

Tax audit: Bangladesh panorama

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Abstract

The present paper is a brief study on the *modus operandi* of the existing income tax audit in Bangladesh. This study centres around: meaning of tax audit; need for tax audit; certain conceptual issues of tax audit; existing scenario of tax audit in Bangladesh, focusing on tax system, tax audit practice, tax audit ambit, tax auditor, tax audit report, existing extent of assessment under tax audit net; and then draws a concluding line with a few recommendations. The paper reflects that the present extent of tax audit practice of Bangladesh is extremely negligible. This paper's policy prescriptions, if followed, will hopefully provide a great boost in expanding tax audit net, which is much needed for improvement of the internal resource mobilisation in the country.

Introduction and methodology

The intent of this paper is to:

- conceptualise the term "tax audit" conducted by professional chartered accountants;
- give an overview of the prevailing tax scenario in Bangladesh;
- discuss the *modus operandi* of tax audit in Bangladesh; and
- make an evaluation of the prevailing extent of tax audit in Bangladesh.

For the purpose of this study, primary data have been collected based on experience survey and secondary data from Government statistical yearbooks, publications of the World Bank and the United Nations Development Programme (UNDP). Analysis has used ratios, time series trend, compound growth rate in percentages over several years and the like. Regarding the coverage of the study, it is limited only to the external income tax audit, not the auditing aspect relating to other taxes.

Audit procedures evolved from time to time to suit the nature and volume of the business, the efficiency of the management, and the effectiveness of the internal control system. Hence, the evolution of tax audit to respond to the call of time, when the intricacies of the tax system are very many.

Tax audit is an extension of the "attest function" of the historical financial audit. It is the audit of an assessee's accounting and other documentary evidences for the preparation of current tax returns, as well as the supporting working statements, followed by an audit report giving the auditor's opinion about the degree of correspondence between the information contained in the tax return and the regulatory provisions of tax laws. In other words, tax audit is an extension of the normal audit generally

conducted for the purpose of expressing an opinion as to the fairness of the accounts examined by the auditor, and the certification of financial statements for tax purposes. It will be meaningful if based on the knowledge of tax laws, similarities and dissimilarities between commercial accounting and tax accounting and reporting to the tax department, recognising their requirements to enable the latter to compute taxable income. It includes what a tax official can look for when aiming to complete an assessment of tax. It covers also the disclosure of all significant accounting practices employed in the organisation, a report on the financial accounts, i.e. the balance sheet, profit and loss account and other related accounts and schedules which are part and parcel of the financial reports. Furthermore, information is required to compute the assessable income as well as to ensure that the compliance of the tax laws and regulations is proper.

A word on Bangladesh perspective

The program of distributing income tax VIP (very important person) cards[1] to outstanding contributors to national exchequer was initiated in Bangladesh in the fiscal year (i.e. assessment year) 1991-1992. And the implementation of this program of honouring the income taxpayers started, in fact, in the assessment year (AY) 1993-1994. In both 1991-1992 and 1992-1993 fiscal years (FYs)[2], there was only a lone individual to get this VIP card. The number of companies was also miserably few. The then Finance Minister of Bangladesh, in the income tax VIP card awarding function on 27 April 1994, "lamented doleful" about the big shots who, in the Minister's words, were spending millions in just fêting friends or paying for electricity nearing a million or donating crores of Taka[3] for constructing hospitals and other purposes, but at the same time, were missing from being honoured with the income tax VIP card (*The Daily Star*, 1994a).



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Although Bangladesh is considered as "a land of hundreds of multi-millionaires and at least a few billionaires" (*The Daily Star*, 1994b), it is hardly believable that there was no more than one individual having annual total income of only more than Tk. 30.4 lakh in assessment year (AY) 1991-1992 or Tk. 40.4 lakh in AY 1992-1993 to pay income tax exceeding Tk. 10 lakh with a maximum investment allowance of Tk. 1 lakh in those AYs[4]. The then Finance Minister cited the situation of the poor performance in the country's tax administration and he called for increased mobilisation of domestic resources (*The Daily Star*, 1994a). As a part of the globalisation process, import tariffs and other trade barriers have to be reduced gradually within the next couple of years and hence the dependency on import taxes and duties have to be reduced also, and the share of direct and consumption taxes has to be progressively increased (Kibria, 2000, pp. 1-2). In this context, the introduction of external tax audit can be thought of as a felicitous and aspiring step in order to ameliorate the tax management and to take care of tax-cleanliness of those whom the society knows as giant earners and very dominating and influential.

Audit is statutory for a company under section 183(3) of the Companies Act 1994 (previously under section 135(2) of the Companies Act 1913), but in the cases of sole proprietorship and partnership firms, there is no obligation to get accounts audited under the regulations of each one's establishment. According to the provisions of the Income Tax Ordinance 1984 (ITO), all companies are subject to audit if they are liable to file an income tax return (vide section 35 of the ITO). These provisions[5] of the ITO state that the company assessee while filing the tax return shall have to attach some additional supporting documents given by a chartered accountant (CA) with the tax return. These provisions are shown in Table I.

