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 Lankan business or company.

A transfer of ownership of a Sri Lankan 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 certain 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 Lankan 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. Taxable profits/income for non-residents are defined to include all profits and income derived from services rendered in Sri Lanka, properties in Sri Lanka and businesses 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 rate of income tax for a resident company, effective from the Year of Assessment 2003/2004, is 32.5%. The standard rate will be increased to 35% from the Year of Assessment 2006/2007. Lower rates of 15% or 20% apply to specific activities.

The corporate income tax rates for the Years of Assessment 2005/2006 and 2006/2007 are as follows:

On profits and income	2005/2006 (%)	2006/2007 (%)
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)	20	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	20
Companies offering professional services outside Sri Lanka for payment in foreign currency	30/32.5	15
Shipping Agents approved by the Director of Merchant Shipping in respect of profits attributable to trans-shipment fees received in foreign currency	30/32.5	15
All other companies: • Quoted Public (with 300 shareholders or more) • Others	 30 32.5	 33 1/3* 35

* For a five-year period from the date of listing.

Non-resident companies are liable for income tax at 32.5% (to be increased to 35% from 2006/2007) of taxable income and at 10% of the remittances of profits abroad.

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 6th November 2002 or a company qualified for an exemption prior to 6th 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 31st December 1994, on an application made prior to 11th November 1993.

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

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 if 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 resident company to another resident company or a non-resident company are subject to withholding tax. The rates are as follows:

	Resident company (Paid by)	**Non-resident company (Paid to)**
Dividends	10%	10%
Interest	10%	20%*
Royalty/Annuity > 50,000 per month or 500,000 per annum	10%	20%*
Service or management fees	5%	5%
Non-residential rents	10%	–
Lottery prizes > Rs 500,000	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 concerned, 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 persons 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, "deemed" exports to export companies registered with Textile Quota Board, and services provided by garment buying offices.	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 and onions (it was proposed in the Budget 2006 to apply VAT on the above products 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 as luxury goods – any kind of liquor, air conditioners, refrigerators, washing machines, dish washing machines, television sets, television antennas, cameras, jewellery, motor vehicles (other than three wheelers, passenger transport buses, motor cycles and bicycles), services provided by hotels, restaurants for wedding receptions and other similar receptions. Pursuant to the Budget 2006, the supply of financial services, previously chargeable at 15%, has been brought under the 20% rate.	15

1.6 Stamp Duty

Stamp duty, other than stamp duty payable to Provincial Councils on the transfer of movable and immovable property, was abolished with effect from 1st April 2002. Stamp duty is payable by the purchaser at 3% on the first Rs 100,000 and 4% on the balance of the consideration (or market value in the absence of a consideration) in excess of Rs 100,000 when acquiring immoveable property.

The Government announced in the Budget for 2006 that stamp duty would be reintroduced, effective from 1st February 2006, in repect of instruments and documents other than those which are subject to debits tax, letters of credit which are subject to the Ports and Airports Development Levy and share market transactions.

The precise documents and instruments that would be subject to stamp duty have not been announced.

1.7 Economic Service Charge (ESC)

ESC is levied annually, effective from 1st April 2004, 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. This is provided that the liable turnover is not less than Rs 50 million (proposed to be reduced to Rs 40 million from the Year of Assessment 2006/2007) in the relevant Year of Assessment and the commercial operations had commenced three years prior to the first day of the relevant year. The maximum ESC chargeable is Rs 50 million for a Year of Assessment (proposed to be increased to Rs 60 million from the Year of Assessment 2006/2007).

ESC rates are as follows:

	Rate of ESC
On such part of liable turnover of an entity, the profits of which are exempt from income tax.	0.25%
On such part of the liable turnover of an entity, which has entered into an agreement with BOI under Section 17 of the BOI Law and which:	
• enjoys income tax exemption on its profits and income;	0.25%
• is entitled to pay income tax at any rate not higher than 15%;	0.5%
• is not referred to in either of the above.	1.0%
On such part of the liable turnover of the entity being the turnover:	
• from wholesale or retail trade of goods, not manufactured or produced by the dealer;	0.5%
• of any tea, rubber coconut processing factory**;	0.5%
• whose profits are charged to income tax at:	
– lower rates specified in the 6th Schedule to the Inland Revenue Act;	0.5%
– rates other than those rates specified in the 6th Schedule.	1.0%

* Effective from 1st April 2005.

** Effective from 1st April 2006.

From the Year of Assessment 2006/2007, 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 two succeeding years. The limitation of set off to income tax payable on profits from trade, business, profession or vocation will be removed. No part of the ESC is refundable.

1.8 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.

1.9 Tax on Unlisted Shares

The 15% tax is payable on any gain from the sale of unlisted shares, if the holding period of such shares is less than two years.

