



Of all the
Debates and Denouncements
about Implementing the
**Value Added Tax (VAT) and
Supplementary Duty Act, 2012**

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The recently concluded session of the parliament that passed the national budget of TK. 400,266 crore for the fiscal year 2017-18 stands out and catches much public attention for deferring the implementation of the much waited and debated Value Added Tax (VAT) and Supplementary Duty Act, 2012 by two more years. The much talked act was passed by the parliament, as its title suggests, in 2012 and after a series of deferment was finally scheduled to be in effect from July 01, 2017. However, the implementation was delayed again amid much worries and oppositions of the business community as well as member of the public. This article intends to critically analyze some of the issues of mass concern and interest regarding the impugned act.

The proposed Value Added Tax (VAT) and Supplementary Duty Act, 2012 (hereinafter, we will term it as "the proposed act") surfaced as a part of ongoing reform process of the tax system of Bangladesh and it will, as and when come into force, supplant the existing VAT act 1991 which is allegedly full of distortions and deviations from a correct VAT system. Apart from removing distortions it is also envisioned that the proposed act for its overarching uniform and single rate of 15% will augment revenue mobilization in the exchequer. In essence, in anticipation of materializing the proposed act, in the current fiscal year 2017-18 the revenue collection on account of VAT is estimated TK. 91,000 crore against 68,000 crore in the fiscal year 2016-17. Hence suspending the implementation of the proposed act may cast serious doubt about realizing the estimated revenue that may in turn put materializing the whole budget in jeopardy for the fiscal year 2017-18.

Coming out of the trap of low tax-GDP ratio is one of the most important agendas, priorities, and necessities in the development paradigm Bangladesh is currently pursuing. Being imbued in the mandate of article 15 of the constitution of the peoples' republic of Bangladesh we have been consistently following planned economic growth as a fundamental principle for governing the economic affairs since independence and as such, so far as, we have covered six 5 year plans and currently in 2016-20 we are following the Seventh Five Year Plan (SFYP) that partly coincides with the period 2016-30 for attaining Sustainable Development Goal (SDG). The SFYP sets the target of enhancing tax as a percentage of GDP from existing around 10% to more than 16% by 2020 seems to be pivotal in attaining sustained GDP growth rate of 7.4%. While the goals and targets of SDG are fundamentally similar to those of SFYP and are equally important SDG 8 - decent work and economic growth - is central to other SDGs and SDG 9 - industry, innovation, and infrastructure - is instrumental to SDG 8. Nevertheless, our dream to be graduated to the status of middle income country by 2021 and developed country by 2041 requires 7.5% to 8% GDP growth rate for which we need the investment to be raised to 33% of GDP as the target set in SFYP. All these achievements rely heavily on internal resources mobilization for adequate investment by the government in the development of infrastructure. In such backdrop reforms in the tax system bringing required changes in the VAT law to eliminate all forms of distortions and deviations with a view to augmenting internal resources mobilization bear much significance to our ongoing nation building efforts.

The proposed act with uniform and single rate of 15% VAT in all applicable stages and cases aims at eliminating distortions of current VAT system prevailing in Bangladesh. A correct and ideal VAT system operates on credit mechanism in which the final consumer is the ultimate payer of VAT and as such all the entities in between are simply intermediaries. None of them is payer; everyone is the collector of VAT since an intermediary collects VAT - output tax - from the intermediary of the next stage or from the final consumer, takes credit of VAT - input tax - paid to the intermediary of the previous stage and finally deposits the remaining amount - output tax less input tax - to the exchequer. However, in order to get input tax credit requires certain conditions to be fulfilled

and proper documentation to be maintained. Fulfillment of conditions and maintenance of documentation even though seem to be cumbersome nonetheless ensure accountability and transparency in the tax system. Such credit mechanism is the bedrock upon which the proposed act and VAT system stand and can operate properly as well as uninterruptedly if and only if a uniform and single rate of VAT is applied in all applicable stages and cases. From this standpoint, the foundation of the proposed act looks much solid and stronger and hence it deserves to be accepted and implemented.

