KPMG

Annual Budget Analysis

2025

Fuelling Growth
Unlocking Tomorrow

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For the clients of KPMG in Sri Lanka

The Hon. President Anura Kumara Dissanayake in his capacity as the Minister of Finance of Sri Lanka presented the 79th Annual National Budget at the Parliament on the 17 February 2025.

His Excellency the President in his Budget Speech stated that the vision of this budget is to ensure the economic rights and well-being of the people. The Government expects to maintain an economic growth of 5% in 2025.

The total expenditure for the year 2025 is estimated to be Rs. 4,218 Bn.

Further the President emphasized that the intention of the Government is to manage the limited tax funds prudently & responsibly and focus on transforming the economy whilst preparing to resume debt repayments from 2028.

An analysis of the Government's key economic and fiscal proposals are presented in this edition of the KPMG Budget Analysis.

This publication has been compiled on a high-level review of the proposals in the limited time available to us. We may also emphasize that these proposals need to be enacted by Parliament for legal enforcement.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

Chartered Accountants

Budget At A Glance

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Budget At A Glance

Economic Stabilization & Growth

Steer the economy towards sustainable growth with a target of achieving a 5% economic growth rate in 2025. Build an economy where every citizen plays an active role. Reduce price shocks to maintain low and stable inflation.

Export & Investment Promotion

The National Export Development Plan and new tariff rates will be introduced, along with eco-industrial parks and Investment Protection Law. Efforts to improve the ease of doing business will be prioritized. Stronger relationships with international partners will also be fostered.

Digital Economy & Innovation

A unique digital ID and new legislation for digital services will be introduced, along with the establishment of an APEX digital body. Efforts will be made to promote commercializable R&D. SMEs and rural entrepreneurs will receive targeted support.

Social Protection & Welfare

Increased cash grants and allowances for vulnerable groups will be provided through expanded scholarships and the Aswesuma program. Initiatives will focus on uplifting marginalized communities, with additional support for senior citizens, women, children, and individuals with disabilities.

Infrastructure Development

Significant investments in road, rail, and port infrastructure. Focus on rural development and connectivity. Investment in modernization of public transport systems.

Governance & Anti-Corruption

Strengthening governance and anti-corruption measures through the Clean Sri Lanka initiative. Legal reforms to improve public service delivery and economic development. Emphasis on fiscal discipline and elimination of corruption.

Budget At A Glance

Boost Industry, Service & Agriculture Sectors

The Government outlines key supply-side and demand-side policies to boost growth in industry, services and agriculture sectors, while maintaining market stability and equitable distribution of benefits. Efforts to ensure an uninterrupted supply of essential goods and services at fair prices are also a priority alongside fostering competition in a well-regulated market environment.

Economic Empowerment

A key focus of the budget is fostering economic empowerment by promoting inclusive development. Central to this approach are significant investments in education, healthcare, and infrastructure, aimed at addressing geographical, social and infrastructural disparities. Additionally, the Government emphasizes the importance of fair competition and implements measures to prevent market concentration, thereby promoting a level playing field.

Budget Statistics- Rs. Bn

- Total revenue and grants - Rs. 4,990
- Total expenditure - Rs. 7,190
  - ➢ Loan interest - Rs. 2,950
- Budget deficit (6.7% of GDP) - Rs. 2,200

Revenue Growth

Revenue growth is expected to arise from liberalized motor vehicle imports, VAT on digital services, corporate income tax on service exports and increased taxes on cigarettes, liquor and gaming. Estimated total tax revenue to GDP is 13.9%.

Revenue to GDP – 15.1%

Despite challenges, the Government's fiscal strategy aims to meet a 15.1% revenue target of GDP for 2025. Efforts to improve tax administration and compliance, coupled with digitalization are expected to strengthen fiscal sustainability and minimize tax leakages, while safeguarding the interests of vulnerable groups.

Budget 2025 - Focus

Budget 2025 sets the foundation for a competitive, participatory economic framework, balancing fiscal discipline with social & developmental priorities and signaling a vision for a resilient & inclusive economy for all Sri Lankans.

Direct Tax Proposals

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Income Tax- What Will Change?

The Hon. President, in delivering the Budget Speech mentioned that revenue proposals in relation to Income Tax were already referred to in his speech on 18 December 2024. Income Tax changes proposed in the Budget mainly focus on providing clarity and easing out the compliance burden by revision of administrative provisions.

1. Quarterly installment payment
2. Removal of the requirement to lodge the SET
3. Increase of CIT Rate from 40% to 45%
4. CGIR is empowered to waive off the interest
5. Exemption for non-resident persons
6. Removal of exemption and application of CIT 15% on export of services
7. Tax on life insurance and other receipts
8. Revision of Capital Gains Tax rate

Direct Tax Proposals

1 Quarterly installment payment

The Inland Revenue Act No 24 of 2017 (IRA) would be amended to introduce the calculation of the instalment payment for a Year of Assessment (Y/A), based on the income tax liability of the immediately preceding Y/A (preceding year basis).

According to the current income tax law, a taxpayer is required to pay income tax instalments for the Y/A based on the estimated income tax liability for the current year (current year basis). The proposal may replicate the rule in the Inland Revenue Act No10 of 2006 (IRA 2006) where it stipulated that the taxpayer would not incur any penalty, if at least ¼ of the tax liability of the preceding year is paid as each installment payment. The balance amount for the Y/A to be paid on or before 30 September as the final payment.

The change of basis would provide ease to the taxpayer in calculating the quantum of Income Tax to be paid on a quarterly basis. However, this would be disadvantageous to a taxpayer whose current year gains and profits is lower than previous year.

Whether or not the taxpayer has the option of choosing between prior year basis or estimated current year basis remains unclear.

2 Removal of the requirement to lodge the SET

It is proposed to remove the requirement to lodge the Statement of Estimated Tax Payable (SET) from the Y/A 2025/2026.

Under the existing law, every individual or entity is required to compute the estimated tax liability and declare to the Inland Revenue Department (IRD) in the specified SET form on or before the first installment payment. Any revisions to the original estimates should be submitted to the IRD before making the respective installment payment.

Accordingly, taxpayer is not required to submit the SET along with the first tax installment payment for the Y/A 2025/2026 (i.e. on or before 15 August 2025).

3 CIT rate revision for cigarettes, liquor and gaming

The applicable corporate income tax rate for business income consisting of cigarettes, liquor and gaming will be increased to 45%.

Currently gains and profits from conducting betting and gaming, and manufacture and sale or import and sale of any liquor or tobacco products are taxed at 40%. The rate of 40% was applicable under the IRA 2006 as well.

CIT rate will be increased to 45% as proposed in the International Monetary Fund (IMF) report in June 2024.This tax increase will generate higher revenue for the Government, helping to reduce budget deficit. The CIT rate of 40% was applicable from April 2011 and has now been revised to 45% after a period of 14 years.

4 CGIR is empowered to waive off the interest.

The Budget proposes to empower the Commissioner General of Inland Revenue (CGIR) to waive off the interest under the IRA) and the Surcharge Tax Act. This applies if the tax liability is for the Y/A 2022/2023 or earlier periods and the total tax is paid within six months of the statutory amendment.

The interest is calculated at 1.5% per month or part month, computed monthly without a ceiling.

5 Exemption for non-resident persons

It is proposed to exempt from income tax, any amount derived by any non-resident person as any payment for aircraft, software licenses or for other related services from the Sri Lanka Air Force. Currently, a similar exemption is available for aforementioned services being provided to Sri Lankan Airlines Limited.

6 Removal of exemption and application of CIT 15% on export of services

The gains and profits from export of services will be subject to tax at a concessionary rate of 15%.

Currently an exemption is available to any service rendered in or outside Sri Lanka to any person to be utilized outside Sri Lanka, and payment is received in foreign currency via Bank in Sri Lanka. Other gains and profits which do not qualify for the aforementioned criteria are subject to tax at 30% at present.

As per the provisions of the IRA, in order to claim the exemption, a taxpayer is required to remit the foreign currency earnings to Sri Lanka. However, the removal of exemption may result in taxpayers retaining the funds outside Sri Lanka unless other measures are introduced to encourage taxpayers to remit funds into Sri Lanka. Clarity is required on whether the failure to remit would attract the penal rate of 30% as opposed to the concessionary rate of 15%.

7 Tax chargeability on insurance and related proceeds

The Budget proposes to introduce provisions in the IRA clarifying the chargeability of income tax on the life insurance proceeds and other amounts received by policy holders.

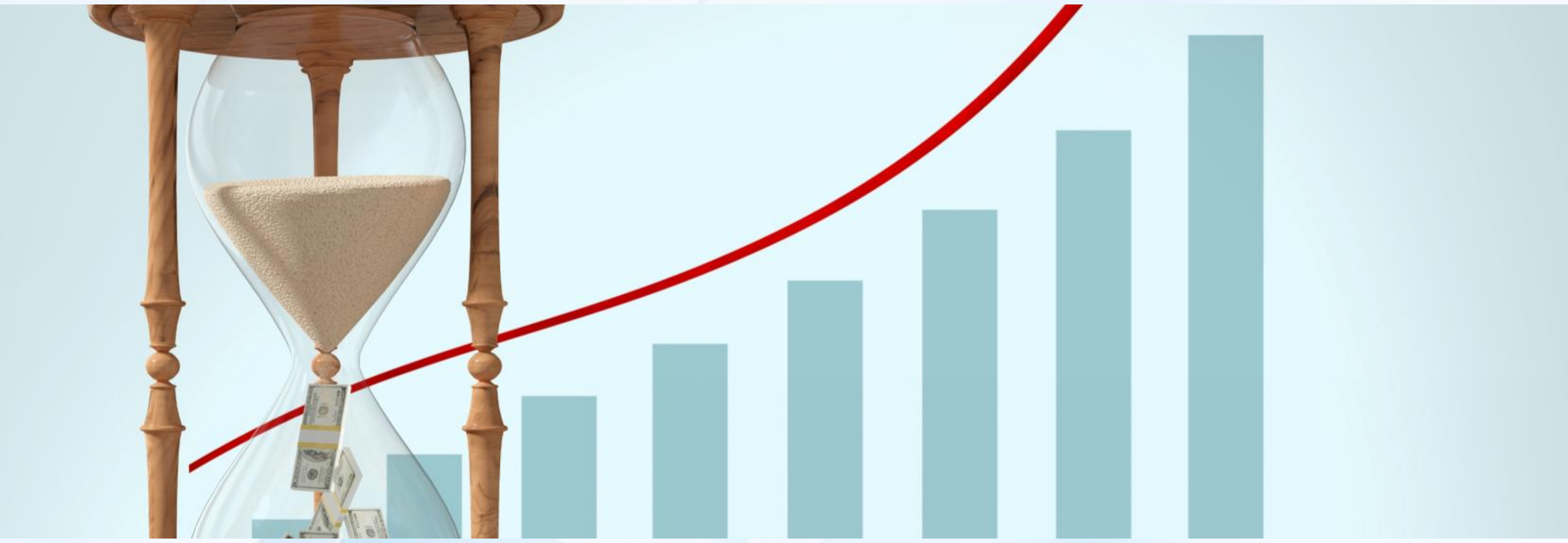
Direct Tax Proposals

8 Increase in Capital Gains Tax rate

The Budget proposal introduces revision to the Capital Gain Tax (CGT) rate in the following manner.

