

VAT ADMINISTRATION: IS IT A PROBLEM FOR INDUSTRIAL DEVELOPMENT IN BANGLADESH ?

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INTRODUCTION

This paper explores whether VAT administration is a problem for industrial development in Bangladesh. Its major message is that VAT administration warrants more stress to simplify the rules and regulations of the VAT system. As we all know, value added tax is commonly known as VAT. It is a breakthrough in the traditional indirect taxation system. It was introduced in Bangladesh in July, 1991. The system was adopted first by the French in the year 1936, after many years of academic and practical experimentation, as a single stage. It was extended to the wholesale stage in 1954 and to the retail stage in 1966. In a highly developed country like France, it took 30 years for this tax to be implemented to cover all manufacturing, trading and service industries. And then it was adopted by many other developed and developing countries considering its utility, simplicity, comprehensiveness and neutrality. But, some adverse and unclear provisions of the VAT law matched with the bureaucratic approach of administration caused hindrance to the industrial development of Bangladesh. To express this idea, this paper presents the difficulties of tax payers relating to the focal issues of the VAT System.

PRICE

As per Sec 5 (2) of the VAT Act 1991, VAT is payable upon the price realizable from a customer by a manufacturer or producer. Price as noted in the said Sec consists of all costs of the manufacturer or producer such as commission charges, all duties including supplementary duty and taxes excluding VAT. The cost of a manufacturer is commonly known as the manufacturing cost.

For a company having manufacturing activity only, price as stated above is quite clear. But, for a company with a self-distribution network for the marketing of its own product, price, being the basis for the computation of VAT, is very much confusing as the amount realizable from customers includes distribution cost and profits from distribution

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activities which are beyond the purview of VAT according to the single-stage principle, still in force, almost for all domestic products.

Again, if the company pays VAT considering the value added by it as a manufacturer only, then the price declared under rule 3 (1) would be much below the amount realizable from the customer as a manufacturer-cum-wholesaler. The difference between market value and declared price will then attract VAT with retrospective effect by dint of the power bestowed upon the VAT authority by SRO no 99 of 15.06.95 as issued by the National Board of Revenue (NBR) and thus the company may end up in a legal battle. More than 8 year have passed since the introduction of VAT, but this fundamental provision of law is yet to be made transparent. However, to remove the lacuna, by this time the NBR has taken some measures, but, unfortunately, instead of addressing the issue they have created additional problems.

On 15 June 1996 the NBRT issued a general order to consider the tariff value of the imported raw material when it is higher than the C & F value for the determination of the vatable price of a production on the grounds that a rebate has been taken on the basis of tariff value being the assessable value. For an industrial company with a fair accounting system it is almost impossible to comply with this order without the manipulation of cost accounting information. If so, the financial information of the company as a whole will be unacceptable to all users including the Income Tax Authority, the Auditor and the Registrar of the Joint Stock Companies. Again, as the product price could not be increased in view of this order, a paper increase in the cost of raw materials will only be supplemented by a reduction in margin. Thus, the order has no impact upon revenue except begin a call to furnish a price declaration with inflated information.

A change curving the way to avoid proportionate VAT by a marketing company dealing with its own brand product, produced and supplied by others on a contract or sub-contract basis, has been incorporated by the addition of Sub Sec 12 Ka to Sec 5 of the VAT Act 1991. The provision is applicable only to the company registered. It is silent about similar company being unregistered and a company which is marketing imported products supplied by overseas principals.

INPUT-OUTPUT RELATION

In pursuance of VAT order no 2 of 19 October 1991, declaration of the input-output relation of every production unit in the prescribed proforma is mandatory for every

manufacturing company. The prescribed proforma asks for complete disclosure of the product formulation. Formulation is a trade secret for which every company should pay a huge amount of royalty or spend a lot of money on research and development activities. Thus, access to formulation is highly restricted even to company personnel. The VAT authority and other office staff are not legally obliged to maintain secrecy of information as furnished by taxpayers. The issue was discussed with the VAT authority in different forums, but the agreed circular relaxing the aforesaid requirement is yet to be issued.

However, on submission of the input-output relation in the prescribed proforma, the Divisional-in-Charge asked for all supporting to the cost of raw materials as shown in the said proforma. Supporting as required by the authorities is the true copies of all documents in connection with the purchase and additional cost of the raw materials concerned brought to the place of production. Depending upon the nature, each production unit may require numerous items of raw materials. For example, the formulation of product A asked for 20 types of raw materials. The weighted average cost method is in practice for the computation of the cost of the raw material consumed. And at the time of price declaration the weighted average price of item no 1 was TK 100 per kg and accordingly the company quoted the price. If the average is the outcome of 10 purchase transactions consisting of 3 local and 7 foreign, then the volume of supporting for item no 1 should be at least 100 pages and for 20 items on average 2,000 pages. If the number of production units is 200 then the company should furnish a supporting of 400,000 pages for an initial price declaration and subsequently on average 2,000 pages for each unit at the time of every change in price. In view of the above data, it is clear to all that the furnishing of supporting to cost for an industrial company is a matter of huge undue expenditure which will simply distort the profitability of the company. On the contrary it is the Divisional-in-Charge who can postpone the delivery by rejecting the price declaration due to non-compliance with her/his order. Thus, in this way the company is on the horns of a dilemma as a result of the bureaucratic approach of the authority.

