

# Transfer Pricing Country Summary

## Sri Lanka

September 2018

## Legislation

### Existence of Transfer Pricing Laws/Guidelines

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 "means a price which is applied in uncontrolled conditions in a transaction between persons other than associated undertakings". The Inland Revenue Department has issued specific regulations with respect to 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 where the aggregate value of international transaction is more than 100 million Sri Lankan rupees (LKR).

### Definition of Related Party

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 book value of the value of the total assets of the other undertaking;
- One undertaking guarantees not less than 25% of the total borrowings of the other undertaking;
- More than half of the board of directors or members of the governing board, or one or more executive directors or executive members of the governing board of one undertaking, are appointed by the other undertaking;
- More than half of the directors or members of the governing board, or one or more of the executive directors or members of the governing board, of each of the two undertakings are appointed by the same person or persons;
- The manufacture or processing of goods or article or business carried out by one undertaking is wholly dependent on the use of know-how, patents, copyrights, trademarks, licenses, 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;
- 90% 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;
- There is a mutual interest relationship between the two undertakings, as may be prescribed.

## Transfer Pricing Scrutiny

The Inland Revenue Department requires documentation to be maintained but does not specify any time frame.

## Transfer Pricing Penalties

Companies which violate the transfer pricing rules can be fined up to 2% of the total value of 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 accordingly.

Penalty of 250,000 rupees is given to companies which do not submit the required documents to the tax authorities. Penalty of up to 100,000 is imposed when the required documents have not been submitted on time.

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

The penalty related to income tax default and they are 10 percent for the first month and subsequently 2 percent for each of the subsequent months.

## Advance Pricing Agreement (APA)

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

## Documentation and Disclosure Requirements

### Tax Return Disclosures

No disclosures on transfer pricing are required in the return.

### Level of Documentation

The prescribed documentation includes:

- a description of the ownership structure of the assessee undertaking;
- a profile of the multinational or group of which the assessee undertaking is a part;
- a broad description of the business of the assessee and the industry in which the assessee operates, and of the business of the associated undertakings with whom the assessee has transacted;

- the nature and terms (including prices) of international or group transactions entered into with each associated undertaking;
- a description of the functions performed, risks assumed and assets employed or to be employed by the assessee and by the associated undertaking;
- a record of the economic and market analysis, forecasts, budgets or any other financial estimates prepared by the assessee for the business;
- as a whole and for each division or product separately, which may have a bearing on the transactions entered into by the assessee;
- a record of uncontrolled transactions taken into account for analyzing their comparability with the transactions entered into, including a record of the nature, terms and conditions relating to any uncontrolled transaction with third parties which may be of relevance to the pricing of the transactions;
- a record of the analysis performed to evaluate comparability of uncontrolled transactions with the relevant transaction;
- 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 carried out in determining the arm's length price, including details of the comparable data and financial information used in applying the most appropriate method, and adjustments, if any, which were made to account for differences between the transaction and;
- the comparable uncontrolled transactions, or between the undertakings entering into such transactions;
- the assumptions, policies and price negotiations, if any, which have critically affected the determination of the arm's length price;
- details of the adjustments, if any, made to transfer prices to align them with arm's length prices determined under these rules and consequent adjustments made to the total income for tax purposes.

## Record Keeping

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

## Language of Documentation

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 in English.

## Small and Medium Sized Enterprises (SMEs)

There is no specific transfer pricing regulation for SMEs.

## Deadline to Prepare Documentation

The law does not provide for any time frame to prepare documentation.

## Deadline to Submit Documentation

The law does not provide for any time frame to submit documentation. However, it needs to be submitted to the tax authorities within 30 days upon request.

## Statute of Limitations

The statute of limitations for transfer pricing is 5 years. No time limitation where return has not been filed or in the case of fraud, evasion, or willful default.

## Transfer Pricing Methods

The Inland Revenue Department has embraced the OECD Transfer Pricing international standards – the Arm's Length Principle. 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.

## Comparables

The Inland Revenue Department has not shown any preference for local comparables including databases.

**Note:** This document is for informative purposes only. We recommend that you consult a [professional](#) when applying its content to your company.