But with the introduction of external tax audit through making changes in section 82 since AY 1991-1992, a penal provision on the CA was also introduced in the same AY 1991-1992 under section 128(3) of the ITO stating that in a case where a certificate is issued by a chartered accountant (CA) as to the correctness of the total income of an assessee under the provision of section 82, it is subsequently discovered by the Deputy Commissioner of Taxes (DCT), the Appellate Joint Commissioner, the Appellate Additional Commissioner, the Commissioner (Appeal) or the Appellate Tribunal that the chartered accountant wilfully or knowingly

withheld any information relating to the particulars of such income, he or it may impose on such chartered accountant a penalty of a sum not exceeding two-and-a-half times the amount of tax which would have been avoided had the total income as certified by such chartered accountant been accepted as correct. This penal provision under section 128(3) was withdrawn by the Finance Act 1993 with effect from 1 July 1993 by introducing more harsh punitive provision for the CA under section 165(c). Under this measure, a CA is guilty of an offence punishable with imprisonment for a term which may be extended to three years, or with a fine, or with both, if he signs and issues any "audit certificate" or "total income certificate" under section 82 which he either knows or believes to be false or does not believe to be true. From AY 1998-99, subsection (2A) was inserted to section 128 again to impose financial penalty of "two and half times of tax evaded" in addition to the punitive measure under section 165. Section 128(2A) has been repealed since AY 1999-2000.

However, under section 35(3) of the ITO, the audit of financial statements is mandatory, but the audit provisions under section 82 are discretionary. On the part of the selective assessee, the audit of accounts and audit certificate on total income are not a compulsory requirement for submission with the tax return. When the respective assessee desires to be assessed on correct return basis under section 82, the correctness and completeness of the tax return without audited accounts and audit certificate on total income depend only on the satisfaction of the Deputy Commissioner of Taxes (DCT) in this regard. But on the part of the DCT, it is imperative to take the tax return submitted by the selective assessee as correct and complete, if supported by the audited accounts and audit certificate on total income in the prescribed form.

"The essence of auditing is found in the service the auditor performs in expressing his expert judgement with respect to the fairness of presentation of financial statements" (Mautz and Sharaf, 1982, p. 158). The statement of the independent auditor on financial statements adds to the justified credibility thereof and ensures reliability on the audited accounts. This is statutorily recognised under the section 82 of the ITO through encouraging audit for tax purpose, which is nothing but "tax audit".

The present study is an endeavour to study the concept of "tax audit" as a new perspective for statutory adoption in Bangladesh.

Table I
Provisions of ITO

Section ^a	Assessee	Documents to be annexed to tax return
35(3)	Every public or private company	Copy of the trading account, profit and loss account and the balance sheet certified by a CA
82	Desiring to make the return correct and complete for "assessment on current return":	
First Proviso (applicable from AY 1991-92, but the scope has been limited from AY 1998-1999)^b	(i) a company, not less than 50 per cent of whose paid-up capital is owned by persons other than Bangladeshis; (ii) a public limited company; (iii) a body corporate established or constituted by or under any law for the time being in force; or (iv) any nationalised banking, insurance or other financial institutions	A certified copy of the accounts audited by a CA and a certificate as to the correctness of the total income of the assessee signed and issued by the CA in the prescribed form

Notes:

^a Sections or rules not mentioned hereinafter with the related laws are to be assumed with reference to the Income Tax Ordinance 1984 or the Income Tax Rules, 1984 respectively

^b This provision was previously applicable under two provisos to section 82 and the provision was applicable to "any industrial or business enterprise" also up to AY 1997-1998. The changes have been made by the Finance Act 1998 with some extra conditions

Purpose of the study

The study has been directed to:

- conceptualise the term "tax audit" conducted by professional chartered accountants;
- give an overview of the prevailing tax scenario in Bangladesh;
- discuss the *modus operandi* of the tax audit in Bangladesh; and
- evaluate the efficacy of the prevailing external tax audit in Bangladesh.

Meaning of tax audit

To the tax administration, tax audit refers to the examination of tax returns by concerned tax officials primarily with respect to checking as to timely arrival, inclusion of all required forms and attachments, and arithmetical accuracy. This may be called internal tax audit[6]. As per paragraph 1 of the International Standard on Auditing (ISA) 1:

an audit is the independent examination of financial statements of related financial information of an entity, whether profit oriented or not, and irrespective of its size, or legal form, when such an examination is conducted with a view to expressing an opinion thereon (IFAC, 1993, p. 10).

The American Accounting Association (AAA) has provided a broader definition of audit which refers to:

... a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users (AAA, 1973, p. 2).

In a narrower sense, audit is an "attestation[7] communication" because it presents the auditor's opinion or judgement concerning the degree of correspondence between accounting information and established criteria (AAA, 1973, p. 6).

Historically, the audit function conducted by public accountants has been associated with this activity of attesting to financial statements (AAA, 1973, p. 14). Tax audit (expected to be performed by public accountants) can be thought of as an extension of this "attest function". For tax purpose, one assessee is liable to file a return to the concerned assessing officer with supporting documents sometimes required by tax law for simultaneous submission with the return. The assessee is sometimes called for by the assessing officer under the tax law for producing the same. In this context, the question of tax audit may arise. And "tax audit" means to audit an assessee's accounting and other documentary evidences to prepare the correct tax return as well as to prepare the statements showing the detailed computational working for different heads of income or items in tax return and other required evidential statements regarding allowances and disallowance for deductions

and all these are to be followed by an audit report giving the auditor's opinion about the degree of correspondence between the information content in the tax return and the regulatory provisions of the existing tax laws. Thus, tax audit comprises the following:

- accounts and other evidences are required to comply with the "tax basis of accounting", i.e. as per requirement of tax laws;
- preparation of tax return, statement of computational working for items in the return and statements containing particulars of allowances and disallowance for deduction;
- giving audit report portraying the attest function whether the tax return and statements have been fairly prepared as per the regulatory requirement of tax laws.

