

Using Direct Taxation to Boost Revenue and Tackle Inequality

Presentation by:

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Bangladesh: Revenue mobilization and public spending have implications for inclusive growth

- Bangladesh's tremendous socio-economic progress
 - ...But two issues need special attention – rising inequality and low public spending



- Low public expenditure contributing to rising inequality?
 - Fiscal space is shrinking; Health, education, social protection spending under pressure

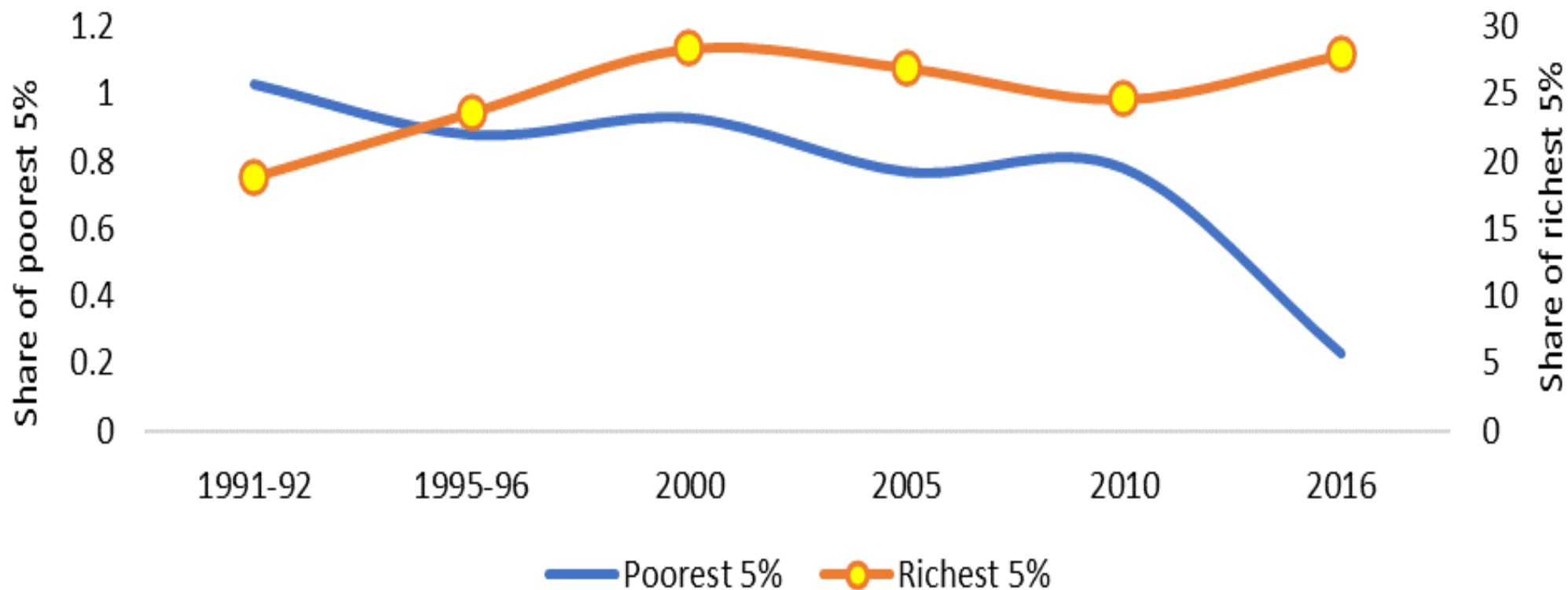


- Why is public spending low in Bangladesh?



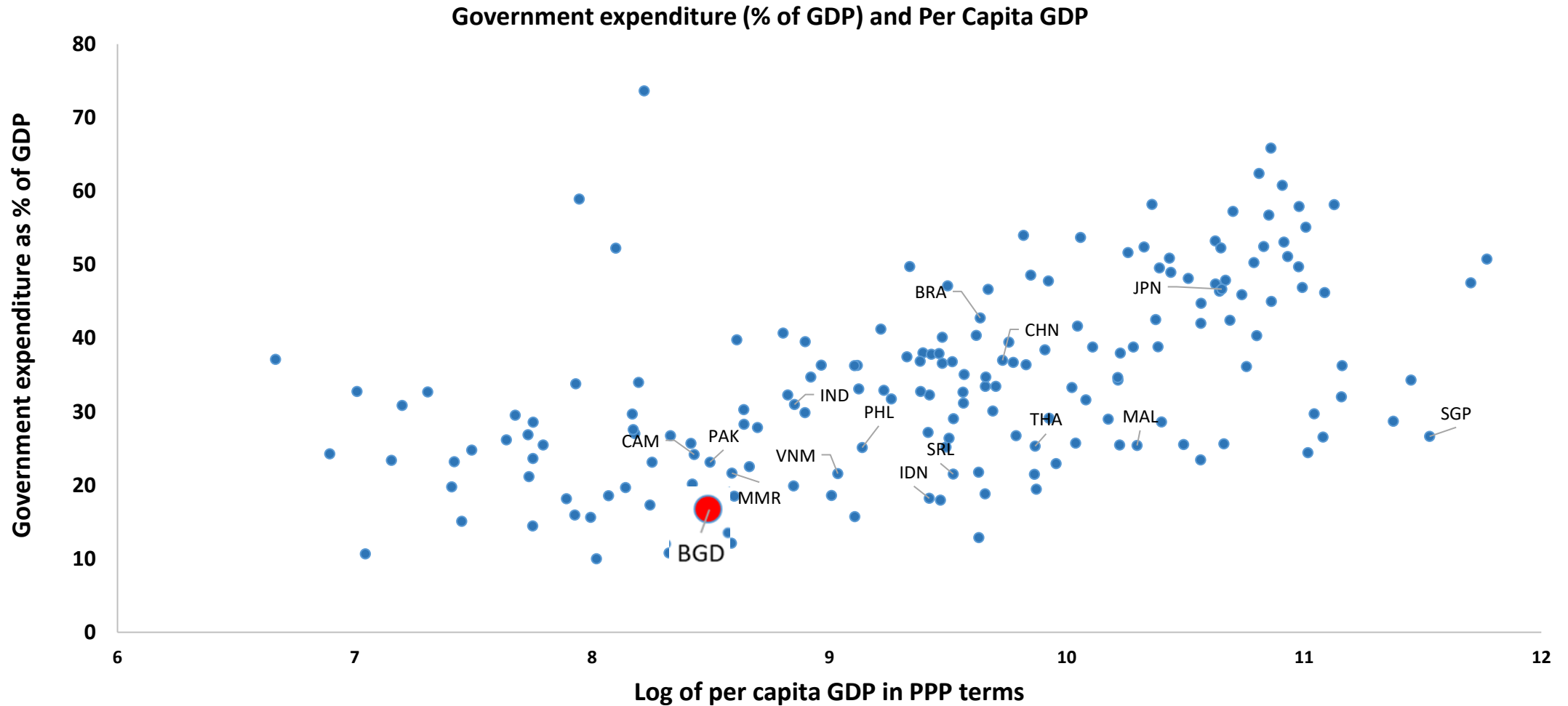
- **There is a massive opportunity to address the above two issues with one single policy instrument.**

The income share of the bottom 40% population fell from more than 17 per cent in the 1990s to 13 per cent in 2016. The income share for the bottom 5% declined from 1.03 per cent to just 0.23 per cent.

