Sri Lanka 2021 budget proposals, at a glance

Ernst & Young, Sri Lanka

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This document has been prepared in reference to the 2021 budget reading presented by Hon. Prime Minister and Finance Minister Mahinda Rajapaksa on 17 November 2021 at the Sri Lanka Parliament.

Introduction

The budget - 2021, which focuses on strengthening the 2021-2023 medium term programme of poverty alleviation and economic revival as envisaged within the "Vistas of Prosperity and Splendour", the policy framework of the Government of HE the President Gotabaya Rajapaksa.

According to the Government, this is a development budget presented to elevate an economy that has been shattered. The budget – 2021 covers all sectors under a macroeconomic vision and it will open up numerous special investment opportunities to the business community for production of local goods and services under the competitive setting of the global economy. The public sector should provide the necessary support in this regard.

Contents

1 Summary of the budget

Summary of the budget

	2021 Budget	2020 Estimate
Revenue (Rs. Bn)	2,029	1,588
Expenditure (Rs. Bn)	3,594	2,854
Budget deficit (Rs. Bn)	(1,565)	(1,266)
Deficit / GDP ratio (%)	8.9%	7.9%
Tax revenue / revenue (%)	85%	85%

5%

Inflation

6%

Growth rate over the medium term

2

New taxes and contribution

Contribution to Insurance Fund

A new insurance scheme

It has been proposed to establish a new insurance scheme with the contribution of 0.25% from the turnover of businesses and factories employing more than 50 employees.

The intention of the scheme appears to be for those employed at retail and wholesale shops with more than 5 employees and for those employed in hotels.

It is expected that, precise guidelines as how this scheme will be implemented including the following areas, will be issued in due course.

- Which businesses and factories are covered?
- What is the mechanism of collection from those business with more than 50 employees and deploying such funds in wholesale, retail and hotel sectors?
- Is this an annual, a quarterly or a monthly contribution?
- Can the expense incurred for this fund, be deductible for income tax purposes?
- Who will administer this scheme?

Special Goods and Services Tax

The Special Goods and Services Tax

It has been proposed to introduce a new tax termed Special Goods and Services Tax ("SGST") in lieu of certain taxes and levies currently imposed under various fiscal laws and administered by various statutory institutions. Generally a Goods and Services Tax ("GST") is considered to be an indirect tax applicable on consumption of goods and services.

The purpose of introduction of SGST

- SGST is proposed to be introduced as an online managed composite tax in lieu of certain identified taxes and levies applicable for specified industries.
- The current regulatory bodies of such industries will be relieved of the role of tax collection, allowing them to focus more on primary regulatory engagements.

Special Goods and Services Tax (Contd.)

The proposed tax base and the tax rate of SGST

It has been proposed that SGST would be applicable for prescribed industries i.e. alcohol, cigarettes, telecommunication, betting and gaming and motor vehicles. However, there is more room for clarity on the applicable tax base and the rate of SGST which is yet to be prescribed.

- In relation to the tax base, the question remains if the SGST would be applicable only in lieu of industry specific taxes or both industry specific taxes and VAT. If so, will there be an input credit mechanism available?
- There is a likelihood that industry specific rates of SGST will be prescribed based on the rates of industry specific taxes and levies contemplated to be replaced by SGST.
- It has been indicated that SGST will come in to force by January 2021.

Special Goods and Services Tax (Contd.)

Taxes and levies currently applicable for specified industries on turnover

Alcohol

- VAT at 8%
- Excise Duty *(Various Duty rates applicable for specific items. Standard product is liable at LKR.3,200/liter)*

Cigarettes

- VAT at 8%
- Excise Duty *(Various Duty rates applicable for specific items. Standard product is liable at LKR.43.10)*

Telecom

- VAT at 8%
- Telecommunication Levy at 11.25%
- CESS at 2%

Betting & Gaming

- VAT at 8% or Levy on Gross Collection at 10%
- Annual Levy

Motor Vehicles

- Excise Duty *(Various Duty rates applicable for specific items)*

3 Concessions

Concessions for key thrust sectors

Tax concessions and exemptions have been granted to key thrust sectors that were identified by the Government from January 1, 2020 onwards.

