Taxing the Digital Economy

Trade-offs and Opportunities

Presentation by

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Key Points for Discussion

- ❑Section 1: Context of the Discussion
- ❑Section 2: Bangladesh’s Digital Economy Landscape
- ❑Section 3: Taxing the Digital Economy in Bangladesh: Current State and Emerging Opportunities
- ❑Section 4: Cross-country Experiences with Digital Economy Taxation
- ❑Section 5: Suggested Policy Initiatives

Section 1: Context of the Discussion

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- The Government of Bangladesh (GoB), justifiably, is giving emphasis on **Digital Bangladesh** towards transition to **Smart Bangladesh**. Indeed, increasingly more segments of the economy are coming under the net of the digital economy.
- From domestic resource mobilisation vantage point, this has two important implications:
  - **Take advantage of digitalisation** to enhance opportunities of fiscal mobilisation.
  - Bring increasingly larger part of the **digital economy under the tax net** towards higher Domestic Resource Mobilisation (DRM).
- This paper argues that now is an appropriate time both to make the digital economy **work towards fast pacing the growth of the economy through targetted support**, and, taking advantage of this, **to explore the frontiers of taxing the digital economy** from a forward-looking perspective.

Section 1: Context of the Discussion (contd.)

- In the current context, issues of taxing Bangladesh's digital economy have emerged as an important area of policy interest, for several reasons.
  - ***Firstly,*** Bangladesh's **low tax-GDP** ratio calls for search for expanding the tax base and exploring new domestic resource mobilization avenues. Indeed, Bangladesh has the lowest tax /revenue-GDP ratio among the countries in developing world.
  - ***Secondly,*** as part of the IMF Programme, Bangladesh will be required to raise tax-GDP ratio from the current 7.8% to 9.4% over the next 3 years (requiring an additional tax mobilisation of about **BDT 234.0 thousand crore** by FY2026).This will demand an energetic search for new avenues of taxation. This adds an urgency to the issue of exploring avenues of new taxation.
  - ***Thirdly,*** The periodic **re-estimation of National Income** by the Bangladesh Bureau of Statistics (BBS) brings many new services within the ambit of the National Income. However, these are not reflected in revenue mobilisation figures. The fiscal authorities need to take cognisance of this broad-basing of the economy from the perspective of taxation.
  - **Fourthly,** there are **definitional ambiguities** concerning what constitutes digital economy, which **appropriate HS code** to put in, and conflicting views persist as to what part of the digital economy should be brought under taxation.

Section 1: Context of the Discussion (contd.)

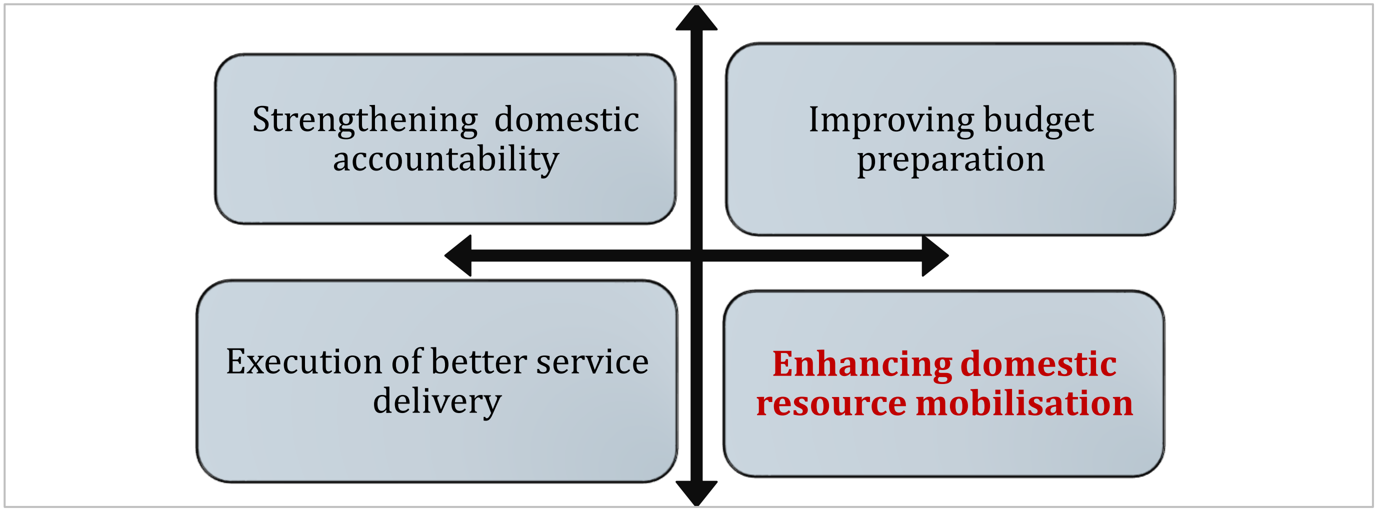
- ***Fifthly,*** given the growing presence of **non-resident digital service providers** in Bangladesh's digital scenario, and their practices in areas of income **transfer and tax payments**, there is a need to examine carefully as to how to deal with the attendant concerns in this regard to remove anomalies and raise taxes.
- ***Sixthly,*** a number of IT-enabled services (ITES) are at present allowed to operate under income tax exemption (28 in all, to be effective till June, 2024). **Policymakers will need to soon take a decision** in this regard.
- ***Seventhly,*** Bangladesh will need to monitor the **developments in the WTO** as regards the decision on ending the moratorium on customs duties on e-transmission and strategies accordingly.

- At the same time, one will need to **carefully weigh the trade-offs** in taking decision on digital economy taxation: issues of protection of import-substituting activities, infant industry argument, short-term versus medium-term interests of the sector, and concerns as regards sustainability, competitiveness and profitability of Bangladesh's enterprises and entrepreneurs will need to be taken into cognisance.
- Issues of **Sequencing, Phasing and Pacing**.

Section 1: Context of the Discussion (contd.)

- For sustaining and accelerating Bangladesh's economic growth momentum, the importance of raising DRM capacity can not be overemphasised.
- In recent years, the Government of Bangladesh (GoB) has been implementing the **Public Finance Management (PFM) Reform Strategy (2016-2021)** and **PFM Action Plan (2018-2023)** to institutionalise past achievements and strengthen PFM practice in Bangladesh. The idea was to raise DRM capacity of the economy to attain national development goals: **post-COVID recovery, 8th Five Year Plan, smooth and sustainable Dual Graduation (Middle Income and LDC, wholesome delivery of SDGs (2030), achieving high-income status (2041).**
- Major components of the PFM (Figure 1) are Improved fiscal governance and Higher domestic resource mobilisation.

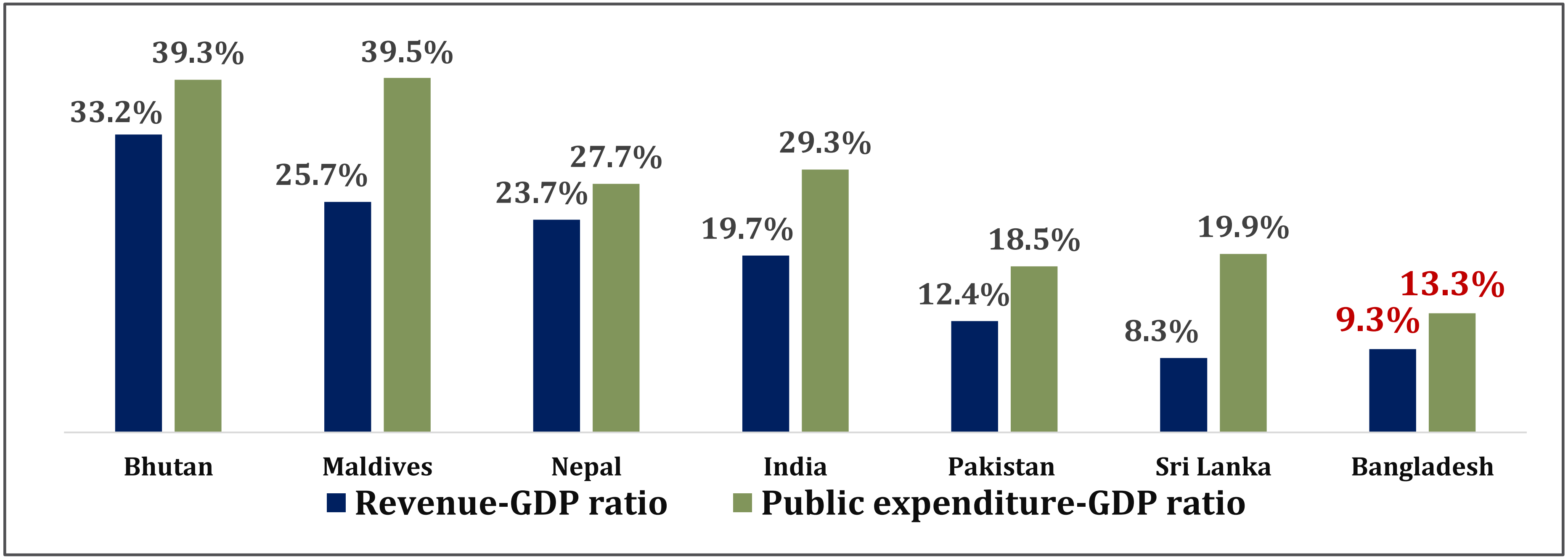
Figure 1: PFM Goals



Section 1: Context of the Discussion (contd.)

