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Changes and Reforms of Value Added Taxes (VAT) and its Application in Bangladesh: An Analytical Study with Special Reference to the Finance Acts

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Abstract

The purpose of this article is to examine the existing law about Value Added Tax (VAT) in Bangladesh along with the collection of VAT in Bangladesh for searching of the implications of the prevailing VAT system. VAT, the new idea of tax system, is a consequence of the pressure of the World Bank and all donor-groups of Bangladesh due to growth of GNP/GDP. This article also elucidates the prevailing laws and regulations for the introducing VAT as an alternate to sales tax law in Bangladesh. The laws and rules regarding value added tax (VAT) in Bangladesh are contained in the "Value Added Tax Act, 1991" and the "Value Added Tax Rules, 1991" which have come into force with effect from 1st day of July 1991. It further highlights the need for a broad based Value Added Tax (VAT) which is proposed to be introduced in the country. The VAT is expected to raise substantial additional revenue in the coming 2-3 years which will amount to increase the Tax to GDP ratio by 2-3%. It also explains that those laws and rules regarding Value Added Tax (VAT) in Bangladesh have been amended by the Finance Act in every year for the improvement of financial system in Bangladesh.

1. Introduction

Value added tax *(VAT)* was, the new-fangled proposal on 1991, innovative idea at the tax system of Bangladesh. *VAT* is one of the major indirect consumer taxes in Bangladesh. Value added tax *(VAT)* means a tax that is added to the price of goods and services. The Value Added Tax is the predominant form of consumption tax used around the world. Consumption taxes mainly (VAT) are the most time-consuming of the taxes, and this can be heavily affected by tax authorities' administrative practices.[1] VAT is the most dominant form of consumption tax around the world in some form or other, it is used in 48 economies. The United States is the only OECD

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1 *World Bank Group, "Paying Taxes 2011-* The global picture", p. 6, available at http://www.ppwc.com/payingtaxes

and G8 member economy that does not have a VAT system.[2] Value added tax *(VAT)* is the consequence of specially the pressure of the *World Bank* for the growth of internal income *(GNP/GDP)*. The time needed for VAT also varies considerably and is dependent on the administrative practices implemented in each economy.[3] The *World Bank* played the ground-breaking role in commencement of *VAT* in Bangladesh. In 1991, the government introduced Value Added Tax for the first time in Bangladesh. This modern system of taxation has taken its roots in the country through applying the value added tax *(VAT)*. The laws and rules regarding value added tax *(VAT)* in Bangladesh are contained in the *"Value Added Tax Act, 1991"* and the *"Value Added Tax Rules, 1991"* which have come into force with effect from Ist day of July 1991. The laws and rules regarding value added tax *(VAT)* in Bangladesh have been amended by the *Finance Act* in every year.

2. Historical Background of Value Added Tax *(VAT)*

In 18th century, a *German* economist first formulated *VAT*. His vision was a tax on goods that did not affected the cost of either the manufacture or the distribution but was collected on the final price charged to the consumer. In 1954, *France* was adopted the new tax system. There after it was introduced in *Denmark* and *Brazil* in 1967, *Netherlands* in 1969, *Luxemburg* in 1970 and *Belgium* in 1971 as well as *Germany* in 1968 soon followed by other members of the European Community[4] *(EC)*.[5] Developing countries like *Brazil* and *Uruguay* also pioneered the *VAT* as early as in 1968. 21 *OECD* countries, among 24, have implemented *VAT*, with the exception of the *US, Switzerland* and *Australia*.[6] Now-a days it is found more than 120 countries around the world including our neighbouring countries *India* and *Pakistan*. It also covers over 70 percent of the world's population and raises nearly 27% of total tax revenue in those countries.[7]

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2 World Bank Group, "PwC Commentary: A fair, stable and sustainable tax system- the Challenge for Governments in the wake of the global economic downturn. In Chapter 2 of Paying Taxes 2011- The global picture, p. 26, available at http://www.ppwc.com/payingtaxes

3 World Bank Group, "PwC Commentary: A fair, stable and sustainable tax system- the Challenge for Governments in the wake of the global economic downturn. In Chapter 2 of Paying Taxes 2011- The global picture, p. 26, available at http://www.ppwc.com/payingtaxes

4 At present EC is EU (European Union).

5 Monjur M. Mahmud, Kanchan K. Purohit and Milan K. Bhattacharjee, *Income Tax*,(1st ed.; Chittagong: Padma Prokashani, 2003), p.382.

