Journal of Business Economics
ISSN 2682- 6933 | E-ISSN 2705-9944
2023 Volume 05 Issue 02: 27 - 39

PROGRESSIVE PERSONAL INCOME TAX AND IMPACT ON MACRO ECONOMIC FACTORS IN SRI LANKA

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Abstract

Purpose: The purpose of this study is to explore the impact of progressive income tax on macro-economic factors in Sri Lanka. Specifically elaborates, though income tax is an effective mechanism for fiscal deficit, still it creates adverse effect on other macro-economic factors.

Design/Methodology/Approach: This exploratory study employs time series data with the data span from 2008 to 2022, which is 15 years. The data of concerned variables of tax revenue and professional migration were extracted from Inland Revenue Department and Sri Lanka Bureau of Foreign Employment.

Findings: APIT has failed to fulfill the qualities of the effective income tax system. As depicted in Laffer curve, due to higher tax rates, future income tax revenue will be lower due to the negative impact it has on professional migration, job performance, investments, savings and other macro-economic factors

Practical Implications: Despite being a tool to recover from fiscal deficit, increased tax rates can worsen the recovering economy. This study encourages the government to reformulate viable tax policies without hindering the long-term sustainability of the economy.

Research Limitations: The relevant data was insufficient to test the casual relationships between variables and this study can be further developed with adequate data to understand the level of impact.

Originality/Value: This exploratory study extends the knowledge on the impact of personal income taxes while the country is recovering from economic crisis which is new in terms of degree of change in tax rates and intensity of the economy.

Key words: Advanced Personal Income Tax (APIT), Tax payers, Income Distribution, Skill Migration, Developing Country

1. Introduction

Sri Lanka is striving towards rebuilding the economy from the worst economic crisis. In the mid of 2022, the nation went to the brink with continuous blackouts and curled around fuel queues with multiple domestic and global factors behind the scene. As a result, Sri Lanka has gone through zero level usable reserves, rapid rupee depreciation and high inflation (*Annual Report 2022 | Central Bank of Sri Lanka*, n.d.).

In addition to the consequences created by global pandemic of COVID-19, many economists have pointed out that, the extra-ordinary tax cuts happened in 2019 in favour of several corporates and professionals have significantly contributed in emptying the country's wealth. Reportedly, during the year of 2020 and 2021, Sri Lanka has lost nearly 1 million tax payers and its aftershock the country from 2022 onwards.

A country's tax system has the ability to influence the economy in multiple ways and tax is the primary revenue generation mechanism for Sri Lanka. Accordingly, tax policy decisions and reforms are crucial for the growth of the country (Kmmcb, n.d.). However, downline the history of tax system of Sri Lanka, multiple reforms have taken place with the changing political leaderships which contributed to the fiscal profligacy (Arunthavarajah et al., 2022). The unprecedent economic environment of the country has crippled the entire nation. The tax system of Sri Lanka has its own inherent weaknesses and continue to fail in generating adequate revenue for the nation(Kmmcb, n.d.).

With the new political leadership of the country in July 2022, Sri Lanka requested IMF bailout for financial assistance to recover the economy from crisis. IMF demanded precise financial discipline and prevents government spending. The immediate repercussion of restricted government spending is tax hikes. On 09th December 2022, Inland Revenue bill was passed in Parliaments with the changes to APIT Scheme with effect from 01.01.2023. Re-iterating the same pattern, unlike previous years, the 2022 reforms came along with IMF demands. Through an Extended Fund Facility (EFF), the Sri Lankan government sought financial assistance from International Monetary Fund (IMF). In September 2022, a staff level agreement was reached with IMF and it demanded comprehensive structural reforms in the economy. One of the key reforms is tax adjustments. The introduction of Advanced Personal Income Tax (APIT) with expanded tax brackets and higher rates have created a huge unrest among the state and private sector workers.

The progressive tax reform was announced by the government where the rates of marginal personal income tax schedule have been increased with the top rate of 36% while imposing Rs. 1.2 million per year as a free- tax threshold per the year of assessment. In mean time, the progressive tax bracket rates are rising by 6% for every Rs 500,000 up to the highest rate (*Annual Report 2022 | Central Bank of Sri Lanka*, n.d.).

