BRAC EPL RESEARCH
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BUDGET FY2019-20:
LOFTY TARGET ALONG WITH NEW VAT LAW AND TAX ON STOCK DIVIDEND

Yearly Notations

FY2018A – Actual
FY2019R – Revised
FY2020B – Budget

Executive Summary

The proposed budget of FY2019-20 introduces a few stimulating policy positions compared to the budget in the previous fiscals. The most significant among these new policy positions is the implementation of VAT & SD Act, 2012. Even though several amendments have been incorporated and a four-layer VAT structure has been proposed, the success of this regulation in terms of mobilizing revenue will depend on the successful implementation of this act. Notably, the government has been struggling for the last few years, resulting from the low revenue to GDP ratio.

- The proposed budget for FY2019-20 is BDT 5.2 trillion (USD 61.5 billion, 18% of GDP), 18% higher than the revised budget of FY2018-19.

- The biggest highlights of this year's budget are:

  i. The imposition of 15% tax on stock dividend and on Retained Earnings and Other Reserves exceeding 50% of Paid-up capital for all listed companies, with the aim of strongly encouraging cash dividends disbursement.

  ii. The increase in the threshold on maximum dividend income for tax exemption on individual investors from BDT 25,000 to 50,000.

  iii. There were no changes in the corporate tax rates.

  iv. Tax rate on interest income on National Savings Certificate (NSC) increased from 5% to 10%. However, interest rate of National Savings Certificate (NSC) remained unchanged.

- National Board of Revenue (NBR) has been assigned the daunting challenge of mobilizing BDT 3.2 trillion in revenues. The target set for NBR is 16% higher compared to the last fiscal year's revised budget. NBR has been appointed to collect 86% of the total tax revenue.

- The total expenditure target has been increased by 18% compared to that of FY2018-19R. Annual Development Program (ADP) target was set at BDT 2.0 trillion (USD 20.6 billion, 7% of GDP), equivalent to 39% of the total expenditure in this budget. ADP allocation was increased by 21% over the revised budget.

- The budget deficit is BDT 1.4 trillion (USD 17.1 billion, 5% of GDP). Financing from foreign sources is targeted at BDT 680 billion, 44% higher than the revised budget of FY 2018-19. Given the inadequate liquidity in the banking sector, there is a possibility of crowding out of private sector credit growth owing to higher bank borrowing by the government. However, we still view bank borrowing positively as it allows banks to earn higher yields on treasury assets, especially in a time when high private sector credit growth has been associated with a surge in non-performing loans. The amount of fund allocated to bank sector recapitalization has been kept unclear.

- The real GDP growth target and inflation target have been set at 8.2% and 5.5% respectively. The real GDP growth for FY2017-18 was 8.1%, according to government estimates. Private investment to GDP target is set at 24.2%, compared to 23.4% in FY2018-19P.

*** For more details on numbers and statistics of the national budget for FY2019-20, please refer to Appendix on page 10.*

