

# THE VALUE-ADDED TAX (VAT) IMPROVEMENT PROGRAM

RAISING THE OPERATIONAL EFFICACY OF THE VAT  
ADMINISTRATION IN BANGLADESH

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Value-added tax (VAT) generates over a third of government of Bangladesh (GoB) revenues, with little progress on strengthening direct taxation. Robust social protection systems can mitigate VAT's regressive character, but Bangladesh's social protection programmes inadequately cover urban low income households. During 2015–2021, the World Bank's VAT Improvement Program facilitated Bangladesh's VAT automation, but lacked equity objectives and fell short on improving transparency and taxpayer satisfaction. The GoB must enhance social protection coverage and make VAT administration gender-aware, given negative effects on low income female entrepreneurs and consumers. Bangladesh and its development partners should focus on boosting progressive direct taxation.

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# EXECUTIVE SUMMARY

Bangladesh currently has a weak and inequitable tax system. This undermines not only domestic revenue mobilization (DRM), but also the social contract between citizens and their government. It is a key driver of budget allocations for education and healthcare that are far below targeted levels. Tax revenues are currently 7.7% of gross domestic product, the lowest level in South Asia. The government depended heavily on indirect taxation for more 55% of revenues in 2018, and this contributes to both real and perceived unfairness. There is a lack of political commitment to reduce widespread exemptions and tax incentives, tax avoidance and evasion from both companies and a growing number of high net-worth individuals.

In his 2016-2017 budget speech, the Minister of Finance committed the government to collect “50% of total revenue from direct taxes in the year 2020-2021” (Ministry of Finance, 2016). This could mobilize more than \$5.9 billion, enough to double the entire health budget. Despite this pledge, from 2014 to 2020, Bangladesh received support from the World Bank not to strengthen direct taxation, but to implement a six-year, \$60 million project called the Revenue Mobilization Program for Results: Value Added Tax (VAT) Improvement Program (VIP). There were concerns that the project would reinforce the country’s dependence on indirect taxes. SUPRO, the Campaign for Good Governance, with support from Oxfam, undertook research on VIP and tax policy in Bangladesh more generally.

VAT is an indirect consumption tax charged on goods and services at each stage of production and distribution processes, from labour and raw materials to the sale of final consumable products or services. So it is broader than a sales tax, which is assessed only at the final stage of consumption.

Over the past 15 years, the Government of Bangladesh (GoB) has relied on VAT for more than a third of all tax revenues, with little progress towards strengthening taxation of high net-worth individuals and large corporations. The country’s VAT law, revamped in 2012 and further amended in 2019, offers businesses the choice of a uniform tax rate or multiple rates. It also exempts certain goods and services altogether. This is a common way worldwide to try to reduce the regressive impact on low income people and protect infant industries, but large corporations and other interest groups also use these exemptions to avoid paying taxes.

VAT’s effectiveness for domestic revenue mobilization (DRM) declines if a large share of economic activities occurs in the informal sector, or if exemptions proliferate into larger industries and economic sectors. A sizeable informal sector also tends to make VAT evasion more likely. In Bangladesh, the informal economy accounts for more than 85% of employment and 40% of gross value added.

Many experts believe that the revised law can help improve the efficiency of revenue mobilization, especially if the country undergoes a smooth transition from manual to automated VAT collection. Automation offers an important way to reduce VAT evasion, which is widespread in Bangladesh.

Studies of VAT around the world indicate that it is a regressive form of taxation, but robust social protection systems can mitigate this, especially if combined with VAT exemptions for necessities. A major issue in Bangladesh is that social protection programmes inadequately cover low income households in urban areas. Although 20% of urban dwellers live in poverty, government safety net programmes only reach 11% of urban Bangladeshis. Low income urban dwellers interviewed for this report were unaware of their eligibility to receive social protection benefits. Also, certain essential purchases remain subject to VAT, e.g. medicines and cell phone charging services.

Women in Bangladesh face unequal rights to own property, wage discrimination, and unequal distribution of power within the household and society. Women entrepreneurs interviewed as part of this research indicated that current tax policy fails to take these inequalities into account. As

most women entrepreneurs have micro-, small- and medium-sized enterprises, they see the standard 15% VAT as threatening their competitiveness. On the consumer side of the equation, low income women have to pay VAT on menstrual products, which takes a bite out of their limited household budgets.

