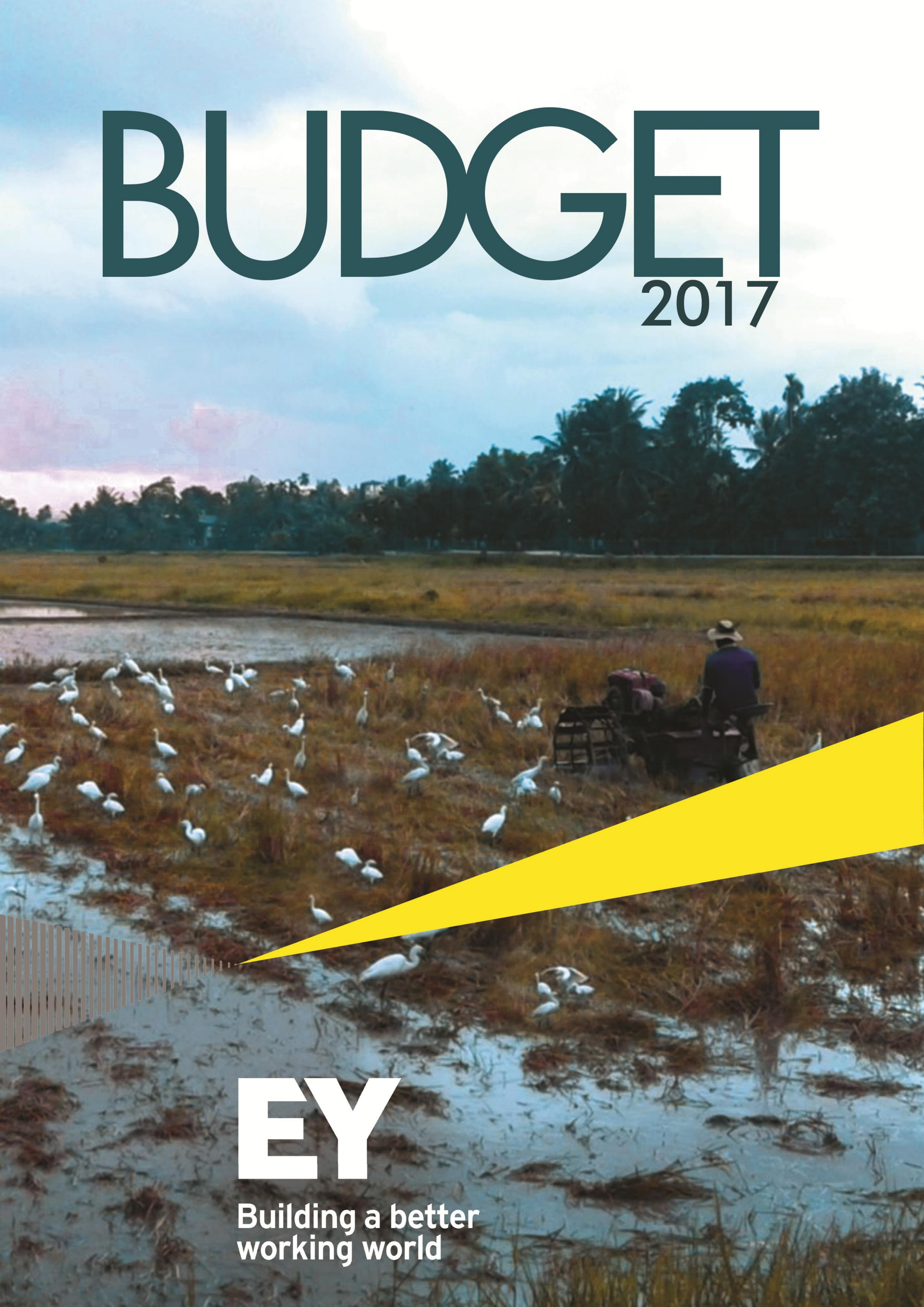
BUDGET 2017



Building a better working world

Tax authorities are clearly leading the global data race.

They are using technology to move beyond the e-filing of tax returns to e-audits and eventually to e-assess, where taxes are assessed based on data received (from the taxpayer or elsewhere) rather than from tax returns. This fundamental shift stands to make the process more efficient, transparent and compliant. But it could also lead to greater controversy. (*Source: EY – Tax Insights for business leaders №17)*

Contents

1 Introduction

Dear Client,

The 2017 budget was presented in Parliament by the Minister of Finance, Hon. Ravi Karunanayake. The second budget of the current government is aimed at achieving sustainable growth by bringing relief to the people. In this regard, the government aims to achieve a tax revenue of 13.5% of gross domestic product ("GDP") and an overall budget deficit of 4.6% of GDP. A number of measures have been proposed to increase tax revenue, chief among which is to introduce a three tier income tax rate structure of 14%, 28% and 40%.The government has also proposed a number of expenditure proposals that are aimed at socio economic development.

In this document, we have analyzed the revenue proposals announced in the budget and provided our comments where appropriate. We hope that the information in this document will provide you with a useful insight of the government's budget proposals for 2017.

2

Overview of the Economy

Overview of the Economy

1 Policy Direction of the Government

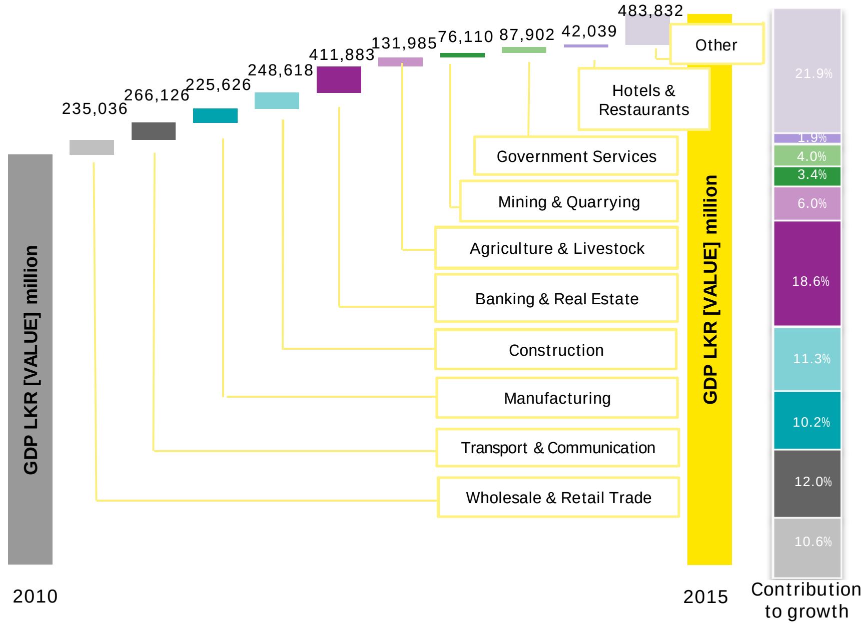
The government aims to create a positive investment climate and bring Sri Lanka within the top 70 nations of the Doing Business Index by 2020 from its current position of 110. This will facilitate the creation of one million new jobs, increase the female labor force participation to 40.0% from the current rate of 34.0%, expand the middle income group by doubling personal income, and achieve a 7.0% growth period by 2025. The thrust will be to form multifaceted economic linkages to global supply chains and trade development. The Government has set an agenda listed below to realize this vision, in addition to the specific initiatives spelt out in the budget under the theme “Accelerating Growth with Social Inclusion” listed in another section of this report.

- A new set of investment incentives based on capital allowances
- A North-Eastern development corridor connecting Eastern Province and the North Central Province to Jaffna linking the Trincomalee Port City to the Rajarata. Trincomalee to be urbanized and transformed into a world-class port city
- Accelerated development within Western Megapolis Urban Area
- Create new markets for exports through trade agreements particularly with India (Economic and Technology Cooperative Agreement - ETCA), China and Singapore
- Accelerate the broad basing of opportunities in distinct economic segments such as the digital economy, tourism and commercial agriculture
- Export Development
- Win GSP+ again to boost apparel sector
- Commercialize agriculture and accelerate the process of industrialization
- Providing large storage facilities for purchasing and storage during the harvesting season and create 250 ‘pola’, farmer markets island-wide for farmers to bring their produce to local markets
- Empower business formation and development through special Small and Medium-sized Enterprises (SME) financing schemes
- Labor reforms
- Public sector and pension reforms

2 Sectoral Contribution to Gross Domestic Product (GDP)

During the 5 year period from 2010 – 2015 the GDP (at constant prices) grew at a Compound Annual Growth Rate (CAGR) of 6.1%. Key sectors that have achieved significant growth over the 5 year period are manufacturing of food, beverage & tobacco products, Information Technology, financial services, growing of spices, and animal production.

Rubber growing industry deteriorated over the period. The contribution of the Agricultural sector to overall GDP declined, though having a growth during the period.



Source: Central Bank of Sri Lanka (CBSL)

2016 First Half GDP growth
3.9% Year on Year (YoY)
Growth Drivers
Financial Services (15.1%)
Construction (9.6%)
Wholesale and Retail Trade (4.5%)

2015 GDP growth
4.8% YoY
Growth Drivers
Financial Services (15.8%)
Wholesale and Retail Trade (4.7%)
Transportation and Warehousing (5.5%)

Source: CBSL

3 Growth prospects

Asian Development Bank (ADB) forecasts an economic growth rate of 5.0% for Sri Lanka in 2016. The growth forecast for 2017 is 5.5%. The lower growth prospects is mainly attributed to weak performance in the first half of 2016 and tightened monetary and fiscal policies required to achieve economic reform objectives.

In comparison to the ADB forecast above, the Central Bank states that growth will accelerate to 6.3% in 2017 from an estimate of around 5.5% in 2016 supported by expanding tourism, information technology, logistics and investments from China. Central Bank expects growth to increase to 7.0% in the medium term and this growth potential is envisaged mainly through productivity improvements supported by the adoption of new technology across production sectors.