BUDGET 2019-20: THE FISCAL SKELETON

Figures in BDT

Revenue
3,778 bn
19% Gr

Deficit
1,454 bn
5% of GDP

Expenditure
5,231 bn

Income, Profits & Capital Gains Tax
1,139 bn
20% Gr
30% of total

Value Added Tax
1,231 bn
17% Gr
33% of total

Supplementary Excise, Import & Export duty
886 bn
11% Gr

Non-NBR Tax Revenue
522 bn
43% Gr
14% of total

Foreign
680 bn
44% Gr
13% of budget

Domestic Bank
474 bn
53% Gr
15% of budget

NSC
300 bn
(37%) decline
6% of budget

Public Services
1,540 bn
31% Gr
29% of total

LGRD
379 bn
10% Gr
7% of total

Agriculture & Others
1,078 bn
18% Gr
21% of total

Social Security & Welfare
298 bn
11% Gr
6% of total

Education & IT
795 bn
20% Gr
15% of total

Fuel & Energy
284 bn
12% Gr
5% of total

Defense & Public Order
602 bn
2% Gr
12% of total

Health
257 bn
15% Gr
5% of total

Figures in BDT billion	2019-20 Budget	Change *	% of Total	% of GDP	2018-19 Revised	2017-18 Actual
Expenditure						
Non Development Expenditure	2,779	12%	53%	10%	2,477	1,789
Development Expenditure	2,117	22%	40%	7%	1,734	1,222
Other Expenditure	336	57%	6%	1.3%	487	208
Total Expenditure	**5,231**	**18%**	**100%**	**18%**	**4,425**	**3,219**
ADP	2,027	21%	39%	7%	1,670	1,195
Interest Payment	571	18%	11%	2%	487	418
Revenue						
NBR Tax	3,256	16%	62%	11%	2,800	1,871
Non-NBR Tax	145	51%	3%	1%	96	72
Non Tax Receipt	377	40%	7%	1%	270	222
Total Revenue	**3,778**	**19%**	**72%**	**13%**	**3,166**	**2,166**
Deficit Financing						
External	680	44%	13%	2%	472	265
Domestic	773	-2%	15%	3%	787	731
Bank	474	53%	9%	2%	309	117
Budget Deficit	**1,453**	**15%**	**27.0%**	**5%**	**1,259**	**1,056**
GDP (Estimated)	**28,859**	**14%**	**5.5x**	**100%**	**25,362**	**22,505**

**Change over FY2018-19Revised, Source: Ministry of Finance*

New lower slabs of VAT rates proposed

PROPOSED CHANGES

- Along with the standard VAT rate of 15%, there will be reduced rates of 5%, 7.5% and 10% for specific goods and services.
- VAT will be charged on fair market price of goods, replacing the existing price declaration system before the supply of goods.
- Paying VAT is going to be more convenient— retail businesses will have the opportunity to get online service for VAT and turnover tax registration, tax payment, return submission, refund etc. while provision to maintain sufficient balance in Current Account Register is removed as VAT returns documents will be sufficient.
- VAT payment is exempted for businesses having a turnover bellow BDT 5 million and 4% VAT on turnover between BDT 5 — 30 million .
- VAT registration threshold has been increased to a turnover of BDT 30 million from BDT 8 million.
- Products paying less than 15% VAT would not get input tax credit. Products paying 15% VAT would continue to benefit from input tax credit.
- VAT at the trading stage of pharmaceutical and petroleum products shall be 2.4% and 2% respectively.
- VAT exemptions on important goods of economic importance to the government are continued while those on necessities is both continued and increased.
- A new provision to submit returns of income for non-resident taxpayers doing business in Bangladesh so that they do not get away without paying tax on business income.

IMPACT

Many goods and services will fall under reduced VAT rates. As VAT comprises a key portion of NBR revenue, introduction of lower slabs poses the threat of missing the target. However, telecom and tobacco account for more than 45% of VAT revenue, and VAT on these will remain unchanged at 15%.

Under the current system, the manufacturer collects VAT on behalf of the government. Now that VAT will be charged on fair market price, it is unclear which party — whether manufacturer, distributor or retailer, will collect VAT for the government. Passing VAT collection responsibility to retailers in addition to exemptions made on low turnover retailers, may reduce overall VAT collection initially. On the positive side, tax revenue will increase from lower input tax credits.

Bringing a larger base of taxpayers to the VAT system, increases in import duties and reductions in the exemption is expected to increase net VAT revenue.

We also believe that the government will allow time to adjust the new law. The risk of lower VAT collection posed by the changes is less than what appears.

IMPACT ON CAPITAL MARKET

PROPOSED CHANGES

- 15% tax imposed on companies for issuing stock dividend, implying that 15% tax will be levied at the addition of paid-up capital owing to stock dividend disbursement.
- 15% tax imposed on Retained Earnings and Other Reserves transferred from Net Profit After Tax (NPAT) in excess of 50% of Paid-up capital in any income year .
- Threshold on maximum dividend income for tax exemption on individual investors increased from BDT 25,000 to BDT 50,000

IMPACT

Overall, the impact on capital markets is mixed and depends on whether all these proposals get approved.

Encouraging cash dividend disbursement and offering tax benefits on it will be received positively by the retail investors in a time when the interest rate spike is causing a drag in capital markets. On top of that, the resultant mispricing created by excess stock dividend disbursement will be minimized.