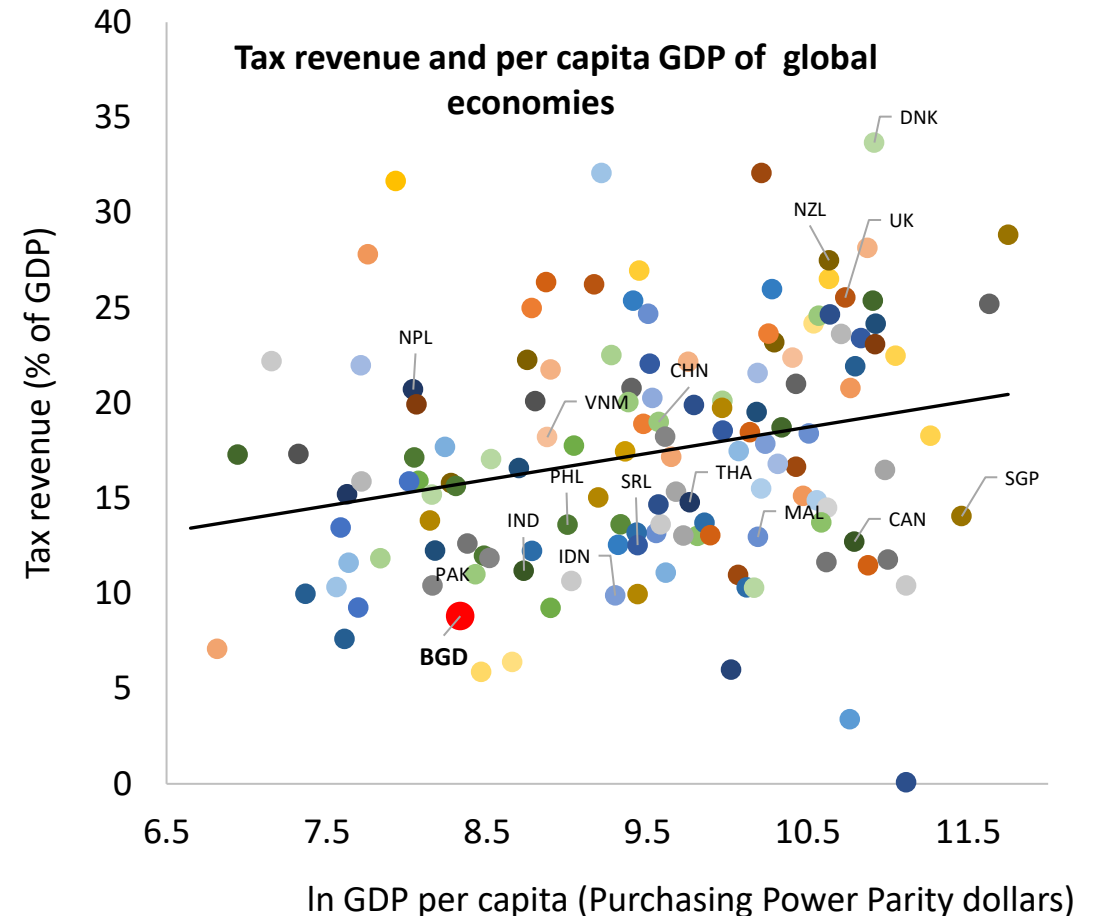
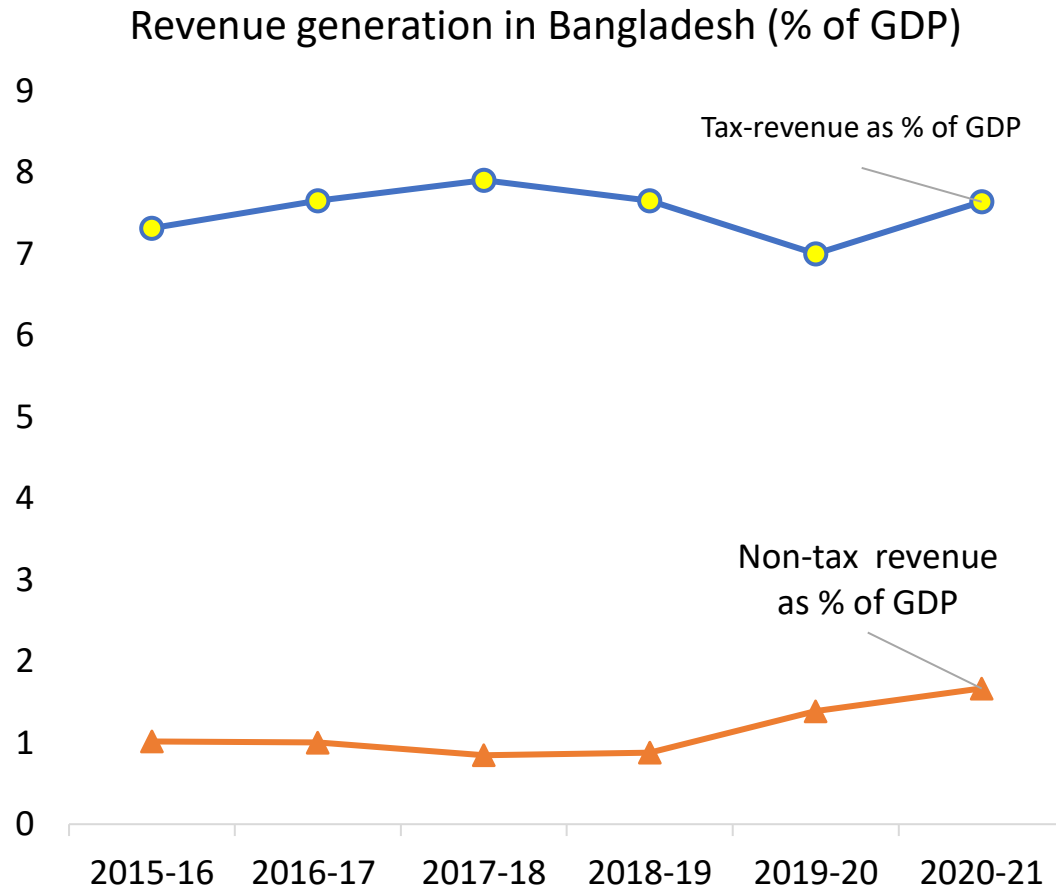


Source: Razzaque et al. (2020) using Household Income Expenditure Survey (HIES) data, various years.

