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## eJournal of Tax Research

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# The use of discretions in taxation: the case of VAT in Bangladesh

Ahmed Munirus Saleheen\*

## ***Abstract***

Discretion is an inevitable part of bureaucratic action and discretion is positioned between the tax authority's immediate concern for maximizing revenue and the wider concern for good governance. Striking a balance between the conflicting concerns is more challenging in developing countries than in ot

Bangladesh is one of the first two South Asian countries that adopted VAT in 1991 by replacing the age old 'excise duty on the domestically produced goods and services and sales tax at the importation stage with the express aim to 'to expand the tax base, simplify the tax collection procedure and curb the tax evasion' (Government of Bangladesh 1991a).

Allegedly characterized by the presence of undue and excessive discretionary powers vested in the tax administration by the primary and secondary legislation, Bangladesh's VAT has caused a great deal of grievances amongst taxpayers since its inception. Among the tax issues that have attracted wide media coverage are key stakeholders' complaints, specifically business people about excessive tax discretions which surely figure more prominently than others.

Given the wide ramifications of excessive and uncontrolled discretions in Bangladesh's VAT regime and that no academic study of this phenomenon has so far been done, the aim of the present paper is to investigate, in the context of VAT in Bangladesh, the level of discretion accorded to the executive branch of government including the tax administration. Essentially explorative in nature, the study attempts to consider discretionary powers from a social science perspective in terms of decision goals and decision process (Hawkins 1992) as impacting the principles of good governance such as transparency, accountability and certainty. Rather than considering the relationship of discretion with the conceptions of justice or rule of law, which is the domain of jurisprudence, an attempt has been made in the paper to explore social problems that uncontrolled or excessive discretions can create in the tax jurisdiction of a developing country.

obtains the lion's share of its tax-revenue from VAT. VAT including supplementary duty<sup>3</sup> presently accounts for 56.85% of the total revenue and 5.09% of GDP (NBR 2011).

As in many other tax administrations in different countries, in Bangladesh, the presence of excessive discretionary powers in tax laws has been a butt of criticism as well as grievances from the business quarters. The grievances manifested especially during the series of consultative meetings at the National Board of Revenue (NBR), the apex body for tax policy and implementation, held with different stakeholders prior to the annual budget. For example, in a recent meeting with the NBR, the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), the country's peak representative organisation representing the interest of the private sector in trade and industry, proposed the reduction of discretionary powers of VAT officials in a bid to ensure hassle-free business (Financial Express 2012). FBCCI particularly expressed its concern over VAT officials' excessive power to search and seize conveyances carrying VAT-able goods.

Not only business bodies, the general taxpayers and civil society members have also expressed their concern over the tax officials' discretionary power (Financial Express 2010). As a result of the growing concern over this issue, the Finance Ministers of different governments in Bangladesh have pledged to reduce tax officials' discretionary powers in their budget speeches. For example, in the FY 2005-06 budget speech, the Finance Minister mentioned the reduction of discretionary powers of tax officials along with measures to ensure transparency and dynamism in tax administration as a major reform measure (Government of Bangladesh 2005). The same commitment to further reducing administrative and liability discretion of tax authorities appeared in the budget speeches in the following period. In the most recent budget speech (FY2012-2013), the Finance Minister mentioned limiting the discretionary powers of tax officials as one of the fundamental principles of revenue collection (Government of Bangladesh 2012).

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The use of discretions as a central and inevitable part of the legal system as well as a feature of decision-making process has been a contested issue. There are a host of arguments for and against the use of discretion both in judicial and administrative laws. While Hawkins (1992) regarded discretion as a "central and inevitable part of the legal order", Davis (1969, cited in Hawkins 1992) regarded discretion as the major source of injustice. Advantages and disadvantages of the use of discretion with reference to both legal jurisprudence and bureaucracy have been quite widely discussed in the literature on discretion. While some consider the relationship between rules and discretion as opposing entities (e.g. Davis) some others (e.g. Dworkin) refuted the supposed dichotomy between rules and discretion; Dworkin's metaphor for discretion as 'the hole in the doughnut' - discretion like the hole in the doughnut, does not exist except as an area left open by a surrounding area of restriction' - (1977b:31 cited in Sainsbury 1992) implies that discretion is in fact bounded by rules. Here

Countries Develop: The Role of Fiscal Policy. S. e. al. Washington, D.C., International Monetary Fund.

<sup>3</sup> Supplementary duty is an excise selective tax imposed by VAT Act. VAT alone accounts for 39.45% of tax revenue.

emerges 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).

