Verité Research
Strategic Analysis for Asia

PROPOSAL TO INCREASE WITHHOLDING TAX TO 15%

DETAILS OF THE SUBMITTER

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THE PROPOSAL (SUMMARY OF THE REVENUE MEASURE)

Increase the withholding tax (WHT) rate from 10% to 15% on all income areas to which WHT currently applies. The proposal does not increase the tax burden on income earners – since WHT payments can be set off against annual tax payments or refunded if collection is in excess of total due. By changing the rate on an existing tax collection instrument it reduces tax evasion, improves the efficiency of collection, and increases fairness towards those who pay taxes.

SHORT ABSTRACT

Increasing the WHT rate to 15% would move Sri Lanka closer to international norms – only 6 out of 98 countries charge less than Sri Lanka's current 10%. It would also reduce the extent of income tax evasion – currently Sri Lanka's income tax collection as a percentage of GDP is less than half the average of even low-income countries, and it can increase government revenue by up to 93 billion. Withholding tax (WHT) is one of the most efficient ways to collect income tax when compliance is weak.

TOPLINE VIEW

Objective of the Proposal

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

Implementing Agency:	Ministry of Finance
Primary Beneficiaries:	General Public
Fiscal Impact:	+ LKR 93 Billion minus, set off on income taxes filed
Policy Type:	Revenue Increasing

HOW IT ADVANCES THE OBJECTIVES

1. **Social Welfare:** Raises an estimated additional LKR 93 billion through an existing instrument (with some of it being set off against income taxes filed), creating fiscal space for social welfare and public investment without introducing new taxes or raising headline income tax rates.

2. **Governance:** Reduces the leakages in income tax collection and increases incentives for opening tax files, thereby improving future compliance as well.

CASE FOR THE PROPOSAL

Sri Lanka chronically under-collects income tax

Sri Lanka under-collects personal income tax. In 2024, Sri Lanka collected just 0.7% of GDP in taxes on the income and profits of individuals, even though it has the second-highest GDP per capita in South Asia (about USD 4,516). The regional comparison shows that Sri Lanka's income level does not explain its low personal income tax collection.

Several neighbours with lower GDP per capita collect substantially more: Bhutan (GDP per capita about USD 3,989) raised 1.3% of GDP, while India (about USD 2,592) raised 3.8%, which is close to six times Sri Lanka's level. Sri Lanka in fact collects less than the average low-income country (1.9% of GDP), placing **Sri Lanka in the bottom 10% of personal income tax collection amongst 125 countries**.

Sri Lanka's tax base is unusually narrow

The poor collection coincides with Sri Lanka's narrow tax base. **In 2024, registered personal income taxpayers represented only 8.7% of the working-age population, placing Sri Lanka fifth in South Asia**.[i] The personal income tax threshold was also raised from LKR 1.2 million to LKR 1.8 million annually in April 2025, which further reduced the tax base.[ii]

The under-collection problem is not limited to the personal income tax base. Published research shows that Sri Lanka collected only 2.0% of GDP in corporate income tax in 2023 despite a 30% rate, while Bhutan and Maldives collected more with lower statutory rates. This reinforces the need to improve collection design, not only statutory rates.[iii]

Mechanism of execution: withholding tax is collected at source

Withholding tax is a practical response to this problem. It is deducted at source by banks and financial institutions before interest reaches the recipient. This makes collection faster and less dependent on the income earner being a taxpayer, and the taxpayer reporting income accurately. It also helps expand the tax net because income earners who are not filing taxes but have a lower total tax obligation than what is deducted on WHT, now have an incentive to file in order to claim credits or relief – and through that will still pay more in taxes than they would otherwise have paid.

Sri Lanka's current rate is low by global standards

Sri Lanka's current 10% rate is low. Research on global withholding tax data has shown that the median WHT rate on interest income is 15% globally among 98 countries, and also in South Asia. India and Bangladesh tax interest income at 20%, while **only six of the 98 countries apply a lower rate than Sri Lanka**.[iv] A 15% rate is therefore a moderate increase: it remains below India and Bangladesh and would move Sri Lanka away from being an outlier, and more towards an international norm, as 70.4% of countries charge 15% or above, and only 29.6% charge less.

