

# BUDGET SPEECH 2003

## Part II

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## **THE BUDGETARY PROPOSALS**

### **REDUCING THE INTEREST COST OF THE PUBLIC DEBT**

I have earlier referred to the national debt, which increased from Rs. 550 billion in 1994 to Rs. 1450 billion in 2001. I also gave you the figures for interest and principal payments. An immediate task is to lower the cost of this existing debt. A large segment of the domestic debt is in the form of short-term facilities with the banking sector. This will be replaced by long-term bonds issued at lower interest rates. The resulting budgetary saving will be Rs. 2 billion.

### **ESTABLISHING PUBLIC DEBT MANAGEMENT OFFICE**

With a view to modernising the way in which our public debt is managed, I propose to establish an independent Public Debt Management Office, which will report directly to the Minister of Finance. For this purpose, a comprehensive Public Debt Management Law will be enacted early in 2003.

It will not be possible to overcome the debt problem overnight. We will have to make adequate provision through a special Fund to meet the future debt obligations that have been incurred in the past.

### **PUBLIC SECTOR EXPENDITURE CONSOLIDATION**

I referred to the administrative reform by which we are rationalising the public sector cadre by eliminating the duplication of functions and not filling vacancies unless essential. Implementing these measures will result in a budgetary saving of Rs. 1.5 billion.

## **COST SAVINGS**

Much wasteful expenditure in the public sector has been identified. Ministries are now required to have their specific proposals cleared by the Cabinet Sub-Committee on Budget and Tenders chaired by the Finance Minister, prior to the budgetary allocation being released. Idle assets of Ministries, other than land and buildings, have to be disposed of. Half of such proceeds could be retained by the Ministry, and the other half paid to the Consolidated Fund. These measures will cumulatively bring an additional saving of Rs. 2.8 billion.

## **TAX REFORM**

Mr. Speaker, every Finance Minister is confronted with the task of balancing the need to provide adequate incentives to non-state sector enterprises, on the one hand, whilst preserving an adequate revenue base to maintain public services. In the last Budget, I outlined the scheme of tax reform envisaged by the Government. This was commenced. I shall now set-forth the further progression of those reforms in the year 2003.

### **Corporate Taxation**

Commencing 1<sup>st</sup> April 2003, the Corporate Tax will be reduced to 30% in the case of companies with a taxable income of over than Rs. 5 million per annum. This measure will cost the Government approximately Rs. 2 billion. However, fifty percent of the tax savings made by such companies in consequence of this reduction will be required to be placed by each company in a Human Resource Endowment Fund.

Companies with a taxable income of less than Rs. 5 million will continue to be taxed at 20%.

## **Human Resource Endowment Fund**

In 2003, this Fund will have Rs. 1 billion accruing to it. The Fund will be managed jointly through a public-private partnership. It will be utilised to provide tertiary education and vocational training to students and youth fulfilling stipulated criteria, and also for the up-grading of skills such as IT of corporate employees. The voucher scheme for deserving students for tertiary education referred to in our Election Manifesto will be implemented through this Fund.

The monies lying to the credit of the Skills Development Fund will be transferred to this Fund. In addition, we are providing Rs. 1,000 Million to the Fund for purchase of equipment under Credit Lines. Repayment will be spread over a period of years. We will discuss with that sector of industry which is presently exempt from tax the contribution they will be required to make to the Fund.

## **Venture Capital Companies and Unit Trusts/Mutual Funds**

A concessionary rate of 20% tax will be applied to existing Venture Capital companies. In the case of new such companies being established on or after 1<sup>st</sup> April 2003, a five year tax holiday and qualifying payment relief will be provided to investors. The object of this measure is to promote investment, foster promising start-ups, and the restructuring of distressed enterprises. The details are given in Annex 1.

For Unit Trusts and Mutual Funds, we shall limit their tax liability to a 10% withholding tax on dividend and interest income with effect from 1<sup>st</sup> April 2003, if they invest in specified areas. Otherwise a tax of 20% will be applied. Unit trust holders will not be taxed again on this same income.

## **Non-Resident Companies**

A remittance tax of 10% will be imposed with effect from 1<sup>st</sup> April 2003, in place of the current system of taxation of remittances.

## **Personal Income Tax**

In the last budget we raised the income tax exemption threshold from Rs. 144,000/- per annum to its present level of Rs. 240,000/- per annum, and also revised the taxable slabs, thus reducing the incidence of personal taxation. We also envisaged reducing the highest rate from 35% to 25% in 2003. However, the difficult fiscal situation as I pointed out earlier does not permit the reduction below 30% with effect from 1<sup>st</sup> April 2003. Although this will result in a revenue loss of Rs. 1.75 billion, this will grant further relief to wage earners and self-employed individuals, and will also result in the tax base getting expanded.

Changes to existing concessions and exemptions on income tax are given in Annex 2.

## **Inland Revenue Special Provisions Act**

The changes I indicated earlier, will bring additional revenue of Rs. 0.5 billion.

## **Public Officers**

Salaries and emoluments received by public officers in their official capacities and employees of qualified international organisations are presently free of tax. This will continue. The method of calculation of tax on their income from other sources is being reconsidered and revised as from 1<sup>st</sup> April 2003, after discussion.

## **Tax Administration**

Income tax procedures are to be simplified in a manner set-out in Annex 3. Simplification of the system is anticipated to widen the tax base and bring in Rs. 150 million in revenue.