The remaining of the paper discusses 1) What is Advanced Personal Income tax and how it differs from the previous personal income tax, 2) background of the country in terms of key indicators of the macro economy, 3) tax revenue and tax composition of the country, 4) implications of aggressive personal income tax in Sri Lanka, 5) whether higher APIT rates induces migration? 6) Does APIT fulfil the characteristics of an effective tax system? 7) Role of income tax in developing countries, 8) and recommendations for effective income tax system.

2. Literature Review

What is APIT?

Key changes in Employment income -APIT enacted under Inland Revenue (Amendment) Act, No.45 of 2022 to the Inland Revenue Act, No.24 of 2017. Advanced Personal Income tax is applicable for all citizens employees either who have furnished primary declarations or who have one employment including both resident and non-resident employees. With effect from January, 01 2023, every employer is required to deduct APIT and tax deduction of APIT made compulsory and stated that, consent of the employees is not required (*Income Tax*, n.d.)

The following gains and profits from employment are liable to tax on total remuneration (*Income Tax*, n.d.).

I. Salary, wages, leave pay, overtime pay, fees, pensions, commissions, gratuities. bonuses, and other similar payments;
II. Personal allowance, including any cost of living, subsistence, rent. entertainment or travel allowance;
III. Payments providing discharge or reimbursement of expenses incurred by the employee or an associate of the employee;
IV. Payments for an individual's agreement to conditions of employment; Payments for redundancy or loss or termination of employment;
V. Retirement contribution made to a retirement fund on behalf of the employee and retirement payment received in respect o f t h employment;

VI. Payments or transfers to another person for the benefit of the employee or an associate person of the employee;

VII. The fair market value of benefits received or derived by virtue of the employment by the employee or an associate person of the employee;

VIII. Other payments, including gifts, received in respect of the employment.

IX. The market value of shares. at the time allotted, under an employee share scheme, including shares allotted as a result of the exercise of an option or right to acquire the shares, excluding the employee's contribution for such shares.

Reliefs for Employment income

In addition to the few gains and profit are exempted from taxable employment income, Rs 1,200,000 relief is available for citizens who are resident or non-resident individuals for the year of assessment 2023/2024 onwards. If any resident or non-resident citizen individual who earns remuneration excess than Rs.100,000 monthly or Rs.1,200,000 per year, is liable to pay APIT (*Income Tax*, n.d.)

Table 01: Summarized Tax Table - Regular Profits from Employment (Monthly)

Monthly Regular profits from Employment (Taxable)	**Tax Rates**
Monthly regular profits from employment up to Rs.100,000/-	Tax Relief
Monthly regular profits from employment exceeding Rs.100,000/- but not exceeding Rs.141,667/-	6%
Monthly regular profits from employment exceeding Rs.141,667/- but not exceeding Rs.183,333/-	12%
Monthly regular profits from employment exceeding Rs.183,333/-but not exceeding Rs.225,000/-	18%
Monthly regular profits from employment exceeding Rs.225,000/-but not exceeding Rs.266,667/-	24%
Monthly regular profits from employment exceeding Rs.266,667/-but not exceeding Rs.308,333/-	30%
Monthly regular profits from employment exceeding Rs.308,333/-	36%

Table 02: Cumulative Tax Table - Regular Profits from Employment (For the year of Assessment)

Annual Regular profits from Employment (Taxable)	**Tax Rates**
Annual regular profits from employment up to Rs.1,200,000/-	Tax Relief
First Rs.500,000/-	6%
Next Rs.500,000/-	12%
Next Rs.500,000/-	18%
Next Rs.500,000/-	24%
Next Rs.500,000/-	30%
Remaining Balance	36%

Source: Inland Revenue (Amendment) Act, No.45 of 2022

Illustration: If a taxable monthly remuneration of a state employee is Rs. 146,000, the APIT tax to be deducted from monthly salary is, Rs. 3020.00 as depicted below.