6 *Ibid.*

7 *Ibid.*

> 'Upon the formation of the Common Market in *Europe* (known the European Union) it was decided that one requirement of joining was the imposition of a form of *VAT*. In 1973 the *UK* joined the European Union replacing their existing Sales Tax with *VAT*.'[8]

The issue of introducing *VAT* in Bangladesh as an alternate to sales tax has been officially initiated by a nine member Taxation Enquiry Commission *(TEC)* which formed by the government of Bangladesh in April 1979. Until 1982, sales tax was being collected under the *Sales Tax Act 1951*, which was replaced by the *Sales Tax Ordinance 1982* with effect from 1 July 1982.[9] In 1989, a World Bank Mission visited Bangladesh for preparing an agenda for tax reform and among others it recommended introduction of *VAT* in Bangladesh. The mission submitted its final report recommended with the introduction of a manufacturing-cum-import stage *VAT* at a single standard rate within three years. Thereafter, a Bangladesh Tax Mission visited *India, Indonesia, the Philippines* and *Thailand* during 13 November - 04 December 1989.[10] The Mission submitted its report in January 1990. The government discussed the issues relating to introduction of *VAT* with all related private and public agencies including the various leading Chambers of Commerce and Industry from time to time.[11]

The then opposition parties i.e. *BNP, Awami League*, etc. profoundly opposed the introduction of *VAT* in the alternative of the sales tax. The Draft version of the Value Added Tax Bill was finalized by the Ministry of Finance in June 1990. After one year latter, 31 May 1991, the *Value Added Tax Act* was promulgated as a Presidential Ordinance *(PO)* with eight sections. *The Business Turnover Tax Ordinance 1982* and the *Sales Tax Ordinance 1982* were replaced after passing the *Value Added Tax Act 1991* in the Parliament of Bangladesh on 9 July 1991. Its initial form of consumption tax, extending its coverage up to the level of import, production or manufacture and service-rendering but not to export (which is zero-rated), wholesale or retail level (vide Section 3 of the *VAT* Act, 1991) with effect from 1 July 1991.[12]

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[8] Owolabi S. A & Okwu A. T, "Empirical Evaluation of Contribution of Value Added Tax to Development of Lagos State Economy", Middle Eastern Finance and Economics - Issue 9 (2011), P. 25. Cited from (BBC Edited Guide Entry, 2005).

[9] Rafiqul Islam & Swapan Kumar Bala, *Banaglapedia*, (ed., Sirajul Islam) Asiatic Society of Bangladesh, 2003., pp. 291-292.

[10] *Id.*, p. 291.

[11] *Id.*, p. 293.

[12] Monjur M. Mahmud, Kanchan K. Purohit and Milan K. Bhattacharjee, *Income Tax*,(1st ed.; Chittagong: Padma Prokashani, 2003), p.382.

3. Objectives of Value Added Tax *(VAT)*

VAT introduced in Bangladesh in its initial form was a sort of consumption tax.[13] The rationale of a *general tax on consumption*, i.e., a value-added tax (VAT), is to raise revenue from domestic consumption.[14] The swap over from the present tax system to *VAT* should guarantee that the following objectives are achieved:

- The first and the primary objective of *VAT* system should be to increase the competitiveness of Bangladesh*i* industry by removing the cascading effect of the various taxes and levies.
- As a consequence to the above, in order to improve competitiveness of the industry, the removal of the multiple taxes that is prevalent in the Bangladesh*i* tax system is absolutely essential.
- Ensuring revenue neutrality in the long run should also be the primary objective of a *VAT* regime.[15]
- To bring transparency in the taxation system.[16]
- To introduce *VAT* as the main vehicle for resource mobilization.
- The *VAT* system ensures that there is simplicity and transparency in the system.
- To activate the overall economy by mobilising more internal resources.[17]
- To draw near a *VAT* regime should be reliable in arrangement and approach.
- To adopt a flat rate of taxation on a broader base, covering a wide range of goods excepting the primary agricultural products.
- To prohibit cascading taxation at different stages of production.[18]
- As far as possible the mechanism should be self-regulated & 'to consolidate the tax administration'[19].
- The scope of *VAT* should cover set-off for service tax paid.
- To bring a consistency in the tax-GDP ratio.[20]

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13 *Banaglapedia, loc .cit.*, p. 292.

14 Emil M. Sunley, "Taxation of Cigarettes in the Bloomberg Initiative Countries: Overview of Policy Issues and Proposals for Reform", December 2009, p.3.

