

**DOING
BUSINESS
IN**

Sri Lanka



HLB Sri Lanka

*doing business in
Sri Lanka*

foreword

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general information

Geographic Location and Climate

Sri Lanka, (Democratic Socialist Republic of Sri Lanka), is an island in the Indian Ocean, lying off the southeastern tip of the Indian subcontinent. Colombo situated on the western coast, is the largest city and the commercial capital of Sri Lanka. Sri Lanka measures 435 km north to south & 224 km east to west, covering a total area of 65,610 sq.km. The island's strategic location in the Indian Ocean on the major air & sea routes between Europe & the Far East gives it an advantage as a global logistics hub. Sri Lanka has a pleasant tropical climate with two climatic zones - the wet & the dry. Temperatures range from 23-30 degrees Celsius in the lowlands & 10-20 degrees Celsius in the hill country. The average temperature in the country is approximately 27 Celsius.

Population and Languages

The population of Sri Lanka is about 20mn. (2004 estimates). Sri Lanka is a multi-ethnic, multi religious country with a diverse & rich culture. The Sinhalese, the majority community, comprise 74.0% of the country's estimated 20mn population. The other ethnic groups that are part of Sri Lanka's social fabric are the Sri Lankan Tamils, Indian Tamils, Moors & other minorities including Malays & Burghers. Each of these groups has its own identity, customs & traditions. The two official languages are Sinhala & Tamil. Sinhala is the language of the majority of the population. Tamil is widely used in the northern & eastern parts of the country. English is widely spoken & understood in the urban centres. It is the language of business & commerce.

Education & Skills

Schooling is compulsory for children from 5 to 13 years of age. Education is state funded and offered free of charge at all levels, including the university level. The government also provides free textbooks to schoolchildren. Literacy rates and educational attainment levels rose steadily after Sri Lanka became an independent nation in 1948. The government gave high priority to improving the national education system and access to education. The adult literacy rate now stands at 93 percent. The language of instruction is either Sinhala or Tamil. English is taught as a second language. We have the highest literacy rate in South Asia (93%) and approximately 50% of the students who have completed their higher education are trained in technical and business disciplines.

Employees

The Sri Lankan work force accounts for 35% of the total population. English is widely spoken in the country and is the main language used by the business community. As a result of extensive investment in education & welfare programmes by successive governments, any foreign Investor will find our work force highly skilled, energetic & intelligent, adaptable and trainable. Foreigners can be employed in Sri Lanka but only with the approval of the Govt. Authorities. Usually such approvals are give for companies formed with the approval of the Board of Investment of Sri Lanka (see paragraph 3.3.2 for details).

Offices working hours are from Monday to Friday and Factories work on Saturdays as well.

Every employer is required to contribute to the following Funds

I . Employees' Provident Fund

The Employees' Provident Fund was established in terms of Act No 15 of 1958 with the objective of providing superannuation benefits to employees of the private sector, government authorities and corporations. It is a mandatory contributory retirement benefit scheme. Contributions are due from employer at the minimum rate of 12% and the employee has to contribute at 8% minimum on the gross earnings. The Central Bank of Sri Lanka manages the fund and it represents the main largest fund in terms of the Government asset portfolio. Employees are guaranteed their lump sum balance at the retirement age with interest lying to their credit.

II. Employees' Trust Fund

Under the Employees' Trust Fund Act, every employer has to contribute at the rate of 3% of each employee's monthly earnings, to the Fund managed by the Commissioner of Labour. Employees are eligible to withdraw their balances at the termination of employment with their interest in the accounts.

government

Executive

The President of Sri Lanka is head of state, Chief Executive, and commander in chief of the armed forces. The President is elected for a six-year term and serves no more than two terms. The President appoints the Prime Minister and the cabinet of Ministers, all of who must be members of the legislature. The legislature of Sri Lanka is a unicameral (single-chamber) body called Parliament, which has 225 members, who serve six-year terms.

