

Sri Lanka

Country M&A Team

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1. Introduction

1.1 General Information on M&A in Sri Lanka

This chapter sets out the main issues that would be of concern to the transacting parties involved in transfer of ownership of a Sri Lanka business or company.

A transfer of ownership of a Sri Lanka business entity can take the form of a disposal of its stock or of its assets. The tax implications arising from a disposal of stock significantly differ from those arising from a disposal of assets.

The Government of Sri Lanka encourages foreign investments, subject to some restrictions, the details of which are given in Appendix A.

Many fiscal incentives are accorded to industrial and other business activities promoted by the Sri Lanka Government. A detailed list of such incentives is provided in Appendix B.

1.2 Corporate income tax

The tax residents of Sri Lanka are taxed on their worldwide income. Non-residents are taxed only on their profits and income arising in, or derived from, Sri Lanka, which are defined to include all profits and income derived from services rendered in Sri Lanka, or from property in Sri Lanka, or from business transacted in Sri Lanka, whether directly or through an agent.

A resident company, for purposes of income tax, is one which has its registered or principal office in Sri Lanka or whose business is managed or controlled from Sri Lanka.

The current standard rate of income tax for a company is 35%, effective from the Year of Assessment 2006/2007, lower rates of 10%, 15% or 20% apply to some specific activities.

The corporate income tax rates for the years of assessment 2006/2007 and 2007/2008 are as follows:

On Profits and Income	2006/2007 (%)	2007/2008 (%)
Companies engaged in non-traditional exports, promotion of tourism, construction work and for overseas management activities paid for in foreign currency	15	15
Companies with taxable income not exceeding Rs 5 million (other than a unit trust mutual fund or a venture capital company)	15	–
Companies with taxable income not exceeding Rs. 5 million (Other than a unit trust mutual fund or a venture capital company, or a holding company, a subsidiary of a group of company)	–	15
Specialised Housing Banks	20	20
Existing venture capital companies or new venture capital companies not qualified for tax exemption	20	20
Unit Trusts and Mutual Funds – profits under specified areas	10	10
Unit Trusts and Mutual Funds – profits under unspecified areas	20	10
Companies offering professional services in Sri Lanka to persons outside Sri Lanka for payment in foreign currency	15	15
Shipping Agents approved by Director of Merchant Shipping in respect of profits attributable to transshipment fees received in foreign currency	15	15
All other companies: Quoted Public for the first 05 years of assessment from the year of assessment which it becomes a quoted.	33 1/3	33 1/3*
Others	35	35

1.3 Taxation of Dividends

Dividends are generally subject to a withholding tax of 10% of the gross dividend, unless otherwise distributed out of tax exempt profits by a company, which has entered into an agreement with Board of Investment of Sri Lanka (BOI) under Section 17 of the BOI Law No 4 of 1978, prior to 6 November 2002 or a company qualified for an exemption prior to 6 November 2002, or distributed to a non-resident shareholder by a company which has entered into an agreement with the BOI under Section 17 of the BOI Law No 4 of 1978, prior to 31 December 1994, on an application made prior to 11 November 1993.

The tax withheld is required to be paid to the Sri Lanka tax authorities within 30 days of distribution of the dividends.

Non-resident companies are required to pay remittance tax at 10% of the remittances of profits abroad.

Corporate shareholders are not required to include dividends in their assessable income if such dividends are paid by a resident company, which has deducted tax from the said dividends, or the dividends are paid out of dividends received from another resident company. The 10% dividend tax paid will be the final tax applicable on any dividends distributed.

1.4 Withholding Tax

Dividends, interest, rent, royalties and service fees paid by a person or partnership to another person or partnership are subject to withholding tax. The rates are as follows:

	Paid to Resident Person	Paid to Non-Resident person
Dividends	10%	10%
Interest	10%	20%*
Royalty/Annuity > 50,000 pm or 500,000 pa	10%	20%*
Service or Management Fees	5%	5%
Non-residential rents	10%	20%
Lottery prizes > Rs 500,000	10%	10%

* Lower rate of 10% applies with respect to countries with which Sri Lanka has entered into double taxation treaties.

Withholding tax paid may be set off against the income tax payable by the recipient concern, provided such income is included in the taxable income.

1.5 Value Added Tax (VAT)

VAT is chargeable at the time of supply on the value of goods imported by any person and on the value of the local supply of goods or services made by a registered person at the following rates.

Category	Rate %	Items	Input Tax Allowability %
Zero rate	0	Applies to export of goods, services connected with international transportation of goods and passengers, and with any movable or immovable property outside Sri Lanka, any services provided to a person outside Sri Lanka to be consumed outside Sri Lanka, for which payment is received in full in foreign currency through a bank in Sri Lanka.	Full, other than on goods and services chargeable to Output VAT at 20%, on which input VAT credit is restricted to 15%
Basic rate	5	Applies to basic food items – sugar, dhal, milk powder, dried fish, chillies, potatoes, onions and jewellery (VAT on the above products is charged only at the point of import and not on subsequent sales)	0
Standard rate	15	Items not included under zero rate, basic rate and luxury rate, and other than exempt and excluded supplies	15
Luxury rate	20	Applies to goods deemed on luxury goods – any kind of liquor, air conditioners, refrigerators, washing machines, dish washing machines, television sets, television antennas, cameras, motor vehicles (other than three wheelers, passenger transport buses, motor cycles, bicycles) services provided by hotels, restaurants for wedding receptions and other similar receptions and supply of financial services.	15

1.6 Stamp Duty

Stamp duty was re-imposed in terms of the Stamp Duty (Special Provisions) Act, No. 12 of 2006, effective from 4 April 2006.

Stamp duty is chargeable on every specified instrument –

- executed, drawn or presented in Sri Lanka; or
- executed outside Sri Lanka being an instrument which relates to property in Sri Lanka at the time of such instrument presented in Sri Lanka at rates prescribed in the Gazette.

