

**Box 22****Major Economic Policy Changes and Measures: 2007<sup>1</sup>****Real Sector**

- 04 January 2007 - Contributory Pension Scheme introduced in 2003 for public employees, was abolished and they were awarded the membership in Widows'/Widowers & Orphans' Pension Scheme.
- 24 April 2007 - Mihin Lanka (Pvt.) Ltd., the second national carrier, commenced its operations as a fully government owned enterprise.
- 27 April 2007 - Postal charges were revised.
- 01 July 2007 - Passenger bus fares were increased by about 17.5 per cent.
- 01 November 2007 - Domestic tariff of Sri Lanka Telecom (SLT) including monthly rental was revised.
- 01 February 2008 - Passenger bus fares were increased by about 4.6 per cent.
- March 2008 - Electricity tariff was increased by 30 per cent.

**External Sector****Trade and Tariff**

- 31 January 2007 - Full duty waiver applicable on importation of selected food items such as dried fish, Maldivian fish, B' Onions, red onions, chickpeas, green gram, cowpea and chillies was extended until 15 February 2007.
- 02 February 2007 - Import duty on petrol was increased from Rs.5.00 per litre to Rs.20.00 per litre.
- 14 February 2007 - A duty waiver of Rs. 15.00 per litre was granted on importation of petrol for a period of one month.
- 10 March 2007 - Full duty waiver applicable on importation of selected food items such as cod, Maldivian fish, sprats, chickpeas, green gram, chillies and prepared or preserved fish was extended and a duty waiver of Rs.10.00 per kg on B' Onions was granted until 30 April 2007.
- 29 March 2007 - A duty waiver of Rs.5.00 per kg was granted on importation of potatoes until 30 April 2007.
- 17 April 2007 - The duty waiver on importation of petrol was increased to Rs. 20.00 per litre (full duty waiver) from Rs. 15.00 per litre.
- 25 April 2007 - Permission was granted to selected public officers to import motor vehicles under concessionary duty rates, through a permit issued by Ministry of Finance and Planning.
- 01 June 2007 - Full duty waiver applicable on importation of selected food items such as cod, Maldivian fish, sprats, chickpeas, green gram and chillies was extended until 30 June 2007.
- Duty waivers of Rs.5.00 per kg on potatoes, Rs.10.00 per kg on B' Onions, Rs.2.00 per kg on cane sugar, beet sugar, other sugar and sakkara, Rs.3.00 per kg on white crystalline cane sugar and white crystalline beet sugar were granted.
- 01 August 2007 - A full duty waiver was granted on importation of selected fresh fish varieties.
- Import duty on importation of copra was removed until 29th February 2008.
- A 10 per cent duty waiver was granted on importation of edible oil for a period of one month.
- A duty waiver of Rs. 1.50 per kg was granted on importation of beet sugar and jaggery.
- Single specific customs duty rates were introduced on ten selected food items instead of the surcharge on imports, Value Added Tax (VAT), Social Responsibility Levy (SRL),

<sup>1</sup> This includes major economic policy changes and measures implemented during 2007 and the first three months in 2008. Policy changes and measures that have been announced and are to be implemented in 2008 are also included.

- cess, Part and Airport Development Levy (PAL) and other charges applicable on them at the customs.
- 15 August 2007 - A duty waiver of Rs.5.00 per kg was granted on importation of B' Onions until 31 December 2007.
  - 20 August 2007 - A duty waiver of Rs.5.00 per kg was granted on importation of potatoes until 31 October 2007.
  - 13 September 2007 - Importing/purchasing (locally) project related items by SLT were exempted from customs duty.
  - 15 October 2007 - A full duty waiver was granted on importation of semi milled or wholly milled rice and broken rice until 31 December 2007.
  - 8 November 2007 - Importation of electric filament or discharge lamps and Arc Lamp Carbon were exempted from customs duty.
  - Registration of ships under Sri Lanka Flag was exempted from customs duty and PAL.
  - December 2007 - Duty waivers, granted on essential food items, were removed except for edible oil.
  - 09 January 2008 - Instead of customs duty, VAT, PAL, SRL and other charges applicable at the customs on importation of essential food items, a Special Commodity Levy was introduced for a period of 4 months.

