PROPOSAL FOR REMOVING TAXATION ON EMPLOYEES' PROVIDENT FUND (EPF) RETURNS

THE PROPOSAL

Verité Research recommends that the 14% tax on returns earned by the Employees' Provident Fund (EPF) be removed. This measure addresses regressive taxation, enhances fairness, and aligns Sri Lanka with international best practices where the majority of countries exempt retirement fund returns from taxation. The fiscal impact can be offset through other measures, that have also been proposed for the budget.

SHORT ABSTRACT

The EPF is Sri Lanka's largest retirement savings fund, covering over 2.2 million active contributors.[i] Over 92% of its members are not liable to pay personal income tax[ii], yet their savings unjustly face a 14% tax on investment returns. Internationally, 78% of countries do not tax the investment returns of provident funds.[iii] Removing this tax in Sri Lanka corrects an inequity, prevents regressive outcomes, and protects retirement security. A revenue-neutral "win–win" can be achieved by replacing the foregone revenue with other more productive taxation.

TOPLINE VIEW

Objective of the Proposal

- ☐ Economic Growth
- ☒ Governance
- ☒ Justice and Rights
- ☒ Social Welfare
- ☐ Other: ....

Implementing Agency:	Ministry of Finance
Primary Beneficiaries:	EPF Holders
Cost Estimate (if available):	LKR 15.7 Bn
Policy Type:	Revenue reduction

HOW IT ADVANCES THE OBJECTIVES

1. Governance: Restores trust by correcting an anomaly in tax policy, aligning retirement savings taxation with fairness and global practice, and enhancing transparency

2. Justice and Rights: Removes an inequitable system where non-taxpayers (92% of EPF members) are taxed on their retirement savings, contrary to the principles of progressivity

3. Social Welfare: Protects retirement incomes and ensures workers retain a fairer share of their savings

CASE FOR THE PROPOSAL

The EPF is Sri Lanka's largest retirement savings scheme, but its members face uniquely adverse taxation. By law, formal sector employees contribute 20% of their income into retirement savings funds, of which the EPF is the largest. However, instead of protecting these savings, Sri Lanka's tax system imposes a uniquely adverse burden on them. Between 2018 and 2022, the EPF paid an average of 13.7% of its gross income in taxes, compared to just 8.0% for the banking sector. [iv] This disparity arises because banks are taxed on net income **after** deducting returns to depositors, while the EPF is taxed on gross income **before** deducting returns to its depositors/members — a far harsher and unequal treatment relative to other financial institutions offering savings deposits.

The injustice is most visible at the household level. Over 92% of EPF members earn less than LKR 100,000 per month and fall below the personal income tax threshold (refer Annex 1). Yet their mandatory savings are subject to a 14% tax on investment returns. If saved privately, these returns would have been tax-free – even the Witholding Tax (WHT) that is automatically applied, would be returnable. The result is a regressive system where the poorest workers pay disproportionately more, while only the high income earners (above LKR 233,333 per month, since the revision to PAYE taxes in April 2025) are taxed below their marginal tax rate.

Internationally, Sri Lanka is an outlier. Most OECD countries treat retirement savings preferentially to encourage long-term security; 32 out of 41 (78%) do not tax provident fund investment returns. [v] By contrast, Sri Lanka has progressively increased taxation on the EPF since 1989, culminating in being the only country to restructure local debt by targeting retirement funds in 2023.

Sri Lanka's approach to Domestic Debt Restructuring (DDR) was exceptional by international standards. An IMF staff paper finds that none of the 14 DDR cases worldwide targeted pension funds exclusively. [vi] While some countries included pension funds among several categories of creditors, Sri Lanka uniquely singled out its superannuation funds, imposing concentrated costs on workers' retirement security. Removing the tax on EPF returns provides a practical and fair way to recoup the unfairness of this exceptional targeting, signalling that the state is committed to restoring equity for workers whose savings were disproportionately burdened during the DDR episode.

The case for reform is therefore compelling. Removing the tax on EPF returns would end a regressive practice, correct for the unjust way in which Sri Lanka targeted the EPF for its DDR, align the country with global norms, and restore fairness in the tax system. Crucially, the fiscal cost can be offset by raising other taxes (for example correcting the anomaly of faling to properly index cigarette taxation), ensuring a revenue-neutral adjustment that delivers a double dividend: fairer taxation and improved public health.