- As is well-known, Bangladesh has the **lowest Revenue-GDP ratio and Tax-GDP ratio** in South Asia (as also among the countries of the developing world). Consequently, the **public-expenditure-GDP ratio** has also remained at low levels, underpinning Bangladesh's low capacity to spend money for its urgent development needs (Figure 2).

Figure 2: Revenue-GDP and Public Expenditure-GDP ratio of South Asian Countries



Source: Authors' visualisation from MoF (2022) for Bangladesh; for other South Asian countries data have been extracted from the World Economic Outlook Database (IMF, 2023)
Note: The above-mentioned ratios for south Asian countries are for 2021 and for Bangladesh FY2020-21.

- **In fact, Bangladesh's tax-GDP ratio was 7.6 % in FY2020-21 (MoF,2022).**

Section 1: Context of the Discussion (contd.)

- Despite setting high revenue and tax collection targets in various policy plans, Bangladesh has consistently failed to meet them. For instance, the **tax-GDP target set in the 7th Five Year Plan (FYP) for FY2019-20 was 14.1%** (GED,2020), but the **actual ratio indeed came down, and was only 7.0%**(MOF, 2022).
- The **8th Five Year Plan** aims to implement reforms and policies to achieve fiscal consolidation and expand the tax base, with the goal of raising tax revenue to **12.3% of GDP by FY2024-25** (GED,2020).
- IMF Country Report No. 23/66 (IMF, 2023) makes the observation that **extensive tax exemptions, complicated tax codes, and weaknesses in revenue administration** have resulted in low tax productivity across all major taxes in Bangladesh.
- In view of USD 4.7 billion loan recently negotiated with the IMF , the recommendation (IMF,2023) is to raise the tax revenue by 0.5 % of GDP annually in FY2023-24 and FY2024-25 and 0.7 % in FY2025-26 (Table 1). This would call for raising **an additional BDT 234.0 thousand crore** by FY2025-26 which is **two-thirds more than** the current fiscal year's tax collection target.

Table 1: IMF Tax Projection

(as % of GDP)

	Estimated		Projection			
Indicators	FY21	FY22	FY23	FY24	FY25	FY26
Total revenue and grants	9.4	8.7	8.8	9.3	9.7	10.3
Of which: Tax revenue	7.6	7.8	7.8	8.3	8.8	9.4

Source: IMF Country Report No. 23/66 (IMF, 2023)

Section 1: Context of the Discussion (contd.)

- **A study by the NBR in 2020** revealed that widespread tax exemptions are a key reason for the low tax-GDP ratio in Bangladesh. These exemptions amounted to **BDT 250.0 thousand crore** in FY2019-20, and that if these were not there, the tax-GDP ratio would be equivalent **to about 17% of GDP**. The point, however, is that these incentives should have generated the capacity to generate more taxes for the country which has not happened in Bangladesh.
- To measure the impact of tax exemption on government revenue source, the Indian government started publishing **the Statement of Revenue Forgone back in 2006**. In India, forgone tax revenue was equivalent to **5.7% of GDP in FY2005-06** and **1.4% of GDP in FY2020-21**, at the same time tax/revenue-GDP ratio went up significantly. **However, this didn't have any negative impact of their tax collection.**
- All the above factors call for a fresh examination of the opportunities to broaden and deepen DRM through taxation. **The issue of taxing the digital economy has gained heightened attention, relevance, and importance in the backdrop of expansion of the digital economy in Bangladesh.**
- As is known, in recent years, the digital economy in Bangladesh has grown at a very fast pace, thanks to easier internet access and the use of digital technologies. This growth has led to the emergence of **various e-commerce and F-commerce enterprises, startups, and businesses**, creating employment opportunities and income windows, and contributing importantly to Bangladesh's GDP growth.
- **Various policy supports and a host of fiscal-monetary incentives** have combined to contribute to trigger this spurt in the digital economy-centric activities in the country.

Section 2: Bangladesh's Digital Economy Landscape

Section 2: Bangladesh's Digital Economy Landscape

Conceptualising the Digital Economy

- The digital economy landscape has changed the way businesses operate and how customers interact with other businesses. Indeed, **trade in goods and digital services have become closely entwined** to become a critical element of competitiveness. This has particularly been the case in Bangladesh over the last decade following the rapid expansion of the internet.

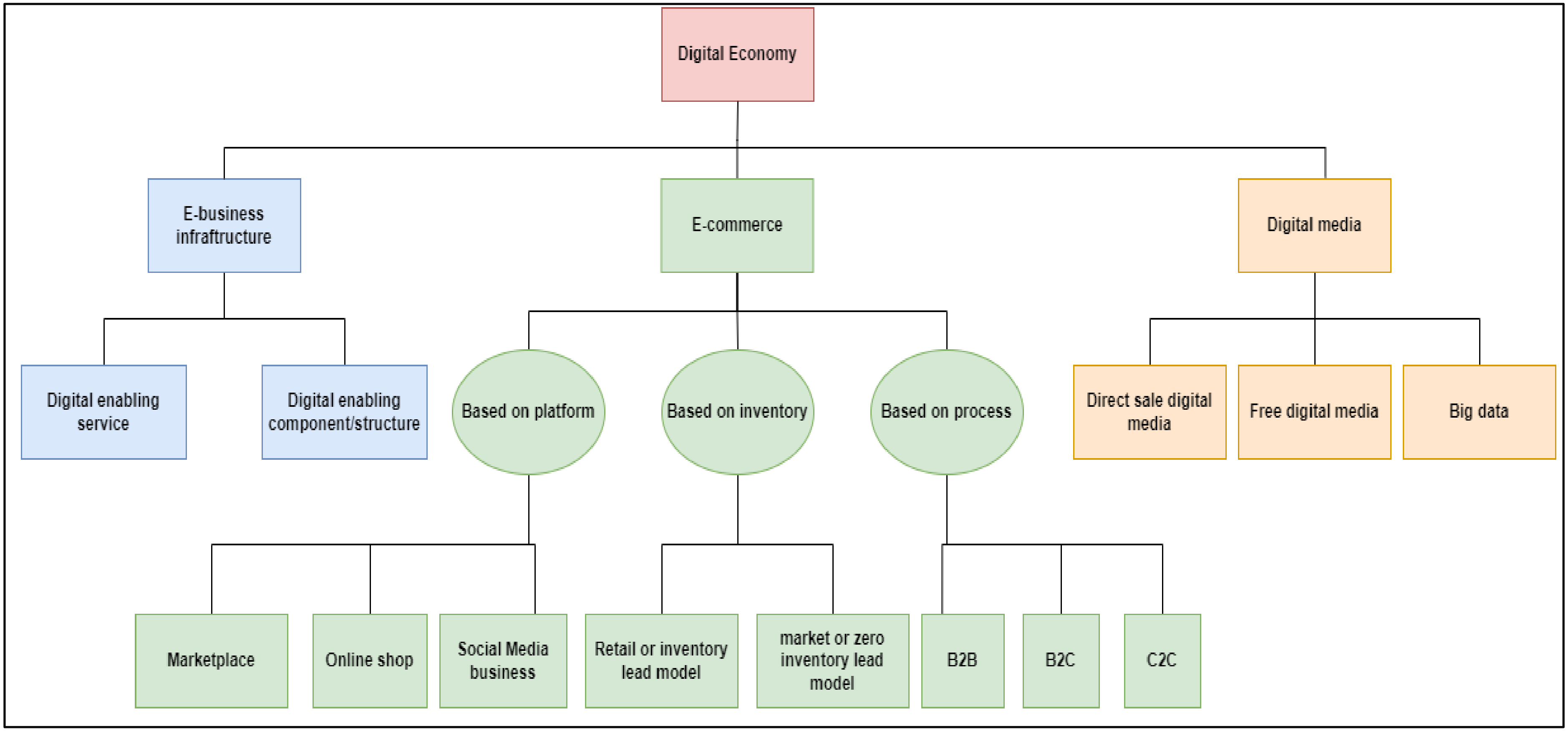
- According to Organisation for Economic Cooperation and Development (OECD, 2017), the dimension of the digital economy can be categorised into three groups: (a) **Nature** (how)- Platformed enabled, digitally ordered, digitally delivered; (b) **Product** (What)-Goods, Services, Information; (c) **Actor** (who)-Business, Consumer, Government, Startups.

