

**TAXATION AND GOOD GOVERNANCE:  
THE CASE OF VALUE-ADDED TAX IN BANGLADESH**

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Dedicated to

My Father—(Late) A.B. Muslehuddin Ahmed whom I lost when I was two years old  
and yet whose ethereal presence has always been a source of guidance

and

My Mother—(Late) Hazera Khatoon whose indomitable spirits shaped me to  
become what I am.

## PAPERS DRAWN FROM THE THESIS

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## ABSTRACT

Inspired by the new fiscal sociological approach which sees taxation as binding a contract between the state and its citizens and engaging the latter in a revenue bargain, this study explores the extent a tax system works as a tool for good governance in a social milieu characterized both by a poor state of governance and poor tax to GDP ratio. This is one of the first empirical studies of VAT from an interdisciplinary approach with special focus on a political science perspective. The context is Bangladesh which adopted a sophisticated modern consumption tax – VAT- in 1991 to maximize internal resources by broadening the tax base and simplifying the tax structure.

In contrast to the traditional role of revenue which has dominated the tax literature until the 1980s, the role of taxation in state-building has captured the attention of political scientists who consider taxation as a political process through which citizens can demand more accountability and responsiveness from the state. Stemming from this premise good governance, taxation and development become interdependent. Participation, transparency and accountability improve mutual trust between taxpayers and the government, and ensure better control and enforcement by the tax authority. The combined impact of these two aspects contributes to more and better voluntary tax compliance. Maximization of tax revenue is enhanced by the degree of voluntary tax compliance, which, in turn, contributes to development. This relationship is dynamic rather than linear as development generally ensures improved governance. This thesis attempts to contribute to that understanding.

Based on this conceptual framework, this qualitative case study research has employed a variety of research methods such as interview and focus group discussion and questionnaire survey involving 214 respondents representing the different segments of stakeholders. The quantitative method of survey questionnaire for a number of respondents has been used to triangulate the qualitative data.

The present study argues that the poor tax-to GDP ratio in Bangladesh, generally attributed to administrative inefficiencies and a narrow tax base, in fact reflects the

poor state of good governance. Although the introduction of the VAT by replacing the excise system in 1991 was mainly prompted by the desire to maximize revenue, the tax reform to introduce a self-assessed tax was also partly inspired by the urgency of making the tax system more transparent, more accountable and more participatory. But while the design features, drawing heavily on the excise system and deviating from the best international practice, undermine the fundamental features of self-assessment, transparency and accountability, many of the practices are also not favourable to the promotion of good governance values. Though more efficient, more transparent, more accountable and more participatory than the tax it replaced, the Bangladesh VAT has been able to utilize only a modicum of its huge potential in promoting good governance.

The contribution of the thesis to the literature lies not only in empirically exploring and evaluating a tax system from a new perspective, but also in identifying policy implications for making the VAT more effective and efficient in Bangladesh. These implications are equally relevant to other developing countries with a similar socio-economic milieu in making their tax system more effective in terms of social contract and revenue bargain through which people can demand more accountability and responsiveness from their governments.

## DECLARATION

I certify that this thesis does not incorporate without acknowledgment any material previously submitted for a degree or diploma in any university; and that to the best of my knowledge and belief it does not contain any material previously published or written by another person except where due reference is made in the text.

Signature:

(Ahmed Munirus Saleheen)

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Although many people and institutions have contributed to this thesis, I alone bear responsibility for its contents, and for all the errors and lack of judgment, if any.

## ACRONYMS

ACR: Annual Confidential Report

ADB: Asian Development Bank

ADR: Alternative Dispute Resolution

ARO: Assistant Revenue Officer

ATO: Australian Tax Office

ATV: Advance Trade VAT

BDT: Bangladesh Taka

CAGB: Comptroller and Auditor General of Bangladesh

CD: Customs Duty

CPD: Centre for Policy Dialogue

CSO: Civil Society Organization

DCCI: Dhaka Chamber of Commerce and Industries

EU: European Union

FAD: Fiscal Affairs Department

FBCCI: Federation of Bangladesh Chambers of Commerce and Industries

FGD: Focus Group Discussion

GDP: Gross Domestic Product

GATT: General Agreement on Tariff and Trade

GTZ: Gesellschaft für Technische Zusammenarbeit

IDS: Institute of Development Studies

IMF: International Monetary Fund

ITD: International Tax Dialogue

LARD: Local and Revenue Audit Directorate

LTU: Large Taxpayers Unit

MDG: Millennium Development Goal

NBR: National Board of Revenue

NPM: New Public Management

NGO: Non-Government Organization

OECD: Organization for Economic Cooperation and Development

PRSP: Poverty Reduction Strategy Paper

RIRA: Reforms in Revenue Administration

RRC: Revenue Reform Commission

RTI: Right to Information

SAARC: South Asian Association for Regional Cooperation

SAI: Supreme Audit Institution

SD: Supplementary Duty

SRO: Statutory Regulatory Order

TIB: Transparency International Bangladesh

TT: Turnover Tax

UNDP: United Nations Development Programme

UO: Unnoyan Onneshan

VAT: Value-Added Tax

WGI: Worldwide Governance Indicators

WTO: World Trade Organization

# CHAPTER 1

## INTRODUCTION

The object of government in peace and in war is not the glory of rulers or of races, but the happiness of the common man- William Beveridge<sup>1</sup>.

### Introduction

The year 1991 is remarkable in the history of Bangladesh for more than one reason. The twentieth anniversary year witnessed one of the deadliest cyclones that claimed about 140,000 human lives. This cruel April natural disaster was followed by the promise of the country's fresh start towards democracy after about sixteen years of military rule. This year could also be remarkable on another count. It was the year in which Bangladesh undertook a major fiscal reform by introducing a modern consumption tax, replacing the age-old excise system. Could the last two promising events be a matter of design complementing each other especially to face the challenges such as the natural disasters which perennially plague its economy, or just a matter of coincidence?

The inevitability of taxes in human life has never been better expressed than by the popular aphorism<sup>2</sup> of the famous US statesman Benjamin Franklin that compared the inevitability of taxation with that of death. But unlike death, the other 'inevitable' is not merely a personal experience; it has been indissolubly related with the evolution of human civilization. Though no tax is exclusively for revenue (Groves 1948), taxation is seen, by and large, as a means of raising revenue. The main objective of taxation is to maximize revenue in order to finance government expenditure. Starting from its narrow role as revenue raiser to finance the state expenditure, taxation over the ages has assumed wider roles comprising

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<sup>1</sup> Cited in Williams (1981)

<sup>2</sup> Benjamin Franklin writing to Jean Baptiste Le Roy, 13 November 1789 – 'In this world nothing can be said to be certain, except death and taxes.' (cited in Wenzel 2003).



representation, re-distribution and re-pricing. In taxation, the economic goal of revenue has faced with of challenge of the socio-political goal of representation. Striking a balance between the maximization of revenue and the enabling process of such collection becomes more challenging for the developing countries such as Bangladesh which struggle hard both to mobilize their own tax revenue and to create an enabling environment of governance.

Situated in the Southern part of Asia, sharing a common border with India on the East, West and North sides and Myanmar and the Bay of Bengal on the South side, Bangladesh is a developing country with a very high population, low per capita income, high rate of illiteracy and heavy dependence on external finances in the form of grants, aid and loans. It has a total land area of 144,000 square kilometres and a population of 164 million (2010 estimate, World Bank 2010).The country emerged as an independent state in 1971 with the dream of economic and social emancipation from the 25 years of the Pakistani rule. Though within the span of last 42 years, the country has achieved significant progress in poverty alleviation and social indicators including education, women empowerment and child mortality, it has not been able to rank at a satisfactory level in good governance indicators, nor has it achieved its original vision of being self-reliant.

Bangladesh represents the most likely case to show how taxation and the good governance process interact with each other especially in developing countries. While the average tax to GDP ratio in high-income countries is 37% and in low-income countries 14% (Keen and Simone 2004; Fjeldstad and Moore 2008), the tax-GDP ratio in Bangladesh is one of the lowest in the world and the lowest among the South Asian countries; the tax-GDP ratio was only 3.4% in 1972-73 and it remained below 9% until the introduction of Value Added Tax (VAT) in 1991.

In this context, this thesis examines the extent to which a tax system in general can be used as a tool for good governance and explores the extent to which the VAT embodies the principles of good governance in the context of Bangladesh. The present research tries to find the answer to the core question— how and to what

extent do the framework of good governance and the country's VAT system complement each other?

In this introductory chapter, I have tried to set forth the general framework of the study, indicating what fundamental questions I pursue and how I have ventured to seek answers to them. The purpose of this chapter is to provide background information on the thesis. The chapter is organized in the following manner. The first section provides the contextual and conceptual background of the study, focusing on good governance as an agenda for development and its relevance to taxation in general and VAT in particular, in order to establish the relevance of the study. This is followed by an overview of the Bangladesh tax system as background to the research. The second section sets out the statement of the problems while the research questions and objectives have been presented in third section. Finally, the structure of the thesis has been presented in the fourth section.

## **1.1 Background of the study: good governance as an agenda for development and taxation**

It is almost universally agreed that the goals of democracy in most of the developing countries in the world today are economic growth, full employment, eradication of poverty, and equality of opportunity. As we think of democracy and development, the term 'good governance' becomes inseparable. The term has specially been tied up with achieving the Millennium Development Goals (MDGs) of individual countries. Good governance is widely regarded as one of the key ingredients for poverty reduction and sustainable development. It can be achieved in an enabling economic environment responsive to the basic needs of the people. It requires sound economic management and the sustainable use of resources as well as the promotion of economic and social rights. In her address to a gathering of civil society representatives in Nigeria on August 12, 2009, Hilary Clinton, the US Secretary of State's comment, 'without good governance, no amount of oil, no amount of aid, no amount of effort can guarantee Nigeria's success' (U.S. Dept. of State 2011) emphasizes how good governance may outweigh economic resources. In the context of the present study it is worthwhile to first have a look at the state of good governance in Bangladesh and then its tax structure.

### **1.1.1 The state of good governance in Bangladesh**

A worldwide pattern that has been found in different studies on governance is that the quality of governance increases with income (World Bank 2003). This assumption somewhat supports the idea that development precedes good governance, not vice versa (Sundaram and Chowdhury 2012). Naturally most developing countries rank poor in the index of governance. This holds generally true for Bangladesh. Most international studies show relatively poor perceptions of governance in Bangladesh. For example, in the governance data set released by the World Bank Institute for 2011, Bangladesh's ranking among 215 countries varies from bottom seventh to thirty-seventh percentile in the six indicators: 7.1 for political stability, 22.3 for regulatory quality, 28.6 for rule of law, 16.1 for control of corruption, 19.9 for government effectiveness, and 37.1 for voice and accountability (World Bank 2012b). The Table below shows that except regulatory quality and rule of law, Bangladesh ranked poorer in governance dimensions in 2011 than in 1996.

Bangladesh's position is significantly worse than its South Asian neighbors in most indicators; only in respect of voice and accountability Bangladesh is ahead of Nepal and Pakistan. But in some development literature, Bangladesh has been identified as an outlier country along with some other countries like China and Chile that appear to demonstrate relatively strong economic performance in the face of relatively poor governance. According to an assessment by the World Bank in 2005, the generally strong GDP growth rate since 1990 and the social gains (in literacy and nutrition, for example) took place in the face of relatively stagnant and poor standards of governance during that time.

**Table 1.1 Bangladesh's good governance record**

Governance dimensions	Year 1996 Percentile rank	Year 2011 Percentile rank
Voice and accountability <sup>3</sup>	47.60	37.01
Political stability and absence of violence <sup>4</sup>	25	7.1
Government effectiveness <sup>5</sup>	24.4	19.9
Regulatory quality <sup>6</sup>	16.2	22.3
Rule of law <sup>7</sup>	18.7	28.6
Control of corruption <sup>8</sup>	27.3	16.1

Source: Adapted from Worldwide Governance Indicators (World Bank 2012b)

Terming Bangladesh an ‘outlier’ in cross-country comparisons relating governance to economic growth, Mahmud et al. argue that Bangladesh’s ‘impressive record of economic growth and social development’ (2008:23) in the early nineties which they call ‘development surprise’ has been achieved in spite of apparently poor governance. They attribute the ‘development surprise’, which seems to be a very complacent view compared to the international standard of development, to the growth in export and remittance from wage earners. They, however, admit the acute problem of poor governance in Bangladesh and maintained, ‘it is increasingly proving a barrier to putting the economy firmly on a path of modernization, global integration, and poverty reduction’ (2008:25).

<sup>3</sup> ‘Voice and accountability’ reflects perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media.

<sup>4</sup> ‘Political stability’ reflects perceptions of the likelihood that the government will be destabilized or overthrown by unconstitutional or violent means, including politically-motivated violence and terrorism.

<sup>5</sup> ‘Government effectiveness’ reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

<sup>6</sup> ‘Regulatory quality’ reflects perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development.

<sup>7</sup> ‘Rule of law’ reflects perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence.

<sup>8</sup> ‘Control of corruption’ reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as ‘capture’ of the state by elites and private interests.

The poor state of governance in Bangladesh is amply evident in the presence of a perennial challenge that a country like Bangladesh faces – the challenge of combating pervasive corruption<sup>9</sup> because poor governance creates greater incentives and possibilities for corruption (Gurgen 2000). This becomes more crucial against the backdrop that, in the absence of transparency and accountability which Transparency International (TI) views as ‘critical to restoring trust and turning back the tide of corruption,’ the Bangladesh tax administration enjoys the bad reputation of being one of the most corrupt public organizations. As Mukherjee et al. argue, ‘Bangladesh’s government is not known for its effectiveness, nor is the public service for its efficiency and effectiveness. Its bureaucratic effectiveness is rated at 4.7 on a 0 to 10 scale (10= best) that puts Sri Lanka at 6.7, India at 5.5 and Pakistan at 4.3’ (Mukharjee, Gokcekus et al. 2001:23). Given the state of good governance in Bangladesh, how the country comes to terms with the challenge of making its tax system effective and efficient is indeed puzzling as well as thought-provoking.

### **1.1.2 An overview of the Bangladesh tax structure**

A unitary state with a typical dual economy, Bangladesh has burgeoning industrial and service sectors which are rapidly outshining the traditional leader- agricultural sector. The once-dominating agricultural sector accounts for about 19.1 per cent of GDP while the burgeoning industry sector, characterized by an overwhelming presence of export oriented industries, accounts for 28.6% of GDP. The average growth rate of GDP over the last six years was over six per cent. Despite a number of development challenges like overpopulation, vulnerability to climate change and natural disasters, Bangladesh has outlined a vision called ‘Vision-2021’ to become a middle income country by 2021.

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<sup>9</sup> According to the Corruption Perceptions Index 2010, of Transparency International, the global civil society organization leading the fight against corruption, Bangladesh ranked 134 with a score of 2.2 while Denmark, New Zealand and Singapore were tied at the top of the list with a score of 9.3 (Transparency International 2012). The situation was even worse a few years back; according to the corruption perceptions index reports of Transparency International, Bangladesh ranked the lowest in the perceptions index (PI) among all the countries, with a score of 0.4, 1.2, 1.3, 1.5 and 1.7 respectively in the years 2001, 2002, 2003, 2004, and 2005. Though the Bangladesh’s PI ranking has slightly improved since 2006, it is far from satisfactory as compared even with the regional standard.

Bangladesh inherited its taxation system from its colonial past in the British and Pakistani regimes. The country has a long tradition of administering both direct and indirect taxes. In the category of direct taxes fall personal income and corporate tax, gift tax, land development tax, non-judicial stamp and immovable property tax. All three categories of indirect tax – Customs Duty, Excise Duty and Sales Tax (Due 1970) – that date back to the time of the British colonial regime are also in practice in Bangladesh. Customs Duty is the oldest form of international trade tax. Excise Duty used to be widely imposed on domestically produced goods and on some services while Sales Tax used to be imposed at the importation stage. Except Land Development tax, Non-judicial stamp tax, Registration and immovable property tax and Narcotics tax, all these taxes are administered and collected by the National Board of Revenue (NBR).<sup>10</sup> Table 1.2 shows the contribution of different taxes over the last five years as percentage of GDP in Bangladesh.

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<sup>10</sup> The National Board of Revenue, an attached department of the Internal Resources Division under the Ministry of Finance, is the apex authority for collection of all tax revenue in the country. The secretary of the Internal Resources Division of the Ministry of Finance is the ex-officio chairman of the Board which comprises four members from the indirect tax wing and four members from the direct tax wing. In addition to its main responsibility of formulating and implementing tax policy, NBR performs all the functions and exercises the powers vested in the government by various tax laws.

**Table 1.2 Contribution of different taxes as percentage of GDP  
(figures in million BDT)**

Tax type/FY	2005-06 (% of GDP)	2006-07 (% of GDP)	2007-08 (% of GDP)	2008-09 (% of GDP)	2009-10 (% of GDP)
Customs Duty	78254.30 (1.88)	96014.20 (2.03)	93712.30 (1.72)	94101.60 (1.53)	94101.60 (1.36)
VAT import	58856.50 (1.42)	84916.50 (1.80)	91814.40 (1.68)	103256.60 (1.68)	103256.60 (1.49)
SD import	15634.20 (0.38)	17538.50 (0.37)	23182.40 (0.42)	31143.40 (0.51)	31343.40 (0.45)
Total import based tax	152745 (3.68)	198469.2 (4.20)	208709.1 (3.82)	228501.6 (3.72)	228701.6 (3.30)
VAT local	64782.9 (1.56)	91848.3 (1.94)	109703.2 (2.01)	109654.1 (1.78)	138215.2 (2.00)
SD local	46657.7 (1.12)	60013.6 (1.27)	61734.7 (1.13)	61734.7 (1.00)	75933.4 (1.10)
Direct tax	71620.1 (1.72)	117446.6 (2.49)	138577.4 (2.54)	170422.8 (2.77)	170422.8 (2.46)
Excise Duty	1611.5 (0.04)	2143.3 (0.05)	2383.4 (0.04)	3474.9 (0.06)	3474.9 (0.05)
Others	2607.1 (0.06)	4435.6 (0.09)	4164.7 (0.08)	4164.7 (0.07)	3860.5 (0.06)
Total NBR Tax	340024.3 (8.18)	474356.6 (10.04)	525272.5 (9.62)	525272.5 (8.54)	620408.4 (8.96)
Total VAT	123639.4 (2.98)	176764.8 (3.74)	201517.6 (3.69)	212910.7 (3.46)	241471.8 (3.49)

Source: NBR Statistics (NBR 2011a)

As evident from the table, the tax structure is overwhelmingly dependent on indirect taxes which currently represent 72% of the total tax revenue collected by NBR. VAT accounts for 54% of the indirect tax revenue, while of the total tax-revenue it is 39%. According to the NBR statistics (NBR 2011a), import-based taxes as percentage of the total NBR taxes have declined from 45% in FY 2005-06 to 37%

in FY 2009-10. On the other hand, the collection of direct taxes as percentage of the total NBR taxes has increased from 21% in FY 2005-06 to 28% in FY 2009-2010<sup>11</sup>.

**Figure 1 Contribution of different taxes in FY 2009-10**

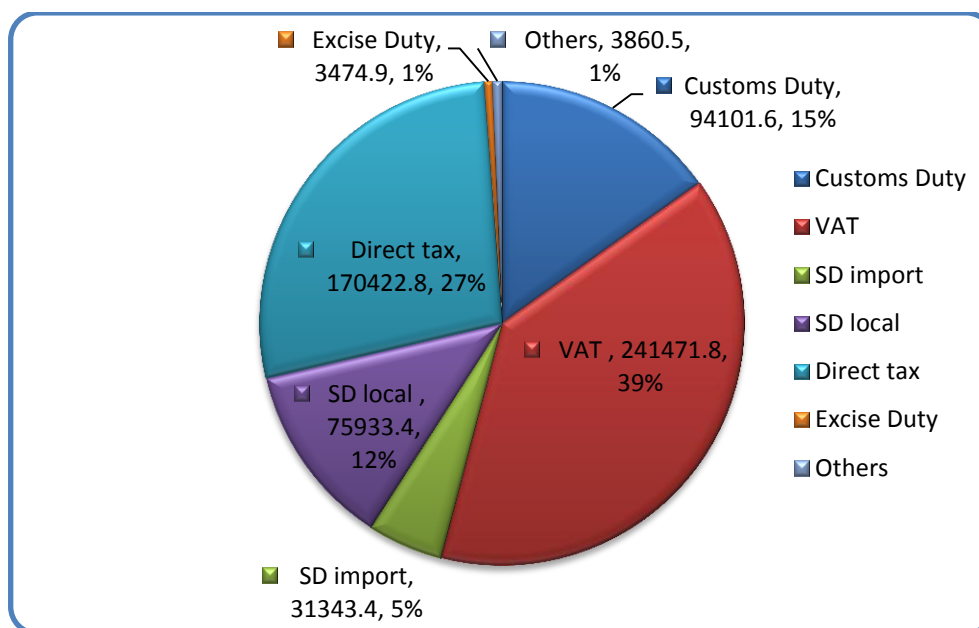


Figure 1 shows Bangladesh's heavy reliance on indirect taxes, more specifically on the international trade tax. The argument that personal income tax, generally considered to be the most effective means of taxing the rich, is relatively unimportant in most developing countries (Bird and Gendron 2005) holds convincingly true for Bangladesh. The predominance of indirect taxes in revenue yield over direct taxes becomes evident as direct taxes account for 27.46% of the tax revenue in 2009-2010 while indirect taxes account for about 72%. And among all the taxes, VAT is the single largest tax that accounts for the lion's share of the country's tax-revenue. The number of people within the tax net also equally indicates the malnourished tax culture of the country. Only 1.17%<sup>12</sup> of the population is registered under personal income tax (PIT) whereas the ratio of PIT taxpayer and population in developed countries varies from 40% to 94% (OECD 2011). Only 13.07% of the total number of businesses is registered under VAT

<sup>11</sup> There is an obvious decreasing trend in reliance on indirect taxes. While the ratio of direct and indirect taxes was 90:10 in FY 1972-73, it was 70:30 in FY 2010-11 (NBR 2012b).

<sup>12</sup> The number of PIT taxpayers was 1,919,368 in FY 2010-2011 (NBR 2012b).



(NBR 2011, BSB 2012). Please see Appendix 1 for a comparison of registered taxpayer populations in several countries.

The fact that the tax-GDP ratio in Bangladesh is one of the lowest in the world and the lowest among the South Asian countries is important in understanding the country's revenue performance. Though the relationship of Tax-GDP ratio with the level and pace of development is not straightforward, in a developing country the significant role of the state in building necessary infrastructure and providing social services depends on its success in mobilizing necessary resources through a robust Tax-GDP ratio (Government of Bangladesh 2003).

At this point some questions related to a country's tax system may arise: Is the tax system simple? Is it effective and efficient? It should be borne in mind that despite the poor current tax to GDP ratio, the tax scenario is improving as compared to the scenario in fiscal 1985-86 when the gross revenue from state-owned enterprises was estimated to be almost double the central government tax revenue (World Bank 1988). The challenge that lies ahead is elevating the current ratio to 12.4 % by 2015 (Government of Bangladesh 2011). In this respect, strong emphasis has been attached to resource mobilization through buoyancy of the tax revenue. Enhancing voluntary compliance and combating tax evasion have been rightly targeted for increasing tax-GDP ratio in Bangladesh. But the questions that have remained unresolved are how to enhance voluntary compliance and how to combat tax evasion. According to the official evaluation:

While Bangladesh's legal tax rates are not low by the regional and international standards, because of inefficiencies in tax administration and inadequate coverage, the tax-to-GDP ratio has remained virtually stuck at below 10% level over many years. (Government of Bangladesh 2011:98)

Are these the only causes for the poor tax to GDP ratio? Can it be achieved without a concurrent improvement in governance indicators? The other supplementary questions that arise are: Does the tax system embody the principle of transparency while instilling the same spirit in its stakeholders? Does it have enough

accountability mechanisms to hold both the tax collector and the taxpayer accountable? What role does it play in making the citizens demand accountability and response from the state? Does it promote a participatory approach? How do the stakeholders perceive the tax system from the perspective of good governance? To what extent does it play a role in state-building? The contextual background depicts a rather dismal picture of the state of good governance as well as the tax to GDP ratio. Are they correlated? Both theoretical and empirical literatures show that they are. Given that the maximization of tax revenue hinges on the level of voluntary compliance, taxpayers' compliance in turn depends on how a tax is collected, and hence enters the good governance paradigm in the context of taxation, which we will explore briefly in the following section and in more detail as we unfold the conceptual framework in the next chapter.

## **1.2 Statement of the problem, rationale and significance of the study**

### **1.2.1 Statement of the problem**

The relationship between taxation and good governance has come to the fore with the emergence of what Martin, Mehrotra et al. (2009) term 'the new fiscal sociology' in the mid-twentieth century. Human history amply shows the way taxation plays a significant role in the relationship between the state and its citizens. Whether taxes should be extracted in a coercive manner or be paid as a matter of civic obligation has been at the centre of debate from time immemorial. The inherent conflict that taxation entails and the attendant relationship between taxation and governance become obvious as we look into the history of human civilization which shows that numerous conflicts<sup>13</sup> have been centred on taxation. While the history of taxation generally reveals the predatory behavior of the rulers in extracting tax revenues mainly through coercion (Levi 1989, Martin, Mehrotra et al. 2009), the other paradigm of motivating the citizens to pay taxes as civic obligation has also been present throughout history. The concern for creating an

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<sup>13</sup> Groves notes that if it is conflict that makes life interesting, then taxation should be one of the world's most fascinating subjects (1948).

enabling environment for the citizens to pay taxes with less hardship is manifest in the Mughal Emperor Akbar's introduction of a *fasli san* (agricultural year) in order to coincide the agricultural year with the fiscal year so that farmers were not hard pressed to pay taxes out of season (Mohanta 2003).

However, even when the question of civic obligation is considered, there is an inherent conflict in people's minds between the benefit (expenditure) and cost (taxation) (Albon, 1986). A fair tax system should contain the principles of equality, of fair play or public trust in tax administration, of proportionality, of non-retroactivity and of charters of taxpayer rights (Vanistendael 1996). On the other hand, as opposed to what a fair tax system should be, a great deal of uncertainty and incentive for corruption characterize the tax administration of the most developing countries (Stotsky and Wolde 2002). Hence, there is a strong emphasis on simplification of the tax system, on continuous efforts to make taxes 'clearer, more transparent, easier, cheaper to administer and less vulnerable to extortion and corruption' throughout the world (Fjeldstad and Moore 2008:236-37). Along with *what* a tax system should be like goes *how* it should be made so? Here enters the question of creating an enabling environment that can work as a catalyst to strike a balance between the costs and the benefits.

The pivot of the present research is the conceptual premise that a tax system in general and VAT in particular being an integral part of the whole system of governance needs to conform to the principles of good governance in order not only to be effective and efficient but also to promote good governance as a whole. But the dilemma is: which comes first – good governance and then a good tax system or the other way round. This dilemma reminds us of William Somerset Maugham's observation, "Money is like a sixth sense – and you can't make use of the other five without it." So, domestic resources mobilization to a satisfactory level is as important for governance in general and state-building<sup>14</sup> in particular as good governance is essential for a good tax system.

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<sup>14</sup> By 'state building', Moore means 'the process of establishing or strengthening formal organizations which increase state capacity, and thus the ability of those who command the state to exercise authority over non-state actors or other states' (Moore 2013:16).

### 1.2.2 Rationale of the study

As far as the study of taxation is concerned, law, economics and accounting guide the majority of the researches, and though political science and social policy approaches are adopted, researches from these approaches are fewer in number (Lamb 2005). In this respect, the observation of the Organization for Economic Cooperation and Development (OECD) is worth noting:

The quality of a country's governance is recognised as a critical factor in its ability to develop. It is therefore surprising how little attention is given to one of the most fundamental drivers of the relationship between a state and its citizens – the *way* (emphasis attached) public revenues are raised. (OECD 2008:5)

There are three key aspects of the interaction between taxation and social policy – taxation as a means of financing social policies, taxation as an instrument of social policy, and the indirect impact of tax regimes on social policy – (Boden 2005). However, as the political scientist Guy Peters argued, the study of tax policy was largely abandoned to the economists until the 1980s. It has, however, drawn the attention of the political scientists since the late 1990s (Radaelli 2005). The tax literature stemming from the new perspective and also from the genre of new fiscal sociology has mainly remained focused on the theoretical aspect of the role of taxation in state-building. Empirical study of taxation from this perspective is quite sparse and it is even sparser in most developing countries.

As stated earlier, the VAT at present is the single largest contributor to GDP in Bangladesh. Its economic importance and the way, as a broad based consumption tax, it affects people in all walks of life justify my choice of VAT as a case study for understanding the relationship between a tax system and good governance. In a socio-economic condition where the immediate concern for revenue outweighs the concern for good governance, i.e. to maximize revenue no matter how, it is interesting to assess how apparently contradictory objectives have been poised in a tax system like VAT.

If the poor tax to GDP ratio or the subdued presence of direct taxes is any indicator of a country's tax culture, as indicated by (Nerré 2008), then the state of tax culture is quite weak in Bangladesh. The same goes for tax mentality which has been defined by Tretter (1974, cited in Nerré 2008) as including 'all attitudes and also all patterns of behaviour which the tax-paying citizens hold against (or with?) the tax and the state'. But despite the conspicuous absence of tax awareness, the absence of good governance elements in the tax system in general and VAT in particular occasionally comes to the fore of the debate. Many stakeholders have expressed their concern over the uncertainty and fear of taxation, the lack of transparency and the NBR officials' harassment through misuse of discretionary powers. For example, the business community expressed such concerns to the then Chief Advisor of the Caretaker government of Bangladesh (Daily Star 2007). The same daily published another report on a seminar titled "Complexities in the Income Tax Laws: A Quest for a Simpler Taxation System" where speakers were reported to have stressed the need for reducing complexities in income tax regulations and easing the overall taxation system (Daily Star 2010).

### **1.2.3 Significance of the study**

Exploring a tax system through the prism of good governance is in one sense an endeavor to understand the tax culture in which this tax is administered. As developing countries seek to reform their tax systems, the understanding of their tax culture is essential in that it is 'the entirety of all relevant formal and informal institutions connected with the national tax system and its practical execution, which are historically embedded within the country's culture, including the dependencies and ties caused by their ongoing interaction' (Nerré 2008:155).

It is particularly significant in a country like Bangladesh which is graduating towards democracy with its expressed commitment to promoting good governance; a tax system in general and a VAT system in particular need to embody the features of good governance in order for it to have a comprehensive impact on the society. Despite the growing importance of VAT throughout the world, 'surprisingly, – shockingly – little serious research effort is devoted to the VAT' (Ebrill et al. 2001). This state is even more shocking if we think of VAT research from a political

science perspective, especially in the context of a developing country like Bangladesh.

One can question: so what? Given the statement of the problem, the kind of research that we have undertaken can surely provide the key stakeholders of a tax system with a more comprehensive understanding of the tax issues and thereby, enable them to initiate more meaningful and pragmatic steps in reforming the tax systems. But what is more important than the policy implications of such a study is its potential contribution to sensitizing an array of stakeholders about the imperative for being engaged in a social contract called taxation as pro-active rather than reluctant partners. Because, at the end of the day, it is the degree of the taxpayers' voluntary compliance on which the efficiency and effectiveness of a tax system hinge. This sensitization is important and urgent in a tax-shy culture such as Bangladesh's.

Considering the importance of the political economy<sup>15</sup> of taxation backed by the above scenario, the Bangladesh VAT deserves a close study through the lens of social policy as well as political science research. But, to the best of my knowledge there has not been any scientific research on the tax policy from a political science perspective in Bangladesh. The present study aims to fill in this void.

## **1.3 Objectives of the study and research questions**

### **1.3.1 Objectives of the study**

Having understood the basic premise that taxation is an integral part of state-building as it is a social contract between the state and its people, and taxation and the congenial enabling environment of good governance are complementary to each other, the principal aim of the study will be to investigate to what extent the three procedural elements of good governance – participation, accountability and transparency – (ADB (1999) interact in the domain of the Bangladesh VAT. The

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<sup>15</sup> Political economy theory 'emphasizes the fundamental interrelationship between political and economic forces in society' (Miller 1994).

present study seeks to examine and analyze the VAT system in Bangladesh as it is administered today from a good governance perspective. In the context of the background and problems laid out above, the present study is based on three broad objectives:

The first objective is to explore critically and empirically the policy and practice of VAT system in Bangladesh against the best international practices that conform to the principles of good governance in general as well as to a good taxation system in particular.

The second objective of the study is to empirically investigate the extent to which the practices in the VAT system promote good governance.

The third objective of the study is to suggest both policy and social implications for improving the VAT system in Bangladesh as a tool for good governance.

### **1.3.2 Research questions**

With these objectives in view, the main research question – the role of VAT as a tool for good governance – can be broken down into the following four specific questions:

- What are the design features of the Bangladesh VAT that are commensurate with the principles of good governance and what are the elements that contradict the principles of good governance?
- To what extent and how, from the perspectives of theory and the stakeholders' perception, do policy and practice of VAT in Bangladesh espouse the core elements of good governance, namely participation, accountability and transparency?
- What are the factors that affect the practice of good governance in the VAT system in Bangladesh?
- To what extent and how, do the VAT policy and practice contribute to improved governance?

The study will remain focused on the three interdependent procedural aspects of good governance, namely participation, transparency and accountability – the core characteristics that have been considered essential for the construction of a tax policy and its administration from a state-building approach<sup>16</sup> to taxation (Everest-Phillips 2008). The timeline of the study is between 1991, the year VAT was introduced in Bangladesh, and 2012.

## **1.4 Structure of the thesis**

The focus of the thesis has been confined mainly to the policy and administration of the Bangladesh VAT from the perspectives of good governance on the basis of documentary analysis and the stakeholder's perception. Following the introduction, the thesis is structured as follows: Chapter 2 provides the research methodology employed in this study. Chapter 3 presents a review of literature that shapes the theoretical framework for understanding governance, development and taxation. After focusing on the different aspects and dimensions of governance vis a vis good governance and exploring the relationship between taxation and governance/state building from an historical perspective, the review looks at the paradigm shift from direct taxation to consumption taxation and in that process, the emergence of VAT as a revolutionary tax system throughout the world and its impact on state-building in general and good governance in particular. The review then attempts to contextualize the Bangladesh's state of governance and its tax structure with specific reference to VAT against the backdrop of the relationship between governance and taxation in general and indirect tax such as VAT and to pin point the gaps in the current knowledge in the subject. Chapter 4 presents a critical appraisal of the Bangladesh VAT based on documentary analysis and set against the backdrop of the international best practices that conform to the maxims of fair taxation system. The chapter shows how a number of deviations and distortions from the international best practices in the process of adaptation gradually removed it from standard VAT practices and turned it into a camouflaged excise or turnover

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<sup>16</sup> Everest-Phillips maintains that the state-building approach to taxation requires the construction of a tax policy and its administration through five core characteristics – political inclusion; accountability and transparency; perceived fairness; effectiveness; and political commitment to shared prosperity (2008: 123). The last three characteristics are indeed embedded in the good governance paradigm of taxation.



tax. Chapters 5, 6 and 7 present the findings of data on the different aspects of good governance, namely participation, transparency and accountability respectively. These chapters contain both documentary analysis and stakeholders' perceptions gathered through both qualitative and quantitative methods. This is followed by an analysis of the data in Chapter 8. In this chapter, the findings of documentary analysis, discussions, and interviews are pooled and the research questions are answered. Finally, Chapter 9 provides a summary of the major findings of the study and their policy implications and guides to the future research directions.

## CHAPTER 2

### RESEARCH METHODOLOGY

Having sketched out the objectives and the research questions of the study in the previous chapter, this chapter presents what research strategy I have employed and why. This chapter provides in detail the research methodology highlighting the disciplinary approach, epistemological stance and the research methods. With both exploratory and evaluative purposes in view, the nature of inquiry has led me to undertake a case study method within the framework of a qualitative research approach. The methodology, however, has a slight element of the mixed method approach as quantitative data have been occasionally used to triangulate the qualitative data.

#### 2.1 Disciplinary approach to taxation research

A bibliographic review of the study of taxation would unmistakably bear out the political scientist Guy Peters' comment made in 1979 that 'to date the study of tax policy has been largely abandoned to economists' (Peters 1979 cited in Radaelli 2005: 86). This was because of the most tangible traditional function of taxation: revenue. But the all pervasiveness of taxation requires it to be seen not only through the single lens of economics or law or accounting. Arguing that a common interest in taxation invokes a multidisciplinary research interest, Lamb says

In this field, researchers based in different disciplines may adopt different approaches to tax research...Each academic discipline – law, economics, accounting, political science, and social policy – has its own particular set of concerns about taxation, as well as an understanding of what taxation is and how it should be researched. (Lamb 2005:4)

She also argues that a tax researcher adopt an interdisciplinary approach in order to capture the comprehensiveness of taxation; by interdisciplinary approach, she means adopting 'the perspectives and research approaches of more than one academic discipline' (2005:7). This argument is reinforced by Everest-Philips as he

maintains that the importance of the role of taxation in state-building requires understanding politics, policy, administration, history, and economics along with the technical detail of law, public administration, and business accountancy (Everest-Phillips 2008:124).

The disciplinary approach of this research is primarily that of political science because of the ‘link between taxation and representation [as] an inherent aspect of democracy’ (Radaelli 2005:85) that the research seeks to address in a particular social setting. As typical domains of taxation as politics seek to address the question such as ‘how do policymakers make constrained use of power to produce tax policy’ or, ‘what is the influence of pressure groups and public opinion in tax policy?’ (Radaelli 2005:87), the objectives of the study already stated would justify my central disciplinary approach of political science. But at the same time, in so far as an objective of the research involves a careful study of how the VAT legislation fits into a rational framework ‘pointing out internal inconsistencies and supposed principles’ (Freedman 2005:13) this research has a legal aspect as well. Further, this study also has a behavioral research orientation in its treatment of aspects of tax compliance. All in all, this research attempts to address the research questions from an interdisciplinary approach as suggested by Lamb (2005).

## **2.2 Epistemological foundation**

There are numerous definitions of good governance or, in other words, the understanding of good governance changes with the change of perspective. The same applies to the issues of equity, efficiency or effectiveness of taxation or the more social science oriented question of participation in the tax policy formulation or its administration. This is to say that there can be different epistemological perspectives to understand the reality. As opposed to objectivist epistemology which holds that meaning exists without any reference to the operation of consciousness, constructionist epistemology maintains that meaning is not discovered but constructed and hence, the meaning of the same phenomenon can be constructed in different ways by different people (Crotty 1998). This epistemological perspective is required for understanding how different actors or

stakeholders perceive the operation of good governance in a particular situation. In contrast to the notion of existing knowledge to be discovered as held by the positivist, scientific style, a constructionist approach argues that

all knowledge , and all meaningful reality as such, is contingent upon human practices, being constructed in and out of interaction between human beings and their world, and developed and transmitted within an essentially social context. (Crotty 1998:42)

The individual process of making a meaning out of some experience does not take place in isolation (Crotty 1998) and their interaction with the context in history and their social life contributes to their construction of the meaning of their experiences.

Along with this goes the argument that all social life is inherently competitive (Mannheim 1952, cited in Adler and Longhurst 1994:27). Mannheim's argument of social competitiveness adding to the construction of meaning is particularly relevant to this research as taxation as a public policy entails more tangible conflict and competitiveness than many other policies. At one level, the conflict is between the state which wants to maximize revenue and the citizens who try to minimize it; at another level, the interests of the different segments of taxpayers, especially in indirect taxes, are often more diverse than congruent. The recognition of the inherent conflict and competitiveness that permeate taxation is important in understanding the perceptions of different actors. Thus the epistemological stand I invoked is constructionism. Hence, it is not merely a matter of discovering if certain traits such as those of good governance are present in a given scenario. It is more of understanding how the actors in a given social context and in a situation perceive them. The pivot of the study is not to overemphasize the competition or conflict in taxation but to explore how 'social order can and does result from accommodations and trade-offs between groups which are in a conflictual relationship with each other' (Adler and Longhurst 1994: 240) in a particular social phenomenon.

## 2.3 Research approach

Social science research employs both qualitative and quantitative approaches. While the quantitative approach with its bent on numerical assignment to the phenomena under study has the advantage over qualitative approach in terms of statistical validity, it fails to provide a rich and in-depth understanding of the population under study that a qualitative approach does. Naturally, fiscal sociological approach to taxation seems to warrant a qualitative rather than quantitative approach.

This is primarily a qualitative research. As epistemologically qualitative research assumes that knowledge is not out there but within the perceptions and interpretations of the individual (Crotty 1998) and this approach captures ‘people’s interpretations of their experiences’, the nature of my research questions dictate the pursuance of a qualitative approach more than a quantitative one. The research design is primarily qualitative in that it involves the interpretations of public documents and the collection of data through in-depth interviews and focus group discussions from a non-representative sample of 214 respondents from different segments of stakeholders.

But, given that each approach has its own advantages and disadvantages, a two-pronged approach that employs both quantitative and qualitative techniques can be ideal (Vanderstoep and Johnston 2009). In view of this understanding, a sort of mixed methods approach has been adopted in this research. However, the qualitative data have been supplemented through some quantitative data collected through structured questionnaire from VAT-paying businesses and VAT officers, mainly with a view to triangulating qualitative data.

The adoption of some quantitative approach for data triangulation can be further defended by the recognized epistemological stance that

Only a multi-faceted, differentiated approach can provide a complete vision of social reality, just as a statue in a square reveals the completeness of its form only when viewed from different angles. (Corbetta 2003:51)

The mixed methods approach enabled me to gather data that could not be obtained by adopting a single method and also facilitated data triangulation so that the findings of the qualitative approach could be weighed and substantiated with the quantitative approach where it was deemed possible and appropriate. However, the focus on the qualitative aspect is based on the fact that it captures the dynamic and holistic elements of individuals' experience in their contexts and their perceptions of such experiences (Crotty 1998).

### **The role of the researcher**

Prior to undertaking this research, I had the opportunity of working in the VAT department of Bangladesh for about 18 years. The beginning of my journey through the terrain in public service coincided with the introduction of VAT in Bangladesh in 1991. In this respect the present research has the effect of an insider research. *Insider research* refers to a process when researchers conduct research with populations of which they are also members (Kanuha 2000) in order for them to be able to share an identity, language, and experiential base with the study participants (Asselin 2003). The process of qualitative research is very different from that of quantitative research primarily in that the qualitative researchers are firmly involved in all aspects of the research process essential to it (Dwyer and Buckle 2009). This aspect becomes more significant in insider research.

The researcher's situatedness and context becomes crucial as we take the concept of 'social situatedness' into consideration. Originally developed by Vygotsky (1962), the concept holds the idea that the development of individual intelligence requires a social and cultural embedding. An insider is in a unique *position* to study a particular issue in depth and with special knowledge about that issue; he/she has *easy access* to people and information that can further enhance that knowledge; he/she has *in-depth knowledge* of many of the complex issues; and he/she can challenge an issue from an informed perspective (Asselin 2003). As an insider research, familiarity with the organizational culture and customs and my professional relationship with many of the organization's stakeholders gave me a unique opportunity to gain easy access to insider information which would have been more difficult for a stranger.

However, insofar as the insider research entails *having* a direct involvement or connection with the research setting (Robson 2002), my role as an insider is a matter of the immediate past than rather than of the present continuous. My shift from the tax domain to another domain of public administration, which virtually had no relationship with taxation, can be viewed as assuming the role of a detached insider. In addition to avoiding any potential conflict of interest, this new role perhaps enabled me to have the space between the subject and object required for getting a better view of the taxation scenario which could be blurred with my previous closeness. This is again a matter of advantage insofar as the question of validity is raised in insider research (see, for example, Rooney 2005). Though the ideal role of a researcher in a scientific research demands a researcher to be without emotion and free from bias (Taylor 2001), a researcher can assume, as Blaikie (2000, cited in King 2006) argues, one of the five other roles<sup>17</sup> including the *mediator of language* who interprets the accounts provided by participants and makes his voice clearly present. My role as a researcher is akin to that of the mediator of language. My working experience and professional expertise in VAT endowed me with the skills to analyze the relevant documents as well as to interpret the accounts given by participants.

This research has exploratory, descriptive and evaluative purposes. It is explorative in the sense that it aims at understanding the perceptions of the stakeholders of VAT with relation to good governance. This research has descriptive purposes in so far as it describes, predominantly on the basis of documentary analysis, the extent to which the current VAT in Bangladesh in its policy and practice possesses the principles of good governance. It is evaluative in that it evaluates a particular tax system with a number of indicators related to standard VAT and good governance.

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<sup>17</sup> King (2000) lists the five roles identified by Blaikie. Besides mediator of language, there are *empathetic observer*, one who tries to get the subjective meaning used by social actors; *faithful reporter* who allows participants to have their voice and ensures they can recognize themselves in the research reports;; *reflective partner* who works in dialogic process in which participants are recognized both to have status in the interpretation of the research and to be changed by the research process; and finally *dialogic facilitator* who seeks to express the diversity of positions perceived in the authentic voices of the participant.

## 2.4 Research method

Of the different types of qualitative research methods – ethnography, phenomenology, case study, textual analysis, and applied research (Vanderstoep and Johnston 2009) – the present study has adopted the case study method.<sup>18</sup> Case study, however, has been seen by Yin (2003) more as a comprehensive research strategy than merely a research method as he defines the scope of case study research as investigating ‘a contemporary phenomenon within its real life context, especially when the boundaries between the phenomenon and context are not clearly evident’ (Yin 2003:13). Since case study ‘is an inquiry that focuses on describing, understanding, predicting, and/or controlling the individual (i.e., process, animal, person, household, organization, group, industry, culture, or nationality)’ (Woodside 2010:1) and the main purposes that this method serves are description, explanation, prediction and control<sup>19</sup> (Ibid), the case study method appeared to be most suitable for the current research. This study, as already noted, seeks to understand the indirect consumption tax phenomenon in the context of good governance in a particular social setting. This method is also better aligned with my epistemological stance of constructionism and my role of insider researcher as in case studies ‘the researcher’s voice and perspective are typically more prevalent than the voice and perspective of the informants’ (Vanderstoep and Johnston 2009:209). But in line with the expected role of a case researcher, the present researcher has tried his best to ‘preserve the *multiple realities*, (italics in the original) the different and even contradictory views’ (Stake 1995:12) of what happens with regard to the case.

## 2.5 Data source

In order to address the research questions and pursue the objectives of the study, the thesis has utilized data from both primary and secondary sources. While the focus

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<sup>18</sup> While the literature often classifies case study as a qualitative research method, many researchers advocate viewing it as not being restricted to one set of research methods (see, for example, Woodside, 2010).

<sup>19</sup> According to Woodside, *description* in Case Study Research (CSR) attempts to answer who, what, where, when and how questions while *explanation* provides the answer to the why question. *Prediction* includes forecasting near term and/or long-term psychological states, behaviors, or events that will follow within the individual case and/or similar cases. *Control* in CSR includes attempts to influence the cognitions, attitudes, and/or behaviors occurring in an individual case’ (Woodside 2010:11-12).



of the study on understanding the current policy and practice of VAT in Bangladesh warrants the use of secondary data in the form of documents, its engagement with the stakeholders' perception about the same phenomenon in relation to good governance necessitates the use of primary data.

The qualitative aspect of the research thus involves documentary analysis, in-depth interviews with- and focus group discussion participated by-, respondents representing different segments of stakeholders. The following subsections focus on the documentary analysis, in-depth interview and focus group discussions respectively.

### **2.5.1 Analysis of documents**

In the present research the use of data from secondary sources should more aptly be called the documentary research method as, according to Bailey (1994), it refers to the analysis of documents containing information about the phenomenon to be studied. It should be well noted that combining research methods to investigate the same phenomenon (Grix 2001) for enhancing the reliability and validity of their analyses by social scientists is not uncommon, though less frequent.

The study has conducted documentary analysis using a variety of legal and administrative as well as non-government documents over the period from 1991 to 2012. While the legal documents include VAT Act, 1991, VAT Rules 1991, Excises and Salt Act 1944, Statutory Regulatory Orders (SROs), general orders and notifications, administrative policy documents such as NBR Annual Reports and other publications, Revenue Reform Commission (RRC) Reports, budget speeches, Poverty Reduction Strategy Papers have also been extensively reviewed. In addition, a number of working papers meant for the NBR consultative committee meetings, and media reports and articles have contributed to the wealth of secondary data. For probing into the administrative policy and practices, a comprehensive range of administrative rules and orders such as citizen's charters, codes of conduct, and secretariat instructions has been analyzed. While documentary analysis offers advantages such as convenience, low cost and replication, it suffers from a few weaknesses such as the lack of representativeness

and the risk of being biased (Sarankos 2005). As the sources of documents mentioned above would reveal, in handling the documentary sources the researcher tried his best to adhere to the quality control criteria formulated by Scott (1990) – authenticity, credibility, representativeness and meaning. The extensive use of documentary sources has indeed shaped the backbone of this study.

Of the different schemes of document analysis – descriptive, categorical, and exploratory and comparative – the present study has employed exploratory and comparative analysis approaches.<sup>20</sup> In particular, the analysis of the VAT legislations in Bangladesh in critically appreciating the tax system presented in chapter 3 is built on documentary study. In addition, throughout the chapters, the trends, characteristics, peculiarities of the VAT system in its policy and administration would be identified, compared and contrasted through the analysis of the plethora of documents relevant to the study.

## **2.6 Respondents for primary data**

VAT as a broad based consumption tax is a cross-cutting issue; it involves an array of stakeholders whose degree of interaction with the taxing system differs widely. While a general consumer pays VAT, knowingly or unknowingly, it is a VAT-registered business that works as tax collecting agent for the government. According to the VAT legislation in Bangladesh, as in many other countries, the responsibility of paying VAT to the government on a VAT-able/taxable transaction rests on the supplier of goods or the provider of a service. VAT registered business has to know all the intricacies associated with the collection of taxes. While a VAT policy maker's concern lies with the system's effectiveness and efficiency, a business leader has to grapple with the collective concern of lessening the compliance cost and increasing competitiveness. Against this backdrop of divergent interest centering on a tax system, a comprehensive assessment of VAT entails the

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<sup>20</sup> According to Sarankos (2005), exploratory approach entails identifying data, comparing them, weighing their relevance and significance and searching for peculiarities, characteristic attributes and trends in the context that mark the identity of the message conveyed through the document. Comparative analysis compares issues across times, countries and cultures.

involvement of as many segments of stakeholders as possible. Hence the present study involved the following respondents for gathering data:

- *VAT taxpayers*: In a VAT, a registered business is a taxpayer; it is a business that collects VAT from its buyers and passes it on to the government. The VAT administration directly deals with businesses in order to implement the tax policy. Their compliance costs as well as their competitiveness depend on the tax system's degree of complexity or fairness. The survey in this study aimed to produce data relevant for understanding their perception of participation, transparency and accountability in VAT system.
- *Business leaders*: They form a very important and influential segment of stakeholders in any tax system. In a business tax like VAT, the role of businesses is more crucial than any other stakeholder as they act as the tax collecting agent for the government. Business leaders representing different business associations and groups tend to play a key role in the different arenas of tax policy formulation and its implementation. Business leaders represent the trading people to the policy makers and work in collaboration with the government to facilitate trade in all possible ways. In Bangladesh, proposals for tax policy are sought from business bodies on the eve of formulating the annual budget
- *VAT officers belonging to both policy and administration*: In Bangladesh, as in many developing countries, the line of demarcation between tax policy and administration is too thin to be distinguished. We can recall the famous observation by Casanegra de Jantscher (1990) that in developing countries, tax administration is the tax policy. Senior level officers in the Bangladesh VAT have the unique opportunity of playing the dual role of policy formulator and implementer. Hence, they are supposed to be familiar with the factors that prompt a particular policy as well as the problems of tax administration. Thus in-depth interviews with some senior officials and the participation of some other officials in Focus Group Discussion (FGD) form a dynamic part and strength of this research

- *VAT experts:* VAT experts from academia as well as from professional arena were included in the survey with the belief that they would be able to judge the Bangladesh VAT from both theoretical and international perspectives. VAT experts also included two retired VAT officials who had knowledge and understanding of VAT as they had played a key role during the early stage of VAT in Bangladesh. Also, retired officers have the knowledge to compare the current VAT with the excise system which it replaced.
- *General consumers:* The ultimate burden of indirect taxes rests on the shoulder of the final consumer. How consciously does a general consumer in a country like Bangladesh shoulder this burden? And, when he/she does so, what is their evaluation of the system that makes him/her pay taxes in an encompassing way? As the effectiveness of a tax system depends to a great extent on the level of motivation of its taxpayers, it is important to assess the system through their lenses.

The selection of the respondents for the study has been done with a conscious effort to understand the characteristic conflict and competition among the different actors that a tax system usually epitomizes: the maximization of revenue by the tax authority is challenged by the taxpayers' efforts to minimize it; improved tax compliance hinges on the compliance cost by the taxpayers; exemptions for small industries conflict with the big industries' concern for losing their competitiveness, so and so forth.

## **2.7 Methods of data collection**

As the respondents are not homogeneous so far as their interest in and understanding of the topic being researched is concerned, three different data collection methods were employed. They were the qualitative tools of in-depth interview, focus group discussions and the quantitative tool of questionnaire based-survey. Prior to interview, FGD and questionnaire-based survey, all participants received an informed consent form to sign. The information sheet indicated the purpose of the study, what would be involved during their participation and how

their privacy and confidentiality would be ensured. They were also told that they could stop and withdraw from the study at any point of time.

### **2.7.1 In-depth interview**

Compared to a questionnaire, an interview is considered more likely to provide better cooperation and understanding between the researcher and the interviewee. An in-depth interview ‘provides the greatest opportunity to find out what someone thinks or feels, and how they react to various issues and opportunities’ (Bouma 2000:180). In the words of Michael Patton,

The purpose of qualitative interviewing is to understand how the subjects studied see the world, to learn *their* terminology and judgments, and to capture the complexities of *their* individual perceptions and experiences...The fundamental principle of qualitative interviewing is to provide a framework within which respondents can express *their own* understandings in their own terms. (Patton, 1990, cited in Corbetta 2003:265)

Of the different types of interview – structured, semi-structured and unstructured – the semi-structured interview suited my purpose as it allows the use of open ended questions to extract interviewees’ ideas while placing some boundaries around the issues to be discussed. Drawing on the researcher’s 18 years of experience in the Customs and VAT department and adopting the role of a detached insider, the interview format acknowledged the interviewee’s expertise and experience in the topic under research while drawing their attention to the some of the theoretical propositions; for example, the discrepancy between the international standard practice of VAT and the practice of VAT in Bangladesh.

### **The Interview Process**

The interviews were conducted on an individual basis, voice-recorded, and transcribed. The in-depth interviews were completed in less than one hour. The objective of the data collection process was to obtain a detailed description of how participants viewed the aspects of participation, accountability and transparency in

the context of VAT in Bangladesh and how their perceptions focus on the challenge of evolving VAT as a fair tax system aligned with a good governance agenda. In the interview with VAT officials, business leaders and civil society members, predominantly open ended questions, which were flexible and subject to change, were asked, because, this method ‘maximizes discovery and description’ (Reinharz 1992:18). This enabled me to undertake a conversational approach. Most of the interviews were held in the respondents’ own work places. Some of them were held in their homes. The researcher had previous professional and /or social interaction with many of them which served as an added advantage for the conversational approach to elicit frank opinion on the studied subject. All interviews were audio-recorded with prior permission from participants and then transcribed. Transcriptions were made available to some participants on their request. (For a coded list of in-depth interviewees, please see Appendix 12).

### **2.7.2 Focus group discussion (FGD)**

The power of FGD as a research tool lies in its group dynamics. Advantages such as synergy, snowballing, stimulation, spontaneity and serendipity that ensue from the group dynamics of a focus group (Stewart and Shamdasani 1990) have made FGD one of the widely used research tools in the social sciences. As a fast and cost-effective technique for eliciting views and opinions of prospective clients, FGD has been found appropriate for obtaining insights into target audience perceptions. This method has been used to gather data from business leaders and VAT officials who are related on the basis of reciprocity of service and taxes.

Considering the importance of the selection and recruitment of participants in view of the research agenda and also the implications that the composition of the group has for the outcome of the discussion, convenience sample has been used for selecting participants as this is the most common method for selecting participants in focus groups (Stewart and Shamdasani 1990). One FGD was organized with participants that included VAT officials working at both field and policy levels, business leaders and representatives from VAT-paying businesses, VAT practitioners and civil society members. The issue for discussion was laid out at the very outset of the discussion. But it was interesting to note how respondents seized

the opportunity to express their ideas and express their feelings, especially in the presence of their counterparts, how a bandwagon effect operated as a comment by one individual often triggered a chain of responses from participants and how serendipitous themes, though not unrelated to the agenda, emerged. However, as is common with FGDs, there were attempts by one or two participants to dominate the session but this was moderated to ensure almost equal participation of each participant. As a result of their spontaneous participation coupled with a sense of security in this kind of academic rather than administrative discussion, the duration of the FGD had to be extended by an hour. (For a coded list of FGD participants, please see Appendix 13).

### **2.7.3 Questionnaire-based survey**

The questionnaire, which is arguably an instrument of the quantitative approach, ‘attempts to place the subject within the researcher’s pre-established schemes... and forces the respondent to limit his answers’ (Corbetta 2003:265) has been used in this research more for the purpose of data triangulation than for deducing a conclusion.

#### **Survey instruments**

The survey instruments consisted of three sets of both open-ended and closed questionnaires. They were designed to collect both qualitative and quantitative data from three groups of respondent, namely VAT-paying businesses, general consumers and VAT officers, on their perception of the extent that the policy and practice of the Bangladesh VAT fit in the broader framework of good governance especially in its principles of participation, transparency and accountability. For VAT-paying businesses and general consumers the questionnaire was prepared in Bangla while the questionnaire on the state of accountability for the VAT officers was prepared in English. A structured questionnaire with fixed alternative questions including simple dichotomy, determinant choice and frequency determination was prepared for the selected respondents belonging to VAT taxpayers for collecting primary data – one set for the general consumers and another set for the taxpaying businesses and/or their representatives. Yet another structured questionnaire was prepared for VAT officers. Questionnaires were sent through postal mail as well as through personal contacts. A covering letter from the researcher along with a letter

of introduction from the research supervisor in the Department of Politics and Public Policy at Flinders University was sent/given to the survey respondents. The English versions of the questionnaire have been appended as Appendix 12, 13, and 14 respectively.

## **2.8 Data collection sites**

Though VAT extends to the whole of Bangladesh, field data were collected from the target population resident in the four main business regions, namely Dhaka, Chittagong, Rajshahi and Khulna. The choice of these regions was prompted by their relative importance for VAT revenue as well as for the number of registered businesses. VAT revenue is highly concentrated in the capital city Dhaka which had about 63% of the total VAT registered businesses and accounted for 80% of VAT revenue in FY 2009-2010. Chittagong, Rajshahi and Khulna accounted for 13.50%, 2% and 2.9% of VAT revenue in respectively during the same period (NBR 2011a). The FGD and most of the in-depth interviews were conducted in Dhaka because of the respondents' location.

## **2.9 Sampling**

Despite respondents being heterogeneous, only one sampling method was employed, the convenience/purposive sampling method.

For understanding the VAT-payers' perceptions of the different process in VAT with regard to good governance, the sample frame ought to be the list of VAT registered persons held by the NBR. In the current study, instead of accessing the central database of VAT registered businesses, the updated lists of VAT-payers held by different territorial jurisdictions such as Dhaka, Chittagong, Rajshahi, were accessed with the permission of the relevant Commissioner. Because of the huge size of survey population, potential respondents were chosen purposively from such lists to make sure that different business sectors and the sizes of turnover were represented. The existing number of VAT registered persons in Bangladesh is 480,467. Purposive / convenience sampling was used for selecting the respondents



in the following groups: business leaders, VAT experts and VAT officers belonging to the executive level, as there is a limited number of people who have expertise in the area being researched. The same method has been used for choosing general consumers for on-the-spot interview.

In selecting the appropriate sampling method for this research I bore in mind that sampling strategy needs to be suitable to the purpose of the study, the availability of resources and the constraints being faced (Patton 2002) and also that ‘sampling in qualitative research is neither statistical nor purely personal’ (Silverman 2005:130). From this point of view, purposive sampling was found most suitable. As taxation is a specialist subject, respondents in in-depth interview and FGD had to have some in-depth understanding of the issue being researched. No other sampling method would ensure that requirement.

### **2.9.1 Sample size**

The sample size in qualitative research is by no means representative. The total sample size was 214. Of these, for questionnaire-based survey, 110 were drawn from VAT-paying businesses segment, 25 from working VAT officials and 50 from general consumers; for the FDG, 16 participants were drawn from business owners/their representatives, VAT consultants, VAT officers and others; and for in-depth interview, a total of 13 respondents were selected from among the business leaders, VAT experts and VAT officials. The business segment formed the majority of respondents because of its frequent and direct interaction with the nitty-gritty of tax matters.

Finally, the thesis adopts a comparative analytical approach of VAT design features in Bangladesh and in some other international best practices such as Australia and New Zealand. The purpose of the comparative analysis is to gain insight on specific provisions in the VAT legislation, which appear to have an impact on the different aspects of good governance in relation VAT at large.

For the VAT-paying business category, 175 businesses belonging to different VAT commissionerates were selected and approached for their participation in the survey. Of them, 110 businesses responded positively. That is, the response rate was 63%. Most of the participating businesses (89%) were represented by their employees; most of the respondents were well qualified in terms of academic qualifications, 35% holding a Masters and 61% holding a Bachelor degree. While 46% of the respondents were involved with the VAT-paying business for more than five but less than 10 years, their frequency of interaction with VAT offices varied from at least once in a month (54%) to twice or more. Demographic details of the participants in this category may be seen at Appendix 12.

## **2.10 Data Analysis**

Primary qualitative data gathered through interviews and FGD were organized thematically in consistence with the research questions. Once the coding was completed, the coded information was printed, the content of the data was reviewed, and important quotations from interviews were translated into English for use during report writing. In the case of quantitative data gathered through questionnaires, a simple tabulation of responses on a question-by-question basis was done and then the tabulated numbers were expressed in percentages for the convenience of comparison. The primary data were presented in tabular form.

## **2.11 Ethical issues**

All participants/respondents were informed of the objectives and methods of the research prior to gathering information from them. It was optional for them to provide their personal details. Even when their personal details were provided confidentiality was assured and maintained. It was the moral responsibility of the researcher to make the respondents confident that their participation will not expose them to any risk of disclosure. Respondents had the full right to withdraw at any time during the data gathering process.

## 2.12 Conduct of surveys

As noted earlier, the researcher's capacity of being an insider of the VAT department for 18 years was an added advantage in accessing the official data as well as selecting and locating most of the respondents. Particularly in selecting respondents for in-depth interview of VAT officials, business leaders and VAT experts as well as in selecting participants for FGD, the researcher's rapport with the VAT environment in Bangladesh contributed immensely. The respondents for in-depth interview were selected purposively, especially through snowball sampling.<sup>21</sup> When approached and appraised of the subject matter and purpose of the research, most of the potential respondents responded enthusiastically. For many of them, the topic being researched was a matter of great interest for its potential to contribute to the improvement of the Bangladesh tax culture and they also considered it a privilege to share their opinion on the different aspects of VAT with a researcher. However, a couple of VAT officers declined to participate in the survey as they thought that they should not talk 'on the record' to a researcher without prior approval from their supervising authority.

## 2.13 Conclusion

Drawing on the epistemological stance of constructionism, the study has attempted to understand and interpret the reality of contested issues such as taxation and good governance, going much beyond how that reality is presented by the more powerful actors such as the ruling elites. Good governance has many ramifications in its application to the development and politics of a country (Sobhan 1993). For the purpose of evaluating a tax system, through the prism of good governance, the focus is the procedural aspects of good governance; in other words, 'how an agency uses governance arrangements to ensure it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness' (Commonwealth of Australia 2007:1). So, in judging

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<sup>21</sup> In snowball sampling, an initial number of individuals are first identified for gathering desired data and then these individuals serve as 'seeds' to help identify other potential respondents from whom the same data are gathered (Magnani et al. cited in Yesegat 2009) .

the tax system in general and Bangladesh VAT in particular in the light of good governance, the scope of the concept of good governance remains delimited to its three core characteristics namely participation, transparency and accountability. While the elements of responsiveness, predictability, equity and effectiveness and efficiency were dealt with throughout the study, some dominant principles such as human rights and gender equity issues were not treated as they do not directly belong to the purview of this study.

## CHAPTER 3

# TAXATION, GOVERNANCE AND DEVELOPMENT: A CONCEPTUAL FRAMEWORK

### Introduction

The aim of this chapter is to present the theoretical framework of the thesis before exploring the main subject matter through the later chapters. This chapter highlights multifarious facets of taxation – starting as a ruler’s unilateral tool to finance his priorities, then evolving as a social contract between the rulers and the ruled, and finally, to its predominant role in state-building in a democratic society – and its relationship with governance. The review of relevant literature will clarify the analytical framework of the current study and reveal the impact of the dynamic relationship among good governance, taxation and development. This conceptual framework will point out the scope and position of the present thesis which fills the gaps of previous works.

Tax is one of the most important social and economic issues and has kept both experts and the general public preoccupied throughout the evolution of human civilization. While the idea of tax may differ according to the context and the space and time, the generally acceptable definition of tax is that it is a compulsory contribution by the people to government imposed in order to raise revenue (Thuronyi 2005). The same idea is rendered in the lexical definition of tax – ‘a compulsory contribution to state revenue, levied by the government on workers’ income and business profits or added to the cost of some goods, services, and transactions’ (Oxford Dictionary). Although this basic definition does not specify under what conditions a contribution is made, it clearly indicates the fundamental purpose of this transaction and also who the players in this interaction are – the government and the people.

There are a host of other definitions given by scholars and thinkers over the ages. These definitions shed light not only on the conditions under which people make a

contribution to their government but also reflect a range of attitudes towards tax. In all definitions there is a pursuit to underpin whether taxation is a civic obligation, a bond between the rulers and the ruled based on reciprocity or just an unrequited payment to finance government expenditures. In 1888, the American political economist Richard T. Ely defined taxes as ‘one sided transfers [ ] for meeting the expenses of government’ (Ely 1888:6–7, cited in Martin, Mehrotra et al. 2009). One century later, the World Bank (1988:79) in the same vein defines taxes as ‘unrequited, compulsory payments collected primarily by central governments.’ The World Bank definition echoes Dalton (1978) who considers taxes as a compulsory contribution imposed by a public authority regardless of the exact amount of service rendered to the tax payer in return. These definitions seem economics biased as the revenue function of taxes becomes prominent in them.

On the other hand, many other scholars and thinkers regard tax as an instrument of reciprocity between the state and its people, broadly, and between tax collector and taxpayers, specifically. The ancient Indian epic poet Kalidasa touches upon the reciprocity of the relationship that taxes entail when he mentions that ‘the king receives taxes from his subjects only for the promotion of their welfare as the sun draws moisture from the earth to return it a thousand-fold in the shape of rain’ (Kale 1922: Canto 1, verse 18). The US Supreme Court Associate, Justice Oliver Wendell Holmes Jr. (cited in Cordes, Ebel et al. 2005:xv) maintains, ‘Taxes are what we pay for civilized society.’ This assumption treats tax as a contribution made on the basis of reciprocity. The same notion has been voiced by Grapperhaus in his historical account of taxation and the forming of society in Europe, America and India where he maintains, ‘an individual sacrifice for collective goal may well be the shortest way of defining taxation’ (cited in Vermeend, Ploeg et al. 2008:9). Taxation, as seen by this school of thought, is a matter of reciprocity between the state and the citizen. But a perennial paradox exists in the matter of reciprocity of tax and service: a taxpayer does not want to pay taxes as he/she thinks that they are not being given services by the government that they are interested in and the government complains that it cannot provide the required services as it cannot generate enough money from the public.

However, a definition of tax stripped of the reciprocity element would relegate it to a mere subscription or payment. But seeing a tax as a mere subscription or payment, as most early definitions do, does not signify what taxation actually is. Hence emerges the argument that taxation is not a one-sided payment, but combines aspects of responsibility and reciprocity. Martin, Mehrotra et al. define taxation as ‘the socially recognized obligation to pay rather than the payment itself’ (2009:3). This elevates taxation from a mere payment of a sum of money to a civic duty. The combination of duty on the part of taxpayers and reciprocity in response to the fulfillment of that duty forms the new paradigm on which rests the conceptual framework of this study.

Whether voluntary or compulsory, reciprocative or one-sided, taxation is inevitable. The inevitability of taxes in human life expressed by the popular aphorism of the famous US statesman Benjamin Franklin, as noted earlier, has been indissolubly related with the progress of human civilization. Taxation is thus as old as the recorded history of human civilization. With the passage of time, tax has grown and evolved as civilizations themselves (Blankson 2007). Over the ages, taxes have remained a major subject of interest to economists as well as social scientists, for, this inescapable phenomenon not only reflects a people’s values and priorities but also provides invaluable insights into how individuals relate to one another, to government and to their broader society (Goham and Reischauer 2005). This is more so because, in addition to raising revenue, tax serves political, economic and social purposes as well, according to the policies of the government of the day (Strachan 1981).

The conceptual framework of this thesis draws on a rich seam of political science research (for example, Levi 1989; Brautigam 2008; Moore 2008; Martin, Mehrotra et al. 2009) that focuses on the place of taxation in the shaping of state-society relations as opposed to the tax specialists’ concern with taxation in terms of operational, economic values of simplicity, efficiency and equity (Moore 2002). At the core of this conceptual framework lies what Moore calls ‘the fiscal sociology paradigm’ which he defines as

the proposition that the sources from which public authorities obtain their revenues, and the ways in which they organise themselves to relate to revenue providers, exercise a major influence over politics and governance. (2011:11)

This paradigm is directly related to the good governance paradigm insofar as it is concerned with the *ways* a tax authority relates to taxpayers. Along with the classic preoccupation with taxation has emerged the concept of good governance which has already become a new approach for individuals to relate to the government. Because of the ingrained relationship between taxes and human society and between governance and the people, it is important to conceptualize different social policy aspects of good governance as well as taxation and the relationship between the two.

