BUDGET HIGHLIGHTS

A national budget is a statement of national priorities. It is a clear enumeration of what our country needs to grow its economy and take its people to prosperity.

2019

BDO

Tel : +94-11-2421878-79-70
+94-11-2387002-03
Fax : +94-11-2336064
E-mail : bdopartners@bdo.lk
Website : www.bdo.lk

Chartered Accountants
"Charter House"
65/2, Sir Chittampalam A Gardiner Mawatha
Colombo 02
Sri Lanka

05th March, 2019

Dear Valued Client,

BUDGET HIGHLIGHTS 2019

BDO Sri Lanka takes great pleasure in presenting a summary of the budget proposals for 2019 and our views on the changes proposed. In this publication, we provide a synopsis of the budget proposals made by Hon. Mangala Samaraweera, Minister of Finance and Mass Media, in his budget speech presented in parliament today.

We believe that being proactive in analysing the tax exposure regarding the proposed changes may provide new tax planning opportunities for the taxpayer. The proposed changes may have an impact on the way you do business and manage your affairs. If you need any further clarifications in relation to the proposed changes our team of tax professionals would be pleased to assist you. Please refer the outer back cover for their contact details.

This publication can also be accessed online through our website www.bdo.lk

This publication also includes in summary the changes made to the revenue statutes by the Amendment Acts of 2018 and a 'Tax desk card' setting out key tax information for the year of assessment 2018/19 which you may find useful.

At BDO nothing matters more to us than our clients. Our brand stands for exceptional client service, delivered by exceptional people. We hope you find our comments useful and hope you will engage with us to discuss any tax planning opportunities.

Yours faithfully,

BDO Partners

CHARTERED ACCOUNTANTS

CONTENT

BDO

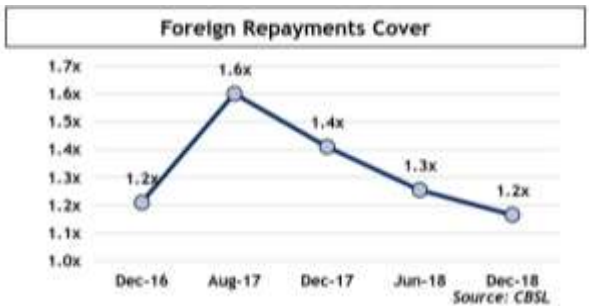
EXECUTIVE SUMMARY

Path towards 2019 Budget – Not a bed of roses

The 2019 budget was presented to the Parliament by the Hon Minister of Finance on the 5th of March 2019. Preparation of the budget happened in the aftermath of a political unsettlement coupled with a series of economic challenges. The circumstances prevalent throughout 2018 and the circumstances which transpired closer to the budget are expected to have influenced the 2019 budget. Some of the factors that would have influenced the budget are summarised below.

Drop in foreign reserves and debt repayments

Dip in reserves in the 2H 2018 started off with delay in the China Development Bank loan of USD 1Bn in Aug 2018. Subsequently, political instability triggered in Oct 2018 delayed the ability to raise funds in the international market pushing down foreign reserves below USD 7Bn by Dec 2018. With 2019 foreign currency repayments amounting to USD 6Bn, foreign repayment cover has fallen to 1.2x.



Overall debt repayments reached close to Rs. 1,000 Bn in 2018 which was the highest in the history. However in 2019 the repayments are expected to ease off.

The Government received a boost last week when the International Monetary Fund (IMF) agreed to extend its USD 1.5 billion Extended Fund Facility (EFF) by one year and space out the remaining payments. Subject to the planned submission to Parliament of the 2019 Budget consistent with the EFF-supported program, the Board is expected to consider Sri Lanka's request for completion of the fifth review in May 2019.

Depreciation of Rupee and its consequences

Continuous rate hikes in US, deterioration in macroeconomic fundamentals and political instability caused 15% depreciation of Rupee in the last two quarters of 2018 resulting in a total depreciation of 20% in the full year of 2018.

With the anticipation of Global Growth to lose pace led by deceleration in the US and further softening in China it is likely to slow-down the pace of rate hikes by providing stability to most emerging market currencies. Supported by, possible peaking of US treasury rates and attractive emerging market yields, global fund flows have shown signs of shifting towards emerging Asia.

EXECUTIVE SUMMARY

Towards latter part of 2018 liquidity shortage escalated despite CBSL cutting banking sector SRR by 150bps and increasing CBSL holdings above Rs. 40Bn. Heavy rupee depreciation leading to accelerated imports resulted in a jump in private sector credit towards latter part of 2018 worsening the liquidity situation.

Inflation

In spite of inflation declining in December, 2018 it appears to be on a rising trend and is expected to be in the range of 4% - 6% throughout 2019.

Drop in GDP growth

The GDP growth remained low throughout 2018 and would be below 4% for the full year of 2018. The current forecast for 2019 is also around 4%. The long term nature of the private investments in the recent past such as Port City may have contributed to the slow- down of growth. It is expected, with the private investments starting to generate returns, that GDP growth to improve in the years ahead.

Momentous expectations on budget 2019

The Budget 2019 was unveiled with the theme 'Empowering the People, Nurturing the Poor' amidst the necessity to create equilibrium between driving the economy with responses to challenges created by the 2018 performance and the need to address the wishes of the masses in an election year.

The Budget 2019 has set ambitious targets to increase public revenue to 17% of GDP while shrinking the budget deficit to 4.5% of GDP. The deficit in 2018 was 5.3%, compared with 4.6% target in the Budget 2018. This would be the first step towards the Government target to reduce the deficit to 3.5% in 2020.

With total public expenditure estimated to be Rs. 4.5 trillion and revenue expected to be Rs. 2.4 trillion the other tough targets include: maintaining the debt-to-GDP ratio to just 70%; and limiting recurrent and capital expenditure to 15% and 3.5% of GDP respectively.