The budget proposals for 2021 whilst reassuring the continuation of these tax concessions and exemptions have further proposed additional concessions targeting the development of these sectors.

Key thrust sectors for which tax concessions are granted

Agriculture

Energy and sustainable development

Construction

Local manufacturing

Information technology and warehousing services

Vocational training

Development of capital markets

EY

1. Concessions for the Agriculture sector

Value Added Agricultural Products

- Permission is to be granted for the import of unique raw materials and intermediate products that cannot be manufactured in the country as well as the import of high technology imports (otherwise the import of identified agricultural commodities is restricted). The specific products need to be clarified.
- Import taxes will be removed on these especially permitted imports.
- Customs duty exemptions and financing facilities are to be granted to obtain land and modern equipment for investing in value added products using crops such as pepper, cloves, cardamom and coffee for the export market
- A tax concession of up to 10 years under the Strategic Development Law will be provided for investments exceeding USD 10 Mn in agricultural products, processing.
- It is proposed to provide a support scheme to promote cultivation of ginger and turmeric. (Currently there is a ban on importation of ginger and turmeric)

EY

1. Concessions for the Agriculture sector (Contd.)

Dairy

- Income tax exemption for 5 years for capital investment over USD 25 million for milk powder processing. Clarification is needed on whether this exemption is only for exporters.
- Accelerated depreciation allowances are to be granted on capital investments on latest technology to collect local liquid milk in collaboration with local dairy farmers, enhancements of milk related productions and promotion of liquid milk.

Fisheries

- Special import mechanism to import fish that are not available in Sri Lanka for the production of dried fish, Maldives fish and canned fish.
- Simplified administrative process for the exportation of fish and aquatic plants, for the development of tissue culture methods, to increase the availability of fish feed.

Farming

- Import duty concessions are to be granted for imports relating to cold room facilities for the preservation of fruit and vegetables.
- Credit facilities are to be granted to acquire these cold room facilities as well.

EY

2. Concessions for energy and sustainable development

Energy

- A 7 year tax holiday is to be granted for all renewable energy projects.
- It is proposed to increase renewable energy capacity to 1,000 MW by the expeditious implementation of both off shore wind and floating solar power plants exceeding 100 MW, with incentives by the Board of Investment.
- It is also proposed to establish natural gas power plants.

Recycling and reuse

- A 10 year tax holiday for recycling and reuse of construction material.

3. Concessions for the construction sector

Domestic Industrialists

- A 5 year tax holiday for domestic industrialists building telecommunication towers and infrastructure using domestic labour and materials

Government infrastructure projects

- Raw materials such as cement, premix, iron rods, bitumen that cannot be produced domestically will be imported in bulk without import duties, to be used to for the construction of mega housing schemes and highways.
- All imported inputs for government infrastructure projects will be exempt from import taxes.
- To ensure continuous payment of contractors engaged in government projects, facilities will be proposed to provide 90% of the value of the certified bills from the banks

Import of machinery

- An exemption would be available on import tax on the import of machinery with modern technologies.

4. Concessions for local manufacturers

Boat and ship building

- A 7 year tax holiday for investments in boat and ship building
- Long term credit facilities to promote boat and ship building activities

Modern investment zone

- It is proposed to set up a modern investment zone for local and foreign private investors under the Strategic Development Act.

Exporters

- A tax concession of up to 10 years under the Strategic Development Law will be provided for investments exceeding USD 10 Mn in exports
- Strategic investment tax concession for a period of 5 years for investments made over USD 25Mn focusing on milk powder processing for export.

5. Concessions for the service sector

Warehousing

- Hub operations involving bonded warehouses and warehouses for offshore business to be exempted from income tax

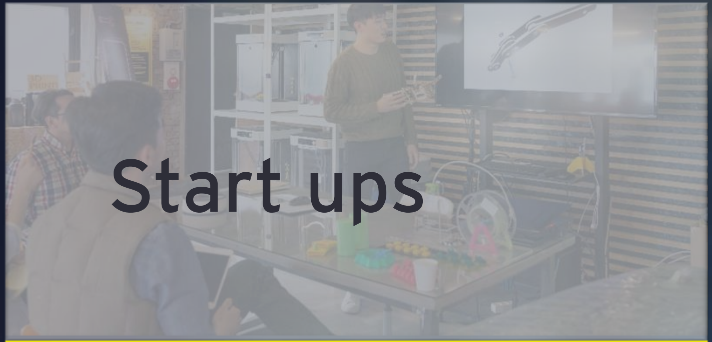
Information technology

- A tax concession of up to 10 years under the Strategic Development Law will be provided for investments exceeding USD 10 Mn in information technology
- The Hon. Minister is proposing to building five techno-parks in Galle, Kurunegala, Anuradhapura, Kandy, and Batticaloa districts,