This chapter thus attempts to synchronize the fiscal sociology paradigm with the good governance paradigm to bring the conceptual framework of the study home. The chapter is organized as follows: following the introduction, Section 1 presents the different aspects and dimensions of governance vis a vis good governance and establishes the relationship between taxation and governance/state building from the historical as well as the theoretical perspective. Section 2 looks into the paradigm shift, first from direct taxation to indirect taxation and then from production taxation to consumption taxation; in that process, the emergence of VAT as a revolutionary tax system throughout the world and its relevance to state-building in general and good governance in particular will be presented. Section 3 will attempt to contextualize the state of governance in Bangladesh and its tax structure with specific reference to VAT. In conclusion, we will be able to pin point the gaps in the current knowledge in the subject.



## **3.1 Governance, good governance, development and taxation**

### **3.1.1 Understanding good governance**

Governance seems to be a chameleon word. It not only means different things to different people, it also means different things to the same people in different contexts (Bowornwathana 2008). Nowadays, governance is qualified i.e. good governance has become a catchword that is used alongside such terms as democracy, civil society, human rights and sustainable development (Agere 2006). For Stoker, governance means ‘creating the capacity to act,’ bringing together the resources required to accomplish the collective ends of society (1991:51). According to Rhodes (1996), governance is a process of regulation, coordination, and control. Lynn Jr., Heinrich et al. (1999:2-3) define governance as ‘regimes of laws, administrative rules, judicial rulings, and practices that constrain, prescribe, and enable governmental activity.’

Governance as the exercise of authority is a neutral concept, one free of value judgment (World Bank 2003). Putting a qualifier, ‘good’, in front of ‘governance’ invokes judgment about the quality of governance. With the adjective ‘good’ added, governance thus ceases to be a neutral, self-explanatory description of a process; the coinage of the term ‘good governance’ implies that there could be ‘bad governance’ as well. Good governance, in fact, refers to the quality and effectiveness of governance crucial to national prosperity (Agere 2006). This judgment, however, can be subjective and thus vary with change of the time, space and culture. The ‘good’, ‘most benevolent’ ruler or the ‘just tyrant’ of the ancient world may not fit well in the current parlance of good government. In their social-anthropological study of people's involvement in politics, Poluha and Rosendahl (2002) note that all the governments in their case studies of Cuba, India, Ethiopia, Taiwan and the Lebanon see themselves as advocates of one or several characteristics of good governance, which reinforces the idea that good governance has different connotations in different contexts.

As opposed to governance which used to be understood as the process of exercising authority mainly by the state on its citizens, the paradigm shifts with good governance as it rests on the inseparable relationship between the state and its people. 'If governance is the exercise of authority in the name of the people, good governance is doing so in ways that respect the integrity, rights, and needs of everyone with the state' (World Bank 2003). The relationship between the state and its people forms the core of good governance as understood by many of the international development organizations such as the World Bank, United Nations Development Programme (UNDP) and International Monetary Fund (IMF).

The World Bank, which first used good governance in its present parlance, defines governance as 'the manner in which power is exercised in the management of the country's economic and social resources for development' (World Bank 1994:xiv). The Bank identifies predictable, open and enlightened policy making, a bureaucracy imbued with a professional ethos, the rule of law, and an accountable, transparent and participatory decision-making process as some identifiable characteristics of good governance. In its pursuit of and advocacy for, good governance in different countries, especially in developing countries, the World Bank considers good governance as encompassing the core values of inclusiveness and accountability (World Bank 2003). Inclusiveness refers to all citizens being equally guaranteed certain basic rights including equality before law and the rights to participate in the governance process on an equal basis. Accountability ensures that those who are selected to act in the name of the people are answerable to people for their failures as well as credited for their successes. In this way, good governance has been viewed as the intersection of the core values of inclusiveness and accountability. Thus two principles under inclusiveness – equal participation and equal treatment, and two principles under accountability – transparency and contestability emerge. According to the Bank, 'Any of the four can improve governance; only the four altogether will ensure good governance' (World Bank 2003:32).

The UNDP views governance as 'the exercise of power or authority, political, economic, administrative or otherwise, to manage a country's resources and affairs. It comprises the mechanism, processes and institutions, through which citizens and

groups articulate their interests, exercise their legal rights...and mediate their differences' (Vayunandan and Mathew 2011). The IMF (1996) stresses ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption as essential elements of a framework within which economies can prosper. Grindle (2007) has provided an impressive tabular presentation of different definitions of good governance gleaned from a number of official and scholarly sources, an adapted version of which can be seen in Appendix 1. All these definitions capture the complexity of the concept and indicate how they differ in terms of specificity and normativity (Grindle 2007).

Governance as 'the setting, application and enforcement of the rules of the game' (Kjaer 2004:12) encompasses both *performance* ('how an agency uses governance arrangements to contribute to its overall performance and the delivery of goods, services or programmes') and *conformance* ('using governance tools to ensure that an agency meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness') (Commonwealth of Australia 2007:1). Good governance thus epitomizes some core values that can be seen both as a means and an end. As an end, Agere (2006) argues, good governance is the highest state of development and management of a nation's affairs. Alternatively, this process can be regarded as a means as it contributes to economic growth, human development and social justice.

The epitome of all definitions refers to a social, political and economic process that creates an enabling environment for all actors and stakeholders in a society for mutual benefit in particular and the socio-economic development in general. An assessment of relevant literature as regards the definition of governance reveals that different definitions do not refer to different phenomena; rather, a core can be identified in all these definitions that posit the term governance in a broader sense than government. While scholars used various expressions and terms to define it, their underlying idea is not fundamentally apart from one another. While in defining good governance the World Bank emphasizes economic and social resources, the OECD human rights democracy and legitimacy of government and the UNDP human development, elimination of poverty and public administration, the general

ideas and focus on issues are the same (Agere 2006). But the concern of the multinational institutions such as the World Bank and the IMF about good governance focuses more on building institutions ‘vital for promoting and supporting markets, investment, and economic growth’ than on the political goal of achieving democracy (Unsworth 2007). In this study, we will also adopt a similar view of good governance as a process for institutions. This aligns us with Hill and Hupe (2009) who maintain that the term governance may function as a norm for the behavior of actors in contemporary public administration.

The above definitions in fact uphold good governance as a concept. In the absence of a quantifiable definition of ‘good governance’, there has been persistent effort to operationalize the abstraction of good governance through outlining a number of characteristics, elements or indicators. The predominant characteristics which indicate the presence of good governance in a society are: accountability, participation, transparency and openness, responsiveness and responsibility, consensus orientation, rule of law, equity and inclusiveness, efficiency and effectiveness and strategic vision. In line with these characteristics, the World Bank has devised six Worldwide Governance Indicators (WGI) which are: a. Voice and Accountability, b. Political Stability and Absence of Violence, c. Government Effectiveness, d. Regulatory Quality, e. Rule of Law, and f. Control of Corruption (World Bank 2012b). These indicators have been considered ‘the good government community’s ‘most prominent product’ (Andrews 2008). It is understandable that the parts that make up the whole of good governance are nothing but ways of concretizing the abstract. That is why, we need to bear in mind that, undoubtedly, good governance is a comprehensive concept; it is the state of affairs that results from the combination and inter-play of a number of complementary activities achieving each of which rests on a symbiotic relationship with achieving all the others. For example, transparency cannot be achieved without ensuring accountability and participation. Similarly, the concept of effectiveness encompasses concerns that a social or economic policy should be predictable, transparent, and enforced by a fair judicial system. Given that good governance encompasses political and administrative governance and refers to the process and structures that guide political and socio-economic relationships (Agere 2006), this

study will remain focused on the process aspects of good governance that will include participation, accountability and transparency.

### **3.1.2 Good governance and development**

A precursor question that has been seriously pursued in governance discourse is: does good governance matter? The question – which comes first: good governance or development? – can remind us of the classic riddle of the chicken and the egg. There is no straightforward answer. As Moore (2011) argues, opinions on the governance agenda have been diverse and are marked by many competing claims. Though in many development discourses, democracy, development and good governance are uttered in the same breath, there is no dearth of critics that have rather skeptical views about the relationship between good governance and development.

A many discourses on good governance invariably consider it as a precondition for development. The term has acquired a central place in the post-cold-war debate in relation to the political system and its overall impact on the economic development. Yadav and Baghel (2009) argue that good governance connotes the elimination of malgovernance to ensure that various agents of the political system work for the betterment of all the citizens, especially the marginalized and vulnerable communities. The impacts of good governance become conspicuous as they are set against the symptoms of poor governance which are more universal (Ray 1999) than the outcomes of good governance. For example, as Ray argues, one of the symptoms of poor governance is the failure to establish a predictable framework of law and government behavior conducive to development (1999:356).

Many studies strongly maintain that for any society to develop and to sustain its development, the social policies have to be good governance-oriented. Good governance has specially been tied with achieving the Millennium Development Goals (MDGs) of individual countries. It is widely regarded as one of the key ingredients for poverty reduction and sustainable development. ‘A geo-political phenomenon, rooted in part in a kind of Western triumphalism following the collapse of the Soviet Union and of the credibility of central economic planning’

(Moore 2011:5), good governance was advanced by the developed Western countries as a prescription for development in developing countries. In 1997, UN Secretary General Kofi Annan declared good governance as perhaps the single most important factor in eradicating poverty and promoting development (Ferranti, Jacinto et al. 2009). The same notion was voiced by the US Secretary of State in 2007 (US Dept.of State 2011) –‘without good governance, no amount of oil or no amount of aid, no amount of effort can guarantee Nigeria’s success.’

Such views contain the notion that good governance precedes development and there is a causal relationship between the two. Good governance has been seen more as a process than an end. And hence it has most commonly been tagged with development or poverty reduction and more specifically as an antidote for all the ills that a poor or developing country may be plagued with. For developing countries in general, major donors and international financial institutions base their aid and loans on the condition of ensuring good governance, as Welsh and Woods (2007:xi) comment, ‘Good governance has become the Holy Grail of foreign aid.’

Relating good governance in developing countries to the international donor’s aid conditionality has given birth to another question: can good governance be exported (Welsh and Woods 2007) from the Western world to the developing world? This raises concern about the rationale of imposing one’s own priorities and processes on others. While the concern of imposing good governance conditionality has been seen by many as infringing an aid-recipient country’s right to self-determination, the question of whether ‘exporting’ westernized good governance to a developing country can yield expected outcomes has been a matter of debate in development discourses. However, the good governance debate has other sides as well.

First, there is scepticism about the concept of an ideal state of good governance, particularly in developing countries. This seems to have come into being in response to the approach that holds that good governance is the highest state of development and management of a nation’s affairs (Agere 2006). Considering the good governance agenda as ‘unrealistically long and growing over time’, Grindle (2004:526) introduces the concept of ‘good enough governance’ – ‘a condition of

minimally acceptable government performance and civil society engagement that does not significantly hinder economic and political development and that permits poverty reduction initiatives to go forward.’ This concept argues that, given the limited resources of money, time, knowledge, and human and organizational capacities, it would be more practical to search for the most cost-effective ways to move towards better governance in a particular country context, as all good governance interventions cannot be pursued and accomplished simultaneously. Grindle’s idea does not negate the imperative of good governance as a tool for development but questions the practicability of achieving a perfect level of good governance on the part of many states.

Second, there is debate about placing good governance before economic growth. Many development scholars take a less supportive view and believe that good governance is not the one and only panacea for development, nor is it true that development must be accompanied by good governance. Hence the question of whether good governance can be achieved without an enabling economic environment responsive to the basic needs of the people has also arisen. This question entails that the relationship between good governance and development may not be one of cause and effect; rather, it is more complex. There are many countries which have achieved a significant level of development without having all the principles of good governance in place. Examples include China and Singapore. Even with reference to the state of governance in Bangladesh, which we will deal with in more detail later in the chapter, the country has been termed as having ‘development surprise’ during the early 1990s despite its poor rank in governance indicators (Mahmud, Ahmed et al. 2008).

The skeptical question, such as ‘Is Good Governance Good for Development?’, as raised by Sundaram and Chowdhury (2012) in the title of their edited book, illustrates the misunderstanding about the relationship between good governance and development that the contributors expose. For, as they argue, it is not a question of whether good governance is good or bad for development, it is a question whether it is a *prerequisite* for development or not. The contributors’ idea about the impact of good governance on development is somewhat similar to Grindle’s in that

they also question if the developing countries have the resources to enforce good governance. Concentrating primarily on the WGIs, the contributors hold that the World Bank good governance measures are problematic and then argue that growth and development improves governance, rather than the other way round as is generally held.

There are considerable complexities in measuring both good governance and development. Neither term has a universal definition. Ferranti, Jacinto et al. (2009) argue that ‘the literature on the relationship between governance and development, which has expanded considerably over the last ten years, shows a correlation – indeed, some authors argue, a causal connection – between the quality of governance and development’ (2009:17). If this assumption is taken to be as correct, then how do the outlier countries fit into the good governance paradigm? The so called outlier countries in fact do not undermine or negate the causal relationship between good governance and development. While China, for example, scores quite low in terms of voice and public accountability, in terms of internal accountability, anticorruption measures and government effectiveness its score is quite high. In the case of Bangladesh, much of what has been called the ‘development surprise’ was attributed to the efforts of civil society actors, including NGOs and microcredit providers. That is to say, some paradigm of good governance is evident even in the case of outlier countries. Furthermore, it can be argued that with better governance, the development of outlier countries would proceed more briskly.

Whether it is essential for development or not, and even if ‘there are no reliable correlations between rates of growth and measures of the quality of governance’ (Moore 2011:6), good governance has its own value as an end in itself. Ferranti, Jacinto et al. (2009) make note of the views that hold transparency, accountability, governance, and anticorruption as desirable ends on their own irrespective of whether they lead to some other benefits such as economic development. With reference to studies such as the World Bank’s ‘Voices of the Poor,’ they note that the poor themselves strongly feel that an absence of ‘power and voice’ is a major source of additional suffering in their lives separate from and beyond that imposed



by inadequate financial and material resources (2009:14). That is to say, whether seen as a process or a means, good governance values have their own intrinsic value. Good governance is an end in itself. Thus, without delving further into the arguments challenging good governance as a means for development, the study is premised on the concept that good governance and development have positive correlation. ‘Good governance is not a luxury but a basic requirement for development’ (Commonwealth Secretariat 2000:10).

### **3.1.3 Taxation and governance**

A clear understanding of taxation and its relation to development and state-building in general and good governance in particular is necessary to operationalize the relationship between the two as a research agenda. Since there are different approaches to both governance and taxation as two different academic disciplines, it will be interesting to see how I establish the linkage between taxation and the various elements of good governance.

The discourse on good governance has been limited to development issues; taxation as integral part of development automatically calls for the principles of good governance. Perhaps one of the early implied references to the relationship between taxation and the quality of governance was made by the World Bank in 1988 in its Development Report. But, though the Report mentioned that its ‘main concern is how appropriate public finance policies can improve the quality of government’ (World Bank 1988:1), it did not elaborate the underlying assumption. The imperative for a complementary relationship between taxation and good governance remained officially implicit until 2009 when the European Commission in one of its communications to its members emphasized the principle of the promotion of good governance in tax matters. Good governance in the tax area defined as embodying the principles of transparency, exchange of information and fair tax competition was stressed as a means of improving tax cooperation and tackling tax evasion and avoidance on as broad a geographical basis as possible (European Commission 2009). A later communication (European Commission 2010) referred to a Norwegian government commission report that said that in 2006 illegal money flowing from developing countries totaled 641 to 979 billion USD, which was at

least seven times higher than official development assistance. According to the European Commission, the problems of capital flights and tax evasion and avoidance in the absence of fair and transparent tax practices require combined efforts by both developing and developed countries to implement the principles of good governance in the tax area; such efforts, in addition to addressing the immediate problems mentioned above, are meant to augment growth prospects and poverty reduction in developing countries while strengthening tax systems at the global level (Ibid, 2010). In the same vein, many tax administrations are convinced that ‘a sound tax system has to be about raising revenue in an equitable and efficient manner. It has to be about economic growth and international competitiveness’ (Government of Australia 1999).

Though no tax is exclusively geared for revenue purpose (Groves 1948), taxation is generally seen as a means of raising revenue. Raising revenue to finance government expenditure is the traditional function of taxation while it also has a distributional function to adjust the distribution of income and wealth among households and a stabilization function to check the business cycle (Vermeend, Ploeg et al. 2008). Yet another equally important, although perhaps less attended, function of taxation is representation (Brautigam 2008).

Sketching out the contractual narrative in the history of taxation, Moore maintains that in the past the prevalence of interstate war necessitated generation of sufficient revenue. As for the present time, he argues, ‘war-driven imperative are not needed to trigger the revenue bargaining process’ (2008:54). What then is the imperative(s) for the present day, especially in developing countries, that is required to trigger the revenue bargaining process? The answer in one word is development. This answer is given by Levi when she maintains that in the absence of war-driven imperatives, the promise of economic development is a common theme to convince the taxpayers of the need for more revenue (Levi 1989). Moreover, if we consider ‘war’ as a metaphor, as we use in describing a challenge, it is now the war against poverty and hunger that will prompt maximization of revenue especially in the developing world. This is to say, war both as a metaphor for a social challenge and as an external stimulus for raising tax revenue is still valid.

The all-encompassing concern about taxation rests on the fact that taxes ‘are a mirror of a people’s values and priorities. They provide invaluable insights into how individuals relate to one another, to government and to their broader society’ (Goham and Reischauer 2005:xiii). Almost the same idea is expressed by Martin, Mehrotra et al. when they say, ‘Taxes formalize our obligations to each other’ (2009:1). Paying taxes goes far beyond a personal experience as socio-political factors and conditions influence tax compliance. Drawing on the history of taxation, Martin, Mehrotra et al. (2009:3) compellingly outline a few features of taxation that entail the far reaching consequences that taxation may have for understanding modern social life. These are:

- taxation establishes one of the most widely and persistently experienced relationships that individuals have with their government and – through their government – with their society as a whole.
- taxation establishes a dynamic relationship between the taxpayer and the state, in which there always exists a potential conflict of interest.
- taxation furnishes fungible resources to the state.

The relationship that taxation moulds between the state and its citizens, between one citizen to another , and the conflict of interest transform taxation from a monetary contribution into a social contract (Moore 2008; Martin, Mehrotra et al. 2009). This is more so in the modern society than it used to be in the past.

The impact of taxation is more far reaching compared to many other legislations as it ranges from ‘impacting personal decisions to shaping economic phenomena, political forces and the institutional fabric of our society’ (Long and Swingen, 1991 cited in Wenzel 2003 :42). So far as taxation involves social and political processes, Tilly (2009) argues that taxation deserves our attention at least for three reasons: first, taxation creates opportunities for the government to intervene in the citizen’s private life; second, the circulation of resources from citizens to government initiated activities provides a sort of CT scan for a regime’s entire operation; and third, taxation ‘dramatizes the problem of consent’. Tilly also argues that taxation involves a number of questions related to political process:

- How does tax compliance ever come about?
- How do regimes compel or cajole their citizens to yield resources repeatedly?
- How does the interplay between economy and taxation work?
- To what extent and how does the development of taxation shape the likelihood and form of democratization? (Tilly 2009:xii)

Clearly, the ‘how’ aspect of taxation is more insightful than its ‘what’ aspect. This enables us to see taxation as a process rather than an end and makes the politics of taxation as overarching an issue as the economics of taxation. The idea of going beyond the economic aspects of taxation would be better understood in the light of the comment about the study of taxation by the economist Joseph A. Schumpeter, one of the pioneers of fiscal sociology:

The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases (cited in Martin, Mehrotra et al. 2009:1).

And,

Our people have become what they are under the fiscal pressure of the state (1918/1991:100-1, cited in Moore 2011:10)

With this caveat in mind we will attempt to establish the relationship between governance and taxation drawing on three perspectives. First, taxation evolving as a social contract between the state and the citizen, secondly, taxation as a collective action problem and thirdly, taxation as embodying the continuum of coercion and persuasion.

### **3.1.3.1 Taxation as social contract**

In his insightful history on the impact of taxation on the evolution of civilization first published in 1993, Adams (2001) shows with examples and anecdotes how the vicissitudes of the great ancient and modern civilizations were tied to the different

aspects of taxation. He demonstrates how tax remained an ever-present subject in the relations between the state and its citizens throughout civilization spanning from the Egyptian, the Greek and Roman eras through the British Civil War and the American and French Revolutions to the modern day:

The three roots of modern civilization – ancient Greece, Rome, and Israel – involve histories filled with drama centered on taxation. The biblical God, who repeatedly chastised his chosen people, selected taxation as his rod (2001: xxii).

Based on the premise that depending on how a tax is devised and managed, it can be used for good or for evil, his emphasis on fair taxation represents the urgency of tax management with relation to the state and the citizens as he draws an analogy between the tax and fire:

When we tax we are dealing with fire, and without proper controls and care, we can easily burn down everything we have built, and our hopes for a better world can go up in smoke (2001:3).

Apparently disgruntled with the modern American tax system which, he argues, shares with many other tax systems the characteristics of inequitable tax with a despotic enforcement mechanism, Adams cites numerous examples from the history of how ‘many great nations taxed themselves to death and how many nations became great because of the right kind of taxation.’ His conclusions finally rest on the interactions of the two actors of the game: the government in devising the just and sound tax system and the citizens in their obligations to pay their taxes. This interaction evolved into what later scholars term ‘social contract.’

The history of taxation has been traced by a number of researchers to explain the scope and nature of this social contract. The history of taxation with relation to its role in state-building reveals that the feudal state evolved into the fiscal state

through the intervening stage of the tax state (Moore 2008).<sup>22</sup> Gabriel Ardant describes the extent and impact of taxation on state-building:

In a sense, the history of taxation is the history of the slow construction of actual states, of their efforts to disengage themselves from the mechanisms of dependency and bondage of the feudal regime. It is the history of rulers overcoming the obstacles in their path, of the resistance they face to their ambitions (cited in Levi, 1988: 95).

According to Goldscheid and Schumpeter, as cited in Moore (2011), the transition from rulers' fiscal dependence on domain revenues (i.e. income from their own properties) to dependence on broad general taxation gave rise to the tax state. Schumpeter and Goldscheid consider this transition to be the defining feature of modernization in Europe as well as a key to the development of effective states, and a central component of the rise of bourgeois society and of democracy. What is important in this societal process is how taxation started as a coercive tool to extract a one-sided contribution from citizens, and, with the passage of time, evolved into a powerful instrument for bargaining which Moore calls 'revenue bargain' (Moore 2008). The social contract or revenue bargain is indissolubly related to what Levi terms 'collective action problem' (1989).

### **3.1.3.2 Taxation as a collective action problem**

Drawing on the history of taxation of the Republican Rome, Medieval and Renaissance France and England, eighteenth century Britain and the Commonwealth of Australia, Levi (1989:3) convincingly presents her hypothesis that 'rulers are predatory in that they try to extract as much revenue as they can from the population.'<sup>23</sup> She also sees taxation as a collective action problem as rulers try to maximize revenue while the ruled try to minimize it. In her theory of predatory rule she in fact reformulates the paradox ingrained in the collective problem. This not only entails the maximization and minimization problem, but also

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<sup>22</sup> Moore defines a tax state as a state that is primarily financed through broad taxation while a fiscal state is a state that is 'able to use a secure, effective and consensual tax system as the basis on which it could engage in large-scale borrowing in private markets' (2002:47).

<sup>23</sup> An ancient Egyptian cartoon drawing shows the tax officials of the pharaoh snooping, inspecting, recording everywhere, even surveying the nests of pigeons to count the eggs to make sure that the Pharaoh received the tax due to him (see Adams, 2001: 8)

the dichotomy of coercion and persuasion. The visual imagery of ‘plucking the goose as to obtain the largest amount of feathers with the least amount of hissing,’ as mentioned earlier, depicts ingrained juxtaposition of coercion and persuasion in taxation that has found numerous manifestations in all relevant literature through ages: striking a balance between maximization of revenue (obtaining the largest amount of feathers) and the process of such collection (with the least amount of hissing) has become a matter of classic preoccupation for both economists and social scientists. The concern for maximizing revenue while minimizing resistance, or, in other words, persuading the taxpayers to contribute to maximizing revenue occupied an important position in tax literature.

Levi (1989) addresses the collective action problem in taxation by outlining three constraints which maximization of revenue is subject to:

- The rulers’ ‘relative bargaining power’ which she defines as ‘the degree of control over coercive, economic and political resources.’
- ‘Transaction costs’ which she defines ‘as the costs of negotiating an agreement on policy and the costs of implementing policy.’
- ‘The discount rate’ which refers to how much ‘an individual values the future relative to the present.’

These constraints are further clarified by Burgess and Stern (1993:774-5) as they tie the ability to tax firstly with administrative capability and then to the improvement of tax system with economic development. The mechanisms for tax collection have undergone revolutionary changes signifying the extent to which tax is collected coercively or persuasively. The transition from tax farming – a system in which the state auctioned taxation rights to the highest bidder, who then collected the state taxes and made payments in fixed installments, keeping a part of the tax revenue for his own use (Encyclopedia Britannica 2011) – to the professional bureaucracy bears out the imperative for choosing the appropriate collection mechanism. The collection mechanisms seek to maximize revenue while there are factors facing taxpayers that play a role in their motivation to minimize payments.

## **Why pay taxes?**

The idea of a revenue bargain is further reinforced as we explore a classic question in tax literature: why do people pay taxes? The literature on the theory of tax compliance is quite rich. Though most of the theories address compliance issues predominantly with reference to direct taxes such as personal and corporate income, compliance literature comes in aid to explain and understand other taxes such as VAT also. Compliance is the pivotal issue, and all other issues such as the relationship between taxpayers and tax authority indeed centre on compliance. Though in the matter of paying taxes individuals exhibit ‘a remarkable diversity in behaviour’ and there is no conclusive answer to the question of why people pay tax, the predominant theoretical paradigm, especially in the economic discourses on taxation, comprehends tax compliance in terms of individual self-interest. This paradigm sees tax compliance as an individual’s rational choice (Wenzel 2003 ).

Had all people paid heed to the Smithsonian maxim of taxation, then they would pay taxes ‘in proportion to their respective abilities’ out of civic obligation to the state (Smith 1776 (2007):536). The economic factors of tax compliance, such as outcome-maximizing choice, have been supplemented by moral and legal obligations. Aaron and Slemrod (2004) argue that people pay taxes for two reasons:

- Paying taxes is a duty of citizenship rather than the outcome of a cost benefit calculation.
- The law requires payment of taxes as willful failure to pay taxes warrants penalty.

But both the economic model of individual self-interest and the citizenship obligation under a legal boundary are inadequate in explaining tax compliance in that they neglect the aspect of reciprocity or exchange. The reciprocity on which tax compliance hinges to a great extent has been identified as a core factor in tax compliance. According to Alm, McClelland et al. (1992), people comply with the obligation to pay taxes as they understand that the public goods they receive need to



be financed by their taxes. ‘An increase in the amount that individuals receive from a given tax payment increases their compliance rate, and individuals pay something in taxes to receive government services even when there is no chance of detection and punishment’ (1992:37). A taxpayer’s motivation to pay taxes comes not only from their rational equation of outcome maximization, but also from the evaluation of the extent to what the exchange between taxes and services is equitable (Cowell 1992). Thus emerges the role of non-economic factors such as fairness and justice in tax compliance.

Given that the taxpaying behavior cannot be fully understood by only a self-interest account (Wenzel 2003 ), non-economic factors have been advanced to explain compliance behavior. For example, Lewis convincingly argues that ‘non-economic considerations, such as trust and confidence in government among taxpayers, were more important influences on the economic behavior of individuals than were the fiscal changes themselves’ (1982:5). He refers to the attitude of tax mentality and tax consciousness and argues that taxpayers’ attitude towards the tax system, its perceived purposes and fairness determines the degree of tax compliance.

Albon (1986) maintains that there is an inherent conflict in people’s minds between benefit (expenditure) and cost (taxation). As mentioned, there has been a tug of war between the rulers who want to maximize revenue through taxation and the ruled who want to minimize the tax burden through different means. The inherent conflict becomes obvious as we look into the history of human civilization which witnessed numerous conflicts centred on taxation.<sup>24</sup> The question is: how to mitigate this conflict?

The degree of tax compliance is directly related to maximization of revenue. Hence, creating cost-effective compliance is of paramount importance. Levi argues that rulers can make compliance cost effective by promoting institutions and structures (1989:52). While she admits the existence of what she calls ‘ideological

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<sup>24</sup> A 2001 Indian Hindi film, *Lagaan*, depicts how the concern for taxes moulds the relationship between the rulers and the ruled. Oppressed by high taxes (*lagaan*) during a drought-inflicted time, the peasants from a barren village, in their desperate attempt to get exemption from taxes for three years, took the arduous challenge of beating the British in a game of cricket, a game which was alien to them.

compliance’– compliance out of moral obligation– she prefers ‘quasi-voluntary compliance’. In her own words: ‘It is *voluntary* because taxpayers choose to pay. It is *quasi-voluntary* (italics in original) because non-compliant are subject to coercion-if they are caught’ (1989: 52).

Levi’s idea of quasi-voluntary compliance is reflected in the tax compliance model presented by Kirchler (2007). In his comprehensive study of tax compliance which he terms ‘the economic psychology of tax behaviour’, Kirchler investigates different approaches, such as appear in economic, legal and social-psychological scholarship, to explain tax compliance. He finds that none of the compliance models presented hitherto satisfactorily explains the compliance dilemma. For example, the economic theory of rational choice of maximizing profits and minimizing costs does not consider taxpayer’s perception of the fairness of the tax system, social norms and attitudes, which are assumed to influence compliance behavior. Kirchler integrates a wide range of findings into a model based on the environment of interaction between taxpayers and tax authorities. The pivot of this interaction rests on the mutual trust between taxpayers and tax authorities. He argues:

Trust is a critical factor in understanding the origins of civic engagement, Cooperation with authorities and compliance...tax authorities’ orientation towards taxpayers and their interaction style create a tax climate which fosters either resistance and individual profit maximization or taxpayers’ trust in the authorities and the perceived legitimacy of authorities (2007:202).

That is, the interaction climate characterized by citizens’ trust in authorities and the power of authorities to control taxpayers effectively determines the level of compliance. Efficiency of a tax system hinges on the compliance behavior of taxpayers – the extent to which taxpayers ‘volunteer’ to comply (Slemrod 2003) (2003:60). Referring to the free-rider problem,<sup>25</sup> the author concludes that the level of voluntary compliance can be enhanced through the government’s improved

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<sup>25</sup> The Free rider problem implies that if one’s own receipt from the state is unaffected by one’s own contribution, then no one should contribute to a public good – pay taxes – voluntarily.

performance as well as by winning the trust of its people. This reminds us that the social psychologists call the relationship between the taxpayers and tax collectors a 'psychological contract' which is obeyed not for the fear of sanction but for the mutual trust between the actors (Feld and Frey 2002).

Whether one-sided or reciprocal, tax compliance requires the force of law. As Adams (2001:451) rightly observes, the duty of every citizen to pay his/her fair share of costs of government that serves and protects them will not be done if 'laws do not obligate [them] to do so'. The revenue bargain which combines taxpayers' trust in the taxing process, their willingness to pay and a compelling environment to pay creates an interaction climate conducive to better tax compliance. The question that automatically arises here is how that climate can be created. That is where governance comes into play in the taxation scenario. This becomes clearer as taxpayers' compliance is influenced by the government performance; this correlation financially motivates the government 'to invest in its reputation for public goods production' (Slemrod 2003:53). This entails balancing between coercion and persuasion.

### **3.1.3.3 Coercion vs. persuasion**

While tax- revenue is essential for any state, raising revenue is inevitably coercive and all too unpopular (Webber and Wildavsky 1986). The historical relationship between taxation and state-building has been further exemplified and formalized by later scholars. Moore and Schneider (2004) have reinforced the idea of participation noted earlier by regarding taxation as a part of a social contract between state and society as well as a mechanism of financing government. Moore (2008) further argues that taxes are involuntary levies on citizens. 'All taxation,' he opines, 'involves the actual or threatened exercise of state power' (2008:35). But he goes on to argue that the tax continuum involves two contradictory aspects: coercion and contract. With reference to the historical evolution of the tax system in different countries, Moore has shown that taxation which came into being as a coercive process of extracting money out of the pockets of the people evolved into a matter of bargain between the ruler and the ruled for their mutual benefit.

The evolved scenario that Moore terms ‘revenue bargaining’ entails some exchanges in the form of representation by the taxpayers and responsiveness and effectiveness from the states. He has identified some observable indicators of revenue bargaining. They are:

- the presence of revenue issues on the public policy agenda;
- collective action by groups of taxpayers around taxation issues, whether through electoral or other channels of representation; and
- the willingness of government to interact with and respond to taxpayers’ expressed or anticipated preferences in making public policy (2008:38).

The foregoing discussion of the theoretical and historical perspective shows that taxation as a powerful instrument for public finance is invariably related to the political process. It is argued in some tax literature (For example, Moore 2007; OECD 2008; Prichard 2009) that in the political process that involves social contract or revenue bargain the dependence on taxation may contribute to improved governance through three channels:

- Common interest process: As governments depend on citizen’s taxes and citizen’s ability to pay for economic growth, so the concern for mutual interest calls for better enabling situation;
- State apparatus process: As efficient and effective collection of taxes requires efficient public administration, so dependence on tax revenue will ask for a compatible and capable bureaucracy;
- Accountability and responsiveness process: By paying taxes, taxpayers not only engage themselves in politics but also empower themselves to demand befitting reciprocity from the state. Governments, in turn, need to respond to the citizens’ demands to sustain state revenue.

Having sketched the relationship between governance and taxation, we can now turn to a more focused discussion on the relationship between taxation and good governance. In this respect we will focus on taxation as a tool for representation and

accountability as well as the significance of taxation in the context of aid- and non-tax revenue dependence and corruption.

### **Tax, aid and accountability**

Historically speaking, the idea of good governance came into being not so much as a political concept but as an assurance from aid-receiving countries that the aid money is well spent (Unsworth 2007). However, the extent to which the assurance of good governance as a precondition for receiving international aid actually promotes good governance within the aid-receiving country is a contested issue. This is because of the difference that a country's dependence on 'unearned' rather than 'earned' income can make. In dealing with what he terms 'the tension between democratic governance and the financial dependence of governments on unearned income,' Moore (2002) categorizes the state income mainly into two categories – earned (revenue collected through bureaucratic and organizational effort) and unearned (own natural resources, aid) and argues that 'the greater the dependence of the state on earned income, the more likely are the state-society relations characterized by accountability, responsiveness and democracy' (2002:85). He goes on to elaborate that in the case of higher dependence on unearned income such as aid, the often competing conditionalities of donors make it impossible for the recipient governments to focus on their own priorities and 'their citizens and legislatures to exercise effective bureaucratic control over the ways in which these states raise and spend money' (2002:85). Given that the exercise of citizen influence over state revenue and expenditure lies at the heart of effective democracy, Moore argues that though official aid donors try to promote the values of democracy and good governance, their aid interventions rather undermine them.

The argument extends to other unearned income such as income from natural resources. As a citizen participates in nation building in the first place by paying taxes, he/she acquires some rights to demand accountability from those responsible for making particular decisions on their behalf. On the other hand, the exogenous rents, which are revenues that a country derives from sources external to the society such as oil or gas, relieve social pressure that might otherwise lead to demands for greater accountability (World Bank 2003). With regard to governments generating sufficient revenues from sources other than taxation, Waterbury (1994, cited in

World Bank 2003) provides evidence from the oil-rich countries of the Middle East and North Africa that they tax their people less heavily and, in turn, the citizens are less likely to demand accountability and representation from their government. In this respect, the exposition in *Newsweek* with reference to Pakistan is worth noting. According to the *Newsweek* (2008):

Extensive research shows that when governments luck into unearned cash (which economists call 'rents') from oil or other resources, the healthy links that bind them to the citizens are often severed. Freed from relying much on taxes, governments spend the money arbitrarily. Citizens, left untaxed, feel less motivation to monitor things carefully. The result is corruption, misrule, and a host of other ills.

The magazine argues that the strategic rents that the military regime in Pakistan under the leadership of Parvez Musharraf received made the country's military enormously powerful and resistant to democratic checks. The hypothesis of the reliance on rents rather than on tax revenue and the resultant decadence has been found correct in many other countries also. Prichard (2009) also has investigated the hypothesis in the context of Ghana that a government that banks primarily on tax revenues, as opposed to natural resource rents or foreign aid, is more likely to be accountable to its citizens and argued that there is significant evidence that taxation has often been a catalyst for demands for greater accountability.

### **Taxation and corruption**

The association of corruption with taxation seems almost archetypal as the image of a tax collector as a corrupt person has been usually encoded in different cultures over a long period of time.<sup>26</sup> The impact of corruption and of tax evasion and avoidance has been widely discussed in the public finance literature. It has been empirically established in a number of studies that countries with a high level of

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<sup>26</sup> In an Italian folktale, tax collectors have been equated with thieves in the following manner:

'Stealing is a sin,' said the priest, 'unless you steal from thieves.'

'We steal,' explained the thieves, 'but we are not committing a sin, because we rob the tax collectors' (Calvino 1982:40).

corruption tend to have lower collection of tax revenue as percentage of GDP (Tanzi and Davoodi 2000).

In addition to the imperatives for accountability of and responsiveness from the government by means of taxation, improved governance is required in taxation, particularly in a developing country, on another count – the pervasiveness of corruption. While the social contract binding the state and the citizen in an enabling socio-economic milieu contributes immensely to increasing revenue, the absence of good governance endangers the revenue potential by inducing corruption. Combating corruption has become a major challenge for most revenue agencies in the world. Fjeldstad (2005b, cited in Zuleta et al. 2007) argues that at least half of the revenue that should be collected can be lost by government treasuries through corruption and tax evasion. Le (2007) has been more specific, noting that surveys in developing and transition countries indicate that revenue administration agencies are typically the most corrupt public institutions. Researchers have attributed the generally more tangible presence of corruption in tax administrations, particularly in those of developing countries, to their complex tax and trade regimes including multiple discretionary exemptions, confusing and nontransparent procedures for tax compliance and excessive discretionary power of tax inspectors (Le 2007; Zuleta, Leyton et al. 2007). The consequences of corruption in tax departments do not end in losing revenue on account of corruption itself: corruption triggers further damages. As Le (2007) points out, corruption and tax evasion reduce voluntary compliance with tax laws and regulations, demoralize honest taxpayers, and create an atmosphere of cynicism.

Zuleta, Leyton et al. (2007) have placed the corruption in taxation in the overall theoretical framework of corruption. Theoretically, corruption occurs when agents (in the case of tax administration, tax officers) enjoy monopoly power over clients (i.e. taxpayers), have discretionary control over provision of services (for example, issuance of Tax/VAT registration certificates) and work under low level of accountability and transparency (Klitgarrd 1988). This framework denotes that there are both incentives and opportunities for tax officials to engage in corrupt practices. The expected gains from corrupt behaviour increase with the increase of monopoly and discretionary power. By contrast, the lower the levels of

accountability and transparency reduce the cost of tax official's engaging in corruption (Fjeldstad 2005b, cited in Zuleta, Leyton et al. 2007).

Corruption with relation to taxation can be further elaborated by shedding some light on the country context of this study. Thuronyi (2003) maintains that while corruption among tax officials in countries like the U.S or Germany is virtually unknown, it is rampant in a number of developing and transition countries. This is quite relevant in the context of Bangladesh. Bangladesh persistently ranks low in international corruption perception surveys and that there is general consensus within the country and among its development partners that corruption is a serious concern that has to be addressed urgently. As the Asian Development Bank commented (ADB. 2005:1), 'The debate on good governance in Bangladesh has centered on corruption.'

Corruption by tax officials and evasion by taxpayers have been advanced as a crucial reason to explain the poor tax to GDP ratio in most developing countries. In the case of Bangladesh, Mahmud, Ahmed et al. (2008) have pointed to 'large-scale tax evasion' to account for the poor tax to GDP ratio in Bangladesh. In this respect we can refer to a recent empirical study. The *Daily Sun* (2011) reports the findings of Transparency International Bangladesh (TIB) in its study, 'National Board of Revenue (NBR): Challenges to Transparency and Accountability and Way Out' which claimed that taxpayers evaded BDT 210 billion (= USD 3 b) which is one-third of the total annual revenue collection in taxes of the last fiscal year and identified tax evasion as one of the major challenges for the NBR in enhancing revenue collection. The study, the report said, attributed NBR's failure to generate optimum revenue to the tax officials' involvement in corrupt practices, a high rate of indirect tax and people's unwillingness to pay taxes due to apparently complex procedures. By regarding tax evasion as the only cause for the unsatisfactory tax to GDP ratio, Mahmud et al. have virtually ignored other serious aspects such as taxpayers' motivation, the tax base, simplicity, administrative and compliance costs, and equity that make a tax system effective and efficient and in turn help the tax system contribute more robustly to a satisfactory level of tax to GDP ratio. They, however, have ventured to explain the tax evasion syndrome through the prism of



governance. According to them, enforcement of better tax compliance costs the government politically and alienates it from the better off people and business community. In the tradeoff between collecting more revenues through effective enforcement of tax rules and antagonizing the well-to-do and the business community, Mahmud et al. argue that, ‘the government seems to have chosen the option of a relatively low tax effort.’

Tracking vulnerabilities to corruption in tax departments has prompted many solutions as well. It has been argued that isolated anticorruption programmes for revenue administration rarely are sustainable. What is rather needed is to undertake reforms that are built on a broader set of governance initiatives (Le, 2007). That is to say, a tax administration inspired by, and a tax system imbued with, the principles of simplicity, transparency and accountability can be kept free to a great extent from being plagued by corruption. It is noteworthy that the international development agencies such as IMF and World Bank have put emphasis on tax reforms not only for generating more revenue but also as an anti-corruption strategy (World Bank 2003).

Besides the two aspects – taxation as a societal contract between the rulers and the ruled and a good governance-oriented taxation system for minimizing the vulnerability to corruption –, there can be another imperative for a taxation system to embody good governance principles. In an era of globalization of trade and capital markets, it is essential that the tax system of a developing country like Bangladesh is what the OECD terms ‘competitive’ (Matthews 2011). The pillars of competitiveness,<sup>27</sup> identified in the Global Competitiveness Report, include, inter alia, the institutions of governance such as fairness, transparency, and the consistent and impartial application of tax laws in a predictable manner (see Matthews, 2011). This competitiveness is not only required for facilitating international trade and creating the enabling environment for national and international investment, but

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<sup>27</sup> The other pillars identified are macroeconomic environment, higher education and training, good market efficiency, labour market efficiency, financial market development, market size, business sophistication and technological readiness and innovation (see Matthews, 2011).

also for achieving high and growing productivity and economic prosperity within the country itself.

Incentives, costs and constraints in the business environment have a direct bearing on businesses which operate in a commercial environment depending on the delivery of public goods as well as efficient and equitable dispensation of public regulations such as taxation (World Bank 2003). In many countries, for example in Egypt, businesses consider the multiplicity of laws, the frequent changes in those laws and their inconsistent application as the major obstacles to business (Nugent 2002, cited in World Bank 2003). Hence, governance and economy are inseparable.

### **Fair taxation vs. good governance**

We have tried to elucidate that historically taxation involves the paradox of the collective action problem as well as the paradox of coercion and persuasion. Overcoming the constraints posed by the paradoxical relationship of coercion and persuasion or, in other words, the concern for maximizing revenue while minimizing resistance, has occupied an important position in tax literature. It would not be inapt to say that the idea of fair taxation stemmed from these concerns.

The conflict that tax invokes between the state and its people and also between one objective and another has to be resolved for a tax system to be effective and efficient. This imperative gave birth to the concepts of fair taxation. The effort of resolving the conflict academically started with the classical economist Adam Smith (Smith 1776 (2007)) in his list of maxims of good taxation. His maxims, known as the canon of good taxation, in fact, foreshadowed the spirit of what later came to be known as good governance. His second maxim of tax policy calls for a tax 'to be certain, and not arbitrary...to be clear and plain to the contributor, and to every other person' (Smith 1776 (2007):536). Smith further added, 'The uncertainty of taxation encourages the insolence and favors the corruption of an order of men who are naturally unpopular, even where they are neither insolent nor corrupt.' Thus, for Smith, a plain and certain tax policy rather than a complex and uncertain one is essential for avoiding corruption and that certain and transparent tax policy thus promotes good governance.

Though the theory of fair taxation is generally attributed to the classical economist Adam Smith, one classical Indian economist had a fair share in it. Writing more than two thousand years before Hume, Smith, Ricardo and J. S. Mill, Kautilya clearly anticipated, as some writers convincingly argue (Waldauer, Zahka et al. 1996), Smith and Ricardo on the principles of fair taxation. Kautilya advocates a fair and efficient system of taxation which would advance the wealth as well as wellbeing of the realm – a tax system which will supply the king with tax revenue while not stifling economic growth. His figurative reference to plucking flowers without destroying the roots underscores his emphasis on the enabling situation for taxation as well as the citizen's ability to pay:

Just as fruits are gathered from a garden as often as they become ripe, so revenue shall be collected as often as it becomes ripe. Collection of revenue or of fruits, when unripe shall never be carried out, lest their source may be injured, causing immense trouble. (cited in Waldauer, Zahka et al. 1996)

Waldauer, Zahka et al. (1996) argue that Kautilya's idea of a tax system embodied the principles that Smith adopted two thousand years later as the principles of good taxation in his *Wealth of Nations* in 1776 – convenience, simplicity, cost-effectiveness, equity and neutrality.

The characteristics of a good tax system put forward by the wise men of old were supplemented and refined by later economists. The criteria advanced by economists mainly to raise a given amount of revenue include the capability to yield sufficient and stable revenue, efficiency, equity, minimum cost of administration and compliance, flexibility, simplicity and transparency and international adaptability (Meade Committee Report 1978; Vermeend, Ploeg et al. 2008). Among others, Musgrave and Musgrave (1989:216) point out, 'The tax structure should permit fair and non-arbitrary administration and it should be understandable to the taxpayer... the good tax system should be designed so as to meet the requirements of equity in burden distribution, efficiency in resource use, goals of macro policy, and ease of administration.' Equity, efficiency and revenue thus have become the central issues in the theory of taxation (Ahmad and Stern 1991). It is interesting to

note that most of the criteria devised by economists for a good tax system ultimately reflect the principles of good governance.

The imperative for an inevitable correlation between good governance and a tax system becomes also evident in what Vanistendael (1996) terms as the principles for making a tax law – principles of equality, of fair play or public trust in tax administration, of proportionality, of non-retroactivity and of having charters of taxpayer rights. The same attitude has been voiced by Stotsky and Wolde (2002) when they advocate a transparent and rules-driven tax system, with minimum scope for discretion on the part of administrators in order to reduce uncertainty and the incentive for corruption which characterize the tax administration of the most of the developing countries. The idea is reinforced by Fjeldstad and Moore (2008:236-237) in their analysis of tax reform and state-building in a globalized world where they observe that there is a strong emphasis world-wide on simplification of the tax system, on continuous efforts to making taxes ‘clearer, more transparent, easier, cheaper to administer and less vulnerable to extortion and corruption.’

The need for participation or representation by the potential taxpayers in the formulation and implementation of a tax policy has been underscored by many scholars. To quote the US politician James Otis, ‘Taxation without representation is tyranny’ (cited in Vanistendael, 1996). ‘No representation, no taxation’ is as valid as no taxation, no representation; because, it is argued, taxation encourages institutional development to be able to respond to demand representation (Herb 2003, cited in World Bank 2003:201)

There are certain other paradoxes that involve governance issues and economic considerations. Striking a compromise between the conflicting criteria of equity<sup>28</sup> and efficiency has come to be known as a classical trade-off in tax literature. In order to achieve equity in taxation many exceptions such as exemptions or special schemes are created which make the system complicated. Besides adding

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<sup>28</sup> With reference to tax, there can be two types of equity – horizontal and vertical. Horizontal equity means that people in similar positions should be treated equally and vertical equity requires that people should pay taxes according to their ability (Gaventa 2004).

complications, equity raises the cost of administration. While the need for maximizing tax revenue is almost universal, political considerations of the ruling parties in shaping the tax system can have a significant effect on the efficiency of the tax system. Vermeend, Ploeg et al. (2008) note that the much-desired simplicity in a tax system can be undermined by political considerations of tax exemptions and special tax regimes.<sup>29</sup>

The interdependence between tax revenue and governance is no longer a very contentious issue. What is really pressing as well as challenging for governments is how they maximize their revenue within a framework of good governance. This becomes more crucial in the context of developing countries like Bangladesh where the state of governance as well as tax revenue is far from satisfactory, which again reinforces the indissoluble relationship between the two.

The core values that good governance stands for are not only essential as an end but also as a means of establishing an effective and efficient tax system – a system that ensures its stakeholders of new services of higher quality and the capacity to do more with less. Thus, the purposes of taxation – revenue, redistribution, representation and re-pricing – have direct relevance to good governance. A tax system as an integral part of the fiscal policy needs to conform to the very essence of good governance. A Gesellschaft für Technische Zusammenarbeit (GTZ) report (GTZ 2003), ‘Institutional Strengthening of the Tax System in Ghana,’ points out that with regard to good governance, a sound tax system plays a threefold role:

- It aids in a sound macroeconomic policy as a crucial precondition for stability, equity and long-term growth.
- It helps increase revenue collection and reduces the dependence of the state on foreign transfers.

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<sup>29</sup> Vermeend, Ploeg et al. quote the German Chancellor Angela Merkel as saying, ‘Everyone wants a more simple tax system. But if this means that certain tax breaks have to be cut, people are no longer so enthusiastic’ (2008:12).

- It ensures that tax collection is based on transparent and contestable rules in a fair manner as transparency and accountability in rendering services as well as in combating corruption.

Moore has presented the relationship between taxation and good governance in a more succinct way, as presented in Table 3.1.

**Table 3.1 Relationship between taxation and governance**

<b>Immediate effects</b>	<b>Intermediate effects</b>	<b>Direct governance outcomes</b>
<i>Effects on the state</i> The state becomes focused on obtaining revenue by taxing citizens	- The state is motivated to promote citizen prosperity  - The state is motivated to develop bureaucratic apparatuses and information sources to collect taxes effectively	More responsiveness  More bureaucratic capability
<i>Effects on citizens</i> The experience of being taxed engages citizens politically	(Some) taxpayers mobilize to resist tax demands and/or monitor the mode of taxation and the way the state uses tax revenue	More accountability
<i>Results of interaction</i> States and citizens begin to bargain over revenues. Taxpayers comply with tax demands in exchange for some institutionalized influence over the level and form of taxation and the uses of revenue ( <i>i.e.</i> public policy).	Taxes are more acceptable and predictable, and the taxation process more efficient  Better public policy results from debate and negotiation  Wider and more professional scrutiny of how public money is spent  The legislature (assuming one exists) is strengthened relative to the executive	More responsiveness, political and bureaucratic capability  More responsiveness and political capability  More accountability  More accountability

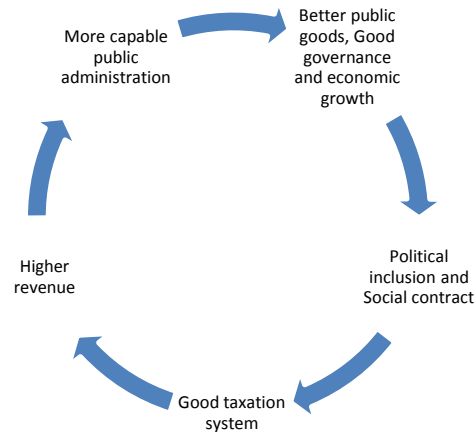
Source: M. Moore (2007:17)

The World Bank emphasizes the importance of an efficient and effective tax system as it comments in respect of the state of governance in Bangladesh, ‘the low revenue effort that stems from weak administration creates a chain of disincentives to good governance, from low salaries for civil servants to inadequate operations and maintenance expenditures’ (World Bank 2007:17). To put it in others words, a tax system has to be effective and efficient in order for it to promote good governance and in order for the tax system to be effective and efficient, it will have to be characterized by the principles of good governance.

The study of the relationship between tax and state-building, or, in other words, tax and the citizenship is a comparatively recent phenomenon. The emergence of what Martin, Mehrotra et al. (2009) label as the ‘new fiscal sociology’ is somewhat linked to the rise of the recent debate over tax and its relationship to better governance. As opposed to earned income, aid dependency has been seen as undermining the accountability of governments to their citizens. Internal resources mobilization in the form of tax revenue can counterbalance the negative impacts of aid dependency. Tax is thus considered to be one of the powerful factors that can bolster the responsiveness of the state to the demands of its citizens (IDS 2012a). The traditional view of taxation as a money generating machine for the state has to be changed to a new understanding that sees tax not merely as an end but as a process – ‘a path to better governance’. Hence the IMF has rightly perceived that though raising revenue is the core objective of any tax system, but it is not the sole concern (IMF 2011). One main concern lies in its role in state-building.

The complex and dynamic relationship among a number of factors forms what Everest-Philips calls ‘the virtuous circle of state-building’ (2008:125). A visual articulation this circle is shown in Figure 3.1.

**Figure 3.1 The virtuous circle of state-building**



Source: Adapted from Everest-Phillips (2008)

From the foregoing discussion, we can devise a simple model to show the dynamic relationship among good governance, taxation and development (Figure 3.2). In this model, good governance principles related to the process aspects such as participation, transparency and accountability improve mutual trust between taxpayers and the government, and ensure better control and enforcement by the tax authority. The combined impact of these two aspects contributes to more and better voluntary tax compliance. Maximization of tax revenue is enhanced by the degree of voluntary tax compliance, which in turn contributes to development. This relationship is dynamic rather than linear. Thus tax as a state-building mechanism goes far beyond its revenue generation role and generates a stronger political culture around fiscal social contract (Everest-Phillips 2008).



**Figure 3.2 Model of the dynamic relationship among governance, taxation and development**



Source: The researcher

Naturally only administrative efficiency, the tax base or tax design is not sufficient for a tax system to be effective and efficient. Bird, Martinez-Vazquez et al. (Bird, Martinez-Vazquez et al. 2010) argue that societal institutions have to be improved for an effective and efficient tax system. We take it one step further by arguing that a tax system needs to evolve as a promoter of societal institutions such as those enshrined in the good governance paradigm.

### **3.2 Tax structure and revenue bargain**

In his seminal social anthropological study on the relationship between the cultures and organizations, Hofstede maintains, ‘tax systems do not just happen: they are created by politicians as a consequence of pre-existing value judgements’ (1991:171). The idea crystallizes as we notice that economic, cultural and historical factors determine how patterns of taxation (both in level and in composition) differ from country to country (World Bank 1991:2). In an attempt to find answers to some intriguing questions like ‘why tax systems differ across the countries in the world?’ or, more specifically, ‘why do more developing countries rely for revenue on indirect taxes and advanced countries more on direct taxes?’, Sandford (2000) has

shown with empirical data that the difference can be attributed to the respective country's level of development, rate of literacy and degree of sophistication in its tax administration. He maintains that direct tax requires a greater degree of administrative sophistication with high level of development and awareness. The impact of the tax structure that a country designs is not limited to its revenue efficiency but also to how the social contract or revenue bargain that we have articulated operates.

### **3.2.1 The tax structure in developing countries**

The poor tax to GDP ratio is a common experience in most of the developing countries. Alink and Kommer (2011) have identified a number of factors which limit the ability of the developing countries to increase their tax revenue. The factors include:

- Weak institutions including tax administration,
- Corruption and a lack of transparency,
- A tax system characterized by numerous tax exemptions and still heavily reliant on cross border tariff,
- Existence of large informal sectors,
- Outflow of funds to tax havens,
- High pressure from international investors within the context of global tax competition.

The list of the factors would have been more comprehensive with the inclusion of the lack of tax awareness that stems from the low rate of literacy, among other things.

Many studies, for example, Burgess and Stern (1993) and Bernardi (2005), have shown that those indirect taxes prevail over direct taxes in most developing countries. The pattern of tax structure among developing countries is similar in their heavier reliance on indirect taxes than on direct taxes. This common experience specifically applies to the South and East Asian countries (Bernardi, Fumagalli et

al. 2006) with the exception of Japan. Ahmad and Stern (1991) point to the similarity of the revenue systems of the Indian sub-continent with those of many other developing countries in terms of low shares of taxation in GDP compared to developed and many developing countries, increasing demand on revenue, low contribution of income taxes and a heavy dependence on indirect taxes, particularly trade taxes. In his discussion on the relationship between taxation and development, Newberry's (1987) argument can be put forward to explain this situation; he argues that personal income taxes in developing countries are a relatively ineffective tax instrument as they cover a small portion of the population. In this respect, despite the desirability of income taxes, indirect taxes will remain a major source of tax revenue.<sup>30</sup>

Tanzi (2006) considers this predominance of indirect taxes in the South and East Asian countries as an outcome of their lack of concern towards equality expressed through the tax system. Further, he also sees broad based VAT with higher rates than many European countries as some East Asian countries' relative indifference to equity concerns. The prevalence of consumption taxation in developing countries has been explained by Sandford from the perspective of trade liberalization and its impact the economy of developing countries. He (2000) argues that against the backdrop that most developing countries cannot rely on direct tax for their tax revenue and their yield from international trade taxes is declining due to international pressures from GATT and the World Trade Organization to reduce trade taxes in the interest of free trade, their reliance on domestic consumption taxation is becoming greater than ever before.

There are both economic and political constraints in devising the most appropriate tax system in developing countries. Newbery (1987) argues that although political constraints are important, most economists feel uneasy about taking them into account. Bird (2004) persuasively argues that it can be highly counterproductive to ignore the political feasibility of a given tax proposal. Considering the factors that

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<sup>30</sup> Adam Smith, again, is perhaps one of the first economists to succinctly explain the emergence of indirect taxes: 'The impossibility of taxing the people, in proportion to their revenue, by any capitation, seems to have given occasion to the invention of taxes upon consumable commodities. The state not knowing how to tax, directly and proportionally, the revenue of its subjects, endeavours to tax it indirectly by taxing their expense, which, it is supposed, will, in most cases, be nearly in proportion to their revenue. Their expense is taxed by taxing the consumable commodities upon which it is laid out' (Smith 2007/1776:566).

account for the design of a tax structure in developing countries, their overwhelming dependence on indirect taxes will also aid in explaining the extent to which taxation has evolved into an effective social contract. In the context of the present research, it would be interesting to see how the socio-political milieu, including an enduring legacy of certain tax cultures, coupled with the global socio-economic scenario, paved the way for a new tax system – VAT – as an indirect tax to play the leading role in fiscal policy in different countries the world. Thus, the adoption of VAT in developing countries is significant – economically, politically and socially.

### **3.2.2 VAT: Its rise and prominence**

Having understood the relationship between taxation and state-building and good taxation contributing to good governance and vice versa, we can now turn to VAT – a specific form of taxation – and its emergence in the domain of fiscal policy. Before we go onto relate it to good governance, it would be better to focus on some technical aspects of VAT.

#### **Understanding VAT**

VAT is a consumption tax imposed on the sale of goods and services. The VAT Directive of the European Union defines VAT as ‘a general tax on consumption applied to commercial activities involving the production and distribution of goods and the provision of services...The tax is calculated on the basis of the value added to goods and services at each stage of production and of the distribution chain’ (European Union 2006).The youngest member of the sales tax family, VAT is considered a phenomenal twentieth century innovation in the arena of taxes .

Dr. Wilhelm Von Siemens first conceived the idea of VAT in 1919 in Germany (Khadka 2005). The problem of tax-on-tax that prevailed in the existing taxes inspired him to conceive what he called an ‘improved turnover tax’ or ‘refined turnover tax’ (Schenk and Oldman 2007:4). After about thirty-five years of experimentation with the concept, France adopted the VAT in 1954 for large businesses and extended it in an incremental way to other business sectors. Theoretically, VAT is a tax on value addition. With the exception of the import stage, VAT is levied on the value addition made at each stage in the process of

production and distribution. It is defined as ‘a tax on the value added by a business firm, through its own activity, to the goods and services it buys from other business firms’ (Shoup 1990:3). Theoretically, at each stage of business, a value is added in the increase of the value of output over inputs; VAT taxes this *value added*.<sup>31</sup> VAT is a type of general consumption tax as it is assumed to be fully shifted forward to consumers (Bickley 2003). In the process of what is known as credit mechanism, businesses get back the VAT paid on their input and the final burden of tax rests on the consumer who does not have any opportunity of shifting it because the life cycle of a good or service ends with consumption.

Unlike other taxes, VATs followed around the world show a great deal of resemblance and uniformity. As Thuronyi (1996:312) notes that despite differences in VAT from one country to another, compared with income tax, VAT laws are remarkably similar. A review of the VAT literature reveals some of the salient features of a VAT. These include:

- VAT is a multi-stage, self-assessment and self-clearance -based tax the core feature of which is an input tax credit mechanism<sup>32</sup> that enables a business to take back the VAT that was paid on the purchase of its input at the prior stage and tax the value added only. The problem of tax-on-tax or cascading is avoided by the credit mechanism.
- VAT is generally non-cascading.<sup>33</sup>
- The rate of VAT is generally single along with a zero rate for exports.

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<sup>31</sup> Khadka (2005) illustrates this with an example: If a wholesaler purchases something from a producer at Rs.100 and sells it to a retailer at Rs.130, then the value addition is Rs.30 and it is on this amount that VAT is levied. VAT is thus imposed on the value added in every stage of production and sale. The total amount of VAT paid or collected at all the stages equals to the VAT amount paid if levied as a single-stage sales tax at the same rate at retail stage only.

<sup>32</sup> Credit mechanism can be illustrated with an example: ‘A’ purchases a product from ‘B’ at a cost of Tk.200 and pays Tk.30 as VAT @ 15%. B uses that product as input and produces a new product and sells it to C at Tk.300 and charges C a VAT of Tk.45 @15%. B takes Tk.30 as input tax credit (tax that he paid to A) and remit the remaining (45-30=) Tk.15 to the government. The total amount of VAT paid to the government in two stages (by A and B) is Tk.45 which is equal to amount of VAT paid by C. This mechanism goes on until the product reaches the final consumer.

<sup>33</sup> Cascading refers to a situation when a commodity or service is taxed more than once under one tax as it passes through various stages of the production distribution chain Zee (1995).

- A threshold of annual turnover for mandatory VAT registration is made, which leaves small businesses outside the VAT net for reasons of administrative and compliance cost.
- VAT is an *ad valorem* tax i.e. the tax is imposed on the basis of the value of goods or services. It is assessed on transaction value.<sup>34</sup>
- VAT is generally a regressive tax; in many countries, the regressivity is neutralized to some extent through differentiated rates, preferential treatment of pro-poor sectors and exemptions and zero-rating.<sup>35</sup>
- A comprehensive VAT (a single rate broad-based VAT with no or very few exemptions) is self-policing as motivation for input tax credit automatically safeguards the confirmation of payment of VAT at an earlier-stage.
- VAT is trade friendly and trade neutral as businesses having the opportunity of shifting the tax incidence to the next buyer are not affected by it (see Due 1970; Tait 1988; Shoup 1990; Ebrill, Keen et al. 2001).

Since its introduction in France in 1954, VAT has been adopted as the main form of indirect taxation by many countries in different parts of the world and at different stages of economic development (Williams 1996). Over the last few decades, consumption taxes have become one of the most important revenue mobilizing instruments in the advanced industrialized countries as well as in the developing countries (Eccleston 2007). It has become the standard element of national fiscal systems in industrialized countries. According to Sandford (2000:77), by the late 1990s over 100 countries used VAT systems, leading to the conclusion that VAT ‘is probably unique in fiscal history. A generation ago, it was virtually unknown. Now it is approaching universal.’ The journey forward of VAT continued unabated and now more than 140 countries use the tax as a major source of revenue (Keen 2007).

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<sup>34</sup> Transaction value, basically referring to the GATT principles of customs valuation, is the fair market value at which goods or services are actually sold in a situation where the buyer and the seller are independent of each other.

<sup>35</sup> Exemption and zero-rate are quite different. Exemption in VAT implies that no tax is chargeable on the supply of the product and hence, no input tax credit can be claimed. On the other hand, zero-rate is a rate in VAT. In this instance, no VAT is practically chargeable but the business is entitled to input tax credit on its zero-rated supplies.

A VAT is required to be adopted as general indirect tax in order to gain membership of the European Union. Of the large industrial nations, only the United States does not levy a VAT. Region-wise, 33 Sub-Saharan African, 18 Asian and Pacific, 17 European Union, 27 Central European, 9 North African and Middle Eastern, and 23 American countries are among those that adopted VAT by 2005 (ITD 2005). Though VAT was not adopted in any of the Asia-Pacific countries before 1976, by 2005 18 of the region's 24 countries have a VAT. The fact that VAT has raised \$18 trillion in 2007, accounting for almost a quarter of global taxation, led the IMF's senior economists to regard VAT as 'probably the most important tax development in the latter part of the twentieth century, and certainly the most breath-taking' (cited in Eccleston, 2007) .

### **Why is VAT a preferred tax?**

VAT has been generally considered intellectually and organizationally demanding (Moore 2013). Yet, the reasons why a VAT is preferred to many other consumption/sales taxes are embedded in its general merit features mentioned above. In particular, the following characteristics, which may be called its 'generic strengths' (Keen 2013), make a VAT preferable to some other forms of consumption taxation:

*Revenue raising potential:* VAT has been generally appreciated for its great revenue raising potential for financing governmental services, and the efficiency with which it may be imposed on imports and waived from exports (Williams 1996). Though some may argue if the ability to raise more revenue should make VAT a desirable tax as raising more tax means paying more by taxpayers, the revenue/efficiency implications of a tax are an important determinant in choosing a tax (Ebrill, Keen et al. 2001). Again, though there is debate about the efficiency gains with VAT in terms of economic considerations, seen from the comparative view of efficiency of the taxes that VAT replaces in developing countries, VAT has proved to be more efficient (Bird and Gendron 2007). The revenue raising potential is embedded in its capacity to broaden the tax base and to apply it to any goods and services in the production distribution chain.

*Administrative ease:* As VAT is adopted in different countries as a replacement of some other taxes, it can be administered by the same tax administration. While in many countries it is being administered by the income tax department, some

countries, for example, Bangladesh, have assigned the responsibility to their customs department. That is to say, adoption of VAT does not generally necessitate the creation of a new tax administration. The widespread popularity of VAT sweeping both the developed and developing world owes much to its adaptability. Tait (1988) argues that a VAT can be tailored in different ways to suit a country's needs without fundamentally deviating from the standard principles on which the tax system rests. This freedom of adaptation, however, has, in some cases degenerated VAT into a hybrid tax, retaining very little of the standard VAT principles.

*Self-assessment:* VAT is a self-assessed tax. Self-assessment in taxation means that 'taxpayers comply with their basic tax obligation without the intervention of a tax official' (Ebrill, Keen et al. 2001:138). The idea of self-assessment is related to the imperative of increasing voluntary compliance which in turn forms the core of the efficiency of a tax system. Ebrill, Keen et al. (2001) note that in many countries the development of self-assessment is closely connected with the adoption of VAT.

*Self-enforcement:* Along with the idea of self-assessment goes self-enforcement. In order for a business to claim input tax credit, it has to possess an invoice from whom the input is purchased. The proof of purchase in the form of invoice handed over to a buyer obligates the seller to account for his/her sale properly to the tax authority.

*Non-cascading:* As a cascading tax is universally regarded as undesirable (Zee 1995), a non-cascading tax like a comprehensive VAT or retail sales tax has become a preferred option to fiscal policy makers. Given the rate of tax being same, a single stage retail sales tax and a multi-stage VAT would yield the same amount of revenue. The non-cascading characteristic of VAT provides a sharp contrast to the consumption taxes like excise tax or turnover tax that were administered in many countries before they switched to VAT. Those taxes were generally characterized by cascading elements as there were no opportunities for businesses to claim input tax credit. It should, however, be mentioned that 'even the best designed VATs embody some degree of cascading in the form of exemptions' (Keen 2013:4), as the VAT on the input of an exempt good or service cannot be credited against out tax.



*Staged-collection of tax:* As opposed to a retail sales tax where the tax is collected at the final stage i.e. at the retail stage, VAT is collected from different stages in the production-distribution chain. In one of the earliest literatures on sales tax, soon after the introduction of first VAT in France, Due discusses the nature of different types of sales tax and its role in the tax structure; he, in fact, favours a single stage retail sales tax and argues that ‘The value added tax offers no fundamental advantages over an equivalent single stage tax, except that of spreading out the impact of the tax over a greater number of firms, an important political advantage in some countries’ (1957:388). There is, however, valid reason to consider this advantage as a significant merit of VAT. It makes VAT more resistant to tax evasion. Because the collection of VAT is spread over production-distribution, the VAT that might be at risk of evasion is the tax on the value added at the stage in production or distribution (McMorran 1995).

*Business neutrality:* The role of businesses in collecting consumption taxes is crucial. Though in most countries, for example, Australia and Bangladesh, the liability to pay VAT is imposed on the person who makes taxable supplies (Schenk and Oldman 2007), a business in fact collects the tax from its buyers and remits it to the government. Effective use of credit mechanisms can make sure that a business as an agent between the buyer and the government is not affected by VAT. This can be seen a motivation for a business to play the role of an ‘honorary’ tax collector.

*Role in ensuring transparency:* Given that no tax should be examined in isolation from another as one tax compliments another in a comprehensive whole, Ahmad and Stern (1991) consider the check on evasion of income tax as another potential advantage of the information flows generated with the operation of a VAT. Dosser (1981) considers VAT as a brilliant device to enforce full accounting procedures on even small businesses and to minimize evasion.

These are some general motives that underpinned the adoption of VAT in most cases but there are other socio-economic reasons that serve as driving forces. Tanzi (1995) examines how against the backdrop of increasing globalization and the growing integration of world’s economies the way was paved for re-structuring the tax structure that showed unambiguous bias towards the adoption of VATs that, he maintains, spread like ‘wildfire’ during the past two decades. The most important

rationale for the original adoption of VAT in Europe was to facilitate trade (Bird and Gendron 2005). For developing countries, the urgency of maximizing revenue through expanding the tax base and the concern of trade facilitation inspired the adoption of VAT. These aside, the rapid spread of VAT throughout the world is attributed to two factors: the early adoption of VAT by the EU countries and its demonstrated success; and the role played by the IMF in spreading the success stories to the developing countries reinforced by strong persuasion in the adoption of a VAT for more efficient revenue mobilization (Bird and Gendron 2007).

