

# Tax Administration

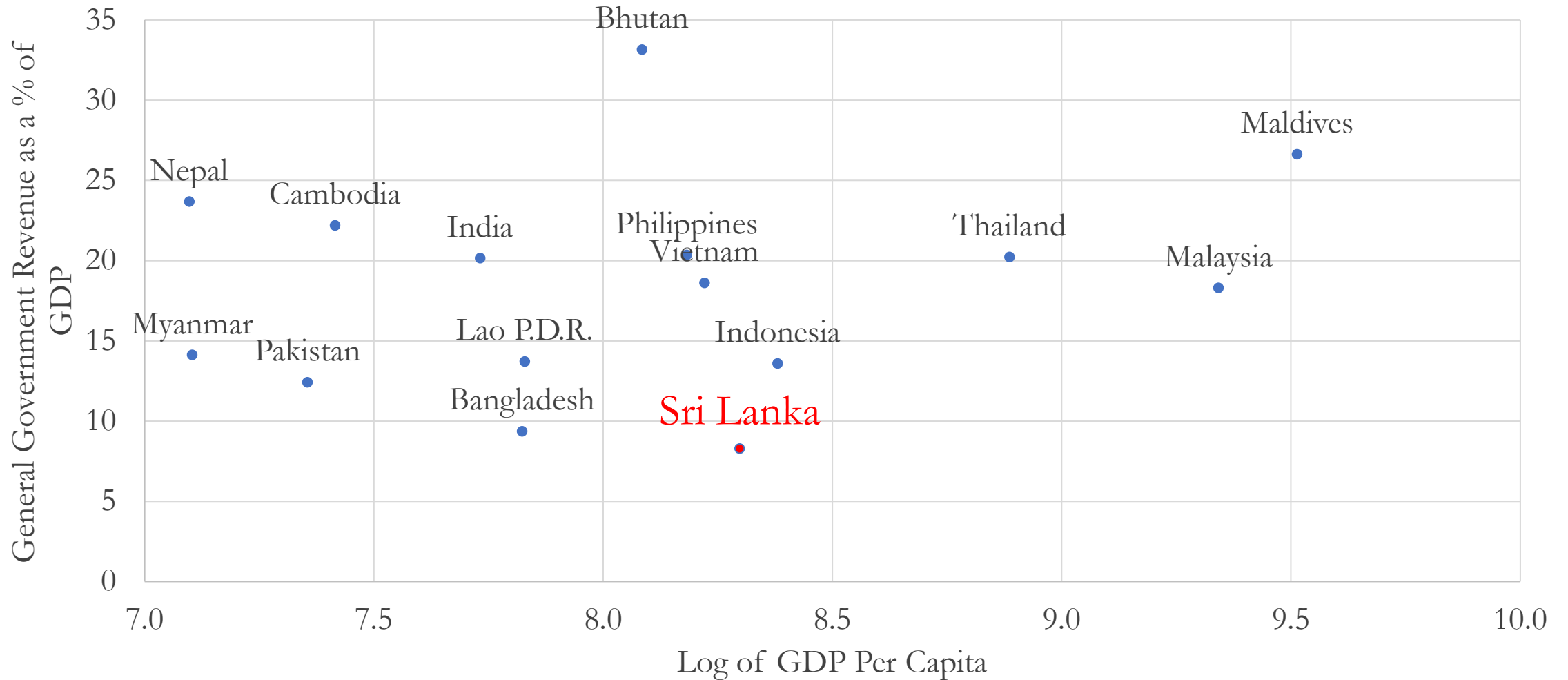
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# **Outline**

- 1. Trends in Government Revenue**
- 2. Economic Crisis, Tax Administration and Tax reforms**
- 3. Implications of reforms**

# Trends in Government Revenue

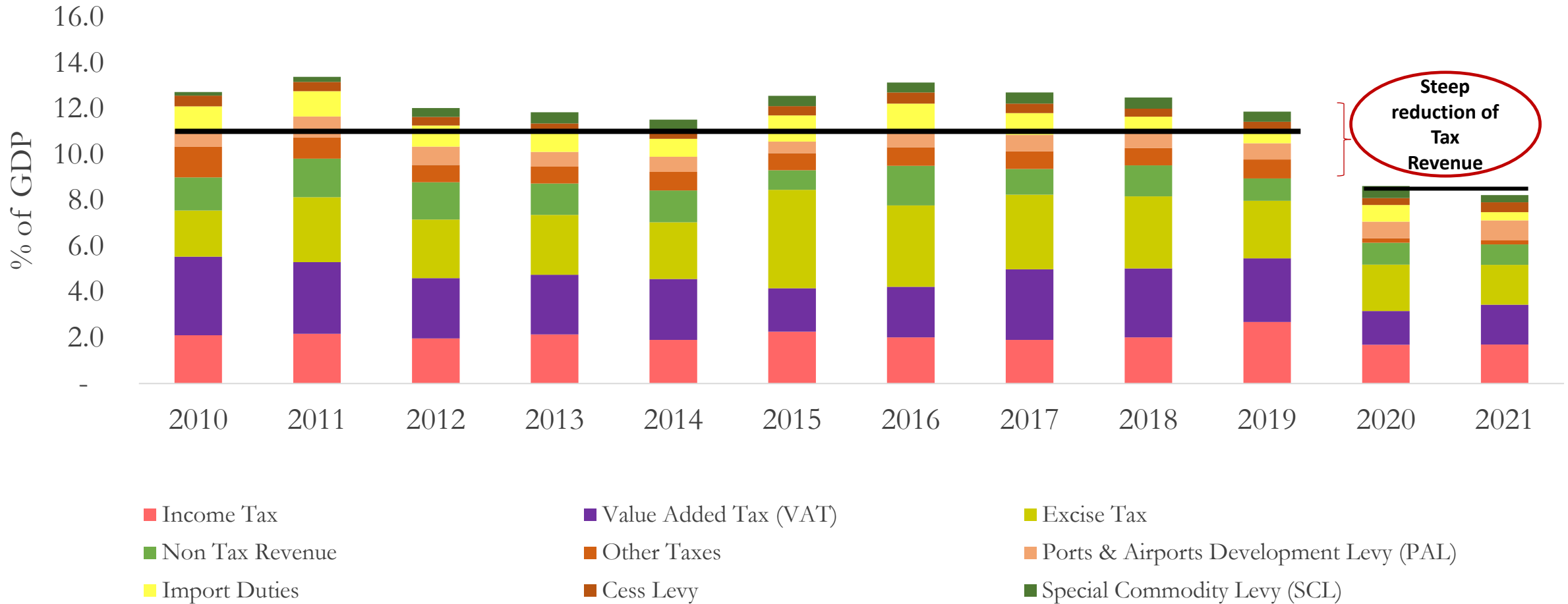
# Government Revenue/GDP vs Per capita Income (2021)