For the country to sustain growth of over 5.0%, the government will be required to increase revenue collection, remove tax exemptions, set-up pro-poor safety nets, improve export competitiveness, and develop a modality to re-finance debt maturing, all of which are being pursued. This would mean strengthening macroeconomic fundamentals, enacting structural reforms that improve the competitiveness of the economy and improving business environment. Further, there is a necessity to align education, training, and skills with the need of the emerging dynamic sectors of the economy.

Though reduction of fiscal deficit is imperative for strengthening macroeconomic fundamentals, development expenditure has to be maintained, if not increased, to enhance growth and the competitive capacity of the country through investment in high quality education, infrastructure, and improvements in health.

The efforts directed towards improving investment attraction, the ease of doing business, trade policy and trade facilitation will require to be pursued more vigorously and effectively if the country is to achieve higher growth rates.

In the pursuit of being an economically successful middle income country, the combination of populist politics and a deeply entrenched culture of entitlement on the part of the people is a concern which requires to be handled with great political will and conviction.

4 Government fiscal operations

LKR billion	2013	2014	2015	2016	2017 Budget	Trend
Total Revenue and Grants	**1,204**	**1,264**	**1,515**	**1,658**	**2,098**	
Total Revenue	**1,188**	**1,254**	**1,509**	**1,648**	**2,088**	
Tax Revenue	**1,006**	**1,050**	**1,356**	**1,432**	**1,821**	
Income Tax	206	198	263	236	335	
Taxes on Goods and Services	572	616	804	854	1,086	
Taxes on External Trade	228	236	289	342	400	
Non Tax Revenue	**132**	**145**	**99**	**144**	**189**	
Provincial Council Tax Sharing and Development Revenue	**51**	**59**	**54**	**72**	**78**	
Grants	**16**	**9**	**6**	**10**	**10**	
Total Expenditure	**1,720**	**1,855**	**2,345**	**2,328**	**2,723**	
Recurrent	**1,256**	**1,382**	**1,756**	**1,842**	**2,024**	
Salaries and Wages	432	486	604	645	675	
Other Goods and Services	104	141	197	170	202	
Interest	444	436	527	603	680	
Subsidies and Transfers	276	318	428	424	467	
Public Investment	**481**	**487**	**603**	**500**	**708**	
Education and Health	56	78	90	115	141	
Other Infrastructure Development	425	408	513	385	567	
Other	**(17)**	**(14)**	**(14)**	**(14)**	**(9)**	
Revenue Surplus (+)/Deficit (-)	**(68)**	**(128)**	**(247)**	**(194)**	**64**	
Primary Surplus (+)/Deficit (-)	**(72)**	**(155)**	**(302)**	**(67)**	**55**	
Budget Deficit	**(516)**	**(591)**	**(830)**	**(670)**	**(625)**	
Total Financing	**516**	**591**	**830**	**670**	**625**	
Total Foreign Financing	**88**	**316**	**369**	**395**	**272**	
Foreign Borrowings Gross	183	423	556	540	450	
Foreign Borrowings	187	245	263	220	230	
Foreign Commercial	(4)	198	293	320	220	
Debt Repayments	(95)	(107)	(187)	(145)	(178)	
Total Domestic Financing	**428**	**276**	**460**	**275**	**353**	
Non-Bank Borrowings	257	193	197	341	261	
Foreign Investment on T Bills and T Bonds	140	21	223	(100)	60	
Bank Borrowings	31	62	41	34	32	
Revenue and Grants/GDP (%)	**12.6**	**12.1**	**13.5**	**13.5**	**15.5**	
Revenue/GDP (%)	**12.4**	**12.0**	**13.5**	**13.4**	**15.5**	
Tax Revenue/GDP (%)	10.5	10.1	12.1	11.6	13.5	
Non-Tax Revenue/GDP (%)	1.4	1.4	0.9	1.2	1.4	
PCs Tax Sharing and Devolved Revenue/GDP (%)	0.5	0.6	0.5	0.6	0.6	
Grants/GDP (%)	**0.2**	**0.1**	**0.1**	**0.1**	**0.1**	
Total Expenditure/GDP (%)	**17.9**	**17.8**	**21.0**	**18.9**	**20.2**	
Recurrent Expenditure/GDP (%)	13.1	13.2	15.7	15.0	15.0	
Non-Interest/GDP (%)	8.5	9.1	11.0	10.1	10.0	
Interest/GDP (%)	4.6	4.2	4.7	4.9	5.0	
Public Investment/GDP (%)	5.0	4.7	5.4	4.1	5.2	
Revenue Surplus (+)/Deficit (-) GDP (%)	**(0.7)**	**(1.2)**	**(2.2)**	**(1.6)**	**0.5**	
PrimarySurplus (+)/Deficit (-) GDP (%)	**(0.8)**	**(1.5)**	**(2.7)**	**(0.5)**	**0.4**	
Budget Deficit/GDP (%) (Excluding Grants)	**(5.4)**	**(5.7)**	**(7.4)**	**(5.4)**	**(4.6)**	

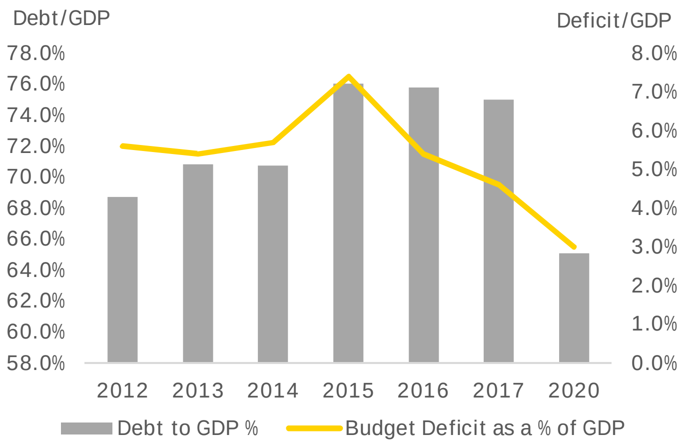
2016 provisional

Source: Budget Speech 2017

Years of low revenue growth and high external debt to fund a public investment-led growth process have resulted in high fiscal deficit and excessive public debt accumulation. This caused a rise in the debt service burden.

The 2017 budget is targeting a reduction in the budget deficit to 4.6% of GDP by increasing tax revenue to LKR 1,821 billion (27.2% YoY) in 2017. Excise duties will contribute highest to tax revenue with a 31.6% contribution.

5 Budget deficit and debt as a % of GDP



*2016 – provisional, 2017 - budget 2020 - projections

Source: CBSL, Ministry of Finance

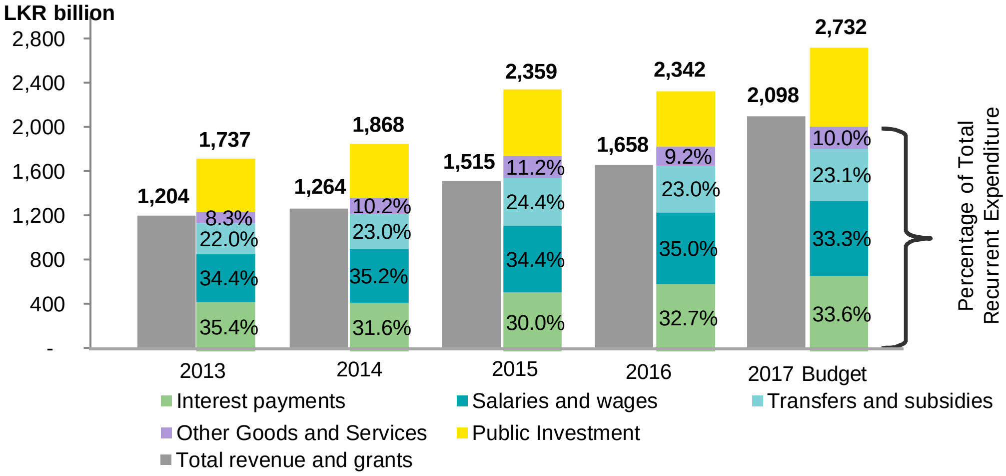
The government expects to increase revenue by ensuring effective tax revenue collection and efficient tax administrative reforms. The contribution of direct tax will increase, shifting to a more progressive and fairer tax system.

Moreover, the government will be required to ensure that it does not exceed its expenditure targets.

The salary and pension payments accounts for about 33.0% of primary expenditure (expenditure excluding interest payment) and interest payments amount to about 25.0% of total expenditure. Hence, the room to cut expenditure in the short term is challenging.

43.5% of the budget deficit is to be financed by foreign debt whilst financing from domestic sources is to increase by 28.4% YoY in 2017 accounting for 56.5% of the budget deficit.

6 Government revenue and expenditure



Source: Budget Speech 2017 *Expenditure Bar excludes expenditure category 'Other'

Sri Lanka raised US$ 3.6 billion in 2015 & 2016 from International Sovereign Bond issuances for Balance of payments (BOP) and fiscal support and also to settle government borrowings. In addition, the government secured US$ 1.5 billion from the IMF in June 2016 under its 3 year Extended Fund Facility (EFF) to bail out the economy from a BOP crisis. The disbursements of this facility would occur in seven equal tranches through the full tenure.

Sri Lanka's debt-to-GDP ratio rose to 76% by end of 2015. Further, the total external debt-to-GDP ratio increased to 54.4%. As much as 90% of government's revenue is directed towards annual debt servicing. The benchmark prudential limit set for the debt-to-GDP ratio by IMF for developing countries is 30% - 60%. The debt–to–export ratio for Sri Lanka stood at 265%. The threshold set by IMF for low income countries was 150%.