The effectiveness of transferring VAT experiences from developed country settings to countries characterized by fragmented economies, large informal sectors, low tax morale, rampant evasion, and total distrust between tax administrators and taxpayers has been seriously questioned (Bird and Gendron 2007). But, like the good governance agenda, the idea of adopting a VAT in the efforts of tax reform has been ‘exported’ from the Western world to the developing countries. It is not a coincidence that the international organizations such as the World Bank and IMF who advocate good governance also advocate the adoption of VAT. However, the adoption of VAT did not seem to be seen so much as a promoter of good governance as the economic consideration of raising tax to GDP ratio in developing countries did. The World Bank prescribed the adoption of VAT as early as 1988 in its report on the public finance issues in developing countries (World Bank 1988) in which it only implicitly referred to the role of public finance mechanisms in ensuring the quality of government.

While there are many proponents of VAT in both academia and among international development organizations, there is no dearth of critiques of VAT as well. While there are academic scholars who are not ready to consider VAT as a more acceptable or desirable tax than any other form of consumption tax, many others who approve of VAT as a more acceptable tax are aware of its shortcomings, or ‘generic weaknesses’ (Keen 2013). The criticism of VAT has mainly been based on its regressivity and complexity.

*Regressivity:* McLure in his discourse (McLure Jr. and Ture 1972) on whether the U.S should substitute a VAT for a personal income tax strongly argues that as the

VAT is a tax on consumption, it would almost certainly be regressive because consumption as a percentage of income falls as income rises. This is a conventional wisdom in economics that the proportion of income spent on consumption of goods and services tends to decrease with the level of income. In plainer terms, the spending on consumption and hence the amount of tax paid on consumption do not increase with the increase of income. And hence, any broad based tax with a single rate – VAT included – is ‘inherently regressive’ (Ebrill, Keen et al. 2001:106). This granted, these authors look at the regressivity concern from another point. They maintain that ‘since an individual’s consumption is one of the best observable indicators of their living, consumption is potentially one of the most equitable of tax bases’ (2001:111-112). This implies that though spending on consumption does not rise proportionately with the increase of the level of income, it rises with the rise of income.

*Complexity:* A charge that has often been brought against VAT is its complexity: ‘an intrinsically complex tax, cumbersome to both authorities and the tax payer (Ebrill, Keen et al. 2001:51). In response to a Congress request for a report on the important lessons learned from selected countries’ experiences administering a VAT, the US Government Accountability Office (United States 2008) reports that information indicates that a VAT may be less expensive to administer than an income tax. It provides a report of the New Zealand Inland Revenue Department telling the auditors that administering the VAT was easier than administering some of their other taxes. The Report, however, does not find a VAT better than any other tax in terms of its compliance risk and compliance burden through exemptions, exclusions, and reduced rates, which can exist in other tax systems. Particularly the reporters express their worries about the fraudulent claims of input tax credit in a VAT.

In contrast to the simplicity argument, the VAT has not been seen nearly as simple as is sometimes argued (Bloomfield et al. cited in Williams, 1996). The involvement of everyone in the production and distribution chain has been noted by Ahmad and Stern (1991) as the major disadvantage of VAT as it imposes a substantial administrative cost both on the authorities and enterprises. Some other common problems identified include complexity in compliance, extensive book-

keeping, treatment of small businesses, delays in the payment of credits, the opportunity cost of funds that are tied up until rebates are paid, the impossibility of getting refunds in some countries, and the inclusion of VAT paid by non-registered traders in producer prices (see Tait 1988; Ebrill, Keen et al. 2001).

The need to maintain written records of all sales and purchases in order to reclaim payments on intermediate transactions is the most irritating feature of VAT which tends to impact especially heavily on smaller businesses unused to keeping extensive records. But seeing the complexity argument in an isolated manner does not portray the total picture. This is also a matter of comparative advantage. While Ebrill, Keen et al. (2001) show with econometric analyses that the VAT performed less well in less developed economies, the predecessors of VAT in many VAT-adopting developing countries were no less complex than a VAT. On another count, the revenue raising potential of VAT has been seen as outweighing its complexity problems. Thus considering the pros and cons, the worst form of VAT has been considered a better choice for raising revenue than most traditional forms of taxation (Terkper 1995, cited in Ebrill et al, 2001; Bird 2005).

In fact, the relative advantage of a VAT as compared to its equivalents seems to be its greatest defense. Bird and Gendron hold that the problems noted are not quantitatively significant in most developing countries especially if compared with the problems associated with a possible substitute form of consumption taxation (2007). Better still, there are ways of neutralizing, if not totally eliminating, the impact of some generic weaknesses. A common argument in neutralizing the impact of regressivity in VAT is that VAT has the mechanism to offset a great deal of regressivity impact through rate differentiation and exemptions. In line with this approach, most of the VAT-adopting countries have introduced progressivity by exempting basic products such as food, medicine and primary agriculture products and also by subjecting luxury or socially undesirable goods and services to higher rates of tax in the form of supplementary tax (Tait 1988; Bickley 2003; Bird and Gendron 2007; Keen 2007).

Empirical studies of VAT in developing countries have also shown that exemption and rate differentiation measures have been successful in mitigating the regressivity impact to a great extent and make the tax more progressive (Casanegra de Jantscher 1986). VAT, however, should not be judged in isolation but as a part of the whole tax structure existing with its counterparts such as income tax, sales tax or excise duty. Hence, the more important question to ask is not whether a VAT is regressive, but whether it is more regressive than the alternative indirect taxes, namely, sales, excise and turnover tax.

The satisfactory implementation of VAT requires sophisticated and capable tax administration which many developing countries including Bangladesh are currently lacking. This leads to questions like whether the VAT in developing and transitional economies could be as good in economic, equity, and administrative terms? Can this be administered sufficiently effectively by hard-pressed revenue administrations? Judging the pros and cons and taking the cost and benefits into account, Bird and Gendron (2005:4) contend that ‘VAT is almost without exception still the best form of general consumption tax available.’ This conclusion seems to have been strengthened from earlier findings that governments all over the world, in developing and developed countries alike, were attracted to the productivity of VATS, even when they were relatively poorly administered (Bird and Oldman, 1990 cited in Schenk and Oldman 2007).

Despite arguments for and against VAT, the fact remains that it has swept the world in a short span of time. And the literature amply shows that the VAT has proved, almost without exception, to be a more effective and efficient tool for maximizing revenue than the tax it replaced in both developed and developing countries. The unabated progress of this indirect tax in different regions throughout the world led Tait (1988:3) to remark, ‘The rise of the value added tax (VAT) is an unparalleled phenomenon... VAT may be thought of as the Mata Hari of the tax world – many are tempted, many succumb, some tremble on the brink, while others leave only to return, eventually the attraction appears irresistible.’ He mentions the flirting of some developed countries such as Australia, Japan, Canada and Iceland with VAT who resisted the adoption of a VAT until 1988 on the grounds that a VAT is

regressive, administration and compliance-wise costly, prone to evasion, specially to fraudulence of refunds. Interestingly, all of these countries adopted VAT in course of time – Japan in 1989, Iceland in 1990, Canada in 1991 and Australia in 2000 (ITD 2005).

A close study of the phenomenal spread of VAT throughout the world shows that the administrative and economic inefficiency of the sales taxes with their complexity, cascading effect, narrow base and multiplicity of rates led fiscal policy makers to switch to a VAT in an attempt to modernize their tax structure. Not only as a ‘fashionable tax,’ as Tait (1988) called it, VAT with its visible success in many countries in generating buoyant revenues, created its own demand among both developed and developing countries. Thus, it seems to be a valid question if a VAT has the equal potential to contribute to improved governance.

### **VAT and good governance**

Having explored a range of competing claims about VAT as an effective and efficient tax, the question that one can validly raise is: what has VAT to do with good governance? The answer to this question essentially lies in the relationship between taxation and good governance in broad spectrum. More specifically, relating VAT to the good governance paradigm is indeed a study of the relationship between taxation and good governance. Moreover, given that ‘good governance and administrative reform issues now form an integral part of development debate’ (Ray 1999:354) and that VAT has emerged as a strong weapon in the arsenal of tax reform, especially in developing countries, the imperative for a symbiotic relationship between a VAT and good governance is easily comprehensible. As we seek to explore what prompted the invention of a tax system like VAT, considerations on which the adoption of a VAT is usually based across different countries are nothing but principles of good governance, expressed in different jargons.

To be more specific, we can point to a couple of principles of VAT – self assessment and accounts-based system – to illustrate its relation to good governance

principles. The core of a modern tax system, self-assessment<sup>36</sup> is the pivot of VAT. Arguing that in many countries the development of self-assessment is linked with the rise of VAT, Ebrill, Keen et al. (2001) regard self-assessment as a tool to minimize the compliance costs to taxpayers, to increase administrative efficiency by reducing the burden of assessment and also to curb corruption that occurs through negotiated tax assessment in the absence of self-assessment. In my view, self-assessment is much more than a method of assessment in taxation. It represents the empowerment of taxpayers as well as the trust that a tax system reposes on its taxpayers. It has a direct bearing on the devolution of power insofar as the administration of a tax is concerned. Along with this self-assessment mechanism goes the potential role of VAT in anticorruption which is evident in its shift from traditional physical verification to accounts-based verification as the former is ‘typically associated with malfeasance’ (Moore 2013:9).

The review of literature on VAT shows that despite some limitations like regressivity (or, being less progressive than income tax) and extensive record keeping posing difficulty to small businesses, a VAT can easily ensure predictability, participation, accountability and transparency while becoming efficient and effective. A number of country reports and staff papers of the IMF (see, for example, IMF 2005; Keen and Smith 2007; IMF 2007b; Abbas, Moriyama et al. 2010) have documented tax policy scenarios, revenue performance, treatment of small trades, exemptions, administrative obstacles, and collection costs in VAT with special reference to individual countries. All these studies attempted to outline the challenges of implementing a sophisticated, document-based tax system like VAT in the VAT-adopting countries, most of which are characterized by their low rate of literacy and unsatisfactory levels of accounts keeping. The ways to overcome the challenges, however, have been suggested as inculcating the good governance principles.

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<sup>36</sup> Self-assessment denotes that a taxpayer self-assess his/her tax without the intervention of a tax official.

### 3.3 Governance and taxation in Bangladesh

A worldwide pattern that has been found in different studies on governance is that the quality of governance increases with income (World Bank 2003). This assumption somewhat supports the idea that development precedes good governance, not vice versa (Sundaram and Chowdhury 2012). Naturally most developing countries rank poor in the index of governance. This holds generally true for Bangladesh. As I have already noted, most international studies show relatively poor perceptions of governance in Bangladesh.

For most developing countries, international donors and other development partners have tagged the conditionality of their ability to improve their governance for achieving their MDGs (Duncan et al. 2002, ADB 2005 cited in Quadir 2007). This was no different for Bangladesh. Besides external stimulus from international donors or development partners, Poverty Reduction Strategy Papers (PRSPs) of different developing countries make explicit commitment to good governance (Grindle 2007). For Bangladesh in particular, promoting good governance has been specifically identified in its PRSP of 2005 called ‘Unlocking the Potential’ as one of the four supporting strategic blocks for the reduction of poverty; the other strategic blocks – ensuring participation, social inclusion and empowerment of all sections, groups and classes of people, providing service delivery efficiently and effectively and caring for the environment and sustainable development on a long-term basis –, in fact, reinforce the promotion of good governance. In its own words:

... the extent of good governance is negatively related to the magnitude of poverty in a country. Lack of good governance produces disparity, injustice, deprivation and lawlessness in the society in general and for the poor in particular. In order to attain a higher rate of poverty reduction there is no escape from ensuring good governance. (Government of Bangladesh 2005a:36)

The same notion has been reiterated in the PRSP of 2011. In the course of emphasising the imperative for good governance for development, the current



PRSP with an undercurrent of self-reflection identifies low public administration capacity, occasional weaknesses of economic management and persistent corruption as some challenges of ensuring good governance (Government of Bangladesh 2011). This is to say that in its vision of accelerating growth and reducing poverty Bangladesh has committed itself to ensuring good governance as explicitly manifest in its PRSPs from 2003 to 2011. But the question that has remained mostly unanswered is the extent to which the political commitment has been translated into action.

### **3.3.1 VAT in Bangladesh**

As already noted, Bangladesh shares the common features in the tax structure with many other developing countries, particularly those of South Asia. The tax system is characterised by its heavy reliance on trade tax and other indirect taxes in the first place, then by its inadequacy in mobilizing enough tax revenue to finance the government expenditure. A former UN economist from Bangladesh captures the complexity of the country's tax structure in a newspaper article in this way:

Direct taxation is seen by governments more as a feared weapon of political self-immolation than as an instrument of economic policy. They, at best, tinker with it from time to time. Their preferred alternative is the opaque and easier world of indirect taxation. (Rahman 2004)

This observation is not only valid but also fits well in the overall tax structure of Bangladesh. Its historical reliance on indirect taxes, more on trade taxes than on domestic consumption taxes, explains to some extent its tax reforms agenda that included the option for adopting a VAT.

We can recall the established proposition that patterns of taxation come into being as offshoots of economic, cultural and historical factors (Hofstede, 1991; World Bank 1991). If we consider the overall socio-economic condition, particularly the rate of literacy, tax awareness and the culture of transparency, and the level of sophistication in business accounting and documentation that a tax system like VAT

requires, then Bangladesh is not an ideal place for a VAT. Then why did Bangladesh adopt VAT?

We have already noted that the motivation to adopt a VAT differs from country to country. While revenue maximization in a more effective and efficient way remains almost a common goal, there were other factors that prompted the adoption of VAT in different countries in different regions or of different development status. Ebrill, Keen et al. (2001) have dwelled briefly on this aspect. They notice that adoption of VAT necessitated from the urge for greater economic integration among the member states of the European Community, while in many transition economies and developing countries, the rapid adoption of VAT reflected the need to augment tax revenue in the wake of the declining trend of import tax revenue. In this part we will attempt to explore why Bangladesh adopted VAT.

Though it is recognized that reforms tools should be used selectively and adapted to local conditions taking the diversity in the different countries' wealth, culture and historical experience (Cheung 2005), the urgency for reforms in developing countries often stems from outside and they are designed by international agencies and not fully understood or supported by citizens (Batley and Larbi 2004). This is truer in developing countries in terms of reform in the taxation system than in any other area. The adoption of VAT in Bangladesh appears to follow suit.

Bangladesh is one of the first two South Asian countries that adopted VAT, the other being Pakistan that introduced VAT in 1990.<sup>37</sup> Introduced in July 1991, VAT replaced the age-old excise duty on domestically produced goods and services and sales tax at the importation stage. The introduction of VAT in Bangladesh was an immediate result of recommendations of tax reform from the World Bank in 1989. Considering the limitations of the existing indirect systems, especially their inability to raise tax to GDP ratio to a satisfactory level, the World Bank (1989) recommended the introduction of what it called a rudimentary VAT – a VAT that would cover only manufacture cum import stages:

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<sup>37</sup> After the adoption of a modified VAT in 2005, India introduced a fully-fledged VAT in 2012. Nepal and Sri Lanka introduced VAT in 1997 and 1998 respectively

...that existing tax instruments be strengthened and modified in order to phase in a rudimentary value-added tax (VAT) at the manufacturing-cum-import stage over a three-year period, with concomitant moves towards introduction of retail stage taxation for selected commodities. (World Bank 1989:15)

The World Bank's recommendation of incremental introduction of VAT was backed by experiences in some other low-income countries such as Indonesia and Pakistan whose consumptions taxes had VAT-like characteristics (World Bank, 1989). The rudimentary VAT, however, was conceived as an intermediate step towards the evolution of a retail-based tax system.

Prior to the introduction of VAT in 1991, Bangladesh had a long and enduring legacy of excise taxes that date back to the 1950s. But as opposed to excise taxes defined or described as the selective taxes on goods and services in many developed countries like UK or USA, Bangladesh and the then Pakistan practiced an extended excise tax which was meant to be a kind of sales tax with a lot of exemptions rather than a selective tax on goods and services. The excise tax system was characterized by physical control and assessment by tax officials as opposed to documentary control based on self-assessment in VAT. The formalities for the purpose of excises that Jenkins and Khadka (2000:11) describe for the Nepalese excise system equally applied to Bangladesh. The formalities included obtaining a license, renewing the license annually, obtaining permission for the commencement of manufacturing from the excise officer concerned, keeping raw materials, semi-processed, and manufactured goods under the supervision of the excise inspector and, finally, obtaining prior approval from the excise inspector and paying the excise duties before removing the goods from factory premises. For ensuring physical control, the government had to post inspectors in factories, while manufacturers were required to provide accommodation for the excise inspectors. Opposed to these command and control mechanisms, VAT seeks to thrive on the taxpayers' trust and cooperation mainly by empowering them with the tool of self-assessment.

In his speech on 12 June, 1991, the then Finance and Planning Minister proposed the introduction of a VAT as ‘a modern and progressive tax system’ (Government of Bangladesh 1991a) that aimed to expand the tax base, simplify the collection procedure and help in curbing tax evasion. Initially limited to a handful of services and to the production and importation of goods, the VAT was rolled out in phases to cover all stages of business transactions from importation to retailing. But to what extent the expectation of elevating the rudimentary VAT to a comprehensive VAT over the span of the last twenty years has been achieved has remained quite puzzling.

Since its introduction in 1991, VAT in Bangladesh has produced increasing amounts of revenue to become the largest source of tax revenue. As already noted, according to the NBR data, starting from Tk.31,900 million (US \$558 million) in 1991 to Tk.241,471 million in FY2009-10, VAT (collected both at importation and home consumption stages) now accounts for more than 50% of the total government revenue (NBR, 2009). Economists have given the introduction of the VAT the lion’s share of credit for the continued increase in the tax-GDP ratio since the early 1990s (Mahmud et al. 2008). However, even in its own evaluation, the government of Bangladesh recognized the relative importance of VAT and observed that the momentum that the VAT showed during the first few years of its introduction could not be sustained due to administrative inefficiency (Government of Bangladesh 2011). Similarly, the Centre for Policy Dialogue (CPD), a prominent civil society think-tank in Bangladesh, mentions in its appraisal of the country’s PRSP (CPD 2006) that VAT could not bring in the expected dynamism in structure of the tax yield.

Although the instrumental role that the Bangladesh VAT has been seen to play in mobilizing more domestic resources can be tagged with the growth trend of economic development (Faridy and Sarker 2011a), the increased collection of revenue through VAT apparently signifies comparative efficiency of the tax system. It is interesting to note that the introduction of VAT in Bangladesh was seen by the ruling elites primarily as a means of raising more revenue and thus increasing the tax to GDP ratio. But the holistic approach – using the tax system as a tool for

representation and social contract as well – that requires a tax system to be effective and efficient was not evident. As a result of the revenue maximization approach to VAT, a great many adaptations and distortions have crept into the VAT system with the passage of time. Besides undermining the prospect of further revenue mobilization, such deviations and distortions have earned VAT the title of ‘so-called VAT’ (IMF 2008) and also undermined the potential of VAT as a catalyst in revenue bargain. Surprisingly, the lack of attention to the generic strengths of VAT as contributing to the revenue bargain and social contract is not limited to Bangladesh alone, but extends to the general approach to VAT in the literature also.

### **3.4 The Study of VAT**

Now that we have sketched out how VAT as a tax system relates to the good governance paradigm and hence to development discourse and why it warrants a political science study, a review of how VAT has so far been studied can be revealing. Interestingly, the dramatic spread of VAT throughout the world does not seem to prompt a proportional academic interest. Keen (2007) argues that there is not a large academic literature on the VAT. He vindicates his assumption by saying that there are only four papers in the *Journal of Public Economics* with ‘VAT’ in the title.

So far, the field of VAT study has been overwhelmingly dominated by economists, especially by those professionally affiliated with the Fiscal Affairs Department (FAD) of the IMF. What mostly preoccupied the researchers is its role as an effective and efficient replacement for some other form of taxation. Most of these studies focused on the theoretical, practical and administrative aspects, and have remained confined mostly to economic points of view. The first in this line is perhaps Tait (1988). He presents the policy and administrative issues in designing a VAT in a very comprehensive manner. It is in a sense a comparative study of VAT practiced internationally, covering almost every aspect that the practice of VAT involves. Like Tait, experts in FAD in the IMF, Ebrill, Keen et al. (2001), drawing on their FAD experiences, succinctly examine the spread and role of VAT, its problems and prospects and provide answers to a number of generally raised

questions related to its efficiency, effectiveness, fairness, and complexity. Understandably, while being aware of the criticism of VAT, they have shown a pro-VAT bias. Almost in the same style, with an explicit textbook approach, is Schenk and Oldman (2007) who have integrated legal, economic and administrative aspects of VAT mainly with the purpose of providing a comprehensive teaching tool.

A significant number of journal articles and pamphlets focusing on the policy and administrative issues in VAT in developing and transitional countries have been written. These studies include Cassandra de Jantscher (1990), Edmiston and Bird (2004), Bird (2004), Bird and Gendron (2005), Grandcolas (2005), Bird (2005) and Bird and Gendron (2007). These papers focus on practices of different developing countries with respect to taxpayer identification, invoicing, filing and payment process and different control mechanisms (Yesegat 2008). In short, all of these studies mostly focus on multifarious aspects of VAT including the rationale for replacing the existing tax with a VAT, the challenges of VAT administration in developing countries, the problems with regressivity and equity, and compliance and enforcement issues.

The IMF has produced a number of country papers and working papers (For example, Casanegra de Jantscher 1986; IMF 2003; Keen 2007), the focus of which mostly remains centered on problems encountered in VAT by the concerned countries in their efforts in graduation from the excise/turn over tax type VAT to standard VAT. The study of country-specific VAT has been undertaken in different countries, mostly by the IMF researchers and that is also from an economics perspective. Diagnosis of the problems of the administration of VAT, along with recommendations for improvement, figures quite prominently in some researches. Debate over whether a country should replace the existing tax system, especially its consumption tax, by a VAT has been a continuing issue in the VAT literature. The debate naturally centres on the advantages and disadvantages of the tax system. In particular, equity, efficiency and effectiveness that form the core of tax system have remained the subject of the debate.

There are a number of country specific studies of VAT in developing countries, mostly by the nationals of the country concerned. For example, Khadka wrote extensively on different aspects of VAT, exploring the ways Nepal infuses a number of excise elements in its VAT and showing that its practice is quite far from theory (Khadka 1998; Khadka 2005). Kitiprawat (1992) and Pott and Supakijjanusorn (1992) in their studies based on documentary analysis present the features of the VAT in Thailand while outlining its problems. Yesegat (2009) studies the operating cost of VAT in Ethiopia in her doctoral research. She has found that the design and administration of VAT have a bearing on the level of compliance. While she puts emphasis on taxpayer education as a strategy to improve compliance, some other factors such as the lack of tax official accountability, and of simplicity of tax laws recognized as obstacles in tax compliance remained unaddressed.

While there is general discussion on the place of a tax system in state-building, as this review demonstrates, the literature on the role of VAT for promoting good governance is quite sparse, if not absent. The theoretical understanding from a fiscal sociological approach through which we have tried to relate a tax system to the good governance paradigm does not seem to have been rigorously studied with reference to any particular tax or country. The universal concern in governance about simplicity, transparency or predictability that a standard VAT embodies has not been explored in the way it has been envisaged in the present study.

In respect of the context of this study, the IMF has sporadically dealt with the overall tax system in Bangladesh in different country papers on selected issues, routinely reinforcing the imperative for the tax system's immediate reform. In line with the general style of a country paper, these papers are naturally prescriptive. But in those prescriptions, the concern seems to have been restricted to the revenue aspect of VAT only. A number of journal articles focusing on the key features of Bangladesh VAT have also attempted to shed light on various problems and possible solutions. These include Islam (1995), Ahmed (2003), Alam and Shil (2009), and Faridy and Sarker (2011b). In two of their papers, Faridy and Sarker attempt to measure the progressivity of Bangladesh VAT and its incidences

respectively (Faridy and Sarker 2011a, 2011b). Khadka (2008) traces the evolution and the existing structure of VAT in five of the eight SAARC countries, i.e. Bangladesh, India, Nepal, Pakistan and Sri Lanka that have adopted VAT. He has shown how the previous tax system that these countries have inherited from their colonial past has influenced the design of VAT. Hossain (1995) underscores the problem of equity in the Bangladesh VAT. His study, again, predominantly dwelled on equity, revenue, price of distribution effects purely from economist's perspective.

The government documents attempted sporadically to evaluate the overall tax system in Bangladesh. For example, the Report (Government of Bangladesh 2003) of the RRC established in 2002 pointed out with facts and figures the acute extent that Bangladesh was lagging behind in generating tax revenue compared to many similar income level countries. The Report observed that 'the prevailing situation in Bangladesh not only demands a change in the attitude of the people, but also a change in the practice of governance.' The report, however, stopped short of detailing how the system lacks good governance principles.

A review of the budget speeches of the Finance Ministers of different regimes in Bangladesh demonstrates their concern about the unsatisfactory state of the country's tax to GDP ratio. Consequently, some critical light has been shed on the tax structure and policy in general and on VAT in particular. Mentioning 'the discretionary power of the tax officials' and 'discriminatory tax collection policies', the Finance Adviser of the 2007 Caretaker government put emphasis on simplification of tax assessment and payment procedures and on ensuring transparency and accountability of the tax department (Government of Bangladesh 2007). Without indicating any causal relationship between the two, the Minister noted 'the general aversion of the taxpayers' and the 'procedural complexities in paying taxes' as adversely affecting the tax revenue collection.

All of these studies have paid attention to either design or administrative problems at the heart of which lies the concern of making VAT more efficient and effective. But the recipe for effectiveness or efficiency hardly contains any reference to



shaping a tax mentality or institutionalizing a tax culture. It appears from these evaluations that everything amiss in the taxing procedure lies with the tax administrative mechanisms or design problems. The role of the other stakeholders or the importance of transparency and accountability has either been ignored or considered unimportant, which belies the imperative of forging greater partnership with the citizens and aligning the country's tax system with the good governance paradigm. On the whole, while there are theoretical studies of taxation in its role in state-building, any tax-specific or country-specific study from that perspective seems quite rare. Even rarer is the empirical study of taxation as a tool for good governance. This is no exception in the study of VAT also.

### **3.5 Conclusion**

The efficiency and effectiveness of a tax system constitutes not merely in raising higher amounts of revenue in a cost effective way. Indeed, one important thing that needs to be borne in mind is that the ability to raise higher amounts of revenue should not be the only criterion that makes a tax system desirable (Ebrill, Keen et al. 2001) because the efficiency of the tax system may be regarded as curtailing equity and, therefore, could become an argument against a buoyant tax system. The fiscal sociological approach takes a broader holistic approach which views a tax system not as an end in itself, but as a social process, a formidable tool for creating a social contract.

The review of literature on both good governance and taxation unequivocally indicates the inevitable and symbiotic relationship between the two. But achieving the objectives simultaneously can be quite challenging, especially in a situation where taxpayers are not very convinced that tax-money would be well-spent. Moreover, in the absence of a healthy tax-culture, where taxpayers can flout tax laws without any or with only few legal strictures and punishments, good governance rather than coercion can be the only motivating factor for compliance. That is, again, 'plucking the goose to obtain the largest amount of feathers (maximizing revenue) with the least amount of hissing (the way it is collected)'.

Since the political elites in Bangladesh do not have a significant amount of resources from non-tax sources such as oil and mineral resources and the flow of foreign aid is also becoming thinner than ever before, the imperative for them to engage in bargaining with taxpayers or other organized groups and to build state capacity to collect and administer revenues has heightened.

Literature on tax policy and administration with reference to good governance in its modern parlance, however, seems to be scarce worldwide, not only in Bangladesh. There are very few studies that exclusively concentrate on VAT with reference to good governance. Governance issues, once left to the civil society, are being voiced by the general mass. In the context of growing concern for good governance, business people also give vent to their concern over harassment by tax authorities, and the uncertainty and complexity of taxing procedures (*Daily Star* 2007). So, with reference to studies of a tax system like VAT as a tool for good governance, or, conversely, of good governance as contributing to the creation of an effective and efficient VAT regime in a developing country like Bangladesh, the gap is obvious. This study has attempted to fill this gap of knowledge.

## CHAPTER 4

# VALUE-ADDED TAX IN BANGLADESH: AN OVERVIEW

### Introduction

In the previous chapter we have provided a definition of VAT for reference in the overall conceptual framework of the thesis. We have seen how VAT has come to occupy a central place in fiscal policy throughout the world and emerged as one of the most influential tools for public finance. We have noted that unlike other taxes VATs around the world exhibit a great deal of resemblance and uniformity. Despite many commonalities, there are differences in the administration of VAT (Thuronyi 2003). A plethora of factors, such as the structure of the economy, the tax culture of the society, limited administrative capacity and the nature of political institutions, among others, have forced many VAT-adopting countries, particularly in the developing world, to adjust to local conditions and to deviate from international norms and best practices. With the primary concern being maximization of revenue, VAT policies have tended to exploit whatever option is available, often to the neglect of the principles of a good tax system. Consequently the VAT policies and practices being followed in such countries represent a significant departure from the ideal model.

This chapter, based on the documentary analysis of VAT legislation, rules and statutory regulatory orders (SROs) and other relevant official documents, addresses the first research question on the extent to which the design features of Bangladesh VAT reflect the principles of simplicity, transparency, accountability and equity which have also been designated as principles of good governance in tax matters (European Commission 2009). The chapter has been organised as follows: the first section presents design issues of VAT. Administrative issues are discussed in the second section while the third section focuses on the revenue performance of VAT

in Bangladesh. All the sections adopt a comparative approach, showing how the Bangladesh VAT conforms to and departs from the best the international practices.

## **4.1 Design issues of VAT in Bangladesh**

The applied literature on VAT clearly shows that though VAT as a consumption or indirect tax is based on some general principles, its design and administration varies quite widely. This section will focus on the different design aspects of VAT in Bangladesh including its legislative tools, administration, tax base, methods of tax collection, some special features of VAT in Bangladesh and the processes of enforcement and compliance. This exploration will reveal the extent of adaptations, deviations or distortions evident in the Bangladesh VAT regime.

### **4.1.1 Type of VAT**

Of different types of VAT – Gross-Product VAT, Income-Type VAT and Consumption-Style VAT – Bangladesh has adopted the consumption type VAT and its invoice-based credit or credit-subtractive method<sup>38</sup> for calculation of VAT payable by a business in each tax period. According to this method, business calculates its tax liability by applying the tax rate to each individual sale and subtracting all input taxes previously paid on purchases. This is by far the most prevalent type of VAT in use throughout the world (Bickley 2003).

### **4.1.2 The base of VAT**

Any discussion of VAT starts with its tax base. The VAT was introduced to maximize revenue mainly through the expansion of the tax base which was quite narrow during the excise regime. Initially VAT was extended to importation and manufacturing of goods and a handful of services and remained so until 1996 when the term ‘supply’ was re-defined to include all business transactions and VAT was extended to cover the whole gamut of business transactions in an incremental way. Though theoretically, in any VAT, the tax base is the difference between the value of output and the value of input, the VAT base is actually determined on the basis

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<sup>38</sup>There are two other methods of VAT calculation in this type of VAT – addition method and sales-subtractive method. Addition method applies the tax rate to the value added, i.e. wages paid, rent and interest expenses, and profit, while sales-subtractive method calculates VAT by applying the tax rate to the difference of all sales and all purchases.

of its coverage and exemptions.

#### **4.1.2.1 Taxable goods and services**

All goods except those mentioned in the First Schedule to the VAT Act and all services except those mentioned in the Second Schedule are taxable goods and services respectively. Initially, the Second Schedule of the VAT Act was a positive list containing the list of services that were subject to VAT. The First and Second Schedules now list statutorily-exempted goods and services respectively. The Third Schedule lists the goods and services which are subject to Supplementary Duty (SD) and the applicable statutory rates thereof.

The number of VAT-able services so far identified and their scope explained through a Statutory Regulatory Order (SRO) by NBR now stands at 79. These services are listed under a vernacular system of classification with heading and code numbers.

#### **4.1.2.2 Exemptions**

The VAT pundits are convinced that it is not feasible to bring the whole gamut of business transaction under VAT network mainly due to the concern of equity as well as of administrative and compliance cost. The two most fundamental methods of addressing these two concerns are exemptions and zero-rating (Bickley 2003). The Bangladesh VAT employs both methods. The first two Schedules of the VAT Act respectively list the goods and services which are exempt from VAT.

The First Schedule is the list of exempt goods which are basically unprocessed agricultural products like cattle, crops, fruits, seeds and primary products like raw hides and natural sand. Exempt services mentioned in the Second Schedule in belong to the following categories:

- Basic services for living;
- Social welfare services;
- Culture related services;
- Finance and financial activities related services;
- Transport service;

- Personal services;
- Other services.

The basic power of exemption rests with the parliament. The Bangladesh Constitution permits the legislature to delegate the tax law making authority to the executive branch of the government.<sup>39</sup> Similarly, in the light of this delegation, enormous power has been delegated to the executive branch of the state to exempt any goods or service from VAT. This is in addition to the power of framing and implementing regulations issued by the executive branch of government in accordance with the framework of administrative law.

The government here is represented by the Internal Resources Division under the Ministry of Finance; the power in practice by the NBR. The same section specifically empowers the NBR to grant specific exemption.<sup>40</sup> In addition to the statutory exemptions in the First and Second Schedules, the list of exempted items – goods and service – through executive notifications called Statutory Regulatory Orders (SROs)<sup>41</sup> issued over the span of the last twenty years is quite long. Among exempt goods, capital machinery figures most prominently. Though a capital machinery, to be classified as such under the harmonized system of coding under the Customs Act, is a taxable good, because of the executive exemption it is treated as a non-taxable good. There are other goods which also qualify for VAT exemption at the manufacturing level upon fulfilling certain conditions<sup>42</sup> of cottage industry.

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<sup>39</sup> Section 14 of The Act empowers the government to grant general exemption to any goods or services: The Government may, by notification in the official Gazette, exempt importation or supply of any goods or class of goods or rendering of any service from value added tax or, where applicable, supplementary duty imposable under this Act, subject to any limitation or condition specified in the notification. (GOB 1991b)

<sup>40</sup> While the general exemption applies to all suppliers of the relevant goods or services, specific exemption applies to a particular person or a particular purpose. Some of the statutorily-taxable services, for example, cold storage, have been exempted vide issued by the government under the executive authority it derives from the legislation.

<sup>41</sup> There are as many as thirty six government notifications which deal with different general and specific exemptions, listing the goods, services or persons entitled to exemptions at different stages of business transaction.

<sup>42</sup> In order to be eligible for cottage industry exemption benefit, to be granted by a Commissioner on an application having jurisdiction, a business needs to produce any goods other than those mentioned in the exemption notification<sup>42</sup> and must fulfill the following conditions: the enterprise is not a joint stock company; the amount of capital invested in plant, machinery and equipment does not exceed BDT 25 lac and the annual turnover of the business must not exceed BDT 40 lac.

#### **4.1.2.3 Zero rating**

The whole regime of export of goods and services is zero rated. Zero rating means that the goods and services are taxable but the rate of VAT applied to them is 0%. Khadka (2003) maintains that when some goods and services are required to be kept completely free from VAT, then zero-rated tax should be applied. There is an obvious difference between tax exemption and zero rating under the VAT system – businesses do not charge VAT on the sale of exempt goods or services as they are not allowed input tax credit on their business purchases but, in the case of zero-rated items, businesses do charge VAT at zero rate and are allowed input tax credit. While an exempt trader is out of the VAT system and is treated as the final purchaser, ‘the zero-rated trader is wholly a part of the VAT system and makes a full return for the VAT in the normal way’ (Tait 1988:49). While all countries extend zero rating to their exports and some countries like Ireland, Mexico, and Italy extend it to the domestic supply of food and medical drugs, zero rating in Bangladesh is limited to exports only.

#### **4.1.3 Rates of VAT**

Most of the VAT adopting countries in the world practice a single standard rate for VAT. Appendix 1 shows the VAT rates of some countries with the year of their introduction of VAT. In line with the best international practice, the Bangladesh VAT legislation provides a standard rate for home consumption goods and services of 15% and a zero rate for exports. According to the Act, all taxable goods and services imported and supplied for consumption within the country are subject to a VAT @ 15%. A rate of 0% applies to all goods and services to be exported and deemed-exported from the country. But there are some other rates in practice (shown in Appendix 2) that emerged due to different methods of calculation of VAT.

#### **4.1.4 VAT threshold**

One of the most critical issues in any VAT is the determination of the appropriate level of threshold of a business firm above which registration of the tax is mandatory (Ebrill et al. 2001). This threshold (see Table 4.1 below for a comparison) is usually determined on the basis of the size of the economy of the respective country and hence it varies widely from country to country. In order to

maximize revenue as well as to minimize distortions of competition between firms of different sizes, the most ideal threshold should be zero (Ebrill et al. 2001) which would bring all taxable activities under the purview of VAT irrespective of their business sizes. Theoretically, the lower the threshold, the more inclusive the VAT is. But for reasons of administrative and compliance costs, it has been found more practical to set a threshold below which businesses are not required to register under VAT.

In Bangladesh, the current (as of 2012) level of VAT threshold is BDT 60 lacs (6 million – equivalent to approx. US\$80,500 as of 2012). Any business or a person dealing in any taxable goods or services and having an annual turnover of BDT 60 *lacs* or more is required to take mandatory VAT registration. Starting with a threshold of BDT 5 *lacs* in 1991, the VAT threshold underwent a number of upward revisions over the last 20 years.

**Table 4.1: VAT threshold of some countries (in U.S dollars)**

Albania	32,000
Bangladesh	80,400
Benin	80,000
Bulgaria	42,000
Burkina Faso	80,000
Cameroon	80,000
Croatia	8,000
Pakistan	22,700
Philippines	14,000
Sri Lanka	33,000
Vietnam	75,000

Source: Ebrill, Keen et al. (2001)

Though many countries have different thresholds for different kinds of business activity, the Bangladesh VAT threshold is not generally business specific. Section 8(4) of the Act, however, empowers the NBR to bring any goods or services within the purview of mandatory VAT registration irrespective of their annual turnover. The empowerment has culminated into a gamut of virtually a zero threshold for a



number of goods and services. Currently there are as many as thirty five goods<sup>43</sup> and 67 services (out of 79 identified VAT-able services) which have zero thresholds for mandatory registration.

#### **4.1.5 Treatment of input tax credit and refund policy**

In line with the credit mechanism of VAT, prior-stage tax is immediately deductible or refundable if it is directly invoiced to a taxable person and the latter uses the input in his / her business. But the Bangladesh VAT legislation does not recognize land, office equipment and vehicles as input, and VAT paid on their purchase is naturally not creditable as input tax. Many other countries, for example, France, adopt a stringent attitude by flatly disallowing credit for business purchases of automobiles and land on the ground that no practical method exists for distinguishing business from personal use. Based on this argumentation, only 60% of VAT paid on the telephone/ fax/ teleprinter bill is creditable in Bangladesh. This kind of problems exists with the use of spare parts also.

In most VAT regimes when, during any tax period, the input tax due becomes more than the output tax payable, the surplus input tax is refunded to the taxpayer immediately after the tax period. As Tait (1988:285) mentions, ‘A VAT is intended to be a tax on consumption and not on a tax on business; in principle, all excess of input tax over output tax should be refunded at once.’ But in Bangladesh such surplus input tax is brought forward by the registered person in the account current for the next tax period and this is treated as input tax in the latter tax period.

The prompt refund through the input tax credit mechanism is most essential for ensuring many of the promised economic merits of a VAT. But the Bangladesh VAT seems to grapple with what Ebrill, Keen et al. (2001) term the tension between ‘the importance of assuring prompt refunds and the desire of governments to guard their revenues against fraud and the temptation they face to strengthen revenues by simply delaying refund payments.’

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<sup>43</sup> Some of the zero threshold goods are coconut oil, biscuits, mineral water, soft drinks, energy drinks, cosmetics, chewing tobacco, cigarettes and hand-made cigarettes, shaving cream, bricks, matches, electric bulbs etc.

#### **4.1.6 Treatment of small businesses**

Small businesses have been identified as a difficult zone for VAT in most of the countries. Due to the constraints of administrative and compliance costs, VAT poses difficulties for small businesses and hence, most of the VAT adopting countries have some special treatment for small businesses. This is no exception with Bangladesh. The first and foremost allowance for small businesses is the turnover tax @ 3% for the businesses whose annual turnover is below the VAT threshold. Most of the retailers have difficulty accounting for VAT on each transaction in the usual way because they engage in a large number of transactions of multifarious unit value and do not normally issue an invoice with every sale. Special schemes have therefore been devised in VAT-adopting countries to enable the retailers to determine their output tax. This is not uncommon even in some developed countries like Great Britain which has devised nine schemes for enabling the retailer to pay their taxes (Ebrill et al. 2001).

In accordance with the power vested by the VAT Act, in 2004 the NBR introduced the system of paying a lump sum VAT by small retail traders. It fixed the rate of value addition at 13.33% for any traders. And for small retail traders,<sup>44</sup> four categories of fixed VAT on the basis of the geographical location of the businesses have been set.<sup>45</sup> For example, the value addition of a small retail trader in Dhaka or Chittagong city corporation area has been fixed at BDT 40,000 which will yield an amount of lump sum VAT of BDT 6,000 @ 15%. There is another provision of collecting lump sum VAT from small traders on the basis of the recommendations of a committee comprising the representatives of business bodies and VAT officials.<sup>46</sup> The then Finance Minister described the latter as a participatory system in his budget speech.

#### **4.1.7 Taxpayers rights**

The VAT Act provides a number of rights<sup>47</sup> to a taxable person. The first and

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<sup>44</sup> The term 'small trader,' however, has not been defined anywhere in the VAT legislation or in any notifications made under it.

<sup>45</sup> Notification SRO No. 209-Law/2010/558-VAT dated June 10, 2010.

<sup>46</sup> General order No. 02/VAT/2005 dated February 2, 2005.

<sup>47</sup> According to the VAT Act and Rules, the following rights have been specifically accorded to the taxpayers:

- Right to appeal against any decision of a VAT officer (s42)
- Opportunity of being personally heard

foremost right that a taxable person enjoys is the right to appeal. Any person aggrieved by a decision of a VAT officer up to the rank of an Additional Commissioner has the right to appeal to the Commissioner (Appeal) and in case of a decision by a Commissioner or Commissioner (Appeal), to the Customs, Excise and VAT Appellate Tribunal.

## 4.2 Administrative issues of VAT

Since the effectiveness of transferring VAT experiences from developed country settings to countries characterized by fragmented economies, large informal sectors, low tax morale, rampant evasion, and total distrust between tax administrators and taxpayers has been seriously questioned (Bird and Gendron 2007), the administration of VAT has remained at the centre of discussion in developing countries. This section focuses on a number of related processes that the administration of VAT consists of – the legal framework, the administrative set up, registration, filing, payment, audit, and enforcement.

### 4.2.1 Legal framework

In line with the history and practice in most countries there is a basic constitutional principle that any act of taxation must have a legal basis (Vanistendael 1996). Article 83 of the Constitution of Bangladesh stipulates ‘No tax shall be levied or collected except by or under the authority of an Act of Parliament.’ Hence, the main legal tool for imposing VAT and implementing the VAT policy is the Value Added Tax Act, 1991 (henceforth referred to as the Act) and Rules, orders, and notifications made under it. Besides VAT, two other taxes, namely, Supplementary

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- Representation through authorized persons (s46)
  - Decisions on matters of value declaration within 15 working days (rule 3) and on appeal cases pending with Commissioner Appeal within one year and in case of Appellate Tribunal, within two years
  - Optional VAT registration for any business below VAT threshold (s15)
  - Claim for refund of overpayment or undue payment of VAT within six months from the date of such payment and getting such refund within 90 days of application (rule 34ka)
  - Confidentiality of business information (s62ka)
  - Interim release of seized vehicles (rule 7)
  - Summary adjudication (s43)
  - Option to pay VAT on truncated base for certain services (s5)
  - Certified copy of VAT return within 30 days (rule 25)
  - Disposal of unused or unusable input (rule 40)
  - Disposal of damaged or destroyed goods by accident (rule 41)

Duty (SD) and Turnover Tax (TT) are also imposed and collected under the same Act. While TT is a presumptive tax for small businesses, SD is a new form of ‘excise duty’ as a selective tax that has been combined with VAT in Bangladesh. Section 7 of the VAT Act provides for SD.<sup>48</sup> Goods and services mentioned in the Third Schedule of the VAT Act are subject to SD at various rates ranging from 20% for powdered milk to 350% for imported cigarettes.

Section 72 of the Act authorizes the tax administration to make rules on different aspects of VAT administration. With this empowerment NBR issued the Value Added Tax Rules, 1991 through an SRO<sup>49</sup> which has been undergoing a continuous process of amendment, change or modification during every budgetary session in the parliament ever since the introduction of VAT.

#### **4.2.2 VAT administration**

VAT in Bangladesh is administered by the Customs Department under the indirect tax wing of the NBR. The study of the organization of the administration of VAT in different countries shows that VAT is administered by one of these three departments (Ebrill, Keen et al. 2001):

- Domestic Tax Department that administers personal and corporate income tax
- Customs Department, and
- VAT Department

While most of the VAT-adopting countries administer VAT through the Domestic Tax Department, there are a few countries that have VAT being administered by the Customs Department. Ebrill et al. (2001) show that by 2001, of the 108 countries studied, 90 countries have VATs administered by the Domestic Tax Department, 4 by the Customs Department and 14 by the VAT Department. Bangladesh is one of the few countries where the VAT is administered by the Customs and Excise Department, or, in other words, the indirect tax wing of NBR. After the introduction

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<sup>48</sup> ‘Luxury goods, non-essential and socially undesirable goods and other goods and services specified in the Third Schedule on which imposition of supplementary duty is justified in the public interest, supplementary duty at the rate specified in the said schedule shall be imposed on such goods and services supplied, imported or rendered in Bangladesh.’ (s7, Government of Bangladesh 1991b)

<sup>49</sup> SRO No178-Law/91/3-VAT, dated 12 June, 1991.

of VAT, the Customs and Excise Department was re-named the ‘Customs, Excise and VAT’ Department. The operational activities of VAT administration are performed by 250 circle offices which are defined in the VAT law and rules as the local VAT offices. Spread over the country with higher concentration in business districts, they are pivotal to the collection of VAT revenue. Each Circle office is headed by a Revenue Officer<sup>50</sup> having the status of a class-I gazetted officer. The Circle offices are monitored by 80 Division offices which in turn are supervised by 12 Commissionerates.<sup>51</sup> Though of late there has been some attempt to replace the territorial jurisdiction by a function-based jurisdiction, each Circle office traditionally is divided into some geographical locations i.e. some blocks/ areas/ranges, as it had been during the excise regime. Among its staff members,<sup>52</sup> officers of the ranks from Asstt. Commissioner up to a Commissioner belong to the Customs and Excise Cadre of the Bangladesh Civil Service. Previously only the officers belonging to the Customs and Excise cadre used to work alternately in Customs and VAT wings; now all employees of the Customs and VAT departments work in turn in both the departments.

As opposed to the traditional geographical jurisdiction-based operation of VAT administration that spans the country, the Board has formed a Large Taxpayers Unit (LTU) meant to service the large taxpayers selected on the basis of their annual turnover and irrespective of their geographical location. The LTU is meant to be a function-based unit. Currently VAT LTU has 156 registered taxpayers, each remitting a minimum amount of VAT revenue of BDT 50 million to the government exchequer annually.

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<sup>50</sup> The designations of superintendent and inspectors were changed respectively to revenue officer and assistant revenue officer in 2010 through the Finance Act of that year.

<sup>51</sup> During the whole span of the excise system and the early period of VAT, the tax jurisdictional territory was called ‘Collectorate’ and the title of the civil servants working in both Customs, Excise and VAT Department was ‘Collector.’ This designation was changed to ‘Commissioner’ in 1995. This change, though not liked by the many traditionalists inside the Customs Department as it, they argued, obliterated the historical specialty of the Customs Department in the country, was prompted by the practice in other countries. Advocates of this change however defended the change in nomenclature from ‘collector’ to ‘commissioner’ as it reflected the shift of approach in tax collection, the core of which was self-assessment and self-clearance.

<sup>52</sup> The Bangladesh VAT Department is staffed by the following categories of officers: Commissioner/Director General; Additional Commissioner/Addl. Director General; Joint Commissioner/ Director; Deputy Commissioner; Asstt. Commissioner; Revenue Officer and Asstt. Revenue Officer. The total number of working staff in the indirect taxes was 4,807 in 2010 against the sanctioned strength of 7,494.

### 4.2.3 Registration for VAT

All importers, exporters with zero threshold and suppliers (manufacturers, distributors, wholesalers, retailers) of all taxable goods and services having a threshold of annual turnover of BDT 60 lacs (BDT 6 million, equivalent to US \$80,400) and above are required to be registered under VAT. In line with international practice, businesses below the threshold can opt for voluntary<sup>53</sup> VAT registration in Bangladesh. It appears from unit-wise revenue statistics that most of the VAT registered persons are registered on an optional or voluntary basis.<sup>54</sup> One of the reasons is that while the threshold has undergone upward revision quite a few times over the last 20 years, those with their existing threshold within voluntary VAT registration could not escape the net once the threshold was increased due to administrative convenience as well as external pressure. The number of businesses registered under VAT system is 480,467, which is glaringly poor as compared to the number of total businesses in the country. According to the economic census of 2001 and 2003 the total number of businesses in different sectors was 3,674, 971 of which 1,127, 613 were registered with the trade licensing authorities (BBS 2012).<sup>55</sup>

The study of different VAT regimes, especially those of the developing countries, suggests that despite the distortionary effects of the different treatment between businesses above and below the threshold, many countries tax businesses below the threshold differently and at a much lower rate in a simpler procedure. This is done mainly due to the concerns of administrative and compliance costs, equity and competitive advantages and disadvantages of the parties involved in the economy. This is no exception in Bangladesh. Section 8 of the Act stipulates that businesses whose annual turnover is less than the VAT threshold and for which VAT

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<sup>53</sup> A business dealing in taxable goods or service may become interested in getting VAT registered for a few reasons:

- Registration enables the business to claim the input tax credit
- When its buyers are VAT registered businesses, they would always require VAT invoices for their input tax credit
- In making supplies to the public and many private and international procuring entities, VAT registration is required

<sup>54</sup> A review of the unit-wise revenue statistics of a VAT commissionerate reveals that there are as many as 2,455 VAT units each of whose annual VAT revenue does not exceed BDT 75,000. If a VAT registered firm's annual turnover is BDT 60,00,000 at the minimum and the minimum value addition is 15% of its total sale, then the net VAT per annum should be  $60,00,000 \times 15\% \times 15\% =$  BDT 1,35,000. Source: field data.

<sup>55</sup> This picture could be better understood if we compare the ratio of VAT-payers to the population in Bangladesh with that of developed countries. For example, while in Australia and New Zealand is 10.92% and 15.04% respectively, it is only 0.3% in Bangladesh (OECD 2011). This figure is, however, higher than some other developing countries such as Peru (0.07% in 1983), Haiti (0.01% in 1985) and Ecuador (0.27% in 1983 (Smith, Islam et al. 2011).

registration has not been made compulsory are entitled to paying turnover tax<sup>56</sup> @ 3% of declared and approved annual turnover with no opportunity to claim input tax credit. Most of the identified taxable services and a number of goods are, however, not entitled to turnover tax as VAT registration has been made mandatory for them.

#### 4.2.4 Filing

Tax compliance is ensured through the submission of periodical returns<sup>57</sup>. Submitted in a prescribed form – (*Mushak* 19) in duplicate to the local VAT office within 15 days of the following month, VAT returns are normally filed on a monthly basis though there are provisions for quarterly and half-yearly submission of returns for some businesses. Though in an ideal VAT system, a Return should be the core of all VAT activities, namely tax liability, input tax credit, drawback, and revenue statistics, but in Bangladesh, VAT Returns have not been given the importance they deserve. The rate of Return filing is very poor. According to the latest published statistics, out of 480,467 registered VAT-payers, the number of units submitting returns in 2009-2010 was only 77,619 i.e. 16.15% (NBR, 2011).

**Table 4.2: Number of VAT registration and return submissions to FY 2009-10**

Number of VAT registered units					Total	Number of units submitting returns	% of return submission
Manufacturers	Services	Traders	Turnover	Cottage			
44,719	265,276	153,217	16,380	875	480,467	77,619	16.15

Source: NBR statistics (NBR 2011)

One of the reasons for poor return filing is that in the case of businesses with more than 70% (estimated) registered persons, such as construction firm, procurement provider, VAT is collected at sources. Another reason for the unsatisfactory rate of return submission is the absence of the culture of voluntary tax compliance. The

<sup>56</sup> Turnover tax is a presumptive tax. Small businesses having fulfilled the criteria for being enlisted as TT unit declares its estimated annual turnover and pays TT at the rate of 3% regardless of whether the actual sale of the unit at the end of the tax period is more or less than the declared turnover

<sup>57</sup> A VAT return contains information of all purchases and sales- taxable, zero rated or exempt, the amount of output tax and input tax and SD, if any, the amount of VAT deducted by or from them and fines/penalty/interest/arrear/refund (if any) adjusted and the amount of VAT deposited with the treasury within a tax period.

situation is further aggravated due to absence of effective enforcement.

Until now, no significant automation of the VAT system has been done in Bangladesh. Though most of the VAT Commissionerates have data processing units with a computer programme called VAT Information Management System (VIMS) in place, returns are not systematically processed. So, the processing of VAT is done manually. This manual processing of returns seems well matched with the way business documents are maintained: also manually. Though a VAT registered person can opt to maintain computerized accounts with the permission from the respective Commissioner, manual records have also to be maintained simultaneously.

Returns are checked at the local VAT offices. An office order from NBR, however, requires the concerned VAT offices at different levels to check a certain percentage of returns. The failure to file a Return within the stipulated time is an offence under the VAT Act. But a variety of methods for VAT collection, such as withholding, render return submission redundant, which largely explains the poor rate of return filing.

#### **4.2.4.1 Assessment of VAT**

The assessment of VAT, or for that matter, any tax, is a pre-condition for filing a return. Though in the standard practices of VAT, the amount of VAT is calculated by applying the VAT rate to the difference between sales and purchases, the Bangladesh VAT contains a number of assessment methods applicable to different groups of businesses. Section 5 of the VAT Act stipulates methods of valuation for the purpose of determining the amount of VAT charged at different stages of business transaction.

At the importation stage, the value on which VAT is charged is the value which is arrived at by adding all duties<sup>58</sup> and charges to the assessable value ascertained/determined under section 25 or 25a of the Customs Act, 1969.<sup>59</sup> At the stage of

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<sup>58</sup> Duties and charges applicable at the importation stage include Customs Duty, Supplementary Duty, Landing charge etc.

<sup>59</sup> If the assessable value (AV) of an item at importation is *taka* 100 and the rate of customs duty is 25%, then the value for VAT will be:

$$AV + CD = 100 + (100 \times 25\%) = 125.$$



supply of goods and services for home consumption, there are following different methods of valuation as well as assessment for different goods and services:

*Normal value:* The general provision of valuation for the supply of goods is the normal value which is the value paid or payable by a buyer; this value must include the cost of input, all charges and commission incidental to the supply, all duties and taxes except VAT and profit.

*Maximum retail price:* For a few items specified by the government notification, there is a system of charging VAT on the maximum retail price (MRP) printed on the body or the pack of a product at the manufacturing stage. Cigarettes are one of those few items. In this instance, the rate of VAT is directly charged to the printed price which obviously includes VAT.

*Total receipt for services:* For taxable services, the assessable value for imposition of VAT is ‘total receipt.’

*Truncated value:* But for a number of services the VAT authority has fixed a notional base commonly known as the truncated base. The RRC Report (Government of Bangladesh, 2003) illustrated the truncated base in the following manner: ‘VAT @ 15% is not calculated on its whole value; instead a certain percentage of the whole base (30, 15 and 10) is taken for calculation of VAT. For example, VAT on the construction service is calculated on 30% of the base. Hence VAT rate for this sector is  $(30 \times 15\%) = 4.5\%$  of the whole base.’ Appendix 3 lists the presumptive truncated tax bases for different services.

*Tariff value:* Tariff value is a notional value based on value addition. This is again a kind of truncated value for some listed goods and services<sup>60</sup> suppliers which are not entitled to claim input tax credit. The difference between the imposition of VAT on a truncated base and that on a tariff value is that while the former is optional the

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If the good attracts other duties like supplementary duty (SD) and Infrastructure development surcharge (IDSC), then the calculation will stand as:

$[100 + CD + \{(100 + CD) \times \% SD\} + IDSC] \times 15\% = \text{VAT payable}$

Assuming 25% CD, 15% SD and 4% IDSC-

CD= 25

SD= 18.75

IDSC= 4. Therefore, the value for charging VAT is taka 147.75.

<sup>60</sup> Prominent among the items and services assessed on the basis of tariff value are: powder milk, refined soybean oil, machine-made biscuits, tomato paste, fruit juice, hand-made cigarettes, LP gas, Petroleum Bitumen imported in bulk, different types of paper, bricks, cold-rolled coils, CI sheets, different types of mild steel products, electric transformers; and suppliers of SIM card for mobile or fixed wireless telephone.

latter is mandatory.

The last two methods of VAT assessment are presumptive methods which pervade the Bangladesh VAT. While VAT is basically assessed ad valorem, i.e. on the basis of the value of the goods and services on the transaction value, the Bangladesh VAT's obsession with presumptive taxation negates the inherent self-policing and self-assessment of a VAT.

#### **4.2.4.2 Value declaration**

The Act enumerates quite clearly that the value on which a VAT is to be charged is the transaction value, i.e., the market value of a good or services agreed between the buyer and seller independent of each other. Unlike standard VAT practices in many countries, the suppliers of VAT-able goods in Bangladesh, before making a supply, have to make a declaration, on a prescribed form, of the selling price of their goods. The declared price is supposed to be the price for the assessment of VAT. The prescribed value declaration Form (*Mushak-1*) requires the supplier to provide information to the VAT office with a description of the goods, the unit of supply, the name and quantity of raw materials and packaging materials used for each unit of the good along with the percentage of wastage, cost of inputs including Customs duty, Supplementary duty, LC fee and other charges, as applicable, etc.

The VAT divisional has the power to determine, after giving the declarant an opportunity for self-defense including a personal hearing, the assessable value for the same good. The determination of value by a VAT officer usually means an upward revision of declared price. No declaration of value, however, is necessary for any services except cinema halls.

#### **4.2.5 Payment of VAT**

The usual practice of paying VAT due (that is, the excess of output tax over input tax) to the government is through a Return at the end of the tax period on the basis of self-assessment by the registered taxpayers. The Bangladesh VAT has four distinct methods of paying VAT for different business transactions: advance payment through an Account Current, payment along with VAT returns, and, finally, advance VAT for commercial goods at the importation stage and

withholding.

#### **4.2.5.1 Payment through account current**

The suppliers of goods maintain a register as known as Account Current<sup>61</sup>. This account is maintained in a prescribed form (*Mushak-18*) in which businesses credit their input taxes and periodical deposits to the government treasury and debit their output taxes. In case the balance in the account current is not sufficient for any amount of tax payable on the supply of goods at any time, businesses are required to credit an amount of money in the government treasury before a supply of taxable goods takes place. In this way of crediting the input taxes and periodic deposit in the treasury, the tax unit needs to keep the balance sufficient to pay the tax due on any supply at a given period of time. This is a system of paying taxes in advance which can be likened to the pre-paid system of billing for a utility service.

The existence of this kind of account current method enables the VAT officers to engage in negotiations with VAT-payers in order to achieve their respective revenue target. A revenue target is fixed for each of the VAT registered businesses under a circle; the performance of a VAT inspector is measured by the extent to which he/she is able to meet the target. The amount of remittance to the government treasury in any tax period, not the amount of VAT actually payable, i.e., the excess of input tax credit VAT, indicates if a business meets the target or not. Even if there is no legal obligation to remit any amount of revenue to the treasury because output tax does not exceed input tax in any tax period, a business has to make a payment in the form of treasury deposit in order to meet the revenue target fixed by the local VAT office. The following observation (Box 4.1) published in a book by a current VAT officer would illuminate the scenario better.

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<sup>61</sup> Section 2(*jha*) of the VAT Act defines ‘account current’ as ‘an account maintained with the Commissioner by a registered person in a specified form in which details of purchases, sales, treasury deposits, payable and creditable value added tax and, where applicable, other taxes shall be entered.

### **Box 4.1 Negotiated VAT deposit: an observation**

In order to achieve the revenue target local VAT officers quite often request the VAT units to make a deposit of the required amount of VAT in the form of treasury deposit. Most of the units, especially those having some *weaknesses* (emphasis attached) in VAT comply with the request. Those having a good business reputation also try to comply with the request with a view to keeping VAT officers in good humour. It is seen that a huge amount of VAT is deposited through treasury *chalan* in the month of June. In fact, this happens at the request of VAT officers. As a result, the revenue collection in the months of July and August falls drastically...The additional VAT revenue that is collected in the months of May and June actually belongs to the revenue of the following fiscal year. (Hossain 2010:868)

#### **4.2.5.2 Payment along with VAT returns**

Other than goods, all service providers, with the exception of cinema halls, are entitled to paying the taxes along with Returns after the end of the tax period. All branches of Bangladesh Bank, the central bank, and some designated branches of Sonali Bank throughout the country function as treasury for taking deposits on account of VAT and other taxes. E-filing, however, is on the card of reform.

#### **4.2.5.3 Withholding**

A unique feature of Bangladesh VAT is the provision for withholding of VAT payable on a particular activity by the procuring entity rather than the service provider. While Section 3(3) has conferred upon NBRs the power to make provisions for advance payment as well as withholding of VAT on any goods or class of goods or services, Rule 18ka of the VAT Rules 1991 has authorized Government, semi-government and autonomous bodies, NGOs, Banking, insurance other financial institutions, public limited companies and educational institutions to deduct VAT on their procurement and deposit the same with the government treasury. Currently, any supply made to any above-mentioned procuring entity or to any tendering-entity is liable to a deduction of VAT @ 3% at source. According to the new system of deducting VAT at source by the person receiving a supply of goods or services, there are eight different rates at which VAT will be withheld<sup>62</sup>.

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<sup>62</sup> VAT @ 3% will be withheld from the supply in which case it is accompanied by a VAT invoice showing a payment of VAT @ 15%; the supplier will be entitled to claim the withheld amount of VAT on the basis of a certificate issued by the procuring entity.

In case of services who pay VAT on the basis of a truncated base, the procurer will deduct VAT at different rates viz. 15%, 6%, 5.0025%, 4.5%, 4%, 3%, 2.25% and 1.5% depending on the nature of the services. These services, however, are not entitled to claim the withheld amount as input tax credit.

The withholding authority has to issue a certificate of deduction in favour of the service renderer which enables the supplier to claim input tax credit of the withheld amount. The NBR has advised procuring entities through a circular to make sure that procurement providers are registered under VAT. In the broadened system of withholding VAT, both the supplier and the procurer have to maintain accounts of withholding and report the information to the VAT office in the prescribed forms. By re-designing the system of deduction of VAT at source in the FY 2010-2011, the tax base has also been broadened by bringing the granting and renewal of licenses and permits within the VAT network. Licensing authorities are to collect VAT at the standard rate i.e., 15% on the license or permit fee or charge.

#### 4.2.5.4 Advance VAT at the import stage

A variant of withholding VAT at source is the collection of VAT in advance at the importation stage. Rule 18ga provides for collection of VAT in advance from the importation of commercial goods @ 3% that the sale of such goods would accrue in their subsequent sale. This is an amount of VAT in addition to the VAT to be paid at the standard rate of 15% on the assessable value.<sup>63</sup>

The registered taxpayers who will pay VAT at the standard rate in their subsequent sale of goods will be able to take the AV paid at the importation stage as input tax credit. But the traders who opt to pay VAT at the retail or wholesale stage on a truncated base are not entitled to any input tax credit. And due to the intricate calculation method their tax burden increases due to an inherent cascade in the

<sup>63</sup> The assessment feature of VAT at the import stage may be understood from the following example:

- Assessable value of the goods for the imposition of Customs duty (CD)	100	(i)
-Rate of CD	25%	
-Amount of CD	25	(ii)
-Value for assessment of supplementary duty (SD) (if any)	100+25 = 125	
-Rate of SD	20%	
-Amount of SD	125 x 20% = 25	(iii)
-Assessable value for VAT	(i)+ (ii) + (iii)= 150	(iv)
-Rate of VAT	15%	
-Amount of VAT	150X15% = 22.50	
-Assessable value for imposition of Advance VAT(AdV)	(iv) + 20% <sup>63</sup> of (iv) =180	
-Rate of AdV	3%	
-Amount of AdV	180X3% = 5.40	

Ref: Rule 5 of 'the VAT to be imposed on the subsequent supply of goods imported by commercial importers (deduction at source) Rules 2010.' ( SRO 207-Law/2010/556-VAT dated June 10, 2010)

process. Under normal circumstances, an addition of 20% at the subsequent sale (retail or wholesale) on a value of BDT 150 would yield BDT 4.5 as VAT (@ 15%). In the above example, it yields BDT 5.40 as AV which a business paying VAT at that stage on truncated base will not be able to offset against his /her output tax.

#### **4.2.6 Audit**

One of the cornerstones of the investigative powers of the tax administration (Greenbaum 1997), auditing has emerged with reinforced urgency as tax systems started to rely more on self- assessment and voluntary compliance than on the tax authority's assessment. The administration of VAT rests on the principles of self- assessment and voluntary compliance. As such, as with the VAT legislations in many other countries, the Bangladesh VAT has specific provision<sup>64</sup> for the carrying out audits of business transactions. Besides, the NBR issued a couple of general orders detailing the audit mechanism in 1999 and then published an Audit Manual in 2006.

The NBR has a central audit directorate headed by a director general. Moreover, each VAT commissionerate has an audit wing headed by a joint commissioner. In addition to the existing organizational set-up for Audit in VAT, NBR constituted a central Audit cell in 2006 for integrated audit through exchange of information among VAT, Income Tax and Customs. Besides employing its own staff, the NBR has the power to appoint commercial auditors for auditing any taxpayer, which has not been practiced yet. According to the VAT Audit Manual (NBR 2006), each VAT unit is supposed to audited at least once in three years. But, inferred from the fact that a reassessment of VAT registered business can be done within five years<sup>65</sup>

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<sup>64</sup> Section 26ka of the VAT act provides:

A value added tax officer, not below the rank of a Joint Commissioner, may order the auditing of tax and tax related activities of a registered or registrable firm for a specified period and the officer or officers ordered for the purpose shall, after completion of the audit on the basis of orders issued by the Board and the audit manual including the provisions of this Act and the rules made thereunder, within the specified time, submit a report to the ordering officer (Government of Bangladesh 1991b).

<sup>65</sup> Prior to the amendment through the Finance Act, 2010, the time frame for issuing a demand was three years.

from the date of certain business transaction according to Section 55 of the VAT Act, at least one audit needs to be done once in every five years.

Like many other developing countries that have adopted VAT, audit is yet to evolve as an effective organizational culture in the Bangladesh VAT. In 2009 only 264 VAT units were audited while the number in 2010 was 176. Compared to the number of businesses registered under VAT and listed under Turnover tax and Cottage industry, the number of audits stands well below 1%. Even compared to the number of large taxpayers, for example, manufacturers, the total number of audits still stands below 1%.

#### **4.2.7 Enforcement**

Enforcement, or, in other words, dealing with tax delinquency, is a crucial issue in any VAT. Because, VAT differs from most taxes in that VAT delinquency is not simply a matter of failure to pay VAT ‘but in effect the embezzlement of public funds. Firms liable for paying consumption taxes have for the most part themselves collected those taxes from others. If they do not remit the funds to the treasury in a timely fashion, they have, not to put too fine a point on it, stolen the money’ (Bird and Gendron: 173). Among enforcement issues, the quasi-judicial powers of VAT officers, preventive surveillance, supervisory clearance of goods and the use of stamp and banderol deserve elaboration.

##### **4.2.7.1 VAT officers’ quasi-judicial powers**

In dealing with tax delinquency, Bangladesh VAT offers a unique approach. All VAT officers from a Revenue Officer up to a Commissioner have quasi-judicial powers of adjudication, in accordance with their respective scale and jurisdiction, of the offences committed under VAT law. In exercise of that power, an adjudicating VAT officer, after following a quasi-judicial process of framing a charge, self-defence by the accused, inquiry and personal hearing, can impose a fine or penalty or confiscate goods in favour of the state. That is, as opposed to ‘assessment of penalty’ as is practiced in many VAT jurisdictions, penalty is imposed through a quasi-judicial process. This is a special situation where the VAT officers act both as prosecutors and adjudicators. Although there is a provision, there are hardly cases that have gone for judicial prosecution.

#### **4.2.7.2 Preventive surveillance**

VAT officers have the power to seize any goods liable to confiscation. A preventive team in each VAT Commissionerate keeps vigilance on the streets to make sure that no goods are transported or transferred without the payment of VAT. That the Bangladesh VAT officers prove more active in enforcing their seizing authority than auditing authority is demonstrated by the much higher number of seizure cases than audits; in 2009-2010, the number of seizures was 638 involving an amount of revenue of BDT 158 million, while far fewer audits (176) unearthed an evasion/avoidance of BDT 1719 million.

#### **4.2.7.3 Supervisory clearance of goods**

Bangladesh has a provision of supervisory clearance which can be made applicable to any goods. Presently this supervision is applied to cigarettes which account for the highest amount of domestically collected VAT and SD. A commissioner has the power to subject any taxable supplier to supervisory clearance.

#### **4.2.7.4 Use of stamp and banderol**

One unique feature of evasion control of the Bangladesh VAT is the use of stamp or banderol for some evasion prone items.<sup>66</sup> Currently, cigarettes (both machine-made and handmade), toiletries, cold drinks and mineral water are some items the packages of which require being stamped or banderoled before being supplied from the place of production. Except the case of *bidi* or handmade cigarettes, the use of the banderol or stamp is meant for evasion control; in case of *bidi* the use of banderol is both for the control of evasion as well as for the collection of revenue. *Bidi* is taxed on a tariff value and a banderol of the amount of VAT and SD payable on a pack of *bidi* has to be affixed. Thus manufacturers of *bidi* pay taxes in advance as they buy banderol from post offices and affix them on the packs of *bidi*.