Provincial and Local Government

The country is divided into 9 provinces, (in 1989 more Central Government powers were vested with Provincial Councils) where the members are elected to serve 5 years. Provincial members are given limited powers in education, health, rural development, social services, agriculture and local taxation. A Governor appointed by the President heads each province. Local Government also includes Local authorities i.e. Municipal, Urban, Village Councils, which has limited powers in local arrears.

Legal System

Sri Lanka's judiciary consists of a Supreme Court, Court of Appeal, High Court, and a number of subordinate courts. Sri Lanka's legal system reflects diverse cultural influences. Criminal Law is fundamentally British. Basic civil law is Roman - Dutch law. The principles of English law is applied in relation to Bills of exchange, Sale of Goods, Partnership, Companies, Insolvency, Banking, Maritime matters, Insurance etc.

Currency and Banking

The monetary unit in Sri Lanka is the Rupee (Rs), which consists of 100 Cents (U.S.\$1 = Rs.100 Approx. or Euro 1 = Rs.138 Approx). The Central Bank of Sri Lanka is the monetary authority of the country, the sole bank of issue, also acts as a financial adviser to the government and administers monetary policy. Banking in Sri Lanka is of high international standard and more than 15 foreign banks have branches here. Significantly, some of these branches have been established for more than 100 years. Sri Lanka also has over ten local banks including two large state banks. Two development finance institutions and several merchant and investment banks are also active.

Exchange Control

The Central Bank of Sri Lanka is the monetary authority of the country. It ensures financial stability by the prudent use of monetary policy instruments and manages the automated cheque clearing system for the Commercial banking system. It also

determines the daily buying and selling rates for the US Dollar against the country's Rupee and the

rates are published daily. The exchange rates of other major international currencies are fixed by supply and demand within the commercial banking system.

Under The Exchange Control Act, the Central Bank functions as the agent of the Government through the Controller of Exchange. Currently the Controller regulates transactions in foreign currencies of a Capital nature only. i.e. Sale or purchase of a Capital Asset. Current or non-capital transactions are liberalized.

Economy and Business climate

Sri Lanka has experienced modest economic growth since independence in 1948. The economy relied on agricultural exports until the 1980s, when export-oriented manufacturing grew in importance. The civil war in Sri Lanka has discouraged foreign investment and constrained economic progress since the early 1980s.

GDP

The gross domestic product (GDP), the total value of all goods and services produced, has grown at an average annual rate of about 3 percent since 1948. The relatively slow growth of the population helped create a greater per capita gain despite the modest growth of the economy. Economic growth has been uneven in the recent past as the economy faced a multitude of global and domestic economic & political challenges. Overall, average annual GDP growth was 5.2% over 1991- 2000. However in the 2001-2003 period it dropped drastically and recovered to 5.2% in 2003. Projections for 6.4% growth in 2004 were not met due to political instability, which influenced the negative performance.

Tourism

Sri Lanka's tropical climate, scenic beaches, and historical sites are prime tourist attractions. By the 1970s, sizeable investments were devoted to the building of infrastructure for the tourism industry, including hotels and resorts. Tourism declined after 1983 as a result of the civil war and related security concerns. About 560,000 tourists, mostly from Europe and India, visited Sri Lanka in 2004.

investing in Sri Lanka

Business climate

Sri Lanka offers the most friendly business climate & is ranked as the most liberalized economy in South Asia.

Direct Investment

Sri Lanka was the first in the South Asian region to promote foreign investment. Foreign investment is an important element in Sri Lanka's economic growth and is therefore actively encouraged.

Approval is required from the Board of Investment (BOI) prior to the establishment of a foreign business venture in Sri Lanka. The BOI is an autonomous agency and is the primary government body responsible for foreign investment. Under Section 17 of the BOI law, BOI grants concessions to companies satisfying certain eligibility criteria. Investors are provided with preferential tax rates, constitutional guarantees on investment agreements, exemptions from exchange control and 100% repatriation of profits & capital. Attractive tax incentives are available for Investors, depending on the Industry & capital investment in Sri Lanka, such as Tax Holidays & Tax concessionary rates, duty exemptions.

