Inland Revenue Act - 2017

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Contents

Introduction

The Inland Revenue Bill published by Gazette on 19 June 2017 along with amendments made at the Committee stage was passed by Parliament on 7 September 2017 and will become an Act of Parliament once it receives the certification of the Hon. Speaker. The new Act provide for the following:

i. Repeal the Inland Revenue Act, No. 10 of 2006 and provide transitional provisions
ii. Simplify the income tax law provisions and make it user-friendly
iii. Address various forms of tax base erosions on employment, business, investment and other income
iv. Introduce capital gains tax

The new Act will have a significant impact on taxpayers as it replaces the existing tax law and its long established practices. Hence, the immediate action for taxpayers will be to understand how the new rules will apply in their own circumstances.

Pending the certification by the Hon. Speaker, we have prepared an analysis of the significant contents of the Bill and the amendments made at the Committee stage in the interest of our clients. This publication highlights the significant differences between Inland Revenue Act, No. 10 of 2006 and the proposed law. Other provisions relating to aspects such as administration of tax, determination of residency, payment of tax, communications, forms and notices have not been dealt in this publication.

The Act will be implemented with effect from 1 April 2018.

We hope you find this publication timely and useful.

Ernst & Young
11 September 2017

Taxation of business profits

- Calculation of taxable income
- Calculation of gains and profits from business
- Disallowable expenses
- Specific deductions
- Finance leases
- Long term contracts and life insurance business
- Trust and Unit Trust
- Transitional provisions
- Interest and penalties for non-compliance
- Transfer pricing

Calculation of taxable income

The table below sets forth the differences between the new Act and the old Act relating to the calculation of taxable income.

Item	Current provision	New provision	Change
Sources of income	The sources include the following: ▸ Trade, business, profession or vocation ▸ Employment ▸ Net annual value ▸ Rent ▸ Dividends, interest or discounts ▸ Charges or annuities ▸ Rent, royalties or premiums ▸ Winnings from lottery, betting or gambling ▸ Grants, donations or contributions (NGO) ▸ Income from other sources	The sources include the following: ▸ Employment ▸ Business ▸ Investment ▸ other sources	The key changes are as follows: ▸ Gains from realization of capital assets and liabilities made liable. ▸ “Business” defined to include trade, profession, vocation etc.. ▸ All passive income sources such as rent, royalties, lottery, betting etc. classified as “investment income”.
Assessable income	The residue of the total statutory income less interest, annuity and losses	Adjusted income from each employment, business, investment or other sources	No change
Taxable income	The residue of the assessable income less allowances and qualifying payments	The residue of the total assessable income less qualifying payments and reliefs	No change

Calculation of gains and profits from business

A comparison between method of accounting and deductions under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Method of accounting	Profits and income computed based on the accounting standards adjusted through statutory provisions	Based on generally accepted accounting principles (SLFRS / LKAS)	
Deductions (general)	All outgoings and expenses incurred in the production of income (subject to specific allowances and disallowances)	Expenses incurred during the year of assessment and in the production of income (subject to specific inclusions and exclusions)	No change

Disallowable expenses

A list of key disallowable expenses under the new Act and old Act is given below:

Item	Current provision	New provision
Disallowable expenses	Examples include the following: ▶ Advertising (deduction limited) ▶ Management fees (deduction limited) ▶ Foreign travelling (deduction limited) ▶ Entertainment ▶ Reserves / provisions ▶ Capital nature expenses ▶ Cost of improvements ▶ Rental paid under finance lease (Excess payment) ▶ Head office expenses (10% restriction) ▶ Tax payable under this Act or other prescribed taxes	Examples include the following: ▶ Capital nature expenses ▶ Domestic expenses ▶ Tax payable under this Act or other taxes and levies specified by the Commissioner General of Inland Revenue (CGIR) ▶ Interest, penalties and fines payable in relation to breach of any written law ▶ Expenditure in deriving exempt amounts or final WHT payments ▶ Retirement contributions, unless those are included in calculating the income of an employee or consist of a contribution by an employer to approved funds by the CGIR (pension, provident, savings funds or provident or savings society) ▶ Outlays or expenses for entertainment ▶ An amount transferred to a reserve or provision for expenditure or losses not yet incurred, but expected to be incurred in a future year of assessment ▶ A payment, which is subject to WHT and such WHT has not been paid to the Inland Revenue Department (IRD) ▶ Dividends of a Company.

Specific deductions

The basis of determining certain deductions under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Interest expenses	Deductible regardless of whether they are revenue or capital in nature	Interest is allowable, if money borrowed under a debt obligation is used during the year or was used to acquire an asset that is used during the year in the production of income For other cases, interest is allowed if debt obligation is incurred in the production of income (e.g., accounts payable etc.)	
Repairs and improvements	Repairs are deductible, but improvements are not deductible	Repairs and improvements whether capital or not are deductible subject to 5% of the written down value (WDV) of building and 20% of the WDV of other assets	Any unclaimed amount will be added to the cost of the asset

Specific deductions (continued)

Item	Current provision	New provision	Change
Research & development (R&D)	R&D expenses (including capital expenses) ▸ In-house - 200% ▸ Through an external institution - 300%	R&D expenses (including capital expenses) ▸ Through an institution 100%. ▸ Improving business process and products beneficial to Sri Lanka – In-house cost is also allowed.	In-house R&D deduction is restricted to R&D expenses relating to high value agro products
Capital allowances	▸ Buildings - 10% ▸ Motor vehicles - 20% ▸ Plant, machinery, equipment - 33 1/3% and 50% ▸ Furniture - 20% ▸ Computer software - 25% &100% ▸ Computer hardware - 25% ▸ Intangibles (other than goodwill) – 10%	▸ Buildings - 5% ▸ Motor vehicles (defined) - 20% ▸ Plant, machinery, equipment - 20% ▸ Furniture - 20% ▸ Computer hardware - 20% ▸ Intangible assets (other than goodwill) – based on actual useful life or where the intangible asset has an indefinite useful life 5%	Rates have changed
Financial cost (Thin capitalization rule)	▸ Applicable in the case of loans to or from holding company and subsidiaries ▸ Unclaimed amount, if any, cannot be carried forward	▸ Applicable to financial instruments of any entity, other than a financial institution. ▸ Unclaimed amount, if any, can be carried forward to the following six years of assessment.	Restriction on deduction extended to cover loans from third parties, including loans from financial institutions.

