



# BRIEFING NOTE Foreign Direct Investment in Sri Lanka

May 2018

## Types of entities that may be established

Persons wishing to establish legal entities in Sri Lanka, for the purposes of carrying on a business therein, may do so in one of the following ways:

- a. Incorporating a limited (or unlimited) liability company; or
- b. Establishing a place of business in Sri Lanka (i.e. a branch, project or liaison office etc.) as an overseas company.

Both incorporation of companies in Sri Lanka, and the registration of overseas companies, are primarily regulated by the Companies Act No. 7 of 2007 (as amended) (**Companies Act**).

### Limited Liability Companies

Limited liability companies can be incorporated as 'private' limited liability companies; these are subject to a less stringent regulatory and compliance framework and as such, in many aspects, can be operated more flexibly than the former. However, they are (i) precluded from offering shares or other securities to the public, and (ii) to a maximum of 50 shareholders (excluding those who became shareholders while being employees of the company).

Limited liability companies can be established with a minimum of one (1) shareholder and one (1) director. Every company incorporated in Sri Lanka must also have a registered office in Sri Lanka, and a company secretary (having the prescribed qualifications).

### Registered Overseas Companies

The Companies Act defines 'overseas companies' as companies or bodies corporate incorporated outside Sri Lanka, which establish a place of business (e.g. whether in the form of a branch, project, liaison, representative or regional office or equivalent) in Sri Lanka. Such overseas companies must, within one (1) month of establishing the said place of business, deliver certain documents and information (including the names and addresses of one or more persons resident in Sri Lanka, who are authorized to accept service on behalf of the company) to the registrar general of companies and obtain registration as an 'overseas company'. Once registered, such overseas companies have the same power to hold lands in Sri Lanka, as if they are companies incorporated in Sri Lanka.

## Foreign ownership and management restrictions

In accordance with regulations issued under the Foreign Exchange Act No. 12 of 2017 of Sri Lanka (**FEA**), foreign persons and foreign legal entities are granted general permission to hold up to 100% of the issued share capital of Sri Lankan companies, except as follows:

<b>No general permission</b>	<b>Up to 40% of the stated capital of the relevant company (unless a higher threshold has been approved by the BOI)</b>	<b>Up to such percentage of the issued share capital for which general or special approval has been granted by the Government, or any legal administrative authority set up for the approval of foreign investment into such businesses</b>
Pawn-broking	Production of goods where Sri Lanka's exports are subject to internationally determined quota restrictions	Air transportation
	Growing and primary processing of tea, rubber, coconut, cocoa, rice, sugar and spices	Coastal shipping
Retail trade with a capital of less than USD5 Million	Mining and primary processing of non-renewable national resources	Industrial undertaking in, <ul style="list-style-type: none"> <li>○ any industry manufacturing arms, ammunitions, explosives, military vehicles and equipment aircraft and other military hardware;</li> <li>○ any industry manufacturing poisons, narcotics, alcohols, dangerous drugs and toxic, hazardous or carcinogenic materials; and</li> <li>○ any industry producing currency, coins or security documents.</li> </ul>
Coastal fishing	Timber based industries using local timber	Large scale mechanized mining of gems
	Deep sea fishing	Lotteries
	Mass Communication	
	Education	
	Freight forwarding	
	Travel agencies	
	Shipping agencies	

Such persons and entities are also granted general permission to engage in investment in debt securities or granting of loans with tenure of 3 or more years to companies incorporated in Sri Lanka either in foreign exchange or Sri Lankan rupees.

Investment in shares in Sri Lankan companies, investment in debt securities or granting of loans pursuant to the aforesaid general permission must be carried out through a special bank account (maintained in Sri Lankan Rupees or certain other designated foreign currencies) opened with a licensed commercial bank in Sri Lanka, in the name of the relevant investor, known as a 'Inward Investment Account' (IIA). All income received from such investments and proceeds of disposal of the investments (including dividends, sales proceeds, capital redemption etc.) must also be remitted out of Sri Lanka through the same IIA.

### Overseas Companies

When establishing a place of business in Sri Lanka, known as an 'overseas company' under the Companies Act, such an entity may carry on;

- any commercial, trading, or industrial activity; or
- any non-commercial, non-trading, or non-industrial activity such as activities undertaken or carried on by a liaison office, representative office, regional office or other similar office provided such activities do not provide any income directly or indirectly to the company.