Bangladesh has low government expenditure-GDP ratio: 15-16% of GDP as against of developing country average of 23% of GDP.



Bangladesh's tax-GDP ratio is one of the lowest amongst global economies—9% of GDP.



Recent policy direction to promote direct tax is a welcome initiative.

- আয়কর এবং মুসকের আওতা সম্প্রসারণ বৃদ্ধি, করহার কমিয়ে রাজস্ব আয়ের পরিমাণ বৃদ্ধির জন্য কৌশলগত ব্যবস্থা গ্রহণ, করযোগ্য বিভিন্ন পেশায় নিয়োজিত সকল ব্যক্তি/প্রতিষ্ঠানকে আয়কর এবং মুসকের আওতায় আনার সুপারিশ করে;
- বাংলাদেশের প্রত্যক্ষ কর ও পরোক্ষ করের বিদ্যমান অনুপাত ৩৫:৬৫ হতে অতিদ্রুত ৭০:৩০ হারে নামিয়ে আনার উদ্যোগ গ্রহণের সুপারিশ করে;

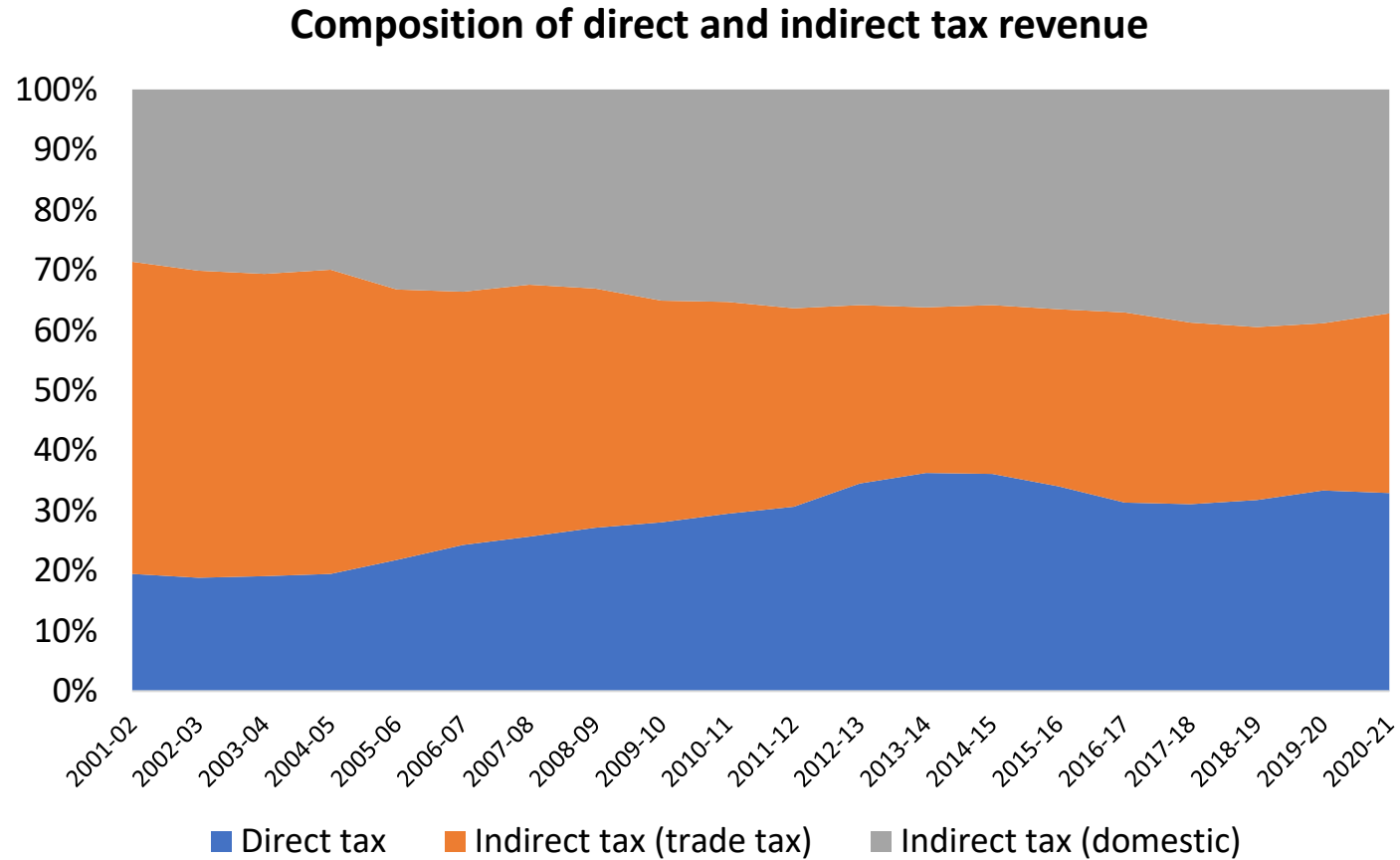


The translation of the relevant second bullet above: Take initiatives to reduce dependency on indirect tax. The ratio of direct and indirect tax will be increased from 35:65 to 70:30 immediately.

Source: According to the PPTs presented by the NBR at national consultation workshop held on 3 September 2022.

দ্বিগুণ করতে হবে প্রত্যক্ষ কর: <https://www.prothomalo.com/business/world-business/sj4dyglexf>

Bangladesh's tax revenue is overwhelmingly dependent on indirect taxation: direct tax comprises just 35% of total revenue.



Why direct tax is important?

Ensures equity (horizontal and vertical equity)

Creates public consciousness – taxpayers directly face the burden of taxes and hence take keen interest in how public funds are spent.

Relatively elastic - As income and wealth of individuals and companies rise, the yield from direct taxes will also increase.