The short to medium term policy framework appear to have directed towards empowering the poor and reduction of poverty. This is expected to be achieved through expansion of Enterprise Sri Lanka and improvement of skills and entrepreneurship opportunities to improve the quality of Sri Lanka's human resources. The budget also includes policies to improve Ease of Doing Business and to increase the number of women in the formal workforce.

EXECUTIVE SUMMARY

ENTERPRISE SRI LANKA – Empowering the People and Nurturing the Poor

The government's main focus would be to empower people which is expected to be achieved by empowering them politically, socially and economically. Social security investments would be the focus, with priority being given to agriculture, health and education. The measures would include the following:

- ***'Gamperaliya' – Accelerating Village Development***
  Gamperaliya program which had a drawback in late 2018 will focus on the infrastructure needs to bridge the gaps of facilities that are needed.

- ***Enterprise Sri Lanka***
  Enterprise Sri Lanka is centred among the youth, to create young entrepreneurs. Awareness programmes will be conducted across the island with priority being given to members of the National Youth Centre. The Government will also bear a significant burden of the interest cost on financial assistance. Enterprise Sri Lanka will become the ecosystem for large scale development and networking. The bank officials who discourage customers will be dealt with.

- ***Supporting Livelihood Development***
  - Farmers in Hambantota, Kurunegala, Puttalam, Ratnapura and Kegalle will be supported with Agriculture sector modernization project;
  - Modern climate-controlled warehousing facilities will be set up in Katunayake, Embilipitiya, Jaffna, and Keppetipola for the benefit of the farmers;
  - Increased incentives would be given for replanting and new planting of Rubber;
  - Cinnamon Exporters to be subjected to certified quality control testing, at the point of export. However, those who fail such certified tests, will be supported to improve their operations within 12 months and further support would be extended to cinnamon producers;
  - Fisheries industry will be boosted by constructing two new harbours and also completing the on-going rehabilitation of harbors, anchorages & landing sites.

- ***A Caring Society***
  - Support the primary school children's nutrition effort by giving a free glass of milk for primary school children across the country;
  - Provide a wash room to every house, bus terminal and railway station;
  - Commercial establishments are encouraged to provide child-care facilities and to be supported through 'Rekawarana' loan scheme;
  - Providing financial assistance to differently-abled persons directly as well as through their employers;
  - Several housing projects for low and middle income earners and for resettlement while introducing housing loan scheme to newly married couples at concessionary interest rate.

EXECUTIVE SUMMARY

- ***Integration to Global markets – Exports***
  - Export Market Access Scheme, and the National Export Strategy introduced in the previous budget will be further supported;
  - An incentive package to attract high value investments has been proposed. This includes significant capital allowances of up to 150% of investment value and removal of up-front taxes for investments over USD 50 Mn, USD 100 Mn & USD 1,000 Mn;
  - Work on on-going Bingiriya and Wagawatta Industrial Zones would be further supported while new zones would be established in the North and East;
  - The Gem and Jewelry Industry will be supported with the PAL and Customs Duty on the importation of machinery used in lapidaries and the PAL on the un-cut gems imported, will be reduced from 7.5% to 2.5%;
  - Nation Building Tax (NBT) on foreign currency receipts by tourist hotels registered by the Sri Lanka Tourism Development Authority (SLTDA) will be removed;
  - Economic Service Charge (ESC) applicable for export sectors which are subject to Corporate Income Tax of 14%, will be reduced to 0.25% from 0.5%;
  - Property Development Sector would be supported by Granting residential visas for 3 years to foreign nationals who invest USD 400,000/= or more in condominiums and reducing the Cess on imported construction material by 30%;
  - Local construction industry would be supported by not allowing any foreign company to bid without forming a joint venture with a local company. Cost of construction will be reduced with the removal of the Nation Building Tax (NBT).

- ***Knowledge driven skilled Society***
  - Construction or development of labs and libraries and providing other infrastructure;
  - Introduction of Continuous Professional Development for teachers;
  - Giving internships to top-notch universities for students who have excelled in studies by setting up 'Scholarship for Education Excellence';
  - Legal framework for regulation and governance of pre-schools;
  - Providing financial assistance for higher education in non-state universities;
  - Private sector is encouraged to provide courses for nurses where a stipend will be paid by the government.

- ***A healthy society***
  - Improving the quality of infrastructure, with allocations being provided for the investments in new equipment, rehabilitation of buildings and other infrastructure at hospitals and other such facilities
  - 'Suva Sariya' will be developed further and expanded island-wide
  - Resources will be allocated to provide Home Dialysis Machines, while also strengthening the Hemo-Dialysis Centres in 45 hospitals, together with RO Water Plants.

EXECUTIVE SUMMARY

- ***Culture of Research and Development***
  It has been observed that in spite of having a number of research institutes, both state and non-state, in the country, most research has not been converted to applicable or commercial solutions, giving rise to questions about the effectiveness of the investments made thus far. Therefore the Challenge "Science at Work" will be introduced, where challenges in 5 themes will be posed to the Scientific Community to work on, and viable solutions will be supported to be implemented with the allocation of the required finances.

- ***Making the Cities Smarter***
  - Urban Re-generation Project will see more than 20,000 houses being constructed out of which 8,000 have already been completed;
  - "Sukithapurawara" Township Development Program which covers all nine Provinces is being implemented to enhance inclusive and sustainable urbanization in the country;
  - Projects on Solid Waste Management, Flood and Drainage Management, Enhancement of Drainage Capacity in Colombo area are in progress and will continue;
  - Investments have been extended beyond the Colombo City into Galle, Kandy and Jaffna Cities, which includes traffic management measures, rehabilitation of major drains & flood reduction measures, urban upgrading, restoration & adaptive re-use of historic & Landmark buildings and coastal erosion reduction measures for selected areas;
  - In order to increase the reach of pipe-borne water at least to 60% by 2020, Rs. 45,000 Mn worth of water projects covering all Districts are underway;
  - Transport systems will be upgraded with modernized facilities.