- US Bureau of Economic Analysis's definition includes (i) the digital enabling infrastructure required for a computer network to exist and function ("**e-business infrastructure**"); (ii) the digital transactions that occur using that system ("**e-commerce**"); and (iii) the content that users of the digital economy generate and access ("**digital media**").

Conceptualising the Digital Economy

- Figure 3 shows the **components of Bangladesh's digital economy**, with e-commerce and F-commerce businesses being prominent, while sectors such as big data still remain in its infancy.

Figure 3: Digital Economy Architecture in Bangladesh



Source: Adapted from Barefoot et al. (2018) , US Department of Commerce Bureau of Economic Analysis (BEA)

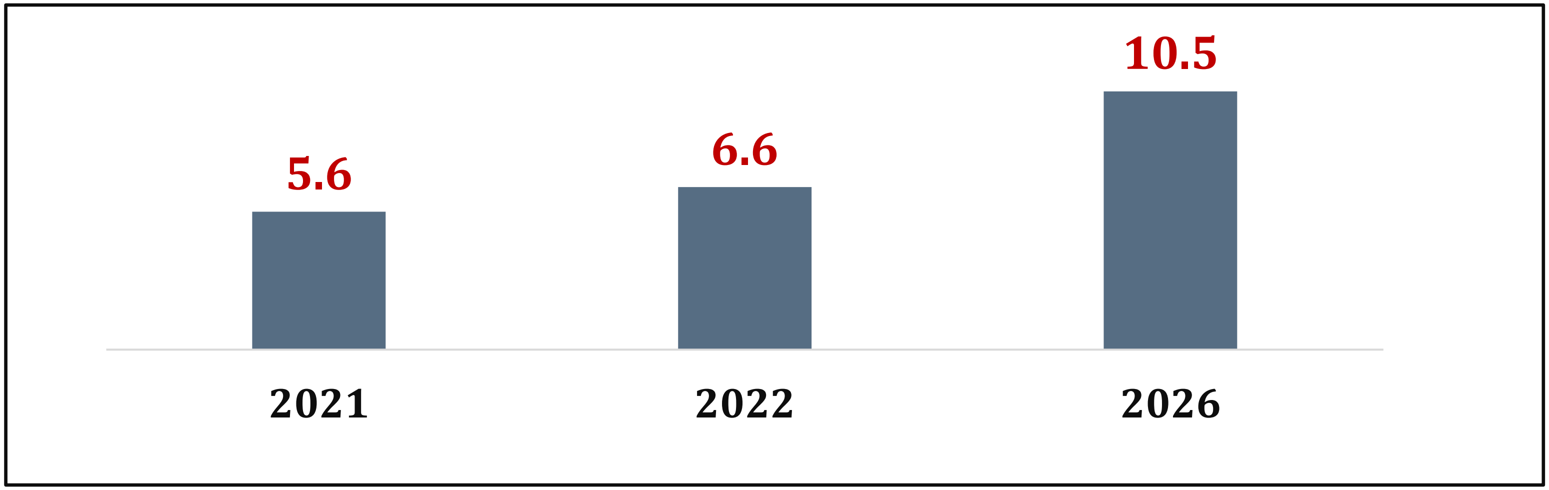
Section 2: Bangladesh's Digital Economy Landscape (contd.)

Growing Digital Economy Business

- **The digital economy landscape of Bangladesh includes three components**: primarily **domestic market-oriented** (e.g., e-commerce, F-commerce, ITES); **interface with global market** (e.g., export of digital services, freelancing service); the **presence of digital-platform-based global business in Bangladesh** (e.g., Facebook, Google etc).
- According to Bangladesh B2C Ecommerce Market Report 2022 (Research and Markets, 2022), The B2C (Business to Consumer) **e-commerce market in Bangladesh was estimated to be about USD 6.6 billion in 2022 and expected to reach USD 10.5 billion in 2026** (Figure 4).

Figure 4: E-commerce Market Size in Bangladesh

(figure in USD billion)



Source: Research and Market (2022)

Note: CARG 12.3% between 2022-2026

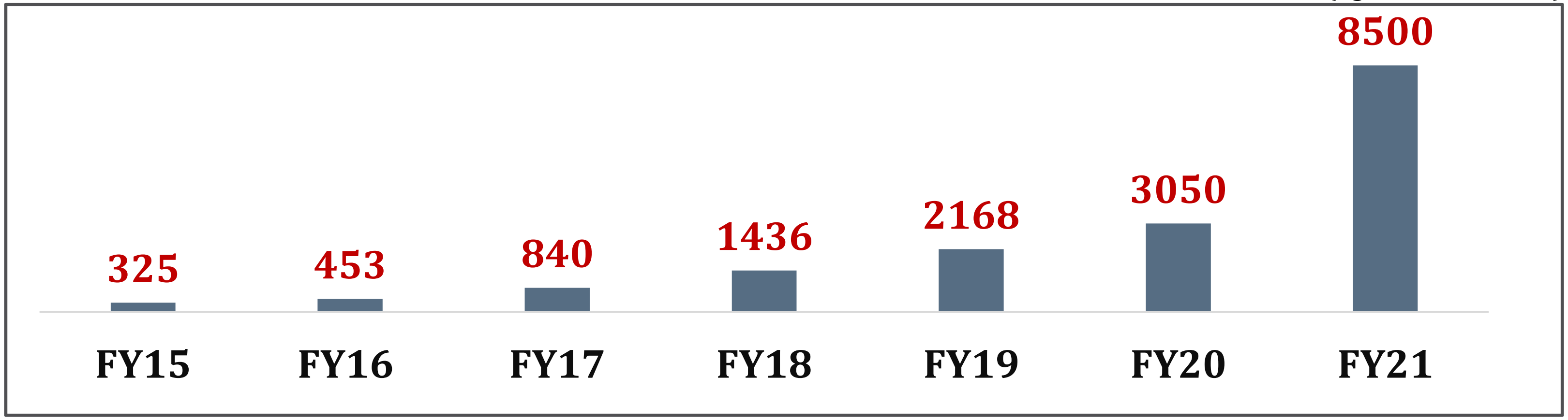
Section 2: Bangladesh's Digital Economy Landscape (contd.)

Growing Digital Economy Business

- According to the e-Commerce Association of Bangladesh (e-CAB), Bangladesh has over **2,500 e-commerce platforms,** of which 1.0% are large, 4.0% are medium, while the overwhelming majority, 95.0%, are small-scale ones(e-CAB,2021). e-CAB had about 2 thousand members.
- It is interesting to note that e-commerce in Bangladesh has experienced a significant increase of **approximately 50.0% during the COVID-19 pandemic**, as compared to a growth rate of 25.0% in the pre-pandemic period (e-CAB,2021).
- **The F-commerce market size in Bangladesh is also rising fast**; Facebook page owners earn, on average, between BDT 10 thousand to BDT 100 thousand per month (IDLC, 2019).
- According to the Statistics department of the Bangladesh Bank, in recent past years, **card-based e-commerce transactions have been increasing at a very fast rate** (Figure 5).