Person	Current CGT Rate	Proposed CGT Rate
Individual	10%	15%
Partnership	10%	15%
Trust	10%	30%
Unit Trust/Mutual Fund	10%	30%
Charitable Institution	10%	30%
Non-Governmental Organization	10%	30%
Companies	30%	30% (No change)

The Budget does not indicate an effective date for this proposal.



Personal Income Tax

The following Budget proposals will specifically impact individuals. While the changes to the Income Tax concessions and reliefs were already mentioned in the Hon. President's speech on 18 December 2024, the Budget speech provides clarity on certain tax provisions and seeks to simplify the tax compliance process.

1. Revision of personal relief and tax slabs
2. Service exporters exemption
3. Changes in residency rules for individuals
   - Holder of Golden Paradise resident visa
   - Employees on Sri Lankan flagged vessels
4. Withholding tax on interest – Self declaration & Refund Mechanism
5. Lodgment of manual return by senior citizens
6. CGT relief on transfer of assets to the Sri Lankan Government or Universities
7. Revision of CGT Rate to 15%
8. Imputed Rental Income Tax

Direct Tax Proposals

Personal Income Tax

1 Revision of personal relief and tax slabs

It is proposed to increase the “personal relief” in calculating the taxable income of an individual to Rs.1,800,000 for a Y/A with effect from 01 April 2025. Currently, the applicable “personal relief” for individuals (excluding non-citizens, non-residents) stands at Rs.1,200,000 for a Y/A.

The evolution of the value of “personal relief” applicable to an individual in the current IRA is tabulated below:

Inland Revenue Act	Period covered	Personal relief Rs.
Income Tax Act, No.24 of 2017 (Principal Act)	1 April 2018 – 31 December 2019	500,000
Income Tax (Amendment) Act, No.10 of 2021	1 January 2020 – 31 December 2022	3,000,000
Income Tax (Amendment) Act, No.45 of 2022	1 January 2023 – to date (Proposed end date 31 March 2025)	1,200,000

It is proposed to widen the “tax slabs” chargeable to income tax applicable to individuals. According to the tax reforms introduced in December 2024, the proposed tax slab to be implemented with effect from 1 April 2025 are as follows:

Tax slabs for Y/A (Rs.)	Tax rate
1.8 Mn	0% (Personal relief)
1.8 Mn – 2.8 Mn	6%
2.8 Mn – 3.3 Mn	18%
3.3 Mn - 3.8 Mn	24%
3.8 Mn – 4.3 Mn	30%
> 4.3 Mn	36%

Direct Tax Proposals

Personal Income Tax

A comparison of the APIT deducted under the current law and the proposed revision along with the tax savings based on the monthly salary level is provided below:

Monthly Salary (Rs)	Proposed APIT (Rs) (p.m)	Current APIT (Rs) (p.m)	Tax Saving amount (Rs)	Tax Saving %
200,000	3,000	10,500	7,500	71.4%
300,000	18,500	35,000	16,500	47.1%
400,000	50,000	70,500	20,500	29%
500,000	86,000	106,500	20.500	19.2%
600,000	122,000	142,500	20,500	14.4%
700,000	158,000	178,500	20,500	11.5%
800,000	194,000	214,500	20,500	9.5%
900,000	230,000	250,500	20,500	8.2%
1,000,000	266,000	286,500	20,500	7.1%

2 Service exporters exemption

The exemption on gains and profits from services provided to a person outside Sri Lanka where the foreign currency is remitted through a bank in Sri Lanka, is removed with effect from 01 April 2025.

Ambiguity prevails as to whether the exemption would be eliminated for individuals and partnerships in addition to the companies. If so, what rate of tax would apply on an individual service exporter and partnership.

3 Changes in residency rules for individuals

A holder of Golden Paradise Resident Visa

It has been proposed to amend the "tax residency" rules to state that a holder of "Golden Paradise Resident Visa" would be treated as a "non-resident" individual for income tax purposes.

Golden Paradise Visa is a special category of "Residence Visa" granted to eligible foreign investors in Sri Lanka. This Visa is valid for 10 years and is extended to spouse and their dependents. Requirements of applying for Golden Paradise Visa is summarized below:

Requirements
• Open Golden Paradise Foreign Currency Account (GPFCA) in a commercial bank recognized by the Central Bank of Sri Lanka and deposit a minimum of USD 200,000. • Investor may withdraw up to 50% of the minimum investment amount after completion of the first year from the date of issuance of the Golden Paradise Visa.

Clarification is required as to whether the non-residency status would be extended to all who qualify for the said Visa category (i.e. spouse and dependents).

Changes in residency rules for individuals (cont.)

Tax status of individuals employed in a Sri Lankan flagged vessel

It has been proposed to amend the chargeability to tax of the following individuals:

- Any individual who is employed in a Sri Lanka flagged vessel, is deemed to be a resident of Sri Lanka for Income Tax purposes during the period of employment; and,

- Any individual who is a citizen or connected to another country and employed in a Sri Lankan flagged vessel and deemed to be a resident of Sri Lanka for income tax purposes, such person's employment income from the ship would be considered as employment income earned from Sri Lanka and other sources of income will not be subject to tax if it does not create a source in Sri Lanka.

Currently, “tax residency rules” cover an individual who is employed on a Sri Lankan ship, within the meaning of the Merchant Shipping Act, as resident individuals during the period of employment.

Being a tax resident, an individual is chargeable to income tax on world income. The chargeability to income tax in Sri Lanka of a non-citizen or individual connected to another country, is limited to employment income derived from a vessel and other income which has a Sri Lankan source.

Direct Tax Proposals

Personal Income Tax

4 Withholding tax on interest

As proposed in the Hon. President's Speech on 18 December 2024, the AIT/WHT (tax at source on interest paid to any person) of 5% would be increased to 10% w.e.f. 01 April 2025. To provide relief for individuals below the personal relief of Rs 1.8 Mn per annum, the following have been proposed in the Budget Speech 2025.

Self declaration - Senior Citizen

- Interest paid by financial institutions on deposit of a senior citizen (citizen of Sri Lankan & resident in Sri Lankan over 60 years of age), would not be subject to WHT, provided he/ she makes a declaration to the financial institution stating that Assessable Income does not exceed Rs.1,800,000 for a Y/A. The relevant guidelines including the format of the declaration will be issued in due course by the CGIR. This proposal will be effective from 01 April 2025.

- Currently, resident senior citizens can obtain a WHT refund by registering for the refund mechanism via a prescribed form and submitting a quarterly "Application for Refund Claim." However, with the introduction of a new self-declaration mechanism, it is anticipated that this refund process for senior citizens will be discontinued in the future.

Refund Mechanism - Other than Senior Citizen

- Any individual (other than a senior citizen) whose Assessable Income does not exceed Rs.1,800,000 for a Y/A would be eligible to claim a refund of the WHT deducted on interest.

- The proposed refund scheme will be similar to the existing refund scheme for senior citizens. To avail of this scheme, individuals must register for the refund mechanism by submitting a written request and the quarterly "Application for Refund Claim." However, the refund request must not exceed Rs. 25,000 per quarter or Rs. 60,000 for the Y/A.

We believe that this refund scheme will be an administrative burden for the tax administrator and the taxpayer. Therefore, it would be more appropriate to introduce either a "Self-declaration" scheme, similar to the one for senior citizens, or introduce a "Direction" mechanism for individuals below the personal relief threshold of Rs. 1.8 Mn.

Personal Income Tax

5 Income tax Return – Senior Citizens

It has been proposed to permit senior citizens to lodge the Income Tax Returns manually from the Y/A 2024/2025.

A senior citizen is defined to mean an individual who is:
- a citizen of Sri Lanka during the Y/A;
- resident in Sri Lanka during the Y/A; and
- who is 60 years old or above at any time during the Y/A.

According to the current tax law, all taxpayers are mandated to lodge the Income Tax Returns electronically. As per the proposal, the senior citizens have the option to file the Tax Returns manually from the Y/A 2024/2025 (i.e. the Return to be filed on or before 30 November 2025 could be filed manually)

6 CGT relief on transfer of assets to the Sri Lankan Government or University

Currently, Section 46 of the IRA provides tax neutrality on the transfer of asset ownership by an individual to an associate or a charitable institution. The new proposal extends this application to include the transfer of ownership to the Sri Lankan Government or any University established under the Universities Act No. 16 of 1978. As a result, individuals can transfer assets at their "net cost" value without realizing a taxable gain. The recipient will also deem to acquire the asset at its "net cost" value.

The expansion of Section 46 will achieve tax neutrality at the time of transfer of the asset between the individual and the Government of Sri Lanka / the said Universities. Since the Sri Lankan Government and Universities are exempt from income tax, the deferred tax attributable to the initial transfer cannot be collected subsequently.

7 CGT rate increased to 15%

The Capital Gains Tax (CGT) rate applicable for individuals and partnerships will be increased to 15%.

8 Imputed Rental Income Tax (IRIT)

The Government has decided not to pursue this tax although it was part of the IMF proposals as an alternative to Property Tax.

Indirect Tax Proposals

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VAT - What Will Change?

The Budget Speech indicates a tax revenue collection of Rs. 2,772 Bn from taxes on goods and services (60% of the tax revenue).
The Budget proposes to introduce VAT on digital platform services, abolishment of the SVAT scheme, concessions via VAT exemptions and compliance related proposals.

1. Replacement of SVAT scheme
2. VAT on services provided through digital platform
3. Mandatory usage of POS machines
4. Computation of Value of Supply of film exhibition services
5. Deferred input tax disallowed
6. Write off arrears of Tsunami projects
7. Reintroduction of exemptions
8. New Exemption - supplies made to BSI

Indirect Tax Proposals

Value Added Tax

1 Replacement of Simplified VAT (SVAT) scheme

It is proposed to abolish the SVAT scheme and to replace the existing SVAT scheme with a risk-based refund system to issue the refunds through RAMIS. A Gazette will be issued specifying the scheme by the CGIR. A pilot project will be implemented to ensure a smooth refund operation.

SVAT Scheme was implemented in 2011 to avert the creation of refunds. The persons eligible to register under SVAT scheme are exporters, specified projects etc. As per the Value Added Tax (Amendment) Bill 2023 issued on 31 August 2023, it was proposed to abolish the SVAT scheme with effective from 01 January 2024. The Cabinet Decisions dated 11 September 2023 which was published on the website of the Department of Government Information, stated that the abolishment is deferred until 01 April 2025. Therefore, the Amending Act which was certified on 13 December 2023 did not introduce the removal of the SVAT scheme.

The abolishment of the SVAT scheme without an efficient refund mechanism in place will negatively affect exporters, who are crucial for attracting foreign currency.

The policy makers should review the timeline of abolishing the SVAT scheme, given the following concerns experienced by the taxpayers:

- Working Capital Constraints - Delayed VAT refunds can strain working capital.
- Increased Costs - Higher costs may limit business investment.
- Administrative Burden - More resources will be needed for processing refunds and audits, increasing interaction with the IRD.

