

Value Added Tax and Supplementary Duty Act 2012

Concerns and Implementation Challenges

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VAT and SD Act 2012: Concerns and Implementation Challenges

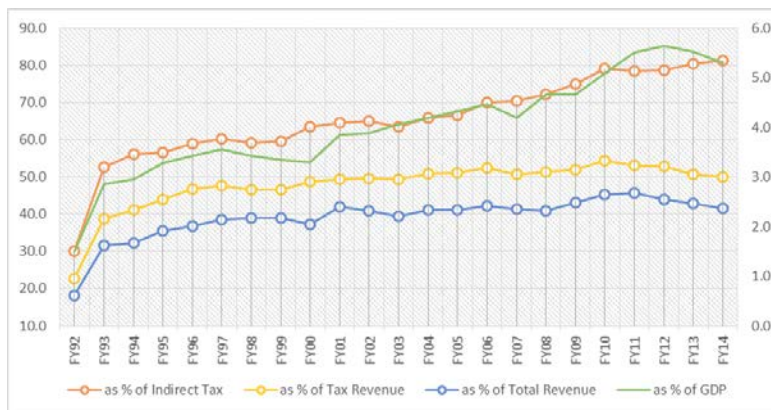
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The existing Value Added Tax (VAT) Act, 1991 is envisaged to be replaced by the recently enacted VAT and Supplementary Duty (SD) Act, 2012. The new Act proposes to bring significant changes in the earlier VAT rules and regulations. The new VAT Act was drafted with the declared objective of generalising the rules and laws in a more comprehensive and user-friendly manner which was expected to make it easier to understand, and would be simple and reliable for the end-users. However, a number of important stakeholders have raised concerns with regard to various provisions of the Act, and their possible implications for enterprise development and they have questioned over the readiness as regards implementation of the new Act of concerned government bodies and the business community. These stakeholders have urged policymakers to review the Act further. As present the review process is taking place. As per the earlier announced implementation plan, the new VAT and SD Act 2012 is expected to come into effect from 1 July 2015. Hence, it is important to have in-depth consultation with participation of major stakeholders to learn about the various perspectives and concerns in this regard, and design initiatives and strategies in going forward.

Role of VAT and SD

The trend of tax collection from VAT and SD has improved significantly since FY1992 when the VAT Act 1991 was first introduced. Collection from these two sources has doubled their share as percentage of gross domestic product (GDP) within one year from 1.5 per cent in FY1992 to 2.9 per cent in FY1993. The trend has gradually increased over time and in FY2010 it crossed the threshold of 5 per cent of GDP (Figure 1). Towards collection of indirect taxes by National Board of Revenue (NBR), VAT and SD contributed about 81.3 per cent in FY2014 while VAT singly contributed about 57.9 per cent.

Figure 1: Share of VAT and SD as % of Indirect Tax, Tax Revenue, Total Revenue and GDP



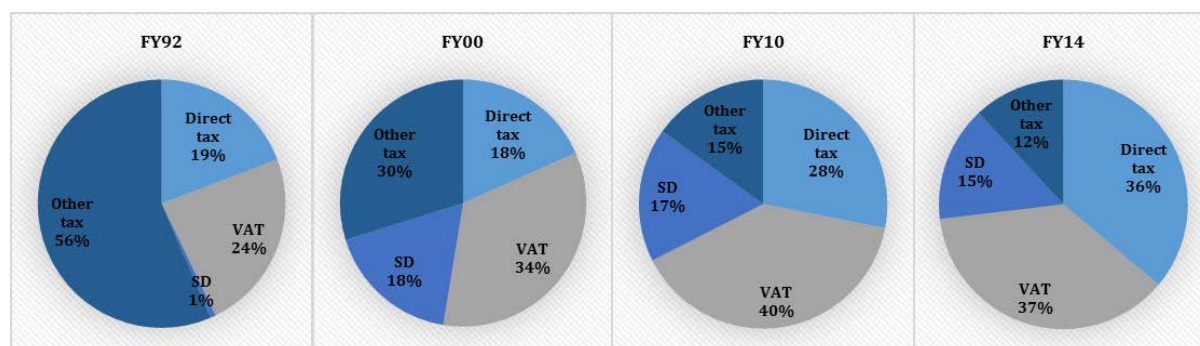
Source: Author's calculation from NBR and MoF data.

