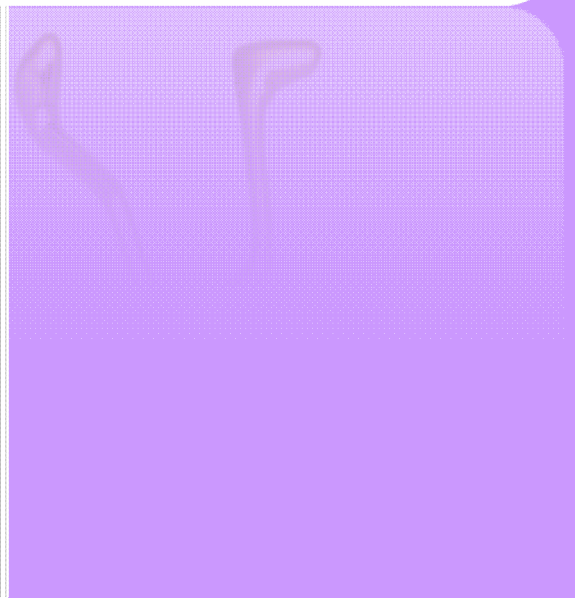


# Tax Highlights of Budget 2011



## Introduction

Dear Client,

We have prepared tax synopsis based on the 2011 budget proposal presented in the parliament by the His Excellency the President of Sri Lanka bringing about significant changes in the Sri Lankan tax structure.

We have selected certain areas, which we think are important for your organization. Therefore, we believe this document provides valuable tax information for your business. In addition, there may be some more information in the budget that we may have not selected and not brought to your notice/ discussed in this document, but may be relevant to your business.

This document does not intend to provide tax consultancy. Therefore, if you need any further clarification on application of the tax laws or on a particular issue pertaining to your entity please do not hesitate to contact us.

We advise you not to act on the information provided without a thorough analysis of the particular situation and a careful study of the particular law applicable.

This document lists out the removed taxes and newly introduced tax rates, and rates of taxes for your fleeting-look. For your general tax knowledge, we intend to update you on what are the allowable expenditure and their limits in brief.

In addition to listing out the changes, removal and introduction of tax rates, we highlight the details that are relevant to the changes, removal and introduction of tax rates. For an example, the removal of the present input tax credit restriction of 85% of the out- put tax is explained with an example in order to provide you an understanding on the practical application of the changes.

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*1-12-2010*

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## Table of Contents

1. Proposed Changes at a Glance .....	4
2. Income Tax .....	5
3. Value Added Tax (VAT) .....	8
4. Economic Service Charge (ESC) .....	12
5. Nation Building Tax (NBT) .....	13
6. Withholding Tax (WHT) .....	14
7. Social Responsibility Levy (SRL) .....	15
8. PAYE (Pay As You Earn) Tax .....	15
9. Other Taxes .....	16
10. Contact Us .....	17

## 1. Proposed Changes at a Glance



The following table summarizes several important existing taxes that were removed and new taxes that have been introduced.

Removed	Introduced
VAT @ 20% (Luxury Rate)	VAT @ 12%
VAT on Financial Services @ 20%	VAT on Financial Services @ 12%
Nation Building Tax (NBT) @ 1.5% & 3%	Nation Building Tax (NBT) @ 2%
Share Transaction Levy @ 0.2%	Share Transaction Levy @ 0.3%
Cellular Mobile Subscribers' Levy	Telecommunication Levy @ 20%
Environment Conservation Levy on telecommunication services	
Social Responsibility Levy (SRL) @ 1.5%	
WHT on Specified Fees @ 5%	
Provincial Council Turnover Tax	
Debit Tax @ 1%	
Regional Infrastructure Development Levy	

