



Chamber of Construction Industry of Sri Lanka

Impact of Recent Tax Law Changes and Mitigating Tax Burden on Construction & Real Estate Development Companies



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Tax Implications on Construction Companies



**Preferential Tax treatment
for Construction Industry ?**

**At Present uniform tax
rate of 30% for all Corporates**

Tax as repricing mechanism

Pros and Cons in providing preferential tax treatment

Pros	Cons
Stimulates Economic Growth: Lower taxes can encourage investment in construction projects, leading to job creation and economic activity	Loss of Tax Revenue: Lower taxes mean less government revenue, potentially impacting public services and social programs.
Infrastructure Development: Preferential treatment might be used to incentivize the building of essential infrastructure like roads, bridges, and public facilities	Inequity: Preferential treatment can create unfairness, as other industries may not receive the same benefits.
Boosts housing affordability: Tax breaks can help lower the cost of construction, potentially leading to more affordable housing	Potential for Abuse: Tax breaks could be exploited by some companies, leading to less overall benefit for the industry.
Attracts investment: Lower taxes can make a country more attractive to foreign investment in the construction sector.	Limited Impact: In some cases, tax breaks might not significantly affect overall construction activity, especially if other factors like demand and financing are limiting.

Types of Tax Incentive around the globe for Construction Industry

- Reduced corporate income tax rates
- Tax exemptions
- Accelerated depreciation.
- Established a special economic zone with preferential tax treatment
- Tax credits for investment in construction machinery and equipment

Who is a Construction Contractor/ Subcontractor

“Construction Contractor” means the person or persons or organization or organizations **named as the contractor in a bid** or who is otherwise accepted by the employer as the person or organization **responsible for the implementation, completion and maintenance of the construction works being carried out under the terms of such contract”**

Source: Construction Industry Guarantee Fund Levy

“Construction contractor or sub –contractor” means any person who has entered into a contract with another person and **provide services in Sri Lanka in constructing of a building, road, bridge, water supply systems, drainage systems, sewerage systems, electricity generation or transmission system or any other infrastructure** for that other person.