Suffice it to say, all the documents must be signed and verified by the respective auditor.

In India, however, tax audit is the compulsory audit introduced under section 44AB of the Income-tax Act 1961 with effect from AY 1985-86, commencing from 1 April 1985. This provision provides that:

... every person carrying on business having total sales, turnover or gross receipts exceeding the specified limit of Rs. 40 lakh for business and every person carrying on profession having a total turnover or gross receipts exceeding Rs. 10 lakh should get their accounts audited by a Chartered Accountant before the specific date and obtain before that date the report of such audit in the prescribed form 3CA or 3CB or 3CC as applicable in a particular case and duly signed and verified by such Chartered Accountant, setting-forth the particulars as described in Form No. 3CD or 3CE (Chakraborty, 1988).

That means, tax audit, here, encompasses only those involving business or professional activities with a threshold of gross inflow and the specificities prescribed in respect of time, form, particulars and the authoritative person to do it.

Need for tax audit

Four conditions tend to create the demand for the independent performance of the audit or attest function. They are as follows:

- 1 conflict of interests between those who prepare accounting information reports and those who use them;
- 2 consequence of information to users while using them in decision-making;
- 3 complexity of subject matter and audit process; and

- 4 remoteness of users from subject matter and preparer (AAA, 1973, pp. 9-11).

When audit function is extended to tax, the above-mentioned four conditions are also required to be satisfied. Here, the preparer of income tax return and relevant information (the assessee) has the conflicting relationship in terms of financial interest with his counterpart user or evaluator of the return (the assessing officer). Because, manipulated information in the tax return may reduce the tax liability. Second, use of the tax return, assumed to be correct and complete, may have serious consequence on Government fiscal estimation and collection thereof. As a result, all the budgetary appropriations may stand for nothing but a baseless imagination. Third, both financial accounting and tax accounting are recognised as a much complex discipline due to technicalities and their distinct characteristics of difficulties. Finally, between the preparer of the return and the information therein (by the assessee) and the assessing officer, there exists a wall of remoteness albeit the latter can call for any additional information from the former to be satisfied with the completeness and correctness of the information provided. But sometimes this may not be possible due to time and cost constraints and some other reasonable causes. In this case, the tax authority can apply his best judgement, which may not be the expression of the reality and thus both the parties, the Government and the assessee may be affected by under- or over-charging of tax. Therefore, all the conditions creating the demand for audit with respect to tax can be found to be satisfied.

Besides, the Committee on Basic Auditing Concepts (COBAC), suggested that the subject matter of any extension of the audit function must have the following attributes (AAA, 1973, p. 14):

- 1 the subject matter has to be susceptible to the deduction of evidential assertions. Such assertions have to be both quantifiable and verifiable;
- 2 there has to be an information system to record the actions, event or results thereof; preferably adequate internal controls have also to be in operation; and
- 3 consensus should exist on the established criteria against which the information prepared from the subject matter can be evaluated.

Each of the attributes stated above is essential. Two additional conditions are also needed. They are: auditor's competence and summarization of findings in a report.

The COBAC of AAA has recognized that extension of the attest function to the audit of income tax return appears to satisfy all the attributes stated above. The subject matter allows the deduction of evidential assertions, which are verifiable as well as quantifiable. Tax law requires the maintenance of an "information system" adequate for recording the actions and events, and the law also serves as a criterion for evaluating the subject matter information. Auditors are generally competent in the tax law, and the tax forms serve as a means of summarizing the auditor's findings (AAA, 1973, pp. 14-15). The International Federation of Accountants (IFAC) Ethics Committee, in the "Code of Ethics for Professional Accountants" has defined "professional service" as "any service requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services" (IFAC, 1993, p. 552). Hence, an auditor must be competent first in accounting, inevitably in auditing, as well as thereafter in taxation. Introduction of tax audit by qualified professional accountants is indeed the esteemed recognition of their specialised competence. The real benefit from compulsory tax audit, if legally enforced, is that the audit will ensure maintenance of proper books of accounts and other records. The growing accounting habit thus developed will enable creation of a transparency of the in-between grey area between assumed income and reported income. Thus, tax evasion will be markedly curbed through checking the fraudulent practices concerning colluded accounts.

Other arguments in favour of tax audit include: tax return with added credibility and accompanied by tax audit reports as well as necessary supporting statements can reliably be presented before the authority facilitating tax administration, relieving assessing officers from carrying out routine verifications, and attending to more important investigation aspects of assessment cases through utilisation of the saved time (Chakraborty, 1988).

Other related conceptual issues of tax audit

We have already mentioned earlier that tax audit has to be done by qualified professional accountants. According to the IFAC's definition, professional accountants are "those persons, whether they be in public practice (including a sole practitioner, partnership or corporate body), industry,

commerce, the public sector or education, who are members of an IFAC member body" (IFAC, 1993, p. 551). In SAFA (South Asian Federation of Accountants) countries, the Institutes of Chartered Accountants of Bangladesh, India, Pakistan and Sri Lanka, the Association of Chartered Accountants of Nepal, the Institutes of Cost and Management Accountants of Bangladesh and Pakistan, and the Institute of Cost and Works Accountants of India are the members of IFAC. Thus professional accountants include both CA (chartered accountant) and CMA (cost and management accountant) or CWA (cost and works accountant). In India, the tax audit has been assigned to CAs only, but both CA and CMA (or CWA) can be the auditor in this respect.