Specific deductions (continued)

The basis of deducting losses under the new Act and old Act is explained below:

Item	Current provision	New provision	Change
Losses	► Business losses (other than losses from exempt business) can be deducted, subject to the deduction limitation of 35% of total statutory income. ► Unrelieved loss can be carried forward indefinitely. ► Losses from leasing or life insurance businesses can be set off only against the profit and income from such businesses	► Business loss can be deducted in full. Balance, if any, can be carried forward for six years. ► The loss can be set off against business profits or investment income, subject to certain restrictions.	► Losses relating to reduced rates can be deducted from; § Profits taxable at such rate; § Profits taxable at lower rate; and § Profits from exempt activities. ► Losses pertaining to exempt activities can only be deducted from exempt profits. ► Business losses can be deducted from business profits or investment income. However, investment losses can be deducted only from investment income. ► The restriction on deduction of losses from leasing or life insurance businesses is removed. ► Losses from long term contracts can be carried back.

Finance leases

The treatment under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Lessor	▸ Rental is taxable ▸ Entitled for depreciation allowance	▸ Interest is taxable ▸ No capital allowance (This is in line with the accounting treatment)	Not certain if existing leases will continue under the current method.
Lessee	▸ Rental is deductible ▸ Finance cost is disallowed	▸ Capital allowances are granted ▸ Interest cost is allowable	
Leasing losses	Leasing losses can only be set off against leasing profits	No restriction. Leasing losses can be deducted from non-leasing profits	Brought forward leasing losses should be deductible.

Long term contracts and life insurance business

The treatment under the new Act and old Act in respect of long term contracts and life insurance business is given below:

Item	Current provision	New provision	Change
Long term contracts	No specific provision	Recognition of profits and income based on stage of completion method	Entitled to carry back losses
Life insurance business	Investment income minus management expenses of the business is liable	Tax is payable on the aggregate of : ▶ The surplus distributed to shareholders from the life insurance policyholders fund; and ▶ Investment income of the shareholder fund minus any expenses incurred in the production of such income	

Trust and Unit Trust

The basis of taxation of Trust and Unit Trust under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Trust	In computing profits of a trust, any share of profits to which beneficiaries are entitled to will be deducted.	▸ Trust will be liable to tax if the beneficiaries are not entitled to the trust's income ▸ Beneficiaries are liable to tax if beneficiaries are entitled to the trust's income ▸ Beneficiaries are not liable to a further tax on distributions made by resident trusts	▸ Trust is taxed at the rate of 24% ▸ Beneficiaries' tax liability depends on the type of the income (i.e., interest income, dividend etc.) ▸ Beneficiaries are taxed at relevant rates
Unit Trust	Unit Trust is taxed as a company for tax purpose and taxed at the rate of 10%	▸ Unit Trusts having eligible investments are not treated as a company, but a trust ▸ Unit Trust that does not engaged in eligible investments will be treated as a company for tax purposes ▸ Eligible investment means a business or investment comprising predominately of owning, investing or trading in § capital assets § financial instruments § other similar assets	▸ Unit Trust with eligible investment is taxed at the rate of 24% (if beneficiaries are not entitled to trust's income) ▸ Other Unit Trusts are taxed at 28%

Transitional provisions

The transitional provisions will be published by the Gazette at a date between now and 1 April 2018 to provide for the following and any other provisions that may be required:

- Profits and income which are currently exempt or subject to a reduced rate for any specified period under the present Act will continue to be treated as such, until the specified period is complete.
- In the case of BOI profits and income, which are fully or partly exempt from income tax for a specified period and such period has not expired by 31 March 2018, the remaining period would continue to be eligible for such exemptions.
- In the case of an individual, who has obtained a loan for the purpose of the construction / purchase of a house, qualifying payment on repayment of such loan can be continued to be claimed.
- Unabsorbed losses can be carried forward and deducted from the profits of future years of assessment.
- Overpayment of tax can be carried forward and set off against the income tax liability of future years of assessment.
- Excess amount of PAYE deduced from employees can be adjusted against the future income liability within the provisions of the previous Act.
- Depreciation allowances on qualified assets used in the business prior to the commencement of the new Act will continue to be computed in accordance with the previous Act.
- Any interest or discount paid in respect of government securities or corporate debt securities, issued on or before 1 April 2018 and tax has been withheld, will not be liable for WHT.
- No specific reference has been made to the applicability of exemptions under SDP Act and the reduced rate of tax granted under any BOI agreement. Hopefully, the regulator would address these going forward.