In matters on enforcement as well as of compliance, the use of automation is notable for its conspicuous absence. In order to combat tax evasion in VAT, cross-checking of invoices and reduction of possible interfaces between the taxpayer and

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<sup>66</sup> According to Section 6 of the VAT Act, the NBR has the power to direct the taxpayers, by notification in the official Gazette, to use, on the body of the package or container or pot of the goods stamp or banderol or special sign or mark of specified size and design for the purpose of realizing VAT or, as the case may be, VAT and SD applicable to any goods or class of goods.



the tax collector have been suggested by VAT experts. In this instance, computer assisted processes have been found much more effective than the traditional manual processes (Shome 2006 ). But in Bangladesh VAT, computers are yet to emerge as an enforcement tool.

### 4.3 Performance of VAT as a revenue raiser

With the introduction of VAT, indirect taxes from domestic sources recorded an impressive progress. Starting with an amount of 19 billion BDT in FY 1991-92, indirect tax revenue from the local sources excluding VAT at the importation stage stood at 217 billion BDT in FY 2009-2010. While customs duty grew from 27.5 billion BDT in FY 1991-92 to 90 billion million BDT in FY 2009-2010, VAT, including excise duty and supplementary duty, from the domestic sources grew more than 10 times in the last 20 years. This growth is comparable with the growth in the direct taxes revenue; the collection of direct taxes of 14 billion BDT in FY 1991-92 soared to an amount of 174 billion BDT in FY 2009-2010 (NBR 2011). Table 4.3 shows a break-down of different indirect taxes from the local level.

**Table 4.3 Domestic consumption taxes revenue in FY 2009-2010**

Tax	Sector	Collection method	Revenue in million BDT	% of local indirect taxes
VAT	Goods manufacturing		56475.2	25.96
	Services	Withheld	24611.8	11.30
		Normal	41552.3	19.09
	Trade VAT	Advance VAT at import stage	11913.1	5.48
		Normal	3615.7	1.67
Turnover Tax			46.7	.02
Sub-total VAT			138214.8	
SD	Goods		65118.8	29.92
	Services		10814.6	4.96
Sub-total SD			75933.4	
Excise Duty			3474.9	1.60
Total			217623.1	100

Source: NBR (2011)

The overall pattern of revenue concentration, more specifically, the pattern of the VAT revenue in developing countries generally coming from imports and a few enterprises (Casanegra de Jantscher 1990) is validated in Bangladesh. Local consumption tax revenue from three taxes – VAT, SD and Excise duty – is concentrated on a handful of items. The amount of VAT paid by the top ten enterprises constitutes more than 60% of the VAT revenue for FY 2009-10.

Cigarettes and mobile phone services respectively accounted for 29.25% and 16.30% of the total collection. Tax deduction at source (withholding and advance VAT) ensured 16.78% of the total local consumption taxes revenue.<sup>67</sup> The remaining chunk of the total collection was based on what is popularly known inside the VAT department as ‘effort.’ To consider the organizational contribution, the VAT LTU alone accounted for 62.06% of the total revenue. It is evident from the above figures that despite rolling VAT to the retail level throughout the country, the trade VAT is yet to emerge as a significant source.

The revenue performance of VAT in Bangladesh can be seen through three performance measures – the VAT efficiency ratio,<sup>68</sup> the C-efficiency ratio<sup>69</sup> and the VAT Gap<sup>70</sup> (Ebrill, Keen et al. 2001). According to the IMF, the average worldwide VAT efficiency ratio is 34%. The average VAT efficiency ratio for Bangladesh is 15.92 % (Smith, Islam et al. 2011). A uniform tax on all consumption has a 100% C-efficiency ratio, whereas the average C-efficiency ratio for Bangladesh is 24.42%. The same researchers have estimated a VAT gap of 492b BDT in FY 2009 (ibid, 2011).

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<sup>67</sup> This can be compared with some other countries’ scenario; In Tanzania, for instance, 286 large firms contribute 70% of the total tax take; in Rwanda, 80% of total taxes are collected from 13 large companies (OECD 2008).

<sup>68</sup> The VAT efficiency ratio is the proportion of VAT to GDP divided by the standard VAT rate. It indicates the percentage of GDP collected by each percentage point of the standard VAT rate. In general, higher ratios indicate better the performance of the VAT

<sup>69</sup> The C-efficiency ratio measures VAT in terms of consumption and is calculated by taking the proportion of VAT as a share of consumption divided by the standard VAT rate. This statistic is a more reliable measure of VAT performance than the VAT efficiency ratio as it is based on consumption rather than GDP

<sup>70</sup> The ‘VAT gap’ is defined as the difference between the VAT actually collected and that potentially realizable if all consumption was taxed at the stated rate

### 4.3.1 Cost of collection of VAT

According to the NBR statistics, the cost of collection<sup>71</sup> of direct taxes as a percentage of revenue was 0.52 and that of indirect taxes (CD, VAT, SD, excise duty and TT) was 1.21 in 2009-2010 (NBR 2011). But, as Shome (2006) mentions with reference to the cost of collection of revenue in Thailand, Australia, Singapore, Hong Kong, India and the Philippines, the cost of collection for customs and VAT is much lower than that of direct taxes. In India collection cost as a percentage of customs and excise is about 0.86 while that of the income tax is near 1. This pattern however does not fit well in the case of Bangladesh. The high additional cost of pre-shipment inspection fee for customs duty and stamp and banderole for VAT over and above the regular administrative cost<sup>72</sup> (NBR 2011) accounts for the higher cost of collection for indirect taxes in Bangladesh.

## 4.4 Conclusion

The foregoing discussion clearly shows that spanning more than 20 years of its introduction, the Bangladesh VAT has undergone an extensive process of adaptations. This fact clearly validates the observation that many developing countries find the VAT more difficult to administer than initially thought (Bernardi, Fumagalli et al. 2005) and, hence, much adaptation has to be undertaken to grapple with the problems of administration and enforcement. The design features with all adaptations have not only affected the coherence of a standard VAT but also undermined the principles of good taxation.

In the next three chapters we will look into specific aspects of participation, transparency and accountability in the policy and practice of VAT in Bangladesh, and then will analyze in Chapter 8 the extent to what the design features and administration of VAT in Bangladesh fit in the good governance paradigm.

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<sup>71</sup> This is in fact only administrative cost; the other cost – compliance cost – incurred both by taxpayers themselves and the third parties such as withholding authorities also needs to be considered as this cost increases with the complexity of a tax system.

<sup>72</sup> Pre-shipment inspection for customs, and stamp and banderole for VAT cost 5,394m BDT and 939m BDT respectively in FY 2009-2010, while the regular administrative cost of indirect taxes was 1061m BDT.

# CHAPTER 5

## PARTICIPATION IN VAT: POLICY, PRACTICE AND PERCEPTIONS

What is the greatest thing in this world, I tell you; it is people, it is people, it is people.

- A Maori proverb (Commonwealth Foundation 1999)

### Introduction

We have already noted that political inclusion, or in other words, participation, has emerged as the one of the core principles for good governance in any society. Since the 1990s the concept of participation has featured extensively in the discourse of development, with participation being mainstreamed as a prerequisite for development. The concept of participation has also been tied with the rights of citizenship and with democratic governance (Gaventa 2004). Despite skepticism<sup>73</sup> about whether participation is able to ‘liv[e] up to the promise of empowerment and transformative development for marginal people’ (Hickey and Mohan 2004:3), experiences throughout the world suggest that participation has actually deepened and extended its role in development (Hickey and Mohan 2004).

With this understanding in mind, this chapter first briefly reviews the concept of participation in development in general and in taxation in particular. It also focuses attention on the participatory process of revenue administration in developed countries. The second section of the chapter will present the policy and practices of participation in the arena of the Bangladesh VAT. The third section will present field data pertaining to the perception of participation among the stakeholders in the Bangladesh VAT. A brief conclusion will be presented at the end.

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<sup>73</sup> For example, this skepticism is marked in the title of the book *Participation: The New Tyranny?* (Cooke and Kothari 2001).

## 5.1 The concept of participation

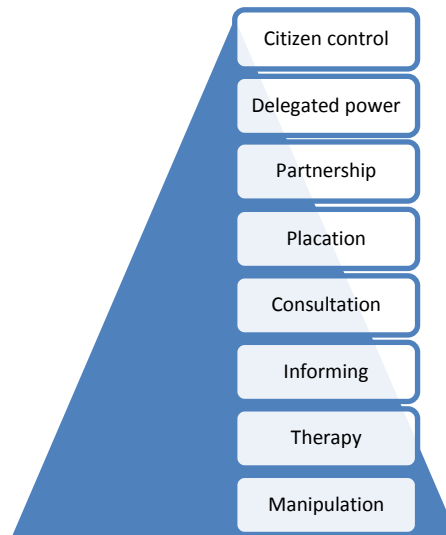
The concept of participation in decision-making has come into being as a response to a number of factors. A brief chronology of the evolution of changes in the public sector would reveal that in the middle of the 20<sup>th</sup> century, public sector departments were rigid, hierarchical organizations, designed to undertake predictable tasks under prescribed rules. The rigidity of this form of governance and the dominance of the state, however, was seen as inefficient and stifling, and in the 1980s and 1990s ultimately gave way to a new ‘market approach’ to government, characterized by privatization, decentralization and deregulation (Loughlin 2004). The market (or neo-liberal) approach to governance was also not without its problems, with a heavy focus on core business and the individual, often at the expense of community. Following this, emerged the ‘network’ (or ‘Third-way’) approaches to governance which emphasize the need to work collaboratively across agencies and with private and non-government organizations, to find a new balance between the state and market approaches of the past, while also incorporating a focus on community (Briggs 2009). Networks are seen as agile, easy to organize, and adaptable in their use to various purposes and timeframes (Bourgon 2008). As we consider the principles of the enabling state, a currency that became popular during the 1990s mainly in the UK, communities, not bureaucracies, have assumed a central role in defining, delivering and managing appropriate forms of social action; and the role of the bureaucracies has changed from being masters to servants of communities (Botsman and Latham 2001).

While there is a great deal of debate on the nature of participation and on what actually constitutes a ‘genuine’ participation and its efficacy, the development discourses generally see the participatory process as an empowering tool and as a means for social solidarity and self-confidence (DeWit 2000). The participatory process of decision-making reinforces two main thrusts of the neo-liberal agenda – the promotion of good governance and shrinking of the state, and the expansion of private sector activity to the public domain (Maclure 2000). The seminal theoretical work on the subject of community participation by Arnstein ((1969) 2011), marked a new insight into the understanding of the concept of participation that challenged its conventional meaning. While the aspect of participation in any democratic

society has been reinforced in scholarly discourses as a precondition for citizens' empowerment in particular and good governance in general, the quality of participation has been seriously considered. Many scholars, for example, Arnstein, raise questions about the effectiveness of common peoples' participation in a stratified society where the opinion of the power holders prevails in the end and participation becomes more a sham than a tool for empowerment.

Arnstein (1969/2011) describes participation as the means by which citizens can induce significant social reform which enables them to share the benefits of the affluent society. She devises a typology of eight levels in a ladder of citizen participation to explain the power structures in society and how they interact. Referring to a French poster which reads in English 'I participate, you participate, he participates, we participate, you participate...they profit,' Arnstein maintains that participation without redistribution of power is an empty and frustrating process for the powerless. Participation in that scenario turns out to be an 'empty ritual' that allows the powerful to claim that all sides were considered, but at the end benefit goes to a few in the rank and file. Arnstein's ladder of participation comprises the following rungs from lower to higher level of participation: Manipulation, Therapy, Informing, Consultation, Placation, Partnership, Delegated power and Citizen Control, as depicted in Figure 5.1.

**Figure 5.1 Arnstein's ladder of participation**



Source: Adapted from Arnstein (1969)

While partnership and delegated power culminating in citizen control form the core participation in the truest sense of the term, informing, consultation and placation are means of tokenistic participation, and manipulation and therapy are not participation at all. Thus, views about the imperative for citizen participation are as convergent as those about the policy makers' intention of making participation effective are divergent.

The aspect of citizen's participation in governance, which has been aptly described by the Commonwealth Foundation (1999) as 'humanizing the process of governance,' does not require much elucidation in an era when people in general have become more concerned and conscious about their role in governance than ever before. With the growing concerns about good governance and state responsiveness, questions about how citizens engage and make demands on the state come to the forefront.

### **5.1.1 Participation in taxation**

Participation in taxation in essence is participation in a public policy. The eulogy, or 'heroic claims' as Cleaver (2001) terms it, that we have for the participation of stakeholders in influencing government policy stems from more recent concepts. According to the Commonwealth Foundation (1999:8), participatory democracy and responsive government are mutually reinforcing and supportive: 'strong, aware, responsible, active and engaged citizens along with strong, caring, inclusive, listening, open and responsive democratic governments.' The Foundation suggests the promotion and facilitation of the participation of citizens in governance as one of the few decisive and effective actions required for realizing citizens' dreams of a good society:

In the formulation of policies and programmes, in evolving solutions to problems and devising strategies for a good society, governments need to reach out to their citizens. Strategies, systems and structures to share information, open public arenas for consultation and enable citizens to participate need to be put in place. (Commonwealth Foundation 1999: 86)

It is traditionally assumed in representative democracies that citizens' preferences are voiced by elected representatives and so it is the responsibility of those representatives to make policy and to hold the state accountable (Gaventa, 2004). But instead of this kind of passive participation or representation, more active and direct participation – new voice mechanisms – has been explored by development scholars and development institutions throughout the world. For example, the Commonwealth Foundation (1999) advocates connection between the state and the citizen on the basis of participation and inclusion rather than on the basis of traditional modes of representation, intermediaries and political party members and structures. Participation has been seen both as a right and a need.

As regards the role of stakeholders in public policy reform, the complexity of an issue or the cost, uncertainty, and delay often associated with public involvement prompt many decision-makers to avoid a broader civic participation (Walters,



Aydelotte et al. 2000). According to a World Bank report (World Bank 2009:10), ‘most of [participation] literature, rooted solidly in public choice theories of public policy, focuses on stakeholders as inherent *constraints* to reform.’ But this attitude towards involving stakeholders in reform has undergone significant change in recent times. Recognising that stakeholders are driven by self-interest, reformers need to engage stakeholders and create new forms of competition among them in order to accelerate change. Participation has not only been seen as resulting in better public policy and better public policy implementation but also as leading to better public decisions by increasing vertical, or social, accountability (Folscher 2007).

If the complexity or the specialist nature of a public policy is any determinant of the extent to which citizens can participate in policy formulation, then, taxation appears not to a very favourable issue. But if we consider the conceptual framework in which taxation binds the citizens in a social contract or revenue bargain, civic participation in the formulation of tax policy and its implementation will not only look pragmatic but also essential. This is more so in the case of tax issues in a developing country where taxation can be called what Walters, Aydelotte et al. (2000) term an ‘ill- structured’ issue that demands the greatest room for public involvement.

The 18<sup>th</sup> century American politician James Otis’s widely quoted slogan ‘taxation without representation is tyranny’ underlines the importance of participation in taxation.<sup>74</sup> Though the classical economist Adam Smith did not specifically spell out people’s participation as one of the canons of good taxation, the humanizing element that participation entails, is very much present there, especially in his maxim for good taxation ‘to be certain, and not arbitrary’ (Smith 1776/2007). Not being arbitrary not only necessitates justice, but also the involvement of the parties concerned. As has already been noted in the literature review, taxation itself is a matter of participation – voluntarily or involuntarily – by citizens in state-building. The role of many governments confronted with resource constraints is shrinking

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<sup>74</sup> A converse proposition like No Representation without Taxation can also be advanced as we have seen in our literature review that some researchers have produced empirical data that rentier countries such as Middle Eastern countries which depend more on their own natural resources than on taxation tend to have fewer democratic rights for their citizens.

while the role of civil society and the market is growing. In this scenario, according to the Commonwealth Foundation, ‘the more the government shrinks in the eyes of citizens, the more they lose their legitimacy’ (1999:20). The Foundation therefore suggests that by listening to citizens, governments may be able to secure greater understanding and cooperation of their citizens to mobilize the resources – human as well as financial:

At the heart of the new consensus of strong state and strong civil society are participatory democracy and responsive government. Responsive government implies the full and continuing participation of citizens in the affairs of government. When this is the case, governance emerges from government. Citizens’ participation in public affairs, in debating and discussing policies and options, in deliberating decisions and choices must be part of the essence of democratic governance, at community, national and international levels. (Commonwealth Foundation 1999:76)

As noted earlier, paying taxes is an important demonstration of participation by the citizens in the building of a nation. But when this participation becomes spontaneous rather than coercive, as taxation may sometimes imply, it becomes rewarding both for the state and its citizen.

Along with participation goes community responsiveness which has started to resonate through tax literature in recent times more vigorously than ever before (Laserberg 2003). Community responsiveness – defined as ‘the evaluation that individuals or groups make of the tax authority in their community, as well as the actions that taxpayers take in response to the expectations of this authority’ (Braithwaite 2003:16) – can be channeled towards a positive dimension when it is tinged with a participatory approach. Motivational postures<sup>75</sup> such as commitment or disengagement indicate the extent to which an individual consents to the tax authority to be a participant in the tax system.

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<sup>75</sup> Braithwaite has devised five motivational postures – commitment, capitulation, resistance, game playing and disengagement which, she argues, reflect the social distance that taxpayers intend to place between themselves and the tax authority. See Braithwaite (2003:34-35).

That participation is highly valued as a tool for an effective and efficient tax administration is evident in many developed countries. We can think of examples<sup>76</sup> of revenue administrations in developed countries which rank high in the index of good governance (see Box 5.1). The revenue administration facilitates public participation through a number of ways, such as update seminars, distribution of draft revenue rules for soliciting opinion, maintenance and analysis of statistical information relating to people's telephone calls to an MP and the like.

### **Box 5.1 Participation in taxation in other countries: examples**

In tax administrations in many developed countries, consultation with stakeholders has been given utmost importance because of its potential to contribute to effective and efficient tax system. According to 'The Green Paper on the future of VAT' launched by the European Commission in 2010, in reply to a question 'what should be done to improve the legislative process, its transparency and the role of stakeholders in the process, from the initial phase (drafting the proposal) to the final phase (national implementation)?', the vast majority of respondents asked for enhanced stakeholder consultation covering the entire legislative process. The need for the stakeholder input as essential at all stages of the process in order to arrive at understandable and workable rules was particularly emphasized. Some respondents wanted the consultation process to be mandatory while many respondents requested a formalized role for stakeholders from the business community (European Commission 2010). The realization in a developed economy that 'as tax systems are adjusted, the community needs to be educated, persuaded and encouraged to cooperate, long after the vote is cast at the ballot box' (ATO 2005) seems quite relevant to the tax systems in developing countries as well. Stakeholders' contribution to reforming tax systems in many developed countries is well documented. For example, Brown (1999) has shown how in 1998 the Australian Government took stakeholders in its confidence with the slogan 'no new tax but new tax system' when it introduced and finally successfully established the GST.

Having sketched a brief outline of the concept of participation in taxation, in the following discussion, I will attempt to explore, in the context of Bangladesh VAT arena, the answers to the seminal questions of participation: who participates, why they participate and how they participate?

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<sup>76</sup> The Office of State Revenue in New South Wales, Australia, claims (OSR 2012) to consult with clients and the public on decisions concerning taxation administration, management policies and recommendations about future tax directions. Participation of the stakeholders is ensured through Liaison Committee meetings with top professional and industry bodies such as Association of Property Conveyancers, Australian Society of Certified Practising Accountants, Chartered Secretaries of Australia, Housing Industry Association, Institute of Chartered Accountants, NSW Chamber of Commerce, Law Society of NSW, Taxation Institute of Australia, Real Estate Institute of NSW, etc. In addition, a Customer Council works to advise on the quality of service provided to clients of the Sydney office. Customer representatives are members of the Council and are appointed for two years with half retiring each year.

## **5.2 Approaches to participation in VAT in Bangladesh: policy perspective**

In this section I explore and analyze different aspects of participation in the arena of Bangladesh VAT. To begin with, I will show the state of participation as reported in the official documents related to VAT on the basis of a documentary analysis of the budget speeches of Finance Ministers from 1991 onwards, the NBR strategy paper and the VAT legislation and orders made under it.

### **5.2.1 Budget speeches**

So far as a budget is a financial statement of how revenue will be earned and expenditure made, it invariably focuses on a government's tax policy and implementation strategies. So the budget process naturally provides an opportunity of citizen participation. It is evident that budget processes gave the Finance Ministers an opportunity of making the so-called participatory approach a point in their budget speeches. A review of the budget speeches of Finance Ministers and Finance Advisers in different regimes since 1991 shows that almost all Finance Ministers attached importance to the aspect of participation of the stakeholders in the formulation of tax policy and its effective implementation. Many categorically claimed to have consulted with the stakeholders in preparing tax proposals. For example, the Finance Minister of the Bangladesh Nationalist Party (BNP) regime in 2005, while presenting the tax proposals, claimed that the basis of all their proposals was the poverty reduction strategy paper, which he claimed to have been formulated with the active participation of people from all walks of life (Government of Bangladesh 2005b). A similar claim was made by the Finance Adviser to the Caretaker Government in 2007 when he specified:

While preparing this budget, I have exchanged views with the economists, researchers, members of the civil society, media personalities and business leaders. During my visit to Khulna and Rajshahi as part of this process, I have heard the views of the local elites and intelligentsia. ... We have used all these inputs while formulating budget. (Government of Bangladesh 2007)

The same Finance Adviser referred to the NBR's two-month long pre-budget dialogue with the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), the apex body of the business people of the country, and other stakeholders representing nearly every sector in his budget speech as 'public-private partnership' in formulating the fiscal proposals of the following year, which he described as 'a new dimension' (Government of Bangladesh 2008).<sup>77</sup> The successive Finance Minister of the Awami League (AL) regime in 2009 also mentioned consulting with the stakeholders in preparing the budget proposals (Government of Bangladesh 2009). He, however, elaborated more about the public-private partnership in investment in infrastructure development than about public-private partnership in addressing tax issues. But all in all, the claims of having a participatory approach to tax policy formulation point to the importance that the state attaches to participation of the stakeholders in public policy.

### **5.2.2 NBR strategy paper**

In 2011, the NBR published a strategy paper entitled 'Outline of Modernization Plan 2011-2016' along with other budget documents. While this document admits that there is little in the nature of taxpayer service and education and designates strategic communication with stakeholders as 'extremely important' to obtain their support for tax reforms, there is no specific mention of involving stakeholders in its long list of strategies to modernize the tax system (NBR 2011b). The strategy paper, however, has been described as an outcome of a couple of workshops involving the senior NBR officials.

### **5.2.3 VAT legislation and orders**

The Constitution of Bangladesh stipulates that 'No tax shall be levied or collected except by or under the authority of an Act of Parliament.' This implies the formulation of tax policies through delegated representation in the parliament. But active and direct participation of citizens rather than delegated participation in

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<sup>77</sup> Though the scenario of having pre-budget discussions with stakeholders was not new, as evidenced in many of the previous year's budget speeches, the Finance Adviser's detailed disclosure of the participatory process is worth noting. He mentioned that he himself had held a series of pre-budget discussions with 'renowned economists, representatives of the civil society and media, major trade bodies, research organizations and visited six divisional towns to hold discussions with chamber leaders, academics and others representing various segments of the society.' He claimed that the discussions had been extremely beneficial as a large number of valuable suggestions were offered in these meetings (Government of Bangladesh 2008).

policy formulation is seriously absent both in the Constitution and the concerned legislations. In the VAT Act and Rules, there is no provision that requires citizens' participation in the formulation of policy or its implementation. Participation, without any qualification being attached to it, however, takes place primarily in the forms of a consultative committee and the participatory system of fixing VAT. Another more recent addition to the participatory dimension of decision-making is the introduction of alternative dispute resolution.

### **5.2.3.1 Consultative committee**

The NBR has formed a consultative committee through its executive order for obtaining suggestions, recommendations and proposals on tax issues. The committee comprises the key stakeholders such as FBCCI, all the Chambers of Commerce and Industry in different districts, sectoral business associations such as Steel Re-rolling Mills Association, Bangladesh, Bangladesh Textile Mills Association, *Dokan Malik Samity*, Bangladesh Computer Samity, and professional associations such as the Institute of Chartered Accountants, the Federation of Customs Clearing and Forwarding Associations. Usually, prior to the announcement of the budget each year, different wings of NBR send out letters to the business bodies inviting their proposals on different tax issues.<sup>78</sup> The members are requested to send in their 'well thought' proposals and recommendations in a given format on the VAT Act, 1991, VAT Rules 1991 and statutory orders, rules and notifications made thereunder and on the Excises and Salt Act, 1944.

The operation of the different tax wings of NBR in preparing budget proposals by engaging in dialogue with the key stakeholders has been described by an ex-member of NBR in his newspaper article (Shahabuddin 2009).<sup>79</sup> Discussion with NBR officials reveals that inviting proposals for inclusion in the budget proposal from a large number of representative business and professional bodies on the eve

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<sup>78</sup> In the absence of any written published document outlining the modus operandi of the consultative committee, the relevant information has been gathered through discussion with the NBR officials and other consultative committee members.

<sup>79</sup> According to Shahabuddin (2009), 'Budget and policy units work throughout the year and especially from the beginning of the latter half of the fiscal year. They exchange views with experts, academicians, various technical groups and with the stakeholders, e.g. chambers of commerce and industries. They enumerate and outline the popular expectations for the ensuing budget which includes non-tax proposals, such as simplification of laws and procedures, increase of transparency, reduction of compliance cost etc., along with tax-related proposals with a view to enhancing facilitation of trade, protection of local industries, reduction of the tax-burden on less fortunate people, the creation of employment opportunities, increase of foreign investment, etc.'

of the nation budget has been a long-standing practice. NBR receive several hundred proposals in writing from different business bodies. Prior to finalizing the tax proposals, the NBR officials sit with different groups to discuss the proposals at length. The Finance Minister takes part in the meeting of the consultative committee.

Business bodies and associations seem to respond to the NBR's request to sending in their budget proposals quite enthusiastically. Officials concerned informed me that the response to the NBR request had always been very enthusiastic as most of the members of the committee sent in their proposals on the different aspects of tax issues. In this respect, a business leader opined that their chamber never missed an opportunity of raising its voice for safeguarding the interest of their members.

We take the NBR's invitation of budget proposals quite seriously. We have three sub-committees for three taxes – customs, VAT and income tax, each headed by an expert or at least a knowledgeable person in the particular field. Sometimes we hire professional persons such as a chartered accountant or an income tax practitioner or a VAT consultant to help us prepare our proposals. Once the proposals are prepared, they are put before the executive committee for their approval before they are sent to NBR. (VBI 1)

This observation seems representative as many other respondents also mentioned their enthusiasm in participation. Because, besides giving the members an opportunity to safeguard their interests, the invitation to participate accords official recognition to the business bodies.

### **5.2.3.2 Participatory system of fixing VAT**

In 2004, the NBR formed committees at different territorial and functional jurisdictions to determine the amount of VAT to be paid by retail traders through a general order.<sup>80</sup> The jurisdictions are Central, Dhaka Metropolitan city, District/Local and Market. Committees at different territorial jurisdictions comprise

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<sup>80</sup> General order No 2/VAT/2005, date: 02/02/2005 issued by the VAT wing of NBR.

representatives both from the NBR and the business bodies, with the representatives from the business bodies outnumbering those from the NBR. For example, the Metropolitan city committee is composed of an additional commissioner, one representative each from FBCCI, DCCI and Bangladesh *Dokan Malik Samity* (Shop owners' Association), and a Deputy or Assistant Commissioner of VAT. Each of these committees is supposed to meet at least once a month. Terms of reference of the committees show that there is considerable overlap of responsibility. According to the general order, it appears that the responsibility of identifying registrable traders, determining the amount of VAT and motivating the taxpayers to pay rests on the local committee. Other committees have only supervisory and advisory roles. Business activities or collection of VAT with regard to small traders,<sup>81</sup> distributors, commercial importers, corporate businesses, wholesalers and 'all other big businesses' such as department stores, super shops, mega shops have been kept outside the purview of the terms and reference of the committees.

The participatory method of fixing VAT is targeted for the hard-to-tax segment of the taxpayers. Though this system contradicts standard VAT practices, it not only enables the VAT officers to reach the hard-to-reach taxpayers in a mutually beneficial way, but also contributes to fostering an enabling environment for clients to participate in the process of decision-making, however small or insignificant the domain may be. Apart from this, the system has not been very effective. It was reported in a print media in Bangladesh that the NBR's effort to collect VAT under the public-private partnership failed to make the businesses tax-compliant as only 12 per cent of the enlisted businesses responded so far (Financial Express 2009a). The report quoted an NBR official as saying that out of 140,000 business organizations enlisted under the 'package system, only 17,879 organizations paid VAT by December 2008. While a VAT official alleged the misuse of the package system by big businesses by hiding their actual turnover, the report mentioned the counter-allegation by a business leader that VAT officials' interference in the market committee's affairs adversely affected the whole system.

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<sup>81</sup> The term 'small traders', however has not been defined or explained in the VAT legislation or in any rules or orders made under it.



### 5.2.3.3 Alternative Dispute Resolution

In accordance with the promise of the Finance Minister in his budget speech of 2011-12, NBR introduced an Alternative Dispute Resolution (ADR) process with effect from March 1, 2012 for two pilot VAT offices and from July 1, 2012 for all VAT offices. The main objective of the ADR is to speed up realization of duty and taxes worth billions of money, blocked with about 22,000 cases pending in courts (Financial Express 2012b). Drawing on participatory management, ADR is expected to resolve income tax, VAT and customs-related disputes between taxmen and taxpayers through the out-of-the-court system. In the ADR process, the key role will be played by a facilitator from a panel of facilitators selected by the government from business people and retired tax officials. The facilitator facilitates a dialogue between the taxmen and taxpayers to resolve tax-related disputes. The relevant rules<sup>82</sup> (NBR 2012a) have vested in NBR the power to select, in consultation with the apex business representative body, the FBCCI, a panel of facilitators from business people as well as from retired civil servants having certain expertise in VAT. Although the extent that the ADR is being effective in motivating taxpayers to resolve outstanding disputes is yet to be ascertained,<sup>83</sup> the participatory management approach undertaken by the NBR merits applause. What is particularly notable in NBR's initiative to resolve long-standing tax related disputes through out-of-the-court procedure is the consultation with a key stakeholder – the FBCCI – in selecting facilitators for ADR. This is a new paradigm in the typical bureaucratic culture where the 'all-knowing' public officials hardly share their authority with the outside stakeholders. This can be seen as an egalitarian attitude demonstrated by the otherwise elitist bureaucrats.

The documentary analysis shows that despite having no legal obligation to involve the stakeholders in the formulation and implementation of tax policies, the tax authority appears to have comprehended the power of citizens', more particularly stakeholders', active and direct participation in formulating an effective contract

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<sup>82</sup> “*Mulya Songzojan Kar (Bikolpo Birodh Nispotti) Bidhimala, 2012* [Value-Added Tax (Alternative Dispute Resolution) Rules, 2012] (NBR 2012) .

<sup>83</sup> In a newspaper article, one NBR official mentioned in June 2012 that though ADR mechanism started from March 1, 2012 at two VAT Commissionerates, a satisfactory number of disputes had not been settled under ADR so far. He assumed that adequate response would be obtained with the roll out of the ADR to all VAT Commissionerates (Rouf 2012).

between the state and the taxpayers. This leads to understanding the actors and process of participation in a public policy like that of taxation. This partnership has been understood to be seminal in making the tax system more effective and efficient.

### **5.3 Participation in practice: stakeholders' perceptions**

Data gathered from different segments of respondents through interviews and FGD can be summarized as forming the following themes which are elaborated in the subsections below:

- Attitudes towards citizen participation
- Processes and actors of participation
- Purposes for participation
- Effectiveness of participation
- Capacity to participate

#### **5.3.1 Attitudes towards citizen participation**

Interviews with NBR officials working both at the policy and implementation levels reveal that there is a growing awareness about the importance of participation among the policy makers. This awareness is in line with the ministerial reassurances that we have noticed in budget speeches. In contrast, this awareness was not present during the excise regime that administrated the indirect taxation system until the introduction of VAT in 1991. This aspect of growing awareness about citizen participation in tax matters would be better understood if we set the current scenario against the past practices. According to some policy makers, even during the introductory phase of VAT, attitudes towards a participatory process were not encouraging. One respondent (VPI 3) belonging to the tax official category remarked that the introduction of a VAT in different countries was preceded by elaborate preparation, not only in the form of equipping the tax administration but also in preparing the taxpayers for the imminent reforms. But in the case of

Bangladesh, VAT was introduced almost without any preparation and, more specifically, without the involvement of stakeholders. In his own words:

...though the prospect of introducing a VAT by replacing the existing consumption was first mentioned in his budget speech in 1982 by the present Finance Minister in his capacity as the Finance Minister of that regime, no tangible follow-up actions were pursued, and VAT was introduced in 1991 almost abruptly, without allowing enough time for the people to get themselves acquainted with it. (VPI 3)

The same notion was voiced by a business leader. He alleged that the VAT system was imposed on them all on a sudden.

I clearly recall that there were a few meetings with different Chambers in different districts. But of the kind of massive campaign and involvement of stakeholders that the introduction of a new tax system requires, there was no such thing. After the enactment of VAT law, there was hectic lobbying by the field level VAT officers to persuade the business people to accept it. (VBI 2)

After the initial indifference towards participation, awareness about the importance of participation in making a tax system effective and efficient began to grow noticeably. Most of the NBR officials mentioned the consultative committee meetings and participatory system of VAT collection as the major manifestation of a participatory approach. An NBR official, who worked as First Secretary in the NBR for a few years and was now a Commissioner in a field office, claimed in an in-depth interview that the VAT wing of NBR was the pioneer in involving stakeholders in the formulation of VAT policies and their implementation. He cited the example of the participatory system of fixing VAT for small business which was first introduced in 1996 and was mentioned in the Finance Minister's budget speech as a participatory system of taxation. In his own words:

In an administrative culture which is predominantly characterized by a top-down decision-making policy, and stakeholders have hardly anything to do but accept what is decided behind the closed doors, involving taxpayers and their elected representatives in determining their tax liability in a mutually acceptable manner is a big step towards fair taxation. (VPI 2)

This respondent also admitted that the participatory process at the initial stage of VAT was inadequate.

In the absence of a bottom-up decision-making process in the administrative culture of Bangladesh, as noted by the previous respondent (VPI 2), all are not equally convinced about the efficacy of a participatory process of decision-making. This may remind us of the traditional bureaucratic approach to participation which used to see it as ‘time consuming, expensive, complicated, and emotionally draining’ (Creighton 1981 cited in Walters, Aydelotte et al. 2000:350). But the importance of the participation of the stakeholders in formulating tax policy as well as its implementation is gaining momentum with the passage of time. However, as one respondent (VPI1) at the policy level of the NBR in an in-depth interview divulged, there are some challenges in participatory approaches. To quote him:

When the question of making the new VAT law came up, I said to the (NBR) Chairman, and to the IMF, and to the World Bank, ‘...before finalizing, please involve the stakeholders, because they run the economy, because at the end of the day, they will have to comply with the law. You are making this law for this people, for this country, for this economy, so if you forget the realities of the economy, if you forget the stakeholders who are involved, if you make a law keeping them outside, then ultimately you will be making a law like sitting in Rawalpindi. I am fighting with my administration, with the IMF, and in presence of the high powered IMF team that came from Washington I said that stakeholders are to be consulted. IMF said you don’t have to consult the stakeholders, *if you*

*consult the stakeholders, the things will be at stake* (emphasis attached).  
(VPII)

The above response from a policy maker is indicative of two aspects in particular. The first is the decision-makers' changing attitude towards participation in public policy. This respondent claimed that on his and some of his other colleagues' repeated insistence the NBR high-ups conceded to a participatory approach in drafting the new VAT law and 'Now the stakeholders are being consulted, both inside organization and outside organization.' He elaborated on the aspect of participation in making the new draft law by saying that a committee had been formed with a Commissioner as its head and that the committee was holding discussions on with different segments of stakeholders. He and some other respondents in the same category referred to the consultation meeting with Dhaka Chamber of Commerce and Industry (DCCI) in December 10, 2011. This consultation meeting was arranged jointly by NBR and Policy Research Institute, an outsourcing consultation firm appointed by the IMF to redraft the VAT law. Attended among others by the NBR Chairman and DCCI officials, the meeting discussed various aspects of the new draft and solicited DCCI opinion on them.<sup>84</sup>

The second point VPII makes is that there is the discrepancy between myth and reality. As opposed to the conventional belief that the good governance agenda such as the participatory approach and empowerment are taken by developing countries as conditionalities set by donor agencies, VPII revealed that the IMF was not interested in involving stakeholders in re-drafting the VAT law.<sup>85</sup> The inherent fear associated with citizen participation in public policy seems to typify the attitude of many organizations otherwise reputed for their advocacy for good governance.

### **5.3.2 Processes and actors of participation**

Once the imperative for citizen participation is recognized both by decision-makers and the other stakeholders, the questions arise as to who the actors are and what the

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<sup>84</sup> The consultation meeting was widely reported in the print and electronic media in Bangladesh. For example, the *Daily Star* quoted Mr. Asif Ibrahim, president of the Dhaka Chamber of Commerce and Industry (DCCI) as saying, 'It is really a praiseworthy step to create a taxpayer friendly environment' (*Daily Star* 2011).

<sup>85</sup> CPD (2006), on the other hand, mentions in its review of the PRSP that the participatory approach for formulating the poverty reduction strategies was undertaken at the behest of donor agencies.

processes are of that participation. As we have already noted, the main space in VAT regime where participation took place was through consultative committee meetings with the representative business bodies and retail traders associations when fixing the amount of retail VAT.

The opportunity for sending in their written proposals to the NBR and also for attending consultative committee meetings was seen by many respondents belonging to the business segment as an important development. The VAT policy makers' claim of attaching utmost importance to stakeholders' participation in the decision-making in Bangladesh VAT has been confirmed by a number of respondents belonging to other segments. A respondent (VEI1) who was an academician with a keen interest in VAT matters validated the NBR officials' claim that the NBR has developed a system of meeting business people through their representative elected bodies.

Apart from these two formal platforms, consultation with VAT-payers or their associations took place in various other informal forms. According to a VAT commissioner,

We invite a particular segment of taxpayers, for example, cement manufacturers for discussion on topical issues. On the other hand, whenever, any business association or group wants to discuss any issue with us we welcome them. (VPI 5)

Stakeholders' participation at the micro-level can be further recognised by examining the perceptions of the VAT-paying businesses, as shown in Table 5.1 below. In reply to the question if they had ever participated in any workshop, seminar or meeting for taxpayer's education organized by VAT department, only 22% of the respondents said that they had taken part in any such activity, while 78% answered in the negative. Of those saying No to the question, 67% said that no such activity was organized by VAT department, 14% said that they were invited but did not attend as they were not interested,

**Table 5.1 Reasons for not participating in workshops, seminars and meetings (N=86)**

Responses	Number of respondents	Percentage of respondents
No such thing was organized in your location	58	67
Even if organized, you were never invited	13	15
You were invited, but you were not interested	12	14
You attended by a proxy	03	4
Total	86	100

Source: Field survey and own computation

In reply to the question if they had ever been asked by the VAT office to give their opinion about any VAT matter formally in a meeting or seminar or workshop etc., 85% of the respondents answered in the negative while only 15% said ‘yes,’ as shown in Table 5.2).

**Table 5.2 Invitation to give opinion (N=110)**

Responses	Number of respondents	Percentage of respondents
Yes	17	15
NO	93	85
Total	110	100

Source: Field survey and own computation

Notably, most of the respondents (82%) revealed that their elected trade bodies did not seek their opinion on VAT matters in formulating the tax proposals that they put forward to NBR, especially prior to each year’s budget. A few respondents, however, pointed out that since the elected association had been given the mandate by the voters to work on their behalf, their opinion was not supposed to be solicited on each and every occasion.

Though the ultimate tax burden of VAT falls on the shoulder of the final consumer, VAT is a business tax which is collected and remitted to the government by businesses. As such, VAT officials both at policy and implementation levels have more frequent interactions with business people than with general consumers. In this respect a VAT official said:

Business people are the bridge between the consumers and the VAT authority. But unless consumers are aware about VAT, the system cannot be successful. For this reason, the VAT authority has developed awareness-building programmes through advertisements in print and electronic media. (VPI 5)

Though there was an attempt to broaden the space of participation by including as many stakeholders as possible, some respondents belonging to different segments thought that the members of the civil society who were vocal on different socio-political issues in Bangladesh seemed to be quite indifferent to tax issues. They had neither been invited by NBR to take part in consultation, nor had they been reported as claiming a role in the consultative process. One participant in an FGD highlighted civil society's apparent apathy<sup>86</sup> towards tax issues. Quoting him at length will be relevant here:

You will see a lot of civil society bodies are raising their voices about so many issues – from big human rights issues like stopping custodial death by the law enforcers to small social issues like the stalking of female students at schools. Influential newspapers like *The Prothom Alo* organize round table discussions on host of issues – good governance, maternal health, acid throwing, and law and order situations. But none of them have ever raised their voice about tax policy in this country. Why? Because, they are interested in popular issues. Just as our people are not interested in tax issues, so the civil society people are not. Why are people not interested?

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<sup>86</sup> One Finance Minister mentioned 'the general aversion of the taxpayers as well as procedural complexities in paying taxes' as adversely affecting the tax revenue collection (Government of Bangladesh, 2007).



Because they don't care about it. They think they don't have to pay taxes, though they are always paying taxes indirectly, without knowing about it. (FGD 9)

But there were certain other views that contradicted the notion that the civil society members were indifferent to an all-encompassing issue such as taxation. A civil society activist presented her idea in the FGD this way:

NBR mainly holds discussion with business bodies as it thinks that they are the revenue gatherers for them. I do not think that NBR thinks that the civil society has a stake in taxation. There is no instance that a consumer association has been invited for any discussion. (FGD 8)

She lamented that the business leaders as business representatives were supposed to be responsive to the wishes of those they represent, but in reality things were not always like that. She said that that because of the conflict of interest, there were many occasions when the business representatives lost sight of the objectives of the people for whom they were acting, and instead, acted for their own gain.

Data show that NBR has crafted some formal space for participation in the form of a consultative committee. This is an invited space which is dominated by business groups rather than by citizens at large. If the number of stakeholders and their level of organization is significant in determining the participation mechanism (Walters, Aydelotte et al. 2000), then the businesses who are quite well organized and wield a great deal of influence in Bangladesh are in an advantageous position to claim broader participation in VAT decision-making.

In this regard, one policy maker respondent (VPI 3) claimed that new means were being adopted in order to ensure broader citizen participation in the tax collection procedures. He mentioned the web-based feedback system that NBR introduced recently. But the NBR attempt to carve new spaces for civic involvement through e-

participation was seriously criticized by a number of stakeholders. For example, one FGD participant remarked:

We are now talking about digital Bangladesh. But the way the VAT administration runs here shows that they lag at least 20 years behind. While the Customs Department has automated their assessment procedures our VAT Department could not enforce the use of Electronic Cash Registers (ECR) or computerize their return processing. The use of computerized maintenance of accounts is virtually discouraged. As regards e-participation through the internet, it is not more than rudimentary. (FGD1)

Though the NBR disseminated some information, such as different rules and orders, and tax forms, by posting them on its webpage, or, even, solicited public opinion on the draft new VAT Act posted there, the initiative is far from interactive. The global trend of turning to the internet in attempts to ‘revitalize democracy through online public consultation and citizen participation, referred to as e-democracy or ‘government 2.0,’ (Macnamara 2010) is virtually unknown in the Bangladesh context. The importance attached to the digitization of the revenue administration in the current PRSP (Government of Bangladesh 2011) is indicative of the prevailing shortcomings.

### **5.3.3 Purposes for participation**

One question posed to the respondents was what motivated participation in VAT matters. The responses were divergent. For the policy makers as well as the implementing officers, the participation of stakeholders was considered essential for the purpose of convincing them about certain aspects of VAT. In the words of a field level NBR official:

When we invite business people to a meeting or seminar, the first objective is to disseminate information. There are many things which cannot be communicated properly through written orders. On the other hand, face to face interaction with stakeholders dispels much confusion. Moreover, by this process, the stakeholders also feel honored. (VPI 4)

Some other respondents also held similar views about the objectives of participation by the stakeholders. One respondent mentioned that the participation of businesses or their representatives enabled the VAT officials to educate as well as persuade them.

We have many examples where what we could not achieve by sending many letters or making telephone calls, we achieved by inviting the respective group of businesses to a meeting. (FGD 7)

In the same discussion, another VAT official (FGD14) maintained that meeting with a group sometimes proved counterproductive as there was conflict of interest among the members of the group.

As noted earlier, the members of the NBR's consultative committee including the business bodies respond to its request for tax proposals quite enthusiastically. One business leader mentioned in an interview:

Business people elect us to voice their concern and safeguard their interest to the government. So any opportunity to participate in the government decision-making is welcome to us. We never miss the opportunity. But in the bureaucratic process of our country, the opportunities are very few. Despite this scarcity, given the opportunity, we have found our participation very useful. (VBI 5)

So, the motivation for participation for different set of actors in the gamut of Bangladesh is divergent in nature. The NBR's idea of the participation of stakeholders appears to be limited to the stages of information and consultation. This idea is reinforced as one NBR official remarked about the success of the participatory system of fixing VAT– 'It was not so much about earning revenue, but about getting people involved in the whole process of tax collection' (VPI 3).

The idea of participation as a means of involving stakeholders in the taxation process in the first place rather than as a means of contributing to the decision-making process was corroborated by a business leader (VBI 1). He termed the participatory system of fixing VAT as a good system which, he thought, gave at least some opportunity for laying down the ground realities to the VAT official and bargaining for a reasonable amount of VAT to be paid by small traders. A number of business leaders confirmed that their consultation with VAT offices was much more frequent than it was during the excise period. But this consultation, one respondent remarked, ‘was not so much to seek our suggestions on a particular matter as to convince us about certain matters that they have already decided. This includes how we can help achieve their revenue target, so on and so forth’ (VBI 2).

While the NBR officials tried to use participation as a tool for persuading taxpayers to achieve the official goals, stakeholders at the other end, namely, business people wanted to seize the opportunity of participation as a tool for social empowerment as well as for raising their voice for a particular cause. Most of the NBR officials tended to blame the business quarters for using the opportunity of participation for vested interest. In this respect, a VAT official (VPI 4) referred to the modernization programme of VAT undertaken by the NBR in collaboration with the World Bank. He said, ‘stakeholders will have to come forward to help modernize the system and they can definitely participate by giving us suggestions on how we can improve the system.’ He remarked that the response from the business community to the NBR’s modernization agenda was not encouraging. He cited the examples of the business community’s lack of interest in installing electronic cash registers (ECR) or computerizing their accounts and their resistance to re-drafting the VAT law. The criticism that many NBR officials made of the business people’s apparent lack of interest in the modernization of the tax system as well as in the transparency of the tax system through the use of a digital accounting system did not seem to be unfounded. It was widely reported in the Bangladesh print media that the business bodies, DCCI in particular, opposed the re-drafting of the VAT law, which, at the behest of IMF as a precondition for the disbursement of the Exogenous Shocks Facility (ESF) fund, was envisaged as eliminating all the anomalies in the existing VAT law (Financial Express 2012d).

### 5.3.4 Effectiveness of participation

Of all aspects of citizen participation – who participates, why they participate and how they participate – the most contested issue is the effectiveness of such participation. Most of the respondents, except for the VAT officials, generally viewed the current state of participation as mostly ineffective. The effectiveness however depends on how the purposes of participation are defined. For most VAT officers, participation was effective so long it enabled them to use it as tool for educating and persuading the taxpayers. On the other hand, considering the extent to which their proposals and opinions contributed to decision-making, the business people were seen to be somewhat dissatisfied with the level of effectiveness. A business leader- interviewee categorically stated:

If participation means ‘you invite me to some discussions, you deliver a lecture or make a presentation and I listen and may make some comments and recommendations and the session ends with some refreshment’, then, yes, participation is there. But if participation means taking our suggestions and transforming them into action, then there is no participation in the VAT arena in particular or in the tax policy area in general. (VBI 2)

Referring to the NBR’s request for proposals on the eve the annual budget, one participant (FGD 1) belonging to the business segment commented that it was more ‘an annual ritual than anything else.’ In the same discussion, one business leader remarked, ‘the frustrating thing is that other than the honour of being invited, you do not have enough motivation to participate as none of our proposals are accepted for implementation (FGD 10).’ Another business-community participant harped on the idea that in the existing system stakeholders do not have enough motivation for participation, ‘because, at the end of the day, it is the NBR officials or the donors who make the ultimate decision’ (FGD 5). This alleged lack of motivation aside, the fact is that NBR’s consultative committee meetings are well attended. Irrespective of the outcome of this kind of participation, many business leaders opined that participation was worthwhile.

Most of the NBR officials in the FGD however refuted the business representatives' allegation of lack of motivation for participation arising from the non-transformative impact of participation. A VAT official contested the argument by saying that it was not always true that suggestions of the business associations or other representative bodies were not accommodated in the tax policy. He cited a number of incidents, such as consultation with the Institute of Chartered Accountants for figuring out the methods of VAT collection from the chartered accountancy service. He was supported by a colleague who mentioned that most of the concessions and exemptions that were made in any budget proposal were based on the proposals received from the business communities. The official claim of the Finance Adviser to the Caretaker Government in his 2008 budget speech is worth noting: he specifically mentioned having a series of consultative meetings with different segments of the stakeholders and 'each one of the proposals was very carefully considered and (they) included only those in this budget proposal that turned out to be more pressing and realistic' (Government of Bangladesh 2008).

Most of the business segment respondents questioned the effectiveness of their participation in the decision-making process in VAT. Though stakeholders participated quite enthusiastically in a discussion or a meeting whenever the NBR or any of its offices organized one, they were not optimistic about the outcomes of their participation. As noted, this lack of effectiveness of participation was seen as demotivating for many stakeholders. This notion was also endorsed by a number of respondents who were NBR officials. A VAT commissioner who also worked in NBR as a First Secretary maintained that if by participation we meant informing people and seeking their suggestions or enabling them to put forward their proposals or recommendations with regard to VAT matters then it is 'sufficiently there.' 'But if the question arises of how much of their proposals and recommendations are accepted for implementation, then the scenario is not very optimistic' (VPI 2).

We can validate the finding by taking into account the perception of the VAT-paying businesses. As regards accommodating the business bodies' proposals in formulating tax policy, 65% of the respondents said their proposals were never

implemented and 21% said ‘very rarely,’ while 12% admitted their ignorance about the issue. Only 2% believed that proposals from the trade bodies were accommodated by the tax authority in devising tax policies. The notion of tokenistic participation expressed by a number of respondents was also corroborated by a newspaper article which observed that the proceedings of the discussion were not recorded, there was hardly any reflection of the proposals in budgetary measures, and decisions came from above rather than emerged from consultations with stakeholders (Shah 2013).

### **5.3.5 Capacity to participate**

We have noted in the first section that the citizen participation in public policy is constrained to a great extent by their capacity to engage in complex issues. This matter emerged as a salient theme as we tried to understand why participation was not effective in the truest sense of the term. Stakeholders’ perceptions on this issue differed quite widely. In response to the question of why they thought participation, in so far as it relates to transforming suggestions into action, was not happening, one NBR official (VPI 3) mentioned, echoing the opinion of some of his other colleagues, that most of the business bodies did not take the opportunity of giving suggestions on tax issues seriously. He defended his argument by saying that ‘if you see the proposals that many organizations send to the NBR each year, you will be astonished to see that they are mere repetitions of the previous year’s.’ He maintained that though there were very efficient and successful business people with a great deal of expertise in business matters, many of them lacked the necessary theoretical and technical knowledge about tax issues in order to put forward worthwhile suggestions.

In response to the same question, another NBR official said:

Most of the suggestions that the NBR receives from the stakeholders either in written form or through different discussions that NBR holds with them are very stereotyped – dealing with very common issues such exemption, request of fixing truncated base or tariff value. As most of the proposals of the business community are not in line with the spirit of VAT,

more importantly, with the idea of making VAT more effective and efficient, these proposals cannot attract policy maker's serious consideration. (VPI 6)

This official attempted to clarify his position by saying that most of the business community's tax proposals were not in line with the spirit VAT as VAT was based on internationally accepted principles. The observation of this respondent was corroborated by the response of another policy-level respondent (FGD 6) in a FGD who maintained that the budget proposals from business bodies generally centre around some very common themes: simplification of taxing procedure, exemption of certain products from VAT at a certain stage or exemption from customs duty of input at the import stage, reducing the rate of VAT, etc. When arguing for simplification, most proposals request the elimination of systems such as the value declaration or account current or deduction of VAT at source, or request tariff or truncated base for certain goods or services or lump sum VAT. He further elaborated:

In my experience, I have never found any business people's proposal that says something about how we can implement a modern VAT. But what is more unfortunate is that most of proposals we receive each year are mere repetition of the previous year's proposals. Obviously, this makes our job of preparing the working paper for the Consultative committee meeting much easier...we just cut and paste. (FGD 6)

A review of the unpublished working papers containing tax proposals put forward by a number of business associations from 2005 to 2010 corroborates the above statement. In their proposals, concerns for immediate business interests seem to outweigh their concern, if at all, for a modern VAT. Such self-interested responses reminds us of the self-interest bias of stakeholders which has been seen as an inherent constraint to reform (World Bank 2009). On the other hand, the stakeholder management model advocates that reform can be achieved through creating competition among self-interested stakeholders. But to what extent NBR



has been able to exploit the model by engaging its stakeholders had been questioned by many respondents.

Besides the business bodies' lack of seriousness about making sustainable suggestions, the technicalities of VAT were seen by many respondents as limiting the scope for transformative participation. In the words of a VAT official:

We should bear in mind that VAT or any tax policy is a technical matter. So the way we see participation in a community development or local governance cannot be applied to VAT...giving any opinion on a tax system requires basic understanding of that law and rules and regulation. For practical reasons, the participation of general consumers, most of whom are not aware of the nitty-gritty of VAT, should not be expected in the formulation of VAT policy. (VPI 1)

Another NBR official upheld the same attitude when he underscored the need for citizens' awareness instead and referred to the government initiative of observing a 'VAT Week' since 2011 in its attempt to boost tax collections by creating awareness among people and businesses. The official stance towards participation of the stakeholders in achieving the organization's goal becomes more evident with the introduction of this 'VAT Week,' which according to the Finance Minister was 'meant to ensure the participation of all to serve the country' (Daily Star 2011b).<sup>87</sup>

The allegations of lack of tax awareness affecting the whole scenario of participation were not limited to participant officials or group representatives. One respondent in the category of general consumer mentioned that they expected their elected representative to voice their wishes and demands and they did so as far as demands for roads, schools, hospitals or electrification are concerned. 'But about taxes,' he scoffed, 'the elected representatives themselves did not know much.'

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<sup>87</sup> In addition to the objective of creating VAT awareness, the VAT Week is the time when official recognition is conferred to the highest taxpayers in VAT in three categories: service, manufacturing and retailing. This has started since FY 2004-2005.

Many business leaders, however, did not agree with the NBR officials' contention that the former's lack of serious interest and technical knowledge was the reason for their participation in the VAT being not effective to the expected level. On the contrary, they thought that the bureaucratic attitude coupled with the prescriptions from development partners such as IMF and the World overrode their proposals. According to one business leader:

NBR listens to our proposal merely as a matter of formality. However good, proposals we make will not be implemented until they are in line with IMF's or World Bank's prescriptions. (VBI 4)

Another business leader noted:

As far as VAT is concerned, NBR people think of an ideal text-book type system. Inspired by donor agencies' prescriptions they want to implement a VAT that does not suit us. But our proposals stem from hard realities which they do not pay heed to. (VBI 5)

So, it appears that the objectives of the revenue administration and those of the business community do not always converge in a way that the participatory approach can be directed to a common destination. This can affect the efficacy of participation to some extent. One participant in an FGD, however, opined that business people or their leaders in general were not as adept in tax laws as their counterparts in the NBR, nor did they have enough time and motivation for that. But he held the NBR responsible for its failure to educate the taxpayers in general and the key stakeholders like businesses in particular.

One participant who was a VAT consultant endeavoured to explain the situation from a different angle. According to him, the main concern of NBR was to get more revenue at any cost while the business people try to minimize revenue by all means. So it was difficult for the two contesting parties to reach an agreement on many issues. He thought that this contesting attitude hindered the accommodation of the

suggestions put forward by stakeholders' representatives. However, he appreciated the NBR's effort in facilitating some key stakeholders to take part in the discussion and solution of many tax issues and termed it a 'new trend'. He particularly mentioned the new generation of VAT officers who, he opined, 'are more easily accessible and open to discussion' (FGD 11).

Apart from the conflict of interest, or in other words, the problem of collective action, the traditional bureaucratic manner of decision-making in Bangladesh poses a challenge to effective participation. A VAT expert-academician (VEI 1) indicated that as regards the matter of participation, the decisions of those in the top management such as the Finance Minister or the NBR chairman, or even the development partners may override the proposals or recommendations received through a participatory process. He nonetheless put emphasis on the *special* capacity of some stakeholders, 'sometimes very ad hoc type of suggestions made by the very powerful people, are quickly implemented' (VEI 1). With regard to taxation, governments and stakeholders have competing interests, because governments want to maximize tax revenue without distorting the market; on the other hand, tax-paying stakeholders want to minimize their tax liabilities. Again, among stakeholders, some are more powerful than others or more affected by policies than others (Sarker and Whalan 2011).

It seems that the participatory space was dominated by the actor who had more power and influence. The power relations that shape the nature of participation are an important issue to consider (see Mclure 2000, Arnstein 1969/2001). The observation points to the fact that the spaces that the politicians and bureaucrats create for civic engagement in public policy are usually dominated by the more powerful actors. One business leader opined that the frequency of NBR's consultation with a multinational cigarette manufacturer was much greater than with a business association like DCCI. This situation can be better understood if we take into cognizance the factors in the tax system that are likely to influence the taxpayer's bargaining power with the state. The extent of revenue concentration is

one of those factors.<sup>88</sup> Despite the anti-tobacco campaign, Bangladesh receives 29.25% of its domestic consumption taxes from cigarettes of which a single MNC contributes about 60%. Building on the argument that ‘where the state is dependent on a specialised tax collection apparatus exploiting a single or a few sources of revenue, the taxed group might have considerable bargaining power’ (Gallo 2008:162), the said MNC’s additional power to engage in bargaining with the NBR is not difficult to understand.

As far as the effective participation in the decision-making process is concerned, data from both in-depth interviews with NBR officials and business leaders and the FGD reveal a blame game: while VAT officials pointed to the problem of the mindset of business people and their lack of understanding of the technical issues of VAT as the reason for their incapability of putting useful suggestions, the business people maintained that VAT officers could not get rid of their bureaucratic and technocratic limitations and hence were not accommodative. Moreover the objectives of the revenue administration such as modernization of administration through extensive use of computers and electronic cash registers were not necessarily equally shared by key stakeholders like business people.

## 5.4 Conclusion

Instead of a cultural shift to make spaces for effective participation, the public service generally prefers to cling to a ‘control paradigm of communication and carefully framed and managed consultation’ (Macnamara 2010). This pattern is amply evident in the Bangladesh VAT scenario. Despite having doubts about the capacity of the key stakeholders, participation as a tool for involving the citizen in the overall framework of taxation as well as for empowering the stakeholders has been generally recognized both by the revenue authority and its clientele. On the one hand, the business people’s lack of technical knowledge and skills as well as of understanding of the best international practice hinders their effective participation, while, on the other hand, the revenue administration has not taken sufficient

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<sup>88</sup> The other factors, as Galle (2008) argues, are the mobility of the taxable asset or resource, existence of internal or external threats to revenue and the political power of the taxed group.

initiatives to educate the taxpayers. To a great extent, VAT officers' bureaucratic and technocratic bent of mind together with their lack of accommodative attitude accounts for the existing low level of participation. Before we present a detailed analysis of the findings in chapter 8, we will delve into the aspects of transparency and accountability in the following two chapters.

## CHAPTER 6

# TRANSPARENCY: POLICY, PRACTICE AND PERCEPTIONS

It is not too much to ask someone seeking the nation's highest office to sacrifice some personal privacy to reassure voters that they have no hidden entanglements.

–New York Times editorial note on the US presidential candidate Mitt Romney's refusal to make his income tax returns public (*New York Times* 2012).

### Introduction

In the previous chapter we explored the extent of participatory approaches to decision-making in tax policy and implementation function. The two other concepts that go along with participation are transparency and accountability. Moving into the mainstream of development and aid discourse, transparency and accountability have not only become buzzwords but also have been considered seminal in democratization, governance, aid and development since the turn of the century (Koptis and Craig 1998:3; McGee and Gaventa 2011). Transparency in taxation figured prominently in Adam Smith's maxims of good taxation. Smith's concern for certainty in taxation was not limited to the making of a fair tax system, but also extended to a much broader domain – the universal concern about corruption. We have already noted that the capacity of VAT to raise revenue in a neutral and transparent manner as well as the potential of VAT to infuse transparency into the overall processes of taxation has made VAT a powerful tool for transparency.

The purpose of this chapter is to address the research question involving the transparency issue in the domain of the Bangladesh VAT system. The first section of the chapter reviews the concepts of transparency in general and tax transparency in particular. The second section of the chapter will present findings on the policy and practices of transparency. The third section will present the state of transparency in business transactions. A brief conclusion will be presented at the end.

## 6.1 Understanding tax transparency

To begin with transparency in public policy, a transparent policy is characterized by understandability, availability of information, accountability and citizen participation (Finkelstein 2000). That is, different elements of good governance such as participation, accountability, transparency and predictability are integral parts of the whole and thus complementary to each other; one cannot be achieved at the expense of the other. ‘Transparency, as a key element of good governance, includes ensuring openness about policy intentions, formulation and implementation’ (Kondo 2002:9). Tax treatment is one of the most important core areas which reflect transparency in government behavior; other areas include the overall structure and functions of government, the budget process, the financing operations and regulatory mechanisms (Koptis and Craig 1998). Koptis and Craig argue that in tax treatment, transparency requires an explicit statutory basis rather than discretionary tax concessions or negotiated tax liabilities, clear administrative procedures, information requirements, a code of taxpayer’s rights and obligations and tax officials’ code of conduct.

The literature on fiscal transparency in general and tax transparency in particular reveals a number of characteristics and indicators and their impact on the overall governance as well as economy. According to Hildreth:

Tax transparency refers to the symmetry of information between tax authority and taxpayers. The economics of information affects markets and accountability. In the context of taxation, transparency is important from the first day a tax structure is introduced in the political arena to the last of its economic impact. (2005:429)

Transparency is essential not only for its potential role in promoting good governance but also in reducing principal-agent problems and minimizing transaction costs in the economy (Hildreth 2005). In this respect the observation of Koptis and Craig is worth quoting:

In general, countries characterized by a relatively high degree of fiscal transparency have exhibited greater fiscal discipline and, in many instances, have been able to achieve a more robust economic performance than other broadly comparable – in terms of resource endowment and cultural characteristics – countries with less transparent practices within the same region. (1998:2)

To the economic impact of fiscal transparency can be added the aspect of social capital comprising the norms and networks that enable collective action, the encompassing institutions, the relationships, and the customs that shape the quality and quantity of a society's social interactions (World Bank 2012a). Further, with tax as a social contract between the state and the people, as we have seen, the importance of transparency of the involved parties for the purpose of bolstering social capital and fostering greater inclusion and cohesion cannot be overemphasized. The IMF has defined the role of transparency in revenue administration as follows:

Laws and regulations related to the collection of tax and non-tax revenues, and the criteria guiding administrative discretion in their application, should be accessible, clear, and understandable. Appeals of tax or non-tax obligations should be considered in a timely manner' (IMF 2007a:35).

Fundamental to fiscal transparency, transparency in tax comprises the following characteristics (Burges and Stern 1993; Koptis and Craig 1998; Hildreth 2005; IMF 2007a):

- Taxation under the authority of law.
- Open policy making process minimizing secrecy of decision-making.
- Accurate and rational justification for tax proposals including how a tax fits into an integrated, comprehensive revenue and expenditure policy package.
- Administrative application of tax laws subject to procedural safeguards, such as taxpayer rights to information, explanation, representation,



confidentiality, the right to challenge assessments and other tax rulings or decisions, and tax dispute procedures

- Well defined tax base.
- Well organized tax laws that include all elements needed to determine tax liabilities and to establish procedures for tax collection.
- Tax administration conducted in a clear and simple manner, assisted by the dissemination of all the necessary information, including instructions for completing tax returns.
- Clearly established and defined powers and limitations of the tax administration to search the premises of taxpayers, demand information from taxpayers and third parties (including banks), apply indirect methods to determine income and sales, and enforce the collection of tax arrears.
- An impartial mechanism for appealing and adjudicating decisions when the taxpayer is dissatisfied with the results of the administrative objection process.
- Small differences between statutory and effective rates on transactions, income, and property.
- No discretionary tax relief provided to particular individual or enterprises.
- No case-by-case negotiation of tax liabilities.

This list of the indicators<sup>89</sup> of tax transparency however is not exhaustive. There are obviously other interrelated and overlapping facets of transparent practices in a tax system. For example, expanding the circle of involved participants in policy making strengthens transparency and improves decision-making quality by providing different perspectives to tax authorities (Stiglitz 1999, cited in Hildreth 2005).

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<sup>89</sup> Simplicity and clarity of regulations with open and non-discriminatory procedures of their application also figure prominently in the characteristics of transparent regulations described by the OECD. Public consultation is integral to the process of transparency (IMF 2007).

## **6.2 Transparency in Bangladesh VAT**

The extent to which the Bangladesh VAT tax policy and practice adhere to the principles of transparency can be examined on the parameters presented above. The areas to be examined for transparency thus include the policy making process and the clarity of tax proposals, the administrative application of tax laws and rules including the use of tax discretions, and taxpayers' rights to information and appeal.

### **6.2.1 The policy making process and the clarity of tax proposals**

Committed to the principles of the rule of law and equality before the law, Bangladesh operates under the doctrine of separation of powers with separate legislative, executive and judicial powers vested respectively in the parliament, the executive government and the judiciary. Parliament has the fundamental power to impose tax as noted earlier. Within the framework of the constitutional provision, it is through the express legislation of parliament that a great deal of authority has been delegated to executive government including the tax authority. In this process, in addition to the primary legislation, the VAT Act, and much secondary legislation such as VAT Rules and other special rules have been enacted. Though in most developed countries, the tax administration is not responsible for tax policy and tax legislation (Alink and Kommer 2011), in Bangladesh the tax policy and legislation are formulated by the tax administration, clearly bearing out the widely quoted observation that 'in developing countries, tax administration is tax policy' (Casanegra de Jantscher 1990). Bangladesh does not have any written and published tax policy within whose framework tax rules and regulations can be formulated.

Though the traditional bureaucracy in Bangladesh does not have the reputation of being transparent, there has never been any dearth of commitments to making the administrative processes transparent. Promises for ensuring transparency and accountability in the administration of taxation have always found some expression in ministers' official statements from as far back as at the time of the introduction of VAT in 1991 to the most recent budget speech. We can recall that the VAT was

introduced as a modern transparent tax system to augment revenue collection in a simplified manner.

Given that a nation's budget is the single most important policy document of a government because it reconciles policy objectives in concrete terms across the spectrum of economic, social and environmental interests (Kondo 2002), transparency in the budget process has been considered very important in the literature. As the strategy of revenue generation is the core of a budget process, it would be worthwhile to look into the process of the formulation of tax laws and rules in Bangladesh. The broad process of the formulation of tax laws and rules starts with the NBR's seeking tax proposals from a number of business and professional organizations and associations as members of its consultative committee and ends with the Finance Minister's budget speech and the placement of the finance bill and all revenue measures before the parliament.

As we have seen in the previous chapter, the NBR engaged a number of its stakeholders in a consultative process which was meant to make the budget activities participatory and transparent, or, at least to make them appear so. Apart from the pre-budget consultative process, a review of the budget speeches from FY1991-92 to FY 2012-2013 reveals that the government attempted to be transparent by providing justifications for different tax proposals in the budget speeches. This justification however did not cover each and every tax proposal. For example, in the FY 2012-2013 budget, there were as many as 37 changes including 18 revenue-significant amendments to the VAT law, but only a few of them were mentioned in the budget speech. In many cases, especially those involving an increase of the tax rate, there had been a tendency to present the scenario in a roundabout way, in a rhetorical garb rather than in plain terms. For example, the increase of the VAT rate for trade was presented in the following manner in the budget speech of FY 2012-2013:

From the first introduction of VAT until the present, trade VAT has been imposed at different rates at different points...This multiple system has created disparity among producers, traders, taxpayers, consumers as well as scope for large scale tax evasion and procedural complexities. In the interest

of trade and revenue collection, this multiple VAT rates need to be changed. Considering this reality, a uniform trade VAT rate at 4 percent at all levels of wholesale and retail sales including advance VAT is proposed to abolish the existing multiple rates of VAT (Government of Bangladesh 2012:96).

The main intention of generating more revenue by increasing the effective rate of trade VAT remained hidden; neither did the justification reveal amount of additional revenue the rate increase would yield. Similarly, the time limit for the disposal of an appeal case pending with the Appellate Tribunal was increased from 90 days to two years through the Finance Act 2012 but there was no mention of, or explanation for, this amendment in the budget speech.

In response to a question about the extent to which the VAT policy is transparent, an NBR official commented that the VAT policy making process was as transparent as *practically* possible. He harped on the notion of the technicalities of tax issues and the problems of being too transparent.

We finalize our tax proposals after an elaborate discussion with key stakeholders accommodating as much of their opinion as possible. But many technical issues cannot be shared with them because of their revenue sensitiveness. (VPI 1)

His views were supplemented by a commissioner of VAT who had worked in the policy level of VAT for some time. He reported that the VAT wing issues an explanatory guideline about the changes brought to VAT laws and rules each year at the time of budget. He claimed this attempt was meant to make the whole process transparent and the implications of the changes easily understandable to all stakeholders. He further claimed that during the previous tax regime (i.e. the excise period) understanding the implications of changes used to be the function of a tax practitioner or a tax expert and ‘we have been able to bring those exclusive matters to the common people by explaining them in plain language’ (VPI 2). A business leader partly agreed with the claim that the policy making process had become *more* transparent than before but contended that it was still far from satisfactory. He observed that it was true that the VAT wing issued explanatory directives about

changes made to the VAT law which were quite uncommon in the past. ‘But, interestingly, you will see that this document is marked “for departmental use”, making it somewhat classified and hence problematic for use for litigation purposes’ (VBI 3).

