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Sri Lanka: tax implications of talent mobility – cross-border movement of employees

This report examines the situation in Sri Lanka in regard to the tax treatment of cross-border employment, addressing residency and source of income rules, the composition and computation of taxable employment income, as well as the applicable tax rates and reliefs available. It also examines the withholding obligations for employers and the relevant social security (Employees Provident Fund (EPF)/ Employees Trust Fund (ETF)) obligations, permanent establishment risks, foreign currency remittance treatment, exit obligations, as well as the compliance and planning considerations for non-resident employers and employees.

1. Overview of the tax system

The income tax system for individuals in Sri Lanka operates on a self-assessment basis, supplemented by withholding taxes, such as the Advance Personal Income Tax (APIT). Income tax is imposed according to the Inland Revenue Act No 24 of 2017, as amended (IRA). It covers persons with taxable income for a given year of assessment and those receiving income subject to final withholding tax.

A year of assessment runs from 1 April to 31 March of the following year (a 12-month period). Taxable income for that year is the individual's total assessable income from employment, business, investments and other sources, minus any qualifying payments and relief. When calculating the tax payable by an individual, any foreign tax credits or other tax credits allowed under the IRA may be deducted.

Basis of taxation (residence vs source)

Residents are taxed on their worldwide income. Non-residents are taxed only on income derived from a source in Sri Lanka.

2. Taxation of employment income

Foreign employees in Sri Lanka are taxed based on tax residency and the source of income. An individual is a tax resident if they are present in Sri Lanka for 183 days or more (in aggregate) in any 12-month period commencing or ending during the year of assessment.

Income from an employment contract is treated differently from independent service providers/freelancers, whose income falls under the definition of business income. Remote workers may be subject to employment rules if an employment relationship exists.

2.1. Scope of taxable employment income

An individual's employment income for a given year comprises their gains and profits derived from their employment during that year. This includes:

- salary, wages, leave pay, overtime, fees, pensions, commissions, gratuities, bonuses and similar payments;
- allowances, including cost of living, subsistence, rent, entertainment and travel allowances;
- payments in discharge or reimbursement of expenses incurred by the individual or an associate of the individual;
- payments in respect of an individual's agreement to the conditions of employment;
- payments for redundancy or the loss or termination of employment;
- payments made to third parties for the benefit of the individual or their associates;
- the fair market value of non-cash benefits and gifts received in respect of employment by an individual or associate of the individual;
- retirement contributions made on behalf of the employee and retirement payments (subject to applicable rules); and
- the market value of shares allotted through an employee share scheme (including upon the exercise of options), reduced by any employee contribution.

The following are excluded from the scope of an individual's employment income:

- exempt amounts and income subject to final withholding tax;
- reimbursements of expenses incurred on behalf of the employer;
- qualifying medical or health insurance benefits provided to all full-time employees within the same grade of service, on equal terms;
- minor or impracticable-to-allocate benefits provided non-discriminately;
- the value of share options at the time of granting as part of an employee share option scheme;
- qualifying employer contributions to an approved pension, provident, gratuity or savings funds (subject to certain conditions); and
- retirement payments, where the related contributions have already been taxed and paid during a previous tax year.

2.2. Source of income rules

Under Section 73 of the IRA, employment income is considered to be locally sourced:

- if it is derived in respect of employment in Sri Lanka, wherever it has been paid;
- if paid by, or on behalf of, the Government of Sri Lanka, wherever the employment is located; or
- if it is derived from a company that is resident and conducting business in Sri Lanka.

A company is a Sri Lankan tax resident if:

- it is incorporated or formed based on Sri Lankan law;
- it is registered or the principal office is located in Sri Lanka; or
- at any time during the tax year, the management and control of the affairs of the company are exercised in Sri Lanka.

Employment income is foreign sourced to the extent that it is not sourced from within Sri Lanka.

2.3. Tax rates

Progressive tax rates

Resident and non-resident individuals are taxed according to the following progressive scale with effect from 1 April 2025:

Taxable Income (LKR)	Tax Rate (per cent)
First LKR 1,000,000	6
Next LKR 500,000	18
Next LKR 500,000	24
Next LKR 500,000	30
Balance	36

Foreign currency income remitted to Sri Lanka through a bank

There are no flat income tax rates applicable to expatriates in Sri Lanka.

However, the maximum tax rate applicable to the following is 15 per cent:

- gains and profits earned or derived from 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 ('service exports'); and
- gains and profits earned or derived from any foreign source where such gains and profits are earned or derived in foreign currency and remitted through a bank to Sri Lanka ('foreign sources').

