CATALYZING GREATER FDI FOR VISION 2041: PRIORITIES FOR BUILDING A CONDUCIVE TAX SYSTEM IN BANGLADESH

FICCI
FOREIGN INVESTORS' CHAMBER OF COMMERCE & INDUSTRY

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CONDUCIVE TAX SYSTEM IN BANGLADESH

FICCI

The Foreign Investors' Chamber of Commerce & Industry (FICCI), an apex chamber of multinational companies has been working as the development frontier of Bangladesh by creating significant footprints in economic growth since its inception in 1963.

As a key economic partner of Bangladesh, FICCI has embraced several spirited actions that expresses their core priorities and the chamber aims to continue its engagement in bringing forth purposeful change through working more closely with the government. The chamber represents more than 200 Foreign Investors from thirty-five (35) countries across the globe in more than twenty-one (21) sectors in Bangladesh. Its member companies are actively participating and contributing to various economic decision making of the nation. As a member of the World Chamber in Paris, FICCI is thriving to continue its partnership in building this nation and is excited to observe Bangladesh's continued success and growth.

Over the last six decades, FICCI has been working with the government as a beacon of progress, forging connections between international investors and the Bangladeshi business community. FICCI has become an integral part of Bangladesh's transformation journey, bringing all the global best practices and knowledge transfer to the country.

With a steadfast vision of a thriving Bangladesh, FICCI has been acting as a development partner for the LDC graduation of the country by advocating for change, fostering policies, bringing technological know-hows, creating industry leadership and upskilled people, developing entrepreneurship and empowering the dynamic private sector.

FICCI, which is a major force in Bangladesh's economy has its members contribute to 30% of the government's internal revenue- which is 90% of FDI in Bangladesh. Its member companies are aligned with the government's goal and contributing more for the community and society which eventually supports the country to attain the status of "Smart Bangladesh" by 2041.

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FICCI
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CHAMBER OF COMMERCE & INDUSTRY

Strategic Partner

BIDA Bangladesh Investment Development Authority

ADB

Knowledge Partner

POLICY ExCHANGE BANGLADESH
Catalyzing Growth Solutions

PREFACE

One of the most important factors determining the attractiveness of business environment, is the level of tax burden or, more generally, tax policy. Among the many tools that countries employ to entice foreign direct investment (FDI), taxation emerges as a pivotal element that significantly impacts investment choices and how resources are allocated. FDI has consistently been acknowledged as a vital catalyst for economic growth and progress, playing a substantial role in fostering the movement of capital across borders, transferring technology, generating employment opportunities, and advancing industrial expansion. In Bangladesh's journey towards prosperity and attaining Vision 2041, private investments as well as revenue collection will need to be bolstered for vital resource allocation in critical sectors like education, skills, and health. FDI can play a pivotal role in that regard. In the pursuit of augmenting FDI inflows, governments globally are consistently investigating different strategies to draw in and maintain foreign investors. Within this array of policy instruments, taxation takes center stage as a critical determinant affecting FDI decisions and the strategies for distributing capital. It is in this context, and to mark its 60th founding anniversary, the Foreign Investors' Chamber of Commerce and Industries (FICCI), the apex business membership organization for foreign investors in Bangladesh, have taken the initiative to put together this important analytics to help Bangladesh in its continued effort to strengthen its investment climate including the tax framework for businesses.

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President, FICCI

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Sr. Vice President, FICCI

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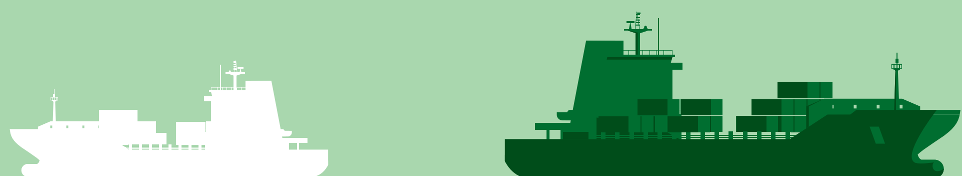

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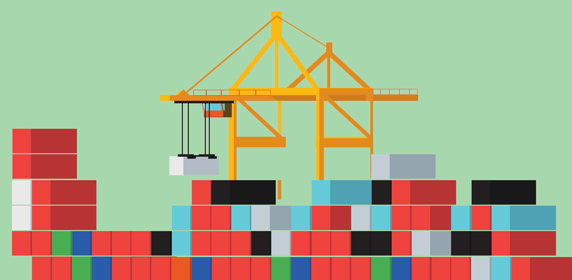

Acronym

4IR	4th Industrial Revolution
ADR	Alternate Dispute Resolution
APTA	Asia-Pacific Trade Agreement
BSTI	Bangladesh Standards and Testing Institution
BIDA	Bangladesh Investment Development Authority
BB	Bangladesh Bank
BEPZA	Bangladesh Export Processing Zones Authority
BHTPA	Bangladesh Hi-Tech Park Authority
BSW	Bangladesh Single Window
BEZA	Bangladesh Economic Zones Authority
BTS	Base Transceiver Stations
CIT	Corporate Income Tax
DTAA	Double Taxation Avoidance Agreements
DDT	Dividend Distribution Tax
DVS	Document Verification Systems
DFQF	Duty-Free Quota-Free
DDT	Dividend Distribution Tax
ETI	Enabling Trade Index
EPZ	Export processing zones
EMC	Electronics Manufacturing Clusters Scheme
ESDM	Electronics System Design and Manufacturing
FERA	Foreign Exchange Regulation Act
FDI	Foreign direct investment
FICCI	The Foreign Investors' Chamber of Commerce & Industry
FOREX	Foreign Exchange Act
FGD	Focus Group Discussions
FMCG	Fast-moving consumer goods
FTA	Free trade agreements
GVC	Global Value Chain
GSTI	Goods and Services Tax
GDP	Gross Domestic Product
GCI	Global Competitiveness Index
GP	Grameen Phone
GE	General Electric
GST	Goods and Services Tax
HTZ	High-Tech Zones
ITO	Income Tax Ordinance
ICT	Information and communication technology
ITA	Income Tax Act
GVC	Global Value Chain
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ITO	Income Tax Ordinance
ICT	Information and communication technology
ITA	Income Tax Act
IT	Information Technology
ITP	Information Technology Parks
IIA	International investment agreements
IMF	International Monetary Fund's
KII	Key Informant Interviews
LDC	Least Developed Country
LPI	Logistics Performance Index
LC	Letters of Credit
LIC	Low-income countries
MTRS	Medium-Term Revenue Collection Strategy
MNE	Multinational enterprise
MSME	Micro, Small, and Medium Enterprises
METR/AETR	Marginal and average effective tax rates
MFN	Most favored nation
MW	Megawatts
MEITY	Ministry of Electronics and Information Technology
NRTA	Non-Resident Taka Account
NBR	National Board of Revenue
OSS	One-Stop-Shop
PPP	Public Private Partnership
PSMP	Private Sector Master Plan
PPE	Personal protective equipment
PLI	Production Linked Incentive Scheme
QR	Quantitative restrictions
R&D	Research and development
RJSC	Registrar of Joint Stock Company
RKC	Revised Kyoto Convention
RMG	Ready-Made Garments
RBI	Reserve Bank of India
SEZ	Special Economic Zones
SDG	Sustainable Development Goal
SOE	State-Owned Enterprises
SAFTA	South Asian Free Trade Agreement
TIN	Tax Identification Numbers
TDS	Tax Deducted at Source
TFI	Trade Freedom Index
UMIC	Upper middle-income countries
VAT	Value Added Tax
WEF	World Economic Forum
WTO	World Trade Organization

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EXECUTIVE SUMMARY

A. Bangladesh Secured Impressive Development Gains Propelled by Trade and Private Investment

Bangladesh's development journey is a tale of extraordinary progress, defined by resilience and unwavering determination. Realizing consistently high GDP growth rates, averaging around 6% over two decades and remarkable strides in poverty reduction and human development, the nation now aspires to attain high-income status by 2041.

AVERAGE GDP GROWTH IN 2016-2021

Bangladesh
6.4%

Vietnam
5.4%

LMIC **3.1%**

$500Billion
Economy by 2025- 2026 according to Standard Chartered Bank

7.1%
growth till 2030 by HSBC

28th largest economy of World by 2030 according to PWC

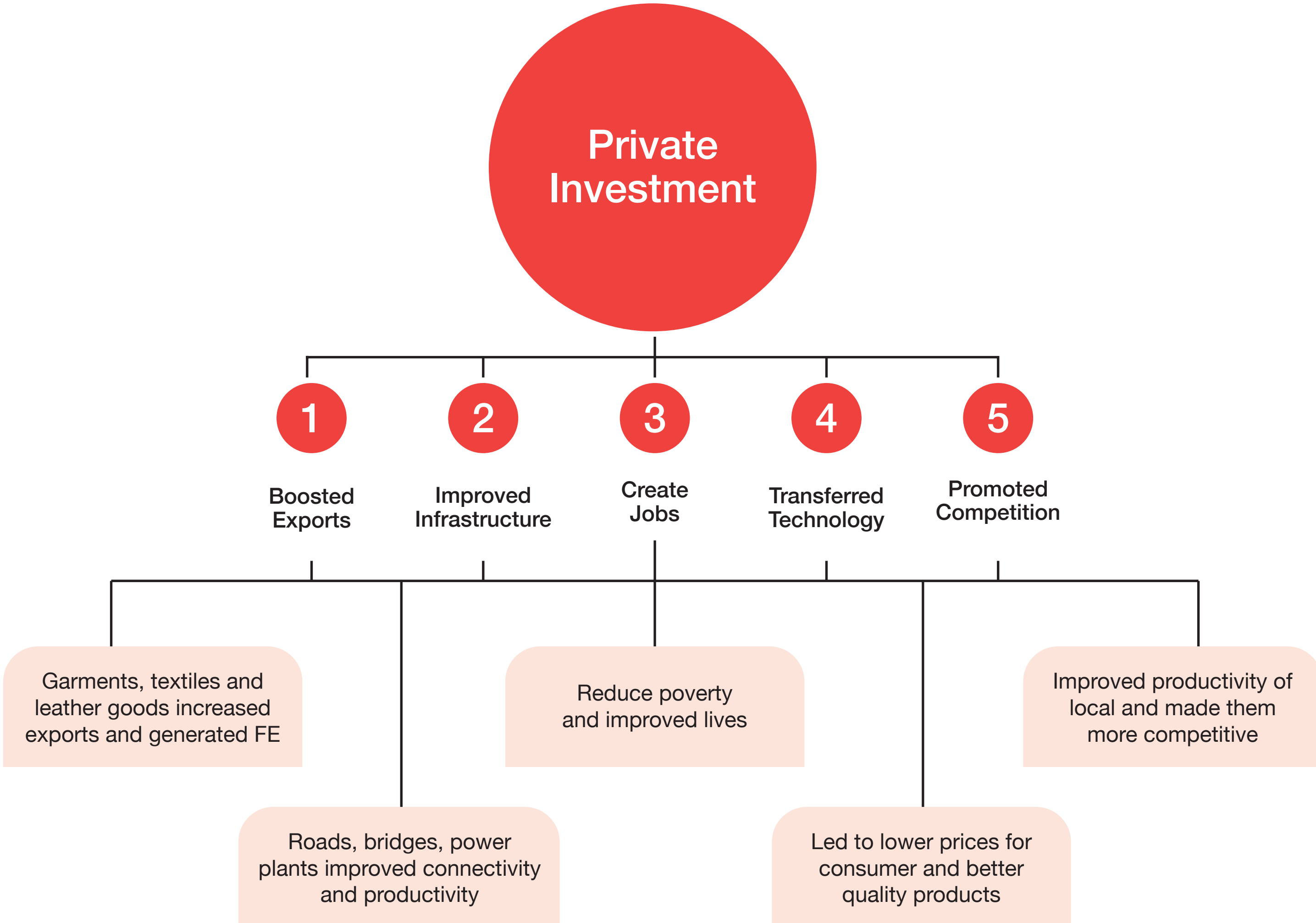
Reduction of poverty
From **48.9%** in 2000 to **18.7%** in 2022

Private investment comprises **76%** of total investment

Average growth of exports is **10.25%** since 2001

Aspiration for upper middle income country by **2031** and developed country by **2041**

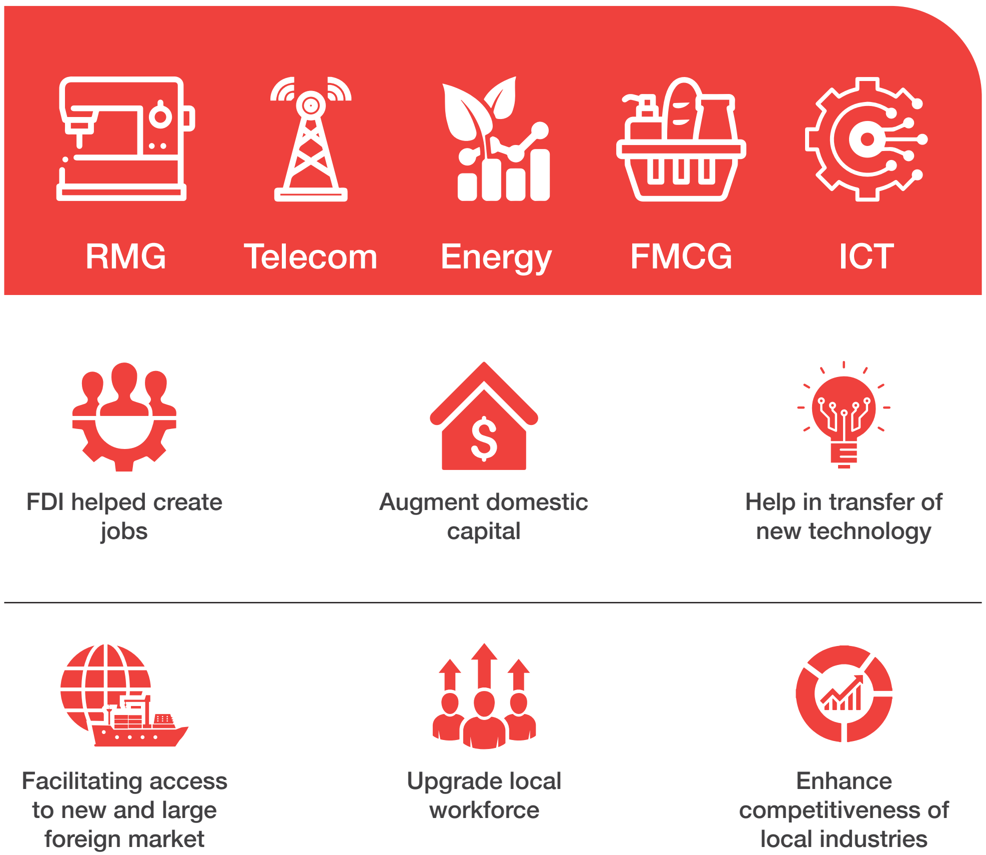
The country's impressive development has been significantly propelled by trade and a surge in private investments. Accounting for 76% of total investments in the last 5 decades, private investment has not only facilitated innovation and job creation, but has also catalyzed substantial advancements in education and healthcare.



B. Foreign Direct Investment (FDI) Helped Growth of Important Industries, Infrastructure and Technology Diffusion with Untapped Potential

FDI-driven transformations have solidified Bangladesh's connectivity, energy security, and technological prowess, positioning it regionally and globally. FDI has played a pivotal role in Bangladesh's progress, driving growth, innovation and resilience. The transformative power of FDI in Bangladesh is most apparent in sectors that have witnessed a large influx of investment and RMG, telecommunications and energy stand out as vivid examples.

RMG, Telecommunication, Energy, FMCG and ICT sectors have largely benefitted from Influx of FDI



C. Investment, FDI and Stronger Tax Revenue Will be Critical to Attain Vision 2041

Vision 2041's ambition to having a smart economy, elevate living standards and establish modern infrastructure is closely intertwined with the contributions of FDI. Private investment, including FDI, has a pivotal role to play in helping Bangladesh to achieve its target of upper middle and higher income status.

FDI across sectors drives economic growth, job creation, higher incomes and improved living standards. It also brings expertise, technology and innovation, aligning with the vision of a smart economy. Additionally, jobs and higher income has the potential to aid revenue mobilization, an area that needs significant attention in order to meet the ambitious targets and spending requirements of the government.

Economic targets set by Vision 2041

GoB spending on **Health** **$47** billion **(2% of GDP)**

FDI needs to be **$69.99** billion **(3% of GDP)**

GDP needs to be **$2333.11 billion**

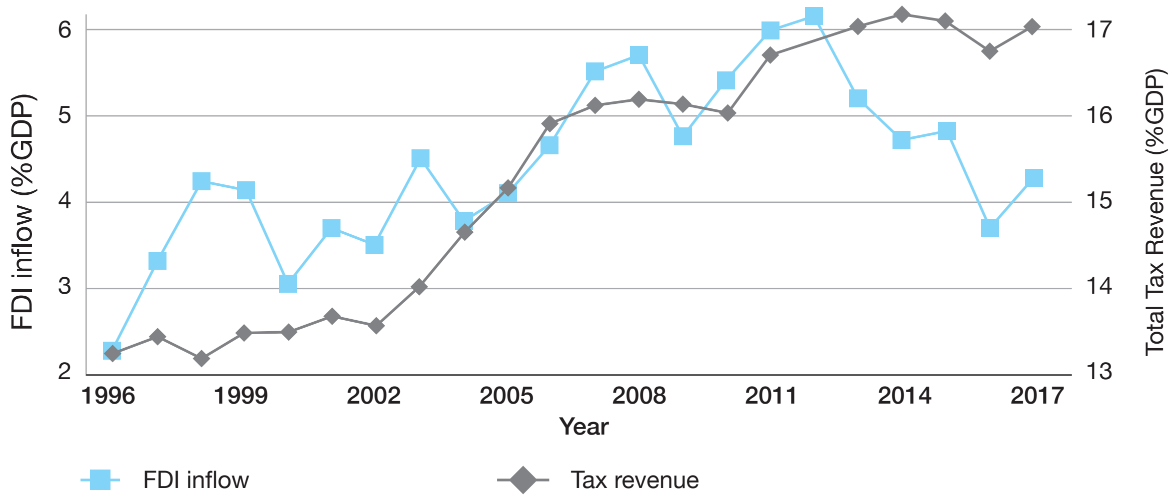
Private Investment needs to be **$848.32** billion **(36.36% of GDP)**

Total Government Revenue needs to be **$563.45 billion** **(24.15% of GDP)**

Investment in Infrastructure and Logistics needs to be **$163.32 billion** **(7% of GDP)**

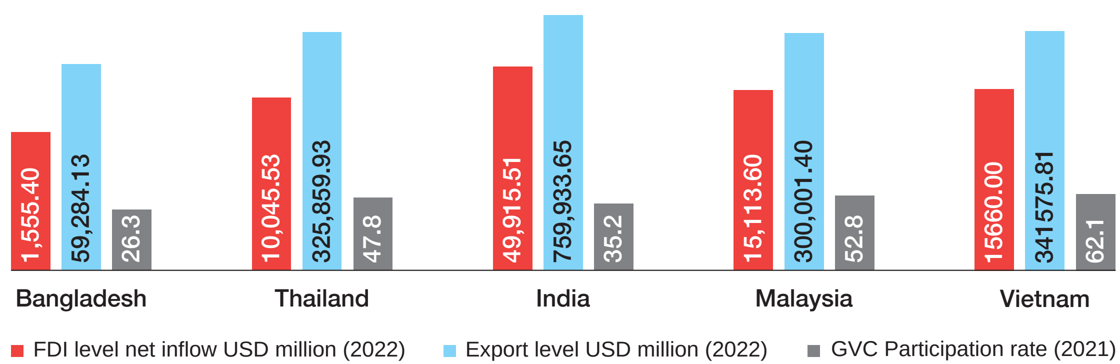
GoB spending on **Education** **$93.32** billion **(4% of GDP)**

Trends of FDI inflows and Tax revenues



In developing countries, FDI inflow affected the tax revenue positively

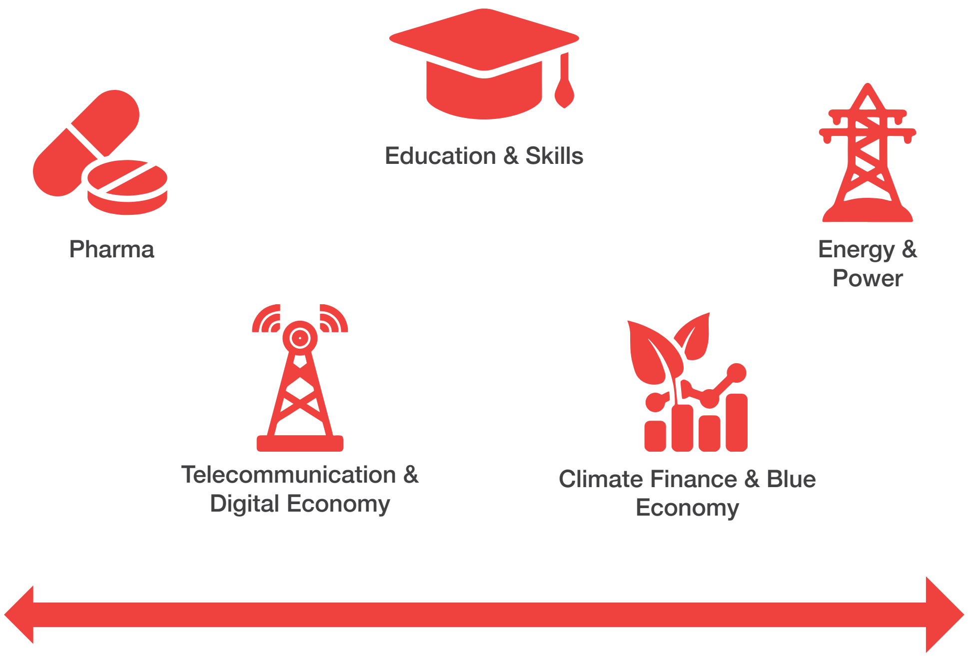
Level of FDI and GVC participation of Bangladesh & comparator countries



Bangladesh's FDI inflow and Global Value Chain (GVC) integration lower than potential and comparators

Source: World Bank and ADB

Key sectors outlined in Perspective Plan 2041 that requires major private investment



D. Several Factors Hinder FDI in Bangladesh, Collectively Diminishing its Appeal as an Investment Destination

Trade Logistics and Infrastructure	Investment Policy and Business Regulations, including investor aftercare	Productivity (e.g. skills, technology adoption)	Lack of depth in the financial sector	Tax Environment

E. Tax Policies Play a Significant Role in FDI Decisions

Taxation policies, including corporate income tax rates and incentives, significantly influence foreign investors' decisions. Studies consistently show that lower corporate tax rates correlate with higher FDI. High tax rates reduce investment returns and deter FDI inflows. Recent research highlights the increasing sensitivity of FDI to taxation due to the removal of non-tax barriers globally.

Studies reveal higher taxes deter FDI, while lower taxes attract it

On average, FDI tends to decrease by 3.7% following a 1 percentage point increase in the tax rate on FDI.

Global evidence indicates there is an inverse relationship between tax rates and FDI inflows.

F. Investment Climate in Bangladesh Faces Several Tax-Related Challenges

Bangladesh's tax policy, while designed to support economic development, exhibits issues that can affect its alignment with FDI goals.

Income Tax Act 2023

- Tax administration and transparency

VAT and SD Act 2012

- Complex input-output coeffitient
- Illogical definition of input material for the input tax credit
- Higher rate of Advance VAT (AT)

Customs Act 1969

- Complex tariff structure
- Customs valuation disputes
- Non-tariff barriers (import licensing requirements, product standards and testing regulations)

Bangladesh's Tax system has Major Gaps when Compared to International Tax Principles

Neutrality	Effectiveness & Fairness	Efficiency	Flexibility	Certainty & Simplicity

Key Challenges in Bangladesh's Tax Environment

Un-Conducive Policies
- Lack of overarching strategy and coordination
- Not aligned to FDI priorities and needs
- High effective tax rates

Tax Compliance
- Unclear Process
- Complicated and contradicting regulations

Tax Disputes and Legal Hassles
- Limited experts and high costs
- Interpretational confusions
- Lack of effective Alternative Dispute Resolution (ADR)

Lack of Predictability
- Constant changes and lack of advanced ruling
- Investor uncertainty

Effectiveness of Tax Incentives and Hurdles in Claiming tax Benefits
- High bureaucracy
- Ambiguity in procedures
- Authorization issues/registration issues/hidden costs

Digitalization Challenges
- ICT-led tax administration lacking
- Integration issues

International Tax Treaties
- Lack of Double Taxation Avoidance Agreements (DTAAS)
- Existing not always followed/respected

High Total Tax Incidence
- Minimum Tax & Double Taxation
- Tax deducted at source
- Different thresholds and rates in VAT

Provisions within the Customs Act 1969 in Bangladesh have inadvertently created an environment marked by a lack of transparency, predictability and investor compliance, particularly impacting foreign investors.

Harmonization & Standardization Issues	• WTO inconsistencies: The minimum price system under Section 25 clashes with WTO rules • Minimum/tariff value higher than international customs price • Not aligned with WCO guidelines
Transparency Issues	• Dearth of clarity in customs decisions • Sections of concern: Sections 65, 71, 94, 204, 204A and 215A(1) contribute to uncertainty • Low Transparency: Section 79C adds to uncertainty
Simplification	• Procedural delays • Bureaucratic issues • Absence of limitation on fee amounts

G. Empirical Analysis Confirms Both Tax Revenue and FDI Would Likely Increase if Tax Environment for FDI is Made More Conducive

FDI can reach as high as:

- $6.6Bn by 2025
- $20Bn by 2031
- $50Bn by 2041, with effective and prudent reforms in tax environment

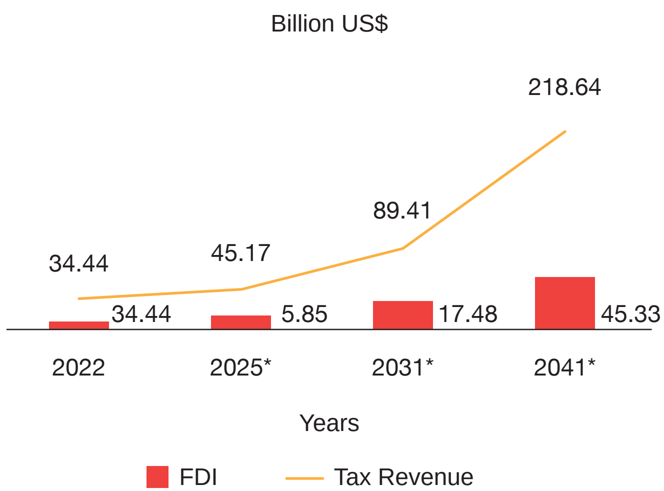
GoB Tax Revenue can reach as high as:

- $45.9Bn by 2025
- $92Bn by 2031
- $227Bn by 2041, in scenario with tax reforms (compared to only $98Bn without reforms)

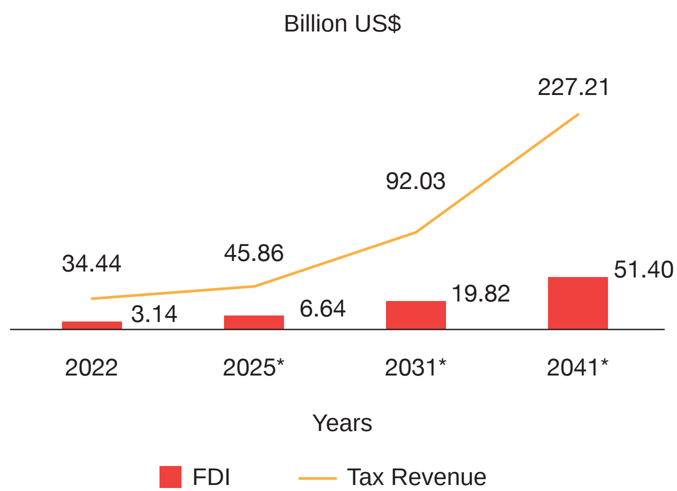
Impact of Changes in Tax Environment on FDI and Tax Revenue (Summary of Regression Results)

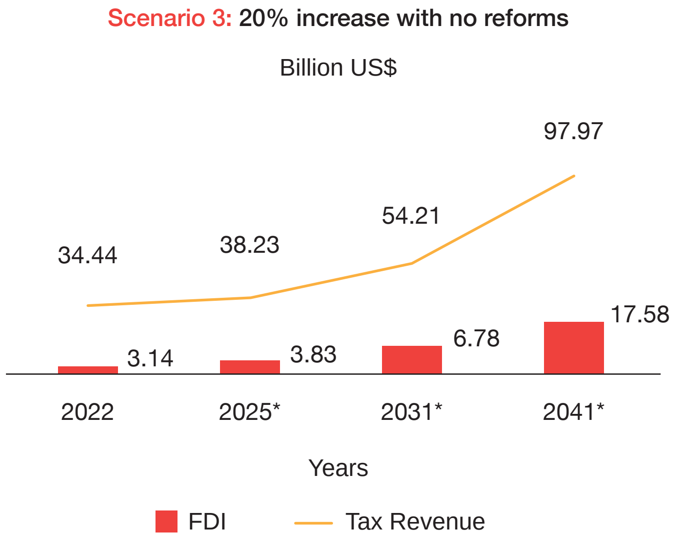
Scenario	Description	Tax rate through 2031	FDI changes by 2041 (approx.)	Revenue changes in 2041 (approx.)
1	20% reduction	24	14.4x increase	6.3x increase
2	Sharp 33% reduction	20	16x increase	6.6x increase
3	20% increase	36	5.6x increase	2.8x increase
4	Sharp 33% increase	40	2.5x increase	2x increase

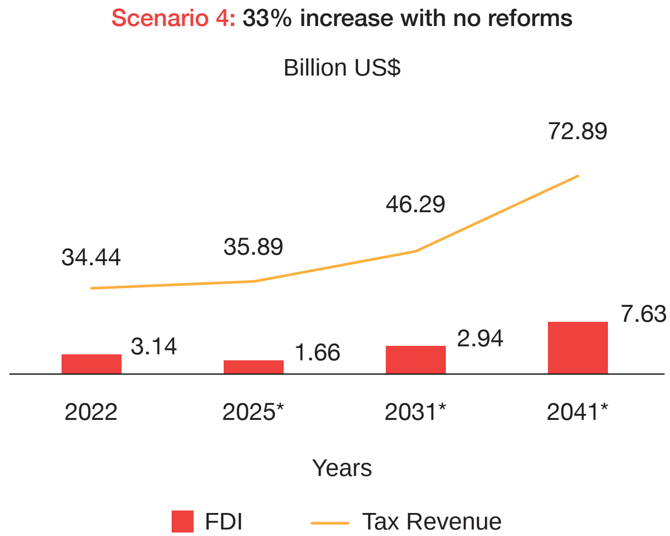
Scenario 1: 20% reduction in Tax and reforms



Scenario 2: 33% reduction with reforms





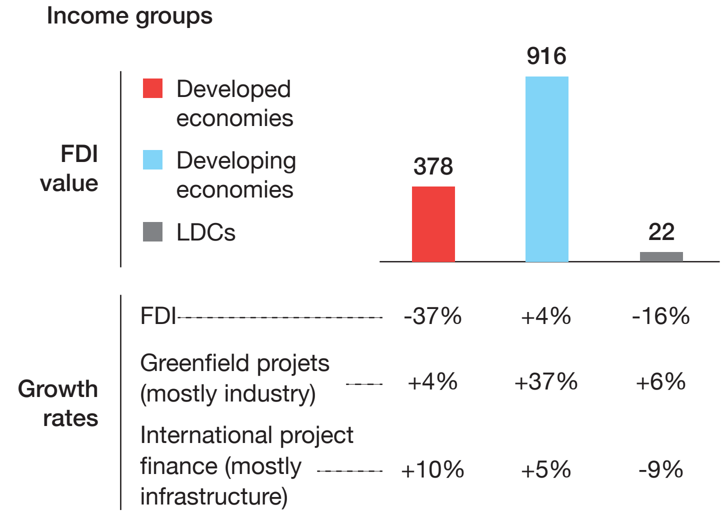


H. In the Wake of Global Economic Shifts, Investment Policies are Gaining Greater Importance as Determinant of Success for FDI Attraction and Retention FDI

Attractive tax policies globally have helped foster economic growth, technological advancement and global integration. In the dynamic global economic landscape, the art of attracting FDI has transcended into a strategic endeavor. The year 2022 witnessed an upsurge in investment-friendly policies, showcasing a resurgence of commitment towards creating an environment conducive to FDI. 66 countries enacted 146 policy measures designed to impact foreign investment. Investment-friendly policies, including tax incentives, played a pivotal role, comprising 52% of favorable measures. Additionally, 40 developing countries offered fiscal benefits to lure investors, emphasizing the importance of tax incentives in promoting FDI amid evolving global economic dynamics.

Project Activity in Developing Countries Continue to Grow, as they Account for 70% of Global FDI in 2023

Tax incentives, played a pivotal role, comprising 52% of measures globally, reflecting the growing importance of taxation as non-tax barriers to FDI are being removed globally.



Source: World Investment Report, 2023

Developing countries offered various fiscal benefits to lure investors and witnessed a growth in FDI of 4%, in comparison to Developed Economies and LDCs, where FDI fell in 2023.

Tax Investment Incentives Introduced by Developing Countries

Country	Incentives
Algeria	Exemption of most taxes, duties and levies within free trade zones.
Argentina	Tax benefits for automotive industry investors, including accelerated depreciation, VAT refund and full exemption from export duties for manufactured goods.
Egypt	Incentives on FDI-funded projects in key industries, offering up to 55% of tax value on generated income.
Ethiopia	Income tax exemption for investors from business license or expansion permit date.
Saudi Arabia	Special Integrated Logistics Zone with a 50-year tax holiday for investors (including 100% foreign ownership), along with VAT advantages for servicing.

A range of incentives offered across different countries, featuring tax exemptions, VAT advantages and additional perks like duty-free imports and foreign ownership opportunities.

I. Global Best Practices: How Vietnam and India Created a Conducive Tax Framework Bolstering Competitive Edge in the Global Investment Landscape

Steps taken by India to enhance FDI

Flat reduction of corporate tax rate with gradual phasing out of exemption/incentives	Targeted Tax Breaks for specific sectors	GST Simplification	Abolishment of Divident Distribution Tax (DDT)
Double Tax Avoidance Agreements (DTAAs)	Quick resolution of disputes under Vishwas Act, 2020	Simplification of direct tax laws and easing of compliance	Reduction in litigation measures

Vietnam's Tax Incentive Startegy

Preferential tax rates for specific sectors	Tax holidays and reduced CIT for investing in specific zones and disadvantaged area	Customs duty incentives	Land rental exemption for new investors

Key Lessons for Bangladesh from Vietnam and India Example to significantly improve investment climate and boost FDI

Lowering corporate tax rates can significantly boost FDI

Streamlined regulatory functions including claiming benefits and settling disputes enhances investor confidence

Harmonizing and simplification of regulations enhances investor confidence and compliance

Having a medium-term startegy for investments and policies in-line with FDI enhances

Comprehensive tax incentives (tax holidays, VAT, import duty reductions, land) for priority sectors

Encouraging foreign ownership and respecting international treaties boosts FDI

J. Concrete Improvement Opportunities in Tax Policies

Reforms in Tax Environment as per OECD Principles

Ensuring Neutrality
Removing double taxation
Respecting DTAA

Ensuring Effectiveness & Faireness
Tax on Income and not on Payments
Repealing Minimum Taxation
Gradual Removal of Tax Deductions at Source (TDS)
Rationalizing Non-Resident Taxation
Rationalization of Advance Value Added Tax Rates
Streamlining Tax Incentives
Withdrawal of Minimum Tariff Value
Rectifying Tax Deduction on Recognized funds

Enhancing Efficiency
Rationalizing Promotional Expenses
Rationalizing Expenditure Limits
Withdrawal of Redundant Tax Deduction

Enhancing Flexibility

Regular Stakeholder Consultation for Continuous Improvements

Prioritization of Investor Concerns and Tax Reforms

Enhanced Automation of Tax System

Increased Coordination between Tax Authorities and Relevant Agencies

Ensuring Certainty and Simplicity

- Tax Rates on a Prospective Basis
- Having a Medium-Long Term Taxation Strategy in line with Government Vision
- Single VAT Rate
- No Withholding VAT
- Withdrawing Restrictions on Definition of Input
- Withholding Tax Rate lower than Legitimate Corporate Tax Rate

Recommendations for Simplification and Streamlining Customs Procedures

Simplification
Expedited Customs Decisions and Fee Transparency
Advance Rulings on Tariff Classification Questions
Raising Minimum Duty and Tax Collection Threshold
Enhancement of Risk-Based Customs Clearance Management
Flexible Customs Clearance Processes

Standardization
Compliance with WTO Valuation Rules
Legal Authority for Automated Risk Management
Grounds for Annulment and Revocation of Decisions
General Rules for Customs Guarantee
Clarity on Rights and Obligations for Imported Goods
Responsibilities and Liability of Importers, Exporters, and Agents
Inclusion of Laboratory and Testing Provisions

Transparency
Transparency in Customs Decisions
Stakeholder Input on Proposed Customs Rules
Cross-Referencing Sectoral Product Requirements
Coordinated Physical Examinations

Priority Areas to Enhance Broader Investment Climate and Overall Investors' Confidence

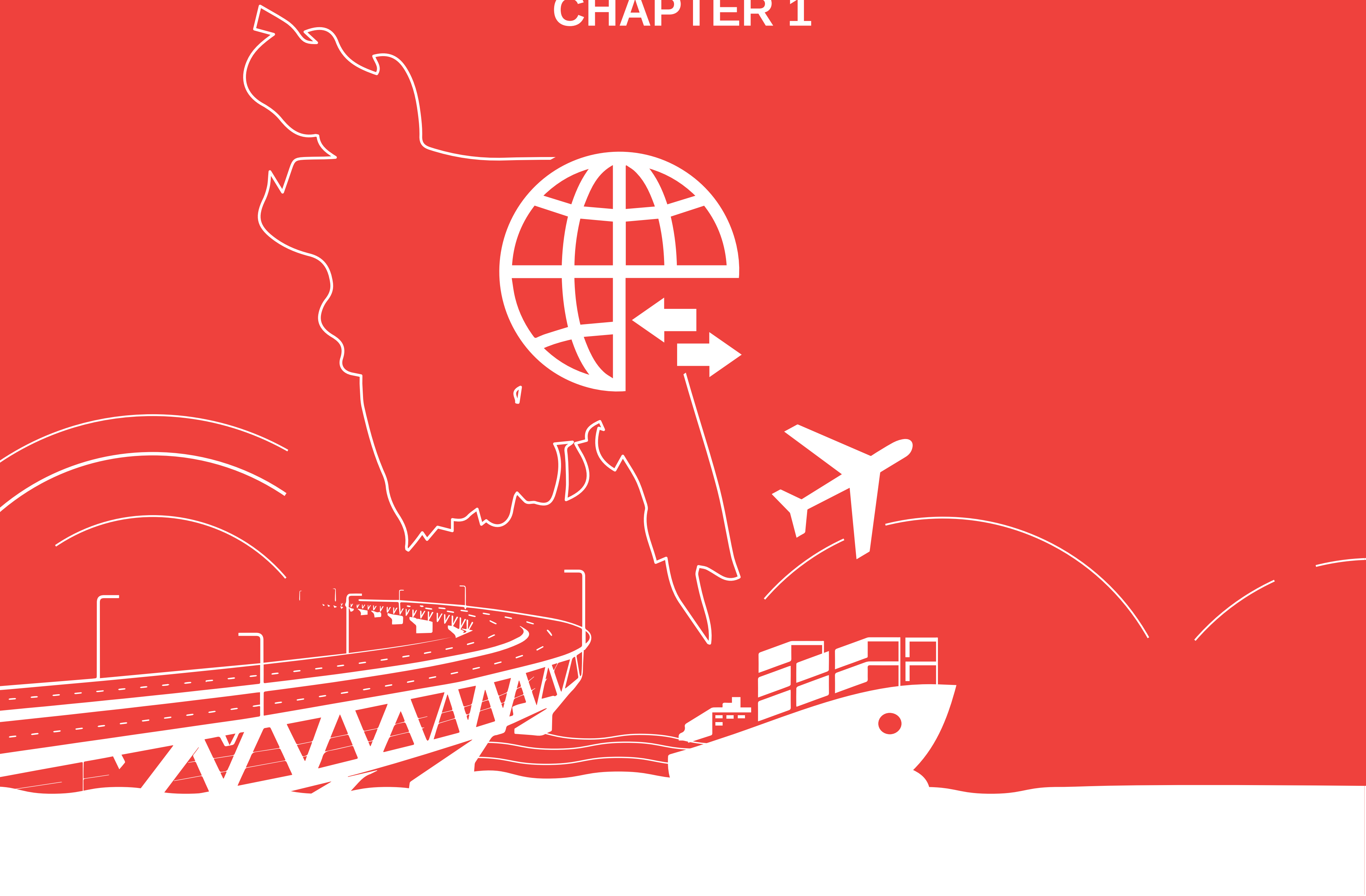
Investment Climate Area	Recommendations	Leading Institutions	Time Required
Business Regulations	Modernizing archaic laws such as the Companies Act 1994, Competition Act 2012, Intellectual Property Rights (IPR) framework and Import and Exports Control Act 1950.	Ministry of Law, Justice and Parliamentary Affairs, Ministry of Finance, Ministry of Commerce	Medium-Term
	Utilization of new generation promotion mechanisms by Investment Promotion Agencies.	PMO, BIDA, BEZA, BHTPA, PPA, and BEPZA	Short-Term
	Develop Standard Operating Procedures (SOPs) to reduce the regulatory burden and bring predictability in regulatory service delivery.	BIDA, BEZA, BHTPA, PPPA and BEPZA	Short-Term
	Introduction of systemic methods such as Regulatory Impact Assessment (RIA) and Feedback Loop to improve regulatory service delivery.	Ministry of Law, Cabinet Division, BIDA	Medium-Term
	Establishing an online portal containing all information relevant to regulatory delivery.	BIDA, BEZA, BHTPA, PPPA and BEPZA	Short-Term
	Revitalizing certain laws such as The Company's Act; Review sectoral licensing regulations for priority export and domestic sectors.	Ministry of Law, Justice and Parliamentary Affairs, Ministry of Finance, Ministry of Commerce	Short-Term
	Introducing a system that accommodates innovative business activities and start-ups.	BIDA, ICT Division, Startup Bangladesh Ltd.	Short-Term
	Introduce and publish a regulatory calendar at the beginning of a fiscal year indicating all upcoming laws for the year.	Ministry of Law, BIDA	Short-Term

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Access to Land	Increasing transparency of the Land Offices and Sub-Registry Offices service by making information on service standards publicly available.	Ministry of Land, RAJUK	Medium-Term
	Computerizing/digitizing all land records and property title registration.		
Infrastructure and Logistics	Strengthen institutional and implementation capacities with regards to PPPs: Review PPP Law and relevant regulations for more effective implementation.	PPPA	Medium-Term
	Financing infrastructure projects by sovereign bond issuance.	Bangladesh Bank, PMO, Ministry of Finance, Securities and Exchange Commission	Medium-Term
	Developing domestic capital markets and issuance of local currency bonds offshore.	Bangladesh Bank, PMO, Ministry of Finance, Securities and Exchange Commission	Medium-Term
	Selection of Economic Zones should be based on careful feasibility studies and competitive analysis.	BEZA, PMO	Medium-Term
	Develop National Logistics Policy and Masterplan; Allow more ICDs and streamline bonded requirements for various modes of logistics transportation including air shipments; Expedite development of Bay Container Terminal.	PMO, Ministry of Shipping, Ministry of Commerce, NBR, Ministry of Civil Aviation, Railways	Medium-Term

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Skills and Productivity	The skills eco-system requires several policy and strategic initiatives which are as follows:	NSDA, Ministry of Education, Industry Skills Council	Long-Term
	Developing long-term skills strategy/Master plan/Program aligning with national growth strategies and projected key growth drivers.		
	Public Private Partnership in delivery of skills. This is critical in high skills matching and high employment outcomes.		
	Greater business orientation of Private Training Providers.		
Commercial Dispute Resolution	Enforce the mandatory mediation provisions through adoption of the administering rules to support the implementation and create of the necessary infrastructure to operationalize mediation.	High Court Division of the Supreme Court of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs	Short-Term
	Establishing time limits for certain stages of court cases and monitoring compliance.	High Court Division of the Supreme Court of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs	Medium-Term
	Amend the Bangladesh Arbitration Act 2001 to improve implementation.	Ministry of Law, Justice and Parliamentary Affairs	

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Trade Facilitation	Adopting certain policy measures such as reducing para-tariffs can support in inducing more trade and thus increasing private investment and FDI.	NBR, PMO	Medium-Term
Technology Diffusion	Reducing the cost of internet connection.	ICT Ministry, NBR	Short-Term
	Gradually build up Bangladesh's technology extension system to support upgrading in more advanced firms and sectors.	PMO, ICT Ministry	Medium-Term
Access to Finance	Implementing a modern resolution framework for distressed assets.	Bangladesh Bank	Short-Term
	Developing local capital markets as a source of long-term finance.	Bangladesh Bank, Bangladesh Securities and Exchange Commission	Medium-Term
	Stimulate the corporate debt market by correct reforms.		
	Develop a domestic green bond market to mobilize private capital for climate-related initiatives.		

CHAPTER 1



INTRODUCTION: BANGLADESH DEVELOPMENT CONTEXT AND PRIORITIES GOING FORWARD

Chapter at a Glance

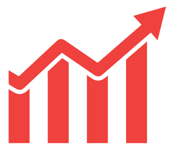
Bangladesh Development Aspirations and Challenges

6% Average GDP growth rate over the last two decades

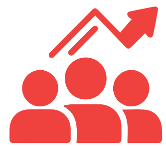
$500 Billion Economy by 2026 (SCB and the IMF)

28th Largest economy as soon as 2030 (PWC)

84% Excessive concentration on RMG products



Demographic dividend, an asset that requires full utilization through skill development and job creation



LDC Graduation-losing access to preferential trade benefits and policy space

7.6% Tax-GDP ratio in 2022 Bangladesh needs substantial tax reforms and fiscal management for crafting sustainable revenue streams

Objectives of the Study

- Understand the importance of Private Investment and FDI for Bangladesh's development
- Identify the prominent role of tax environment in FDI decisions
- Identify the relationship between tax, FDI and revenue generation
- Critically assess Bangladesh's tax system and how it hinders FDI
- Highlight the international best practices in attracting FDI
- Find the gaps and reform opportunities specific to the sectors

Approach and Methodology of the Study

- Desk Research- Review of secondary literature and Analysis of publicly available data
- KIIs and consultations with Foreign Investors and government officers
- FGDs with Business Chambers and Practitioners
- Identification of best practices & deriving lessons
- Identifying impact of reforms on FDI and Tax Revenue
- Recommendations on optimal tax burden
- Time-bound strategies for enhancing FDI

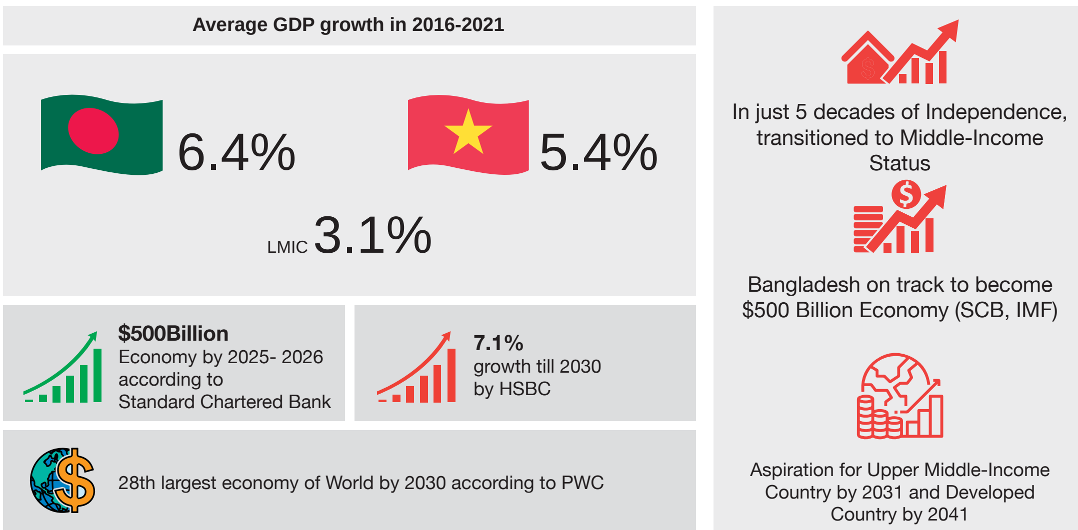
CHAPTER 1

INTRODUCTION: BANGLADESH DEVELOPMENT CONTEXT AND PRIORITIES GOING FORWARD

1.1 Bangladesh Secured Robust, Consistent Growth Performance

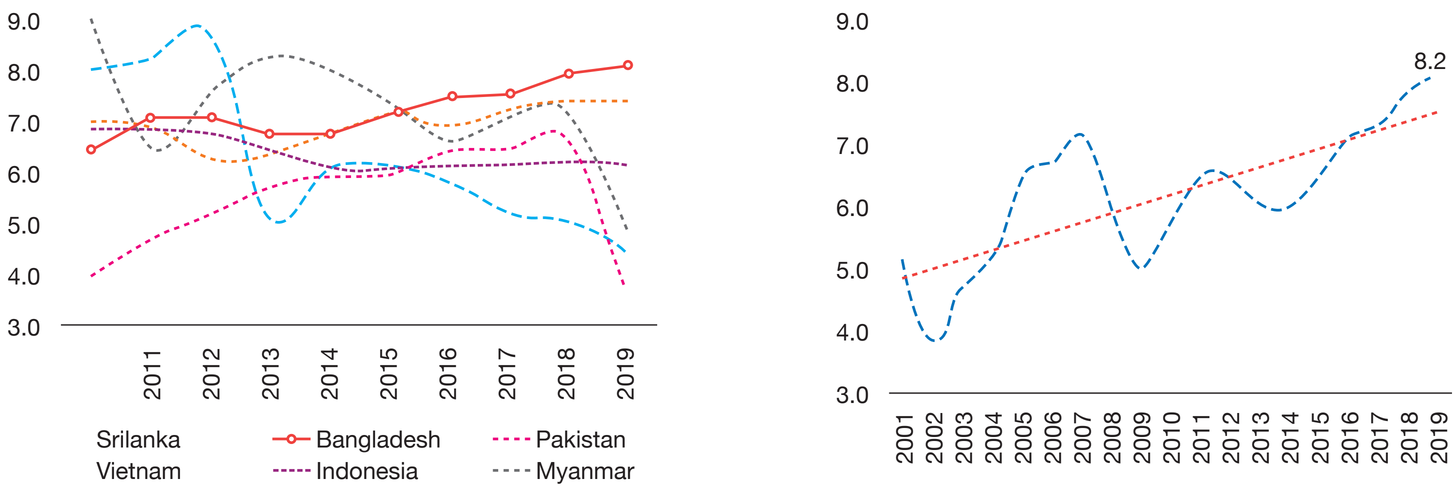
Bangladesh's developmental narrative is a blend of resilience, determination, and progress. Over the past few decades, the nation has achieved substantial economic growth, transforming from an agrarian economy to one that boasts a significant industrial and services sector. The nation's Gross Domestic Product (GDP) growth rate has been consistently commendable, averaging around 6% over the last two decades. Additionally, efforts to improve human development indicators have borne fruit, with significant strides made in reducing poverty and improving social indicators. With extreme poverty rate plummeting to 14.9% in 2016 from 46% in 1991 and remarkable achievements in human development, Bangladesh has taken significant steps toward reaching the first Sustainable Development Goal (SDG) target of eradicating extreme poverty by 2030. Building on these impressive records, Bangladesh has laid out its grand vision to become a 'High-Income Country' by 2041.

Figure 1: Bangladesh's Rampant Growth and Development Performance



Bangladesh's stellar development so far has primarily been global trade and investment led. Over the years, Bangladesh became an important player in the global textile and ready-made garments value chain, which accounts for more than half of manufacturing employment. Exports from Bangladesh have recorded an annual average growth of about 10.25% since 2001[1] while employment in the textile and ready-made garment sector grew 11% a year between 2003 and 2010, outpacing all other nonagricultural sectors[2]. Bangladesh's robust export achievements, coupled with advancements in human development, have strategically positioned the country to attain a $500 billion economy by 2026, as projected by research from SCB and the IMF. Additionally, Bangladesh is expected to ascend to the ranks of the world's 28th largest economy as soon as 2030, as forecasted by PwC.

Figure 2: Growth Trend of Bangladesh and Comparison to Selected Asian Countries



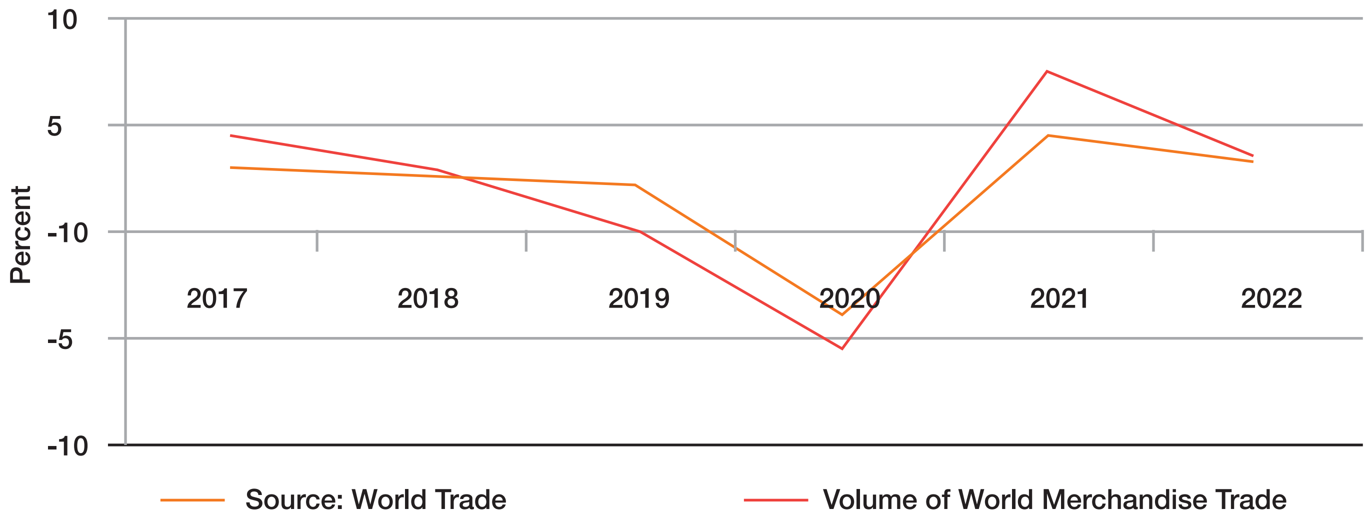
Source: World Bank, Bangladesh Bank, IDLC-SL Reseach

Countries that are generally open to international trade tend to grow faster. Global trade and GDP are intertwined, as shown in the figure below. Deeper trade integration helps improve productivity and provide higher income to their people, as trade presents new opportunities and opens up markets. Increased trade leads to a multiplied expansion of the economy and leads to higher employment and a more equitable standard of living. Due to comparative advantages associated with trade and the increase in market access, developing countries are given the platform to earn a higher return than before by being able to sell at a higher price. International trade has a positive effect across a variety of channels that includes fostering productivity growth and exposure to high quality products, services and processes that leads to higher proliferation of technical capacity over time. According to the 2030 Agenda for Sustainable Development, trade has been regarded as an engine for inclusive economic growth and poverty reduction. Going forward, Bangladesh has to use the international market even more intensively to create employment for youths entering the labor force every year, as exports will continue to be a key drivers of GDP growth and jobs.

[1]Export Performance of Bangladesh during the Pandemic: the Impact of Export Concentration (2022), Bangladesh Bank

[2]Moving Forward: Connectivity and Logistics to Sustain Bangladesh's Success, World Bank 2021

Figure 3: Global Trade and Global GDP, Intertwined



As Bangladesh continues its remarkable journey of development, it envisions a future characterized by even greater prosperity and global prominence. The nation is determined to transition from its current status as a lower-middle-income economy to a 'High-Income Country' by 2041. This ambitious objective is rooted in the belief that Bangladesh's potential for growth and transformation is boundless. To achieve this, the country aims to diversify its economic landscape, reduce inequality, strengthen governance, and invest in human capital. Bangladesh aspires to emerge as a knowledge-based society, harnessing the power of innovation and technology to drive sustainable economic growth. Furthermore, the nation is committed to playing a pivotal role in regional and global affairs. With this vision firmly in place, Bangladesh embarks on a transformative journey, driven by the principles of inclusivity, sustainability, and progress for all its citizens.

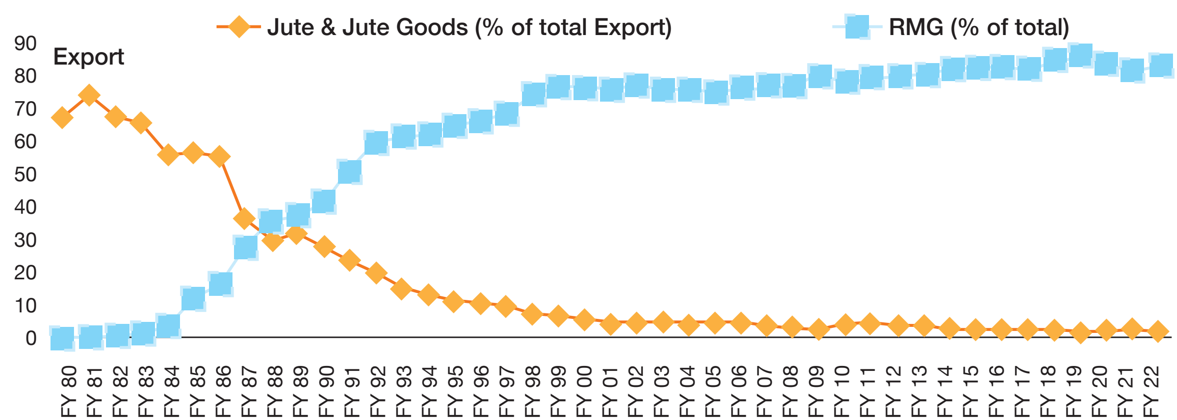
In the intricate tapestry of global economies, Bangladesh stands as a nation that has traversed remarkable strides on its developmental journey. Yet, the path to progress is not without challenges. The confluence of the Covid-19 pandemic and geopolitical upheavals, exemplified by the Ukraine-Russia conflict, has ignited a nexus of issues within the country. These challenges are acutely felt in the form of rising living costs, unemployment surges, and energy deficiencies, underscoring the need for a robust strategy to steer the nation toward sustained prosperity. The years ahead hold pivotal significance, as Bangladesh aspires to graduate from its Least Developed Country (LDC) status, consolidate the gains of its two-decade growth trajectory, and crystallize its vision of attaining high-income country status by 2041.

12 Economic Diversification, Productivity Enhancement and Enhancing Tax Revenue: Bangladesh's Top Development and Growth Priorities

Bangladesh faces an array of challenges that demand strategic and comprehensive solutions. Foremost among these challenges are the pressing imperatives of export diversification, job creation and fiscal strengthening. This chapter encapsulates the multifaceted developmental landscape of Bangladesh, focusing on its imperatives for export diversification, job creation and fiscal resilience.

Bangladesh's export-led growth, led by the garment sector, faces vulnerability and requires diversification for sustained development. At the heart of Bangladesh's remarkable developmental trajectory lies its export-led growth model, with the garment sector being the vanguard of this success story. However, the risks of over-reliance on this sector are vividly evident. A dire need for diversification emerges, as the country's vulnerability to external shocks is palpable. The excessive concentration on Ready-Made Garments (RMG) products, which constitute about 84% of the export basket, exposes the economy to turbulence. A crucial turning point looms as Bangladesh prepares to graduate from LDC status in 2024, losing access to preferential trade benefits and policy space. This transformation necessitates urgent exploration of new economic avenues to ensure sustained growth. While some diversification has occurred, the pace and scale have been insufficient to mitigate the risks posed by over-concentration on a single sector. To achieve true diversification, Bangladesh must harness its competitive advantages, invest in research and innovation and strategically enter higher-value markets and industries.

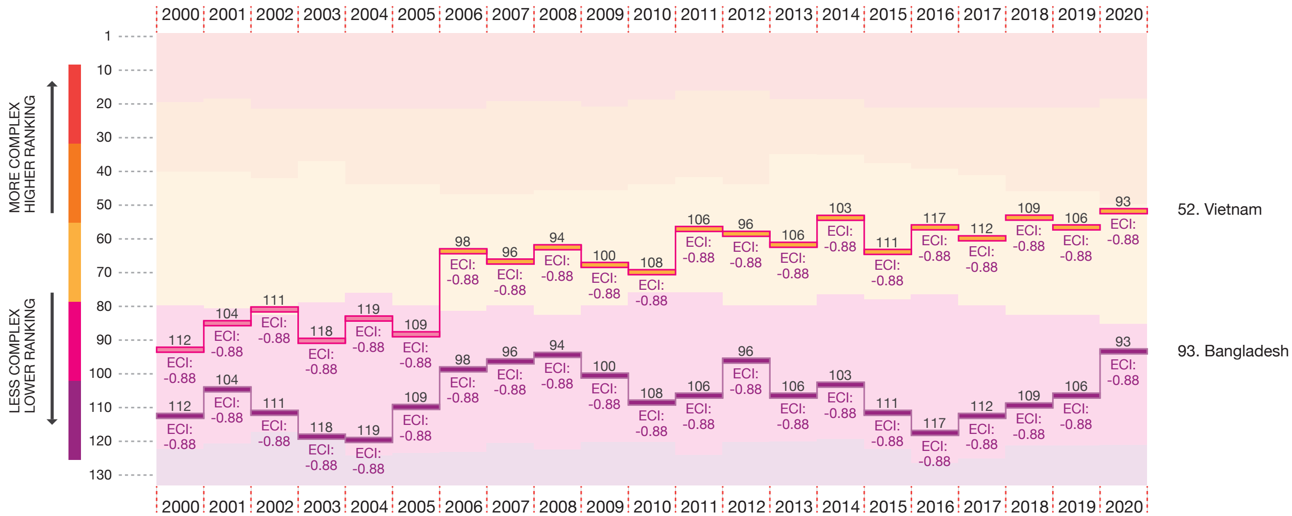
Figure 4: Export Concentration Trends (FY 1980-2022)



Source: PRI estimates based on EPB data

Bangladesh has an urgent need to enhance productivity in manufacturing and maintain global competitiveness. The manufacturing exports have been a significant driver of Bangladesh's economic growth, with an average annual growth of approximately 10.3% since 2001, resulting in a rise from USD 6 billion to USD 52 billion over that period. While the ready-made garments (RMG) sector plays a crucial role, accounting for 43.1% of the manufacturing value, other industries such as textiles, food products, and leather works also contribute to this growth. However, the majority of manufacturing in Bangladesh remains low-tech and low-skilled, leading to low labor productivity compared to international standards. The emergence of modern technologies and the 4th Industrial Revolution (4IR) has transformed global production, driven by automation, robotics and artificial intelligence. In order to maintain competitiveness and achieve Vision 2041, Bangladesh's manufacturing sector needs to embrace technological sophistication and enhance productivity to keep up with global comparators benefiting from the digital economy and widespread technology adoption across sectors.

