# Implementing new VAT Law—Govt should stay the course

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The new VAT law "The VAT and Supplementary Duty Act 2012" is set to come into effect with the new budget. Its full and effective implementation across the country, nonetheless, will probably take two-to-three more years. Different quarters have raised questions and expressed concerns about the impact of the proposed new VAT law on the domestic price level. Recently at a forum jointly organised by the National Board of Revenue (NBR) and the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), some members of the business community, expressed concerns about price impact of the 15 per cent VAT, demanded a reduction of the VAT rate to 7.0 per cent, and threatened to force the government to reverse its course through movements if the government proceeds with the implementation of the new VAT Law.  The purpose of this op-ed is to clarify the issues objectively for the public to understand the issues and implications of the new VAT law and alleviate their concerns. ON THE VAT RATE: The 15 per cent VAT rate stipulated in the new VAT law has drawn widespread criticism as being too high and burdensome for the business community. But the reality is that, more than 60 per cent of countries around the world have 15 per cent or above VAT or Goods and Services Tax (GST) rates. Moreover, in the context of Bangladesh, the 15 per cent rate is not something new. The rate has been there since the introduction of the current VAT Law in 1991 and the business communities are used to paying the VAT at this rate for the last 26 years. The base for the new to-be-applied VAT rate will largely be the same as already applicable. As under the current 1991 VAT Law, there will be a negative list and only the items listed there will be exempted from the new law. Even before the introduction of 1991 VAT Act, there were excise duties (on domestic products and services) and sales tax (on imported products) at 10 per cent, 15 per cent and 20 per cent rates. The estimated average of the sales tax and excise duty rates at that time was also about 15 per cent.  In other words, the 15 per cent average rate had existed since Pakistan time. Importers, manufacturers, and all other businesses are already used to paying indirect taxes at this rate for 50 years or more. So, what is new about the 15 per cent rate? Essentially none! Against this background, if the basic VAT rate is reduced to say 12 per cent as reported in some media reports, it will lead to huge revenue loss for the government in the amount of Tk 240 billion (24,000 crore) from the targeted VAT revenue in the FY18 budget. Bulk of the loss will come from domestic sources (about Tk 180 billion (18,000 crore) and the remainder from import stage VAT. The revenue loss to be incurred by the Large Taxpayer Unit (LTU) alone will be about Tk 130 billion (13,000 crore). Ongoing automation and administrative reforms will take time to have a significant positive impact on revenue through improved tax administration, generally in the range of 3-5 years. The group which is most vocal against the basic VAT rate of 15 per cent is the retailers. Their argument is that since they are currently paying VAT at 4.0 per cent, the move to the 15 per cent rate would sharply increase retail prices. This argument is without merit under a fully operational VAT system with complete input credit chain. Actually, under the current truncated VAT system, retailers are implicitly charging more taxes on the consumers. At import and manufacturing stages, VAT is already paid at 15 per cent. In addition, Advanced Trade VAT (ATV) is collected at the import stage at 4.0 per cent rate which the wholesalers cannot take credit if they are not under the proper VAT system. Thus the retailers are already buying products at 19 per cent (=15 per cent +4.0 per cent) from the wholesalers or importers because of the cascading effect in the absence of proper VAT credit system. In addition they have to pay 4.0 per cent on the final sale price which can take the effective tax rate to well above 22 per cent. The fact that the 19 per cent of the taxes are hidden (but already paid by the retailer) does not mean that consumers are not paying that; the consumers are actually paying the hidden 19 per cent plus the visible 4.0 per cent. In contrast, if the whole value chain comes under the new VAT system, the final incidence of VAT can never exceed 15 per cent of the sale price and the consumers will be much better off. Then why should there be an inflationary effect at the retail level with the 15 per cent across the board VAT? As a matter of fact, the current ATV rate of 4.0 per cent and retail VAT at 4.0 per cent are punitive in nature, and designed in such a way as to encourage retailers and wholesalers to come under the standard VAT net. Actual VAT incidence at the retail level should not exceed 1.5 per cent to 3.0 per cent, given that the difference between sale and purchase generally range between 10 per cent-20 per cent at the retail level. Furthermore, the principle of VAT clearly states that VAT is the tax paid by the consumers and not the retailers or manufacturers or importers. In other words, VAT is not collected from the business enterprises, they simply act as agents on behalf of the government to collect VAT from the consumers/buyers and pay it