There over US$ 5 billion debt maturing 2019 onwards over 3 years. There are no foreign debt maturing in 2017 & 2018. The government intends to use the respite they have in 2017 and 2018 to go to market to mobilize some debt to retire early some of the debt that are bunched-up and maturing during a very short period around 2021 and 2022.

Further, more space in managing the debt burden is expected to be created with a Chinese company expected to buy 80% of the US$ 1.5 billion port in Hambantota. China has also been offered an Investment zone of 15,000 acres in Hambantota.

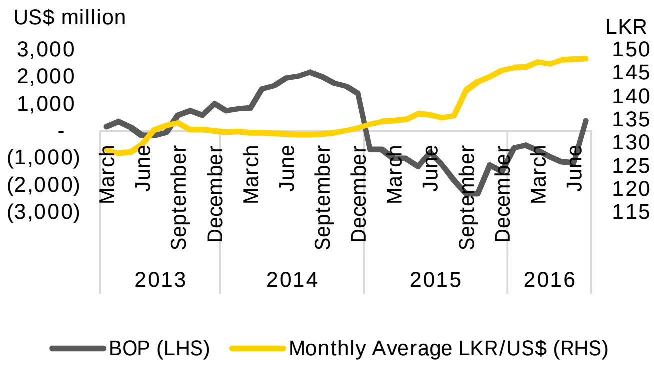
7 Current account deficit and exchange rate

The Current Account (CA) deficit is projected to narrow in 2016.

Despite the deficit in the trade account, a surplus in the current account of BOP is expected with higher inflows from service exports, tourism inflows, and worker remittances.

The Sri Lankan Rupee has depreciated by 2.1% against the US$ by end October 2016.

BOP and Exchange rate movement



Source: CBSL

8 Major components of the current account and their movement in 2016

Exports US$ 6.87 billion (8 months) — 4.1% YoY

Imports US$ 12.40 billion (8 months) — 1.6% YoY

Earnings from Tourism exceeded US$ 2.50 billion (9 months) — 14.6% YoY

Earnings from worker remittances US$ 5.40 billion (9 months) — 3.9% YoY

Trade Balance US$ -5.50 billion (8 months) — 1.6% YoY

Gross Official Reserves US$ 6.50 billion (End of September)

9 Influential factors for exchange rate fluctuations

Appreciation of LKR

The government has embarked on various projects to improve exports, increasing foreign currency inflows to the country. This might not have an immediate impact on the exchange rate, but will have a favorable impact in the medium to long term

Proceeds of US$ 1 billion from sale of 80% stake in Hambantota Port to China and will benefit CA balance

Expected growth in tourism earnings and remittances will positively influence BOP

Depreciation of LKR

If the FDI inflows to the country does not improve, it is likely to affect the BOP deficit

Inflationary pressure from increase in VAT and increasing credit to private sector could affect the current account deficit through increased imports

If US investments become more attractive foreigners might exit from T-Bill and T-Bond markets as well as the stock market creating pressure on the exchange rate

Stock market has recorded a net foreign outflow of LKR 3.2 billion at the end of Q3 2016. This will exert pressure on the exchange rate if the trend continues

IMF expects the government of Sri Lanka to revamp its economic policies and move to a more flexible exchange rate arrangement. The government has also expressed views on the ability to relax exchange controls for greater exchange rate flexibility.

10 Policy Rates and Interest Rates

The monetary policy tightening measures adopted by the CBSL during the year 2016 resulted in sharp upward pressure in both lending and deposit interest rates.

The persistently low interest rates during 2014-2015 period fueled high growth in credit to private sector creating inflationary pressure.

CBSL expects reductions in credit growth with the lagging effect of monetary policy transmission and expects interest rates to remain at current levels or to fall gradually with improving economic conditions.

The government aims to reduce the interest cost by at least LKR 90 million. This will require domestic interest rates to decrease at least by 1.5%.

However, Central Bank recently raised the interest cap on finance company deposits to 13.5% p.a. from 12.5% p.a. which has the potential to push up interest rates.

Further, if USA increases its interest rates, in order to retain the foreigners from withdrawing from the market, the Sri Lankan government may look at keeping the interest rates at higher levels.

SDFR – Standing Deposit Facility Rate

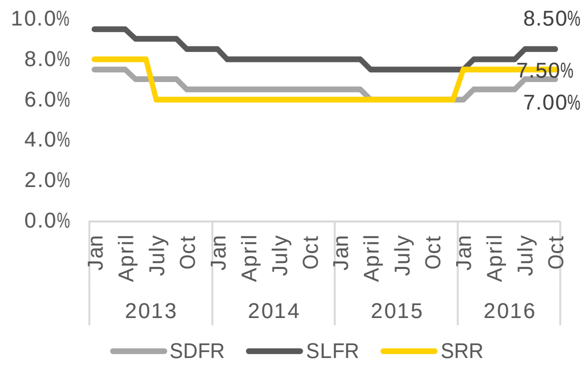
SLFR – Standing Deposit Lending Rate

SRR – Statutory Reserve Ratio

AWPLR – Average Weighted Prime Lending Rate

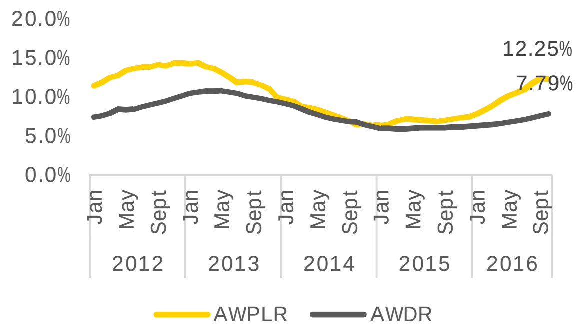
AWDR – Average Weighted Deposit Rate

Government Policy rates



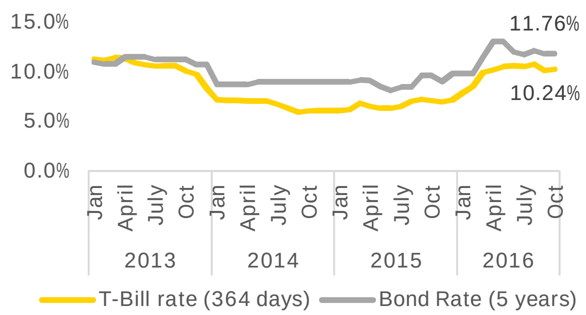
Source: CBSL

Commercial Bank Lending and Deposit rates



Source: CBSL

Government T-Bill and Bond Rates



Source: CBSL

11 Inflation

Inflation measured by National Consumer Price Index (NCPI) shows an increasing trend in 2016. This is further expected to increase in 2017, however remain in mid-single digits with a one off inflationary impact in late 2016 on the back of increase in Value Added Tax (VAT) from 11% to 15%, increase in the Nation Building Tax (NBT) on importers, manufacturers, and service providers from 2% to 4%, and the removal of certain exemptions applicable on VAT and NBT with effect from 01st of November 2016. Currency depreciation over the last few years will also impart upward pressure on inflation.

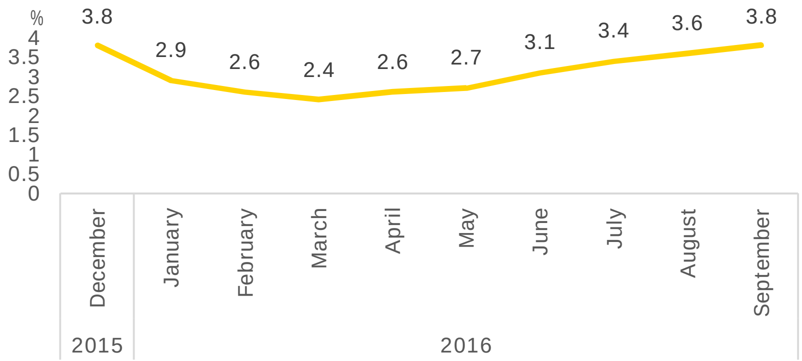
Increasing credit in the economy will also contribute to upward pressure on inflation.

Total credit to the private sector stood at LKR 3,449 billion in 2015. This has increased to LKR 3,798 billion within the first half of 2016.

Further, if the Central Bank directly purchases securities issued by the government to finance the budget deficit it will lead to greater money base growth, creating more inflationary pressure.

Recently the central bank accommodated the foreign sales in treasury bills by injecting liquidity. The Treasury bill stock of the Central Bank moved up from about LKR 210 billion in mid-October to about LKR 234 billion by 04th of November 2016.

Inflation as measured by NCPI



Source: CBSL

3

Corporate Income Tax

1 Three tier income tax rates

In the budget speech delivered by the Hon. Minister it is proposed to implement a three tier income tax rates structure of 14%, 28% and 40%. In this proposal the sectors that would qualify are broadly identified as the lower rate of 14%, the standard rate of 28% and the higher rate of 40%. It is also proposed to remove the exemption from income tax of certain institutions. Although, not specifically mentioned by the Hon. Minister, we have analyzed below the effect of such a proposal on the different sectors of the economy that will be affected due to the proposed three tier structure. Hence, further clarification may be required prior to the implementation of the proposals

Description	Prevailing rate	Propose rate
Agriculture	10% & 12%	14%
Education	10%	14%
Export of goods and deemed exports	12%	14%
SME – Taxable Income below 5Mn	12%	28%
Export of Services (13ddd)	exempt	14%
Tourism	12%	28%
Construction	12%	28%
Entrepot Trade	exempt	14%
Unit Trusts and Mutual Fund and Unit Trust Management Companies	10%	14%
Charitable Institutions, Employees Trust Fund, Provision or Pension Fund	10%	14%
Dividends	10%	14%
Government Securities (WHT)	10%	14%
Corporate Debt Securities (WHT)	10%	14%
Corporate Debt Securities (Quoted) for companies	exempt	28%
Royalty income of non-resident companies	15%	28%
Reduced rate after the tax holiday under section 48	15%	28%
Healthcare Services	12%	28%

In addition to the above sectors we also expect the tax rates to be applied to the following sectors as follows. However, further clarifications may be required.

