



# Budget Analysis 2021

*Road to Resilience and Recovery*



Tax Proposals | November 2020



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The graphic features a winding road with a dashed white center line and a light blue glow. Five circular markers are placed along the road, each connected by a thin line to a colored box containing a page number. The boxes are yellow for 'Page 19', 'Page 04', and 'Page 03'; purple for 'Page 16'; and red for 'Page 10'. The text labels for each item are placed to the left or right of the road.

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# Foreword

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**18<sup>th</sup> November 2020**

**For the clients of KPMG in Sri Lanka**

The budget proposals for 2021 were presented in Parliament on 17<sup>th</sup> November 2020, which focuses on poverty alleviation and economic revival as envisaged within the “Vistas of Prosperity and Splendour”, the policy framework of the government.

*This publication has been compiled on a high-level review of the proposals in the limited time available to us. We may also emphasize that these proposals need to be enacted by Parliament for legal enforcement.*

*The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.*



Chartered Accountants



# Key Tax Proposals

## Direct Taxes

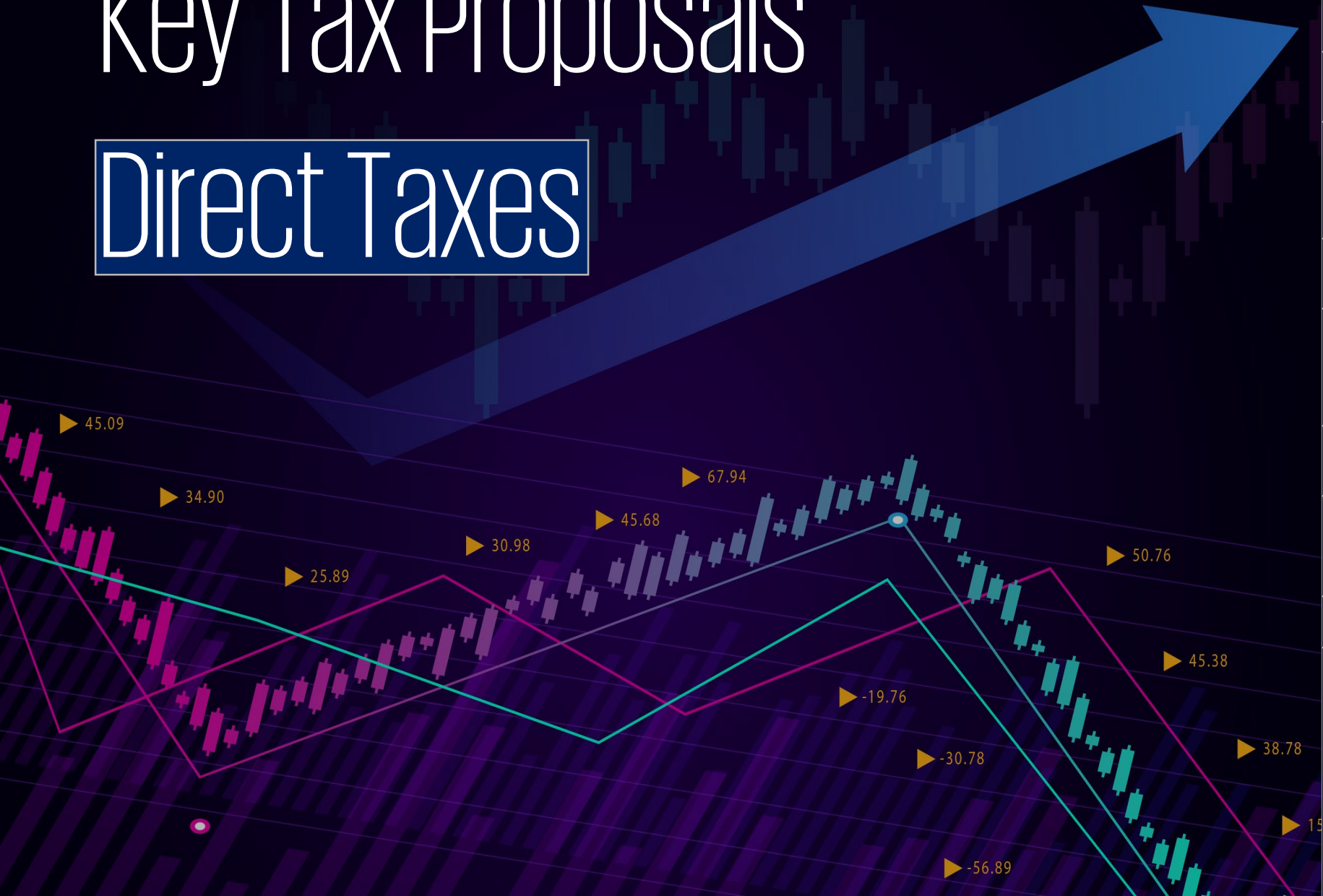


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# Key Tax Proposals - Concessions



