of the Government is covered under section 7(c) of the IR Act, and accordingly, is not required to deduct income tax equal to ten per centum of the amount of gross dividend payable to the General Treasury, under section 65(1) (a) of that Act?

As per section 65 (1) (a) of the IR Act, every resident company, other than a unit trust or mutual fund approved by the Securities and Exchange Commission of Sri Lanka, shall deduct from the amount of gross dividend payable to any shareholder, other than any company or body of persons which is exempt from income tax under paragraph (a) or paragraph (c) of section 7.

The paragraph (c) of section 7 states that the income of any local authority or Government institution is exempt from income tax, and as defined in section 217 of the IR Act, 'Government institution' means any Department or undertaking of the Government of Sri Lanka.

The Treasury is a Governmental Department under the Ministry of Finance and Planning. The Treasury is sometimes referred to as Treasury Department (particularly, in USA).

Accordingly, the General Treasury in Sri Lanka could be regarded as a Department of Government, and thereby is a Government institution, for the purposes of paragraph (c) of section 7 of the IR Act.

Therefore, it is not required to deduct income tax from the gross dividend payable to the General Treasury.

[IC/2013/80] [Section 65(1)]

20. Whether the employment services of foreign employees who provide services in their respective home countries fall within the scope of the chargeability to income tax in Sri Lanka as per the provisions of sections 2 and 85 of the IR Act for PAYE Tax purposes?

In this case two employees from India and Bangladesh respectively provide service from their home countries to a resident company in Sri Lanka relating to activities to be carried out in their home countries and both of them are resident for the tax purposes in those countries. Sri Lankan company remits the gross salary and travelling allowance directly from Sri Lanka to the respective bank accounts of the said employees as per the contract of employment.

Whether the employment income is liable for PAYE purposes will depend on the facts of the case. As per the facts of this case the said employees do not render services in Sri Lanka to be chargeable to tax under section 2 (Charging Section) since they do not exercise employment in Sri Lanka . Hence, there is no liability to PAYE tax.

[IC/ 2014/33] **[Sections 2 & 85]**

21. Requesting advice to determine the appropriate basis to allocate commonly shared expenses (overheads) of the company with regard to the different segments of activities on which the profits are exempted from income tax or chargeable with income tax at different rates

As provided in sub section (11) of section 106 of the IR Act, as amended by the IR (Amendment) Act, No.22 of 2011, the company is required to maintain and prepare accounts separately by identifying the profits and income with regard to the

undertakings which are exempted from income tax or chargeable with income tax at different rates.

Accordingly, the direct expenses, which are clearly identified with a segment, should be allocated to particular segment and the expenses which cannot be identified as direct expenses such as overhead expenses should be split over among relevant segments proportionately on appropriate allocation methodology providing justifiable reason for selection of such basis.

[IC 2014/11] **[Section 106(11)]**

22. Directive on the issue of directions under section 139 of the IR Act, on the deductibility of WHT on interest on Corporate Debt Securities

The upfront deduction of income tax on the interest on Corporate Debt Securities was introduced in Budget 2012 in order to accommodate the process of secondary market transactions of the Corporate Debt Securities similar to Government Securities such as Treasury Bills and Treasury Bonds. Further, a provision relating to Notional Tax Credit has been incorporated by the Amendment Act, No. 10 of 2007 to section 137 of the IR Act to facilitate the secondary market transactions.

Accordingly, the issuing of direction under section 139 is not practically possible for the purposes of section 135 of the IR Act. However, the provision has been incorporated in section 135 to refrain the deductibility of WHT in respect of interest which is exempt from income tax.

[IC/2013/53] **[Sections 139&135]**

23. Whether the amendment introduced to section 137 of the IR Act is applicable for the past period which clarifies the position relating to the entitlement of Notional Tax Credit to be set off against the tax payable on profits and income from business of providing financial services [section 3(a) profits] by banks and financial institutions?

Subsection (4) of section 137 clarifies the position referred to in subsection (1) with the words " **For the avoidance of doubts**, interest income referred to in subsection (1) in relation to any bank or financial institution means the profits and income earned or accrued from any Security, Bond or Bill".

Hence, the provision is only a further clarification of the position which is applicable for the past period as well.

[Ref No: IC/2014/66] **[Section 137]**

24. Whether the non-resident company is bound to furnish audited accounts in Sri Lankan Rupees, in relation to its branch operated in Sri Lanka?

