

VAT ON FINANCIAL SERVICES



*For University Students, CA Students,
Tax Professionals and others.*



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1. Imposition of VAT on Financial Services (Sec 25A)

VAT on financial services shall be charged in accordance with the provisions of Chapter IIIA of the VAT Act **with effect from 01.01.2003** on the supply of financial services in Sri Lanka made by any person which carries on a business of supplying such financial services.

Supply of “financial services” means (Sec. 25F):

- a) the operation of any **current, deposit or savings account**
- b) the **exchange of currency**
- c) the issue, payment, collection or transfer of ownership of **any note, order for payment, cheque or letter of credit**
- d) the issue, allotment, transfer of ownership, drawing, acceptance or endorsement of **any debt security**, being any interest in or right to be paid money owing by any person other than the transfer of nonperforming loans of licensed Commercial Bank to any other person in terms of a re-structuring scheme of such bank as approved by the Central Bank of Sri Lanka with the concurrence of the Minister.

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- e) the issue, allotment, transfer of ownership of **any equity security** or a **participatory security**
 - f) issue, underwriting, sub-underwriting or subscribing of **any equity security, debt security or participatory security**
 - g) the provision of **any loan advance or credit**
 - h) the provision
 - i. of the facility of installment credit finance in a **hire purchase conditional sale or credit sale agreement** for which facility a separate charge is made and disclosed to the person to whom the supply is made
 - ii. of goods under any **hire purchase agreement or conditional sale agreement** which have been used in Sri Lanka for a period **not less than twelve months** as at the date of such agreement
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- iii. of leasing facility under any –
 - finance lease agreement, or
 - operating lease agreement in respect of any installment for any period prior to 01.11.2016on any asset other than any land or building, if such agreement is entered into on or after 25.10.2014.

Even though, the following persons supply financial services as a business, they are excluded from the chargeability of VAT on Financial Services:

- i. Co-operative Society registered under the Co-operative Law No. 5 of 1972
 - ii. Lady Lochore Loan Fund established under the Act No. 38 of 1951
 - iii. Unit Trust or a Mutual Fund
 - iv. The Central Bank of Sri Lanka (w.e.f. 01 July 2013)
 - v. The Sri Lanka Deposit Insurance Scheme (w.e.f. 01 April 2018)
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1. Imposition of VAT on Financial Services (Sec 25A)

VAT on Financial Service is applicable to following persons.

- i. All banks licensed under the Banking Act No. 30 of 1988 namely Commercial banks, development banks and savings banks or any other specialized banks.
- ii. All finance companies registered under the Finance Companies Act, No. 78 of 1988.
- iii. All persons who are engaged in the business of exchange of currencies.
- iv. All persons who are engaged in providing facility of installment credit finance in a hire purchase or credit sale agreement
- v. All pawn brokers
- vi. Any other person who is engaged in the provision of one or more of the said financial services.

2. Requirement for Registration (Sec 25A(2))

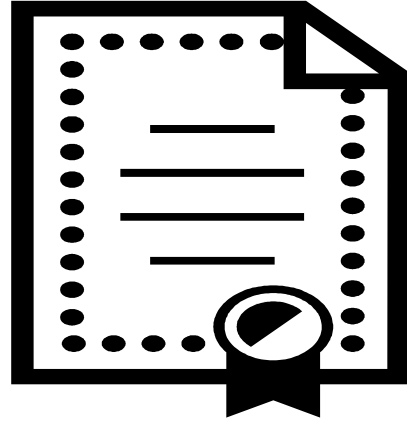
Every specified institution or other person carries on the business of financial services in Sri Lanka, shall be required to register where the value of such supply for a period of three months exceeds the required threshold limit.

Period	Threshold Limit
Up to 01.01.2013	Rs. 500,000 per quarter Rs. 1,800,000 per annum
01.01.2013 – 31.12.2014	Rs. 3,000,000 per quarter Rs. 12,000,000 per annum
01.01.2015 – 01.05.2016	Rs. 3,750,000 per quarter Rs. 15,000,000 per annum
02.05.2016	Rs. 3,000,000 per quarter Rs. 12,000,000 per annum

3. Application for Registration (SEC 25A(3))

Every specified institution or other person required to be registered shall make an application for registration in the specified form to the CGIR **not later than 30 days** from the date of completion the requirement.

