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EXPLANATORY NOTE ON THE APPLICATION OF ADVANCE PERSONAL INCOME TAX (APIT)

This explanatory note intends to clarify the application of Advance Personal Income Tax (APIT) imposed in terms of the Section 83A(1A) of the Inland Revenue Act, No. 24 of 2017 (IRA), as amended by the Inland Revenue (Amendment) Act, No. 45 of 2022, for certain practical issues.

1. Identification of profits from employment and Service fee payments made to Individual Independent Service Providers (IPS).

   It is important to properly classify an individual as an employee or Independent Service Provider. An employee will derive income from employment whereas the latter will derive income from business. It is difficult to clearly define the boundaries between employment and provision of Independent Individual Service. However, weighing the most significant facts, such difference should be identified as it decides the mode of payment the individual's income tax liability.

   The criteria such as applicability of usual rights set out in the labor laws and employment related bylaws, degree of control, the permanence of relationship, independence, ability to subcontract the assigned task could be applied in classifying difference between employment and provision of independent service. To elaborate further, IPS are told what is required but not how to do it whereas employees are subject to instructions as to not only what they are to do but how they are to do it. To perform the service, IPS use their own equipment and materials but employees are provided with equipment and materials. IPS have the power to delegate their duties to a third party whereas Employees have no such delegation of power. Employees are remunerated by fixed and ascertainable amounts for the time worked and therefore, no risk of earning remunerations. In case of IPS, they take risks and derive varying returns and may incur even losses. Employees are bound by the entity's rules, regulations, circulars, bylaws and terms and conditions of the contracts whereas IPS are hardly affected by such limitations.

Further, section 195 of the IRA defines "employee" as an individual engaged in employment. "Employment" is defined as a position or public office held by an individual. As per the principle of dominance over the sources of income: employment, business, investment and other income, "employment income" is dominant over "business income". Therefore, firstly, it should be investigated whether an income falls within the meaning of "employment" and it could amount to a "business income" unless it is an employment income.

As the facts revealed, most probably, Visiting Lecturers of Universities are given letter of appointment for a "position" of visiting lecturer under the same employer or a different employer. If a lecturer was given an appointment for postgraduate and other faculty duties under the same employer, then, such visiting lecturer has only one employment contract and all gains and profit from such employment (normal duties and such other duties of postgraduate or other faculties) should be considered to deduct APIT by the same employer. If visiting lecturers' appointments are given by the different employers, then the APIT should be deducted based on the primary employment declaration or secondary employment declaration; as the case may be. Positions holding by university employees during a period of sabbatical leave fall within the meaning of "employment". However, earnings derived by a particular Subject Matter Expert in the relevant field by delivering a special lecture (not under the employer) fall within the meaning of a service fee of "teaching" or "lecturing" as mentioned in paragraph (c) of Subsection (1C) of Section 85 of the IRA.

Further, if an employee has resigned from the employment and reaccepted the same job or work with or without certain employment rights, such as contribution to Employees' Provident Fund (EPF) and Employees' Trust Fund (ETF), Gratuity, pension, statutory payment, health insurance or no pay leave, such reacceptance should be still considered as an employment contract for the purpose of income tax based on the weight of factors explained above.

2. Identification of the service of a member or director of a Council, Board, Commission, Authority or Committee or Entity.

   A position of an individual as a Manager of an entity is defined as an "employment" in section 195 of the IRA. Further, in the same section, "manager" is defined as a councilor, director, manager, member, officer or other person who participates or may participate, whether alone or jointly with other persons, in making **senior management decisions** on behalf of the entity.

   Accordingly, as an Individual who makes senior management decisions on behalf of the entity alone or jointly, above member or director carries on the "employment" in such particular entity.

Once a particular income is identified as employment income as explained in item number 1 and 2 of this explanatory note, such employee should be allowed to select whether it is his/her primary employment or secondary employment and accordingly, relevant declaration should be obtained by the employer. An employee who is having only one employment is not required to submit a declaration as such employment automatically becomes his primary employment. If any other employee has not submitted the relevant declaration, APIT should be deducted at the maximum individual income tax rate.

3. Deduction of APIT on salary arrears.

Salary arrears are always linked to a previous period with retrospective effect. As per sub section (2) of section 21 of the IRA, an individual shall account for income tax purposes on a cash basis in calculating the individual's income for employment. Under the cash basis of accounting, as per sub section (1) of Section 22 of the IRA, a person derives an amount when payment is **received by or made available** to the person. Therefore, irrespective of the reasons for salary arrears and the tax law provisions applicable for such previous period, salary arrears should be taxable as per the provisions of income tax law prevailing when such **salary arrears are received by** or **made available** to the employee.

The terms "payment is made available" is meant an instance where following all conditions are satisfied in respect of such payment.

i. The legal entitlement to the payment made by a higher authority.
ii. The payee should have been informed of the payment.
iii. The legal assurance that bad debts are not incurred in respect of such payment by the employer.

If in any case, where the legal entitlement to the payment is on a date prior to the date of payee is informed of such payment, the payment should be considered as "made available" on such date when the payee is officially informed of the payment. It is an indication which assures that bad debts are not occurred in respect of such payment. For example, in any case where an employee has been acquitted of any charge by a competent court and salary arrears are arised on such court decision, payment is not "made available" until such time the respective administrative authority of the employee officially informs the payment of salary arrears to the employee.

An employee may face both situations where the payment of salary arrears is made available or such payment is received. In such instance, the situation where provisions of income tax law are more convenient and beneficial to the employee should be considered. However, once the situation is decided, it cannot be changed considering the fact that salary arrears are paid in instalments.

4. Quantification of the value of the benefit included in the traveling, transport or related facilities provided by the employer.

   The circular, Directive or Regulation mentioned in item 3(b) and 3(c) of Commissioner General's circular Number SEC/2023/E/02 dated 06.04.2023 (similar to the item 3(b) and 3(c) of the SEC/2022/E/05 dated 07.02.2023) means the Public Administration circular issued by the Ministry of Public Administration and Home Affairs as applicable to the Public Officers of Government of Sri Lanka or a local authority including any Government department. Accordingly, entities such as Government Corporations, Statutory Boards, Government Owned Companies, Commissions, Universities and institutes established by particular Acts etc. cannot quantify the value of the benefit included in the traveling, transport or related facilities provided by the employer as per the item 3(a) and 3(b) of Commissioner General's circular Number SEC/2023/E/02 dated 06.04.2023.

   The item 3(b) and 3(c) of Commissioner General's Circular Number SEC/2023/E/02 dated 06.04.2023 is reproduced below;

   "(b) The value of the benefit shall be 25% of the cost incurred by the employer, for the payment of any amount to the employee for using a vehicle owned or rented by that employee, where such employer should provide a vehicle or pay an amount in lieu of providing a vehicle for official use (fully or partly) to that employee, under any Circular, Directive or Regulation issued in that behalf by the Government.

   (c) where any employee is required to be provided with a vehicle for official use (fully or partly) and entitled to a payment for fuel under any Circular, Directive or Regulation issued in that behalf by the Government, such part of the cost incurred by the employer as attributable to 25% of the fuel quantity for which the employee is entitled under such Circular, Directive or Regulation, shall be the value of the benefit to be included."

The Employers as WHT Agents are advised to adhere to above explanatory note in deducting APIT. Additional tax liability will be arised with interest and penalty to both employer and employee who fail to pay APIT as required by the provisions of the IRA.

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