Source: VAT Act – Interpretation Section

Types of Construction

- **Residential Construction**

E.g. House , Apartments etc

- **Commercial Construction**

E.g. Office building, retail spaces, hotels/
restaurants etc

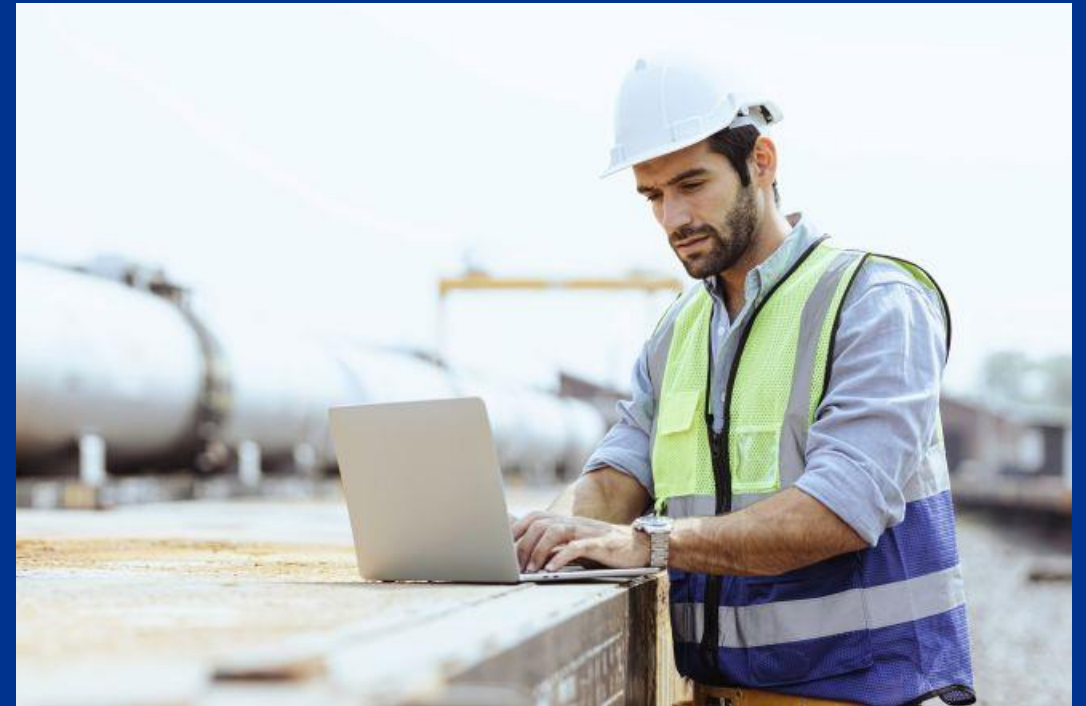
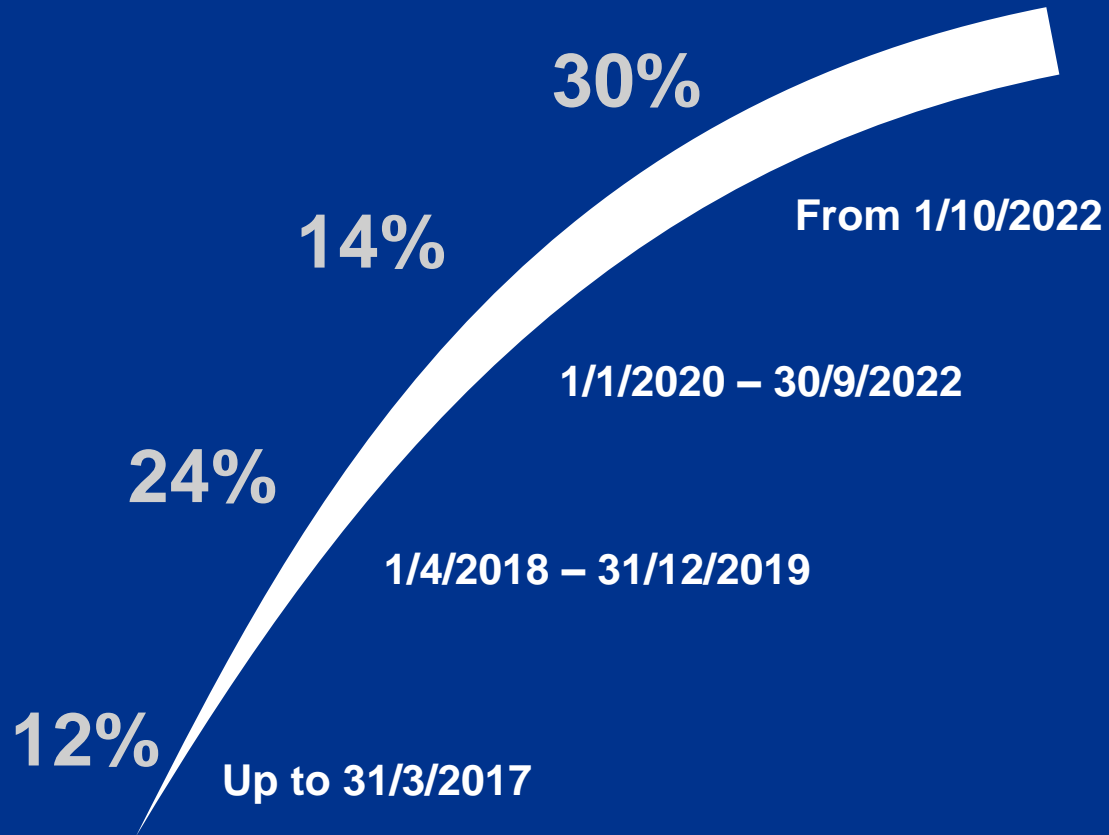
- **Industrial Construction**

