



Tax Evasion in BANGLADESH:

Causes, Consequences and Remedies

Dr. Sams Uddin Ahmed
Commissioner of Taxes
Taxes Zone 2, Dhaka
ahmedsamsuddin593@gmail.com

Abstract

Tax evasion is a problem sans frontier. The developing countries and the transition economies are the worst sufferers of tax evasion. Bangladesh is no exception. The informal economy is very strong in Bangladesh. Compliance rate is low and tax culture is poor. Every year billions are siphoned away from Bangladesh to the detriment of the much needed revenue. The purpose of the present article is to discuss the causes, consequences and remedies of tax evasion in Bangladesh.

Keywords: Tax Evasion, Income Tax, Bangladesh.

Part I: Introduction

Tax evasion involves the violation of tax law, where taxpayers do not report their exact taxable income or tax to be paid on that income, as per taxation law (Sandmo, 1998). It is a premeditated and deliberate failure by taxpayers to comply with their tax obligations (Franzoni, 1998). Every tax system faces the problem of tax evasion and avoidance (Kaibel and Nwokah, 2009). Minimizing tax evasion creates a challenge for the tax administrations (Home, 2005) of both developed and developing countries. In the US, 17 per cent of income taxes are unpaid each year. (Fisman and Wei, 1994). In Europe, \$1.3 trillion

is lost every year due to tax evasion (Plogander, 2013). In Australia, there is tax evasion. Schneider finds that the average value of the underground economy in Australia, Canada, Japan, New Zealand and the US in 2010 was 9.7 per cent, and, in 2013, was 8.6 per cent (Schneider, 2013).

While all countries experience tax evasion, the problem is more serious in developing countries, such as Bangladesh. Systematic large-scale tax evasion is omnipresent in many developing countries (Flatters and Mcleod, 1995). Buehn and Schneider estimate that the average size of the shadow

economy in developing countries in 2007 comprised 37.4 per cent of the GDP (Buehn and Schneider, 2012). Government estimation in Bangladesh reveals that the black economy comprised 80 per cent of the GDP—some \$110 billion (The Economist, 2011). Hasan (2009) finds the size of the shadow economy in Bangladesh to be 38.1 per cent. Thus, in Bangladesh, the famous saying that ‘there is nothing certain in the world except death and taxes’ appears to be a myth, given that tax can be evaded with ease (Stiglitz, 1983). However, the purpose of the present article is to discuss the causes, consequences and remedies of tax evasion in Bangladesh. The article is arranged as follows. Part I gives an introduction. Part II discusses the causes of tax evasion in Bangladesh while part III discusses the consequences of tax evasion. Part IV discusses some of the ways and means that the National Board of Revenue undertook to combat the problem of tax evasion in Bangladesh. Part V gives a conclusion.

Part II: Causes of Tax Evasion in Bangladesh

The causes of tax evasion in Bangladesh are multiple, with evasion motivated by many factors (Akram et al, 2012). These factors have been found by various researchers as being related to peer effect, age, gender, level of income, status, economic position, education, source of income, the probability of being caught and punished, the marginal tax rate, the complexities of the tax system, high compliance costs, inefficiencies in tax collection, weak enforcement of the law, low tax morale and many others. No single factor is solely responsible for tax evasion in a given society. Against this backdrop, the main reasons for tax evasion in Bangladesh are discussed below.

I. High Tax Rate

A high tax rate is generally thought to be one of the main causes of tax evasion. Alingham and Sandmo (1998), Clotfelter (1983), Wallschutzkt (1984) and Bayer (2006) find a positive relationship between tax evasion and tax rate. Fisman and Wei found that any increase in tax rate is likely to produce a reduction, rather than an increase, in tax revenue (Fisman and Wei, 1994). Likewise, the high rate of tax in Bangladesh is thought to be one of the main reasons for tax evasion (Hussain, 2003), and survey evidence supports this claim (RIRA, 2003). Waresi (2012) argues that the corporate tax rate is high compared to the rates in other countries, while

the average tax rate in Bangladesh is 35 per cent, which is considered high. (PWC, 2013). Thus, the tax rate should be adjusted as a measure to reduce tax evasion in the country.