1.7 Economic Service Charge (ESC)

ESC is levied quarterly, effective from 1 April 2006, on every person or partnership in respect of the liable turnover of every trade, business profession or vocation carried on by such person or partnership, provided the liable turnover is not less than Rs 10 million (reduced to Rs 7.5 million from 1 April 2007) in the relevant quarter. The maximum ESC chargeable is Rs 15 million for a quarter).

ESC Rates

ESC rates applicable for any quarter commencing on or after 1 April 2007 are as follows:

	Rates %
On such part of the liable turnover	
1. as consists of the turnover from any trade or business of a distributor	0.05
2. as consists of the turnover of	
i. export of apparels or the supply of locally manufactured textiles to apparel exporters for use in the manufacture of apparels for export by such exporter	0.1
ii. any BOI approved trading house engaged in the business of the export of apparels	0.1
iii. the relevant turnover from any entrepot trade conducted by any consignor or consignee in respect of the export of any goods	0.1
3. as consists of the turnover from	
i. any trade, business, profession or vocation	0.25
a. the profits of which are exempt from income tax	
b. of any enterprise which has entered into an agreement with the BOI and which enjoys income tax exemption on its profits	
ii. any trade or business which deals in wholesale or retail (other than as a distributor or dealer in motor vehicles or liquor)	0.25
iii. primary conversion of any tea, rubber or coconut plantation including desiccated coconut, coconut oil, coconut fibre, copra and sheet rubber (other than any conversion which produces any alcoholic beverage)	0.25

	Rates %
4. as consists of the turnover from:	
i. any trade or business which deals in wholesale or retail (other than as a distributor) of motor vehicles or liquor not manufactured by the dealer	0.5
ii. any trade, business, profession or vocation of any venture capital company, unit trust or mutual fund	0.5
iii. any trade, business, profession or vocation of which the taxable income does not exceed Rs 5 million	0.5
iv. any trade, business, profession or vocation	
a. the profits of which are chargeable at lower rates specified in the 5th schedule to the Inland Revenue Act other than item 28 of that schedule	0.5
b. of any enterprise which has entered into an agreement with BOI and whose profits are chargeable at the rates equal to the rates specified in the 5th schedule to the Inland Revenue Act	0.5
5. as consists of the turnover from:	
i. any trade or business of carrying on any lottery or betting or gaming activity	1.0
ii. any trade, business, profession or vocation the profits of which are chargeable at any rate other than a rate specified in the 5th schedule to the Inland Revenue Act	1.0
iii. any business of freight forwarder in relation to turnover reduced by the sum payable on account of the carriage as per Gazette No 1502/10 of 20 June 2007	1.0
iv. any trade or business of export of cut and polished diamonds from raw diamonds imported in relation to the turnover on the excess of the FOB value of such exports over the CIF value of such raw diamonds	1.0
v. any trade or business of export of garments manufactured from materials imported on NFE basis in relation to the turnover on the excess of the FOB value of such exports over the CIF value of such materials	1.0
vi. any trade or business of primary dealer in relation to the turnover on the excess of proceeds of sale of securities held by such primary dealer over the aggregate of	1.0
– sum invested in that quarter in the purchase of securities and	
– the interest paid or the discount allowed by such primary dealer in relation to any repurchase transaction entered into in that quarter	

ESC may be set off against the total income tax payable for the relevant year; any balance may be set off against the total income tax payable for the next four succeeding years. No part of the ESC is refundable.

1.8 Share Transaction Levy

Share Transaction levy at the rate of 0.2% is imposed on the buyer and seller each on the turnover on listed share transactions.

1.9 Stamp duty on unlisted Shares

Stamp Duty of Rs.5 for each Rs.1000 or part thereof on the market value of unlisted shares is payable at the time of the transfer of such shares.

1.10 Other Taxes

Excise duties and Special Excise Levies are charged on tobacco, cigarettes, liquor, motor vehicles and selected petroleum products.

2. Acquisitions

2.1 The Preference of Purchasers: Stock v. Assets Deal

Sri Lanka does not have specific legislation dealing with the tax treatment of acquisitions. Accordingly, general principles of taxation would apply when structuring a deal and choosing between an acquisition of assets or of stock.

Whether a deal should be structured as a stock deal or asset deal may largely depend on commercial considerations.

2.2 Stock Acquisition

Generally, it is less expensive for a purchaser to acquire the business under a stock deal, as currently no stamp duty is payable on a transfer of listed stock. However, 0.2% share transaction levy is payable by the seller and the buyer on the turnover of such stocks.

2.2.1 Preservation of tax losses

Where a target company has accumulated losses carried forward and the buyer wishes to preserve the losses, it will have to acquire the business via a stock deal, as there are no provisions for transfer of losses from one entity to another. The tax statute provides that, where there has been a change in the ownership of a company resulting in more than 33 1/3% of the issued capital of that company being held directly or through nominees who did not hold such share capital in the tax year in which the loss was incurred, the carry forward losses may only be set off against the profits derived from the same business.

The amount of loss incurred by a company in any year of assessment in any trade, business, profession or vocation, including any brought forward loss, may be set off only up to 35% of the total statutory income excluding any income that does not form part of the assessable income.

However, any loss incurred on or after 1 April 2007 from the business of life insurance could be set off against the profits from the business of life insurance included in the total statutory income.

2.2.2 Continuity of tax incentives

Where the target company enjoys any tax incentives, the business has to be acquired via a stock deal to ensure the continued applicability of the incentives.

2.3 Asset Acquisition

An asset deal allows a purchaser to select the desirable assets to be acquired and to transfer assets between one or more entities (including offshore entities) so as to mitigate the future inter group tax payments.