An export oriented enterprise, which has entered into an Agreement with the Board of Investment of Sri Lanka (BOI) under section 17 of the BOI Law and granted exemptions from exchange control regulations may:

- Open and operate a foreign currency account with any foreign currency Banking Unit (FCBU) of a commercial bank.
- Borrow offshore.
- Open and operate a Sri Lankan currency account with any commercial bank.

Under Section 16 of the BOI law, The Sri Lankan government permits up to 100% foreign participation in many sectors of the economy, and the BOI provides automatic approval for such investments. Investment in certain restricted sectors is subject to screening and approval is given on a case-by-case basis if the foreign investment exceeds 40%.

The BOI is the only organization a foreign investor should contact & its services include providing advice & assistance at every stage of the Investment process.

The services provided by BOI are:

- Information & guidance for project application procedure, coordinating approvals from other Agencies.
- Evaluating applications, granting approvals, with concessions where applicable.
- Providing assistance during start-up, site selection, advising on factory buildings /technical

matters, arranging support services e.g. Water, power, waste treatment & telecommunication etc.,

- Making recommendation to Immigration Authorities for issuing Resident Visas.
- Facilitating Import/Export clearance
- Advising on Environmental norms/approvals
- Assistance in good Industrial relations & formation of Employees' councils.

Portfolio Investment

In the recent past investing in the Capital & Share Market in Sri Lanka has shown a rapid growth.

The Securities and Exchange Commission (SEC) regulates the securities market in Sri Lanka & grants License to Stock Exchanges, Stockbrokers & dealers etc. Foreign investors can freely purchase up to 100 percent of equity in Sri Lankan companies in permitted sectors. In order to facilitate portfolio investments, country funds and regional funds are also allowed to invest in Sri Lanka's stock market after prior approval. These funds should make transactions through Share Investment External Rupee Accounts maintained in commercial banks. (SIERA)

The Colombo Stock Exchange (CSE), while small by big emerging market standards, is one of the most efficient in the region. A fully computerized clearing and settlement system was introduced through the establishment of a Central Depository System (CDS) in 1991. In 1997, the CSE commissioned a state of the art computer based automated order matching system. The CDS was linked real time with the Automated trading system. These developments placed the CSE alongside the most technologically advanced exchanges in the world. In 1998 CSE became the first South Asian member of the world federation of Stock Exchanges. The CDS also gained the membership in the Asia-Pacific Central Securities Group (ACG) in the same year.

The CSE officially launched its Debt trading System (DEX) in March 2004. DEX enables the trading of corporate debt instruments and the beneficial interest of Govt. bonds and treasury bills through the exchange. DEX has advanced features such as scripless trading real-time exposure management, multiple settlement cycles and compatibility with web based technologies. Fifteen local and foreign joint venture brokers currently operate at the CSE.

Real Estate Investment

Foreign Investments in real estate in Sri Lanka, including interest in properties, do not require any approvals. However, a 100% Transfer Tax on the value of the property is payable, except in the purchase of condominium properties above 3rd floor, acquisition of land for development for more than 100 residential units, for Hospitals, infrastructure and non citizens maintaining over US\$ 150,000 in Foreign Currency Government securities Accounts.

In a like manner, in the case of a Company, if more than 25% of the issued Share Capital is held by non-citizens, the company is liable to pay this 100% transfer tax.

types of business organisations

General

Sri Lankans may establish their businesses in Sri Lanka through any of the following forms:

-Private Limited Liability companies	-Peoples Companies
-Public Limited Liability Companies	-Co-operatives
-Offshore Companies	-Joint Ventures
- Representation/Liaison Offices	-Unlimited companies
-Sole Proprietorship and Partnerships	

Foreign Investors may establish their business presence in Sri Lanka through any of the following forms:

- Private Limited Liability companies	- Offshore Companies
- Public Limited Liability Companies	- Representation/Liaison Offices
- Joint Ventures (on foreign funded projects for Govt. Agencies)	

In Sri Lanka, the law that governs the creation & operation of companies is the Companies Act of 1982, which is based on the principles of the English Companies Act 1948.