Table 03: Tax Calculation for monthly Regular Profits from Employment

Tax Slabs	Rate	Tax Bracket- liable income	Tax needs to be paid
First Rs. 100, 000/-	0%	Rs.100,000/-	-
Rs. 100,000/ - 141,667/-	6%	Rs. 41,667/-	Rs. 2500.02
Rs. 141,667/ - 183,333/-	12%	Rs. 4,333/-	Rs. 519.96
Rs. 183,333/ - 225,000/-	18%	-	-
Rs. 225,000/ - 266,667/-	24%	-	-
Rs. 266,667/ - 308,333/-	30%	-	-
More than Rs. 308,333/-	36%	-	-
Total			**Rs. 3019.98**

How APIT differs from the prevailed personal income tax?

In the prevailed personal income tax system, the relief was wider and tax brackets were narrow. Personal relief of Rs. 3,000,000 was given for residents or citizens of Sri Lanka and expenditure relief of Rs. 1,200,000 was granted. The tax rates are imposed for the year of assessment as follows:

Table 04: Summarized Tax Table - Regular Profits from Employment for the year of assessment 2019/2020

Annual Taxable Income	**Tax Rates**
Annual taxable income up to Rs.3,000,000/-	Tax Relief
First Rs.3,000,000/-	6%
Next Rs. 3,000,000/-	12%
Remaining Balance	18%

Source: Sri Lanka Inland Revenue

With the introduction of new personal income rates, small and medium sized enterprises and even average income earners are started to be more concerned about the taxable income. In addition to the concern, it created among the tax payers, with regard to check the tax liability, the employers and payroll managers need extra hands now.

Table 05: Factors contributed to economic Vulnerability

Challenges	**Time Period**
Civil War	1983- 2009
Tsunami	2004
Bond Scam	2015
Drought	2016-2017
Constitutional coup	2018
Easter Sunday Attack	2019
Covid -19	2019- 2021
Economic Crisis	2021 - 2022

Source: CA Sri Lanka Tax Journal, 2022

Background of the Country

Sri Lanka is poor in economy while rich in resources. An inability to re-create more wealth using the available resources is one of the major reasons for the tragic economy of the country. Over the past, there had been several factors which contributed to the economic vulnerability of Sri Lanka. Though in 1997, Sri Lanka has welcomed an open economic policy, with the following challenges, implementing economic policy decisions and reforms were never easy, especially the policies related to tax (Arunthavarajah et al., 2022).

Government Revenue and Tax composition

According to fiscal management report of 2023, in addition to the income tax, VAT, Excise duty, Ports & Airports Development Levy, import duty, Special Commodity Levy, CESS Levy, telecommunication and other tax and non-tax are contributing to the government revenue as a whole (Wickremesinghe, n.d.).

According to the Performance report of Inland Revenue Department for the year of 2022, income tax has generated more revenue compared to other taxes and comparably there is a significant increase from 2021 to 2022(Hapuarachchi, 2022).

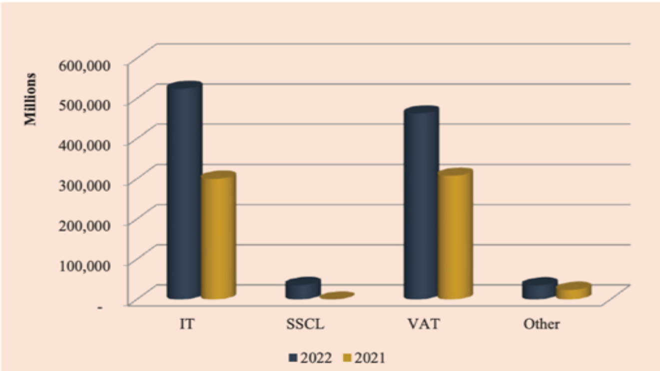

Figure 01: Revenue Comparison of Year 2022 with 2021
Source: IRD performance report 2022

Categories of Income tax payers in Sri Lanka

Income tax payers of Sri Lanka are categorized into major three main groups. The elite income earners are corporate tax payers, the largest and groups is wage or salaried tax payers and the final group is remaining income tax payers who are generating income from professional and business (Vijayakumaran & Vijayakumaran, 2014).