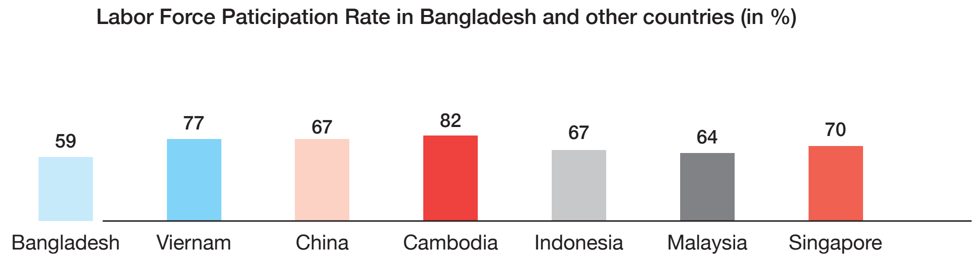
Figure 5: Economic Complexity of Bangladesh and Vietnam Over the Years



Source: Atlas of Economic Complexity

Bangladesh's demographic dividend is an asset that requires full utilization through skill development and job creation. Bangladesh stands on the cusp of a demographic dividend, with a burgeoning youth population. However, this demographic advantage can transform into a liability without meaningful job creation. The private sector's capacity to generate employment currently falls short of the demand and the Covid-19 pandemic has exacerbated this challenge. The need for quality employment is underscored by the fact that a significant portion of the workforce remains underemployed or engages in informal sector activities. Realizing the potential of this demographic dividend requires multi-dimensional strategies, including investment in skill development, fostering an enabling environment for entrepreneurship and private investment and facilitating the emergence of new sectors to absorb the growing labor force.

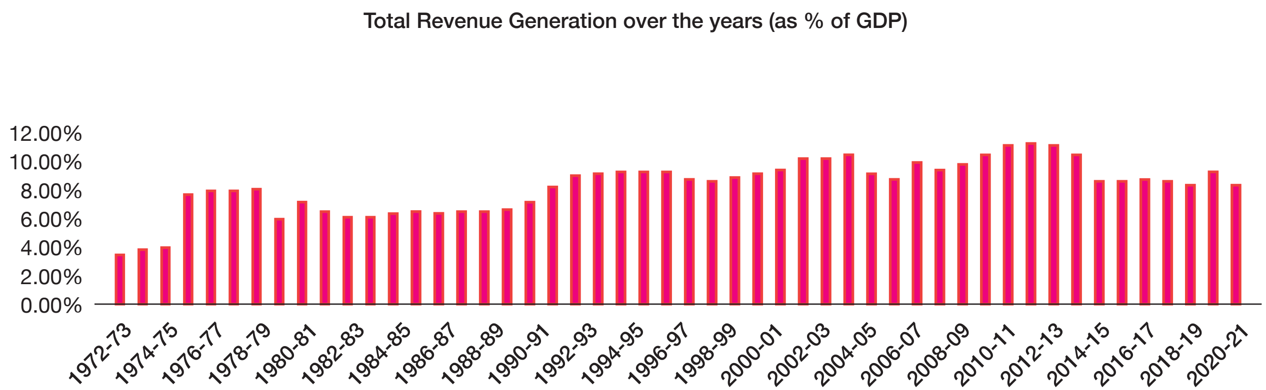
Figure 6: **Labor Force Participation Rate in Bangladesh and Comparator Countries**



Source: LFS 2016, World Bank

Bangladesh needs substantial tax reforms and fiscal management for crafting sustainable revenue streams. A robust economy demands a resilient fiscal framework. However, Bangladesh faces the challenge of a tax system that struggles to meet ambitious revenue targets. This challenge is exacerbated by the inadequacies of ad hoc tax measures, which fail to catalyze substantial revenue growth. Meaningful tax reforms, encompassing institutional changes, digitization and simplification, are indispensable to strengthening the revenue base. Furthermore, prudent fiscal management is crucial to ensure that the budget deficit remains sustainable, and financing mechanisms are effective. The potential of revenue mobilization through State Owned Enterprises (SOEs) also remains largely untapped, requiring transformative governance and pricing reforms.

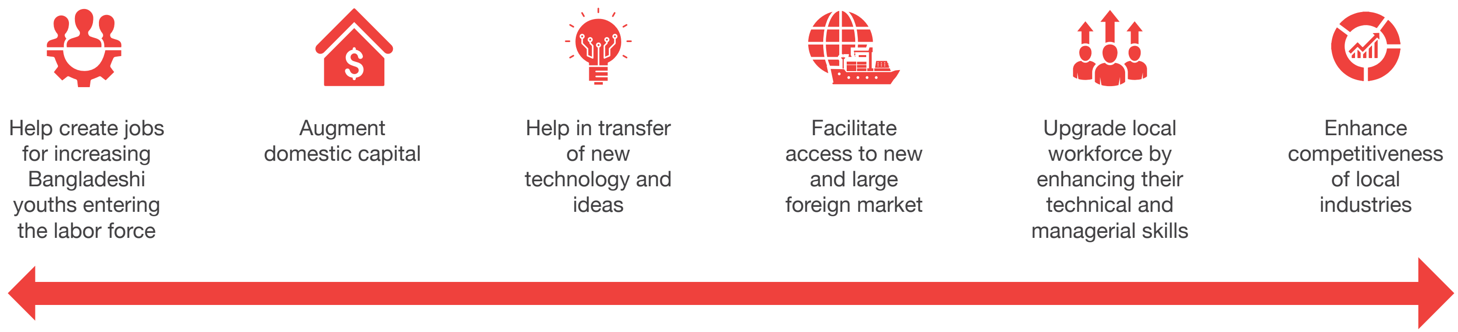
Figure 7: **Revenue Mobilization Challenge in Bangladesh**



Source: NBR

Private investments, including foreign direct investment (FDI) emerges as a potent instrument in Bangladesh's journey to address these pressing challenges and secure a prosperous future. Private investments and FDI can serve as a catalyst for diversification by attracting investments into new sectors and industries, thus reducing the country's over-reliance on the garment sector. Moreover, FDI brings not only capital but also technological know-how and managerial expertise, which can facilitate the emergence of high-value industries and enhance overall productivity. In the context of job creation, FDI has the potential to bolster employment opportunities significantly, especially in sectors beyond traditional manufacturing. By strengthening the tax system and improving fiscal management, Bangladesh can optimize the revenue generated from FDI, which can then be channeled into vital areas such as education, healthcare and infrastructure development. As Bangladesh navigates these multifaceted challenges, FDI can be a vital partner in driving sustainable growth, fostering innovation and ensuring that the demographic dividend becomes a true asset for the nation's development.

Figure 8: Benefits of FDI to Bangladesh Economy



As Bangladesh treads the path toward sustainable development, the challenges it faces are pivotal crossroads that demand bold and strategic responses. Export diversification, job creation and fiscal strengthening are not isolated objectives; they are interconnected and mutually reinforcing facets of a nation's growth story. By prioritizing diversification, nurturing entrepreneurship, investing in education and skills and embracing comprehensive tax reforms, Bangladesh can pave the way for inclusive growth, economic resilience, and the realization of its aspiration to become a high-income country by 2041.

1.3 Objective and Methodology of the Study

The primary objective of this study was to comprehensively examine the dynamics between tax policies and FDI inflows. The study aimed to shed light on how tax reforms and the broader tax environment influence FDI decisions by foreign investors and sought to identify the key constraints hindering investments. Additionally, it sought to identify lessons and best practices from both domestic and international experiences to provide actionable recommendations for Bangladesh. Ultimately, the study's overarching goal was to assist policymakers in optimizing tax policies and strategies to foster a more attractive investment climate, stimulate FDI and ensure sustainable revenue generation, thus contributing to Bangladesh's economic growth and development.

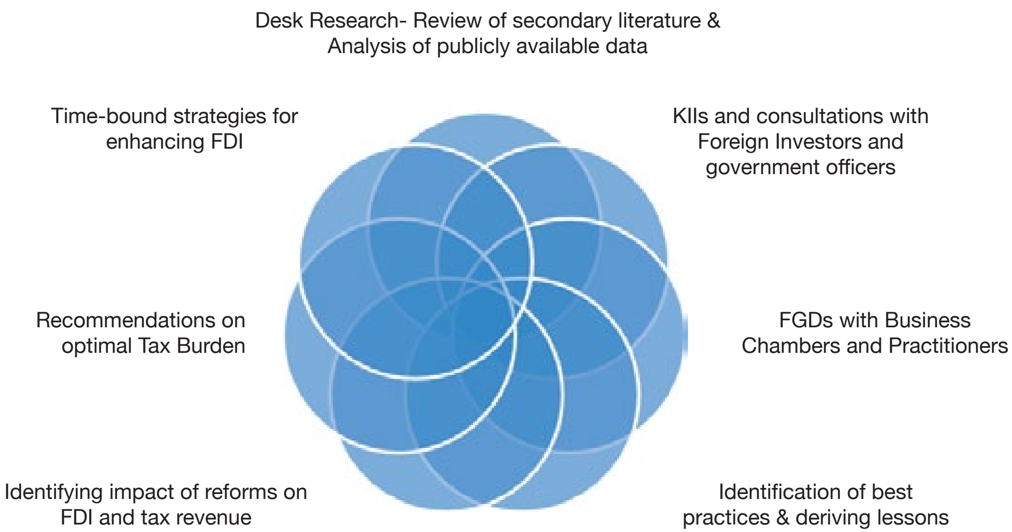
Figure 9: **Broad Objectives of The Report**

Understand the importance of Private Investment and FDI for Bangladesh's development	*Identify the prominent role of tax environemnt in FDI decisions*	*Identify the relationship between tax, FDI and revenue generation*
Critically assess Bangladesh's tax system and how it affects FDI	*Highlight the international best practices in attracting FDI*	*Find the gaps and reform opportunities specific to the sectors*

Approach and Methodology:

The study encompasses a multi-faceted approach aimed at thoroughly exploring the intricate relationship between tax policies and FDI and tax revenue in Bangladesh. Our research journey commenced with an extensive desk research phase, wherein we conducted a meticulous review of secondary literature and meticulously analyzed publicly available data. This initial phase provided valuable insights into existing scholarly perspectives and the empirical landscape, laying the foundation for our subsequent investigations. Subsequently, we engaged in Key Informant Interviews (KIIs) and consultations with foreign investors, government officers and stakeholders closely involved in the realm of taxation and investment. This qualitative dimension added depth to our analysis by incorporating expert opinions and real-world experiences. Furthermore, we organized Focus Group Discussions (FGDs) involving representatives from prominent business chambers and industry practitioners, fostering an inclusive dialogue that captured the diverse viewpoints of key stakeholders.

Figure 10: **Key Approach**



Methodology Adopted in The Report:

1. **Desk Research:** The study initiated with an extensive desk research phase. This involved the review of secondary literature, academic papers, reports, and publicly available data related to FDI trends, tax environments and economic policies in Bangladesh.

2. **Key Informant Interviews (KIIs) and Consultations:** In-depth Key Informant Interviews (KIIs) were conducted with foreign investors currently operating in Bangladesh. Additionally, consultations were held with government officers responsible for economic policy formulation and implementation. These interviews and consultations provided valuable qualitative insights into the challenges, opportunities and perceptions related to FDI and tax reforms in Bangladesh.

3. **Focus Group Discussions (FGDs):** Focus Group Discussions (FGDs) were organized with representatives from business chambers and practitioners in Bangladesh. These discussions delved into the practical experiences and perspectives of local business communities regarding the impact of tax policies and the investment climate on FDI.

4. **Identification of Best Practices and Lessons:** Findings from the desk research, KIIs, and FGDs were synthesized to identify international best practices in tax policy and investment promotion. Lessons were drawn from the experiences of countries known for their successful FDI attraction strategies.

5. **Impact Assessment:** The study employed quantitative methods to assess the impact of tax reforms on FDI and tax revenue in Bangladesh. Regression analysis was conducted using historical data to understand the relationship between tax environment, business freedom and FDI inflows. Sensitivity analysis was performed to evaluate the potential impact of varying tax rates on FDI and revenue.

6. **Strategies for Enhancing FDI:** The study developed time-bound strategies for enhancing FDI inflows in Bangladesh. These strategies encompassed short-term, medium-term and long-term actions to create a conducive investment climate.

This comprehensive methodology allowed for a multifaceted examination of the relationship between tax policy, FDI and revenue generation in Bangladesh. The combination of qualitative and quantitative research methods provided a holistic understanding of the subject, enabling the formulation of practical recommendations and strategies to support the country's economic development goals.

Figure 11: Detailed Methodology

Role of FDI for Growth and Vision 2041	Desk research
	Secondary literature review and analysis
	International case studies
Current State of Tax and Perception	Secondary literature
	KIIs with NBR officials to understand planning considerations
	Stakeholder analysis
	KIIs/FGDs with Investor groups and Business Chambers
Impact of Reform on FDI/Tax Revenue	Economic Modelling
	Projection based on extrapolating historic data and obtaining coefficients
	Cost-benefit analysis
Optimal Tax Policies	Best practice analysis
	Stakeholder consultations
	Analyzing feasibility of reforms
Other Necessary Reforms for Conducive Environment	Stakeholder consultations
	Desk research/Secondary literature review
	Analysis of best practices
	Time-bound strategies on FDI

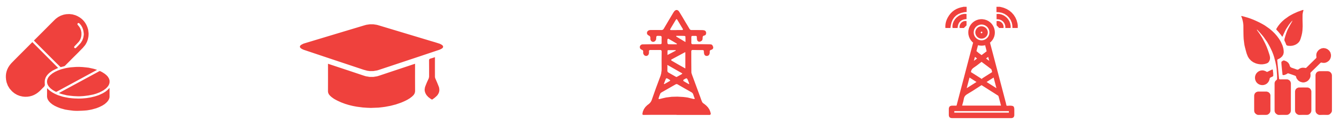
In the chapters that follow, we delve deeper into the intricate nuances of these challenges, exploring potential solutions and offering insights to shape a future that is not only prosperous but also sustainable. It begins by highlighting the paramount role of private investment in fostering economic growth and employment and subsequently delves into the criticality of FDI for trade competitiveness and integration into Global Value Chains (GVCs). The report then scrutinizes the impediments hindering inbound FDI and assesses the intricate relationship between taxation policies and investment decisions. It navigates through the complexities of Bangladesh's taxation system, evaluates the potential impacts of tax reforms in attracting FDI and enhancing revenue and concludes with a deep dive into global best practices for designing taxation frameworks that allure FDI. By offering tailored recommendations and insights, this report aims to steer Bangladesh toward a future of prosperity and resilience by leveraging the potential of private investment, FDI and effective taxation strategies.

CHAPTER 2

PROPELLING BANGLADESH'S STELLAR DEVELOPMENT SUCCESS: THE CATALYTIC ROLE OF PRIVATE INVESTMENT

Chapter at a Glance

Sectors Outlined in Perspective Plan 2041 with High Need for Private Investment



- Pharma
- Education and Skills
- Energy and Power
- Telecommunication and Digital Economy
- Climate Finance and Blue Economy

How Private Investment in Bangladesh Helped Stimulate Economic Growth

Private Investment

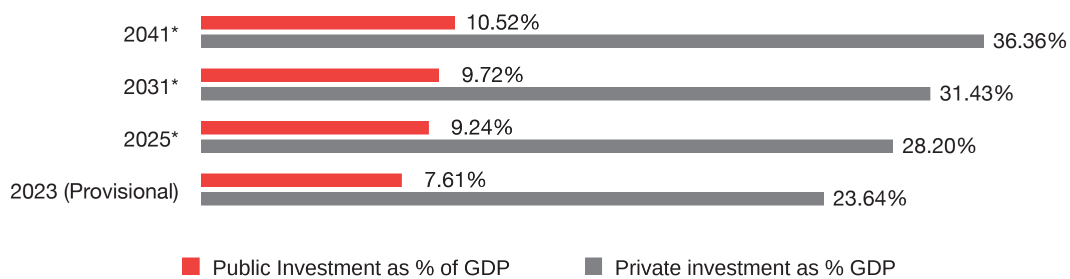
1	**Boosted Exports**	Garments, textiles, and leather goods increased exports and generated FE
2	**Improved Infrastructure**	Roads, bridges, power plants improved connectivity and productivity
3	**Created Jobs**	Reduce poverty and improved lives
4	**Transferred Technology**	Improved productivity of local firms and made them more competitive
5	**Promoted Competition**	Led to lower prices for consumers and better quality products

Reforms Undertaken in the Early Years that Laid Foundation for Private Investment in RMG

- Tariff Rationalization
- Removal of Trade-Related Quotative Restrictions
- Elimination of Import Licensing, Bonded Warehouse, Back-to-Back LCs

The Perspective Plan Emphasizes on the Criticality of Private Sector for Attainment of Vision 2041

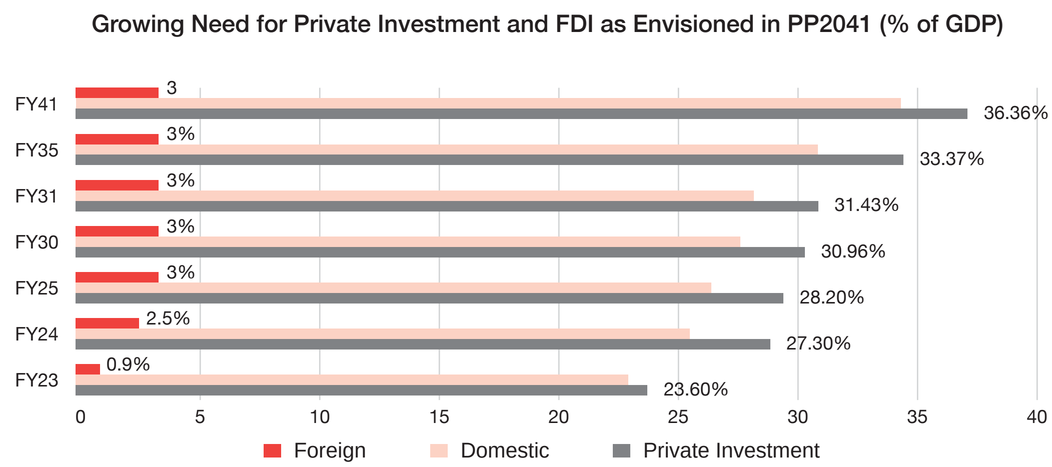
Public Investment vs Private Investment Need for Attainment of Vision 2041 (as % GDP)



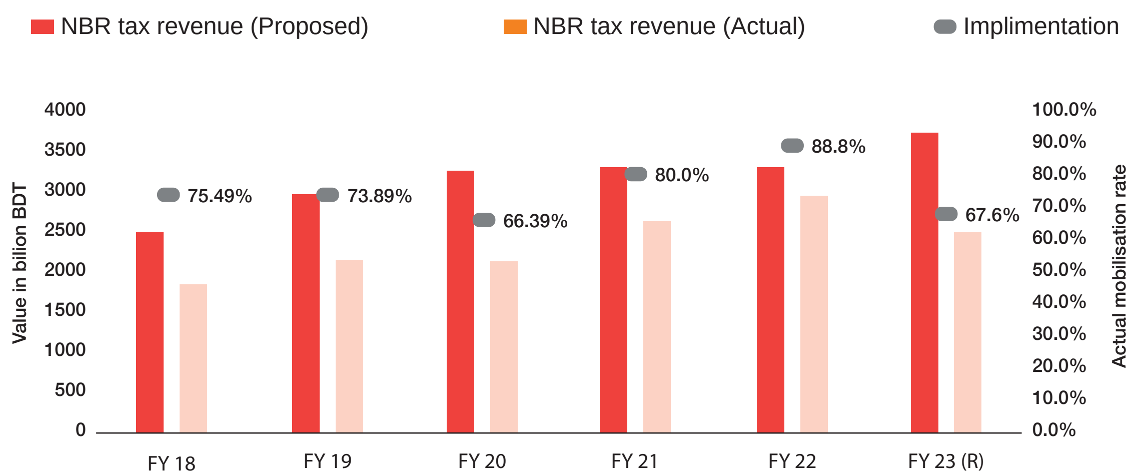
*Target

Source: Ministry of Finance, pp2041

Growing Need for Private Investment and FDI as Envisioned in PP2041



Need for Strengthening Revenue



CHAPTER 2

PROPELLING BANGLADESH'S STELLAR DEVELOPMENT SUCCESS: THE CATALYTIC ROLE OF PRIVATE INVESTMENT

Bangladesh's transformative journey led to dynamic economic growth, poverty reduction, and resilience amidst challenges, supported by growing private sector engagement. Bangladesh's Remarkable Development Gains Since gaining independence in 1971, Bangladesh has embarked on a transformative journey, transcending its agrarian roots to become a dynamic manufacturing-based and service-oriented economy. This evolution has propelled the country's economic growth, poverty reduction, and social development, reflecting an average growth rate exceeding 5% over the past three decades.

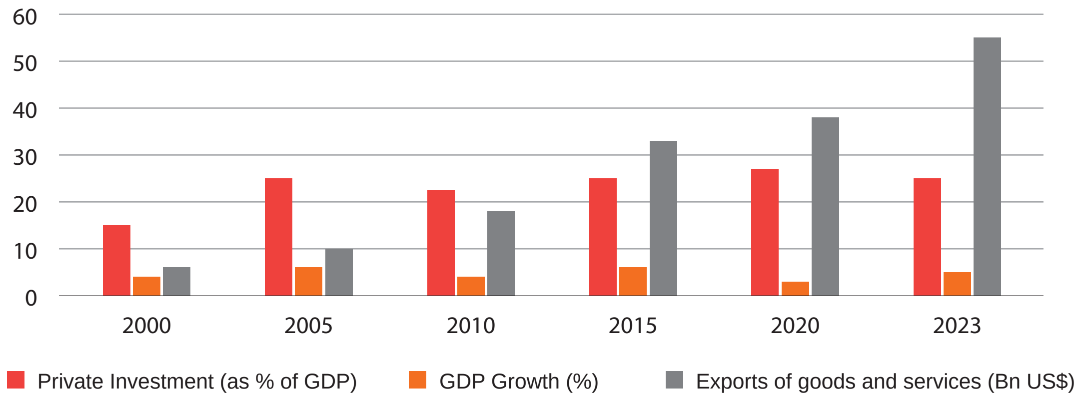
Bangladesh's GDP has grown significantly over the years and the country proved its resilience despite grave challenges, supported by growing private sector engagement. Notably, the GDP has quadrupled since 2009, reaching an impressive $465 billion in 2022. These strides are underscored by significant advancements in key indicators. Per capita income has surged from $137 to $2,687, demonstrating tangible improvements in living standards. Despite grave challenges from the COVID-19 pandemic, Bangladesh's economy proved its resilience by achieving a growth rate of 5.2% in fiscal year 2020 which was higher than comparators such as India with 4.2%, Bhutan with 0.6% and Vietnam with 2.9%. The success of a persistent and sturdy growth rate is based on real structural transformation, growing private sector engagement, export-oriented industrialization, rural renewal and steady development outcome.

2.1 Importance of Private Investment in Driving Bangladesh's Development

Private Sector Key Driver Behind Investments, Exports and GDP Growth

Private investment, propelled Bangladesh's growth, innovation and development, across sectors. Amidst this transformative journey, private investment has emerged as a central force propelling Bangladesh's growth trajectory. Over five decades, the nation transitioned from agrarian beginnings to a modern economy, with private investment constituting a substantial 76% of total investment. This inflow has played an instrumental role in nurturing economic expansion, igniting innovation, and generating employment opportunities. As a result, Bangladesh has achieved notable milestones in poverty reduction, education, healthcare and gender equality. The inflow of private investment has also facilitated the development of crucial infrastructure, leading to further economic expansion and increased trade. The private sector's impact reverberates across various domains, including telecommunications, transport, housing, media, education and health services.

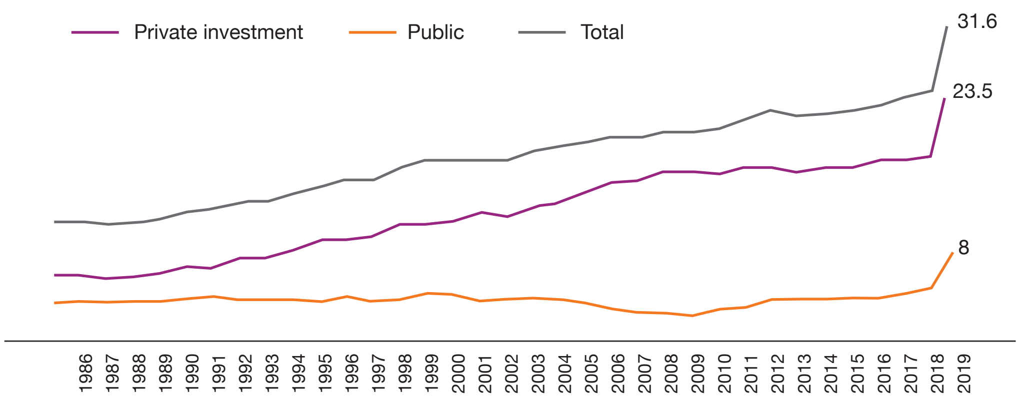
Figure 12: **Private Investment, GDP Growth and Exports in the Last Decade**



Source: BBS, World Bank

Private investment has undeniably stood as the bedrock of growth across pivotal sectors that have been instrumental in propelling Bangladesh's developmental journey. Notably, a robust and dynamic private sector has flourished in areas like telecommunications, transport, housing, media, education and health services. In the realm of urban housing, the private housing market exhibits vibrancy and competitiveness; however, it grapples with challenges such as high land costs, limited long-term housing finance, and inefficiencies within the land market. While public resources support the development of road network infrastructure, the private sector predominantly shoulders the responsibility of providing transport services, often complemented by limited public bus services. Within the private sector, the foremost service exports in FY 2019 were dominated by transport at 15%, closely followed by Telecoms and ICT at 14%, business services at 13% and tourism at 5%. The residual 6% encompasses a diverse spectrum of services, encompassing financial services among others.[3]

Figure 13: **Bangladesh's Private and Public Investment, 1985-2019 (% of GDP)**



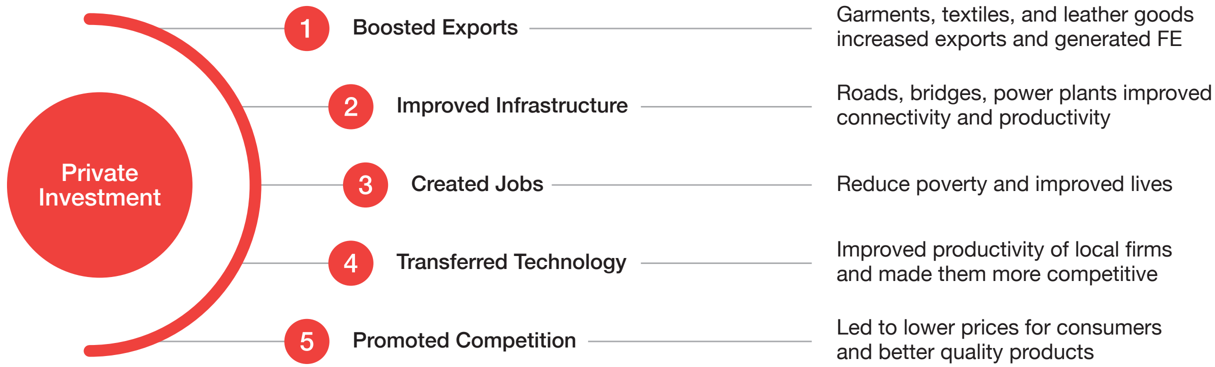
Source: Policy Exchange Database

[3] 8th Five Year Plan July 2020- June 2025: Prompting Prosperity and Fostering Inclusiveness

Bangladesh's private sector has undergone distinct phases, each contributing to the nation's evolving economic landscape. In the era termed "Bangladesh Private Sector 1.0" during the 1980s and 1990s, the country focused on catalyzing growth through three fundamental drivers. Firstly, enhancements in agriculture productivity and the Agri supply chain spurred rural development and food security. Secondly, the inflow of remittances buoyed gainful employment opportunities and consumer spending, propelling economic vitality. The third core driver materialized through the growth of the ready-made garment (RMG) industry, a transformative force that rippled across manufacturing, employment and service sectors, creating a multi-faceted impact.

The next phase reshaped Bangladesh's economy, fostering diversification, connectivity, and technological innovation. The transition to "Private Sector 2.0" in the early 2000s marked a paradigm shift towards modernization and expansion of Bangladesh's economic foundation. A robust focus on industrial and connectivity infrastructure became pivotal, acting as cornerstones for future growth. This phase witnessed diversification across sectors, including pharmaceuticals, agribusiness and processing, leather and footwear, construction, and fast-moving consumer goods (FMCG). As the nation deepened its global integration, an embrace of financial services and technology began to redefine the business landscape. The amplification of digital infrastructure and technology-driven solutions further empowered the private sector, catalyzing innovation and streamlining operations. Collectively, these phases underscore the private sector's pivotal role in propelling Bangladesh's journey from agricultural economy to modern, diversified growth engine.

Figure 14: How Private Investment in Bangladesh Helped Stimulate Economic Growth



Catalysts for Private Sector Growth: Trade Liberalization and Supportive Policies

Trade liberalization has played a pivotal role in propelling the growth of Bangladesh's private sector, particularly the export-oriented segment. Bangladesh's historical economic trajectory mirrors a pivotal transformation that unfolded from the 1970s through the 1980s, gradually shifting away from protectionist economic policies towards a more open and liberalized trade regime by the 1990s. This strategic evolution ushered in a new era of opportunities for the country's private sector, with certain industries, most notably the RMG sector, reaping substantial benefits. This transition was characterized by sweeping reforms, including a substantial reduction and streamlining of tariffs, the abolition of trade-related quantitative restrictions (QR), and the complete dismantling of import licensing procedures. These changes collectively laid the foundation for Bangladesh's emergence as a significant player in the global economic landscape, particularly within the textile and RMG industry and set the stage for further economic growth and development.

Figure 15: **Reforms Undertaken in the Early Years that Laid Foundation for RMG Sector's Growth**

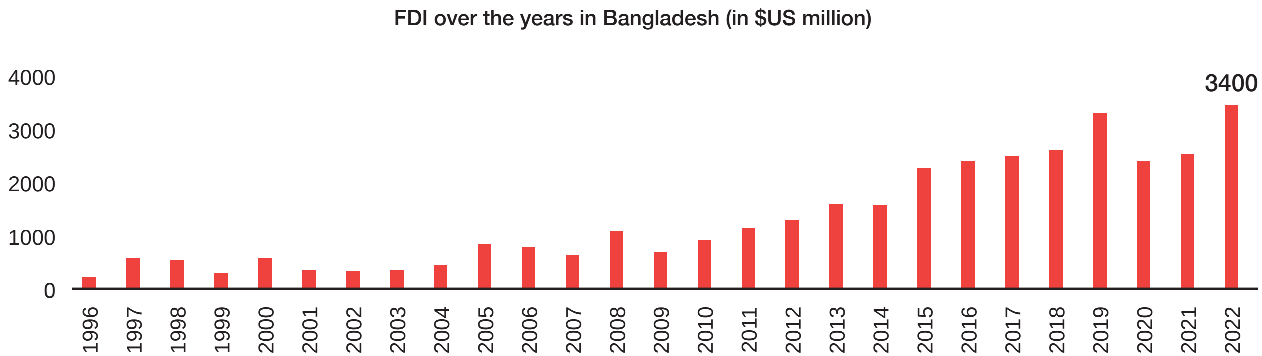
Tariff Rationalization

Removal of Trade-Related Quantitative Restrictions

Elimination of Import Licensing, Bonded Warehouses, Back to Back LCs

Bangladesh has gradually progressed towards favorable investment climate and being more receptive to foreign investments too. Bangladesh has allowed foreign investors allowing them to establish wholly owned subsidiaries, joint ventures, or invest in existing local companies. The government provides residence permits and work permits to foreign nationals investing a certain amount. Tax incentives include tax holidays for up to 10 years, 100% tax exemption on certain projects and priority sectors, and exemptions on export-related income, royalties, technical fees and interest on foreign loans. Export-oriented businesses receive customs and import duty exemptions, export credit guarantee schemes, cash incentives and preferential access to international markets. These multifaceted incentives underscore Bangladesh's commitment to creating an investor-friendly ecosystem and fostering economic growth through foreign direct investment.

Figure 16: **Growth of Foreign Investment Over the Years in Bangladesh**



Source: Bangladesh Bank

Bangladesh offers a range of investment incentives under its industrial policy and export-oriented growth strategy with few formal distinctions between foreign and domestic private investors. Tax holidays ranging from 5 to 10 years, along with reduced tax rates based on the investment's geographical area, are offered. Projects under the Public Private Partnership (PPP) framework enjoy 100% tax exemption on income and capital gains for a decade. Priority sectors like Power can benefit from tax exemptions for up to 15 years. Export-oriented businesses receive a range of benefits, including customs duty exemptions on capital machinery, import duty waivers on raw materials for exports and refund of paid tariffs on imported raw materials. Bonded warehousing facilities are accessible, while exporters can secure loans against Letters of Credit (LC). Cash incentives, export credit guarantee schemes and preferential access to international markets, including the DFQF (Duty-Free Quota-Free) benefits with the EU and other countries, further enhance the attractiveness of investing in Bangladesh.

Figure 17: **Various Incentives Provided to Boost FDI**

Tax Incentives

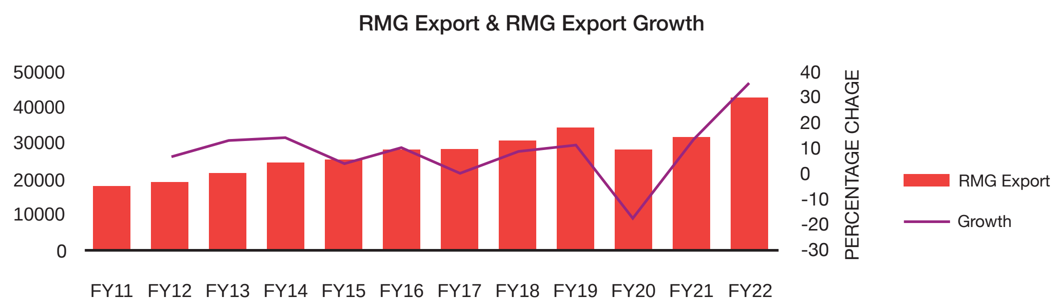
- Tax holidays for up to 10 years along with reduced tax rates based on the investment's geographical area
- 100% tax exemption on certain projects and priority sectors (Projects under the Public Private Partnership (PPP) framework)
- Export-oriented businesses receive customs and import duty exemptions on capital machinery
- Power can benefit from tax exemptions for up to 15 years
- Import duty waivers on raw materials for exports
- Refund of paid tariffs on imported raw materials

Other Incentives

- Export credit guarantee schemes
- Preferential access to international markets
- Bonded warehousing facilities are accessible, while exporters can secure loans against Letters of Credit (LC)
- Cash incentives, export credit guarantee schemes, and preferential access to international markets, including the DFQF (Duty-Free Quota-Free) benefits with the EU and other countries
- Exemptions on export-related income, royalties, technical fees, and interest on foreign loans

The RMG sector, in particular, emerged as a prime beneficiary of these policies. The introduction of measures such as a bonded warehouse system for duty-free imported inputs, back-to-back letters of credit for import finance, and a customs green channel for swift import-export cargo clearance bolstered the efficiency and competitiveness of RMG production. The establishment of free trade channels within export processing zones (EPZs) or the domestic economy further enhanced the sector's growth prospects. Nonetheless, amidst these gains, there has been a counterproductive trend with the rise of para-tariffs, notably supplementary and regulatory duties, which introduced anti-export bias and hindered non-RMG sectors.

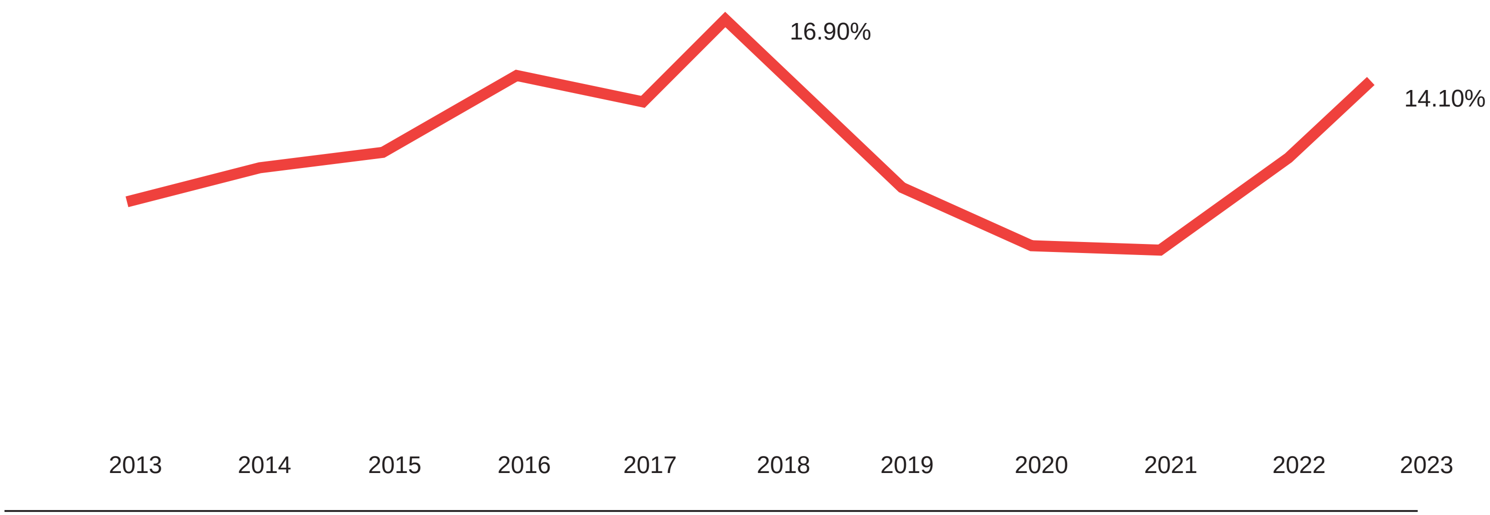
Figure 18: **RMG Export Growth Across the Years**



SOURCE: EPB

Bangladesh's private sector growth story extends to the financial landscape. The liberalization of the banking sector in the late 1980s opened doors for the establishment of new banks, fostering an environment conducive to private sector expansion. These reforms facilitated the intermediation of significant volumes of remittances, which have consistently averaged around US$10 billion in recent decades. Bangladesh Bank's encouragement of private sector credit growth, encompassing both industry and rural sectors, further invigorated investment prospects.

Figure 19: Private Sector Credit Growth, Despite Some Decline, has Remained Positive in the Last Decade



Source: Bangladesh Bank

Prudent Fiscal Management as a Bedrock: Bangladesh's private sector ecosystem has also thrived due to the government's commitment to prudent fiscal management. Over the last two decades, the government has maintained a relatively sustainable fiscal policy, aligning expenditure growth with revenue performance. This disciplined approach has resulted in manageable fiscal deficits consistently below 5%, ensuring economic stability. Historically high fiscal deficits, often ranging from 8% to 12% of GDP, have been replaced by a more responsible approach. Although revenue mobilization challenges and increased fiscal spending for pension payments and energy subsidies have emerged in recent years, these fluctuations have not deviated significantly from the prudent fiscal trajectory.

2.2 Private Investment: A Critical Enabler of Vision 2041 and High-income Bangladesh

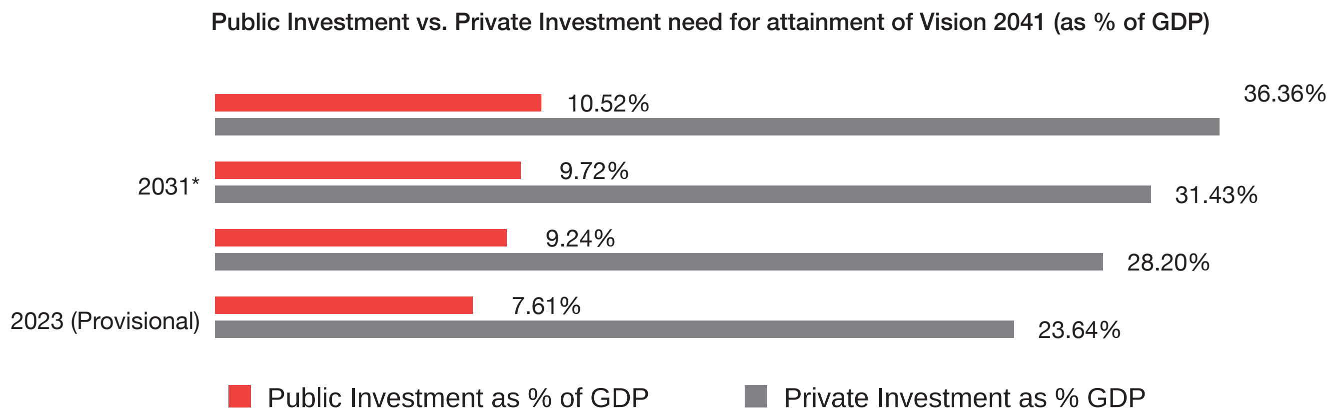
Bangladesh's Vision 2041 represents a bold and ambitious blueprint for the nation's future, envisioning a prosperous, technologically advanced, and globally influential economy. As Bangladesh continues to chart its course towards Vision 2041, the role of private investment remains paramount. The country's journey from agrarian economy to a modern and diversified growth engine has been largely underpinned by private sector engagement fostered by trade liberalization and strategic financial policies. In this journey of transformation, private investment stands as the cornerstone, serving as the driving force to propel Bangladesh towards the realization of its developmental aspirations. Looking ahead, the collaboration between public and private sectors, backed by innovation-centric policies, will be essential to ensure sustained economic expansion, poverty reduction, and the realization of Vision 2041's transformative goals.

Perspective Plan 2041 Emphasizes on Private Sector's Important Role

"The private sector will be the leading agent in raising economic growth, and public investment will be restructured to become more effective in promoting growth and development. The Government is fully committed to letting the private sector to be the growth driver. As such, much of the additional increase in the growth of investment is projected to come from the private sector – domestic and foreign."

Catalyzing Economic Growth and Diversification is central to Vision 2041. Private investment has a pivotal role in generating the necessary momentum for such growth, allowing Bangladesh to achieve its target of upper-middle-income status. The infusion of private capital into key sectors, from manufacturing and services to technology and innovation, creates a virtuous cycle of economic expansion, leading to job creation, higher income levels, and enhanced standards of living. Moreover, private investment enables economic diversification, a critical component of Vision 2041. By encouraging a broad spectrum of industries, private investment reduces dependence on a few sectors, mitigating risks associated with economic volatility. This diversification strategy aligns with the goal of creating a resilient economy capable of weathering global challenges, ensuring sustained progress towards the vision's ambitious objectives.

Figure 20: **The Perspective Plan Emphasizes on the Criticality of Private Sector for Attainment of Vision 2041**



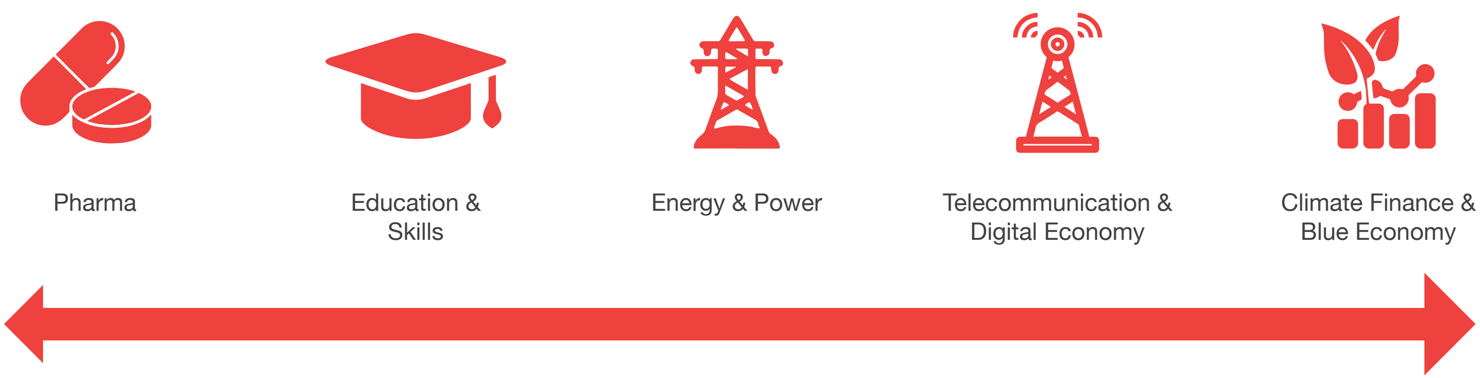
*Target

Source: Ministry of Finance, PP2041

Linking Private and Foreign Investment to Important Aspirations in Vision 2041

The strategic alignment of private sector engagement with Vision 2041's goals creates a harmonious pathway toward achieving a prosperous and advanced economy. The comprehensive strategies outlined in PP2041 underscore the importance of leveraging private investment's potential to unleash a wave of growth, innovation and sustainable development that will resonate for generations to come.

Figure 21: **Sectors Outlined in Perspective Plan 2041 with High Need for Private Investment**



Boosting Growth Across Vital Sectors: Private investment has been instrumental in propelling growth across crucial sectors of the economy. Bangladesh's pharmaceutical industry, for instance, has witnessed notable expansion, with private investment serving as a cornerstone for this growth. The country's robust track record in this industry forms a foundation on which Vision 2041's Private Sector Development Strategy (PP2041) seeks to build. This strategy aims to not only strengthen the support for private investment in pharmaceuticals but also enhance quality control for drug manufacturing and distribution. By bolstering the testing and certification process, PP2041 ensures that the private sector's contribution in this sector continues to thrive and evolve, aligning with the vision's objectives.

Transforming Education and Higher Learning: The private sector's involvement in education has witnessed a surge in recent years, paving the way for a transformative impact on the nation's education landscape. The Vision 2041 strategy acknowledges this momentum and seeks to strengthen the role of the private sector in higher education. Beyond the 12 years of schooling, the responsibility for education will primarily rest with the private sector. This paradigm shift recognizes the capability of the private sector to drive innovation and excellence in higher education. While public provision of higher education will persist, the focus will be on areas where private investment is currently lacking. Additionally, the strategy targets closing the gender gap in tertiary education and enhancing disciplines such as science, technology and medicine.

Empowering the Energy Sector: Private investment has played a crucial role in energizing Bangladesh's power sector. The Private Sector Master Plan (PSMP) laid the groundwork for this progress, and the PP2041 aims to further amplify the private sector's contribution to power generation. By encouraging the establishment of large-scale, fuel-efficient power plants, Bangladesh's energy landscape is set to undergo a transformation. The strategy also envisions exploration of options for private distribution of electricity, promoting efficiency and competition. Renewable energy supply by private producers will be incentivized, and a carbon tax will encourage the adoption of green technology. Moreover, the PP2041 strategy extends its purview to the oil and gas markets, aiming to broaden the private sector's role through deregulation and pricing reforms.

Driving Communication Advancements: The private sector's pivotal role in modernizing Bangladesh's communication landscape is acknowledged and reinforced by the PP2041. The strategy focuses on policy and institutional support for private investment in expanding telecommunications networks and services. It not only stimulates the expansion of private print, audio and video media but also fosters an environment conducive to the competitive and healthy growth of communication services and information sharing.

Financing Climate Change Initiatives: As Bangladesh prioritizes the integration of environmental protection with its growth strategy, the need for innovative financing mechanisms becomes evident. The PP2041 outlines strategies to ensure environmental sustainability through an inclusive approach involving both the public and private sectors. Private investment is set to play a pivotal role in areas such as forestry, fisheries, and eco-tourism, facilitated by proper regulatory frameworks. Legal and regulatory policies will encourage private investment in environmental protection measures, and public-private partnerships will co-finance various environmental services.

Realizing the Blue Economy Potential: The blue economy's development, vital for Bangladesh's progress, will draw substantially from private sector investment. PP2041 recognizes this and emphasizes incentivizing and regulating private investment in the blue economy. The role of FDI will be promoted to infuse new knowledge, technology and financing. The strategy also underscores the importance of ensuring access to marine resources for small-scale artisanal fishers, contributing to the socio-economic development of coastal communities.

Table 1: Examples of Sectors Where the Increased Role of Private Financing is Recognized in the Perspective Plan 2041

Sectors	Role of Private Investment as mentioned in Perspective Plan
Pharmaceutical Industry	PP2041 will leverage Bangladesh's existing experience in the pharmaceutical sector. The focus will be on enhancing private investment and ensuring quality control for drug manufacturing and distribution through strengthened testing and certification processes.
Higher Education	The private sector will play a strengthened role in education beyond the 12th grade. Recent growth in private investment in higher education demonstrates its capability in this area. Public provision will continue, especially in sectors lacking private investment and in areas like closing gender gaps and promoting science, technology and medicine.
Energy	PP2041 builds upon the encouragement of private sector involvement in power generation from PP2021. Focus will shift from rental power plants to more efficient, large-scale and fuel-efficient power plants. Private sector engagement in distribution of electricity, along with regulatory reforms and pricing strategies, will be explored. Renewable energy supply by private producers will be incentivized, along with broadening private sector's role in oil and gas markets. Budget funding will reduce over time as private investment grows.
Private Investment in Telecommunication	Building on past successes, PP2041 will modernize communications. The strategy supports private investment in expanding telecommunication networks, boosting private print, audio, and video media expansion, and creating an enabling environment for competitive growth in communication services and information sharing.
Climate Finance	PP2041 aims to integrate environmental protection into the growth strategy, targeting about 4.5% of GDP for investments. Various financing options, including private financing, will be pursued. Private supply encouragement in areas like forestry, fisheries and eco-tourism will be backed by proper regulations. Legal and regulatory policies will encourage private investment in environmental protection measures. Public-private partnerships will be used for co-financing environmental services.
Blue Economy	Private sector investment will drive the blue economy's development. Incentive and regulatory policies will be adopted based on policy framework recommendations. FDI will be promoted to bring in knowledge, technology and financing. Access to marine resources for small-scale artisanal fishers will be ensured.

Source: Making Vision 2041 a Reality: PERSPECTIVE PLAN OF BANGLADESH 2021-2041

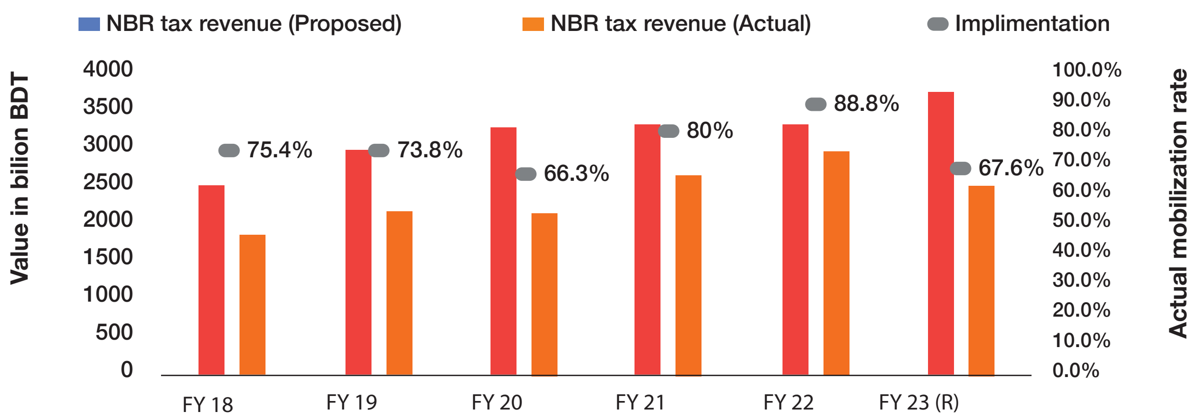
Private Investment Drives Innovation, Propelling Bangladesh Towards Tech-Driven Growth, Entrepreneurship and Global Competitiveness as per Vision 2041.

Vision 2041 envisions Bangladesh as a technological powerhouse, leveraging innovation to drive growth and competitiveness. The private sector's role in this transformation is indispensable. Private investment not only brings financial resources but also promotes innovation-driven activities. Businesses actively engage in research and development, adopt new technologies and catalyze the diffusion of innovative solutions across industries. Furthermore, private investment encourages entrepreneurship, creating a fertile ground for startups and technology-driven ventures. This vibrant startup ecosystem, supported by private funding, nurtures innovation, attracts talent and positions Bangladesh as a hub for emerging technologies. These technological advancements not only elevate the competitiveness of domestic industries but also enhance Bangladesh's global positioning, aligning with the aspirations of Vision 2041.

Private investment underpins Vision 2041's inclusive growth, fostering employment, skill development, and societal empowerment. A central tenet of Vision 2041 is the creation of inclusive growth that benefits all segments of society. Private investment plays a pivotal role in achieving this goal by generating employment opportunities across various sectors. As businesses expand and new ventures emerge, the demand for skilled and unskilled labor increases, contributing to reduced unemployment and poverty rates. Moreover, the private sector's role in enhancing the skill development ecosystem is essential. Private investment in education and vocational training aligns with Vision 2041's emphasis on human capital development. A well-skilled workforce not only supports the growth of industries but also empowers individuals, enabling them to participate meaningfully in the nation's progress.

A central tenet of Vision 2041 is the creation of inclusive growth that benefits all segments of society and private investment plays a pivotal role in achieving this goal by generating employment opportunities across various sectors.

Figure 22: **Challenges in Domestic Revenue Mobilization**



Source: NBR

Private Investment, including FDI, has been identified to drive modern infrastructure for a prosperous Bangladesh, fostering innovation and sustainable development. Vision 2041 envisions a Bangladesh with modern infrastructure that supports economic activities and enhances the quality of life for its citizens. Private investment serves as a crucial enabler of this infrastructure development. From energy and transportation to telecommunications and urban housing, the private sector's involvement accelerates the creation of essential facilities and services. Private investment brings not only financial resources but also innovative approaches to infrastructure development. Public-private Partnerships (PPPs) have the potential to revolutionize the infrastructure landscape, leveraging private sector expertise, efficiency, and long-term commitment. This collaborative approach ensures that the vision's infrastructure targets are not only achieved but also sustained over the long term.

Investment in Infrastructure and Logistics Sector

Current	Required
2-3% of GDP	6-7% of GDP

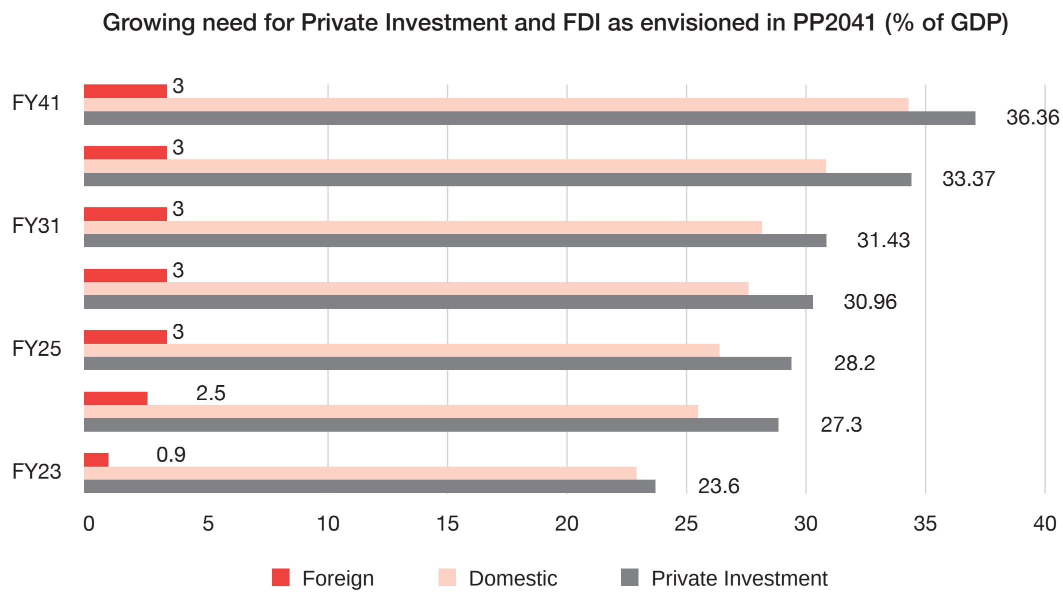
Figure 23: Key Areas of Supporting Infrastructure and Appropriate Political and Structural Reforms that will Drive Private Investment in the Future

- Adequate energy supply including electricity and gas (or LNG)
- Infrastructure including roads, railways, bridges
- Telecommunications
- Ports
- Legal and administrative systems including property rights issues
- Socioeconomic environment including law and order situation
- Sound monetary policy and sustainable management of public finances

Source: Vision 2041

Vision 2041's success hinges on nurturing private investment through policy reforms, fostering collaboration for shared prosperity. To fulfill the transformative goals of Vision 2041, Bangladesh must foster an environment conducive to sustained private investment. This entails policy measures that promote ease of doing business, ensure regulatory clarity, provide incentives for innovation and address challenges related to access to finance. A proactive role of the government, in partnership with the private sector, will be instrumental in creating this enabling environment. By recognizing private investment, including FDI as the cornerstone of Vision 2041, Bangladesh positions itself to realize a future that resonates with progress, prosperity and global significance.

Figure 24: Growing Need for Private Investment and FDI as Envisioned in PP2041



Source: Perspective Plan 2041

FDI assumes a pivotal role in the realization of Vision 2041, standing as a catalyst for Bangladesh's transformation into a technological and economic powerhouse. As the nation aspires to become a global hub for innovation and progress, FDI injects not only substantial financial resources but also brings forth a wealth of expertise, technology and international market access. Bangladesh's remarkable growth trajectory and strategic positioning make it an attractive destination for FDI, with the potential to bolster critical sectors. By facilitating knowledge transfer and technology diffusion, FDI aligns with the vision's emphasis on innovation-driven growth. Furthermore, FDI has the capacity to enhance human capital development through the creation of employment opportunities and by fostering skill acquisition. The global nature of FDI introduces diverse business practices, management methods and cultural exchange, which could play a pivotal role in catalyzing sustainable economic growth. Vision 2041's ambition to elevate living standards, ensure inclusive growth and establish modern infrastructure is closely intertwined with the contributions of FDI. By embracing FDI as an indispensable partner in its transformative journey, Bangladesh positions itself to harness the global resources needed to realize the vision's lofty ambitions, ensuring a prosperous and competitive future on the world stage.

As Bangladesh aspires to become a global hub for innovation and progress, FDI injects not only substantial financial resources but also brings forth a wealth of expertise, technology and international market access.

CHAPTER 3

CRITICALITY OF FDI FOR COMPETITIVENESS AND GLOBAL VALUE CHAIN (GVC) INTEGRATION FOR BANGLADESH

Chapter at a Glance

FDI has Surged Over the Years Leading to Development of Strategic Sectors

Bank

RMG

Telecommunication

Energy

International Trade Indices Show Rapid Need for Competitiveness Improvement

Freedom of Trade Index

Country	Rank (Out of 180 Countries)
BANGLADESH	143
VIETNAM	76
INDONESIA	66

Enabling Trade Index by World Economic Forum

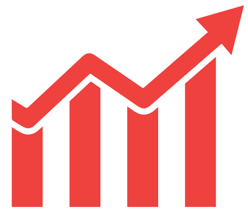
Country	Rank (Out of 136 Countries)
BANGLADESH	123
VIETNAM	73
INDONESIA	70

Logistics Performance Index

Country	Rank (Out of 160 Countries)
BANGLADESH	100
VIETNAM	39
INDONESIA	46

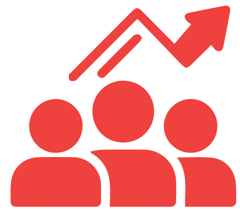
Factors that make FDI Important for Global Value Chain

FDI helps raise overall product complexity through technology transfer and knowledge spillovers, building competitiveness



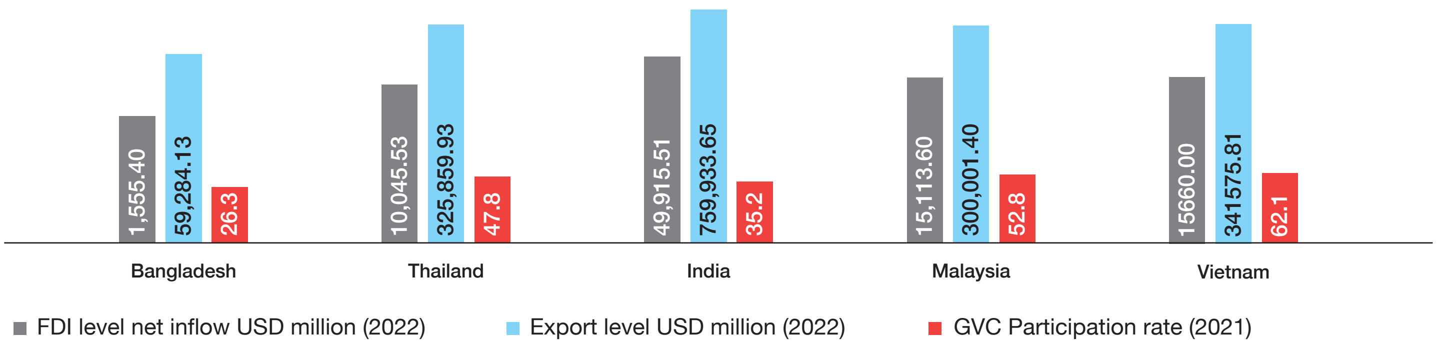
Increased interaction with MNCs raises probability of a firm to become direct exporters and grow

Domestic industries become integral components of the intricate global production networks



With GVC-driven development, countries generate growth by moving to higher value added products

Level of FDI and GVC Participation of Bangladesh and Comparator Countries



CHAPTER 3

CRITICALITY OF FDI FOR COMPETITIVENESS AND GLOBAL VALUE CHAIN (GVC) INTEGRATION FOR BANGLADESH

3.1 How FDI Helped Propel Bangladesh's Impressive Growth Journey

FDI empowers nations to ascend the value chain, gain competitiveness and expand into new markets, leveraging strengths globally and catalyzing transformative growth. FDI is a powerful driver that empowers countries to climb the value chain, gain competitive advantages and venture into new markets. This strategic infusion of foreign capital and expertise catalyzes transformative growth, enabling nations to leverage their strengths and position themselves more competitively on the global stage. The role of FDI in facilitating this upward trajectory is crucial, and Bangladesh's development story is a testament to the profound impact of this investment inflow.

