Tax Composition and Issues in Sri Lanka

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Tax Composition and Issues in Sri Lanka

Direct and Indirect tax mix

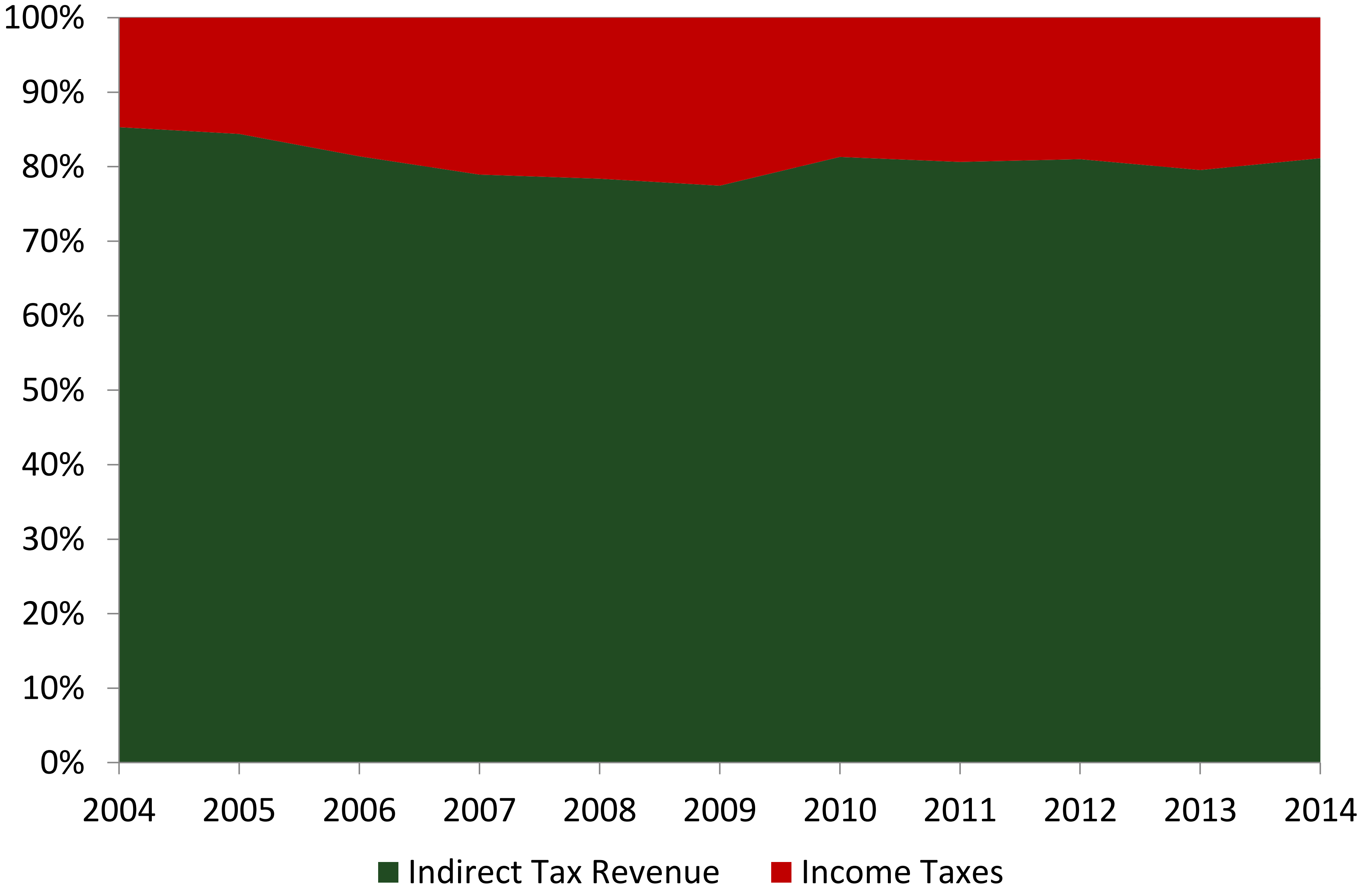
Direct tax:

1. Personal Income tax
2. Corporate Income tax
3. Tax on Interest

Indirect tax

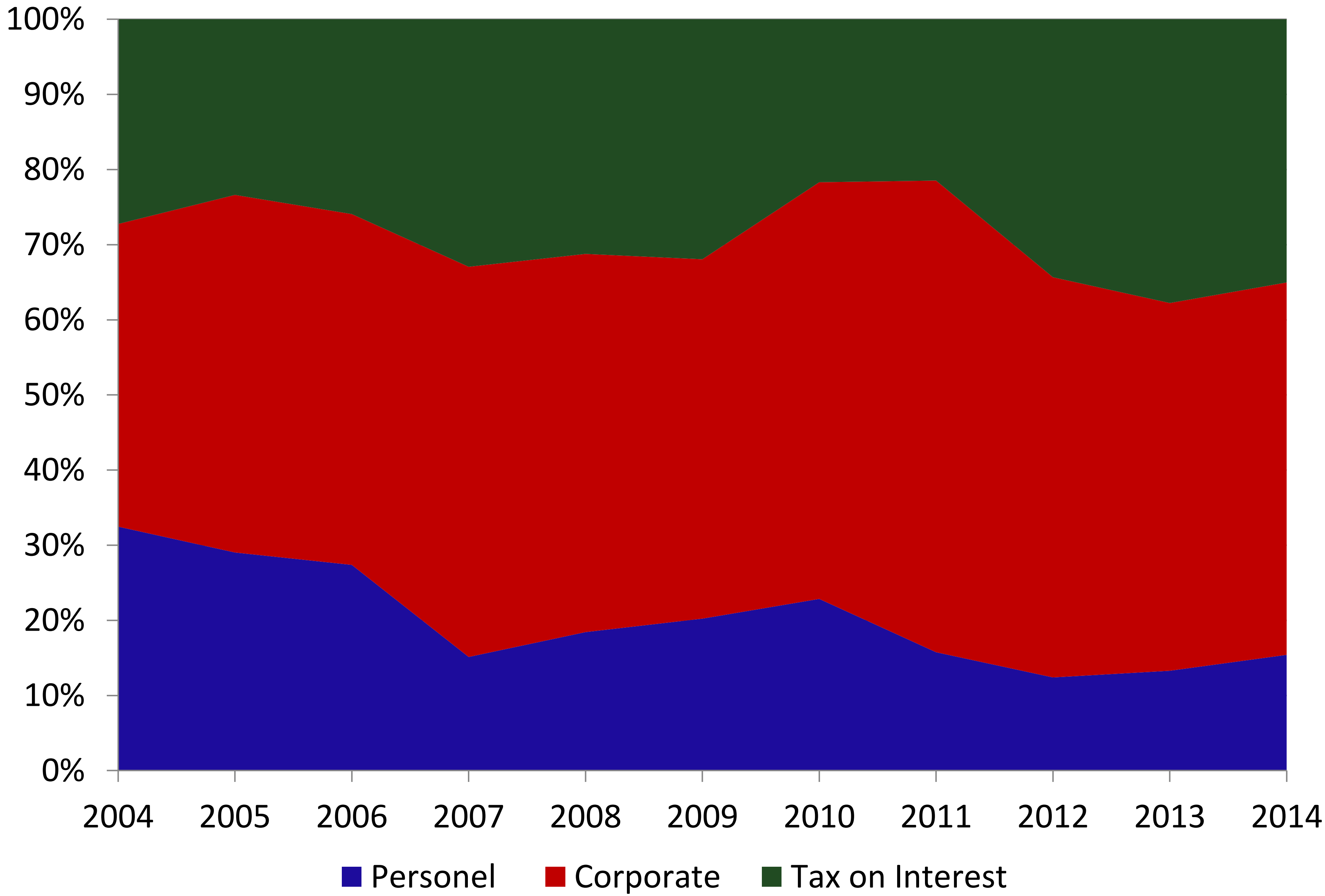
1. VAT
2. Excise
3. Import Duties
4. Other Indirect Taxes

