2018 Budget Analysis

November 2017

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For clients of KPMG in Sri Lanka

The budget proposals for 2018 were presented in Parliament today, focusing on an environmentally sustainable development strategy, whilst initiating “Enterprise Sri Lanka”, a strategy to re-awaken the entrepreneurial spirit of Sri Lanka.

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

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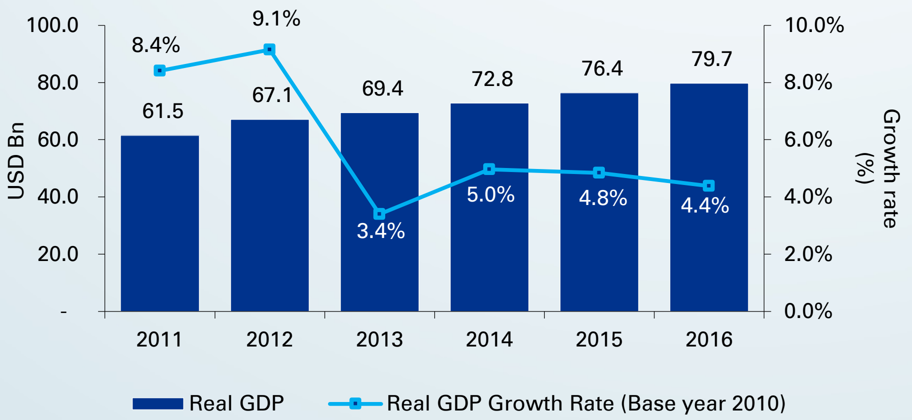
Economic Overview

Nominal and real GDP

Sri Lanka reported a nominal Gross Domestic Product ("GDP") of LKR 11.8 Tn in 2016, compared to LKR 11.0 Tn in 2015. Real GDP growth was recorded at 4.4% in 2016, slower than the 4.8% growth experienced in 2015.

AdveLKRe weather conditions and contractionary monetary policy were key contributors to the decrease in GDP growth rate.

Real GDP



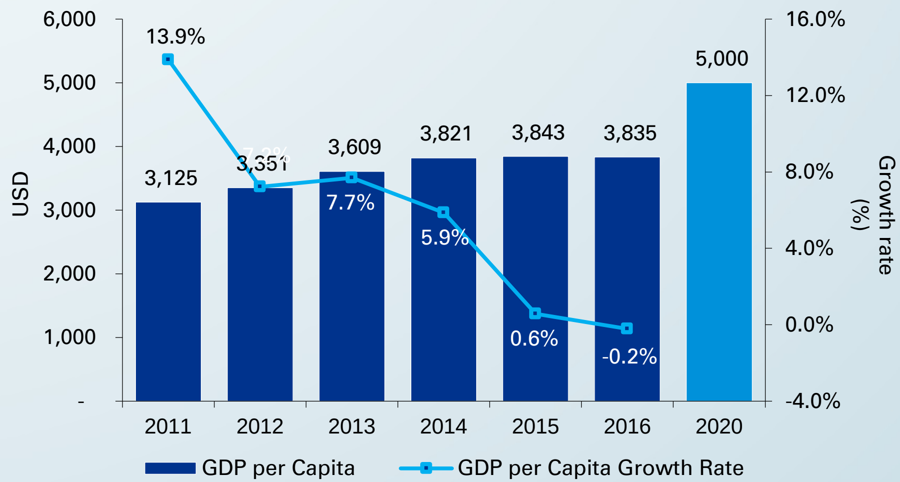
During the first half of 2017, GDP grew at 3.9%, compared to 3.7% recorded in the same period of 2016. Unfavorable weather conditions that prevailed during the period, hampered the agriculture sector and resulted in a negative contribution to the GDP growth. However, a significant growth was recorded in the industrial and services sectors, mainly driven by financial, construction, trade and other services sub-sectors.

The World Bank projects the Sri Lankan economy to grow at 4.7% in 2017 and over 5.0% thereafter, mainly driven by private consumption and investment growth.

A GDP per capita of USD 3,835 was recorded in 2016. The Government targets GDP per capita to increase to USD 5,000 by 2020, in a bid to drive Sri Lanka's status towards being an upper-middle income country.

GDP per capita grew at a CAGR of 4.2% for the period from 2011 to 2016 the Government expects the GDP growth rate to reach 6.0% by 2020.

Real GDP per capita



Source: World Bank, Central Bank of Sri Lanka, Department of Census and Statistic, KPMG analysis

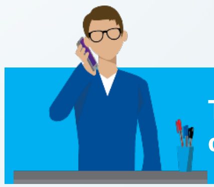
Economic Overview

Sectoral composition of GDP

The service sector recorded the highest contribution to the GDP of 56.5% while industry and agricultural sectors recorded 26.8% and 7.1% respectively during 2016.

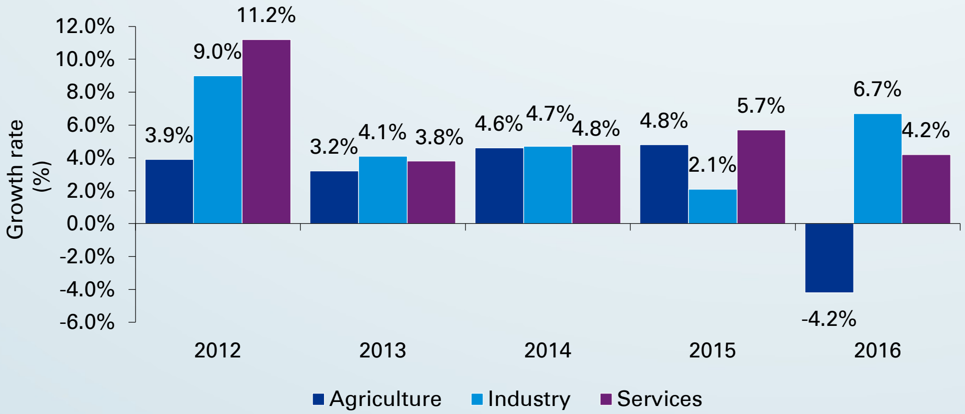
The industry sector is the second largest contributor to the economy which grew by 6.7% in 2016 compared to a 2.1% in 2015. The significant increase in the rate was driven by the construction sector growth (14.9%) as a result of the recommencement of several large-scale government projects. The industry sector also comprised of mining and quarrying and manufacturing which grew by 14.4% and 1.7% respectively.

The least contribution to GDP came from the agriculture sector. During the second half of 2016 and first half of 2017, the sector was significantly affected by droughts and floods, which translated to a decline in exports of agricultural goods, mainly driven by a reduction in plantation yield. The drought crisis extended to the power sector as well, where during the latter part of 2016, hydro power reservoirs ran dry which increased the country's demand for alternative sources of power. This fueled the increase of imports in crude oil during the latter part of 2016. During the first half of 2017, agricultural exports declined by 2.9%.



The service sector expanded by 4.2% in 2016 in comparison to 5.7% in 2015.

Growth of sector wise contribution to GDP (%)

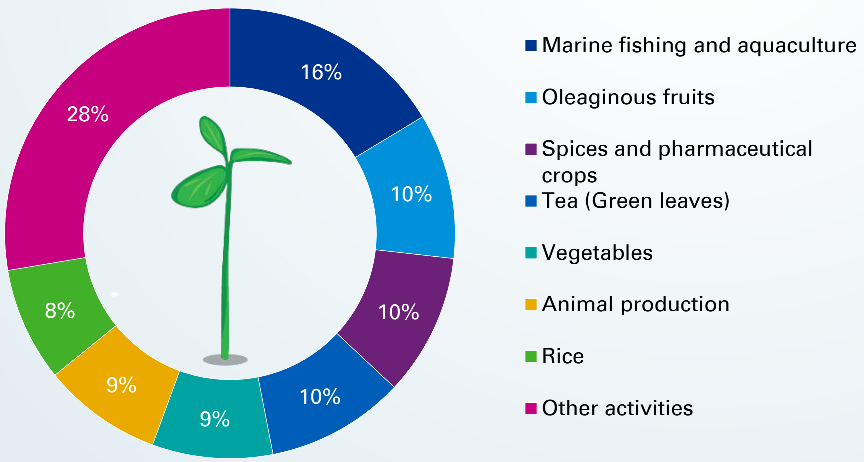


The service sector continued to be the highest contributor towards GDP, having contributed approximately 56.2% to the GDP over the last 5 years. The service sector related economic activities at the end of the second quarter of 2017 recorded a growth of 4.2% YoY, in comparison to 3.6% growth in the corresponding period of 2016. Growth in this segment, was mainly driven from the expansion in financial services activities, together with developments in the transportation of goods and passengers including warehousing activities.