Strategic infusion of foreign capital and expertise catalyzes transformative growth, enabling nations to leverage their strengths and position themselves more competitively on the global stage.

For Bangladesh, FDI has been a catalyst for monumental growth and progress, exemplified by transformative joint ventures. FDI has played an indispensable role in propelling Bangladesh's Ready-Made Garments (RMG) sector to its current stature as a global powerhouse. The strategic harnessing of FDI has been pivotal in driving monumental growth and fostering transformative joint ventures within the country.

Bangladesh's investor-friendly policies and geographic advantage make it a compelling FDI destination, driving substantial inflows. The country's strategic measures to create an investor-friendly environment, coupled with its geographical advantage and a vibrant, young population, have positioned it as an attractive destination for foreign investments. The remarkable surge in FDI inflows, reaching a record high of $3.4 billion in 2022, exemplifies the confidence of global players in Bangladesh's potential. This investment has not only bolstered the economy but has also generated employment opportunities and enhanced infrastructure, underpinning the nation's development aspirations. The transformative power of FDI in Bangladesh is most apparent in sectors that have witnessed a large influx of investment. While many sectors such as FMCG and ICT have benefitted from large investments in the past decades, which significantly levelled up the skill, technology and overall management standard of the industries, RMG, Telecommunications and Energy stand out as vivid examples.

The remarkable surge in FDI inflows, reaching a record high of $3.4 billion in 2022, exemplifies the confidence of global players in Bangladesh's potential.

Box 1: FDI has been a Driving Force for Bangladesh's Stellar Growth in RMG

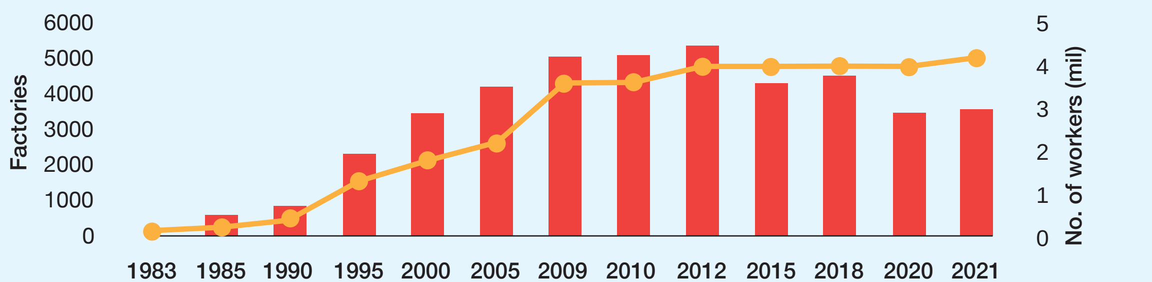
The genesis of Bangladesh's remarkable journey in the RMG sector through FDI can be traced back to its pioneering joint venture – the establishment of Desh Garments. This groundbreaking partnership, forged with the Korean Daewoo Corporation, marked Bangladesh's inaugural entry into the world of 100% export oriented RMG. Notably, this collaboration extended beyond investment; it encompassed the comprehensive training of 130 workers and staff for an intensive six-month period. This transformative experience not only equipped the workforce with invaluable skills but also sowed the seeds for future garment factory ownership. Many of those who underwent this training have since established their garment factories, catalyzing the sector's indigenous growth. Simultaneously, Korean entrepreneurs ventured into the RMG sector within Bangladesh, further contributing to its dynamism. The profound impact of this joint venture resonates in the sector's current composition, where RMG exports constitute over 80% of Bangladesh's total exports.

Beyond this seminal partnership, the historical context of Bangladesh's RMG sector reveals a consistent pattern of growth fueled by FDI. In 1978, when the sector was in its nascent stages, a mere nine export oriented RMG manufacturers generated a modest $1 million in export earnings. Among these early pioneers was Reaz Garments, a small domestic player that marked its international debut by shipping 10,000 garments worth 13 million Francs to a Paris-based firm.

In a parallel trajectory, the establishment of Desh Garments in 1977 through a joint venture with South Korean garment manufacturer Daewoo catalyzed significant industry growth. Daewoo's infusion of cutting-edge technology and marketing expertise rejuvenated Bangladesh's RMG industry. This partnership initiated with a $1.3 million investment from Daewoo in Desh Garment paved the way for a transformative journey. Armed with a workforce of 600 and a capacity to produce 5 million pieces, this venture laid the foundation for substantial sectoral expansion.

Youngone, a prominent South Korean garment manufacturing company, entered Bangladesh's RMG landscape through a joint venture with local RMG manufacturer Trexim LTD in 1980. This strategic collaboration, leading to the formation of Youngone Bangladesh, marked Bangladesh's entry into the global RMG arena. In December 1980, Youngone Bangladesh celebrated a significant milestone by exporting its first consignment of padded and non-padded jackets to Sweden. South Korea has traditionally been the single largest foreign investor in the local readymade garments and textiles sector and the government is impressing upon South Korea to invest more. Over 200 Korean companies have invested significantly in Bangladesh's garment sector, solidifying Korea's status as the largest foreign investor in the RMG and textile industry. This symbiotic relationship between FDI and the RMG sector's expansion is evident in the exponential growth of Bangladesh's RMG exports to Korea, which surged by more than 400% over the past decade. The sector's exports escalated from $125 million in 2012 to an impressive $564 million in 2022.

Figure 25: Growth in the Number of Factories and Employment in RMG



Source: Study on the Decline of Women Workers in the Textile Industry in Bangladesh 2023, Ethical Trading Inititiative

In contemporary times, FDI continues to be a driving force in Bangladesh's RMG sector. Bangladesh is strategically positioning itself as a desirable destination for businesses looking to relocate their low-end readymade garments manufacturing units, primarily due to China's escalating manufacturing costs, rendering such production less feasible in the country. Bangladesh has sought China's cooperation in reshaping its RMG industry by transitioning from cotton-based manufacturing to producing high-value non-cotton items, thus ascending the value chain. In a parallel effort, Bangladesh is also actively vying for Japanese companies seeking to relocate from China, a trend that emerged following China's implementation of a zero-Covid lockdown policy. Furthermore, India has expressed its keen interest in investing within the non-cotton segment of Bangladesh's burgeoning textile industry. As Bangladesh actively seeks FDI to bolster its foreign exchange reserves, the RMG sector's well-established infrastructure and evolving global dynamics makes Bangladesh an attractive destination for businesses seeking relocation.

Box 2: FDI in Telecommunications: Fueling Connectivity and Economic Growth

The telecommunications sector stands as a remarkable illustration of how FDI has been a pivotal game-changer for Bangladesh, positioning the nation as a regional trailblazer. Through pioneering investments by internationally acclaimed corporations, Bangladesh's telecommunications landscape has undergone a profound transformation. These strategic investments have not only expanded mobile phone coverage but have also accelerated the country's journey toward heightened internet speeds and enhanced accessibility.

The telecom sector's growth narrative in Bangladesh paints a tale of remarkable evolution. While the introduction of the first telecom company, Citycell, dates back to 1989, the industry's transformative growth truly ignited in 1997 with the entrance of GrameenPhone (GP), the country's largest telecom operator. Since then, the sector has expanded at an astonishing rate, with multiple players vying for market share, leading to significant advancements in connectivity and accessibility. This fierce competition has not only translated into economic growth but has also empowered consumers with choices and convenience, demonstrating how FDI-driven growth can revolutionize an entire industry and the lives of its citizens.

Figure 26: 6 Mobile Operators have Existed in Bangladesh, 5 of which are Joint Ventures with Foreign Entities

Five out of six mobile operators in Bangladesh are joint ventures with foreign entities

- Telenor (62%)
- Grameen Telecom (38%)

- Telecom Malaysia Berhad TM
- A.K. Khan & Company Limited

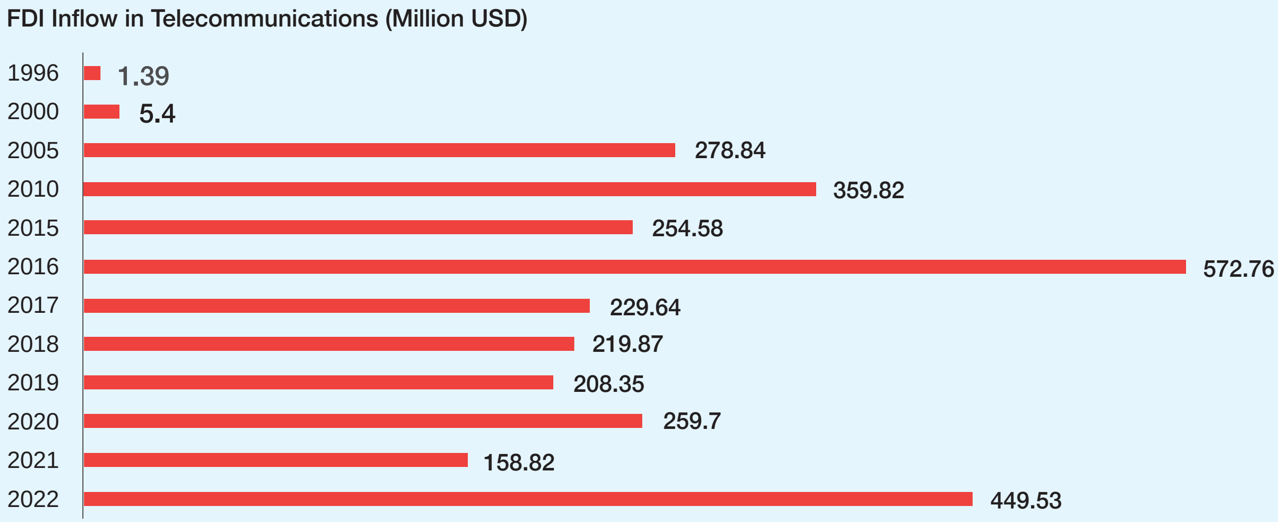
- Orascom Telecom Co. originated from Egypt

- Public Limited Company
- Owned by GoB (100%)

An illustrative instance of FDI's transformative prowess can be observed through the influence of Norway's telecommunications giant, Telenor. With a remarkable injection of $1.5 billion, Telenor embarked on a venture that transcended mere financial investment. This strategic move not only fortified the nation's telecommunications network but also sent ripples of growth across multiple sectors. A resounding testament to FDI's capacity to ignite a virtuous cycle of development, Telenor's investment ushered in a surge of opportunities, creating a staggering 10,000 job openings within the economy. Beyond job creation, the infusion of Telenor's capital catalyzed an environment of technological upskilling, where individuals and businesses alike were compelled to harness and adapt to cutting-edge innovations.

Huawei's investment in a cutting-edge data center exemplified FDI's transformative potential, creating broad economic ripples. China's technological titan, Huawei, entered the scene with a resounding impact, channeling a monumental $1 billion into the establishment of a state-of-the-art data center. This move was not just a fiscal injection; it was a strategic maneuver that reverberated across Bangladesh's economic landscape. The outcomes were multifaceted, from the creation of direct employment within the data center to the indirect employment generated through the supporting industries that sprung up. Such endeavors are reminiscent of FDI's ability to function as a catalyst, sparking a ripple effect that extends far beyond the initial investment figures. Huawei has also focused on bringing in ICT and telecommunication services and solutions, developing ICT talents, and enabling the digital ecosystem of Bangladesh. In the telecom sector, Huawei has facilitated the telco industry with 2G, 3G and 4G technologies and played a crucial role in the 5G enrollment. Huawei has also provided support to connect more than 15,000 Base Transceiver Stations (BTS) with fiber.

Figure 27: FDI Inflow in Telecommunications Over the Years



Source: Bangladesh Bank

These investments reshaped Bangladesh's telecommunications and global positioning, elevating digital connectivity and innovation through FDI. Collectively, the investments have not only transformed the telecommunications landscape of Bangladesh but have also redefined its position on the global stage. The country's mobile phone penetration rates have soared, making it a standout leader in digital connectivity. The multifaceted impact of these foreign investments is a testament to the catalytic role that FDI can play in fostering innovation, creating job opportunities and propelling a nation's technological and economic progress.

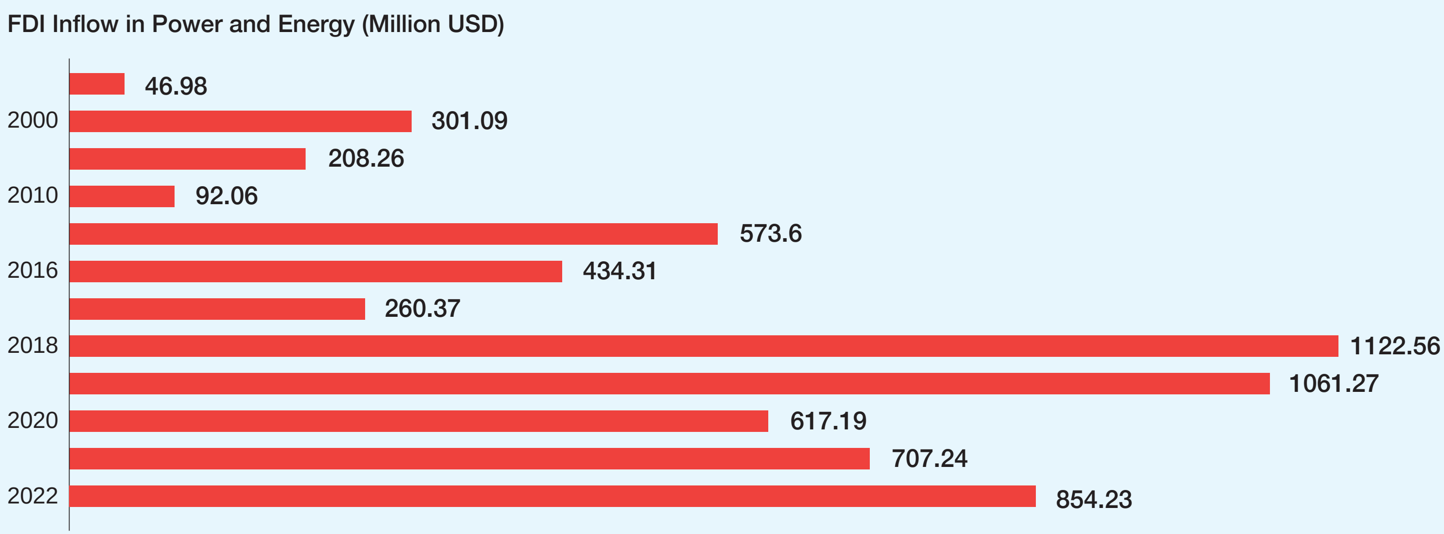
FDI as Catalysts for Technological Advancement and Employment: Equally transformative is the software and IT service industry's journey in Bangladesh. What was once a sideline endeavor has blossomed into a robust sector that not only significantly contributes to the national income but also plays a pivotal role in creating high-quality employment opportunities for the nation's burgeoning youth population. The enthusiasm and resilience of young entrepreneurs have become the driving force behind the growth of Bangladesh's IT industry, underscoring how FDI can incubate innovation, generate employment and propel an industry into the global mainstream.

Box 3: FDI Powering Bangladesh's Energy Security and Diversification

FDI's transformative impact extends unequivocally into the energy sector, where it has addressed pressing challenges and steered Bangladesh towards an era of energy security. Notably, the power sector has emerged as the primary beneficiary of foreign investment, fetching an impressive $30 billion over the past 13 years since 2009. During this period, it stands alone as the sector with the highest influx of foreign capital, underscoring its critical importance to the nation's development trajectory.

Strategic energy investments have reshaped Bangladesh's power sector, infusing diversity and reliability. Investments in various energy sources, ranging from coal-fired to hydroelectric and gas-fired power plants, have effectively addressed Bangladesh's chronic power shortages while concurrently building a resilient and diversified energy infrastructure. The transformative impact of these investments is exemplified by India's Adani Group, which committed a significant $1.2 billion to a coal-fired power plant. Beyond just bridging energy gaps, this investment has played a crucial role in job creation, offering employment opportunities in both construction and operational phases. This showcases how foreign investment in the energy sector can drive not only infrastructural growth but also contribute to human resource development.

Figure 28: FDI Inflow in Power and Energy Over the Years



Source: Bangladesh Bank

A noteworthy contribution to Bangladesh's energy self-reliance journey comes from the United States' General Electric (GE). GE significantly contributes to Bangladesh's journey towards energy self-sufficiency. With a current presence of 37 turbines generating 2,200 megawatts in the country, GE is set to develop a novel 600-megawatt combined-cycle power plant near Dhaka. This facility will employ GE Power's advanced 9HA gas turbine in conjunction with a steam turbine and generator to produce electricity. Anticipated to go live in 2021, the power station will provide energy equivalent to the needs of approximately 700,000 local households. This investment not only amplifies energy generation capacity but also symbolizes global acknowledgment of Bangladesh's strides in constructing a resilient energy infrastructure. The far-reaching impact of this endeavor is evident in the emergence of employment opportunities within the local gas industry and associated supply chains. Beyond its immediate implications, GE's investment underscores the prospect for international entities to collaborate with Bangladesh in advancing its energy objectives, thereby nurturing economic prosperity.

FDI sparks solar revolution, igniting energy generation, employment and innovation, bolstering Bangladesh's sustainable future. One striking example of FDI's significance is showcased in Bangladesh's foray into solar power. The nation's ambitious clean energy targets were given a substantial boost with investments in solar power projects. A monumental rooftop solar power project, funded by Korea's Youngone, stands as the largest of its kind in Bangladesh, with a cumulative capacity of 40 megawatts (MW). As the project unfolds in phases, it exemplifies FDI's potential to revolutionize energy generation. This strategic investment not only addresses energy gaps but also ushers in employment opportunities and technological advancements. Furthermore, as Bangladesh navigates the challenges of fossil fuel dependence and climate vulnerability, FDI's role in renewable energy projects gains paramount importance. A landmark proposal for an offshore wind project, aligned with the nation's 'Blue Economy' goals, presents an opportunity to maximize coastal resources and mitigate climate risks. This proposal, coupled with strategic FDI, holds the potential to drive a climate-resilient and prosperous future.

The remarkable impact of FDI on Bangladesh's telecommunications, energy and technology sectors, among other sectors such as FMCG and ICT, is both profound and promising, showcasing transformative development driven by the force of FDI. Through foreign investment, the country has fortified connectivity, energy security, and technological advancement, propelling itself toward a trajectory of sustainable growth. By further committing to providing an enabling environment to harness the power of FDI, Bangladesh is not only positioning itself as a regional leader but also as a global player.

As Bangladesh's development trajectory continues to soar, the role of FDI remains instrumental. The recent trends in FDI inflows indicate promising prospects, with the government's commitment to enhancing the investment climate serving as a catalyst. The nation's focus on attracting strategic investments in key sectors, such as telecommunications and energy, has been pivotal in amplifying growth, creating jobs and fortifying infrastructure. By harnessing FDI for sustainable growth and strategically diversifying its economic landscape, Bangladesh is poised to achieve its ambitious development goals. Through collaboration with global partners, innovation and a steadfast commitment to progress, Bangladesh can navigate its path to a prosperous and resilient future, all underpinned by the transformative force of FDI.

3.2 Leveraging Global Value Chains (GVCs) and Enhancing Competitiveness for Bangladesh's Vision 2041

Bangladesh's Vision 2041 isn't just an economic growth target; it represents a comprehensive transformation of the nation and its exports. To achieve the goal of reaching upper middle-income status by 2041, Bangladesh must focus on two pivotal imperatives: enhancing the competitiveness of its key manufacturing sectors and establishing a robust presence in Global Value Chains (GVCs). This journey is aligned with the evolving dynamics of the global economy, where cross-border collaborations, innovation and technology drive development. In this new era, economies are no longer isolated; they are interconnected, participating in intricate value chains that span nations. To thrive in this landscape and break into new markets with highly competitive products, Bangladesh must harness the power of GVCs, which are integral to the nation's development aspirations.

Competitiveness is the lifeblood of global trade in the 21st century. In an interconnected world where borders are increasingly porous, nations must constantly strive to enhance their competitiveness to thrive in the global marketplace. Competitiveness isn't merely about producing goods and services efficiently; it's also about innovation, adaptability and the ability to meet evolving consumer demands. A competitive edge enables countries to attract foreign investment, foster the growth of domestic industries and participate meaningfully in GVCs.

It encourages businesses to constantly improve and innovate, which, in turn, drives economic growth and job creation. Moreover, competitiveness bolsters a nation's resilience in the face of economic uncertainties and global shocks, ensuring stability and prosperity for its citizens. In an era where trade agreements, technological advancements and consumer preferences shape the global trade landscape, competitiveness is the compass that guides nations towards economic growth, sustainable development, and a prominent role in the global economy.

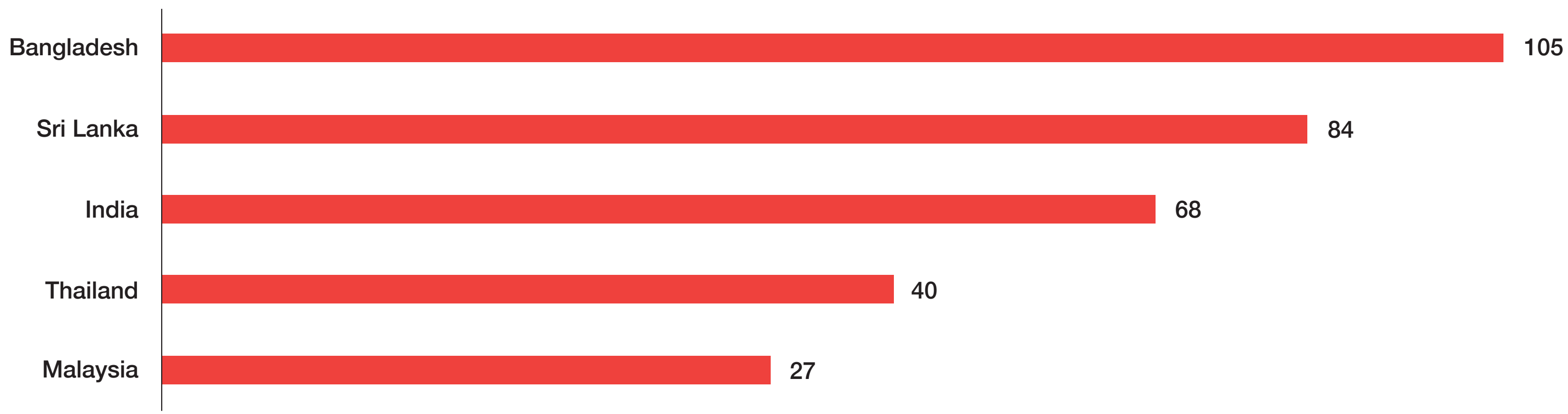
Competitiveness isn't merely about producing goods and services efficiently; it's also about innovation, adaptability, and the ability to meet evolving consumer demands.

While Bangladesh possesses low-cost labor, it confronts the reality of being ranked low in terms of competitiveness, underscored by reports from the World Economic Forum (WEF) and the World Bank. The WEF's Global Competitiveness report places Bangladesh at a modest rank, reflecting the need for transformative strategies.

Despite having an edge in terms of cost-effective labor, the nation's global competitiveness rankings remain subdued. While Bangladesh possesses low-cost labor, it confronts the reality of being ranked low in terms of competitiveness, underscored by reports from the World Economic Forum (WEF) and the World Bank. The WEF's Global Competitiveness report places Bangladesh at a modest rank, reflecting the need for transformative strategies. It places Bangladesh at 105 out of 141 countries in its Global Competitiveness report. A cocktail of factors including lack of innovation, underdeveloped infrastructure, inefficient trade processes and inadequate skill levels has curtailed the nation's ability to keep pace with dynamic global markets. Bangladesh's ranking in the Doing Business Index, particularly in Trading Across Borders, is indicative of these challenges. Inefficiencies in documentary compliance and enforcement of contracts, alongside procedural delays in obtaining electricity, collectively culminate in its modest ranking.

The productivity of firms, a linchpin of competitiveness, remains subpar with a substantial variance between high and low productive entities.

Figure 29: Ranking of Bangladesh and Comparator Countries in Global Competitiveness Index, 2019



Bangladesh grapples with diminishing competitiveness and a string of challenges that could potentially hinder the realization of Vision 2041. As Vietnam strategically focuses on technological efficiency, Bangladesh's reliance solely on low-cost labor becomes precarious, exposing it to the risk of losing its competitive edge. Lengthy trade document processing times and inefficiencies in border control further inflate trade-related costs, diminishing its attractiveness for investors and eroding competitiveness. Furthermore, Bangladesh's imminent graduation from Least Developed Country (LDC) status poses a unique challenge. Tariff-free privileges will diminish, potentially increasing export prices. In a realm where Bangladesh already boasts some of the world's most affordable labor, abrupt tariff impositions can destabilize the economy. Efficient adaptation becomes the imperative to mitigate these challenges.

Table 2: International Trade Indices Show Room for Improvement

Trade Freedom Index 2023		Enabling Trade Index by World Economic Forum 2016		Logistics Performance Index 2023	
Country	**Rank (out of 175 countries)**	**Country**	**Rank (out of 136 countries)**	**Country**	**Rank (out of 160 countries)**
Bangladesh	131	Bangladesh	123	Bangladesh	88
Vietnam	53	Vietnam	73	Vietnam	43
Indonesia	37	Indonesia	70	Indonesia	63

Source: The Global Economy, World Bank, World Economic Forum

To boost competitiveness, Bangladesh must streamline business processes, reducing costs and delays in trade. Notably, Bangladesh's labor cost advantage is offset by excessive trade transaction expenses and trade barriers. The nation's economic ties with key players like India, China and South-East Asia offer avenues for export growth, but these opportunities mandate the reduction of border and non-tariff barriers. By reducing the time and cost of doing business, the nation can enhance its competitiveness. Currently, cumbersome border documentation and compliance procedures contribute to extended export times and elevated costs. The path forward demands a concerted effort to ameliorate these shortcomings. Streamlining contract enforcement, reducing electricity acquisition time, and simplifying trade documentation will be instrumental. Bangladesh’s position in global indices hinge on such reforms.

Besides bolstering trade infrastructure and refining trade procedures, Bangladesh's ability to remain competitive necessitates heightened productivity and efficiency. The traditional paradigms of mere labor cost advantage are insufficient in the current landscape. The evolution of global markets has shown that sustained competitiveness thrives on innovation, adaptability and efficiency at every level of production. The ability to produce more with less and to swiftly respond to changing consumer demands defines the new paradigm of global competition. The essence of Vision 2041 converges with this narrative. The vision envisions a Bangladesh that is technologically advanced, resilient and well-integrated into the global economy. It's a call to fortify the nation's competitive edge by transforming industries, nurturing innovation and fostering a business environment conducive to growth. Bangladesh aims to transition from its current status of labor-driven advantage to a stage where technology, innovation and efficiency are the cornerstones of its competitiveness.

Bangladesh's pursuit of enhanced competitiveness and GVC integration is a roadmap that aligns seamlessly with Vision 2041. GVCs epitomize the modern economic ecosystem where each component's specialization merges into a cohesive whole. GVC integration is about becoming an essential player in the production network, leveraging strengths and collaborating with global partners. The integration into GVCs is an avenue to expand export horizons and product diversity. This entails not only producing intermediate goods but also emerging as an "assembling" hub. China's trajectory offers insights, showcasing the efficacy of assembling hubs in capturing market access. Bangladesh’s vision 2041 places GVC participation at the epicenter of its strategy, signaling a strategic shift towards fostering an environment where productivity, innovation and quality thrive. Bangladesh's collaboration with global partners can elevate its competitiveness and GVC participation and secure its position in the international market.

The integration into GVCs is an avenue to expand export horizons and product diversity. This entails not only producing intermediate goods but also emerging as an "assembling" hub.

The seamless integration of domestic businesses into GVCs hinges on private sector engagement, as it is often the engine driving exports and ensuring participation in cross-border production networks.

Private investment, including FDI, is a critical necessity for propelling nations towards enhanced competitiveness and seamless integration into GVCs. As countries strive to carve out their niche in the global economic arena, the role of private investment, specially FDI becomes paramount. It infuses much-needed capital, fosters innovation, and catalyzes technological advancements, positioning industries on the cutting edge of global competition. The seamless integration of domestic businesses into GVCs hinges on private sector engagement, as it is often the engine driving exports and ensuring participation in cross-border production networks. Additionally, private investment facilitates the development of critical infrastructure and nurtures a skilled workforce, two vital components that underpin a country's competitiveness in today's interconnected world. FDI, in particular, with their global market linkages, advanced technology, experience and agility, are well-suited to navigate the complexities of international markets, thereby strengthening a nation's foothold in GVCs. In essence, private investment serves as the conduit through which countries can elevate their competitive edge and secure a meaningful position in the global economic landscape.

3.3 FDI's Catalytic Role in Elevating Competitiveness

FDI as a Trade Competitiveness Game-Changer: FDI has emerged as a transformative force driving trade competitiveness worldwide. Its impact resonates across sectors by transferring technologies, fostering knowledge spillovers, promoting healthy competition and unlocking access to new markets. This section delves into the multifaceted role of FDI in enhancing trade competitiveness and its potential to reshape the economic landscape for nations striving to attain global prominence.

Technology Transfer: Elevating Competitiveness Through Innovation

At the core of FDI's contribution lies its ability to infuse new technologies into the fabric of host countries. Multinational corporations, seeking to leverage their technological expertise, establish subsidiaries or acquire local companies. Apple's foray into China's manufacturing landscape stands as a testament to this phenomenon, introducing advanced production techniques and skilled labor. This infusion of technology not only optimizes production costs but also augments the competitive edge of exports. Similarly, Volkswagen's investment in Mexico has propelled the country into an automotive hub through the introduction of cutting-edge manufacturing technologies.

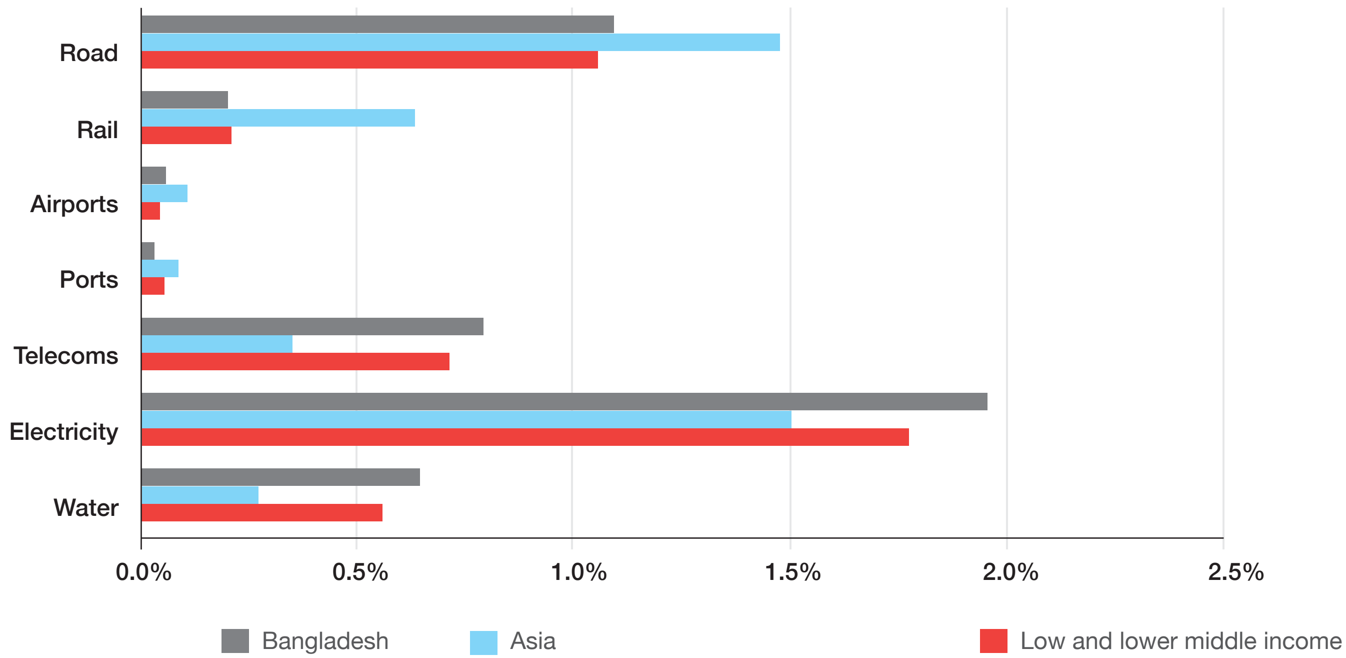
Apple's foray into China's manufacturing landscape stands as a testament to this phenomenon, introducing advanced production techniques and skilled labor.

When multinational corporations invest in a host country, they often bring with them substantial resources dedicated to infrastructure development.

Infrastructure Enhancement: Elevating Competitiveness Through Connectivity

FDI carries immense potential to bolster a nation's infrastructure, thereby enhancing its overall competitiveness. When multinational corporations invest in a host country, they often bring with them substantial resources dedicated to infrastructure development. These investments can manifest in various forms, from the construction of modern transportation networks and logistical hubs to the establishment of state-of-the-art energy generation facilities. Such infrastructure enhancements not only facilitate the movement of goods and people but also create a conducive environment for businesses to thrive. For instance, the development of world-class ports and shipping facilities in Singapore has solidified the nation's position as a global trading hub. Similarly, FDI in India's renewable energy sector has led to the creation of cutting-edge solar and wind energy installations, improving the country's energy infrastructure and reducing reliance on fossil fuels. In this way, FDI can be a catalyst for enhancing a country's infrastructure, positioning it as a more competitive player in the global economy.

Figure 30: **Infrastructure Investment Need as % of GDP (2016-2040)**



Source: Oxford Economics

Fostering Knowledge Spillovers: Collaborative Learning for Trade Enhancement

FDI's impact goes beyond technology infusion; it triggers a valuable exchange of knowledge between foreign and local firms. Collaborative efforts, such as joint research and hiring specialized talent, facilitate the transfer of best practices and advanced technologies. This symbiotic knowledge exchange not only enhances local firms' productivity but also empowers them to compete on the global stage. Collaborations in India's pharmaceutical sector, for instance, have elevated the country's status as a global supplier of generic drugs.

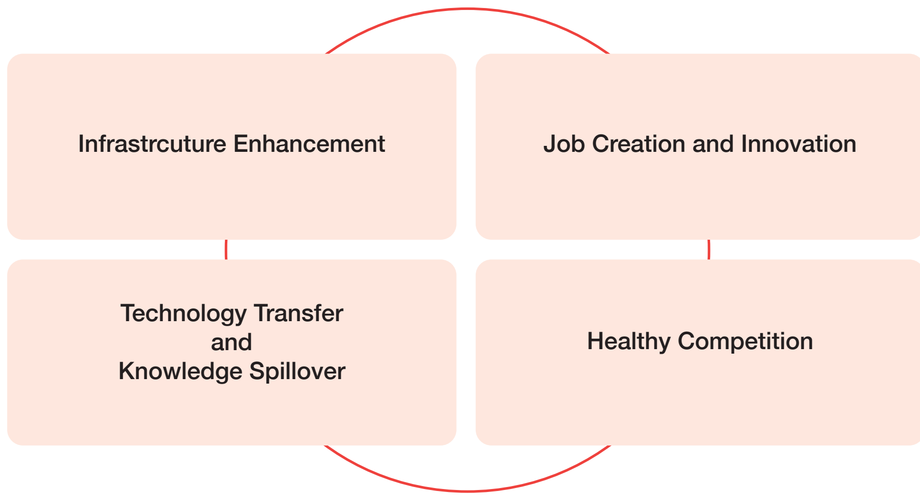
Healthy Competition: Powering Efficiency and Innovation

Foreign investments introduce a crucial element of competition into the local market. The entry of foreign firms challenges domestic companies to enhance their efficiency, innovate and elevate product quality to remain competitive. This competitive impetus prompts local firms to streamline operations, boosting their global competitiveness. Walmart's entrance into India's retail sector exemplifies this, spurring innovation among local retailers and propelling them to align with shifting consumer preferences.

Job Creation and Innovation: A Symbiotic Trade Cycle

FDI brings more than just capital; it brings job opportunities and skill development for the local workforce. New facilities and labor-intensive processes create employment, which in turn raises income levels and stimulates demand for goods and services. This surge in demand fuels increased production and exports. Moreover, FDI acts as an innovation catalyst, compelling local firms to match the technological strides of foreign investors. South Korea's journey from aid recipient to innovation leader is partly attributed to the knowledge infusion catalyzed by FDI.

Figure 31: Importance of FDI for Trade Competitiveness



FDI holds the key to unlocking a prosperous future for Bangladesh and provides a pathway to trade excellence. In the context of Bangladesh, these global examples underscore the transformative potential of FDI in enhancing trade competitiveness. Its role in technology transfer, knowledge spillovers, healthy competition, market access, job creation and innovation make it a linchpin for economies aspiring to thrive in the global trade arena. For Bangladesh, FDI stands as a potent tool to reshape its trade landscape and secure a position of prominence in the global economy. By strategically attracting FDI, Bangladesh can fast-track its technological capabilities, foster innovation and carve a significant niche in regional and global trade networks. Channeling FDI into pivotal sectors like textiles, technology and manufacturing can expedite Bangladesh's journey towards its goal of becoming a high-income economy by 2041.

3.4 FDI Helps in Global Value Chain Integration and Access to New Markets

FDI acts as a bridge, providing host countries access to new markets and enabling export growth, ultimately enhancing economic stability and trade balance. FDI has emerged as a crucial driver for the integration of economies into the Global Value Chain (GVC), a phenomenon that fosters economic growth, technological advancement and enhanced market access. FDI facilitates the integration process through various mechanisms, including access to new markets, supply chain linkages and technological transfer. FDI serves as a conduit through which countries like Bangladesh can tap into the benefits of globalization and achieve significant milestones in economic development. For countries like Bangladesh, which aspire to harness the benefits of globalization and achieve economic development milestones, the role of FDI in GVC integration is of paramount importance.

A foundational advantage of FDI lies in its capacity to grant host countries access to new markets. The presence of foreign companies within a host nation opens avenues for exporting products to international markets. This is exemplified by foreign companies investing in a host country and subsequently exporting their products to other nations, including theirs. This dynamic not only bolsters the host country's export earnings but also strengthens its trade balance, thereby contributing to economic stability. Additionally, FDI propels the host country's industries to engage with international customers and suppliers, gradually becoming integral components of the broader global production networks. This integration goes beyond mere trade, propelling local industries to engage deeply with global customers and suppliers. Consequently, domestic industries become integral components of the intricate global production networks, enhancing economic stability and growth.

The presence of foreign companies within a host nation opens avenues for exporting products to international markets, including theirs.

The Transformative Power of FDI-Driven GVC Integration is Illuminated through Global Exemplars

FDI's significance in facilitating GVC integration is monumental, serving as a catalyst for countries seeking to establish themselves on the global stage. The injection of capital, advanced techniques, skills and innovation that FDI brings is vital for successful competition in the global market. Additionally, FDI creates the foundation for building global production networks within host economies, as local firms strategically collaborate with international corporations, thereby increasing their potential to become direct exporters. Through the ripple effects of spillovers and agglomerations, FDI fosters a conducive environment for expanded GVC access and continuous updates. Globally, numerous economies have reaped the substantial rewards of GVC integration and advancement, primarily driven by FDI. China, Vietnam and India serve as models where FDI has facilitated GVC integration across sectors, propelling economic growth, exports and poverty reduction.

China, Vietnam, and India serve as models where FDI has facilitated GVC integration across sectors, propelling economic growth, exports and poverty reduction.

China, a standout success story, has leveraged FDI to seamlessly integrate across sectors such as textiles, electronics and manufacturing. This influx of foreign investment catalyzed China's economic growth, propelling it into a global economic powerhouse with intricate ties to value chains. Similarly, FDI played a pivotal role in Vietnam's GVC journey, fostering domestic competition, increasing production efficiency and facilitating innovation and technology transfer. Vietnam's utilization of FDI for integration, particularly in textiles, footwear and electronics, resulted in augmented exports and reduced poverty, underscoring FDI's role in facilitating economic upliftment. This integration has led to increased exports and a reduction in poverty, signifying the positive outcomes of FDI-driven GVC participation.

India, too, has harnessed FDI to bolster its integration into GVCs. Notably, sectors like software, pharmaceuticals and automobiles have experienced significant FDI inflows, enabling India to establish itself as a critical player in global value chains. The benefits of this integration are evident in increased exports and job creation, underscoring FDI's capacity to drive economic growth and development. Another illustrative case is Costa Rica, which significantly enhanced its GVC integration through robust FDI inflows over the past decades. This enabled the country to shift its export composition from primary products to high-tech manufacturing and value-added services, reflecting FDI's transformative potential. Notably, the combined efforts of FDI and foreign entrepreneurs facilitated domestic farmers' access to international markets, propelling the horticulture exports of Kenya and highlighting FDI's far-reaching impact in diverse sectors. These global examples collectively demonstrate that FDI plays a transformative role in enabling countries to participate in GVCs and reap the associated advantages.

FDI stands as a cornerstone for Bangladesh's development goals through diverse benefits. The potential dividends of FDI-fueled GVC integration for Bangladesh are manifold. Primarily, it offers a gateway to new markets and export diversification. Analogous to the experiences of China, Vietnam, and India, FDI can drive Bangladesh's exports to new heights while reducing dependency on a restricted range of products. Moreover, FDI introduces cutting-edge technologies and knowledge, a crucial element in Bangladesh's transition towards technology-intensive industries. By attracting FDI in sectors aligned with global trends such as e-commerce and green investments, Bangladesh can simultaneously diversify its economy and enhance its global competitiveness.

Figure 32: Factors that make FDI Important for GVC

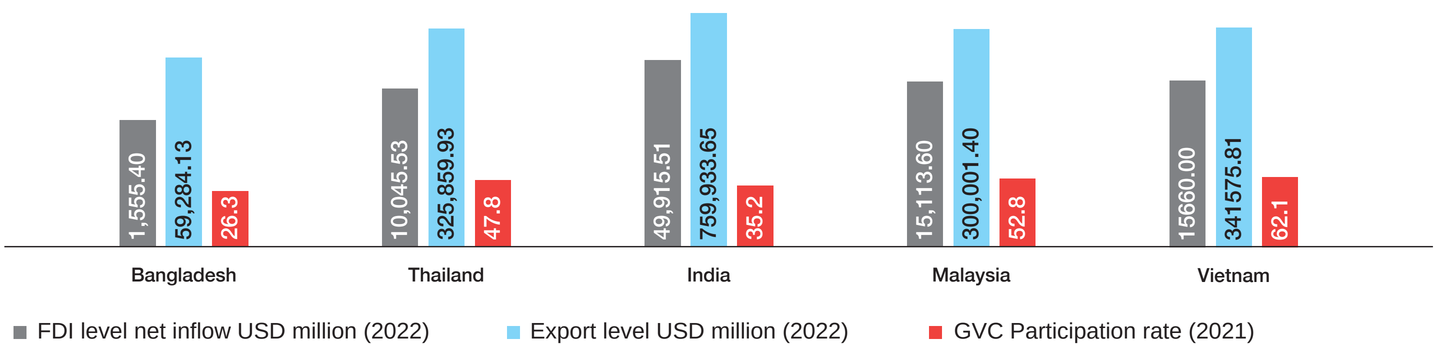
- FDI helps raise average product complexity and overall exports
- Increased interaction with MNCs raises the knowledge and probability of a firm becoming a direct exporter
- FDI propels the host country's industries to engage with international customers and suppliers, gradually becoming integral components
- Domestic industries become integral components of the intricate global production networks
- With GVC-driven development, countries generate growth by moving to higher-value-added products. China, India, Vietnam harnessed FDI to bolser GVC integration

FDI offers Bangladesh avenues to diversify its exports, infuse advanced technologies, create jobs and groom a skilled workforce, contributing to economic growth and competitiveness. For Bangladesh, FDI holds immense relevance in the pursuit of economic development and GVC integration.

By integrating into global production networks, Bangladesh can tap into advanced technologies, managerial expertise, and international market access, enhancing its position in the global economy.

The country's progress in poverty reduction, economic growth, and export-oriented industrialization owes much to foreign investments in key sectors. To ensure sustainable economic growth and achieve its ambitious development goals, Bangladesh recognizes the need to leverage FDI for greater GVC participation. By integrating into global production networks, Bangladesh can tap into advanced technologies, managerial expertise and international market access, enhancing its position in the global economy. Moreover, FDI-fueled GVC integration can catalyze job creation and skill development, addressing the challenge of absorbing a burgeoning youth workforce. This aligns with Bangladesh's demographic profile, where a substantial portion of the population is entering the labor force. The integration into GVCs can provide valuable employment opportunities in sectors aligned with international industry standards, effectively contributing to human capital development.

Figure 33: Level of FDI and GVC Participation of Bangladesh and Comparator Countries



Source: World Bank and ADB

The inflow of FDI may play an important role in Bangladesh in the long run in reducing the deficit in the country's trade balance. FDI typically exerts a more positive influence on economies by enhancing exports rather than raising imports. Research indicates FDI-funded companies tend to prioritize exports due to their advantages in global market insights, efficient distribution channels, and adaptability to evolving international trends.

Policies like Export Processing Zones (EPZs) further reinforce the link between FDI and exports.

Policies like Export Processing Zones (EPZs) further reinforce the link between FDI and exports. Bangladesh stands to benefit in the long run as FDI inflows could potentially alleviate trade deficits. Though initial FDI influx may elevate imports, this trend is attributed to FDI-backed firms importing capital and intermediate goods not readily available locally. However, if FDI is channeled into import-substitution industries, it may reduce imports as foreign investors begin producing goods domestically. Overall, FDI's potential to augment exports and potentially mitigate trade imbalances makes it a valuable component of Bangladesh's economic vision.

Navigating challenges for boosting FDI for optimal GVC integration. The criticality of FDI in GVC integration is indisputable, yet the path towards realizing its full potential requires addressing key challenges. Improving the investment climate, enhancing infrastructure, and nurturing a skilled workforce are essential steps. Strategic FDI attraction, aligned with Bangladesh's strengths and global demand, will play a pivotal role in ensuring efficient participation in GVCs. By fostering an investor-friendly environment and aligning with emerging global trends, Bangladesh can harness FDI's potential to transform its economy.

Strategic FDI attraction, aligned with Bangladesh's strengths and global demand, will play a pivotal role in ensuring efficient participation in GVCs.

In the tapestry of economic development, FDI stands as a thread that weaves together various facets of growth, from technology infusion to market expansion. Global exemplars like China, Vietnam and India have illuminated the transformative capacity of FDI in GVC integration. For Bangladesh, the prospect of leveraging FDI for sustainable growth, technological advancement, and international competitiveness is not just an aspiration but a tangible pathway. By crafting an environment conducive to FDI, nurturing strategic partnerships and aligning with emerging global trends, Bangladesh can harness FDI's potential to realize its economic aspirations. The journey towards GVC integration through FDI is a roadmap towards economic prosperity, technological elevation and a prominent position in the global economy.

CHAPTER 4

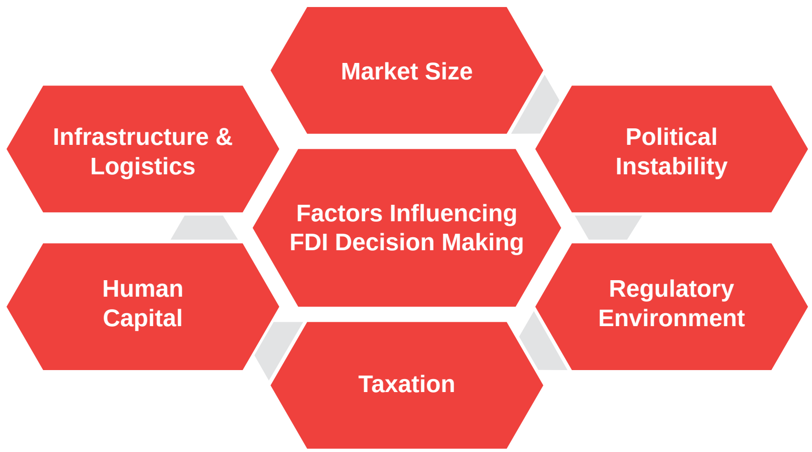
THE INVESTMENT CLIMATE FOR FDI IN BANGLADESH: A WORK IN PROGRESS AND REQUIRES PRIORITY ATTENTION

Chapter at a Glance

Issues in Regulatory Framework that Adversely Affects FDI Facilitation

- Elevated levels of regulatory ambiguity
- Complex mechanisms requiring numerous approvals and clearances
- Reluctance towards profit repatriation
- Absence of a medium-long term FDI strategy
- Lack of investor after-care services

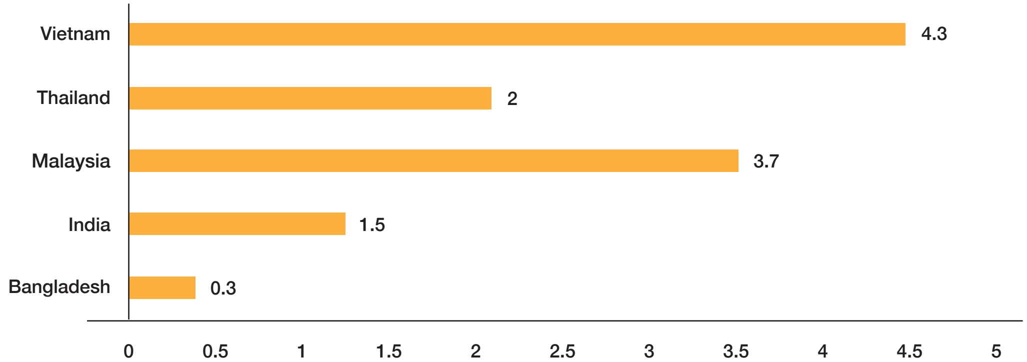
Factors Influencing FDI Decision Making



Gross Investment as % of GDP target of **46.9** in accordance to Vision 2041

FDI as % of GDP target of **3** in accordance to Vision 2041

FDI as a percentage of GDP in Bangladesh behind comparator countries



Several factors that collectively hold back the nation's appeal as an investment destination

- Trade Logistics and Infrastructure
- Complex Taxation Environment
- Lack of depth in the financial sector
- Investment Policy and Business Regulations, including investor aftercare
- Productivity Enhancement (e.g. Skills, Technology Adoption)

Issues in Regulatory Framework that Adversely Affects FDI Facilities

- Elevated levels of regulatory ambiguity
- Complex mechanisms requiring numerous approvals and clearances
- Reluctance towards profit repatriation
- Absence of a medium-long term FDI strategy
- Lack of investor after-care services

Top Three Tax Constraints for Investor in Bangladesh (BBX 2022)

Burdensome Compliance	High Effective Tax Rate	Low Awareness among Tax Payers and Limited Outreach by Tax Authorities

CHAPTER 4

THE INVESTMENT CLIMATE FOR FDI IN BANGLADESH: A WORK IN PROGRESS AND REQUIRES PRIORITY ATTENTION

Bangladesh's impressive achievements over the preceding decades will necessitate a substantial enhancement in Private Investment & FDI. FDI assumes a pivotal role in the realization of Vision 2041, standing as a catalyst for Bangladesh's transformation into a technological and economic powerhouse. By recognizing private investment, including FDI as the cornerstone of Vision 2041, the government has set some ambitions targets reflected in the perspective plans and the five-year plans leading to Vision 2041. As the nation progresses towards Vision 2041, the private sector's unwavering commitment to investment will be essential, given that the forthcoming phase of advancement demands the nation to attain ambitious developmental benchmarks.

Bangladesh's private investment and FDI relative to GDP needs to improve drastically to attain 2041 targets. The 8th Five-Year Plan (FYP) of the country aims to expedite economic progress and harmonize it with its aspirations, as manifested through key objectives: (i) amplification of gross investment from 31.8% to 36.6% of the Gross Domestic Product (GDP), (ii) augmentation of private investment from 23% to 27% of GDP, (iii) elevation of FDI from 0.5% to 3% of GDP, and (iv) escalation of exports from US$ 33.6 billion in 2020 to US$ 56 billion by 2025. FDI as a fraction of GDP, however stood at 1.01% in FY2022. The attainment of the nation's envisioned benchmarks will mandate the initiation of a more cohesive phase of policy formulation and requisite reforms. This is essential to uphold and amplify the recent trajectory of growth and to enhance comprehensive competitiveness on a broader scale.

Table 3: Development Performance in FY21 and FY22 and Targets for FY25 as Reflected in the 8th Five Year Plan

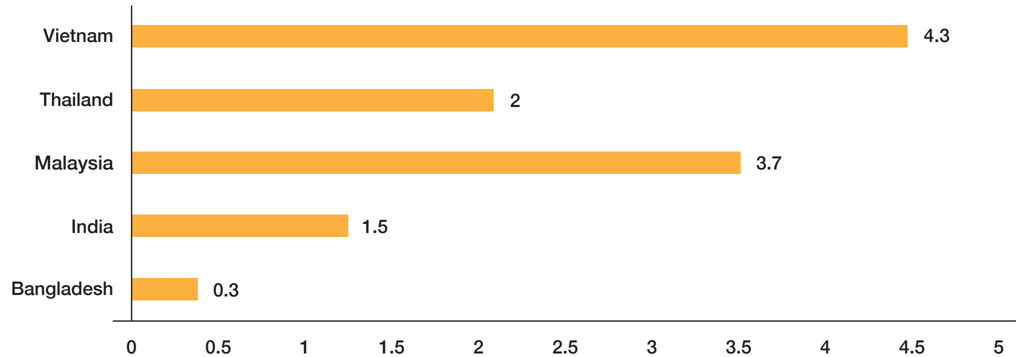
Indicator	FY21 (Achieved)	FY22 (Achieved)	FY25 (Target)
Gross Investment as % of GDP	31.01	31.68	36.59
Private Investment as % of GDP	23.70	24.06	27.35
FDI as % of GDP	0.3	1.01	3.00
Exports (in billion US$)	40	52	56

Source: 8th Five Year Plan, General Economics Division, Bangladesh Planning Commission, GOB, MTMPS, Finance Division, Ministry of Finance

Bangladesh's FDI lags behind peers, hindering its potential for economic growth and diversification. FDI has the potential to stimulate both private investment and economic diversification. However, the influx of FDI has been subpar over time. Heightened FDI correlates with amplified economic growth and private investment through bolstering domestic capital, enabling technology and product transfer, enhancing technical and managerial expertise, workforce training, and facilitating entry into new extensive foreign markets. Nonetheless, FDI's contribution to GDP has remained below 1% in recent years. According to latest World Bank figures published by the World Bank, Bangladesh in 2022 received US$ 1.56 billion. This is considerably low when compared to India (US$49.92 billion), Malaysia (US$15.1136 billion), Thailand (US$ 10.04553 billion) and Vietnam (US$15.66 billion). A stark contrast is noticed when these figures are converted to a fraction of the GDP figures of the respective countries as shown in the table below.

Bangladesh in 2022 received US$ 1.56 billion, which is considerably low compared to India (US$49.92 billion), Malaysia (US$15.1136 billion), Thailand (US$ 10.04553 billion) and Vietnam (US$15.66 billion).

Figure 34: FDI as a Percentage of GDP in Bangladesh and Comparator Countries



Source: World Bank

Several factors hinder FDI in Bangladesh, Collectively Diminishing the Economy's Appeal as an Investment Destination:

- **A complex and fragmented regulatory landscape,** involving 23 government agencies, necessitates numerous approvals and clearances, exacerbating costs and timelines for investors. Moreover, a conservative bureaucracy's reluctance towards profit repatriation deters FDI, in stark contrast to neighboring countries that have streamlined regulations to attract foreign investment. A systematic approach to investment promotion and investor after-care is also paramount, ensuring that investors receive comprehensive support throughout their investment lifecycle fosters trust and encourages long-term commitments.

- **One significant obstacle lies in the inefficiencies of trade logistics and infrastructure, which compromise the nation's competitiveness.** Cumbersome customs procedures, inadequate transportation networks, and congested ports impede the smooth flow of goods, raising operational costs and deterring potential investors. Inadequate industrial infrastructure further compounds the challenges. Subpar facilities and utilities, coupled with underdeveloped industrial zones, limit the nation's appeal as an investment destination. This lack of modern infrastructure hinders operational efficiency and the overall ease of doing business.

- **Addressing low productivity is another pivotal concern.** Skills development and the adoption of modern technology are crucial for attracting FDI. A skilled and technologically adept workforce is an essential asset for prospective investors, and Bangladesh must invest in these areas to remain competitive on the global stage. Access to finance remains a persistent challenge. Securing long-term loans proves difficult due to financial institutions' preference for short-term financing. Additionally, accessing foreign funding sources often involves protracted approval processes, causing delays.

- **Lastly, taxation issues affect the investment climate.** Investors encounter complexities related to profit repatriation, which deters FDI inflow. Neighboring countries have streamlined investment regulations to attract FDI, highlighting the need for Bangladesh to adopt similar strategies to enhance its investment allure. These multifaceted constraints emphasize the urgent need for comprehensive reforms to bolster investment prospects and create a more conducive environment for FDI in Bangladesh.

Figure 35: Few Factors that Collectively Hold Back the Nation's Appeal as an Investment Destination

Trade Logistics and Infrastructure	Investment Policy and Business Regulations, including investor aftercare	Productivity Enhancement (e.g. Skills, Technology Adoption)	Lack of depth in the financial sector	Tax Environment

4.1 Need for a More Predictable and Level-Playing Regulatory Framework

Regulatory uncertainty dampens investor confidence and trust in the policy landscape. Bangladesh's business landscape is marred by elevated levels of regulatory ambiguity, a factor that significantly dissuades foreign investors from establishing a presence within its borders. In the process of selecting suitable investment destinations, prospective investors meticulously evaluate the lucidity of prevailing policies, the credibility of government authorities, and the degree of adherence to established norms. Unfortunately, Bangladesh frequently falls short in delivering on its commitments, underscoring a deficiency in coordinated efforts due to entangled bureaucratic processes. This prevailing scenario undeniably dampens investor enthusiasm and trust, perpetuating an environment where the perceived risks of engagement outweigh the potential gains. This presents a compelling case for Bangladesh to streamline its administrative mechanisms and policy implementations, fostering an environment of certainty and reliability that can not only attract foreign investment but also promote sustained economic growth.

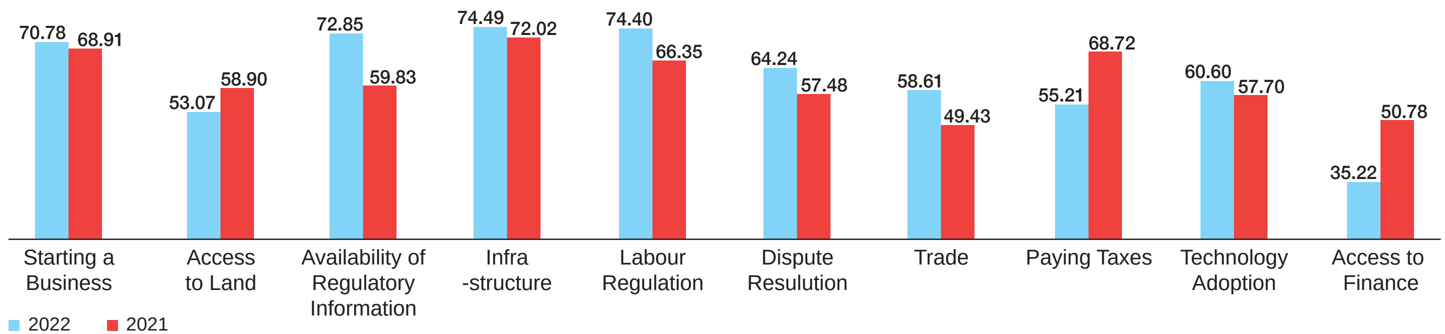
> *Bangladesh frequently falls short in delivering on its commitments, underscoring a deficiency in coordinated efforts due to entangled bureaucratic processes.*

Inefficiencies stemming from deficient coordination and centralized structures within the governmental apparatus contribute to the compromised attractiveness and competitiveness of the nation's business environment. The regulatory landscape in Bangladesh is intricate, composed of a labyrinthine network of 23 distinct government agencies responsible for catering to investor needs. Aspiring investors are compelled to navigate this intricate landscape, often encountering the requirement to secure up to 150 approvals, registrations, certificates, or clearances from a multitude of entities, such as the Bangladesh Investment Development Authority (BIDA), Registrar of Joint Stock Companies and Firms (RJSC), Bangladesh Bank (BB), and the National Board of Revenue (NBR), among others. This extensive, non-cohesive system results in duplicated requisites, intensifying costs and elongating the timeline for obtaining approvals, consequently impeding the growth of private investment.

Aspiring investors are compelled to navigate this intricate landscape, often encountering the requirement to secure up to 150 approvals, registrations, certificates, or clearances from a multitude of entities.

According to Bangladesh Business Climate Index (BBX) 2022-23, access to digitally enabled regulatory transparency vary significantly between central and local level regulatory service delivery agencies. A 23.63-point difference between the highest and the lowest performing divisions in access to regulatory information imply that there is a huge disparity in availability of regulatory information across divisions. This not only reflects a gap in access to internet across divisions but a disparity in availability of information regarding rules and regulations by the local government such as municipal corporations.

Figure 36: Comparison of BBX Pillar Scores between 2022 and 2021

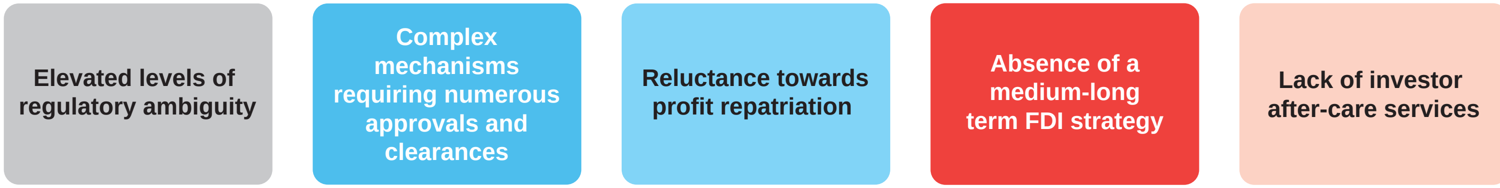


Source: Bangladesh Business Climate Index 2022, Policy Exchange and MCCI

Strength of robust laws and regulations are severely compromised due to non-systematic and non-inclusive changes in the regulatory framework creating regulatory unpredictability. About 71 percent of respondents mentioned that the government often changed or modified regulations that affected their businesses. There are several elements that lead to high level constraints for proliferation of private sector investment and significantly hinder business dynamism in Bangladesh. This is characterized by over-regulation, weakness in regulatory service delivery, and challenges in transparency and accountability which are detrimental to the regulatory environment and make the process costlier both in terms of time and money.