Figure 5: Card-based E-commerce Transaction Statistics

(figure in BDT crore)



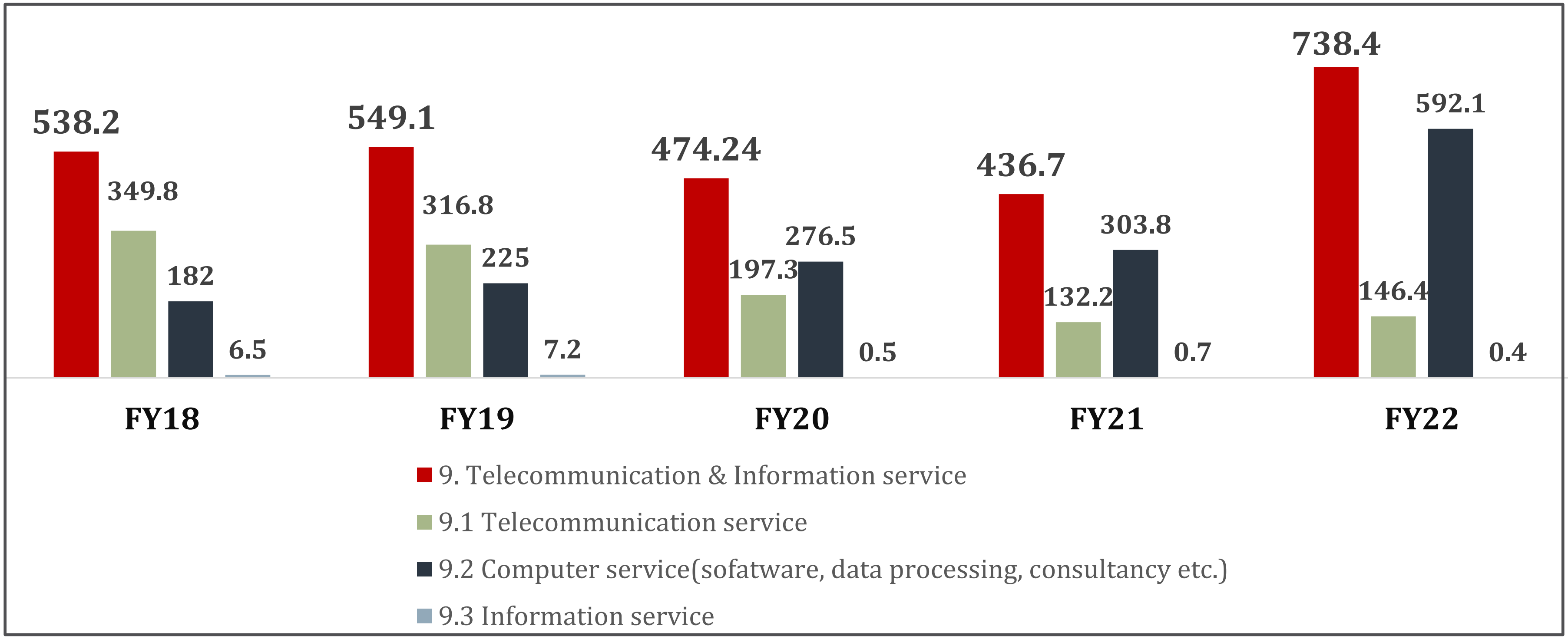
Source: Bangladesh Bank Time Series Data

Growing Digital Economy Business

- The GoB has declared ICT as a priority sector in its policies. Indeed in 2022, "ICT Product and Service" was declared as "**Product of the Year**". The GoB has set the target of **exporting USD 5.0 billion** worth of IT products and services by 2025.
- **Local IT companies saw their export earnings of computer service shoot up 95% year-on-year** to USD 592.1 million in FY 2021-22 (Figure 6).

Figure 6: Export Value of ICT goods and Services of Bangladesh

(figure in USD million)



Source: Export Promotion of Bureau (EPB)

Section 2: Bangladesh’s Digital Economy Landscape (contd.)

Growing Digital Economy Business

- Bangladesh is emerging as an important hub of software products. According to BASIS Software and IT Service Catalogue (BASIS, 2021), Bangladesh has **4,500 Software and ITES companies**; **over 400 companies export to 80 countries**.
- Annual IT export revenues is estimated to be about **USD 1.3 billion in FY2020-21** (BASIS, 2021). This estimate, however, is considerably higher than the estimate of the EPB.
- Business Process Outsourcing (BPO) industry started its journey in Bangladesh in 2009 and maintained a **20.0 % growth year-on-year** to reach about **USD 300 million in 2017** (LightCastle, 2020).
- The **Bangladesh Hi-Tech Park Authority (BHTP)** aims to attract high-tech industries, create jobs, by offering an investment-friendly environment. **BHTP currently has 10 parks and 134 investors** as of March 2023 (BHTPA, n.d). Companies are expected to invest BDT 2400 crore by 2025, with BDT 327 crore already invested in the parks by 2020 (BHTPA, 2022).
- **Bangladesh is the second largest supplier (approximately 36,800 freelance workers)** at 14.3 percent, behind India's 18.4 percent (Gig Economy Data Hub, Sep. 2022). **Bangladesh ranks 8th among the top 10 countries for freelancing income** with a growth rate of 27%, while India ranks 7th with a growth rate of 29% (Payoneer, 2019).

Section 2: Bangladesh’s Digital Economy Landscape (contd.)

Growing Digital Economy Business

- BIDA estimates earnings from freelancing to be at USD 100 million while BASIS estimate talks of USD 250-300 million; however, accurate data is difficult to obtain **due to the absence of widely accepted payment gateways** such as PayPal in Bangladesh.
- In recent past years, **non-resident tech giants(Facebook, Google, Amazon, etc.) are expanding their reach in Bangladesh** and this trend is expected to continue in future. Bangladesh is one of **the top three countries** where people are most active on **Facebook**. India and Philippines hold the first and second positions respectively.
- According to sector insiders and the Association of Television Channel Owners(ATCO), **digital ad spaces receive commercial ad worth at least BDT 2,000 crore from Bangladesh** through Facebook, Google, Amazon, and other internet-based firms every year.
- As reported by **BTRC in June 2019,** in response to a High Court Order, **five mobile phone operators of Bangladesh paid internet-based firms including Google, Facebook etc. BDT 8,750 crores in advertisement revenue over five years**. However, a report by NBR mentioned an amount of only about BDT 133 crore.
- There has been a noticeable growth in the use of OTT (Over-The-Top) streaming platforms in Bangladesh.
- In Bangladesh revenue from **OTT video streaming platforms** is projected to reach **USD 152.7 million** in 2023 and the number of users is projected to reach **11.3 million by 2027** (Statista, 2023).

Section 2: Bangladesh's Digital Economy Landscape (contd.)

Growing Digital Economy Business

- **Netflix has around 200 thousands active subscribers** in Bangladesh with earnings of about **BDT 200 crore** as subscription(pi STRATEGY, n.d.). There is a rise in local OTT platforms like Chorki, Bioscope, Toffee etc.
- With the rise of access to digital financial products and services, the **Mobile Financial Service (MFS)** sector of Bangladesh has also been on a steady rise in recent years. **Presently, there are 13 MFSs providers in the country.**
- The growth of the digital economy in any country depends on the availability**, usage of the internet, smartphone, and computer**. No doubt, development of information technology and the various associated tools have contributed to this significant rise in the digital economy players in Bangladesh over the recent past years.
- However, **number of internet users in Bangladesh is still relatively low.**While in terms of **mobile data pricing Bangladesh fares well**, the **low internet speed** means that the actual costs turn out to be relatively high.

Section 2: Bangladesh’s Digital Economy Landscape (contd.)

Government Policy Regarding Digital Economy

- The GoB has set the ambition of making Bangladesh a **digital economy by 2021** and a **knowledge-based economy by 2041**. Several Policy plans of the GoB highlight the potentials of the digital economy in Bangladesh as a step towards Smart Bangladesh.
- The GoB has initiated various policies to stimulate the digital economy: **'Made in Bangladesh' Policy for digital devices, upgrading of National Broadband Policy, National Digital Commerce Policy, and National Policy for Start-ups**. However, some of the deadlines have already been missed as the 8th FYP crosses the halfway line.
- **The Perspective Plan of Bangladesh (Vision 2041) aims to broaden the tax base, raise direct and indirect taxes through rationalization and reforms, strengthen professional and technical capacities of revenue administration**, combat tax evasion, and provide effective services to taxpayers to improve tax compliance.
- The **Ministry of Commerce's WTO cell** developed the **National Digital Commerce Policy 2018** to expand digital commerce in Bangladesh, and the government has implemented measures such as **online payment of taxes**, opportunities for digital commerce investments, and digitizing all trade.
- To achieve Vision 2021, **Aspire to Innovate (a2i**) project of the ICT Division has taken several measures, **including launching of Ekshop**. **A2i aims to accelerate** the digital transformation of cottage, micro, small, and medium enterprises **(CMSMEs)** and promote **rural e-Commerce**.

Section 2: Bangladesh’s Digital Economy Landscape (contd.)

Government Policy Regarding Digital Economy

- **The National ICT Policy 2018** aims to increase domestic capacity in Bangladesh's ITES sector by establishing high-tech parks and providing tax incentives such as tax holidays, reduced tax rates, and incentives for software technology and hi-tech park investments. Local entrepreneurs in hardware, software, and ITS sectors are exempt from income tax until 2030, and local exporters receive cash incentives until the same year.