PAYMENT

In accordance with Sec 6 (2), VAT is due for payment at the time of delivery. Delivery means the release or removal of a product from the place of production by a manufacturer; it is generally sold to the customer. So VAT is an advance tax payable by a manufacturer which is realizable along with sale proceeds from the customers. In the present competitive market, avoidance of credit sale is almost impossible. In case of credit sale, a

manufacturer should wait for an additional period of time after the execution of sales to realize the VAT advanced earlier. Again, there is no provision for taking the credit of VAT related with bad debts which are a reality in every business environment.

Thus, VAT is a part of working capital to be invested by a manufacturer at the time of procurement of raw materials and delivery of products. This investment generates no margin but incurs loss as a result of the complicacy of law. To analyze the impact of VAT upon the liquidity and profitability of a manufacturing company, a simple example has been presented below.

Alpha Ltd., manufacturer of a toilet soap, commenced business on 01.01.97 and cleared the first consignment of imported raw material on 31.03.98. The landing cost of the consignment excluding AIT and VAT was Tk 500 lakh on which the company paid an amount of Tk 60 lakh, it being 15% of the VAT leviable value of TK 400 lakh as VAT. While receiving the raw materials, a transit loss of 5% was observed and recorded. The company added the value of Tk 250 lakh to the entire input and completed the production process by 30.06.98. On 01.07.98 the total output worth Tk 750 lakh was delivered to different sales centres on payment of Tk 52.5 lakh as output VAT, it being the net of the rebate. But the VAT authority rejected the rebate on lost quantity amounting to Tk 3 lakh and compelled the company to make an additional deposit to that extent. The policy of the company is to extend 1-month credit to institutional customers, it being 50% of the total sales. The entire products were sold out within 3 months at even rate following the date of delivery. For better understanding, the said data are given below in tabular form:

Alpha Limited

Month	Cash	Sales Credit	Total	Realization from Debtors	Bad Debt - 5% of Credit Sales	VAT Paid	Realized	Lost
	Tk.	Tk.	Tk.	Tk.	TK.	Tk.	Tk.	Tk.
March	-	-	-	-	-	60	-	-
June	-	-	-	-	-	55.5	-	3
July	143.75	143.75	287.50	-	-	-	18.75	-
Aug.	143.75	143.75	287.50	136.56	7.19	-	36.56	.94
Sept.	143.75	143.75	287.50	136.56	7.19	-	36.56	.94
Oct.	-	-	-	136.56	7.19	-	17.81	.94

The table reveals that a mandatory investment of Tk 115.5 lakh in the Government Exchequer as VAT has been realized long after sustaining a loss of Tk. 5.82 lakh.

REBATE

Avoidance of tax on tax is an interesting feature of the VAT system. The principle was confirmed at the commencement by incorporating Sec 9 into the Act. But, since the inception of the Vat System, taxpayers have been deprived of this legitimate right to have a rebate on different input items simply because of the legal complicity and bureaucratic approach of some service-rendering government organizations.

VAT on the services of Tar (ie wire) and Telephone Board (T&T) was imposed with effect from July 1992. In view of the provision of Sec 9 many taxpayers approached to claim a rebate but the VAT authority rejected the claims on the grounds that T&T had not issued any *challan-patra* in the prescribed proforma. Thereafter, numerous humble requests were made to the T&T authorities but none could convenience them to issue the required *challan-patra*. However, considering the suffering of the taxpayers, the NBR was kind enough to authorize the format of the T&T bill as a substitute for the prescribed proforma subject to mentioning the VAT registration no of T&T therein. Again, by the same order, the NBR restricted the quantum of rebate to 60% of the VAT paid along with the T&T bill, raising the question of personal use by company personnel.

AUDIT

To conduct an audit on the accounts as maintained u/s 31 of the VAT Act 1991, the Vat authority has a separate audit department. Further, the NBR is authorized to appoint an auditor by an order u/s 26 (3). In a manufacturing environment for the successful completion of a VAT audit, one should have a through idea of business is also essential. In short, like an audit, in pursuance of the Companies Act, income tax laws and other relevant laws, professional expertise is a must for the successful completion of a VAT audit.

Probably, considering those facts and realities the said Sec 26 (3) was incorporated in the VAT Act by the Finance Act 1993. But, most unfortunately, instead of utilizing the services of professional auditors, the government has imposed VAT upon audit service by the Finance Act 1998. Thus, the hope for a quality audit of the VAT account as raised by the Finance Act 1993 has been nipped in the bud by the same Act of 1998.