Direct indirect tax mix



- 80 per cent tax revenue from indirect taxes: Regressive
- 20 per cent tax revenue from direct taxes: Progressive
- Sri Lankan tax system is regressive

Composition of Direct taxation (% Total Income Tax)



- Tax revenue from personal income is declining
- Corporate sector is a major contributor: Impact on investment?

Individual Income Tax
Year of Assessment 2014/2015

Taxable Income	Rate
First Rs. 500,000/-	4%
Next Rs. 500,000/-	8%
Next Rs. 500,000/-	12%
Next Rs. 500,000/-	16%
Next Rs. 1, 000,000/-	20%
On Balance	24%

Tax rates for Professionals
Year of Assessment 2014/2015

Taxable Income	Maximum %
Does not exceed Rs. 25Mn	12%
Exceeds Rs. 25Mn but not exceeds Rs. 35Mn	14%
Exceeds Rs. 35Mn	16%

Corporate income tax

Standard Rates	Rates
Not dealing in Liquor and Tobacco	28%
Dealing in Liquor and Tobacco	40%
Dividend Tax	10%
Deemed Dividend Tax	15%
Dividend Distributed out of dividends received out of Sri Lanka	Exempt
Remittance tax on non-resident companies	10%
Relocating International headquarters in Sri Lanka	Exempt
Royalty on International property earned in foreign currency	Exempt

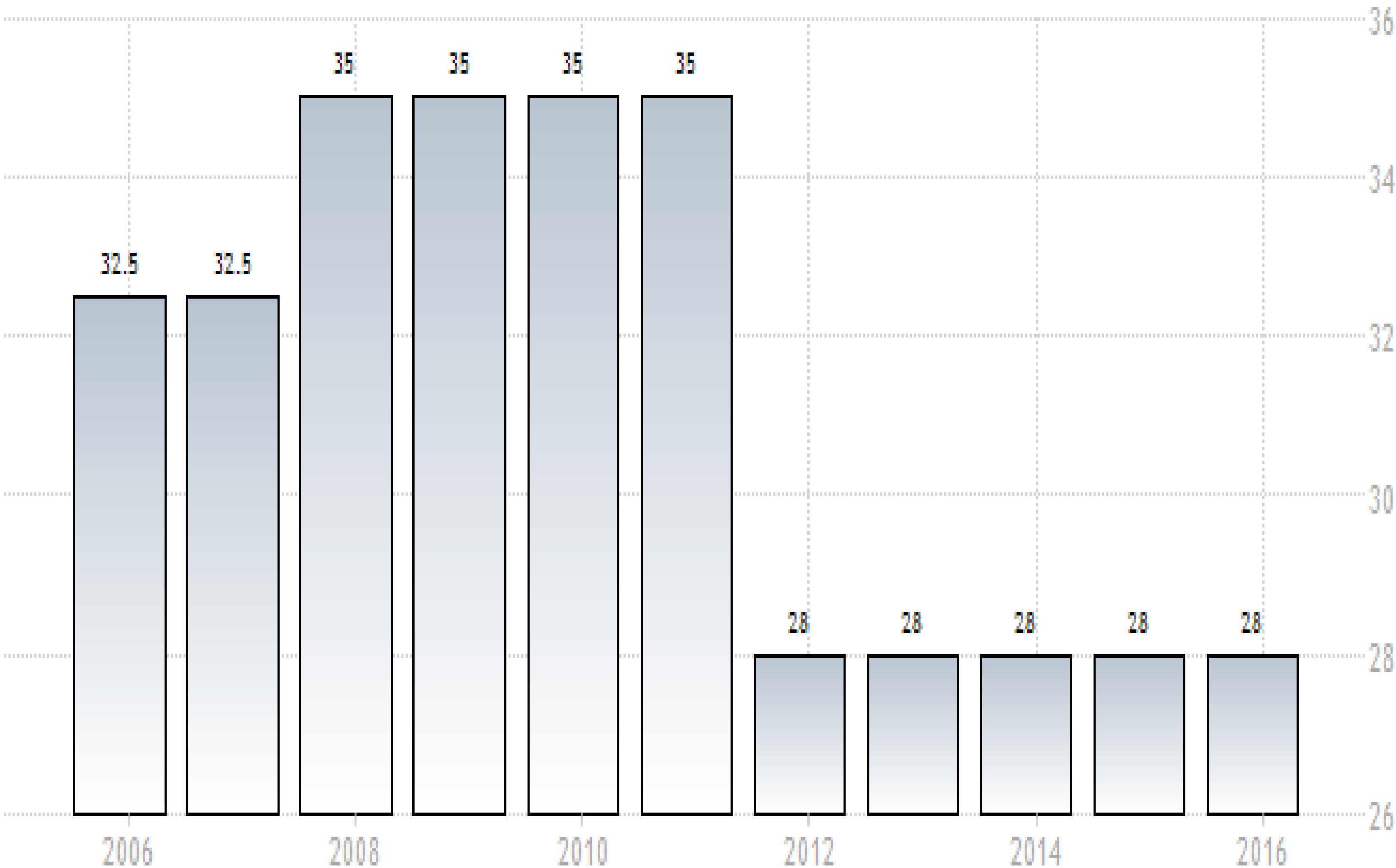
Highest Marginal Corporate Tax Rates in the World-2014

United Arab Emirates	55.0%
Chad	40.0%
United States	**39.1%**
Japan	37.0%
Argentina	35.0%
France	34.4%
Brazil	34.0%
Venezuela	34.0%
Pakistan	34.0%
India	34.0%
Sri Lanka	**28.0%**
Worldwide Average	**22.6%**
Worldwide Weighted Average	30.6%
http://taxfoundation.org/article/corporate-income-tax-rates-around-world-2014	

