

SRI LANKA

TRANSFER PRICING LANDSCAPE

March 2006: Transfer pricing provisions were introduced for the first time in March 2006 under section 104 of the Inland Revenue Act (IRA) of Sri Lanka.

April 2008: Transfer pricing regulations were introduced by Gazette Notification No. 1546/10.

August 2013: Section 104 of the IRA was amended with effect from 1 April 2013.

Gazette Notification No. 1823/5 dated 12 August 2013 provides transfer pricing regulations with effect from 1 April 2013.

March 2015: Gazette Notification No. 1907/26 dated 25 March 2015 requires a certificate (from an approved accountant) containing the details of transactions with related parties to be furnished along with the Return of Income (effective from assessment year 2015-2016).



Introduction

Section 104 of the IRA empowers the Commissioner General (CG) to ascertain the arm's length price in any transaction entered into between two associated undertakings.

In case the income or loss has not been as ascertained with regard to the arm's length price, the CG may estimate the amount of the profit and income or the loss and make an assessment. Accordingly, the CG has powers to re-compute or adjust the income and may impose a tax liability on the undertaking.

In August 2013, transfer pricing regulations were published by the Finance Minister of Sri Lanka through a gazette extraordinary. As per the gazette, all international transactions between associated undertakings were required to be conducted on an arm's length basis.

Associated undertaking

An affiliated party covers relations arising out of capital participation, control or management, family relationships, etc. with a threshold as low as 20%. Furthermore, the definition goes beyond the ownership/control criteria to include the following purchase/sale transactions between unrelated parties if it exceeds 50% of total purchases/sales.

It also extends to intangible assets/intellectual property and company financing. Transfer pricing regulations in Vietnam also apply to domestic transactions between related parties.

Arm's length principle

The arm's length price has to be derived using any of the five internationally recognised methods, namely, the traditional transaction methods (comparable uncontrolled price, resale price and cost plus) and profit methods (profit split and transactional net margin).

The transfer pricing regulations do not give preference to any specific method or methods and taxpayers are free to choose the most appropriate method out of the five transfer pricing methods based on the facts and circumstances of each case (in line with the Organisation for Economic Co-operation and Development (OECD) guidelines).

Transfer pricing documentation

No specific format is prescribed for documentation but it should include the following information:

- Detailed description of the company (organisation structure, operational aspects, competitors, description of business environment, ownership structure, etc.);
- A profile of the multinational or group of which the company is a part along with certain details (such as name, address, business, etc.);
- Transaction details such as the nature and terms, quantum and value of each such transaction;
- Pricing policies and/or cost allocation policies;
- A description of the functions performed, risks assumed and assets employed by the company and by the associated undertaking involved in the transaction;
- Comparability analysis - Selection of comparables; and
- Application of transfer pricing methods selected by the taxpayer along with the reasons for rejecting the other methods.

Taxpayers (falling within the thresholds above) are required to keep contemporaneous documentation in English for demonstrating the arm's length nature of the related party transactions.

The record keeping (i.e. retention of the documentation) should be made for a period of five years from the end of the relevant year of assessment.

Exemptions and thresholds

Thresholds: Preparation of transfer pricing documentation is mandatory:

- in case cross-border related party transactions are in excess of LKR 100 million (approximately USD 680 thousand); and
- in case domestic related party transactions are in excess of LKR 50 million (approximately USD 340 thousand)

The threshold applies to the aggregated value of the transactions with an associated undertaking.

Exemptions: For cases where the aggregate value of intra-group transactions does not exceed the above identified limits, there is no requirement to prepare transfer pricing documentation.

However, taxpayers in such cases are required to substantiate the arm's length nature of related party transactions.

Selection of comparable data

For a comparability analysis, the taxpayer can use publicly available databases. Based on our experience, due to an absence of local databases, the Inland Revenue Department (IRD) has opted to use Indian or any other appropriate database, while appropriate adjustments need to be made if necessary, to arrive at arm's length price.

Certain specific transactions

Intra-group services

The IRD guidelines specify that for intra-group services, it is necessary to consider the perspective of both the service provider and the service recipient.

Taxpayers need to apply the 'Benefit Test' to substantiate whether the intra-group services are actually received and the quantum of service charge is commensurate with the benefits derived. Furthermore, the taxpayers need to ensure that the amount paid is in line with the amount an independent recipient would be prepared to pay in comparable circumstances.

