PN-AAP-789
ISN-35521

INTERNATIONAL LICENSING AND TRADING
CONDITIONS ABROAD:
SRI LANKA

Prepared for
USAID
By
Business International

December 1982

3107

INVESTMENT, LICENSING, AND TRADING CONDITIONS
IN SRI LANKA

Currency: Sri Lanka Rupee, which floats against a trade-weighted basket of currencies. Exchange rate US$1:Rs22 in November 1982.

In the Past Twelve Months

* The President, J.R. Jayawardene, was reelected in Sri Lanka's early presidential elections. This gives him another six years in office (1.01).

* Real GDP grew by about 5.8% in 1981, about the same as in 1980, but down from the three years before that. Inflation eased considerably to about 18-20% in .981 (1.03).

* The rupee depreciated against the dollar, but far less -- or not at all -- against European and other currencies (1.04).

* A stock exchange was set up, replacing the Colombo Brokers' Association in this function (11.04).

In the Next Twelve Months

* The United National Party (UNP) sponsored referendum, to extend the term of the present parliament with its 5/6 UNP majority, will probably be passed. This will give Sri Lanka another six years of probusiness government (1.01).

* Nevertheless, the government, while remaining favorable to foreign investment, will be more selective about incentives given to investors (10.01). Increased protectionism is also possible (1.03).

* Changes are expected in legislation affecting severance pay, maternity leave (12.05), and taxes on share transfers (3.07).

1. INTRODUCTION

1.01 Political Forecast

Sri Lanka is a presidential democracy and the President is both head of State and head of government. The ruling party is the United National Party (UNP), led by President Junius R. Jayawardene. The party returned to power in 1977, after seven years of rule by the primary opposition party, the Sri Lanka Freedom Party (SLFP). The UNP has followed strongly pro-business policies, in contrast to the socialist SLFP.

The political situation has been Sri Lanka's greatest advantage, but also investors' greatest concern; they have feared the policy consequences of an opposition return to power. President Jayawardene preponed the presidential election from 1984 to 1982 to take advantage of oppostion disunity and provide a stable political climate for investment. Having won this election, he has now decided to try to extend the term of the present parliament for another six years by referendum (December 22, 1982) instead of holding the parliamentary elections due in 1983. If, as expected, the move passes -- which requires only a simple majority constituting at least a third of the electorate -- the UNP will retain its 5/6 majority in parliament. In an election, this would almost certainly be diluted to 50-60%.

Moreover, if a seat is vacated by any member of parliament, the party is free to nominate a replacement rather than hold a by-election. This will give Jayawardene the ability to hand-pick 5/6 of his parliament.

In the unlikely event that the referendum returns a negative result, parliamentary elections are due in 1983. Most probably, the UNP would get a majority, but not an overwhelming one as it has at present.

Since independence, Sri Lankan politics have been marked by sharp swings between the socialist policies of the SLFP, and the more free-enterprise attitudes of the UNP. Recently, the electoral system has been altered from the British "First past the post" to a system of proportional representation. While this would already have strenghthened the ruling party -- which has traditionally polled more votes than its chief opponent, the Sri Lanka Freedom Party, but often lost because of the voting patterns -- the recent manouevres have practically wiped out the opposition.

The UNP, on winning power in 1977, changed the electoral system. Based on proportional representation, the present system is thought to favor stability (see box for how system works). The president is directly elected for a term of six years and is eligible to stand for reelection. He has wide executive powers -- including that of dissolving parliament or taking on any portfolio himself. Since the parliamentary and presidential elections are not directly linked, it is possible for the president to preside over an unfriendly parliament.

Changes to the constitution require a two-thirds majority in parliament; while the new system was intended to ensure that no party would obtain such a majority unless voting patterns change considerably, the referendum method has provided the ruling UNP with a loophole.

Though Sri Lanka has a number of opposition parties (see box on p. 18) the only one of any significance is the SLFP. The Tamil United Liberation Front, which is, by a quirk of fate, the major opposition in parliament today, has only limited regional appeal. There is now speculation as to whether the opposition will resort to unparliamentary procedures, or if it will join with the ruling party to form a "National Government".

On the whole, six more years of the UNP will improve the business climate. Jayawardene's election win has been regarded as an endorsement for free enterprise, and certainly business and industry are more confident now of stability in industrial policy. However, firms should not be surprised to find some hardening of the government's line. In the first five years, they had the difficult job of convincing firms to invest in what had traditionally been a difficult environment; now they can afford to be more discriminating in the type of investment they favor and the terms allowed.

BOX 1.01A

How The Proportional Representation System Works

1. The country is divided into 22 voting districts. Candidates run for a seat within a single district.

2. Parties that poll less than 12.5% of the votes in any district are completely eliminated from the running.

3. The seats in the district (varying between four and 21) are then divided up among the remaining parties, in proportion to their percentage polled.

   For example: Party A wins 5% of the vote, party B wins 12%, Party C wins 13%, Party D wins 25%, and Party E wins 45%. Parties A and B will be eliminated completely. Parties C, D, and E will apportion the seats among them, on a base of 83% (the vote without A and B) -- and will therefore receive 16%, 30%, and 54% of the seats respectively. The system thus tends to be weighted heavily against smaller parties.

   The parliamentary election is held separately from the presidential election; the next parliamentary election is due in 1983. The presidential election has been preponed from 1984 to October 1982.

BOX 1.01B

How the Referendum Works

1. The president drafts a constitutional amendment that will extend the term of the present parliament for another six years.

2. If the amendment is approved by a majority of the voters, constituting at least one third of all registered voters, it is passed.

3. This means that the present parliament -- in which 5/6 of the seats are filled by MPs from the UNP -- has its term extended another six years.

4. In an election, on the other hand, a simple majority of the votes would give only 50-60% of the seats. This was predicted as the likely outcome, were the UNP to have gone to the polls rather than held a referendum.

BOX 1.01C

The Opposition in Sri Lanka

PARTY	% votes 1970 (Seats	1977 won)	Description
Sri Lanka Freedom Party (SLFP)	36.9% (91)	29.7% (8)	Led by Sirimavo Bandaranaike, the party has moderate socialist policies. The SLFP was the leader in the United Front coalition that governed Sri Lanka in 1970-77. Bandaranaike cannot run for office until 1986.
Tamil United Liberation Front (TULF)	7.2%* (16)	6.4% (18)	A moderate Tamil separatist party. Its head -- M. Sivasithamparam is the leader of the opposition since it received more seats in the last election (with substantially fewer votes) than the SLFP.
Janatha Vimukthi Peramuna (JVP)	--	--	(Translates as the Peoples' Liberation Front.) Led by Rohana Wijeweera, its policies are extreme left. It played a major role in the 1971 insurrection.
Lanka Sama Samaja Party (LSSP)	8.7% (19)	3.6% (-)	Leftist, Trotskyite party. Translates as "Lanka Equal Society Party"
Communist Party	3.4% (6)	2.0% (-)	Moscow-oriented, leftist
Ceylon Workers' Congress	--	1% (1)	An Indian Tamil, trade union-based party with strong support in the plantations. Led by S. Thondanam, who serves in the UNP cabinet.

Note: Figures in brackets refer to number of seats won.

The legal system consists of the Supreme Court, the Courts of Appeal, the High Court, and District Courts. Thirty Courts of Requests have original civil jurisdiction in all actions in which the value of the amount at dispute does not exceed a stipulated amount.

A special presidential commission tries offenses connected with government misuse of power -- it recommended that Bandaranaike be stripped of her civic rights and is currently hearing the case of a member of parliament who is alleged to have accepted bribes. It has no punitive powers but makes recommendations to parliament. The opposition has accused the commission of being used for political ends.

Sri Lanka's constitution and law have tended to hold up. It is possible that a government would go outside the law -- for instance, to change the electoral system. Nevertheless, the judicial system is well established and adequate for business purposes.

Bureaucracy and red tape are better than in most South Asian countries, but companies have faced problems from the lack of organization and the relaxed attitude of many bureaucrats. The Sri Lanka government is still heavily influenced by colonial British styles. The upper levels are efficient and reasonably flexible, but the lower levels are still slow. Compared with Western countries, red tape remains a problem. The export processing zones have a better reputation for efficiency. The GCEC is the only authority companies need to deal with, and it does try to be helpful.

Sri Lanka maintains peaceful and friendly relations with most countries. India is its largest and closest neighbor, and the relationship has always been friendly. A bilateral Sri Lanka-China trade agreement (principally a rice for rubber barter deal) has been in force for many years, and Sri Lanka imports Chinese textiles and other consumer goods. (Recently, China has also agreed to supply oil.) Sri Lanka has recognised the PLO. The government has made overtures to the ASEAN countries and may eventually succeed in developing a special tie with the association.

One issue which was outstanding between India and Sri Lanka is treatment of the Indian Tamil population in Sri Lanka. The repatriation of fairly large numbers of Tamils to India has reduced friction; however, during periods of communal agitation the relationship tends to become somewhat uneasy.

1.02 Attitude toward Free Enterprise

The present government under the UNP is extremely pro-business and strongly favors free enterprise. This would not be true under an SLFP government, which, however, is unlikely to gain power in the medium term.

While the private sector will continue to increase its role, denationalization of existing state corporations is unlikely. The Business Acquisition Act, brought in by Bandaranaike, allows the government to take over private companies relatively easily. It has not been repealed under Jayawardene. In the unlikely event of the SLFP returning to power, a more socialist pattern would be adopted, and a spate of nationalizations is not impossible.

Trade Unions, mostly affiliated to political parties, are quite powerful. Industry associations and Chambers of Commerce can be influential in representing trade views to the government, and to some extent, in regulating their members. Chambers of Commerce have successfully made representations to the government for reductions in certain tariffs.

1.03 Market Forecast

Sri Lanka can expect a real GDP growth of 4-6% over the next 18 months.

Sri Lanka's GDP, which averaged only 2.9% per year real growth from 1970 to 1977, increased by an average of 6.8% per year from 1977 through 1980. In 1980 the rate declined to an estimated

5.8%, because of drought, the poor performance of the public corporations, sluggish growth in the manufacturing sector as it was hit by the impact of lower tariffs, and construction growth slowed as the industry encountered bottlenecks in the supply of labor, materials, and equipment.

In 1981, GDP again grew 5.8%. Agriculture this time was not at fault; it showed reasonably strong growth at 6.9%. But construction actually declined from the peak levels of earlier years, and the industrial sector was hurt by power shortages. Credit restraint, aimed at curbing inflation, slowed growth in trade, services and other sectors.

Inflation in fact, has been one of the most serious problems the economy has had to face in recent years -- in part, because the country had become accustomed to a slow-growth, low inflation life-style. It rose sharply as a result of the UNP's economic policies, but is now gradually being brought under control, inevitably at the expense of rapid economic growth. Some of it was artificial; the removal of price controls allowed prices to trend upward. However, massive investments in projects with long-gestation periods also fueled inflation. Production responded to increased prices, but not rapidly enough. Inflation has gone down from the 35-40% level of 1980; but it was still estimated at about 18% in 1981, and 13% in the first half of 1982. And these figures may be understated; other estimates show rates of about 24% for 1981.

Constrained by power shortages, and inefficient after years of protectionism, domestic industry is not well developed and has not expanded greatly since 1977. The domestic market, small as it is, seems to prefer imported goods, and demand for domestically produced goods has grown only slowly. The government is becoming increasingly aware of the problem, and some infant industry protection is not unlikely in future.

It appears per capita income may even have declined in recent years, further decreasing demand. Inflation has boosted costs, eroding price differentials. In 1981, manufacturing accounted for only 17.4% of the GDP at current factor cost (GDP can be stated at either market prices or at factor cost; GDP at factor cost, plus indirect taxes, less subsidies, equals GDP at market prices), down from 23% in 1977. (At 1970 prices, these were 13.7% and 13.6% respectively -- indicating that in real terms, manufacturing has grown no faster than GDP as a whole.)

The fourth rolling five year plan, 1982-86, calls for an expenditure of Rs98 billion in current terms. The lead projects (see below) will account for 36% of the expenditure (as against 44% in the 1981-85 plan). Resources have been shifted to power from other sources, water supply schemes, education, and health. Expenditure on short-gestation projects -- other irrigation, plantation agriculture, field and minor export crops, animal husbandry, forestry and lands, fishreies and industry -- have also been increased.

The government's main investment plans over the next five years center on three schemes which will account for 33% of planned government investment between 1982 and 1986. The lead projects are:

<u>The Mahaweli project</u>: The project consists of a series of dams, power generating stations, and irrigation channels off the Mahaweli river. Five giant multipurpose reservoirs will irrigate 391,000 acres of land and provide 500 megawatts (Mw) of hydroelectric power. They will provide 500,000 permanent jobs in agriculture and service industries, and over 400,000 construction jobs. Cost escalation, insufficient aid, and technical problems have led to a scaling down of the project.

The Integrated Development Programme of the Mahaweli Authority promotes the development of agri-industries, integration of crop and animal husbandry. Foreign investors could take advantage of these investment opportunities.

Housing and urban development: The government plans to construct 100,000 new houses and upgrade 84,000 more. The Greater Colombo Urban Renewal Program is intended to completely reorganize Colombo.

Colombo Investment Promotion Zone: Sri Lanka's export processing zone, located near Colombo's airport, opened in 1978. Its objective is to provide jobs and increase exports by attracting foreign investors. The zone is not a major investment for the government.

Investment must be largely financed from abroad, since domestic savings are low and could decline further. High inflation makes fixed interest rates unattractive, and potential savings lie locked up in consumer durables. The savings of the public sector have tended to be negative. A large part of this is because of the losses of the Central Transport Board.

1.04 Currency Outlook

The rupee floats against a basket of currencies, which is heavily weighted toward the US dollar. It has steadily depreciated since the UNP took charge, before which a system of dual exchange rates existed. (In recent months, however, though it has declined against the US dollar, the strength of that currency has meant that the rupee remained stable or appreciated against most others.)

Critics have argued that the country's exports, mainly commodities, tend to be supply inelastic, while imports, designated in dollars, are also fairly inelastic. According to this argument, depreciation imports inflation, without substantially improving the trade balance. However, the falling rupee has curbed imports to some extent.

With balance of payments problems, high import levels, and a soft export market, downward pressure on the rupee is inevitable. A gradual decline is expected over the next few years, after which some strengthening is possible.

Sri Lanka has the highest foreign aid per capita of any country in the world. Foreign aid has been used liberally to finance the new planned investments. If the country does not succeed in bringing its trade deficit under control, it may have to resort increasingly to commercial borrowings to finance the deficit.

1.05 Attitudes toward Foreign Investment

The Jayawardene government actively encourages foreign investment in most areas of the economy (except trading). With plans to transform the economy on the Singapore pattern, the government has opened areas to foreign companies and given concessions that would have been unthinkable a few years ago.

While Sri Lanka welcomes foreign investment as part of its new strategy, an underlying nationalist sentiment does exist. If it were economically feasible, Sri Lanka might again close its doors. Should the SLFP return to power at any stage, it may follow more nationalistic policies. To reassure investors, Sri Lanka has entered into several investment protection agreements that will be honored regardless of the party in power.

The export processing zones are gaining widespread acceptance as a tool for economic progress -- it provides the possibility of drawing advantages from foreign investment while also insulating the economy from potentially harmful effects. (See section 13.05).

If the present government is removed (which is impropable), a change in policy is likely. Changes that could be expected under an SLFP government include a crackdown on consumer goods imports and an erosion of concessions to foreign investors.

Sri Lanka has tried to ensure protection of investments made by foreign companies. Sri Lanka has concluded several double taxation agreements that are especially tailored to allow for the tax breaks Sri Lanka provides. In 1981, it reached an investment protection agreement with Japan, which will remain effective for 10 years. It also has entered into investment protection agreements with the US, West Germany, the UK, Singapore, and France. The Japanese pact is expected to make a difference in the level of Japanese investment, which has been quite modest. Japanese investors attach considerable importance to the protection guaranteed by the agreement. When Japan signed such a treaty with Egypt, Japanese investment in Egypt increased sharply.

Over the next 18 months, the government will remain basically favorable to foreign investment but fine tuning of incentives is probable, with some hardening of requirements. Generally Sri Lanka favors the setting up of industries that are basically export oriented, labor intensive and where possible resource - based.

According to the FIAC, it actively encourages investment in several resource based projects:

- o Rubber-based industries.
- o Graphite based industries.
- o Coconut palm products.
- o Clay, dolomite, feldspar and silica based products.
- o Other agro-based industries using sugar cane, soya bean, spices and essential oils.

The GCEC and the FIAC periodically send out investment promotion missions. One to Hong Kong is intended to attract investors nervous of the colony's instability.

1.06 Amount of Foreign Investment

The government's new economic policies have had a very positive influence on the level of overall investment. From 1979 to mid-1981, total investment was Rs1,530 million, in 450 projects. By comparison, total investment was only Rs130 million in the eight years immediately before. This includes investment both under the auspices of the Foreign Investment Advisory Committee (FIAC) and the Greater Colombo Economic Commission (GCEC). (All foreign investment must fall into one of these two categories.)

Foreign investment outside the export processing zone must be approved by the Foreign Investment Advisory Committee. Not all of the projects approved by the FIAC are implemented; out of a total of 512 projects approved between 1977 and mid-1982, about half were under way as of mid-1982. The rest were under negotiation (121 projects) or had been abandoned (128 projects). Seven others had been implemented, but not under the FIAC. The leading sector was fabricated metal/machinery/transport equipment, but significant investments have also taken place in other sectors (see Box 1.06A). In the first three quarters of 1982, the FIAC approved 84 projects, with a total of Rs1.7 billion in foreign investment, to be matched by local investment of Rs2.5 billion.

Top investors in Sri Lanka (in FIAC approved projects) from 1977- mid 1982 were the United Kingdom with 79 enterprises, Hong Kong with 55, West Germany and Singapore with 54 each, Japan with 36 and the United States of America with 33.

In the GCEC, 74 industrial investment projects were contracted in the Investment Promotion Zone coming under the authority of the Greater Colombo Economic Commission in 1978-1981 (see box 1.06B). The capital investment of these enterprises amounted to Rs 2,269 million. Gross earnings from GCEC exports during 1981 was Rs 882 million. The largest number of GCEC projects have been in the field of garments, but manufacturing is starting to catch up.

BOX 1.06A

Industrial Investments Contracted - FIAC
1978-1981

Category	Number of Units				Foreign Investments (Rs million)				Local Investments (Rs million)			
	1978	1979	1980	1981a	1978	1979	1980	1981a	1978	1979	1980	1981a
Food beverage and tobacco	-	6	8	13	-	37	527	178	-	77	589	229
Textiles, wearing apparel and leather products	7	29	12	8	20	261	16	30	31	688	43	55
Wood and wood products (including furniture)	-	-	2	-	-	-	1	-	-	-	6	-
Paper and paper products	-	3	3	3	-	3	6	3	-	12	24	20
Chemicals, petroleum, coal, rubber and plastic products	11	7	12	15	24	36	193	100	36	75	385	210
Non-metallic mineral products (except petroleum and coal)	1	1	-	6	9	4	-	89	21	12	-	235
Fabricated metal products and transport equipment	2	9	10	13	21	41	226	232	33	97	361	362
Manufactured products	-	6	19	6	-	5	90	9	-	10	177	50
TOTAL:	21	61	66	63	74	387	1049	642	121	971	1585	1161

9

BOX 1.06B

Industrial Investments Contracted - GCEC
1978-1981

Category	Number of Units				Foreign Investments (Rs million)			
	1978	1979	1980	1981a	1978	1979	1980	1981a
Food beverage and tobacco	1	-	2	-	2	-	25	-
Textiles, wearing apparel and leather products	20	9	5	2	73	126	755	111
Wood and wood products (including furniture)	-	-	1	-	-	-	1	-
Paper and paper products	-	-	-	-	-	-	-	-
Chemicals, petroleum, coal, rubber and plastic products	3	-	2	3	22	-	44	43
Non-metallic mineral products (except petroleum and coal)	-	2	-	1	-	388	-	18
Fabricated metal products and transport equipment	1	1	3	1	9	8	377	33b
Manufactured products	4	-	10	3	16	-	98	120
Services	-	-	-	-	-	-	-	-
TOTAL:	29	12	23	10	122	522	1300	325

a: provisional
b: includes expansion of earlier projects.

1.07 Examples of Foreign Investment

A number of foreign investments have been made over the last few years. In hotels -- the Taj Hotel in Colombo (owned by Indian Hotels group); a resort hotel being erected at Bentota by the Robinson group of Germany; a Sheraton hotel in Colombo; and a 500-room hotel in Colombo owned by the Galadhari Brothers of Dubai. In the manufacturing sector, Gilbey's of the UK has gone for a local public subscription to obtain local equity for a distillery project; Mitsui and Shigyo, of Japan, have set up the Tokyo Cement Co (Colombo) Ltd. to make 200,000 metric tons of cement per annum.

For many Western firms, Sri Lanka's small domestic market means that an investment by the foreign firm is not cost-effective in terms of travel expenses and executive time. Some of these have found it worthwhile to invest in Sri Lanka through subsidiaries based in India or Pakistan. Expatriates can also be brought in from those countries. For example, International Cosmetics Ltd was set up in 1961 to produce a wide range of cosmetic products for the domestic market. The company is 40% owned by Maharajah Organisation Ltd, a Sri Lankan company. The remaining 60% is owned by Ponds (India) Ltd, which itself is 40% held by Cheseborough Ponds Inc of the US. The Sri Lanka company is managed by executives delegated from Ponds (India).

The government will accept innovatively structured deals, if they are beneficial to both parties. For instance, Prima of Singapore, with three associates, has set up a complete wheat flour milling facility (milling 2,200 tons per day) on land leased by the government. The government will supply whole wheat for milling, free. Prima will return 76% of the flour to the government free of charge, retaining the bran etc. and the remaining 24% as their share. After about 20 years, the mill will be returned to the government. In the interim, a lumpsum payment has been made in lieu of all taxes.

The government has also entered into some joint venture projects with foreign partners in areas usually reserved for the State sector (see section 2.02).

In general, many examples of successful foreign investments in Sri Lanka are available. A few of these:

o The Nestle group of companies have three different operations in Sri Lanka with different foreign equity shares. Food Specialities Ceylon Ltd has an 80% foreign equity share. They have set up a factory on a 50-acre area in the Kurunegala district on the banks of the Maha Oya. The Rs 430 million investment project will develop and utilise all principal local raw materials and resources. It is rockoned that 300 persons will receive direct employment, while amost 2,000 others will be involved in ancillary activities. Milk powder, infant formulae, milk cereals and malted milk will be manufactued and production is estimated to begin in 1983.

International Dairy Products Limited, another Nestle company has a sweetened condensed milk factory in Polonnaruwa. The foreign equity share is 60%.

