

06 May 2022

Dear Member,

CA Sri Lanka submits wide-ranging proposals to the Ministry of Finance on how to revive the economy

In our standing as the National Body of Accountants, the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) acted upon our responsibility to the nation by developing a comprehensive set of proposals on how to revive the economy and help the country overcome the current crisis.

In this regard, we reached out to our dynamic membership-based in Sri Lanka and overseas, as well as our overseas chapters for their recommendations and suggestions, which were then deliberated and compiled by a Special Task Force appointed for this initiative. On behalf of the Council of CA Sri Lanka, I take this opportunity to thank all our members who contributed to this important national endeavour.

I am pleased to inform you that on 05th May 2022, a delegation from CA Sri Lanka submitted the proposals to the Secretary to the Treasury Mr. K.M.M. Siriwardana at the Ministry of Finance.

The recommendations spanning short-term, medium-term, and long-term solutions covered the following:

- Proposals Connected to Improving Balance of Payment and Increasing Foreign Reserves
- Proposals Connected to Improving Government Fiscal Situation (Increasing Government Revenue and Decreasing Government Expenditure)
- Proposals Connected to Reforms and
- Other suggestions,

Attached herewith are the comprehensive set of proposals handed over to the Ministry of Finance by CA Sri Lanka for your information. I am pleased to state that our proposals were well received by the Secretary to the Treasury. Further, we will also take steps to submit this proposal to other relevant authorities as well. We are hopeful that our members will be encouraged by this initiative taken by CA Sri Lanka and will forward any other proposals and suggestions that can be furnished to overcome the current situation. We will compile a second set of proposals based on suggestions that we are currently receiving from our members, along with any other new suggestions we receive in the future and will hand over the second set of proposals also to the Government in the near future.

Once again, on behalf of CA Sri Lanka, I take this opportunity to extend my appreciation to all of our members who took time to share their valuable input on how we as a nation can come out of this ongoing economic crisis.

Thank you,

Yours sincerely,

**THE INSTITUTE OF CHARTERED ACCOUNTANTS
OF SRI LANKA**

S. Bandara

Sanjaya Bandara
PRESIDENT



Proposals from the Institute of Chartered Accountants of Sri Lanka to Help Revive Sri Lanka's Economy

Version 1

5th May 2022

Proposals Recommended to be Implemented within 3 Months (Short Term Solutions)	Proposals Recommended to be Implemented within a Year (Medium Term Solutions)	Proposals That May Take Over One year to Implement (Long Term Solutions)
Proposals Connected to Improving Balance of Payment and Increasing Foreign Reserves		
<ol style="list-style-type: none"> 1. Expedite the process of obtaining funding from the International Monetary Fund (IMF) and the World Bank to reduce the foreign currency liquidity crisis. 2. Liaise with donor countries to restructure foreign debts to minimize the impact on the economy. 3. Request donor agencies and developed countries to provide financial assistance at concessionary rates, considering the current low per capita income of Sri Lanka. 4. Provide incentives to increase remittances by migrant workers/professionals and discourage illegal transactions such as Undiyal. (Eg: offer a duty-free allowance scheme depending on the remittance bracket, such allowance can be one-off or continuous) 5. Suggest the Central Bank of Sri Lanka (CBSL) to consider introducing a system focusing on key sectors such as tea, garment and rubber, to ensure that export proceeds in respect of all invoices raised are remitted to Sri Lanka. (Introduce a sound ICT system similar to Indian 'Export Data Processing and Monitoring System (EDPMS)') 	<ol style="list-style-type: none"> 1. All overseas Sri Lankan embassies to be given Key Performance Indicators (KPIs) in the area of exchange inflows to the country and monitor achievements. Eg: set KPIs on the followings; <ul style="list-style-type: none"> o Foreign employment targets o Tourism promotion projects and increase the number of tourists – Joint project with Ministry of Tourism and Ministry of International Affairs (Focusing on tourists from Europe and the Americas) o Trade agreements enabling export quotas from Sri Lanka o Increase higher education opportunities for foreign students in Sri Lankan universities o Promote tourism in niche markets such as Ayurveda medical treatments 2. Recommend local banks to introduce additional and flexible services to improve fund remittances by changing the traditional exchange handling system. 3. Suggest CBSL to introduce a sound IT system like EDPMS in India, covering all sectors to ensure that foreign currency for all foreign currency denominated invoices raised have been duly received. 4. Suggest CBSL to seek a special certificate from Company Auditors, stating that all foreign currency invoices raised for sale of goods/ services are properly accounted and remittances received. 	<ol style="list-style-type: none"> 1. Encourage skilled migrant workers by providing relevant educational and training programs (Eg: promote nurses to seek foreign employment). 2. Discourage exporting raw products/ materials and promote value-added exports. (Eg: Identify the highly valuable natural resources in Sri Lanka in the international market such as, Phosphate, Silica sand etc and sell them to the international market as a value-added product) 3. Establish globally recognized higher education institutions/universities in Sri Lanka to reduce exchange outflow on foreign education and attract overseas students to improve foreign currency inflows. Government should facilitate this by providing relevant infrastructure. 4. Allow foreign students to follow state university programmes by paying commercially comparable fees. To facilitate this process, steps should be taken to increase the university intake for lucrative degree programs.

