Box 19

Major Economic Policy Changes and Measures: 2005-2006[a]

Real Sector

03 January 2005	– Unemployed graduates (42,588) who participated in the special orientation programme, were posted to Ministries as trainees (formal training).
04 January 2005	– Sri Lanka Railway Authority (Repeal) bill was approved by the Parliament to re-establish Sri Lanka Railways.
15 March 2005	– A new compensation formula was gazetted by the Commissioner-General of Labour under the Termination of Employment of Workmen (Special Provisions) Amendment Act.
30 March 2005	– A new bank was established by the government for the development of the SME sector.
01 April 2005	– The government initiated a housing loan scheme for government employees.
	– The value of the fertiliser subsidy was revised downwards from Rs.23,000 per metric ton to Rs.22,000 per metric ton.
04 May 2005	– Retail prices of petrol, diesel and kerosene were increased by Rs.6.00, Rs.4.00 and Rs.3.00 per litre to Rs.74.00, Rs.46.00 and Rs.28.50 per litre, respectively.
01 June 2005	– Uva Wellassa University was established.
05 June 2005	– Retail prices of petrol, diesel and kerosene were increased by Rs.6.00, Rs.4.00 and Rs.2.00 per litre to Rs.80.00, Rs.50.00 and Rs.30.50 per litre, respectively.
10 June 2005	– Passenger bus fares were increased by 15 per cent.
23 June 2005	– A bill was passed in the Parliament to restrain coconut land fragmentation.
08 July 2005	– The Institute of Aesthetic Studies was elevated to the University of the Visual and Performing Arts.
13 July 2005	– Cabinet approval was granted to introduce gliricidia as the fourth plantation crop to establish agro energy plantations to develop dendro power in Sri Lanka.
01 August 2005	– Rail fares were increased by about 50 per cent.
10 August 2005	– The value of the fertiliser subsidy was increased from Rs.22,000 per metric ton to Rs.23,000 per metric ton.
	– The Kapruka Fund bill was passed by the Parliament to increase coconut production and upgrade the coconut industry in Sri Lanka.
30 August 2005	– The Sri Lanka Transport Board (SLTB) bill was passed by the Parliament.
28 September 2005	– Sri Lanka Transport Board (SLTB) was re-established.
November 2005	– Reconstruction and Development Agency (RADA) was established to facilitate the government's reconstruction and development efforts in all districts affected by natural disasters.
05 December 2005	– The fertiliser subsidy was raised leading to a recorded price of Rs.350 per a 50 kg bag of all varieties of fertiliser used by paddy and vegetable farmers.
15 April 2006	– Retail prices of petrol, diesel and kerosene were increased by Rs.8.00 each per litre to Rs.88.00, Rs.58.00 and Rs.38.50 per litre, respectively.

External Sector

Trade and Tariff

01 January 2005	– The 10 per cent surcharge on customs duty on all imported goods, except for some selected items, was extended till 31 December 2005.
03 January 2005	– The dutymaiver of Rs.9.00 per kg granted on rice imports was extended up to 15 January 2005.
01 March 2005	– A cess was imposed on selected imported items such as maize, chocolate and cereal products under section 14 of the Sri Lanka Export Development Act, No. 40 of 1979, in addition to the cess imposed on 04 November 2004.

(a) This includes major economic policy changes and measures implemented during 2005 and the first 4 months in 2006. Policy changes and measures that have been announced and are to be implemented in 2006 are also included.

Box 19 (contd.)

01 June 2005	– A scheme for granting duty free concessions for the importation of new machinery utilising advanced technology was introduced by the Ministry of Advanced Technology and National Enterprise Development.
12 June 2005	– Pakistan – Sri Lanka Free Trade Agreement came into effect.
30 June 2005	– The duty waiver granted on the importation of wheat grain (2.5 per cent) and wheat flour (15 per cent) was withdrawn.
01 July 2005	– Sri Lanka was qualified to receive concessions under the Generalised System of Preferences plus (GSP+) scheme introduced by the European Union (EU).
04 August 2005	– Customs duty on the importation of selected heavy vehicles was reduced from 27.5 per cent to 6 per cent.
31 January 2006	– Customs duty on the importation of wheat flour was increased from 2.5 per cent to 15 per cent or Rs.4.50 per kg (whichever is higher).
	– Customs duty on the importation of rice was increased from Rs.9 per kg to Rs.20 per kg.
01 April 2006	– A duty waiver up to 25 per cent of levies was granted on importation of motor cars below 1,500 cc for compliant tax payers.

