



BUDGET HIGHLIGHTS

2012

3rd Budget in Post War Sri Lanka

65th Budget in Post-Independence Sri Lanka

34th Budget of Democratic Socialist Republic of Sri Lanka



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INTRODUCTION

The finance and planning minister for the Government of Sri Lanka presented the budget proposal for the year 2012 on the 21st of November 2011. The budget focus is mainly towards the long-term socio economic development of the island. The government will specifically target Exports, health, education, agriculture and tourism etc., to achieve their objective of an 8% GDP growth for the year 2012.

The focuses on the socio economic factors are to be approached through the increase in the per capita income levels. The current per capita income is USD 2800; the government expects to increase the per capita income to USD 4000 by the year 2016 this will be achieved through the planned 8% growth in the economy. The budget has allocated 496Bn in light of social welfare and over all development. This will be achieved through programs such as “Divi Neguma”. Further the budget has proposed to start a fund worth LKR 50Mn to aide fulltime artists, Journalists and writers who face economic difficulties.

The government plans to reduce the budget deficit from 8% of GDP to 6.4%. The estimated budget deficit is recorded as USD 4.2Bn. The islands inflation has dropped to 5% from the previous year’s 8%; the global economic crisis and the global commodity price increases might create inflationary pressures in the market, but the government is confident that they are capable of maintaining low and stable inflation levels.

The unemployment level has reduced to 5% from the previous year’s 8%, further the government has been successful in reducing the poverty level with in the island and has reduced the population living below the poverty line to 8.9% in contrast to the previous year’s 15.6%. The budget has proposed to increase the wages of the government servants and security personnel (Military personnel) by 10%, further the allowance given to pensioners is proposed to be increased.

The budget has proposed to devalue the rupee by 3% in an effort to encourage exports from the island amidst the country is experiencing a continuous heavy trade deficit. The central bank will still maintain the US dollar peg; the imports will potentially get affected by the devaluation as imports become more expensive. This will lead to the islands balance of payment to decrease its trade imbalance. The government stated that the island has achieved self-sufficiency in the production of rice. In light of make the island self-sufficient in agricultural commodities the budget has proposed to increase the CESS for import of commodities such as green grams, peanuts, ginger, corn etc. to encourage local cultivation of necessary commodities. The budget has proposed to allocate LKR 230Bn for defense expenses, of which 88% is to be utilized for military personnel remunerations, food and clothing. The overall proposed budget will record LKR 1.6 trillion (USD 14.5Bn) expenditure, and will only generate a projected revenue of LKR 1.13 trillion (USD 10.2Bn). Therefore, the proposed budget will result in an estimated budget deficit of USD 4.2Bn which supposed to be financed from both domestic & foreign borrowing sources.

Government's Focus on 2012 Fiscal Proposals

Focus on Domestic Industry, Export Development & Import Substitution

- Moving towards a self-sufficient economy by improving agricultural productivity in items such as rice, coconut, tea, rubber, and spices.
- Increased exports focus on finished goods and services in order to increase export income.
- Depreciation of the domestic currency by 3% in order to increase competitiveness in the global market.
- Reducing import expenditure by incentivizing the manufacture of import replacements by local producers.

Tourism & Foreign Employment

- Establishment of electronic visa facilities and simplifying the Visa Fee structure.
- Conservation and promotion of archaeological sites and other sites and facilities of tourist interest such as art galleries.
- Development of sanctuaries and wildlife parks located island – wide as tourist attractions
- Exploitation of foreign employment opportunities for Sri Lanka

Investment in Human Capital and Infrastructure Development via Private –Public Participation

- Investment in the development of national road networks, transportation systems including domestic airports.
- Expanding access to essential utility services such as drinking water, electricity and transport.
- Development of 1000 high quality secondary schools and modernization of primary and secondary schools vocational education programs.
- Incentivizing institutes engaged in research and technology and promotion of Information Technology
- Building infrastructure such as sport complexes needed to project Sri Lanka as a sport hub in the Asian region.
- Modernization of government institutions by relocation and increased use of information technology

Budget Proposals – Major Highlights

Agriculture & Forestry

Value Added Tax (VAT)

It is proposed to exempt the following from VAT

- The import of Green Houses, Poly Tunnels and materials for the construction of green houses and poly tunnels by growers.

Value Added Tea

- A grower cum manufacture or a manufacture of tea, who establishes a joint venture with a tea exporter for the purpose of exporting pure Sri Lankan tea, in value added form, with a Sri Lankan brand name, will be eligible to be taxed at the rate of 12% on the manufacturing income on tea sold.