In evaluating the state of transparency in the VAT domain, another respondent (VEI 2) who was retired after serving the NBR as a senior policy making official was more dispassionate. He preferred to focus on transparency as a matter of social and organizational culture rather than merely as a feature of an organizational mechanism. He pointed out that the very fact that the lion’s share of Bangladesh tax revenue came from indirect taxes bore out the fact that the taxing process was not transparent. ‘Lack of transparency and corruption go hand in hand and they are the way of life in countries like ours,’ he commented. ‘It is not a problem with the taxation system alone; it is a problem of culture. People here do not like to pay directly; they are rather manipulated to pay indirectly.’ He illustrated his views with an example of what he called the manipulation of people to pay indirectly as well as non-transparently:

In 1997, we (as VAT policy makers) proposed the withdrawal of exemption of VAT from certain items. That accounted for a few *crore*<sup>90</sup> of extra earning for the government. But there was huge hue and cry and people left no stone unturned to establish the government as anti-people. In the same budget proposal, there was an amendment proposal for a section of the VAT Act in which some words were inserted and the system of the calculation of the supplementary duty at the import stage was totally changed. That amendment was meant to yield additional revenue of BDT 100 *crore*. Nobody, simply nobody, took any note of it and it was implemented successfully. The insertion of some words implied that SD would be calculated on the basis of the duty paid value instead of existing assessable value.<sup>91</sup> (VEI 2)

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<sup>90</sup> One *crore* is equivalent to 10 million.

<sup>91</sup> The respondent in fact referred to section 7(2) of The VAT Act, 1991 which was amended in 1997 through the Finance Act, 1997. Prior to the amendment, supplementary duty at the import stage used to be collected on the basis of assessable value, i.e. the value on which customs duty is charged. If the assessable value is 100 and the rate of customs duty is 20%, then amount of customs duty is 20. Supplementary duty used to be collected in

The above example raises a couple of issues. First, knowing full well that the people in general have an aversion to paying taxes, no matter how valid they are, the tax authority tends to adopt some manipulative way to extract money from taxpayers. This observation is supported by the way the increase of the rate of trade VAT was presented in the ministerial budget speech. Second, stakeholders in general are either not adept enough to understand the implications of certain measures wrapped in a jugglery of words or are not interested in voicing their grievances.

## **6.2.2 Administrative application of tax laws**

Transparency in tax entails that its administration is conducted in a clear and simple manner, subject to procedural guidelines and safeguards and assisted by dissemination of all the necessary information, including instructions for completing tax returns. The administrative application of tax laws and rules involves the use of discretionary powers by the tax authority, clarity of tax base, simplicity and clarity of legal language and processes.

### **6.2.2.1 Tax discretions vs. transparency**

The use of discretion as a central and inevitable part of the legal system as well as a feature of the decision-making process has been a contested issue. While Hawkins (1992) regards discretion as a ‘central and inevitable part of the legal order,’ Davis (1969, cited in Hawkins 1992) regards discretion as the major source of injustice. The advantages and disadvantages of the use of discretion with reference to both legal jurisprudence and the bureaucracy have been quite widely discussed in discretion literature. There is a dichotomy between rules and discretion which prompts the argument that ‘the use of rules involves discretion, while the use of discretions involves rules’ (Hawkins 1992:12). Though in the Weberian bureaucracy there is no room for discretion in decision-making, later scholars have recognized that discretion is an inevitable part of bureaucratic action (Feldman 1992).

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the same manner. But with the amended provision, the rate of SD is charged to the sum of assessable value (100) and customs duty (25).

In most good governance and anticorruption discourses, administrative discretionary power has been seen as an element that curtails transparency and hence contributes to corruption. For example, the Commonwealth Secretariat (2000) sees ‘undue’ administrative discretion and lack of transparency as contributing to corruption and, therefore, advances the elimination of the use of discretionary authority in tax administration as a policy reform agenda. This pattern of understanding seems to have taken root from the widely used corruption formula devised by the American economist Robert Klitgaard (1988) that shows discretion as a major factor of corruption:

$$\text{Corruption} = \text{Monopoly} + \text{Discretion} - \text{Accountability}$$

This formula clearly highlights the general perception that the higher the rate of discretion in decision-making, coupled with higher monopoly and lower rates of accountability, the broader the potential for corruption. Tax discretion can also be seen from this point of view. It is argued that tax administrations in developing and transitional countries are more vulnerable to corruption (Le 2007) than many other branches of the state machinery. We can recall our discussion that researchers have attributed the generally more tangible presence of corruption in tax administrations, particularly in those of developing countries, to their complex tax and trade regimes including multiple discretionary exemptions, confusing and non-transparent procedures for tax compliance and the excessive discretionary power of tax inspectors (Le 2007; Zuleta, Leyton et al. 2007). In this context, it has remained a matter of debate as to what extent tax administration should be given discretion and how the paradox of discretion will be balanced. Against this background and with the critical question in mind, the following subsection will investigate the level of discretionary powers in VAT.

#### **6.2.2.2. Discretionary powers in Bangladesh VAT**

Discretionary powers have been granted by the VAT Act, 1991, to three sets of actors namely, the government represented by the Internal Resources Division under the Ministry of Finance, the NBR and VAT officials at different hierarchical levels. The functions of these three sets of actors overlap. While the VAT officers act as the agents of the government and the NBR, the functions of the government

and the NBR differ only in the procedure of discharging their responsibilities. The government and the NBR are in fact two facades of the same body.

In terms of the contents of discretions, there are essentially three types of discretions granted to the above mentioned actors:

- a. Discretion to produce secondary legislations and to sub-delegate powers to VAT officers, granted to both Government and NBR. This type of discretion includes the power to grant tax concessions;
- b. Specific administrative and liability discretion granted to the government and the NBR;
- c. Specific administrative and liability discretions granted to VAT officers.

The delegation and exercise of discretionary powers in the Bangladesh VAT can be examined at two levels: organizational and individual.

### **Organization level**

Delegation of legislative competences to the government and the revenue authorities is quite common in many countries. Researches show that within the framework of the rule of law the parliament makes policy decisions and assigns policy guidelines to the executive (Dourado 2011; Walpole and Evans 2011). In the case of Bangladesh, legislative competences and specific discretionary powers have been delegated to the government and the revenue authority.

#### *Power of the Government*

Among the discretionary powers that the government enjoys under the VAT Act in Bangladesh, the following are prominent:

- Power to exempt any goods and service from VAT and/or supplementary duty; [s 14];<sup>92</sup>
- Power to write-off any government dues when it can be ascertained that the dues cannot be realized [s 71ka];

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<sup>92</sup> All references to sections in this thesis are to the sections in the VAT Act, 1991. Bangladesh has enacted a new VAT law which will be effective from 2015.



- Power to determine the goods which will be VAT assessed on the basis of maximum retail price printed on the packet of the goods [s5(3)].

#### *Power of the NBR*

The most important delegation of powers to the tax authority is authorizing the NBR to produce secondary legislation.<sup>93</sup> In addition to the overwhelming power to make rules, NBR has been granted a number of specific powers in the VAT Act. NBR has discretionary powers to

- exempt any goods or services for any special purpose [s 14(2)];
- determine the threshold for VAT registration [s 15];
- determine the rate and amount of value addition in respect of goods and services at the retail stage [s 5(2)];
- determine services on which VAT can be assessed on the basis of specific rate of value addition [s 5(4)];
- fix tariff value of any goods for the assessment of VAT [s 5(7)];
- select goods or services for withholding and advance payment of VAT [s 6(4)];
- use of banderol or stamp for any goods [s 6(4)];
- determine turnover threshold and bring any goods or services under VAT irrespective of their turnover (s 8).

#### **Individual level**

VAT officials have been granted enormous discretionary powers both in the VAT Act and the VAT Rules. The most prominent discretion that the Bangladesh VAT officers enjoy lies in their power to adjudicate offences committed under VAT law. Drawing heavily on the excise regime practice, this power is popularly known as the quasi-judicial power of VAT officers. Adjudication power is conferred on all

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<sup>93</sup> Section 72 of the VAT Act confers upon the Board the power to make rules 'for carrying out the purposes of this Act.' Within the limits of not breaching the generality of the legal provision laid down in the primary legislation, NBR has the power to make rules on a wide range of areas that include determination, assessment, and collection of VAT and determination of value for the assessment of VAT. In exercise of this power, NBR produced the Value Added Tax Rules, 1991, and a number of other special rules, SROs and general orders.

VAT officers, except an assistant revenue officer, on the basis of the limit of the value of goods and services related to the offence. As adjudicating officers, they have the discretion to impose a penalty, in case of evasion, between the equal amount of the payable tax and two and a half times of payable tax. Among other discretions that different levels of VAT officers in Bangladesh enjoy, the following are noteworthy:

- A commissioner has the power to grant exemption of VAT to any goods that fall within the given criteria of cottage industry.
- A commissioner has the power to issue an order for supervised clearance for any goods if he has *reasons to believe* (emphasis attached) that it is required [s 26kha] and to determine the amount of payable tax for a tax period on the basis of a single verification [s26kha (4)].
- A commissioner of VAT has the power to fix, *suo moto*, for any reason *he considers* appropriate, the base value of any goods on which VAT will be calculated (Rule 3, VAT Rules, 1991).
- A VAT divisional officer has the power to grant a VAT registration on being *fully satisfied and* also to give forced registration to a taxable business on being *satisfied* (s15).
- An officer not below the rank of an assistant commissioner has the power to order sale verification if he *thinks* that it is needed to determine the input-output coefficient or sale has been suppressed [s 35(3)].
- Under Rule 3 of the VAT Rules, 1991, a VAT divisional officer has the power to revise a declared price if it *appears* that the declared price is
  - o inconsistent with the provision of the Act, *significantly lower* than the price of similar goods;
  - o *significantly low* due to some relationship between the buyer and the seller; and
  - o the amount of value addition is *significantly low*.

Besides the above examples, a reading of the complete list of discretionary powers in the Bangladesh VAT Act and rules and orders made under them (See Appendices 5 and 6) would show more clearly the extent of discretion. In case of all discretionary entities, discretion is at times explicit and at other times embedded. The recurrence of constant allusions to standards: necessary, essential, exceptional, reasonable, or satisfactory that form the familiar discretionary formula endows the officers with significant freedom to maneuver (Harlow and Rawlings, 1984, cited in Sainsbury 1992).

The presence of excessive discretionary powers in the tax laws has been a cause of grievances and the butt of criticism from the business quarters. Grievances are aired forcefully, especially during the series of consultative meetings that NBR holds with different stakeholders prior to annual budget. For example, in a recent meeting with NBR, the FBCCI proposed a reduction of the discretionary power of VAT officials in a bid to ensure hassle-free business (Financial Express 2012a). The apex business forum particularly expressed their concern over VAT officials' excessive power to search and seize conveyances carrying VAT-able goods. Not only business bodies, but also the general taxpayers and civil society members expressed their concern over the discretionary power of tax officials (Financial Express 2010a). As a result of the growing concern over this issue, the Finance Ministers of different regimes pledged to reduce the discretionary powers of tax officials in their budget speeches. For example, in the FY 2005-06 budget speech, the Finance Minister mentioned the reduction of the discretionary powers of tax officials along with measures to ensure transparency and dynamism in tax administration as a major reform (Government of Bangladesh 2005b). The same attitude towards further reducing the administrative and liability discretion of tax authorities was manifested in the budget speeches since. In the most recent budget speech (FY 2012-2013), the Finance Minister mentioned limiting the discretionary powers of tax officials as one of fundamental principles of revenue collection (Government of Bangladesh 2012).

Thus far, we have examined the tax discretion scenario on the basis of documentary analysis. We can now turn to observe the stakeholders' perceptions about the issue.

As regards the clarity of the powers and the limitations of the tax administration to search the premises of taxpayers, to demand information from taxpayers and third parties, to apply indirect methods to determine income and sales, and to enforce the collection of tax arrears, most of the respondents argue that tax laws have given the tax collectors unbridled scope and powers. One respondent referred, for instance, to section 24 of the VAT Act which empowers even a lower level VAT officer (Revenue Officer) to summon any person, if he *thinks necessary*, to give witness or provide information for a VAT matter. Grievances about administrative discretions, voiced by a number of respondents, corroborated the excessiveness of discretionary power discussed earlier. This was further validated by the responses from VAT-paying businesses, as shown in Table 6.1, where 53% of the respondents thought discretionary powers were more than necessary, while 69% believed that they were used either to harass taxpayers or for the concerned officer's personal gain rather than for facilitating the business, as shown in Table 6.2.

**Table 6.1 Discretionary powers of VAT officers (N=110)**

Response	Number of respondents	Percentage
More than necessary	58	53
As much as is necessary	21	19
Less than necessary	15	14
No idea	16	14
Total	110	100

Source: Field survey and own computation

**Table 6.2 Use of discretionary powers by VAT officers (N=110)**

Response	Number of respondents	Percentage
To facilitate trade	26	24
To harass taxpayers	54	49
For personal gain	24	22
No idea	6	5
Total	110	100

Source: Field survey and own computation

Another interesting phenomenon is that the pervasiveness of discretionary powers in the first place implies that VAT officials have a great deal of power to act beyond the call of stipulated rules. But here also, the sense of bias towards revenue even at the cost of taxpayer's service prevails. One VAT administrator thus confided,

There are hardly any discretionary powers for a VAT officer to facilitate a businessman by bypassing the written rules. Rather, ironically, all the discretionary powers vested in him/her are meant for generating more revenue in the form of enforcing more control on taxpayers. (VPI 4)

### **6.2.2.3 Clarity of tax base**

A well-defined tax base is one of the important criteria of a transparent tax system. But in the case of the Bangladesh VAT, the clarity of tax base has been damaged through the excessive use of presumptive taxation which we have already noted. The question of what prompted so many presumptive elements in a VAT in contrast to its widely acclaimed principle of transparency was answered by respondents. Many respondents, especially those belonging to the policy-making and implementation levels of VAT, argued that one of the main reasons for the pervasive presence of presumptive taxation in Bangladesh VAT is the lack of transparency in business accounts. One NBR official noted:

If the key-players in VAT i.e. business people do not want to be transparent in their business transactions it is really difficult to implement a model VAT. Many businesses keep computerized records but they are for their own use, not for VAT purposes. (VPI 1)

In the absence of transparent account keeping among the key stakeholders, i.e. business people, the VAT authority adopted presumptive taxation as a stop-gap arrangement perhaps mainly to acclimatize the businesses with the new tax system. However, subsequently, that taxation method became so ingrained in the whole texture of the business scenario which is characterized by opaqueness rather than transparency that it became an enduring part of the tax system. So, if obscurity in

tax rates and base violates transparency (Burges and Stern 1993), then Bangladesh VAT has many reasons to be condemned as a non-transparent tax system.

#### **6.2.2.4 Simplicity and clarity of language and processes in VAT legislations**

As noted, simplicity and clarity of language and processes in any tax system is an important determinant of tax transparency. Particularly for a tax like VAT that is based on voluntary compliance, unambiguous legislation is essential for effective implementation (Cnossen 2010). Taxpayers' perception of the simplicity and clarity of VAT rules can shed more light on the level of transparency in the VAT in Bangladesh. VAT replaced the excise system more than 20 years ago and naturally many business owners or their representatives had little or no knowledge about the previous system of business taxation. In the interviews some respondents who had the experience of working in the excise system of taxation unequivocally stated that as compared to excise duty, VAT was much easier and its modes of operation more transparent. One respondent in an FGD maintained that during the excise regime the inspectors and superintendents and other field officers were all powerful and could do and undo anything they liked. He further noted:

Because of their unbridled discretionary powers, many things depended on their sweet will. As a result, there were more opportunities for indulging in malpractices both by tax officials and business people than it is now. (VB1 4)

Without having to compare the VAT with excise system, most of the VAT-paying businesses believed that VAT was either very trade friendly (21%) or fairly trade friendly (34%), as show in Table 6.3. But as we examine their perception about the clarity of VAT laws, we see that almost half of the surveyed population (45%) considered that VAT rules were not clear at all, while 23% thought that they were very clear and 27% fairly clear as shown in Table 6.4. The business people's perception of VAT as a very trade friendly or fairly trade friendly tax system can be understood better by the following comment of a VAT official:

It is matter of relative advantage. Compared to customs duty or income tax, business people find VAT more trade friendly. One reason of VAT

being liked by them could be the fact that VAT accommodates more of business people's demand than any other taxes. The process of this accommodation started from the first day of its introduction and is still continuing, obviously contaminating the whole system. (VPI 2)

However disagreeable they may be to the advocates of a standard VAT, the range of adaptations and deviations discussed in Chapter 3 have an unmistakable bearing on the efforts to make the VAT acceptable and trade friendly to a host of business people.

**Table 6.3 Trade-friendliness of VAT (N=110)**

Response	Number of respondents	Percentage
Very Trade friendly	23	21%
Fairly trade friendly	30	27%
Not trade friendly at all	42	38%
No idea/no comment	8	7%
Total	110	100

Source: Field survey and own computation

**Table 6.4 Clarity of VAT rules (N=110)**

Response	Number of respondents	Percentage
Very clear	25	23%
Fairly clear	30	27%
Not clear at all	49	45%
No idea/no comment	06	5%
Total	110	100

Source: Field survey and own computation

When asked about specific tasks such as return filing and taking input tax credit, the number of respondents who considered a return filing fairly easy was outnumbered

by a total of 63% respondents who either believed it to be ‘not that easy’, or, ‘complicated,’ as shown in Table 6.5. Some VAT officers, however, were not ready to subscribe to the observation that VAT return filing was complicated or not easy. One officer, for instance, said that VAT return was reduced to one page in 2007 on the advice of the consultants of a project called Reforms in Revenue Administration (RIRA). He also defended the clarity and simplicity of VAT forms including VAT return by stating that almost all of them contain instructions in plain language about how to fill them. About another aspect of the VAT-input tax credit mechanism, which is considered to be the hallmark of self-policing in a VAT system, 34% of the VAT-paying businesses considered it a simple automatic process while 41% thought it was a complicated process.

**Table 6.5 Ease of filing VAT returns (N=110)**

Response	Number of respondents	Percentage
Fairly Easy	41	37
Not that easy	46	42
Complicated	23	21
Total	110	100

Source: Field survey and own computation

The comment of a former adviser to the Caretaker Government of 2008, Mr Hussain Zillur Rahman, corroborated the above perception:

Difficult tax laws remain the NBR's main problem. They need to be simplified and made taxpayer-friendly. The major objective of any reform measures should be to rid taxpayers' mind of fear. (Akter 2011)

Many respondents belonging to businesses complained about the use of legal jargon which cannot be understood by people other than tax officials and practitioners and which made the laws complex. While admitting this, a VAT policy maker contended that the use of a certain style and legal jargon is not unique to



Bangladesh VAT law, but extends to any law. Box 6.1 below further highlights the accusation of complexity of tax laws in Bangladesh.

### **Box 6.1 Complexity in tax system: newspaper readers' views**

The authorities who manage the tax system are not fair and have made this process *complex* and time-consuming. (*Daily Star* 2008)

Needless to say, tax, VAT and levy are essential economic factors in the running and development of a nation. However, this indispensable source of economic contribution declines through tax evasions on account of the *complicated procedures*...other causes of non-compliance are lack of awareness, officials' harassments, *complicated law*, reluctance to disclose income and assets, venal tax officials, nepotism, high compliance cost and political pressure and so forth...There are very few citizens who pay their income tax to the government while most of us are evading it due mainly to the *complicated and inconvenient process*, lack of awareness and lack of stringent actions against tax evaders. (*Daily Star* 2009).

### **Clarity of language in VAT rules and regulation: an example**

The official instruction<sup>94</sup> on the use of ECR can be cited as a typical example of the extent to which an official circular is transparent and clear. The vagueness or complexity that is usually alleged about tax rules and orders in Bangladesh is amply evident in the ECR order. First, some of the terms such as 'big and medium businesses' or 'luxury shopping complex' used in the order are not self-explanatory, nor does the general order or any other order contain an explanation or definition of these terms, leaving them to the discretion of the implementers to explain and apply them. Second, while the ambit of the general order seems to cover the listed businesses, the inclusion of 'other businesses' practically leaves no businesses in city corporations and district towns outside the purview of this general order.

### **6.2.3 Taxpayers' rights to information and appeal**

Transparency in taxation requires that the administrative application of tax laws is subject to procedural safeguards, such as taxpayer rights to information, explanation, representation, confidentiality and tax dispute resolution procedures. This part will focus on the right to information and a citizen's charter, and the right to appeal with relation to the Bangladesh VAT.

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<sup>94</sup> NBR general order No. 17/Musak/2008 Date: 15/05/2008.

### **6.2.3.1 Right to information and a citizen's charter**

Bangladesh is one of the 93 countries in the world and four countries in South Asia that have adopted Right to Information laws (IDS 2012b ). The Right to Information (RTI) Act 2009 was adopted in order to be able to monitor the work of government bodies and to enhance their transparency and accountability. While the RTI law in Bangladesh has been praised as a good law, progress in the implementation of the law even after two years of enforcement has been evaluated as rather slow. Awareness about the law is lacking among majority of government officials, many of whom refuse to accept RTI applications from people (IDS 2012b).

The RTI law was preceded by a launch of citizen's charters in government offices in 2007. The adoption of citizen's charters first and then the RTI legislation is due to the global rather than the local stimulus. Of all forms of public sector reforms, 'New Public Management' (NPM) came into being with a paradigmatic break from the traditional model of public administration (Hood 1991). While many developed countries such as the United Kingdom, Australia and New Zealand have become the torch-bearers of public sector reforms by breaking from the bureaucratic paradigm of public administration (O'Flynn 2007) and have strived continuously to improve their public services through a number of other approaches like joined up government and whole of government, developing countries also wished to take some cues from their examples, obviously not without external stimulus in the form of a conditionality for international aid. As NPM, joined-up government or the whole of government approaches became more and more popular, with their imperatives on a citizen-centric attitude, a citizen's charter as a tool of NPM has become popular around the world as a means of improving public service delivery. In a bid to make the public service more effective and efficient, the objectives of a citizen's charter<sup>95</sup> are to make administration accountable and citizen friendly, to ensure transparency and the right to information and to adopt a stakeholder approach.

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<sup>95</sup> Though in the literature the origin of the concept of a citizen's charter can be traced back to the Magna Carta of 1215 and the People's Charter of 1838, in contemporary history the credit for the introduction of a citizen's charter goes to 1991 in John Major's government in the United Kingdom.

This new approach stemmed from the NPM which was adopted as a reaction to perceived weaknesses of the traditional bureaucratic paradigm of public administration (O'Flynn 2007). The NPM encompassed 'a critique of monopolistic forms of service provision and an argument for a wider range of service providers and a more market-oriented approach to management' (Stoker 2006:45, cited in O'Flynn 2007). But the wave of NPM took quite a long time to reach the shores of the Bangladesh public administration. The late response can be attributed to the fact that Bangladesh shares a common colonial heritage with many other African and Asian countries not sharply responsive to changes. As happens in developing countries where public sector values are rarely addressed because of the public sector orientation remaining focused towards 'command and control' rather than serving the citizenry (Shah 1998), the public service scenario in Bangladesh has not been different.

However, clearly influenced by the NPM movement (Jahan 2006), the Public Administration Reform Commission in 2000 suggested the adoption of a number of citizen-centric approaches such as the introduction of a citizen's charter in public offices, which remained shelved until the interim military-backed caretaker took the initiative to implement the suggestion in 2007. In response to the directive of the military-backed interim administration, most of the public offices developed their citizen's charters overnight and displayed them prominently with the stated goal of 'providing the citizens with high quality service, ensuring the ambit of transparency, responsiveness and accountability' (Government of Bangladesh 2010:9). The apex revenue authority and the field offices were also included. The NBR had its citizen's charter ceremoniously unveiled by the then Finance Adviser on the January 5, 2008 in a bid to bring 'transparency and accountability in its work' (*Financial Express* 2008).

The citizen's charters of the NBR and its subordinate VAT<sup>96</sup> offices reflect the same style: cataloguing the charter of duties and mentioning some specific services

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<sup>96</sup> The Citizen's Charter of the VAT wing of NBR contained the following information:

- Its charter of duties.
- Services that it provides directly to its customers/clients with reference to the legal provision and the stipulated time frame within which a certain service is provided.
- Services that field VAT offices provide and the stipulated time limit for receiving those services with reference to the legal provision.

that are provided. But even in the narrow scope of the citizen's charter, the time frame for the provision of some services has remained quite vague. For example, the VAT wing of NBR grants approval for central registration for VAT. But as regards the time limit for this service, the citizen's charter only requires it to be 'speedily doable'. As there is no mention of time limit within which a decision of central VAT registration has to be accorded, the citizen's charter also remains vague.

Monitoring and publication of explicit standards, information for and openness to the service recipients, regular and systematic consultation with users and well-publicized and easy-to-use complaints procedures are some of the core principles of public services with regard to introducing a citizen's charter (Great Britain 1992). If the NBR's or its field offices' citizen's charters are evaluated on the basis of these principles, they are hardly more than a compilation of pre-existing provisions, legal rights, administrative regulations and mere management promises. Though quite far from the principles of citizen's charter, they, however, have some potential benefits to the service recipients in so far as they collate and concisely present the taxpayers' rights in a single document.

When asked about the formulation process of their citizen's charter, one NBR official (VPI 1) simply admitted that their citizen's charter was a product of the top-down approach. There was no consultation with stakeholders in preparing the citizen's charter. On the whole, the organizational structure, job description of different offices and the rights of taxpayers enumerated in the VAT law and Rules had been collated in one place to produce a document called 'citizen's charter.'

The government's renewed emphasis on what it called 'pro-people service delivery' through citizen's charters was evident in its undertaking of a project entitled Civil Service Change Management Programme (CSCMP) which produced a manual of a citizen's charter in 2010 (Government of Bangladesh 2010). But the NBR did not seem to have comprehended the renewed emphasis for an effective citizen's charter.

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- Telephone and email contact details of different officials at policy and implementation levels.

When a policy maker was reminded that the then NBR Chairman promised in the launch ceremony of its citizen's charter in 2008 that they would amend and revise the charters, if necessary, on the basis of the opinion of stakeholders, he said that no amendment or revision to the first citizen charter would be made until 2012. As regards their lack of interest or inability to revise and amend their citizen's charter on the basis of a detailed guideline of the Ministry of Establishment, one respondent in NBR (VPI 5) opined that amendments were not made perhaps because they were not considered as exigent as other duties such as revenue collection. A business leader however attempted to explain this inaction in other words:

In our bureaucratic culture, nothing comes from within. Nobody or no agency does anything pro-actively until and unless they are compelled to do so. During the military backed-caretaker government there was tremendous pressure from above to introduce a new idea like a citizen's charter and each government office complied with the directive without batting an eye-lid. (VBI 2)

A number of FGD participants also opined that the citizen's charter in different public offices was the result of pressure from the military-backed government in 2007. However, what prompted the government organizations such as the NBR to adopt a citizen's charter is not as important as the effectiveness of such an initiative. The question that requires to be answered is the extent to which the objectives of the citizen's charter have been achieved. Encouragingly, stakeholders recognized a trend of a paradigmatic shift with the adoption of citizen's charters in different public offices including VAT offices.

In response to the question: if they were aware of the citizen's charter in the local VAT office, most of the respondents (61%) belonging to VAT-paying businesses answered in the positive. Some FGD participants referred to them as positive during the interim government regime. 'But things went back to square one with the end of that regime. Now citizen's charters are only decorative pieces outside many government offices or printed souvenirs,' commented one participant (FGD 10). Some other participants were not so bluntly negative about the implications of citizen's charters. One participant said, 'there is no doubt that it is a very good

initiative. It gives us an idea about what services we can get from government offices like a VAT office and within what time frame' (FGD 9). Another participant corroborated this by citing his personal experience:

Once I went to a VAT divisional office for VAT registration. A clerical level staff member was trying to indicate that getting a VAT registration would involve such and such things and would take a minimum 8/10 days. But when I showed him the citizen's charter of that office which promised to deliver a VAT registration within three working days, he did not try to show me 'high court'<sup>97</sup> anymore and rather helped me get VAT registration as quickly as possible without any hassle. (FGD5)

As opposed to the general consensus that a citizen's charter can contribute to better service delivery, one respondent belonging to VAT administration endeavored to downscale the importance of such charters as he commented:

It would not be wise to compare the services provided by tax offices with those of a health office, because services that our field offices provide to an existing taxpayer or a potential taxpayer are already mentioned in the legislation. So whether or not there is a citizen's charter, a tax official is supposed to go by those bindings. (VPI 4)

A business leader did not agree with the above contention. He argued that 'instead of wandering in the mazy world of rules and laws of tax matters, it is much easier for a taxpayer to claim a service from a VAT office with reference to a citizen's charter' (FGD 11). He, however, opined that a charter must not use the characteristics jargons that are used in tax laws.

The official *Citizen's Charter: A Manual* (Government of Bangladesh 2010) provides an insightful assessment of what it called the first generation citizen's charters of 2007-2008. The shortcomings of the existing citizen's charters – poor understanding of the concept, lack of need assessment, no participation of

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<sup>97</sup> 'High court dekhano' (showing high court) is a slang in Bangla meaning a roundabout way of speaking – making simple things appear complex – with a sinister purpose.

stakeholders – equally applies to the citizen’s charters in the VAT administration. The Manual’s objective assessment that the first generation of citizen’s charters in Bangladesh mainly focused upon the product side, in other words, the documents themselves, and almost totally ignored the more important process side, which should have involved citizens during the development of the charters, in a cycle of discussion, formulation, monitoring and evaluation.

### **6.2.3.2 Rights to appeal**

An impartial mechanism for appealing and adjudicating decisions when the taxpayer is aggrieved with the results of the administrative decision process is a much cherished criterion for the transparency of a tax system. In addition to a number of other rights, any person dissatisfied by any decision made by any officer of VAT has the right to appeal to a designated VAT office within 90 days from the date of such decision.<sup>98</sup> As noted in Chapter 4, VAT officers adjudicate offences committed under VAT through a quasi-judicial process. Similarly, the first two stages of appeal, which need to be exhausted before proceeding to the next stage, lie with the departmental officers. The appeal mechanism of the two preliminary stages was generally perceived to be far from impartial because the key adjudicator-positions in both the Appeal Commissionerate and the Appeal Tribunal are held by current VAT officers. Though the Appellate tribunal has a member from the judiciary, the tribunal is presided over by a sitting member of NBR who is essentially a VAT officer.

As presented in Table 6.6, the questionnaire-based survey among selected VAT-paying businesses revealed that most (69%) were aware of their rights accorded in the VAT law. But, opposed to this scenario, the majority of the respondents (52%) perceived that taxpayers’ rights were not usually easily available (the sum of the responses of ‘Sometimes, but not always available’, ‘Difficult to avail’ and ‘Not available at all’). This can be better understood by the comments of a business leader in an in-depth interview:

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<sup>98</sup> According to section 42 of the VAT Act, any person dissatisfied by any decision, excepting that of a seizure or sales order given under section 56, made by any officer of VAT has the right to appeal to a designated office within 90 days from the date of such decision. As regards the infringement of the right to appeal in the exceptional case of section 56, no explanation or clarification has been given in the Act.

It is unrealistic to expect impartiality from a VAT officer on matters of appealed cases because, in the departmental adjudication process, the adjudicator is a member of the same team to which the prosecutor also belongs. Moreover, they are essentially motivated to safeguard the government interest at any cost (VBI 2).

**Table 6.6 Availability of taxpayers’ rights (N=110)**

Response	Number of respondents	Percentage
Usually easily available	50	45
Sometimes, but not always available	36	32
Difficult to avail	17	15.5
Not available at all	5	4.5
No idea/no comment	2	2
Total	110	100

Source: Field survey and own computation

One participant belonging to the VAT administration agreed with the observation that the departmental adjudication and appeals mechanism was not impartial and attempted to explain VAT officers’ alleged bias:

VAT officers do not have the immunity for judicial decisions that the judiciary enjoys. That is why, to be on the safe side, more specifically to keep themselves aloof from the clutches of a fault-finding AG audit or anticorruption agency, VAT officers tend to be biased towards revenue, however irrational that may be. (FGD 7)

One participant in an FGD remarked that it was the organizational culture of the tax administration in Bangladesh that harsh and discourteous treatment of taxpayers by an officer was sometimes treated as the sign of an officer’s competence. ‘Hence, respecting a taxpayer’s rights is at times misconstrued as collusion and is not generally held in high esteem within the tax or VAT administration’ (FGD 3). Another participant in the FGD added that an officer of VAT could raise a demand



of a huge sum of so-called evaded VAT on very flimsy or totally unsubstantiated grounds which may prove wrong later but he/she would never be made accountable for his/her action as there was a provision for immunity for any VAT officers for any action done in good faith (FGD 10).

In the same discussion, one business community representative raised the question about the factors that compelled a taxpayer to go to appeal rather than whether the appeal process is neutral or fair:

Even if the appeal mechanism is fair and neutral, the question is why I am compelled to file an appeal? An appeal procedure is not without the cost of time and money! (FGD 5)

He further added, ‘many a time we hear local VAT officers say, “we are doing what we are supposed to do under the provision of the law. If you have any objection or feel aggrieved, you can always appeal to the proper authority.”’ According to observations made in the FGD, weighing the cost and benefits of the appeal process, most of the VAT-payers tended to negotiate with the relevant VAT officers in a win-win approach. Though the nature of such negotiations was not elaborated, it could be understood that most of time the negotiation involved some compromise with revenue and some ‘extra earning’ for the officer.

From data gathered on the respondents’ perception of the taxpayers’ right to appeal as well as of the adjudicating system, it has become clear that the revenue administration’s preference for revenue over taxpayers’ service was working to the detriment of ensuring taxpayer’s rights and upholding the impartiality of the adjudication system. The following observation by a respondent working for NBR is pertinent:

The provision of service by a revenue department differs widely from that of a health service provider or the Water and Sewerage authority (WASA). It provides service to its taxpayers or potential tax payers with a value for money approach. Every service it provides or every

*taka* it spends needs to be cost effective in generating more revenue’ (VPI 5).

Stakeholders’ perception of taxpayers’ rights in Bangladesh VAT reminds us of IMF’s general observation: ‘In most countries, these rights exist on paper; however, they often function imperfectly. In particular, the appeals system may fail to provide safeguards against arbitrary administrative action and to keep the tax administration within the bounds of the law’(IMF 2007a:82). This issue of giving preference to revenue collection at the cost of citizen participation, taxpayer’s rights or transparency seems to form a recurrent theme in our exploration of the research topic. In dealing with taxpayers and their problems, the traditional ‘cop and robber’ attitude rather than the ‘customer and service’ attitude seems to characterize the mind-set of many VAT officials.

### **6.3 Transparency in business transactions**

We have so far focused on the policy and practice aspects of transparency insofar as they are applied in the VAT administration. We can now turn to the other side of the coin. In understanding transparency in a tax system, we need to bear in mind the widespread perception that agency relationships should be as transparent as possible, as transparency not only improves accountability but also aligns the interests of the agent with the interests of the principal (Prat 2005). This becomes more important in taxation which is seen as a social contract between the state and the citizen. Hence, tax transparency is a responsibility equally shared by the taxpayers and tax authority (Hildreth 2005). The extent of transparency in business transactions can be seen by investigating a couple of aspects directly related to a business such as methods of record keeping and invoicing.

#### **6.3.1 Record keeping**

The imperative for bringing discipline and enhancing transparency in transactions of trade, commerce and financial sector of the country has been repeatedly emphasized in the official documents. This approach fits quite well in the government’s vision of ‘Digital Bangladesh’ that comprises ensuring people’s

democracy and rights, transparency, accountability, establishing justice and ensuring delivery of government services to each door through maximum use of technology, with the ultimate goal to improve the daily lifestyle of general people. In line with this objective, some provisions in the income tax law were made ‘to encourage the conduct of business transactions through banking channels’ with a view to both reducing the risk of carrying cash on the one hand and to enhance transparency and discipline in the financial sector on the other (Government of Bangladesh 2012). While maintaining computerized accounts was made an optional choice for any VAT registered taxpayers in addition to keeping records in the prescribed forms, subject to official approval from VAT authority, the use of ECR or Point of Sales (POS) was made mandatory for big and medium businesses<sup>99</sup> situated in city corporations and district towns.<sup>100</sup>

A VAT-registered business has to maintain business records in the prescribed formats.<sup>101</sup> 36% of the respondents from VAT-paying businesses commented that record keeping on VAT was fairly easy, while a total of 62% respondents thought that it was ‘not at all easy’ or ‘very complicated’ (Table 6.7). While more than half of the respondents believed that electronic record-keeping ensures transparency for other purposes such as income tax statement as well, only 19% of the surveyed population used computers for their record keeping. Among the reasons given for not keeping records electronically, having no legal obligation to do so figured prominently (41%), followed by the concern of the additional cost to be incurred from the employment of additional computer-trained employees, as shown in Table 6.8. According to the NBR statistics the number of registered traders under VAT in 2011 was 153,217. Visits to a number of retailers in Dhaka city liable to be registered under VAT revealed that only 20% of them used ECR which had been made mandatory for all retailers by NBR.

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<sup>99</sup> Businesses are hotels, restaurants, sweetmeat shops, furniture shops, beauty parlours, community centres, all businesses in luxury shopping complexes in metropolitan areas, department stores, other big and medium businesses and jewellery shops.

<sup>100</sup> General order No 17/VAT/2008 dated 15/05/2008

<sup>101</sup> According to the VAT Rules, 1991, a VAT-registered business has to maintain a Purchase Register (*Mushak-16*), a Sales Register (*Mushak-17*), an Invoice Register (*Mushak-11*) and an Account Current Register (*Mushak-18*).

**Table 6.7 Record-keeping in VAT (N=110)**

Response	Number of respondents	Percentage
Fairly easy	40	36
Not easy at all	47	43
Very complicated	21	19
No Comments	2	2
Total	110	100

Source: Field survey and own computation

**Table 6.8 Reasons for NOT keeping records through computers (N=108, multiple answers possible)**

Response	Number of respondents	Percentage
It is complicated	11	10%
It requires trained staff	38	35%
It is not legally required	41	38%
There is no additional incentive for it	13	12
Other (please specify)	05	5%
Total	108	100%

Source: Field survey and own computation

Newspaper reports in this regard corroborated the field data. For example, a newspaper reported in 2009 that the NBR would make some 200,000 shops use electronic cash register to make VAT payment transparent as well to boost tax collection (Financial Express 2009b). But the same newspaper reported that despite NBR's massive campaign to enforce the use of ECR, businesses hardly any paid attention to it (Financial Express 2009c). According to that report, the NBR found that only 782 out of 2,727 shops and business houses had installed ECR by March 2009, after five months of making ECR mandatory for businesses. But even after three years, situation did not improve much as only 1,308 out of the targeted- businesses throughout the country had installed ECRs by July 2012 (Amar

Desh 2012 ). Worse still, installation of ECRs did not necessarily mean their utilization, as a senior NBR official was quoted as saying, ‘We have noticed that some businesses purchased ECR, but are reluctant to operate it They are continuing their business transactions manually as before to evade tax’(Financial Express 2012c). A general consumer’s experience in this regard is worth quoting:

I saw an ECR on the desk of cashier in a sweetmeat shop. When he issued a cash-memo in a simple newsprint chit, I asked him why he is not giving me receipt from ECR. Only then he gave me a receipt from ECR with a sulky look. (VGC 3)

This reluctance towards using ECR, however, was attributed by the president of the Chittagong Chamber of Commerce and Industries(CCCI) to the lack of financial means of buying, operating and maintaining the ECR by 90% of the businesses (Financial Express 2010b) rather than the business people’s attempt to evade taxes as implied by most VAT officials.

### **6.3.2 Invoicing**

Although it is legally binding for all VAT registered businesses to issue a VAT invoice – either a full or an abridged version, depending on the size of business – for each sale and it is commonly taken to be a tool for ensuring accountability and transparency on the part of business, most of respondents (67%) in the general consumer segment said that they did not receive VAT invoices from retailers. In interviews, some respondents said that businesses, mainly retailers, issued VAT invoices only when they were requested to do so. Some respondents observed that issuing an invoice after the business transaction was not a normal, spontaneous response from a business. In this regard an experience recounted by a former VAT policy level officer is worth mentioning:

It happened in a restaurant in Dhanmondi. They were doing roaring business from 7 to 12 pm. I went with two other friends. When I asked for a VAT invoice, it came in a newsprint chit. I said where is my VAT *chalan* from that ECR? No sooner had I asked for the VAT *chalan* than I was grabbed by 5 or 6 people. One of them grabbed me by my collar and asked, ‘Who the

hell are you?’ In the blink of an eye, the police came and told me, you have created a law and order situation and we must take you (into custody). I told them that I am not creating law and order situation and that I asked for the VAT *chalan*. And as law enforcing people, you should also help collect VAT. The more I talked about VAT, the more they kept talking on my creating a law and order situation. Then they grabbed me and put me in the police van. Sitting inside the van I thought that there are more laws and rules in the police book than the number of stars in the sky. They are taking me and I could be implicated in any offence. They can say that I am a *dacoit*, I attempted a rape and so on and so forth. Thinking that, I made calls from my mobile to the IGP who is a friend of mine and also to the NBR chairman. (VEI 2)<sup>102</sup>

Though this kind of extreme reaction from a business to the request for a VAT invoice is not a general trend, it indicates the general reluctance of retail businesses to issue invoices and implies the collusion between the non-compliant and the law enforcer. Most of the general consumers (65%) interviewed believed that VAT invoices ensure accountability and transparency. But they also perceived a serious lack of willingness of businesses to issue VAT invoices and 67% of them reported not to have received VAT invoices for their purchases.

Some business and the VAT department respondents argued that lack of awareness among general consumers was one of the reasons for many retailers for not feeling compelled to issue VAT invoices. But, data gathered through semi-structured interviews of 57 general consumers showed that almost all the respondents were aware that they paid VAT on their purchase. While this segment of respondents mostly (72%) believed that people were not generally aware of VAT or tax matters in the country, the high level of awareness about VAT evident among the respondents can be attributed to the fact that respondents in this segments, chosen from shoppers in sophisticated business premises such as supermarkets in metropolitan areas, were more educated and conscious than the vast majority living in different areas of the country. The recent government initiatives of building

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<sup>102</sup> The respondent published this experience in a vernacular daily, the *Sangbad*, in August 2011.

awareness through media publicity contributed to making people more informed than they were five years back. In contrast, the respondents identified a number of reasons for the lack of a satisfactory level of awareness about among people in general. These are, the low rate of literacy, the lack of campaigns about tax matters, people's indifference to tax issues, lack of or no opportunity for secondary and higher secondary students to learn about VAT or other taxes through their syllabus. An elderly respondent in this regard mentioned:

In our school days we became familiar with the terms and concepts of loss, profit, shares, and stocks in business as we did statement sums on percentage or ratio. If now the concepts of VAT or tax matters are introduced in mathematics, for example, in percentile sums, students can become familiar with these terms and automatically some awareness about tax issues will build up. (VGC 32)

Many general consumers in interviews pointed out that though they knew that a certain business, for example, a sweetmeat shop, was supposed to issue an invoice using their ECR, they did not dare ask for it as they apprehended that their request would not be met with proper courtesy and, worse still, such request might put them in some unpleasant situation. One respondent in this regard commented, 'Law is there. Law is everywhere, almost for everything. But what is absent is its enforcement' (VGC 24). Another respondent who happened to be an owner of a VAT-registered business offered a somewhat different explanation for retailer's general unwillingness for issuing a VAT receipt. He said, 'Most of the retailers in this city pay a fixed amount of VAT, irrespective of their sales. So, when the amount of VAT to be paid is fixed, then what is the use of issuing a VAT invoice? It is a mere waste of time' (VGC 21).

The perception that the VAT that most businesses especially those at the retail level paid was a negotiated amount was borne out by a few VAT officers. They maintained that the negotiated VAT was not meant to be an avenue for VAT officer's personal gain. Rather, when the VAT administration was convinced that they were not administratively in a position to collect 100% of VAT payable on a business's actual sales, they adopted the strategy of collecting the optimum VAT in

collaboration with the business. ‘As for retailers or most service providers, if we can collect at least 70 to 80% of the VAT payable by them, we should be happy’, said one VAT officer (VPI 10). He maintained that if the local administration did not opt for this kind of negotiated approach at least for the less organized sectors then the VAT collection would be drastically lower than what it was.

However, what was missing in this kind of negotiated approach was the spirit of transparency in business transactions that a VAT is ideally reputed to promote. But the attitude of achieving revenue targets or, in other broader terms, immediate gain or characteristic ad-hocism outweighs the long term goal of building a tax culture.

### **6.3.3 Remitting tax collected to the government**

As we have noted, a business in the course of its business transaction collects VAT from its buyers and, after adjustment of input taxes if any, passes the net VAT to the government exchequer. They have an important role in dealing with public money. Naturally the extent to which they are transparent and accountable in discharging this responsibility is of paramount importance. The perception of the general consumers in this regard was expectedly aligned with their perception that most businesses did not issue tax invoices. 49% of the general consumers believed that VAT collected by businesses is not properly remitted to the government.<sup>103</sup> This perception is borne out by an observation in a newspaper article that maintained that businessmen who collect VAT from consumers also do not deposit the actual amounts by underreporting the amount of sales (Nahida and Saleh 2011) .

Almost half (49%) of the respondents among general consumers believed that VAT collected from consumers by businesses was not properly remitted to the government exchequer. Those who believed that 100% of the collected VAT was not remitted to the government assigned almost equal importance to three factors, namely business people’s malafide intention (36%), lack of enforcement of tax laws

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<sup>103</sup> A recent (2013) TV commercial, sponsored by a VAT commissionerate in Dhaka, on the importance of receiving a VAT invoice glaringly reveals the current situation: the commercial tells a story which shows that by not taking VAT invoices from a sweetmeat shop, buyers help the business to defalcate an amount of about 1.6 m BDT of VAT collected annually from buyers. While this money helps the business expand, the evasion deprives people of many services they expect from the state.



(31%) and connivance between businesses and tax officials (30%) for not proper reporting and remitting of VAT.

The general perception about the business transparency fits quite well to the pattern that 'Business communities in most developing countries are not transparent, paying only a fraction of the taxes that are legally due' (Anam 2007). However, there are also different explanations from the ones given by many respondents. The following argument in a newspaper article is representative of the explanations given by a number of respondents both in interview and FGD:

In order to sell to the extremely price sensitive local consumers, businessmen are forced to cut corners, resulting in tax fraud and poor quality. The reality on the ground is that most businesses are not profitable if: a) Quality is maintained. b) Taxes are fully paid, and c) Employees are given decent living wages, given that utilities are highly unreliable, transport and port facilities are poor, extortion is rampant from government employees and elected officials alike, and local banks charge usurious interest rates.

Most businesses cannot afford to pay full VAT, simply because the market does not allow it. The end result is that the full VAT amount cannot be passed off to the consumers, and businesses must make up the shortfall by other ways and means (Hossain 2007).

The above statement argues well in defense of tax evasion, but at the same time it focuses on the socio-economic complexities and constraints that always offer some extenuating grounds for deviating from an expected pattern of behavior. For example, in the above observation, tax fraud was justified on account of factors such as the corruption of public officials, and the unreliability of utilities. But it seems really difficult to ascertain which the cause is and which the effect is.

Data show that while most of the respondents belonging to demand-side of stakeholders expect more transparency from the revenue authority, they are not as

vocal about their own transparency. This dichotomy became more apparent as the VAT-paying businesses expressed their strong dislike for special procedures like value declaration and supervisory clearance and their strong liking for similar deviations such as tariff value and lump sum VAT. This kind of collective action problem seems to have further detached transparency from the overall taxation culture.

## **6.4 Conclusion**

Data gathered from an array of stakeholders reveal the tax administration in Bangladesh shares the characteristic non-transparency that extends the length and breadth of the public service in Bangladesh. Though transparency is yet to evolve as organizational or institutional culture, the policy and practices in VAT have been generally perceived to be more transparent than the tax it replaced. Further, the tax administration was perceived to be placing renewed emphasis on becoming more transparent. The tax authority has committed itself to addressing the issue of the lack of transparency, evident through the excessive use of discretionary powers by the VAT officials, by gradually reducing many of these powers. But an equally important aspect – ensuring transparency in business transactions – seems rather unattended. The opportunity of using the VAT mechanisms for ensuring such transparency has remained mostly unutilized.

## CHAPTER 7

### ACCOUNTABILITY IN BANGLADESH VAT

Tax is not the sole determinant of rapid development but it is one pillar of an effective state, and may also provide the basis for accountable and responsive democratic systems

- OECD (2008).

#### Introduction

We have noted in Chapter 3 that historically the role of taxation in different countries has gone beyond financing the state expenditure to figure prominently in the evolution of states in Europe and North America (Tilly 1990). While there is general agreement among scholars that the elements of good governance such as participation, transparency and accountability are essential for effective and efficient taxation, there is a provocative hypothesis that the governments that rely more on tax revenue are likely to be more accountable than those that depend on non-tax revenue sources such as natural resource rents or foreign aid (OECD 2008). As Moore proposes, ‘The more government income is “earned”, the more likely are state-society relations to be characterized by accountability, responsiveness and democracy’ (2002:95).

Accountability as having a complex and mutual relationship with participation and transparency is uttered in the same breath in good governance as well as anticorruption discourses. While the relationship of accountability with transparency is inextricable, accountability also presupposes participation. In the last two chapters, I explored the extent to which the Bangladesh VAT in its policy and administration is infused with the good governance principles of participation and transparency. Pursuant to that discussion, this chapter addresses another seminal research question: To what extent does the Bangladesh VAT incorporate the principle of accountability in policy as well as practice? The chapter focuses on

two types of accountability mechanisms that the Bangladesh VAT department faces – internal formal administrative accountability and external informal accountability towards stakeholders, and measures the effect of the current state of these mechanisms in fulfilling democratic accountability through the process of tax collection. The chapter is organized as follows: the first section builds upon the conceptual framework of accountability. The second section explores at length the policy and practice of the different facets of administrative accountability in the Bangladesh VAT while the third section presents findings on taxpayers' accountability. A brief conclusion appears at the end.

## **7.1 Understanding accountability**

In plain terms, accountability is a process through which one is required to give an explanation for one's actions and performance. There are a host of definitions and interpretations of accountability in both public administration and development discourses. Definitions of accountability focus on two aspects: 'giving account' and 'holding to account.' In contrast to 'giving account,' 'holding to account' entails that an actor's accountability will not remain limited to disclosing information and justifying their behaviour but also that they are in a relationship with another entity which has the authority to impose sanctions or give rewards (Brandsma 2007). Based on this sense of accountability, Bovens defines it as 'a relationship between an actor and a forum, in which the actor has an obligation to explain and to justify his or her conduct and the forum can pose questions and pass judgment, and the actor may face consequences' (Bovens 2006:9).

There are many facets and dimensions of accountability that include political accountability, legislative accountability, judicial accountability, administrative accountability, professional accountability, constitutional accountability, social accountability etc. While political accountability involves accountability to ministers, Parliament, and also to voters and the public in general, bureaucratic/administrative accountability is imposed formally through the hierarchy within organizations – particularly bureaucratic organizations. It entails internal, but also mixed internal/external supervision, such as accountability to

ombudsmen, supreme audit institutions (Lonsdale and Bemelmans-Videc 2007). The government accountability incorporates two separate but intimately intertwined facades – political and administrative – as the one cannot be achieved at the expense of the other.

From the public service perspective, accountability is regarded as a proven means of ensuring that a civil servant conducts his/her administrative and social behavior according to the established codes of conduct. While Romzek and Dubnik (1987) see public administration accountability as a strategy for managing expectations generated within and outside the organization, Jabbra and Dwivedi (1989) view public service accountability as involving the methods by which a public agency or a public official fulfills its duties and obligations, and the process by which that agency or the public official is required to account for such actions. Bureaucratic accountability thus requires ‘public officials to remain liable to be called to account for their actions in terms of adherence to the rules and procedures, fiscal managerial and other administrative responsibilities’ (Siddiquee 1999).

A straightforward mapping of accountability involves four basic questions inherent in accountability: Who is accountable? To whom? For what? And how? (Bendell 2006). The first and second questions require identification of the agent and the principal. The third question invokes a clear specification of performance expectations and the fourth question is related to the various reporting relationships between the agent and the principal. But the answers to the questions will vary widely depending on the type of accountability as well as the context.

### **7.1.1 Accountability in taxation**

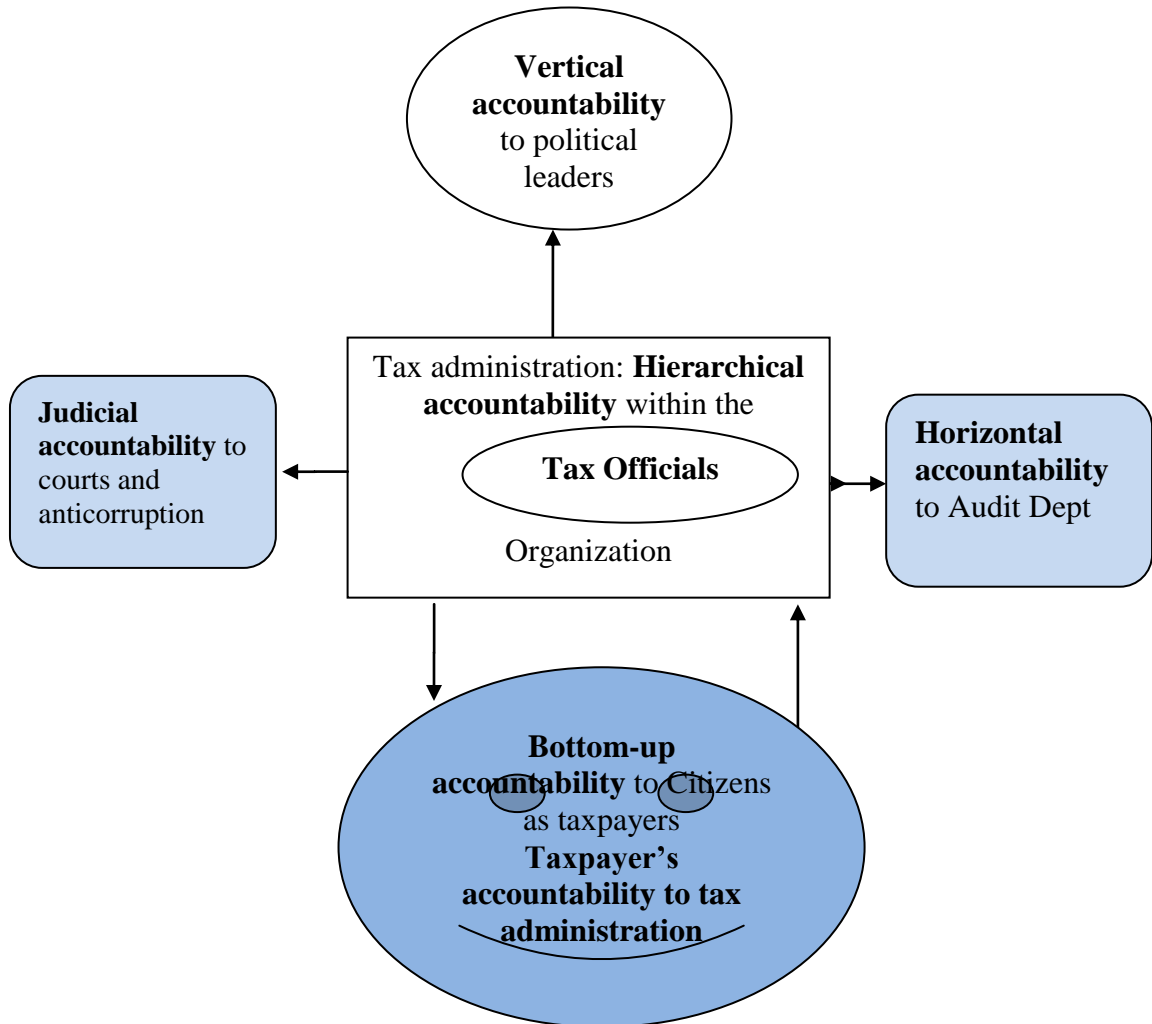
After the end of the cold war, factors such as the rising democratization of countries and the attendant emergence of strong civil societies and open media created more radical demands for transparency and accountability in the public sector (Khan and Stern 2007). However, the question can be raised as to whether all the actors of the public administration should be subject to the same mechanism, or the same standard of accountability. To be more specific, holding tax officials to account is more important than holding any other group of actors in the public administration to account, especially in the context of Bangladesh, for a couple of

reasons. First, as we have seen in the previous chapter, the VAT officers in Bangladesh have enormous discretionary powers and secondly, tax officers in developing countries are more vulnerable to corruption than many of their colleagues in the public sector. So, if the accountability mechanisms are meant to keep a democratic ‘check’ upon the behavior of public officials with discretionary powers (Brandsma 2007) as well as upon corruption, then accountability becomes an indispensable weapon in the bureaucratic arsenal for the tax administration. The accountability of tax officials is important on another count also. It is essential for breeding trust which is pivotal for voluntary compliance in taxation. If the public are convinced that the tax mechanism itself, not only the tax officials, is not subject to transparent accountability, then the tax mechanism will fail to command the trust and respect that is essential for a good tax system.

Accountability in the context of taxation provides a somewhat different paradigm from the traditional bureaucratic accountability. As a multilateral process, accountability entails that all actors are accountable for their actions in some way or other; it is not that one group of actors will hold another group of actors accountable while first group remains immunized from accountability. The multiplicity of accountability is more visible in taxation than in any other sector of public administration. In the case of taxation, it is not that taxpayers will hold the tax authority accountable while the taxpayers themselves remain unaccountable. Rather, taxpayers should demonstrate the same principle of accountability they call for in the tax authority and vice versa. Taxation is the area where the accountability relationship with regards to the public is reciprocal. As opposed to many other public sector domains where the public service providers (agents) are generally held accountable to the citizens (principal), in taxation, both the agents and principals are required to be accountable to each other. Hence in the arena of taxation, accountability does not remain limited to the obligation of those holding power to take responsibility for their behavior and actions. Actualizing accountability in taxation thus involves at least three critical aspects: first, the hierarchical or bureaucratic accountability of the tax officials within the administrative set up, secondly, their bottom-up or social accountability to the people as principals and thirdly, taxpayers’ accountability to the tax authority. In other words, accountability in a tax system is the practice of holding the tax system responsible for the extent to

which it is effective and efficient. Figure 7.1 below presents a visual articulation of the multi-channel accountability of the tax administration.

**Figure 7.1 Multi-channel accountability of tax administration**



Source: The researcher

Another still broader dimension is that taxation triggers accountability as there is historical evidence that the formation of accountable and effective states has been closely tied with the emergence of taxation systems (Moore 2007). In that dimension, the issue of accountability is closely knit with the concepts of revenue bargain and fiscal social contract that I discussed in the literature review chapter. It is interesting to note that in this paradigm, taxation acts as a tool for promoting accountability while it requires accountability of its actors in order for it to be effective and efficient.

## 7.2 Accountability in VAT in Bangladesh

In order to understand the accountability phenomenon in any public domain we need to look at its different dimensions such as policy, practice and perceptions. As a democratic state, Bangladesh is committed to ensuring accountability. As in the case of the promotion of participation and transparency, the annual the budget speeches show that there has always been a political emphasis on holding tax administration accountable. The commitment to accountability has been expressed, repeatedly almost ritualistically, by the Finance Ministers of different regimes. Unlike many countries, specially developed ones, Bangladesh does not have a taxpayers' bill of rights<sup>104</sup> as a separate legislation to use as a tool for ensuring tax officials' accountability. The absence of such a bill of taxpayers' rights has been compensated to some extent by a number of provisions in the tax laws that stipulate a number of taxpayer rights.<sup>105</sup>

In accountability discourse, accountability generally refers to the accountability of the agents to the principal. But taxation offers a different space where both the agents and principals have the imperatives to remain accountable to each other. In

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<sup>104</sup> The idea of taxpayer's bill of rights can be illustrated with an example. A Taxpayers' charter enumerates the following rights and obligations of the taxpayers. Taxpayers have the rights to expect the tax department to:

- Treat a taxpayer fairly and reasonably.
- Treat a taxpayer as being honest unless a taxpayer acts otherwise.
- Offer a taxpayer professional service and assistance.
- Accept a taxpayer can be represented by a person of his/her choice and get advice.
- Respect a taxpayer's privacy.
- Keep the information the tax office holds about a taxpayer confidential.
- Give a taxpayer access to information the tax office holds about a taxpayer.
- Help a taxpayer to get things right.
- Explain the decisions we make about a taxpayer.
- Respect a taxpayer's right to a review.
- Respect a taxpayer's right to make a complaint.
- Make it easier for a taxpayer to comply.
- Be accountable.

Taxpayers have the obligations to:

- Be truthful
- Keep the required records
- Take reasonable care.
- Lodge by the due date.
- Pay by the due date.
- Be cooperative

Source: ATO (2000).

<sup>105</sup> Refer to footnote 47 in the chapter 4 for the rights accorded to taxpayers in the Bangladesh VAT law.



this section I will first explore how the tax authority is made accountable, and then discuss the process of ensuring taxpayers' accountability in the next section.

### **7.2.1 Accountability of the tax authority**

While often regarded as a specialized public organization dealing with a specialist subject like tax, the NBR has institutional characteristics similar to other public sector organizations. The NBR has to deal with the diversity of legitimate and occasionally conflicting expectations from the political system of which it is a part. At the institutional level the organization deals with the need for being part of the wider social system which is the source of the meaning, legitimation, or higher level support which makes implementation of the organization's goals possible (Romzek and Dubnick 1987). So, it would not be practical to consider the case of accountability of the NBR and its staff in isolation. Three different dimensions of the accountability of the staff of the VAT department will be explored here: traditional bureaucratic accountability or hierarchical accountability which constitutes the formal internal accountability, horizontal accountability to an external agency like Supreme Auditing Institution (SAI), and accountability to the stakeholders or social accountability.

#### **7.2.1.1 Traditional bureaucratic accountability**

Hierarchy functions as a powerful instrument for monitoring the behaviour of the subordinates as well as for ensuring accountability in a government organization. In the hierarchical organization of the public administration in Bangladesh, each and every employee is accountable to their supervisor while the Secretary is accountable to his/her Minister, who is in turn, accountable to parliament. As members of the public administration, the employees in the VAT department are generally subject to the same standard accountability mechanisms that are practiced to ensure bureaucratic accountability. The efficacy of the mechanisms for ensuring hierarchical accountability will be examined against the criteria of charter of duties, specificity and clarity of rules and instructions, office inspection and performance appraisal. Though the accountability scenario in the Bangladesh bureaucracy is generally assumed to be similar across different organizations, how the VAT officers themselves perceived the scenario can add to understanding it better.

## VAT officials' charter of duties

In the Bangladesh VAT administration, a kind of job description outlining the roles and responsibilities of different administrative units and their staff was first made in 1995 through a general order which was later updated in 1999. In addition, VAT commissionerates have their own job descriptions for their staff. A close look into the job descriptions revealed that job description as a means of 'informing the incumbent of his/her duties and responsibilities as well as to whom the incumbent reports and who the incumbent supervises' was not fully developed in the VAT administration. But interestingly, most of the VAT-officer respondents (73%), however, were satisfied with the level of its clarity and specificity.

**Table 7.1 Clarity and specificity of job description/  
charter of duties (N=22)**

Level of Clarity and Specificity	Frequency	Percentage
Full	16	73%
To some extent/partial	6	27%
Not at all	0	

Source: Field survey and own computation

Against the common scenario that there are no clear, comprehensive job descriptions for any positions in most government units (Siddiquee 2003) in Bangladesh, the scenario of job description and the level of its specificity and clarity appeared to be better than in many other organizations. One NBR official's response in an interview corroborates the finding:

Both VAT law and rules clearly specify the authority, roles and responsibilities of different levels of officers. Moreover, there is a general order on the responsibilities of different units of a Commissionerate. So, I do not think that there is any room for ambiguities in discharging one's duties. (VPI 1)

But it would be interesting to see whether this specificity and clarity of job description contributed to holding the VAT officials accountable.

### **Rules/regulations/instructions for guidance**

It is recognized in the literature that rules and regulations are the primary means by which an administrative system designates responsibility and authority to its various organs and lays down the procedures for an efficient conduct of official business (Talib and Iqbal 2000). VAT officers in Bangladesh are primarily guided by the VAT Act and rules and orders made thereunder for discharging their duties in enforcing the tax law. In addition to the VAT legislations, they, as all other public servants, are subject to various service rules and regulations.<sup>106</sup>

In response to a question if they thought that VAT rules/regulations and orders guide them properly in performing their duty, 76% of the respondents answered in the positive. Of the respondents who opined that the rules/regulations/orders did not guide them properly in performing their duties, 27% stated that rules were either not clear or specific. But when it came to the question if they had ever experienced any conflict in different written orders and/ or verbal orders, the response was somewhat disconcerting. Almost an equal number (68%) to those who had agreed that rules guided them properly maintained that there were some conflict between different written orders, between written and verbal orders of superiors and also between verbal orders of different superiors.

The same notion was reflected in the opinion of a respondent who had worked in the NBR VAT policy level for quite some time. He explained the contradictory aspect in the VAT rules with an example:

The vagueness in or contradictions among some rules and orders is an established fact. NBR issues clarification about any ambiguity as and when it is approached by a subordinate office or a stakeholder. And clarifications are issued by different sections of the VAT wing at NBR. This negatively affects a coordinated response. I can give you an example. One business that manufactured construction materials

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<sup>106</sup> Service rules and regulations include: Bangladesh Service Rules (BSR Part I & II), The Government Servants (Conduct) Rules, 1979; The Government Servants (Discipline & Appeal) Rule, 1985, The Government Servants (Special Provisions) Ordinance, 1979, The Public Employees Discipline (Punctual Attendance) Ordinance, 1982, The Public Servants (Dismissal on Conviction) Ordinance, 1985, The Secretariat Instructions 1976.

approached the VAT wing with a request to classify their activity as a construction service that would require them to pay VAT at a truncated rate of 4.5% instead of standard 15% for a manufacturer. One section of the VAT wing upheld the view of the business while another section maintained that it was a manufacturing activity. There are numerous examples of this kind of conflict. (VPI 5)

Those who mentioned that they experienced some conflict were asked to specify the nature of conflict. Their responses, shown in Table 7.2, indicate the nature of the different types of contradictions. The most prominent was the conflict between different orders issued by the NBR from time to time. Next came the conflict between the written order and the superior's verbal order.

**Table 7.2 Nature of conflict rules/orders/verbal orders  
(N=17, F= 27) (Multiple answers possible)**

Nature of conflict	Frequency	Percentage
Between legal provision and NBR orders	5	19 %
Between different NBR orders	10	37%
Between written order and superior's oral order	6	22%
Between different oral orders of different superiors	4	15%
Other (please specify)	2	7%

Source: Field survey and own computation

The first phenomenon can be better understood if we consider the volume of regulatory orders: the NBR has so far (as of June 2012) issued about 600 SROs, 150 general orders and a host of explanatory letters to administer VAT. Though through the continuous process of repeal, replacement and amendment, the number of effective regulatory orders – both statutory and executive – has been reduced, many stakeholders including VAT officers sometimes find it difficult to keep track of SROs and orders that are in force. The second scenario – the conflict between a written order and the superior's oral orders – is not difficult to understand in a society characterized by an acute patron-clientelistic relationship (David Lewis). This argument is further advanced by the opinion of an NBR respondent:

We have to make certain concession on the basis of situational exigency. According to a general order, all cigarette manufacturing units are to be supervised round the clock by VAT officers. But in the case of an MNC, there has been no supervision. This was done considering the level of their compliance and integrity, and it was done on a verbal order. I do not think that the frequency of the contradictions between a written order and the order of a superior is statistically significant. Even in the case when it happens, it does not necessarily constitute a mala fide motive. (VPI 2)

This exception, no matter however bona fide it is, can be seen by an external auditor as a lapse on the part of the concerned VAT official and hence can affect the issue of his/her accountability.

### **Performance appraisal**

Academic writings have identified an interdependent relationship between accountability and performance (see, for example, Siddiquee 1999). Since the relationship between the supervisor and the subordinate in bureaucratic system is hierarchical and based on the ability of the supervisors to reward or punish (Romzek and Dubnick 1987), the performance appraisal is of paramount importance in ensuring the subordinate's accountability. In the case of Bangladesh, shortcomings in the performance appraisal of the public servants have been tagged with the weak system of accountability (Siddiqui 1996; Siddiquee 1999; Talib and Iqbal 2000; Rahman 2007). The extent of performance evaluation ranges from formal or informal feedback from the superior through the linkage between performance and incentives to the formal performance evaluation in the form of Annual Confidential Report (ACR).

#### *Feedback*

In response to the question of whether they generally received formally any feedback from their superiors on their performance, 76% of the surveyed VAT officers said there was very rare or no formal feedback. In interviews a number of NBR officials maintained that formal feedback was not a part of the performance appraisal culture anywhere in the Bangladesh public service. It should be mentioned here that performance appraisal in the public service in Bangladesh is not generally

followed by any feedback from the supervising officers unless there are hostile remarks by the reporting officers.

### *Sanction*

When asked to share their perception of sanction in case of the violation of the rules, procedures, instructions and codes of conduct, more than half of the respondents believed that for the violation of the codes of conduct, there was either very little or no sanction, while 32% believed that sanction was applied in a majority of the cases. This scenario becomes even more credible as none of the respondents reported having been subject to any disciplinary action. This picture reflects the general pattern in the Bangladesh public administration that officials/staff frequently deviate from correct and expected courses of action but are not penalized for abuse of power or for ignoring the need for neutrality (Talib and Iqbal 2000).<sup>107</sup>

A VAT Commissioner however did not subscribe to the idea that VAT department followed the pattern of sanction following any delinquent behaviour:

Whenever any breach of the rules or instruction is reported to us and we find that it has been done with mala fide purpose, we must take some action, though all actions are not very formal. We take informal measures like placing them in a less important position or making them OSD.<sup>108</sup> Bringing an officer formally to book for each and every deviation irrespective of its merit will not be cost effective. Moreover, if sanctions always loom large as the sword of Damocles, it will adversely affect the morale of the VAT officers.  
(VPI3)

The pattern of counterbalancing formal sanction with informal punishment that is characteristically evident across the Bangladesh public service seems to be more predominant in the VAT department, because, placement is an important issue in

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<sup>107</sup> A situation where 'good performance goes relatively unrecorded and bad performance is relatively unpunished'(Klitgarrd, 1995 cited in Kobb 2003) along with a pervasive presence of corruption and collusion may project the image of the many public organizations in Bangladesh as 'sick institutions.'

