

Synopsis of the VAT law-2003

1. At a Glance

Name of the Tax : Value Added Tax

Date Introduced : 01st August 2002

However the same tax was in force with effect from 01.04.1998 under the name Goods and Services Tax.

Administered by : Inland Revenue Department

VAT Rates : Standard Rate -- 20%
Reduced Rate - 10%
Zero Rate - 0%
Special Rate - Rs.25/- per piece of garment released to the local market by B.O.I. companies with special approval of Customs.

VAT Number Format : 12345689 – 7000

A nine digit number with code number 7000. The nine digit number is the taxpayer identification number (TIN) which is the National Identification Number in the case of individuals and a number derived from the business registration number in the case of others

VAT Return Periods : i. Quarterly
ii. Monthly if the annual turnover exceeds Rs.30 Million. However Commissioner Generals approval can be obtained to file quarterly returns.

Registration Threshold: If the value of the taxable supplies exceeds or likely to exceed Rs.500,000/-per quarter or Rs.1.8 Million per annum.

Recovery of VAT by Non-established business: No.

Group Registration : No.

Reverse Charge Mechanism: No

2. **Scope of the Tax**

i. **Transactions -**

VAT applies to the following transactions.

- (a) Supply of Goods & Services in Sri Lanka **by a Registered Person**
 - (b) Importation of Goods into Sri Lanka **by any person.**
- (a) On the supply of Goods and Services in Sri Lanka by a Registered person VAT is charged
- at the **“time of supply”**
 - on every **“taxable supply”**
 - made in a **“taxable period”**
 - in the course of carrying on or carrying out a **taxable activity** in Sri Lanka
 - by that Registered person.

In the case of supply of goods the ***goods must be in Sri Lanka at the time of supply.***

In the case of supply of services the ***services must be performed in Sri Lanka by the supplier or his agent.***

- (b) On the importation of goods into Sri Lanka by any person VAT is charged.
- at the time of supply
 - by the Department of Customs.

ii. **Exclusions from the Scope**

Following supplies (transactions) are excluded from the Scope of VAT.

- (a) Supplies made in the course of wholesale and retail supply of goods and commodities
and
 - (b) Specified imports.
- (a) For the purpose of this exclusion wholesale and retails supply of goods and commodities does not include

- wholesale and retail supply by a manufacturer of such goods.
- Wholesale and retail supply by an importer of such goods.
- Whole sale and retail supply by a supplier who is unable to satisfy the Commissioner General as to the source from which such goods were acquired.
- Supply of goods on tender
- Sale of goods by auction.

Thus the above five categories of transactions are **within the scope of VAT.**

(b) Following specified imports are excluded from the scope.

- any imported goods which are entered into a Customs Bonded Area
- In addition importation of fabric by certain garment manufacturers cum exporters and importation of yarn grey cloth, chemicals and dyes for the purpose of manufacturer of fabric to be used by the above mentioned garment manufacturers cum exporters are excluded from the scope of VAT.

iii. **Persons within the Scope**

From the point of view of persons there are two categories of persons who are within the scope of VAT.

They are

- (a) The persons who are liable to pay VAT to government or the VAT tax payers, and
- (b) The persons who are subject to VAT as consumers on the goods and services consumed by them or on goods imported by them.

(a) **Who is liable**

The “VAT taxpayer” who is required to file returns with the Inland Revenue and pay VAT to the government is known as the “**Registered person**” in the VAT Act. This refers to any “**individual**” or “**body of persons**” who makes “**taxable supplies**” of goods and services in the course of carrying on carrying out a “**taxable activity**” in Sri Lanka and

who is **registered** for VAT. No individual or “body of persons” is exempted from the requirement to register for VAT if the (taxable) supplies made by such person exceeds the registrable threshold. **Every registered person** is liable to charge and collect VAT on the (taxable) supplies made by such person and to account for such collections to Inland Revenue.