2.4 Transaction Costs

2.4.1 Value Added Tax (VAT)

- Stock Deal

The transfer of shares is exempt from VAT.

- Asset Deal

A transfer of a continuing business which satisfies certain conditions is also exempt from VAT. Transfer of assets is however, liable to VAT at the standard rate of 15% or luxury rate of 20% depending on the type of the assets. If the asset is used in the production of income and tax depreciation can be claimed, the input VAT suffered could be claimed, provided the asset is purchased from a VAT registered person.

2.4.2 Stamp Duty on Immoveable Property

Stamp duty is payable to Provincial Councils on the transfer of immoveable property. Stamp duty is payable by the purchaser at 3% on the first Rs 100,000 and 4% on the balance consideration (or market value in the absence of a consideration) in excess of Rs 100,000.

2.4.3 Share Transaction Levy

A levy at the rate of 0.2% is imposed on the buyer and seller each on the turnover on listed share transactions.

2.4.4 Tax Deductibility of Transaction Costs

The share transaction levy is not tax deductible to the buyer. Similarly, the stamp duty, if levied, would also not be deductible for tax purposes as it relates to a capital transaction.

Any input VAT not claimable could be capitalised and added to the purchase price of the relevant assets acquired.

3 Financing of acquisitions

3.1 Thin Capitalisation

Effective from 1 April 2006, any interest payment made between members of a group of companies is restricted in computing profits and income in the debt-equity ratio of 3:1 in the case of manufacturing companies and 4:1 in the case of other companies.

3.2 Deductibility of Interest

3.2.1 Stock Deal

Prospective buyers could utilize domestic loans to fund an acquisition. There are, however, restrictions placed on Sri Lankan companies raising debts from overseas markets.

Interest on loans and overdrafts is deductible only if such loans and overdraft are used in any trade, business, profession or vocation. Interests on any loan taken to purchase stocks are not deductible for tax purposes unless buying and selling of stock is the business of the company.

3.2.2 Asset deal

Interest incurred on loans used to acquire assets under an asset deal is tax deductible, provided such assets are used in the production of income.

4 Mergers

There are no specific provisions relating to mergers. Specifically, the transfer of carried forward losses and of unabsorbed capital allowances may not be made from the merging entities to the merged entity. Thus, where a company has substantial tax losses or unutilised capital allowances, the profit making company should, subject to commercial considerations, be merged into the loss making company.

5 Other Structuring and Post Deal Issues

5.1 Repatriation of Profits

Sri Lanka does not impose any restrictions on the repatriation of profits, other than on any capital profit. Dividends distributed out of prior year profits need specific exchange control approval for remittance abroad.

5.2 Losses Carry Forwards and Unabsorbed Capital Allowance

Operating losses may be carried forward indefinitely and applied against income in future years. However, the amount of losses that may be set off is restricted to 35% of the total statutory income, excluding any income that does not form part of the assessable income. Any loss incurred from the business of life insurance could be set off only against the profits from the business of life insurance included in the total statutory income.

Government announced in the budget for 2008 of its intention to apply the same loss treatment to the business of leasing as well.

5.3 Continuity of Tax Incentives

Where the Target Company enjoys any tax incentives the business has to be acquired via a stock deal to ensure the continued applicability of the incentives.

5.4 Group relief

No such group relief system is available in Sri Lanka.

6 Disposals

6.1 The Preference of Seller: Stock v. Assets Deal

From a seller's viewpoint, it would be less complicated to sell a Target Company through a stock deal.

Generally, when the investor wants to exit, he may sell his investment through stock or asset deal. Where a non-resident investor is selling stock in a Sri Lanka company, the investor will not be exposed to liability to income tax on any gains arising from sale of unlisted stocks.

However, listed stocks would attract a share transaction levy of 0.2% on the sale / purchase price from the buyer and the seller each; and unlisted stocks would attract the stamp duty of 0.5% on the market value of such stocks.

Listing the stock of the Target Company will also avoid exposure to stamp duty, if any, on subsequent transfers of stock.

If the exit is via a sale of assets, the seller will be liable to income tax on the profit on sale. From a tax efficiency perspective, a stock deal is the preferred route.

6.2 Stock Disposal

6.2.1 Profit on sale of stock

Gain from sale of listed and unlisted stocks is not liable to income tax.

6.2.2 Distribution of profits

Dividends are generally subject to a withholding tax of 10% of the gross dividend unless otherwise distributed out of tax exempt profits by a company which has entered into an agreement with the Board of Investment of Sri Lanka (BOI) under Section 17 of the BOI Law No 4 of 1978 prior to 6 November 2002 or a company qualified for an exemption prior to 6 November 2002, or distributed to a non-resident shareholder by a company which has entered into an agreement with the Board of Investment of Sri Lanka under Section 17 of the BOI Law No 4 of 1978, prior to 31 December 1994, on an application made prior to 11 November 1993.

Corporate shareholders are not required to include dividends in their assessable income if the dividends are paid by a resident company which has deducted tax from the dividends or the dividends are paid out of dividends received from another resident company. 10% dividend tax paid will be the final tax applicable to any dividends distributed.

Avenues by which profits of the Target Company could be repatriated to home country (other than by way of dividends), include such payments as interest, royalties, technical and management fees. However, the tax authorities may disallow payments in excess of what is considered reasonable and commercially justifiable.

6.3 Asset Disposal

6.3.1 Profits on Sale of Assets

In an asset deal, any price received for sale of goodwill (including self generated intellectual property which has been used in the business) should not be subject to tax in the hands of the seller. However, any profits on the sale of inventories or tax depreciable assets (i.e., to the extent of the tax depreciation recouped) should be subjected to tax in the hands of the seller.

A corporate seller should be prepared to enter into an asset deal if it has tax losses or un-utilised tax depreciation, or if the sale price of the inventories and tax depreciable assets are not substantially higher than their book value.