Incentives

- Develop 4 rice exporting zones in South, East, Rajarata and North.
- Tax concession for those willing to set up modern rice processing mills in those zones.
- Removal of taxes imposed on food produced from Coconut, Palmyrah, and Kithul
- Subsidy given to tea smallholders for replantation and new plantation increased.

Financial Services

Income Tax

- Profits and income of a newly set up branch of a commercial bank dedicated to **development banking** of SMEs is proposed to be taxed at a concessionary rate of 24% opposing to the current tax rate of 28%

Exemptions for Unit Trusts and mutual funds

- Profits and income from the redemption of a Unit of a Unit Trust or Mutual Fund is clarified to be exempt from income tax.

Exemptions for interest paid on foreign loans

- Interest accruing to any person or partnership outside Sri Lanka on a loan granted to any person or partnership in Sri Lanka is proposed to be exempt from income tax.

Healthcare & Pharmaceuticals

Income Tax

- Concessionary tax rate applicable for healthcare services is reduced to a maximum of 12%

Value Added Tax

- VAT exemption on imports of pharmaceutical machinery and spare parts for manufacturer of pharmaceuticals

Tourism

Income Tax

- The tax holiday regime of three years stipulated has been extended to new enterprises engaging in tourism activities, provide that the investment is made on or before 31st March 2015 and the investment is not less than LKR 50 Mn.

Value Added Tax

- Products using locally produced raw materials which are supplied to tourist hotels and airlines have been made exempt from VAT with effect from 01st January 2012.
- VAT removal for tourist buses

Custom Duty & Cess

In order to promote Sri Lanka as tourist destination Customs Duty/ Cess have been reduced on branded and other goods of tourists interest such as footwear, glassware, ornamental porcelain & ceramic products, cutlery, sunglasses and hair accessories etc.

Visa Fees

Sri Lankan Visa Fees have been revised in the following maner

- SAARC Countries US\$ 10
- Other Countries US\$ 20
- Less than 48 hour Visas – No Charge
- Children exempt from Visa Fees

Textiles & Apparel

Strategic Import Replacement Enterprise

- An enterprise which locally produces fabric replace importation of fabric with an investment of US\$ 5 Mn would enjoy income tax exemptions and concessions.

VAT Exemptions

- VAT exemptions for domestic manufacturers of fabric (not enjoying BOI concessions)

Import Duty

- Duty was reduced on importation of yarn

Power & Energy

Income Tax

- Accelerated depreciation from 33% to 50% on energy efficient machinery as deductions under corporate tax in determining profits.

Value Added Tax

- Exemptions on the import of machinery for manufacture of bio mass briquettes and pallets by the manufacturer of such products.
- Exemptions on the supply of locally manufactured Hydropower machinery and equipment and Turbines.

Customs Duty

- Customs duty has been removed on import of Lamps/ LED mounted in one housing and solar lanterns and sets for decorative lightening from previous rates of 15% and 30%

Motor Vehicle & Transport

Value Added Tax

- VAT is exempted for the import or supply of Lorries, Trucks and Buses under specified HS Codes

Nation Building Tax

- NBT is exempted to Importation of air crafts or ships under specified HS Codes

Import Taxes

- Import duties on tyres used for buses and lorries proposed to be reduced by 50%

Vehicle Registration Fees

- Vehicle registration fees for luxury vehicles were increased by 50% for 1st year of registration, 27% for second year and 10% for third year of registration etc.

Telecommunications, IT & BPO

Levy on International Call Charges

- Outgoing international calls : Increased from Rs 2 per minute to Rs.3 per minute
- Incoming International calls : increased from USD 0.07 per minute to USD 0.09 per minute

IT & BPO

- New enterprises engaged in IT or BPO activities will be entitled to an exemption of 3 years provided an investment of LKR 50 Mn is made in acquisition of fixed assets prior to 31st March 2015

Effective Dates of Proposed Amendments

Amendments	Effective Date
<i>Income Tax</i>	<i>1-Apr-12</i>
<i>Economic Service Charge</i>	<i>1-Apr-12</i>
<i>Value Added Tax</i>	<i>1-Jan-12</i>
<i>Nation Building Tax</i>	<i>1-Jan-12</i>
<i>Telecommunication Charges</i>	<i>1-Jan-12</i>
<i>Visa Fee</i>	<i>1-Jan-12</i>
<i>New Registration of Motor Vehicles</i>	<i>24-Nov-11</i>
<i>Luxury Motor Vehicle Tax</i>	<i>Immediate Effect</i>
<i>Cess</i>	<i>Immediate Effect</i>
<i>Ports and Airports Development Levy</i>	<i>Immediate Effect</i>
<i>Exercise Duty</i>	<i>Immediate Effect</i>
<i>Customss Duty</i>	<i>Immediate Effect</i>

Plantation Sector

Taking back of 37,000 Ha of unutilized lands by plantation companies and to redistribute amongst small holders to the maximum 2 acre each on 30 year lease basis.