CONCLUDING REMARKS

It is clear from the foregoing discussion what problems the manufacturers are facing to

pay VAT. Several non-transparent rules and regulations, together with huge paper work, and the too bureaucratic approach of VAT administration appear to be a great problem for taxpaying businessmen and industrialists. Everybody blames the taxpayers calling them dishonest and insincere. True, they are not so sincere and honest as the nation expects them to be. But what about the VAT administration machinery? It is also very bureaucratic in its approach, which is unbecoming of a democratic country. To attain sustainable development, there is no alternative to industrialization. A company is required to fulfil numerous legal obligations to run an industrial undertaking. The VAT Act 1991 is a unit of the portfolio of laws to be complied with by every industrial company. The provisions of the VAT law are equally applicable to all manufacturers having a turnover exceeding Tk 15 lakh. Small and cottage industries are the pioneers of industrial development in Bangladesh. The problems discussed earlier appear very tough for such industries as they run with very limited resources. Again, we are competing with other developing countries to attract foreign investments. Foreign investors are looking for a congenial environment to invest but the aforesaid problems are seriously discouraging them.

In view of this new provision, the taxpayers proceeded further to claim a rebate, but the authority stopped them again raising the question of non-availability of the registration no of T&T on the bill. However, after a long struggle, recently T&T has incorporated the said registration no in its computerized billing system.

Now the taxpayers are expecting a clear decision from the VAT authority regarding the amount deposited by them during the period from July, 1992 to May, 1998.

VAT on services concerned was deposited initially by taxpayers into the bank account of T&T, which was ultimately transferred to the Government Treasury. As the bank account of T&T belongs to the government, the said initial deposit formed a deposit into the Government Treasury. Thus, rejection of the genuine claim for a rebate simply because of the negligence of a state-owned organization was an unjust action upon the taxpayers. Again, restriction of the quantum of the rebate to 60% with a plea of personal use is also irrational as the personnel are barred from running any personal business while in employment almost in every company and the entire cost of services is added with value for the determination of VAT.

The taxpayers are facing similar problems in connection with the services of another state-owned monopoly viz WASA.

The normal loss of raw materials due to handling is a reality in every manufacturing environment. But, unfortunately the VAT authority refused to give a rebate proportionate to the lost quantity on the grounds that those materials were not consumed. This is ignorance of the universal practice on the one hand and a punishment for honest producers who maintain a fair record on the other.

ACCOUNTS

As per Sec 181 of the Companies Act 1994, maintenance of books of accounts at the registered office relating to the following is compulsory for every company:

- a) All sums received and expended;
- b) All sale and purchase of goods;
- c) All assets and liabilities and
- d) All manufacturing, processing, extraction costs and overheads.

In view of the internal control system in practice, almost all companies used to maintain more subsidiary books of accounts to satisfy the multifarious queries of different users of financial statements. The aforesaid books of accounts are utilized simultaneously to satisfy the requirements of the Company Law Authority, the Income Tax Authority, the Security and Exchange Commission and others.

In pursuance of the provision of Sec 31 of the VAT Act 1991, a company should maintain the following books of accounts in the prescribed proforma at the place of production:

- a) Purchase of all taxable and exempted commodities and services;
- b) Sales including the export of all taxable and exempted commodities and services;
- c) Current account;
- d) VAT deposit account;
- e) Stock register for input and output and
- f) Any other accounts as determined by rules.

A simple analysis of the aforesaid requirements reveals that all accounting information as required by the VAT Act is readily available in the books of accounts as maintained by the company in pursuance of the Companies Act to be noted hereinafter as institutional accounts. Again, as per the Companies Act, books of accounts should be kept at the registered office but the VAT Act asked for the maintenance of books of accounts at the

place of production usually beyond the registered office.

Thus, just to satisfy the requirements of the VAT Act a manufacturer should maintain a duplicate set of accounts incurring huge expenditure with the information available in the said institutional accounts. It is notable that the returns as required by the VAT authority could easily be generated from the base data of institutional accounts with certain rearrangement in the system.

It is not understood why the VAT authority could not come out of the traditional idea of record keeping in this age of information revolution, why they could not accept more comprehensive institutional accounts while the Income Tax Authority, being another wing of the NBR of the collection of Government revenue, could.

Only a through change in the bureaucratic approach accompanied by amendments of the relevant provisions of law can remove the problems which stand in the way of industrial development. Otherwise the political commitment of the government to economic emancipation will die in the ditch of the Manifesto.

However, there is no denying the fact that for development activities and overall economic growth, mobilization of internal resources is a prerequisite condition. VAT may prove to be a practical solution to this. But its implementation and enforcement need adequate groundwork and caution. Too much of a bureaucratic approach in VAT administration and too much of paper work matched with a lot of non-transparent rules & regulations will not serve the purpose for which VAT was introduced in Bangladesh.

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