Discretion has been defined by scholars in numerous ways. All definitions, more or less, posit discretion as the power or right to make official decisions using reason and judgment to choose from among acceptable alternatives. Despite considerable agreement on defining discretion as well as its inevitability prompted by 'vagaries of language, the diversity of circumstances and the indeterminacy of purposes' (Galligan, cited in Hawkins 1992:11), what is actually a contested area, is the boundary of discretion- both in judicial and administrative laws. Admitting the need for some discretion for officials, Davis advocated the





Discretionary powers have been granted by the Value Added Tax Act, 1991 (henceforth the VAT Act) (Government of Bangladesh 1991b) to three sets of actors as follows:

- x The Government<sup>5</sup> represented by the Internal Resources Division under the Ministry of Finance;
- x NBR, the apex body for the formulation and implementation of tax policy;
- x

### ***2.3.1 Organisation Level***

Delegation of legislative power to the government and the revenue authority is quite common in many countries. Research shows 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 Ales 2011). In the case of Bangladesh, legislative competences as well as specific discretionary powers has been delegated to the Government and the revenue authority.

Government's discretionary powers

Among the discretionary powers that the Government enjoys under the VAT Act in

### ***2.3.2 Individual Level***

VAT officials have been granted enormous discretionary powers both under the VAT

### 3.2.1.1 Discretionary powers conferred on the executive branch by the VAT Act and Rules

Having laid out the wide scope of discretions conferred on the executive branch by the VAT Act and Rules, we can now turn to examine a selection of the use of discretions by different actors.

#### 3.2.1.1.1 Exemptions

The Government in the exercise of the powers conferred under section 14 of the VAT Act to exempt any goods or services from VAT has issued as many as 36 Statutory Regulatory Orders (SROs) which deal with different general and specific exemptions, listing the goods, services or persons entitled to exemptions at different stages of business transaction. These exemption SROs supplement the list of VAT-exempt goods and services appended to the primary law as the First Schedule. This means, in order to find out the taxability of a good or service in the Bangladesh VAT regime, one will have to go through not only the First Schedule of the VAT Act but also all the exemptions set out in the SROs.

#### 3.2.1.1.2 Assessment

By exercising the power conferred in section 5(3) of the VAT Act to assess VAT on goods on the basis of their retail price at the production level, the Government initially included seventeen items which has now been reduced to two, namely cigarette and disinfectants. The provision in section 5(3) of the VAT Act allows a cascading method of calculation of VAT. For example, if the MRP is Taka 100, then VAT payable at the manufacturing level is Taka 15 (Taka 15 as would have been derived from a backward calculation). So the MRP equals the manufacturer's share of Taka 85 plus VAT Taka 15, which means Taka 15 has been realized as VAT on a selling price of Taka 85 therefore the VAT rate increases to 65% instead of the statutory rate of 15%. Though in this instance, the problem is not so much with the exercise of discretionary powers as with the legal provision itself, the Government's decision to resort to this method of calculation was challenged in the Supreme Court by a multinational footwear manufacturer in 1998.

#### 3.2.1.1.3 Tariff

The "strong"<sup>11</sup> discretionary power that NBR derives from the law, enables it to fix a tariff value for the assessment of VAT for any goods, or, a truncated base for any services. In line with the best international

VAT on the basis of actual rate of value addition Rules, 2010". Arising from that statutory regulatory order, as many as nine other effective rates, namely 1.5%, 2.25%, 3%, 4%, 4.5%, 5%, 5.0%, 5.5% and 6% have emerged due to different tax bases enumerated in the VAT Rules. For example, the rate of VAT for construction services is 4.5% as the VAT assessment is done on the basis of 30% of the total receipt, i.e.

## 6.1.1

It has already been noted earlier in the paper that one important aspect in the exercise of discretionary powers is the interpretation of rules and their application. Unlike the discretion conferred on Her Majesty's Revenue and Customs in the United Kingdom to interpret the law, the primary legislation of VAT, i.e. the VAT Act does not give the Government or the Board any power to interpret law. In contrast, the VAT Rules made by the NBR under the authority derived from the VAT Act has granted both itself and the Commissioners powers to issue orders, notification, explanation or circular on ensuing matters of their jurisdiction. This power has yielded a good number of explanatory orders, circulars and letters of no objection which have been alleged to be contradictory to one another (Financial Express 2009).