In allocating the price for the assets sold, the value allocated to inventories and tax depreciable assets should be on an arm's length basis, lest it may be challenged by the tax authorities.

6.3.2 Distribution of Profits

Dividends are generally subject to a withholding tax of 10% of the gross dividend unless otherwise distributed out of tax exempt profits by a company which has entered into an agreement with the Board of Investment of Sri Lanka (BOI) under Section 17 of the BOI Law No 4 of 1978 prior to 6 November 2002, or a company qualified for an exemption prior to 6 November 2002, or distributed to a non-resident shareholder by a company which has entered into an agreement with the Board of Investment of Sri Lanka under Section 17 of the BOI Law No 4 of 1978, prior to 31 December 1994, on an application made prior to 11 November 1993.

Corporate shareholders are not required to include dividends in their assessable income if the dividends are paid by a resident company which has deducted tax from the dividends or the dividends are paid out of dividends received from another resident company. 10% dividend tax paid will be the final tax applicable to any dividends distributed.

Avenues by which profits of the Target Company could be repatriated to the home country, (other than by way of dividends), include such payments as interest, royalties, technical and management fees. However, the tax authorities may disallow payments in excess of what is considered reasonable and commercially justifiable.

7 Transaction Costs for Sellers

7.1 Profits on Sale of Assets

An asset deal could involve the disposal of assets on which depreciation for tax purposes has been deducted and the disposal of assets on which tax depreciation has not been deducted.

The gain representing the excess of the sale proceed over the tax depreciated value on the sale of assets is taxed at normal rates as part of business profits.

The profit from the disposal of assets (tangible and intangible) on which tax depreciation has not been deducted is not subject to tax.

The assets should be transferred at their open market value. In certain circumstances in respect of depreciable assets, the tax authorities may accept a valuation based on the net book value.

7.2 Value Added Tax (VAT)

The sale of assets will be subject to VAT at 15% (20% if falling into the category of luxury goods). The seller has to charge and account for VAT to the tax authorities. However, if buyer is VAT registered, the buyer is entitled to claim a credit in respect of the VAT paid.

7.3 Stamp Duty

Stamp duty, if imposed, would generally be payable by the purchaser unless otherwise stated in a contract.

7.4 Concessions Relating to Mergers and Acquisitions

The only concession that is provided in respect of acquisitions is the tax holiday granted for acquiring non-performing or under-performing enterprises.

7.5 Tax Deductibility of Transaction Costs

Transaction costs are generally not tax deductible to the seller in Sri Lanka except any expenses which may be attributed to the sale of inventories.

8 Preparation of a Target Company for Sale

8.1 Declaration of Dividend Prior to the Sale

One of the means of extracting surplus cash in a company that is identified for sale is through payment of dividends. Where the company identified for sale has revenue reserve that could be distributed, dividends should be declared to the maximum extent provided the payment of dividend does not adversely affect the sale price.

9 De-mergers

There are no specific provisions in relation to demergers. A demerger usually takes place through the sale of assets or business. It is important to note that any brought forward losses, unabsorbed capital allowances may not be transferred. The implications for a demerger would be the same as an asset deal as discussed in Section 2 Asset acquisition.

10 Listing/Initial Public Offer (IPO)

Generally, when the investor wants to exit, he may sell his investment through a stock or asset deal. Where a non-resident investor is selling stock in a Sri Lanka company, the investor will not be exposed to liability to income tax on any gains arising from such sale.

However, listed stock would attract a share transaction levy of 0.2% on the sale/purchase price or from the buyer and the seller each; and unlisted stocks would attract the stamp duty of 0.5% for the market value of such stocks.

Listing the shares of the Target Company will also avoid exposure to stamp duty, if any, on subsequent transfers of shares.

If the exit is via a sale of assets, the seller will be liable to income tax on the profit on sale. From a tax efficiency perspective, a share deal is the preferred route.

Avenues by which profits of the target company could be repatriated to the home country (other than by way of dividends), include such payments as interest, royalties, technical and management fees. However, the tax authorities may disapprove payments in excess of what is considered reasonable and commercially justifiable.

Appendix A

1. Common Forms of Business Entity

Business may be conducted in Sri Lanka in any of the following forms:

- Company incorporated in Sri Lanka
 - Private
 - Public
 - Quoted
- Branch office of a foreign company
- Representative or liaison office of a foreign company
- Partnership
- Sole proprietorship
- Offshore company

The private limited liability companies and branches of foreign companies are the types of business entities most commonly used by foreign investors. Certain tax concessions are available to foreign investors, depending on the amount of investment and type of business activity carried out in Sri Lanka.

2. Foreign Ownership Restrictions

Since the opening of Sri Lanka economy in 1977, Sri Lanka has adopted a policy of encouraging foreign investment. Except for investment in certain business activities (see below), foreign investors are permitted to set up wholly owned subsidiaries in Sri Lanka.

The following businesses are restricted to citizens of Sri Lanka:

- Money lending
- Pawn broking
- Retail trade with a capital of less than one million US dollars
- Coastal fishing
- Providing personal services other than for the export and tourism sectors

3. Areas subject to automatic or conditional approval

Foreign investments in the areas listed below will be approved, limited to 40% of equity. Foreign ownership in excess of 40% will be approved on a case by case basis by the BOI.

- Production of goods where Sri Lanka's exports are subject to internationally determined quota restrictions
- Growing and primary processing of tea, rubber, coconut, cocoa, rice, sugar and spices
- Mining and primary processing of non-renewable natural resources
- Timber based industries using local timber
- Fishing (deep-sea fishing)
- Mass communications
- Education
- Freight forwarding
- Travel agencies
- Shipping agencies

4. Regulated areas

Foreign investments in the areas listed below will be approved by the respective government agency or BOI (up to the percentage of foreign equity specified by BOI). The BOI assists potential investors by referring applications to the appropriate agency and approval is usually straightforward.