15 Subash K. Bijlani, "Towards an Indian common market VAT implementation in the northern region", Magnusconsultants, 2003, Available At http://www.magnusconsultants.com/pdf/towards_an_Indian_common_market.pdf \

16 Banaglapedia, *loc .cit.*, p. 292

17 Ibid.

18 Ibid.

19 Ibid.

Further the National Board of Revenue *(NBR)* pointed out that the objectives behind introducing the value added taxation were: bringing transparency in the taxation system, prohibiting cascading taxation at different stages of production, thoroughly integrating the tax administration, above all activating the overall economy by mobilizing more internal resources, and also brining the consistency in the *Tax-GDP* (gross domestic product) ratio.[21]

4. Regulations regarding Value Added Tax (*VAT*)

Value Added Tax (*VAT*) is a percentage tax on the value added of a commodity or service as each constituent stage of its production and distribution is completed.[22] *VAT* is one of the major indirect taxes in Bangladesh. It is paid on the value that an individual or an organization adds to goods and services at each stage of their production and distribution. The tax eventually gets passed on to the consumers. This may be illustrated as under Table 1 (in Tk. and presuming *VAT* at 15%):

Table 1.
VAT Transaction Value

Transactions	Value added	VAT	Value added plus VAT	Price sold to next stage
A sells raw materials to B for 100,000	100,000	15,000	115,000	115,000
B processes them and sells them to C for 154,675	167213.7 (35% of TPV*)	5,175	39,675	154,675
C sells them to retailers at 172,462.62	15,467.5 (10% of TPV*)	2,320.12	17787.62	172,462.62
Retailers sell them to consumers at 192,296.35	17,246.2 (10% of TPV*)	2,586.93	19,833.73	192,296.35
TOTAL	167,213.7	25,082	192296.35	

**TPV*= Total Purchased Value of the Goods.

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20 Ibid.

21 *Ibid.*

22 Banglapedia, *loc .cit.*, p. 291.

4.1. Imposition of Value Added Tax (VAT)

Section 3 of the *Value Added Tax (VAT), 1991* prescribed provision about the imposition of value added tax (*VAT*). *VAT* shall be payable at the rate of 15% on the value of all goods except those specified in the First Schedule of the Value Added Tax (*VAT*), 1991 and on all services specified in the Second Schedule of the Value Added Tax (*VAT*), 1991. In the case of imports, the importers are liable to pay *VAT*. In the case of goods manufactured or produced in Bangladesh, the manufacturers or producers are liable to pay *VAT*. In the case of rendering of services, the persons rendering the services are liable to pay *VAT*. In other cases, the suppliers are liable to pay *VAT*.

4.2 Determination of value for charge of VAT

The value for charge of *VAT* would be determined under Section 5 of the *Value Added Tax (VAT), 1991*. In the case of imports, the value would be the amount chargeable to import duty as per the *Customs Act 1969* and adding therewith the import duty, supplementary duty and other duties and taxes -if any, except advance tax. In the case of supply of goods, the value would be the price receivable from the buyers. The price would include all expenditure incurred by the manufacturer or producer or supplier including the commission, charges, supplementary duty and all other taxes and duties (excluding *VAT*). However, if the goods subject to *VAT* are manufactured or produced utilizing the imported input or in the case of sale, exchange or transfer of imported goods, the value would be the amount on which input tax rebate is availed under Section 9 on the basis of the value arrived at as per the *Customs Act 1969*. In the case of *VAT* chargeable on the basis of retail price on any goods as per notification of the Government, the retail price for the charge of *VAT* on such goods would be as fixed by the manufacturer or producer with the approval of the concerned *VAT* authority. The price would be inclusive of all expenditure, commission, charge, duty and taxes. Such price must be printed prominently, clearly and legibly on the surface of the goods or on the covers or packages of the goods. In the case of services, *VAT* would be charged on total receipts. In the case of supply of goods by any registered person or by a person qualified for registration, the total price received or deemed to be received by such person during a particular tax period would be the basis for imposition of *VAT*. The said price for imposition of *VAT* would be determined as per the (*VAT*) Rule. In the case of products where trade discounts are allowed, *VAT* would be charged on the value arrived after deducting trade discount. In the public interest, the Board may fix tariff value for taxable goods and services for determining the value for imposition of value added tax (*VAT*) and supplementary duty.

4.3. Time and method of payment of VAT

The provisions with regard to time and method of payment of *VAT* are as under[23]:

(a) In case of imported goods, the method of payment of *VAT* will be the same as customs duty as per the *Customs Act 1969*.

(b) In the case of goods manufactured, produced, imported, purchased, or procured or collected in any manner by a registered person or by a person qualified for registration, *VAT* would be payable (on the taxable goods) at the time of the following which occurs first:

- When goods are delivered or supplied;
- When challan relating to the goods to be delivered or supplied is issued;
- When goods are taken for person's use or for use of others; and
- When payment is received in full or in part.

(c) In the case of service rendered by registered person or by a person qualified for registration, *VAT* would be payable (on the taxable services) at the time of the following which occurs first:

- When the service is provided;
- When the invoice relating to the service is provided; and
- When payment is received in full or in part.