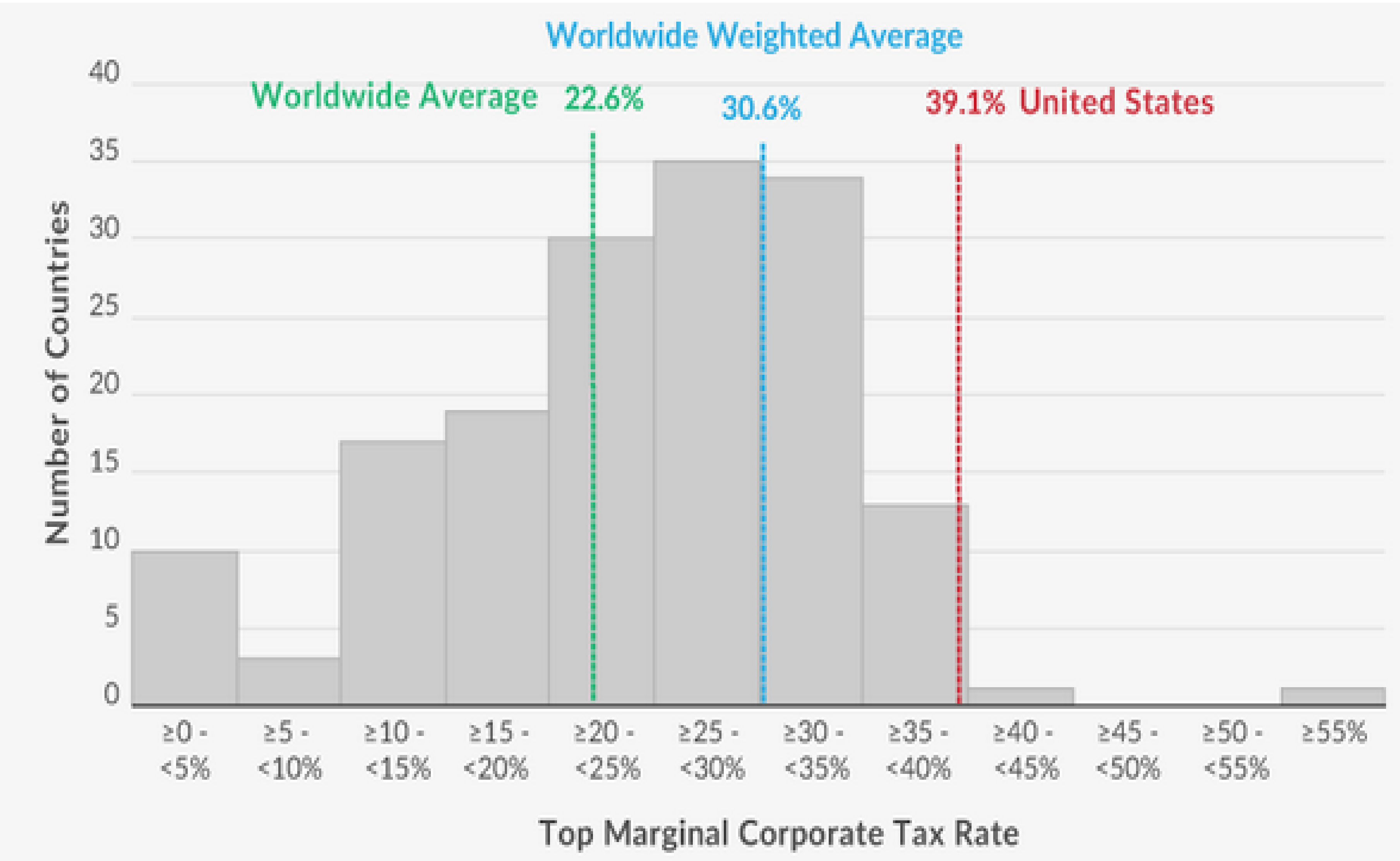
Lowest Marginal Corporate Tax Rates in the World-2014

Jordan	**14.0%**
Ireland	**12.5%**
Cyprus	**12.5%**
Paraguay	**10.0%**
Qatar	**10.0%**
Kyrgyzstan	**10.0%**
Andorra	**10.0%**
Bulgaria	**10.0%**
Montenegro	**9.0%**
Turkmenistan	**8.0%**
Bahrain	**0.0%**
Worldwide Average	**22.6%**
Worldwide Weighted Average	**30.6%**
http://taxfoundation.org/article/corporate-income-tax-rates-around-world-2014	

