

shall be apportioned between the part of the asset realised and the part retained according to their market values immediately after the realisation.

CHAPTER V

TYPES OF PERSONS

Division I: Individuals and Entities

52. (1) In arriving at the taxable income of an individual or entity for a year of assessment under section 3, the aggregate qualifying payments referred to in the Fifth Schedule to this Act shall be deducted.

Qualifying
payments and
reliefs.

(2) In arriving at the taxable income of an individual who is resident in Sri Lanka for a year of assessment under section 3, the aggregate reliefs referred to in the Fifth Schedule to this Act shall be deducted.

(3) In arriving at the taxable income of an individual who is not resident in Sri Lanka for a year of assessment but is a citizen of Sri Lanka under section 3, the relief referred to in paragraph 2(a) of the Fifth Schedule to this Act shall be deducted.

Division II: Partnerships

53. (1) Subject to subsection (2), a partnership shall not be liable to pay income tax with respect to its taxable income and shall not be entitled to any tax credit with respect to that income, but shall be liable to pay income tax with respect to withholding payments.

Partnerships.

(2) The provisions of subsection (1) shall not apply to a partnership to the extent that the partnership's taxable income includes a gain from the realisation of an investment asset.

(3) Partnership income or a partnership loss of a partnership shall be allocated to the partners in accordance with this Division.

(4) Amounts derived and expenditure incurred in common by partners shall be treated as amounts derived or expenditure incurred by the partnership and not by the partners.

(5) Assets owned and liabilities owed in common by partners shall be treated as assets owned or liabilities owed by the partnership and not by the partners and shall be treated as –

- (a) in the case of assets, acquired when they begin to owe such assets in that way;
- (b) in the case of liabilities, incurred when they begin to owe such liabilities in that way; and
- (c) realised when they cease to be so owned or owed in that way.

(6) Subject to this Act, all business activities of a partnership shall be treated as conducted in the course of a single partnership business.

(7) Subject to this Act, arrangements between a partnership and its partners shall be recognised in instances other than the following, which shall be taken into account in determining a partner's share under subsection (5) of section 55:-

- (a) loans made by a partner to a partnership and any interest paid with respect thereto; and
- (b) services provided by a partner to a partnership (including by way of employment) and any service fee or income from employment payable with respect thereto.

(8) Subject to any consequences under section 63, where there is a change of partners in a partnership at least two existing partners continue with the partnership, the partnership shall be treated as the same entity both before and after the change.

(9) The precedent partner or in the absence of such partner in Sri Lanka, an agent of the partnership in Sri Lanka, shall withhold tax in accordance with section 84 and at the rate provided for in paragraph 10 of the First Schedule to this Act on each partner's share of any partnership income of the relevant partnership year, excluding the share of any partnership income that includes a gain from the realisation of an investment asset in respect of which tax is payable on assessment by the partnership.

54. (1) Partnership income of a partnership for a year of assessment shall be the partnership's income from its business or investment for that year of assessment (sections 6 and 7).

Partnership
income or loss.

(2) A loss incurred by a partnership for a year of assessment shall be the partnership's loss from its business or investment for the year (subsection (5) of section 19).

55. (1) For the purposes of calculating a partner's income from a partnership for a year of assessment of the partner, the partner's share of any partnership income shall be included or the partner's share of any partnership loss of the relevant partnership year shall be deducted. The relevant partnership year is the year of assessment of the partnership ending on the last day of or during the year of assessment of the partner.

Taxation of
partners.

(2) Gains on disposal of an interest of a partner in a partnership shall be treated as income from a business and included in calculating the income of the partner from the partnership and shall be calculated under Chapter IV subject to the adjustments in section 56.

(3) Partnership income or a partnership loss allocated to partners under subsection (1) –

- (a) shall retain its character as to type and source;
- (b) shall be treated as an amount derived or expenditure incurred, respectively, by a partner at the end of the partnership's year of assessment; and
- (c) shall be allocated to the partners proportionately to each partner's share, unless the Commissioner-General, by notice in writing and for good cause, directs otherwise.

(4) Tax paid under the provisions of this Act and foreign income tax paid or treated as paid by the partnership with respect to the partnership income shall be allocated to the partners, proportionately to each partner's share, and shall be treated as paid by them. The allocation occurs at the time partnership income is treated as derived by the partners under paragraph (b) of subsection 3.

(5) For the purposes of this section and subject to subsection (7) of section 53, a "partner's share" shall be equal to the partner's percentage interest in any income of the partnership as set out in the partnership arrangement.