Ceylon Nutritional Foods Ltd, a long established company and the third of the Nestle operations is a distribution company and will distribute the products of Food Specialities Ceylon Ltd and International Dairy Products Ltd. It has a foreign equity share of 49%.

o Nestle's also look over the assets of the National Milk Board, formerly a state-owned organisation. The National Milk Board had been a loss-making concern.

o Lever Brothers Ceylon Limited, 100% owned by UniLever, has set up two projects through fully-owned subsidiary companies. Lever Agro Enterprises Ltd was started in 1981 to manufacture rice bran; it is expected to go into production by the end of 1982. The objective of this project is to reduce the use of coconut oil in soap and animal feed by using a satisfactory substitute. Lever Aqua Products Ltd, a prawn farming venture, has been set up on Government owned land. It is primarily an export oriented project and is expected to be commercially viable by 1983.

o The Somerville Group of Companies have invested an estimated Rs 33 million in a hotel resort to be opened on the South coast shortly. Somervilles will contribute 51%, the Beaufort International hotel 20% and the balance will be offered to the public. As the foreign partner, Beaufort International Hotels will manage the resort on the payment of a 10% management fee.

o Haleys Limited (a large local manufacturing and trade organization) set up a seed station at Olugantota in the Welimada area with Zaadunie B V a Dutch Collaborator. Approved by the FIAC, the seed station provided many local women with jobs.

o Tootals of the UK has set up a joint venture for the manufacture of sewing thread, the Colombo Thread Company. They received approval in 1979, started construction in 1980, and production in March 1981. The foreign equity share is 60% from Tootals. The authorised capital is Rs 25 million. However, this includes a sum of Rs 5 million for which there is no matching local equity; the company has found it difficult to raise local capital.

1.08 Profitability of Foreign Investment

No figures are available from most companies, since only public companies have to publish profitability figures. However, firms consider profitability in Sri Lanka average to above-average.

1.09 Official Sources of Business Information

For any firm interested in investing in the Export Processing Zones, the Greater Colombo Economic Commission maintains various data

that may be useful. The address is:
The Investment Promotion Division,
Greater Colombo Economic Commission,
P.O. Box 1768, Colombo, Sri Lanka

GCEC also has an information centre in New York:
Mr. Arjuna Kadirgamar
Greater Colombo Economic Commission
UNIDO Investment Promotion Service
821, U N Plaza, 6th Floor
New York, NY 10017, USA
Phone: (212) 935-0369

Proposals for foreign investment in Sri Lanka outside the Investment Promotion Zones of the GCEC, are examined by the Foreign Investment Advisory Committee, Secretariat Building, Galle Face, Colombo 1, Sri Lanka.

The FIAC is serviced by the International Economic Co-operation Division of the Ministry of Finance and Planning which provides advice to prospective investors on suitable areas for investment outside the GCEC area of authority. It also provides assistance to investors (local and foreign) in finding suitable collaborators in joint venture projects, and in overcoming various difficulties encountered in setting up an industry. Project proposals should be forwarded to the Director, International Economic Co-operation Division, Ministry of Finance and Planning, Secretariat Building, Galle Face, Colombo, Sri Lanka.

Among other activities undertaken, the Ceylon Chamber of Commerce helps visiting businessmen make contacts in Sri Lanka, organizes trade exhibitions and operates an information service.

The Ceylon Chamber of Commerce is located at 127 Lower Chatham Street, PO Box 274, Colombo 1, Sri Lanka.

The Sri Lanka Export Development Board helps in the development of supplies of export products, and will carry out export potential surveys related to Sri Lanka products. It is located at 310, Galle Road, Colombo 3, Sri Lanka.

Feasibility studies for industry are undertaken by: Industrial Development Board (IDB), 615 Galle Road, Katobedde, Moratowa, Sri Lanka.

The Integrated Development Programme of the Mahaweli Authority promotes the development of agri-industries, integration of crops and animal husbandry. Foreign investors could take advantage of these investment opportunities. The Mahaweli Authority of Sri Lanka has set up an Economic Unit at 500, T B Jayah Mawatha, Colombo 1, Sri Lanka which will assist investors with information and procedural matters.

The Ministry of Agricultural Development and Research could also provide useful information and assistance. The Ministry is situated at 73/1, Galle Road, Colombo 3, Sri Lanka.

The following overseas offices will provide information pertaining to investment in Sri Lanka:

Los Angeles Pacific Basin Marketing Corporation
9100, Sebulveda Eastway
Los Angeles, California 90045, USA
Phone: (213) 641-1373
(800) 421-5643

Sri Lanka Investment and Trade Centres
International House
Bella Centre
Centre Boulevard DK 2300
Copenhagen, Denmark
Phone: (01) 520211

Sri Lanka Trade and Investment Centre
App 1519
Enauel Leitze Str 1a
4000 Dusseldorf, West Germany
Phone: (0211) 593053/54

2.00 STATE ROLE IN INDUSTRY

2.01 General

Partly as a legacy of its socialist past, large sections of Sri Lankan industry are government owned and managed. Power generation, the railways, public transport, plantations, most newspapers are in the government's charge, as are many industrial ventures (see 2.02). However, the UNP has no intention of expanding this role further -- quite the opposite, in fact. The government believes that expertise available in private companies can help turn around some inefficient performers in the state sector.

The leftist policies of the previous government -- and, some say, political vendettas -- resulted in the nationalization of large sectors of the economy. Most important were the plantations, which were the heart of Sri Lanka's economy. Nationalization usually has led to inefficient production units, with overstaffing and lower productivity.

While the private sector will continue to increase its role, wide-scale denationalization of existing state corporations is unlikely. The Business Acquisition Act, brought in by Bandaranaike, allows the government to take over private companies relatively easily. It has not been repealed under Jayawardene, and, in fact, in an earlier term the UNP used it to take over the Independent Television Network, and Times of Ceylon, a newspaper in the hands of Anura Bandaranaike. Were the SLFP to come to power, a more socialist pattern would be adopted, and a spate of nationalizations, while unlikely, is not impossible.

The role of the State at present is to promote industrial growth in desired directions. The highest priorities are to provide jobs, promote exports, and utilise effectively the country's natural resources. For instance, the government has been trying to promote agri-based industry, where comsiderable potential for expansion of field crops and minor agricultural export crops exists, especially on unused lands and on lands being diversified out of other crops such as tea. The government leases land to companies to promote agri-based industries where local workers could be employed.

For example, Lankem Ceylon Ltd (a Shell Company) which had been engaged in the distribution of lemon grass oil for some years apllied to lease 2,000 acres of land in the Mahiyangana area from the government; it was approved.

In some cases, it is less successful. Despite the stress on exports, growth has not been encouraging. In some cases, the protection provided in the local market tends to offset the benefits of exporting -- despite the incentives provided by the government -- and many companies have opted for the former. Import substitution is generally more profitable than export. But this is largely true only on the average: there are many instances of import substitutes which receive little or no protection. Conversely there are some very highly subsidized export subsectors.

The EDB (Export Development Board) has recognised the problem, and are making efforts to rectify the situation. Funds constraints will prevent any very major changes in the short term.

2.02 State-owned Industry

Besides the usual areas -- such as utilities -- the public sector operates in industries such as fertilizer, petroleum, cement, steel hardware, transport, plantation agriculture, banking, shipping, caustic soda and chlorine, paper, textiles, ceramics, oils and fats, plywood, leather goods, sugar, minerals and sand, slats, tyres and tubes, trade, etc.

By policy, state monopolies are petroleum and minerals, railways, and mining. (General mining is an exception in the Mahaweli reservoir areas, in order that rapid exploration could take place before inundation. The State Gem Corporation had invited an Australian Mining company to engage in strip mining for gems in the Mahaweli area; but the company has discontinued the project since it is not satisfied with its finds so far.) Further expansion is reserved for the public sector (except in the Greater Colombo Economic Commission Area). However, the present government is flexible about this; for example, they have invited investment in a hydrocracker.

It has been a Treasury policy on the whole to encourage collaborations between state industry and well-known international companies, subject to the demand that the necessary capital contributions are raised by the Corporations themselves out of their own resources. Generally, it should be possible to obtain a tax holiday, and often, the pioneering industry concession would also be given (see Section 10.04). In the event of a strike, there is a cost-recovery and production-sharing agreement.

Several state-owned corporations and other statutory bodies are currently seeking government authority to enter joint venture agreements with international companies. The Cabinet has recently authorised a venture between the State Development and Construction Corporation and Showa of Japan in the ready-mixed concrete production industry. It has also authorized a tobacco export venture between the Sri Lanka Tobacco Industries Corporation and Interbex of Belgium. The Sri Lanka Sugar Corporation and KCP Ltd of India are to set up a sugar factory, planned to produce 27,000 metric tons annually from 1985.

Pending government approval are two more projects. They are a tyre manufacturing venture between the Sri Lanka Tyre Corporation and the Swiss subsidiary of the Chicago-based Bear Cat Company, and the Lanka Leyland collaboration with Ashok Leyland of India for the assembly and progressive manufacture of buses. They expect to get both the tax holiday and the pioneering industry concession.

During 1980, most major state corporations made profits. The more profitable corporations which earned returns on sales of over 20%

were the tyre, Plywoods, Tobacco, Salt and Chemical Corporations. The State Hardware, Paper and Steel Corporations performed poorly with returns of less than 6% on sales (see box 2.02A for profitability of state corporation from 1976 onwards.) However, the Ceylon Transport Board has also been losing money heavily. So also have the railways (a government department).

BOX 2.02A

Performance of major state industrial corporations 1976-1981

Corporation	Net profit (Rs million) 1976	1977	1978	1979	1980	1981a	1980 net profits as % of Capital investment[b]	Sales
Ceylon Petroleum	-77.0	-178.9	-374.1	192.0	108.8	na	13	1
National Textile	-11.9	-8.1	-24.7	-87.3	na	na	-23	-29
State Flour Milling	30.4	-15.3	45.5	10.4	1.0	-11.7	2	e
Ceylon Cement	-4.8	-24.1	15.6	10.4	134.9	na	34	18
Ceylon Steel	13.3	1.5	25.5	40.8	28.3	27.9	8	6
Sri Lanka Tyre	6.5	2.4	42.9	-28.4	58.3	na	34	24
National Paper	17.7	12.3	14.0	-0.9	18.3	2.3	2	6
Ceylon Ceramics	12.1	2.6	13.8	18.1	44.5	34.1	17	23
Ceylon Plywoods	-2.1	-12.0	-3.1	0.4	35.8	na	22	32
Sri Lanka Tobacco	12.3	11.0	30.6	33.3	10.2	12.2	31	24
National Salt	8.2	5.6	6.7	8.3	14.2	19.2	39	40
State Hardware	-11.9	-9.2	-1.3	0.8	1.0	na	2	2
Ceylon Leather products	1.1	0.7	3.6	6.8	4.2	1.9	10	14
Paranthan Chemicals	7.8	3.4	3.9	6.0	7.6	4.5	16	28
TOTAL/AVERAGE	1.5	-208.1	-201.1	267.5	467.1[c]	d	13	4
Excluding Petroleum	78.5	29.2	173.0	75.5	358.3[c]	d	13	13

a - Provisional
b - Capital investment is defined as capital reserves and long term liabilities-accuulated losses
c - Excludes National Textile Corporation for which data is not available
d - Not provided as information for five or more Corporation is not available
e - Less than 1%
Sources: Central Bank of Ceylon and Ministry of Industries and Scientific Affairs

2.03 Nationalization Policy

No nationalizations will take place as long as the current government remains in place. In fact, the government believes that expertise available in private companies can help turn around some inefficient performers in the state sector.
Some other examples:

- Five large state-run textile mills were handed over to the management of three Indian firms and a joint UK-Indian venture. They have shown sharp increases in production and improved labor discipline.

- The state-owned bus services are to be streamlined and already face competition from private operators. The state-owned transport board, set up in 1958 when the bus services were nationalized, lost US$67 million in 1981. It runs 6,000 buses and employs 60,000 people -- of whom as many as 20,000 may be redundant, employed because of political pressure. In 1979, private firms were allowed to run parallel services, and 4,000 private vehicles were believed to be in operation by 1980.

- The government may draw on private sector expertise to manage (but not own) tea, rubber, and coconut plantations, most of which are state owned.

- Private agencies are allowed to handle some mail and telecommunication services, including subagencies for the sale of postal items, local telegrams, and foreign telexes.

- Private companies may even be allowed to generate electricity and distribute it through the national grid.

However, the government has not repealed the Act under which previous governments have made most of their nationalisations. The

Business Undertakings (Acquisition) Act of 1971 is similar to British law whereby it is possible for the government to take over businesses with the public interest in mind. The act empowers the government to appoint a 'competent authority' to manage the affairs of the undertaking. All the rights and liabilities under any contract at the time of takeover vest with the government. Appeals may be made against the takeover to the Minister of Finance within fifteen days of the vesting order. The government may direct a bank in which the proprietors of the undertaking has an account to prevent the operation of the account. Several companies were taken over during the SLFP regime under this act.

There is no stated intention to nationalise any companies in the future. The following companies were absorbed as government owned business undertakings under the Business Undertakings Acquisitions Act, during the SLFP and are now managed by a government appointed Competent Authority:

- Acland Finance and Investment Ltd
- Colombo Commercial Company (Engineers) Ltd
- Colombo Commercial Company (Fertilizer) Ltd
- Contact Ltd
- Essential Oils Ceylon Ltd
- Heavyquip Ltd
- Hunnas Falls Ltd

- The Wellawatte Spinning and Weaving Mills Ltd
- United Motors and Automobile Assemblers and Manufacturers Ltd
- Ceylon Silks Ltd
- British Ceylon Corporation
- Ceylon Oxygen Ltd
- Orient Company Ceylon Ltd
- Colombo Gas and Water Company Ltd

All employees of the above companies receive tax-free salaries and wages comparable to other government employees. A tribunal was set up to appeal against the take over and also to decide on the quantum of compensation offered. Compensation for the Commercial Group (comprising the first seven companies listed) has recently been approved at Rs 78 million.

Court actions can be successful in foiling an acquisition. For instance, Jafferjees was ordered to be taken over under the SLFP government. After it came to power, the UNP continued the action; but Jafferjees won the case on the basis that the original vesting order was incorrectly served and therefore invalid.

The Act has also been used punitively against companies that broke the law. In fact, there has been a strong lobby to limit it to such use, but such legislation is unlikely. The takeover of the Colombo Commercial Company group was a punitive action. In one instance, however, a company itself sought to be taken over. This was permitted, and the company was nationalised.

The government (under the SLFP) has also, in the past, taken over the Lakehouse Group of newspapers by a special act of parliament -- rather than under the Act.

The Land Acquisition Act is also similar to British law that permits the government to take over land and buildings with the public interest in mind. The premises of Shaw Wallace and Hedges Ltd were acquired by the SLFP-dominated United Front government to house the Ministry of Plantations. When the stores of Shaw Wallace and Hedges Ltd were acquired, the company was compensated. In 1981, Mackinnon Mackenzie and Company's buildings were taken over the Airports Authority, but the buildings were later returned to the Company.

Compensation payments may be delayed by upto five years. This may be a major disadvantage as compensation is based on market value at the time of takeover.

In order to reassure investors, and provide a stable framework within Sri Lanka's volatile democracy, the present government has sought to protect foreign investors through the

Constitution. It gives special status to international treaties and agreements to promote and protect foreign investments in Sri Lanka. Where Parliament, by two thirds majority, approves any agreement between the government of Sri Lanka and a foreign government for the promotion and protection of investments in Sri Lanka, as being essential for economic development, the agreement is to have the force of law in Sri Lanka. No written law -- or executive or adminstrative action -- can then be made (except for national security reasons) which contravenes the agreement.

The government has investment protection agreements with the US, West Germany, the UK, Singapore, Korea, and France. In 1981, it reached an agreement with Japan, which will remain effective for 10 years. The Japanese pact is expected to make a difference in the level of Japanese investment, which has been quite modest. The government are negotiating similar agreements with other countries.

The Greater Colombo Economic Commission provides special protection in addition. Neither the assets nor income of a business that comes under the GCEC may be liable to acquisition, expropriation or nationalization. The capital investment of non-resident shareholders, the profits, and any liquidation proceeds will be freely transferable, and not subject to exchange controls.

For companies that come under the GCEC, disputes relating to their agreements with the GCEC will generally be referred to the International Centre for Settlement of Investment Disputes (ICSID) (see Section 3.01).

3. ORGANISING

3.01 General

Companies that mean to do business in Sri Lanka must be incorporated in that country; no company may carry on any undertaking in Sri Lanka, nor have an interest in any property in Sri Lanka, unless it is incorporated in Sri Lanka (see section 3.10) or is exempted by the Minister of Trade and Shipping. However, this does not apply to banks.

Sri Lanka's policy on foreign investment and incentives is determined by the Cabinet. The Ministers (and the departments under them) for each portfolio assist in formulating the overall policy. The general policy is determined by the Ministry of Planning and Economic Affairs and the Ministry of Finance. For taxes, the Ministry of Finance is assisted by the Department of Inland Revenue. The Department of Exchange Control of the Central Bank assists the Ministry of Finance for policy concerning foreign exchange transactions. The Ministry of Industries and Scientific Affairs is in charge of the industrial sector. Fishing and tourism come under the Ministry of Fisheries and the Ministry of Shipping and Tourism respectively.

All foreign investments come either under the Foreign Investments Advisory Committee (FIAC) or the Greater Colombo Economic Commission (GCEC). In the private sector, in general, only 49% foreign equity is permitted, and the domestic shareholders must retain effective control. However, the government is flexible about this if the projects are particularly attractive; they may allow majority foreign ownership. In the state sector, foreign investment may be negotiated.

The Greater Colombo Economic Commission Law provides for two types of enterprises which are eligible for special treatment, namely "Area enterprises" and "Licensed enterprises". In both cases, they must be companies with which the GCEC has an agreement. The difference between the two is that an "Area enterprise" operates within Greater Colombo Economic Commission Area, while a "Licensed enterprise" operates outside the area. The law is sufficiently flexilble to extend the special treatment which is given to companies in the GCEC Area to other enterprises as well.

For hotel projects, FIAC recently revised its project approval terms. Foreign investors can now hold up to 70% of the equity in hotels of the five star category, with at least 200 rooms, situated in the Colombo area. In Ceylon Tourist Board approved sites outside Colombo, hotels with a minimum of 50 rooms will be permitted upto 49% equity. This is not rigid, and can be further modified on a case by case basis.

Proposals for projects that will operate under the GCEC aegis must be authorized by the GCEC. These are mainly investments in the Investment Processing Zones (see 13.05) but may include GCEC Licensed Enterprises also. For investments in the GCEC Area, there are no equity restrictions; even 100% foreign ownership will be allowed. The GCEC is directly under the control of the President; it has one Director-General and four directors. Wide powers are conferred on the Commission (see 13.05).

Under GCEC Law, any disputes about the agreements between the foreign investor and the GCEC will, unless otherwise agreed, be referred to the International Centre for Settlement of Investment Disputes (ICSID). The District Court of Colombo may enforce the awards of ICSID. Even if the company, by incorporating in Sri Lanka, becomes Sri Lankan, it is regarded as a foreign national for this purpose.

3.02 Basic Approval Procedure for New Investments and Expansions

Under the Companies (Special Provisions) Law, No. 19 of 1974, no company may have an interest in any property in Sri Lanka, or do business in Sri Lanka, unless it is incorporated in Sri Lanka (see section 3.10). This does not apply to banks. The government may exempt companies from this provision.

Besides banks, the following businesses are exempt:

- any proprietorship or partnership companies, owned by Sri Lankans
- foreign airline, shipping, and insurance companies.
- buying agents of foreign governments or state corporations who do not engage directly in trade, but only supervise the trade with Sri Lanka;
- any foreign company which owns proprietory rights in industrial or intellectual property (patents, trademarks, industrial designs or copyright);
- any foreign company which has agreements with the government or with local businesses for specific works, services or the supply of imported goods;
- any foreign company that has stopped doing business in Sri Lanka;
- any foreign plantation company;
- certain other businesses specified by name.

Enterprises in the Greater Colombo Economic Commission area (Investment Promotion Zones), must also be incorporated in Sri Lanka.

Proposals for investment in the GCEC Zone must be authorized by the GCEC. In addition to investments in the Commission Area, the GCEC may grant licences to investments outside the Commission Area (see 13.05). Enterprises enter into agreements with the Commission. The terms are subject to negotiation, and the GCEC takes a case by case approach.

The GCEC Law has not provided guidelines for evaluating projects for the Commision Area. However, GCEC will consider the following when granting incentives:

- creation of employment;
- degree of export orientation;
- capital investment;

- o development of technology;
- o use of local raw materials and components, etc.

The government is more conservative regarding foreign investment proposals outside the authority of the GCEC, but they will be considered if they conform to government policies, and if prove out on a social cost-benefit analysis. Important considerations would be:

- o use of indigenous raw materials;
- o production primarily for export, particularly those products which diversify Sri Lanka's export trade and have a net foreign exchange earning. (Projects could include further processing of Sri Lanka's traditional products);
- o locating the project in one of the less industrialized or less developed parts of the country, provided that the costs of locating there are not excessive;
- o adopting intermediate or labor intensive techniques of producton;
- o whether the project will tend to foster local technology growth.

Projects that conform to these specifications may be able to negotiate a higher equity share than the prescribed 49% (e.g. see Nestles, section 1.07).

In addition, foreign investment proposals in the private sector will be evaluated for the following:

- o the technical skill necessary for the industry must not be available locally;
- o if the cost of imported machinery is high, the foreign investor should contribute enough capital to cover its cost in foreign exchange.
- o the greater part of the product must be exported.

For foreign participation with the public sector, the conditions will be dealt with on a case by case basis.

An example of an instance in which the government has been reticent about allowing increased foreign investment is the footwear industry -- in which, incidentally, it is represented through a major state Corporation. Bata Shoe Company, which already has a factory in Sri Lanka, wishes to expand by setting up a second factory. The government has so far withheld permission to expand, as no provision has been made for local equity participation. The matter is still pending.

During the period 1978-1981 there were increases in approvals granted by the FIAC in projects relating to (i) food, beverage and tobacco, (ii) Chemicals, petroleum, coal, rubber, and plastic products, (iii) non-metallic mineral products (except petroleum and coal) (iv) fabricated metal products, machinery and transport equipment. On the other hand there was a considerable drop in investment in textiles, wearing apparel, leather products, paper and paper products and manufactured products. In 1981 investment in wood and wood products including furniture was nil.

Already established joint ventures do not usually require FIAC approval for expanding company operations if the scope of the expansion was defined in the original application to the FIAC. If a change of equity structure is envisaged, then FIAC approval is necessary.

FIAC approvals would take from four to eight weeks to process. In the case of Tootals Ltd UK, the application for a joint venture with 60% foreign ownerships and an authorized capital of Rs 23 million, took eight weeks to process.

No special laws or procedures are applicable to oil and mining, which are state monopolies. Foreign investment in these areas will usually be permitted only in conjunction with state participation. The Ceylon Petroleum Corporation determines the extent of foreign participation in ventures pertaining to petroleum and petroleum products.

Graphite (in which Sri Lanka has considerable reserves) mining is another area which is restricted to the foreign investor, but a case by case consideration of the proposed project by the State Graphite Corporation is possible.

Sri Lanka has signed the IBRD Convention in the Settlement of Investment Disputes.

BOX 3.02A

Investment Approvals by FIAC

Applications are made in the prescribed form to the International Economic Co-operation Division of the Ministry of Finance and Planning. Specimen application forms may be obtained from:

Director, International Economic Co-operation Division,
Ministry of Finance and Planning, 1st Floor, Galle Face Secretariat
Colombo 1

Twelve copies of the forms should be submitted to the FIAC. They must contain the following details:

Part I

1. a) Name and address of proposed business
   b) Form of business organization

2. Summary description of the proposed venture.

3. Proposed site of project/base of operations and estimated area of land required.

4. a) Name and address of local investor/promoter
   b) Name and address of foreign collaborator
Documentary evidence of foreign collaborator's willingness to invest, and an appropriate bank reference.

5. Why foreign collaboration is necessary:
a) Contribution envisaged from foreign collaborator
b) Experience and know-how available to foreign collaborator for the production of commodities/services proposed
c) Information regarding investments undertaken by the proposed foreign collaborator outside his home country.