During 2015–2021, the World Bank’s (WB) VAT Improvement Program (VIP) assisted the Bangladesh National Board of Revenue (NBR) in improving VAT administration. Notably, the project helped significantly in expediting the automation process. VIP also exceeded its target on increasing the total value of electronic VAT payments by a factor of nearly 25 (BDT 2.6bn vs. the target of BDT 105m). The project sought to reduce the processing time for VAT refunds from 120 to 102 days, and surpassed that goal, achieving 90 days.

However, the VIP project did not include any objectives to improve equity and fairness of VAT or the tax system more broadly. The project did not conduct a distributional impact analysis to understand which income groups are most affected by VAT automation, or how this reduced or increased inequality.

VAT revenue increased to 1.15 trillion Bangladeshi takas (BDT) in fiscal year (FY) 2020–2021, surpassing VIP’s target of BDT 914bn. Revenues increased by 15.1% annually during the life of the programme, although growth slowed to just 4.9% after the onset of the coronavirus pandemic. In contrast, growth in revenues from direct taxation – such as corporate and personal income tax – was slower, even declining from 2014 to 2018. This highlights an important trade-off, and missed opportunity to improve direct taxation as committed to by the Minister of Finance in 2016.

Due in part to the COVID-19 crisis, VIP fell short on its ambitions to improve the transparency of VAT administration. The programme sought to enhance auditing, so that additional revenue might come from more accurate assessments. But the government never issued an audit manual to help achieve this objective. The NBR website does disclose monthly VAT collection and refunds, and has also posted information on e-services, regulations, forms, frequently asked questions, enabling structures, systems, processes and how to contact Right to Information (RTI) officials. It is questionable how much the website contributes to transparency given that the World Bank points out that less than 13% of the population of Bangladesh has access to the internet.

Nor did VIP achieve the target level of increased taxpayer satisfaction with services. Research for this report and other studies have found high levels of dissatisfaction with numerous aspects of VAT among both consumers and entrepreneurs, and notably among low income and female consumers and entrepreneurs, so the outcome is a disappointing one.

Since economic activities through e-commerce and Facebook-based commerce, as well as digital payments, are expanding fast, VAT evasion is also likely to increase. In this context, integrating technology-based solutions will be key to improve VAT compliance management.

The key challenge for NBR is to continue the framework and process developed with the support of VIP and fine-tune it when and where required. In this regard, it is concerning that prior aid-supported tax reform projects ceased to have much effect beyond the life of those projects. Furthermore, resistance to fully automated VAT compliance procedures is likely to come from both within and outside NBR, as such procedures challenge NBR officials’ discretionary power and the scope of VAT evasion for businesses and political elites.

In order to address the regressive nature of VAT and its significant impact on low income households, it is imperative that the government improve the coverage of social protection programmes, particularly in urban areas. Those programmes will require improvements in their design and targeting, as well as better outreach to ensure that eligible people know how to access the benefits to which they are entitled.

Bangladesh and its external partners, such as the World Bank, need to focus future DRM efforts on strengthening effective taxation of corporations, high net-worth individuals, wealth, property and capital, and on other progressive streams of revenue.

At the same time, the government needs to put an end to gender-blind VAT administration and recognize that the tax currently has negative effects on low income female entrepreneurs and consumers. Such measures as reduced VAT and tariff rates for micro-, small- and medium-sized businesses (the bulk of women-owned enterprises) and adding menstrual products to the VAT-exempt list would contribute to both fiscal and gender justice.

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## Research reports

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## SUPRO

Sushasoner Jonny Procharavizan (SUPRO/Campaign for Good Governance) is a national network of grassroots nongovernmental organizations in Bangladesh, working to establish economic, social and cultural rights of poor and marginalized people at all spheres of society and state through facilitating right based activism at grassroots, national and global level. SUPRO critically analyses global and national level rules, regulations and policies to facilitate grassroots activism to make these work for the poor and marginalized people.

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