- ***Public Sector Service Delivery***
  - Salaries of the public sector employees will be revised so that the minimum salary of a lower grade employee will be Rs. 21,400/- in 2020
  - In line with the above, the pensions will also be revised
  - The benefits and allowances to personnel in the Police and Armed Forces will also be revised
  - Service delivery of public sector will be strengthened by introducing new technology

ECONOMIC ANALYSIS

Overview

The Sri Lanka stock market witnessed a decline in 2018, with the All Share Price Index declining 5% to 6052 points. The average daily turnover fell to the lowest since 2008 at US $ 4.6mn. Initial Public Offering remained at two during 2018 and is likely to remain subdued in 2019 as well.

Meanwhile the rupee is expected to reach levels above the average annual depreciation rate of the past decade. Average Sri Lankan Rupee is forecast to depreciate 7% and 8% to year end external value of Rs. 195/US $ and Rs. 210/US $ by end of 2019 and 2020 respectively.

Given the current uneasy co-existence between political leaders and the major political parties, political risk continues to remain at elevated levels.

Moody's downgraded Sri Lanka rating from stable to negative citing the political turmoil in the country. However, the Central Bank is of the opinion that the country's macroeconomic fundamentals has not deteriorated to warrant such a change.

Obtaining the 100th position in the "Doing Business Index" by advancing eleven positions is a competitive advantage for the country.

The debt portfolio of the central government is subject to important risks with over 50 percent being denominated in foreign currencies, of which around 30 percent is expected to mature in the next five years.

- Credit Rating at 37.50
- Cash Reserve Ratio at 6.00 %
- Gold Reserves at 19.90 Tonnes
- Producer Prices at 137.60 Index Points
- Interest Rate at 8.00 %
- Tourist Arrivals at 244239.00
- Terrorism Index at 4.05
- Population at 21.44 Million
- Unemployment Rate at 4.10 %
- Standing Lending Facility Rate at 9.00 %
- Prime Lending Rate at 12.09 %
- Money Supply M0 at 613590 LKR Million
- Core Inflation Rate at 5.50 %
- Core Consumer Prices at 132.50 Index Points

ECONOMIC ANALYSIS

Economic growth

GDP Growth is forecast at an average of +4.3% per annum for the year ended 2019, which is below its potential level of 6-7%.

External risks include steeper than expected global financial conditions that would increase the cost of debt and make rolling over the maturing Eurobonds from 2019 more difficult; disappointing growth in key countries that generate foreign exchange inflows to Sri Lanka through exports, tourism, remittances, FDI, and other financing flows; faster than expected rises in commodity prices that would increase pressure on the balance of payments; and capital outflows that would further increase currency pressure.

Composition of GDP

Agricultural sector saw a 3.7% increase in 2018 with a growth forecast of 3.6% in 2019. The grant of US $ 102mn by the World Bank for the modernization of the agricultural sector has a positive impact on the sector. However, the production of paddy, tea and rubber continued to remain dependent upon weather conditions.

There was a 2% growth in the Industrial Sector where the contribution was from construction sector. This is expected to continue due to projects initiated by both the public and private sector.

Largest contribution to the service sector is expected to be from accommodation, food and beverage service activities, with the growth likely to be driven by directives to promote the local tourism industry.

There was a 2% growth in the Industrial Sector where the contribution was from construction sector. This is expected to continue due to projects initiated by both the public and private sector.

Largest contribution to the service sector is expected to be from accommodation, food and beverage service activities, with the growth likely to be driven by directives to promote the local tourism industry.

ECONOMIC ANALYSIS

Inflation

As per the Colombo Consumer Price Index, inflation levels are to remain in the 4 – 5 range in 2019 where the result was 4.3% in 2018. Upward pressure for the food category remains a key risk, being highly susceptible to erratic weather patterns where increased crop output would contain the overall food inflation in the near future.

Interest rates

Finance company Fixed Deposit rates have seen a sharp rise in early 2019, which will affect the opportunity cost of equity investing in the near term.

Challenges to reaching the twin goals of ending poverty and boosting shared prosperity

1. The fiscal challenge
2. The challenge of fostering growth and jobs for the bottom 40 percent.
3. The social inclusion challenge
4. The governance challenge
5. The sustainability challenge

Export and import, current account deficit

The Government of Sri Lanka expects to attract US $ 3 bn worth of Foreign Direct Investment (FDI) in 2019 and is focused on accessing larger markets through free trade agreements with India, China and Singapore.

Export earnings forecast to increase by 5% to US $ 11.9 bn in 2018 and by 6% in 2019 to US $ 12.7 bn while 2020 is optimistic at a 7% growth to reach US $ 13.6 bn.

The contribution in 2019 to exports is expected from industrial export earnings stemming from textiles and garments and rubber products. Further, the continued benefits from the GSP+ preferential tariff system by the European Union and the five year National Export Strategy initiated in 2018 supported Sri Lanka's export competitiveness.

Import expenditure is expected to be US $ 24.1 bn in 2019. A deceleration of growth in import expenditure is expected in 2019 resulting from restrictions on import of personal vehicles and tighter LC Margins. Worker remittances are expected to decrease by 1% in 2018 (US $ 7.1 bn).

Growing imports have resulted in an increase in the minimum amount of reserves required (4 months of imports) to USD 8.0 bn.

The trade deficit is expected to increase by 15% in 2018 (US $ 11.1 bn) even though in August 2018 there was an indication of a reduction in the trade deficit. The Balance of payment recorded an outflow during August 2018 due to the withdrawal of foreign investments from both the stock market and government securities and continued debt service payments. Overall balance of payment is expected to be at US $ 0.7 bn in 2019.