Note: Collection as % of GDP has shown in the secondary axis.

Indeed, during two decades of 1990s and 2000s VAT and SD significantly contributed towards higher revenue augmentation by the NBR. In FY1992, VAT and SD contributed only 25 per cent of total NBR revenue (Figure 2). In FY2010, their combined share to total NBR revenue collection increased to 57 per cent. However, recently their share declined to some extent. In FY2014, the share stood at 52 per cent, thanks to faster growth of income tax collection.

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Figure 2: Share of VAT and SD as % of Total NBR Revenue

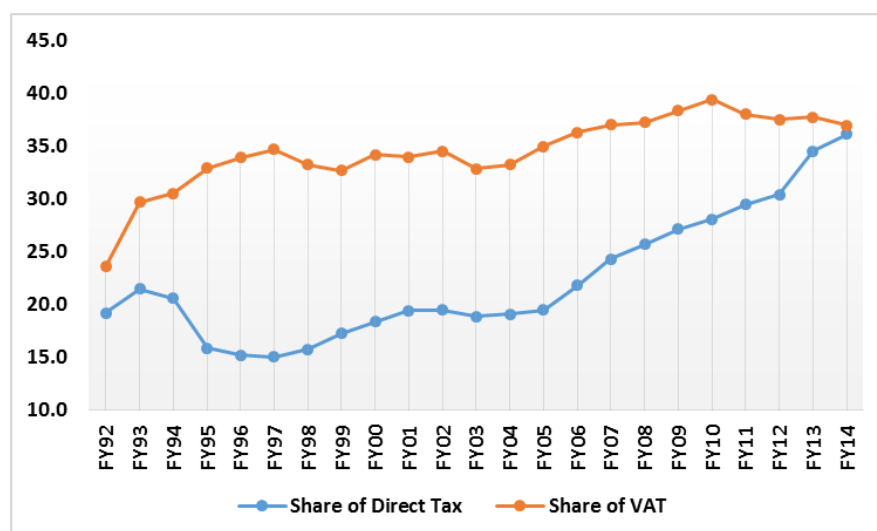


Source: Author's calculation from NBR data.

Note: Other sources of tax include import duty, excise duty, export duty, turnover tax etc.

As a single source of revenue income, VAT continues to remain the highest revenue earner with 29.7 per cent of total revenue share in FY2014. Between FY2000 and FY2014, VAT collection increased almost 10 times. Indeed, tax revenue collection from VAT source remains higher than income from all direct sources (e.g. income tax, travel tax and others) of tax revenue income by NBR. However, since FY2005, the gap between these two sources (i.e. VAT vs Direct tax) declined significantly to converge (Figure 3). Growth of tax revenue earnings from VAT sources failed to maintain the momentum that was gained by the direct tax sources. Earning from direct tax grew at 21.1 per cent annually since FY2000, while the growth for VAT income was about 15.6 per cent per annum for the mentioned period.

Figure 3: Share of direct tax and VAT as % of total NBR collection



Source: Author's calculation from NBR and MoF data.

Revisiting VAT Act 1991

The regeneration of the old Sales Tax Act 1951 had initially been done through injunction of Sales Tax Ordinance 1982. Draft of VAT Act 1990 was prepared keeping a provision to introduce a single rate VAT system at import and manufacturing stage under the tax reform agenda. The Parliament House proclaimed the final version of the VAT Act as a bill in mid-1991. The bill came into effect as Value Added Tax Act, 1991 (Act No. 22 of 1991) from July 1991. Since then VAT remains the single-largest source of revenue for the Bangladesh government.

It also needs to be mentioned that a number of items enjoy exemption from VAT under the coverage of VAT Act 1991. Cottage industries are kept outside the VAT net. Exported items and essential commodities are zero-rated to VAT. Some special sectors within the small industries category enjoy VAT exemptions and differential rates (truncated rates). Turnover tax (TT) gives

preferential provision to the small enterprises, which has annual turnover below Tk. 80 lakhs, to pay turnover tax at a lower rate of 3 per cent. Under 'turnover tax' provision, an entrepreneur has to keep minimum ledger accounting that could reduce his administrative cost. There is also provision for 'Package VAT' for small scale trading enterprises which usually do not maintain any formal ledger accounting. All other enterprises need to pay VAT according to the respective provisions articulated in the Act. All these dimensions have significant implications in terms of progressivity of VAT. It is important to note here that, over the last two and half decades, the rules under the VAT Act 1991 has revised and amended from time to time through a number of Statutory Regulatory Orders (SROs).

