



Tax Expenditure Statement

Ministry of Finance, Economic Stabilization and National Policies

Sri Lanka

TAX EXPENDITURE STATEMENT

DEPARTMENT OF FISCAL POLICY
MINISTRY OF FINANCE, ECONOMIC STABILIZATION AND
NATIONAL POLICIES

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1. Introduction

Tax system primarily aims to raise adequate revenue for financing the Government budget. However, by ways of targeted tax exemptions, deductions, deferrals, allowances and others of tax liability and concessional tax rates, Government expects to achieve social and economic objectives. Tax expenditures are estimates of the total revenue forgone as a result of exclusions, exemptions or deductions from the tax base to provide a special credit, a preferential rate of tax or a deferral of tax liability.

This report presents Government's latest estimates of the fiscal cost of tax expenditure and assumptions and the methodology used to produce these estimates. The purpose of the Tax Expenditure Statement (TES) is to improve transparency in Sri Lanka's financial reporting, aligned with international best practices.

Types of tax expenditure items and the type of taxes considered in preparation of this report are as follows.

Table 01 : Tax Expenditure Classification

| Tax Expenditure Items | Tax Expenditure by Type of Taxes | | | |
|--|----------------------------------|----------------------|-------------------------|---------|
| | Personal Income Tax | Corporate Income Tax | Consumption Taxes (VAT) | Customs |
| Preferential tax rates | ✓ | ✓ | ✓ | |
| Tax holidays | | ✓ | | |
| Special Zones | | ✓ | ✓ | ✓ |
| Capital Recovery Incentives | | ✓ | | |
| Exemptions | ✓ | ✓ | | ✓ |
| Investment Subsidies | | ✓ | | |
| Tax deferrals | | ✓ | ✓ | ✓ |
| Fiscal regime benefits for extractive industries | | ✓ | ✓ | ✓ |

2. Basis for Tax Expenditure Calculation

This tax expenditure statement is prepared on the following basis;

- a) There are three main approaches to estimate revenue foregone
 - (i) Revenue foregone
 - (ii) Revenue gain
 - (iii) Outlay equivalent

This estimate uses the "revenue forgone" method, which is an ex-post calculation of the loss of revenue incurred by the Government. It assumes that the tax payers' behaviour remains unchanged in response to withdrawal of tax expenditure.

- b) Inland Revenue Department (IRD) calculations are based on the tax return submitted.
- c) Base erosion of revenue due to valuation issues, procedural errors, transfer pricing and non-compliance are not considered.
- d) Tax expenditure on free services provided by Government is not taken into consideration.
- e) Tax expenditure calculations on Personal Income Tax are based on 2021/2022 actual data & estimates.
- f) Tax expenditure calculations on Corporate Income Tax, Value Added Tax and import taxes calculations are based on 2022/2023 actual data and estimates.
- g) Any deviations from the Schedules in the Inland Revenue Act No.24 of 2017 are treated as tax expenditure;
 - 1st Schedule = Tax Rates
 - 2nd Schedule = Investment incentives
 - 3rd Schedule = Exempt Amounts
 - 4thSchedule = Capital Allowances, Balancing Allowances and Assessable Charges
 - 5th Schedule = Qualifying Payments and Reliefs
 - 6th Schedule = Temporary Concessions
- h) Tax concessions granted to BOI undertakings and the concessions offered under various free trade agreements were considered in calculating tax expenditure at the point of customs.

3. Tax Expenditure Estimates

3.1. Personal Income Tax (PIT)

Until December 31, 2022, a personal relief up to Rs. 3 million per annum and an expenditure relief up to Rs 1.2 million per annum were granted for Personal Income Tax and the tax was levied only under 3 slabs of Rs. 3 million at the rates of 6%, 12% and 18%. However, the reduction of personal relief up to Rs. 1.2 million per annum, the removal of expenditure relief and increase of number of tax slabs and rates are not reflected in the following tax expenditure estimates for 2021/2022 as the effective date for the revisions was January 01, 2023.

With the tax policy revisions that reduced of personal tax-free limit, the removed expenditure relief, removed exemptions and narrowed the tax slab, the personal tax expenditure amount might be significantly reduced with effect from the year of assessment 2023/2024.

Table 02 : Personal Income Tax Expenditure for 2021/2022

| Expenditure Type | Tax Expenditure (Rs Mn) |
|--------------------------------|-------------------------|
| Relief and Qualifying payments | 5,816 |
| Exempted | 5,727 |
| Total | 11,543 |

Source : Inland Revenue Department

3.2. Corporate Income Tax (CIT)

The increase of Corporate Income Tax rate from 24% to 30% and the removal of sector specific concessionary rates were implemented with effect from October 01, 2022. However, the impact of the above revisions are not fully reflected in the Tax Expenditure Statement for 2022/2023 as the revisions have only been effective for two quarters in the said year of assessment.