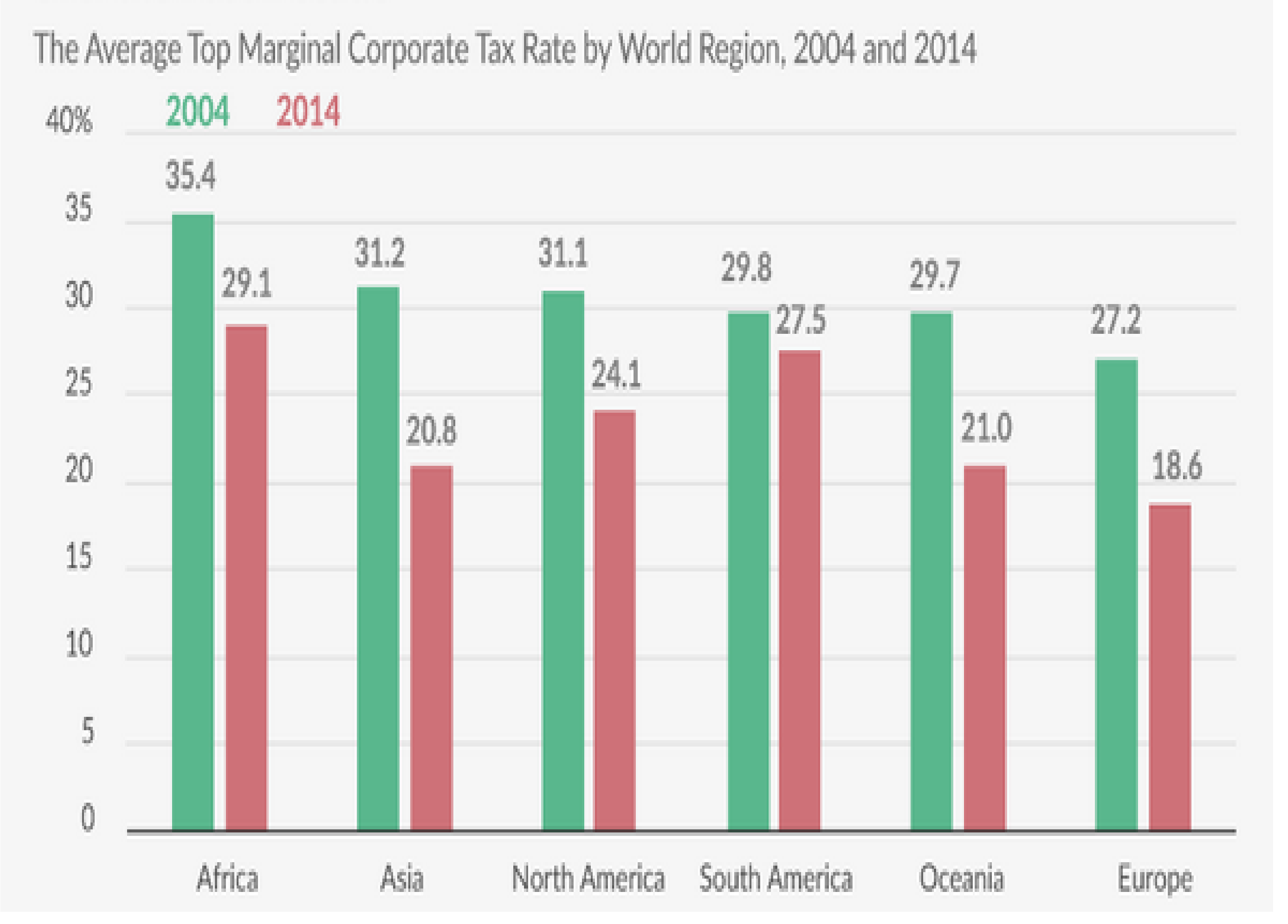
Sri Lanka Corporate Tax Rate



Few Countries with corporate tax rates above 35 Percent:2014



Corporate Tax Rates have Declined in the world: 2004-2014



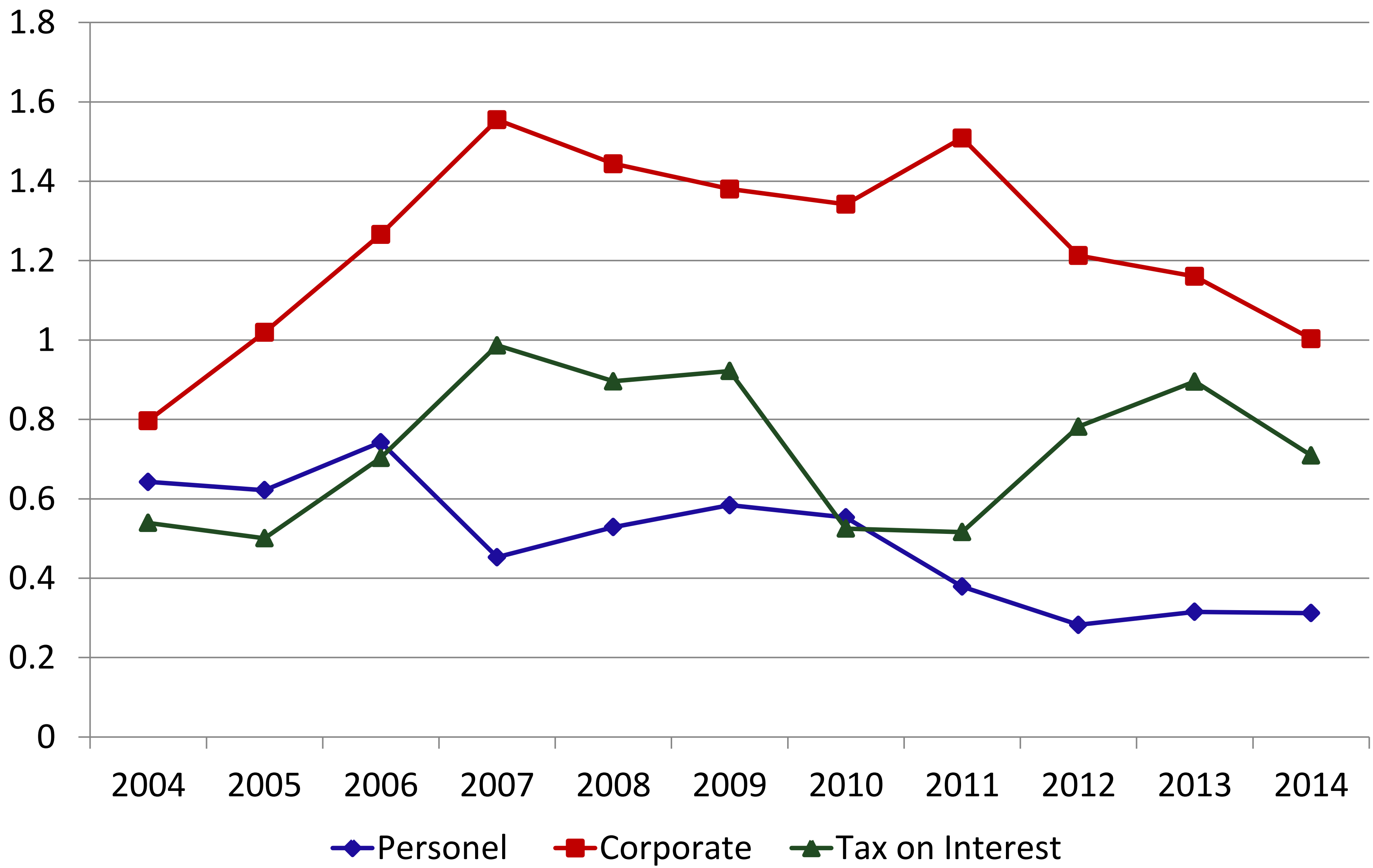
This will affect

- Business expansion
- Investment
- FDI Inflow

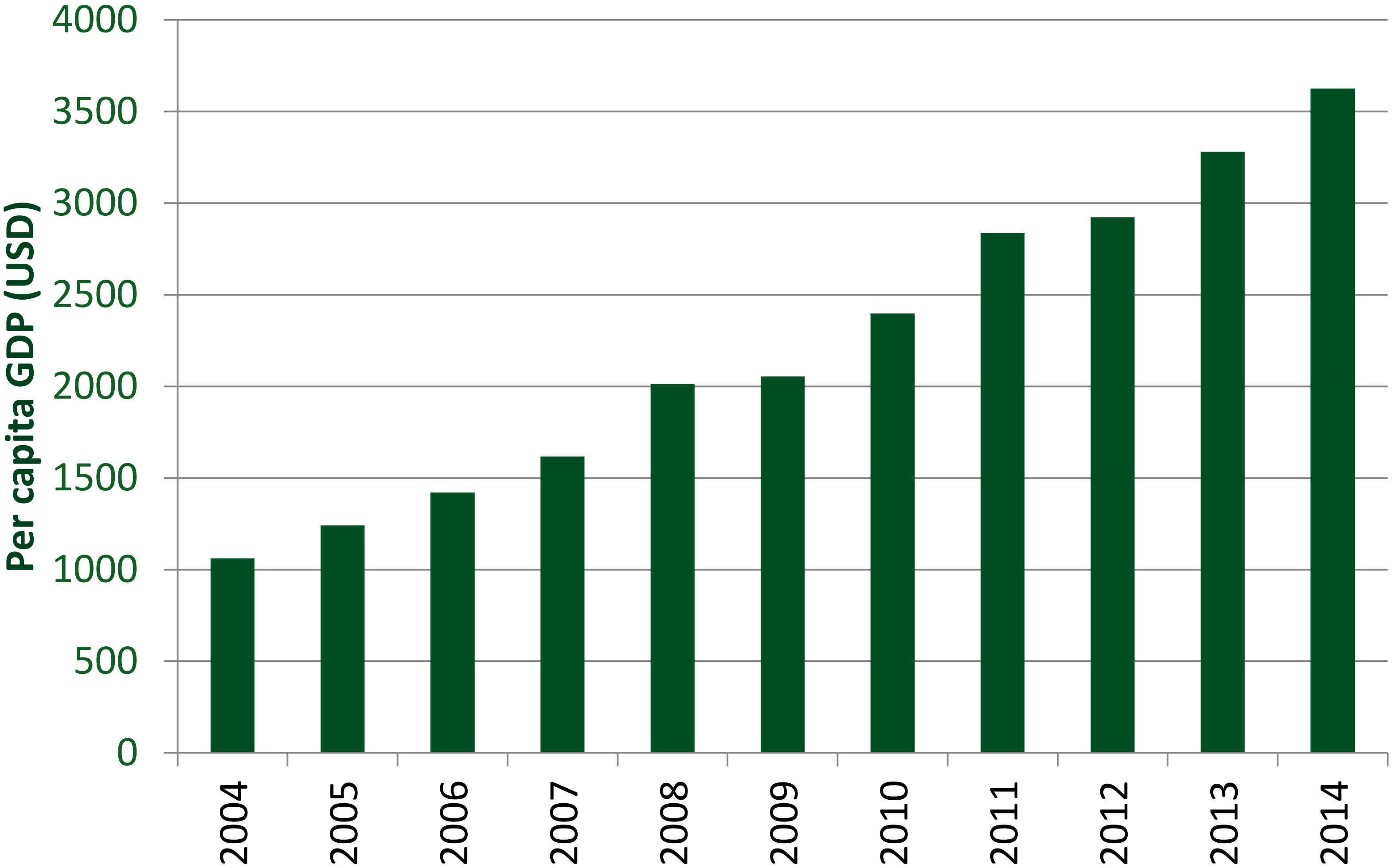
Summarized PAYE Tax Table - Regular Profits from Employment