## 4.1

To begin with the nature of discretions, it can be said that the discretion granted to the Government and the NBR is ultimate as they are not subject to review other than by their 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). In another dimension, 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 far as they are drawn from both primary and secondary legislation, there has been strong criticism from many stakeholders for the inclusion of excessive discretionary powers in tax laws in general and VAT law in particular. Despite repeated ministerial pledges to reduce tax discretions and the 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 rules and their certainty are concerned. As undue and excessive discretionary powers with their concomitant unpredictability, inconsistency and unfairness are seen as a threat to the wider framework of good governance, tax discretions in VAT in Bangladesh have been decried by different segments of stakeholders since the inception of VAT in Bangladesh in 1991. In response to this kind of criticism, as noted earlier, Finance Ministers have been seen to make a promise to reduce tax official administrative discretion almost in each of their past budget speeches (see for example Government of Bangladesh 2005; Government of Bangladesh 2008).

It is generally argued in the literature that discretion itself is not as unacceptable as the lack of a control mechanism for the exercise of that discretion (Freedman and Vella 2012). 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. For example, as noted earlier, a VAT officer has the power to increase the value of a product if it appears to him/her that amount of value addition in the product under consideration is significantly low. But there is no written standard of value addition in respect of the goods.

By contrast, tax administrations in many developed countries, for example, the Australian Tax Office (ATO 2004), have given guidelines to guide officers in the exercise of the statutory discretion contained in their tax laws. But, the potential for arbitrariness that negates the spirit of the rule of law (Dicey, 1885, cited in Freedman

and Vella, 2011) is amply evident in the VAT Act and Rules in Bangladesh. Looking at the pervasiveness of the discretionary powers especially on 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. This bias towards the use of discretionary powers by the Government to some extent explains that the Members of the Parliament (MPs) do not have a significant role in the formulation of the country's annual budget, especially the formulation of tax rates (Sirajuzzaman 2012). This pattern corroborates the fact that despite Parliament being the formal supreme law-making institution, the Government, with its unlimited discretionary powers monopolizes the legislative process from initiation to approval (Rahman 2007).

In addition to adversely contributing to the imbalance between the revenue authority discretions and the rule of law, the use of discretions causes certain other social impacts.

First, the relationship between discretion and corruption is well established. Though there are no empirical studies, the general per

Of this amount, VAT at domestic stage one accounts for Taka 428 billion (GOB 2010b). It is usually believed by the officers in VAT administration as well as many stakeholders that many of these cases owe



more opportunity there is for favouritism and corruption to occur' (ICAC 1995:104). Corruption and unethical behaviour, poor administrative practice, and inconsistent decision making are some of the consequences of unbridled discretion. This aspect needs to be paid special attention to in jurisdictions like Bangladesh which are more vulnerable to corruption than others. Moreover, besides the tangible negative consequences of undue discretions, improper exercise of discretion affects all stakeholders as it weakens the integrity of the system, and involves the loss of public trust and faith. This is another dimension to be taken into consideration for the sake of fostering fair taxation culture in jurisdictions where healthy tax culture is only in a formative stage.

The uniqueness of situation, as some scholars like Handler argue, warrants discretion as its flexibility can be turned to the advantage of social justice (cited in Hawkins 1992) but cannot be a defence for the pervasiveness of discretion in taxation. On the other hand, applying discretions to a set of similar situations can give birth to inconsistent decisions causing discrimination among the taxpayers. Given the excessive and pervasive presence of discretionary powers at different levels of administration currently existing in Bangladesh's VAT law, replication of some international best practice will be worth considering.

Enormous power of the Government and NBR to produce secondary legislation, without any reference to the Parliament in the form of SROs and other orders, affecting tax liability of taxpayers in particular and other stakeholders' economic decisions in general, has to be regulated in order to ensure certainty and predictability of the system.

In order to prevent discretions from degenerating into arbitrariness as has often been alleged in the Bangladesh revenue context, '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 a couple of commitments. First, the discretionary behaviour in the decision-making process as a social rather than individual 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. Given that Bangladesh ranks poorly in the global good governance index (Mahmud, Ahmed et al 2008), and its taxation system is alleged to lack good governance qualities (Fom Alo 2012), it is imperative that the tax policy and implementation be infused with good governance principles such as participation, transparency and accountability. 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) certain action is done with integrity, competence, tolerance and in the public interest (Ombudsman 2006). This guideline, is practiced in many developed countries' jurisdictions in exercising discretionary powers and will ease the situation to a great extent and improve administrative practice. Better still, they could be used as tools for making the concerned officers accountable for their action. Moreover, the 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.

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