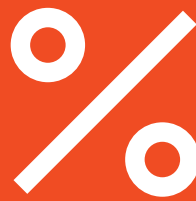


# ALERT ON TRANSFER PRICING



Transfer pricing provisions were first introduced to Sri Lanka income tax in 2006 via the Inland Revenue Act No. 10 of 2006 (old IRA), and thereafter amended in 2013, to incorporate legal provisions to cover international and domestic transactions separately. Based on the above, Gazette notifications were issued in 2013 and 2016. However, with the implementation of Inland Revenue Act No 24 of 2017 (new IRA), additional features have been introduced to the transfer pricing provisions, and consequently a revised regulation has been published to accommodate the new provisions.

**This Alert highlights the significant changes contained in the legislative provisions of the Inland Revenue Act No 24 of 2017 and regulations issued by Gazette No 2104/4 dated 31st December 2018 (published on 1st August 2019), effective 1st April 2018.**



## 1. Application of Transfer Pricing regulations

TP regulations are applicable to a person who has entered into an international (i.e cross border) or domestic related party transactions with associated enterprises. The nature / type of transactions covered and the methods to determine Arm's Length Price (ALP) are the same as previous regulations.

A person has been defined to include a business establishment that has a permanent establishment<sup>1</sup> (PE) in Sri Lanka. As such TP regulations and documentation will be applicable to branches

## 2. Application of Transfer Pricing regulations – domestic transactions

Under the new rules, TP regulations will not apply to domestic transactions if the associated enterprises concerned enjoy the same income tax rate.

TP regulations will apply to domestic transactions only in the following instances

- Where one associated enterprise in the domestic transaction is exempt from income tax under the Inland Revenue Act No. 38 of 2000 or No. 10 of 2006 or No. 24 of 2017 or under the Board of Investment of Sri Lanka Law No. 4 of 1978 (BOI) as applicable, or
- Where one of the associated enterprises enjoy a concessionary rate of tax under the above Inland Revenue Act or the BOI
- Where one of the associated enterprises has a brought forward tax loss or a tax loss for the year.

<sup>1</sup>(i) in relation to a country with which an agreement has been entered into on avoidance of double taxation means, a permanent establishment defined in an agreement for the relief of double taxation where an agreement is in force between the government of Sri Lanka and the government of any territory in which any person and their agencies, branches or establishments in Sri Lanka is resident; or

(ii) in relation to a country with which an agreement has not been entered into on avoidance of double taxation, includes any business connection or a fixed place of business through which the business of the enterprise is wholly or partly carried out irrespective of the number of days of such business carried out in Sri Lanka;

### 3. Arm's Length Price

As per the 2013 gazette notification, ALP was taken to be the arithmetical means of such prices with a permitted deviation of +/- 3%.

As per the new Gazette, the fortieth to sixtieth percentile is the arm's length range. Where the actual price is not within the above range the ALP will be the median. The ALP range introduced in the new Gazette gives more advantage to taxpayers vis-à-vis old Gazette.

### 4. Maintaining of contemporaneous documentation

Where any controlled / related party transaction continues to have effect over more than one year of assessment, fresh documentation need not be maintained separately in respect of each year of assessment, unless there is any significant change in the nature or terms of such transaction, in the assumptions made, or in any other factor which could influence the transfer price.

In case the operations of the associated enterprise reflects no significant change, the searches in databases for comparables should be updated **every three years** instead of annually. Financial data for the comparables should nonetheless be updated every year in order to apply the arm's length principle reliably.

### 5. Documentation

#### 5.1. Documentation and the threshold applicable to each associated undertaking / entity Under the **Old Gazette**

Documentation	Entity	Transaction	Threshold LKR
Approved accountant Certificate & Director's disclosure (filed with IRD annually)	AE in Sri Lanka	International	100Mn per AU
TP Disclosure Form	AE in Sri Lanka	International	100 Mn per AU
TP Report	AE in Sri Lanka	Domestic & International	50Mn & 100Mn per AU

Approved accountant Certificate & Director's disclosure (filed with IRD annually)

5.2 Documentation and the threshold applicable to each associated undertaking / entity  
Under the **New Gazette**

Documentation	Entity	Transaction	Threshold LKR	Timeline for submission
Local File	AE in Sri Lanka	International & Domestic	200mn per AE (controlled or category of controlled transactions)	30 calendar days of written request by CGIR
Master File (Prescribed format)	AE which is part of a MNE Group	International	7.5Bn per AE	30 calendar days of written request by CGIR
CbCR (prescribed format)	1. Ultimate parent Entity tax resident in SL or in another jurisdiction or 2. Constituent Entity tax resident in SL <sup>2</sup> or 3. Surrogate Parent Entity	International	115Bn consolidated group revenue	on or before 12 months after the last day of the Reporting Fiscal Year of the MNE Group
Disclosure Form (prescribed format)	AE in Sri Lanka	International & Domestic	NA	Filed with annual corporate tax return on or before 30th November

<sup>2</sup>The term “Constituent Entity” means

- (a) any separate business entity of an MNE Group that is included in the Consolidated Financial Statements of the MNE Group for financial reporting purposes, or would be so included if equity interests in such business unit of an MNE Group were traded on a public securities exchange;
- (b) any such business entity that is excluded from the MNE Group’s Consolidated Financial Statements solely on size or materiality grounds; and
- (c) any permanent establishment of any separate business entity of the MNE Group included in (a) or (b) of above item provided the business entity prepares a separate financial statement for such permanent establishment for financial reporting, regulatory, tax reporting, or internal management control purposes.

