

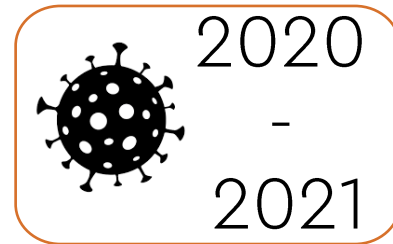
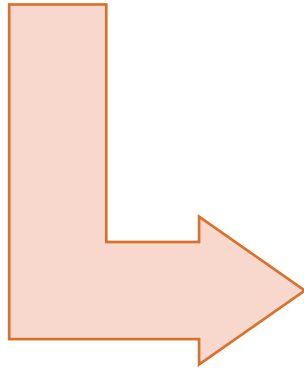
Recent Revenue Mobilization in Sri Lanka

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Department of Fiscal Policy
Ministry of Finance, Economic Stabilization and National Policies

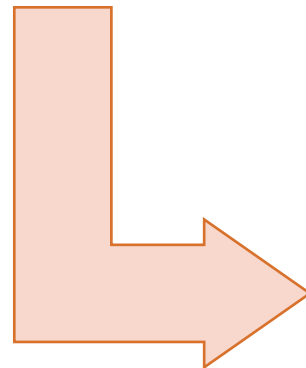
Deep-rooted economic crisis of Sri Lanka



- Major tax cuts across key taxes- Policy missteps
 - Reduced tax rates particularly in income Taxes and Value Added Tax
 - Reduced tax bases particularly in Income Taxes and Value Added Tax
 - Awarding of tax exemptions and concessions
 - Abolishment of key revenue-generating taxes (Economic Service Charge, Nation Building Tax, etc.)



- Continuous impact of COVID-19 and related economic conditions
 - Low tax revenue to economic inactivity and import restrictions imposed to balance of payment pressures
 - High Expenditure due to social welfare needs, increased inflation, and high health expenditure
 - Government had to rely on domestic financing to finance the deficits with the loss of access to global capital markets



- Eruption of economic crisis
 - Severe government cash flow constraints
 - Unsustainable government debt
 - Fiscal imbalances, along with balance of payment pressures, adjudged to be roots of the economic crisis

Economic Crisis

Foreign Exchange Crisis



Economic Crisis

Fiscal Crisis

Tax issues - Current system not delivering needed revenue

Too many exemptions, lot of evasion

A few days before President Mahinda Rajapaksa presents the 2011 national budget (takes place tomorrow), Dr. Saman Kelegama, Executive Director, Institute of Policy Studies of Sri Lanka and Member of the Presidential Taxation Commission, spoke to the Business Times on the serious issues that confront tax reform in the country.

How Sri Lanka's tax cuts crippled its economy

AUTHOR : SOUMYA BHOWMICK

Expert Speak Raisina Debates

Published on Aug 06, 2022



Will the recent tax changes alleviate the ongoing economic crisis?

Role of tax cuts in Sri Lankan crisis

Sri Lanka Lost Around 10 Lakh Taxpayers Since 2019 Tax Cuts: Finance Minister Sabry

The Cabinet had slashed the value added tax (VAT) to 8 per cent from 15 per cent and also abolished seven other taxes

Economic Crisis

Fiscal Crisis (2)

“Tighten your belts”: Special Circular issue to the Government sector

January 14, 2024 at 1:11 PM

No new recruitments to public service except for essential vacancies?

October 8, 2023 10:40 am

No spending for functions – Secy. to the Treasury issues circular again

November 27, 2022 at 3:08 PM

**f Sri Lanka has little tax money left
t after paying state workers, economy
e in historic crisis: Bandula**

Circular issued to state institutions to cut down budgetary provisions for 2023

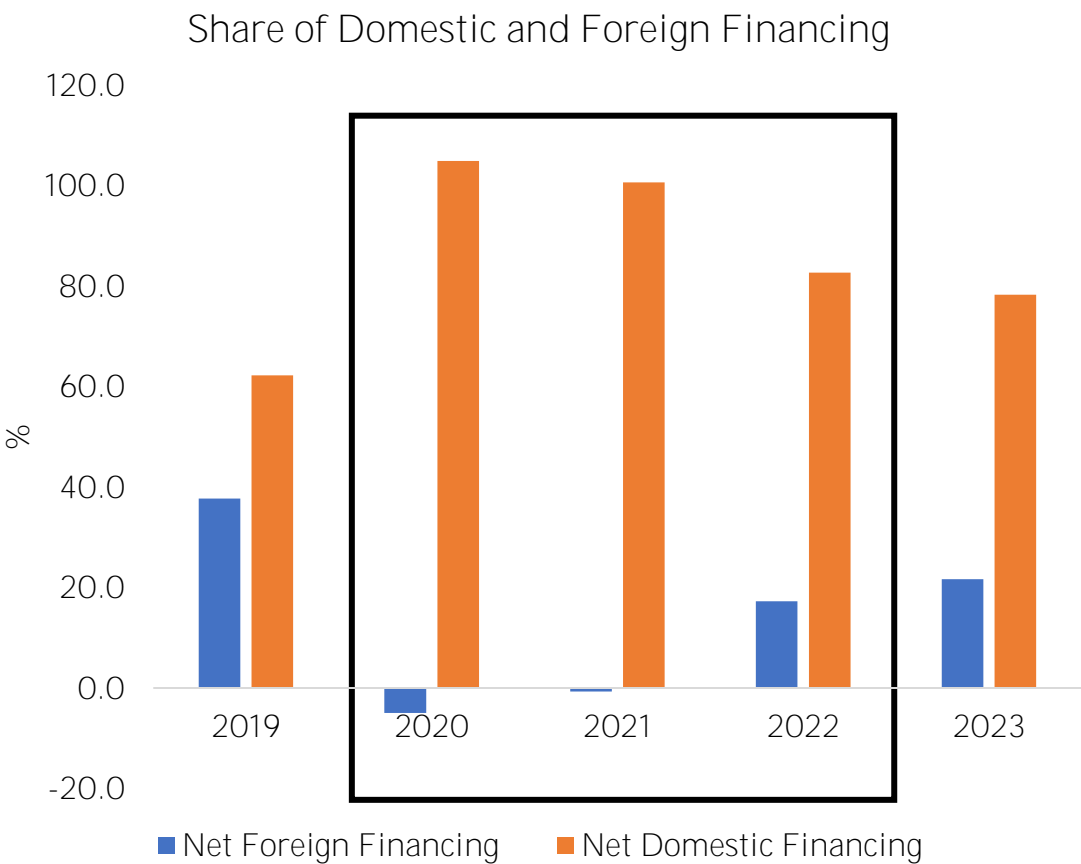
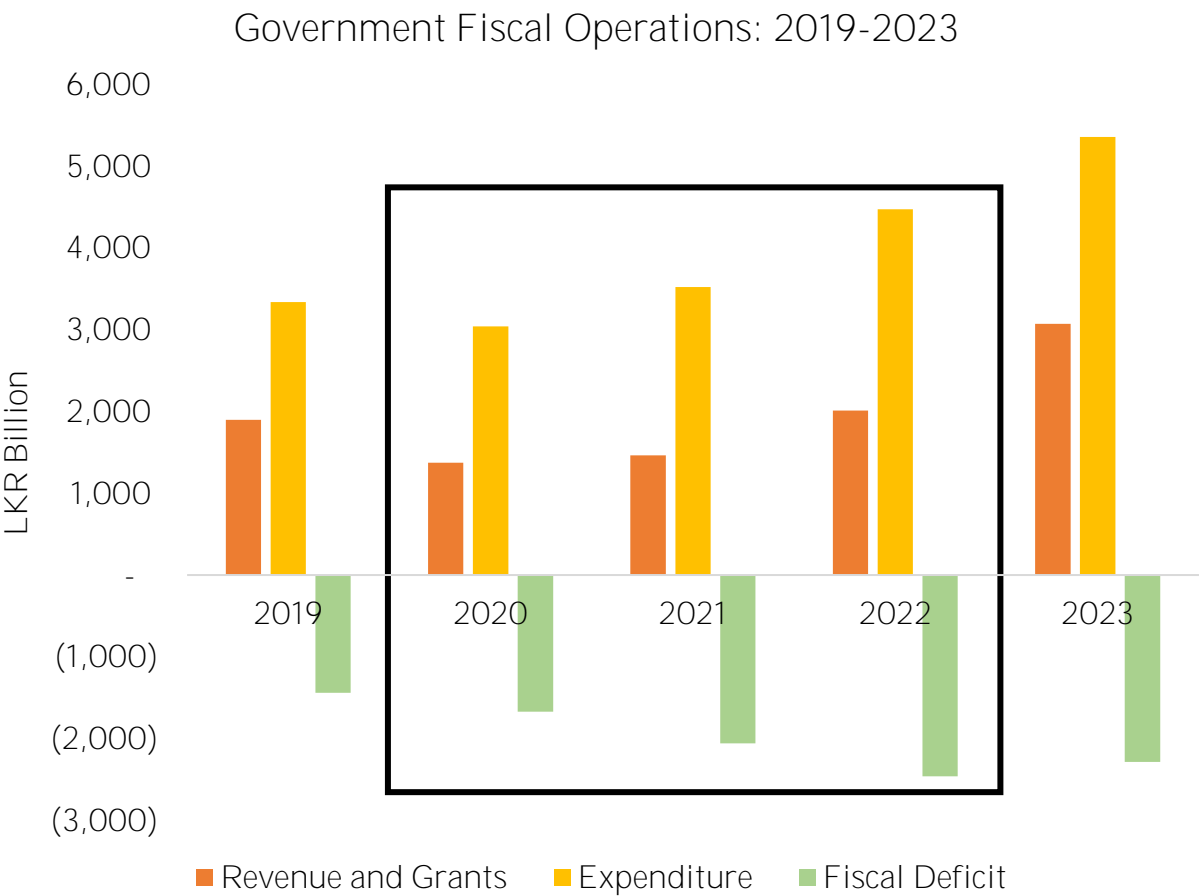
February 2, 2023 07:04 am

Treasury in crisis, govt employees' salaries & Samurdhi allowances to be delayed - Bandula