Even though the company is a non-resident company, taxes are imposed under the provisions of respective enactments legislated by the Parliament of Sri Lanka. The currency, wherever applicable, referred to in the enactments is Sri Lankan rupees. For instance, in this case of income tax, restrictions, ceilings, allowances and even rate schedules are given based on Sri Lanka rupees.

This matter was further emphasised with the Regulations issued under the Gazette No, 1857/8 dated April 9, 2014, in complying with the respective provisions of the IR Act, as consequential to the adaptation of Sri Lanka Accounting Standards which consist of Sri Lanka Financial Reporting Standards and in item 10 of the regulations (the effects of changes in foreign exchange rates)

provides that the financial statements submitted for tax purposes should be presented in terms of Sri Lanka Rupees.

Therefore, it is obvious to furnish audited statement of accounts and other related documents prepared in terms of Sri Lanka rupees, to the Commissioner General of Inland Revenue.

[IC/2013/56] **[Sections 107 & 212]**

25. Instructions on the method of calculating the market value of a share for the purpose of a share buyback

The definition of dividend in section 217 of the IR Act, as amended by the Act, No. 18 of 2013, has been widened by the addition of the following:

> **"*Dividend" includes……..***
>
> ***"(v) Where a company buys back shares from its shareholders, the excess, if any, paid to any shareholder over the market price of such share quoted in the Colombo Stock Exchange or the market value of such share as the case may be, as at the date on which the shareholders of such company at a meeting approved such share buyback;"***

The market value of such share of the company" for the purpose of this definition could be taken as –

"The value of net assets of the company (at the date of approval of share buyback) divided by the number of shares (at the date of such approval)."

[IC/2014/06] **[Section 217]**

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

[hereinafter referred to as "ESC Act"]

26. Liability to Economic Service Charge (ESC) of enterprises approved under PART IV of the Finance Act, No. 12 of 2012 as amended by PART III of the Finance Act, No. 12 of 2013 (Hub Provisions)

In terms of section 18A of PART IV of the Finance Act, No. 12 of 2012 as amended by PART III of the Finance Act, No. 12 of 2013, the exemption (subject to the fulfillment of other conditions specified in the said Act) shall be applicable only relating to the provisions of the Acts specified in the Schedule referred to in section 13 of that Act. ESC Act has not been specified in that Schedule. As such, the provisions of the ESC Act are applicable to enterprises under Hub provisions.

In terms of the ESC Act, No. 13 of 2006 subject to the other conditions, ESC is payable by any person or partnership who or which does not have taxable income or entitle to any exemption from income tax. However, the liability arises only if the turnover for any quarter including turnover relating to exempt income exceeds Rs. 50 million.

Section 18B of the said Finance Act provides that any new enterprise established on or after the date of coming into operation of the said Act, which is engaged in any one or more of the businesses set out below, within the meaning of an agreement entered into with the Board of Investment of Sri Lanka under the Board of Investment of Sri Lanka Law No. 4 of 1978, shall be eligible, subject to the other provisions of that section, the exemption under the relevant sections of the IR Act, **if such enterprise satisfies the requirements specified in the**

relevant section by which the exemption applicable is granted.

The businesses which are eligible for the application of hub provisions (subject to the fulfilment of other conditions specified therein) are as follows:-

(i) *entrepot* trade involving import, minor processing and re-export;
(ii) off-shore business where goods can be procured from one country or manufactured in one country and shipped to another country without bringing the same into Sri Lanka;
(iii) providing front end services to clients abroad;
(iv) headquarters operations of leading buyers for management of finance supply chain and billing operations;
(v) logistic services such as bonded warehouse or multi-country consolidation in Sri Lanka.

Accordingly, the conditions under the IR Act to be eligible for the exemption or makes a loss for the previous year of assessment and if the turnover exceeds Rs. 50 million for a quarter, the liability to ESC arises. However, some of the enterprises approved under hub provisions are not exempted from Income tax. As such, those enterprises are not liable to ESC.

[IC/2014/41]

(C). VALUE ADDED TAXACT, NO. 14 OF 2002

[hereinafter referred to as "VAT Act"]

27. Clarification on the ascertainment of liable threshold (for the purposes of section 3) of a subsidiary or associated company of a group of companies, engaged in a wholesale or retail sale of different types of products: viz. paints, consumer products and agro chemicals with an annual turnover of each such company exceeding the liable thresholds for registration for VAT (exceeds Rs. 3 Mn per quarter but not registered as the turnover is only from wholesale and retail trade on locally purchased goods)

As stipulated in the respective provision, for determining whether a company engaged in wholesale or retail sale (fully or partly) is liable to pay VAT on such sale, the aggregate value of the turnover of each company (in the group) which is engaged in the wholesale or retail sale of goods purchased locally (fully or partly) should be considered even where different type of products are dealt with.