(Body of persons means any body corporate or unincorporate, provincial council, local authority, any fraternity, fellowship, association or society of persons, whether corporate or unincorporate, any partnership and includes any government department or any undertaking of the government or any co-ownership of immovable property)

(b) **Persons subject to VAT**

The second category is the persons who do not pay VAT direct to the government and or do not file returns but are subject to VAT on the goods and services purchased by them from registered persons and on the goods imported by them. That means they pay VAT along with the price paid for goods and services etc. **In this category there are some exempt persons.** They are Diplomatic Missions and Privileged Individuals as defined in the Diplomatic Privileges Act. They are exempted from VAT in the sense that they are required to pay only the “**VAT –exclusive price**” in respect certain goods and services identified by the Commissioner General of Inland Revenue and on the importation of identified goods. Subject to this exemption all individuals and “bodies of persons’ including government Departments & Ministries, religious and charitable institutions, non-profit making bodies are within the scope of VAT in the sense that they will be required to pay “**VAT inclusive prices**” in respect of goods and services purchased by them from registered persons and on the importation of goods.

3. **Who is liable and Registration**

As stated above the **VAT tax payer or the person who is liable to pay VAT to the government is known as the registered person.** Every registered person is liable to charge and collect VAT on the taxable supplies made by him and to file returns with the Inland Revenue in order to account for such collections. There are four types of registrations. Broadly there are two types of registrations namely (i) those who are liable to register and (ii) these who are entitled to register.

(i) **Who is liable to register**

(a) **Compulsory Registration**

Every person (ie an individual or a body of persons) who carries on a taxable activity should register for VAT if the value of his taxable supplies exceeds or likely to exceed Rs.500,000/- per quarter or Rs. 1.8 Million per annum. No person is exempted from registration requirements if he satisfy the above conditions Thus Govt. Departments, Ministries, Religious, Social Services and charitable institutions, Non-profit making bodies are all liable to register.

In computing the value of supplies to determine the above threshold the following should be excluded.

- Value of any exempt supplies
- Value of any excluded supplies consisting of retail and wholesale sales.
- VAT chargeable on the supply.

(Although certain bodies of persons like partnerships are not juristic persons they are required to be registered under the VAT Act. All partners of a partnership and principle officers of other organization are singly and severally liable for any offences under the Act).

(b) **Forced Registration**

If the Commissioner General having regard to the nature of the activity is of the opinion that a person is required to be registered but has not made an application to that effect, he still register such person.

(ii) **Entitlement to register**

(a) **Voluntary Registration – After the commencement of commercial operations**

- If a person has commenced making taxable supplies irrespective of whether the value of taxable supplies has reached the threshold or not any person who wishes to register for VAT can apply for voluntary registration. Such application may be refused by the Commissioner General if it is considered an impediment to the protection of revenue.
- Retail and wholesale suppliers who are otherwise excluded can also apply for voluntary registration.

(b) **Voluntary Registration – Before the commencement of commercial operations - Registration of Newly Commenced Businesses**

Even before the commencement of making taxable supplies (ie. Even before the commencement of commercial operations) any newly commenced business or project is entitled to register for VAT, subject to any conditions specified by the Commissioner General. In such cases output tax = 0 and the person is entitled to refund of input tax incurred on project related inputs.

(iii) **Exemption from Registration**

No individual or body of persons is exempted from the requirement to register if such person satisfies the conditions required to register.

(iv) **Consequences of Registration**

Once registered such person must charge & collect VAT on all taxable supplies made by him even if his turnover falls below the threshold until he is officially de-registered. De-registration will not be done within the first 12 months of registration. Thus a registered person must charge & collect VAT at least for one year.

(v) **Cancellation of Registration (De-registration)**

Application can be made at any time after the laps of 12 months if the turnover has fallen below the threshold. Notwithstanding the de-registration such person is liable for any act done or omitted to be done while he was registered. Any goods and assets at the time of cancellation of registration shall be deemed to be supplied in the course of carrying on that taxable activity. Thus before de-registration a person will be asked to pay VAT on existing stocks and assets unless the taxable activity is transferred as a whole to another registered person who undertakes to carry on the taxable activity.