Proposals Recommended to be Implemented within 3 Months (Short Term Solutions)	Proposals Recommended to be Implemented within a Year (Medium Term Solutions)	Proposals That May Take Over One year to Implement (Long Term Solutions)
<p>6. Promote micro/off grid system to generate power, to reduce the fuel cost of power generation. <i>Eg: Propose all Government buildings including schools to establish solar panels under the model of Private - Public Partnership (PPP). The private sector can provide capital to establish panels and government can provide space to setup panels.</i></p> <p>7. To promote micro/ off grid system, remove all import duties/taxes (VAT) on equipment for setting up micro/off grid solar systems, setting up financial assistance for transition into solar power, creating awareness regarding benefits, addressing inefficiencies within the Ceylon Electricity Board (CEB) that causes delays in converting households to solar power and set KPIs for employees of CEB to promote the use of solar power.</p> <p>8. Conduct tea auctions in Sri Lanka (by Colombo Tea Traders Association) only in foreign currency.</p> <p>9. Encourage Capital Market participants to introduce mutual fund/ venture capital arrangements for migrant workers with the intention of attracting foreign exchange.</p> <p>10. Relax the restrictions enforced on legal tender (LKR) by CBSL and allow Micro, Small, and Medium Enterprises (MSMEs) to accept/pay foreign currency for goods/services provided/ received.</p>	<p>5. Expand the activities of the SOEs to increase local production with identified buy-back agreements from the private sector (<i>Eg: State Pharmaceuticals Manufacturing Corporation (SPMC) to widen its pharmaceutical production in the country while implementing a transparent procurement procedure, Chlorine production initiation of Paranthan Chemicals Ltd.</i>)</p> <p>6. Recommend CBSL together with the Sri Lanka Bankers' Association, to come up with a special scheme to enhance the efficiency and flexibility of foreign currency fund transfer system, such as developing digital banking, mobile banking, etc.</p> <p>7. Uplift and look after the MSME sector who can enhance either export earnings or reduce imports through substitutions by allowing tax and non-tax incentives.</p> <p>8. Introduce a mechanism to increase local value addition by exporters, by providing incentives based on the local value addition.</p> <p>9. Encourage export oriented companies to raise capital and debts outside the country by way of foreign exchange.</p> <p>10. Remove restrictions on dividend payments on foreign investments to attract Foreign Direct Investments (FDI).</p> <p>11. Introduce a proper strategy (<i>such as hedging</i>) in acquiring and utilizing fuel and LP Gas for the country with the increasing prices that are anticipated in the foreseeable future.</p>	<p>5. Establish regional reinsurance and Risk Management Hub partnership with multinational regional reinsurer to attract reinsurance inflow initially from Pakistan, Bangladesh including Sri Lanka and later to be extended to other regions. This will attract initial capital inflow to the country and the inflow will continue via reinsurance premium.</p>

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<p>11. CBSL to call and review audited financial statements of companies and branches set up by Sri Lankan companies and individuals in overseas countries (either via approval route or Outward Investment Account (OIA)) and require them to declare and remit a set percentage of dividends to Sri Lanka.</p>	<p>12. Introduce an effective mechanism to monitor all non-commercial foreign exchange inflows to the country. <i>(Eg: Need a mechanism such as Foreign Contribution Act in India)</i></p> <p>13. Introduce selected agriculture projects such as Agarwood and medicinal products to the export market under the supervision of relevant government institutions such as, Department of Export Agriculture, Ministry of Health, Export Development Board (EDB) and Board of Investment (BOI).</p> <p>14. Introduce an incentive scheme for exchange earners (individuals/ corporates) to pay taxes in foreign currencies.</p> <p>15. Authorize banks to grant concessionary local currency loans for Foreign Employees irrespective of registration with the Sri Lanka Bureau of Foreign Employment (i.e. upon the submission of work permit & long term visa) who could make repayment of loans in foreign currency at the prevailing exchange rate.</p> <p>16. In order to attract workers/ professionals working overseas to remit foreign currency earnings to Sri Lanka, allow them to import motor vehicles under a special scheme where import cost, custom duty, etc be paid in foreign currency. Foreign currency for this purpose shall be remitted to foreign workers/ professionals' bank accounts in Sri Lanka.</p>	

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	17. Promote Sri Lanka as the Hub for emerging IT professionals which will offer competitive rates to international clients. 18. To have regular negotiations with foreign countries to get more quotas for Sri Lankan employees for foreign employments.	
Proposals Connected to Improving Government Fiscal Situation (Increasing Government Revenue and Decreasing Government Expenditure)		
1. Re-introduce income tax at source. (Eg: <i>Withholding Tax (WHT), PAYE</i>) 2. Reduce the VAT registration threshold to increase the number of organizations required to register for VAT. (Refer Annexure A for CA Sri Lanka Tax Proposals) 3. Increase service delivery fees of government institutions while improving the efficiency of service delivering (Eg: <i>Revenue License Fee</i>). Also, increase charges/ fines and penalties enforced on various offences, such as road traffic violations. 4. Reassess and cut down both capital and recurring government expenditure, wherever possible. Introduce a mandatory requirement to submit a project audit report and introduce KPIs for each project to evaluate and monitor progress. Re-allocate funds already committed to areas of immediate requirements instead of capital projects.	1. Reassess and increase VAT rates. 2. Income Tax rates for individuals and corporates should be reassessed and increased, and remove exemptions where possible. 3. Establish a strategy for both direct and indirect taxation and eliminate ad-hoc changes to the tax system. 4. Establish an independent government Procurement Commission with relevant experienced professionals who will be empowered to report their findings to the Auditor General. 5. Establish an e-government procurement platform and transparent procurement process to reduce the corruption and inefficiencies encountered in the system. 6. Eliminate the inefficiencies in State Owned Enterprises (SOEs) through proper restructuring practices	1. Restructure Tax policy to enhance direct tax proportion in line with other emerging countries. 2. Introduce and make use of CCTV systems to fine motorists as and when they break the law. 3. Allow all charges, traffic offences, rates, penalties and taxes to be paid online. 4. Suggest that all elections are held in a single day to minimize public expenditure. This could be done by synchronizing the term of the presidency, parliament and local government durations.

