

Dialogue on
SME Development in South Asia
How Conducive are the Tax Policies?

Tax Policy and Enterprise Development in South Asia
Bangladesh Study Findings

Organised by
Centre for Policy Dialogue (CPD)
in collaboration with
Governance Institutes Network International (GINI)

Dhaka: 23 April 2015



CENTRE FOR POLICY DIALOGUE (CPD)
B A N G L A D E S H

a civil society think tank



Bangladesh Study Teams

- ▶ **Theme I on Tax Exemptions and Concessions**
 - Mustafizur Rahman
 - Khondaker Golam Moazzem
 - Mehruna Islam Chowdhury
 - Saifa Raz

- ▶ **Theme II on Value Added Tax (VAT)**
 - Mustafizur Rahman
 - Towfiqul Islam Khan
 - Md. Zafar Sadique

- ▶ **Theme III on Property Tax**
 - Swapan Kumar Bala
 - Towfiqul Islam Khan



Background of the Study

- ▶ Inclusive growth continues to remain a challenge for South Asian economies
- ▶ Research indicates that enterprise development and employment generation is strongly linked to tax policy
- ▶ Key taxation issues linked to the development of enterprises (particularly small enterprises) are:
 - Tax exemptions and concessions
 - Value Added Tax (VAT) reforms
 - Local property taxes
- ▶ Major observations are:
 - Tax exemptions and concessions are largely skewed in favour of large enterprises
 - Enterprise development is affected by Value Added Tax (VAT)
 - Enterprise development is affected by weak local property taxation



General Methodology

- ▶ **Following approaches have been undertaken for addressing the research questions under various themes**
 - Primary survey
 - Secondary data analysis
 - Key informants' interview (KIIs)
 - Focus group discussion (FGDs)



Sample for Primary Survey

- ▶ Perception-based primary survey
 - To learn about the impact of taxation on the state of growth of SMEs in Bangladesh
- ▶ Survey covered only manufacturing enterprises
 - 262 enterprises surveyed in four districts (Bogra, Dhaka, Chittagong and Narshingdi)
 - SME: 223 enterprises (with less than 100 employees)
 - LSE: 39 enterprises (100 and above number of employees (represented the 'comparison' group))
 - Of the 262 samples, 37 enterprises (26 SMEs and 11 LSEs) were from BSCIC (comparison group)

NUMBER OF ENTERPRISES SURVEYED BY LOCATION

Division	SMEs	Total
Bogra	56	70
Chittagong	59	60
Dhaka	81	101
Narshingdi	27	31
Total	223	262



Primary Survey Map

Survey Areas





Firm Characteristics

▶ **Most of the firms are registered**

- Most of the enterprises are registered (258 off 262). 50% of the SMEs have trade license from City Corporation
- More than 80% of the SMEs were sole proprietorship-based enterprise, while for LSEs partnership-based firms were more frequent

▶ **Many of the Entrepreneurs are experienced**

- Average years of experience of entrepreneurs were found to be 13.6 years (highest 45 years old enterprise were also located) for all surveyed firms
- About 77.8% enterprises are operating for more than 5 years
- 62% of the 202 reported SMEs came into operation after 2005

▶ **Employment generation capacity of the SMEs is poor**

- For SMEs: ranges between 8 and 85 (on average 22 employees worked in reported 222 SMEs)
- Employment generation capacity of SMEs is found to differ significantly



Firm Characteristics

- ▶ **Educational Qualification of Entrepreneurs is high among the LSEs**
 - 30% of the SME entrepreneurs have either primary or less education
 - Every 3 out of 4 large entrepreneurs have at least a graduation degree
- ▶ **Assets and turnover are disproportionately skewed towards LSEs**
 - 119 SMEs (or more than 50% of the surveyed SMEs) have capital investment below Tk. 5 lakh
 - Average capital investment of the LSEs: Tk. 3.65 crore
 - Capital investment of BSCIC enterprises (37 reported): Tk. 28 lakh; outside BSCIC enterprises (225 reported): Tk. 5 lakh (median value)
 - Annual turnover: SMEs: Tk. 45 lakh; LSEs: Tk. 2.88 crore (median value)
- ▶ **High access to formal credit is evident**
 - 66.5% of the surveyed SMEs got access to formal commercial loan; 7.7% from cooperatives and 16.5% money lenders
 - 80.6% of LSEs availed credit through formal lines
 - Outstanding personal loan for business development: 53% of SMEs and 77% of LSEs



General Tax Behaviour

- ▶ **Firms, by and large, are tax compliant**
 - 96% enterprises were either direct or indirect tax payers
 - Low level of responses observed in case of payment of property taxes and/or land revenue
 - Large variations were observed in terms of payment of taxes by enterprises
- ▶ **Overall perception and experience as regards tax was rather unsatisfactory**
 - 80% either strongly or moderately agreed that structure of tax was not favourable for businesses (numerous types of taxes and procedural complexities)
 - Multiplicity of taxes has multi-dimensional adverse impacts (harassment, increased cost, waste of time)
 - Competency and performance of the tax administration was perceived to be more or less acceptable by the surveyed firms