Growth focused companies might be forced to disburse cash dividends and this can drag the long-term growth. However, there are very few companies in Bangladesh that adhere to conservative dividend policy with growth in mind. Note that tax levied on excess 'Retained Earnings and Cash reserves' will typically encourage stock dividend disbursement (stock dividend increases paid-up capital). However, levy in stock dividends will eventually incentivize companies to pay cash dividends.

Particularly, the bank sector will be negatively impacted. The capitalization and liquidity conditions of well-managed banks and NBFIs can be compromised as cash dividends are encouraged and the sector comprises a segment of the market.

We think that some of the proposed changes might be exempted for the banking sector when the proposals are actually approved.

IMPACT ON CAPITAL MARKET

BANKS & FINANCIAL INSTITUTIONS

The new budget does offer reforms and levies that affect the banking industry both positively and negatively. The government proposed to increase tax rate on interest income on National Savings Certificate (NSC) from 5% to 10% in the Finance Bill which was released post Budget Speech — thereby reducing the effective annual interest rate on NSC by around 50 – 60 bps. This change is positive for mobilizing funds to the banking sector where 1-year fixed deposits rates have risen to around 8.5% - 9.0% recently. However, there was no announcement to change the nominal interest rates on NSC.

In the previous fiscal year, the government ended up borrowing more from domestic sources than its initial as well as its revised target by 31% and 20% respectively. This was the result of lower than forecasted external borrowing to cover up the budget deficit. Although the government has borrowed a major portion from the National Savings Certificate, recent steps are taken to discourage savers from investing in the NSC — from increasing tax rate on NSC income — creating a database of NSC buyers and mandating the registration of e-TIN for buyers mean that the government will increase bank borrowing. This should benefit the banking sector as the government will have to offer higher treasury yields to the banks that buy treasury assets. Banks with strong deposit capabilities will benefit more from higher investment income.

One negative aspect of the proposed budget is the new tax levied on stock dividend and excess 'Retained Earnings and Cash Reserves' over Paid-up capital, as mentioned in the previous section of this report, for which many banks will be tempted to pay cash dividend in order to maintain 'A' category status in the DSE. With excess liquidity shrinking and high NPL and low profitability dragging the capital condition, growth-focused banks would rather avoid paying cash dividends. However, if banks do opt to pay stock dividend, they can still minimize their effective tax rate hike to within 1% to 2% change by paying 10% stock dividend and still maintain 'A' category, and as such the impact is not significant. However, tax on excess Retained Earnings and related Reserves can be much more significant. We strongly think that the new proposed tax imposition might eventually be modified with regards to the financial sector.

In the budget, there was a fresh tariff of USD 0.70 on each magnetic stripe card import, USD 2 for chip-and-pin card and USD 3 for contactless card. Previously, the maximum tariff rate paid on any kind of imported cards was USD 0.52. Banks would want to pass on the increased tariff on cards to customers and as such, this can impact the growth of retail products.

The speech offered to reform the sector by making several proposals. The budget proposes flexibility for banks to change interests on loans and deposits —- banks will be able to adjust interests on loans and deposits on a monthly basis from a more rigid restriction imposed by Bangladesh Bank — enabling banks to improve spreads. Of other positive reforms mentioned in the speech are — capping the weighted average spread of 5 % (such caps are already applied by Bangladesh Bank) — creating a central database for monitoring large loans , called the Central Database for Large Credit (CDLC) — creating a database on collaterals against all types of loans in order to prevent misuse of collaterals — heavily promoting the bond sector with the promise to launch the Floating Rate Treasury Bond as soon as possible.

The speech also proposed a cap on the maximum balance on MFS accounts of BDT 300 thousand. It should not be a major hurdle as the average balance on such accounts is of much smaller size. The government proposed to hike supplementary duty on imported smartphones to 25% from existing 10% in the budget. Making smartphones more expensive can hurt the long term growth of app based earnings of MFS providers.

CONSUMER DURABLES

Proposal to continue existing VAT and supplementary duty exemptions given to the heavy industries like automobiles, refrigerators, freezers, air conditioners, motorcycles, mobile industries, etc. will help to grow and develop the heavy domestic industry and export sector. In addition, the proposal to allow the import of some essential raw materials of lift, refrigerator, compressor, air conditioner, electric motor, mold and footwear industries at a concessionary rate will help the respective industries. Reduction of 5% duty tax on steel plate import by VAT registered refrigerator manufacturing industry will bring an additional advantage in the business. Companies like **Singer, Runner Automobiles, Walton**, etc. will be benefited due to such changes. The government has proposed to increase the customs duty of smartphones to 25% from the existing 10%, which will put the local cell phone manufacturer Walton in an advantageous position.

