# Tax Reforms in Budget 2011[a]

*Budget 2011, presented in November 2010, includes major reform initiatives to correct the long felt deficiencies in the country's tax system. The ongoing reforms have been designed to address the fundamental changes towards a simple and broad-based tax system. They are based on an extensive consultative process among the stakeholders and broad guidelines of the Presidential Commission on Taxation. This document contains the highlights of these tax reforms.*

**Contents**



[a]Source: pp 174-183 of the Annual Report of the Ministry of Finance and Planning

# Changes to Key Tax Legislations - At a Glance

## Inland Revenue Act No. 10 of 2006

Effective from 1.4.2011

**Individual Tax**

- Tax rates and slabs were amended to expand concessions. Maximum tax rate applicable to individuals was reduced from 35 percent to 24 percent. The tax slabs were widened and the tax free allowance was increased from Rs. 300,000 to Rs. 500,000.
- Further, in relation to those whose only source of income is employment, the need to file income tax returns was removed by making PAYE as a tax at source.
- With regard to employees, if their only source of income is employment, an additional tax free allowance up-to Rs. 100,000 was granted. The Provident Fund withdrawals were exempted from income tax. A vehicle allowance up to Rs. 50,000 or the benefit of providing a vehicle, were also exempt from income tax.

**Corporate Tax**

- The maximum corporate tax rate was reduced from 35 percent to 28 percent. The concessionary rate for exports, tourism, construction etc., was reduced from 15 percent to 12 percent.
- With regard to high value added exports or where their total annual turnover is less than Rs. 300 mn – applicable tax rate was fixed at 10 percent.
- Capital allowances were increased, and double deductions were introduced for expenses on research and development.
- Company listing expenditure was allowed up to a certain level, and the Nation Building Tax paid was allowed in full as deductions. Restrictions were reduced in relation to advertisements, management expenses etc.
- Withholding Tax (WHT)
  - WHT on specified fees, rent and similar services was removed.
  - WHT rate on interest income was reduced to 8 percent.
  - WHT limits for application of directions were amended to match with the new tax rates.
  - WHT on corporate debt securities was adjusted to be on par with Government securities.
- Others (including administrative changes)
  - Provisions were introduced to identify Islamic Financial Transactions.
  - Provisions were introduced to require any person who carries on any trade, business or vocation in several units or undertakings, to maintain and prepare separate statements of accounts, in respect of each unit or undertaking.
  - A time bar was introduced for the making of an assessment, effective from the date of submission of the return.
  - The Board of Review that heard tax appeals was abolished and an autonomous Tax Appeals Commission was setup in terms of a new statute.
  - A Tax Interpretations Committee was introduced to ensure uniformity in relation to interpretations.
  - Provisions were made to enable transfer of refunds directly to the tax payer’s bank
  - Deterrents were introduced against misinterpretation of the provisions of the Act by auditors and tax practitioners.
  - Charitable institutions were redefined.
  - Restrictions were imposed with regard to qualifying payments in certain sectors.

## Economic Service Charge Act No. 13 of 2006

Effective from 1.4.2011

- Simplification of the rates schedule.
- Introduction of exemptions for certain categories such as distributors, dealers in Lottery, Unit Trusts and Mutual Funds, Airlines and Shipping Lines.
- Permitting to file annual returns with quarterly payments.
- Threshold increased from Rs. 7.5 mn to Rs. 25 mn.
- Exemptions granted relating to past non-payments consequent to the conflict environment that prevailed, to the benefit of the SME Sector.

## Value Added Tax Act No. 14 of 2002

- Effective from 1.1.2011
- VAT on financial services reduced from 20 percent to 12 percent and the tax savings to be used to create an Investment Fund Account to promote long term lending.
- A new VAT Suspension Scheme introduced.
- New exemptions and a set-off mechanism on unabsorbed input credit as at 31.12.2010 introduced.
- Withholding Tax on VAT removed.
- A concessionary rate structure on optional VAT introduced
- Provisions were made to permit the submission of quarterly returns for VAT while having to make monthly payments, to simplify compliance.

## Nation Building Tax Act No. 9 of 2009

Effective from 1.1.2011

**Rates**

- Reduced from 3 percent to 2 percent.

