Loss of Corporate Income Tax Revenue due to Exemptions: An Analysis Based on Company Tax Returns

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Abstract

This study computes the loss of corporate income tax (CIT) revenue in Sri Lanka due to the tax exemption policy based on a sample of 1015 company tax returns each year during the period from 2010/11 to 2016/17 assessment years. The loss of CIT revenue due to tax exemption is defined as the difference between the potential CIT revenue on profits and income and the potential CIT revenue on profits and income liable to tax. The estimated annual average loss of CIT revenue accounted for is Rs. 6,642 million during the period. It accounted for 25% of the annual average potential CIT revenue of the companies and about 0.07% of the country's GDP. An annual average of Rs. 6.5 million tax loss per company is thus reported. If the projection is made to the population of 5075 companies concerned, the annual average tax loss due to exemptions accounted for is about Rs. 32,988 million. Results also reveal that the annual average of CIT loss due to exemptions per large company stood as Rs. 33 million which is 8 times higher than that of a small company and 17 times higher than that of a medium company. The study also found that service and industrial companies receives larger benefits from tax exemptions than agricultural companies. Further, tax exemptions granted for food beverages and tobacco producing companies and financial service companies together accounted for about 65% of the estimated total CIT revenue loss on average. Generally, results of this study indicate that the corporate tax exemption policy of Sri Lanka has created a significantly high tax revenue loss. Further, exemptions given to large companies have eroded the CIT revenue largely. These results indicate that the government of Sri Lanka needs to revisit its corporate income tax exemption policy.

Keywords: *Corporate income tax loss, Tax exemptions, Potential tax revenue, Company tax returns*

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