CHOCOLATE & BISCUIT

Existing 0% import duty on lentils, wheat, onion, edible oil, fertilizer, seed, raw cotton will remain unchanged. On the other hand, the government has proposed to increase the existing specific duty from BDT 2000.0/MT to BDT 3000.0/MT on the import of raw sugar. For refined sugar, the specific duty will be increased from BDT 4,500.0/MT to Tk. 6,000.00/MT. Regulatory duty will be 30% instead of 20% for both refined and raw sugar import. It is worth noting, wheat and sugar are the key raw materials of biscuit manufacturing company **Olympic.** However, the proposal to exempt VAT on the production and supply of bread, hand-made biscuits, and hand-made cakes up to the value of BDT 150 per kg will not provide any benefit to Olympic.

PHARMACEUTICALS

The government proposed exemptions and concessionary rate of duties of some pharmaceutical raw materials. Particularly, there is a proposal to exempt all the raw materials of cancer medicine from import duty. Pharmaceutical companies focusing on Oncology such as **Beacon Pharma** and **Renata Limited** will benefit from the exemption. However, all the pharmaceutical companies will benefit from reduced import duties of other pharmaceutical raw materials.

Moreover, the government proposed to decrease regulatory duty from 20% to 10% on import of liquid Oxygen, Nitrogen, Argon and Carbon Dioxide for making these lifesaving gases available to the poor patients at low cost. All the local producers of these liquefied gases, including **Linde Bangladesh Limited**, may, to some extent, lose competitive advantage to importers.

Textile and RMG

The tax rate for readymade garments is 12%. The rate is 10% if there is green building certification. Besides, for the textile sector, the tax rate is 15%. These sectors are enjoying reduced rates of taxes for a long period of time. This advantage will expire by 30 June of this year. The government has proposed to continue this provision of a reduced rate of taxes for these sectors.

Moreover, four sectors of ready-made garments are receiving export incentives at 4.0%. It is proposed in the budget FY 2019-20 to provide an export incentive of 1.0% in the next fiscal year to the rest of the sectors of ready-made garments. Allocation of additional BDT 28.3 billion will be made in the budget for FY2019-20 for this purpose.

TOBACCO

The government proposed to fix the price of the low segment for every 10 sticks of cigarette at BDT 37.0 and above while fixing the supplementary duty rate at 55.0%. The government also proposed to increase the price of the medium segment for every 10 sticks of cigarette at BDT 63.0 and keep the supplementary duty rate of 65.0% unchanged. At the same time, the government proposed to increase the price of the high segment for every 10 sticks of cigarette at BDT 93.0 and BDT 123.0 and keep the supplementary duty rate to the existing 65.0%. The government has also proposed to withdraw the existing 10% export duty on non-manufactured tobacco.

Table: Existing and proposed price slabs and supplementary duty structure

	Existing Price per 10 sticks (BDT)	Proposed Price per 10 sticks (BDT)	% chg	Existing SD	Proposed SD	chg (bps)
High	75.0 & 105.0	93 & 123	NA	65%	65%	0
Medium	48.0	63.0	31%	65%	65%	0
Low (Local)	35.0	37.0	6%	55%	55%	0

Source: Ministry of Finance

Illicit market is growing at an alarming rate in recent years in Bangladesh. In the previous year, a large number of smokers switched from lower segment to low-priced illicit cigarettes or bidi due to the price hike in the lower segment. This scenario may take place once again this year due to the same reason. **BATBC** is very likely to experience a decline in its sales volume mainly due to — (a) proposed price hike in every segment, (b) competition coming from Japan Tobacco International, and (c) increasing illicit trade.

Increase in price of bidi: In order to reduce the prevalence of bidi smoking which is considered more harmful than factory-made cigarettes, the price of filtered bidi has been increased by 13.3% to BDT 17.0 per 20 sticks with supplementary duty rate at 40%. On the other hand, the government proposed to increase the supplementary duty rate on non-filtered (hand-rolled cigarettes) bidi from existing BDT 12.5 to BDT 14.0 per 25 at 35%.