Monthly Remuneration	Tax
1) Up to Rs. 62,500 /-	Exempt
2) Exceeding Rs. 62,500/- but not Exceeding Rs. 104,167/-	4% of monthly remuneration less Rs. 2,500/-
3) Exceeding Rs. 104,167/-but not Exceeding Rs. 145,833/-	8% of monthly remuneration less Rs. 6,667/-
4) Exceeding Rs. 145,833/-but not Exceeding Rs. 187,500/-	12% of monthly remuneration less Rs. 12,500/-
5) Exceeding Rs. 187,500/-	16% of monthly remuneration less Rs 20,000/-

Income Taxes (% of GDP)



Per capita GDP in Sri Lanka



Income Inequality in Sri Lanka

Income Group	1953	1963	1973	1978/79	1981/82	1986/87	1996/97	2002	2009/ 2010	2012/13
Poor 40%	14.5	14.7	19.3	16.1	15.3	14.1	15.3	13.8	13.8	13.8
Middle Class 40%	31.7	33.0	37.8	34.1	32.8	33.6	34.8	32.5	31.9	32.5
Rich 20%	53.8	52.3	43.0	49.9	52.0	52.3	49.9	53.7	54.3	53.7

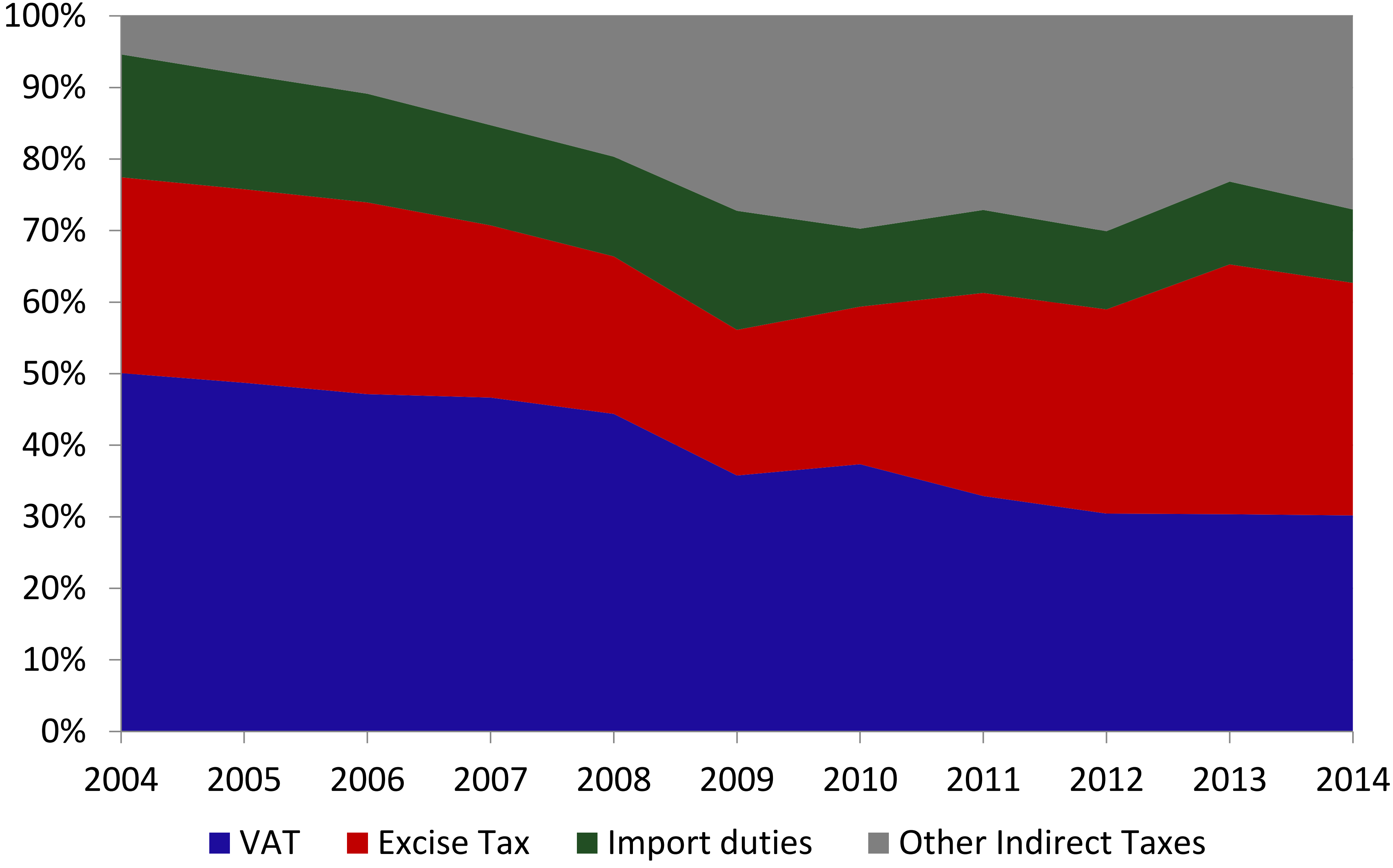
Source: Central Bank of Sri Lanka and Department of Census and Statistics

- **Tax avoidance and evasion:** This year(2014) more than 4,000 private companies and individuals failed to pay their taxes amounting to Rs. 139 billion (Sunday Times: October 5,2014)
- Tax intelligent Unit? FCID?
- Usage of modern technology? Using IC number?
- You are monitored?

