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Corporate Tax Transparency Issues and Concerns in Bangladesh

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Highlights

- In Bangladesh, the magnitude of tax loss reaches a staggering BDT 842 billion, representing a substantial 30.2% of the total economy.
- Tax evasion is responsible for a tax loss ranging from BDT 418 billion (15% estimate) to a staggering BDT 2,230 billion (80% estimate). Tax avoidance, on the contrary, results in a loss ranging from BDT 140 billion (5% estimate) to BDT 695 billion (25% estimate).
- The tax loss is 2.6 times the health sector expenditure and equals 100% of the education and technology budget. It surpasses social safety and welfare expenditure by 300% and accounts for over 60% of the total budgeted expenditure of BDT 1,395 billion in 2021 across vital sectors like health, education, technology, social safety, and welfare.
- To ensure greater tax transparency and improve the tax structure, key recommendations include expanding the taxpayer base, granting purposeful tax exemptions, promoting digitalisation and cashless transactions, addressing corruption and enhancing tax officials' efficiency, disclosing information on tax court proceedings, and implementing mandatory sustainability reporting.

1. INTRODUCTION

In developing countries like Bangladesh, where over four-fifth of government revenue is collected from tax, the socio-economic impacts and consequences of tax avoidance and evasion are very severe. Aligned with Bangladesh's development goals, both tax avoidance and tax evasion must be prevented by ensuring tax transparency that would ultimately contribute to minimising fiscal deficit and sustainable growth of the country.

The study primarily involved reviewing existing literature and analysing data from reports and research articles on selected developing countries. The objective was to understand the tax structure and issues related to tax avoidance and evasion. Surveys were planned to collect information from corporate entities, but no response was received from the intended groups. Key Informant Interviews (KIIs) were conducted with renowned chartered accountants and former top-level executives of the National Board of Revenue to gather their opinions on tax transparency and suggestions for improving the existing tax system.

This document is a brief version of the study that examines the tax framework in developing nations, the connection between the informal economy and tax income, and an examination of the tax-to-GDP ratio and corporate tax rate in Bangladesh throughout the years. It also examines secrecy scores across various indicators and the occurrence of tax abuse at varying desired levels of the tax-to-GDP ratio. Furthermore, it presents a set of suggestions derived from primary and secondary data to promote corporate tax transparency in Bangladesh.

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2. TAX STRUCTURE AND TAX LOSS OF BANGLADESH

2.1 Tax Structure

Table 1: Comparative Average Corporate Tax vis-a-vis Other Tax Rates

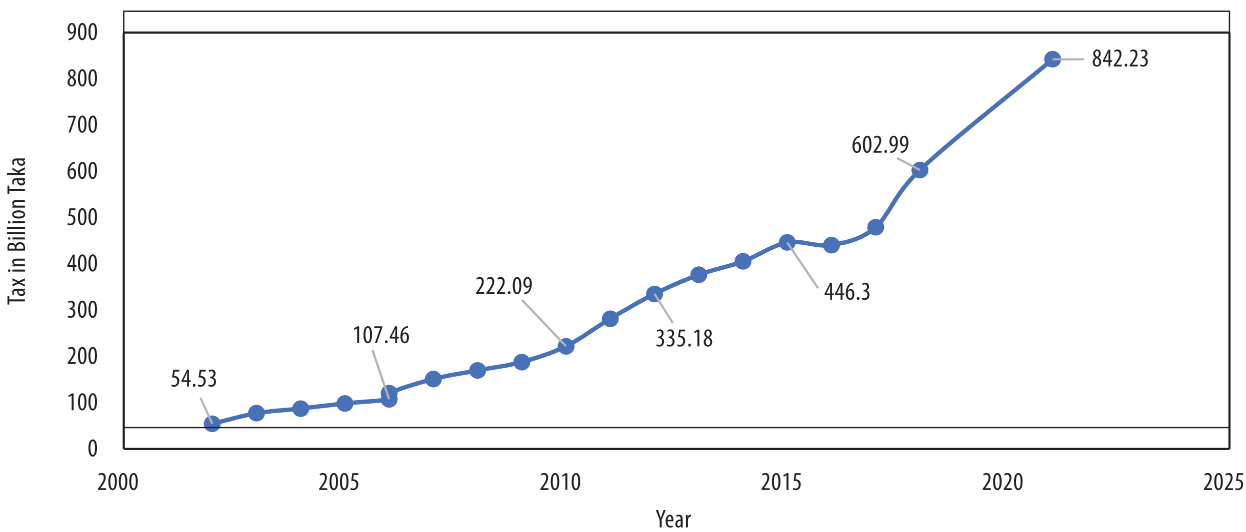
Tax Type	Global Average	Asia Average	South Asian Average	Bangladesh Average
Personal Income Tax	30.7%	19.22%	23.11%	25%
Sales Tax	15.78%	12.34%	17.63%	15%
Corporate Tax	23.56%	19.52%	25.68%	30%