## Tax Exemptions

Sector	Concession	Qualifying Criteria
Exports, dairy, fabric, tourism, agricultural products/ processing and information technology	Tax concessions under the Strategic Development Projects Act for a maximum of 10 years	Investment exceeding USD 10 Million with the potential to change the landscape of the economy
Agriculture	5 year income tax exemption	Engaged in agriculture, including fisheries and livestock farming
Warehousing in ports	Exemption from all taxes	Investment in bonded warehouses, and warehouses related to offshore business
Pharmaceutical manufacturing	Tax concessions under the Strategic Development Projects Act	Investment to be made into the investment zone identified for local and foreign private investors
Renewable energy	Tax holiday of 7 years	No specific criteria
Port City Economic Zone	Tax concessions	Business to be established in the zone

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# Key Tax Proposals - Concessions



## ✓ Tax Exemptions (Cont.)

Sector	Concession	Qualifying Criteria
Dairy	Strategic investment tax concessions for a period of 5 years	Investment should be over USD 25 Million focusing on processing milk powder for export. It is unclear whether the concessions stated in the previous slide for the dairy sector would be different from the concessions stated here
Recycling of construction material	Tax holiday of 10 years	Investment in selected recycling sites
Local boat and shipbuilding	Tax holiday of 7 years	No specific criteria
Owner/ operator of Telecommunication towers	5 year tax concession from 1 January 2021	Investor is required to be a domestic industrialist
Approved startups by individuals who have completed vocational education	Tax exemption for 5 years for the business carried out by the individual	The business is required to be approved
Private sector vocational education institutions	Tax holiday on income for a period of 5 years	Intake of students should be doubled up to a minimum of 50,000 students

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# Key Tax Proposals - Concessions



## Other Sector Specific Concessions

Sector	Concession	Qualifying Criteria
Real Estate Investment Trusts (REITs)	<p>Exemption from Capital Gains Tax on investment into REITs</p> <p>Exemption on dividends derived through REITs</p> <p>Concessionary rate of Stamp Duty of 0.75% on transfer of property to REITs</p>	No specific criteria
Listing of companies	50% reduction in Income Tax for the year of assessment 2021/2022 and a reduced tax rate of 14% for the subsequent 3 years	The company is required to be listed on the Colombo Stock Exchange before 31 December 2021
Multi National Companies (MNCs)	Reduction in tax on dividends by 25% in the year 2021 and 50% reduction in the year 2023	Exports to be increased by 30% in the year 2021, and by 50% in the year 2023. Since it has already been proposed at the beginning of this year to exempt dividends paid to any non-resident, this proposal would have to be further studied
Commercial banks	Exemption from taxes on gains on realization of Sri Lanka international sovereign bonds	Minimum investment of USD 100 Million
Welfare societies/institutions	Exemption from income tax on interest income	No specific criteria
Samurdhi	Exemption from income tax on interest income derived from investment into government securities by Samurdhi Bank	The investments are to be made using funds available in Samurdhi Life Savings Accounts (SLSA) opened for each Samurdhi beneficiary

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# Key Tax Proposals - Direct Taxes



## Ascertainment of Income

- Relevant instructions are to be issued under the Inland Revenue Act in relation to the deduction of provision for anticipated losses of loans and doubtful debts, in computing business income of banks and financial institutions, with the objective of ensuring better and transparent management. Presently, a deduction is granted for provisions made in accordance with the relevant directives issued by the Central Bank of Sri Lanka, except for those items specifically identified as excluded. This proposal may have been introduced to provide a deduction for potential loss provisions due to granting of debt moratorium.
- Capital Gain Tax is proposed to be calculated based on the sale price of the property or the “assessed value” of the property, whichever is higher. It is unclear as to what is meant by “assessed value” and whether there is a significant change in the method of calculating Capital Gain Tax.
- It has been proposed to grant an additional deduction in computing business income for cost of funds incurred by the banks and financial institutions on providing loans as start-up capital to individuals who have completed vocational education for approved businesses identified as eligible for tax exemption.
- The contribution made by a local entrepreneur from a Samurdhi beneficiary family to establish shops will be considered a deductible expense in calculating his/ her personal income tax.
- Accelerated depreciation over 2 years is proposed to be granted for investment into latest technology in relation to collection of local liquid milk in collaboration with local dairy farmers, enhancements to milk related production and promotion of liquid milk.
- Expenditure incurred by commercial banks and financial institutions on acquisition of, or merger with, subsidiary companies to be allowed as a deduction in ascertaining business income.

