

DOING BUSINESS

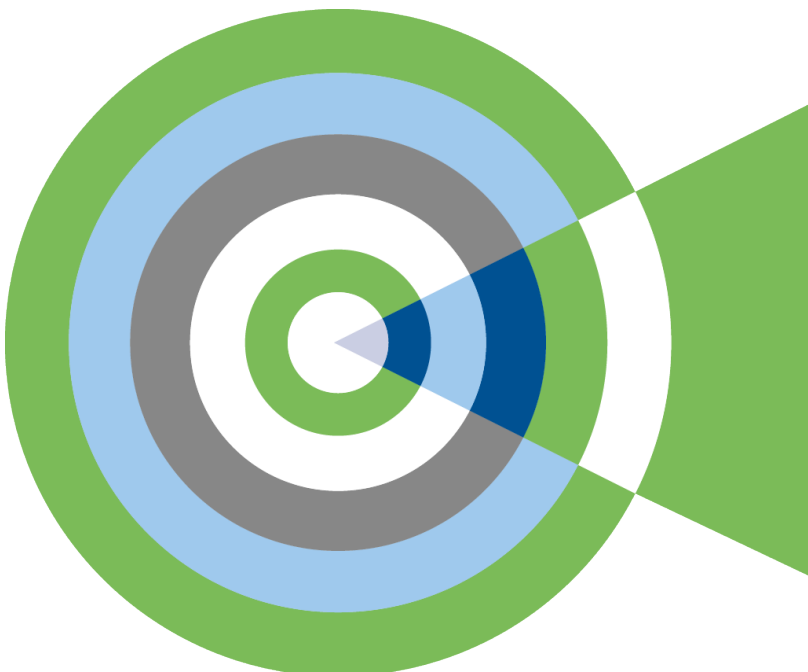
IN SRI LANKA



The network
for doing
business

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1 – INTRODUCTION

UHY is an international organisation providing accountancy, business management as well as consultancy services through financial business centres in over 100 countries across the world.

Business partners work simultaneously within the network to perform transnational operations for the clients as well as to offer expert knowledge and proactive support within their specific national boundaries. Furthermore, the availability of International Consultation specialists from various industries and market sectors makes up the total solution package that the organization provides.

This detailed report provided by the office of UHY representatives provides significant issues and information for investors considering business operations in Sri Lanka:

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Information in the following pages has been up-to-date so that they are effective at the date shown, but inevitably the provided information is general and subjected to changes and should be only used for guidance purposes. During specific matters, investors are strongly advised to obtain further information and take relevant professional advice when it comes to decision making. This publication is current in November 2020.

We look forward to help you manage your business effectively and support you actively to stay ahead of the competition in Sri Lanka.

2 – BUSINESS ENVIRONMENT

BACKGROUND

Sri Lanka is an island located at the south of the Indian sub-continent known earlier as Ceylon and for many centuries as the pearl of the Indian Ocean, was separated from India by a few nautical miles along the narrow Palk Straits and is located at the north of the east-west international shipping corridor in the Indian Ocean.

As the first country that embarked towards economic reform in South Asia in 1977, Sri Lanka offers a variety of opportunities for business and investment. Emerging from three decades of internal conflict, the country's economic fundamentals have improved prominently and at present, it experiences sustained levels of good economic growth.

Sri Lanka's economic freedom score is 56.4, making its economy the 115th freest in the 2019 Index. Its overall score has decreased by 1.4 points, with a steep decline in the score for judicial effectiveness outweighing an improvement in fiscal health. Sri Lanka is ranked 25th among 43 countries in the Asia-Pacific region, and its overall score is below the regional and world averages.

Although economic expansion continues, political and economic uncertainties worry investors. Sri Lanka's sizable external debt and twin current and fiscal account deficits signal very weak macroeconomic fundamentals. To maintain growth, the government must service high levels of debt out diminished tax receipts while simultaneously reducing the bloated public sector and lowering historically high budget deficits; it requires better management of public finances and additional structural reforms to improve the business climate. A weak judiciary continues to undermine property rights, and perceived corruption is debilitating high.

POPULATION

The population of Sri Lanka is estimated to be 21.9 million in 2020 with the densest areas lying in the urban areas such as the capital, Colombo, and other large cities that are also the industrial and economic hubs of the country. It is growing at a rate of 0.42% annually and houses people from many different ethnicities and religions, which gives the country a multi-cultural and multi-ethnic identity.

GEOGRAPHY

Sri Lanka an island in the Indian Ocean, is separated from India by the Palk Strait, a 48km wide stretch of water. The total land area is 65,525 km with internal waters being 1,570 km. Most of the island is low-lying yet astonishingly varied. A length of 435km and breadth of 240km encompass beautiful tropical beaches, verdant vegetation, ancient monuments and a thousand delights to please all tastes. The relief features of the island consist of a mountainous mass somewhat south of the centre, with a height exceeding 2,500 metres, surrounded by broad plains. The mountainous region of the island is gifted with around 100 waterfalls while giving birth to numerous rivers, of which the longest at 335km. Palm-fringed beaches surround the island and the sea temperature rarely falls below 27°C.

Sri Lanka generally offers warmth and sunshine throughout the year. Temperatures average between 27°C–30°C in Colombo and coasts, and peak in April. They average about 10°C cooler in the hill country. Sri Lanka lies 400 miles north of the equator and is affected by two Southeast Asian monsoons. The Southwest monsoon brings most rain to Colombo and the south and west coasts in May and June. The inter-monsoon affects the months of October and early November, although at all times of year sunshine is plenty and at most time's rain falls in heavy bursts at night. The Northeast monsoon affects the North and East between December and February. Rainfall is becoming increasingly unpredictable. On average it varies from 1000mm (39in) - 5,000mm (197in) throughout the year. The North and East are dry, while the western slopes of the central highlands are considered wet. Humidity ranges between 70%–90% in Colombo, lowering the highlands and cultural triangle.