Foreign Exchange Management

03 January 2005	– A scheme for monitoring the repatriation of export proceeds was initiated.
14 February 2005	– A scheme was introduced to monitor post tsunami inward remittances received by the government, non-governmenal organisations (NGOs) and others for tsunami releted relief activities and a special account titled "Post Tsunami Inward Remittances Account" (PTIRA) was introduced for this purpose.
February 2005	– A committee was appointed by the Central Bank to recommend suitable measures to strengthen the existing monitoring scheme for foreign exchange drawings on Electronic Fund Transfer Cards (EFTCs) to prevent misuse of such cards.
08 April 2005	– Indirect Exporters Foreign Currency Accounts (IEFCAs) were introduced permitting indirect exporters to receive payments in foreign currency from direct exporters.
01 June 2005	– Following measures were introduced to strengthen and discipline the conduct of Money Changers. – The minimum issued and paid up capital required to qualify for a Money Changer was raised from Rs.1 million to Rs.10 million. – The required average monthly turnover to continue with the money changing business was increased from US dollars 5,000 to US dollars 10,000 or its equivalent in other convertible currencies.
23 September 2005	– A monitoring scheme for foreign exchange drawings against international electronics, credit, debit or any other fund transfer card was introduced.

Fiscal Sector

Government Revenue

01 January 2005	– A new value added tax (VAT) rate of 18 per cent was imposed on selected items.
	– Agriculture seeds and plants, leasing of three wheelers, financial services relating to stock market transactions, animal feed and shrimp feed and providing electricity to rural areas were exempted from VAT.
	– Gems and gold were made liable to VAT at the rate of 15 per cent.
	– Tax exemptions for income earned from the sale of gems, gold and jewellery was removed. However, income earned from export of gold, gems and jewellery was exempted from income tax.
	– The rate of Economic Service Charge (ESC) was reduced from 1 per cent to 0.5 per cent on wholesale and retail trade, irrespective of whether they are engaged in trading local or imported goods.
	– The income/profit arising from the cultivation of land with plants of any description and sale of such unprocessed products were exempted from income tax.

Box 19 (contd.)

- The Ports and Airports Development Levy (PAL) on imports for processing and exports was reduced from 0.5 per cent to 0.25 per cent.
- A Social Responsibility Levy (SRL) of 0.25 per cent was imposed on tax and levies collectable under the Excise (Special Provisions) Act, No.13 of 1989, the Excise Ordinance (Chapter 52), the Customs Ordinance (Chapter 235) and the Inland Revenue Act, No.38 of 2000 (excluding Withholding Tax and Dividend Tax).
- A Share Transaction Levy of 0.2 per cent was imposed on every buyer and seller on the turnover of every share trading transaction, which is conducted through the Stock Exchange.
- A Construction Guarantee Fund Levy was imposed as follows:
  - All construction projects between Rs.15 million and Rs.50 million were made liable at a rate of 0.25 per cent of the project value.
  - All construction projects between Rs.50 million and Rs.150 million were made liable at a rate of 0.5 per cent of the project value.
  - All construction projects over Rs.150 million were made liable at a rate of 1 per cent of the project value.
- Four dedicated tax courts were set-up in Gampaha, Kandy, Galle and Anuradhapura for the purpose of speedy dispensation of tax related cases including cases in respect of tax recovery and compliance.
- An appeal unit was set-up in the Department of Inland Revenue (IRD) to deal with the settlement of appeals made by taxpayers against assessments sent by assessors.

08 February 2005
- Following bills were approved by the Parliament.
  - The Finance bill (to give legal effect to the measures proposed in Budget 2005)
  - The Increase of Fines bill (in keeping with the government's commitment to making law enforcement more effective in the country)
  - The Value Added Tax (Amendment) bill (to give legal effect to the measures proposed in Budget 2005)

February 2005
- An information centre was set up at the IRD to collect and analyse information on tax evasion thereby strengthening the surveillance mechanism.

