

To: All DCGS, SCC, CCIR, DCC, AIC, SAA & AA

Value Added Tax (VAT)
Amendments to the VAT Act as per the Budget 2009

Changes to the Value Added Tax, as announced in the Budget 2009, have already been effected, pending amendments being made to the Value Added Tax Act No. 14 of 2002.

This note is intended to provide you with clarifications and guidance for application of such changes maintaining uniformity.

(1) Exemptions

(a) (i) The supply of locally manufactured tea machinery w.e.f. 01.10.2008

This is to be in par with the exemption given on the importation of machinery in the previous Budget. The criteria is that such machinery should be manufactured in Sri Lanka and used for tea industry as tea machinery. For this purpose the type of the machinery should be identified by Sri Lanka Tea Board established by the Sri Lanka Tea Board Law No. 14 of 1975, as Tea Machinery. The effective date is 01.10.2008, as this has been administratively implemented from that date.

(ii) The supply of locally manufactured surgical gauze used for surgery with effect from 01.01.2009.

The persons who apply for this exemption should prove that the gauze is manufactured locally and supplied to hospitals etc.

(Amendment is made to paragraph (b) of PART II of the First Schedule.)

Please note that any input tax is not deductible on the purchase of goods or on services obtained on or after the effective date of the exemption.

If the file is to be closed due to the application of these exemptions, please note that the VAT on deemed disposals is collected, prior to the closure of the file.

(b) (i) The importation of buses on or after 09.07.2008 to replace the buses destroyed due to terrorist activities

This is a specific exemption applicable to special circumstances. The criterion is that the bus imported should replace the bus destroyed due to terrorist activity. The owner of the bus (destroyed) shall obtain the approval of National Transport Commission or any Provincial Road Passenger Transport Authority to

prove that the bus was destroyed due to terrorist activities and the person who imports such bus is the owner of the bus destroyed.

(ii) The importation of brass sheets, brass ingots, thread, dyes, paraffin wax or shellac for manufacture of brassware by the National Craft Council with the approval of the Ministry of Rural Industries and Self Employment Promotion (with effect from 01.01.2009)

This is a specific exemption subject to the fulfillment of the conditions specified.

The manufacturers, who are registered with National Craft Council, are entitled to import such items through that organization, if only it is used by them for manufacture of brassware and submit the approval of the Ministry of Rural Industries and Self Employment Promotion to the Director General of Customs based on the recommendation of the National Craft Council. The goods should be imported by National Craft Council, on behalf of the manufacturers.

(iii) The importation of chemical naphtha on or after 01.01.2009 by Ceylon Petroleum Corporation to be supplied to Ceylon Electricity Board for the generation of electricity

This is also a specific exemption applicable only to Ceylon Petroleum Corporation, subject to the conditions specified in that paragraph.

(iv) The importation of packing material exclusively for the use of packaging pharmaceuticals manufactured in Sri Lanka and imported by the manufacturer of such pharmaceuticals, so far as such packing materials are not manufactured in Sri Lanka and approved by the Minister in charge of the subject of Finance on the recommendation of the Secretary to the Ministry of Healthcare and Nutrition

This is also a conditional exemption which is to be effective from the date of certification of the Act.

(Amendment is made to paragraph (c) of PART II of the First Schedule.)

- (c) The importation or supply of solar modules and accessories for the generation of solar power energy specified under HS Code Nos 8501.31.10, 8541.40.10, 8513.10.10, 9405.10.10, 9405.10.20, 9405.20.10, 9405.20.20, 9405.40.30, 9504.40.40, 9032.89.10 and 8539.31.20 with effect from 01.01.2009. The above HS Code Nos have been produced to the Director General of Customs and accordingly, any such item imported are VAT free

if items fall under the above HS Code Nos. The local exemption could also be obtained if the same items are manufactured in Sri Lanka.

(Amendment is made to paragraph (a) of PART II of the First Schedule.)

The input tax relating to exempt supplies should be disallowed.

- (d) The supply of services, being construction services for Gama Naguma, Maga Naguma, Samurdhi projects or for community irrigation projects, carried out through the participation of the community and approved by the Secretary to the Ministry in charge of the subject of Nation Building and State Infrastructure Development.

A new paragraph as paragraph (g), is added to PART II of the First Schedule. The exemption is effective from 01.01.2009.

