

YOUR WALLET AND HAWK EYE; IMPACT OF MANIFOLD TAX REGIMES ON THE EMPLOYMENT GAINS IN SRI LANKA

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A. Introduction

The functions of a tax system involve several aspects. First, the primary function of a taxation system is to raise revenue for the government for its public expenditure as well as for local authorities and similar public bodies. Its efficiency is therefore primarily judged by whether this function is performed adequately and satisfactorily. The second function is to reduce inequalities through a policy of redistribution of income and wealth. The equity principle in taxation implies that taxes should be imposed in accordance with the ability to pay principle. This has two

dimensions: (a) horizontal equity, i.e., similar treatment of persons placed in similar circumstances, and (b) vertical equity, i.e., different treatment of persons with different taxable capacity. Thirdly, the fiscal system is also employed for social purposes such as discouraging certain activities which are considered undesirable.¹

Domestic tax system has the strings of control where the financial stability of a State is considered. The income and expenditure generated are the basic forces of an economy however the revenue generated would be the deeming factor creating the sustainability.

¹D.D.M Waidyasekera- former Commissioner of Inland Revenue, Secretary of 1990 Presidential Taxation Commission, present editor of the institute of policy studies of Sri Lanka/*Taxation in Sri Lanka: Current Trends*

and Perspectives- No.25 Working Paper of Institute of Policy Studies of Sri Lanka/2016/page 1

The Inland Revenue Act No.24 of 2017 (hereinafter at times called as the 'Act') provides with the legal authority to charge, levy and collect income tax on the gains and profits of every person, on a year on year basis with effect from 1st of April, 2018 in relation to four main sources of income namely, employment income, business income, investment income and other income.

Engaging in an employment and receiving a salary is the most common method of generating income. Such employment income concerned, the involvement of diverse taxes could be identified in stages of Employment and Post-employment, specifically as to terminal benefits², compensation received directly from the Employer or through the Department of Labour, and compensation from the Labour Tribunal.

²Employee's Provident Fund (EPF), Employee's Trust Fund (ETF), Gratuity
³S. 195(1) of the Act

It is the author's understanding that the public lacks the knowledge as to how their salary and all the other gains from employment being taxed. Therefore the objective of this paper is to give a comprehensive overview on manifold tax regimes in consideration of employment gains.

B. Stage of Employment

Under the charging provision section 2, income tax is payable by a person. A person is defined as an individual or an entity, and includes an executor, non-governmental organization and charitable institution.³ An entity means a company, the charging provision is found in Chapter I of the Act,⁴ and is the central provision from which the rest of the provisions considered as branches. Generally, income tax is payable on taxable income; and final withholding

⁴ S. 2(1) of the Act

payments. Calculation of an individual's gains and profits from employment for a year of assessment will be described in Chapter III of the Act.

Generally, employment involves provision of labour for gain. The definition of "employment" in section 195 to the Act essentially refers to the general law concept of employment. This general law concept is extended to include past and prospective employment and so amounts received either before or after employment may be required to be included in income and an employee means any individual who earns remuneration in money or otherwise, for the present or past services performed by such individual.

It is important to properly classify a person as an employee or an independent contractor. The employee will derive income from

employment from their activities whereas the contractor will derive income from business. The rules for calculating these types of income are different and, no deductions are permitted in calculating income from employment, section 10(1) (a) since, employees have few expenses, but an independent contractor providing services may have substantial expenses for which relief is granted.

Tax liability arises on total remuneration received by an employee, during the year of assessment⁵ in money or otherwise from employer or others for services rendered, if not specifically exempted. The Remuneration liable to tax includes;⁶

- i. Salary, wages, leave pay, overtime pay, fees, pensions, commissions, gratuities, bonuses, and other similar payments

⁵ Year of assessment is a period of 12 months from 1st April to 31st March of every year

⁶S. 5(2) of the Act

- ii. allowance, including any cost of living, subsistence, rent, entertainment or travel allowance
- iii. Payments providing discharge or reimbursement of expenses incurred by an individual or an associate of the individual
- iv. Payments for an individual's agreement to conditions of employment
- v. Payments or transfers to another person for the benefit of an individual or an associate person of the individual
- vi. The fair market value of benefits received or derived by virtue of the employment by an individual or an associate person of the individual

The excluded gains and profits are demonstrated under section 5 (3) to the Act.