Value Added Tax

2 VAT on services provided through digital platform

It is proposed to introduce provisions permitting the issuance of Regulations to impose VAT on the supply of services through digital platforms in Sri Lanka. The Regulations will cover registration, chargeability, tax collection, filing of the return.

The imposition of VAT at the rate of 18% on digital services provided to Sri Lankan consumers by non-resident digital service providers was introduced as a tax reform under IMF Report published in June 2024.

Careful drafting of the Law is essential to ensure that non-resident service providers operating through digital platforms are included within the VAT framework. It is advisable to implement a registration system for non-resident digital service providers. Without a such system, the tax administrator may face challenges in ensuring that all relevant service providers are registered for VAT.

3 Mandatory usage of POS machines

It is proposed to mandate the VAT registered persons to use POS machines.

It was introduced in the Budget speech 2024 to encourage the VAT registered persons to use POS machines for automated invoicing.

The use of electronic POS machines for VAT record purposes is adopted by many foreign jurisdictions such as United Kingdom (UK), United Arab Emirates (UAE) etc., for the retail industry. The use of electronic POS machines is to collect real time data effectively by the tax administrator. This was proposed in previous year budgets as well. However, no visible steps were taken to implement the same.

Clarity is required on the mechanism that would be adopted to implement the above proposal.

Value Added Tax

4 Computation of Value of Supply of film exhibition services

It is proposed, in ascertaining the value of supply of film exhibition services to allow a deduction for the Entertainment Tax charged by the Local Authorities.

The supply of any film for exhibition is liable to VAT since 01 January 2024 and the value chargeable to VAT included the Entertainment Tax.

5 Deferred input tax disallowed

It is proposed to disallow the input tax credit deferred at the time of importation of capital goods such as machinery, equipment or vehicles for projects.

Clarity is required on the persons/projects which will be subject to input tax credit disallowance

6 Write off arrears of Tsunami projects

It is proposed to write off the VAT arrears of construction contractors engaged in Tsunami projects. This proposal seeks to provide relief to construction contractors who contributed to the post tsunami reconstruction efforts.

Value Added Tax

7 Re introduction of VAT Exemptions

- **Exemption on fresh milk and yoghurt**

  It is proposed to re-introduce the exemption for the supply of locally produced liquid milk and locally manufactured yoghurt with effective from 01 April 2025.

Previously, the VAT Act exempted locally produced dairy products, excluding powdered milk with added sugar or sweeteners, made from fresh milk produced in Sri Lanka. This exemption was removed on 01 January 2024. The proposed Law should be reviewed to determine whether the exemption will apply to all locally produced dairy products, as before, or be limited to yoghurt.

- **Exemption on importation of pharmaceutical/ayurvedic medicine packing material**

  It is proposed to re-introduce the VAT exemption on importation of materials used for packaging locally manufactured pharmaceuticals or ayurvedic medicines.

  This exemption would be available to packing materials that are not manufactured in Sri Lanka as approved by the Secretary to the Ministry of the Minister to whom the subject of Health is assigned or the Commissioner of the Department of Ayurveda.

Value Added Tax

8 New exemption – supplies to/ by Business of Strategic Importance (BSI)

It is proposed to exempt from VAT, the supply of goods or services by/ to any a business identified and approved as a “Business of Strategic Importance” in terms of Section 52 of the Colombo Port City Economic Commission Act No.11 of 2021.

As per the current law applicable to the Port City, the Commission has the power to grant an exemption from application of the VAT Act (including an exemption for supplies made by the BSI). As a practice the Commission has been providing an exemption for local purchases of goods and services by a BSI, which is ultra vires the powers of the Commission.

The Budget proposal seeks to provide an exemption for supplies made by persons to BSI to legitimately exempt the transaction from VAT. In addition, the Budget proposal also seeks to grant an exemption for supplies made by a BSI. This is superfluous as the power is vested with the Commission, if so desired to provide an exemption for supplies made by a BSI. However, for existing BSI where such an exemption has not been granted by the Commission in a Gazette, the exemption proposed for output supplies of the BSI would resolve the current problem.

SSCL - What Will Change?

The Social Security Contribution Levy Act No 25 of 2022 (SSCL Act) has been amended twice within the past 2 years of implementation. This Budget too has introduced certain amendments to provide more clarity on the prevailing provisions of the Act.

1 Expanding the definition of "Transportation of Goods & Passengers"

2 Exemption for Wholesale and retail of petrol, diesel or kerosene

3 Restriction of exemption on import or local purchase for machinery & equipment used for generation of electricity

Social Security Contribution Levy (SSCL)

1 Expanding the Definition of the term "Transportation of goods & passengers"

As per the prevailing law "transportation of goods and passengers is exempted from SSCL". It is proposed to expand the definition of transportation of goods and passengers to include services provided in relation to international transportation by container terminal operators.

The effective date of such exemption is not clarified in the proposal.

2 Exemption for Wholesale and retail of petrol, diesel or kerosene

It is clarified in the proposal that the exemption granted for the sale of "petrol, diesel or kerosene sold in a filling station" under Part 1B of the SSCL Act, extends to the wholesale or retail of such articles. Accordingly, sale of petrol, diesel and kerosene regardless of the sale being at a filing station, is exempt from SSCL.

The clarification is provided to ensure that sale of such products outside a filling station is also exempt from SSCL

Social Security Contribution Levy (SSCL)

3 Restriction on exemption of import or local purchase of machinery and equipment used for generating electricity

It is proposed to grant the exemption for the importation and local purchase of machinery or equipment for the purpose of generation of electricity by any institution which has entered into an agreement with the CEB only if such agreement is entered into with CEB prior to 18 February 2025.

Clarity is required whether this proposal would limit the application of the exemption to agreements with the CEB after 18 February 2025 or whether the exemption would be removed from 18 February 2025 .

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What Will Change?

With the lifting of the vehicle import ban w.e.f. 01 February 2025, significant changes were made to the tax structure. The relevant Gazette notifications have already been issued and the new tax structure which includes 5 taxes at the point of importation is currently being implemented.

1 Imposing Customs Import Duty and Surcharge on Customs Import Duty on the Importations of Motor Vehicle

2 Changes to Luxury Tax

3 Revision of Excise Duty and 100% Excise Duty increase for Electric Vehicles

4 VAT exemption removal from 01 January 2024

5 Exemption to be continued for PAL & SSCL

1 Imposition of Customs Duty and Surcharge on Customs Duty on the importation of motor vehicles

The composite tax system which was introduced in 2014 was designed to streamline the duty and tax structure applicable to motor vehicle imports. It combined various taxes, including VAT, NBT, Ports & Airport Development Levy, and Customs Duty, into a single Excise Duty under the Excise Duty (Special Provisions) Act. However, the government has periodically adjusted the composite tax mechanism to maintain a balance in economic growth.

- **Custom Duty**

As per the Gazette Extraordinary Notification No 2421/05 dated 27 January 2025the Custom Duty (CD) has been reimposed, w.e.f 28 January 2025, on the vehicles import under the Chapter 87 of the HS code by the removing the below exemption :

> *"Import of vehicles, chassis fitted with engines, bodies and cut portions, as defined in Chapter 87 where Excise (Special Provisions) duty under the Excise (Special Provisions) Act, No. 13 of 1989, is Applicable"*

Accordingly, Custom Duty of 20% will be applied to such imports.

- **Surcharge on Custom Duty**

As per the Gazette Notification No2421/43 dated 31 January 2025, a surcharge tax at the rate of 50% on the applicable Customs Duty rate (either general or preferential) will be applicable w.e.f. 01 February 2025 for a period of 01 year.

Accordingly, if the general duty of 20% is applicable on the importation of Motor Vehicle, that the Surcharge would be 50% of 20%, i.e. 10%. Accordingly, the applicable Custom Import Duty (including the surcharge) would be 30%.

Import Tax Levies

2 Changes to luxury tax

The Gazette Notification No 2421/41 dated 31 January 2025, the Luxury Tax threshold has been increased by Rs 1.5 Mn.

However, the Luxury Tax rates of 60%, 80%, 90% ,100%,120% for identified HS Codes remain unchanged

3 Revision of Excise Duty and 100% Excise Duty increase for electric vehicles

The Excise Duty Gazette Notification No 2418/43 dated 10 January 2025 increased the Excise Duty rate by 5.9% (as inflationary adjustment) for all vehicles including the vehicles which were removed from the temporary suspension from 01 February 2025.

Further, as per the Gazette Notification No. 2421/42 dated 31st January 2025 the Excise Duty rates for identified HS Codes under heading 87.03 and 87.04 for electric vehicles has been increased by 100%.

4 VAT exemption removal from 01 January 2024

The rationalization of the VAT exemption which was implemented from 01 January 2024 removed the exemption granted for the Importation of vehicles where such Importation is subject to the Excise Duties. According importation of Motor Vehicle attracts VAT at 18%.

When the composite tax mechanism was introduced in 2014 on the importation of Motor Vehicles, in determining the Excise Duty, the VAT rate of 12% which prevailed at that time was considered. However, the Excise Duty rates which were released were not adjusted for the VAT effect. In addition, VAT at the rate of 18% has been introduced on import of motor vehicles.

5 Exemption to be continued for PAL & SSCL

Port and Airports Development Levy (PAL)

The following exemption was included in the Gazette Notification No. 2312/67 dated 31st December 2022

"Importation of Vehicles, chassis fitted with engines, bodies or cut portions as defined in chapter 87 of Harmonized Commodity Description and Coding Number for custom purposes, where such vehicles, chassis fitted with engine, body or cut portion is liable to the Excise (Special Provision) Duty, imposed under the Excise (Special Provision) Act No 13 of 1989."

No changes to the above exemption was referred to in the Budget speech. Hence, the PAL exemption on the importation of Motor Vehicle is still applicable.

Social Security Contribution Levy (SSCL)

The SSCL was introduced via the Social Security Contribution Levy Act No 25 of 2022 with effect from 01 October 2022.

However, the following exemption was introduced via the Amending Act No 15 of 2023 :

> *"any motor vehicle identified under Harmonized Commodity Description and Coding Numbers for Custom purpose and liable to the excise duty under the Excise (Special Provisions) Act, No. 13 of 1989, on the importation"*

Hence, SSCL will be not charged on the importation of motor vehicles where it is liable to Excise Duty.

Import Tax Levies

Following illustrations provide the changes in the Duty structure for selected H S Codes (under Chapter 87.03)

H.S Code : 8703.80.42 Capacity of motors exceeding 50kW but not exceeding 100kW

	Previous Tax Structure	Current Tax Structure
CIF Value **	13,500,000	13,500,000
CID & Surcharge	N/A	4,050,000
PAL	N/A	N/A
Excise Duty	2,715,000	5,430,000
Luxury Tax	4,500,000	4,500,000
VAT	N/A	4,379,400
Total Cost	**20,715,000**	**31,859,400**

HS Code 8703.40.28 - Motor cars including station wagons and racing cars ,of cylinder capacity not exceeding 1,000cc Other, not more than three years old

	Previous Tax Structure	Current Tax Structure
CIF Value **	2,000,000	2,000,000
CID & Surcharge	N/A	600,000
PAL	N/A	N/A
Excise Duty	1,710,000	1,810,900
Luxury Tax	N/A	N/A
VAT	N/A	829,962
Total Cost	**3,710,000**	**5,240,862**

** The CIF values are based on assumptions

Miscellaneous Taxes

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Miscellaneous Taxes

Excise Duty on sweetened beverages

Excise Duty on Sweetened Beverages was introduced in 2017 via the Gazette Notification No. 2044/32 dated 09 November 2017.