Data drawn from World Economic Outlook (October, 2022)

Department of Fiscal Policy

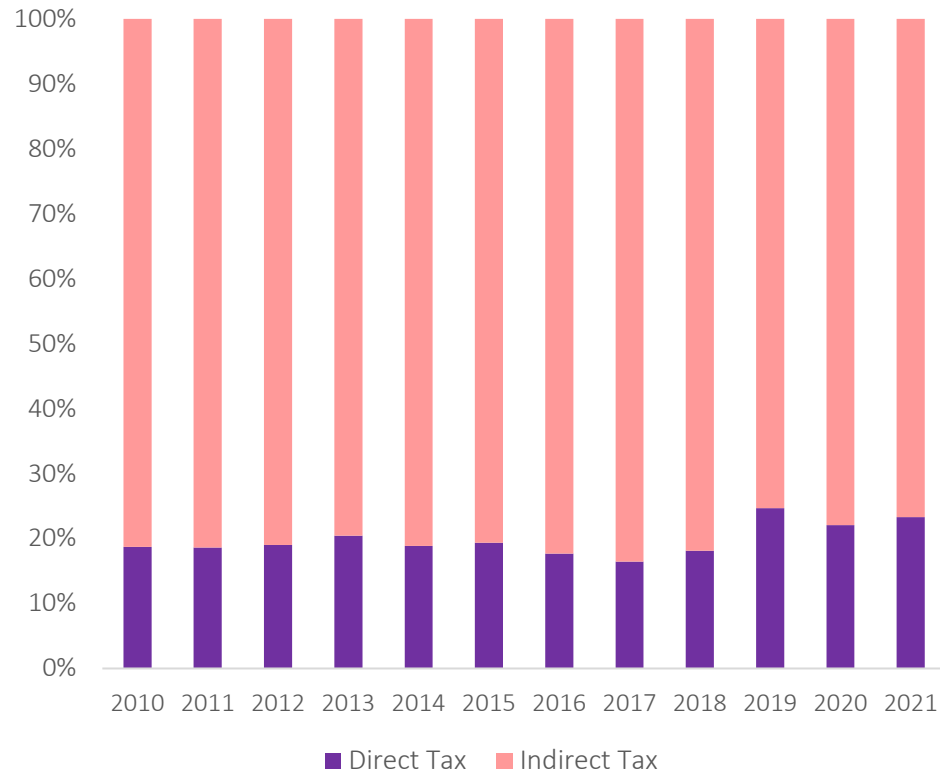
# Change of revenue composition since 2019