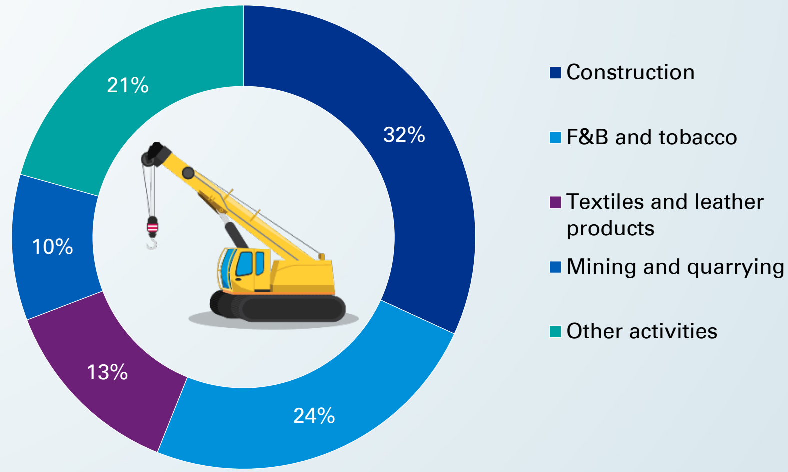
Source: Central Bank of Sri Lanka, KPMG analysis

Economic Overview

Gross National Income from agriculture, forestry and fishing



Gross National Income from industries



The industries sector continued to be the largest contributor to GDP growth, despite being the second largest contributor to the GDP. This sector grew by 6.7%, driven by the growth in construction, mining and quarrying activities.

The gross value added by financial, insurance and real estate activities including ownership of dwellings increased by 8.4% YoY in 2016, compared to a 13.3% YoY growth recorded in the previous year. Further, wholesale and retail trade activities grew by 2.5% YoY in 2016 compared to a 5.1% YoY growth recorded in 2015.

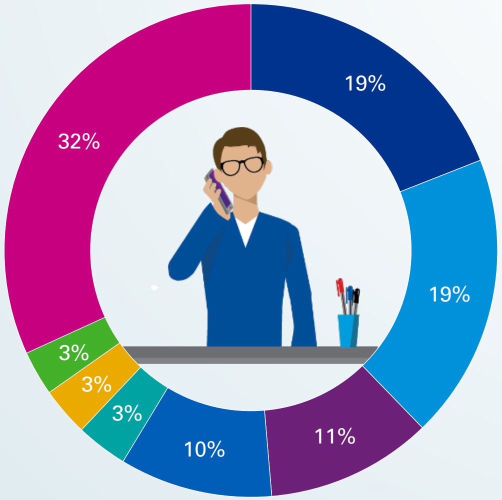
The industries sector demonstrated a growth of 6.7% YoY in 2016 in comparison to a growth of 2.1% YoY in 2015. Construction (14.9%), mining and quarrying (14.4%), manufacturing (1.7%) and electricity, water and waste treatment (10.0%) activities were the main contributors to the positive momentum in growth.

Construction activities grew by 14.9% YoY in 2016, in comparison to a contraction of 2.7% YoY in the previous year. Growth in construction activities was boosted by the recommencement of large scale infrastructure projects, condominium and housing development activities. The growth was mainly attributable to the recommencement large scale infrastructure projects including the Port City Project Plan with a investment value of USD 15.0 Bn and increase in private construction activities.

Source: Central Bank of Sri Lanka, KPMG analysis

Economic Overview

Gross National Income from services



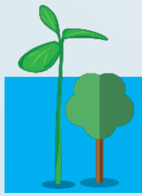
Inflation

Inflation has been increasing during the second half of 2016. The annual average of the National Consumer Price Index ("NCPI", 2013=100) rose to 4.0% by end of 2016, compared to 3.8% in 2015. The YoY change in NCPI was recorded at 8.6% by end of September 2017, compared to 4.7% recorded an year earlier. The strong increase in inflation is mainly due to the increase in VAT rates, international commodity prices and severe adverse weather conditions.

An increasing trend in core inflation was also witnessed during the second half of 2016, mainly due to the increase in the prices of non-food items such as health, education and hotels caused by the hike in VAT rates. High levels of credit to the private sector and increase in wages throughout the economy contributed to the inflationary pressure.

It is expected that the decline in international commodity prices and reduction in prices of essential items by the GoSL would support the downward pressure on inflation.

The Government expects the inflation rate to stabilize at 6.0% in 2018.



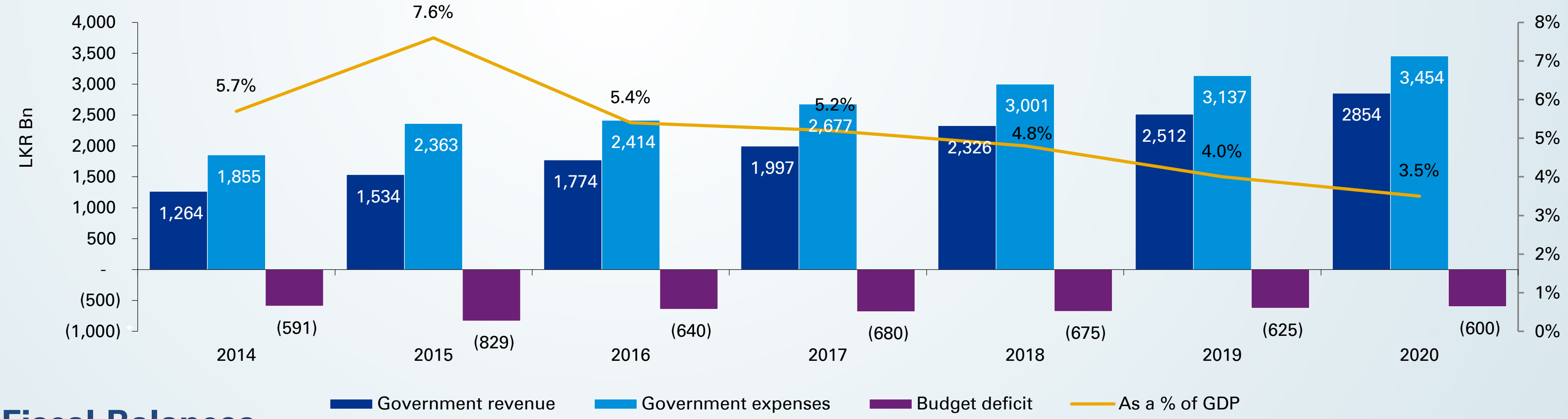
Contribution by agriculture activities declined by 4.2% in 2016, as opposed to a 4.8% growth recorded in 2015.

YoY Inflation in September 2017, based on the NCPI, was estimated to be 8.6%, compared to 4.7% recorded in September 2016.

Source: Central Bank of Sri Lanka, KPMG analysis

Economic Overview

Budget deficit



Fiscal Balances

The overall budget deficit as a percentage of GDP declined to 5.4% in 2016, compared to 7.6% recorded in the previous year, due to improvements in revenue and rationalization of expenditure. The overall budget deficit for the first eight months of 2017 was LKR 520.2 Bn, a decline of 7.2% compared to the budget deficit of LKR 485.1 Bn, recorded during the corresponding period of 2016.

During the year 2016, more than 60.0% of the overall budget deficit of LKR 640.3 Bn was financed from foreign sources such as the Sovereign Bond of USD 1.5 Bn and syndicated loans amounting to USD 0.7 Bn.

The remaining 39.0% was financed through domestic sources mainly through the banking sector via the CBSL. Net domestic financing declined to LKR 248.4 Bn during 2016 from LKR 592.7 Bn recorded in 2015, while net foreign financing increased to LKR 391.9 Bn during 2016.

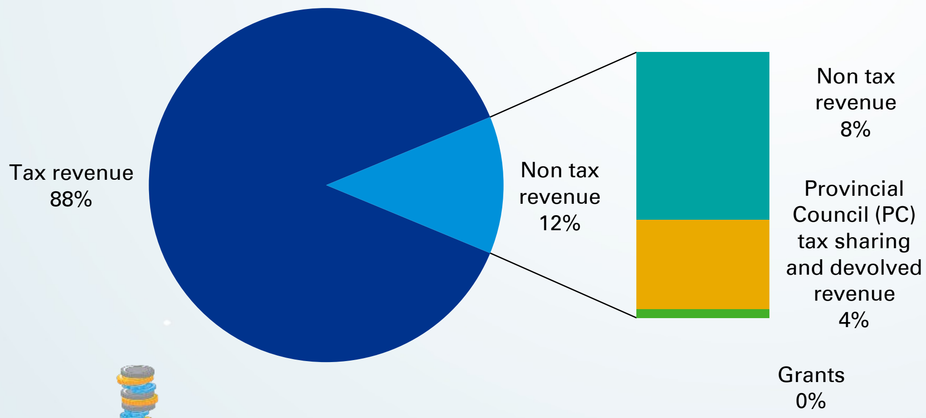
The Government has revised the 2017 budget deficit target of 4.6% to 5.2% of GDP, and estimates this to decline to 4.8% in 2018.