5. Changes and Reforms through the Finance Acts

5.1. Changes and reforms through the Finance Act 2002-03

5.1.1. Withdrawal of VAT

VAT is withdrawn on tractor, power-tiller, aerator, full fat Soya-been both at import and local production stage. *VAT* is also withdrawn on electricity used for irrigation purposes and on home made gur (raw sugar). It is also withdrawn in case of transfer of land and apartment; "Body building of bus and truck" and "Travel agency" sectors.

5.1.2. Imposition of VAT

VAT is imposed on baking services like DD, MT, Bank Guarantee, Pay order, TT etc., certain advertisements in addition to the advertisements through electronic media, glass sheet coating and designing organization.

5.1.3. Reforms of Supplementary Duty

Supplementary duty is withdrawn from all items of goods at the local stage except cigarette, natural gas, C.R. Coil, cosmetic products, marble slab, tiles, ceramic bathroom fittings and powder milk etc. Supplementary duty on soft drinks is increased to 10% from

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[23] Sec. 6 of the *Value Added Tax Act, 1991*.

5%. Supplementary duty is reduced on cinema ticket from 85% to 35%. Supplementary duty is imposed on "satellite channel distributors" @ 15%.

5.1.4. Other Reforms

Registration under *VAT* Act is compulsory irrespective of the annual turnover in the case of Motor Garage, Indenting, Survey, Constancy and Supervisory Firm, Satellite Channel Distributor and Operator, Gold and Silver Shops, Car/Conveyance Rental etc. Tariff value of bricks is increased by 50%. Tariff value on ship scraps supplied from ship-breaking yards is raised to Tk. 1,500 per MT from Tk. 700. All businesses are brought under *VAT*- net. A minimum annual payment is levied at Tk. 5,400 in the case of small shops in city corporation locality and Tk. 3,600 for small shops in other areas annually. *VAT* on airline ticket has been increased from Tk. 50 to Tk. 200. No credit facility in case of truncated value and ruination or destruction of raw materials at the factory or service site; Increase the time for claiming refund by the tax payer from 4 months to 6 months; To include the provision for cancellation of *VAT* registration in case of declaration; enactment of specific provision for seizure and confiscation of cigarettes without stamps or bandroll; to introduce maintenance of computerized records and books of accounts side by side with the manual system; to reduce the time for submission of *VAT* documents relating to clearance of goods and services at the *VAT* office from 7 days to 72 hours; and to file appeal to the Commissioner within 30 days of value fixation by the divisional officer. The rate of *VAT* applicable to certain services based on deemed value addition has been changed, significant of which are as follows under Table 2:

Table 2
The Rate of VAT Applicable to Certain Services in 2002-03

Service Code	Service renderer	Rate applicable Previously	Current Rate
S003	Motor vehicle garage and workshop	4.95%	4.50%
	Dockyard	4.95%	4.50%
S032	Consultancy and supervisory firm	5.25%	4.50%
S034	Audit and accounting firm	5.25%	4.50%
S037	Procurement provider	3.00%	2.25%
S057	Distributor of electricity	Various rates on the basis of industrial, residential consumption	Single rate of 5.00%

5.2. Changes and reforms through the Finance Act, 2003-04

(i) Full exemption of *VAT* on locally produced and packed rice, pulses, wheat, maize, garlic, onion, chilly, ginger, coriander seed, vegetables, fresh fish and meat.

(ii) *VAT* is withdrawn from Gypsum di-hydrate used as fertilizer and on pesticides for killing rats in the grain field.

(iii) At present bulk importation of gas are enjoying *VAT* exemption. The enterprises bottling LP gas produced locally are paying *VAT* on bulk purchase.

(iv) Travel agency has a significant role in the development of the tourism industry of the country. With a view to promote tourism and to increase foreign exchange earnings, *VAT* on this sector has been withdrawn.

(v) Presently *VAT* is levied on all categories of advertisement published in the Newspaper. VAT on small types of advertisements like "birthday", "chehlum", "tutor wanted" and lost notice etc. has been withdrawn.

(vi) Local manufacture of toiletries & cosmetic like Shampoo and Skincare Cream are facing uneven competition with the importers of the same as they are paying supplementary duty at the rate of 20% ad-valorem. The government thus reduced supplementary duty on Shampoo and Skincare cream products from 20% to 10%.

(vii) At present minimum *VAT* leviable on small shops of the city corporation areas are fixed at Tk. 4200, and outside the city corporation - areas – Tk. 3000, To reduce the burden on the small shops located outside the city corporation and the district town areas, *VAT* is fixed at Tk. 2000 only. But large traders including importers, dealers, distributors commission agents, NIS products and Cement traders will continue to pay *VAT* on the basis of their actual sales.