## **Ten Percent Withholding Tax on Interest**

As a measure of relief to pensioners and self-employed persons, I propose to raise the tax-free limit on interest received from deposits made in banks and financial institutions from Rs. 72,000/- per annum per deposit to Rs. 108,000/- with effect from 1<sup>st</sup> January, 2003. This will result in a net loss of around Rs. 100 million.

The law will be amended to prevent measures that have been devised by large depositors to avoid just payment of this tax.

## **Debits Tax**

Methods to evade payment of this tax have been devised. In order to arrest this, the debits tax will be made applicable to all accounts. The rate of 0.1% will remain unchanged.

However, as a measure of relief, the tax will not be applied to withdrawals from any account up to a maximum of Rs. 20,000/- per mensem.

These changes will be implemented from 1<sup>st</sup> January 2003. The net gain to revenue is estimated at Rs. 1.6 billion. Administrative measures to improve and simplify the system will be made through an amendment to the Act.

## **Value Added Tax**

The Government is committed to progressively widen the VAT base. As will be appreciated, VAT replaced the Goods and Services Tax and National Security Levy, which had cascading effects. VAT will be extended in the under-noted directions:-

- Banks and other financial sector organisations paid an annual average of Rs. 10 billion on NSL and Turnover Tax. They are presently exempted from VAT resulting in a considerable revenue loss. These institutions will now be subject to VAT at a rate of 10% commencing 1<sup>st</sup> January 2003. The base will be calculated as the total of net profit and expenditure on employee remuneration inclusive of benefits. No input credit will be permitted. In view of the fair method of calculation in that the tax is on net income and wages, it cannot be passed down through the system. This will generate an additional Rs. 2.75 billion in revenue.
- The wholesale and retail sectors will be subject to VAT from 1<sup>st</sup> July 2003 with the same threshold limit of Rs. 1.8 million per annum. The additional revenue will be Rs. 0.8 billion.
- Certain adjustments found necessary in rates and administrative changes are contained in Annex 4.

## **TARIFF POLICY**

### **Import Duties**

The number of items subject to import duty has got reduced from 40% in 1996 to 25% in 2001. This means that effectively approximately 75% of all imports into Sri Lanka are duty-free. These items of course include wheat, raw materials, crude oil and defence-related items, which account for a large share of total imports. It is intended to apply a low rate of duty varying from 2% to 10% on items which are exempt today other than, inter-alia, wheat and crude oil. This will generate Rs. 2 billion in additional income.

### **Surcharge on Imports**

It is not possible to wholly eliminate the existing 20% surcharge in view of the relief given on corporate and personal taxation in the last and present Budgets. Its elimination requires to be phased-out. Phasing-out commencing by the end of 2003 will provide an additional Rs. 2.5 billion in revenue.

### **Tariff Anomalies**

The recommendations of the Tariff Advisory Council appointed by me will be implemented through a Gazette which will be issued today.

Commencing 1<sup>st</sup> March 2003, the tariff provisions of the Indo-Sri Lanka Agreement will come into force.

## **Imports of Vehicles and Machinery**

No imports of road vehicles and agricultural and construction machinery which are more than ten years will be permitted. This is to protect the environment.

## **PORTS & AIRPORTS DEVELOPMENT LEVY**

The international export market has become more competitive. With a view to protecting the competitiveness of our export industry, the Ports and Airports Development levy on all imports that are to be used solely for processing and re-export will be reduced from 0.75% to 0.5% from 1<sup>st</sup> January, 2003.

This measure will reduce revenue by Rs. 600 million.

## **EXCISE TAX**

The Finance Ministry estimates that illicit liquor, much of which has a high alcohol content accounts for nearly 60% of alcohol sales. The resulting health hazards have increased the cost of our public health-care services. There is also a considerable loss of revenue. To remedy this, we intend issuing licences to outlets for the sale of soft liquor but subject to the distance limitations from schools and places of worship. Additionally, tighter controls are being imposed on use of rectified spirits for industrial purposes to eliminate its diversion to the illicit liquor trade.

The under-noted two revisions will also be effected:-

- ❖ Licensing fees paid by Super Markets, Grocery Stores and like enterprises that sell alcoholic beverages and have an annual turn-

over of over Rs. 72 million will be increased from 1<sup>st</sup> January, 2003.

- ❖ With a view to assisting the rural sector, the Tree Tax on Kitul is being re-introduced from 1<sup>st</sup> January 2003, so as to make such tapping legal.

The combined impact will raise Rs. 400 million in 2003.

### **DUTY FREE ALLOWANCE TO MIGRANT WORKERS**

This allowance was increased by the last Budget to US\$ 1,500/- for those who work overseas for over one year. This allowance will now be increased to US\$ 1,750/- effective from 1<sup>st</sup> April 2003.

### **INFORMATION, COMMUNICATION AND TELECOMMUNICATION DEVELOPMENT**

The Government is committed to create an e-lanka where information and communication technologies would be used to the fullest extent in order to make our industries and services competitive in the global economy, and where the benefits of e-Government and related applications are made available to all people in the cities as well as in the rural areas. The Government will also ensure that proper incentives are set in place to increase connectivity in the rural areas.

The telecommunication sector through the 20 percent VAT charged on all bills is a major and reliable source of tax revenue for the Government. The Government will apply the general value-added taxation principles to gross inter-connection payments, international as well as domestic. This charge will not have an impact on

consumers, or on inter-connection payments for domestic calls. The Government also intends to review the current fee structure for radio frequencies as a disincentive for hoarding of frequencies. With regard to numbering systems, the Government will impose a charge on number blocks to discourage inefficient use. These measures are expected to yield Rs 2 billion in 2003.