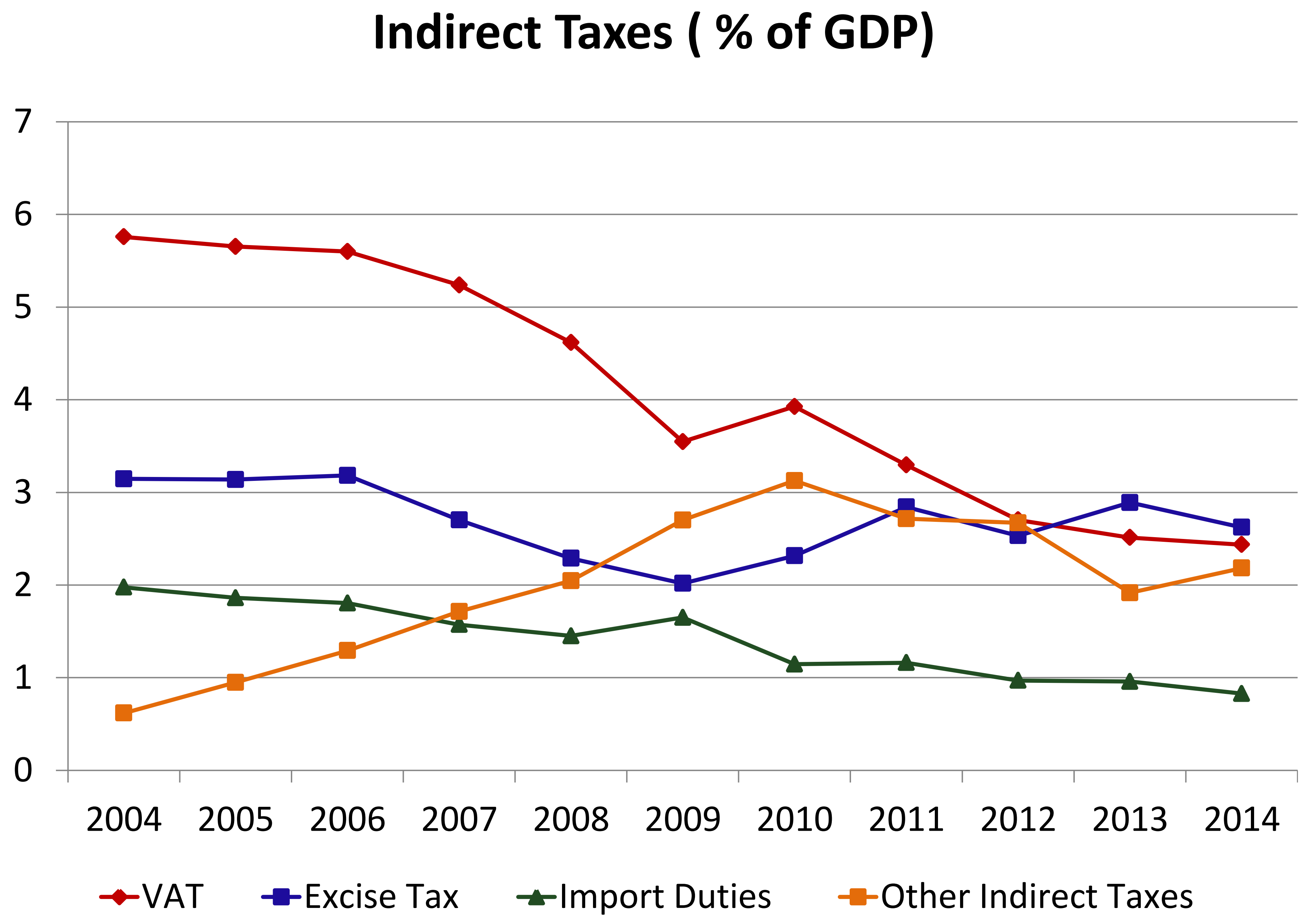
Indirect Taxes

- VAT
- Excise
- Import Duties
- Other Indirect Taxes

Indirect Taxes (% of Total Indirect Taxes)



- VAT : Declining
- Excise : Improvement after 2009
- Import duties: Clear decline(liberalization, WTO etc)
- Other indirect taxes: PAL, NBT, CESS etc



Indirect Taxes (% of GDP)
7
6
5
4
3
2
1
0
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
VAT
Excise Tax
Import Duties
Other Indirect Taxes

- VAT, and import duties are declining,
- Excise: improvement after 2009
- Other indirect taxes: due to ad hoc measures
- Not elastic but buoyancy

- **Value Added Tax**
- Tax on the **value** that is added to goods and services at **each stage** of the **production and distribution process**

BTT

Stage	Amount (Rs)	Tax Rate (%)	Tax (Rs)	Tax Input (Rs)
Instance 1				
Stage 1	100	10	10	110
If in stage 2 Rs 20 is added				
Stage 2	(110+20)=130	10	13	143
Total Tax			23	

VAT

Stage	Amount(Rs)	Tax Rate 10(%)	Tax(Rs)
Instance 1			
Stage 1	100	10	10
If in stage I Rs 20 is added			
Stage 2	20	10	2
Total Tax			12

- France introduced VAT in 1954
- The value-added tax is viewed as
- a business tax which does not reduce profit,
- a consumer tax which unseen by the consumer,
- a low rate tax with large yield,
- a tax with built-in self enforcement in collection,
- VAT is considered more difficult to evade
- From a revenue point of view, VAT is the best tax

Higher Revenue Generation under BTT

Stage	Amount (Rs)	Tax Rate (%)	Tax (Rs)	Tax input (Rs)
1	100	10	10	110
If in stage 2 Rs 20 is added				
2	(110+20)= 130	10	13	143
Total Tax			23	

Inefficiency of BTT

Stage	Amount (Rs)	Tax Rate (%)	Tax (Rs)	Tax Input (Rs)
Instance 1				
Stage 1	100	10	10	110
If in stage 2 Rs 20 is added				
Stage 2	(110+20)=130	10	13	143
Total Tax			23	
Instance 2				
Stage 1	20	10	2	22
If in stage 2 Rs 100 is added				
Stage 2	(22+100)=122	10	12.20	134.20
Total Tax			14.20	

Efficiency of VAT

Stage	Amount(Rs)	Tax Rate 10(%)	Tax(Rs)
Instance 1			
Stage 1	100	10	10
If in stage I Rs 20 is added			
Stage 2	20	10	2
Total Tax			12
Instance 2			
Stage 1	20	10	2
If in stage I Rs 100 is added			
Stage 2	122	10	10
Total Tax			12

Possibility of lower revenue generation under VAT

Stage	Amount (Rs)	Tax Rate (%)	Tax (Rs)
1	100	10	10
If in stage I Rs 20 is added			
2	20	10	2
Total Tax			12