However, CGIR shall register any person who has not made any application for a registration if CGIR is of the opinion that such person is required to be registered.



4. Taxable Period (Sec 25B)

- Taxable period is **six months** for the period commencing on or after 01st January 2011 (up to 31.12.2016).
- Taxable period is **twelve months** for any taxable period commencing on or after 01st January 2017.

However, in case of a person whose accounts are made up for a twelve months period ending on 31st March, such period of twelve months may be commenced on 1st April. In the event of changing the accounting period with the approval of the CGIR, the taxable period may be adjusted at the time of such change.



5. Furnishing Return (Sec 25B(2))

The liable person shall furnish a return of VAT on financial services in the form specified in respect of each taxable period as follows.

- a) Return should be filed before the **end of the succeeding month** of the **six months taxable period** commencing **prior to 01.01.2017**.
- b) Return should be filed **within the period of six months** succeeding the end of the **one year taxable period** commencing **on or after 01.01.2017**.



5. Furnishing Return (Sec 25B(2))

Examples:

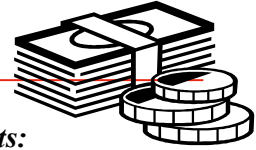
- *Company's accounting year ending 31 December 2020 – the return is due or before 30th June 2021*
- *Company's accounting year ending 31 March 2021 – the return is due or before 30th September 2021*

However, each company should file Interim Estimate of VAT on financial service on bi-annually (on or before the 20th day of the succeeding month of each six months period).

Examples:

- *Company's accounting year ending 31 December 2020, for the six months period ended 31st December 2020 – the Interim Estimate is due or before 20th January 2021*
- *Company's accounting year ending 31 March 2021, for the six months period ended 31th March 2021 – the Interim Estimate is due or before 20th April 2021*

6. Payment of Tax (Sec 25B(3))



The liable person shall be paid on a monthly basis on or before the **20th day of the succeeding month** subject to the making of any **final adjustment**, if any, with the submission of the return.

However, for the taxable period on or after 01.01.2017, the tax payable on a monthly basis shall be adjusted for the total liability for every six months period on the interim estimate referred to in section 25C(b) and payable with the submission of the interim estimate, if the monthly payments made are less than the tax as per the interim estimate.

Where such tax is not so paid, such tax shall be deemed to be in default.

Example:

- **Monthly Payments:**
 - ✓ January 2021 – on or before 20th February 2021
- **Interim Payments:**
 - ✓ 6 months ended 31 December – on or before 20 January
 - ✓ 6 months ended 31 March Companies – on or before 20 April
- **Balance Payment:**
 - ✓ 31 December Companies – on or before 30 June
 - ✓ 31 March Companies – on or before 30 September

7. Calculation of Tax (Sec 25C)

Calculation of Total Value Addition (Sec 25C(1))

Every registered person shall be liable VAT on Financial Services on its total value addition.

There were two methods to calculate the liability of VAT on FS, namely;

- a) Tax credit method
- b) Attributable method

However, w.e.f. 01.01.2013, only **attributable method** is applicable.

In the calculation of VAT on FS, the liable person shall follow the **Gazette Notification No. 2316/13 (Dated 24 Jan 2023)**.