CURRENCY

The monetary unit in Sri Lanka is the Rupee, which consists of 100 Cents (approx. USD 1 = Rs. 181.65 in January 2020). The currency code for Rupees is **LKR**, and the currency symbol is **Rs.**

LANGUAGE

Sri Lanka is a diverse and multicultural country with many religions, ethnic groups, and languages. In addition to the majority Sinhalese, it is home to large groups of Sri Lankan and Indian Tamils, Moors, Burghers, Malays, and the aboriginal Veddahs.

The first language of the Sinhalese is Sinhala, which is an Indo-European language, and for the Tamils, the first language is Tamil. Tamil is also the first language for most Moors as well. Malays speak Malay, and Indo-Portuguese is spoken by many of the Burghers, although its use has declined and the majority now speaks Sinhala. English is widely spoken and is the main language used by the business community.

MAJOR EXPORTS

Earnings from merchandise exports continued its growth in 2019, albeit marginally, amidst heightened domestic and external vulnerabilities. Earnings from merchandise exports increased at a higher rate during the first half of the year, but decelerated thereafter, limiting the year-on-year export growth to 0.4 per cent. Accordingly, earnings from merchandise exports recorded US dollars 11,940 million in 2019 in comparison to US dollars 11,890 million in 2018.

Earnings from industrial exports, which accounted for around 79 per cent of total export earnings, increased in 2019, predominantly supported by the growth in exports of textiles and garments. Accordingly, industrial exports increased by 1.8 per cent to US dollars 9,426 million in 2019 from US dollars 9,258 million in 2018. Being the largest contributor to exports, earnings from textiles and garments increased by 5.2 per cent to US dollars 5,596 million in 2019. Earnings from garment exports to the USA in 2019 increased by 3.0 per cent to US dollars 2,338 million. Garment exports to the EU also showed an increase of 4.9 per cent to US dollars 2,153 million, benefitting from the restoration of the GSP+ facility, while the UK, being the largest single buyer within the EU, accounted for US dollars 747 million. In addition, Italy, Germany, Belgium, and the Netherlands in the EU as well as Canada, Australia, China, India, and Japan, were among the largest buyers of Sri Lankan garments in 2019. Earnings from textiles and made-up textile articles also increased in 2019 due to increased demand from India, the UK, the USA, Germany, and Pakistan. Meanwhile, export earnings from gems, diamonds and jewellery grew by 10.0 per cent to US dollars 306 million in 2019, recovering from the low amount of export earnings recorded in 2018.

Earnings from transport equipment increased by 21.3 per cent to US dollars 146 million, with a significant increase in export earnings from ships, boats and floating structures, reflecting mainly the supply of a naval craft to Japan. Earnings from chemical products exports also increased by 5.7 per cent, driven by exports of activated carbon.

Further, export earnings from base metals and articles increased by 6.7 per cent, mainly due to the increase in export earnings from iron and steel and articles. Earnings from animal fodder increased, driven by exports of residues from food industries, while earnings from printing industry products increased with exports of currency notes. In contrast, earnings from petroleum products exports, which mainly comprise bunker and aviation fuel, declined by 16.2 per cent to US dollars 521 million in 2019. Lower export volumes driven by the high competition between bunkering ports in the region and cancellation of several flights following the Easter Sunday attacks as well as lower prices caused the decline in export earnings from bunker and aviation fuel. Exports of other petroleum products, including lubricants and petroleum bitumen, also declined in 2019. Despite the increase in earnings from rubber glove exports, earnings from rubber product exports declined by 1.1 per cent to US dollars 866 million during 2019, driven by lower tyre exports. Earnings from machinery and mechanical appliances exports declined by 8.0 per cent to US dollars 400 million due to low export earnings from most subcategories, despite higher export earnings from machinery and equipment parts. In addition, earnings from food, beverages and tobacco exports declined, led by lower manufactured tobacco exports, while all exports of subsectors under leather, travel goods and footwear also declined during 2019

MAJOR IMPORTS

Following the policy measures implemented by the government and the Central Bank to dampen non-essential imports during the latter part of 2018, the expenditure on merchandise imports declined considerably in 2019, reversing the growth trend observed in the preceding three years. Accordingly, expenditure on imports declined by 10.3 per cent to US dollars 19,937 million in 2019 from US dollars 22,233 million in 2018. Lower expenditure on consumer goods and intermediate goods mainly contributed to the decline in imports in 2019, while expenditure on investment goods also declined marginally.

Meanwhile, import expenditure, excluding fuel imports, declined by 11.3 per cent to US dollars 16,045 million in 2019. Import expenditure on intermediate goods, which accounted for 57 per cent of total imports, declined by 9.0 per cent to US dollars 11,370 million in 2019 in comparison to the previous year. Expenditure on fuel imports declined by 6.3 per cent to US dollars 3,892 million in 2019 due to the drop in import prices of all subsectors; crude oil, refined petroleum, and coal as well as the import volume of refined petroleum. In line with the reduction in oil prices in the international market, the average crude oil import price declined to US dollars 68.80 per barrel in 2019 from US dollars 76.25 per barrel in 2018. Expenditure on diamonds, precious stones and metals imports exhibited a considerable decline due to the reduction in gold imports during 2019, following the imposition of customs duty of 15 per cent on gold imports in April 2018. Import expenditure on base metals declined by 17.6 per cent in 2019, driven by lower iron and steel imports.

Expenditure on wheat imports declined due to lower import volumes, despite the growth in average wheat import prices, while expenditure on fertiliser imports declined, led by lower import volumes of Urea. Most other subcategories of intermediate goods imports, including plastic and articles thereof, chemical products, paper and paperboard and articles thereof, food preparations, rubber, and articles

thereof, and vehicle and machinery parts, also showed a declining trend. However, expenditure on textiles and textile articles, driven by fibre and fabrics imports, increased in 2019, in line with the increased exports of textiles and garments. Besides, expenditure on mineral products imports increased, led by the substantial increase in cement clinker during 2019 compared to the previous year. Expenditure on consumer goods imports, which accounted for about 20 per cent of total imports, declined substantially with the decline in expenditure on both food and beverages and non-food consumer goods.

