



Transfer Pricing **Country Summary**

Sri Lanka

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1. Introduction

The new Income Tax Act (The Inland Revenue Act No. 24 of 2017) has changed the Transfer Pricing (TP) scenario in Sri Lanka. In addition to the requirements in the Statute, the Minister of Finance recently released rules pertaining to transfer pricing (TP Regulations), which became effective on 1 April 2018 (by Gazette extraordinary No. 2104/4 dated 31 December 2018).

2. Laws & Regulations

a) References to OECD/EU/Local Rules

The new Inland Revenue Act (IRA) No.24 of 2017 and the Gazette Extraordinary No.1546/10 of 22 April 2008 governs the transfer pricing in Sri Lanka.

According to the Inland Revenue law, arm's length price is defined as "price which is applied in uncontrolled conditions in a transaction carried out between persons other than associated undertakings". The Inland Revenue Department has issued specific regulations concerning documentation and methods for determining the arm's length price for transfer pricing purposes.

Transfer pricing rules apply where there is a degree of direct or indirect control between the parties, and the aggregate value of international transactions is more than 100 million Sri Lankan rupees (LKR).

b) Definition of Related Party

A related party is defined as:

- One enterprise holds, directly or indirectly, shares carrying not less than 50% of the voting power in each of such undertaking;
- Any person or undertaking holds, directly or indirectly, shares carrying not less than 50% of the voting power in each such undertaking;
- Loans advanced by one undertaking to the other undertaking constitutes not less than 51% of the total assets' book value of the other enterprise;
- One undertaking guarantees not less than 25% of the total borrowings of the other undertaking;
- Any entity holds the majority of the board of directors, members of the governing board, one or more executives, or executives of the governing board of one undertaking, are appointed by the other undertaking;
- More than half of the directors or governing board's members, one or more of the executives, members of the governing board, or each of the two undertakings, are appointed by the same person or persons;
- The use of patents, know-how, copyrights, trademarks, franchises, licenses, or any other commercial or business rights of similar nature, or any data, drawing, documentation, or specification relating to any model, design, patent, invention, secret formula, or process, of which the other undertaking is the owner or in respect of which the other undertaking has a license, is entirely dependent on the use of know-how, patents, copyrights, trademarks, licenses, franchises, or any other;
- 90% or more of the raw materials and consumables, which are necessary for the manufacture or processing of goods or articles undertaken by one entity, are supplied by the other entity, or by persons specified by the other entity, and the prices and other conditions relating to the supply are influenced by such other entity;
- As may be prescribed, there is a mutual interest relationship between the two undertakings.

c) Nature of Transfer Pricing Documentation

A transfer pricing disclosure form should be submitted with the CIT return. The disclosure form¹ must include four columns that allow authorities to identify:

- the type of transaction company conducted;
- the associated enterprises with which the company conducted those transactions;
- the transfer pricing methodology company used to test those transactions (only if the total amount of transactions exceeds LKR 200 million); and
- the comparable arm's length price or range the company used to test those transactions.

d) Tax Havens & Blacklists

Not applicable.

e) Advance Pricing Agreement (APA)

Unilateral and bilateral APAs are available. An APA is effective for a fixed period not specified in the transfer pricing regulation.

f) Audit Practice

In order to select cases for TP evaluation, IRD may use a risk-based assessment technique, which is used in other countries. It enables IRD to concentrate on situations with considerable risk of tax revenue loss. Also, instead of single-year audits, the IRD may contemplate multi-year audits, and the frequency of audits should be decided by risk assessment, taxpayer compliance behaviour, and audit resource availability.

3. Transfer Pricing Documentation

a) Level of Documentation

The prescribed documentation includes:

- a description of the assessee undertaking's ownership structure;
- a profile of the multinational or group to which the assessee undertaking belongs;
- a broad description of the assessee's business and industry, as well as the business of the associated undertakings with whom the assessee has transacted;
- the nature and terms (including pricing) of each related undertaking's foreign or group transactions;
- a summary of the assessee's and the related undertaking's functions performed, risks taken, and assets used or to be used ;
- a record of the assessee's economic and market analyses, forecasts, budgets, or other financial estimations for the business;
- as a whole and for each of divisions or products separately, which may have an impact on the assessee's transactions;
- a record of uncontrolled transactions taken into consideration for comparing them to the transactions entered into, including a record of the type, terms, and circumstances of any uncontrolled transaction with third parties that may be relevant to transaction pricing;
- a record of the analysis performed to evaluate the comparability of uncontrolled transactions with the relevant transaction;

¹ http://www.ird.gov.lk/en/Downloads/IT_Corporate_Doc/Asmt_TPDF_01_2020_2021_E.pdf

- a description of the methods considered for determining the arm's length price in relation to each transaction or class of transaction; the method selected as the most appropriate method along with explanations as to why such method was selected, and how such method was applied in each case;
- a record of the actual work done in determining the arm's length price, including specifics of comparable data and financial data used in determining the best method, and any adjustments made to account for differences between the transaction and the arm's length price, if any were made;
- comparable uncontrolled transactions, or between the parties involved in such transactions;
- assumptions, policies, and, if applicable, pricing discussions that have had a significant impact on the assessment of the arm's length price;
- details of any adjustments made to transfer prices to match them with arm's length prices set under these guidelines, as well as any tax adjustments made as a result.

b) Industry Analysis

By identifying value drivers for the relevant industry, a first indication of the level of profitability common in the industry is being given.

c) Company Analysis

A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

A detailed description of the business and business strategy pursued by the local entity, including an indication of whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

d) Functional Analysis

In conducting a functional analysis, an assessment is made of the significant activities and responsibilities that are performed by the related parties relevant to the Intercompany Transactions under review, the tangible and intangible assets that are employed and the risks that are borne in undertaking the business activities. Such an assessment is consistent with the recommendations that have been made in the OECD Guidelines in paragraph 1.51.