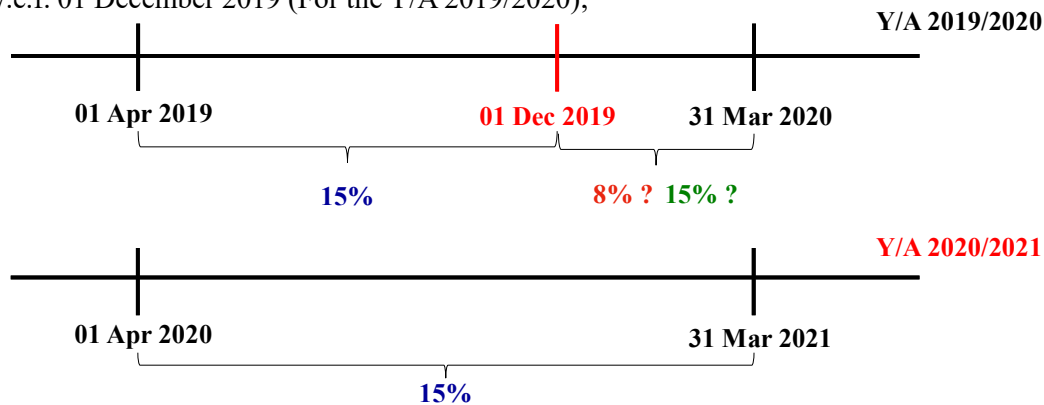
For any taxable period on or after 01.01.2017, where the amount of profits **cannot be accurately ascertained for monthly payments**, such amount may be estimated on the basis of available information, and the registered person **shall furnish an interim estimate** of the profits in a specified form in respect of **each six months period before the 20th day of the succeeding month** of the each such six months period.

7. Calculation of Tax (Sec 25C)

Rate of Tax (Sec 25C(3))

15% for any taxable period from 01.11.2016 onwards.

W.e.f. 01 December 2019 (For the Y/A 2019/2020);



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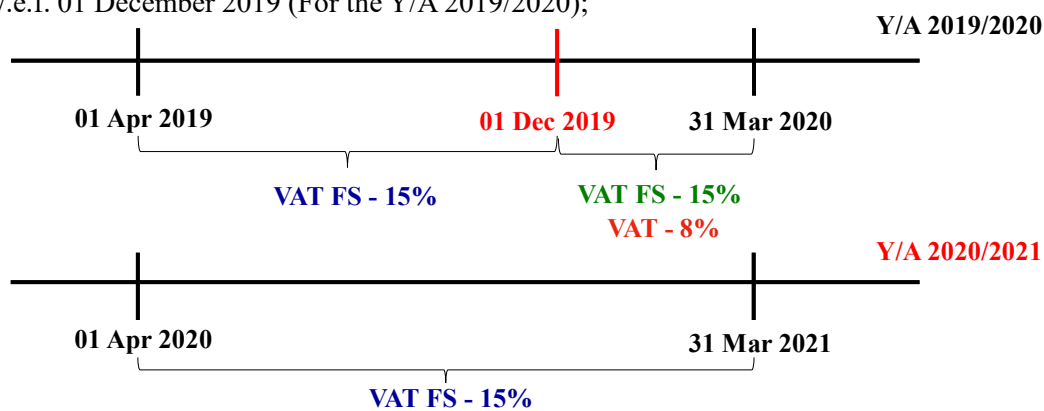
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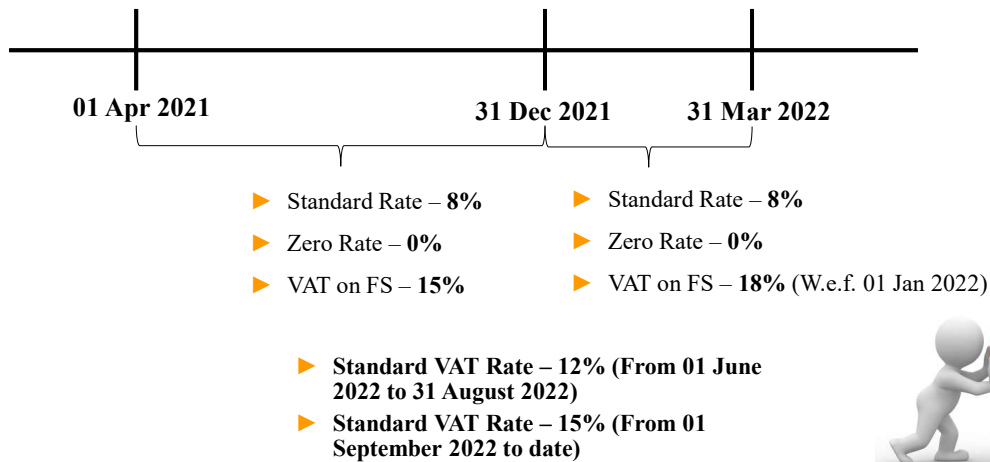


