

THE TAX PROPOSALS OF BUDGET 1986 - A COMMENT

Norman Cassie Chitty
Tax Consultant and Attorney-at-law

The Minister of Finance in his budget speech stated that over the past 3 or 4 years he effected a gradual reduction in Income Tax rates. He said that he did this "in order to reduce the heavy burden of personal income tax in Sri Lanka with the twin objectives of reducing tax evasion and leaving a larger surplus in the hands of taxpayers for increased investment". He also said that this was the trend in India and Pakistan where they had effected gradual reductions in the maximum rate and the raising of the minimum limit below which no tax is payable.

In keeping with this trend in India and Pakistan the Minister effected the following changes for year of assessment 1986/87.

- a) Reduction of the maximum rate of personal income Tax in Sri Lanka from 55% to 50%.
- b) Increase of the exemption limit below which no Income Tax is payable from Rs.24000/- to Rs.27000/- per annum.
- c) Reduction of the number of tax bands from 11 to 5, namely 10%, 20%,30%,40% and 50%.
- d) Lowering the maximum amount of Wealth Tax and Income Tax a person pays from 80% of his assessable income to 60%.

(See Table 1).

Despite these reductions the Minister admits that Sri Lanka still has the highest level of personal income tax in Asia.

Example

Point at which maximum Rate is reached.

India-S.L.Rs. 230,000/- Max Rate 50%
 Pakistan Rs.340,000/-Max Rate 45%
 Sri Lanka Rs.120,000/- Max Rate50%

Despite the acknowledgement that Sri Lanka's personal income taxation is the highest in Asia, the Minister states that he has gradually reduced the various exemptions and

concessions like lump sum depreciation and qualifying payments on the grounds that they are seriously eroding our tax revenue and quotes U.S.A, U.K and Australia as having this trend.

Thus it would appear that to justify reductions the Minister quotes the trends in Asian developing countries but to justify increases he quotes the developed countries. For consistency it is suggested that we draw our comparisons and examples from Asian countries which are developing countries and with whom we have far more in common.

annum is allowed. Even here except in the case of vehicles where the rate of depreciation is 25% p.a. the lease rental allowance on all other assets is higher.

Example

Rate for depreciation of equipment is 12½% p.a. maximum for the same equipment. But the lease rental deductible is 25% of total amount due on lease agreements.

The Minister has in his desire to prevent erosion of the tax revenue reduced the ceiling on Qualifying Payments from Rs.500,000/- to Rs. 150,000/-.

Table 1 **COMPARISON OF INCOME TAX PAYABLE**
FOR THE YEAR OF ASSESSMENT 1983/84/ TO 1986/87

	83/84	84/85	85/86	86/87
Personal Allowances	12000	18000	24000	27000
Slabs	4800	6000	9000	27000
Lowest Rate	7½%	7½%	7½%	10%
Highest Rate	65%	55%	55%	50%
Example I				
Assessable Income	50000	50000	50000	50000
Less P.A.	12000	18000	24000	27000
Taxable Income	38000	32000	26000	23000
Tax	8600	6250	2775	2300
Example II				
Assessable Income	150000	150000	150000	150000
Taxable Income	138000	132000	126000	123000
Tax	62460	55800	43875	34500

Lump sum depreciation was withdrawn in 1981 and various rates of depreciation ranging from 5% to 25% are allowed. But fortunately for tax payers leasing as a means of financing is becoming popular and leasing companies are sprouting all over so that taxpayers claim the Leasing Rental as a deduction and not the depreciation allowance. The entirety of the Leasing Rental claimed was allowed as a deduction on agreements up to 31.12.83 and on agreements entered into after 01.01.84 only 25 per centum per

How and why Rs.150,000/- was arrived at nobody will ever know; whether it is the optimum amount or whether it is designed to encourage savers or investors whose assessable incomes do not exceed Rs.450,000/- we will not know, or whether those whose assessable incomes are over Rs.450,000/- should not be encouraged to invest even though under these proposals they are expected to have larger surpluses than before or whether they could look after themselves we will never know.

A comparison of the effect of the maximum Qualifying payment is given in Table 11

But it is generally agreed that Qualifying Payments are too generous.