**Liability to Tax**

- Liability extended to include the carrying on business of wholesale or retail trade of goods other than the sale of;
    - Pharmaceuticals.
    - Any article subject to the Special Commodity Levy by the importer.
    - Gems and jewellery on the payment of foreign currency.

**Threshold**

- Reduced generally from Rs 650,000/- to Rs 500,000/- per quarter.
- Increased from Rs. 500, 000/- per quarter to Rs 25 mn per quarter for the following categories;
    - Operating a hotel, guest house, restaurant or other similar business.
    - Local value added agricultural produce, rice based products.
    - Local educational institutions.
    - Supply of labor (manpower) or employment.
    - Introduction of a special threshold on the liable limit of buying and selling.

## Other Reforms

- A composite Telecommunication levy was introduced having removed VAT, NBT, Regional Infrastructure Development Levy, Environment Conservation Levy and the Mobile Subscriber's Levy on Telecommunication Sector.
- In relation to the Banking and Finance Sector, an Investment Fund Account was created to be maintained by banks or financial institutions using, (i) tax savings of VAT[b] and (ii) tax savings of Income Tax[c] to be used towards long term credit financing in the economy.
- Certain Taxes such as the Regional Infrastructure Development Levy, Social Responsibility Levy and Debit Tax were altogether removed, responding to public demands for a simpler tax system.
- In relation to other facets of tax administration, there was a common grievance that a level playing field did not exist among taxpayers with regard to interpretations of tax laws, since different individuals, gave contradicting interpretations with regard to similar matters.
    - Further, there was another common grievance that justice did not prevail with regard to the appeals process that prevailed with the operation of the Tax Appeals Board since the Board was virtually a part of the Inland Revenue Department and hence decision makers were not sufficiently independent.
    - Consequently, there was a tendency for many such appeals to end up in Court, which is a time consuming exercise for the state and which also increases the workload of the judiciary contributing to laws delays, which could be avoided, if an effective appeals mechanism is introduced.
    - In this backdrop, a uniform interpretation mechanism and an autonomous appeals process was institutionalized. An Interpretations Committee that is in charge of providing interpretations, consisting of senior officers of the Inland Revenue Department was formulated having made the necessary changes to the Inland Revenue Act[d]. Further, with the enactment of the Tax Appeals Commission Act No. 23 of 2011, an autonomous Tax Appeals Commission was appointed to hear appeals.

[b] VAT was reduced from 20 percent to 12 percent.

[c] Corporate Income Tax was reduced from 35 percent to 28 percent.

[d] Section 208 A of the Inland Revenue Act No. 10 of 2006 as amended by Inland Revenue (Amendment) Act No. 22 of 2011 required the appointment of a Committee consisting of Senior Official of the IRD to interpret the provisions of all Acts administered by the Commissioner General of Inland Revenue.

To implement the policy announced in the 2011 Budget, **15 legislations were enacted in end March 2011**, prior to the commencement of the Financial Year, on 1 April 2011 which areas follows.

| Statute | Objective |
|---|---|
| Value Added Tax (Amendment) Act No. 09 of 2011 | To introduce a new VAT suspension scheme for exporters and deemed exporters, to provide for reduction, removal, exemption and simplification of VAT, to provide concessions to identified segments of the society affected during the period of conflict. |
| Nation Building Tax (Amendment) Act No. 10 of 2011 | To expand the tax base, to introduce NBT to wholesale and retail trade, to revise applicable thresholds including a revision for the benefit of SMEs, to introduce new exemptions and concessions to identified segments of the society affected during the period of conflict. |
| Economic Service Charge (Amendment) Act No. 11 of 2011 | To simplify the rates schedule and to introduce Annual Returns in place of Quarterly Returns. |
| Strategic Development Projects (Amendment) Act No. 12 of 2011 | Changes introduced to bring in greater clarity relating to its provisions and to add subsequent legislation to the Schedule, in order to enhance the scope of exemptions in relation to strategic investments. |
| Provincial Councils (Transfer of Stamp Duty ) Act No. 13 of 2011 | To enable the transfer of revenue collected by the Inland Revenue Department to the Provincial Councils. |
| Debits Tax (Repeal) Act No. 14 of 2011 | To repeal the Act and remove the Debits Tax. |
| Finance (Amendment) Act No. 15 of 2011 | To remove the Social Responsibility Levy, to exempt Special Projects from the Construction Industry Guarantee Fund Levy, to revise the rate of the Share Transactions Levy, to remove the Cellular Mobile Subscribers' Levy, to extend the period during which tax has to be paid to qualify to get a concessionary rate on the importation of vehicles in the case of good tax payers, to introduce a levy on 5 star hotels based on the room rate and to introduce new rates for luxury and semi- luxury motor vehicles. |