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5. Reassess and cut down facilities and perks given to politicians.	7. Re-visit and stop the budgetary transfers to SOEs and promote self-financing for SOEs. 8. Introduce a Voluntary Retirement Scheme (VRS) to remove excess staff at all public institutions, ministries and departments, based on a comprehensive carder analysis. Alternatively, allow public sector employees to go on no-pay leave and work in private institutions, and at the same time, allow the private sector to recruit such personnel without paying EPF/ETF. 9. Introduce an income tax to recover unusual gains made from scams/ fraudulent activities.	
Proposals Connected to Reforms		
1. Implement a cost reflective pricing mechanism for Fuel, Electricity, LP Gas, Water, etc. and subsidize low-income groups with a targeted subsidy scheme. However, the pricing mechanism should be fair, transparent, based on international norms and should be honoured by the relevant Authorities.	1. Activate independent audit committees in all SOEs with qualified professionals. It is recommended to have a member of CA Sri Lanka as a member of all key SOE Audit Committees. 2. Introduce a mechanism to employ non-politicized and competent people to the Board of SOEs and appoint professionally qualified financial experts to lead finance function of SOEs. 3. Establishment of an Independent Oversight Board with competent professionals to monitor performances of all SOEs that can report to the Committee on Public Enterprises (COPE).	1. Introduce relevant programmes to tertiary education system based on the market demand to reduce the burden of providing government employment for unemployed graduates. (<i>Eg: Cut down relevant Degrees where there are high unemployment rates</i>) 2. It is strongly recommended that all government organizations should be digitalized and all services offered to public should be made available online. 3. Reassess the country's social welfare schemes and introduce one integrated targeted welfare programme.

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	<p>4. It is strongly recommended to strengthen the National Audit Office in terms of resources, funding, competency and technology, etc. to further enhance the trust within the public sector.</p> <p>5. Revisit various licensing schemes/ permits with the intension of reducing corruption. (Eg: <i>Liquor license, Sand - Permit for Sand Excavation</i>)</p> <p>6. Provide legislative powers to enhance the independence of the Auditor General, the Attorney General's Department, Inland Revenue Department, Department of Police and CBSL to act independently without political intervention.</p> <p>7. Combine and amalgamate SOEs based on a rational approach, to enhance productivity and efficiency. <i>Eg:</i></p> <ul style="list-style-type: none"> ○ <i>Co-operative Wholesale Establishment (CWE) + Lanka Sathosa</i> ○ <i>Colombo Commercial Fertilizer + Ceylon Fertilizer</i> ○ <i>ITN Sri Lanka + Sri Lanka Rupavahini</i> <p>8. Establish investigation and forensic audit divisions with relevant experts in places such as Inland Revenue Department, Department of Police, Attorney General's Department, Bribery Commission, etc.</p> <p>9. Approval processes for starting businesses should be further improved to attract more Foreign Direct Investments (FDIs). Further, it is recommended to relax constraints in labour laws and enable labour reforms.</p>	<p>4. Revamp the legal administration system to expedite litigation process. (Eg: <i>Average time period to complete a civil litigation is about 12 years</i>)</p> <p>5. Allow use of expert knowledge in finance, in investigations of corruption and fraud in the judiciary process.</p> <p>6. Introduce a monitoring mechanism to ensure government ministries follow national policies and budgetary provisions.</p> <p>7. It is recommended that Government capital expenditure should be in-line with the national policies approved by the Parliament and to be monitored by the special parliament finance committee.</p> <p>8. Integrate all government related computer systems into one and allow access to different government agents based on their need. (Eg: <i>System of Inland Revenue need to be linked with Customs</i>)</p> <p>9. Gradually remove monopoly of electricity, fuel and water and attract private sector service providers with a strong regulator.</p> <p>10. To expand the tax net, increase efficiency and eliminate corruption, provide a Tax ID number to all citizens/ residents and connect it into the integrated government computer system. As the first step, the Tax ID can be linked to the National ID number.</p>