<sup>108</sup> In Bangladesh, Officer on Special Duty (OSD) is a misnomer as it virtually means officer with no duty. Designating an official as an OSD is seen as handing out a penalty. The OSDs, however, receive pay and benefits, but are not assigned to perform any task (Huque 2011).

the Bangladesh public service in general and the tax departments in particular. It has been gathered from a few informant interviews that expressions such as ‘prize posting,’ or ‘punishment posting’ indicate the value of posting. And this ‘value,’ arguably, is not always based on official fringe benefits or social prestige. It has a rather sinister connotation. It seems to be an open secret that the NBR’s transfer policy for certain categories of officers is based on the extent to which a posting is rewarding or punitive.<sup>109</sup> However, putting ethical consideration aside, it is quite difficult to ascertain if this kind of posting policy can be effectively maneuvered to ensure some degree of accountability.

While it is true that hanging the sword of Damocles over the heads of the actors in the form of evaluation and subjecting them to an accountability overload can be counterproductive (Brandsma 2007), failure to tag delinquent administrative behaviour with some sort of formal sanction is sure to cause damage to an accountability regime. The NBR’s informal sanction for VAT officers can be a tool for deterring delinquent behavior, but the action itself lacks transparency and has the potential to degenerate into corrupt practice.

#### *Linkage between performance and incentive*

Along with the sanctions for violation of rules and instruction in ensuring accountability, reward for satisfactory level of performance is equally important in the system of accountability. In contrast to most public service departments in Bangladesh, the taxation departments have provisions to link performance with some monetary incentives. Particularly, the VAT Act has the provision for financial reward for any person including a VAT officer for the detection of tax evasion or contravention of law.<sup>110</sup> The NBR has set the conditions of demonstrating

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<sup>109</sup> The NBR’s transfer policy for certain categories officers is manifest in its circular about how posting tenure of the Revenue and Asstt Revenue Officers will rotate from an A category of posting to a D category, A being the best and D the worst. Though the basis of this categorization has not been made public, it is believed to be based on the extent of ‘extra benefits’ an officer is likely to get from a particular place of posting. One argument in favour of this explanation is that while one office (i.e. Dhaka North VAT Commissionerate) has been categorized as A, another office (i.e. Inspection Directorate) in the same region, for example, has been categorized as B, C or D.

<sup>110</sup> According to section 71AA of the VAT Act, financial reward can be claimed by any person in case of the following situations:

- (i) The goods or other things to which such evasion or attempted evasion of tax or revenue or contravention of the provisions of law relates, are seized or forfeited; or
- (ii) the value added tax or relevant revenue is realised or, as the case may be, the fine imposed upon the person liable is realised under this Act and any other law for the time being in force; or
- (iii) the person liable under this Act or any other relevant law is punished..

extraordinary intelligence, honesty, rigor, additional efforts, and bravery by the claimants of such rewards<sup>111</sup> in the detection of tax evasion or attempt of evasion (NBR 2007).

In the same vein, in case of exceeding the target of revenue collection, a provision of giving VAT officials and employees a part of the additional collection as financial incentive was incorporated in the VAT legislation in 2007. Though the financial incentive scheme in the Bangladesh VAT administration is now broader in scope,<sup>112</sup> the legal provision has never been practiced, except once in 2008, even when the revenue target was exceeded.

The above mentioned financial incentive measures are in line with the generally recognized notion that through adequate motivational rewards such as financial incentives, or job security, recognition by the top level of the tax administration hierarchy of an employee's contribution to the organization's performance is not only a major component of the personnel management package but also eliminates or greatly reduces the incidence of dishonesty or corruption (United Nations 2002 :50). Though it is difficult to quantify the impact of such incentives and because there are no empirical studies on this issue in the present context, the financial incentive measures described above are widely appreciated across the length and breadth of the VAT administration in Bangladesh. This sentiment was aptly voiced by a VAT official:

Do you know that many honest VAT officers have become multi-millionaire by getting this reward for the detection and realization of evaded VAT? I believe that the NBR reward policy is a demonstration of tying incentives with performance. And if we can carry this trend forward, the propensity to indulge in corrupt practices will drastically fall. (VPI 2)

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<sup>111</sup> In FY 2009-2010, an amount of 90 million BDT reward money was allocated for all taxes under the NBR. An amount of 81 million BDT was disbursed as rewards among the tax officials and members of law enforcing agencies such as Border Guard of Bangladesh (BGB), Bangladesh Police and Bangladesh Navy (NBR 2011).

<sup>112</sup> Similar examples are evident in the tax administration of many other developing countries. For example, according to United Nations (2002), Uruguay established a Participation Fund financed by 30% of the additional collection received by the tax administration as a result of audits, examination and legal proceedings undertaken by its officials.



This is a comparatively recent initiative which was endorsed by most respondents as a move in the right direction. This initiative can be seen as an extension of the NBR initiative of linking the taxpayers' performance with some non-monetary rewards and social recognition. Based on the amount of income tax and VAT paid, the NBR has started honoring the highest income tax and VAT-payers in different sectors since 2007. Moreover, the state award of the status of Commercially Important Person (CIP) also hinges on the recipient's tax compliance.

As regards the linkage between their performance and different non-financial incentives such as getting an important or prestigious placement or being selected for a foreign tour or training, the majority of the respondents (60%) answered in the negative. Responses presented in Table 7.3 show that receiving an incentive depended more on the personal rapport with the superiors than any other factor. The second factor specified by respondents was regionalism.

**Table 7.3 Factors for getting non-financial incentives  
(N=15, F= 25) (Multiple answers possible)**

Response	Frequency	Percentage
Personal rapport with the superiors	13	52%
Political Influence	4	16 %
Other (for example, regionalism)	8	32%

Source: Field survey and own computation

On the other hand, some insiders in the NBR contradicted the allegation of 'subjective' distribution of non-financial incentives, pointing out that 'they are based on written guidelines.' But, again if we consider the pattern that 'rules are followed more in their violation than in their observance in Bangladesh bureaucracy' (Siddiqui 1996:75), the alleged subjective approach does not seem surprising.

### **Formal performance appraisal: ACR**

The ACR is the only means of formal, hierarchical performance appraisal in the Bangladesh public administration which applies equally to all members of the staff except the fourth class category. Employees are assessed on a number of personal traits and professional skills indicators.<sup>113</sup> It is evident that almost all of the

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<sup>113</sup> Indicators for assessing the personal characteristics are: a sense of discipline, judgment and a sense of proportion, intelligence, effort and exertion/enthusiasm, personality, cooperation, honesty/integrity, punctuality,

evaluation criteria are based on the subjective judgment of the evaluation supervisor.

The weaknesses, limitations and inadequacies of the performance appraisal system in the Bangladesh public administration in general have been widely noted in different studies (see Siddiqui 1996; Talib and Iqbal 2000; Jahan 2006). The unsatisfactory state of performance evaluation is almost as well known to the insiders as the outsiders and was reinforced by the perception of the incumbents. Data corroborate the already grounded level of dissatisfaction with the system, as more than 52% of the respondents expressed their dissatisfaction about the performance appraisal system against the number of moderately satisfied respondents at 28%.

Similarly, one NBR official admitted that subjectivity in the form of personal rapport, nepotism, favouritism and regionalism had some role in influencing the outcome of a performance appraisal:

It is true some officers sometimes undeservingly get a higher grade in performance appraisal due to personal rapport or nepotism, but it is quite unlikely that a deserving officer gets a lower rating than he/she deserves just because he/she did not maintain personal rapport. (VPI 5)

Another field-level VAT officer, however, maintained that the problems of the performance appraisal were not so much with the system as with the mindset of the reporting officers. He said, ‘Honesty is an indicator in ACR and if you look at ACRs, you will find that there is not a single dishonest person in the department (VPI 10).’

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dependability, a sense of responsibility, enthusiasm, pro-activity and carrying out orders, security consciousness and dealings with people. Criteria for evaluating the professional skills include professional knowledge, quality and amount of accomplished work, ability in directing and supervising other staff, relationship with co-workers, competence in taking decisions, ability in implementing decisions, interest and competence in giving training to subordinates, writing ability, spoken ability, promptness in writing and countersigning of ACR.

This view clearly vindicates the findings of other general studies on this issue. The observation by a veteran senior bureaucrat is worth quoting in this respect:

...there are also officers who feel embarrassed to write unpleasant reports against subordinates, and hence prefer to sleep over ACRs. On the other hand, since there is delay, subordinates find an opportunity to indulge in *tadbir*<sup>114</sup> not only to expedite the writing of ACR but also to extract praise in superlative terms. This activity is intensified particularly on the eve of promotions...Confidentiality is also totally gone. (Siddiqui 1996:99)

An ACR in the Bangladesh public service is generally important at promotion or upgradation time mainly for its potential nuisance value, because a hostile ACR may jeopardize a promotion but an excellent one will not expedite it. Given the perfunctory treatment to an accountability tool like performance appraisal as evidenced in the Bangladesh bureaucracy, it hardly pays the ACR to strengthen the accountability mechanism. The observation that ‘ACR has lost much of its value and there is an urgent need for its replacement’ (Siddiquee 2003 ) made a decade back seems to have lost very little of its relevance even to today’s public administration in Bangladesh. The case of the VAT department in this respect appeared in no way different from other departments.

### **Office inspection**

The Secretariat Instructions which stipulates the process and procedures to be followed in discharging administrative duties in general in the public administration has attached emphasis on the inspection of subordinates’ offices by the higher level officials in the hierarchy. The NBR issued a detailed directive<sup>115</sup> in 1997 to enforce inspection as a mechanism to bolster the hierarchical accountability within the organization. The directive determined the scale of inspection and provided a

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<sup>114</sup> A Bangla term for lobbying.

<sup>115</sup> Memo No 3(3) VAT (Audit and complaint) 97/440 (33) dated 10 September 1997. According to this directive an inspection plan is to be prepared on half-yearly basis and needs to be communicated to all concerned offices. Once the inspection is completed the report highlighting a number of critical administrative issues such as the collection of revenue against the target (NBR fixes a revenue target for each VAT Commissionerate which in turn divides it among the local VAT offices under it. The target of revenue is fixed on the basis of the expected growth of revenue collected in the preceding financial year) fixed for the office, the rate of the receipt of VAT returns, the number of audits and seizure cases and their disposal etc. A copy of the report is to be sent to the Inspection directorate who will then prepare an evaluation report and send that to the NBR.

template for inspection report. While all of the respondents admitted the importance of inspection as a tool for ensuring accountability, data suggest that office inspection in the VAT department was an irregular phenomenon.

The lack of office inspection was seen by a business leader as a contradiction in the behavior of VAT officials who ‘are so keen to control us by inspecting our business premises as frequently as they can’ (VBI 4). Again, in the opinion of a retired VAT officer (VEI 2), the office inspection scenario deteriorated as compared to the excise time when there was an office named ‘Directorate of Inspection and Training.’ With the renaming of the directorate as ‘Directorate of Audit, Intelligence and Investigation,’ the focus of this directorate seems to have shifted to the taxpayers. One NBR official (VPI 9) put emphasis on office inspection as a tool for internal audit. A catalyst for improving an organization's effectiveness and efficiency, internal auditing can be used as a tool for ensuring accountability in the management process as well. But in the VAT Department, as elsewhere, the idea does not seem to have been translated into action.

All in all, admitting the accountability deficit, a VAT policy maker maintained that the state of accountability in VAT department was a reflection of the whole scenario and if accountability standards are to be improved, then some holistic approach to the improvement of the overall accountability mechanism in the public administration has to be taken (VPI 1). What this part of the study specially depicts is that despite the specificity and clarity of job description that a VAT inheres, the traditional bureaucratic accountability mechanisms hinder a higher level of accountability for VAT officials. We can now turn to another façade of the problem.

#### **7.2.1.2 Horizontal accountability through external audit**

The audit of taxpayers’ accounts as well of the tax collectors’ performance dates back to the recorded history of taxation (Adams 2001). With the renewed emphasis on transparency and accountability, there has been the advent of what many anthropological researchers term ‘audit culture’ (Giri 2000). According to Power, ‘Audits are needed when accountability can no longer be sustained by informal relations of trust alone but must be formalized, made visible and subject to

independent validation(1994:11). With the rise of the phenomenon of what Power (1994) terms the ‘audit explosion,’ audit has become a ubiquitous tool of accountability (Giri 2000). We will discuss the role of two external auditing institutions: the Supreme Auditing Institution (SAI) and the Tax ombudsman.

### **Role of SAI in ensuring accountability**

As a traditional mechanism for accountability, most countries have SAIs to hold the public service providers accountable. Bangladesh is no exception.<sup>116</sup> Different directorates of the office of the Comptroller and Auditor General (CAG), the SAI in Bangladesh, conduct routine and special post audits with the motto of ‘attaining transparency and accountability in public financial management for achieving good governance’ (CAGB 2010). Revenue audit has emerged as a specialized domain of public auditing and has become the focus of SAI’s intense attention. The International Congress of International Organization of Supreme Audit Institutions (INTOSAI) puts special emphasis on the broadest possible supervision of revenues, a more intrusive check on whether tax payments are in line with legislation and on ascertaining if there has been negligence in the matter of collections of tax revenues (ASOSAI 1998a).

Local and Revenue Audit Directorate (LARD) of the Office of the CAG of Bangladesh (CAGB) periodically conducts<sup>117</sup> both traditional and performance audits of the NBR and its subordinates’ offices. (The revenue audit process in Bangladesh appears in Appendix 7). We can take the instance of the audit of VAT-LTU as an example of the horizontal auditing process in the VAT department of Bangladesh by an organ of the SAI. According to the Special Audit Report 2006-2007 (CAGB 2009) of the audit completed in June 2009, the LARD auditors found a number of irregularities that accounted for the loss of VAT amounting to BDT 12650 million. The Director General of the Office of CAGB commented in his remarks in the Report:

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<sup>116</sup> Pursuant to the provision of Article 127 of the Bangladesh Constitution, the office of the Comptroller and Auditor General (CAG) was established in 1973. Article 128 stipulates the functions of the CAG:

The public accounts of the Republic and of all courts of law and all authorities and officers of the Government shall be audited and reported on by the Auditor-General and for that purpose he or any person authorised by him in that behalf shall have access to all records, books, vouchers, documents, cash, stamps, securities, stores or other government property in the possession of any person in the service of the Republic.(Government of Bangladesh 1972)

<sup>117</sup> Though there is a controversy on the question of CAG’s mandate to audit income tax assessments as they are confidential as per the Income Tax Ordinance 1984, there is no such controversy in respect of auditing assessment records of indirect taxes (ASOSAI 1998b).

The financial irregularities of the audited organization that have been included in the report were a reflection of the small part of the total transactions carried out during the audit period. Objections and comments are only exemplary and not the complete picture of the financial discipline. It appears from the analysis of the irregularities included in the Report that non-compliance of the legal provisions of VAT Act and Rules and other orders and instructions of NBR, lack of financial discipline and lack of adequate internal control mechanism are the causes of these irregularities (CAGB 2009:5) .

The said audit report put forward a number of recommendations which emphasized the need for strict adherence to the legal provisions. Advice to increase supervisory monitoring and internal control mechanisms indicated the chronic problem that plagues many public service departments in Bangladesh. One recommendation – to determine the responsibility of the VAT officers involved in irregularities and ensure realization of evaded/avoided taxes – had a direct bearing on holding the concerned VAT official accountable for not doing what they were supposed to do according to the VAT rules.

It was learnt that in the VAT department there was no practice, following an audit report, to determine the responsibility of the VAT officers ‘involved in irregularities.’ One rationale for this practice, as gathered from a few VAT officials in VAT LTU, was that the responsibility of complying with VAT rules primarily rests with the taxpayers. So, if there is any deviation– bona fide or mala fide – the blame primarily rests on them.

Though, in accordance with the constitutional mandate, the CAGB audit should be directed to ‘the public accounts of the Republic and of all courts of law and all authorities and officers of the Government’ and hence, in this case, to the VAT offices and their staff, it ultimately turns out to be the audit of taxpayers. This is evident from different audit reports where the financial loss of revenue figured more prominently than the performance of the VAT officers. This notion of audit found manifestation in the observation by a respondent from the business community:

The CAG is supposed to audit the performance of the VAT office. But as soon as they come to audit a VAT office, the CAG audit team hands over a list of businesses to the VAT office and have the VAT office collect all their business records. And, at the end of the day, it becomes our responsibility to meet their official and ‘unofficial’ demands. More or less the same thing happens in the case of other audits also. (VBI 2)

Some business leaders, while admitting the imperative for effective auditing, also indicated that there were many instances where objections about so called irregularities were raised on the basis of whim rather than on substantial grounds. Worse still, though the burden of compliance with audit findings falls on the audited business firms, they had hardly any opportunity of defending their cases.

Almost the same point was made when attention was drawn to observations about a number of irregularities and the consequent loss of revenue in the most recent special audit report. One official in VAT LTU (VPI 9) commented that while there was some meritorious detection of irregularities, many of the objections were ill-conceived, without proper understanding of VAT.<sup>118</sup> An analysis of the aforesaid audit report revealed that in some cases (for example, audit observation in paragraph number 9 the objection of not realizing a sum of BDT 68.5 m) objections had been raised merely on presumption, a characteristically predominant trend of VAT assessment in Bangladesh. In the above instance, the objection of tax evasion was raised based on the presumptive quantity of medicine that could be produced with the raw material as per declared input-output coefficient.

The relationship between the auditor and the auditee, especially the level of trust and confidence between the involved parties is crucial in making the auditing process effective. In response to a question on how effective the audit by CAG in ensuring accountability of a VAT officer was, most of the respondents gave

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<sup>118</sup> This respondent cited an example of the audit observation that cigarette manufacturers evaded an amount of BDT 337m by not paying VAT on supplying unprocessed tobacco from their processing units to their factory. He maintained that it was conventionally known as an exempt item and no VAT was collected from the supply of raw tobacco from manufacturer’s warehouse to its factory since bringing tobacco products under VAT. Even if they would pay VAT on it, they would get the full VAT back as input tax credit and hence, in a true sense, no VAT was evaded. But the audit department did not subscribe to the explanation and the observation was not set aside, only to inflate the amount of potential revenue loss ensuing from audit.

somewhat negative opinion. A total of 84% of the respondent VAT officers perceived the CAG audit as either fairly effective or not effective at all. When the respondents who considered the CAG as 'Not Very Effective' were asked to give reasons, most of them held CAG auditors' lack of sufficient knowledge and skills about VAT and their 'censorious' attitude responsible. In the same vein, an NBR official commented that the CAG audit was done in a perfunctory manner and illustrated his view with an example:

One Auditor raised a very silly objection. When I asked him why he did so, he said, 'I have found everything OK. But if I do not make one or two objections, then it looks very odd.' (VPI 10)

A CAGB official however did not agree with the contention that their audit was not very effective. He pointed out that CAGB took the initiative to extensively train its auditors assigned to audit the tax department and hence the question of auditors not having required skills could not be sustained. On the other hand, he pointed to the mind-set problem of the auditee in making audits more effective:

No individual or organization likes to be audited. Audit people are seen as enemies or predators. But it is the responsibility of the audit department to see if the performance conforms to the set standard. And hence comes the question of fault finding, and there is always a tendency to thwart the process, mainly by resorting to different ways of non-cooperation. (CGA 1)

The audit expectation gap – the gap between what the auditors do and what the auditees or the third party perceive they do or expect them to do – (Lee, Azham et al. 2009) is a perennial problem in the domain of auditing. In the context of the Bangladesh public service, Chowdhury and Innes (2003) found that there were significant differences between the CAG auditors and the audit report-users in such important areas as auditor accountability, auditor independence, auditor competence, truth and fairness of the reported information and the role of the performance audit. The perception of the VAT officers of the statutory audit corroborates the earlier findings on the existence of a big gap between the



expectations of different stakeholders. If we take the number of irregularities that the external audit brought to light and also the amount of VAT revenue involved, then the CAGB audit would not look as ineffective as many of the audit report-users tended to suggest. This picture of the success of audits was, however, tainted by the allegation that the audits were more focused on inflating the figures of revenue loss than on improving the performance of the revenue department.

The SAI promised to devise adequate procedures for identifying loopholes, lacunae and deficiencies not only in tax administration but also in tax laws. But, the revenue audit by the SAI in Bangladesh was still limited to financial, compliance and proprietary aspects (ASOSAI 1998b). However, it is claimed by the Bangladesh SAI that its audit plays ‘a dominant role in bringing accountability and transparency in government operation with respect to revenue administration’ by bringing irregularities to light and facilitating the Parliament to hold the revenue authority accountable (ASOSAI 1998b). But, a review of the audit objections raised in audit reports, such as the aforementioned VAT LTU audit report, found that a lack of strict adherence to many established principles of audit<sup>119</sup> limited the potential of a more effective external accountability of the VAT officials. Moreover, there was evidence of repeated failure of the executive to respond to the critiques, suggestions and recommendations made by the oversight institutions and thus the ‘wild goose of accountability has forever remained a matter of mere chase and well beyond the reach of governance’ (Financial Express 2004).

### **Role of tax ombudsman**

The office of the ombudsman or tax ombudsman can be seen as another mechanism for ensuring external horizontal accountability of the public officials. The constitutional provision<sup>120</sup> for the establishment of the office of ombudsman was partially fulfilled by setting up the tax ombudsman office in 2006 ‘to ensure transparency in tax administration and accountability’. The Tax Ombudsman Act 2005 stipulated four roles, as evident in the statement of objectives (Government of

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<sup>119</sup> According to the OECD audit guideline, the principles are: accuracy, efficiency, fairness, objectivity, transparency, completeness, consistency, and defensibility (OECD 2006).

<sup>120</sup> Article 77 of the Bangladesh Constitution provides for the establishment of the office of ombudsman, and the Ombudsman Act was passed in 1980 in pursuance of this constitutional provision, but the office of the national ombudsman has not yet come into being.

Bangladesh 2005c), to diagnose, investigate, redress and rectify any injustice done to a person through maladministration by functionaries administering tax laws.

The definition of ‘maladministration’ with relation to tax administration was quite exhaustive<sup>121</sup> and captured the array of maladministration that a tax official might be susceptible to. The scope of this law was extended to 10 specific tax-related Acts<sup>122</sup> including the VAT Act. But the office of the tax ombudsman was abolished in 2010 on the ground of its being ‘dysfunctional and ineffective’. (See Box 7.1 for details). Instead of amending or modifying the Act to make it effective, the Act was repealed. It was paradoxical in that while placing the bill to repeal the Tax Ombudsman Act 2005, the Finance Minister lamented the nation’s failure to appoint an ombudsman ‘in around last four decades in line with the constitutional provision due to negative culture of politics’ (UNB 2011).

#### **Box 7.1 The genesis and the abolition of the office of Tax Ombudsman**

Tax Ombudsman Act, 2005 was explicitly modelled on the Federal Tax Ombudsman Ordinance-2000 of Pakistan (Government of Pakistan 2000). Though in Pakistan, the establishment of the office of the Federal Tax Ombudsman originated from the ‘public outcry against the tax collectors and the demand of business community for redressal of their grievances’ (Federal Tax Ombudsman Pakistan 2000), in the case of Bangladesh, the adoption of the Tax Ombudsman Act seemed to spring from external pressure rather than from within. It was reported in the print media that the World Bank insisted on the adoption of the Act and the donor went so far as to suspend the disbursement of the third tranche of the Development Credit Support (DSC), amounting to US\$200 million during June-July 2005, because of the government’s failure to appoint a tax ombudsman in time. Then Government took hurried steps to enact the Tax Ombudsman Act in July 2005. General perception of pervasive corruption in the tax department was surely a generic factor for the establishment of this office. Transparency International ranked the fiscal sector *sixth* in its sector-wise corruption ranks in 2002, *fifteenth* in 2004 and again *sixth* in 2005.

The tax ombudsmanship was withdrawn in 2010. The Finance Minister defended the bill to repeal the Tax Ombudsman Act 2005 in the parliament by saying that the office lost its efficacy in removing misrule in the tax administration. It has also become an expensive and dysfunctional institution. He was also reported to have said that the Tax Ombudsman office failed to detect wrongs for which it was created. Terming the Tax Ombudsman a powerless figure, the Finance Minister remarked, “It was simply wastage of money from the government exchequer” (UNB 2011).

Respondents debated whether there should be some additional mechanism for making the tax officials accountable, an issue that we have posed at the very outset of this chapter. One business leader maintained:

As tax officers enjoy a great deal of power, and power has an inherent relationship with corruption, the traditional bureaucratic practice of accountability for VAT or other tax officials is quite inadequate and the office of the tax ombudsman was a right approach. (VB I 2)

Almost the same view was voiced by a number of FGD participants belonging to the private sector. They maintained that the office of the tax ombudsman was a reflection of the idea that some additional accountability mechanism is needed to hold the tax official answerable. But a few other respondents belonging NBR contradicted the idea of having a separate or additional accountability mechanism for the tax officials. One of them argued:

Every professional has their own strengths and weaknesses. Indulging in corruption is not the sole prerogatives of the tax officials especially in Bangladesh. According to the TIB report, the tax department was never identified as the most corrupt department in the public service. So, if public service departments identified as the most corrupt ones, which I do not want to name, can operate under the bureaucratic mechanism of accountability, then what is wrong with the tax department? (FGD 7)

In response to the question whether the abolition of the tax ombudsman office was justified, an NBR official commented that the tax ombudsman office was abolished because it was not effective. He went on to say:

Why it was not effective is difficult to answer. But personally I think that it (inefficacy of tax ombudsman) has something to do with our overall culture. An aggrieved taxpayer has the forum to file an appeal. On the other hand, the tax ombudsman dealt with maladministration of tax department only, which is quite difficult to prove. (VPI 3)

It is interesting to note that though the respondents belonging to the private sectors generally favoured the existence of the office of the tax ombudsman, the abolition of the office was not protested by any business body. So the way it died a premature death is surely puzzling. The unexpected abolition of the office of the tax ombudsman is not an end in itself, but can also be seen as a paradigm that points to some socially intrinsic stumbling block to accountability and transparency and also sheds light on the intricacies related to ensuring accountability in Bangladesh, which I will deal with in more detail in chapter 8.

### **7.2.1.3 Accountability to the stakeholders**

Though ‘the primary concern of the concept of accountability has been on internal means of control’ (Paul 1991), the hierarchical control in ensuring public service accountability has been found inadequate and hence there has been a quest for an additional mechanism of accountability. So far we have examined the state of the internal, hierarchical formal mechanism of accountability in the Bangladesh VAT department. Administrative rules and procedures and auditing requirements can be seen as means of improving the ‘supply-side’ of governance (Malena, Forster et al. 2004:1). The inadequacy or the limited success of these top-down accountability mechanisms for the public service has prompted another type of accountability that is demand-driven, known in the development literature as ‘social accountability.’ Though mechanisms of social accountability can be initiated and supported by the state, or citizens or both, they are very often *demand-driven* and operate from the bottom-up.

Social accountability has been defined as ‘an approach towards building accountability that relies on civic engagement, i.e., in which it is ordinary citizens and/or civil society organizations who participate directly or indirectly in exacting accountability’ (Malena, Forster et al. 2004:1). This type of accountability draws mainly on the principal-agent model which has been extended to interpret the relationship between citizens and their governments. In this approach, citizens are considered the principals and the government with its service organs is the agent. The application of the principal-agent model is based on the assumption that ‘legitimacy and power of a government ultimately derive from those it governs and

that a government's primary purpose is to serve the interests of the electorate' (Ferranti, Jacinto et al. 2009:37).

Traditional forms of social accountability like public demonstrations and advocacy campaigns have been supplemented by more modern social accountability initiatives that include citizen report cards, participatory budgeting, public expenditure tracking, monitoring of public service delivery, investigative journalism, public commissions and citizen advisory boards (Ahmad 2008). Actors in ensuring social accountability include the general public, the media, research and policy organizations, community-, activist-, and faith-based organizations, labour organizations, business associations and private sector entities, public commissions and oversight boards and academic institutions (Ferranti, Jacinto et al. 2009).

Social accountability is very important for making the tax system effective. For instance, even if we assume that there is no lack of good intention on the part of the VAT office to enforce VAT law effectively and equally, one constraint to the effective administration of the VAT lies in the shortage of VAT personnel compared to the size of the population and number of businesses. In this regard it is not always possible for VAT office to monitor business activities of all businesses within its jurisdictions. Opportunities for the citizens to report irregularities in business transactions, for example, the non-issuance of VAT *chalan*, would not only ensure better compliance, but would also act a deterrent to indulging in any form of corruption that is believed to be quite rampant in the whole taxation scenario. The creation of such opportunities for the citizens entails creating some forum for civic engagement. But, in the context of taxation in Bangladesh, the issue of social accountability seemed quite unfamiliar. We have seen in the previous chapter on participation that there were some attempts on the part of the tax authority to engage stakeholders in the tax policy formulation. But this participation with its very limited space and scope was far from emerging as a mechanism for ensuring accountability.

We have noted that besides traditional bureaucratic accountability, there is no legal provision for civil servants to be accountable to any outside actor or forum. In this subsection, we will discuss a few actors and forums that could play a part in

ensuring bottom-up accountability for the tax officials in general and VAT department in particular. In doing so, we will examine the role of three actors/forums, namely citizens' forums, civil society organizations (CSOs) and the media.

### **Citizens' forums**

The imperative for a citizens' forum not only to hold the tax officials accountable but also to bridge the social distance between taxpayers and tax collector has been given due importance in the tax literature. We have discussed some of this aspect in the previous chapters on participation and transparency.

Respondents from different segments of VAT stakeholders put emphasis on the need of bottom-up accountability of the VAT officials. Even all the respondents among the VAT officials underscored the need for accountability towards the stakeholders and most thought that the mechanism for such accountability was extremely inadequate. Respondents representing the key stakeholders, such as the business community, shared the view that there was an acute dearth of this kind of accountability mechanism. In the FGD, one participant mentioned:

As a restaurant owner in Chittagong I pay a certain amount of VAT. But there are many restaurants twice the size of my business in terms of business turnover in the capital city who pay much less than I. But I do not have any forum or authority where I can raise this question.  
(FGD 5)

The lack of opportunity such as a forum to raise the tax issues in the existing system and the prospect of such forum being established was discussed in the FDG. The arguments about the potential of having a forum for bottom-up accountability are presented in the box below.

### **Box 7.2 District Coordination Committee: reflections from FGD**

In every district there is a forum called a district development coordination committee which is composed of the senior-most officers of all important departments, development agencies, and other organisations and representatives from the civil society and business bodies. The functions of this committee are mainly focused on the overall coordination and monitoring of all development programmes and projects under implementation and their review. The performance of different public service departments also come under the scrutiny of this committee. But usually taxation matters are not discussed in these committee meetings. This forum could be used both for making people aware of tax issues and for holding tax officials accountable socially. As opposed to income tax activity, the taxable activity in VAT is not so hidden; it is not impossible to guess how a business is doing from the briskness of its business. A sweetmeat shop that does brisk business from morning to midnight may not issue any VAT *chalan* to its customers. Issues such as if this kind of business is registered under VAT or whether it pays a reasonable amount of VAT or not can be raised in the district development coordination committee meeting. It is not only to hold a VAT officer accountable for his/her job performance, but also to raise awareness about VAT.

It is evident that while there are some opportunities for citizens to hold some sectors of the public service to account, however inadequate they may be, there is no such forum for the tax officials' accountability. The participation of the business representatives in the consultative committee discussed in the previous chapters gave them some role in formulating tax policy, but the issue of accountability remained quite unaddressed.

### **Complaints and feedback**

Enabling people to be heard, including handling complaints, is recognized as a key component of accountability to the stakeholders. Client feedback policy is a demonstration of an organization's commitment to being open, accountable and fair. Feedback includes compliments, complaints, suggestions or any information about the organization's program delivery, services or performance. Mechanisms of feedback, along with the citizen's rights and obligations, are also the key factors in a mutually beneficial relationship between the taxpayers and the tax administration (ATO 2010). Many tax administrations reputed for their taxpayer's service take special care to create an accessible space for citizens' feedback and their handling. Appendix 8 presents the expressed commitments to the rights to citizens' feedback in four countries for a brief overview of how tax administrations across the world value the importance of feedback including complaints. As opposed to this scenario,

the feedback mechanism in the Bangladesh tax administration in general did not seem to be satisfactory. This is even more unsatisfactory in the VAT administration. Like all other tax wings of the NBR, VAT wing has a section dealing with complaints. However, unlike the Customs and Income Tax wings, VAT wing has not made any mention of a redressal mechanism in its citizens' charter (NBR 2008). One VAT official in the NBR argued:

Complaints boxes have been placed in NBR headquarters as well as in the VAT commissionerates. But we do not receive many complaints that would merit investigation. (VPI 2)

The reason for the lack of interest in providing feedback including complaints is not very straightforward. One business leader (VBI 3) said that getting very few complaints did not mean that people had no complaints. He opined that making a complaint entails a level of trust and confidence in the person or authority one complains to. 'In our culture there is a proverb *'kaker mangsho kake khay na'* (a crow does not eat the flesh of another crow) and many aggrieved persons think that it is pointless to make a complaint against a tax officer to the tax authority.' The risk of being exposed and then facing a possible backlash is another deterrent for making complaints with full identity. Hence many anonymous complaints are made which do not merit consideration, let alone investigation, because, there is an official instruction from the Cabinet Division<sup>123</sup> not to entertain anonymous complaints. One participant in a FGD humorously mentioned that making a complaint as a VAT-payer against a VAT officer was tantamount to *'jole bas kore kumirer sathе zogRa kora'* (picking a quarrel with a crocodile while living in water).

### **Role of the CSOs**

It has been argued in the fiscal sociological discourse that open debate on tax policies forms an essential ingredient for the development of the social contract through which citizens feel motivated to pay their right share of taxes as they are confident of the fairness of the tax system (Moore and Schneider, 2004). The role of

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<sup>123</sup> Cabinet Division circular No. 1(4)91-MoPoBi (*Sadharon*)/163 (300), Date: 05/08/1993



CSOs and NGOs both as service providers and as promoters of good governance and democratization in Bangladesh has been highlighted internationally. Lewis notes ‘this sector continues to play key roles in providing important social services and, in some cases, to innovate new approaches to tackling poverty, and advocates in support of citizens’ rights’ (Lewis 2011:134-135). The reasons for CSOs to engage in tax issues are manifold. Besides ensuring adequate resources for financing anti-poverty programmes and improving the distribution of income and wealth, they can play a key role in enhancing government transparency and accountability (Friedman 2006). However, by contrast, the involvement of CSOs in making people aware of their rights and responsibility in relation to taxation has not been worthy of mention either by respondents or other researchers.

So far as the published records are concerned, the engagements of the CSOs in tax issues were only sporadic. One such attempt was made in 1997 by the NGO, Proshika, when it conducted a campaign for pro-poor financial reforms under the banner of ‘*kemon budget chai*’ (what kind of budget do we want?). It brought a range of individuals and organizations from political parties, trade unions and community groups face to face with the Minister of Finance in order to press for a more consultative budgetary planning process (Lewis 2011). The CPD is another CSO that has dealt with tax issues to some extent. According to the list of programmes posted in its website, CPD organized 18 different kinds of dialogues on an array of socio-political and economic issues in the last four years. But none of them exclusively focused on tax issues. Its dealing with tax matters seemed confined to its annual submission of a set of proposals for the national budget and its annual analysis of the budget measures.<sup>124</sup> In none of its suggestions did CPD emphasize the need for social accountability of the tax administration.

The perceived indifference of the CSOs to the tax issue, as noted earlier, is glaringly evident in another important document by the same CSO. *Bangladesh Vision 2021* published by CPD in 2007 put emphasis on the imperative of ‘an efficient, transparent and people-friendly land administration’ and ‘a trusted,

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<sup>124</sup> A study of its set of proposals for the national budget in the last five years shows that it made recommendations on the procedural aspect of improving the tax system. For example, in case of VAT, it recommended the introduction of a VAT inclusive maximum retail price (MRP), implementation of ECR and, more broadly, the adoption of a new VAT Act.

decentralized, and impartial police force,’ and an ‘independent central bank’ (CPD 2007). But in its suggestions for ‘an efficient, accountable, transparent and decentralized system of governance’, the need for a fair, effective and efficient tax system remained unmentioned. In fact, in this document, there was no substantive reference to the role of the tax administration, let alone VAT or any other specific tax.

These findings corroborate the findings in an earlier empirical study. Tasnim (2007) catalogues a number of policy advocacy issues in which CSOs in Bangladesh are involved: women's rights, education, public health, environment, labour rights and unemployment, political and human rights, law and order, corruption, and separation of judiciary from the executive branch. It can be inferred from her study that either none of the CSOs was involved in the advocacy of tax issues or, the CSO advocacy of tax issues was too insignificant to merit a mention.

### **Role of the media**

The role of media in ensuring government accountability and efficacy by reducing the information gap between officials and constituents and by mobilizing citizens to defend their interests has figured quite prominently in the development literature. Given that the pervasive presence of a top-down bureaucratic mechanism and the difficulty in accessing political information, the role of the media is especially crucial for ensuring accountability in developing countries (Stiglitz 2002). A veteran editor of the widely circulated English Daily commented on the role of media in promoting good governance in Bangladesh:

The boldness, the depth, and the frequency with which some of the leading newspapers write about corruption in government and in the private sector, abuse of political power, nepotism, and irregularities in general, are something previously unknown in Bangladesh. (Anam 2002:267)

We can compare the treatment of tax issues against this backdrop. A review of the newspaper reports in 2012 shows that most of the tax related-reports centre on budgetary measures involving different taxes, on business people’s grievances about tax matters, on the revenue performance of the NBR and its subordinate

offices, and on irregularities and corruption in tax offices. Respondents in interviews and the FGD generally opined that while the media in Bangladesh was playing a laudatory role in bringing public sector corruption to light, their efforts in making people aware of tax matters, their rights and responsibilities in the domain of taxation, and their right to demand accountability from the tax authority were inadequate. One FGD participant in this regard commented:

Both the *Daily Star* and the *Prothom Alo*<sup>125</sup> have launched active sensitizing campaign for a number of social causes that include human rights, environment, women's empowerment etc. But so far as I know, the only policy dialogue on the tax issue that a leading national daily arranged was on tobacco taxation in 2011, by the *Daily Star*. Other than some sporadic efforts, I do not think that tax is an important agenda on their cards. (FGD 2)

The role of media in promoting transparency and accountability seems to have matched that of the CSOs. Both seem to be moved by immediate public concerns and popular issues. A generic approach to state revenue and expenditure and how they are earned and spent is yet to capture their imagination. This lack of attention to tax issues seems more an omission than a commission because taxation has not emerged as a national agenda in Bangladesh to the same extent as in many developed and developing countries.<sup>126</sup>

Looking at the different mechanisms of accountability practiced in the Bangladesh public sector, it is not surprising that the findings on the practice of accountability and on perception are remarkably congruent. As a veteran newspaper editor observed 'there exists an adversarial relationship between the government and oversight institutions, a relationship in which the government is at best a reluctant partner, but most often a totally disinterested party' (Anam 2007). This disinterestedness and reluctance perhaps characterize not only the government

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<sup>125</sup> The *Daily Star* and the *Prothom Alo* are the two leading dailies published in English and Bangla respectively.

<sup>126</sup> The campaign against unjust tax reform under the banner of 'Movement to Defend Social Rights under Threat by Tax Reform (MSDR) in Brazil in 2008 (IBP 2012) can be cited as an example of increasing awareness about tax issues and their relation to state-building.

behavior but also other actors. We will delve into the details of this understanding in a later chapter.

### **7.3 Taxpayers' accountability**

Following the paradigm of multichannel accountability that I have presented earlier, the accountability of taxpayers is required not only to make the tax system effective and efficient but also to foster a pervasive culture of accountability. We have noted already that the efficiency and effectiveness of a tax system depends to a great extent on the level of voluntary compliance. It was also noted in Chapter 4 that the rate of Return filing was very poor in the Bangladesh VAT with the number of units submitting returns in 2009-2010 only 77,619 i.e. 16.15%. Against this background, we will investigate how VAT-payers in Bangladesh are held to account. Needless to say, the first and foremost tool for holding taxpayers to account is auditing.

#### **7.3.1: Tax Auditing**

Discussion on audit in the VAT literature has been limited to the audit of the taxpayers' business transactions. One of the cornerstones of the investigative powers of the tax administration, audit has come to play crucial role of deterrent as the economic theories of tax compliance suggest that taxpayers are amoral utility maximizers, i.e. the taxpayer's decision to pay or evade taxes depends on the probability of detection and the consequences thereof (Marti, Wanjoh et al. 2010). Auditing has emerged with reinforced urgency as tax systems started to rely more on self- assessment and voluntary compliance than on tax authority's assessment. In a modern tax system which relies more and more on automation and continuously strives to reduce human interaction, tax auditors through their numerous interactions with taxpayers operate very much as the 'public face' of a revenue body (OECD 2006). As already noted, as opposed to the earlier excise duty regime which used to rely more on physical control than on document check, VAT ideally relies on audit for ensuring enforcement. But many developing countries that have adopted VAT out of the pressing need for reforming their tax systems, have not been able to achieve a satisfactory level of audit performance (ITD 2005). We will explore the extent to which this general observation holds true in case of Bangladesh.

### 7.3.2 Audit scenario in VAT

Though the primary objective of audit is not to safeguard individual businesses against their errors, there is obviously an education element in every audit (Government of Meghalay 2009). But there is no component of taxpayer's education or identification of gray areas in the tax system in the expressed objectives of audit in the Bangladesh VAT department. That is to say, the audit is focused on taxpayer's delinquency. Table 7.4 below reports the audit scenario in numbers for six years from 2005. According to the NBR statistics, only 264 audits were done in FY 2008-2009 and 176 in FY 2009-2010 against a total of 480,467 VAT registered units and 44,719 manufacturers (NBR 2011a). Compared to the number of businesses registered under VAT and TT, and as Cottage industry, the number of audits stands well below 1%. Even compared to the number of bigger taxpayers, for example, manufacturers, the total number of audits still stood below 1%.

**Table 7.4 Audit scenario in Bangladesh VAT**

Year	Number of audited units	Percentage of the registered VAT-payers	Amount of evasion identified (in million BDT)
2005	450	.102%	1429
2006	569	.113%	1220
2007	1101	.187%	4285
2008	376	.061%	2635
2009	264	N.avail	1457
2010	176	N.avail	1719

Source: Hussain 2008, Annual Report (NBR 2011)

As opposed to the bleak scenario of audit, the scenario of physical control in the form of seizures of vehicles carrying VAT-able goods was much brighter. The number of seizures in 2009-2010 was 638 involving an amount of revenue of BDT 158 million. Far fewer audits (176), however, unearthed an evasion/avoidance of BDT 1719 million. VAT officers in general believed that the audit scenario in Bangladesh VAT is not as bleak as the published statistics shows. One VAT officer defended his stance in this way:

The total number of VAT registered persons includes an overwhelming number of service renderers and traders. Service renderers include importers

also. Besides, for most of the service renderers, VAT is withheld by service procuring entities. Hence auditing these VAT-payers will not be cost effective. The NBR statistics of audit did not capture the full picture. From my experience as a field level officer, I can tell with certainty that there is no manufacturing unit that has not been audited at least once in a three year period. (VPI 4)

This observation was borne out by the responses from the VAT-paying businesses, 73% of whom said that they were audited at least once in the last three years. This means that there might be gap between the number of audits actually done, audits in progress and audits reported to the higher authority.

As regards what a VAT audit unearths, false claims for credit or refund has been identified as the main target of audit (Keen and Smith 2007). VAT officers maintained that in their audits the number of under-reported sales outnumbered the cases of false input tax credit claims. The type of VAT evasion – reporting ‘only a portion of sales, falsifying records and accounts to match, or making some sales “off the books” entirely’ (Keen and Smith 2007: 7) – warrants immediate action like physical verification rather than a *post facto* audit. This rationale has been advanced in defense of the weaker profile of audit than physical control.

The relative importance attached to physical control, as noted earlier, indicates the VAT official’s general preference for it over documentary control such as auditing. Both VAT officers and VAT-payers considered physical control mechanism such as search and seizures more powerful than audit in combating non-compliance especially in the form of tax evasion. Given the correlation between the size of the VAT gap, the size of the shadow economy, and the prevalence of suppression fraud in the developing countries (Cnossen 2010), it is not difficult to understand the VAT officers’ bias towards the immediate impact of the search and seizure mechanism rather than the long-drawn process of audit with its delayed response. This approach is consistent with the idea that holds that one of the objectives of the tax administration is to work as much as possible in the here-and-now (Government of the Netherlands 2008). Moreover, the Bangladesh VAT officers’ preference for

physical control over audit can to some extent is understood in terms of their preference for an immediate reward over deferred or delayed gratification.

### **Frequency of audit**

As opposed to the number of formal audits, the number of visits to businesses by VAT officers is quite frequent. Most of the VAT-paying business respondents said that they were visited by field level VAT officers almost at regular intervals. The purposes of these visits range from reminding the business owners of their revenue target to routine checking of documents. VAT inspectors visit businesses to monitor that the trend of treasury deposit is in proper order.

In the interviews and the FGD, some respondents, however, maintained that in addition to their official significance, the VAT officers' visits of the taxpayers' business premises served the purpose of maintaining an 'unofficial relationship' which most modern tax administrations try to minimize in order to reduce the potential of an unholy alliance between the taxpayer and the tax collector. In response to the question whether the business was audited in the last five years, 63% of the responded answered in the positive. 48% of those respondents thought that they were given enough time to prepare for the audit. 42% respondents thought that they were given opportunity of self-defense. Only 17% thought that there was any element of education in the whole process of audit.

One complaint that came up as a pressing concern in relation to VAT audit was the duplication of audits mainly due to the lack of coordination between different auditing agencies. One participant in the FGD argued:

There is more than one agency for auditing us and many a time there is a lack of coordination. We face audit from CAG, the Audit unit of the VAT commissionerate and also from Audit directorate, one after another, and sometimes, even simultaneously. (FGD 11)

The duplication of audits has the potentiality of increasing the administrative cost for the auditee. In addition to keeping an officer tagged with the audit team, there is some informal expenditure associated with

audit. As one respondent remarked, in many cases they had to bear the expenses of accommodation, food and transport for the audit team that came from the headquarters. It was learnt from a few respondents that this matter of informal expenditure equally applied both to the VAT auditors and CAGB auditors.

### **Effectiveness of audit**

We can think of two statements about the fear associated with the tax audit:

Audit. It's a word that can send a shiver down your spine, and almost needs a phobia named after it. (Taxpayers Australia Inc 2012)

And,

Is there a word in the English language that strikes more fear into the hearts of American taxpayers than 'audit'? (MoneyInstructor.com 2012 )

Is this fear universal? This fear has something to do with the effectiveness of an audit. Respondents in the present study, however, generally did not give vent to a sense of fear associated with audit. They seemed to have been more concerned with the cost of 'managing' an audit. According to one respondent, 'unless you are in the hands of a few officers who are very skilled, honest, many of whom are arrogant and discourteous as well, audit is a matter of managing involving some additional cost' (VBI 3) .

On the other hand, when dealt with by what some business-community respondents termed 'skilled, honest but arrogant and discourteous,' officers, audits appeared to be a frightening matter. Because, as one respondent said, 'right from the beginning of an audit they start with the attitude of "catching a thief"'. They do not discount even a bona fide mistake. Their ultimate goal is to find a huge amount of evasion and raise a demand for that' (VBI 4). As opposed to the characteristic lax attitude of majority of the VAT auditors,



the attitude of some officers was seen as tantamount to arbitrariness causing a great deal of hassle to the taxpayers in the absence of their (VAT officers') proper accountability mechanism. As one respondent put it:

If a VAT officer raises a demand on unsubstantial grounds causing a great deal of harassment to a taxpayer and if the demand is withdrawn or revised downward on appeal later on, the relevant officer will never have to account for the harassment that he/she caused. The VAT law has given them the indemnity that whatever a VAT officer does in 'good faith' is beyond any question. (VBI 5)

The incident of receiving a demand on unsubstantial grounds can arise in two cases – a negotiation could not be reached with the 'compromising' auditors, or, you are caught in the hands of some uncompromising officers. The audit process in the Bangladesh VAT seemed to be characterized by a continuum of 'arrogance' and 'laxity'. While the characteristic laxity towards audits makes audits ritualistic, 'arrogance' is equally counterproductive. For, one proven consequence of raising demands on the basis of unsubstantial grounds is the ever increasing number of appeals and court cases which, as noted earlier, blocked a huge amount of revenue for years together.

### **7.3.3 Factors for the poor state of audit**

The findings presented in this section clearly show that audit – both in terms of its breadth and impact – is yet to evolve as a powerful tool for ensuring tax compliance in the VAT regime of Bangladesh. According to the respondents belonging to the VAT policy and administration, auditing has yet to take an institutional and professional shape. Data gathered from the different segments of respondents attributed the unsatisfactory state of audit to the following factors: a lack of pro-audit institutional culture and support, the predominance of excise mentality, lack of professional skills and orientation, political influence and preference for immediate gain over long-term benefits.

#### **Lack of audit culture**

Given the nature of the tax system and the verbal recognition of the importance of audit, audit should have been one of the most important wings in the VAT

administration. But, ironically, it is the most neglected section in the whole VAT administration. The main reason for this neglect lies in the tax authority's attitude towards audit. In most cases, the audit directorate or the audit wing of VAT commissionerate has been made a dumping ground. Placement in the audit directorate or in the audit wing is considered a 'punishment posting' by others. This is not a matter of perception only. It was pertinently evident that when a delinquent officer was to be given a less important job as an informal punitive measure, he/she was placed either in the audit wing or in the training academy. A VAT officer noted:

When an officer is posted in the audit department, you can see from his/her very facial expression that there is something wrong about him/her. When a colleague hears of another colleague's placement in the Audit directorate, there is every likelihood that the former would ask the later, 'What is wrong with you?' (VPI 6)

As noted in chapter 6, posting or placement in the VAT department matters a lot. Posting in an important station or section is not only related to a VAT officer's sense of recognition or social dignity, for many of them it means much more. The importance of the place of posting for many officers has something to do with how much extra booty they get out of their normal duty. But even the ones who care for recognition or social dignity do not want to be posted in the audit wing due to its low social image.

The potential for power with its attendant illegal financial gains plays a vital role in determining the place of audit as a posting. VAT-payers are generally more scared of the VAT vigilant teams that are empowered to intercept a conveyance carrying VAT-able goods and seize it than an audit team. So, a vigilance team exercises more power and commands more respect than an audit team. This again points to the fact that the audit is not as feared or respected by the taxpayers as it is in the tax administration in many developed countries. The lack of emphasis on audits in Bangladesh is in striking contrast to the fact that audits have become the major tool for tackling non-compliance and in revenue bodies in most OECD countries they

constitute the largest deployment of resources for administration of the laws (OECD 2006).

The neglect that the VAT authority seems to nurture towards audit is historical and dates back to the excise past of VAT. The majority of the field level VAT officers were recruited during the excise period and their excise mentality in many cases outweighs their VAT mentality. Officers mostly with excise orientation always prefer physical-skill based tasks to the technically challenging task of auditing. The RRC Report (2003) rightly terms this as ‘old habits die hard.’

### **Lack of institutional support**

The lack of audit culture seemed to have been reinforced by a lack of institutional support for audit. The importance of exchange and sharing of information between VAT and income tax or between VAT and customs is essential for the effectiveness of both the taxes. But, in Bangladesh, while the exchange and sharing of information between VAT and Customs departments is quite common in practice, the same between VAT and income tax is almost nonexistent. The complementary relationship that VAT and income tax forge in different developed countries, or at least, are supposed to forge, is remarkably absent in Bangladesh. The relationship is competitive rather than complementary. In the words of a VAT officer:

Though both Income Tax and VAT work under the same umbrella, there is rather rivalry between the two. This stems from a number of complex issues. It can be called a kind of sibling rivalry. (VPI 5)

It was learnt that some sporadic attempts for the exchange of information between the two departments were made, which were far from satisfactory.

The lack of institutional support was also manifest through the VAT administration’s failure to automate its core processes. While the customs assessment process was automated through ASYCUDA and has been running successfully in different major customs stations, the automation in the VAT department is still in the elementary stage. Given that an effective audit needs to have an optimum informational position through gathering ‘counter information’ from the third parties (Kamerling 2011), the absence of automated data interchange

with financial institutions or other organizations that have a stake in the whole process of taxation has made audit more difficult.

### **Political influence on audit**

When asked if there was any political influence on audit, an NBR official denied the existence of direct political influence in the first place. He touched upon what could be termed as indirect influence:

What is important is the emergence of the new political scenario where more and more business people are coming to the forefront of politics. A big chunk of the MPs are business persons. Naturally, our field level officers definitely feel shaky when dealing with a business of an MP or a minister. There is a kind of self-censorship out of fear of some bad consequences. (VPI 8)

Another NBR official supported the view of self-censorship by saying that the VAT officers had reasons to be cautious and self-restraining as there are precedents of bad outcomes following the audit or investigation of businesses of persons holding powers.

I know of a very good officer who undertook an audit of a big industry and unearthed a huge of evasion of VAT. The news of his detection was even published in a national daily. Though the businessman himself was not a politician he had ally among the politically powerful ones. He convinced the local MP that the very VAT officer was harassing him in the name of audit and the MP wrote a demi-official letter to the NBR Chairman requesting the officer's withdrawal on the grounds of public interest. And, the Chairman obliged the MP by withdrawing that officer from that station and dumping him in a less important place. So what lesson does this kind of incident offer to other officers? It is better to avoid than to engage in complications. In our department if you succeed in doing something beyond the call of your normal duty, everybody will cheer you. But if you are entangled

in some complication, no matter however innocent you are, you will be castigated as a ‘tactless officer’. Once bitten twice shy. (VPI 7)

The ‘patron-client’ relationship prevalent in Bangladesh and characterized among others by the political structures of domination (Jahangir 1982; Lewis 2011) is obviously present in the tax administration, and this relationship stifles much of the accountability mechanism. The political influence in formulating tax policy in general and tax auditing in particular can be better understood if we consider the ever increasing participation of business people in the politics of Bangladesh. Tasnim (2007) shows that while the percentage of business professions among the members of the parliament was 24% in 1971, the figure rose to 61% in 1991; it was 60% in 2001.

### **Lack of audit skills**

Lack of audit skills coupled with the same degree of lack of motivation on the part of VAT auditors is another hurdle to effective auditing. In the words of one respondent:

Many VAT auditors do not have enough skills and willingness to audit a business. I know of some instances where the auditors only put their signature on an audit report prepared by the business itself. (VBI 1)

The lack of audit skills among VAT officers was admitted by many VAT officers. One respondent (VPI 4) particularly mentioned that due to legal complications there was no recruitment at inspector (now re-designated as Assistant Revenue Officer-ARO) level since the late 80s. Most of the AROs and ROs were promoted from clerks and *sepoys* without the required level of academic skills. He however added that after the withdrawal of the legal embargo in 2011, recruitment to the position of ARO started and fresh university graduates with relevant academic backgrounds were expected to join the VAT staff soon.

## 7.4 Conclusion

Theoretically a VAT has the capacity to ensure the paradigm of multi-channel accountability that taxation entails. But in the case of Bangladesh, the VAT officers, or, for that matter, tax officers, are subject to the same inadequate accountability mechanism as other members of the public service. The powers that tax officials hold and their vulnerability to corruption require additional mechanisms such as horizontal accountability to the SAI or to an ombudsman and social accountability to the wider section of stakeholders. But no such mechanisms have emerged to a satisfactory level so far. Alongside the public accountability, the role of VAT in promoting the demand side accountability has also been found far from satisfactory. Given the broad range of roles that the tax audit is supposed to perform – promote voluntary compliance, detect non-compliance at the individual taxpayer level, gather information on the ‘health’ of the tax system (including patterns of taxpayers’ compliance behavior), gather intelligence, educate taxpayers, and identify areas of the law that require clarification – (OECD 2006), it is essential that a modern tax administration such as VAT allocate the majority of its staff resources to the audit function. But not only lacking in the commitment of resources, the Bangladesh VAT administration does not seem to have fully grasped the roles of audit yet. I will elaborate this finding in more detail in the next chapter.

## CHAPTER 8

### VAT IN BANGALDESH: JUST A REVENUE MAXIMIZER OR A TOOL FOR GOOD GOVERNANCE AS WELL?

Nothing shows so clearly the character of a society and of a civilization as does the fiscal policy that its political sector adopts. (Schumpeter 1954)

#### Introduction

Following the conceptual framework of the study which espouses the tax system as entailing an unavoidable social contract between the state and its citizens, the four preceding chapters explored the extent to what the Bangladesh VAT captures the spirit of good governance in its design as well as in practice. We may now try to piece together the findings and analyses into the perspective of our central research theme: the role of VAT as a tool for good governance in state-building.

The purpose of this chapter is thus to focus more critically on the answers embedded in the findings. The chapter has been organized as follows: the first section presents the design implications of the Bangladesh VAT and its bearings on good governance. The second section looks into the good governance values in the practice of VAT focusing in turn on the state of participation, transparency and accountability in the domain of VAT. The third section provides the factors that affect good governance in the design and practice of this tax system. The final section presents a brief conclusion focusing on the application of the findings to the research objectives.

## 8.1 Design of VAT and its bearing on good governance

The first research question involves an exploration of the extent to which the design features of the Bangladesh VAT are characterized by the principles of a good tax system. Findings in Chapter 4 show that Bangladesh adopted VAT in response to the imperative of maximizing its tax revenue mainly by broadening the historically narrow tax base and plugging the loopholes of tax evasion and avoidance. Though the political decision to adopt a sophisticated tax system like VAT was evidently inspired by pressures and prescriptions from the development partners such as the World Bank and IMF, the underlying idea was to make the consumption tax system more effective and efficient. Recalling the basic premise of the study that fundamental to development and economic growth, taxation can catalyze state-building and enhance accountability between citizens and the state (OECD 2010b), we can safely argue that tax reforms are not possible by sidetracking or failing to incorporate the values and practice of good governance.

Though VAT is based on some general principles, there is a great deal of diversity in its design and application in the different countries that have adopted a VAT. Given the view that ‘tax policy issues should be resolved in a manner that is compatible with the capabilities of the tax administration’ and that ‘tax design must ultimately be attuned to the countries’ divergent circumstances’ (Keen and Simone 2004:303), some adaptations of what is called the standard practice of VAT may become inevitable, and be considered desirable. However, experience shows that often adaptations and deviations are so extensive that the tax system is reduced to a position far removed from its core values and principles. This raises the critical question – where to draw the line of this ‘tuning process’ before a tax system degenerates into something other than what it was meant to be? This question becomes more pertinent in the case of Bangladesh VAT when it is labeled by IMF as a ‘so-called VAT’ or ‘an excise or turnover tax’ (IMF 2008).

The Bangladesh VAT is believed to be modelled on the UK VAT, as is the case for most Commonwealth countries (Thuronyi 2003). However, the view that ‘the initial VAT legislation in most developing and transitional countries was usually close to standard international models in part because it was often drafted in whole or part



with the participation of international experts' (Bird and Gendron 2007:67) does not apply fully to Bangladesh as it designed its VAT in a hybrid fashion, drawing heavily on the excise system and retaining a great deal of the excise traits, such as value declaration and account current method of payment, all noted in Chapter 4. It is pertinent to note here that deviations in practice from the theory of VAT are not uncommon. Bird and Gendron (2005) maintain that in implementing a VAT there is no such thing as 'one size fits all;' the country context may require some 'bad' features (such as too high or too low a threshold, extensive exemption, or domestic zero-rating, or multiple rates) for successful adoption in the first place. The evolution of the Bangladesh VAT legislation and regulations records an unmistakable inclination towards further deviations as they undergo a routine process of amendments every year during the budgetary session of the parliament. In the process, a great deal of adaptations and distortions have been introduced to rules and regulation which have distanced VAT from the standard practice. A narrow base with too many exemptions and multiple effective rates, stringent use of an input tax credit mechanism and the predominance of presumptive taxation are some glaring design features that have been found to affect the principles of good governance.

### **8.1.1 Narrow base with too many exemptions and multiple rates**

Bangladesh has adopted a gradualist approach in expanding its VAT base. Given that it is not feasible to bring the whole gamut of business transactions under the VAT network due to the concerns of equity as well as administrative and compliance costs, exemption is widely used as one of the fundamental methods of addressing such concerns (Bickley 2003). But the immediate impact of exemptions is that they affect the comprehensiveness of a VAT in a couple of ways: first, by narrowing the tax base, and secondly, by breaking the VAT chain.<sup>127</sup> But in the present context, the more pressing question is: to what extent are these exemptions

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<sup>127</sup> Looking from the perspective of procedural implications, exemptions break the VAT chain and give birth to the incidence of tax-on-tax which is undesirable in any tax system; for exempted items, a buyer does not pay VAT on exempted items and the supplier is not allowed input tax credits on their purchase of exempt items. An example may clarify the idea: (i) X buys a *taxable* input from Z at Tk. 100 and pays VAT of Tk. 15; (ii) X produces an *exempt* output and adds value of Tk. 30, does not charge a VAT and is not allowed input tax credit; but his selling price must include the VAT that he had paid to Z in the process of shifting his tax burden. [Tait (1988) notes that in selling exempt goods the trader must pass on the tax on inputs to the public in his price or cut payments to his factors of production]; (iii) Y buys X's output at Tk. 100 (input cost) + 30 (value added) + 15 (VAT, X paid) = 145 and produces a *taxable* output, adds value and charges VAT but is not allowed input tax credit as he did not receive any VAT invoice from X.

meant for ensuring equity?

In making decisions to grant exemptions, the progressivity or equity rationale did not seem to have been followed uniformly. For example, while the exemptions of unprocessed agricultural products, life-saving drugs and other basic essentials rightly fit the equity rationale, subjecting many 'standard' exempt items such as medical services to VAT was inconsistent. On the other hand, a VAT Commissioner's discretionary power to exempt a manufacturing industry fulfilling certain conditions of cottage industry belies the commitment to equity, as exemption for the sake of equity needs to be directed to a particular commodity or a segment of consumers, rather than to a type of business. In addition, the exemption scenario in VAT exemplifies how the tax authority wields its discretionary power to distribute its favours.

Differentiated rates in VAT also have been justified on the grounds of equity, otherwise, multiple rates in VAT distort both consumer and producer choices and complicate the tax collection procedure (Tait 1988). As shown in chapter 4, besides two statutory rates, there are as many as nine other effective rates of VAT in Bangladesh. In addition to creating unequal treatment among the VAT registered businesses, multiple rates complicate the tax structure and the pattern of uniformity that VAT upholds (Hemming and Kay 1981 cited in Tait, 1988). The same argument can be extended to multiple effective rates as offshoots of divergent methods of tax calculation. The resultant impact of a different product/service specific tax base and calculation methods has caused dents to the statutory principle of using a single rate VAT with a zero rate for exports. Though in many VAT regimes multiple rates have been adopted for equity reasons, in the Bangladesh VAT, its multiple effective rates seem little to do with concerns of equity. This is because differentiated rates of VAT have come into being due to different methods of calculation of VAT based on some notional base rather than actual one, only to contribute to the complexity of the whole process.

### **8.1.2 Treatment of credit mechanism**

Self-policing or, in other words, transparency that a VAT characterizes is embodied in its credit mechanism and, hence, forms the core of VAT. This transparency

mechanism has been mutilated by adopting some stringent attitudes. The first aspect relates to the fragmented definition of ‘input.’ The credit mechanism principle requires that prior-stage tax is immediately deductible or refundable if it has been directly invoiced to a taxable person and the latter uses the commodities in his / her business (Tait 1988). But, the definition of input in the VAT Act is truncated insofar as it does not entitle a business to claim input tax credit for a number of inputs such as building, vehicles, however incidental they may be to the value-addition process. Against the broad perspective of credit mechanism, the definition contains some contradictions as well. For example, the services of rent-a- car, architects and designers or furniture vendors are taxable services and *any* service is recognized as ‘input’ under section 2, hence, disqualifying these services as input even when they are used in any taxable activity in section 9 of the VAT Act is not well justified.

It is true that some countries such as France (Tait 1988) and China (Bird and Gendren 2007) take a stringent attitude by flatly disallowing credit for business purchases of automobiles and gasoline on the ground that no practical method exists for distinguishing business from personal use. Given that tax credit is an area most vulnerable to corrupt practices in a VAT and also the characteristic non-transparency in business accounts in Bangladesh, some stringent attitude in controlling input tax credit is quite desirable. But, control measures such as disallowing credit for automobiles without any reference to their usage as evident in the Bangladesh VAT do not seem to make much sense.

Another aspect of the treatment of input tax credit relates to the taxpayer’s right to immediate refund of the input tax. As Tait (1988:285) argues, ‘A VAT is intended to be a tax on consumption and not a tax on business; in principle, all excess of input tax over output tax should be refunded at once.’ However, instead of refunding the surplus input tax, Bangladesh provides it to be carried forward by the registered person in the account current for the next tax period. The input tax, thus, has to be adjusted against output tax in a long drawn process, and the process continues until and unless a VAT registered business is closed. This negatively affects the cash-flow of a business. Together with this, the provision of cancelling input credit proportional to the decrease in value of goods for some reason, as

evident in Rule 41 (5)(*kha*) of the VAT Rules, is tantamount to imposing a tax on the business itself.

### **8.1.3 Presumptive taxation**

We have noted in chapter 4 that the most glaring deviation in Bangladesh VAT from standard VAT practices is the predominant presence of presumptive elements. The effect of the presumptive elements was the main reason that the IMF classified the Bangladesh VAT as a ‘so-called VAT’ or ‘excise/turnover tax.’ Some forms of presumptive taxation are quite explicit, whereas others, although they have significant revenue implications, are implied. The most explicit form of presumptive taxation is the turnover tax. The implied forms of presumptive taxation include the notional values for assessing VAT, such as application of ‘tariff values’ and a ‘truncated base’ for a number of services and the fixed VAT liability for retail traders.

A proxy for a standard tax (Pashev 2005), presumptive taxation is commonly used for taxation of the so-called ‘hard-to-tax’ transactions, i.e. activities in respect of which the tax authorities cannot expect that taxpayers properly measure their tax liability on the basis of reliable accounts (Thuronyi 1996). Ahmad and Stern (1991) define presumptive taxation as covering some procedures under which the tax base is inferred from some simple indicators which can more easily be established than the base itself. Whereas Bulutoglu (1995) maintains that presumptive taxation is used mostly as a proxy for the imposition of income tax on small businesses, Thuronyi adds that presumptive taxation can be used for any tax (income tax, turnover tax, VAT or sales tax) that is normally based on taxpayers’ accounting records. Most discussion on presumptive taxation in literature focuses on direct taxes, i.e. income tax, property tax and land tax.

Being one of the oldest forms of taxation, presumptive taxation<sup>128</sup> is aimed at improving the efficiency of tax collection by reducing the compliance and administrative costs and also by facilitating the transition from a system of tax

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<sup>128</sup> Presumptive taxation is one of the oldest forms of taxation. The earliest forms of presumptive taxation date back to the 18th century, when the number of assets, rather than their value, was the most important tax base. At that time, taxes were based on wealth rather than on income. One of the earliest recorded presumptive taxes was the window tax in England, which was introduced in 1696; the number of windows in a taxpayer’s home served as the base for tax assessment (Smith 1776/2007).

assessment based on indicators and self-assessment based on actual income (Pashev 2005). It is mainly used to tax hard-to-tax sectors. Although Thuronyi (1996) argues that presumptive taxation can be used for any account-based tax, including VAT, there is not much attention in tax literature on presumptive VAT systems, and the reason for the lack of attention is obvious. It is not appropriate to apply presumptive criteria for VAT purposes because, in business-to-business relationships, the VAT liability of one business (the supplier) has, through the mechanism of input tax deduction, a direct effect on the tax position of other businesses (their customers). Another possible reason for the limited significance of presumptive taxation in VAT is that the tax is basically an *ad valorem* tax (Tait 1988). If it were not based on the actual value of transactions, the tax could be even more regressive than it is already considered to be, because, under an *ad valorem* tax, the burden of the tax increases in proportion to an increase of the value of the goods and services, whereas, under a presumptive method, such as a presumed ‘tariff value’ the burden of VAT remains constant, even if the quality and the value of the goods and services are higher than they are presumed to be under the tariff value.

Discussion of presumptive taxation in VAT literature is limited to its application to small businesses or, more specifically, businesses whose annual turnover is below the VAT registration threshold. Due (1970) notes that France, Italy and several other countries employ a *forfait* system for collecting taxes from small businesses. Tait (1998) suggests that the presumptive taxation scheme is just the fourth of the five ways<sup>129</sup> of treating the smallest businesses for VAT purposes. That is, in the field of VAT, presumptive taxation is an ad hoc measure, not an end in itself but a pathway to the standard form of taxation. Only judicious rather than indiscriminate use of presumptive elements yields beneficial results, such as ‘increasing government revenue in a way commensurate with efficiency, equity and administrative expediency’ (Taube and Tadesse 1996). Alm et al. strengthen this inference by noting that international experience shows that presumptive systems do not support the bigger overarching goals of the tax system, as they erode the tax

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<sup>129</sup> The first method is to straightaway exempt the transactions of small businesses from VAT. The second and third methods are based on the application of differentiated rates to transactions of small businesses.

base and provide an outlet for tax evasion and avoidance (Alm, Martinez-Vazquez et al. 2004).

In glaring contrast to the practice of presumptive methods in a VAT worldwide, the findings in Chapter 4 reveal the pervasive presence of presumptive elements in the Bangladesh VAT. The VAT authorities, however, have never publicly defended in writing their preference for presumptive taxation, nor does the VAT Act spell out the precise circumstances under which imposition of VAT on the basis of actual prices is replaced by presumptive criteria. Presumptive taxation in the field of Bangladesh VAT has become so pervasive that the effects go beyond the objectives of simplicity and efficiency; the presumptive elements damage the coherence and transparency of the VAT system itself.

As regards the turnover tax for small businesses, the arguments of equity and reduced compliance cost seem to be valid to some extent. Nonetheless, VAT policymakers also put forward the arguments of simplification and incentives, as mentioned by Thurony (1996), to defend presumptive measures in the form of tariff value or the application of a truncated base. However, in view of the broad scope of presumptive taxation, it cannot be reasonably maintained that the special measures can be justified on the ground that they apply to businesses whose business records cannot be relied on for tax purposes. In practice, the beneficiaries (or victims) of the presumptive measures are mostly established businesses that can dispose of quite sophisticated accounting systems, which gives rise to the question of why the Bangladesh legislature is so obsessed with presumptive taxation in the field of VAT.

