Effect Of Vat And Tax On Economy: An Analysis In The Context Of Bangladesh

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Abstract
'VAT' has assumed different meanings over time. Government requires enormous amount of money in the discharge of its constitutional responsibilities. Although there are many sources of such revenue, tax is an important aspect. It can affect the economy in a number of ways ranging from national and local economic growth to how individuals manage their personal finances. Although taxation itself is pervasive, whether taxes have a positive or negative effect on the general economic condition of the country is the subject of much debate. A country like Bangladesh where 31.5% (2011 est.) of its population is beyond poverty line the income tax plays relatively a small role in the country's tax system. Thus the distributional impact of VAT is of concern. Here, in this paper we are going to focus what effects tax and VAT have in the economy of Bangladesh.
Key words: tax, vat, agricultural sector, economic impact.

Introduction

Value-Added Tax (VAT) is a type of consumption tax that is placed on a product whenever value is added at a stage of production and at final sale. Value-added tax (VAT) is most often used in the European Union. The amount of value-added tax that the user pays is the cost of the product, less any of the costs of materials used in the product that have already been taxed.

Many VAT systems can be described as having a basic rate, special rates for some goods and services, and exemption status for certain economic activities or specific goods and services. These features influence the nation's aggregate effective tax base.

One inevitable change in circumstances accompanying any tax change and bearing on subsequent economic developments is the possible use of new revenues. New tax revenues may be used by the government: (1) to purchase goods and services; (2) to reduce or replace another tax; (3) to retire outstanding debt; or (4) to hold balances in commercial or central banks.

Monetary conditions also influence the effects sometimes associated with tax policy. Monetary policy and tax policy are often considered separately from each other. Also, increases in the money stock can finance government expenditures. Additionally, changes in the money stock have influences over objectives which tax policy often considers namely, those relating to inflation, economic growth and stability, income distribution, and the international balance of payments. While monetary policy and the government budget are not the only influences on these matters, both are significant. (A Value Added Tax and Factors Affecting Its Economic Impact, by CHARLOTTE E. RUEBLING)

In April 1979, the Taxation Enquiry Commission (TEC) officially took the issue of introducing VAT in Bangladesh as an alternative to sales tax. The objectives of introducing VAT in Bangladesh were to (a) bring transparency in the taxation system; (b) prohibit cascading the tax administration; (c) consolidate the tax administration; (d) activate the overall economy by production; (e) bring a consistence in the tax- GDP ratio.

The standard rate for VAT has been fixed all along at 15% (for taxable goods and services). The primary research question of the study is to examine the current tax policy of Bangladesh. A brief analysis of the economic effect of tax and VAT on the economy of Bangladesh is discussed in the following to section. The final section provides the concluding remarks.

In Bangladesh, the major chunk of Government earnings comes through the National Board of Revenue (NBR). The components of the tax earnings of NBR are taxes on income and profit, VAT, customs duty and supplementary duty.

Methodology

Basically our study depends on Primary sources as well as secondary sources. We collect information or survey directly from the organization as well as we followed the secondary sources like, online, reference and journal.

Objectives of the Study

The objective of the study is as follows:

❖ To classify the different kinds of tax in Bangladesh.

- To shed light in the current tax structure of Bangladesh
- To analyze the economic effect of tax structure of Bangladesh
- To analyze the effect of VAT on the economy of Bangladesh

Literature Review of VAT

VAT is a tax on consumption; the more you buy the more tax you pay. It is also a neutral tax on businesses in that it does not represent a real cost to anyone but the end consumer. Everybody pays tax to the Government whenever they purchase goods or services. This tax is collected for the government by the supplier of those goods and services. VAT revenue has become a significant source of government revenue in Nigeria. Therefore, the primary objective of fiscal policy is to raise more revenue through value added tax. The tax authorities have been guided by the need to design equitable and efficient VAT system capable of complementing government expenditure and, thus, reduce recourse to public borrowing. VAT rate in Nigeria has been determined in a way that minimizes disincentive effects on economic activities. The effects of low tax effort in Nigerian have been strengthened by the value added tax system. This, in turn, has addressed part of the worries of Kaldor (1963) who asked "will underdeveloped countries learn to tax?" Bird, Vazques and Torgler (2007) noted that the underlying assumption of Kaldor's question is that a country [or state] wishing to develop needs to collect in taxes an amount greater than the 10-15 percent found in many developed countries. To meet the global aspiration of attaining the Millennium Development Goals (MDGs) come 2015, these countries must spend more on economic and social infrastructures, which can only be achieved through improvement in tax efforts to realize the required level of public expenditure (Golit, 2008).