#### Foreign Exchange Management

- 01 January 2007 - The minimum turnover for the renewal of the money changing permits was increased from US dollars 120,000 to US dollars 600,000 per annum.
- Permission was granted for Authorised Money Changers to encash Travellers' Cheques.
- 08 January 2007 - A Foreign Currency Fixed Deposit Accounts scheme was introduced for ex-Sri Lankans/ Sri Lankans living abroad, who would apply for dual citizenship status, in the domestic banking units.
- 22 January 2007 - The minimum holding period applicable on the investments in rupee denominated Treasury bonds by foreign investors was withdrawn.
- 19 March 2007 - Two foreign currency account schemes, Resident Guest Foreign Currency Account (RGFCA) and Resident Guest Rupee Current Account (RGRCA), were introduced to foreigners, who obtain visas under Resident Guest Scheme.
- 14 June 2007 - The issuance of foreign currency notes as a part of the travel allowance for Sri Lankans travelling abroad was increased from US dollars 500 to US dollars 1,000 or its equivalent in any other convertible foreign currency as a further measure of liberalising current international transactions and giving benefits to Sri Lankans travelling abroad.
- 15 June 2007 - Permission was granted to dealers and Licensed Specialised Banks (LSBs), which are permitted to open and maintain Non-Resident Foreign Currency (NRFC) accounts to accept foreign currency to the credit of NRFC accounts from an immediate family member of the account holder. Foreign currency so collected from such a family member of the account holder should not exceed US dollars 1,000 or its equivalent in other convertible foreign currency per transaction.
- 05 July 2007 - Permission was granted to Authorised Money Changers whose annual foreign exchange operations (amount of deposit with the Authorised Dealers) exceed US dollars 4 million or equivalent in other permitted currencies to sell foreign exchange subject to a limit of US dollars 1,000 per transaction. However, if the threshold of US dollars 4 million could not be maintained throughout the year, the permission granted to such money changers to sell foreign exchange was withdrawn.
- 27 September 2007 - The limit on the declaration requirement to Sri Lanka Customs on foreign currency bringing into the country by a person was increased to US dollars 15,000 and above or its

- equivalent in other convertible foreign currency from the level of US dollars 10,000.
- 06 December 2007 - Foreign Country Funds, Regional Funds and Mutual Funds approved by the Securities and Exchange Commission of Sri Lanka, Corporate bodies incorporated outside Sri Lanka and citizens of foreign states were permitted to purchase and hold rupee denominated Treasury bonds up to a level of 10 per cent of the total value of Treasury bonds outstanding at any given point of time.

### **Forthcoming**

- 2008
- Introducing a new foreign currency account scheme for gem and jewellery exporters.
  - Reviewing existing Exchange Control Act incorporating necessary measures for further liberalisation of capital account transactions.
  - Issuing Operation Instructions to authorised dealers permitting private sector to borrow from global capital markets as proposed in Budget 2008.

