

Tax Policy and Enterprise Development in South Asia
IPS, Sri Lanka Research Design Document

1. Institutional Information	
1.1. Name of institution	Institute of Policy Studies of Sri Lanka
1.2. Country of origin	Sri Lanka
1.3. Research theme	Theme 2: The Impact of VAT on Enterprise Development
1.4. Institution Focal Person / Member, Steering Committee	Dushni Weerakoon, PhD Deputy Director Institute of Policy Studies of Sri Lanka 100/20 Independence Avenue Colombo 7 Sri Lanka Tel: +94-11-2143100 dushni@ips.lk
1.5. Team Leader	Anushka Wijesinha Research Economist Institute of Policy Studies of Sri Lanka 100/20 Independence Avenue Colombo 7 Sri Lanka Tel: +94-11-2143100 ext 219 anushka@ips.lk
2. Literature Review	
2.1. Data sources	Inland Revenue Act No.9 (2011) – VAT implementation Inland Revenue Act No. 14 (2002) – VAT introduction (moving from GST) Inland Revenue Department Performance Report (various years including latest 2011) Household Income and Expenditure Survey 2009/10 (Department of Census and Statistics) Final Report of the Presidential Commission on Taxation 2009/10

	<i>(literature review of international experience + international refereed journals pending)</i>
2.2. Key knowledge gaps	<p>No previous studies have been undertaken in relation to VAT in Sri Lanka and their impact on small enterprises.</p> <p>No government agencies collate/calculate tax expenditures.</p> <p>Enterprise-level (microeconomic) data on value-addition, earnings/wages, turnover, fixed capital, etc. are not available.</p> <p>Sri Lanka does not have an established, national definition of “small enterprise”, “Small and Medium Enterprise (SME)”. Different definitions/categorizations are employed by different institutions including banks, Central Bank, government agencies and other SME-mandated institutions.</p>
3. Conceptual and Theoretical Framework	
3.1. Research Questions	<ol style="list-style-type: none"> a. What are the differences in VAT burdens faced by registered SMEs versus unregistered small enterprises? b. How much of a determinant is the VAT burden in the degree of informality among small enterprises? (and by extension their ability to grow and increase performance) c. To what extent do VAT compliance costs determine the ability of small enterprises to grow and improve performance?
3.2. Definitions of key concepts and their translation into measurable parameters of enquiry	<p>For the purpose of this study, SMEs will be defined as a firm employing 49 workers or less, while a larger enterprise will be defined as firm employing 50 workers or more</p> <p>SMEs that are not registered with either the Divisional Secretariat or incorporated with Company’s Registrar at the national level will be treated as firms operating in the informal economy (i.e. undocumented)</p> <p>Improvements in performance of an enterprise will be measured by increases in annual profits, expansion in employment, ease of/cheaper access to credit, proportion of retained profits reinvested in the enterprise, and willingness to formalize</p> <p>Progressivity impacts will refer to the relative ability of SMEs to pass on VAT to final consumers and or obtain VAT refunds for intermediate goods purchases</p>

	Cost of Vat compliance will be assessed by the number of documents required for compliance, the level of in-house knowledge to comply with VAT (e.g. preparing accounts and filing returns/refunds etc), the time taken to comply, and (if applicable), the financial burden in hiring specialized help to comply
3.3. Hypothesized relationships between parameters	<p>Undocumented enterprises face a heavier VAT burden as they are unable to pass on VAT to final consumer</p> <p>Undocumented enterprises face a heavier VAT burden as they are unable to claim input credit for intermediate good purchases</p> <p>Smaller firms compared to larger firms lack resources and knowledge to comply with VAT requirements and as such refrain from formalizing to avoid VAT compliance as a result curtails their ability to expand</p>
4. Analytical Framework	
4.1. Policy analysis framework (problem definition, policy alternatives, evaluation criteria for policy alternatives, and recommendation of alternative)	<p>An example of a policy consideration would be whether the refund element of VAT causes difficulties to small enterprises and whether policy changes can be made to improve VAT refund mechanism, solve issues associated with timing of VAT refund, etc</p> <p>If small informal enterprises find VAT a significant barrier to growth and formalization, a recommendation may be to raise the VAT registration threshold (based on turnover)</p>
4.2. Level of analysis (national, sub-national, etc.)	Sub-national (Western Province)
4.3. Analytical approach and assumptions	<p><i>Assumptions:</i></p> <p>SME definition chosen can be applied right across the chosen sample (registered SMEs, informal SMEs)</p>
4.4. Analytical tools and techniques to be applied	<p>Regression analysis investigating impact of VAT on key dependent variables measuring enterprise performance (<i>see 3.2</i>)</p> <p>(Specific econometric methodology will be decided after completing thorough literature review of previous studies done of a similar nature. Much of the existing studies examine VAT progressivity analysis on households, and learning from these methodologies and adapting to present study is now underway.)</p>

