TAX REFORMS – 2012[1]

Taking forward the reform initiatives proposed in the 2011 Budget, as recommended by the Presidential Tax Commission, the Government introduced appropriate amendments to bring the country's taxation in line with other fast growing emerging economies. Amendments were made to the Nation Building Tax Act No. 9 of 2009, Inland Revenue Act No. 10 of 2006, Economic Service Charge Act No. 13 of 2006 and Value Added Tax Act No. 14 of 2002.

Further, Finance Act No. 12 of 2012 was introduced and Regulations were issued under other relevant statutes, to reduce tax rates and broaden the tax base.

Emphasis was on Small and Medium Enterprise (SME) development by creating Investment Fund Accounts, using savings from VAT on Financial Services and corporate income collected from Banks. Tax rates on SMEs, exports and on the construction, tourism and agriculture sectors were reduced to concessionary rates of 10- 12 per cent, while applying low rates of duties and taxes on plant and machinery and essential raw material.

To promote predictability and improve level-play in relation to investment, concessions and tax holidays were rationalized under three categories - SMEs, large scale investments and strategic investments. VAT concessions were expanded to cover targeted sectors, specific activities and certain local manufacturing. Nation Building Tax and Provincial Turnover Tax were combined. Debit Tax, Social Responsibility Levy and Regional Infrastructure Levy, were removed, to simplify taxation. Corporate and personal tax rates were further rationalized and simplified.

Value Added Tax (Amendment) Act No. 7 of 2012

Exemptions;

- Importation of speakers & amplifiers, digital stereo processors & accessories, cinema media players and digital readers for the cinema industry, pharmaceutical machinery and spare parts, machinery for the manufacture of bio mass briquettes, green houses, poly tunnels and grower material, plant, machinery or equipment for certain enterprises enjoying tax holidays, subject to conditions specified in the related agreements.

[1] Extracted from Annual Report 2011 of the Ministry of Finance and Planning (pp. 38-41)

- Local manufacture of hydropower machinery and equipment, value added local products to tourist hotels and airlines, canned fish, turbines, specified products to identified State Institutions, products replacing imports, pottery products by a manufacturer.

- Research and development services, services by the Department of Commerce, the BOI or the SLPA to exporters, and paintings by the creator of such paintings.

- Any value addition attributable to a Unit Trust or a Mutual Fund from interest, dividend or dealing in debt instruments - from VAT on financial services.

- Importation or supply of lorries and trucks, buses, sport equipment, machinery used for the production of rubber and plastic products, wood (sawn), sunglasses, perfumes, mammoties, artemia eggs, peat moss (used as fertilizer), moulding (steel, glass, rubber or plastic), items and spares needed in the poultry industry or for the manufacture of spectacles and frames.

- Input tax restrictions: The present restriction of 5% on the claimability of unabsorbed VAT was removed.

- VAT Suspension Scheme: Changes were made to the VAT suspension scheme, to ensure its smooth Implementation.

Inland Revenue (Amendment) Act No. 8 of 2012

Changes in relation to Tax Holidays (in three levels)

SME Sector: The scope was expanded and the minimum investment limit was reduced to Rs. 25 mn for services such as agriculture, agro processing, animal husbandry etc. The tax holiday period was extended from 3 years to 4 years and based on the level of investment, the tax holiday period was further extended to 6 years.

Large Scale Investments: Qualifying activities are expanded and included under respective sections of the Act; the period of tax holiday extends up to 12 years based on the level of investment.

Strategic Import Replacement Enterprises: An undertaking for the manufacture of cement, pharmaceutical, fabric or milk powder, replacing imports with a specified investment in capital assets is entitled for a tax holiday of 5 years followed by a concessionary period at the rate of 12%.

Expansion of Undertakings: SMEs/Large Scale - qualifying payment relief in 4 equal payments of the total quantum of investment if the sum invested is not less than Rs 50 mn prior to 1/4/2015.

Strategic Import Replacement: Qualifying payment relief in 4 equal payments of the total quantum of investment if the sum specified for the exemption purposes invested by an existing company on or after 1/4/2012.

Tax Exemptions (in general without any investment criteria):

Royalty received from outside Sri Lanka if remitted to Sri Lanka through a bank.

Redemption of a Unit of a Unit Trust or a Mutual Fund.

Interest accruing to any person or partnership outside Sri Lanka on a loan granted to any person or partnership in Sri Lanka.

The administration of any sport ground, stadium or sport complex.