Interest and penalties for non-compliance

The new Act imposes interest and penalties for non-compliance as follows:

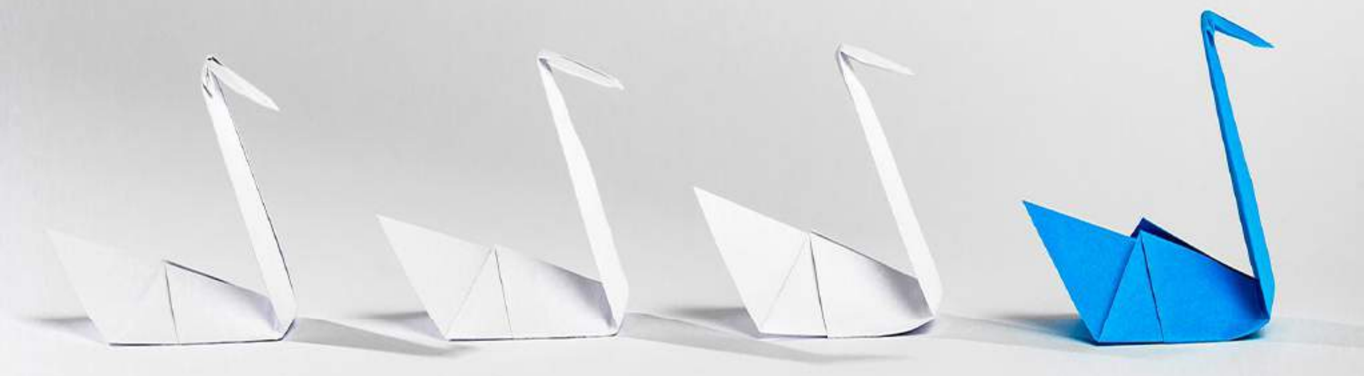
Description	Basis of charging interest / penalty
Interest on delayed payments	1.5 % per month or part of a month, compounded monthly (for the period from the due date to the date of payment)
Penalty on late filing of Return	The greater of ; ► 5% of the tax owing, plus a further 1% of the tax owing for each month or part of a month during which the failure to file continues, and ► Rs. 50,000 plus a further Rs. 10,000 for each month or part of a month during which the failure to file continues However, the penalties cannot exceed Rs. 400,000
Penalty on late payment	► Failure to pay tax due for a tax period; § within 14 days of the due date or § by the due date specified in the notice of assessment if later • Penalty - 20% of the tax due ► Failure to pay all or part of an installment within 14 days of the due date • Penalty -10% of the tax due (but not paid)
Penalty for negligent or fraudulent underpayment (intentional conduct or negligence)	► 25% of the underpayment; or ► 75% of the underpayment if underpayment is; § higher than Rs. 10 million; or § higher than 25% of the person's tax liability
Penalty for false or misleading statements to a tax official	The greater of; ► Rs. 50,000/- or ► the amount by which tax the payable/refund would have reduced/increased if it were determined based on such statement
Willful evasion	Rs. 10 million or two year imprisonment or both

Transfer pricing

The key provisions includes the following:

- Tax on transfer pricing adjustments are always calculated at the higher rate
- No tax exemption or benefit is provided on the Taxable Income enhanced as a result of transfer pricing adjustments
- A clear process for assessing international and domestic transactions has been introduced. This requires that all assessments relating to transfer pricing must be based on the order issued by either Technical Review Committee or Dispute Resolution Panel
- A Permanent Establishment in Sri Lanka is recognized as a distinct and separate entity from its Head Office and related branches in Sri Lanka
- The CGIR can specify safe harbour rules, simplifying transfer pricing compliance and administration
- The new Act provides a specific transfer pricing penalty regime in the following manner:

Type of non-compliance	Basis of charging penalty
For failure to maintain required documents	1% of the aggregate transaction value
For not furnishing required documents	Rs. 250,000
For non-disclosure of any required information relative to transactions with associated persons	2% of the aggregate transaction value
For failure to submit documents on the specified date	Rs. 100,000
For concealment of income, furnishing inaccurate particulars or evasion	200% of incremental tax on the TP adjustments



Withholding taxes (WHT)

- WHT on dividends
- WHT on deposit interest
- WHT on Government securities
- WHT on quoted corporate debt securities
- WHT on unquoted corporate debt securities
- WHT on payments to non-residents
- WHT on certain payments to residents

WHT on dividends

The basis of taxation, definition of dividends and chargeability of dividends under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Basis of taxation	Final WHT	Same (final for residents)	
Definition	Distribution of profit by a company to its shareholders, in the form of; ▸ Money or of an order to pay money ▸ Shares in any other company ▸ Debentures in that company or any other company ▸ Scrip dividend or dividend in specie ▸ The excess of the market value relating to a share buy-back ▸ Reduction of capital within six years of a bonus issue.	Dividend ▸ means a payment derived by a member from a company, whether received as a division of profits, in the course of a liquidation or reconstruction, in a reduction of capital or share buy-back or otherwise; ▸ Includes a capitalization of profits (bonus share) ▸ Excludes a payment to the extent to which it is § matched by a payment made by the member to the company; § debited to a capital, share premium or similar account; or § otherwise constitutes a final withholding payment or is included in calculating the income of the member.	▸ The coverage of dividend definition broadened ▸ Not clear whether the entire buy back price or the price paid on capital reduction is dividend or the value net of costs is dividend
Chargeability	The company is liable to pay dividend tax. Such tax can be recovered from the shareholders.	The company has no liability to dividend tax other than as a withholding agent.	The dividend is income of the shareholder.

WHT on dividends (continued)

The application of WHT under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Dividends	Liable at 10%	Liable at14%	Rate increased by 4%
Exemptions	Certain exemptions given under Section 10	Dividend received by a non resident is exempt if the paying company has invested more than US$ 1,000 million on depreciable assets	Although not specifically stated, certain BOI, SDP exemptions should be granted
Dividends distributed out of dividends received	Not liable for WHT	Same	No change
Foreign dividends	Exempt	Exempt if there is a participation of at least 10% of the value of shares in the foreign Company	New conditions imposed for exemptions
Dividends distributed out of dividends (foreign) received	Exempt if declared within 3 months	Liable at 14%	Increased to 14%