2. Corruption in the Income Tax Department

It is argued that corruption encourages tax evasion (Tanzi and Davoodi, 2000). Corruption is generally perceived as the misuse of public power for private gain (Schneide, 2013). Schneider observes that high levels of corruption among bureaucrats and government officials create a larger informal economy. Corruption reduces the size of the GDP, increases the size of the informal economy, distorts the tax structure, and destroys the morality of taxpayers, thereby eventually attenuating the revenue collection capacity of the economy (Transparency International, 2012). Tanzi and Davoodi (2000) find a statistically significant negative correlation between corruption and personal income taxes, where a one percent increase in corruption causes a 0.63 per cent reduction in income tax.

The situation is more alarming in developing countries such as Bangladesh (Tanzi and Davoodi, 2004), where corruption in the ITDB is another cause of tax evasion. Average taxpayers believe that tax officials are corrupt, and taxpayers must pay bribes to tax officials in order to complete their tax assessments. Survey evidence supports this claim—previous research has found that more than 50 per cent of the taxpayers surveyed stated that they had been asked by tax officers to pay bribes, while 58.5 per cent of the survey respondents thought that corruption in the tax department was a cause of tax evasion (RIRA, 2005).

3. Political Intentions

Kim (2008) argues that tax evasion is positively related to the political intentions of the government. In developing countries, politicians try to control the tax administration for political gain. In Bangladesh, governments often influence tax policies to gain political support from the influential and wealthy members of society. For example, during the 1980s, the government pressured the income tax administration to pass a law so that politicians could receive gifts from relatives, without paying tax. As such, these politicians received millions of dollars of ‘gifts’ from fictitious relatives, with no questions asked. These provisions of the law allowed black money holders to launder their black money and evade a huge amount of tax (Waresi, 2012).

4. Lack of Information

Information is vital to detect tax evasion and improve voluntary compliance. According to Lederman, the main problem encountered by tax administrations is information asymmetry (Lederman, 2003). In most cases, the authority must depend on the taxpayer to provide information about the taxpayer's income. Likewise, the ITDB faces the problem of asymmetric information on taxpayers' financial transactions. Due to the lack of an effective information reporting regime, the ITDB is in no position to gather information about taxpayers. Therefore, taxpayers are able to misrepresent or conceal the true state of their affairs in order to reduce their tax liability.

5. Inefficient Tax Administration

The effectiveness of a tax system not only depends on proper tax legislation, but also on the efficiency of the tax administration (Kaldor, 1964). Kaldor (1994) observes that the tax administrations of developing countries are generally inefficient and ineffective, although some have been more successful in recent years (OECD, 2011). As a developing country, Bangladesh shares this common feature. Thus, inefficiency of the tax administration remains another cause of tax evasion in Bangladesh. This is evident from the poor level of enforcement, which encourages tax evasion (Richardson, 2008). Complex regulations and the inefficiencies of tax officers are identified as causes of the large shadow economy in Bangladesh (Dusk, 2011).

6. Inadequacies and Complexities of the Tax Law

Tax law complexities and inadequacies provide opportunities for tax evasion by discouraging honest taxpayers to be noncompliant, and encouraging dishonest taxpayers to create ways to evade tax by passing laws with the help of tax advisers and big law firms (Braithwaite and Braithwaite, 2001). The present tax statute of Bangladesh is complex and full of rebates and exemptions (Warresi, 2012). A tax statute is complex if, under the law, compliance becomes difficult, requires a significant amount of money, and is not easy to comprehend by taxpayers (TAS, 2012).

Hussain (2003) and Akhand (2012) state that the income tax law of Bangladesh is complex. This is demonstrated by the Income Tax Manual, which is divided into two parts, with Part I alone containing 184 sections and eight schedules. These sections are again divided into numerous subsections, while

the schedules are divided into several parts. In addition, every year, the parliament passes finance acts that cause various changes in the income tax law. To apply these finance acts, the NBR issues circulars, statutory rules and orders, and various clarifications. This frequent change to the law is another major cause of complexity. The income tax law also depends on various other laws of the land for proper implementation; thus, the income tax laws of Bangladesh are complex and exacerbate the problem of noncompliance.