Description	Section Reference	Prevailing rate	Propose rate
Dividends out of qualified export profits	53	10%	14%
Any Services to an exporter	58	12%	28%
Transshipment agency fees	59	12%	28%
Manufacture of animal feed	45 & 46	12%	28%
Entrepot Trade - operation and maintenance of storage facilities	43	10%	14%
Reduced rate after the tax holiday under section 48 under sec. 18 & 22	48	10%	14%
Any agricultural undertaking referred to in section 16 of the Act	48A	10%	14%
Any partnership	78	8%	14%
Profession or vocation of an entertainer or artiste An entertainer or artiste	96	12%	28%
Income from petroleum exploration	105	12%	28%
Facilities for storage, development of software, or supply of labor		10%	14%

1 Three tier income tax rates - Continued

Description	Section Reference	Prevailing rate	Propose rate
Companies after the expiry of the tax exemption period – under section 16D	48B	12%	28%
Strategic Import replacement undertakings	59C	12%	28%
Branch established for development banking		24%	28%
Research activities defined in section 25(1)(i)		20%	28%
any grower or manufacturer of tea who has established a joint venture with a tea exporter		12%	28%
manufacture (locally) of handloom products		12%	28%
Poultry farming		12%	28%
Supply of goods or services to foreign ships	56B	12%	14%
Sale products manufactured in SL for payment in foreign currency	56C	12%	14%
Alternative energy including mini hydro power projects	59E	12%	28%
Venture capital company		12%	28%
Interest on compensation payable	36	10%	14%
Interest received from any bank deposit	37	10%	14%
Gross interest on loans granted by a company, partnership or other body or persons outside Sri Lanka	38	15%	28%
Royalty payable to any company, partnership or other body or persons outside Sri Lanka	39	15%	28%

2 Unit Trusts

The present income tax rate of 10% on the taxable income of a Unit trust as per the provisions *Section 75 & item 2 (a) of the second schedule*, could be increased to 14 % from the year of assessment 2017/2018 as per proposals.

As per the provisions of the section 10 (1) (b), the 10 % of income tax on dividend distributions is not applicable for a unit trust or mutual fund. However, with the amendment proposed to section 10 (1) (b), the Unit Trust or Mutual Fund is liable for dividend tax at the rate of 14% (as proposed) on its future dividend distributions for corporates. However, such dividend receives in the hands of corporates will be a final tax subject to provisions specified under section 63.

3 Unit holders

The proposed income tax exemption on any dividend paid to a unit trust or mutual fund as per section 10 (1) ((b) of IRA is limited to persons other than corporates. Accordingly, the proposed zero tax position applicable for a Company on dividends received from investments in unit trust or mutual fund, will be removed and such dividend will be taxed at the rate of 14%.

The present income tax exemption on the profits and income accruing to any person from redemption of a unit of a Unit Trust or a Mutual Fund as per the section 13 (tt) will be removed . Accordingly, any person including corporates will be liable for income tax on profits and income from such securities at the maximum rate of 28%.

If the above proposals are implemented, the tax impact from the point of dividend distributed to the Unit Trust and thereafter to the Unit holder is described below.

If the Unit Trust invests in Government Instruments			
Description	Present	Proposed Corporate	Proposed Individual
Interest to Unit Trust (UT)	100.00	100.00	100.00
WHT	(10.00)	(14.00)	(14.00)
Profit	90.00	86.00	86.00
Notional Tax Credit	10.00	-	-
Tax Profit	100.00	86.00	86.00
Income Tax to UT	(10.00)	(12.04)	(12.04)
Net	90.00	73.96	73.96
Dividend Tax to Unit Holders	-	10.35	-
Total Tax	10.00	36.39	26.04

3 Unit holders - Continued

If the Unit Trust invests in Shares			
Description	Present	Proposed Corporate	Proposed Individual
Dividend to Unit Trust	100.00	100.00	100.00
WHT	-	(14.00)	(14.00)
Profit to UT	100.00	86.00	86.00
Tax Profit	NIL	86.00	86.00
Income Tax to UT	-	-	-
Net	-	86.00	86.00
Dividend Tax to Unit Holders	NIL	(12.04)	-
Total Tax	NIL	26.04	14.00

4 Capital allowances claim period extended

It has been proposed to revise the rate of capital allowances in respect of any plant machinery or equipment to 20% from the current rates of 33 1/3rd%, 50% or 100%. In respect of buildings the current rate of 10% will be reduced to 5%. It is expected that the above proposal will be applicable for the acquisition of plant and machinery and construction or the purchase buildings after 1st April 2017.

5 Notional Tax Credit removed

The current notional tax credit which is allowed as a credit against income tax to whom the interest income is not a final tax will be abolished with effect from 1st April 2017. As such, the interest income will be taxable at the normal rate calculated on the net interest received. It is expected that the unclaimed notional tax credit as at 31st March 2017 will be permitted to be carried forward and set off against the income tax of future years.

6 Specified Fees- WHT

It has been proposed to impose a WHT of 5% on all specified fees exceeding Rs. 50,000/= per month. It is expected that more details with regard to conditions to meet the Rs. 50,000/= threshold will be specified when the law is enacted.

7 Financial Transaction Levy

It has been proposed to introduce a new Financial Transaction Levy of Rs. 5 for every Rs. 10,000. At this point of time it is not clear the types of transactions that will be subject to this levy and who will bear the cost of the levy. However, it appears that the levy will be imposed on banks and other financial institutions on the total value of interbank transactions of each such institution. This levy will qualify as an expense for a deduction in arriving at the taxable income. Further clarifications on this levy is expected.

8 Removal of exemptions from Corporate Debt Securities

It has been proposed to remove the current exemption for income arising from listed corporate debt securities and other instruments. Further, clarification will be required whether income arising from other debt instruments such as Sri Lanka Development Bonds etc, will also be liable to income tax.

9 Revision of time bar provisions

- Assessments – Reduced to six months - The current period to issue an assessment is eighteen months from the 30th day of November of the immediately succeeding year of assessment. It has been proposed to reduce this time to nine (09) months.
- Appeals – Reduced to six months - Presently, a time period of twenty four (24) months (from the date on which such petition of appeal is received) is prescribed to the Commissioner General of Inland Revenue (CGIR) to determine an appeal.

Similarly, two hundred and seventy (270) days' time period is also prescribed to determine an appeal at the Tax Appeal Commission (TAC) Act, which commences from the date on which the TAC commences its sittings for the hearing of such appeal.

It has been proposed to reduce the time period to six months in respect of the appeals to both the CGIR and the TAC. Although, the proposed time bar periods place a heavy onus on the tax authorities, it is expected that such revision of time lines will encourage the speedy settlement of appeals.

However, it is our understanding that there is no timeline prescribed under the TAC Act to commence an appeal hearing.

As the above provisions in respect of issuance of tax assessments and appeal procedures applicable to income tax, are at present applicable to Economic Service Charge, Nation Building Tax, Stamp Duty and Income Tax under the PAYE scheme, it is presumed that the proposed changes will apply to such taxes as well.

10 Capital Gains Tax

It was proposed to reintroduce the tax on capital gains arising from the disposal of immovable property at the rate 10% with effect 1st April 2017. At this point of time a further analysis cannot be made in the absence of more details such as the assets that would be liable, exemptions, determination of the gain etc.

4

Investment incentives

The Hon. Minister recognising that investments are key in sustaining and maintaining growth has proposed the following investment incentives.

1 Accelerated capital allowances or reduced rates of tax

Benefit	Criteria
100% of capital allowances	· Not less than USD 3 million investment in fixed assets (excluding land) · Not less than 250 employees · Investment in Uva and Eastern Provinces
200% of capital allowances	· Not less than USD 3 million investment in fixed assets (excluding land) · Not less than 250 employees · Investment in the Northern Province
OR	
Tax rate reduced by 50% for 3 years	· Not less than 500 new employees · Uncertain if a minimum investment of USD 3 mn in fixed assets (excluding land) is required · Uncertain if this is only for Nothern, Uva and Eastern Provinces
Tax rate reduced by 50% for 5 years	· Not less than 800 new employees · Uncertain if a minimum investment of USD 3 million in fixed assets (excluding land) is required · Uncertain if this is only for Nothern, Uva and Eastern Provinces

Benefit	Criteria
· 100% of capital allowance and · 5% of the investment as a tax credit up to a maximum of tax payable –in the 2nd year of commercial operations · If above conditions are maintained for 5 years the government will pay 5% of the original investment	· Not less than USD 5 million investment in fixed assets (excluding land) · Not less than 500 employees (indication that this may be 300 employees) · Generate more than 40% value addition

It is assumed that the above benefits will be extended to both new companies and to expansions carried out by existing companies.

A company which makes a high profit in the first year of commercial operations would get the intended benefit of the accelerated capital allowance. A new company which does not make immediate profits is likely to have a tax loss given this accelerated capital allowance. A tax loss could be carried forward to be set off against future tax profits only up to 35% of the statutory income per year of assessment.

Similarly, a company which makes a high profit in the first few years of commercial operations would get the true benefit of the reduced tax rate. The benefit of a reduced tax rate will be marginalized for a new company which does not make significant profits within the first few years of commencing commercial operations.

2 Special incentive package

Proposed to design a special incentive package with specific tax concessions for Landmark investments of over US$ 100 million and up to US$ 500 million and investments over USD 500 million and above, that will change the landscape of the Country.

3 Entry visa

Proposal to issue a 5 year multi entry visa to such investors and their skilled expatriate labour.

4 Concession to exporters

Where the profits from export in foreign currency increases over 15% or more in the Y/A 2016/2017 compared to Y/A 2015/2016, it is proposed to give a rebate of 75% on the income tax attributable to such *excess* profits only.