Fiscal policy

The political turmoil delayed the presentation of the National Budget for 2019. The government has formulated amedium-term fiscal strategy in line with the "Vision 2025, A Country Enriched" launched on 05th September, 2017, aimed at creating an environment where all citizens have the opportunity to achieve higher incomes and better standards of living while making Sri Lanka a prosperous nation by 2025.

In line with the Vision 2025 and above medium-term fiscal objectives, the government's priorities are :

- Reducing the public debt to 70 % of GDP in 2020;
- Curtailing the budget deficit to 3.5 % of GDP in 2020;
- Maintaining a primary surplus in 2018 and beyond;
- Balancing direct to indirect tax ratio to 40:60 from its current ratio of 20:80;
- Increasing government revenue to around 16-17 % of GDP and tax revenue to about 14-15 % of GDP in the medium term;
- Maintaining public investment at 5-6 % of GDP in the medium term ;
- Rationalizing government expenditure while eliminating unproductive expenditure.

CORPORATE INCOME TAX

Inland Revenue Act, No. 24 of 2017

(All changes are proposed with effect from 01st April, 2019 unless specified otherwise.)

New exemptions

The following income tax exemptions have been granted for **resident persons**;

- Interest income on sovereign bonds denominated in foreign currency, including Sri Lanka Development Bonds (SLDB)

The following income tax exemptions have been granted for **non - resident persons**;

- Interest paid to any person outside Sri Lanka on loans granted by such person to any person in Sri Lanka. (However, this exemption will not be applicable to loans granted by a Non-resident company to its Holding company or a Subsidiary Company in Sri Lanka)
- The Earnings on any sovereign bond denominated in local or foreign currency

Lower rate of income tax

The Inland Revenue Act, No. 24 of 2017 currently provides a lower rate of income tax of 14% for certain business activities relating to exports, education, agriculture, tourism and information technology services. The lower rate of 14% is to be applied on the taxable income of the company including both business income and investment income. This lower rate is only available to companies that are "predominantly" engaged in such businesses. The term "predominantly" has been defined to mean 80% or more calculated based on "gross income".

It has been proposed that the "gross income" definition will be the total income excluding investment income. This means that any interest income, dividend income etc. recorded as Income will not be considered when computing the gross income percentage to claim the lower rate of income tax. Further, it has been proposed that the lower rate of 14% will only be applicable to the business income which qualifies for such lower rate. As such any investment income earned by the company will be taxed at the standard rate of 28%.

HIGHLIGHTS

- Interest stemming from sovereign bonds exempted for non-residents.
- Interest income on foreign currency denominated sovereign bonds and SLDBs exempted for residents.
- Interest on foreign loans exemption reintroduced san loans between group companies.
- Concessions for IT industry enhanced with removal of 50 employee criteria in order to be eligible for 35% salary cost deduction.
- Enhanced capital allowances granted for existing business for investments
- Gross income of concessionary sectors re-defined to exclude investment income.
- An incentive regime for mid and large scale projects has been proposed to accelerate high domestic value additions and FDI.

Revision of incentives

Information technology

A company that is predominantly engaged in the business of information technology (as defined) is currently entitled to an additional deduction of 35% of the total amount that represents payments made by the company to its employees (other than as a company director). This additional deduction was however, only available is such company has at least 50 employees during the whole year.

It has been proposed to remove the staff requirement to have a minimum of 50 employees. Accordingly, any company that is predominantly engaged in the business of information technology will be able to enjoy this concession.

Investment incentives

It has been proposed that accelerated depreciation allowances will be given to existing companies rather than the regular capital allowances.

Our Comment

The quantum of investment to be made, the specific industries, other the criteria to qualify for the accelerated depreciation and the accelerated depreciation rates have to be specified by the law.

Additional deduction for maternity benefits

An additional deduction of 50% of the salary cost of the mandatory 3 months maternity leave granted to an employee will be allowed as a deduction for income tax purposes, subject to a maximum of Rs. 20,000/- per employee per month. If an additional 4th month of maternity leave is granted the additional deduction will be 100% of the salary cost. This concession is applicable for a period of 5 years.

High value investment incentives

Large scale projects – Investment above USD 100 million

The following tax incentives are to be granted for large scale projects with an investment of over USD 100 million in depreciable assets (excluding intangible assets) for projects approved by the Board of Investment of Sri Lanka;

- Income tax – deduction of 150% of such actual expenditure incurred on depreciable assets in each of such years up to a period of 10 years from commencing commercial operations.

During the project implementation or construction period (until the commencement of commercial operations) the following concessions are to be afforded:

- Exemption on Nation Building Tax
- Exemption on Port and Airport Development Levy
- Cess to be exempt on all project related items
- Duty and other taxes on negative list (i.e. such projects may import project related items or purchase locally at their discretion as the negative list shall not apply.)

The necessary guidelines for claiming the above exemptions need to be published.

Investments above USD 1 billion

In addition to the tax benefits outlined above for "Large scale projects", a person investing over USD 1 billion on a project approved by the Board of Investment of Sri Lanka will also be entitled to;

- Deduct unrelieved losses for a period of 25 years.
- No dividend tax will apply on any dividend paid by such company to a non-resident during the period that such dividends are paid out of profits sheltered by enhanced capital allowances.
- Expatriate employees will not be subject to withholding tax on their employment income during the period that the company is entitled to enhanced capital allowances

Mid-size investments – Investment above USD 50 million and less than USD 100 million

The company will be entitled to deduction of 100% of the actual expenditure incurred on depreciable assets in each of such years up to a period of 10 years from commencing commercial operations. The investment has to be channeled through the Board of Investment of Sri Lanka.

It will also be entitled to the same tax incentives provided to Large Scale investments during the project implementation or construction period set out above.