Income of a non citizen trainer of any sport, brought to Sri Lanka for that purpose.

Concessionary Rates

Development activities carried out by specified bank branches – 24 %

Research and development - Company 20%, others max 16% (with triple deductions of the expenditure incurred, if services are obtained from a Government institution).

Value Added Tea exported through a joint venture of the grower and manufacturer, local manufacture of Handlooms, and Healthcare 12%

Deductions

Capital allowances: Increased to 50% on energy efficient high tech plant, machinery or equipment.

Travelling expenses: Companies exclusively providing the services of design development, product development or product innovation - permitted to deduct in full, any travel expenditure (whether local or foreign) incurred in relation to such services.

Maintenance and management expenses: Incurred by any person in respect of any Sports ground, Stadium or Sports Complex could be deductible without any restriction.

Pre - commencement expenses incurred by any SME with an expected turnover not exceeding Rs. 500 mn. in the year of assessment immediately preceding the year in which the SME commences commercial operations, is allowed for deduction from the total statutory income of the year of commercial operation.

Qualifying payments on expenditure of community development projects incurred in identified areas to be treated as a qualifying payment deductible subject to an upper limit of Rupees one million in the case of an individual and Rupees ten million in the case of a company.

Note: Investments of a strategic nature will continue to be considered under the provisions of the Strategic Development Projects Act No. 14 of 2008, subject to approval and other requirements stipulated in such Act.

Nation Building Tax (Amendment) Act No. 9 of 2012

Exemptions;

- Importation of an air craft or a ship, arficial limbs, crutches, wheel chairs, hearing aids, accessories for such aids, white canes for the blind, Braille typewriters and parts, Braille writing papers and boards, timber logs, yarn except sewing thread and vegetable fiber based yarn, fabric - subject to a Cess of Rs 75/- per kilo.
- Wholesale or retail sale of printing of books, goods to exporters, collectors of fresh milk, green leaf, cinnamon, rubber(latex, crape or sheet rubber), petrol, diesel or kerosene in a filling station
- Locally manufactured clay roof tiles and pottery products by a manufacturer.
- Sale of a painting by the creator of such painting.

Economic Service Charge (Amendment) Act No. 11 of 2012

- Threshold expanded from Rs. 25 mn. to Rs. 50 mn. per quarter
- Chargeability simplified by removing the liability on the turnover of any business of which the profits are subject to Income Tax
- Exemptions granted on any sale of locally manufactured clay roof tiles and pottery products by a manufacturer

Finance Act No. 12 of 2012

- Removal of the levy on rooms of Five Star Hotels provided to Airline Crew to whom the concessionary rates specified by Price Regulations applies.
- Removal of withholding tax on Registration of Motor Vehicles.
- Rate changes on the annual luxury motor vehicle levy, annual semi- luxury motor vehicle levy and annual semi- luxury dual purpose vehicle levy.
- Exemption from the application of the provisions of the Customs Ordinance, Exchange Control Act and Import and Export Control Act, to enterprises recognized by the BOI as companies engaged in specified export or international trade.

Other Special Treatment

- **Yarn:** All yarn except sewing thread and vegetablefiber based yarn were made free from all taxes to facilitate handloom manufacturing or fabric manufacturing with a value addition and import replacement.
- **Fabric: Imported fabric for domestic consumption**- An all-inclusive tax of Rs. 75/- per kg. including sale of any excess export oriented fabric, except cut pieces of fabric not more than two meters - Tax of Rs. 25/- per kg.

  Sales by export oriented companies with approval
  - All inclusive tax of Rs. 40 per kg

Domestic manufacturers of fabric who are not enjoying BOI concessions
- Exempted from Value Added Tax

- **Airline Services:** Any goods (other than motor vehicles and goods for personal use) required for the purpose of provision of services of international transportation which are consigned to Sri Lankan AirLines Ltd., Mihin Lanka (Pvt) Ltd. or Air Lanka Catering Services Ltd. - exempt from tax at the point of importation.

- **Apparel: All imports of branded apparel products including sportswear** - Subject to a maximum of 35% of all inclusive tax at the point of Customs.

- Sales by export oriented manufacturers who have approval to supply to the domestic market – an all inclusive tax of Rs. 25 per piece and Rs. 25 for a bundle of 6 pieces in relation to selected categories.

  (Relevant amendments have been incorporated to the VAT Act, NBT Act, and Orders made under the PAL Act, Customs Ordinance and EDB Act (relating to chargeability to Cess) – Through Gazette Notifications.