- The MoC issued the **Digital Commerce Operation Guidelines, 2021** to ensure transparency and accountability in the digital commerce sector, create employment opportunities, protect consumer rights, and increase reliance on digital commerce by creating a regulatory framework and a competitive market.

- The MoC issued **Digital Business Identification Digit (DBID)** Registration Guidelines 2022. **Online businesses are not eligible to operate without the DBID**. As of February 9, 2023, **473 DBIDs have been issued and 3207 businesses have applied for DBID.**

- The GoB is planning to bring more taxpayers into the net by increasing the number of registered taxpayers to **10 million by 2026** and installing another 300 thousand electronic fiscal devices (EFD) over the next five years (IMF, 2023).

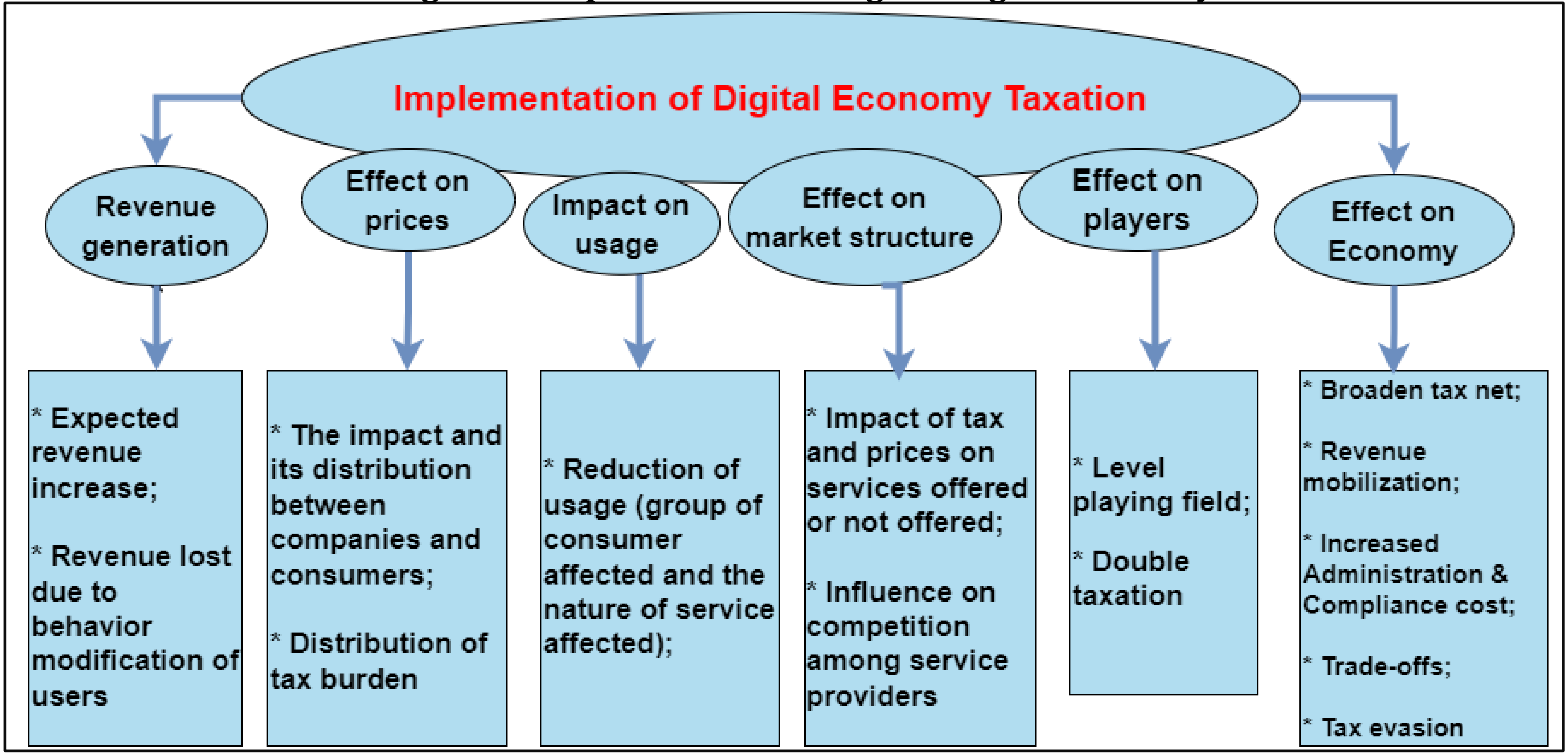
- Thus, one observes that, through various Plans and Programmes, the GoB aims at expanding and deepening the ambit of the digital economy in Bangladesh. Policies are being put in place and exemptions and incentives are being offered to promote the digital economy.

Section 3: Taxing the Digital Economy in Bangladesh: Current State and Emerging Opportunities

Be Cognizant of the Trade-Offs

- When considering digital economy taxation, several competing interests must be considered, including the digital economy's long-term viability, competitiveness, and profitability; protection; the nascent industry argument; the sector's short-term vs. medium-term interests; and others (Figure 7).

Figure 7: Implication of Taxing the Digital Economy

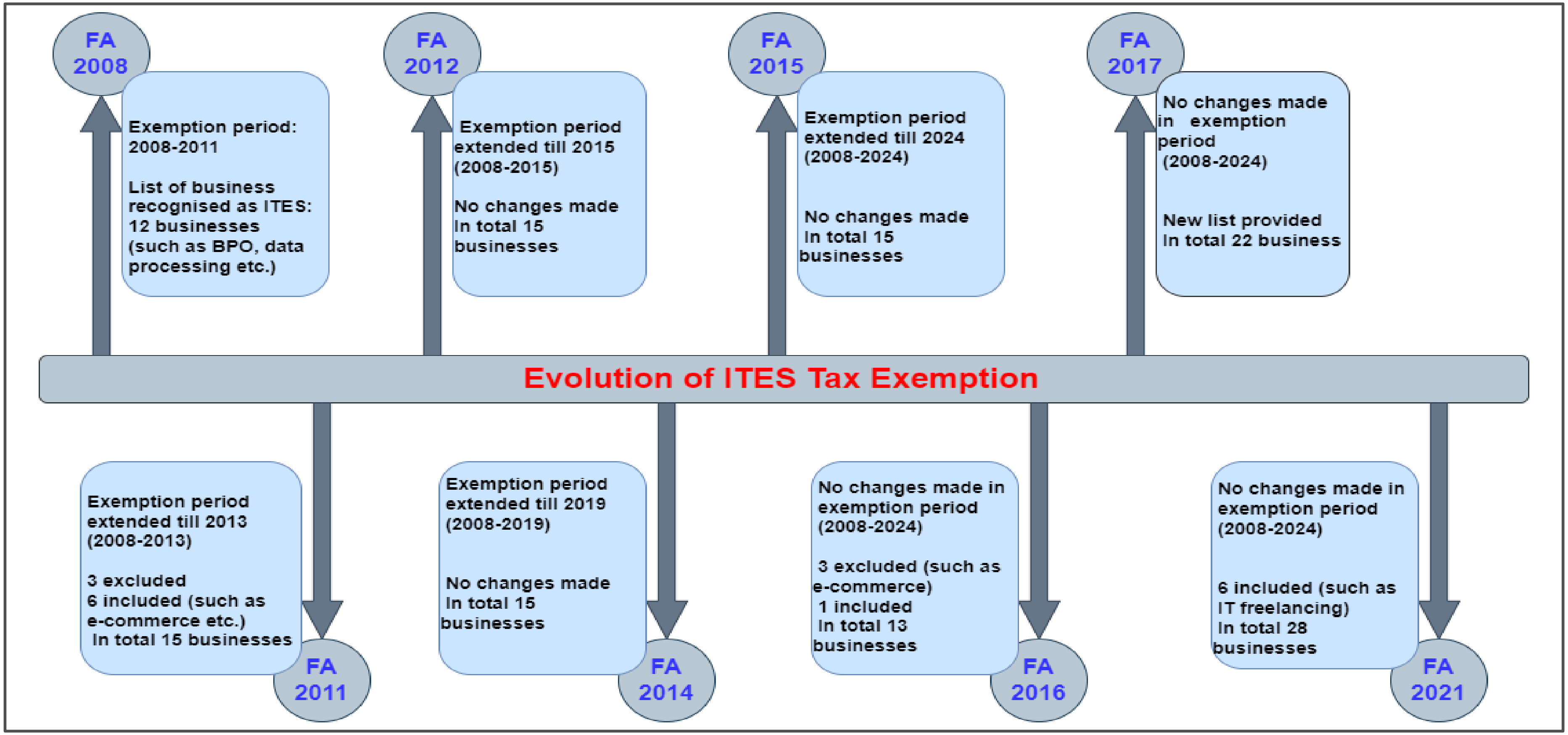


Source: Adapted from Mpofu (2022)

Tracing of ITES Taxation

- Businesses or items listed in the **para 33 of sixth schedule(Part A) of Income Tax Ordinance (ITO) 1984**, known as IT Enabled Service (ITES) have been exempted from paying direct tax on any type of income derived from the ITES business of a person being a resident or a non-resident Bangladeshi. This is to be in place till June 30, 2024. ITES tax exemption provision has undergone notable evolution over the past years (Figure 8) with more inclusion but few exclusions.

