

will also analyze whether applying this principle as a tool for investment dispute settlement undermines the state sovereignty with recent decided case laws.

### Research Methodology

The necessary data and information for this research study is mainly collected through secondary sources. A number of published articles, books, journals, decided cases and international treaties have been used and analyzed to conduct this study. In addition, internet articles and web sites were also referred for this work. The major analytical method of the study is descriptive and qualitative.

## Tax Incentives and the Economic Development in Sri Lanka

*R.P.D. Pathirana*  
*Department of Commercial Law*

### Background and Objectives

The purpose of this paper is to analyze the effects of the use of tax incentives on economic development in Sri Lanka, based on a review of international best practices and some empirical evidence. Most of the countries offer direct and indirect tax incentives to encourage the development of the private sector, to improve their competitive position in today's global economy and to boost employment. Incentives that are capable of compensating for market failures are often seen as effective policy tools for achieving economic and social objectives, which are easy to be implemented.

Tax incentives can either be concessions, provisions or conditions made available to tax payers and aim to serve as motivators or encouragements that reduce the tax liability thereby lessening the tax burden on tax payers. Various types of tax incentives include exempted income, tax holidays, concessionary tax rates, reliefs, expenses, tax rebates, capital allowances, dividends and free zones, etc.

These incentives are granted to attract more and more citizens to pay taxes and also to achieve a rapid growth in the economy as well. The Government offers many incentives to personal tax payers, indirect tax payers and investors (incorporated or unincorporated) in Sri Lanka with the view of stimulating industrial growth and development.

Under the Inland Revenue Act No: 10 of 2006 of Sri Lanka, there are numerous income tax incentives that have been granted to tax payers. In terms of the Budget 2011 the Government has offered more and more incentives on personal income since its main purpose is development. The Government has thus laid a foundation by the 2011 budget to achieve the said purpose. Tax reforms are yet another major part of this path. The Government is convinced that a clear and simplified tax regime would assist in this regard.

### Literature Review

There is a significant amount of literature in this field of research. For the purpose of this study, two most relevant texts are reviewed to identify the need to address evolving issues of tax incentives and exemptions. The following preliminary reviews demonstrate the areas to be focused on for analysis.

1. Balaratnam's *Income Tax in Sri Lanka* in its fifth edition explains the principles and practices of the law of income tax enacted by the new Inland Revenue Act No. 10 of 2006. The important aspects of the law of tax are discussed in the book and its' chapters enabling easy access to the relevant provisions of the Law of Taxation
2. E. Gooneratne's *Income Tax in Sri Lanka*, in its' second edition discussed and illustrated the principles and practices of the tax law, apply to given set of circumstances that may be applied in any particular situation.

### Findings

The location of foreign direct investment may be influenced by various incentives offered by a Government to attract multinationals. These incentives include fiscal incentives, financial incentives as well as other incentives like market preferences and monopoly rights.

Host country taxation and international investment incentives generally play a limited role in determining the international patterns. Factors like market characteristics, relative

production costs and resource availabilities are thus vital in the development process. Transparency, simplicity, stability and certainty in the application of the tax laws and in the tax administration are often ranked by investors ahead of special tax incentives. Control of Government finance is also identified as a key element which helps to provide stability in tax laws and to achieve greater certainty over tax treatment as well as greater stability and less risk in the overall economy.

### Methodology

This research is basically based on both library and fields research. The necessary information will be gathered from secondary sources accessible and available in the library such as journal articles, textbooks, research or working papers, Government publications or official statements, newspapers, bibliographies and electronic databases such as World Wide Web sites and e-journals. The mode of this research is qualitative. Field research includes interviews/discussions with relevant bodies.

### Conclusion

Tax incentives alone are generally not sufficient to attract major flows of investment. Since most successful countries attracting investment offer many other advantages to their potential investors other than tax breaks. They are attracting investment opportunities by, stable economic and political conditions, a well-educated labour force, good infrastructural facilities, open trade for exporters, dependable rule of law and effective investment promotion system.

### References

- Balaratnam S., *Income Tax In Sri Lanka*, (2007), 5<sup>th</sup> Edition  
Gooneratne E., *Income Tax in Sri Lanka*, (2009) 2<sup>nd</sup> Edition  
Slemrod J., *Tax policy in the real world*, (1999)