01 April 2005
- Personal income tax rates were revised as follows:

(1)	First Rs.300,000 = Nil		(2)	Next Rs.300,000 = 5 %	
(3)	Next Rs.200,000 = 10 %		(4)	Next Rs.200,000 = 15 %	
(5)	Next Rs.200,000 = 20 %		(6)	Next Rs.200,000 = 25 %	
(7)	Balance = 30 %				

- Tax on terminal benefits for employment was revised as follows:
  - The present exemption of Rs.2.0 million applicable to terminal benefits such as Provident Fund and Employees' Trust Fund (ETF) was made available only if the period of contribution is more than 20 years.
  - If the period of contribution is less than 20 years, the applicable exemption was limited to Rs.1.0 million.
  - The balance is taxed at following concessionary rates:

    (1) First Rs.500,000 = 5% (2) Next Rs.500,000 = 10% (3) Balance = 15%
- An upfront tax of 10 per cent was imposed on the divisible profit and other income of all Partnerships.
- Restrictions were imposed on various deductions, which are applicable to corporate and non-corporate sectors.
- The rate of capital allowance applicable to software, developed in Sri Lanka, was increased from 25 per cent to 100 per cent from the year of assessment 2004/05.

Box 19 (contd.)

	– Betting and Gaming Levy was increased.
	– Administrative fees and charges were revised upward.
	– A withholding tax was imposed on the registration of motor vehicles.
	– The export cess for desiccated coconut was increased to Rs.2,000 per metric ton from Rs.1,000 per metric ton for a period of three years w.e.f. 01 April 2005.
09 April 2005	– Excise duty on cigarettes was raised based on the length of the cigarettes.
11 May 2005	– Fines on offences committed under certain laws were increased.
20 July 2005	– Concessions were granted on the payment of VAT on donations/purchases of goods and services by organisations or persons engaged in rehabilitation work in tsunami affected areas.
01 August 2005	– The 15 per cent VAT on the importation of diesel, pearls, diamonds and precious stones was removed.
02 August 2005	– The 18 per cent VAT rate was increased to 20 per cent.
04 August 2005	– Excise duty on the importation of heavy vehicles more than five years old was raised by 100 per cent.
05 August 2005	– The VAT on milk powder (5 per cent) and LP gas (15 per cent) was removed.
15 September 2005	– An independent Tax Ombudsman was appointed.
02 November 2005	– Issuance of privilege cards to good tax payers was commenced.
08 November 2005	– Excise duty on cigarettes was increased based on the length of cigarettes.
	– Excise duty on liquor was revised upward.
26 November 2005	– Imports or supply of computers or computer accessories, machinery used in the construction industry and machinery, yarn or dyes used in the handloom industry were exempted from VAT.
23 December 2005	– Import of rice milling machinery was exempted from VAT
01 January 2006	– Ports and Airports Development Levy (PAL) was increased to 2.5 per cent from 1.5 per cent.
	– The rate of Social Responsibility Levy (SLR) was increased from 0.25 per cent to 1 per cent.
	– The VAT on Financial Services was increased from 15 per cent to 20 per cent.
	– The VAT on locally manufactured medicated soft drinks such as Ginger Beer, Peyawa and Nelli was reduced from 20 per cent to 15 per cent.
	– The annual license fee for liquor sales outlets was increased.
	– The services provided by the Tower Hall Foundation, agro foods manufactured out of grain cultivated in Sri Lanka, the equipment used by differently abled people, and ships registered under the Sri Lanka flag were exempted from VAT.
	– Importation of milk processing machinery and unprocessed timber logs were exempted from VAT.
	– Importation of new plant and machinery for new industries located outside Colombo and Gampaha districts was exempted from VAT.
	– All international sports events were exempted from income tax.
	– The mark up on the CIF value for charging VAT at the customs point was increased from 5 per cent to 7 per cent.
	– The period specified for the issue of refunds to exporters, was reduced from 30 days to 15 days.
	– VAT deferment facility available to direct exporters was extended for the import of capital goods that are used for manufacturing goods for export and raw materials imported by indirect exporters who are registered with the Textile Quota Board.
01 April 2006	– Stamp duty was reintroduced.
	– Personal income tax rates were revised as follows:
	(1) First Rs.300,000 = Nil (2) Next Rs.300,000 = 5%

Box 19 (contd.)

(3) Next Rs.200,000 = 10%	(4) Next Rs.200,000 = 15%
(5) Next Rs.200,000 = 20%	(6) Next Rs.200,000 = 25%
(7) Next Rs.200,000 = 30%	(8) Balance = 35%

- The following revisions were introduced to the corporate income tax system
  - Corporate tax rate on Co-operative Societies was reduced from 20 per cent to 5 per cent.
  - Tax rate on SMEs of which taxable income does not exceed Rs.5 million was reduced to 15 per cent from 20 per cent.
  - Tax rate applicable to companies of which taxable income exceeds Rs.5 million was increased up to 30 per cent.
  - Tax rate applicable to income and profit from the business of gaming and auto lotteries was fixed at 40 per cent.
  - Income of companies located outside Colombo and Gampaha districts was exempted from income tax for a period of 5 – 10 years.

