

Inshira Hanifa
DL & F De Saram, Colombo
inshira@desaram.com

Recent changes to tax laws in Sri Lanka

Introduction

This report provides an overview of the recent changes to tax laws in Sri Lanka. The recent tax developments showcase the agreements reached with the International Monetary Fund (IMF) to mitigate the economic challenges faced by Sri Lanka and the government's ongoing efforts to modernise the tax regime, enhance compliance and align with global digital tax trends.

Income tax

Foreign service income and foreign source income

Prior to 1 April 2025, the gains and profits earned or derived by any person from the following sources were exempt from income tax;

- any service rendered in or outside Sri Lanka to any person to be utilised outside Sri Lanka, where the payment for such services is received in foreign currency and remitted through a bank to Sri Lanka; and
- any foreign source where such gains and profits are earned or derived in foreign currency and remitted through a bank to Sri Lanka.

Effective from 1 April 2025, the exemption on foreign service income and foreign source income was removed and the said profits/income are subject to income tax in Sri Lanka. However, a concessionary income tax rate of 15 per cent is applicable for companies and for individuals, at a maximum rate of 15 per cent under the progressive personal income tax.

If the conditions are not met, the standard rate of income tax will apply, which is:

- 30 per cent for companies; and
- up to 36 per cent for individuals.

Betting and gaming, liquor and tobacco products

From 1 April 2025, gains and profits from betting and gaming, as well as the manufacture and sale or import and sale of liquor and tobacco products, are subject to income tax at the rate of 45 per cent. This revision applies to both companies and individuals involved in these activities. Prior to the revisions, such gains and profits were subject to income tax at 40 per cent.

Personal relief and income tax slab rates

The local income tax laws provide for a personal relief (ie, tax-free allowance) for resident individuals and non-resident Sri Lankan citizens. The tax-free allowance has been increased from LKR1.2m to LKR1.8m for each year of assessment (Y/A, from 1 April of one year to 31 March of the next year) commencing on or after 1 April 2025.

Accordingly, the progressive income tax rates applicable to individuals were also revised to reflect the revised personal relief and removal of the 12 per cent tax rate. With effect from 1 April 2025, the taxable income of resident or non-resident Sri Lankan citizens are subject to income tax as follows.

Taxable income (LKR)	Tax rate
Tax-free allowance – LKR1.8m	0 per cent
Next LKR1m	6 per cent
Next LKR500,000	18 per cent
Next LK500,000	24 per cent
Next LKR 500,000	30 per cent
Thereafter (more than LKR4.3m)	36 per cent

Advance income tax (AIT) on interest and discounts

Interest and discounts, paid with a source in Sri Lanka to a resident or non-resident, is subject to withholding tax (AIT) in Sri Lanka unless exempted. The AIT rate on interest and discounts was increased from 5 per cent to 10 per cent, effective from 1 April 2025.

This change aims to enhance tax collection on interest income while maintaining the status quo that AIT on interest is not a final withholding payment.

A self-declaration mechanism for prevention of deduction of AIT from low-income earners – ie, assessable income below personal relief – was introduced with effect from 1 April 2025. A Sri Lankan resident individual earning less than LKR1.8m per Y/A from all sources of income is permitted to make a declaration to the banks and financial institutions in which such individual maintains deposits confirming their income is below the said threshold. Once a valid self-declaration is submitted, no AIT will be deducted from the interest earned on deposits and savings accounts.

Changes to refund claim provisions

The mechanism for issuing refunds has been revised to ensure timely payments. Accordingly, refund claims for resident individuals must be processed within three months prior to an audit, if the refund claim is below the prescribed amount.

The time period to claim a refund has been reduced from four years to 30 months from the deadline for submission of the return.

VAT

VAT on digital services by non-residents

Effective from 1 October 2025, VAT chargeability has been extended to cover supply of services by non-resident persons via electronic platforms to recipients in Sri Lanka, at the rate of 18 per cent. This measure, originally proposed for 1 April 2025, was deferred to allow for administrative readiness. Provisions were introduced to empower the Commissioner General of Inland Revenue (CGIR) to prescribe the procedure for registration, payment and compliance with respect to the VAT liability of the above-mentioned persons.

Key terms of the charging provisions have been defined in the amendment law. Such provisions contain broader definitions. Accordingly, the term ‘electronic platform’ is defined as any procedure in the form of a website or mobile application used by one or more service

providers to provide their services to the service recipients, while ‘non-resident person’ is defined as any person who occasionally undertakes transactions involving supply of services, whether as principal or agent or in any other capacity, but who has no fixed place of business in Sri Lanka. It does not include a person registered under the relevant laws, where such person carries on or carries out a taxable activity in Sri Lanka without a fixed place of business, but having an agent to act on behalf of such person.

Abolition of the simplified VAT scheme (SVAT)

The SVAT scheme is a special system introduced in Sri Lanka in 2011 to make VAT easier for certain businesses, especially exporters and those supplying exporters. The main goal is to avoid the need for these businesses to pay VAT upfront on their purchases and then wait for refunds from the government, which can take a long time and result in cash flow issues.

The SVAT scheme will be abolished with effect from 1 October 2025 and will be replaced by a risk-based refund scheme. The persons who are eligible to make claims under the refund scheme include eligible exporters (ie, persons with more than 50 per cent of zero-rated supplies made during the preceding calendar year) and VAT-registered persons with 50 per cent or more of its supplies made to strategic development or specified projects.

Refunds must be issued within 45 days from the due date of the VAT return submission, subject to submission of proper VAT return.

With the removal of SVAT, the taxable period is revised as a period of one month for any person eligible to obtain a refund as set out above, or a period of three months for other VAT-registered persons or persons who have obtained the prior written approval of the CGIR.

Revisions to exemptions from VAT

New VAT exemptions have been introduced, with effect from 11 April 2025:

- supply or import of chemical naphtha supplied to the Ceylon Electricity Board by the Ceylon Petroleum Corporation for electricity generation; and
- supply of liquid milk and yoghurt produced out of locally produced fresh milk.

The VAT exemption on the import of aircraft engines and spare parts has been removed with effect from 11 April 2025.

Mandatory e-filing of VAT returns

Currently, a VAT-registered person is permitted to submit their VAT returns either manually or electronically. From 1 July 2025, VAT returns must be filed electronically. Manual submissions will only be permitted under exceptional circumstances approved by the CGIR.

Mandatory VAT registration

Registration for VAT was previously only mandatory if the taxable supplies of a person who carries on taxable activity in Sri Lanka reaches the prescribed registration thresholds. However, with effect from 11 April 2025, all persons engaged in commercial import or export of goods are required to register for VAT, regardless of thresholds or exemptions.

Stamp duty

In Sri Lanka, instruments relating to the lease of any property are subject to stamp duty. This is levied on the total lease or hire value, inclusive of any premium (aggregate lease rental for the first 20 years, if the lease term exceeds 20 years).

With effect from 1 April 2025, the applicable stamp duty rate has been increased from 1 per cent to 2 per cent.