### **AFFORDABLE HOUSING FINANCE FOR LOW AND MIDDLE INCOME HOUSEHOLDS**

We wish to stimulate the development of the private housing sector for low-middle income households, i.e. those with a monthly income in the range of Rs. 3,000 to Rs. 15,000. The Government will use its long-term institutional savings and status as a preferred borrower, to lower the cost of mortgage credits offered through the banks. The commercial banks will be provided refinancing facilities and interest-offsets to provide loans ranging up to Rs. 500,000/-, with a repayment period of up to 15 years. In the first year, we would expect Rs. 3 billion of additional liquidity, and the Government interest-rate subsidy portion will be around Rs. 300 million. This will provide support for the construction of nearly 10,000 low-middle income homes. Guidelines will be issued with a view to commencing the programme on January 1, 2003.

### **ROAD FUND**

A well-maintained road network is an essential component of good infrastructure. In this budget, we are establishing a Road Fund to be financed from reasonable levies on vehicles. This will be levied at the time of issue or renewal of vehicle licenses (see Annex 5 ). The Fund will be managed by a Roads Board, comprising representatives of the public and private sectors under a Road Fund Act. An estimated Rs. 0.5 billion will be collected for the Fund in 2003, to be used for road repairs and maintenance.

## **INFRASTRUCTURE AND CORPORATE RESTRUCTURING FUND**

Mr. Speaker, the Government plans to establish a Sri Lanka Infrastructure and Corporate Restructuring Fund managed jointly by the State and the private sector. The proposed Fund will mobilize two tranches of US\$ 75 million each, to promote greater investment in infrastructure, and to help restructure distressed companies. A shortage of long-term equity is constraining investments in the infrastructure sector. We expect to raise about half of the financing for this Fund from international capital market institutions. Government would transfer its existing holdings in the Private Sector Infrastructure Development Corporation (PSIDC) to the new Fund, worth approximately US\$ 10 million.

## **WOMEN'S DEVELOPMENT**

In each of the special funds being set-up for sectoral development under these Budget proposals, there will be a separate window for women to access funds. This will be on the basis of principles of disbursement prepared in consultation with the Ministry of Women's Affairs and civil society women's organisations. This initiative is part of the implementation of the Women's Agenda presented by our Party at the general election.

## **SPORTS DEVELOPMENT**

Sri Lankan sportsmen and women have brought us international credit. Cricket and Athletics are areas of special significance. Their success has brought Sri Lanka an international brand recognition for high achievement in competitive sports. Rural youth primarily have given the lead into this international competitive arena. To recognise the achievements of our rural youth, all Maha Vidyalayas which have a high standard in sports, but which do not

have state-of-the-art facilities for training, will be provided resources for this purpose. Secondary schools, especially in the rural areas where soft-ball cricket is popular, will be provided with modern cricket facilities to enable a larger pool of younger talent to emerge at the national level.

A majority of young people in the country do not have facilities for recreation and enjoyment. Therefore the Government will make available a Million Rupees worth of equipment for each electoral division to commence Youth Centres.

### **AN ENABLING ENVIRONMENT FOR PROMOTING GROWTH**

We are committed to providing opportunities for our enterprises to invest, create new jobs, increase wages and boost productivity. Each of these is essential for growth. Six key measures are being taken to widen the scope for private sector investment :

- ◆ Firstly, we are reforming the legal framework of the economy. Commercial laws are being modernised and are ready to be presented to Parliament shortly.
- ◆ Secondly, investment will be made to improve our roads, develop ports in the South and East, and expand our international airport infrastructure.
- ◆ Thirdly, State land in the urban areas which are not required for public purposes and which could be used by the private enterprise for development and middle class housing has been identified, and will be sold on the open market to the highest bidder at commercial prices. We expect to raise Rs 3 billion in 2003 from this exercise.

- ◆ Fourthly, the Government will sell a further part of its holdings in Sri Lanka Telecommunications. We are also opening up the import of petroleum products by issuing franchise licences to two to three petroleum importers. These franchises, plus the sale of the Government's minority stake in various hotels and other small commercial companies, will generate an estimated Rs. 13.5 billion for the Budget.
  
- ◆ Fifthly, certain existing restrictions on current international transactions and capital account transactions will be liberalised. The reforms taken to ease exchange controls are provided in more detail in Annex 6.
  
- ◆ Sixthly, the Government will continue to spread the benefits of economic activity throughout the country. I have already mentioned the five regional zones that will be developed under the auspices of the BOI. An incentive scheme outlined in Annex 7 will be implemented from 1<sup>st</sup> April 2003.

## **ENHANCING JOB CREATION**

In a country with over 90% literacy, providing more jobs is vital. The support we hope to receive from our development partners in Oslo and Tokyo will enable us to embark upon a number of new projects which will create productive employment opportunities in many areas of the country. The main purpose of the Oslo meeting is to obtain additional support in 2003 for our peace dividend in the form of emergency relief for re-settlement, and infrastructure development in the North and East. These funds are not included in the current Budget as the precise amount is yet to be determined. Once finalised, they will be provided through a supplementary estimate. The main purpose of the subsequent meeting in Tokyo is to

discuss medium-term assistance for the core countrywide programs outlined in this Budget.

