

**Income Tax**

**Tax Rate Changes**

Corporate and personal

- Companies with Taxable Income not exceeding 5 Million 15%
- Companies with Taxable Income exceeding 5 Million  
Quoted public companies for 5 years from quotation 33 1/3 %  
Others 35%  
(Marginal relief also provided)
- Approved Shipping Agents –  
In respect of income (in foreign currency) from  
transshipments agency fees 15%
- Income in foreign currency arising from sub contracts on  
sewing, assembling or the provision of services resulting in  
improvement in character of the value 15%
- Companies providing services to persons outside Sri Lanka  
for receiving payment in foreign currency 15%
- Co-operative Societies 5%
- Profits from the business of Gaming or Auto Lotteries 40%
- Individual rate schedule for Year of Assessment 2007/08 onwards

Taxable Income			Rate
1 <sup>st</sup>	300,000	-	5%
next	200,000	-	10%
next	200,000	-	15%
next	200,000	-	20%
next	200,000	-	25%
next	500,000	-	30%
	Balance	-	35%

- Non-citizen employees for a 3 year or 5 year (flagship co.) period, 15%
- Employment income of non-citizens after the expiry of 3 year or 5 year (flagship co.) period of non-resident
  - Employed in Flagship co. ( 5 years or the rest of  
Exemption period, whichever is less) 20%
  - Others (for next 2 years) 20%

<sup>1</sup> The views expressed in this paper are the views of the author and do not necessarily reflect the views or policies of the Asian Development Bank (ADB) or its Board of Directors or the governments they represent. ADB makes no representation concerning and does not guarantee the source originality, accuracy, completeness, or reliability of any statement, information, data, finding, advice, opinion, or views presented.

## **Exemptions**

### **Agriculture**

- Current 5 year exemption on profits from agriculture is extended to primary processing of such produce.

### **Establishing Industries in underdeveloped Areas**

- Companies setting up new industries outside Colombo and Gampaha districts by investing not less than Rs. 30 Million in plant, machinery or building within two years from 01.04.2006, and employing not less than 200, are eligible to the following incentives.
  - 5 to 10 years tax holiday depending on the amount invested
  - Investment relief
  - VAT and Customs Duty exemption on import of new machinery
  - Exemption of interest on any credit facility granted by lending institutions for such industries
  - Same exemption is available for existing industries in Colombo or Gampaha if relocated in other districts
  - In addition, relocation expenses are deductible for tax purposes

### **International Sport Events**

- All international sport events will be exempt

### **Annuities**

- Totality of purchased annuities of retirees are exempt

### **Interest**

- Interest income of charitable institution providing institutionalized care for sick or the needy is exempt
- Interest Income of Town Hall Theatre Foundation is exempt

### **Foreign Exchange Earnings**

- Foreign currency earnings of professionals from professional services rendered in Sri Lanka to persons outside Sri Lanka is exempt from income tax, if remitted to Sri Lanka
- Such professionals living abroad are entitled to invest in foreign currency treasury bonds with the maturity period of 3 to 5 years.
- They are also entitled to import a motor vehicle at a value not exceeding 1/5 of the bond value by paying only 25% of all taxes

### **Taxation of certain non-resident persons**

- When the profits of a business of a non-resident person cannot be readily computed and if that person makes a declaration to that effect, then the Commissioner General is empowered to enter into an agreement with party fixing profits at not less than 6% of the turnover relating to activities in Sri Lanka

### **Deductions in Arriving at Profits for Taxation**

#### **Depreciation**

- Plant of machinery for use in health care, printing, gem cutting and polishing, packaging or rice milling

Rate of depreciation

33 1/3%

### Transfer Pricing

- A legal basis is introduced to enforce the arms length principle

### Thin capitalization

- The following debt equity ratio is introduced to make adjustments on interest deductible:

-	manufacturing companies	2:1
-	Others	3:1

(This is applicable only to companies within the group)

### Economic Service Charge (ESC)

#### Liability Turnover

- Definition where necessary will be published in the gazette under regulation (particularly with regard to distributors, business of cutting and polishing of diamonds, small tea factories)
- The definition will be modified to base the current year's turnover. Suitable adjustments will be made to dates of payments

#### Maximum Tax

- Maximum amount of ESC payable is increased from Rs. 50 million to Rs. 60 million per annum. (The return is quarterly. Accordingly, the maximum liability per quarter is Rs. 15 million.)

#### Liability Turnover limit

- The Limit of "liability turnover" to pay ESC is reduced from Rs. 50 million to Rs. 30 million.