According to the Performance report of Inland Revenue Department for the year of 2022, the total number of tax payers in 2021 were 507, 095 whereas in 2022 it has decreased to 437, 547. It shows a declining patter in number of tax payers (Hapuarachchi, 2022). The increase of income tax rates to the extreme level might be one reason and the negative repercussions caused by the economic crisis may led reduction in the economic level of the individuals.

Role of income tax in developing countries

In both developed and developing countries, inequality exists. However, in developing countries poor citizens are poorer and rich people are richer compared to developed countries. Though personal income tax has been considered as the primary tool for redistributing income and wealth from rich to poor in developed countries, there are limitations in relying on personal income tax for redistribution in developing countries (Bird & Zolt, 2005).

Especially, in Asian countries, personal income taxes are not comprehensive or progressive and it is unlikely to create the significant impact on the distribution. And even when the tax system is introduced to be more progressive, it generates administrative, political, economic and compliance costs. In such situations, tax revenue is lesser than the costs associated with tax. Further, when a country wants to use the tax system to slash poverty or minimize the inequality, the country has to forgone opportunities (Bird & Zolt, 2005).

In 2022, 88% of total revenue is generated through tax revenue and out of which 34% is income tax revenue (*Annual Report 2022 | Central Bank of Sri Lanka*, n.d.). Accordingly, as an emerging lower- middle income economy, Sri Lanka should re-consider on highly reliable on income tax for revenue generation.

Does APIT fulfil the characteristics of an effective tax system?

An effective tax system should meet at least five basic characteristics which are fairness, transparency, adequacy, simplicity, and administrative ease (Kmmcb, n.d.). Though Sri Lankan tax system has multiple compositions, the aim is to evaluate the effectiveness of newly reformed Advanced Personal Income tax.

1. Fairness – It ensures that everybody pays a fair amount of share as tax. When the tax payers consider that, they are being treated unfairly, there will be more room for tax evasion. According to Inland Revenue, the highest rate for Advanced Personal Income Tax is 36% whereas the Corporate Income Tax reached only up to 30%. The income tax for gaming, betting, liquor and tobacco has kept as 40% to limit the consumption. The above disparity, challenges the characteristic of fairness and it has created a considerable amount of disagreement among the tax payers of APIT.
2. Transparency – When tax payers are informed on who are being taxed, how much revenue is generated through tax, for what purpose the collected money has been used and who being exempted for tax and enjoy tax holidays, tax payers refer that as transparent tax system. Unfortunately, in Sri Lanka, the tax payer is only aware about the money he/she paid as tax. These information asymmetry on tax discourages the individuals to pay tax on time and stimulates a disbelief on tax system.
3. Adequacy – The collected tax revenue should be adequate enough to fulfil the needs of society. However, throughout the history of Sri Lankan economy, the primary balance is always negative and government expenditure is higher than the income generated by the government.
4. Simplicity- It is hen a tax system is easy to understand by the tax payers and payers can avoid filling out pile of forms. Not only that eases the tax payers, and also reduces the cost of compliance. In terms of APIT, the newly introduced personal income tax is more complicated than the existing PAYE. Even the professionals find it difficult to explain to others using simple terms.
5. Administrative Ease – The process of collecting tax money should not be troublesome for tax collectors. And most importantly, the cost of collecting tax should be less than the tax money collected. Inland revenue department initiate actions to digitalize their platform to ease the administration of tax. However, the technological literacy of the tax payers needs to be considered while moving to such paradigm shift.

Laffer Curve Tax Theory

The Laffer curve tax theory provides the foundation for tax revenue as the function of tax rate. An ordinary citizen of the country will think that, when the government increases the tax rate, it would improve the tax revenue. According to the tax theory, it is not viable. When the tax rates are 0% or 100%, the total tax revenue would be zero. Therefore, to maintain a smooth relationship between tax rate and tax revenue, it is not necessary for a government to impose higher tax rates as the same level of tax revenue can be achieved with lower rates as well (Arunthavarajah et al., 2022). In the picture shown below, at the rate of B and C, the tax revenue would be same, then why would the governments should go for the higher rate of C, while the option of B available already.