6. If the local or foreign investor/promoter has any interests in any existing local industrial concern, details and the precise nature of the interest must be given.

Part II

7. Cost of project:
a) Fixed assets - (Separate schedule giving details of each item)
b) Current assets

8. Proposed financing:
A statement showing duration of loans, source quantum under each duration, repayment schedules and rate of interest. A specific explanation must be made if shares are being issued to foreign parties for consideration other than cash.

9. Use of raw materials for 5 years. (A separate schedule must be

attached, detailing quantities and values of different products.)

10. Sales over 5 years. (Separate schedule detailing quantities and value of different products.)

11. Requirements of power and fuel.

12. Water use, effluents.

13. High intensity noise/vibration generating equipment, potentially dangerous or injurious substances/processes, fire risk.

14. Marketing of products.

15. Estimate of operating results, funds flow statement, manpower requirements, time schedule.

Part III

16. If machinery is to be imported, it must be stated whether it will be new or re-conditioned. If re-conditioned, reasons must be given as to why that particular machinery is to be imported. Investor must state if investigations to ascertain whether any or part of the production equipment could be locally fabricated were made. Also, if investigations were made to ascertain whether prices to be paid for machinery are competitive in relations to similar machinery in world markets. Details of capacities to be installed. The productive life of the main items of equipment and what replacements will be needed during this period.

17. Royalty payments: amount, basis and period of payment, whether payment of royalties is linked to export performance.

18. Details of technical collaboration, technical service fees.

19. Foreign personnel to be employed, job description, period of contract and terms of payment.

20. Dividends on foreign capital.

21. Foreign loans and suppliers' credits - terms of repayment, rates of interest, period of payment.

22. Any other remittable recurrent liabilities.

23. Basis of projected export programme and rate of foreign collaborator in marketing the products.

Each project proposal should be supported by a letter from the foreign collaborator stating his willingness to join the project. Projects are evaluated in terms of the technology transfer involved, access to foreign markets, gains in foreign exchange, spread of skills as well as the contribution to output and employment.

BOX 3.02B

Investment Approvals by the GCEC

The GCEC provides one-stop shop processing for foreign investments that come under its purview.

The application for investment approval (in triplicate) must include:

- a description of the project
- the cost of the project (foreign and local currency);
- capital structure (issued and paid up share capital);
- details of long term loans (including repayment and interest rates);
- projected amount and value of foreign and local raw materials and components for each of the next five years;
- production programme for each of the next five years;
- markets for the products;
- projected cash flow statement for the next five years;
- the infrastructure requirements;
- manpower;
- time schedule for start-up;
- proposals for training local personnel, if any.

If any part of an existing business is to be transferred to the new enterprise, full details should be given of the exports, the items of manufacture; the number of employees; the machinery, equipment, etc. to be transferred. Particulars of any splitting up, reconstruction or amalgamation of an existing business with the new enterprise should also be furnished.

The terms of approval will be included in the investment agreements with the Greater Colombo Economic Commission.

The Commission has prepared a draft agreement, which provides that the enterprise must commence business within a period of nine months, but this can be extended.

The draft also provides that the enterprise must

- maintain an accounting system which will clearly show its revenue and expenditure, and must make available to the Commission, whenever necessary, the quantum of the revenue and expenditure in foreign currency as distinct from such revenue and expenditure in Sri Lanka currency
- within four months of the end of a company's financial year, it must give the GCEC a statements of accounts, audited by a member of the Institute of Chartered Accountants.

For machinery and equipment to be imported, a certificate from an internationally reputed firm of surveyors is required. The certificate should indicate

- whether the machinery is new and modern (if not new the age of the machinery)
- that the price is fair, reasonable and competitive.

3.03 Activities not Open to Foreign Capital

Generally, foreign investment in trading will not be permitted. Recently, the government has also decided to slow further investment in garment manufacturing. Garments had been a major area of interest among foreign investors and numerous Asian investors had started manufacture in Sri Lanka to avoid quota restrictions on exports from their own countries. The government does not want to become overdependent on this kind of investment, and, in the future, only certain specialized garment manufacturers will be allowed to invest.

In the case of sectors in which state enterprises are engaged or which are reserved to them, foreign participation must be with such enterprises.

Certain other areas may be limited to foreign companies in special circumstances. For instance, Guthrie, a Malaysian controlled UK firm gained approval for a palm oil plantation in the Mahaweli area, but was not able to go ahead with the scheme. Resistance came from the local scientific community for ecological and social reasons. The USAID, which is assisting the Mahaweli project also opposed it as a misallocation of resources.

3.04 Limitations on Foreign Equity

Outside the export promotion zones -- where even 100% foreign shares are permitted -- foreign equity is theoretically limited to 49%, and the domestic shareholder must retain effective control. As a matter of practice, the government permits a majority foreign held company even outside the zones if it feels the project is worthwhile.

Transfer of business interests to foreigners requires Central Bank permission. According to the Exchange Control Act, Central Bank permission (either special or general) is required for any resident to do anything that will cause a business which is controlled by Sri

Lanka residents to cease to be so controlled. Further, the Central Bank must approve any transfers of a business in Sri Lanka by a non-resident to a resident, but this does not apply to shares in a company.

In the case of 5 star luxury hotels of over 200 rooms the equity share of the foreign investor could be as much as 70%. However this percentage would refer to the hotels which are under construction, not to the hotels that are already in existence. In the case of construction projects undertaken for the Mahaweli Development Programme, the foreign equity share could go upto 60%. In contrast, in those instances, in cases where there is no significant transfer of technology -- as in the garment industry, for example -- the equity share holding of the foreign investor is limited to 25%.

Tootal's sewing thread venture is Colombo Thread Company Ltd is an exception; of its authorised capital of Rs 23 million, 60% is foreign. In the case of Gilbeys (Lanka) Ltd, a joint venture in the liquor industry, shares were offered to the local public. These were not fully subscribed. The unsubscribed amount was then offered to the foreign partner which now has a majority shareholding.

In all other cases, as a rule, the minimum share holding for the local investor is 51% and the maximum for the foreign share holder is 49%.

3.05 Building and Related Permits

In the GCEC, sites for investment are allotted on a 99-year lease basis on the payment of an initial premium of Rs300,000 per acre and an annual ground rent of Rs8,000 per acre. Companies can use these only for buildings for projects approved by the GCEC, subject to any conditions prescribed by the GCEC. At present, no alternations or additions in the structure can be made without the written permission of the GCEC. The company cannot sub-lease or part with leased property without the GCEC's consent. However, right and interests in the lease can be mortgaged to any Bank or credit institution approved by the GCEC.

All applications to construct any type of building must be made to the relevant local authority - i.e. Municipal Council, Urban Council, Town Council, or Village Council. The application must state the purpose of the proposed building, the materials and chemicals to be used, and the site. This application will then be forwarded to the Urban Development Authority (UDA) which comes under the Ministry of Local Government, Housing and Construction.

Zoning approvals are granted by the UDA. In a primarily residential area, industry of any sort will not be permitted. In a mixed residential area, cottage industries are permitted, but not large scale industry.

The UDA would need to know the extent of pollution and what measures could be taken to safeguard the environment, and would require proof that the public sewage system will not be utilised for waste matter. In certain cases concessions are granted to industries as long as they are not detrimental to the environment.

No new industries may be set up within city limits.

A foreign investor needs investment approval from the Foreign Investment Advisory Committee (FIAC) before permits for construction are granted. Occasionally a foreign investment project approved by the FIAC could need further approval from local governmental authority. Prima Ltd, a Singapore based company obtained FIAC approval for a flour milling plant in Trincomalee on the North-east coast of the countrry. Although the company's project had been approved, the Municipal Council (i.e. local authority) decided to impose a tax on the plant.

If all necessary information is supplied in the application form to the UDA, approvals would normally take a month or two to process. There are no regional differences in UDA regulations.

The President heads a Cabinet Sub-committee for urban development mainly to take up a specific position with regard to policy, when a difference of opinion arises between the investor, and the UDA.

At present there is some discussion about moving company offices out of residential premises in Colombo. However, in view of the fact that even State Corporations are housed in such premises, this will take some time to come about.

Besides the area which comes under the authority of the Greater Colombo Economic Commission and has been demarcated as the investment promotion zone, the UDA has been instrumental in setting up industrial estates. Such estates have been set up on the outskirts of Colombo. The Ministry of Industries has also opened up small scale industrial estates.

Companies will have to approach the Post and Telegraphs Department for telephone and telex connections; the waiting time in Colombo can be upto six months. Obtaining telegraph addresses takes about one month, and post box addresses, around one year. However these times may vary substantially.

3.06 Acquisition of Real Estate

There is no legal restriction on the ownership of land and buildings by foreigners. A transfer of land or a building to a non-citizen is subject to a tax of 100% of its value. However, the tax does not apply to transfers to a company incorporated in Sri Lanka (even if controlled by foreigners).

(For land in the GCEC area, see see 3.05).

Under the Land Reform Act of 1972 the ceiling on ownership of land is 50 acres. This is applicable to individuals as well as companies. Exceptions may be made in special cases. For example, the government allowed several agribusiness ventures land in excess of the ceiling.

3.07 Acquisitions and Takeovers

It is impossible for a foreign firm to take over a Sri Lankan one without Central Bank and FIAC permission; the Exchange Control Act prohibits it.

If foreign companies wish to have 100% ownership of a local company, the matter will also have to be taken up by the FIAC. Usually 100% foreign ownership is not granted. In the event of purchasing shares in a local company a foreign investor is subject to a tax of 100% on the shares; this tax, however, is soon to be abolished.

3.08 Local Content Requirements

The government encourages maximising local content, but does not specify any fixed percentage. In the Investment Promotion Zone, at least 25% domestic value added is desired; this includes the value of local labor.

Companies are allowed to import certain items under license for which specific quotas are allowed. For renewal of the licence a letter is required from relevant local suppliers to say that the specifications of the item cannot be met locally.

Companies may start by importing their raw material requirements, and shift to local suppliers when possible. For example, Lever Brothers initially sourced the plastic sachets for Sunsilk shampoo from abroad, but have now developed a local supplier.

3.09 Mandatory Memberships

Membership in any business or industry association is entirely voluntary.

3.10 Establishing a Local Company

The basic forms of doing business are proprietorships, partnerships, companies, and co-operative societies. Companies are further subdivided into private and public companies. A private company is limited by its Memorandum or Articles of Association to not more than 50 shareholders, with limited rights to transfer shares; public offers are prohibited.

Companies may be limited by shares, limited by guarantee, or unlimited. The company is the most popular form of doing business, though many firms are not public.

The procedures for incorporation are quite simple (see box).

No minimum capital is stipulated. Capital may be in the form of cash or in the form of immovable property. A company that is limited by shares must state its authorised capital at the time of registration, but this can be increased by an ordinary resolution, and the Registrar of Companies notified within 15 days. Reduction of authorised capital is more difficult, requiring authorisation under the Articles of Association, a special resolution, and confirmation of the resolution in Court.

If shares are allotted for consideration other than cash it will be necessary to value such property for the purpose of paying stamp duty. Shares may be alloted against knowhow, but the government does not favor such arrangements, in part because of valuation difficulties.

The government stipulates that a foreign investor importing machinery should obtain a certificate of quality and prices from a Surveyor of international repute. (e.g. Lloyds International, Bureau Veritas) These valuations will be useful in determining the value of machinery for stamp duty when shares are issued.

A minimum of two shareholders is required for a private company, and of seven for a public company. Non-residents or their nominees need Central Bank permission to subscribe to shares -- including the qualifying shares. The company may have founders' shares.

Public companies must have at least two directors. No nationality or age requirement is imposed; a corporate director is not prohibited. Directors retire from the Board at the age of seventy-three save with the approval of the shareholders. There is no statutory requirement of share qualification. Disclosure of interests in contracts with the company is necessary. The company cannot pay a director remuneration free of income tax, and loans cannot be granted to directors except under certain circumstances. A company should have a qualified secretary if its turnover is more than Rs one million (Rs 1,000,000) or if it has a paid up capital of Rs five hundred thousand (Rs 500,000) or more. Every company must maintain a register of directors or managers at its registered offices.

A company may appoint non-nationals or non-residents as managers; however the necessity of foreign personnel and the grant of visa will be determined by the FIAC.

There is no requirement for labor to be represented on the Board.

A company may hold shares, but a partnership cannot hold shares in its own name; the partners will be joint holders.

Every company must maintain proper books of accounts of money received and expended, all sales and purchases and all assets and liabilities of the company. The books must be open to inspection by the Directors, the Registrar of Companies or the Company's Auditors.

For example, under the disclosure provisions of the Companies Act No. 17 of 1982, firms must reveal emoluments of Directors (as a lump sum, not individually); and also contracts of the company in which its Directors have interest. For e.g. Walker Tours Ltd, a local travel firm in Colombo, was required to report that four of its directors are also directors and shareholders of John Keels Ltd and John Keels Holdings Ltd, with which companies they (Walker Tours) had contracts for payment. Contracts for payment have been stated to be the rent to John Keels Ltd for the premises occupied by Walker Tours Ltd and a fee of 1% on turnover or Rs 150,000 per month, whichever is higher for the provision of higher managerial services.

Within eighteen months of incorporation and at least once in every calendar year, at intervals of not more than fifteen months, the directors must submit to the company at its annual general meeting a profit and loss account, a balance sheet and directors' report with respect to the state of the company's affairs.

On authorised capital the maximum fee payable on incorporation is Rs 5,000. However, if company pays Rupees Three thousand (Rs 3,000) on incorporation for a company have authorized capital of Rs 1,000,000 and later increases the authorised capital to Rs 10,000,000 the balance sum of Rs 2,000 is payable at the time of the increase. Stamp duty and other charges amount to Rs 300. The approximate stamp duty payable on issue of share certificate is Rs 0.50 per Rs 100 share registration fee, while notification of charges of the directorate and other particulars amount to Rs 100.

Shares may be ordinary or prefered. Non-voting shares are permitted. If authorised by the Articles of Association, redeemable preference shares may be issued, but may be redeemed only if fully paid up, and out of either profits or proceeds of a new share issue. Share warrants may be issued by public companies subject to certain conditions, with permission of the Central Bank if non-residents are involved.

Shares of a public company may be converted into stock. The common practice is for shares in public companies to be quoted in the share market. Non-residents' share cannot be sold or transferred without the permission of the Central Bank. Bonus shares may be issued against revalued assets.

Shares may be issued at a discount if authorized by an ordinary resolution and sanctioned by the court. There are no restrictions exist about the issue of shares at a premium. Commissions for subscriptions may be paid if authorised by the Articles; they cannot exceed 10% of the issue price -- or the amount authorized by the Articles, if less. A company cannot purchase its own shares. It also cannot provide financial assistance for the purchase of its shares except for employees.

Dividends may be paid only from profits and not from capital. They may be paid from capital gains.

Control of a company depends on the control of the vote at the Directors' meeting and shareholders meetings. The usual practice is for a director to have one vote on a show of hands and one vote per share on a poll at a shareholders meeting. A resolution passed at the directors' meeting is by majority resolution, while that passed at a shoareholders' meeting may be ordinary, extra ordinary or special. An ordinary resolution is a resolution passed by a majority of persons on voting. An extra ordinary resolution is a resolution passed by a majority of not less than 3/4 or those present with not less than 10 days notice in the case of a private company and 14 days notice in the case of public company been given. A special resoultion is on which is passed by a majority of not less than 3/4 of such members of which not less than 14 days notice in the case of private company and 21 days notice in the case of a public comlpany has been given. The Companies Act No. 17 of 1982 provides all information with regard to amending the Memorandum and Articles of Association passed by a special resolution.

Every public limited company must hold a statutory meeting of the members of the company not more than three months (and not less than one) after the date on which it is entitled to commence business. A statutory report must be sent to every member at least seven days before the meeting, and a copy filed with Register of Companies.

An annual general meeting must be held by every company in every calendar year, not more 15 months after the last annual general meeting. Extraordinary general meetings may be called either by the directors themselves (if the articles provide for it), or on the request of members holding at least 10% of the paid up share capital. If the articles do not provide otherwise, two or more members holding not less than 10% of the issued share capital may call a meeting.

BOX 3.10A

How to Form A Company

- o Draw up Memorandum and Articles of Association.
- o Print the Memorandum and Articles of Association and obtain the signature of at least two subscribers on the Memorandum and Articlesd of Association.

It is necessary that a Notary Public should attest the signing, if a non-resident wishes to sign the Memorandum and Articles of Association prior to the approval of the Central Bank.

File with the Registrar of Companies within 28 days of incorporation:

- o Two copies of the Memorandum and Articles of Association, duly signed.
- o A statutory declaration of compliance with the requirements of the Ordinance, which must come from an attorney-at-law of the Supreme Court, or a Director or a Secretary of the Company;
- o A statement of authorised capital;
- o A list of persons who have consented to be Directors of the company, if it is to be a public company.
- o Non-resident directors or their nominees need Central Bank permission to subscribe to shares.
- o If it is to be a public company, undertakings by the directors to take and pay for their qualification shares, if they have not signed the Memorandum of Association as subscribers for such shares;

Declaration of Compliance with the requirements of the Companies Act to be signed by an Attorney-at-law engaged in the formation of a person named in the Articles of Association as Director or Secretary of the Company.

- o Pay the requisite registraiton fee (a maximum of Rs 5,000) and stamp duty.
- o The name of a company may not be similar to a company already existing.

If the company is a private limited liability company the words 'PRIVATE LIMITED' should be printed.

- o A Private Company can commence business immediately after the Certificate of Incorporation is received from the Registrar of Companies. In the case of a Public Company it is necessary to obtain a further certificate to commence business.

BOX 3.10B

Off-shore Companies

A company incorporated in Sri Lanka or outside can apply for registration as an off-shore company. An off-shore company is not entitled to carry on any business in Sri Lanka and its requirements are restricted to only carry on any business outside the shores of Sri Lanka.

The documents required for registration are:

i) A banker's statement that the company has a minimum amount of US$25,000 in the account.

ii) A registration fee of Rs 10,000.

3.11 Establishing a Branch

Generally speaking, companies cannot do business in Sri Lanka through branches, except for banks, airlines, and a very few service organisations. Branches require special Ministerial permission. Companies which establish a place of business in Sri Lanka must, except with this permission, form a company in Sri Lanka. This does not apply to banks and some other firms (see section 3.02).

If Ministerial permission is granted, the company must, within one month from establishing a place of business, deliver to the Registrar of Companies certain documents specified in the Companies Act. ("Business" includes a share transfer or share registration office.) These are similar, but not identical, to those required of a company.

Under the Companies Act number 17 of 1982, new companies which are set up in Sri Lanka cannot be established as branches. They need to be incorporated as companies. The Travel Corporation of India sought approval to establish a branch in Sri Lanka, but was turned down.

Incorporation does not require approval, but it is registered with the Registrar of Companies. Exchange Control regulations are operative for remittance - i.e. a permit is required for outward remittance. The Central Bank of Ceylon approves all inward remittances. Taxes on branches are 5% higher than on companies.

Thomas Cook, and Reuters are two exceptions to the general rule; they have been given permission to retain their branches. However, this puts them at a tax disadvantage; branches pay 5% more. (They are allowed some expense deductions for headquarters expenses, but these are usually minor.) A company that decides to incorporate its branch in Sri Lanka may retain 100% equity.

4.00 RULES OF COMPETITION

4.01 General

There is no specific anti-trust or monopolies and restrictive trade practices legislation in Sri Lanka.

Several cases exist in which brands of products (e.g. soap, talcum powder, biscuits) constitute 50% of market sales of that respective product. There is no antitrust or competition law which restricts the marketing of these items.

The Consumer Protection Act No. 1 of 1979 ensures fair practice among traders. The Act deems that an act of competition contrary to honest practices in industrial or commercial matters will constitute an act of unfair competition. All the following acts would constitute unfair competition: confusion with goods, services, or the establishment or with industrial or commercial activities of a competitor; false allegations; any indication of source, or appellation of origin which is liable to mislead the public as to the nature of the goods; any false or deceptive indication of the source of goods; and imitation of an article. The Business Undertakings (Acquisition) Act No. 35 of 1971 (see section 2.03) empowers the government to take over any enterprise that engage in unfair practices.

4.02 Monopolies and Market Dominance

There is no legislation regarding monopolies. Monopolies in the private sector are not unknown, and include the Ceylon Tobacco Co, the sole supplier of locally manufactured cigarettes. The government has a monopoly in the railway, petroleum and mining sectors.

4.03 Mergers

Under the Companies Act Number 17 of 1982, the proposed compromise or arrangement between two companies, must be with the purpose of reconstruction of any company or companies, or the amalgamation of two or more companies.

4.04 Freedom to Sell

Under the Consumer Protection Act No. 1 of 1979, refusal to sell is an offence. Only with the written approval of the National Prices Commission, can a trader engage in the practice of exclusive dealing; this too will be granted only in the national interest. It is not permitted to discriminate between purchasers of goods, in relation to the prices charged for the goods, discounts, allowance, rebates or credit given in relation to the supply of goods, the provision of services or facilities in respect of the goods or the making of payments for services or facilities provided in respect of the goods.

However, no recent prosecutions under this Act have occurred.

4.05 Resale Price Maintenance

A manufacturer cannot enforce a minimum resale price and dealers are free to undercut margins as long as consumer price is maintained. A trader cannot sell any article at a price above the minimum retail or wholesale price and all price lists must be conspicuously displayed.

Prices are either controlled or supervised by the National Prices Commission (See Section 5.0). While making an application for a price revision the entire price structure should be given to the authorities. The price structure would include all costs involved in the production of any article. The cost of raw materials, manufacturing costs like labor and packaging, and marketing costs covering delivery and discounts to trade, would constitute the price structure.

5.00 PRICE CONTROLS

Under Section 61 C of the Consumer Protection Act, the Commissioner of Internal Trade has the power to declare price controls and price supervision on items that are deemed 'essential to the life of the community'. Items like bread, flour, sugar, pasteurised and sterilized milk, petroleum products (diesel oil, kerosene oil) are price controlled. Many items are "price-supervised", among them rice, soap, toothpaste, talcum powder, and aerated water.

Permission for revision of prices may be made by the manufacturer or importer to the National Prices Commission, setting out the price structure (see Section 4.05) according to which the revised prices (ex-factory, wholesale and retail) are to be fixed. The Commission's view is referred to the Ministry concerned for consideration.

In the case of price supervised items (items which are not price controlled) the manufacturer is free to disregard the view of the National Prices Commission and act as he pleases. However it is considered unwise to do so, particularly in view of the fact that the National Prices Commission can advertise in the media that its recommendation went unheeded. This has never been actually done by the Commission.

The National Prices Commission has no specific legislation regarding price controls, but keeps a vigilant eye on market prices, hoarding and black marketing. It is with the approval of this body that prices are fixed. Under the Consumer Protection Act No. 1 of 1979 the Commissioner of Internal Trade may issue directions to manufacturers or traders in respect of the price marking, labelling and packeting of articles.

The Commissioner has the power to specify the maximum quantity of any article to be sold on any day, and the time during which and the places at which such an article may be sold.

It is an offence to sell, or offer to sell any article at a price above the maximum retail or wholesale price as the case may be.

All the traders are required to display prices on a board in a conspicuous place.

Imports are not subject to administered prices, save those that are imported by government Ministries, State Corporations, Boards and other State institutions.