7. Lack of Knowledge

Eriksen and Fallan (1996) highlight that tax knowledge has a relationship with tax compliance, and taxpayers' lack of knowledge is another cause of noncompliance in Bangladesh. This lack of knowledge may be caused by taxpayers' inability to understand the law (Milliron, 1986), or by the lack of tax information available from the tax department. In a survey, 23.9 per cent of the taxpayers stated that lack of knowledge is a cause of tax evasion in Bangladesh.

Part III: Consequences of Tax Evasion

Tax evasion enlarges the gyre of poverty and erodes the economy of developing countries (Oxfam, 2013). According to Global Financial Integrity, developing countries an estimated \$100 billion to \$160 billion annually to corporate tax dodging alone. It is revealed that developing countries lose three times as much to tax evasion as they receive in foreign aid. According to Tax Justice Network, data on tax evasion is really illusive but the actual amount of tax lost because of evasive activities is thought to be much higher than is published. Obtaining the amount of tax lost due to tax evasion is a difficult task (Herculaas). However, the consequences of tax evasion are briefly summarised below:

a. The Informal Economy

In developing countries, tax evasion and avoidance cause a loss of revenue of approximately \$385 billion a year (Cobham, 2006). Kim finds that, when tax evasion increases, the size of the informal economy also increases, while Hug and Spörri (2011) observe that tax evasion seriously diminishes the state's capacity to provide basic public goods. In Bangladesh, tax evasion erodes a huge amount of government revenue every year. It is estimated by the NBR that approximately Tk 40,000 crore is lost each year because of tax evasion and avoidance (Karim, 2011).

b. Distortion of the Tax Law

Tax evasion causes the tax law to become distorted. It is activity undertaken by wealthy individuals and large corporations that frustrates the tax law by engineering new avenues to evade tax. Ingenious tax advisers develop products to evade and avoid tax. To counter the efforts, tax authorities amend tax laws. The tax law is compared with a ship to which wholes are made constantly by the taxpayers and tax advisers and the tax authorities constantly repair the ship resulting in numerous patches that has the effect of distorting the tax law (Braithwaite and Braithwaite, 2002). The same process applies in case of developing countries like Bangladesh. Tanzi and Shome (1993) comment that tax evasions are numerous and that taxpayers continuously engineer new ways to reduce their tax burden. This is an accurate representation of the situation in Bangladesh.

c. Erosion of the Tax Base

It is well recognized that illegal tax evasion erodes the tax base in developing countries. As a result of such erosion, revenue is reduced, administrative costs increase, tax policy goals are not achieved and social equity is affected (Alm et al, 1991). In Bangladesh, widespread tax evasion is gradually eroding the tax base. For example, in terms of revenue loss due to transfer mispricing from 1990 to 2008, Bangladesh lost \$34.08 billion, placing Bangladesh at the top of the list (OECD, 2013).

d. Credibility of the Tax Administration

As a result of tax evasion, the burden of taxes falls disproportionately on low-income earners. This makes people dubious about the efficiency and fairness of the tax administration. The reduction of state capacity due to tax evasion also affects the tax morale of the populace (Hug and Spörri, 2011). The tax administration loses credibility if it is not fair and, if there is tax evasion, the tax administration is perceived to be unfair (Devos, 2012).

Part IV: Remedial Measures to Curb Tax Evasion

Bangladesh must urgently address the tax evasion problem by taking appropriate measures. During a taxpayer's survey conducted by the Reforms in Revenue Administration (RIRA) in 2003, taxpayers were asked about measures to curb tax evasion. According to 88.5 per cent of the respondents, publicity, media reporting and better coverage of

tax evasion cases would have a positive effect on preventing tax evasion. Eighty-nine per cent of the respondents said that the NBR needs to improve the quantity of publicity, publicize how to file a tax return properly and make tax payments, and adequately describe the penalties involved in evasion. Eighty per cent of the respondents stated that awareness about the responsibilities of paying tax must be improved through publicity, public seminars, and school and university participation in awareness campaigns. Around 40 per cent of the taxpayers said that the existing penal provisions in the tax statute regarding tax evasion are insufficient, and that stricter penalties and punishment provisions should be incorporated in the tax law. However, the NBR has undertaken some commendable measures, some of which are discussed below.