As applicable in India, tax audit is directed towards business and professional income only, but it can cover other heads of income where accounting discipline can be effectively used such as salary income of non-government employees, or persons with a regular employment and having other part-time jobs or self employment and other sources of income where possibility of maintenance of a double set of books or absolute undeclaration may cause serious revenue implication. The time-dimension of the tax audit must be specified, which may be maximum four to six months from the end of income year. In India, period for tax audit is maximum four months. The reporting aspects of the tax audit should be articulated by means of prescribed form for audit report and related statements.

Tax system in Bangladesh

Bangladesh is unable to raise enough resources through taxes. Taxes to GDP (gross domestic product) ratios, which indicate the ability to tap resources from a growing economy, are usually low in South Asia (The Mahbub ul Haq Human Development Centre, 1999, p. 79). But the case of Bangladesh is more alarming. On average, tax revenues in Bangladesh are only little more than 9 per cent of GDP, which is lower than South Asian average of 11 per cent, the developing country average of 15 to 20 per cent, the average of 16 per cent for South East Asia and the Pacific, the industrialised country average of 30 per cent and the average of 24 per cent for high-income countries. The size of tax-GDP ratio becomes particularly insignificant when it is compared with several European countries, where tax revenues are between 35-40 per cent of GDP. As per Table II, in SAARC (South Asian

Table II
Tax structure in South Asian countries

Country	1996 Revenue as a % of GDP			1999 Tax Revenue as a % of GDP
	Tax	Non-tax	Total	
Bangladesh	9.35	2.48	11.84	9.06
India	9.1	2.3	11.4	8.9
Pakistan	15.3	4.1	19.4	12.6 ^a
Nepal	8.8	2.0	10.8	8.8 ^a
Sri Lanka	16.9	2.1	19.0	14.5 ^a
Maldives	20.5	17.3	37.8	20.6 ^a
Bhutan	8.0	11.0	19.0	7.8 ^a
South Asia (W)	11.0	3.4	14.4	11

Notes: W = weighted average; ^a Year = 1998

Source: The Mahbub ul Haq Human Development Centre (1999, p. 184), Government of India (1999, pp. 24-31) and UNDP (2000, pp. 206-9)

Association for Regional Co-operation) region, the position of Bangladesh is only better than that of India, Nepal and Bhutan in 1996 and also in 1999 (see Table II; The Mahbub ul Haq Human Development Centre, 1999, p. 79).

In Bangladesh, the annual trend of tax-GDP ratios shows that these are of fluctuating nature. After liberation, the trend is an increasing one up to financial year (FY) 1980-1981 except one year (FY 1974-1975, the year of famine). During the last half of the 1980s, the tax-GDP ratios are almost stagnant (the average is 7.31). The tax-GDP ratio exceeds 9 per cent (9.76 per cent, the highest also) first in FY 1992-1993 (the second year after introduction of value added tax). Thereafter, this ratio remains above 9 per cent, but with a fluctuating trend to some extent. Recently it is targeted to rise. In the budget of FY 1999-2000, the tax-GDP ratio is targeted to 9.43 per cent and the ratio of total revenue to GDP was targeted to all time highest at 12.10 per cent. The stagnating or declining nature of the Bangladesh tax system is a "clear indication of a tax system that remains inelastic and non-responsive to growth in the economy" (see Table III; National Board of Revenue, 1994, 1995, 1996, 1997, 1998, 1999; The Mahbub ul Haq Human Development Centre, 1999, p. 79).

The share of direct tax in total tax is not significant in Bangladesh. In the 1970s, this ratio of direct tax to total tax was 18.13 per cent. Over the years, the trend is expected to be rising, but the fact is that it was and is highly fluctuating. From FY 1972-1973 to FY 1999-2000, the highest share of direct tax in total tax was in FY 1992-1993 (26.71 per cent). During the first half of the 1990s, the average share of direct tax in total tax was 24.96 per cent. Recently the direct tax to total tax ratios have fallen to around 22 per cent. For FY 1999-2000, this ratio has been targeted to

reach at 22.32 per cent. Of the direct tax, the share of income tax is significant (average 63.27 per cent over the FY 1972-73 to 1997-1998). But the income tax is paid mostly by the companies (average 43.07 per cent of the direct taxpayers over the FY 1972-73 to 1997-1998). But the number of corporate assesseees is around 2.5 per cent of the total income taxpayers on an average (see Table III; National Board of Revenue, 1994, 1995, 1996, 1997, 1998, 1999).

In South Asia, the income tax base remains narrow, since most people refuse to pay the tax. Around 1 per cent of the total population here pays income taxes. In that case, the situation is even worse for Bangladesh. In FY 1995-1996, the employed civilian labour force was 54.6 million, of which 0.59 million non-company assesseees (i.e. 1.75 per cent of the employed civilian labour force) paid income tax (see Table II (The Mahbub ul Haq Human Development Centre, 1999, p. 79) and Table III (Bangladesh Bureau of Statistics, 1999, p. 53)).