(viii) With effect from F Y 2003-04 the rates of *VAT* deduction at source are under Table 3:

Table 3

The Rate of VAT Applicable to Certain Services in 2003-04

Service code	Contents	Rate of VAT
S.003.10	Motor vehicles garage and workshop	4.50%
S.00320	Dockyard	4.50%
S.004.00	Construction contractor	4.50%
S007.00	Advertising firm (payment by Govt./ Semi-Govt./autonomous bodies, nationalized banks and insurance)	15.00%

Service code	Contents	Rate of VAT
	Advertisement firm (payment by other banks-, insurance, NGOs, firms etc for classified adv.)	9.00%
	Advertisement firm (payment by others)	15.00%
S.008.10	Printing press	4.50%
S.014.00	Indenting (only on commission)	15.00%
S.020.00	Survey firm (on commission, fees and charges)	15.00%
S.032.00	Consultancy and supervisory firm	4.50%
S.033.00	Leaser (Izaradar)	15.00%
S034.00	Audit and Accounting firm	4.50%
S.037.00	Procurement provider	2.25%
S.048.00	Transport contractor (transportation of petroleum products)	2.25%
	Transport contractor (Others)	4.50%
S.049.00	Transportation service provider on hire (except taxi cab)	4.50%
S.053.00	Directors fees for attending board meetings	15.00%
S.056.00	Banking service provider (on all fees, commissions etc.)	15.00%
S.060.00	Sale of goods on auction	1.50%

5.3. Changes and Reforms through the Finance Act 2005-06

(i) For establishing a Large Taxpayers Unit comprising of the enterprises paying large amounts of tax with a view to ensuring improved management and collection of *VAT* and to provide better service to the taxpayers.

(ii) 100% export oriented industries have been enjoying exemption facilities in respect of some services and utility charges at both the stages of import and export.

(iii) to introduce similar facility for the enterprises situated in EPZ areas and those engaged in deemed exports with a view to providing more encouragement to export business.

(iv) to exempt of Trade *VAT* on insecticides, fungicides, pesticides, anti-sprouting products, plant growth regulator and disinfectants used in the sector in order to provide increased assistance to agriculture sector I propose.

(v) The hefty amount of penalty of Tk. Twenty Five thousand ($ 385 US) for both major and minor offences appears to be a little inconsistent. In order to remove this inconsistency on the Budget 2005-06 proposed reduction in the amount of penalty for minor offences from Tk. Twenty Five thousand ($ 385 US) to Tk. Ten thousand ($ 154 US).

(vi) The Finance Act, 2005 amends the following provisions of the Value Added Tax Act, 1991:

(a) Inclusion of 'Local *VAT* office' and 'Divisional Officer' of the Large Tax-payers' Unit (LTU) in the definition of ' Local *VAT* Office' and 'Divisional Officer' in clause (Antosta Ja) and clause (Ra) of Section 2.

(b) Insertion of a new sub-section 1ka under section 13 to fix the rate of duty drawback on certain goods by the government in the official gazette.

(c) Reduction of minimum penalty from Tk. 25000 ($ 385 US) to Tk. 10000 ($ 154 US) thousand for minor offences under sub-section (1) of section 37.

(d) Insertion of 'Service' in clause (Triple Nio) of sub-section (2) under section 37.

(e) Insertion of provision regarding request from a *VAT* officer to another *VAT* officer in the recovery of the government dues.

(f) Inclusion of 'Superintendent' of the Large Tax Payer Unit (LTU) ' in the definition of 'Superintendent' in clause (Nio) of rule 2. (2) Clause (Ka) of proviso under sub-rule (1) of rule 17Ka has been amended to extend the time limit from thirty days to ninety days for bringing the goods back to the factory, in cases where the goods are damaged or unfit for consumption or when there is a material change in the nature of supply.

(vii) Exemption on Iron Ore, Petroleum Bitumen, Magnesium Sulphates (Fertilizer), Zinc Sulphates (Fertilizer), Disodium Tetraborates (Fertilizer), Waste Paper, Infusion Set with or without IV fluid bag at the import stage.

5.4. Changes and Reforms through the Finance Act 2009-10

The most significant element of indirect taxes is VAT (Value Added Tax) which contributed around 38.0 percent of tax revenues in *Finance Year 2009*. VAT as a share of total tax revenues has been in the region of 31.4 percent to 38.1 percent in recent years and as a percentage of GDP it increased from 2.9 percent in FY05 to 3.7 percent in FY09. As against the VAT from local sources, VAT from imports (as percentage of total VAT) has been declining during FY05 to FY09 (Table 4).