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	<p>10. Introduce a targeted programme to improve the ranking in the 'Ease of Doing Business (DBI) Index' and 'Corruption Perceptions Index'. <i>(There are 11 indicators in DBI. Working on these indicators to improve them by 10 points would facilitate to decrease the cost of doing business, improve the efficiencies, credit quality and will reflect in GDP growth as well. Further improvement in DBI assures the confidence for foreign investors and increase Foreign Direct Investment inflows.)</i></p> <p>11. Implement a strategy to utilize the increased port capacity available in Sri Lanka.</p> <p>12. Create a national level think-tank for making policy recommendation for each sector and introduce national policies for all sectors, independent from political intervention. <i>Eg:</i></p> <ul style="list-style-type: none"> ○ <i>Agricultural policy for next two decades</i> ○ <i>Educational policy</i> ○ <i>SME protection & development policy</i> ○ <i>Fiscal rule for next 10 years</i> ○ <i>Energy policy including Electricity.</i> ○ <i>Labour policy</i> ○ <i>Health policy</i> ○ <i>Social safety net</i> ○ <i>Governance, accountability, transparency policy for the public sector including politicians.</i> <p>13. Introduce a KPI based evaluation system linked with some incentives for senior public servants.</p>	<p>11. Introduce a mechanism to adopt accrual accounting in Government departments/ ministries.</p> <p>12. It is strongly recommended that the Constitution of Sri Lanka should be changed to have a financially affordable and efficient political system. At present Sri Lanka has one politician for every 800 work force members.</p> <p>13. To enhance public finance discipline, identify and introduce appropriate models and frameworks. <i>(Eg: Process of submission of cabinet papers with financial implications, integrity model for government agencies, good governance guide to government agencies)</i></p> <p>14. It is recommended that all regulations of the government (Financial and Administrative) should be updated in line with international norms.</p> <p>15. Facilitate transactions between producers and consumers to supply and demand in commodities. <i>(Eg: Indian Commodity Exchange, Malaysian Palm Oil Board which allows the producers to trade their excess production)</i></p> <p>16. Ensure independency of government media channels and appoint a committee to overlook the same as the government media channels have a wide role in the development of the country and circulating accurate information.</p>

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	<p>14. It is recommended that all senior public servant appointments should be handled by an Independent Nomination Committee, established under a new Act of Parliament. With regard to the carder approval, the same Act could provide powers to the Committee to fix and approve acceptable number of employees. (This will stop political influence in increasing the carder of public institutions in a haphazard manner).</p> <p>15. Tax filling and payment should be further simplified.</p> <p>16. Strengthen laws and legal framework relating to bribery and corruption to empower the Bribery Commission allowing them to enforce fines and recover losses to the government. De-politicize appointments to the Bribery Commission and strengthen the independence of the Bribery Commission.</p> <p>17. Introduce minimum qualifications and compulsory retirement age for all political candidates. National list MPs should have a higher-level education qualification.</p> <p>18. Cost of all subsidies given (<i>Eg: Fertilizer, fuel, electricity subsidies</i>) should be measured and considered in the decision-making process.</p>	

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Other Suggestions		
<ol style="list-style-type: none"> 1. Action should be taken immediately to introduce the 21st Amendment to the Constitution by repealing the 20th Amendment and restoring the 19th Amendment. 2. Prioritize and ensure supply of un-interrupted fuel, power and LP Gas to enable continuous functioning of industries and households. 3. Introduce a National agricultural plan and enhance warehouse facilities for agricultural products. 4. Bring all black money in the market into circulation, cancel the existing high value Rupee notes and re-issue new currency notes. 5. Introduce an immediate program to the energy sector to reduce dependency on diesel and introduce alternative power sources. It is recommended to re-commence renewable energy projects. 6. To support effective supply chain, uplift the restrictions imposed on importing of raw materials and spare parts for machinery, equipment, vehicles, etc. 	<ol style="list-style-type: none"> 1. Develop a framework for Accountability in the public sector, similar to the provisions introduced in the Companies Act. 2. Allow the private sector to participate in management of SOEs. <i>Possible areas for getting private investments; Sri Lankan Airlines, Hilton Hotel, Grand Hyatt Hotel, Power Generation, Plantation sector</i> 3. Introduce a separate index for SOE's in the Colombo Stock Exchange and promote listing of SOEs. 4. As per the World Bank Group Supreme Audit Institutions Independence Index 2021, Sri Lanka has been ranked under "substantial" category on level of independence of the National Audit Office (marks between 8 - 8.5). Take steps to draw a plan to obtain "high" status (marks 9 - 9.5) within a short period of time. 5. It is recommended that the Auditor General engage with the media, general public, anti-corruption activist and others, in providing publicity on their findings, apart from providing adequate legal coverage. 6. Arrange a "Review Day" to assess the progress made on the previous year's budget activities, in the presence of legislators, media and other civil society organizations. This needs to happen prior to the next year's budget. 	<ol style="list-style-type: none"> 1. Establish Development Finance Institutions with the primary objective of increasing access to affordable finance for MSMEs. 2. Establish low interest foreign credit lines for MSMEs through the banking sector. 3. It is strongly recommended that unutilized and under-utilized government/SOE assets should be optimized by using Private Public Partnerships (PPP). It is also suggested to develop a framework for PPP. 4. Introduce efficiency target levels for all SOEs based on the international best practices. 5. Develop a policy for dealing with related parties of SOEs (disclosure of interested parties, prohibitions, disclosure as per accounting standards etc.) 6. Allocate resources for National Audit Office to launch a public awareness campaign to educate stakeholders on the role they play in improving efficiency, reducing frauds, and actions taken by the government on the findings.