Early works on tax effort include those of Musgrave (1969), Lotz and Morss (1970), Chelliah, Baas and Kelly (1975) and Tait, Gratz and Eichengreen (1979) which captured developments during the 1960s to the late 1970s. Musgrave (1969) noted that the tax performance of a developing country can be measured by the 'ability to give up approach', 'efficient resource use approach', 'ability to collect approach', and 'comparison with average performance or stochastic approach'. Going by these, VAT has no problems with the ability to give up and collect approaches. This study will give an insight into the efficient resource use and stochastic approaches, within the context of Lagos State.

Eltony (2002) used time-series and cross-sectional country data for the period 1994-2000 for 16 Arab countries to examine the determinants of tax effort. The results showed that the main determinants of tax revenue share in GDP where per capita income, agricultural output-GDP ratio and mining-GDP ratio. The share of exports, imports and outstanding foreign debts were other variables found to be important. Also, country-specific factors such as the political system, attitudes toward government, the quality of tax administration and other institutions of government appeared to be important determinants of tax-GDP ratio.

In a recent study, Teera (2003) attempted an assessment of Uganda's tax performance relative to 18 other Sub-Saharan countries aimed at evaluating the feasibility of raising tax revenues in Uganda. The study used pooled data to construct an index of tax effort for these countries, and also applied the model to individual tax shares to pinpoint the source of high and low effort. By extension, the model must have incorporated value added tax. The result showed that Uganda's tax effort index for total taxes on income were less than unity, while the indices for international trade taxes and taxes on goods and services exceeded unity. One may be tempted to consider this as defining a place for value added tax.

Emran and Stiglitz (2005) argue that the current consensus that favors a reduction and eventual elimination of trade taxes, and almost exclusively relies on VAT as the instrument of indirect taxation in developing countries, is built on fragile results derived from a partial model that ignores the existence of an informal sector. The results from a more complete model demonstrate that replacing trade taxes with VAT can reduce welfare under plausible assumptions. The authors argue that the results raise serious doubts about the wisdom of the indirect tax reform policies pursued by a large number of developing countries.

In their 2005 paper, Emran and Stiglitz extended their analysis to the case of a selective reform of trade tax and VAT in an economy with an informal sector. The term selective reform refers to tax changes that apply only to a subset of the commodities falling under the tax net. In the context of selective reform, Michael et al. (1993) show that, in a tradable-only economy with no informal sector, a reduction in the import tariff on the commodity bearing the highest tariff and also the highest total indirect tax burden, increases welfare under suitable assumptions of substitutability, when the lost revenue is compensated for by an increase in the consumption tax on the commodity bearing the lowest indirect tax burden. The extant literature, however, completely ignores the implications of an informal economy in the efficiency of a consumption tax (VAT) as an instrument of revenue-raising, which can be especially important in developing countries.

Role of Indirect Taxes in Developing countries

The role of direct taxation in developing countries is much more limited. In contrast to developed countries where taxation on personal income and social security contributions raise two thirds of the total tax revenue, a narrow tax base and high enforcement costs render direct taxation impractical for developing countries. The income tax base is mostly comprised of wages of employees in the public sector, because all other taxpayers are self-employed or small businesses who evade paying all, or most, of the income tax. In addition, taxation of personal capital income is easily evaded

In developing countries: about two-thirds of the tax revenue comes from indirect taxes, mostly VAT, sales tax, excises and taxes on trade. The remaining one-third consists largely of corporate income tax.