6.00 LICENSING

6.01 General

Proposals for technical collaboration without equity investment are welcome in both public and private sectors. Some companies have used licensing agreements as a way to enter Sri Lanka without an equity commitment. Well-known brand names may be licensed to Sri Lankan companies (e.g. Tek toothbrushes).

The government reserves the right to invalidate a contract if it is found to be "detrimental to the economic development" of Sri Lanka, but this provision is unlikely to be used under the present government, except in exceptional cases.

Though licensing is not very popular in Sri Lanka, some companies have found this an inexpensive way to access Sri Lanka's tiny domestic market. British Paints, for instance, licenses the use of its brand name, Permaglaze. Metal Box also has a licensing agreement with Metcan Ceylon Ltd.

Several foreign companies in Sri Lanka use the brand name of the foreign parent company, (and its subsidiary companies); for instance, Eveready (Union Carbide) or Waterbury's Compound (Warners). Lever Brothers Ceylon Ltd uses brand names of the parent company Unilever (London) Ltd, as well as those of the Unilever subsidiaries, A & F Pears Ltd, and B & W Gibbs Ltd. Lever Brothers Ceylon entered into agreements with these companies before the Code of Intellectual Property Act No. 52 of 1979 became legislation. (The Act ordains that all agreements must be registered with the Registrar of Patents and Trademarks.)

Companies seldom seek patent protection in Sri Lanka; the patent office reports very few applications. Recently, Ceylon Tobacco company won patents on two inventions relating to the manufacture of coir dust briquettes, and Jose R. Concepcion of the Philippines was granted a patent on an alcohol-powered car.

6.02 Patent and Trademark Protection

In 1979, the patent laws were changed from the old prewar UK system to incorporate the WIPO (World Intellectual Properties Orangization) code. The Code of Intellectual Property Act, No. 52 of 1979 protects most products. Patents have a maximum life of 15 years; trademarks of 10 years. However, trademarks can be renewed.

Companies are not forced to disclose the contents of patent registrations.

Copyright protection is given to original literary, artistic, and scientific works, and the derivative works. Copyright is protected during the life of the last surviving author and for 50 years after his death. Copyright in cinematographic, radiophonic or audio-visual work is protected until 50 years after the making of the work or, if the work is made available to the public during that time with the consent of the author, 50 years from the date of its being made public. In the case of photographic work or a work of applied art, the period of protection is 25 years from the making of the work. On sound recordings, the maker has the exclusive right to reproduction of the sound recording for 50 years from its first publication.

Trade names are protected even prior to, or without registration, against any unlawful act committed by a third party.

It is possible to obtain a patent from the Registrar of Patrents and Tademarks within a year. However, obtaining a trademark would take longer -- anything from three to four years. An acute shortage of staff in the office of the Registrar of Patents and Trademark has been the reason for this delay.

The Registrar does not protect the rights of patentees or owners of trademarks, but in the case of infringment, the victimised party may take legal action either in the country's District Court or Magistrate's Court. Companies usually opt to take up the case in the

District Court where an injunction may be served on the infringing party, rather than in the Magistrate's Court where it is treated as a criminal offence. A permanent injunction prevents the coutinuance of the abuse by the infringing party. Until the case is over, a temporary or interim injunction is served.

Chemical Industries Ceylon Ltd (which is affiliated to Imperial Chemical Industries), challenged the Swedish company, Dyrup, which marketed a paint bearing a similar name to their own. Ceylon Cold Stores Ltd, the established manufacturer of Elephant Brand soft drinks, often have infringement problems; Elephant brand labels are used to sell other drinks. Pfizer has also found tablets for sale, bearing brand names similar to those they manufacture. In all these cases injunctions have been served on the infringing party.

Lever Brothers Ceylon Ltd have had frequently encountered brand piracy, with spurious brands and imitations of Lever products being manufactured. The company's sales representatives, and nominated Lever wholesalers, are always vigilant for such products; when they are found, Levers tries to reach a written agreement without police intervention. If this is not possible, action is filed in the District Court. Identifying distributors of these fake products is relatively easy -- and the firm can cut off supplies, at least temporarily, by making the arrangement with the distributor -- but it is sometimes difficult to trace manufacturers of spurious products.

Legal proceedings would cost from Rs 10,000 to Rs 15,000.

No changes are anticipated in this area in the next eighteen months.

BOX 6.02A

Patents: Basic Laws

Conventions - The Patent Co-operation Treaty of 1978. Sri Lanka became party to this on February 26, 1982.

Basic Laws - The world Intellectual Property Ordinance (WIPO) Act number 52 of 1979.

Duration - The period of protection is 15 years from the date of the grant of a patent. A patentee who intends to keep a patent in force must pay an annual fee. (This can be paid in advance.) There is no provision for renewal of the patent after the expiry of 15 years.

Novelty - An invention is patentable if it is new, involves an inventive step and is industrially applicable.

Unpatentable

* discoveries, scientific theories, and mathematical methods.
* plant or animal varieties, or essentially biological processes for production of plants or animals, other than micro-biological processes and the products of such processes.
* schemes, rules, or methods for doing business, performing purely mental acts or playing games.
* methods for the treatment of the human or animal body by surgery or therapy, and diagnostic method practised on the human or animal body.

Application procedure

An application for the grant of patent must be made to the Register of Patents and Trademarks, Union Place, Colombo 2. It should be made in the prescribed form and contain:

* a request for the grant of the patent
* a description
* a claim or claims
* a drawing or drawings where required for the understanding of an invention
* an abstract.

Where the applicant's ordinary residence or principal place of business is outside Sri Lanka, he should be represented by an agent resident in Sri Lanka, whose name and address must be supplied in the application. The application should be accompanied by a power of attorney granted to such an agent, by the applicant. Where the applicant is not the inventor, the request for the patent must be accompanied by a statement justifying the applicant's right to the patent.

Provided that legalization or certification is not necessary, the application must be accompanied by a declaration signed by the inventor, giving his name and address and requesting that he is named as such in the patent.

The request should contain:

* a petition that that patent be granted
* title of the invention
* name, address, description and any other prescribed information concerning the applicant, the inventor and the agent if any.

An application for the grant of a payment will not be entertained unless the prescribed fee has been paid to the Registrar.

Examination Procedure

Every applicant must submit a report of an international type search as may be prescribed, to the Registrar in English, (or a translation in English).

In lieu of the international type search an applicant may request the Registrar to refer the application to a local examiner, who will examine the applicaton on the basis of the claims with regard to descriptions and drawings (if any), and furnish a reporet to the Registrar.

Grant of a patent

This will not be refused and a patent will not be invalidated on the ground that the performance of any act in respect of the claimed invention is prohibited by any law or regulation, except where the performance of that act would be contrary to public order.

On granting the patent, the Registrar will:
* issue a certificate of the grant of the patent and a copy of the patent together with a copy of the search report to the applicant.
* record the patent in the register.
* publish in the Gazette a reference to this grant.
* make available to the public copies of the patent together with the search report.

The court may declare the patent null and void on grounds that the subject matter is not an invention, is not patentable, the description unsatisfactory, non-furnishing of drawings or that the right to the patent does not belong to the patentee or has not been assigned to him.

The patentee may exploit the patent invention assign or transmit the patent or conclude licence contracts.

Fees

Where a patentee intends at the expiration of second year from the date of grant of the patent to keep the same in force, he must pay the prescribed annual fee, twelve months before the date of expiration.

Compulsory licensing

There is no legislation to this effect in Sri Lanka. Foreign companies may extend brand names/marks to be used by local firms but these are not subject to licensing conditions. However, all agreements with principals must be recorded with the Registrar of Patents and Trade Marks.

Right of priority is given for applicants from any State which is party to the Paris Convention for the Protection of Industrial Property.

BOX 6.02B

Trademarks: Basic Laws

Duration: Registration of a mark (trademarks and service marks) may be valid for a period of 10 years, as of the date of receipt by the Registrar.

Renewal: Registration of a mark may be renewed for consecutive periods of 10 years each on payment of the prescribed fee. This must be done within the 12 months preceding the date of expiry of the period of registration. The renewal is not subject to further examination by the Registrar or any opposition.

Legal effect: The Code of Intellectual Property Act deems that the registered owner of a mark shall have the following exclusive rights in relation to the mark: to use the mark; to assign or transmit the registration of the mark; to conclude licence contracts.

Without the consent of the registered owner of the mark, third parties are precluded from using the mark in any such way as to mislead the public, or in a manner that would be prejudicial to the registered owner of the mark.

The registration of the mark does not confer on its registered owner the right to preclude third parties

* from using, bona fide, their names, addresses, pseudonyms, a geographical name or exact indications concerning the kind, quality, quantity, production or of supply of their goods and services in so far as such use is confined to the purpose of mere identification or information and cannot mislead the public as to the source of the goods or services;
* goods lawfully manufactured, imported, offered, for sale, sold, used or stocked in Sri Lanka under that mark, provided that such goods have not undergone any change.

Qualifying for registration

Arbitrary or fanciful designations, names, pseudonyms, geographical names, slogans, devices, reliefs, letters, numbers, labels, envelopes, emblems, prints, stamps, seats, vignettes, selvedges, borders and edgings, combinations or arrangements of colours and shapes of goods or containers.

Marks which cannot be registered

That which consists of shapes or forms imposed by the inherent nature of the goods or services, or by the industrial function, cannot be registered. Service marks and collective marks may be registered.

Application procedures

Applications should be made to the Registrar of Patents and Trademarks, Union Place, Colombo 2, in the prescribed form and should contain:

* request for the registration of the mark.
* name, address and description of the applicant and if resident outside Sri Lanka, a postal address for service in Sri Lanka.
* four copies of a representation of the mark.
* a clear and complete list of the particular goods or services in respect of which registration of the mark is requested with an indication of the corresponding class or classes in the international classification.

If filed through an agent, the application should be accompanied by a power of attorney.

The application is then subject to an examination by the Registrar.

Fees

The Gazette Extraordinary of 31-10-1979 carried all official fees relating to filing, registration, and annual renewal, fees.

BOX 6.02C

Industrial Designs and Models: Basic Laws

Duration: The period of protection is five years, with renewal for two consecutive periods of five years each, on payment of renewal fees. Protection of industrial designs applies only to new designs. 'Industrial designs' means any composition of lines, or colors, or any three dimensional form (whether or not associated with lines or colors), that gives a special appearance to a product of industry or handicraft, and is capable of serving as a pattern for a product of industry or handicraft.

Application: The application must be made by the owner to the Registrar of Patents and Trade Marks. The application must contain:
* The name, address and description of applicant; if the applicant resides away from Sri Lanka a postal address for service in Sri Lanka must be included.
* a specimen of the article embodying the industrial design, or copies of a photographic or graphic representation of the industrial design, in color where it is in color, or drawings and tracings of the design.
* an indication of the kind of products for which the industrial design is to be used.
* a declaration that the design is new to the best of the applicant's knowledge.

Where the application is filed through an agent it must be accompanied by a power of attorney. Right of priority is given to an applicant from a State which is party to the Paris Convention on Industrial Property.

Novelty: A new industrial design shall mean an industrial design which has not been made available to the public anywhere or anytime.

Rights of registered owner of industrial design

The registered owner of an industrial design has the following exclusive rights in relation to the industrial design:
* to reproduce and embody such industrial design in making a product.
* to import, offer for sale, sell, or use, a product embodying such industrial design.
* to stock for the purpose of offering for sale, selling, or using, a product embodying such industrial design.
* to assign or transmit the registration of the industrial design.
* to conclude licence contracts.
* No person shall do any of the acts earlier referred to without the consent of the registered owner of the industrial design.
* If done by any unauthorised person, these acts shall not be lawful solely by reason of the fact that the reproduction of the registered industrial design differs from the registered industrial design in minor respects, or that the reproduction of the registered industrial design is embodied in a type of product different from a product embodying the registered industrial design.

6.03 Legal and Adminisitrative limitations on Licensing

The law does not state that government approval is necessary for licensing agreements, although any agreements between principals and companies must be registered with the Registrar of Patents and Trade Marks. If national interest is involved, then the Registrar has the authority to refer the matter to the Central Bank of Ceylon.

There is no priority basis for the granting of approval. The Colombo Thread Company made an application for the registration of 'Astra' thread in 1979 to the Registrar of Patents. It took two years before it was approved.

All patent licences and technical assistance agreements must be first recorded with the Registrar of National Patents and Trade Marks. All royalties must be paid, to have any legal effect. It is possible for a licensee to sue in his own name against infringement of the licensor's patent.

The Controller of Imports and Exports restricts the import territory of a licensee.

A licence agreement cannot outlast the patent right for which it was granted. Before the licence contract expires, should the patent application be withdrawn, or patent application be rejected, or patent surrendered or declared null and void, or if registration of licence contract is invalidated, then the licensee shall no longer be required to make any payment to the licensor under the licence contract. The licensee will be entitled to repayment of the payments already made.

6.04 Royalty and Fee Patterns

Reasonable royalties and technical assistance fees will be permitted. The amount of royalties payable are fixed when the investment proposal is approved. The Foreign Investment Advisory

Committee (FIAC) will attempt to strike a fair balance between the actual services received (and the benefit to the country) and royalties payable. The GCEC has not issued any guidelines.

Though no guidelines are actually specified, the FIAC will usually approve fees of 1-3%, (rarely 5%) on turnover. The maximum period is usually 5 years. However, FIAC is flexible on the matter. Lumpsum payments are allowed.

Usually, only firms in a manufacturing industry can obtain the permission for technical service fees. The J. Walter Thompson Company, USA, and Hindustan Thompson Associates Ltd, India, set up a joint venture advertising agency in Sri Lanka with local collaboration. Their request to the FIAC for a 3% technical service fee was turned down.

Capitalisation of technology (e.g. equity for knowhow) is permitted, but not favored -- in part because of valuation problems. However, it is sometimes granted. In one case, even pre-operating expenses -- mainly travel costs -- were allowed to be capitalised.

The government does not generally favor requests to pay royalty for marketing foreign brand bames or trade marks in Sri Lanka, but has approved them on occasion.

There are usually no difficulties with respect to remittance of technical service fees. The Exchange Control authorities approval is required, along with an auditors' certificate.

Though there is no legal restriction on payment of interest, FIAC usually fixes the rate of interest which may be paid.

Some examples of fees and royalties in Sri Lanka:

o The Colombo Thread Company Ltd has been allowed to remit 2% of net sales value (less the cif value of imported raw materials) to the parent company as a fee for unspecified technical services. This figure is below the company's international norm.

o Sri Lanka Tyre Corp, which has a technical collaboration -- including use of the trademark -- with Goodrich Tyre Co (US) was permitted to pay 2-1/2% on turnover as royalties/technical service fees.

o Two textile mills in the private sector are paying 10%, and 22% of net profits, respectively, to two Indian firms under management contracts.

o When five government mills were brought under foreign management contracts, the terms given were:

* Tootals of UK: 2-1/2% on inputs (costs)
* Bombay Dyeing: 2% on turnover, or 35% of net profit to be reduced gradually
* Others: 30-35% of net profits. The periods were for upto 7 years.

7.00 REMITTABILITY OF FUNDS

7.01 Exchange controls

Exchange controls are imposed outside the export processing zone, but these are formalities and approved foreign projects should anticipate little trouble with exchange controls under the present government.

When the UNP government came to power, the former dual exchange rate system was abolished. A unified rate of exchange was introduced and the rupee permitted to float. In consequence, the Foreign Exchange Entitlement Certificate (FEEC) Scheme was abolished. Exchange rates are announced daily by the Central Bank. However, in November 1982, the Central Bank decided to deal with commercial banks only in US dollars (rather than a range of foreign currencies) and allow the commercial banks a crack at the foreign exchange market.

Foreign banks may open and operate non-resident accounts without prior approval of the Exchange Control Department. Domestic Banks can operate accounts for certain categories of non-nationals. Foreign companies need approval from the Exchange Control Department for local borrowing.

The Department of Exchange Control of the Central Bank is the administrative agency. The GCEC Law stipulates that investments that fall within its scope (that is, under agreement with the GCEC) may be exempted from the Exchange Control Act; for these projects, the GCEC is the Administrative Agency.

Capital may be imported for investments in government-approved projects. Investments can also be made from blocked accounts in Sri Lanka in investments approved by the Controller of Exchange. (Blocked accounts are accounts which hold funds of non-residents, repatriates and emigrants which are not permitted to be transferred abroad.)

Foreign currency investments may also be made from special accounts maintained by Sri Lankans working abroad. If these are made in projects approved by the Controller of Exchange, they are exempt from income and wealth tax.

Issue or transfer of securities registered in Sri Lanka to a non-resident requires Central Bank permission. ("Securities" mean shares, stock, bonds, notes other than promissory notes, debentures, debenture stock, units under a unit trust scheme and shares in an oil royalty.) No permission of the Central Bank is required to transfer shares in a company from a non-resident to a non-resident.

Similarly, the permission of the Central Bank is required to issue any bearer certificate of coupon in Sri Lanka, or to transfer it to a non-resident outside Sri Lanka. Only Sri Lankan residents need this permission for transfers to or from Sri Lankan residents.

Permission of the Central Bank is also needed for a resident in Sri Lanka to get payment of capital payable on a security registered in Sri Lanka outside Sri Lanka. Further, where the certificate of title to a security is in Sri Lanka, similar permission is required for a resident in Sri Lanka to secure the payment outside Sri Lanka without production of the certificate to the person making the payment.

The GCEC has indicated that shares in companies falling under its authority may be transferred within or outside Sri Lanka to residents or non-residents, and the country of payment for such shares may be decided between the buyers and sellers.

Loan agreements with enterprises which are not under the GCEC require the approval of FIAC. GCEC has not yet indicated its position relating to loan agreements. Land leased out by the GCEC cannot be mortgaged to a third party.

Controls exist on certain other forms of remittances.

* Commissions to agents abroad for export orders secured may be remitted, with a ceiling of 5% of the c.i.f. value of the export orders.

* Remittances by foreign individuals working in Sri Lanka are also controlled. Remittances of up to two thirds of gross income for family maintenance are permitted; but value limits, which may have the effect of reducing the remittable amounts, apply in some cases. Rules for Indian and Pakistani nationals are more stringent; the upper limit on remittances for these persons is Rs200,000. The individual however, may remit the balance at the time of departure.

* Sri Lanka nationals are not entitled to any exchange for family remittance other than for education in specified categories.

7.02 Transfer of Profits and Dividends

Companies do not need special permission to remit profits or dividends after income tax clearance, through authorised dealers, though a procedure has been specified. Interim profits or dividends may also be remitted; firms do not have to wait for the final annual report to be made available.

The application for final dividend remittance must contain the following documents:

* audited copy of the company's profit and loss account and the balance sheet for the year to which the remittance relates;
* a certificate from the company's auditors confirming that the amount sought to be remitted represents dividends earned during the period to which it relates and does not include undistributed dividends of previous years or any transfers from the comlpany's reserve or on account of the sale of any of the company's fixed assets;
* a certificate from the secretary/accountant/officer of the company authorized to sign documents on its behalf confirming that the

beneficiary is, according to information available to him, resident outside Sri Lanka;

* a schedule certified by the secretary/accountant/officer of the company authorized to sign documents on its behalf indicating the name/names of the beneficiaries and the net amount due to each of them.

If these conditions are not fulfilled, the Controller of Exchange may direct that the amount be placed in a blocked account.

All profits and dividends from investment promotion Zone companies can be transferred without being subject to a remittance tax or income tax.

Profits and dividends declared out of the year's profits could be remitted freely through the commercial banks. Reinvested earnings may count as original investment for purpose of the base of calculating the percentage dividend. No tie up exists between the firm's export earnings and its ability to remit profits.

7.03 Transfer of Interest

Interest, royalties and technical service fees paid by enterprises in the GCEC Area may be repatriated freely in accordance with the agreements entered into with the GCEC. The interest rates payable have to be approved by the Exchange Control Authorities and should be in line with prevailing rates. One foreign joint venture company has been permited to pay 3/4% over LIBOR on a loan from its parent company.

Hotel Services (Ceylon) Ltd -- part-owner of Hotel Ceylon Intercontinental -- is allowed to remit loan repayment instalments, and interest at 6%, to the Export-Import Bank of the United States on account of the Intercontinental Hotels Corporation, New York. Accrued funds have been invested in short term deposits. The current loan agreement with the Export-Import Bank requires that if any cash dividend in excess of 6% is paid to shareholders, a dollar equivalent

Reinvested profits can be transferred once taxes have been paid.

There is no tie-up between a firm's export earnings and its ability to repatriate capital.

7.06 Repayment of Principal

There is no limitation on repayment of principal on foreign private loans.

7.07 Guarantees against Inconvertability

Under current exchange control conditions, the government does not provide guarantees against inconvertibility.

of the excess must be paid to the bank against the final instalment of the loan due to be liquidated in 1985.

7.04 Transfer of Fees and Royalties

(see 7.03)

Firms will have no problems in remitting fees and royalties, once approved. All royalties and interests are taxed at source. Relief is provided if there is a double taxation agreement.

7.05 Repatriation of Capital

For investments in the GCEC area, the GCEC guarantees repatriation of capital -- including liquidation proceeds -- without exchange control restrictions. The shares in a GCEC company may be freely transferred to residents or nonresidents in or out of Sri Lanka.

The transfer of shares in companies that fall outside the GCEC authority is also freely permitted, provided that the transfer would not affect the prevailing ratio of non-resident shareholding permitted by the FIAC.

For FIAC investments, exchange control permission is required for the repatriation of capital (including liquidation proceeds). Companies should have no problems with foreign investments in approved projects (other than investments made from blocked accounts). Capital may include the proceeds of capital appreciation. The Exchange Control Department will allow a foreign investor to repatriate his capital contribution towards the equity of a company on the sale or liquidation of the investment, after settlement of local liabilities like taxes.

The liquidation and sales proceeds of foreign investments not approved by the government may not be transferred abroad, but may be reinvested in approved projects or transferred to blocked accounts.

8.00 CORPORATE TAXES

8.01 General

The UNP cut taxes sharply after coming to power. Public quoted companies face tax rates of 40% down from 60% in 1978. Resident companies other than public quoted companies pay 50%.

In the 1981 budget, surcharges on income tax of upto 10% were levied on companies earning taxable incomes of over Rs25,000. Turnover taxes, ranging from 2% to 35%, are levied on local manufacture, services, wholesale and retail sales, and on imports.

Import duties range from 5% to 500%.

Tax incentives in the form of tax holidays, exemption of income taxes on dividends, capital gains investment in shares and exemption of turnover taxes are available in the agriculture, animal husbandry, sericulture, fishing, tourist, export, gem, paddy milling, housing urban development and GCEC sectors as well as far small scale manufacturing and pioneering and import substitution industries.

Tax morality is reasonably high. However in order to flush out 'black money' banks have been permitted to start 'Certificate of Deposit' schemes whereby investors may invest funds at prevailing interest rates in time deposits without revealing their names, addresses or source of funds.

8.02 Corporate Income Tax Rates

Closely held resident companies, unlimited liability companies, and limited liability companies that are not listed on the stock exchange (other than "people's companies") are taxed at 50% of their profits, plus a 10% surcharge. (See box 8.02A for definitions.)

Non-resident companies are charged 55%. In addition there is a tax of 33 1/3% on remittances out of the country, or 1/9 of its taxable income, whichever is less. Further, a 5% tax in lieu of estate duty is imposed on dividends, bringing the rate to 38 1/3%.

All Quoted Public Companies (QPCs) enjoy a 40% tax rate, and exempt from the 33 1/3% dividends tax. This exemption also applies to People's companies.