(vi) **Group Registration**

There is no provision in Sri Lanka VAT law to allow closely related companies which are under common control or which are in one group to register as a group. Transactions between the companies are liable to VAT. However a ruling has been given by the Commissioner General of Inland Revenue permitting central invoicing in the case of companies in one group. That means invoices from the suppliers will be allowed to be received by one central company and the expenditure will be allowed to be debited to other companies on some valid basis. Entire VAT (input tax) can be claimed/recovered by the central company who receive the invoices. This procedure is allowed only if all the companies are making **only** taxable supplies but not exempt supplies.

(vii) **Importers Registration**

Apart from such registration every importer of goods, if he is not a VAT registered person he is required obtain an **Importers Identifications Number (IIN)** from the Commissioner General of Inland Revenue in order to clear goods from the Customs because irrespective of the status of the importer (i.e whether he is a VAT registered person or not) he is required to pay VAT on imports to the Customs. This I.I.N. is not a VAT registration because a person cannot charge and collect VAT with such a registration.

(viii) **Registration of Partnerships and other non-legal entities**

As all “**bodies of persons**” are liable to register for VAT if they are carrying on or carrying out taxable activities and if value of the taxable supplies made by them exceeds the threshold all non legal entities such as partnerships, clubs, associations etc. are liable to register for VAT. The individual partners of a partnership and the principle officer of other entities are personally liable for any offences under the Act including failure to register.

(ix) **Non-Established Businesses**

Businesses that have no fixed establishment in the territory of Sri Lanka are not obliged to register for VAT in order to do the business of supply of goods and services to persons in Sri Lanka. However if such company carries on a taxable activity and supply goods or services in Sri Lanka through a representative in Sri Lanka who is acting on behalf of the foreign principle then such representative is liable to VAT in the like manner and to the like amount as the foreign principle (Section 55 of the Act). The representative should register for VAT on behalf of the foreign principle if he satisfies the registration conditions.

(x) **Late Registration Penalty**

A person is required to make an application for registration for VAT within 15 days of becoming liable to register. Failure to register will be subject to a fine of Rs. 25,000/- and or a term of imprisonment not exceeding 6 months after a summary trial by a magistrate.

4. **Taxable Activity**

A person (ie an individual or a body of persons) must carry on a taxable activity in Sri Lanka for such person to be registered for VAT – Taxable Activity means

- (a) * any activity carried on as a trade, business, profession or vocation (other than employment)
- * every adventure and concern in the nature of trade.

- (b) In relation to a club, association or organization, taxable activity means
 - * provision of facilities for a consideration (to members and others)
 - * collection of subscriptions, membership fees and similar charges
- (c) Anything done in connection with the commencement or cessation of activities referred to in (a) & (b) above.
- (d)
 - * hiring or leasing of any movable property.
 - * renting or leasing of any immovable property
 - * administration of any property.

For registration for VAT one of the above mentioned activities must exist.

5. Taxable supply

As stated earlier VAT is charged on “**every taxable supply**” made in the course of carrying on or carrying out a taxable activity by a registered person. Thus once a person is registered, even if his turnover falls below the threshold, VAT is charged on “**every taxable supply**” made by him. Taxable supply means any supply of goods or services,

- * made in Sri Lanka or
- * **deemed to be made** in Sri Lanka
- * which is chargeable with VAT under the Act, and
- * includes a zero rated supply
- * but not an exempt supply

The “**taxable supply**” refers to supplies of goods and services and imports that are liable to a rate of VAT including zero rate(0%).

Whether a certain supply of goods or services is a taxable supplies or not can be found out by reference to schedule I of the Act which enumerates supplies of goods and services which are exempted. If a certain supply is not an exempt supply and or not an excluded supply as mentioned above in para 2(ii) above then it is a taxable supply.

The exempt supplies are within the scope of VAT but they do not give rise to a right of input tax deduction.