Although central government debt grew slower in nominal terms compared to the previous years, total government debt as a percentage of GDP increased to 79.3% in 2016, compared to 76.0% in 2015. This is mainly due to the depreciation in the exchange rate and the impact from real interest rate effects. **The Government aims to bring down debt as a percentage of GDP to 70.0% by 2020.**

Source: Central Bank of Sri Lanka, KPMG analysis

Economic Overview

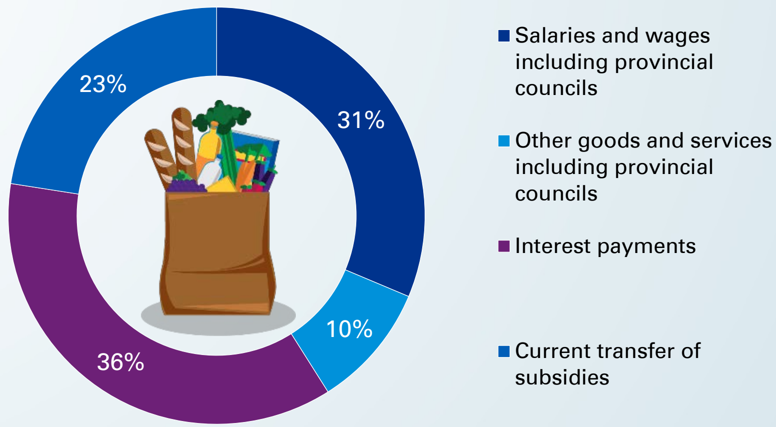
Revenue composition - Budget 2018



To collect a total government revenue and grants of LKR 2,326 Bn during 2018.

Tax revenue increased by 8.0% YoY to LKR 1,464 Bn in 2016 and is expected to reach LKR 1,749 Bn in 2017, which is a YoY growth of 19.5% compared to 2016. The above growth is to be achieved by higher revenue collection from major tax categories such as VAT, PAL and import duties. Based on the fiscal budget for 2018, the Government expects to collect a tax revenue of LKR 2,034 Bn.

Composition of the recurrent expenditure - Budget 2018

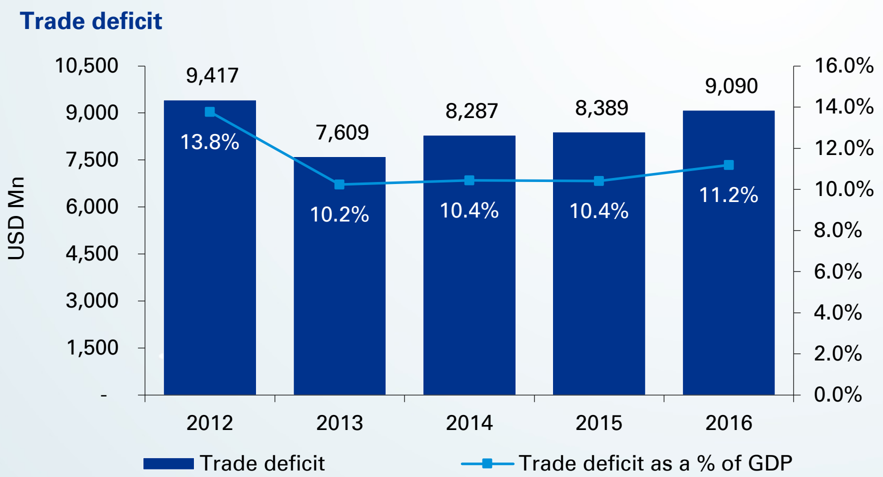


Recurrent expenditure as a percentage of GDP has declined by 15 basis points to 20.4% in 2016 (LKR 1,839 Bn) compared to 20.6% (LKR 1,774 Bn) in 2015. However, the above percentage is expected to increase up to 21.8% (LKR 2,053.6 Bn) in 2017, as per the revised estimates provided in 2018 budged speech, creating an expansionary impact on the overall economy. The budgeted recurrent expenditure for 2018 is LKR 2,250 Bn.

The estimated government expenditure on capital products has increased by 6.6% in 2017 (LKR 633 Bn), compared to 2016 (LKR 594 Bn). The fiscal budget for 2018 has allocated LKR 761 Bn for government capital expenditure, which is a 20.2% growth compared to 2017 estimates.

Source: Central Bank of Sri Lanka, Budget Speech 2018, KPMG analysis

Economic Overview



Export earnings reported a YoY growth of 7.6% up to August 2017

Trade Balance

Sri Lanka's trade deficit during the first eight months of 2017 increased by 12.2% YoY to USD 6,186.0 Mn, from USD 5,514.7 Mn in the corresponding period of 2016.The increase was mainly due to higher demand for imports particularly driven by higher expenditure on intermediate goods such as fuel, gold and textiles and textile articles.

Export earnings grew by 7.6% YoY to USD 7.4 Bn during the eight months ending August 2017, following a 2.2% YoY contraction experienced during 2016.

Industrial exports (75.0%) made the largest contribution to the growth in export earnings during the eight months of 2017, followed by agricultural exports (24.5%), and mineral and others (0.5%). Earnings from industrial exports grew by 4.2% YoY to USD 5.6 Bn, while agricultural exports was USD 1.8.Bn indicating an YoY increase of 19.4% during the first eight months of 2017. The increase in industrial exports was led by higher exports of petroleum products, food, beverages and tobacco.

However, earnings from exports contracted in 2016 for the second consecutive year, mainly owing to the downward movement in commodity prices in the international markets. Over the last five years, exports were heavily concentrated towards countries such as USA, UK followed by India.

In 2016 the USA was the largest export destination accounting for 27.3% of export revenue

According to CBSL, export earnings are expected to increase annually at an average rate of 12.8% to 2020, owing to higher export oriented domestic production supported by improved trade linkages, including the reinstating of GSP+ concession and proposed trade and economic partnership agreements (Free Trade Agreements with China and Singapore).

Source: Central Bank of Sri Lanka, KPMG analysis

Economic Overview

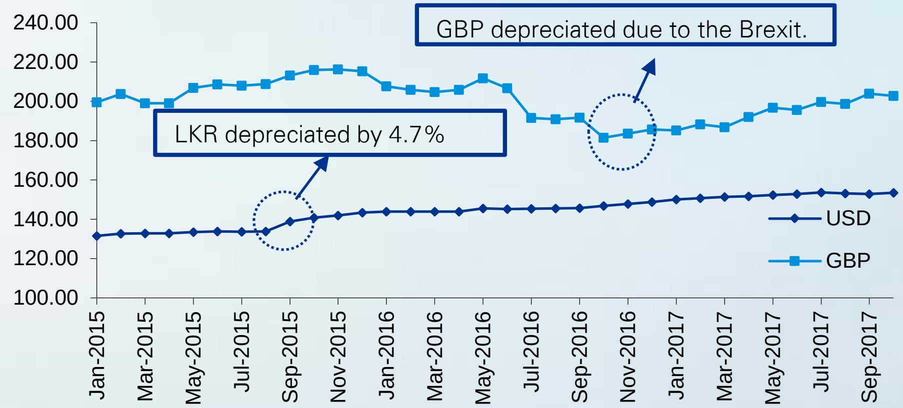
Expenditure on imports increased to USD 13,599.1 Mn for the first eight months of 2017, recording a 9.6% YoY growth compared to the corresponding period of 2016, reflecting higher demand for intermediate goods (mainly fuel) and expenditure on consumer goods.

Expenditure on imports increased by 2.5% YoY in 2016, compared to a 2.5% YoY decline in the previous year. The 2016 increase was due to increase in investment goods (13.8% YoY) and non-fuel intermediate goods (4.2%YoY). China became the main origin of imports, accounting for 21.7% of the total expenditure on imports in 2016. Expenditure incurred on Chinese imports increased by 13.6% YoY to USD 4.2 Bn in 2016. India, ranked second as the largest origin of imports in 2016, accounted for 19.7% of total imports, recorded a decline of 10.6% YoY due to the reduction in import expenditure on petroleum products and vehicles.

According to CBSL, expenditure on imports is projected to increase annually at an average rate of 8.5% to 2020, stemming from higher intermediate goods imports, with the expected increase in global oil prices, and higher demand for investment goods.

Source: Central Bank of Sri Lanka, KPMG analysis

Exchange rates



The USD/LKR depreciated by 3.8% YoY in 2016.