Employees earning their salary in foreign currency, thus falling within the ambit of service exports or foreign-sourced income, would be subject to income tax as follows:

Foreign currency income remitted to Sri Lanka through a bank (LKR)	Tax rate (per cent)
First LKR 1,800,000	0
Next LKR 1,000,000	6
Balance	15

The onus of paying the above tax will fall on the employee where the employer is a person located outside Sri Lanka.

Personal relief

Prior to applying the aforementioned progressive tax rates, a resident individual or a non-resident citizen of Sri Lanka is eligible to deduct a sum of LKR1,800,000, as personal relief, from their total assessable income, in arriving at the taxable income for a given year of assessment.

2.4. Miscellaneous issues

Employer's withholding obligations

An employer is responsible for deducting APIT from all payments to an employee, which are considered as gains and profits from their employment. Thereupon, the employer as a withholding agent is obliged to pay to the Commissioner General of Inland Revenue (CGIR) the amount withheld within 15 days after the end of each calendar month.

Guidance is available to employers on the deduction of APIT, including in relation to non-cash benefits, displayed in the APIT tax tables, published on the Inland Revenue Department's website.

Employers must also file an annual statement with the CGIR. The statement must set out payments made by the employer subject to withholding tax (ie, APIT); the name, address and tax identification number of the withholder; the tax withheld from each payment; and any other required information. The statement should be filed within 30 days after the end of each year of assessment (31 March).

The employer is liable to pay APIT in respect of a payment made to an employee regardless of whether APIT was in fact withheld from the payment for the relevant period. However, the employer may recover the APIT amount from the employee in such circumstances. Where an employer fails to withhold APIT from employment income, the employee shall be jointly and severally liable with the employer for the payment of the tax.

APIT withheld and paid to the CGIR is treated as tax paid by the employee. The employee may claim a withholding tax credit for the APIT paid by the employer on their behalf by submitting a tax credit certificate provided by their employer. The amount withheld on behalf of a non-resident non-citizen is considered to be a final withholding payment.

Employers are required to prepare and issue withholding tax certificates that set out the payments made to the employee and the APIT withheld by the employer from such payments. The withholding tax certificates should cover the period of employment and be provided to the employee prior to 30 April of the following year or within 30 days from the date of cessation of their employment.

Interplay with social security contributions

Social security contributions are governed by the Employees' Provident Fund Act No 15 of 1958, as amended (EPF) and the Employees' Trust Fund Act No 46 of 1980, as amended ("ETF").

In regard to the EPF, employers must contribute 12 per cent and employees eight per cent of the total monthly earnings, totalling 20 per cent.

In regard to the ETF, employers must contribute three per cent of total monthly earnings.

Total monthly earnings refer to the gross income of the employee (before tax).

Based on decided case law,¹ foreign nationals employed in Sri Lanka are not excluded from the application of the EPF/ETF Acts.

Contributions in respect of EPF and ETF should be remitted to the relevant funds prior to the last working day of the following month.

¹ *Blanka Diamonds (Pvt) Ltd v Van Els* (2004) 3 SLR 314 (SC); *Strabag AG v Commissioner General of Labour and Others* (2020) 1 SLR 74 (CA).

3. Permanent establishment (PE) risks

A ‘Sri Lankan permanent establishment’ is defined in the IRA as ‘any business connection or fixed place of business through which the business of the enterprise is wholly or partly carried out, irrespective of the number of days of such business being carried out in Sri Lanka’.

Sri Lanka has also entered into double tax avoidance agreements (DTAA) with 46 countries, namely, Australia, Bahrain, Bangladesh, Belarus, Belgium, Canada, China, the Czech Republic, Denmark, Finland, France, Germany, Hong Kong, India, Indonesia, Iran, Italy, Japan, Jordan, Korea, Kuwait, Luxembourg, Malaysia, Mauritius, Nepal, the Netherlands, Norway, Oman, Pakistan, Palestine, Philippines, Poland, Qatar, Romania, Russia, Saudi Arabia, the Seychelles, Singapore, Sweden, Switzerland, Thailand, Turkey, the United Arab Emirates, the United Kingdom, the United States and Vietnam.

3.1. Fixed-place PE

In *Johnson and Johnson (Private) Limited v The Commissioner General of Inland Revenue*,² on examination of Article 5 of the Sri Lanka–India DTAA, the Court of Appeal noted a list of positive examples of a fixed-place PE, including a place of management, a branch, an office, a factory or a workshop, etc. The appellant company (a company incorporated in India) had a branch office in Sri Lanka and earned profits and income from its business in Sri Lanka. Accordingly, the Indian company was held as having a PE with a registered branch office in Sri Lanka within the meaning of Article 5 of the DTAA. The Court further identified a negative list in the context of a fixed-place PE in terms of the DTAA, setting out, ie, that certain activities of a preparatory or auxiliary character will not constitute a PE as defined in Article 5(3) and held that a “mere maintenance of a fixed place of business solely for the purposes referred to in Article 5 (3), including the mere preparation or auxiliary character in the business would be insufficient to create a PE”.