1. Tax Amnesty Scheme

Tax amnesty is a type of temporary incentive provided to taxpayers to let them pay tax at a reduced rate, so they can be within the tax net. This is known as a 'black money whitening' scheme and is highly controversial (Gani, 2006). During the past 40 years, such tax amnesties have been allowed on many occasions; however, the NBR has failed to access the underground economy (Mala, 2012). Rather, this scheme has encouraged honest taxpayers to pay tax incorrectly, or resort to evading practices (Gani, 2006).

2. Reward Incentives for Income Tax Officials

The income tax department of Bangladesh has provisions to reward income tax officers who unearth income tax evasion—Section 184B of the Income Tax Ordinance 1984 deals with this. This reward is aimed at encouraging tax officials to more seriously seek to detect tax evasion. The reward system in the civil servant is part of the New Public Management theories which is in fact not widely used in Bangladesh (Gani, 2006). The NBR has only recently begun using this tool to curb tax evasion. In addition, the extent to which this tool will prove effective has not yet been studied empirically.

3. Income Tax Fair

To encourage taxpayers' voluntary compliance, from 2010, the ITDB has held an annual income tax fair. At this fair, taxpayers can submit their return and pay their tax easily and without harassment. The income tax fair is considered successful to improve compliance (Mustafa, 2013), and taxpayers' reactions have been very positive.

4. Central Intelligence Cell in the NBR

In 2004, a Central Intelligence Cell (CIC) was established in the NBR as a part of the NBR modernization project (Karim and Alauddin, 2012). According to the IMF, the establishment of the CIC was a bold step to improve the weaknesses of the tax administration in Bangladesh (Almekinders et al, 2009). The CIC is an integrated unit comprising officials from both the direct and indirect tax wings of the NBR. The CIC performs a tax intelligence function and investigates tax evasion and fraud cases in the areas of income tax, customs and value-added tax. The CIC, headed by a director general, is working hard to improve taxpayer compliance, for both direct and indirect taxes. Information and data are held confidentially by the CIC and are not readily accessible; however, the CIC works under strong monitoring from the NBR to negotiate with potential tax evaders to pay the correct amount of tax. Thus far, the CIC has been able to create a positive effect on taxpayer compliance (Karim and Alauddin, 2012). Since its establishment, the CIC has undertaken 1,750 investigations related to tax evasion for income tax, value-added tax and customs. Substantial tax evasion cases have been detected, and, in the majority of cases, the evaders paid their taxes (Karim, 2013).

5. Creating a Robust Tax Culture

Tax culture is essential to ensure the sustainable development of a country (UNDP, 2008). It plays a vital role in tax administrations (Chuenjit, 2014). Tax culture reflects the tax compliance mentality of a region's taxpayers in general terms. It is understood in terms of taxpayers' consciousness regarding payment of tax—that is, taxpayers pay tax because of the tax culture (Nerré, 2001). However, tax culture encompasses more than the tax mentality, and varies from country to country. As Nerré (2001) states:

'A country-specific tax culture 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.'

Poor tax compliance reflects a poor tax culture. It is observed that developing countries like Bangladesh face a formidable challenge to improve revenue collection in an efficient, fair and consensual way. One of the factors of such challenge is poor

tax culture. Thus, Bangladesh's poor income tax compliance indicates the country's insufficient tax culture. It is urgent that this culture be improved to combat the evils of tax evasion in Bangladesh.

Part V: Conclusion

Tax and tax evasion go hand in hand. Where there is tax there is evasion. As is observed tax evasion seriously affects the economy of developing countries like Bangladesh. Tax evasions distorts the economy, creates sub-soil economy and breeds corruption in the tax administration. The paper is a modest attempt to discuss some of the issues relating to tax evasion in Bangladesh. It is observed that there are multifaceted causes of tax evasion. The problem is acute in Bangladesh. Despite the fact that of late National Board of Revenue took some effective measures to combat the problem of tax evasion in the country, more remains to be done if the country is to be free from the reign of tax evasion. A very strong tax culture boosted by strong political will be conducive to tackle the problem of tax evasion in Bangladesh. 