Value Added Tax: International Experience

- Over 136 countries, impost VAT
- VAT raises around 20 per cent of tax revenue

- According to Shoup (1988) the VAT is not ideal for all developing countries where

(a) foreign trade plays a minor role;

(b) small-scale agriculture is important;

(c) retail trade is fragmented among very small sellers;

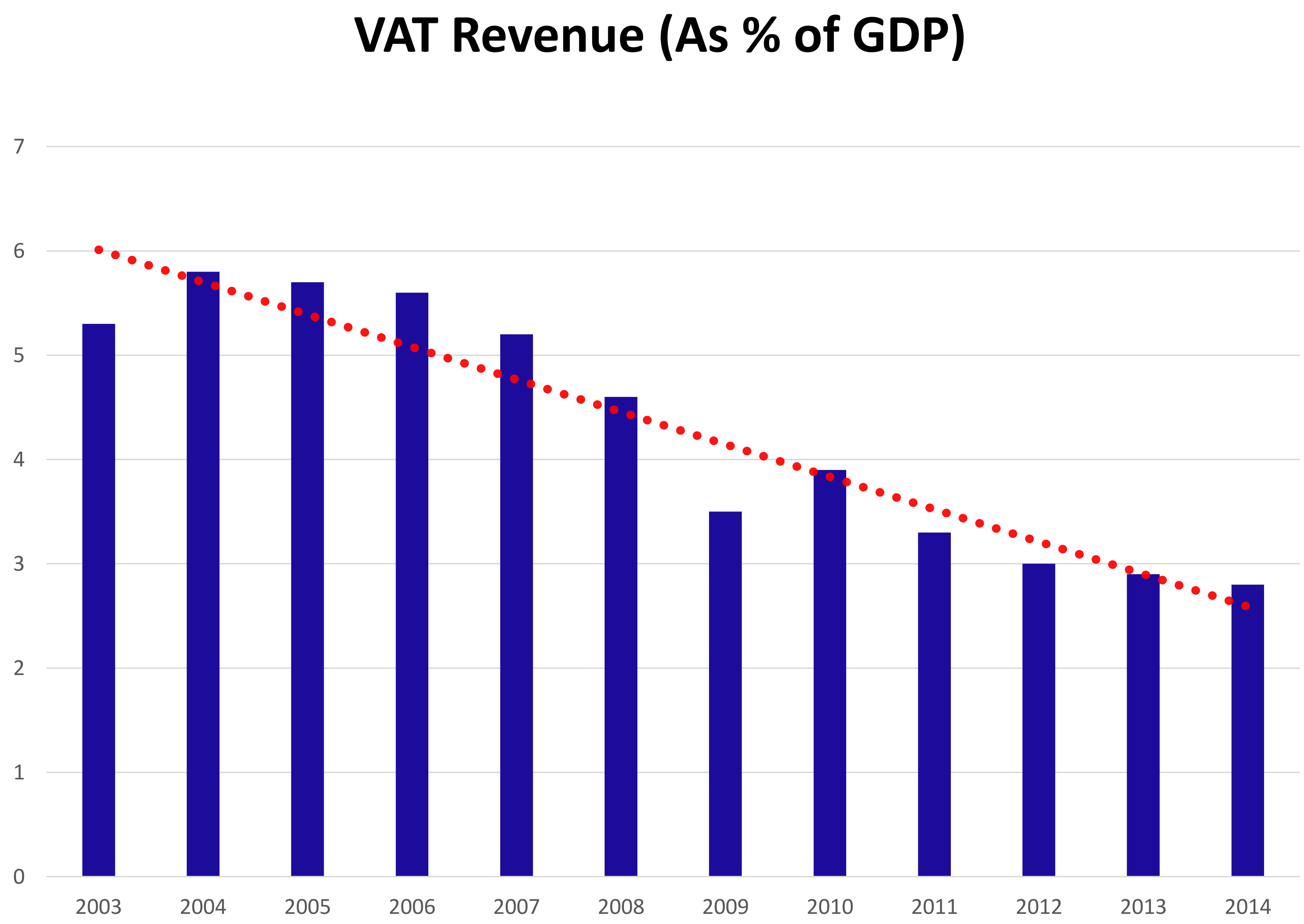
(d) basic accounting is not widespread, and

(e) efficient and impartial tax administration has not been achieved.

- **Value Added Tax: The Sri Lankan Experience**
- Sri Lanka has shifted from Business Turnover Tax(BTT) to Goods and Services Tax(GST) and then from GST to VAT in the past.
- Though the turnover tax is considered to be administratively simple, numerous shortcomings of this tax system existed.

- Among the criticisms leveled at BTT were
- the cascading effect;
- taxation of investment goods;
- vulnerable to evasion and avoidance;
- difficulty of exempting exports;
- difficulty to evaluate the growth and distributional impacts of such a tax system.
- As a result of these shortcomings, turnover tax was labeled an inferior tax over time with more demerits than merits.

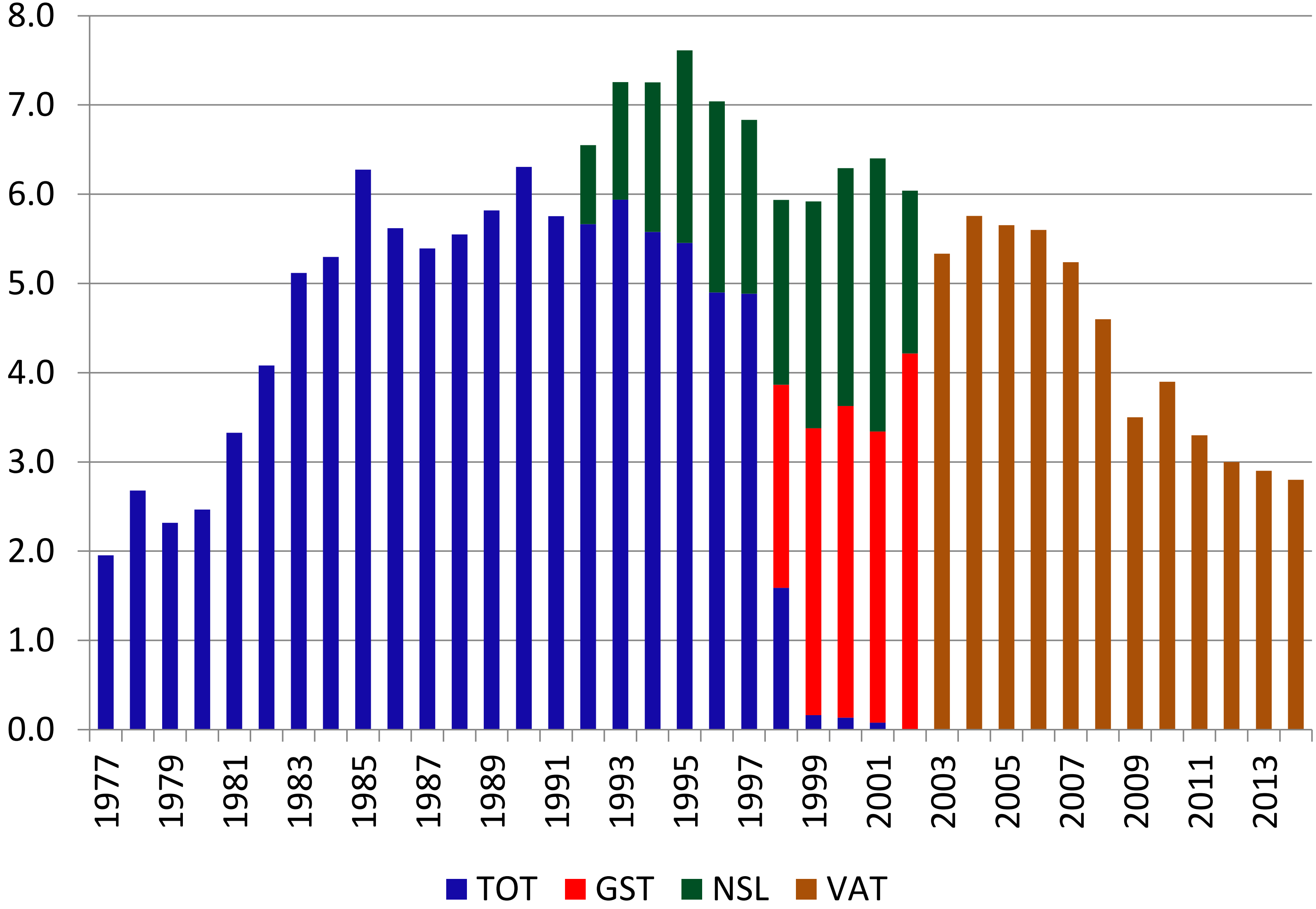
- Sri Lanka introduced value added tax with effect from August 2002.
- It was expected that the VAT will do its job as a ‘money machine’ to increase the tax revenue of Sri Lanka.