The exemption is applicable only to a specific project referred to in that paragraph subject to the fulfillment of the conditions specified therein.

The input tax on purchases should form part of the cost of the construction project, since the output tax is exempt.

(2) Changes to the deduction of input tax

- (a) **Deduction of input tax credit on a customs declaration related to importation of goods :**

Prior to 01.01.2009, the claimability of input tax on a cusdec was similar to a claim on a tax invoice. With effect from 01.01.2009, the period of one year is extended to two years on claims of input tax on a cusdec.

Accordingly, if the input tax on :-

- (i) a tax invoice is claimable against the output tax for any taxable period ending on or before the expiry of 12 months from the date of such tax invoice;
- (ii) a Customs Declaration is claimable against the output tax for any taxable period ending on or before the expiry of 24 months from the date of such tax Custom Declaration.

by furnishing within the said period of 12 months in the case of a tax invoice, or 24 months in the case of a Custom Declaration, the return for that taxable period.

Any input tax after the expiry of the above period is not claimable by amending the return. Any subsequent amendment should be made within the specific time frame as specified in this paragraph, from the date of the issue of the tax invoice or the date of the custom declaration. (Any claim after the specific time frame is treated as disallowable input tax). The other restrictions on claimability of input tax remain unchanged.

(The relevant amendments are made to Section 22 of the VAT Act.)

- (b) **Restriction of input credit**

Consequent to the change of the standard rate of 15% to 12%, the restriction on the claimability of 20% input tax is restricted to 12%:

This restriction is applicable on 20% input tax paid on tax invoices issued on or after 01.01.2009. Any tax invoice issued at 20% prior to 01.01.2009, if deductible, even though claimed on or after 01.01.2009, (subject to the time frame specified in para (a) above) the restriction will be up to 15%.

(3) Expansion of VAT suspension through Export Development Board (EDB)

The scheme of suspension of VAT on supplies made to exporters (liable supplies) by local manufacturers (deemed exporters) of non apparel goods, was introduced through EDB with effect from 01.07.2006.

This was extended to provision of services as well with effect from 01.06.2008.

The services are special services which results in the improvement of the quality, character or value of any goods manufactured in Sri Lanka by an exporter.

Presently, the blending of tea has been considered as a service which fulfils the conditions specified therein.

(Circulars issued to EDB for the purpose of implementation of suspension scheme have been amended including the services as well. The guidelines specified in the circular should be followed once the service is considered as an service in which the VAT is suspended).

**(4) The limits for the registration for VAT
(Effective from 01/01/2009)**

(a) Normal VAT (Section 10 of the VAT Act is amended)

The present limit of Rs. 500,000/- per taxable period or Rs. 1.8 Million per year, is increased to Rs. 650,000/- per taxable period or Rs. 2.5 Million per year.

Any registration on or after 01.01.2009 has to be made on this basis. However, the VAT registered person below the present increased threshold can not cancel the files, unless the normal conditions in cancellation of the file is applied. Before cancellation the liability to deemed disposals should be checked. (According to the provisions of the VAT Act, a registration can not be cancelled unless a period of one year from the registration is completed)

(b) Optional VAT

The present maximum limit of the registration for optional VAT of Rs. 2.5 Million is increased to Rs. 3 Million.

(5) Rate Changes
(Effective from 01/01/2009)

(a) Basic rate of 5%

The goods which are liable to tax under the provisions of Special Commodity Levy Act No. 48 of 2007 are removed from the Basic Rate Schedule. Such goods are:-

Sugar, dhal, potatoes, onions, dried fish, chilies (so far as such goods are imported and is taxed under the provision of Special Commodity Levy Act and not liable to VAT).

The Third Schedule (Basic Rate Schedule) is closed with effect from 01.01.2009.

Accordingly, the other goods which are not falling under the Special Commodity Levy Act, fall under the Standard Rate of 12%.

Such goods are :

Jewellery, petrol, high tech medical equipment and any machinery used for the manufacture of ticket issuing machinery.

Hence, VAT files should be reopened for those items as such items are taxed at 12% and input tax is allowable to such persons on payments at the custom point. However, any VAT paid at 5% prior to 01.01.2009 is not claimable as input tax. Hence, such input tax will remain as part of the cost.