E.g. Building factories, warehouses, power plants
etc

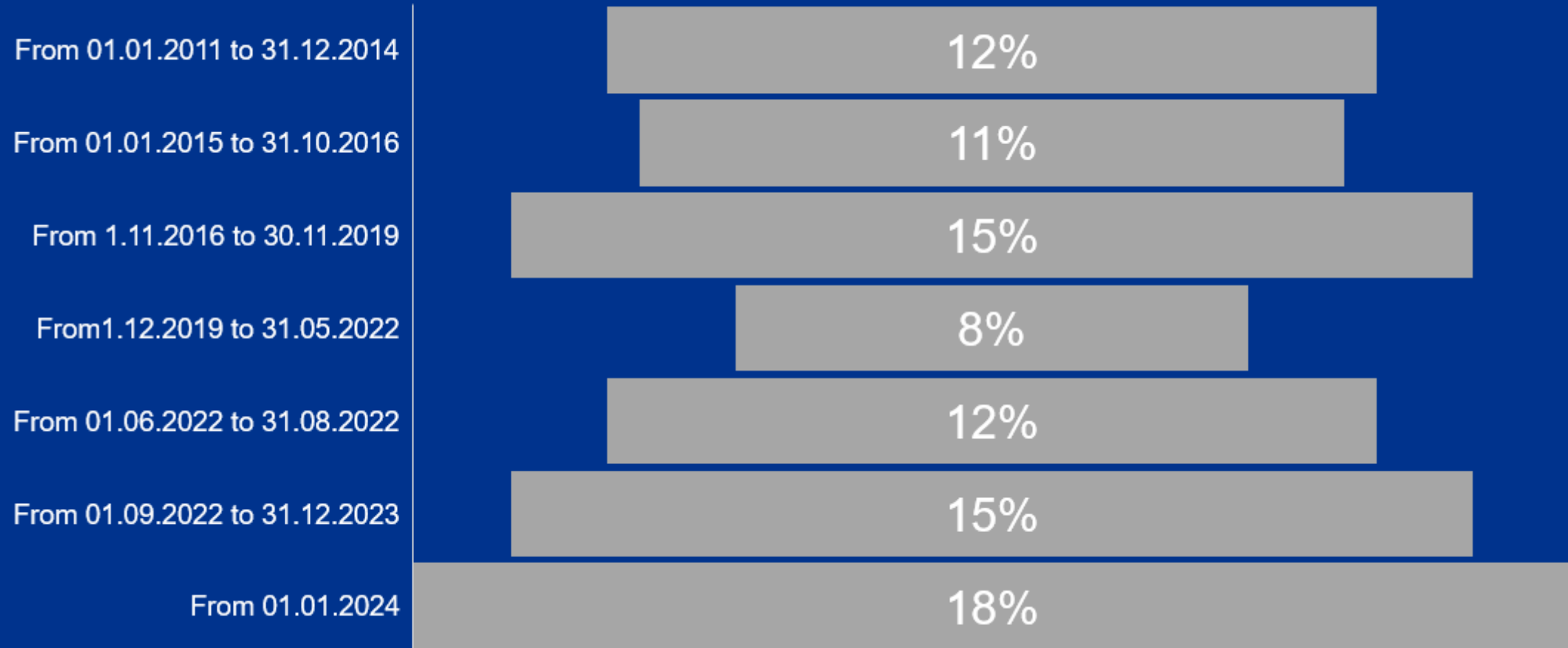
- **Infrastructure Construction**

E.g., Building roads, bridges, tunnels, airports, and
other public works projects etc