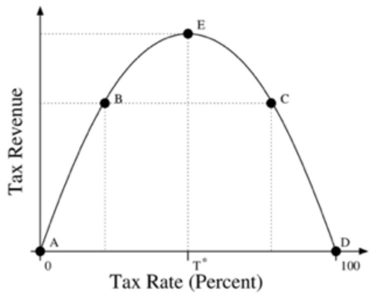

Figure 02: Arthur Laffer Tax theory

3. Methodology and Analysis

This study employs secondary time series data for the period from 2008 to 2022 from World bank indicators alongside with other data sets obtained from several issues of Central bank of Sri Lanka, Inland Revenue Department and Sri Lanka Bureau of Foreign Employment. The purpose of the study is to analyze the pattern and impact of increased income tax levels on the macro-economic factors.

Gross Domestic Growth (GDP), savings and investments, government revenue and expenditure and inflation are the key measures to identify the current status of an economy. This part analyses how the economy has impacted due the rapid increase in income tax rates.

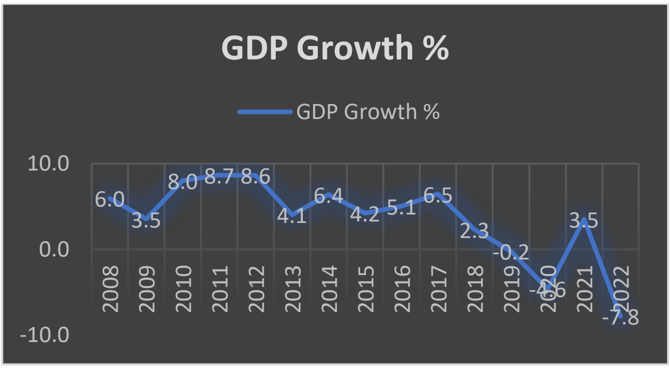

Figure 03: Gross Domestic Product (GDP) Growth %
Source: Indicators- World Bank Data

Gross Domestic Product (GDP) Growth

GDP growth rate has been below 10% from 2008 to 2019. The reason for less growth rate of 3.5% in 2009 might be the end of civil war. In 2020, the GDP growth has hit rock bottom a negative rate of 4.6% and it heavily influenced by the global pandemic of COVID 19. In 2002, negative rate of -7.8% the recorded which shows the tragic situation of the country during economic crisis.

As highlighted in the literature, tax structure and tax level can create greater impact on economic growth. According to (Asel et al., 2022), tax level has positive impact on the short-run and long-run economic growth in Sri Lanka. However, (Kesavarajah, n.d.) found that higher level of income taxes had a significant negative impact on output growth.

Savings

For the last 15 years, it shows an average of 20% of savings as a percentage of GDP and for last two years, it shows the decreasing pattern. National saving is one of the major factors which affected by personal income tax.

When the tax rates are low, people are encouraged to do more work and can able to save more. Extensive researches have been done determining the effect of income rates on saving. According to (Zheng, 2007), increased income tax rates have a negative impact on savings.

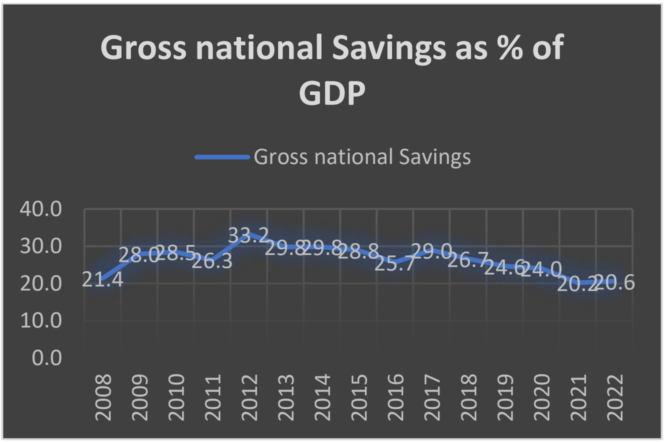

Figure 04: Gross national Savings as % of GDP
Source: Indicators- World Bank Data