## 6. Country-by-Country Report (CbCR)

### Who should file the CbCR in the prescribed format with CGIR in SL?

- Each Ultimate Parent Entity (UPE) of a MNE Group that is tax resident of Sri Lanka or UPE of an MNE resident in another tax jurisdiction or
- Constituent Entity (CE) tax resident in SL where,
  - UPE is not required to file CbCR or
  - Where the UPE in another jurisdiction does not have effective Qualifying Competent Authority Agreement (QCAA) with SL or where such agreement has been suspended. (where there is more than one CE tax resident in SL one CE maybe nominated.) or
- A Surrogate Parent Entity SPE<sup>3</sup> provided
  - The said SPE can file a CbCR in the prescribed format with CGIR of SL
  - The jurisdiction of the tax resident of the said SPE has a valid and effective QCAA with SL
  - Prior to filing the CGIR of SL has been notified of the SPE and the tax residency of the SPE

N.B : CE resident in SL should notify the CGIR of SL whether it is a UPE or SPE and if it is not then the tax residence of the reporting entity<sup>3</sup> before 31st Dec of the reporting fiscal year<sup>4</sup>

### Time for filing

- CbCR shall be filed **commencing Y/A 2019/2020** and no later than 12 months after the last day of the Reporting Fiscal Year of the MNE Group.

### Contents of CbCR

- Aggregate information relating to the amount of revenue, profit or loss before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets other than cash or cash equivalents with regard to each jurisdiction in which the MNE Group operates;
- An identification of each Constituent Entity of the MNE Group setting out the jurisdiction of tax residence of such Constituent Entity, and where different from such jurisdiction of tax residence, the jurisdiction under the laws of which such Constituent Entity is organized, and the nature of the main business activity or activities of such Constituent Entity;
- The Country-by-Country Report shall be filed in a form identical to and applying the definitions and instructions contained in the standard template

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<sup>3</sup> SPE means one Constituent Entity of the MNE Group that has been appointed by such MNE Group, as a sole substitute for the Ultimate Parent Entity, to file the Country-by-Country Report in that Constituent Entity's jurisdiction of tax residence, on behalf of such MNE Group.

<sup>4</sup> Reporting Fiscal Year means that Fiscal Year the financial and operational results of which are reflected in the Country-by-Country Report.

APA shall have a validity not exceeding **four** years of assessments and maybe amended or modified subject to CGIR evaluation and approval. The Commissioner General will specify the manner in which the advance pricing agreement process shall operate by issuing an APA Guideline, which will specify

- eligibility for application for an advance pricing agreement ;
- term limits for advance pricing agreements ;
- the application procedure and process ;
- annual compliance procedures for concluded advance pricing agreements ;
- the conditions and procedures for revocation or cancellation of an advance pricing agreement ;
- other requirements as may be necessary

## 8. Corresponding Adjustments

- Domestic Transactions
- No corresponding tax adjustments will be permitted
- Intentional Transactions  
Corresponding adjustment permitted to the Sri Lanka tax resident subject to certain conditions and subject to the availability of a Double Taxation Agreement with Sri Lanka being in force with the tax resident country of the AE

## 9. Penalties

Description	Penalty
Concealed/ furnished inaccurate particulars of income	200% of the value of additional tax
Required documents have not been submitted on the specified date	Sum not exceeding Rs 100,000
Non-disclosure of any required information	sum not exceeding 2% of aggregate value of transactions with its AEs
Required documents have not been maintained	sum not exceeding 1% of aggregate value of transactions with AEs
Required documents have not been submitted	sum not exceeding Rs 250,00

## 10. Deemed Associated Enterprises

### Equity/Debt

- Majority of the voting powers direct/indirect in shares or otherwise, or  $\geq 50\%$  of the voting power, direct/indirect holding by any person or enterprise; or;
- Loan  $\geq 51\%$  of Book value of Total Assets;
- Loan and equity  $\geq 51\%$  of Book value of Total Assets
- Guarantees  $\geq 25\%$  of total borrowings; or;

### Management

- Appointment  $> 50\%$  of Directors or members/ one or more Executive Director or members by an enterprise.
- Appointment by same person in each enterprise.

### Activities

- Direct / indirect supply of  $\geq 90\%$  Raw Materials processed under influenced prices and conditions.
- Sale or transfer of goods or articles manufactured or processed to an enterprise or to a person specified by the enterprise and under influenced prices and conditions.

### Control

- One enterprise controlled by an individual and the other by himself or his relative or jointly.
- One enterprise is a firm, association of persons, or body of individuals, the other undertaking holds  $\geq 10\%$  interest in the first undertaking.

### Others

Control transaction differs from transactions that would make or impose by a person not participating in the management, but confers potential advantage to the enterprise.

## ***Let's Talk***

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