Source: Trading Economics.

Bangladesh has a corporate tax rate (30%) that exceeds global (23.56%), Asian (19.52%), and South Asian (25.68%) averages, while sales tax and personal income tax rates are relatively lower. However, a limited number of individuals and companies shoulder the tax burden due to higher marginal income tax rates. The majority of income tax contributors are salaried employees, with their employers responsible for tax payments. About 85% of income tax revenue comes from taxes withheld at the source. Besides, the tax policy faces challenges due to the widespread use of exemptions, incentives, and special provisions, which restrict revenue collection, reduce the effective tax base, and deviate from the standard taxation systems. These practices are believed to promote tax evasion, undermine fairness, and introduce economic imbalances. Additionally, numerous legally sanctioned tax advantages exempt a significant number of individuals from tax obligations.

In the FY22 budget speech, it was highlighted that the total number of taxpayers in Bangladesh stood at a mere 2.5 million. Considering the country's population exceeds 165 million, this figure is remarkably low. Furthermore, the report highlights that out of the 0.25 million registered companies in Bangladesh, only 30,000 file income tax returns. A survey

Figure 1 **Growing Tax Loss Due the Shadow Economy** *(in billion BDT)*



Source: Based on World Economics Data.

conducted by CPD indicates that a significant 68% of Bangladeshis do not contribute to income tax payments.

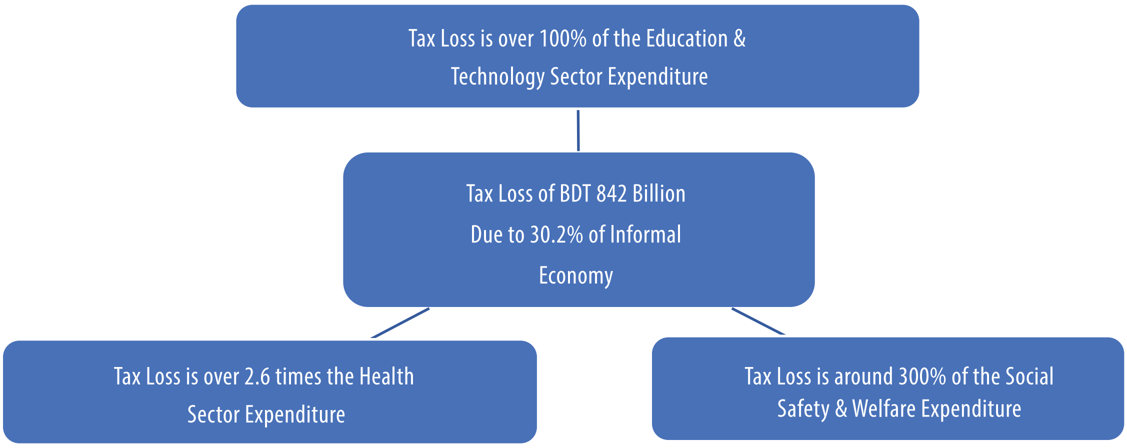
2.2 Tax Loss Associated with Informal Economy, Tax Evasion, and Tax Avoidance

Tax losses in an economy are significantly influenced by the size of the informal sector. World Economics estimates reveal a gradual reduction in the size of Bangladesh's shadow/informal economy over the time. From 2002 to 2021, it decreased from more than 36% of the official GDP to 30.2% of the GDP. Despite this decline as a proportion of the official GDP, the absolute tax loss attributable to the shadow economy has increased. Over a span of 10 years (2010-2021), the tax loss stemming from the shadow economy has quadrupled, rising from BDT 222 billion in 2010 to BDT 842 billion in 2021.