Accordingly, expenditure on consumer goods imports declined by 20.5 per cent to US dollars 3,957 million in 2019 compared to US dollars 4,980 million in 2018. Import expenditure on food and beverages declined by 11.2 per cent, as a result of lower imports of main food categories except for seafood, vegetables, and spices. Expenditure on rice imports, which is categorised under cereals and milling industry products, declined significantly due to lower import volume in 2019 compared to 2018. Accordingly, the volume of rice imports declined to 24 million kilograms in 2019 from 249 million kilograms in 2018, led by an improved domestic paddy harvest in 2019. The considerable decline in import volumes of sugar and average import prices led the expenditure on sugar and confectionery imports to decline by 19.4 per cent in 2019. Further, expenditure on dairy products declined by 6.1 per cent in 2019, led by lower import volumes of milk powder, despite a marginal increase in average import prices of milk powder. In addition, expenditure on imports of oils and fats led by coconut oil, fruits, led by processed fruits, and beverages led by alcoholic beverages imports also declined in 2019 when compared to 2018. However, expenditure on seafood imports increased by 8.8 per cent to US dollars 215 million in 2019, led by increased imports of canned fish. Also, expenditure on vegetable imports increased with increased expenditure on garlic, masoor dhal, big onion and potatoes, while expenditure on spices increased moderately, as a result of higher import prices of chillies in 2019.

The deficit in the trade account, which expanded continuously for the previous five years, contracted substantially in 2019. This was due to lower expenditure on imports resulting from policy measures taken to curtail non-essential consumer goods during the latter part of 2018 as well as the marginal increase in earnings from exports. Accordingly, the trade deficit contracted considerably by US dollars 2,346 million to US dollars 7,997 million in 2019 compared to US dollars 10,343 million in 2018. This was the lowest deficit since 2013. The trade deficit as a percentage of GDP contracted to 9.5 per cent in 2019 from 11.7 per cent in 2018.

EDUCATION – PRIMARY AND SECONDARY

Literacy rates and educational attainment levels rose steadily after Sri Lanka became an independent nation in 1948. Schooling is compulsory for children from 5 to 13 years of age. Education is state-funded and provided free of charge at all levels, including the university level. The government also provides free textbooks to school children. The language of instruction is either Sinhala or Tamil. English is taught as a second language. Several International Schools function in Sri Lanka for foreign expatriates and offer British and American systems of education.

As at now, there are 10,390 government schools as well as 33 non-fee-levying private schools and 33 fee-levying autonomous private schools which offer the local syllabus as well as the British system. Besides, there is another category of English medium International Schools approved and registered by the Board of Investment, Sri Lanka. Some international schools offer the curriculum for the IB Diploma while others

coach students for the Edexcel G.C.E Ordinary Level (O/L) Advanced Subsidiary (A/S) and Advanced Level (A2) examinations. A few schools offer the curriculum for the Cambridge Examinations as well.

TERTIARY EDUCATION

Sri Lanka has 15 universities, all of which are public institutions. Other institutions of higher education include medical schools, engineering schools, schools of law, and technical and vocational training schools and National Colleges of Education.

Admission at the undergraduate level to these public universities are based solely on the results of the G.C.E. (A/L) Examination and the Z-score. Due to the restricted facilities, admissions have become extremely competitive thus only 6% of the students who sit the examination are admitted to the universities. Combined with the fact that those who take the British examinations are not permitted to apply for the University admissions, an increasing number of students are seeking for opportunities to continue their higher studies abroad.

HEALTH CARE SYSTEM

Sri Lanka has over the years built high-quality primary healthcare systems. The Sri Lankan Government strives to provide the best healthcare for its citizens, partnering with both public and private enterprises.

The Public sector under the Ministry of Health operates the largest number of hospitals (593) in Sri Lanka. Consequently, the public sector dominates the inpatient segment.

While the public sector operates almost 3 times as many hospitals as the private sector, healthcare expenditure directed towards the private sector accounted for almost 55% of total healthcare expenditure.

The private sector caters majority of outpatients (60%) and currently only addresses one-tenth of inpatient numbers in the country. There are approximately 197 private hospitals distributed island wide.

Sri Lanka Ayurvedha Service providers attract patients from Germany, Austria Italy and other countries, the CIS region, the Middle-East and Eastern Asia such as Japan and China. Sri Lanka Private Medical service providers attract patients from Maldives and other countries for dental care, cosmetic surgeries, and other surgeries.

COMMUNICATIONS

The country has developed its telecommunications industry on par with the developed country standards. As a result of the pertinent regulatory initiatives, the local telecommunications sector has taken pride in being the prime figure to introduce some of the latest global telecommunications technologies in the South Asian Region.

Sri Lanka has facilitated some of the most advanced technologies in the world such as GSM, 3G, 3.5G and HSPA (High-Speed Packet Access) which allows high-speed mobile broadband. Sri Lanka is also the first country to introduce Next Generation Networks such as 4G, which would enable the use of WiMAX (Worldwide Interoperability for Microwave Access) and LTE (Long Term Evolution).

- Southeast Asia - Middle East - Western Europe 5 (SEA-ME-WE 5) state-of-the-art submarine cable system that will link 17 countries, have a landing point located in Sri Lanka. The 1st of February, 2016 marked the arrival of this multi-regional superhighway by the opening of the - cable-landing station building for the SEA-ME-WE 5 in Southern Sri Lanka
- The new cable will assist Sri Lanka in achieving its 'SMART 2020' digital society goals and promoting
- Sri Lanka as a preferred destination in the region for data centre operation

BANKING AND FINANCIAL SERVICES

Central Bank of Sri Lanka is the monetary authority of the country, the sole bank of issue, which also acts as a financial adviser to the government and administers the monetary policy.