### **Presumptive taxation: causes and consequences**

Findings indicate two major causes for this phenomenon. Firstly, the presumptive elements in the VAT system are directly derived from the tax that it replaced. According to Hofstede, 'tax systems do not just happen: they are created by politicians as a consequence of existing value judgements' (1991). That statement clearly applies to the policy, rules and procedures of the Bangladesh VAT system, which is still predominantly based on features of the former excise duty. In this

context, the RRC also noted that ‘old habits die hard’ (Government of Bangladesh 2003).

Secondly, the existence of presumptive elements in VAT is to a large extent prompted by a lack of transparency of business transactions, which we have noted in Chapter 6. Not only can small-scale businesses easily manipulate their tax liability in view of the fact that they mainly deal with cash transactions, bigger businesses also tend to keep ‘double’ records, i.e. records for (internal) commercial purposes and different records for (external) tax purposes. This lack of transparency in business records, or, in other words, the business people’s predominant reluctance to maintain transparency of business transactions, as supported by findings in Chapter 6, culminates in their preference for presumptive VAT.

Finally, specific instances of tariff value and the application of a truncated base are believed to have resulted from concessions granted to vested interest groups. This inference is reinforced as we note that in many countries presumptive taxation in VAT has been forced on governments by the recalcitrance of politically powerful small retailers (Due 1970). This reaffirms the point of how politics matters in taxation (Bird, Martinez-Vazquez et al. 2010).

Generally, the embedded rationale for adaptations in VAT includes maximizing revenue through procedural simplification and trade facilitation. As Saleheen and Siddiquee (2013) argue,

some tangible benefits that can be attributed to the adaptive measures including presumptive taxation in VAT in Bangladesh include but are not limited to: i. acclimatizing a sophisticated tax system like VAT to a culture characterized by non-transparent business transaction and non-compliance and thus making the transition from a narrow-based, more regressive tax system to broad-based, less regressive tax system acceptable to stakeholders in general; ii. revenue protection through customized devices such as value declaration, supervisory clearance, withholding and advance realization and the use of banderol; iii. facilitation of trade by means of notional bases for

the assessment of VAT and lump-sum or fixed VAT or even ATV at import stage, though not without compromising with revenue.

Given the Bangladesh VAT-payers' general preference for simplification in the form of fixed VAT, truncated base, tariff value rather than standard procedures of VAT, it can be argued that presumptive taxation helped expand the tax base. But going much beyond its transitional role or its use as a means of addressing the hard-to tax segment, it has become a norm rather than an exception. From the findings it can be safely argued that presumptive taxation did more harm than good. Its negative impact is not only limited to affecting VAT revenue and its design integrity, but also the overall tax culture.

The most important negative consequence of presumptive taxation in the form of notional valuation of transactions relates to the design of VAT. It disrupts the core principle of VAT-input credit mechanism that ensures the VAT itself is not a burden on businesses.<sup>130</sup> Another consequence of the presumptive method relates to the revenue efficiency of VAT. Saleheen and Noore (2013) show that there was a considerable gap between the amount of VAT revenue the production quantity of MS products should have yielded and the amount of actual collection of VAT revenue. Insiders in Bangladesh VAT generally hold the presumptive tax assessment method responsible for the alleged loss of revenue in such instances. This corroborates the theoretical underpinning of presumptive taxation as yielding less than potential revenue

There are a number of other social and procedural consequences as well. First, presumptive taxation undermines the most fundamental aspect of VAT: self-assessment. By downplaying the principle of self-assessment, the system in fact distances itself from promoting the culture of voluntary compliance. Secondly, deviations from the standard VAT system which are advantageous or

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<sup>130</sup> Business A, who pays VAT on the basis of a tariff value or truncated base, has purchased inputs for a total price of BDT 230 (BDT 200 plus BDT 30 in VAT). If its added value is DBT 60 and the tariff value or truncated base of the item is also BDT 60, business A cannot deduct the amount of DBT 30 and remits DBT 9 (15% of BDT 60) to the authorities on the subsequent supply to company B, even though the VAT exclusive selling price is DBT 290 (BDT 230 + BDT 60). Under the rules on input tax deduction, company B can only deduct the amount of DBT 9 that company A charged on the related invoice. Under the method prescribed by the NBR, company B is entitled to deduct BDT 39 (BDT 30 + BDT 9). However, that method is quite complex and cumbersome.



disadvantageous for specific businesses (other than small businesses) are discriminatory in the sense that they damage the neutrality of the tax. Thirdly, fixing a tariff value or the application of a truncated base for assessing VAT negates the very basic transparency element in the VAT. Fourthly, revenue statistics based on hypothetical, rather than actual, values produce inaccurate and possibly misleading statistics for future planning. Fifthly, as information on business turnover derived from presumptive VAT cannot be used for the purposes of income tax (Ahmad and Stern 1991), the presumptive elements of the VAT system hinder the full potential advantages of VAT. Finally, in practice, the presumptive elements in the Bangladesh VAT system have the effect of reducing the burden of VAT for businesses involved in the processes of production and distribution of goods and service, not for final consumers.

#### **8.1.4 How do design flaws affect good governance?**

As shown in Chapter 4 and the discussion above, the VAT was introduced in Bangladesh with a view to making the tax system simpler, more transparent and efficient. The intention of empowering citizens, and thus, facilitating voluntary compliance through self-assessment was ingrained in that approach. A hybrid tax system retaining as well as acquiring a great deal of characteristics from the previous tax system, the current VAT is perceived to be much simpler, more transparent and more efficient than the tax it replaced. But a VAT tempered with so many adaptations and distortions is bound to be inefficient. This inefficiency heightens the necessity of good governance as we consider the empirical findings that countries with a high perception of corruption tend to have low VAT efficiency ratios (Tanzi and Davoodi 2000). But on the other hand, Bangladesh VAT's obsession with presumptive taxation was seen as infringing taxpayers' right to self-assessment, and as blurring the inherent transparency in a VAT system. Presumptive taxation has given birth to double jeopardy as the tax officers' discretionary powers have become stronger while the promotion of transparency in business culture has been thwarted. Given that a transparent tax system is not an end in itself but a process of instilling the same spirit of transparency among its stakeholders, the Bangladesh VAT seems to lag far behind in playing that role. As argued earlier, a VAT can play a policing role not only within its own domain but also in making income tax evasion difficult. For example, the invoices that buyers

are supposed to receive in buying a VAT-able product are evidence of income for the sellers. That is why Hillman maintains, ‘with a value-added tax, buyers impose tax discipline on sellers’ (2009:254). But this role has become strained in the Bangladesh VAT as presumptive taxation discourages issuing or receiving tax invoices in many cases.

From the foregoing discussion it can be inferred that the tax reform agenda in adopting a VAT has so far remained focused mainly on increasing domestic tax revenue. The effects of the design and practice of the VAT on the overall good governance environment will be explored further as we look into the specific issues.

## **8.2 Good governance values in practice**

Having explored and analysed how the design features of a VAT affected the principles of good governance in the context of Bangladesh, we can now further elaborate the research premise by focusing on some more specific issues presented in the second research question. To what extent do the policy and practice of VAT in Bangladesh espouse the principles of participation, accountability and transparency has been presented in the three following subsections.

### **8.2.1 Actors, factors and processes of participation in VAT**

The enduring legacy of the colonial bureaucracy, which Bangladesh inherited from the British rule, still looms large. In this bureaucratic culture, the decision-making process in most of the government organizations is characterized by a hierarchical process that flows from top-down. According to Jamil (2007:129), ‘the bureaucracy in Bangladesh is characterized somewhat more by traditional than by modern norms.’ The traditional bureaucracy, as opposed to NPM, was not focused on external relations, and politicians, more specifically elected representatives, rather than external constituencies or communities, were the key point of contact between bureaucracy and the outside world (Tiernan and Althaus 2005). Jamil

(2007) argues that the Bangladesh bureaucrats' elitist<sup>131</sup> rather than egalitarian attitudes towards citizens go along with the level of their openness to citizen participation in influencing government policy.

The cooperation with taxpayers is deemed so crucial that Daunton goes on to say, 'The administration of taxes should, as far as possible, rest on cooperation with taxpayers, even at the expense of a degree of evasion or avoidance (Daunton 2002:6). On the other hand, Radaelli (2005:90) argues, 'when no attentive public exists, predatory policymakers encounter fewer constraints in extracting revenue.' Accordingly, citizens' participation can be a way for being attentive to tax policy and its administration. Insights into the participatory aspects of the Bangladesh taxation in general and VAT in particular would reveal the extent to which the administration responded to participatory approach in a public policy like taxation.

In the domain of Bangladesh taxation, the recognition of the importance to participation seems somewhat a welcome departure from the traditional administrative culture. It was optimistic to note that in contrast to many other government organizations, the NBR has been pursuing the issue of stakeholders' participation in the form of the consultative committee and occasional discussions with key stakeholders and has pioneered some innovative approaches like participatory fixation of VAT for the hard-to-tax segment of the taxpayers and the more recent scheme of ADR. Drawing on the findings presented in Chapter 5, the following subsections address the questions of who, why, where and how of participation in relation to the Bangladesh VAT.

#### **8.2.1.1 Who participates?**

Findings in Chapter 5 show that the tax administration was quite selective in choosing participants in its so-called participatory process. The opportunities of consultation with the apex revenue authority were few and far between and many business organizations generally regarded them as a favour extended to them by the NBR. But the NBR's consultation – favour – is alleged by respondents not to be

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<sup>131</sup> While an elitist bureaucrat maintains a distance from citizens whom he perceives as inferiors and expects them to follow his directions, an egalitarian bureaucrat considers citizens as equals with an ability to choose between alternatives (Jamil 2007).

distributed equally. The NBR's consultation widely varied from one segment of taxpayers to another. It is recognized that among stakeholders, some are more powerful than others or are affected by policies more than others (Sarker and Whalan 2011) and that the diversity and conflict of their self-interested special interests might jeopardize the overarching goals of public policy reform. As many regard participation as an inherently political process rather than a technique (Cornwall 2008), the process of inclusion and exclusion and the capacity to participate show that the VAT domain in Bangladesh can represent a stage for the politics of participation. Given the nexus between politicians and businesspersons and that business guilds constituted a substantial pressure group in influencing public policy in Bangladesh (Baldersheim, Jamil et al. 2001), the participation of the business persons and their guilds in the VAT policy was much deeper and wider than that of the general consumers. Going back to the design features of VAT in Bangladesh, the presumptive elements, many of which are believed to have stemmed from business group pressure, have a number of adaptive features primarily benefitting the businesses and not the final consumers. The same pattern is manifest in the NBR's space of participation.

While there is equal right for participation in elections, citizens in a democratic society do not possess equal opportunities in participation, when participation entails lobbying and other organized efforts to influence public policy, 'where differentials of wealth, power, and education shape people's ability and willingness to participate and influence policy outcomes' (Robinson 2002:159). If we consider the modernization theory that argues that political participation increases with socio-economic development and also consider the assumptions that increased income, high levels of education, urbanization and the existence of media are conducive to participation (Robinson 2002), then the case of Bangladesh generally does not hold a bright prospect for participation. The absence of participation of the general people and the limited participation of less powerful stakeholders clearly support this gloomy prognostication.

### **8.2.1.2 Capacity to participate**

Participation in the decision-making process inevitably presupposes a certain level of empowerment on the part of the participants in order for it to be transformative in nature. Empowerment can be in a variety of forms. While social power such as being leaders enables participants to exert their influence in molding decisions in their favour, technical skills and expertise on tax matters remain a pre-requisite for effective participation. In this respect, the lack of the expected level of participation in the tax arena in Bangladesh can be attributed to a great extent to the stakeholders' lack of skills. By extension of the modernization theory, people with lower level of skills in technical matters like VAT tended to have lower level of participation. Apparent apathy of a big chunk of stakeholders towards tax issues, as evident from findings presented in Chapter 5, seems to stem from the overall low rate of literacy coupled with lack of information and taxpayers' poor education about tax. The lack of taxpayers' education about tax or tax literacy has been perceived to be a particularly serious problem, about which, according to NBR's own confession, 'very little has been done' (NBR 2011b).

This scenario of the lack of capacity to participate can be looked at from another angle, i.e., from what the World Bank terms 'stakeholder management.' According to the World Bank (2009), stakeholder management is a process that creates new forms of competition among stakeholders and 'stakeholder participation is endogenous to reform, rather than an exogenous constraint.' But the three factors outlined by the World Bank – a. incentives driven by perceptions of benefits and costs, b. opportunities for influence, and c. capacities for participation – which determine stakeholder participation, need be taken into consideration. Our findings reveal that most of the respondents did not perceive their participation as cost effective and their opportunities to influence policy decisions were also very limited. Capacity to participate is a factor that has seriously limited the efficacy of participation. In the case of Bangladesh VAT, many stakeholders lack the capacities for effective participation. The tax administration's indifference to, if not neglect of, taxpayer capacity building through tax education and dissemination of information, as noted in the findings, has the effect of limiting wider stakeholder participation. The tax administration in general does not seem to have given heed to

the World Bank concept that strategic stakeholder communication through stakeholder management is an effective way for governments to successfully achieve significant policy reforms.

The blame game that we noticed in field data has its roots in the traditional bureaucratic attitude towards stakeholders' participation in public policy reform. Many VAT officials' attitude of downplaying the stakeholders' capacity to participate may remind us that 'public participation is inhibited by fears that while the process of decision-making may take longer, better decisions may not be made' (Petts and Leach 2000:57). Curtain (2003) notes that at times citizen participation may be opposed by politicians and public servants because it can be viewed as 'time consuming, expensive, complicated and emotionally draining.' Findings show that the fears and dilemma about involving the stakeholders in reforming the VAT loom large. This attitude seems dominant not only among local policy makers, but even among the international development partners when it comes to policy reforms in a developing country. We can recall from Chapter 5 that a VAT policy-maker quoted a donor-official as saying that consultation with stakeholders would put the reform process 'at stake.' This skepticism about the outcome of a participatory approach to tax policy formulation is indeed a pattern and hence works as a constraint to effective participation.

### **8.2.1.3 Space of participation**

To begin with a note of optimism, the findings in Chapter 5 show that there has been an expansion of what Cornwall (2008) terms the 'participatory sphere' in the domain of taxation, especially with the growing importance of the tax administration's institutionalized mechanisms for consultation with the key stakeholders. Moreover, the adoption of a participatory approach for fixing VAT at the retail level and the ADR scheme indicate the further broadening of the participatory sphere. The trend of increasing the breadth of participation can also be seen as a demonstration of the changing attitude of the policy makers to the concept of participation as a whole.

But while the sphere of participation has expanded as compared to the excise regime, the foregoing findings indicate that as far as VAT policy is concerned,

participation is taking place mostly in what Cornwall (2002) terms ‘invited spaces.’ It is the revenue administration which creates some spaces for participation for some key stakeholders and it is evident that there is a shift of attitude from the traditional view of participation to an NPM view of participation among the policy makers. What prompted the NBR to incline towards the participatory approach to some extent has a number of explanations. In the first place, there is an element of conceptual re-awakening: the command and control policy formulation has been challenged by the realization that democracies have to engage in consultative policy formulation to be more legitimate in their decisions as effective democratic policy formulation requires publicity, equality and inclusiveness (Pesquex 2009). Secondly, there has been some practical urgency in engaging taxpayers in the taxing process. For example, the participatory system of fixing VAT at retail level can be seen as an effort to avert resistance or non-compliance, while long-standing litigations in the courts blocking a huge amount of revenue prompted the adoption of ADR. Thirdly, the tax administration’s efforts to carve new space for citizens’ participation seem also to have stemmed from the bureaucratic policy makers’ responsiveness to both internal and external factors. The political preferences of the ruling elites serve as internal stimuli while the pressure from donor agencies serves as external one (Jamil 2007). These factors have created some ‘invited spaces’ of participation in the domain of VAT.

On the other hand, the much desired participation in ‘claimed spaces’ is not evident in the arena of Bangladesh VAT. This is due to several factors. First, so far as the tax legislation in general and the VAT legislation in particular are concerned, participation cannot be claimed as a matter of right. Second, the administrative culture generally has not been pro-participation. Third, the external force that could prompt the demands for claimed spaces is not active. Our findings show that the CSOs have not been seen as working towards advancing tax issues nor have they been engaged in campaigns or other activities to make people aware of their rights and responsibilities in the matter of taxation. It would not be inappropriate to say that the very idea of taxation as a tool for citizens to demand accountability and responsiveness is yet to be ingrained among the CSOs. This has posed a striking contrast to the ‘vibrancy’ of the role of the CSOs in Bangladesh. Parnini (2006) criticizes the primary concern of the Bangladesh CSOs with their own professional

requirements and efficiency. Parnini's observation has been borne out by the findings of this study of the CSO's very limited role in the sphere of taxation. Similarly, the business associations, who are otherwise more active than many other stakeholders, have mostly remained preoccupied with their own interests rather than with taxation as a national agenda to pave the way for building a healthy tax culture.

#### **8.2.1.4 Level of participation**

Whatever the level, participation in the domain of VAT in fact takes place in the form of what is known as 'delegated representation' (Birch 1971), more specifically, through the business bodies. But the extent to which the delegated representation reflects the hopes and aspiration of those who delegate the representation or the extent to which the representatives serve their own interest is a matter of long debate. But the popular perception is that representatives serve their own interest more than that of the people they represent.

In the case of Bangladesh VAT, participation has been a limited concoction of information, consultation and placation. This is tokenistic in nature. In Arnstein's ladder of participation, information precedes consultation as the third and fourth rungs, preceded by manipulation and therapy. Legitimate citizen participation necessitates informing citizens of their rights, responsibilities, and options and these can be the most important first steps toward participation (Arnstein 1969).

This pre-requisite for an effective participation can be better understood if we consider the approach that some VAT administrations adopted in introducing their VATs. Khadka (2005) attributes the success of the introduction and implementation of VAT in Singapore to the ways and means through which the majority of the Singaporeans were made to internalize the tax system as a part of their life style, while he identified ineffective taxpayer education as one of the causes of Ghana's first failed attempt of introducing VAT. In contrast, lack of dissemination of information and motivation through taxpayer education was evident right from the inception of VAT in Bangladesh.



Drawing on the depth and scope approach<sup>132</sup> to participation proposed by Farrington and Bebbington (1993), participation in the VAT domain in Bangladesh is both shallow in depth and narrow in breadth in that it includes a handful of participants with limited access to information and consultation and proceeds no further up the rungs of Arnstein's ladder. In this respect, a comment in the appraisal of the country's PRSP by the CPD is worth noting:

Number of consultations is not always the best indicator of participation. It is the process through which the consultation is undertaken and the mechanism for inclusion/exclusion of views presented by the participants. (CPD 2006:23)

The ministerial references in the budget speeches to the number of meetings the tax authority had with different segments of stakeholders attempted to showcase the breadth of participation, but the findings in the study clearly show that the breadth, let alone its effectiveness, has remained ever doubtful. Given that 'invited spaces and opportunities to participate [...] are often structured and owned by those who provide them' (Cornwall 2008), the NBR's power to include or exclude coupled with the above mentioned skepticism limited both the depth and breadth of participation.

### **8.2.1.5 Impacts of participation**

If the general perception about participation in the VAT matters is taken to be true, i.e. tokenistic or pseudo, that is participation in name only, then the NBR's attempts to involve stakeholders in pre-budget dialogue could be criticized as a process of providing opportunities for the more powerful and serving to maintain exploitation and exclusion (Hildyard, Pandurang et al. 2001). Taking into cognizance Arnstein's ultimate goal of the participatory process as culminating in citizen control, we can say that the existing practice of participation does not elevate citizens to the levels of partnership and citizen control. But does it mean that the current state of

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<sup>132</sup> Farrington and Babington's (1993) axis for measuring the depth and breadth of participation entails that a deep and wide participatory process engages a wide range of participants in all stages of a given activity while a shallow and narrow participation involves a handful of people in the preliminary levels of participation such as information and consultation. With varied combination, participation can be profound in depth and narrow in scope and so forth.

participation is useless? Perhaps, no. Different situations and interests invoke different levels of participation (Wilcox 1994) and the process of participation has its own value (Wilcox 1994) even if power is not always transferred in all participative processes. By extension of this understanding to the participatory process in the VAT domain of Bangladesh, the revenue administration's efforts to broaden participation by engaging the main stakeholders in tax policy formulation and its implementation can be seen as serving the purposes<sup>133</sup> of legitimization,<sup>134</sup> persuasion and education. These purposes should not necessarily be seen as only serving the ends of the administration (Denis Lucy 2005).

Although tokenistic participation has the potential of leading to loss of faith by the community in the long run (Bhatt 1997), the consultative nature of participation provides an opportunity for legitimizing decision-making and enlarging citizenship and thus enhancing democracy (Petts and Leach 2000). Numerous references to adopting a participatory approach in budget speeches served the purpose of legitimization quite well. In addition, participation aided in recognizing<sup>135</sup> key stakeholders as important actors in the field of taxation. It also partly paved the way for earning people's confidence in the tax system by forging a spirit of cooperation and trust. As the lack of the confidence of the taxpayers in the taxing system was an impediment to raising tax-GDP ratio to an expected level in Bangladesh (Government of Bangladesh 2007), a meaningful participatory approach in taxation emerged as an imperative.

There is no denying the fact that tax administration as a core component of broad bureaucracy has to uphold the spirit of 'joined-up government', a twenty-first century leitmotif in administrative reform that seeks to 'bring together not only government departments and agencies, but also a range of private and voluntary bodies, working across organizational boundaries towards a common goal'

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<sup>133</sup> Walters, Aydelotte, et al. have identified five purposes of citizen participation in public policy. They are a. discovery (aid in the search for definitions, alternatives, or criteria), b. education, c. measurement (assess public opinion regarding a set of options), d. persuasion and e. legitimization (2000:352).

<sup>134</sup> However, Cooke and Kothari (2001) take a cautious note of the tyrannical potential of participation as the fact of including people as participants endows authority to exercise power and control over individuals.

<sup>135</sup> The social importance of recognition can be comprehended better as we consider the damage that its absence can cause. According to Taylor (1994:25), non-recognition or misrecognition can inflict harm, can be a form of oppression, imprisoning someone in a false, distorted, and reduced mode of being.

(Bogdanor 2005:1). Carving new spaces of participation is surely one of the ways of achieving that end.

In the multidimensional and interdependent relationship between participation, transparency and accountability, informed public participation presupposes transparency while participation and transparency are essential for improving accountability. Can accountability or transparency be enhanced by introducing participatory elements into the tax system? The existence of ‘significant evidence that projects are more successful when there is a participatory element that can elicit accountability’ (Winters 2010:225) can be extended to the tax scenario as well. From another perspective, the participatory justice<sup>136</sup> that Young (1990) advocates, relates to the fundamental right to self-determination which has been guaranteed in the national constitution also.

### **8.2.2 Transparency and Bangladesh VAT**

While transparency has been seen as crucial ingredient in making an effective and efficient tax system, the choice of tax system itself indicates the extent to what the stakeholders prefer transparency. It has been already noted that the general pattern of greater reliance on indirect taxes in developing countries than on direct taxes is an indicator of their lack of a transparency culture. So, the overwhelming dependence for tax revenue on the indirect taxes in Bangladesh is indicative of the shortcomings in the transparency culture in the first place.

The low tax to GDP ratio in Bangladesh has been attributed to an array of socio-economic reasons. The most tangible among them is the pervasive presence of the shadow economy. Alm, Martinez-Vazquez et al. (2004) estimated the size of the shadow economy of Bangladesh in 2000 at 35.6% of the GNP against the Asian average of 26%. A more recent study observes a downward trend of the shadow economy and estimates the current size of this economy at 24% of the formal GDP (Hassan 2011). The policy suggestions to reduce the size of the shadow economy

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<sup>136</sup> Young (1990) advocates participatory justice for ensuring comprehensive environmental justice which can be advanced in respect of tax matters as well. Though distributional justice (i.e., equally dividing goods and burdens among stakeholders) can be possible without ensuring participation of the parties involved, he sees participatory justice as a basic element of the right to self-determination.

that the latter study put forward are mostly related to ensuring accountability and transparency.<sup>137</sup>

Findings presented in Chapter 6 generally indicate the poor state of transparency in the tax system in general and in the VAT domain in particular. They also show that there has been renewed emphasis on making the taxing process more and more transparent, and the existing VAT is more transparent than its predecessor – the excise system. The state of transparency in the policy and practices of the Bangladesh VAT can be comprehended in a couple ways: its lack of transparency in itself and its inadequate role in instilling the spirit of transparency among its actors. Both the principal and its agents i.e. the tax administration and taxpayers have an equal share in contributing to the current state of transparency.

#### **8.2.2.1 Supply-side transparency**

The revenue authority's share of this contribution can be judged from two dimensions namely, policy and implementation. The tax policy has not been imbued with the spirit of trust and confidence between the tax authority and taxpayers. In the absence of such trust, there is a tendency to manipulate the people through subtle obfuscation about the required payment of taxes rather than to motivate them with full disclosure to pay voluntarily out of a social contract or bargain of reciprocity. This lack of trust seemed to prompt the tax authority to present tax proposals in such a way that their implications are not clear. Keeping the actual purpose either vague or hidden from the citizens seemed to have stemmed from the belief that the vagueness would lessen the potential risk of resistance and help generate revenue. This attitude could be better understood if we consider the primacy of revenue generation where selective obfuscation is often quite creative (Manor 2002). In a political culture where reforms may be resisted just for the sake of opposing whatever the party in the government proposes without exploring its

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<sup>137</sup> The policy suggestions include:

- Increased financial transparency.
- Simplicity and transparency of tax laws.
- A system of rigorous audits with the full force of law without exception and with any undue political influence.
- All commercial transactions, beyond a fixed limit, through banking channels.
- Legal reform to ensure the highest level of transparency and accountability of tax officials and staff (Hassan 2011).

veracity, a thoroughly transparent approach might give the powerful interests the opportunity to offer stout resistance that could scuttle reform (Manor 2002). This utilitarian approach of selective obfuscation may be justified on the grounds of revenue maximization. The change of the calculation method of supplementary duty at the import stage as narrated by a retired NBR member in Chapter 6.2.1 is a good example of selective obfuscation. But the findings show that the obfuscation policy in the NBR is ubiquitous rather than selective.

As regards the implementation side, the traditional bureaucratic orientation that the public service generally inherited from the colonial past, and the revenue administration's characteristic preference for revenue over taxpayer's service accounted to a great extent for their non-transparent administrative behaviour. Part of the wide organizational culture, this non-transparent administrative behaviour was found to be deeply embedded in the pervasiveness of discretionary powers in the application of VAT rules as well as in the complexity of tax laws and regulations.

#### **Discretionary administrative powers vs. transparency**

Given that effective and efficient operation of revenue authorities requires a certain amount of discretion, it is equally important that discretions used for efficient collection of taxes do not negate or undermine the taxpayers' rights and interests. Hence, the critical question that haunts scholars as well as politicians is: how to strike a balance between revenue authority discretions and the principles of good governance in general and the rule of law in particular?

As noted in Chapter 6, the discretions granted to the government and the NBR are absolute as they are not subject to review other than by the discretionary entities' own volition. On the other hand, the discretions used by the officers are provisional as they are subject to review and possible reversal by another official (Hawkins 1992). Besides, most of the discretions are strong as the parameters for applying them, either by the organization or by individuals, are not clearly defined or standardized or published.

Though all these discretions are legitimate in so far as they are drawn from both primary and secondary legislations, there has been strong criticism from many stakeholders of the inclusion of excessive discretionary powers in tax laws in general and VAT law in particular. Findings demonstrate the predominance of excessive discretionary powers in the hands of VAT officers. Despite repeated ministerial pledges to reduce tax discretions and some resultant actions to curtail discretionary powers of tax officials, the extent of discretionary powers is still wide enough to create uneasiness among the taxpayers as far as transparency in applying tax rules and their certainty are concerned. As undue and excessive discretionary powers with their concomitant unpredictability, inconsistency and unfairness are seen as potential threats to the wider framework of good governance, tax discretions in VAT in Bangladesh have been decried by different segments of the stakeholders since its inception in 1991.

The administrative culture of command and control largely explains, as it does how spaces of participation are created, the pervasiveness of discretionary powers. Bangladesh, like many other Asian countries, has been categorized as a large-power -distance country (Hofstede 1991). The wide array of discretions vested in the public officials in general and the tax officials in particular in Bangladesh partly bear out the power distance concept as ‘the way power is distributed is usually explained from the behavior of the *more* powerful members, the leaders rather than those led’ (Hofstede 1991:61). Hofstede’s concept aptly describes the characteristic command behaviour which is so ingrained in the public administration of developing countries. The control culture arises from the tax administration’s perception of the taxpayers’ compliance behaviour which is generally characterized as non-compliant.

Given that ‘discretion is not only a pervasive feature of the administration of justice but one with certain positive aspects’ (Walker 1993:17), discretions in the VAT law in Bangladesh obviously have their significance. But, again, the problem is not with discretion itself but with its misuse. The judicious use of the power by the NBR to fix tariff value or the notional valuation method for certain sectors can help facilitate trade by enabling the concerned business sector to avoid the cascading effect in the absence of a comprehensive VAT; similarly the discretionary authority

of the VAT officers to re-determine the assessable value for the imposition of VAT can be justified on the ground of revenue protection in an evasion-prone culture. But, the potential of the misuse of discretionary powers aside, even the bona fide use of many discretionary powers has given rise to a number of consequences affecting the coherence of the VAT.

In the case of the Bangladesh VAT, there is an ostensible lack of a control mechanism for the exercise of administrative discretion, which tends to infuse a great deal of arbitrariness in the application of laws and rules. For example, the legislation that conferred upon the government and the NBR so many wide and strong<sup>138</sup> discretions did not specify under what circumstances and within what boundaries these powers are to be exercised. Practices in the Bangladesh VAT show that the exercise of the many of these powers has affected the basic design of the VAT and yet that has been done without any reference to the Parliament. For example, the NBR's power to bring any taxable goods and services under VAT irrespective of their annual turnover simply negates the standard principle of setting a VAT threshold. Also, the NBR's power to bring any goods or services within the purview of mandatory VAT registration irrespective of their annual turnover has virtually culminated in a gamut of zero thresholds for a number of goods and services. Similarly, there is no written standard guideline for the exercise of a VAT officer's power to increase the value of a product if it *appears* to him that amount of value addition in the product under consideration is *significantly low*.<sup>139</sup>

The potential of arbitrariness, as evident in the VAT Act and Rules in Bangladesh, negates the spirit of the rule of law (Dicey, 1885, cited in Freedman and Vella 2011). Looking at the pervasiveness of the discretionary powers, especially the government's blanket power to exempt any goods or services from VAT and NBR's power to produce rules, the balance between discretionary powers and the rule of law appears to be tilted towards the former. In addition to blurring transparency, the array of administrative discretions undermines the role of the MPs

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<sup>138</sup> According to Dworkin, there are two types of discretion: strong and weak. While strong discretion implies creating one's own standards for judgment, weak discretion involves interpreting a given standard in order to apply it (cited in Galligan 1986).

<sup>139</sup> By contrast, tax administrations in many developed countries like the Australian Tax Office (ATO 2004) have written guidelines to aid officers in the exercise of the statutory discretion contained in their tax laws.

as peoples' representative in making fiscal decisions that affect the electorates at large (Sirajuzzaman 2012).

We can note some other social consequences – both actual and plausible – of excessive discretionary powers. First, we have already noted the relationship between discretion and corruption is well established. Though there are no other empirical studies, the findings of the present study reveal the perception that a great deal of corruption in the Bangladesh tax administration emerged from the misuse and abuse of discretionary powers. This applies both to organizational and individual discretions. Second, undue and excessive use of discretionary powers infringes taxpayers' rights. The taxpayers' grumbling over the discretionary powers given to tax officials who are widely accused of abusing such power not only to harass the taxpayers but also to benefit themselves frequently made newspaper reports in Bangladesh. Third, the use of discretionary powers in tax law has prompted high incidence of litigation. Litigations filed by aggrieved taxpayers were identified as a serious bottleneck in the collection of tax revenue in Bangladesh. According to the statement placed before the Parliament in 2010, litigations impeding the collection of different taxes blocked the revenue flow amounting to BDT 1200 billion<sup>140</sup> (Government of Bangladesh 2010a). Of this amount, VAT at the domestic stage alone accounted for BDT 428 billion (Government of Bangladesh 2010b). It is usually believed by the insiders in the VAT administration as well as many stakeholders that many of these litigations owed their origin to the excessive discretionary powers of the VAT officials (Financial Express 2012a).

### **Complexity of tax laws and regulations**

The complexity of tax law seems to be a perennial problem worldwide. Not only in developing countries, the complexity of tax laws and the challenges to interpret them properly have been a problem in OECD countries also (Owens and Hamilton, 2004 cited in Kirchler 2007).<sup>141</sup> Unambiguous legislation is essential for the effective implementation of any tax, and it is even more urgent for a tax such as a VAT that is based on voluntary compliance or self-assessment (Cnossen 2010). In the case of the Bangladesh VAT, responses from the VAT-paying businesses as

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<sup>140</sup> This figure is about 20% of the tax revenue collected in FY 2009-10.

<sup>141</sup> Kirchler himself gives an impressive example of ambiguity by quoting from the Australian GST legislation: the lack of clarity won the legal paragraph The Plain English Campaign's 'Golden Bull'.



well from some other respondents indicate that the complexity of tax laws is one of the main problems of the tax administration. The difficulty or complexity of tax is not limited to the linguistic aspect, but also to the design.

To some extent, the complexity issue has been aggravated due to the powers of the government and the NBR to produce secondary legislations as and when they want. Secondary legislations in the form of SROs, Rules, General Orders, and Notifications are innumerable. Many taxpayers and VAT practitioners alleged that to find a valid legal provision of a certain matter was tantamount to wandering in a maze (Financial Express 2010a) comprising a plethora of rules, orders and notifications – some still valid, some rescinded, some substituted by others.

Apart from the clarity of legal provisions or the number of rules and regulations, the number of special provisions, tax bases and rates in the Bangladesh VAT would posit it as a complex tax. One potential social cost of tax complexity lies in the erosion of the transparency of interaction between the government and the citizens (Slemrod 2009). The tax authority, however, has been seen to take cognizance of the complexity issue as we see repeated references in the budgets speeches to their commitment to simplifying the taxing procedures. The efforts of making the VAT administration more transparent include publication of pamphlets on different aspects of VAT and explanatory notes on the implications of the changes and amendments made to VAT law and rules, and advertisements in print and electronic media. The observance of VAT week since 2010 has also added to that endeavour. Another positive development is that a number of discretionary powers of the field officers have been reduced and brought under some control mechanism.<sup>142</sup> But those vested in the government and the NBR have remained as wide as before.

#### **8.2.2.2 Demand-side transparency**

The satisfactory level of transparency in a good taxation system presupposes that tax transparency is a responsibility equally shared by the taxpayers and tax authority (Hildreth 2005). Findings suggest that there is a severe lack of transparency in business transactions, and VAT mechanisms have not improved the

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<sup>142</sup> Organizational and individual discretions have been significantly reduced in the new VAT law, which is supposed to come into effect in 2015.

situation to the extent it was expected. It is interesting to note that some factors such non-transparency in business, as noted above, contributed to presumptive taxation which in turn further added to making the scenario more opaque. Thus, this lack of transparency owed almost an equal share to business people's apparent apathy towards transparent business practices in the form of maintaining electronic bookkeeping or issuing VAT invoices. The paradox goes on as the business people persistently demand for transparency from the tax authority while keeping their own lack of transparency unattended.

Given that many developing countries have a large traditional agriculture sector and a significant informal (shadow) economy, both operating largely outside the formal tax system (Bird and Zolt 2007) and also that the relative size of the informal sector is often three or four times larger in developing countries compared to developed countries (Alm, Schneider et al. 2004), the general apathy towards using technology for business purposes is easily discernible. As business preference for remaining in the informal sector is prompted by the relative high costs and low benefits of operating in the formal economy (Bird and Zolt 2007), we have seen that there is neither compulsion nor additional incentive for keeping records electronically. Again, if we take that the cost of operating informally is the probability of detection, then the issue of the failure to enforce tax law arises, which ultimately encourages non-transparent business transactions.

In the absence of any compulsion or incentive from the VAT administration for keeping records electronically, a couple of factors prompted many businesses to reap benefits from non-transparent mechanisms. First, there is an opportunity of reducing tax liabilities based on presumptive standards rather than on actual ones. By extension, this offers the opportunity of indulging in corruption by VAT officers and tax evasion/avoidance by businesses. Secondly, as Ahmed (2011) in his study of Pakistan VAT/GST argues, the business community's apprehension of the use of VAT data by the tax authority to determine income tax liability is one of the reasons for their apparent resistance against VAT reforms that should be in their interest and that require transparent business transactions.

The dynamic and reciprocal relationship between the tax authority and the taxpayers requires a holistic approach to transparency and accountability. This is more crucial in a social setting where ‘unfair business practices are alleged to be prevalent [ ] in the production, importation and distribution of some goods and rendering of some services, both in the public and the private sectors’ (Government of Bangladesh 2005a:73). Fung and Weil argue that transparency must be applied across all of society, not just government, as the energy devoted to making open government must not come at the expense of leaving the operations of large private sector organizations opaque and secret. Adherence to the inherent transparency mechanisms in a VAT can be an aid to ‘marshal forces in government and the civic sector into a movement for an *open society*’ (2010:136, italics in original). But those mechanisms, as noted, have been more flouted than adhered to.

### **8.2.3 Role of VAT in promoting accountability**

Building institutions of accountability as well as giving accountability an institutional shape is of paramount importance in order for accountability to be a key player in the process of good governance. In addition to the effective accountability mechanisms within the spectrum of the public service, institutions and mechanisms are needed for citizens’ voice and exit, the norms and networks of civic engagement (Shah 1998 ). As in respect of transparency in a tax system, accountability also does not remain confined to holding the agents (tax officials) accountable only; but the accountability of both tax officials and the taxpayers (principals) is mutually reinforcing.

The findings on the state of accountability presented in Chapter 7 demonstrate that the accountability in the domain of the Bangladesh VAT is quite typical of the characteristic state of accountability in the public service in the first place. So far as the administrative accountability of the tax officials as agents to hierarchical superiors or the citizens as principal is concerned, we find the following traits:

- The same degree of inadequate hierarchical accountability as evident across the different domains of the public service;
- Inadequate horizontal accountability to organizations such as CAGB;

- Inefficient mechanisms for taxpayer's accountability;
- Absence of social accountability.

Drawing on our argument that accountability in a tax system involves a reciprocal or two-way accountability between the taxpayer and the tax authority, findings show that the Bangladesh VAT plays a very limited role in promoting accountability across the board. We will bring the point home by focusing on both supply-side and demand-side accountability.

### **8.2.3.1 Administrative accountability**

Findings suggest that accountability practiced generally in the Bangladesh public service is of the top-down category. The tax administration is no exception. While the issue of using compensation and other incentives to motivate tax administrators to act in accordance with the interests of the government (World Bank 2011) has become an agenda in tax reform, a concomitant issue may arise: should tax officials be subjected to a different set of accountability mechanisms? This becomes more compelling in the context of Bangladesh as we consider the wide range of tax discretionary powers, as presented in Chapter 5, and the tax officials' relative vulnerability to corruption as compared to many other public service agents. In this context, an independent external institution carrying out the tax administration's audit of operations and assessing its performance along with a system of internal audit is essential for tax administration's accountability (Miller 1994). If we consider the creation of the office of the tax ombudsman as a bid to subject tax officials to an additional accountability mechanism, then its untimely abolition surely casts doubt on the administration's sincerity of intention to make the tax administration accountable.

Findings on the scenario of VAT officials' horizontal accountability to the SAIs too do not present any better picture. The VAT officials' external accountability to the SAI was seen as affected by a few factors. First, the VAT officers were not seen as clearly convinced of the authority of the CAGB to audit them. Particularly, the debate over the authority of the CAGB to access taxpayers' files has been a long-standing issue between the CAGB auditors and the income tax officials (ASOSAI

1998a). Second, the relationship between the CAGB auditors and the VAT officers was found to be more of competition than of cooperation. While the VAT officers questioned both the legal authority and the technical capabilities of the CAGB auditors to audit them, the latter treated the former's skepticism and reluctance to cooperate as a demonstration of characteristic fear and aversion towards audit. Moreover, the absence of performance audit and the prevalence of fiscal audits characterized by a number of presumptive criteria seemed to contribute to the fact that the SAI audits were yet to evolve as a formidable tool for holding the tax officials accountable.

### **8.2.3.2 Taxpayers' accountability**

In self-assessed taxes like VAT, 'the success of the self-assessment strategy hinges on taxpayer perceptions of the effectiveness of auditing' (McCarten 2005). But most of the VAT-adopting countries in the developing world acutely suffer from the lack of effective auditing-syndrome. Many of the reasons that the International Tax Dialogue (ITD) identified for the failures to implement effective audit programs hold equally true for Bangladesh: a. organizational culture characterized by the lack of audit culture (i.e. the lack of an institutional history of sound audit practice); b. the lack of institutional support; c. the lack of skilled auditors and, d. the lack of clear political support for the tax administration (ITD 2005). The other reason – the lack of an appropriate legal and judicial environment – though present, did not seem to pose a significant stumbling block to effective auditing in the Bangladesh VAT scenario. This list of reasons, however, can be supplemented by other reasons, namely, lack of automation, and lack of interface between different taxes.

What is more necessary for making the audit effective in the first place, however, is a pro-audit institutional culture that Hofstede (1991) terms 'the software of the mind' which appears to be severely lacking in the organizational culture of the tax administration in Bangladesh. This seems to be another paradox: an audit based tax system is administered while nurturing an apparently anti-audit bias. The combined impact of these factors has resulted in VAT officers' general unwillingness for placement in audit units. This has made audit a perfunctory task rather than an effective tool for ensuring higher level of tax compliance. All in all, the opportunity that a VAT offers in promoting reciprocal accountability has not been availed in

Bangladesh. And of all shortcomings, a lack of a strong organizational commitment towards institutionalizing audit to a great extent accounts for the perceived failure to effectively hold taxpayers accountable. Such an organizational commitment, nonetheless, needs to be balanced by a service and client approach.

### **8.2.3.3 Social accountability**

In the context of the low effectiveness of bureaucratic mechanisms for accountability in Bangladesh, Huque (2011) suggests that extra-bureaucratic means, such as legislative committees, parliamentary debates, public hearings, ministerial control, ombudsman, and media scrutiny should be advanced for improved public accountability. One institutional and influential mechanism – parliamentary committees – has also been found ‘generally not successful in ensuring responsible behaviour’ (Ahmed and Ahmed 1996:92) in Bangladesh. Against this backdrop, social accountability can be approached as a viable alternative extra-bureaucratic measure. The fiscal sociological argument that taxation enables taxpayers to demand accountability and responsiveness from the state rests in essence on social accountability. We will analyze the findings presented in Chapter 7 by from the aspect of citizens’ voice and the role of the civil society.

### **8.2.3.4 Citizen’s voice**

The citizen’s voice is not only instrumental in ensuring public accountability, but is also ‘a shorthand for participation in decision-making’ (Budd and Zagelmeyer 2000:478). Findings show the lack of voice in the arena of taxation is well-matched with the limited scope of participation noted earlier. We will approach this lack of voice from the perspective of taxpayers’ exit/disengagement behavior.

### **Exit and voice paradigm in taxation**

The ‘exit’ and ‘voice’ mechanisms (Hirschman (1970) entered the public accountability regime with the realization that in many developing countries, the public/beneficiaries do not have the ability or incentive to demand efficient services or to insist on greater public accountability. These two mechanisms have been used to ensure public accountability to the stakeholders. As Paul (1991) argues, effective public service accountability can be sustained only when hierarchical control in the

public service is reinforced by ‘exit’ and ‘voice.’<sup>143</sup> But given the different pattern of relationship between the tax authority and the taxpayers that I have attempted to explore above – a relationship that is not a linear one of agent and principal, but of bargain on the basis of reciprocity – the very question that immediately arises is if ‘exit’ could at all be a desirable option for the people with regard to making a more accountable tax system.

If natural or artificial monopoly is an important attribute of many public services that tends to limit the public’s scope for exit (Paul 1991), then taxation is the ideal example of a public service which apparently limits such scope. One obvious manifestation of a taxpayer’s exit is to move out to some other jurisdiction. Could there be any other exit mechanism in order to make the tax authority more accountable and responsive? Before answering this question it would be appropriate to clarify what service a tax department actually provides. At the broadest level, the service comprises the roles that taxation performs: revenue, representation, redistribution and re-pricing (Brautigam 2008; Vermeend, Ploeg et al. 2008). Opting not to subscribe to this service will be self-defeating for the taxpayers and hence undesirable. It is difficult to conceptualize a tax department as a service provider in the sense of a utility, health or education department. The service that taxation provides, as evident in its traditional roles, relates to the taxpayers more as participants than as recipients. However, all citizens are by default tax customers as they are morally and legally obliged to pay their fair share of the cost of the government that, at least theoretically, serves and protects them. The more tangible service that the tax department renders to the citizens is to serve the taxpayers, which, again basically means to facilitate a taxpayer to comply with tax liabilities. Hence the opportunity to exit from receiving this service i.e. finding an alternative service provider, for example, a tax consultant, will not affect the tax authority so far as it relates to its accountability. But in so far as the customers’ exit affects the revenue of the concerned entity or organization, the imperative for the tax officials to be responsive and accountable to their customers comes to the fore. This is where we can posit an exit paradigm in taxation.

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<sup>143</sup> ‘Exit’ implies the opportunity for the public to exit – the extent to which the public has access to alternative suppliers, public or private, of a given public service – and ‘voice’ denotes the scope for the public to seek better performance from public service providers, without opting for alternative sources of supply (Paul 1991).

So far as exit as moving out from one tax jurisdiction to another is concerned, there has not been any reported exit in Bangladesh. In order for a tax system to perform its role of revenue, representation, re-distribution and re-pricing, the first and foremost objective of a tax administration is to command ‘loyalty’ of its taxpayers. Since ‘loyalty holds exit at bay and activates voice’ (Hirschman 1970:78), in the normal circumstances of providing and receiving services, the people’s loyalty to the tax system would prompt voice. But the overall scenario explored so far in the Bangladesh tax system naturally questions the extent to which the citizens are loyal to the tax department. If we take a few factors such as the number of registered taxpayers as compared to the number of population, the poor tax to GDP ratio, the wide tax gap and the conspicuous lack of tax awareness, the loyalty aspect does not at all seem promising. Exit is negatively correlated to voice. But, since the provision of the tax service cannot be substituted by any other service provider, the taxpayers’ exit cannot, as noted, be a desirable mechanism for making the service provider (tax authority) more accountable. Desirable or not, the dissatisfied customers tend to demonstrate some form of exit and this is no exception with the public service of taxation in Bangladesh. This idea can be further expanded by probing into the abolition of the office of the tax ombudsman.<sup>144</sup>

### **Implications of the abolition of tax ombudsmanship**

The official justification for establishing the office of the tax ombudsman was to ensure more transparency and accountability of the tax administration and also to redress its alleged ‘maladministration.’ Therefore, the abolition of such an institution, for whatever reasons, downplays the government’s commitment to transparency and accountability from the outset. But what is more significant in this abolition is the institutional failure to develop a voice mechanism for the general stakeholders.

Taxpayers’ lukewarm response to the service provided by the office of the tax ombudsman was officially cited as one of the indicators of its so-called ineffectiveness.<sup>145</sup> The findings of this study show that there was no dearth of

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<sup>144</sup> As the scope of tax ombudsmanship extended to all taxes, this discussion is more generic in nature.

<sup>145</sup> According to media reports, the office of the tax ombudsman received 119 complaints in 2007, of those, 47 complaints were considered for investigation. Of the 47 complaints, 36 were investigated and disposed of with recommendations to the NBR.



complaints about the tax service in particular. Then, why did not the citizens feel motivated to approach the tax ombudsman? In this respect we can look into the aspect of complaining as a form of raising voice and then proceed to explain why this form of voice failed in the context of Bangladesh.

### **Failure to make complaints as a form of raising voice**

In many developed societies, such as the USA or the UK, demanding recompense through litigation for accidents is now perceived, not only as a common-sense way of gaining financial compensation, but also as a way of holding public services to account (Furedi and Bristow 2012 :13). In contrast, litigations for demanding compensation for certain failures of the public sector in providing a service are quite rare in Bangladesh. Given that a litigious climate inexorably leads to the diminishing of the ethos of public service (Furedi and Bristow 2012 :70), the alternative is the move to encourage and institutionalize a ‘culture of complaint.’

The establishment of the office of ombudsman can be regarded as a move to encourage and institutionalize a ‘culture of complaint’ in a bid to get some relief from the curse of a litigious culture. But the forum for raising voice in the form of complaints in the contentious area of taxation did not become effective enough to sustain. There can be a couple of explanations for this failure: the first relates to the taxpayers’ posture of disengagement and the second to the collusion between the taxpayers and the tax collectors.

#### *Citizen’s posture of disengagement*

Citizens’ complaining behavior as a multidimensional and extremely complex phenomenon is logically subsequent to dissatisfaction (Day 1984). Also, a customer’s decision to make a complaint hinges on the costs and benefits (Hirschman 1970) which are not only economic, but also psychological (Andreasen 1985). In the case of the tax ombudsman’s office in Bangladesh not receiving enough complaints, it can be argued on the basis of findings that the citizens did not find complaining cost effective in the first place, and secondly, they did not have enough confidence about the outcome of their complaints to that office. We can recall a respondent comparing the filing of complaints against tax officials to ‘picking a quarrel with crocodiles while living in water.’ Taxpayers’ refraining from making complaints can be related to what Braithwaite (2003) terms the

‘posture of disengagement.’<sup>146</sup> When taxpayers assume this posture, their behavior is characterized by widespread disenchantment and they do not find any point in challenging the authority. One of the plausible reasons for such posture is the lack of trust by the taxpayers in the tax authority.

This lack of trust is based on the tax authority’s perceived lack of accountability and transparency which we have noted predominant in the arena of Bangladesh VAT already. There is an obvious lack of a ‘service and client’ approach which, characterized by supportive and respectful treatment of taxpayers, transparency of procedures and taxpayer acceptance of the tax authority, would enhance trust and a cooperative atmosphere leading to voluntary compliance (Kirchler 2007:56). This is well aligned with the stakeholder theory (Freeman 1984) which suggests that the effectiveness of an organization rests on its ability to create as much value as possible for stakeholders. On the other hand, the ‘command and control’ approach, as evident in the VAT culture, establishes a climate of distrust and creates ‘social distance.’ This social distance is manifest by a limited space of participation and indicates the extent of the individuals’ or groups’ willingness or unwillingness to associate or be aligned with an authority. As opposed to a customer’s behavior in case of dissatisfaction, a taxpayer distances himself/herself from taxation not in a bid to find an alternative service provider but in the tangible manifestation of non-compliance. The root cause of such exit, partial exit, withdrawal or disengagement for both the customer and the taxpayer, however, remains the same: dissatisfaction.

To return to the issue of ‘exit:’ we have not found any evidence of physical exit from the tax service in Bangladesh. But exit outcomes are quite evident in the taxation scenario. They are manifest in the wide tax gap and the lack of customer’s voice. The disengagement posture as manifested by the citizens’ perceived unwillingness to file complaints against the tax authority as a means holding it accountable can be called a soft version of exit or a metaphorical exit.

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<sup>146</sup> Five motivational postures identified in the context of taxation compliance are: (a) commitment, (b) capitulation, (c) resistance, (d) disengagement, and (e) game playing (see Braithwaite 2003). While the postures of commitment and capitulation reveal an overall positive orientation towards tax authorities, resistance, disengagement and game-playing reflect a negative orientation. ‘Disengagement reflects a negative orientation and correlates with resistance. Individuals and groups keep socially distant and blocked from view and have moved beyond seeing any point in challenging tax authorities’ (Kirchler 2007:98).

### *Collusion between the taxpayers and tax collectors*

The framework of administrative corruption in taxation may partly explain the lack of motivation for filing formal complaints to the third party such as the tax ombudsman. Many researchers have pointed out that, in South Asian culture, the exchange of favors and small amounts of money, both in one's public and private life, is both commonplace and unobjectionable (Schnek 1989). Given that there is large scale systemic tax evasion through the collusion between taxpayers and collectors in developing countries (Flatters and Macleod 1995) and Bangladesh obviously is no exception, the motivation to keep a third party out of a win-win situation is not difficult to discern. Though there is no empirical study as to the extent of the unholy alliance between the tax collector and the taxpayer as well as the resultant loss of revenue, we have noted that the perception of endemic collusion between taxpayers and VAT officers is embedded in the responses of a number of participants.

### *Collective action problem*

Yet another reason for the lack of citizen's voice in the overall tax system in Bangladesh seems to arise from what Ferranti, Jacinto et al (2009) term 'the collective action problem,' which we have presented in our conceptual framework as a fault in the relationship between the state and society. Such problems seemed to loom large even among different demand-side stakeholders. Findings aptly suggest that the different segments of stakeholders are not motivated to the same extent to raise their voice against certain injustice because of their inherent conflict of interest. Moreover, this is symptomatic of the patron and client relationship that figures prominently even in the participatory spaces.

### **8.2.3.5 Role of civil society**

We have noted that there are convincing reasons for CSOs to engage in tax issues. Besides advocating for adequate resources for financing anti-poverty programmes and improving the distribution of income and wealth, they can play a key role in enhancing government transparency and accountability. But in Bangladesh, the otherwise 'vibrant' CSOs' apathy towards tax issues is surprising.

Ackerman has developed a model of co-governance 'which involves inviting social actors to participate in the core activities of the state' (Ackerman 2004:447) . She

has cited the participatory budgeting (PB) process as an excellent example of ‘co-governance for accountability.’ While there are considerable efforts in engaging the stakeholders in the form of participatory budgeting in ensuring that public expenditure is made transparently and accountably, the equally overarching issue of how the revenue is raised has remained mostly within bureaucratic boundaries. Studies suggest that even in Bangladesh, participatory budgeting programs at the *Union Parishad*, the lowest tier of local government, with the help of NGOs, have enabled citizens to monitor the spending of local governments through the instrument of open budget sessions (Ahmad 2008). By contrast, the case of the taxation in Bangladesh exhibits an ‘unfortunate’ pattern which the OECD (2008) describes as the ‘lack of organized bargaining on the revenue side in many developing countries.’ The role of the CSOs in Bangladesh has been called ‘vibrant but not vigilant’ (Tasnim 2007), meaning that despite their wide involvement in the grass-roots development, they play a very limited role in promoting good governance and upholding democratic norms. Their disengagement from the tax issues, like the taxpayers’ disengagement, supports the above conclusion.

If civil society interests provide an important channel for understanding the exigencies of the public interest and if their main role lies in promoting public interests, then taxation does not appear to be an interesting or popular issue to the CSOs of Bangladesh. This apparent indifference of the CSOs is quite consistent with the public apathy, ensuing from their disengagement posture towards taxation. One of the glaring examples of the society’s general apathy towards and lack of interest in, taxation is manifest in the fact that the 2008 election manifestos of neither Awami League, nor BNP contained a single reference to taxation.

Though little demand for accountability of tax investment in Bangladesh has sometimes been attributed to its low rates of tax collection and a culture of tax evasion (SDC 2008), the citizens’ general apathy towards engaging themselves in organized bargaining can be explained by the existence of other multiple interrelated factors: the preference for indirect taxes over direct taxes, tax being a specialist subject and a general lack of awareness about taxation.

### **8.2.3.6 Impacts of the lack of social accountability**

The overall revenue performance of the Bangladesh tax system together with the extent to which the citizens voluntarily participate in the whole process of taxation indicate that they are more ‘disengaged’ than ‘committed.’ This disengagement or metaphorical exit accounts for their absence of voice which in turn is reflected in the way tax issues are dealt with by the CSOs. But the primary impact of the citizen’s disengagement posture or, metaphorical exit behavior, is on revenue, as it triggers non-compliance in the form of tax avoidance and evasion.

In focusing on the good governance elements with reference to a tax system, the central concern has been to validate the hypothesis that taxation engages the citizens in forming a social contract with the state which contributes immensely to characterizing state-society relations by accountability, responsiveness and democracy. VAT offered Bangladesh a unique opportunity to considerably strengthen the accountability regime. This should not be limited to holding the public officials accountable but can also be extended to institutionalizing an accountability culture among the multifarious actors of the economy.

However, to date the tax regime in Bangladesh in general is far from performing the role of binding the citizens in a ‘revenue bargain’ or a ‘social contract,’ and therefore extracts less responsiveness and accountability from the government. The impacts of revenue bargain or social contract are enormous as the effectiveness and efficiency of the tax system is contingent upon the effectiveness of such revenue bargain or the power of the social contract. The absence of a satisfactory state of a hierarchical accountability mechanism for tax officials rendered the tax authority incapable of, if not completely unsuccessful in, making the other players – taxpayers – accountable. It would not be right to treat the tax department the same way as other public sector departments are treated, mainly because of the imperative for reciprocal accountability that taxation entails. The ‘great power’ of collecting tax revenue has to be tempered with an equally ‘great sense of responsibility’. Effective bureaucratic accountability can only partially help make it happen: the accountability deficit or gap has to be fulfilled by the practice of social accountability.

### 8.3 Factors affecting good governance

Having explored the state of some core principles of good governance in policy and practice in the Bangladesh VAT and the extent to which VAT plays a role in promoting good governance, we can piece together the factors that affect the state of affairs. The first set of these factors is directly related to the tax administration:

- Excise hangover;
- Colonial administrative culture;
- Lack of political will;
- Ad hocism;
- Lack of enforcement.

The second set of factors is generic in nature and thus cross-cutting an array of stakeholders:

- Lack of tax literacy and tax education;
- Low level of trust;
- Lack of social awareness about taxation;
- Culture of corruption.

#### *Excise hangover*

The shadow of the excise past is unmistakable in the design and administration of VAT. The excise hangover manifest through a number of procedures such as such as value declaration, notional valuation and physical control, clearly put some hurdles to making the VAT system more transparent, accountable and participatory. The tax administration's fascination for excise methods was due to the fact that most of the VAT officials at the time of the introduction of the VAT had strong excise orientation. Without taking adequate measures to re-orient them in the new system, the tax administration expected them to administer an old tax in the garb of VAT.

#### *Colonial administrative culture*

The attitude of command and control rather than motivation ingrained in the

administrative culture of Bangladesh has been seen as creating blocks to participatory approach of decision-making. Similarly, the traditional bureaucratic mechanisms, particularly, those of accountability limited by a considerable number of discretionary powers vested in the tax authority both at organizational and individual level have weakened the process of transparency.

#### *Lack of political will*

The political decision to reform the tax system seems more oriented towards exploiting the VAT as a money machine than evolving the system as a tool for representation or for social equity. The efforts to make people aware of tax issues and motivating them to pay taxes out of civic obligation instead of coercion and manipulation are very limited. The lack of political will is also evident in the failure to shape an audit culture for holding the actors to account.

#### *Ad hocism*

It is true that most revenue authorities have tended to focus on short-term, output-driven indicators of performance (OECD 2010a). But in the case of Bangladesh, the objective of revenue generation seems to have outweighed all other goals of the tax system like a VAT. In the absence of a clearly spelled out vision and specific policies to evolve the VAT into a better and fairer taxation system, ad hocism has become all pervasive. Approached from the angle of Levi's theory of predatory rule (Levi 1989), the VAT authority's engagement in ad hocism would identify the rulers as having high discount rates because they seem to have subordinated the overarching imperative for a healthy tax culture to the immediate goal of revenue.

#### *Lack of enforcement*

Even the existing rules and policies, with all their limitations, are not enforced properly. Failure to enforce the issuance tax invoices and the use of ECR by a section of businesses are glaring examples. Findings of the study corroborate the conventional wisdom that the corruption of both the business people and tax officials is one of the major causes of non-enforcement of tax rules and regulations. Added to this is the inefficiency of the tax officials.

#### *Lack of tax literacy and tax education*

Tax literacy and tax compliance are twin concepts in tax literature and the first precedes the latter. Tax literacy is particularly important in a self-assessed tax like

VAT as self – assessment requires a certain degree of tax literacy encompassing an understanding of the tax system and its procedures and of the compliance obligations (Hansford, Loo et al. 2005). In the context of Bangladesh, the study findings indicate that the low rate of tax literacy is the root cause of people’s general indifference towards taxation. Drawing on the research that indicates that a consensual tax bargain is more likely where taxpayer awareness and education are high (OECD 2010b), the low rate of tax literacy coupled with its attendant impact of low tax awareness explains to a great extent Bangladesh’s people general lack of engagement in the revenue bargain.

#### *Low level of trust*

If we consider the voting turn-out as an indicator of civic literacy, as Milner (Milner 2002) does, then the people of Bangladesh do not seem to be very civically illiterate as the rate of voting turnout in the last two general elections of 2001 and 2008 was 74.97% and 85.26% respectively (IDEA 2012) ,which was much higher than that of many developed countries with established democracies. Given this level of civic literacy, the low rate of tax literacy only partly explains the low level of compliance in taxation. Obviously tax compliance is influenced by a number of economic, social, psychological and demographic factors including the taxpayers’ perception of the unfairness of the tax system and the ambiguity and complexities of the tax laws (Kirchler 2007; Devos 2009; OECD 2010a) . Factors, such as wide spread campaigns, social pressure, or a sense of civic obligation that prompt political or electoral participation, are not present in the tax domain. As suggested by Baldersheim, Jamil et al. (2001), the enhanced confidence of voters in the integrity of the electoral process under a neutral and non-partisan caretaker government partly explains the impressive voter turnout. Conversely, extending this rationale to the tax phenomenon, the lack of confidence in the integrity of the tax system partly explains the lack of participation or of voice.

#### *Lack of social awareness about taxation*

Findings show that tax has not evolved as a national discourse, or figured prominently in the nation’s development agenda. The politicians’ general tendency to hide the unpleasantness of taxation from the public view seems to have been equally matched by the public’s general aversion towards it. The process of ‘constructive contestation’ that is required for revenue bargain has not flourished so



far in Bangladesh. The role of the above factors has been joined by other factors such as the lack of government initiative to motivate the citizens and the lack of civil society initiative. While many business associations were seen as taking part in the invited spaces of participation, they were not seen as working with civil society or the general people in a process of constructive contestation so as to transform the state-society relationship into one of social contract or revenue bargain for state-building.

### *Culture of corruption*

The existence of widespread corruption in the developing countries has been interpreted as the result of cultural traits or traditional ways of existence. Bangladesh perhaps falls in those societies where ‘many transactions cannot be finalized without corruption having an effect’ (Pellegrini 2011:30). Anam (2007) calls this a ‘culture of secrecy’ in the context of Bangladesh, which embraces both public and private lives. In his trenchant book, *A Culture of Corruption*, Daniel Smith writes, ‘When Nigerians talk about corruption, they refer not only to the abuse of state offices for some kind of private gain but also to a whole range of social behaviors in which various forms of morally questionable deception enable the achievement of wealth, power, or prestige as well as much more mundane ambitions’ (Smith 2007:34). Findings suggest that replacing ‘Nigerians’ with ‘Bangladeshis’ in the above observation would constitute an equally valid perception of corruption in Bangladesh.

While attention in the literature has primarily remained focused on bribes by entrepreneurs to tax officials (Ivanyna, Mourmouras et al. 2010), the lack of transparency and its concomitant impact on corruption have attracted very little attention. But in the domain of business taxation in particular, the role of businesses in aggravating corruption is considerable. As the findings on the transparency of business transaction reveal, business people have shown a disquieting indifference to be transparent in their business transactions. So, if corruption entails the misuse of power, opportunity or resources for private gains then it extends to both tax collectors and taxpayers: while the tax officials benefit by obtaining extra financial benefits, the taxpayers gain by tax evasion or avoidance.

## 8.4 Conclusion

Given the distinctive factors discussed above, can a tax system contribute to improved governance? We argue that it can. We also argue that in the case of Bangladesh, merely addressing the so-called administrative inefficiencies of the tax administration or extending the tax base, as stipulated in the country's PRSP (Government of Bangladesh 2011), will not be sufficient to improve the country's tax-GDP ratio, let alone develop a healthy tax culture. The virtuous cycle of taxation as state-building that we conceived in Chapter 3 can aid to break free from the vicious cycle of socio-economic factors that put hurdles in the way of development.

With the emergence of what has come to be known as new fiscal sociology which considers that 'the relations of taxation are pervasive, dynamic, and central to modernity' (Martin, Mehrotra et al. 2009), the role of taxation in state-building cannot be overemphasized. While the taxation has been compared to the art of plucking the maximum of feathers with the minimum amount of hissing, the question of whether revenue should be 'extracted' like an infected tooth, rather than 'raised' like a child (Howard 2009) has come to the forefront of the discussion about the role of taxation in state-building. Given the causal relationship between good governance and development, and between taxation and development, the relationship between good governance and taxation is also interdependent and complementary. The practice of good governance values in taxation is essential for effective and efficient tax system; similarly, a fair tax system encompassing those values plays a vital role in promoting good governance.

In the context of Bangladesh, which ranks quite low both in terms of good governance indicators and its tax revenue efficiency, the question of the role of taxation in general and the VAT in particular in state-building has posed a daunting challenge. There are obviously a number of socio-economic constraints to evolving a fair tax system that can be effective and efficient while working as a tool for promoting good governance across different sectors and actors of the society. In reforming a public policy like tax policy, the challenge is whether the politicians or

other decision-makers will be intimidated by or dictated to by the constraints or take measures to overcome them. The present study has argued that although the introduction of the VAT in 1991 in replacement of the excise system was mainly prompted by the desire to maximize revenue, the tax reform to introduce a self-assessed tax was also partly inspired by the urgency of making the tax system more transparent, more accountable and more participatory. But the initial commitment became deflected with the passage of time as the VAT system gradually turned into a hybrid tax system by the incorporation of a number of adaptations that restricted the fundamental features of self-assessment, transparency and accountability. Though comparatively more efficient, more transparent, more accountable and more participatory than the tax it replaced, the Bangladesh VAT has been able to utilize only a modicum of its huge potential in promoting good governance.

## **CHAPTER 9**

### **SUMMARY OF THE FINDINGS AND CONCLUSION**

#### **Introduction**

The purpose of this chapter is to review the whole thesis highlighting the major findings, to focus on their implications for the policy and practice of VAT in the developing countries, particularly in Bangladesh, and finally to highlight future research directions. The chapter has been organized as follows. The first section presents an overview of the thesis and its major findings. The implications of the findings on the policy and practice of VAT in Bangladesh in particular and the developing countries in general are presented in the second section. Finally, the limitations of the thesis and future research directions are presented in section three.

#### **9.1 Overview of the thesis and its major findings**

##### **9.1.1 Overview of the thesis**

Characterized by its low tax to GDP ratio, Bangladesh also ranks poorly in good governance indicators. If the poor tax to GDP ratio or the subdued presence of direct taxes is any indicator of a country's tax culture, then the state of tax culture is quite weak in Bangladesh. Though an increasing amount of revenue is being collected through VAT, which the county adopted in 1991 by replacing its excise system and sales tax, the tax system has been found to be functioning far below its potential. In this respect whether the state of good governance is related to the effectiveness and efficiency of a tax system is a compelling question. But the more important question is whether a tax system like VAT can play a role in promoting good governance in a developing country like Bangladesh. Thus the conceptual framework of the thesis rests on the fiscal sociological idea of the relationship between taxation and state-building. This framework incorporates 'the proposition that the sources from which public authorities obtain their revenues, and the ways in

which they organize themselves to relate to revenue providers, exercise a major influence over politics and governance’ (Moore 2011:11).

The review of the literature traced the history of taxation starting from its function as a ruler’s unilateral tool to finance his priorities, through its evolution as a social contract between the rulers and the ruled to its predominant role in state-building in a democratic society – and its relationship with governance. It was seen that the transition from rulers’ fiscal dependence on domain revenues (i.e. income from their own properties) to dependence on broad general taxation gave rise to the tax state. Social thinkers considered this transition to be the defining feature of modernization in Europe as well as a key to the development of effective states, and a central component of the rise of bourgeois society and of democracy. What is important in this societal process is how taxation started as a coercive tool to extract one-sided contribution from citizens, and, with the passage of time, evolved into a powerful instrument for bargaining which Moore calls ‘revenue bargain’ (Moore 2008). The social contract or revenue bargain is indissolubly related to what Levi terms the ‘collective action problem’ (1989) in the predatory revenue maximizing behavior of the rulers.

The revenue maximization policy that governments pursue presupposes that there is a revenue bargain between the state and the citizens which tries to balance the paradox of maximization of taxes by the ruler and minimization of taxes by the ruled. Maximization of tax revenue thus hinges on the level of tax compliance. The level of trust reposed in the government, the perception of fairness in the taxing procedures, the performance of the government, and the government’s power of enforcement play crucial parts in taxpayers’ meeting their obligation, or, in other words, in ensuring tax compliance.

It has been argued that taxation is a political process in the form of ‘revenue bargaining’ which entails some exchanges in the form of representation by the taxpayers and responsiveness and effectiveness from the states. In this process, the dependence on taxation may contribute to improved governance through three processes, namely common interest, state apparatus, and accountability and responsiveness. In these processes, the government’s reliance on citizen’s taxes and

citizen's ability to pay mutually call for a better enabling situation while a compatible and efficient tax administration is required for efficient and effective collection of taxes. Further, paying taxes empowers taxpayers to demand befitting reciprocity from the state. Thus, greater dependence of the state on earned income rather than on unearned income such as aid or natural resources tends to ensure more responsive and accountable state-society relations. In addition to the impact of taxation on improved governance processes, good governance values are required in taxation for other reasons also: first, for combating corruption in tax administration and second, for enhancing a country's competitiveness in the wake of the changing global scenario.

The literature review emphasized that combating corruption has become a major challenge for most revenue agencies in the world. Researchers have attributed the generally more tangible presence of corruption in tax administrations, particularly in those of developing countries, to their complex tax and trade regimes including multiple discretionary exemptions, confusing and non-transparent procedures for tax compliance and excessive discretionary power of tax inspectors. While the absence of good governance principles makes a tax system vulnerable to corruption, their presence can make the system competitive.