Excise Duty has been increased to Rs. 15 per liter or 36 cents per gram of sugar (excluding 6 grams per 100 milliliters), whichever is higher for following items

- Waters and aerated waters containing added sugar, other sweetening matter, or flavoring,
- beverages put up for retail sale as 'Energy Drinks

Summary of the Gazette Notification No. 2418/43 dated 10 January 2025 is provided in the subsequent page. The values are adjusted for inflation indexation of 5.9%.

Below is the summary of the applicable Excise Duty on the Sweetened Beverage

2025	2023	Measurement	Variance
Waters, including mineral waters and aerated waters, containing added sugar or other sweetening matter or flavored and Beverages put up for retail sales as "Energy Drinks"			
Rs. 15 per liter or 36 Cts per gram of sugar, excluding 6grams per 100 milliliters, contained in the product whichever is higher	Rs. 14 per liter or 34 Cts per gram of sugar, excluding 6 grams per 100 milliliters, contained in the product whichever is higher	Rs. Per Liter	7.14%
		Cts Per Gram	5.88%
Beverages based on fruit or vegetable juices with a sugar content exceeding 6 grams per 100 milliliters			
36 Cts per gram of sugar, excluding 8 grams per 100 milliliters, contained in the product	34 Cts per gram of sugar, excluding 8grams per 100 milliliters, contained in the product	Cts Per Gram	5.88%

Miscellaneous Taxes

Excise Duty on liquor & tobacco

Gazette Notification No. 2418/42, issued on 10 January 2025, increased excise duty on liquor and tobacco by 5.9% (Inflationary Adjustment).

Stamp Duty

Effective from 01 March 2025, the stamp duty on any instrument related to the lease or hire of any property will increase from Rs. 10 to Rs. 20 for every Rs. 1,000 (or part thereof) of the aggregate lease or hire amount, including any premium, payable for the entire term of the lease or hire agreement (excluding hire purchase agreements).

Accordingly, the stamp duty on any instrument related to the lease or hire of property will be increased to 2% effective from 01 March 2025.

The Gazette Extraordinary No. 1439/1 states that for the purpose of charging stamp duty on lease and hire agreements, if the term of the lease or hire exceeds 20 years, the total lease or hire amount payable for the entire term will be treated as the total amount payable for the first 20 years of the lease. We presume this condition will not be amended.

Miscellaneous Taxes

Betting and Gaming Levy

- **Gross Collection Levy will be increased from 15% to 18%.**

  The Gross Collection Levy must be paid monthly on the total revenue from bookmaker or gaming businesses if the monthly gross collection exceeds Rs. 1 mn.

  This levy should be paid on or before the end of first week of the month immediately following the relevant month.

- **Casino Entrance Levy to be increased from USD 50 to USD 100.**

  Casino Entrance Levy is collected from every citizen of Sri Lanka who enters to the place of gaming by the person who carries on the business of gaming.

  This levy was first introduced on 01 April 2015, requiring every individual entering a place of gaming to pay a fee of USD 100 or its equivalent in any convertible foreign currency or Sri Lankan rupees. On April 1, 2023, the fee was reduced to USD 50 and applied only to Sri Lankan citizens. However, the latest budget proposes restoring the fee to USD 100.

Tax Appeals Commission

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Tax Appeals Commission

It is proposed to introduce the following amendments to the Tax Appeals Commission Act No 23 of 2011 (TAC Act) and the comparison of the current law and the proposed amendments to the statute is tabulated below.

	Existing Provisions	Proposed Amendments
The fees charged to state a case of question of law for the opinion of the Court of Appeal.	Rs.1,500/-	Rs.10,000/-
The fees charged to make an appeal to the TAC	Rs.2,500/-	Rs.15,000/-
Transfer of the bank guarantee to the CGIR irrespective of decision to appeal to the Court of appeal.	The bank guarantee of 25% of the tax payable is valid until determination by the TAC and shall be transferred to the CGIR upon determination of the respective appeal and shall be set off against the sum as assessed by the CGIR.	Mandatory transfer of said bank guarantee to CGIR irrespective of the appellant's decision to appeal to Court of Appeal

Tax Appeals Commission

Areas of Concern	Existing Provisions	Proposed Amendments
Payment into a special account upon making an appeal to the TAC	• Non-refundable deposit of 10% on the disputed tax or, • Refundable deposit of 25% on the disputed tax or, • Bank guarantee of 25% on tax payable (tax, levy, duty or penalty)	Cash deposit of 25% of the disputed tax amount including penalty & interest to the special account by CGIR. *Clarity is required on weather the option is available to submit non refundable deposit of 10%*
Right to appeal	Appeal to the TAC against the Determination of the CGIR or appeal to the TAC upon the lapse of 7 months from filing the request for administrative review (in the absence of the CGIR determination)	An appeal to the TAC will not be allowed unless a request for administrative review has first been made and a decision thereon has been received from the CGIR or a request for administrative review is deemed to have been disallowed.
Mediate settlements between CGIR and appellant during the TAC hearing process.	No specific legal provisions	Necessary legal provisions to be introduced to mediate settlements between the CGIR and the Appellant, subject to the supervision of the TAC during the hearing of the Appeal

Tax Appeals Commission

Areas of Concern	Existing Provisions	Proposed Amendments
Submission of new evidence and taking up new issues during TAC hearing.	Except with the consent of the Commission, the appellant shall not at the hearing, be allowed to produce any new document, evidence or witness which was not produced to the CGIR.	During the TAC hearing no new evidence which was not submitted or new issues which was not taken or disputed during the assessment or administrative review will be permitted.
Term of office of the panel of Legal Advisers & reappointment	Every member of the TAC shall hold office for a term not exceeding 3 years, and shall be eligible for re-appointment.	The term of office of the panel of Legal Advisers will be increased to 5 years and eligible for re-appointment.
Term of office of the members of the Commission	Every member of the TAC shall hold office for a term not exceeding 3 years, and shall be eligible for reappointment.	The term of member of the TAC will be increased to 5 years from the date of appointment.

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Other Proposals

Free Trade agreement (FTAs) and Double Tax Avoidance Agreement (DTA's)

FTA network will be expanded and DTA will also be expanded with priority given to countries with high trade and investment potential. Sri Lanka has currently entered into 46 DTA's, which includes 4 limited Treaties.

Proposed legal reforms for 2025

Introduction of new enactments such as an Act to enable Exchange of Information between State Institutions, Investment Protection Act, State Business Enterprises Management Act, Public – Private Partnership Investment Management Act, Statistics Act, Valuation Act, Public Asset Management Act, Public Procurement Law and Micro Finance and Credit Regulatory Authority Act.

The Budget further refers to strengthening of Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Framework and amendments to the Paddy Marketing Board Act No 14 of 1971.

Digitalizing of Tax System

The Budget speech refers to digitalizing of the tax system to improve, enhance transparency and reduce tax leakage efforts will be directed towards digitalization of tax system to minimize human interaction in tax administration.

Revamp the Customs

The Government intends to introduce new tariff rates based on the National Tariff Policy to create a simple, transparent and predictable tariff framework. This is aimed at removing restrictions on access to high-quality, affordable raw materials. In the Budget 2024 it was proposed that steps would be taken to eliminate the para tariffs to improve Sri Lanka's involvement in foreign trade.
It is further proposed to introduce a new Customs Law to enhance trade facilitation and revenue collection. Similar proposal was introduced in the Budget Speech 2016.

Investment promotion and facilitation

The Hon. President in delivering the Budget speech shared his insights on the steps being taken to enhance investment promotion and facilitation. The following is a synopsis of the key areas:

The Government plans to support the expansion of export-oriented investments and sector-specific zones, including establishing eco-industrial parks through Public Private Partnerships (PPPs) and privately-run zones, focusing on sustainable practices and green technology.

The Economic Transformation Act will be revisited with appropriate revisions for emerging developments. Under-utilized state-owned land will be leased out for productive economic activities.

An Investment Protection Bill will be enacted to safeguard investments, while improvements in the country's ease of doing business will be prioritized in key areas such as property registration, tax payments, trade facilitation, contract enforcement, and obtaining credit to attract foreign direct investments (FDI).

Measures for digitizing public services and laws for effective implementation of the one-stop-shop concept will be introduced. Additionally, a PPP Bill will be enacted. Barriers for local firms investing overseas will be reviewed and rationalized, with safeguards for tracking repatriation of earnings and dividends.

The Government will call for foreign direct investments to maximize Sri Lanka's untapped potential in investment, industrial development, and value-added exports of mineral resources and the marine economy.

Technical and financial assistance will be provided to exporters and importers for obtaining quality testing and certifications. Development efforts will include testing and calibration labs, referral centers, and universities, such as the health research referral center for cancerous inputs and other conformity assessment bodies, including the Industrial Technology Institute. A proposed allocation of Rs. 750 Mn for 2025 aims to fulfill the desired outcome of the National Quality Infrastructure (NQI) system in the country.

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Economic Analysis

Executive summary

Sri Lanka's economy has demonstrated a steady progress in 2024, recovering from the financial crisis that impacted the nation in recent years. Following significant contractions in 2022 and 2023, the country has experienced a robust growth in the year 2024, driven by a combination of strategic policy measures, external financial aid, and strong performances across key sectors, including tourism, agriculture, and industry. The government's fiscal position has also improved, with increasing revenues, a primary balance surplus, and a decline in the public debt-to-GDP ratio.

Sri Lanka’s economic recovery has been further reinforced by a significant reduction in inflationary pressures that previously plagued the economy. Inflation, which peaked at 70% in 2022, declined sharply to -1.7% by December 2024, providing much-needed relief to consumers and businesses alike. Additionally, a 40% increase in the national minimum wage has bolstered domestic consumption and purchasing power, contributing to overall economic stability.

On the external front, Sri Lanka has experienced a surge in exports, a sharp rise in tourist arrivals, and stronger remittance inflows, all of which have strengthened foreign exchange reserves and stabilized the external sector. Meanwhile, ongoing debt restructuring efforts have provided significant debt relief and contributed to an improvement in the country’s credit rating, further enhancing economic stability. Looking ahead, Sri Lanka’s growth trajectory is expected to stabilize at approximately 3.5% in 2025, underpinned by continued fiscal discipline, structural reforms, and investor confidence. The government has set ambitious targets, including a revenue goal of Rs. 5,000 Bn, while prioritizing macroeconomic stability. However, challenges such as managing the trade imbalance, improving labor migration policies, and ensuring long-term sustainable growth persist. Despite these uncertainties, the overall outlook remains cautiously optimistic, with targeted policy interventions and ongoing economic reforms paving the way for sustained recovery.