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<p>7. Promote an Island Wide Home Gardening Campaign</p> <ul style="list-style-type: none"> ○ Campaign to be facilitated by the Ministry of Agriculture alongside the Agriculture departments of State Universities. ○ Necessary support in terms of technical advice, seeds, compost, and other homemade fertilizers to be provided via the local government institutions and Grama Niladharis. ○ Public figures to volunteer for promoting the campaign island-wide 	<p>7. It is recommended that all election related funds received and utilized by individuals and political parties should be subject to an audit appointed by the Election Commission. Report to be published within 6 months from the election. Related expenses to be borne by the relevant political party.</p> <p>8. All government ministries/departments to have Technical Advisory Committees with relevant industry expertise and professionals.</p> <p>9. When procuring for government projects give priority to local goods/services providers. Also, introduce a sustainable program to enhance the capacity of such providers.</p> <p>10. To improve transparency, all political candidates should file a short CV with qualifications and experience together with their nomination papers. This information to be published in a public website.</p> <p>11. Asset declaration for all political appointments and senior government officials should be made compulsory. Audited Asset declarations to be published annually by all politicians and senior government officials. The Auditor General should conduct an audit of this process and formulate actions against non-compliance.</p> <p>12. In order to improve finance literacy in the public sector, CA Sri Lanka to take the lead in introducing programs that will improve finance literacy.</p>	<p>7. It is recommended to introduce mass urban transport system to manage fuel consumption. <i>(Develop railway system. (i.e., Double line in Kaleni Valley, increase the number of compartments in main line & coastal line railways), Develop canal / boat transportation, Start domestic flights. I.e., From Rathmalana to Palali)</i></p> <p>8. Make use of garbage collected in all key cities to generate power. This will manage garbage disposal and reduce dependency on diesel for power generation.</p> <p>9. It is recommended for the Ministry of Education to promote a hybrid learning concept in the schools.</p> <p>10. Create a pool of Board ready personnel to take-up Board positions in the SOEs. Chosen members would be provided KPIs to evaluate performance and established accountability.</p> <p>11. It is recommended to introduce a mechanism to recover cost of free education and free health, from individuals who are migrating before the age of 50 years.</p>

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	<p>13. Inland Revenue to conduct wealth reconciliation exercise for all property owners who owns properties over an identified threshold (say; Rs. 50 Mn on historical basis).</p> <p>14. Encourage entrepreneurs by introducing relief subsidies and tax concessions.</p> <p>15. Introduce Whistle-Blower Protection Law to safeguard legitimate whistle-blower complaints. The process of whistle-blower complaints to be monitored by the Bribery Commission.</p> <p>16. Investigate all alleged scams using foreign investigators.</p>	



The Institute of Chartered Accountants of Sri Lanka -Tax Proposals

5th May 2022

Proposals to increase tax revenue in Sri Lanka

Introduction

The Government of Sri Lanka recorded a drastic drop in tax revenue recording a 29.9% decline in 2020 which amounted to just Rs. 1,216.6 Bn in comparison to Rs. 1,734.9 Bn in 2019, as per the latest Annual Report of the Central Bank. The relative share of the revenue from direct taxes declined to 22.1% in 2020 from 24.7% in the previous year, which mainly reflected the impact of subdued income of businesses and individuals amidst the pandemic. The direct to indirect tax ratio in Sri Lanka was approximately 1:4. Tax to GDP recorded a decline from 11.6% in 2019 to 8.1% in 2020.

All these statistics showcase that the tax revenue being collected has declined due to several factors, among which were the sweeping changes made to the tax law with effect from 2020 which was carried out just before the pandemic adversely impacted the Sri Lankan economy. The impact of these changes under normal economic conditions was anticipated to increase spending and thereby growth in the economy. However, this is now moot as the pandemic was a crisis situation of epic proportions to the economy and as such the tax revenue declined due to reduced economic activity.

In a post pandemic scenario, we are still unsure about economic recovery and how events would pan out and how we can overcome the present economic woes in the country. Looking to tax the people in this situation will definitely not be a solution. As Winston Churchill eloquently explained– “For a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle.” As such, it is interesting to see the role that taxation can play in providing the much-needed revenue to the Government.

When considering direct Tax revenue, revenue from income tax declined by 37.3% from 2019 to 2020 which was mainly attributable to the abolition of the PAYE tax and ESC, along with the revisions to WHT and corporate and non-corporate income tax with effect from January 2020.

On Indirect Tax revenue, VAT revenue declined significantly by 47.3% to Rs.233.8 Bn in 2020 from 443.9 Bn in 2019 amidst the slowdown in economic activity and the reduction of the VAT rate from 15% to 8% effective from 01st December 2019. Revenue from excise duties, as a percentage of GDP, declined to 2.2% in 2020 compared to 2.7% in 2019, mainly on account of lower revenue collection from excise duty on motor vehicles and petroleum products.

Summary of Government Revenue

Item	2019 (a)	2020 (b)
Rs. million		
Tax Revenue	1,734,925	1,216,542
Income Taxes	427,700	268,249
VAT	443,877	233,786
Excise Taxes	399,478	321,932
Import Duties	98,427	114,183
Other Taxes	365,443	278,392
Non Tax Revenue	155,974	151,417
Total Revenue	1,890,899	1,367,960
As a percentage of GDP (c)		
Tax Revenue	11.6	8.1
Income Taxes	2.8	1.8
VAT	3.0	1.6
Excise Taxes	2.7	2.2
Import Duties	0.7	0.8
Other Taxes	2.4	1.9
Non Tax Revenue	1.0	1.0
Total Revenue	12.6	9.1
(a) According to the Ministry of Finance, the fiscal sector statistics of 2019 have been restated as announced in the Budget Speech for 2020.	Source: Ministry of Finance	
(b) Provisional		
(c) For 2019, revised GDP estimates were used, as released by the Department of Census and Statistics on 16 March 2021.		