An overseas company operating a place of business such as a branch office, project office, or other similar office are required to invest a minimum of USD 200,000 (or an equivalent amount in other designated foreign currencies), channeled through an IIA. Further, the proof of such remittance should be given to the Department of Registrar of Companies within thirty days (30) of registration of the overseas company.

In the case of a place of business such as a liaison office, representative office, regional office or other similar office, the investment requirement is only limited to funds required for the setting up and maintenance of such place of business. Similarly, such investment is required to be channeled through an IIA.

## Taxation

Income tax in Sri Lanka is charged in accordance with the provisions of the Inland Revenue Act No. 24 of 2017 (IRA).

### Individuals

Individuals will be permitted a tax-free income of LKR 500,000 for any year of assessment (YOA), which will be increased to LKR 700,000 in respect of employment income. Income tax is thereafter chargeable based on progressive slabs from four percent (4%) (for the first LKR 600,000 of taxable income) to twenty-four percent (24%) (for any taxable income exceeding LKR 3Mn).

### Companies

Corporate income tax has been simplified to 3 rates:

- a concessionary fourteen percent (14%) for SME's, exporters, agricultural businesses, tourism businesses, educational service providers, and IT services;
- forty percent (40%) for the betting & gaming, liquor and tobacco industries; and
- twenty eight (28%) for all others.

## Capital Gains Tax

'Capital gains tax' (which is in effect a limited income tax on the gains on the realisation of certain investment assets) applies at the rate of ten percent (10%) on the relevant gains.

There are, however, some exemptions:

- gains from the realisation of shares listed on the CSE;
- gains made by resident individuals which do not exceed LKR 50,000 per transaction, and LKR 600,000 per YOA;
- gains made by a resident individual from the disposal of his/her principal residence (provided the residence was owned by the said individual for 3 consecutive years prior to the disposal and he/she lived in the property for at least 2 of those years); and
- gains made from the disposal of shares of an offshore company where a resident company in Sri Lanka holds 10% or more of the equity or voting shares.

## Withholding Taxes

Withholding taxes will also apply to certain qualifying payments which have a source in Sri Lanka and are made to resident or non-resident persons (including dividends and other distributions to shareholders of companies incorporated in Sri Lanka, profit remittances by registered overseas companies, royalties, management or technical fees, interest on loans and corporate debt securities etc). While the general rate is fourteen percent (14%), concessionary rates are applicable to certain payments (such as interest and rent payments).

## Other Taxes

Other applicable direct and indirect taxes include Value Added Tax (VAT), Economic Service Charge (ESC), Nation Building Tax (NBT), Stamp Duty, Share Transaction Levies, Betting and Gaming Levies, and Construction Industry Guarantee Fund Levies.

## Investment concessions

There are enhanced capital depreciation allowances, ranging from 100% to 200%, made available for certain expenses (which must, for any particular YoA, aggregate amount to more than USD3 Million) in depreciable assets (excluding intangibles). These are provided as investment incentives.

## DTAAs and FTAs

Sri Lanka is party to a number of bilateral agreements for the elimination or minimization of the effects of double taxation, including with Australia, Bangladesh, Belgium, Canada, China, Denmark, France, Finland, Germany, Hong Kong, India, Indonesia, Iran, Italy, Japan, Korea, Kuwait, Malaysia, Mauritius, Nepal, Netherlands, Norway, Oman, Pakistan, Philippines, Poland, Qatar, Romania, Russia, Saudi Arabia, Singapore, Sweden, Switzerland, Thailand, UAE, UK, USA, Vietnam, Seychelles, Belarus, Palestine and Luxembourg. Sri Lanka is also party to a (limited) multilateral agreement among the South Asian Association for Regional Cooperation (SAARC) countries on double taxation avoidance and administrative assistance in tax matters.

Sri Lanka also has entered into free trade agreements with India, Pakistan and Singapore, and is also party to a number of multilateral trade agreements including the South Asian Free Trade Area (SAFTA) agreement and the Asia Pacific Trade Agreement (APTA).

## Property

Under the Land (Restrictions on Alienation) Act No. 38 of 2014 (as amended), transfers of freehold title to land in Sri Lanka to foreign persons (including foreign companies), or companies incorporated in Sri Lanka, where the foreign shareholding is 50% or more, is (except in certain limited circumstances) prohibited.