Accordingly, each company is liable to be registered for VAT and pay VAT on respective sales, if the aggregate quarterly turnover of the aforesaid companies exceeds Rs. 250,000,000.

[IC/2014/02] **[Section 3]**

28. Whether a company, is entitled to claim refunds of "Residues of Excess Input Tax" accumulated on purchases made by way of imports, under the provisions of section 22(5) read with section 22(10) of the VAT Act as amended?

Subsection (10) of section 22 of the VAT Act, as introduced by the amendment Act, No. 14 of 2007 and which is amended subsequently, deals only with

- a further restriction of deductibility of input tax (up to a sum of 85% or 100% of output VAT); and
- providing for an accelerated basis for deduction of accumulated excess allowable input tax as at specified dates.

It does not make any change to the provision for disallowance of refunds of excess input tax to the registered persons who import goods for re-sale without processing, as referred to in the 3rd proviso to said section 22(5). The said section 22(5) has been amended only to making it subjected to section 22(10).

Accordingly, the disallowance of any refund of excess input tax, in the case of importers of goods for retail without any processing, as referred to in the 3rd proviso to section 22(5) will continue to apply without any change.

[IC/2013/23] **[Section 22]**

29. 'Value of supply' and other connected matters under the VAT Act, of a company entered into an agreement with BOI for the development and sale of condominium housing apartments. [The total construction cost including the lease payment of the land (belongs to Urban Development Authority (UDA)) is borne by the company and has the liberty to identify prospective buyers]

Issues raised are set out below:

(i) Ascertainment of the 'Value of supply' of the land and improvement thereon

In terms of section 5(7) of the VAT Act, the value of supply of land and improvements thereon, shall be the value of such supply less the value of land at the time of supply and the value of any improvements (if any) on the land as at March 31, 1998 which shall not be less than the open market value of such supply excluding the value of such land at the time of supply and the value of any improvements on such land as at March 31, 1998.

Accordingly, the value of supply has to be calculated as follows:

Sale price	xxxxx
Market Value of the land at the time of sale	(xxxxx)
Value of supply for VAT purposes	xxxxx

(Note: the improvements as at March 31, 1998 is disregarded on constructions taken place after that date)

(ii) Whether the company could claim input credit on lease rental paid on the land, if so whether the SVAT facility could be obtained during the project construction period?

As per section 22(6) (ii) of the VAT Act, any input tax attributable to the supply of goods or services received shall not be deducted , if the supply of goods or services received is not connected with the taxable activity or **not included in the value of taxable supply.**

Since the market value of the land does not form part of the taxable supply no input tax is claimable on the lease rental paid to UDA and accordingly SVAT facility is not available to UDA for the said transaction**.**

(iii) Whether to advance payments received during the project implementation period be chargeable to VAT and if so, whether the input credit could be set off against the VAT payable?

The time of supply as per section 4 of the VAT Act specifies that the payments in advance are liable at the time of receipt of such advance. Accordingly, VAT is payable on advance without setting off the input tax relating to project implementation period.

(iv) Whether the project implementation period would be ceased upon the receipt of advance payments?

The project implementation period will cease to be in operation once the output on the taxable supplies is declared. However, as ruled by the Department, the project implementation will continued to be applied notwithstanding the fact that the company collects deposits prior to the completion of the project, subject to the payment of VAT on

the total deposit collected without setting off the input tax. The input tax would be separately claimed as a deduction.

(v) Whether the increase of the market value could be adjusted on the payment in instalments or on subsequent sales by deducting the increase of the market value in ascertainment of the value of supply for VAT?

- If the price is already agreed at the time of entering into sales agreement and payments are made in installments, the issue relating to the increase of the market value does not arise unless the price is increased subsequently considering the increase of the market value. If so increased, the increase of market value attributable to the building is liable to VAT whereas the increase attributable to the land can be excluded.

- Similarly, on the outright sales of apartments if the price is increased due to the increase of the market value the value attributable to the land does not form part of the taxable supply but the increase of the market value attributable to the building forms part of the value of taxable supply.

[ACT 17/9] **[Sections 5(7) &22(6)]**

30. Whether the sale of management right which was held by a company, could be considered as a taxable supply as defined under section 83 of the VAT Act?