In the context of Bangladesh, the magnitude of tax loss reaches a staggering BDT 842 billion, representing a substantial 30.2% of the total economy. This alarming figure surpasses the health sector expenditure by over 2.6-fold and constitutes a formidable 100% of the budget allocated to the education and technology sector. Remarkably, the tax loss attributed to the informal economy far surpasses the social safety and welfare expenditure by a striking 300%, while simultaneously accounting for more than 60% of the collective budgeted expenditure of BDT 1,395 billion, designated for crucial sectors such as health, education, technology, social safety, and welfare in 2021. Moreover, this tax loss stemming from the informal economy represents a notable 2.39% of Bangladesh's GDP for the same year.

A substantial tax loss of BDT 418 billion is attributable to a lower range estimate of 15% pertaining to tax evasion, while a staggering BDT 2,230 billion represents the upper range estimate of 80% for this form of illicit tax behaviour. Similarly, tax avoidance contributes to a substantial loss of BDT 140 billion at a lower range estimate of 5%, escalating to a significant BDT 695 billion at a higher range estimate of 25%. If the tax loss of BDT 842 billion due to the informal economy was avoided, then an amount ranging between Taka 1,862 to 6,844 could have been used to increase per capita health

Figure 2 **Tax Loss Due to Shadow Economy**



Source: Author's illustration of the study's findings.

expenditure. And, if the tax loss of BDT 2,230 billion due to 80% tax evasion (KII upper range) was avoided, then an amount ranging between Taka 4,655 to 17,850 could have been used to increase per capita education expenditure.

3. SECRECY INDEX AND ENABLING ENVIRONMENT FOR TAX LOSS

Financial secrecy facilitates tax abuse, enables money laundering, alongside undermining human rights. Bangladesh has witnessed an increase in financial secrecy, leading to a two-position rise to the 52nd rank among 141 nations in the Tax Justice Network's Financial Secrecy Index 2022. This indicates a greater inclination towards aiding individuals in concealing their financial activities from legal oversight. Financial secrecy has negative consequences as it facilitates tax abuse, and money laundering, and undermines human rights. The index assesses countries based on their financial and legal system's ability to allow individuals to hide and launder money, globally.

According to the Tax Justice Network's Financial Secrecy Index (2022), Bangladesh received a secrecy score of 75 for Corporate Tax Disclosure and 63 for the Capacity of the Tax Administration. Higher scores in these indicators suggest a greater potential for hiding income, avoiding taxes, and evading tax obligations.

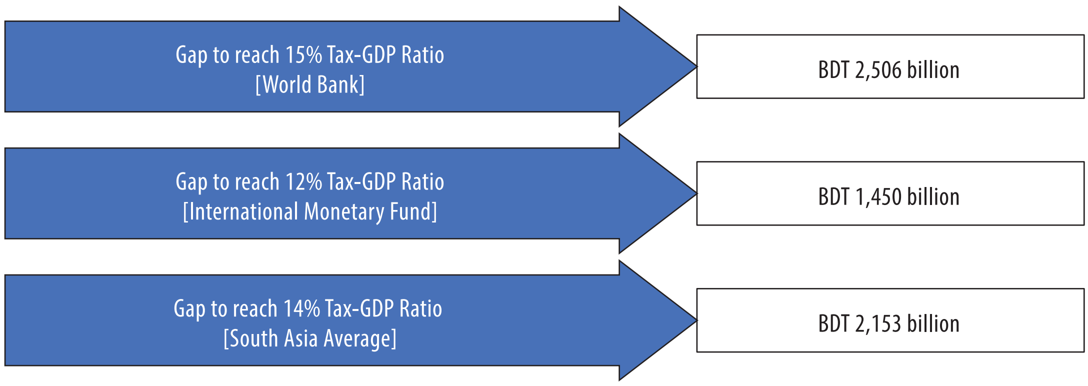
Bangladesh scored 90 for the indicator Avoids Promoting Tax Evasion and 38 for the indicator Anti-Money Laundering. A higher score in Avoids Promoting Tax Evasion indicates a greater potential for hiding income and evading taxes, while a higher score in Anti-Money Laundering suggests notable efforts in preventing tax evasion through money laundering.