Figure 8: Evolution of ITES Tax Exemption



Source: Authors' visualisation based on Finance Act, ITO 1984

Note: FA denotes to Finance Act

Tracing of ITES Taxation

- As of now, **28 businesses** are currently enjoying income tax exemption for several years, ranging between 2 to 15 years (Table 2).

Table 2: Timeline of Businesses Enjoying Tax Exemption for ITES

Year	List of Business under ITES
Since 2008	**8 businesses:** Digital content development and management; Digital animation development; Geographic Information Service (GIS); IT support & software maintenance; Website service; BPO (only IT Process Outsourcing and Robotics Process outsourcing) ; Call centre; Digital data entry and processing.
Since 2011	**4 businesses:** Digital Graphic design; Search engine optimization; Website listing; Document conversion, imaging and archiving
Since 2017	**9 businesses:** Software development; Software or application optimization; National Telecommunication Transmission Network (NTTN); Website development; Website hosting; Software test lab service; Digital Data Analytics, Cybersecurity service; Oversee medical transcription
Since 2021	**6 businesses:** Cloud service; System integration; e-learning platform; e-book platform; Mobile application development service; IT freelancing

Source: Authors' compilation based on the Finance Act

Note: Some definitions as regards the various ITESs have changed over time.

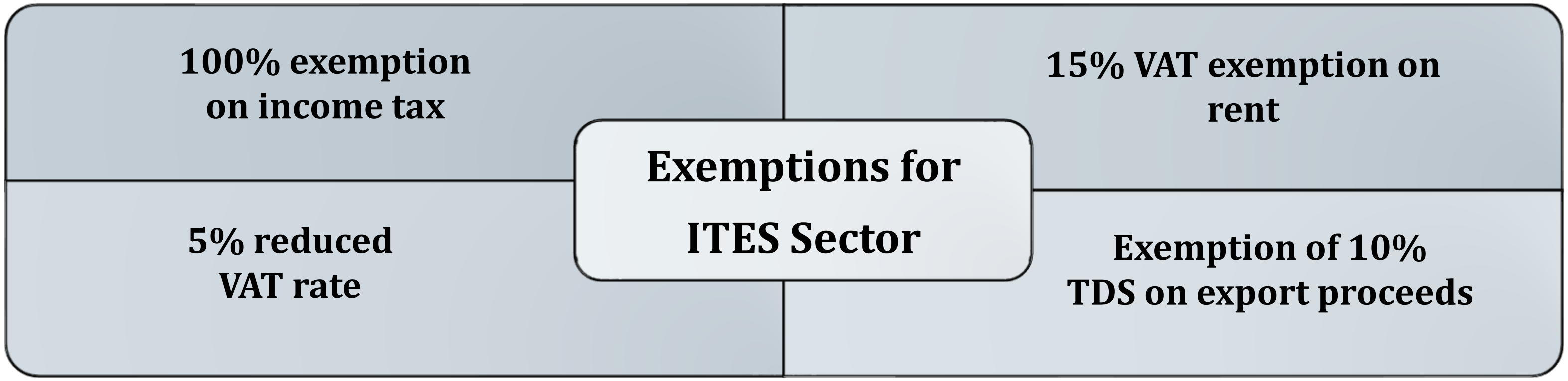
- There is a **lack of clear-cut and precise definitions as regards ITES** and the 28 exempted businesses. As a result, there are instances of **misuse by companies** disguising as ITES to evade the various taxes including the VAT.

Section 3: Taxing the Digital Economy in Bangladesh: Current State and Emerging Opportunities (contd.)

Tracing of ITES Taxation

- Along with the 100% income tax exemption, the ITES sector also enjoys several other tax exemption benefits (Figure 9).

Figure 9: Multiple Tax Benefits for ITES Sector



Source: Authors' visualisation based on ITO,1984; SROs

- An attempt has been made to calculate the revenue foregone owing to the exemption of **10.0% TDS on ITES export proceeds**. Due to the unavailability of the exact amount of export proceeds, export proceeds of the EPB under code 9.2.3- Computer data processing and hosting service (IT-enabled service) have been considered for the calculation of revenue forgone.
- The export proceeds rose from USD 171.6 million in FY2019-20 to **USD 484.4 million in FY2021-22**. **The exempted amount of TDS is estimated to be USD 17.2 million in FY2019-20 rising to USD 48.4 million in FY2021-22.**
- If a 12% tax is imposed on the revenue of the BPO sector, which is a major sub-sector belonging to the tax-exempted ITES sectors, the GoB could have collected approximately **BDT 1860 million between 2018 and 2022**, even if the low figures are considered.

E-commerce Taxation

- Through Finance Act 2011, **e-commerce and online shopping were brought under the net of ITES**, however, these were excluded in Finance Act 2016, with these once again coming under tax net from FY2016-17.
- **Issue of imposing VAT on the e-commerce sector of Bangladesh has raised a great deal of controversy**. The evolution of VAT on e-commerce is depicted in Table 3.

Table 3: Summary of the Evolution of VAT on E-commerce

FY	Vat Rate and explanation
2015-16	4.0% VAT was suggested in the Budget. But it was swiftly rescinded in response to pressure from interested parties.
2018-19	5.0% VAT was imposed. Then in a post-budget discussion, the vat was rescinded by stating printing mistake
2019-20	7.5% vat was suggested on social media and virtual business under Service Code(S0) 79.00. However, SO79.00 has been omitted from VAT and SD act 2012 vide Statutory Regulatory Order (SRO) no.234-AIN/2019/70-VAT.
2019-20	5.0% VAT was imposed on commissions and fees charged by the e-commerce agencies under SO99.60 “Sales of goods through online”.

Source: Authors’ compilation based on literature review.

E-commerce Taxation

- According to General Order No-17/VAT/2019, **any online shop**, ITES, ride-sharing business with SO99.60, SO99.10, and SO 80.00 respectively along with super shop, shopping mall are **required to be VAT registered regardless of annual turnover.**
- According to experts, the SO99.60 relating to VAT on sales of goods and service through Online, is ***narrow***. As per the definition of SO99.60, **it doesn't cover online business carried through Marketplace.** This creates a VAT anomaly between general e-commerce and platform-based e-commerce.
- Through Finance Act 2021, e-commerce exceeding **BDT 1 crore annual turnover** is considered as Tax Deducting Authority. However, **in the ITO, 1984, there is no definition of e-commerce** for income tax purpose.
- Regarding taxation of e-commerce, the e-Commerce Association of Bangladesh (e-CAB) had put forwards several demands such as **elimination of lack of equal treatment between e-commerce and conventional business for purpose of VAT**; proper classification of online marketplace; removal of VAT imposed on the rent of business's office, warehouse etc; bringing the entire VAT system under digitisation; **elimination of the minimum tax rate of 0.60% on gross receipts**; considering e-commerce as TDS authority from 2027; amendment of The Trade License Act 2016 to add "e-commerce" under the types of business category in the trade license.

Non-resident Digital Service Providers Taxation

- According to VAT and Supplementary Duty Act 2012, a **non-resident business not having any physical presence** in the country must have to appoint a **local agent for executing its VAT-related activities**. Such non-resident business entities are to pay VAT at the standard **15.0% on revenue earned locally**.
- It is important to note that, local agents of non-resident digital service providers are supposed to submit VAT returns to the NBR on behalf of their clients, unregistered users (not having Business Identification Number-BIN). Registered users (having BIN) have to pay VAT through dealing banks.
- Till now, **The nine companies have received their BIN identification number** and paid a **VAT amount of BDT 57.72 crore** in FY2021-22 on **total revenue of BDT 384.8 core** in FY2021-22.
- Majority of multinational resident companies, which are registered in Bangladesh, **do not pay advertising fees** to non-resident digital service providers such as Facebook, YouTube, Google, etc. **from their bank accounts held in Bangladesh**. Payment is made by parent companies, which are mostly located in tax havens.
- Another concern relates to **payments made to tech giants through informal channels**. Small online businesses often use Facebook pages or groups to pay for social media boosting services, but these pages pay for the services **using foreign bank accounts**, leading to a loss of significant VAT for the GoB.