## 2. Income Tax



### 2.1 Rates of Tax

<i>Nature of Profit</i>	<i>Proposal</i>	<i>Prevailing</i>
Profits and income from sale and manufacture or import of liquor or tobacco products	40%	35%
Companies or NGOs	28%	33 1/3%, 30%
Banks and other financial institutions, including off –shore banking activities, Finance companies, Leasing, Insurance and Other specialized banking services	28%	35%, 20%
Concessionary Rate	12%	15%
Venture capital companies	12%	20%
Profits representing sales of any product having a domestic value addition of 65% and Sri Lankan brand name	<i>Maximum</i> 10%	35%/15%
Clubs and association	10%	20%
Undertaking for operation and maintenance of facilities for storage, local software development or supply of labour	10%	35%
Agricultural undertakings –after section 16 exemption period	10%	<i>Exempt</i>
Partnership Tax	8%	10%

### 2.2 Capital Allowances

Capital Allowances on **Plant & Machinery** are increased to **33.33%** from the prevailing 12.5%.

Capital Allowances on **Buildings** are increased to **10%** from the prevailing 6.67%.

### 2.3 Advertisement Expenditure

75% of advertisement expenditure will be allowed for income tax purposes. *At present, only 50% of advertisement expenditure is allowable.*

### 2.4 Deemed Dividend Tax

The **minimum amount** of the distribution of dividends from the “distributable profits” **has been reduced to 10%**. Thus, at Deemed Dividend Tax can be avoided by paying 10% of distributable profits.

*At present, if a company has not distributed at least 25% of the distributable profits in the preceding year as dividend to the shareholders, the company is liable for a 15% tax liability (**Deemed Dividend Tax**) on the excess as computed below.*

	<u>Rs.</u>
<i>1/3 of distributable profits for the preceding year</i>	xx
<i>Less: Dividend distributed within 18 months out of preceding year profits</i>	<u>(x)</u>
<i>The Excess liable for Deemed Dividend Tax</i>	<u>xx</u>

### 2.5 Foreign Travel and Foreign Training Expenditure

The **present restrictions** on foreign travel and foreign training expenditure **will be removed**.

However, the maximum amount allowable on **aggregate** expenditure on foreign travel and foreign training will be restricted to **2%** of the previous year’s statutory income.

*At present, foreign travel expenses were deductible only if it was incurred in relation to,*

- *Promotion of the export trade*
- *Provision of any services for payment in foreign currency*
- *Promotion of tourism*

*At present, foreign training expenses were deductible only if it is,*

- *Directly relevant to the duties performed by such employee before the commencement of such training*
- *Essential for upgrading the skills or performance of such employee, in such trade or business and*
- *Necessary for improving the efficiency and performance of such trade or business*

## 2.6 Time bar for raising of assessments

The time bar period for making assessments will be determined **from the statutory date of filling of income tax returns.** (i.e. 30<sup>th</sup> November)

*Under the current provisions, the time period within which an assessment could be raised commences from the end of the said year of assessment.* (i.e. 31<sup>st</sup> March)

## 2.7 Tax refund method

Provisions will be made to credit refunds directly to the bank account of the tax payer.

### 3. Value Added Tax



#### 3.1 Luxury tax rate reduced

Present 20% luxury rate is **reduced to 12%**. As a result, there will be only two VAT rates i.e. 12% and 0%

#### 3.2 New exemptions introduced

a) The Supply of,
Telecommunication services
Locally manufactured briquettes and pallets using bio mass waste
Any goods ( including imports) or services to a specific project carried on, out of foreign funds or donation received by the government, as approved by the minister considering the economic benefit to the country
Any goods or services by an institution set up by the Ministry of Defense for the rehabilitation of disabled soldiers, so far as the activities are carried out by the participation of such soldiers
Locally developed software
Services being receipts from re-insurance by way of commission or compensation in a insurance business
Leasing facilities of: <ul style="list-style-type: none"> <li>– Motor coaches with seating capacity not less than 28 passengers seats and used for public transport services</li> <li>– Lorries</li> <li>– Tractors</li> </ul>



b) The Import and Supply of,
Prescribed codes for, – Coal – Bitumen – Machinery and equipment for leather or footwear industry or manufacture of bags – High-tech medical and laboratory equipment
Prescribed codes for, – Hybrid and Electronic vehicles – Motor homes – Taxi Meters
Prescribed codes for, Promoting international shopping items
Prescribed codes for, Fashion Jewellery items
Prescribed codes for, Machinery and equipment for manufacture of grain mixed bakery products
Machinery and high-tech equipment imported for the telecom industry, which are specifically identified and approved by the Ministry of Finance

### 3.3 Input tax restriction removed

The present input tax credit restriction of 85% of the out put tax will be **removed**. Thus 100% of the input tax would be allowed against the output tax.

