28 November 2019

Tax Alert

An economic revival initiative

This Alert contains amendments to direct and indirect taxes as approved by the Cabinet of Ministers on 27 November 2019 on a proposal made by His Excellency, the President. The contents of this Alert, including our analysis, are based on the press briefing given by the Cabinet Spokesman subsequent to the Cabinet meeting.

We will be sending you a more detailed analysis of the implications of the proposals mentioned in the Alert upon the enactment of these proposals.

Building a better working world

Income tax

The following income will be exempted from income tax with effect from 1 December 2019.

- Income generated from agriculture, fishing and livestock.

  It is presumed that the Government will consider addressing the inclusion of profits from minor processing of agriculture products such as plantation agriculture, for the exemption.

- The foreign currency earnings by Sri Lankans providing professional services.
- Income from the provision of information technology (IT) services and other enabling services.
- Taxes imposed on religious institutions.

In addition to the above, the rate applicable to the construction industry will be reduced from 28% to 14%.

At this point in time, it is unclear as to how the legislation will be drafted to exempt the income specified above from income taxes during an year of assessment. Generally, exemptions on income tax and changes to rates are granted not mid year – but from the commencement of the year of assessment. We hope that the Government will address this matter adequately at the time of drafting the legislation.

Economic Service Charge (ESC)

It has been proposed that the current ESC rate of 0.5% will be abolished. The effective date of this amendment is yet to be announced.

Personal income tax

- The maximum rate was reduced from 24% to 18% and the tax-free threshold has been increased.
- The present threshold applicable to withholding tax on employment (PAYE) will be revised from an all-inclusive monthly salary of Rs. 100,000 or an annual salary of Rs. 1,200,000 to a monthly salary of Rs. 250,000 or an annual salary of Rs. 3,000,000 for all public and private sector employees, effective from 1 January 2020.
- The proposed tax-free allowance and tax slabs will be as follows:

Taxable income	Tax rate
Tax-free allowance up to Rs. 3,000,000	Nil
Next Rs. 250,000	6%
Next Rs. 250,000	12%
Balance	18%

The following table shows the taxable income, tax payable and the effective tax rate applicable under the current and proposed tax laws to an employment income of Rs. 4,500,000.

	Current Rs.	Proposed Rs.
Employment income	4,500,000	4,500,000
Reliefs granted	(1,200,000)	(3,000,000)
Taxable income	3,300,000	1,500,000
Tax payable	432,000	225,000
Effective tax rate	9.6%	5%

Interest income

- In the event that the monthly interest income is less than Rs. 250,000 or annual interest income is less than Rs. 3,000,000, the withholding tax will be removed on such interest income. Currently, the withholding tax on interest is at a maximum rate of 5% and is considered a final withholding tax.

- Interest income exceeding Rs. 3,000,000 per annum will be liable to income tax at the normal rates of 6%, 12% or 18% as the case may be as described above.

Nation Building Tax (NBT)

- The current NBT of 2% imposed on liable turnover will be removed in respect of goods and services supplied, with effect from 1 December 2019.

- NBT on banking, financial services and insurance to be removed.

- NBT at import point will be amalgamated with Ports and Airports Development Levy (PAL).

- The higher PAL rate of 7.5% will be revised to 10%, inclusive of NBT. It is not certain but expected that the concessionary rate of PAL at 2.5% will continue.

Value Added Tax (VAT)

- The applicable rate of VAT on goods and services will be reduced from 15% to 8% with effect from 1 December 2019.

- VAT on banking, financial services and insurance is to be maintained at 15%.

- The VAT registration threshold is to be revised from Rs. 3 million per quarter (Rs. 12 million per annum) to Rs. 75 million per quarter (Rs. 300 million per annum).

- The VAT on businesses engaged in the tourism sector will be reduced to 0%, provided that 60% of the turnover is sourced from local supplies i.e., local agriculture and locally manufactured goods.

We expect that the legislation will provide adequate clarity on the basis of calculating the qualifying criteria for the zero rating.

- Condominium properties will be exempted from VAT.

- We expect that the transitional provisions will provide guidance on the manner in which the input taxes relating to carry-forward stocks etc., can be claimed.

Telecommunication Levy

- The Telecommunication Levy has been reduced by 25%. At present, the levy is imposed at 15% and a 25% reduction will result in a new rate of 11.25%.

Debt Repayment Levy

- The Debt Repayment Levy, which is imposed at the rate of 7% and paid by banks and other financial institutions will be abolished.

Import point duties

- As a means of addressing the concerns of the sectors relating to agriculture, natural resources, security, health, and quality standards, it has been proposed to introduce a negative list for the importation of certain items.

- A Special Commodity Levy (SCL) and Cess will be maintained to manage the seasonal agricultural crops and other activities.

- In order to safeguard the local agricultural industry of tea, pepper, raw rubber, cinnamon and other agricultural commodities, the import of such items could be included in the negative list or high customs-based taxes could be introduced.

- Further, it has been proposed to review the preferential rates of Customs duty under the various Free Trade Agreements.

Special Goods and Services Tax

- It has been proposed to introduce a special tax on liquor, cigarettes, telecommunication services, motor vehicles, entertainment etc., by consolidating the current taxes on these industries. It appears that the objective of this measure is to simplify and maintain a single tax regime.

  (Prior to 2015, liquor, tobacco and motor vehicles had a consolidated excise duty instead of the current VAT, NBT and other taxes).

Dates of implementation

This Alert states the implementation dates for certain taxes, where a reference has been provided. However, we presume that the Government will announce the implementation dates of the other taxes in the near future. It is also expected that the changes proposed above will be implemented administratively pending legislative enactment.

What this means for you

These developments will have a far-reaching impact on taxpayers. Further, these also indicate that the Government is focusing on increasing the tax base for tax compliance purposes. Therefore, taxpayers should closely monitor developments in this area in order to be compliant with the new provisions.

Please contact EY's team of tax professionals to learn more about the impact on your businesses.