The financial system remained resilient without causing major macroprudential concerns, though the performance of the sector, in terms of expansion, credit quality and profitability were moderated during the year. The financial sector expansion and performance slowed down during the year 2019 compared to the previous year mainly due to subdued economic activities and the uncertainty caused by the Easter Sunday attacks and the political instability which prevailed during the year. The credit quality of the deposit-taking financial institutions as reflected by the Non-Performing Loans (NPL) ratio deteriorated in 2019. However, banks and other deposit-taking financial institutions, the major segment of the financial sector, exhibited resilience amidst a challenging business environment prevailed both global and domestic contexts, by maintaining capital and liquidity well above the regulatory minimum requirements. Timely and appropriate regulatory and supervisory measures assured the overall stability of the financial system without causing any major macroprudential concerns during the year.

The banking sector continued to expand at a slower pace during the year compared to the previous year while exhibiting resilience amidst a challenging business environment. The banking sector dominated the financial sector accounting for 62.1 per cent of total assets in the financial system at the end of 2019. Credit growth of the banking sector, which moderated during the first half of the year largely due to the lack of demand for credit, displayed signs of recovery towards the second half of 2019. Deposits continued to be the dominant source of financing for the sector, while a decline in borrowings was observed during the year. The banking sector profitability declined compared to the previous year due to deteriorating asset quality, rise in operating costs and increase in taxes. However, the banking system-maintained capital and liquidity well above the regulatory minimum requirements, demonstrating the resilience of the sector.

By end-2019, the banking sector comprised 32 banks i.e. 26 licensed commercial banks (lcbbs), and 6 licensed Specialised banks (lSbs). The 26 lCBs include 13 branches of foreign banks. Out of these, 2 branches of foreign banks had commenced closing procedures based on decisions taken by their head offices. Further, Lankaputhra Development Bank Limited was merged with Pradeshiya Sanwardana Bank, while Sri Lanka Savings Bank Limited was acquired as a subsidiary by the National Savings Bank during the year. The banking sector continued to support the financial intermediation of the economy by enhancing banking services and expanding the banking network, thereby promoting financial inclusion.

In 2019, several banks introduced technology-based products/services to facilitate financial inclusion. Further, 42 bank branches and 564 ATMs were established during 2019, while 11 bank branches and 13 ATMs were closed. Accordingly, the total number of banking outlets and ATMs had increased to 7,387 and 5,571, respectively, by end-2019. The asset base of the banking sector increased by USD 3.95 billion or 6.2 per cent during the year and surpassed USD 67.57 billion by end-2019, whereas the growth rate recorded in 2018 was 14.6 per cent.

The challenging business environment resulting from the Easter Sunday attacks in April 2019 and political uncertainties that prevailed in the year 2019 led to a lower demand for credit resulting in a lower credit growth which contributed to the decline in assets growth. Growth in loans decreased significantly from 19.6 per cent in 2018 to 5.6 per cent during the year 2019. Of this 5.6 per cent loan growth, 77.0 per cent could be attributed to the increase in rupee loans. Increase in lending was largely diversified across major sectors of the economy. In terms of products, rescheduled loans (102.2 per cent), pawning (17.0 per cent) and credit cards (15.3 per cent) were the main products that reported higher growth during 2019.

Meanwhile, term loans, despite being the product with the highest increase in terms of value (USD. 1.20 billion) during the year, recorded only a 5.0 per cent growth due to the high base effect. Lower demand for credit than other years resulted in more funds of banks to be directed towards investments. As a result, year-on-year growth in investments increased considerably from 4.6 per cent as at end-2018 to 12.2 per cent as of end-2019. The held-to-maturity portfolio grew by 18.1 per cent during 2019 with increases in Treasury bills, Treasury bonds and Sri Lanka Development Bonds (SLDBs) by USD 660 Million, USD 778 million, and USD 616 million, respectively. However, investments in the trading portfolio contracted by 7.3 per cent during 2019 with investments in SLDBs decreasing by USD 627 million, offsetting the increase in investments in Treasury bills and Treasury bonds of USD 282 million and USD 122 million, respectively.

TRANSPORTATION LINKS

The country is positioned at the traffic circle of major shipping routes linking South Asia, the Far East and the Pacific with Europe and America, and is well located next to the fast-growing Indian sub-continent with proximity to Southeast Asia and the Middle East. Sri Lanka has strong air connectivity with over 100 weekly flights to India alone.

The country is also connected to the SEA-ME-WE III and IV (South East Asia – Middle East – Western Europe) fibre optic communication backbone with over 11 communication satellites orbiting above the southern part of the country

Further, our access to key markets providing duty-free access to over 1.3 billion consumers from the island, Sri Lanka is the only nation to have free trade agreements with both India and Pakistan. In the year 2000, as an outcome of the Indo-SriLanka Free Trade Agreement (ISFTA), Sri Lanka got strategic access for over 4,200 products at zero duty to India, which is the world's second-most populous market.

Also, in 2005, the Pakistan – Sri Lanka Free Trade Agreement (PSLFTA), provided strategic access from Sri Lanka for nearly 4,500 products duty-free from 2008, to the Pakistan market.

Bilateral trade between Sri Lanka and India has grown more than 5 times and between Sri Lanka and Pakistan has grown 3 times since the agreements were signed. Moreover, by locating in Sri Lanka, a

company can also gain privileged trade access to two large regional blocs under the South Asian Free Trade Area (SAFTA) and the Asia–Pacific Trade Agreement (APTA).

HOLIDAYS LABOUR LAW

Wages Board Ordinance and Shop and Office Employees' Act are covered under laws relating to terms and conditions of employment. Wages Boards are bodies set up to ensure minimum wages and a few other conditions such as holidays, leave and overtime rates in respect of specified trades.

The Shop and Office Employees' Act applies to all employees within the definition of a “shop” or “office” and deals with five areas regulation of hours of employment in shops and offices: health and comfort of employees, payment of remuneration, regulation of remuneration, closing order for shops and general matters.

The employment of women young persons and children Act, the maternity benefits ordinance, and the employment of females in mines Act are amongst laws on welfare and the well-being of employees. Laws on social security of employees are addressed by three main mechanisms: employees' provident fund (EPF), employees' trust fund (ETF) and the gratuity fund. Such mechanisms enable employees to get financial benefits upon completion of a statutory period of service, change of employment or reaching the retirement age.

