A Study on the Problems and Prospects of Value Added Tax in Bangladesh

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Abstract

In common with many developing countries, Bangladesh faces problems in raising sufficient tax revenues to fund its economic and social development. To address this problem and to improve economic efficiency and growth, a major tax reform program was initiated in 1991 which centered on the introduction of a valued-added tax (VAT) to replace a range of narrowly-based consumption taxes. This paper revisit the basic structure of VAT system of Bangladesh and attempt to analysis the contribution and performance of VAT in Bangladesh as comparing to other developing countries and also attempt to identify and provide some suggestions in possible area where attention and improved performance are required to enhance the contribution of VAT in economic development of Bangladesh. The relevant data shows that the performance of VAT was quite satisfactory in the initial years - but subsequently VAT collection has remained stagnant at a certain level. As a result, VAT is unable to meet the objectives for which it was introduced. The reasons behind this performance are many, such as: a relatively small number of VAT tax-payers, a general lack of awareness, and a weak monitoring system etc. There is still scope for improving the revenue collection from VAT: by increasing the number of VAT taxpayers; reforming the VAT administration; creating intensive awareness among the people, revisiting the list of VAT exempted items and increasing the efficiency of the monitoring system.

Keywords: Value Added Tax, Problems, Prospects, Tax, Rate, Potential, Import, Export.

1. Introduction

Value Added Tax (VAT) is a percentage-wise tax on the value added to a commodity or service as each constituent stage of its production and distribution is completed.

VAT may be classified in three ways:

i. On the basis of coverage of stages - throughout the production and distribution stages, or confined to limited stages - manufacturing plus wholesale, or wholesale plus retail;

ii. On the basis of the method of calculation - tax credit method, subtraction method, and addition method; and

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iii. On the basis of tax treatment of final-product capital goods such as machinery, equipment, and supplies - the consumption form, the income form, and the product variety.

Thus the three broad types of VAT are the gross national product (GNP) type, income type and consumption type. VAT is to be paid as withholding tax and VAT is collected, deducted and deposited by the receiver of the services or the persons paying the price or commission as the case may be. For any other goods and class of goods or services, VAT is to be paid at the time as indicated in the NBR rule. Taxation remains a poor tool of government revenue collection in Bangladesh. Taxes to GDP (gross domestic ratio) ratios are usually not high in South Asia. But in case of Bangladesh the figure is alarmingly low - only a little higher than 9%, while the average for South Asian countries is 11%, the developing countries more than 15%, the industrialized countries 30%, and high income countries 24%.

Exempted Goods from value added tax are included in the First schedule, Exempted services from value added tax are included in the Second schedule and the Supplementary duty imposable goods and services are included in the Third schedule of the VAT Act. are subject to VAT. Almost the whole economy falls under the VAT-net and as a consumption tax, VAT is supposed to streamline the economic activities with corrective measures by applying supplementary duty. The objective of introduction of VAT in Bangladesh significantly to raise the tax revenue collection and behind the introducing of VAT in Bangladesh were to (a) bring transparency in the taxation system; (b) prohibit cascading taxation at different stages of production; (c) consolidate the tax administration; (d) activate the overall economy by mobilizing more internal resources; and (e) bring a consistency in the tax-GDP ratio.

In April 1979, the Taxation Enquiry Commission (TEC) officially took up the issue of introducing VAT in Bangladesh as an alternate to sales tax. Until 1982, sales tax was being collected under the Sales Tax Act 1951, which was replaced by the Sales Tax Ordinance 1982 with effect from 1 July 1982. The World Bank played the pioneering role in introduction of VAT in Bangladesh. The Value Added Tax Act 1991 was introduced in Bangladesh in 1 July 1991. The Value Added Tax and Supplementary Duty Act 2012 had been passed by the parliament.