Tourism

- A tax concession of up to 10 years under the Strategic Development Law will be provided for investments exceeding USD 10 Mn in tourism
- Simplification of the taxes ad levies imposed by local govt.
- Extension of concessions and recovery of loans granted under the re-financing facilities of the Central Bank until September 30, 2021

6. Concessions to encourage vocational training



Start ups

- A tax holiday of 5 years to entrepreneurs, starting their own business, on the successful completion of a vocational education.
- The Hon. Minister is proposing to provide start up capital at low interest rates and moratoriums.

Vocational institutions

- Technical and vocational education institutions to get a 5 year tax holiday if the student intake is doubled.

7. Concessions to develop the capital markets

Real Estate Investment Trusts (REIT)

- REIT is a trust which owns/leases income generating real estate assets. REITs are popularly used in other countries to own many types of commercial real estate, ranging from office and apartment buildings to warehouses, hospitals, shopping centers, hotels and commercial forests.
- REITs in Sri Lanka are governed under the rules gazette by the Securities and Exchange Commission of Sri Lanka dated July 31, 2020. These rules provide for the regulatory framework for SL-RIETS and the manner in which they operate in Sri Lanka.
- In order to promote investments in the housing market through the REIT, it is proposed to exempt REITs from capital gains tax. A REIT is likely to give rise to capital gains tax on the following incidences. The budget speech does not provide clarity on whether all of the below incidences will be exempted from capital gains tax.
- Capital gains at the time the sponsor transfers the real estate property to the REIT
- Capital gains if the REIT divests the real estate
- Capital gains by the unit holders of the REIT on divesting the units (either through the stock exchange of otherwise)
- It is proposed to exempt from dividend tax, the dividend distributed by the REIT.
- The transfer of property is currently subjected to stamp duty of 4%. It is proposed to reduce the stamp duty up to 0.75%. It is presumed that this will be the stamp duty that is charged at the point the property is transferred to the REIT.

7. Concessions to develop the capital markets (Contd.)

Exemptions for listing

- A 50% tax concession for the years 2021/2022 is provided for companies that are listed before December 31, 2021.
- A concessionary corporate tax rate of 14% will be provide for the subsequent 3 years.
- It is not clear as to the percentage of holding that needs to be listed.

Exemptions from dividend tax

- Currently dividends received by non-residents are exempted from tax with effect from January 1, 2020.
- An exemption has been proposed on tax on dividends of foreign companies for 3 years if such dividends are reinvested on expansion of their businesses or in the money or stock market or in Sri Lanka International Sovereign bonds. It is uncertain of the relevance of this proposal in light of the prevailing blanket exemption enjoyed by non residents on dividend income received from Sri Lanka.
- It is also proposed that a reduction of tax imposed on dividend income received by mufti national companies by 25% in 2021 and 50% in 2023 under the condition that they increase their exports by 30% and 50% respectively. The relevance of this proposal too is unclear in light of the prevailing blanket exemption enjoyed by non residents on dividend income received from Sri Lanka.

8. Concessions for mega projects

Special Economic Zone

- Investments exceeding USD 10 million with potential to change the landscape of the economy, in areas of export industries, dairy, fabric, tourism, agricultural products, processing and information technology to be given concessions under the Strategic Development Act.
- Applications for Strategic Development Projects were made previously through the Board of Investment.

Strategic Development Projects

- Colombo Port City is to be developed as a Special Economic Zone.
- A new legal framework is to be drafted for the governing of operations inside this Special Economic Zone and for granting of exclusions from various taxes and laws.