Companies

In Sri Lanka the most common forms of Companies are, Private & Public Limited Liability Companies, and they are the most suitable for Foreign Investors in Sri Lanka due to the following

- i. Liability of each Shareholder is limited to the amount he has undertaken to pay for his shares or by way of guarantee.
- ii. Limited Liability in the event of Insolvency

A non-resident company may establish a branch or a liaison office in Sri Lanka.

- a) A branch office can be established in Sri Lanka by a Company (foreign) incorporated outside Sri Lanka provided within one month of establishment of place of the business, it is registered in Sri Lanka.

b) A foreign company may establish a liaison office in Sri Lanka.

Both Foreign Company Branches and Liaison Offices could;

- Coordinate Business promotion activities, business planning & market intelligence
- Source of raw materials and manufactured (accessories) products
- Have Quality control & Technical support.

However they are prohibited to engage in any import, export, trade and investment in Sri Lanka.

Most of the foreign companies seek approval as liaison offices in Sri Lanka.

Sole Proprietorship, Partnerships and others

Foreign investors cannot invest in business as Sole proprietorships, enter into Partnerships or joint ventures (other than on foreign funded projects for Govt. Agencies) etc, where the formalities of commencing a business are less but not recommended since the liability for debts are unlimited.

Formation of Companies

A Company registered in Sri Lanka is a legal person.

(i) Limited Liability Company

Under the Companies Act of 1982, following is required:

(a) Memorandum of Association and Articles of Association.

Memorandum of Association should give the following basic information:

- § A selected Name approved by the Registrar of Companies,
- § The district in which the registered office is situated,
- § The objects for which the Company is formed,
- § The Authorized Share Capital of the Company.
- § The members liability is limited.

(b) The Articles of Association should contain the regulations for its internal management including the rights and duties of the members in their capacity as members.

(ii) Offshore Company

Any Company incorporated in Sri Lanka or outside Sri Lanka may apply to the Registrar to be registered as an Offshore Company. The Registrar may having regard to national interest or in the interest of the national economy issue a certificate of Registration after the required fee is paid and a certificate is produced from a bank that a sum of US\$ 100,000 has been deposited to meet its expenses in Sri Lanka.

An Offshore Company cannot carry out business in Sri Lanka. Such Company will be exempt from complying with any other provisions of the Companies Act and are not subject to Exchange Control regulations.

accounting and audit requirements

Accounting Profession

The Institute of Chartered Accountants of Sri Lanka (ICASL) was established under the Institute of Chartered Accountants Act.No.23 of 1959 by the Parliament. The Council of the Institute is responsible for the management of its affairs, for the issue of Sri Lanka Accounting and Auditing Standards, and for the registration and control of the maintenance of the professional standards and discipline by the persons practicing or acting as accountants in Sri Lanka

Legislative and institutional framework

Companies Act No 17 of 1982 has a mandatory requirement to all the Companies to have their Financial Statements audited by a member of Institute of Chartered Accountants of Sri Lanka or Registered Auditors.

Accounting Standards & Auditing Standards

In terms of the Sri Lanka Accounting and Auditing Standards Act, No 15 of 1995, ICASL is the sole authority /formulating body for Sri Lanka Accounting Standards (SLAS) and Sri Lanka Auditing Standards (SLAuS). Further, this Act has made provisions to formulate Accounting & Auditing Standards committees with the objective of making recommendations and assisting the ICASL to formulate and revise the SLAS and SLAuS.

Sri Lanka Accounting & Standards Monitoring Board, which has been empowered to monitor the compliance with the SLAS and SLAuS by Specified Business Enterprises.(SBE).

Taxation

There are many areas where tax incentives are available. Section 3.3 above details some of the areas where incentives are available for foreign investments.

In general, the preferred areas are exports of goods or services, tourism, agriculture, infra-structure development, construction, Information Technology & software.

general structure

General Structure

Indirect Taxes

- Value Added Tax (VAT)
- Turnover Tax

Direct Taxes

- Income Tax (Personal and Corporate)
- Economic Service charge (ESC)
- Custom Duties
- Remittance Tax
- Others-Social Responsibility levy.

