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Global Tax Alert

Sri Lanka releases 2019 budget proposals

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Executive summary

Sri Lanka's Government released its National Budget 2019 (the Budget) on 5 March 2019. The Budget proposals include: (i) withholding tax exemption on interest and gains earned on sovereign bonds by a foreign person; (ii) changes to the economic service charge (ESC); (iii) favorable changes to tax incentives; (iv) changes to the value added tax (VAT), nation building tax (NBT), ports and airports (PAL) development levy and excise duties. Unless stated otherwise, the income tax proposals will be retroactively effective from 1 April 2019, the VAT, NBT and ESC proposals will be effective from 1 June 2019 but the PAL and excise duty proposals are already effective.

This Alert summarizes key aspects of the Budget.

Detailed discussion

Withholding tax exemption

The Budget extends the current exemption earned by a foreign person on interest from sovereign bonds denominated in foreign currency but also revises the provisions to include gains and sovereign bonds denominated in the local currency. In addition, interest on loans earned by a foreign person is exempt; however, the exemption is inapplicable if the loan is granted by a foreign holding company or foreign subsidiary of a Sri Lanka company.

Revisions to ESC

The current 0.5% rate on revenues from the export of goods or services in excess of Rs 50 million (US$280,000) is proposed to be reduced to 0.25%.

The current exemption on revenues earned by distributors will be extended to include a distributor who is a person or a partnership appointed by an importer of goods to Sri Lanka for sale in the wholesale market.

An ESC computation basis on importation is proposed to be the aggregate of cost insurance and freight value and amounts of custom import duty, PAL and other amounts imposed on imported articles and goods.

The Budget proposes to impose ESC on the importation of any article or good other than capital goods[1] specified by the Finance Minister.

Tax incentives

The capital allowance[2] incentive is proposed to be extended to new investments made by existing businesses.

The Budget proposes to remove the current requirement of maintaining a minimum 50 employees to qualify for the additional deduction equal to 35% of the salary cost when computing income from information technology services.

Benefits approved by the Board of Investment of Sri Lanka (the Board)

- Large scale projects (investments of US$100 million or more):
  - Acceleration of deduction – A person investing US$100 million or more on depreciable assets, other than intangibles in a project approved by the Board will be eligible for a 150% deduction on the actual cost incurred each year over a 10-year period.
  - Exemption from taxes – NBT, PAL, CESS[3] on project-related items, and duty and other taxes on negative list items incurred during project implementation or construction period will be exempt.
  - Additional incentives for an investment in excess of US$1 billion:
    - A 25-year net operating loss carryover period.
    - Exemption from a 10% withholding tax on a dividend distribution if the distribution is from profits sheltered by the capital allowances.[4]
- Mid-size investments over US$50 million.
  - A deduction is limited to 100% of actual cost.
  - Exemption from taxes stated above also applies during a construction period.[5]

Changes to VAT, NBT, PAL and excise duty

- VAT
  - Importation of pharmaceutical machinery may be subject to a 15% VAT due to a potentially narrowed definition of "pharmaceutical machinery"
  - Effective as of 1 June 2019
- NBT
  - Repeal of NBT on construction contractor services
  - A 2% charge on cigarette manufacturers
  - Effective as of 1 June 2019
- PAL
  - A reduced 2.5% on imported items classified under HS Codes 0712.20.00, 0712.90.10 and 7801.10.00
  - A reduced 2.5% on certain high-tech machinery and equipment
- Excise duty
  - A new excise duty provision for beverages containing sugar c
  - A reduced 20% on fatty acids

Endnotes

1. No definition is provided yet.
2. The term refers to depreciation and/or amortization.
3. Cess is a levy imposed on all imports into Sri Lanka and the rate of tax varies by product type.
4. A definition is pending but it may refer to profits computed without depreciation/amortization deduction.
5. It is not clear whether the proposals is intended to also include project implementation.

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