Expected fiscal impact: a higher rate would raise significant revenue

The revenue increase from this measure would be significant. At the current 10% rate, WHT is estimated to collect LKR 185 Bn in 2026. Increasing the rate to 15% is estimated to raise collections to LKR 278 Bn, **generating an additional LKR 93 Bn in gross revenue**.[iv] The net gain can be lower because WHT paid can be deducted against final income tax liability when being reported. But the measure still improves the timing and compliance of tax collection.

In summary, raising the withholding tax to 15% is a modest, administratively simple reform that works through an existing instrument. It strengthens collection at source, helps reverse Sri Lanka's chronic under-collection of income tax, moves the country toward international norms, and raises significant revenue, without new taxes or higher headline rates.

RISKS TO IMPLEMENTING THE PROPOSED REVENUE STRATEGY, AND MITIGATION MEASURES

1) **Risk:** A higher WHT rate means more income earners – particularly those whose total tax liability is below the amount withheld – will be entitled to refunds or credits. If the Inland Revenue Department (IRD) is unprepared to process and issue these refunds in a timely manner, delays could cause justifiable discontent.
   - ⇒ **Mitigation:** The refund process should be improved and actively monitored. The IRD should set clear performance benchmarks for refund turnaround – for example, a maximum number of working days to process a valid claim – track performance against those benchmarks, and report on them.

2) **Risk:** A larger deduction at source increases the possibility of some income earners and institutions doubling down on evasion and arranging their affairs to avoid the income being detected – for instance, by moving activity into the informal cash economy where income is harder to trace.
   - ⇒ **Mitigation:** The most durable mitigation is to reduce the scope for concealing income in cash. Increasing Sri Lanka's adoption of digital and cashless transactions narrows the cash economy in which WHT-liable income can be hidden, making deduction at source harder to avoid and improving traceability.

PUBLISHED SUPPORTING ANALYSIS

PublicFinance.lk, "Sri Lanka's Personal Income Taxpayer Base Lags Behind South Asian Peers Despite Recovery" (15 August 2025), citing ISORA, ILO and World Bank, at https://publicfinance.lk/en/topics/sri-lanka-s-personal-income-taxpayer-base-lags-behind-south-asian-peers-despite-recovery-1755239541 [last accessed 8 June 2026]

PublicFinance.lk, "Sri Lanka's Withholding Tax on Interest Income Remains Among the World's Lowest" (8 May 2026), citing the KPMG Global Withholding Taxes Summary 2024, at https://publicfinance.lk/en/topics/sri-lanka-s-withholding-tax-remains-among-the-lowest-in-the-world-1778226446 [last accessed 8 June 2026]

PublicFinance.lk, Sri Lanka's Higher Tax Rate and Lower Revenue Collection (29 November 2024), at https://publicfinance.lk/en/topics/sri-lanka-s-higher-tax-rate-and-lower-revenue-collection-1732874763 [last accessed 8 June 2026]

REFERENCES AND END NOTES

[i] PublicFinance.lk, “Sri Lanka’s Personal Income Taxpayer Base Lags Behind South Asian Peers Despite Recovery” (15 August 2025), citing ISORA, ILO and World Bank, last accessed 8 June 2026.

[ii] Ministry of Finance / Inland Revenue Department, announcement on the personal income tax threshold increase from LKR 1.2 million to LKR 1.8 million annually, effective April 2025.

[iii] PublicFinance.lk, “Sri Lanka’s Higher Tax Rate and Lower Revenue Collection” (29 November 2024), last accessed 8 June 2026.

[iv] PublicFinance.lk, “Sri Lanka’s Withholding Tax on Interest Income Remains Among the World’s Lowest” (8 May 2026), citing the KPMG Global Withholding Taxes Summary 2024, last accessed 8 June 2026.