Corporate income tax rates in selected countries in 2020

Europe-America

Asia-Pacific

Personal income tax rates in selected countries in 2020

Europe-America

Asia-Pacific

Capital gain tax rates in selected countries in 2020

Europe-America

Asia-Pacific

4 Banking and Financial Services

Banking and financial services

Tax Exemption on the investment in International Sovereign Bonds

Tax Exemption on the investment in International Sovereign Bonds

- At present, interest received by any licensed Commercial Bank in Sri Lanka from the investment made in sovereign bonds denominated in foreign currency is exempt from income tax irrespective of the amount of investment made. However, as per the proposals, it has been extended to exempt both profits and interest from the investments in sovereign bonds, by Commercial Bank, subject to the minimum investment criteria of USD 100 million. Further, the risk weighted provisioning under CBSL has been proposed to be suspended for three years.
- It is expected that necessary guidelines as how to fulfil the said minimum investment criteria and the effective date will be issued.

Banking and financial services (Contd.)

Deductibility of provisions for debt claims

Deductibility of provisions for debt claims

- At present, specific provision for a debt claim in accordance with the relevant directives made by the Central Bank of Sri Lanka (CBSL), is deductible and the provisions under the Sri Lanka Financial Reporting Standards (SLFRS), are not deductible for income tax purposes.
- As per the budget proposals, it has been proposed to issue instructions on a better and transparent method of allowing the provisions for *anticipated* losses of loans and doubtful loans. It is our understanding that this is due to the CBSL proposing to adopt the provisioning method as per the SLFRS, instead of the current method that they are using for CBSL reporting purposes.

Banking and financial services (Contd.)

Deductibility of the expenditure on proposed financial sector consolidation

The expenditure on the acquisition of Finance Companies under the proposed financial sector consolidation by the CBSL

- Proposed to be allowed as a deduction, in calculating the income of the respective Bank.
- It is expected that this cost would be considered as a qualifying payment. However, it is uncertain whether there would be a limit on the deductible amount for a year of assessment, as the Department of Inland Revenue adopted the similar provision when consolidating Finance Companies in 2014.

5 Tax administration

Tax administration

Tax amnesty to entrepreneurs

Subject to a payment of tax amounting to 1% on undeclared funds a tax pardon is to be provided to entrepreneurs utilizing such funds for any investment facilitated by the Budget. However, the scope of persons falling within the scope of 'entrepreneurs' for the purpose of this amnesty and the period for which this pardon is applicable is not yet clear.

Establishment of Special Tax Appeals Court

It is proposed to establish a Special Tax Appeals Court which is responsible for resolving tax appeals. The intention appears to be to enable settlement of tax disputes in an efficient and focused manner outside the general judicial process.

e-filing made mandatory

All companies are required to file their tax Returns via "e-filing" system from 1 April 2021 (i.e., from the year of assessment 2021/2022).

Time Frame for Private Rulings and Settlement of Appeals

It is proposed to strengthen legal provisions stipulating time frames in regard to issue of private rulings and settlement of appeals submitted against the tax administrative decisions made under the IRA.

Unpaid NBT and ESC

A concessionary payment plan will be introduced for unpaid NBT and ESC based on payment capacity of the tax payer leading to a full and final settlement and closure of those files.

Calculation of capital gains

It is proposed to simplify the taxes on Capital Gains where such taxes will be calculated based on the sale price of property or the assessed value of the property whichever is higher. The intention appears to be to deem the consideration to be an amount not less the 'assessed value' of the property.

6 VAT and tariff changes

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VAT and tariff

- Currently, certain items which are exempt from VAT at import point may be liable for VAT where such items are manufactured and suppled locally. In this regard, it has been proposed to make all imported commodities, which are exempt from VAT at import point to be exempt, even if the same items are manufactured and supplied locally.
- Current 3 band tariff structure of 0%, 15% and 30% to be revised to 0%, 10% and 15% respectively and the relevant gazettes will be released soon.

Pre 2016

Exempt | 7.5% | 15% | 25%

- Prior to November 20, 2016, Customs Duty was implemented as a four band tariff at 0%, 7.5%, 15%, 25%

2016

Exempt | 15% | 30%

- As per proposals of 2016 Budget implemented, Customs Duty revised to three band tariff at 0%, 15% and 30%.
- However, certain other special rates have been in force subsequently to such change, in relation to specific items.