Legal definition of Value Added Tax:

A tax levied at each addition of value in the processing of a raw material, the performance of a service, or the production and distribution of a commodity with each payer except the consumer reimbursed from payment ant the next stage called vat. (Source: Law dictionary. Merriam Webster)

A value-added tax (VAT), known in some countries as a goods and services tax (GST), is a type of general consumption tax that is collected incrementally, based on the surplus value, added to the price on the work at each stage of production, which is usually implemented as a destination-based tax, where the tax rate is based on the location of the customer. VATs raise about a fifth of total tax revenues both worldwide and among the members of
the Organization for Economic Co-operation and Development (OECD).\(^1\) As of 2014, 160 of the world's approximately 193 countries employ a VAT, including all OECD members except the United States, which uses a sales tax system instead. There are two main methods of calculating VAT: the credit-invoice or invoice-based method, and the subtraction or accounts-based method. Using the credit-invoice method, sales transactions are taxed, with the customer informed of the VAT on the transaction, and businesses may receive a credit for VAT paid on input materials and services. The credit-invoice method is the most widely employed method, used by all national VATs except for Japan. Using the subtraction method, at the end of a reporting period, a business calculates the value of all taxable sales then subtracts the sum of all taxable purchases and the VAT rate is applied to the difference. The subtraction method VAT is currently only used by Japan, although subtraction method VATs, often using the name "flat tax", have been part of many recent tax reform proposals by US politicians.\(^2,\)\(^3\) With both methods, there are exceptions in the calculation method for certain goods and transactions, created for either pragmatic collection reasons or to counter tax fraud and evasion.

2. Objectives of the Study

In the context the present research program is formulated to study the factors of VAT in Bangladesh with the major objectives mentioned below:

1. To identify the major problems of VAT system in Bangladesh.
2. To find out the prospects of VAT system in Bangladesh.
3. To provide recommendations for solving the problems.

3. Methodology of the Study

3.1 Study area

The study was conducted at 8 divisions in Bangladesh.

Sites-any 3

   National
   Divisional
   District


3.2 Study design
The study was Investigative Questionnaire Based Survey. Some Expert Group Consultation were done for result interpretations. Some case studies and user and professional group discussion also were done.

3.3 Sampling method
Random sampling method was used for the study.

3.4 Sample size and sampling plan
Sample size and sampling plan was given in the table below:

<table>
<thead>
<tr>
<th>Respondent</th>
<th>National</th>
<th>Divisional</th>
<th>Business Centers</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankers</td>
<td>22</td>
<td>25</td>
<td>25</td>
<td>72</td>
</tr>
<tr>
<td>Businessman</td>
<td>47</td>
<td>32</td>
<td>41</td>
<td>120</td>
</tr>
<tr>
<td>Practitioners</td>
<td>31</td>
<td>37</td>
<td>34</td>
<td>102</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>94</td>
<td>100</td>
<td>294</td>
</tr>
</tbody>
</table>

3.5 Sources of data
Data were collected from primary and secondary sources.

3.6 Sources of primary data
Primary data were collected from the respondents of the study area.

3.7 Sources of secondary data
Secondary data were collected from the books, journals, research report, annual report of different organizations, web site of National Board of Revenue and internet etc.

3.8 Tools for data collection
Data were collected by using questionnaire

3.9 Method of data collection
Data were collected by face to face interview with the respondents.

3.10 Variables
Respondent- any 3
Bankers
Businessman
Teachers
Practioners
Service holders

Age-
Below 40 years
40-65 years
More than 65 years
Population to be studied – Total Minimum 300.

3.11 Analysis of data
Collected data were tabulated, categorized and analyzed by using computer Program Microsoft EXCEL.

4. Results and Discussion
The results obtained from the present Value Added Tax system Research in Bangladesh are sequentially given here after analysis along with necessary interpretations.

4.1 Important problems for VAT system
The results obtained on the important problems of VAT system are given in the Table 1. The results show that less and incorrect skill of the VAT Payer and the Collector constituted and made the problem very complex. However the business Centers were fund to be more caring about the VAT system of the country.

Table 2: Respondent’s percent priority scores on most important problems for VAT system as per site

<table>
<thead>
<tr>
<th>Respondent</th>
<th>National</th>
<th>Divisional</th>
<th>Business Centers</th>
<th>Total</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT rate fixation</td>
<td>5</td>
<td>3</td>
<td>11</td>
<td>19</td>
<td>6.3</td>
</tr>
<tr>
<td>Skill of VAT payer and collector</td>
<td>15</td>
<td>14</td>
<td>29</td>
<td>58</td>
<td>19.3</td>
</tr>
<tr>
<td>Admin corruption</td>
<td>12</td>
<td>11</td>
<td>21</td>
<td>44</td>
<td>14.6</td>
</tr>
<tr>
<td>Legal weakness</td>
<td>10</td>
<td>9</td>
<td>16</td>
<td>35</td>
<td>11.6</td>
</tr>
<tr>
<td>Complex system</td>
<td>11</td>
<td>14</td>
<td>23</td>
<td>48</td>
<td>16</td>
</tr>
<tr>
<td>VAT item selection</td>
<td>13</td>
<td>14</td>
<td>23</td>
<td>50</td>
<td>16.6</td>
</tr>
<tr>
<td>Others</td>
<td>18</td>
<td>8</td>
<td>14</td>
<td>40</td>
<td>13.3</td>
</tr>
<tr>
<td>Total</td>
<td>84</td>
<td>73</td>
<td>137</td>
<td>294</td>
<td></td>
</tr>
<tr>
<td>Mean</td>
<td>12</td>
<td>10.4</td>
<td>19.6</td>
<td>42</td>
<td></td>
</tr>
</tbody>
</table>