(b) The reduction of the Standard Rate

The Standard Rate of 15% is reduced to 12% with effect from 01.01.2009.

The following transitional provisions should be noted, on supplies liable at Standard Rate.

(i) The application of the rate should be based on the time of supply.

If the time of supply falls on or before 01.01.2009 even though the invoice is raised on or after 01.01.2009, the rate applicable should be 15%.

This may arise on the following circumstances.

- The time of supply is the earliest of
Date of invoice
Due date of payment
Date of receipt of payment/ advance

Date of delivery/ Date of performance of services (if invoice is issued within 10 days then that date, it is treated as the time of supply)

The time of supply should be decided on this basis.

Since, the tax invoice could be issued within 28 days, the date of issue of 'tax invoice' may fall in the month of January 2009. In such a case the rate applicable is 15% as the time of supply falls in December 2008.

However, if the approval is obtained by the supplier of services under section 23 (cash basis is allowed only for construction services or consultation services), the time of supply is the time on which the payments are made. Hence, if the payments are made in January by a supplier who is approved to make supplies on cash basis any tax invoice issued on or after 01.01.2009, can be made at the rate of 12% (However, it should also be checked that in certain cases even though the cash basis approval is obtained, tax invoices may have been issued prior to 01.01.2009, in such cases, the total VAT invoiced should be paid.)

Special attention should be drawn on such cases as the issue of invoice is not permitted prior to payments.

- (ii) **Advance payments :** If advances are received prior to 01.01.2009, both under cash basis and accrual basis, time of supply on such advance is the time of receipt of the advance. Hence liable at 15%. Accordingly, any advance received prior to 01.01.2009, which is taxed at 15% should be deducted when the supply is invoiced after 01.01.2009.

Illustration : Rent agreement is entered into in December 2008, 20% of the total Rent for one year is received as an advance payment in December.

Monthly Rent is 100000.

Advance received in December	240,000
VAT 15%	<u>36,000</u>
	276,000
	=====

Month of January Rent	100,000
Less Advance	<u>20,000</u>
	80,000

VAT 12%	9,600
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Adjustment in respect of

- Bad debts on invoices issued prior to 01.01.2009.
- Bad debts recovered which was written off prior to 01.01.2009.
- Adjustment for Debit Notes, Credit Notes etc.

The adjustments also should be made based on the rate applied prior to 01.01.2009. i.e. 15%. Since there is no column in the VAT Returns for adjustments at the rate of 15%, the tax (VAT) should be shown in the column at 12% and adjust the value accordingly. However, this is only for the purpose of filing the return. The value of supply for any other purposes should be the actual value of supplies. The registered person should keep a record of the adjustment made in this manner, for the reconciliation of the value of supplies for VAT purposes and the turnover for income tax purposes.

Illustration :

(1) Value of supply liable at 12% for the
 Month of January 2009 Rs. 500,000
 VAT at 12% 60,000

Bad debts. Written off
 on supplies declared on actual basis in 2005
 Rs. 5,000 and VAT is 750

			VAT
Value of supply	500,000		12%
			60,000
Bad debts 5,000	<u>6,250</u>		<u>750</u>
	493,750		59,250

$\left(\frac{750 \times 100}{12} \right)$

Value of supply for income tax purposes = 495,000
 (500,000 – 5,000)

Value of supply for VAT purposes = 493,750

(2) Value of supply at 12% in the month of
 January 2009 500,000

Supply under declared in the
 Month of December
 Which was adjusted through a credit note
 5,000 VAT 15%

			VAT
Value of supply	500,000	12%	60,000
Adjustment on credit note	<u>5,000</u>	15%	<u>750</u>
	505,000		60,750

$\left(\frac{750 \times 100}{12} \right) = 6,250 = 506,250$ 60,750

Value for VAT purposes should be shown as Rs. 506,250.

Claimability of input tax on tax invoices received after 01.01.2009, is at the rate of 15%.

There may be situation that tax invoice is raised on or after 01.01.2009, for supply made in December 2008, (since there is a time gap of 28 days to issue a tax invoice) or any tax invoice issued prior to 01.01.2009 received on or after 01.01.2009.

In such cases the input is claimable without restriction based on the reduction of the rate subject to other restrictions specified in Section 22 of the Act, including restriction of allowable input tax subject to 85% of the output tax.

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