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How compliant are the large corporate taxpayers? The Bangladesh experience

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Abstract

Several tax compliance approaches have been designed to improve the tax compliance of large corporate taxpayers. In many tax administrations, Large Taxpayer Unit (LTUs) have been set up to closely monitor the assessment and collection of revenues from the large corporations. There has not been any research conducted to investigate how compliant the large corporations have been under the LTU model of tax administration. This research is an attempt to fill this gap taking Bangladesh LTU as an example. Using original survey data, this paper finds that the finance sector corporations achieve the highest compliance in return filing, while the manufacturing and service sectors corporations achieve the highest compliance in payment and reporting compliance respectively. In overall compliance, manufacturing sector corporations are the top compliers. The study findings would be different if tax compliance as a variable is measured differently. Additionally, differences in legal and regulatory structure of tax audits might limit the study findings further.

Keywords: *Tax compliance, LTU, large taxpayers, corporate sector, Bangladesh*

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Taxpayers are not homogeneous in their risk and revenue characteristics. Each group of taxpayers poses different risk and revenue potentialities to the tax base and therefore requires a different set of compliance tools to regulate them. Tax compliance mo

Such evasive tax culture among large corporations call into question the contribution of cooperation and gentle persuasion for improving tax compliance among the large corporations (CATA 2006).

One of the ways to examine the contribution of this soft, persuasion-based LTU compliance models is to see whether the corporate tax compliance in the LTUs have increased or decreased over time. Thus the purpose of this paper is to measure the level of tax compliance achieved by large corporations, taking Bangladesh as the case, to understand the usefulness of LTU compliance model. The paper is mainly divided into four sections. The first section discusses the nature of large corporations and the Large Taxpayer Units (LTUs). The second section presents the research methodology. The third section produces the analysis and research findings, and the fourth section presents the conclusion of the study.

In general, big taxpaying corporate entities are treated as large corporate taxpayers. Watts (1978, p. 22) comments that, defining a large industrial enterprise is beset with problems. For example, size can be measured in several ways number of staff employed, net assets (capital employed), value added (net output), turnover, issued capital and market capitalisation Watts (1978) identifies six characteristics by which large businesses can be distinguished from small and medium businesses in the non-corporate sector: sepa-6(s)-81 02-260(uu 0 1 255.41 5s.4(T)-8(h)11u(si)-6)-4(axu 5s.4(a-6(4( )-3211(e

make LTUs an essential organ of tax administration (Bodin, 2003, quoted in Ainsworth, 2006; Santos, 1994).

The concept of the LTU was introduced in Argentina in the late 1970s (McCarten, 2003). In the early days, LTUs used to audit high turnover corporations to increase reporting compliance. During the early 1980s, the concept of the LTU was adopted in Bolivia and Peru, with the sole aim of increasing filing compliance. Vazquez-Caro (1996) emphasises two issues in the spread of the LTU in Latin America: first, close monitoring of those taxpayers with the highest revenue concentrations; and second, a shift of assessment and collection responsibilities from the public to the private sector. LTU expansion got its momentum in the early 1990s, under IMF patronage. By 2002, 50 countries, and by 2006, 67 countries, had established LTUs as an independent unit or as a special wing within the semi-autonomous revenue administrations (Baer et al., 2002; CATA, 2006).

Table 1: Tax collection by LTUs in OECD countries for 2006–2007

Country	Tax collected (Figures in billion Euros)	Percentage of tax collected	Taxes administered
Australia		64.5%	Corporate income tax (CIT)
Canada		53%	CIT
France		33%	CIT and business local tax, VAT, local Tax
Ireland		41.3%	CIT, VAT, employment tax, excise, customs, vehicle registration tax, stamp duties
Netherlands		60%	CIT, VAT, employment withholding tax
Norway		16%	CIT
UK		70%	CIT, VAT, employment tax, petroleum tax
US		90%	CIT

Source: OECD, 2009.