As defined in section 83 of the VAT Act, disposal of the management right could be considered as a supply of services which is a taxable service. In addition, such supply of service does not fall within the exempt supplies referred to in PART II of the First Schedule to the VAT Act. Therefore, VAT is payable

on disposal of the management right in terms of section 2 of the VAT Act.

[IC/2013/24] **[Sections 2 & 83]**

31. Treatment of VAT on local sales permitted by BOI to export oriented BOI registered companies operated in BOI zones

The procedure applicable on the local sales of this nature as per the guidelines issued with the application of Goods and Services Tax (GST) remains unchanged. The relevant provisions of the VAT Act are set out below

(i) VAT shall be charged (subject to the provisions of the Act) on the **importation** of goods into Sri Lanka, by any person on the **value of such goods.**

(ii) As per the proviso to subsection (3) of section 2 of the VAT Act, Director General of Customs may, defer the payment of the tax due on certain transactions which **include any goods which entered into customs bonded area or free port.**

(iii) Value for import of goods is specified in section 6 of the VAT Act. As specified in that section,

"the value of goods imported shall be the aggregate of-

(a) the value of the goods determined for the purpose of Custom Duty increased by ten per centum ; and

(b) the amount of any Custom Duty payable in respect of such goods with the addition of any Surcharge, Cess, any Port and Airport Development Levy payable under the Finance Act, No. 11 of 2002, and any excise

duty payable under the Excise (Special Provisions) Act, No. 13 of 1989 on such goods"

As defined in section 83 of the VAT Act:

*"**Customs bonded area**" means-*

(a). a bonded warehouse approved under section 69 of Customs Ordinance;

(b). a bonded warehouse approved under section 84A of Customs Ordinance;

(c). a warehouse of the Republic as defined in section 167 of Customs Ordinance ;

(d). a Free Trade Zones declared by the Board of Investment of Sri Lanka which is subject to monitoring by the Department of Customs; and

***"importation"** includes the bringing into Sri Lanka of goods from outside Sri Lanka by any person or **goods received from a custom bonded area** the purchase of goods on a sale by the Director-General of Customs, the Sri Lanka Ports Authority or the Commissioner-General, for the levy of the tax and other dues ;*

Based on the above provisions, importation includes the goods received from the bonded area (which is the local sale by the company as permitted by BOI) and the importer is the buyer outside the zone and the value should be the value specified for the importation of goods (i.e. the CIF value + Custom duty+ Cess+ PAL+ Excise duty etc. + 10% of the CIF value).

However, in order to facilitate the local sales and also for administrative purposes it is made to understand that the BOI

and the Department of Customs allow the seller (the BOI Company) to raise the Customs Declaration (CusDec) in the name of the seller.

Even though it is done for administrative purposes, the facts remain that the importer is the buyer and not the seller who facilitates the sale. Hence, the importer (buyer) is liable to pay the taxes on importation. Since, the input is not claimable by the buyer on the CusDec raised in the name of the seller, a tax invoice (if the sale is made to a registered person) or a tax inclusive invoice (if the sale is made to a person not registered for VAT) should be issued by the seller and the total value has to be declared as output tax on which input tax is claimable on the CusDec. However, it should be noted that the value of invoice in any case should not be lower than the value declared for Custom purposes. The taxes payable at the Customs including the value addition added should be a part of the cost of the sale made for the purpose of the issue of the tax invoice (or tax inclusive invoice as the case may be). Under no circumstances the output VAT could be lower than the input VAT claimed on the CusDec by the seller.

[IC/2014/03, IC/2012/72] **[Sections 6, 20 & 83]**

32. Whether lease rentals in respect of any machinery or vehicles falling under HS Code 84.29 are exempted from VAT in terms item (iii) of sub-paragraph (A) of paragraph (b) of PART II of First Schedule to the VAT Act, as amended by Act, No. 17 of 2013?

In terms of aforesaid item (iii), the provision of leasing facilities for bowsers, bulldozers, graders, levelers, excavators, fire fighting vehicles or road tractors for semi-trailers which is exempted for Customs purposes under respective Harmonize

Commodity Description and Coding System Numbers, is exempt from VAT as regards any rental for such items falling due for payment on or after January 1, 2013.

Accordingly, the provisions of leasing facilities are exempt from VAT only for bulldozers, graders, levelers, excavators specified under H S Heading 84.29.