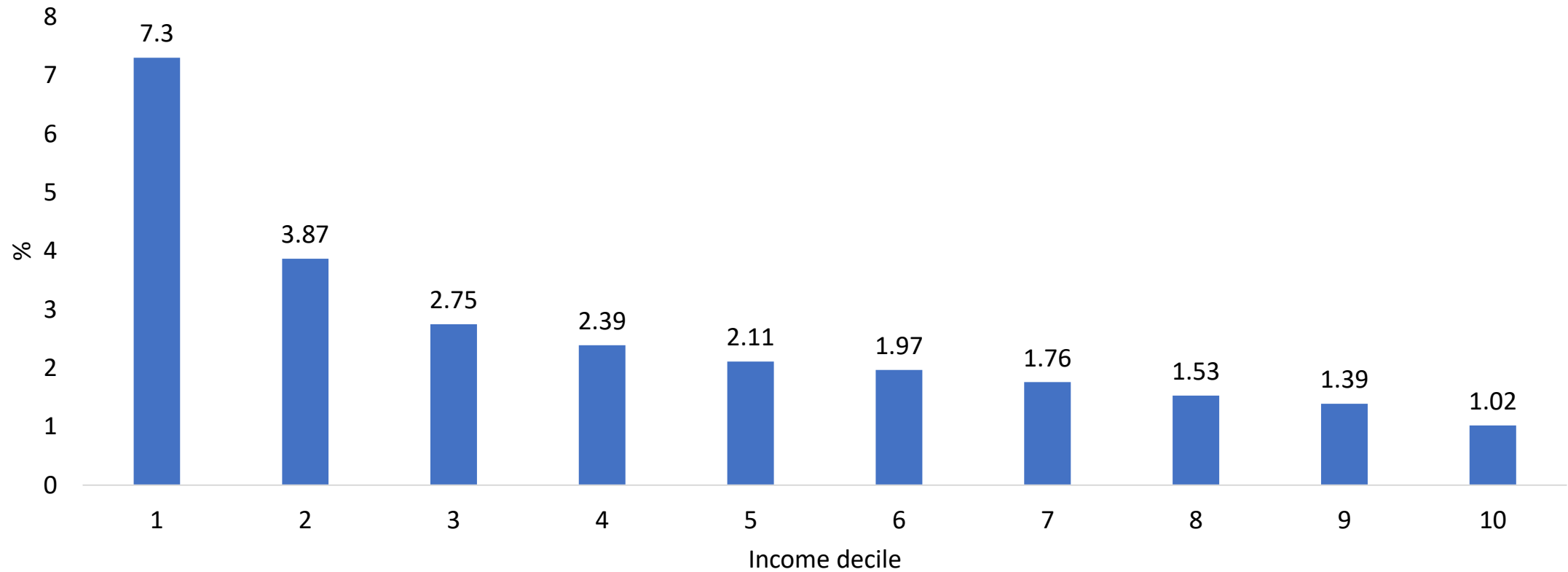
Reduces income inequality and promotes fairness

Cross-country evidence suggests that direct tax is likely to address inequality

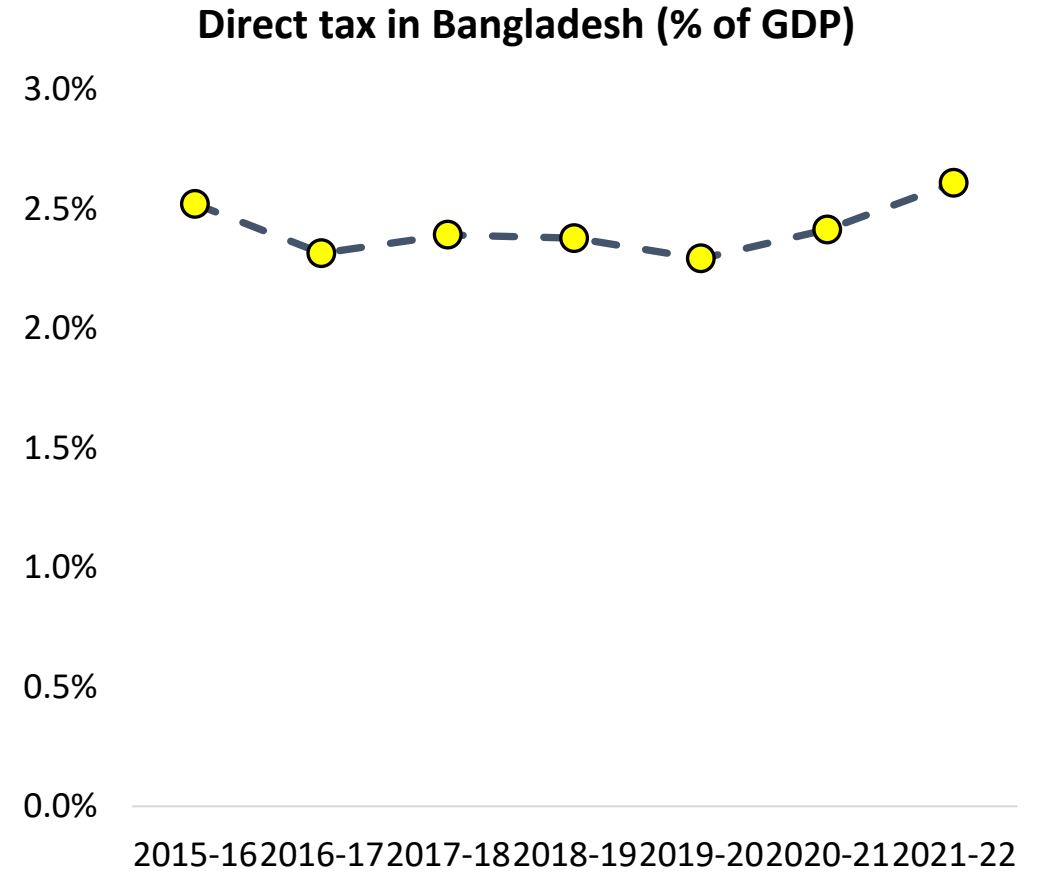
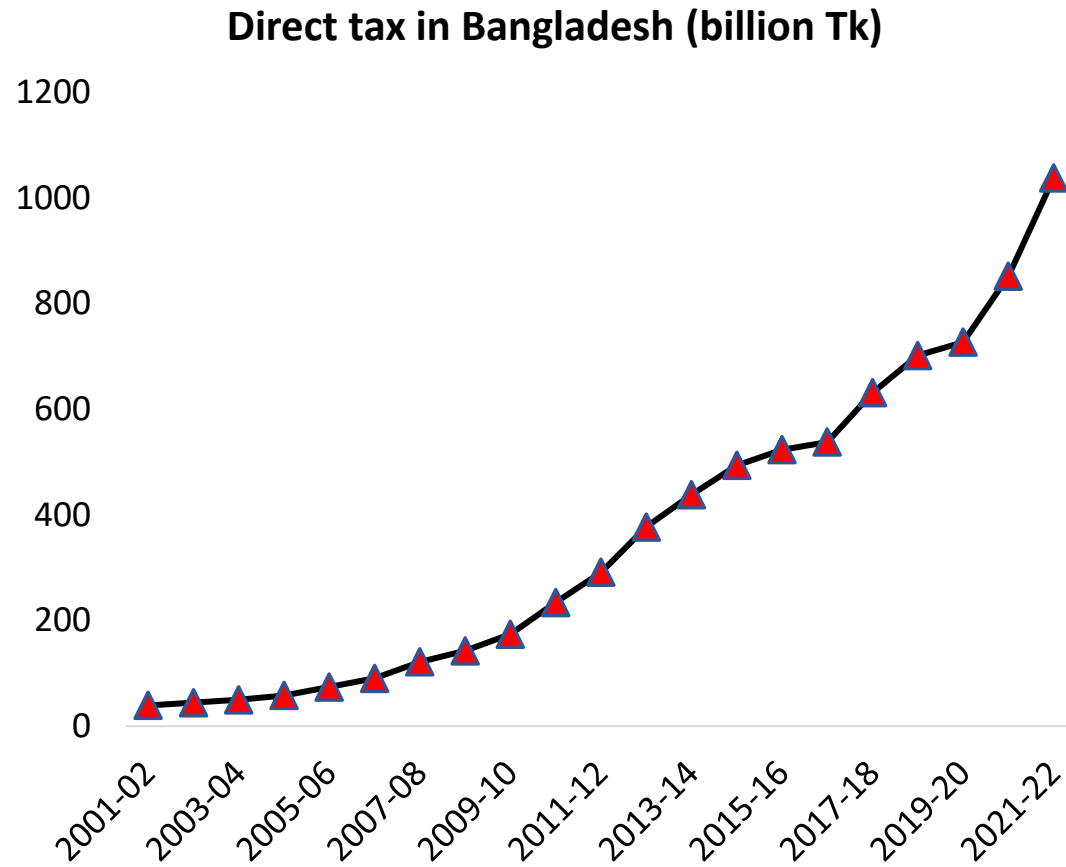


