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20th November 2015.

To: Clients of Tudor V. Perera & Co.

Dear Client,

Budget Proposals - Year 2016 (Taxation)

It gives us great pleasure in forwarding herewith an overview of the Budget Proposals (Taxation) announced by the Minister of Finance, Honourable Ravi Karunanayake, in the Parliament on 20th November 2015.

However, this should not be treated as authoritative statement, since the Budget Proposals for the year 2016 are pending legislation.

The facts given are for general guidance and professional advice should be sought prior to acting on same.

Should you need further clarifications, please feel free to contact us.

Yours faithfully,
TUDOR V. PERERA & CO.

Tudor V. P

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Table of Contents

1. Income Tax (IT).
2. Value Added Tax (VAT).
3. Nation Building Tax (NBT).
4. Share Transaction Levy (STL).
5. Construction Industry Guarantee Fund Levy (CIGFL).
6. Luxury & Semi-Luxury Motor Vehicle Tax.
7. Betting and Gaming Levy.
8. Economic Service Charge (ESC).
9. Excise Duty.
10. Excise (Special Provisions) Duty.
11. Customs Duty.
12. Ports and Airports Development Levy (PAL).
13. Tourism Development Levy.
14. Special Commodity Levy (SCL).
15. Cess.
16. Land (Restriction on Alienation) Act.
17. Stamp Duty.
18. Mansion Tax.
19. Telecommunication Levies.
20. Other Levies and Charges.
21. Technical Rectifications and Administrative provisions.
22. Effective Dates of Proposals.

BUDGET PROPOSALS 2016 - TAXATION

1. **Income Tax (Amendments to the Inland Revenue Act No. 10 of 2006)**

1.1. ***Tax Concessions***

1.1.1. *Agriculture*

1.1.1.1. Development of seeds and planting martials by a company:
A reduction of 50% of the tax payable on the profits from the locally developed seeds and planting materials for a period of 5 years.
(Section 16B will be amended)

1.1.1.2. Drip irrigation, greenhouse technology and high yielding seeds:
A reduction of 50% of the tax payable on the profits from agriculture by a company using drip irrigation method, greenhouse technology and high yielding seeds for a period of 5 years.

For this purpose greenhouse technology, drip irrigation and high yielding seeds will be defined.
(Relevant provisions of the Inland Revenue Act will be amended)

1.1.1.3. Fruit and Vegetable Industry:
The cost of acquisition of any machinery used for canning fruits and vegetables will be treated as a qualifying payment in addition to the depreciation allowance claimable on such machinery.
(Sections 25 and 34 will be amended)

1.1.2. *Development of Micro and SME Sector*

1.1.2.1. Tax payable by Private Equity Funds or Venture Capital companies on the profits earned by providing funds to upgrade SMEs registered with the SME Board of CSE up to the trading level, will be reduced by 50% for a period of 5 years.

1.1.2.2. SMEs, creating incubators for SMEs (not by splitting or reconstruction of an existing SME) by investing in designated areas will be entitled to 50% reduction of the tax payable on profits of such activity for a period of 3 years.

For this purpose 'SME' and the 'identification of activities of Venture capital companies and Equity Funds' will be specified.

1.1.3. *Incentive for Thrust Industries*
A reduction of 50% of the tax payable on the profits from the locally manufacturing of red clay tiles for a period of 3 years.

1.1.4. *Concessions to other Sectors*

1.1.4.1. A reduction of 50% of the tax payable for a period of 5 years on the profit from the following activities carried out by any person:

(i) being an academic entity which offer internationally accredited courses or training programmes aimed at geriatric care or child care;

(ii) engage in building housing facilities for the elderly persons;

(iii) construction and sale of housing units in collaboration with the Government, to officers of the government sector.

1.1.4.2. A reduction of 50% of the tax payable for a period of 5 years from the commencement of the commercial operations by any company specifically incorporated for MICE (Meeting, Incentives, Conferences and Exhibitions) on the profits from such activities.