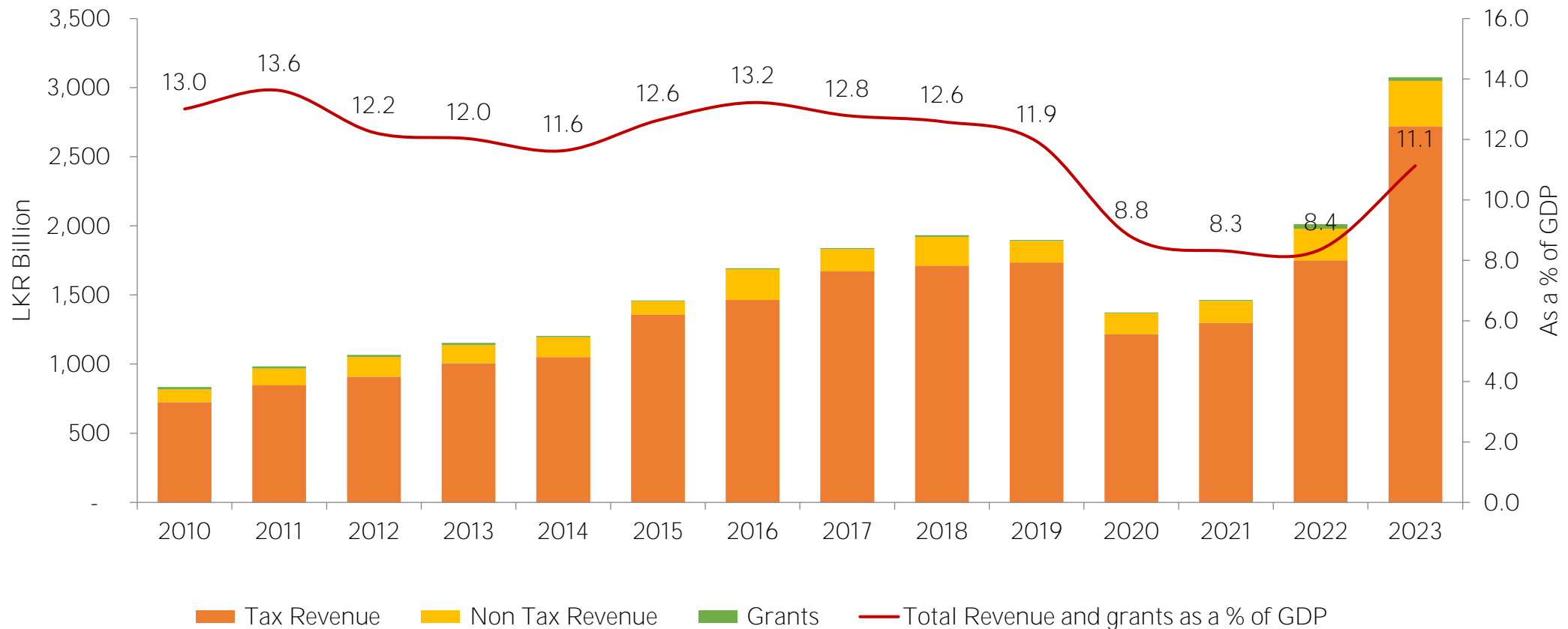
January 10, 2023 11:38 am

Economic Crisis

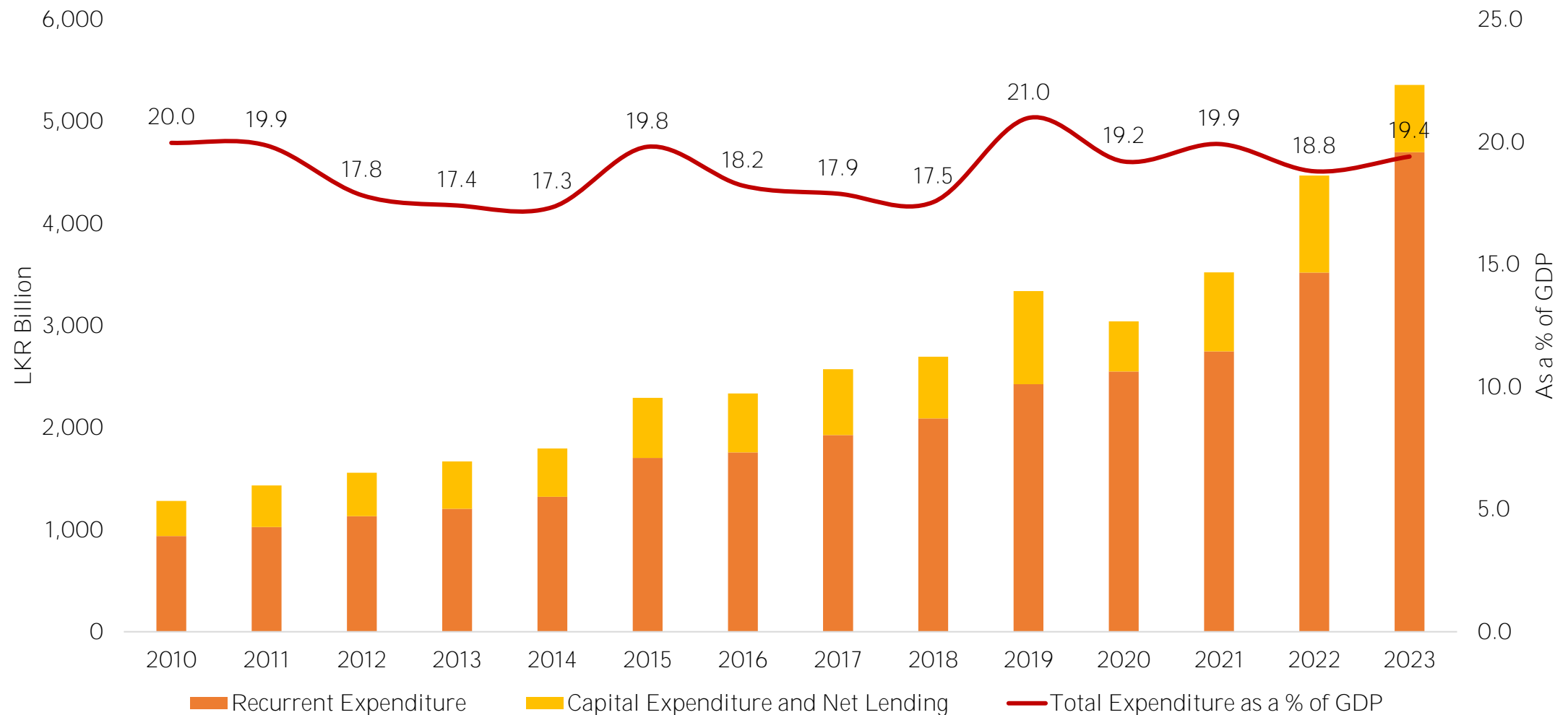
Fiscal Crisis (3)



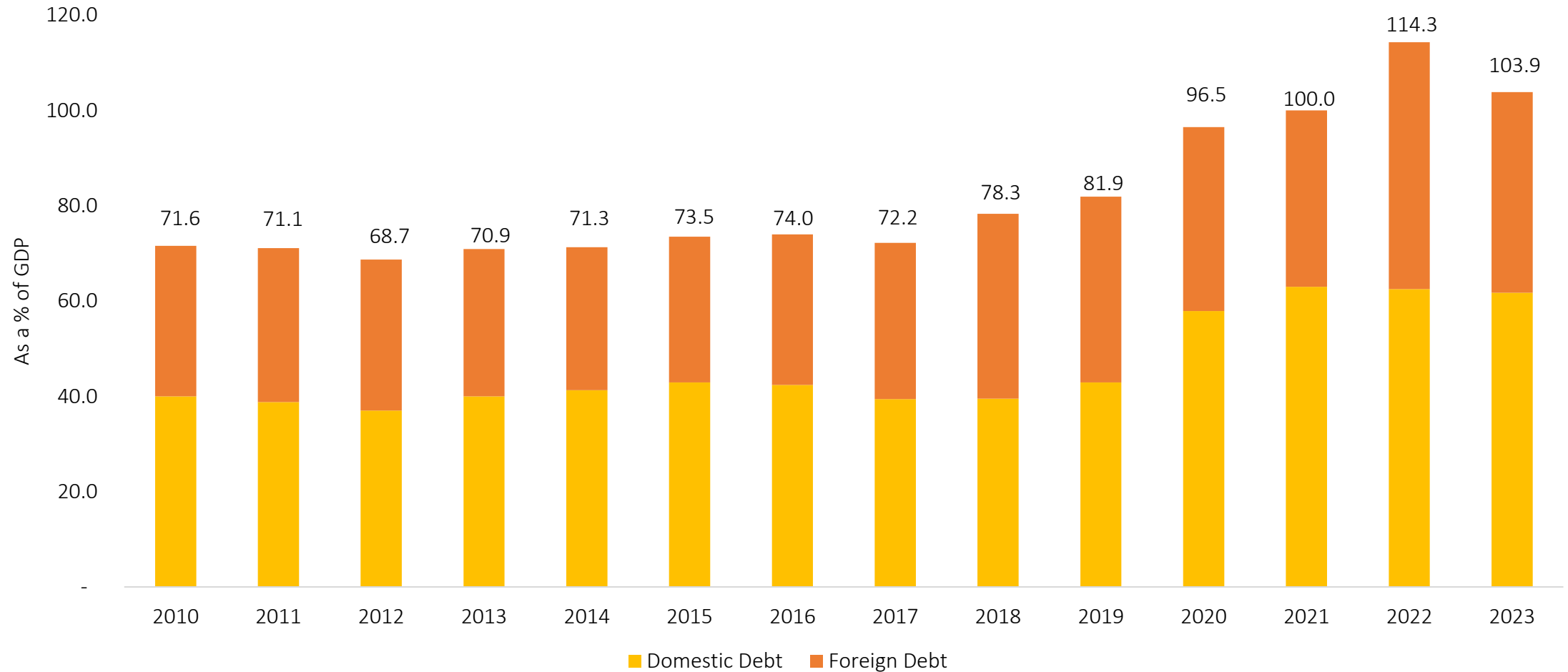
Revenue yield has been alarmingly low mainly due to policy missteps...



Expenditure has been maintained at around 20 percent of GDP...



Central Government Debt rose over 100 percent of GDP...