WHT on deposit interest

The application of WHT under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Individuals – Senior citizens	Exempt	Up to Rs. 1.5 million exempt and as per regulations	
Individuals – Others	Liable @ 2.5% (final tax)	Liable @ 5% (final tax)	Rate increased by 2.5%
Body of persons (including clubs & associations)	Liable @ 8% (final tax)	Liable @ 5%	Rate decreased by 3% (taxable at 28% and credits available)
ETF, provident or pension fund and approved termination funds	Liable at 8% (final tax)	Liable at 5%	Rate decreased by 3% (taxable at 14% and credits available)
Charitable institutions	Liable at 2.5% (final tax)	▸ Liable at 5% (final tax) ▸ Exempt if such charitable institution is established for the purpose of care of children, elderly or the disabled – no change	Rate increased by 2.5%
Financial institutions	Liable at 10%	Liable at 5%	Rate decreased by 5% (taxable at 28% and credits available)
Companies other than financial institutions	Liable at 10%	Liable at 5%	Rate decreased by 5% (taxable at 28% and credits available)
Foreign currency accounts maintained by corporates (e.g., FCBU and NRFC)	Exempt	Same rates as applicable for rupee deposits will apply for both corporates and individuals	

WHT on Government securities

The application of WHT under the new Act and old Act is given below:

Item	Current provision	New provision	Change
Individuals	Liable @ 10% (final tax)	No WHT	The income will be taxed at progressive rates (4% - 24%)
Charitable institutions	Liable at 10% (final tax)	No WHT	The income will be taxed at 14%
ETF, provident or pension fund and approved termination funds	Liable at 10% (final tax)	No WHT	The income will be taxed at 14%
Body of persons (including clubs and associations)	Liable at 10% (final tax)	No WHT	The income will be taxed at 28%
Financial institutions	Liable at 10%	No WHT	The income will be taxed at 28%
Companies other than financial institutions	Liable at 10%	No WHT	The income will be taxed at 28%

WHT on quoted corporate debt securities

The quoted corporate debt securities are currently exempt not only from WHT, but also from income tax. The application of WHT under the new Act is explained below:

Item	Current provision	New provision	Change
Individuals	Exempt	Liable at 5% (final tax)	Rate increased by 5%
Charitable institutions	Exempt	Liable at 5% (final tax) Exempt if such charitable institution is established for the purpose of care of children, elderly or the disabled	Rate increased by 5%
ETF, provident or pension fund and approved termination funds	Exempt	Liable at 5%	Rate increased by 5% (taxable at 14% and credits available)
Body of persons (including clubs and associations)	Exempt	Liable at 5%	Rate increased by 5% (taxable at 28% and credits available)
Financial institutions	Exempt	Liable at 5%	Rate increased by 5% (taxable at 28% and credits available)
Companies other than financial institutions	Exempt	Liable at 5%	Rate increased by 5% (taxable at 28% and credits available)

WHT on unquoted corporate debt securities

WHT under the new Act and old Act is summarized below:

Item	Current provision	New provision	Change
Individuals	Liable at 10%	Liable at 5% (final tax)	Rate decreased by 5%
Charitable institutions	Liable at 10%	Liable at 5% (final tax) Exempt if such charitable institution is established for the purpose of care of children, elderly or the disabled	Rate decreased by 5%
ETF, provident or pension fund and approved termination funds	Liable at 10%	Liable at 5%	Rate decreased by 5% (taxable at 14% and credits available)
Body of persons (including clubs and associations)	Liable at 10%	Liable at 5%	Rate decreased by 5% (taxable at 28% and credits available)
Financial institutions	Liable at 10%	Liable at 5%	Rate decreased by 5% (taxable at 28% and credits available)
Companies other than financial institutions	Liable at 10%	Liable at 5%	Rate decreased by 5% (taxable at 28% and credits available)

WHT on payments to non-residents

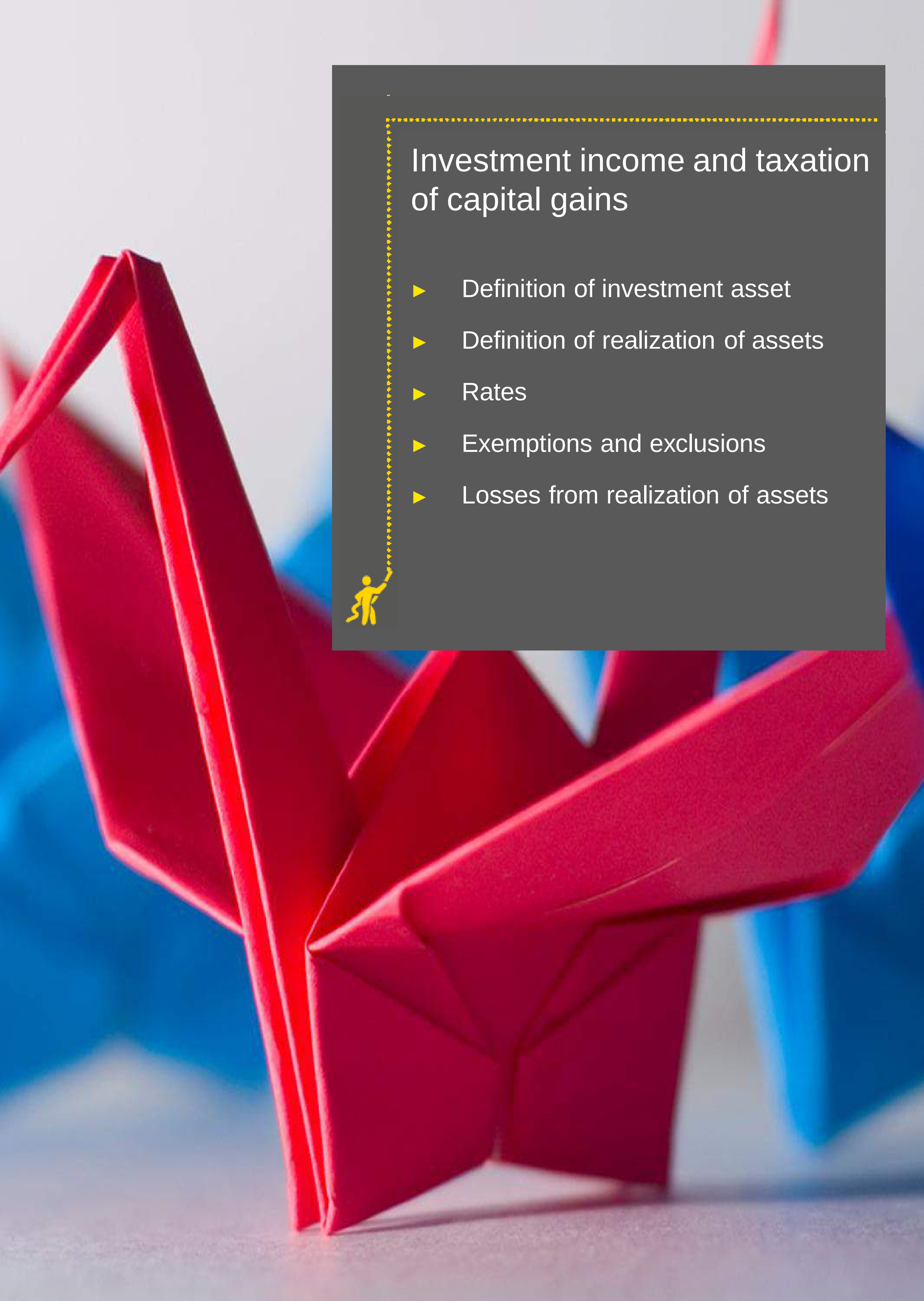
The table below summarizes the application of WHT under the new Act and old Act:

Item	Current provision	New provision	Change
Non-resident loans	Exempt	Liable at 14% subject to DTA rate	Final tax
Royalty payments to non-resident	20% or subject to DTA rate	Liable at 14% subject to DTA rate (final tax)	Rate decreased by 6%
Management fees, technical fees and service fees paid to non-residents	20% or subject to DTA rate	Liable at 14% subject to DTA rate (final tax)	Rate decreased by 6%
Telecommunication services, if apparatus established in Sri Lanka	Not liable	Rates to be published by regulations	
Payments to non-resident ship owners	Not liable	Liable at 6%	WHT credit available
Insurance premium paid to non-residents	Not liable	Liable at 14% subject to DTA rate	

WHT on certain payments to residents

The table below summarizes the application of WHT under the new Act and old Act:

Item	Current provision	New provision	Change
Sale of any gem sold at the auction conducted by gem and jewelry authority	Liable at 2.5% (final tax)	Liable at 2.5% (final tax)	
Royalty	Liable at 10%	Liable at 14%	Rate increased by 4%
Management fees	Liable at 5%	Not liable	Rate reduced by 5%
Rent	Not Applicable	Liable at 10%	Increased by 10%



Investment income and taxation of capital gains

- Definition of investment asset
- Definition of realization of assets
- Rates
- Exemptions and exclusions
- Losses from realization of assets

Definition of investment asset

- An investment asset is a capital asset held as part of an investment.
- A capital asset is defined to mean
  - Land or building
  - A membership interest in a company or partnership
  - A security or other financial asset
  - An option, right or other interest in the above assets
  - But excludes trading stock or a depreciable asset
- Therefore, an investment asset is any of the above assets held as part of an investment and not as an asset connected to the business.

Definition of realization of assets

- Realization of an asset means when the owner of that asset parts with the ownership of that asset by
  - Sale, transfer, exchange, distribution, cancellation, redemption, destruction, loss, expiry, expropriation or surrender
  - When a person ceases to exist, including the death of an individual, there would be a realization of that asset immediately before
  - This would include gifting of an asset

Rates

- Applicable tax rate on gains from the realization of investment assets is 10%
- Applicable rate on other assets effectively connected with a business would be the rate at which the respective company or individual is liable.
- Cost of an investment asset held as at 30 September 2017, shall be equal to the market value at that time.

Exemptions and exclusions

Exemptions

- No tax will be imposed if it's the principle place of residence if it is owned continuously for 3 years before disposal and lived in for at least 2 years.
- Gains by a resident individual from the realization of investment assets that does not exceed Rs. 50,000 per asset and does not exceed Rs 600,000 per annum in total.
- Gains from the realization of assets consisting of shares quoted in any official list published by any stock exchange licensed by the SEC Sri Lanka

Exclusions

- In the following cases, the Act deems that there would be no capital gain from the realization of an asset as it deems the amount realized from the transfer to be the net cost of the asset.
- Transfer of an asset to a spouse or former spouse due to death or part of a divorce settlement (where the spouse specifically asks for this exclusion to apply in writing).
- Transfer on death – the realization of any asset upon the death of an individual.
- Transfer to an associate an interest in land or building

Losses from realization of assets

- Unrelieved losses from a business may be deducted in calculating investment income.
- Unrelieved losses from an investment can be deducted only in calculating income from investments.
- A gain from the realization of an investment asset cannot be reduced by a loss on the disposal of another investment asset.

Investment incentives

- Investment incentives
- Temporary concessions

Investment incentives

- No tax holidays
- Tax incentives are provided through enhanced capital allowances for new companies in addition to the normal capital allowances.
- The capital allowance has to be claimed in the year of assessment.
- Any unrelieved loss arising on this claim should be claimed within 10 years. Further, if a person has incurred more than US$ 1000 million on the qualified assets, any unrelieved loss, arising on this claim would be allowed within 25 years.
- The basis of calculating the enhanced capital allowance is given below:

Investment criteria	Expenses should be incurred on	Location criteria	Enhanced capital allowance
Exceeds US$ 3 million	Depreciable assets (other than intangible assets)	Northern province	200%
Exceeds US$ 3 million, but does not exceed US$ 100 million	Depreciable assets (other than intangible assets	Other provinces	100%
Exceeds US$ 100 million	Depreciable assets (other than intangible assets)	Other provinces	150%
Exceeds US$ 250 million	Assets or shares of a state-owned company	State-owned company	150%