1.1.4.3. The profits generated by a company which is attributable to the expansion carried out by modernization of existing factories which is considered based on the employment generation within a period of one year commencing from April 1, 2016, will be subject to half tax rate of the applicable rate for 3 years.

For this purpose the necessary criteria will be specified.

1.1.4.4. To encourage persons to be part of the country's higher education revolution through endowments given to our National Universities to engage in research, the triple tax deductions available for R&D activities be extended to accommodate endowments given to our National Universities.

1.1.4.5. Construction Industry: The cost of acquisition of machinery necessary for purifying sea sand will be treated as a qualifying payment in addition to the depreciation allowance claimable on such machinery.

1.2. ***Investment promotion***

1.2.1. *New Foreign Exchange Management Act (FEME)*
A new Act named 'Foreign Exchange Management Act' will be introduced to facilitate foreign investments. The Inland Revenue Act will also be amended to accommodate such investments (where necessary) and to exempt income tax on foreign currency inflows.

1.2.2. Income from dividends on investment made by non-citizens or foreign companies in listed shares through inward remittance will be exempted from income tax.

1.2.3. *Concession on investment in lagging region*
In lieu of the present concessions introduced in 2015, the following new concession will be introduced:

50% reduction of the tax payable by a new company (not by splitting or reconstruction of an existing company) set up in any lagging region with a minimum investment of US$ 10 Mn or 500 new employment (with new EPF Nos.) for manufacturing (other than liquor or tobacco) or provision of services, for a period of 5 years form the commencement of commercial operation.

The period will be expanded to 8 years, if the new employment exceeds 800 and to 10 years if the investment is for theme park.

(The concessions under Section 59I, 59J and 59K will be removed which are redundant due to rate revision).

1.2.4. The 50% rate reduction available under the IR Act, for listing in CSE will be extended by expanding the present deadline of April 1, 2017 for further;
(i) 2 years for listing in CSE; or
(ii) 3 years for listing in any foreign Stock Exchanges (Section 59D will be amended)

1.2.5. The profits and income from the cultivation of tea or rubber by any plantation company, of which the Government shareholding is in existence, will be exempted for a period of 2 years commencing from April 1, 2016.

1.2.6. *Tax holidays and exemptions*
(i) The Strategic Development Act will continue to be effective for existing companies that have availed the concessions under that Act. For new investments, instead of Strategic Development Act, the "New investment" Act will be enacted.

(ii) The granting of tax concessions for any investment should be strictly under the supervision and monitoring of the Ministry of Finance which would be governed by regulations issued by the Minister. BOI or IRD will not grant any new tax holidays other than facilitation and implementation of the concessions.

1.3. ***Other Changes/amendments***

1.3.1. Management fee will be defined for insurance industry.

1.3.2. The triple deduction for Research and Development expenses will be allowed only if a technology advancement and yield development is proved.
(Sections 25 and 92 will be amended)

1.3.3. The exemption on the interest income on foreign loans will be restricted on the interest on loans taken from foreign banks or financial institutions.
(Section 9 will be amended)

1.3.4. Certain exemption on dividends after the completion of the tax holiday period will be removed.
(Section 10 will be amended)

1.3.5. The refund claim for any year of assessment commencing on or after April 1, 2016, should be finalized within three years from the claim of such refund (with the Return). If not finalized, the refund would be allowed to be set off against future tax liability of the same.
(Relevant provisions of the Act will be amended)

1.3.6. The penal provisions will be;
- amended to strengthen the tax collection and compliance by tax payers and tax practitioners; and
- introduced to ensure proper implementation of ‘transfer pricing”.

1.3.7. Relevant amendments will be incorporated (where necessary) for the implementation of RAMIS.

1.3.8. The expansion of the term “Approved Accountant” for the purposes of Section 107 by adding AAT member, will be revisited by restricting the area of audits to the turnover limit not exceeding Rs. 100 million and making provision to grant approval by the Commissioner General of Inland Revenue having satisfied that the respective individual has acquired necessary competencies to perform the required work under the Inland Revenue Act, in conformity with an appropriate regulatory mechanism in place.
(Section 107 will be amended)

1.3.9. Administration of the transfer pricing on domestic transactions will be simplified and the areas will be specified limiting the scope considering the associated cost involved.
(Section 104 and 104A will be amended and relevant Gazette will be published)

1.3.10. Individual Taxpayers who pay Rs. 25 million or more will be granted special privileges and such privileges will be regularized through a Gazette Notification by incorporating the relevant provisions to the Act.