1. INCOME TAX PROPOSALS

1.1. Re-introduce withholding tax on investment returns – dividend, interest, rent etc.

Rationale

Collecting tax at the source is a cost-effective tax collection mechanism. This method of tax collection imposes the responsibility on a third person to pay the tax on behalf of the taxpayer. This also provides for greater tax compliance among taxpayers. It also eases the compliance burden on the taxpayers as the withholding agent will pay due taxes to the revenue authority and will provide a tax deduction certificate to the taxpayer. This allows the revenue authority to track the taxpayer's income accurately and precisely which facilitates the tax assessment process.

The self-assessment tax collection process currently requires the taxpayers to make tax payments on a quarterly basis. However, the withholding tax collection process will provide the Government periodic income in shorter intervals as the withholding agents are required to remit the tax withheld to the Commissioner General on a monthly basis.

With the current trend in the increase in interest rates, collecting tax on investment returns such as interest and dividends will help increase the tax revenue for the Government.

Recommendations

- Introduce withholding tax on investment returns at the following rates;
dividend – 10%
interest – 5%
rent 10%
- Withholding tax on rent to be deducted only where the payment is above Rs. 50,000 per month
- Provide a tax credit for corporates for taxes deducted at source against their corporate income tax liability

- Make withholding tax deducted at source on dividend and interest a final tax for individuals having an annual taxable income of less than Rs. 6,000,000 as these income sources are investments made out of income which has already been subjected to tax.
- Make withholding tax deducted at source from non-resident taxpayers as final tax.

1.2. Re-introduce withholding tax on service payments made to individuals – lawyers, doctors, architects, accountants etc.

Rationale

Individuals providing services (other than through partnership or company) pay income tax on self-assessment basis on a quarterly basis. Since taxes are currently paid by these individuals on self-assessment basis, it is difficult for the tax authorities to collect information about the actual income earned by such individuals. Therefore, it is recommended to collect tax at the source by introducing a withholding tax on payments made to individual service providers. This will provide greater transparency on the income earned by such individuals which will allow the revenue authorities to collect a fair share of tax from these individuals.

Other benefits of collecting taxes by withholding are articulated in point 1.1. will also apply in this case.

Recommendations

- Introduce withholding tax on service payments made to individuals
- De-minimis rule: Introduce a minimum threshold per month above which the withholding tax is to be deducted on payments made to individuals
- Provide a tax credit for such individuals for taxes deducted at source against their income tax liability
- Mandate the withholding agent to issue a tax deduction certificate

1.3. Re-introduce withholding tax on employment income

Rationale

Currently, it is not mandatory for employers to deduct tax on the employment income of their employees. Therefore, an employee can either opt to consent to the employer to deduct tax or not to deduct tax. It is recommended to mandate all employers to deduct tax on the employment income paid to its employees. This will ensure that the income tax on employment income will be collected upfront which will ease the compliance burden on the employees. Since it is a withholding tax, the benefits explained in 1.1. above will also apply in this case.

Recommendations

- Introduce withholding tax on employment income paid to employees.
- Mandatory for all employers to deduct the tax from their employees (irrespective of consent from employees)
- Employers to apply the tax tables provided by the Commissioner General of Inland Revenue (CGIR) based on the tax rates applicable to individuals
- Provide a tax credit for such employees for taxes deducted at source against their income tax liability
- Mandate the employer to issue a tax deduction certificate for each year of assessment.

1.4. Increase individual tax rates on high income earning individuals

Rationale

Currently, the income tax rates for individuals are spread across 3 income bands as follows;

Taxable income for a year of assessment	Tax payable
Up to Rs. 3,000,000	6%
Between Rs. 3,000,000 to Rs. 6,000,000	12%
Exceeding Rs. 6,000,000	18%

It is proposed to increase the income tax rates on high income earning individuals.

Recommendations

Amend the first schedule on tax rates applicable on individuals as follows;

Taxable income for a year of assessment	Tax payable
Up to Rs. 3,000,000	6%
Between Rs. 3,000,000 to Rs. 6,000,000	12%
Between Rs. 6,000,000 to Rs. 9,000,000	18%
Exceeding Rs. 9,000,000	24%

1.5. Increase corporate income tax rate

Rationale

At present, the standard corporate income tax rate is 24%. It is proposed to increase this to 28% to earn a higher tax revenue.

Recommendations

Amend the first schedule on tax rates applicable to companies where the normal corporate income tax rate is 28%.

1.6. Remove the exemptions for non-residents on interest and dividend

Rationale

At present, there is an exemption on interest and dividends paid to non-residents. The objective presumably would be to attract more foreign investment into the country. However, these exemptions have resulted in draining out more and more foreign exchange out of the country as the investors are repatriating funds more frequently and siphoning out all excess profits accumulated in their companies. Given the foreign exchange crisis in Sri Lanka, we feel that these exemptions should be removed.

Recommendations

- Remove the exemptions available to non-residents on interest and dividends.

1.7. Earnings stripping rule – interest payable to foreign lenders deductible up to a maximum of 20% of profit before tax

Rationale

Currently, there is an exemption on interest paid to a non-resident lender. Therefore, most investors are infusing funds to local businesses by way of loans rather than equity. The return on a loan which is interest is charged as an expense to the profit and loss account which is considered as a deduction when computing the profit before tax. However, dividend which is the return on equity is distributed after tax profit. Therefore, there is a tendency for non-resident investors to charge higher interest rates to reduce their profits which are liable to income tax in Sri Lanka. Therefore, it is recommended to introduce an earning stripping rule where the deductible interest expenses payable to a foreign lender is limited to 20% of profit before tax.