The collection performance of tax revenue in recent years was considerably better than past years. As we see in Table III, total tax collection went up gradually over the last years. During the early 1990s (1990-91 to 1993-1994), collection of both the tax revenue and non-tax revenue on an average was higher than their budget estimates (104 per cent and 111 per cent respectively) and thus total revenue was 106 per cent of the budget estimates over those years (Chowdhury, 1995, pp. 102-3). But the very recent collection performance (in FY 1999-2000) was estimated to be much lower than budgeted amounts. The credence in this tax collection at an enhanced scale goes to possibly the introduction of value added tax (VAT) since 1 July 1991 which has "self-policing" characteristics against tax evasion for the "credit method" of its computation (Bala, 1992, pp. 129, 141), replacement of the "filing

Table III
Selected tax indicators in Bangladesh

Indicators	FY 75	FY 85	FY 90	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99 ^a	FY 2000 ^b
In crore Taka											
Total tax	430.49	2,967.22	5,715.01			11,356.03	12,174.10	13,452.92	14,792.83	15,855.00	18,635.00
Direct tax	72.52	646.59	1,296.37			2,504.09	2,532.02	2,824.08	3,162.03	3,549.87	4,156.49
Indirect tax	357.97	2,320.63	4,418.64			8,851.94	9,642.08	10,628.84	11,630.80	12,305.13	14,478.51
As a per cent of GDP											
Total tax	3.46	7.29	7.75			9.70	9.35	9.59	9.56	9.06	9.43
Indirect tax	2.88	5.70	5.99			7.56	7.41	7.58	7.51	7.03	7.32
Customs duty	1.21	2.91	2.90			3.14	2.90	2.86	2.93	2.72	2.91
Excise duty	1.17	1.70	2.24			0.15	0.14	0.14	0.14	0.12	0.11
Sales tax/VAT ^c	0.50	1.10	0.86			2.96	2.97	3.09	2.96	2.74	2.87
Suppl. duty ^d	n/a	n/a	n/a			1.31	1.40	1.48	1.47	1.45	1.42
Turnover tax	n/a	n/a	n/a			0.002	0.002	0.002	0.003	0.003	0.003
Direct tax	0.58	1.59	1.76			2.14	1.95	2.01	2.04	2.03	2.10
Income tax	0.38	0.95	1.06			1.27	1.18	1.19	1.27	1.33	1.41
Other tax	0.20	0.64	0.70			0.87	0.77	0.83	0.77	0.70	0.69
As a per cent of total tax											
Indirect tax	83.15	78.21	77.32			77.95	79.20	79.01	78.62	77.61	77.68
Customs duty	34.99	39.87	37.40			32.38	30.99	29.83	30.69	29.99	30.86
Excise duty	33.86	23.32	28.86			1.57	1.50	1.51	1.45	1.29	1.22
Sales tax/VAT ^c	14.30	15.02	11.06			30.50	31.71	32.25	31.02	30.27	30.47
Suppl. duty ^d	n/a	n/a	n/a			13.49	14.98	15.39	15.44	16.02	15.10
Turnover tax	n/a	n/a	n/a			0.02	0.02	0.02	0.03	0.03	0.03
Related to external trade	45.65	53.79	46.70			53.54	54.94	53.92	54.13	54.43	55.13
Related to internal trade	37.50	24.42	30.62			24.41	24.27	25.09	24.49	23.18	22.55
Direct tax	16.85	21.79	22.68			22.05	20.80	20.99	21.38	22.39	22.32
Income tax	11.12	13.00	13.68			13.13	12.59	12.38	13.32	14.73	14.98
Other tax	5.73	8.79	9.00			8.92	8.21	8.61	8.06	7.66	7.34

(Continued)

Table III

Indicators	FY 75	FY 85	FY 90	FY 93	FY 94	FY 95	FY 96	FY 97	FY 98	FY 99 ^a	FY 2000 ^b
Taka in real terms (per cent of GDP)											
Per capita GDP	3,565	4,174	4,628			5,086	5,262	5,472	5,681	5,899	6,127
Per capita total tax	123.41 (3.46)	304.33 (6.58)	358.60 (7.05)			493.53 (9.70)	492.13 (9.35)	524.72 (9.59)	542.79 (9.55)	534.70 (9.06)	577.61 (9.43)
Per capita income tax	13.72 (0.38)	39.57 (0.95)	49.08 (1.06)			64.82 (1.27)	61.98 (1.18)	64.94 (1.19)	72.27 (1.27)	78.75 (1.33)	86.51 (1.41)
No. of income taxpayers (per cent of total population)											
Total number (% of population)	494,938 (0.43)				549,006 (0.47)	582,662 (0.49)	610,329 (0.50)	648,763 (0.52)	698,642 (0.55)	755,428 ^e (0.59)	871,100 ^f (0.67)
Company	11,743				15,228	19,855	16,867	16,035	18,815		
Salaried	63,765				82,856	97,652	103,570	104,981	109,437		
Others	419,430				450,922	465,155	489,892	527,747	570,390		
Cost in Taka for collecting tax revenue of Tk. 100											
Direct tax				1.55	1.60	1.93	1.88	1.69	1.59	1.23	1.15
Indirect tax				0.72	0.83	0.61	0.60	0.49	0.45	0.44	0.37
Total tax				1.00	1.04	0.92	0.86	0.73	0.71	0.64	0.56

Notes: ^a Revised estimates; ^b Budget estimates; ^c VAT introduced in FY 92; ^d Supplementary duty; ^e Actual for number of assesseees, but cost information as per projected trend; ^f As per projected trend

Sources: National Board of Revenue (1994, 1995, 1996, 1997, 1998); Bhattacharya (2000); Government of Bangladesh (1999)

threshold" system of charging income tax by the "conventional exemption limit" from AY 1992-1992 (Abedin, 1992, p. 1), simplification of tax administration, state recognition of noted contributors to national exchequer by awarding VIP income tax cards from AY 1991-1992; and so on. But still in Bangladesh, tax evasion is a "growing industry" and one conservative estimate in 1990 showing the underground money at Tk. 6,000 crores (Baree, 1990, p. 41), has become, so to say, more bulky with the influx of time.

