

**EXPLORE WAYS AND MEANS OF
IMPROVING RATE OF TAX COMPLIANCE BY THE
INFORMAL ECONOMY OPERATING IN SRI LANKA**

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ABSTRACT

The econometric study undertaken by Schneider (2002) Sri Lanka's total informal economy was almost 45% of the Gross National Product (GNP) in 1999/2000. Same study reveals that the size of the Informal Economy as a percentage of GDP in Asia Region 26.0 percentage. There have been a burgeoning number of studies attempting to measure the size of the 'informal' economy. These are based on a variety of methodologies and provide a range of estimates. This raises a number of issues: What is meant by the term 'informal' economy? Is it an appropriate description? What, if any, is the theory underlying the estimates of informal economic activity? At the macroeconomic level, there are a number of indirect methods used to estimate the size and dynamics of informal economy, reported in literature as "Monetary Approach", "Implicit Labour Supply Method", "National Accountancy", "Energy Consumption Method", etc. Many times there are huge differences among the estimated shares of informal economy obtained by various methods. The subject goes well beyond the domain of economics, raising the question of whether heightened understanding on the part of economic agents about the extent and locus of non-compliance and its implications for economic stability and growth. Further light is shed on these issues by a review of theoretical and empirical literature on tax compliance, as well as an examination of the problem of measuring tax evasion in the specific context of informal sector in Sri Lanka. This paper examines issues related to non-compliance to tax with the existence of informal economy and concludes that the level of tax evasion in the informal economy is inevitable. The complexity of the structural components of the tax system impacting upon the taxpayer and their relationships will require a long term commitment to the implementation of an integrated strategy to make informal economy to tax compliance.

Key words: tax, compliance, revenue, informal, economy.