Further, apart from the above items, any lease rental falling due for payment on or after January 1, 2013 in respect of following items are also exempted from VAT.

i). Browsers under HS Code No. 8704.23.10, 8704.23.20, 8704.32.10, 8704.32.20
ii). Fire fighting vehicles under H S Code No. 8705.30.10
iii). Road tractors for semi- trailers under H S Code 8701.20.10

[IC/2013/44] **[PART II of the First Schedule]**

33. Whether the service income earned by the company by providing services of design and built of residential houses solely for residential purposes of their customers is exempt from VAT?

Engaging in designing residential houses on the land owned by the customers on their requirement but the company does not supply, lease or rent of the residential accommodation. It is purely a service provided to the client on their requirements. Such a service does not fall within the supply, lease or rent of residential accommodation by the company.

Accordingly, the supply of services by the company does not fall within the exempt services referred to in item (xi) of paragraph

(b) of PART II of the First Schedule to the VAT Act, No. 14 of 2002.

[IC/2014/01] [PART II of the First Schedule]

34. Clarification as to how the mechanism could be applied in obtaining VAT free invoices from local suppliers in order to enjoy the VAT exemption granted by the Board of Investment (BOI) to enterprises approved under the Commercial Hub Regulations

The provisions relating to Commercial Hub Regulations have been provided in PART III of the Finance Act, No. 12 of 2012 as amended by Finance (Amendment) Act, No. 12 of 2013. The concessions, exemption etc. are applicable to an undertaking entered into an agreement with BOI. However, as provided in the said provisions the application of the exemption for VAT and Income Tax shall be within the provisions of the VAT Act and the IR Act.

The exemption, concessions etc. are applicable to the new undertaking which will enter into the agreement with BOI and not to the person who or which provides goods or services to such undertaking. As such, suppliers of goods or services cannot supply their supplies free of VAT unless such supplies fall within the exempt supplies referred to in PART II of the First Schedule to the VAT Act.

However, if the undertaking to which the Hub Provisions are applicable is carrying on a taxable activity and the supplies are zero rated supplies being direct exports or zero rated services as stipulated in section 7 of the VAT Act, the refund of VAT paid to suppliers on purchases could be obtained by registering as a

zero rated supplier. Any others, who are not registered, cannot obtain VAT invoices from the suppliers on the supplies.

Further, it is noted that administrative guidelines have not been issued with regards to the procedure applicable for new undertakings entering into agreement with BOI under Hub provisions.

As such, the purchases should be on VAT inclusive basis as the activities of such undertakings are treated as exempted activities for VAT. There is no restriction in registering for VAT if the activities carried on by the undertaking fall within Zero rated activities and obtaining the facilities available under Simplified Value Added Tax Scheme.

[IC/2014/10] **[PART II of the First Schedule]**

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

[hereinafter referred to as "NBT Act"]

35. Ascertainment of the turnover of a person appointed by a telecom company as a distributor of telecom cards and reload for NBT purposes

The sale of rechargeable cards, global cards and reloads carries by the distributor could not be considered as carrying on a business of buying and selling of an article as the value of the card is not the physical value of the card but the value of service inbuilt in it. The mere title as a "distributor" does not make the distributor, a seller of an article manufactured by the principal. The sale of telecom cards is a sale of future service and in the process the seller gets a commission by connecting the two parties. The liability for Turnover Tax was also ascertained in the same manner.

Accordingly, the turnover for NBT means the gross commission or discount from the sale of cards received or receivable (prior to deduction of commission or discount paid to sub distributors). The value of supply for VAT is also ascertained in the same basis.

With regard to income tax, it may not be an issue as the income is charged based on the net profit. If the sales are declared as turnover after deducting expenses including purchase cost the net result could be the commission or discount. The sub distributors are separately liable for their commission or discount on the same basis.

[IC/ 2013/57] **[Section 3]**

36. Whether the exemption provided under item number (vi) of Part II of NBT Act is applicable for operating leasing in relation to movable properties carried out by a company?

The exemption provided under the aforesaid section is intended to be for businesses providing finance leasing facilities (under 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 operating leasing agreements which is carried on by the company could not be interpreted as falling within the exemption under item number (vi) of Part II of the Nation Building Tax Act.

[IC/2013/78] **[PART II of the First Schedule]**

37. Whether the services provided by a company which includes designing, building and installing machines for manufacturing division and provision of skilled labour for continuous maintenances and supervision of machines etc. could fall within the ambit of excepted services referred to in item (viii) of PART II of the First Schedule?