- Air transportation
- Coastal shipping
- Industrial undertaking in the Second Schedule of the Industrial Promotion Act No. 46 of 1990, namely-
 - any industry manufacturing arms, ammunitions, explosives, military vehicles and equipment aircraft and other military hardware, any industry manufacturing poisons, narcotics, alcohols, dangerous drugs and toxin, hazardous or carcinogenic materials, any industry producing currency, coins or security documents
- Large scale mechanised mining of gems
- Lotteries

Appendix B

Tax Incentives

1. Introduction

Sri Lanka offers to private investors fiscal incentives designed to stimulate investment, in the expectation that more investment in the Sri Lanka economy would produce enhanced employment opportunities, yielding higher income for Sri Lankans. Tax holidays, tax-rate concessions and customs duty waivers have been the major instruments granted under the incentive system.

The fiscal incentives are offered by the investment authority, the Board of Investment of Sri Lanka (BOI) and also under the tax statute. Pursuant to rationalisation of the incentive structures, the fiscal incentives now offered by the BOI follow substantially similar incentives offered under the tax statute. Discussed below are the current fiscal incentives offered under the tax statute, and under the BOI.

2. Agricultural and Industrial Projects

2.1 Qualifying Activities

Tax incentives are granted in respect of the profits of:

- i. an undertaking carried on by a company –
 - incorporated on or after 1 April 2002 with a minimum investment of Rs 10 millionfor
 - agriculture (i.e. cultivation of land with plants of any description and rearing of fish);
 - agro processing (i.e. processing of any agricultural product or fishing product other than processing of black tea in bulk);
 - industrial and machine tool manufacturing;
 - information technology and allied services;
 - electronics;
 - export of non-traditional products which means export of any goods (other than export of black tea in bulk, crepe rubber, sheet rubber, scrap rubber, latex, fresh coconuts) including deemed export of goods (i.e. manufacture of non traditional products and supplied to an exporter), where not less than 80% of the total turnover of such undertaking for any year of assessment is from the export or deemed export of such non-traditional goods;
 - animal husbandry including poultry farms, veterinary and artificial insemination services and other support services;

- deep sea fishing;
 - manufacture of machinery; or
 - export or deemed export of services.
- ii. an undertaking carried on by a company on or after 1 April 2002 but before 1 April 2004 with an investment in excess of Rs 250 million.
- iii. any designated project carried on by a company incorporated before 1 April 2002 and which undertaking commenced operations on or after 1 April 2004, with a minimum investment of Rs 50 million.

The designated projects are as follows:

- Manufacture of ceramics, glassware or other mineral based products
- Manufacture of rubber based products
- Any project in light or heavy engineering industries
- Any project engaged in the provision of refrigerated transport services or cold room storage services
- Export production Village Company as defined in Section 17 (3) of the Inland Revenue Act, No.38 of 2000
- Management of any offshore company or maintaining a back office in relation to any activity in a foreign country

(Note: The minimum investment is not required in respect of an Export Production Village Company.)

- iv. any pioneering project carried on by a company on or after 1 April 2004 with an investment in excess of Rs 250 million.

2.2 Incentives offered

Period		Tax Rate %
1st – 5th year*		0
6th & 7th year		10
8th year onwards	– Agriculture and non-traditional exports	15
	– Others	20

Where the investment exceeds Rs 1 billion in any pioneering undertaking, the concessions offered will be as follows:

Amount of Minimum Investment Rs (Million)	Tax Exemption Period (Years)
1000 to 2499	8*
2500 and above	10*

After the end of the tax exemption period	Tax Rate %
Immediately succeeding 2 years	10
Thereafter	
• Agriculture & non-traditional exports	15
• Others	20

* The tax exemption period will be granted from the tax year in which the undertaking commences to make profits but not later than two years from the commencement of commercial operations

3 Infrastructure Projects – Large Scale

3.1 Qualifying Activities

Tax incentives will be granted to any company on its profits and income from an undertaking carried on by it on or after 1 April 2002 for

- development of any airport, sea-port, highway or railway;
- development of any industrial park;
- development of any warehouse or store;
- provision of any sanitation facility or solid waste management system;
- power generation, transmission or distribution;
- development of water services; or
- urban housing or town centre development.

3.2 Qualifying Investment Criteria and Incentives offered

Amount of Minimum Investment (Rupees million)	Tax Exemption Period* (Years)
1,000	6
2,500	8
5,000	10
7,500	12

* The tax exemption period will be reckoned in the same manner as for Agricultural and Industrial Projects. After the expiry of the tax exemption period, a 15% tax rate will apply.

4 Infrastructure Projects – Small Scale

4.1 Qualifying Activities

Tax incentives will be granted to any company on its profits and income from an undertaking carried on by it on or after 1 April 2002 and which is engaged in infrastructure development for:

- generation of power;
- tourism;
- recreation;
- warehousing and cold storage;
- garbage collection and disposal;
- construction of houses;
- construction of hospitals; or
- re-development of housing schemes.

4.2 Qualifying Investment Criteria

Investment of not less than 10 million rupees but not exceeding 50 million rupees which investment should be made within one year of commencement of the undertaking.

4.3 Incentives offered

Period	Tax Rate %
1st – 5th year*	0
6th – 7th year	10
8th year onwards	20

* The tax exemption period will be reckoned in the same manner as for Agricultural and Industrial Projects.

5 Research and Development

5.1 Qualifying Activity

Tax incentives will be granted to any company which commences a new undertaking which is engaged in research and development.

“Research and development” is defined to mean any systematic or intensive study carried out in the field of science and technology with the object of using results thereof for the production or improvement of materials, devices, products, produce or process (other than quality control of products or routine testing materials, devices, products or produce, research in social sciences or humanities, routine data collection, efficiency surveys or management studies and market research or sales promotion).