Source: Department of Fiscal Policy

# Direct tax to indirect tax remains intact over the years: More tax burden to the poor

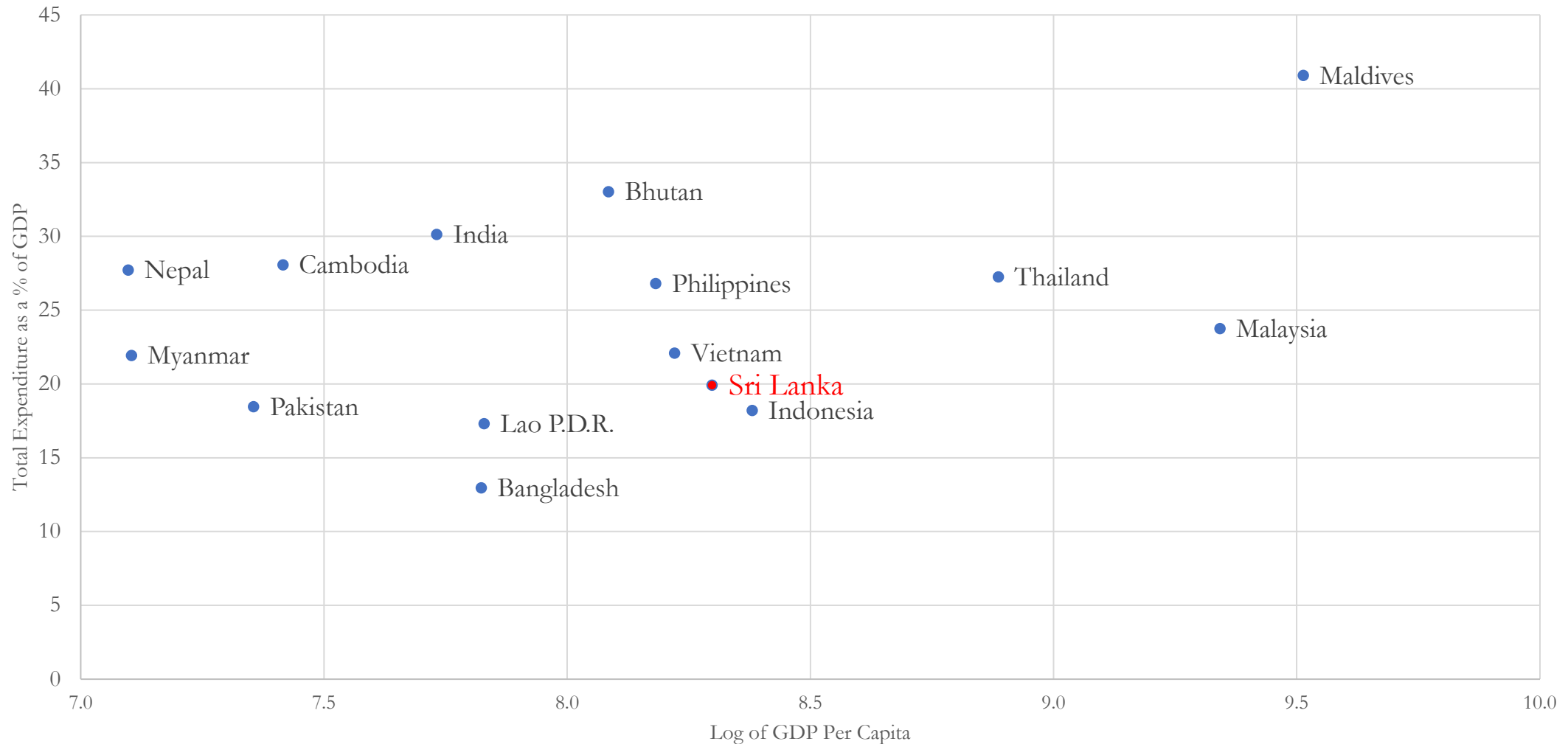
Direct tax and indirect tax ratio



Source: World Bank Revenue Dashboard

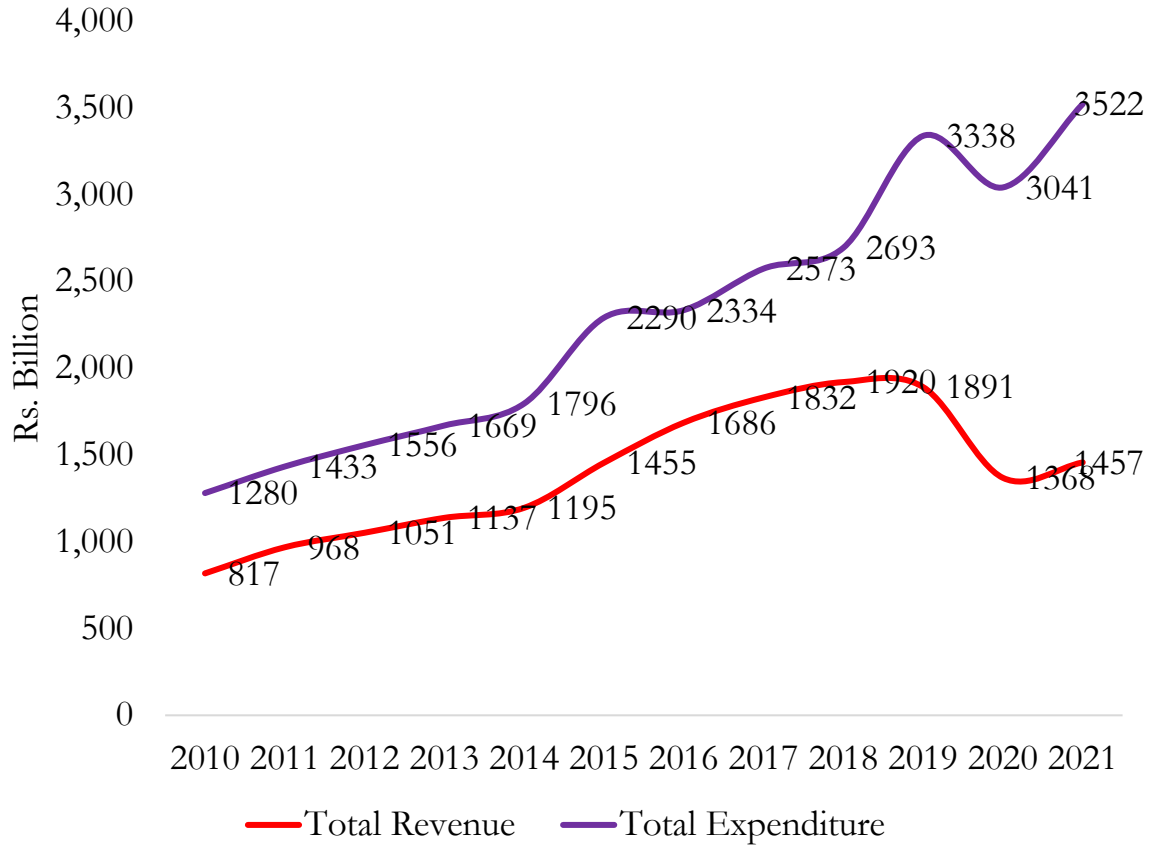
| Direct: Indirect Tax Ratio |                                 |                                    |                                  |                  |
|----------------------------|---------------------------------|------------------------------------|----------------------------------|------------------|
| Country                    | Total Tax Revenue as a % of GDP | Indirect Tax Revenue as a % of GDP | Direct Tax Revenue as a % of GDP | Direct: Indirect |
| <b>South Asian Region</b>  |                                 |                                    |                                  |                  |
| India (2019)               | 16.4                            | 10.9                               | 5.5                              | 33:67            |
| Bangladesh (2020)          | 8.2                             | 5.2                                | 3                                | 37:63            |
| Bhutan (2020)              | 11.7                            | 3.1                                | 8.6                              | 74:26            |
| Nepal (2021)               | 23.4                            | 16.1                               | 7.3                              | 31:69            |
| Pakistan (2020)            | 13.8                            | 7.1                                | 6.7                              | 49:51            |
| Sri Lanka (2021)           | 7.3                             | 5.6                                | 1.7                              | 23:77            |
| <b>Asia Pacific Region</b> |                                 |                                    |                                  |                  |
| Country                    | Total Tax Revenue as a % of GDP | Indirect Tax Revenue as a % of GDP | Direct Tax Revenue as a % of GDP | Direct: Indirect |
| Australia (2019)           | 27.6                            | 6.5                                | 21.1                             | 76:24            |
| Vietnam (2019)             | 18.4                            | 10.9                               | 7.5                              | 41:59            |
| Thailand (2020)            | 15.7                            | 8.3                                | 7.4                              | 47:53            |
| Philippines (2020)         | 14.0                            | 6.6                                | 7.4                              | 53:47            |
| New Zealand (2020)         | 33.7                            | 12.2                               | 21.5                             | 64:36            |
| Cambodia (2020)            | 18.3                            | 12.7                               | 5.6                              | 31:69            |