Revenue-based Based Fiscal Consolidation

Key Policy interventions (1)

Since 2022, the Government has been implementing a number of revenue measures focusing on making the tax system more

- Progressive
- Broad-based
- Compliant; and
- Simplified

Key Policy interventions (2)

More Progressive Personal Income Tax Rates

Tax Slabs decreased and tax rates increased

Previous

First Rs. 3 Mn – 6%

Next Rs. 3 Mn – 12%

On the Balance – 18%



Revised

First Rs. 0.5 Mn – 6%

Next Rs. 0.5 Mn – 12%

Next Rs. 0.5 Mn – 18%

Next Rs. 0.5 Mn – 24%

Next Rs. 0.5 Mn – 30%

On the Balance – 36%

Key Policy interventions (3)

Rate Increases

Tax	Time	Rate (%)	Tax	Change
Corporate Income Tax	Up to 31.09.2022	24%	Excise Duties on Liquor and Tobacco	<ul style="list-style-type: none"> Multiple increases in 2022 and 2023 Indexed to inflation since 2024
	From 01.10.2022	30%		
Value Added Tax	Up to 31.05.2022	8%	Excise Duty on Petroleum	<ul style="list-style-type: none"> Two time increase in 2023 by Rs. 25 per litre each.
	Up to 31.08.2022	12%		
	Up to 31.12.2023	15%	Excise Duty on other articles	<ul style="list-style-type: none"> Indexed to inflation since 2024
	From 01.01.2024	18%		
Telecommuni-cation Levy	Up to 31.05.2022	11.25%		
	From 01.06.2022	15%		
Betting and Gaming Levy	From 01.04.2023	Increased for all applicable categories		

Key Policy interventions (4)

Tax Base Broadening

Tax	Time	Change (%)
Personal Income Tax	From 01.10.2023	<ul style="list-style-type: none">• Reduction of Personal Income Tax (PIT) relief from Rs. 3 million to Rs. 1.2 million• Removal of Expenditure Relief up to Rs. 1.2 million
Corporate Income Tax	From 01.10.2022	Removal of sector-specific exemptions and concessionary rates
Value Added Tax	From 01.10.2022	Reduction of registration threshold from Rs. 300 million per annum to Rs. 80 million
	From 01.01.2024	Reduction of registration threshold from Rs. 80 million per annum to Rs. 60 million
	From 01.01.2024	Removal of majority of exemptions
Social Security Contribution Levy	From 01.10.2022	Introduction of a new tax based on turnover

Key Policy interventions (5)

Increasing Compliance

Reinstating Withholding Tax on Employment Income

- Withholding tax on Employment Income or Advance Personal Income Tax (APIT) made mandatory for all liable taxpayers
- Earlier, it was only mandatory for non-residents and was optional for residents

Reinstating Withholding Tax

- Withholding tax on other payments or Advance Income Tax (AIT) made mandatory under following rates

Rate (%)	Relevant Category	Final/Non-Final
15	Dividend	Final
5	Interest or discount paid	Non-Final
10	Rent payments exceeding Rs. 100,000 per month	Non-Final
5	Service payments exceeding Rs. 100,000 made to individuals such as professionals	Non-Final
14	In all other cases	Non-Final

Key Policy interventions (6)

Increasing Compliance- Strengthening Tax Administration

- Introducing compulsory tax registration for all residents who are above 18 years of age.
- Expanding mandatory electronic tax filing system introduced to the corporate sector to the non-corporate taxpayers including employees.
- Discouraging cash transactions and encouraging bank/card transactions with specific limits by not allowing payments in aggregate to Rs. 500,000 or more in a day or a single transaction or a single event to be deducted as expenses for tax purposes.
- Obligating financial institutions to submit taxpayer transaction information to the Inland Revenue Department (IRD) and facilitating information sharing by relevant government institutions to the IRD.
- Introducing modern risk-based audits.
- Establishing a High Wealth Individuals (HWI) Unit at the IRD.
- Enhancing digital revenue administration systems at key revenue departments.

Key Policy interventions (7)

Simplification of Tax System

Phasing out para-tariff

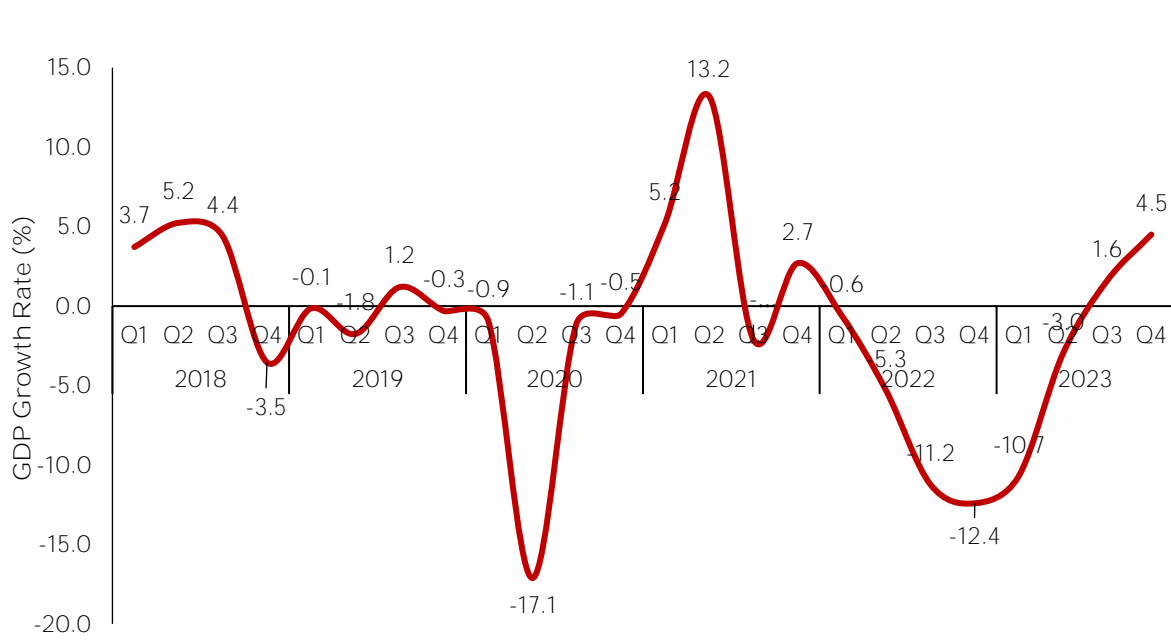
- Key taxes based on international trade will be phased out in a revenue-neutral manner.
 - Special Commodity Levy will be abolished in 2024 and VAT and SSCL will be applied.
 - CESS Levy (Commodity Exports Subsidy Scheme Levy) will be phased out in 3 years commencing from 2023
 - Ports and Airports Development Levy (PAL) will be phased out in 5 years commencing from 2023
 - Forgone revenue from CESS and PAL will be recouped through increase of Customs Import Duty (CID)

Improvements in the Macroeconomic Environment (1)

The economy shifted towards a positive economic growth momentum

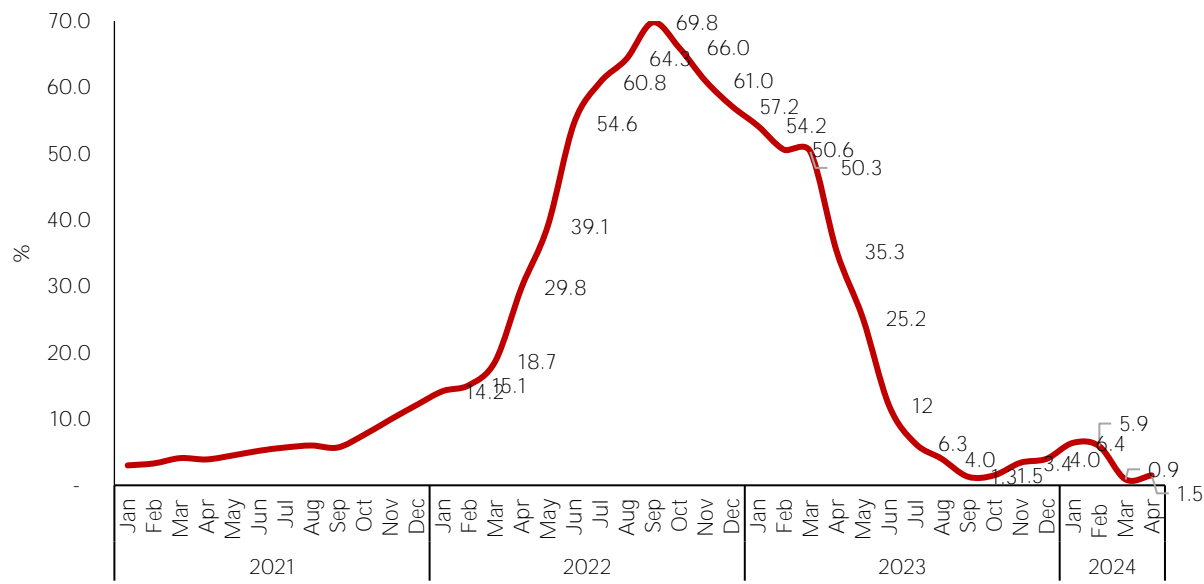
CCPI returned to a single digit level

Quarterly GDP Growth Rate



Source : Department of Census and Statistics

Monthly movements of Inflation- Colombo Consumer Price Index

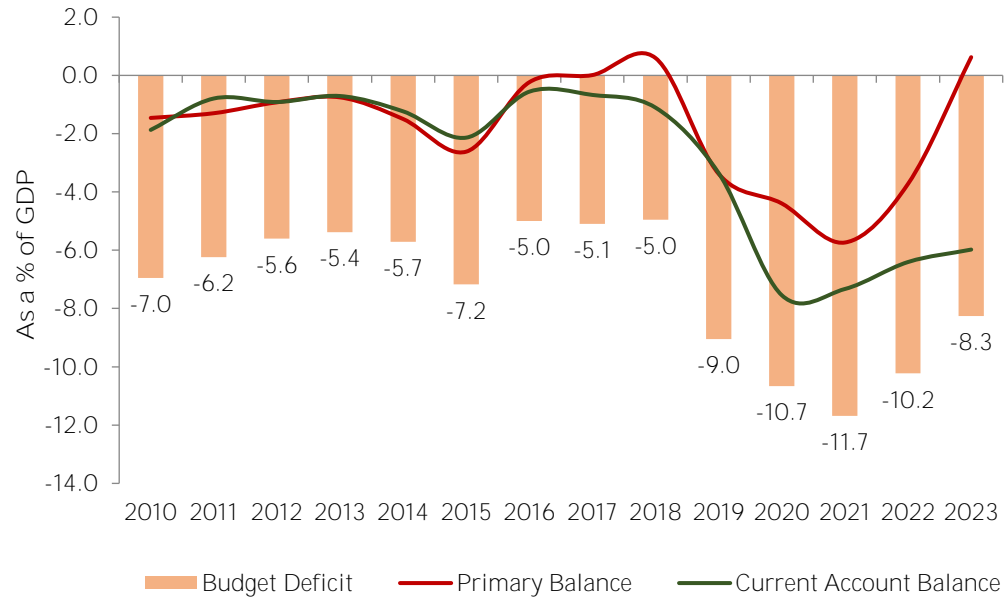


Source : Department of Census and Statistics
Note: 2020 January-2023 January based on CCPI(2013=100) and 2023 January-2024 April based on CCPI (2021=100)