Exchange Rates

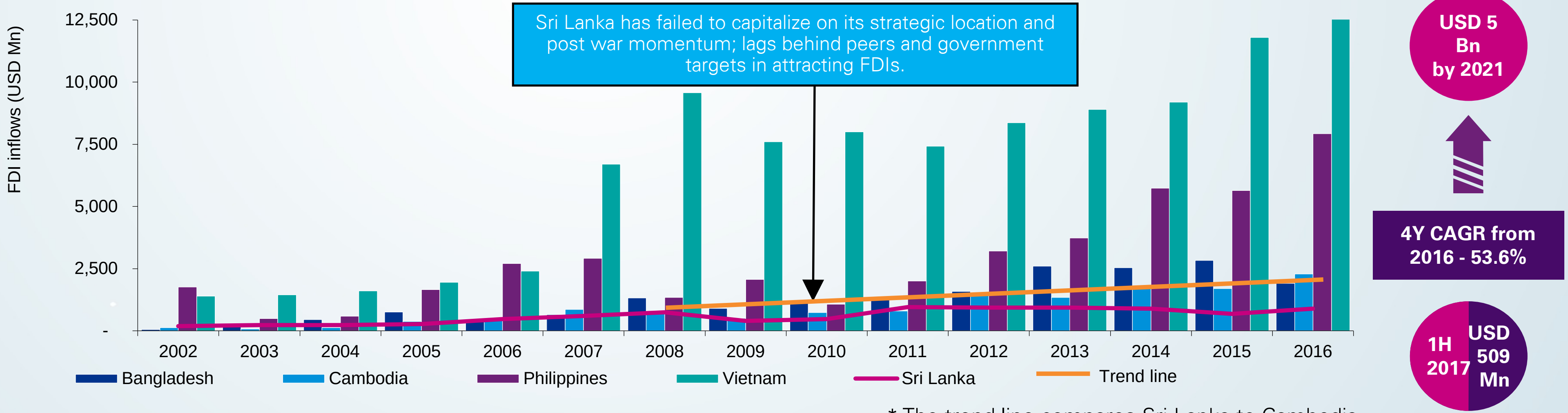
As at end October 2017 the Sri Lankan rupee continued to depreciate, recording a 4.5% deprecation against the dollar and a depreciation of 11.7% against GBP, in comparison to the same period in 2016.

In 2016, the LKR depreciated against all the major currencies except for the sterling pound, which was affected by Brexit. The depreciation pressure was mainly due to increased imports, continued foreign debt service payments and outflows on account of reversal of foreign investments from the government securities market amidst monetary policy normalization in the US.

The LKR mostly remained stable during the first four months, with some intervention by the CBSL. However, during the latter part of the year it was allowed to reflect market demand and supply conditions, which resulted in an overall 3.8% YoY depreciation of the LKR against the USD in 2016.

Economic Overview

FDI inflows remained lower than Asian Lower Middle Income peers



* The trend line compares Sri Lanka to Cambodia

Capital Flows

Sri Lanka received 2.2% of the total FDI to the South Asian region, and 0.7% of the total FDI to lower middle income countries over the five years up to 2016, with FDI inflows to Sri Lanka diminishing during the post-war period.

Over the five years ending 2016, FDI to Sri Lanka averaged 1.1% of GDP in comparison to 5.6% in Vietnam and 10.0% in Cambodia. FDI in Vietnam and Cambodia which were channeled primarily in to manufacturing and export industries, fueled a five year real GDP CAGR of 5.9% and 7.1% respectively.

However, in Sri Lanka, FDIs were predominantly concentrated on non-tradable sectors such as telecommunications and real estate developments as well as uncompetitive import substitutes, thus having little impact on broader economic growth. As a result, Sri Lanka's real GDP CAGR over the five years up to 2016 was lower than its peers at 5.3%.

It is to be noted that CSE continues to account for only 25% of Sri Lanka's GDP, notably lower than its peers with developed capital markets. Shortcomings in the investment climate such as a poor national policy framework, persistent fiscal and current account deficits resulting in unstable exchange and interest rates and high levels of national debt are believed to have hampered FDI.

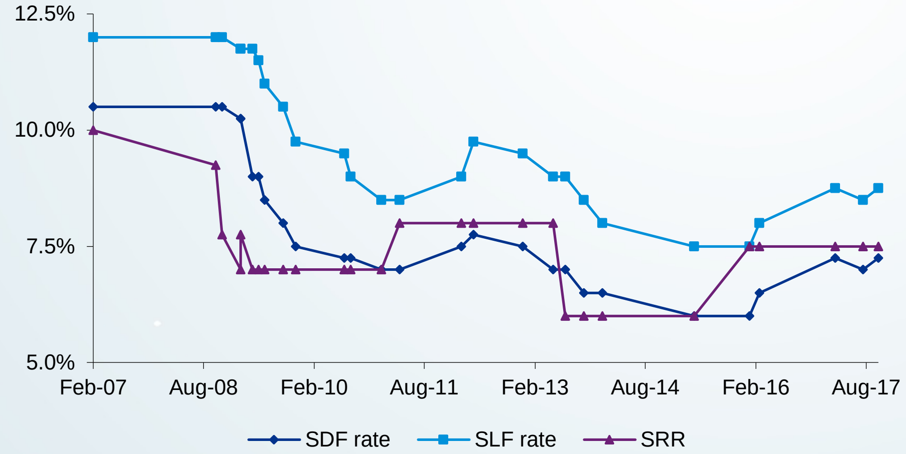
As per the Vision 2025 of the GoSL, the Government wishes to build a conducive environment for FDI with its fiscal and policy reforms in order to capitalize on Sri Lanka's strategic trade location, skilled workforce, growing disposable income and a positive macroeconomic outlook.

Foreign holdings of government securities continued to decline from 2014 up to 2016. However, eight months up to August 2017 recorded net inflows of USD 1.1 Bn, as local interest rates showed a downward trend while exchange rates remained stable.

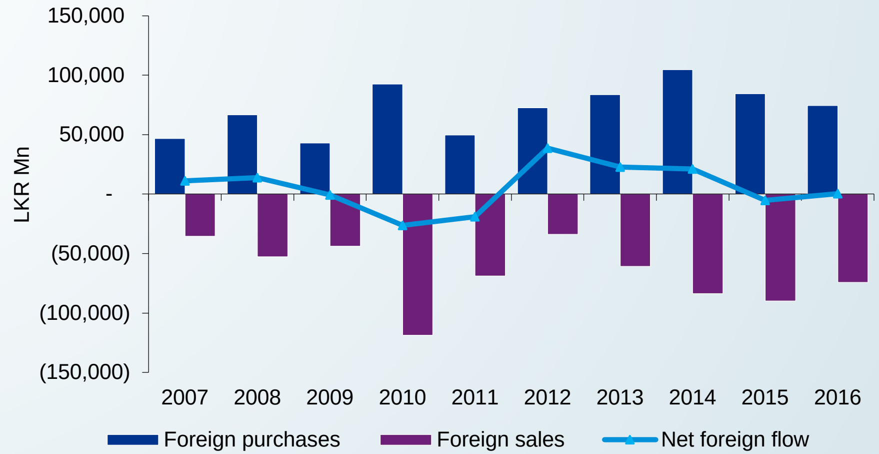
Source: World Bank, Central Bank of Sri Lanka, Vision 2025, KPMG analysis

Economic Overview

Policy rates



Net foreign flows deteriorated over the last five years



As shown above, policy rates have stabilized at single digit levels in recent years. However, the CBSL has indicated that it is closely monitoring inflationary pressures and credit growth and will tighten monetary conditions if necessary. The IMF has stressed on the importance of monetary policy in containing inflationary pressure and controlling credit growth to maintain an optimum interest and exchange rate environment.

The Government has made several USD denominated market borrowings in the form of International Sovereign Bonds ("ISB") and Sri Lanka Development Bonds ("SLDB") to control debt service costs by tapping institutional and high net worth investors in the global market. In the first half of 2017, Sri Lanka made a USD 1.5 Bn ISB issuance in addition to the USD 1.5 Bn issuance during 2016.

The All Share Price Index ("ASPI") of the Colombo Stock Exchange ("CSE") has delivered negative returns during the years 2015 and 2016 on the lack of Government policy direction and rising interest rates in global markets.

However, the CSE witnessed a turnaround with net foreign inflows of USD 328.3 Mn up to August 2017, on the back of attractive valuations and improving corporate earnings. In 2017, the Colombo Bourse was further stimulated by a number of mergers and acquisitions and corporate restructuring arrangements.

The CSE together with Sri Lanka's Securities and Exchange Commission ("SEC") and multilateral development financing agencies such as the Asian Development Bank is also investing in required infrastructure and strengthening regulations to ensure a more equitable, efficient and transparent market.

Net foreign inflows since 2012 reversed in 2015, with minimum inflows in 2016 given the volatility in both local and global equity markets and lack of policy direction in Sri Lanka.