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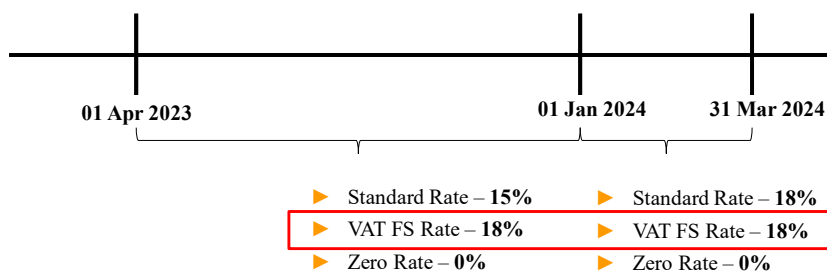
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7. Calculation of Tax (Sec 25C)



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Calculation of VAT on Financial Services on Attributable Method (Sec 25C(4))

The computation of total value addition is based on the net profit or loss (computed in accordance with accepted accounting standards) as per the financial statements subject to adjustments.

The following points may also be noted in computing total value addition.

1. Emoluments

The emoluments payable is added in arriving at the total value addition. Emoluments payable means gross remuneration payable to all the employees. Gross remuneration means aggregate of both cash and non-cash benefits including retirement benefits which is charged to the income statement.

2. Economic Depreciation

The rates of economic depreciation determined by the Minister and published in the Gazette Notification No. 1606/30 dated 19.06.2009 are as follows:

7. Calculation of Tax (Sec 25C)

Asset	Rate (Per Annum)
Data processing equipment and accessories including computer software	25%
Motor Vehicles	20%
Other Machinery, Plant, Equipment, Furniture or Fixture	12 ½%
Intangible assets (other than Goodwill)	10%
Buildings	6 2/3%

- The above rates refer to annual depreciation. In case of computing monthly economic depreciation, such annual depreciation is to be divided by twelve.
- All assets are subject to economic depreciation, regardless of the fact such assets are eligible for depreciation for income tax purposes under IRA.
- Economic depreciation shall not apply asset being an asset which forms part of the leasing stocks of such person.

7. Calculation of Tax (Sec 25C)

Turnover - financial services	90%	9,000
Turnover - non financial services	10%	1,000
Total Turnover		10,000
Net Profit or Loss (before income tax expenses)		100
Add:		
VAT on supply of financial services charged to P&L	20	
Depreciation charged to the Income Statement	20	
Emoluments Payable	120	160
Less:		
Economic Depreciation		(30)
Total value addition prior to tax		230
Total value addition prior to tax	(230 * 90%)	207
Less:		
VAT on Supply of Financial Services (VA/120.5*18)		(31)
SSCL on Supply of Financial Services (VA/120.5*2.5)		(4)
Value addition attributable to supply of financial services		172
VAT on supply of financial services @ 18%		31
SSCL on supply of financial services @ 2.5%		4

* Taxable value addition shall exceed Rs. 75,000 for any calendar month for the liability of VAT on FS.