# General Government Total Expenditure as a % of GDP vs GDP Per Capita (2021)

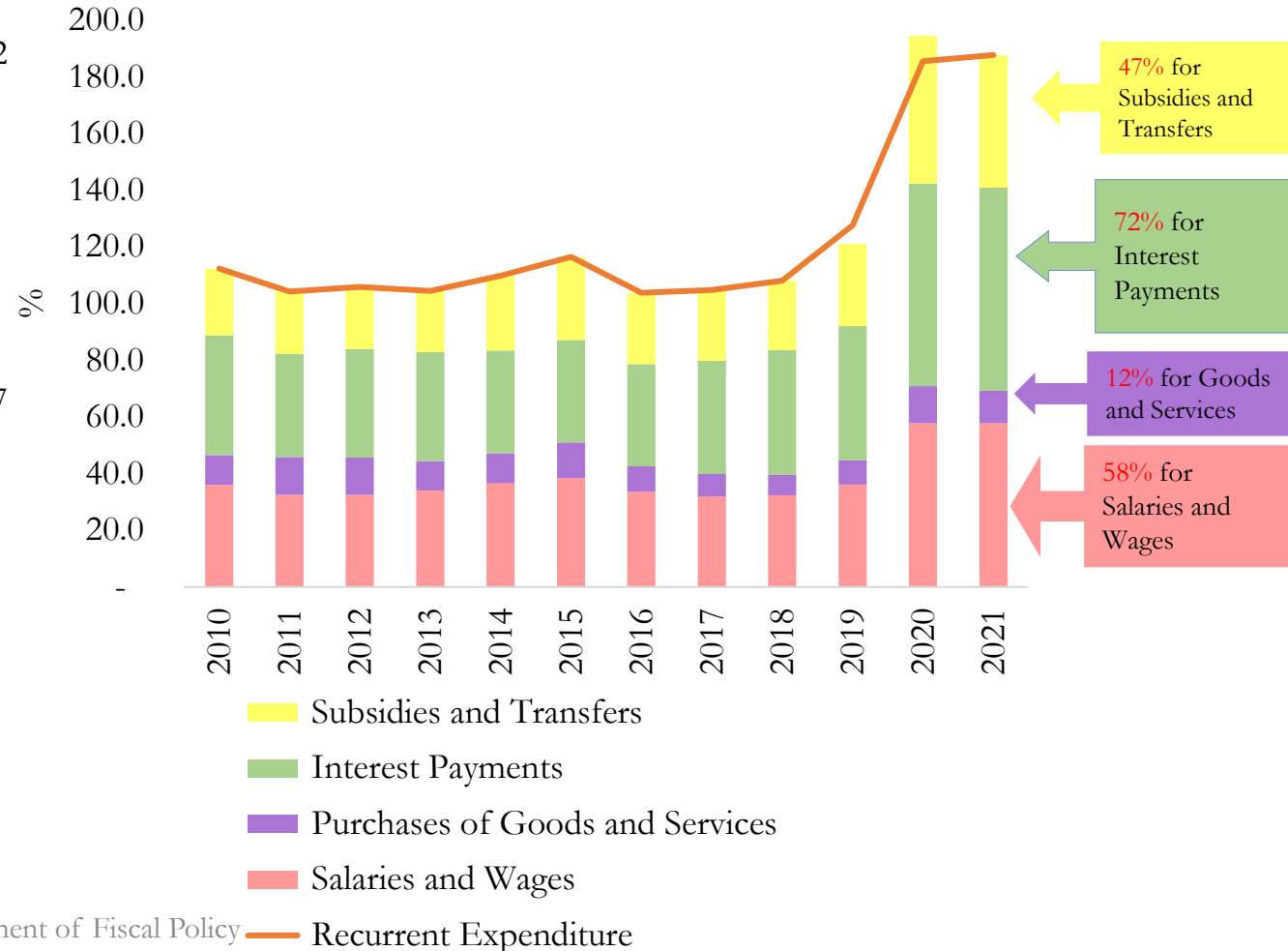


# Revenue and Expenditure Gap has widened...

## Total Revenue and Total Expenditure



## Recurrent Expenditure vs Government Revenue



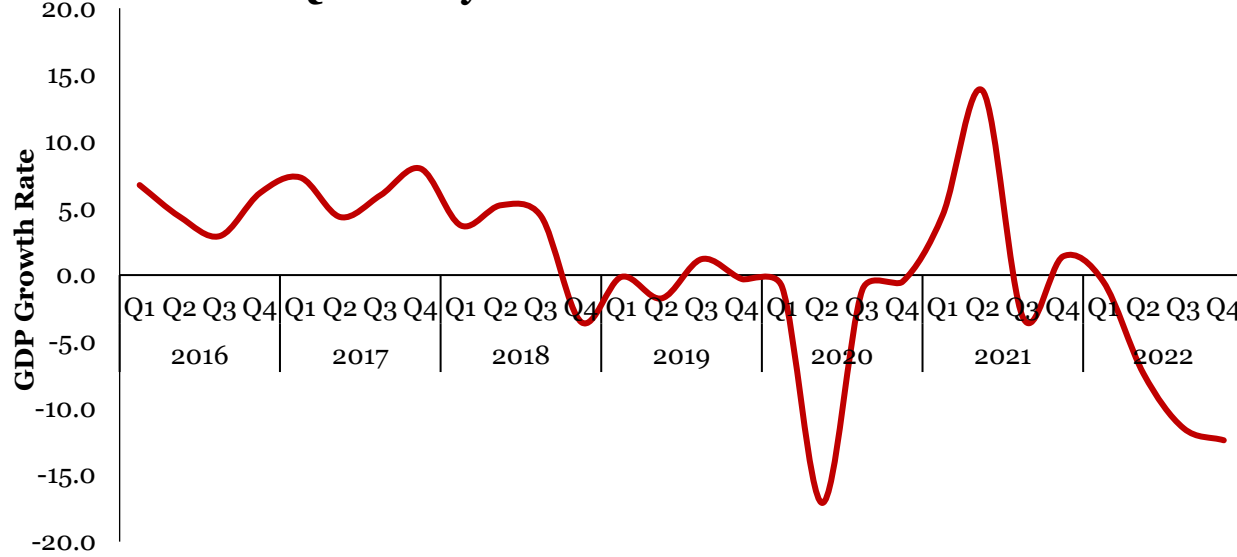
Source: Department of Fiscal Policy



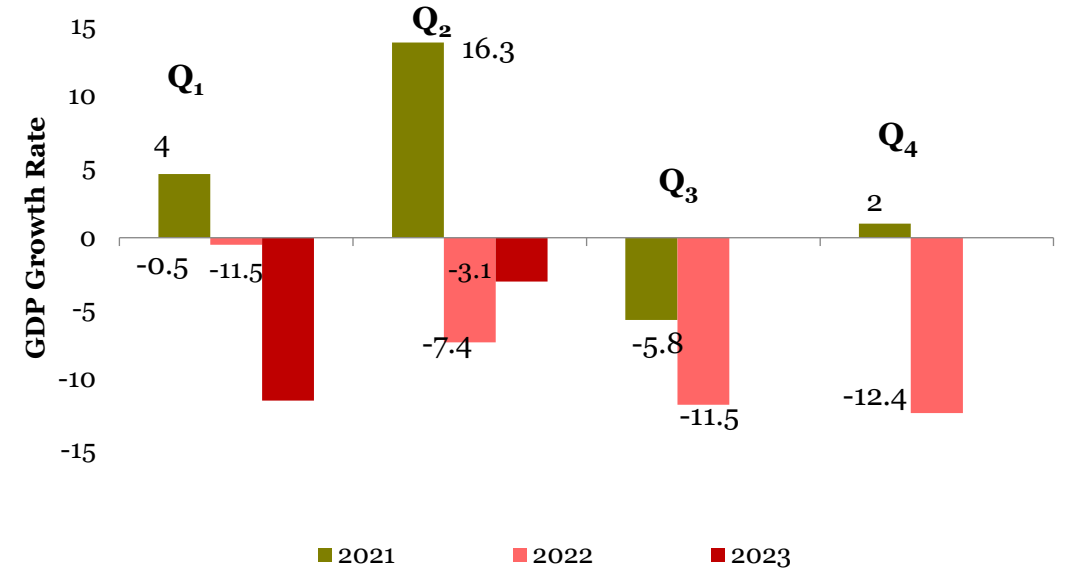
# **Economic Crisis, Tax Administration and Tax reforms**