Goods

- * Supply or import of bread, rice, rice flour, wheat flour and eggs.
- * Supply or import liquid milk

Services

- * Supply of public passenger Transport services
- * Supply of health care services

(other than supply by some BOI companies)

- | | | | |
|---|---|---|--|
| * | Supply or import of books | * | Supply, lease or rent of residential accommodation (other than by some BOI companies) |
| * | Supply or import of diamonds, precious metals and gold coins | * | supply of leasing facility for motor coaches used in public passenger transport services if the seating capacity exceeds 28 seats. |
| * | Supply or import of unprocessed agricultural, horticultural; animal husbandry fishing and forestry products | | |

VAT Act also recognizes deemed supplies. **Deemed taxable supplies** occur when the registration of a registered person is cancelled. The goods or services (including fixed assets) remaining at the time of cancellation of registration are deemed to have been supplied by that person. He is required to pay VAT on the market value of such stocks & assets. Any goods and services taken for the personal use/consumption of the registered person are also treated as deemed supplies.

6. **Taxable period**

Registered persons are required to file their returns and account for VAT charged and collected in respect of each taxable supply **for each taxable period**. There are two taxable periods viz.

- * Month and
- * Quarter

For details please refer to para No. 12.

7. **Time of Supply and Accounting for VAT**

(a) **Time of supply or the “Tax Point”**

The time when VAT becomes due is called the “**time of supply**” or the “**tax point**”. The “time of supply” depends on the particular type of supply. Following are few examples of time of supply.

i. **Supply of goods**

Time of supply is the earliest of

- Date of invoice
- Due date of payment
- Date of receipt of payment/advance

Date of delivery

However if the invoice is issued within 10 days of delivery then the time of supply is the date of invoice.

ii. **Supply of services**

Time of supply is the earliest of

When the invoice is issued
When the payment is due
When the payment is received
When the service is performed.

However, if the invoice is issued within 10 days of performing service then the time of supply is the date of invoice.

iii. **Importation of goods**

- * If there is no duty suspension, the time at which goods are cleared by the Customs and leave the Customs or Customs Bonded warehouse as the case may be
- * If there is a duty suspension the time when and if the suspended duty becomes payable.

iv. **Supply under hire-purchase agreements**

Time at which the agreement is entered into.

v. **Supply under agreements for periodic payments (other than hire-purchase agreements)**

When the payment is due or
When the payment is received

Whichever is earlier.

(b) **Accounting for VAT**

Taxable Persons (i.e Registered Persons) are required to file returns and account for VAT on invoice basis. Approval can be obtained in certain situations to file returns on cash basis which is also called payment basis. Under the invoice basis of accounting a registered person must account for VAT when the tax point occurs as given above. For example in the case of supply of goods the output tax must be declared when the invoice is issued or when the payment is received or on the due date of payment or on the date of delivery whichever ever the date that comes first. **Input tax is recoverable** (claimable) on the basis of **invoices received**.

Under the (cash) payment basis of accounting (if approved by the Commissioner General) a registered person must account for VAT, **that**

means output tax must be declared when cash is received. Input tax is claimable only on the basis of invoices paid. (This method has a disadvantage in Sri Lanka because whichever the basis of accounting the Registered Person must claim input tax within six months of the date of receipt of invoice.).

8. Value of supply

VAT is calculated on the value of each supply. Value of supply too depends on the type of supply. How to ascertain the value of supply in certain situations is given below.

<u>Type of Supply</u>	<u>Value</u>
i.. Supply of goods and services	<p><u>When the recipient is a registered person</u></p> <ul style="list-style-type: none"> * If the consideration is in money <ul style="list-style-type: none"> - Total consideration less VAT or - Open market value which ever is higher * If not in money or partly in money <ul style="list-style-type: none"> - Open market value <p><u>When the recipient is not a registered Person</u></p> <ul style="list-style-type: none"> - tax inclusive consideration or - open market value which ever is higher
ii. Import of goods	CIF + Customs Duty + any surcharge + Cess + any Excise Duty payable to Customs
iii. Benefits from employment	<ul style="list-style-type: none"> * Open Market Value or * Cost of a similar benefit to any other employee as determined by the Assessor if the open market value cannot be ascertained.
iv. Lottery or Wagering contract or any business Of like nature	Total amount received less value of the prize or winnings awarded.
v. Supply of goods under Hire purchase agreement	<p>Cash price determined under Consumer Credit Act or Market value which ever is higher (subject to adjustments for non claimable input by the seller of goods when the seller is a person different from the Hirer.)</p> <p>If the hired goods are second hand and more than one year old.</p> <ul style="list-style-type: none"> - Value specified in the agreement less hire purchase charges
vi. Supply of land and improvement	Consideration – (Value of Land at the time of supply + improvements upto 31.03.1998)