5.2 Qualifying Investment Criteria

Minimum investment of 2 million rupees should be made within one year from the commencement of the new undertaking.

5.3 Incentives offered

Period	Tax Rate %
1st – 5th year*	0
5th year onwards	15

* The tax exemption period will be reckoned in the same manner as for Agricultural and Industrial Projects. The exemption will be limited to the income earned from the research and development activities only.

6 Acquisition of Non-Performing or Under-Performing Enterprises

6.1 Qualifying Activity

Tax incentives will be granted to a company which:

- **acquires** (i.e acquiring the ownership of the enterprise or acquiring not less than 51% of the enterprise with management rights or by becoming the partner or a joint venture); or
- **to rehabilitate** (which means to recommence the commercial operations of the enterprise on a sustainable basis) such enterprise,
 - **a non-performing** (which means failure to carry out commercial operations) business enterprise; or
 - **an under-performing** (which means the incurring of operational losses for a period not less than two consecutive years of assessment) business enterprise;
- **engaged** in the manufacture of textiles, poultry, farming, fish rearing, or any other area as may be determined by the Minister by Order published in the Gazette.

6.2 Qualifying Criteria

This incentive is subject to:

- terms approved by the Minister, and
- adequate provision being made to meet the statutory liabilities outstanding at the time of acquisition of the enterprise concerned.

Note: A proposal should be forwarded to the Minister of Finance, with details of the provision for settlement of statutory liabilities (e.g EPF, ETF dues etc) of such acquired enterprise, and approval obtained.

- Acquisition should be completed and commercial operation of the acquired enterprise commenced prior to 1 April 2004.

6.3 Incentives offered

Period	Tax Rate %
1st – 3rd year	0
4th year onwards –Agriculture, promotion, tourism and construction work	15

The acquiring Company will be granted a 3-year tax exemption period, reckoned from the tax year in which the acquired enterprise commences to make profits but not later than two years from the date of commercial operations of such acquired enterprise.

7 Expansion of Industrial Undertakings for Export of Non-Traditional Products

7.1 Qualifying Activity

Tax incentives are granted to a company which:

- has an undertaking engaged in the manufacture of non-traditional products, and undertakes the expansion of such products; and
- makes the full amount of investment (see below) prior to 1 April 2004.

7.2 Qualifying Investment Criteria

An investment of not less than 10 million rupees but not exceeding 100 million rupees should be made prior to 1 April 2004.

Note: Investment in any capital asset used in the expansion of the undertaking will satisfy the eligibility criteria. However, there should be an expansion of activities as a result of the investment.

7.3 Incentives offered

Period	Tax Rate %
1st – 2nd year	0
3rd year onwards	15

A tax exemption period of 2 years will be granted in respect of the entire profits and income of the company undertaking the expansion.

The two-year tax exemption period will be granted:

- if the company is already entitled to a tax exemption period on the export of non-traditional goods, from the end of such tax exemption period; and
- in every other case, from the date of commercial operations of such expansion.

8 Expansion of Industrial Undertakings for Traditional Exports & Non-Exportable Goods

8.1 Qualifying Activity

Tax incentives will be granted to any company:

- which has an undertaking which is engaged in the manufacture of products (other than non-traditional products for export), and undertakes the expansion of such undertaking; and
- makes the full investment (see below) prior to 1 April 2004.

8.2 Qualifying Investment Criteria

An investment of not less than 10 million rupees should be made prior to 1 April 2004.

Note: Investment in any capital asset used in the expansion of the undertaking will satisfy the eligibility criteria. However, there should be an expansion of activities as a result of the investment.

8.3 Incentives offered

Tax exemption for a period of 2 years will be granted on the profits and income attributable to the expansion of the undertaking (i.e the incremental profits and income).

The period of 2 years will be granted from the year in which the expansion of the undertaking commences to make profits, but not later than 1 April 2006.

Note: In this Section, the incremental profits, in relation to any year of assessment which is qualified for tax exemption, means the trade profits of that undertaking for that year of assessment less the average annual profits of that undertaking computed by reference to 3 years immediately preceding the year of assessment in which the tax exemption period commences.

9 Agricultural Undertakings

Agricultural undertakings, carried on by any individual, partnership or company, qualify for tax exemption on their profits and income.

9.1 Period of tax exemption

A period of 5 years from the commencement of the year of assessment commencing on 1 April 2006.

9.2 Incentives offered

The profits and income from the cultivation of land and the sale of the produce therefrom are exempt for 5 years commencing on 1 April 2006.

Where the undertaking is also engaged in any process of production or manufacture of the produce from the said cultivation of land, such produce should be deemed to have been sold for production or manufacture at the prevailing open market price and the profits and income should be computed, based on such deemed sales.

10 Dividend Exemption

The dividends paid by companies carrying on the aforesaid projects and activities out of their exempt profits during the period of tax exemption or one year thereafter will be exempt from income tax in the hands of the shareholders. Such exemption will not apply to any dividend paid on or after 1 April 2004 by any company which qualified for tax exemption on or after 6 November 2002.

11 Other Tax Concessions under the Tax Statute

Profits attributable to the export of non-traditional goods by an undertaking are entitled to pay income tax at a maximum rate of 15% (Non-traditional goods are defined to include goods other than black tea sold in bulk, crepe rubber, sheet rubber, scrap rubber, latex fresh coconuts).

Profits attributable to the performance by an undertaking of any of the following services for payment in foreign currency are made liable to income tax at a maximum rate of 15%.

