



Transfer pricing regulations under the Inland Revenue Act no. 24 of 2017

August 2019

Transfer pricing regulations under extraordinary gazette no. 2104/04 ("Regulations"), have been issued under Section 194 of the Inland Revenue Act no.24 of 2017 ("IRA"), to replace the extraordinary gazette notification no.1823/05 issued under Inland Revenue Act no.10 of 2006. The Regulations will be effective from 1 April 2018.

These Regulations will apply in the following cases:

- a) International transactions between associated enterprises ("AEs") recognised under Section 76 of the IRA
- b) Domestic transactions among AEs as identified below:
 - If tax exemptions have been granted to any AE under the Inland Revenue Act no. 38 of 2000 or Inland Revenue Act no. 10 of 2006 or no. 24 of 2017 or Board of Investment (BOI) of Sri Lanka Law no. 4 of 1978
 - If any difference between income tax rates specified in any schedules to the Act or any income tax rate given in the BOI agreement is applicable to any AE
 - If loss has been incurred by any AE for the year of assessment or immediately the preceding years of assessment, which has been brought forward to that year of assessment

A permanent establishment and its head office or other related branches in Sri Lanka shall be treated as a distinct and separate entity from its head office and related branches under the IRA for the purpose of transfer pricing.

The salient changes introduced under the Regulations with regard to transfer pricing compliances and requirements are discussed below.

1. Arm's length price

Under the Regulations, arm's length price is determined on the basis of arm's length range, which is the 40th–60th percentile of the relevant financial indicators. The range is calculated using the most appropriate transfer pricing method as applicable to the enterprise under the Regulations.

If the actual price for a controlled transaction is not within the arm's length range, the 50th percentile of the range shall be treated as the arm's length price. However in the previous regulations, arm's length price was the arithmetic mean of the comparable margins with a 3 percent variation.

2. Definition of AE

The instances in which two entities are considered AEs (earlier referred to as associated undertakings/AUs) remain same except in the following cases:

Previous definition	Definition modification/exclusion under the Regulations
No corresponding definition	Regulation no. 8(d) "Loans and equity provided by one enterprise to another enterprise constitute not less than 51 percent of the book value of the total assets of the other enterprise, provided that it is not given by a bank which is not considered as an AE under any other item of this Regulation."

Previous definition	Definition modification/exclusion under the Regulations
<p>Regulation no. 7(g) and 13(g) “The manufacture or processing of goods or articles or business carried out by one undertaking is wholly dependent on the use of know-how, patents, copyrights, trademarks, licences, franchises, or any other business or commercial rights of similar nature or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other undertaking is the owner or in respect of which the other undertaking has exclusive rights.”</p>	<p>Excluded under the Regulations</p>
<p>Regulation no. 7(h) and 13(h) “Ninety percent or more of the raw materials and consumables required for the manufacture or processing of goods or articles carried out by one undertaking, are supplied by the other undertaking, or by persons specified by the other undertaking, and the prices and other conditions relating to the supply are influenced by such other undertaking.”</p>	<p>The new inclusions are highlighted as below.</p> <p>Regulation no. 8(h) “Ninety percent or more of the raw materials, semi-finished goods and consumables required for the manufacture or processing of goods or articles carried out by one enterprise or of purchases required for the sale, are supplied by the other enterprise or persons specified by the other enterprise, and the prices and other conditions relating to the supply are influenced by such other enterprise.”</p>
<p>No corresponding definition</p>	<p>Regulation no. 8(i) “The goods or articles manufactured or processed by one enterprise are sold/transferred to another enterprise or persons specified by the enterprise, and the prices and other conditions relating thereto are influenced by such enterprise or vice versa.”</p>
<p>Regulation no. 7(k) and 13(k) “There exists between the two undertakings, any relationship of mutual interest, as may be prescribed.”</p>	<p>Excluded under the Regulations</p>
<p>No corresponding definition</p>	<p>Regulation no. 8(l) “Where the controlled transaction differs from the transactions that would have been made or imposed by any person not directly participating in the management, control or capital as mentioned in section 76 or 77, but confers a potential advantage to the enterprise.”</p>

3. Expansion of the transfer pricing documentation scope

The compliance scope for the transfer pricing documentation has been widened. An entity meeting compliance requirements, will be required to maintain the following supporting documentation.

i. **Local file**

It will record material transactions of local taxpayers.

The local file is required to be maintained by enterprises where controlled transactions or each category of controlled transactions with AEs exceed LKR 200 million for each year of assessment, in respect of both international and applicable domestic transactions, respectively.

The file must be kept available for a period of six years from the end of the relevant year of assessment.

In case of international transactions, documentation must be prepared in English.

ii. **Master file**

It will contain standardised information as prescribed that is relevant for all members of a multinational group. The file must be maintained in English.

However, only enterprises that have declared revenue exceeding LKR 7.5 billion for each year of assessment, will be required to prepare and maintain the master file.

iii. **Country by country report ("CbCR")**

CbCR will contain certain information related to the global allocation of the multinational group's income and taxes paid together with some indicators of the location of economic activity within the group.