Tax audit practice in Bangladesh vis-à-vis audit obligations under laws

As already mentioned, external tax audit exists in Bangladesh both in obligatory and discretionary forms. But controversy lies in its application because of the fact that audit under the Companies Act is subject to the Act itself and the generally accepted accounting principles (GAAP) as well as the International Standards on Auditing (ISA) prescribed by the IFAC; and this audit does not necessarily mean the same thing as the audit under the income tax laws. In the later case, the financial statements have to be prepared for audit purpose in accordance with the "income tax basis of accounting".

Moreover, under company audit, any expenses supported by audit evidence obtained through "compliance test" or "substantive test" are allowable, but income tax laws specify a number of allowances and disallowances and prescribe the asset-wise depreciation rates. Thus, for audit function, income tax laws provide the "established criteria" particularized in a more objective and specific way than as provided by GAAP, ISA or the Companies Act. Hence, tax audit has to be conducted for accounts expected to be prepared on an income tax basis.

Coverage of tax audit ambit: Bangladesh context

Since "audit" presupposes "accounting", tax audit may cover the heads of income for which any method of accounting must be followed for recording purpose. Under section 35(2) of ITP, income from business or professional, agricultural income and income from other sources (exclusive of income from interest on security, income from salary, capital gains and income from house property) are subject to compulsory accounting. And tax audit is mandatory under section 35(3) for both public and private companies, but it is discretionary

under section 82 for companies having at least 50 per cent of capital-owners being foreigners, public limited companies, corporate body, and nationalised banking, insurance or other financial institution. But this is in a society where accounting practice is so scanty in the trading sector not to mention the situation in other areas. So tax audit has to be imposed on business or professional income with an expanded base so as to ensure proper maintenance of account and independent scrutiny thereof by auditors. The criteria for compulsory tax audit have to be based on gross turnover or gross revenue, not on capital. Because profitability in terms of absolute or residual income (RI) which is the very tax base, is obviously indicated in a better way by the gross revenue inflow than in terms of relative income such as return on investment (ROI) based on capital. It can be usually assumed that the higher the gross earning, the higher the taxable income. But higher capital does not necessarily mean yielding higher income.

Hence, tax audit can be made mandatory on the basis of gross turnover for business and gross receipts for profession. Alternatively, net asset rather than capital can be considered a criterion for statutory tax audit in other cases. In India, tax audit was introduced with effect from 1 April 1984 for every person carrying on business having total sales, turnover or gross receipts exceeding the specified limit of Rs. 40 lakh for business and every person carrying on a profession having a total turnover or gross receipts exceeding Rs. 10 lakhs (Chakraborty, 1988). In Bangladesh, tax audit should be introduced for all types of assessee's having income from business or profession.

Who should act as a tax auditor in Bangladesh?

The relevant provisions requiring tax audit under the Income Tax Ordinance 1984 plainly mention that the tax auditor shall be a chartered accountant (CA) within the meaning of the Bangladesh Chartered Accountant Order 1973. Presently, all the external independent audit functions are also performed by the CAs practising for this purpose with the approval of the Institute of Chartered Accountants of Bangladesh (ICAB). Only under section 220 of the Companies Act 1994, a cost and management accountant (CMA) can be appointed an auditor in addition to statutory financial audit, for the purpose of performing audit in respect of those companies engaged in

production, distribution, marketing, transportation, processing, manufacturing, grinding or milling grains, excavation of quarry, and extraction of mineral resources, which shall have to maintain books of accounts on material, labour and overhead as per section 181(1)(d) of the Companies Act, 1994. But this appointment of cost auditors (which can only be done by a CMA only) depends on the discretion of the Government through written order. As such, a CMA is considered a professional expert on cost audit. But in the income tax laws, CMAs are given due importance having professional competence on income tax. For instance, under section 11(3) of the ITO, both the CA and the CMA require an equal level of professional experience (not less than eight years) to be an accountant member in the Taxes Appellate Tribunal. Under section 174, both the CA and the CMA can be an "authorised representative" of an assessee. Under rule 37(2), any person qualifying in the Intermediate Examination conducted by the Institute of Chartered Accountants of Bangladesh (ICAB) or all the examinations conducted by the Institute of Cost and Management Accountants of Bangladesh (ICMAB) for granting membership of the concerned institutes, can be a registered income tax practitioner. Thus, in case of "tax audit", both the CA and the CMA can be the appropriate auditor. But the CAs are probably the most tax conscious, since they are directly related to the tax questions while performing statutory audit. Before giving his/her independent opinion in the audit report on the "true and fair view" of the financial statements of the concerned entity's financial position and the results of its operations, she/he must evaluate the reasonableness of the reported amounts of income tax, since income tax is obviously a deduction in the profit and loss account to show the after-tax-net income and may be a liability shown in the balance sheet, if the payment is pending for non-assessment or for other reasons. The reported income tax amounts should not be a rough estimation, rather those should be substantiated in conformity with the specific income tax provisions, otherwise, the basic objectives of auditing will be violated and the financial statements will not be "presented fairly".