## Other Proposals

- Dividends arising to foreign companies are proposed to be exempt for 3 years if such dividends are reinvested on expansion of their businesses or in the money/ stock market or in Sri Lanka International Sovereign Bonds. Based on the proposals announced at the beginning of this year, dividends paid to any non-resident shareholder were proposed to be exempt from 1 January 2020. The budget proposal seems to limit granting of such exemption on the condition of such dividend being reinvested into Sri Lanka. Hence, this proposal has to be further studied.
- Amnesty to be granted for entrepreneurs who bring in funds which were previously undisclosed, if 1% tax is paid.

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# Key Tax Proposals - Direct Taxes



## Administrative Provisions

- It has been proposed to amend the tax law incorporating provisions to make it mandatory for all companies to file tax returns on an E-Filing system, with effect from 1 April 2021.
- Legal provisions relating to establishment of specific time frames for the implementation of rulings and for the settlement of appeals submitted against tax administrative decisions made under the Inland Revenue Act would be introduced. Presently, there is no time limit specified under the Inland Revenue Act for the Department of Inland Revenue to intimate a decision on a request for administrative review or an appeal made against such review.
- A special Tax Appeals Court is to be established, which would be responsible for resolving tax appeals.
- Technical and legal provisions are to be introduced into the tax laws to strengthen the RAMIS, and as a further measure of strengthening the tax administration, the various units of the Department of Inland Revenue managing the files of high earning and large scale businesses, banks and financial institutions, will be brought under one Large Tax Payer Unit (LTPU) which will operate under the direct responsibility of the Commissioner General of Inland Revenue.
- Necessary changes to be made to the Department of Inland Revenue to enable enhanced self-compliance and to strengthen tax audits with the intention of increasing tax revenue.
- Punitive legal provisions to be introduced to penalize, including barring from practicing, tax consultants and auditors who prepare and certify fraudulent tax reports, or who aid and abet in such action, representing taxpayers.

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# Key Tax Proposals

## Indirect Taxes



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# Key Tax Proposals - Indirect Taxes



## Value Added Tax (VAT)

The following proposals mentioned in the Budget Speech 2021 are the changes introduced by the Department of Inland Revenue (DIR) acting on the instructions of the Ministry of Finance to the VAT regime of Sri Lanka via the publication of web notices and implemented subject to legislative enactment.

- The VAT registration threshold increased to Rs. 75 Mn per taxable period or Rs. 300 Mn per annum from Rs. 3 Mn per taxable period or Rs. 12 Mn per annum with effect from 01 January 2020.
- Re-introduction of the voluntary registration scheme which was abolished in 2013, for persons who have taxable supplies less than the VAT registration threshold with effect from 01 January 2020.
- VAT exemption on sale of condominium housing units with effect from 01 December 2019.
- VAT exemption on information technology and enabling services with effect from 01 January 2020.

- The mainstream VAT rate applicable on import and supply of goods and services was reduced to 8% from 15% with effect from 01 December 2019 and subsequently the change to the VAT rate was published in Gazette No 2151/52 dated 29 November 2019.
- Further it was proposed in the Budget Speech 2021 that the tax policy introduced with respect to the VAT rate change of 8% would be maintained consistently during the next five years except for banking, finance and insurance sectors.

### Removal of Deemed Input Tax

- Deemed input tax credit available to wholesale & retail traders will be removed.
- Deemed input tax credit was introduced in 2016 to provide input tax credit for purchases from non-VAT registrants.

### Reduction in VAT Rate

- The VAT on garments sold by export oriented BOI companies to the local market would be reduced to Rs.25 for each piece of garment from Rs.100.

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## Value Added Tax (VAT) (Cont.)

### New Exemptions

- Supply of services in respect of inbound tours by a travel agent registered with Sri Lanka Tourist Development Authority with effect from 01 April 2020.
- Supply or donation of health protective equipment and similar products by export oriented BOI companies to the Ministry of Health and Indigenous Medical Services, Department of Health Services, Tri Forces and Sri Lanka Police at their request.
- Import, import and supply or import and donation of machinery and equipment including medical, surgical, surgical and dental instruments, apparatus, accessories and parts thereof, hospital/medical furniture and drugs, chemical and similar items required for the provision of health services to address the COVID 19 Pandemic for the period from 20 May 2020 to 31 December 2020.
- VAT exemptions available to goods at the point of importation are extended to the domestic production of such goods.