Indirect tax has disproportionately higher burden on low-income households thus further aggravating the inequality situation.

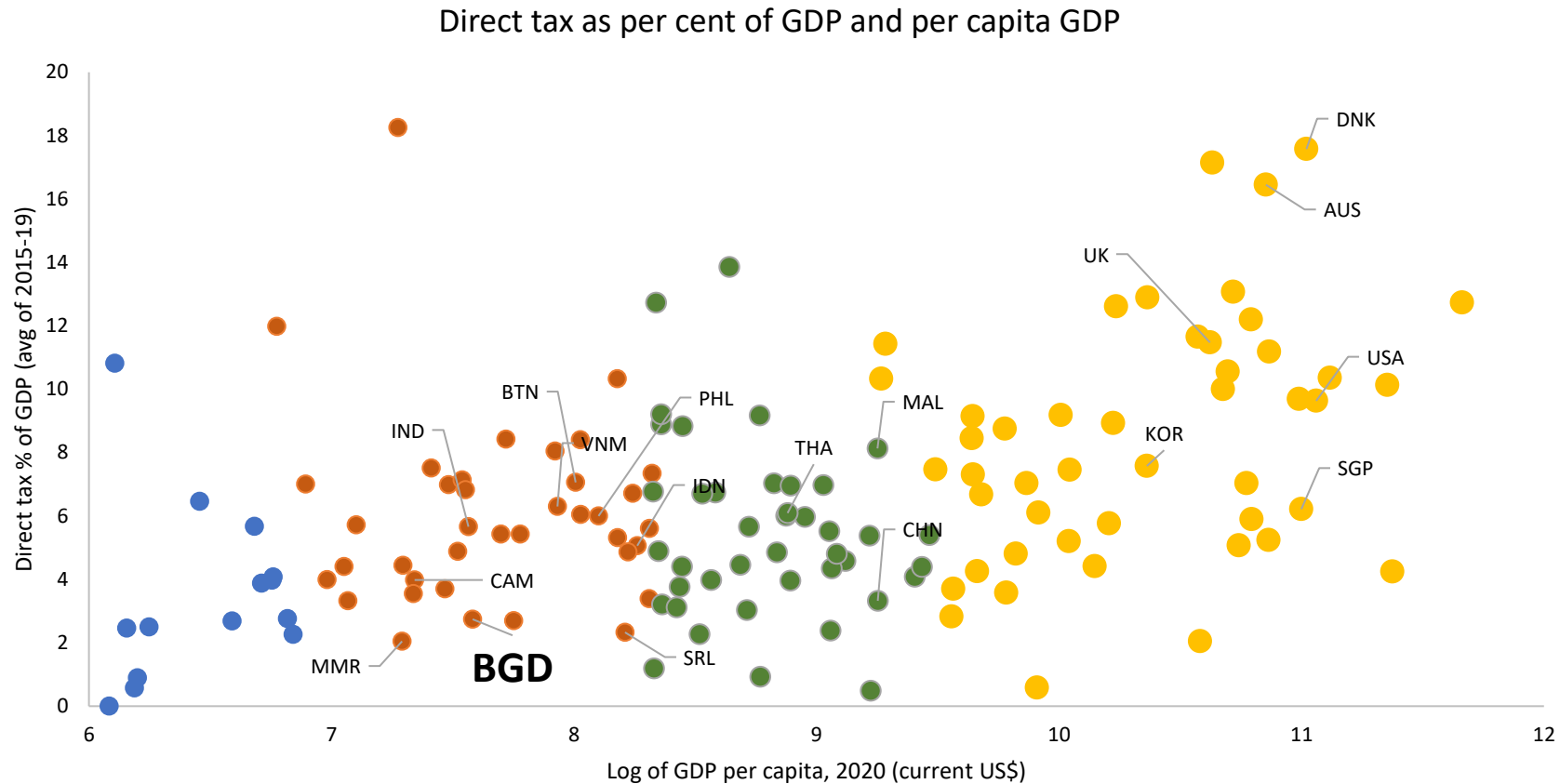
VAT as percent of household income



Direct tax revenue is just 2.6% of GDP



Direct tax as per cent of GDP is one of the lowest in Bangladesh



Direct taxation in Bangladesh

There are
several
instruments
of direct tax

- Personal and corporate income taxes
- Surcharges on wealth as percentage of income tax payable in any tax year
- Additional taxes for public limited companies not paying a 15 per cent dividend to shareholders
- and taxes on excess profit by the banks.