4. TAX GAP IN BANGLADESH

According to the International Monetary Fund (IMF), countries should aim for a tax-to-GDP ratio of at least 12% to drive economic growth. The World Bank suggests that tax revenues exceeding 15% of GDP are essential for growth and poverty reduction. Bangladesh needs over BDT 2,500 billion in additional tax revenue to reach the World Bank's target. Achieving a 12% tax-GDP ratio would add BDT 1,450 billion in tax revenue, enabling a significant increase in budgeted expenditure on vital sectors such as health, education and technology, and social safety and welfare by over 100%.

The dissemination of published information reveals a disconcerting reality,. Bangladesh's Tax-GDP ratio is not only well below the average of South Asian countries but also lags behind its competing and neighboring nations by a significant margin. In order to harmonise with the regional standard of approximately 14%, Bangladesh is required to amass tax revenue exceeding BDT 2,000 billion, thereby necessitating an

Figure 3 **Gap to Reach Tax-GDP Targets**



Source: Estimates of International Monetary Fund, World Bank, and South Asian region.

additional tax contribution equivalent to over 6% of the nation's GDP. When compared to distinguished neighbouring countries such as India, Sri Lanka, and its major competitor Vietnam, Bangladesh finds itself significantly lagging behind in terms of tax collection prowess.

5. IMPROVING TAX TRANSPARENCY IN BANGLADESH: RECOMMENDATIONS

The study puts forward the following recommendations for ensuring greater tax transparency in the country and for improving the tax structure.

Widening Tax Net: The expansion of Bangladesh's tax net is crucial to address the significant portion of businesses that currently operate outside of the tax system. To achieve targets such as the 14.2% tax-GDP ratio outlined in the Eighth Five-Year Plan, Bangladesh must undertake extensive efforts to expand its tax net. This expansion is essential for the country to accomplish its goals. It is recommended to establish specific targets for each year, accompanied by a declaration of the desired increase in tax revenue volume and the corresponding strategies to be implemented. By implementing these measures, Bangladesh can make notable progress toward achieving its objectives.

Purposive Tax Exemptions and Tax Avoidance Opportunities: Tax exemptions and incentives should be thoughtfully designed and time-limited to ensure their purposeful use. Clear timeframes should be established for their application, accompanied by a declaration of their intended purpose. Additionally, a mechanism for assessing their effectiveness in achieving objectives should be developed. These measures will ensure tax benefits serve their intended purpose within a defined period and are evaluated for their efficacy.

Digitalisation and Promotion of Cashless Transactions by the Corporates: The utilisation of cashless transactions by corporates provides a higher level of transparency, reducing the likelihood of financial activities going unnoticed by tax authorities. Such transactions leave digital trails that can be easily tracked and monitored, making it challenging to hide or manipulate financial information. Furthermore, it is essential for tax administrations to adopt and leverage information technology to enhance their efficiency in managing and analysing tax-related data. By embracing technology, tax authorities can improve their ability to effectively monitor cashless transactions, identify potential tax evasion, and ensure greater compliance with tax regulations.

Addressing Corruption and Efficiency of the Tax Officials: One of the primary causes of tax evasion in the country is attributed to the corruption exhibited by a portion of tax officials. It is crucial to address this issue effectively by implementing targeted measures that tackle corruption within the tax administration. Additionally, there is a pressing need to provide adequate training to tax officials, equipping them with the necessary skills and knowledge to enhance their efficiency in carrying out their duties.

Disclosure of Information on Tax Court: To incentivise corporate entities to comply with tax regulations, it is essential to disclose information related to tax evasion and its consequences in a readily accessible online format. By doing so, companies can be made aware of the penalties and court verdicts associated with tax evasion, fostering a culture of transparency and accountability. Brazil, Argentina, Malaysia, and Kenya have implemented practices that serve as good examples in this context.

Mandatory Sustainability Reporting for Greater Tax Transparency: The adoption of mandatory sustainability reporting is increasingly recognised as a valuable tool to promote greater transparency and disclosure among corporate entities. In 2019, the introduction of GRI 207 facilitated the inclusion of tax reporting within sustainability reports by businesses and corporate houses.

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