⁷ 4 SLTC 140

In Wimalasundera J. Kanaga sabapathy vs. CGIR⁷ it was clearly observed what amounts to employment gains.

“..... the kinds of receipts with the item wages and going down to perquisite are receipts in respect of a person’s service as employee. The statute requires that these receipts must be payments “which an employee receives in the course of his employment””

Having ascertained the component of remuneration liable, it is notable that imposing taxes varies sector-wise.

Public Sector Employees

The public sector is a portion of an economic system that is governed by national, state or provincial, and local governments.

It is stated to be the largest sector of any economy, whereby one can argue that it consists of national economy providing basic goods or services that

are either not, or cannot be provided by the private sector.

Every employer is required to deduct income tax from the gross remuneration for every pay period of every employee who is liable to income tax, at the time such remuneration is paid or credited.⁸ The pay period can be a month, week or such other period in respect of which remuneration is calculated and paid by an employer to an employee, and accordingly, the tax should be deducted and remitted monthly to the Department of Inland Revenue. This is known as PAYE scheme.⁹ The Commissioner General of Inland Revenue specifies Tax Tables which are to be used in making such tax deductions.

Section 83 to the Act empowers the Commissioner General to specify circumstances where the employers

should withhold tax from an amount included in taxable income.

The section being linked with Section 10 of the first schedule to the Act it is mentioned that with regard to both resident and non-resident employees such sums would be taxed at the rates Commissioner General publishes in Gazette.

Withholding by Employers Regulations by the Gazette No. 2064/60 dated 01st April 2018, came into operation at the same time as the Act, No. 24 of 2017 specifies tax rates of the following.¹⁰

- a. *Tax Table 01* for regular profits from the employment of an employee who is having one employment or any employee who has furnished a primary employment declaration¹¹,

⁸ S. 83 of the Act

⁹ Pay as you earn (PAYE)

¹⁰ The below mentioned tables can be found at link:

<<http://www.ird.gov.lk/en/publications/sitepages/PAYE%20Tax%20Tables.aspx?menuid=1502>>

¹¹ In case of having two or more employment

- b. *Tax Table 02* for payment constitutes a Lump-sum payment¹²
- c. *Tax Table 03* for once-and-for-all payment (Terminal Benefits)¹³
- d. *Tax Table 04* for payment received by the non-citizens in Sri Lanka
- e. *Tax Table 05* for monthly regular profits of an employee from a primary employments is less than Rupees 100,000 but the cumulative profits from the primary employment up to any month in the year of assessment exceeds Rupees 1,200,000 due to payment of higher remuneration in certain months¹⁴Tax deduction should start from the month in which the cumulative profits up to that month exceed Rupees 1,200,000. Thereafter tax

deduction should be made monthly till end of the year of assessment, using this table.

- f. *Tax Table 06* for payment or reimbursement of the employee's tax liability on his income from employment by the employer
- g. *Tax Table 07* for the remuneration of a chairman or a Director or a Non Executive Director of a Company who has not furnished a primary employment certificate, or in respect of remuneration of any employee employed under more than one employer, or from the remuneration of employee who are engaged in more than one employment where such remuneration is paid by any employer other than the employer of primary employment.

¹² Bonus, Incentives etc.

¹³ Will be specifically addressed in a later stage of this article

¹⁴Will be specifically addressed in a later stage of this article

Employers are required to maintain PAYE Pay Sheets for the purpose of PAYE Tax deduction in the prescribed form, for each employee who is liable to tax. These pay Sheets should be maintained in addition to the normal pay sheets maintained by the employer for recording purpose. Annual Declaration of government sector should be furnished to PAYE Branch not later than the 30th of April every year.¹⁵

An employee is obliged to furnish a declaration nominating the employment as the employee's primary employment to an employer, except any employee who is having one employment. Such an employment shall be considered as primary employment of an employee for a year of assessment. There can't be more than one primary employment throughout the respective year of assessment.¹⁶

Primary and Secondary Employment

Paragraph 3 of 'Withholding by Employers Regulations by the Gazette No. 2064/60 dated 01st April 2018' resorts as to the requirements and how the tax liability is governed in accordance with the aforementioned tables where employee is employed under more than one employer.

