

Time to act on the new VAT law

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Bangladesh, despite its good track record in macroeconomic stability, faces the challenge of shifting to a higher growth trajectory through higher investment and improved quality of essential public services. Low tax revenue is limiting the ability of the government to invest in infrastructure such as roads and power and improve human capital through health and education. The underinvestment is limiting the ability of the economy to grow to its potential and unleashing the energies of the private sector. The good news is that, in the face of this dual deficit, the government is beginning to see revenue mobilisation as a potential cure. Prime Minister Sheikh Hasina’s recent meeting with senior officials of the National Board of Revenue (NBR) on different ways to expand the revenue base in the country is an indication of the government’s renewed focus on this issue.

Bangladesh’s low revenue as shown by the tax-GDP ratio of 9 percent is stark when compared to the region being only higher than Afghanistan. It is imperative that this problem be addressed immediately so that we are not left behind in this Asian century and can

capitalise on the accelerating growth of India and China by taking advantage of our strategic location.

The modernisation programme of the NBR, encompassing several far reaching reforms, is appropriate and timely in this regard. The VAT law is being modernised to incorporate international best practices, improve taxpayer services, reduce distortions and improve compliance. The income tax law is being re-written to keep it up-to-date with the various changes in the economy and make it more efficient from allocative and more equitable from social perspectives. The Digital NBR programme aims to computerise the tax administration with the aim to improve taxpayer services, reduce day-to-day contact with taxpayers through e-services while also tackling tax evaders who remain outside the tax net or under report their taxes.

In this article I wish to make the case for VAT reform and dispel some of the misperceptions relating to this issue.

A new VAT Act, along the lines of the draft law posted in the NBR website, makes sense on several grounds. At the time when the VAT system was first introduced in Bangladesh, it was only targeted towards import and manufacturing sectors and was applicable to a limited number of service sectors. Attempts to expand it to the wholesale, retail, and a broad range of services over the years have created numerous distortions. This is evident in low VAT productivity of the country which is less than 20 percent of the potential revenue that can be collected.

The low productivity of the VAT is primarily attributable to structural deficiencies in tax design and outdated tax administration, followed by weak compliance by taxpayers resulting from inefficient use of information. Therefore, introducing a VAT system that ensures efficient tax administration and at the same time improving taxpayer's services would require an overhaul of the entire VAT code, entailing a series of administrative and policy reforms. Patching up the current VAT law through the use of amendments and issuing SROs (statutory regulatory orders) will not be sufficient to simplify the VAT system and raise revenue more efficiently in a taxpayer friendly manner.

An efficient VAT system should have a broad base (for revenue collection), with fewer

exemptions and lower rates. Any new VAT Act must take these lessons into account and focus on expanding the tax horizon with more deduction at source, introduce efficient valuation system using transaction value or fair market price and offer an effective 15 percent flat rate. Thus the new draft law rightly does not allow for tariff values, fixed VAT rates and the truncated base system, which lead to numerous effective rates, reemergence of cascading (tax on tax), and an uneven playing field for taxpayers.

The new draft VAT law also addresses the issue of too much contact between taxpayers and the tax officials. Currently, the VAT system suffers from excessive use of physical monitoring of businesses at all locations rather than the use of consolidated accounts and secondary information. In order to deal with this, the new VAT law proposes a central registration system, and single Business Identification Number (BIN) as opposed to multiple registrations and BINs based on geographical location.

The VAT performance is also directly contingent on an efficient VAT payment process. The new law will make the payment system simple, safe and hassle-free. At present, the payment is confined to old-fashioned 'Treasury Chals', and to be paid in advance for manufacturing enterprises during clearance of goods from the factories. The modernisation of payments under the new law would allow payments of VAT through electronic bank transfers, credit cards, and certified bank checks to be paid at the time of return submission.

A centrally managed VAT administration is the backbone for these new services, which will essentially reduce the interfaces between taxpayers and tax officials, resulting in improved taxpayer's services and fewer pockets for corruption. The new VAT Act will create avenues for centrally managed database with options to outsource the database management functions to private sector firms allowing officials of the NBR to focus on core functions of VAT administration. At present, return submission and processing are channeled through local circle offices of the NBR giving them a little time to deal with their main task of revenue administration and taxpayer education/services. The fragmented structure of administration has also reduced tax compliance to such an extent that less than 50,000 out of more than 200,000 active taxpayers are submitting tax returns regularly, while the total number of registered VAT taxpayers is believed to be about 600,000.

There is no doubt that the new draft VAT law, if enacted, will improve revenue performance

of the NBR while making it easier for taxpayers to comply. And yet there will be many voices against the recent efforts of revamping the VAT Act. Fewer exemptions send out a cautionary message to the business community, creating the illusion that production costs will go up, although, with a simpler system and with a lower burden of complying with the VAT, businesses would be the overall beneficiaries. Consumers may also rebel against the idea, believing that inflation would hit them hard as they would end up spending a higher percentage of their income. However, when the higher revenues flow back to the economy through better infrastructure and living conditions, it would create a virtuous cycle with lower costs of doing businesses, higher private investment and jobs and resulting higher revenues and better living conditions in the future. We need to sustain the investment in infrastructure like the recent government efforts in the power sector as well as road infrastructure, the proposed Padma Bridge being a good example.

The government is making efforts to reach out to the business community, and may be more intensified education campaigns will be needed for the businesses community to realise the benefits of the new VAT Act so that they become a partner in making the new VAT system a success. To achieve this objective, the NBR would need to engage more extensively with the private sector through a series of consultations across the country.

We have to make a choice, and make it quickly. Do we aim to reform our VAT system in an efficient way or, stick to the old excise-type VAT system, which will continue the existing distortions in the economy and poor revenue performance? Our decision will determine the trajectory of the economy for the years to come.

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