Cost of and consideration received for partnership interest.

56. (1) The following shall be included in the cost of a partner's membership interest in a partnership:-

- (a) amounts included in calculating the partner's income, under subsection (1) of section 55 at the time of the inclusion; and
- (b) the partner's share (subsection (5) of section 55) of exempt amounts and final withholding payments derived by the partnership, at the time the amount or payment is derived.

(2) The following shall be included in the consideration received for a partner's membership interest in a partnership:-

- (a) amounts deducted in calculating the partner's income, under subsection (1) of section 55 at the time of deduction;
- (b) distributions made by the partnership to the partner, at the time of distribution; and
- (c) the partner's share (subsection (5) of section 55) of domestic or excluded expenditure incurred by the partnership, at the time the expenditure is incurred.

Division III: Trusts and Unit Trusts

57. (1) Subject to subsection (2), a trust shall be liable to tax separately from its beneficiaries, and – Taxation of trusts.

- (a) a trust shall be taxed as an entity, except a trust of an incapacitated individual (not being a minor), which shall be taxed as though it were an individual; and
- (b) amounts derived and expenditure incurred by a trust or a trustee (other than as a bare agent or for an absolutely entitled beneficiary) shall be treated as derived or incurred by the trust and not any other person, regardless of whether or not the amount is derived or incurred on behalf of another person and whether or not any other person is entitled to such an amount or income constituted by such an amount.

(2) A beneficiary of a trust (instead of the trust) shall be liable to tax on the income of the trust to which that beneficiary is presently entitled for the relevant year of

assessment of the trust ending on the last day of or during the year of assessment and –

- (a) amounts derived and expenditure incurred by a trust or a trustee shall be treated as derived or incurred by the beneficiary and not the trust or trustee or any other person;
- (b) each amount shall retain its character as to type and source;
- (c) each amount shall be treated as an amount derived or expenditure incurred, respectively, by the beneficiary at the end of the year of assessment of the trust;
- (d) each amount shall be allocated to the beneficiaries proportionately to each beneficiary's share, unless the Commissioner-General, by notice in writing and for good cause, directs otherwise; and
- (e) tax paid under this Act and foreign income tax paid or treated as paid by the trust with respect to the trust income shall be allocated to the beneficiaries at the time trust income is treated as derived by the beneficiaries under paragraph (c) proportionately to each beneficiary's share, and treated as paid by them.

(3) For the purposes of subsection (2) –

- (a) a beneficiary shall be presently entitled to the income of a trust if the beneficiary has a vested and indefeasible interest in the income and an immediate right to demand payment of the income from the trustee of the trust; and
- (b) provisions of subsection (2) shall not apply to a trust to the extent that the trust's taxable income include a gain from the realisation of an investment asset.

(4) Assets owned and liabilities owed by a trust or a trustee (other than as a bare agent or for an absolutely entitled beneficiary) shall be treated as owned or owed by the trust and not any other person.

(5) Separate calculations of income shall be made for separate trusts regardless of whether they have the same trustees.

(6) Subject to the provisions of this Act, arrangements between a trust and its trustees or beneficiaries shall be recognised.

58. (1) Distributions –

Taxation of
beneficiaries.

- (a) of a resident trust shall be exempt in the hands of the trust's beneficiaries; and
- (b) of a non-resident trust shall be included in calculating the income of the beneficiaries of the trust, except to the extent that the distribution represents an amount that is subject to tax to the trust or trustee under subsection (1) of section 57 or a beneficiary under subsection (2) of section 57.

(2) Gains on disposal of the interest of a beneficiary in a trust shall be included in calculating the income of the beneficiary.

59. (1) For the purposes of this Act, every unit trust or every mutual fund that does not conduct an eligible investment business shall be deemed to be a company resident in Sri Lanka and the provisions of this Act relating to companies resident in Sri Lanka shall apply.

Taxation of unit
trusts.

(2) Without prejudice to the generality of the provisions of subsection (1) –

- (a) a “unit” in any unit trust or a mutual fund shall be deemed to be a share in that company;

- (b) a unit holder in any unit trust or mutual fund shall be deemed to be a shareholder in that company;
- (c) the income derived by or which arose from or accrued to the benefit of, the trustee of any unit trust or the custodian of any mutual fund from any property subject to that unit trust or mutual fund or from any business carried on by such trustee or such custodian for or on behalf of, that unit trust or mutual fund shall be deemed to be the income of that company;
- (d) any distribution, in any manner whatsoever, of the income of any unit trust or mutual fund to its unit holders shall be deemed to be a dividend distributed to the shareholders of that company; and
- (e) the paid up value of any unit in any unit trust or mutual fund shall be deemed to be the paid up value of any share in that company.