### **Fiscal Sector**

#### **Government Revenue**

- 01 January 2007
- Every person having supplies on the border of VAT threshold of Rs.1.8 million, but not registered for VAT, was given an option to register for VAT voluntarily and pay 5 per cent non-refundable VAT.
  - Following were exempted from VAT.
    - Supply of locally manufactured handloom textiles
    - Machinery and equipment imported by CEB
    - Importation of any bus by any bus owner holding a valid route permit
    - Importation of machinery for the modernisation of selected factories (machinery for tea industry, for the preparation or manufacture of food or drink and machinery for shelling coconuts)
    - Furnace oil
    - Breeding animals and materials
    - Generation and distribution of electricity
    - Hiring of ships
    - Production, distribution and exhibition of any film and supply of laboratory facilities for production of a film
  - VAT on following items was reduced to 5 per cent from 15 per cent.
    - High technological medical equipment
    - Machines used to manufacture ticketing machines
    - Importation of selected items for film industry with the approval of the National Film Corporation
    - Jewellery
  - Unit Trusts and Regional Development Banks were exempted from stamp duty.
  - Business Turnover Tax rate on liquor and cigarettes applicable to North and Eastern Provinces was increased.
- 02 January 2007 - Accounts maintained at Bank of Ceylon and People's Bank by Samurdhi Authority, a District Secretariat or a Divisional Secretariat were exempted from debits tax.
- 13 March 2007 - Excise duty on liquor was increased.
- 01 April 2007 - The threshold of relevant quarterly turnover for the calculation of Economic Service

	Charge (ESC) was reduced to Rs.7.5 million from Rs.10 million .
	- The non-chargeability of ESC was applied in respect of turnover from certain trades and businesses etc. arising during the period of 3 years following the commencement of operation if such trade or business only in relation to manufacturing industries.
	- The entrepot trade-turnover from off-shore transactions and reopening of closed factories (completion of 3 years from the reopening) was exempted from ESC.
	- Unit trusts were made liable to pay ESC at a rate of 0.5 per cent.
	- The tax on terminal benefits for employment was revised as follows.
	- If the contribution period is 20 years or more, following rates were applied.
	• First Rs. 5,000,000 Nil
	• Next Rs. 1,000,000 5 per cent
	• Balance 10 per cent
	- If the contribution period is less than 20 years, following rates were applied.
	• First Rs.2,000,000 Nil
	• Next Rs.1,000,000 5 per cent
	• Balance 10 per cent
	- The depreciation allowance on machinery used in the construction industry was increased to 25 per cent from 12.5 per cent.
	- New rules were applied on withholding tax on interest accruing to individuals from banks and other financial institutions. Accordingly, if the deposit holder declares that his total income for any year of assessment is;
	- Less than Rs. 300,000, no tax deduction is made.
	- More than Rs.300,000 but not more than Rs. 600,000, a 2 1/2 per cent tax is deducted.
	- More than Rs. 600,000 , a 10 per cent tax is deducted.
	- The withholding tax on consultation fees was decreased to 1 per cent from 5 per cent.
	- The profits of any individual, who is engaged in construction work outside Sri Lanka and receives payments in foreign currency and remits to Sri Lanka through a bank, were exempted from income tax.
	- The Commissioner General of Inland Revenue was empowered to administer the Construction Industry Guaranty Fund Levy.
	- The capital allowance on ships was increased to 33 1/3 per cent.
April 2007	- Treasury bond Investment External Rupee Account (TIERA) was exempted from debits tax.
14 May 2007	- Exemptions and concessions on the payment of PAL were granted for certain imported goods.
01 June 2007	- Excise duty on selected brands of cigarettes was increased based on their length.
06 June 2007	- VAT on importation of selected fresh fish, chickpeas and green gram was reduced to 5 per cent from 15 per cent.
01 July 2007	- Healthcare services provided by a medical institution, which has entered into an agreement with Board of Investment (BOI), and clay tiles, unprocessed vegetables, fruits and fish products so far as such products are manufactured or produced locally were exempted from VAT.
	- Importation of Rattans, classified under HS Code No.1401.20, or the supply of such imported Rattans was exempted from VAT.