TELECOMMUNICATION

SD will increase from 5% to 10%: The increase of SD will increase the tariff of all services provided by the telecom companies. This may result in reduced usage of voice/data after its implementation. At present, mobile phone users have to bear 15% VAT, 5% supplementary duty and 1% surcharge on their bill for phone calls, internet, and other usage.

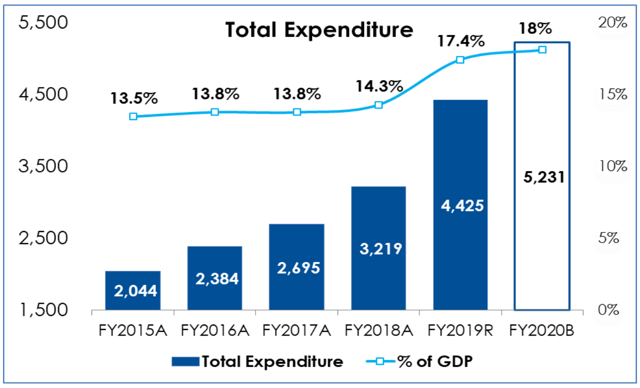
VAT on import of Telecom Equipment: Telecom equipment enjoyed a VAT exemption until now. But in the budget 2019-20, it has been declared that VAT will be imposed on the import of telecom equipment. Base stations and transmission equipment constitutes a significant portion of fixed assets of a telecom company. The new VAT on telecom equipment will increase the cost of purchasing new equipment. But according to the tower sharing agreement, the telecom companies will not build new mobile towers. So the tower sharing companies will have to bear the majority chunk of the increases in cost. There are four licensed tower sharing companies, namely Edotco Bangladesh Tower Company Limited, TASC Summit Tower, Kirtankhola Tower Bangladesh Limited and AB HiTech Consortium Limited.

Minimum Tax Limit Increase: The minimum tax rate has been increased from 0.75% of turnover to 2% of turnover. This can be potentially harmful to Robi and Banglalink as these companies are loss-making. Grameenphone pays well above the minimum tax rate imposed in the budget.

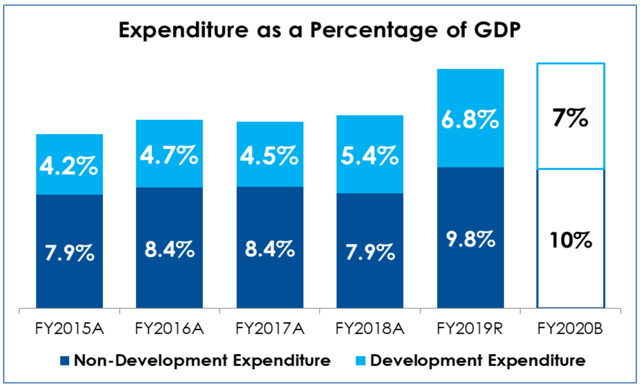
The VAT & duty exemption will be continued for the telecom industry. Moreover, the corporate tax structure is unchanged for the industry. Publicly traded mobile operators will have to pay 40% tax while non-publicly traded operators will have to pay 45% tax

