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The hidden compliance cost of VAT: An exploration of psychological and corruption costs of VAT in a developing country

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Abstract

A Value Added Tax (VAT) is seen as critical in providing the tax revenue base for governments, especially developing nations. However, prior research about VAT compliance costs has largely occurred in developed nations and has generally excluded psychological and corruption costs.

This article reports a study which measures and reflects upon the psychological costs both in quantitative and qualitative terms for small and medium enterprises in a developing nation, Bangladesh. The cost of corruption is also considered. The findings of this study provide valuable insights as to what is the true compliance cost for VAT in a developing country.

Keywords: Small business; VAT; compliance cost, Bangladesh

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1. INTRODUCTION

Small and Medium Enterprises (SMEs) are considered as a key engine of economic growth in developing countries.[5] Due to the importance of the SME sector to a country's economy, governments around the world have commonly emphasised the importance of a healthy SME sector and geared public policy toward fostering SME development and growth.[6] Bangladesh is no exception; SMEs create large scale and low-cost employment opportunities using mainly locally available inputs and technologies, and develop entrepreneurship by mobilising private savings.[7]

In Bangladesh, 768 922 listed SME establishments[8] account for about 45 per cent of the total value-added in manufacturing; 80 per cent of industrial employment; about 25 per cent of the total labour force;[9] and 90 per cent of all businesses.[10]

VAT has been generally chosen for its revenue-raising potential for financing governmental services.[11] It has become one of the most important revenue-mobilising instruments in advanced industrialised countries as well as developing countries.[12] However, for a VAT system to achieve these economic aims, compliance costs should not be burdensome. International evidence suggests that VAT compliance costs are often regressive, that is, disproportionately higher for small businesses than large businesses (Coolidge, 2012). Consequently, to make the VAT system an effective tool for revenue-raising, measures have to be directed towards the aim of gaining trust and confidence of the taxpayers and encourage them to pay the correct amount of VAT as a social obligation.

Evans points out that the costs of operating a tax system consist not only of the costs expended by taxpayers in complying (or not complying) with their tax obligations, but also the administrative costs for government of collecting its taxes.[13] In a broader

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[5] P Shome, *Tax Administration and the Small Taxpayer* (Policy Discussion Paper No PDP/04/2, The International Monetary Fund, Fiscal Affairs Department, 2004). For the Bangladesh manufacturing sector, a small and medium business is one with the value/replacement cost of durable resources other than land and factory buildings being less than 100 million taka (BDT) (USD1.3 million). Note a 'small' enterprise for manufacturing means an industry in which the value/replacement cost of durable resources other than land and factory building is less than BDT15 million (USD200 000). In a non-manufacturing context, a SME means an enterprise with up to 100 people employed (Bangladesh Bureau of Statistics, 2005). Note a 'small' enterprise for the non-manufacturing sector means an enterprise in with fewer than 25 people work (eg, family members working together in a cottage industry).

[6] A Hansford, J D Hasseldine and C Horworth , 'Factors affecting the costs of UK VAT compliance for small and medium-sized enterprises' (2003) 21 *Environment and Planning: Government and Policy* 479–92.

[7] Bangladesh Bank, *Annual Report 2006–2007* (Bangladesh Security Printing Press) .

[8] National Board of Revenue, *Annual Report 2011–2012* (NBR, 2014).

[9] Finance Minister Abul Maal Abdul Muhith, 'Budget Speech 2013' (Speech delivered at the National Parliament House, Dhaka, Bangladesh, 2013).

[10] S Alam and A Ullah, 'SMEs in Bangladesh and Their Financing: An Analysis and Some Recommendations' (2006) 34(3) *The Cost and Management* 57–72.

[11] D Williams, 'Value Added Tax' in V Thuronyi, *Tax Law Design and Drafting* Vol 1 (International Monetary Fund, 1996).

[12] R Eccleston, *Taxing Reforms: The Politics of the Consumption Tax in Japan, the United States, Canada and Australia* (Edward Elgar Publishing, 2007).