Source: Central Bank of Sri Lanka, KPMG analysis

Key tax proposals

Income Tax

Enhanced depreciation allowance for new investments	• Investment over USD 3 Mn can be made in capital assets within a period of 4 years, effective from 01 April 2018, in order to qualify for an enhanced depreciation allowance. In terms of the provisions of the new Inland Revenue Act, the investment should be made within 3 years. However, as per the Budget Speech, same has been extended to 4 years. • The enhanced capital allowance has been granted at the rate of 200% for the investments to be made in the Northern Province, whilst investments made in other provinces to be qualified for the concession at the rate of 100%. • The above concession to be granted in addition to depreciation allowances for such assets.
Backward integrated activities relating to agriculture	• Backward integrated activities related to agriculture to be taxed at the concessionary rate of 14%.
Profits from renewable energy	• Profits from renewable energy to be taxed at the concessionary rate of 14% for a period of 4 years effective from 01 April 2018. • As per the provisions of the new Inland Revenue Act, the above concession has been provided for a period of three years from 01 April 2018.
Expenditure incurred on flood mitigation measures	• Any expenditure incurred by private sector entities and NGOs, partnering the Government on its flood mitigation measures, will be treated as qualifying payment relief for such private sector entities/NGOs.

Economic Service Charge

ESC on importation of motor vehicles

- The tax base for calculating ESC on importation of motor vehicles has been amended as follows;

Category	Base
Motor vehicles liable to Excise Duty	Excise Duty liability
Motor vehicles not liable to Excise Duty	CIF value

- Currently, all motor vehicles are subject to ESC at the time of importation on CIF value.

Removal of exemptions

- Sale of condominium housing units.
- Import or supply of the following imported goods:

Description	HS Code
Plants & Flowers	06.01, 06.02.10, 06.02.20, 06.02.30, 06.02.40, 06.02.90.90
Plastic Beads	39.26.90.70
Yarn/Fabrics	50.01, 50.02, 50.03, 50.04, 50.05, 50.06, 50.07, 51.11, 51.12, 51.13, 52.01, 52.03, 52.05, 52.06, 52.08, 52.09, 52.10, 52.11, 52.12, 53.09, 53.10, 54.02, 54.03, 54.07, 54.08, 55.09, 55.10, 55.12, 55.13, 55.14, 55.15, 55.16, 58.01, 58.02, 58.04.21, 58.04.29, 58.04.30, 58.06, 58.09, 58.11, 60.01, 60.02, 60.03, 60.04, 60.05, 60.06, 62.15
Wood & Articles	44.03, 44.07, 44.08, 44.09
Dyes	32.04.11, 32.04.12, 32.04.13, 32.04.14, 32.04,15, 32.04.16,32.04.17
Glass Beads	70.18.10
Plant and Machinery/Industrial racks	84.07, 84.11.91, 84.13.40, 84.43.19.10, 84.43.32.30, 84.43.32.40, 84.43.39.20, 84.43.99.30, 84.44, 84.45, 84.46, 84.47, 84.48, 84.51.40.10, 84.51.50, 84.51.80.10, 84.51.90, 84.70.10, 84.79.89.10, 84.79.89.20, 84.79.89.30 84.79.89.40
Electronic goods	85.16.40, 85.16.72, 85.27.21, 85.27.29, 85.27.91, 85.27.92, 85.39.31.20, 85.43.70.30, 85.43.70.90, 85.43.90

Value Added Tax

<table>
<tr><td>Removal of exemptions contd.</td><td>

Description	HS Code
Aeroplanes & Parts	88.02, 88.03.30, 88.05.21, 88.05.29
Spectacles	90.01, 90.02, 90.03, 90.04, 90.05
Cameras & Projectors	90.06, 90.07, 90.08, 90.10
Watches	91.01, 91.02, 91.05

</td></tr>
<tr><td>New exemption</td><td>• Solar tracker - HS Code 84.79, 89.50</td></tr>
<tr><td>VAT refund</td><td>• A VAT refund scheme will be implemented at the airports and seaports for foreigners w.e.f. 01 May 2018.
• A similar VAT refund mechanism was proposed in the Budget 2017. However it has not been implemented.</td></tr>
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Nation Building Tax

New exemptions	• The following goods will be exempted at the point of importation: – Advanced technology equipment for agriculture – Gem stones for cutting and re-export – Non-motorized equipment and accessories for water sports – Non -powered equipment and accessories for aero sports • Domestic coconut oil and kernel products – exempt for one year only.
Removal of exemption	• The current exemption applicable on sale of liquor will be removed.

Import / Export Duties and Levies

Customs Duty	• The following items imported for the sole purpose of manufacturing bio-degradable packaging products and materials would be exempt from Customs Duty. – Machinery – Equipment – Accessories – Raw materials and intermediate materials • Importation of crust (semi processed) leather for further processing and supply of raw materials for the leather products industry is to be exempted from Customs Duty.
Customs operations	• A new legislation to be introduced repealing the current archaic Law. • Digital signatures for electronic documents will be introduced. • 2017 Version of Harmonized System of Commodity Classification and Coding System, as amended by the World Customs Organization (HS System 2017 Version) will be effective from November 10, 2017. • Document processes required for imports are proposed to be automated from 1 January 2018. • Usance LC facility will not be permitted to be used for the importation of motor vehicles from 1st January 2018.
Para tariffs	• Para tariffs applicable on the tariff lines which do not at present carry any Customs Duty (approximately 1,200 para tariffs) will be abolished within the next three years, in keeping with the policy of liberalizing and globalizing. • Para tariffs applicable on importation of sports shoes will be removed / exempted. • In keeping with the above, CESS will be removed from 253 items to facilitate the emerging sectors such as tourism, value adding industries and other industries. This includes items falling within the categories such as, meat and edible meat offal, edible fruit and nuts , coffee, tea, mate and spices, beverages, spirits and vinegar, plastics, rubber, vehicles, furniture etc. • PAL on a significant number of items including non-powered equipment and accessories for aero sports such as hang gliding, ballooning, dirigibles , parachutes and para gliders will be removed. Other items include those falling within the categories such as, live animals, meat and edible meat offal, coffee, tea, mate and spices, beverages, spirits and vinegar, rubber, organic and inorganic chemicals, paper and paperboard, electrical machinery equipment and parts.

Import / Export Duties and Levies

Ports and Airports Development Levy	• PAL on the following items will be reduced. These include in relation to plastics, iron and steel, copper tubes and pipes, parts of nuclear reactors, refrigerators and freezers, air conditioning machines, parts of household or laundry type washing machines, fly wheels and pulleys, thermostats etc. - 3920.30.10, 7210.30.00, 7212.40.00, 7411.10.00, 8401.40.00, 8414.30.00, 8414.90.10, 8415.90.90, 8418.91.10, 8418.91.20, 8418.99.00, 8450.90.00, 8471.41.90, 8471.49.90, 8471.50.90, 8473.30.90, 8483.50.00, 8501.10.90, 8501.20.00, 9032.10.00 • PAL will be revised on the importation of non-motorized equipment and accessories for water sports, • PAL will be exempted on machines and equipment including solar panels and, storage batteries which will be imported for the establishment of solar charging stations.
CESS	• CESS will be revised on the 22 items listed below in order to facilitate the availability of goods for value addition and consumption purposes. This includes items such as onions, mushrooms, cheese, safety helmets, food grinders, radiators and parts, electrically operated clocks. - 0406.10.00, 0406.40.00, 0709.99.12, 0709.99.20, 0712.20.00, 2922.42.10, 4806.24.00, 4805.25.00, 4810.29.00, 5208.11.20, 5208.21.10, 5208.21.90, 6402.19.90, 6403.19.90, 6506.10.20, 8509.40.00, 8708.91.10, 8708.91.20, 4013.90.10, 4013.90.90, 9105.21.00, 9105.29.00
Tax concessions	• Tax concessions will be granted on capital goods imported through bonding facilities during the construction period for large scale pharmaceutical investments, dairy industry and solid waste management ventures.
Other	• Importation of motor vehicles below the emission of EURO 4 or its equivalent will be prohibited from 1st January 2018 in line with the health and safeguard measures. • Importation of motor vehicles which do not comply safety measures, namely, air bags for drivers and front passengers, anti locking breaking systems and three point seat belts for the driver and passengers, will be prohibited with effect from 1st January 2018.

Levies and Charges

Excise Duty	• Volume based duty will be imposed on liquor. • A duty of LKR 15 per litre will be imposed on non-potable alcohol. • Duties will be imposed on raw materials for manufacturing of ethanol.
Plastic resin	• Excise duty of LKR 10 per kg is imposed on plastic resins. The proposed revenue is Rs 2 bn.
New levy on OTA	• A tax of 1% will be imposed on the reservation commission derived or accrued in Sri Lanka by Online Travel Agents.
Other fees and charges	• The fees and charges of government agencies which have not been revised over the past 3 years, will be increased by 15%.

