

27 January 2020

Tax Alert

Proposed amendments to Income Tax

This Alert contains the proposed amendments to the Inland Revenue Act, No. 24 of 2017 based on documents made public by the Ministry of Finance and the press releases. The amendment Bill pertaining to these changes are yet to be tabled in Parliament.

This material 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.

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.



January to March 2020

Employment Income

- ▶ PAYE tax will be calculated estimating the employment income (including lump sum payments) for the entire three months and dividing it equally amongst the three months. The PAYE tables have been issued giving instructions on calculating PAYE for this period. Adjustments can be made for any variation in the estimate.
- ▶ Residents will be taxed at the following rates. Non-Citizens and Non-Residents will be taxed at the same rates but will not be eligible for the tax free allowance of LKR 750,000/-.

Taxable Income (3 months)	Tax Rate
Tax-free allowance up to LKR 750,000	Nil
Next LKR 750,000	6%
Next LKR 750,000	12%
Balance	18%

- Table 1 -

- ▶ Table 3 illustrates the PAYE tax saving for this period due to the revised tax rates.

Terminal Benefits

- ▶ Taxation of terminal benefits (amounts received in commutation of a pension, retiring gratuity, loss of office on a uniform scheme and ETF) will be taxed at the following rates from January 1, 2020;

Total Income from Terminal Benefits	Tax Rate
Up to LKR 10,000,000	Nil
Next LKR 10,000,000	6%
Balance	12%

- Table 2 -



Salary per month (LKR)	Estimated Salary for 3 months (LKR)	Tax for 3 months on the previous tax bands (max 24%)	Tax for 3 months on the new tax bands (max 18%)	Saving due to revised tax bands
150,000	450,000	6,000	-	6,000
200,000	600,000	18,000	-	18,000
250,000	750,000	36,000	-	36,000
300,000	900,000	60,000	9,000	51,000
350,000	1,050,000	90,000	18,000	72,000
400,000	1,200,000	126,000	27,000	99,000
500,000	1,500,000	198,000	45,000	153,000
600,000	1,800,000	270,000	81,000	189,000
700,000	2,100,000	342,000	117,000	225,000
750,000	2,250,000	378,000	135,000	243,000
800,000	2,400,000	414,000	162,000	252,000
900,000	2,700,000	486,000	216,000	270,000
1,000,000	3,000,000	558,000	270,000	288,000

- Table 3 -



Dividend

- ▶ WHT on dividend is at 14%. This withholding will be a final tax.

Interest

- ▶ WHT on Interest will be at the following rates.

Interest Income	Tax Rate
Up to LKR 250,000	Nil
Balance	5%

- Table 4 -

Service Fees

- ▶ WHT will not be deducted from January 1, 2020. Individuals are liable to pay tax on a self assessment basis.



April 2020 onwards

Employment Income

- ▶ PAYE tax is to be abolished. Individuals are liable to pay tax on employment income on a self assessment basis at the rate provided in Table 5.

Dividend

- ▶ There is no WHT on dividend. Individuals are liable to pay tax on dividend on a self assessment basis at the rates provided in Table 5 unless specifically exempted.
- ▶ Dividend distributed from dividend received is proposed to be exempted.

Interest

- ▶ There is no WHT on interest. Individuals are liable to pay tax on interest income on a self assessment basis at the rates provided in Table 5 unless specifically exempted.
- ▶ It is proposed to exempt interest income arising from Personal Foreign Currency Accounts (previous NRFC and RFC accounts).

Service Fees

- ▶ There is no WHT on service fees. The individual is liable to pay tax on service fee on a self assessment basis at the rates provided in Table 5 unless specifically exempted.

The following table applies to taxable income of a resident individual.

Taxable income	Tax Rate
Tax-free allowance up to LKR 3,000,000	Nil
Next LKR 3,000,000	6%
Next LKR 3,000,000	12%
Balance	18%

- Table 5 -

► It is uncertain whether non-residents will be taxed at the same rates as above and whether they will be eligible for the tax free allowance of LKR 3,000,000.

► In arriving at the taxable income, the qualifying payments amounting to LKR 1,200,000 per annum will be permitted on following:

- Health expenses including contributions to medical insurance
- Education expenses incurred locally
- Interest paid on housing loans
- Contributions made to an approved pension scheme
- Expenditure incurred for the purchase of equity or security

Accordingly, the tax free benefit (tax-free allowance and qualifying payments) will be LKR 4,200,000 per annum.