Key Changes in the New VAT and SD Act 2012

The parliament passed the new VAT and SD Act, 2012 (Act No. 47 of 2012) as a bill on November 27, 2012 and is expected to come into effect from 1 July 2015 according to the existing implementation plan. The Act was also one of the conditionalities of IMF's Extended Credit Facility (ECF) programme which is currently being carried out. Accordingly, during the last two years a number of adjustments have been made in the present VAT Act 1991 as part of preparing the relevant stakeholders for the proposed new one. The new Act will cover three form of taxes – VAT, SD and TT. The key changes brought by the new Act are discussed below.

- The new VAT and SD Act will have a *broader coverage*. VAT will now be applied to all sectors. Besides imports, production, trading and services, it will cover wider range of services including rendering of services and import of services, immovable property, lease, grant, license, permit, rights, facilities etc.
- However VAT is *not applied* for certain good and services including supply or import of basic food for end consumption, prescribed supply or import of life-saving medicine, import of goods those are exempted or zero-rated, supply of the transportation of passengers by taxi, bus, mini-bus, or ferry, not being either transportation provided in a vehicle that is air conditioned; or a supply of a chartered tour of a kind ordinarily provided to tourists or other visitors, a supply of the health care and medical services, education and training, child care activities and residential care facilities for aged, indigent, infirm, or disabled persons who need permanent care services relating to social welfare activities, if these services are provided by a government entity or an approved charitable institutions, an import of goods exempted from taxes, by the Government by notification, in favour of an approved charitable institution, or to the state, an import of goods shipped or conveyed to Bangladesh for trans-shipment or conveyance to any other country, an import of goods made available free of charge by a foreign government or an international institution with a view to assisting the economic development of Bangladesh, as approved by the Board etc.
- Under the new VAT and SD Act, the existing *price declaration* provision has been discarded. Instead the taxpayers will need to notify the current price and input-output coefficient.
- VAT *registration thresholds* have been changed. A second lower threshold has been established below which businesses are exempted from VAT and turnover tax. However, every person who carries on the economic activities of manufacturing any supplementary dutiable goods in Bangladesh; or provides supply of any supplementary dutiable service in Bangladesh shall be required to be registered.
- *Truncated value base* will be discontinued being termed as a 'distortion under the present VAT system'.
- Provision for '*Package VAT*' will also no longer exist. Hence, besides TT, all the entrepreneurs will be treated equally. The current broad based 'exemption list' has also been narrowed down significantly in the new Act.
- There is no time limit for *discount sale* under the new Act. In the present Act, sale at discount prices were under the conditions of being advertised in a national daily, discount to be bound

at 15 per cent or less of the declared and approved value and, discount prices not being offered for more than 30 days in a year.