#### Different Rate applicable to different activities.

Turnover	Rate	
	Present	Prior to 01.04.2007
1. Distributors (as defined in the Act)	0.05%	0.1%
2. Export of gems/ diamond (cutting & polishing)	1% on the value addition (CMT Value)	0.25% on the total turnover (FOB Value)
3. Apparel exporters/ deemed export of textile and BOI Trading Houses.	0.1%	Vary from 0.5% to 0.25%
4. Entrepot trade	0.5%	1%
5. Small companies	0.5%	1%
6. Primary conversion of Tea, Rubber & Coconut including desiccated coconut oil, coconut fiber, and copra and sheet rubber.	0.25%	0.5%

**Set-off of ESC**

- The set-off of ESC will be allowed against any income tax payable for the applicable year

**Exemptions**

- Government Institutions and Local Authorities are exempt from the ESC liability

**Stamp Duty**

Stamp Duty will be re-introduced except in respect of

- documents subject to Debit Tax
- letters of credit subject to Port & Airport Development Levy (PAL)
- share market transactions

**Betting & Gaming Levy**

Rates applicable to betting are revised as follows:

- live telecast - Rs. 300,000 for each centre
- non-live telecast - Rs. 500,000 for each centre

**Social Responsibility Levy**

- Rate is increased to - 1% (from 0.25%)

**Value Added Tax**

**Exemptions:** The following exemptions have been provided.

1. Import of ships to Sri Lanka including registration of ships under Sri Lanka flag
2. Import and supply of computers or accessories
3. Importation of unprocessed timber logs
4. VAT on high protein, high energy agro foods manufactured in Sri Lanka out of grain cultivated in Sri Lanka if procurement of such grain through backward integration from out growers
5. Importation of plant or machinery for industries where income tax exemption is applicable to setting up of new industry in districts outside Colombo and Gampaha
6. Import of large construction machinery or equipment including machinery for crushing
7. Services provided by the Tower Hall Foundation
8. Yarn and dyes used for handloom industry
9. Import of machinery to be used for handloom industry under the advanced technology package
10. New exemptions (Effective from 1.1.2007)
  - (a) Import of Machinery and equipment for generation of electricity.  
Machinery for the modernization of factories.  
Any film produced in Sri Lanka and taken abroad for further processing or printing.  
Any Bus by any bus owner holding a valid route permit.
  - (b) Import of supply of  
Furnace oil  
Breeding animals and materials.
  - (c) Import of essential food be exempted with effect from 1/7/2007

**Refunds**

1. The refunds made to exporters within 30 days at present will be made within 15 days provided that they furnish bank guarantee or Insurance Bond to cover the full amount of the refund
2. Separate account will be maintained at the Central Bank to ensure the smooth processing of refunds. For that purpose 10% will be credited from VAT collection on imports.

### **VAT Base**

#### **(At the Import Point)**

7% Mark up applied on CIF value at Customs is increased to 10%

#### **Payment dates**

Every VAT registered person is required to pay VAT on monthly basis, but return can be furnished either monthly or quarterly depending on the applicable taxable period

### **Extension of VAT**

#### **Suspension/deferment facilities**

1. The existing suspension scheme applicable to supply of goods to apparel manufacturers/exporters registered with Textile Quota Board/Export Development Board will be expanded to –
2. Supply of goods and intermediate goods manufactured in Sri Lanka to companies exporting non-traditional goods
3. Non-traditional export oriented companies including apparel manufacturers registered with Textile Quota Board/EDB are entitled to VAT deferment facility on importation of raw materials and capital goods
4. Reduction of rate to 5% (Effective from 01.01.2007)
  - (i) importation of machines used
  - (ii) Importation of high-tech medical equipment.
  - (iii) Import of supply of Jewelry
5. Introduced of VAT withholding system on payment of VAT to contractors by government agencies. Provisions (Effective from 01.01.2007)

### **Tax Administration**

#### **Delegation of Authority**

- Delegation of authority to Senior Officials only

#### **Official secrecy in Value Added Tax**

- The provision of Value Added Tax relating to secrecy will be amended in line with Income Tax
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#### **Time bar – Income Tax**

- Return to be filed on or before 30<sup>th</sup> September
- Time bar for issuing assessments will be restricted to 18 months from the end of the relevant year of assessment, if the return is filed on time and fixed at 3 years for all other situations except fraud, evasion or willful default cases (for which no time bar is applicable)

### **Tax Compliance**

- New taxpayers registered voluntarily.
  - Return will be accepted without requiring accounts if the income is less than 1 million.
- Acceptance of returns – year of assessment 2005/2006 and onwards (individuals) if:
  - Complied with the return and payment requirements for 3 preceding years,
  - Paid as tax not less than 120% of tax or declares assessable income not less than 125% of that of immediate preceding year and furnished the return accordingly,
  - Makes an affidavit that there is no willful default committed,

### **Incentives for good Taxpayers (Individuals):**

- If the Income Tax payment is made one month before the due date, a 10% discount will be allowed
- If any individual has paid income tax not less than Rs. 250,000/- and maintain that position over a period of 5 years commencing from 2003, he is entitled to import a motor vehicle with a 25% reduction on all duties and taxes applicable thereon, subject to following restriction on the capacity of the vehicle.

A Car	-	Not exceeding 1500 CC
Other vehicle	-	No restriction

### **Acknowledgement of appeals**

- Income Tax and VAT Appeals not acknowledged within 30 days will be deemed to have been acknowledged