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| 17 July 2007       | - Locally produced chemical Naphtha was exempted from VAT.   |
|                    | - Importation of aircraft engines or aircraft spare parts, classified under HS Code Nos. 8411.91 and 8803.30, was exempted from VAT.   |
| 24 September 2007  | - Cellular Phones Subscriber Levy (CPSL) was increased to 10 per cent from 2.5 per cent.   |
| 15 October 2007    | - Regional Infrastructure Development Levy (RIDL) was revised to apply different rates based on the cylinder capacity of the vehicle.  |
| 25 October 2007    | - Excise duty on liquor was revised upwards.   |
| 07 November 2007   | - Excise duty on importation of non essential items was increased.   |
| 26 November 2007   | - The cess imposed on selected imported items was revised and a cess was imposed on selected new items.  |
| 01 January 2008    | - VAT on petrol was reduced to 5 per cent from 15 per cent .   |
|                    | - The 10 per cent subscriber's levy applicable on mobile phones was extended to wireless phones as well.   |
|                    | - Following were exempted from VAT.  |
|                    | - Co-operative Rural Banks on financial services   |
|                    | - Supply of goods and services by Co-operative Societies registered under Co-operative Societies Law No. 05 of 1972  |
|                    | - Machinery imported for business purposes by enterprises qualified for tax holidays under ' <i>Negannahira Udanaya</i> ' programme  |
|                    | - Certain identified government projects   |
|                    | - Milk products made out of milk manufactured in Sri Lanka   |
|                    | - Products made out of rice manufactured in Sri Lanka  |
|                    | - Locally manufactured sugar   |
|                    | - Import of yarn for textile industry  |
|                    | - VAT on importation of electric filament or discharge lamps including sealed beam lamp units, ultra violet or infra-red lamps and arc lamp carbon was reduced to 5 per cent from 15 per cent. |
|                    | - ESC was limited to 2.5 per cent if the turnover of any business comprises of export or earnings in foreign exchange.   |
|                    | - ESC charged on the turnover on sale of liquor and motor vehicles was increased to 1 per cent from 0.5 per cent.  |
|                    | - SRL was increased to 1.5 per cent from 1 per cent.   |
|                    | - RIDL was increased to 5 per cent from 2.5 per cent.  |
|                    | - Donations to the <i>Api Wenuven Api Fund</i> , made after 1 January 2008, were allowed in full as a deduction under qualifying payments.   |
|                    | - An income tax of 2.5 per cent was imposed on the value of gems sold at the gem auctions.   |
| <b>Forthcoming</b> |  |
| 01 April 2008      | - Exempting profits and income of Co-operative Societies (including Co-operative Rural Banks) from income tax for a period of 5 years.   |
|                    | - Exempting Co-operative Societies (including Co-operative Rural Banks) from withholding tax on interest from any deposit made by such societies in banks or other financial institutions.     |
|                    | - Exempting any current or savings account maintained by a Co-operative Society or a Rural Bank registered under Co-operative Societies Law No. 5 of 1972 from debits tax.                     |
|                    | - Exempting new investment undertakings in the Eastern Province from income tax for a period of 5 years, if the investment is over Rs. 50 million and provides employment                      |

- opportunities for more than 50 persons.
- Exempting any profits and income including the interest accruing on bank deposits of *Api Wenuven Api Fund* from income tax, withholding tax on interest from any deposits and debits tax.
  - Exempting profits and income from the export of gems, which were imported in raw form, and cut and polished later, from income tax.
  - Increasing ESC rate applicable on the sale of liquor and motor vehicles to 1 per cent from 0.5 per cent.
  - Following changes will be made on tax holidays granted.
    - Tax holidays that have already been granted under the BOI Law or Inland Revenue Act will not be extended further after the expiry.
    - Tax holidays, which commences after 01 April 2008 under the BOI Law or Inland Revenue Act, will not be for more than three years maximum. The profits and income derived after the expiry of such tax holidays will be taxed on the succeeding years as follows.
      - i. First year, at 5 per cent
      - ii. Second year, at 10 per cent and
      - iii Third year at 15 per cent
    - The five year tax holiday under the BOI Law or Inland Revenue Act for regional development will remain unchanged.
    - These limitations will not apply to tax holidays on special projects (flagship), which had been identified as of national importance.
    - Before granting a tax holiday available under any of the Acts, approval from the Ministry of Finance and Planning has to be obtained.
    - A list of persons who received tax holidays will be published in the gazette at the end of the year.
  - Following changes will be applicable on income taxes.
    - Foreign earnings from the following sources will be exempted from income tax, if such profits and income are remitted to Sri Lanka through a bank.
      - Salaries, allowances or fees paid in respect of services rendered by such person or partnership outside Sri Lanka
      - Dividends or interest on an investment made outside Sri Lanka
    - Deductions will be allowed without any limit in respect of qualifying payments being invested in housing projects for the development of houses for inmates of shanties in urban areas
    - SRL charged on a company's income tax will remain unchanged and SRL on personal income tax will be removed.
    - Income tax will be charged only at a rate of 2.5 per cent on the value of gem auctions conducted under the supervision of State Gem Corporation.