Since the 1980s, developing countries have undergone frequent tax reforms, gradually replacing trade taxes with domestic consumption taxes, particularly value-added tax (VAT). The purpose of replacing trade taxes with domestic consumption taxes was mainly to improve macroeconomic stability, and to introduce the benefits of free trade to developing economies. Export taxes are seen as inefficient, because they put the local producers who export their goods at a disadvantage compared with foreign producers. VAT was viewed as more efficient than import taxes, as it does not discriminate between domestic and imported goods. By eliminating import taxes, local consumers benefit from lower prices in the competition created between domestic and foreign producers, and it forces the local producers to become more efficient and concentrate their efforts on their comparative advantage.

Current Tax Policy in Bangladesh

Among direct taxes, income tax is one of the main sources of revenue. It is a progressive tax system. Income tax is imposed on the basis of ability to pay. The more a taxpayer earns the more he should pay"- is the basic principle of charging income tax.

Bangladesh personal income tax rates for assessment year 2010 - 2011 is progressive up to 25%.

Bangladesh Income Tax Rates for individuals other than female taxpayers, senior taxpayers of 65 years and above and retarded taxpayers - Assessment Year 2010 - 2011

First	BDT 1,65,000	Nil
Next	BDT 2,75,000	10%
Next	BDT 3,25,000	15%
Next	BDT 3,75,000	20%
Rest Amount		25%

Bangladesh Income Tax Rates for female taxpayers, senior taxpayers of age 65 years and above - Assessment Year 2010 - 2011

First	BDT 1,80,000	Nil
Next	BDT 2,75,000	10%
Next	BDT 3,25,000	15%
Next	BDT 3,75,000	20%
Rest Amount		25%

Income tax is one of the main sources of revenue in Bangladesh. It is a progressive tax system. Bangladesh Income tax is imposed on the basis of ability to pay. The more a taxpayer earns the more tax he should pay. This is the basic principle of charging income tax in Bangladesh. The tax system aims at ensuring equity and social justice. Tax rates in Bangladesh also differ between male and female individuals.

The general rate of Value Added Tax (VAT) in Bangladesh is 15%.

- Value Added Tax (VAT) is imposed on goods and services at import stage, manufacturing, wholesale and retails levels;
- A uniform VAT rate of 15% is applicable for both goods and services;
- 15% Value Added Tax (VAT) is applicable for all business or industrial units with an annual turnover of Taka 2 million and above;
- Turnover tax at the rate of 4% is leviable where annual turnover is less than BDT 2 million;
- Value Added Tax is applicable to all domestic products and services with some exemptions;
- Value Added Tax (VAT) is payable at the time of supply of goods and services;
- Tax paid on inputs is creditable / adjustable against output tax;
- Export is VAT exempt;
- Cottage industries (defined as a unit with an annual turnover of less than BDT 2 million and with a capital machinery valued up to BDT 300,000) are exempt from Value Added Tax;
- Tax returns are to be submitted on monthly or quarterly or half yearly basis as notified by the Government.

Finance Minister proposed to introduce submission of acknowledgement receipt of return submission side by side TIN certificate in certain cases, introduce online service for payment of tax through specified banks against registration or renewal of fitness of car/motor vehicle, organize tax fair from 17-22 September 2011 in all divisional headquarters to provide one-stop service for submission of return and introduce provision.

Effect of Tax Policy on the People of Bangladesh

The heavy reliance on indirect taxation has been treated as one of the main obstacles in attaining economic progress in developing countries. The problem arises mainly due to the fact that only a few taxpayers share the burden of taxes. Bangladesh is no exception which is also trying to reform its tax structure for long time through structural adjustment and growing demands have been placed on it to suggest towards a desirable tax system. A huge segment of the population living in acute poverty and disparity is also evident in income distribution. Tax burden is ultimately shared by a limited number of individual taxpayers and corporations. Thus attaining a broad based and optimal taxation system is a much desirable task for the government. This study tries to keep forward such an endeavor by analyzing the distribution of burden of income taxation in Bangladesh.