Sri Lanka's economy rebounded in 2024, navigating challenges to maintain momentum

In 2024, Sri Lanka's economy has experienced a remarkable recovery, rebounding from its most severe financial crisis in decades. Following contractions of 7.3% in 2022 and 2.3% in 2023, the economy achieved a 5.5% growth in Q3 2024. This growth not only reflects the country's resilience but also marks the highest annual GDP growth in seven years, driven by a range of key economic factors. Sri Lanka's recovery is driven by accommodative monetary policies that have stimulated investment and economic activity, alongside effective inflation control measures that have ensured price stability, improved consumer purchasing power, and reduced business costs.

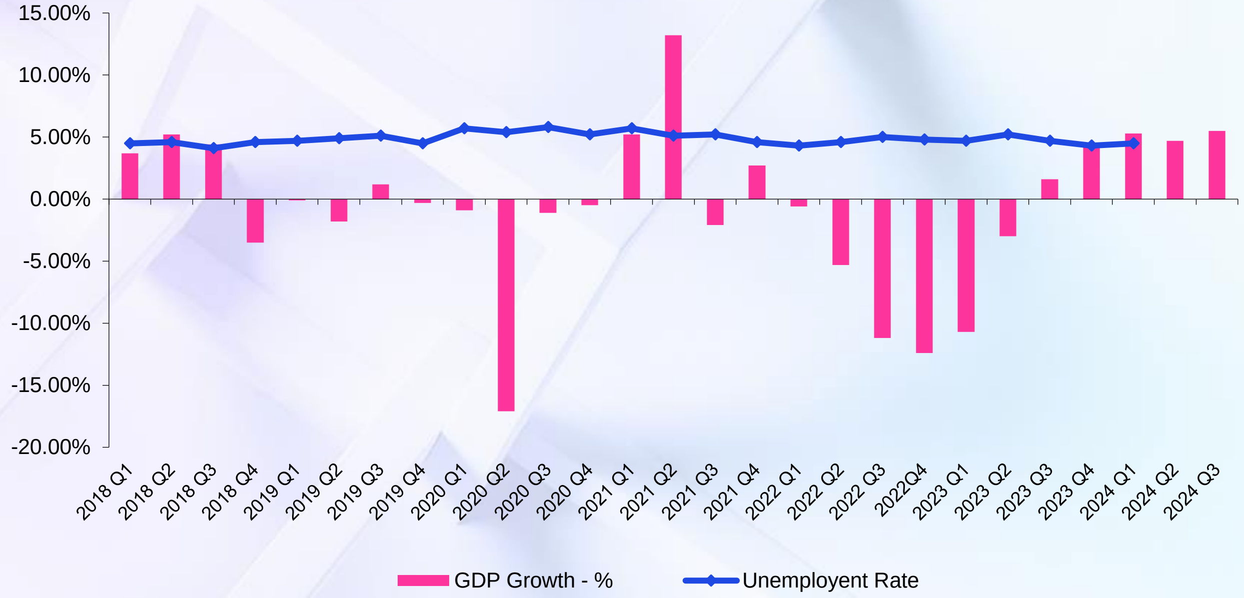
Additionally, external financial support, including an approximately USD 3 Bn IMF program, has bolstered investor confidence and fiscal stability. Key sectors, including industry, services, agriculture, and tourism, have been instrumental in driving this recovery. In Q3 2024, GDP growth by industrial origin was, Industry – 10.8%, Agriculture – 3.0%, and Services – 2.6%, collectively supporting an overall GDP growth. The tourism sector plays a particularly significant role in boosting GDP, contributing USD 3.17 Bn to the economy. These factors have collectively strengthened the economic foundation, paving the way for sustainable growth and making a remarkable recovery from the crisis.
Sri Lanka increased the national minimum wage by 40% in 2024, raising both the monthly and daily wages for private sector employees. At the same time, the unemployment rate decreased to 4.5% in Q1 2024, compared to 4.7% in 2023 and 2022, signaling a positive shift in the labor market. These wage adjustments, coupled with improved employment levels, are expected to stimulate domestic consumption, enhance workers' purchasing power, and contribute to broader economic stability and growth.

Economic Analysis

Sri Lanka's economy rebounded in 2024, navigating challenges to maintain momentum

The World Bank initially projected Sri Lanka's real GDP growth at 4.3% for 2024. However, the country has outperformed this forecast, achieving growth rates of 5.3% in Q1, 4.7% in Q2, and 5.5% in Q3, reflecting a robust economic rebound. Looking ahead, the World Bank anticipates a moderation in growth, forecasting real GDP expansion at 3.5% in 2025 and 3.1% in 2026. This reflects a stabilization phase following the rapid recovery of the past year.

As per The World Bank, Sri Lanka's economic outlook remains cautiously optimistic, supported by macroeconomic stability, improved fiscal health, and increasing investor confidence. However, sustaining this momentum will require continued structural reforms, improved policy coordination, and targeted efforts to enhance employment and foster private sector growth. While the sharp recovery from the crisis of 2022 is a remarkable achievement, it underscores the need for an investment driven and well-balanced economy capable of withstanding external shocks and ensuring long term prosperity.



Source: CBSL, Department of Census and Statistics

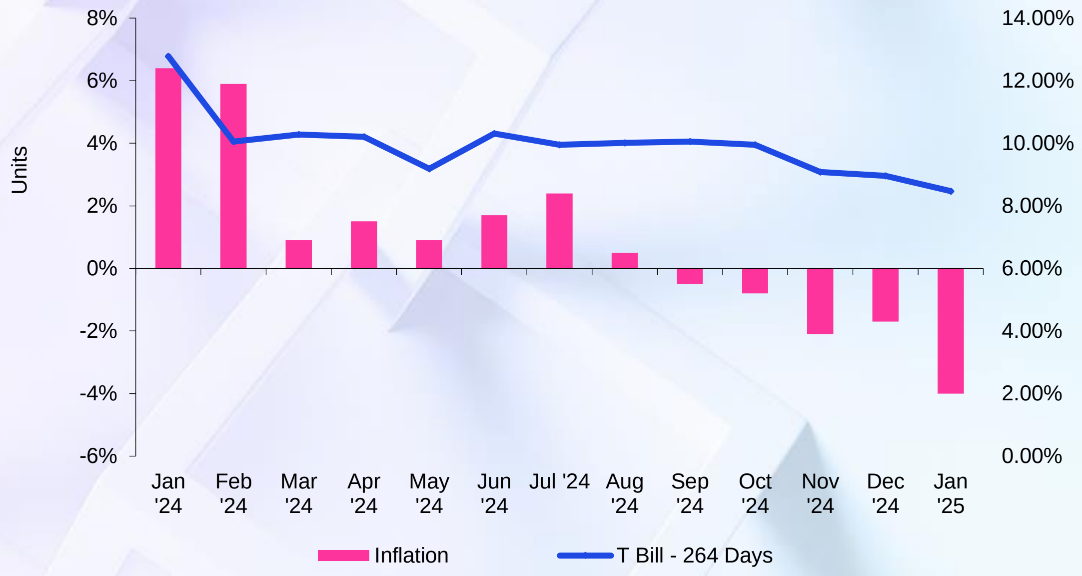
Economic Analysis

Inflation eases amidst lower energy prices, stronger Rupee, and accommodative policies.

Sri Lanka's inflationary pressures continued to ease in early 2025, primarily driven by reductions in administratively determined energy price, an appreciating local currency, and accommodative monetary policy measures. The Colombo Consumer Price Index (CCPI)-based headline inflation recorded a year-on-year (YoY) decline of -4.0% in January 2025, marking a sharper contraction compared to -1.7% in December 2024.

The food and non-alcoholic beverages category contributed -0.83% to the overall YoY inflation in January, reflecting reduced cost pressures on essential goods. Similarly, non-food inflation declined substantially, contributing -3.22% to the deflationary trend. The YoY inflation of the food group decreased to -2.6% in January 2025 from 0.8% in December 2024, while the non-food group inflation fell to -4.7% from -3.0% over the same period.

While deflation is expected to persist in the short term, the Central Bank of Sri Lanka remains focused on stabilizing inflation in the second half of 2025. Strategic adjustments to interest rates are being made to maintain low and stable inflation, with the goal of guiding inflation toward its 5% target, while fostering economic growth and ensuring public welfare.

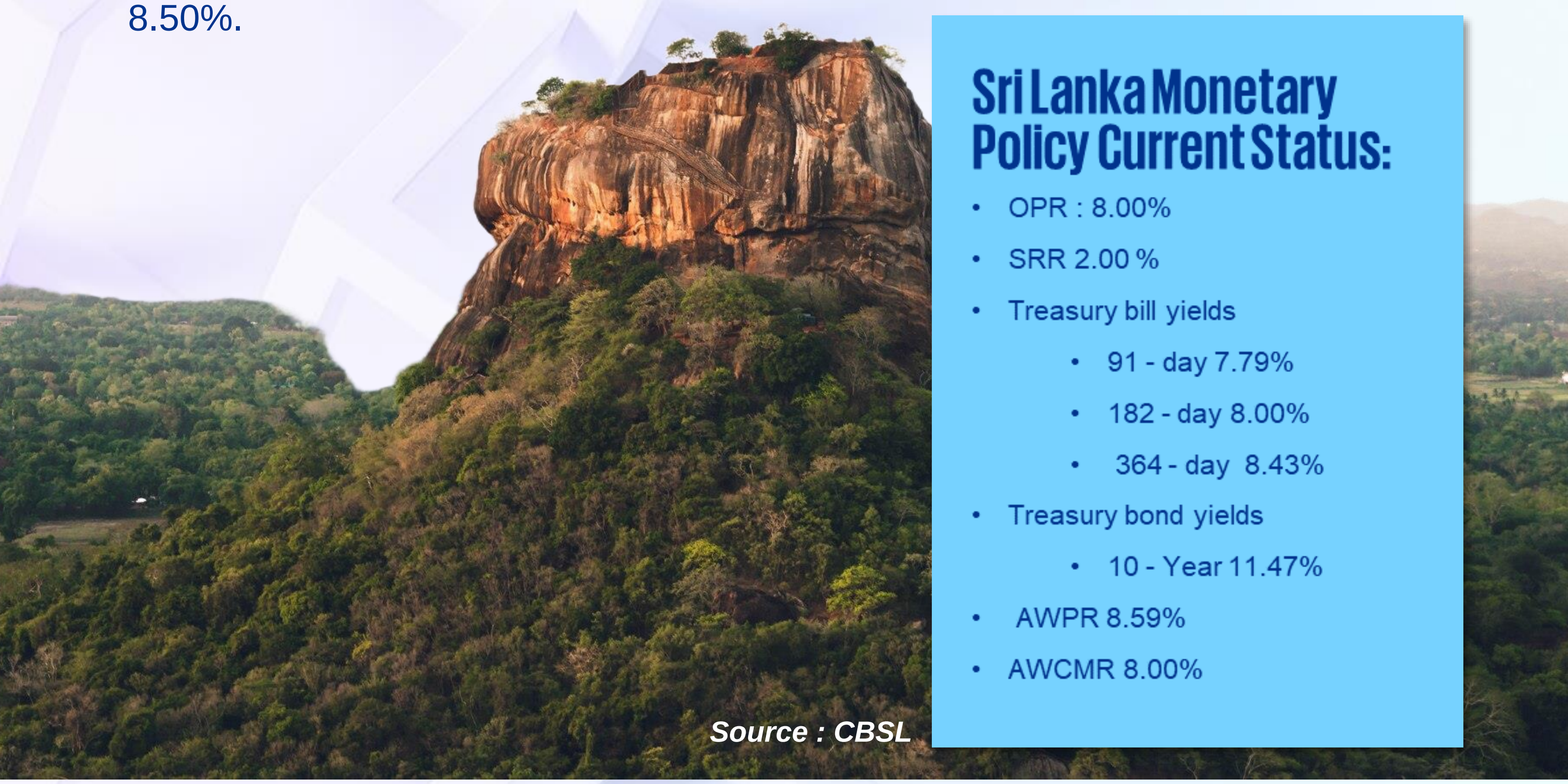


Source: CBSL, Department of Census and Statistics

Economic Analysis

Central Bank's Monetary Policy adjustments foster economic stability and support growth