PERSONAL INCOME TAX

Inland Revenue Act, No. 24 of 2017

(All changes are proposed with effect from 01st April, 2019 unless specified otherwise.)

New exemptions

- The interest exemptions granted to residents and non-resident on sovereign bonds will apply to individuals as well.
- Interest income on NRFC/RFC accounts will be exempted for 5 years.
- The interest income, up to Rs. 5,000/- per month, earned by children of less than 18 years of age, in relation to any deposit account maintained in a financial institution.

Withholding tax

Royalty payments

Any Royalty payment made to a resident individual was subject to withholding tax at the rate of 14%. It has been proposed that any royalty payments not exceeding Rs. 50,000/- per month, subject to Rs. 500,000/- for each year of assessment, made to any resident individual will not be subject to withholding tax.

Rent payments

Rent payment made to a resident individual was subject to withholding tax at the rate of 10%. It has been proposed that any rent payments not exceeding Rs. 50,000/- per month, subject to Rs. 500,000/- for each year of assessment, made to any resident individual will not be subject to withholding tax.

Our Comment

The proposal seeks to recognize the tax free allowance provided to each resident individual of Rs. 500,000/- for each year of assessment, in imposing withholding taxes. This will reduce the instances where individuals will be required to claim refunds for tax over payment.

HIGHLIGHTS

- Earnings by non-residents on local or foreign currency denominated sovereign bonds exempt.
- Interest income earned by residents on foreign currency denominated sovereign bonds and SLDBs exempt.
- Interest income on NRFC/RFC will be exempted for 5 years.
- Interest income on deposits earned by children exempt up to Rs. 5,000/- p.m.
- WHT on rent and royalty paid to resident individuals exempted up to Rs. 50,000/- p.m. or Rs. 500,000/- per Year of Assessment.

VALUE ADDED TAX

Value Added Tax Act, No. 14 of 2002 (as amended)

(All changes are proposed with effect from 01st June, 2019 unless specified otherwise.)

Value Added Tax is the main indirect tax source in Sri Lanka and is imposed based on consumption of goods and services. Goods and Services Tax (GST) and National Security Levy (NSL) were levied on consumption prior to the introduction of VAT on 1st August, 2002 by Value Added Tax Act No. 14 of 2002 (principal enactment). The principal enactment has been amended by fourteen (14) Amendment Acts as of date.

Rate on local sale of certain garments by Export Oriented BOI Companies

The per unit rate currently levied on domestic sale of certain garments such as linen, curtains, bags made out of fabric etc supplied by Export Oriented BOI companies has been increased to Rs. 100/- from Rs. 75/-

Supply of condominium housing units

The Value Added Tax (Amendment) Act No. 25 of 2018 repealed the exemption on the supply of condominium housing units with effect from 1st April, 2019. However, clarification was required whether the agreement should have been executed on or before 1st April, 2019. The budget has clarified same and imposes VAT only where the deed of agreement relating to such supply is not executed prior to 01st April, 2019.

Basis for chargeability of VAT

The Minister will be empowered to prescribe the basis for chargeability of VAT on certain goods for the purpose of revenue protection.

Our Comment

The changes announced periodically should ideally be communicated to the taxpayers with sufficient notice in order to help the business community prepare for same.

Re-defined

Definitions will be revised for "locally produced rice products" and pharmaceutical machinery.

NATION BUILDING TAX

Nation Building Tax Act, No. 09 of 2009 (as amended)

(All changes are proposed with effect from 01st June, 2019 unless specified otherwise.)

Imposition of NBT on foreign payments

All foreign payments made to purchase goods or services including offshore digital services by using any credit and debit cards will be subjected to NBT at the rate of 3.5%. This proposal seeks to replace the current credit card stamp duty charged on foreign payments.

New exemptions

The following exemptions have been proposed

- Nation Building Tax (NBT) on foreign currency receipts by tourist hotels registered by the Sri Lanka Tourism Development Authority (SLTDA) will be removed. In order to remove the NBT anomaly among tour operators, DMC Agencies and hoteliers who are receiving foreign currency will be adjusted.
- NBT on main construction contractor will be removed
- Importation of Lucerne (alfalfa) meal and pellets

Withdrawal or restricted exemptions

- Importation of rough unprocessed gem stones by lapidary service providers registered under the National Gem & Jewellery Authority for re-export after cutting & Polishing will be exempted.
- The exemption granted to the manufactures of cigarettes will be removed.

Our Comments

- Currently all the construction subcontractors are not liable but main construction contractors are liable to NBT. However with the intention of improving the infrastructure projects, government proposed to remove the main- construction contractor from the chargeability of NBT. This will reduce cost of construction of infrastructure.
- The proposed removal of NBT on foreign currency receipts received by tourist hotels, tour operators and DMC Agencies will contribute to the growth of tourism sector. Further the government is also looking to integrate SME tourism sector in to the formal economy in order to boost the growth of tourism industry. The proposal to exempt only institutions registered with the Sri Lanka Tourism Development Authority (SLTDA) complements this policy.

ECONOMIC SERVICE CHARGE

Economic Service Charge Act, No. 13 of 2006 (as amended)
(All changes are proposed with effect from 01st June, 2019 unless specified otherwise.)

Rate of ESC

ESC is currently charged on every person and every partnership on the relevant turnover exceeding Rs. 12.5 Million for a quarter at the rate of 0.5%. It was proposed to grant a concessionary rate of 0.25% on export of goods or services.

Our Comment

The reduction in rate incentivizes the export sector.

The applicability of the reduced rate of 0.25% on the export, tourism and IT sector is mentioned in Budget speech but the technical notes refer only to exports of goods or services. Clarity is required on same.

