

Chapter 01: Introduction to Taxation

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Learning Outcomes

At the end of the lesson, the students should be able to:

1. State the economic and social functions of taxation.
2. Explain the taxation principles and the difference between direct and indirect taxes
3. State the role of the tax authorities in Sri Lanka.
4. Identify the major taxes in Sri Lanka.

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Introduction to taxation

- Functions of taxation
- Principles of taxation
- Direct and Indirect tax
- Tax Authorities in Sri Lanka
- Main taxes charged in Sri Lanka

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Introduction to taxation

- What is Tax?



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Introduction to taxation

- Tax is a compulsory charge imposed by the government or government authorized institution. Even though it has no direct benefit, there is an indirect benefit to the public at large.
- The Government collects revenue in the form of taxes, charges, levies, fines, etc.
- Taxes are imposed in two forms as direct and indirect taxes. Direct tax is levied directly on personal & corporate income and profits. Whereas indirect tax is levied on the price of a good or services.

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History of Taxation In Sri Lanka

- The colonial Government introduced income tax system in Sri Lanka in 1932. After the independence in 1948, the tax system in Sri Lanka underwent several changes such as introduction of wealth tax, Gift tax and Expenditure tax. Subsequently these taxes were abolished, however income tax continued to be in force.
- The main indirect tax, namely turnover tax, was introduced in 1981 and was transformed into goods and services tax (GST). Later goods and services Tax (GST) was substituted by value added tax (VAT).

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Why do governments charge various taxes?



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Functions and principles of taxation

- ❖ Functions of taxation can be separated into
 - primary function,
 - economic function &
 - social function.

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Primary function

- Raising funds for public expenditure.
- *Examples for public expenditures:*
 - free medical services
 - infrastructure facilities
 - security & law
 - free education service
 - road development
 - electricity and water & etc.

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Economic and Social Function

Economic functions of taxation:

- Set local and foreign investment direction – The State could encourage or discourage private sector investments by using taxation tools such as rates and incentives.
- Protect local industries from foreign competition – Vital local industries could be protected from foreign competition via tools such as import taxes.

Social functions of taxation:

- Discourage activities which are undesirable by the society - Tax tools could be used to curb undesirable activities such as consumption of liquor & tobacco or gaming & gambling.
- Encourage activities which are desirable by the society - Desirable activities such as savings, retirement investments, innovation, research & development, etc. could be encouraged via taxation system.
- Reduce income disparity between rich and poor – Income inequality in the society could be reduced via taxation system using progressive tax rates, rebates, etc.

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Principles of Taxation

Principles on which the state should be guided by designing and implementing a tax system are considered as principles of taxation.

- Equity (*Horizontal equity, Vertical equity*)
- Certainty
- Convenience and voluntary compliance
- Economy
- Progressivity
- Efficiency
- Adequacy
- Broad base
- Simplicity

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Classification of Taxes

- Direct tax – Directly paid by tax payer, tax burden can not be shifted.
 - Example: Income tax
- Indirect Tax – Collect through tax agent, tax burden can be shifted.
 - Example: VAT

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Direct and indirect taxes

	Direct tax	Indirect tax
Imposition of payment	Direct taxes should be paid by taxpayer directly to the Government	Indirect taxes are collected by a person other than the person on whom the tax is imposed
Shifting of tax burden	Tax burden cannot be shifted	Tax burden can be shifted to the final consumer
Collection	Collection cost is high unless there is voluntary compliance	Low collection cost
Tax burden	generally direct taxes are progressive	Indirect taxes have regressive impact
Example	Income tax	VAT

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Direct and indirect taxes - *Exercise*

	Direct tax	Indirect tax
Income Tax		
Value Added Tax (VAT)		
Custom Duty		
Stamp Duty		
Lottery Tax		
Tax on Betting and gambling		

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Classification of Taxes Cont.

- Proportional Taxes
- Progressive Taxes
- Regressive Taxes

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Tax Authorities in Sri Lanka

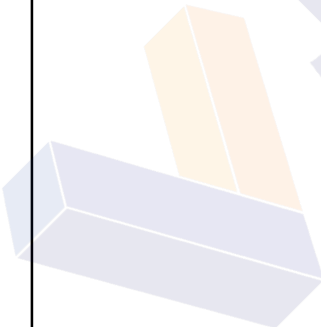
- **Department of Inland Revenue** - *Income Tax, VAT Stamp duty*
- Department of Custom – *Import Duty and role of control and monitoring*
- Department of Excise – *Liquor and Tobacco taxes*
- Provincial Departments – Under 13th amendment , *Stamp Duty, Drug and Chemical taxes*
- Local authorities (Municipal and Pradesheeya Sabha) - *Rates(Property Tax on rating assessment), Licenses, Trade tax*

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Main taxes Charged in Sri Lanka

- Income Tax -under Income Tax Act No 24th of 2017 (No 10 of 2021 amended) .
- Value Added Tax – under Value added Tax Act No 14th of 2002.
- Nation Building Tax –NBT-under Nation Building Tax Act No 9th of 2009 (Now this taxes had been abolished).
- Economic Service Charge – ESC-under Economic Service Charge Act No 13th of 2006 (Now this taxes had been abolished).
- Stamp Duty – under Stamp duty special provision Act no 12th of 2006.

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Q&A ?

Thank you

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