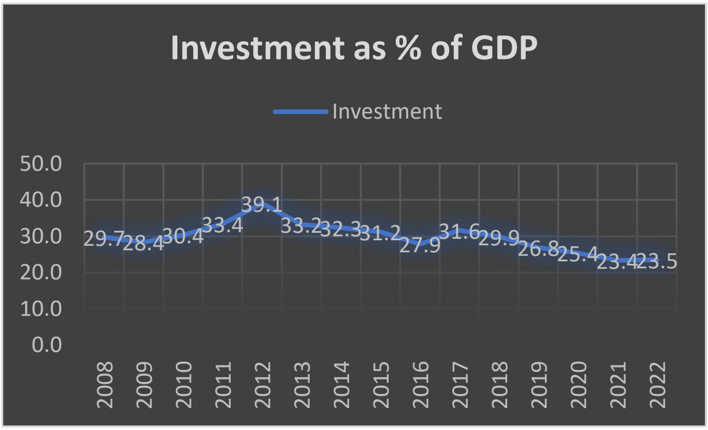

Figure 05: Investment as % of GDP
Source: Indicators- World Bank Data

Investment

From 2008 to 2012, the investment to GDP % shows an increasing pattern, whereas from 2013 onwards, it keeps on declining which is adverse situation to the economy. Investment also one of the major factors severely influenced by the tax policies of the country.

Magnitude of the investment varies as tax level changes. Tax rates affect the businesses in organizing their operations, and deciding how much to borrow and invest. (Madsen et al., 2021) argued that income taxes reduce the investment.

Government Revenue and Government Expenditure

For the past 15 years of Sri Lankan economy, the country has never recoded a surplus. As depicted below, the government expenditure is higher than government revue which creates deficit. By quoting Laffer Curve theory, (Jayasooriya, n.d.) found that, there is a positive relationship between income tax rates and tax revenue, however, it has significant negative impact on tax revenue in long run.

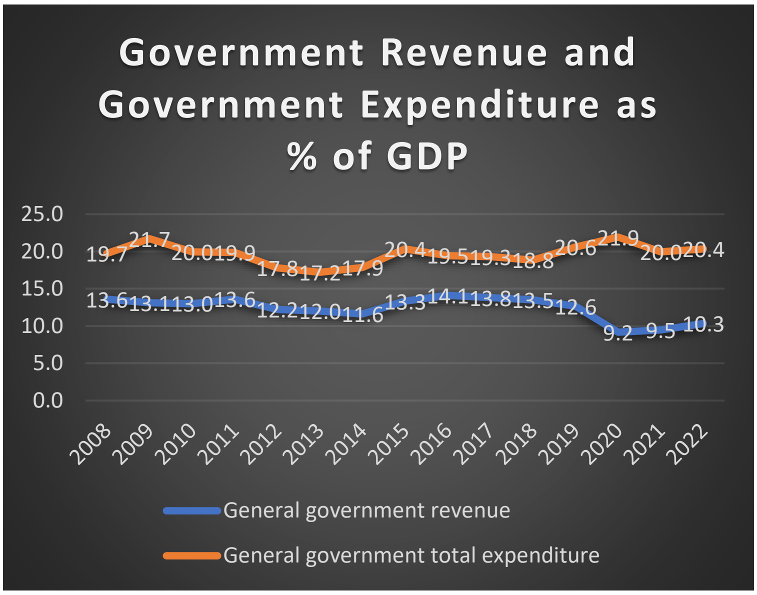

Figure 06: Government Revenue and Government Expenditure as % of GDP
Source: Indicators- World Bank Data