If an employee has ceased the primary employment during a year of assessment and the employee has another employment after the primary employment has ceased, the employee must provide the employer of the other employment with a new declaration and the withholding tax

¹⁵Morefully explained by the latter part to this article

¹⁶Parah 3 (i) – (v) of Gazette No. 2064/60 dated 01st April 2018

certificate¹⁷ issued with respect to the prior primary employment.¹⁸

Where an employee ceases two or more primary employments during a year of assessment, the employee may provide the new employer with multiple withholding tax certificate and the employers shall act accordingly with respect to those multiple withholding tax certificates.¹⁹

Secondary Employment refers to any employment that is not the primary employment of the employee.

Rates for the deduction of tax from the regular profits from employment of any employee who has not furnish the primary employment declaration, or in respect of regular profits from employment of any employee employed under more than one employer, where such regular profits from employment is paid by any

employer other than the primary employer the tax liability shall be imposed as, on monthly remuneration less than or equal to Rupees 50,000 per month, at 10%; and Balance amount exceeding Rupees 50,000 per month, at 20%.²⁰

Private Sector Employees

Resident individuals are subjected to income tax on their worldwide income while non-resident individuals are taxed only on their income generated in Sri Lanka.²¹

An individual is charged on such person's taxable income on progressive rates based on the level of income.

The rates currently applicable are: on the first Rupees 600,000, 4% of the taxable income; on the next Rupees

¹⁷Certificate being issued under paragraph 7 of Gazette No. 2064/60 dated 01st April 2018

¹⁸Parah 4 (i) – (iii) of Gazette No. 2064/60 dated 01st April 2018

¹⁹Parah 4 (iii) of Gazette No. 2064/60 dated 01st April 2018

²⁰ Table 07 at <<http://www.ird.gov.lk/en/publications/site/pages/PAYE%20Tax%20Tables.aspx?menuid=1502>>

²¹ S. 4 (a) & (b) of the Act

500,000, Rupees 24,000 plus 8% of the amount in excess of Rupees 600,000; on the next Rupees 600,000, Rupees 72,000 plus 12% of the excess of 1,200,000; on the next Rupees 600,000, Rupees 144,000 plus 16% of the amount in excess of 1,800,000; on the next Rupees 600,000, Rupees 240,000 plus 20% of the amount in excess of 2,400,000; and Rupees 360,000 plus 24% of the amount in excess of Rupees 3,000,000 on any amount exceeding Rupees 3,000,000.²²

A resident of Sri Lanka for income tax purposes will be entitled to claim a tax-free allowance of Rupees 500,000 for each year of assessment.

An individual who has profits from employment and is a resident or citizen of Sri Lanka is entitled to a further deduction of Rupees 250,000 as a qualifying payment.

²² First Schedule 1 (1) of the Act

²³Can be a **NIL return** where no taxable income generated but the obligation lies on the

Section 132 of the Act requires a taxpayer to assess the tax payable by himself and to file return²³ for the taxable period. Self-assessment taxpayer can file a return declaring a loss and be treated as he has assessed his income. A return which includes pre-filled information provided by Commissioner General of Inland Revenue (CGIR) and electronically computed payable amount of tax should be completed in writing or electronically as to be furnished.

As per section 85 (1) (a) to the Act coupled with paragraph 10 (c) (i) of the First Schedule service fees as to teaching, brokering, endorsement, supply of any article on contract basis, and any other prescribed by regulation rendered to resident individual shall be taxed at 5% on amounts exceeding Rupees 50,000 per month.

taxpayer to declare the amount he has earned. (Will be treated as having made an assessment)

Section 85 (1) (b) with paragraph 10 (c) (ii) of the First Schedule the same services rendered to non-resident individual shall be taxed at 14%.

C. Post Employment (Terminal Benefits and Compensation)

“When an employee’s employment terminates, either as a consequence of dismissal, redundancy or retirement, it is common that the employer will pay a lump sum payment to the employee. These payments may be referred to as a golden boot or a golden handshake.”²⁴

According to the paragraph above an employee is entitled to receive retirement payments irrespective of the nature of cessation of such services.

In any event of unjustifiable and unlawful termination an aggrieved employee is entitled to go before the Labour Tribunal as per section 31B of

the Industrial Disputes Act No. 43 of 1950 which has the jurisdiction to reinstate the employee with or without back-wages and in lieu to compensate.²⁵

Terminal benefits are subjected to income tax as per Section 1 (2) and (3) of the Act.