Improvements in the Macroeconomic Environment (2)

Major Fiscal Balances improved

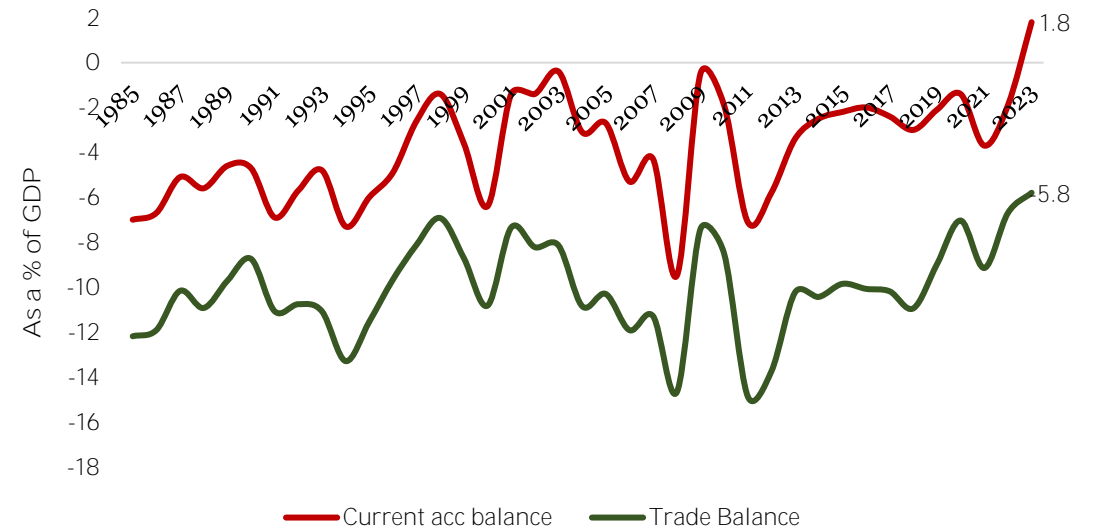
Major Fiscal Balances (% of GDP)



Source : Department of Fiscal Policy

External sector improved with positive growth

Trade Balance and Current Account Balance (% of GDP)

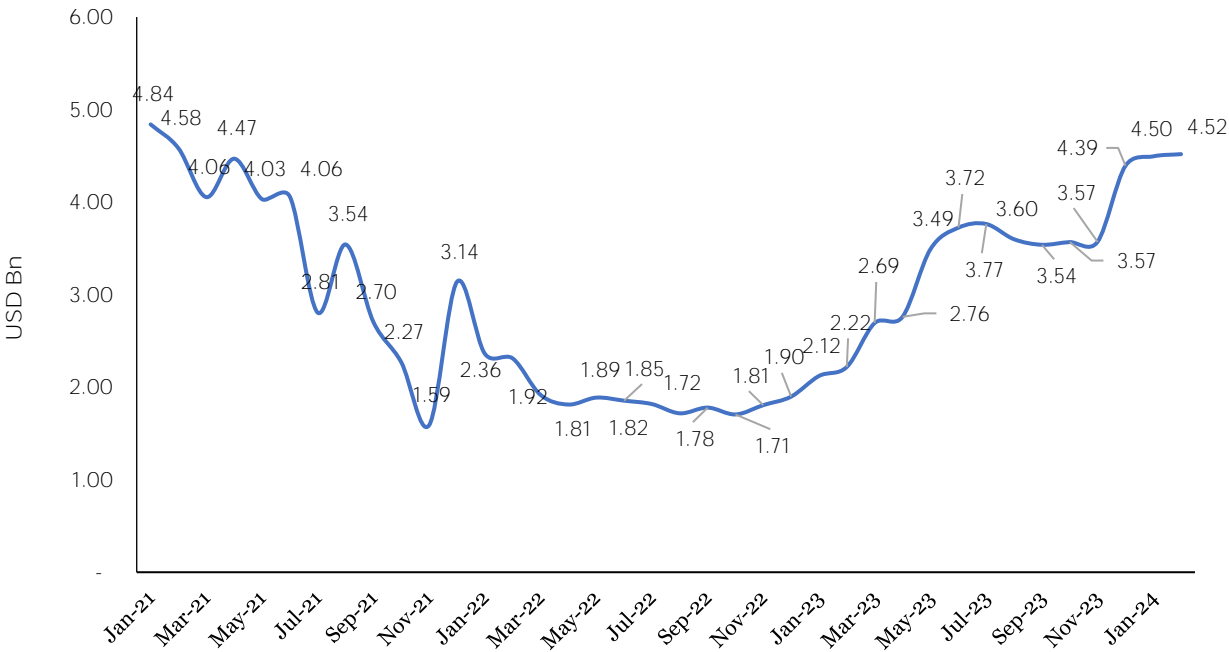


Source : Central Bank of Sri Lanka

Improvements in the Macroeconomic Environment (3)

Gross official reserves increased substantially

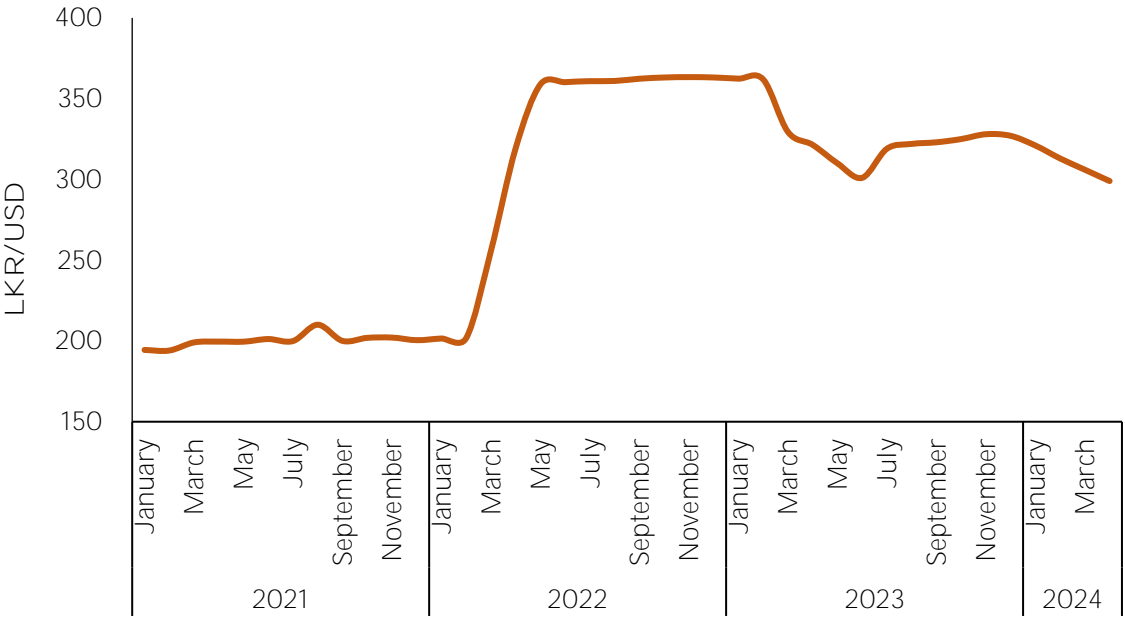
Gross official reserves



Source : Central Bank of Sri Lanka

Exchange Rate remained relatively stable

Exchange Rate Movements

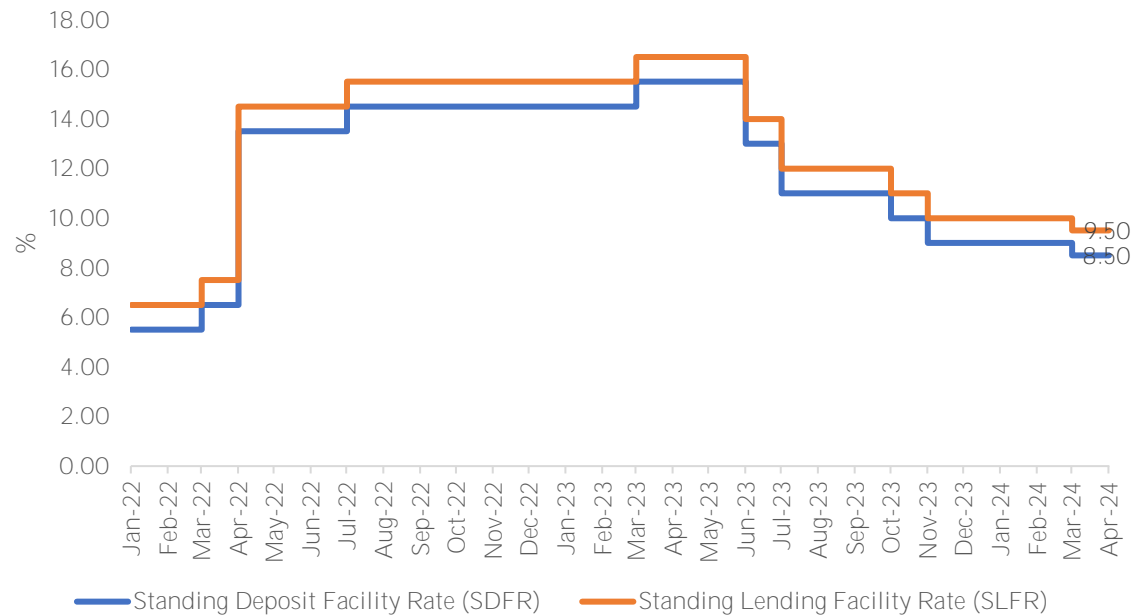


Source : Central Bank of Sri Lanka

Improvements in the Macroeconomic Environment (4)