Job creation requires private sector expansion. This means additional machinery and equipment. But the private sector firms big and small, have gone through hard times. They have liquidity problems. Therefore, with the aim of giving an impetus to the private sector for job creation, the Government will make available Rs. 6,000 million to purchase machinery and equipment by specified sectors on very concessional terms from India. We thank the Government of India for making this credit available on concessional terms. This facility will be available for small, medium and large enterprises. The details of the scheme will be announced by the Government and the scheme will be linked to job creation.

I now pass on to a number of proposals designed to create new jobs in the tourism, plantation, agribusiness, fishing industry and gems and jewellery sectors. Donor funds and credit lines have been established for this purpose.

## **DEVELOPMENT OF THE RURAL ECONOMY**

Mr Speaker, the farming community, the backbone of our Nation, contributes about 15% to our GDP. The Government has already initiated action on several development projects for the economic upliftment of the rural sector. To pursue these projects further and to introduce new projects, a sum of Rs. 600 Million has been identified.

The Rural Economy Resuscitation Fund was established last month to develop small and medium-scale industries and to assist on-going projects including the fishing industry. I propose to allocate Rs. 200 million towards this Fund next year.

Further, with a view to obtaining a higher price for rural produce, in addition to the two economic centres at Meegoda and Embilipitiya, five more such centres will be opened in 2003.

## **TOURIST DEVELOPMENT**

Tourism is a strategic sector. With the cease-fire, there has already been a substantial upsurge in visitor arrivals. We propose to add a US \$ 5 levy for international travel to the existing embarkation tax of US\$ 10 on every international flight ticket to or from Sri Lanka, from 1<sup>st</sup> April 2003. Both the levy and the embarkation tax will be collected directly when flight tickets are issued. This new levy per ticket will be earmarked to finance tourism promotion activities by the Tourism Development Council, a public-private partnership.

In addition, a levy of 1 percent will be introduced on the turnover of all Tourist Board licensed institutions from 1<sup>st</sup> April 2003. The proceeds of this levy will be earmarked for the Hotel School.

## **TEA SECTOR AND PLANTATIONS DEVELOPMENT**

Mr. Speaker, with this budget, we propose to create a new Tea Sector Association, with representatives from the Government and all stakeholders in the sector. This Association shall take-over the regulatory, and market development functions hitherto managed by Government. It will also be responsible for the development of "Ceylon Standards" to differentiate our product from the rest of the teas in the world.

## **AGRO-ENTERPRISE DEVELOPMENT**

Mr. Speaker, in co-operation with a recognized apex body, we will establish an Agro-Enterprise Development Fund. The Agro-Enterprise Development Fund will provide assistance to small and medium scale farmers to improve their agricultural practices, introduce new crops and new technology and maintain village tanks. The Government will initially contribute a sum of Rs. 100 million to the Fund. Discussions are under way to obtain assistance from donors to augment this Fund. Immediately, we will make available to the Fund a sum of Rs. 3,000 million to help farmers to obtain specified agricultural equipment such as drip irrigation, tractors etc.

The Fund will also assist to establish a hybrid seed industry and develop improved varieties of commercial crops such as potato, banana, and pineapple through tissue culture. Since rice is our staple food, we must ensure that sufficient incentives are given to rice farmers to intensify production and improve yields. Government will therefore continue to maintain a farm-gate price of Rs 13 per kg of paddy. Providing improved marketing facilities for fruit and vegetable growers has already commenced.

## **GARMENTS FORUM**

A Forum of the Sri Lanka Apparel Association will be created, as a private-public partnership, to oversee the 2005 transition. They have prepared a plan to advance the industry and overcome the challenges posed by the phase-out of Multi Fibre Association quotas. Design and product development, market support, and factory modernisation will take place with initial capital from the Government.

## **RE-POSITIONING THE GEM AND JEWELLERY INDUSTRY**

A Gem and Jewellery Trade Promotion Council is being established as an apex body to assist in the re-positioning of the industry. The Council will encourage existing banks to establish a gem-trading branch for specialized industry financing. The Government will support industry plans for the establishment of a gemstone laboratory testing facility and industry certification.

## **REFORMING CORPORATE GOVERNANCE**

The Government is committed to the development of the corporate bond market in Sri Lanka, keeping in mind the safety and security of investments made by the public. The crisis faced by the finance companies in the past was largely due to lack of public information from independent sources relating to entities that solicit funds. An effective method of allowing the public to assess the risks involved in their investments is through an overall credit rating of the relevant entity by an accredited rating agency. We therefore intend to make credit rating and publication of such rating mandatory for all deposit taking institutions and all varieties of debt instruments other than those issued by the Government. This will be applicable to all issues exceeding Rs. 100 million, which is not guaranteed by a rating institution. Rating activities including rating fees will be regulated by the SEC. Implementation details are given in Annex 8.

## **DECENTRALISED BUDGET**

This Scheme, in existence for several years, is designed mainly to enable elected representatives of the People to have public funds at their disposal for development activities in the areas they represent. With a view to infusing greater impetus, the allocation for each

Member of Parliament will be increased from Rs. 3.5 million per annum to Rs. 5 million. The existing guidelines and controls will continue.

### **THE BUDGET FORECAST FOR 2003**

Mr. Speaker, if the measures presented above are enacted fully and forcefully, we can begin to regain the progress that our Government is committed to deliver. Annex 9 provides the budgetary out-turns for the years 2002, 2003, 2004 and 2005 in an economic format basis, in Tables 1 and 2 respectively. Table 3 provides the budget out-turn in a summary form for 2003 incorporating the proposals put forward today. Based on the measures outlined above, the fiscal deficit is estimated at Rs. 134 billion or 7.5 percent of projected GDP in 2003.