Plastic resin:

H.S Code	Description
3901.10	Polythene having a specific gravity of less than 0.94
3901.20	Polythene having a specific gravity of less than 0.94 or more
3902.10	Polypropylene
3903.11	Polystyrene - Expansible
3904.10	Poly (vinyl chloride), not mixed with any other substances

Finance Act

Cellular Tower Levy	• Introduction of a new levy on the Mobile Tower Operators at the rate of LKR 200,000 per month per tower.
Debt Repayment Levy (DRL)	• A levy will be imposed on financial institutions at the rate 0.02% on the total cash transactions. • A similar levy called "Financial Transaction Levy", at the rate of 0.05% on the total cash transactions, including easy cash, was proposed at the Budget 2017. However, it was not legislated.
SMS Advertising Levy	• A levy will be charged on the advertiser of bulk SMS advertisements at the rate of 25 cents per SMS.
Luxury Tax on motor vehicles	• The Luxury Tax will be revised to be a one-time payment vis-a-vis the present system of payment over 7 years, for new vehicles. • The present system will continue for vehicles registered currently.
Carbon Tax	• The tax will be imposed on vehicles (except electric vehicles) based on the engine capacity. • The rate will depend on the age and fuel type of the vehicle and will be charged on a daily basis. This was a proposal introduced in the Budget 2017, but it was not implemented.

Foreign Exchange Act

Shipping & freight forwarding agencies	• The current restriction on foreign ownership of shipping and freight forwarding business will be relaxed. • The current restrictions are as follows: - Foreigners cannot engage in shipping and freight forwarding via branches. - Foreign shareholding in resident companies is limited to 40% of issued share capital.

Land (Restrictions on Alienation) Act

Acquisition of land by foreigners	• Listed companies with foreign ownership will be permitted to acquire freehold rights of land. • The current restriction on foreigners acquiring condominium properties below the fourth floor, will be removed. • The above were proposed in the Budget 2017 as well, but not legislated.

Tax Administration

Amendments to Statutes	• In order to streamline the revenue administration and rectify ambiguities and unintended effects, necessary amendments will be introduced to the following Acts : – Value Added Tax Act No.14 of 2002 – Nation Building Tax Act No. 9 of 2009 – Economic Service Charge Act No. 13 of 2006 – Finance Acts – Default Tax (Special Provisions) Act No. 16 of 2010 – Telecommunication Levy Act No. 21 of 2011 – Ports and Airports Development Levy Act No. 18 of 2011 – Tax Appeals Commission Act No. 23 of 2011 – Imports and Exports (Control) Act No. 1 of 1969 – Stamp Duty (Special Provisions) Act No. 12 of 2006 – Land (Restrictions on Alienation) Act No. 38 of 2014

Effective Dates of Proposed Amendments

- All statutory provisions relating to the following taxes are effective from the dates mentioned below unless specified otherwise;

Effective date	Type of tax
01 April 2018	• Value Added Tax • Nation Building Tax • Economic Service Charge • Finance Act
Immediate effect	• Customs Duty • Excise (Special Provision) Duty • Excise (Ordinance) Duty

An overview of industry specific proposals

- Automotive
- Agriculture
- Education
- Exports
- Fisheries
- Food and beverage
- Finance
- Healthcare
- Information technology
- Small and medium enterprises
- Sports
- Tourism

Automotive

<table>
<tr>
<td>Fiscal proposals</td>
<td>

Pre-shipment inspection certification for importation of used vehicles to be revised effective from 01 January 2018.
Usance LC facility will not be permitted to be used for the importation of motor vehicles from 01 January 2018.
In line with the health and environmental safeguard measures, the importation of Motor Vehicles below the Emission Standards of EURO 4 or equivalent, will be prohibited Effective from 01 January 2018.
In line with the safety of passengers/travelers, importation of Motor Vehicles that does not comply with the safety measures (i.e. Air Bags for driver and the front passenger, Anti-Locking breaking system (ABS), three point seat belts for driver and passenger in the front and rear seats), will be prohibited effective from 01 January 2018.
In order to enhance the public transportation, LKR 500 Mn has been allocated to introduce 50 electric busses into the SLTB bus fleet.
In the perspective of financing, loan to value ratio for the electric busses and three wheelers are to be revised to 90/10.
All Government vehicles are proposed to be converted to hybrid or electric vehicles by 2025.
Furthermore, It has been proposed that relevant initiatives will be taken to convert all the vehicles in the country to be powered by non-fossil fuel sources by 2040.

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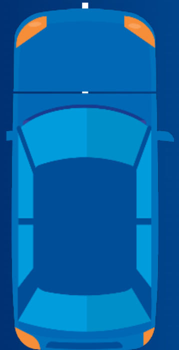
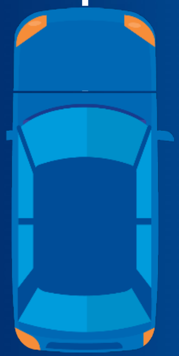


Automotive



Luxury Tax on Motor Vehicles

- The Luxury Tax will be revised to be a one-time payment vis-a-vis the present system of payment over 7 years for new vehicles.

	Engine capacity	Super Luxury (LKR)	Luxury (LKR)	Semi-Luxury (LKR)
Dual purpose (petrol/diesel) 2200cm³ <				250,000
Motor Car	Petrol 1800cm³ < x ≤ 2500 cm³ Diesel 2200cm³ < x ≤ 3000 cm³ Electric 200 kw < x ≤ 300 kw			500,000
Motor Car	Petrol 2500cm³ < x ≤ 3500 cm³ Diesel 3000cm³ < x ≤ 4000 cm³ Electric 300 kw < x ≤ 400 kw		1,000,000	
Motor Car	Petrol 3500cm³ < Diesel 4000cm³ < Electric 500 kw <	2,000,000		

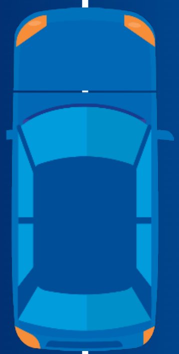
- The present system will continue for vehicles registered currently.

Carbon Tax

- The tax will be imposed on vehicles (except electric vehicles) based on the engine capacity.
- The rate will depend on the age and fuel type of the vehicle and will be charged on a daily basis

Type of vehicle	Less than 5 years	5 to 10 years	more than 10 years
Hybrid (Petrol/Diesel)	25 Cents per cm³	50 Cents per cm³	50 Cents per cm³
Fuel (Petrol/Diesel)	50 Cents per cm³	LKR 1.00 per cm³	LKR 1.50 per cm³
Passenger bus	LKR 1,000	LKR 2,000	LKR 3,000

Automotive



Valuation basis for motor vehicles

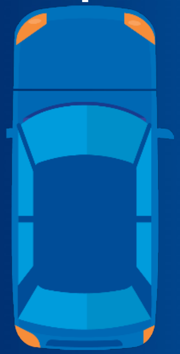
- Ad-valorem rate of excise duty on motor vehicles will be removed.
- Excise duty will be applied only on the engine capacity for petrol and diesel motor vehicles.
- Excise duty base for electric vehicles will be the motor power of the engine. (kilowatt (kw)).

Excise duty rates on petrol and petrol hybrid vehicles

- The duty rates based on engine capacity for petrol motor cars are as follows.

Engine capacity	Petrol fuel (LKR per cm^3)	Petrol hybrid (LKR per cm^3)
$\leq 1000cm^3$	1,750	1,250
$1000cm^3 < x \leq 1300cm^3$	2,750	2,000
$1300cm^3 < x \leq 1500cm^3$	3,250	2,500
$1500cm^3 < x \leq 1600cm^3$	4,000	3,000
$1600cm^3 < x \leq 1800cm^3$	5,000	4,500
$1800cm^3 < x \leq 2000cm^3$	6,000	5,000
$2000cm^3 < x \leq 2500cm^3$	7,000	6,000
$2500cm^3 < x \leq 2750cm^3$	8,000	7,000
$2750cm^3 < x \leq 3000cm^3$	9,000	8,000
$3000cm^3 < x \leq 4000cm^3$	10,000	9,000
$4000\ cm^3 <$	11,000	10,000

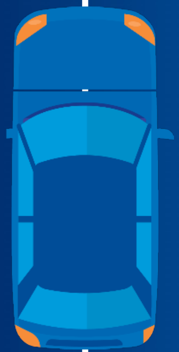
Automotive



Excise duty rates on diesel and diesel hybrid vehicles

- The duty rates based on engine capacity for diesel powered motor cars are as follows.