Source: Field Survey, 2017
4.2 Most important Potential for VAT item

The found on the important potential of the VAT item was stated to be the import followed by agricultural processing sector as for future. The export sector was less mentioned for VAT but the higher VAT coverage than small VAT was recommended by the respondents.

Table 3: Most important Potential for VAT item

<table>
<thead>
<tr>
<th>Respondent</th>
<th>National</th>
<th>Divisional</th>
<th>Business Centers</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Import</td>
<td>25</td>
<td>17</td>
<td>25</td>
<td>67</td>
</tr>
<tr>
<td>Export</td>
<td>7</td>
<td>4</td>
<td>19</td>
<td>30</td>
</tr>
<tr>
<td>Agriculture</td>
<td>16</td>
<td>15</td>
<td>28</td>
<td>59</td>
</tr>
<tr>
<td>Increasing small VAT coverage</td>
<td>13</td>
<td>8</td>
<td>15</td>
<td>36</td>
</tr>
<tr>
<td>Increasing high VAT coverage</td>
<td>16</td>
<td>13</td>
<td>15</td>
<td>44</td>
</tr>
<tr>
<td>Others</td>
<td>9</td>
<td>5</td>
<td>7</td>
<td>21</td>
</tr>
<tr>
<td>Total</td>
<td>99</td>
<td>69</td>
<td>126</td>
<td>294</td>
</tr>
</tbody>
</table>

Source: Field Survey, 2017

Figure 1: Whether VAT system of Bangladesh is good

Whether VAT system of Bangladesh is good has shown in the above graph. From the result it was found that 32% respondents were agreed which was the maximum and 18% respondents were strongly agreed which was the minimum. On the other hand 31% respondents were disagreed and 19% respondents were strongly disagreed.
Figure 2: Whether VAT system of Bangladesh is updated

Whether VAT system of Bangladesh is updated has shown in the above graph. From the result it was found that 80% respondents were disagreed which was the maximum and no respondents (0%) were strongly agreed which was the minimum. On the other hand 10% respondents were agreed and 10% respondents were strongly disagreed.

Source: Field Survey, 2017

Figure 3: Whether VAT system of Bangladesh is lengthy

Whether VAT system of Bangladesh is lengthy has shown in the above graph. From the result it was found that 68% respondents were strongly agreed which was the maximum and no respondents (0%) were strongly disagreed which was the minimum. On the other hand 22% respondents were agreed and 10% respondents were disagreed.

Source: Field Survey, 2017
Figure 4: Whether VAT system of Bangladesh is complex

Whether VAT system of Bangladesh is complex has shown in the above graph. From the result it was found that 90% respondents strongly agreed which was the maximum and 0% respondents were disagreed and strongly disagreed which was the minimum. On the other hand 10% respondents were agreed. From the result it was clear that each and every respondent replied that the vat system is complex.

Figure 5: Whether there are problems in VAT system of Bangladesh

Whether there are problems in VAT system of Bangladesh has shown in the above graph. From the result it was found that 79% respondents were strongly agreed which was the maximum and 0% respondents were disagreed and strongly disagreed which were the
minimum. On the other hand 21% respondents were agreed. From the result it was clear that each and every respondent replied that there are problems in VAT system is.

Figure 6: Whether VAT system of Bangladesh should be modified

\[
\begin{array}{c|c|c|c|c}
 & \text{Strongly agreed} & \text{Agreed} & \text{Disagreed} & \text{Strongly disagreed} \\
\hline
\text{Strongly agreed} & 76\% & 24\% & 0\% & 0\% \\
\hline
\end{array}
\]

Source: Field Survey, 2017

Whether VAT system of Bangladesh should be modified has shown in the above graph. From the result it was found that 76% respondents were strongly agreed which was the maximum and 0% respondents were disagreed and strongly disagreed which were the minimum. On the other hand 24% respondents were agreed. From the result it was clear that each and every respondent replied that the vat system of Bangladesh should be modified.