Restriction and the conservative mindset of bureaucracy against profit repatriation deters FDI inflow. Bangladesh Bank frequently introduces obstacles to profit repatriation, a vital requirement for FDI, thereby impeding FDI inflow. Foreign investors encounter challenges in retrieving earnings and dividends. In contrast, neighboring countries like India, Vietnam, and Indonesia have streamlined investment regulations to attract FDI. Bangladesh should consider adopting a comparable strategy to enhance its investment allure.

Figure 37: Issues in Regulatory Framework that Adversely Affects FDI Facilitation



It is imperative for Bangladesh to draft a FDI policy. The absence of a thorough and focused FDI policy has proven to be a significant vulnerability for Bangladesh. Additionally, the untapped potential lies in the possibility of forging free trade agreements (FTAs). Despite economic zones offering land prices that are just a quarter of those in Vietnam, this factor alone fails to persuade potential investors. Ensuring land's freedom from ownership disputes remains a key concern for investors. Furthermore, aligning the Foreign Exchange Regulation Act with the standards observed by competitor nations is crucial to enhance Bangladesh's investment appeal.

4.2 Hurdles in Market Access

Bangladesh is a founding member of the World Trade Organization (WTO). As a Least Developed Country (LDC), it benefits form preferential market access to a number of key markets under the generalized system of preferences.

As Bangladesh readies itself to transition from its LDC status to that of a Developing Country in 2026, significant transformations and challenges await on the economic front. This shift is poised to reshape the nation's investment landscape and impact FDI in several critical ways.

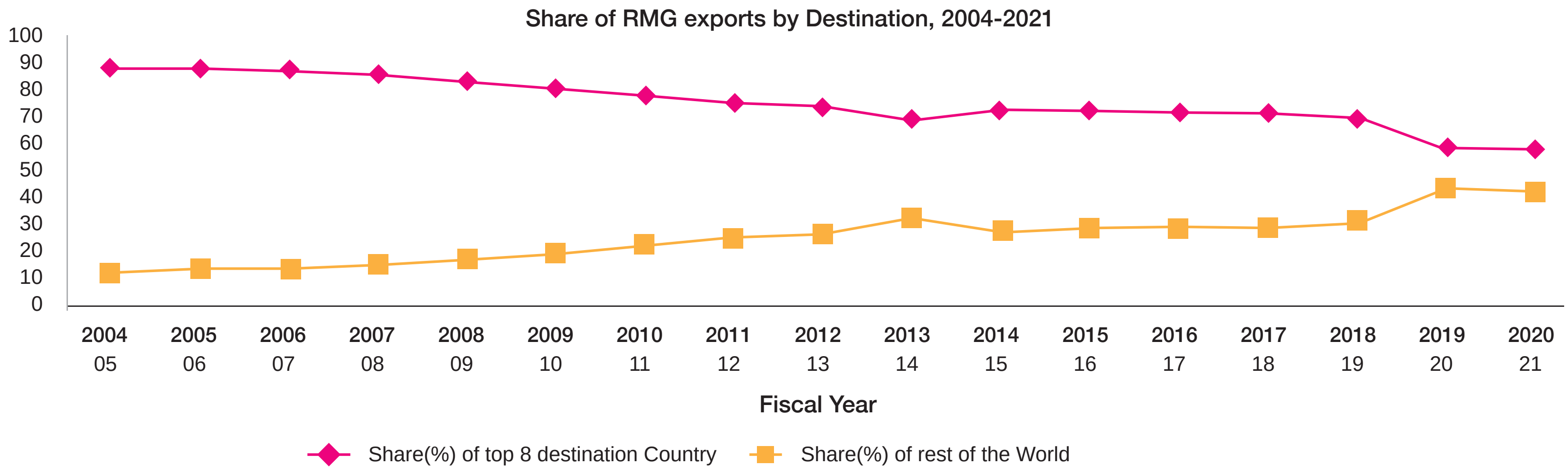
1. **Loss of Market Access and Benefits:** One of the primary challenges post-graduation is the loss of preferential market access. Currently, nearly 80% of Bangladesh's exports enjoy duty-free access to international markets. However, this advantageous status will terminate post-graduation, subjecting Bangladeshi exports to customary customs duties. This shift threatens established export patterns and could potentially alter the competitiveness and cost structures of Bangladeshi goods on the global stage. The ripple effect on FDI is noteworthy, as investors often seek countries with favorable trade conditions.

2. **Export Subsidies and Incentives:** Another significant challenge lies in the discontinuation of export subsidies and incentives that have boosted the competitiveness of Bangladeshi products. These incentives are a crucial driver of export growth. As Bangladesh transitions to a Developing Country, these incentives are set to vanish, potentially leading to a substantial decline in exports. According to the World Trade Organization (WTO), this drop could be as high as 14%. This contraction in exports has far-reaching consequences, affecting investment, employment, and, ultimately, the nation's GDP. Reduced export revenue could deter potential investors.

3. **Financing Dynamics:** The cessation of concessional interest rates for development financing is another pressing challenge. Bangladesh has enjoyed access to development financing with favorable terms, including low-interest rates. However, this privilege will fade post-graduation, necessitating the country to bear higher interest rates for loans. This shift can alter the cost-benefit calculations for development projects and investments, prompting Bangladesh to reconsider its economic strategies. Increased financing costs could dissuade potential FDI.

While these challenges are formidable, Bangladesh's transition away from LDC status also signals newfound capabilities and opportunities. Bangladesh participates in two regional trading blocs, the Asia-Pacific Trade Agreement (APTA) and the South Asian Free Trade Agreement (SAFTA). The nation's trade partners align closely with the RMG sector's trade flow. Bangladesh imports raw materials like cotton and yarn from China and India, then processes these into garments for export, primarily to the United States and the EU. Over time, there's been a shift from the United States toward the EU as a major trading partner. With time and efforts in diversifying products and markets, Bangladesh is now seeing a trend of increased exports to untraditional markets, a trend likely to strengthen due to rules of exporting to EU.

Figure 38: **Recent Progress in Geographical Diversification of RMG Exports**



Source: EPB, PRI estimates; Trade Policy Challenge for Export Diversification (Sattar & Alam, 2023)

The outcome of regional economic integration initiatives will be pivotal for Bangladesh's sustained growth and FDI attraction. This shift could lead to a rise in efficiency-seeking and export-oriented FDI. from Asian countries that view Bangladesh as a gateway to markets. Signs of this are already evident in FDI sources for the country's Special Economic Zones (SEZs). Meanwhile, China and India's prominence as import partners continues to grow, reflecting South-South trade's rising importance and Bangladesh's integration into regional production value chains, presenting new FDI opportunities. The outcome of regional economic integration initiatives will be pivotal for Bangladesh's sustained growth and FDI attraction, particularly as it approaches a post-Least Developed Country (LDC) era. Navigating these challenges effectively is crucial for the nation's economic future.

Limited standards and certification facilities constraint Bangladesh's market access to global giants. If we take the case of the agribusiness sector, the local certification body, Bangladesh Standards and Testing Institution (BSTI) can only provide certification for 181 products. For halal products, BSTI and Islamic foundation both provide halal food certification, but this is not globally recognized. Moreover, capacities of testing labs are constrained by a lack of technical human resources and adequate equipment. This lack of standards severely hampers market access in several regions of the world for Bangladesh.

4.3 Current Level of Efficiency in Infrastructure and Logistics Resulting in Competitiveness Challenges

Inefficiencies in logistics infrastructure hamper trade facilitation efforts and in turn FDI inflow. The availability of transport logistics services are often neutralized by high cost and in efficiency of such support factors. A World Bank report suggests that logistics cost comprise between 4.5 to 47.9% of total sales. As the economy slowly expands to facilitate more business sectors, the current transport services are not well suited for sectors in need of specialized logistics systems. The BBX reports that firms from the construction sector found it challenging to find transportation as the sector requires a special set of transport services/vehicles to carry their raw materials and products which are heavy-weighted.

Despite improvements in recent past, Bangladesh still falls behind its competitors. Bangladesh has improved in logistics performance according to the World Bank's Logistics Performance Index (LPI). This improvement is owed to prudent actions taken by the Government of Bangladesh through its various agencies such as Bangladesh Investment Development Authority (BIDA) and others in taking active steps towards improving the logistics ecosystem of the country. However, there is some way to go as Bangladesh falls behind its comparators, leading to FDI moving away from Bangladesh to other countries.

Table 4: Logistics Performance Index 2023 Results

Country	LPI Grouped rank	Customs Grouped rank	Infrastructure Grouped rank	Timeliness Grouped rank
Bangladesh	88	101	108	87
India	38	47	47	35
Vietnam	43	43	47	49
Thailand	34	31	25	46
South Korea	17	7	9	25

Source: World Bank

In World Bank's report on Trade Across Borders, Bangladesh's performance revealed a mix of achievements and challenges. The report assessed the efficiency and effectiveness of trade procedures and regulations, highlighting the time and cost associated with cross-border transactions. Bangladesh's rank in this report was 176 out of 190 countries, showcasing the room for improvement. In comparison to regional peers such as India, Indonesia, Pakistan, Vietnam, and even global powerhouses like China and Germany, Bangladesh lagged behind in terms of trade facilitation. For instance, countries like Vietnam and China demonstrated more streamlined and efficient cross-border processes, contributing to their competitive edge in international trade. Bangladesh's lower performance underscores the significance of enhancing trade-related procedures, addressing bureaucratic complexities, and investing in infrastructure to bolster its standing in the global trade landscape and foster sustainable economic growth.

Table 5: Trading Across Border Ranking for Bangladesh and Selected Countries

Country	Trade Across Border Rank 2019	Score
Bangladesh	176	31.8
India	68	82.5
Indonesia	116	67.5
Pakistan	111	68.5
Vietnam	104	70.8
China	56	86.5
Germany	42	91.8

Source: World Bank

In the 2021 World Bank Container Port Performance Index, Bangladesh's performance exhibited a mixed trend, reflecting both progress and areas of concern. The index evaluates the efficiency of container ports, measuring factors such as time and cost required for container handling and the reliability of port operations. Bangladesh secured a position of 93 out of 351 ports, showcasing improvements compared to the previous report. This performance, while indicative of advancements, also emphasizes the need for further enhancements. In comparison to regional counterparts like India, Indonesia, Pakistan, and Vietnam, Bangladesh's ranking varied, with some countries surpassing its performance due to more streamlined processes and investments in port infrastructure. Moreover, global leaders such as China, Germany, the UK and the United States demonstrated superior port efficiency, attributing to their trade dominance.

Table 6: The Container Port Performance Index 2021

Country	Port	Rank
Bangladesh	Chattagram	341
India	Mundra	48
	Jawahrlal Nehru Port	54
	Chennai	79
Pakistan	Karachi	90
China	Shanghai	316
	Ningbo	7
Indonesia	Belawan	250
Vietnam	Haiphong	63
United States	Los Angeles	370
	Long Beach	369
UK	Felixstowe	334
	London	347
Germany	Hamburg	232

Source: World Bank

Bangladesh's progress in the Container Port Performance Index highlights its efforts in improving logistical operations, which is essential for facilitating international trade. Nevertheless, the ranking also underscores the imperative for sustained investments in port modernization, streamlined procedures, and the reduction of bottlenecks to ensure seamless cargo movement. By learning from the practices of top-ranking countries, Bangladesh can further optimize its port operations, increase trade competitiveness, and enhance its position in the global supply chain.

Lack of technology adoption is also a deterrent for FDI. Technology adoption is slowly but gradually gaining pace and it is faster in sectors with greater global integration. According to the BBX, more than half of the respondents mentioned that they invested in new technology equipment, software, or digital solution for their business functions in the past 24 months. Majority of firms in Financial Intermediaries and RMG have invested in a technology equipment or solution, whereas a handful of firms in Textile, Agriculture & Forestry and Electronic and Light Engineering have invested in the same, implying lower adoption of technology in these sectors.

4.4 Labor Productivity and Availability of Skills

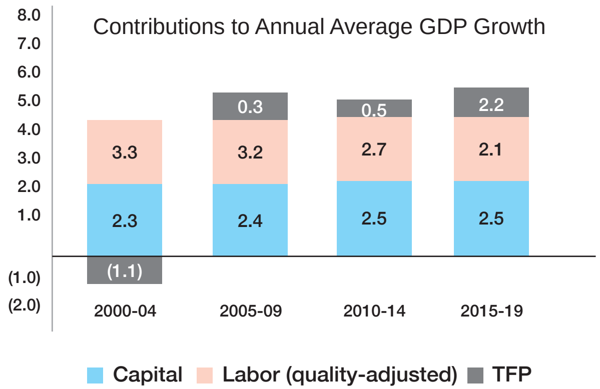
In the context of Bangladesh's unique demographic composition and economic context, labor productivity and skill development emerge as pivotal components in shaping the country's developmental trajectory. The World Bank's publications and the Bangladesh Government's Vision 2041 document underscore the necessity for Bangladesh to capitalize on its demographic dividend – a burgeoning youth population that holds immense potential for economic growth. With its population of 170 million, a majority of whom are youth, Bangladesh's potential strength lies in its human capital. The influx of approximately 2.5 million new entrants into the workforce annually for the next 15 years provides a significant opportunity for growth. The country's historical growth has been propelled by the integration of workers into the labor force and the accumulation of capital. To fully exploit this demographic advantage, it is imperative for Bangladesh to strategically invest in human capital, elevate productivity, and create an enabling economic environment that generates quality employment opportunities.

The influx of approximately 2.5 million new entrants into the workforce annually for the next 15 years provides a significant opportunity for growth.

Despite strides in economic growth, Bangladesh faces multifaceted challenges regarding poverty and employment. The Bangladesh Government's Vision 2041 and World Bank publications converge on the need to confront high poverty rates and vulnerability exacerbated by the deceleration in job creation, predating the COVID-19 pandemic. Around 40 million people live below the poverty line, while an additional 80 million – half of the population – teeter on the brink of poverty. The majority of employment opportunities, roughly 90%, remain informal, exposing workers to issues like unpaid labor, underemployment, and subpar working conditions. Distinctly, the crucial readymade garments (RMG) sector experienced a significant employment slowdown from 2013 onwards. This economic context has disproportionately impacted two key segments poised to reap the benefits of the demographic dividend: women and youth. Female labor force participation stagnates at 35%, while nearly 30% of the youth remain disconnected from employment, education or training.

Figure 39: **Contributions of Productivity and Expenditure Components to Growth**

CONTRIBUTIONS OF PRODUCTIVITY TO ANNUAL AVERAGE GDP GROWTH, 2000–19

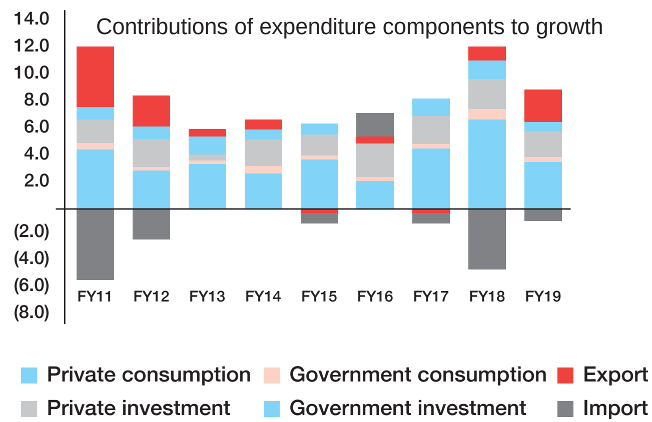


Note: TFP = Total Factor Productivity.

Source: World Bank staff calculations based on 40/60 capital-to-labor ratio

Source: World Bank

CONTRIBUTIONS OF EXPENDITURE COMPPONEN TO GROWTH, 2011-19



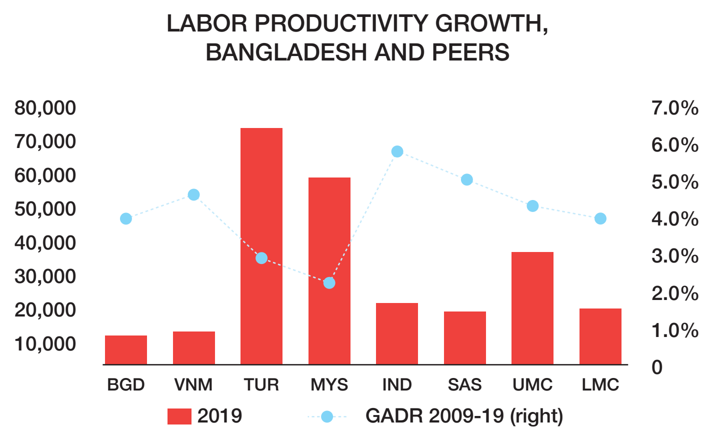
Note: FY = Fiscal Year

Source: Bangladesh Development Update, various years.

Addressing the multifaceted challenges of labor productivity and skill development demands robust investments in human development infrastructure. The education sector, while witnessing rising enrollment figures, grapples with quality issues. Similarly, access to healthcare remains inadequate, with 80 million people lacking sufficient coverage. This disconnect between demographic potential and development infrastructure is mirrored in cumulative public expenditure on education and healthcare, which stands at 2.5% of GDP – significantly lower than the 10% benchmark in upper middle-income countries. Both Vision 2041 and the World Bank reports accentuate the urgency of bridging these gaps, emphasizing that investing in quality education, healthcare, and skill development is essential for harnessing the full potential of Bangladesh's demographic dividend and transitioning to a knowledge-based, inclusive economy.

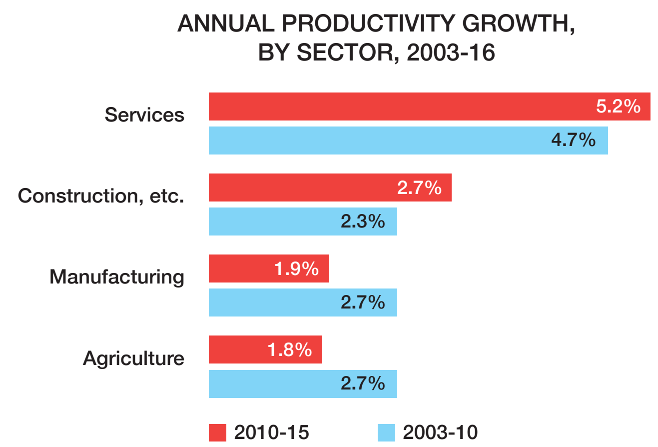
Enhancing productivity stands as the pivotal catalyst for ushering in accelerated growth and improved earnings for the workforce. This imperative becomes increasingly pronounced as the economy steers toward targeted investment thresholds while simultaneously grappling with the impending diminishment of its demographic dividend over the next two decades. Although there has been a substantial augmentation in value added per worker over the past two decades, this progress pales in comparison to peer countries. When juxtaposed with comparable nations, Bangladesh's value added per worker stands at 80% of Vietnam's level, half of India's, and merely a quarter of the average observed in upper middle-income countries (UMICs). This contrast becomes especially salient in the context of the International Monetary Fund's (IMF) 2013 report, which attributes sustained growth in low-income countries (LICs) not just to robust investment, but also to reforms fostering heightened productivity and robust export expansion. Furthermore, historical growth rates have consistently lagged behind those of Bangladesh's peers.

Figure 40: Labor and Productivity Growth



Note: CAGR = Compound Annual Growth Rate

Countries are BGD-Bangladesh,VNM-Vietnam, TUR-Turkey, MYS-Malaysia, IND-India
Source: World Development Indicators, World Bank



Note: Productivity gap is calculated in taka per worker.

Source: National accounts and Labor Force Surveys in Farole and other 2017

Critical sectors like agriculture and manufacturing grapple with persistently low productivity levels. Elevating agricultural productivity assumes heightened significance to sustain the rural economy and underpin the broader structural transformation of the nation's economic fabric. While there is an upward trajectory in agricultural productivity, it remains disproportionately inferior to other economic segments, accounting for just one-fourth of the productivity witnessed in other sectors. An array of obstacles impedes this productivity surge, encompassing challenges related to climate change, weak transport and storage networks that result in elevated wastage, inadequate market connectivity, and a limited expansion of more diversified, value-added ventures.

Augmenting productivity emerges as an imperative in Bangladesh's pursuit of comprehensive economic advancement. Addressing the prevailing disparities vis-à-vis comparator countries necessitates multifaceted reforms. Mitigating hurdles that curtail productivity growth, such as climate-related vulnerabilities and infrastructural deficiencies, forms a central tenet of this endeavor. By focusing on productivity enhancement strategies across key sectors, Bangladesh can harness its demographic potential, elevate economic performance and position itself more robustly on the global economic stage.

4.5 Challenging Business Taxation Environment

The taxation landscape in Bangladesh is marked by its intricacies and ambiguities. The country relies heavily on indirect taxes, primarily the Value Added Tax (VAT), which accounts for a substantial portion of government revenue. However, this dependence on indirect taxes can create challenges for foreign investors who may be unfamiliar with the complex VAT regulations. The multiplicity of taxes and levies, coupled with frequent changes in tax policies and rates, contribute to a lack of predictability in the taxation system, making it challenging for investors to plan their financial strategies effectively.

According to the latest BBX, Bangladesh's tax environment is less conducive and a major impediment to investment. Regulatory predatory behavior is more prevalent in nascent sectors and sectors that are less organized. The index results for paying taxes show that tax environment is less conducive in emerging sectors such as electronics and light engineering, real estate, construction, and transport, storage and communication. It was found that paying taxes was a challenge for Wholesale and Retail and Transport, Storage and Communication sectors. The top three constraints in the paying taxes pillar as reported by businesses were time consuming procedure, high corporate tax and low tax education. Overall, the results depict businesses face several bottlenecks in these areas and significant efforts are required to address the challenges.

Figure 41: Top Three Constraints by Business in Paying Taxes Category

Burdensome Compliance	**High Effective Tax Rate**	**Low Awareness Among Tax Payers and Limited Outreach by Tax Authorities**

Source: BBX 2022

- **Predictability in Tax Policies:** One of the most significant concerns for foreign investors in Bangladesh is the unpredictability of tax policies. Frequent changes in tax laws and regulations can catch investors off guard and disrupt their financial plans. For instance, alterations in tax rates or the introduction of new tax measures can have a substantial impact on the profitability of investments. The lack of stability and predictability in tax policies can deter foreign investors from making long-term commitments in the country.

- **Tax Incentives and their Ambiguities:** Bangladesh offers various tax incentives to attract foreign investment in specific sectors and regions. While these incentives can be appealing to investors, their implementation and interpretation often lack clarity. Ambiguities in the eligibility criteria and conditions attached to these incentives can lead to disputes between investors and tax authorities. Such disputes not only erode investor confidence but also result in lengthy legal battles, adding to the overall cost of doing business in Bangladesh.

- **Effectiveness of Double Taxation Avoidance Agreements (DTAAs):** Double Taxation Avoidance Agreements (DTAAs) play a crucial role in facilitating cross-border investment by preventing the double taxation of income. Bangladesh has signed DTAAs with several countries to provide relief to taxpayers. However, issues related to the interpretation and application of DTAAs have arisen, leading to disputes between taxpayers and tax authorities. realizing these benefits mandates formal authorization from the National Board of Revenue (NBR). The extent to which the NBR actively upholds these DTAAs emerges as a significant preoccupation for foreign investors, given the recurrent objections voiced by foreign corporations and enterprises. The apprehension stems from concerns about whether the NBR consistently respects and applies the provisions of these treaties. These disputes can be time-consuming and costly to resolve, deterring foreign investors from utilizing the benefits offered by DTAs. The consistent stream of complaints from foreign entities further underscores the urgency of clarifying and ensuring the dependable implementation of DTAAs. This issue plays a pivotal role in influencing foreign investors' confidence in the host country's commitment to creating a favorable and predictable investment environment, which is crucial for sustaining and augmenting foreign investment inflow.

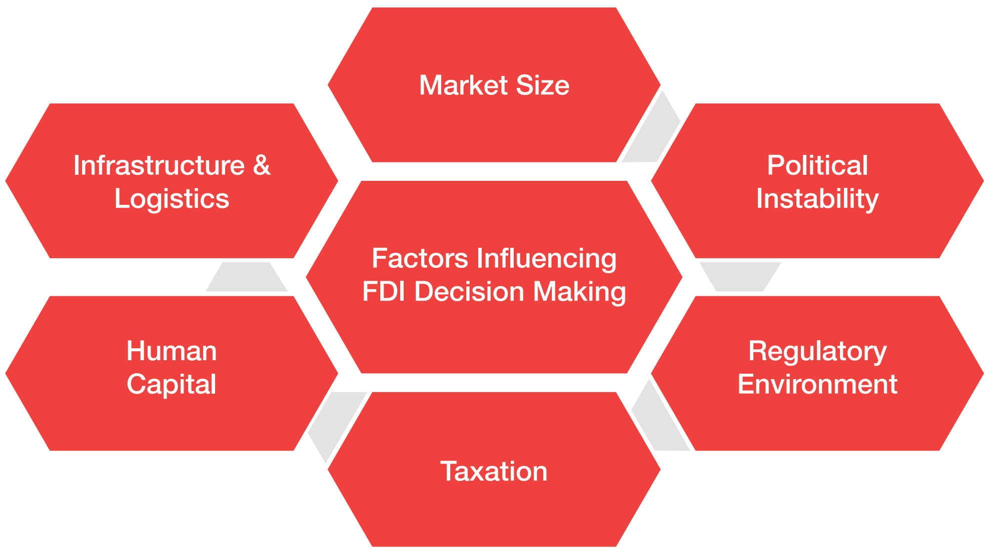
- **Transfer Pricing Regulations:** Transfer pricing regulations are another area of concern for foreign investors in Bangladesh. The country has introduced transfer pricing rules to prevent profit shifting and tax evasion. While these regulations are essential for ensuring fair taxation, their implementation can be challenging. Investors often struggle with determining arm's length prices for their intra-group transactions, and disputes with tax authorities over transfer pricing adjustments are not uncommon.

- **Inefficiencies in Tax Administration:** The efficiency and transparency of tax administration in Bangladesh are areas that need improvement. Delays in tax assessments, lengthy appeals processes, and bureaucratic red tape can create frustrations for investors. Additionally, the lack of skilled tax professionals who can provide guidance on tax compliance and planning further exacerbates the challenges faced by investors.

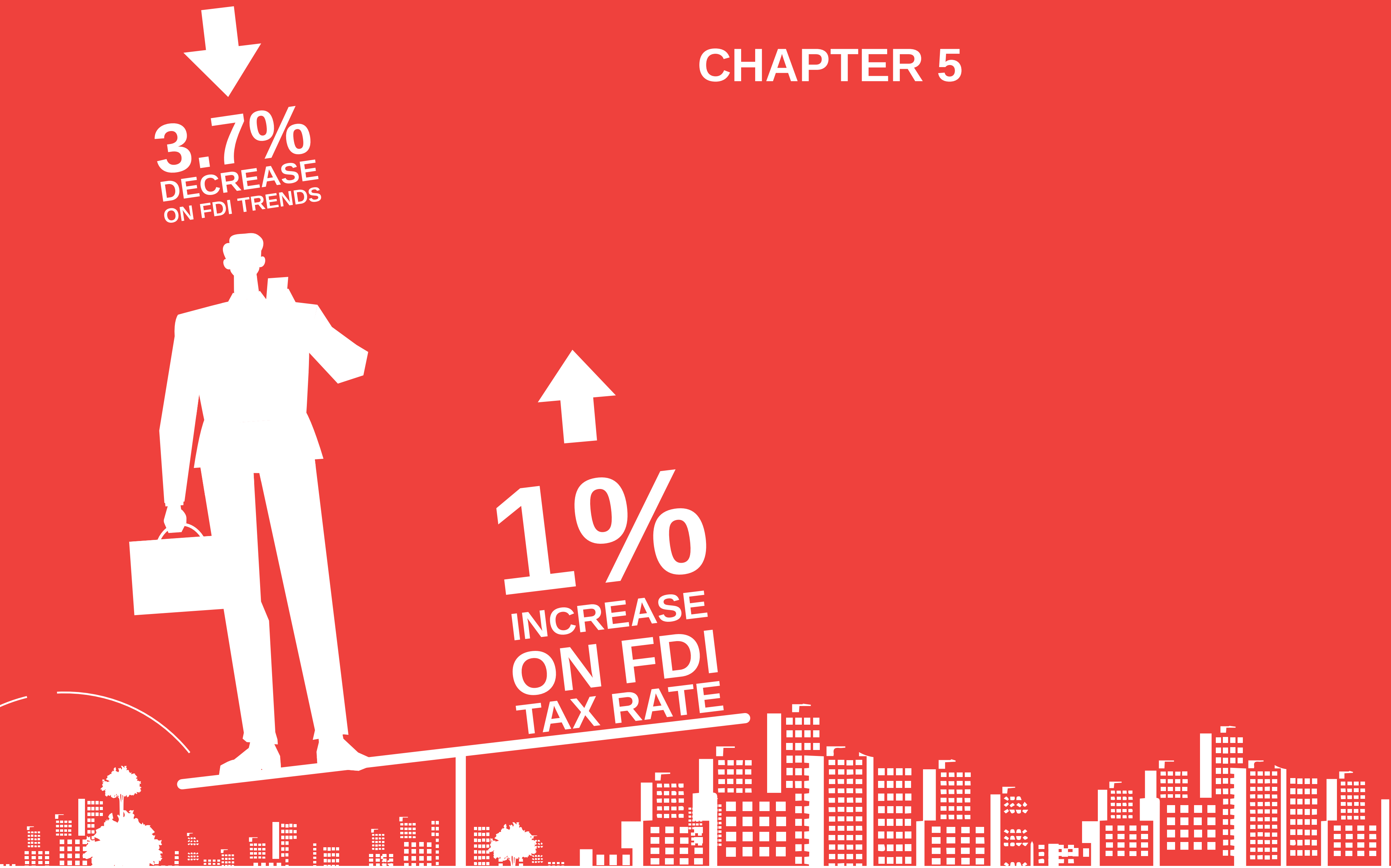
- **Taxation of Perquisites and Minimum Taxation:** The taxation of perquisites and the imposition of minimum tax are specific issues that impact both employers and employees in Bangladesh. Perquisites provided to employees, such as housing allowances and commuting allowances, are subject to taxation. This dual taxation, where both the employer and employee are taxed on the same benefit, is seen as unfair and discourages companies from offering competitive employment packages. Minimum taxation, which obliges taxpayers to pay a predetermined rate on their total receipts or tax collected/deducted at source, irrespective of their actual profit or loss, is also a contentious issue. Paying minimum tax, even in the absence of profit, diverts funds from equity or capital, weakening businesses' financial and capital management.

- **The taxation complexities and uncertainties in Bangladesh have a direct impact on FDI decisions.** Foreign investors seek stable and predictable tax regimes that allow them to plan their financial strategies effectively. The frequent changes in tax policies, coupled with ambiguities in tax incentives and regulations, create an environment of uncertainty that can deter potential investors. Disputes with tax authorities, whether related to transfer pricing, tax incentives, or DTAs, not only disrupt business operations but also erode trust in the local tax system. Investors often weigh the risks associated with taxation when deciding whether to invest in a particular country, and the challenges posed by Bangladesh's taxation system can make it less attractive compared to other investment destinations.

Figure 42: Factors Influencing FDI Decision Making



CHAPTER 5



BUSINESS TAXATION: A CRITICAL ENABLER OF FDI DECISIONS AROUND THE GLOBE

Chapter at a Glance

Evidence from OECD Countries on Effect of Tax Environment on FDI

Multiple empirical studies on select OECD countries confirm the substantial influence of tax rates on FDI.

On average, FDI tends to decrease by 3.7% following a 1 percentage point increase in the tax rate on FDI.

Increased tax rates reduce the return on investments, leading to lower FDI inflow. Lower corporate tax leads to higher FDI.

Recent studies suggest that FDI is becoming more sensitive to taxation, reflecting the increasing mobility of capital as non-tax barriers to FDI are removed.

The core observation is the inverse relationship between tax rates and FDI inflows-higher taxes deter FDI, while lower taxes attract it.

Relation between Corporate Income Tax Rate and FDI

Country	2021 Tax rate	2022 Tax rate	Change from 2021 to 2022	Net FDI inflow (milion USD)		
				2021	2022	% Change
France	28%	25.80%	-2.6 ppt	88427.62	96241.67	9%
Turkey	20%	23%	+3 ppt	13325	13094	-2%
Greece	24%	22%	-2 ppt	6132.476	6846.333	12%
Zambia	35%	30%	-5 ppt	-351.647	115.8992	-133%
Myanmar	25%	22%	-3 ppt	2066.61	2980	44%
Bangladesh	32.5%	30%	-2.5 ppt	1723.86	1555.41	-10%

Source: Tax Foundation, World Bank

Current Tax Perception in Bangladesh

The tax system in Bangladesh is complex, retroactive and subject to frequent law changes, creating unpredictability for foreign investors.	Withholding tax leads to extra administrative burden and technology adoption for tax collection is low.	Bangladesh's tax system exhibits disparities, such as a 5% tax rebate for listed companies and specific surcharges, like the 2.5% surcharge on tobacco companies.	Bangladesh's corporate tax rates range from 20% to 45%, offering a broad spectrum of tax liabilities for potential investors.

Study shows that a rise of 1 percentage point in FDI inflows corresponds to a 1.5 percentage point increase in the overall tax revenue ratio for developing nations.

Trends of FDI inflows and tax revenues

CHAPTER 5

BUSINESS TAXATION: A CRITICAL ENABLER OF FDI DECISIONS AROUND THE GLOBE

Among various policy instruments nations deploy to attract FDI, taxation stands out as a critical factor influencing investment decisions and capital allocation strategies. FDI has long been recognized as a crucial driver of economic growth and development, playing a significant role in promoting cross-border capital flows, technology transfer, job creation and overall industrial expansion. As nations vie for increased FDI inflows, governments around the world are continuously exploring various policy measures to attract and retain foreign investors. Among these policy instruments, taxation stands out as a critical factor influencing FDI decisions and capital allocation strategies. This chapter aims to delve into the role of taxation in shaping FDI decisions and explore its implications on host countries' economic performance. By analyzing existing literature, empirical studies and policy frameworks, this report aims to gain a deeper understanding of the complex relationship between taxation and FDI.

Taxation policies, including corporate income tax rates, tax incentives and exemptions have a profound impact on foreign investors' decisions to invest in a particular country. While low tax rates may attract foreign businesses by enhancing after-tax profitability, tax incentives can further incentivize FDI inflows into specific sectors or regions. When high tax rates and complex tax systems may discourage FDI, potentially leading investors to seek more favorable jurisdictions. However, the relationship between taxation and FDI is multifaceted, extending beyond mere tax rates. Other factors, such as the quality of public goods and services, the stability of the tax system, transparency and efficiency of tax administration, also play significant roles in shaping FDI decisions. Consequently, it is essential to adopt a comprehensive approach to assess the impact of taxation on FDI inflows and evaluate the effectiveness of different tax policies.

While low tax rates may attract foreign businesses by enhancing after-tax profitability, tax incentives can further incentivize FDI inflows into specific sectors or regions.

This chapter aims to contribute to the existing body of knowledge on the role of taxation in FDI decisions by examining empirical evidence from diverse economies and regions. This evidence was also be complemented with extensive Key Informant Interviews (KIIs) of foreign investors, procurement managers, Chambers of Commerce, CNF agents and former NBR officials to gain a deeper understanding of the challenges in the system for FDI inflow into Bangladesh from the taxation apparatus. By synthesizing key findings, we seek to provide policymakers and tax officials of National Board of Revenue (NBR) with valuable insights into the complexities of taxation's influence on FDI flows. This will inform them on the need for appropriate tax reforms to increase the FDI inflow into Bangladesh for the next stage of the country's growth story. The report will also explore potential policy recommendations that can help Bangladesh design effective tax frameworks to attract and retain FDI, fostering sustainable economic growth and development by looking at cases of global best practices where such tax reform has taken place.

It is worth noting that while taxation is a vital factor, FDI decisions are influenced by a multitude of interrelated factors. They including market size, political stability, infrastructure, human capital and regulatory environment. Therefore, this report acknowledges the need for a holistic understanding of the broader investment climate and aims to shed light on the specific role of taxation within this complex landscape.

5.1 Sensitivity of FDI to Taxation

I. Evidence from OECD Countries Show Taxation Reforms Lead to an Influx of FDI

The impact of corporate tax rates on FDI inflows is a crucial aspect of economic policymaking, particularly in OECD member countries during the period from 2003 to 2013. It has been consistently observed that an increased tax rate tends to decrease the rate of return on investments, resulting in a lower level of FDI inflow. Conversely, a reduction in corporate tax rates is often associated with higher levels of FDI, as it improves the after-tax profitability of investments. Several empirical studies conducted on selected OECD members have confirmed the significant influence of corporate income tax rates on FDI inflows.[4]

FDI decreases by 3.7% following a 1% increase in the tax rate on FDI.

The focal point of investigation within the paper "Tax Effects on Foreign Direct Investment" by the OECD, resides in comprehending the intricate relationship between corporate tax rates and the influx of FDI. This nexus carries paramount importance in shaping economic policies, particularly within the OECD member nations, spanning the timeline from 2003 to 2013. The temporal and geographical scope underscores the relevance of the study, considering this era witnessed profound economic shifts and heightened global interconnectedness. The methodology adopted to unravel this tax-FDI interplay involves a meticulous examination of empirical data from select OECD member countries. By meticulously dissecting the intricate dynamics between corporate tax rates and FDI inflows, this research offers insights into the responsiveness of FDI to alterations in tax parameters.

Studies found that a reduction in corporate tax rates is consistently linked with heightened levels of FDI. Studies examining cross-border flows suggest that on average, FDI decreases by 3.7 percent following a 1 percentage point increase in the tax rate on FDI. But there is a wide range of estimates, with most studies finding decreases in the range of 0% to 5%. This variation partly reflects differences between the industries and countries being examined, or the time periods concerned. Some recent studies find, for example, that FDI is becoming increasingly sensitive to taxation, reflecting the increasing mobility of capital as non-tax barriers to FDI are removed. Such estimates may be used to estimate the long-run impact on FDI of corporate tax reform. The core observation derived from multiple instances is the inverse correlation between tax rates and FDI inflows. This means that an augmentation in corporate tax rates exerts a dampening effect on the return on investments, consequently leading to a decrease in the volume of FDI entering the host economy.

The core observation derived from multiple instances is the inverse correlation between tax rates and FDI inflows. This means that an augmentation in corporate tax rates exerts a dampening effect on the return on investments, consequently leading to a decrease in the volume of FDI.

[4]Tax effects on Foreign Direct Investment, OECD.

Figure 43: Empirical evidence from OECD countries

Multiple empirical studies on select OECD countries confirm the substantial influence of tax rates on FDI.

On average, FDI tends to decrease by 3.7% following a 1% increase in the tax rate on FDI.

Increased tax rates reduce the return on investments, leading to lower FDI inflow. Lower corporate tax lead to higher FDI.

Recent studies suggest that FDI is becoming more sensitive to taxation, reflecting the increasing mobility of capital as non-tax barriers to FDI are removed.

The core observation is the inverse relationship between tax rates and FDI inflows - higher taxes deter FDI, while lower taxes attract it.

Numerous studies have consistently reported a negative relationship between taxation and FDI. While it is evident that taxation plays a significant role in shaping FDI decisions, the precise magnitude of its impact remains subject to considerable debate. These variations in estimates underscore the complexity of the relationship between taxation and FDI, urging for a nuanced approach to crafting effective tax policies that attract foreign investors while promoting sustainable economic growth.

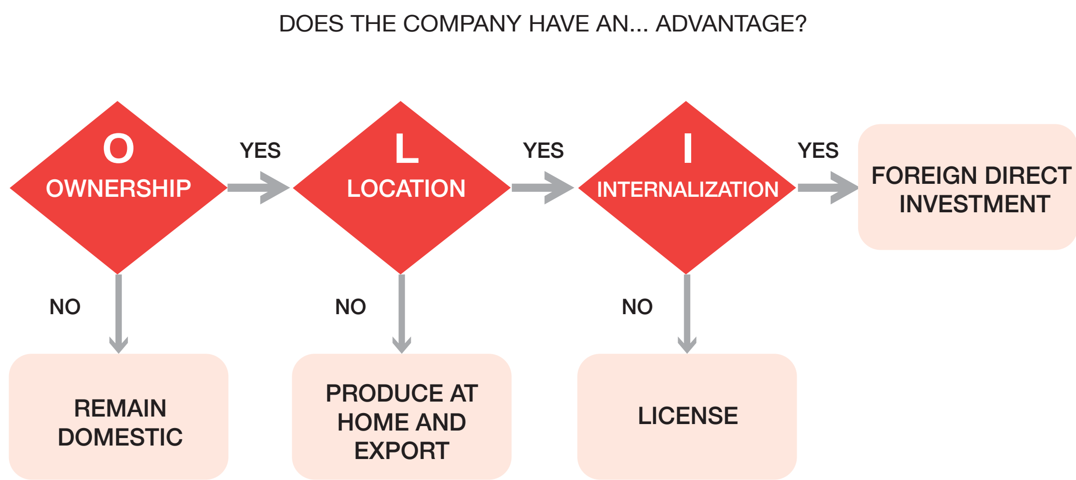
II. The OLI Framework Advocates for Foreign Ownership Reforms in Areas Such as Trade Costs, Labor Expenses and Favorable Tax Environment

The OLI framework, a seminal approach in understanding FDI decisions, encompasses the evaluation of Ownership, Location, and Internalization conditions. Within this framework, horizontal FDI, characterized by foreign production, arises as a viable alternative to exporting or licensing when OLI conditions are fulfilled. A Multinational Enterprise (MNE) embarking on horizontal FDI must possess ownership advantages such as patents, know-how and trademarks that confer a competitive edge over local firms in foreign markets. Furthermore, FDI becomes attractive if it offers location advantages, such as reduced trade costs, labor expenses, energy costs and a favorable tax environment, thereby rendering local production more profitable compared to exporting.

Similarly, internalization advantages, propels the preference for FDI over licensing. Opting for FDI implies that a business activity is undertaken directly, safeguarding proprietary knowledge and assets, thereby securing and capitalizing on the ownership advantage. This underscores the significance of the OLI conditions in shaping FDI choices. Vertical FDI decisions, revolving around segmenting production stages to foreign locations, similarly revolve around the triad of ownership, location and internalization advantages. These decisions underscore the intricate interplay between cost-efficiency, access to specialized skills and control over proprietary processes.

Shifting focus to investment policy frameworks, the policy framework for investment presented by the OECD in 2005 targets policy makers in developing and transitioning economies. By delineating guidance across ten policy domains, including taxation, this framework aids in setting priorities and devising effective strategies. The tax chapter of the framework heavily relies on comprehensive survey studies. It identifies pivotal factors in evaluating the trade-offs associated with corporate tax incentives, alternate tax strategies and designs that beckon FDI while concurrently generating revenue to support essential infrastructure development.

Figure 44: **OLI Framework for Attracting Greater FDI**



The preeminent framework extensively employed by public finance economists to scrutinize the impact of taxes on both domestic and cross-border direct investment is the neo-classical investment framework. This framework garners considerable attention due to its integration of key statutory tax parameters that intricately shape capital costs and establish the tax burden on investment returns as mandated by law. Central to its utility are the parameter-driven marginal and average effective tax rates (METRs/AETRs) extracted from the neo-classical investment model. These METRs and AETRs serve as foundational metrics for quantifying the proportional alterations in tax burden measures as a consequence of individual or bundled adjustments to corporate tax policies. Pairing these rates with empirical evaluations of FDI responsiveness to the variations in these effective tax rates facilitates the extrapolation of the enduring ramifications of corporate tax reform on FDI patterns.

However, the utilization of these concise tax metrics warrants prudence, as they omit an array of elements that significantly influence the tangible tax burden on FDI. Aspects like tax planning strategies, discretionary tax liability determinations and other unaccounted taxes not encompassed by the model inject complexity into the practical tax scenario. Moreover, scrutiny can be cast upon the fundamental assumption of diminishing marginal productivity of capital, particularly in instances where business concentrations lead to elevated rates of return. This phenomenon, known as increasing returns to scale at the industrial level, could potentially diverge from the typical assumptions and consequently yield distinct policy implications that deviate from the norm.

III. Review of Global Findings Indicate Significant Relationship Between Tax Rate and FDI Inflow

Mooij and Ederveen (2005) in their paper write that that while the majority of research demonstrates an adverse correlation between taxation and FDI. The tax elasticity of FDI exhibits a broad spectrum of estimates. In essence, it is reasonable to anticipate that the responsiveness of FDI to taxation would inherently fluctuate, contingent upon the conditions and strategies of the host country. This includes factors like the extent of corporate tax rates, the specific industries or business activities under scrutiny, the time frame examined, and additional influential elements. The literature review finds an average semi-elasticity value of –3.72, which measures the percentage change in FDI in response to a 1 percentage point change in the tax rate.

Literature suggests that there is a widespread acknowledgment that the escalation of international tax competition is evident. It's apparent that what might have previously been perceived as a competitive tax load in a specific host nation might cease to be the case over time, given multiple rounds of corporate rate reductions carried out by nations vying for FDI, irrespective of other influencing factors.

Devereux and Freeman (1995) conducted an examination of the influence of taxation on foreign direct investment in the context of ax integration schemes[5]. Their study encompassed an analysis of seven countries during the time frame of 1984 to 1989. Their key observations can be distilled into two main outcomes: Firstly, it was confirmed that taxation does indeed impact the geographic positioning of outward FDI, aligning with expectations. Secondly, they found no substantial correlation between taxation and the choice between domestic investment and the entirety of outward FDI.

Swenson (1994) concentrated on the impetus triggered by tax reforms on FDI. He delved into the repercussions of the 1986 tax reform in the United States by evaluating both average and effective tax rates. Despite a mere two-point rise in the average tax rate, its repercussions were more profound across different industries. Swenson also emphasized the sensitivity of FDI to tax rates, establishing that the average tax rate displayed greater responsiveness compared to the effective tax rate.

Gropp and Kostial (2000) tackled the ramifications of EU tax harmonization on corporate tax revenues and its impact on FDI flows. They put forth the argument that the tax regime holds a pivotal role in shaping FDI patterns and corporate tax revenues. They highlighted instances such as Germany, Italy and Ireland. While Germany and Italy observed increases in tax revenues following EU harmonization, Ireland witnessed a decline. This phenomenon underscored the influence of corporate tax rate adjustments on FDI flows and the subsequent impact on tax income.

On a related note, Jun (1994) undertakes an analysis encompassing the period from 1980 to 1989, incorporating data from the United States and ten other countries. His inquiry centers on the influence of distinct taxes on FDI flows within both home and host countries. His predictive hypothesis finds validation in the empirical findings, affirming that home country tax systems wield an impact on FDI, whereas host country tax systems do not wield a parallel influence on FDI dynamics. Drawing from data spanning the period 1980-1989, Jun (1994) analyzed the effect of specific taxes on FDI flows in both the home and host nations. As anticipated, his findings affirmed that home country tax structures have a discernible effect on FDI patterns, whereas host country tax systems do not exert the same level of influence on FDI dynamics.

Figure 45: Findings from Literature Review

Nations are competing to reduce corporate tax rates and imporve tax compliance to attract FDI.

Research emphasizes the sensitivity of FDI to tax rates, with the average tax rate being more responsive than the effective tax rate.

Impact of EU tax harmonization on FDI patterns and corporate tax revenues can be seen in Germany, Italy and Ireland.

An IMF study reveals significant differences in FDI outflows between low-tax and high-tax countries.

[5]The Effect of Corporate Tax Rate on Foreign Direct Investment: A Panel Study for OECD Countries

In study by IMF (2000) shows a clear disparity in FDI outflows is evident between countries categorized into low-tax and high-tax groups[6]. Specifically, nations within the low-tax group exhibited significantly lower net FDI outflows compared to their counterparts in the high-tax group. This finding highlights the influential role of taxation in shaping cross-border capital flows and underscores the importance of tax policies in attracting and retaining foreign investment.

FDI significantly impacts corporate tax revenue, primarily through transfer pricing practices. For instance, when a multinational company operates in a high-tax country and sources inputs from a branch in a low-tax jurisdiction, it has the incentive to manipulate the prices of these inputs. By overstating the cost of inputs, the multinational can increase its profits in the low-tax country while reducing its profits in the high-tax country. Consequently, this minimizes the overall tax liabilities of the company across the globe.

IV. Assessment of Taxation Reforms and Effect on FDI: Global Examples

Tax rates significantly impact FDI attraction. This analysis below examines tax rate changes in four countries in 2022 and their effects on FDI inflow.

Table 7: How Corporate Income Tax Rate & FDI Varies Globally

Country	2021 Tax rate	2022 Tax rate	Change from 2021 to 2022	Net FDI inflow (milion USD)		
				2021	2022	% Change
France	28%	25.80%	-2.6 ppt	88427.62	96241.67	9%
Turkey	20%	23%	+3 ppt	13325	13094	-2%
Greece	24%	22%	-2 ppt	6132.476	6846.333	12%
Zambia	35%	30%	-5 ppt	-351.647	115.8992	133%
Myanmar	25%	22%	-3 ppt	2066.61	2980	44%

Source: Tax Foundation, World Bank

Corporate tax rates and FDI has an inverse relationship. When corporate tax rates go up, FDI falls and vice versa. This is illustrated in the table above which shows the net Foreign Direct Investment (FDI) inflow and corresponding changes in tax rates for the year 2021 and 2022 for five different countries - France, Turkey, Greece, Zambia and Myanmar. This provides valuable insights into the relationship between FDI and tax policies.

It is evident that there is a varied impact of changes in tax rates on FDI inflow. In France, for example, there was a decrease in the tax rate from 28% to 25.80%, resulting in a positive FDI inflow growth of 9%. This suggests that a more favorable tax environment can attract higher levels of foreign investment. In contrast, Turkey raised its tax rate from 20% to 23%, resulting in a slight decrease in FDI of -2%. This indicates that while tax rates are important, they are not the sole determinant of FDI, as other factors may have influenced the decrease.

In France, there was a decrease in the tax rate from 28% to 25.80%, resulting in a positive FDI inflow growth of 9%.

[6]Gropp and Kostial (2001). FDI and Corporate tax Revenue: Tax Harmonization or Competition?

The data also finds that FDI inflow depends on a variety of other factors including tax rates. Greece reduced its tax rate from 24% to 22%, resulting in a 12% increase in FDI. This positive correlation suggests that a reduction in tax rates can incentivize foreign investors. On the other hand, Zambia's decision to decrease its tax rate from 35% to 30% led to a massive 133% increase in FDI, Myanmar's situation is unique; despite reducing the tax rate from 25% to 22%, FDI increased by 44%. This could be attributed to other factors, such as emerging market potential or resource availability, playing a more significant role in attracting investors.

Zambia's decision to decrease its tax rate from 35% to 30% led to a massive 133% increase in FDI.

This dataset highlights the complex relationship between FDI inflow and tax rates. While lower tax rates often attract more FDI, other factors like political stability, infrastructure and market potential also play a crucial role. Careful consideration of a country's overall business environment is necessary to fully understand the dynamics of FDI inflow.

5.2 Current Perception of Taxation in Bangladesh

The perception of taxation in Bangladesh is influenced by various factors. They include the complexity and unpredictability of the tax system, inefficiencies in tax administration, and the challenges associated with tax documentation and technology adoption. Addressing these issues is essential to enhance the country's attractiveness as an investment destination and promote economic growth.

Developing nations face practical constraints in tax policy design, diverging from optimal economic theories. In developed countries, a well-established tax system with strong collection and redistribution capabilities is prevalent. Typically, in these economies, the tax exemption threshold is positioned at the lower end of the income distribution, as seen in the US, where around 90% of individuals are obligated to pay income taxes. On the other hand, developing economies like India have a higher tax exemption threshold, located closer to the top of the income distribution, resulting in approximately 5% of economically active individuals being liable to pay income taxes.

In the USA, around 90% of individuals are obligated to pay income taxes but developing countries like India top of the income distribution are liable to pay income taxes (5% of economically active individuals).

In developed countries, direct taxation, particularly income taxation, holds a more significant role compared to developing countries. In these advanced economies, income taxes play a crucial part in generating revenue and facilitating the redistribution of wealth. On the contrary, in developing countries, tax policy is often shaped by practical constraints and political considerations, rather than focusing on achieving optimal economic outcomes. Consequently, economic theories, including the literature on optimal taxation, have had limited influence on the design of tax systems in these nations. The emphasis in developing countries remains on creating tax structures that are workable within the existing socio-economic context and address immediate fiscal needs.[7]

[7]Tax Policy for Developing Countries, IMF.

Bangladesh's tax regime is more complex than some other countries, with some attractive benefits. Key Informant Interviews (KII) have informed us that there is a general perception that the current tax administration is archaic, marred by lack of transparency and efficiency. Digitizing tax system is mandatory for transparency and easing the process. However, Bangladesh's tax regime is perceived as complex, posing challenges for businesses. While there are tax incentives available for certain investments, the overall complexity of the tax system can be daunting for both domestic and foreign investors. Additionally, the efficiency of tax administration in Bangladesh is questioned, with reports of a slow and inefficient bureaucracy creating obstacles for businesses.

Figure 46: Perception of Taxation Regime

The tax system in Bangladesh is complex, retroactive and subject to frequent law changes, creating unpredictability for foreign investors.	Withholding tax leads to extra administrative burden and technology adoption for tax collection is low.
Bangladesh's tax system exhibits disparities, such as a 5% tax rebate for listed companies and specific surcharges, like the 2.5% surcharge on tobacco companies.	Bangladesh's corporate tax rates range from 20% to 45%, offering a broad spectrum of tax liabilities for potential investors.

Retroactive and Unpredictable Taxation: The retroactive nature of the taxation system in Bangladesh leaves limited room for planning, particularly for foreign investors. Frequent and abrupt changes in tax laws further compound the challenge of predictability. Investors, both local and foreign, face difficulties in adequately planning their financial strategies due to the lack of tax stability. The complexity and unpredictability of the tax system are viewed as deterrents to investment.

Burdensome procedures in the Tax deduction system: In the pursuit of gathering revenues from the multifarious transactions involving the exchange of goods and services, the NBR has implemented a mechanism colloquially recognized as the Tax Deducted at Source (TDS) system. Within this framework, those who receive goods and/or services are entrusted with the responsibility of subtracting a designated portion, the TDS, from the payments made to their specified suppliers or service providers. Subsequently, these deducted sums are directed towards the Government Treasury, facilitated through intermediaries such as the Bangladesh Bank, Sonali Bank, or other duly authorized financial institutions. In the realm of fiscal matters within Bangladesh, the practice of collecting or deducting taxes at the source holds the appellation of "Withholding Tax." It merits highlighting that this fiscal endeavor is grounded in Section 75A of the Income Tax Ordinance (ITO) of 1984. This results in corporations providing tax return of their respective vendors to the NBR creating extra burden on top of the tax burden.

Challenges in Tax Documentation and Technology Adoption: In Bangladesh, businesses must submit hard copies of tax returns and documentation, as technology adoption by tax collection authorities is relatively low. This reliance on manual processes adds to the administrative burden faced by businesses. Moreover, the National Board of Revenue (NBR) in Bangladesh serves both as the tax regulator and tax collector, leading to institutional conflicts. Lack of thorough research when formulating tax laws and regulations contributes to unpredictability regarding the extent of tax incidence and valuation, further complicating the tax landscape.

5.3 Tax Planning and How it Shapes Investment Decisions

Tax planning plays a pivotal role in shaping investment decisions globally. Tax planning is an essential component of financial decision-making for individuals and businesses worldwide. It involves a deliberate effort to structure financial activities and transactions in a manner that minimizes tax liabilities while adhering to legal requirements. Effective tax planning can significantly impact investment decisions, influencing the choice of investments, timing of transactions and overall portfolio management. Combining tax planning with investment strategy offers substantial advantages for constructing tax-efficient portfolios. Investors, both individuals and corporations, carefully strategize to optimize their tax liabilities while maximizing returns. In this section, we delve into how tax planning shapes investment decisions and examine the implications of an unpredictable tax environment, with a particular focus on Bangladesh.

- **Tailored Tax-Efficient Investing:** Tailored tax planning is essential for constructing a tax-efficient portfolio, and consulting tax planners and financial advisors is paramount for personalized guidance. Each investor's unique goals necessitate specific approaches. A crucial element of tax-efficient strategy involves a deliberate allocation of assets between taxable and nontaxable investments. Striking the right balance optimizes tax advantages within the portfolio.

- **Timing of Transactions:** Tax considerations also impact the timing of investment transactions. Investors may strategically buy or sell assets to optimize capital gains or losses, taking advantage of tax laws. For example, selling an investment after a holding period of one year in the United States often qualifies for lower long-term capital gains tax rates.

- **Diversification and Risk Management:** Tax planning can affect diversification strategies. Investors may allocate assets across different tax-advantaged accounts to balance risk and tax efficiency. For instance, allocating high-yield bonds to tax-advantaged retirement accounts and low-yield bonds to taxable accounts can enhance after-tax returns.

- **Strategizing Capital Gains:** Capital gains tax planning is integral to investment strategy, impacting the timing and choice of investment assets. For investors dealing with capital assets like stocks, bonds or real estate, understanding the tax implications of capital gains is crucial. Profits from the sale of assets held for less than a year are treated as ordinary income and taxed accordingly. In contrast, holding assets for over a year qualifies for long-term capital gains tax rates, which are often more favorable. Therefore, investors should collaborate with financial advisors to formulate a long-term tax plan that aligns with their investment goals. This planning is especially vital when considering the acquisition of new investment properties or managing existing capital assets.

- **Tax Environment and Investment Decision Making:** KIIs highlight the significance of the tax environment in investment decisions. Businesses weigh factors like tax rates, incentives, and tax administration. For example, a business contemplating investment in Bangladesh considers corporate tax rates ranging from 20% to 45%, along with available tax incentives for foreign investors. These considerations impact investment choices.

A fundamental aspect of tax-efficient investing involves the careful allocation of assets between taxable and nontaxable investments. Taxable investments, such as stocks and bonds, generate annual tax liabilities, while nontaxable investments, like retirement accounts, offer tax advantages. Striking a balance between these two categories is essential for optimizing after-tax returns. Tax planners and financial advisors assist investors in achieving this balance.

Tax environment and Investment Decision-Making: Key Informant Interviews (KIIs) reveal that the tax environment plays a pivotal role in investment decision-making. Businesses, both domestic and foreign, weigh several tax-related factors when evaluating investment opportunities. The corporate tax rate is a primary consideration, with rates ranging from 20% to 45% in Bangladesh. Additionally, businesses take advantage of various tax incentives offered to foreign investors. However, the efficiency and transparency of the tax administration also impact investment decisions. A streamlined and efficient tax system can enhance investor confidence, while an unpredictable and bureaucratic tax environment may deter potential investors.

> *The corporate tax rate is a primary consideration when evaluating investment opportunities worldwide, with rates ranging from 20% to 45% in Bangladesh.*

While tax planning is crucial for investors, an unpredictable tax environment can pose significant challenges:

1. **Lack of Predictability:** Investors require a stable and predictable tax regime to make informed decisions. Frequent changes in tax laws, rates and regulations can disrupt long-term investment strategies. In Bangladesh, for example, abrupt changes in tax rules have led to uncertainty among investors.

2. **Complexity and Ambiguity:** Complex tax codes and ambiguous regulations can make tax planning a daunting task. Investors may struggle to understand their tax obligations fully, leading to unintentional non-compliance. In Bangladesh, the tax system is often perceived as complex and investor unfriendly.

Figure 47: Factors that effect Tax planning

- Allocation between taxable and nontaxable investments
- Optimize capital gains and losses
- Diversification and risk management
- Balancing risk and tax efficiency
- Strategizing capital gains
- Tax administration efficiency

In the context of Bangladesh, the unpredictable tax environment may deter foreign investors. Frequent changes in tax rates and rules can create uncertainty, making it challenging for investors to assess the long-term tax implications of their investments. Even when preparing the financial statements and other documents for the current fiscal year, investors and accountants are in the dark about the tax rates to be applied— as the tax rates are disclosed at the beginning of the following fiscal year. Investor confidence is closely tied to tax predictability. A stable and transparent tax regime can attract more investors and foster economic growth. Conversely, an unpredictable tax environment can lead to capital flight and reduced investment.

Figure 48: **Impact of Unpredictable Tax Regime**

Inability for companies to plan ahead

Pulling back of investment

Shareholders losing out on dividends

The integration of tax planning and investment strategy offers investors a powerful tool to enhance portfolio performance. Tailored tax-efficient approaches, careful allocation of assets, and strategic capital gains planning are essential elements of this synergy. Collaboration with tax planners and financial advisors ensures that investment decisions align with individual goals and the ever-changing tax landscape. Informed by Key Informant Interviews (KIIs), it becomes evident that businesses weigh the tax environment heavily when making investment choices. Corporate tax rates, incentives and the efficiency of tax administration play a pivotal role in determining the attractiveness of a particular investment destination. Therefore, policymakers and governments must prioritize creating a stable, transparent and investor-friendly tax environment to foster economic growth and attract both domestic and foreign investments.

5.4 How FDI Helps Improve Tax Collection as One of its Impacts

FDI can lead to additional value-added tax generation. The positive impact of FDI can manifest through both direct and indirect channels, encompassing productivity enhancement, technology transfer and job creation[8]. FDI inflows provide financial resources that stimulate formal sector activities, leading to additional value-added tax generation. Additionally, the creation of new jobs through FDI can contribute to tax revenue from labor income. Moreover, FDI's influence on exports and market access facilitates customs-duties revenue growth.

Knowledge transfer and technology dissemination by FDI also contribute to the utilization of natural resources, leading to income generation. Corporate tax revenues in the host country benefit from FDI's capital gains and profits. For developing countries with low-tax populations, FDI inflows can broaden the taxpayer base, generating more tax revenue by supporting investments and employment opportunities. In countries reliant on critical natural resources, FDI directed toward these sectors is likely to yield substantial royalties.

To attract foreign investments, countries should adopt a holistic approach, addressing not only tax policies but also factors like political stability, infrastructure and market potential.

[8]Abdramane Camara. The effect of foreign direct investment on tax revenue in developing countries. 2019. ffhal-03188025v2

Figure 49: Impact of FDI on Host Country

01 FDI has both direct and indirect positive impacts, including productivity enhancement, technology transfer and job creation.

