

ECONOMIC SERVICE CHARGE (ESC)

Explanatory Notes

Economic Service Charge was imposed with effect from the year of assessment commencing on 1/4/2004 consequent to the proposal made in **Budget 2004** describing as a levy for the use of Government infrastructure facilities and services. Every person or partnership carrying on or carrying out a trade, business, profession or vocation, irrespective of whether such person or partnership is liable to pay income tax or not, is required to pay this levy. However, in order to give a relief to tax payers who pay income tax, provisions have been made to set off ESC paid against income tax.

(1) Legislation

- (i) PART I of the Finance Act, No. 11 of 2004 (covers the imposition of ESC for the period from 01/04/2004 to 31/03/2005 subject to certain amendments made in 2005)
- (ii) Finance (Amendment) Act, No.7 of 2005 (includes certain amendments introduced to regularize administrative instructions.
- (iii) Economic Service Charge Act, No.13 of 2006 (introduced with effect from 01/04/2006 to impose ESC under a separate Act terminating the respective provisions under the Finance Act, No.11 of 2004.

(2) Chargeability

- ***For the period from 01/04/2004 to 31/03/2006 ESC is chargeable:***
- from every person (including a company, public corporation or body of persons but not including a co- operative society or a non-resident owner or charterer of an aircraft or ship) and partnership.
 - in respect of every part of the **liable turnover of an year of Assessment** .
 - at the rates specified
(Subsection (1) of Section 2 of the Finance Act No. 11 of 2004)

- BOI enterprises are not liable to ESC for the year of Assessment 2004/2005.
- Liability to ESC for any year of Assessment arises only if the liable turnover for that year exceed Rs. 50 Million,
- Maximum amount of ESC payable for an year is Rs. 50Million. **(Proviso to subsection 2 of The Finance Act No. 11 of 2004)**
- **The terms “liable turnover” and “turnover” have been defined as follows: (Applicable for the years of Assessment 2004/2005 and 2005/2006.**

Liable turnover:- the aggregate turnover of every trade, business, profession or vocation other than any trade, business, profession or vocation the commercial operations of which commenced by such person or partnership or **by any other person or partnership**, within 36 months prior to the due date of liability (This has been amended by the Finance (Amendment) Act, No. 7 of 2005 in which the application of the concession is restricted effective from 01.04.2005, to undertaking other than buying and selling businesses) **in Sri Lanka** whether directly or through an agent or more than one agent , being turnover for the **year of assessment preceding that year of assessment.**

Turnover:- the total amount receivable, whether received or not from every transaction entered into in that **year of assessment** excluding the following:

- VAT (if registered)
- Disposal of capital assets on which allowance for depreciation has been claimed
(this was amended by Amendment Act No. 7 of 2005 by removing the condition of claim of depreciation allowance, in order to cover up non depreciable assets as well).
- Bad debts incurred (subject to condition that the recovery of bad debts to be added)

- **With regard to Banks and business of insurance, however, the following are applicable.**

- (i) Banks:- the receipts of such bank by way of, or on account of, interest, discount , dividends, exchange, service charges, commissions, brokerage and other income derived by bank in the course of its business deemed to be included to the turnover.
- (ii) Business of a insurance:- exclude the following-
-premia on life insurance; and

-premia on insurance against damages or destruction by strike, riot, civil commotion or acts of terrorism and paid into the Consolidated Fund.

(Sub-Section (3) of Section 2 of the Finance Act, No. 11 of 2004)

➤ ***For the period from 01/04/2006 ESC is chargeable***

- from every person (including a company, public corporation or body of persons but not including a co-operative society or a non-resident owner or charterer of an aircraft or ship) and partnership.
- in respect of every part of the **relevant turnover for every quarter**.
- at the rates specified.

(Sub-Section (1) of Section 2 of the ESC Act, No. 13 of 2006)

- **The Liability to ESC for any quarter arises only if the relevant turnover for that quarter exceeds Rs. 10 Million. (Sub-Section 2 of the ESC Act, No. 13 of 2006)**
- The maximum amount of ESC payable for quarter is Rs 15m **(Proviso to Sub-Section 2 of The ESC Act, No. 13 of 2006)**
- **The term “Relevant turnover”, “turnover” “quarter” and “BOI enterprise” have been defined as follows: (Applicable for the period with effect from 1.4.2006)**

Relevant turnover:- the aggregate turnover of every trade, business, profession or vocation other than any trade, business, profession or vocation the commercial operations of which commenced by such person or partnership, within 36 months prior to the due date of liability (other than an undertaking for buying and selling businesses without any process.) **in Sri Lanka** whether directly or through an agent or more than one agent, being turnover for that **relevant quarter**.