(Consideration shall not be less than the **open market value**) **Thus, it is = Open Market Value of improvements after 31.03.1998**

- | | |
|--|---|
| vii. Supply under non-reviewable Agreement, other than Hire Purchase Agreement, Entered prior to 01.04.1998. | Total amount paid/payable under the agreement (It is considered as a tax inclusive consideration) |
| viii. Transfer of goods on Termination of Lease | |
| * If the consideration is less than 10% of the value of the agreement | Treated as an installment under lease agreement. |
| * If the consideration is more than 10% of the value of lease Agreement | Treated as a separate supply of goods and the value is the amount paid to acquire the asset. |
| ix. Supply is a combination of taxable and non taxable supplies | Open Market Value of the taxable portion |
| x. Goods which are manufactured using other goods or services/supply of services using other goods or services | - Consideration received or
- Open Market Value
which ever is higher |
| xi. Issue of ticket or deposit of money for the supply of goods or services | Value of the ticket or deposit less the VAT, not being any refundable amount |

9. VAT Rates

In Sri Lanka **four** rates of VAT are currently applicable; the standard rate at 20%, the reduced rate at 10%, the zero rate (0%) and the special rate of Rs.25.00 per piece of garment released to the local market by companies registered under Section 17 of the Board of Investment Law to manufacture and export garments. This is payable by the buyer through a Customs Declaration as if it is an imports.

The following table lists examples of 20% supplies, 10% supplies and 0% supplies. The list is not exhaustive.

Supplies taxed

Supplies taxed

Supplies taxed

<u>at 0%</u>	<u>at 10%</u>	<u>at 20%</u>
* Export of goods (Even exempt goods if they are exported is taxed at 0%)	* Supply of electricity	* Supply or import of Motor vehicles
* Services directly connected with movable and immovable property outside Sri Lanka.	* Supply of services by construction contractors.	* Supply or import of Building materials
* International transportation	* Supply of services by Hotels, guest houses, Restaurants	* Any other supply or import which is not in 0% list and 10% schedule.
* Repair of any foreign ship or air craft, refurbishment of marine cargo containers	* Supply or import of Magazines & Journals	
* Services provided in Sri Lanka consumed outside Sri Lanka to the extent that the payment for such services are received foreign currency through a bank.	* Supply or import of petrol, diesel, fuel, L.P. Gas	

10. **Recovery of VAT (input tax) by taxable persons**

i. **How to re-claim**

A taxable person (i.e a registered person) can recover or re-claim from the government the VAT paid (that means the input tax incurred) on the goods and services **used** by it for business purposes. Input tax is generally recovered by being deducted from output tax payable to the government on the goods and services **supplied** by such persons. ***(Thus what is payable to the government by a registered person is output tax charged less input tax incurred)***

Input tax includes VAT paid along with the price paid for goods and services used by it for the purpose of making the taxable supplies and VAT paid on import of goods for the same purpose. A valid tax-invoice or customs document should generally accompany a claim for input tax.

(ii) **Non-deductible input tax**

Input tax credit cannot be claimed on purchases of goods and services that are not attributable to the making of taxable supplies by the registered person. (For example goods acquired for private use.) In addition input tax may not be claimable in respect of certain items of business expenditure. Following table sets out some items of expenditure for which input tax is deductible and non – deductible.

Expenses for which input Tax is not – deductible

- * Private expenditure
- * 50% of expenditure on purchase, hire, lease, maintenance and fuel for travelling vehicles
- * Expenditure directly connected to exempt supplies

Expenses for which input tax is deductible

- * Advertising
- * Conferences and Seminars
- * Business gifts (output tax must be accounted for)
- * Private use of business assets (output tax must be accounted for)
- * Business telephones including mobile phones
- * All other expenses which are directly connected to output.