02 FDI inflows stimulate formal sector activities, leading to additional Value-Added Tax (VAT) generation.

03 Creation of new jobs through FDI contributes to tax revenue from labor income.

04 FDI's influence on exports and market access can lead to growth in customs duties revenue.

05 To attract foreign investments, countries should adopt a holistic approach, addressing not only tax policies but also factors like political stability, infrastructure and market potential.

Transparency plays a crucial role in channeling the favorable outcomes stemming from initial natural-resource earnings towards increased domestic tax revenues. Ehrhart (2011) demonstrated that within nations abundant in resources, the presence of democratic institutions becomes pivotal due to their enhanced transparency levels. This transparency plays a crucial role in channeling the favorable outcomes stemming from initial natural-resource earnings towards increased domestic tax revenues. Moreover, considering that a significant portion of FDI targets natural-resource exploitation endeavors in developing nations, it can be deduced that heightened transparency levels hold the potential to positively influence the revenue generated through FDI. Consequently, a strong institutional framework becomes a magnet for foreign investors, facilitating their active involvement in contributing to tax revenues.

Figure 50: **Benefits of FDI Inflow to a Host Country**

FDI inflows can broaden the taxpayer base, generating more tax revenue by supporting investments and employment opportunities.

Transparency and strong institutional frameworks play a crucial role in channeling natural resource earnings towards increased domestic tax revenues.

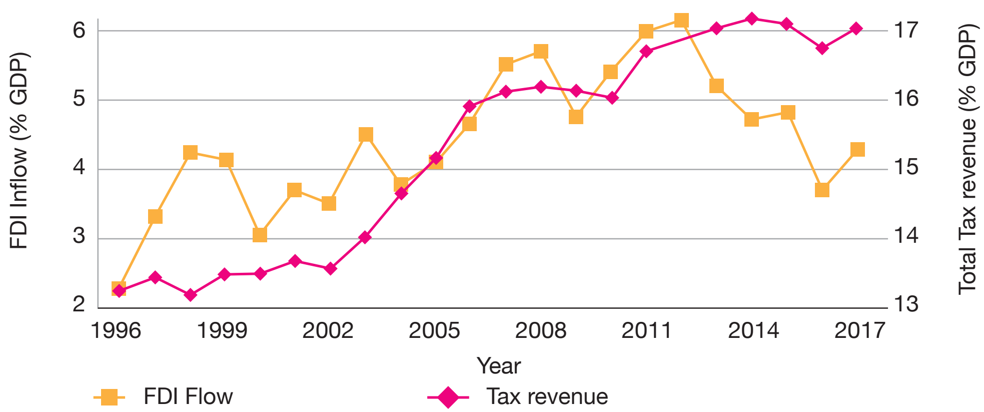
Tax rates play a pivotal role in attracting FDI, with investors scrutinizing a nation's tax policies before committing capital.

FDI inflows stimulate formal sector activities, leading to additional Value-Added tax (VAT) generation.

Research highlights the significance of FDI inflows as a notable contributor to tax revenue generation. A study shows that a rise of 1 percentage point in FDI inflows corresponds to a 1.5 percentage point increase in the overall tax revenue ratio for developing nations[9]. This finding underscores the significance of FDI inflows as a notable contributor to tax revenue generation. Consequently, policymakers may explore viable strategies to enhance the appeal of FDI and enhance their nations' tax revenue collection. Typically regarded as a substantial driver of economic progress in developing nations, FDI enables the transfer of resources from home countries to host nations. It catalyzes local investments, thereby enhancing human capital and the quality of institutions in developing countries. Through these mechanisms, FDI has the potential to bolster tax collection in developing nations.

Study shows that a rise of 1 percentage point in FDI inflows corresponds to a 1.5 percentage point increase in the overall tax revenue ratio for developing nations.

Figure 51: **Trends of FDI Inflows and Tax Revenues**



Source: Abdramane Camara. The effect of foreign direct investment on tax revenue in developing countries, 2019.

[9]Abdramane Camara. The effect of foreign direct investment on tax revenue in developing countries. 2019. ffhal-03188025v2f

Further studies reveal that FDI inflows affected the total tax revenues positively. Gropp and Kostial (2000) analyzed the correlation between FDI, taxation and corporate tax revenues in 19 OECD countries over 1987–1997 using panel data analysis and found that FDI inflows affected the corporate tax revenues positively. Furthermore, Mahmood and Chaudhary (2013) analyzed the effect of FDI on the total tax revenue in Pakistan during 1972–2010 and revealed that FDI inflows affected the total tax revenues positively. Okey (2013) conducted research into the influence of FDI inflows on the mobilization of tax revenue in the West African region spanning the years 1989 to 2009. Through the application of panel regression analysis, Okey arrived at the conclusion that FDI inflows have a favorable impact on the enhancement of tax revenues.

Several other studies highlight the multifarious benefits of FDI, which in turn could lead to higher revenue in medium-long term. The earlier studies typically found a positive relation between FDI and government revenue. Dunning (1993) and Raff and Srinivasan (1998) focus their investigation on the FDI effect through the determinants of tax revenues. Dunning (1993) argued that the welfare effects of FDI in the host country depend on the bargaining power of the host country with foreign investors, including either by offering the tax rebates on energy or labor costs to attract foreign investment or by imposing the tax. Raff and Srinivasan (1998), on the other hand, have claimed that FDI could create employment, transfer technology through training local labor and improve management skills. Thus, they argue the government should lose some tax revenue in the short-run to attract foreign investment inflow.

CHAPTER 6

BANGLADESH'S CURRENT TAXATION SYSTEM AND IMPLICATIONS FOR FOREIGN INVESTMENTS

Chapter at a Glance

Overview of Tax Policy Framework and Structure in Bangladesh

Tax Policy Objectives: Economic expansion, revenue increase and social infrastructure development.

National Board of Revenue (NBR): Central authority for tax administration, consisting of five wings.

Recent Reforms: Broadening the tax base, reducing exemptions and enhancing tax administration.

Tax System: Progressive individual income tax system.

Income Tax Administration: Split into administrative and judicial functions, each with defined powers and responsibilities.

Additional Reforms: Online VAT registration, tax administration automation, NBR strengthening and modernization of tax laws.

Challenges: Narrow revenue base, numerous exemptions and administrative issues leading to low tax collection.

Government's Commitment: Increasing tax revenue through a broader taxpayer base, streamlined processes and technology-driven VAT collection.

Medium Term Revenue Collection Strategy (MTRS): Being developed to achieve revenue targets.

Bangladesh's tax related policy while designed to support economic development, exhibits issues that can affect its alignment with FDI goals

Act	How it aligns Global Standard Compliance	Contradictions (Negatives)
Income Tax Act 2023	• Double Taxation Avoidance Agreements (DTAAs) • Transfer Pricing Regulations	• Tax Administration and Transparency
Vat and SD Act 2012	• Exemption of export and the import of raw materials directly related to exports with some conditions	• Complex input-output coefficient • Illogical definition of input material for the input tax credit • Higher rate of Advance VAT (AT)
Customs Act 1969	• Duty Exemptions and Concessions • Streamlined Customs Procedures • Temporary Importation	• Complex Tariff Structure • Customs Valuation Disputes • Non-Tariff Barriers (import licensing requirements, product standards and testing regulations)

Bangladesh's Tax system has Major Gaps when Compared to International Tax Principles

Neutrality	Effectiveness & Fairness	Efficiency	Flexibility	Certainty & Simplicity

Key Challenges in Bangladesh's Tax Environment

Un-Conducive Policies
- Lack of overarching strategy and coordination
- Not aligned to FDI priorities and needs
- High effective tax rates

Tax Compliance
- Unclear Process
- Complicated and contradicting regulations

Tax Disputes and Legal Hassles
- Limited experts and high costs
- Interpretational confusions
- Lack of effective Alternative Dispute Resolution (ADR)

Lack of Predictability
- Constant changes and lack of advanced ruling
- Investor uncertainty

Effectiveness of Tax Incentives and Hurdles in Claiming Tax Benefits
- High bureaucracy
- Ambiguity in procedures
- Authorization issues/registration issues/hidden costs

Digitalization Challenges
- Digital transformation
- Integration issues

International Tax Treaties
- Lack of Double Taxation Avoidance Agreements (DTAAS)
- Existing not always followed/respected

High Total Tax Incidence
- Minimum Tax
- Tax deducted at source
- Different thresholds
- Different rates in VAT

Customs Regulations Present Significant Hurdles for Businesses

Harmonization & Standardization Issues	• WTO Inconsistencies: The minimum price system under Section 25 clashes with WTO rules • Minimum/Tariff value higher than International customs price • Not aligned with WCO guidelines
Transparency Issues	• Dearth of clarity in customs decisions • Sections of Concern: Sections 65, 71, 94, 204, 204A, and 215A(1) contribute to uncertainty • Low Transparency: Section 79C adds to uncertainty
Simplification	• Procedural delays • Bureaucratic issues • Absence of limitation on fee amounts

CHAPTER 6

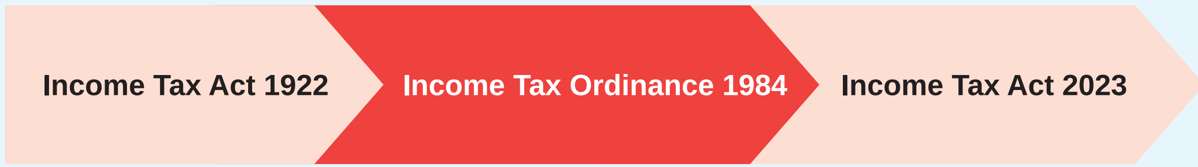
BANGLADESH’S CURRENT TAXATION SYSTEM AND IMPLICATIONS FOR FOREIGN INVESTMENTS

Taxation in Bangladesh, spanning individual, corporate, and value-added Tax (VAT) and customs shapes its global competitiveness.
In common with other nations, Bangladesh has formulated a framework of tax regulations, both direct and indirect, encompassing individual and corporate income. The nature of these tax policies can significantly impact a country's competitiveness on the global stage, particularly concerning businesses seeking to relocate or establish new ventures. The assessnent will delve into the three pivotal tax categories within Bangladesh- firstly, Direct Tax (including income tax and corporate tax), goverened by the Income Tax Act 2023, replacing the Income Tax Ordinance of 1984; second, the Value Added Taxation (VAT), governed by the Value-Added tax and Supplementary Duty Act of 2012 and thrid, customs, which is goverened by the Customs Act 1969. The National Board of Revenue (NBR) is entrusted with the pivotal role of administration and tax collection from the taxpayers.

Box 4: Key Tax Legislations in Bangladesh and Their Evolution

Income Tax Act, 2023: The income of people, businesses and organizations will all be taxed according to the terms of this Act. The Income Tax Act in Bangladesh governs the taxation of income, including that of foreign companies and investors engaging in FDI. It outlines tax rates, incentives and rules for foreign entities operating within the country, along with provisions for withholding taxes and transfer pricing regulations. The Act plays a crucial role in determining the tax treatment of FDI and ensuring compliance with tax laws.

Evolution of Income Tax law

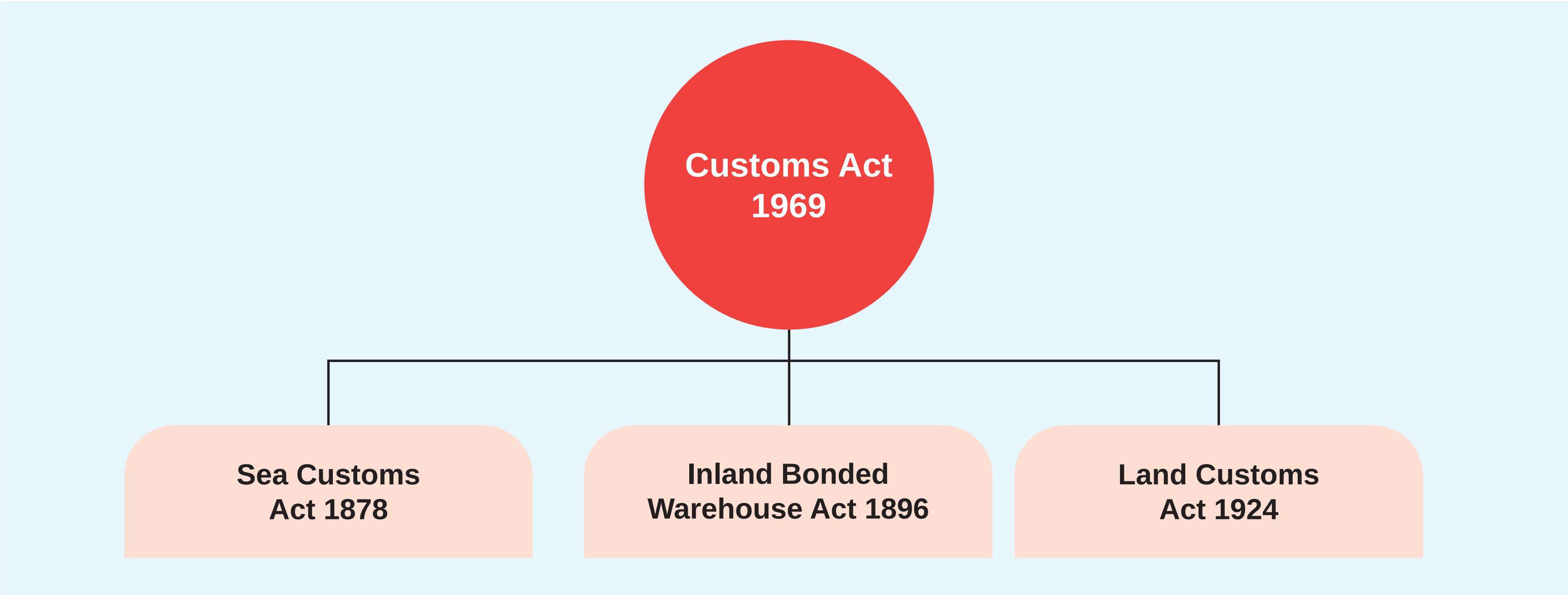


VAT and SD Act, 2012: This act outlines how value-added tax (VAT) will be charged and collected on goods and services. In Bangladesh, the Act has implications on trade and investments through governing the taxation of goods and services, specially those produced or supplied by foreign companies within the country. FDI enterprises must comply with VAT registration, collection and reporting requirements, affecting their overall tax liabilities and financial operations in Bangladesh.

Having said that, changes that were brought periodically through the 2012 Act, in an attempt to aligned with OECD principles were subsequently amended through various S.R.O., notifications, Finance Acts. Over time, the Act returned back to old 1991 Act in substance. This has created hindrance of the overall acceptance of VAT & SD law which in turn will create hindrance to achieve Bangladesh's desired vision.

Evolution of VAT law

Customs Act, 1969: This act sets rules for importing and exporting, including the amount of customs taxes that must be paid. This act is relevant to FDI as it governs the import and export of goods and services. FDI enterprises must comply with customs regulations for importing raw materials, equipment and other goods required for their business operations, impacting the cost structure and supply chain management of foreign companies operating in Bangladesh.



6.1 Overview of Bangladesh Tax Structure: Ensuring Fundamental Principles of Taxation System to Achieve Vision 2041

6.1.1 Key Issues in Tax Policy Framework, Tax Administration Structure and Authorities

Bangladesh's tax structure, marked by a limited base and exemptions, requires reforms to bolster revenue. The challenges in revenue mobilization within Bangladesh are widely acknowledged and have been the subject of various government initiatives. Despite these efforts, the fundamental issues persist, as reiterated in the most recent budget document. Bangladesh's tax laws have traditionally featured a limited revenue base, an abundance of tax exemptions and administrative complexities, resulting in a tax collection that falls short of a desirable percentage of the GDP. In recent years, the government has embarked on a series of initiatives in the realms of tax, VAT and customs.

Despite these efforts, the challenges in revenue mobilization continue to persist, prompting a continued focus on finding comprehensive and sustainable solutions. In the latest budget speech, the government reaffirmed its commitment to addressing these challenges. It outlined its plans to boost tax revenue by focusing on expanding the taxpayer base, simplifying the process for submitting tax returns, rationalizing tax exemptions and implementing a transparent Value-Added Tax (VAT) collection system through electronic fiscal devices. These objectives reflect the government's determination to create a more effective and efficient tax system.

Despite some recent initiatives, Bangladesh's tax structure continues to face key challenges in terms of complexity, transparency and predictability. Complex and ever-changing tax laws and regulations pose a significant barrier for both local and foreign investors. The intricate operational complexity, documentation requirements and convoluted tax calculations, deductions and exemptions hinder ease of compliance, impacting investor confidence. Disputes and lengthy judicial actions further deter foreign investors and create an uncertain business environment.

The lack of transparency and predictability adds to the complexity, leading to an unfavorable investment environment. The unclear application process and inconsistent eligibility criteria can discourage foreign investors. Moreover, varying interpretations of tax regulations by different authorities and the absence of clear guidelines can lead to confusion and delays in tax assessments. Unpredictable changes in tax laws in Bangladesh make it difficult for foreign investors to plan for the future and make sound investment decisions. The lack of predictability may lead to uncertainty, financial losses and potential withdrawal of investments. Addressing these challenges is essential for creating a more favorable and stable investment environment in Bangladesh.

The NBR is the central authority responsible for tax administration in Bangladesh. It operates as a statutory body within the Internal Resources Division of the Ministry of Finance, wielding authority over tax policy formulation, implementation, law enforcement and tax collection. The NBR's operations are primarily structured into five wings, comprising the Income Tax wing, Value Added Tax (VAT) wing, customs wing, IT wing and Research and Statistics wing.

Within the domain of income tax administration, two primary categories of authorities exist: administrative and judicial. The administrative function encompasses the entire spectrum of activities within the income tax wing, spanning from taxpayer identification to tax collection. On the other hand, the judicial segment adjudicates the grievances of taxpayers and issues prompt verdicts. The powers, authorities and responsibilities of these two groups, as well as the individuals heading them, are delineated in the chart below.

Figure 52: Overview of Tax Policy Framework and Structure in Bangladesh

Tax Policy Objectives: Economic expansion, revenue increase and social infrastructure development.

National Board of Revenue (NBR): Central authority for tax administration, consisting of five wings.

Recent Reforms: Broadening the tax base, reducing exemptions and enhancing tax administration.

Tax System: Progressive individual income tax system.

Income Tax Administration: Split into administrative and judicial functions, each with defined powers and responsibilities.

Additional Reforms: Online VAT registration, tax administration automation, NBR strengthening and modernization of tax laws.

Challenges: Narrow revenue base, numerous exemptions and administrative issues leading to low tax collection.

Government's Commitment: Increasing tax revenue through a broader taxpayer base, streamlined processes and technology-driven VAT collection.

Medium Term Revenue Collection Strategy (MTRS): Being developed to achieve revenue targets.

6.1.2 Alignment of Bangladesh's Taxation System to Global Principles

OECD has well known principles which are followed by numerous countries to foster revenue collection. Globally, the Organization for Economic Co-operation and Development (OECD) collaborates with governments, policymakers and citizens to establish evidence-based international standards and develop solutions for a wide spectrum of social, economic, and environmental challenges. These challenges span from enhancing economic performance and job creation to promoting robust education systems and effective taxation policies. The OECD is renowned for its set of principles that serve as guiding beacons for numerous countries in their pursuit of bolstering government revenue collection to meet their defined milestones and objectives. These principles provide a solid foundation for governments to strive for fiscal excellence and financial sustainability. A summary of these principles and Bangladesh's tax policy's alignment to the established principles are given below.

Table 8: Key elements of Bangladesh's Tax Policy and their alignment to Global Principles

Principles	Alignment with OECD framework	Factors not aligned
Neutrality	• Progressive slab-based tax rate for individual.	• Proving benefits to specific sectors • Minimum tax • Multiple VAT rate • Input recovery is restricted by definition • Imposing a minimum/ Tariff value which is higher than international price • Tax incidence is higher for private sector employee compare to government employee • Hidden cost
Efficiency	• Addressing the issues of digitalization for VAT and Income Tax. • Introduction of Alternative Dispute Resolution (ADR) systems	• Lack of digitalization and modernization • Process and concept of withholding tax and VAT
Certainty and simplicity	• Certain industrial undertaking, physical infrastructure, sectors has defined tax rate up to 15 years.	• Retrospective application of policies • Lack of predictability • Different Identity numbers for the same business • Lengthy process for getting the incentives • Limits on business expenses. • Conditions and time limit on input Tax credit.

Principles	Alignment with OECD framework	Factors not aligned
Effectiveness and fairness	• Easy return forms for VAT return and Tax. • Respect certain articles of DTAA such as interest, dividend, royalty. • Higher taxes for wealthier persons.	• Higher discretionary power of the tax authority • Limited number of transfer pricing experts • DTAA with a limited number of countries • Does not follow business profit article of DTAA's • Higher withholding tax rate than the legitimate tax rate • Tax on taxes • Same duty rate for industrial raw materials and trading items • Tax on payment rather than income • VAT should be on value addition only
Flexibility	• On the process of digitizing system.	• Paper based return system • In person appeal filling process

Bangladesh's tax system exhibits several gaps across the OECD principles, impacting its effectiveness and equity.

Under the principle of **Neutrality**, the system tends to favor specific sectors through benefits, imposes minimum taxes, maintains multiple VAT rates, restricts input recovery and sets tariff values above international prices. This bias can hinder fairness and efficiency.

Efficiency is compromised due to the lack of digitalization and modernization in tax processes, especially concerning withholding tax and VAT procedures. The reliance on traditional paper-based return systems and in-person appeal filing processes slows down operations.

Certainty and simplicity are also lacking, with retrospective application of policies and unpredictability in tax regulations. The use of different identity numbers for the same business and a lengthy process for obtaining incentives further compound the complexity.

Effectiveness and fairness are undermined by the higher discretionary power of tax authorities, a limited number of transfer pricing experts and the absence of Double Tax Avoidance Agreements (DTAA) with many countries. Non-compliance with business profit articles of DTAA agreements, a higher withholding tax rate than the legitimate tax rate, and tax on taxes further hinder fairness.

Under the **Flexibility** principle, the reliance on a paper-based return system and in-person appeal filing processes adds inefficiencies. Addressing these gaps across these OECD principles is vital for improving Bangladesh's tax system and fostering a more equitable and efficient environment for businesses and investors.

6.2 Review of Taxation Laws, Regulations, Compliance Requirements and Institutional Issues That Have Implications for FDI

Figure 53: Key Challenges in Bangladesh's Tax Environment

Un-Conducive Policies
- Lack of overarching strategy and coordination
- Not aligned to FDI priorities and needs
- High effective tax rates

Tax Compliance
- Unclear Process
- Complicated and contradicting regulations

Tax Disputes and Legal Hassles
- Limited experts and high costs
- Interpretational confusions
- Lack of effective Alternative Dispute Resolution (ADR)

Lack of Predictability
- Constant changes and lack of advanced ruling
- Investor uncertainty

Effectiveness of Tax Incentives and Hurdles in Claiming Tax Benefits
- High bureaucracy
- Ambiguity in procedures
- Authorization issues/registration issues/hidden costs

Digitalization Challenges
- Digital transformation
- Integration issues

International Tax Treaties
- Lack of Double Taxation Avoidance Agreements (DTAAS)
- Existing not always followed/respected

High Total Tax Incidence
- Minimum Tax
- Tax deducted at source
- Different thresholds
- Different rates in VAT

6.2.1 Lack of Conducive Tax Policies and Laws

Lack of Overarching Strategy and Coordination: One of the key challenges facing Bangladesh's Tax structure is the lack of an overarching strategy and coordination in its tax policies. The absence of a comprehensive and well-coordinated tax strategy can result in disjointed and inconsistent tax regulations and incentives. This lack of strategic direction can create confusion for both domestic and foreign investors, as they struggle to navigate a tax system that lacks a clear, long-term vision. Without a unified strategy, tax policies may be subject to frequent changes and amendments, leading to unpredictability and uncertainty in the business environment. Furthermore, the absence of a clear roadmap for tax policy development can hinder the government's ability to align taxation with broader economic and investment objectives.

Misalignment Between Tax Policies and Industrial Policy: Another hurdle to fostering a conducive tax environment for FDI lies in the misalignment between the government's industrial policy and its tax policies. While the government's industrial policy emphasizes particular sectors like manufacturing and agro-processing as priorities for economic growth, the country's tax policies do not consistently align with these priorities. This discrepancy can deter potential investors who may question

the government's commitment to its own industrial objectives. To address this challenge, Bangladesh should strive for greater harmony between its industrial policy and tax policies, ensuring that the tax system is structured to incentivize and support the targeted industries in a consistent and coherent manner. Such alignment will create a more appealing and investor-friendly landscape for foreign businesses looking to invest in sectors that align with the government's development goals.

High Effective Tax Rates: High effective tax rates present a substantial obstacle to attracting and retaining foreign investment in Bangladesh. While statutory tax rates may appear competitive, it is the effective tax rates that foreign investors ultimately face. Various factors, such as the application of multiple taxes, fees, and compliance costs, can significantly raise the effective tax burden on businesses. This high tax incidence can erode the competitiveness of the country, making it less appealing to foreign investors. Addressing this challenge requires not only a reduction in nominal tax rates but also a comprehensive review of the overall tax structure to streamline and rationalize the tax system, ensuring that effective tax rates align with FDI priorities and remain competitive on a global scale.

Not Aligned to FDI Priorities: Another critical challenge lies in the alignment of tax policies with the priorities of foreign direct investment (FDI). For Bangladesh to attract and retain foreign investors, its tax policies should be tailored to accommodate the needs and preferences of these investors. However, the existing tax framework may not always align with the investment priorities of foreign businesses. This misalignment can deter potential investors who may perceive the tax system as unfavorable or unfriendly. To enhance the attractiveness of Bangladesh as an FDI destination, tax policies must be designed to cater to the specific requirements and interests of foreign investors, offering them a competitive and conducive environment for their operations.

Bangladesh's tax policy, although designed for supporting the country's economic development objective, has certain issues that can impact the alignment of tax policy with FDI objectives. The legislative landscape in Bangladesh exhibits a mix of provisions that both align with and contradict FDI objectives. The Income Tax Act of 2023 facilitates FDI by incorporating measures such as Double Taxation Avoidance Agreements (DTAAs) and Transfer Pricing Regulations. However, it still grapples with challenges related to tax administration and transparency. Similarly, the VAT and SD Act of 2012 provides positive support by exempting exports and related raw material imports, yet it contains complexities in input-output coefficients, illogical definitions of input materials for tax credits and higher advance VAT rates. The Customs Act of 1969 streamlines customs procedures and offers duty exemptions and concessions, but it also presents contradictions like complex tariff structures, disputes in customs valuation and non-tariff barriers. The table below shows some key ways how the tax policies contradict with the overarching objective of enhancing private investments, including FDI.

Table 9: Tax policies and how it aligns to FDI objectives

Act	How it aligns to FDI (Positives)	Contradictions (Negatives)
Income Tax Act 2023	• Double Taxation Avoidance Agreements (DTAAs) Transfer Pricing Regulations	• Tax administration and transparency
Vat and SD Act 2012	• Exemption of export and the import of raw materials directly related to exports with some conditions	• Complex input-output coefficient • Illogical definition of input material for the input tax credit • Higher rate of Advance VAT (AT)
Customs Act 1969	• Duty Exemptions and Concessions • Streamlined Customs Procedures • Temporary Importation	• Complex Tariff Structure • Customs Valuation Disputes • Non-Tariff Barriers (import licensing requirements, product standards, and testing regulations)

6.2.2 Lack of Tax Predictability and Consistency

There is a concern about the lack of predictability of tax law and regulation and applying it retrospectively. Tax rates are applied retrospectively by announcing the Finance Act each year. Therefore, investors are not aware of current tax rates until the end of fiscal year. As a result, investment feasibility and business profitability cannot be estimated. The lack of predictability of tax law changes in Bangladesh has a negative impact on FDI. Foreign investors are often hesitant to invest in countries where the tax laws are constantly changing and applied retrospectively, as they may be subject to unexpected tax liabilities. This can make it difficult for foreign investors to plan for the future and make sound investment decisions. This can lead to uncertainty and risk for foreign investors which can lead to financial losses and may even force foreign investors to withdraw their investments from Bangladesh.

The government has historically introduced tax reforms and amendments in an ad hoc manner, often without considering the long-term consequences and implications for businesses and the economy. This lack of foresight results in an unpredictable and ever-changing tax landscape, creating uncertainty for businesses. Foreign investors, in particular, require a stable and reliable tax environment to make informed investment decisions and strategic planning. The absence of a comprehensive long-term tax strategy undermines the country's competitiveness and attractiveness to FDI. To address this challenge, Bangladesh should prioritize the formulation of a clear and coherent tax strategy that aligns with its broader economic objectives and provides investors with the predictability and stability they need to thrive in the country.

The following table shows some examples of sudden changes or reversals in tax laws and regulations that are related to FDI.

Table 10: Example of Ad-hoc Changes/Reversals in Tax Regulations and Impact on Business

Reference/Section	Details	Impact
Section 70 of ITA 2023	Business loss can be set off or carried forward only against the head of income from business.	This will increase the tax liability of the entity established through FDI as there is a high probability of business loss in the earlier years.

Reference/Section	Details	Impact
Section 32 of ITA 2023	Incentive bonus to employees is also part of the 'Perquisite' calculation. Any amount above ten lakhs paid to an employee by way of perquisites is disallowable as business expenditure.	As a result of this inclusion, the incentive bonus was also subsumed within the perquisite limits; which will increase the tax burden of companies. In this regard, it should be noted that an incentive bonus is given to employees to increase their work motivation; which helps the company to reach its ultimate goal.
Section 163 of ITA 2023	The minimum tax rate on gross receipts of carbonated beverage manufacturers increased from 0.06% to 3%.	The 500% increase in minimum tax on these drinks is truly astounding. The industry must earn a pre-tax profit of 10% to settle the minimum tax liability; which will increase the price of the product abnormally. And due to this abnormal increase in the price of the product, the consumer will lose interest in consuming the product. This will reduce the company's production to a large extent.
VAT & SD Act, 2012 2(18)(ka)	Excludes certain goods and services from the definition of input or production materials.	This clause contradicts the basic features of the Act, resulting in the imposition of VAT on VAT. As a result, the actual/effective rate of VAT on consumers is higher than the standard rate of 15%, which is against the VAT Act.

6.2.3 High Effective Tax Rate/Total Tax Incidence

The Effective Tax Rate (ETR) is the actual amount of tax that a company pays, considering all tax benefits and incentives. It is different from the statutory tax rate, which is the nominal tax rate that companies are required to pay. A lower ETR can make a country more attractive to foreign investors, as they can increase their profitability.

The effective tax rate is one of the pivotal concerns that revolves around the taxation levels extended to foreign investors. Elevated corporate tax rates can act as a deterrent to the inflow of FDI, as investors tend to favor nations with more competitive tax frameworks. Bangladesh has taken steps to address this issue by gradually decreasing the corporate tax rate, but the effective tax rate remains relatively high compared to neighboring competitors. It is advisable to continue the reduction of the effective corporate tax rate to enhance FDI attractiveness.

This increase in high effective tax rate is mainly driven by, but not limited to either or with a combination of:

- **A** Limits put on business expenses by Income Tax Act (ITA 2023)
- **B** Excessive Tax Deduction at Source which is considered as minimum tax
- **C** Minimum Tax on gross receipts
- **D** VAT imposed on VAT
- **E** Minimum/Tariff value

a. Limits put on business expenses by the Income Tax Act (ITA 2023) a contradiction of Simplicity principle

An illustration regarding the restrictions imposed in accordance with the provisions of ITA 2023 demonstrates a company generating BDT 50 lakh in profit before tax may find itself subject to an estimated tax rate of 42%, as opposed to the authorized rate of 27.5%. The following table further elaborates on this.

Table 11: Example of High Tax Incidence due to limit on expenses

Particulars	BDT	BDT
Revenue		**50,000,000**
Profit Before Tax (A)		5,000,000
Add: Disallowance as per Section 55		
Capital Expenses (Entire amount)	300,000	
Provision for Expenses (Entire amount)	400,000	
Promotional Expenses (Allowable up to 0.5% of turnover)	150,000	
Royalty Expenses (Allowable up to 10% of net business profit)	200,000	
Technical Know How Fees (Allowable up to 10% of net business profit)	80,000	

Particulars	BDT	BDT
Foreign Travel (Allowable up to 0.5% of turnover)	200,000	
Excess Perquisite (Excess of 1 million for each employee)	250,000	
Impairment Loss (Entire amount)	400,000	
Transfer to Unrecognized Fund (Entire amount)	300,000	
Total Disallowance		**2,280,000**
Total Taxable Income (B)		7,280,000
Tax on PBT (A*27.5%)		1,375,000
Tax on Total Income [C= B*27.5%]		2,002,000
Tax on Disallowance		627,000
Effective Tax Rate [C/A]		**40%**

Assumptions:

- Capital Expense BDT 300,000;
- Provision for Expenses BDT 400,000;
- Promotional Expenses BDT 400,000;
- Royalty Expenses BDT 700,000;
- Technical Know-how Fees BDT 80,000;
- Foreign Travel BDT 450,000;
- Perquisite 1,250,000;
- Impairment Loss 400,000;
- Transfer to Unrecognized Fund BDT 900,000.

b. Excessive Tax Deduction at Source which is considered as minimum tax is in contradiction of Neutrality principle

As seen in the example in Table 12, if the same company is within the scope of minimum tax then the estimated effective tax rate becomes 46%, as opposed to the authorized rate of 27.5% which generates a BDT 5 million profit before tax. The following table further elaborates on this.

Table 12: Example of High Tax Incidence due to Tax Deduction at Source

Particulars	BDT	BDT
Profit Before Tax (A)		**5,000,000**
Add: Disallowance as per Section 55		**2,280,000**
Total Taxable Income (B)		**7,280,000**
Tax on Total Income [C= B*27.5%]	2,145,000	
Tax deducted at source [D]	2,300,000	
Tax determined [E= Higher of C & D]		**2,300,000**
Tax on PBT (A*27.5%)		**1,375,000**
Effective Tax Rate [E/A]		**46%**

c. Minimum Tax on Gross Receipts in contradiction of Neutrality principle

On top of various imposed limits on business expenses and tax deductions at sources that are considered as minimum tax, there is another parameter 'Minimum tax on Gross Receipts' which plays a pivotal role in increasing the effective tax rate. The rate of this tax can vary from 3.00% to 0.60% on gross receipts by the business entity.

An example is given to provide an overview of how effective tax rate increases where a company generates profit before tax of 1 million ends up paying an estimated effective tax rate becomes 48%, as opposed to the authorized rate of 27.5% due to minimum tax on gross receipts concept.

Table 13: Example of High Minimum Tax on Gross Receipts

Particulars	BDT	BDT
Gross receipts (A)		**16,000,000**
Profit before tax (B)		**1,000,000**
Add: Accounting Depreciation		**100,000**
Less: Tax Depreciation		**(80,000)**
Less: Lease Payment		**(100,000)**
Add: Disallowance as per Section 55		**500,000**
Total Taxable Income (C)		**1,420,000**

Particulars	BDT	BDT
Tax on total income [D= C*27.5%]	390,500	
Tax deducted at source u/s 163 [E]	400,000	
Minimum tax on gross receipts @ 3% [F= A*3%]	480,000	
Tax determined [G= Higher of D, E & F]		**480,000**
Tax on PBT (B*27.5%)		**275,000**
Effective tax rate [G/B]		**48%**

d. VAT imposed on VAT is a contradiction of effective and fairness principle

The fundamental principle of VAT is that ultimate consumer of supplies will bear the VAT and manufacture and trader will claim input VAT rebate to pass on the VAT amount. Due to restriction in input definition in section 2 (18ka) and conditions in section 46 of the VAT and SD Act 2012, the effective rate of VAT increases from standard 15%.

Table 14: Example of High Effective VAT rate

Particulars	Value for VAT	VAT @ 15%
Output	1,000,000	150,000
Non-recoverable input VAT		30,000
	1,000,000	180,000
Effective VAT rate	**18.0%**	

- 15% VAT passed on to the customer
- 3% VAT absorbed by the company

e. Minimum/Tariff Value

In many cases, Custom sets a minimum assessable value for specific items. As it is the minimum value, customs accept higher assessable value than this but don't accept the lower value. Which increases the cost of the importer significantly. The issue has been demonstrated through the following example:

Table 15: Example of High Effective Tax Incidence

SL No.	Items	HS code	Actual value ($)	Minimum value ($) per liter	Multiplier due to min. value	Assessable value in BDT	Tariff rate (%)					
							CD	RD	SD	VAT	AT	AIT
1	Fruit drink-Mango	2202.99.00	0.63	1.50	2.38	102.01	25.0	3.0	150.0	15.0	5.0	5.0
2	Fruit drink-Apple	2202.99.00	0.51	1.50	2.94	102.01	25.0	3.0	150.0	15.0	5.0	5.0

Notes:
1. Assume the CIF price is 100.
2. Assessable value is determined by adding 1% for insurance and 1% for landing charge with CIF Price.

SL No.	Items	Effective duty and tax rate (%)						Total Duty	Recoverable Duty (VAT, AT, AIT)	Effective tax rate (non-recoverable) (CD, RD, SD)	Irrecoverable/ effective tax rate with minimum assessable value
		CD	RD	SD	VAT	AT	AIT				
1	Fruit drink-Mango	25.50	3.06	195.86	48.96	16.32	5.10	**294.81**	70.39	**224.42**	**534**
2	Fruit drink-Apple	25.50	3.06	195.86	48.96	16.32	5.10	**294.81**	70.39	**224.42**	**660**

Notes:
1. SD is recoverable only in case of re-export.

Key Issues Surrounding Effective Tax Rate (ETR)

There are a number of reasons why the ETR can matter more than other benefits in the case of an FDI destination. First, the ETR has a **direct impact on the profitability** of a company. A lower ETR can increase the company's bottom line, which can make it more attractive to investors. Second, the ETR is **more predictable** than other benefits. Tax breaks and incentives can change over time, but the ETR is typically more stable. This predictability is important for businesses, as it allows them to make more informed investment decisions. Third, the ETR is a **transparent measure of a country's tax competitiveness.** It is easy to compare the ETRs of different countries, which makes it easier for businesses to identify the most attractive FDI destinations.

Other benefits, such as government subsidies and infrastructure, can also be important for FDI destinations. However, these benefits can be more difficult to quantify and compare across countries. Additionally, these benefits can change over time, which can make them less predictable for businesses.

6.2.4 Addressing Tax Disputes

Tax disputes could arise for various reasons, namely; differences in tax demand by authority and paid by the taxpayer, compliance-related matters and interpretations of law. In order to resolve tax disputes there are different appeal forums such as the Commissioner of taxes (Appeal), taxes Appellate Tribunal, Alternative Dispute Resolution (ADR), High Court and Appeal to the Appellate division where a taxpayer may appeal if aggrieved by tax demand.

However, the procedure to appeal is very complex, for example, collecting different certified copies, strict timelines and rarely any communication by authority except for the letter which might not even reach the taxpayer. The cost of filling for appeal and higher expert is also high, for example, a taxpayer needs to pay additional tax on top of the appeal. A summary of the appeal procedure has been given below:

Table 16: Summary of Appeal Procedure

Appeal against the order of	Appeal to be submitted to	Appeal fee	Disputed tax to be deposited	Timeline of filling
Deputy Commissioner of taxes	Commissioner of Taxes (Appeal)	200	10% if return not submitted	45 days
Commissioner of Taxes (Appeal)	Taxes Appellate Tribunal	1,000	10%	60 days
Taxes Appellate Tribunal	High Court Division	2,000	15-25%	90 days
High Court Division	Appellate Division	N/A		

6.2.5 Tax Compliance

The Assessment and Examination of the Ease of Compliance and the Associated Administrative Burdens related to Claiming the Incentives and Exemptions for Foreign Investors Reveal Crucial Insights.

Lack of Coordination Between Different Tax Authorities can pose challenges in compliance: The issue of coordination, or rather the lack thereof, between various tax authorities in Bangladesh is a significant impediment to effective and consistent tax policies related to foreign direct investment (FDI). Bangladesh has multiple tax authorities, each having its own jurisdiction and mandates. This fragmented tax administration system can lead to disjointed and inconsistent tax treatment for businesses operating within the country. The absence of harmonious coordination can result in different tax interpretations, varying enforcement practices, and divergent tax assessments. For foreign investors, this lack of unity in tax administration poses challenges in understanding and complying with the tax requirements, as they must navigate a complex web of authorities. This issue highlights the necessity of establishing a more cohesive and synchronized framework for tax administration in Bangladesh to ensure clarity, fairness, and predictability for all investors.

Overlapping and Contradictory Tax Provisions Results in a Complex Taxation System and Hampers Compliance: Bangladesh's tax code contains numerous instances of overlapping and contradictory tax provisions, both within and between different tax authorities. This complex web of tax regulations can present formidable challenges for businesses attempting to comprehend their tax liabilities and comply with tax laws. The presence of overlapping provisions can lead to ambiguity and inconsistent interpretations, while contradictory provisions may create confusion and legal disputes. Such a scenario discourages foreign investors who seek clarity and simplicity in tax compliance. To enhance the effectiveness and fairness of the tax system and foster a conducive environment for FDI, Bangladesh should embark on a comprehensive review of its tax code, streamlining and harmonizing provisions to eliminate redundancy and contradiction. This measure will enhance the clarity and ease of understanding for all businesses operating in the country.

Several Administrative Challenges are Associated with Tax Compliance for FDIs in Bangladesh. Bangladesh has implemented several measures to attract FDI from diverse countries. However, for these measures to be truly effective, they must be user-friendly, easily comprehensible and consistently upheld in policies over time. The complexity of tax laws and regulations stands out as a significant barrier, as they are often formulated in a manner that makes them challenging for the average person to decipher. Moreover, Bangladesh lacks policy consistency, with each fiscal budget introducing markedly different sets of tax rates and policy tools. This unpredictability can discourage long-term investment commitments in the country. Additionally, the processes for foreign investors to access facilities within various Export Processing Zones (EPZs) are often convoluted.

There exist numerous rules, provisions and conditions that must be met before these facilities can be availed, adding further layers of complexity to the investment landscape. Navigating the tax landscape in Bangladesh demands adherence to a series of requirements, each carrying its own potential complexities and intricacies:

1. **Tax Registration:** Before embarking on any business endeavor in Bangladesh, it's imperative to initiate the process by registering with the National Board of Revenue (NBR) and obtaining a Tax Identification Number (TIN). This initial step lays the foundation for all subsequent tax-related obligations. However, complications may arise from the bureaucratic processes, documentation requirements and potential delays in obtaining the TIN.
2. **Corporate Income Tax:** Earning profits within Bangladesh necessitates compliance with Bangladeshi tax law, which mandates corporate income tax payments. The current corporate tax rate ranges from 27.5% to 30%. The complexity here may stem from understanding the intricacies of tax calculations, deductions and exemptions applicable to your specific business.

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3. **Withholding Tax:** Businesses must navigate the intricate landscape of Wthholding tax, which involves deducting and remitting tax on specified payments made to non-resident individuals or foreign corporations. The applicable Withholding tax rate varies depending on the nature of the payment. Ensuring accurate withholding and timely remittance can pose challenges.

4. **Advance Tax:** Foreign investors may be required to pay advance tax on their estimated income for the year. The advance tax payments can be burdensome and it can be difficult to obtain refunds if the actual income is lower than estimated. In the case of direct tax, the direct tax, Advance Income Tax (AIT), needs to be paid in 4 equal installments in the income year starting from 15th September to 15th July. On the other hand, the Indirect Tax (VAT) Advance Tax (AT) rate is generally 5%, however, it can be 3% for the manufacturer by maintaining some regulations and guidelines.

5. **Value Added Tax (VAT):** Businesses meeting certain criteria must register for VAT, collect VAT on taxable supplies and regularly file VAT returns. Compliance entails meticulous record-keeping and adherence to the VAT Act's prescribed documentation standards. The complexity lies in understanding the criteria triggering VAT registration and navigating the detailed reporting requirements.

6. **Customs Duties:** Importing and exporting goods involves compliance with customs regulations and the payment of relevant customs duties. Understanding the intricacies of customs procedures, tariff classifications and valuation methods can be daunting, especially for businesses engaged in international trade.

7. **Capital Gains Tax:** Any sale or transfer of assets within Bangladesh, such as property or shares, may trigger liability for capital gains tax on the profits generated. Navigating the complexities of determining capital gains, allowable deductions and applicable tax rates is crucial.

8. **Transfer Pricing:** Businesses engaged in transactions with related parties must adhere to transfer pricing regulations, ensuring that prices are set at arm's length. This demands comprehensive documentation, transfer pricing studies and adherence to evolving regulatory standards.

9. **Double Taxation Treaties:** Depending on your home country, considering double taxation treaties between Bangladesh and your home country is essential to determine applicable tax rates and avoid the burden of double taxation. Understanding the specific provisions of these treaties can be intricate.

10. **Annual Return and Financial Statements:** Timely filing of an annual tax return, along with the submission of audited financial statements, is obligatory. This entails reporting income, expenses and other pertinent financial details accurately. The challenge lies in meticulous record-keeping, financial reporting and adherence to prescribed formats.

11. **Tax Audits and Assessments:** Foreign investors are subject to tax audits and assessments by the NBR. The audit and assessment process can be time-consuming and expensive and it can be difficult for foreign investors to understand and respond to the NBR's findings. The details on it have been provided in the tax disputes sections.

Table 17: **Important Tax Measures Relevant for FDI and Their Challenges with Respect to OECD Principles**

Fundamental Principle Gap	Examples of challenges
Simplicity	**Tax Registration:** Before embarking on any business endeavor in Bangladesh, it's imperative to initiate the process by registering with the National Board of Revenue (NBR) and obtaining a Tax Identification Number (TIN). This initial step lays the foundation for all subsequent tax-related obligations. However, complications may arise from the bureaucratic processes, documentation requirements and potential delays in obtaining the TIN.
Fairness, Flexibility	**Corporate Income Tax:** Earning profits within Bangladesh necessitates compliance with Bangladeshi Tax law, which mandates corporate income tax payments. The current corporate tax rate ranges from 27.5% to 30%. The complexity here may stem from understanding the intricacies of tax calculations, deductions, and exemptions applicable to your specific business.
Neutral, Simplicity	**Withholding Tax:** Businesses must navigate the intricate landscape of Withholding tax, which involves deducting and remitting tax on specified payments made to non-resident individuals or foreign corporations. The applicable withholding tax rate varies depending on the nature of the payment. Ensuring accurate withholding and timely remittance can pose challenges.
Flexibility	**Advance Tax:** Foreign investors may be required to pay advance tax on their estimated income for the year. The advance tax payments can be burdensome and it can be difficult to obtain refunds if the actual income is lower than estimated. In the case of direct tax, the direct tax, Advance Income Tax (AIT), needs to be paid in 4 equal installments in the income year starting from 15th September to 15th July. On the other hand, the indirect Tax (VAT) Advance Tax (AT) rate is generally 5%, however, it can be 3% for the manufacturer by maintaining some regulations and guidelines.
Simplicity	**Value Added Tax (VAT):** Businesses meeting certain criteria must register for VAT, collect VAT on taxable supplies and regularly file VAT returns. Compliance entails meticulous record-keeping and adherence to the VAT Act's prescribed documentation standards. The complexity lies in understanding the criteria triggering VAT registration and navigating the detailed reporting requirements.

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Simplicity	**Customs Duties:** Importing and exporting goods involves compliance with customs regulations and the payment of relevant customs duties. Understanding the intricacies of customs procedures, tariff classifications and valuation methods can be daunting, especially for businesses engaged in international trade.
Efficiency	**Transfer Pricing:** Businesses engaged in transactions with related parties must adhere to transfer pricing regulations, ensuring that prices are set at arm's length. This demands comprehensive documentation, transfer pricing studies and adherence to evolving regulatory standards.
Effectiveness and Fairness	**Double Taxation Treaties:** Depending on your home country, considering double taxation treaties between Bangladesh and your home country is essential to determine applicable tax rates and avoid the burden of double taxation. Understanding the specific provisions of these treaties can be intricate.

In addition to those, there are some other issues such as administrative inefficiencies and lack of clarity and guidance which makes it more difficult for the foreign investor to comply with those regulations. However, the government has introduced some steps to ensure the tax complaints and reduce the complexities. Some of them are:

- The government has introduced a number of online tax services, such as online tax filing and payment, especially for individuals. Also tries to introduce the business and corporates. This will make it easier for businesses to comply with tax laws and reduce their tax compliance costs.
- The government has also simplified the tax forms that businesses need to fill out. This has reduced the time and effort required for businesses to comply with tax laws. Such as in the new Income Tax Act of 2023, the government has reduced the total number of withholding tax returns to only 12 from a total of 29 returns.

6.2.6 Effectiveness of Tax Incentives

In Bangladesh, a spectrum of tax incentives and exemptions is proffered to catalyze economic growth and beckon foreign investments. These incentives are dispensed by distinct government bodies, each vested with its own set of regulations and provisions.

The Bangladesh Economic Zones Authority (BEZA) takes center stage in nurturing economic zones across the nation, with the aim of diversifying industries, fostering employment, upscaling production and expediting economic expansion. BEZA, having garnered approval for establishing 97 economic zones, extends an array of incentives to developers and investors in manufacturing units. These perks encompass a remarkable 12-year tax holiday with income tax exemptions, featuring a 100% waiver for the initial decade. Additionally, tax exemptions are granted on dividends, capital gains, royalties and technical know-how for a decade. Furthermore, these zones permit duty-free imports of machinery and construction materials. Additionally, Bangladesh has forged Double Taxation Avoidance Agreements (DTAAs) with 40 countries to avert the dual taxation of income for residents in both nations.

The Bangladesh Export Processing Zones Authority (BEPZA) offers substantial fiscal incentives to foreign investors operating within BEPZA areas. These incentives encompass a 10-year tax holiday for industries established before January 1, 2012, with varying tax exemption rates for different periods. Duty-free imports of construction materials, machinery, office equipment and spare parts are also allowed, along with duty-free imports and exports of raw materials and finished goods. Other benefits include relief from double taxation, exemption from dividend tax and access to the Generalized System of Preferences (GSP) facility.

The Bangladesh Hi-Tech Park Authority (BHTPA) extends incentives and benefits to foreign investors and expatriates located in hi-tech parks. These incentives encompass repatriation of capital and dividends, no ceiling on FDI, 100% backward linkages for raw materials, foreign loans and remittance facilities. Provisions for the remittance of salaries by expatriates, repatriation of sale proceeds of non-resident-owned equity and repatriation of royalties and technical fees are also in place.

While Bangladesh does indeed provide a range of tax incentives and exemptions targeted at specific sectors and regions, the accessibility and utilization of these benefits can present substantial challenges. These incentives, administered by various authorities, are tailored to stimulate investment and economic growth in specific areas or industries. However, the eligibility criteria and the procedural requirements for accessing these incentives often entail a convoluted and lengthy process, culminating in a degree of ambiguity and unpredictability for potential investors.

The process of claiming incentives and benefits in Bangladesh involves several key procedural intricacies, which can potentially be time-consuming. These procedures, entailing claiming incentives and benefits, can be encumbered by delays, a lack of comprehensive guidelines, registration complexities and hidden costs. Firstly, obtaining authorization from the National Board of Revenue (NBR) is a fundamental step, with the standard timeframe for securing this authorization typically set at one month. However, this period can significantly extend if the submitted documentation does not align precisely with the stipulated requirements. One notable challenge in this process is the absence of a clear and comprehensive guideline outlining the overall procedures and the specific documentation essential for securing authorization, which can create confusion and delays.

Registering businesses is mired in complexity and hidden costs. Registering the company with the Registrar of Joint Stock Company (RJSC) is a prerequisite for commencing operations in Bangladesh. The registration fees are subject to variation depending on the type and nature of the organization, adding an additional layer of complexity to the process. Furthermore, hidden costs can emerge during these procedures, primarily attributable to the extensive professional hours often required to navigate the complexities of the system. These unanticipated costs are not explicitly outlined in any official guidelines or documentation, contributing to the challenges faced by investors.

Figure 54: Procedural Challenges in Claiming Tax Benefits

Authorization Issues		Registration Issues		Hidden Cost
There is no clear guideline on overall procedures and required documents.	Actual required time may become longer than **1** month if the documentation does not match the requirements.	The company needs to be registered under the Registrar of Joint Stock Company (RJSC) for starting operations in Bangladesh.	Registration fees for different types of businesses vary based on the type of organization.	The actual cost may increase as there are hidden costs due to lengthy professional hours which are not mentioned in any guideline.

To enhance the appeal of these incentives and ensure that they effectively fulfill their intended purpose, there is a pressing need to simplify and streamline the application procedures and eligibility criteria. Addressing these challenges by streamlining procedures, enhancing transparency and providing clearer guidance can significantly improve the accessibility and attractiveness of these incentives for potential investors. By doing so, Bangladesh can create a more investor-friendly environment, encouraging greater utilization of these incentives and promoting economic development in the targeted sectors and regions.

6.2.7 ICT-led Tax Administration / Digital Tax Delivery

The pursuit of simplicity in tax systems is a fundamental goal that holds significant benefits for both the government and taxpayers. In the case of Bangladesh, despite the positive steps towards digitalization, a critical challenge lies in achieving the desired level of simplicity. The complexity of the existing tax laws and regulations can often be a source of confusion and inefficiency. taxpayers, including foreign investors, face a myriad of intricacies in understanding tax calculations, deductions, exemptions, and compliance requirements. The complexity extends to the bureaucratic processes and documentation standards, which can be burdensome for businesses, hindering their ability to navigate the system with ease.

In the context of Bangladesh, the transition towards digitalizing tax-related administrative processes has emerged as a pivotal element in expanding the tax base and curbing malpractices. For foreign investors, transparency and a streamlined tax administration are paramount and these goals can be realized through the comprehensive digitalization of the tax system. The National Board of Revenue (NBR) has embarked on this journey by gradually introducing digital platforms such as E-TDS, A-Challan, VAT online (IVAS) and online submission of individual tax returns. While this marks a significant step forward, there are notable challenges that warrant attention.

The existing digital platforms, while commendable in their intent, currently fall short of being user-friendly and integrated. This lack of user-friendliness can hinder the efficiency and effectiveness of tax-related processes for foreign investors and local businesses alike. Clarity and ease of use are essential to encourage widespread adoption of digital systems.

Furthermore, the absence of integration among these digital platforms can result in fragmented processes and data silos, which can, in turn, lead to inefficiencies and complexities. A more streamlined and interconnected approach to digitalization would ensure a cohesive and seamless experience for taxpayers, making it easier for them to comply with tax regulations and reporting requirements.

6.2.8 International Taxation

Investment from abroad, import of technical know-how, financial as well as repatriation of profit would be crucial for FDI. Bangladesh has a Double Tax Avoidance Agreement (DTAA) with many countries. However, to ensure the minimization of base erosion and profit shifting to another country, transfer pricing regulation is also enacted.

Double Taxation Avoidance Agreements (DTAAs):

The existence of Double Taxation Avoidance Agreements (DTAAs) is vital for reducing tax burdens on foreign investors. Bangladesh has signed DTAAs with 40 countries to prevent double taxation. However, the scope of these agreements could be expanded to cover more countries, especially major investment partners. Expanding the network of DTAAs would enhance the confidence of foreign investors and reduce tax-related uncertainties.

In many cases, all the articles in DTAA that ensure that income is not double taxed is not upheld by tax authority. For example, one of the key concepts of DTAA is if a business entity does not have Permanent Establishment (PE) in Bangladesh then it does not have to pay tax in Bangladesh or pay tax that is attributable to PE in Bangladesh.

Transfer Pricing Regulations

Transfer pricing refers to the pricing of goods, services and intellectual property within multinational corporations. Proper transfer pricing regulations are necessary to ensure that transactions between related entities are conducted at arm's length and to prevent profit shifting. Bangladesh has introduced transfer pricing regulations, but there is a need for further clarification and guidance to the tax authority on how to gather data and interpret the data that can be applied to determining arms-length price.

A critical review of tax laws/policies in Bangladesh has been provided in annexure, with concrete improvement opportunities and recommendations provided in chapter 9.

6.3 Customs Act 1969 and its Implications on Investors

The provisions within the Customs Act 1969 in Bangladesh have inadvertently created an environment marked by a lack of transparency, predictability and investor compliance, particularly impacting foreign investors. These challenges are multifaceted, encompassing delays in obtaining decisions from customs, a dearth of clarity in customs decisions and an absence of limitations on fee amounts. Sections 65, 71, 94, 204, 204A and 215A(1) have contributed to this atmosphere of uncertainty. Furthermore, the application of the minimum price system for imported goods, as outlined in Section 25, is inconsistent with the rules set forth by the World Trade Organization (WTO), adding another layer of unpredictability for investors. Section 79C, related to the notification of decisions concerning applications to use customs computer systems, has cast a shadow on customs decisions by operating in a low-transparency environment.

6.3.1 Issues in the old Customs Law

Figure 55: Key Issues in Customs Laws/Policies in Bangladesh that Contradict with Trade Facilitation Agreement

Harmonization and Standardization Issues	• **WTO Inconsistencies:** The minimum price system under Section 25 clashes with WTO rules • **Minimum/Tariff value higher than international customs price** • **Not aligned with WCO guidelines**
Transparency Issues	• **Dearth of clarity in customs decisions** • **Sections of Concern:** Sections 65, 71, 94, 204, 204A and 215A(1) contribute to uncertainty • **Low Transparency:** Section 79C adds to uncertainty
Simplification	• **Procedural delays** • **Complexities in processes** • **Absence of limitation on fee amounts**

Harmonization and Standardization Issues:

The customs framework in Bangladesh grapples with notable issues in harmonization and standardization. Firstly, there is an inconsistency between the national minimum price system, as laid out in Section 25 of the Customs Act and international trade rules established by the World Trade Organization (WTO). This disparity in regulations has the potential to create conflict and confusion for foreign investors, as it implies that compliance with local customs requirements may inadvertently lead to violations of international trade agreements.

Customs Act's failure to provide a formal mechanism for stakeholder input on proposed rules further contributes to uncertainty. In international trade, clear guidelines and stakeholder involvement are essential for transparency and predictability. Establishing mechanisms for stakeholder input and access to critical information will significantly improve investor compliance with customs rules and decisions, thus creating a more transparent and predictable regulatory environment.

Standardization of customs processes is a crucial step in ensuring that customs procedures are clear, consistent and effective. An area of concern is the absence of established rules to guide the National Board of Revenue (NBR) when canceling prior customs decisions. Without specific regulations in sections 13 and 79F, uncertainty surrounds customs processes and investors may feel that their prior decisions are subject to change without clear guidelines. Standardizing the rules for canceling prior customs decisions can provide much-needed clarity and predictability.

Minimum or tariff values set for various goods often surpass international customs prices. Such discrepancies can place an additional burden on investors, forcing them to pay more than standard international rates for the customs valuation of their goods. This can deter foreign investors and impact the overall competitiveness of Bangladesh as a trading destination.

In addition to these concerns, **the existing customs framework is not adequately aligned with guidelines put forth by the World Customs Organization (WCO).** This lack of alignment not only affects the clarity and coherence of customs processes but also hinders efficient and smooth cross-border trade. Therefore, harmonizing the customs regulations with international standards, particularly those specified by the WTO and WCO, is crucial for creating a business-friendly environment and enhancing the ease of doing business in Bangladesh.

Furthermore, the absence of a valuation database and mutual understanding among customs offices in different countries makes it challenging to issue advance rulings on valuation or duty rates. This ambiguity surrounding valuation creates a lack of transparency and predictability for foreign investors. Therefore, standardizing and establishing a valuation database can enhance clarity and consistency in customs procedures[10].

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Transparency Issues:

Transparency within the customs framework plays a vital role in creating a conducive environment for foreign investors. Resolving transparency-related issues by enhancing clarity in customs regulations and procedures is essential to foster investor trust and facilitate smoother cross-border trade. By increasing transparency, Bangladesh can significantly boost its attractiveness to foreign businesses and improve its standing in the global market.

However, the current system grapples with several transparency-related challenges. The lack of clarity in customs decisions, stemming from multiple sections of the Customs Act, such as Sections 65, 71, 94, 204, 204A and 215A(1), adds an element of unpredictability and uncertainty. Foreign investors require a clear understanding of customs procedures and decisions to make informed business choices and this opacity in the legal framework hinders their confidence.

Currently, the customs framework in Bangladesh grapples with the lack of legal authority for automated risk management. The absence of this authority can complicate customs operations and create uncertainty, as automated systems have the potential to make decisions that impact trade and compliance. To enhance efficiency and predictability, it is crucial to establish the legal framework for automated risk management.

Section 79C of the Customs Act adds to this lack of transparency. Without clear and straightforward guidelines, stakeholders are often left in the dark regarding how decisions are made and the criteria for various customs-related processes. A transparent system should not only clearly articulate decision making procedures but also provide insights into the rationale behind these decisions.

[10]UNCTAD: Investment Policy Review (2015)

The Necessity for further Simplification of Customs Procedures

Simplifying customs procedures, addressing bureaucratic complexities and fostering better coordination among authorities during physical examinations can significantly improve the ease of doing business and boost investor confidence in Bangladesh. Simplification of customs procedures is pivotal for ensuring that the flow of goods across borders is smooth and efficient. However, the customs framework in Bangladesh grapples with several simplification-related challenges. One of the primary issues is procedural delays, often resulting from bureaucratic complexities. These delays add unnecessary costs and hinder the timely clearance of goods, making the process cumbersome for foreign investors.

A significant issue is the lack of coordination among border authorities during physical examinations of goods. This disjointed approach not only results in delays but also raises the overall operational costs for foreign businesses. Delays in customs clearance can deter foreign investors from choosing Bangladesh as their destination for trade and investment. Furthermore, the absence of clear limitations on fee amounts adds another layer of complexity to the customs framework. The lack of prescribed limits on fees can lead to unpredictable expenses for foreign investors, further eroding their confidence in the system.

A critical review of Customs Laws/ Policies in Bangladesh that contradict with Trade Facilitation Agreement, World Customs Organization guidelines and national priority of promoting investment and FDI in Bangladesh has been provided in provided in Annexure B, with concrete improvement opportunities and recommendations provided in Chapter 9.

Table 18: Gap analysis & improvement area in the Customs Act 1969

Gap / Problem Statement	Improvement Areas
Harmonization and Standardization	
The Customs Act 1969 does not contain provisions on laboratory and testing, for a reference to tests in relation to the assessment of duty under Section 80 and provisional assessment of duty under Section 81. There is no detail as to how and when such tests will be carried out; those provisions are in other legal instruments discussed elsewhere in this report. Laboratory and testing provisions may be required to identify whether a particular product falls within a particular H.S.Code or not for the purpose of applying a tariff to it.	The Customs Act 1969 may be amended to cross-refer to the relevant provisions of the other laws providing for laboratories and testing, as it is the customs officers who are authorized to open cargo for the purposes of taking samples at the point of import, among others. Laboratory and testing provisions may be included in the Customs Act 1969 to identify whether a particular product falls within a particular H.S.Code or not for the purpose of applying a tariff to it.