The VAT act 1991 - the law currently in force - and for that matter, the existing VAT system is featured by 15% VAT as well as a bunch of rates less than 15% in contrast to the uniform and single rate of 15% in the proposed act. Such multiplicity of rates less than 15% is the prime reason of preference to adhere to the existing system and repugnance against the adoption of the proposed act by the business community. In essence, the very idea of rates less than 15% is a misnomer. The rate is still 15%, however, the base or value upon which the rate 15% is applied is reduced or truncated. For example, in the existing system, it is said that the rate of VAT on construction work is 6%. It so turns out that for VAT excluded value of a construction work of TK. 10,00,000/- VAT amounts $(10,00,000/- * 6%) = \text{TK. } 60,000/-$. Here, actually for the purpose of imposing VAT the base or value of the construction work TK. 10,00,000/- has been reduced or truncated to 40% at $(10,00,000/- * 40%) = \text{TK. } 400,000/-$ upon which the rate 15% is applied to arrive at the same amount of VAT $(400,000/- * 15%) = \text{TK. } 60,000/-$. The basic idea of this illustration is true for all the rates below 15% in the prevailing system. However, as the rate varies, so does the extent of reduction or truncation of the base or value. Hence, the rate 4.5% implies that the VAT imposable base or value has been reduced or truncated to 30%. Similarly, the rate 3% results in the reduction or truncation of the base or value to 20%. It may be generalized in the following way:

Percentage to which the base or value is reduced or truncated = $\frac{\text{(Rate below 15\%)}}{\text{(Actual rate 15\%)}} * 100$

While the rates below 15% resulting from truncated base appear to be glamorous to the intermediaries it does not, on the other hand, allow them to take the benefit of input tax credit. The same is true for the tariff value of imposing

VAT in existing system. On this count, both the truncated base and tariff value of imposing VAT are stark departures from the correct VAT system and the sources of distortions in existing system, but paradoxically, the main arguments of the intermediaries for adhering to the existing system.

A long list of goods and services, in the prevailing system, is subject to VAT under tariff value and truncated base and their magnitudes are different for different items. However, if the magnitudes of tariff values and truncated bases are computed properly based on the amount of value addition there would not exist any incentive for these schemes to be accepted in view of the fact that intermediaries are not entitled to get input tax credit if they resort to tariff value or truncated base. Ideally, there should not be any difference between the VAT payable without input tax credit under tariff value or truncated base and the net VAT payable based on usual sale value with input tax credit. If this is the case then an obvious question arises - why do the intermediaries or for that matter business community prefer the existing VAT system featured by tariff values and truncated bases and oppose implementing the proposed act that sheds off tariff values and truncated bases? In my analysis I find three possible answers to this question. First, intermediaries find it cumbersome of maintaining proper documentation required for getting input tax credit. Second, intermediaries are inordinately biased to the rates below 15% associated with truncated base and apparently less amount of VAT resulting from tariff value while they are not aware of the fact that the net VAT resulting from 15% rate and usual sale value with input tax credit does not make any significant difference to the VAT arising from truncated base and tariff value. Third, Intermediaries care less about cascading effect - VAT on VAT - which is an obvious concomitant of truncated base and tariff value. Since under truncated base and tariff value regime input tax credit is not allowed, VAT paid for purchasing raw materials and other inputs is essentially included in the product cost and hence becomes the part of value addition which in turn is taxed as output. However, it results in fewer amounts of net income and income tax payable as the input taxes are claimed as expenses which in the correct VAT system are credited against output tax and hence are not allowed as expenses in computing net income and income tax payable.

Apart from aforesaid reasoning, it seems to be taken as guaranteed that the implementation of the proposed act will induce inflation in the economy because of the imposition of 15% VAT at all stages and cases. However, a careful analysis may reveal otherwise. For example, in the current system, M.S. Products and utilities such as electricity, gases are subject to VAT under tariff value and truncated base respectively. If the market price of a ton of M.S. Product is TK. 50,000/- and the tariff value of the same for imposing VAT is TK. 3000/- , a ton of M.S. Product will cost a consumer TK. $(50,000/- + (3000/- * 15\%)) = 50,450/-$ in total in the current system. Someone may come to the naive conclusion that in the proposed act the total cost of a ton of M.S. Product to the final consumer will be TK. $(50,000/- + (50,000/- * 15\%)) = 57,500/-$ and hence, it will induce inflation as price rises from TK. 50,450/ to TK. 57,500/- and also argue that since these items i.e. M.S. Products and utilities such as electricity, gases are the basic inputs for the production of myriad goods and services VAT induced rise in prices of these inputs will result in negative supply shock leading to the increase in overall price level and decrease in total output of the economy. However, such conclusion and argument may not prove convincing in the exercise of rigorous scrutiny. Under the proposed act, the VAT excluded price of a ton of M.S. Product must come down below TK. 50,000/- since the VAT paid for purchasing inputs and subsumed in TK. 50,000/- must be subtracted from it. If it so happens that the amount of VAT paid for purchasing inputs and subsumed in TK. 50,000/- is TK. 6130/- the VAT excluded price of a ton of M.S. Product will stand at TK. $(50,000/- - 6130/-) = 43,870/-$ and hence in the proposed act a ton of M.S. Product will cost a consumer TK. $[43,870/- + (43,870/- * 15\%)] = 50,450/-$ in total as well.