(iii) **Partially recoverable input tax(Partial Exemptions)**

Normally input tax directly related to taxable supplies is deductible in full, while input tax directly related to exempt supplies is not deductible. If the registered person is making both exempt and taxable supplies and if the input tax is related to both such supplies (eg: input tax on general business overheads) the deductible portion of input tax is calculated on a general pro-rata basis i.e the percentage of deductible

$$\text{Input tax} = \frac{\text{Value of taxable supplies}}{\text{Value of Total supplies}} \times 100$$

(iv) **Input tax recovery on capital goods**

Capital goods are items of expenditure which are used in a taxable activity (business) over several years. But the input tax incurred on the acquisition of a capital asset is deducted in the taxable period which it was acquired. If the input tax is deductible only – partially (on a pro-rata basis) for the reason that the asset is used for both taxable and exempt activities no adjustments are made over time on account of change in the percentage if deductible input tax from one taxable period to another.

(v) **Recovery of Input tax by newly commenced businesses**

As any newly commenced business or project is entitled to register for VAT prior to the commencement of making any taxable supplies input tax incurred on project related goods (other than non-deductible input tax) is recoverable by any new business although the output tax is zero.

(vi) **Input tax restriction**

With effect from 1st July 2003 it is proposed to restrict the recoverable input tax to 10% even if input tax has been incurred at 20%. If the output relating to such supplies is taxed at 10%. That means in situations where

the output tax is 10% the input tax claimable will also be restricted 10%. Thus the enterprise will have to capitalize the balance 10%.

(vii) **Refund Application (Excess Input tax)**

If the amount of '**input tax recoverable**' in taxable period exceeds the amount of "**output tax payable**" in that period the registered person has an input tax credit or input tax surplus. The registered person is entitled to a refund of this surplus(or excess input tax) **except in the case of persons engaged in import and re-sell of the goods imported.** Such importers are required to carry forward the excess input tax indefinitely from one taxable period to the next and so on. In the case of others a refund is made within 30 days of the receipt of the return. No separate refund application is necessary to claim such refunds. VAT return from it self is the refund application. Thus no time bar operates to make a refund application because a return can be made at any time after the taxable period (subject of course to a penalty for late submission). **However a time bar operates** to make a claim for input tax in an invoice. Input tax in an invoice should be claimed within six months from the date of receipt of the invoice. Thus **if a return in respect of an old taxable period is furnished after six months the registered person will not be allowed to claim input tax in respect of that period. All input taxes claimed in that return will be disallowed.**

(viii) **Recovery of input tax by non-established businesses**

Sri Lanka VAT law does not allow refund of VAT (input tax) incurred by businesses that are not registered for VAT in Sri Lanka.

(ix) **Repayment interest**

Interest is payable on delayed refunds. A refund is required to be made within 30 days from the date of receipt of the return. (A return is required to be furnished within 30 days from the end of the taxable period).

11. **Invoicing**

(i) **VAT invoices and Credit Notes**

A registered person must provide a tax invoice within 28 days for all taxable supplies made to other registered persons if a request is made within 14 days. Tax invoices are not automatically required for supplies made to non-registered persons (i.e ordinary customers) A tax invoice should indicate the "**value of supply**" and the "**VAT charged**" separately whereas a normal invoice should indicate only the "**VAT inclusive (total)**"

consideration” All invoices should contain the VAT registration number, serial number of the invoice and the name and address of the supplier.

A VAT invoice is essential to support a claim for deduction of input tax by a registered person who received the supply.

A **credit note** must be used to reduce the VAT charged on a **supply made to a registered person** if VAT has been over charged in the original invoice. The Registered person who receives the credit note should pay as (VAT) output tax the amount of VAT that is indicated in the credit note. A credit note must be cross-referenced to the original tax invoice, must detail the reasons for the adjustment, should be in the form specified by the Commissioner General and must contain a serial number. In the case of supplies made to other persons and in cases where no credit note is issued the supplier must account for the higher amount which he has charged.

