

By Arjuna Ranawana

It all began when a junior clerk in Sri Lanka's Auditor General's Department was checking a series of receipts for tax refunds issued by the government in 2004. He noticed that, although the names of the people accepting a series of checks for a group of 20 companies differed, the writing was remarkably similar. Curious, the officer began checking more receipts and the correspondence between the Inland Revenue Department (IRD) and the companies.

There were more similarities, which raised more questions. The letterheads used in the correspondence looked remarkably similar, and some of them appeared blatantly false. The audit officers then looked up the addresses on the letters and found some to be fake. Further investigations revealed that the refunds, huge by Sri Lankan standards, were not backed up with paperwork from other government departments such as the Customs.

Eventually the paper trail led to revelations that are today being called Sri Lanka's — and probably Asia's — biggest alleged tax scandals ever, known as the "VAT (Valued-Added Tax) Scam."

The investigation resulted in Sri Lanka's Auditor General presenting an extraordinary report to Parliament¹ alleging that, "either willfully or negligently," the Sri Lanka Inland Revenue Department caused the loss of 441 billion rupees (US\$3.89 billion) in taxes between 2002 and 2004. To put this in perspective, the total tax revenue from Sri Lanka's relatively small economy in 2004 was 397 billion rupees (US\$3.5 billion), meaning the money lost due to alleged fraud was more than all of the government's annual earnings. The report also concluded that the 441 billion rupees (US\$3.89 billion) was what could be computed and that "the amount that cannot be computed is extremely large."

Governmental corruption is endemic in Sri Lanka, and the public is accustomed to daily tales of the sleaze among politicians, officials and police, but the sheer magnitude of the VAT Scam shocked the nation. Parliament convened a special session to debate the revelations, and the Criminal Investigation Department of the police was ordered to probe and prosecute those responsible.

The police are currently focusing their investigation on the 20 companies that had the similar signatures and allegedly defrauded the government 15 billion rupees US\$360 million. The alleged scam is so simple that investigators

say it could not have been carried out without the complicity of officials in the Tax Department.

The Sri Lankan government refunds VAT paid by manufacturers when they import raw materials and export the goods they make. The alleged fraudsters received refunds for taxes they never paid on goods they never exported for companies that did not exist. Only four of the 20 companies under investigation had done legitimate business and exported manufactured goods. But, according to the allegations, the four companies had been refunded sums vastly more than they were legally due.

“Certain companies out of the 20 under reference are companies merely limited to names only, while a physical examination of four companies revealed that such companies did not exist at the addresses stated,” the government’s report stated.

The Auditor General said that the total amount defrauded was paid using fictitious documents fabricated in support of exports that never took place. All of the 235 refund checks had been collected from the Tax Department by the same person on the day the checks were written or a day or two later. The check collector had also allegedly used 13 National Identity Cards with different numbers, all that were later found to be false. All of the checks in question were issued between Nov. 15, 2002, and Aug. 25, 2004.

Last year, the police arrested five people, including Gnanasiri Soysa Jayatileke, a former senior official in the IRD’s VAT Division, and several Colombo businessmen in connection with the fraud.² However, a suspect named Kamil Kuthubdeen, the alleged mastermind behind the scheme, has reportedly jumped bail and is believed to have left the country. The police say Interpol has been notified to look for him.

This case is just the tip of the iceberg, said Sarath Chandra Mayadunne, the former auditor general of Sri Lanka, who authored the report that revealed the VAT Scam. “The bigger issue is that, by negligence, the entire revenue-collection system has been shown to be corrupt,” he told Global Integrity in an interview. “The VAT Scam is only a symptom of a larger disease.”

Mayadunne pointed out that tax collection in Sri Lanka is based on “guesstimates” rather than accurate forecasting based on true economic data. “This gives the space for officials to wield discretionary powers and limits the power of Parliament to enforce checks on revenue collection,” he added. “This, therefore, leaves room for corruption.”

In response to the scandal, the IRD has confirmed the loss of taxes but points out that the department is currently functioning with less than 40 percent of the staff it requires and, therefore, cannot efficiently handle the work.

A litany of revelations about corruption is available in the public domain. The Parliamentary Committee on Public Enterprise, which periodically surveys state-run corporations, released a recent report in which it alleged that around 113 billion rupees (US\$1 billion) has been lost due to corruption in the 26 enterprises it investigated.

All this corruption is seriously affecting Sri Lanka's economy. The president of the Sri Lanka Economists Association, A.D.V. de S. Indraratne, estimated that if the money lost to corruption in the state sector were invested, overall economic growth could be increased by about two percent per year.

Victor Ivan, a crusading anti-corruption journalist, said what is going on in Sri Lanka is a farce. In an interview with Global Integrity, Ivan charged that "every public institution in Sri Lanka is corrupt. They include judges, politicians and bureaucrats. Every time someone comes to power, either politically or officially, they take it as a license to rob this country."

That is a view commonly shared by many Sri Lankans. A survey carried out in April and May 2007 by the Centre for Policy Alternatives, a non-governmental research organization, found that a majority of Sri Lankans accept that there is corruption throughout society. According to this survey, 43 percent said they believed the police was the most corrupt institution, but felt that all institutions, including the judiciary, the health care system and the schools, were also tainted.

Initiatives to correct the situation are being taken. Mayadunne is leading a task force of experts drafting laws that will give greater autonomy and power to the Auditor General's Department. But he complains that there is "stiff resistance from both officials and politicians" to the process. Attempts to enact a Freedom of Information law have been stymied, again by politicians in power. This law, which would give the public the right to obtain information from government officials and protect whistleblowers, was passed by the Cabinet of Ministers in 2003. However, it has yet to be brought before Parliament.

Ivan said there is little hope for piecemeal reform. "The whole system is rotten to the core. Our only hope is that

the whole system will collapse like a house of cards; it is only then that we can rebuild and install a clean country.”