- a. Any sum paid in commutation of pension,
- b. Retiring Gratuity(Payable as per the Payment of Gratuity Act No. 12 of 1983)
- c. Compensation for loss of office or employment under a uniformly applicable scheme recognized by the Commissioner- General,
- d. Any sum paid at/after the retirement from a provident fund approved by the Commissioner-General which does not represent employee’s contributions to the fund.

²⁴ACCA Qualification Paper F6/*Taxation on Termination Payments*<<https://www.accaglobal.com/conte>

nt/dam/acca/global/PDFstudents/2012s/sa_mar11_f6irl_2.pdf>
²⁵ Discussed below in detail

- e. Any sum paid from a regulated provident fund which does not represent employer's contributions to the fund before 01.04. 1958, where the interest has been accrued if the tax paid by the employer at 15% and interest accruing thereon.
- f. Any sum paid from Employee's Trust Fund (ETF) established by Employee's Trust Fund Act No. 46 of 1980 at/after the cessation of employment.²⁶

In consideration of the above income identified, where the period of service is *twenty years or less*, such sum would be taxed as, no liability upto Rupees 2,000,000, between Rupees 2,000,000 and 3,000,000, the excess amount of Rupees 2,000,000 at 5%, and tax payable for any sum exceeding Rupees 3,000,000 is Rupees 50,000 plus 10% on the amount in excess of Rupees 3,000,000.

²⁶As per section 8 under Schedule I taxable income of an employee's trust fund, an approved provident or pension fund or an

Where the period of service is *more than twenty years* there is no liability upto Rupees 5,000,000. Between Rupees 5,000,000 and Rupees 6,000,000, the excess amount of Rupees 5,000,000 at 5%, and tax payable for any sum exceeding Rupees 6,000,000 is Rupees 50,000 plus 10% on the amount in excess of Rupees 6,000,000.

However, any income shall not be taxed if such sums have already been subjected to final withholding payments.²⁷

As it was mentioned earlier section 83 to the Act the Commissioner General has authority to specify circumstances where the employers should **withhold tax** from an amount included in taxable income. Section 10 of the first schedule it is mentioned that such rates shall be gazetted.

Withholding by Employers Regulations by the Gazette No. 2064/60 dated 01st April 2018 refers

approved termination fund shall be taxed at rate of 14%
²⁷ S. 5 (3) (a) of the Act

to the *Tax Table 03* for once-and-for-all payments which are Terminal Benefits.²⁸

Tax is stated to be withheld at 10% from pension, retiring gratuity, compensation for loss of office or employment under a scheme which is uniformly applicable to all employees and approved by the Commissioner General of Inland Revenue.

A scheme is uniformly applicable, where the Commissioner General is of the opinion that it is uniformly applicable to all the employees.

Where the payment made by the employer is in accordance with a scheme which is uniformly applicable to all the employees, or where the payment is made out of a Fund to which the employer has made contribution in accordance with a scheme which is uniformly applicable to all the employees, then such a scheme would be a uniform scheme.

However 24%, would be the rate for tax deductions in the circumstances referred to in compensation for loss of office or employment under non uniform scheme.

In the case of uniform scheme once-and-for-all payments, deduction should not be made in the situations where aggregate amount is Rs. 1,000,000 where the period of service or contribution is less than 20 years and/or Rs. 1,500,000 where the period of service (or contribution) is equal to or more than 20 years.

D. Conclusion

*“Every worker and employer is directly affected by taxes on wages. Taxation is one of the principal ways we finance public services. It also helps us achieve important social objectives, such as redistributing wealth to address inequalities.”*²⁹

In light of the above it is to be understood the significance of

²⁸Parah2 (c) to the regulation *ibid*
²⁹Paturot Dominique, OECD Centre for Tax Policy and Administration/*Taxing wages: how taxes affect the*

disposable income of workers and wage costs of employers in OECD countries <<http://oecdobserver.org/news/fullstory.php>

sufficient knowledge on the imposition of manifold tax regimes under the Inland Revenue Act. To be responsible and vigilant citizens such knowledge is mandatory.

Therefore, it will be the need of the hour to bring into the cognizance of the general public the provisions of the Inland Revenue Act and other supportive legislation with a view of promotion of adequate knowledge.

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