Temporary concessions

- Enhanced capital allowances for new companies in addition to the normal capital allowances for three years of assessment after the commencement of the Act
- Applicable to a person who incurs expenses on the below depreciable assets
- The depreciation allowance has to be claimed in the year of assessment
- The basis of calculation is given below:

Investment	Location	Employees	Qualified asset	Rate
Up to US$ 3 million	Northern Province	None	Computers, data handling equipment, specified plant or machinery, buildings, and structures	200%
Up to US$ 3 million	Other than Northern Province	None	Computers, data handling equipment, specified plant or machinery buildings, and structures	100%

Temporary concessions (continued)

- The law also provides the following concessions:

Category / person	Conditions	Concession	Applicable years of assessment (after the commencement of the Act)
Life Insurance - The portion of gains and profits (surplus distributed to a policyholder) of a life insurance company		14%	3 years
Headquarters relocation - Headquarters or regional head office as specified by the CGIR	Established in Sri Lanka on or after 1 October 2017	0%	3 years
Renewable energy - Any person	Entered into standardized power purchase agreement on or before 10-November-2016 with the CEB	14%	3 years

Temporary concessions (continued)

Category / person	Conditions	Concession	Applicable years of assessment (after the commencement of the Act)
Company providing IT services	► Should have 80% of gross income from the business of providing IT services. ► At least 50 employees during the whole year; and ► Include those employees in the annual statement. ► Not entitle to deduct enhanced capital allowance. ► Any unrelieved loss cannot be deducted in any succeeding year of assessment.	35% of the total amount of employee benefits considered for employees' taxable income other than benefits of the company's directors	Not specified
R&D expenses - Any person	100% of total R&D expenses deducted under section 15 from business income		3 years

Tax exemptions

- Exemptions (for corporates)
- Current exemptions abolished

Exemptions (for corporates)

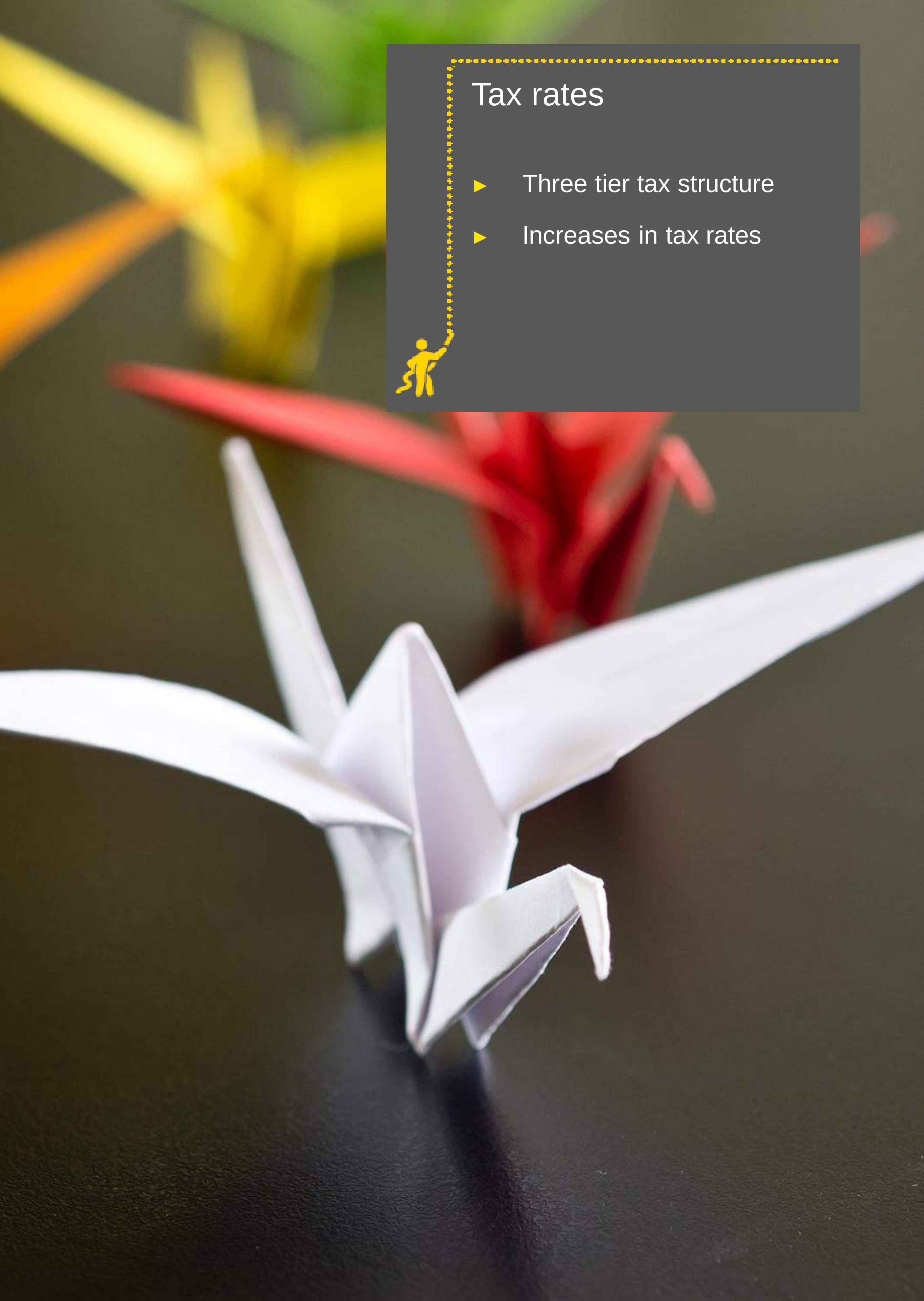
- Gain from realization of asset consisting of shares quoted in any official list published by the SEC in Sri Lanka.
- Gain from realization of shares in a non–resident Company if there is a participation of at least 10% of the value of shares in the foreign Company.
- Interest income on sovereign bonds denominated in foreign currency accruing to non resident persons or licensed Commercial Bank in Sri Lanka.
- Dividend paid by a resident company out of dividend received, which was subject to WHT.
- Any amount derived from sale of any gem on which WHT has been deducted.