Table 4

Structure of Total Tax Revenue (Taka in billion)

	2004-05 Actual	2005-06 Actual	2006-07 Actual	2007-08 Actual	2008-09 Actual
			Taka in billion		
Total Tax Revenue	**304.8**	**339.6**	**380.3**	**481.29**	**528.66**
Direct Taxes	**69.98**	**84.87**	**104.76**	**139.82**	**150.33**
Income Taxes*	25.69	26.41	30.71	48.02	61.51
Profit Taxes*	30.08	45.21	56.5	69.42	77.06
others	14.21	13.25	17.55	22.38	11.76
Indirect Taxes	**234.82**	**254.73**	**275.54**	**341.47**	**378.33**
Customs Duties	75.58	71.25	74.55	86.66	84.4
Excise Duties	1.44	1.00	1.83	2.14	2.83
Vat on Imports	53.7	56.54	61.86	82.99	91.87
Vat (domestic)	42.11	61.12	73.46	89.87	109.43
Supplementary Duties:	57.56	59.07	57.91	73.7	85.12
Import	19.53	14.02	10.71	15.62	23.39
Local	38.03	45.05	47.2	58.08	61.73
Others	4.43	5.75	5.93	6.11	5.2
As Percent of Total Tax Revenue					
Tax Revenue					
Direct Taxes	**23.0**	**25.0**	**27.5**	**29.1**	**28.4**
Income Taxes	8.4	7.8	8.1	10.0	11.6
Profit Taxes	9.9	13.3	14.9	14.4	14.6
others	4.7	3.9	4.6	4.7	2.2
Indirect Taxes	**77.0**	**75.0**	**72.5**	**70.9**	**71.6**
Customs Duties & Excise	24.8	21.0	19.6	18.0	16.0
VAT (Import)	17.6	16.6	16.3	17.2	17.4
VAT (domestic)	13.8	18.0	19.3	18.7	20.7
Supplementary Duties	18.9	17.4	15.2	15.3	16.1
Import	*6.4*	*4.1*	*2.8*	*3.2*	*4.4*
Local	*12.5*	*13.3*	*12.4*	*12.1*	*11.7*
Others	1.5	1.7	1.6	1.3	0.9

Source: FSMU, Finance Division; National Board of Revenue;

**Data sources are different, so the numbers may vary slightly*

On average 48.7 percent of total VAT has been collected from imports while the rest has been collected domestically (Table 5) in the recent years. In FY05, overall Value Added Tax as a percentage of total revenue was 25.2 and steadily increased to 31.5 in FY09 (Table 5). During the same period, as a percentage of tax revenue, it increased to 38.1 percent in FY09 from 31.4 percent in FY05. Despite the significant fluctuation, it maintained a robust growth of 20.4 percent (annual average rate) over FY05 to FY09. A noteworthy shift however has taken place between the mix of VAT from imports and VAT from local sources as expected due to the implementation of WTO rules.

Table – 5

Structure and trend of Value Added Tax (Taka in billion)

	2004-05	2005-06	2006-07	2007-08	2008-09
Total Revenue	380.20	429.04	483.40	591.53	641.00
Tax revenue	304.80	339.6	380.30	481.29	528.66
VAT:Import	53.70	56.54	61.86	82.99	91.87
VAT:Local	42.11	61.12	73.46	89.87	109.43
Total VAT	95.81	117.66	135.32	172.86	201.3
As % Total Revenue	25.2	27.4	28.0	29.2	31.5
As % of Tax Revenue	31.4	34.6	35.6	35.9	38.1
Growth: VAT import	-	5.3	9.4	34.2	10.7
Growth: VAT local	-	45.1	20.2	22.3	21.8
Growth:Total VAT	-	22.8	15.0	27.7	16.5
VAT:Import: % of Total VAT	56.0	48.1	45.7	48.0	45.6
VAT:Local: % of Total VAT	44.0	51.9	54.3	52.0	54.4

Source: National Board of Revenue, Bangladesh

Some of these measures will have negative impact on cost of business and production:[24]

- Increasing VAT rate from truncated to actual (15%) on services provided by dockyards, advertising agencies, printing presses, courier services, consultancy and supervisory firms, audit and accounting firms will raise companies' cost of doing business;
- on September 2009, 15% VAT was imposed on commercially rented space, establishment and machinery.