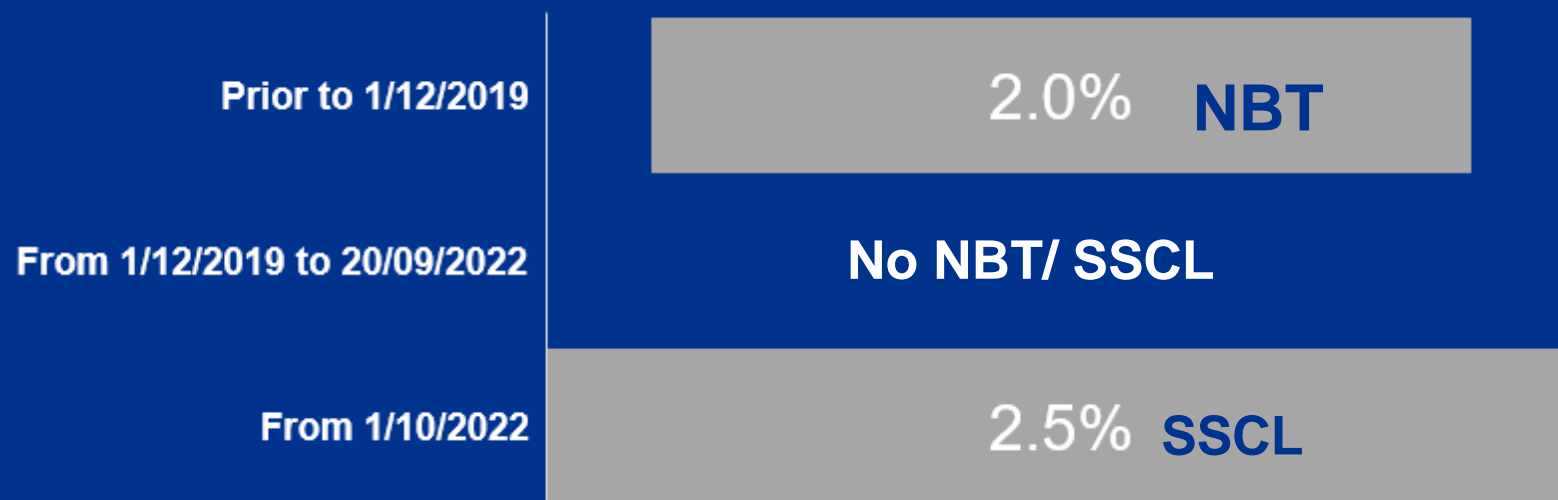
Income Tax Rate - Construction Industry



Standard VAT Rate - 18%



NBT / SSCL Standard Rate



NBT Act – Excepted Services

- (i) prior to January 1, 2011, of a construction contractor, not being a sub- contractor;
- (ii) on or after January 1, 2011, **of a construction contractor or subcontractor insofar as such services are in respect of** constructing any building, road, bridge, water supply, drainage or sewerage system, harbour, airport or any infrastructure project in telecommunication or electricity;

Long Term Contract S. 25

What is a long-term contact ?

- a) for **manufacture, installation or construction** or, in relation to each, the performance of related services; and
- a) which is **not completed within twelve months** of the date on which work under the contract commences.

**P/L = Income of the Contract –
Deduction for that year**

Long Term Contract S. 25

- Accrual basis
- **Percentage completed** = comparing the total expenses allocated to the contract and incurred before the end of a Y/A with the estimated total contract expenses at the beginning of the contract
- The CGIR may allow the unrelieved loss to be **carried back** and treated as an unrelieved loss of an earlier year of assessment for the purpose of S.19

VAT – Zero Rating

Zero Rating on the goods supplied by any construction contractor to be utilized on a construction project carried out by such contractor outside Sri Lanka on fulfillment of criteria

S.7 (1)

goods shall be zero rated where the supplier of such goods has exported such goods for which payment is received in foreign currency through a bank in Sri Lanka licenced under the Banking Act, No. 30 of 1988 within a period of six months from the end of the taxable period of which such exportation has taken place;

For the purpose of this paragraph, **any goods supplied by any construction contractor** to be utilized on a construction project carried out by such contractor outside Sri Lanka, shall be deemed to be **goods exported by such contractor**;

Removal of the Exemption on VAT- Import of machinery used for Construction Industry

W.E.F 1 Jan 2024 – Removal VAT exemption granted for importation of machinery used for construction industry

- (xii) machinery used for construction industry, milk processing machinery, computers including computer accessories, machinery, yarn used for textile industry and dyes used for the handloom industry, as identified under the Harmonized Commodity Description and coding System Numbers for custom purposes and (effective from 1/1/2008), and machinery used for rice milling industry (effective from 23.12.2005) which are identified by the Commissioner General of Inland Revenue under Harmonized Commodity Description and Coding System Numbers for Custom purposes;
- [s 9 (1) of 15 of 2008]
w.e.f.
1/1/2008
[s 5 (1) (ii) of 7 of 2012]*

Removal of the Exemption on VAT- Supply of clay roof tile

W.E.F 1 Jan 2024 – Removal VAT exemption granted on supply of clay roof tiles - 17-years exemption removed

(xxii) clay roof tiles (effective from 1/7/2007) or chemical naphtha (effective from 17/7/2007) , to the extent that such clay roof tiles or chemical naphtha are manufactured in Sri Lanka;

Removal of the Exemption on VAT- Import of Goods to any project approved by CGIR

W.E.F 1 Jan 2024 – Removal VAT exemption granted on import of goods to any project approved by CGIR - 19-years exemption removed

- (ix) goods to any project approved by the Commissioner-General, as having a capital investment of not less than rupees one hundred million which are considered as project related capital goods, other than the goods in the negative list published by the Secretary to the Treasury, during the project implementation period which shall not exceed three years from the commencement of the project, provided that such project makes taxable supplies upon the completion of the project (effective from 1.1.2005); *[s 13(7) Of 6 of 2005]*

SSCL – Cascading Impact in the Construction Industry

The provisions of SSCL Act shall apply to every person (in this Act referred to as a “taxable person”) who

a) **imports any article;**



a) carries on the **business of manufacture of any article;**



c) **carries on the business of providing a service of any description**

d) carries on the **business of wholesale or retail sale of any article** including importation and sale of such article



Exempt - SSCL

Plant, Machinery or equipment imported on temporary basis for larger scale infrastructure development projects are exempted.