Current exemptions abolished

- Export of services (Section 13 ddd)
- Services performed outside Sri Lanka (Section 13 bb)
- Entrepot trade (Section 13 bbb)
- Redemption of units in a Unit Trust
- Interest and gain from sale of sovereign bonds and Sri Lanka development bonds
- Buying from one country and exporting to another country
- Export and local sale of gem and jewelry for foreign currency
- Certain subsidies given

Tax rates

- Three tier tax structure
- Increases in tax rates



Three tier tax structure

14%

SMEs, exports, education, agriculture, promotion of tourism and IT

28%

Standard rate of 28% for all other industries, including banking, finance, insurance, leasing and related services, trading and unincorporated bodies

40%

Higher rate applicable to betting and gaming, liquor and tobacco

Three tier structure effective from 1 April 2018

- Concessionary rate of 14% will be applicable for companies predominately (80%) engaged in the business of exports, education, agriculture, promotion of tourism and IT.
- For this purpose, export means export of goods and services including the following specified undertakings –
  - Entrepot trade involving import, minor processing and re-export;
  - Offshore business where goods can be procured from one country or manufactured in one country without bringing the same into Sri Lanka;
  - Providing front end services to clients abroad;
  - Headquarter operations of leading buyers for management of financial supply chain and billing operations;
  - Logistic services such as bonded warehouse or multi-country consolidation in Sri Lanka;
  - Transshipment operations;
  - Freight forwarding;
  - Sale of gem and jewelry for foreign currency;

Three tier tax structure (continued)

- § Supply of services to any exporter of goods or services or to any foreign principal of such exporter directly, being services which could be treated as essentially related to the manufacture of such goods or provision of such services exported by such exporter either directly or through any export trading house, including any service provided by an agent of a ship operator to such agent's foreign principal, and the payment for such services are made by such exporter or foreign principal to such person in Sri Lanka in foreign currency;
- § Production or manufacture, and supply to an exporter of non-traditional goods; and
- § The performance of any service of ship repair, ship breaking repair and refurbishment of marine cargo containers, provision of computer software, computer programs, computer system or recording computer data, or such other services as may be specified by the minister by notice published in the Gazette, for payment in foreign currency";

► Undertaking for the promotion of tourism means an undertaking for the operation of-

- § any hotel or guest house approved by the Ceylon Tourist Board;
- § any restaurant graded by the Ceylon Tourist Board as being in "Class A" or "Class B";
- § any business of travel agent who provides travel management services for domestic travel in Sri Lanka;
- § any business of transporting tourists only; or
- § any business approved by the Ceylon Tourist Board for providing facilities for recreation or sports.

► Providing IT means;

- § Software development services or
- § The provision of IT services under a Business Process Outsourcing arrangement or a knowledge process outsourcing arrangements

► Small Medium Enterprises means;

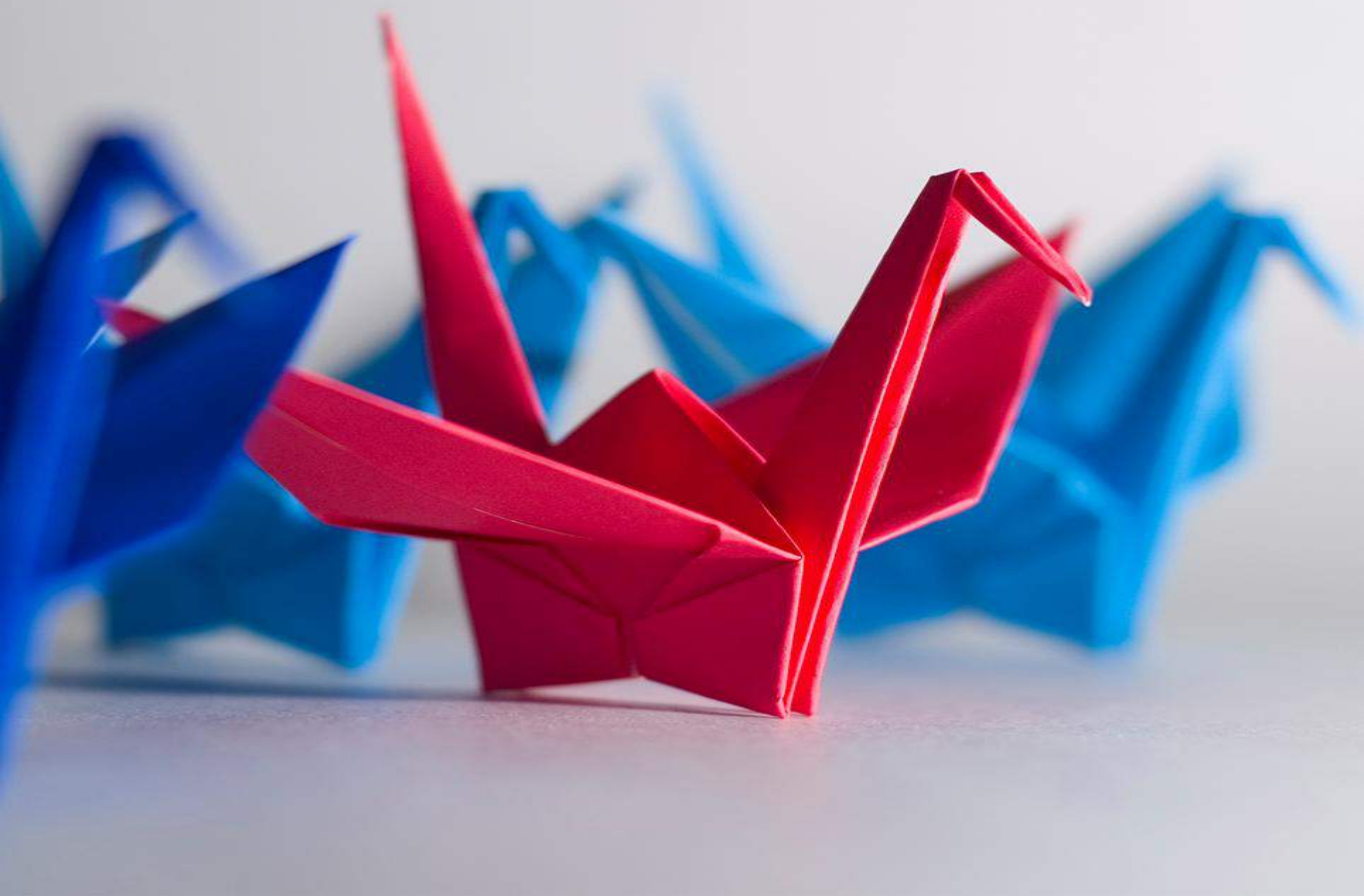
- § The person conducting business solely in Sri Lanka other than an individual engaged in providing professional services individually or in partnership being an individual who is professionally qualified;
- § The person does not have an associate that is an entity; and
- § The person's annual gross turnover is less than Rs. 500 million.