e) Choice of Transfer Pricing Method

The Inland Revenue Department has embraced the OECD Transfer Pricing international standards – the Arm's Length Principle. There is no priority over any method. However, the most appropriate method should be chosen based on the best method factors in the context of generally accepted transfer pricing practice.

f) Economic Analysis – Benchmark Study

The Inland Revenue Department has not shown a preference for local comparables, including databases. The TP rules also do not give guidelines on benchmarking studies or ban regional comparables. Regional comparables should thus be allowed as long as the discrepancies can be minimised via suitable adjustments and analysis.

g) Inter-company (IC) Legal Agreement

Although an Inter-company legal agreement formalises the business and financial relationship between group entities, the legal agreements have a lower ranking since the OECD 2017 Guidelines made the "conduct of parties" the prevailing concept.

h) Financial Statements

The Institute of Chartered Accountants of Sri Lanka made the decision in late 2009 to fully converge with all IASB pronouncements and then to adopt all IASB pronouncements. Since 2012, specified business enterprises (SBE) such as listed companies, banks, insurance companies, factoring companies, finance companies, leasing companies, unit trusts, fund management companies, stockbrokers and stock dealers, and stock exchanges have been required to adhere to Sri Lanka Financial Reporting Standards (SLFRS), which are nearly identical to International Financial Reporting Standards (IFRS).

As a transitional measure, the Institute of Chartered Accountants of Sri Lanka (CASL), Sri Lanka's official standard-setter, adopted SLFRS 7 without requiring comparative information for periods beginning before January 1, 2013. CASL also moved the effective dates of SLFRS 10, 11, 12, and 13 to January 1, 2014, but "recommended using the principles contained in IFRS 13 in the measurement of fair value due to its practical prominence." In light of pertinent issues identified by regulators and other stakeholders, Sri Lanka has also adopted a Statement of Alternative Treatment (SoAT) regarding the right-of-use of leased land.

i) Production Process for TP Relevant Returns, Documents, Forms and Financials

In the chart below, the existence of the filing requirements with the details of which format is used, the latest filing date, notification requirement and its deadline, thresholds to be applied in case it exists, and the required languages are demonstrated. These information can be seen respectively for CIT, master file, local file, CbCR, local forms, annual accounts and segmented P&L documentations.

	Prepare or File?	Format	Deadline	Notification Deadline*	Threshold* (Yes/No)	Local Language (Yes/No)*(If "No", it can be filed in English)
Corporate Income Tax	File	Electronic	August, 30 th .	N/A	N/A	No
Master File	File	Local Form	August, 30 th .	No	Yes	No
Local File	File	Local Form	August, 30 th .	No	Yes	No
CbCR	File	By email or post	December, 31 st .	No	Yes	No
Local Form	File	Transfer Pricing Disclosure Form	August, 30 th .	No	Yes	No
Annual Accounts	Prepare	SLFRS	February, 28 th .	No	No	No
Segmented P&L	N/A	N/A	N/A	N/A	N/A	N/A
* Sri Lanka has NOT signed the MCAA agreement for the filing of CbCR.						
* There is no specific transfer pricing regulation for SMEs.						

Sri Lankan Law does not provide for the TP disclosure form time frame that it should be submitted with the CIT return of the company. Therefore, the same deadline applies to the disclosure form too. For Master and Local files, filing is not mandatory, but the submission must take place at the latest in 60 days after the official request. The statute of limitations for transfer pricing documentation is 5 years. There is no time limitation where the (i) return has not been filed, (ii) in the case of fraud, evasion, or wilful default.

j) Mandatory Language

There is no express stipulation in the Act on the language for documentation in transfer pricing. However, the documentation can be filed in one of the national languages – Sinhala or Tamil – or English.

k) Notification Requirement

According to the Art. 6(e)(II)(iv) of the Regulations made under section 194 of the Inland Revenue Act, No. 24 of 2017, the following information should be included in the CbCR notification:

- if the entity in Sri Lanka is obliged to file a CbCR;
- if the condition above is affirmative, is the MNE group's ultimate parent entity (UPE), surrogate parent entity (SPE), or constituent entity?
- if not, the reporting entity's identification and tax residence; and
- a list of the MNE Group's component entities in Sri Lanka

The official sample notification can be reached [here](#).²

l) Record Keeping

The specified documentation should be maintained for audit purposes for 5 years.

m) Penalties and Interest Charges

Companies that violate the transfer pricing rules can be fined up to 2% of the total value of the transaction between related parties in case of non-disclosure of any required information.

Up to 1% of the total value of the transaction with associated enterprises can also be fined where the required documents have not been maintained in accordance with regulations.

The penalty of LKR 250,000 is given to companies that do not submit the required documents to the tax authorities. A penalty of up to LKR 100,000 is imposed when the required documents have not been submitted on time.

A penalty of 200% of the additional tax value can be imposed when entities conceal particulars of income or furnish inaccurate particulars of such income.

The prescribed penalty for late submission of the tax return is; the greater of (i) 5% of the amount of tax payable plus 1% of the amount of tax due for each month, or part of a month, or (ii) LKR 50,000 plus LKR 10,000 for each month or part of a month.

Moreover, in case of a false or misleading statement that can lead to an underpayment or a higher refund than the actual amount, is liable to pay the penalty equal to the greater of (i) LKR 50,000 or (ii) the amount by which the tax payable or refund would have been reduced or increased based on the false statement.

² http://www.ird.gov.lk/en/publications/Unit%20Profiles_Tax%20Payer%20Service%20Unit/TP_CbCR_001_E.pdf