17. Plant, machinery or equipment imported on temporary basis for the use of large-scale infrastructure development projects approved by the Minister in charge of the subject of Finance as being of beneficial for the economic development of Sri Lanka, on condition that goods will be re-exported after the completion of work;



Construction Industry Guarantee Fund Levy

Removed W.E.F 1 January 2016 administratively

Construction Industry Guarantee Fund Levy

- CIGFL was originally introduced in PART III of the Finance Act No. 5 of 2005
- CIGFL is payable by any “Construction Contractor” or “Subcontractor” on the “value of any construction contract” enforced in Sri Lanka (on or after January 1, 2005) at the specified appropriate rate.

Value of Contract	Rate
Less than Rs 15Mn	Nil
Not less than Rs. 15 Mn but less than Rs. 50 Mn	0.25%
Not less than Rs. 50 Mn but less than Rs. 150 Mn	0.5%
Rs. 150 Mn or more	1%

Potential Impact of Imputed Rental Income Tax - April 1, 2025

IMF Country Report No. 24/161 June 2024

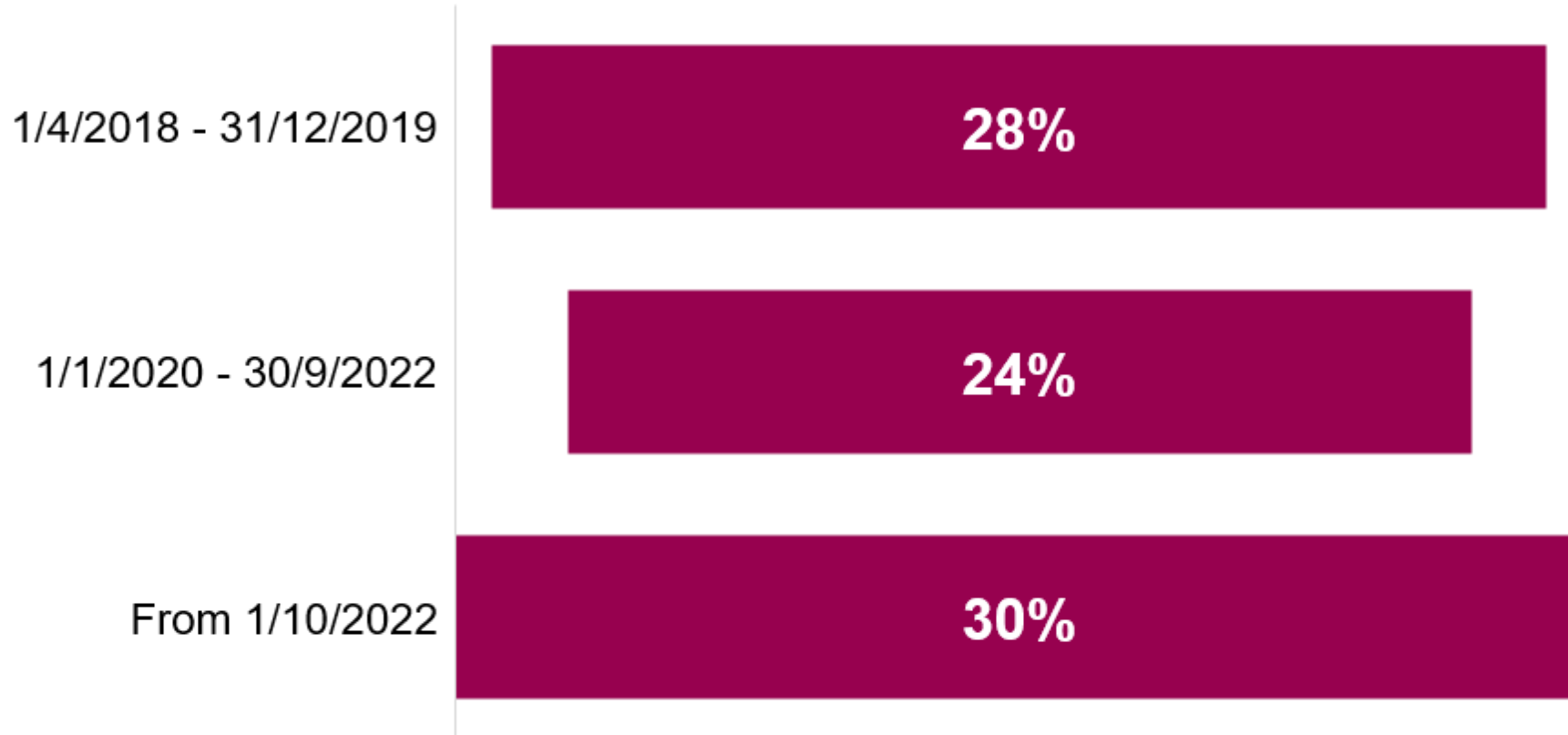
Renting a House Vs
Purchasing a House



Tax Implications on Property Development Companies



Standard Income Tax Rate



Tax Rate

Tax Rate applicable for property development and construction company ?

Tax Rate applicable for Property development and construction company which has subcontracted the construction work?

Segment P&L -Before 1/10/2022

- **Gains/ Profit from Construction – 14%**
- **Gains/ Prof from Property Development – 24%**

After 1/10/2022

Gains/ Profits from Construction and Property Development – 30%



Should Property Developers be given preferential tax rates ?

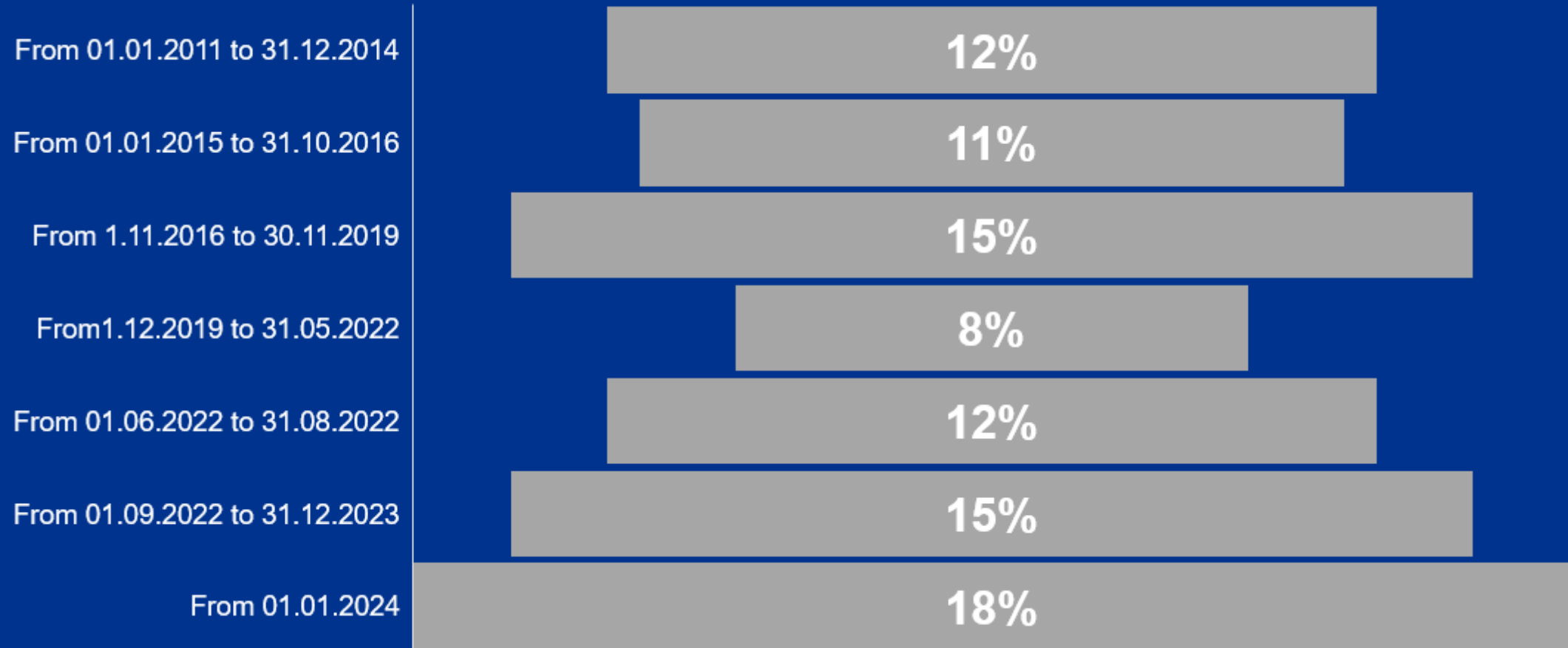
Pros and Cons on providing preferential tax treatment