Indirect Taxes

VAT

A Value added Tax system was introduced on 1st August 2002. Value Added Tax is charged on the destination principle & is liable on supply of goods & services in Sri Lanka. It is a consumption tax, thus goods imported into Sri Lanka and goods & services supplied within the territorial limits of Sri Lanka are the subject matter of this tax. For clarity, the table below states the rates applicable. For clarity, the table below states the rates applicable.

Category	Rate	Input Credit
Essentials	5%	Not entitled (except for motor vehicles for transport & production machinery)
Standard Rate	15%	15%
Luxury Rate	18%	Limited to 15%

Zero Rate is applicable on Exports and Supply of services in Sri Lanka to be consumed outside Sri Lanka (includes services provided by a Garment Buying office).

VAT is not collected on listed Exempt Supplies of Goods & Services and no input credit is available.

A special rate of 25/= per piece of garment supplied to the Local market by a BOI manufacture cum Exporter with the approval of BOI/Director General of Customs.

Turnover Tax

In 1981, the Business Turnover Tax introduced by Finance Act No.11 of 1963 was replaced by the Turnover Tax Act No. 69 of 1981 and is effective from 13th November 1981. Goods & Services Tax was introduced w.e.f. 01.04.1997 (and presently Value Added Tax) to mitigate the cascading effect

on domestic consumption Goods & Services. Turnover Tax is collected only from Wholesale & Retail sector and payable to Provincial Councils.

Turnover Tax is charged for every quarter from every person who carries on any Wholesale or Retail business in Sri Lanka.

The tax is payable for a quarter in respect of any business, if the Turnover for that quarter is not less than Rs.25,000.

Direct Taxes

Income Tax

The main rationale and the primary function of Income Tax is the raising of revenue for Government expenditure. The other functions include social & economic purposes such as

- A more equitable income re-distribution
- Increasing savings and Capital formation.
- Channeling investment in desired directions through the allocation of resources

The existing income Tax in Sri Lanka is based on the Inland Revenue Act No: 38 of 2000 and upto 31st March 2000 it was based on Inland Revenue Act No: 28 of 1979 with its subsequent amendments.

The principles of Taxation and its main characteristics are as follows

- The Tax is levied on the Income of any person arising in or derived from Sri Lanka. A resident is taxable on world income, and any other person is taxable only on income arising or derived in Sri Lanka.
- The Tax is based on Global System, i.e income from all sources are aggregated, except Interest & Dividend Income is Taxable on Scheduler system w.e.f. 2002/2003.
- The Income Tax is based on self assessment system, where every person has to make his own Return of Income, compute his Tax liability and pay taxes estimated on previous year tax payable on quarterly basis.
- The Statutory date for filing of Return of income is 30th November immediately succeeding the year of assessment.
- There are number of Tax holidays and Investment incentives, and exemptions and reliefs for emoluments and Income derived from abroad.
- Concessionary tax rates are applicable for Charitable Institutions, Insurance Companies Trusts, Executors, Clubs and Associations etc.
- A system of Withholding Tax is also in use, where Tax is levied at source.

(a). Personal Income Tax

Rates of Income Tax (2005/06). A statutory tax free Allowance of Rs. 300,000 is granted to all resident individuals.

Rate	Taxable Income	Tax
05%	300,000	15,000
10%	200,000	20,000
15%	200,000	30,000

20%	200,000	40,000
25%	200,000	50,000
Balance at 30%		

Interest income on Deposits, Secondary market transactions on Treasury Bills (& re-purchases) is not part of Assessable Income where 10% is deducted at source.

Dividend Income where dividend tax has been deducted will not be a part of Assessable income.

Corporate Tax

Tax Rates

Where the Company's Taxable Profit over Rs.5,000,000, the tax is follows

- Public Quoted @ 30%
- Others @ 32.5%

Where the Companies Taxable Profit is less than Rs.5,000,000, the tax is at 20%

Generally, Companies with tax concessions, exports, construction, Tourism are taxed at 15%.

Agriculture is exempt for five years from 2005/06.

Dividend Tax

All Dividends paid will be liable for a Tax of 10%.