The services are considered as excepted services for NBT under the aforesaid paragraph only if such services are provided to any exporter of any article, being services **directly related to** improving the quality and character of **such article.**

Accordingly, the services should be directly related to the articles manufactured for export which should be part of the article exported.

The services provided by the company are for the machinery used for the manufacturing process but such machinery is not part of the exported article.

As such, the services provided are not directly related to improve the quality and character of the articles exported and therefore liable to NBT.

[IC/2013/107] **[PART II of the First Schedule]**

38. Whether the local sale of knitted fabrics manufactured by the company registered with BOI, which is subject to the payment of Cess at Rs 40/- per kilogram would be liable to NBT?

The local supply is either to exporters (deemed exports) or to the local market. The local sale is made through a Customs Declaration (CusDec) issued in the name of the supplier.

In terms of paragraph (b) of the proviso to subsection (1) of section 22 of the VAT Act, No. 14 of 2002, the amount of tax due on the supply of fabric including any product as specified in that paragraph (as set out below) made out of fabric within such percentage as permitted to sell locally by the BOI under the agreement entered into by the manufacturer of fabric for export under section 17 of the BOI law, as approved by the BOI or the Director-General of Customs shall be at the following rates:—

(i) linen or curtains at rupees forty per kilogram;

(ii) towels at rupees twenty five per item;

(iii) bags made out of fabric at rupees forty per item ;

(iv) excess fabric as cut pieces not more than two meters in length of each piece at rupees twenty five per kilogram;

(v) any other fabric at rupees forty per kilogram

It is also provided that no other tax or levy is payable at the point of entry into the country including any duty under the Customs Ordinance (Chapter 235) or Cess under subsection (1) of section 14 of Sri Lanka Export Development Act, No. 40 of 1979, shall be charged or collected on such sale of fabric, where the amount of Cess specified in the preceding proviso has been paid on such sale.

The releasing of fabric from the bonded area (BOI zone is treated as a Custom Bonded area) is treated as an importation which is subject to Custom taxes charged on importation of goods. The taxes payable to the Custom such as NBT, VAT, PAL, Duty etc. are not applicable once the tax of Rs 40/- per kilogram is paid on a Cusdec. Basically the buyer is treated as the importer (the consignee of the CusDec). However, in this case the seller himself has been treated as the consignee. However, even the issue of the CusDec in the name of the seller would be in order as no input tax is claimable on the Cess paid at the point of Custom. The Cess of Rs 40/- per kilogram is a composite tax payable by the seller and no further tax is payable by the seller on the same transaction.

The Cess paid at the import of goods is a liability of the seller and the Cess charged is part of the cost of the goods paid by the buyer. **However, the buyer is liable to NBT (and VAT) on the sale of fabric, if such fabric is sold in the local market by the buyer.**

The seller is required to keep records to prove that Cess at the rate of Rs 40/- per kilogram is paid on the local sale of fabric as permitted by the BOI.

Further, it should also be noted that deemed exports (sales to exporters) should also be treated as a local sale which is liable to the same levy.

[IC/2014/23] **[PART I of the First Schedule]**

39. Whether the Insurance Brokers are liable to Nation Building Tax under the NBT Act?

Any service of an auctioneer, broker, insurance agent or commission agent, not in relation to any local produce, is not falling within the excepted services covered under the item (xiii) of the list of excepted services set out in PART II of the Schedule to NBT Act (or under any other item therein).

Accordingly, the turnover from services provided by Insurance Brokers constitutes liable turnover for the purposes of NBT.

[IC/2013/83] **[PART II of the First Schedule]**

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

[hereinafter referred to as "SD Act"]

40. Stamp Duty Exemption on Transfer of Shares - Whether the share certificates on transfer of shares, upon the liquidation of a share holding company, to its parent company is exempt from Stamp Duty under item number 5 of the Gazette Extraordinary No. 1465/20 dated October 05, 2006?

The Gazette Extraordinary No 1465/20 dated 05.10.2006 states in its item number 5 that "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", shall be exempt from Stamp Duty.

This exemption refers to certain situations where the respective new share certificate is issued by a company to the same shareholder (not even to the successor). The number of shares too, should be different from the existing number. In this instance, as the shareholder is not the same party and also there is no change in the number of shares, the conditions required for the eligibility to the aforesaid exemption do not satisfy.

Accordingly, stamp duty is payable on share certificates issued in the above circumstances and not exempt under aforesaid Gazette notification.

[IC/2013/5]

TAXES - FOR A BETTER FUTURE

Secretariat - Department of Inland Revenue