The Central Bank of Sri Lanka (CBSL) has actively adjusted its monetary policy stance to manage inflation and support economic recovery. At its meeting on January 28, 2025, the CBSL maintained the Overnight Policy Rate (OPR) at 8.00%, reaffirming its commitment to price stability while fostering economic growth. The transition from the previous Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) to the OPR as the primary policy instrument has streamlined the monetary framework. However, the SDFR and SLFR remain applicable for overnight standing facilities, maintaining a ±50 basis point margin around the OPR, with the SDFR set at 7.50% and the SLFR at 8.50%.



Sri Lanka Monetary Policy Current Status:

- OPR : 8.00%
- SRR 2.00 %
- Treasury bill yields
    - 91 - day 7.79%
    - 182 - day 8.00%
    - 364 - day 8.43%
- Treasury bond yields
    - 10 - Year 11.47%
- AWPR 8.59%
- AWCMR 8.00%

Source : CBSL

In contrast, in March 2023, the CBSL had adopted a tight monetary policy stance to curb inflation, resulting in the SDFR reaching 15.5% and the SLFR rising to 16.5%. This policy shift was aligned with the staff-level agreement reached with the International Monetary Fund (IMF) under the Extended Fund Facility program. As inflationary pressures subsided, the CBSL gradually eased monetary policy over the past year, aiming to sustain inflation at a single digit level. Furthermore, the Statutory Reserve Ratio (SRR) has been maintained at 2.00%, facilitating greater liquidity in financial markets and supporting credit expansion.

Central Bank's Monetary Policy adjustments foster economic stability and support growth

Government securities and market lending rates have remained stable, reflecting improved investor confidence, fiscal discipline, and the CBSL's accommodative monetary stance. As of February 5, 2025, Treasury bill yields have declined compared to early 2024 levels, with 91-day, 182-day, and 364-day bills yielding 7.79%, 8.00%, and 8.43%, respectively. Similarly, Treasury bond yields have remained stable, with 10-year bonds yielding 11.47%. The decline in government securities yields reflects improved fiscal performance and a reduction in sovereign risk premiums, further reinforcing financial market stability.

Lending rates have also adjusted downward, supporting private sector credit expansion. As of February 7, 2025, the Average Weighted Prime Lending Rate (AWPR) stood at 8.59%, while the Average Weighted Call Money Rate (AWCMR) was at 8.00%.

Economic Recovery Strengthened by Trade Growth, Rising Remittances, and Tourism Revival

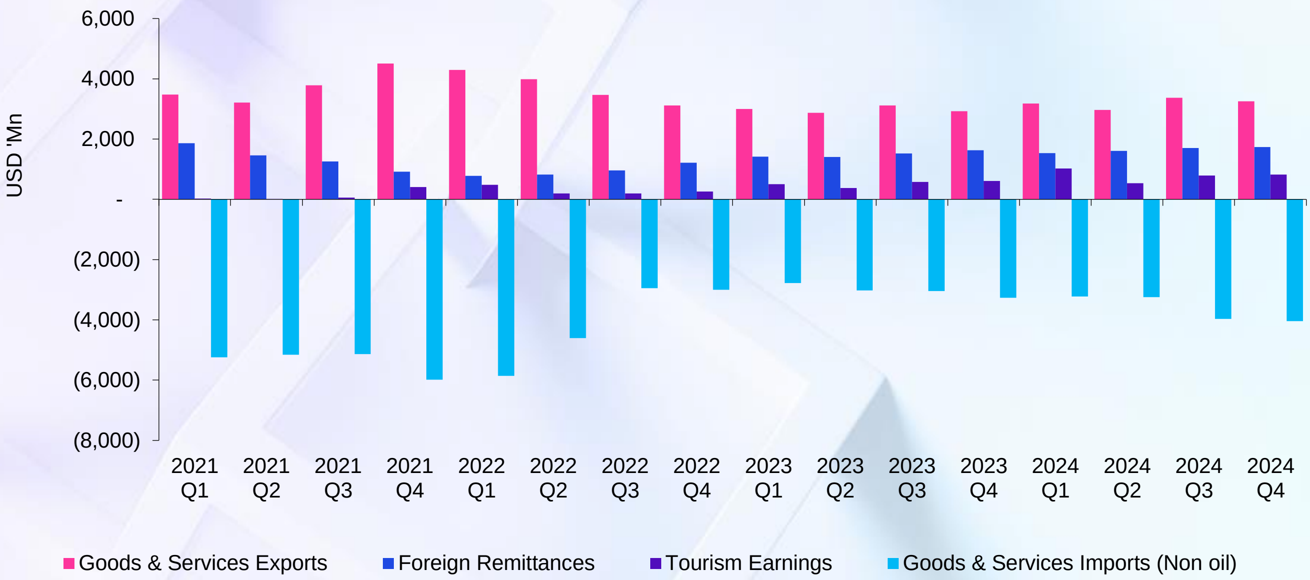
In 2024, non-oil goods and services imports increased by 20%, reaching USD 14.5 Bn compared to USD 12.1 Bn in 2023. This growth was driven by significant rises in both investment goods and consumer goods. Investment goods surged by 26%, reflecting a positive outlook for economic expansion and capital investment. Meanwhile, consumer goods imports rose by 14%, with food and beverages accounting for 38% of total consumer goods imports. The rise in imports indicates stronger demand for both essential and capital goods, indicating an economy adjusting to evolving market conditions. Exports of goods and services increased by 7%, reaching USD 12.7 Bn compared to USD 11.9 Bn in the previous year. Agricultural exports grew by 8%, while industrial exports expanded by 7%, reflecting balanced growth across both sectors. Tea accounted for 52% of agricultural exports, while textiles and garments comprised 51% of industrial exports. The export performance reflects contributions from both the agricultural and industrial sectors, supporting overall trade stability. However, the merchandise trade account deficit for 2024 increased to USD 6,069 Mn, up from USD 4,900 Mn in 2023. This widening of the deficit was primarily driven by increase in import expenditure, which outpaced the growth in export earning.

In 2024, Sri Lanka experienced a 5% increase in labor migration as opposed to previous year, with a total of 312,836 individuals migrating for employment abroad. Male workers accounted for 59% of the total migrant workforce, indicating a significant share in the migration trend. This rise in labor migration contributed to a 10% increase in foreign remittances, which grew from USD 6 Bn in fiscal year 2023 to USD 6.6 Bn in fiscal year 2024.

Economic Recovery Strengthened by Trade Growth, Rising Remittances, and Tourism Revival

The primary destinations for Sri Lankan migrant workers included Kuwait, the United Arab Emirates, Israel, Japan, and South Korea. The increase in both migration numbers and remittance inflows highlights the growing importance of labor migration as a crucial driver of foreign exchange earnings, underscoring its role as a significant source of income for Sri Lanka's economy. The sustained demand for Sri Lankan workers in these key markets continues to bolster remittance inflows, which play an essential role in supporting domestic consumption and economic stability.

Sri Lanka's tourism sector has shown a strong sign of recovery, achieving its highest performance since 2018. Tourist arrivals surged to approximately 2.05 Mn, a 38% increase from the previous year. This upward momentum continued into early 2025, with 252,761 visitors recorded in January and 44,293 in the first five days of February. With this growth, the country has set an target of attracting 3 Mn tourists in 2025. The tourism sector significantly contributed to the economy, with earnings rising by 53.2% to USD 3.17 Bn, up from USD 2.07 Bn in the previous year. With these positive trends, the country aims to generate USD 5 Bn in tourism revenue in 2025, reinforcing the sector’s role in driving economic growth.



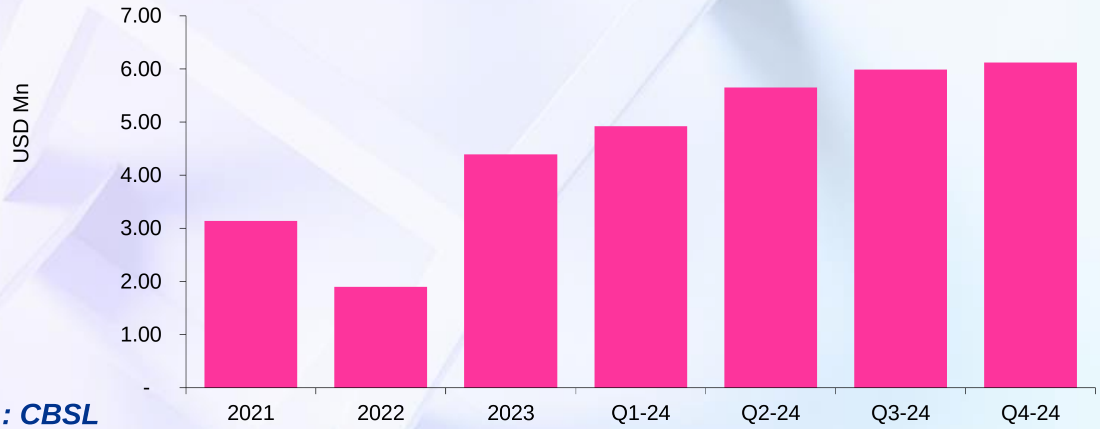
Source : CBSL

Foreign Exchange Reserves Surge, Strengthening Economic Stability and Investor Confidence

In 2024, Sri Lanka experienced a significant recovery in its foreign exchange position, following a period of economic challenges. Official reserves surged by 81.0% year-on-year, reaching USD 6.5 Bn by October, surpassing the IMF's target of USD 5.6 Bn and strengthening the country's external stability. This improvement was driven by gains in tourism, worker remittances, and a rebound in exports. The Central Bank reported a record USD 2.3 Bn in net foreign purchases, reflecting increasing confidence in the economy.

The Sri Lankan rupee appreciated by over 10.0% within 11 months, supported by these forex inflows. Inflation, which had reached 70.0% in 2022, fell to -1.7% by December 2024, contributing to greater price stability. The rise in foreign exchange reserves also contributed to improved economic conditions.