- The new VAT and SD Act will bring the automated *VAT challan*. Information for VAT challan will be stored and processed in an automated system. So, sending Challan to the VAT Circle Offices, as is the practice at present, will no longer require.
- The new Act provides a broader scope to use up *input tax credits*. Under the new VAT and SD Act, provisions have been kept to cover almost all the raw-materials of production for which input tax credit can be availed. Under the present VAT regime, a number of factors including land, building, office-equipment, vehicles and labour are not recognised as inputs. Hence, input tax credit cannot be claimed.
- There will be no *Account Current Register* under the new Act. Under the existing rule, in case of services who do not take input tax credit by them, VAT is to be paid before submission of return. But in the case of goods and in the case of services who take input tax credit, VAT requires to be deposited to the government treasury in advance and keep balance in the 'Account Current Register' from where VAT is to be deducted while making supply. Under the new rule, all registered persons will require paying VAT while submitting their return but not in advance through Account Current Register.
- *Withholding VAT* is applicable for a broader range of services including government entities, NGOs, banks, insurance companies and other financial institutions, limited companies, post-secondary institutions. Withholding tax is mandatory in a supply under an agreement by tender, a supply under an ongoing supply agreement, a supply or set of related supplies for which consideration exceeds Tk. 25,000. Withholding entities are not permitted to take supply unless: person is registered and has a valid VAT honor card. There are a number of obligations to withhold by a withholding entity including (i) one-third of the payable VAT amount to be withheld; (ii) to issue a certificate; and (iii) withheld amount to be accounted for in the VAT return.
- The new VAT and SD Act will apply *standard calculation method*. The amount of VAT due in each reporting period will be based on the 'invoice-credit method' where the amount of tax to be paid equals VAT charged on sales (and other positive adjustments) minus VAT paid on inputs (and other negative adjustments).
- The new Act allows the tax to be remitted to Government when the return is due. It eliminates the current requirement for manufacturers and some service providers to *remit VAT* before shipping goods or providing services.
- Every taxpayer shall, in such form and manner as may be prescribed, keep, up to five years, all *accounts, documents, and other records* of his economic activity so as to ascertain his tax liability and other obligations.
- The VAT *refund system* has been simplified. Excess amount of paid VAT in relation to an economic activity involving construction, building or property development can be carried forward indefinitely. For other cases an excess VAT may be carried forward or be deducted over 6 (six) tax periods.
- Under the new Act, NBR will be vested with additional powers to *recover tax arrears*, including freezing a tax debtor's bank accounts, placing a lien on the tax debtor's property, and holding company directors liable for paying unpaid taxes.
- Under the new VAT Act, taxpayers aggrieved in connection with any dispute in relation to liability for tax, entitlement to refunds, extent of remittance of default surcharge or penalty, quantum of increasing and decreasing adjustment may apply to the board for solution through an *Alternative Dispute Resolution (ADR)* committee. However, a taxpayer will also be required to pay 10 per cent of a disputed tax before being entitled to file an appeal. It may be

mentioned that provision for alternative dispute resolution was included in existing VAT Act in 2012.

CPD Study on impact of VAT on SMEs

Recently the Centre for Policy Dialogue (CPD) has conducted a research study to examine the impact of VAT on small and medium entrepreneurs. The study was conducted under a research programme titled *Tax Policy and Enterprise Development in South Asia* being conducted in five South Asian countries. The study team conducted an enterprise level primary survey with 262 enterprises comprised from 4 different locations in Bangladesh. A number of the samples were drawn from large enterprises and also from enterprises located at special economic zones to provide dimensions for comparison purpose.

The study found that large firms are more compliant with regard to VAT payments than SMEs. In parallel, larger firms faced VAT related complexity relatively more than SMEs because of their compliance state. The SMEs took more time to become compliant than large firms. The VAT compliant firms believed that they have better access to formal commercial loans and enjoyed the legal status because of their compliance. Perception of major respondents is that VAT cost decreases their profitability and make them market uncompetitive. Main reason for non-compliance to VAT is procedural complexity. 'Lack of awareness' of enterprises was the second cause that sets them off from being VAT compliant. Perception towards VAT regulations was found 'somewhat low' while many of the stakeholders are 'indifferent' over the performance of the VAT administration.

The study suggested a number of following policy recommendations that may be considered to establish a SME friendly VAT regime. *First*, the forthcoming new VAT regime needs to recognise SMEs with an explicit definition in the VAT Rule. The definition needs to commensurate with the definition placed by the other concerned policies (e.g. industrial policy, BSCIC). *Second*, the VAT related act and rules needs to incorporate SME related special provisions in a clear and well-articulated manner. *Third*, the VAT laws and procedures are often found to be complex. A more committed effort will be required to identify and simplify these laws and procedures. *Fourth*, for SMEs in Bangladesh costs as regards VAT compliance is found to be higher compared to other South Asian countries. Indeed, to ensure the institutional capacity to service a large number of SMEs, the tax administration needs to be strengthened. Towards this end, further decentralisation of tax administration should be a priority. *Fifth*, the tax administration will be required to ensure fair enforcement to establish a level playing field for the compliant SMEs to keep them market competitive.