Taxes are the major source of mobilizing internal resources of an economy. Bangladesh revenue structure has been burdened by taxes from indirect sources for long time and usually characterized by heavy import and excise duties. To cope with the challenge due to globalization, government of many such countries has to cut down such duties and levies. It seems that government might have to collect more money either through VAT (Value Added Tax) or from direct taxes. In Bangladesh VAT introduced in 1991 by replacing the sales taxes is still known as the vital reform in Bangladesh revenue structure. The remaining potential sector is the income taxes sharing almost all taxes coming through direct sources. In Bangladesh having a population of about 133 million, the number of registered taxpayers is only 1.25 million2 (which is only 0.94 percent of the total population). Tax base is too narrow and the tax law is full of exemptions and allowances. Agriculture sector provides employment for around 60 percent of the population contributes only 25 percent of GDP and virtually pays little in the form of income tax. There is always a controversy whether this sector is extra protected or not and if yes – to continue for how long. There are many affluent people lying in the category of agricultural income and more such people avoiding taxes showing their entire income as a means of agriculture.

It is widely known that very few people even among the registered taxpayers pay any tax in the form of income taxes in Bangladesh. Major share of income taxes come from the corporate sector and there is always an uneasy feeling having its higher rates. It has been said that, about 100 foreign investors pay 60 percent of the total revenue to the exchequer in Bangladesh. Taxes imposed are usually in progressive rates and maximum collection is done at source under withholding tax system. In Bangladesh, income tax for government employees is deemed paid by the employer that is by the government, considering the fact that they are underpaid. However, in case of private sectors, such payments are considered income, which creates additional tax burden for the employee of the private firms. This is discriminatory and obviously encourages employees of private firms to avoid or evade taxes. So, in reality very few people share the burden of income taxes in Bangladesh and thus it is a real problem for the government to distribute the tax incidence in a fair manner.

Direct Tax Contributes Only a Small Portion of the Tax Revenue

Tax revenue structure of Bangladesh can be divided into direct and indirect taxes. A direct tax is paid by a person to the revenue authority. Direct tax is borne by the tax payer and cannot be passed on to any person, whereas indirect tax is passed on by the tax payer so that the burden of the tax is ultimately borne by another, for example Value Added Tax(VAT) which, although paid by the businessmen, is passed on to the customers. That is, indirect tax is charged on consumption in one way or another. Indirect tax is regressive because it takes a higher portion of a poor person’s income than of a reach person’s. VAT is the same for all people. Indirect taxes do not develop any civil consciousness in the minds of tax payers because nobody feels that he is paying a tax as it is concealed in price, whereas direct tax create a civic consciousness among the tax payer; they feel that they are contributing towards the state expenditure. In the case of direct taxes, the relation between the tax payer and the revenue authorities is direct personal. But there is an indirect relation between the tax payer and tax authorities in the case of indirect taxes, for the taxes are collected unofficially through the agency of merchants.

Negligible Direct Tax Contribution of the Agricultural Sector of the Tax Revenue

Direct taxation on agricultural sector normally takes two forms; land revenue tax and tax on agricultural income. This sector accounted for more than 50% of total direct tax revenue in the early sixties, but now agricultural income tax is very negligible. It accounts for only 0.01% of the GDP, although the average contribution of agriculture to the GDP is 35%.Agriculture, more specifically, non-farm activity still remains an untapped source of revenue to the government. In most cases, income from agriculture does not exceed the ceiling of non-taxable limit primarily due to subdivision and fragmentation of holdings for which income is distributed to different hands. Furthermore, tax administration is not expanded down to village, and therefore, current information on this source of income cannot be easily collected for making assessment. Placing more emphasis on the collection of income tax from agriculture may augment the price of our main food and may create socio-political unrest. Government does not like others to do politics with food. High cost of collection of agricultural tax may be another consideration. All these factors may contribute to the poor tax performance of agriculture sector.

Effect of Tax on the Economy

Bangladesh is the lowest tax effort country among the developing country. This has important policy implications that Bangladesh and other countries have low tax effort are not utilizing their full capacity of tax revenue, and therefore have the potential for financing budgetary imbalance through increasing tax revenue. The tax effort index for both direct and indirect tax is below 0.6, implying that Bangladesh has the potential for raising revenue collection from direct and indirect tax.

Under the present arrangement any income accruing from poultry, fishery, etc is exempted from income tax until June 2011. This provision is being abused indiscriminately. A lot of black money is being generated is being laundered into the market through this mechanism.

It has been experienced in Bangladesh that a number of companies are reluctant in paying dividend to shareholders so regularly rather than retain their earning for tax purpose. As a result not only the shareholders are deprived, the general investors are also discouraged from investing in capital market.