Also, the Budget speech mentions that this concession is granted for "export sectors which are subject to Corporate Income Tax at the rate of 14%". As explained, to enjoy the 14% rate; a company must be predominantly (i.e. 80% of gross income) engaged in exports. ESC is paid quarterly, there will be a practical issue for the companies who are involved in local trading and other activities to identify the appropriate rate at the time of ESC payment. It is noteworthy that the 14% is applicable only for companies. Therefore, the eligibility of the reduced rate of ESC on others needs to be clarified.

HIGHLIGHTS

- Economic service charge rate halved for export industry
- Distributor defined to include any person or partnership appointed by an importer of goods to SL for sale in wholesale market of same.
- ESC on importation extended to any article unless specified by the Minister. The base would be CIF together with the import tariffs payable in respect of such articles.

ECONOMIC SERVICE CHARGE

ESC on imports

Economic Service Charge is proposed to be charged at the rate of 0.5% on the importation of any article or good other than any capital goods prescribed by the Minister of Finance. Economic Service Charge base on the importation of any article or good will be the aggregate of the CIF value as approved by the Director General of Customs and the Custom Import Duty, CESS, PAL and SCL payable in respect of such articles or goods.

Our Comment

ESC on importation was introduced in 2016 on every consignment of imports of gold or other precious metal and items chargeable with special commodity Levy. In 2017, the base was extended to import of motor vehicles as well.

This proposal seeks to broad-base the chargeability to every article (unless specifically prescribed by the Minister). However this will have a serious impact on the cash flow of the importers as this can only be recouped when making the quarterly ESC payments.

Definition of "Distributor"

The definition of the term "distributor" will be clarified to include any person or partnership, appointed by an importer of any goods to Sri Lanka.

Carbon tax

(Proposed with effect from 01st June, 2019)

The Carbon Tax was introduced by Finance Act No. 35 of 2018 payable on commercial vehicles with the intention of protecting the environment. The budget retains the rates enacted but has introduced a cap to each level of fuel type as tabulated below

Fuel Type	Less than 05 years	05 to 10 years	Over 10 years
Hybrid (Petrol/Diesel)	Rs. 0.25 per cm^3 or Rs. 3,500 whichever is lower	Rs. 0.5 per cm^3 or Rs. 5,500 whichever is lower	Rs. 1.00 per cm^3 or Rs. 7,500 whichever is lower
Fuel (Petrol/Diesel)	Rs. 0.5 per cm^3 or Rs. 3,500 whichever is lower	Rs. 1.00 per cm^3 or Rs. 5,500 whichever is lower	Rs. 1.50 per cm^3 or Rs. 7,500 whichever is lower

Luxury tax on motor vehicles

(Proposed with effect from 06th March, 2019)

The Finance Act No. 35 of 2018 imposed Luxury Tax on Motor Vehicles as a one-time payment and the tax rate was based on the engine capacity of the motor vehicle. It has been proposed to revise this tax and the rate will be based on the Cost Insurance Freight (CIF) value or the manufacturer's price as the case may be. Further, a Luxury tax free threshold has also been provided based on the value of the motor vehicle. The tax will be calculated as follows;

Type of Vehicle	Luxury Tax free threshold**	Rate*
Diesel	Rs. 3.5 Mn	120%
Petrol	Rs. 3.5 Mn	100%
Hybrid Diesel	Rs. 4.0 Mn	90%
Hybrid Petrol	Rs. 4.0 Mn	80%
Electric	Rs. 6.0 Mn	60%

* Applicable on the amount exceeding the Luxury Tax free threshold

** Luxury tax free threshold will be calculated based on the CIF value in the case of imported vehicles and ex-factory cost (Manufacturer's price), in the case of locally assembled vehicles

HIGHLIGHTS

- Carbon tax payable on commercial vehicles has been capped as tabulated
- Luxury Tax on Motor Vehicle rates have been specified with thresholds depending on vehicle type.
- International Telecommunication Operators Levy will be removed
- Embarkation Levy will be increased by US $ 10 to US $ 60 per passenger

International telecommunication operators levy

(Proposed with effect from 01st June, 2019)

The International Telecommunication Operators levy imposed under the Finance Act No. 11 of 2004 has been removed.

Our Comment

It is assumed that no changes will be made to the Telecommunication Levy Act No. 21 of 2011 as this proposal was aimed at supporting families of migrant workers to reduce tax on international calls only.

Embarkation levy

(Proposed with effect from 01st April, 2019)

The Embarkation Levy imposed by the Finance Act No. 25 of 2003, has been increased from USD 50 to USD 60 per passenger for persons leaving Sri Lanka by aircraft or by ship.

IMPORT TARIFF AND TAXES

Ports and Airports Development Levy Act, No. 18 of 2011 (as amended)

All changes are proposed will take effect immediately (unless specified otherwise)

Ports and Airports Development Levy (PAL) is currently imposed at a standard rate of 7.5% on all articles imported on the CIF value (subject to exceptions). The Levy and policy revisions proposed in respect of PAL are as follows:

Rate reduction

PAL on the following items will be reduced to 2.5%;

- Onions (0712.20.00), Garlic (0712.90.10) and Refined lead (7801.10.00).
- 525 variants of High Tech Machinery and equipment classified under specified HS codes (Chapter 84 and 85). Effective dates have been specified as 1st June 2019 and 1st September 2019 in respect of Chapter 85 and Chapter 84 respectively.

Removal of exemptions

PAL on the following items have been removed;

- PAL applicable on the sale of pleasure or excursion vessels and yachts manufactured by any BOI company to another BOI company which is conducting a business of chartering such vessels and yachts.
- Lucerne (alfalfa) meal and pellets used in the livestock industry.
- Sawing Machines (8464.10.00), Grinding or Polishing Machines (8464.20.00), other machines (8464.90.00) used in the lapidary sector.