# Sri Lanka's Economic Crisis

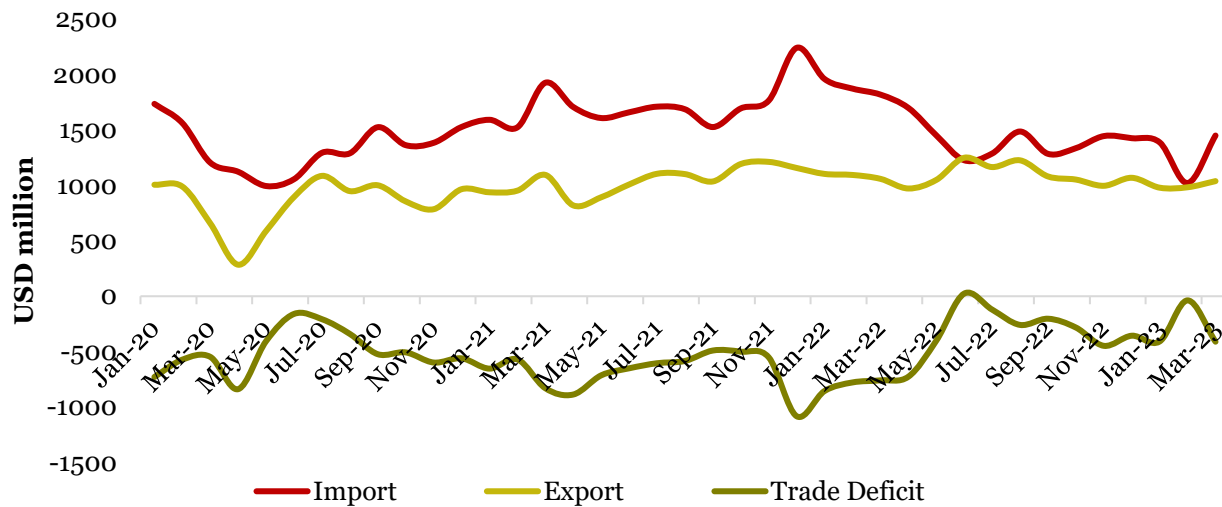
## Quarterly GDP Growth



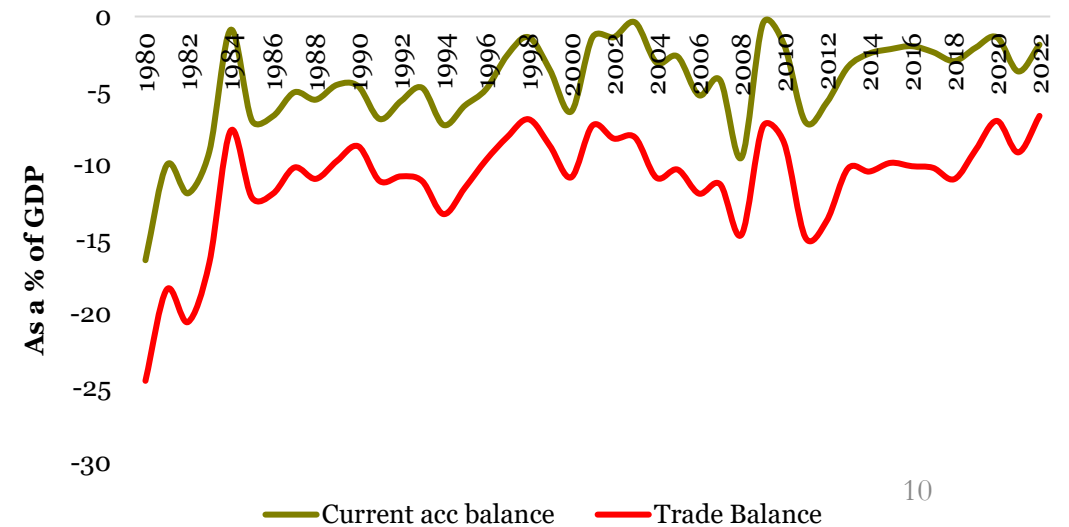
## The economy contracted steeply



## Import, Export and Trade Deficit



## Trade Balance and Current Account Balance



# Some Successful Tax Reforms in Recent Years around the World

- The international experiences on revenue enhancement measures assure the possibility of attaining sustained increases in tax revenues as a share of GDP
- Most of the countries introduced such amendments during a crisis situation
- Therefore, Sri Lanka took the crisis as an opportunity to implement much-neglected reforms.

| Country                     | Reform Year  | Result                 | Result Period |
|-----------------------------|--|------------------------|---------------|
| Bosnia and Herzegovina      | 2007-09  | 0.6%–3.3% <sup>a</sup> | 2006–2012     |
| Brazil                      | 1988   | 22%–30%                | 1990–2004     |
| Burkina Faso                | 2010   | 9.6%–15.6%             | 2002–2019     |
| Cambodia                    | 2016   | 10%–19%                | 2009–2019     |
| China, People's Republic of | 1994   | 12.6%–16.1%            | 2001–2016     |
| Colombia                    | 1992–1993, 1995  | 8.2%–15%               | 1990–2004     |
| Denmark                     | 2010   | 46.3% <sup>b</sup>     | 2019          |
| The Gambia                  | 2013   | 13.0%–17.5%            | 2010–2015     |
| Georgia                     | Phase I (2004–2007); Phase II (2007–2009); Phase III (2010–2011) | 7.62%–23.18%           | 2002–2012     |
| Hungary                     | 1988, 1991   | 25.55%–19.83%          | 1991–2010     |
|                             | 2010   | 21.07%–22.93%          | 2011–2012     |
| Indonesia                   | 1983   | 8.0%–8.9%              | 1983–1989     |

| Country            | Reform Year           | Result        | Result Period |
|--------------------|-----------------------|---------------|---------------|
| Korea, Republic of | 1950s–1980s           | 6%–20%        | 1950s–1990s   |
| Liberia            | 2003                  | 10%–20%       | 2003–2015     |
| Lithuania          | 2009                  | 28.8%–29.8%   | 2005–2009     |
| Malaysia           | 2015                  | 14.8%–12.4%   | 2007–2019     |
| Maldives           | 2010                  | 9.38%–25.20%  | 2010–2015     |
| Mauritania         | 2009                  | 11.1%–17.2%   | 2009–2014     |
| Mozambique         | 2010                  | 14.74%–27.06% | 2010–2019     |
| Nepal              | 1997–2005             | 9%–22%        | 2006–2019     |
| Paraguay           | 2004                  | 8.8%–12.8%    | 2003–2010     |
| Rwanda             | 2010–2015             | 12.90%–16.65% | 2010–2016     |
| Senegal            | 2012                  | 18.0%–20.9%   | 2009–2017     |
| Slovakia           | 2013, 2014            | 28.1%–34.7%   | 2012–2019     |
| Spain              | 1985                  | 18.4%–34.0%   | 1975–1990     |
| Thailand           | 1992                  | 15.5%–17.2%   | 1999–2019     |
| Uganda             | 2010/11–2014/15       | 10.5%–14.0%   | 2012–2017     |
| Ukraine            | 2004                  | 20%–25%       | 2004–2011     |
| Viet Nam           | Phase III (2006–2010) | 20.0%–22.3%   | 2009–2010     |