General Tax Behaviour

▶ **Compliance cost is high**

- Firms need to spend significant amount of money at different stages of operations
- Expenses vary widely depending on differences in size, location and informal understanding for 'unauthorised' payments
- Other tax related costs are burdensome (40% of total tax related costs in 2012)
- Tax related expenses are much higher for large firms. Large firms maintain formal ledger

▶ **Firms are not willing to become formal**

- 70% of the surveyed firms are not interested to get tax benefits: mainly to avoid hassles and high costs related to compliance requirements

Theme 1 Findings
Impact of Tax Exemptions and Concessions
on Enterprise Development



Observations as regards Tax Exemption and Concessions

- ▶ According to survey data, majority of the firms (78%) do not enjoy significant benefits of tax exemptions and concessions
 - Tax related benefits help the firms to reduce production cost and make them competitive both locally and in the international market
 - As there is lack of government initiative, SMEs are not bothered about tax payment and compliance
- ▶ Tax exemptions and concessions and other tax related benefits have disproportionate impact on different categories of firms
 - SME's are facing bias in terms of tax exemptions and concessions which impact on the firm's performance
- ▶ Respondents are divided in their perceptions on the biasness of tax exemptions and concessions for SMEs
 - Bias against SMEs may be found in case of getting access to various kinds of financial and non-financial benefits
- ▶ 47% of the surveyed SMEs got exemption only on VAT (in the form of 'package VAT')
 - Large firms generally enjoy tax holiday



Recommendations

- ▶ From the survey responses, major proposed changes include reduction of tax rates (35%), provision of tax exemption (30%) and tax holiday (17.0%) making rules easier (17.0%) and tax concessions (14.0%). Other major required changes include easy loan process and tax payment procedure etc.
- ▶ Entrepreneurs also require assistance from the Government for simplification of taxation system
- ▶ Entrepreneurs require assistance for SME development to access easy loan (54%), to avail low interest credit (28%), and to access land to set up firms (11%)

Theme 2 Findings
Impact of VAT on Enterprise Development



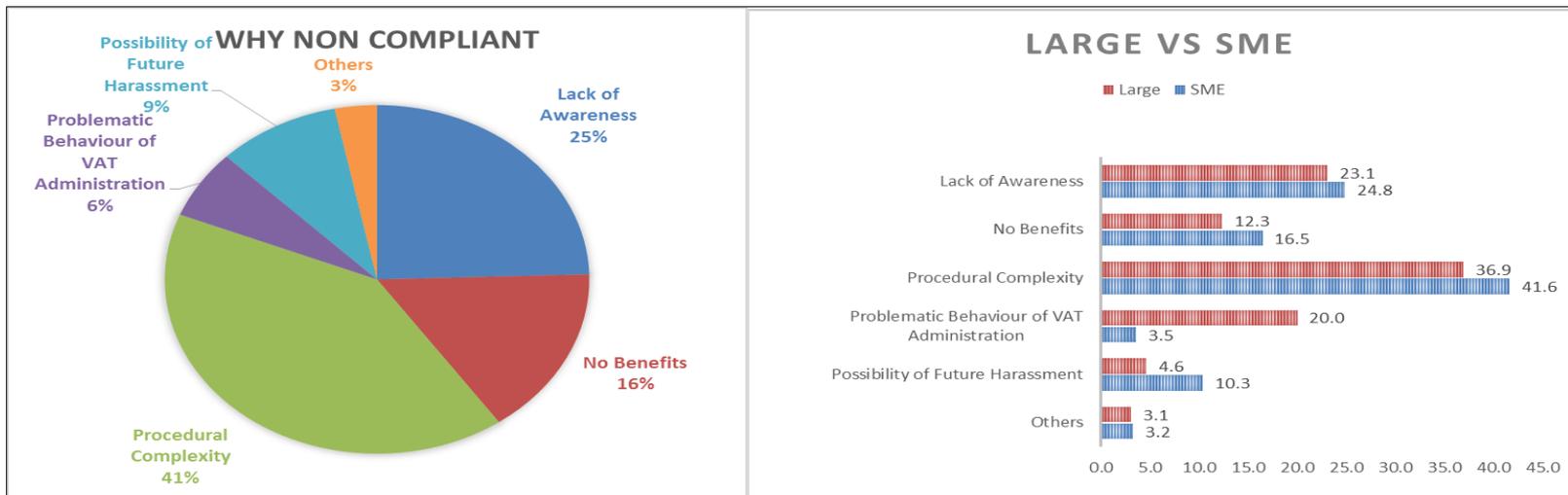
Observations as regards VAT Compliance

- ▶ The present VAT regime in Bangladesh does not adequately address the issues concerned by the SMEs
- ▶ VAT registration, compliance cost and amount of VAT paid by the SMEs are not significant compared to large firms
 - Only 54% SMEs are registered to VAT authority (223 SMEs)
 - SMEs took on an average five and half years to become VAT registered after their inception
 - Annual average VAT paid by an SME in 2012 was only Tk. 19,000 (median value)
- ▶ The compliance cost of VAT was found not to be burdensome for SMEs. The fact was also evident in Survey data, KIIs and FGD
 - Average annual cost of VAT compliance is about Tk. 3,000. For some capital intensive SMEs, it was as large as Tk. 20,000 per month
- ▶ Survey results found there is growing VAT compliance in recent times in SME sector. However, KIIs responses does not reflect this