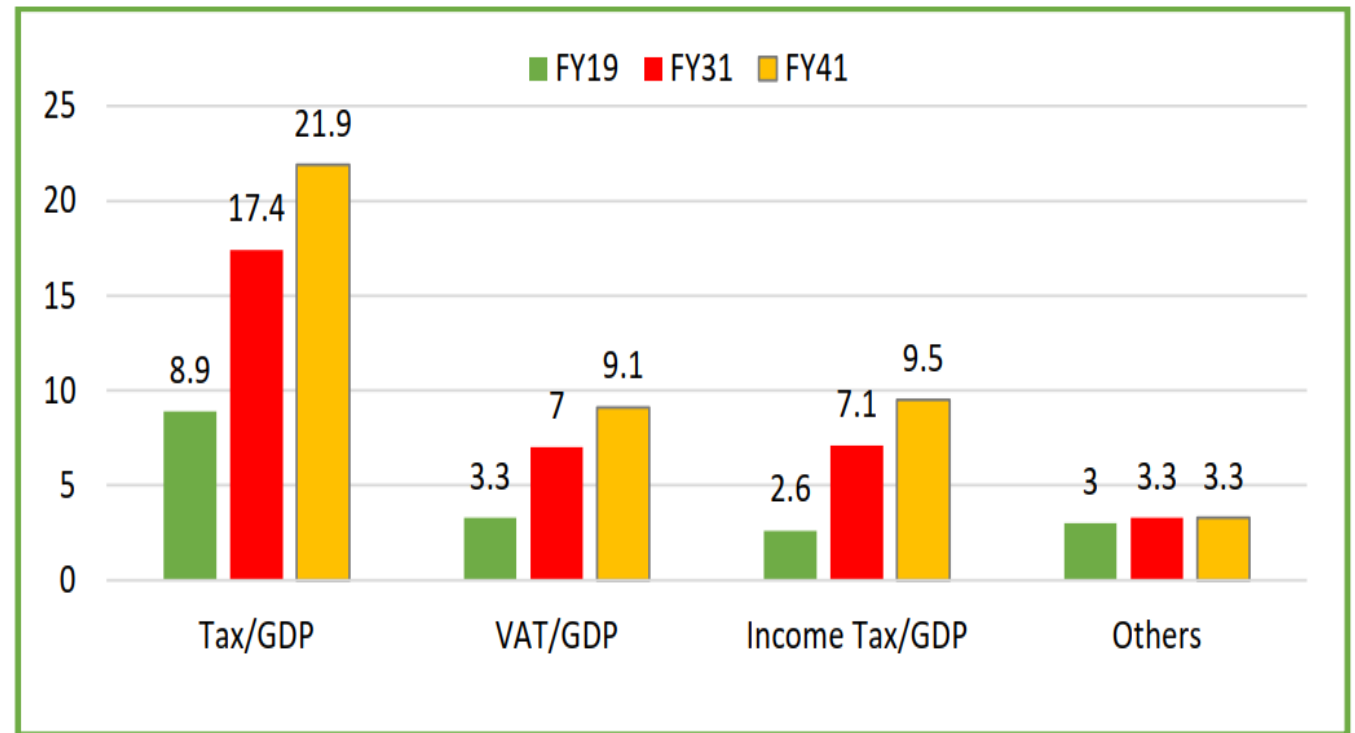


The need for enhanced resource mobilization from Direct Taxes

As per the Perspective Plan 2041, Bangladesh tax-GDP ratio should rise to 17% by 2031, and almost 22% by 2041.

Direct tax (% of GDP) is targeted to increase by more than 4 times by 2041

Fiscal Framework for Perspective Plan 2041 (PP2041)



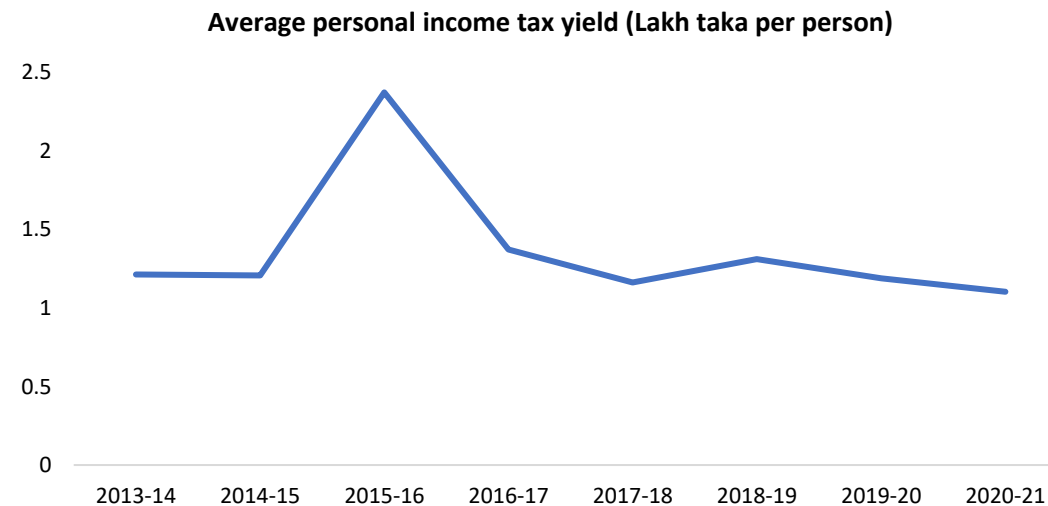
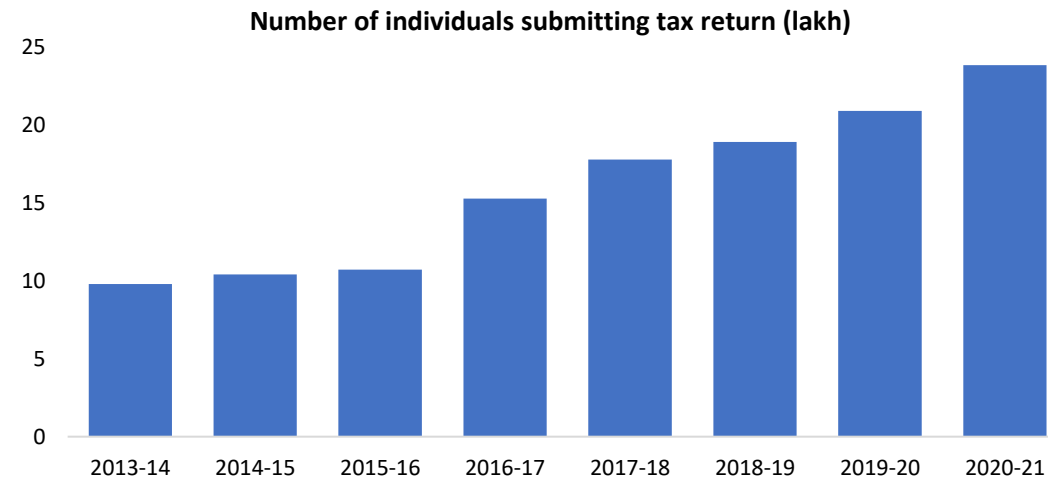
Source: PP2041 Macroeconomic Framework

Bangladesh has not benefitted from the existing progressive income taxation structure and the rapid growth of the economy.