Bibliography

- African Tax Administration Forum, *A Practical Guide on Exchange of Information for Developing Countries* (2013) 4 <www.oecd.org/ctp/tax.../practical_guide_exchange_of_information.pdf>.
- Akhand, Zakir Hossain, *Coercion or Persuasion? Making Large Corporations Tax Compliant in Bangladesh* (PhD Thesis, Birmingham University 2012) 134 <http://etheses.bham.ac.uk/3801/1/Akhand_12_PhD.pdf>.
- Akram, Muhammad et al, 'The Phenomenon of Tax Evasion and Avoidance in Pakistan: An Exploratory Approach' (2012) 46 *Elixir Financial Management* 8240, 8242.
- Alex Cobham, 'Tax Evasion Keeps the Developing World Poor', *The Guardian* (online), 20 February 2006 <<http://www.guardian.co.uk/society/2006/feb/20/internationalaidanddevelopment.comment>>.
- Alm, James, Roy Bahl and Matthew N Murray, 'Tax Base Erosion in Developing Countries' (1991) 39 (4) *Economic Development and Cultural Change* 849.
- 'Bangladesh Allows "Black Money" in Stock Exchange', *The Economist* (online), 29 June 2011 <<http://economictimes.indiatimes.com/markets/global-markets/bangladesh-allows-black-money-in-stock-exchange/articleshow/9036503.cms>>.
- Braithwaite, Valerie and John Braithwaite, 'Managing Taxation Compliance: The Evolution of the Australian Taxation Office Compliance Model' in Michael Walpole and Chris Evans (eds), *Tax Administration in 21st Century* (Prospect Media, 2001) 215.
- Buehn, Andreas and Friedrich Schneider, 'Shadow Economies around the World: Novel Insights, Accepted Knowledge, and New Estimates' (2012) 19 *International Tax and Public Finance* 139, 159.