Economic Service Charge threshold was increased to LKR 50Mn revenue per quarter from LKR 25Mn revenue per quarter

Macro-Economic Impact

The economic impact of the Budget seems positive in our opinion since there is no any major additional tax burden on business activities as a whole which stem the business community to grow continuously under the backdrop of high government commitment on infrastructure development.

The most significant and immediate impact would be the devaluing the LKR against the US\$ by 3%, signaling the government's active intervention in the economy. However, this move will stem the exporters to be more competitive in the global market coupled with the other tax holidays and incentives granted towards them through this budget proposal. Therefore, this budget seems exporter friendly while discouraging imports through imposing import tariffs on various commodities coupled with promoting import substitute businesses amidst the country's trade deficit standing at staggering USD 6 Bn for the first 8 months of the year leading to a foreign exchange crisis if it fails to attract more foreign direct investments to the country. Therefore, the increased focus towards exports compared to previous 2011 budget could be considered as a timely move while safeguarding the country's foreign reserves despite domestic inflationary pressures that could be expected due to imports becoming more expensive, as to Sri Lanka been an import dependent economy, mainly due to the ever increasing oil bill. This could result in a possible medium term interest rate hike. Further, the largest portion of the budget deficit of USD 4.2 Bn is expected to be financed by domestic non-bank sources, intensifying upward pressures on medium term interest rates of the country. Moreover, the cheap rupee could result a negative impact on foreign investments but the devaluation cannot be treated as a major impact on the investment climate since the foreign investments mainly focus on the long-term growth momentum of the country with a minimum risk.

Further, the leisure sector, healthcare sector, manufacturing sector, could be considered as the winners of this budget. Further, the development banking sector was also supported by income tax reductions.

Moreover, the nationalization of unutilized 37,000 hectares of lands from plantation companies with the view of re-distributing amongst small holders will create practical implementation problems. Further, this government intervention coupled with the controversial expropriation bill will create a grim outlook for investment climate in the economy while exhibiting wrong signals to the more anticipated and essential Foreign Direct Investments (FDI). Therefore, in our view the government has to address this issue immediately by been more informative about government's intentions towards the investment climate to make the development plans a reality.

Potential Impact on Business Entities

Export Oriented Companies

All export oriented companies as a whole will fall under winner's category due to the devaluation of LKR by 3% specifically the companies such as Dip Products PLC, Textured Jersey.

Import Dependent Companies

The companies which depend on imported raw materials will experience an adverse effect due to the fall of rupee value prompting the cost of sales to go up while reducing margins. On the other hand, we expect the growth in the domestic economy with the emergence of new markets such as the North & East. This will stem the volume growth while ensuring the overall profitability. Further, industries such as Cables will solely depend on imported **Copper**; therefore, will experience a low margin but the rapidly growing construction activities in the country will have a positive impact on the bottom-line.

Commercial Banking

Commercial Banks' newly setup branches with more emphasis on the SME & Development banking will be taxed at concessionary 24% as opposed to the 28% charged previously. Therefore, banks that have high focus on SME & Development Banking will be benefited.

Healthcare Service Providers

All hospitals will experience a low tax burden on their bottom line since the corporate tax rate of healthcare providers is proposed to be cut down to a concessionary 12%.

Plantation Companies

Plantation companies will be negatively affected due to the loss of 37,000 Hectares of land but this will not lead to hamper the current corporate earnings since this will not apply for the revenue generating land area.

Telecommunication Companies

Telecommunication companies will experience a difficult time ahead with the escalation of tariffs for both outgoing & incoming international calls.

Way Forward

In conclusion, Budget 2012 has created an environment for the business community to grow with high expectations amidst the rapidly growing infrastructure developments in the county. Further, this will lead the local business to experience an increase in their operations which will result to record higher earnings. Therefore investors will be attracted towards these businesses which could lead to an inflow of investments. But this will only incur if the investors are confident about the overall business and economic stability within the island. However the government's full commitment for the economic growth and the its efforts to create an investor friendly environment will help to reach the growth targets.

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