Concerns from Business Community and Recent Developments on Implementation of New VAT and SD Act 2012

While formulating the VAT and SD Act 2012, the Government and NBR went through a number of scrutinies. A series of meetings were conducted with the stakeholders including the business community. Indeed, the earlier drafts of proposed VAT and SD Act also experienced substantial reviews and revisions. However, the business community led by FBCCI felt that while preparing the new VAT and SD Act their comments and concerns were not adequately considered. On 10 September 2014, the business community led by the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI) organised a seminar where FBCCI placed their concerns in detail to the policymakers and proposed a number of changes. Some of the important government actors also backed the concerns of the business community. Some of the major areas of concerns include: (i) single rate and abolition of truncated value base; (ii) discontinuation of package VAT; (iii) significant expansion of documentation requirement; and (iv) with additional powers to recover tax arrears, including freezing a tax debtor's bank accounts. The FBCCI also argued that required reforms can be implemented by making required changes in the existing VAT Act 1991; hence, there was no need for a new Act. At the same time, the FBCCI also recommended to abolish provisions as regards Advanced Trade VAT (ATV) and withholding VAT. These provisions were part of the 1991 Act which have been also kept in the new Act.

In face of the call for a reconsideration during the aforementioned seminar, the Finance Minister proposed to form a committee consisting of representatives from the NBR and FBCCI to resolve the existing differences between the government and business community and help implementation of the new Act. A committee was formed on 28 October 2014 which include officials of NBR and FBCCI representatives. The seven-member committee can co-opt one or more than one experts if necessary. The committee will place their recommendations within two months (by the end of December 2014).

Government was committed to implement the Act from 1 July 2015. As was mentioned above it was also one of the commitments from the part of government to IMF. Accordingly, the IMF prepared a VAT and SD Act implementation plan for NBR. The World Bank is currently funding the plan under the project titled *Revenue Mobilization Program for Results: VAT Improvement Program*. The total project cost is USD 73 million; of which the World Bank is providing loan to the tune of USD 60 million.

Following committing the FBCCI a review of the VAT and SD Act 2012, the Finance Minister after meeting an IMF mission on 24 September 2014, announced that IMF had agreed to the revise the implementation plan and NBR will provide a fresh layout. However, IMF postponed disbursement of the sixth tranche of the IMF-ECF credit which may be released together with the final instalment in April 2015, subject to announcement of the roll-out of the VAT and SD Act in July 2016.

Concluding Remarks

The need for a legal and administrative reform of the existing taxation system has been felt by many stakeholders. The new VAT and SD Act was a major reform agenda for the government. Indeed, the NBR has another two new Acts in the pipeline – the Direct Tax Act and the Customs Act. Implementation of these Acts may also be delayed. The ongoing review of the VAT and SD Act 2012 hopefully will help formulation of the Act with consensus from both NBR and FBCCI. However, the NBR must continue to work on developing the infrastructure (physical, human and technical) required to implement the new Act. Also, the business community particularly the small and medium entrepreneurs should also take necessary preparation. Besides, it is critically important that the policymakers including NBR and Ministry of Finance recognize the role of taxation in a comprehensive manner taking cognizance of the broader development objective(s). There are four roles of any taxation: (i) it is a *source of government revenue* which is required to run any government; (ii) it provides finance for public services and investment (public goods), particularly at a time when the availability of finance for development (including overseas development assistance) is lean; (iii) it is a strategic tool for government to promote certain sectors with a view to support investment, economic growth and employment; and (iv) it is an instrument to ensure social and economic equity and justice. It is felt that the ongoing taxation reform agenda in Bangladesh is more biased towards the first two roles. The policymakers will need to consider the latter two roles with similar importance. The implementation of VAT and SD Act 2012 brings forth a number of important lessons as well. Implementation of any reform agenda needs to keep the relevant stakeholders on board. Awareness building should always be an integral part of reform implementation plan. Readiness of both implementing agency and the concerned stakeholders need to be taken into cognizance. Phasing of a major reform is also very important which help the stakeholders adjust to a changed environment. The overall macroeconomic impact of the reform agenda must also be examined beforehand. Finally, the reform agenda must be tailor-made keeping the country context in view and must be formulated independently. These lessons can help implementation of the forthcoming taxation reform plans of the government.