Foreign Exchange Reserves



Source : CBSL

Sri Lanka's Debt Restructuring and Fiscal Reforms in Restoring Stability and Ensuring Long-Term Economic Resilience

In response to the challenges posed by previous fiscal policies, loosened monetary measures, and delayed IMF engagement, the government implemented a comprehensive debt restructuring plan in April 2022 to restore debt sustainability. This effort enabled the country to secure financial support from the IMF under its Extended Fund Facility (EFF), laying the foundation for economic stability and growth.

As part of the Debt Restructuring plan, Sri Lanka completed its domestic debt restructuring process in July 2023, marking a crucial milestone in managing the country's financial crisis. This initiative played a vital role in stabilizing the economy by addressing domestic financial imbalances and laying the groundwork for broader debt sustainability efforts.

Building on this progress, by December 31, 2024, Sri Lanka had made significant strides in negotiating debt relief with external creditors. The restructuring of USD 12.5 Bn in defaulted bonds and accrued interest resulted in a 40.3% reduction in the net present value (NPV) and achieved 98.0% investor acceptance rate. Major international creditors, including BlackRock and Amundi, supported the bond exchange, while China endorsed the principle of equal treatment for all creditors in line with IMF terms. The restructuring introduced GDP and governance linked bonds, effectively reducing debt service payments by USD 9.5 Bn over four years and extending maturities by five years.

Under the IMF-supported recovery plan, Sri Lanka implemented a bond exchange program in November 2024 and successfully settled its obligations with the China Development Bank by December 2024. However, negotiations with smaller bilateral creditors remain ongoing. The IMF's second review under its 48-month EFF enabled Sri Lanka to access approximately USD 336 Mn, and a staff-level agreement for the third review was reached in early 2025.

These debt restructuring measures contributed to an improvement in Sri Lanka's credit ratings, with Fitch upgrading its foreign currency rating to CCC+ and Moody's raising it to Caa1 by December 2024.

Sri Lanka's Debt Restructuring and Fiscal Reforms in Restoring Stability and Ensuring Long-Term Economic Resilience

Additionally, Sri Lanka's debt sustainability outlook has shown significant improvement. Public debt declined from 128.0% of GDP in 2022 to 99.9% in June 2024, with Debt Sustainability Assessment (DSA) Targets indicating a further reduction to below 95.0% by 2032. This progress underscores the country's ongoing efforts to restore fiscal stability and strengthen its long-term economic resilience.

However, despite the successful negotiations, government debt levels remain relatively high, and litigation challenges, such as the ongoing case with Hamilton Reserve Bank, are yet to be resolved.

Sri Lanka's revenue showed improvements, with a 32.2% increase year-on-year in the first eleven months of 2024, and a target revenue of Rs. 5,000 Bn for 2025. Government expenditure increased by 1.9%, while the primary balance shifted to a surplus, a significant improvement from the previous deficit. The government aims to maintain expenditures at 20.0% of GDP in 2025 and limit the budget deficit below 5.0% of GDP, with a primary surplus of 2.3% of GDP to aid debt management.

Looking forward, Sri Lanka's fiscal and debt sustainability will depend on sustaining reform efforts, boosting revenue generation, and strengthening both external and fiscal buffers. The IMF-backed reform program aims to increase government revenue to 15.4% of GDP and gross international reserves to USD 15.1 Bn by 2028. Key policy actions, such as relaxing import restrictions on motor vehicles and strengthening governance through critical reforms like the Public Financial Management Act and Anti-Corruption Act, will help ensure long-term fiscal discipline. Additionally, the government's expanded social security programs demonstrate its commitment to fortifying social safety nets.

While Sri Lanka's debt restructuring and fiscal reforms have significantly enhanced its financial outlook, maintaining macroeconomic discipline and implementing robust governance reforms will be pivotal for sustaining long-term debt sustainability.

Industry Analysis

Banking & Finance

Industry Analysis

Fiscal proposals

- Establishing a Development Bank - initially through a new administrative structure within existing state banks, with the support of the National Credit Guarantee Institution (NCGI) to promote SMEs.

- Development of Financial markets - To enhance the real economy, the Government encourages the private and state entities to raise funds through listed equity and debt capital markets.

- Introduction of a new Micro Finance and Credit Regulatory Authority Act - To strengthen the consumer protection and supervision of the micro finance industry.

- Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) Framework.

- In order introduce a robust framework to promote financial sector integrity and to ensure compliance with international standards following new provisions will be introduced to the below legislations;

  - The Convention on the Suspension of Terrorist Financing Act, No. 25 of 2005
  - Prevention of Money Laundering Act, No. 5 of 2006
  - Financial Reporting Act, No. 6 of 2006

- The Ministry of Environment, in collaboration with the Ministry of Finance and the Central Bank, will seek sustainable financing opportunities to create a thriving ecosystem for Environmental, Social, and Governance (ESG).

Fiscal proposals (Cont.)

- Special Interest Scheme for Senior Citizens - A Special Interest Scheme for Senior Citizens (above the age of 60 years) would be introduced to provide financial stability.

  Banks should introduce a special fixed deposit that could be opened with one year tenure up to Rs. 1 Mn, with an extra 3% interest rate on top of the current market rates. 3% additional interest to be paid would be subsidized by the Government.

  This scheme is expected to be implemented from July 2025.

Current tax status

- The 30% income tax rate will continue to apply to the banking and finance industry. VAT on financial services and SSCL on financial services will continue to apply at 18% and 2.5% on the value addition, respectively.

Energy Sector

Industry Analysis

Fiscal proposals

- The focus is on diversifying energy sources, especially renewable energy, and modernizing infrastructure. Investments will be encouraged, with a focus on attracting local and foreign investors offering competitive tariffs. Regulatory reforms, including a new Act, will support sector efficiency.
- Future energy investments will prioritize competitive pricing and avoid higher tariffs, ensuring affordable energy for industries and consumers.
- Government explores partnerships with international companies to enhance Sri Lanka's global energy position by developing of Trincomalee oil tank complex.

Tax proposals

- No new tax proposals for the energy sector, except for restricting the SSCL exemption on machinery or equipment imported or purchased locally for electricity generation by institutions that have agreements with the CEB after 18 February 2025.

Current tax status

- Businesses in the energy industry are subject to income tax, VAT and SSCL at standard rates, unless specific exemptions or exclusions apply.

Export

Industry Analysis

Fiscal proposals

- A national export development plan (2025-2029) will be formulated to increase exports of goods and services by enhancing Sri Lanka's ability to export into global markets.
- MSMEs will be supported to explore new export markets, expand existing ones, and connect with global value chains.
- A new National Tariff policy will be introduced which will create a simplified, transparent, and predictable tariff framework.
- Free Trade Agreements with strategic partners will be expanded through the Regional Comprehensive Economic Partnership (RCEP), to strengthen economic ties, especially with ASEAN nations.
- Enhancement of Sri Lanka exports of goods and services via focusing on more dedicated and more professionalised diplomatic missions.
- Sri Lankan expatriates will be utilized to enhance access to international business networks and opportunities.
- Automation and integration of the registration of key border agencies and exporters via the implementation of the Trade National Single Window (TNSW)

Current tax status

- The corporate income tax rate for the export of goods will continue to be at 30%.
- The current exemption enjoyed by service exporters will be removed from 01 April 2025 and will be subject to CIT at the rate of 15% w.e.f 01 April 2025.

Agriculture

Industry Analysis

Fiscal proposals

- The government prioritizes productivity, competitiveness, and resilience in agriculture, with a focus on quality seeds, water efficiency, and cascade management.
- Paddy farmers will continue to receive a fertilizer subsidy (Rs. 35 Bn allocated for 2025).
- A buffer stock system for rice will be established with a budget of Rs. 5 Bn to stabilize prices.
- A comprehensive agriculture information system will be developed with ADB and World Bank support.
- An accelerated program (2025-2027) will promote the cultivation of field crops beyond paddy.
- The Paddy Marketing Board Act will be amended to regulate paddy and rice storage and collection.
- Underutilized lands managed by government entities will be identified for private investment (Rs. 250 Mn allocated).
- Producer cooperatives will be promoted, following global models. Youth entrepreneurship in agro-based SMEs will be supported.
- Rs. 2.5 Bn will be invested in dairy value chain improvements in 2025-26 to enhance milk production.

Fiscal proposals (Cont.)

- To meet rising coconut demand, Rs 500 Mn will be allocated for planting 16,000 acres in the Northern Coconut Triangle.
- Traditional exports like cinnamon will receive Rs 250 Mn for product development and trade promotion, with support from embassies and joint ventures.
- Rs 200 Mn will be invested in boosting prawn farming through PPP hatcheries and improved marketing.
- The government plans to introduce rail-based transportation for agricultural goods to reduce costs, post-harvest losses, congestion, and environmental impact.
- A comprehensive development program in the Eastern Province, funded by India, will support agriculture, among other key sectors.

Current tax status

- Businesses operating in the agricultural sector is liable for income tax at 30%. The 5-year income tax exemption granted for agro farming business lapsed from Y/A 2023/24. No proposals in the budget to extend the same
- VAT is applicable at 18% unless the supplies are specifically exempt or zero-rated. SSCL is charged at 2.5% on the liable turnover, which is calculated after excluding exempt amounts.

Digital

Industry Analysis

Fiscal proposals

- Prioritize the introduction of Sri Lanka Unique Digital Identification (SL-UDI) for all citizens.
- Create new legislation and the strengthening of existing legislation and related institutional farmwork to govern and protect the Digital Economy.
- Enact new Legislation to accelerate the Digital Economy and to empower an Apex Digital Economy Authority as well as other subject specific agencies in the Digital Eco-System.
- Strengthen legislation and institutions related to Cyber Security, Data Privacy and Data Protection.
- Adoption of digital payments flowing between Government, Business and Citizens. For instance, the launch of GovPay system.
- Attract investments towards innovations in artificial intelligence, robotics, FinTech, and other emerging technologies.
- Grow Sri Lanka's Digital Economy to a level in excess of USD 15 Bn or 12% of the National Economy over the next 5 years

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- Increase in the ICT industry's annual export revenue to USD 5 Bn. Allocate Rs. 3,000 Mn for the acceleration of the Digital Economy Development.
- Introduce a digital ticketing system to address issues of overcrowding and improve capacity of the tourism sector.

Tax proposals

- Imposition of corporate income tax at the rate of 15% on export of services, further to the removal of exemption with effect from 01 April 2025.
- Introduction of VAT at the rate of 18% on services provided through digital platforms

Current tax status

- Gains and profits from services provided to a person outside Sri Lanka where foreign currency is remitted through a bank in Sri Lanka, is exempted from Income Tax. This exemption will be removed from 01 April 2025
- Other services providers who do not fall under the above exemption are taxed at the standard Income Tax rate of 30%.
- Local Digital Services providers are liable to VAT at 18% for the services provided in Sri Lanka and Zero rating for services provided outside Sri Lanka subject to condition.
- SSCL is charged at 2.5% on the liable turnover, which is calculated after excluding exempt amounts.