Turnover:- the total amount receivable, whether received or not from every transaction entered into in that **relevant quarter** excluding the following:

- VAT (if registered)
- Disposal of capital assets
- Bad debts incurred (subject to condition that the recovery of bad debts to be added)

With regard to Banks and Business of insurance, the earlier definitions remain unchanged.

(Subsection 3 of section 2 of the ESC Act, No. 13 of 2006)

Quarter:- in relation to any year of assessment means the period of 3 months commencing on the first day respectively of April, July, October or January of that year of assessment.

BOI Enterprise:- means any enterprise in relation to which an exemption of its profits and income from income tax in terms of any agreement entered into by the Board of Investment of Sri Lanka (BOI) with such enterprise under section 17 of the BOI Law No. 4 of 1978, subsists during the whole or any part thereof of that relevant quarter. (This definition is applicable for the Y/A 2005/06 as well.)

(Section 12 of the ESC Act, No. 13 of 2006)

(3) ESC Rates

For the period prior to 01.04.2006:-

Part of the liable Turnover	Rate
The profits and income which are exempt from income tax (including of BOI enterprises during the taxholiday period- effective from 01/04/2005)	0.25%
The profits and income are taxed at reduced rates (Sixth Schedule) and BOI companies taxed at the rates equalent to such rates	0.5%
From retail or whole sale <i>not manufactured or produced by the seller (effective from 01.04.2005)</i>	0.5%
Other	1%

Distributors and freight forwarders:

This has been regularized from 01.04.2006. Prior to that specific category of distributors and Freight Forwarders were identified and turnover was defined on the basis of gross commission as per the guide line issued (Ref ACT 2/2004/8 dated 22/11/2005, which is self explanatory-See Annexure 1)

For the period commencing on 01.04.2006:-

Part of the liable Turnover	Rate
The profits and income from which are exempt from income tax (including of BOI enterprises during the tax holiday period)	0.25%
The profits and income are taxed at reduced rates (5th schedule of the Inland Revenue Act No. 10 of 2006) and BOI companies taxed at the rates equivalent to such rates	0.5%
From retail or whole sale <i>not manufactured or produced by the seller</i>	0.5%
Distributors	0.1%
Other	1%

Distributors:

In relation to any manufacturer or producer of any goods in Sri Lanka means any person or partnership appointed by such manufacturer or producer for the sale in the wholesale market of such goods, at such price as may be determined by such manufacturer or producer, from time to time.

Freight forwarders:

This has been regularized from 01.04.2006 by Order published in the Gazette where the turnover of the Freight Forwarder is treated as the gross commission without any exemption limit if the conditions specified are fulfilled.(refer Gazette Extraordinary No 1447/10 dated 30/5/2006 -See Annexure 2)

(4) Set off of ESC against Income Tax

For the period prior to 01.04.2006

ESC paid by any person for any year of assessment can be set off against that part of income tax:

- which is equal to proportion to the statutory income from trade, business, profession or vocation to the total statutory income for that year of assessment.

ESC paid by a **partnership** for any year of assessment should be apportioned to its partners in the profit sharing ratio.

Such shares are available to partners to set off against that part of income tax which is equal in proportion to the profits and income from trade, business, profession or vocation forming part of share of profits, to the statutory income for that year of assessment.

(Simultaneously Section 71A of the Inland Revenue Act, No.38 of 2000 has also been amended, so that, where ESC payable is more than the Partnership tax (10%) then, there is no liability to partnership tax and where the partnership tax is higher than the ESC, then the partnership tax is reduced by the ESC payable.

The balance, if any of ESC can be carried forward to be set off against such income tax for next succeeding two years of assessment
(Section 3 of the Finance Act, No.11 of 2004, as amended by the Finance (Amendment) Act, No. 7 of 2005)

ESC will not be refunded.

For the period commencing on 01.04.2006

ESC paid by **any person** for any relevant quarter is deductible from the **income tax payable*** by that person for the year of assessment, of which that relevant quarter is a quarter.