3 – FOREIGN INVESTMENT

Sri Lanka pioneered in South Asia's economic liberalization over three decades ago. The following transparent investment laws aim to foster foreign direct investments.

The Board of Investment Law No. 4 of 1978 and its amendments is the principal law applicable to foreign investments in Sri Lanka. BOI is structured to function as the Central Facilitation point for investors and empowered to enter into agreements with investors providing investment incentives of tax holidays, tax concessions and exemptions from customs duty & exchange control law.

FDI inflows, which include foreign borrowings of companies registered with the Board of Investment (BOI), declined significantly in 2019. Total FDI inflows, including foreign loans received by BOI companies, amounted to US dollars 1,204 million in 2019. FDI inflows in 2019 were less than the inflows of US dollars 2,139 million in 2018 (US dollars 1,457 million excluding the Hambantota port proceeds received by the government) and US dollars 1,910 million in 2017. The moderation in FDI inflows could be primarily attributed to the weakened investor sentiments with increased uncertainties in the aftermath of the Easter Sunday attacks and political developments. FDI inflows, excluding foreign loans to BOI companies, which amounted to US dollars 758 million, comprised US dollars 374 million of net intercompany debt, US dollars 264 million of reinvested earnings and US dollars 120 million of net investments in equity during the year 2019. In comparison, FDI, excluding foreign loans obtained by BOI companies, amounted to US dollars 1,614 million in 2018. A notable reduction in equity and intercompany borrowings was recorded in 2019 compared to the previous year.

However, there was a healthy level of reinvested earnings from a few large publicly listed FDI companies. On a sectoral basis, major FDIs were received by projects related to port infrastructure, property development and hotels and the telecommunications sector. Based on the origin of the immediate investor, India, Singapore, Canada, Hong Kong, and China were the top five source countries of FDI in 2019. Despite some moderation in FDI inflows in the near term, it is expected that the Hambantota industrial zone, the Colombo Port City, the hotel sector, and the mixed development sector will attract significant inflows in the coming years. The telecommunications sector is also expected to receive notable FDI flows, primarily targeting the development of the Information and Communication Technology (ICT) sector in Sri Lanka. It is also expected that the implementation of the Strategic Project Development Act (SPDA), as well as the recent revisions to the tax structure, will also provide impetus to attract FDIs. However, persistent issues such as relatively low ranking in the Doing Business Index, high wage rates and utility costs compared to regional peers, high costs of land acquisition, rigidity in labour laws and government procedures remain the main impediments in terms of attracting FDIs to the country.

INVESTMENT PROTECTION

Sri Lanka is one of the safest countries in the world to invest in, due to several mechanisms in place to protect investors. Article 157 of the island's constitution guarantees the safety of investment protection treaties and agreements approved by parliament by a two-thirds majority.

Sri Lanka has signed bilateral Investment Protection Agreements (IPA) with 28 countries. The country has a very independent system of courts that can redress any concerns of investors. Sri Lanka also has bilateral Double Tax Avoidance Agreements (DTAA) with 42 countries. Sri Lanka is a founder member of the Multilateral Investment Guarantee Agency (MIGA), an investment guarantee agency of the World Bank. This provides a safeguard against expropriation and non-commercial risks.

Sri Lanka has managed to improve a notch in World Bank's "Ease of Doing Business index" for 2020 to rank 99, up from 100th in 2019, out of 190 economies across the world. However, the country aims to be ranked among the top 70 nations of the doing business index by 2020. Sri Lanka promotes the following sectors for foreign direct;

- Maritime Sector
- Aviation sector
- Knowledge sector
- Energy sector
- Commercial hub related services
- Tourism sector
- Manufacturing sector
- Infrastructure
- Services sector (Utilities)
- Agriculture sector

4 – SETTING UP A BUSINESS

The government of Sri Lanka is providing more opportunities & facilities for foreign investors. Recently, Sri Lanka launched a one-stop online shop to help the foreign investor to obtain all official approvals. We, UHY Centra Management help foreign investors to set up a business in Sri Lanka and any other services such as audit, accounting, tax compliance, payroll compliance, visa & immigration services and business consultancy services.

OVERSEAS COMPANY

According to the prevailing law in Sri Lanka, any person residing outside Sri Lanka may engage to open a place of business in Sri Lanka, the permission granted for such a place of business governed by either one of the following laws in Sri Lanka;

UNDER BOARD OF INVESTMENT (BOI) IN SRI LANKA

The Board of Investment (BOI) is an autonomous statutory agency incorporated in 1978 and is the primary government authority responsible for foreign investments. The Board of Investment is structured to function as a central facilitating point for investors. The BOI Act provides for two types of investment approvals.

- a) Under Section 17 of the Act, the BOI is empowered to grant special concessions to companies satisfying specific eligibility criteria that are designed to meet the strategic economic objectives of the government. This mechanism grants concessions depending on the amount of investment brought to the country.
- b) Approval under Section 16 of the BOI Act permits foreign investment entry to operate only under the 'normal laws' of the country; that is, for such enterprises, the provisions of the Inland Revenue, Customs and Exchange Control Laws shall apply. To grant approvals and incentives, companies incorporated under the Companies Act are treated equally regardless of whether the shareholding is controlled by nationals or non-nationals. BOI promotes the following sectors as priority sectors for foreign direct investments:
 - Tourism and leisure
 - Infrastructure development
 - Knowledge services and utilities
 - Apparel manufacturing and export services
 - Agriculture and education
 - Promotes trans-shipment trading, international logistics services, operations of headquarters, offshore businesses.