Non-resident Digital Service Providers Taxation

- Yet, another concern arises from **violation of the principle of taxation arising from double taxation**. Unregistered small businesses and individuals suffer because of this when they make payments to tech giants through the banking channel and are taxed twice.
- The situation arises when after the tech giants began to **register with the VAT** wing of the NBR and started submitting VAT returns in compliance with the VAT's law.
- As per VAT law, tech giants charge 15% VAT from unregistered customers with the bill charged for the service provided to the customers; when these customers pay the bill, the bank again charges 15% VAT on the total bill as this is considered as an overseas payment. This results in double taxation – payment of about **32.5% as VAT**.
- **At present, Non-resident digital service providers are not under the tax net of the NBR** and hence are not liable to submit their tax returns in Bangladesh and **they don't have any Tax Identification Number (TIN)**. The budget speech for FY2022-23 (MoF, 2022) had proposed removing the exemption from filing income tax returns for those without a permanent establishment in Bangladesh. **Changes will need to be made in Income Tax Ordinance 1984.**

Potential Impact of Withdrawal of Moratorium 1998 in Bangladesh

- Since 1998, as per the decision of the WTO Ministerial Conference (MC), imposition of customs duties on electronic-transmission (ET) has been prohibited. Many developing countries (led by India, China, and others) claim that it is the developed countries that benefit the most from the moratorium (since they are the major exporters).
- According to one estimate, **developing countries lost potential tariff revenue of about USD 50 billion** due to the moratorium between 2017 and 2020 (ThePrint, 2022). Banga (2019) estimated that **India lost about USD 497 million** between 2011 and 2017 because of this.
- India, China, and some of the other developing countries have proposed that the WTO review the moratorium on ET at the time of the MC12. This became a highly debatable issue at WTO-MC12 held in June 2022.
- At the MC-12, WTO members failed to reach an agreement. In the end, the moratorium on ET was extended until **MC13 or March 31, 2024**, whichever comes first. If no agreement is reached, the moratorium was to come to an end and countries will be able to impose customs duties on ET.
- **The present study has estimated the tariff revenue loss for Bangladesh imports of 24 such digitalised goods, following the methodology developed by Banga, 2019**.

Potential Impact of Withdrawal of Moratorium 1998 in Bangladesh

- In the first stage, the study used actual physical import data from 1996 to 2014 to calculate the average annual growth of imports. Following this, the average growth rate was used for purposes of making a linear projection of actual physical imports for the years 2015 through 2021. The difference between the actual physical imports and projected physical imports, for each of these years, for each of the products, was then considered to be the estimated electronic transaction of digitalised goods. By considering applied tariffs for each of the products, tariff revenue loss, both product-wise and total, was estimated for each of the years (Table 4).

Table 4: Estimated Revenue Losses Arising From the Moratorium 1998

(figure in USD million)

Year	Estimated Tariff Revenue Loss using applied tariff (24 products)	Estimated Tariff Revenue loss (All 49 products) *
2017	12.34	20.73
2018	16.24	28.23
2019	21.73	39.84
2020	26.56	55.73
2021	29.86	62.41

Note: For *, import share has been considered as proxy factor following Banga (2019)

Potential Impact of Withdrawal of Moratorium 1998 in Bangladesh

- The magnitude of tariff revenue loss is significant and perhaps represents only a partial picture since these 24 (or 49 products) are not an exhaustive list of products traded through ET. **A more thorough study of the issue is called for to arrive at possible revenue implications**.
- **If the moratorium 1998 is lifted, developing countries which are net importers of ET services will stand to gain through additional tariff income**. However, this could also entail some consumer welfare loss.

Potential Market Opening, Opportunities and Threats

- Bangladesh has a potential opportunity in digital device manufacturing, low-cost manufacturing of digital appliances, and semiconductor design. In view of the ongoing conflict between the United States and China, product diversification seeking **Foreign Direct Investment** (FDI) could play an important role in this regard.
- According to Bangladesh Start-up Ecosystem 2021-2022 (LightCastle, 2023), in 2021, the country has attracted a total of **USD 415 million in startup investment** which was 12.1% of the total FDI flow to the country in the corresponding year.
- The start-up ecosystem in Bangladesh is at **a nascent stage of development** and needs to be supported. Foreign investors face bureaucratic hurdles, weak infrastructure, high costs, and delays in decision-making, a complicated tax system. These obstacles hinder international investment.
- **A number of companies which have set up units in Hi-Tech Park are not able to enjoy tax benefits** since it takes a long time for them to begin production and the tax exemption period often expires before the enterprises start to make profit.
- The tax structure and high fees for cash-out and transactions by platform gateways are seen as obstacles to growth and digitization in Bangladesh's MFS industry. Lowering these fees and revisiting tax rates could boost e-commerce growth and create tax revenue opportunities.

Tax Exemptions, Incentives and Digital Economy

- The GoB has implemented **various tax incentives along with ITES tax exemption** aimed at promoting and facilitating the expansion of the digital economy (Figure 10).

Figure 10: Fiscal Benefits in Digital Economy

SRO-163/Law /Income Tax/ 2021	Companies manufacturing motherboard, casing, UPS, speaker, sound system, power supply, USB cable, CCTV, and pen drive can enjoy a 10-year income tax exemption on the products' earnings if they begin commercial production before June 30, 2030.
FE circular No -03	Exporters of software, IT-enabled services, and hardware receive a 10% cash incentive on the Net FOB value of their exports, except for businesses in Export Processing Zone, Economic Zone, and Hi-Tech Park. It can be questioned under Bangladesh's LDC graduation.
FE circular No -07	Freelancers in Bangladesh, who are not members of BASIS, can receive a 4% cash incentive for exporting software, IT-enabled services, and hardware. This applies to their earnings from 55 endorsed international online marketplaces.

Tax Exemptions, Incentives and Digital Economy

Figure 10: Fiscal Benefits in Digital Economy

Hi Tech Park (HTP)	• Developers in HTPs can enjoy a 10-year income tax exemption, starting with a 100% waiver for the initial 10 years, followed by 70 % and 30 % waivers in the 11th and 12th years, respectively. • Investors in HTPs can receive a tax exemption on their earnings, starting with a 100 % waiver for the initial 7 years and a 70 % waiver for the 8th to 10th years
Economic Zone	Developers and investors enjoy tax exemption on business income for a period of 12 and 10 years respectively, starting from the date of commercial operation. The exemption reduces gradually for developers – 100 % for the first 10 years, 70 % for the 11th year, and 30 % for the 12th year.
Start up Sandbox	The Finance Act 2022 provides exemptions and incentives to support the growth of startups, including carrying forward business losses for nine years, a minimum tax rate of 0.1%, and reduced reporting obligations if the company grants access to its system and records to the tax authority.

Section 4: Cross-Country Experiences with Digital Economy Taxation

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- OECD's MC 1998 had come out with the conclusion that the **same five tax canons (Neutrality, Efficiency, Certainty and Simplicity, Effectiveness and Fairness, Flexibility)** that apply to conventional commerce should also apply to the digital economy.
- Several challenges raise questions about whether the current international tax framework is appropriate for the digital economy and **the allocation of taxing rights between source and residence jurisdictions**.
- OECD (2015) has developed options to address direct tax issues of the digital economy-(i*) **A nexus based on the concept of Significant Economic Presence (SEP)*** ; (ii) ***Withholding tax on digital transaction****;* (iii) ***Introducing an Equalisation Levy (EQL).***
- India was the first country to adopt all the tax measures suggested by OECD for the digital economy taxation (Table 5).

Table 5: Indian Policies as Regards Taxing the Digital Economy

Year	Provisions
2016	India was the first country to impose EQL at a rate of 6.0% on Indian-sourced earnings of non-resident **online advertising companies through the Finance Act 2016**.
2018	The significant Economic Presence term (SEP) was introduced in the Income-tax Act, 1961 to tax income based on economic presence rather than physical presence.
2020	The scope of EQL was expanded with effect from 1 April 2020 to include **a levy of 2.0% on consideration received by a non-resident 'e-commerce operator' from 'e-commerce supply or services**'
2020	A tax withholding obligation of 1.0% was imposed on amounts received by resident e-commerce sellers on the sale of goods or services facilitated by an e-commerce operator through its digital or electronic facility.
2021	India prescribed a revenue threshold of INR 20 million (USD 2,70,000) and user threshold of 300,000 for the application of the SEP rules from the Financial Year 2021-22.

