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**The laws
and
rules of
business
governing
the
CA profession
must
be suitably
modified
and
updated**

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IN THIS ISSUE

Editorial

Institute News 1

FINANCE & ECONOMICS

Development 22

Planning 26

Currency 29

Banking 33

OFFICIAL RELEASE

IASC 38

IFAC 49

INVESTMENT

Feature 67

STOCKMARKET

Analysis 73

TAXATION

Budget 82

VAT 88

ACCOUNTING

Reporting 93

ECONOMY

Analysis 97

Views 100

Abroad 117

MANAGEMENT

IT 122

STUDENT SECTION

WTO 126

REVIEW

IAS 30 129

FEATURE

A brief audit of cost capital 143

—Md Abul Hossain

—Dr Dilip Kumar Sen

Providing relief to small and medium-size companies 151

—Syed Aftab Hyder

ACCOUNTANTS ABROAD

Analysis 157

Management 161

Accounting 165

VAT: A bottleneck to industrial development

Abdul Khalek FCA

Value added tax, commonly known as VAT, a breakthrough in traditional system of indirect taxation, was introduced in our country with effect from July 1991. The system was adopted

drance to the industrial development of our country. To express the idea, difficulties of taxpayers relating to focal issues of VAT system have been pre-sented in this article.

first by the French in the year 1936 and then by many other developed and developing countries considering its simplicity, comprehensiveness and neutrality. But, some adverse and unclear provision of VAT law matched with the bureaucratic approach of administration caused hin-

PRICE

As per Sec 5(2) of VAT Act 1991, VAT is payable upon the price realisable from customer by a Manufacturer or Producer. Price as noted in said Sec consists of all cost of the Manufacturer or Producer inclusive of commission, charges, all duties including supplementary duty and taxes excluding VAT. Cost of Manufacturer is commonly known as manufacturing cost.

For a company having manufacturing activity only, price as stated above is crystal clear. But, for a company with self distribution network for the marketing of own product, price being the basis for computation of VAT, is very much confusing as the amount realisable from customers includes distribution cost and profits from distribution activities which are beyond the purview of VAT in accordance with single stage principle, still in force, almost for all domestic products.

Again, if the company pays VAT considering the value added by it as a Manufacturer only, then the price declared under rule 3(1) would be much below the amount realisable from customer as a Manufacturer-cum-Whole Seller. Difference between market value and declared price will then attract VAT with retrospective effect by dint of the power bestowed upon VAT Authority by SRO no 99 of 15.06.95 as issued by the National Board of Revenue (NBR) and thus the company may end-up in a legal battle. More than 5 years have elapsed since the imposition of VAT but this fundamental provision of law is yet to be made transparent. However, to remove the lacuna, by this time the NBR has taken a few measures but unfortunately, instead of addressing the issue they have created additional complications.

On 15-06-96 the NBR issued a general order to consider tariff value of imported raw material when it is higher than C&F value for the determination of Vatable price of a product on the ground that rebate has been taken on the basis of tariff value being the assessable value. For an industrial company with fair accounting system it is almost impossible to comply with this order without manipulation of cost accounting information. If so, the financial information of the company as a whole, will be unacceptable to all users

including Income Tax Authority, Auditor and the Registrar of the company. Again as the product price could not be increased in view of this order, a paper increase in the cost of raw materials will only be supplemented by the reduction in margin as shown in MUSHAK-1. Thus, the order has no impact upon revenue except a call to furnish price declaration with inflated information.

A change curving the way to avoid proportionate VAT by a marketing company dealing with own brand product, produced and supplied by others on contract or sub-contract basis has been incorporated by the addition of Sub-Sec 2 Ka to Sec 5 of VAT Act 1991. The provision is applicable only to the company registered but is silent about similar company being unregistered and a company which is marketing imported product, supplied by overseas principal.

INPUT-OUTPUT RELATION

In pursuance of VAT order no 2 of 19-10-91, declaration of input-output relation of every production unit in prescribed proforma 'Sanglag Ka' is mandatory for every manufacturing company. Prescribed proforma 'Sanglag Ka' asked for complete disclosure of product formulation. Formulation is a trade secrecy for which every company should pay huge amount of royalty or should spend a lot of money for research and development activities. Thus, access to formulation is highly restricted even to company personnel. There is no legal obligation of VAT authority and other office staff to maintain secrecy of information as furnished by taxpayers. The issue was discussed with VAT authority in different forum but requested and agreed circular relaxing aforesaid requirement is yet to be issued.

However, on submission of input-output relation either in prescribed proforma 'Sanglag Ka' or like manner, Divisional-in-Charge asked for all supporting to the cost of raw materials as shown in said proforma. Supporting as required by the authorities are the true copies of all documents in connection with purchase and additional cost of concerned raw materials brought to the place of production. Depending upon the nature, each production unit may require

numerous items of raw materials. For example formulation of product 'A' asked for 20 types of raw materials. The weighted average cost method is in practice for the computation of the cost of raw material consumed. And at the time of price declaration weighted average price of item no 1 was Tk 100 per kg and accordingly the company quoted the price in 'Sanglag Ka'. If the average is the outcome of 10 purchase transactions consisting of 3 local and 7 imports, then the volume of supporting for item no 1 should be at least 100 pages and for 20 items in average 2,000 pages. If the number of production units are 200 then the company should furnish supporting of 400,000 pages for an initial price declaration and subsequently in average 2,000 pages for each unit at the time of every change in price. In view of the above data it is clear to all that furnishing of supporting to cost for an industrial company is a matter of huge undue expenditure which will simply distort the profitability of the company. On the contrary it is Divisional-in-Charge who can postpone the delivery by rejecting price declaration due to non-compliance with her/his order. Thus, in this way the company is on the horn of dilemma as a result of the bureaucratic approach of authority.