Our Comment

There is an inconsistency between the Budget Speech and the technical notes with regard to the PAL on the above machines used in the lapidary sector. The Budget speech mentions that PAL will be reduced from 7.5% to 2.5%. However, the technical notes specify that the PAL will be removed on such items.

HIGHLIGHTS

- The PAL reductions seek to complement the policy of boosting the lapidary, tourism and manufacturing industries.
- The proposed changes to Cess will reduce input costs on imports in the tourism and construction industries.
- The para-tariff process where all HS codes with an import Cess will be subject to a phasing out which will take place over a 5 year period.
- The Government is in the process of drafting a new Customs Act.
- Rate of the Customs Import Duty on selected goods will be revised.
- Unit rate of the Customs Import Duty will be increased by 10% on importation of selected goods.
- Special Commodity Levy will be adjusted on the import of palm oil in lieu of the NBT applicable on local value addition.

IMPORT TARIFF AND TAXES

Sri Lanka Export Development Act, No. 40 of 1979 - CESS Levy

All changes are proposed will take effect immediately (unless specified otherwise)

Cess is currently imposed on imports as well as export on certain articles (Subject to exceptions). The Levy and policy revisions proposed in respect of Cess are as follows;

- Cess on Import of Go-Kart and Go-Kart Tyres will be removed in order to facilitate promotion of international sport tourism.
- Cess on 25 variants of fruits and nuts classified under HS codes will be removed.
- Cess on 19 items including head gear, Motor Vehicle parts and plastics classified under HS codes will be revised.
- Cess on imported construction material to be reduced by 30% to support the property development sector.
- Cess rates on selected items will be reduced to support refurbishment of hotels.
- Cess on Beedi Leaves will be increased to Rs. 3,500/ - per Kg

HS Code	Description	Current Rate	Proposed rate
1404.90.10	Beedi Leaves	Rs. 2,500 per kg	Rs. 3,500 per kg

An accelerated Cess reduction programme spanning over a 3 year period will be implemented for intermediate goods that are used in the Construction sector, Tourism and Manufacturing.

HIGHLIGHTS

- Duty rates increased on liquor, sweetened beverages and cigarettes.
- Duty reduced on palm oil fatty acids
- Excise duty on refrigerators will be imposed at 25%.
- The Excise Duty on vehicles imported as Chassis fitted with engines will be reduced.

Customs Ordinance (Chapter 235) - Customs Duty

All changes are proposed will take effect immediately (unless specified otherwise)

The duty shall be levied and paid upon all goods, wares and merchandise imported into or exported from Sri Lanka. The Government is in the process of drafting a new Customs Act.

Imported fruit drinks

Custom duty applicable on imported fruit drinks will be adjusted with effect from 01st June, 2019.

Undenatured ethyl alcohol

Customs duty on Undenatured Ethyl Alcohol will be increased from Rs. 800/- to Rs. 1,000/- per litre.

IMPORT TARIFF AND TAXES

Special Commodity Levy Act, No. 48 of 2007

Special Commodity Levy will be adjusted on the import of palm oil in lieu of the NBT applicable on local value addition.

Excise Ordinance - Excise Duty

The Excise Ordinance to consolidate and amend the law relating to the import, export, transport, manufacture, sale, and possession of intoxicating liquor and of intoxicating drugs.

Revision of excise duty rates - Alcohol

Excise Duty based on the Alcohol volume will be revised as follows;

Category	Current Duty (Per litre of Alcohol)	Proposed Duty (Per litre of Alcohol)
Special Arrack	Rs. 3,300/-	Rs. 3,300/-
Other Arrack	Rs. 3,300/-	Rs. 3,550/-
Country made foreign liquor	Rs. 3,300/-	Rs. 3,550/-
Beer Less than 5%	Rs. 2,400/-	Rs. 2,700/-
Beer more than 5%	Rs. 2,400/-	Rs. 2,700/-
Wine- Local plant materials	Rs. 100/- (Bulk liter)	Rs. 600/- (Absolute liter)

The Excise duty rate of imported liquor will be revised as follows;

Category	Current Duty (Per bulk litre)	Proposed Duty (Per bulk litre)
Malt liquor	Rs. 50/-	Rs. 55/-
Wine	Rs. 100/-	Rs. 110/-
Other liquor	Rs. 200/-	Rs. 215/-

IMPORT TARIFF AND TAXES

Excise (Special Provisions) Act No. 13 of 1989 - Excise Duty

Section 3 of the Exercise (Special Provisions) Act, No. 13 of 1989 imposes the rate of Excise duty applicable on every article specified in Gazette orders from time to time.

Cigarettes

Excise Duty on Cigarette will be increased by 12% as follows;

Category	Current Duty Per 1000 Sticks	Proposed Duty Per 1000 Sticks
60- 67 mm	Rs. 17,375/-	Rs. 19,500/-
67- 72 mm	Rs. 20,500/-	Rs. 23,000/-
72- 84 mm	Rs. 33,550/-	Rs. 37,580/-
‘ > 84 mm	Rs. 37,675/-	Rs. 42,200/-

Sugar contained in beverages

The exempt quantum of sugar contained in beverages will be revised as follows:

- Carbonated beverages - 4 grams per 100 ml
- Fruit based beverages - 8 grams per 100 ml

Duty rate will be revised from 50 cents to 40 cents per gram of sugar in excess of the exempt quantity.

Palm oil fatty acids

Excise duty on palm oil fatty acids will be revised as follows;

Category	Current Duty	Proposed Duty
Palm Oil fatty acids	25%	20%
Tallow fatty acids	25%	20%

Refrigerators

Excise duty on refrigerators will be imposed at 25%.

Our Comment

The class of refrigerators that will be subject to this imposition is unclear. Currently refrigerators are charged at various excise duties such as 17%, 20% and 25% depending on the HS Codes.