5 Relaxation on Land Alienation

Current practice	Proposal
Foreigners are not allowed to purchase condominium property situated below the 4^{th} floor	Foreigners are allowed to purchase condominium property in the first 4 floors as well
Condominium property could be purchased by foreigners only if the entire value is paid upfront through an inward foreign remittance	Foreigners are allowed to raise 40% of the cost from a domestic bank. The debt servicing must be from foreign currency.
Quoted public companies with direct and indirect foreign ownership exceeding 50% cannot purchase land in Sri Lanka	This restriction on quoted public companies with foreign shareholding is to be removed.

6 Incentives for listing

Currently a company listing in the Colombo Stock Exchange prior to March 31, 2017 qualifies for discount of 50% of the tax payable for 3 years. It has been proposed to extend this concession until 2017/2018. Further, such companies will receive a 25% grant of the total amount of tax paid by such company in the previous year.

7 Location of headquarters

Proposal to grant tax exemptions for International organizations and business that locate in Sri Lanka. Currently the profits and income of any institution, established on or after April 1, 2013, by relocating in Sri Lanka the headquarters or regional head offices of institutions in the international network, as specified by the Commissioner-General by Notice published in the Gazette is exempted from income tax. It is uncertain how the proposal would affect the existing exemption.

8 Exchange control

Current practice	Proposal
Legislative enactment	
Inward remittances are regulated under the Exchange Control Act	Inward remittances to be regulated under the Investment Inflow Management Act
Outward remittances	
General permission is given for a non-listed company to invest only USD 100,000 in a foreign company (Gazette Notification 1686/50 dated January 1, 2011)	· Permit apparel companies to invest in overseas entities involved in apparel design and manufacture up to 5% of their average export turnover of the preceding 3 years in any given year. Profits and income of such enterprises established overseas should be remitted back to Sri Lanka. · Persons who have already made investments through the Outward Investment Account (OIA) and has received capital gains on such investments, permitted to re-invest through the same OIA up to 50% on the value of the capital gain received.
Declaration	
A person coming into Sri Lanka must declare foreign currency of more than US$ 15,000.	Increase this limit to US$ 40,000
Foreign borrowings	
Foreign borrowing permitted on the strengths of the balance sheet, provided the exchange risk is hedged. No penalty specified in this regulation (Gazette Notification 1970/8 dated June 7, 2016)	Impose a fine of Rs. 50 million for violating this regulation
Licensed finance Companies need special approval from the Controller. Will not come within general permission under Gazette Notification 1970/8	Grant general permission for Non-Bank Financial institutions to increase the foreign liabilities beyond 35% of the total assets of the balance sheet.

5

Personal Income Tax

1 Employment income (PAYE)

- A significant increase of the income tax rates on employment income has been proposed where the maximum rate of tax which stood at 16% has been increased to 24%. This would result in a 50% increase on the taxes paid on the highest income slab.
- The annual tax free allowance on employment income which stood at Rs 750,000/= will be increased to Rs 1.2 million (Rs 100,000 /= per month) with effect from April 1, 2017.
- The proposals also refer to the removal of the present exemptions on providing transport. The present exemption provided for transport in relation to employment income is
    - either the provision of a company provided vehicle (including fuel and driver) would be exempt or
    - an allowance of Rs 50,000/= in lieu of such benefit would be exempt.

  The removal of this exemption would not have a significant impact on an employee receiving the transport allowance of Rs 50,000/=, as a result of the increased tax free allowance (to Rs 1.2m per annum).
- As per the Gazette issued by the Commissioner General of Inland Revenue the value of a vehicle provided by the employer has been deemed to be a maximum of Rs 50,000/= per month. If this Gazette is going to be applicable, Rs 50,000/= would be the benefit of such a non cash benefit which would be added to the salary of such employee who receives a vehicle from his employer. In such a scenario the impact would be the same as in the case of a cash benefit.
- The rates applicable on the second employment have also been revised from a flat rate of 16% to the following:
    - If the payment is less than Rs 50,000/- per month the rate is 10%
    - If the payment is more than Rs 50,000/- per month the rate is 20%
- The slabs on which the progressive rates were imposed have also been increased from Rs 500,000/- to Rs 600,000/-. The following tables shows the change in slabs and rates.

Year of assessment 2016/17

Taxable income	Rate (%)
Tax free allowance up to Rs.750,000	-
On the first Rs. 500,000	4%
On the next Rs. 500,000	8%
On the next Rs. 500,000	12%
Balance	16%

Year of assessment 2017/18

Taxable income	Rate (%)
Tax free allowance up to Rs. 1,200,000	-
On the first Rs. 600,000	4%
On the next Rs. 600,000	8%
On the next Rs. 600,000	12%
On the next Rs. 600,000	16%
On the next Rs. 600,000	20%
Balance	24%

1 Employment income (PAYE) - Continued

The following illustration shows the total tax liability of an employee receiving remuneration of Rs 10 million per annum prior to the budget proposals and after the implementation of such proposals. The increase in the tax rates result in an overall increase in tax of 39%.

Description	Present – Year of Assessment 2016/2017		Proposal – Year of Assessment 2017/2018	
	Taxable income Rs. '000	Tax Rs. '000	Taxable income Rs. '000	Tax Rs. '000
Tax free allowance including transport allowance	1,350		1,200	
Balance	8,650	1,264	8,800	1,752
Total	10,000	1,264	10,000	1,752

Exemptions provided on certain special allowances to special categories of public sector employees are also proposed to be removed. The details of such exemptions that are to be removed have not been specified.

2 Personal income other than employment income

- Professionals - Income taxes paid by professionals will also increase if the proposals are intended to cover professional income. The tax slabs applicable to professionals prior to the proposals and after the proposals come into effect are given below.

Year of assessment 2016/17

Taxable income	Rate (%)
Tax free allowance Rs.500,000	-
On the first Rs. 500,000	4%
On the next Rs. 500,000	8%
On the next Rs. 24 million	12%
On the next Rs. 10 million	14%
Balance	16%

Year of assessment 2017/18

Taxable income	Rate (%)
Tax free allowance Rs. 500,000	-
On the first Rs. 600,000	4%
On the next Rs. 600,000	8%
On the next Rs. 600,000	12%
On the next Rs. 600,000	16%
On the next Rs. 600,000	20%
Balance	24%

- Interest income
    - The final tax of 2.5% on interest income by way of a Withholding Tax (WHT) deducted by Banks has been increased to 5%.
    - The exemption of interest income from WHT where such interest income was less than Rs 60,000/- per annum has been proposed to be removed. Therefore the 5% WHT would be withheld by banks on all interest regardless of how small such amount is.
    - Interest income earned by senior citizens which was exempt without a restriction has been now limited to Rs 1.5million per annum or Rs. 125,000 per month. Any interest in excess of this amount would be subject to WHT of 5%.

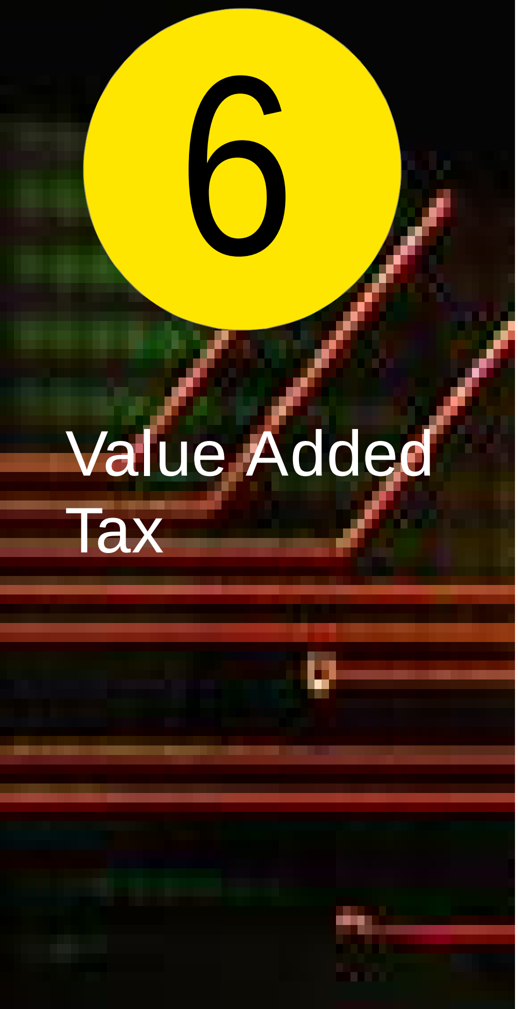
- Other sources
    - Individuals earning income that does not fall within employment income, professional income and interest income on which WHT is deducted would be taxed as follows. The table below shows the tax rates prior to and after the 2017 budget proposals.

Year of assessment 2016/17

Taxable income	Rate (%)
Tax free allowance Rs. 500,000	-
On the first Rs. 500,000	4%
On the next Rs. 500,000	8%
On the next Rs. 500,000	12%
On the next Rs. 500,000	16%
On the next Rs. 1,000,000	20%
Balance	24%

Year of assessment 2017/18

Taxable income	Rate (%)
Tax free allowance Rs. 500,000	-
On the first Rs. 600,000	4%
On the next Rs. 600,000	8%
On the next Rs. 600,000	12%
On the next Rs. 600,000	16%
On the next Rs. 600,000	20%
Balance	24%



6 Value Added Tax

The Hon. Minister of Finance proposed the following changes to the VAT Act with effect from 1 January 2017 (VAT revision on importation of certain items will take effect immediately).

1 SVAT Scheme to be abolished

- SVAT system which was introduced in 2011 to avoid VAT refund claims largely by zero rated suppliers and suppliers under Section 22(7) will be terminated. Consequently, those who were under SVAT scheme will have to pay VAT upfront and claim the VAT refund thereafter from the IRD.
- It is proposed to implement the Post VAT refund audits upon obtaining bank guarantee to minimize delays in VAT refund process.