The balance, if any can be carried forward and set off against any income tax payable for the immediately succeeding two years of assessment,

In a case of a **partnership** for that relevant quarter:

- the amount paid is apportioned among the partners in the ratio of the profit sharing of the year of assessment of which the relevant quarter is a quarter
- the partners are entitled to deduct from the income tax payable and the balance, if any can be carried forward to be set off against the tax payable in the two years of assessment immediately succeeding that year of assessment.

(ESC including carried forward ESC from the Y/A 2005/2006 can be set off against any income tax with out restricting to income tax payable on profits from trade, business, profession or vocation.)*

No part of the ESC can be refunded.

(Section 3 of the ESC Act, No. 13 of 2006)

(5) Notice of chargeability

For the period prior to 01.04.2006

Every person or partnership chargeable with ESC should give notice in writing to the CGIR of such chargeability before first day of June of the relevant year of assessment disclosing the income tax file number or Taxpayer Identification Number as the case may be. **(Section 5 of the Finance Act, No. 11 of 2004)**

For the period commencing on 01/04/2006

Every person or partnership chargeable with ESC should give notice in writing to the CGIR of such chargeability before 15th day of the last month of that quarter disclosing the income tax file number or Taxpayer Identification Number as the case may be. **(Section 5 of the ESC Act No. 13 of 2006)**

(6) Payment Dates:

For the period prior to 01.04.2006

Tax is payable in 4 quarterly installments on or before:

June 30 TH	- 1 ST installment
September 30 th	- 2 nd installment
December 31 st	- 3 rd installment
Mach 31 st	- 4 th installment

On the basis of $\frac{1}{4}$ the of previous year's turnover. **(Section 6 of the Finance Act No.11 of 2004)**

The payments should be made to Bank of Ceylon, Metropolitan Branch located at the Inland Revenue Building, Colombo 2.

For the period commencing on 01.04.2006

Quarter commencing

1st April

Payment Date

20th July of the

1st July

same year
20th October of
the same year
20th January of
the following

1st October

year
1st January

20th April of the
same year

(Section 6 of the ESC Act No13 of 2006)

Payment can be made to any of the bank of Ceylon Branch designated for payment.

(7) Filing Returns

For the period prior to 01.04.2006

On or before the last day of the relevant year of assessment
(Section 7 of the Finance Act No 11 of 2004)

For the period commencing on 01.04.2006

It is required to furnish the quarterly return on or before the 20th day of the month following the end of the relevant quarter.

(8) Administrative Provisions

Assessments can be made for:-

- any unpaid ESC, or
- any short payments of ESC

The provisions in the Inland Revenue Act, relating to finality of assessments, penalty for delayed payments and for incorrect returns, appeals, recovery of ESC, repayments, penalties and offences, administration, are applicable in relation to ESC as well (To be adjusted suitably)

Annexure-1

SEC\2005\10
22/11/2005

ACT 2\2004\8

SCIR/CIR/DCC/SAA/AA

Instructions on the implementation of certain provisions relating to Economic Service Charge (ESC), of the Finance Act No. 11 of 2004 as amended by the Finance (Amendment) Act No. 7 of 2005

Provisions relating to the ESC liability of BOI companies and the definition of turnover in relation to certain sectors of businesses have in their implementation resulted in some unintended effects. Having taken into account the various submissions made by several parties in this regard, an administrative decision has been taken to give effect to those provisions, pending formal amendments to the Act or action under the Act where necessary, as follows:-

- 1) Liability of Board of Investment (BOI) approved enterprises.
 - Year of Assessment 2004/2005 –
ESC should not be charged from any BOI approved company including companies approved under section 16 of the BOI Law for the year of assessment 2004/2005
 - Year of Assessment 2005/2006 - The application of rates are as follows:
 - Undertakings enjoying a tax holiday (exemption) on income tax (during the previous year of assessment, for the full period or part thereof) 0.25%
 - Undertakings that are changeable to income tax (during the previous year) at a rate not exceeding 15% - 0.5%
 - Others -1%

- 2) ESC Liability of Distributors
Year of Assessment 2005/06

The turnover of a “Distributor” for ESC purposes is the “gross margin” and the ESC on such turnover should be computed at 1 % irrespective

of whether the quantum is less than Rs.50 million or not, if the following conditions are satisfied.