back to the government. One may now ask: why are these retailers and wholesalers against the new VAT Law? The real answer lies in the fact that these people do not want to open up their books of accounts for the tax department since that will increase their income tax burden. Can the Government reduce the VAT rate in some sectors without any significant loss of revenue for the budget?  That is certainly possible. If we examine the compliance level of various sectors, it becomes clear that many of the services are de facto outside the tax net. Taxing the service sector is universally difficult, in part, because unlike the goods sector where VAT is collected at several stages, VAT on services is generally collected at one stage when the services are rendered. Even if service renderers are allowed to take input tax credit, the extent of VAT paid inputs is only a fraction of the total value of services rendered. Thus in most cases about 12 per cent-13 per cent of net VAT would be collected at one stage, which is essentially evasion-prone.  Services provided by lawyers, dentists, diagnostic centres, doctors, consulting firms of various types, workshops, media, advertising agencies, and similar professional service providers may fall under this category. If the VAT rate on these services is reduced to 7.0 per cent-10 per cent, there will be no loss of VAT revenue and through enhanced compliance there could be higher revenue. One may ask: why am I suggesting full 15 per cent VAT at the retail stage but a lower rate for the selected service sectors? My response will be that, although both are retail-type activity, for retailers selling goods the net VAT collected at that stage will be in the range of 1.5 per cent to 3.0 per cent on the assumption that margin between buying and selling at the retail level is not likely to exceed 10 per cent-20 per cent range.  In contrast, at the same 15 per cent basic VAT rate for service renderers the net VAT payable will be 12 per cent-13 per cent, and thus the service sector is likely to be much more  evasion-prone than the retail (goods) sector.
INFLATION AND PRICE HIKE: It is being argued that the price impact of the new VAT law will take a big toll on the people. According to a calculation by Policy Research Institute (PRI), the overall inflationary impact of the new VAT Law will be merely 0.5-0.7 per cent for only one time. In other words, the impact will be virtually inconsequential from macroeconomic and household perspectives. It must be noted that inflation is primarily a monetary phenomenon which is managed by central banks through appropriate monetary policy. As long as the macroeconomic indicators are prudently managed, inflation would be contained within the target range. For example, in the last round of virtual doubling of government and public sector salaries, many people were apprehensive of its inflationary impact. But, in reality no noticeable inflationary pressure was observed because of prudent monetary policy and overall macroeconomic management. Furthermore, since the new VAT system will modernise

the tax administration and comes with automated online registration, return submission and payment systems, the resulting reduction in cost of doing business should enhance competitiveness of the business enterprises which may also dampen inflation. The new VAT law will make business operations easier and efficient. The law, the supporting technology and the reformed tax administration, if enforced and used effectively, will finally put in place a modern tax administration to offer quality services to the taxpayers, perhaps for the first time in Bangladesh. Physical controls and visits by inspectors will be replaced by invoice and document-based oversight. Tax audits will be centralised, whereby the opportunity of misuse by audit officials will be significantly reduced. The outdated Account Current system, under which taxes are collected in advance before sale (a leftover from the old excise system), will be replaced by return-based tax payment leading to refund of millions of advance payments currently being withheld by the tax department to the taxpayers.  These are the reasons why the new VAT Law is being welcomed by LTU members and organised business houses. Small businesses will also benefit from the new tax law. All business activities with annual turnover below Tk. 3.0 million will be completely out of the tax net, while the same firms are currently under the Turnover Tax system and subject to 4.0 per cent turnover tax under the 1991 VAT Act. Similarly, all economic activities with turnover up to Tk 8.0 million will be subject to Turnover Tax at 3.0 per cent rate, while currently these firms are subject to 15 per cent VAT if they are not covered under the Package Vat system. The opponents of the new law should honestly ponder: which tax system is better for the business in general, and small business in particular? GOVERNMENT NEEDS TO BE STEADFAST: Reforms are always difficult in any country – and Bangladesh is no exception. During the introduction of the VAT law in 1991, most quarters of the business community in the country opposed the law. On many occasions, demonstrators numbering in thousands cordoned off the NBR building and put obstacles in the streets of Dhaka. But the government stayed firm and showed the political will to implement the law. Soon enough all the resistance disappeared and the law took its course. I firmly believe that, if the government remains firm this time also, the threats of resistance will not translate to anything significant – and definitely not anything that the government cannot handle. All that the government needs to demonstrate is its firm political resolve and to maintain proper communication with taxpayers and citizens to counter the ongoing misinformation campaign by certain vested quarters. The country cannot eradicate extreme poverty by 2030, and simultaneously become an upper middle-income country, if it cannot expand its tax base. The current tax to GDP (gross domestic product) ratio of Bangladesh is embarrassingly low at roughly 10 per cent. For OECD (Organisation for

Economic Cooperation and Development) countries, the average tax to GDP ratio is some 34 per cent, the level being in the 40 per cent plus range in some countries in the Western Europe. In tax collection effort, Bangladesh trails behind its regional neighbours such as India and Nepal which are close to 17 per cent of GDP. Given the ongoing economic growth momentum, if Bangladesh does not make a strong push for tax reforms now, it will be a lost opportunity of monumental proportions for the country. Despite years of backsliding, it is now time for the government to step up and properly implement the new VAT Law.