2 Introduction of e-invoice

Smart e-invoice devices will be provided to VAT registered persons which will make the VAT collection process more simple and efficient.

3 VAT refunds for foreigners

Refund mechanism at ports and airports will be introduced for foreigners who stay in Sri Lanka for not more than 30 days to refund VAT on goods purchased in Sri Lanka.

4 New VAT exemptions

Following supplies will be exempted.

- Locally manufactured dairy products, other than milk powder (previously, this has been restricted to locally manufactured dairy products made out of locally produced fresh milk)
- Supply of geriatric care and child care services
- International telecommunication services provided to local operators by external gateway operators
- Medical machinery and medical equipment identified under specified H.S. Codes.
- Plants, machinery and accessories for renewable energy generation for specified H.S. Codes
- Plant & machinery imported by CEB for generation, transmission and distribution (Previously, import of machinery or equipment by CEB or other institution who supplies electricity to national grid were exempt)
- Electric goods identified under specified H.S. codes
- Magazines, journals or periodicals other than newspapers, identified under specified H.S. codes (currently, magazines and periodicals are liable)
- Import of trans-planters, handweeders etc. used by farmers and farmer cooperatives to improve mechanization

5 Exemptions removed

Exemption on following items is proposed to be removed.

- Locally manufactured milk powder (Currently, only locally produced milk powder without sweetening matters is exempt)
- Gold coins, precious metals and precious stones identified under specific H.S. Codes
- Import or supply of jewelry

7

Nation Building Tax

1 New exemptions

- International telecommunication services provided to local operators by External Gateway Operators.
- Import of Printed books, magazines, journals or periodicals other than newspapers under identified HS Codes. In the absence of specific mention that the exemption applies to subsequent sale of such items it is assumed to be liable to NBT at an effective rate of 1% upon sale.
- Solar panels, modules and accessories under identified HS Codes. The import of these items are already exempt under the NBT Act. Since imports are already exempt it is assumed that the exemptions proposed in the budget is for the subsequent sale of such items which is liable to NBT at an effective rate of 1%. However it is not clear if such items are installed and such value of the items form part of a service contract, whether such service contract (inclusive of the value of these items) would also be exempt from NBT at 2%.

2 Removal of existing exemptions

- Services being construction services including services of sub-contractors. As the law stands this exemption applies to the services provided in respect of constructing any building, road, bridge, water supply, drainage or sewerage system, harbor, airport or any infrastructure project in telecommunication or electricity. It is assumed that this exemption would be removed on construction services in relation to all of the above projects. The effective date for the removal of this exemption would be January 1, 2017. Therefore the basis of computing the NBT liability on construction contacts that have already been entered into prior to this date would have to be evaluated.
- The sale of residential accommodation where the project cost is less than USD10 million is currently exempt from NBT. This exemption has been removed with effect from January 1, 2017. This removal will have no impact on projects where the project cost exceeds USD 10million as such apartments are already liable to NBT at 2%.
- Services of a travel agent in relation to inbound tours. Therefore from January 1, 2017 all sales of any travel agent (whether registered with the Tourist Board or not) in relation to inbound tours would be liable to NBT at 2%.
- Any goods consigned to Sri Lankan Air Lines, Mihin Lanka Ltd or Air Lanka Catering Services Ltd for the purpose of providing services of international transportation.
- Any article imported or sold by any registered society under the Co-operative Societies Law or any Statute enacted by a Provincial Council or Lak Sathosa Limited.
- Services provided by any registered society under the Co-operative Societies Law or any Statute enacted by a Provincial Council or Lak Sathosa Limited.

8

Economic Service Charge

1 New proposals – year of assessment 2017/2018

The Hon. Minister has proposed the following changes with effective from 1 April 2017

- Threshold of Rs. 50 million will reduce to Rs. 12.5 million
- Advance WHT of ESC on import of vehicles

2 Proposals applicable for year of assessment 2016/2017

The proposals listed down below were introduced in the 2016 budget and are currently administratively implemented pursuant to paper notice issued by the IRD dated 8 April 2016. It is presumed that these changes will be legislated effective from 1 April 2016.

- Removal of exclusion on profit making businesses.
- Removal of maximum liability of Rs. 120 million per annum.
- ESC carry forward to claim against income tax reduced to that year of assessment and 2 years thereafter.
- Petrol, diesel and kerosene retail trade liable if aggregate turnover exceeds Rs. 50 million (will reduce to Rs. 12.5 million after 1 April 2017). Tax will be calculated on $1/10^{th}$ of the liable turnover of the trade.
- Advance payment of ESC on persons liable for the Special Commodity Levy.

9

Import point tax

1 Sri Lanka Customs poised for enhanced competitiveness and growth

The proposed initiatives by the Government with the aim of strengthening Sri Lanka's competitiveness in the global market will be hailed by the trading community, as it is set to better Sri Lanka's Customs administration.

- Ratification of the World Trade Organization's (WTO) Trade Facilitation Agreement, which will enhance global appeal for international trade in Sri Lanka through improved speed and efficiency in border procedures.
- With the growth of online transactions, there is a significant loss of revenue to the Government due to inefficiencies in collection of taxes at the point of entry to the country. As such, the Information and Communication Technology Agency (ICTA) will create a common platform, which will be monitored by the General Treasury to facilitate online firms such as Amazon, e bay etc to be able to collect taxes on behalf of the Government of Sri Lanka for transactions carried out in Sri Lanka.
- Rationalization of the duties and taxes imposed at the point of import by the gradual removal of the CESS;
- Establishment of a Valuation Database for approximately 700 commonly imported goods, with corresponding minimum values with effect from January 1, 2017. This initiative will provide reference values at the time of clearing goods. This is expected to supplement the basis used at present for clearing goods for duty purposes, which is the application of the 'Transaction Value' as per WTO Valuation Agreement;
- Issue of Advance Rulings covering the origin of goods, which will assist in the predictability of taxes at the point of import;
- Registration of all importers with the Sri Lanka Customs so as to grant them with appropriate levels of facilitation in the clearance process with effect from January 1, 2017 and the rewarding of compliant importers.
- Risk profiling of Importers enabling low risk importers expeditious clearance;
- To process import documentation within three (3) hours and release containers within 24 hours. Correspondingly, for exports, to process documents and containers within two (2) hours, from the time of submission at the Exports Facilitation Centre. To publish average processing times for import and export documentation and release of goods;
- Pre arrival processing of documentation ensuring just in time delivery of goods for compliant importers.
- Implementation of a 'National Trade Information Portal' to ensure transparency of Sri Lanka Customs practices and procedures;
- Installation of a "Container Scanning System" at the Port and Airport to ensure effectiveness and efficiency in baggage and container clearing process;
- Enhancing and extending the "single window" concept in order to assist the importation, exportation as well as transit of goods;
- Introduction of smart e invoice devices to the Excise Department enabling a more efficient collection process.
- Re-activation of the Sri Lanka Customs Marine Division to curb smuggling activities;

1 Sri Lanka Customs poised for enhanced competitiveness and growth - Continued

Certain changes to Custom Duty, CESS, Ports and Airport Development Levy and Excise (Special Provisions) Duty as set out below have been gazetted with effect from November 11, 2017 and certain other changes are proposed to take effect from November 11, 2017 unless provided otherwise by law. Please refer the Sri Lanka Customs website for the respective changes (www.customs.gov.lk)

2 Customs Duty

- HS Code National Sub Divisions have been created as directed by the World Customs Organization (WCO);
- Duty rates of ninety six (96) tariff lines have been adjusted based on Sri Lanka's rate commitments to the World Trade Organization (WTO);
- Cost of Freight to be determined as 15% of the Free On Board (FOB) value of imported goods, when an importer imports his own goods by his own vessel or an importer imports single goods by using a chartered vessel as a bulk cargo;
- Import licences on lubricants, bitumen and gold will be introduced;
- The bi-annual registration fee payable on lubricant agreements revised to Rs 2.5 Mn or 0.75% of total invoiced sales, whichever is higher. This will be effective from January 1, 2017. The presently applicable upper ceiling to be removed.
- Duty rates to be revised on the following items:
  - Duty on powdered milk to reduce by Rs. 35 per kg;
  - Duty on portable ethanol increase to Rs. 800 per litre;
- The duty on industrial raw materials reduce to facilitate industries and trade;

3 Excise (Special Provisions) Duty

- Extension of the engine capacity based unit rate method for calculating excise duty to Motor Cycles similar to motor cars as introduced in the last budget;
- To encourage local industries, the extension of the age limit for importing Lorries and refrigerated trucks of capacity over five (5) metric tonnes to ten (10) years, with effect from November 11, 2016.
- Introduce safety standards for motor vehicles;
- The Vehicle Entitlement Fee (VEF) is currently paid at the point of opening the LC. It is now proposed to pay the VEF to the Sri Lanka Customs at the point of clearance of the vehicle. A certificate to be issued once such payment is made;
- In an endeavor to reduce environmental problems, a tax incentive has been proposed for the export of vehicles, which are more than five (5) years old. It has been proposed to provide an Excise Duty waiver of 50%, when importing a motor car with a CIF value not exceeding USD 50,000 to any exporter of a minimum of 20 vehicles, with a value not less than USD 200,000;
- Excise Duty on electric cars with motor power less than 100 kw has been proposed to be reduced to encourage green energy;
- Excise Duty will be also imposed on the following items:
  - On beer cans
    - not more than 350 ml at the rate of Rs. 10/- per can; and
    - more than 350 ml at the rate of Rs. 15/- per can
  - On any lottery ticket at Rs. 5/- per ticket

Several other changes implemented to correct anomalies in the duty structure and is proposed to be effective from November 11, 2016;

4 Ports and Airports Development Levy

- PAL at the point of import on printed books, magazines and journals to be removed;
- PAL on pharmaceutical products under HS Code No. 3926.90.80, 9602.00.10 to reduce to 2.5%;

5 CESS

- CESS on the following to increase as follows:
  - Export of Rubber to Rs. 15 per kg;
  - Printing ink identified under HS Code Nos. 3215.11 and 3215.19 to Rs. 30 per kg;
- CESS on hundred (100) identified products to be removed.