(ii) **Foreign Currency Invoices**

If a tax invoice is issued in a foreign currency, the value for VAT should be computed in Sri Lanka rupees based on the official bank (selling) rate on the date of the transaction.

(iii) **Export – Invoices and Proof of Exports**

Export invoices should be supported by evidence to the effect that goods have in fact left Sri Lanka. Export Cus-Dec is not sufficient. Bill of lading or Air Way Bill, Boat Note and other relevant documents should be furnished to prove the export and to be eligible for zero-rating.

12. **VAT returns and Payments**

VAT returns are required to be submitted monthly or quarterly as indicated above in para 6. .

Taxable period is one month in the case of the following registered persons.

- Registered persons with total taxable supplies exceeding Rs.30 Million per annum.
- Registered persons making more than 50% zero rated supplies.
- New projects registered under Section 22(7) of the Act during the project implementation period.
- Registered persons who have entered into agreement prior to 01.09.2001 with Board of Investment under Sec. 17 of BOI Law.
(However a person can opt to file returns quarterly if approved by the CGIR).

All other registered persons should file returns quarterly.

The return must be filed by the last day of the month following the end of the reporting period, together with full payment. If VAT is payable return must be handed to an assigned bank with payment. If no VAT is payable return must be handed to the tax office. Return periods begin on the first day of a month and end on the last day of a month.

Penalty

- * Maximum penalty for non filing return in time is Rs.50,000/- by the Commissioner General or Rs.25,000/- or 6 months imprisonment by Magistrate.
- * Penalty for non-payment is 10% of the tax plus 2% for each month in default subject to a maximum of 100% of the tax due.

13. **VAT Deferment Scheme**

In Sri Lanka certain persons are entitled to join the VAT deferment scheme at the Customs. Such persons are not required to pay VAT up front when they import goods. The payment is differed for 60 days. In the meantime they can submit their VAT returns to the Inland Revenue and if a refund is due to any one of them such refund is issued direct to the Customs Department in the form of a “**credit voucher**” to be set off against the deferred VAT.

Persons who are eligible to the deferred facility are persons who are usually entitled to refunds. Following are two examples of such persons.

- (i) Registered persons who import goods to be used as a raw material of a product to be manufactured and exported by the same person. (As the exports are zero rated such persons are entitled to refunds of input tax. Such refund is diverted to Customs to be set off against the deferred VAT on such imports)
- (ii) Registered persons who are approved by the Commissioner General to claim input tax incurred before the commencement of commercial operations, i.e. before commencement of showing any output tax in the returns. As the output tax = 0 such persons are also entitled to refunds of input tax. If such a person has imported any goods required to commence the new project the refund is diverted to the Customs to be set off against the deferred VAT on such imports.

14. **Assessments and Appeals**

(i) **Power to make assessments**

An assessor has the power to make assessment on a registered person,

- who fails to furnish a return –
 - who fails to pay tax, after furnishing the return –
 - who requests for alternations to the return submitted –
who fails to furnish a return but tax is paid which in the opinion of the assessor is less than the amount payable –
 - who has obtained a refund or claimed input tax, in excess of the amount due
 - who has furnished a return but the assessor does not accept the return
- The Assessor shall assess the amount of tax, which such person, in the judgement of the Assessor, ought to have paid. The notice of assessment may relate to one or more taxable periods.
 - Where an assessor does not accept a return furnished by the registered person, he shall communicate in writing 'why' the return is not accepted.

(ii) **Power to make additional assessments**

- The assessor also has the power to make additional assessment when a registered person has for any taxable period furnishes a return but has paid tax an amount less than the proper amount. (Sec. 31).
- The amount assessed is deemed to be tax in default and is liable to penalty from the date such tax ought to have been paid.

(iii) **Time Bar – Sec. 33**

- Three year time bar is applicable in respect of assessment and additional assessments unless fraud is alleged.
- To make an assessment three years is counted from the last day of the taxable period if a return has been duly furnished as per Section 21(I)
- To make an additional assessment 3 years is counted from the date of the original assessment made as per Section 31 or made in the absence of a return.
- Only a return furnished on or before the date specified in Section 21(I) may be treated as a return furnished under Section 21(I).