► Taxation of terminal benefits (amounts received in commutation of a pension, retiring gratuity, loss of office on a uniform scheme and ETF) will continue to be taxed at the following rates from April 1, 2020;

Total income from terminal benefits	Tax Rate
Up to LKR 10,000,000	Nil
Next LKR 10,000,000	6%
Balance	12%

- Table 6 -

► Table 7 illustrates the tax saving based on the new tax rates.



Annual Income	Previous tax bands at max 24% *	New tax bands at max 18%	Saving due to revised tax bands
600,000	-	-	-
1,000,000	-	-	-
1,500,000	12,000	-	12,000
1,800,000	24,000	-	24,000
2,400,000	72,000	-	72,000
3,000,000	144,000	-	144,000
3,600,000	240,000	36,000	204,000
4,200,000	360,000	72,000	288,000
4,800,000	504,000	108,000	396,000
6,000,000	792,000	180,000	612,000
7,200,000	1,080,000	324,000	756,000
8,400,000	1,368,000	468,000	900,000
9,000,000	1,512,000	540,000	972,000
9,600,000	1,656,000	648,000	1,008,000
10,800,000	1,944,000	864,000	1,080,000
12,000,000	2,232,000	1,080,000	1,152,000

- Table 7 -

* The tax-free allowance of LKR 1,200,000 which was previously available for persons with employment income is considered.





Partnerships

- ▶ Currently partnerships are not liable to pay tax with respect to its taxable income. April 1, 2020 onwards it is proposed that every partnership will be liable to tax separately from its partners. Accordingly, the current withholding tax on the partner's share of any partnership income will be removed.
- ▶ Credit can be obtained by the partners proportionately against the tax paid by the partnership.
- ▶ The tax on a partnership will be as follows:

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

- Table 8 -



Companies

Business income

The proposed rates and exemptions are as per Table 9.

- ▶ These rates are proposed to apply from Y/A 2020/2021 unless stated otherwise.
- ▶ The current predominate rule (which required 80% of gross income to be from the specific sector) is proposed to be removed from Y/A 2020/2021 onwards. Therefore, any income regardless of the percentage will be eligible for the concessionary rate.



Sector	Current	Proposed
Small and Medium Enterprises (SMEs)	14%	14%
Export of goods	14%	14%
Manufacturing	28%	18%
Export of services	14%	Exempt <i>If the service is utilized outside Sri Lanka and foreign currency is remitted to Sri Lanka through a bank (This exemption is to apply from January 1, 2020)</i>
Information technology and enabled services *	14%	Exempt <i>(This exemption is to apply from January 1, 2020)</i>
Tourism	14%	14%
Educational services	14%	14%
Healthcare services	28%	14%
Construction services	28%	14%
Agricultural, livestock and farming	14%	Exempt <i>(This exemption is to apply from April 1, 2019)</i>
Agro processing	14%	14%
Betting and gaming	40%	28%
Liquor and tobacco **	40%	28%
Other	28%	24%

- Table 9 -

* IT and enabling services are proposed to be prescribed.

** This is to be extended to manufacture and sale or import and sale of any liquor and tobacco products.

Dividend

- ▶ No WHT from April 1, 2020 on dividend income. The recipient shareholder will have to pay tax on the dividend income on a self assessment basis.
- ▶ It is presumed that this income will be taxed at the proposed standard tax rate of 24%.
- ▶ The following exemptions are proposed;
 - Dividend distributed from dividend received
 - Dividend distributed to a non-resident person

Interest

- ▶ There will be no WHT on interest from April 1, 2020. The recipient will have to pay tax on the interest income on a self assessment basis.
- ▶ It is presumed that this income will be taxed at the proposed standard tax rate of 24%.
- ▶ The following exemptions are proposed;
 - Interest accruing to any person outside Sri Lanka on loans granted to any person in Sri Lanka or to the government of Sri Lanka (this exemption is proposed to apply from April 1, 2018)

- Interest accruing to any person on money lying to his credit in foreign currency account opened by him in any commercial bank with the approval of the Central Bank of Sri Lanka
- Income earned by a non-resident person on interest, discount, realization gain, on any sovereign bond denominated in foreign or local currency issued by or on behalf of the Government (this exemption is proposed to apply from April 1, 2018)
- Income earned by any person on interest or discount paid or allowed on any sovereign bond denominated in foreign currency (this exemption is proposed to apply from April 1, 2018)

Rent and Royalty

- ▶ No WHT for residents from April 1, 2020 onwards. The recipient will have to pay tax on these income sources on a self assessment basis.
- ▶ Rent and royalty paid to non-residents will continue to be subject to WHT at 14%.

Other Foreign Payments

- ▶ Any foreign payment (other than those specifically exempt such as interest and dividend) will be liable for WHT at 14%.



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.

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