

## VAT Compliance Improvement Plan 2

### PLAN OVERVIEW

The **VAT Compliance Improvement Program** consists of two compliance improvement plans (CIPs).

**Plan 1** addresses risks presented by Registered Identified Supplier and Purchasers (RIS/RIP), with predominant focus on RIS, transitioning to the VAT system following repeal of the Simplified VAT (SVAT) regime from October 1, 2025.

**Plan 2** Addresses additional priority risks to the VAT system.

### CONTEXT

When the Simplified Value Added Tax (SVAT) regime is repealed from October 1, 2025, approximately 27% of Sri Lanka's active VAT registrants must settle their business-to-business VAT transactions with cash rather than credit vouchers. SVAT has been in place since 2011, so this change represents a significant shift from long established compliance requirements. In addition to being predicably resistant to change, these taxpayers may face challenges in knowing how to properly comply with their new obligations. There is risk to revenue if they are not properly educated, monitored and supported - before, during and after transition.

**Plan 1** identifies the principal compliance risks posed by these taxpayers, and outlines treatment responses to mitigate those risks. Focus in on building a taxpayer mindset and providing quality communications/education to increase understanding, closely monitoring initial compliance, and providing tailored support to the largest withholder/remitters.

**Plan 2** - specifically targets critical risk areas that have emerged since the implementation of the initial VAT Compliance Improvement Plan

### 2. Segment Profile

#### Active VAT population as at 2024.12.31

Population Segment	No of VAT Active Accts
LTO Total	577
UCO Total	1,635
MCO Total	5,425
METRO Total	3,787
REGIONAL Total	9,664
OTHER Total	185
Grand Total	21,273

Since 2023, the VAT population has increased more than 50%. This increase is attributable to the lowering of the VAT registration threshold, reactivation of certain accounts, sunsetting temporary registrations and making them permanent, tax status of certain supplies in the legislation and voluntary registrations.

#### SVAT Impacted Accounts

No. Registrants	Total Supply
1,011	taxpayers>LKR 18
2,161	taxpayers>LKR 50M
347	taxpayers>LKR 0-49M

The SVAT sub-group of the population identified in VCIP1 will continue to be a priority.

### 3. Risk Assessment

#### Risk Assessment

##### Correct Registration: **Moderate**

- Authentication processes for VAT registration may not prevent the infiltration of bad actors into the VAT population leading to unwarranted refunds and/or false invoicing.

##### On Time Filing: **High**

- A considerable number of VAT registrants have poor filing compliance. This is significantly elevated in the lower turnover segments and is not adequately addressed.

##### Accurate Reporting: **High**

- Reporting risk is considered high across the VAT population overall due to the historical absence of compliance activities.

##### Timely Payment of VAT: **High**

- As of December 31, 2024, 6,403 VAT registrants owe more than 43 billion LKR (\$143 million USD)

#### 5. Workflows and Monitoring

Treatments	Plan	Numbers
Enhanced registration reviews Con	Sample a selection of new registrations and apply enhanced validation	2-5% of new registrations
Risk based examinations of special project supplies	Validate tax status of supplies to project and input eligibility	TBD # of projects to review
Performance measurement of communications channels	Several channels are being exploited, such as, SMS, social media and awareness sessions that are not tracked for effectiveness.	Introduce tracking methods to determine the effectiveness of these approaches.

### 4. Risk Treatments

#### Registration

- Design and document the process for registration and for post registration confirmation activities including coverage rate.
- Conduct enhanced registration review activities.

#### Filing

- Examine current practices to determine the right measures to address delinquent filers.
- Determine the capacity of RAMIS to automate the processes to address delinquent filers and reduce manual workloads.

#### Reporting

- Initiate risk-based examinations of special project suppliers, for accuracy and compliance.
- Conduct field visits for high-risk cases, where possible.
- Determine the capacity of RAMIS to automate the processes to address outstanding debt and reduce manual workloads

#### Payment

- Monitor the payment and refund patterns for the VAT population to identify emerging trends and behaviours.
- Focus on RIS/RIP filing behaviours as outlined in VCIP1, by the SVAT Repeal Project team, to ensure integrity in the payment and refund process.

**Risk Hypothesis**

VCIP2 highlights areas of risk, that are important to the overall effectiveness of the administration’s compliance work and revenue generation capabilities. Additionally, the VAT population has increased more than 50% yet staffing resources have remained static. This reality will place even greater pressure on the administration and its ability to address risk.

**1. Special Project Suppliers to Government**

The special tax status granted for the approximately 50 government projects will require close monitoring to ensure compliance and prevent revenue leakage. Further, the expedited payment status of refunds for this group will create additional strain on the IRDs scarce resources.

**2. New Registrants, including the onboarding of former temporary VAT registrants.**

New accounts present elevated refund risk as they do not have an established filing pattern or filing behaviour. Additionally, without a rigorous registration and authentication processes identity theft and registration of fictitious entities can occur. Unwarranted refunds or false invoicing to reduce net tax are possible.

**The pressing need to address filing and payment non-compliance.** Only 43% of the VAT returns are filed on time, 36% are filed late and 21% are never filed (2024). Additionally, more than \$43 billion rupees were payable at December 31, 2024.

Filing and Payment Non-compliance

Current practices are manual and take considerable time. They are also ineffective.

Automate processes to notify and address filing and payment non-compliance (i.e. RAMIS)

**6. Evaluation of Compliance Impacts**

Revenue	Total revenue effects and revenue assured
Registration	% of enhanced registration reviews completed of new VAT accounts  # of identified incorrect registrations
Filing	% increase in registrants filing on time
Payment	% increase of registrants paying in full and on time % reduction in tax arrears
Reporting	% of risk assessed cases with a material change to amounts reported. (>5% of tax reported.) # of field visits and or audits at the place of business.

**Resource Requirements/Dependencies**

- Augment SVAT repeal Project Team, as necessary.
- Ensure adequate analytical resources are in place to identify problems and/or opportunities post repeal.
- Resource enhanced registration review activities.

**7. Capacity Development Needs**

Remote and in-country support to adjust and redirect both VCIP1 and VCIP2 implementation based on trends and risks identified through close monitoring by the VAT CIP Committee.