1.3.11. The qualifying payment relief introduced on the expenditure associated with cost of acquisition or merger of banks or financial companies under the Banking and Financial institutions consolidation process will be removed considering the deduction already available as a cost.
(Section 34 will be amended retrospectively)

1.4. **Simplification of Income Taxation**

The following measures will be taken to simplify the Income Tax Structure

(i) Rate structure will be limited only to two tax rates as the standard rate of 15% with the higher rate of 30%.

(a) The higher rate (30%) is applicable for the profits and income of:
- Betting &Gaming
- Liquor

- Tobacco
- Banking and Finance including insurance, leasing and related activities etc.
- Trading activities other than manufacturing or providing of services

All the other sectors will be liable to the standard rate of 15%;

(b) The progressive tax rates applicable to individuals will be removed by increasing the tax free allowance to Rs. 2.4 million per year (Rs. 200,000/- per month) and any balance will be liable at the standard rate of 15% (flat rate);

(c) The above tax treatment will be applicable to both employees subject to PAYE and self-employees.

(d) Deductions from the total statutory income and the assessable income will be removed considering the tax free allowance entitled to be deducted by individuals, charitable institutions etc. except the losses incurred from trade, business, profession or vocation (deductible subject to the limitations);

(e) The exemption on profit from employment referred to in Section 8 of the Act will be removed other than the following:
- Retiring benefits and pension paid out of the consolidated fund to Government employees;
- Earnings in foreign currency on employment out of the country, if such earnings are remitted to Sri Lanka;
- Exemptions for diplomatic missions and diplomatic personnel;
- Release of the provident fund balance at the time of retirement;
- Compensation for loss of office subject to conditions;

All the other cash and non-cash benefits (treated as benefit from employment) are liable to tax, if exceed the tax free threshold.

(f) The employees who are employed under more than one employer will be liable to tax at the rate of 15%.

(g) Tax on partnership will also be adjusted accordingly.

(h) The present Withholding Tax deductible by Bank or Financial institutions on interest from deposits at the rate of 2.5% will be removed and such income will be considered as part of the total statutory income.

(i) The exemption of income from interest on money deposited in banks or financial institutions by senior citizens (over 60 years of age) will remain unchanged.

(j) Deduction of Withholding tax on interest income arising to individual out of Sri Lanka under section 95 of the Act, will be at 15% subject to the rate specified under any Double Taxation Avoidance agreement entered into with the Government of Sri Lanka.

(Relevant provisions and the Rate Schedules will be amended)

(ii) Tax exemptions granted to certain organizations under Section 7 or miscellaneous exemptions under Section13 will be removed.

(a) *Removal of Institutional exemptions:*
- The exemption on the profits and income of the International Institutions will be restricted to any profits and income other than profit and income from sources generated by charging any fee or contribution from the public in any other manner;

- The present exemption applicable to local institutions will be removed other than any Government Department, Foreign Government, University, Co-operative Society, Central Bank including Monetary Board, charitable institution (subject to conditions) or Government assisted school;
  (Section 7 will be amended)

(b) *Removal of Miscellaneous exemptions:*
The following exemptions will be removed:

- the profits and income arising or accruing to any person from any undertaking for the construction of any Port in Sri Lanka.

- the profits and income arising or accruing to any person from the administration of any sports ground, stadium or sports complex.

- the profits and income arising or accruing to any company, partnership or body of persons in a country outside Sri Lanka, from any payment made for the use of any computer software, by Sri Lankan Air Lines Ltd. or Mihin Lanka (Pvt) Ltd., as a special requirement of such Airlines, if a Double Taxation Avoidance Agreement providing relief for double taxation of such profits and income is not in force between Sri Lanka and that country or tax is not payable in such country on such profits and income.