Tax audit report: Bangladesh perspective

We have already mentioned that under section 35(3) of the Income Tax Ordinance, auditors are required to certify the final

accounts of the relevant assessee and under section 82, for being assessed on correct return basis, the return is to be accompanied by a certified copy of accounts and a certificate as to the correctness of the assessee's total income signed and issued by the auditor in prescribed form. But the prescribed form of certification is yet to be prescribed under the Income Tax Rules. The use of auditor's "certification" or the word "certificate", does not seem the same as "audit report". In 1990, as per section 35, the ICAB recommended two forms of audit report – one for where no audit is done under any other law and the other for where the accounts have been audited under any other law by an accountant, and an annexure for reporting "prescribed particulars" in respect of allowances, disallowances and the information about the method of accounting regularly employed and its consistency of employment over the years (ICAB, 1990, pp. 15-21). But the recommendation is still pending for incorporation in the tax laws. In the absence of any prescribed form, there is no standard "tax audit report" and these words are not yet used by the chartered accountant firms auditing the respective assessee. The reputed CA firms have their own style, format and language for giving any certificate in this purpose[8]. Usually, they give a certificate under section 82 and enclose a statement showing the computation of total income determined in accordance with the provisions of the Income Tax Ordinance (ITO). For the purpose of uniformity and standardization, the words "certification" or "certificate" can be replaced by "tax audit report" in the provisions of the ITO and this report may be presented as per the form given as an example in the Appendix I of International Standard on Auditing (ISA) 24: Special Purpose Auditor's Reports. According to paragraph 12 of ISA 24, a tax basis financial statement might be entitled "Statement of assets and liabilities – income tax basis" (IFAC, 1993, pp. 333-8). Accordingly, the trading account and then profit and loss account also can be titled "Trading account – income tax basis" and "Profit and loss account – income tax basis". All the financial statements must be prepared as per the provisions of the income tax laws (for example, as required by sections 28-30 and other related sections and relevant schedules, Statutory Rule and Order (SRO), etc.). The tax audit report must contain:

In our opinion, the financial statements give a true and fair view of (or "present fairly") the financial position of ... (assessee's name) ... at ... (closing date of the income year) ... and its

revenue and expenses for the income year that ended corresponding to the assessment year ... on the basis of accounting used for income tax purposes as described in Note ... [9].

The audit report should be accompanied by the financial statements prepared on the income tax basis along with the necessary notes containing particulars of:

- Disallowances under section 30, such as salaries on which tax has not been deducted at source; interest, salary, commission or remuneration made by a firm to any partner; brokerage or commission paid to non-resident without deducting tax; employer's contribution to provident fund or other fund without making arrangements of tax education before any payment from the fund; excessive perquisites or Tk. 72,000 whichever is less; and other expenses (entertainment, foreign travel of employees and their dependants for holidaying and recreation, publicity and advertisement, and distribution of free samples) in excess of the prescribed limit.
- Depreciation expenses as per the Third Schedule of the ITO.
- Other deductions allowable under section 29 for which clarification may be called for by the assessing authority such as investment allowances, obsolescence allowances, provision for bad and doubtful debts made by banks, etc.
- Other information such as method of accounting employed, method of valuation of beginning and ending inventories, etc.

Prevailing extent of assessment under the tax audit net in Bangladesh

There are no available statistics about the extent of assessment under the prevailing tax audit net. From a personal interview with a tax official[10] in the National Board of Revenue (NBR), the apex taxation body, it has been revealed that the tax audit net is very insignificant as compared to the whole tax net. According to his approximation, most of the total income tax comes from the insignificant number of companies, around 15 per cent of income tax comes from individual category and the remaining from other categories (partnership firms, co-operatives, etc.). In Bangladesh, the number of income taxpayers is meagre. In FY (fiscal year) 1998-1999, the number of total income taxpayers was only 755,000 (i.e. 0.59 per cent of total population) only, which has been estimated to be 871,000 (i.e. 0.67 per cent of total population) in FY 1999-2000 (see Table

III). The tax official interviewed, further mentioned that on the part of the public limited companies the number of which was around 220 on the last day of FY 2000, that is, around 1.2 per cent of around 19,000 company assesseees, certified copy of audited accounts along with the certificate of total income issued by the chartered accountant are usually given with the tax return, and thus their assessment is done on the basis of correct return under section 82. But other types of companies such as private insurance and banking companies, though eligible to be assessed on correct return basis by enclosing certified copy of audited accounts and a certificate as to the correctness of the total income signed and issued by a chartered accountant, do not usually avail this opportunity. From an experience survey among the practising chartered accountants and also among the personnel responsible for handling the tax affairs of the eligible companies, the following observations have come into notice:

- Only few reputed chartered accountant firms[11] are willing to give the total income certificate as required by section 82, only if they audited the company in the preceding year of the concerned income year and they charge a large fee separately only for the total income certificate.
- Less established chartered accountants are often reluctant to do the audit of tax basis accounting due to inadequacy of information, lack of efficient personnel, want of logistic supports to maintain track record of information for future reference in tax cases, absence of audit continuity over the years, and so on.
- Private insurance, banking and financial companies are not responding much, because of their unawareness of having such benefit and absence of effective response from the professional accountants in terms of cost-benefit analysis. The fee of tax audit is highly discouraging to continue the audit over the years, since the tax audit is virtually monopolised by some chartered accountant firms.