Relatively narrow tax net.

Currently, around 7.6 million people have a taxpayer identification number (TIN). **Only 2.4 million (one-third of total TIN holders) submitted returns.**

The average tax revenue per taxpayer declined (from 2.4 lakh in 2015-16 to 1.1 lakh in 2020-21).



Despite Bangladesh having amongst the highest levels of corporate tax rates in the region, corporate tax effort was low (around 1.6% of GDP).

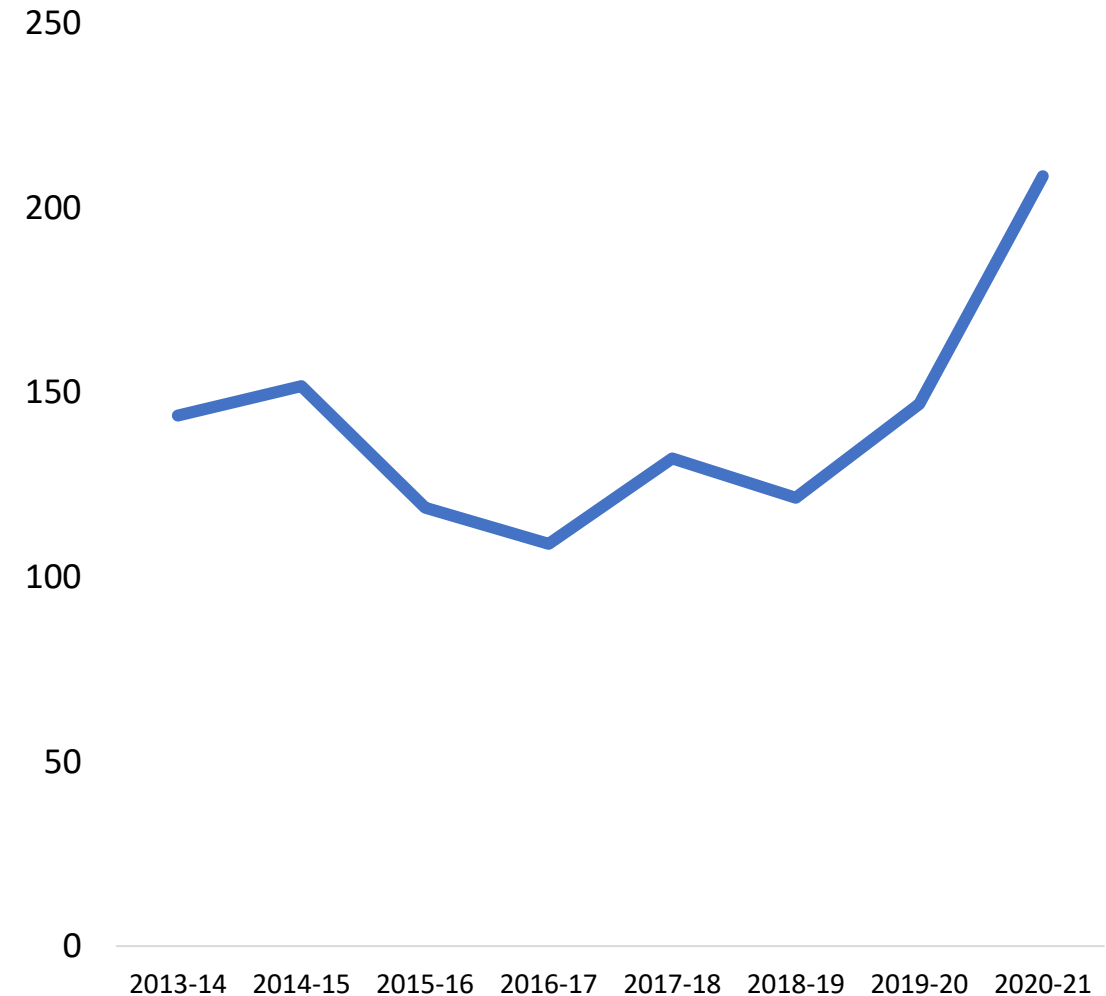
Taxes levied on income of companies and other entities as of FY2021-22

	Existing 2021-2022	Proposed 2022-2023	*Applicable tax rate if fails to meet the condition
Publicly traded company that issues shares worth more than 10 percent of its paid-up capital through Initial Public Offering (IPO)	22.5%	20%	22.5%
Publicly traded company that issues share worth ten percent or less than ten percent of its paid-up capital through IPO	22.5%	20%	25%
Non-publicly traded company	30%	30%	30%
One Person Company (OPC)	25%	22.5%	25%
Publicly traded bank, insurance, and financial institution (except merchant bank)	37.5%	37.5%	not applicable
Non-publicly traded bank, insurance, and financial institution	40%	40%	not applicable
Merchant bank	37.5%	37.5%	not applicable
Publicly traded mobile operator company	40%	40%	not applicable
Non-publicly traded mobile operator company	45%	45%	not applicable
Association of persons	30%	27.5%	30%
Artificial juridical person and other taxable entity	30%	27.5%	30%
Private university, private medical college, private dental college, private engineering college or private college solely dedicated to imparting education on ICT	15%	15%	not applicable

*Condition: All receipts and income must be transacted through bank transfer and all expense and investment over Tk. 12 lakhs must be made through bank transfer.