Hospitality

Industry Analysis

Fiscal proposals

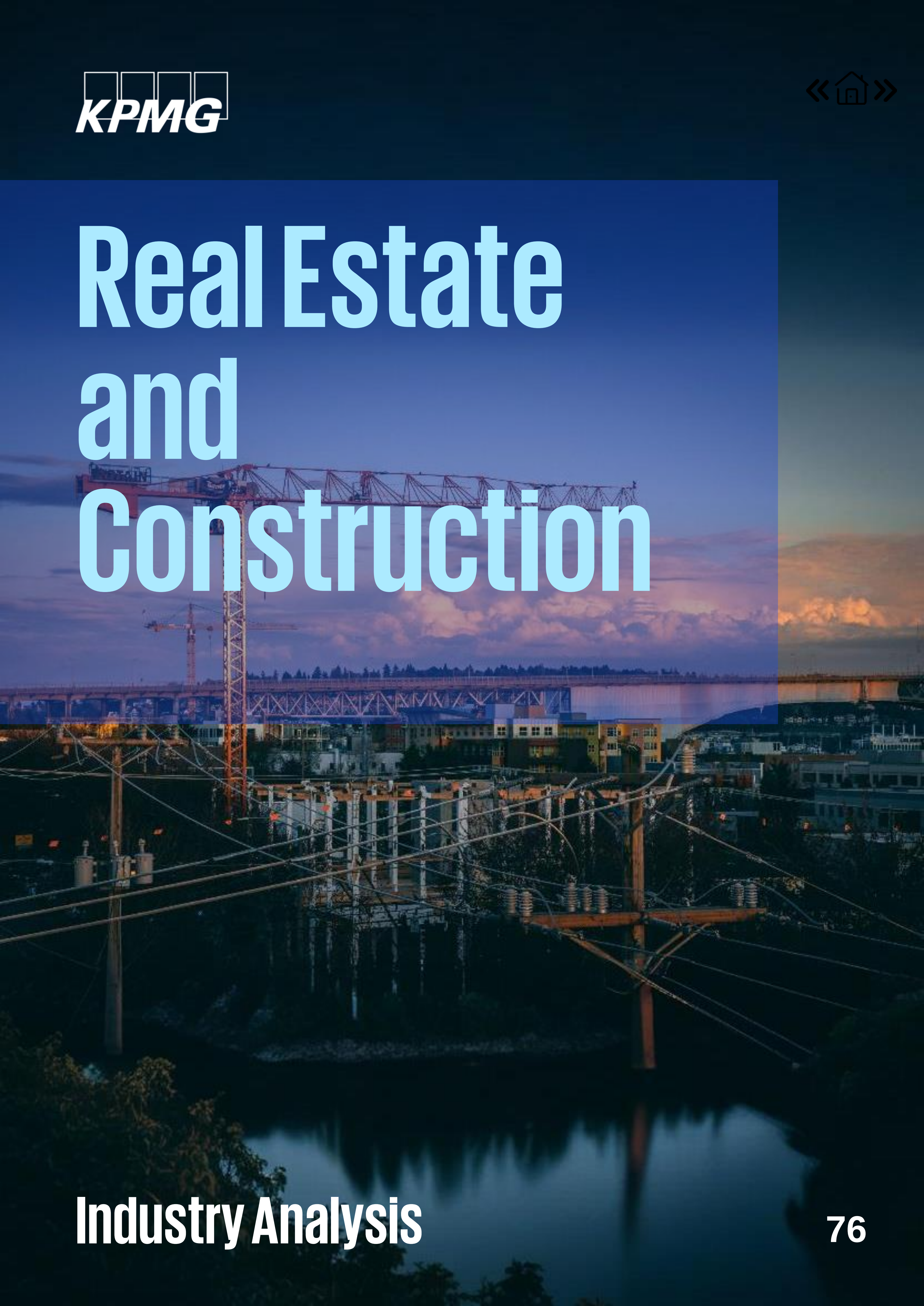
- Rs 500 Mn allocated in 2025 to enhance tourism destinations with city branding and infrastructure.
- Government will facilitate youth training in communication and essential skills.
- Efforts will be made to expand tourism by developing and promoting new locations.
- Digital ticketing system will be introduced to manage overcrowding and improve efficiency at tourist sites.
- Bandaranaike International Airport Terminal 2 will be expanded with Japanese investments.
- A tech-based system will link tourist police, government agencies, and civic organizations to provide security alerts, attraction details, and complaint monitoring.
- Rs 3 Bn allocated for rural road improvements, prioritizing access to tourist destinations and economically significant areas.
- A comprehensive development program in the Eastern Province, funded by India, will support key sectors including tourism.

Fiscal proposals (Cont.)

- A national festival will promote inter-ethnic and inter-religious harmony while enhancing Sri Lanka's cultural appeal for tourists.
- Training programs will be introduced for three-wheeler drivers, taxi operators, and tour guides to improve service quality.
- Rs. 1,050 Mn has been allocated for reforestation, forest conservation, and mangrove management, contributing to environmental sustainability while enhancing eco-friendly tourism.
- A major cultural event will be held in December, aligning with peak tourist arrivals, with private sector participation (Rs. 300 Mn allocated).

Current tax status

- Businesses in the tourism industry are subject to income tax, VAT, SSCL, and the Tourism Development Levy at standard rates, unless specific exemptions or exclusions apply.



Real Estate and Construction

Industry Analysis

Fiscal proposals

- Bimasaviya program aims to provide high-quality land titles for small-scale landowners.
- Complete the East and West Container Terminal projects to enhance the capacity of the Colombo Port
- Bandaranaike International Airport Terminal 2 will be expanded with the support of Japanese investments.
- New water resources development projects and down-stream developments are expected to be implemented over medium term.
- Allocation has been made to build houses for the Orphan children. Further a housing scheme of 108 units will be constructed in Kottawa Palathuruwatte, funded by the Chinese Government, for artists and journalists
- Proposals are made to improvement and rehabilitation of rural roads and bridges..
- Allocation has been made for development of estate housing and infrastructure development and accelerate the housing programs for internally displaced persons in the North and East.

Tax proposals

- Proposed to write-off the VAT arrears related to construction projects undertaken as part of the Tsunami relief effort.
- Proposal to disallow the input tax deductions on capital goods such as machinery, equipment, or vehicles imported for projects if the VAT was deferred at the time of importation.
- Effective from 01 March 2025, the stamp duty on any instrument related to the lease or hire of property will increase from 1% to 2%.
- In June 2024, the IMF proposed the introduction of an Imputed Rental Income Tax on owner-occupied and vacant residential properties to take effect before 1 January 2025.

  However, in the budget, it was indicated that the Government has decided not to pursue in this year.

Current tax status

- Currently gains and profits from business of companies in real estate and construction industry are taxed at the standard income tax rate of 30% unless a specifically exempted.
- VAT is applicable at 18% unless the supplies are specifically exempted or zero-rated.
- SSCL is charged at 2.5% on the liable turnover, which is calculated after excluding exempt amounts.

About KPMG Sri Lanka

KPMG Sri Lanka at a glance

Professionals In KPMG Sri Lanka

Professionals

1,200+ People locally

20 Partners

Tax - 55

Audit - 853

Advisory - 296

Part of

143

Countries in the Global Network

Celebrating excellence spanning

125

years and beyond

Combined Global Revenues

$36.4

USD in Billions

Established in

1897

The oldest Chartered Accountancy firm in the country

Awards and Recognitions

2023
One of **LMD's most Respected Entities** in Sri Lanka for **2023**

2022
Sector winner in **Financial Services** by **LMD's most Respected Entity** in Sri Lanka for **2022**

2022
KPMG firms named a **"Strong Performer"** by **Forrester - The Forrester Wave™**: Oracle Cloud Apps Implementation Services Partners, Q2 2022

2021
KPMG Sri Lanka **ACCA Platinum Employer Status for Training and Professional Development**

2021
Sector winner in **Financial Services** by **LMD's most respected entity** in Sri Lanka for **2021**

2021
Best Corporate Advisory Firm - Sri Lanka **2021** **Global Economics Awards**

2019
First in **Financial Services** Category **LMD Most Respected 2019**

2019
Forrester Wave Leader – 2019 – Global Cyber Security Consulting Services

2018
Sri Lanka **Tax Firm of the Year Asia Tax Awards 2018**

2018
Oracle SaaS Partner of the Year 2018
Oracle ERP Partner of the Year 2018
Oracle SCM Partner of the Year 2018

2017
First in the **Auditors League** in Sri Lanka **LMD 100 - 2017**

2017
First in the **Auditors League** in Sri Lanka **LMD 100 - 2017**

2016
Best Advisory Firm in Sri Lanka **The International Finance Magazine 2016**

2016
Best Deal Advisory Firm in Sri Lanka **Global Banking and Finance Review 2015**

KPMG Leadership Team – Sri Lanka

Suren Rajakarier
Partner - Chief Operating Officer
Head of Audit & Assurance

Ranjani Joseph
Partner - Head of
Banking Services and
Clients & Markets

Chamara Abeyrathne
Partner – Audit,
Head of Delivery Centre &
Deputy Head of Audit

Upul Karunaratne
Partner – Audit
Deputy Risk Management
Partner

Thamali Rodrigo
Partner – Head of
Restructuring, Enterprise
Advisory and Corporate
Governance.

Harsha Rajan
Partner – Audit
Head of PPC

Shameel Nayeem
Partner – Audit,
Head of Maldives
Office

Dhammika Rajapakse
Partner - Audit

Raditha Alahakoon
Partner - Department
of Professional
Practice (DPP)

Pyumi Sumanasekara
Partner - Sustainability, ESG,
Family Business & Board
Governance,
Global Assurance

Duminda Rathnadiwakara
Partner - Audit

Audit

Priyanka Jayatilake
Managing Partner

Kamaya Perera
Partner - Head of
Management Consulting &
Technology, Deputy Head
of Advisory & PPC

Jagath Perera
Partner - Governance Risk
& Compliance Services,
Forensic Services
Risk Management Partner

Shiluka Goonewardene
Principal - Deal Advisory
Head of Advisory
Deputy Head of Sales and
Markets

Karthikeyan Somasundaram
Principal – Deal Advisory

Dushani Corea
Principal – Deal Advisory

Advisory

Suresh Perera
Principal - Head of
Tax & Regulatory

Rifka Ziyard
Principal - Tax &
Regulatory

Hasitha Raddella
Principal - Tax &
Regulatory

Tax

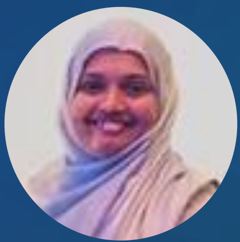
KPMG

Our Tax Team

Suresh Perera
Principal - Head of Tax and Regulatory

Rifka Ziyard
Principal - Tax and Regulatory

Hasitha Raddella
Principal - Tax and Regulatory



Hasna Hassan
Director - Tax and Regulatory

Sushendra Senanayake
Associate Director - Tax and Regulatory

Radhini Thomas
Associate Director - Tax and Regulatory

Lourdes Mirani Ratnarajah
Associate Director - Tax and Regulatory

Budget At A Glance
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