Figure 7: Whether the new VAT law of Bangladesh should be implemented now

\[
\begin{array}{c|c|c|c|c}
 & \text{Strongly agreed} & \text{Agreed} & \text{Disagreed} & \text{Strongly disagreed} \\
\hline
\text{Strongly agreed} & 19\% & 11\% & 0\% & 70\% \\
\hline
\end{array}
\]

Source: Field Survey, 2017

Whether VAT system of Bangladesh should be implemented now has shown in the above graph. From the result it was found that 70% respondents were strongly disagreed which was
the maximum and no respondents (0%) respondents were disagreed which was the minimum. On the other hand 19% respondents were strongly agreed and 11% respondents were agreed.

Figure 8: Whether the new VAT law of Bangladesh should be implemented after 2 years

![Bar graph showing the percentage distribution of responses.](image)

*Source: Field Survey, 2017*

Whether VAT system of Bangladesh should be implemented after 2 years has shown in the above graph. From the result it was found that 69% respondents were strongly agreed which was the maximum and 0% respondents were strongly disagreed which was the minimum. On the other hand 11% respondents were agreed and 20% respondents were disagreed.

Figure 9: Whether the rate of VAT in new VAT law of Bangladesh should be decreased

![Bar graph showing the percentage distribution of responses.](image)

*Source: Field Survey, 2017*

Whether the rate of VAT in new VAT law of Bangladesh is accurate has shown in the above graph. From the result it was found that 90% respondents were strongly agreed which was
the maximum and 0% respondents were disagreed and strongly disagreed. On the other hand 10% respondents were agreed.

**Figure 10: Whether there are mismanagements in VAT Administration systems**

![Bar graph showing mismanagements in VAT Administration systems](image)

Source: Field Survey, 2017

Whether there are mismanagements in VAT Administration systems has shown in the above graph. From the result it was found that 80% respondents were strongly agreed and 5% respondents were disagreed and strongly disagreed which was the minimum. On the other hand 10% respondents were agreed.

**Figure 11: Different source of Government income**

![Pie chart showing different sources of Government income](image)

*Source: National Board of Revenue, 2016*

Different source of Government income has shown in the above graph. From the result it was found that income tax was the maximum source of government income which was 37% then second source of government income was Value Added Tax (VAT) which was 36%, then
third income source was supplementary duty which was 15% then the fourth income source was customs which was 10% and minimum income source was others which was 1%.

Table 4: Year wise total revenue and its growth

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Revenue (in BDT Crore)</th>
<th>Revenue Growth</th>
<th>Tax-GDP Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>1972-1973</td>
<td>166</td>
<td>-</td>
<td>3.34%</td>
</tr>
<tr>
<td>1980-1981</td>
<td>1,723</td>
<td>936%</td>
<td>5.35%</td>
</tr>
<tr>
<td>1990-1991</td>
<td>6,152</td>
<td>257%</td>
<td>5.57%</td>
</tr>
<tr>
<td>2000-2001</td>
<td>18,774</td>
<td>205%</td>
<td>7.40%</td>
</tr>
<tr>
<td>2010-2011</td>
<td>79,403</td>
<td>323%</td>
<td>10.08%</td>
</tr>
<tr>
<td>2014-2015</td>
<td>136,740</td>
<td>72%</td>
<td>10.80%</td>
</tr>
</tbody>
</table>

Source: National Board of Revenue, 2016

Year wise total revenue and its growth has shown in the above table. From the result it was found that each and every year, revenue and its growth were increasing.

5. Recommendations

1. All the activities of VAT system should be online based. VAT rules and regulations should be business friendly and the VAT laws should be revised in order to ensure compliance at the sale point is enhanced this will ensure improved compliance.

2. The NRB management should ensure that it comes out with a plan on how it could educate all the players in social VAT in order to ensure a better communication in terms of due dates for paying VAT and the way to make the payments. This education would go far in reducing non compliance and other errors relating to tax payment in the social platform transaction.

3. The study recommends that security levels of the e-VAT should be upgraded and maintained to user’s satisfaction. This will encourage more people to use the online services in their sales as well as compliance of VAT in the country. This will ensure that the government through NBR collects revenue inform of VAT through the social commerce platform.
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