HOW DOES IT HELP THE COUNTRY

1) **Restores Fairness in Taxation** - Removing the tax on EPF returns corrects a regressive system where over 92% of contributors — who are not liable for income tax — are

unfairly taxed on their retirement savings. This restores equity in the tax system by ensuring workers are not penalised for mandatory savings

2) **Protects Retirement Security** - The policy ensures that households retain more of their long-term savings, improving financial resilience at retirement. This is particularly important in a context of rising life expectancy and limited social safety nets

3) **Aligns with International Best Practice** - Globally, 78% of countries do not tax provident fund investment returns. Adopting this standard brings Sri Lanka in line with international norms, strengthening policy credibility and consistency

4) **Redresses Exceptional Burden of Domestic Debt Restructuring -** Sri Lanka's 2023 domestic debt restructuring was exceptional in targeting pension funds exclusively — unlike any other case documented in research published by the IMF. Removing the EPF tax provides a fair means of partially offsetting the concentrated burden imposed on workers' retirement savings during this restructuring

5) **Delivers a Revenue-Neutral Win–Win** - The estimated revenue cost of removing the EPF tax (LKR 15.7 billion) can be offset by other available revenue measures (for example, correcting an anomaly in cigarette taxation). This makes the reform fiscally sustainable as well.

PUBLISHED SUPPORTING ANALYSIS

Verité Research. Retirement Funds Face Regressive Taxation in Sri Lanka (October 2023) at https://www.veriteresearch.org/publications/retirement-funds-face-regressive-taxation-in-sri-lanka/ [last accessed 18 August 2025]

Publicfinance.lk. The Exceptionalism of Domestic Debt Restructuring in Sri Lanka (8 August 2023) at https://publicfinance.lk/en/topics/exceptionalism-of-domestic-debt-restructuring-in-sri-lanka-1691519159 [last accessed 18 August 2025]

ANNEX 1 - BREAKDOWN OF EPF MEMBER ACCOUNTS

Monthly Income (LKR)	Number of Currently contributing EPF account holders end of Sept 2024	% of EPF Member Accounts
Upto 100,000	2,024,569	91.6%
100,000 - 141,667	65,656	3.0%
141,667 - 183,333	39,695	1.8%
183,333 - 225,000	26,119	1.2%
225,000 - 266,667	13,920	0.6%
266,667 - 308,333	9,138	0.4%
308,333 - 350,000	6,609	0.3%
350,000 - 391,667	4,362	0.2%
391,667 - 433,333	3,413	0.2%
More than 433,333	16,066	0.7%
Total	**2,209,547**	**100.0%**

REFERENCES AND END NOTES

[i] Central Bank of Sri Lanka. *Annual Economic Review 2024*. Table 2.7, Colombo: Central Bank of Sri Lanka, 2 April 2025, p. 66. https://www.cbsl.gov.lk/en/publications/economic-and-financial-reports/annual-economic-review [last accessed 18 August 2025]

[ii] Refer Annex 1, Information obtained via a Right to Information Request

[iii] OECD. *Annual Survey of Financial Incentives for Retirement Savings 2024*. OECD Publishing, 12 June 2024, https://www.oecd.org/publications/annual-survey-of-financial-incentives-for-retirement-savings-2024-web.pdf [last accessed 18 August 2025]

[iv] Verité Research. *Retirement Funds Face Regressive Taxation in Sri Lanka* (October 2023) at https://www.veriteresearch.org/publications/retirement-funds-face-regressive-taxation-in-sri-lanka/ [last accessed 18 August 2025]

[v] OECD. *Annual Survey of Financial Incentives for Retirement Savings 2024*. OECD Publishing, 12 June 2024, https://www.oecd.org/publications/annual-survey-of-financial-incentives-for-retirement-savings-2024-web.pdf [last accessed 18 August 2025]

[vi] Verité Research. *The Exceptionalism of Domestic Debt Restructuring in Sri Lanka* (8 August 2023) at https://publicfinance.lk/en/topics/exceptionalism-of-domestic-debt-restructuring-in-sri-lanka-1691519159 [last accessed 18 August 2025]