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8. Exclusions from Taxable Value Addition

1. **Exempt supplies** (As provided in 1st Schedule of the VAT Act)
2. **Zero Rated Supplies** (Referred to in section 7 of the VAT Act)
3. **Taxable supplies under normal VAT** (VAT paid at 15% / 8%)
4. **Interest from inter company transactions** (Profits or income on interest arising from inter-company transactions of a group of companies relating to any loan, advance or credit. However, if such interest received by such company in the group as being profits from a business, it cannot be removed, and therefore such interest is chargeable to VAT on FS)
5. **Interest from certain funds** (ETF, Pension Fund, savings or building society or welfare fund to which contributions are made by employees only, any approved gratuity fund)
6. **Interest Income** (Non business)
7. **Dividend Income** (Not being profits from a business)
8. **Profits and Income from dealing in shares** (Not being profits from a business)
9. **Exchange of currency** (Not being profits from a business)

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8. Exclusions from Taxable Value Addition

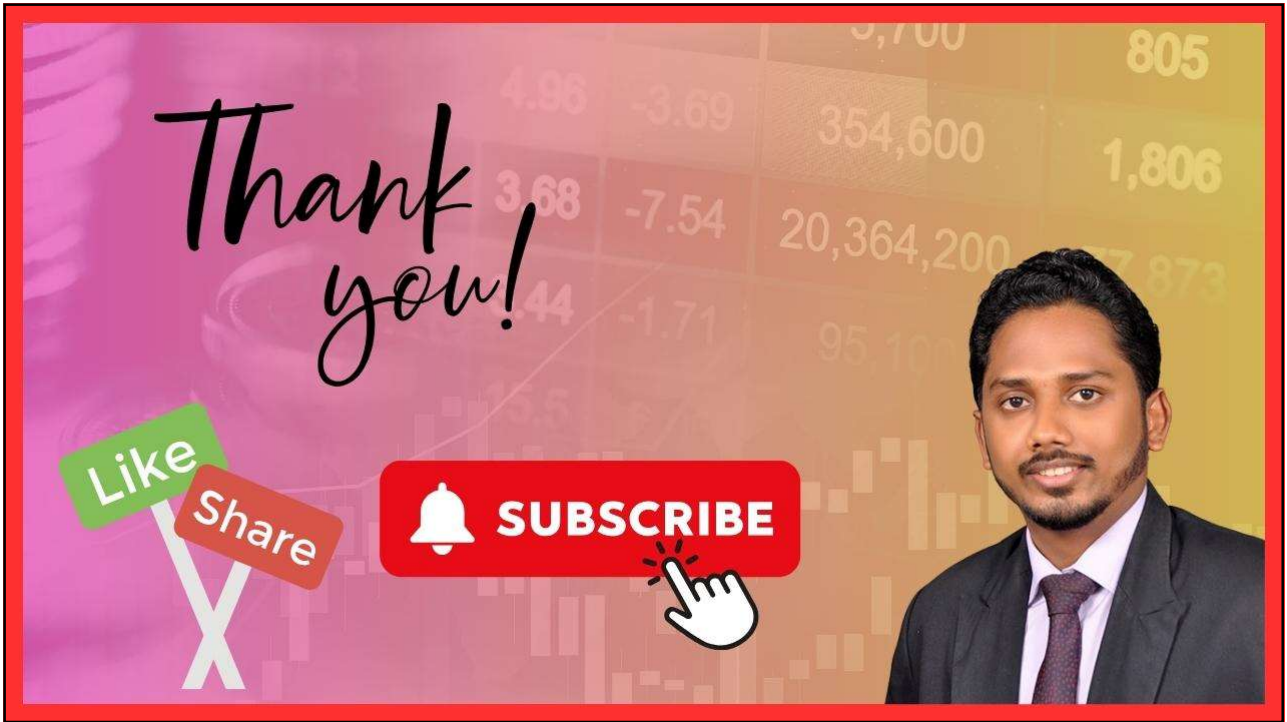
The above exclusions as non taxable mentioned in (4) to (8) shall not apply to following persons so that such value additions are taxable value addition to them.

- a) *Any licensed commercial bank within the meaning of the Banking Act, No. 30 of 1988.*
- b) *Any finance company registered under the Finance Company Act, No. 78 of 1988 or Finance Business Act, No. 42 of 2011.*
- c) *Any Licensed Specialized Bank within the meaning of the Banking Act, No. 30 of 1988.*
- d) *Any person not registered with the Central Bank of Sri Lanka, but providing services similar to such services provided by a finance company.*

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