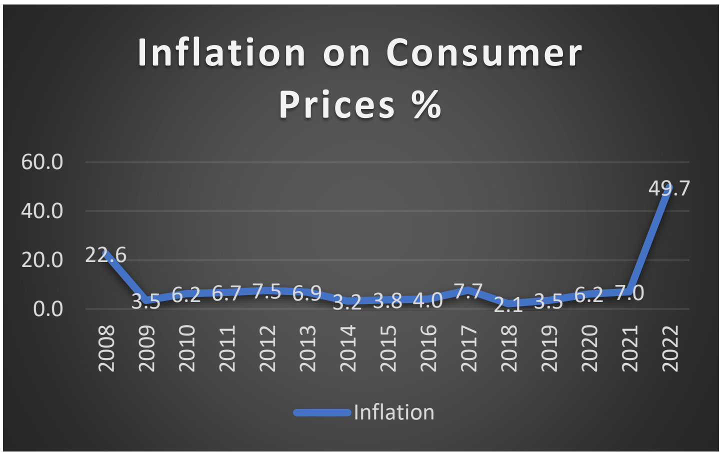

Figure 07: Inflation on Consumer Prices as % of GDP
Source: Indicators- World Bank Data

Inflation

In 2008, the inflation on consumer prices were 22.6% and after 14 Years it again skyrocketed for 49.7% which made the cost of living to the ordinary citizens unbearable. When the commodity prices are not affordable, imposing higher personal income tax rates, will drastically reduce the net wages of the employees.

Tightening the fiscal policy brings down the fiscal deficit and it supports monetary policy as well. It certainly helps central bank to curtail price hikes. On the other hand, according to (Casanegra De Jantscher et al., n.d.), since inflation restricts the purchasing power of money, it affects all kinds of economic activity, specially tax administration costs.

Even with the global pandemic, while other countries are moving forward, declining revenues, record high inflation and negative economic growth are alarming to the future of Sri Lanka (Arunthavarajah et al., 2022).

4. Implications of aggressive Advanced Personal Income Tax (APIT) in Sri Lanka

Governments fight with economic, social and political setbacks to formulate a suitable tax system in the country. When analyzing the individual tax systems, it is vital to consider the implications on the following factors (Moramudali, n.d.).

Impact on job and performance

Not all the tax payers who are against to the certain tax system come to road for protests. Many of them are passive and they deliberately reduce their work performance. Rather than working hard, they prefer to utilize all their leaves, enjoy free time more, doing part-time jobs to build up their take-home income and searching options for tax evasion (Moramudali, n.d.).Hence more aggressive the income tax, it negatively impacts the performance and productivity of the employees.

Impact on saving and consumption

Majority of the income earned by the low-income citizens is spent on consumption. Higher tax rates, not only reduce the amount of saving for low-income earners, but also reduce savings of rich people. Ultimately it will negatively impact the investments of the country (Moramudali, n.d.).

Impact on size of the income

For the government, when more income is required, an easy solution is increasing the tax rates. Though increasing rates, will result in only a small fraction of increase, contradictorily it can affect many other macro-economic factors of the country. In contrary, for the individual, the net income remains for the consumption, savings, and investment will decline when the income tax rates are increased (Wickremesinghe, n.d.).

Impact on complexity of the tax system

The main argument of having progressive tax is, the complexity of the system. Especially administrative burden may increase in terms of conducting awareness and collecting tax

A growing tax rate can have the positive impact on the tax revenue; however, it is essential to consider the cost incurred to collect those tax revenue.

Impact on migration

Some countries use taxation as a tool to attract highly skilled labours from foreign countries. Irrespective of the personal preferences and job opportunities available in abroad, one of the key factors that determines the migration is net wages. With related to effective tax burden of the highly skilled workers, countries differ from each other. The redistribution of the income and extent of taxation determined through social political factors and heavier the taxation prompts the migration (Egger & Radulescu, 2009).

Tax payers especially who are highly paid and highly skilled workers do move as reaction to taxation levels. When people who earns, more are sensitive to changes in tax rates, then the income tax progressivity will not be optimal. In response to hikes in income taxes and increasing migration, it is important to clearly understand the after-tax earnings to propose an optimal tax schedule (Simula & Trannoy, 2018).

According to Sri Lanka Bureau of Foreign Employment (SLBFE), male and female registration with the SLBE by manpower level for skilled, middle level and professional level is stated for the years from 2018 to 2022. Compared 2020, the migration of male and female has drastically increased in 2022. It alarming the economy in terms of number of tax payer remains in the country (STATISTIC 2022 - Sri Lanka Foreign Employment Bureau, n.d.).