[13] C Evans, 'Taxation compliance and administrative costs: An overview', in M Lang et al (eds), *Tax compliance costs for companies in an enlarged European Community* (Linde Verlag and Kluwer Law International, 2008) 447–68.

sense, the compliance costs to government as a whole include the wages and salaries of personnel engaged by government institutions such as tax authorities, tax policy makers, legislators and the judiciary (which may involve local and national tribunals and/ or appeal commissions and courts).[14]

Pope identified that compliance costs include three major components, namely monetary costs, time costs and psychological costs to the taxpayers.[15] Monetary costs include money spent on tax professionals and expenses relating to taxation guides, books, communication and other incidental costs. Time costs relate to record keeping for tax purposes, completing the tax return and preparation of tax details for tax authorities or for tax professionals. In economic terms, the psychological costs of taxation are the net economic costs of the pressure, anxiety and stress[16] encountered when taxpayers seek to submit their tax returns in a timely and correct manner.[17]

In terms of empirical studies about VAT, the international evidence suggests that in most countries the introduction of a VAT results in significantly higher compliance costs for taxpayers than other forms of taxation, and that VAT compliance costs are disproportionately higher for small businesses than large businesses.[18] However, most of these studies have considered developed nations, such as the United Kingdom, Australia and the United States of America.

The World Bank Group (WBG) conducted large-scale semi-structured questionnaire-based studies into tax compliance costs in transitional and developing countries (such as South Africa, Vietnam, Ukraine, Yemen, Peru, Nepal, Uzbekistan and Kenya) from 2006 to 2011, not only in relation to the time and costs spent on compliance with VAT, but also with income tax and payroll tax.[19] Semi-structured questions were used to ask taxpayers about the following: their bookkeeping practices; computer and internet access; experience with tax inspections and audits; taxpayer morale; their reasons for any non-compliance (including failure to register for VAT); and their perceptions of the competence, fairness, consistency and integrity of tax authorities and tax officers. This study also found that tax compliance costs are regressive in nature.[20]

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[14] W A Yesegat, *Value added tax in Ethiopia: A study of operating costs and compliance*, PhD Thesis, University of New South Wales; L Barbone, R Bird and J Vázquez-Caro, 'The Costs of VAT: A Review of the Literature', *CASE Network Report No. 106/2012*, Warsaw.

[15] J Pope, 'The compliance costs of taxation in Australia and tax simplification: the issues' (1993) 18(1) *Australian Journal of Management* 69–90.

[16] Positive events or experiences help to neutralise or offset the distress caused by negative events (eg debts owed, financial responsibility, fear of rejection, and unexpected visits from tax officers). This 'netting' effect in relation to psychological costs is explored further in section 3.

[17] Ibid; C Sandford, M Godwin and P Hardwick *Administrative and Compliance Costs of Taxation* (Fiscal Publications, 1989); C Evans, J Pope and J Hasseldine (eds) *Tax Compliance Costs: A Festschrift for Cedric Sandford* (Prospect Media, 2001); Hansford, Hasseldine and Horworth, above n 6.

[18] S Cnossen, 'Administrative and Compliance Costs of VAT – a review of the evidence' (1994) 8 *Tax Notes International* 1649–68.

[19] Investment Climate Advisory Services of the World Bank Group, *Tax Perception and Compliance Cost Surveys: A Tool for Tax Reform* (March 2011) World Bank Group Investment Climate <https://www.wbginvestmentclimate.org/uploads/TPCCS_Consolidated_Web.pdf>.

[20] Ibid; K Ritchie, 'The Tax Compliance Costs of Small Business in New Zealand' in C Evans, J Pope and J Hasseldine (eds) *Tax Compliance Costs: A Festschrift for Cedric Sandford* (Prospect Media Pty Ltd, 2001) 297–315; and H Abdul-Jabbar, *Income tax non-compliance of small and medium enterprises*

In Bangladesh, Saleheen conducted a field survey in 2012 and showed that 49 per cent of the surveyed population considered that VAT Law in Bangladesh was not at all clear, and 45 per cent considered the VAT law to be complex and not trade-friendly.[21]

More recently Faridy et al (2014) found, in terms of Bangladesh SME compliance with VAT law, that the complexity of the law can influence taxpayers' ability to comply.[22] Because of the complexity of the tax system, some businesses (those who can afford it) may engage expert tax professionals to help them with sophisticated tax planning to minimise tax payments. In addition, Faridy et al found that negative perceptions about government policy and spending of tax revenue may contribute to non-compliance.[23] Other negative influences on compliance include perceptions of tax officers being unfair, corrupt and abusing the discretionary power afforded to them.[24]

In terms of actual compliance cost, Faridy et al (2014) found that the reported compliance cost for non-complying VAT payers was higher than that reported by complying VAT payers (see Table 1 and Table 2). While Faridy et al touched upon some initial findings in respect of potential psychological costs, these were not explored in detail. It is, however, interesting to note that, for Group 2 in both Tables 1 and 2, compliance costs were higher for complying taxpayers than for non-complying taxpayers. The reason for this apparent anomaly is that Group 2 compliant taxpayers were comprised mainly of manufacturers, who felt more government pressure to remain compliant. As a result, their psychological costs were higher than those for non-compliant (non-manufacturer) taxpayers in Group 2.

in Malaysia: Determinants and tax compliance costs (PhD Thesis, Curtin University of Technology, 2009).