- Ship repair
- Ship breaking
- Repair and refurbishment of marine cargo containers
- Provision of computer software, computer programmes, computer systems or recording computing data
- Such other services as may be specified by the Minister of Finance by notice published in the Gazette

Profits attributable to the production or manufacture and supply to any specified undertaking, of non-traditional goods (for export by that undertaking of such goods or for the production or manufacture of any commodity for export by such undertaking will be liable to income tax subject to a ceiling of 15% of such profits, provided the undertaking is chargeable at the concessionary rate of 15% and there is documentary evidence to satisfy the Inland Revenue Department that the exports relating to such supplies were made.

Profits by any resident company or partnership in Sri Lanka attributable to services rendered outside Sri Lanka, in the course of carrying out a trade, profession, vocation or a construction project are exempt from income tax, where the respective profits are earned in foreign currency and are remitted to Sri Lanka.

Corporate profits from agriculture, fisheries, livestock, tourism and specified construction undertakings are taxed at 15%.

Profits and income earned in foreign currency by any partnership in Sri Lanka or any individual from any services rendered in or outside Sri Lanka to any person or partnership outside Sri Lanka in the course of any profession carried on or exercised by such individual or partnership in Sri Lanka are exempt from income tax where the respective profits are earned in foreign currency and are remitted to Sri Lanka, through a bank in Sri Lanka.

12 Other Tax Incentives - Under BOI Regime

There are a few tax exemptions and incentives, which are offered only under the BOI regime.

12.1 Export Trading Houses

- Qualifying Activity
 - Export of the entirety of the locally procured manufactured products or re-export of the entirety of imported products.
 - Location of warehouse within an Export Processing Zone (EPZ) which is continuously supervised by Sri Lanka Customs.

Qualifying Criteria and Incentives offered as follows:

Export Value	Incentives
US\$ 5 mn to 10 mn	10% tax rate for 5 years and 15% tax rate thereafter
US\$ 10 to 25 mn	5% tax rate for 5 years and 15% tax rate thereafter
Over US\$ 25 mn	Tax holiday for 5 years and 15% tax rate thereafter

(No minimum investment required)

12.2 Export Oriented Services

- Qualifying Activity
 - Provision of services to persons outside Sri Lanka for which payment should be made in foreign currency.
- Qualifying Investment Criteria
 - Minimum investment of US\$150,000
- Incentives offered are as follows:

Period	Tax Rate %
1st – 5th year	0
6th – 7th year	10
8th year onwards	15

12.3 Regional Operating Headquarters

- Qualifying Activity
 - Provision to offshore companies of two or more of the following services: administration, business & co-ordination, sourcing of raw materials & components, R&D services, technical support services, financial & treasury management, marketing & sales promotion.
- Incentives offered are as follows:

Period	Tax Rate %
1st – 3rd year	0
4th – 5th year	10
6th year onwards	20

(No minimum investment required)

12.4 Information Technology (IT) and/or IT Enabled Services

- Qualifying Activity
 - IT enabled services include call centers or contact centers, transcription (data entry), data centers, hosting centers, e-governance related projects and any other related activity determined by the BOI with the concurrence of the Minister in charge.
- Qualifying Criteria
 - Employment of 15 technically qualified persons
- Incentives offered are as follows:

Period	Tax Rate %
1st – 3rd year	0
4th – 5th year	10
6th year onwards	20

12.5 IT Related Training Institutes

- Qualifying Activity and Criteria
 - Provision of IT related training to minimum of 300 students
- Incentives offered are as follows:

Period	Tax Rate %
1st – 3rd year	0
4th – 5th year	10
6th year onwards	20

Note: The tax exemption period will, in all above-mentioned activities, be reckoned from the tax year in which the enterprise commences to make profits but not later than two years from the commencement of commercial operations.

12.6 New Enterprise in a non-difficult area

“Non-difficult area” means an area in any divisional Secretary’s division (other than the districts of Colombo and Gampaha) designated by the Board of Investment (BOI) qualifying investment criteria.

Minimum investment of Rs.30 million within a period of 2 years from 1 April 2006.

- Qualifying Activity
 - Production or manufacture of goods (other than apparel) or provision of services.

With the employment of such number of local person given below the incentive offered:

Number of Employees	Period of Exemption
50 – 99	2 years
100 – 199	3 years
200 and above	5 years

- Manufacture of apparel with the employment of 200 or more local persons, if its exports are not less than 80% of its products –
 - Incentive Offered
 - The profits and income are exempt for 5 years.

The tax exemption periods mentioned under paras 12.6 to 12.17 from the tax year in which the enterprises commences to make profits but not later than 2 years from the commencement of commercial operation.

12.7 New Enterprise or expansion to existing enterprise to carry on an undertaking in education in a non-difficult area.

- Minimum Investment = Rs.15 Million within the period of 2 years from 1 April 2006.

12.7.1 Education in the areas of

- Information Technology related training
- Vocational Training and Management
- Skills Development
- Training for foreign employment and English
- Accountancy
- Legal and Finance and
- Other approved courses for business process.

With a training of such member of persons per annum as given below:

- Incentive offered are as follows;

Number of Persons to be Trained per annum	Period of Exemption
500	3 years
1000	5 years
1500	8 years

12.7.2 Education in the areas of

- Textile and Clothing Industry
- Nurses Training
- Training for Food Processing and Agriculture and
- Plantation Industry

With a training of such number of persons per annum as given below:

- Incentive Offered are as follows:

Number of Persons to be Trained for annum	Period of Exemption
100	3 years
300	5 years
500	8 years

12.8 Setting up of a manufacturing or servicing unit from rural sector in a non-difficult area

Qualifying investment criteria and number of employees with a minimum investment of an amount as given below within a period of 2 years, from 1 April 2006 and with the employment of such number of local persons as specified below.

- Incentive Offered are as follows:

Investment	Number of Employees	Period of Exemption
Rs. 15 Million	100	3 years
Rs. 20 Million	200	5 years
Rs. 30 Million	300	8 years

12.9 New Enterprises in a difficult Area

“Difficult area” means an area in any divisional Secretary’s division (other than the districts of Colombo and Gampaha) designated by the Board of Investment (BOI).