Observations as regards VAT Compliance

- ▶ Special provisions of VAT and issues regarding double taxation for SMEs did not get adequate focus in the survey findings. KIIs and FGD highlighted the fact with importance
- ▶ The survey data explored the general reasons for being non-compliant (i.e. procedural complexity, lack of awareness building, complex rules, possibility of harassment etc.)
- ▶ However, KIIs and FGD findings identified some additional causes (i.e. bargaining capacity of SMEs, variety of products etc.)





Observations as regards VAT Compliance

- ▶ Perception towards VAT policy and tax officials were found to be 'indifferent' from the survey data, KIIs and FGD
- ▶ There was a clear knowledge gap as regards the new VAT law



Recommendations

- ▶ **The forthcoming new VAT regime needs to recognise SMEs with an explicit definition in the VAT law**
- ▶ **VAT related act and rules need to incorporate SME related special provisions in a clear and well-articulated manner**
- ▶ **The VAT laws and procedures are often found to be complex. A more targeted effort will be required to identify and simplify these**
- ▶ **Tax administration needs to ensure better service delivery to SMEs**
- ▶ **Tax administration will need to ensure fair enforcement of the provisions to establish a level playing field for compliant SMEs**



Follow up of the New VAT Law

- ▶ **Some of the major areas of concern include:**
 - single rate (15 per cent) and abolition of truncated value base;
 - discontinuation of package VAT;
 - significant expansion of documentation requirement; and
 - additional powers vested in tax authorities to recover tax arrears, including freezing of a tax debtor's bank accounts
- ▶ **The VAT rates in Bangladesh remain too high - needs to be adjusted**
- ▶ **The new VAT and SD Act will have provision of automated *VAT challan*. There should be alternative mechanism for small traders for compliance**
- ▶ **Procurement of the software, hardware and networking materials for planned integrated VAT administration system was not completed by June 2015**
- ▶ **The (revised) ACT will come into effect from 1 July 2016**
- ▶ **The new VAT law needs to be amended in such a way which will promote the interest of SMEs with a view to support investment, economic growth and employment**
- ▶ **At the same time, social and economic equity and justice need to be ensured**

Theme 3 Findings
Impact of Property Tax on Enterprise
Development



Observations as regards Property Tax

- ▶ **Property tax rates are very low in Bangladesh and is collected in the form of land tax or holding tax**
 - It hardly has any impact on SME business development
- ▶ **Level of property tax compliance is considerably low**
 - 37.1% SMEs and 41.5% of large firms are compliant as regards property tax
 - SMEs pay annual property tax of around \$2.50 to \$1,560 with an average of \$60, whereas large firms pay around \$40 to \$875 with an average of \$260
- ▶ **Value of property is used as a criteria for property tax valuation**
- ▶ **Property tax payment plays an important role in selection of business location**
 - The type of property a firm operates in, also affect its decision to develop/expand business
- ▶ **Capacity of Property Tax Administration was perceived to be poor.**
 - Only 22.4% of the respondent firms perceived the property tax administration capacity as either very poor (1.2%) or poor (21.2%)



Observations as regards Property Tax

Key Weaknesses identified in Current Property Tax Systems from KIIs

Valuation

- ▶ The official land price list is not updated very regularly
- ▶ Lower “shown price” compared to the actual “paid price” (to evade tax and fee)
- ▶ Higher “shown price” (helpful for loan application)
- ▶ Increasing price of land are no longer affordable for SMEs

Administration Capacity

- ▶ Irregular property tax collection
- ▶ Low awareness and knowledge level among the SMEs.
- ▶ Unaccounted wide range of economic activities under the tax system specially in rural areas



Observations as regards Property Tax

Record-keeping

- ▶ Financial recording and reporting costs are insignificant as property tax payment is infrequent

High Compliance Costs

- ▶ Compliance cost in relation to property tax is 'to some extent' visible. But in other areas the toll/rent paid by small entrepreneurs/ businessmen are minimum
- ▶ Acquisition of land without dispute is difficult

Anti-commercial Bias in Tax Rates

- ▶ Discriminations among shopkeepers by charging same amount of toll/rent without considering the sales volume



Recommendations

The following suggestions were made from the FGD

Valuation

- ▶ Tax officials may find out location specific real transaction value of various real estate properties at a regular interval and update regularly
- ▶ Digitisation of lands and ensuring its online availability

Administrative Capacity

- ▶ Competency of human resources in the tax administration and incentives for collection of taxes to improve administrative capacity

Record-keeping

- ▶ Digital mapping of all lands, mentioning the last transaction value and linking the NID (National Identification) of the land owners to improve record-keeping

Compliance Costs

- ▶ Property tax compliance cost is not burdensome unless the possibility of double taxation from dual administration. This needs to be addressed



THANK YOU

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