Engine capacity	Diesel fuel (LKR per cm^3)	Diesel hybrid (LKR per cm^3)
$\leq 1500cm^3$	4,000	3,000
$1500cm^3 < x \leq 1600cm^3$	5,000	4,000
$1600cm^3 < x \leq 1800cm^3$	6,000	5,000
$1800cm^3 < x \leq 2000cm^3$	7,000	6,000
$2000cm^3 < x \leq 2500cm^3$	8,000	7,000
$2500cm^3 < x \leq 2750cm^3$	9,000	8,000
$2750cm^3 < x \leq 3000cm^3$	10,000	9,000
$3000cm^3 < x \leq 4000cm^3$	11,000	10,000
$4000cm^3 <$	12,000	11,000



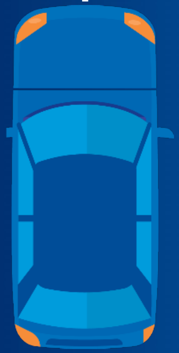
Duty rates for electric vehicles

- . The prevailing duty rates for electric vehicles are given below.

Engine capacity	Excise Duty (LKR per kw)
≤ 50 kw	15,000
50kw < x ≤ 100 kw	25,000
100 kw < x ≤ 200 kw	35,000
200 kw	45,000

- The proposed duty rates for electric vehicles have been segregated into two categories i.e brand new and used vehicles. The proposed rates are as follows.

Engine capacity	Unregistered (brand new) vehicle (LKR per kw)	Used vehicle (LKR per kw)
≤ 50 kw	7,500	15,000
50kw < x ≤ 100 kw	12,500	25,000
100 kw < x ≤ 200 kw	25,000	40,000
200 kw	40,000	55,000



Automotive

Duty rates for three wheelers

- The duty rates for three wheelers have been revised as follows.

Three wheelers	New Excise Duty (LKR per cm^3)	Prevailing Duty (Ad Valorem / LKR per cm^3)
Petrol	2,100	105% or LKR 1,600
Diesel	1,260	105% or LKR 1,000
Electric	Brand new – 7,500 per kw Used – LKR 10,000 per kw	50% or LKR 10,000 per kw

- The proposed rates are based on engine capacity or motor power. The proposed rates for petrol and diesel three wheelers have increased while the proposed rates for brand new electric three wheelers have reduced.

Off-road electric sports vehicles

- The duty will be reduced on the following HS Codes to facilitate promotion of sports tourism

  - 8703.10.11 , 8703.10.19, 8703.10.21, 8703.10.29

Vehicle permits for public sector employees

- Upper ceiling of excise duty concession of vehicle permits is to be defined in Rupee value without changing the existing concessionary rate.
- Upper ceiling of CIF value to be removed.
- Restriction of transferability is removed.

Agriculture

Fiscal proposals	• Companies engaged in agriculture and agro processing, inter alia, drip irrigation, poultry, canning, plantation, to be provided a loan scheme at a subsidized interest rate of 8% to encourage the use of off-grid solar power. • Complete the construction of three warehouses for agricultural produce in Polonnaruwa, Ratnapura and Kilinochchi and uplift existing warehouses operating on trust receipt basis. • The Government will provide incentives to increase the production of high quality planting materials of Cinnamon and Pepper for 1,000 nurseries. • A revenue model will be developed in the medium term for Tea industry. • The import of maize will be liberalized. • Underutilized State farms or land suitable for the poultry industry will be leased out to develop modern poultry farms. • The Government is proposing to allocate LKR 1 Bn which will be used to desilt small and medium tanks in a systematic manner to harvest rainwater. It has also been proposed to allocate LKR 250 Mn to complete the construction of three warehouses for storage of agricultural produce, in Polonnaruwa, Ratnapura and Kilinochichi and to uplift the existing warehouses operating on trust receipt basis. • Having considered the recent environment impacts on the agricultural sector, the Government has proposed to allocate LKR 3 Bn to provide a weather indexed insurance scheme for farmers. Additionally, LKR 200 Mn has been allocated to upgrade the Department of Meteorology with state of the art technology and elevate the capacity of the personnel. • LKR 175 Mn has been allocated for bearing 50% of the cost of introducing technology such as refrigerated storage to reduce post-harvest losses in multi-day boats.
Nation Building Tax	• The importation of advanced technology equipment will be exempted. • Domestic coconut oil and kernel products – exempt for one year only.

Education

Fiscal proposals

- LKR 2.5 Bn has been allocated to implement a youth training programme for undergoing training in specific skills and LKR 2 Bn has been proposed for further strengthening the National Youth Corp.
- Five technical and vocational schools are to be established in Badulla, Kandy, Trincomalee, Ratnapura and Anuradhapura with an allocated budget of LKR 1 Bn. Further, the ratio of Science Technology Engineering and Medicine (“STEM”) to non STEM subjects are proposed to be improved the allocated budget is LKR 3.5 Bn.
- Continuous Professional Development (“CPD”) for Teachers has been proposed to be continued with an allocation of LKR 1.2 Bn for 2018.
- LKR 755 Mn has been allocated to be used for the “Smart Class Room” concept with the development of e-text books.
- Technology stream degree programmes in the Universities of Rajarata, Ruhuna, Sabaragamuwa, Kelaniya, Colombo, Sri Jayewardenepura and the South Eastern University, are proposed to be expanded. Further LKR 1.25 Bn has been allocated to establish state medical faculties at Wayamba, Sabaragamuwa and Moratuwa Universities in order to expand medical education.
- LKR 200 Mn has been allocated to the Vavuniya Campus of the Jaffna University, in order to include a state of the art library facility and an IT center.

Export

Fiscal proposals

- Allocation of LKR 800Mn for export companies which promote domestic brands overseas.
- The BOI and the Customs Department to establish procedures, to facilitate Business to Customer (B to C) transactions w.e.f. 01 April 2018.
- The importance of reducing dependence on non-tradable foreign currency earners and introducing trade reforms to liberalize international trade was highlighted.
- The GoSL will commit LKR 10 Bn to establish a development bank with an EXIM window to facilitate small-scale entrepreneurs to access international markets.
- The “Export Market Access Support” initiative will be allocated LKR 800 Mn to assist local companies with less than USD 10 Mn in export earnings to meet the costs of free samples, compliance, promotional costs and rent of retail space for a period of 36 months.
- The establishment of a LKR 500 Mn SME Guarantee Fund, encompassing exporters in the CRIB, to improve access to borrowings.
- Establish dedicated industry zones in Trincomalee and Koggala to develop the boat building industry, at a cost of LKR 100 Mn, to derive dual benefits of export earnings and growth of nautical tourism.
- The establishment of an e-Trade Information Platform to facilitate exporters to access timely trade statistics, promotional tools, regulatory requirements and trade procedures.
- Establishment of a buffer zone in Killinochchi for the private sector to harvest and process sea cucumbers in light of lucrative export market generating ~USD 1,000 per kg.
- The Export Development Board will invest LKR 3 Bn under the “IT Initiative” drive to provide mentoring, financial and technical assistance for the IT sector to achieve export earnings of USD 5 Bn in the next 05 years.

Fisheries

Fiscal proposals

- The Government will bear 50% of the cost of introducing technology, such as, refrigerated storage, to mitigate post-harvest losses in multi-day boats.
- A Milk Fish Hatchery and a Marine Ornamental Fish Hatchery will be established in Bangadeniya.
- To establish a dedicated buffer zone in the Kilinochchi District, and plots given to the private sector to harvest and process Sea Cucumbers.
- The Government will establish cool rooms and storage facilities to enable fishermen to store their fish.
- Further, the government is to allocate LKR 400.0 Mn to bear 50.0% of the cost of multi-day boats of more than 55 feet long in order to encourage deep sea fishing.
- LKR 1.75 Bn has been allocated for the purposes of upgrading the anchorages and landing sites of fishery harbours in Chilaw, Mirissa, Karainagar and Purana Wella. Furthermore, LKR 200.0 Mn has been allocated to develop the Gandara Fishery harbor together with a new fishery harbor in Wellamankara in the Mannar District.
- An additional LKR 450.0 Mn has been provisioned to improve fishery villages in coastal areas which were initiated in 2017 under the programme of “Wewak Sahitha Gamak”.
- LKR 100.0 Mn from the 2018 fiscal budget has been allocated to establish a Milk Fish hatchery and marine ornamental fish hatchery in Bangadeniya. Further LKR 250.0 Mn has been allocated to develop infrastructure facilities of the model Aquaculture Industrial Park in Batticaloa and to establish similar parks in Mannar and Hambantota districts.

Food & Beverage

Fiscal proposals

- To establish two food processing centers in the Delft Island and Kilinnochchi.

Nation Building Tax

- The current exemption applicable on sale of liquor will be removed.