'Small' companies -- issued capital of below Rs 500,000 -- pay taxes at 20% of the first Rs50,000 of profits, 30% of the next Rs 100,000, 40% on the next Rs 100,000 and 50% on the balance.

In the 1981 budget, concessional rates of tax applicable to small companies were repealed in the case of those companies with a taxable income of over Rs 250,000. They now have to pay the normal rate of 50%. However, a small company which is a quoted public company is still entitled to the concessional rates.

Partnerships are taxed 30% on estimated profits.

A resident company is liable to be taxed on its world-wide income. A non-resident is liable to be taxed on profits and income arising in or derived from Sri Lanka.

BOX 8.02A

Types of Companies for Tax Purposes

o Resident companies, Nonresident companies:

A company is deemed to be resident if it has its registered or principal office in Sri Lanka, or if the control and management of its business are exercised in Sri Lanka. All other companies are non-resident.

o Quoted public companies (QPCs)

A quoted public company must be resident in Sri Lanka and have its shares quoted in any official list published by the Stock Exchange or the Colombo Brokers' Association.

o People's company:

A company is known as a people's company if it is resident in Sri Lanka; is not a private company within the meaning of the Companies Ordinance; has more than 100 shareholders; the nominal value of each share does not exceed Rs10; no person holds or controls (through wife, minor children or nominees) more than 5% of the issued share capital; it has at least three shareholding directors, none of whom is a director of any other people's company; and none of its shares are held by any other company.

o Small company

A small company is a resident company which satisfies the following conditions: the issued capital does not exceed Rs500,000, and has not been reduced from 15 November 1978; it has not been formed after 14 November 1978 by the reconstruction of an existing company or from the assets of an existing company.

BOX 8.02B

Corporate Taxation in Sri Lanka, 1982/83

The simplified example below shows the tax burdens for companies with a 49% foreign shareholding (usually the maximum). The first is for a public limited company whose shares are quoted on the Stock Exchange (i.e., a QPC); the second example is not quoted. For purposes of illustration, capital of Rs5 million, pretax profits of Rs2 million, and remittance to the foreign parent of 49% of after tax earnings are assumed.

	Quoted Resident Public Company		Other held Resident Public or Private Company	
Pretax profits		2,000.0		2,000.0
Corporate tax	(40%)	800.0	(50%)	1,000.0
Total tax		800.0		1,000.0
After Tax		1,200.0		1,000.0
Excess profit tax		--		--
Net profit after tax		1,200.0		1,000.0
Dividend	(49%)	588.0	(49%)	490.0
Tax on dividend		--	(20%)	98.0
Withholding tax	(5%)	29.4	(5%)	24.5
Total taxes		829.4		1,122.5
Total burden as %		41.47%		56.125%

8.03 Taxable Income Defined

The meaning of "income" is not defined in the Inland Revenue Act, but it enumerates different sources of income. Except in the case of capital gains, income must be distinguished from capital receipts.

A resident company is liable to be taxed on its world-wide income. A non-resident is liable to be taxed on profits and income arising in or derived from Sri Lanka. Profits and income arising in Sri Lanka include all profits and income derived from services rendered in Sri Lanka (profession or vocation), or from property in Sri Lanka (e.g. rents, divdidends and interest) or from business transacted in Sri Lanka (agriculture, industry, etc.) whether directly, or through an agent.

The taxable income of a company comprises income from trade or business; profession or vocation; net annual value of land and improvement; dividends; interest; discounts; any charge or annuity; rents; royalties; premiums; net capital gains; other sources. If income can be assessed as falling under different sources of income, the choice lies with the tax authorities.

The taxable income is equal to the assessable income for the year less 'qualifying payments' upto 1/3rd of the assessable income made in that year. These payments include cash donations to approved charities, organizations or funds, government expediture on approved government projects, purchase of approved shares, and expenditure incurred for the construction of employees' accommodation with an area of below 2,000 square fee.

Companies should be aware that many of the expenses that may be acceptable tax deductions in their home countries may be disallowed in Sri Lanka. Business entertainment, legal fees under certain conditions, depreciation on passenger cars for business use, many fringe benefits provided to employees, and various other items may not be deducted for tax purposes.

Income from business transacted in Sri Lanka, whether directly or through an agent, is income arising in Sri Lanka.

"Business transacted in Sri Lanka whether directly or through an agent" (i.e. trading in Sri Lanka) is taxable, but profits arising from trading with Sri Lanka are not taxable in Sri Lanka. An important criterion to determine whether it is "in" or "with" is "the place of contract". If the contract is made outside the country and the price is paid abroad, merely arranging delivery through an agent in Sri Lanka is not equivalent to carrying on business within Sri Lanka. This is not applicable in the case of deliveries which affect the transfer of title. However, the place of contract is not necessarily the sole criterion, especially for non-merchant business.

A substantial portion of Sri Lanka produce is sold outside Sri Lanka (e.g. London Tea Auctions). Sec. 71 of the Inland Revenue Act covers such transactions. "Where a non-resident person carries on in Sri Lanka an agricultural, manufacturing or other productive undertaking and sells any product of such an undertaking outside Sri Lanka or for delivery outside Sri Lanka, whether the contract is made within or without Sri Lanka, the full profit arising from the sale in a wholesale market shall be deemed to be income arising in or derived from Sri Lanka..." It does not matter whether the contract is made within Sri Lanka or outside Sri Lanka.

To prevent transfer pricing to evade taxes between a non-resident and a resident with whom he has a close connection, there is a special provision. Where a non-resident carries on business with a resident person, with whom he is closely connected, and this business is arranged so that it produces for the resident less than ordinary profits, the business done by the non-resident person will also be deemed to be carried on in Sri Lanka. The non-resident will be taxed as though the resident person were his agent.

Profits arising to non-residents from business transactions in Sri Lanka through a person in Sri Lanka are treated as Sri Lanka-source business income. Where the goods sold or disposed of are produced or manufactured by such non-resident person outside Sri Lanka, the profits from the sale or disposal shall be taken as the reasonable profit from selling; in other words the profits attributable to manufacturing will be excluded. (See Section 68 of the Inland Revenue Act.)

In income from a profession or vocation, the tax is on income earned and not merely income received.

8.04 Depreciation

Since the government has used depreciation laws to confer incentives, different conventions are in force simultaneously.

For plant, machinery fixtures and buildings acquired on or after April 1, 1981, the straight line depreciation method is used.

This depreciation is at 25% per annum (of the original cost) on specified plant machiery and fixtures. These include air compressors, electronic computers, and tractors. All other plant, machinery, and fixtures, can be depreciated at 12-1/2%. The rate applicable to buildings is 5%. No investment allowances are given. Accelerated depreciation (upto 75% in the first year) is allowed on licensed private omnibus carriages.

For plant, machinery and fixtures acquired between April 1 1977, and April 1 1981, Sri Lankan tax law allowed 100% depreciation on plant, machinery or fixtures -- purchase price plus installation -- in the year of acquisition. Of course, depreciation can only be claimed once for any item. When fully depreciated items are sold, the proceeds count as income.

Before April 1 1977, depreciation rates were less favorable, and varied between 33 1/3 and 80%. For plant, machinery and fixtures purchased before 1 April 1957, the declining balance depreciation method was used, but a change in 1978 permitted the entire amount to be written off.

No depreciation allowance is allowed on vehicles used for travelling for business.

For all other buildings, where no depreciation has been allowed, the cost of renewal may be deducted in the year of renewal.

Assets can be revalued for balance sheet purposes; there are no taxes on account of revaluation of assets, or further depreciation on such revalued projects.

8.05 Schedule for Paying Taxes

Taxes are prepayable on the current tax year's estimated profits (usually April 1 to March 31) in four equal installments payable on the 15th of August, November, and February of that fiscal year, and by 15th of May of the next fiscal year.

Tax returns stating income and expenses must be filed by 30th November of the succeeding fiscal year. Upto 50% of the tax payable may be levied as penalties for default or delayed payment. Penalties for delay can be avoided by paying, as a quarterly installment, an amount not less than 1/4 of the income tax payable for the preceding year, and the balance by the 30th of November of the following year of assessment.

Under the Pay As You Earn (PAYE) scheme, income tax is payable by an employer on employees' employment income at the time that salaries are paid. These have to be remitted to the Inland Revenue Department through banking channels by the 15th of the following month.

8.06 Excess Profits Tax

Surcharges of upto 5% of the taxable income were levied with the 1981 budget on taxable income over Rs 25,000, going up to 10% in the case of income over Rs 50,000.

In the 1981 budget, concessional rates of tax applicable to small companies were repealed in the case of those companies with a taxable income of over Rs 250,000. They now have to pay the normal rate of 50%. However, a small company which is a quoted public company is still entitled to the concessional rates.

8.07 Capital Taxes

There are no annual taxes on a firm's capital or assets, with the single exception given below.

The taxable wealth of a non-resident company is five times that portion of its taxable income attributable to the income derived from its immovable property in Sri Lanka. The tax rate is 1%.

8.08 Capital Gains Taxes

Capital gains are treated as normal income and are taxed as such, except that the maximum rate is 25%. Capital gains are taxed in the case of change of ownership of, and relinquishment or transfer of rights in property, redemption of shares or debentures, the formation, dissolution or liquidation of a company or the amalgamation of two or more companies.

Capital gains taxes are exempt in the following cases:

* first sale of exclusively residential premises
* sales made in the ordinary course of business
* passing of property to a beneficiary of a trust, to the heir of a decreased person, by way of a gift, by way of shares in a company incorporated in Sri Lanka under the GCEC, the surrender of a life insurance policy, through change of ownership of any household effect or article of personal use (excluding jewelry or a motor vehicle for which depreciation has been allowed).

Capital gains are also exempt if they are less than Rs 2,000 in respect of movable property other than stock, shares debentures or debture stocks. No capital gains tax applies on shares of quoted public companies.

On property or shares sales, 25% of capital gain is exempt if held for over five years; 50% is exempt if they are held for over 15 years.

8.09 Taxes on Dividends

A resident company, other than a Quoted Public Company (QPC), must pay 20% tax on dividends distributed. It can withhold the tax amount from the dividends. If the dividends are to be paid to non-resident companies, there is an additional 5% tax. QPCs are not subject to this 20% tax, but must withhold the 5% where applicable.

Intercorporate dividends are generally not included in the assessable income of the recipient company.

A non-resident company is subject to a remittance tax at the rate of 33 1/3% on dividend remittances.

The issue of bonus shares is not considered a dividend. Certain undistributed profits of a closely controlled company may be treated as dividends.

Dividends from a GCEC enterprise may be tax exempt if so provided by the agreement.

8.10 Taxes on Interest

Interest includes income from loans, charges on unpaid debts, Court awards, etc. (However, income arising from the business of lending money is treated as business income.) Certain categories of income are exempt.

Interest is taxed on the full amount of interest falling due whether paid or not, without deduction for expenses. But the assessor may exclude interest which has not been received; if it is received later, it will be taxable at that time.

Where interest is payable to a non-resident person on a loan, and the interest is borne by a resident, or part of the loan has been brought into Sri Lanka, the interest is deemed to be derived from Sri Lanka.

Interest payable to non-residents (except banks) is taxable at 66.11% and to non-resident individuals at 33-1/3%.

The gross interest arising on or after 1st April 1982 on loans given by foreign lending institutions is taxable at the rate of 15%. This tax will not apply to interest on loans already exempt from income tax. In the recently signed double taxation relief agreements, there is a provision to tax interest at 10%.

Gains arising from the casual discounting of bills of exchange, cheques, etc. are taxed as "discounts", but if they arise in the normal course of a business which consists of discounting, it is treated as business income.

Where debentures are issued at a discount or premium, the discount or premium must be treated as capital and not as income. For other loans, it may, be either capital or income, depending on various factors. If a loan not carry any interest at all, the discount or premium will usually be chargeable as income.

8.11 Taxes on Royalties and Fees

Royalties payable to non-residents companies are taxed at 66.11% and those payable to non-resident individuals at 33-1/3%. Royalties are deemed to be derived from Sri Lanka if they are borne by a person resident in Sri Lanka, or deductible from the total statutory income for purpose of determining assessable income.

No definition of royalty exists in Sri Lankan law. Royalties arising from patents, copyrights, leasing of mineral rights, lumber rights, etc. are included.

However, proceeds from the sale of patents, copyrights, etc. are capital receipts, not royalties. Capital receipts arising from the sale will not be taxed in Sri Lanka if the contract is entered outside Sri Lanka. Sale or assignment in Sri Lanka may attract tax in respect of any capital gains.

Technical assistance fees are taxed either as business income or as other income. The distinction between capital receipts and income receipts will also apply.

8.12 Tax Treaties

Sri Lanka has treaties for avoiding double taxation with Czechoslovakia, Denmark (on income and capital), Federal Republic of Germany (on income and capital), India (on income), Japan (on income), Malaysia (on income), Pakistan (on income and capital), Singapore (on income), United Kingdom (income), Australia (on income), the Netherlands (on income) and France.

Agreements with certain countries have been negotiated, and only await approval from Parliament. These include Belgium, Rumania, the US, Sweden, Italy, Switzerland, Norway, Korea, Bangladesh, Canada, Poland. Discussions are under way with Yugoslavia, Philippines, and German Democratic Republic.

Special relief for Commonwealth citizens resident in nontreaty countries is also provided by the Sri Lanka government. In general, Sri Lanka provides unilateral relief -- it deducts foreign tax from the foreign income which is liable to tax in Sri Lanka.

The amount of the credit cannot exceed the amount of the Sri Lanka tax payable on the doubly taxed income.

8.13 Taxation of Headquarters Companies

Regional management companies, which show no profits, but which receive fees from affiliated firms are taxed on normal trading profits. Profits are taxed as income, deficits treated as a loss are carried forward. Zero tax situations are permitted. Profits are not imputed to the operation of their affiliates. Tax arrangements may be negotiated in advance with the tax authorities.

8.14 Turnover, sales, and excise taxes

The resource squeeze that the government is facing, with revenues growing slower than inflation and expenditure rising at the same rate or faster, may force it to consider revisions in the tax laws. While the government will try to avoid raising corporate income taxes, some temporary increase may be necessary. For 1981, a 10% surcharge was levied. Indirect taxes will almost certainly be raised.

Turnover Tax (TT) levied on sales of most products, is a major revenue instrument and may become even more important in the future. It has recently been raised in the 1981 budget and is likely to be further revised upward over the next five years. In 1981, the coverage was also extended.

Business which generate a turnover of Rs 25,000 in any fiscal quarter are liable to turnover tax. Turnover is defined as the total amount received or receivable in respect of that business.

Turnover taxes are levied on sales of most products and services. There are three basic rates i.e. 2%, 5% and 10%. A few products higher rates. These are liquor, beedies and cigars (15%) and cigarettes (35%). Certain consumer durables attract a tax of 10% i.e. Air conditioners, Refrigerators, Washing Machines and Electric Fans.

Turnover tax is also applicable to imported items at the point of import.

Shipping companies that do not pay an income tax in Sri Lanka are subject to a 4% TT.

Certain establishments are exempt from TT. These include certain businesses related to the manufacture and cultivation of tea, rubber, and coconut; export of jewellery or gems; and certain educational establishments. In the 1981 budget, infant milk foods, fertilizer and crude oil were also exempted. The rate applicable to banks was raised from 2% to 5% and for finance companies from 5% to 10%. Rates applicable to advertising receipts of newspapers and periodicals were increased from 5% to 10%. Turnover tax on hotels were increased from 15% to 20% and on luxury restaurants from 2% to 10%.

Excise duties are levied on liquor cigarettes and beedies. The duties on liquor range from Rs 3 to Rs 10 per bottle and on cigarettes they are Rs 282 per kilogramme of tobacco.

Import duties range from 5% to 500% with 'luxury' goods attracting higher rates of duty. For more details see Section 13.03.

8.15 Other Taxes

Rent is considered as income, but various deductions are given. Letting of commercial premises by a company is treated as a business and income from such letting is taxed as business income. Rentals from movable property will be taxed as business income or as income from other sources.

Remittance tax is imposed on remittances made abroad by a non-resident company. "Remittances" include sums remitted abroad by a non-resident company (not including dividends if the resident company has already made a deduction at source); any amounts from export of goods from Sri Lanka that is retained abroad. Remittance of deductible head office expenses is not subject to remittance tax. The tax-rate is 33 1/3% if the remittance is less than 1/3 of taxable income, and 11 1/9 percent if it is more.

A non-resident company owning immovable property in Sri Lanka must pay five percent of that part of its taxable income which is attributable to the immovable property in Sri Lanka as wealth tax.

When any sum paid as insurance premium has been allowed as an expense on the production of income or profit, any sum realized under the contract is treated as part of the profits or income for that assessment year.

9.00 PERSONAL TAXES

9.01 General

Income taxes in Sri Lanka are moderately high, with a ceiling marginal rate of 55% with a surcharge of 5%-15% if taxable income exceeds Rs 25,000.

However, foreign technicians, experts, and advisers employed by firms which qualify for the tax holiday under Foreign Investment Law (see section 10.00) are exempt from personal income taxes for upto five years during the tax holiday. Similarly, foreign personnel approved by the government for a new hotel are exempt for three years. Otherwise, expatriates are taxed at a flat 25% for three years on all remuneration paid.

9.02 Persons liable to tax

Income arising out of Sri Lanka taxed at 25% for non-citizens who are employed in Sri Lanka for the first three years of employment and are deemed to be non-resident during this period. After three ears they pay taxes at rates applicable to residents and are taxed on their global income.

Residence is determined on the basis of a person's physical presence in the country. If a person spends 182 days or more in Sri Lanka in any tax year, he is taken to be resident for the whole year if he is in Sri Lanka at the end of the year, or from arrival to last departure if he is out of the country at year end. An absence of less than 91 days for a resident doesn't count as an absence. If a person has been resident for 24 months continuously, he continues to be resident unless he has been away for 12 consecutive months; if he has, he is counted as non-resident from the beginning of the 12 months.

Expatriate employees are deemed non-residents for three years from the date of commencement of employment in Sri Lanka.

Individuals employed on Sri Lanka ships are deemed resident.

Husband and wife are taxed separately. Income of children under 18 are usually included with the father's income.

9.03 Determination of taxable income

All salaries and other remuneration or income from any source that has not been exempted is subject to tax. Deductions are available on several counts:

* Sums payable by way of annuity, ground rent, royalty and interest
* Losses incurred by a person in trade, business profession or vocation.
* Qualifying payments including specified donations, purchases of approved shares, repayment of loan capital from an approved institution, expenditure on purchase or construction of a house (with various restrictions) contribution to life insurance premia and approved provident funds.
* Exemptions for foreign technicians, advisors, and experts of companies with tax holidays under the Foreign Investment Law, or GCEC law.
* Earned income allowance. This is paid on earned income; if it is below Rs6.000, the rate is Rs1,200 per year or actual value of earned income, whichever is less; for earned incomes over Rs6,000 the allowance is 20% of the earned income upto a limit of Rs3,000. A similar allowance is given for the wife's earned income.

o Individuals who invest in approved projects are given a tax relief of upto 10% of assessable income or Rs25,000 whichever is less, where the investment exceeds Rs50,000 or 20% of assessable income.

o A special exemption is given for foreign writers, artists, and retired persons, defined as "persons of goodwill". They are exempted from income and wealth tax and from estate duties, for an initial period of five years which may be extended if their visas are also extended. They may not engage in business, trade, political activities, or employment in Sri Lanka. (A cabinet decision is now required to determine whether an individual falls into this category.)

9.04 Personal Tax Rates

The rates of income tax are the same in the case of resident and non-resident employees, except in the case of a non-citizen employee who is deemed to be non-resident during the first three years of his employment, who pays a flat 25% of all remuneration including perquisites.

The rates applicable are:

On the first Rs4,800 of taxable income	7.5%
On the next Rs4,800 of taxable income	10%
Six increments in slabs of Rs4,800	six slab increments of 5% each to 40%
On the ext Rs 7,200 of taxable income	45%
On the next Rs 7,200 of taxable income	50%
On the balance of taxable income	55%

Certain lump sum receipts from employment (such as commuted pensions, retiring gratuities and withdrawals from approval provident funds) are concessionally taxed. The rates applicable are:

On the first Rs 50,000	- Nil
On the next Rs 25,000	- 5%
On the next Rs 25,000	- 10%
On the balance	15%

Capital gains are taxed at a maximum of 25% and are treated in the same way as corporate capital gains (See Section 8.08).

BOX 9.04A

Personal Tax Calculation

The tax on residents earning the equivalent of $15,000 and $25,000 (approximately Rs 300,000 and Rs 500,000 respectively) and having no allowance deductions would be as follows for fiscal 1981/82:

(1)	Total income	Rs300,000	Rs 500,000
(2)	Income tax	Rs151,560	Rs 261,560
(3)	Tax burden as %	50.52	52.31

9.05 Capital Taxes

Resident citizens of Sri Lanka pay capital taxes on worldwide capital, except immovable property outside Sri Lanka. Resident non-citizens are also exempt from the tax on moveable property outside of Sri Lanka. Non-residents must pay the tax only on capital in Sri Lanka.

There is no wealth tax on net wealth below Rs 200,000, except for non-resident companies. The rates of wealth tax applicable are:

(1) Individuals -	
On the first Rs 200,000 of taxable wealth	0.5%
On the next Rs 500,000 of taxable wealth	0.75%
On the next Rs 1,000,000 of taxable wealth	1%
On the balance	2%
(2) Charitable institutions -	
On all taxable wealth	0.5%

An exemption on wealth tax is given for any approved investment for five years, as also for investment in any "corporation, company or undertaking receiving tax relief and exemption from income tax for new development projects considered essential to the economy."

10.00 INCENTIVES

10.01 General

The government gives substantial incentives to foreign investment, export and domestic investment. Some lessening of incentives for hotel projects and a general diminution of incentives to foreign investment is likely over the next year or two.

Under the Inland Revenue Act No. 28 of 1979 and as amended by Act No. 28 of 1979, numbers 24 of 1980, and number 40 of 1981, several tax incentives are available in the form of tax holidays and investment relief i.e. deduction from taxable income.

Quoted public companies (QPC) are offered special incentives for participation in hotel projects, urban development, manufacturing, and the Mahaweli development. (See section 8.02 for definition of QPC.)

Companies incorporated after November 1979 with equity capital exceeding Rs100 million and engaged in hotel projects and urban development receive a 10-year tax holiday. Dividends are tax-free for 11 years. If the equity and loan capital exceeds Rs500 million, a shareholder can deduct the full amount of his investment from his taxable income for the year; any excess can be carried forward.

The government gives tax holidays for various types of projects. Generally, these apply from the date of starting business. Other incentives include:

Mahaweli: Companies working with the Mahaweli development project receive a five-year tax holiday, and dividends are tax free for six years.

Industrial sector: Companies producing products for import substitution, or that are in a "pioneering industry" and that have

Finance Ministry approval, receive a five-year tax holiday, and dividends are tax free for six years.

Double taxation relief is provided by bilateral treaties (see section 8.12). Under the treaties, investors are spared taxes payable in Sri Lanka, although the tax often is less or zero under tax holiday schemes.

Substantial export incentives are given (see Section 13.06).

Companies engaged in large scale industries that promote the cultivation of non-traditional products, profits from gem sales, fishing and related industries, and goods imported on a consignment basis and re-exported, also are exempt from taxes. In addition, all GCEC undertakings are granted special concessions.

10.02 Qualifying for incentives

The government is fairly flexible about incentives, and will arrange good terms for companies that are in line with its objectives and have attractive projects. Generally, the present government gives incentives for promoting non-traditional exports -- or substituting imports; for promoting the tourist industry; and for helping Sri Lanka's economic development. Employment potential is an important factor, as is local sourcing of raw materials.