Accordingly, the gross borrowing requirement for the year 2003 is estimated at Rs. 316 billion. The proposed borrowing limit will encompass all borrowing made by the Government, from domestic and foreign sources.

The combination of a recovering economy and a steady decline in public sector borrowing from domestic banks will reduce inflation and, in so doing, make commodities available at lower prices and provide impetus to development.

### **MY THANKS**

The preparation of this Budget has presented many a difficulty. But assistance has not been lacking. I proffer my thanks to my Hon. Deputy Minister and the Officials of my Ministry for their dedication. The staff attached to my office have toiled diligently. I am grateful to the Hon. Prime Minister for his many useful suggestions. Several trade chambers, professional organisations and trade unions also

forwarded well-considered suggestions. The Hon. Speaker and staff of Parliament have been co-operative in arranging the logistics for today.

## **IN CONCLUSION**

Mr. Speaker, may I conclude with this observation. In the past, Governments have been judged on the quality of the flowery promises they have made. Let us break with the past. We ask that we be judged on the results that we deliver. Our credibility hinges on this. Parliament and the People of Sri Lanka are entitled to hold us accountable to deliver on what we have promised. This is exactly what we shall do. This Budget carves out our work in the coming year, to lay the foundations for peace and economic prosperity that our nation so desperately requires. We are through this Budget taking the best possible measures in the circumstances to undo the defects of the past and build positively for the future, having always in mind the less fortunate members of society.

I thank you.

## **Annex - 1**

### **New Venture Capital Companies -**

Exemption and Investment relief.

- A 05 year tax holiday will be given to new companies commencing operations on or after April 1<sup>st</sup> 2003, if at least 80% of the funds have been invested in specified areas as determined by the Minister. Balance funds (not exceeding 20%) may be invested in global activities of a local company which has foreign subsidiaries or branches. Exchange control procedures will be relaxed in this respect on a case by case basis.
- For investments in new venture capital companies, a qualifying payment allowance to be given up to 50% of the investment, subject to a maximum of 1/3 of assessable income for individuals or 1/5 of assessable income for companies, where the investment per year per person is not less than Rs. 500,000/-.

## **Annex - 2**

### **Proposed Changes in Concessions and Exemptions under the Inland Revenue Act -**

- Exemption of employment income will be limited to employees of public service and personnel of qualified international organizations.
- The taxation of compensation for loss of employment will be modified as follows -
  - Any taxable compensation paid for loss of employment which is not paid under a unified scheme applicable to all employees will be taxed @ 20% w.e.f. April 1<sup>st</sup> 2002 (This was earlier liable as a capital gain @ 25%.)
- The exemption on rent income will be limited to 05 years from the year of construction for houses constructed on or after April 1<sup>st</sup> 2003.
- Dividends out of export profits (section 48) and dividends out of deemed export profits (section 49) will also be taxed @ 10%.
- The exemptions on dividends will be withdrawn w.e.f. April 1<sup>st</sup> 2004 and made liable @ 10% withholding tax.
- The enhanced depreciation allowances given now over and above the economic depreciation will be reconsidered w.e.f. April 1<sup>st</sup> 2004.
- Interest income on extended deposits (section 34) will also be liable to final withholding tax @ 10%.
- All other categories of persons now taxable @ 35% and the category of unspecified persons will also be liable to tax @ 30%. Lower rated activities will not be changed.
- Reward payments to informants and others, including share of fines, paid by the Government to be subject to 10% withholding tax.
- Lottery prizes, gambling and betting winnings etc. not less than Rs. 500,000/- to be subject to withholding tax @ 10%.

- Profits and income earned in foreign currency and remitted through a bank by any resident company which has engaged in management activities abroad to be liable to tax @ 15%.
- Any taxable dividends received by a resident person including a company from outside Sri Lanka to be liable to tax @ 10%.
- Any foreign exchange remittances by an individual which represents net earnings abroad to be taxed @ 15% if remitted to a bank in Sri Lanka.
- Income tax exemptions now enjoyed by Government Corporations etc. engaged in business activities will be withdrawn w.e.f. April 1<sup>st</sup> 2003.
- An Employee Share Ownership Scheme (ESOS) will be implemented w.e.f. April 1<sup>st</sup> 2003 and the income will be recognized when such shares received from the employer as a benefit from employment are realized by the relevant employee. The realization proceeds which should not be less than the market value will be considered as profits from employment and will be taxed without aggregation.
- Five percentum deduction given to certain quoted public companies from the taxable income before computing the tax liability will be withdrawn w.e.f. 1<sup>st</sup> April 2003.
- Where any person is carrying on business activities which are taxable at lower rates as well, they will be required to prepare accounts reflecting income from such activities separately.

### **Annex - 3**

#### **Proposed Changes in Tax Administration -**

- Recovery of default taxes will be limited to 05 years from the year in which such taxes became default subject to holdover provision.
- Time limit for making assessments under the Inland Revenue Act and Value Added Tax Act in cases of evasion or willful neglect or other situations (now unlimited) will be made 05 years from the end of the relevant year of assessment. As a result the period of preserving books and records may not be required after 05 years.
- A simplified tax return will be introduced. The requirement of special audit certificate and schedules will be limited to quoted public companies and other persons or partnerships having turnover exceeding Rs. 250 m. or net profit exceeding Rs. 100m per year.
- Appeal procedure will be simplified to avoid delays for both income tax and VAT. Initial inquiry will be made by an assessor other than the assessor who made the assessment. The time limit up to and including CGIR's determination will be reduced to 02 years. The final settlement of questions of fact including the Board of Review will be within 04 years. A separate office will be setup for the Board of Review.
- The determination of tax liability of non-residents including in areas such as shipping, aircrafts, insurance, construction contracts etc. will be reconsidered in keeping with the current international practices and transfer pricing arrangements.