#### Government Expenditure

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| 15 June 2007 | - | The interest rates on public officers' housing and property loans were revised to reflect prevailing interest costs.  |
| August 2007  | - | The government provided Rs. 4,000 as a lump sum payment to each fishing boat owner in order to cushion the burden that arises due to the removal of fuel subsidy. |



- September 2007 - The government commenced to grant Rs. 100 per month as a kerosene subsidy to Samurdhi recipients deprived of electricity.

#### Debt Management

- 19 January 2007 - Regulatory requirements on Treasury bonds, issued to foreign investors, were revised.
- 02 February 2007 - Central Bank's wide area network (CBSLNet) based application to record small value customer overnight Repo repositioning transactions, was implemented.
- 01 August 2007 - Retail outlets for the sale of Treasury bills and Treasury bonds were opened.
- 24 October 2007 - The first international Sovereign Bond of Sri Lanka, amounting to US dollars 500 million, was issued.
- October 2007 - Amendments were made to the CBSLNet based application to record Customer Repo Repositioning transactions or Customer Outright Repositioning transactions to the value of Rs. 5 million or below.
- 03 December 2007 - The maximum limit applicable on foreign investments in rupee denominated Treasury bonds was increased to 10 per cent of the outstanding Treasury bond stock from 5 per cent.
- 14 December 2007 - The Treasury bill limit approved by the Parliament was increased to Rs. 375 billion from Rs. 300 billion.

#### Financial Sector

- 01 January 2007 - Finance Companies (Lending) Direction No.1 of 2007 was issued.
- Central Bank decided not to provide the Reverse Repurchase facility on days when there is a liquidity surplus in the banking system as per Central Bank estimates.
- 02 January 2007 - The "Road Map: Monetary and Financial Sector Policies for 2007 and Beyond" was announced by the Central Bank.
- 11 January 2007 - The availability of Reverse Repurchase facility to a particular bank was restricted only up to six times per calendar month until 31 March 2007 and up to three times per calendar month thereafter, when there is a liquidity shortage in the banking system according to Central Bank estimates.
- 19 January 2007 - New directions were issued to Licensed Banks under the Banking Act to implement a new policy on share ownership in banks.
- Banks were requested to conduct due diligence in respect of customers involved in cross-border financial transactions and to notify the relevant authorities of any suspicious transactions as required by relevant statutes.
- 13 February 2007 - The Inter Regulatory Institutions Council was established to promote coordination among regulators in the financial sector.
- 14 February 2007 - Amendments to the Credit Information Bureau (CRIB) Act to modernise and widen the scope of CRIB have been proposed.
- 20 February 2007 - New directions were issued under the Banking Act to Licensed Banks covering prudential requirements on maximum amount of accommodation that may be granted to single customers or grouped customers by Licensed Banks.
- 23 February 2007 - The Repo and Reverse Repo rates were increased by 50 basis points to 10.50 per cent and 12.00 per cent, respectively.
- 28 February 2007 - A determination was given to Registered Finance Companies (RFCs) to include the face value of unsecured debentures in capital funds of the company, subject to certain conditions.
- The Finance Companies (Revenue Recognition and Disclosures in the Financial Statements) Direction No. 1 of 1995 was revoked.