- i) sales of the Distributor are out of the purchases made from a Manufacturer or Importer registered with the Department (of Inland Revenue) and by whom such Distributor is appointed.
- ii) the Distributor himself is not a retailer in respect of goods purchased from such Manufacturer or Importer.(However, in case any distributor selling any part of such goods other than diesel and petrol, in retail then it is not the margin thereon, but such sales should form part of liable turnover).
- iii) the price of goods are fixed by the Manufacturer or Importer, with a margin of not more than 6%. (If all other conditions are fulfilled and the margin is the sole consideration to the Distributor, subject to the approval of the Commissioner General, the margin can vary up to 7.5%)
- iv) the Manufacturer or Importer computes ESC on the liable turnover including the margin allowed to the Distributor,

Manufacturers or Importers who have appointed Distributors being Distributors fulfilling the above requirements are required to provide a list of Distributors with relevant details (viz. Name, address, TIN No. of Distributor, gross margin, break up of the turnover and computation of ESC) and as agreed, the Manufacturer or Importer is required to collect ESC payable by Distributors for the last two quarters and remit to the Department ,which in turn, will be credited to such Distributors.

(The liability for the year of assessment 2004/2005 has been already settled on case by case basis).

3). ESC - Liability of Freight Forwarders
Year of Assessment 2005/06

The turnover from the services of a “Freight Forwarder” for ESC purposes is the “gross freight collection excluding the actual freight charges collected on behalf of the shipping line” and the ESC on such turnover is computed at 1 %, irrespective of whether the quantum is less than Rs.50 million or not, if the following conditions are satisfied.

- (i) Services are provided by Freight Forwarders (Agents) or their local representatives who are registered with the Central bank of Sri Lanka under the provision of Exchange Control Act to facilitate international transportation; and
- (ii) Such services are evidenced by a document of carriage covered by a “Freight Forwarders All risk Legal Insurance Policy” issued in favour of the local freight forwarders.

Freight Forwarders who fulfill above conditions are requested to forward the relevant proof with the statement of turnover for the period in the format referred to in the Gazette No.641/15 dated December 20, 1999 for exchange control purposes to the Deputy Commissioner (ESC).

Commissioner General of Inland Revenue

22/12/2005

Note: No separate instructions issued for the year of assessment 2004/2005. The above instructions may be followed for Y/A 2004/2005 as well.

Gezette Extraordinary No 1447/10 dated May 30, 2006

Economic Service Charge Act No. 13 of 2006

REGULATIONS made by the Minister of Finance under section 12 of the Economic Service Charge Act No. 13 of 2006 read with Article 44(2) of the Constitution of the Democratic of Sri Lanka.

Mahinda

Rajapaksa

President

Ministry of Finance and Planning

Colombo

29th May, 2006

Regulations

In the ascertainment of turnover for the purposes of section 2 of the Economic Service Charge Act No. 13 of 2006, for any relevant quarter, from any trade or business of freight forwarder, there shall be deducted, in addition to the deductions specified in paragraph (b) of sub section (3) of that section, any sum payable by such freight forwarder to any person on account of the carriage, by such person, of any cargo loaded into any ship or aircraft owned or chartered by such person.

02. The non- chargeability to the Economic Service Charge provided for in sub- section (2) of Section 2 shall, for any quarter, not apply to any freight forwarder in circumstances wherein the relevant turnover of such freight forwarder, for such quarter, does not exceed rupees ten million.

03. In these regulations a “freight forwarder” means a person or a partnership who or which is registered with the Central Bank of Sri Lanka under the Exchange Control Act, as a freight forwarder and who-

(a) issues multi- modal documents of carriage covered by a “ Freight Forwarders All Risk and Legal Liability Insurance Policy” and

(b) furnishes, together with the return of relevant turnover for any relevant quarter, copies of the statement, furnished to the Controller of Exchange in respect of each month comprised in such relevant quarter, of-

(i) turnover prepared in the form specified in the Third Schedule, and

(ii) net collections prepared in the form specified in the Fourth, Fifth and Sixth Schedules

to the Notification issued by the Controller of Exchange under section 29B of the Exchange Control Act.

Department of Inland Revenue
Secretariat Branch
30/10/2006