SRI LANKA

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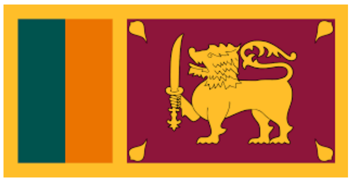

Implementation of New Income Tax Act

With the help of the International Monetary Fund (IMF) team, the Sri Lankan Government introduced the new income tax law to the Sri Lankan tax system by the Inland Revenue Act, No. 24 of 2017. As part of the Government's policy on tax reforms, the Bill for the new Inland Revenue Act was first issued in June, 2017. It was passed in Parliament on 7th September, 2017 and certified on 24th October, 2017 as Inland Revenue Act, No. 24 of 2017 effective from 1st April, 2018.

The main purposes of introducing the new Act were to:

- Consolidate the law relating to income tax
- Simplify the tax law and expand the existing tax base
- Enhance the efficiency and effectiveness of the tax system
- Enhance the level of tax compliance
- Make more taxpayer friendly tax culture
- With the use of international best practices, align the Sri Lankan domestic tax rules with current International rules

When comparing the new Act with the previous Inland Revenue Act No. 10 of 2006, there are several changes can be seen in new Act.

<u>Salient features of new Act:</u>

The new Act consists of two parts. Part I focuses on the statutory provisions relating to the ascertainment of tax payable including specific provisions on tax payments and Part II mainly concentrates on administrative provisions to deal with common application.

In the new Act several income sources are consolidated. The eight sources of income liable to tax under section 3 of the previous Act have been re-classified into 4 sources. They are:

- Employment income
- Business income

- Investment income
- Other income

Under the investment income it introduced the capital gain tax, which was not applicable under the previous Act. Capital gain tax is on the profits from the sale of properties including houses. The capital gain tax will be 10% of the profits and will be calculated based on the market price of the property on 30th September, 2017. However, if the payee lived in the property for more than 3 years, the tax will be exempted.

The new Act limits the exemptions and removes the concessionary rates applicable for most sectors which were given by previous Act. Moreover, tax administration provisions have been strengthened by the new Act.

The annual tax free threshold for PAYE tax under previous tax system was Rs. 750,000. The new tax system increases this threshold to Rs. 1,200,000. According to the new tax system, only those earning a monthly wage of Rs. 100,000 or more are subject to PAYE taxes. In addition, a withholding tax was introduced for the following sources of investment income and several service incomes.

Investment income:

- 5 percent of withholding tax is levied on the interest earnings on bank deposits and it is treated as final withholding tax for individuals
- 10% of gross rent income received to a resident person
- 14% for other investment income – dividends, charges, annuities, royalties, winning from lotteries, betting & gambling

Service income:

- 5% rate is applicable on several service fees with a source in Sri Lanka to a resident individual.
- 14% on service fee or insurance premium with a source in Sri Lanka to a non-resident person.

There are many more changes in the new Inland Revenue Act focusing on higher revenue collection as stated above. With considering those changes, the Sri Lankan tax authority started the processes to implement this new Act. Accordingly, the Sri Lankan tax authority appointed the New Act implementation project team to:

- Conduct internal workshops and public awareness programs
- Prepare guidelines and drafted gazettes
- Prepare forms, circulars and PAYE tables etc.
- Make required changes to RAMIS system

Many provisions of the new Inland Revenue Act are expected to achieve a wider taxation base, reduce tax avoidance and tax evasion, which will help the government to raise revenue in the long term. The extent to which revenue is increased depends not only on the legislation, but on the efficiency of the tax administration. Accordingly, the Department of Inland Revenue of Sri Lanka aims to collect higher tax revenue and wishes to be the highest contributor to the national economy.

The Act will reduce the indirect taxes levied from the people from 80% to 60% and increase the direct taxes from 20% to 40% within three years.

New TVRS Office

Meanwhile, the value added tax on various goods purchased by foreigners arriving in the country will be returned to them at the airport when they depart from Sri Lanka. The new policy (Tourist VAT Refund System) became effective from August 1, 2018. Accordingly, a separate office (TVRS) is located at emigration terminal of Bandaranaike International Airport to make such VAT refunds.