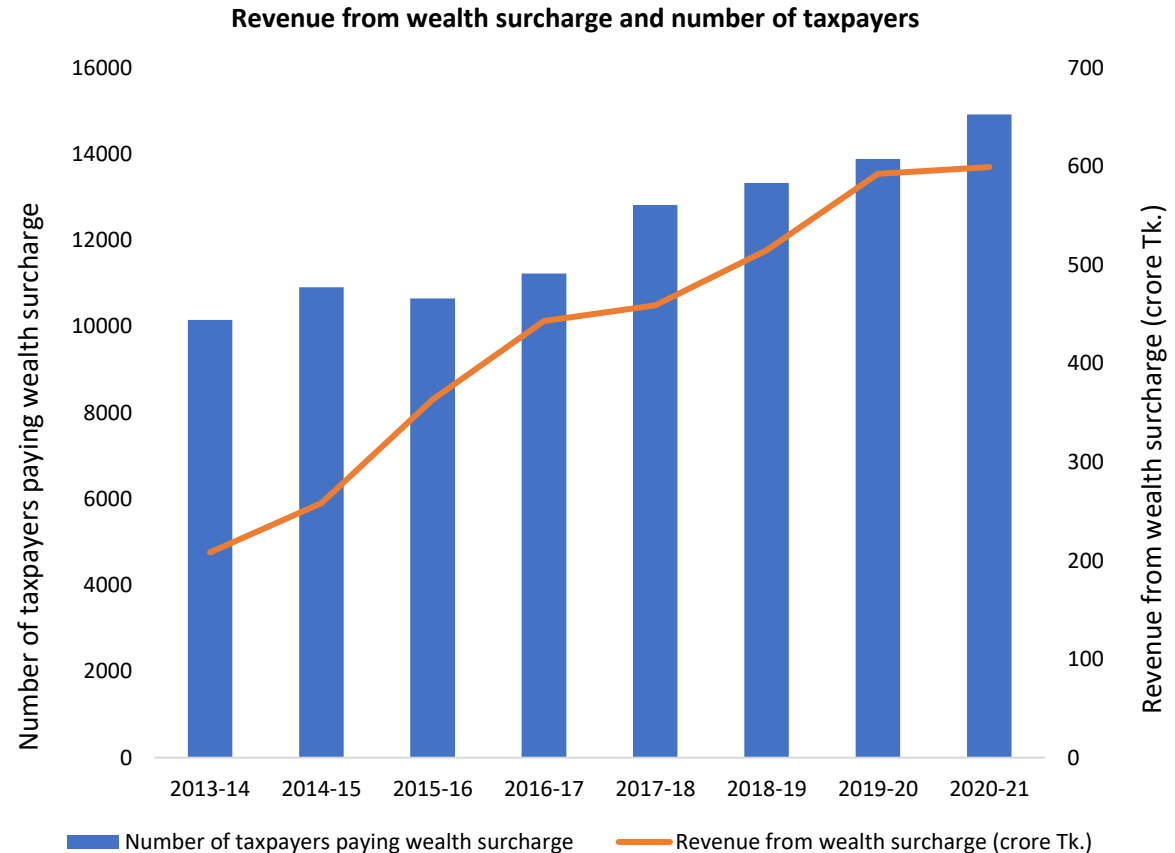
- In 2020-21, around 29 thousand companies submitted corporate tax returns and paid Tk. 604.5 billion
- **2.73 lakh traders registered with the Registrar of Joint Stock Companies and Firms (RJSCF) – Only 11 per cent paid corporate taxes**
- **Tax exemptions for many sectors**, and high level of informality associated with various economic activities, etc. are major reasons for low revenue collection

Average corporate income tax yield (Lakh taka per company)



As of 2020-21, only about 15,000 individuals paid Tk. 6 billion as a wealth surcharge.

- A wealth surcharge is payable if an individual's net asset holdings exceed a specific threshold.
- Valuation is also a great problem.



Low personal income tax base and high tax evasion are the results of multiple factors

- Legal tax exemptions and loopholes
- Tax exemptions
- Complexities of tax assessment and collection
- Inefficient tax audits
- Presence of a large informal economy.
- Underreporting income among the taxpayers through informal arrangements involving a section of income tax practitioners (ITP) and tax collectors.
- Lack of automation, improper and irregular scrutiny, and corrupt practices undermine the tax effort.
- Lengthy time requirement for manual tax filing, lack of knowledge, and fear of harassment after tax filing

Large informal sector poses a challenge for tax collection (both direct and indirect)

Many entities/companies remain outside the tax net due to a large informal economy and low administrative capacity.

Most of the micro, small and medium enterprises operate outside the formal sector, often lacking any credible and effective accounting practices.

On the other hand, many large businesses in the formal sector enjoy tax benefits granted under different policies.

Policy Implications

- **Develop a roadmap and action plan of policy measures to achieve the new direct taxation target.**
 - One target could be increasing the share of direct tax by 5 percentage points within the 8th Five-Year Plan period (2024-25)
- **The objective of any taxation reform should not be only about raising revenue but also to deal with this growing inequality as much as possible.**
- **Implement the requirement to submit returns for taxpayers to access public services.**
 - A welcome initiative, and it must help increase the tax net
 - Other services should be included in the list in the next years
- **Increase the tax eligibility floor and the highest rate of personal income tax**
 - Since the economy has made a significant recovery, the highest personal income tax rate should be restored to 30%
 - Estimation suggests this can help raise the revenue generation from PIT by around 0.5% of GDP

Policy Implications

- **Rationalise corporate tax rate**
 - The number of tax rates can be brought down
- **Increase the number of registered taxpayers**
 - Estimates suggest that if all eligible individuals pay taxes according to their income tax slabs, revenue collection from PIT only would rise to 3.1% of GDP from just around 1% currently
 - Government has a target to increase the number of registered taxpayers to 10 million
 - An effective geographic targeting approach can be pursued – first, focusing on large cities and emerging growth centres
 - Two potential interventions can be: (i) conducting a socio-economic survey; and (ii) conducting a business prospect survey.
- **Send notices to registered taxpayers to submit tax returns**
 - Identify and inform the taxpayers (individuals and businesses) who are not submitting the return
 - The registered taxpayers should be notified through an automated system

Policy Implications

- **Review and rationalise tax exemptions and incentives**
 - Revenue-GDP ratio would be 2 percentage points higher in the absence of exemptions.
 - Conduct cost-benefit analysis to assess the impact of all available tax incentives
- **Automated and centralise the audit system**
- **Improve tax administration through digitalisation and automation**
- **Strengthen the capacity of NBR**
 - Provide specialized training on technical adaptation, and legal, qualitative, and quantitative aspects of tax policies
 - Huge shortage of manpower - analysis suggests that the recruitment of additional 100 revenue officers can generate Tk. 15 billion in revenue
- **Separate tax policy and tax administration**
- **Deduct calculable tax obligations at source and automate tax returns**
 - Around 60 per cent of the direct tax comes from tax deduction at source (TDS)
 - a system should be adopted where employers will collect all calculable income tax obligations
 - A properly automated refund system should be introduced

Questions for us

- Do we have an opportunity to deal the twin problem of growing inequality and low public spending?
 - **Yes**, through increased direct taxation (and spend more of that revenue for health, education, social protection)
- Can an increased focus on direct taxation be part of an inclusive policy approach?
 - **Yes** (too much emphasis on indirect taxation has an inequitable effect for the poor)
- Has the policy option of increased direct taxation been identified?
 - **Yes** – thanks to our policymakers (more work needed to raise awareness). But implementation must be taken seriously.

Thank you.