A review of revenue collection in selected OECD countries (see Table 1 above) shows
nges from a
minimum of 16 per cent (Norway) to a maximum of 90 per cent (the US). The US
year
2006 2007, which equals 14.6 per cent of US national tax revenues, and 90 per cent of corporate tax revenues. Australia collects 64.5 per cent of corporate income taxes from LTUs and Canada 53 per cent. In some countries, for instance the UK and

France, LTUs collect more than one tax, including income tax, VAT, customs, excise and employment taxes. Seventy percent of the aforementioned taxes in the UK and 60 per cent in the Netherlands are provided by the LTUs.

In the developing countries, the potentiality of revenue collection from the large taxpayers is also very high. The International Monetary Fund (2011) finds that usually a few hundred large corporations in the developing countries can secure 60 per cent to 80 per cent of domestic taxes. Table 2 shows that in Africa and in the Middle Eastern countries large corporations are less than one per cent of the total taxpayers, but they provide over 70 per cent of tax revenues. One reason for this, as the International Tax Dialogue (2007) explains, is that the large corporations act as the withholding agents for medium and small taxpayers, so some of the tax payments made by the large corporations constitute the advance taxes and prepayments made by the smaller enterprises.

Table 2: Concentration of tax revenues in large corporations (

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Figure 2: Patterns of individual (left) and corporate (right) tax compliance

Source: Braithwaite & Wirth, 2001.

As shown above in Figure 2, the pyramid depicts the tax compliance pattern of individual taxpayers, while the oval depicts the tax compliance patterns of the large corporations. The individual tax compliance pattern is pyramidal; most taxpayers are lying at the bottom, whereas the large corporate tax compliance pattern is oval, with most of the taxpayers falling within the grey area in the middle. What is needed to make the compliance pattern pyramidal, according to Braithwaite and Wirth (2001), is to push the middle group towards the bottom. Braithwaite and Wirth (2001) argue that an acceptable way to achieve pyramidal compliance for the large corporations is to apply more of the self-regulatory instruments (that is, taxpayer education, service delivery etc.) instead of command regulations (penalty, tax audit etc.).

A further challenge for large corporate tax compliance management is a continued lack of professionalism, widespread corruption and political intervention. Many large taxpayers successfully hide income by setting up shell offshore corporations or having a partnership with their parent corporation instead of a subsidiary relationship (Easter, 2008), or enjoying tax holidays through undue political intervention (McCarten, 2004). A survey of US corporations shows that nearly all large corporations and more than half of medium sized corporations have been offered safe transfer of money by tax shelter promoters (Slemrod, 2004). According to Christian Aid (2010), as a result of trade mispricing by the multinational companies, the poor countries are deprived of US$160 billion of tax revenues every year and Bangladesh is one of the five low-income countries suffering the biggest tax losses (£186m).

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quality financial and accounting standards set by local and international accounting

Table 3: Descriptive statistics on sample corporations (N = 154)

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The next section discusses the impact of appeals on the measurement of tax compliance.

6.3

In consideration of the high appeal rate and its probable impact on study results, adjustments were made in the measurement of tax compliance. Without considering the effects of appeals, the tax collections reported in the LTU annual reports and studies based on such reporting are going to be misleading and methodologically inappropriate.

As in the LTU of Bangladesh, corporations declared non-compliant for any compliance component may opt for an appeal to the Taxes Appellate Authority (TAA). If a taxpayer fails at the TAA stage, it may opt for a second appeal to the Taxes Tribunal Authority (TTA). Finally, there may be an appeal to the High Court (HC) of Bangladesh. The LTU also reserves the right to challenge any appellate or tribunal judgment passed in favour of a taxpayer.

Table 5: Appeal outcome on cases found non-compliant by desk and comprehensive audit (N=154).