In *Access International (Private) Limited v The Commissioner General of Inland Revenue*,³ the Court of Appeal considered whether the mere registration/existence/maintenance of a fixed place of business in Sri Lanka constituted a PE under the Sri Lanka–UK DTAA. The Court found this alone to be insufficient unless it can be shown that the branch office also carries out business in Sri Lanka from that fixed place of business. In this case, the Court observed that there was no

² *Johnson and Johnson (Private) Ltd v Commissioner General of Inland Revenue CA (Tax) CA/TAX/0002/2018 (SCOA) (27 May 2022).*

³ *Access International (Private) Ltd v Commissioner General of Inland Revenue CA (Tax) CA/TAX/0016/2018 (SCOA) (5 August 2022).*

evidence in the form of bank statements or financial statements indicating that the branch office had carried on business in Sri Lanka.

In *Indian Overseas Bank v The Commissioner General of Inland Revenue*,⁴ the Court of Appeal held that the income of an individual or company from one country (Country 'A') will be taxable in the other country (Country 'B') only if there is a PE in Country 'B' and only the income attributable to such PE in Country 'B' will be subject to tax in Country 'B'.

3.2. Consultancy PE

A consultancy PE may arise where personnel from a foreign enterprise work in Sri Lanka on a project without a fixed office (ie, a branch office, factory). In the *Johnson and Johnson* case it was noted that if such a person works in Sri Lanka on a project involving any construction company that continues for more than 183 days, it may constitute a PE in Sri Lanka.

3.3. Agency PE

An agency PE arises when a person in Sri Lanka is appointed as an agent of a foreign enterprise and is vested with the authority to regularly act or habitually exercise authority to conclude contracts or conduct business on the enterprise's behalf. The *Johnson and Johnson* decision confirmed that an agent with such authority can create a PE even if operating without a fixed place of business.

4. Exit tax/departure rules

Sri Lanka does not impose specific exit taxes. Departing employees must ensure that all of their taxes are paid and their tax returns filed up to the date of their departure. Non-resident employees with no taxable income in Sri Lanka post-departure may apply for cancellation of their tax files with effect from the date of cessation of their employment in Sri Lanka.

5. Key takeaways

5.1. Major risks for non-resident employers

Some of the main risks facing non-resident employers are outlined below:

⁴ *Indian Overseas Bank v Commissioner General of Inland Revenue* CA (Tax) CA/TAX/0005/2019 (SCOA) (27 January 2023).

- a failure to identify that a PE has been established in Sri Lanka and inadequate preparation for the tax exposure attributable to such a PE. The standard corporate tax rate on business profits is 30 per cent;
- a failure to account for taxes on non-cash benefits provided to employees can leave room for potential additional tax assessments;
- non-compliance with withholding tax obligations on employment income or social security contributions in Sri Lanka; and
- non-compliance with local employment laws at termination, including gratuity and statutory compensation due under the Termination of Employment of Workmen (Special Provisions) Act No 45 of 1971, as amended (TEWA).

5.2. Major risks for non-resident employees

Some of the main risks facing non-resident employees are outlined below:

- being present in Sri Lanka for 183 days or more in any 12-month period will expose such individuals to income tax in Sri Lanka on their worldwide income. The maximum progressive income tax rate in Sri Lanka is 36 per cent; and
- a failure to pay taxes on a self-assessment basis and a failure to file returns in accordance with the IRA will lead to consequences and penalties.

5.3. Key planning considerations

For non-resident employers, a major concern in regard to structuring their operations in Sri Lanka concerns the need to assess whether the activities performed by employees in Sri Lanka would constitute a PE and if so whether it can rely on a DTAA. The scope of a Sri Lankan permanent establishment under the IRA is much wider than that under a DTAA; and if the employer is a resident in a country with which Sri Lanka has a DTAA, whether the activities performed by the employees in Sri Lanka would give rise to a PE or whether such activities are merely preparatory or auxiliary in nature.

For non-resident employees, careful planning is necessary in terms of the length of stay and payment structure of their employment income, given the potential exposure to income tax in Sri Lanka on their worldwide income.

6. Upcoming amendments

The Inland Revenue (Amendment) Bill, issued on 24 February 2026, proposes amendments to widen the definition of a Sri Lankan tax resident. The bill has not yet been enacted as of 23 April 2026.