Concluding remarks with recommendations

From the foregoing discussions, we may now conclude that, external tax audit exists in Bangladesh both mandatorily and discretionarily with a wide coverage of tax audit net. But the extent of tax audit practice is awfully inadequate and the major reasons

for this unwanted reality have been identified as unawareness or undesirability of most of the assesseees, and the hesitation of the practising chartered accountant (CA) firms to take up the task of tax audit because its sensitivity spreads not in the relevant year, but also in the future years until the finalisation of the audit. Although the use of sampling is a usual practice in the case of any audit but most of the respondent CAs have apprehended more risk in the case of a sample-based tax audit than in their regular financial audit. Because they think that here, the possible punitive measures for being an unwilling party of tax evasion is more likely than any other situation since internal auditing of tax documents by the tax assessment officials is often a routine and rigorous process. Considering this higher risk, high audit fee is usually charged by the willing CA firms and this also discourages the discretionary tax audit in view of cost-benefit analysis.

A comprehensive reform in the tax code is necessary for ensuring transparency in tax law, reducing discretionary power of tax administration and also for creating a climate of confidence between assesseees and tax administration. A new environment is required to be created for the assesseees so that they themselves come forward to pay their taxes voluntarily. In the context of the world-wide trends in reduction of tariff with the effect of globalisation, augmentation of direct taxes should be taken as an urgent step. To enhance the share of direct tax, coming forward by the assessee is an ambitious expectation and the practical extent of tax audit can be said to be the proper instance here. To get rid of the problems, the following recommendations may be prescribed:

- 1 Tax audit should be made mandatory for the assesseees having income from business or profession. Tax audit should be based on gross turnover in case of business income and on gross receipts in case of professional income. And assesseees having annual gross turnover exceeding Tk.50 lakh from business and those having annual gross receipts exceeding Tk. 10 lakh from professional sources may be mandatorily brought under the tax audit net.
- 2 Tax audit fee should be fixed as a percentage of gross turnover or gross receipts, say at 0.5 per cent.
- 3 Tax audit and statutory financial audit should be made by the same CA firms and in this regard time-frame can be pre-fixed. But where statutory audit is not

applicable, tax audit may be open for both CA and CMA.

- 4 Tax audit report should be prepared in consonance with the International Standard on Auditing (ISA).
- 5 As already mentioned, various deductions allowable under section 29 of the Income Tax Ordinance (ITO), such as investment allowances, obsolescence allowances, provision for bad and doubtful debts made by banks, depreciation expenses as per the Third Schedule of the ITO etc. for which there were limits and conditions. There were also some disallowances prescribed under section 30 of the ITO, such as salaries on which tax has not been deducted at source; interest, salary, commission or remuneration made by a firm to any partner; brokerage or commission paid to non-resident without deducting tax; employer's contribution to provident fund or other fund without making arrangements of tax education before any payment from the fund, etc. For the allowances deductible from income from business or profession under section 29 of the ITO, a columnar supporting schedule should be prepared in the following format:
 - *Items of deduction.* Heads of allowances in various clauses of section 29(1).
 - *Actual (Tk.)* Expenses incurred actually.
 - *Disallowance (Tk.)* Excess of prescribed limit under sections 29 and 30.
 - *Allowable (Tk.)* Differences between actual and disallowance.

Above all, the tax auditor in Bangladesh as well as everywhere should be fully conscious of his/her duties and responsibilities in respect of the assignment undertaken. She/he should be very much careful in regard to certification of accounts and expression of her/his views thereon. Her/his tax audit program has to be prepared judiciously. The program needs to be flexible, depending on the nature and volume of the business and degree of control exercised within the organisation concerned. It might be necessary to curtail or enlarge the program of work according to necessity.

Notes

- 1 These income tax VIP cards are awarded to companies contributing more than Taka 5 crore and to individuals contributing over Taka 10 lakh as income tax to the exchequer.
- 2 Fiscal year starts from 1 July of a calendar year and ends on 30 June of the succeeding calendar year.
- 3 Taka (abbreviated as Tk.) is the currency of Bangladesh. "Crore" means "ten million". The

- current exchange rate of £1 is Taka 77.23 and that of \$US1 is Taka 54.30 as on 15 May 2001 (*The Financial Express*, 2001).
- 4 The total income has been computed as per the tax rates provided in the Finance Acts, 1991 and 1992.
 - 5 This provision was also applicable to registered partnership firms having at least five lakh Taka capital. The section 111 of the ITO which represented the provisions in respect of registration of partnership firms was repealed from AY 1995-1996 as per section 6(29) of the Finance Act, 1995.
 - 6 Hussain (1965) mentioned that within the various tax administrations (with respect to Pakistan), the internal audit is carried out by the staff within the organization itself, while the external audit is conducted by the staff under the Comptroller and Auditor-General (CAG). But for the purpose of this study, all these are internal audits, since they are conducted by internal government staff.
 - 7 Attestation is a communicated statement of opinion (judgement), based on convincing evidence, by an independent, competent, authoritative person, concerning the degree of correspondence in all material respects of accounting information communicated by an entity (individual, firm, or governmental unit) with established criteria (AAA, 1973, p. 6).
 - 8 For this paper, audit certificates given by several firms have been examined but since they are of confidential nature, no information has been disclosed here publicly.
 - 9 Compiled from the examples of audit reports under ISA 24 (IFAC, 1993, p. 338).
 - 10 Mr R.K. Bhowmik, Second Secretary, National Board of Revenue (NBR), Dhaka (June 2000).
 - 11 The names of the CA firms are not for disclosure due to unavailability of permission.

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