# The Tax administration

- Accountability and transparency are the two central pillars of good governance. Their institutionalization reflects the principle that **tax administration should be answerable for the way they use public resources and exercise authority.**
- To enhance public confidence and trust, **tax administration should be openly accountable for its actions within a framework of responsibility** to the minister, legislature and the general public.
- **Identifying and addressing governance and corruption vulnerabilities is essential for sustaining progress on fiscal consolidation, for supporting inclusive economic growth,**

## Best Practices

- **Mandatory reporting to parliament/public, by way of an Annual Report of tax administration operational and financial performance**
- **Independent and impartial investigation of taxpayer complaints**
- **Tax ombudsman and anti-corruption agency actions**
- **Codes of conduct and mechanism to prevent tax officials' abusing of powers of their position**
- **Proper Internal and external audits and controls**
- **Taxpayer surveys**

# Sri Lankan Practices

- There is an independent audit mechanism in place (Internal Audits and External Audits)
- The Auditor General conducts external audits of the IRD's financial statements and operational performances
- Public sector related controls – Financial regulations, Government Establishment Code, Inland Revenue Department (IRD) Code of Ethics and Conduct, Actions through the Commission to Investigate Allegations of Bribery or Corruption
- IRD publishes its annual performance report timely

## Proposed Practices

Mechanism to conduct survey's to monitor the people's confidence in the tax administration

Appointing a Tax Ombudsmen (Proposed in National Budget 2023)

# **Improve governance, accountability and transparency of the government's fiscal management**

- Amendment of Fiscal Rules Framework and inclusion of Fiscal Rules Framework into the new Public Finance Management Bill
- Establishment of Parliament Budget Office to provide independent and non-partisan analysis of the budget cycle, fiscal policy and the financial implications of proposals
- Enactment of anti-corruption law to establish robust anti-corruption legislation for Sri Lanka

## **Objectives Tax administrative reforms**

- Broaden the tax base
- Eradicate tax avoidance
- Improve revenue collection
- Avoid revenue leakages
- Enhance tax governance
- Maximize tax compliance

# Recently introduced Tax Administrative reforms

- Digital integration into tax administration
- Mandatory tax file for all above 18 years of age
- Focus on tax audits
- Strengthening of large taxpayer unit at Inland Revenue Department
- Single Window mechanism at Sri Lanka Customs
- Security Features and Security Features Management System established at the Excise Department

# Recently introduced specific **Tax Reforms**

- Imposition of surcharge tax as a one-off tax at the rate of 25 percent from individuals, partnerships or companies whose taxable income exceeds Rs. 2,000 million for the year of assessment 2020/2021
- Reduction of VAT registration threshold to Rs. 80 million from Rs. 300 million effective from October 2022
- Increase of standard CIT rate from 24 to 30 percent
- Removal of almost all sector-specific CIT exemptions and concessionary rates from October 2022
- Amendment of marginal PIT rate schedule to rise from 6 percent to 36 percent for every Rs. 500,000 per annum
- Reduction of PIT tax-free allowance to Rs. 1.2 million per annum from Rs. 3.0 million per annum
- Introduction of mandatory withholding taxes starting from January 2023
- Introduction of fuel excises to yield 0.3 percent of GDP in January 2023 with a further increase in June 2023
- Increase of VAT rate from 15 percent in September 2022 to 18 percent from 1 January 2024