Government Expenditure

05 January 2005 – The government decided to provide Rs.15,000 for each death due to the tsunami disaster without considering the income limits of the affected people.

11 January 2005 – The government decided to provide a weekly grant of Rs. 200 per person in cash and a dry food ration of Rs.175 per person affected by the tsunami disaster.

– The government commenced providing Rs.2,500 to each tsunami affected family to buy kitchen utensils.

17 January 2005 – The government commenced the granting a periodic allowance of Rs.5,000 per family (Rs.2,500 per single person family) as a start up allowance for tsunami affected people.

April 2005 – The government commenced granting Rs.250,000 for a fully damaged house and Rs.100,000 for a partially damaged house due to the tsunami through state banks.

Government Debt

February 2005 – A debt moratorium was granted by Paris Club members and some other bilateral donors on debt service payments to enable country to implement tsunami related activities.

18 April 2005 – Following directions were issued by the Central Bank;
- Allowing Primary Dealers (PDs) who maintain a capital at a level between Rs.250 million and Rs.300 million to declare 25 per cent of the profits as dividends.
- Requiring PDs to allocate a minimum of 25 per cent of the profits to a special reserve after meeting the minimum capital requirement of Rs.300 million to strengthen the capital base further.
- Allowing PDs to maintain up to a maximum of 50 per cent of Tier I capital as Tier II capital.

14 May 2005 – The Scripless Securities Settlement System was upgraded in line with the upgrading of the SWIFT system, providing more facilities to participants.

01 July 2005 – Minimum capital requirement of PDs was enhanced to Rs.250 million from Rs.200 million.

December 2005 – A sovereign rating for Sri Lanka was obtained from international rating agencies to establish a benchmark in the international capital market.

01 December 2005 – A system called LankaSecureNet was implemented enabling account holders of the Central Depository System to obtain details of their investment at any point of time through the internet.

14 December 2005 – Index linked Treasury bonds were issued with a maturity period of 3 years.

30 December 2005 – A US dollars 100 million Syndicated loan was obtained from the international market.

03 February 2006 – Issuance of foreign currency denominated Sri Lanka Nation Building Bonds to non-resident Sri Lankans was initiated.

Box 19 (contd.)

Forthcoming

01 July 2006	– Enhancing the minimum capital requirement of PDs to Rs.300 million from Rs.250 million.
	– Introduction of Risk Weighted Capital Adequacy Framework for primary dealers.
	– Introduction of a debt consolidation process to reduce rollover risk and improve the secondary market.

Financial Sector

12 January 2005	– Central Bank introduced the SUSAHANA loan scheme to assist tsunami affected SMEs.
01 February 2005	– Registered finance companies were allowed to accept savings deposits.
	– A ceiling on the interest rates was imposed for savings deposits of finance companies.
	– Registered finance companies were directed to maintain liquid assets not less than 20 per cent of the outstanding value of savings deposits.
	– Registered finance companies were allowed to lodge Treasury bills and other securities with either licenced commercial banks (LCBs) or PDs. Earlier they could hold such securities only with LCBs.
	– Registered finance companies were required to obtain the approval of the Director of the Department of Supervision of Non Bank Financial Institutions to close their office/s for business on any day of the week from Monday to Friday, which is not a holiday declared by the Ceylon Chamber of Commerce. Prior to this, they were required to get approval of the Governor of the Central Bank.
11 February 2005	– The Monetary Board approved the limits for lending to directors and close relations against approved securities as Rs.500,000.
	– The Monetary Board approved the limit for credit cards for directors of banks and close relations of a bank as Rs.500,000 without security.
	– The amendments to the Banking Act permit banks to offer banking products based on Islamic principles. Guidelines were issued for banks wishing to offer these services, which require such products to comply with the existing regulatory requirements.
18 February 2005	– Guidelines were issued for banks to submit monthly and quarterly compliance reports with the signature of the Chief Executive Officer of the respective bank.
03 March 2005	– Loan limit for the purchase of paddy and other crops under Forward Sales Contracts was increased from Rs.25 million to Rs.50 million.
07 March 2005	– The basis for calculation of the Single Borrower Limit (SBL) of LCBs incorporated abroad was changed to 30 per cent of capital funds from 15 per cent of advances.
	– Directors of banks were required to submit an affidavit and a declaration to assess their suitability (fit and proper), in terms of Section 42 of the Banking (Amendment) Act, No.2 of 2005.
12 April 2005	– The minimum equity capital requirement for LCBs was increased to Rs.2,500 million from Rs.500 million, and for licenced specialised banks (LSBs)(excluding Regional Development Banks) to Rs.1,500 million from Rs.200 million. In the case of existing banks, the Tier I capital should reach the above limits. Existing LCBs were allowed till end 2007 to meet the increased capital requirement, provided that 50 per cent of the shortfall has to be met by end 2006.
11 May 2005	– A committee consisting of Central Bank officials, representatives from the industry and auditors, was appointed to study a proposal to impose a floor level for core capital to be maintained by existing Registered Finance Companies (RFCs).
13 May 2005	– The Repurchase (Repo) and the Reverse Repurchase (Reverse Repo) rates were increased by 25 basis points to 7.75 per cent and 9.25 per cent, respectively.
15 June 2005	– The Repo and the Reverse Repo rates were increased by 50 basis points to 8.25 per cent and 9.75 per cent, respectively.