Recommendations

The deductible finance expenses payable to a non-resident lender is limited to 20% of the profit before tax of the company.

1.8. Better administration of Capital Gain Tax (CGT)

Rationale

We have not witnessed any material contribution from CGT (Rs. 357,594,125 collected in 2020 and 0.07% from total revenue), as the policy is not drafted in a manner to collect the tax from the source itself. The Inland Revenue Department (IRD) does not have a direct link with the land registry or Registrar of Companies (ROC). As such, IRD officials are collecting manual records from the above entities and issuing notices to taxpayers. In fact, this process would take more than one year, and in some instances, these taxpayers would have left the country by then.

It is recommended that legal provisions be introduced or administratively implemented that it is necessary to obtain a clearance or certificate from IRD before registration of any instruments by the land registry or ROC that the capital gain tax (if any) has been paid.

Recommendations

- Make it mandatory to obtain tax clearance from the IRD prior to registration of any transfer deed at the land registry or share transfer at the ROC on whether the Capital Gain Tax (if any) on such transaction has been paid.

2. VALUE ADDED TAX

2.1. Increase VAT rate

Rationale

The VAT rate of 15% was reduced to 8% from 01st December 2019. When comparing the tax revenue from VAT collected in 2019 against the VAT revenue in 2020 there is a significant drop of 47.33% in revenue.

2020	Rs. 233,786,120,184
2019	Rs. 443,877,131,612
Difference	Rs. 210,091,011,428
Decrease in collection as a %	47.33%

Source: Annual Performance Report 2020 – IRD

Given below are the VAT rates/Goods and Services Tax (GST) rates in a few selected ASEAN countries;

Country	VAT/GST rate
India	12% and 18%
Bangladesh	15%
Singapore	7%
Vietnam	10%
China	13%

Based on the above numbers, Sri Lanka is a country which has a comparatively lower VAT rate at 8%. However, increasing VAT will further increase inflation and price of goods. Further, since it is a cascading tax, it will impact everyone in the supply chain. Therefore, it is recommended to increase VAT in a phased-out manner and not immediately, to avoid the immediate inflationary pressures on the economy.

Instead, VAT revenue should be increased not through increase of tax rates but rather through the increase in the tax base. Therefore, it is recommended to reduce the VAT registration threshold to expand the tax base as explained in point 2.2. which is detailed below.

2.2. Reduce the VAT registration threshold

Rationale

Currently the VAT registration threshold is Rs. 75 Mn per quarter or Rs. 300 Mn per annum. It is recommended to reduce this to Rs. 25 Mn per quarter or Rs. 100 Mn per annum as this will increase the tax base. This will help improve the tax revenue in Sri Lanka. Further, businesses with a turnover of less than Rs. 25 Mn per quarter will not be affected by this proposal.

Recommendations

- Revise the mandatory VAT registration threshold to Rs. 25 Mn per quarter or Rs. 100 Mn per annum.
- Ease of obtaining VAT registrations should be facilitated.
- Collection of data should be fully automated – i.e. filing of returns, uploading schedules etc.

2.3. Introduce VAT on the sale of condominium property

Rationale

Currently there is an exemption on the sale of “residential accommodation” which is enjoyed by developers selling condominium housing units. There is a significant amount of investment made by taxpayers toward these condominium housing units. The Government can earn a significant amount of tax revenue in subjecting these transactions to VAT as these transactions are done mostly for investment purposes rather than for personal use. Therefore, it is recommended to exempt the sale of “residential accommodation other than condominium units”.

Recommendations

- Remove the exemption for VAT on the sale of condominium units.

3. INTRODUCE A MINIMUM MANDATORY TAX ON BUSINESSES

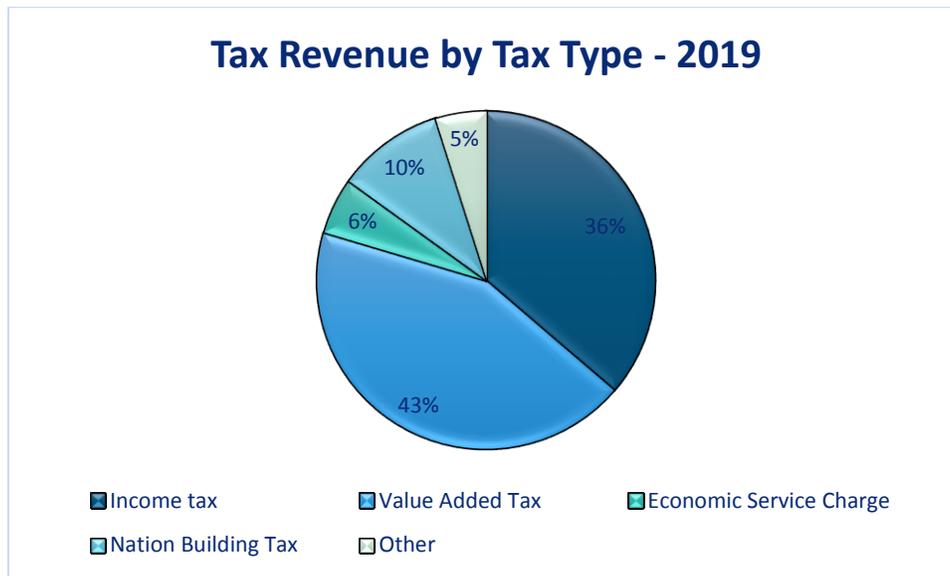
3.1. Minimum mandatory tax

Rationale

Based on the Annual Performance Report published by the Inland Revenue Department, the revenue earned by multiple tax types administered by the Commissioner General for the year 2020 and 2019 are as follows;