Table 03 : Corporate Income Tax Expenditure for 2022/2023

| Expenditure Type | Tax Expenditure (Rs Mn) |
|--------------------|-------------------------|
| Concessionary Rate | 86,575 |
| Exempted | 1,158 |
| Total | 87,733 |

Source : Inland Revenue Department

3.3. Value Added Tax (VAT)

Value Added Tax incentives are mostly enjoyed by the Non-BOI sector compared to the BOI Companies. Out of the BOI companies, apparel, services and utility, and manufacturing sectors have mostly benefited from VAT incentives.

Banks and financial sector are not considered due to their liability for VAT on financial services.

Table 04: Value Added Tax (VAT) Expenditure Estimates by Sector for 2022/2023

| | Sector | Tax Expenditure (Rs Mn) |
|--------------|----------------------|--------------------------------|
| BOI | Agriculture | 5,885 |
| | Apparel | 37,562 |
| | Infrastructure | 837 |
| | Knowledge Services | 2,516 |
| | Manufacturing | 20,012 |
| | Services and Utility | 36,026 |
| | Tourism | 1,454 |
| | Other | 3,011 |
| | Non-BOI | |
| Total | | 554,358 |

Source : Inland Revenue Department

3.4. Taxes on Imports

Customs Import Duty is the major contributor to tax expenditure on import taxes. Deferral of taxes under Temporary Imports Export Processing (TIEP) scheme was not considered for tax expenditure, since the tax if paid is refundable after the goods are exported. Tax deferment on project cargo is granted for specified projects where the Government has to bear the tax cost is not taken into account in calculating the tax expenditure.

Tax exemptions granted for BOI undertakings and concessions offered under Trade Agreements are considered for tax expenditure.

Table 05 : Sector wise Tax Expenditure on Custom Duties for 2023

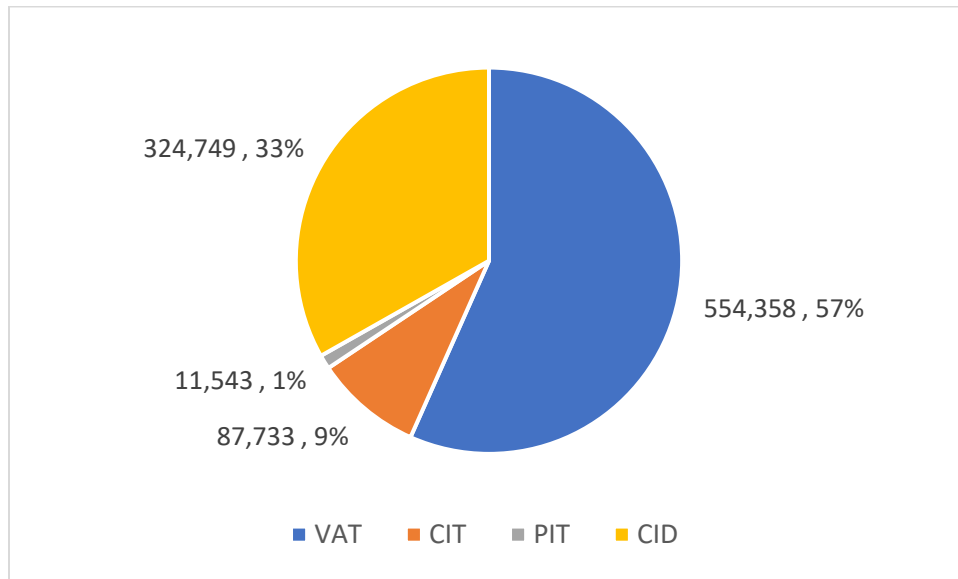
| Sector | Tax Expenditure (Rs Mn) |
|------------------|-------------------------|
| BOI | 313,648 |
| Trade Agreements | 11,101 |
| Total | 324,749 |

Source : Sri Lanka Customs

3. Conclusion

The Highest contributor to the Tax Expenditure is VAT which represents 57% of the total tax expenditure, followed by CID which contributes 33% of the total tax expenditure.

Graph 01 : Summary of Tax Expenditure (Rs. mn)



However, with the recent tax policy reforms including the removal of a vast majority of VAT exemptions from January 01, 2024, the tax expenditure estimated for the year 2023 and onwards is expected to be significantly lowered.

The tax expenditure is generally defined as a reduction in tax liability compared with a benchmark tax system. Lack of a benchmark tax system is identified as a great obstacle in preparing the tax expenditure statement.