- 27 March 2007 - The 50 per cent margin deposit requirement against the letters of credit opened with Licensed Banks for the importation of selected non-essential consumer goods was withdrawn.
- 26 April 2007 - The Finance Companies (Maintenance of Savings Accounts for Minors) Guidelines No. 1 of 2007 was issued. These Guidelines require every RFC to include a clause that, with the instructions of a parent or a guardian, the balance in minors' savings accounts should be transferred to another account maintained in an authorised deposit taking institution after a period of sixty months. It also specified instances where the money can be withdrawn from minors' accounts.
- 23 May 2007 - A Direction was issued to Licensed Banks permitting them to include perpetual debt capital instruments that satisfy certain conditions, as core capital in the computation of capital adequacy and expanding the eligibility criteria applicable for hybrid (debt/equity) capital and subordinated debt instruments.
- 19 June 2007 - A Consultative Paper on the implementation of the New Capital Adequacy Framework - Basel II was issued to banks for their comments, prior to the issue of Directions to banks.
- 27 June 2007 - Money, Payment, Clearing and Settlement Service Providers Regulation No. 01 of 2007 (under the Payment and Settlement Act) was issued by the Hon. Minister of Finance and Planning.
- 29 June 2007 - Finance Companies (Business Transactions with Directors and their Relatives) Direction No. 22 of 2007 was issued.
- The Finance Companies (Lending) Direction No. 1 of 2007 was issued replacing the Finance Companies (Lending) Direction No. 5 of 2006.
- 25 July 2007 - A Discussion Paper on International Accounting Standards (IAS) 32 and 39 was issued to banks.
- 01 August 2007 - Assets and liabilities of Pramuka Savings and Development Bank were vested in a new state bank called Sri Lanka Savings Bank Ltd.
- 23 August 2007 - Primary Dealers (PDs) were re-enrolled as participating institutions in Open Market Operations of the Central Bank.
- Central Bank decided to announce the total amount available under Reverse Repurchase Facility at the bank's policy rate to the commercial banks and PDs and to allocate the amount offered on prorata basis.
- 01 November 2007 - Prudential requirements on maximum amount of accommodation that may be granted to single customers or grouped customers by Licensed Banks were revised.
- 14 November 2007 - General Direction on the Participating Institutions Service Norms and Standard Times for Accepting Cheque Deposits from Customers and Crediting Cheque Proceeds to Customers Accounts under the Cheque Imaging and Truncation System was issued by the Central Bank.
- 21 November 2007 - The availability of Reverse Repurchase facility to a particular bank was restricted only up to four times per calendar month at the Central Bank Reverse Repo Rate (policy rate) with effect from 3 December 2007 and any borrowing of more than 4 times by a particular participant during a calendar month was allowed at a penalty rate of 19 per cent per annum.
- 26 December 2007 - Directions on maintenance of Capital Adequacy Ratio under Basel II was issued, requiring banks to apply the Standardised Approach for credit risk, the Standardised Measurement Method for market risk and the Basic Indicator Approach for operational risk in computing the capital requirements with effect from 1<sup>st</sup> January 2008.



- Directions on Corporate Governance for Licensed Banks were issued with a view to making board of directors responsible and accountable for the business of banks and to promote a healthy and robust risk management framework for banks with effect from 1<sup>st</sup> January 2008.
- 31 December 2007 - A new policy on procuring services of expatriates in the banking sector was introduced considering the significant expansion of banking operations of foreign banks, the need for the introduction of innovative financial products and the need for expertise in the areas of advanced risk management practices.
- 02 January 2008 - The "Road Map: Monetary and Financial Sector Policies for 2008 and Beyond" was announced by the Central Bank.
- 10 March 2008 - The Sri Lanka Savings Bank Ltd. commenced its operations.

#### **Forthcoming**

- Issuing guidelines on integrated risk management to banks to improve the risk management process of banks.
- Issuing directions on mandatory lending to the agriculture sector.
- Making arrangements to adopt IAS 32 and 39 with parallel reporting commencing from June 2008.
- Issuing prudential regulations on managing out-sourced activities.