Type of tax	2020	% on Total	2019	% on Total
Income tax	252,941,572,901	48.28%	371,795,681,316	36.26%
Capital Gain Tax	357,594,125	0.07%	602,439,115	0.06%
Value Added Tax	233,786,120,184	44.62%	443,877,131,612	43.29%
Debt Repayment levy	3,002,271,834	0.57%	28,673,572,980	2.80%
Betting & Gaming Levy	1,428,071,291	0.27%	2,435,982,807	0.24%
Share Transaction Levy	2,347,277,681	0.45%	1,023,443,599	0.10%
Migrating Tax	5,853,185	0.00%	5,008,044	0.00%
Stamp Duty	11,354,837,819	2.17%	14,863,016,823	1.45%
Economic Service Charge	14,950,042,437	2.85%	55,301,397,165	5.39%
Nation Building Tax	3,740,463,661	0.71%	105,185,802,597	10.26%
Goods and Services Tax	226,221	0.00%	17,036,964	0.00%
Turnover Tax	16,257,541	0.00%	29,626,965	0.00%
National Security Levy	2,399,368	0.00%	9,045,921	0.00%
CIGFL	636,657	0.00%	1,219,286	0.00%
Vehicle Entitlement Levy	-	0.00%	1,498,601,586	0.15%
Remittance Fee	-	0.00%		0.00%
TOTAL	523,933,624,905		1,025,319,006,780	

Based on the above numbers, 2019 had a significant amount of tax revenue being generated from turnover based taxes such as Economic Service Charge (ESC) and Nation Building Tax (NBT).



Once ESC and NBT was abolished from 31st December 2019 and 30th November 2019 respectively, the Government lost this tax revenue in 2020.

It is proposed that a revenue-based tax be introduced as a minimum mandatory tax payment by all taxpayers on trade or business. This should be considered as an advance payment of income tax where the tax paid on turnover can be deducted against the income tax liability of the taxpayer. By this, the inflationary pressures that are being created on taxing the turnover can be avoided as this would not be an additional tax burden on the taxpayers but rather an advance payment of income tax. Further, the credit available against income tax can be time bound, where the credit will only be available for the year of assessment in which the tax is paid + 2 years of assessment. As such, a company making losses perennially will be excluded from obtaining a tax credit unless the business becomes profitable once again. This tax will be in the form of a minimum mandatory tax that has to be paid by all businesses.

The tax should be payable by all businesses including those that are making losses or are exempt from income tax under the BOI laws or the Inland Revenue laws since this tax will be a minimum mandatory tax that is payable by all businesses as a contribution to the tax revenue of the Government for the infrastructure and other public services/utilities which are being enjoyed by all. The liability can cover manufacturers, service providers, exporters and all other businesses with minimal exemptions/concessions.

The proposed tax would be imposed as a percentage of turnover, which can be at a lower rate of 0.5% or 1% since it is a tax on the topline. As the tax is being imposed on Turnover there will be little room for manipulation on the numbers unlike a tax based on profits. The revenue officers will also be in a position to easily assess the tax liability as the Turnover can be easily verified through invoices. Therefore, the collection costs and cost of administering the tax will be minimal.

There can be a minimum turnover threshold above which the tax has to be paid of Rs. 25 Mn per quarter. This will relieve the small businesses from having to bear the added compliance costs and efforts.

The tax should be paid by the businesses on a quarterly basis which will provide the Government with periodic income in short intervals to finance its expenses.

Recommendations

- The tax rate to be between 0.5% to 1% as this is a turnover based tax
- The tax to be a minimum mandatory tax payment – i.e. this tax should be paid by all businesses including those that are making losses, and those enjoying income tax exemptions, etc
- This tax to be considered as an advance payment of income tax – i.e. Provide a tax credit for the tax paid on turnover against the income tax liability of the taxpayer
- The tax paid will be considered as a tax credit against income tax for the year of assessment in which it is paid + 2 years of assessment
- Tax to be remitted to the CGIR on a quarterly basis
- Introduce the de-minimis rule – tax to be paid only by taxpayers with turnover above Rs. 25 million per quarter.

4. INCREASE EXCISE TAXES

4.1. Excise on liquor, cigarettes and tobacco

It is proposed to increase the excise taxes on liquor, cigarettes and tobacco in order to increase tax revenue.

5. TAX ADMINISTRATION

5.1. Income tax administration

Recommendations

- Any individuals who are having the following sources of income where withholding tax has been deducted is not required to file an income tax return. (Reduce administrative burden)
 - Employment income
 - Interest
 - Dividend
- Inland Revenue Department must implement better systems to assess sole proprietorships and partnerships to avoid tax leakages from these businesses.
- Expediate collection of taxes in default. (As per the last budget speech, taxes in default amount to 1.5% of GDP.)

5.2. VAT administration

Recommendations

- Expediate the VAT refund process
- Expediate the process of resolving mismatches in the system on output/input VAT.