FOREIGN EXCHANGE ACT, NO. 12 OF 2017

A person who resides outside Sri Lanka may engage in business as per the Gazette Notification No. 2045/56 issued on 17th November, 2017 of the Foreign Exchange Act No. 12 of 2017, subject to exclusion and limitation. As per the Foreign Exchange Act, no permission is granted in respect of shares of a company proposing to carry on or carrying on any of the following business;

- Money lending, pawn broking

- Retail trade with a capital of less than USD 5 million
- Coastal fishing
- Growing and primary processing of tea, rubber, coconut, and rice
- Mining and primary processing of non-renewable national resources
- Freight forwarding, shipping agency business and mechanized mining of gems

Further, foreign direct investments in the following businesses have a set upper limit of 40% of the stated/ issued share capital of the company.

- Production of goods where Sri Lanka's exports are subject to international quota restrictions
- Growing and primary processing of sugar, cocoas, and spices
- Timber based industries using local timber
- Deep-sea fishing, Mass communication, Education and Outbound travel agency business
- Local air transportation, Coastal shipping
- Any industry manufacturing or producing- arms, ammunition, explosives, military vehicles and equipment, aircraft, and other military hardware;
- Poisons, narcotics, alcohols, dangerous drugs, and toxics, hazardous or carcinogenic materials;
- Currency, coins, or security documents.

The following commercial, trading, industrial activities are not permitted for overseas companies;

- Money lending and pawn broking
- Retail trade with a capital of less than USD 5 million
- Coastal fishing
- Growing and primary processing of tea, rubber, coconut, and rice
- Mining and primary processing of non-renewable national resources
- Freight forwarding, shipping agency
- Mechanized mining of gems and lotteries

REGISTRATION OF AN OVERSEAS COMPANY

A company incorporated outside Sri Lanka and can be registered as an "Overseas Company" shall have the meaning as given in the Companies Act No. 24, of 2007. An overseas company registered as a branch office under the Companies Act, No. 24 of 2007, may carry out any commercial, trading or industrial activity, other than certain specified activities, provided that prior permission has been obtained from the government of Sri Lanka or any other authority, such as the Board of Investment of Sri Lanka established to permit foreign investments for the proposed activities.

However, an overseas company may undertake any non-commercial, non-trading or non-industrial activity, such as those undertaken or carried out by a liaison office, representative office, regional office, or other similar offices, provided such activities do not provide any income directly or indirectly to the company.

An overseas company can establish a "place of business" within Sri Lanka, commonly referred to as a branch office. Registration of a branch office requires the following documents to be filed with the relevant authorities:

- A certified copy of the charter, statutes or memorandum and articles of the company, or other instrument constituting or defining the constitution of the company
- A statement (Form 44) containing the full address of the registered or principal office of the company; and the principal place of business of the company within Sri Lanka
- A list of the directors of the company (Form 45) containing such particulars of the directors as required by the Act, in the register of the directors of a company
- The names and addresses (Form 46) of one or more persons residing in Sri Lanka, authorized to accept on behalf of the company service of documents and of any notices required to be served on the company
- Power of Attorney, authenticated by the company's seal, authorising a person or persons resident in Sri Lanka to act on behalf of the said company.

An overseas company registered under the Companies Act, No. 24 of 2017, may carry out any commercial, trading, or industrial activity, other than certain specified activities, provided that prior permission has been obtained from the government of Sri Lanka or any other authority, such as the Board of Investment of Sri Lanka established to permit foreign investments for the proposed activities.

On incorporation of the company, the Registrar of Companies will issue the Certificate of incorporation and a specified number will be given as a registration number of the company.

REGISTERING OF A LOCAL COMPANY WITH FOREIGN SHAREHOLDINGS

A business can be incorporated outside or foreign individuals can incorporate as a local company in Sri Lanka with foreign shareholding or as a subsidiary company. A company incorporated in Sri Lanka must comply with all statutory requirements imposed on domestic companies. We provide all advisory and business incorporation services.

COMPANY CAPITAL

An overseas company such as a branch office or project office engaged in permitted commercial, trading, or industrial activity need an initial investment of USD 200,000. This also applies to an equal amount in other designated foreign currencies. You'll have to record and maintain these funds in the company books until this company ceases its business in Sri Lanka.

A place of business such as liaison office, representative office or other similar offices shall remit the funds required for the maintenance of such place of business from abroad in designated foreign currency via Inward Investment Account (IIA).

TYPES OF COMPANIES

Any company or body corporate incorporated outside Sri Lanka can establish whose business has been granted permission for the Exchange Control Act, subject to the exclusions, limitations and conditions published in the Government Gazette No. 1232/14 of 19th April 2002; and

- **Private Companies** - A private company must consist of at least one and not more than fifty members. It must have at least one director. A private company cannot invite a public subscription for its shares.
- **Public Companies** - At least seven members are required to form a public company (there is no upper limit). It must have at least two directors. Public companies may invite public subscriptions for their shares or debentures and other securities, and can also be listed on the stock exchange. They cannot commence business without a business commencement certificate.
- **Offshore Companies** - A company registered within or outside Sri Lanka may register itself in Sri Lanka as an offshore company to carry on any business outside the shores of Sri Lanka. If a company registered outside Sri Lanka registers itself as an offshore company, it is deemed to have been incorporated in Sri Lanka. An offshore company cannot conduct any business in Sri Lanka
- **Subsidiaries** – To establish a business in Sri Lanka foreign companies can incorporate as a local subsidiary company. Following incorporation, a subsidiary in Sri Lanka must comply with all statutory requirements imposed on domestic companies.
- **Branch Office** - A company incorporated outside Sri Lanka may establish a place of business in Sri Lanka by registering a branch office with the Registrar of Companies.
- **Liaison/ Representative Offices** - Company incorporated outside Sri Lanka may maintain its presence in Sri Lanka through a representative office, and is of similar status to that of a branch office. It is, however, prohibited from engaging in any trading or investment activity or accruing any turnover in Sri Lanka. No tax incident arises since it is not permitted to trade. Therefore, the question of permanent establishment is not relevant.
- **Joint Venture Company** - A joint venture can be with other Sri Lankan companies or foreign entities. A joint venture business may be incorporated or carried on as an unincorporated business similar to that of a partnership. Joint ventures have become popular in recent years; particularly in export-oriented projects.
- **BOI Approved Investment** - The Board of Investment (BOI) of Sri Lanka is the primary agency responsible for approving private Foreign Direct Investment (FDI) as well as a local investment under the Board of Investment Law No. 4 of 1978 (BOI Law) and its amendments to invest in a permitted business activity either under Section 16 or Section 17 of the BOI Law.
 - ✓ If an investor meets the eligibility criteria stipulated under Section 17 project, the concessions including corporate tax concessions granted under the Inland Revenue Act of Sri Lanka, customs duty-free import of capital goods and raw materials (granted under the BOI Law) and exemption from Exchange Control Act.