Source: Authors' compilation based on literature review

Section 4: Cross-Country Experiences with Digital Economy Taxation (contd.)

- OECD is currently rethinking the aforementioned measures due to concerns as regards double taxation and potential violation of international tax laws.
- On 8 October 2021, after a period of consultation on draft reforms, the OECD and the Inclusive Framework released a statement outlining **a two-pillar international tax reform framework.**
  - **Pillar One** involves the reallocation among the various market jurisdictions of 25.0% of profit above 10.0% of very large multinationals with revenue exceeding **EUR 20 billion**. The threshold of revenue was to be reviewed after seven years to bring it down to EUR 10 billion. India and other developing countries had proposed a threshold of EUR 1 billion to cover five thousand global companies (Seth, 2021).
  - **Pillar Two** model rules require large MNCs (those with consolidated global revenue of over EUR 750 million) to pay a **minimum effective tax rate of 15 % in each jurisdiction where they operate.** However, it was initially proposed to be brought into effect in 2023 but has now been deferred till 2024.
- OECD's opinion is that the two-pillar solution addresses concerns of countries with low capacity to enforce tax rules.

Tax Incentives in India

- **Sunset Clause for Developers** has become effective from 01.04.2017 and **Sunset Clause for Units** has become effective from 01.04.2020 to limit the unlimited tax exemption benefits in Special Economic Zone.
- **Freelancers in India came under the purview of Income Tax and GST** (Goods & Services Tax). As per the tax perspective, **freelancing income is taxable as *Profits and Gains from Business or Profession.***
- Freelancers in India can make use of the Presumptive Taxation Scheme under Section 44ADA of the Income Tax Act, 1961 and **pay tax on freelance income on only half of their gross annual income**, provided the total income for the year is less than Rs. 50 lakhs (Groww, 2022).

Section 4: Suggested Policy Initiatives

Section 5: Suggested Policy Initiatives

- Drawing on the preceding discussion, the present section puts forward a number of recommendations as regards digital economy taxation in Bangladesh. The proposals here considers both opportunities of revenue mobilisation, as also the trade-offs between tax collection and growth potentials of an otherwise nascent digital economy of Bangladesh

A. Review Tax Exemptions and Broaden Tax Net

- ***Make Tax Incentive Decisions in a Transparent Manner***
  - Before granting tax exemption, the following factors should be considered- *development status of the specific sector, maturity of the industry, number of years the exemption has been in effect, rationale for the protection and justification of extension of exemption or new exemption.*
  - **A detailed assessment of tax expenditures** including an appropriate definition and a methodology for measuring tax expenditure needs to be developed in view of restructuring existing tax expenditure measures.
- ***Take Decision as Regards Taxing Selected ITES Sector on Expiration of Tax Exemption in FY2023-24***
  - In view of the current exemptions coming to an end in FY 2023-24, **a through assessment** in this regard is called for so that a decision that balances cost and benefits can be taken.
  - The case of businesses that have enjoyed ITES tax exemptions for **more than a certain period (for example ten years), and are making profits** should be reviewed and considered for purpose of imposition of tax
- ***Put in Place Sunset Clause with respect to Tax-Exempted Areas***
  - As in many other countries, the NBR may think of introducing sunset clauses with respect to existing tax-exempted digital sectors, as also in case of introducing new exemptions.
- ***Bring Non-Resident Tech Giants under Income Tax Net***
  - **Legal provisions** will need to be put in place for non-resident businesses to get TIN in order for them to submit their tax returns. This should be addressed through **required initiative in the Finance Act of FY2023-24.**

Section 5: Suggested Policy Initiatives (contd.)

B. Address Definitional Ambiguity as regards Digital Economy

- ***Extend the Scope of Service Code 99.60***
  - The NBR should consider **extending the scope of existing definition of service code 99.60** to also include online marketplace. The NBR may also consider issuing a **new service code** for online marketplace.
- ***Introduce a Precise Definition of E-commerce in ITO, 1984***
  - In the present scenario, a significant number of businesses have an online presence in addition to their physical presence. Consequently, there is a need to include a **precise definition of e-commerce in the ITO of 1984**, considering the likelihood of the vast majority of businesses to establish online presence.
- ***Introduce an Unambiguous Definition of ITES***
  - NBR needs to come up with **precise and comprehensive definition of each of the ITESs** which are granted exemptions so that misclassification can be avoided and the NBR does not end up with collecting lower amount of taxes.
  - **HS classification of e-services** needs to be introduced for this purpose which will help also to capture these for trade-related purposes.

C. Introduce Standardised Accounting Practices for Valuation

- A Standardised Accounting Framework may be developed expressly for the digital economy. Such a Framework would spell out **proper guidelines as regards valuation and depreciation practices**. This would allow the NBR to determine actual tax liabilities of a digital company and will help with enforcement of tax regulations by NBR officials.

Section 5: Suggested Policy Initiatives (contd.)

D. Take Steps to Broad-Base Tax Net concerning Digital Economy

- ***Address the Disparity Between the Reported Export Proceeds of EPB and Actual Proceeds***
  - Steps should be taken to **capture reliable export data**. Bangladesh Bank and the EPB should put in place appropriate tools to encourage and incentivise sending of these earnings through formal channels. In view of the current pressure on forex reserves, this has become even more urgent.
- ***Take Preparation for the Possible Lifting of the Moratorium on E-transmission***
  - The NBR should take adequate preparation, with appropriate technological infrastructures in place, to capture imports through electronic transmission and impose custom duties on these.
  - However, coverage and duties should be decided by taking into **consideration consumer welfare implications, interests of the domestic services sector, and revenue implications**.
- ***Track the Earnings of Non-Residents Tech Giants in view of OECD's Two Pillar Proposal***
  - The NBR and GoB should **monitor the developments as regards OECD's Two-Pillar Solution**. Thus, the NBR will need to develop the capacity (by introducing TIN and making it mandatory to submit tax returns) to track the revenue generated by the non-resident companies operating in Bangladesh so that the two-pillar approach may be implemented.
  - **A coordinated strategy and readiness in technological and infrastructure areas** will be needed to successfully implement the OECD's Two-Pillar proposal, if and when this is accepted.
- ***Address Concerns as Regards Vat Payment***
  - The NBR needs to have the technological infrastructure to monitor informal transaction channels used by e-services and to bring those into the VAT net.
  - **A policy should be formulated to ensure that multinational companies pay advertising fees to non-resident companies from their bank accounts held in Bangladesh instead of through their respective parent companies**.

Section 5: Suggested Policy Initiatives (contd.)

D. Take Steps to Broad-Base Tax Net concerning Digital Economy (contd.)

- ***Address Concerns as Regards VAT Payment (contd.)***
  - To address the issue of double taxation, NBR and Bangladesh Bank should develop a coordinated policy so that **individuals without BIN are not doubly taxed**. The VAT wing of the NBR, in collaboration with Bangladesh Bank, should establish a dedicated e-commerce monitoring team to track transactions of non-resident businesses and **identify cases of double taxation**.
- ***Raise Capacity to Tax the Digital Economy Digitally***
  - The NBR will need to develop the capacity to monitor and assess the transactions of internet-based businesses and **use the metadata to assess incomes and returns**.
  - The NBR will need to **bring the entire digital economy into tax network digitally** and be able to track and trace the transactions.

E. Additional Steps

- Adequate investment must be made to **improve the internet speed** to stimulate the growth of digital platform-based activities and businesses.
- The GoB should consider **introducing PayPal** in Bangladesh to capture the actual export proceeds from freelancing activities.
- The GoB needs to take measures to formalize the F-commerce sector by bringing it within **the ambit of legal framework**. However, such regulations should not impede the organic growth of this sector

Section 5: Suggested Policy Initiatives (contd.)

E. Additional Steps (contd.)

- To make it easier for businesses to operate in the digital ecosystem, the GoB may consider developing a **special website** that contains all the relevant rules, regulations, provisions, and SROs associated with digital economy taxation.
- It is important for the GoB to **develop a National Startup Policy** aimed at fostering the growth of the startup ecosystem and attracting foreign investment to the sector.
- The NBR may consider publishing **guidelines for digital economy taxation similar to the Income Tax Nirdershika.** These guidelines should include an explanation of relevant tax provisions related to the digital economy, along with practical examples.
- To ensure interests of consumer and secure their personal data, concerned authorities may consider **introducing a personal data protection law**. This will ensure that the interests of consumers are safeguarded, and their personal information is **protected from unauthorized access and misuse**. On the other hand, use of metadata for purpose of taxing evidence-based developmental decision also needs to be promoted for evidence- based policymaking.

Thank you