

INCOME TAXATION AND ITS EFFECT ON SMALL AND MEDIUM ENTERPRISES IN SRI LANKA : AN ANALYSIS

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Small and Medium Enterprises (SMEs) play a vital role in Sri Lanka's economy, contributing significantly to employment, innovation, and GDP. However, income taxation policies and their implementation often present challenges for SMEs, impacting their growth and sustainability. This study examines the effects of income taxation on SMEs in Sri Lanka, focusing on compliance costs, cash flow constraints, and overall business performance. The research adopts a mixed-methods approach, combining an analysis of tax policy frameworks with qualitative insights from SME owners and tax professionals. Key findings reveal that complex tax regulations and high compliance costs disproportionately burden SMEs compared to larger enterprises. Furthermore, limited access to tax incentives and ambiguous guidelines exacerbate these challenges, discouraging formalization and investment in the sector. The study also identifies potential opportunities for reform, such as streamlining tax compliance processes, expanding SME-specific incentives, and enhancing awareness of tax obligations and benefits. By addressing these issues, the government could foster a more equitable tax environment, enabling SMEs to thrive and contribute more effectively to national development. This research provides policymakers with actionable recommendations to align income tax policies with the needs of SMEs, promoting economic growth and fiscal sustainability in Sri Lanka.

Keywords: *Small and Medium Enterprises, Economic growth, Fiscal sustainability*