| | |
|---|---|
| Regional Infrastructure Development Levy (Repeal) Act No. 16 of 2011 | To repeal the Act and remove the Regional Infrastructure Development Levy. |
| Excise (Special Provisions) (Amendment) Act No. 17 of 2011 | To introduce an amendment to simplify the calculation of Excise Duty |
| Ports and Airports Development Levy Act No. 18 of 2011 | Removal of PAL applicable to items imported for special projects. |
| Recovery of Loans by Banks (Special Provisions) (Amendment) Act No. 19 of 2011 | *Parate Execution* rights introduced in terms of the Act not to be applicable in instances where the principal amount borrowed is less than Rs. 5 mn excluding any interest and or penalties, mainly for the benefit of SMEs. |
| Excise (Amendment) Act No. 20 of 2011 | To permit tapping of Palmyra and Kithul trees without having to obtain a license to encourage related domestic industries. |
| Telecommunication Levy Act No. 21 of 2011 | To Introduce a composite levy relating to telecommunication service, in lieu of VAT, NBT Cellular Mobile Subscribers Levy and Environment Conservation Levy. |
| Inland Revenue (Amendment) Act No. 22 of 2011 | To reduce the rates of individual taxes, to expand tax slabs, to revise corporate tax rates, to simplify the income tax system, to improve tax administration, to appoint an Interpretation Committee, to grant concessions to identified segments of the society affected during the conflict period, to provide new tax holidays and exemptions for specific sectors. |
| Tax Appeals Commission Act No. 23 of 2011 | To establish an autonomous Tax Appeals Commission, to hear all appeals relating to imposition of taxes and levies with regard to Statutes set out in the Schedule, and to make the appeal process independent and expeditious. |

## Tax Appeals Commission Act No. 23 of 2011

Effective from 1.4.2011

The Tax Appeals Commission established by Tax Appeals Commission Act No. 23 of 2011, is responsible for the hearing of all appeals in respect of matters relating to imposition of any tax or levy.
As required in terms of the provisions of the Act the following are the members appointed by the Minister of Finance as members of the Commission;

1. Justice Hector Yapa – Retired Judge of the Supreme Court
2. Mr. P. A Pematillake – Retired Auditor General
3. Mr. Jolly Somasunderam – Retired Director, National Budget Department

The Hon. Minister has also appointed Mr. K. A. P. Kaluarachchi – a Deputy Commissioner General of the Inland Revenue Department, released on full-time basis, as the Secretary to the Commission. A panel of 10 Legal Advisors are also being appointed to assist the Commission.

As provided for in the Act, a person aggrieved by a determination of the Commissioner General of Inland Revenue given in respect of an imposition of a tax or levy under the provisions of the Inland Revenue Act No. 10 of 2006, Value Added Tax Act No. 14 of 2002, Nation Building Tax Act No. 9 of 2009 or the Economic Service Charge Act No. 13 of 2006 could appeal to the Commission upon the payment of a sum equivalent to 25 percent of the assessment as assessed by the Commissioner General of Inland Revenue, which assessment is the subject of the appeal.

Once the intention of an aggrieved party to prefer an appeal against a determination is communicated to the Commission and within one month of receipt of such appeal, a copy of the same is forwarded to the Commissioner General by the Commission requiring him to transmit in writing the reasons for his determination.

If the party aggrieved is not satisfied with the reasons given by the Commissioner General, he has the right to refer an appeal to the Commission, within 30 days on receipt of the same.

A decision in respect of the appeal has to be made within One Hundred and Eighty (180) days from the date of the commencement of the hearing of such appeal.