- No losses will be allowed to be set off against the profits from other activities, unless in case of start up expenses or major improvements.
- All tax rates applicable to income taxation will be given in the schedules to the Inland Revenue Act.
- Any default penalty payable and outstanding as at today will be waived off in full, if the relevant tax has been paid. Where only a part of the tax due has been paid the proportionate amount of penalty will be waived off.

#### **Annex - 4**

#### **Proposed Changes in VAT Law.**

**Invoicing** -The Government institutions, provincial councils, local government institutions, corporations and other statutory bodies to be entitled to receive Tax Invoices under the VAT Act for taxable purchases made by these institutions.

**Finance Leasing** - Lower rate of 10% to be allowed only to finance leasing transactions subject to the following conditions basically -

- Treatment of advance payments @ 20%
- Regulate the structuring of lease installments payments
- Early settlements to be considered as separate supplies

**Import of Computer Software** - Specific software products (given below) and cases where the value of contents separately identifiable in a software imported, to be considered as services and not goods for VAT purposes.

#### **Specific Software Products -**

- Items made to customers special requirements either as unique programme or adaptation for standard programme.
- Inter company information data and accounts.
- Enhancement and update of existing specific programmes.
- Enhancement and up date of existing normalized programmes supplied under contractual obligation to customer who have bought the original programme.

### **VAT on Travelling Vehicles -**

- 50% of input tax will be allowed if the vehicle is used fully or partly in taxable activities.

### **Local Sale of Garments by Exporters -**

Payment of VAT @ Rs. 25 per piece of garment now applicable to BOI companies will be extended to exporters (non- BOI) supervised by the Sri Lanka Customs.

### **Extension of the Deferment Facility -**

Import of ships which will be liable to tax .w.e.f. 1<sup>st</sup> January 2003 will be given a 3 year deferment during which period such deferred amount shall be settled in quarterly installments.

### **Changes in VAT Rates - (w.e.f. 01.01.2003)**

- Services provided by Professional Conference Organizers registered with the Sri Lanka Convention Bureau in organizing seminars etc. - 10%.
- Import or supply of textiles and handloom products-10%
- Import or supply of ships - 10%.
- Import or supply of any jewellery - 10%.
- Import or supply of maize - 10%
- Import or supply of medical and dental equipment and surgical dressings - 10%

### **Other Changes in the Text**

Amendments in the following areas will be made to simplify the administration as well as for purposes of clarity.

Entitlement for monthly refunds, issue of assessments, validity of tax invoices, 3 year time limit for refund claims, excess input tax which is not refundable to any importer-trader to be carried forward to VAT regime and to include definitions on "an exporter", and "a recognized institution" in relation to educational services.

## **Annex - 5**

### **Road Fund**

Annual Fee with effect from 01.01.2003

- Motor Cycles, Motor Tricycles, Motor Tricycle Vans - Rs. 250/-
- Motor Cars, Ambulances, Hearses, Jeeps
  - Not exceeding 1500 cc - Rs. 1000/-
  - Exceeding 1500 cc - Rs. 2000/-
- Lorries - (Gross vehicle weight)
  - Gross vehicle weight not exceeding 15000 kg - Rs. 1000/-
  - Gross vehicle weight exceeding 15000 kg - Rs. 2000/-
- Dual Purpose Vehicles - (Gross vehicle weight)
  - Gross vehicle weight not exceeding 2000 kg - Rs. 1000/-
  - Gross vehicle weight exceeding 2000 kg - Rs. 2000/-
- Land Vehicles - (Tractors/Trailers, Hand Tractor/Trailer) - Rs. 100/-
- Public Passenger Transport Vehicles
  - Not exceeding 30 seats - Rs. 1000/-
  - Exceeding 30 seats - Rs. 1500/-

## **Annex - 6**

### **Exchange Control Liberalization**

#### **A. Current Account Transactions**

##### **1. Payment terms for imports**

To amend existing payment terms stipulated in the Regulation No. 1022/6 of 8<sup>th</sup> April 1998 imposed under the Import Export Act, enabling Sri Lanka Customs to release imports which do not fall within such payment terms including imports on no exchange involved basis over US \$ 1,000 at the discretion of Customs, in terms of Customs regulations without reference to Exchange Control.

#### **B. Capital Transactions**

- 1. Rupee credit facilities to BOI enterprises approved under section 17 of the BOI Act, and, controlled directly or indirectly by persons resident outside Sri Lanka.**

To permit such credit facilities without a limit subject to grant of such credit only by licensed commercial banks, National Development Bank (NDB) and DFCC Bank.

**2. Credit facilities, by suppliers of goods and services not resident in Sri Lanka, to buyers resident in Sri Lanka.**

To permit such credit facilities up to 360 days, at a rate of interest not higher than international market rates, if supplier insists on payment of interest.

