

EXECUTIVE SUMMARY

The Department of Inland Revenue has been the major collector of tax revenue to the state coffers of the Sri Lankan Government for the past periods. In order to fulfill the above requirement, the Department attempts to achieve the targets given by the Ministry of Finance based on the annual budget proposals. With the end of the 30 years old insurgency, Sri Lanka has entered into a new era of growth reconciliation and reconstruction and development challenges are many both in the national and international contexts.

According to the past experience, it is disclosed that fiscal and taxation system of the country is at a very crucial stage while overall Gross Domestic Products (GDP) and Per Capital Income have been steadily increasing, the total government revenue and tax revenue been decreasing. Commencing with analyzing the functions of a tax system, it identifies the declining revenue ratio to GDP as perhaps the dominant factor in current fiscal problems in Sri Lanka. In analyzing the reasons for the decline and measures necessary to upturn this trend, weakness in tax administration and the administrative mechanism is one of the main reasons.

In the current context, with the declining tax ratio and the urgent need to increase government revenue, the effectiveness of the tax administration, its structures, systems and processes need thorough examination, its weaknesses identified and measures taken to rectify these weaknesses and make the tax administrative system an efficient and effective instrument of tax collection.

Tax system of Sri Lanka is entirely based on the Self-Assessment System and it generates 96% of total tax collection. Nevertheless, auditing and examination of Returns and Financial Statements is an integral part of assessment procedure. However, it represents only 4% by way of additional assessment as a result of that. Therefore, Audits would be undertaken on taxpayers specially in the Large Tax Payer Unit (LTU) as LTUs contribute substantial amount of revenue by way of Self-Assessment System and additional tax agreed after audit for the total revenue collection of the Department. Banking and Financial Services Unit (BFSU) is the biggest LTU in the Department and it contributes considerable amount for collection of tax revenue. Though the collection of revenue has been increased, it indicates the deficit and downward trend compared to the target given by the management of IRD. It is noted that the

prevailing audit system does not contribute more revenue by way of issuing additional assessments based on the additional tax assessed and agreed.

Therefore, in order to address this issue, in the study paper it is intended to design an improved audit plan to increase the Income Tax revenue in the BFSU as importance of this unit in LTU of the Department. Therefore, it is also expected to overcome this issue by upturning the declining trend of contribution of IRD to GDP.