- the profits and income from any service rendered by any person or partnership in any port in Sri Lanka in the course of any business carried on within such port.

- the profits and income arising or accruing to any person from any undertaking for the operation of any port terminal in Sri Lanka;
  (Section 13 will be amended)

2. **Value Added Tax (VAT) (Amendments to VAT Act No. 14 of 2002)**

2.1. The present single rate will be revised to 3 bands 0%, standard rate of 8% and higher rate of 12.5%.
- 0% for export of goods and provision of services for payment in foreign currency outside Sri Lanka.
- Services sector - 12.5%
- Manufacturing or import of goods - 8% (with the limitation of input tax)

2.2. The present exemptions on the Import or supply of telecom equipment or machinery, high-tech equipment including copper cables for telecom industry will be removed.

2.3. The wholesale and retail trade (other than by a manufacturer or importer) will be excluded from VAT.

2.4. The present threshold will be revised to Rs. 3 million per quarter or Rs. 12 million per year.

3. **Nation Building Tax (NBT) (Amendments to NBT Act No. 9 of 2009)**

3.1. The present rate of NBT will be revised to 4%.

3.2. The present exemptions on the following articles or services will be removed:
- Telecommunication service
- Supply of electricity
- Lubricants

3.3. The present threshold will be revised to Rs 3 million per quarter and the threshold of Rs. 25 million per quarter will be removed except for any locally procured agricultural produce in the preparation for sale.

4. **Share Transaction Levy (STL) (Amendment to PART II of the Finance Act No. 5 of 2005)**
STL will be removed with effect from January 1, 2016.

5. **Construction Industry Guarantee Fund Levy (CIGFL) (Amendment to PART III of the Finance Act No. 5 of 2005)**
   CIGFL will be removed with effect from January 1, 2016.

6. **Luxury & Semi-Luxury Motor Vehicle Tax (Amendment of PART II of the Finance Act No. 16 of 1995)**
   Luxury & Semi-Luxury Motor Vehicle Tax will be removed with effect from April 1, 2016.

7. **Betting and Gaming Levy (Amendments to Betting and Gaming Levy Act No. 40 of 1988)**
   (i) The present entry fee of US$ 100 per person who enters Casino entertainment will be removed.

   (ii) The present annual levy of Rs. 200 million for carrying on the business of playing rudjino will be reduced to Rs. 5 million per year.

   (iii) The present annual levy of Rs. 200 million for carrying on the business of Casino will be increased to Rs. 400 million per year.

   (iv) Directors and shareholders will be personally liable for non-payment or any act which is done to avoid payment of Casino Industry Levy (one off levy) introduced in the interim budget.

8. **Economic Service Charge (ESC) (Amendments to ESC Act No. 13 of 2006)**
   (i) The present exclusion of profit making businesses will be removed.

   (ii) The present maximum liability of Rs. 120 million per year will be removed.

   (iii) The rate is increased from 0.25% to 0.5%.

   (iv) The period for carried forward of ESC to be set off against income tax payable for any period commencing from April 1, 2016, is reduced from 5 years to 3 years.

   (Relevant provisions of the ESC Act will amended)

9. **Excise Duty**
   The liquor manufacturing License fee and duty rates will be revised.

10. **Excise (Special Provisions) Duty**
    The concessions and rates will be revised.

11. **Customs Duty**
    (i) The present 4 band tariff structure of exempt, 7.5%, 15% and 25% will be changed as exempt, 15% and 30%.

    (ii) Custom Duty will be revised on following items:
    - Beedi leaves, Beedi, Garments, Foot-wear, Beer, Wine, Whisky, and Ethanol.
    - Agriculture machinery and equipment, dairy industry machinery and equipment and fishing nets.
    - Sports equipment and Musical instruments.
    - yachts , caravan carriages, surfing equipment and mini cruise boats identified under specified HS Code No

    (iii) Certain items in the negative list (tiles, ceramic and sanitary ware) will be removed

    (iv) Sri Lanka will complete its commitments on Tariff Liberalization (Phase I) of the South Asian Free Trade Area effective from November 21, 2015.