**3. Conversion into foreign currency of rupee proceeds realized on the sale of properties mortgaged as securities for foreign currency loans, in settlement of the outstanding balances of such loans in case of default.**

To permit such conversion to the extent of the outstanding balance of the loan without prior approval of Exchange Control on availability of satisfactory evidence with the lending bank to the effect that -

- a) Assessment of credit risk at the time of granting the loan has been properly done; and,
- b) Attempts to sell the mortgaged property against foreign currency to another party have failed.

**4. Forward purchase of foreign exchange in respect of repayment of foreign loans etc.**

To permit such forward purchases up to a limit of 720 days subject to production of evidence of underlying transactions.

**5. Purchase of foreign currency forward from a bank other than the bank establishing documentary credit for imports and collecting import bills on D/A or D/P terms.**

To permit such forward purchases up to 360 days subject to satisfactory documentary evidence being provided to the selling bank about the underlying transaction.

**6. Issue of bid bonds in favour of persons not resident in Sri Lanka in respect of export of goods and services and outward remittances arising out of valid claims.**

To permit issue of such bid bonds without a limit and outward remittances arising out of valid claims over such bonds subject to conditions stipulated in the tender.

**7. Issue of performance bonds in favour of persons not resident in Sri Lanka in respect of export of goods and services and outward remittances arising out of valid claims.**

To permit issue of such performance bonds without a limit and outward remittances arising out of valid claims over such bonds subject to proof of the award of tender as stipulated in the tender.

**8. Issue of letters of guarantee in favour of persons not resident in Sri Lanka, for purposes other than those referred to in items 6 and 7 and outward remittances arising out of valid claims.**

To permit issue of such guarantees upto a value of US \$ 500,000, subject to submission of proof of related transactions and restriction of any claim under the guarantee to the outstanding liability of the transactions and outward remittances arising out of valid claims over such guarantee.

**9. Direct investment by way of opening branch or liaison offices in Sri Lanka by persons not resident in Sri Lanka.**

To permit such investments subject to the requirements of item B (1) above, subject to furnishing evidence of bringing in a minimum capital of US \$ 100,000 or its equivalent in other foreign currencies to Sri Lanka, if the branch/liaison office is to be engaged in commercial activities or undertaking to meet all local expenses out of foreign currency brought into Sri Lanka, if it is not to be engaged in commercial activities.

**10. Purchase of real property in Sri Lanka by persons not resident in Sri Lanka.**

To permit purchase of property for residential purposes against funds out of inward remittances and repatriation of sale proceeds of properties so purchased to investors or heirs up to the extent of foreign currency brought into Sri Lanka for such purchase and for development of the property without referring to Exchange Control, retaining capital gain in an account in a licensed commercial bank in Sri Lanka

**11. Re-naming of the Share Investment External Rupee Accounts as Securities Investment External Rupee Accounts (SIERA).**

To permit renaming of existing Share Investment External Rupee Accounts as Securities Investment External Rupee Accounts (SIERA) and the opening of such accounts for non-resident in respect of investment to be made in equity shares, debentures, government securities and other permitted non-resident direct investment in Sri Lanka.

**Annex - 7**

**Special Incentive Package Proposed under the BOI for the Regional Zones (only for companies)**

**Region - I**                      Western Region

**Region - II**                     Other regions

<b>Type of Industry</b>	<b>Qualifying Criteria</b>	<b>Fiscal Incentive</b>
A (i) Manufacture and Export of goods including deemed exports(Non-traditional)	Exports 80% or more Investment - US\$ 150,000 - (Rs.15 mn Approx)	Region I 03 year tax holiday, 4 <sup>th</sup> and 5 <sup>th</sup> year 10% tax, 6 <sup>th</sup> year onwards 15% tax Region - II 05 year tax holiday, 6 <sup>th</sup> & 7 <sup>th</sup> year 10% tax, 8 <sup>th</sup> year onwards 15% tax
A (ii) Expansion of Existing undertakings for export of goods as mentioned above	Investment - Rs.100 mn if no relocation - Rs. 50 mn if relocated in Region II	2 year tax holiday and thereafter the rates applicable to the activity
B. Agriculture, Fisheries and Agro processing (other than tea and prawn culture)	Investment - US\$ 10,000 - (Rs.1 mn Approx)	Region I and II 05 year tax holiday, 15% from 6 <sup>th</sup> year onwards
C. Industrial tool & machinery	Investment - US\$ 150,000 - (Rs. 15 mn Approx)	Region I 03 year tax holiday, 4 <sup>th</sup> and 5 <sup>th</sup> year 10% tax and 6 <sup>th</sup> year onwards 20% Region II 05 year tax holiday, 6 <sup>th</sup> & 7 <sup>th</sup> year 10% and 20% thereafter;
D. Small scale infrastructure (Power generation, Tourism and recreation, Warehousing and Cold Storage, Garbage collection and/or disposal, Construction of houses Construction of hospitals	Investment - US\$ 500,000 - (Rs. 50 mn Approx)	Region I 03 year tax holiday, 4 <sup>th</sup> and 5 <sup>th</sup> year 10% tax and 20% thereafter Region II 05 year tax holiday, 6 <sup>th</sup> & 7 <sup>th</sup> year - 10% and 20% thereafter.