The appeals pending before the respective Board or Boards of Review are transferred to the Commission. If any appeal had commenced prior to the date of coming into operation of this Act, such appeal should either be determined or an opinion should be expressed within One Hundred and Eighty (180) days from the date of coming in to operation of the Act.

| The Investment Regime | |
|---|---|
| Section 16 of the BOI Law | Foreign Investors seeking to bring inward Foreign Direct Investment could get approval of the Board of Investment (BOI) in terms of this section. |
| Section 17 of the BOI Law | Foreign Investors seeking concessions to bring inward Foreign Direct Investment could seek facilitation of the BOI under this Section. The BOI may grant exemptions from the laws referred to in Schedule B of the BOI Act i.e. Inland Revenue Act, Customs Ordinance, Exchange Control Act, Companies Act, Merchant Shipping Act, Finance Act No.65/1961 and Air Navigation Act.<br><br>With the new reforms, the BOI and the Inland Revenue regimes have been harmonized in relation to Section 17. |
| Inland Revenue Act No. 10 of 2006, as amended | 16 A Fisheries, 16 B Seed and Plant Material, 16 C Medium Scale Investments, 17 A Large Scale Investments, 24 A Cinematographic Films (For details, refer the explanatorysection below on Fiscal Concessions and Incentives under the Inland Revenue Act). |
| Strategic Development Projects Act No. 14 of 2008,as amended | Foreign Investment of a strategic nature could be treated in terms of the Strategic Development Projects Act. The BOI can facilitate this process in consultation with the Minister in charge of the subject of Investment and the Minister in charge of the subject of Finance, having followed the process envisaged in the Act. |

## Fiscal Concessions and Incentives

## Inland Revenue Act No. 10 of 2006, as amended

| Item | Description |
|---|---|
| **Section** | **16A Fisheries** |
| Exempt Undertakings | Any person or partnership carrying on an undertaking for fishing. |
| Criteria for exemption | "Undertaking for fishing" includes cleaning, sizing, sorting, grading, chilling, dehydrating, packaging, cutting or canning of fish in preparation for the market. |
| Investment Requirement | Not applicable. |
| Period of tax holiday | The trade profits and income within the period of five years, commencing 1.4.2011. |
| Relevant Gazette No. | Need not be gazetted. |
| **Section** | **16B Seed and Plant Material** |
| Exempt Undertakings | Any person or partnership carrying on an undertakingof producing agricultural seeds or planting material, orprimary processing of such seeds or material. |
| Criteria for exemption | - Carrying on an undertaking of producing of agriculturalseeds or planting material, orprimary processing ofsuch seeds or material.<br><br>- "Primary processing" means cleaning, sizing, sorting,grading, chilling, dehydrating, cutting, canning orpackaging for the purpose of preparation of suchproduce for the market. |
| Investment Requirement | Not applicable. |
| Period of tax holiday | Trade profits and income, other than profits and incomefrom the disposal of any capital asset, within the periodof five years, commencing 1.4.2011. |
| Relevant Gazette No. | No gazetting requirement. |

| Section | 16C Medium Scale Investments |
|---|---|
| Exempt Undertakings | Any person or partnership investing in a new undertaking, investing a minimum of Rs. 50mn. |
| Criteria for exemption | "New undertaking" means an undertaking -<br>(a) engaged in the manufacture of any article otherthan liquor or tobacco;<br>(b) in which the sum invested in the acquisition offixed assets after 22.11.2010 but before 31.03.2012,is not less than Rs. 50 mn. and,<br>(c) which has commenced commercial operations onor after 1.4. 2011. |
| Investment Requirement | Not less than Rs. 50 mn. |
| Period of tax holiday | Trade profits and income for 3 years, from the year inwhich the company commences to make profits fromthat year's transactions, or from 2 years from the date ofcommencement of its commercial operations, whicheveris earlier. |
| Relevant Gazette No. | Need not be gazetted. |
| **Section** | **17A Large Scale Investments** |
| Exempt Undertakings | A New undertaking commenced on or after 1.4.2011. |
| Criteria for exemption | "New undertaking" means an undertaking engaged inany activity prescribed by the Minister, as needed for theeconomic development of the country. |
| Investment Requirement | Not less than USD 3 mn. currency invested in fixedassets. |
| Period of tax holiday | The trade profits and income for a period of 5 years,from the year in which the company makes profits fromthat year's transactions or 2 years from the date ofcommencement of its commercial operations, whicheveris earlier, a tax holiday period not exceeding 7 years. |
| Relevant Gazette No. | Has been gazetted.[e] |

