Fostering Resilience for Global Stability

Dr. Nishan de Mel

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Dr. Nishan de Mel claimed that additional revenue can be collected in Sri Lanka by reinstating two underutilized methods of efficient tax collection that were phased out in 2020. That is, with the withholding tax (WHT) and the pay-as-you-earn (PAYE) methods of tax collection without any change in the current, reduced tax rates and a WHT of 10%, the additional revenue that can be collected is estimated to be 0.70% of GDP (which is LKR 184.2 billion in 2023).

Dr. De Mel stressed that tax policy changes were one of the major catalysts for the current economic crisis in Sri Lanka. In 2019, Sri Lanka engaged in momentous tax cuts. The personal income tax rate was reduced from 24 percent to 18 percent. It was stated that the tax-free threshold was increased from half a million rupees to three million rupees. The VAT rate was reduced from 15 percent to 8 percent. The standard corporate income tax rate was reduced from 28 percent to 24 percent. Abolished the PAYE tax, the Service Charge, and withholding tax (WHT) on interest income. As a result of the above-mentioned policy changes, there was a dramatic reduction in the tax base. Dr. De Mel further mentioned that the number of registered taxpayers paying personal income tax decreased by 42 percent. There was a 75 percent reduction in those registered to pay VAT. Sri Lanka's tax revenue dropped from 12 percent of GDP in 2019 to 7.7 percent in 2021.

Dr. De Mel pointed out that actions without analysis got the country into this crisis and that actions without analysis will not get us out of this mess. Thus, he points out three immediate fixes, which are reinstating WHT at 10% on interest, fees, and other incomes, implementing the taxation formula for cigarettes and reinstating PAYE tax collection (even at current tax rates and thresholds). The additional tax revenue collected by reinstating a 10 percent WHT alone is estimated to be 185 billion rupees for the year 2023. The potential increase in tax revenue from introducing the cigarette taxation formula is estimated at 45 billion rupees.

Further, according to a study conducted in 2020, Samurdhi coverage systematically excludes 58 percent of the eligible recipients, and a sizable number of those who received the Samurdhi payments were ineligible to receive them. At a time like this, it is crucial that cash transfer programs are able to help those in need the most.

Based on the findings of a recent study by Verité Research, Dr. De Mel proposed a new targeting mechanism that is highly effective at reaching the eligible and excluding the ineligible, efficient at keeping the administrative costs at a minimum, easy to implement, and free from political bias and corruption. The study proposes targeting households that consume 60 KWH or less electricity. As 99 percent of households are connected to the national grid, electricity usage data is readily available.