- Qualifying investment criteria
 - Minimum investment of Rs.30 million within a period of 2 years from 1 April 2006.
- Qualifying Activity
 - Production or manufacture of goods (other than apparel) or provision of services.

With the employment of such number of local person given below the incentive offered:

Number of Employees	Period of Exemption
50 – 99	3 years
100 – 199	5 years
200 and above	8 years

- Manufacture of apparel with the employment of such number of local persons, given below the incentive offered:

Number of Employees	Period of Exemption
200 - 299	8 years
1000 and above	10 years

12.10 New Enterprise or expansion to existing enterprise to carry on an undertaking in education in a difficult area

- Minimum Investment = Rs.15 Million within the period of 2 years from 1 April 2006.
- Qualifying Activity

12.10.1 Education in the areas of

- Information Technology related training
- Vocational Training and Management
- Skills Development
- Training for foreign employment and English
- Accountancy
- Legal and Finance and
- Other approved courses for business process

With a training of such member of persons per annum as given below:

- Incentive offered are as follows:

Number of Persons to be Trained per annum	Period of Exemption
500	5 years
800	8 years
1000	10 years

12.10.2 Education in the areas of

- Textile and Clothing Industry
- Nurses Training
- Training for Food Processing and Agriculture and
- Plantation Industry

With a training of such number of persons per annum as given below:

- Incentive Offered are as follows:

Number of Persons to be Trained per annum	Period of Exemption
100	5 years
250	8 years
350	10 years

12.11 Setting up of a manufacturing or servicing unit from rural sector in a difficult area

- Qualifying investment criteria and number of employees
 - With a minimum investment of an amount as given below within a period of 2 years, from 1 April 2006 and with the employment of such number of local persons as specified below.
- Incentive Offered are as follows:

Investment	Number of Employees	Period of Exemption
Rs. 10 Million	75	5 years
Rs. 15 Million	100	8 years
Rs. 20 Million	225	10 years

12.12 New Enterprise in a most-difficult area

“Most-difficult area” means an area in any divisional Secretary’s division (other than the districts of Colombo and Gampaha) designated by the Board of Investment (BOI) qualifying investment criteria.

Minimum investment of Rs.30 million within a period of 2 years from 1 April 2006.

- Qualifying Activity
 - Production or manufacture of goods (other than apparel) or provision of services.

With the employment of such number of local person given below the incentive offered:

Number of Employees	Period of Exemption
50 – 99	5 years
100 – 199	8 years
200 and above	10 years

- Manufacture of apparel with the employment of 200 or more local persons, if its exports are not less than 80% of its products
 - Incentive Offered:
 - The profits and income are exempt for 5 years.

12.13 New Enterprise or expansion to existing enterprise to carry on an undertaking in education in a most difficult area.

- Minimum Investment = Rs.15 Million within the period of 2 years from 1 April 2006.
- Qualifying Activity

12.13.1 Education in the areas of

- Information Technology related training
- Vocational Training and Management
- Skills Development
- Training for foreign employment and English
- Accountancy
- Legal and Finance and
- Other approved courses for business process.

With a training of such member of persons per annum as given below:

- Incentive offered are as follows:

Number of Persons to be Trained per annum	Period of Exemption
300	5 years
500	8 years
750	10 years

12.13.2 Education in the areas of

- Textile and Clothing Industry
- Nurses Training
- Training for Food Processing and Agriculture and
- Plantation Industry

With a training of such number of persons per annum as given below:

- Incentive offered are as follows:

Number of Persons to be Trained per annum	Period of Exemption
75	5 years
150	8 years
250	10 years

12.14 Setting up of a manufacturing or servicing unit from rural sector in a most-difficult area

- Qualifying investment criteria and number of employees
 - With a minimum investment of an amount as given below within a period of 2 years, from 1 April 2006 and with the employment of such number of local persons as specified below.
- Incentive offered are as follows:

Investment	Number of Employees	Period of Exemption
Rs. 10 Million	50	5 years
Rs. 12 Million	100	8 years
Rs. 15 Million	200	10 years

12.15 Agricultural Undertakings

Where a new enterprise carrying on an undertaking in agriculture with employment of not less than 20 local persons and with a minimum investment of Rs.15 Million within a period of 2 years, from 1 April 2006, the profits and income of such new enterprise will be exempt from income tax for a period given below:

In an Area	Period of exemption
Non-difficult	5 years
Difficult	8 years
Most difficult	10 years

12.16 Relocation of existing factories

Profits and income for a period specified below of an existing enterprise which is having its factory / factories located either in the districts of Colombo or Gampaha, relocates its factory / factories whilst maintaining a minimum employment of 200 local persons in its employment within a period of 2 years from 1 April 2006 to a site within the area given below, will be exempt from income tax.

In an Area	Period of exemption
Non-difficult	8 years
Difficult	10 years

12.17 Takes over a Sick Industry

“Sick Industry” means any existing enterprise which has not made any profits in relation to its transactions for any year of assessment, continuously for a period of 2 years immediately preceding the last year of assessment from the date of the application to the Board of Investment (BOI) or which has not been in operation for at least 6 months prior to the date of the application.

Profits and income for a period specified below of a new enterprise which takes over a Sick Industry situated in an area given below with the assets and employees of such Sick Industry for the production or manufacture of goods (other than apparel) or provision of services to the local market with an investment of not less than Rs.30 million within a period of 2 years from 1 April 2006 and that it continues the employment of the current number of employees of such Sick Industry or employees not less than 200 local persons, whichever is higher, are exempt from income tax.

In an Area	Period of exemption
Non-difficult	3 years
Difficult	5 years
Most difficult	8 years