Interest Rates reduced with easing of monetary policy

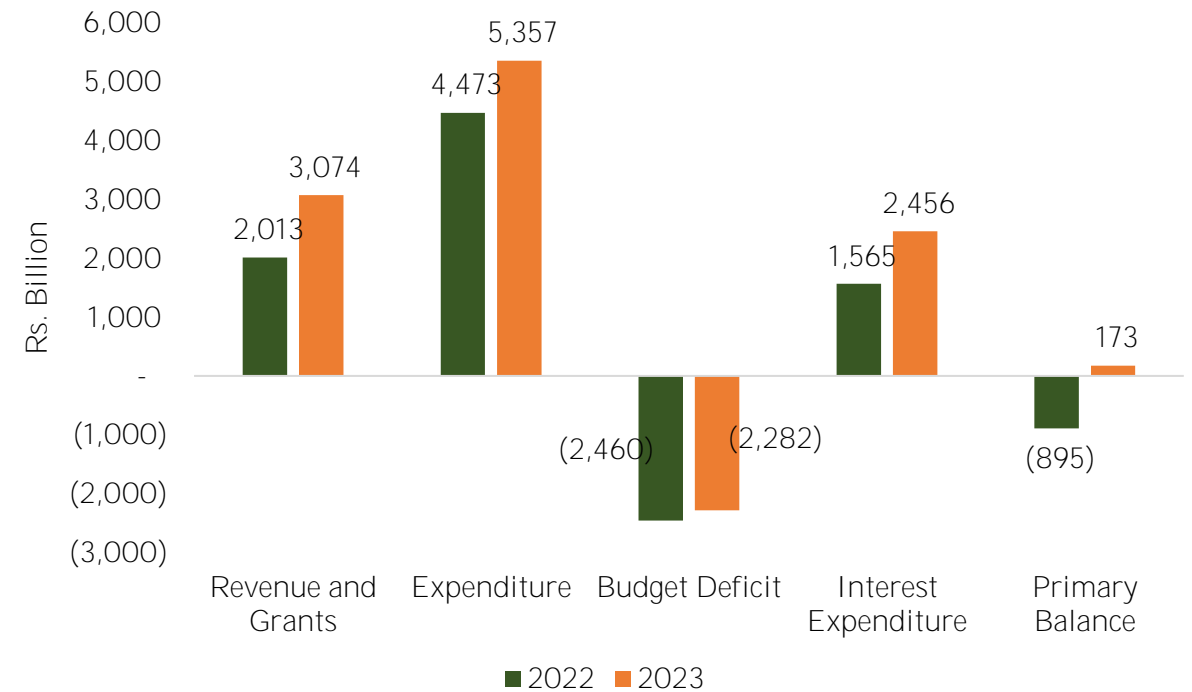
Interest Rates



Source : Central Bank of Sri Lanka

Government Fiscal Operations substantially improved (1)

Revenue, Expenditure, Budget Deficit, Interest Expenditure and Primary Balance (Nominal Value)

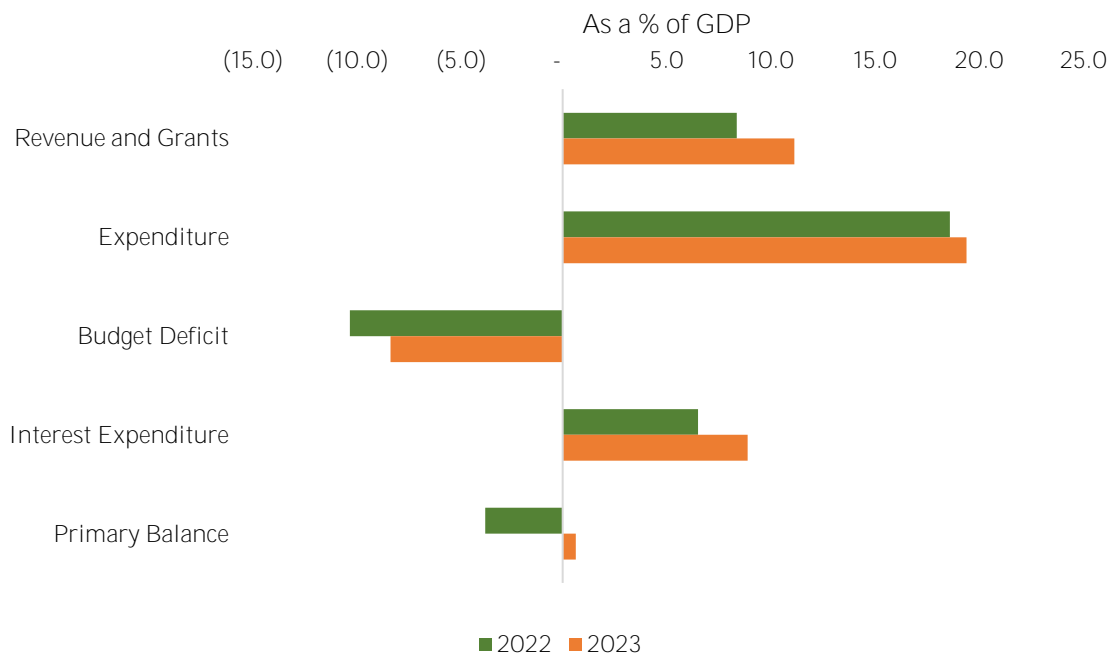


Source : Department of Fiscal Policy

Improvements in the Macroeconomic Environment (5)

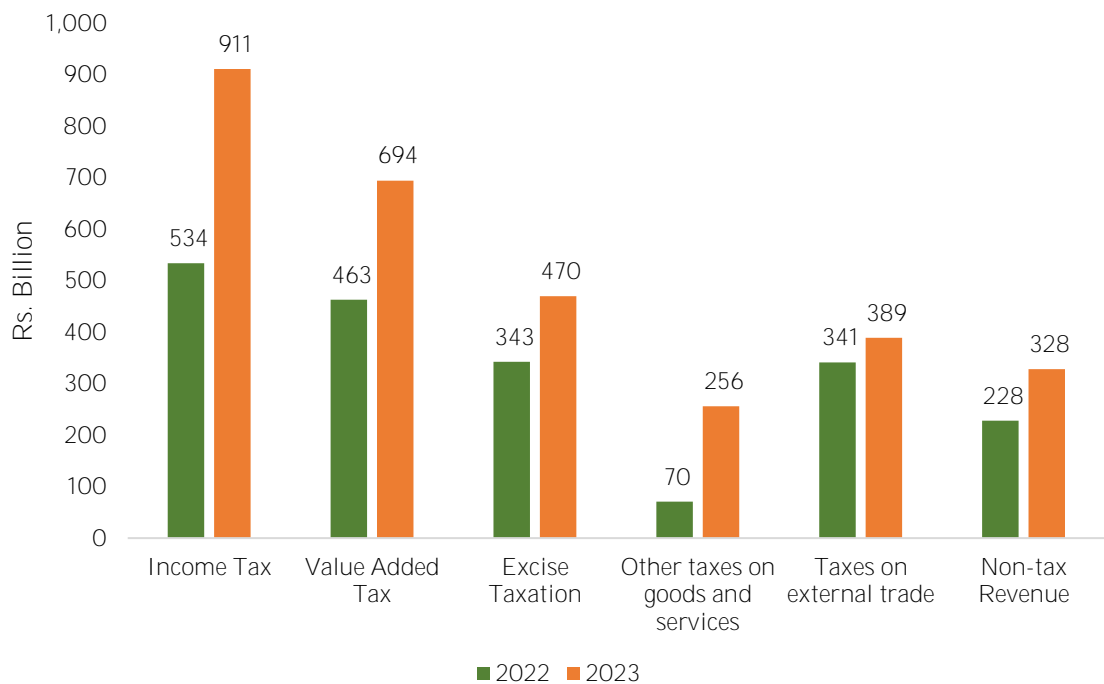
Government Fiscal Operations substantially improved (2)

Revenue, Expenditure, Budget Deficit, Interest Expenditure and Primary Balance (as a % of GDP)



Source : Department of Fiscal Policy

Government Revenue Performance

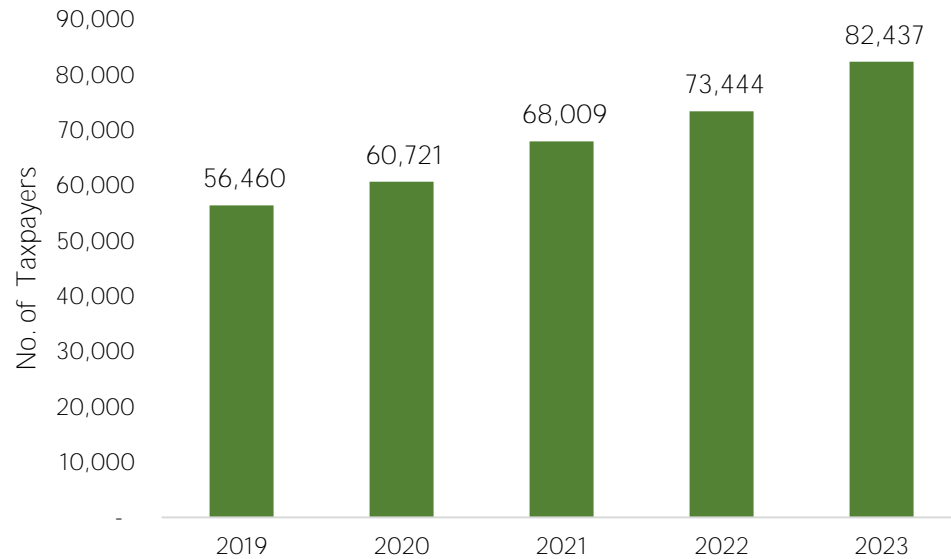


Source : Department of Fiscal Policy

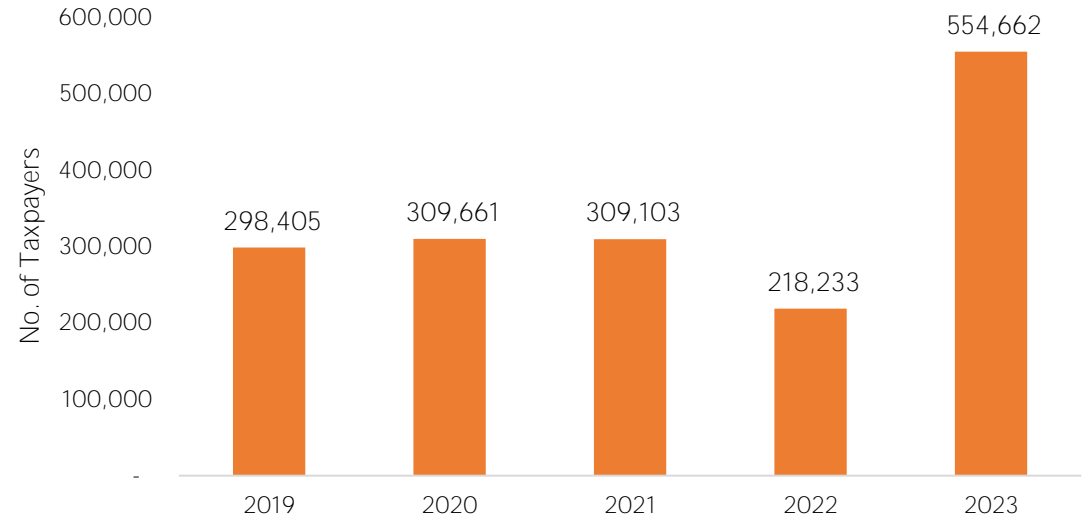
- Revenue performance has considerably improved with the introduction of new tax reforms.
- Total revenue as a percentage of GDP increased to 11.1 % in 2023 from 8.4 % in 2022

