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உள்நாட்டு இறைவரித் திணைக்களம்
INLAND REVENUE DEPARTMENT

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செயலகம்
14 வது மாடி
உள்நாட்டு இறைவரிக் கட்டிடம்
சேர் சிற்றம்பலம் ஏ காடினர் மாவத்தை
த.பெ.இல. 515, கொழும்பு - 2, இலங்கை

Secretariat
14th Floor
Inland Revenue Building
Sir Chittampalam A Gardiner Mawatha
P.O. 515, Colombo 2 - Sri Lanka

ෆැක්ස් / பக்ஸ் / Fax: 011 - 2338574/ 2338659/ 2338635/ 2338570/ 2338543
දුරකථන / தொலைபேசி / Telephone: 011- 2135300/ 2135410/ 2135412 / 2135413
E-Mail – secretariat@ird.gov.lk
Web: www.ird.gov.lk

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14.02.2023

EXPLANATORY NOTE ON THE APPLICATION OF WITHHOLDING TAX /ADVANCE INCOME TAX

This explanatory note intends to clarify the application of Advance Income Tax and Withholding Tax (WHT) imposed in terms of the Section 84, 84A and 85 of the Inland Revenue Act, No. 24 of 2017 (IRA), as amended by the Inland Revenue (Amendment) Act, No. 10 of 2021 and 45 of 2022, for certain practical issues.

1. Identification of Service fee payments made to Individual independent service providers.

   Only the Doctors, Engineers, Accountants, lawyers, Software Developers, Researchers and Academics should be treated as Independent Service Providers for the purpose of deduction of 5% WHT on Service fee payments made to Individual independent service providers, for the purpose of paragraph (c) of Subsection (1C) of Section 85 of IRA.

   The WHT Agents are required to limit the WHT deduction to the service payments made to the above independent service providers only under such paragraph. The aggregate service fee payment which exceeds Rs. 100,000/- per month is subject to WHT deduction and WHT should be applied to the entire amount (if the payment for a month is exactly Rs. 100,000, WHT deduction is not required).

2. Identification of service fee payments made to Individual service providers as prescribed by regulation, in terms of paragraph (c) of Subsection (1C) of Section 85 of the IRA.

   This regulation may be issued by the Minister by a Gazette notification in due course. The WHT Agents are required to comply with such regulation, when it is issued. Until such time, any service fee payment made to an Individual service provider is not subject to WHT deduction. Accordingly, **for examples**, service payments for security services, janitorial services, manpower services, sub-contract payments, catering services, construction services, management services, transport services etc are not subject to WHT deduction.

3. Identification of transport services

As clarified above, service payments for transport services are not subject to WHT deduction. When the ability to control the utilization of vehicle is vested with the owner (service provider), it is considered that the owner is giving transport service.

The following criteria together could be used to determine that the ability to control the utilization of vehicle is with the owner.

i. The driver, fuel, repair/maintenance and lubricants are provided by the owner.
ii. The vehicle is in the physical possession of the owner and even if the vehicle is parked in the User's premises.
iii. The vehicle is used by the user for a shorter period and/or for a specific purpose.

If a service payment satisfies above criteria, such service payment could be treated as a payment for transport services, even if the word "rent" or "hire" has been mentioned in the service agreement.

4. Identification of renting of vehicles

Renting out of vehicles are subject to WHT deduction. When the ability to control the utilization of vehicle is with the user (service receiver), it is considered that the owner has rented out the vehicle. Accordingly, renting out of vehicle refers to a situation wherein control and possession of the vehicle is being transferred by the owner to the user.

Any of the following criteria could be used to determine that the ability to control the utilization of vehicle is with the user.

i. The existence of a written rent agreement between the owner and the user of the vehicle.
ii. Even if the driver, fuel and lubricants are provided by the owner, the physical possession ~~is~~ remains with the user for certain period and within such agreed period the owner cannot reclaim the vehicle.
iii. The identity of the user on the vehicle is greater than that of the owner such as by displaying the user's trade name, logo and others on the vehicle.
iv. The vehicle is used by the user for the general purposes of transportation of goods or passengers of which the details are not necessarily be known to the owner.

The aggregate rent payment <u>which exceeds Rs. 100,000/- per month</u> is subject to WHT deduction and WHT should be applied to the entire amount (if the payment for a month is exactly Rs. 100,000, WHT deduction is not required).

Same explanation could be applied for renting of other assets ex: machineries rent. However, payments for the use of or right to use any industrial, commercial, or scientific equipment should be treated as a "royalty".

5. Rental payments made under a finance lease agreement.

   As per provision of the IRA, rental payments under a finance lease agreement are considered as repayments of loan instalments. Therefore, rental payments made under a finance lease agreement are not subject to WHT deduction.

   However, payments under an operating lease agreement constitute "rent payments" for which WHT is applicable.

6. Rent payments made to non-resident person.

   Rent payments made to non-residents are subject to WHT (under all other payments) at the rate of 14% without having any threshold. However, lower rate of WHT may be applicable as per a Provisions of Double Tax Avoidance Agreement (DTAA) between Sri Lanka and other country.

7. Rent payments made to Co-owners.

   If the rent agreement has been entered in to with Co-owners (when the relevant asset is jointly owned), attributable portion of rent payment for each Co-owner (in proportion to the legal interest of the relevant asset) should be considered for WHT deduction separately (should be considered as separate payments to each owner and the threshold should also be applied separately). Separate WHT certificate must be issued to each person who derives rent income.

   When the rent agreement has been entered in to with a sole owner and the rent payment is made for several person on a direction of the owner, it should be treated as the rent payment was made to the sole owner before the direction is operated.

8. Storage Facilities

   A person who provides space for the storage of goods or materials (without allocating a separate space to the customer to use whenever the customer requires and whatever the purposes of customer) and deriving a payment for such service could not be considered as "Rent" for the deduction of WHT.

   In this type of storage facilities, service provider agreed to store the customers goods or materials according to the agreed terms of the contract but the control of the premises of store is vested with the service provider and such control is not transferred from the service provider to customer at anytime. Therefore, payment made by the customer to service provider is not a rent.

The WHT Agents are advised to adhere to above explanatory note in deducting WHT. If any WHT Agent find difficulties in identifying any WHT payment unanswered by this explanatory note and Commissioner General's circulars SEC/2022/ E/02, SEC/2022/ E/03 and SEC/2022/ E/06, (CGIR's Circulars), such WHT agent should get clarifications over such unanswered specific issue from the Commissioner, Tax Policy and Legislation unit (email:tpl@ird.gov.lk).

Therefore, except for the directions for exempt amounts mentioned in CGIR's Circulars, the WHT agents should not direct withholdees (service providers) to get clarifications over such specific issues from the Tax Policy and Legislation unit. Provisions of the IR Act will be applied to the WHT Agents who fail to deduct WHT as required and instructed.

D.R.S. Hapuarachchi
Commissioner General of Inland Revenue

D.R.S. Hapuarachchi
Commissioner General of Inland Revenue
Inland Revenue Department
Sri Chittampalam A. Gardiner Mawatha
Colombo 02.