The present income-tax base of Bangladesh is one of the lowest even among the developing country. Less than 1% of are within the tax net. In case of personal income tax, the burden is unevenly distributed among the registered tax payers. In reality only a small group of people is with higher marginal rate. In case of Bangladesh, such tax payers are small and medium traders and manufacturer. A lot of investment remains untaxed due to tax amnesty is a problem too in Bangladesh.

Gross tax revenue for FY11-12 is budgeted to increase by 21% over the FY11 RE, in
FY10-11, indirect taxes account for the major share of total tax revenue and NBR revenue represents around 83.6% of the total revenue. Only 24.1% of the revenue comes from income tax. Up to FY11-12, NBR revenue represents 67.1% of the total revenue. Only 20.0% of the revenue comes from income tax. The revenue projection in the case of Income Tax for the next fiscal year FY11-12 is 275.61 billion taka, up by 65.56 billion Taka from the original budget for the outgoing fiscal. The earnings from VAT have been projected at 343.04 billion Taka, up by 72.12 billion Taka from that of the original budget for the current fiscal. The present budget has brought an end of tax holiday facility for readymade garments (RMG), textile and many other traditional sectors. Present budget has proposed 1.50% tax at source from all export proceeds, which is zero now for all export earrings other than RMG. However, this present budget projected to raise tax-GDP ratio to 13% with a target to collect918.70 billion Taka tax revenue & 56.2% of the non-development and development budget. .
The income tax collection target has been set at 275.61 billion taka while 343.04 billion taka target has been set for VAT and 126.34 billion taka for import.

Income tax revenue has reduced by 3.9% compared to last fiscal year which indicates that income has become stable but the price of other utilities become higher compared to last year.

It indicates the higher rate of inflation. Government has projected higher Income tax revenue by 65.56 billion taka which cannot be met up during the fiscal year that causes a great increase of Budget deficit. The amount of VAT collection has been projected at 343.04 billion taka which is higher than the last fiscal year that indicates people are willing to pay VAT for development of the country which represents a good trend of our economy. Present budget proposed 1.5% tax at source form all export proceeds which is zero percent during the last fiscal year. It will reduce the gap between the export and import of the total amount of the balance of payment

The Non NBR tax revenue during the present fiscal year projected to increase by 663 Crore taka which indicates that people are more interested to contribute for the well being of the country. Compared to last fiscal year actual budget and revised budget, the rate of tax revenue is increased by 13.41% which is a record of performance in the history of Bangladesh. The increasing rate indicates that people are interested to contribute in the sector such as, land paper, non judicial paper, motor vehicle tax and narcosis.

Effect of VAT on the Economy

Tax structure in Bangladesh is still heavily dependent on indirect taxes. Import duties during the fiscal years 1990-91, 91-92 and 92-93 constituted 51.57%, 55%, 54.34% respectively of the total revenue collection. The components were import duties, sales tax, VAT and supplementary duty at import stage.

The Bangladesh VAT regime incorporates two other taxes in addition to the VAT under the same legislative and administrative framework an arrangement which is not normally found in most other countries. While the VAT is comparable to those found in other countries, there is also a turnover tax (a form of sales tax without input credits), which applies on a *deminimis* basis and an excise type tax known as "supplementary duty". This last tax has been included within the VAT Act for enforcement and administrative reasons but in other respects is effectively a separate tax. Because of these three taxes incorporated under one umbrella, the complexity of the VAT regime is much greater (if the three components are regarded as one tax regime) than that found with Vats found elsewhere.

VAT is imposed at the import, manufacturing, wholesale and retail levels on both goods and services at a uniform rate of 15% at the time of supply of taxable goods or services. In determining the VAT liability, tax paid on inputs is creditable against output tax. VAT returns are required to be submitted on monthly or in some cases on quarterly (e.g. brick manufacture) or biannually (e.g. hundred percent export oriented). All exports are zero rated. Besides this zero-rate, there are other VAT rates enforced in Bangladesh which are termed "reduced rates" or "truncated rates"

The tax-base for VAT in Bangladesh is the difference between the value of outputs and the value on which input tax has been paid.