Gap / Problem Statement	Improvement Areas
Section 197A of the Customs Act, 1969 provides for customs control and risk management.	The risk management provisions in the Customs Act , 1969 do not specifically address the clearance of bulk agro items. Rules and operational procedures issued under this provision of the Customs Act have not been found upon review; such rules and operational procedures should be issued to enhance risk-based customs clearance management in accordance with global good practices and treaty obligations.
The Customs Act, 1969 does not contain specific requirements for the import and export of sectoral products. Such requirements would be found more readily in the Import Policy Order 2021-2024 and the Export Policy 2021-2024, as well as the general provisions of the Imports and Exports (Control) Act 1950.	The Customs Act, 1969 may be amended to cross-refer to the relevant provisions of the Import Policy Order 2021-2024 and the Export Policy 2021-2024, as well as the general provisions of the Imports and Exports (Control) Act 1950.
Lack of transparency and predictability	
Delays in obtaining decisions from customs lack of clarity in customs decisions.	NBR will be required to issue decisions promptly tand no later than 120 days after receipt of all required information. NBR will be required to notify applicant if decision is delayed. NBR will be required to give written reasons for adverse decisions and notify rights of appeal.
Lack of transparency in setting fee amounts and limitations on amount of fees. {Sections 65, 71, 94, 204, 204A, 215A(1)}	NBR authorized to prescribe fees for a defined or limited list of customs services. Amount of such fees is limited to cost of service provided. Proposed fees shall be published for stakeholder comment.
Use of minimum price system for imported goods inconsistent with WTO rules **(Section 25)**.	Customs valuation of imported goods shall be determined by WTO valuation rules. Customs valuation of export goods shall be based on FOB price, inclusive of transport and related costs to move goods to the Bangladesh port of shipment.

Gap / Problem Statement	Improvement Areas
Section 79C: Notification of decisions relating to applications to use customs computer systems creates an environment of low transparency in customs decision	NBR will be required to give written reasons when adverse decision is taken and notify the applicant for the decision of rights of appeal **(Section 9)**.
Lack of legal authority for automated risk management and other automated decisions.	Automated decision or automated provision of information by customs computer system shall be deemed decision or provision of information by a customs officer **(Section 29)**.
Lack of rules to guide discretion of NBR in cancelling prior decisions applicable to the following provisions: Section 13: NBR may cancel private warehouse license provided licensee is given 30 days prior notice and opportunity to be heard Section 79F: Notification of cancellation of customs computer system user registration	Grounds for annulment and revocation of decisions defined; NBR required to notify person where decision has been annulled or revoked **(Section 10)**.
Absence of a valuation database and mutual understanding among customs offices in other countries make it difficult to issue advance rulings on valuation or duty rates. Therefore, the provision has been revised to cover tariff classification only. "Section 219A: Customs may issue binding rulings on requests concerning any matter raised in the application, including tariff classification, valuation or duty rates."	Customs shall issue **advance rulings on tariff** classification questions (Section 11).
No formal mechanism for stakeholders to provide input on proposed rules implementing the Customs Act (Section 219).	Unless it is determined impracticable, unnecessary or contrary to public interest, the NBR shall publish rules in draft form to allow stakeholders the opportunity to provide input (Section 14). NBR shall publish rules 30 days prior to entry into force (Section 15.1). NBR shall hold regular consultations with stakeholders (Section 16). NBR shall establish "enquiry points" to respond to stakeholder's questions and requests for information and forms, including by electronic means (Section 17).

Gap / Problem Statement	Improvement Areas
Stakeholder access to information required for compliance with customs rules and decisions. Manner of publication not specified in Section 219B.	NBR to use the internet, if feasible, to disseminate rules as well as decisions, forms, explanations etc. (Section 15.2).
Raise the minimum value of 1,000 Taka in goods/rev value. Administrative cost of collecting small amounts of duty and Tax, which exceeds the revenue recovered. Lack of administrative flexibility to adjust the minimum amount based on inflation.	Collection of duty and Tax shall be waived if total amount assessed or the difference between the amount declared and the amount assessed, is less than 2,000 Taka. NBR is authorized to raise the minimum amount by notification in the Official Gazette.
Overly restrictive definition of persons who may make a bill of entry or bill of export.	A goods declaration for import shall be made by the importer and a declaration for export shall be made by the exporter.
Limited payment facilities for compliant traders.	NBR may authorize AEOs with good payment and compliance record to defer payment of duties and Taxes under guarantee up to 14 days from date of release.
Simplification of procedures to reduce time and cost	
Lack of clarity with respect to requirements and use of guarantees in customs operations, other than the customs warehouse procedure (Sections 86, 86A, 114).	General rules for customs guarantee defined for all customs operations and processes including: **Acceptable forms of guarantees, limitations on guarantors, rules for determining amount of guarantee,** based on risk and requirements for prompt release of guarantees upon satisfactory completion.
Lack of clarity of rights and obligations of owners and customs with respect to imported goods held prior to their release.	Goods on arrival deemed to be under a temporary storage regime and rights and obligations of customs and importer with respect to such regime are defined, including places where such goods may be stored pending release, conditions of access of importer to such goods and operations permitted on such goods. (Sections 97–100).

Gap / Problem Statement	Improvement Areas
Lack of clarity of responsibilities and liability of importers, exporters and their agents in customs clearance **(Section 31)**.	Importer and exporter shall be responsible for truth and accuracy of data and documents submitted, payment of duties and taxes, and provision of other information as requested for clearance. Agents shall also be held responsible for accuracy of submitted declarations.
Lack of coordination among border authorities in physical examinations added costs and time in clearance.	Customs shall ensure that examination or drawing of sample of goods required by other competent authorities are carried out at the same time as customs controls.
Lack of flexibility to simplify or prescribe alternative customs clearance processes where required by trade and risk considerations.	NBR is authorized to simplify and expedite the release of goods where required by trade and risk considerations.
Section 79A, 79(D), 79(E): NBR authorized to accept electronic bills of entry and related documents.	Designate documents or payments that may be submitted or effected electronically: - Designate or appoint computer systems for transmission of such documents or payments - Require use of electronic communication for specified documents or payments - Prescribe technical and procedural requirements for electronic communication
Increased integrity due to a reduced level of discretion and negotiation Current law discourages importers and exporters from voluntarily correcting mistakes and thus encourages bad declaration of data. Lack of formal legal authority to allow importers to challenge tests by customs. (**Section 205:** May allow amendment of documents subject to payment of a fee)	Importer or exporter may amend declaration as a matter of right with no fee. Importers have right to request retesting where initial test is adverse.

Gap / Problem Statement	Improvement Areas
Section 197D of the Customs Act 1969 provides for the establishment of a Bangladesh Single Window (BSW) which shall serve as the single electronic entry point and a platform for person involved in import, export, warehousing, transit or transshipment of goods. Whether and to what extent this would replace the currently used Asycuda World system will depend on the notification under Section 197D(4) to be issued by the Government in this regard.	If and when the BSW is established and made fully operational in line with global customs single window best practices, this would probably be a significant improvement over the current customs clearance system in place in terms of documentary requirements and duplication, time and cost. The BSW should be prioritized for implementation.

6.3.2 Ongoing Reform and Modernization Efforts

Recognizing the need for reforms, multifaceted initiatives were undertaken to simplify customs procedures modernize the Customs Act. Recognizing the need for substantial changes to the existing customs law to align it with international best practices and to facilitate trade in Bangladesh, the government and the National Board of Revenue (NBR) embarked on a comprehensive reform and modernization program. Multifaceted initiatives aimed to simplify customs procedures, promote international standards of customs management, and enhance the business-friendliness of Bangladesh's customs law.

Over the years, a series of new rules have been incorporated into the customs framework to simplify customs procedure and improve transparency. Some of the new rules were incorporated within the new Customs Act and others through Statutory Regulatory Orders (SROs). These changes are designed to streamline various customs procedures, in line with international standards. Major ongoing facilitation reforms, such as prearrival processing, risk-based Post Clearance Audit (PCA), and the Authorized Economic Operator Program, have collectively reduced the complexities of the customs regime. These reforms have not only sped up the cargo clearance process but have also significantly improved transparency and predictability.

The process of customs reform and modernization is ongoing and requires the support of development partners for some of the more complex reform measures. Several development partners, including the Asian Development Bank (ADB), have extended support for policy reforms to assist Bangladesh in complying with the World Trade Organization (WTO) Trade Facilitation Agreement (TFA) and in implementing the Customs Modernization Strategic Action Plan for 2019-2022. ADB's program on South Asia Subregional Economic Cooperation Integrated Trade Facilitation Sector Development Program focuses on three key areas: (i) aligning the customs legal framework with international standards, (ii) enhancing cargo clearance processes, and (iii) strengthening the capacity of customs agencies.

6.3.3 The New Customs Bill 2023

A new Customs Bill 2023 was recently passed in the parliament to ensure alignment with international standards and facilitate trade. While new customs laws have been presented before the parliament multiple times since 2014, the draft of the new acts had faced various issues and remained pending. However, a significant breakthrough occurred when the Customs Bill 2023 was recently passed in parliament on October 31, 2023. This new bill is a substantial step forward, aiming to ensure fiscal discipline, accountability in import revenue collection, and trade facilitation.

The Customs Bill 2023 was meticulously crafted to incorporate up-to-date provisions related to revenue collection, expansion of import and export trade, business facilitation, and the development of new industrial sectors. This new law consists of 269 sections, aligning with international agreements and conventions approved by the World Customs Organization (WCO). These provisions cover areas such as Authorised Economic Operator (AEO), Mutual Recognition Agreement (MRA), Electronic Declaration, Risk Management, Post Clearance Audit (PCA), Non-Intrusive Inspection (NII), and more.

Importantly, the proposed bill embraces various essential aspects of the Trade Facilitation Agreement (TFA) as endorsed by the World Trade Organization (WTO). These aspects include Advance Ruling, Stakeholder's Consultation, National Inquiry Point (NEP), Website, Advance Passenger Information (API) / Passenger Name Record (PNR), among others. Although some of these best practices were already in practice and implemented through amendments to the previous act, the new law formally incorporates them to minimize any legitimate complexities.

The new Customs Bill 2023 is a significant step forward in mitigating the existing challenges within the Customs Act 1969. Additionally, the proposed bill makes stakeholder consultation mandatory before introducing any changes, amendments, or framing new rules. If this proposed bill becomes law, it is expected to ensure fiscal discipline and accountability in import revenue collection, ultimately leading to enhanced trade facilitation. It represents a significant step forward in mitigating the existing challenges within the Customs Act 1969, creating a more transparent and investor-friendly environment for Bangladesh.

Urgency of Implementation

The passage of the Customs Bill 2023 signifies a remarkable stride toward modernizing customs regulations in Bangladesh. It reflects the government's commitment to fostering a conducive business environment, aligning with international standards, and ensuring the accountability and transparency of customs operations.

It is imperative that this new customs bill be swiftly implemented. By doing so, Bangladesh will be better equipped to address the challenges outlined in the existing Customs Act 1969, such as the lack of transparency, predictability, and investor compliance. Furthermore, it will bring the country in line with international trade practices and strengthen its position in the global trade landscape. The sooner this bill becomes law, the sooner the nation can benefit from the improved environment it promises, ultimately boosting foreign investments and facilitating international trade.

CHAPTER 7

POSSIBLE IMPACT OF BUSINESS TAXATION REFORMS

Chapter at a Glance

Empirical Analysis Confirms Both Tax Revenue and FDI Would Likely Increase if Tax Environment for FDI is Made More Conducive

FDI can reach as high as:

- $6.6Bn (1.15% of GDP) by 2025,
- $20Bn (2% of GDP) by 2031
- $50Bn (2.2% of GDP) by 2041
  with effective and prudent reforms in tax environment

GoB Tax Revenue can reach as high as:

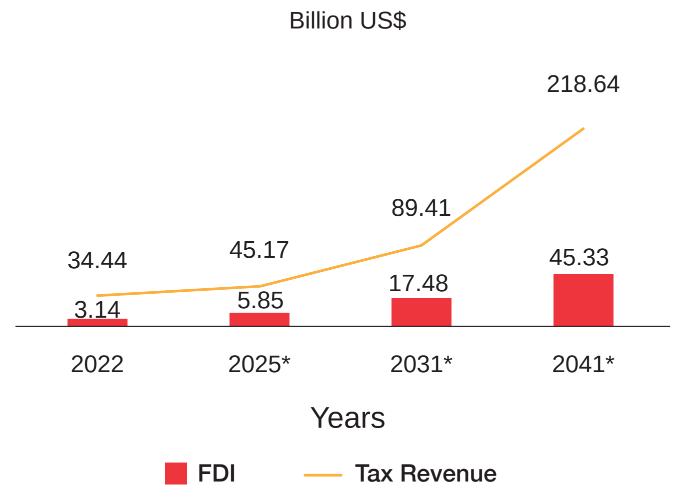
- $45.9 Bn by 2025
- $92 Bn (9.33% of GDP) by 2031
-$227 Bn (9.74% of GDP) by 2041

in a scenario with tax reforms compared to only $98 Bn withouth reforms

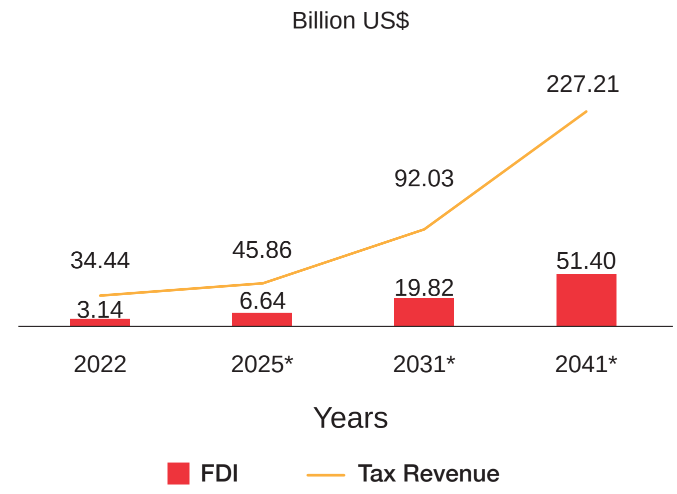
Impact of Changes in Tax Environment on FDI and Tax Revenue (Summary of Regression Results)

Scenario	Description	Tax rate through 2031	FDI changes by 2041 (approx.)	Revenue changes in 2041 (approx.)
1	20% Reduction	24	14.4x increase	6.3x increase
2	Sharp 33% Reduction	20	16x increase	6.6x increase
3	20% Increase	36	5.6x increase	2.8x increase
4	Sharp 33% Increase	40	2.5x increase	2x increase

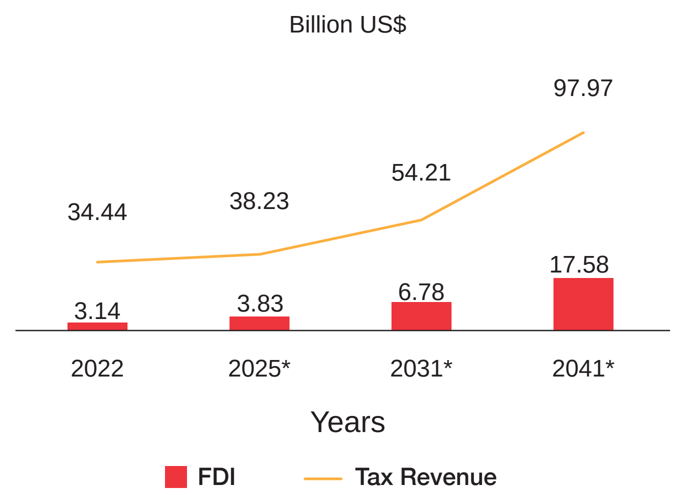
Scenario 1: 20% reduction in tax and reforms



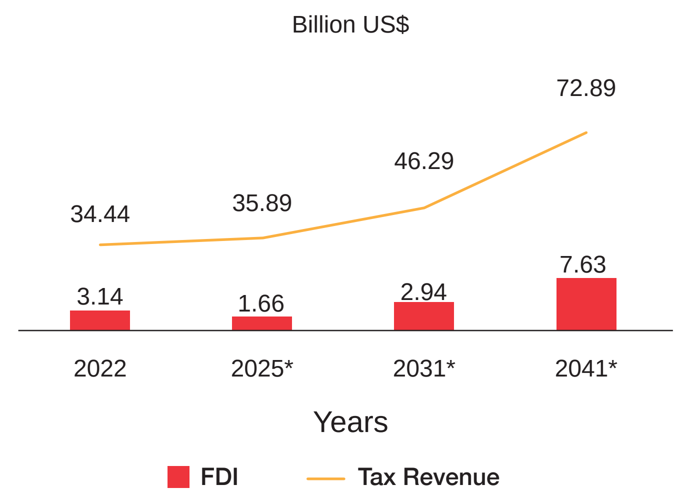
Scenario 2: 33% reduction with reforms



Scenario 3: 20% increase and no reforms



Scenario 4: 33% increase with no reforms



CHAPTER 7

POSSIBLE IMPACT OF BUSINESS TAXATION REFORMS

7.1 Evaluation of the Potential Impact of Tax Reforms on FDI Inflows

Understanding the dynamics between the state of a country's taxation system and FDI is pivotal in the realm of economic policy and international business. A favorable taxation system can act as a magnet, drawing in substantial FDI inflows, thereby stimulating economic growth and development. Bangladesh, a nation with ambitious aspirations, is no exception. With a vision to achieve high-income status by 2041, the role of FDI in fostering economic transformation cannot be overstated.

This chapter embarks on an empirical journey to decipher the intricate connection between FDI and the taxation system in Bangladesh. Our analysis is rooted in comprehensive data spanning nearly three decades, from 1995 through 2022. The primary objective is to unravel the relationship between FDI inflows and the state of Bangladesh's taxation system, gauged through a series of indices and indicators that evaluate its efficiency and effectiveness.

7.1.1 Brief Overview of Methodology to Gauge Impact

The methodology has been structured around a systematic approach, comprising several key steps:

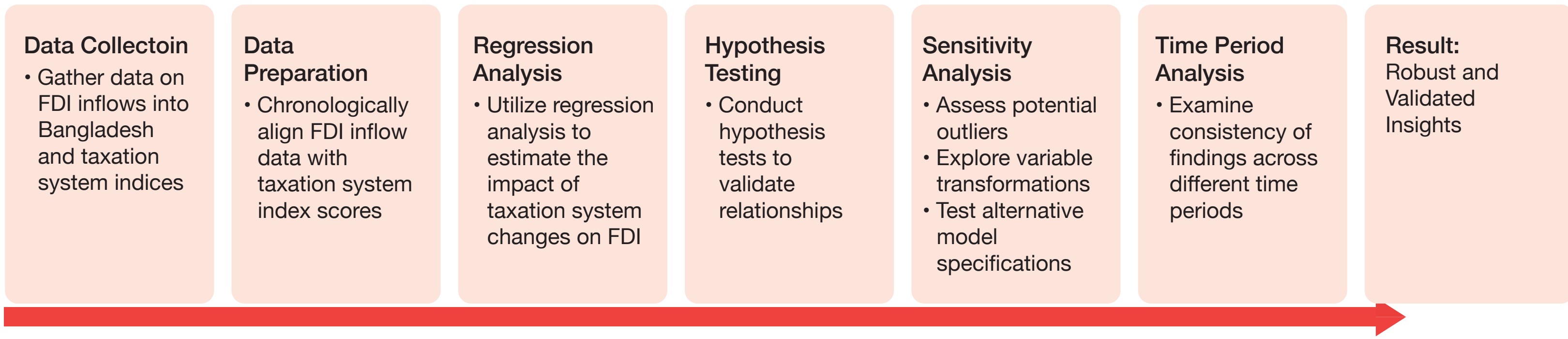
Data Collection: Our study initiates with the meticulous collection of data pertaining to FDI inflows into Bangladesh over the specified timeframe. This dataset provides valuable insights into the patterns and magnitudes of foreign investments in the country. Concurrently, we procure data related to various indices and indicators that evaluate the state of Bangladesh's taxation system. These include internationally recognized indices such as the World Bank's "Ease of Doing Business" index and the World Economic Forum's "Global Competitiveness Report." These indices encompass aspects of the taxation system's efficiency, simplicity, and overall attractiveness to potential investors.

Data Preparation: In the data preparation phase, we carefully organize the collected data in chronological order. This alignment ensures that FDI inflow figures correspond to the relevant scores or rankings of taxation system indices, maintaining a coherent temporal arrangement of variables for subsequent analysis.

Regression Analysis: To precisely model the relationship between taxation system factors and FDI inflows, we employ regression analysis. This statistical technique enables us to estimate the impact of changes in the taxation system on FDI inflows. By identifying statistically significant relationships, we can quantitatively predict the potential growth in FDI resulting from improvements in the taxation system, measured as a percentage change.

Sensitivity Analysis: Additionally, our methodology incorporates sensitivity analysis to validate and refine our findings. This involves examining potential outliers, exploring variable transformations, testing alternative model specifications, and conducting analyses across different time periods. These steps ensure the robustness and reliability of our conclusions regarding the relationship between Business Freedom Score, Tax Environment Score and FDI.

Figure 56: **Methodological and Empirical Framework**



This comprehensive approach allows us to provide a thorough and well-substantiated assessment of the impact of Bangladesh's taxation system on FDI inflows. The study acknowledges the complexity of FDI determinants and the multitude of factors influencing foreign investment decisions. Therefore, while we aim to uncover the relationship between FDI and the taxation system, we recognize that the causation is multifaceted. Our findings should be considered alongside qualitative assessments and expert opinions when formulating policy recommendations.

To get a better sense of FDI movements and its association with tax reforms, the methodology used by Global Alliance for Trade Facilitation was modelled. In the GATF study, Border Administration sub-index of the World Economic Forum's Enabling Trade Index (ETI) was used as proxy for changes in TF environment, which was then compared against FDI to find any correlation.

However, the Trade Freedom Index (TFI), was used instead of ETI. Bangladesh's position in most globally accepted and highly prestigious competitiveness and economic freedom related indexes (such as Ease of doing Business, Trading Across Border, and Global Competitiveness Index) has not produced much distinguishable difference in recent years. It is important to note that any movement in FDI and investment with respect to such indexes might be inconclusive, however modelling Tax Burden scores[11] of the Heritage Foundation's Index of Economic Freedom with FDI inflows, provided better understanding of the relationship and was thus adopted for the study. Higher scores of Tax Burden indicates a poor environment for taxation and business.

Heritage Foundation's Index of Economic Freedom provided better insight of Bangladesh's overall tax environment over the years consistently. The Index has provided comprehensive scoring of Bangladesh's trade openness and customs procedures, as well as tax Environment for a number years going back to 1995. In 2021, Bangladesh scored 63.4 out of 100, compared to 63.6 in the preceding year. Since the 2021 scores were based on Bangladesh's performance and evaluation in the previous year, the yearly scores were matched with Bangladesh's FDI performance in the preceding years.

In the subsequent sections, we delve into the results of our analysis, offering insights into the potential impact of taxation system reforms on FDI inflows in Bangladesh.

[11]Tax Burden is a measure of the tax burden imposed by government. It includes direct taxes, in terms of the top marginal tax rates on individual and corporate incomes, and overall taxes, including all forms of direct and indirect taxation at all levels of government, as a percentage of GDP. Thus, the fiscal freedom component is composed of three quantitative factors:

The top marginal tax rate on individual income,
The top marginal tax rate on corporate income and
The total tax burden as a percentage of GDP.

Source: https://www.heritage.org/index/country/bangladesh

7.1.2 Analyzing the Relationship Between Tax Environment and FDI in Bangladesh

It is critical to understand the relationship and potential impact of the taxation environment on FDI inflows. The role of taxation in FDI decisions and attracting investment is well-established, particularly as other factors that provide an enabling environment for business converge globally through Trade Facilitation efforts. In the case of Bangladesh, FDI serves as a critical driver of economic growth, technological advancement, and global integration. It is thus critical to understand the potential impact of the taxation environment (proxied by the Tax Burden score as per the Heritage Foundation Economic Freedom Index) on FDI inflows. This section delves into the analysis of this relationship, aiming to understand how improvements in the taxation system might influence FDI.

We ran a regression test to assess the potential influence of taxation on FDI inflow. As FDI decisions are not solely based tax and multiple other factors as part of the overall investment climate comes into play, we thus incorporated the overall business freedom index of Heritage Foundations Economic Freedom Index. Considering these two key variables in our model enhanced the robustness and explanatory power of our equation. This statistical technique also enables us to model the relationship and predict the potential growth in FDI resulting from improvements in the taxation system.

The results show that there is a statistically significant relationship between tax environment (proxied by Tax Burden and Investment Freedom Scores) and FDI. For a one-unit increase in the Tax Burden Score, FDI is estimated to decrease by 19.37 units. The coefficient for Business Freedom Score, 58.746 (t-statistic = 2.510, p-value < 0.02) also suggests a strong positive relationship between Business Environment and FDI. A one-unit increase in Business Freedom Score is associated with an estimated increase in FDI of 58.745 units. The relationships are statistically significant.

There is a strong correlation between Tax Environment and overall Business Environment and FDI. Approximately 92% of the variation in FDI can be explained by the independent variables included in the model. The model's goodness of fit reaffirms that over 90% of the variation in FDI can be attributed to tax and business environment. F statistics indicate that the regression model, as a whole, is statistically significant. Sensitivity analysis provides confidence in the reliability and stability of the relationships observed in the regression model.

Figure 57: Key Findings of the Empirical Analysis

FDI can reach as high as:

- $6.6Bn (1.15% of GDP) by 2025
- $20Bn (2% of GDP) by 2031
- $50Bn (2.2% of GDP) by 2041, with effective and prudent reforms in tax environment

• Empirical analysis confirms enhancing tax and business environment in Bangladesh can substantially attract higher levels of FDI.

• Adjusted R2 of 0.921 indicates the model explains a substantial portion of the variation in FDI.

In the box below, we delve into the details of the analysis:

Box 5: Findings of Empirical Analysis

Regression Model[12]

We employed a multiple linear regression model to understand the relationship between FDI, Tax Environment Score and Business Freedom Score. The model is represented as:

FDI=ß0+ß1.Tax Burden Score+ß2. Business Freedom Score+ ß2. GDP + є

Where:

- FDI represents the Foreign Direct Investment inflows.
- ß0 is the intercept.
- ß1 is the coefficient for Tax Burden Score.
- ß2 is the coefficient for Business Freedom Score.
- ß23 is the coefficient for GDP.
- є is the error term.

Regression Results provided some interesting insights, summarized below (Details in Annex):

This implies that for a one-unit increase in the Tax Burden Score, FDI is estimated to decrease by 19.373 units.

The coefficient for Business Freedom Score suggests a strong, positive relationship between Business Freedom Score and FDI. A one-unit increase in Business Freedom Score is associated with an estimated increase in FDI of 58.746 units. The relationships are statistically significant.

[12] The regression analysis assumes that the relationship between the variables is linear, errors are normally distributed, errors are independent and have constant variance (homoscedasticity) and there is no multicollinearity between Tax Environment Score and Business Freedom Score.

R-squared and Adjusted R-squared Values: The multiple R is 0.965, indicating a strong correlation between the independent variables (Tax Environment Score and Business Freedom Score) and the dependent variable (FDI).

- It reaffirms that over 92% of the variation in FDI can be attributed to the Tax Burden Score and Business Freedom Score.

The regression analysis provides valuable insights. It confirms that improving the tax environment and a generally more friendlier tax landscape is expected to boost FDI. It also reaffirms strongly that there exists strong, positive relationship between overall business environment and FDI. Enhancing tax and business environment in Bangladesh can substantially attract higher levels of foreign direct investment.

Sensitivity analysis conducted confirms that the relationship between Business Freedom Score and FDI and Tax Environment and FDI is robust and consistently positive, signifying the importance of a business-friendly and favorable tax environment in attracting foreign direct investment to Bangladesh[13].

7.2 Analysis of the Potential Impact of Reforms on Tax Revenues in Bangladesh

Tax reforms impact FDI and revenue: Reduction in tax enhances both FDI and Revenue; Sharp increase leads to FDI decline and significant revenue drop. This section explores the anticipated impact of tax reforms on government revenue and FDI in Bangladesh. We employ a scenario analysis approach, guided by a regression model. We conducted a regression study to examine the relationship between tax revenue and various economic factors, specifically Foreign Direct Investment (FDI), Tax Burden and Gross Domestic Product (GDP). The primary objective was to assess how changes in these economic variables could impact tax revenue. By assessing the potential consequences of these tax reforms (analyzed through various scores in Tax Burden and corresponding FDI and GDP growth), we gain insights into how changes in tax policies may consequently influence government tax revenue.

Regression Analysis: A multiple linear regression analysis was employed to model the relationship between tax revenue and the selected independent variables. The regression equation used is as follows:

Tax Revenue = Intercept + (ß1 * FDI) + (ß2 * Tax Burden) + (ß3 * GDP) + Error Term

It is important to note that while these scenarios offer valuable insights, they do not encompass the entirety of the tax system and other factors such as political stability and global economic cycles may also play a role in shaping economic outcomes. Nonetheless, this analysis provides a foundational understanding of the relationship between tax policies, FDI and revenue generation and the expected increase in tax revenue based on different scenarios to provide some interesting findings.

[13] Methodology and elaborated results explained in Annexure

Regression Results:
The results of the regression analysis provided valuable statistics. Notably, the adjusted R-squared value indicated the proportion of the variation in tax revenue that could be explained by the chosen independent variables.

High Adjusted R-Square: The adjusted R-squared value of approximately 0.994 suggests that the model is highly effective in explaining the variation in tax revenue. This indicates that the selected independent variables, including FDI, Tax Burden and GDP, together have a strong association with changes in tax revenue.

Statistical Significance: The p-values associated with each coefficient in the regression equation indicate the statistical significance of each independent variable. In this context, Tax Burden, FDI and GDP were all found to be statistically significant, with p-values below the conventional significance level of 0.05.

Interpretation of Coefficients: The coefficients associated with each independent variable represent the strength and direction of their impact on tax revenue. Notably, the coefficient for FDI (1.5962) suggests that a unit increase in FDI results in an increase in tax revenue by approximately 1.6 units. Similarly, GDP (0.0629) indicates that a unit increase in GDP contributes positively to tax revenue.

7.2.1 Methodology for Scenario Analysis

To assess the potential impact of tax reforms on government revenue and FDI in Bangladesh, we constructed three distinct scenarios. These scenarios were designed to simulate varying degrees of corporate tax rate reductions while considering the estimated changes in the Tax Burden and Business Freedom Scores as derived from our regression model.

Scenario 1: Reduction of corporate tax by 20% and minor improvement in tax environment through reforms

Scenario 1 entails substantial tax reforms, with corporate tax rates being reduced to 24%, alongside minor improvements in business and taxation environment in Bangladesh. This scenario explores the implications of an aggressive tax policy shift to a more investment friendly one.

Scenario 2: Reduction of corporate tax by 33% and major improvement in tax environment through reforms

Scenario 2 entails substantial tax reforms, with corporate tax rates being slashed substantially to 20%, alongside other improvements in business and taxation environment in Bangladesh. This scenario explores the implications of an aggressive tax policy shift to a more investment friendly one.

Scenario 3: Increase of corporate tax by 20% with no reforms in taxation environment

We then extend our forward-looking analysis to include an additional scenario where corporate tax rates undergo an increase of 20% (from current 30% to 36%). Here we try to examine the implications of this tax rate hike on FDI inflows and government revenue in Bangladesh.

Scenario 4: Sharp Increase of corporate tax by 33% with significantly worse business environment
We then extend our forward-looking analysis to include an additional scenario where corporate tax rates undergo a substantial increase of 33%, significantly worsening the business environment.

7.2.2 Our Forward-Looking Analysis Reveals Positive Effect of Tax Environment on FDI and Positive Correlation Between FDI and Tax Revenue

Table 19: Impact of Tax Reforms on FDI and Tax Revenue

Scenario	Description	Tax rate through 2031	FDI changes by 2041 (approx.)	Revenue changes in 2041 (approx.)
1	20% Reduction	24	14.4x increase	6.3x increase
2	Sharp 33% Reduction	20	16x increase	6.6x increase
3	20% Increase	36	5.6x increase	2.8x increase
4	Sharp 33% Increase	40	2.5x increase	2x increase

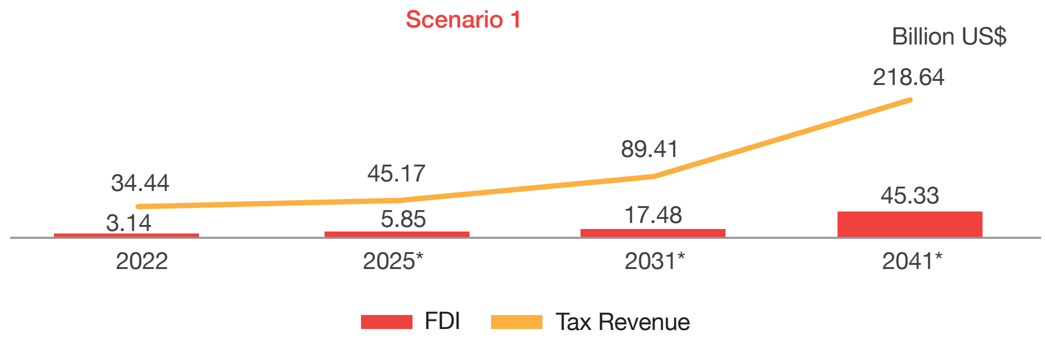
Scenario 1: A 20% Reduction in Corporate Tax and Minor Tax Reforms

The predicted **FDI values** exhibit rapid growth, **almost doubling by 2025 and exceeding $17 billion and $45 billion by 2031 and 2041 respectively.**

Corresponding government tax revenue is projected to **increase 30% by 2025**, reaching **8% of GDP** (3930 billion BDT).

This scenario demonstrates a growth in revenue of **approximately 160% by 2031 and overall 6.3 times higher in 2041.**

Figure 58: **Projected Change in FDI and Consequent Revenue after Moderate Decrease in Taxation Rate**



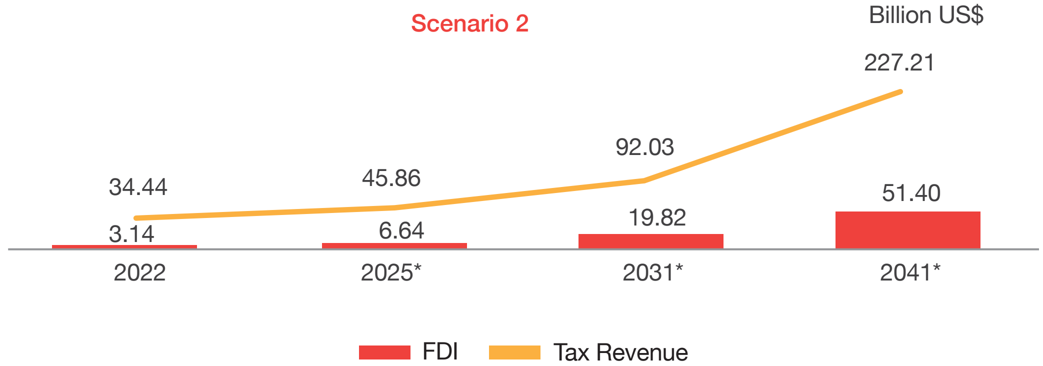
Scenario 2: Sharp 33% Reduction in Corporate Tax and Major Tax Reforms

Under **the sharp 33% reduction** scenario, FDI inflows are projected to increase notably, **doubling to $6,637.1 million (1.15% of GDP) in 2025 and increasing 5x by 2031 to almost $20 Billion (2% of GDP) and 51.4 Billion by 2041.**

Projected government revenue follows an upward trajectory, **reaching BDT 3,990 billion by 2025 (33.2% growth).**

This scenario shows a growth in revenue of approximately **167% by 2031 and almost 6.6x by 2041 (19.8 billion BDT).**

Figure 59: **Projected Change in FDI and Consequent Revenue after sharp reduction in taxes**



The forward-looking analysis highlights the potential benefits of tax reforms on FDI inflows and government revenue. Across all two scenarios, FDI is expected to increase, signifying heightened investor confidence and economic growth. The accompanying rise in government revenue further underscores the positive impact of these reforms on fiscal sustainability.

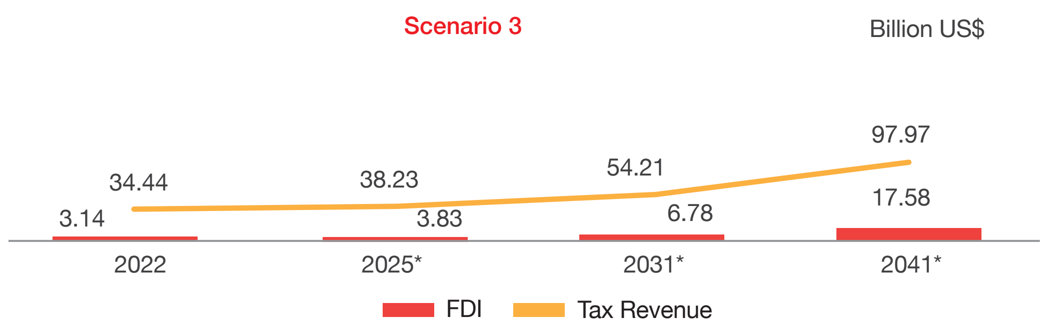
Scenario 3: A 20% Increase in Taxation Rate with No Reforms

The tax increase scenario results in just 50% growth in FDI by 2025, **reaching just over 1% of GDP by 2031 and 1.6% of GDP by 2041.**

Government revenue projections showcase a similar trend, **increasing at a much slower rate** and reaching **3300 billion BDT by 2025 (11% growth).**

This scenario demonstrates a growth in revenue of approximately **57%** by 2031, **lower than scenario 1 & 2, hovering around 9% of GDP in 2041.**

Figure 60: Projected Change in FDI and Consequent Revenue after Increase in Taxation



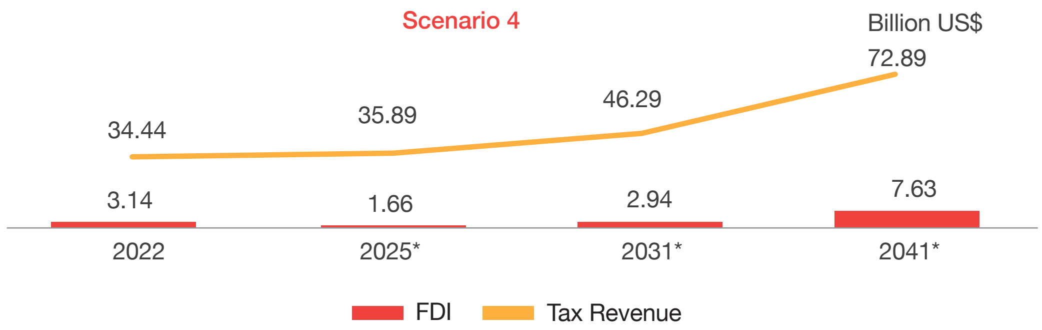
Scenario 4: Sharp Increase (33% Increase) in Taxation Rate with Significantly Worse Business Environment

Under the sharp tax increase scenario, FDI inflows are predicted to decrease significantly by 50% in 2025 and reaching just $7.6 Billion in 2041.

Government revenue projections expected to increase only by **4%** in this scenario **over 2025**, at **3122 Billion BDT.**

This scenario demonstrates an increase in revenue of **just over 34% over** 2031 and posting revenue numbers lower than 8% of GDP till 2041.

Figure 61: **Projected Change in FDI and Consequent Revenue after Sharp Increase in Taxation Rate**

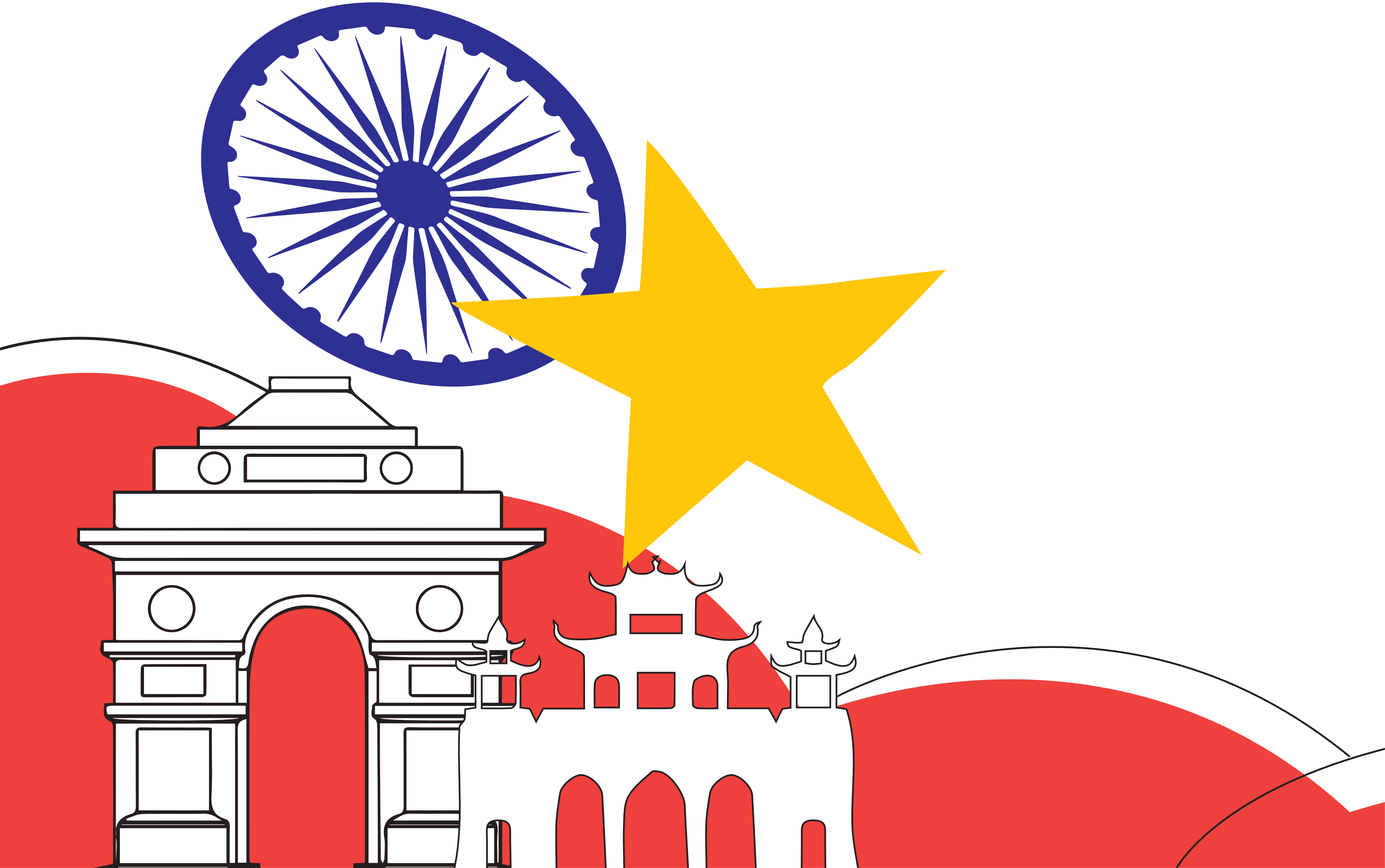


In conclusion, tax reforms impact FDI and revenue: The findings suggests reduction in tax enhances both FDI and revenue greatly; sharp increase leads to FDI decline and significanly less revenue.

The inclusion of a contrasting scenario in our analysis highlights the divergent outcomes that different tax policies can yield and underscores the sensitivity of FDI to taxation policies. In this scenario, where corporate tax rates sharply increase, FDI inflows decline significantly in FY 31, while also causing substantially less revenue collection. This underscores the sensitivity of FDI to tax policy changes and emphasizes the importance of carefully considering the potential consequences of tax rate adjustments.

While it is necessary to note the role of other factors in FDI decisions and revenue generation, the findings do provide conclusive evidence on how tax reforms and increased FDI can generate greater revenue. It is essential to note that while tax policies can significantly impact FDI and government revenue, other factors such as the overall business environment, political stability, and economic conditions also play pivotal roles. Therefore, policymakers must thoroughly evaluate and consider the broader economic context when making decisions about tax reforms. Comprehensive analyses that incorporate various economic variables are critical for formulating effective tax policies that promote economic growth and fiscal sustainability.

CHAPTER 8

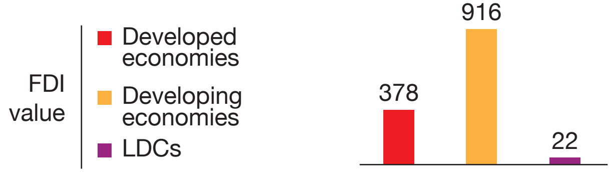


CONDUCIVE TAX ENVIRONMENT FOR FDI: THE CASE OF VIETNAM AND INDIA

Chapter at a Glance

Attractive tax policies globally have helped foster economic growth, technological advancement, and global integration. Tax incentives played a pivotal role, comprising 52% of measures globally, reflecting the growing importance of taxation as non-tax barriers to FDI are being removed globally.

Income groups



Growth rates	Developed economies	Developing economies	LDCs
FDI	-37%	+4%	-16%
Greenfield projets (mostly industry)	+4%	+37%	+6%
International project finance (mostly infrastructure)	+10%	+5%	-9%

Source: World Investment Report, 2023

Developing countries offered various fiscal benefits to lure investors and witnessed a growth FDI on 4%, in comparison to Developed Economies and LDCs, where FDI fell in 2023.

Tax Investment Incentives Introduced by Developing Countries

Countries	Incentives
Algeria	Tax benefits for automotive industry investors, including accelerated depreciation, VAT refund and full exemption from export duties for manufactured goods
Argentina	Incentives on FDI-funded projects in key industries, offering up to 55% of tax value on generated income
Egypt	Income tax exemption for investors from business license or expansion permit date
Ethiopia	Income tax exemption for investors from business license or expansion permit date
Saudi Arabia	Arabia Special Integrated Logistics Zone with a 50-year tax holiday for investors (including 100% foreign ownership), along with VAT advantages for servicing

Steps Taken by India to Enhance FDI

- Flat reduction of Corporate Tax Rate with gradual phasing out of exemption/incentives
- Targeted Tax Breaks for specific sectors
- GST Simplification
- Abolishment of Divident Distribution Double Tax (DDT)
- Double Tax Avoidance Agreements (DTAAs)
- Quick resolution of disputes under Vishwas Act, 2020
- Simplification of Direct Tax Laws and easing of compliance
- Reduction in litigation measures

Vietnam's Tax Incentive Strategy

- Preferential Tax Rates for specific sectors
- Tax Holidays and reduced CIT for investing in
- Specific zones and disadvantaged area
- Customs Duty Incentives
- Land Rental Exemption for new investors

Key Lessons for Bangladesh from Vietnam and India Example to significantly improve investment climate and boost FDI

- Lowering corporate tax rates can significantly boost FDI
- Having a medium-term startegy for investments and policies in-line with FDI enhances
- Streamlined regulatory functions including claiming benefits and settling disputes enhances investor confidence
- Comprehensive tax incentives (Tax holidays, VAT, import duty reductions, land) for priority sectors
- Harmonizing and simplification of regulations enhances investor confidence and compliance
- Encouraging foreign ownership and respecting international treaties boosts FDI

CHAPTER 8

CONDUCIVE TAX ENVIRONMENT FOR FDI: THE CASE OF VIETNAM AND INDIA

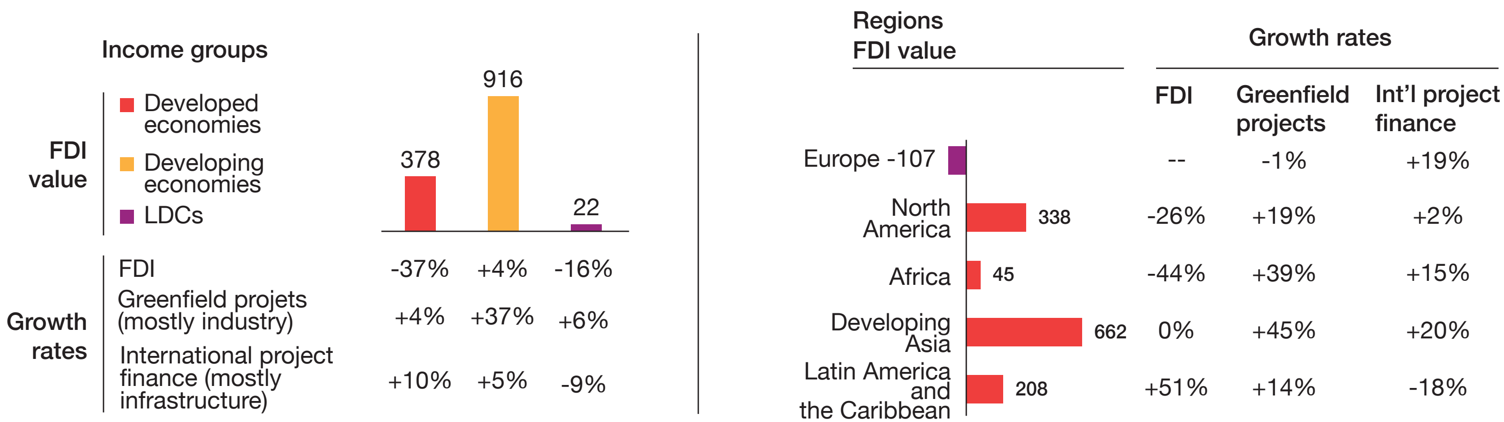
8.1 A Look into International Best Practices in Attracting FDI

In a dynamic global economy, attracting FDI drives growth, innovation and resilience through strategic policies. In the dynamic global economic landscape, the art of attracting FDI has transcended into a strategic endeavor, fostering economic growth, technological advancement, and global integration. Against the backdrop of economic uncertainties, the year 2022 witnessed an upsurge in investment-friendly policies, showcasing a resurgence of commitment towards creating an environment conducive to FDI. This chapter delves into the multifaceted world of best practices for attracting FDI, placing a spotlight on the critical role of taxation and regulatory frameworks. Through a detailed exploration of these practices, this chapter uncovers their profound influence on bolstering FDI inflows, propelling sustainable development, and crafting economies resilient to challenges.

In the wake of global economic shifts, investment policy trends emerged as transformative forces, dictating the momentum of FDI. A remarkable escalation was observed in 2022, as 66 countries enacted 146 policy measures designed to impact foreign investment. Notably, these measures marked a 35% surge from the previous year, signifying an assertive response to impending economic challenges. Embracing the essence of these trends, both developed and developing nations orchestrated 102 policies conducive to investment, echoing the imperative for economic revitalization.

> *66 countries enacted 146 policy measures designed to impact foreign investment and these measures marked a 35% surge from the previous year.*

Figure 62: **Investment Project Activity in Developing Countries Continue to Grow, as they Account for 70% of Global FDI**



Source: World Investment Report, 2023

In Developing Countries, Investment Promotion and Facilitation Measures Continue to Dominate.

At least 40 developing countries implemented promotion and facilitation measures in 2022, to attract additional FDI and to help overcome the economic challenges caused by the global crisis.

Investment facilitation measures accounted for almost 52% of all measures more favorable to investment. At least 22 developing countries introduced incentives for investors, most of them in the form of new fiscal benefits for priority sectors or through the institution of special economic zones. Within this dynamic landscape, Tax incentives have emerged as the linchpin in propelling FDI. A consensus has evolved across nations, highlighting the efficacy of Corporate Income Tax (CIT) incentives in captivating foreign investors. These incentives are characterized by their intricate and meticulously crafted design, encompassing an array of mechanisms such as preferential tax rates and strategically timed tax holidays. The nuances embedded within such incentives mirror the intricate dance between countries' regulatory frameworks and their determined pursuit of sustainable economic growth.

Investment facilitation measures accounted for almost 52% of all measures more favorable to investment.

Algeria: Algeria has positioned itself as an exemplar of this strategic approach. By enacting a law dedicated to free trade zones, Algeria has woven a multifaceted tapestry of incentives. This legislation intricately shields activities within these zones from a plethora of taxes, duties and levies. A calculated exception is made for specific taxes associated with vehicles, passenger cars and contributions to the social security system. This tailored blend of incentives showcases Algeria's commitment to enticing foreign investment while acknowledging the importance of maintaining fiscal equilibrium.

Argentina: Argentina, too, has deftly intertwined tax benefits within its investment landscape. In a concerted effort to invigorate the automotive industry, Argentina has introduced measures including accelerated depreciation and early refund of Value Added Tax (VAT) for acquisitions of new capital goods. The pièce de resistance lies in the full exemption—a 0% rate—from export duties for manufactured goods emerging from investment projects. This strategic orchestration underscores Argentina's endeavor to foster a robust export-driven manufacturing ecosystem.

Egypt: Egypt has strategically announced incentives targeting projects funded by FDI in key industries and strategic areas. This approach extends a welcome hand by offering incentives equivalent to up to 55% of the value of the tax on income generated. The condition, necessitating a significant proportion of the investment or expansion to be financed in foreign currency, accentuates Egypt's intent to attract substantial foreign investment and contribute to its economic development.

Ethiopia: Ethiopia, too, has honed its investment landscape through judicious tax incentives. By introducing income tax exemptions right from the date of obtaining a business license or expansion permit, Ethiopia is nurturing an environment ripe for investment. This is further bolstered by allowing investors to import capital goods, construction materials and motor vehicles exempt from customs duties. This calculated suite of incentives underscores Ethiopia's dedication to catalyzing private sector investment and fostering sustainable growth.

Saudi Arabia: Meanwhile, Saudi Arabia has unveiled a visionary approach by introducing its first Special Integrated Logistics Zone. This ambitious initiative extends a remarkable 50-year Tax holiday to investors, including those with 100% foreign ownership. This move is accompanied by VAT advantages on servicing and assembly, forming a potent combination of Tax incentives poised to establish Saudi Arabia as an attractive investment destination.

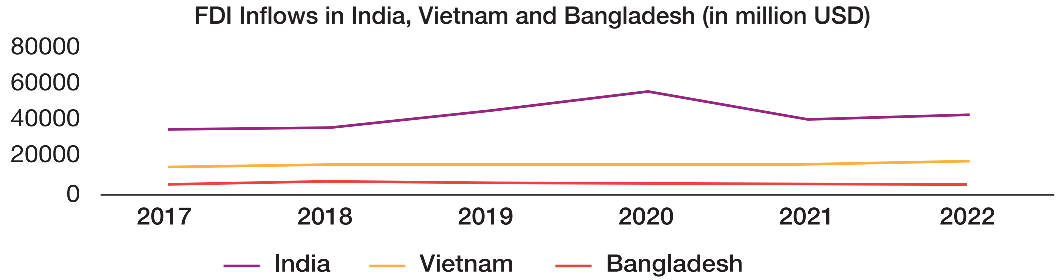
Table 20: Tax Investment Incentives Introduced by Developing Countries

Country	Incentives
Algeria	Exemption of most taxes, duties and levies within free trade zones, except for certain taxes and contributions to social security system.
Argentina	Tax benefits for automotive industry investors, including accelerated depreciation, VAT refund and full exemption from export duties for manufactured goods.
Egypt	Incentives on FDI-funded projects in key industries, offering up to 55% of tax value on generated income, subject to foreign currency investment conditions.
Ethiopia	Income Tax exemption for investors from business license or expansion permit date, plus duty-free import of capital goods, materials and vehicles.
Saudi Arabia	Special Integrated Logistics Zone with a 50-year Tax holiday for investors (including 100% foreign ownership), along with VAT advantages for servicing.

International Cases: Effective Mix of Investment and Tax Policies to Attract FDI

In parallel, the strategic paradigm of Vietnam stands as a testament to a meticulous approach. The country has finely crafted its Tax incentives strategy, offering reduced CIT rates and strategically timed Tax holidays for businesses operating within designated sectors. This calibrated orchestration resonates with potential investors, reinforcing Vietnam's commitment to cultivating an investment-friendly landscape. Meanwhile, India has deftly scripted its narrative of attraction, unveiling tailored tax breaks designed to allure foreign investors. This bespoke approach fortifies India's position as an FDI magnet and underscores its dedication to fostering sustainable economic expansion.

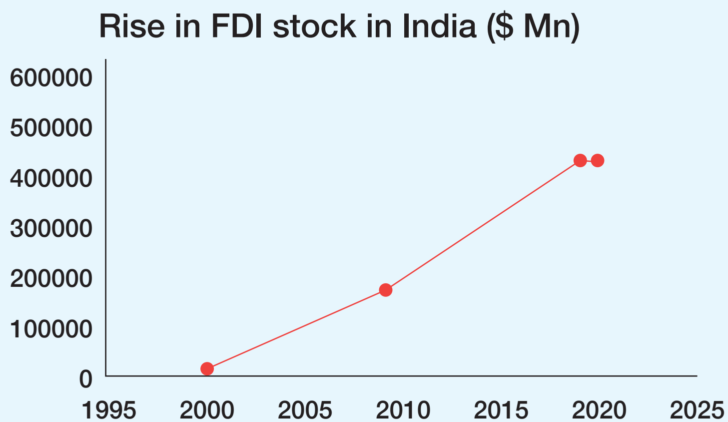
Figure 63: FDI Inflow in India and Vietnam Compared to Bangladesh



Source: Policy Exchange Database

Box 6: Incentives offered by India to attract foreign investments[14]

The Indian government has executed a comprehensive set of strategies to stimulate foreign investments, aiming to bolster the nation's economic growth and global competitiveness. These strategies encompass a spectrum of measures designed to enhance business continuity, sectoral resurgence, and the overall ease of doing business. These efforts underscore the commitment to positioning India as an attractive destination for global investors.



One of the pivotal catalysts in this endeavor is the Budget of 2020-21, which has introduced a host of measures aimed at significantly improving the ease of doing business in India. This proactive approach aims to attract more foreign direct investments (FDI), particularly from countries like the United States.

The strategic changes introduced to encourage more FDI are as follows:

Reduction of Corporate Tax Rate with gradual phasing out of exemption/ incentives: India has taken initiatives to bring down corporate and effective tax rates to encourage investments. Starting from the Finance Act, 2016, the corporate tax rates have been gradually reduced while phasing out exemptions and incentives available. In furtherance of this policy, an option has been provided through Taxation Laws (Amendment) Act, 2019 to pay tax at concessional rates of 22% (plus applicable surcharge and cess) if they do not avail certain exemptions/ incentives.[15]

Special Tax Breaks for Foreign Investors: The budget offers special tax breaks targeted at foreign investors, particularly sovereign wealth funds willing to commit for the long term. This incentive seeks to attract patient capital, fostering sustained investments that contribute to economic growth and stability.

Digital Industry and Infrastructure Boost: Measures to boost the digital industry and increase investments in the infrastructure sector demonstrate India's commitment to modernization and growth. Developers of specific infrastructure projects aligned with India's vision are eligible to claim 100% of deduction of the capital expenditure incurred wholly and exclusively for the purpose of development of projects. Despite the global economic slowdown, India's focus on these sectors positions it as a robust contender for foreign investments.

[14] Incentives offered by India to attract investments from Foreign Nations, India Law Offices. Retrieved on 13th August from Indian law offices website

[15] Recent Reforms in Direct Taxes. Income Tax Department, Central Board of Direct Taxes, India.

Tax holidays for specific sectors: A tax holiday is permitted on the profits earned by an undertaking engaged in handling, storage, and transportation of food grains, commercial production or refining of mineral oils, processing, preservation, and packaging of fruits or vegetables and operating and maintaining a hospital in a rural area. The tax holiday periods range from five to ten years, and the percentage of the rebate is 30%, 50%, or 100% in initial years and 30% in the later years.

Manufacturing Promotion and Export Expansion: The budget announcement includes the formulation of schemes aimed at increasing the manufacturing of electronics and medical devices. These initiatives are expected to boost domestic production, increase exports and attract investments in these critical sectors.

GST Simplification: Efforts to simplify the Goods and Services Tax (GST) system aim to create a more business-friendly environment. This is expected to reduce complexities and bureaucratic hurdles, making it easier for both domestic and foreign businesses to operate in India.

Enhancing Ease of Compliance for Taxpayers: India has taken specific initiatives to further simplify and ease compliance for taxpayers. The Faceless Assessment Scheme, 2019 and Faceless Appeal Scheme, 2020 were some initiatives taken with the objective of minimal interface and maximum governance through digitization of the assessment and appellate divisions. In order to bring efficiency and transparency in the functioning of income tax department, all communication and notices mandatorily have a computer-generated Document Identification Number. There were further simplifications in filing returns and other compliance norms which overall enhanced the tax environment in India.

Support for MSMEs: Micro, Small, and Medium Enterprises (MSMEs) form a crucial part of India's economic fabric. The budget introduces measures like no audit requirements for MSMEs with a turnover of up to Rs. 5 crore, streamlining compliance and fostering a favorable business ecosystem.

Abolishment of Dividend Distribution Tax (DDT): The removal of DDT has been widely appreciated by foreign investors. This move eliminates a major disincentive that foreign companies previously faced and makes India a more attractive destination for expanding business operations.

Indian government has also taken steps to promote foreign investments sector-wise, underscoring its commitment to fostering a favorable investment climate:

1. **Pharmaceutical Industry:** Expedited environmental clearances for projects related to pharmaceuticals have been introduced, streamlining processes and encouraging investments in this critical sector.

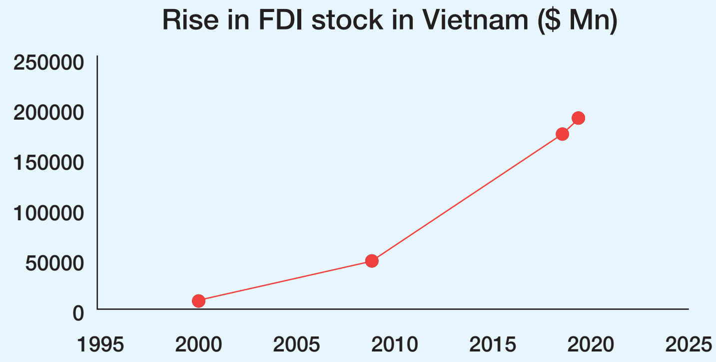
2. **Medical Devices:** To support the medical devices industry, the government has granted exemptions from basic customs duty and health cess on the import of essential items such as ventilators, masks, personal protective equipment (PPE) and test kits, along with inputs used for their manufacture.

3. **Electronics Sector (ESDM):** The Ministry of Electronics and Information Technology (MEITY) has introduced schemes such as the Production Linked Incentive Scheme (PLI), the Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors (SPECS) and the Modified Electronics Manufacturing Clusters Scheme (EMC 2.0). These schemes aim to boost India's standing in the global Electronics System Design and Manufacturing (ESDM) sector and attract significant foreign investments.