In sum, in order to understand the dynamic and reciprocal relationship among good governance, taxation and development, we can think of a simple model where good governance principles such as participation, transparency and accountability improve mutual trust between taxpayers and the government, and ensure better control and enforcement by the tax authority. The combined impact of these two aspects (mutual trust and better control and enforcement) contributes to more and better voluntary tax compliance. Maximization of tax revenue is enhanced by the higher degree of voluntary tax compliance, which in turn contributes to development. This relationship is dynamic rather than linear. So, the crux of the issue is that in order for a tax system to be effective and efficient, it needs to evolve as a tool for good governance. This is more so because, after exploring the competing claims about the relationship between good governance and development, especially which comes first – good governance or development – we have posited

that good governance is a precondition for development especially in developing countries.

Given the positive correlation between taxation and development and good governance and development, and also Bangladesh's commitment to good governance and an effective and efficient tax system for maximizing internal resources mobilization, the overarching research question has been: To what extent and how does the Bangladesh VAT embody the principles of good governance and contribute to the promotion of good governance as well? The choice of VAT for a case study to explore the research question is crucial in that it has emerged as the single largest contributor to the Bangladesh tax revenue.

Dissatisfied with their existing system of taxation which arguably failed to generate enough revenue to finance the government, most countries adopted VAT for a variety of reasons: on its revenue raising potential and its simple collection system, which make the tax more efficient than other consumption taxes. VAT has proved, almost without exception, to be a more effective and efficient tool for maximizing revenue than the tax it replaced in both developed and developing countries. In the case of Bangladesh, VAT accounts for 39 % of tax revenue in FY 2010-2011. The current Five Year Plan projects an increase in the tax to GDP ratio by 3.7 percentage points to 12.4 % of GDP by FY 2015 (Government of Bangladesh 2011). To achieve the ambitious goal of an expected average annual revenue growth of 19.4%, and particularly the growth of VAT and income tax at 23.4% and 25.4% respectively, VAT will have to play a crucial role. The inevitable question is: can it be achieved without aligning the tax system with the good governance paradigm?

It has been recognized in general theoretical literature that the principles of taxation need to conform to the principles of good governance by incorporating transparency, accountability and participation. The approach of treating taxpayers as customers in line with the NPM approach has also been widely studied in theoretical literature. While there are many country-specific studies of VAT in respect of its equity, regressivity and cost of compliance, there has not been any

empirical study of VAT from the perspective I have espoused in this research: a case study of VAT from an interdisciplinary perspective of law, political science and behavioral science at the broadest and from a good governance perspective in particular. These gaps in the literature stimulated the overarching research question of the thesis: does VAT in Bangladesh play a role in promoting good governance, and if so, how?

Based on the epistemological stance of constructionism, the research has taken an interdisciplinary approach, primarily of political science complemented by a legal and behavioral research orientation. Tinged with some elements of insider research, the present study adopted the case study method which is qualitative in essence. The qualitative aspect of the research involved documentary analysis, in-depth interviews and focus group discussion with participation by representatives from different segments of stakeholders. A total of 214 respondents were chosen purposively for collecting primary data. VAT officials, business leaders, academicians and other resource persons such as VAT practitioners, members of the civil society participated in in-depth interviews and FGD. However, some quantitative methods were employed in order to triangulate the qualitative data. The questionnaire survey of the opinion of VAT-paying businesses served as method for validating data collected through the qualitative methods.

### **9.1.2 Major findings of the study**

The major findings of the study are summarized below by way of addressing the research questions involving the design and administration of VAT, the elements of participation, transparency and accountability in the policy and practice of VAT in Bangladesh, and the socio-economic factors that account for the state of governance.

#### **9.1.2.1 Design features characterized by excise traits and complexity undermine self-assessment and transparency elements**

Chapter 4 explored the first research question related to the design features of the Bangladesh VAT on the basis of documentary analysis and employed exploratory and comparative analysis approaches. Bangladesh has adopted a gradualist approach in expanding its VAT base. Although the initial VAT legislation in most



developing and transitional countries is usually close to standard international models in part because it was often drafted in whole or part with the participation of international experts (Bird and Gendron 2007:67), the findings show that Bangladesh designed its initial VAT in a hybrid fashion drawing heavily on the excise system and retaining many of the excise traits such as value declaration, presumptive taxation and account current method of payment. Some adaptations to what is called the standard practices of VAT may become inevitable, and be considered desirable. But the evolution of the VAT legislation and regulations in Bangladesh over the last 20 years features an unmistakable inclination towards further deviations as a routine process of amendments are undertaken every year during the parliamentary budgetary session. In the process, many adaptations and distortions have been introduced to rules and regulation which have distanced VAT from the standard practice.

The absence of comprehensiveness coupled with the pervasive presence of presumptive taxation has been identified as reigning supreme in the Bangladesh VAT. The comprehensiveness of VAT has been affected by factors such as a narrow base with too many exemptions, differentiated rates and the conservative treatment of the input tax credit mechanism. Though exemptions and differentiated rates arguably can be used to reduce the regressivity of a VAT, the way they have been rampantly used in Bangladesh does not prove convincingly that the progressivity or the equity rationale was followed consistently. Similarly, as many as nine differentiated rates have little or nothing to do with concerns of equity. This is because these differentiated rates of VAT have come into being due to different methods of calculation of VAT based on some notional base rather than an actual one. In addition to undermining the statutory single rate of 15%, these rates have rather contributed to the complexity of the whole process.

But the more important as well as disquieting feature of the Bangladesh VAT is its obsession with presumptive taxation. It has been found that contrary to general arguments against presumptive taxation in a VAT, or, its selective use for the hard-to-tax segment, Bangladesh uses it quite extensively in its VAT. Some forms of presumptive taxation are quite explicit, whereas others, although they have significant revenue implications, are implied. The most explicit form of

presumptive taxation is the ‘turnover tax’ that applies to businesses whose annual turnover remains below the VAT registration threshold. The implied forms of presumptive taxation include the adoption of notional values for assessing VAT for a number of services and a fixed VAT liability for retail traders.

The study indicates two major causes for VAT’s heavy reliance on presumptive taxation. Firstly, the presumptive elements in the VAT system are directly derived from the tax that it replaced. The practices of value declaration and notional valuation of transactions were features of the former excise duty. The prevalence of presumptive taxation is thus a manifestation of excise hangover. Secondly, the existence of presumptive elements in VAT is to a large extent prompted by a lack of transparency in business transactions, which is typical for developing countries including Bangladesh. The business people’s predominant reluctance to maintain transparency of business transactions prompts the policy makers to devise a wide range of presumptive VAT. Finally, specific instances of tariff value and the application of a truncated base are believed to have resulted from concessions granted to vested interest groups.

Some adaptive measures including presumptive taxation aid in making the transition from a narrow-based, more regressive tax system to broad-based, less regressive tax system acceptable to stakeholders in general and produce ad hoc benefits in terms of generating revenue and easing compliance. But far beyond its transitional role or its use as a means of addressing the hard-to-tax segment, presumptive taxation has become a norm rather than an exception. In sum, it has been argued that presumptive taxation does more harm than good. Its negative impact is not only limited to VAT revenue and design integrity, but also to the overall tax culture.

The present study reveals a number of negative consequences of presumptive taxation in VAT. First, it disrupts the core principle of VAT-input credit mechanism. Second, it undermines the most fundamental aspect of VAT: self-assessment. When the tax system is pervaded by presumptive taxation as in case of the Bangladesh VAT, the conditions having an overarching significance in shaping the total tax culture become subordinate to the immediate goal of revenue. Thirdly,

fixing a tariff value or the application of a truncated base for assessing VAT negates the very basic transparency element in the VAT. Fourthly, revenue statistics based on hypothetical, rather than actual, values produce inaccurate and possibly misleading statistics for future planning. Fifthly, as information on business turnover derived from presumptive VAT cannot be used for the purposes of income tax (Ahmad and Stern 1991), the presumptive elements of the VAT system hinder the full potential advantages of VAT. Sixthly, presumptive taxation tends to cause loss of revenue. Finally, in practice, the presumptive elements in the Bangladesh VAT system have the effect of reducing the burden of VAT for businesses involved in the processes of production and distribution of goods and services, not for final consumers.

The current VAT, however, is perceived to be much simpler and more efficient than the tax it replaced. On the other hand, the design features of Bangladesh VAT with its obsession with presumptive taxation, numerous rates, and special provisions do not generally are congruent with the principles of good taxation. Particularly, presumptive taxation infringes taxpayers' right to self-assessment and thwarts the promotion of transparency in business transactions. All in all, the design features of Bangladesh VAT show that it has a great deal of complexity insofar as it contains a number of tax rates, bases and special provisions which in turn indicate the extent to which taxation is corrupted by politics and bad public management (Hettich and Winer 1999).

#### **9.1.2.2 Shallow and narrow participation in invited space**

In respect of participation, findings show, as presented in Chapter 5, that in the traditional bureaucratic culture characterized by elitist rather than egalitarian attitudes towards citizens, there is a new awareness, especially in the tax authority, that importance is to be attached to participation; this was not very evident 20 years ago. In contrast to many other government organizations where decisions are made behind the closed doors, the VAT administration has pursued the issue of stakeholders' participation in three ways: a consultative committee and occasional discussions with key stakeholders, innovative approaches like participatory fixating of VAT for the hard-to-tax segment of the taxpayers, and the more recent scheme of Alternative Dispute Resolution. But while there has been an expansion of the

‘participatory sphere’ in the domain of taxation, compared to the excise regime, participation takes place mostly in ‘invited spaces’. The revenue administration creates some spaces for participation for some key stakeholders. The tax administration’s efforts to carve new space for citizens’ participation seem also to have stemmed from the bureaucratic policy makers’ responsiveness to both internal and external factors. The political preferences of the ruling elites serve as internal stimuli while the pressure from donor agencies serves as an external stimulus. As participation is an inherently political process rather than a technique, the process of inclusion and exclusion along with the capacity to participate makes the VAT domain in Bangladesh a stage for the politics of participation. It has been argued that participation in the invited space is dominated by participants hand-picked by the tax administration. Given the nexus between politicians and businesspersons and that business guilds constitute a substantial pressure group in influencing public policy in Bangladesh, the participation of the business persons and their guilds in the VAT policy is much deeper and wider than that of the general consumers.

On the other hand, the very desirable participation in ‘claimed spaces’ is not evident in the arena of Bangladesh VAT due to several factors. First, so far as the tax legislation is concerned, participation cannot be claimed as a matter of right. Second, the administrative culture generally has not been pro-participation. Third, the external force that could prompt the demands for claimed spaces is not active. Our findings show that the CSOs have not been working towards advancing tax issues nor have they been engaged in campaigns or other activities to make people aware of their rights and responsibilities in the matter of taxation. It would not be inappropriate to infer that the very idea of taxation as a tool for citizens to demand accountability and responsiveness is yet to be accepted by CSOs, in striking contrast to the ‘vibrancy’ of their other roles in Bangladesh.

In respect of the level of participation, it was found that participation in the domain of VAT is tokenistic in nature in that participation has been limited to the rungs of information, consultation and placation. Again, participation is both shallow in depth and narrow in breadth in that it includes a handful of participants with their participatory access limited to information and consultation.

Findings indicate that the current participatory process does not elevate citizens to the level of partnership, nor does it culminate in citizen control. This is mainly due to the perception that proposals from the stakeholders are rarely considered in making the tax policy decisions. But the study argues that despite being tokenistic in nature and being shallow in depth and narrow in breadth, the participative processes evident in VAT still have value. The nature and the scope of the participatory process can be seen as serving the purposes of legitimization, persuasion and education. These purposes should not necessarily be seen as serving the ends of administration only. Participation aided in recognizing key stakeholders as important actors in the field of taxation. It also partly paved the way for earning people's confidence in tax system by forging a spirit of cooperation and trust.

### **9.1.2.3 Lack of transparency in both supply and demand sides**

Our findings, presented in Chapter 6, on the state of transparency generally indicate the poor state of transparency in the tax system in general and in the VAT domain in particular. They also show that there has been renewed emphasis by the tax authority on making the taxing process more and more transparent, and the existing VAT is certainly more transparent than its predecessor – excise duty. But the overall state of transparency in the policy and practices of VAT in Bangladesh is far from satisfactory. The study argues that both the principal and its agents i.e. the tax administration and taxpayers have an equal share in contributing to the lack of transparency evident in the VAT arena.

So far as the formulation of policy is concerned, the study argues that there is an obvious lack of trust between tax authority and taxpayers. In the absence of such trust, there is a tendency to manipulate the people by the tax authority's subtle obfuscation about the taxes that have to be paid rather than to motivate the people with full disclosure of information in order to have them pay voluntarily as a social contract or bargain of reciprocity. This lack of trust seems to prompt the tax authority to present tax proposals in such a way that their implications are not always clear. Keeping the actual purpose of certain tax policies either vague or hidden from the citizens seems to have stemmed from the belief that the vagueness would lessen the potential risk of resistance and help achieve the revenue maximization agenda.

As regards the implementation side, lack of transparency is widely evident. The traditional bureaucratic orientation that the public service generally inherited from the colonial past, and the revenue administration's characteristic preference for revenue over taxpayers' service account to a great extent for their non-transparent administrative behavior. There have been, however, certain attempts to inculcate the NPM approach of treating taxpayers as customers. One such attempt is evident in the tax authority's emphasis on using citizens' charter, which, though quite narrow in scope and effectiveness, has been perceived as a paradigmatic shift in the administrative culture of Bangladesh.

However, non-transparency seems more generic as non-transparent administrative behavior is deeply embedded in the pervasiveness of discretionary powers in the application of VAT rules as well as in the complexity of tax laws and regulations. Findings show that discretionary powers conferred upon the administration as organization and tax officials as individuals are both strong and wide. Besides infringing taxpayers' rights and contributing to the complexity of tax statutes, these discretionary powers have been perceived to produce a great deal of administrative corruption in the Bangladesh tax administration. In fact, discretion itself is not as unacceptable as the lack of control mechanism for the exercise of that discretion. In the case of Bangladesh VAT, there is an ostensible lack of a control mechanism for the exercise of administrative discretion, which tends to infuse a great deal of arbitrariness in the application of laws and rules. However there have been attempts from the tax administration to make the VAT system more transparent through a number of measures that include reducing the discretionary powers of VAT officials and disseminating information through pamphlets and advertisements in the print and electronic media.

A satisfactory level of transparency in a good taxation system presupposes that tax transparency is a responsibility equally shared by the taxpayers and tax authority. In respect of demand-side transparency, it has been found that many business people have apathy towards transparent business practices such as maintaining electronic bookkeeping or issuing VAT invoices. Findings indicate that business people's preference for non-transparent transactions not only paved the way for malpractices, but also prompted the VAT authority to adopt a range of adaptive measures for

determining tax liabilities that negatively affected the coherence of the whole tax system. The lack of transparency in business transactions which is typical for developing countries, including Bangladesh accounts to a large extent for the existence of presumptive elements in VAT. It was found that there is a lack of obligation or incentive for keeping more transparent business records such as VAT accounting software, or ECRs for small businesses. The lack of transparency especially in issuing VAT invoices or in remitting the collected VAT to the government properly is a paradox in so far as business people generally demand more transparency from the VAT authority. In addition to the non-transparent culture and profit maximizing attitude of the businesses, the lack of enforcement by the tax administration has been seen as a factor contributing to the prevalence of non-transparent business practices.

#### **9.1.2.4 Inadequate administrative accountability mechanisms with an acute lack of social accountability**

The study has emphasized that while participation in and transparency of public policy have their own value, they are equally crucial in promoting accountability. Drawing on the new fiscal sociological approach that taxation endows citizens with a powerful handle to hold the state accountable, it has been argued that the adoption of VAT provided an opportunity of institutionalizing the culture of accountability both in tax collectors and taxpayers. As the thesis argues, accountability in a tax system, as opposed to that in many other public sectors, involves a reciprocal or two-way accountability between the taxpayer and the tax authority.

In respect of the administrative accountability of VAT officials, it was found in Chapter 7 that they are subject to the same accountability mechanisms as other public sector officials. The findings of the present study strengthen the evidence in the literature that the traditional mechanisms for administrative accountability in the Bangladesh public service are far from satisfactory. Equally unsatisfactory is the VAT officials' horizontal accountability to SAI because of the competitive rather than complementary relationship between the two organizations and the lack of auditors' technical expertise on VAT matters. Moreover, the CAGB's scope of audit is narrow in that they generally remain focused on financial audit and rarely on performance audit. Given the wide range of tax discretionary powers and the tax

officials' relative vulnerability to corruption as compared to many other public service agents, the question of subjecting them to additional accountability mechanisms arises. And in that respect, the office of tax ombudsman seems to be a lost opportunity. Its sudden and unexpected abolition is revealing of a number of problems such as the government's lack of commitment to making tax officials more accountable and the taxpayers' pattern of behavior.

The study posits social accountability as the mechanism to enable taxpayers to demand accountability and responsiveness from the state. In this respect, it was found that there is an obvious lack of appropriate mechanisms of social accountability for the public service in general and the tax department in particular. The thesis has considered the social accountability mechanism by examining the aspect of citizens' voice and the role of the civil society.

In the discussion about the abolition of the office of the tax ombudsman, which the thesis considers was a potential forum for raising voice by the action of filing complaints against the maladministration in tax administration, it is argued that the taxpayers' posture of disengagement and the collusion between taxpayers and tax collectors restrain citizens' voice. Drawing on the 'exit, voice and loyalty' paradigm propounded by Hirschman (1970), the study argues that although citizens have limited scope to choose the 'exit' option to make the tax authority more accountable, they make a metaphorical exit by adopting a posture of disengagement. This posture of disengagement arises in part from their lack of loyalty to the tax authority which not only negatively affects the level of compliance, but also deactivates voice. In the case of Bangladesh's overall tax scenario, taxpayers' lack of loyalty, or, in other words, lack of trust, followed by their metaphorical exit is advanced in this thesis as an explanation of citizens' general unwillingness to raise voice. In part, this explains the failure of the office of tax ombudsman in making people raise their voice through complaints. Another reason identified for the lack of voice lies in the framework of administrative corruption in taxation which binds the taxpayers and the tax collector in an unholy alliance. The latter inference is in line with similar findings that there is large scale systemic tax evasion through the collusion between taxpayers and collectors in developing countries. The lack of voice in the arena of taxation is well-matched



with the limited scope of participation and the poor state of transparency noted earlier.

In respect of the role of CSOs in ensuring social accountability of the tax officials, it was found that though there are convincing reasons for CSOs to engage in tax issues, the otherwise 'vibrant' CSOs have hardly played any substantive role in taxation. In contrast to their role in participatory budgeting, their role in the equally overarching issue of how the revenue is raised is unsatisfactory. However, this apparent indifference of the CSOs is quite consistent with the public apathy, ensuing from a disengagement posture, towards taxation, and vice versa. One reason for this apathy is rooted in the fact that taxation has not yet emerged as a national agenda, nor has it figured prominently as a political issue in Bangladesh.

As regards the extent to which VAT has been able to ensure taxpayers' accountability, the scenario is far from satisfactory. The absence of a pro-audit institutional culture that Hofstede (1991) terms 'the software of the mind' appears to characterize the organizational culture of the tax administration in Bangladesh. The attitude of immediate gain with physical control rather than a long-term goal of shaping a tax culture with effective auditing predominates. Given that 'the success of the self-assessment strategy hinges on taxpayer perceptions of the effectiveness of auditing' (McCarten 2005), the perceived ineffectiveness of auditing in Bangladesh VAT can be attributed to a number of other factors prominent among which are a lack of institutional support, lack of automation and lack of cooperation in terms of information exchange between different taxes and financial institutions.

#### **9.1.2.5 Multifarious socio-cultural factors affecting good governance in VAT**

A plethora of multifarious factors affect the state of good governance in the arena of taxation in general and the VAT in particular. While some of these factors owe their origin to the tax administration, there is a wide range of cross-cutting social issues. The factors that stem from the tax administration include but are not limited to – excise hangover, the colonial administrative culture, the lack of political will, ad hocism, and the lack of enforcement. On the other hand, the social factors that negatively affect the practice of good governance values in taxation are: the lack of

tax literacy and tax education, the lack of social awareness about taxation, the lack of trust and the culture of corruption.

As ‘the relations of taxation to modernity’ are ‘pervasive, dynamic, and central’ (Martin, Mehrotra et al. 2009), taxation as a tool of good governance has a definitive role in state building. In the process of state-building and its relations to taxation, while the taxation has been compared to the art of plucking the maximum of feathers with the minimum amount of hissing, the question of whether revenue should be ‘extracted’ like an infected tooth, rather than ‘raised’ like a child (Howard 2009) has come to the forefront of discussion. Given the causal relationship between good governance and development, and between taxation and development, the relationship between good governance and taxation is also interdependent, and complementary. The practice of good governance values in taxation is essential for effective and efficient tax system; similarly, a fair tax system encompassing those values plays a vital role in promoting good governance.

In the context of Bangladesh which ranks quite low both in terms of good governance indicators and tax revenue efficiency, the question of the role of taxation in general and the VAT in particular in state-building has posed a daunting challenge. There are obviously a number of ingrained socio-economic constraints to evolving a fair tax system that can be effective and efficient while working as a tool for promoting good governance across different sectors and actors of the society. In reforming a public policy like a tax policy, the challenge is whether the politicians or other decision-makers will be intimidated or dictated to by the constraints or take measures to overcome them. The present study has argued that although the introduction of the VAT in 1991 in replacement of the excise system was mainly prompted by the desire to maximize revenue, the tax reform to introduce a self-assessed tax was also partly inspired by the urgency of making the tax system more transparent, more accountable and more participatory. But the initial commitment became deflected with the passage of time since its inception as the VAT system gradually turned into a hybrid tax system with the incorporation of a number of adaptations that damaged the fundamental features of self-assessment, transparency and accountability.

Though more efficient, more transparent, more accountable and more participatory than the tax it replaced, the Bangladesh VAT has been able to utilize only a modicum of its huge potential in promoting good governance. The study thus argues the poor tax-to GDP ratio in Bangladesh, generally attributed to administrative inefficiencies and a narrow tax base, in fact reflects the poor state of good governance, and vice versa. If reciprocal transparency, understanding and trust in the relationship between taxpayer and the tax administration are the principles of a compliance covenant (Government of the Netherlands 2008), then a tax system has to evolve as a tool for good governance for it to be effective and efficient. The focus must be on the big picture of taxation as state-building and obviously not narrowed down to the immediate gain of revenue only.

## **9.2 Implications of the findings for policy and practice**

The findings of the study are relevant for making the Bangladesh VAT system in particular more effective and efficient and for developing the tax system as an instrument for promoting good governance in general. In this respect the implications are not only limited to the government of Bangladesh but also to the other stakeholders of the tax system.

### **9.2.1 Implications for the tax administration**

1. In respect of the design of VAT, it is well established in VAT-adopting countries that there is no ‘one size fits all’ approach. But while tax reforms should be well attuned to the socio-cultural milieu, considerations should be given that a tax system does not become old wine in a new bottle. Some generic strengths like self-assessment, input tax credit mechanism and ad-valorem method should not be so compromised that a VAT turns out to be a ‘so-called VAT’ or an excise tax. In order to evolve into an efficient and effective tax system or, at least, to get rid of its qualification as a ‘so-called VAT’ and to prevent further degeneration into a hybrid VAT at the expense of the effectiveness that a standard VAT promises, the Bangladesh VAT system should be stripped of all existing presumptive elements as soon as possible.

2. In respect of VAT administration, the pervasiveness of ad hocism should be replaced by a long term goal for a tax culture conducive to more voluntary compliance. In this respect, of all tools of enforcement, effective auditing must be given the top priority. The VAT administration needs to come to terms with the fact that there must be an institutional culture of audit for it to be effective. The institutional support has to be strengthened by recruiting skilled officers, automation, and exchange of information with other taxes and financial institutions such as banks.
  
3. With regard to exemptions and differentiated rates, the concern of reducing regressivity should be the guiding principle. The way a number of differentiated rates have come into being due to different presumptive bases is not progressive in that most of the services and products that have lower rates are used by people irrespective of their income level.
  
4. Invoicing in VAT should not only be seen as a legal obligation, but also as a sentinel of transparency. All VAT-registered businesses must use electronic record-keeping and invoicing devices. If the use of ECRs can be made mandatory for small and medium retail businesses, there is no logic why computerized maintenance of accounts should not be made mandatory for big businesses that in fact do so for their own purpose. The VAT administration can provide software support to motivate them to keep their records in computers. Invoicing should not be seen merely as ensuring that VAT paid by a buyer is properly accounted for, but also to promote a transparency culture in an otherwise transparency-shy business.
  
5. Long-term elaborate programmes need to be created in order to make people aware of tax matters, and to enhance tax literacy. Tax matters should be included in the curriculum of secondary and higher secondary levels of education. Students can be made familiar with the importance of VAT, Income Tax and Customs Duty and how they work in non-technical

language. For example, a simple percentile statement sum mentioning the rate of VAT can make a stimulate student's curiosity.

6. In respect of evolving the tax system in general and VAT in particular as a tool for a social contract and revenue bargain, measures have to be directed towards the aim of having people gain trust and confidence in the system and feel motivated to pay tax as a civic obligation, reinforced with a proper control mechanism. A few steps can be taken in this regard. First, the client and service mentality rather than cops and robber mentality has to be adopted. The partnership between taxpayer and tax authority needs to be built. This can be achieved through a variety of ways. The engagement of people in policy making and implementation is surely one of them. The existing space of participation has to be broadened. The government can carve new spaces of participation by extending the invited space to general people, not by limiting it to the business groups only. Civic engagement is particularly required for much needed trust as the greatest deficit in trust can be made up with greater public participation in decisions (Welch, Hinnant et al. 2003). Moreover, extending participation rights to citizens boosts the emergence of a psychological contract between the actors that helps quasi voluntary compliance based on mutual trust (Feld and Frey 2002). As a first step, CSOs should be invited to take part in the consultative committee meetings. The existing for a, such as district development coordination committees, can be used for broadening the participatory sphere. Another way of expanding the sphere of participation is through e-participation. Currently the website of the tax administration is not at all interactive. Based on the models of some tax administrations, as cited in Chapter 7, an interactive webpage can be created where citizens will be able to provide feedback, post complaints and get their queries answered.
7. One way of building trust is to dispel the fear of complexity. Instead of obfuscation, tax measures should be as transparent as possible. Given the wide and strong discretionary powers of the tax officials, in order to prevent discretions from degenerating into arbitrariness, 'confining, structuring and checking of discretionary power' (Davis, cited in Hawkins 1992:17) is essential at all levels. The confining, structuring and checking of

discretionary powers requires several commitments. First, the discretionary behaviour in the decision-making process can be streamlined by some social control (Feldman 1991). This social control obviously entails a paradigm of good governance in the state of affairs as a whole. Second, as for individual discretionary powers, there must be some written guidelines, especially for applying liability discretion. A guideline may contain principles such as: (i) decisions are based on material that can be logically demonstrated; (ii) reasons are given for decisions; (iii) power is used for the proper purpose; and (iv) a certain action is done with integrity, competence, tolerance and in the public interest (Ombudsman 2006). This guideline is practiced in many developed countries' tax jurisdictions in the exercise of discretionary powers and will ease the situation to a great extent and improve administrative practice. Better still, a guideline could be used as a tool for making the concerned officers accountable for their actions. Finally, a control mechanism is not only essential but also a prerequisite for gaining and retaining the trust of the taxpayers in the tax system in order for it to be effective and efficient.

8. Simultaneously, substantive financial and non-financial rewards for good performance of tax officials have to be ensured. Considering the vulnerabilities to corruption, this has been a common recommendation for improving the efficiency of tax administration in developing countries. As tax administration is better positioned to measure its officials' performance, reward and punishment should be tagged with performance. In line with the administrative measure, there must also be a demonstration of how the tax authority values its honest taxpayers and censures its delinquent ones.
9. Despite a great deal of lacunae and loopholes, weaknesses and complexity in the existing VAT laws, their proper enforcement would eliminate many of the ills that plague the system. So enforcement of rules and regulations has to be ensured in the first place. We can bear the Shakespearean words in mind:

We must not make a scarecrow of the law,  
Setting it up to fear the birds of prey,  
And let it keep one shape till custom make it  
Their perch, and not their terror.

*(Measure for Measure, Act II, scene I)*

### **9.2.2 Implications for other stakeholders**

1. Assuming that the traditional bureaucratic accountability mechanisms are not going to be significantly improved in the near future, tax officials should be subjected to an additional accountability mechanism through some independent institutional mechanism such as tax ombudsman. And in order to make it effective, measures need to be taken to make people aware of such avenues. In addition to the internal audit mechanism, a horizontal external accountability mechanism such as an SAI audit is essential for a tax administration's accountability (OECD 2010) and can reinforce the performance audit. Instead of limiting themselves to typical revenue audits only, CAGB auditors should focus on investigating lacunae and loopholes in the tax laws.
2. At the heart of elevating a tax system from a public finance tool to a tool for promoting good governance lies social awareness and social accountability. In this respect, the CSOs have a crucial role to play. In line with the vibrancy of their role in many other sectors, it is high time CSOs took up tax issue in their priority agenda. A similar role needs to be adopted by the media as well.

These implications may be relevant to other developing countries having a similar socio-economic milieu for the improvement of their tax system in terms of social contract and revenue bargain through which people can demand more accountability and responsiveness from their governments.

### 9.3 Limitations of the study and future research directions

As with other studies, this thesis has its own strengths and weaknesses. The most discernible strength of the thesis is its general fiscal sociological approach to a tax system. Empirical case studies of a tax system in a developing country from this approach are scarce. In this respect this thesis contributes to the emerging field of the fiscal sociological study of taxation. In terms of research methodology, a mixed methods approach, combining qualitative research tools such as documentary analysis, interviews and FGDs, and the quantitative tool of a questionnaire-based survey contributes to increase the confidence in the main findings of the study. Another strength of the thesis lies in the researcher being somewhat of an insider,<sup>147</sup> with an insider's understanding of the problems of a tax system, thus reducing problems associated with misunderstanding and misinterpretation of some technical aspects as well as of the responses of the participants. The researcher's insider past also assisted in the quest for undisguised and honest opinion from the participants.

The lack of econometric analysis in a study of taxation such as this may be seen by some as a weakness. The researcher however does not think so as the research approach is quite different. However, further research using more economic data, for example, in measuring the economic impact of presumptive taxation, would be useful in corroborating the findings of this study.

One of the limitations of this thesis, due to the constraints of the scope of a PhD thesis, is the lack of a more holistic approach to all taxes in the given context. As a tax culture encompasses all taxes and many of the findings of the research are related to taxes in general, the consideration of other taxes, such as income tax and customs duty in considering good governance paradigm in taxation, would surely enhance the reliability and generalizability of the findings.

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<sup>147</sup> This however can be seen as a weakness also. Concerns about bias and validity have been raised in insider research. In the present instance, the researcher's involvement with the VAT administration is a matter of the past now and his new role in another arena of public administration has enabled him to undertake the study with the disinterestedness of a scientific researcher.



The broad scope of the study might be seen as limiting a more insightful investigation into each of the axiomatic themes of good governance. Good governance indicators such as rule of law, human rights, responsiveness, equality have not been explored in detail, again due to the limited scope of a PhD study. Each of the axiomatic themes of good governance certainly warrants full-length research.

Recalling that very little attention has been paid in academic research to the role of taxation in state-building, particularly emphasizing the imperative for a good governance framework for making a tax system effective and efficient, the avenues for further research are quite wide and unexplored. The empirical political economy literature has paid very limited attention to the analysis of tax systems with the objective of explaining a country's development and growth (Profeta and Scabrosetti 2010). This is more true in the context of developing countries where tax issues have remained captive in the hands of bureaucrats and people's role in taxation is mostly limited to their being passive and reluctant partners. There are a number of other central issues which deserve rigorous empirical research. These include building trust for more and better voluntary compliance, and the ability of the political systems to maximize tax revenue by consent rather than by coercion.

Further research in the context of developing countries should also arise from the awareness of making taxation a national agenda as it has already become in many developed countries. As we believe that 'The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases' (Schumpeter [1918] 1991, cited in Martin, Mehrotra et al. 2009:1), the importance of more taxation research from a social science perspective cannot be overemphasized. And this research is a humble contribution to that stream of consciousness.

## APPENDICES

## APPENDIX 1

### Comparison of registered taxpayer population (2009) and Tax to GDP ratio (2008)

Country	Populations (millions)	Number of registered taxpayers (millions)		Registered PIT payers/citizen population (%)	Tax to GDP ratio <sup>148</sup>
		Personal Income Tax (PIT)	VAT		
<b>1. OECD countries</b>					
Australia	21.96	20.63	2.40	0.94	27.1
France	62.63	36.40	4.20	0.58	43.2
Japan	127.51	23.69	3.63	0.36	28.1
New Zealand	4.32	5.72 <sup>149</sup>	0.65	1.33	33.7
UK	60.93	31.30	1.9	0.51	35.7
USA	307.01	258.20	NA	0.84	26.1
<b>2. Non-OECD countries</b>					
Argentina	40.13	0.93	0.92	0.02	
China	1334.74	n.avail	12.30	n.avail	17.3
India	1199.06	32.65	n.avail.	0.03	18.6
Indonesia	231.55	12.70	0.67	0.05	19.2
Malaysia	27.76	8.86	n.avail.	0.32	15.2
Singapore	5.01	1.62	0.08	0.32	13.5
South Africa	49.32	5.54	0.74	0.11	26.5
Bangladesh	163.00	1.71	.48	0.28	8.96

Source: OECD Report (OECD 2011), NBR (2011)

<sup>148</sup> Except Bangladesh, all figures are for FY 2008

<sup>149</sup> Figures include all PIT taxpayers who are registered for personal income, but some do not have current liabilities for income tax

## APPENDIX 2

### Comparative definitions of good governance

Source	What is governance
World Bank (No Date)	Inclusiveness and accountability established in three key areas: 'selection, accountability and replacement of authorities (voice and accountability; stability and lack of violence); efficiency of institutions, regulations, resource management (regulatory framework; government effectiveness); respect for institutions, laws and interactions among players in civil society, business, and politics (control of corruption; rule of law)
UNDP (1997)	Characterized as 'participatory, transparent ... accountable ... effective and equitable ... promotes the rule of law ... ensures that political, social and economic priorities are based on broad consensus in society and that the voices of the poorest and the most vulnerable are heard in decision-making over the allocation of development resources'
IMF (2005)	'ensuring the rule of law, improving the efficiency and accountability of the public sector, and tackling corruption'
DFID (2001)	'seven key governance capabilities: to operate political systems which provide opportunities for all people ... to influence government policy and practice; to provide macroeconomic stability ... to promote the growth necessary to reduce poverty; to implement pro-poor policy; to guarantee the equitable and universal provision of effective basic services; ensure personal safety and security ...; to manage national security arrangements accountably ...; to develop honest and accountable government ...'
USAID (2005)	Democratic governance: 'transparency, pluralism, citizen involvement in decision-making, representation, and accountability; focusing particularly on five areas: legislative strengthening, decentralization and democratic local governance, anti-corruption, civil-military relations, and improving policy implementation'
Hyden et al. (2004)	Can be measured along five dimensions ('participation, fairness, decency, efficiency, accountability, and transparency') in each of six arenas (civil society, political society, government, bureaucracy, economic society, judiciary)
Kaufmann (2003)	Can be measured along six dimensions (voice and external accountability; political stability and lack of violence, crime, and terrorism; government effectiveness; lack of regulatory burden; rule of law; control of corruption)
Hewitt de Alcantara (1998)	Processes through which there is incorporation of more creative and less technical understanding of reform, more dialogue about institutional and programmatic change, more concern with the public sphere (state and civil society) and how to strengthen it, more integration of economic policy and institutional reform, more attention to both national and international factors that affect governance

Source: Adapted from Grindle (2007:556-557)

## APPENDIX 3

### VAT in different countries

No	Country	Year of introduction	Standard Rate
1	Albania	1996	20.0
2	Algeria	1992	21.0
3	Argentina	1975	21.0
4	Armenia	1992	20.0
5	Australia	2000	10.0
6	Austria	1973	20.0
7	Azerbaijan	1992	18.0
8	Bangladesh	1991	15.0
9	Barbados	1997	15.0
10	Belarus	1992	18.0
11	Belgium	1971	21.0
12	Benin	1991	18.0
13	Bolivia	1973	13.0
14	Botswana	2002	10.0
15	Brazil	1967	20.0
16	Bulgaria	1994	20.0
17	Burkina Faso	1993	18.
18	Cambodia 1999 10.0		
19	Cameroon	1999	19.25
20	Canada	1991	7.0
21	Cape Verde	2004	15.0
22	Central African Republic	2001	18.0
23	Chad	2000	18.0
24	Chile	1975	19.0
25	China	1994	17.0
26	Colombia	1975	16.0
27	Congo (Brazzaville)	.....	18.00
28	Congo Republic	1997	18.0

29	Costa Rica	1975	13.0
30	Côte d'Ivoire	1960	18.0
31	Croatia	1998	22.0
32	Cyprus	1992	15.0
33	Czech Republic	1993	19.0
34	Denmark	1967	25.0
35	Dominica	2006	15.0
36	Dominican Republic	1983	12.0
37	Ecuador	1970	12.0
38	Egypt	1991	10.0
39	El Salvador	1992	13.0
40	Estonia	1992	18.0
41	Ethiopia	2003	15.0
42	Faroe Islands		25.0
43	Fiji	1992	12.5
44	Finland	1994	22.0
45	France	1968 (or 1948)	19.6
46	French Polynesia		3.0
47	Gabon	1995	18.0
48	Georgia	1992	18.0
49	Germany	1968	16.0
50	Ghana	1998	12.5
51	Greece	1987	19.0
52	Guadeloupe and Martinique		8.5
53	Guatemala	1983	12.0
54	Guinea	1996	18.0
55	Guyana	2005	
56	Haiti	1982	10.0
57	Honduras	1976	12.0
58	Hungary	1988	25.0 (20% effective 1/1/06)
59	Iceland	1990	24
60	India	Some subnational VATs	
61	Indonesia	1985	10.0
62	Ireland	1972	21.0
63	Israel	1976	16.5

64	Italy	1973	20.0
65	Ivory Coast		18.0
66	Jamaica	1991	16.5
67	Japan	1989	5.0
68	Kazakhstan	1992	15.0
69	Kenya	1990	16.0
70	Korea	1977	10.0
71	Kyrgyz Republic	1992	20.0
72	Latvia	1992	18.0
73	Lebanon	2002	10.0
74	Lesotho	2003.	14.0
75	Liechtenstein		7.6
76	Lithuania	1992	18.0
77	Luxembourg	1970	15.0
78	Macedonia,	FYR 2000	18.0
79	Madagascar	1994	20.0
80	Madeira		15.0
81	Malawi	1989	17.5
82	Mali	1991	15.0
83	Malta	1995	18.0
84	Mauritania	1995	14.0
85	Mauritius	1998	10.0
86	Mexico	1980	15.0
87	Moldova	1992	20.0
88	Mongolia	1998	15.0
89	Morocco	1986	20.0
90	Mozambique	1999	17.0
91	Myanmar		
92	Namibia	2000	15.0
93	Nepal	1997	13.0
94	Netherlands	1969	19.0
95	Netherlands Antilles	1999	5.0 or 3.0
96	New Zealand	1986	12.5
97	Nicaragua	1975	15.0
98	Niger	1986	19.0
99	Nigeria	1994	5.0
100	Norway	1970	25.0
101	Pakistan	1990	15.0
102	Palestine Autonomous Areas	1976	17.0
103	Panama	1977	5.0
104	Papua New Guinea	1999	10.0
105	Paraguay	1993	10.0
106	Peru	1973	19.0
107	Philippines	1988	10.0
108	Poland	1993	22.0
109	Portugal	1986	21.0
110	Romania	1993	19.0

111	Russia	1992	18.0
112	Rwanda	2001	18.0
113	Samoa	1994	13.0
114	Senegal	1980	18.0
115	Serbia & Montenegro	S 2005 M2003	S 18.0 M 17.0
116	Singapore	1994	5.0
117	Slovak Republic	1993	19.0
118			
118	Slovenia	1999	20.0
120	South Africa	1991	14.0
121	Spain	1986	16.0
122	Sri Lanka	1998	15.0
123	Sudan	2000	10.0
124	Suriname	1999	10.0 goods 8.0 services
125	Palestine Autonomous Areas	1976	17.0
126	Sweden	1969	25.0
127	Switzerland	1995	7.6
128	Taiwan	1986	5.0
129	Tajikistan	1992	20.0
130	Tanzania	1998	20.0
131	Thailand 0	1992	7.0
132	Togo	1995	18.0
133	Trinidad and Tobago	1990	15.0
134	Tunisia	1988	18.0
135	Turkey	1985	18.0
136	Turkmenistan	1992	20.0
137	Uganda	1996	18.0
138	Ukraine	1992	20.0
139	United Kingdom	1973	17.5
140	Uruguay	1968	23.0
141	Uzbekistan	1992	20.0
142	Vanuatu	1998	12.5
143	Venezuela	1993	14.0
144	Vietnam	1999	10.0
145	Zambia	1995	17.5
146	Zimbabwe	2004	15.0

Source: Ebrill, Keen et al (2001); Schenk and Oldman (2007)



## APPENDIX 4

### Differentiated rates of VAT on truncated base

Service	Value on which VAT is charged	Rate of net VAT
Restaurant	<b>a.</b> For air-conditioned restaurant: 100% of the total receipt	15%
	<b>b.</b> For other restaurant: 40% of the total receipt	6%
Moto garage and workshop	30% of the total receipt	4.5%
Construction firm	36.67% of the total receipt	5.5%
Land Development firm	10% of the total receipt	1.5%
Building construction firm	10% of the total receipt	1.5%
Photography studio	30% of the total receipt	4.5%
Furniture sales centre	<b>a.</b> At manufacturing stage: 40% of the total receipt	6%
	<b>b.</b> At retail sale: 20% of the total receipt (provide that the seller has proof of paying VAT at the manufacturing stage)	3%
Jewelry	10% of the total receipt	1.5%
Medical centre	15% of the total receipt	2.25%
Dental clinic	15% of the total receipt	2.25%
Pathological laboratory	15% of the total receipt	2.25%
Air-conditioned bus service	33.35% of the total receipt	5.0025%
Procurement provider	26.67% of the total receipt	4%
Security service	30% of the total receipt	4.5%
Legal Adviser	30% of the total receipt	4.5%
Transport contractor	<b>a.</b> Transport of petroleum products: 15% of the total receipt	2.25%
	<b>b.</b> Transport of other products: 30% of the total receipt	4.5%

Car rental	30% of the total receipt	4.5%
Electricity distributor	33.35% of the total receipt	5.0025%
Buyer of auctioned goods	20% of the total receipt	3%
Building/premises maintenance firm	15% of the total receipt	2.25%
Immigration adviser	30% of the total receipt	4.5%
Coaching centre	30% of the total receipt	4.5%
English Medium school	30% of the total receipt	4.5%
Private University	30% of the total receipt	4.5%
Private medical and engineering college	30% of the total receipt	4.5%
Event management	30% of the total receipt	4.5%
HR supplier and management firm	30% of the total receipt	4.5%
Shops that sell their own branded garments	33.35% of the total receipt	5.0025%

## APPENDIX 5

### Discretionary powers in Value-Added Tax Act, 1991

Discretionary entity	Discretionary power	Section
Government	Determination of tax period	2(e)
Government	Determination of goods to be assessed on the basis of retail price	5(3)
Government	Determination of rate of drawback	13(1ka)
Government	General exemptions power	14(1)
Government	Exemption from VAT registration	16(1)
Government	Examination of records of the subordinate offices	47
Government	Power to write-off irrecoverable government dues	71ka
NBR	Designating a local VAT office	2(jhha)
NBR	Power to declare a good a service and vice versa	3(4)
NBR	Determining the scope of a service	3(4)
NBR	Determining the rate or amount of value addition for goods and services	5(2) proviso
NBR	Imposition of VAT on services on the basis of specific rate of value addition	5(4) proviso
NBR	Imposition of minimum VAT on services that provide free service	5(4)
NBR	Assessment of VAT on traders on the basis of their total receipt or deemed receipt	5(4ka)
NBR	Fixation of tariff value for any goods or services	5(7)
NBR	Selection of goods or services for withholding and ordering advance payment of VAT	6(4)
NBR	Use of banderol or stamp	6(4ka)
NBR	Determination of turnover threshold	8(2)
NBR	Exemption from turnover tax	8(3)
NBR	Bringing any goods or services under VAT irrespective of their turnover	8(4)
NBR	Determination of flat rate for Drawback	13(3)
NBR	Devising conditions for drawback	13(4)
NBR	Specific exemptions	14(2)
NBR	Exemption of exporters or importers from VAT registration	16(2)
NBR	Examination of records of the subordinate offices	43
NBR	Power to make rules for carrying out the purposes of the Act	72
Commissioner	Extension of time for export	3(2)(a)

Commissioner	Order for supervised clearance if he has <i>reasons to believe that it is required</i>	26kha
Commissioner	Determination of tax for a tax period on the basis of single verification.	26kha(4)
Commissioner	Granting payment of government dues in installment.	55(4)
Commissioner	Setting conditions for transfer of ownership of a business on submission of bank guarantee	59
VAT divisional officer	Granting VAT registration on being <i>fully satisfied about the information provided</i>	15(3)
VAT officer	Giving forced registration to a business on <i>being satisfied</i>	15(4)
VAT divisional officer	Registering a person not liable to be registered <i>on being satisfied</i>	17
VAT divisional officer	Cancellation of a VAT registration whose turnover is below the VAT threshold on being <i>satisfied</i>	19(2)
Revenue Officer and above	Sending summon to anybody for giving witness or providing information, if there <i>is reason to believe</i> that it is required	25
VAT officer – Asstt Commissioner and above	Order to enter business premises, stock of goods and books of account	26
Joint Commissioner	Power to re-examine or re-audit tax activities of a taxpayer at any time if there <i>appears</i> to have any <i>reason</i> to do so.	26ka
VAT officer	Order a sale verification if he <i>thinks</i> that it is needed to determine the input-output coefficient	36(3)
VAT Officer	Power to re-assess, without any reference to timeframe, tax liabilities, if he has reasons to believe that a return was not submitted or information [ this discretion virtually negates the timeframe ( 5years) stipulated in section 55 within which a demand for less paid/unpaid taxes has to be raised]	36(4)
Adjudicating VAT officer	Imposition of penalty between <i>taka</i> 5,000 and 25,000 for minor offence	37(1)
Adjudicating VAT officer	Imposition of penalty, in case of evasion, between equal amount of payable taxes and two and half times of payable tax	37(2)
Adjudicating VAT officer	Imposition of penalty, in case of irregularity other than evasion, between <i>taka</i> 10,000 and <i>taka</i> 1,00,000	37(2)
Commissioner (Appeal)	Extension of time for filing an appeal by 60 days if he so <i>thinks</i> necessary	42(1ka)

VAT officer empowered by NBR	Arrest of any person if the officer has <i>reasons to believe</i> that a person has committed an offence under VAT Act	49
VAT officer	<i>Ascertaining</i> if a non-payment or short payment of taxes has been done with a mala fide intention	55
VAT officer	Realization of government dues by applying any of methods of realization	56

Source: Value Added Tax Act, 1991 (Government of Bangladesh, 1991a)

## APPENDIX 6

### Discretionary powers in Value-Added Tax Rules, 1991

Discretionary authority	Discretionary power	Rule
VAT divisional officer	Revision of a declared price if found <i>necessary</i>	3(2ka)
VAT divisional officer	Revise a declared price if it <i>appears</i> that the declared price is <i>significantly lower</i> than the price of similar goods, <i>significantly low</i> due to some relationship between the buyer and the seller or amount of value addition is <i>significantly low</i>	3(2ka)
Commissioner	Fixation of base value if <i>he considers</i> it necessary	3(7)
VAT divisional officer	Revision of input output coefficient of items on tariff value if he <i>thinks</i> it necessary	3(9)
VAT divisional officer	Enlist turnover tax unit if he is <i>fully satisfied</i> about the declared turnover	4(2)
VAT divisional officer	Imposition of 2% interest on unrealized turnover tax	4(5)
Commissioner	Re-fixation of turnover tax if it <i>appears</i> to him that the turnover declared by the taxpayer or fixed by the divisional officer is not correct	3(20)
VAT officer not below the rank of an Asstt. Commissioner and officers empowered by him	Inspection, search and seizure of vehicles if <i>it is considered that there is reasonable ground to believe</i> tax has evaded	7
VAT divisional officer	Grant of VAT registration if the application is <i>considered acceptable</i>	11(1)
Commissioner	Order to submit a registration document <i>for necessary</i> amendment	14
VAT divisional officer	Cancellation of registration if he is <i>satisfied</i> that a person is no more liable to be registered after giving two notices within a gap of <i>reasonable</i> time	15(2)
Commissioner	<i>Grant of</i> approval for using computerized invoice	16(2ka)
Revenue Officer	Certifying copy of return if <i>it is considered</i>	25

	<i>correct</i> to the examining officer	
Commissioner	Taking <i>necessary action</i> to see that the taxpayer has paid output tax and taken input tax credit correctly	25(2)
Appropriate Officer in Duty Exemption and Drawback Office (DEDO)	Recommending drawback <i>on being satisfied</i> by verifying relevant documents	29(3)
Director General, DEDO	Re-examination of a return	29(3)
Director General, DEDO	Order to complete a survey for granting drawback within 21 days if he is <i>satisfied</i> that the drawback application has been filed correctly	30(7)
Commissioner	Time of removal of goods in case of any business if the commissioner finds it <i>necessary</i>	39
Revenue Officer	Disposal of unused or not-fit for- use input if he so <i>considers</i>	40(1)
VAT divisional officer	Disposal of unused or not-fit for- use input in accordance with his <i>satisfaction</i>	40(3)
Revenue Officer	Disposal of damaged or destroyed goods and if they <i>appear</i> to be suppliable, after determining the proper price of such goods in <i>his opinion</i>	41(2)
VAT divisional officer	Disposal of damaged or destroyed goods <i>on being satisfied</i>	41(4)

Source: Value Added Tax Rules, 1991 (Government of Bangladesh 1991b)

## APPENDIX 7

### Revenue audit process in Bangladesh

- Intimation of audit to the selected office
- Audit team issues audit queries
- In course of auditing, the audit team discusses the findings with the head of the concerned revenue office or with the nominated representative
- The auditee has to put his seal and signature in the inspection report as evidence of his perusal and discussion
- Some observations may be dropped during that discussion if satisfactory answers/ documents can be provided on the spot
- serious financial irregularity is responded to through the next higher office of the respective auditee office
- If no response is received, the report is elevated from 'Ordinary Paragraph' to 'Advance Paragraph' stage and issued to the Secretary of IRD
- If a satisfactory response is not received within 8 weeks of such report, a demo official letter is sent to the secretary
- If no satisfactory response is received , the report is sent to the Auditor General's office for inclusion in the Audit Report
- The reports are discussed t in the Parliamentary Committees attended by the Auditor General and the Secretary of the Internal Resources Division
- Serious financial irregularity published as advance paragraph may be settled by tri-partite meeting among the controlling Ministry, the revenue department and the audit office.

Source: Adapted from the country paper for the Fourth ASOSAI Research Project:- Government Revenues - Accountability and Audit (ASOSAI 1998b).



## APPENDIX 8

### Treatment of complaints in tax administrations in different countries

#### Australia

“We want you to be confident that you can come to us with any problems and complaints and have them resolved quickly and fairly. Once your complaint is lodged in our complaints system, a tax officer will contact you; we aim for the contact to occur within three working days. This officer (the resolver) will work with you to resolve your issue (or issues) and will keep you informed of the progress of the case.

Other avenues available to you:

“If you have a complaint about the ATO, you should try to resolve it with us first. If you are unable to, or you are dissatisfied with the way we have handled your complaint, the Taxation Ombudsman may be able to help you.”

#### Singapore

“IRAS is committed to treating any complaints seriously and dealing with them in a timely, professional and cordial manner. We treat each complaint as a learning opportunity for IRAS as it will help us identify areas for improvement.

“For complaints received via our email service or QSM helpline, we will work towards resolving the complaints within 4 working days. Our officer will work with you to resolve your complaint. We will update you on the progress if we require more time to look into the matter.”

#### Thailand

The Revenue Department (RD) receives queries through its Call Center. In addition the RD website has contact option for citizens to make any query or provide any feedback.

“"Contact Us" is an option to service taxpayers and other people who can question on any information related to the Revenue Department by indicating the appropriate type of question such as tax filing and tax returns, tax refund, tax law, making a request in relation to the Revenue Department's practices and other related issues .”

#### New Zealand

“Complaints Management Service

“Let us know as soon as possible if our service has let you down, so we can fix the problem for you and take steps to ensure it doesn't happen again. Your feedback will help us improve our processes.

“The Ombudsmen: At any time you may ask the Office of the Ombudsmen to view decisions made by us. The Ombudsmen will usually expect you to have first tried to resolve the issue with us using our complaints processes”

Source: Adapted from the websites of Australian Tax Office (ATO 2012), Inland Revenue Authority of Singapore (IRAS 2012), Revenue Department of Thailand (Revenue Department 2012) and Inland Revenue of New Zealand (Inland Revenue 2012)

## APPENDIX 9

### Survey questionnaire for VAT-paying businesses

#### Part: 1 Information about the respondent

1. Name of the respondent: (optional)
2. Age
3. Location: District:
4. Educational Qualification: (Check the appropriate box)
  - a. Masters and above
  - b. Graduation
  - c. Higher Secondary
  - d. Others
5. Name of the relevant VAT unit: (optional)
6. Location: District
7. Relationship with the VAT unit: (Check the appropriate box)
  - a. Owner/shareholder of the Unit
  - b. Employee
8. Tenure of involvement with this Unit: (Check the appropriate box)
  - a. More than 10 years
  - b. Less than 10 years but more than 5 years
  - c. Less than 5 years but more than 2 years
  - d. Less than 2 years
9. Frequency of contact with VAT office (Check the appropriate box)
  - a. Once in a month
  - b. 2/3 times in month
  - c. Other
10. Usual reasons of contact (Check the appropriate boxes , can be more than one)
  - a. To submit Returns
  - b. To submit value declaration
  - c. To know legal explanation of some matter
  - d. For other reasons (hearing, auditing, to explain something to the VAT officer, etc.)

#### Part 2: Questionnaire

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11. VAT is called a trade friendly tax. To what extent do you think VAT is-
  - a. Very Trade friendly
  - b. Fairly trade friendly
  - c. Not trade friendly at all
  - d. No idea/no comment
12. How SIMPLY do the VAT Act and Rules specify what responsibilities you as a taxpayer will have to carry?
  - a. Very simply
  - b. Fairly simply
  - c. Not simply at all

- d.
- 13. How CLEARLY do the VAT Act and Rules specify what responsibilities you as a taxpayer will have to carry?
  - a. Very Clearly
  - b. Fairly Clearly
  - c. Not Clearly at all
- 14. Are you aware of the rights that a taxpayer is entitled to in the VAT Act?
  - a. YES
  - b. NO... skip to Q 16
- 15. If the answer to Q14 is YES I, do you think that those rights are-
  - a. Usually easily available
  - b. Sometimes, but not always available
  - c. Difficult to avail
  - d. Not available at all
- 16. If the answer to Q.14 is NO, it is because-
  - a. Nobody ever told you of them
  - b. You did not try to know about them
  - c. Other
- 17. How often do you submit VAT Return?
  - a. Monthly
  - b. Quarterly
  - c. Yearly
- 18. Is filling a VAT return-
  - a. Fairly Easy
  - b. Not that easy
  - c. Complicated
- 19. In filing a return, you submit it –
  - a. In person
  - b. By postal mail or courier
  - c. Electronic mail
- 20. After filing a Return, you are supposed to get the certified Return back. Do you usually get it back?
  - a. YES, always
  - b. Sometimes
  - c. Never
  - d. Not aware of it
- 21. If the answer to Q20 is **Sometimes or Never**, it is because-
  - a. VAT office is reluctant to do this
  - b. You did not push VAT office enough to give it
  - c. You are not interested in getting a certified return
  - d. Other
- 22. Do you take Input tax credit?
  - a. YES
  - b. NO---- skip to Q.24
- 23. If the answer to Q22 is **YES** , do you think getting input tax credit is-
  - a. A simple automatic process
  - b. Quite a complicated process

- c. Something that cannot be taken without the consent of the VAT officer
  - d. No idea Skip to Q.25
24. If the answer to Q22 is **NO**, why don't you take input tax credit?
- a. We pay VAT on truncated or tariff value
  - b. We pay fixed VAT
  - c. We do not use any taxable input
  - d. We are not sure if we can get input tax credit
25. Do you think that VAT rules are enforced equally to all taxpayers?
- a. YES, almost always... skip to Q.27
  - b. Sometimes
  - c. Never
26. If the answer to Q24 is **Sometimes or Never**, the discrimination is based on-
- a. The reputation of the business (honest, dishonest, fraudulent, complying, non-complying etc.)
  - b. Size of the business
  - c. Personal relationship with VAT officers
  - d. Others
27. Are you aware that VAT officers have some discretionary powers?
- a. YES
  - b. NO... skip to Q 30
28. If the answer to Q27 is YES, do you think that their discretionary powers are-
- a. More than necessary
  - b. As much as is necessary
  - c. Less than necessary
  - d. No idea
29. If the answer to Q27 is YES, do you think their discretionary powers are used –
- a. To facilitate trade
  - b. To harass taxpayers
  - c. For personal gain
  - d. No idea
30. Have you ever participated in any workshop, seminar or meeting for taxpayer's education organized by VAT department?
- a. YES... skip to Q 32
  - b. NO
31. If the answer to Q30 is NO, it is because-
- a. No such thing was organized in your location
  - b. Even if organized, you were never invited
  - c. You were invited, but you were not interested
  - d. You attended by a proxy
32. Have you ever been asked by the VAT office to give your opinion about any VAT matter formally? (in a meeting or seminar or workshop etc.)
- a. YES
  - b. NO
33. Business associations put forward their proposals and recommendations on tax issues to the NBR. In formulating proposals does your trade association solicit your opinion regarding VAT issues?
- a. YES

- b. NO
- 34. Do you think the proposals put forward by your association are generally reflected in formulating tax polices?
  - a. YES, almost always
  - b. Very rarely
  - c. Never
  - d. NO idea
- 35. To what extent do you consider that VAT officers are accountable for their actions?
  - a. Quite Satisfactorily
  - b. Fairly satisfactorily
  - c. Not satisfactorily
  - d. No idea
- 36. VAT officers usually-
  - a. Pay attention to providing services to taxpayers
  - b. Help facilitate trade
  - c. Prefer collecting taxes at any cost to providing services
  - d. No idea
- 37. To what extent the VAT record keeping is easy or complicated?
  - a. Fairly easy
  - b. Not easy at all
  - c. Very complicated
  - d. No Comments
- 38. Do you think that VAT record keeping helps you maintain your accounts transparently for other purposes (for example, income tax) as well?
  - a. YES
  - b. NO
- 39. There are different methods the assessment of VAT, namely, tariff value, truncated base, standard credit mechanism, fixed VAT for different businesses. Do you think they create discrimination?
  - a. YES
  - b. NO
  - c. NO idea
- 40. In complying with your taxpayer obligation-
  - a. You know what documents or information you will have to provide because they are written or informed well ahead
  - b. You do not know what documents or information you will have to provide because VAT office ask for them all of a sudden
- 41. To what extent do you consider the penal provision in VAT Act appropriate?
  - a. Very harsh
  - b. Quite ok
  - c. Very lenient
  - d. No idea
- 42. How do you consider the quasi-judicial process in adjudicating VAT offences?
  - a. Ample opportunity of self defence
  - b. Scant opportunity of self defence
  - c. Neutral
  - d. Biased
  - e. No idea



46. Please list some aspects of VAT you like MOST

- a.
- b.
- c.
- d.

Please justify your answer:

.....  
.....

47. Please list some aspects of VAT you like LEAST

- a.
- b.
- c.
- d.

Please justify your answer:

.....  
.....

48. If you have any suggestions for improvement of VAT in Bangladesh, please provide them here.

## APPENDIX 10

### Semi-structured interview questionnaire for general consumers

1. All of us pay taxes, directly or indirectly. Why do you think that we pay taxes?
  - a. Tax is the price that we pay for the services we get from the state.
  - b. We pay taxes because we have to. ( because of law)
  - c. I don't know why we pay taxes
2. Do you think that the VAT and other taxes that we pay are required for the services (roads, schools, colleges, hospitals, infrastructure, etc.) that we receive?
  - a. YES
  - b. NO
  - c. NO idea
3. If you don't like to pay taxes, it is because-
  - a. I don't have the ability to pay
  - b. I don't get enough return (services) in exchange of my taxes
  - c. The money I contribute in the form of taxes is not spent accountably and transparently
  - d. Some other reason... please specify-----  
-----
4. Are you aware that you as a consumer pay VAT for most of your purchases?
  - a. YES
  - b. NO
5. The rate of VAT is 15% in Bangladesh. Do you consider the present rate of VAT is-
  - a. Just fine
  - b. Very high
  - c. Very low
  - d. No idea
6. Do you usually care to know how much VAT you paid in your purchases?
  - a. YES
  - b. NO

Why/Why Not .....
7. A business is supposed to issue a VAT invoice after each VAT- able transaction. Do you **usually** receive VAT invoice after a taxable transaction? (for example from a sweetmeat shop, restaurant, etc.)
  - a. YES
  - b. NO
8. In case a business does not give an Invoice or forgets to give you an invoice, do you ask for it?
  - a. YES
  - b. NO

Why or why NOT .....
9. Do you think a VAT invoice can ensure better accountability and transparency by a business?
  - a. YES
  - b. NO
  - c. NO idea
10. Do you think the tax that businesses collect from consumers are generally properly accounted for i.e. deposited to the government treasury?
  - a. Most of the businesses (75% and above) do it properly
  - b. Most of the businesses (75% and above) DO NOT do it properly
  - c. Other.....
  - d. No idea



11. If the answer to the above is ‘Most of the businesses (75% and above) do not do it properly’, it is because-
- Lack of enforcement of law
  - Business people’s malafide intention
  - Connivance between business and tax people
  - Other reason.....
  - No idea
12. Would you agree with a proposal that you receive no invoice and pay no VAT?
- YES
  - NO
- Why? .....
13. Do you think in this country we pay taxes equitably (i.e. proportionate to our income)?
- YES
  - NO
  - No idea
- Can you please explain or give an example?  
 .....  
 .....
14. If the answer to Q13 is NO, would you be motivated to pay more taxes within the limit of affordability if you were assured of the usage of your tax money more accountably and more transparently?
- YES
  - NO
15. Do you think that taxes we pay are well spent?
- YES
  - NO
  - No idea
- Can you please justify your answer?  
 .....  
 .....
16. Do you think that people in general are aware of taxes in our country?
- YES
  - NO
- Please justify your answer:  
 .....
17. If you think that people in general are **not** very much aware of taxes, why do you think it is so?  
 .....  
 .....  
 .....
18. Do you have any suggestions to improve the tax system’s efficiency and effectiveness in Bangladesh?

## APPENDIX 11

### Survey questionnaire for VAT officials on accountability

Your Designation .....

Year(s) in service.....

**(Please fill in the blank spaces by using tick (✓) or cross (X) marks in the appropriate boxes)**

1. Do you have official job description/charter of duties?

Yes

No

2. If yes, how clear and specified it is?

Full

To some extent/Partial

Not at all

Not sure

3. Do you think that the rules/regulations/orders etc. guide you properly in performing your duty?

Yes

No

Not sure

4. If NO, what is/are the reason(s)? [You may tick multiple boxes]

Rules not clear

Not specific

Not up to date

Lack clear goals/objectives

Other...Lack of proper guidance from senior officials

.....

5. Have you ever experienced any conflict in different written orders and/ or verbal orders?

Yes

No

6. If YES, what is/are the nature of conflict? [You may tick multiple boxes]

Between legal provision and NBR orders

Between written order and superior's oral order

Between different oral orders of different superiors

Other (please specify).....

7. In your opinion, how is the condition of the compliance of rules/regulations/codes of conduct in VAT dept. (by VAT officers)?

Very good

Good

Average

Below-average

Poor

Not sure

8. How effective is the AUDIT by CAG (Local and Revenue Audit Directorate) in ensuring accountability of a VAT officer?

Very effective

Fairly effective

- Not effective at all
- No idea

9. If it is not VERY EFFECTIVE why do you think it is so? [You may tick multiple boxes]

- CAG auditors do not have sufficient knowledge about VAT
- Their main attitude is to find fault
- Other (Very adverse attitude towards VAT officers)

10. How is the case(s) of sanction for violation of rules?

- For every case
- For majority of cases
- For a few cases
- No sanction at all
- I don't know

11. Have you ever been a subject of disciplinary action?

- Yes
- No

12. Do you receive feedback from your authority for your performance/activities?

- Yes, always
- Yes, most often
- Yes, often
- Yes, but rarely
- No

13. Are you satisfied with the overall evaluation of your performance?

- Highly satisfied
- Satisfied
- Neutral
- Dissatisfied
- Highly Dissatisfied

If dissatisfied, what is the reason?

.....

.....

.....

14. How satisfied are you with the current practice with and the format of ACR?

- Highly satisfied
- Satisfied
- Neutral
- Dissatisfied
- Highly Dissatisfied

If dissatisfied, why?

15. Do you think that incentives like your promotion/ placement in a prestigious place/ foreign training depends on your performance?

- Yes
- No

16. If NO, what do you think is/ are the criterion/criteria [You may tick multiple boxes]

- Personal rapport with the superiors

- Political Influence
- Other (please specify).....

17. Do you think **inspection** can be a tool for ensuring accountability?

- Yes
- No

18. Does your authority visit your workplace for inspection purpose?

- Yes
- No

19. If yes, how frequently?

- Once in a month
- Once in 2-3 months
- Once in 6 months
- Once in a year
- Irregular

20. Do YOU visit your subordinate office for inspection purpose?

- Yes
- No

21. If yes, how frequently?

- Once in a month
- Once in 2-3 months
- Once in 6 months
- Once in a year
- Irregular

22. Do you think there **should be** some mechanism for VAT officials to be accountable to the stakeholders such as taxpayers?

- Yes
- No

23. Do you think there **is** some mechanism to be accountable to the stakeholders such as taxpayers?

- Yes
- No

24. Do you have any particular comment about the state of accountability or accountability mechanisms in VAT department that you would like to share?

.....

## APPENDIX 12

### List of interviewees (in-depth interview)

- a. Value- Added Tax officials
  1. A Member ( VAT policy), National Board of Revenue , Dhaka code: VPI 1
  2. A Commissioner, Value Added Tax, National Board of Revenue , Dhaka code: VPI 2
  3. A Commissioner, Value Added Tax, National Board of Revenue , Dhaka code: VPI 3
  4. A Commissioner, Value Added Tax, National Board of Revenue , Chittagong, code: VPI 4
  5. A Director General, Value Added Tax, National Board of Revenue , Dhaka code: VPI 5
  6. A Commissioner, Value Added Tax, National Board of Revenue , Dhaka code: VPI 6
  7. A Commissioner of Customs , National Board of Revenue , Dhaka code: VPI 7
  8. A First Secretary, Value Added Tax, National Board of Revenue , Dhaka code: VPI 8
  9. An Additional Commissioner, National Board of Revenue , Dhaka code: VPI 9
  10. An Additional Commissioner, Value Added Tax, National Board of Revenue , Dhaka code: VPI 10
- b. VAT Experts
  1. A professor of accounting , Dhaka University , Dhaka; Code VEI 1
  2. A retired member of VAT policy, National Board of Revenue, Dhaka; code VEI 2
  3. A Researcher in a research organization based in Dhaka,; code VEI 3
- c. Business leaders
  1. A business leader belonging to Bangladesh Federation of Chambers of Commerce and Industries (FBCCI), Dhaka ; code VBI 1
  2. A business leader belonging to Dhaka Chamber of Commerce and Industries (DCCI), Dhaka ; code VBI 2
  3. A business leader belonging to Dhaka Chamber of Commerce and Industries (DCCI), Dhaka ; code VBI 3
  4. A business leader belonging to Chittagong Chamber of Commerce and Industries (CCCI), Chittagong; code VBI 4
  5. A business leader belonging to Bangladesh Dokan Malik Samity , Dhaka ; code VBI 5
- d. CGA auditors
  1. An Auditor, CAGB, Dhaka

### General Consumer Participants in semi-structured interview

Participant code VGC1 to VGC 57.

## APPENDIX 13

### List of FGD Participants (serial number indicates participant's code)

1. A chartered accountant working as company secretary in an MNC, Dhaka
2. A VAT practitioner, Dhaka
3. A VAT consultant and income tax practitioner, Dhaka
4. A VAT-dealing officer working in a cigarette manufacturing company, Dhaka
5. A business person ( a restaurant owner), Chittagong
6. A Commissioner of Customs ( worked as First Secretary, VAT) , Benapole, Jessore
7. A Commissioner of Customs ( Worked as Second Secretary, VAT), Dhaka
8. A Civil society activist, based in Dhaka
9. An Executive Director, Steel Re-rolling Mills, Chittagong
10. A VAT-dealing officer working in a pharmaceutical company, Pabna
11. A business owner ( packaging industry) , Chittagong
12. A Director General, Value Added Tax , Dhaka
13. An Additional Commissioner, VAT LTU
14. An Additional Commissioner, VAT, Dhaka
15. An executive working in an international organization, Dhaka
16. A journalist, working for an English Daily, Dhaka

## APPENDIX 14

### Profile of Survey respondents: VAT paying businesses

a. Business Location (N=110)

Dhaka	45	41%
Chittagong	34	31%
Rajshahi	19	17%
Khulna	12	11%

b. Academic qualifications of respondents (N=110)

Masters and above	38	35%
Bachelor	67	61%
Higher secondary	5	4%
Others	0	0%

c. Relationship with the VAT unit (N=110)

Owner/shareholder of the Unit	12	11%
Employee	98	89%

d. Tenure of involvement with this Unit (N=110)

More than 10 years	29	26%
Less than 10 years but more than 5 years	43	39%
Less than 5 years but more than 2 years	37	34%
Less than 2 years	1	1%

e. Frequency of interaction with VAT office (N=110)

Once in a month	59	54%
2/3 times in month	38	35%
Other	13	11%

f. Usual reasons for contact with VAT offices (N=204, multiple answers possible)

To submit Returns	110	54%
To submit value declaration	59	29%
To know legal explanation of some matter	12	6%
For other reasons (hearing, auditing, to explain something to the VAT officer, etc.)	23	11%

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