Number of Taxpayers has also increased (1)

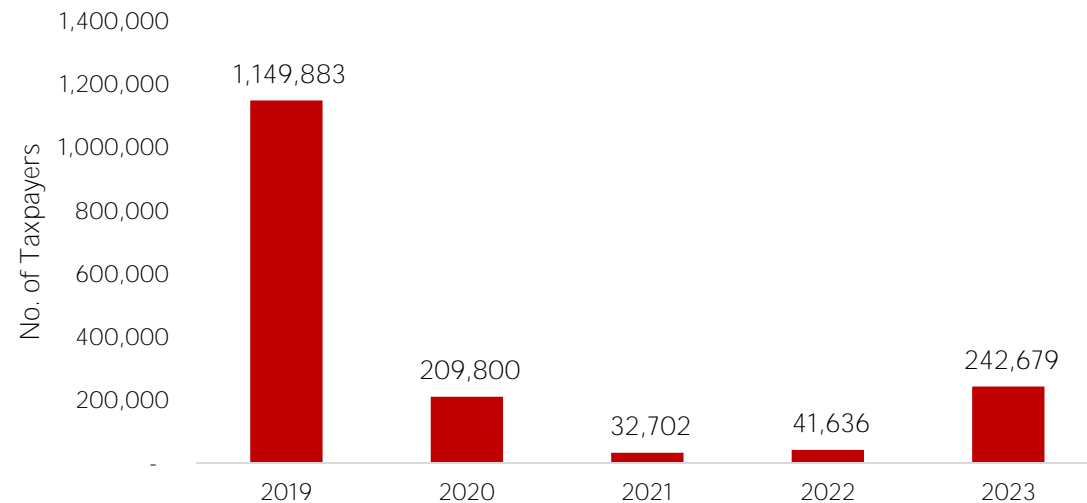
Corporate Income Tax Payers



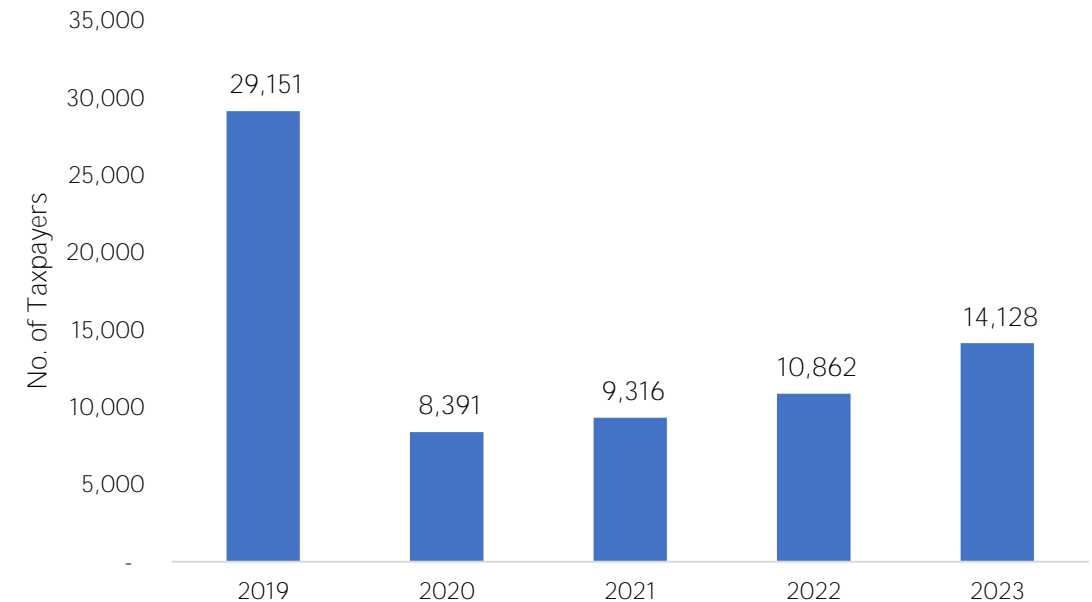
Non- Corporate Income Tax Payers



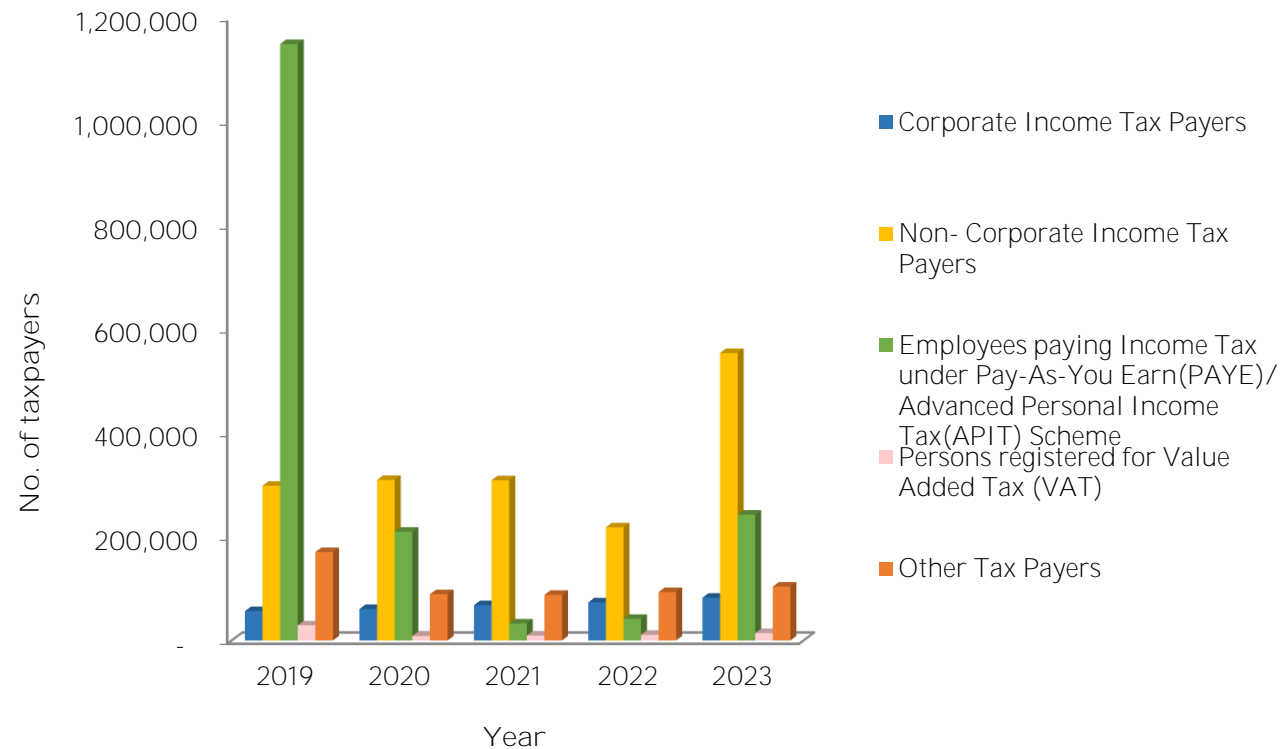
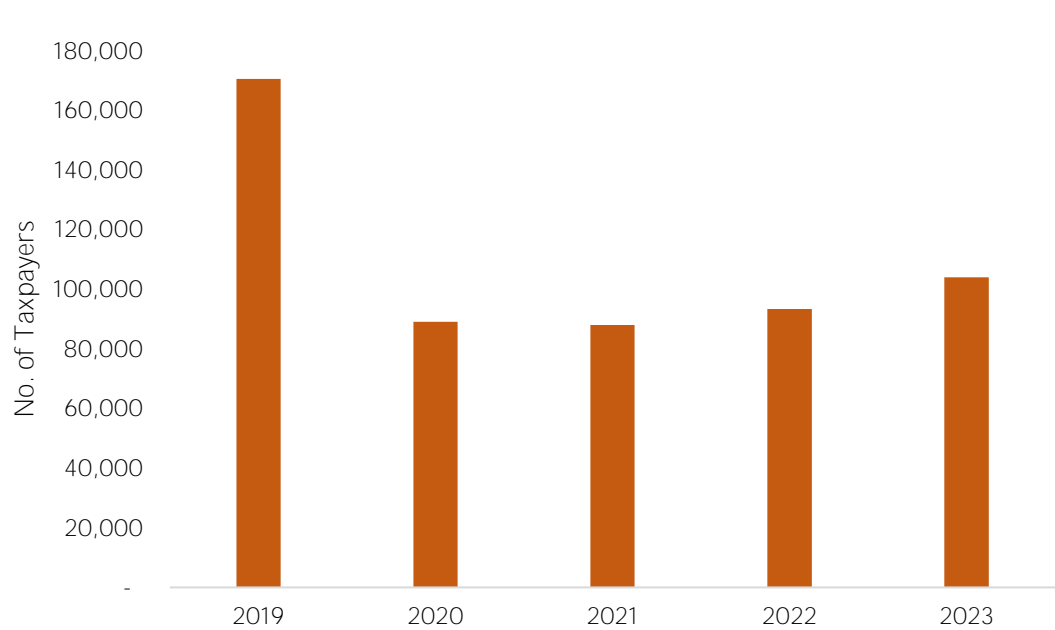
Employees paying Income Tax under Pay-As-You Earn(PAYE)/ Advanced Personal Income Tax(APIT) Scheme



Persons registered for Value Added Tax (VAT)