4. **Environmental Clearances:** The extension of validity for prior environmental clearances for projects expiring during specific periods ensures the uninterrupted operations of foreign projects, fostering investor confidence.

5. **Financial Support by RBI:** The Reserve Bank of India (RBI) has implemented several policies to address financial stress due to COVID-19. These policies include easing credit flows, expanding liquidity and improving market functioning, ensuring a conducive financial environment for foreign investors.

The comprehensive approach adopted by the Indian government encompasses a wide spectrum of sectors and initiatives, demonstrating the nation's commitment to creating a conducive investment ecosystem. By implementing these measures, India aims to attract foreign investments, encourage economic growth, and position itself as a resilient and dynamic global player in the realm of investments and business opportunities.



Box 7: Incentives offered by Vietnam to attract foreign investments[16]

Vietnam has strategically positioned itself as an alluring investment hub for foreign investors aiming to diversify their portfolios, leveraging its favorable geographic location, competitive labor force and cost-efficient factors. The Vietnamese government has consistently advanced its business climate, undertook reforms and enhancing investment incentives to elevate its attractiveness on the global investment stage. Notably, one of the most prominent and impactful features of Vietnam's investment landscape is its tax incentives. The government has introduced various measures to offer Corporate Income Tax (CIT) incentives to both foreign and local investors, aligned with sectors and areas that align with the nation's developmental strategies.

Key aspects of Vietnam's tax incentive strategy include:

Preferential Tax Rates: Vietnam offers a range of preferential tax rates that allow companies to pay CIT at rates lower than the standard 20%. These preferential rates include 10%, 15%, and 17%. These reduced rates can apply either throughout the project's lifespan or for a predefined period, dependent on specific provisions. For certain sectors like high-tech enterprises, the preferential tax rate can commence from the first year of generating revenue.

Tax Holidays: The tax incentive strategy extends to tax holidays, allowing companies to be exempt from CIT for a predefined period, usually around four years. After this initial tax holiday, firms might also qualify for a partial tax holiday, involving paying only 50% of the payable tax. This tax holiday typically initiates with the first year of profit generation or the fourth year of revenue generation, whichever is earlier. In certain scenarios, businesses can enjoy both tax holidays and preferential tax rates concurrently.

Vietnam has also rolled out customs duty incentive policies and land rental exemption policies, further minimizing financial burdens for businesses. **The following highlights key components of Vietnam's tax incentives:**

Eligibility Criteria: Tax incentives are granted based on sector, location and investment size. This comprehensive approach ensures that businesses in specific sectors and areas receive tailored incentives.

Incentives for Prioritized Sectors: Industries such as high-tech, software, research and development, renewable energy, education, healthcare and others are earmarked for tax incentives. Companies operating in these sectors benefit from preferential tax rates, either for specified periods or the entire lifetime of their projects.

Incentives in Disadvantaged Locations: Vietnam categorizes locations based on socio-economic conditions, offering tax incentives to firms operating in areas with difficult or extremely difficult conditions. Special Economic Zones (SEZs), High-Tech Zones (HTZs) and Information Technology Parks (ITPs) also qualify for tax incentives.

[16] Incentives for Foreign Investors in Vietnam, Bloomberg
Retrieved on 13th August from

https://news.bloombergtax.com/daily-tax-report-international/incentives-for-foreign-investors-in-vietnam

Size of Project Incentives: Large manufacturing projects meeting specific criteria, such as high investment capital disbursed within a defined timeframe or substantial revenue generation, receive tax incentives. These projects are eligible for a tax rate of 10% for 15 years, along with tax holidays and reduced CIT rates.

Exemption from Customs Duties: Businesses can secure exemptions from import duty for various scenarios, including imports for forming fixed assets, export processing contracts, software production, scientific research and technological development.

Incentives on Land Rental: Investment projects aligned with specific conditions, such as encouraged sectors or geographical locations, receive land rental fee exemptions. These exemptions vary based on the nature of the project and its socio-economic impact.

On 23 April, the Prime Minister signed Decision 508/QD-TTg, approving the Tax system reform strategy through to 2030, with a focus on building a modern and effective taxation regime. A key objective of the strategy was to harmonize Vietnam's Tax policies with international practices, in order to achieve the key targets of 2025 and 2030.

A number of measures were proposed, which includes

VAT	Broaden the tax base, apply a single VAT rate and simplify VAT credit and refund regulations.
Special Consumption Tax (SCT)	Extend the SCT to additional products and gradually increase rates on tobacco, beer and spirits.
Import/Export Duty	Reduce import duty rates, review duty policies to boost exports and tackle tax evasion.
CIT (Corporate Income Tax)	Revise or eliminate inconsistent CIT incentives, promote investments in key sectors and address transfer pricing and BEPS.
PIT (Personal Income Tax)	Simplify PIT by reviewing taxable items and finalization procedures.
Natural Resources Tax (NRT)	Review tax base determination for NRT.
Property Taxes	Extend the exemption of agricultural land taxes and discourage property speculation.
Environmental Tax	Review and apply environmental taxes to items contributing to pollution.

Vietnam's strategic focus on tax incentives has positioned it as an investment-friendly destination, attracting foreign investors seeking favorable tax conditions, operational advantages and growth opportunities. By tailoring incentives to sectors, locations and project sizes, Vietnam has created a comprehensive tax framework that fosters investment, supports economic growth and bolsters its competitive edge in the global investment landscape.

Box 8: Tax Reforms in South Korea

South Korea has undergone a remarkable transformation in its tax landscape over the decades, marked by a series of well-planned and strategic tax reforms. Through a series of strategic reforms and measures, the government has successfully attracted investments, streamlined the tax system, and promoted economic development. This section delves into the key tax reforms and specific measures undertaken by South Korea, shedding light on the lessons that can be drawn for other nations. **Establishing a modern tax administration agency, equipped with well-trained professionals, can significantly enhance the efficiency and effectiveness of tax collection.** In 1966, South Korea witnessed a pivotal moment in its tax administration with the establishment of the National Tax Service (NTS). This marked the initiation of modern tax administration, characterized by professionalism and efficiency. The NTS has been pivotal in assessing and collecting internal taxes, thereby improving the government's capacity to oversee revenue collection.

Alignment with the National Vision of Economic Growth: The strategic economic policy shift in the 1980s was a response to the challenges of the time. The government recognized that economic stagnation could only be overcome by embracing competition, openness, and a reduced role in the private sector. This shift aligned with the national vision of economic growth and development, as it sought to create an environment conducive to investment, innovation, and international trade. The government aimed to promote a free-market economy that could thrive in a global context.

Tax incentives can serve as powerful tools to stimulate economic growth, making it attractive for investors, both domestic and foreign. During the period of rapid economic growth, South Korea prompted a series of comprehensive economic reforms. As a part of these reforms, the government made various changes in tax laws to facilitate restructuring, stimulate investment, and broaden the tax base. Tax incentives and measures were introduced to encourage corporate mergers and acquisitions, asset swaps, and other transaction-related activities. For example, profits resulting from the revaluation of corporate assets after mergers and acquisitions were deferred from corporate income tax until the alienation of the revalued assets.

Attracting Foreign Investment: To address the withdrawal of foreign capital, the government prioritized restoring the confidence of foreign investors and attracting Foreign Direct Investment (FDI). The Foreign Investment Promotion Act (FIPA) and the Special Tax Treatment Control Law (STTCL) played a pivotal role in creating a more liberalized and favorable business environment for foreign businesses. Tax incentives, including exemptions from individual and corporate income taxes, were granted to foreign businesses and investors making advanced technology FDI. Exemptions from various local taxes, as well as customs duties and VAT, further incentivized foreign investment.

Stimulating Investment in SMEs: Tax incentives were extended to small and medium-sized enterprises to stimulate employment and technology investment. These incentives included tax exemptions on stock options, tax credits and exemptions on Research And Development (R&D), and reductions in various taxes related to consumer electronics, automobiles, and capital gains.

Streamlining the Tax Incentive System: While these incentives were beneficial for growth, they also complicated the tax system and led to inequities. In 1982, the government recognized the need for streamlining the tax incentive system, a vital step to promote investment and growth efficiently.

Harmonizing tax systems with global standards can enhance simplicity and international competitiveness. Aiming to establish an advanced tax system characterized by low tax rates and a broader tax base. These measures were in line with global tax reform trends and aimed to make the tax system more attractive to businesses and individuals. Income tax became closer to a comprehensive income tax, incorporating interest and dividend income into the global income tax system. This streamlined the taxation of various income sources and enhanced revenue collection.

Tax systems can be effectively used to address equity concerns and broadening the tax base can enhance revenue stability. In 1974, South Korea shifted its focus towards income redistribution, recognizing the importance of equity. Measures were introduced to create a progressive tax system and broaden the tax base. The introduction of the capital gains tax was a significant step in broadening the tax base.

South Korea's tax reforms offer a valuable roadmap for other nations seeking to simplify, modernize, and enhance their taxation systems. The strategic reduction of the number of taxes, establishment of a modern tax administration agency, use of tax incentives to promote economic growth, emphasis on income redistribution, and the introduction of modern tax systems like VAT have been key drivers of success. These reforms emphasize that a well-thought-out tax policy can play a pivotal role in revenue enhancement, economic growth, and improved compliance.

In essence, the realm of tax incentives transcends fiscal considerations to emerge as a strategic cornerstone. It's a realm where governments intricately craft policies to signal their commitment to nurturing economic growth, innovation and global collaboration. The nuanced fusion of tax incentives with diverse industries, investment scales and geographic contexts exemplifies a profound understanding of the complex dynamics that define the modern investment panorama. As nations traverse the intricate terrain of economic evolution, tax incentives stand as a tangible embodiment of strategic vision, attracting FDI, catalyzing industries and bolstering global eminence.

Institutional Reforms to Promote and Facilitate FDI

Regulatory Reforms- Orchestrating the Investment Climate: Complementing the impact of tax incentives, regulatory reforms emerged as architects of an attractive investment milieu. Developing countries, in particular, unveiled a comprehensive spectrum of investment promotion and facilitation measures. Algeria's stride towards development took form in the creation of free trade zones, housing activities exempt from most taxes, duties and levies. Saudi Arabia's innovation was embodied by the establishment of Special Integrated Logistics Zones, an ambitious endeavor rewarding investors, including those with 100% foreign ownership, with a remarkable 50-year tax holiday. Nations such as Fiji and Mexico adopted a transformative approach by reconfiguring their institutions, transitioning from mere regulators to active catalysts in attracting investments, thus amplifying their appeal to investors.

Table 21: Several Developing Countries Adopted New or Enhanced Institutional Mechanisms to Promote FDI in 2022

Country	Incentives
Fiji	Realigned mandate to transition from regulator to promotion agency, focusing on attracting both foreign and domestic investors.
Mexico	Launched **Invest in Mexico Business Center,** providing economic intelligence, investment information, guidance on procedures, and vendor linkages.
Saudi Arabia	Established **Saudi Investment Promotion Authority,** collaborating with Ministry of Investment to propose laws, procedures, and manuals.
Sri Lanka	Introduced **Ministry of Technology and Investment Promotion,** focused on promoting FDI and private sector investment.

Source: World Investment Report, 2023

Sectoral Focus and Liberalization- Tailoring for Resonance: With a fine balance of sectoral focus and liberalization, nations showcased their acumen in tailoring incentives to captivate FDI. Strategic sector targeting through innovative investment incentives emerged as a hallmark of effective policy design. India's policy amendment permitting FDI in the state-run Life Insurance Corporation stood as a testament to sector-specific reforms. China's audacious step of revising the Negative List for Foreign Investment Access, eradicating barriers in sectors like automobile manufacturing, unveiled a commitment to embracing liberalization and international collaboration. FDI liberalization accounted for 21% of the policy measures more favorable to FDI that developing countries introduced in 2022.

FDI liberalization accounted for 21% of the policy measures more favorable to FDI that developing countries introduced in 2022.

Table 22: FDI Liberalization Initiatives by Developing Countries

Country	Incentives
China	Revised the Negative List for Foreign Investment Access, removing the 50% cap on foreign investment in automobile manufacturing and satellite broadcast.
Ethiopia	Announced the privatization of 40% of Ethio Telecom, open to foreign investors.
India	Approved a policy amendment allowing FDI in up to 20% of State-run Life Insurance Corporation of India, previously restricted for foreign investors.
The Philippines	Allowed foreign investors to set up and fully own small and medium-sized businesses, removing previous restrictions.
United Arab Emirates	Permitted investors to establish 100% foreign-owned companies in most sectors, with exceptions for strategic activities.

FDI liberalization dismantles barriers, fostering global collaboration: Embracing FDI liberalization, nations eradicated barriers to foreign ownership, proclaiming their allegiance to openness and integration. A pioneering example materialized through the United Arab Emirates, endorsing 100% foreign-owned companies in most sectors, reflecting a remarkable stride towards international collaboration. Simultaneously, the reform of International Investment Agreements (IIAs) at bilateral, regional and multilateral levels continued to evolve. These developments underscored the evolving dynamics of investment governance and their intrinsic relevance in shaping a conducive investment climate.

8.2 Lessons for Bangladesh from International Investment Strategies

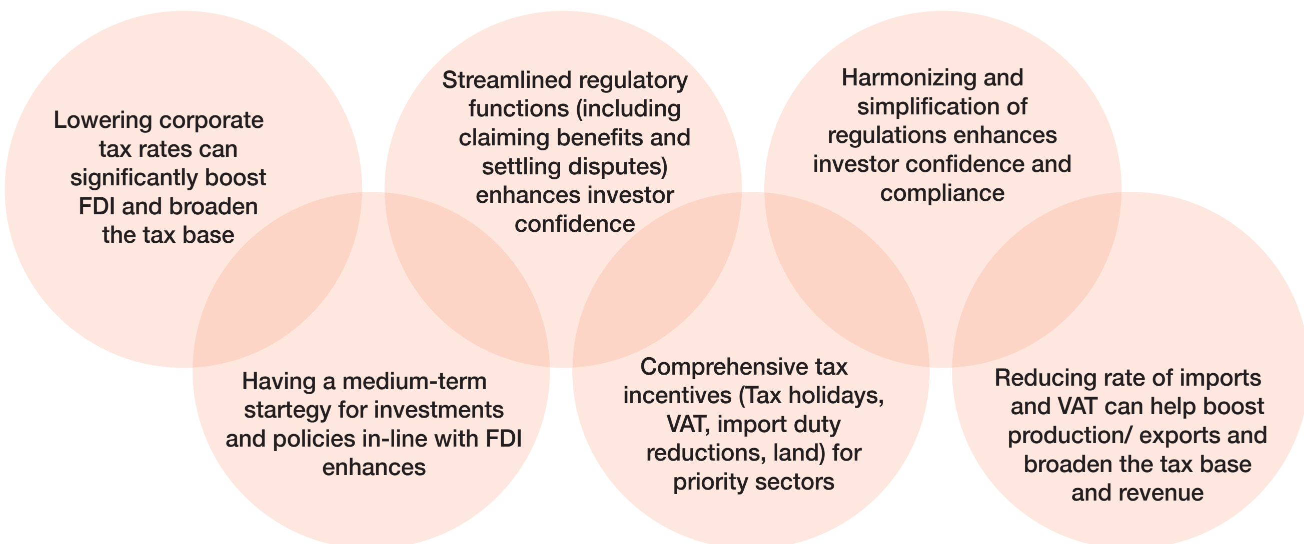
As Bangladesh sets its sights on further enhancing its attractiveness to FDI, there is a wealth of valuable insights to glean from the diverse strategies and practices employed by countries around the world. These experiences offer a blueprint for designing a comprehensive and effective investment framework, with a particular focus on tax policies and the regulatory environment.

Comprehensive Tax Vision with Clear Focus on Investment Support: Several countries have shown that a comprehensive tax strategy with a clear focus on supporting investments can significantly boost FDI. For instance, Vietnam tailors tax incentives to specific industries, aligning them with its economic strengths. India customizes tax breaks to cater to specific investor needs and sectors. These approaches can serve as blueprints for Bangladesh, encouraging targeted tax incentives that attract FDI while fostering a stable investment environment.

Green Investment Promotion for Sustainable Development: Developed nations are increasingly promoting investments in renewable energy and environmentally beneficial projects. Bangladesh can follow suit by designing tax incentives that encourage investments in sustainable energy infrastructure. Italy's incentives for sustainable energy projects and Spain's depreciation benefits can be emulated to accelerate the development of the renewable energy sector, aligning economic progress with sustainable development goals.

Sector-Specific Targeted Incentives: Countries like Algeria and Argentina have effectively employed sector-specific tax exemptions and benefits to attract FDI. Bangladesh can adopt a similar approach to entice foreign investors into critical areas of its economy, creating a mutually beneficial scenario.

Figure 64: Key Lessons for Bangladesh from International Best Practices



Streamlined Regulatory Environment: Fiji's transition from a regulator to an investment promotion agency demonstrates the value of consolidating investment-related regulatory functions. Bangladesh can enhance efficiency and create a more investor-friendly environment by streamlining regulatory functions, thus attracting greater FDI.

Openness to Foreign Ownership and Investment Facilitation: Mexico's Invest in Mexico Business Center provides a valuable blueprint. Bangladesh can establish similar centers to offer foreign investors vital information, guidance and assistance, eliminating administrative hurdles and promoting a seamless investment experience. Simplifying foreign ownership rules, as observed in the Philippines, can signal to global investors that Bangladesh welcomes and accommodates their investments.

Measured FDI Liberalization: Taking cues from China, Ethiopia, India and the United Arab Emirates, Bangladesh can progressively open up sectors for foreign investment. This approach attracts diversified and substantial FDI while allowing control over strategic sectors.

Multifaceted Tax Incentives: Countries effectively use a multifaceted tax incentive strategy, encompassing profit-based incentives, VAT exemptions and import duty reductions. Bangladesh can adopt a similar approach to appeal to a wide spectrum of investors.

Harmonized Investment Regulations: Establishing dedicated ministries or authorities, as seen in Saudi Arabia and Sri Lanka, to oversee investment promotion and harmonize regulations can create a reassuring and simplified investment framework for investors.

Bangladesh stands to gain immensely by heeding the lessons garnered from international investment strategies. By leveraging these insights, particularly in the areas of tax policy and regulatory environment, Bangladesh can not only attract increased FDI but also cultivate an environment conducive to sustainable economic growth and development.

CHAPTER 9

IMPROVING FDI BUSINESS CLIMATE: REFORM OPPORTUNITIES IN TAX ENVIRONMENT

Chapter at a Glance

Reforms in Tax Environment as per OECD Principles

Ensuring Neutrality

- Removing double taxation
- Respecting DTAA

Ensuring Effectiveness & Fairness

- Tax on Income and not on Payments
- Repealing Minimum Taxation
- Gradual Removal of Tax Deductions at Source (TDS)
- Rationalizing Non-Resident Taxation
- Rationalization of Advance Value Added Tax Rates Streamlining Tax Incentives
- Streamlining Tax Incentives
- Withdrawal of Minimum Tariff Value
- Rectifying Tax Deduction on Recognized Funds

Enhancing Efficiency

- Rationalizing Promotional Expenses
- Rationalizing Expenditure Limits
- Withdrawal of Redundant Tax Deduction

Enhancing Flexibility

- Regular Stakeholder Consultation for Continuous Improvements
- Prioritization of Investor Concerns and Tax Reforms
- Enhanced Automation of Tax System
- Increased Coordination between Tax Authorities and Relevant Agencies

Ensuring Certainty and Simplicity

- Tax Rates on a Prospective Basis
- Having a Medium-Long Term Taxation Strategy in line with Government Vision
- Single VAT Rate
- No Withholding VAT
- Withdrawing Restrictions on Definition of Input
- Withholding Tax Rate lower than Legitimate Corporate Tax Rate

Recommendations for Simplification and Streamlining Customs Procedures

Simplification
Expedited Customs Decisions and Fee Transparency
Advance Rulings on Tariff Classification Questions
Raising Minimum Duty and Tax Collection Threshold
Enhancement of Risk-Based Customs Clearance Management
Flexible Customs Clearance Processes

Standardization
Compliance with WTO Valuation Rules
Legal Authority for Automated Risk Management
Grounds for Annulment and Revocation of Decisions
General Rules for Customs Guarantee
Clarity on Rights and Obligations for Imported Goods
Responsibilities and Liability of Importers, Exporters and Agents
Inclusion of Laboratory and Testing Provisions

Transparency
Transparency in Customs Decisions
Stakeholder Input on Proposed Customs Rules
Cross-Referencing Sectoral Product Requirements
Coordinated Physical Examinations

Priority Areas to Enhance Broader Investment Climate and Overall Investors' Confidence

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Business Regulations	Modernizing archaic laws such as the Companies Act 1994, Competition Act 2012, Intellectual Property Rights (IPR) framework, and Import and Exports Control Act 1950.	Ministry of Law, Justice and Parliamentary Affairs, Ministry of Finance, Ministry of Commerce	Medium-Term
	Utilization of new generation promotion mechanisms by Investment Promotion Agencies.	PMO, BIDA, BEZA, BHTPA, PPA, and BEPZA	Short-Term
	Develop Standard Operating Procedures (SOPs) to reduce the regulatory burden and bring predictability in regulatory service delivery.	BIDA, BEZA, BHTPA, PPPA and BEPZA	Short-Term
	Introduction of systemic methods such as Regulatory Impact Assessment (RIA) and Feedback Loop to improve regulatory service delivery.	Ministry of Law, Cabinet Division, BIDA	Medium-Term
	Establishing an online portal containing all information relevant to regulatory delivery.	BIDA, BEZA, BHTPA, PPPA and BEPZA	Short-Term
	Revitalizing certain laws such as The Company's Act; Review sectoral licensing regulations for priority export and domestic sectors.	Ministry of Law, Justice and Parliamentary Affairs, Ministry of Finance, Ministry of Commerce	Short-Term
	Introducing a system that accommodates innovative business activities and start-ups.	BIDA, ICT Division, Startup Bangladesh Ltd.	Short-Term
	Introduce and publish a regulatory calendar at the beginning of a fiscal year indicating all upcoming laws for the year.	Ministry of Law, BIDA	Short-Term

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Access to Land	Increasing transparency of the Land Offices and Sub-Registry Offices service by making information on service standards publicly available.	Ministry of Land, RAJUK	Medium-Term
	Computerizing/digitizing all land records and property title registration.		
Infrastructure and Logistics	Strengthen institutional and implementation capacities with regards to PPPs: Review PPP Law and relevant regulations for more effective implementation.	PPPA	Medium-Term
	Financing infrastructure projects by sovereign bond issuance.	Bangladesh Bank, PMO, Ministry of Finance, Securities and Exchange Commission	Medium-Term
	Developing domestic capital markets and issuance of local currency bonds offshore.	Bangladesh Bank, PMO, Ministry of Finance, Securities and Exchange Commission	Medium-Term
	Selection of Economic Zones should be based on careful feasibility studies and competitive analysis.	BEZA, PMO	Medium-Term
	Develop National Logistics Policy and Masterplan; Allow more ICDs and streamline bonded requirements for various modes of logistics transportation including air shipments; Expedite development of Bay Container Terminal.	PMO, Ministry of Shipping, Ministry of Commerce, NBR, Ministry of Civil Aviation, Railways	Medium-Term
Skills and Productivity	The skills eco-system requires several policy and strategic initiatives which are as follows:	NSDA, Ministry of Education, Industry Skills Council	Long-Term
	Developing Long-term Skills Strategy/Master plan/Program Aligning with National Growth Strategies and Projected Key Growth Drivers.		
	Public Private Partnership in delivery of skills. This is critical in high skills matching and high employment outcomes.		
	Greater business orientation of Private Training Providers.		

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Commercial Dispute Resolution	Enforce the mandatory mediation provisions through adoption of the administering rules to support the implementation and create of the necessary infrastructure to operationalize mediation.	High Court Division of the Supreme Court of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs	Short-Term
	Establishing time limits for certain stages of court cases and monitoring compliance.	High Court Division of the Supreme Court of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs	Medium-Term
	Amend the Bangladesh Arbitration Act 2001 to improve implementation.	Ministry of Law, Justice and Parliamentary Affairs	
Trade Facilitation	Adopting certain policy measures such as reducing para-tariffs can support in inducing more trade and thus increasing private investment and FDI.	NBR, PMO	Medium-Term
Technology Diffusion	Reducing the cost of internet connection.	ICT Ministry, NBR	Short-Term
	Gradually build up Bangladesh's technology extension system to support upgrading in more advanced firms and sectors.	PMO, ICT Ministry	Medium-Term
Access to Finance	Implementing a modern resolution framework for distressed assets.	Bangladesh Bank	Short-Term
	Developing local capital markets as a source of long-term finance.	Bangladesh Bank, Bangladesh Securities and Exchange Commission	Medium-Term
	Stimulate the corporate debt market by correct reforms.		
	Develop a domestic green bond market to mobilize private capital for climate-related initiatives.		

CHAPTER 9

IMPROVING FDI BUSINESS CLIMATE: REFORM OPPORTUNITIES IN TAX ENVIRONMENT

9.1 Suggested Reforms in Tax Environment to Promote Greater FDI

i. Ensuring Neutrality

Reform Proposal 1: Addressing No Double Tax on same transaction (Double Tax)

Taxing benefits received under employment contracts, such as leave encashment allowance, house rent allowance, and commuting allowance, both at the employee and employer levels, result in double taxation. To resolve this, it is recommended to amend Section 55(gh) to exclude these benefits from perquisites and promote a more business-friendly taxation system.

Rationale: The issue regarding the permissible limit for additional perquisites, as outlined in Section 55(gh) of the ITA 2023, and its inclusion of benefits received under employment contracts is a matter that needs addressing. Benefits such as leave encashment allowance, house rent allowance, and commuting allowance, which are part of employment contracts, should not be considered as perquisites. Perquisites are typically additional benefits provided by an employer and should be included in an employee's personal income, subject to taxation.

Taxing these allowances both at the employee level and the employer level results in double taxation, which goes against the principles of fair taxation and the prevailing tax policies in neighboring countries. Moreover, these allowances are legitimate business expenses and should be fully allowable, reducing the overall tax burden on companies.

To rectify this issue, it is recommended to amend Section 55(gha) of the Income Tax Act, 2023. The proposed amendments include excluding benefits provided to employees in accordance with their employment contracts from the definition of perquisites. Additionally, the definition of perquisites should exclude leave encashment, house rent allowance, and conveyance allowance. These changes would align the tax treatment of employment-related benefits with international practices and promote a more business-friendly taxation system.

Reform Proposal 2: Respecting DTAA

There have been cases where the Bangladeshi authorities have not respected Double Taxation Avoidance Agreements (DTAAs). This can be a problem for foreign investors, as it can lead to them being taxed twice on the same income. This can lead to disagreements between the Bangladeshi authorities and foreign investors about the interpretation of DTAs. Providing training to the tax authorities on the terms of DTAs and simplifying the tax laws.

Rationale: Bangladeshi tax authorities may not be aware of the terms of all DTAs that Bangladesh has entered into. This can lead to disagreements between the Bangladeshi authorities and foreign investors about the interpretation of DTAs. When a foreign investor is faced with a situation where the Bangladeshi authorities are not respecting a DTA, they have a few options. One option is to try to negotiate with the tax authorities to reach a settlement.

Another option is to file a complaint with the Bangladeshi government. Finally, the foreign investor may be able to take the matter to international arbitration.

A prospective tax charge is a charge that is levied on income that is earned in the future. This is fairer to taxpayers, as it gives them time to plan for and budget for the tax charges.

ii. Enhancing Efficiency in Tax Environment through minimizing Compliance and Administration Costs

Reform Proposal 1: Rationalizing Promotional Expenses

The current uniform cap on promotional expenses at 0.50% of turnover is impractical and hampers various industries. A one-size-fits-all approach to promotional expenses harms market competitiveness and economic recovery. To rectify this, it is recommended to abolish Section 55 (NG) and introduce industry-specific limits for promotional expenses.

Rationale: The issue of inadmissible expenses, particularly the restriction on promotional expenses, poses significant challenges for businesses. Currently, there's a uniform and rigid cap of 0.50% of turnover, which is deemed irrational and detrimental to various industries. Promotional spending is vital for market competitiveness and economic recovery, making a one-size-fits-all approach unreasonable. Unlike global practices, Bangladesh lacks industry-specific regulations on allowable expenses, leading to higher effective tax rates for companies and negating the benefits of reduced corporate taxes. This not only hinders business expansion but also discourages both domestic and foreign investments. To address this, a reform proposal suggests abolishing Section 55 (NG) and replacing it with industry-specific limits for promotional expenses, fostering a more business-friendly and competitive environment.

Reform Proposal 2: Rationalizing Expenditure Limits

The existing 10% limit on expenses like royalty, technical service fees, and technical know-how fees contradicts international standards and guidelines. It is proposed to consider these expenses as fully admissible, with allowable limits in line with FOREX and BIDA regulations, at 6% of the reported turnover in financial statements.

Rationale: The issue of setting a permissible limit on expenditures like royalty, technical service fees, and technical know-how fees is a matter of concern. The current regulation, which limits these expenses to 10% of net profits, conflicts with international standards, particularly the OECD Transfer Price Act. This practice is uncommon in countries following this law. Such expenses, including those related to patents and technical support, are crucial for businesses to remain competitive globally and contribute to Bangladesh's economic development. Furthermore, this regulation contradicts the guidelines established by the Foreign Exchange Act (FOREX) and the Bangladesh Investment Development Authority (BIDA), which already allow for 6% of total sales as permissible expenses.

To address this issue, it is proposed that expenses related to royalty, technical service fees, technical knowledge fees, technical assistance fees, or similar expenditures should be fully admissible, recognizing them as genuine business expenses. The allowable limit should align with FOREX and BIDA guidelines, set at 6% of the turnover reported in the financial statements. This change would promote a more consistent and business-friendly regulatory environment.

Reform Proposal 3: Withdrawal of Redundant Tax Deduction

Section 102(1) imposes a 5% tax deduction at source on interest income of provident funds, gratuity funds, authorized superannuation funds, or pension funds, which is considered redundant as the entire income of these funds is already exempted under Part A of the Sixth Schedule to the Act.

To address this issue, it is recommended to withdraw the 5% tax deduction at source on retirement funds, such as Provident Funds, Gratuity Funds, Workers' Profits Participation Funds and Superannuation Funds.

iii. Ensuring Simplicity in Tax System and having a Predictable System

Reform Proposal 1: Application of Tax Rate on a Prospective Basis

Predictability and planning are crucial elements of any sound tax system. To enhance tax predictability and foster effective tax planning, it is necessary that tax rates be applied on a prospective basis. This means that taxpayers would have advanced knowledge of the tax rates that will apply in the current fiscal year and even in the foreseeable future. Such a measure provides individuals and businesses with the confidence and stability they need to make informed financial decisions. It eliminates the uncertainties associated with ad-hoc or retroactive changes in tax rates. A prospective tax system aligns with the principles of fairness, ensuring that taxpayers can plan their financial affairs accordingly. It also encourages compliance, as taxpayers are more likely to meet their obligations when they understand and can predict their tax liabilities.

Reform Proposal 2: Having a Medium to Long-Term Tax Strategy in Line with the Government of Bangladesh's Vision and Development Goals

Taxation should not operate in isolation from a nation's broader development objectives. To ensure a coherent and effective tax regime, it's recommended that Bangladesh adopts a medium to long-term tax strategy that aligns with the government's vision and development goals. This strategic approach not only provides a clear direction for taxation but also harmonizes it with broader socio-economic aims. By linking taxation to national development objectives, we can achieve two critical outcomes: Firstly, it fosters the government's capacity to mobilize revenue for essential public services and infrastructure, aligning with the principles of efficiency and fairness. Secondly, it provides investors and businesses with a clear understanding of the government's taxation plans, promoting confidence and long-term investment. This strategic coherence results in a win-win situation where the tax system becomes an instrument of economic development and growth, further enhancing compliance and the effectiveness of the tax system.

Reform Proposal 3: The Withholding Tax Rate should be Lower than the Legitimate Corporate Tax Rate

In the case of deducting or collecting withholding Tax (TDS), the taxable income of the business or organization is not considered but rather deducted at a uniform rate irrespective of the applicable tax rate of the business. In most cases, those deductions are considered as minimum tax rates. So, the taxpayer can’t claim back a refund. To resolve this, it is recommended to withhold based on the taxable income, and amendment of the clause of withholding tax as a minimum promotes a more business-friendly taxation system.

Rationale: A lower withholding tax rate would make it easier for businesses to operate and grow, and it would attract more foreign investment. It is important to note that a lower withholding tax rate should not be uniform. A lower withholding tax rate would reduce the upfront tax burden on businesses. This would free up more cash for businesses to invest in their operations and to create jobs. The withholding tax rate should be tailored to the specific needs of different sectors of the economy. For example, the withholding tax rate could be lower for export-oriented industries and for industries that are trying to attract foreign investment.

Reform Proposal 4: Input Tax Credit should not be restricted by giving a different definition of Input

Section 2(18ka) of the VAT and SD Act, 2012, through the Finance Act, 2020, defines the scope of the input materials for imposing restrictions on availing tax exemptions that are not in conformity with international law. The definition excludes certain important things such as labor, land, buildings, office equipment, and fixtures, from the input on which input tax credits are not applicable.

Rationale: Input Tax Credit (ITC) should not be restricted by giving a different definition of input. The ITC is a mechanism that allows businesses to claim a credit for the taxes that they have paid on their inputs against the taxes that they owe on their outputs. This mechanism is designed to prevent businesses from being taxed twice for the same goods and services.

If the definition of input is restricted, it can make it more difficult for businesses to claim the ITC. This can increase the tax burden on businesses and make them less competitive.

The ITC can help to reduce the cost of doing business. This can make businesses more competitive and can lead to lower prices for consumers. ITC can help to promote investment and job creation. When businesses are able to reduce their tax burden, they are more likely to invest in their operations and to create jobs.

Reform Proposal 5: Single VAT Rate

According to Schedule 3 of the VAT and SD Act, 2012 there are different VAT rates other than the standard rate of 15% applicable on different goods and services such as 10%, 7.5%, or 5%, and others.

Rationale: A single VAT rate is simpler to administer and comply with than a multiple VAT rate system. This is because businesses only need to learn and apply one set of rules, and tax authorities only need to track one rate. This can lead to lower costs and fewer errors. A single VAT rate is seen as fairer than a multiple VAT rate system, as it treats all taxpayers equally. This can help to improve public trust in the tax system.

Reform Proposal 6: No withholding VAT (VDS)

As per SRO 240-AIN-2021/163/Mushak (Dated 29 June, 2021), withholding entities need to deduct VAT while making payments for different goods or services.

Rationale: For withholding the VAT and depositing it to the government treasury and then issuing a withholding certificate to the supplier or service provider creates extra hassle for the organization. This will increase the administrative cost of the business.

iv. Enhancing Effectiveness and Fairness

Reform Proposal 1: Tax should be on Income and not on payment

One of the fundamental principles of taxation is that it should be equitable and fair. Taxing payments, particularly through mechanisms like withholding tax, can often run counter to this principle. Taxing payment, instead of income or profit, introduces complexities and can lead to double taxation. To enhance the fairness of the tax system, it is recommended that taxes be imposed on income rather than payments. This approach aligns with the principles of effectiveness and fairness, ensuring that taxpayers are taxed proportionally to their actual income and not on every financial transaction they undertake. Shifting the focus to income-based taxation simplifies the system, fosters compliance, and makes it more equitable for all parties involved.

Reform Proposal 2: Rectifying Tax Deduction on Recognized Funds

Section 105 currently imposes a 10% tax deduction at source on interest income from investments in recognized provident funds and workers' participation funds, which is considered illegal as the income of these funds is already exempted.

To rectify this issue, it is recommended to:
- Withdraw the provision for tax deduction at source from interest income on savings notes purchased by the fund.
- Issue a directive clarifying that Tax Identification Numbers (TINs) are not applicable to recognized funds.

Reform Proposal 3: Reforming Minimum Taxation

The current imposition of minimum tax under Section 163(4) of the ITA 2023, which obliges taxpayers to pay a predetermined rate on their total receipts, irrespective of profit or loss, contradicts the fundamental principle of income taxation. To rectify this, it is suggested to repeal the minimum tax provision, levy taxes based on actual income, gradually remove Tax Deducted at Source (TDS) from the minimum tax, and implement rational TDS rates using Document Verification Systems (DVS) for a more equitable and transparent tax system.

The imposition of minimum tax under Section 163(4) of the ITA 2023, which obliges taxpayers to pay a predetermined rate on their total receipts or tax collected/deducted at source, regardless of their actual profit or loss, is contrary to the fundamental principle of income taxation. Taxes should ideally be levied on income generated, not on total receipts, to ensure fairness and rationality in the tax system.

Paying minimum tax even in the absence of profit can result in a diversion of funds from equity or capital, which can undermine a business's financial and capital management.

To address these issues, it is recommended that:

- The provision of minimum tax be repealed, and taxation be based on actual income to ensure a more equitable system.
- Gradual removal of Tax Deducted at Source (TDS) from the minimum tax provision.
- Implementation of rational TDS rates by utilizing Document Verification Systems (DVS) developed by ICAB to accurately identify income and expenditure. This approach would lead to a fairer and more transparent tax system in Bangladesh.

Reform Proposal 4: Repealing Section 56 which imposes an unfair tax liability on businesses

Section 56, which treats disregarded expenses under Section 55 as separate income, imposes an unfair tax liability on businesses, increasing their operational costs. The proposal suggests repealing Section 56 to reduce the financial burden on businesses and create a more equitable taxation system.

Rationale: The issue surrounding Section 56 of the ITA 2023, which treats disregarded expenses under Section 55 as separate income for taxation at regular rates, is a matter of concern. This section essentially imposes an additional tax liability on taxpayers, which can be seen as unfair and unjustifiable. It significantly increases the cost of doing business in Bangladesh, which is not conducive to fostering a business-friendly environment.

Furthermore, under Section 56, taxpayers are required to pay tax separately on disregarded expenditures, even if their business is incurring losses. This adds an undue financial burden on businesses, especially during challenging economic periods when businesses may not be profitable. Additionally, the specified clauses treated as tax deducted/collected and minimum tax under Section 163 cannot be carried forward or claimed back by the company, further complicating the tax landscape.

To address these concerns and promote a more equitable taxation system, it is important to repeal Section 56 of the ITA 2023. This would help reduce the financial burden on businesses, encourage investment, and contribute to a more business-friendly environment in Bangladesh.

Reform Proposal 5: Rationalizing Non-Resident Taxation

Section 119(1) of the ITA 2023 currently imposes a 30% tax deduction at source on non-resident income, which is perceived as high during a review. This high rate burdens compliant taxpayers and encourages irregular practices to evade this tax, impacting fair competition.

To address these concerns and promote business growth, it is recommended to:

- Rationalize the rate of tax deduction at source on non-resident income to a more competitive 5%-10% range.
- Introduce a new paragraph in the Double Taxation Agreement to provide tax benefits for the payment of technical service fees, encouraging the proper conduct and expansion of business while avoiding double taxation issues.

Reform Proposal 6: Rationalization of Advance Value Added Tax Rates

Withdraw all advance taxes on raw materials and spare parts, and set a uniform advance tax rate of 3%.

The existing advance tax rates of 3% or 5% are deemed excessively high and impractical, assuming a 20% or 33% value addition on all imported goods. This doesn't align with economic realities, and rationalizing the advance tax rate is essential to reduce refund amounts significantly.

Reform Proposal 7: Streamlining Tax Exemptions

The current situation involves a discrepancy between the provision for tax exemption on income mentioned in the Sixth Schedule of the Income Tax Act and the absence of a corresponding tax exemption certificate in various provisions related to tax deduction at source. This incongruity results in the imposition of tax deduction at source on tax-exempt individuals, leading to complications in field-level operations.

To streamline this process and eliminate unnecessary complexities, it is recommended that the provision of tax exemption certificates under the Income Tax Act, 2023, pertaining to income mentioned in the Sixth Schedule of the Income Tax Act, be abolished. This change would align the provisions more logically with the existing tax exemption on such income.

Reform Proposal 8: Withdrawal of Minimum Tariff Value

The concept of minimum tariff value has been found to be misaligned with best practices and market dynamics. This provision can introduce barriers to trade and hinder investments. To create a more conducive environment for trade and investments, it is recommended that the minimum tariff value be withdrawn. The removal of this minimum tariff value aligns with principles of fairness and effectiveness. It allows businesses to operate in a market-driven, competitive environment where prices are determined by supply and demand, rather than artificially imposed values. Such a move promotes fair competition, encourages investments, and simplifies trade procedures, contributing to an equitable and effective tax system that encourages compliance and economic growth.

v. Developing a Flexible and Dynamic Tax System

Reform Proposal 1: Enhanced Automation and Digitization of Tax Assessment and Appeals

In the digital age, where technology is transforming every facet of our lives, it's only prudent that the tax system keeps pace. By embracing enhanced automation and digitization in tax assessment and appeals, we can usher in a new era of efficiency and transparency. This recommendation underscores the importance of transitioning from paper-based, cumbersome processes to streamlined, digital solutions. A modern tax system should empower taxpayers to file returns, track assessments, and lodge appeals through user-friendly online platforms. This not only reduces administrative costs but also ensures faster, error-free processing, and increased compliance. It enhances the taxpayer's experience, making them more likely to adhere willingly to tax regulations. Furthermore, this transition can significantly reduce the burden on tax authorities, allowing them to focus on more complex compliance issues and ultimately improving the effectiveness of tax collection.

Reform Proposal 2: Increased Prioritization of Investor Concerns & Regular Stakeholder Consultations for Continuous Improvement of Tax Environment

Investor confidence is the lifeblood of a thriving economy, and the tax environment plays a pivotal role in shaping that confidence. By increasing the prioritization of investor concerns and regularly engaging in stakeholder consultations, we can build a tax system that is not only investor-friendly but also agile and responsive. Investors, whether domestic or foreign, need to know that their concerns are being heard and addressed. By fostering a two-way dialogue through consultations, we ensure that tax policies remain adaptable to evolving economic conditions and investor expectations. This approach does not only promote fairness but also enhances the effectiveness of the tax system. When investors perceive a fair, predictable, and responsive tax environment, they are more likely to commit to long-term investments, ultimately contributing to economic growth. It's a win-win strategy that can lead to continuous improvement in the tax environment.

Table 23: Key Recommendations for Improving Tax Environment to Enhance FDI

Principle	Recommendations
Ensuring Neutrality	Addressing No Double Tax on the same Transaction (Double Tax)
	Respecting DTAA (Double Tax Avoidance Agreement)
Enhancing Efficiency in Tax Environment	Rationalizing Promotional Expenses
	Rationalizing Expenditure Limits
	Withdrawal of Redundant Tax Deduction
Ensuring Simplicity in Tax System	Adjusting Depreciation Limits and Rates
	Efficient Utilization of Depreciation Allowance
	Single VAT Rate
	No Withholding VAT (VDS)
Enhancing Effectiveness and Fairness	The Withholding Tax Rate should be lower than the Legitimate Corporate Tax Rate
	Fair Tax Liability on Businesses
	Reforming Minimum Taxation
	Rationalize the Rate of Tax Deduction at Source on Non-Resident Income to a More Competitive 5%-10% Range
	Rationalization of Advance Tax Rates

Principle	Recommendations
Flexible and Dynamic Tax System	Enhanced Automation and Digitization of Tax Assessment and Appeals
	Increased Prioritization of Investor concerns and regular stakeholder consultations for continuous Improvement of Tax Environment

Table 24: Specific Recommendations for Modification and Withdrawal of Certain Provisions to Reduce the High Effective Tax Rate

Sections in ITA 2023	Amendment suggested
55 (NG)	Abolish Section 55 (NG) and introduce industry-specific limits for promotional expenses
	Expenses related to royalty, technical service fees or similar expenditures should be recognized as genuine business expenses and fully admissible. The allowable limit should align with FOREX and BIDA guidelines, set at 6% of the turnover
Section 55 (gha) and 2(55)	Excluding benefits provided to employees in accordance with their employment contracts from the definition of perquisites
	The definition of perquisites should exclude leave encashment, house rent allowance and conveyance allowance
Section 56	Repealing Section 56 to reduce the financial burden on businesses and create a more equitable taxation system
Section 163(4)	The provision of minimum tax be repealed and taxation be based on actual income
	Gradual removal of TDS from the provision of minimum tax
	Implementation of rational TDS rates by identifying income and expenditure using DVS
Section 71	Implement a minimum tax on total income only when the amount of depreciation allowance exceeds the business income
	Allow any excess depreciation allowance to be carried forward to the next year, creating a reserve for depreciation allowance in the following year

Table 25: Summary Recommendations for Rationalizing Tax Deduction at the Source

Section	Amendment suggested
Section 119	Rationalize the rate of tax deduction at source on non-resident income to a more competitive 5%-10% range
	Introduce a new paragraph in the Double Taxation Agreement to provide tax benefits for the payment of technical service fees
Section 105	Withdraw the provision for tax deduction at source from interest income on savings notes purchased by the fund
	Issue a directive clarifying that Tax Identification Numbers (TINs) are not applicable to recognized funds
Section 102(1)	Withdraw the 5% tax deduction at source on retirement funds, such as provident funds, gratuity funds, workers' profits participation funds and superannuation funds
Section 124	Either exempt the sale proceeds received from power plants from tax or provide explicit clarification on whether they are subject to taxation taking due consideration
Sixth Schedule	Provision of tax exemption certificates pertaining to income mentioned in the Sixth Schedule, be abolished

vi. Amendments in VAT & SD Act 2012 for attracting FDI and improving Business Climate

1. Repeal of Clause (18 Ka) in Section 2: Clause (18 Ka) of Section 2 is proposed for repeal due to inconsistency with the fundamental principles of the Act.

Clause (18 Ka) of the VAT and SD Act, 2012, as introduced by the Finance Act, 2020, defines input materials for restricting tax exemptions. However, this clause contradicts the Act's basic features, resulting in double taxation of VAT, ultimately increasing the effective VAT rate for consumers beyond the standard 15%. Simplifying and liberalizing the tax system will encourage new taxpayers and support government revenue goals.

2. Removal of Sub-section (2)(gha) in Section 46, Repeal of Subsection (5) in Section 32 and Abolition of Rule 21: Declaration of Co-production of Materials

Taxpayers will be obliged to provide input-output co-efficient of raw material consumption and finished products whenever the authorities want for audit. Which is mentioned in sub-section (2Ng) of section 107. Further sub-section (5), “Section 32 - Determination of value of taxable supplies” is inconsistent with and contrary to the basic concept of Value Added Tax and Supplementary Duties Act, 2012. Therefore, considering the complexity of the business-friendly law and taxpayers, it is reasonable to abolish this unreasonable provision.

9.2 Simplification and Streamlining of Customs Procedures

i. Streamlining Processes and Expediting Customs Clearance Processes Through Automation, Increased Flexibility and Coordination

Streamlining Customs Clearance with Bangladesh Single Window (BSW): Section 197D of the Customs Act, 1969, introduces the potential of the Bangladesh Single Window (BSW), which could significantly improve customs processes. Prioritizing the implementation of the BSW, aligning it with international customs single window best practices, can simplify customs procedures, reduce duplication, and enhance efficiency, ultimately making Bangladesh more appealing to foreign investors.

Streamlining Physical Examinations through Coordination: It is necessary for Customs to coordinate physical examinations and sampling of goods required by other competent authorities simultaneously with Customs controls. This approach eliminates additional time and costs associated with multiple, disjointed examinations, expediting customs clearance and reducing trade-related expenses. This issue will be resolved as and when the new Customs Bill 2023 is implemented and a profile-based risk management system is used.

Enhancing Flexibility in Customs Clearance Processes: Empower the National Board of Revenue (NBR) to adjust declaration, verification, and release procedures through regulatory amendments. These changes should simplify and expedite the release of goods as needed based on trade and risk considerations. This flexibility allows for more efficient customs clearance processes, ultimately reducing time and costs associated with trade. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Enhancing Clarity in Tariff Determination: The Customs Act, 1969, lacks provisions for laboratory testing, leading to ambiguity in tariff determination. Amending the Customs Act to reference relevant provisions in other laws governing laboratory testing is necessary to provide clarity on product classification, helping to establish accurate tariffs and boosting investor confidence. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Bolstering Risk-Based Customs Management: Section 197A of the old Customs Act does not address customs clearance for bulk agricultural items, creating a gap in risk-based management. Developing rules and operational procedures under Section 197A to enhance risk management for bulk agricultural imports and exports. This aligns customs practices with international standards, fostering a more favorable environment for foreign investment. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Digital Transformation for Efficient Customs Processing: It is necessary to authorize the NBR to identify documents or payments that can be submitted electronically. Designating or appointing computer systems for transmitting such documents or payments, mandating the use of electronic communication for specified transactions, and setting technical and procedural requirements for electronic communication will be greatly beneficial and this digitalization initiative will streamline customs processes, making them more efficient and cost-effective. The newly-approved Customs Bill 2023 largely incorporates the suggested improvements, and the transitioning to a smart Customs will be boosted as and when the new Customs Bill 2023 is implemented.

ii. Enhancing Transparency, Predictability & Compliance

Efficient Customs Decision Processes for Investor Confidence: It is necessary for NBR to be mandated to issue customs decisions promptly, within 120 days after receiving necessary information. Timely decisions and clear communication will enhance investor confidence. The recommendation bridges the gap of delays and lack of clarity in customs decisions. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented, as a profile-based risk management system and online agreement on valuation will be possible.

Transparent Fee Structure for Improved Investor Predictability: It is necessary to empower NBR to establish fees for specific customs services, limited to the actual cost of the service. Proposed fees must be open for stakeholder feedback, enhancing transparency and investor predictability. This recommendation addresses the gap of unlimited fees and opacity in fee determination. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Enhancing Transparency in Customs Computer System Usage Decisions: It is necessary for customs authority to provide written reasons and notification of appeal rights for adverse decisions related to customs computer system usage (Section 79C). This enhances transparency and investor confidence. The recommendation addresses the gap in transparency in customs decisions regarding computer system usage. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Empowering Automated Risk Management and Decisions: It is necessary to grant legal authority to automated customs risk management and decisions, treating them as decisions made by customs officers. This streamlines the process and ensures efficiency, addressing the gap in the lack of legal provisions for automated decisions. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Defining Grounds for Decision Cancellations: Specify grounds and procedures for NBR to annul or revoke prior decisions, ensuring transparent procedures and due process. This recommendation bridges the gap of ambiguity in decision cancellations under various sections. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Facilitating Advance Rulings for Tariff Classification: Issuing advance rulings on tariff classification queries is important to ensure clarity for importers. This recommendation addresses the gap of limited scope in issuing advance rulings. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented, as a profile-based risk management system and online agreement on valuation will be possible.

Enabling Stakeholder Input in Customs Rules Implementation: Establish formal mechanisms for stakeholders to provide input on draft customs rules. Regular consultations, online information dissemination, and accessible “enquiry points” enhance transparency and stakeholder involvement. This addresses the gap in stakeholder engagement and access to information. This has been incorporated in the newly-approved Customs Bill 2023, which mandates stakeholder consultation before issuing any new rule, and the issue will be resolved as and when the new Customs Bill 2023 is implemented

Streamlining Duty Collection for Minimal Transactions: Introduce a waiver for duty and tax collection if the assessed amount or the discrepancy is below Tk 2,000. This cost-effective approach minimizes administrative burdens on small transactions and addresses the gap in cost-efficient duty collection.

Defining Responsibilities and Liabilities in Customs Clearance: Establish clear responsibilities and liabilities for importers, exporters, and their agents during customs clearance. Importers and exporters should be responsible for data accuracy, payment of duties and taxes, and providing requested information. Agents must also be accountable for the accuracy of submitted declarations. This recommendation clarifies the gap in understanding roles and liabilities in customs clearance, and has been incorporated in the newly-approved Customs Bill 2023. The issue is likely to be resolved as and when the new Customs Bill 2023 is implemented.

iii. Standardization and Harmonization of Customs Rules and Procedures

Aligning Customs Valuation with WTO Rules: Revise the customs valuation process to comply with WTO rules. Imports shall be valued based on WTO guidelines, and export valuation should consider the FOB price inclusive of transport costs to the Bangladesh port. This recommendation bridges the gap between the current use of minimum price system and international standards. This has been incorporated in the newly-approved Customs Bill 2023, and the issue will largely be resolved as and when the new Customs Bill 2023 is implemented.

Clear Guidelines on Customs Guarantees: Define general rules for customs guarantees applicable to all customs operations. These rules should cover acceptable forms of guarantees, limitations on guarantors, criteria for determining guarantee amounts based on risk assessment, and provisions for the prompt release of guarantees upon satisfactory completion. This recommendation addresses the gap in clarity regarding the use of guarantees in customs operations beyond the warehouse procedure.

Clarifying Rights and Obligations for Goods in Temporary Storage: Goods arriving in Bangladesh should be automatically placed under a temporary storage regime. Define the rights and obligations of both Customs and importers concerning such goods. This includes specifying storage locations, importer access conditions, and permitted operations on these goods. This addresses the gap in clarity regarding imported goods held before release (Sections 97–100). This has been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Coherent Customs Procedures for Sectoral Products: The Customs Act, 1969, lacks specific requirements for sectoral products, leading to fragmented regulations in various policies and acts. Amending the Customs Act to reference relevant provisions in sectoral regulations and laws like the Import Policy Order and Export Policy will provide a more cohesive framework, promoting clarity and consistency in customs procedures and encouraging foreign investment in Bangladesh. New products have been incorporated in the newly-approved Customs Bill 2023, and the issue will be resolved as and when the new Customs Bill 2023 is implemented.

Table 26: Streamlining Customs Clearance Processes Through Automation, Increased Flexibility, and Coordination

Recommendation	Summary	Incorporated in the customs bill
Enhancing Transparency and Predictability		
Transparency in Customs Decisions	Enhance transparency by requiring written reasons for adverse decisions and notifying applicants of their rights to appeal customs decisions.	Yes
Coordinated Physical Examinations	Coordinate physical examinations with other authorities, reducing costs and time, and expediting customs clearance for imported goods.	Yes
Advance Rulings on Tariff Classification Questions	Issue advance rulings on tariff classification, aiding in valuation and duty rate decisions and promoting predictability in customs procedures.	Yes
Stakeholder Input on Proposed Customs Rules	Publish draft rules for stakeholder input, engage in regular consultations, establish "enquiry points" and disseminate rules and decisions online.	Yes
Digital Transformation for Efficient Customs Processing	Empower NBR to identify and mandate electronic submission of documents and payments, streamlining customs processes and reducing costs.	Yes
Clarity on Rghts and Obligations for Imported Goods	Clarify the rights and obligations of Customs and importers regarding goods held before release, enhancing procedural clarity and compliance.	Yes
Streamlining Processes and Expediting Customs Clearance processes		
Raising Minimum Duty and Tax Collection Threshold	Waive duty and tax collection for amounts less than Tk 2,000, grant NBR authority to raise the minimum amount through Gazette notifications.	No
Expedited Customs Decisions	Ensure NBR issues decisions promptly, notifies delays, provides written reasons for adverse decisions and publishes proposed fees for stakeholder input.	Yes

Recommendation	Summary	Incorporated in the customs bill
Bangladesh Single Window (BSW) Implementation	Prioritize the implementation of the Bangladesh Single Window (BSW) to streamline customs clearance processes and reduce time and costs.	Partly
Flexible Customs Clearance Processes	Authorize NBR to vary declaration, verification and release procedures as needed for trade and risk considerations, promoting efficiency.	Yes
	Standardization and Harmonization of Customs Rules and Procedures	
Compliance with WTO Valuation Rules	Align Customs valuation of imported and export goods with WTO rules and FOB pricing, enhancing consistency and predictability for traders.	Yes
Legal Authority for Automated Risk Management	Establish legal authority to treat automated decisions or information provisions by the Customs computer system as decisions made by customs officers.	Yes
Grounds for Annulment and Revocation of Decisions	Define grounds for annulment and revocation of decisions, with mandatory notifications to affected parties, ensuring procedural clarity.	
General rules for Customs Guarantees	Define general rules for customs guarantees applicable to all customs operations, reducing ambiguity and ensuring prompt release of guarantees.	Yes
Responsibilities and Liability of Importers, Exporters, Agents	Specify responsibilities and liability for importers, exporters, and agents for data accuracy, duty and tax payment and information provision.	Yes
Inclusion of Laboratory and Testing Provisions	Amend the Customs Act to cross-reference relevant provisions in other laws for laboratory and testing procedures, ensuring tariff classification accuracy.	Yes
Enhancement of Risk-Based Customs Clearance Management	Issue rules and operational procedures for risk management in customs clearance, aligning with international best practices and treaty obligations.	Yes
Cross-Referencing Sectoral Product Requirements	Amend the Customs Act to cross-reference relevant provisions in import and export policies and control laws to clarify sectoral product requirements.	Yes

Shifting the taxation paradigm from indirect to direct taxation is not merely a financial reform but a crucial step toward achieving a more equitable and efficient fiscal system. Indirect taxes tend to be regressive, disproportionately affecting lower-income groups. In contrast, direct taxation places a fairer burden on those with higher incomes, aligning with principles of social justice. To harness the full potential of this transition, substantial investments in digitization and automation are imperative. An integrated infrastructure, encompassing all relevant wings of the National Board of Revenue (NBR), such as VAT, Income Tax, and Customs, can streamline processes, reduce compliance costs, and enhance revenue collection efficiency.

The approval of the Customs Bill 2023 represents a significant step forward in the modernization of customs regulations in Bangladesh. It underscores the government's dedication to nurturing a favorable business environment, aligning with global standards, and ensuring the transparency and accountability of customs operations. Carefully crafted, the Customs Bill 2023 incorporates contemporary provisions related to revenue collection, the expansion of import and export trade, business facilitation, and the development of new industrial sectors. Comprising 269 sections, this new law aligns with international agreements and conventions sanctioned by the World Customs Organization (WCO), covering areas such as Electronic Declaration, Risk Management, Post Clearance Audit (PCA), Non-Intrusive Inspection (NII), and more.

Harmonizing and aligning national tax legislation with international standards, including compliance with the Revised Kyoto Convention and the WTO Trade Facilitation Agreement, holds paramount importance. These agreements not only promote global economic integration but also attract foreign investment by ensuring a predictable and transparent trade environment. Notably, the proposed bill embraces various crucial aspects of the Trade Facilitation Agreement (TFA) endorsed by the World Trade Organization (WTO). These elements include Advance Ruling, Stakeholder's Consultation, National Inquiry Point (NEP), Advance Passenger Information (API) / Passenger Name Record (PNR), among others.

It is imperative that this new Customs Bill 2023 be swiftly implemented. Doing so will empower Bangladesh to effectively tackle challenges outlined in the existing Customs Act 1969, such as the lack of transparency, predictability, and investor compliance. Furthermore, it will bring the country in alignment with international trade practices, enhancing its position in the global trade landscape. The expeditious enactment of this bill will enable the nation to promptly reap the benefits of the improved environment it promises, fostering increased foreign investments and facilitating international trade.

Strong political commitment and will are the driving forces behind these reforms and implementation of the Customs Bill 2023. Leadership that recognizes the importance of a robust and modern tax system, capable of facilitating trade, boosting investment, and fostering economic growth, is essential. It is incumbent upon the government to provide an enabling environment for such reforms, incorporating feedback from stakeholders and addressing their concerns. In the journey towards a more equitable, efficient, and investment-friendly fiscal landscape, these measures will undoubtedly pave the way for a brighter economic future for Bangladesh.

9.3 Addressing Non-Tax Factors Influencing FDI Decisions

The quality of the enabling environment for investment is pivotal for both domestic and foreign investors. Rather than narrowly defining FDI policies, creating an attractive investment landscape should be integrated into a country’s overall industrial policy, available to all investors – foreign and domestic alike. Professor Magnus Blomström from the Stockholm School of Economics emphasizes the importance of focusing incentives on activities that generate strong potential for spillovers, such as fostering linkages between foreign-owned and domestic firms, investing in education, training, and research and development (R&D).

Cumbersome border documentation and compliance procedures contribute to extended export times and elevated costs, leading to diminished competitiveness. Lengthy trade document processing times and inefficiencies in border control inflate trade-related costs, diminishing its attractiveness for investors and eroding competitiveness. By reducing the time and cost of doing business, the nation can enhance its competitiveness. Bangladesh’s ranking in the Doing Business Index, particularly in Trading Across Borders, is indicative of these challenges. Inefficiencies in documentary compliance and enforcement of contracts, alongside procedural delays in obtaining electricity, collectively culminate in its modest ranking. The path forward demands a concerted effort to ameliorate these shortcomings. Streamlining contract enforcement, reducing electricity acquisition time and simplifying trade documentation will be instrumental. Bangladesh’s position in global indices hinge on such reforms.

Creating a conducive investment climate through enhanced transparency and good governance. FDI incentives, while important, should be supplemented by broader reforms that align with fundamental investment site requirements. The OECD Development Center's report by Charles Oman underscores that investment incentives may prove counterproductive if the underlying conditions of potential investment sites do not meet the basic requirements of serious investors. Effective governance is a key factor that not only attracts FDI but also enhances the developmental impacts of such investments. Countries that excel in governance are more successful in attracting FDI. This suggests that comprehensive reforms encompassing regulatory reforms, trade liberalization and privatization are essential to create a conducive investment climate.

Raising accountability and transparency levels is crucial to mitigate the risk of illicit practices in investor attraction strategies. The developmental impacts of FDI incentive policies are highlighted by the OECD Development Center's report. It emphasizes that while investment incentives have become more prevalent due to decreasing investment barriers, competition based on incentives remains mostly regional. The report advises that governments should focus on meeting the fundamental requirements of good governance to attract serious investors, rather than relying solely on incentives. The report suggests that raising accountability and transparency levels is crucial to mitigate the risk of illicit practices in investor attraction strategies.

Poor Infrastructure and logistics: Bangladesh ranking in global indices clearly denotes improvement opportunities in logistics & infrastructure. In Bangladesh, high economic costs are accrued due to its congested transportation system and nascent logistics ecosystem, which significantly adds to the cost and time of doing business through delays during loading/ unloading and transportation of shipment between warehouse and port/border alongside traffic delays and police checks. This is well reflected in Bangladesh's position in global indices, which goes to show that Bangladesh's strong export performance over the years could have been higher, had it been able to address the logistics and infrastructure needs. While innovation at different stages of the value chain is crucial to increase productivity and remain competitive, there is a substantial need for supporting infrastructure for trade to thrive.

9.3.1. Priority Areas to Enhance Broader Investment Climate and Overall Investors' Confidence

Simplified Regulatory Environment: Streamlining and simplifying business regulations and procedures is essential to reduce the complications and promote investment. A simplified regulatory environment not only saves time and resources for investors but also demonstrates a commitment to creating a business-friendly ecosystem. Implementing a single-window system for business registration, permits, and approvals can significantly enhance the ease of doing business. This approach minimizes the need of navigating multiple government agencies and fosters a more efficient and transparent process, further attracting foreign investors.