Chassis fitted with engines

The Excise Duty on vehicles imported as Chassis fitted with engines will be reduced.

Motor vehicles

Excise Duty on hearses will be revised. The Excise Duty on the hybrid and electric vans will be revised to reflect the energy efficiency benefits. The Excise Duty on Buddy Trucks with cargo carrying capacity less than 2,000 kg and single cabs will be revised.

Excise duty revisions passenger vehicles

a. Fuel

Engine Capacity	Petrol Fuel (Rs. Per cm3)	Diesel Fuel (Rs. per cm3)
x ≤1000cm3	2,000 or 1,650,000*	4,600
1000cm3< x ≤ 1300cm3	3,200	4,600
1300cm3< x ≤ 1500cm3	3,700	4,600
1500cm3< x ≤ 1600cm3	4,250	5,750
1600cm3< x ≤ 1800cm3	5,300	6,900
1800cm3< x ≤ 2000cm3	6,350	8,000

*Duty per unit

b. Hybrid

Engine Capacity	Petrol Fuel (Rs. Per cm3)	Diesel Fuel (Rs. per cm3)
x ≤1000cm3	1,500,000*	3,400
1000cm3< x ≤ 1300cm3	2,300	3,400
1300cm3< x ≤ 1500cm3	2,850	3,400
1500cm3< x ≤ 1600cm3	4,000	4,600
1600cm3< x ≤ 1800cm3	5,200	5,700
1800cm3< x ≤ 2000cm3	5,700	6,900

*Duty per unit

c. Electricity

Motor Power of the Engine	Less than one year	More than one year and less than three years
50kW < x ≤ 100kW	10,000	20,000

d. Three wheelers

Type	Rs. (per cm3/Per kW)
Petrol (cm3)	2,400
Diesel (cm3)	1,450
Electric (kW)	7,500
Cargo - Petrol (cm3)	500
Cargo – Diesel (cm3)	375
Cargo – Electric (kW)	7,500

e. Motor cycles

Engine Capacity	Rs. per cm3
x ≤50cm3	575
50cm3< x ≤ 150cm3	1,150
150cm3< x ≤ 200cm3	1,150
200cm3< x ≤ 250cm3	1,725
250cm3< x ≤ 350cm3	1,725
350cm3< x ≤ 450cm3	2,300
450cm3< x ≤ 500cm3	2,300
500cm3< x ≤ 800cm3	2,875
800cm3< x ≤ 1000cm3	2,875
1000cm3< x	3,450

Excise duty on small truck

Excise duties on small trucks will be reduced along with LTV which will be increased to enable better affordability for SMEs.

MISCELLANEOUS TAXES AND LEVIES

Betting and gaming levy

The Betting and Gaming Levy (Amendment) Act, No. 14 of 2015 imposes a levy on carrying on the business of gaming including playing rudjino per year of Rs. 200 million. The budget proposes to split the business of gaming playing rudjino and the other gaming. Accordingly, the following has been proposed:

- The annual levy payable by a person carrying on the business of gaming (excluding playing rudjino) has been increased from Rs. 200 million to Rs. 400 million.
- A separate annual levy of Rs. 1 million has been proposed for carrying on the business of playing rudjino

Casino entrance levy

The Casino entrance levy is currently charged at USD 100 and it has been proposed to be reduced to USD 50 per person.

Levy on gross collection

The levy imposed on the gross collection of a business of bookmaker or gaming which is payable on a monthly basis has been increased from 10% to 15%.

Stamp duty on credit cards

The stamp duty on credit card payments for foreign purchases will be removed.

HIGHLIGHTS

- The annual Betting and Gaming Levy business of gaming playing rudjino and the other gaming have been segregated and revised.
- Casino entry fee has been reduced to USD 50 per person
- Rate of gross levy collection increased to 15%
- Fees for vehicle registration, passport fee have been increased.
- The fees and charges imposed by government agencies will be increased by 15%.

MISCELLANEOUS TAXES AND LEVIES

Fee for the reservation of vehicle registration number

The fee charged for reservation of a vehicle registration number in advance from the current registration number will be increased to the following;

Available number limit	Fee (Rs.)
10,000	70,000
20,000	90,000
30,000	100,000

A lifetime personal vehicle registration number can be obtained for a fee of Rs. 1 million.

Passport fee

Passport fee has been revised to the following fees;

Available number limit	Fee (Rs.)
Alteration fee - per unit	1,000
Processing fee (urgent basis) – per unit	15,000
Processing fee (normal basis) – per unit	3,500

Fees and charges of government agencies

The fees and charges imposed by government agencies which have not been revised in the last 3 years will be increased by 15%.

Our Comment

The effective date on which each of the above revisions are to take effect will have to be set out clearly in the statute in order to avoid ambiguity as to the tax rates that are applicable.

WE TAKE IT PERSONALLY

The team of professionals at BDO Partners is equipped with the knowledge and capacity to assist you for all your tax related matters

KEY CONTACTS

Sujeewa Rajapakse
Managing Partner
sujeewa@bdo.lk

Sarah Afker
Partner - Tax Services
saraha@bdo.lk

Ranjith Samarasinghe
Consultant - Tax Services
ranjith@bdo.lk

Dinusha Rajapakse
Associate Director – Tax Services
dinushar@bdo.lk

WE ALSO OFFER THE FOLLOWING SERVICES

- Audit and Assurance
- Tax
- Risk Advisory and Forensic
- Transaction Advisory
- Company Secretarial
- Business Process Outsourcing

BDO
"Charter House"
65/2, Sir Chittampalam A
Gardiner Mawatha
Colombo 2

Tel : +94-11-2421878-79-70
Fax : +94-11-2336064
E-mail : bdopartners@bdo.lk
bdoconsulting@bdo.lk
bdosecretaries@bdo.lk
bdooutsourcing@bdo.lk
Web : www.bdo.lk