    (v) Sri Lanka will fulfill its December 2015 target of commitments on the Tariff Liberalization (Phase II) of the South Asian Free Trade Area effective from November 21, 2015.

    (Relevant Gazette will be issued specifying the rate change with effect from November 20, 2016]

12. **Ports and Airports Development Levy (PAL) (Amendments to PAL Act No. 18 of 2011)**
    - (i) PAL will be increased from 5% to 7.5%
    - (ii) To encourage spending by tourists rate will be reduced from 5% to 2.5% on certain electronic and electrical items
    - (iii) The present rate of 5% on certain machinery will be removed.

    (Relevant Gazette will be issued specifying the rate change)

13. **Tourism Development Levy -** will be removed.

14. **Special Commodity Levy (SCL)**
    - (i) In order to promote local industry SCL will be increased on import of fish and fish related products.
    - (ii) Rate will be revised on certain commodities.

    (Relevant Gazette will be issued specifying the rate changes)

15. **Cess**
    - (i) Removal of Cess: To encourage export of value added products 'export Cess' will be remove on pepper, cloves and nutmeg.
    - (ii) Impose of Cess: To encourage local industry Cess at the rate of 10% will be imposed on import of jewellary.

16. **Land (Restriction on Alienation) Act**
    - (i) Restriction on transfer will be removed for certain identified investments.
    - (ii) Tax on leasing of lands will be removed.

    (the relevant provisions of the Land (Restriction on Alienation) Act No. 38 of 2014 will be amended]

17. **Stamp Duty [Stamp Duty (Special Provisions) Act No. 12 of 2007]**
    - (i) Present Stamp Duty of 1.5% (every Rs. 1,000/- or part thereof Rs. 15/-) levied on Credit Card usage will be removed with regards to local usage of credit cards.
    - (ii) Usage of credit card for foreign purchases will be increased to 2.5% (on every Rs 1,000/- or part thereof Rs. 25/-)
    - (iii) "Share Certificate" will be exempted from with effect from January 1, 2016.

    (Relevant rate change will be Gazetted and applicable on transactions entered into on or after January 1, 2016)

18. **Mansion Tax (PART VIII of the Finance Act No. 10 of 2015)**
    - (i) The mansion tax applicable on condominium units will be removed; and
    - (ii) The first installment of the Mansion tax is payable on or before March 31, 2016.

    (PART VIII of the Finance Act No. 10 of 2015 will be amended)

19. **Telecommunication Levies**
    - (i) International Telecommunication Operators Levy (ITOL) on incoming calls will be increased US$ Cents 9 to US$ Cents 12.
    - (ii) Environmental Fee will be charged per tower at the rate of Rs. 50,000/- per annum.
    - (iii) Cess levied at 2% for international transit traffic will be exempted with effect from January 1, 2016.

20. **Other Levies and Charges**

(i) Beedi manufacturing Licence fee will be increased from Rs. 1,500/- to Rs. 5,000/-

(ii) Embarkation Levy will be increased from US$ 25 to US$ 30.

(iii) Passport Fee will be revised as follows:
- One Day Service - Adult Rs. 10,000/-
- One Day Service - Child Rs. 5,000/-
- Normal Service - Adult Rs. 3,000/-
- Normal Service - Child Rs. 2,000/-

with effect from January 1, 2016.

(iv) Application fee for dual citizenship from Rs. 250,000/- to Rs. 300,000/- and SAARC Visa from US$ 10 to US$ 20.

(v) New Residence Visa fee for foreigners will be introduced to encourage foreign investments:
- US$ 01 million for residence visa for a period of 3 years; and
- US$ 05 million for residence visa for permanent residence.

(vi) ***Company Registration Fee:*** Every company registered with the Registrar of Companies will be subjected to an Annual License fee of:
- Private Companies Rs. 60,000/-
- Public Quoted Companies Rs. 500,000/-
- Other Rs. 100,000/-

(including companies non-functioning) and payable to the Registrar of Companies.

(vii) ***Company Registration Fees:*** The present rates will be revised with effect from January 1, 2016.