Excise Duty

- Volume based duty will be imposed on the following types of liquor:

Type of Liquor	Duty (LKR)
Hard Liquor	3,300 per litre
Beer and Wine	2,400 per litre

- A duty of LKR 15 per litre will be imposed on non-potable alcohol
- The following duties will be imposed on raw materials for manufacturing of ethanol.

Type of raw material	Duty (LKR)
Toddy	05 per litre
Molasses/Maize/Rice/Fruits	10 per kg

Liquor licenses

- Rate structure will be simplified w.e.f. 01 January 2018.
- Issuance of new liquor licenses to be simplified.

Food & Beverage

Canned beer	• The following duty applicable on canned beer (HS Code 2203) will be removed. - Less than 350 ml – LKR 10/- - More than 350 ml – LKR 15/-
Sugar tax on sweetened beverages	• A duty will be introduced based on the quantum of sugar contained in 'beverages with added sugar' (HS Code 22.02). • The rate will be 50 cents per gram of sugar. • The proposed revenue from the introduction of sugar tax is LKR 5 bn.

Finance

Fiscal proposals	• Establishment of a Development Bank for the SME sector, to facilitate long term financing. • State owned commercial banks; Bank of Ceylon and People's Bank, indicated their interest in evaluating options of tapping global capital markets by leveraging on their strong financial positions. • However, in raising equity capital for Bank of Ceylon and People's Bank, the GoSL will not dilute its controlling ownership and will provide preferential allocations to depositors and employees. • The GoSL will infuse LKR 10 Bn to BOC by 2018 to enhance capitalization in the light of near term pressures on capital requirements post implementation of BASEL III. • It is also proposed that LKR 2.5 Bn be infused in to the Pradeshiya Sanwardhana Bank. • The GoSL reinforced its stance on divesting state interests in non-strategic businesses to elevate momentum in the Colombo Stock Exchange. • Reviewing several legislations affecting the financial sector, such as, Monetary Law Act and the Banking Act, to ensure economic and price stability, while maintaining its resilience and growth momentum. • The GoSL has identified that laws relating to bankruptcy have to be rehabilitated to minimize costs of failure and improve recovery rates. • Introducing Limited Liability Partnerships to encourage venture capital firms. • GoSL expresses its intent in repealing the Revival of Underperforming Enterprises or Underutilized Assets Act to curtail any uncertainty among private investors and enhance ease of doing business. • Proposal to enact legislation relating to Public Finance Management, Securitization, Development Banks and Public Enterprises.
Debt Repayment Levy (DRL)	• A levy will be imposed on financial institutions at the rate 0.02% on the total cash transactions for a period of three years. • This levy cannot be passed onto customers.

Healthcare

Fiscal proposals

- A health insurance scheme targeting university students at an expense of LKR 100 Mn is to be launched .
- Three new specialized renal units will be established in Polonnaruwa, Anuradhapura and Jaffna hospitals at a cost of LKR 450 Mn to combat the increasing prevalence of the Chronic Kidney Disease.
- Activities of the Health Education Bureau ("HEB") will be strengthened to combat the rising threat of non communicable diseases, at a cost of LKR 100 Mn.
- The Karapitiya Cancer Unit is to be strengthened, while cancer units are to be setup at Batticaloa and Ratnapura hospitals at a cost of LKR 300 Mn.
- The network of Government of primary health care dispensaries is to be strengthened with an allocation of LKR 100 Mn.
- Three highly specialized obstetrics centers in Colombo, Kandy and Anuradhapura, and an assisted Reproductive Treatment Centre at the Castle Street Hospital for Women, are to be established at a cost of LKR 275 Mn.
- Work to be commenced on a cardiothoracic complex, cardiac and critical care complex, at the Lady Ridgeway Hospital at a cost of LKR 400 Mn.
- The divisional Hospitals in Deniyaya and Moratuwa are to be upgraded, and the Beruwala Base Hospital is to be strengthened with curative care units, laboratories, a blood bank and a sewerage treatment plant, which is expected to cost LKR 375 Mn.
- The new District General Hospital at Matara will be revamped and the maternity, pediatric, medical and the administrative units will be moved to Kamburugamuwa at a cost of LKR 150 Mn.
- The Nurses Training Schools are to be upgraded at a cost of LKR 300 Mn.
- The oral health care unit at Ratnapura and the Dental Health Institute at Maharagama are to be strengthened with better facilities at a cost of LKR 300 Mn.
- The Suwaseriya Ambulance service was allocated a sum of LKR 750 Mn.

Information Technology

Fiscal proposals	• The Government will support financing of 50% of rent expenditure for two years on the Hatch Incubator and extend similar support to any such private ventures. • LKR 2 Bn has been allocated to the Information Communication Technology Agency ("ICTA") for on-going initiatives and operational expenditure. • An Integrated Treasury Management Information System (ITMIS) is to be launched with an allocation of LKR 500 Mn during 2018. • Local Startups and Small and Medium sized IT companies are to be supported through the launch of "IT initiatives" with an allocation of LKR 300 Mn. • In order to upgrade the testing facilities at the Industrial Technology Institute, Sri Lanka Standards Institution, National Quarantine Center, National Aquatic Research Agency and other similar agencies, LKR 250 Mn has been allocated. • LKR 500 Mn has been allocated in order to introduce an E-local Government application system and LKR 100 Mn for the establishment of the Hi-Tech Innovation Park . • LKR 25 Mn has been allocated for the "Multi-National Corporation Outreach" programme (MNC Outreach) to attract global Electronic and Electrical Machinery (EEM) players into the country.

Small and Medium Enterprises

Fiscal proposals	
	• Introduction of an "Enterprise Sri Lanka Credit Scheme" by the Government combining the existing and the proposed low interest credit schemes to support SMEs and micro level entrepreneurs. The Government will bear the interest subsidy on these schemes. • Provision of financial and non-financial assistance through the "Enterprise Sri Lanka Credit Scheme" for the formation of certain companies which have at least 10 equity shareholders, and each shareholder, with investment of at least LKR 10,000/-. • To encourage women entrepreneurs, "Enterprise Sri Lanka Credit Scheme" will make available credit facilities with an interest subsidy of at least 10% more, relative to others. This scheme is also extended to differently abled persons with a interest subsidy of at least 15% more, relative to others. • A "SME Guarantee Fund" to be established to expand the borrowing capacity of SMEs. • University graduates with viable business ideas are eligible to utilize the "Erambuma" credit facility with a maximum loan facility of LKR 1.5 Mn per idea per person. The interest is 100% subsidized with the Government guarantee on the repayment of loan. • The Government will bear 50% of the investment cost incurred on equipment and machinery by SME polythene producers when converting from polythene to an environment friendly alternative.

Sports

Fiscal proposals	• 100 rural playgrounds to be developed Island wide, and talent identification programmes to be conducted to identify young athletes at District and Provincial Levels. • Establish a sports school and an academy at Diyagama as a training ground for National level athletes.
Port and airport development levy	• Exemption on importation of non – motorized water sports equipment.
Nation Building Tax	• The following goods will be exempted at the point of importation: - Non-motorized equipment and accessories for water sports - Non -powered equipment and accessories for aero sports

Tourism

Fiscal proposals	• Special credit facilities to be introduced to upgrade houses to accommodate tourists. • Liquor license fee structure will be rationalized to promote tourism. • Extended support to "tuk tuk" drivers to develop the tourism industry by providing initiatives to go electric and train "tuk tuk" divers to be tourist guides in collaboration with the hospitality industry, and register them with the Bureau. • Tourism arrivals are estimated to reach 4.5 Mn by 2020. • In order to reduce coastal erosion, the coastal belt form Mount Lavinia to Ratmalana will be refilled at a cost of LKR 400 Mn. • An allocation of LKR 250.0 Mn for Hotels and other industries which dispose waste into lagoons, will be assisted to invest in new technologies to reach a zero waste discharge. • Boat building industry is to be incentivized with the setting up of waterfront industrial zones in Trincomalee and Koggala via an allocation of LKR 100 Mn. • New sites will be developed in collaboration with the Sri Lanka Tourism Development Authority (SLTDA) and the Sri Lanka Tourism Promotion Bureau (SLTPB) as tourist sites with an allocation of LKR 250 Mn. • Colombo Fort, Nanu Oya, Galle and Ella railway stations are to be declared as archeological sites and modernized in collaboration with the private sector, to improve rail commuter experience, with an allocation of LKR 75 Mn. • The domestic airports in Sigiriya, Batticaloa, China Bay and Koggala are to be developed as Public Private Partnerships ("PPP") to support tourism.
Value Added Tax	• VAT refund scheme for foreign passport holders will be implemented at the airport and seaports w.e.f. 01 April 2018.
New levy on OTA	• A tax of 1% will be imposed on the reservation commission derived or accrued in Sri Lanka by Online Travel Agents.

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