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 vs. 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 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 stock. However, the Government announced in the Budget for 2006, the reintroduction of stamp duty in respect of instruments and documents other than those which subject to debits tax and letters of credit subject to the Ports and Airports Development Levy as well as share market transactions. However, the applicability and, if so, the rate of stamp duty on documents with respect to acquisitions of stock have not been announced.

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 commencing on or after 1st April 2004, 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.

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. However, the transfer of assets is liable for 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

Stamp duty was abolished with effect from 1st April 2002, other than stamp duty payable to Provincial Councils on the transfer of moveable and 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.

The Government announced in the Budget for 2006 the reintroduction of stamp duty in respect of instruments and documents other than those which are subject to debits tax, and letters of credit subject to the Ports and Airports Development Levy and share market transactions.

However, the applicability (if any) and rate of stamp duty on documents with respect to acquisitions of stock have not been announced.

2.4.3 Share Transaction Levy

A levy at the rate of 0.2% is imposed on the buyer ands eller 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

Sri Lanka does not have any rules in regard to thin capitalisation. The Government announced in the Budget for 2006 that, effective from 1st April 2006, interest payments made between members of a group of companies will be restricted in computing profits and income in the debt-equity ratio of 2:1 in the case of manufacturing companies and 3:1 in the case of other companies.

3.2 Deductibility of Interest

3.2.1 Stock Deal

Prospective buyers could utilise 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 overdrafts are used in earning chargeable profits and income in any trade, business, profession or vocation.

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.

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 vs. 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 a stock or asset deal. Where a non-resident investor is selling stock in a Sri Lankan company, the investor will be exposed to liability for income tax on any gains arising from the sale of unlisted stocks if such stocks were held for less than two years. The potential exposure to income tax on the gains derived from the sale of stocks could be mitigated, if commercially viable, by:

- listing the stock of the Target Company and making the sale after the listing. However, this would attract a share transaction levy of 0.2% on the sale/purchase price from the buyer and the seller each; or
- holding the investment through a company located in a country with which Sri Lanka has a double tax treaty (DTT) as such treaty exempts Sri Lankan tax on the capital gains; or
- holding the investment through a company located in a tax haven country and when the Sri Lankan investment is to be sold, the company in the tax haven be sold instead.

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 for 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

Gains from sale of unlisted stocks is liable for income tax at 15% if the stocks were held for less than two years or no share transaction levy (which is applicable for listed shares) is paid. Such gains may be exempt from the aforesaid tax if the owner resides in a country which has entered into a DTT with Sri Lanka and the DTT exempts taxation of capital gains in Sri Lanka.

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 6th November 2002 or a company qualified for an exemption prior to 6th 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 31st December 1994, on an application made prior to 11th 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. The 10% dividend tax paid would 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 subject 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 6th November 2002, or a company qualified for an exemption prior to 6th 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 31st December 1994, on an application made prior to 11th 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. The 10% dividend tax paid would 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 proceeds 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 falls into the category of luxury goods) on the consideration for the assets sold. The seller has to charge and account for VAT to the tax authorities. However, if the buyer is VAT registered, the buyer is entitled to claim a credit in respect of the VAT paid. The sale of the assets will not be subject to VAT provided they are sold as part of a going concern.

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 M&As

The only concession that was 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 Comapnay 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 dividends does not adversely affect the sale price.

9. De-mergers

There are no specific provisions in relation to de-mergers. A de-merger 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 de-merger would be the same as an asset deal as discussed in section 2.

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 Lankan company, the investor would be exposed to liability for income tax on any gains arising from such sale if the shares were held for less than two years. The potential exposure to income tax on the gains derived from the sale of stocks could be mitigated by:

- listing the shares of the Target Company and making the sale after the listing. However, this would attract a share transaction levy of 0.2% on the sale/purchase price or from the buyer and the seller each; or
- holding the investment through a company located in a country, with which Sri Lanka has a double tax treaty as such treaty exempts Sri Lankan tax on the capital gains; or
- holding the investment through a company located in a tax haven country and when the Sri Lankan investment is to be sold, the company in the tax haven to be sold instead.

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 for 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; or
- 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 the Sri Lankan 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 USD one million;

- coastal fishing; and
- 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 would be approved, limited to 40% of equity:

- production of goods where Sri Lankan 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; and
- shipping agencies.

Foreign ownership in excess of 40% will be approved on a case by case basis by the BOI.

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):

- 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; and
- lotteries.

The BOI assists potential investors by referring applications to the appropriate agency and approval is usually straightforward.

Appendix B

Tax Incentives

1. Introduction

Sri Lanka offers to private investors, fiscal incentives designed to stimulate investment. This is in expectation that more investment in the Sri Lankan 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 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:

- An Undertaking Carried On by a Company:
  - incorporated before 1st April 2002 and commenced commercial operations between 1st April 2002 and 31st March 2004 with a minimum investment of Rs 2 1/2 million;
  - incorporated before 1st April 2002 and commenced commercial operations on or after 1st April 2004 with a minimum investment of Rs 50 million;
  - incorporated and commenced to carry on the undertaking on or after 1st April 2002 but before 1st April 2004; or
  - incorporated on or after 1st April 2004 with a minimum investment of Rs 10 million.