Regulations related to CbCR is effective for reporting fiscal years of multinational enterprises ("MNEs"), beginning on or after 1 April 2019.

The report is required to be maintained by a group with a total consolidated group revenue exceeding LKR 115 billion in the immediately preceding fiscal year.

4. Maintaining transfer pricing documentation

If a transaction continues to have an impact on more than one year of assessment, fresh documentation is not required to be maintained separately in respect of each year of assessment, unless there has been a significant change in:

- Nature or terms of the transaction
- Assumptions made
- Any other factor that could influence transfer price

If a taxpayer's operation reflects no significant change, searches in databases for comparables should be updated every three years (not annually).

However, the financial data for comparables should be updated annually to apply the arm's length principle.

5. Timelines to submit transfer pricing documentation and disclosure forms

Compliance requirement	Submission timeline
Local file/master files	Within 30 calendar days of a written request issued by the commissioner general
CbCR	No later than 12 months after the last day of the reporting fiscal year of the MNE **
Transfer pricing disclosure form <i>Note: Enterprises that carry out categories of transactions with AEs below LKR 200 million, need to disclose only the transaction category and details of AEs.</i> <i>In addition to disclosing the transaction category and details of AEs, enterprises that carry out categories of transactions with AEs exceeding LKR 200 million, must disclose details of the transfer pricing methodology and arm's length price.</i>	Submitted annually per prescribed format, along with the income tax return, irrespective of the transactions value with AEs

**A reporting entity that is a resident of Sri Lanka for tax purposes must file CbCR. It may be the ultimate parent entity, the surrogate parent entity, or any other entity as described under Regulation 6(e)(II)(ii) as applicable.

Notification for CbCR

To submit CbCR, a constituent entity of an MNE group that is a resident of Sri Lanka for tax purposes, must notify the commissioner general of inland revenue ("CGIR") whether it is the ultimate parent entity or the surrogate parent entity, which will file CbCR, not later than 31 December of the reporting fiscal year of such an MNE group.

If a constituent entity of an MNE group that is a resident of Sri Lanka for tax purposes, is not the ultimate parent entity or the surrogate parent entity, which will fill CbCR, CGIR must be informed of the identity and tax residence of the reporting entity responsible for filing CbCR, not later than 31 December of the reporting fiscal year of such an MNE group.

6. Penal provisions

Penal provisions as specified under Section 184 of the IRA will apply in case of any non-compliance mentioned below.

Non-compliance	Penalty
Non-maintenance of required documents	1% of aggregate value of transactions with associated undertakings
Non-submission of required documents on specified date	LKR 100,000
Non-submission of required documents	LKR 250,000
Non-disclosure of required information	2% of aggregate value of transactions with AUs

Non-compliance	Penalty
Concealing particulars of income or furnishing inaccurate particulars of income and seeking to evade tax	200% of the value of additional tax
Failure to comply with a notice to give information	Penalty not exceeding LKR 1 million
	Criminal investigation under Chapter XVIII of the IRA

7. Validity period for advanced pricing agreements (“APA”)

Further guidance has been provided under the Regulations on APAs, which can be entered into with the CGIR in respect of the arm’s length price for international transactions.

The Regulations have now specified that any APA signed between the taxpayer and the CGIR shall be valid for a period not exceeding four years of assessments.

8. Corresponding adjustments

Transaction nature	Corresponding adjustment
Domestic transactions	If the CGIR makes an adjustment to the taxpayer’s taxable income, a corresponding adjustment cannot be made to the taxable income of the other party to the transaction.
International transactions	<p>The taxpayer resident in Sri Lanka can request the CGIR to examine the consistency with the arm’s length principle of an adjustment made/proposed by the tax administration of the AE’s country.</p> <p>On such a request, if the adjustment made/proposed is consistent with the arm’s length principle, corresponding adjustments must be made by the CGIR, to eliminate economic double taxation that would result from the inclusion of the same profits in the taxable income of both the taxpayer in Sri Lanka and the AE.</p> <p>This request must be made within the applicable time-period, so that it can be resolved by way of the mutual agreement procedure under the applicable double tax avoidance agreement between the two countries.</p>



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

SJMS Associates is an affiliate of a Deloitte Touche Tohmatsu India LLP a DTTL member firm in India.

This material is prepared by SJMS Associates ("SJMS"). This material (including any information contained in it) is intended to provide general information on a particular subject(s) and is not an exhaustive treatment of such subject(s) or a substitute to obtaining professional services or advice. This material may contain information sourced from publicly available information or other third party sources. SJMS does not independently verify any such sources and is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such sources. None of SJMS, Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this material, rendering any kind of investment, legal or other professional advice or services. You should seek specific advice of the relevant professional(s) for these kind of services. This material or information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person or entity by reason of access to, use of or reliance on, this material. By using this material or any information contained in it, the user accepts this entire notice and terms of use.