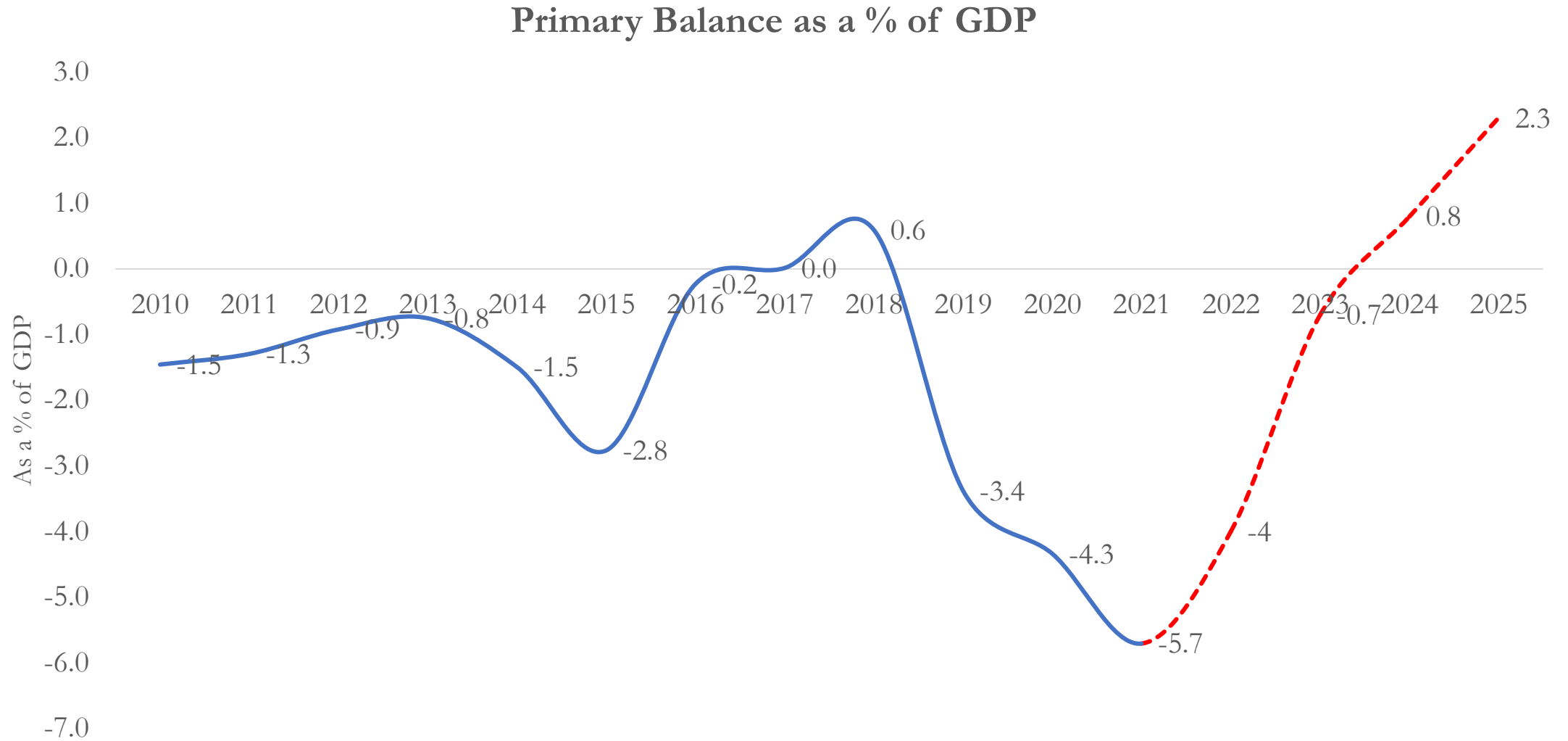
# **Implications of Reforms**

# Performance of the Fiscal Operations

*Rs. Bn*

|                        |                       | 2021    | 2022    | Deviation/2021/2022 | 2021/2022<br>Growth% | 2022 Revenue<br>Estimate | As a %of<br>Estimate |
|------------------------|-----------------------|---------|---------|---------------------|----------------------|--------------------------|----------------------|
| Total Revenue & Grants |                       | 1,464   | 2,013   | 549                 | 37.5                 | 2,094                    | 96.1                 |
| Total Revenue          |                       | 1,457   | 1,979   | 522                 | 35.8                 | 2,084                    | 95.0                 |
|                        | Tax Revenue           | 1,298   | 1,751   | 453                 | 34.9                 | 1,852                    | 94.5                 |
|                        | Non-Tax Revenue       | 159     | 228     | 69                  | 43.4                 | 232                      | 98.3                 |
| Grants                 |                       | 7       | 34      | 27                  | 385.7                | 10                       | 340.0                |
|                        |                       |         |         |                     |                      |                          |                      |
| Total Expenditure      |                       | 3,522   | 4,473   | 951                 | 27.0                 | 4,427                    | 101.0                |
|                        | Recurrent             | 2,748   | 3,520   | 772                 | 28.1                 | 3,620                    | 97.2                 |
|                        | Capital & Net Lending | 774     | 953     | 179                 | 23.1                 | 807                      | 118.1                |
| Primary Balance        |                       | (1,010) | (895)   | 115                 | (11.4)               | (954)                    | 93.8                 |
|                        |                       |         |         |                     |                      |                          |                      |
| Budget Deficit         |                       | (2,058) | (2,460) | (402)               | 19.5                 | (2,333)                  | 105.4                |

# Fiscal Path: Primary Balance as a % of GDP



# Medium-Term Macro Fiscal Framework from 2022 to 2027

|  | As a % of GDP |              |             |             |             |             |             |
|--|---------------|--------------|-------------|-------------|-------------|-------------|-------------|
| Indicator                              | 2021          | 2022 Revised | 2023        | Projections |             |             |             |
|  | Provisional   | Est.         | Estimate    | 2024        | 2025        | 2026        | 2027        |
| <b>Total Revenue and Grants</b>        | <b>8.3</b>    | <b>8.8</b>   | <b>11.3</b> | <b>13.5</b> | <b>15.0</b> | <b>15.1</b> | <b>15.2</b> |
| Total Revenue                          | 8.2           | 8.7          | 11.3        | 13.5        | 15.0        | 15.0        | 15.1        |
| Tax Revenue                            | 7.3           | 7.8          | 10.3        | 12.6        | 14.1        | 14.1        | 14.1        |
| Non-Tax Revenue                        | 0.9           | 1.0          | 0.9         | 0.9         | 0.9         | 0.9         | 1.0         |
| Grants                                 | 0.04          | 0.04         | 0.02        | 0.04        | 0.04        | 0.04        | 0.04        |
| <b>Total Expenditure</b>               | <b>19.9</b>   | <b>18.6</b>  | <b>19.2</b> | <b>19.9</b> | <b>20.0</b> | <b>19.9</b> | <b>19.9</b> |
| Recurrent Expenditure                  | 15.5          | 15.2         | 15.2        | 15.3        | 15.6        | 15.4        | 15.3        |
| Capital Expenditure and<br>Net Lending | 4.4           | 3.4          | 4.0         | 4.5         | 4.5         | 4.5         | 4.5         |
| Public Investments                     | 4.5           | 4.5          | 4.0         | 4.5         | 4.5         | 4.5         | 4.5         |
| <b>Current Account Balance</b>         | <b>-7.3</b>   | <b>-6.4</b>  | <b>-4.0</b> | <b>-1.8</b> | <b>-0.6</b> | <b>-0.4</b> | <b>-0.2</b> |
| <b>Primary Balance</b>                 | <b>-5.7</b>   | <b>-4.0</b>  | <b>-0.7</b> | <b>0.8</b>  | <b>2.3</b>  | <b>2.3</b>  | <b>2.3</b>  |
| <b>Budget Deficit</b>                  | <b>-11.6</b>  | <b>-9.8</b>  | <b>-7.9</b> | <b>-6.3</b> | <b>-5.0</b> | <b>-4.9</b> | <b>-4.7</b> |

Thank you.