Box 19 (contd.)

12 July 2005 – Amended directions were issued to RFCs in respect of Risk Weighted Capital Adequacy Ratio.

20 July 2005 – A committee was appointed by the Governor of the Central Bank to draft prudential norms/guidelines for leasing companies.

29 July 2005 – The Monetary Board approved an amendment to the Direction on SBL to exempt from SBL

(i) Facilities secured by a guarantee issued by highly rated ("A" rated) international and local banks or by an undertaking/guarantee issued by the Head Office in case of foreign banks up to 100 per cent of the capital funds and

(ii) Facilities granted for funding of infrastructure development projects up to 50 per cent of capital funds subject to conditions stipulated.

– Permission was granted to foreign banks to maintain part of their new capital brought into the country in foreign currency subject to the following conditions:

- Only a maximum of 50 per cent of the capital that is brought in could be maintained in foreign currency. The balance to be converted to Rupees.
- 25 per cent of the capital that is brought in has to be maintained in a non-interest bearing account with the Central Bank.
- 25 per cent could be retained in the Off-shore Banking Unit for lending to Board of Investments (BOI) enterprises only. Any amount that cannot be lent in this manner to be deposited with the Central Bank.

12 September 2005 – The Monetary Board decided that the new companies seeking registration under the Finance Companies Act, No.78 of 1988 should have an issued and paid up capital of Rs.200 million.

13 September 2005 – The Repo and the Reverse Repo rates were increased by 25 basis points to 8.50 per cent and 10.00 per cent, respectively.

20 September 2005 – Payment and Settlement Systems Act, a comprehensive payment statute, was passed in the Parliament.

September 2005 – Revised format for disclosure of quarterly financial statements of banks was issued with effect from the 3rd quarter of 2005. Under the new format, selected key performance indicators such as non-performing loans, capital adequacy, liquidity, interest margin, operational expenses and profitability should be disclosed.

01 October 2005 – System Rules of LankaSettle were changed by increasing the number of days from 10 to 31 days for Forward Dated Transactions.

01 December 2005 – Revised directions on Financial Derivative Products were issued.

22 December 2005 – The Repo and the Reverse Repo rates were increased by 25 basis points to 8.75 per cent and 10.25 per cent, respectively.

28 December 2005 – Finance Leasing (Minimum Capital) Direction, No.1 of 2005 was issued regarding minimum core capital requirement of leasing companies along with some other directions.

29 December 2005 – Finance Companies (Structural Changes) Direction, No.5 of 2005 was issued.

– Finance Companies (Opening/Closure of Branches/Offices) Direction, No.6 of 2005 was issued.

– Finance Companies (Registration and Licensing) Rules No.1 of 2005 was issued.

30 January 2006 – Finance Companies (Minimum Core Capital) Direction, No.1 of 2006 was issued. In terms of this, finance companies are required to maintain at all times an unimpaired core capital of Rs.200 million.

– Finance companies (Risk Weighted Capital Adequacy Ratio) Direction, No.2 of 2006 was issued.

Forthcoming 2006

- Introducing a capital charge for market risk to the Capital Adequacy Ratio.
- Introducing prudential norms for classification and valuation of investment portfolios of banks.
- Issuing a direction to banks to report abandoned property in terms of section 72 of the Banking Act.