Intangible property

The Comparable Uncontrolled Price Method (CUPM) can be used to benchmark transactions involving intangibles. In case of non-availability of CUPM data, the Profit Split Method (PSM) or any other method that can provide the highest degree of comparability can be accepted as the most appropriate method wherein there are unique intangibles or interrelated transactions.

Taxpayers need to justify the existence of the intellectual property, its value in generation of profits to the licensee, the ownership of the intellectual property with the licensor and the arm's length nature of the payment made.

Financial transactions

For intra-group loans, CUPM is considered to be the most reliable. Appropriate indices such as the London Interbank Offered Rate (LIBOR), prime rates offered by banks and specific rates quoted by banks for comparable loans can be used to benchmark intra-group loans.

Reporting and compliance

Directors' Report

In the case of cross-border transactions with associated undertakings, taxpayers are required to submit a Directors' Report in the manner specified in the regulations.

Obligation of the director: The director of the taxpayer (having cross-border transactions) is required to certify that the taxpayer has complied with the transfer pricing regulations and all the transactions had been submitted to independent auditors for auditing.

Certificate from an approved accountant

Gazette Notification No. 1907/26 dated 25 March 2015 provides for a requirement of furnishing a certificate from an approved accountant containing details of transactions with related parties.

The certificate was introduced effective from assessment year 2015-2016 and would confirm the arm's length nature of related party transactions and the disclosures required to be made in the prescribed format.

Submission of transfer pricing documentation

Taxpayers are not required to submit documentation along with the Return of Income. However, it needs to be submitted to the tax authorities within 30 days upon request.

Transfer pricing audit/assessment

The IRD established a Transfer Pricing Regulations Unit (TPRU) for the implementation and administration of transfer pricing regulations and to provide a framework to confirm if the related party transactions comply with the arm's length principle.

The transfer pricing officers have already commenced collecting information from multinational companies on their related party transactions.



Advance Pricing Agreement procedures

The IRD has made arrangements for entering into an Advance Pricing Agreements (APAs) in accordance with an appropriate set of criteria (e.g. method, appropriate adjustments thereto and critical assumptions for future events) for controlled transactions for the determination of the transfer pricing for those transactions over a fixed period of time.

The options available are unilateral APAs and bilateral APAs. APA provisions related to the filing process, fees, time period and other related procedures **are yet to be notified**.

Penalties and other consequences of non-compliance

Currently, there are no penalties for non-compliance under the transfer pricing regulations.

However, penalties are applicable for all tax underpayments including those arising from transfer pricing related audit adjustments and may attract penalties in addition to the taxes payable.

The IRD provides for an immediate penalty of 10% for the first month and penalties of 2% for each additional month outstanding, up to a maximum of 50% of the tax payable.

BEPS/CbC applicability

Base Erosion and Profit Shifting (BEPS) issues and Country by Country (CbC) reporting are expected to be more remote. For the time being, transfer pricing regulations in the country still need to mature.





SUMMARY OF TRANSFER PRICING REQUIREMENTS

Effective from

March 2006

Compliance requirements

- Transfer pricing documentation is mandatory for:
 - i. cross-border related party transactions in excess of LKR 100 million (approximately USD 680,000); and
 - ii. domestic related party transactions in excess of LKR 50 million (approximately USD 340,000).
- Obtain a certificate from an approved accountant confirming the arm's length nature of related party transactions and making the disclosures in the prescribed format.
- Submit the certificate to the IRD by the due date of filing the Return of Income.

Penalties

No specific penalty for transfer pricing non-compliance.

Penalties are applicable for all tax underpayments in addition to the taxes payable.

Penalty of 10% for the first month and penalties of 2% for each additional month outstanding, up to a maximum of 50% of the tax payable.

Method and preference for comparable

Five methods as defined by the OECD without any hierarchy.

Peculiar features

In the case of cross-border transactions with associated undertakings, taxpayers are required to submit a Directors' Report in the manner specified in the regulations.

Safe harbour and APA

No safe harbour provisions are available.

APA provisions related to the filing process, fees, time period and other related procedures to be notified.

BEPS/CbC applicability

Not yet introduced.

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