

# Country Presentation<sup>1</sup>

## Tax Reforms in Bangladesh<sup>1</sup>

- 1 The views expressed in this paper are the views of the author and do not necessarily reflect the views or policies of the Asian Development Bank (ADB) or its Board of Directors or the governments they represent. ADB makes no representation concerning and does not guarantee the source originality, accuracy, completeness, or reliability of any statement, information, data, finding, advice, opinion, or views presented. <sup>1</sup>

# About the presentation

- ❖ The views expressed in this paper are the views of the author and do not necessarily reflect the views and policies of the National Board of Revenue, Bangladesh or Asian Development Bank.
- ❖ The presentation is based on my experience gained from being involved in the reform process & my 21 years service in the Taxation Department of Bangladesh.

# What is Tax reform

Generally tax reform is re-structuring and improvement in the tax system that includes:

- ❖ removal of imperfections, faults, errors, or short-coming in the tax system.
- ❖ change in the distribution of tax burden.
- ❖ Tax reform is not merely a tax change but a series of significant changes in the tax system, coupled with objectives in addition to the need for increase in tax revenue.
- ❖ Tax reform may take a variety of forms which can cover increases or decreases in tax rates, brackets or thresholds and changes in the tax base, the introduction of new taxes and the abolition of existing taxes and it can comprise changes in the mix.

## What is Tax reform (Cont.)

- ❖ Two approaches in tax reform- incremental approach and comprehensive approach.

The incremental approach consists of a series of small steps of tax changes and directed towards a predetermined goal. The reform is undertaken gradually and easy to manage by the tax authorities as well as to withdraw the reform if unpopular.

Comprehensive approach provides the opportunity for major tax changes in the tax reform. The reform comprises a series of essentially inter-related measures affecting more than one tax. This approach is considered difficult and too complex to undertake. It requires expertise and exceptional administrative measures to undertake.

- ❖ Bangladesh uses the incremental approach in introducing tax reforms from the beginning of 90's and generally it has been introduced through the Annual Budgets.
- ❖ Comprehensive approach tax reform started from late 90's mainly as conditionality of donor agencies-example is LTU- 4

# Why Tax Reform

Some common intellectual themes & concern of tax reform are as follows:

- ❖ Address adverse incentives effects of marginal tax rates;
- ❖ Increase and have certainty in revenue collection;
- ❖ Ensure vertical & horizontal equity;
- ❖ Curb tax evasion;
- ❖ Broaden tax base;
- ❖ Increase voluntary compliance of taxpayers;
- ❖ Enhance tax education;
- ❖ Pressure for internationalization of the world economy.

# Principles of Tax Reform

IMF (1997) identified 10 principles of Tax Reform:

- **Ascertain** political commitment & sustainability;
- Encourage voluntary compliance by taxpayers;
- Simplify tax system to facilitate administration and reduce compliance cost;
- Define a clear strategy;
- Identify tax and accounting laws which have to be changed;
- Ensure effective management of the reform process;
- Differentiate the treatment of taxpayers by size;
- Take an integrated approach to tax collection process;
- Set priorities and establish timetable;
- Begin reforms with projects;

# Fiscal Reform in Bangladesh

Fiscal policy reform started in in early 80's under Structural Adjustment Programme (SAP) as conditionality of IMF and World Bank. The aims of SAP were as follows:

- ❖ Macroeconomic stabilization;
- ❖ Reduced persistent fiscal deficit;
- ❖ Reduced dependence on scarce foreign aid for development;
- ❖ Financial sector reform;
- ❖ Trade liberalization & open market economy;
- ❖ Increased government revenues to finance govt. expenditures through tax reform.