Similar exercise can be done for utilities such as electricity, and gas. It is argued that the implementation of the proposed act will increase the price of utilities and thus cause inexplicable miseries to the common people. However, it can be shown as above that since in the current system unit price of utilities includes VAT paid for purchasing inputs the VAT imposable unit price under the proposed act will come down below the prevailing unit price, as the input VAT shall be subtracted from it, to such extent so that the

imposition of 15% VAT will not make the total cost of electricity to a consumer any significant difference between the existing system and proposed act.

Also the argument of VAT induced inflation on account of the proposed act is untenable from the standpoint that more items are reported to be exempted from VAT in the proposed act than those are exempted in the current VAT regime.

Finally, the proposed act is pounded with criticism with regard to the some of the issues relating to the transition from the current VAT regime to the proposed act. One of such issues is the VAT Deduction at Source (VDS) on contract made in the current regime but payment shall be made under the proposed act. For example, if the VDS excluded value of a contract for a construction work made under the current VAT regime is TK. 10,00,000/-, the VDS shall be at 6% so that the total contract value will be TK. 10,60,000/- and the contractor expects to receive TK.10,00,000/- after VDS. It is argued that had the proposed act been implemented and the payment for this contract would have been made in the proposed VAT regime the contractor would be adversely affected since after the VDS at 15% of TK. (10,00,000/- * 15%) = 150,000/- the contractor would receive TK. (10,60,000/- - 150,000/-) = 910,000/- which is less than his/her expectation of TK. 10,00,00/- . However, such argument is not tenable in view of the fact that the VDS excluded value of the contract TK. 10, 00,000/- includes the VAT paid for purchasing all the inputs required for the execution of the contract. If the amount of such VAT is, suppose, "T" the VDS imposable value of the contract under the proposed VAT regime will be TK. (10, 00,000/- - T) and the contractor is entitled to receive input tax credit of TK. "T" subject to the maintenance of proper documentation. In such case, it may be shown in the following way that for a certain amount of "T" the contractor will remain unaffected even though the VDS is applied at 15% instead of 6%:

$$[(10, 00,000/- - T) * 15\%] - T = (10, 00,000/- * 6\%)$$

Hence, T = 78,268/-

Here, T = 78,268/- is the critical value. If the contractor can produce the documents of "T" for more than TK. 78,268/- s/he will end up receiving more than TK. 10,00,000/- and thus will be benefited rather than adversely affected for

switching to the proposed act from the current VAT regime.

In this article, efforts have been made to address some of the issues raised against implementing the proposed Value Added Tax (VAT) and Supplementary Duty Act, 2012. However, revenue impact of the proposed act on both VAT and income tax has not been analyzed because of the limited scope of the article. It is argued in the article that intermediaries and for that matter business community for themselves should not much worry about the rate of VAT. Whatever may be the rate is not going to affect them as eventually they are not paying any VAT. They are simply as intermediaries collecting the VAT in order to deposit to the government exchequer from the final consumers who are the ultimate payers. The proposed act requiring them to maintain proper documentation envisions bringing transparency and accountability in the tax system with a view to improving trust and confidence among tax authority, intermediaries, and final consumers in order to make sure that right amount tax is collected and the collected tax is deposited to the exchequer properly and timely. The article claims that the much of the worries and concerns of the business community and members of the public about the adverse effects of implementing the proposed act are unfounded. However, in order to dispel the wrong notions and to make it clear that the proposed act is beneficial to all, effective dialogues are needed among the related parties. The ideas expressed in this article may come as a help in this regard.

The article also argues that the proposed act through ensuring transparency and accountability in the tax system will boost the mobilization of both VAT and income tax. Because of the symbiotic relationship between VAT and income tax, prominently as the bottom line of both the taxes is sales revenue, the proposed act may result in revenue synergy for both VAT and income tax. Thus both the wings of National Board of Revenue (NBR) should work together in a holistic approach and take collective efforts for implementing the proposed act. The sooner, the better. 

"In investing, what is comfortable is rarely profitable."

- Robert Arnott