Example:

	Rs.	
	<u>Proposed</u>	<u>Prevailing</u>
Output VAT	150,000	150,000
Less: Input VAT	<u>(100,000)</u>	<u>( 85,000)</u>
VAT payable	<u>50,000</u>	<u>65,000</u>
Unabsorbed input VAT	0	15,000

### 3.4 Deductibility of unabsorbed VAT input credit as at 31st December 2010 against profit

The unabsorbed input VAT credits as at 31st December 2010 will not be recoverable against output VAT, but it can be **deductible against the profit** as follows.;

1. If Input credit is related to revenue expenditure (Ex: VAT paid on purchase of raw material, utility bills)

Can be deducted in **four equal annual installments** in four years from the year of assessment 2010/11.

Example:		Rs.
Unabsorbed input VAT		15,000
Annual Installment	$15,000/4 = 3,750$	
2010/11		3,750
2011/12		3,750
2012/13		3,750
2013/14		3,750

If Input credit is related to capital expenditure (Ex: VAT paid on purchase of Machinery, equipment)

To be treated as part of the capital assets for the purpose of **capital allowances**

### 3.5 Optional VAT

The rates applicable for optional VAT during a period of 12 years and the rates applicable to optional VAT period in which the business could remain in the status of optional VAT would be changed as follows.

Period	Rate
Date of registration to end of the 3 <sup>rd</sup> year	2%
4 <sup>th</sup> year to 6 <sup>th</sup> year	4%
7 <sup>th</sup> year to 9 <sup>th</sup> year	8%
10 <sup>th</sup> to 12 <sup>th</sup> year	12%

There is no upper limit of turnover for the application of the above rates. However, the option is available to register for normal VAT at any stage.

*At present, the tax payers whose aggregate turnover is below 3 million may opt for registration under the scheme.*

### 3.6 VAT Suspension Scheme

Monitoring of the VAT suspension scheme will be taken over by the Department of Inland Revenue under a separate unit.

*At present, VAT suspension scheme is monitored through EDB & TQB.*

### **3.7 VAT Refunds**

- VAT Refunds will be directly credited to the Bank account of the tax payer
- 15 days refunds scheme to be removed and a suspension scheme will be introduced.
- A proper mechanism to cross check input credit will be introduced
- Provisions will be introduced to disregard the claim of refunds in case where there is no response within a reasonable time.

### **3.8 VAT Advance Payment Scheme (WHT)**

Deduction of 1/3<sup>rd</sup> from payment made by a government agency in pursuance of a contract will be removed.

### **3.9 Filing of VAT Returns on Quarterly Basis**

Provisions will be made to file VAT returns on quarterly basis other than zero rated persons.

### **3.10 Time Bar Removed**

Time bar of 5 years relating to fraud and willful evasion will be removed.

### **3.11 Effective Date**

All changes to VAT are to be effective from 01.01.2011 unless otherwise stated.

## 4. Economic Service Charge (ESC)



### 4.1 Increase in the threshold

Present threshold of Rs. 7.5 million per quarter will be increased to **Rs. 25 million** per quarter.

### 4.2 Exemptions

Turnover of the following businesses will be exempt from ESC;

- Distributors as defined in the ESC Act
- Dealers in lottery
- Unit trust or mutual fund
- All air lines & shipping lines

### 4.2 Revised Rates

The existing rates have been simplified to **four categories**.