Foreign firms that transfer technology, employ and train local staff, or contribute to the major development projects are likely to be able to negotiate substantial concessions.

Specifically, some sectors qualifying for incentives are urban development projects, property development projects, import substitution projects, and export oriented projects. A tax holiday is available for agriculture, sericulture and animal husbandry, fishing, the tourist industry, the gem industry, milling of paddy, small scale manufacturing undertakings, and pioneering undertakings.

These incentives are available in every part of the Island. Provinces do not have their own incentives.

10.03 Applying for incentives

Sri Lanka has been able to cut much of the red tape that firms expect to encounter in South Asia, particularly for projects that are to come under the GCEC law. Substantial firms with large, attractive projects may start negotiations at the level of the Director General or at the Ministerial level for FIAC.

For foreign firms, FIAC and GCEC are the relevant authorities. The FIAC has set up an Investor Services Unit which directs the foreign investor to the relevant department/organization for assistance and information.

Applications for financial incentives may be made to any of the national financial institutions in Colombo (listed under section 11.03). Specifically,

* Those interested in export incentives should apply to the Controller of Imports and Exports, Ministry of Trade and Shipping, 21, Vauxhall Street, Colombo 2, and the Export Department Board, 310, Galle Road, Colombo 3.
* Expansions in industry are the responsibility of the Ministry of Industries and Scientific Affairs, 48, Sri Jinaratana Mawatha, Colombo 2
* Projects in the Mahaweli area fall under the Mahaweli Development Authority, 500, T B Jayah Mawatha, Colombo 10
* Agricultural projects fall under the Ministry of Agricultural Development and Research, 73/1, Galle Road, Colombo 3.

10.04 Corporate Tax Incentives

Various tax concessions are available to both resident and non-resident companies after approval is granted by the Minister of Finance and Planning. Quoted Public Companies (QPCs) with a 40% public equity holding are eligible for tax holidays.

Dividends, Interest and Royalties: Dividends, interest and royalties arising in Sri Lanka and received by a non-resident are liable to Sri Lanka income tax. However, concessionary rates varying from 10-15% have been extended to residents from countries with which Sri Lanka was entered into Double Tax Relief Conventions.

Hotel Sector: A 10-year tax holiday is available to new tourist hotels, provided they are QPCs with a paid-up equity capital of Rs100 million or more. A 5-year tax holiday is available, on the recommendation of the Ceylon Tourist Board, to other hotels which do not satisfy these conditions,. All approved hotel projects can claim deductions from profits of cost of furniture, utensils etc. Management fees paid tc a non-resident person by a hotel which is entitled to a 10-year tax holiday are tax exempt if the fees are a percentage of gross profit.

Property Development: QPCs incorporated after 15th November 1979, engaged solely in approved property development projects, are entitled to a ten year tax holiday on the recommendation of the Urban Development Authority.

Housing Sector: Profits from the construction and first sale of houses are are eligible for tax exemptions in slab rates based on floor area. If the floor area is less than 500 sq ft, profits are 100% tax exempt.

Tax concessions are available for the construction of a house or flat for employees, provided the floor area does not exceed 2,000 sq ft and no depreciation allowance was granted.

From 1-4-82 the concession has been modified to extend the relief to the cost of purchase of any unit of residential accommodation, constructed with the approval of the Urban Development Authority, and comprised in registered condominium property.

Mahaweli Development: A five-year tax holiday to companies, incorporated on or after 15th November 1979, and engaged solely in the performance of contracts with the Mahaweli Authority.

Pioneering Undertakings and Import Substitution Industries: A 5-year tax holiday to newly-formed QPCs approved by the Ministry of Finance and Planning. In the case of an import substitution industry, it should result in 25% net savings in foreign exchange and employ a minimum of 50 persons.

Gems and Jewellery: Profits arising from export, sales to the state Gem Corporation, at fortnightly gem auctions conducted by the Ceylon Chamber of Commerce or from sales resulting in payment in foreign exchange through authorized dealers are exempt.

Agriculture: 10-year tax holidays to approved QPCs incorporated after 1st January 1981, with a paid up capital of Rs 100 million or more, engaged in the cultivation or processing of non-traditional produce (other than tea, rubber, coconut or paddy). Capital expenditure incurred in the opening up of land for cultivation or animal husbandry is exempt. Subsidies paid by the Sri Lanka Tea Board, Coconut Cultivation Board, and under the Rubber Replanting and Cocoa Planting Subsidy Schemes are also exempt.

Export Sector: Export oriented companies are entitled to either 5 or 18 year tax holidays depending on their date of incorporation. They are also entitled to a rebate on customs duty on imported raw materials at the point of export of finished products.

Entrepot Trade: Profits from entrepot trade in petroleum products and precious stones and metals not mined in Sri Lanka, which are brought in to Sri Lanka on a consignment basis and re-exported are exempt in the hands of both consignor and consignee.

Foreign Currency Banking Units (FCBUS): Profits from all off-shore transactions with other FCBUS, GCEC enterprises, and with residents approved by the Central Bank, are exempt upto 31st March 1985.

Fishing Sector: Tax holiday upto 31st March 1985 for companies, incorporated after 15th November 1977, engaged in fishing and related activities. Certain capital expenditure and subsidies paid by the Ministry of Fisheries for purchases of capital equipment are also exempt.

Paddy Milling: Tax holiday upto 31st March 1983 for approved companies.

Small Scale Undertakings: For companies incorporated after 15th November 1977, engaging in production or manufacture of goods (other than paddy milling), a tax holiday upto 31st March 1983.

Exemption of Dividends: Dividends declared out of exempt profits upto one year after the tax holiday period are exempt from taxes in the shareholders hands.

Investment Relief: Shareholders' investments in approved undertakings are exempt upto 1/3 of their assessable income, except in investments in hotels, property development and large scale agriculture where the investment exceeds Rs 500 million.

In the case of company controlled by not more than five persons, if the company has not distributed a reasonable part of its profits for any assessment year, the assessor may treat the profits as distributed, (subject to certain conditions) and tax them at the highest rate at which income tax is chargeable for that year upon the taxable income of an individual.

GCEC Undertakings: Non-resident shareholders in the GCEC area are exempt from taxation on all dividends. If declared during the tax holiday period or within the ensuing year, a resident shareholder's dividend is exempt from income tax.

Depreciation cannot be delayed until after a tax holiday. No depreciation allowances are available under incentive programmes.

10.05 Personal Tax Incentives

Income tax is charged for every year of assessment in respect of the profits and income of a person for that year. A 'resident' person is taxed on his income within and outside Sri Lanka. A 'non-resident' person is liable to tax on income arising in Sri Lanka.

Sums payable by way of annuity, ground rent, royalty and interest, losses incurred in trade, business, profession or vocation, and qualifying payments to specified charity organisations etc, contributions to life insurance premia and approved provident funds determine the amount of taxable income.

The official emoluments arising in Sri Lanka and other income arising abroad of the following persons are exempt from income tax:

* The diplomatic representative in Sri Lanka of a foreign government and certain members of his staff.
* Any official of the United Nations Organization or Asia Foundation who is not a citizen of Sri Lanka.
* Any expert, adviser, technician or official whose salary is not paid by the government of Sri Lanka and who is brought to Sri Lanka by the government of Sri Lanka through -

- any specialised agency of the UNO
- The Point Four Assistance Programme
- The Colombo Plan Organisation
- The Asia Foundation or
- a similar organization approved by the Minister.

Where the assessable income of a non-citizen employee, who is deemed to be non-resident during the first three years of his employment in Sri Lanka, consists solely of income from employment which does not exceed Rs 12,000 for a year, such income is exempt from income tax.

A non-citizen employed in Sri Lanka is liable to income tax at a concessionary rate of 25% for a period of three years from the date of commencement of his employment in Sri Lanka. Any income arising abroad during this period alone is also exempt from income tax. Global income arising after that period is liable to be taxed. In the hotel sector, if it is a QPC incorporated on or after 15 November 1979, management fees paid to a non-resident person by a company operating an approved hotel for tourists which is entitled to a 10-year tax holiday, are exempted from income tax.

Those non-residents operating yachts and pleasure crafts (for operation outside Sri Lankan waters) registered with the Director of Merchant Shipping are exempt from income tax.

Non-citizens employed in GCEC enterprises are not liable to income tax on their official emoluments.

Benefits to an employee are exempt from income tax. These include:

* The cost of passage granted to a non-citizen and his family.
* Any allowance received by a non-citizen for travelling, subsistence and lodging when travelling abroad.
* All perquisites (housing, transport, medical benefits) are tax free.

Interest earned on non-resident foreign currency accounts is not taxed during the period in which the account holder is non-resident in Sri Lanka.

For example, qualifying for a special tax incentive is the Liberty Plaza Compex (78 flats, 150 shops, supermarket office space etc.) in Colombo. Approved by the FIAC, the Complex was developed by the Colombo Land and Development Company Ltd and is a joint venture between the Urban Development Authority and Clarissa Pte Ltd of Singapore. Buyers are eligible for the following incentives:
- Income from apartments purchased for rental to be tax exempt for seven years, with the purchase cost deductible from assessable income.
- Tax deductibility of both interest and capital of funds borrowed for the purchase of these apartments.
- Profits from re-sale of such apartments to be free of capital gains tax.
- Discounted municipal rates are offered to buyers of these assessments so that for five years the rating assessment would be a fifth of the normal charges, with a 50% rebate on regular rates for the next five years.

Double taxation relief agreements are in force (see section 8.12). Investors are spared taxes normally payable in Sri Lanka, even though they benfit from the lower -- or nil -- taxes under the various incentive schemes.

Relief is also available to a person who is taxed on the same income both in Sri Lanka and in another Commonwealth country, if:
* he is not a resident of a country with which Sri Lanka has a double taxation relief agreement, and
* that other country grants reciprocal relief.

The relief is equal to one half of the Sri Lanka tax or the tax payable in the other country, whichever is lower, in respect of the doubly-taxed income.

10.06 Tariff Incentives

Except for a few items which require individual import licences, the controls on imports into Sri Lanka have now been relaxed.

Items which require import licences are:

- Single shipments of any commodity, which exceed (Sri Lanka) Rs 100,000.
- Infant milk foods.
- Arms, ammunitions and explosives.

The investment promotion gone at Katunayake provides incentives that allow the manufacturer to import, duty free, whatever is required as raw materials, and then process them for export. Outside the GCEC areas raw materials may be imported with the rate of duty ranging from 5%-500%.

Tariff protection cannot usually be obtained against competing imports, neither can imports of competing products be banned. However, as the government sees the need to protect its infant industries, this may change somewhat.

10.07 Capital Incentives

The main purpose of the National Development Bank (NDB) of Sri Lanka is to finance investment by way of loan and equity, in the capital of productive enterprises in the country. The agricultural and industrial sectors are the main areas covered by NDB operations, but based on potential economic contributions the bank is open to financing other projects. Although the NDB finances joint ventures between Sri Lanka entities and foreign enterprises, it will not finance fully-owned foreign enterprises.

A special area of the bank's responsibility is the financing of small and medium-size industries (SMI) particularly in the rural sector. Under this programme, any privately or co-operatively owned enterprise which is engaged in manufacturing, mining, construction, agro-industry, fish processing, handicraft production or industrial service activities is eligible to receive assistance.

For projects which are not covered by the SMI scheme, re-financing upto 60% is available for loans in selected industrial sub-sectors.

The NDB is interested in assisting project sponsors especially in the Public Sector, to develop projects suitable for the bank's financing. With this end in view, the bank is willing to advance funds needed for feasibility studies and the use of consultants. In the event of the NDB agreeing to finance the resulting project, the advance would be converted into a long-term loan.

Housing loans are available from the State Mortgage and Investment Bank.

The Development Finance Corporation of Ceylon (DFCC) also finances projects. Some which qualify:

- Industrial enterprises - manufacturing, processing, assembling, reconditioning, repairs, engineering, brewing and bottling.
- Agro-based industrial enterprises - processing, canning, drying, altering and reconstituting agricultural products and by-products.
- Processing of shrimps and other marine foods, as well as commercial fishing and shrimping operations.
- Agricultural enterprises including plantation crops and the cultivation of primary and subsidiary food crops on a medium and large scale.
- Services including printing and repair workshops.
- Tourism - mainly hotels and restaurants.

DFCC's participation in an enterprise can take the form of local and foreign currency loans, convertible debentures, ordinary shares, preference shares, guarantees or any combination of these, depending on the nature and needs of the enterprise.

The order to grant financial and technical assistance to small scale enterprises, DFCC has set up a special unit.

10.08 Research and Development Incentives

No special incentives are given for research and development, but companies can, for tax purposes, expense certain research and development expenditures in the year in which they are made.

11.00 CAPITAL SOURCES

11.01 General

The underlying rate of inflation in Sri Lanka is high as is the government's budget deficit. The money supply continues to grow rapidly. The government will be under pressure to reduce this deficit, and may have to rein in credit expansion.

Even with an expected rise in taxes, the budgetary deficit will continue to exacerbate inflation. Borrowing from the Central Bank is the only viable alternative to finance the deficit, since public and foreign borrowing could not possibly bring in enough to close the budgetary gap. The financing of the deficit will fuel inflation, and a credit squeeze on the private sector is likely.

The Central Bank exercises official control over all credit. A budget plan developed by the Central Bank encompasses budget plans of all other banks in Sri Lanka. The Central Bank advises and offers assistance to individual banks.

Following a recent liquidity surplus, the People's Bank had reduced rates of interest to customers, and followed an aggressive policy on the whole. The surplus was wiped out and the interest rate was raised to the usual 18%. The finance companies -- which had followed the lead of the People's bank -- will now have to revise their own rates.

Financial center: Sri Lanka has ambitions to become a major international financial center. Located halfway between Bahrain and Singapore, the island would have advantages; however, its progress will depend on the economic growth in its South Asian neighbors -- which could be a long time coming.

The lack of adequate legal expertise has been cited as one problem in setting up as a financial center. Also, guidelines from the authorities are often vague or undefined, leading to operational problems for bankers. For instance, one bank offered interest on current accounts -- a practice forbidden in many places, but apparently not in Sri Lanka. It drew a large number of accounts, via newspaper advertising, before the matter came to the government's attention some days later. The bank was then informed that this was not permitted -- although no rule to the effect was explicitly stated anywhere. The bank was faced with the embarrassment of having to explain this to its customers.

Foreign banks have shown much interest, and Sri Lanka now has 25 commercial banks in operation (see box for list of foreign banks). The economy is undoubtedly rather overbanked, and competition is stiff; however, some banks still report satisfactory results. One banker felt that, as the system settles down, each bank will have to carve a niche for itself.

Two important public sector banks are the Bank of Ceylon and the People's Bank. They have an extensive network of branches in all parts of Sri Lanka. In addition, two private local banks (the Hatton and National Bank and the Commercial Bank of Ceylon Ltd) exist.

The government has tried to encourage offshore banking through the <u>Foreign Currency Banking Scheme</u>. This provides for authorized banks through their foreign currency banking units (FCBUs) to accept time and demand deposits from nonresidents in foreign currencies, borrow in foreign currencies from nonresidents, lend in foreign currencies to nonresidents, and enter into other foreign currency transactions. It exempts FCBU offshore income and interest on deposits in certain FCBU accounts from taxation and provides FCBUs a tax holiday and reduced tax rates.

While nearly all banks have installed FCBUs -- 24 out of the 25 have the units -- most of them find that they are severely underutilized. One banker felt that the chances of the concept proving successful for his bank were about 50:50. The main problems seem to be the infrastructure and red tape, and the time advantage may not be sufficient to overcome these problems.

Corporate borrowing patterns vary considerably, depending on who the borrower is, the purpose for which the loan is sought, and various other factors.

The main sources of short- and medium-term finance are commercial banks and, for the medium term, special financial institutions. Since Sri Lanka has a serious capital shortage, officials are reluctant to allow foreign firms to borrow locally. Credit is tight, and most companies face a liquidity squeeze.

Another option open to firms is leasing equipment. This is becoming extremely popular -- specially for motor vehicles, on whcih depreciation is not allowed. (However there is some concern that leasing costs many not be tax deductible, either). It also obviates the need for complex capital budget approvals for some companies. For example, the Baltic Orient Shipping Lines Ltd has leased a container gantry crane to the Port Authority of Sri Lanka for three years. The port has an option to purchase the crane at the end of it. Hire purchase, however, is forbidden.

Unless a newcomer to the export trade can offer acceptable security and collateral, banks are on the whole unwilling to provide the required credit and finance facilities. In such a situation the exporter can obtain the backing of the Sri Lanka Export Credit Insurance Corporation (SLECIC) to raise finance from the banks.

BOX 11.01A

Foreign Banks in Sri Lanka

- Algemene Bank of Nederlands N.V.
- American Express Banking Corporation
- Amro Bank
- Bank of America
- Bank of Credit & Commerce International
- Bank of Oman
- Citibank
- Dubai Bank
- European Asian Bank
- Girart Bank
- Grindlays Bank
- Habib Bank (A.G. Zwich)
- Hong Kong and Shanghai Banking Corporation
- Indian Bank
- Indian Overseas Bank
- Indo-Suez Bank
- Overseas Trust Bank
- Standard United Bank
- State Bank of India
- Union Bank of the Middle East

11.02 Short term credit:

Commercial banks are the primary source of short term credit. Overdraft borrowings, loans, advances, trust receipts on imports, letters of credit, and guarantees, are common forms of short term credit. The usual interest rates on short term credit range from 18-23%. For loans, interest rates vary from 20% to 24. The three major finance companies in Sri Lanka -- The Finance Company, Mercantile Credit Ltd, and Maharajah Investments Ltd -- offer interest rates upto 30%.

Another source of borrowing is the unofficial money market which is controlled mainly by money lenders, pawn brokers and traders, and patronised mainly by those in lower income groups.

Conditions imposed vary widely, and much is left to the discretion of the banks, which are, however, advised by the Central Bank as to what sectors should receive credit. Credit for export would probably require less stringent terms than import credits.

11.03 Medium and Long term credit

In addition to the commercial banks mentioned in section 11.01, specialized financial institutions are found in Sri Lanka:

o The National Savings Bank (NSB): this bank encourages savings and grants loans for development purposes.

o Development Finance Corporation of Ceylon (DFCC): It was established to assist in the promotion, establishment, expansion and modernization of private industrial, agricultural and commercial enterprises in Sri Lanka. The assistance may be in the form of medium and long term loans or in the form of participation in the capital. It may provide the foreign exchange needed for investment.

o State Mortgage and Investment Bank: It provides long term loans for the development of agriculture, industry and housing.

o National Development Bank of Sri Lanka: It is empowered to provide medium term and long term credit to industrial, agricultural, commercial and other enterprises and to stimulate the development of the investment, share and security markets of Sri Lanka.

o Loan Board: It grants loans on the security of house property situated in a municipal or urban council area.

o Department of National Housing: It provides housing loans, among its other activities.

Sri Lanka also has a number of privately owned finance companies. Besides making loans to industry and commerce, they provide lease financing for industrial and agricultural plant and equipment, and for consumer durable goods. They generally charge higher interest rates than banks.

Off shore funds are available through foreign banks via the medium of the Foreign Currency Banking Units (FCBU). The Central Bank approval is required before an incorporated foreign company can borrow..

Foreign investors who collaborate with local partners may apply to the following sources for credit facilities:

o National Development Bank of Sri Lanka (NDB).

As an example of the kind of funding available, the NDB has just approved an equity investment of Rs9.85 million and a term loan of Rs1.7 million to a private limited liability company to set up a pilot plant to manufacture rubberised coir products for export. This project is a joint venture, with equity participation by the Swedish Fund for Industrial Co-operation with Developing Countries (SWEDFUND) local entrepreneurs and the NDB.

- Development Finance Corporation of Sri Lanka.

- Employees' Trust Fund

Private funds can be mobilized for equity participation through the share market, but the volume of funds (rupee funds) is limited.

11.04 Stock and Bond Financing

The government is trying to develop the financial markets. A stock exchange was recently started in Sri Lanka. Earlier, the functions of the stock exchange were carried on in Sri Lanka by the Colombo Brokers' Association. Company shares -- both equity and preference, government securities and other stocks are traded. Usually, but not invariably, only listed securities are traded. The market is not very active; investors tend to prefer real estate to the share market.

The new stock market will be more than a share market in function as it hopes to undertake other lines of securities business.

Companies can issue debentures, but all foreign companies require prior permission from the Controller of Exchange in order to borrow. The borrowing powers of a company may be limited by the Memorandum or Articles in a variety of ways.

Companies must issue a prospectus when offering debentures, but there is no requirement to keep a register of debenture holders. Although a trust deed is not required by the Companies Act, one is generally executed and trustees are appointed. For Quoted Public Companies (QPCs -- see section 8.02 for definition), the Colombo Brokers' Association requires at least two trustees to be appointed, or an approved sole trustee. Perpetual debentures are allowed. Re-issue of redeemed debentures is allowed.

The members of the Brokers' Associaion do not act as jobbers.

Tax concessions given to QPCs has given the stock market a fillip. With the tax incentives on offer, more private companies are likely to convert to public. At the end of the first half of 1982, there were 118 new quoted companies on the share list, excluding tea companies and management houses. It is believed that more companies will register before March 1982.

However, the current climate for industrial shars is not too favorable. The Sri Lanka Cement Company, which is extremely competitive in the country's important cement industry, failed to raise the capital it sought on the stock exchange. Singer Industries shares, which were open to the public, were also undersubscribed. Taj Lanka Hotels Ltd, on the other hand, was heavily oversubscribed despite its being a new and untried project, due mainly to the tax concessions granted to hotels (See "Exemption of Dividends", Section 10.04).

This would appear to indicate that people regard dividends as being inadequate, rather than uncertain. The high interest rates offered by the National Savings Bank (22% per annum) and reputed finance companies could also impede investment in shares by providing alternate avenues of investment.

Some companies have issued bonus shares against asset revaluations (e.g. hotels belonging to John Keels).

12.00 LABOR

12.01 General

Unskilled labor is freely available in Sri Lanka, but skilled personnel may be more difficult to get.

Technically skilled personnel may be in short supply, but companies can train their workers to their requirements. Unemployment rates are high, particularly among those with some education. The labor force in 1980 was about 5.9 million, of which half were employed in agriculture. Unemployment was 15%. Already a third of the workforce is in manufacturing.

The workforce appears to pick up new skills quickly, mainly because of the high literacy levels and a widespread working knowledge of English. The level of motivation is high, and workers have been known to put in overtime without extra pay in order to learn new skills.

The GCEC has started a training school where investors can train workers to operate machines and learn basic skills even while the factory is under construction. Also, the National Apprenticeship Board will reimburse wages paid to trainees hired through the board for in-plant training.

Women constitute a growing percentage of the workforce, as education is lowering birthrates (and thus, the time out for child-rearing), and changing aspirations. Since employer attitudes have not changed as rapidly, female workers are easier to obtain than male labor. The Investment Promotion Zone (IPZ) already employs a large number of women. Companies have found women employees better at tasks that require manual dexterity or that are repetitive.

Attractive jobs in the Middle East will increase the competition for skilled labor; already large numbers of Sri Lankans have gone abroad to work. Training personnel makes them more employable in those countries, and some turnover is inevitable. This will not affect female workers to the same extent.

Turnover will increase, and availability of skilled workers could become something of a problem as the industrial sector expands, increasing competition. In general, however, turnover rates are low, reflecting the high unemployment rates and traditional attitudes.