The designated activities include:

- 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; and
- export or deemed export of services.

• an undertaking carried on by a company on or after 1st April 2002 but before 1st April 2004 with an investment in excess of Rs 250 million;

• any designated project carried on by a company incorporated before 1st April 2002 and which undertaking commenced operations on or after 1st April 2004, with a minimum investment of Rs 50 million;

The designated projects include:

- manufacture of ceramics, glassware or other mineral based products;
- manufacture of rubber based products;
- any projects in light or heavy engineering industries;
- any projects 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; and
- 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.)

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

2.2 Incentives offered are as follows:

Period	Tax rate%
1 – 5th year*	0
6th & 7th year	10
8th year onwards • agriculture and non-traditional exports • others	 15 20

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

Amount of minimum investment (Rupees million)	Tax exemption period (Years)
1000 to 2499	08*
2500 and above	10*
After the end of the tax exemption period	**Tax rate %**
Immediately succeeding two years	10
Thereafter: • agriculture & non-traditional products • others	 15 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 1st 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; and
- urban housing or town centre development.

3.2 Qualifying investment criteria and incentives offered are as follows:

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 by it on or after 1st 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; and
- redevelopment of housing schemes.

4.2 Qualifying Investment Criteria

The investment, of not less than 10 million rupees, should be made within one year of commencement of the undertaking.

4.3 Incentives offered are as follows:

Period	**Tax rate%**
1^{st} – 5^{th} year*	0
6^{th} – 7^{th} year	10
8^{th} 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 Activities

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

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

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 would 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 Activities

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);
- 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;
- to rehabilitate (which means to recommence the commercial operations of the enterprise on a sustainable basis) such enterprise.

6.2 Qualifying Investment 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 (for example, EPF and ETF dues) of such acquired enterprise, and approval obtained.

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

6.3 Incentives offered are as follows:

Period	Tax rate%
1st – 3rd year	0
4th year onwards • agriculture, promotion, tourism and construction work • others	 15 20

The acquiring company will be granted a three-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 Activities

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 1st 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 1st 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 are as follows:

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

A tax exemption period of two 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 emption 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 Activities

Tax incentives will be granted to any company:

- which has an undertaking that 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 1st April 2004.

8.2 Qualifying Investment Criteria

An investment of not less than 10 million rupees should be made prior to 1st 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 two 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 two years will be granted from the year in which the expansion of the undertaking commences to make profits, but not later than 1st 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 three 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

Tax exemption is granted for a period of five years from the commencement of the year of assessment commencing on 1st April 2005.

9.2 Incentives Offered

The profits and income from the cultivation of land and the sale of the produce are exempt for five years.

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 exemptions will not apply to any dividends paid on or after 1st April 2004 by any company which qualified for tax exemption on or after 6th 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, and 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; and
- 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 would be liable for income tax subject to a ceiling of 15% of such profits. This is 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 earned by any partnership in Sri Lanka attributable to services rendered in Sri Lanka to any person or partnership outside Sri Lanka in the course of any profession or any vocation (in the field of literature or fine arts) carried on or exercised by such individual or partnership in Sri Lanka are made liable to income tax at a maximum rate of 10%, where the respective profits are earned in foreign currency and are remitted to Sri Lanka.

12 Other Tax Incentives - Under the BOI Regime

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

12.1 Export Trading Houses

- Qualifying Activities:
  - export, in entirety, of the locally procured manufactured products or re-export, in entirety, of imported products; and
  - location of warehouse within an Export Processing Zone (EPZ) which is continuously supervised by Sri Lanka Customs.
- Qualifying Investment Criteria:
  - no minimum investment is required.
- Incentives offered:

Export value	Incentives
US$ 5 million to 10 million	10% tax rate for 5 years and 15% tax rate thereafter
US$ 10 to 25 million	5% tax rate for 5 years and 15% tax rate thereafter
Over US$ 25 million	Tax holiday for 5 years and 15% tax rate thereafter

No minimum investment is required.

12.2 Export Oriented Services

- Qualifying Activities:
  - 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 :

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

12.3 Regional Operating Headquarters

- Qualifying Activities
  - 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.
- Qualifying Investment Criteria:
  - no minimum investment is required.
- Incentives offered:

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

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

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

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

12.5 IT Related Training Institutes

- Qualifying Activities and Criteria
  - provision of IT related training.
- Qualifying Investment Criteria:
  - Training must have minimum of 300 students.
- Incentives offered:

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

Note: The tax exemption period will, in all abovementioned 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.