- ✓ Foreign investors may obtain BOI approval to set up under Section 16 if the project does not fulfill the approval criteria requirements under Sec. 17 of the BOI Law. The approval under Section 16 of the BOI Law will operate under the normal laws of Sri Lanka and are not eligible for any of the special concessions provided under Section 17 of the BOI Law.

5 – LABOUR

The Sri Lanka Labour Force Survey Annual Bulletin 2019 published by the Department of Census and Statistics states that the economically active population of Sri Lanka is estimated at 8.5 million. Of that about 5.6 million (65%) are males and 2.8 million (35%) are females. Of which, about 46.0% are engaged in the Service sector, 28.7% in the Industries sector and 25.3% in the Agriculture sector.

Even though agriculture used to be the dominant contributor to Sri Lanka's economy, by now it is evident that the country's output is more driven by the service sector. This sector should be further advanced due to increasing internet penetration (32%) as well as the on-going investments towards infrastructure such as the Colombo Port City and Western Region (Megapolis) Development projects.

6 – TAXATION

INCOME TAX LAW

The Inland Revenue Act provides the legal authority to charge, levy and collect income tax on the profits and income of every person or partnership.

According to the Inland Revenue Act No. 24 of 2017, both resident and non-resident individuals are liable to pay taxes in Sri Lanka. An individual shall be deemed a resident in Sri Lanka for a year of assessment, resident individuals are taxed on their worldwide incomes while non-resident individuals are taxed only on Sri Lanka-source income. The source of incomes is;

- Employment Income
- Business Income
- Investment Income (rent, dividends, interest, discount, or annuities)
- Other Income (except profit of a casual and non-recurring nature)

COMPANY TAXATION

The following applies to tax-resident companies:

- A company shall be liable to tax separately from its shareholders.
- All business activities of a company shall be treated and as conducted in the course of a single company.
- Dividends distributed by a resident company shall be taxed in hands of the company's shareholders, while those of a non-resident company shall be included in calculating the income of the shareholders.

FOREIGN TAX CREDIT

A foreign tax credit may be claimed by a resident person (company) on any tax paid outside Sri Lanka in respect of profits and income arising outside of the country. Such credit should not exceed the amount of Sri Lankan tax payable in respect of such profits or income.

TAX RATES FOR COMPANIES

For any year of assessment, commencing on or after 1st April, 2020 a four-tier rate schedule applies as follows:

- A lower rate of 14% is applied for specific sectors
 - ✓ Small and Medium enterprises (as defined in section 195)
 - ✓ Specified undertaking (as defined in section 195)
 - ✓ Export, Tourism, Education, Medicare, Construction and Agro-processing
- Manufacturing sectors taxed at 18%
- A standard rate of 24% on the taxable income is applied for Trading, Banking, Finance, Insurance, etc.
- A higher rate of 40% applies in the case of a company with income from a business consisting of betting and gaming, liquor and/or tobacco

- 0% rate will be applied in respect of an institution in an international network relocating its headquarters or regional head office in Sri Lanka

The following incomes are exempted or concessionary rate of tax or concessionary period is introduced with effect from 2020/21

1. Tax on dividends of foreign companies for three years if such dividends are reinvested on the expansion of their businesses or in the money or stock market or Sri Lanka international sovereign bond.
 - Individuals and companies engage in farming, including agriculture, fisheries and livestock farming will be exempted from taxes in the next 5 years.
 - Earnings from both domestic and foreign sources by those engaged in business in Information Technology and enabling services and their earnings when made while being resident or non-resident will also be exempted from income taxes.
 - Profits earned from any service rendered in or outside Sri Lanka, including the income earned from any foreign source to any person to be utilized outside Sri Lanka if the payment for such service or income is received in foreign currency through a bank.
 - To promote the listing of local companies with the Colombo stock exchange, propose to provide a 50% tax concession for the year 2021/22 for such companies that are listed before 31st December, 2021 and to maintain a corporate tax rate of 14 % for the subsequent three years.
 - Gains from the realization of investment assets those gains, tax at 10%. To simplify the taxes on capital gains, where such taxes will be calculated based on the sale price of a property or the assessed value of a property whichever is higher.

WITHHOLDING TAX RATES

Any person (company), making a payment of income to a non-resident, shall pay a withholding tax at the prescribed rates: payments to non-residents where such payment has a source in Sri Lanka are treated as final withholding payments; Interest Payments -5% and any other payments -14%.

PARTNERSHIP TAXABLE INCOME

Partnership – required paying taxes on or before the 15th day of May at the end of the year of assessment. Entitled to Rs 1,000,000 relief per annum and the balance taxable income is liable to pay income tax at the rate of 6%.

FILING COMPLIANCE

Every company chargeable with income tax shall file a return of income not later than eight months from the end of the relevant year of assessment. All companies with a taxable income from the realisation of an investment asset should file a capital gains tax return no later than one month after the realisation of that asset.

PAYMENT COMPLIANCE

A person, who pays income tax in quarterly instalments basis, is required to pay such instalments according to the following schedules for the financial year ended 31st March:

- First three instalments: on or before 15th day of August, November, and February in that year of assessment; and
- Fourth instalment: on or before 15th May of the next succeeding year of assessment.

FOREIGN TAX CREDIT

A foreign tax credit may be claimed by a professional or another individual in respect of any tax paid outside Sri Lanka on profits and income earned outside Sri Lanka. The tax credit should not exceed the amount of Sri Lankan tax otherwise payable on such profits and income.