VAT Revenue (As % of GDP)
7
6
5
4
3
2
1
0
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014

VAT
(Year of Assessment 2015/2016)

Description	Rate
Standard Rate	11%
VAT on Financial Services	11%
On wholesale and retail business with turnover not less than Rs. 100 Mn per quarter	11%
Direct export of goods & supply of certain services referred to in section 7 of the VAT Act (Zero rated supplies)	0%

Revenue from TOT, GST, NSL and VAT (As a % of GDP)



- The performance of the VAT has not been satisfactory
- The Sri Lankan experience contradicts the theory.
- Sri Lankan VAT contrasts sharply with its reputation as a ‘money machine’.
- It seems that the turnover tax system performed relatively well as far as revenue generation is concerned.

- Presently VAT is not money machine in Sri Lanka : Why?

✓ its complicated structure,

✓ administrative weaknesses,

✓ political influence,

✓ tax avoidance and evasion,

✓ complexities in the tax law,

✓ lack of application of modern information technology, etc.

- VAT implementation: Difference between Sri Lanka and other countries
- Like France, Sri Lanka did not introduce a restricted version of VAT at the beginning and did not take many years to introduce a comprehensive tax system.
- Sri Lanka introduced a comprehensive VAT within a one year period.
- Many countries planned well and ensured taxpayer education, before the implementation of VAT

- Korea prepared a film about the VAT which was shown in every movie theater.
- Australia introduced VAT in the year 2000 after 25 years of consumption tax reform effort.
- China took fifteen years to introduce a comprehensive VAT.

- However, Sri Lanka introduced VAT within a short period of time on a broad base goods and services.
- Though Sri Lanka introduced VAT on 1st July 2002, even the empowering law was not in place at that time.
- VAT was hurriedly introduced in Sri Lanka without the development of proper infrastructure.
- VAT was introduced in 2002, up to date not even 50 per cent of possible tax payers have been included in tax system.
- Therefore the VAT is unable to function as a ‘money machine’ for Sri Lanka.

- Shoup (1988) argues that the VAT is not ideal for all developing countries under certain circumstances.
- Among them four circumstances are applicable to Sri Lanka.

1) small-scale agriculture is important,
2) retail trade is fragmented among very small sellers,
3) basic accounting is not widespread, and
4) efficient and impartial tax administration has not been achieved-

The VAT may not be an ideal tax and money machine for Sri Lanka until **these circumstances disappear** as a result of economic change or are **resolved by the tax authority**.

- Possible measures to improve VAT.

- ✓ More taxation on the growing economic sectors (luxury apartments?)
- ✓ Heavier taxation on income-elastic items (e.g. - vehicles, petroleum products,
- ✓ Bringing informal economic activities into tax system,
- ✓ heavier taxation on price-inelastic items (e.g. - alcoholic beverages and tobacco products).
- ✓ Using modern technology
- ✓ Strengthening administrative mechanism

Tax Invoice

		VAT Reg No: 12345678-7000	
		Date: 15.01.2011	
PINO Ltd., Galle Road,			
Colombo : 06		Date of Supply;:13.01.2011	
To: LINEX Ltd., Galle Road			
Colombo: 03			
Description of Supply	Quantity/Volume	Rate	Rs
Supply of Chairs	12	200.00	2,400.00
Supply of Tables	10	300.00	3,000.00
			5,400.00
VAT at 12%			648.00
			6,048.00

Budget 2016

Income Tax - Individuals

1	**Progressive tax rates to be removed** **- Single standard tax rate of 15%.**
2	Tax free allowance increased to **Rs. 2.4 Mn.** P.A. (i.e. Rs. 200,000 P.M.) - All cash and non-cash employment benefits are liable to tax
3	Remuneration received from multiple employments, if any, will all be taxed at the standard rate of **15%**.

Calculation of Income Tax

An individual receiving monthly income of Rs. 300,000

Pre Budget

Monthly tax payable

= (Rs. 300,000 x 16% - Rs. 20,000)

= Rs. 28,000

Post Budget

Monthly tax payable

= (Rs. 300,000 - Rs. 200,000)x15%

= Rs. 15,000

Country	Highest Tax Rate (%)
USA	39.6
India	33.99
Indonesia	30
Malaysia	26
Singapore	20
Hong Kong	15
Sri Lanka	15

Corporate Income Tax

15%	Standard Rate
30%	• **Betting and gaming** • **Liquor and Tobacco** • **Banking and Finance including insurance, leasing and related activities** • **Trading activities other than manufacturing or provision of services**

- **Singapore – 17%**
- **Hong Kong – 16.5%**
- **India – 30%**
- **Malaysia – 24%**
- **Indonesia – 25%**

- Indirect Taxes

VAT Rates

0	**Export of goods and provision of services outside Sri Lanka paid / payable in foreign currency**
8	Manufacturing or import and sale of goods (Limitation of input tax is applicable)
12	Service sector

VAT

Threshold	**LKR 3 Mn per quarter or LKR 12 Mn p.a.**
Exclusion	**Wholesale and retail trade (other than by a manufacturer or importer)**

NBT Rates

	Now	From January 2016
Standard Rate	2	4
Distributors	0.5	1
Traders	1	2

Customs Duty

Current	Proposed
0	0
7.5	-
15	15
25	30

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