Executives from both domestic and foreign companies have complained about the lack of adequate managerial staff. The educational system is, by and large, not geared to providing analytical or managerial skills. While basic knowledge of English is prevalent, fluency is much less common. Most companies find it essential to bring in some managers from abroad.

Most companies advertise in the English press for vacancies above supervisory levels. Current advertising rates are approximately Rs50 per column centimetre. There are also a few recruitment agencies which select personnel on behalf of their clients. They are, however primarily engaged in recruitment for overseas, Middle-East based jobs. They usually charge the client the equivalent of one month's salary of the selected appplicant.

The usual age of retirement is 55 years. New retirement rules framed by an employer have no application to an employee already in service, unless the employee accepts the new rules as part of his service contract.

Absenteeism, particularly on days before and following holidays and in the month of April (Sinhalese New Year), is and will remain a problem. Deeply engrained in cultural attitudes, absenteeism has been reduced only slightly by production incentives and bonuses. Average rates vary between 10-20%, but companies report that it sometimes goes up to 75% in some areas -- particularly on night shifts. Some factories handle this problem by scheduling maintenance shutdowns for April. One result of this is a high usage of casual labor.

The Employers Federation -- of which most large companies are members (199 companies) -- enters into collective agreements with various unions regarding wage and welfare matters. The Commissioner of Labor has the authority to extend clauses in these agreements even to companies which are not members of the Employers Federation. One of the strongest unions is the Ceylon Mercantile Union for clerical workers. There are no company unions.

12.02 Unions and Work Stoppages

The Jayawardene government has clamped down heavily on labor unrest, often in the past a disruptive factor. The urban workforce in Sri Lanka is leftist in its orientation and can be militant. Outbreaks of labor trouble over the next few years are possible, though less likely under the present regime. However, labor unrest is not often a problem for foreign firms, although strikes in state-run facilities or government offices can be a hindrance.

Unions exist and are fairly powerful; but companies have evolved techniques for working with them. In 1981 there were 1,180 functioning trade unions with a total membership of 1.0 million.

Politically motivated strikes could be inspired on occasion by the opposition groups; in such a case, a heavy crackdown from the Jayawardene administration is likely. In recent years, however, the incidence of politically motivated labor trouble has been rather lower than in the early 1970s. The number of strikes have increased in the last few years resulting in increased loss in man days, as shown below:

	Strikes	Workers involved	Man-days lost
1977	119	38,667	210,470
1978	134	62,667	265,069
1979	181	56,044	293,752
1980	227	78,555	334,215
1981	308	216,073	465,026

In 1981, 96% of the strikes and 98% of the man-days lost were accounted for by the plantation sector. Of the total number of strikes in 1980, 48% represented demands for wage increases or wage related disputes, 10% pertained to working conditions, 23% to dismissals and loss of employment, and 19% reflected general demands and welfare issues. The general strike of July 1980 was the last major strike in the island. However, strikes have usually been in 'sympathy' over a political issue, and not demands for individual companies.

There are three main pieces of labor welfare legislation. The Workmen's Compensation Ordinance provides for payment of compensation to workmen who suffer personal injury in the course of employment (in 1980 a total of Rs1.6 million was paid as compensation for 805 industrial accidents). The Factories Ordinance lays down requirements affecting the safety, health and welfare of factory employees, while the Shop and Office Employees Act cover similar provisions for other mercantile establishments.

The Employers' Federation (EFC) has the right to reject membership. This does not usually happen, but EFC tries to keerp out those companies that have government participation. (This is difficult when government mandates have to be taken into consideration.) Hotel Lanka Oberoi and Hotel Ceylon Intercontinental are exceptions to this policy. Usually, local entrepreneurs (such as Maharaja) are not members of EFC on account of collective agreements.

A company's personnel department handles all internal problems and goes to the parent body to resolve the matter. If this fails it is referred to the Department of Labor. Corporation employees may approach the Dept. of Labor, but government employees may not. The Employers' Federation uses the technique of voluntary arbitration if collective agreement fails.

A collective agreement for white collar workers exists with the Ceylon Mercantile Union. The last strike was in 1961; only minor, sporadic strikes have occurred since, as all conditions are covered by this agreement.

There are also collective agreements with manual categories of workers, but here the tendency to strike, agitate, and resort to violence is rather higher. Between 1971-80, one company, Volanka had about 100 strikes, despite their terms being covered by collective agreements. Management attributes this to petty minded leaders.

Company executives dealing with agitating workers sometimes fear manhandling. Some sources believe that many managers in Sri Lanka are not competent to handle problems relating to industrial relations.

Sri Lanka is a member of International Labor Organisation (ILO), but membership does not mean ratification (via Parliament). If the recommendation is ratified, firms must abide by these recommendations. There are conventions on working hours, wages, and night shifts.

12.03 Wages

Sri Lankan wages are among the lowest in Asia. Wages can be expected to rise at about 15-20% per year but will remain competitive with other Asian countries and, in fact, continue to grow more slowly than inflation. Productivity is fairly high and improves with training and experience.

Under the Wages Boards Ordinance, 33 Wages Boards have been established for selected industries and trades (see box for industries covered). The ex-officio chairman of the Wages Boards is the Commissioner of Labor. Employers' and employees' representatives are nominated onto the Boards, which fix minimum wages, for skilled, semi-skilled, unskilled, and trainee workers, and review them from time to time. Broadly, Wages Boards fix a daily rate of pay, referred to as a time rate. However piece rates are allowed, even when time rates have been fixed, provided they do not fall short of the minimum wages.

While Wages Boards generally base minimum wages on a daily rate, between employers and employees may replace these with monthly rates. Where monthly wages operate, annual increments become payable at agreed rates for about 20 to 25 years. Monthly wage scales are determined voluntarily through agreements, both individual and collective. The scale of salaries applicable to office employees varies widely; in some cases, salary scales are governed by previsions of Collective Agreements.

The minimum average daily wage rates for agricultural workers has increased from Rs6.03 in 1976 to Rs13.95 in 1981. The rates for other workers have increased from Rs5.17 to Rs17.34 during the same period. The minimum wage rates vary by industry.

Since 1967 several ad hoc allowances were granted to employees in order to compensate for the increases in the cost of living. Not all these were mandatory and some were only applicable to employees earning low salaries i.e. usually below Rs 1,000 per month. At a gross salary level (inclusive of allowances) of Rs 800 per month, these allowances would account for about 40% of the gross salary while at a gross salary of Rs 2,500 they would account for about 20%.

In November 1981 an allowance linked to the Colombo Consumer's Price Index came into force for all public sector employees. Real wages (computed by deflating minimum wages by the Colombo Consumers Price Index) declined by 3% in 1981 (compared to 12% in 1980) for government employees.

In the private sector minimum wages of workers increased by 13% in 1981, compared to 22% in 1980.

Typical salary scales in US dollars are show below.

	Salary/Rs per month
Senior Executive with professional qualifications (in engineering, accountancy law, industrial economics etc) and ten years' experience	275-500
Middle level Executive with professional qualifications and five years experience	165-275
Junior Executive with University degree	85-165
Secretary/clerk with training in stenography and good command of English	50-100
Skilled worker with technical qualifications	55-100
Semi-skilled worker with six months on the job training	40-55
Unskilled worker	30-40

BOX 12.03A

Industries which have Wages Boards

Manufacturing of:

aerated waters, biscuits and confectionery, brick and tiles, cigars, coconuts, garments, hosiery, matches, rubber, leather goods, tyres, tubes and plastic goods;

and the following trades:

cinema, cinammon, engineering, liquor and vinegar, motor transport, nursing homes, printing, rubber export, tea export, and tobacco

12.04 Working Hours

Most private sector organisations work an five day week, with an eight hour day (from 8.30 am to 4.30 pm) with 30 minutes off for lunch. Some companies work till lunch on Saturdays.

By law, no employee may be employed for over 45 hours per week (excluding an interval of one hour for a meal or rest per day) or 9 hours for a day (including the interval of one hour for a meal or rest). New rules permit women to work night shifts if they wish, but no employer may require it.

Overtime is paid at the rate of 1-1/2 times the normal hourly rate for every hour of overtime work done. The hourly rate is determined by dividing the monthly rate by 240, or the daily rate by 8.

An employee is entitled to 1-1/2 days as holidays with pay each week, provided he works for not less than 28 hours in the week. The 28 hours referred to is calculated on the basis of an 8-hour working day, and in this context is the equivalent of 3-1/2 days; if the working day is shorter the qualifying period calculated in hours is shorter. The qualifying period of work, therefore, is really therefore 3-1/2 days.

Normally the half-holiday is granted on Saturday and the full holiday on Sunday. In computing whether an employee has worked for the minimum of 28 hours to be entitled to his paid 1-1/2 days holidays, authorized leave, public holidays and Poya Holidays are also reckoned. An employee required to work on a half-holiday, must be paid for the hours worked at overtime rate, irrespective of the number of hours worked. In addition, he must be given an alternative paid half-holiday in the succeeding week, i.e. if an employee works after normal hours on a Saturday whether he works for 10 minutes or for a few hours, he must be paid for the period worked at overtime rate and in addition he be given an alternate paid half-holiday in the succeeding week. If the alternative paid half-holiday is not given, the employee must be paid an additional half day's salary. This payment must be included in the salary in respect of that month.

Similarly, if an employee is required to work on Sunday, he should be paid for the hours worked at overtime rate, irrespective of the number of hours worked. In addition, he must be given an alternate paid holiday in the succeeding week i.e. if an employee works on a Sunday, whether he works for 10 minutes or for a few hours, he must be paid for the period worked at overtime rate, and in addition be given an alternate full holiday in the succeeding week. If the alternate full holiday is not being given then the employee must be paid an additional full day's salary. This payment must be included in the salary in respect of that month.

12.05 Fringe Benefits

Only social security is mandatory, and for those companies that pay only this, fringes add only 15% to salary. However, at management levels, far more fringe benefits are customary; housing (in Colombo), free transport, medical benefits, free servants, telephone, and recreational facilities. These would probably equal 150% of the salary. For example, in the case of a senior local manager drawing a salary of Rs 10,000 per month the total cost of these benefits would be about Rs 15,000 per month.

Paid holidays: An employee is entitled to nine public holidays. If a public holiday falls on a Saturday or Sunday an alternate half holiday or full holiday must be given in the succeeding week. If the public holiday falls on a Poya Day no alternate holiday need be given. Should an employee be required to work on a public holiday, he must be paid an extra day's salary or be granted an alternate holiday with pay during the calendar year. If the alternate holiday is not being given and an extra day's salary is being paid then that payment must be included together with the salary of the current month.

Every Full Moon "Poya Day" is an unpaid holiday. However, no deduction from the salary can be made in respect of Poya Day. If an employee is required to work on a Poya Day, he should be paid only an additional half day's salary. This payment must be included in the current month's remuneration. No alternate holiday need be given. If a Poya Day falls on a Saturday or Sunday, no alternate half day or full holiday need be given.

Annual leave: Employees are entitled to 14 days annual leave. An employee is not entitled to any leave in the first calendar year of employment i.e. upto December 31 of that year. Thereafter he qualifies for leave proportionate to the number of days worked in the first year.

Casual leave: An employee is entitled to seven days paid casual leave. This may be utilised for private reasons, illness or other reasonable cause. In the first year of employment i.e. up to 31 December, he is entitled to one day for each period of two months completed service. Casual leave, if unused, is forfeit, and no paymente will be made in lieu thereof; casual leave cannot be accumulated or carried forward.

Medical/Maternity leave: While employees are not entitled to paid medical leave many companies grant upto 14 days per annum at their discretion. A woman is entitled to a maximum of 42 day's maternity leave at each pregnancy, to be taken 14 days before delivery, and for 28 days after (leave not taken before the birth cannot be taken later). However, the government is considering introducing three months maternity leave for women bearing their first or second child. This may somewhat affect enterprises in the Investment Promotion Zone, where the majority of the workers are women aged 18-25 years.

Social Security: This is known as the Employees Provident Fund Scheme (EPF). Employers must make contribute 12% of the employee's monthly earnings to EPF. Employees contribute 8%. Total earnings includes basic salary, cost-of-living allowance, special living allowance and all other similar allowances (whether statutory or not), payment in respect of holidays including payments made in respect of weekly, public and annual holidays, the cash value of any cooked or uncooked food provided by the employer to the employee, remuneration paid to an employee by way of commission for any service rendered to the employer and payments made by way of incentive. Total earnings do not include rent allowance, children's allowance, travelling allowance, entertainment allowance, overtime payments and bonus payments. The employer and the employee can opt to make higher rates of contributions, but once such option is made the rates cannot thereafter be reduced. In addition the Employees Trust Fund Scheme (ETF) requires employers to contribute 3% of an employees salary (as defined in the case of the EPF). Hence an employer contributes 15% of an employee's salary to Social Security.

Severance pay: There is, at present, no statutory provision for the payment of gratuity to an employee on termination. However, a law is being drafted to provide for two weeks' severance pay for each year of service.

An employee can apply to the Labor Tribunal within six months of the termination of his employment for a gratuity, and a Labor Tribunal is empowered -- where the cessation of employment is on reaching the age of retirement or in 'retiral' circumstances e.g. physical incapacity to continue in employment -- to grant gratuity depending on the length and quality of the employee's service, and the financial capacity of the employer. Such gratuity where granted has generally been an amount equivalent to one month's gross terminal salary for each year of service less the employer's contribution to the Provident Fund.

Workman's compensation: An employee who sustains personal injury by accident arising out of and in the course of his employment is entitled to workmen's compensation at specified rates. This law applies to employees earning not more than Rs500 in monthly salary. For a workman earning Rs500 the maximum payable for permanent disablement is Rs14,750.

Bonus: There is no legal requirement to pay bonus. Many firms do pay either a profit bonus (i.e. a bonus based on profit which may vary from year to year depending on profit), or a customary bonus (i.e. a bonus paid at some particular fixed time of the year irrespective of profit or loss).

Other voluntary benefits offered by some companies are:

* Added benefits for managers i.e. accommodation, car telephone, servants, club membership.
* Subsidized meals (usually lunch)
* Free uniforms for certain categories of staff.
* Special leave for long service.
* Pension/retir ment schemes.
* Free or subsidised clinic or dispensaries on company premises.
* Holiday bungalows for senior office staff.
* Indoor recreational facilities.
* Creches for children especially in the plantation sector.
* Group insurance schemes for employees.
* Reimbursement of medical expenses or a medical insurance scheme membership.

12.06 Dismissal

The employer may dismiss an employee on disciplinary grounds e.g. misconduct, fraud, refusal to carry out lawful orders of the employer etc. However, should the employee file an application with the Labor Tribunal, the employer has to justify such dismissal before a Tribunal. A domestic inquiry prior to such disciplinary action is not a legal requirement, nor is a Labor Tribunal bound by the findings of a domestic inquiry.

If an employer employs more than 15 employees, the employer cannot lay off, retrench, retire or dismiss an employee (other than for disciplinary reasons) unless the employer has obtained the prior consent in writing of the employee, or the prior written approval of the Commissioner of Labor. But this provision does not apply to employees with less than one year's service. The employer can terminate such an employee, but the employee is then entitled to make an application to the Labor Tribunal, and the Labor Tribunal is empowered to grant him relief.

12.07 Limitations on Foreign Nationals

Foreign nationals need work permits; these are usually granted at the time the project is approved and the expatriate staff requirement discussed. The government is quite reasonable about allowing firms the necessary complement of foreign staff.

Nevertheless, Sri Lanka is sensitive about the influx of foreign personnel. The investing company is expected to train Sri Lankans to gradually take over foreign held positions, usually within a maximum of five years (except for GCEC companies). The number of foreign personnel to be employed is authorized in the foreign collaboration agreement.

Getting the required work permit and residence visa usually takes about three months, but meanwhile, an extension of a temporary tourist visa is usually possible. A tax of Rs1,000 per adult for whom a residence visa is required is levied; this includes non-working spouses. Residence visas are usually given for a period of one year and must be renewed annually. Some justification for asking for renewal is usually necessary.

In non-priority sectors the government is more rigid about extension of residence visas. One foreign advertising agency was initially permitted four expatriate employees, but after their two-year visa expired, only two were renewed. Usually expatriates are allowed to work for three years without much difficulty. After that time, most will want to return in any case, because of the tax law; but if they are to be replaced by other expatriates, a strong case may have to be made.

13.00 FOREIGN TRADE

13.01 General

Sri Lanka's major markets are the US, the UK, the Federal Republic of Germany, the People's Republic of China, Iraq, Saudi Arabia, Pakistan and Japan. Although industrial manufactures form a growing part of SRi Lanka's export commodities, tea, rubber, and coconut still predominate. Petroleum products (the excess production of certain fractions of imported oil) are also exported in addition to non-traditional goods like coir products, gems, handicrafts, cinnamon and frozen fish. The principal imports are petroleum, crude oil, flour, rice, fertilizers, sugar and machinery, which are supplied by Japan, Saudi Arabia, the UK, Iraq, Iran, India, the USA, France, the People's Republic of China and Australia.

Sri Lanka has entered into Trade Agreements with the Philippines and the Maldives for the development of trade. Sri Lanka has also entered into an agreement with the US for export of textiles for May 1980 to April 1983, as well as with Sweden covering the period August 1980 to July 1982. These impose export quota restrictions on certain categories of textiles to those countries. Textile quota agreements were also in operation wilth the EEC, Canada and Norway.

Being a member of the International Natural Rubber Agreement, Sri Lanka obtained price support for rubber at the end of 1981. Sri Lanka has been admitted to membership of the International Coffee Agreement, and the Common Fund under the auspices of the UNCTAD. The Sri Lanka - China Trade and Payments Agreement, which became operative in 1981, channels payments for imports and exports through the respective Clearing Accounts.

The balance of trade registered a deficit in 1981 with the total expenditure on imports being Rs34.6 billion (SDR 1.5 billion) and the total earnings from exports Rs19.7 billion (SDR 0.9 billion) -- resulting in a trade deficit of Rs14.8 billion (SDR 0.7 billion).

This was 9% lower than the trade deficit of Rs 16.4 billion (SDR 0.8 billion) in 1980. The insignificant increase in the volume of exports, and high import expenditure were responsible for the adverse balance of trade account.

The government has tried to promote non-traditional exports by bringing in export-oriented foreign investment and by a complex system of incentives (see Section 13.06). However, the import content of the Island's new exports often is high; in free trade zone exports, it is estimated at 60-80%.

Among non-traditional products available for export from Sri Lanka are canned fruits and fruit juices, live fish and marine products, leather and leather products, ceramic and porcelain ware, textiles and garments, precious stones and jewellery, minerals, handicrafts and coir products.

The government restricts exports of some commodities, mainly to ensure domestic supplies. A permit from the Controller of Imports and Exports, and from the relevant government institution, are required in order to export certain restricted items (see box for restricted items). Other restrictions may be imposed from time to time; they are announced in the government Gazette.

However, hardly any major controls exist on exports and moves to enhance them are unlikely. A move to restrict certain gem exports was scrapped by the State Gem Corporation.

Companies may export without letters of credit, but do require an export licence issued by any bank in Sri Lanka which has been given this authority by the Ministry of Trade. Goods sent on a consignment basis require the prior approval of the Exchange Control Department.

BOX 13.01A

Restricted Exports

Items which cannot be freely exported include:

- meat in any form
- dead fish, chilled fish or frozen fish
- crustaceans and molluscs
- vegetables in any form
- wheat flour and rice
- betel leaves
- animal feeds
- minerals and mineral products
- metal ores
- pharmaceuticals
- hides and skins of animals, raw or processed
- timber - i.e. wood and articles of wood
- metal and metal screap
- waste paper and paper board
- ivory and ivory products
- bone and bone products
- passenger motor vehicles registred in Sri Lanka prior to 1st January 1945.

13.02 Import Controls

Few controls on imports now exist, in sharp contrast to the past. Under previous governments, Sri Lanka had a quota system that limited an importers' total imports to the highest level in certain previous years. In addition, actual users needed to apply for special import licenses. The licenses were difficult to obtain and involved a tangle of red tape. The tight import controls virtually prohibited import of most goods, except for staples such as food and oil.

Foreign exchange is now not limited to certain categories of imports, and very few items are banned from import, although certain items are subject to licence control. The State Trading Corporation is expected to adopt commercially viable policies and compete with the private sector -- a change from its previous monopoly situation.

The trade deficit may force reconsideration of the liberal import policy during the next five years. At present, the government believes controls are not necessary since "avoidable" or discretionary imports constitute only a small portion of total imported goods. The main imported items are fuel, machinery, and food.

Banks have been requested to give priority to financing capital goods, raw materials, and essential consumer items. With the introduction of the new turnover tax on imports, customs duty on machinery and raw materials used in industries have been reduced from 12-1/2% to 5%. If an imported item is used in the manufacture of goods in Sri Lanka, the turnover tax on that item will be deducted from the turnover tax payable by the manufacturer. The Investment Promotion Zone provides incentives that allow a manufacturer to import whatever he requires as raw materials, duty free.

Only a few items require prior approval and special import licences. Certain essential consumer items, such as infant milk foods also are controlled. For security reasons, arms, ammunitions, and explosives, are also subject to licence control. The import of high value consumer goods like autombiles and some agricultural goods are controlled though not prohibited.

For single shipments of capital goods of a value of over Rs. 700,000, the importer must obtain prior approval of the Local Investment Advisory Committee (if the investment is wholly local) and of the Foreign Investment Advisory Committee where foreign investment in involved.

For machinery and equipment to be imported for investment projects, a certificate from an internationally reputed firm of surveyors is required. The certificate should indicate

- o whether the machinery is new and modern (if not new the age of the machinery)
- o that the price is fair, reasonable and competitive (see section 3.02)

Petroleum is a State monopoly, and is imnported only through the State Petroleum Corporation. No other products are channelized through state trading corporations. However, in order to safeguard the interest of the consumer, certain essential consumer items such as chillies, onions and potatoes were imported in restricted quantities by state organizations to overcome temporary shortages.

13.03 Tariffs and Import Taxes

Those items which are now controlled (although not prohibited) are mostly high-value consumer goods, such as automobiles and some agricultural goods, mainly to protect local farmers. Customs duties on many products are high. The government uses import tariffs both as a revenue measure -- import duties are one of the major sources of government income -- and to discourage unwanted luxury imports.

Import duties range from 5% to 500% on essential to luxury goods respectively.

The turnover tax, imposed on most imports, is in addition to the present customs duty. However, if the imported item is used in the manufacture of goods in Sri Lanka, the turnover tax paid on the imported item is deducted from the turnover tax payable by the manufacturer. All imports of manufactured goods are subject to this tax. Imported goods or materials which are used in the production of commodities for export are exempt from the turnover tax. Three different rates of turnover tax are levied i.e. 2%, 5% and 10%.

The 2% rate applies to the following:

- agricultural imports
- building materials
- food items (other than infant milk foods which are tax free)
- fishing boats and fishing nets
- handloom and pure cotton textiles
- petroelum and petroleum products
- pharmaceuticals (including ayurvedic preparations)
- other manufactured items which are now subject to turnover tax at 1%.

Many items belong to the 5% category, and only a few items come under the 10% category.

The Brussels Tariff Nomenclature is used. Both ad valorem sales and specific taxes are used based on quantity and volume. Live animals, animal products of the milling industry, pharmaceutical products, fertilizr and base metals are taxed on weight in kilogrammes. Units of quantity which determine duty rates on photographic and cinematographic goods are 'dozen' metre and kilogrammes. Beverages, spirits and vinegar are measured in terms of litre, liquid litre and proof litre.