5. Data Collection Methodology	
5.1. Research Methods	
5.1.1. Key Informant Interviews	
5.1.1.1. List of intended respondent types with examples	<p><i>Officials of revenue administration agencies</i> Director General, Department of Customs Former Director General, Department of Customs Commissioner General, Department of Inland Revenue Deputy Commissioners, Department of Inland Revenue VAT Commissioner, Department of Inland Revenue</p> <p><i>Officials of other government agencies</i> Director Fiscal Policy Department, Ministry of Finance and Planning Director Investment Promotion, Research and Policy Advocacy, Board of Investment Secretary, Ministry of Industry and Commerce Addl Secretary – Policy, Ministry of Industry and Commerce Chairman, National Enterprise Development Authority (NEDA) Secretary, Ministry of Traditional Industries and Small Enterprise Development Director - SME, Ministry of Traditional Industries and Small Enterprise Development Chairman, Industrial Development Board Director - Private Sector Development, Ministry of Economic Development</p> <p><i>Representatives from non-governmental organizations/chambers of commerce/tax consultants</i> President or General Secretary, Sri Lanka Institute of Taxation President, Institute of Chartered Accounts (CA Sri Lanka) President or CEO, Federation of Chambers of Commerce and Industry Director – SMED Programme, Federation of Chambers of Commerce and Industry President or CEO, Chamber of Small and Medium Industries President or CEO, National Chamber of Commerce Senior Partner, KPMG Senior Partner, Ernst and Young Senior Partner, Pricewaterhouse Coopers</p>

<p>5.1.1.2.Instrument (semi-structured interview outline)</p>	<p>Semi-structured questionnaire Basic information on the Key Informant (type of organization, location, designation, etc) Sections examining particular areas of inquiry, with structured as well as open ended questions</p>
<p>5.1.2. Survey Research</p>	
<p>5.1.2.1.Sample frame (including secondary sources tapped for developing it)</p>	<p>Three districts in Western Province, Sri Lanka, i.e., Colombo, Gampaha, Kalutara Selected Grama Niladhari Divisions (GN Divisions) in each district</p> <p><i>Registered SMEs (50)</i> Population: Database of the district-level SME associations obtained from the National Chamber of Commerce of Sri Lanka (NCCSL) Sample: Randomized selection of enterprises</p> <p><i>Registered large enterprises (50)</i> Population: Board of Investment (BOI) database (including Section 16 and Section 17-registered enterprises) Sample: Randomized selection of enterprises</p> <p><i>Un-registered SMEs (50)</i> Population: Snowballing operation to identify enterprises in each GN Sample: Randomized selection of enterprises</p>
<p>5.1.2.2.Sampling design and rationale</p>	<p>Western Province is selected as it is the largest contributor to national Gross Domestic Product (GDP) of over 45 per cent, and the three districts constituting it have the highest concentration of private enterprises in the country. Moreover, due to the proximity to the capital city, administering the survey (including arranging field-testing, monitoring, etc) and data collection is made easier, to fit in with the study's time and resource constraints.</p> <p>For registered SMEs, the NCCSL database will be used owing to its credibility and ease of access (IPS has existing links with NCCSL on ongoing SME research) For registered large enterprises, the BOI database owing to credibility and ease of access (IPS has existing links with BOI on previous taxation research)</p>

	For unregistered SMEs, there is no clear database of enterprises. A snowballing exercise has to be conducted as an alternative to the ideal but highly cost-intensive listing operation)
5.1.2.3.Survey instrument (including field pre-testing procedure)	Questionnaire Pre-testing will be conducted on a representative sample of 6 enterprises (2 from each enterprise category above)
5.1.2.4.Action Plan (primary sampling units and dates they are sampled)	Primary sampling unit will be the GN Division (for unregistered SMEs) and the District level (for registered large enterprises and SMEs) Will be sampled in April 2013 onwards
5.1.2.5.Data collection protocols (including field team training, organization, monitoring and reliability checks)	Enumerators will be employed for questionnaire administration/data collection Training and briefing will be provided to enumerators by the study team Study team will accompany enumerators during the field pre-testing period Study team will participate in randomly selected surveys to conduct monitoring In the middle of the survey period the study team will revisit selected completed interviewed enterprises to conduct simple verification/reliability checks.
5.1.2.6.Data entry and verification protocols	Data will be entered by data entry operators selected by the study team and be housed within the institute with close guidance from the study team For quality checking, data cleaning will be conducted by the study team (and enterprises re-visited if there appears to be mistakes)
6. Reporting Formats for Year 1, 2 and 3 deliverables	
7. Team Composition	
7.1. Names, designations, qualifications, experience, and responsibilities of Team Leader and other Team Members	Team Leader: <i>Will take the lead in conducting the study and pull in the necessary research expertise required at different stages of the project. Along with the other team member, the team leader will prepare the literature review, refine the areas of inquiry, research questions, conduct KIIs, and other deliverables at each stage of the project. The team leader will ensure quality</i>

delivery of research outputs at each stage of the project.

Anushka Wijesinha

Anushka is currently a Research Economist at IPS, with significant experience in private sector development issues as well as policy advisory experience in industrial policy and SMEs (specifically SME financing) in several government ministries and taskforces. He was previously the Research Officer to the Presidential Commission on Taxation (2009/10). His research interests include industrial policy, innovation, FDI, taxation, governance, and international economics. Anushka holds a BSc in Economics from University College London and a MA in Economics and Development from University of Leeds.

Team Members:

Will be responsible for initiating and conducting the literature review and refining the areas of inquiry. Along with the team leader, the team member will refine the areas of inquiry, research questions, conduct KIIs, administer the survey and the subsequent data analysis

Raveen Ekanayake

Raveen is currently a Research Assistant at IPS. Formerly employed in the financial services industry (with a focus on SMEs), Raveen has several years of private sector experience. He holds a Masters in Public Policy (with a specialization in Economic Policy) from Australian National University, Canberra. He holds a BSc in Accounting and Finance (University of London), and a Postgraduate Diploma in Economic Development (University of Colombo)

(Additional research staff with specific expertise in, for example, survey design/administration and econometric analysis will be pulled in during selected periods of the project cycle.)