<p>E. Large scale infrastructure- (Power generation, Transmission and distribution, Development of highways, Sea ports, Airports, Rail transport, Water services and other infrastructure projects and to establishment of Industrial Estates)</p>	<p>Investment -  (i) US\$ - 10,000,000 (Rs.1,000 mn Approx)  (ii) US\$ - 25,000,000 (Rs.2,500 mn Approx)  (iii) US\$ - 50,000,000 (Rs.5,000 mn Approx)  (iv) US\$ - 75,000,000 or above (Rs.7,500 mn Approx)</p>	<p>Region I and II  (i) 06 year tax holiday and 15% tax from 7<sup>th</sup> year  (ii) 08 year tax holiday and 15% tax from 09<sup>th</sup> year  (iii) 10 year tax holiday and 15% tax from 11<sup>th</sup> year  (iv) 12 year tax holiday and 15% tax from 13<sup>th</sup> year</p>
<p>F. Rehabilitation of non-performing or under-performing industries (criteria to be determined)</p>	<p>Existing companies can submit proposals for approval which should include provisions regarding statutory liabilities</p>	<p>Region I and II  03 year tax holiday and 15% or 20% tax from the 4<sup>th</sup> year depending on the activity</p>
<p>G. Companies engaged in Research and Development - (In relation to any trade or business)</p>	<p>US\$ 50,000 (Rs. 5,000,000 Approx)</p>	<p>Region I and II  05 year tax holiday and 15% tax from the 6<sup>th</sup> year</p>

**Note 1:** Tax holiday period referred to above will commence from the year of commercial operations. However, this period will be extended for a further period of maximum 2 years depending on the year of profit making, other than for A(ii) above.

**Note 2:** In the case of A (ii) and (F), investments must be completed by 31.03.2004 to obtain the above relief.

## Annex - 8

### Credit Rating

The following institutions will be required to obtain a credit rating by the specified dates:

<b>Category of Institution</b>	<b>Credit Rating Completion Date</b>
Licensed Commercial Banks and Licensed Specialized Banks	1 January 2004
Registered Finance Companies	1 January 2005
Leasing Companies that raise funds by issuance of debt instruments to the public	1 January 2005
Private Companies that raise funds by issuance of debt instruments to the public	1 January 2006

**Annex : 9****Table 1****Revised Budget Outturn 2002 ( Economic Classification )**

<b>Item</b>	<b>Rs Billion</b>	<b>As a % of GDP</b>
Total Revenue	262	16.8
Tax Revenue	226	14.5
Non- tax Revenue	36	2.3
Total Expenditure and M	-402	-25.7
Recurrent Expenditur	-330	-21.1
Public Investments	-72	-4.6
Restructuring	-5	-0.3
Other	5	0.3
Current Account Deficit	-68	-4.3
Overall Budget Deficit	-140	-8.9
Financing <sup>1</sup>	140	8.9
Foreign Grants	7	0.5
Net Foreign Borrowin	32	2.1
Net Domestic Financi	79	5.1
Divestiture Proceeds	21	1.3

  

Debt/GDP Ratio	105.3
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Note:

1. Relative changes may occur in the individual financing items

**Table 2**

**Summary of the Medium Term Budget 2003 - 2005 ( Economic Classification )**

Item	2003		2004		2005	
	Rs Billion	As a % of GDP	Rs Billion	As a % of GDP	Rs Billion	As a % of GDP
Total Revenue	304	17.1	366	17.9	433	18.7
Tax Revenue	265	14.9	325	15.9	385	16.6
Non- tax Revenue	39	2.2	41	2.0	48	2.1
Total Expenditure and Net Lending	-438	-24.6	-498	-24.4	-563	-24.2
Recurrent Expenditure <sup>1</sup>	-345	-19.3	-368	-18.0	-392	-16.9
Public Investments	-95	-5.3	-133	-6.5	-174	-7.5
Restructuring	-5	-0.3	-6	-0.3	-6	-0.3
Other	7	0.4	8	0.4	9	0.4
Current Account Deficit	-41	-2.3	-2	-0.1	41	1.8
Overall Budget Deficit	-134	-7.5	-132	-6.5	-129	-5.6
Financing <sup>2</sup>	134	7.5	132	7.4	129	7.3
Foreign Grants	9	0.5	9	0.4	9	0.4
Net Foreign Borrowings	25	1.4	42	2.0	44	1.9
Net Domestic Financing	87	4.9	76	3.7	69	3.0
Divestiture Proceeds	14	0.8	5	0.2	8	0.3
GDP Growth ( % )	5.5		6.5		6.8	
Debt / GDP Ratio	101.5		95.0		89.6	

Notes:

1. The discount element on Treasury Bonds has been treated as interest. Interest payments in the Draft Budget Estimates 2003 have been revised to include Rs.1,015 million interest payment on planned US\$ 250 mn borrowing. Further, due to the reduction in the government overdraft and reduction of interest rates in the second half of 2002 have resulted in a saving on interest payment. Due to the above reasons the combined effect on debt service payments amount to a saving of Rs. 3,302 mn.

2. Relative changes may occur in the individual financing items

**Table 3****Summary of the Budget Estimates - 2003**

(Rs. Billion)

<b>Total Receipts ( excluding borrowings)</b>		<b>339</b>
Revenue	316	
Divestiture Proceeds	14	
Foreign Grants	9	
<b>Total Payments</b>		<b>-649</b>
Recurrent Expenditure	-333	
Capital Expenditure	-118	
Debt Repayments	-196	
Advance Accounts	-2	
<b>Gross Borrowing Requirement in Terms of Book Value</b>		<b>311</b>
<b>Add:</b>		
<b>Additional On Lending to Private Sector Development Loans</b>		<b>5</b>
<b>Total Gross Borrowing Requirements in Terms of Book Value</b>		<b>316</b>