- Clotfelter, C.T. 'Tax evasion and tax rates: an analysis of individual returns (1983) 65(3), *The Review of Economics and Statistics*, 363-373.
- Devos, Ken 'A Comparative Study of Compliant and Non-compliant Individual Taxpayers in Australia' (2012) 7(2) *Journal of Business and Policy Research* 180, 183.
- Dusk, Sean, Taxes, Regulations, and Laws Fuel Bangladesh's Underground Economy <<http://allagora.blogspot.com/2011/01/taxes-regulations-and-laws-fuel.html>>.
- Eriksen, Knut and Lars Fallan, 'Tax Knowledge and Attitudes towards Taxation: A Report on a Quasi-experiment' (1996) 17(3) *Journal of Economic Psychology* 387.
- Fisman, Raymond and Shang-jin Wei, 'Tax Rates and Tax Evasion: Evidence from Missing Imports in China' (1994) 112(2) *Journal of Political Economy* 471.
- Flatters, Frank and W Bentley Mcleod, 'Administrative Corruption and Taxation' (1995) 2 *International Tax and Public Finance* 397.
- Franchise Tax Board, Tax Gap Plan: A Strategic Approach to Reducing California's Tax Gap (2006), 9 <<https://www.ftb.ca.gov/aboutftb/taxgapstratplan.pdf>>
- Franzoni, Luigi A, Tax Evasion and Tax Compliance (1998) <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=137430>
- Fuest, C. & Riedel, N. 2009. Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature. Oxford University Centre for Business
- Home, Parthasarathi 'Tax Systems and Tax Reforms in South and East Asia: The Control of Tax Evasion and the Role of Tax Administration' (Working Paper No 411, Economic Society of Italy, July 2005) 1 <<http://www-3.unipv.it/websiep/wp/411.pdf>>.
- Hug, Simon and Franziska Spörri, 'Referendums, Trust and Tax Evasion' (2011) 27 *European Journal of Political Economy* 120. On the disproportionate burden of taxation as result of tax evasion see Manos Matsaganis and Maria Flevotomou, Distributional Implications of Tax Evasion in
- Hussain, MdSajjad, 'Taxation in Bangladesh: Measures for Improving Income Tax System' (2003) *Tax Chronicle (Special Edition)* 1.
- International Tax Compact, Addressing Tax Evasion and Tax Avoidance in Developing Countries (2010) 6 <http://www.taxcompact.net/documents/2011-09-09_GTZ_Addressing-tax-evasion-and-avoidance.pdf>.
- Jackson, BR and VC Milliron, 'Tax Compliance Research: Findings, Problems and Prospect' (1986) 5 *Journal of Accounting Literature* 125, 132.
- Kaldor, Nicholas, *The Role of Taxation in Economic Development* (Duckworth, 1964) 253.
- Karim, Rejaul, 'Tk 40,000cr Lost in Incentive, Tax Evasion a Year: NBR', *The Daily Star* (online), 14 June 2011 <<http://www.thedailystar.net/newDesign/news-details.php?nid=189846>>.
- Kiabel, Bariyima D and N Gladson Nwokah, 'Curbing Tax Evasion and Avoidance in Personal Income Tax Administration: A Study of the South-South States of Nigeria' (2009) 15 *European Journal of Economics, Finance and Administrative Sciences* 51.
- OECD et al, Supporting the Development of More Effective Tax Systems (2011) 10 <www.oecd.org/ctp/48993634.pdf>.
- Oxfam International, Tax evasion damaging poor country economies, 1 September 2013. <<https://www.oxfam.org/en/pressroom/pressreleases/2013-09-01/tax-evasion-damaging-poor-country-economies>>.
- Plogander, Barbro 'Nordic Countries Target Tax Evasion Ahead of EU Summit', *Epoch Times* (online), 20 May 2013 <<http://www.theepochtimes.com/n3/64997-nordic-countries-target-tax-evasion-ahead-of-eu-summit/>>
- RC Bayer, 'A Contest with the Taxman—The Impact of Tax Rates on Tax Evasion and Wastefully Invested Resources' (2006) 50(5) *European Economic Review* 1071.
- Reforms in Revenue Administration (RIRA), Taxpayer Survey Report (October 2003) 5.
- Richardson, G 'The Relationship between Culture and Tax Evasion across Countries: Additional Evidence and Extensions' 17(2) *Journal of International Accounting, Auditing, and Taxation* 67.
- PricewaterhouseCoopers, Paying Taxes 2013: A Global Picture (2013) 59 <<http://www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2013-full-report.pdf>>.
- Sandmo, A 'The Theory of Tax Evasion: A Retrospective View' (2005) *National Tax Journal* 643, 645.
- Schneider, Friedrich, Shadow Economy, Tax Evasion and Corruption in Portugal and in other OECD Countries: What Can be Done? (2013) 3 <http://www.nipe.eeg.uminho.pt/Uploads/ShadPortugal_2013_Schneider.pdf>.
- Schneider, Friedrich, Size and Development of the Shadow Economy of 31 European and 5 other OECD Countries from 2003 to 2013: A Further Decline (2013) 1 <http://www.econ.jku.at/members/Schneider/files/publications/2013/ShadEcEurope31_Jan2013.pdf>.
- Stiglitz, Joseph, 'The General Theory of Tax Avoidance' 36 (3) *National Tax Journal* 325.
- Stinespring, John Robert, 'Dynamic Scoring, Tax Evasion, and the Shadow Economy' (2011) 39(1) *Public Finance Review* 50.
- Tanzi, Vito, and Hamid Davoodi, 'Corruption, Growth and Public Finances' (IMF Working Paper WP/00/82, November 2000) <<http://www.imf.org/external/pubs/ft/wp/2000/wp00182.pdf>>.
- Transparency International, Exploring the Relationships between Corruption and Tax Revenue (2012) 1 <<http://www.u4.no/publications/exploring-the-relationships-between-corruption-and-tax-revenue/>>...
- Taxpayer Advocate Service, The Complexity of the Tax Code (Annual Report, 2012), vol 1, 3 <<http://www.taxpayeradvocate.irs.gov/userfiles/file/Full-Report/Most-Serious-Problems-Tax-Code-Complexity.pdf>>.
- Vito Tanzi and Parthasarathi Shome, 'A Primer on Tax Evasion' (1993) 40(4) *IMF Staff Papers* 807.
- Venter, Jan Herculaas, Factors Influencing Tax Evasion, Masters Dissertation, University of Pretoria, November 2011.
- Wallschutzky, IG, 'Possible Causes for Tax Evasion' (1984) 5 *Journal of Economic Psychology* 374.
- Waresi, Shawkat Ali, 'Interpretation of Taxing Statutes and the Role of Professional Accountants' (2012) *The Cost and Management* 85.