But it must be mentioned here that it is unlikely that there is tax evasion which connotes fraud. But it is clear that there has been NON-DECLARATION because most of the amounts in Fixed Deposits are small amounts owned by people who have not heard of Income Tax.

Table II COMPARISON OF ALLOWANCE OF QUALIFYING PAYMENTS FOR YEARS OF ASSESSMENT 1983/84 TO 1986/87

QUALIFYING PAYMENTS (LIMIT)			
83/84	84/85	85/86	86/87
1/3 of Assessable Income	1/3 of Assessable Income	1/3 of Assessable Income OR Rs500,000/- whichever is lower	1/3rd of Assessable Income Rs 150,000 whichever is lower
EXAMPLE Assessable 2000,000 Income 1/3rd Rs 666,000 or Limit	ALLOWANCE OF 2,000,000 Rs 666,000	QUALIFYING PAYMENTS 2,000,000 Rs 500,000 because it is less than 1/3 of Assessable Income	 2,000,000 Rs 150,000 because it is less than 1/3 of Assessable income

At this point it must be mentioned that promoters of Public Companies offered the Qualifying Payment Deduction as a bait to the public in order to secure funds by share subscription. The gullible public swallowed the bait and invested most of their savings in shares in these Public Companies whose performance has been poor so far.

The Minister also announced the death knell for Estate Duty and Gifts Tax. But he has chosen to retain the other Capital Tax - Wealth Tax. The reasons he gives are unconvincing and do not justify the intention of the levy is an incentive to tax payers to Wealth Tax is retained because "the annual declaration of capital assets helps the Department of Inland Revenue in checking on the declaration of annual income and also because the levy is an incentive to taxpayers to move their assets from unproductive to more productive investments".

If the Wealth Tax forms are helpful to assessors it is suggested that the Wealth Tax forms be retained and used as a supplement to the Income Declarations (FORM 1R4). But why should a taxpayer be taxed for furnishing a Wealth Declaration. In other

words, the same package of forms be mailed without the levy of Wealth Tax.

The expectation that there will be a movement of assets from unproductive to productive investments is fanciful, because the unproductive assets would have no value and have little effect on the Wealth Tax contribution. The same argument was made in connection with Land Tax.

But what would cause movement of assets is the abolition of the Estate Duty and Gifts Tax- the Capital Transfer Taxes. (Note that here too the Minister cites the Asian examples and not the Western or U.S.A examples to abolish taxes).

The with-holding Tax of 20% on interest income is another instance of the Minister citing the U.S. example to impose a levy. He says the U.S.A where compliance is very high has introduced a with holding tax on income. The Minister states that the "Inland Revenue Department has reported to me that one of the major forms of tax evasion in the country is the NON DISCLOSURE of interest income on Fixed Deposits in Banks, Finance Companies and other financial institutions".

This is the innocent aspect of NON-COMPLIANCE and despite the attempts to issue directions not to withhold and refund speedily, it is unlikely that these professions are solemn enough to persuade small investors to continue making Fixed Deposits.

The problem appears to be the inability of the Department to process information which is being readily furnished by the Banks, etc. It is also likely that the interposing of tax authorities between the Saver and Institution will have the same result that followed the measures taken by Section 32 B of Act No.27 of 1982, which imposed Deductions of Income Tax from interest on Long Term Fixed Deposits; a scheme launched by the Bank of Ceylon and abandoned because of this measure. The irony of it is that in 1970 Dr.N.M. Perera introduced the N.S.B and the Fixed Deposit Scheme after an intensive publicity campaign when he learnt from his demonitization exercise that the rural folk and lower income groups had a hoarding habit rather than a saving habit because they stashed away big currency notes in almira's and trunks. It is expected that with this bureaucratic interference the Fixed Deposit Scheme will die away. But as for the imagined tax evaders they will certainly find less naive ways of putting their money beyond the reach of the Tax Department. In the light of all these factors one can foresee another Scheme being proposed by the Central Bank to supplement the Certificates of Deposit.

In concluding one is compelled to say that the proposals of the 1986 Budget are piecemeal administrative reforms designed to assist a Department already clothed with a plethora of power and that the proposals are not in pursuance of any express or imlicite Fiscal Policy of the Government.