Improvement in Investment Climate: The business environment in Bangladesh is yet to support its vision for a high-country by 2041. Despite several recent reform initiatives, Bangladesh continues to secure lower positions in Global Doing Business rankings. In 2019, Bangladesh's score in Enforcing contracts, getting electricity, and registering property remain low, followed by trading across borders, getting credit, and resolving insolvency. Modernizing archaic laws such as Companies Act, Bankruptcy Act, improving government service delivery through establishing effective One-Stop-Shop (OSS), strengthening contract enforcement through introduction of Alternate Dispute Resolution (ADR) and faster disposal of commercial cases and strengthening regulatory governance through the introduction of systematic tools such as Regulatory Impact Assessment (RIA), are some of the critical policy measures to improve the business operating environment of Bangladesh.

Enhancing Infrastructure and Logistics for Greater Efficiency and Competitiveness: Investment in robust infrastructure, encompassing transportation, energy, and telecommunications, is a strategic move that yields both short-term benefits and long-term advantages. Adequate infrastructure lowers operational costs for businesses and enhances overall productivity. It also signals the government's commitment to facilitating business operations, making the country more appealing to potential investors seeking to establish a stable operational base.

Quickly upgrade ports with better and more modern facilities and increased handling capacity to support the expected growth in trade, enabled by the best technologies available. The role of ports have evolved over time into logistic integrators[17]. It includes the provision of value-added logistics services which enables reduction in cost, time and complexity in accomplishing import and export activities[18]. Through the use of advanced technologies enabling better management of containers and efficient logistics service delivery, the competitiveness of the port can be enhanced to facilitate better trade performance. A well connected and efficient port system with enhanced logistical abilities is a key determinant of FDI into a country[19], and can serve as a catalyst for regional economic development through building up ecosystems, attracting foreign investments in productive sectors and fostering productivity and economies of scale, as opposed to disorganized development routes.

Improve the efficiency and availability of clusters for industrial development are some of the policy actions that are key to maximize Bangladesh's agglomeration benefits. Evidence suggests that the concentration of high-return economic activities around Bangladesh's growth poles – Dhaka and Chittagong leads to higher productivity in the eastern part of the country. Therefore, acquiring maximum productivity benefits from rapid urbanization requires policies to leverage on agglomeration economies while minimizing the adverse impacts of urban congestion. Cooperation with private firms to develop 'plug and play' industrial zones with R&D facilities, waste disposal and recycling facilities, investment in infrastructure to better connect and equip secondary cities and pursue decentralization, and collaboration with private sector will be key.

Property Rights and Land Acquisition: Enhancing property rights and ensuring a transparent land acquisition process is vital for attracting foreign investment. Establishing a comprehensive land registry system and offering clear land titles simplifies property transactions and minimizes the risk of legal disputes. This clarity promotes confidence among investors in securing property for their ventures.

Effective Dispute Resolution: A well-functioning legal system that ensures swift and fair dispute resolution is essential for maintaining investor confidence. A reliable mechanism for handling commercial disputes and enforcing contracts not only protects the interests of investors but also showcases the government's commitment to providing a secure environment for business operations.

Intellectual Property Protection: Enforcing strong intellectual property rights is a critical factor for attracting technology-driven industries and encouraging innovation and research. By safeguarding innovations and creations, the government can attract industries that rely on intellectual property protection, fostering an environment conducive to investment and technology transfer.

Continued Trade Facilitation Initiatives to Lower Transaction Costs and Demonstrate the Government's Dedication to Improving Business Climate: The nation's economic ties and proximity to regional players offer avenues for export growth, but these opportunities mandate the reduction of border and non-tariff barriers. Currently, cumbersome border documentation and compliance procedures contribute to extended export times and elevated costs. Facilitating cross-border trade through modern customs procedures and reduced trade barriers enhances trade relations and attracts businesses engaged in export-import activities. Efficient logistics and trade processes lower transaction costs and demonstrate the government's dedication to facilitating international business transactions.

Focus on Skill Building and Encouraging Firms to Engage in Incremental Innovation and Investing in R&D: Investing in education and skills development programs is vital for creating a skilled workforce that meets industry needs. A skilled workforce enhances productivity and encourages businesses to invest in the country, knowing that they will have access to qualified and capable human resources. Incentivizing firms to engage in incremental innovation, focusing on enhancing inputs that are complementary to R&D investments such as technology, skills and finance, articulate a comprehensive vision for skills development, reskilling the current labor force through greater access to non-formal training and skills-building, and improving the quality of foundational education through increased private sector participation and industry-academia partnership are some of the key policies that will enhance skills and capacity of the future work-force and firm capability in the country.

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[17] UNCTAD study

[18] "Logistics performance refers to cost, time, and complexity in accomplishing import and export activities"-Hausman WH, Lee HL, Subramanian U (2013) The impact of logistics performance on trade. Prod Oper Manag 22(2): 236–252

[19] Panayides PM, Parola F, Lam JSL (2015) The effect of institutional factors on public–private partnership success in ports. Transp Res A Policy Pract 71:110–127

Enhancing Transparency and Accountability Through Digitalization and E-Governance: Promoting transparency and accountability within public administration and governance is essential for building investor trust. Transparent, dynamic and easy to navigate systems resonates positively with both domestic and foreign investors. Embracing digital technologies and e-governance solutions can significantly improve the efficiency of government services. Automation enhances transparency, and provides a seamless experience for businesses and investors engaging with regulatory processes.

Better access to Finance: Developing a robust financial sector with accessible and affordable financing options is pivotal for businesses, especially small and medium-sized enterprises (SMEs). By promoting microfinance, venture capital, and ensuring a smooth credit flow, Bangladesh can enable businesses to access the capital required for growth and expansion, thus attracting investment across various sectors.

Alternate Credit Assessment and Digital Credit: Traditionally, large banks have controlled capital investments in Bangladesh. Most financial institutions have been reluctant to lend beyond large corporates. One prevalent reason is complexities associated with assessing the creditworthiness of SMEs. To address this issue Bangladesh can consider introduction of digital methods of credit assessment and disbursement of loans. Many countries have successfully used mobile applications that help make use of available data points for innovative credit scoring mechanisms, enabling them to assess creditability within minutes. As Bangladesh gradually moves deeper into the realm of Digital Banking, successful cases in Philippines, Kenya, and Tanzania might be worth exploring.

Concessional Financing for Small Businesses: Supporting SMEs through soft loans/working capital loan can help them navigate the current business environment better. Banks and financial institutions may sanction up to BDT 25 lacs to women entrepreneurs against personal guarantee. Entrepreneurs' credit limit may be ranged from BDT 50,000 to BDT 50 lacs. However, current stimulus packages that are applicable through banks depend on existing relationships with SMEs, which many of the smaller players will lack.

Environmental Sustainability: Integrating environmental sustainability into business practices is increasingly important for attracting responsible investors. Implementing green policies and encouraging eco-friendly technologies not only align with global trends but also appeal to investors who prioritize sustainability and corporate social responsibility. Ensuring and providing ETPs in the Economic Zones and provide necessary incentives for private sector to come forward and play leading role in climate mitigation and adaptation initiatives will be important here.

Public-Private Partnerships: Fostering collaborations between the public and private sectors through public-private partnerships (PPPs) can leverage expertise and resources for infrastructure development and service delivery. These partnerships not only enhance the quality of public services but also signal the government's commitment to fostering a collaborative environment that benefits both domestic and foreign investors.

Labor Market Reforms and Maintaining Stability: A flexible labor market is a key consideration for foreign investors. Enacting balanced labor laws that safeguard the rights of workers while accommodating the needs of businesses is crucial. Clear and fair labor regulations provide stability and predictability for both employers and employees, creating an environment that nurtures investor confidence. Ensuring social stability and security is essential for creating a conducive environment for businesses to operate without disruptions. A stable social and political climate reduces uncertainty for investors and contributes to a sense of security in their investments.

Table 27: Priority Areas to Enhance Broader Investment Climate and Overall Investors' Confidence

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Business Regulations	Modernizing archaic laws such as the Companies Act 1994, Competition Act 2012, Intellectual Property Rights (IPR) framework, and Import and Exports Control Act 1950.	Ministry of Law, Justice and Parliamentary Affairs, Ministry of Finance, Ministry of Commerce	Medium-Term
	Utilization of new generation promotion mechanisms by Investment Promotion Agencies.	PMO, BIDA, BEZA, BHTPA, PPA, and BEPZA	Short-Term
	Develop Standard Operating Procedures (SOPs) to reduce the regulatory burden and bring predictability in regulatory service delivery.	BIDA, BEZA, BHTPA, PPPA and BEPZA	Short-Term
	Introduction of systemic methods such as Regulatory Impact Assessment (RIA) and Feedback Loop to improve regulatory service delivery.	Ministry of Law, Cabinet Division, BIDA	Medium-Term
	Establishing an online portal containing all information relevant to regulatory delivery.	BIDA, BEZA, BHTPA, PPPA and BEPZA	Short-Term
	Revitalizing certain laws such as The Company's Act; Review sectoral licensing regulations for priority export and domestic sectors.	Ministry of Law, Justice and Parliamentary Affairs, Ministry of Finance, Ministry of Commerce	Short-Term
	Introducing a system that accommodates innovative business activities and start-ups.	BIDA, ICT Division, Startup Bangladesh Ltd.	Short-Term
	Introduce and publish a regulatory calendar at the beginning of a fiscal year indicating all upcoming laws for the year.	Ministry of Law, BIDA	Short-Term

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Access to Land	Increasing transparency of the Land Offices and Sub-Registry Offices service by making information on service standards publicly available.	Ministry of Land, RAJUK	Medium-Term
	Computerizing/digitizing all land records and property title registration.		
Infrastructure and Logistics	Strengthen institutional and implementation capacities with regards to PPPs: Review PPP Law and relevant regulations for more effective implementation.	PPPA	Medium-Term
	Financing infrastructure projects by sovereign bond issuance.	Bangladesh Bank, PMO, Ministry of Finance, Securities and Exchange Commission	Medium-Term
	Developing domestic capital markets and issuance of local currency bonds offshore.	Bangladesh Bank, PMO, Ministry of Finance, Securities and Exchange Commission	Medium-Term
	Selection of Economic Zones should be based on careful feasibility studies and competitive analysis.	BEZA, PMO	Medium-Term
	Develop National Logistics Policy and Masterplan; Allow more ICDs and streamline bonded requirements for various modes of logistics transportation including air shipments; Expedite development of Bay Container Terminal.	PMO, Ministry of Shipping, Ministry of Commerce, NBR, Ministry of Civil Aviation, Railways	Medium-Term
Skills and Productivity	The skills eco-system requires several policy and strategic initiatives which are as follows:	NSDA, Ministry of Education, Industry Skills Council	Long-Term
	Developing Long-term Skills Strategy/Master plan/Program Aligning with National Growth Strategies and Projected Key Growth Drivers.		
	Public Private Partnership in delivery of skills. This is critical in high skills matching and high employment outcomes.		
	Greater business orientation of Private Training Providers.		

Investment Climate Area	Recommendations	Leading Institutions	Time Required
Commercial Dispute resolution	Enforce the mandatory mediation provisions through adoption of the administering rules to support the implementation and create of the necessary infrastructure to operationalize mediation.	High Court Division of the Supreme Court of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs	Short-Term
	Establishing time limits for certain stages of court cases and monitoring compliance.	High Court Division of the Supreme Court of Bangladesh, Ministry of Law, Justice and Parliamentary Affairs	Medium-Term
	Amend the Bangladesh Arbitration Act 2001 to improve implementation.	Ministry of Law, Justice and Parliamentary Affairs	
Trade Facilitation	Adopting certain policy measures such as reducing para-tariffs can support in inducing more trade and thus increasing private investment and FDI.	NBR, PMO	Medium-Term
Technology Diffusion	Reducing the cost of internet connection.	ICT Ministry, NBR	Short-Term
	Gradually build up Bangladesh's technology extension system to support upgrading in more advanced firms and sectors.	PMO, ICT Ministry	Medium-Term
Access to Finance	Implementing a modern resolution framework for distressed assets.	Bangladesh Bank	Short-Term
	Developing local capital markets as a source of long-term finance.	Bangladesh Bank, Bangladesh Securities and Exchange Commission	Medium-Term
	Stimulate the corporate debt market by correct reforms.		
	Develop a domestic green bond market to mobilize private capital for climate-related initiatives.		

Incorporating these priority areas into a comprehensive strategy will significantly improve Bangladesh's investment climate, making it more attractive to both domestic and foreign investors. By addressing these aspects, Bangladesh can position itself as a desirable destination for investment, fostering sustainable economic growth and development.

CHAPTER 10

CONCLUSION

CHAPTER 10

DRIVING REVENUE GENERATION AND ACHIEVING VISION 2041: THE CRUCIAL ROLE OF FDI AND TAXATION REFORM IN BANGLADESH

Bangladesh is at a critical juncture in its development journey as it aspires to achieve Vision 2041 - a strategic plan that envisions the nation as a prosperous, inclusive, and sustainable high-income country. To realize this ambitious vision, Bangladesh must harness the power of FDI as a vital driver of economic growth, innovation, and job creation. As the nation aspires to become a global hub for innovation and progress, FDI injects not only substantial financial resources but also brings forth a wealth of expertise, technology, and international market access. By facilitating knowledge transfer and technology diffusion, FDI aligns with the vision's emphasis on innovation-driven growth. Furthermore, FDI has the capacity to enhance human capital development through the creation of employment opportunities and by fostering skill acquisition. The global nature of FDI introduces diverse business practices, management methods, and cultural exchange, which could play a pivotal role in catalyzing sustainable economic growth.

Foreign Direct Investment plays a pivotal role in Bangladesh's quest for robust revenue generation. As the nation seeks to diversify its revenue streams and reduce dependence on traditional sources, FDI can provide a significant boost. The tax revenue derived from FDI is particularly valuable due to its sustainability. Unlike many forms of government revenue that fluctuate with economic cycles, tax revenue from FDI remains relatively stable, ensuring a consistent flow of funds to support various public initiatives. Moreover, FDI often results in the establishment of new businesses, expansion of existing ones, and the introduction of innovative technologies and practices. These factors contribute to economic growth and job creation, increasing the overall tax base and reducing the burden on individual taxpayers. A thriving FDI sector also leads to higher exports, which, in turn, can augment revenue through trade taxes and duties.

Taxation is a fundamental consideration for investors when deciding where to deploy their capital. A well-structured, predictable, and transparent tax system can significantly enhance a country's attractiveness for FDI. Conversely, a complex, unpredictable, and inefficient tax environment can deter potential investors. In developed countries, tax systems are well-established and reliable. Investors can predict their tax liabilities with a high degree of certainty, enabling them to make informed decisions about their investments. In contrast, developing economies like Bangladesh have often struggled with tax systems characterized by ambiguities, frequent changes, and bureaucratic inefficiencies. These challenges introduce unpredictability and risk into the investment equation, undermining the nation's ability to attract and retain foreign investors.

Bangladesh can learn valuable lessons from countries that have successfully attracted FDI through tax reform and the creation of an investor-friendly tax environment. Several nations have implemented strategies to streamline their tax systems, boost investor confidence, and drive economic growth. For instance, Singapore's straightforward tax regime, with low corporate tax rates and extensive tax treaties, has positioned it as a global hub for foreign investments. Similarly, Ireland's competitive corporate tax rate and proactive approach to promoting FDI have attracted numerous multinational corporations. These examples highlight the crucial role that tax policies play in shaping FDI decisions.

Bangladesh is well aware of the importance of FDI in achieving Vision 2041. The nation has taken significant steps to improve its business climate and promote investment. However, substantial tax reform is still required to create a predictable and investor-friendly tax environment. The current VAT system in Bangladesh is complex, characterized by multiple rates and frequent changes. Streamlining the VAT structure, reducing the number of rates, and simplifying compliance procedures are essential steps to enhance the tax system's transparency and predictability. The Income Tax Act of 2023 is in need of amendment to align it with international best practices and create a more predictable income tax regime. This includes simplifying tax provisions, reducing compliance burdens, and addressing ambiguities.

To expedite customs clearance and reduce the time and cost of trade, Bangladesh must prioritize customs modernization. This includes improving coordination among border authorities, simplifying Customs clearance procedures, and adopting electronic systems for document submission and communication. To attract global investors, Bangladesh must ensure that its tax laws and customs procedures comply with international standards, including the Revised Kyoto Convention (RKC) and the WTO Trade Facilitation Agreement. These agreements promote efficient customs processes, transparency and predictability. Beyond reforming tax laws, Bangladesh must create an enabling environment for investment. This involves enhancing infrastructure, strengthening the rule of law, and enhancing human capital. A strong commitment from policymakers is essential to driving these reforms forward.

Bangladesh's journey towards Vision 2041 hinges on its ability to attract and retain foreign investment. FDI is not only a source of economic growth but also a significant contributor to tax revenue. To harness the full potential of FDI, Bangladesh must prioritize tax reform, modernize its tax and Customs systems, and create an investor-friendly environment. Global best practices, as demonstrated by countries like Singapore and Ireland, emphasize the importance of a transparent and predictable tax environment in attracting foreign investments. The nation's commitment to tax reform, coupled with a focus on broader reforms for improving investment climate, will be pivotal in shaping its future as a thriving hub for foreign investment. Through these measures, Bangladesh can secure its position as a prosperous and sustainable high-income country, realizing the aspirations of Vision 2041.

Annexure

A. Critical Review of Tax Laws/Policies: Concreate Improvement Opportunities

Corporate Tax				
Modification and withdrawal of certain provisions to reduce the high effective tax rate				
Section		Problem areas/Gaps	How it affects FDI	Possible amendments/ improvements
ITO 1984	ITA 2023			
30(p)	55 (NG)	**Inadmissible Expense** The maximum limit of allowable expenditure under the Promotional Expenses sector is 0.50% of the turnover of the business.	Sales in every market can be attributed in large part to promotional spending. It is completely irrational to set the ceiling of permitted cost in such a sector similarly for all industrial enterprises, as it has become necessary for all industries to spend on promotional expenditures to speed up the recovery of the running economy. Moreover, there is no global precedent for such regulations to consider unreasonably unallowable expenditure. As a result, the effective tax rate of the company also increases and the companies cannot enjoy the benefit of the reduction in the corporate tax rate. It creates adverse obstacles for industrial enterprises to expand their business; Which creates barriers to domestic and foreign investment. Therefore, it is proposed to fix the maximum limit of allowable expenditure on promotional expenditure on an industry basis.	By repealing Section 55 (NG) imposition of industry-based limits on the ceiling of allowable expenditure in the Promotional Expenses sector

Section		Problem areas/Gaps	How it affects FDI	Possible amendments/ improvements
ITO 1984	ITA 2023			
30(h)	55 (NG)	**Inadmissible Expense** The permissible limit of royalty, technical service fee, technical know-how fee or technical assistance fee, or any other expenditure of similar nature is 10% of the net profit of the business or profession excluding income or profit from the subsidiary, associate, or joint venture as shown in the financial statements.	Setting a permissible limit on existing charges is against the guidelines of the Organization for Economic Co-operation and Development (OECD) Transfer Price (TP) Act. In all countries where this law exists, there is no such permissible spending limit. • Expenses related to the use of patents and technical support are essential real business expenses for surviving in the global marketplace and developing the Bangladeshi economy. • This is against the Foreign Exchange Act (FOREX) and Bangladesh Investment Development Authority (BIDA) guidelines, where 6% of the total sales are already allowed.	• Royalty, Technical Service Fee, Technical Knowledge Fee, Technical Assistance Fee or expenses of similar nature shall be treated as fully admissible expenditures taking into account the actual business expenses • The allowable limit shall be 6% of the turnover shown in the financial statements in line with FOREX & BIDA
30(e) & 2(45)	55 (gha) & 2(55)	**Inadmissible Expenses** As per Section 55(gha) of the ITA 2023, the permissible limit for sanction of additional perquisites is BDT 10 lakh. By amending Section 2(55) of the ITA 2023, leave encashment allowance, house rent allowance, and commuting allowance are treated as additional perquisites.	Benefits under the employment contract include leave retirement allowance, house rent allowance, commuting allowance, etc. Benefits received under the employment contract should not be considered as perquisites. The perquisites paid to the employee by the employer are included in the employee's personal income and are considered to be the individual employee's taxable income. As the allowance paid to the employee is not considered as an authorized expenditure of the company, the company's tax increases, which is against the prevailing tax policy. Because these allowances are legitimate expenses for business purposes and these expenses are fully allowable. Therefore, both employer and employee should not be taxed twice on the same expenditure (25% on the employee + 30%-45% on the employer). There is no such double taxation in neighboring countries.	Replace/amend section 55(gh) of the Income Tax Act, 2023 as follows: • From the definition of perquisites, the benefits provided to employees in accordance with the employment contract to be excluded • Definition of perquisites to be provided excluding the leave encashment, house rent allowance, and conveyance allowance

Section		Problem areas/Gaps	How it affects FDI	Possible amendments/ improvements
ITO 1984	ITA 2023			
30B	56	**Inadmissible Expenses** Under section 56 of the ITA 2023, "Notwithstanding anything contained in section 163, no matter what the profit or loss in the business or profession is calculated, the expenses disregarded under section 55 of the ITA 2023 are treated separately as income of the business or profession and are taxed at the regular rate.	The business income is to be computed under section 45 including considering section 56 ITA 2023. According to Section 56, the business income is calculated by taking into account any kind of disregarded expenses, and the tax liability is determined accordingly. The tax paid separately under section 56 on such disregarded expenditure under section 55 creates an additional tax liability for the taxpayer, which is a violation of fairness and not justifiable. This increases the cost of conducting business in Bangladesh. On the other hand, despite the loss of business, the taxpayer has to pay the minimum tax under Section 163. Moreover, the specified clauses are treated as tax deducted/collected and minimum tax, which the company cannot carry forward and claim back.	We strongly propose to repeal Section 56.
82C	163	**Minimum Tax** The minimum tax liability of a taxpayer under Section 163(4) of the ITA 2023, irrespective of the actual profit or loss, is payable at the rate of 0.60% to 5.00% on the total receipts or tax collected/deducted at source under Section 163 (2 (b)).	The imposition of minimum tax is against the spirit of the Income Tax Act, as income tax is paid on income and not on total receipts. If the minimum tax is paid despite the loss of the business, it is a reversal of the payment from equity or capital, which weakens the financial or capital management of the business.	We, therefore, request that: • The provision of minimum tax to be repealed and tax is imposed on real income to ensure rationality • Gradual removal of TDS from the provision of minimum tax • Implementation of rational TDS rates by identifying income and expenditure using DVS (Document Verification Systems) developed by ICAB.

Section		Problem areas/Gaps	How it affects FDI	Possible amendments/ improvements
ITO 1984	ITA 2023			
3rd Schedule	3rd Schedule	**Inadmissible Expense** a) At present, the maximum limit of depreciation on motor vehicles is allowed up to BDT 30 lakh b) The current depreciation rate of office equipment is 10%	The depreciation of the taka against the US dollar has led to a significant increase in the price of motor vehicles. Even a medium-sized Toyota car cannot be bought for BDT 30 lakh. Therefore, it is proposed to increase its depreciation limit. The depreciation rate should be reconsidered considering the nature of the property.	**We propose the following:** (a) Increase the ceiling of applicable depreciation value to BDT 40 lakh and b) The current depreciation value of office equipment should be increased by 10%.
42(6)	71	**Minimum Tax** ".....the allowance or part of the allowance to which effect has not been given, as the case May be, shall be added to the amount of the allowance for depreciation for the following year and be deemed to be part of that allowance or if there is no such allowance for that year, be deemed to be the allowance for that year and so on for succeeding years.''	Under the minimum tax of the law, where the company pays the minimum tax on the total income, it is prescribed for the company to fully implement the depreciation allowance in the context in which the business income is calculated. As a result, the benefit of depreciation allowance is not available in cases where the minimum tax on total income is higher than the regular tax payable on business income. There is a rule for the company to use unnecessary depreciation allowance, although there is no benefit from such depreciation allowance.	**We are proposing the following changes:** Minimum tax on total income for the purpose of efficiency where the amount of depreciation allowance is equal to the business income. The excess amount will be considered in the next year and the depreciation allowance can be kept in reserve in the following year.
		Rationalize tax deduction at the source		
56	119	Section 119(1) provides that the rate of tax deduction at source on non-resident income is 30% in most cases.	In a review of Section 119 of the present ITA 2023, the rate of tax deduction at source on the income of non-residents appears to be high. A non-resident cannot get a tax exemption in his home country. Taxpayers who operate in a regulated manner are bearing the burden of this tax on their own, thereby increasing their business costs and falling behind the competition. On the other hand, those who run irregularly are evading the said tax by resorting to various malpractices. At present, we have to rely on companies outside our country to take most of the technical services to conduct business in the country. Therefore, double tax benefits should be provided on payment of technical service fees for the proper conduct of business and expansion of business outside the country.	It is recommended to rationalize the rate of tax deduction at source applicable on the income of non-residents to 5%-10% instead of 20%-30%. Moreover, no tax benefit is provided for the payment of technical service fees under the existing double tax rate agreement. We therefore strongly urge the inclusion of a new paragraph providing tax benefits for the payment of technical service fees in the Double Taxation Agreement.

Section		Problem areas/Gaps	How it affects FDI	Possible amendments/ improvements
ITO 1984	ITA 2023			
52D	105	At present, there is a provision of a 10% tax deduction at source on the interest income earned from the money invested in the savings account of a recognized provident fund, workers' participation fund. TINs are sought from accredited funds.	The provision for deduction of tax at source on the interest income earned from the funds invested in them is wholly illegal as the entire income of the funds quoted has already been exempted as per Para-4 (1) and (2) of Part I of the Sixth Schedule to the Income-Tax Act 2023.	Withdraw the provision of deduction of tax at source from the interest on savings notes purchased by the fund and issue a directive that TIN is not applicable from the recognized funds.
53F	102	Section 102 5% tax deduction at source on interest income of the provident fund, gratuity fund, authorized superannuation fund, or pension fund has been made applicable and it has been brought under the minimum tax provisions of 163 of the ITA 2023.	Tax at source under the Minimum Tax Regime (163 of the ITA 2023) is the amount of tax levied against the Fund when the entire income of such Fund has already been exempted under Part A of the Sixth Schedule to the Ordinance.	The provision of 5% tax deduction on retirement funds like Provident Fund, Gratuity Fund, Workers' Profits Participation Fund and Superannuation Fund should be withdrawn.
52Q	124	There is no direction as to whether the sale proceeds of exempted power plant machinery shall be exempt from tax deduction under Section 124.	After the expiry of the power project, the barge machinery is being sold for re-export outside Bangladesh. Since the power plants are exempted from tax, and the machinery is exported out of Bangladesh, clarification is required if the exemption under Section 124 is applicable. For the sake of the country's revenue, clarification is needed considering the size of the power plants and the price of their equipment.	We propose that the sale proceeds received from the power plant be exempted or clarified subject to tax under section 124.

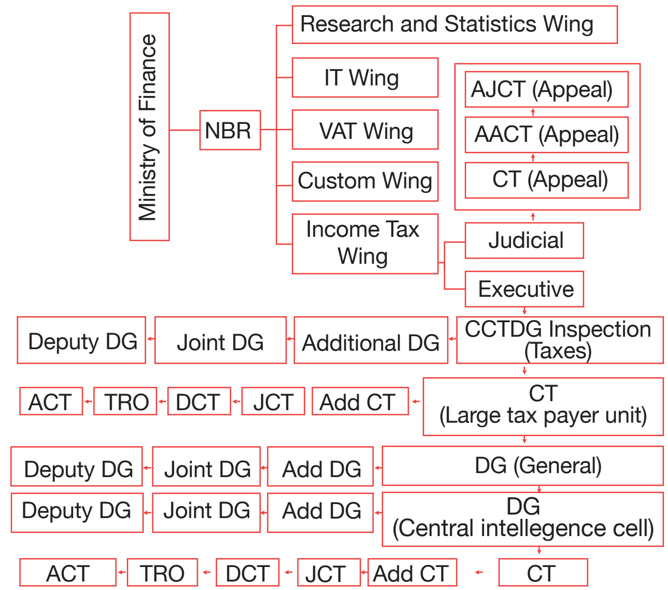
Section		Problem areas/Gaps	How it affects FDI	Possible amendments/ improvements
ITO 1984	ITA 2023			
6th Schedule	6th Schedule	At present, there is a provision for tax exemption on the income mentioned in the Sixth Schedule of the Income Tax Act, but due to the absence of the provision of tax exemption certificate in all the provisions of tax deduction at source, the provision of tax deduction at source remains in force on the tax-exempt person, which creates complications at the field level.	The provision of tax exemption certificate is completely unreasonable as the income mentioned in the Sixth Schedule of the Income Tax Act, 2023 is already exempt from tax.	If there is a provision of tax exemption on the income mentioned in the sixth schedule of the Income Tax Ordinance, then the Income Tax Act, 2023 exemption certificate in the provision of tax deduction at source will be canceled.

VAT and SD Act 2012			
The authorities should address the following provision of the VAT and SD Act 2012 which will help to attract more FDI in the country:			
Section	Existing provision	Proposal/suggestions	Justification
2(18ka)	Section 2(18ka)[20] excludes certain goods and services from the definition of input or production materials. For example: a) Labour, land, buildings, office equipment and fixtures, buildings or structures or construction, improvement, modernization, replacement, extension, reconstruction and repair b) Purchase or repair of all types of furniture, office supplies, stationery, refrigerators and freezers, air conditioners, fans, lighting equipment, generators c) Interior design, architectural planning, and design; d) Renting and leasing of vehicles e) Travel, entertainment, employee welfare, development work, and related products or services and f) The premises of business establishments, offices, showrooms or similar areas, by whatever name called, rent etc. have been kept out of the purview of input material	Clause (18Ka) of Section 2 is proposed to be repealed as inconsistent with the basic features of the Act.	Section 2(18ka) of the VAT and SD Act, 2012, through the Finance Act, 2020, defines the scope of the input materials for imposing restrictions on availing tax exemptions that are not in conformity with international law. This clause contradicts the basic features of the Act, resulting in the imposition of VAT on VAT. As a result, the actual/effective rate of VAT on consumers is higher than the standard rate of 15%, which is against the VAT Act. The more simplified and liberalized the tax system is, the more new taxpayers will be created. This will help in achieving the government's target.

Section	Existing provision	Proposal/suggestions	Justification
31(2)	At present advance VAT (AT) is levied at the rate of 3 (three)% on input of materials for production and other cases 5 (five)% on the taxable base value of taxable imports in all cases irrespective of the product.	• Withdrawal of all advance tax on raw materials and spare parts. • In all other cases, the advance rate shall be 3 (three)%.	The currently applicable advance tax of 3 (three)% or, 5 (five)% is realistically very high and unreasonable. In this case, 20% or 33% value addition has been considered on all imported goods. In fact, in many cases, value addition at the rate of 20% or 33% is not feasible. Hence advance tax rate rationalization is inevitable which will reduce the amount of refund to a large extent.
46(2) (gha)	Input VAT rebate on transportation charges Section-46(2)(gha): "That achievement is more than 80% of the cost of goods transportation services."	Remove sub-section (2)(gha) of section 46.	The cost of goods transported is one of the components of the supply of goods or services. Which is essential for economic activities and is an integral part of expenditure. Therefore, the VAT paid on services related to the transportation of goods should be fully deductible.
32(5) Rule-5 Form- 4.3	**Section 32** subsection 5: The registered and listed person shall submit the input-output co-efficient to the concerned officer in a prescribed manner. Rule 21: Declaration of co-production of materials: For sub-section (5) of section 32, before the manufacture and supply of goods to any registered or enlisted person, an input-output co-efficient shall be furnished to the Divisional Officer in Form VAT- 4.3, a copy of which shall be forwarded by the Divisional Officer to the Commissioner concerned within seven working days.	(1) subsection (5) of section 32 shall be repealed (2) The rule 21 (VAT & SD Rulle (2016) shall be repealed (3) Form VAT- 4.3 be abolished	Currently, the applicable Input-output co-efficient is the other name of the value declaration. Taxpayers will be obliged to provide input-output co-efficient of raw material consumption and finished products whenever the authorities want for audit. Which is mentioned in sub-section (2Ng) of section 107. Further sub-section (5), “Section 32 - Determination of value of taxable supplies” is inconsistent with and contrary to the basic concept of Value Added Tax and Supplementary Duties Act, 2012. Therefore, considering the complexity of the business-friendly law and taxpayers, it is reasonable to abolish this unreasonable provision.

[20] As mentioned in the Vat & SD Act (2012), Official Bangla Version (Updated in Finance Act 2020)

B. Evaluation of Institutional Support for FDI-related Tax Matters



Bangladesh has a number of institutions that provide support for FDI-related tax matters. These institutions include:

1. **National Board of Revenue (NBR):**
   The NBR is the central tax administration authority in Bangladesh. It formulates tax policies, enforces tax laws and collects taxes, including those related to FDI. The NBR plays a key role in providing guidance, conducting tax assessments, and addressing tax-related issues for foreign investors. It has made efforts to enhance taxpayer services, modernize tax administration and improve compliance through digitalization and automation.

2. **Bangladesh Bank (BB):**
   The Bangladesh Bank is the central bank of Bangladesh and regulates foreign exchange transactions, including those related to FDI. It sets foreign exchange policies, manages foreign currency reserves and monitors capital flows. The BB works in collaboration with the NBR to facilitate FDI-related tax matters and ensure compliance with foreign exchange regulations.

3. **Bangladesh Investment Development Authority (BIDA):**
   BIDA is the primary investment promotion agency in Bangladesh. It serves as a one-stop service for investors, providing information, assistance and coordination in various investment-related matters, including tax issues. BIDA plays a crucial role in attracting FDI, promoting ease of doing business and facilitating investment approvals and clearances.

4. **Bangladesh Economic Zones Authority (BEZA):**
   BEZA focuses on developing and managing economic zones in Bangladesh to attract investments, create employment and promote industrial growth. It offers a range of incentives to investors, including tax exemptions, reduced tax rates and customs duty benefits within economic zones. BEZA collaborates with other relevant authorities, including the NBR, to facilitate tax-related matters for investors operating within economic zones.

5. **Bangladesh Export Processing Zones Authority (BEPZA):**
   BEPZA is responsible for promoting and managing export processing zones in Bangladesh. It aims to attract export-oriented industries and foreign investments. BEPZA offers various incentives, including tax exemptions, duty-free import of raw materials and machinery and simplified customs procedures to investors operating within export processing zones. BEPZA works closely with the NBR to facilitate tax-related matters for investors in export processing zones.

6. **Bangladesh Hi-Tech Park Authority (BHTPA):**
   BHTPA focuses on developing and managing hi-tech parks in Bangladesh. It aims to attract investments in the IT and software industry. BHTPA offers incentives, including tax exemptions, reduced tax rates and other benefits to promote investment in hi-tech parks. It collaborates with the NBR to facilitate tax-related matters for investors in hi-tech parks. These institutions provide a range of services to foreign investors, including:

   - Information on investment opportunities
   - Land acquisition
   - Tax incentives
   - One-stop service
   - Conducive environment for businesses
   - Infrastructure facilities

The current institutional support for attracting FDI in Bangladesh faces significant challenges, such as accessibility and utilization of these benefits are hampered by complex procedures, a lack of coordination and administrative hurdles, which can discourage potential investors. Prominent among them is the lack of coordination among the various authorities involved. While Bangladesh offers tax incentives and exemptions to incentivize investment, the fragmented approach to tax policies and incentives results in inefficiencies and complexities that deter potential investors.

Multiple entities, including the National Board of Revenue (NBR) and various government ministries, administer these incentives independently. This lack of synchronization leads to duplication of efforts, contradictory regulations and a general lack of coherence in the incentives' implementation. Potential investors often find themselves navigating a complex web of regulations and requirements from different authorities, which hampers the ease of doing business in Bangladesh.

The process of claiming incentives and benefits in Bangladesh involves several key procedural aspects that are intricate and time-consuming. Delays, a lack of comprehensive guidelines, registration complexities and hidden costs are common challenges. Obtaining authorization from the National Board of Revenue (NBR) is a fundamental step, typically taking one month, but this timeframe can significantly extend due to documentation discrepancies. The absence of clear and comprehensive guidelines for the overall procedures and required documentation further compounds these challenges.

Furthermore, several administrative challenges are associated with tax compliance for FDIs in Bangladesh. The complexity of tax laws and regulations, often difficult to decipher, poses a significant barrier. Inconsistency in fiscal budgets, with varying tax rates and policy tools, adds unpredictability, discouraging long-term investment commitments.

Additionally, the processes for foreign investors to access facilities within various Export Processing Zones (EPZs) are often convoluted, further deterring potential investments. To enhance the efficiency of tax compliance and attract more FDI, Bangladesh should work toward simplifying tax regulations, ensuring policy consistency and streamlining processes for foreign investors, ultimately fostering a more conducive environment for investment and economic growth.

C. Various Tax Incentives and Exemptions Provided in Bangladesh

BEZA's Policies

BEZA is creating Economic Zones in promising locations to diversify industries, increase employment, output and exports and accelerate economic growth. BEZA has received approval to develop 97 economic zones nationwide, 68 governments, and 29 privates. BEZA would provide multiple incentives, to the developers of the Economic Zones as well as to the manufacturing unit investors. Some of them are given below:

Tax holiday: Income tax exemption of varying degrees for 12 years including 100% exemption for 1st 10 Years.

Period	Rate of Exemption
1st 10 years	100%
11th year	70%
12th Year	30%

Source: SRO No 227-Law/Income Tax/2015 Date: 8 July 2015 of Internal Resources Division

Tax exemption on dividends, capital gain and royalties:

The exemption on income tax has been given on dividends, capital gains, royalties and technical know-how for up to 10 years.

Areas	Period	Rate of Exemption
Income tax exemption on dividend	1st 10 years	100%
Income tax exemption on capital gains from transfer of shares	1st 10 years	100%
Income tax exemption on royalties, technical know-how, and technical assistance fees etc.	1st 10 years	100%

Source: SRO No 299/Law/Income Tax/2105 Date: 8 Oct 2015 of Internal Resources Division

Duty-free import of machinery and construction material:

Area	Rate of Exemption
Duty-free import of capital machinery and construction material (except for MS Rod/Bar, Cement, Pre-fabricated Building, Iron/Steel Sheet)	100%

Source: SRO No 209- Law/2015/46/Customs Date:1 July, 2015 of Internal Resources Division,
and SRO No. 121- Law/2020/72/Customs Date:11 June, 2020 of Internal Resources Division

Double Taxation Avoidance Agreements:

Bangladesh has entered into Double Taxation Agreements (DTAs) with 40 countries (Finance Act, 2022). These agreements are designed to prevent double taxation of income earned by residents of one country who are also taxed on that income in the other country.

The DTAs with Bangladesh typically provide for different types of relief from Double Taxation (Section-144, ITO-1984). The specific provisions of the DTAs with Bangladesh vary from country to country. It is important to consult with a tax advisor to determine which DTA applies to your situation and to understand the specific provisions of that agreement.

Exemption on different taxes and duties:

The exemption on different taxes and duties has been allowed to increase and development of FDI up to 100%:

Area	Rate of Exemption	Source
Exemption of Customs Duty, Regulatory Duty, VAT, Supplementary Duty for import of vehicles (up to 2000 cc, one sedan car and one microbus/pick up van/double cabin pick up)	100%	SRO No. 210- Law/2015/47/Customs Date: 1 July, 2015 of Internal Resources Division Amendment: SRO No. 312- Law/2015/57/Customs Date: 28 Oct, 2015 of Internal Resources Division
Duty exemption on export	100%	1st Schedule of The Customs Act,1969
Exemption from VAT on Utility services related to the production of goods	100%	SRO No. 190-Law/2019/47-VAT Date: 13 June, 2019 of Internal Resources division
Land development tax exemption	100%	SRO No. 05-Law/2016 Date: 11 Jan, 2016 of Ministry of Land
Exemption of stamp duty on lease registration	50%	SRO No. 06-Law/2016 Date: 12 Jan, 2016 of Internal Resources division
Exemption from tax sub, tax rate, toll fees etc imposed under section 65 of Local Government (Union Parishad) Act, 2009	100%	SRO No. 333-Law/2015 Date: 12 Nov, 2015 of Local Government Division
Exemption from tax on transferring immovable property imposed under section 44 of Upazilla Parishad Act, 1998	100%	SRO No. 328-Law/2018 Date: 11 Nov, 2018 of Local Government Division

BEPZA's Policies:

If a firm is operating within a BEPZA area as a foreign investor, here are some key points regarding tax compliance obligations:

Fiscal Incentives: 10 years tax holiday for the Industries to be established before 1st January 2012 and duration and rate of tax exemption for Mongla, Ishwardi & Uttara EPZ for the industries set up after January 01, 2012:

Duration of Tax Exemption	Duration of Tax Exemption
First 3 years (1st, 2nd and 3rd year)	100%
Next 3 years (4th, 5th and 6th year)	50%
Next 1 year (7th year)	25%

Duration and rate of Tax exemption for Chittagong, Dhaka, Comilla, Adamjee, & Karnaphuli EPZ for the industries set up after January 1, 2012:

Duration of Tax Exemption	Duration of Tax Exemption
First 2 years (1st and 2nd year)	100%
Next 2 years (3rd and 4th year)	50%
Next 1 year (5th year)	25%

- Duty-free import of construction materials
- Duty-free import of machinery, office equipment & spare parts etc.
- Duty-free import and export of raw materials and finished goods
- Relief from double taxation
- Exemption from dividend tax
- GSP facility available
- Accelerated depreciation on machinery or plant allowed
- Remittance of royalty, technical and consultancy fees allowed
- Duty & quota free access to EU, Canada, Norway, Australia etc.

Non – Fiscal Incentives:

- 100% foreign ownership permissible
- Enjoy MFN (most favored nation) status
- No ceiling on foreign and local investment
- Full repatriation of capital & dividend
- Foreign Currency loan from abroad under direct automatic route
- Non-resident Foreign Currency Deposit (NFCD) Accounts permitted
- Operation of FC account by 'B' and 'C' type Industries allowed

BHTPA's Policy

The Government is providing repatriation facilities to foreign investors and remittance facilities to the expatriates, who are located at Hi-Tech Parks in the following manner:

Incentives & Beneficiaries	Details	Ref.
Repatriation of Capital & Dividend	100%	FE Circular No.21 Dated:11.5.2017
No Ceiling of FDI	100%	FE Circular No (general)/Industrial Policy
100% Backward Linkages of raw materials to sell for E0I	Extent-100%	FE Circular No.21 Dated:11.5.2017
Foreign Loan	100%	FE Circular (general)/FE Circular No. 21 Dated:11.5.2017
Remittance of Salary by expatriates	Up to 80% of their current savings of net income	FE Circular No.33 Dated:27.12.2021
Remittance of leave salary, actual savings and pension benefits	100 (hundred)% without prior permission of Bangladesh Bank	FE Circular No- 32 Dated: 31.8.2014
Repatriation of Sale proceeds of non-resident owned equity	100%	
Repatriation of Royalty, Technical fees	6 (six)% of Import value of Machinery or, 6 (six) % of the previous year's sales as declared in the income tax returns.	FE Circular No.21 Dated:11.5.2017
FC Account for non-resident	Full	FE Circular No.21 Dated.11.5.2017
FC Account for local & JV	Full	FE Circular No.21 Dated: 11.5.2017
Temporary Non-Resident Taka Account for foreign investors	Foreign Investors may open Non-Resident Taka Account (NRTA) in the name of the proposed company/enterprise of foreign investors contemplating to invest in Bangladesh without prior approval of Bangladesh Bank.	FE Circular No.21 Date: May 16, 2019
Credit/Loan Facilities	Enterprises of HTPs may obtain short/medium/long term credit facilities from abroad (including from parents, associates or shareholders), other associates in Bangladesh, other banks in Bangladesh.	FE Circular No. 21 Date: May 16, 2019

Incentives & Beneficiaries	Details	Ref.
Repatriation of dividend to non-resident Shareholders of enterprises (FDI/JV with Foreign Investors) of HTPs	Investors may remit dividends favoring non-resident shareholders of enterprises (FDI/JV with Foreign Investors) of HTPs without prior permission of Bangladesh Bank.	FE Circular No. 21 Date: May 16, 2019
Repatriation of disinvestment proceeds by non-resident shareholders	Repatriation of sales proceeds of shares held by non-resident investors of HTP enterprises listed with the stock exchange(s) may be repatriated without prior approval of Bangladesh Bank and not listed with the stock exchange(s) may be effected with the prior permission of Bangladesh Bank.	FE Circular No. 21 Date: May 16, 2019

D. Detailed Results of Regression and Consequent Hypothesis and Sensitivity Analysis

Regression Model

This section outlines the methodology employed for the Regression Analysis and provides insights into the empirical findings regarding the relationship between tax and business environment and Foreign Direct Investment (FDI) in Bangladesh. The analysis aimed to explore the impact of tax burden, business freedom and GDP on FDI inflows into Bangladesh.

Equation: The regression equation used for the analysis is as follows: FDI=−1368.81−19.37×Tax Burden+58.75×Business Freedom+0.01×GDPFDI= −1368.81−19.37×Tax Burden+58.75×Business Freedom+0.01×GDP

Variable Definitions:

- **FDI:** Foreign Direct Investment, representing the inflow of foreign capital into Bangladesh.
- **Tax Burden:** A measure of the tax environment's influence on investment, including corporate tax rates and related factors.
- **Business Freedom:** A proxy for the ease of doing business in Bangladesh, reflecting regulatory environment and business-related factors.
- **GDP:** Gross Domestic Product, an indicator of the country's economic size and potential.

Regression Findings: The empirical analysis indicates a statistically significant relationship between tax and business environment and FDI in Bangladesh. Key findings include:

- **Tax Burden Impact:** The regression analysis reveals a statistically significant and negative relationship between tax burden and FDI. Specifically, for every unit increase in tax burden, FDI decreases by approximately 19.37 units.
- **Business Freedom Impact:** Business freedom exhibits a positive relationship with FDI. For each unit increase in business freedom, FDI is estimated to increase by 58.75 units. This suggests that a more favorable business environment attracts higher FDI.
- **GDP Impact:** The analysis also demonstrates that GDP has a positive and significant impact on FDI. A one-unit increase in GDP ($1 million) is associated with an estimated increase of 0.0058 units in FDI.

Model Fit: The model's goodness of fit is measured by the Adjusted R-squared value, which stands at approximately 0.921. This indicates that the model explains a substantial portion (about 92.1%) of the variation in FDI, signifying its capability to predict FDI levels based on the included variables.

Conclusion: The results underscore the importance of enhancing the tax and business environment in Bangladesh to attract higher levels of FDI. A more favorable tax burden and business freedom contribute positively to FDI inflows, while a larger GDP also encourages foreign investment. These findings can serve as valuable insights for policymakers and stakeholders seeking to promote economic growth and investment in Bangladesh.

Sensitivity Analysis

To assess the robustness of our regression results, we conducted a sensitivity analysis. This analysis involved adjusting our model and observing how these adjustments affected the relationships between FDI and the independent variables: Tax Environment Score and Business Freedom Score.

Outlier Analysis indicated that the relationships between FDI, Tax Burden Score and Business Freedom Score were consistent and stable. To begin, we examined the dataset for potential outliers—data points that deviate significantly from the general pattern of the data. Outliers can have a substantial impact on regression results. After identifying potential outliers, we conducted the regression analysis both with and without these outliers to evaluate their influence. The results indicated that the relationships between FDI, Tax Environment Score and Business Freedom Score were consistent even when outliers were removed, reinforcing the stability of our findings.

Variable Transformation revealed the findings shows reasonable representation of the data. We also considered the possibility of nonlinear relationships between the independent variables and FDI. To test this, we applied variable transformations such as logarithmic and quadratic transformations to the data. These transformations aim to capture nonlinear patterns that may exist in the relationships. The results showed that while there might be some nonlinear elements in the relationships, they did not significantly alter the overall interpretation of the findings. The linear model remained a reasonable representation of the data.

Model Specification showed robustness of the variables across various model specifications. In our main analysis, we employed a multiple linear regression model with both Tax Environment Score and Business Freedom Score as predictors. In this sensitivity analysis, we explored alternative model specifications. We tested models that included interaction terms between the two independent variables and models that considered only one independent variable at a time. The sensitivity analysis confirmed that the core relationship between Business Freedom Score, Tax Environment and FDI remained robust across various model specifications.

Time Period Analysis revealed that the positive and statistically significant association. We recognized that economic conditions and policies might change over time. To address this, we conducted separate regression analyses for different time periods within our dataset. This allowed us to assess whether the relationships between the independent variables and FDI were consistent across time. The findings revealed that the positive and statistically significant association between Business Freedom, Tax Environment Scores and FDI held consistently across different time periods.

Sensitivity analysis provides confidence in the reliability and stability of the relationships observed in the regression model. The results of our sensitivity analysis reinforce the main findings of our regression model. The relationship between Business Freedom Score and FDI, and Tax Environment and FDI is robust and consistently positive, signifying the importance of a business-friendly and favorable tax environment in attracting foreign direct investment to Bangladesh.

E. Business sectors eligible for investment incentives and special investment incentives in Vietnam

1. Business sectors eligible for special investment incentives:

Hi-techs, information technology, ancillary industries:

- Application of high technologies on the list of high technologies given priority under the Prime Minister's decisions
- Production of products on the list of hi-tech products given priority under the Prime Minister's decisions
- Production of ancillary industry products under the Prime Minister's decisions
- Development of high technologies and high technology enterprises; venture investment in high technology development; application, research and development of high technology according to regulations of law on high technology; manufacturing of biotechnology products
- Production of software products, digital products, key information technology products, software service, information security services, information protection service according to regulations of law on information technology
- Production of renewable energy, clean energy, and waste-to-energy production
- Manufacture of composite materials, light building materials, and rare materials

Agriculture:

- Cultivation, protection and development of forests
- Farming, processing, preserving agriculture, forestry, and aquaculture products
- Production, breeding, cross-breeding plant varieties, animal breeds, and aquatic breeds
- Salt production, extraction, and refinement
- Offshore fishing combined with advanced fishing methods; fishing logistics services; construction of shipyards, and ship-building
- Rescue services at sea

Environmental protection, infrastructure construction:

- Concentrated waste collection, treatment, recycling and reuse
- Construction, operation of infrastructure of industrial parks, export-processing zones, hi-tech zones and specialized areas in economic zones
- Development of water plants, power plants, water supply and drainage system; bridges, roads, railroads, airports, seaports, river ports; airfields, train stations, and other particularly important infrastructural works decided by the Prime Minister
- Development of public transportation in urban areas
- Construction, management, and operation of rural markets

Culture, society, sports, healthcare:

- Construction of social houses, and relocation housing
- Investment in epidemic prevention facilities

- Research and development of preparation technology and biotechnology for production of new medicines
- Production of medicines ingredients and essential medicines, medicines for prevention and treatment of sexually transmitted diseases, vaccines, biological, herbal medicines, oriental medicines; medicines whose patents are about to expire or relevant proprietary medicines; application of advanced technology and biotechnology to production of medicines for humans according to international GMP standards; production of primary packages of medicines
- Investment in manufacture of methadone
- Investment in centers for high-performance sports, sports training centers for the disabled; construction of sports facilities having training and competition equipment suitable for used at international competitions; professional sports training facilities
- Investment in geriatric centers, psychiatry centers, centers for treatment of dioxin patients, centers for caring elders, the disabled, orphans and homeless children
- Investment in Social Treatment – Education – Labor centers; rehabilitation centers smoking cessation centers; HIV/AIDS treatment centers
- Investment in national museums, ethnic culture centers; traditional theatre groups; theatres, film studios, film production facilities, film development facilities; fine art – photography exhibition centers; production, repair of traditional musical instruments, maintenance of ethnic museums and art schools; facilities and trade villages for introduction and development of traditional trades

2. Business sectors eligible for investment incentives:

Science and technology, electronics, mechanics, material production, information technology:

- Production of products on the list of key mechanical products under the Prime Minister's decisions
- Investment in research and development
- Production of steel billets from iron ore, high-grade steel, alloys
- Production of coke and activated carbon
- Production of energy-saving products
- Production of petrochemical products, pharmaceutical-chemical products, technical plastic – rubber components
- Production of products with at least 30% added value (according to instructions of the Ministry of Planning and Investment)
- Production of automobiles, automobile parts, ship-building
- Production of electronic components and electronic clusters other than those eligible for special investment incentives mentioned above
- Production of farming machines, equipment, components, machines serving agriculture, forestry, aquaculture, salt production, food processing machines and irrigation equipment other than those eligible for special investment incentives mentioned above
- Production of materials to replace asbestos

Agriculture:

- Cultivating, gathering, processing herbs; protection of genetic resources, rare and special herbs
- Production, processing of animal feeds
- Technological services related to cultivation, breeding, aquaculture, protection of plants and animals
- Construction, upgrade or slaughterhouses; industrial preservation and processing poultry and livestock
- Development of material areas serving processing industry

Environmental protection, infrastructure construction:

- Construction and development of infrastructure of industrial complexes
- Construction of apartment buildings for workers in industrial parks, export-processing zones, hi-tech zones, economic zones; construction of dormitories for students and houses for beneficiaries of incentive policies; construction of urban areas (including kindergartens, schools, hospitals) serving workers
- Recovery of oil spill, landslide, dyke, riverbank, seashore, dam, reservoir erosion, and other environmental emergencies; application of technology to minimization of greenhouse gas emission
- Investment in operation of exhibition centers, logistics centers, warehouses, supermarkets, shopping malls

Education, culture, society, sports, healthcare:

- Investment in operation of infrastructure of educational institutions, development of non-public educational institutions, including preschool education, compulsory education, and vocational education
- Production of medical equipment, construction of warehouses for preservation of pharmaceuticals and reserve of medicines for humans in case of disasters, epidemics
- Manufacture of ingredients of medicines and pesticides; drugs for animals and aquatic organisms
- Investment in biological testing facilities, bioavailability assessment, pharmaceutical facilities that meet good practice standards for manufacturing, preservation, testing, clinical trial of medicines
- Investment in research into scientific foundation of traditional medicines and establishment of standards for testing traditional medicines
- Investment in sports centers, stadiums, swimming pools; facilities for production, repair sports equipment
- Investment in public libraries and cinemas
- Investment in construction of cemeteries, crematories

F. Few findings from Key Informant Interviews

Manufacturing - Construction	**Tax system for various types of investment in similar sector is different (EPZ tax system is different than the other investment outside EPZ)**
	Investment procedure is too lengthy as there are various institutes and everything is manual.
	Digitizing tax system is mandatory for transparency and easing the process.

Logistics- C&F Agent	**Negative approach of the custom house towards foreign investors regarding their personal packages, such as, asking for irrelevant fine penalty, foreign delegates are discouraged to come to our country.**
	Complicated manual procedures regarding custom clearance is another big hassle (running between multiple offices) which is discouraging.
	There are laws to smoothen custom clearance, however, employees of the custom house abuse the laws to their own benefit and make clearance complicated for the importers.
	Due to frequent changes in H.S. Code, employees of the custom house exploit this to their own benefit.
	When local importers can “Negotiate” with the employees of the custom house, MNCs cannot do so for their transparent system.
	Digitizing the system similar to neighboring countries will be helpful to make the system easier for the importers and make the system transparent.
	There is a Time Sensitive Release procedure have been introduced, however, this also takes 11-12 days.

Manufacturing - Tobacco	**Corporate tax has discrimination. According to the tax system of Bangladesh, a listed company gets a 5% tax rebate, however, tobacco companies have to pay 2.5% surcharge.**
	Tobacco companies are among the highest paying tax group, but tax system squeezes more from them. Which is discouraging for the potential foreign investors.
	Customs are mentioning that they are following the WTO HS Code and they follow the integrated system. However, it is not the actual scenario, they forcefully changes the H.S. Code of items and put them into higher tax base H.S. Code to earn more revenue. One example is, suppose an item is being imported from a country with a particular H.S. code, but Bangladesh custom changes that H.S. Code to earn more revenue.
	When a multipurpose machine is being imported by a tobacco company, such as a packaging machine, which can be used for packaging different types of products, but as the tobacco company imports the machine, they need to pay extra tax.
	To resolve any issue at the court, companies had to deposit 20% of the total amounts and it takes about 10-20 years to resolve it. This amount is not refundable also.
	To resolve any legal issues at a quick pace there is an ADR system which is resolved by the commissioner and the process suggest that no one can reinvestigate it. However, NBR reinvestigate it and says that the resolve is not accepted and they forcefully opens the case again.

Logistics- C&F Agent	**When importers import machineries for the production purpose, they mostly import the machines part by part. Due to this, custom officers put each part under different HS code and charges fine.**
	Even if the importers are willing to pay the fine, and even if the custom officer knows about the product, for testing purpose, the machines are sent to BUET for testing. This consumes huge amount of time.
	Tax on finished products are 37% and semi-finished products tax is 89% which does not align.
	Custom officers abuse the definition to collect revenue forcefully.
	There is no linear channel of law, which makes all the procedures complicated.
	When running between different offices, the products are parked in the port and this parking requires extra charges. As the procedures are too lengthy, the cost rises every day.
	While exporting products, custom officers are focusing on laws rather than the export revenue.
	In some cases, there are digitized system to make the procedures easy. But the officers do not focus on these and use backdated system, so that they can "negotiate" with the importers.

Manufacturing - FMCG	**BSTI & BCSIR Test: According to the IPO, we are required to send samples of imported food items and food raw materials to BSTI (for BSTI mandatory items) and BCSIR for testing. The testing time is significantly long resulting in port and shipping demurrage. For trusted importers, the process can be simplified by sampling during clearance under provisional assessment.**
	BSTI Lock: Some of the headings of BSTI mandatory items are locked in the Asycuda system although the item imported is not a BSTI mandatory item. Hence, NOC is required from BSTI which requires 2/3 days.
	Clause 23(16) of Import Policy Order: There is an ambiguity regarding this clause of IPO. According to the clause, the requirement of a Radioactivity Test Report Certificate has been relaxed for imports from SAARC, South-East Asian and Asia Pacific Countries. Customs officials interpret this clause differently and send the samples for radioactivity tests in Bangladesh. The IPO clause requires further clarification to clear the ambiguity.
	Application of clause 23(19) of the IPO: For many imports of food raw materials the manufacturing and expiry dates are printed on a self-adhesive label which is then put on the cartons. For many exporters in developed countries, the practice of printing product information, batch number, manufacturing date and expiry dates on self-adhesive labels is common. Due to this clause, we face issues during customs examination and delivery.

Manufacturing - FMCG	**H.S. Code issue for machinery and spare parts:** Customs officials are reluctant to accept the declared H.S. Code for machinery and spare parts.
	Valuation issue: Customs officials generally, do not follow the valuation rules 2000. Their first approach is the application of database value. Transaction value is not considered at all.
	SAFTA Certificate verification process: Customs authority verifies the SAFTA Certificate by sending a letter to the concerned bank and needs a written reply from the bank certifying that the certificate is true. We lose at least three working days for this.
	Late start of work by customs officials: Generally, the RO and AROs arrive at their desks not earlier than 11:30 a.m. And the deputy commissioners are frequently unavailable at their desks and attend meetings almost every day resulting in a delay in customs assessments.

Foreign Chamber of Commerce	**Custom duty is already too high, which increases the price of the raw materials. Also, the tax law is not stable/not indicative, which is why MNCs cannot predict their cost of doing business properly and faces unpredictable situations in the long run.**
	While implementing tax or when the tax rate increases, government does not think much. They just take policies whimsically.
	Corporate tax/effective tax rate is too high, but the neighboring countries tax rates are business friendly. Which is why we are getting low FDI compared to our competitors. This overburden of tax needs to bring into attention.
	While doing business MNCs are not getting level plain field. It happens due to corruption and integrity. Most of the foreign investors are transparent while doing business and paying taxes. But the domestic business investors are not transparent about it and their profit share is much higher. For this reason, foreign investors are less interested to invest in Bangladesh.
	When solving any tax related cases, the court asks for a huge sum of money to be deposited and this case remains unsolved for a long time. And the deposited money is nonrefundable. This system portrays a disadvantage situation of Bangladesh.
	Foreign investors want to bring new technology for efficient production to remain competitive with the developed countries. However, dues to tax burden for the new machineries, the production cannot reach its full potential. Government needs to give a tax rebate or incentivizes the foreign investors while bringing new technology.

Logistics	**The tax regime in Bangladesh is complex and can be a challenge for businesses. However, there are some incentives available. For example, businesses can get tax breaks for investing in certain sectors or in certain regions.**
	The tax environment is an important factor in the decision-making process for investing. Businesses need to consider the tax rates, the tax incentives and the tax administration when making investment decisions. For example, a business that is considering investing in Bangladesh would need to factor in the country's corporate tax rate of 20%-45%, as well as the various tax incentives that are available for foreign investors.
	Bangladesh's tax regime is more complex than some other countries, but it also offers some attractive incentives for investors. For example, businesses can get tax breaks for investing in certain sectors or in certain regions. However, the tax administration in Bangladesh can be slow and inefficient, which can be a challenge for businesses.
	Sometimes it takes much longer time to get a clarification from the National Board of Revenue. They follow some routine mechanism during Assessment and do not want to come out from the conventional mindset. They generally do not take into consideration the company's level of compliance in practice and judge all in same bucket.
	Bangladesh has made some improvements in its tax structure and policy over the years. The government has reduced the tax rates. It has also introduced some new tax incentives for investors. For example, the government introduced a new tax incentive in 2021 that allows investors to get a tax holiday for up to 20 years if they invest in certain sectors.
	Bangladesh can improve its tax environment by simplifying the tax provisions further, reducing the tax rates and improving the tax administration. It can also introduce more tax incentives for investors. For example, the government could introduce a tax credit for businesses that export their products.
	The primary challenge we face when advocating tax reforms is the complexity of the tax system. It is difficult to understand all the rules and regulations, and it can be more difficult to get proper attention from the regulator side.
	Despite the challenges from the tax environment, there are some factors that make Bangladesh an appealing market for businesses. These factors include the large market size, the growing economy, the low labor costs and the strategic location.

Logistics- C&F	**Documents procedures are too time consuming. And if the mistake occurs in the documents by shipping agent, the penalty has to be paid by the importer.**
	When a company imports machineries' in dissemble condition. The parts are put under different H.S. Code and has to pay large amount of tax, but the law suggests that machineries' parts are not individual item but a single product.
	When testing chemical products, testing facilities has inadequate testing kits and lacks manpower.
	The targets of the custom house to increase profit in any way possible. They do not care about if the procedures of importing is correct or wrong.
	Due to frequent changes in the H.S. Code, law changes and makes things complicated. Due to this, wrong H.S. Code occurs and importers have to pay huge amount of fine.

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Sitting from left:

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CATALYZING GREATER FDI FOR VISION 2041: PRIORITIES FOR BUILDING A CONDUCIVE TAX SYSTEM IN BANGLADESH

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