Annexures to the Tax Expenditure Statement

Individual Income Tax Expenditure 2021/2022

| Exemption | Total Relief Amunt (Rs Mn) | Regular Rate | Consessionary rate | Tax after including exempt or relief (Rs Mn) | Actual (Rs Mn) | Tax expenditure (Rs Mn) |
|------------------------|----------------------------|-------------------------|--------------------|--|----------------|-------------------------|
| Relief for Rent income | 7,121 | | | | | |
| Relief for Expenditure | 11,492 | | | | | |
| Qualifying Payment | 3,379 | <=3,000,000 0% | 0% | | | |
| Exemption - Employment | 10,273 | 3,000,000-6,000,000 6% | | | | |
| - Business | 9,438 | 6,000,000-9,000,000 12% | | | | |
| - Investment | 24,131 | 9,000,000 <= 18% | 0% | | | |
| | | | | 39,674 | 28,131 | 11,543 |

Corporate Income Tax expenditure 2023

| Discription | Tax base (Rs Mn) | Tax Rate (%) | Tax (Rs Mn) | Tax base (Rs Mn) | Standraed Rate | Tax (Rs Mn) | Tax expenditure (Rs Mn) |
|---|------------------|--------------|----------------|------------------|----------------|----------------|-------------------------|
| Tax Liabe income tax under concessionary Rate | 780 | 0 | - | 780 | 24 | 187 | 187 |
| | 168 | 10.5 | 18 | 168 | 24 | 40 | 23 |
| | 765,898 | 14 | 107,201 | 765,898 | 24 | 183,815 | 76,615 |
| | 55,165 | 15 | 8,275 | 55,165 | 24 | 13,240 | 4,965 |
| | 75,884 | 18 | 13,659 | 75,884 | 24 | 18,212 | 4,553 |
| | 5,739 | 20 | 1,148 | 5,739 | 24 | 1,377 | 230 |
| | 168 | 22.5 | 38 | 168 | 24 | 40 | 3 |
| | 12,755 | 30 | 3,827 | 12,755 | 30 | 3,827 | 0.01 |
| Total | 916,558 | | 134,164 | 916,558 | | 220,739 | 86,575 |
| Exempt Amounts under Third Schedule of the Inland Revenue Act, No. 24 of 2017 | 476,161 | Exempted | | 476,161 | 24% | 1,143 | 1,143 |
| Exemptions under the Provisions of the Inland Revenue Act, No. 10 of 2006 | 6,491 | Exempted | | 6,491 | 24% | 16 | 16 |
| Total | 482,652 | | | 482,652 | | 1,158 | 1,158 |
| Grand Total | 1,399,210 | | 134,164 | 1,399,210 | | 221,898 | 87,733 |

Note : CIT Expenditure includes the CIT concessions granted under the BOI agreements as well.

VAT Expenditure by Sector for BOI Companies 2022/2023

Rs Mn

| Sector | Tax Base | Tax Rate | Tax Rate | Estimated Tax | Tax Expenditure | Sector total |
|----------------------|----------------|-----------------|----------|----------------|-----------------|----------------|
| Agriculture | 8,622 | Exempted | 0 | 690 | 690 | 5,885 |
| | 5,554 | Exempted | 0 | 666 | 666 | |
| | 30,191 | Exempted | 0 | 4,529 | 4,529 | |
| Apparel | 996 | Exempted | 0 | 80 | 80 | 37,562 |
| | 9,770 | Exempted | 0 | 1,172 | 1,172 | |
| | 242,067 | Exempted | 0 | 36,310 | 36,310 | |
| Infrastructure | 40 | Exempted | 0 | 3 | 3 | 837 |
| | 106 | Exempted | 0 | 13 | 13 | |
| | 5,476 | Exempted | 0 | 821 | 821 | |
| Knowledge Services | 298 | Exempted | 0 | 24 | 24 | 2,516 |
| | 150 | Exempted | 0 | 18 | 18 | |
| | 16,495 | Exempted | 0 | 2,474 | 2,474 | |
| Manufacturing | 27,694 | Exempted | 0 | 2,216 | 2,216 | 20,012 |
| | 16,413 | Exempted | 0 | 1,970 | 1,970 | |
| | 105,513 | Exempted | 0 | 15,827 | 15,827 | |
| Power | - | Exempted | 0 | - | - | |
| | - | Exempted | 0 | - | - | |
| | - | Exempted | 0 | - | - | |
| Services and Utility | 55,226 | Exempted | 0 | 4,418 | 4,418 | 36,026 |
| | 170,570 | Exempted | 0 | 20,468 | 20,468 | |
| | 74,266 | Exempted | 0 | 11,140 | 11,140 | |
| Tourism | 286 | Exempted | 0 | 23 | 23 | 1,454 |
| | 353 | Exempted | 0 | 42 | 42 | |
| | 9,256 | Exempted | 0 | 1,388 | 1,388 | |
| Other | 50 | Exempted | 0 | 4 | 4 | 3,011 |
| | 1,401 | Exempted | 0 | 168 | 168 | |
| | 18,926 | Exempted | 0 | 2,839 | 2,839 | |
| Grand Total | 799,718 | Exempted | | 107,303 | 107,303 | 107,303 |