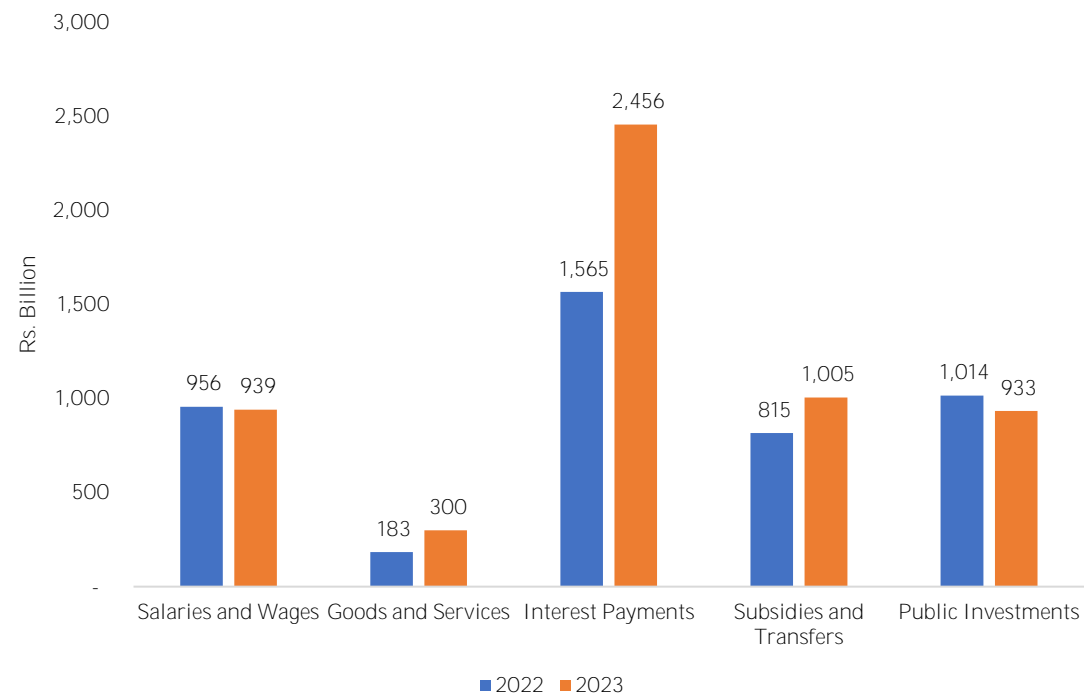
Number of Taxpayers have also increased(2)



Despite recent signs of stabilization, the economy is still facing significant challenges

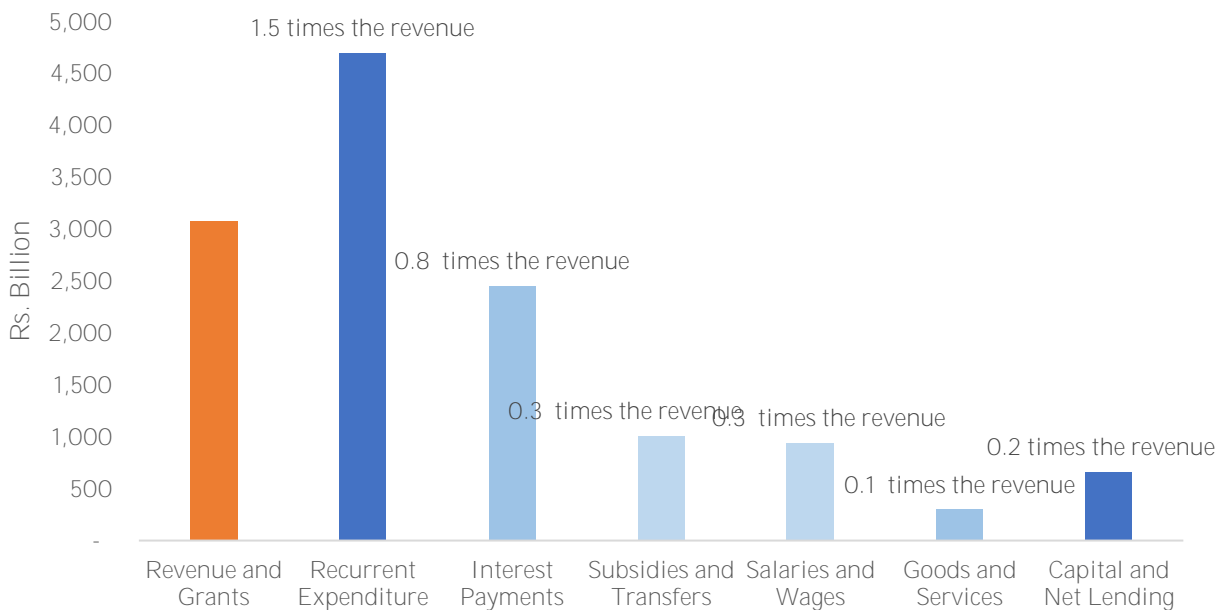
Challenges(1)

Government Expenditure



Source : Department of Fiscal Policy

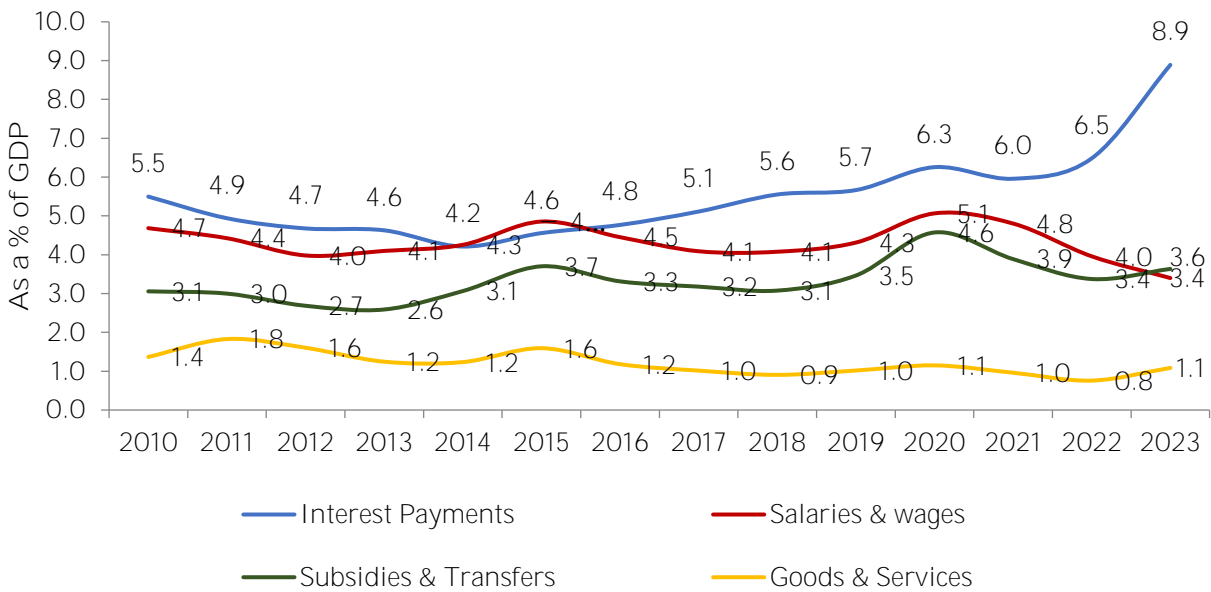
Government revenue and Expenditure - 2023



Source : Department of Fiscal Policy

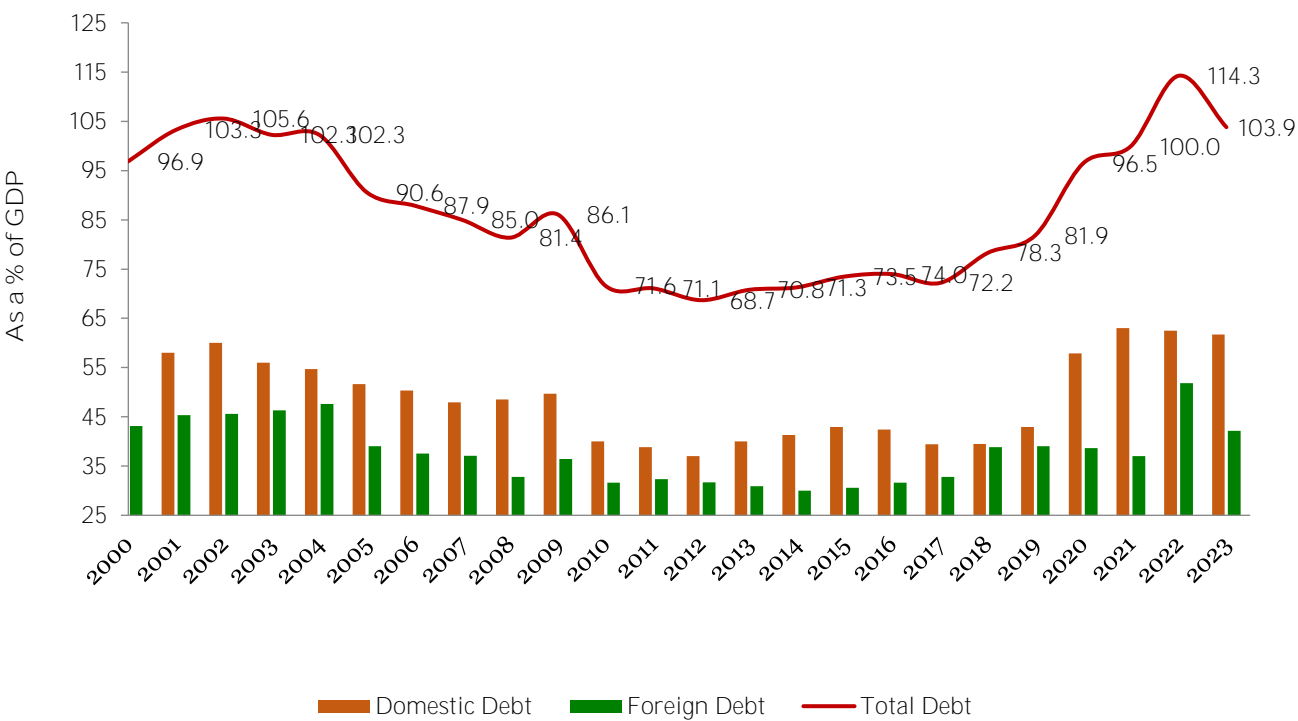
Challenges(2)

Major Components of Recurrent Expenditure



Source : Department of Fiscal Policy

Outstanding Central Government Debt (% of GDP)