The VAT that has been introduced in Bangladesh is of the consumption type profit and loss account. (as opposed to the income or gross product type) under which the

VAT shall amount to a tax on the consumer goods only leaving out capital goods. This has been done to ensure neutrality with regard to the choice of techniques. With regard to the regime for international trade, the destination principle (as opposed to the origin principle) has been adopted, under which a VAT taxes all value added, at home and abroad, in relation to goods that have as their destination the consumers of Bangladesh. Under this system exports are zero rated and imports are subject to VAT. The destination principle is compatible with the consumption type of VAT. The other reasons for adopting the destination principle are that it emphasizes employment more than consumption and ensures neutral treatment of imported and domestic goods by taxing imports and domestic goods going into domestic consumption at the same rate. In a country like Bangladesh where the exchange rate does not adjust quickly and the factor prices are also not flexible, the destination principle has to be favored. In respect of the method by which a tax paying firm may compute its tax liability, the invoice or tax credit method (as opposed to the account based method) has been adopted in Bangladesh in view of its compatibility with a consumption destination type of VAT. The tax credit method avoids the direct calculation of value added, instead, the tax rate is applied to a component of value added (output and inputs) and the resultant tax liabilities are subtracted to get the final net tax payable. Its other advantages are that the tax liability is attached to the transaction and the invoice becomes the crucial documentary evidence and that it creates a good audit trail. Further, any tax period (monthly or quarterly) can be used under this method, while the account based VAT would focus on the annual

With regard to the tax on goods, the VAT in Bangladesh was restricted to the import and manufacturing stage since the accounting system at the other levels of operation is weak. This would mean relatively few registered traders, clearly identifiable taxable commodities and a less complex administration. The disadvantages here are that the revenue base is relatively small implying a higher rate of tax and that firm in collusion with wholesalers or retailers might understate the true value of sales and thus cause erosion of VAT revenue

Bangladesh has adopted a single rate of VAT at 15%. However, with the turnover tax and truncated VAT rates effective VAT rates will differ from the standard 15% rate because the actual amounts of value-added and the amounts assumed with the truncated rates will not be the same. The regressivity of the single rate VAT is partly compensated with the extensive range of exemptions and the supplementary duty even though it is not strictly a VAT. To address the problem of regressivity the Bangladeshi VAT exempts foodstuffs that are typically consumed by the poor such as rice, pulses etc. At same time imposing "supplementary duty" at a higher rate on certain luxurious and socially undesirable items makes the VAT system more equitable.

In terms of complexity of development, demand for human resources and the impact it will have the society, the implementation of VAT in Bangladesh will rank as one of the most significant development projects ever undertaken in this country. The introduction of VAT in any country poses a gigantic management problem. The transitional issues need special attention which often span over 3-4 years. Once the transitional phase is over, and the base is consolidated, then the benefits of the system come into full play. It is, therefore, imperative to strive hard to lay the system firmly in place, initiate related changes and integrate the same into socio-economic mosaic of the country as surely and as smoothly as possible so that the tax induced and related distortions are removed, paving the way for industrial expansion along economically justified lines and at the same time enough revenues are generated to reduce external dependence and contribute to the building of a self-reliant Bangladesh.

Conclusion

The taxation system in Bangladesh is based on the ability to pay theory and hence utilizes the progressive tax system. The revenue administrative body is the National Board of Revenue under the Ministry of Finance. The main responsibility of NBR is to collect domestic revenue for the government. However, revenue collection and management has been a perennial challenge for Bangladesh since its very inception. As a resource constraint nation coupled with limited capacity, we are confronted with persistent pressure to address that challenge. The implementation of an effective revenue system will involve the setting up of new organizational structures, the designing of new procedures and forms, writing of new instructions, arranging for the provision of better management information and statistics, etc. This gives the administration the opportunity to develop new skills and abilities which can subsequently be deployed.

The Bangladeshi VAT regime is a complex one and probably would be difficult to administer and enforce properly in a developed country let alone in a developing country such as Bangladesh. This complexity may reflect the influence of outside aid bodies upon the design of the VAT regime combined with local input to make the tax workable in Bangladesh. It also raises wider policy questions of how tax expertise from developed countries can be appropriately applied in developing countries.

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