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Where industries will have to bear the brunt

Analysing the new fiscal measures under the proposed budget for financial year, 2004-05, **Abdul Khalek** pleads for a pro-active stance on industrialisation

INDUSTRY needs huge investments while returns thereon come relatively later. Industrial investments carry higher risks and, therefore, demand risk premiums. Irrespective of territories, investment moves always behind returns. For an existing unit, return denotes the profit net of taxes while in case of a newly established ones enjoying tax holiday, the entire profit turns into returns.

At the top of return, an organised investor looks into net present value (NPV) while assessing the viability of any project. The NPV means the present value of future cash inflow from a project, in the context of investment therein.

Tax holiday makes the return higher and NPV healthier and, therefore, the scheme is known as the most effective instrument to attract investments. The government has declared the withdrawal of tax holiday with effect under the proposed budget for fiscal year (FY) 2004-05. Because of this, all forthcoming projects will fetch lower returns and poorer NPVs. Bangladesh would then otherwise be less attractive to both local and foreign investors, in a situation where most of the competing countries are still maintaining the scheme.

Tax evasion is the biggest plea for the withdrawal of tax holiday. Over the period, the procedures, policies and formalities have reached such a level that even a laymen can detect abuses and manipulations in matters of taxes, by initiating a simple investigation on any prescribed application. However, it is not the transparency of the system, rather the intention of the authority which can stop tax evasion.

To satisfy the changing needs of the consumers, a manufacturer needs modernisation of plant and machinery for the survival of products. In view of this hard reality, a provision for 25% investment allowance on the cost of plant and machinery installed for the purpose of balancing, modernisation and replacement (BMR) was made under the Finance Act 1989.

The provision for this investment allowance has now been proposed for withdrawal. As a result, the return thereof on investment will be lowered, so also be the related NPV. This move will, thus, weaken the position of Bangladesh as a destination for investment.

Technology and quality go side by side. Quality is an important attribute for marketing of any product. Bangladesh is lagging far behind others in areas of technology. Technology cannot be brought in without royalty and technical knowhow fees. Though a genuine business expense, the amount of allowable royalty and technical knowhow fees was restricted to 2.5 per cent of profit under the Finance Act 2003. The restriction is against the guideline of the Board of Investment (BoI). In general, it has limited the payment of royalty and technical knowhow fees up to 6.0 per cent of the previous year's sales. Further, the remittance of both royalty and technical knowhow fees are subject to the deduction of 10 per cent tax at source. The members of the business community made strong recommendations for the withdrawal of such an unjustified provision. But nothing of the sort has been considered under the proposed Finance Bill for FY 2004-05. This will continue to impede the process of industrialisation and the attraction of investment.

The rate of customs duty has now been proposed for restructuring from a four-tier system to a three-tier one. The lower limit of 7.5 per cent, as applicable to raw materials, will remain unchanged while the highest limit of 30 per cent, applicable to finished goods, is proposed for reduction to 25 per cent. The move will make imported finished goods cheaper and is, thus, most likely to adversely affect the operations of existing local industries. The revenue loss on this score will turn into an indirect burden upon the existing taxpayers.

For strategic reasons, medium and big manufacturers, having distribution network, require production facilities and distribution outlets at different locations. In absence of specific provision under the Value Added Tax (VAT) law for such multi-dimensional operations, taxpayers had earlier persuaded the government to go for a modest solution. After long consultations and reviews, a historical order - Government Order (GO) 14, dated November 30, 2000 - was issued by the National Board of Revenue (NBR), prescribing a comprehensive procedure for such taxpayers under a central registration system. The system had a provision for the payment of distribution-stage VAT at the manufacturing stage at the time of delivery of products from factories. This was literally foolproof, in terms of revenue collection. In spite of an extra load on working capital, a large chunk of taxpayers had accepted the system to get rid of the hassles involved in dealing with the authorities at numerous locations.

For unknown reasons, the government had withdrawn the coverage under the central registration from manufacturing activities through the Finance Act 2003. Consequently, allocation of value addition at manufacturing and distribution stages and the movement of raw materials and finished goods from one plant to another and then to sales outlets have become a very complicated task.

Realising the gravity of the problem, the government has now proposed an option for the payment of VAT on the maximum retail price (MRP) at manufacturing and import stages. Under the option, taxpayers should furnish an undertaking to the NBR to sell the products throughout the country at the declared prices. The samples of the products on which the declared prices would be embossed by irremovable ink, would also be submitted along with relevant supporting documents. The NBR will review all relevant papers and documents and accord approval thereafter.

On receiving the NBR's approval, the divisional-in-charge of the relevant tax collecting authorities will allow the taxpayers to deliver the products from the date that he deemed the same fit. The system will be highly cumbersome and time-consuming in the context of the exiting system about delivery of products immediately after the declaration of prices to the concerned divisional-in-charge.

The rate of VAT on the products or services which are exported or deemed to be exported, is zero. Accordingly, the relevant manufacturers and service providers are entitled to the refund of the input VAT.

The supply of materials or services in foreign currencies through international contracts was considered deemed exports under Rule 31 of VAT Act 1991. It was a policy support for local manufacturers and service providers to explore export market on their home turf. The NBR has now deleted the rule by a Statutory Regulatory Order (SRO), issued in conjunction with proposed fiscal measures on June 10, 2004.

The move will damage the price competitiveness of local products and services in a situation where foreign bidders do not require to pay VAT for their supplies against related contracts. The withdrawal of this facility would also have a negative impact on the foreign exchange reserves, as the foreign bidders will take out the money in foreign currencies.

The writer is a Chartered Accountant