(3) Any sum appropriated or paid by way of remuneration to the manager or the trustee of any unit trust or to the manager or custodian of any mutual fund out of the funds of that unit trust or mutual fund shall, for the purposes of section 11 be deemed to be an expense incurred by that company in the production of its income.

(4) Where this section applies, section 57 shall not apply.

Division IV: Companies

Taxation of companies.

60. (1) A company shall be liable to tax separately from its shareholders.

(2) Subject to the provisions of this Act, all business activities of a company shall be treated as conducted in the course of a single company business.

(3) Subject to the provisions of this Act, arrangements between a company and its managers or shareholders shall be recognised.

61. (1) Dividends –

Taxation of shareholders.

(a) distributed by a resident company shall be taxed on the company's shareholders; and

(b) distributed by a non-resident company shall be included in calculating the income of the shareholders.

(2) Gains on disposal of shares in a company shall be included in calculating the income of the shareholder.

62. (1) A non-resident person who carries on business in Sri Lanka through a Sri Lankan permanent establishment shall pay tax on the remitted profits earned within the year of assessment.

Remittance tax.

(2) A non-resident person who has earned remitted profits under subsection (1) shall pay a final tax on the gross amount of the remitted profits to the Commissioner-General in accordance with the rate set out in the First Schedule to this Act on or before the thirtieth day succeeding the date of making such remittances.

(3) In this section, "remitted profits" means amounts remitted or retained abroad out of the profits and income of the non-resident person that are subject to income tax in Sri Lanka, and any amount received outside Sri Lanka by or on behalf of the non-resident person from conducting business in Sri Lanka that is subject to income tax in Sri Lanka, excluding dividends paid by a resident company to the non-resident person.

Division V: Entities

Asset dealings
between entities
and members.

63. Subject to section 46, where an asset is realised by way of transfer of ownership of the asset by an entity to one of its members or *vice versa* –

- (a) the transferor shall be treated as deriving an amount in respect of the realisation equal to the market value of the asset immediately before the realisation; and
- (b) the transferee shall be treated as incurring expenditure of the amount referred to in paragraph (a) in the acquisition.

Change in
control.

64. (1) When the underlying ownership of an entity changes by more than fifty percent as compared with that ownership at any time during the previous three years, the entity, after the change, shall not be permitted to –

- (a) deduct financial costs carried forward under subsection (3) of section 18 that were incurred by the entity prior to the change;
- (b) deduct a loss under subsection (1) of section 19 that was incurred by the entity prior to the change;
- (c) in a case where the entity has, prior to the change, included an amount in calculating income in terms of subsections (2), (4) or (5) of section 24, claim a deduction under those provisions after the change; or
- (d) carry back a loss under subsection (5) of section 25 that was incurred after the change to a year of assessment before the change.

(2) Where a change in ownership of the type referred to in subsection (1) occurs during a year of assessment of an entity, the parts of the year of assessment before and after the change shall be treated as separate years of assessment.

(3) This section shall not apply to a partnership or company that conducts the same business after a change as it conducted before the change for a period of two years after the change.

CHAPTER VI

SPECIAL INDUSTRIES

Division I: Petroleum Operations

65. (1) Any individual or entity who or which has entered into an agreement as a contractor or sub-contractor under the Petroleum Resources Act, No. 26 of 2003 shall be deemed to be resident in Sri Lanka over the term of such contract or sub contract, as the case may be, for the purposes of this Act.

Petroleum operations.

(2) The turnover from exports and local sales of petroleum exploited under any Petroleum Resources Agreement referred to in subsection (1), shall be determined on the basis of accepted commercial practices and be subject to any specific provisions in the Petroleum Resources Agreements, entered into under the Petroleum Resources Act, No. 26 of 2003.

(3) The income, gains and profits from the business of petroleum exploitation under any Petroleum Resources Agreement referred to in subsection (1), shall be ascertained after allowing the following deductions in addition to other allowable deductions under the provisions of this Act, and shall notwithstanding anything to the contrary in any other provision of this Act, be chargeable with income tax at the appropriate rate set out in the First Schedule to this Act, provided that the same item of expenditure shall not be deducted more than once:-

- (a) payments made to service sub-contractors for conducting petroleum operations;