Interest and Dividend Income

Dividends received does not form part of Assessable Income.

Gross Interest is liable for Income Tax and the 10% withholding Tax can be deducted.

Interest Income on Secondary Market transactions should gross up and taxed and withholding tax deductible.

ECONOMIC SERVICE CHARGE (ESC)

A new tax was introduced called ESC from 1st April 2004, which could be setoff against Income Tax of the same year, with the provision to carry forward the unutilized balance for the next two years.

Every person or Partnership in every business, profession or vocation other than trading, which has been operating for three years or more, whose aggregate Turnover (excluding sale proceeds of capital assets & VAT) is Rs.50 million in the relevant year is liable, and ESC Payable is limited to Rs.50.mn in that year. The relevant year refers to the turnover of the previous year. Trading become liable even below three year rule.

For clarity, the table below states the rates applicable.

Category	Rate
Any profits tax at specified rates	0.5%
Exempt Profits /BOI Co. approved under sec.17	0.25%
Trading (w.e.f.1st April 2005)	0.5%
Any other Turnover	1.0%

Customs Duties

Presently the following rates are applicable

Basic Raw Material	2.5%
Semi Processed Raw Materials	6%
All Intermediate Products	15%
Motor Vehicles & finished Products	28%

Absolutely essential items & items not manufactured in Sri Lanka are exempt. Duty Free imports are granted for machinery to acquire new technology where new Companies invest over Rs. 5 mn and existing Companies invest over Rs. 2 million.

Remittance Tax

In terms of section 57 (1) of the Inland Revenue Act, a Non- Resident Company is liable to pay remittance tax at 10% on total remittances for that year, from year of assessment 2003/04.

Others

i. Social Responsibility Levy

Under the Finance Act No 5 of 2005 a Fund was established for the National Action Plan for Children. For this purpose a Social Responsibility Levy of .25% on all Tax payable is charged w.e.f.2005/06 except on GST,VAT & ESC.

ii. Capital Gain Tax

Capital Gain arising on a transaction was treated as a different source of Income in Sri Lanka upto 31st March 2002 and was withdrawn since then.

Non Citizen Employees

Non Citizen Employees are deemed to be non-residents for a period of 3 years from the commencement of employment in Sri Lanka. In this period they will be liable on Employment income at concessionary rate of 15% and if they continue to be employed for a further 2 year period the 15% tax continues. Any other income in Sri Lanka is taxed at normal rates.

Withholding Tax

There is also a system of withholding Tax where tax is levied at source. Following are some of the withholding tax rates applicable at present:

All Dividends	10%
Lottery Prize > Rs.500,000	10%
Interest	10%
Treasury Bills	10%
Non Residential Rental Income > Rs.50,000 p.m	10%
Specified Fees paid by Specified Persons	5%

International Treaties & Agreements

Sri Lanka's tax treaties have generally followed the following two basic principles for granting relief:

- (a) the foreign tax credit principle, (b) the exemption principle

Under the foreign tax credit principle the country of residence imposes tax on a resident's total income inclusive of foreign income but allows a set off or credit against the foreign tax paid by the resident on his foreign source of income. Where the foreign tax is lower than the domestic tax, only the excess of such tax is payable to the country of residence, where the foreign tax is high, no tax is collectible in the country of residence.

Under the exemption method, income exempted is not taken in to consideration for the determination of tax to be imposed on the taxpayer's other income.

Tax Sparing Credit relief is also provided in some double taxation agreements, to prevent the loss of double taxation credit negating the incentives offered to taxpayers in the form of tax holidays and tax concessions in developing countries. Such credits are generally given for Dividends, Interest or Royalties or tax spread under a tax holiday or on the profits of subsidiaries out of which dividends have been paid.

Some of the Double Tax Agreements in force at present are:

Australia	Poland	Romania
Bangladesh	Sweden	Switzerland
Belgium	Norway	Thailand
Canada	Indonesia	USA
Denmark	India	Italy
UK	Korea	Singapore
France	Germany	Japan
Pakistan	Malaysia	Netherlands
Finland	Nepal	Oman