APPENDICES

GOVERNMENT EXPENDITURES

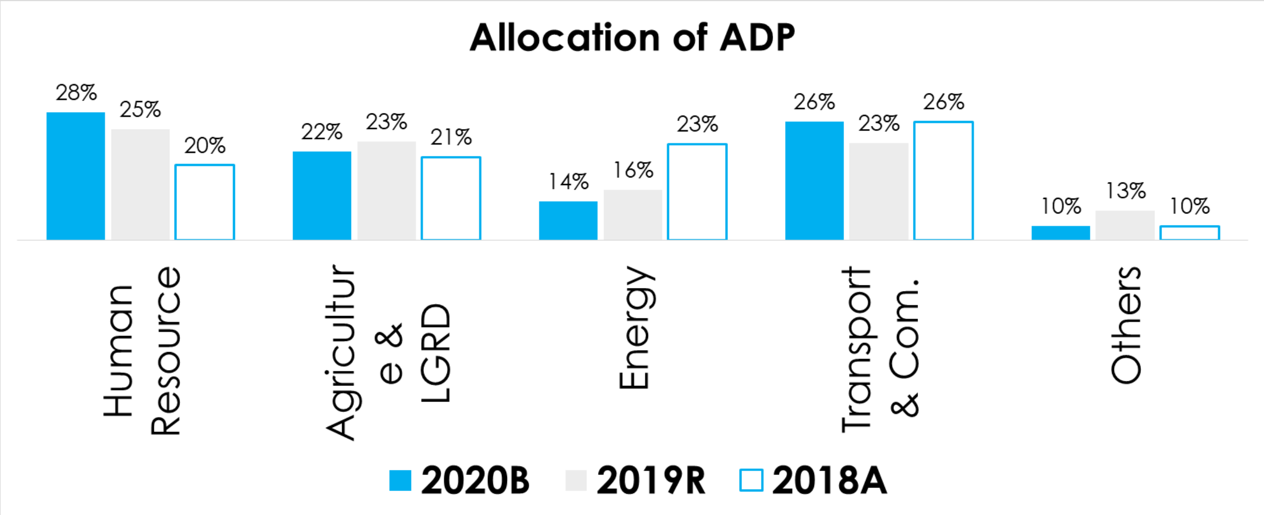


Source: Ministry of Finance



Source: Ministry of Finance

ALLOCATION of ADP

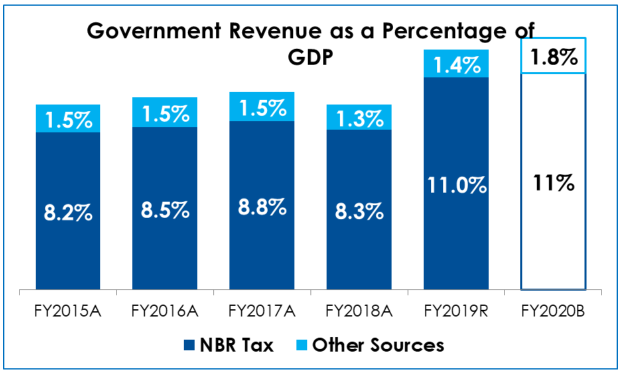


Figures in BDT billion	2018-20 Budget	Change *	% of Total	2018-19 Revised	2017-18 Actual
Human Resource	556	32%	28%	422	234
Agriculture & LGRD	435	12%	22%	389	250
Energy	279	6%	14%	264	274
Transport & Com.	528	37%	26%	386	316
Others	203	-3%	10%	209	121
Total	**2,001**	**20%**	**100%**	**1,670**	**1,195**

**Change over FY2018-19 Revised, Source: Ministry of Finance*

APPENDICES

REVENUE COLLECTION



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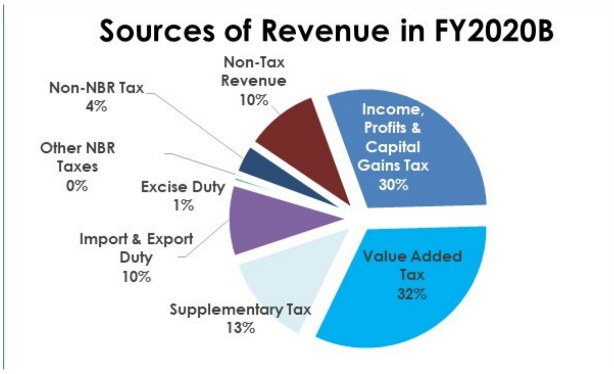