Pros	Cons
Stimulates Economic Growth: Tax breaks can incentivize developers to invest in new projects, creating jobs and boosting local economies.	Income Inequality: Tax breaks primarily benefit wealthy developers and investors, potentially exacerbating income inequality.
Increases Housing Supply: Reduced tax burdens can make housing more affordable, particularly for first-time buyers and middle-income earners.	Government Revenue Loss: Reduced tax revenue can limit government spending on essential services like education and healthcare.
Attracts Foreign Investment: Preferential tax treatment can make a country more attractive to foreign investors, bringing in capital and expertise.	Market Distortion: Preferential treatment can distort the market, leading to overbuilding and speculative activity, which can create bubbles and subsequent crashes.
Infrastructure Development: Large-scale developments often require significant infrastructure investment, which can benefit the wider community.	Corruption and Inefficiency: Tax breaks can be susceptible to corruption and inefficiency, with benefits not always reaching intended recipients.

Types of Tax Incentive around the globe for Property Developers

- **Tax breaks:** These can include reduced corporate tax rates, exemptions from property taxes, or accelerated depreciation allowances.
- **Investment incentives:** Governments may offer tax credits or subsidies for investments in specific regions or projects.
- **Stamp duty exemptions:** This can reduce the upfront costs of property purchases, making it more attractive for developers to acquire land.
- **Land use concessions:** Governments may offer favorable land use policies, such as zoning changes or expedited approvals, to encourage development.

Standard VAT Rate - 18%



VAT - Residential Accommodation

Supply of condominium residential accommodation.



Liable – 1 Apr 2019

Supply of residential accommodation



Liable – 1 Jan 2024

Lease or rent of residential/ commercial accommodation



Liable

IMF TECHNICAL ASSISTANCE REPORT

May 2024

Type of transaction	International common practice	Treatment in Sri Lanka
Sales		
Commercial properties	Taxable	Taxable
Residential properties		
New sale	Taxable	Condominiums (taxable); others (exempt)
Resale	Exempt	Condominiums (taxable); others (exempt)
Leasing		
Commercial properties*	Taxable	Taxable
Residential properties**	Exempt	Taxable

* Should be defined to include hotel and hotel accommodation.

** Should be defined to exclude the supply of any residential accommodation for use for short term occupation by an individual, which would be treated in the same way as commercial properties.

