



## Tax self-assessment is a smart policy move if properly implemented

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The low and declining tax-to-GDP ratio is a major constraint to the future development progress of Bangladesh, which is aspiring to attain upper middle-income country (UMIC) status by FY2031 as stated in the Perspective Plan 2041 (PP2041).

The macroeconomic policy framework associated with PP2041 recognised the importance of domestic resource mobilisation and set a tax-to-GDP target of 12.3% by FY2025 and 17.4%

by FY2031. As compared to these ambitious targets, the actual tax-to-GDP ratio was a mere 7.4% in FY2023, falling from 8.5% of GDP in FY2015.

What happened? The tax-to-GDP targets of the PP2041 macroeconomic framework were predicated upon the implementation of major structural reforms that would have transformed the primitive and regressive tax system of Bangladesh, which was heavily reliant on indirect taxes, especially import taxes, to a modern income-based progressive tax system (reliant on direct taxes based on ability to pay). In the event, little or no progress was made to modernise the tax system. As of FY2023, total income taxes were a mere 2.6% of GDP (35% of total taxes) while the remaining 4.8% of GDP came from indirect taxes (65%).

I have been writing about the need for major tax reforms for well over a decade. My reform ideas are not just theoretical but based on 40-plus years of experience in working on development issues and fiscal policy reforms in several countries in the Middle East, East Asia and South Asia. The socio-political and governance environment in these countries is broadly similar to Bangladesh.

The core institutional reforms for modernising the tax system that I have suggested include the following: (a) separating tax planning and tax policy from tax collection; (b) substantially strengthening both units with autonomy, professional management and quality staffing; (c) instituting an effective self-assessment tax system by digitising tax assessment and collection thereby eliminating the interface between taxpayer and tax collector; (d) simplifying tax filing by eliminating the income, expenditure and wealth reconciling; (e) selective and productive audits done by professional auditors; (f) implementing the 2012 VAT Law; and (g) introducing a modern property tax system. These recommendations are consistent with the reforms proposed in the PP2041 and as such can be considered politically acceptable.

Newspapers have reported that the National Board of Revenue (NBR) has finally agreed to implement at least one of the major recommendations to move towards a self-assessment tax system starting with the FY2025 National Budget. If correct, this is a smart policy move. However, the main challenge is its proper implementation.

The institution of a true self-assessment tax system requires several complementary policy

actions. First and foremost, tax filing must be fully digitised in order to avoid the interface between the taxpayer and the tax collector. Without this, the self-assessment system will not work properly. Wherever tax filing requires interaction between the taxpayer and the tax collector, the self-assessment system will degenerate into the present system of negotiated tax settlements.

Secondly, the digitised tax filing will require simplified tax forms. A particularly contentious requirement is the need to reconcile income and expenditure with asset accumulation. The complex and dubious accounting entailed in this reconciliation has created tremendous scope for tax harassment and associated negotiated settlements. The revenue implications of this requirement are doubtful as suggested by the falling tax-to-GDP ratio and a stagnant and very low share of personal income taxes at around 1.3-1.4% of GDP. This revenue contribution of personal income taxes is amongst the lowest even among developing countries. On the contrary, it is very likely that by discouraging tax filing due to the fear of tax harassment and by promoting negotiated tax settlements, this requirement has lowered the revenue yields for the government. With a progressive income tax system, an additional wealth tax is not very meaningful. Instead, by scaling up the tax rates at the higher income levels and instituting a proper property tax system, the revenue yields can be boosted substantially.

Finally, self-assessment makes sense only if tax audits are meaningful and productive. Global experience shows that tax audits must be highly selective (1-2% of tax files) and productive in terms of additional net revenue yields after allowing for public expenditure on audits. The audits must be conducted by professional tax auditors. Audit selection must be based on a computerised programme using well-defined audit triggers. In most cases, the audit should be focused on high-income groups to ensure the productivity of audits.

In conclusion, a tax system based on self-assessment must be accompanied by digitised filing, simplification of tax forms, and highly selective and productive audits conducted by professional tax auditors. This is one whole package that must be implemented together to get the benefits of the self-assessment system. So, the move to a self-assessment tax system is a welcome and smart policy move provided other elements of the package are implemented simultaneously.

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