PAYMENT

In accordance with Sec 6(2), VAT is due for payment at the time of delivery. Delivery means release or removal of product from the place of production by a Manufacturer, generally sold to the customer. So,

VAT is an advance tax payable by a Manufacturer which is realisable alongwith sales proceeds from the customers. In the present competitive market, avoidance of credit sale is almost impossible. In case of credit sale, a Manufacturer should wait for an additional period of time after the execution of sales to realise the VAT advanced earlier. Again, there is no provision for taking credit of VAT related with bad debts being a reality in every business environment.

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

X Ltd, a Manufacturer of toilet soap commenced business on 01.01.95 and cleared 1st consignment of imported raw material on 31.03.96. The landing cost of the consignment excluding AIT and VAT was Tk 500 lac on which the company paid an amount of Tk 60 lac being 15% of VAT leviable value of Tk 400 lac as VAT. While receiving the raw materials, a transit loss of 5% has been observed and recorded. The company added value of Tk 250 lac to entire input and completed the production process within 30.06.96. On 01.07.96 total output of Tk 750 lac have been delivered to different sales centre on payment of Tk 52.5 lac as output VAT being net of rebate. But VAT authority rejected the rebate on lost quantity

<u>X Limited</u>								Tk in lac
Month	Cash	Sales Credit	Total	Relisation from debtors	Bad debt 5% of cr sales	VAT Paid	Realised	Lost
March	--	--	--	--	--	60	--	--
June	--	--	--	--	--	55.5	--	3
July	143.75	143.75	287.50	--	--	--	18.75	--
Aug	143.75	143.75	287.50	136.56	7.19	--	36.56	.94
Sept	143.75	143.75	287.50	136.56	7.19	--	36.56	.94
Oct	136.56	7.19	--	17.81	.94
	431.25	431.25	862.50	409.68	21.57	115.5	109.68	5.82

amounting to Tk 3 lac and compelled the company to make an additional deposit to that extent. Policy of the company is to extend 1 month credit to the institutional customers being 50% of total sales. Entire products were sold out within 3 months at even rate following the date of delivery. For better understanding the said data has been presented in a tabular form (see previous page).

The Table reveals that a mandatory investment of Tk 115.5 lac in the Government Exchequer as VAT have been realised long after sustaining a loss of Tk 5.82 lac.

REBATE

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

VAT on the services of Tar and Telephone Board (T&T) was imposed with effect from July, 1992. In view of the provision of Sec 9 many taxpayers approached to take rebate but VAT authority rejected the claims on the ground that T&T had not issued challan-patra in prescribed proforma Mushak-11. Thereafter, numerous humble requests were placed before T&T authority but none could convince them to issue required challan-patra. However, considering the suffering of the taxpayers the NBR was kind enough to authorise the format of T&T bill as a substitute of Mushak-11, subject to mentioning of the VAT registration No of T&T therein (Go No 8/MUSHAK/95 of 16.07.95). Again, by the same order, NBR restricted the quantum of rebate to 60% of VAT paid along with T&T bill raising the question of personal use by company personnel.

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

Now taxpayers are expecting a clear decision from VAT authority regarding the amount deposited by them during the period from July 1992 to May 1996.

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

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

Normal loss of raw materials due to handling is a reality in every manufacturing environment. But, unfortunately VAT authority used to reject the rebate proportionate to lost quantity on the ground that those materials were not consumed. This is, on one hand, ignorance of universal practice and on the other, a punishment for honest producer who maintains fair record.

ACCOUNTS

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

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

In view of the internal control system in practice, almost all companies used to maintain more subsidiary books of accounts to satisfy the multifarious queries of different users of financial statements. The aforesaid books of accounts are utilised simultaneously to satisfy the requirement of Company Law

Authority along with Income Tax Authority, Security and Exchange Commission and others.

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

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

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

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

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

AUDIT

To conduct audit on the accounts as maintained u/s 31 of VAT Act 1991, VAT Authority has a separate audit department. Further, the NBR is authorised to

appoint auditor by an order u/s 26(3). In a manufacturing environment for successful completion of VAT audit, one should have thorough idea regarding accounting system with special emphasis on costing. Again, a clear idea regarding business is also essential. In short, like an audit, in pursuance of Companies Act, income tax laws and other relevant laws, professional expertise is a must for successful completion of VAT audit.

Probably, considering those facts and reality said Sec 26(3) was incorporated in VAT Act by Finance Act 1993. But, most unfortunately instead of utilising the services of professional auditors, the government has imposed VAT upon audit service by Finance Act 1996. Thus, the hope for quality audit of VAT account as raised by Finance Act 1993 was nipped in the bud by the same Act of 1996.

CONCLUSION

To ensure sustainable development, there is no alternative to industrialisation. A company should oblige numerous legal rules of different laws to run an industrial undertaking. VAT Act 1991 is an unit of the portfolio of laws to be complied with by every industrial company. The provisions of VAT law are equally applicable to all manufacturers having turnover exceeding Tk 15 lac. Small and cottage industries are the pioneer of industrial development of our country. The problems discussed herein before appeared very tough for such industries as they run with very limited resources. Again, we are in the competition with other developing countries to attract foreign investments. Foreign investors are looking for a congenial environment to invest their money but the aforementioned problems are seriously discouraging them.

A radical change in bureaucratic approach accompanied by the amendment of relevant provisions of law could only remove the bottlenecks to industrial development. Otherwise, political commitment of the government for economic emancipation will die in the ditch of the Manifesto. ■