2020

Exempt | 10% | 15%

- It has been proposed to revise the current tariff bands to 0%, 10% and 15%.
- Therefore, the prevailing rates of Custom Duty will be reclassified under such bands and may result in either an increase or a reduction of the Custom Duty.

Standard VAT / GST rates in selected countries in 2020

Europe-America

Asia-Pacific

7

COVID-19 relief

Tax relief measures for COVID-19

Supply of Health protective equipment and similar products to be deemed as exports

Health protective equipment and similar products manufactured by BOI companies on the request of Ministry of Health Services, Tri Forces and Sri Lanka Police will be considered as deemed exports and eligible for reduced tax rates. It is anticipated that the concessions provided to exports for income tax and VAT would be applicable to such supplies.

A grace period is to be granted to settle taxes in arrears

It is proposed to grant a grace period for tax payments as agreed with the Legacy Unit, Default Tax Recovery Unit and the RAMIS Unit of the Department of Inland Revenue .

Waiver of income tax in arrears payable by SMEs

This waiver is proposed on all assessments issued up to the year of assessment 2018/2019 by the CGIR, where he is satisfied that there is no fraud or willful neglect involved. It is our understanding that this would apply to all taxes assessed by the CGIR for each period in arrears.

The legal and procedural aspects of how this would be implemented and how this would get reflected in the RAMIS system expeditiously including the waiver of penalties would have to be done carefully and efficiently.

This is imperative to avoid a bigger hassle to tax payers in clearing the past records.

No additional assessments for SMEs

Return of Income furnished by SMEs for the year of assessment 2019/2020 will be accepted and no additional assessments will be issued for that year on tax payers who furnish the returns of income for the year and pay the tax declared in the return.

Grace period for payment of tax/submission of returns

The payment or/and submission of the returns of any tax administered by the CGIR, which is due for the period from March 1, 2020 to June 30, 2020 is proposed to be treated as paid or/and submitted on the due date if such payment/submission is made on or before December 31, 2020

8 Pre-budget proposals

Highlights on Personal Income Tax

Personal Income Tax slab for the Y/A 2020/2021

Taxable Income	Tax Rate
Personal relief up to LKR 3,000,000	Nil
Expenditure relief up to LKR 1,200,000*	Nil
Next LKR 3,000,000	6%
Next LKR 3,000,000	12%
Balance	18%

Following expenses up to 1,200,000/- per annum:

- Health expenditure including contributions to medical insurance
- Educational expenditure incurred locally for such individual or on behalf of his children
- Interest paid on housing loans
- contributions made to an approved pension scheme
- Investment in Government Securities and shares of listed companies

Highlights on Partnership Income Tax

Partnership Income Tax Rate for the Y/A 2020/2021

Taxable Income	Tax Rate
First LKR 1,000,000	Nil
Balance	6%

* No WHT of 8% on any partner's share of partnership income

EY

Highlights on Corporate Income Tax

Corporate Income Tax Rate for the Y/A 2020/2021

Sector	Up to March 31, 2019	From April 01, 2019
Agro Farming	14%	Exempt (5 years)

Sector	Up to December 31, 2019	From January 01, 2020
Export of services	14%	Exempt
Information technology & enabled services	14%	Exempt

Highlights on Corporate Income Tax (Contd.)

Corporate Income Tax Rate for the Y/A 2020/2021

Sector	Up to December 31, 2019	From January 01, 2020
Construction services	28%	14%
Healthcare services	28%	14%
Manufacturing	28%	18%
Others	28%	24%

Highlights on Withholding Tax

Source	Up to December 31, 2019	From January 01, 2020
Employment Income	PAYE	APIT (opt.)
Dividend: Non-Residents	WHT	Exempt
Dividend: Residents	WHT	14%
Interest, rent and etc.	WHT	AIT (opt.)

Highlights on Value Added Tax

VAT Rates

15%	Higher Rate (VAT FS)
8%	Standard Rate
0%	Zero Rate

Highlights on Value Added Tax

VAT Threshold

Period	Up to December 31, 2019	From January 01, 2020
Per Quarter	LKR 3Mn	LKR 75Mn
Per Annum	LKR 12Mn	LKR 300Mn

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