Appeal cases	Frequency	Percentage	Valid percentage	Cumulative percentage
Dismissed	58	37.7	37.7	37.7
Allowed				
Others				
Total				
Not an appealable case				
Did not opt for an appeal				
Total				

corporations increased to 83. If this adjustment had not been made, the measurement of both reporting compliance and overall compliance would have been affected. However, no records were found on how many of those who failed in the first appeal opted for further appeals in the TAA or HC levels. Since some appeals were still pending in the TAA and HC levels, at the time the survey was conducted, it was not possible to take into account the effects of these appeals on the study design. Therefore the adverse effect of high appeals on the study outcome could be mitigated largely, but not fully.

Another issue related to the accuracy of this measurement is the quality and neutrality of appeal judgments. It was argued by a respondent that the appellate authority is outright corrupt and they sell judgments for money (Respondent 26). Another respondent stated, Large corporations know that if the LTU does not accept the audit reporting is 53.9 per cent and by payment of taxes is 75.3 per cent. Filing compliance has a mean of 0.84 which means that 84 per cent of taxpayers are filing compliant, since the higher code 1 is treated as tax compliance and 0 as non-compliance. The mean value for any nominal variable that has only two categories has meaning (Leech et al., 2008). In the case of tax payment, mean compliance (M = 0.75) falls as compared to filing compliance; and for reporting compliance, mean value falls further (M = 0.54). In each case, the modal group is 1, which represents tax compliance.

Table 6: Descriptive statistics on the tax compliance levels of large corporations (N = 154)

Tax compliance components	Compliance status	Frequencies	Percentages	Cumulative percentages
Filing compliance (FC)	Compliant	130	84.4	84.4
	Non-compliant	24	15.6	100
Reporting compliance (RC)	Compliant	83	53.9	53.9
	Non-compliant	71	46.1	100
Payment compliance (PC)	Compliant			
	Non-compliant			

Table 7: Cross-tabulation on measurement o1(t)

example, in Hungary all large corporations are audited every second year (Pitti & Vazquez-Caro, 1998). In the US, the audit rate for large corporations in 2006 was nearly 50 percent up from 2003 (IRS, 2006), although in the recent years there has been a decline in the number of large business audits (TRAC, 2011). However, as Table 8 reveals, the amount of audit demands (column 6) and collections from these (column 7) have decreased over the years, except in tax year 2005 2006.

Table 8: Annual audit outputs from large corporate taxpayers in millions of Bangladeshi Taka

Tax year
(1)

Source: LTU Annual Report, 2009.

For example, in tax year 2003 2004, additional tax of 5,340.00 million Bangladeshi Taka was demanded from the tax audits of 80 files (column 2), that is, the per file audited tax demand was 66.75 million Taka. In 2005 2006, per file audit demand decreased to 16 million Taka, and in 2007 2008 to 1.33 million Taka.

Declining audit demands may have two potential explanations: first, audit actions have been successful in reducing the amount of income underreporting. Second, the deterrent effect of tax audit has fallen in the face of complicated game-playing techniques by the corporations. It should be noted that roughly half of the demands created in every tax year remained uncollected (column7), may be because the audit demands were fictitious or the enforcement measures were weak or ineffective. Aside from enforcement measures, political instability and the quality of institutions might be associated with the tax compliance and audit of the large companies (Tsibouris et al, 2006).

The other explanation for the declining audit demands may be the huge knowledge and skills gap between the audit teams and the representatives of large corporations. An investigation was carried out into the taxation and accounting knowledge of tax officials (see Appendix 2), which many respondents identified as a potential barrier to make undisputed audit adjustments. Fourteen tax were officials interviewed, only 4 of whom had academic knowledge of accounting and taxation. The remainder had only in-service training on tax law.

To address this significant accounting and tax knowledge deficit

Table 9: Tax compliance by large corporations viewed from corporate ownership, corporate sector, and corporate location (N = 154)

Compliance types	Compliance status	Ownership structure	Corporate sectors	Location
		Public		

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Appendix 1: Approval letter from the LTU Bangladesh.

Appendix 2: Lack of knowledge and training.

