



Sustaining the recent success in tax revenue mobilisation

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Ahsan H Mansur in the first of a two-part article on tax revenue mobilisation during the Sixth Five Year Plan

The government of Bangladesh (GoB) has been most successful in tax revenue mobilisation in recent years. For the first time in the history of Bangladesh, the National Board of Revenue (NBR) has exceeded the tax revenue targets specified in the budget for three successive years. This remarkable performance in revenue mobilisation has been recorded despite significant challenges in the form of declining dependence on import-based taxes and increased volatility in imports. Buoyant performance in domestic-based taxes – Value Added Tax (VAT) and direct taxes in particular – helped reduce dependence on import-based taxes and better anchored the revenue performance to development in domestic economic activity.

The purpose of this write-up is to identify the sources of the revenue gains, the tasks ahead in terms of achieving the tax revenue targets under the Sixth Five Year Plan (SFYP) and what lesson we derive for sustaining the gains in future. The brief argues that despite the recent gains, achieving the SFYP tax revenue targets remains challenging. It also finds that enormous potentials remain on both VAT and direct tax fronts, which can be reaped through sustained structural reforms in tax policy and in the administration of the tax system. It also outlines a number of specific measures which would help NBR achieving the SFYP targets

while continuing with the medium-term reforms in the context of its Modernization Plan. It also argues that, while efforts should continue on both VAT and income tax fronts, greater potential can be realized through information sharing between the two important wings of the NBR.

Revenue potentials and the sources of recent revenue growth: Both VAT and income tax performance exceeded their respective targets during the last three years, despite the targets being quite ambitious.

A closer review of the strong NBR performance indicates that, in case of both VAT and income tax, revenue collection exceeded their respective base expansion. In the case of VAT, which is a consumption type tax, the average rate of growth of consumption in nominal terms over the last three years was 13.3 per cent compared with a much rapid growth in total VAT collection (19.6 per cent). Much of the VAT revenue growth came from domestic sources, which accounts for 62 per cent of revenues from VAT. Growth in domestic VAT surged to an average of 25 per cent during the same three-year period, almost double the pace of expansion in domestic consumption. The higher growth performance of domestic VAT is not a recent phenomenon, and it has been happening since the introduction of VAT in fiscal year (FY)92, when import stage VAT accounted for more than 73 per cent of total VAT revenue. However, it certainly gained momentum in recent years.

This shift in the composition of VAT revenue is a positive development. It shows that domestic consumption has been tilting towards domestic production and rendering of goods and services. Certainly, the steady expansion of domestic-based VAT to wholesale, retail and service sectors have played important roles. The strong growth of key sectors like the newly emerged cell phone-based telecommunications and the formal construction sector (real estate/housing industry), travel and transport, and the organised service sector (large hotels and restaurants). Another interesting phenomenon is the marked shift in consumption towards the private sector over the last two decades. Private consumption which accounted for 85.4 per cent of total consumption in FY92 increased further to almost 93 per cent of domestic consumption by FY12. Since government consumption – mostly in the form of payroll – and government delivery of services (which constitute bulk of public services) are not subject to VAT, this shift in favour of private consumption has also worked in enhancing buoyancy in domestic VAT.

On the income tax side also gains have been certainly made in relation to the tax base. Total income tax collection increased by 26.6 per cent during FY07-FY12, while the expansion of the tax base during the corresponding period was 12.7 per cent. While the corporate side of the income tax was impacted (negatively and positively) by developments in macroeconomic environment like the global economic crisis and the phenomenal surge in stock market prices inducing strong fluctuations in the performance of this component, personal income tax maintained its higher growth rates almost unhindered by market/external developments.

Growth in corporate income tax slowed down to 11 per cent in FY09 with the slowing of global and domestic economic activity, but performed very strongly in FY11 influenced in part by the stock market boom.

An examination of income tax collection process indicates that although income tax from source deduction has remained important, revenue from income tax returns has gained more importance over time. Income tax deducted at source declined from 61.5 per cent in FY04 to 48.2 per cent in FY10.

While the increase in tax payments through submission of returns is a welcome development, the slower growth in withholding at source indicates a fundamental weakness in direct tax administration and the current focus and inadequacies of the withholding measures. The structure of tax withholding in Bangladesh is very old-fashioned and does not indicate proactive management of tax withholding agents. In most cases the captive sources – using public offices (for contracts and supplies), financial institutions (withholding of interest and dividend income) and customs points (advance income tax from importers) – have been relied upon for collection of withholding tax. A careful review indicates that despite a decline in dependence in recent years, withholding from contractors on account of government supplies/projects accounts for more than 30 per cent of total withholding in FY10.

Withholdings from financial institutions on account of interest on savings, term deposits, security and treasury bonds accounts for the second highest source of withholding (21 per cent), followed by advanced tax on importers (17.4 per cent) in FY10.

The unpleasant fact is that despite significant gains in recent years, withholding from salary income accounts for less than 6.0 per cent of total withholding. Although this component has registered the fastest growth (29 per cent during FY06-FY10), at only Tk. 5.3 billion it is relatively insignificant and falls well short of its potential. It is even more disturbing that out

of this total Tk. 2.7 billion (56 per cent) was withheld by the very few enterprises under the Large Taxpayers Unit (LTU) of the Direct Tax Department. None of the commissionerates reported any withholding on income from doctors' fees (which may be easily doable through hospitals and clinics) despite clear legal provision in this regard.

Reflecting these administrative deficiencies, some of which may also originate from inadequacies in the tax laws, tax efficiency in Bangladesh has remained very low compared with its regional comparators. Given the 15 per cent basic VAT tax rate, Bangladesh's current tax efficiency in VAT was only 0.24 in FY11, compared with much higher levels for its comparator countries. The story in terms of Bangladesh's direct tax efficiency is also similar. Although the gains recorded in recent years is encouraging, Bangladesh has a long way to go.