Entities engaged in banking, financial, insurance, maritime, aviation, advanced technology or infrastructure development projects which have been designated as 'strategic development projects' under the Strategic Development Projects Act No. 14 of 2008 (as amended) (**SDPA**), as well as foreign companies engaged in international commercial operations which seek to purchase land to locate or relocate their global or regional operations, or set up branch offices, may be able to apply for exemptions from this prohibition.

There are no restrictions however on foreigners (including foreign companies) or companies incorporated in Sri Lanka which have 50% or more foreign shareholding, leasing land (subject to the maximum tenure of each such lease not exceeding 99 years).

## Special Concessions

### **BOI Section 16 and section 17 companies**

The Board of Investment of Sri Lanka (**BOI**) is a public corporation established by the Board of Investment of Sri Lanka Law No. 4 of 1978 (as amended) (**BOI Law**). Its primary objects are *inter alia*, to

- (a) foster and generate the economic development of Sri Lanka;
- (b) widen and strengthen the base of the economy of Sri Lanka;
- (c) encourage and promote foreign investment within Sri Lanka;
- (d) diversify the sources of foreign exchange earnings and to increase export earnings; and
- (e) encourage and foster the establishment and development of industrial and commercial enterprises within Sri Lanka.

To enable it to carry out its objects, the BOI is conferred by law with certain powers including *inter alia*, the power to give incentives concessions and privileges.

Accordingly, the BOI gives various fiscal incentives and concessions (including exemptions from certain laws including the FEA and the Customs Ordinance) to enterprises that meet certain investment criteria. These fiscal incentives and concessions are granted by the entering into an agreement under section 17 of the BOI Law by the BOI with the enterprise to which it has granted such incentives and concessions. The BOI also enters into agreements under section 16 of the BOI Law, where the quantum of the foreign investment is at least US\$250,000; these entities are not entitled to any fiscal incentives and concessions, but the BOI provides certain facilitation services (including coordinating with other Government entities in procuring residency visas for the investors etc., and importing capital machinery and other goods).

## Strategic Development Projects

Under the Strategic Development Projects Act No. 14 of 2008 (as amended) (**SDPA**), certain large scale projects which are designated as ‘strategic development projects’ by the Government, may obtain exemptions of up to 25 years from the applicability of certain laws, including the Inland Revenue Act, Customs Ordinance, Value Added Tax Act, Economic Service Charge Act, and the Finance Act. These exemptions are granted primarily to provide (substantial) fiscal benefits and concessions to the enterprises engaging in the said projects.

The BOI is the primary agency for assessing whether a particular project qualifies as ‘strategic development project’, which is defined in the SDPA as “*a project which is in the national interest and which is likely to bring economic and social benefit to the country and which is also likely to change the landscape of the country, primarily through—*

- (a) the strategic importance attached to the proposed provision of goods and services, which will be of benefit to the public;*
- (b) the substantial inflow of foreign exchange to the country;*
- (c) the substantial employment which will be generated and the enhancement of the income earning opportunities; and*
- (d) the envisaged transformation in terms of technology.”*

## Investment Protection

Sri Lanka has entered into agreements for the promotion and protection of foreign investments with a number of countries, including China, France, Malaysia, Germany, India, Indonesia, Italy, Japan, Singapore, UK and the USA. Most of these agreements have been ratified by Parliament and have the force of law in Sri Lanka. Sri Lanka is also a member of the Multilateral Investment Guarantee Agency (**MIGA**), a member of the World Bank Group. MIGA provides political risk insurance and credit enhancement guarantees to assist investors to hedge political and non-commercial risks in developing countries.

**FOR FURTHER INFORMATION, PLEASE CONTACT:**

**Sudath Perera**

Founder-Managing Partner

E: [sudath@sudathpereraassociates.com](mailto:sudath@sudathpereraassociates.com)

T: +94 11 7559944 (extension 311, 302)



**Dushyantha Perera**

Partner - Head of Investments, Mergers & Acquisitions

E: [dushyantha@sudathpereraassociates.com](mailto:dushyantha@sudathpereraassociates.com)

T: +94 11 7559944 (extension 377)



**Himani Perera**

Partner - Head of Intellectual Property

E: [himani@sudathpereraassociates.com](mailto:himani@sudathpereraassociates.com)

T: +94 11 7559944 (extension 315)



**Dharshika Herat-Gunaratne**

Partner – Conveyancing, Property & Construction Law


E: [darshi@sudathpereraassociates.com](mailto:darshi@sudathpereraassociates.com)

T: +94 11 7559944 (extension 260)



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