7 – ACCOUNTING & REPORTING

According to the Companies Act, No. 07 of 2007, every company shall keep accounting records which correctly record and explain the company's transactions, and will; at any time enable the financial positions of the company to be determined with reasonable accuracy and enable the directors to prepare financial statements in accordance with this Act and readily and properly be audited.

A company shall keep its accounting records in Sri Lanka. However, where the Registrar considers it not prejudicial to the national economy or the interests of shareholders of the company, he may permit a company to keep its accounting records outside Sri Lanka.

Further, corporate financial reporting requirements in Sri Lanka are outlined in several laws, which include the Companies Act No. 7 of 2007, Securities and Exchange Commission Act No. 36 of 1987, Banking Act No. 30 of 1988, Finance Business Act of 2012, Regulation of Insurance Industry Act No. 27 of 2011, Inland Revenue Act No. 24 of 2017, Microfinance Act No. 6 of 2016, Finance Act No. 38 of 1971, and Accounting and Auditing Standards Act No. 15 of 1995.

The Accounting and Auditing Standards Act No. 15 of 1995 requires specified business enterprises (SBE) to prepare financial statements in compliance with accounting standards as set by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). The institute has adopted the Sri Lanka Accounting Standards (SLFRS). SLFRS are developed based on the 2017 version of the International Financial Reporting Standards (IFRS) consolidated without early adoption, with modifications. CA Sri Lanka has also adopted IFRS for SMEs as SLFRS. Furthermore, the amendments to the existing IFRS along with new IFRS are being reviewed and adopted when available.

The Accounting and Auditing Standards Act No. 15 of 1995 stipulates mandatory audits for all SBEs. The act specifies that only Chartered Accountants (CAs), members of CA Sri Lanka with a Certificate to practice, are authorized to perform audits following auditing standards as set by CA Sri Lanka. Under the same legislation, CA Sri Lanka is also empowered to set auditing standards in the country and the institute has adopted the Sri Lankan Auditing Standards (SLAuS). SLAuS are developed based on the 2016 version of the International Standards on auditing with modifications due to local laws.

8 – UHY REPRESENTATION IN SRI LANKA



UHY CENTRA MANAGEMENT ASSOCIATES SRI LANKA



CONTACT DETAILS

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Colombo
Sri Lanka
Tel: +94 112 301 606
Fax: +94 112 301 608
www.uhycentra.com

CONTACTS

SOCIAL MEDIA CONNECTIONS

- LinkedIn: <https://www.linkedin.com/in/uhy-centra-management-srilanka-854978158/>

Year established: 2012
Number of partners: 2
Total staff: 36

ABOUT US

Redefining Excellence

BRIEF DESCRIPTION OF FIRM

UHY Centra Management Associates is a full member of Urbach Hacker Young (UHY) International Limited, established in 2012 which has become one of the leading Chartered Accounting (CASL) firms in Sri Lanka within a decade, offering diversified business advisory services. Currently, we operate with two offices, a corporate office in Colombo and a branch office in Kandy supported by highly motivated partners and with over forty professional employees focused on serving clients' needs with the utmost integrity. Our vision is "to be the leading business advisor and reliable business partner in Sri Lanka by working closely and together with our clients and our alliance partners". We are committed to the development of a professional practice that is well placed to provide a comprehensive scope of professional services to our clients and offer our staff the opportunity for personal advancement in a dynamic and exciting business environment.

SERVICE AREAS

Finance Services

SPECIALIST SERVICE AREAS

BPO Services
Business Advisory Service
Payroll & Visa Service
Government Sector Registration & Approvals
Staff Recruitment & Training
Finance due diligence & feasibility studies
Permanent establishment (PE) & Transfer Pricing
Legal services



The network
for doing
business



PRINCIPAL OPERATING SECTORS

Accounts & Audit
Company Incorporation & Approvals
Tax & Compliance Services

LANGUAGES

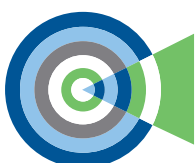
English
Sinhala
Tamil

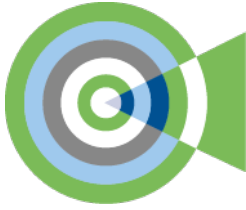
CURRENT PRINCIPAL CLIENTS

Agent for Dialog Axiata PLC
Agent for Dialog Axiata PLC (2)
Aluminium & Engineering, China
Computerized Graphics & Printing, Sri Lanka
Construction & Civil Engineering, China
Desing & Printing, Sri Lanka
Digital Printing, Sri Lanka
Eraeliya Villas & Gardens, Weligama
FB_IMG_1597854077452
IT Solutions, Worldwide
Leading Car Exporter, Japan
Member of TATA Housing, India
Mobile & Communication, Hong Kong
Office Space, SriLanka
Printing & Packaging, Sri Lanka
Printing and Media, Sri Lanka
Riding & Sports, Sri Lanka
Security & Safty, Sri Lanka
Sole Agent, SriLanka
Specialized Doors & Windows, China
Spices Exporters, Sri Lanka

BRIEF HISTORY OF FIRM

UHY Centra Management Associates is a member of UHY, global, is a fast-growing organization network of independent member firms, servicing a diverse portfolio of clients ranging from small-medium enterprises (SME) to large multinationals based in Sri Lanka, India, China, Singapore, Hong Kong, United Arab Emirates, Maldives, and Japan. Our provision of high-quality services lead us to be appointed as a full member of UHY global in 2018, and prior to being a member of UHY International, we operated under the brand name Centra Management which has been active since 2012. UHY Centra Management in Sri Lanka is being headed by three partner directors and supported by more than 40 staff members. Our head office is located in Colombo and we also have a branch under operation in Kandy.





LET US HELP YOU ACHIEVE FURTHER BUSINESS
SUCCESS

To find out how UHY can assist your business, contact any of our member firms. You can visit us online at www.uhy.com to find contact details for all of our offices, or email us at info@uhy.com for further information.

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