Import duties on tobacco, liquor and electric kettles which are of a non-essential nature have been revised since the Budget proposals for 1981-82. So have the duties on building materials and steel products, to protect the local industry. On the other hand, duty rates on electric generators, television sets and photographic equipment were reduced.

A duty-free shopping centre for both nationals and non-nationals is widely patronised. There is no limit on the value of goods purchased by visiting foreigners, but one exists for resident expatriates. Sri Lankans who have returned to the country to reside also have restrictions on the value of duty-free purchases.

No changes are envisaged in current tariff rates. Budget proposals for 1982-83 are likely to be presented in the first half of 1983. The Controller of Imports and Exports notifies banks and the Ministry of Trade and Shipping of any changes in duty rates, tariffs etc.

13.04 Nontariff Barriers

No major non-tariff barriers exist, and the procedure for import is quite straight forward.

The Principal Collector of Customs does not accept invoices as supporting documents unless details are provided to ensure correct tariff classification and positive identification of goods of valuation purposes. The following information must be included:

* brand marks e.g. make, model etc.
* fabrics - the composition of fibre, and proportion of each by weight, and whether fabric is dyed, printed or coated mst be specified. The width of the fabric must be stated and for synthetic fibres it must be stated whether the fibres are continuous or discontinuous.
* vehicle engines - make, model, whether new or second hand, reconditioned etc.
* chemicals - names of chemical compounds or element in respect of certain chemicals
* price - whether price is CIF or FOB etc

* discount - type and amount of given discount
* packing - packing details must be given unless provided for in a separate packing list
* The Customs Co-operative Council's Tariff nomenclature number must be supplied if known.

Some protection is provided to local firms. Lakehouse, Independent Newspapers Ltd, Express Newspapers Ltd and the Upali Group which publish leading newspapers are entitled to a special discount on newsprint. It is also widely accepted that the national carrier Air Lanka, is entitled to more privileges than other air lines operating in the island.

13.05 Free Ports, Zones

The country has one Export Processing Zone at Katunayake, with another planned for Biyagama.

The Greater Colombo Economic Commission (GCEC) Law was enacted in order to provide for the institutional.machinery for the development of Investment Trade Zones in Sri Lanka. Under this law, a zone equivalent to 200 square miles is demarcated as GCEC area, and the GCEC will have very wide powers over this area.

Within the Greater Colombo Economic Commission Area, there will be demarcated several Investment Promotion Zones. The first is at Katunayke, adjacent to Sri Lanka International Airport. The government encourages the establishment of export-oriented industries and of essential investment and export services, e.g. international banks, insurance companies, freight forwarding firms, warehousing, etc. in the Investment Promotion Zone.

The Greater Colombo Economic Commission Law provides for two types of enterprises which are eligible for special treatment under the law, namely "Area enterprises" and "Licensed enterprises". An "Area enterprise" is an enterprise with which the Commission has entered into an agreement and which carries on business or is proposing to carry on business within its area of authority, namely, the Greater Colombo Economic Commission Area. A "Licensed enterprise" is an enterprise with which the Commission has entered into an agreement and which carries on a proposes to carry on any business outside the area of authority. Hence, the law is sufficiently flexible as to extend the special treatment which is to be provided to enterprises located in the Greater Colombo Economic Commission Area also to enterprises located outside the area.

In fact, the GCEC is currently seeking even further powers -- to allow it to engage in business itself, that it be allowed to subscribe to equity, and to provide for Government underwriting of the loans that the GCEC proposed to raise in Sri Lanka or abroad.

The investment promotion zone (IPZ) at Katunayake will remain an important area for companies seeking to invest in Sri Lanka. The zone authority -- the Greater Colombo Economic Commission (GCEC) cuts through much of the red tape that affects the rest of the country. The GCEC has wide-ranging powers and is a "one-stop shop" for investors.

The zone will stay a privileged area even though the country's economic troubles will affect it as well as all other areas. Improved infrastructural facilities for the zone are scheduled for completion shortly. Once these are in place, the zone will have significant advantages over the rest of the country, which can expect trouble with power shortages and transportation for some years yet.

The second zone -- planned at Biyagama, 14 km from Colombo -- will come in during the next five years. The infrastructural arrangements for Phase II at Biyagama, however, may take longer than was first projected because of the country's current economic constraints. The zone is expected to have an area of 450 acres and cost the country Rs500 million to develop. This zone will primarily be for heavy industry, particularly those with a heavier water consumption than those at Katunayake.

The GCEC plans that by 1983 the Katunayake zone will provide 50,000 jobs to Sri Lankans. This is probably optimistic, but, by end-1982, about 23,000 people worked in the zone.

The incentives for investing in the zone are:

* no limits on foreign equity holdings;

* free transfer of shares to Sri Lankans or foreigners and no tax or exchange controls on such transfers;

* dividends of nonresident shareholders exempt from taxes and remittances of such dividends exempt from exchange control;

* no import duty on machinery, equipment, construction materials, and raw materials used in the zone and such imports are exempt from normal import control and exchange control procedures; and

* transfer of capital and proceeds of liquidation exempt from exchange control.

The GCEC will extend tax holidays of between two and 10 years based on employment levels, net foreign exchange earnings, introduction of new technology, and substantial exports to new markets. During the tax-holiday period, foreign personnel are exempt from income tax, companies are free from royalty taxes, and dividends to resident and nonresident shareholders are not taxable. After the tax holiday, the project is eligible for concessionary taxes for another 15 years before the normal taxes apply. Double taxation relief agreements with various countries have been concluded so that these benefits are not offset in the investor's home country.

Export-oriented and import substitution industries are also entitled to a five-year tax holiday, even though situated outside the zone. The other tax concessions -- except for the tax-free dividends -- are not usually given outside the zone, although exceptions may be made on a case-by-case basis.

The zone has drawn considerable interest, and, as of November 1982, 88 foreign investors have entered into agreements to invest in the free trade zone; 51 factories were in production and another 16 under construction. Of these, 25 manufactured garments or hosiery. In the first nine months of 1982, the zone exported Rs1.3 billion worth of goods, out of which the domestic value added, according to the GCEC, was about 20-25%. The industries represented are diverse, but textiles and garments account for much of the export volume.

Among the ventures concluded in 1980:

* Sentosa Development Co, from Singapore -- will build expatriate housing for the IPZ valued at Rs195 million. Construction has already started on the estate "Singapore Gardens".

* El Steel, a Swiss company, will make steel enclosures for switchboards. The investment is worth Rs12 million.

* Multistretch Ltd, a joint venture between Commerce and Industry Suppliers (Hong Kong) and Lankem Ceylon Ltd, will make rubber latex thread. The investment is worth Rs36 million.

* Martin Emprex (Ceylon) Ltd, a garment project partly owned by Albert Martin Holdings of the UK, will make light clothing, nightclothes, and underwear. The investment is worth Rs24.9 million.

More recently, the product mix seems to be changing. Harris Semiconductors signed on in February 1982, with a US$19 million integrated circuit plant. Other recent projects:

* Lanka Dainichi Co. Ltd is a collaboration between Onishi & Co, and Dainichi Seitosho of Japan, and a Sri Lankan investor, to manufacture china clay figurines for export to the US, Europe, and Australia. The project, with an investment of Rs14 million, is expected to employ 350 people.

* Lanka Hiqu Ltd. is an investment by Woelke Top Heads GmbH of W. Germany to make magnetic electronic heads for export to Germany and Singapore. These magnetic heads are used in computers, cameras, recorders, and audio-visual equipment.

* Inter-Fashion Co. Ltd is a garment project, but it will specialise in high quality winter wear for export to Germany. It is an investment by Adler-Bekleidungswerke GmbH, and the Deutsche Entwicklungs Gesellschaft -- founded by the W. German government to

promote economic collaboration with developing countries.

* Orient Silver Co, a collaboration between the Finnish firms Timanttiala-Oy-Gem Diamonds Ltd, Joen Kulta Kultasilta Oy, and the Sri Lanka C.W. Mackie is to produce silver handicrafts for Scandinavian and US markets. It is partly financed by the Finnish Fund for Industrial Development Corp.

BOX 13.05A

Details of the Katunayake Investment Promotion Zone

Located near Colombo, the zone comes under the authority of the Greater Colombo Economic Commission. It is targeted at foreign companies in any industry. By November 1982, 51 factories were in production and another 16 under construction.
Special infrastructural facilities include:

Power: Mahaweli hydroelectric scheme to provide power -- 230/400 volts, 50 cycles AC. Special grid subsystem to supply power.

Water: Planned pipeline to supply 125,000 gallons per day.

Transport: Close to Colombo Port (40 min. by road). Air transport to be developed at Katunayake International Airport, next to the zone.

Communications: Sophisticated telecommunications system will be installed. International direct dialing exists. Postal system adequate.

Housing: Special Katunayake-Seeduwa new township under development. Will provide housing, medical, and extensive recreational facilities. Special expatriate housing under construction.

Premises: Land cost is Rs600,000 per acre, with a 99-year lease. Ground rent is Rs25,000 per acre p.a. Companies erect their own buildings. Construction costs are approximately US$120 per sq meter.

Financial: The zone has a large number of foreign banks. Offshore banking facilities are available to nonresidents and GCEC enterprises.

Labor: Freely available and well-educated, low-cost labor available. In-house training may be required for skilled labor. High literacy rate (85%) gives unusually high trainability. Minimum wage is Rs20-25 per day.

Red tape: The zone is unusually free of red tape for a developing country. All required processing is organized at the GCEC, which will even assist investors in arranging for visas.

Industries in the zone: Electronic products including semiconductor devices, electronic components, and magnetic heads; domestic electrical appliances; high-voltage electrical control panels and switchgear; engineering items such as drop-forged hand tools; footwear; fishing gear; irrigation pumps; rubber products including solid industrial tires, hot water bottles, and latex thread; lapidaries and jewelry manufacture; tropical plants; sportswear; china figurines; and ski jackets.

Address: The Investment Promotion Division, Greater Colombo Economic Commission, P.O. Box 1768, Colombo, Sri Lanka.

13.06 Export Incentives

Export incentives are important to Sri Lanka's policy, and will continue, or even improve, if the trade deficit worsens. Substantial export incentives are given, and these can be critical to companies. For one garment manufacturer, it made the difference betwee profit and loss.

Besides the existing schemes (detailed later in this section) certain additional benefits are being considered:

* a proposal (by the EDB to the government) for a compensatory grant to exporters on the basis of past performance in exports
* an special export incentive package covering agro-based industries, in addition to manufacturing industries.
* a refund of Business Turnover Tax on imports used for export production -- along the lines of the duty rebate. The Department of Inland Revenue does not favor this proposal.

Incentives currently being given include:

Customs duty rebate scheme: This provides for the refund of import duties paid on raw materials and components used in production for export. The refunds payable on specified products are gazetted as a percentage of the f.o.b. price of each product, and can be recovered from the exporter's commercial bank on after the export proceeds are realized.

Instead of actually paying the duties on imported goods to be used for export, firms can arrange for their commercial bank to issue bank guarantees to the Customs Department. This cuts down on working capital requirements.

Guarantees by the Sri Lanka Export Credit Insurance Corporation (SLECIC: SLECIC issues guarantees against payment defaults to commercial banks, for export finance facilities given by by the banks to exporters. This is to decrease the risk to commercial banks, enabling them to be more liberal in the grant of such facilities. Such guarantees make it possible for the Sri Lanka exporter to grant limited credit terms to the buyer abroad, where this is essential to the conclusion of an export transaction.

Bank guarantees for gems: A special bank Guarantee Scheme has been designed to promote the gem export trade in Sri Lanka. Is is intended to encourage commercial banks to finance the purchase of gems at the auctions conducted by the Ceylon Chamber of Commerce, and their export. SLECIC gives concessional terms to banks for these purposes.

Export villages: SLECIC operates an incentive Bank Guarantee Scheme for the benefit of exporters and producers that come under the aegis of a Model Export Village Programme launched by the Sri Lanka Export Development Board.

The Sri Lanka Export Development Board (EDB) offers exporters the following incentives:

Finance on concessional terms for export-oriented investment: The Central Bank provides concessional finance for export-oriented investments, through the commercial banks in Sri Lanka. The basic objective of the scheme is to expand production for export in selected primary commodities, processed products and manufactures. An export-oriented activity for assistance under the scheme is defined as an agricultural activity, or industrial activity engaged in the cultivation, manufacture, processing or preserving of goods primarily intended for export.

The maximum term loan obtainable under the scheme for investment is Rs30 million. The rate of interest is 13%, which compares favorably to the present commercial rate of 24% to 28%. The repayment of the loan will be in 3 to 15 years in quarterly or half-yearly instalments, in relation to the projected cash flow. However, a three year grace period is allowed depending on the project.

In addition, the permanent working capital requirements of new projects up to the break-even point are available at 13% interest. The remaining working capital requirements are available under a separate facility through all commercial banks at 16% interest.

Annual Presidential export awards: These awards are made for the most creditable export performances in each year, judged on the basis of criteria established by a Committee appointed by the EDB and the Ceylon Chamber of Commerce, and headed by a retired judge of the Supreme Court. Each award carries a cash prize of Rs 100,000.

Export expansion grants: These grants are made to exporters on the basis of the increased export earnings in each specified product in a calendar year, compared against average export earnings in the three previous years. The amount of the grant is calculated as a percentage of the increment to export earnings, and varies according to the net foreign exchange earning capacity of the products grouped in the following categories:

Net foreign exchange earning on f.o.b. value	Export expansion
i) less than 30%	5% of increment
ii) 30%-60%	10% of increment
iii) over 60%	15% of increment

The gems and jewelry import scheme permits a jewelry exporter to import gems and jewelry up to 15% of the value of the exports. The EDB also helps provide training facilities, technical assistance for design improvements, casting machinery, and funds to enable exporters to participate in trade fairs.

Reduction of export duty on processed tea: The processing of tea into tea packets and tea bags is encouraged by the reduced export duty on tea in processed form. While the export duty on bulk tea is Rs10.50 per kilogram, tea in packets and bags are charged at Rs8 and Re1 per kilogram respectively.

White coir fibre program: This is aimed at increasing production of white coir fiber by 500%, increasing export earnings from Rs5 million to Rs300 million, and providing new employment opportunities for 30,000 people by 1985. The EDB helps to finance R&D and provides loans and training schemes.

The manufacture of white coir fibre products for exports has been constrained due to inadequate supplies of white fibre yarn. Mechanical precrushing (which reduces the retting time) has been introduced, and work is under way to set up two more pilot projects for the mechanical production of white fibre.

Rubber and rubber products: The EDB gives high priority to the manufacture of finished rubber products, particularly based on latex, for export. It gives incentives on the basis of cost of production and the net foreign exchange gains. A series of measures have been adopted to bring about product adaptation and new export marketing approaches. Action has been taken to encourage the production of sole crepe, liberalize the export of sheet rubber, and to present the sheet rubber in new forms such as pressed bales.

Handloom products: Together with the assistance of the Commonwealth Secretariat the EDB has initiated a comprehensive programme for product design and market development to give an export orientation to the handloom industry. A few looms and ancillary equipment imported from India serve as prototypes to manufacture similar looms in Sri Lanka. Quality control is an important consideration, and as such, training programmes have been conducted.

13.07 Export Insurance

The Sri Lanka Export Credit and Insurance Corporation covers exporters against various risks. Two major ways in which it does this are: by issuing guarantees to commercial banks, to encourage them to extend credit for exports; and by issuing insurance policies to exporters against losses resulting from both commercial and non-commercial (political) risks on foreign credit sales.

The Export Payments Insurance Scheme has worked quite well; its initial impact was to reduce dependence on Letters of Credit, which had tended to restrict import sales.

SLECIC will insure the exporter against the following:

* commercial risks --
  -- Insolvency of the buyer
  -- Protracted default of the buyer
  -- Non-acceptance of goods after shipmenbt

* non-commercial or political risks --
  -- War, civil commotion or other disturbances in the buyer's country
  -- A general moratorium on external debts decreed by the government of the buyer's country
  -- Exchange and/or import control restrictions imposed in the buyer's country after the goods have been shipped
  -- Delay in transfer of payments from the buyer's country to Sri Lanka
  -- Diversion of voyage
  -- Any other cause of loss, not normally insured by the general insurers (i.e. Insurance Corporation of Sri Lanka, National Insurance Corporation of Sri Lanka) and beyond the control of both the exporter and the buyer.

SLECIC will not cover losses arising from disputes started by the buyer regarding the supply (e.g. quality, packing etc.), unless the exporter gets a court decree in his favor. Neither does it cover losses from causes inherent in the nature of the goods, defaults by the exporter's agent or the collecting bank, or exchange rate fluctuations.

The SLECIC's insurance scheme operates on the underwriting principle of whole turnover or comprehensive cover. Credit terms have to be offered for cover under the Export Payments Insurance Policy. All shipments on D/P (Documents against Payments) and D/A (Documents against Acceptance) terms have to be insured with SLECIC irrespective of the buyer, the commodity or the country of destinatioin.

The premium payable under the policy, determined on the 'no profit - no loss' principle, varies according to the terms of payment and the length of credit extended. The premium rate structure of SLECIC is heavily weighted in favor of the Sri Lankan exporter. The reason is that while the bulk of the country's exports on credit terms goes to first class destinations, a substantial portion of this trade takes place on D/P sight terms. The average premium rate is well below 0.5% and compares favorably with the pemium charges in other countries.

The application procedure is as follows:

* The exporter submits proposal form (Form No. 401 which is available at commercial banks and SLECIC) to SLECIC
* If SLECIC accepts, it issues an Acceptance Letter
* SLECIC issues policy form (Form No. 404) after the exporter confirms acceptance of the terms of cover and the premium rates
* The exporter pays a policy fee by exporters. This varies from Rs 50 to Rs 500 depending on the maximum liability limit

<u>Pre-shipment Credit Guarantee Scheme</u>: These guarantees protect commercial banks who grant pre-shipment credit to exporters from any loss due to default by the exporter. The amount of loss so guaranteed is 66 2/3%. For advances given to exporters againstletters of credit or confirmed export credits, SLECIC prescribes no margin requirements, and will guarantee 100% of the value.

Application for the Pre-shipment Credit Guarantee Scheme can be made through bankers who would apply to SLECIC for guarantee in respect of advances.

13.08 Export Credit

Exports are financed by commercial banks which are re-financed by the Central Bank at 16%. In order to improve short term credit terms for export purposes, an interest rate subsidy on working capital requirements has been approved by the government. (see section 11.02 and 11.03)

14.00 QUALITY OF INFRASTRUCTURE

Companies operating in Sri Lanka face a variety of infrastructural problems, and, despite the government's efforts, these will continue to be a constraint on industry through the forecast period. Sri Lanka's port facilities are also inadequate, and its transport system is antiquated, which could cause difficulties for companies trying to export from Sri Lanka. The export processing zone receives preferential treatment, and in this area the infrastructure will be adequate to highly satisfactory within the next two or three years.

14.01 Power

Sri Lanka depends on hydroelectricity for much of its power, which means that it is highly vulnerable to the droughts that recur every few years. It is likely to remain so at least until 1984 -- and quite possibly even longer. At present, seven hydropower stations -- with a total capacity of 329 Mw, together with thermal power generation of another 114 Mw -- supply the country's needs. Since the reservoirs are dependent on the monsoon, and Sri Lanka is not large enough to spread the risk of a failure of the rains, drought has a disastrous effect on power generation. In 1981, for instance, drought brought five-hour power cuts to Colombo.

Sri Lanka's ambitious development plans have increased the demand for electricity; it is now growing at 11-14% per year, as against 6% before 1977. The demand could rise as high as 17% per year to 1985 if the economy grows rapidly. Additional thermal generating stations are being installed as a backup.

The Victoria component of the Mahaweli scheme, planned to come onstream by 1984 (135-210 Mw) may ease the situation, but delays are now likely because of the difficult economic situation. Until the the Victoria plant is operational, power shortages will continue. Meanwhile, two smaller hydroelectric projects (Bowatenna, 20-40 Mw and Canyon, 50-60 Mw), are planned for 1981 and 1982, and two thermal projects to generate 120 Mw from gas turbines are also planned for the same period. Beyond that, the Kotmale (150-180 Mw) and Randenigala (100-122 Mw) segments of the Mahaweli project are planned for 1985 and 1986.

Some experts have predicted that Sri Lanka will need 1,500-2,000 Mw of thermal generation capacity by the year 2000, in addition to the Mahaweli scheme. Even though thermal generation is cost inefficient for Sri Lanka due to high running costs, the government must still rely upon it for the added power.

The FTZ power supply will be from diesel-based generators, installed by private investors. The FTZ's at Katunayake and Biyagama can expect an adequate power supply even when the rest of Colombo has power cuts.

14.03 Ports

Colombo is well situated at the junction of major trade routes and is a major port. Other ports are Galle, Jaffna, and Trincomalee. The government is trying to modernize the port at Colombo with Japanese assistance, and substantial improvements in efficiency have already been made. Partly because of a new container terminal, cargo transshipments increased 340% between 1979 and 1980.

14.04 Airports

The government is in the process of expanding its Katunayake International Airport, in a project that will cost Rs1.5 million. It involves upgrading services in the terminal building, constructing cargo buildings, engineering workshops, and warehouses for ground handling operations, and refurbishing the airfield's lighting system.

14.05 Roads

Sri Lanka has 80,800 km of roads, of which half are surfaced. The rest are bridle paths and dirt roads. Although the network of roads is sufficient, road conditions are poor. Inadequate maintenance in the past has left the government with a need for massive rehabilitation on roads and bridges. The government has substantially increased capital expenditure for this purpose, but the investment in regular maintenance is still too low and falling in real terms -- which will mean that a similar rehabilitation burden could develop again.

Public transport services are to be streamlined -- and one of the ploys used has been to open them to competition from the private sector.

Railways: Railway freight charges, which were raised 200% in July 1979, have made road freight competitive; freight hauled actually declined 40% (in ton-kilometers) in 1980.

Rail transport is not ideal for Sri Lanka; the country is small and the population concentrated, so the average haul is only 100-110 miles for freight. Steep gradients and sharp curves slow operations. Nevertheless, the government is planning to invest Rs1.5 billion in 1981-85, mainly in tracks and wagons, so as to improve railway efficiency.

The suburban railway system is quite important for commuters in Colombo, and it carries 16-20% of the commuting load. This could increase as Colombo expands; the congested roads cannot cope with the additional traffic. The government is considering an electrification project for the suburban railway. However, given the economic situation, this investment will probably be postponed, and it is unlikely to be attempted for some years.

Telecommunications in Sri Lanka are problematic. As of 1980, excess demand for telephones was estimated at 50% over supply. Extensive modernization is under way: the government plans to invest Rs2.1 billion in the mails and telecommunications in 1981-85.

A modern electronic telephone exchange, commissioned in October 1981, should help solve the problems. A digital electronic exchange with a capacity of 28,000 lines has been installed at the Colombo Central Exchange at a cost of Rs140 million. The government also plans on installing new telex lines, expanded satellite links, and a US$80 million rural telephone service.

The media are mostly government-run. The two major newspapers were both nationalized -- under different regimes. Radio, the most far-reaching medium, is also government owned. In October 1981, the Upali group of companies (which is the largest local business -- almost wholly owned by Upali Wijewardene, who is also the Director General of the GCEC) started a weekly called The Island. Wijewardene plans to follow this with daily newspapers in English and Sinhala. The publications' mission is to provide an "alternate voice" -- but some say Wijewardene will use it as a vehicle for his political ambitions.