5.4. Changes and Reforms through the Finance Act 2010-11[25]

To modernize the VAT system, the Finance Minister declared in the Budget Speech in FY 2010-2011 that Bangladesh government try to propose to simplify the price declaration procedure and introduce amendments in the law for payment of taxes using various means now. At the same time, Finance Minister proposes necessary amendments in VAT Act to impose VAT on e-commerce.

i. VAT on the services of specialist doctors is withdrawn. VAT on domestic production of drugs for cancer prevention is also withdrawn.

ii. 2.5% supplementary duty applicable to the processing of liquid milk to be converted into powdered milk is withdrawn. Tariff value for powder milk fixed at Taka 100 per kg which results in only Taka 15 per kg as VAT instead of the current Taka 50 per kg.

iii. VAT exemption is offered for the next one year for complete manufacture of refrigerators and motorcycles.

iv. The threshold level for imposing excise duty on bank deposits raised to Taka 20,000 instead of the existing Taka 10,000.

v. VAT on the internet services used in the educational institutions withdrawn.

vi. The threshold value of the plants and machineries of cottage industry for VAT exemption raised by 67 percent from Tk 150,000 to Tk. 250,000. The condition of barring subcontracting for VAT registered units for cottage industry is withdrawn.

vii. The penalty for evasion of VAT or supplementary duty re-fixed at minimum equivalent amount to maximum two and half times the tax amount.

viii. VAT on domestic generation of power along with domestically produced/ assembled generators withdrawn. Solar Panel exempted from all VAT at stages of import, domestic production and supply.

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24 Mustafizur Rahman, "Dialogue on State of the Bangladesh Economy and Budget Responses 2010-11", Centre For Policy Dialogue (CPD), 19 June 2010, p. 33.

25 Public Finance, Chapter- 8, p. 88.

ix. VAT on the imports of raw materials for pesticides is withdrawn.

x. VAT on importation of pulp which is a virtual raw material for this industry is withdrawn.

The growth rate of VAT has a rapid pace than all the other types of taxes and the growth rate of tax can be interpreted as the growth rate of VAT (Table - 6).[26]

Table –6

Shares of Revenue Receipts and its growth

Fiscal Years	*VAT as % 0f total Revenue*	*Vat as % of NBR*	*Growth rate of VAT (%)*	*Growth rate of Tax (%)*
2001-2002	25.15	74.92	13.50	12.51
2002-2003	25.93	76.32	15.82	13.77
2003-2004	24.22	76.41	6.38	13.43
2004-2005	27.05	77.81	23.67	12.90
2005-2006	27.63	76.79	16.91	13.22
2006-2007	27.66	75.76	10.36	8.49
2007-2008	28.10	75.93	24.34	22.33
2008-2009	29.08	76.61	18.24	10.11
2009-2010	28.55	76.39	13.32	20.97
2010-2011	29.18	78.18	18.85	18.90

Source: Unnayan Onneshan, "Growth, Tax, Inflation and Consumers", *Bangladesh Economic Update,* Vol.1. No.1, July, 2010, p.7.

The collection of VAT alone has a share of 29.18 per cent of the total revenue receipts in the current fiscal year. Thus the lower middle class and the poor consumers face the burden of indirect tax on them along with inflationary pressure.[27]

6. Rationale of Value Added Tax (VAT) in Bangladesh

Value Added Tax is one of the most fundamental reforms that have been proposed for the Bangladeshi economy after years of political and economic debate. The rationale for advocating for *VAT* is that it will substitute an intricate tax structure that will also do away with the deceptive practices. Few advantages of *VAT* in Bangladesh are mentioned below:

- *VAT* helps avoidance of cascading effects across different levels of production, harmonization of tax burden and administrative ease.[28]

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[26] Unnayan Onneshan, "Growth, Tax, Inflation and Consumers", *Bangladesh Economic Update,* Vol.1. No.1, July, 2010, p.7.

[27] Growth, Tax, Inflation and Consumers, op.cit.

- It is hard to avoid because the tax collector imposes it on the total amount of sales excluding the cost of inputs.
- The incidence of the tax is widely spread, which makes it difficult of a singe firm to shift the burden of the tax to one group or another.
- The tax is not readily apparent to the consumer, because it has been included in the price before the purchase is made.
- It provides a psychological advantage to the tax payers in that the tax payers pay out in installment.[29]
- The government gets its money earlier; it does not have to wait until after the final sale.[30]
- The *VAT* is easy to collect because businesses would make their *VAT* payments along side their tax payments to the government.
- The smallest of *VAT*s can raise a tremendous amount of revenue for socio-economic development of a country.
- *VAT* will encourage and result in a better-administered system that deters tax evasion. The taxpayers will also be compelled to keep proper records of their sales and purchases.
- *VAT* evades the problem of under valuing, as all stages of production and distribution are subject to a tax.
- *VAT* (if computed using the input tax credit method) permits easy and effective targeting of tax rates as a result of which the exports can be zero-rated.
- The input tax credit method encourages a system that ensures better tax compliance by generating a trail of invoices that supports effective audit and enforcement strategies.
- *VAT* provides a good system of rebate and refund which prevents tax on tax i.e., recurring tax.[31]
- As far as Bangladesh is concerned, *VAT*, if enforced properly could help in fiscal consolidation for the country. As a steady source of revenue, it could be used for reducing the debt burden.
- *VAT* will help Bangladesh integrate better in the *WTO* regime.
- A significant advantage of the value added form in any country is the cross-audit feature. Tax charged by one firm is reported as a deduction by the firms buying

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28 *Income Tax, loc. cit.*, p.384.