6 Excise Duty under Excise Ordinance

- The evaporation allowance of ethanol in the production of liquor to be reduced to 0.15 (wastage 0.10% and evaporation 0.05%) percent from 1.5 percent. This revision has been effected after ten (10) years due to technological advancements that have taken place in the production process;
- To provide assistance to the local manufacturers of spirits, Excise Duty on imported ethanol will be increased. Excise Duty of Rs. 25 per litre introduced for imported non-portable alcohol for the same purpose.
- An annual license fee imposed on importers of Beedi leaves at Rs 5 Mn.
- Excise Duty introduced on the quantum of raw materials used for producing ethanol as given below and it is expected that this would assist in the reconciliation of production of ethanol;

Type of raw material	Proposed Duty Rs.
Molasses	20/- per Lt
Coconut Toddy	10/- per Lt
Maize	20/- per Kg
Rice	20/- per Kg
Any Other	20/- per Kg

7 Other

- The import & export fee of 1% on the CIF price of tea abolished in order to support the tea industry through a more simplified tax & tariff structure.
- Potential identified to position Sri Lanka as an educational hub, a maritime hub in Asia, an aviation hub and a financial hub.
- Further, the import of branded products permitted for enterprises operating under the commercial hub regulation.
- The promotion of aquaculture industry zones in Hambantota, Mannar & Batticaloa.
- Establishment of four (4) free trade zones in Kalutara (Bandaragama), Rathnapura (Embilipitiya), Puttalam and Vavuniya Districts. The target industries for the free trade zones will be Rubber based products, Pharmaceuticals, Fabric manufacturing, Mineral, Chemical and Automotive Industry etc.
- Fifteen (15) export villages to be established focusing on IT, Robotics, Fashion, High end Apparel and Boat Manufacturing.
- Free trade agreements are pursued with Singapore, China, Japan, Korea, Bangladesh and growing markets in Africa.
- An EXIM Bank to be established in 2017.
- Establishment of Dry-ports on a PPP basis;

10

Finance Acts, Betting and Gaming Levy and other fees and levies

1 Finance Acts

The Finance Acts will be amended to revise / impose the following levies and taxes:

- Finance Act, No. 10 of 2015 to be amended to include the introduction of proposed one-off taxes.
- Luxury and Semi-Luxury Motor Vehicle Tax to be revised.
- Introduction of a Financial Transaction Levy of 0.05% on the total transaction value of banks and financial institutions.
- Annual license fee and a fee on voluntary liquidation imposed on companies.
- Vehicle Entitlement Levy to be collected by the Director General of Customs at point of import with effect from 1 January 2017.
- Tele drama Levy applicable on foreign tele dramas dubbed in Sinhala and Tamil or any other language to be increased.
- Embarkation Levy increased to USD 50.
- Case filing fee to be imposed on any person filing a Court case in any Court.
- Annual license fee on firearms of Rs. 20,000 to be imposed on firearms other than those used for agricultural purposes. A penalty of Rs. 5 million to be levied for the use of firearms without the payment of the license fee.
- Import license fee to be charged on the license for the import of lubricants, bitumen or gold.

2 Betting and Gaming Levy

- The Hon. Minister has proposed to increase the annual levy on the business of gaming to Rs. 250 million.
- As per a paper noticed issued by the Inland Revenue Department on 31 March 2016, currently an annual levy of Rs. 400 million is imposed on gaming (other than rudjino) and an annual levy of Rs. 5 million is imposed on rudjino.
- It is uncertain whether the intention of this budget proposal is to actually reduce the annual levy from Rs. 400 million to Rs. 250 million or, to increase the annual fee of rudjino from Rs. 5 million to Rs. 250 million.

3 Other fees and levies

- Traffic offenses to be subject to spot fines of not less than Rs. 2,500.
- A Carbon Tax to be imposed on all vehicles other than electric cars and tractors. Existing emission test fee to be included in this tax.

11

Telecommunication Industry

The Honorable Minister of Finance proposed the following levies and charges on the telecommunication industry.

1 Increase of Telecommunication Levy on internet services

Telecommunication Levy on internet services which is currently at 10% is proposed to increase to 25% in line with the other telecommunication services.

2 Exemptions on international termination services

International termination services provided by external gateway operators to local operators are proposed to be exempt from VAT and NBT

3 Introduction of SIM Card Activation Levy

A SIM Card Activation Levy is proposed to be introduced on new SIM cards at the rate of Rs. 200 per SIM.

4 Surcharge on failure to upgrade infrastructure

All mobile operators are required to upgrade their infrastructure to provide 3G coverage within 6 months. Failure to comply will result in a surcharge of Rs. 100 million per District.

5 Increase of Annual Spectrum License Fee

Annual Spectrum License Fee is proposed to be increased by 25% with effect from 1 January 2017.

6 A company for telecommunication towers

It is proposed to form a company with public private partnership (PPP) to own telecommunication towers as a measure to reduce cost of telecommunication operators.

12

Accelerating growth with social inclusion

In presenting the 2017 budget in Parliament today, the Hon. Minister made a number of expenditure proposals for accelerated growth, social inclusion. These expenditure proposals are given in Annexure II of the budget speech.

Appendix A: Corporate tax at a glance

1 Corporate tax rates

Description	Current	Proposed
All Companies including Banking & Finance, insurance, leasing and related activities (other than those taxed at special rates)	28%	28%
Deemed dividend tax	15%	Same
Income tax on dividends including scrip dividends and dividends in specie	10%	14%
Remittance tax on non- resident companies	10%	14%
Liquor , Tobacco, Betting & Gaming	40%	Same

2 Changes made – special rates, exemption and withholding tax

Description	Current	Proposed
Manufacturers and service providers (SMEs)	12% (Turnover Rs. 750 Mn)	14% (Turnover 500 Mn)
Export of services	Exempt	14%
Export of goods, Indirect exports and Agriculture	12%	14%
Education, Funds (EPF, ETF), Charitable institutions and Withholding tax on Dividends, Treasury Bonds and Treasury Bills	10%	14%
Any other sector taxed at lower rate	10%	14%
Certain dividends and interest or profits from investments on listed securities (Corporate debt securities etc.) and other instruments	Exempt	14%
Dividends received by Unit Holders of Unit Trusts and Mutual Funds for corporate sector	Exempt	14%
Interest on savings accounts of individuals and Charitable institutions	Exempt (total up to Rs. 5,000)	5%
Interest on deposits applicable to senior citizens	Exempt	Exempt up to Rs. 1.5 Mn per annum
Withholding tax on interest income of individuals and Charitable institutions	2.5%	5%
Withholding tax for specified fees exceeding Rs. 50,000/- per month	Not Applicable	5%
Notional Tax Credit on instruments such as Treasury Bills, Bonds or Corporate Debt securities	Applicable and gross interest is liable	Removed and net interest is liable

3 Specific concessions and new tax exemptions

Description	Proposed
Any investment in any trade or business not less than USD 100 Mn with minimum employment of 500	To be announced
Investment in any trade or business not less than USD 500 Mn	To be announced
Exporters where profits from exports in foreign currency increased by 15% or more in YA 16/17 compared to YA 15/16.	A rebate of 75% of the income tax attributable to excess profits
Investment in fixed assets not less than USD 5Mn with minimum of 300 employment.	A tax credit of 5% of the investment for the second year of commercial operation

4 Capital allowances

Description	Current	Proposed
Buildings purchased (conditions apply) or constructed building	10%	5%
Plant Machinery and Equipment (except export industry)	33.33%	20%
Computer hardware, Software and calculating equipment	25%	Same
Commercial vehicles and furniture	20%	Same
Purchase of locally produced software	100%	Same
Intangible Assets excluding goodwill	10%	Same
Bridges, railway tracks, reservoir, electricity/ water distribution and toll roads	6.67%	Same
High tech plant machinery or equipment for energy efficiency	50%	20%
Plant, Machinery or Equipment for upgrading new technology	50%	20%
Plant, Machinery or Equipment for energy efficiency (Alternative source, electricity bill cost should be reduced by 30%)	100%	20%
Plant, Machinery and Equipment for Broker Back Office system	100%	20%
Plant, Machinery and Equipment for export industry (export more than 60%)	50%	20%
Investment in sugar Mills – conditions applied	N/A	100%
Investment in fixed assets not less than USD 3Mn with not less than 250 employment.	N/A	100%
Investment in Northern Province in fixed assets not less than USD 3Mn with not less than 250 employment.	N/A	200%
Investment in fixed assets not less than USD 5Mn with not less than 300 employment.	N/A	100%

5 Value Added Tax

Description	Current	Proposed
VAT Rate	15%	Same
Threshold for VAT Registration	Rs. 3 Mn p.q. Rs. 12 Mn p.a.	Same
SVAT Scheme	Applicable	Removed
VAT Refund mechanism is introduced to foreigners who stays less than 30 days in Sri Lanka on goods purchased by such foreigners	Not in place	To be in place
Following supplies, - Plants, machinery and accessories for renewable energy generation (for certain HS Codes) - International Telecommunication services provided to local operators by EGO - Geriatric care services and child care services - Certain electrical goods (for certain HS Codes) - Magazines, journals or periodicals other than newspapers, (for certain HS Codes) - Medical machinery and medial equipment's (for certain HS Codes)	Liable	Exempt
Following exemptions, - Gold coins, precious metals and precious stones (for certain HS Codes) - Import or supply of jewelry - Locally manufactured milk powder	Exempt	Liable