## Stamp Duty

It is proposed to reduce the Stamp Duty on Real Estate Investment Trust (REITs) to 0.75%. Stamp Duty applicable on REITs are two fold.

- a) Stamp Duty payable to Provincial Councils in relation to transferring land and building into and out of REIT. The applicable rate is 3% on the first Rs.100,000 and 4% on the excess.
- b) Stamp Duty payable to Inland Revenue Department in relation to execution of leases. Applicable rate under the Stamp Duty (Special Provisions) Act No.12 of 2006 would be 1% on the aggregate premium payable for the entire duration restricted to 20 years.

Whilst the rate under Stamp Duty (Special Provisions) Act No.12 of 2006 could be reduced by the Parliament, the rate charged by the Provincial Councils could be varied only by the Provincial Councils due to the provisions in the 13th Amendment to the Constitution.



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# Key Tax Proposals - Indirect Taxes



## Introduction of a Special Goods and Services Tax

An online managed single special goods and services tax will be introduced on telecommunication, motor vehicles, cigarettes, liquor, betting and gaming in lieu of various taxes and levies imposed under different Acts and administered by different Government Departments. This composite tax is introduced in order to improve the efficiency of the existing tax collection. Following is the synopsis of the current indirect taxes applicable on the aforementioned industries.

### Telecommunication Services

Currently, the telecommunication services are subject to Telecommunication Levy, Cess (administered by the Telecommunications Regulatory Commission) and VAT (administered by the Department of Inland Revenue). The telecommunication industry first witnessed the composite tax called Telecommunication Levy in lieu of VAT and NBT in 2011. Later, in 2016, VAT and NBT were re-imposed on telecommunication industry in addition to the Telecommunication Levy. NBT was discontinued from December 2019.

### Motor Vehicles

A composite tax was introduced in 2014, on motor vehicles specified under Chapter 87 of the tariff guide for both import and supply of such vehicles in lieu of VAT and NBT.

In addition to the composite tax, Custom Duty and Port and Airport Development Levy is imposed at the point of importation. Further, Luxury Tax on Motor Vehicles was introduced in 2019 in lieu of Annual Luxury Motor Vehicle Tax on prescribed motor vehicles. ESC imposed on importation of motor vehicles w.e.f. April 2017 was discontinued from January 2020.

### Cigarettes and Liquor

Currently, cigarettes and liquor are subject to Excise Duty and VAT. A composite tax was introduced in 2014, for cigarettes and liquor in lieu of VAT and NBT. However, VAT and NBT was reintroduced from November 2016 on cigarettes and liquor in addition to the Excise Duty imposed. NBT was discontinued from December 2019.

### Betting and Gaming

Currently, the business of betting and gaming is subject to an annual levy for carrying on the business of gaming and a levy on gross collection of the business. Further, a Casino Entrance Levy is imposed and collected from the persons entering such places of gaming.

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# Key Tax Proposals - Indirect Taxes



## Import Duties & Levies

The Budget Proposals refer to revisions in Import Duties and Levies impacting across many industries, however, the proposals do not refer to a specific duty or a levy. Hence, we should await further guidance to identify the revisions to the type of import tariff, duty or levy and the relevant HS Codes.

- To promote products of direct and indirect exporters, small and medium scale exporters and the export of high value addition local imports, a Temporary Import for Export Scheme (TIEP) will be implemented. The TIEP Scheme will provide temporary import facilities for raw materials not available in Sri Lanka, spare parts, processing and packing materials, labels, stickers, catalogues and brochures.
- To boost exports and domestic industries producing value added goods, the import taxes will be removed on raw materials that are not locally available. Further, import tax on importation of machineries and equipment with modern technology will also be removed.

- The taxes applicable on the import of fish not available in Sri Lanka for the production of dried, canned and Maldives fish will remain high to encourage domestic production.
- The importation of agricultural commodities, other than those that cannot be produced locally will be limited.
- To incentivize entrepreneurs in the automobile industry engaged in vehicle repair and vehicle assembly, the import taxes levied on the import of vehicle spare parts would be reduced.
- The import of machinery with modern technology will be exempt from import taxes for the benefit of the construction industry.
- Import duties on cement, premix, iron rods and bitumen that cannot be produced locally and are imported in bulk will be free of import duties, if such materials are used for the construction of housing schemes, highways and to ensure uninterrupted availability for small and medium construction activities.
- The importation of batik will be banned in order to develop batik as a national industry.
- Cess will be imposed to protect the imports and exports of domestic production. The relevant HS Codes are to be specified.