Type of Turnover	Rate
i. BOI enterprises (liable to income tax) <ul style="list-style-type: none"> <li>• Apparel exporters</li> <li>• BOI trading Houses</li> <li>• Manufacturers of textiles to apparel exporters</li> </ul>	<b>0.1%</b>
ii. Exempt / concessionary rate or others <ul style="list-style-type: none"> <li>• Exempt from income tax (including tax holiday companies)</li> <li>• During the period which losses are made</li> <li>• Subject to tax at concessionary rates</li> <li>• Wholesale or retail trade other than manufactured or produced by the seller (except distributors or dealers in motor vehicles or liquor)</li> <li>• Primary conversion of any tea , rubber or coconut plantation including desiccated coconut, coconut oil or fiber, copra and sheet rubber, but excluding any conversion which produces ant alcoholic beverage.</li> </ul>	<b>0.25%</b>
iii. Commercial operations – Advertising Agents	<b>0.5%</b>
iv. Other (including dealers in motor vehicles, liquor, tobacco and petroleum) and turnover of businesses defined under the gazette notification.	<b>1%</b>

### 4.3 Submission of Returns

Returns for ESC should be submitted annually with the existing scheme of quarterly payments of tax. At present ESC returns are submitted quarterly.

## 5. Nation Building Tax



### 5.1 Rates Reduced

Existing rate of 3% will be reduced to **2%**.

### 5.2 Threshold

The threshold in relation to NBT will be reduced to **Rs.500, 000/-** per quarter from the prevailing Rs. 650,000 per quarter.

In relation to the following categories, the proposed threshold is Rs.12.5 Mn. per quarter:

- Operating a hotel, guesthouse, restaurant or other similar business;
- Local value added agricultural produce, rice based products;
- Local educational institutions;
- Supply of labour (manpower) or employment

### 5.3 Allowable deduction

NBT will be **fully deductible** for tax purposes with effect from 1.04.2011.

*At present, 2/3rd of NBT is not an income tax deductible expenditure.*

### 5.4 Change in liability

Amendments will be brought to include the business of wholesale and retail trade of goods as well.

*At present, the business of wholesale and retail trade of goods is excluded from the chargeability of NBT.*

## 6. Withholding Tax (WHT)



### ***WHT on specified fees abolished***

WHT on specified fee payments **will be abolished from 01.04.2011.**

*At present, WHT at 5% should be deducted in respect of specified fees payable. “Specified Fee” is a sum or sums not less than Rs. 50,000 for any month or Rs. 500,000 in that Year of Assessment.*

However, the WHT provisions on rent, management fee and royalty payment will be applied.

*Example: The present WHT provision of 10% deduction from rent, lease rent which is not less than Rs. 50,000 per month or not less than Rs. 500,000 per year on any land or building used will prevail.*

## 7. Social Responsibility Levy (SRL)



- SRL on **income tax** will be removed **with effect from 01.04.2011**.
- SRL on **other levies** will be removed **with immediate effect**.

## 8. PAYE (Pay As You Earn) Tax

PAYE will be the final tax. No directions or refunds will be available.

### 8.1 *On Employees*

PAYE will not be deducted on employment income less than Rs. 600,000 per annum

### 8.2 *On Directors' Fee*

Payments to directors in excess of Rs. 25,000 per month, is subjected to be taxed at 16%.

Payments to directors less than Rs. 25,000 per month, is subjected to be taxed at 10%.

## 9. Other Taxes



### 9.1 Provincial Council Turnover Tax (TT)

Turnover Tax (TT) will be abolished with effect from 01.01.2011.

### 9.2 Debit Tax

Debit tax was introduced by the government for the payments/withdrawals via bank accounts – current accounts/ savings accounts (Except certain payment such as payment made to EPF, Inland Revenue Department)

It was proposed that the Debit tax will be removed with effect from 01.04.2011

### 9.3 Construction Industry Guarantee Fund Levy (CIGFL)

Exemption will be considered for special projects approved by the Minister in charge of Finance.

### 9.4 Regional Infrastructures Development Levy

It was proposed that the above levy will be removed with effect from 01.01.2011.

### 9.5 Share Transaction Levy

Share Transaction Levy will be increased from the current rate of 0.2% to 0.3% with effect from 01.01.2011.



## 10. Contact Us ...



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