[e] The Gazette Notification No. 1708/34 dated 03.06.2011 relevant to this is given in the Annex I of this document.

| Section | 24A Cinematographic Films |
|---|---|
| Exempt Undertakings | Exhibition on or after 1.4.2007 of any cinematographicfilm in any;<br>- New cinema.<br>- Upgraded cinema.<br>“New Cinema “ means a cinema;<br>(i) in which the exhibition of cinematographic filmscommences on or after 1.4.2007; and<br>(ii) which is certified by the National Film Corporation asbeing equipped with digital technology and DigitalTheatre Systems and Dolby Sound Systems, and<br><br>“Upgraded Cinema” means a cinema;<br><br>(i) in which the exhibition of cinematographic films hadcommenced prior to 1.4.2007.<br>(ii) which was not equipped with digital technology andDigital Theatre Systems & Dolby Sound Systems prior to1.4.2007.<br>(iii) which is certified by the National Film Corporation ofSri Lanka, established by the National Film Corporationas being equipped on or after 1.4.2007, with digitaltechnology & Digital Theatre Systems & Dolby SoundSystems. |
| Criteria for exemption | In relation to any cinema or upgraded cinema , from theyear in which the exhibition ofcinematographic filmscommenced. |
| Investment Requirement | Not Applicable. |
| Period of tax holiday | 10 years - new cinemas, 07 years - upgraded cinemas. |
| Relevant Gazette No. | Need not be gazetted. |

## Strategic Development Projects Act No. 14 of 2008, as amended by Act No. 12 of 2011 (April 2011)

Projects coming under the purview ofthe Board of Investment (BOI) of Sri Lanka,bringing in strategically importantforeign investment into the country areprovided with facilities as envisagedin the Strategic Development Projects(SDP) Act. A project, which in the nationalinterest, is likely to bring economicand social benefits to the countryand which is also likely to change thelandscape of the country, primarilythrough;

- Strategic importance attached tothe proposed provision of goodsand services, whichwill be ofbenefit to the public.
- Substantial inflow of foreignexchange to the country.
- Substantial employment, whichwill generate and enhanceincome earning opportunities.
- The envisaged transformationin terms of technology couldbe recommended to bedeclaredas a SDP.[f]

A SDP may be granted exemptions,either in full or part, from time to time,from the applicability of the provisionsof one or more of the followingenactments[g];

- Inland Revenue Act No. 10 of2006.
- Value Added Tax Act No. 14 of2002.
- Finance Act No. 11 of 2002.
- Finance Act No. 5 of 2005.
- Excise (Special Provision) Act No.13 of 1989.
- Economic Service Charge Act No.13 of 2006.
- Debits Tax Act No. 16 of 2002.
- Customs Ordinance (Chapter 235).
- Nation Building Tax Act No. 09 of2009.
- Ports and Airports DevelopmentLevy Act No. 18 of 2011.

[f] Section 6, Strategic Development Projects Act No. 14 of 2008 as amended by Act No. 12 of 2011
[g] Schedule, Strategic Development Projects Act No. 14 of 2008 as amended by Act No. 12 of 2011

Further, SDPs may be given suchother assistance or facilitationas may be necessary, but any taxexemption is subject to a maximum of25 years.

**The process required to befollowed[h];**

- The Board of Investment (BOI)and the relevant line Ministry,identifies SDPs;
- The Minister of Investment topublish a notice in the Gazette tobring information relating to theSDP to the public domain;
- Upon the expiry of 30 daysfrom such Gazette notification,the Minister of Investment – inconsultation with the Ministerof Finance, informs the Cabinetof Ministers the rationale forconsidering such project as aSDP, the period of exemptionproposed to be granted, andobtain Cabinet approval toidentify such project as a SDPand the exemptions proposed tobe granted;
- If approved by the Cabinetof Ministers, the Minister ofInvestment must within 6weeks hence, publish for thesecond time an Order in theGazette to bring more specificinformation of the SDP to thepublic domain, i.e. the name ofthe SDP, the proposed date ofcommencement of such a project,the commencement and enddates of proposed exemptions.
- Every such Order published in theGazette should be placed beforethe Parliament within 3 monthsfrom the date of publication.

Such an Order will become operativeimmediately upon approval byResolution of Parliament. If notapproved by Parliament, the order istreated as rescinded with immediateeffect without prejudice to anythingpreviously done[i].