# Objectives of Tax Reform of Bangladesh

- ❖ Increase tax-GDP ratio;
- ❖ Reduce compliance cost by rationalizing rate & structure of taxes;
- ❖ Widen tax base;
- ❖ Enhance institutional capacity to manage tax policy by establishing effective database management system;
- ❖ Strengthen taxpayer education & service;
- ❖ Implement organizational reform that would modernize tax administration;
- ❖ Improve tax administration by sealing leakage loopholes;
- ❖ Reduce corruption & enhance transparency

# Income Tax Reform

- ❖ Revenue: Reduce dependency on indirect taxes through increasing collection of income tax;
- ❖ Tax Law: Review & update of laws, regulations which will improve transparency, consistency, efficiency & administrability;
- ❖ Reduce exemption & allowances to remove economic distortions ;
- ❖ Data processing & MIS: Develop computer processing & information systems to automate certain tax administration activities;
- ❖ Widening Tax base: Increase no. of taxpayers. At present, around 1.8 million individual taxpayers & .5 million corporate taxpayers;

## Income Tax Reform (Cont.)

- ❖ Broadening the base of withholding tax: At present, tax is withheld from 33 items such as salary contractors, supply of goods, dividend etc.
- ❖ Taxpayer Education & Assistance: Promote taxpayer compliance by making taxpayer aware of their rights & responsibilities;
- ❖ Audit: Develop risk-based comprehensive audit program to ensure genuine declaration by taxpayer;
- ❖ Organizational Structure: Establish functional type organization to take advantage of the efficiencies of specialization. Large Taxpayers Unit (LTU) established. Develop comprehensive human resource plan to support functionally-oriented organization;
- ❖ Appeal: Establish expeditious, fair & transparent appeals system to build a relationship of trust;

# Customs Reform

- ❖ Tariff duty rate reduced from 250% to 25%;
- ❖ Amendment of Custom law;
- ❖ Simplification of policy & procedure: for import consignments signature requirement brought down to 11-13 from 49-51.
- ❖ Automation;
- ❖ PSI introduced;
- ❖ Direct Traders Input (DTI) introduced;
- ❖ HS code classification restructured and this enhanced transparency.
- ❖ All Customs SROs were complied and a single book was published for ready reference

# VAT Reform

- ❖ Introduced in 1991 - First resistance then widely accepted;
- ❖ Modern system of tax on goods & services;
- ❖ Coverage now up to retail level;
- ❖ Rate normally 15% - special rate on some specific goods & services;
- ❖ Amendment in VAT registration;
- ❖ Strengthening VAT audit;
- ❖ Turnover tax;
- ❖ Computerization.

# Organizational Reform (NBR Reform)

Under the Strategic Development Initiative, a project has been started to reform National Board of Revenue (NBR). NBR modernization strategies are:

- ❖ Organizational restructuring;
- ❖ Improving Human Resource Management;
- ❖ Strengthening Legal & Regulatory framework;
- ❖ National implementation of tax administration functions/procedures;
- ❖ Customs modernization & trade facilitation;
- ❖ Strengthening computerization of NBR

# Post Reform condition

- ❖ No evaluation has so far been done;
- ❖ None of these reforms has delivered every thing it promised but resulted in substantial improvement in tax system;
- ❖ All tax rates and structures rationalized;
- ❖ Collection of revenue increased;
- ❖ Discretionary powers of tax officials have been curtailed;
- ❖ Simplification of laws & procedures has not been done as expected;
- ❖ Computerization program achieved little success;
- ❖ Dependence on indirect tax is still continuing;

# Post Reform condition (cont.)

- ❖ Increase in number of taxpayer-tax base is still narrow;
- ❖ Voluntary compliance has not been increased as expected;
- ❖ Poor taxpayer service and taxpayer education;
- ❖ Excessive exemptions & allowances;
- ❖ Autonomy of NBR;
- ❖ Modern tax practices are not followed completely by tax administration . Tax administration could not develop a comprehensive human resource programme to do its job efficiently and effectively
- ❖ Reform through LTU is still under question;
- ❖ Tax Ombudsman office established for tax related maladministration.

# Lessons Learnt

- ❖ Incremental reform has been successful but comprehensive & prescriptive reform was not very successful;
- ❖ Comprehensive reform needs government with long horizon & sustained political commitment to change;
- ❖ Adaptation of reform to domestic condition;
- ❖ Support from the country's tax administration;
- ❖ Involve tax officials in identifying the problems to be addressed;
- ❖ Pressure of a politically powerful mentor;
- ❖ Comprehensive tax reform takes time, needs continual evaluation & adjustment;
- ❖ Tax policy and administration are interdependent and therefore they must be considered together in tax reform;
- ❖ Tax reform is a component of broader fiscal reform. If other fiscal reform does not take place then comprehensive tax reform is difficult.

Thank You