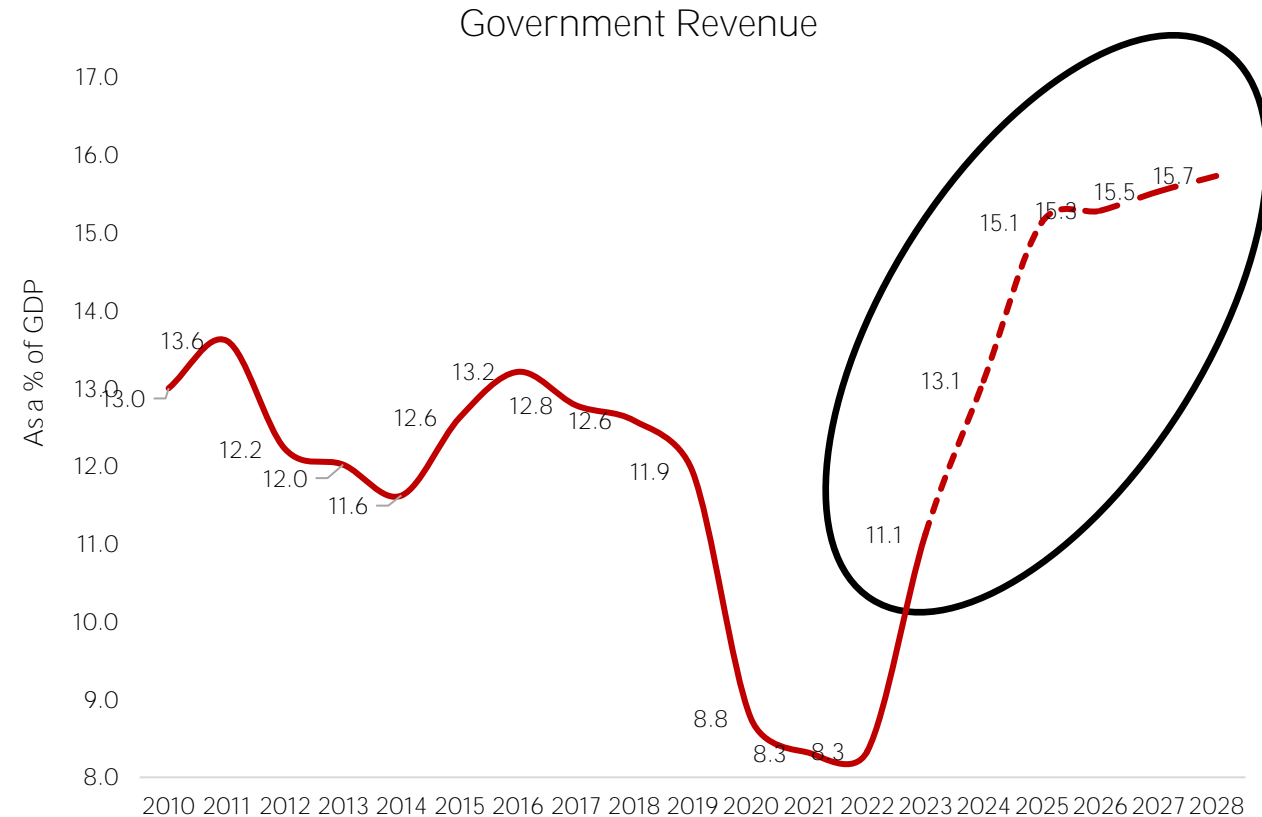


Source : Department of Fiscal Policy

Way Forward...

Revenue based fiscal consolidation will be continued.

- Further revenue measures will be introduced with the view to raise Government revenue as a percentage of GDP to 15 percent by 2025.
- Focus will be to enhance revenue administration in key revenue agencies focusing on enhancing compliance, improving digitalization, enhancing risk-based audits and reduce revenue leakages and corruption vulnerabilities.



Legal Reforms

Upcoming legal reforms would further facilitate revenue mobilization.

1) Public Financial Management Bill

- Legally establishes the Medium Term Fiscal Framework (MTFF)
- Introduces more binding fiscal rules linked to the MTFF. Two fiscal rules on
 - Primary Balance Target
 - Primary Expenditure Ceiling
- Fiscal Rules are linked to the overall debt reduction objective
- Provides a coherent legal framework for the budget cycle

2) Public Debt Management Bill

- Provides for the establishment of a professional authority to manage the country's debt portfolio: Public Debt Management Office
- PDMO will have the responsibility for long term debt strategy, with appropriate risk frameworks for yield, tenor, liquidity, and forex exposure management with regard to the debt portfolio

Legal Reforms (2)

3) Economic Transformation Bill

- Outlines the basis for the establishment of National Policy on Economic Transformation
- Provides the basis for the establishment of several new institutions including
 - Economic Commission, which will succeed the Board of Investment and eventually merge with the export development function, thereby creating a single agency that overlooks promotion of investment and exports;
 - Office for International Trade, which will function as a dedicated agency for the negotiation of trade agreements, developing the necessary capacity and institutional structure to support this key aspect of trade relations;
 - a new institution to manage investment zones, consolidating a number of existing institutions with a view to creating enhanced management services and focused resources towards this important aspect of investment development;
 - Productivity Commission which will support measures to enhance productivity of sectors as they gear up to take advantage of new trading opportunities whilst also supporting firms through productivity enhancement to face up to greater exposure to external and internal competition

Legal Reforms (3)

4) Public Private Partnerships Law

- Establishes a legal framework to enhance the management and performance of PPPs

5) Public Procurement Law

- Establishes a legal framework to streamline public procurement processes and reduce associated corruption vulnerabilities

Following legal reforms which are already enacted would also further facilitate revenue mobilization.

1) Anti-corruption Act, No. 9 of 2023

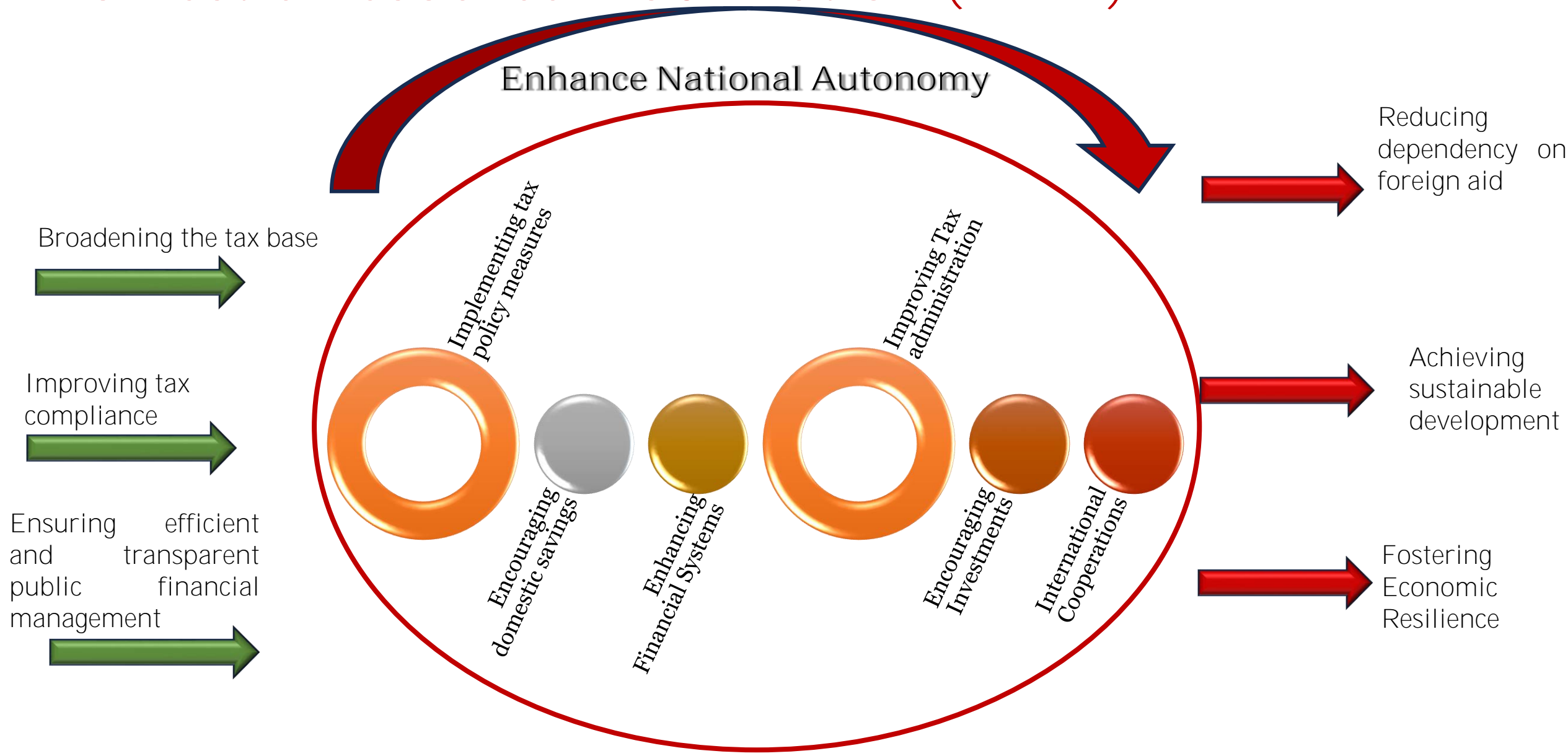
- Provides for the strengthening of the Commission to Investigate Allegations of Bribery and Corruption (CIABOC)
- Includes provisions to strengthen the asset declaration framework of Sri Lanka

Expenditure Rationalization will complement the Revenue Mobilization efforts

Number of expenditure control measures have been taken to optimise efficiency, productivity, and value for money from government spending.

- Number of circulars in this regard have been issued covering:
 - Maintaining discipline in expenditure on over-time payments, transport and fuel allowances, government events, among others;
 - Controlling cadre management and limiting new recruitments to essential positions;
 - Managing greater prudence in capital expenditure due to limited fiscal space, particularly in terms of prioritisation and ensuring value for money
- Introducing Zero based budgeting concept and establishing 10 Public Expenditure Review Committees (PERC) with the participation of public and private sector experts to rationalize the government expenditure of 10 key Ministries

With all these efforts it is expected to strengthen Domestic Resource Mobilization (DRM)



Other countries can use Sri Lanka as a model country through the lessons learned

The crisis opened a window of opportunity to address its critical issues

The economy was hit by a severe economic crisis

Now Sri Lanka is on a sustainable recovery path



The Government adjusted macro-economic policies

The Government introduced a series of important reforms

Thank You.