Rental Income and Tax Obligations in Sri Lanka – A Simple Guide

Owning a rental property can provide a steady source of income. However, many property owners are unsure how rental income is taxed in Sri Lanka and whether expenses can be deducted.

In Sri Lanka, rental income is generally taxed in **two different ways**, depending on how the property is treated for tax purposes:

1. As **passive rental income (with a 25% deemed deduction)**
2. As **business income (where actual expenses are deducted)**

This guide explains both approaches clearly.

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1. Rental Income as Passive Income (25% Deemed Deduction Method)

In many cases, rental income is treated as **passive income**. Under this method, the tax system allows a **standard deduction of 25%** from the gross rental income.

How it works

- You receive total rent (gross rental income)
- The law allows a **deemed expense deduction of 25%**
- Tax is calculated on the remaining **75% of rental income**

Example

If your annual rent is LKR 1,000,000:

- Deemed deduction (25%) = LKR 250,000
- Taxable rental income = LKR 750,000

You are taxed only on LKR 750,000 (subject to your personal tax rates and thresholds).

Key points

- You do **not need to prove actual expenses** under this method
- It is simple and commonly applied for individual landlords
- No detailed expense tracking is required for the 25% deduction

However, you **cannot separately claim actual expenses** if you choose this method.

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2. Rental Income as a Business (Actual Expense Deduction Method)

In some cases, rental activity is treated as a **business or commercial activity**, especially when:

- You own multiple properties
- You provide services (e.g., maintenance, cleaning, furnished rentals)
- You actively manage properties like a business operation

In such cases, you are taxed on **net profit**, not gross rent.

How it works

- You calculate total rental income
- You deduct **actual allowable business expenses**
- The remaining amount is your taxable profit

Allowable expenses may include:

- Repairs and maintenance
- Property management fees
- Utility costs (if borne by owner)
- Insurance premiums
- Staff salaries (if applicable)
- Loan interest (where allowable under tax law)
- Advertising and agent fees

Key points

- You must maintain **proper records and receipts**
- Only **business-related expenses** are deductible
- Capital expenses (like building construction) are generally not immediately deductible
- This method may result in **lower taxable income** if expenses are high

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3. Which Method Applies to You?

The correct tax treatment depends on the **nature of your rental activity**:

Situation	Tax Treatment
Single property, simple renting	25% deemed deduction method
Multiple properties or active management	Business income method
Furnished rentals with services	Likely business income
Passive long-term leasing	25% deduction method

The Inland Revenue Department may assess the nature of your activity based on facts.

Is Rental Income Taxable?

Yes.

Rental income is generally subject to Income Tax under the Inland Revenue Act, No. 24 of 2017 (as amended).

- **Residents**: Taxed on worldwide income (including rental income)
- **Non-residents**: Taxed on Sri Lanka–sourced rental income

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Do You Need to File an Income Tax Return?

You may be required to file a return if you earn rental income, depending on your total income and tax obligations.

Even if tax is low or nil, filing may still be required.

Keep Proper Records

Good record-keeping is important, especially if you use the **business expense method**.

Maintain:

- Rental agreements
- Bank statements or rent receipts
- Expense invoices
- Loan documents
- Property-related bills

Common Mistakes

- Not declaring rental income
- Mixing personal and business expenses
- Claiming expenses without receipts
- Assuming rental income is tax-free
- Choosing the wrong tax method

Frequently Asked Questions

Is rental income always taxed the same way?

No. It may be taxed using either the **25% deemed deduction method** or the **business expense method**, depending on your situation.

Can I switch between methods?

In some cases, the method depends on how your rental activity is classified by the tax authorities.

Which method is better?

- 25% deduction: simple and easy
- Business method: better if you have high expenses

Need Professional Advice?

Choosing the correct tax treatment can significantly affect your tax liability.

At **eFiling Tax Consultants**, we help property owners:

- Determine whether rental income is passive or business income
- Apply the correct 25% deduction or expense method
- Maximize allowable deductions legally
- Prepare and file Income Tax Returns
- Handle IRD compliance matters

Contact us for expert guidance tailored to your rental income situation.

Disclaimer: This article is for general information only and is based on the Inland Revenue Act, No. 24 of 2017 (as amended). Tax treatment depends on individual facts and circumstances. Professional advice should be obtained before making tax decisions.