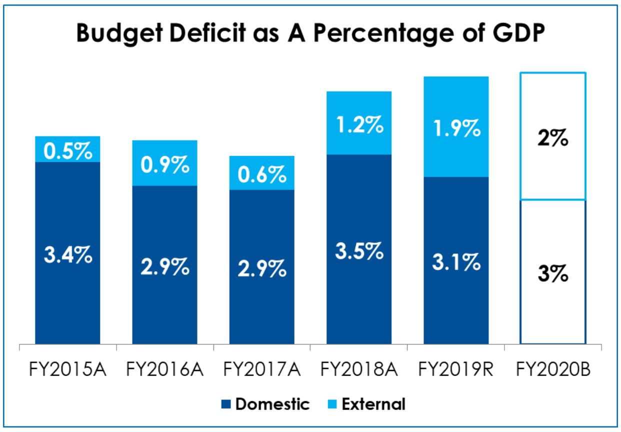
Source: Ministry of Finance

SOURCES OF TAX

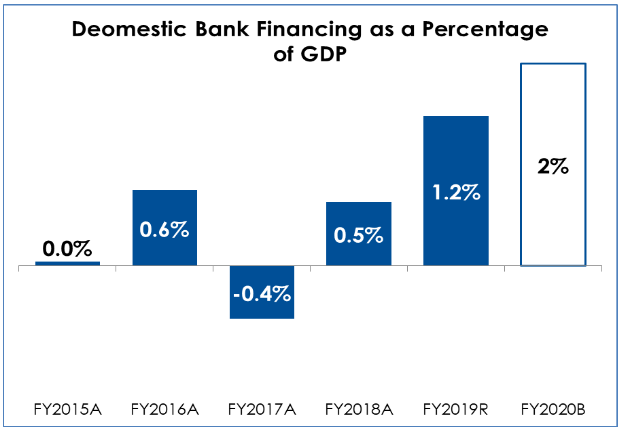
Figures in BDT billion	2019-20 Budget	Change *	% of Total	2018-19 Revised
Income, Profits & Capital Gains Tax	1,139.1	20%	30%	951.7
Value Added Tax	1,230.7	17%	33%	1048.0
Supplementary Tax	481.5	6%	13%	452.2
Import & Export Duty	365.5	16%	10%	314.4
Excise Duty	22.4	13%	1%	19.8
Other NBR Taxes	16.8	20%	0%	14.0
Non-NBR Tax	145.0	51%	4%	96.0
Non-Tax Revenue	377.1	40%	10%	270.1
Total	**3,778.1**	**19%**	**100%**	**3,166.1**

**Change over FY2018-19 Revised, Source: Ministry of Finance*

FINANCING THE DEFICIT



Source: Ministry of Finance



Source: Ministry of Finance

APPENDICES

TAX EXEMPTION THRESHOLD FOR INDIVIDUALS

CURRENT		PROPOSED
Tax Exemption Threshold	in BDT	Unchanged
General Taxpayers	250,000.0	
Women & Senior Citizen (65 years+)	300,000.0	
Person with Disability	400,000.0	
War-wounded Freedom Fighters	425,000.0	
General Tax Rate	Tax Rate	
On First, BDT 250,000.0	Nil	
On Next, BDT 400,000.0	10.0%	
On Next, BDT 500,000.0	15.0%	
On Next, BDT 600,000.0	20.0%	
On Next, BDT 30,00,000.0	25.0%	
On the Balance of Total Income	30.0%	
Special Tax Rate		
Tobacco Products Manufacturers	45.0%	
Income of Non-Resident	30.0%	
Income of Co-operative Society	15.0%	

Source: Ministry of Finance

CORPORATE TAX RATES

DESCRIPTIONS	CURRENT RATE	PROPOSED
Publicly Traded Company	25.0%	Unchanged
Non-listed Companies	35.0%	
Publicly Traded RMG	12.5%	
RMG (Green Factory)	12.0%	
Non-listed RMG	15.0%	
Listed Financial Institutions	37.5%	
Newly Established Financial Institutions in 2013	37.5%	
Non-listed Financial Institutions	40.0%	
Merchant Banks	37.5%	
Cigarette & Other Tobacco Products Manufacturing Company	45.0%	
Listed Telecom Operators	40.0%	
Non-Listed Telecom Operators	45.0%	
Dividend Income	20.0%	

Source: Ministry of Finance

APPENDICES

CORPORATE TAX RATES

DESCRIPTIONS	CURRENT RATE
Net wealth up to BDT 30 million	Nil
BDT 30 million but not exceeding BDT 50 million	10.0%
BDT 50 million but not exceeding BDT 100 million	15%
BDT 100 million but not exceeding BDT 150 million	20.0%
BDT 150 million but not exceeding BDT 200 million	25.0%
Exceeding BDT 200 million	30.0%

Source: Ministry of Finance

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