Increases in tax rates

- Key sectors where the rate of tax is increased from 10% or 12% to 28% are as follows:
  - Construction services
  - Healthcare services
  - Warehousing
  - Agro processing, animal feed and fishing
  - Clubs and associations

Employment income and personal tax

- Key changes to the taxation of employment income
- Employment benefits
- Income tax rates
- Income tax relief for individuals



Key changes to the taxation of employment income

- The maximum rate has been increased from 16% to 24%
- Income slabs are modified
- A comparison of the slabs and tax rates are given below:

Current provision		New provision	
Employment income	Rate	Employment income	Rate
First Rs. 750,000	Nil	First Rs. 1,200,000	Nil
Next Rs. 500,000	4%	Next Rs. 600,000	4%
Next Rs. 500,000	8%	Next Rs. 600,000	8%
Next Rs. 500,000	12%	Next Rs. 600,000	12%
Balance	16% (over Rs. 2.25 million)	Next Rs. 600,000	16%
		Next Rs. 600,000	20%
		Balance	24% (Over Rs. 4.2 million)

Employment benefits

The table below summarizes the employment benefits granted under the new Act and old Act:

Item	Current provision	New provision	Change
One motor vehicle provided by the employer for personal use	Exempt	Liable (value to be determined)	Exemption removed
Travelling allowance in lieu of one motor vehicle	The aggregate up to Rs. 50,000 exempt	Liable	Exemption removed
Value of the benefit from private use of vehicle (more than one) provided by the employer	Value of the benefit varies from Rs. 10,000 to Rs. 50,000 based on the facilities provided and engine capacity	Liable (value to be determined)	
Housing benefit	Irrespective of the actual value of the benefit, the maximum amount liable to tax is Rs. 16,500 per month	Liable (value to be determined)	
Payment of telephone bills including annual charges used for private purposes	Up to 50% of the bill cost	Liable (value to be determined)	
Reimbursement or payment of medical expenses	Liable to tax (in the case of medical insurance contribution or actual benefit as applicable)	Exempt (provided the benefits is available to all fulltime employees on equal terms)	Exemption granted

Income tax rates

The table below summarizes the tax rates applicable under the new Act and old Act:

Item	Current provision	New provision	Change
Second employment (including director fees)	Director fees or second employment ▸ Up to Rs. 25,000 p.m. - 10% ▸ Exceeds Rs. 25,000 p.m. - 16%	▸ First Rs. 50,000 p.m. - 10% ▸ Balance - 20%	Rate application has been modified
Individuals other than who are in employment	First Rs. 500,000 – Nil Next Rs. 500,000 - 4% Next Rs. 500,000 - 8% Next Rs. 500,000 - 12% Next Rs. 500,000 - 16% Next Rs. 1,000,000 - 20% Balance - 24%	First Rs. 500,000 - Nil Next Rs. 600,000 - 4% Next Rs. 600,000 - 8% Next Rs. 600,000 - 12% Next Rs. 600,000 - 16% Next Rs. 600,000 - 20% Balance - 24%	Slabs have been modified.
Professionals	First Rs. 500,000 - Nil First Rs. 500,000 - 4% Next Rs. 500,000 - 8% Next Rs. 24,000,000 - 12% Next Rs. 10,000,000 - 14% Balance - 16%	As above	Tax payable will be more

Income tax relief for individuals

The table below summarizes the income tax reliefs available under the new Act and old Act:

Item	Current provision	New provision	Change
Any pension fund, Provident Fund approved by CGIR or income derived from the Employee Trust Fund	Amount paid to employee at the time of retirement is exempt	Same	No change
Income earned in foreign currency from any services rendered in or outside Sri Lanka by a resident individual or partner of a partnership	Exempt	Exempt up to Rs. 15 million	


Taking up the
challenge

Taking up the challenge

The Bill provides the wherewithal for the Government to change the adopted tax rules and practices. However, uncertainties may arise with regard to the detail and hence taxpayers should consider the following steps for forming plans within this environment:

- Understand and quantify odds and scenarios of outcomes.
- Assess the worst-case scenario impact.
- Deconstruct rules into meaningful parts.
- Spot opportunities to drive change.
- Address what can be addressed now.
- Identify trigger points and signposts.

Now is the time for businesses to make sure their tax functions have the right people, processes and technology in place. Getting things right the first time can pay dividends – from higher levels of control, greater efficiency and value in the tax function to reducing the incidence of risk.

This publication was prepared to present time-sensitive information affecting our clients. Hence, it has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice.

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