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## Customs Duty

### Concessions and Reliefs

A concession is proposed for the import of cold room facilities for the preservation of fruits and vegetables in order to encourage agriculture industry.

Further a relief is provided on the import of modern equipment for entrepreneurs investing in value additions to local crops such as pepper, cloves, cardamom and coffee that are suitable for the export market.

### Rate Change

It is proposed to revise the import tariff bands to 0%, 10% and 15% for all imports other than for specific commodities. The prevailing tariff bands are 0%, 15%, 25% and 30%.



### Special Commodity Levy (SCL)

SCL will be imposed on selected agricultural products to balance the domestic supply and demand.

As per the circular dated 17 November 2020, uploaded on the Customs Website as at 9:40 pm, Special Commodity Levy will be imposed on the following HS Codes with effect from 18 November 2020 for a period of six months.

Description	HS Code	Rate
Prepared or preserved fish; caviar and caviar substitutes prepared from fish eggs	1604	
<ul style="list-style-type: none"> <li>Fish, whole or in pieces, but not minced:           <ul style="list-style-type: none"> <li>Salmon</li> <li>Herrings</li> <li>Sardines, sardinella and brisling or sprats</li> <li>Tunas, skipjack and bonito (<i>Sarda spp.</i>)</li> <li>Mackerel</li> <li>Anchovies</li> <li>Eels</li> <li>Other</li> </ul> </li> <li>Other prepared or preserved fish,           <ul style="list-style-type: none"> <li>Canned Fish Curry</li> </ul> </li> </ul>	1604.11.00 1604.12.00 1604.13.00 1604.14.00 1604.15.00 1604.16.00 1604.17.00 1604.19.00 1604.20.00	Rs.100 per Kg Rs.100 per Kg Rs.100 per Kg Rs.100 per Kg Rs.100 per Kg Rs.100 per Kg Rs.100 per Kg Rs.100 per Kg Rs.100 per Kg

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## Condominiums for Non-residents

A proposal has been introduced granting permission for non-residents to purchase super luxury condominiums in Sri Lanka with the foreign currency earnings (earned in or outside Sri Lanka) or loans obtained from banks outside Sri Lanka. As per the principal enactment of the Land (Restrictions on Alienation) Act No.38 of 2014 prior to 01 April 2018, the foreigners were only allowed to purchase condominium parcel on or above the 4th floor of the building.

Subsequently it was relaxed by the Land (Restrictions on Alienation) (Amendment) Act No 21 of 2018 (w.e.f. 01.04.2018), where the foreigners were allowed to buy any unit in any floor of the condominium properties, provided the entire value is paid upfront via inward remittance of foreign remittance. This proposal enables, a non-resident who earns in foreign currency in Sri Lanka without any inward remittance to invest in condominiums in Sri Lanka.

## Outstanding Taxes

A mechanism has been proposed for the settlement of outstanding taxes including a concessionary payment plan based on the payment capacity of the taxpayer in order to close the tax files such as NBT (not chargeable w.e.f. 01 December 2019) and ESC (not chargeable w.e.f. 01 January 2020).

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# Key Tax Proposals - Others



## Tax Pardon

It is proposed to make legal provisions to provide a tax pardon to entrepreneurs who utilize the undeclared funds for any investments facilitated by budget 2021. The proposed tax on such undeclared funds would be restricted to 1%.

The Foreign Exchange Act No.12 of 2017 introduced a mechanism in 2017 for funds undeclared prior to 20 November 2017 to be remitted to Sri Lanka, subject to the payment of 1% remittance fee for remittances over USD 1mn. Remittances are permitted sans 1% remittance fee, provided the sum remitted is below USD 1mn or such money is invested in development bonds issued by Government of Sri Lanka. The Act also contains a condition that such funds should be free of any pending case or a court order under Prevention of Money Laundering Act, Convention on the Suppression of Terrorist Financing Act, Bribery Act.



## Contribution to Insurance Fund

It is proposed to create a new insurance scheme with the contribution of 0.25% on the turnover of the businesses and factories with more than 50 employees to support the employees at retail and wholesale shops with more than 5 employees and hotels who temporarily loose livelihoods due to the quarantine process related to epidemics including COVID.

This has not been proposed as a distinct tax, however it is an imposition on the turnover of the specified businesses and factories.

Crop Insurances Levy is a similar levy introduced in 2013, at the rate of 1% on the profit after tax of specified institutions with a view of covering the damages suffered by the farmers of Sri Lanka due to natural disasters.

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years of excellence



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People locally

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Audit

# 842

Tax

# 178

Advisory

# 272

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