[h] Section 3, Strategic Development Projects Act No. 14 of 2008 as amended by Act No. 12 of 2011
[i] Section 4, Strategic Development Projects Act No. 14 of 2008 as amended by Act No. 12 of 2011

**Annex I**

ශ්‍රී ලංකා ප්‍රජාතාන්ත්‍රික සමාජවාදී ජනරජයේ ගැසට් පත්‍රය

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# The Gazette of the Democratic Socialist Republic of Sri Lanka

EXTRAORDINARY

අංක 1708/34 - 2011 ජුනි 03 වැනි සිකුරාදා - 2011.06.03

No. 1708/34 - FRIDAY, JUNE 03, 2011

(Published by Authority)

## PART I : SECTION (I) — GENERAL

### Government Notifications

INLAND REVENUE ACT, No. 10 OF 2006

Order under Subsection 17A

BY virtue of the powers vested in me by Section 17A of the Inland Revenue Act, No. 10 of 2006, I Mahinda Rajapaksa, Minister of Finance and Planning do by this Order :

(*a*) prescribe, that the activities referred to in Part I of the Schedule to this Order, for the purposes of sub-section (2) of that section, in relation to any company referred to in that Section ; and

(*b*) grant the respective periods of exemption, in relation to the profit and income of such new undertaking, as referred to in Column II of Part I, of any company carrying on such new undertaking investing in any such activity not less than the corresponding quantum specified in Column I of Part II of that Schedule, and where such investment is made in full not later than one year from the commencement of corresponding tax exemption period specified in Column II of Part II of that Schedule,

Mahinda Rajapaksa,
Minister of Finance and Planning.

Ministry of Finance and Planning,
Colombo.
29th April, 2011.

SCHEDULE

Part I

Activities

1. Agriculture or Forestry :
   - Cultivation of food crops, industrial crops, or horticulture
   - Forestry

2. Animal Husbandry :
   Dairy, poultry, swine, goat etc.

3. Manufacture :

- For export market including deemed export :
  Manufacture, production or processing of non-traditional goods *
- For the domestic and/or export market, the manufacture of :
  - Boats
  - Pharmaceuticals
  - Tyres and tubes
  - Motor spare parts
  - Furniture
  - Ceramics, glassware or other mineral based products
  - Rubber based products
  - Cosmetic products
  - Edible products manufactured out of locally cultivated agricultural products
  - Constrution materials

* Exports of non-traditional goods (including deemed/indirect exports) should be not less than ninety per centum (90%) of the volume of its output of each category of item at HS six digit level.

However the Minister of Finance reserves the right to withdraw the permission granted for local sales in the event of a substantial injury to the domestic industry.

4. Services :

- Provided to a person or partnership outside Sri Lanka *
- Tourism/Tourism related projects
- Providing hotel services guest houses or similar services
- Infrastructure projects including construction of commercial buildings
- Development of any warehousing or storage facility
- Power generation using renewable resources
- Establishment of industrial estates, special economics zones or knowledge cities
- Urban housing or town center development
- Provision of any sanitation facility or waste management systems
- Development of water services
- Development of Internal waterways, and/or related transport (passenger/freight)
- Construction of hospitals and provision of healthcare services
- Maintenance/repair of maritime vessels or aircrafts
- Sporting services (*eg*. motor racing/golf course)
- Software development
- Any project in light or heavy engineering industry
- Artificial insemination for cattle (dairy development)
- Higher education/skill development /adult education

* For services provided outside Sri Lanka, seventy per centum (70%) of its turnover should be in convertible foreign currency.

5. Any other manufacture of products or supply of services which could be considered as having economics benefits to the country and approved by the Minister of Finance.

**Part II**

| *Column I* *Amount of Investment* * | *Column II* *Period of exemption* |
|---|---|
| Not less than an amount equivalent to 3 Million US$ | 5 years |
| Not less than an amount equivalent to 5 Million US$ | 6 years |
| Not less than an amount equivalent to 7 Million US$ | 7 years |

* The minimum investment value in Part II Column I should consist of the value of "Fixed assets" such as land, plant machinery and equipment

06-395

PRINTED AT THE DEPARTMENT OF GOVERNMENT PRINTING, SRI LANKA.