(iv) **Assessment on Partnerships**

Normally assessments are made on registered persons – Sec. 28. Although a partnership is recognized as a person for VAT purposes (Sec. 83) it is not a legal person to institute any legal proceedings for recovery of any tax in default. However Sec. 48(2) provides that it shall be lawful to take action against any partner as if he is responsible for such default unless he proves to the contrary. Thus an assessment on a partnership may be issued in the name of the precedent partner or any other partner.

(v) **Assessments on Executors**

Assessments/additional assessments in respect of periods prior to death of a deceased person can be made within 3 years from the last day of the taxable period in which death occurred – Sec. 54(1)(6).

(vi) **Appeals**

Any appeal against an assessment, additional assessment or penalty must be made within 30 days to the CGIR.

- **Hold over of tax in a special situation :**
 - * On appeal, CGIR may defer the due date of payment of tax :
 - if a request to that effect is made in writing, and
 - **if it is proved that the VAT has not been charged** by the appellant on the alleged supplies.
 - * **Pre requisites to entertain an appeal :**

In order to entertain an appeal against an assessment/additional assessment

 - tax payable on the basis of the return furnished by him and any penalty accrued upto the date of notice of assessment must be paid.
 - if the assessment/additional assessment is in the absence of a return the petition of appeal **should accompany a return and proof of payment** of tax and penalty thereon.
 - Commissioner General may consider an extension of time to pay in cases where appellant has suffered serious financial hardship.

An appeal is first settled by the Assessor. If the appellant cannot come to an amiable settlement with the Assessor the appeal is referred to the Commissioner General for a **determination**. If the appellant is dissatisfied with the determination an appeal can be

made to the Inland Revenue Board of review. The **Order** of the Board of Review is final on a matter of fact. On a question of law the Order of the Board can be canvassed, by **stating a case**, before the Court of Appeal.

15. **VAT on some specific transactions**

(i) **Hire – Purchase**

Hire purchase transactions are treated as supply of goods, and the value of supply in a hire – purchase transaction is treated as having two components namely a supply of goods component a supply of financial services component which is the hire purchase charges. The financial service component is exempt from VAT. Hire purchase of second hand goods i.e goods which have been in circulation in Sri Lanka for more than 12 months is exempt from VAT. Thus input tax cannot be claimed on hire purchase of second hand goods. In the case of new goods input tax attributable to finance charges is disallowed. The tax point is the time at which the transaction is entered into.

(ii) **Leasing**

Leasing is treated as a supply of a service. The tax point is the earlier of the due date or date of receipt of the rentals. Any advance is also treated as a lease installment.

If the leasing is under the finance leasing Act No. 56 of 2000 the rate of VAT is 20% while other leases such as any operating lease are subject of Vat at 10%.

If the leasing facility is for a period less than 3 years (including cases of premature termination) the input tax recoverable by the lessor is restricted to 10% even if he has paid at 20% when the asset was acquired.

Leasing of public passenger motor coaches with 28 passenger seats is exempt from VAT.

If the asset can be acquired at the termination of the lease the amount payable to acquire the asset is treated as another leasing installment. If it is less than 10% of the total amount payable under the lease. If it is more than 10% it is treated as a separate supply goods and the rate of VAT applicable to the supply of such goods is applicable to that payment.

16. **VAT on Financial Services**

In Sri Lanka like is other countries Financial Services were exempt from VAT. However with effect from January 01st 2003 Financial services supplied by banks and finance companies were made subject to VAT. The method of calculating VAT is different form calculating VAT on other transactions. VAT on financial services is calculated at 10% of (profits + emoluments) of the bank or the finance company. In calculating the profits instead of the book depreciation, and economic depreciation as determined by the Minister is used. Thus financial institutions are required to calculate their profit every month is order to compute the VAT payable on financial services. The scope of financial VAT was enlarged with effect from July 01st , 2003 by making other institutions providing financial services also liable to financial VAT.