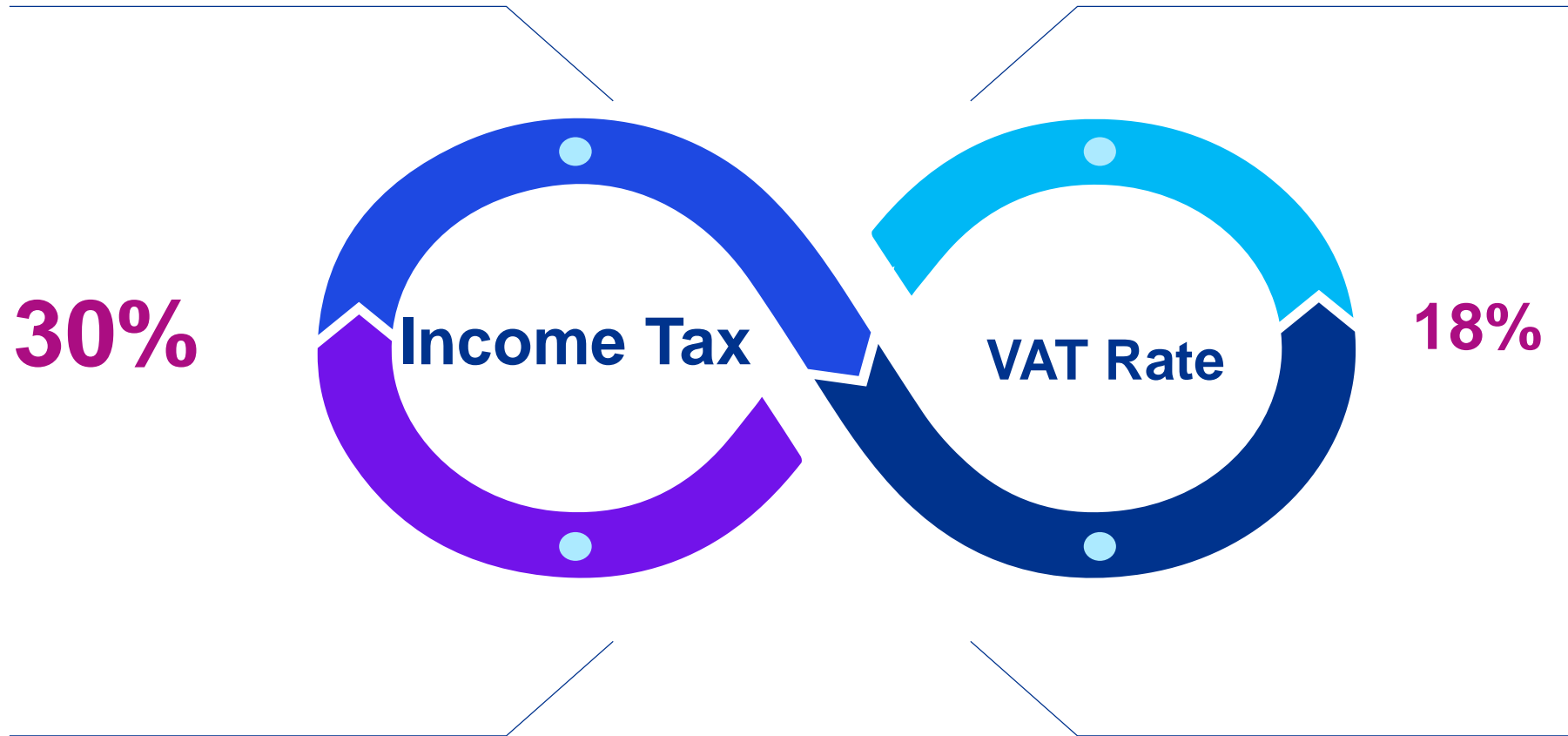
Source: VAT Act

To improve neutrality and fairness, Sri Lanka's VAT system should be aligned with international best practice, including by imposing tax on the first sale of all residential property.



Tax Implications on Real Estate Companies and Consultancy Service Companies

Standard Income Tax Rate and VAT Rate



SSCL

The provisions of SSCL Act shall apply to every person (in this Act referred to as a “taxable person”) including

- **Imports any article;**
- **carries on the business of providing a service of any description**

“service” includes any business of real estate and improvement thereon;

Tax Issues / Considerations and Mitigation Measures



Tax Issues/ Considerations

- Increase in Income Tax Rate from 14% - 30%
- Removal income tax exemption on import of construction machinery
- Cascading effect due to SSCL -2.5%
- Are direct and indirect tax rules applicable to construction contractors equally applicable to Construction Contractors and Subcontractors ?
- Is the exemption or lower tax rate applicable to construction contract enjoyed by the Contractors and Subcontractors equally ?

Mitigation Measures - Ideas

- **Lower corporate income tax rate/ tax incentive for selected streams of construction activities**
Ex : Gain / Profits from Industrial Construction - Factories, other industrial facilities
- **Colombo Port City – Invest as a Primary Investors**
- **Enhanced Capital Allowance**

BUSINESSES OF STRATEGIC IMPORTANCE (BSI)



Primary
Investors

Real Estate
Investments



Real Estate
Development



Real Estate
Operations



QUALIFYING CRITERIA

Satisfy the following criteria;



Minimum investment

USD **100** Mn
per land plot

Corporate Income
Tax Holidays

0%

For up to
25 years

+

Concessionary
Corporate Income
Tax Rate

50%

prevailing tax rate
for a further period
of 10 years
following the end
of 25 years

OR

Enhanced Capital
Allowances

300%

Of Investment in
depreciable assets as
an alternative to tax
holiday and
concessionary rate

EXEMPTION FROM OTHER TAXES



0%

Sales taxes
(VAT)



0%

Dividend
Income Tax



0%

Customs duty and
other border tariffs
(CESS and PAL)

Enhanced depreciation allowances

“To a person who invests in Sri Lanka (other than the expansion of an existing business) during a Year of Assessment”

	<u>Investment in depreciable assets</u>	<u>Allowance</u>
<i>In northern province (excluding intangible)</i>	USD 3 Mn above	200%
<i>Other than northern province (excluding intangible)</i>	USD 3 mn - 100 mn	100%
	USD 100 Mn above	150%
<i><u>Expenses incurred by a person on assets of a 'state owned company'</u></i>	USD 250 Mn above	150%



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