6 Economic Service Charge

Description	Current	Proposed
Rate on liable turnover (may be retrospectively)	0.25%	0.5%
ESC threshold limited per quarter	Rs. 50 Mn	Rs. 12.5 Mn
Advance WHT of ESC on import of vehicles collected by Customs	Not Applicable	Applicable
A maximum limit of Rs. 120Mn per annum	Applicable	Removed
Period for carried forward of ESC limited to	5 years	3 years

7 Other taxes

Description	Current	Proposed
PAL on printed books, magazines, journals & periodicals	Liable	Removed
A Financial Transaction Levy on total transaction value by the banks or financial institutions	N/A	0.05%
Annual license fee & fee on voluntary liquidation on Companies	N/A	Applicable
Embarkation Levy	USD 30	USD 50

8 Nation Building Tax

Description	Current	Proposed
NBT Rate	2%	2%
Threshold of liable turnover	Rs. 3.0 Mn p.q.	Rs. 3.0 Mn p.q.
Threshold of liable turnover- local procured agricultural produce	Rs. 25 Mn p.q.	Rs. 25 Mn p.q.
Following exemptions, - Any goods being consigned to Sri Lankan Air Lines Ltd, Mihin Lanka (Pvt) Ltd or Air Lanka Catering Services Ltd for international transportation - Any article imported or sold by any society (registered under Co-operative Societies Act or statutes enacted by the provincial councils) or Lak Sathosa Limited - Services of a travel agent in respect of inbound tours registered with the CTB - Construction services including the services of sub-contractors - Sale of residential apartments - Services provided by any society (registered under Co-operative Societies Act or statutes enacted by the provincial councils) or Lak Sathosa Limited	Exempt	Liable
Following articles and services, - Printed books, magazines, journals or periodicals other than newspapers, (for certain HS Codes) - Solar panel modules and accessories under specific HS Codes. (for certain HS Codes - -International telecommunication services provided to local operators by EGO	Liable	Exempt

9 Capital Gains Tax

Description	Current	Proposed
Capital gain - realized gain from disposal of immovable properties	Not liable	10%

10 Financial Transaction Levy

Description	Current	Proposed
Financial Transaction Levy payable at 0.05%	Not applicable	Deductible

Appendix B: Personal income tax at a glance

1 Tax rates on income other than employment income

Taxable income	Rate (%)
Tax free allowance Rs. 500,000	-
On the first Rs. 600,000	4%
On the next Rs. 600,000	8%
On the next Rs. 600,000	12%
On the next Rs. 600,000	16%
On the next Rs. 600,000	20%
Balance	24%

2 Tax rates on employment income

Taxable income	Rate (%)
Tax free allowance Rs. 1,200,000	-
On the first Rs. 600,000	4%
On the next Rs. 600,000	8%
On the next Rs. 600,000	12%
On the next Rs. 600,000	16%
On the next Rs. 600,000	20%
Balance	24%

3 Other employment

Individual employed under several employers liable to tax on profit from other employments as follows;

- If payment per month < Rs.50,000 10%
- If payment per month > Rs.50,000 20%

4 Other provisions on employment income

- All employment benefits including travelling benefit will be liable to PAYE.
- PAYE payable by employees of government institutions and state owned enterprises should not be borne by such institution.
- Terminal benefits- Provident fund (Approved or Regulated) - Exempt
- Withholding Tax on Gratuity, Commuted Pension or any other payment uniformly applicable to all employees may be revised as follows:
  - Retain 10%- if the payment exceeds Rs. 1 million and service less than 20 years.
  - Retain 10%- if the payment exceeds Rs. 1.5 million and service more than 20 years.
- If the above payment is not uniform – Retain 24%.
- Any other payments, which are not uniform other than compensation for loss of office-Retain 24%.
- Compensation for loss of office under non-uniform scheme- Retain 24%.

5 Interest

- Withholding Tax on Interest will be increased to 5%.
- Interest on saving accounts will be liable for Withholding tax irrespective of the amount.
- Interest income in excess of Rs.1.5 Mn per annum of a senior citizen will be liable to income tax

Access our global tax guides

Please visit our global tax guides at http://www.ey.com/gl/en/services/tax/tax-services_access-our-global-tax-guides

Worldwide Corporate Tax Guide (2016)
Summarizes the corporate tax regimes in 164 jurisdictions.

Worldwide VAT, GST and Sales Tax Guide (2016)
Summarizes value-added tax, goods and services tax and sales tax systems in 114 countries and the European Union.

Worldwide Personal Tax and Immigration Guide (2016-17)
Formerly the Worldwide Personal Tax Guide, this guide summarizes personal tax systems and immigration rules for expatriates in 164 jurisdictions.

Worldwide Digital Tax Guide (2016)
This guide offers a thought-provoking look at sector-specific digital business models within several diverse industries, while identifying known and emerging tax and law issues.

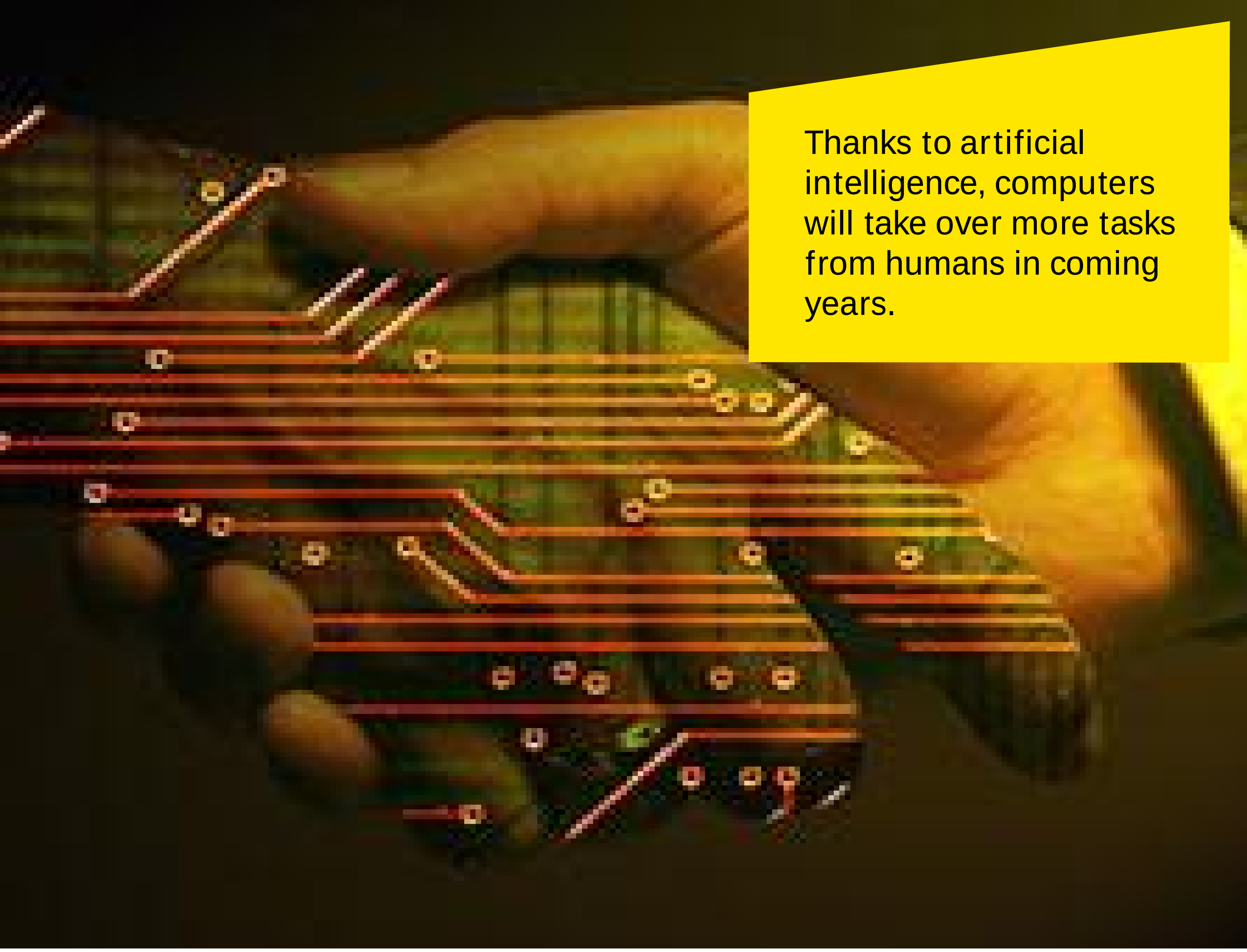
Worldwide R&D Incentives Reference Guide (2014-15)
Our guide offers a description of available benefits, the incentive application process, eligibility and IP jurisdictional requirements.

Global Oil and Gas Tax Guide (2016)
Our annual global oil and gas tax guide summarizes the oil and gas tax regimes in 86 countries.

Worldwide Estate and Inheritance Tax Guide (2016)
Summarizes the estate tax planning systems and wealth transfer planning considerations in 38 jurisdictions.

Worldwide Transfer Pricing Reference Guide (2015-16)
Summarizes the transfer pricing rules and regulations adopted by 117 jurisdictions.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.



EY | Assurance | Tax | Transactions | Advisory

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

For more information about our organization, please visit ey.com.

About EY's Tax Services

Your business will prosper as you build it on a strong foundation and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our global teams of talented people bring you technical knowledge, business experience and consistency, all built on our unwavering commitment to quality service – wherever you are and whatever tax services you need.

We create highly networked teams that can advise on planning, compliance and reporting and help you maintain constructive tax authority relationships – wherever you operate. Our technical networks across the globe can work with you to reduce inefficiencies, mitigate risk and improve opportunity. Our 38,000 tax professionals, in more than 140 countries, are committed to giving you the quality, consistency and customization you need to support your tax function.

All Rights Reserved.

EY
Building a better working world