(viii) ***Voluntary liquidation of a company:*** Rs. 250,000/- will be charged on liquidation.

(ix) All business entities should be registered with their respective local councils at a nominal fee of Rs. 100/- per year.

(x) ***Surtax:*** Surtax will be imposed with effect from any Year of Assessment commencing from April 1, 2016, at the rate of 25% of the income tax liability of profit on business of Tobacco, Liqour and Betting and Gaming which were earlier subject to income tax at 40%.

(xi) ***Fine on Road Accidents:*** A fine of Rs. 10,000/- will be imposed on person who is responsible on road accidents payable in case of road accidents. In addition the cost to the government property damage (if any) is also payable.

(xii) ***Vehicle Valuation Certificate Fee:*** A fee on valuation certificates obtainable for finance facilities will be charged:
- Three wheeler/Motor Cycle - Rs. 5,000/-
- All other vehicles - Rs. 25,000/-

with effect from January 1, 2016.

(xiii) ***Unregistered vehicles to be registered before 31.03.2016:*** Such vehicles could be registered by paying the following fee to RMV:
- Cars/ Vans - Rs. 01 Mn
- Other vehicles - Rs. 0.75 Mn

(xiv) ***Vehicle Entitlement fee:*** A fee will be imposed in lieu of 'Motor Vehicle Importers Registration fee' with effect from January 1, 2016, payable to the Commissioner General of Inland Revenue before the opening of LCs at the following rates:

Type	Rate per vehicle
Motor Cycle/three wheelers	Rs. 2,000/-
Motor Cars	Rs. 15,000/-

(xv) ***Auctioning of Number Plate:*** Unique lifetime Number will be subjected to an Onetime fee of Rs.2.50 Mn.

(xvi) ***Emission Levy***
The levy is payable to the Divisional Secretariat at the point of renewal of annual licence on every motor vehicle which is over 03 years at the rate of Rs. 5,000/- per year.

(xvii) Motor Vehicle Licence Fee will be revised with effect from January 1, 2016.

(xviii) ***Import taxes on Garments and Footwear:***

(i) The present composite tax imposed on (at the Custom point) sale of garments to the local market by export oriented companies [refers to in section 22(1) of the VAT Act] will be increased to Rs. 200 /- per piece.

(ii) The same rate will be extended to sale of footwear to the local market by export oriented companies.

(iii) The applicable rate for sale of fabric and cut pieces remains the same.

(iv) The sale of export quality products to the local market by export oriented BOI companies will be restricted to 5% of the total turnover and will be subjected to the tax at the rate specified above.

(xix) A charge will be imposed on Airlines on the sale of international tickets at US$ 2.00 per passenger.

21. **Technical Rectifications and Administrative provisions**
Necessary amendments will be made to the respective provisions of the Inland Revenue Act No. 10 of 2006, Value Added Tax Act No. 14 of 2002, Nation Building Tax Act No. 9 of 2009, Economic Service Charge Act No. 13 of 2006, Finance Acts and Finance (Amendment) Acts, Betting and Gaming Levy Act No. 40 of 1988, Default Tax (Special Provisions) Act No. 16 of 2010, Telecommunication Levy Act No. 21 of 2011, Ports and Airports Development Levy Act No. 18 of 2011, Tax Appeals Commission Act No. 23 of 2011, Imports and Exports (Control) Act No. 1 of 1969, Land (Restriction on Alienation) Act No. 38 of 2014 and Strategic Development Projects Act No. 14 of 2008 in order to streamline the revenue administration and to rectify certain ambiguities and unintended effects (including differences in translations).

22. **Effective Dates of Proposals**
Unless stated otherwise, the proposals in relation to;

(i) Income Tax and ESC will take effect commencing from April 1, 2016.

(ii) Value Added Tax, Nation Building Tax, Betting and Gaming Levy and Land (Restriction on Alienation) Act will be implemented with effect from January 1, 2016.

(iii) Cess, Ports and Airport Development Levy, Custom Duty, Excise (Special Provisions) and Special Commodity Levy will take effect immediately.