29 *Ibid.*

30 *Ibid.*

31 *Ibid.*

from it. Only on the final sale to the consumer is there no possibility of cross audit.

But *VAT* has several disadvantages from the view point of raising price, administrative difficulties resulting from number of collecting points, complex recording, etc.[32] Disadvantages will always give birth to amendments to the existing policy so that traders can ride jerk free on it adding value to the existing Bangladeshi taxation system. The main disadvantages that have been identified in connection with the Value Added Tax are:

- It is claimed that the tax is regressive, i.e., its burden falls disproportionately on the poor since the poor are likely to spend more of their income than the relatively rich person.
- It attempts to replace direct or indirect taxes with steep, progressive rates.
- *VAT* is too difficult to operate from the position of the administration. It is often argued that *VAT* places a special burden on tax administration. However, it is worth noting that wherever *VAT* was introduced one of its effects was the rationalisation and simplification of the previous indirect tax system and its administration. The consolidation and incorporation of numerous indirect taxes into the *VAT* would simplify the rate structure, tax base, and administration of the indirect tax system, thereby eliminating the overlapping auditing practices that had plagued those systems.
- *VAT* is too difficult to operate from the position of Business. It is true that the *VAT* is collected from a larger number of firms than under any form of income tax or single state sales tax; to the typical smaller firms the complexities of the tax and the need for more extensive records (for example, to justify deductions) are likely to prove serious.
- It is often overlooked that businesses already function with considerable administrative responsibility for a number of laws including the Insurance Act and the *Income Tax Ordinance, 1984*.
- *VAT* also allows for the exemption of small businesses from the system.
- *VAT* is inflationary. Some businessmen seize almost any opportunity to raise prices, and the introduction of *VAT* certainly offers such an opportunity. However, temporary price controls, a careful setting of the rate of *VAT* and the significance of the taxes they replace should generally ensure that there is no increase if any in the cost of living. To the extent that they lead to a reduction in income tax, any price increases may be offset by increases in take-home pay.
- *VAT* favours the capital-intensive firm. It is also argued that *VAT* places a heavy direct impact of tax on the labour-intensive firm compared to the capital-

32 *Income Tax, loc .cit.*, p.385.

intensive competitor, since the ratio of value added to selling price is greater for the former. This is a real problem for labour-intensive economies and industries.

7. Conclusions

The Income Tax Ordinance, 1984 did not undergo any major reforms, so, some provisions of this Act which are related to VAT should be reformed. The more extensive programs have been undertaken to reform the VAT process for mobilizing more taxes by widening the tax-net. Introduction of *VAT* and the relevant legislation has far reaching implications for industry and trade. The complexities in the sales tax structure are expected to be addressed after the implementation of *VAT*. The introduction of a dual *VAT* would among other things remove the cascading impact of taxes. The introduction of *VAT* contributed significantly to raise the tax revenue collection in Bangladesh.[33] Goods other than primary unprocessed agricultural products and food items listed in the First Schedule of the *VAT* Act (live animals or poultry, human or animal hair, parts of animal body or animal products, parts of plant, green or dried vegetables, fruits, unprocessed spices, food items, oil seeds, natural gums or like products, wood, uncared wool or cotton, and raw jute, etc) are subject to *VAT*.

> "Due to the global economic downturn commodity prices in the international market fell significantly which adversely affected VAT collection from imports. As the world economy rebounds from the recession, this scenario is expected to improve gradually. However, Bangladesh still has to make further progress towards the implementation of the ongoing VAT reform process. Once the reform process is completed, overall mobilization is most likely to increase substantially".[34]

The Finance Minister states on Budget Speech,[35] "currently, there is no provision in the VAT Act for protection of information provided by the taxpayers. Considering the demands of taxpayers, I propose to insert a new provision in the existing law for protection of information given by the taxpayers."[36]

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33 Banglapedia, *loc .cit.*, p. 293.

34 Ministry of Finance, "Medium-Term Budgetary Framework (MTBF) 2011-12 to 2015-16", Chapter 3, Medium –Term Revenue Performance, Outlook and Strategy, p. 40.

35 The Budget Address of the Finance Minister Abul Mal Abdul Muhit (2010-2011), para. 259.

36 *Ibid.*