Figure 1: Respondents' academic knowledge of accounting and taxation.

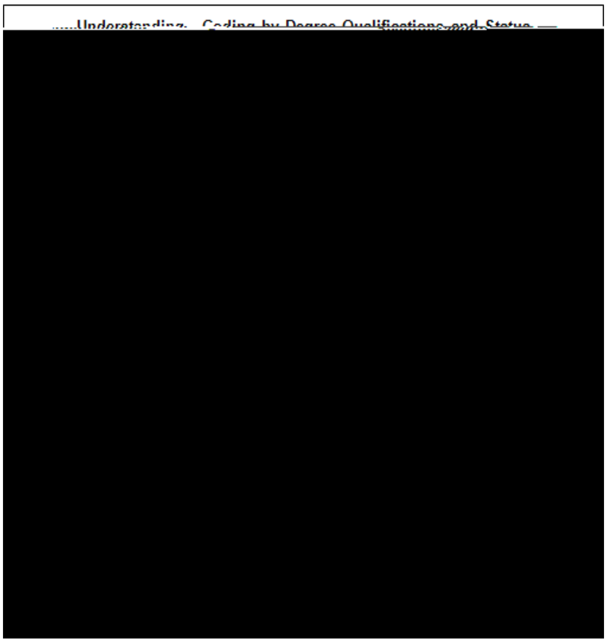

Figure 2 Respondents' work experience and accounting knowledge

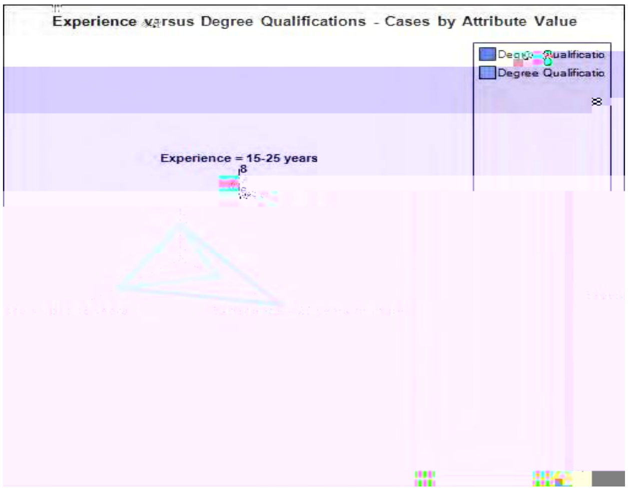

Chart 1 shows that out of fourteen tax officials interviewed, only four had academic knowledge of accounting and taxation; the others had only in-service training on tax law. Almost all tax professionals have accounting or business degrees. Four per cent of tax professionals have no qualification in accounting, because the ITO, 1984 has allowed retired tax officials to plead tax cases, who do not require having academic qualifications in accounting or taxation.

Appendix 3: Summary of key evidence from interviews

RESPONDENT NO.	TITLE	ISSUES
RES-01		

RES-12	Tax Commissioner, Chittagong	Hierarchical tax bureaucracy and tax audit problems; focused on the necessity for simplified tax law and reducing knowledge gaps.
RES-13	Tax Commissioner, LTU	Acknowledged the issue of transfer pricing among large corporate taxpayers.
RES-14	Additional Commissioner	Concentrated on mutual understanding and the probable impact on tax laws. Supported the persuasive mode of encouraging tax compliance.
RES-15	Chief Finance Officer	Complex and costly tax laws make bribery likely and stimulate non-compliance.
RES-16	Deputy Commissioner, LTU	

RES-24	Former Member, NBR	res make taxpayer service fail.
RES-25	Chartered Accountant	Argued for coercive actions and focused on increasing penal actions and strengthening regulation.
RES-26	Chartered Accountant	Taxpayer service and simplified tax law can be a good source of high corporate tax compliance.
RES-27	Second Secretary NBR	Explained why mutual understanding fails and complicates the compliance process.