Year	Professional Level		Middle Level		Skilled	
	No.	%	No.	%	No.	%
2018	9,005	4.27	6,530	3.09	67,013	31.73
2019	9,861	4.85	5,725	2.82	62,711	30.88
2020	2,957	5.50	1,496	2.79	16,664	31.03
2021	8,575	6.98	4267	3.47	40,390	32.87
2022	14,307	4.60	8130	2.61	92836	29.85

Figure 08: Total Registration with the SLBFE by Manpower Level 2018-2022
Source: Information technology division- SLFBE

Recommendations

Many developing countries are considering tax revenue to GDP as an instrument to economic development to meet public, service and social expenditure. Sri Lanka as a developing country needs to spend more on infrastructure, education and health care services. Since the debt from foreign countries and money creation has more adverse effect on the economy than tax revenue, many countries prefer to increase tax rates (Amirthalingam, 2013). It does not indicate that, increased income tax rates will not create any negative impact.

Nevertheless, Sri Lanka still faces several issues after changing the income tax policies time to time. Declining tax ratio, poor tax composition and lack of efficiency are some of the major issues (Amirthalingam, 2013). Sri Lanka should take necessary measures to eliminate the inherent weakness in the tax system and improve the tax revenue through income taxes.

Improving the transparency

The income tax payers are more conscious about knowing for what purpose, the generated income tax revenue being used by the government. Having more transparent administrative system, will improve the tax payers trust on government and when tax payers feel, that they are being treated fairly in terms of tax, it will increase the tax compliance as well (Thayaparan et al., 2021). Therefore, government should take necessary actions in being transparent on who are being taxed, how much is generated as tax revenue and for which public expenditure, the revenue has been utilized.

Reduction of number of taxes

In Sri Lanka, tax payers consider income tax as a burden and reduction of their take home income, and not realizing that, they are contributing to the public expenditure, for free education, free healthcare and infrastructures in the country (Amirthalingam, 2013). One of the main reasons for such mentality is number of taxes imposed in the country. Including direct and indirect taxes, there are more than 10 tax types prevail in the country. Though the amount paid in each tax are low, when the number of tax types are higher, it negatively impacts the behaviour of the tax payers that they are heavily taxed in various ways.

Through technology, improving tax administration

The Revenue Administration Management Information system (RAMIS), a technological tax tool was introduced by Inland Revenue Department for the year of assessment of 202/2021 to file their incomes online. Though it is very visionary initiative as the technology is evolving in all sectors, it is important to flexibility and complexity of the system. Many have argued that, there is lacking awareness about the new system and many working hours are wasted in identifying the know how's (Arunthavarajah et al., 2022). Hence, IRD should take corrective actions on educating the tax payers on the new system.

Avoiding political motive tax concessions and minimizing the interference of political parties in tax administration

Sri Lanka has witnessed multiple tax reforms when there is a change of government. In Sri Lanka, the taxation policy is treated as mechanism for each party's political agenda instead of a revenue generation tool for the government. One of the major tax cuts happened in 2019 after the new government formed created an economic turmoil in the Sri Lankan economy (Arunthavarajah et al., 2022). Hence, Sri Lankan policy makers should find strategies to keep the politicians and their ideologies away from the taxation policies.

Simplifying the tax laws

Income tax laws should be simplified in understandable terminology. Since Inland Revenue Department encourages voluntary compliance, it is vital that, tax payer should have known about the tax types and relevant tax laws. When the tax payers do not know what they are liable to how they are liable to, the compliance will be very poor (Thayaparan et al., 2021). Therefore, IRD should take consideration on simplifying the laws and educating the tax payers through seminars, workshops to improve their compliance.

Strengthening audit, inspection and enforcement capacity

Sri Lanka's Tax to GDP percentage is very lower than other countries in the region and the tax payers are only a small fraction of entire population of the country (Amirthalingam, 2013). When a country already suffering from widespread fiscal deficit, tax evasion is adding more negative repercussions. Rather than increasing the tax rates to the extreme level, Inland Revenue Department should strengthen the investigation and audit on penalizing the tax evasion exists in the country.

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