[21] A M Saleheen, 'Reigning Tax Discretion: A Case Study of VAT in Bangladesh' (2013) 16(2) *Asia-Pacific Journal of Taxation* 77–91.

[22] N Faridy et al, 'Complexity, Compliance Costs and Non-Compliance with VAT by Small and Medium Enterprises (SMEs) in Bangladesh: Is there a relationship?' (2014) 29(2) *Australian Tax Forum* 281–328.

[23] Ibid 297–98.

[24] Ibid 298 and 306.

Table 1: Average Compliance Costs of Compliant Taxpayers

Group	VAT Payment Group (BDT)	VAT Compliance Costs for CT		
		Monetary Costs (BDT)	Time Costs (Total Hours)	Psychological Costs (BDT)
1	Under 400 000	27 822	97	4648
2	400 001 to 500 000	57 136	143	10 106
3	500 001 to 600 000	70 545	187	12 727
4	600 001 to 700 000	68 000	213	11 527
5	800 001 to 900 000	78 666	286	13 888
6	900 001 to 1 000 001	92 947	189	19 238
7	More than 1 000 001	179 265	336	31 176

Source: Faridy et al (2014)

Table 2: Average Compliance Costs of Non-Compliant Taxpayers

Group	VAT Payment Group (BDT)	VAT Compliance Costs for NCT		
		Monetary Costs (BDT)	Time Costs (Total Hours)	Psychological Costs (BDT)
1	Under 400 000	35 091	113	6622
2	400 001 to 500 000	52 466	276	6916
3	500 001 to 600 000	77 500	230	14 583
4	600 001 to 700 000	82 500	245	15 625
5	800 001 to 900 000	92 000	290	17 916
6	900 001 to 1 000 001	109 800	451	19 166
7	More than 1 000 001	227 655	448	33 045

Source: Faridy et al (2014)

According to Franzoni (2000), businesses may resent tax authorities for high levies and too complex a tax system. Franzoni argues that such taxpayer resentment may be associated with a weakening of taxpayers' 'moral consciences', even to the extent of emboldening them to evade in order to 'punish' tax authorities for imposing such high levies and complex rules on taxpayers. Murphy (2008) also argues that taxpayers who feel resentment in response to tax authorities' attempts at enforcement are more likely not to comply with tax regulations in the future.[25] To the extent that taxpayers cannot

[25] See K Murphy, 'Enforcing tax compliance: to punish or persuade?' (2008) 38(1) *Economic Analysis and Policy* 113–35.

or do not 'let go' their feelings of resentment, the costs of coping with resentment can form part of psychological costs[26] (the other part being anxiety).[27]

While there is some research into compliance with consumption taxes in developed economies, there is a paucity of research into VAT compliance generally in developing countries, and in particular in Bangladesh. In addition, while the literature has paid more attention to the psychological component of compliance costs in recent times, relatively little attention has been paid to psychological costs when compared with other elements of compliance costs. This relative lack of evidence does not suggest that psychological costs are unimportant, but rather reflects practical concerns about how best to measure them.

The current study explores the 'hidden cost' of VAT compliance for Bangladeshi SMEs, in particular psychological and corruption costs. The literature suggests that, in the case of transition economies, higher levels of corruption are associated with lower tax and regulatory compliance.[28] This study looks at two subsets of psychological costs, anxiety and resentment, as well as providing some preliminary monetary values for psychological costs in a developing country context. These results may be relevant to other developing nations, insofar as they show that expected benefits of a sound VAT system – perceived as a fundamental cornerstone of governments' ability to extract adequate tax revenue for public spending – may be undermined by psychological and corruption costs. Both form part of compliance costs.[29]

The remainder of the article is organised as follows. The next section briefly discusses the Bangladeshi VAT system. Section 3 reviews the literature regarding the psychological and corruption costs of VAT. This discussion is followed in section 4 by an outline of the methods used in this study, namely a survey and in-depth interviews. Section 5 analyses the results of the study, while section 6 makes recommendations for VAT policy and administration in Bangladesh. Section 7 sets out the limitations of the research and provides avenues for future investigation, before the conclusions of the study are presented in section 8.

2. BANGLADESH: THE VAT IN PRACTICE

The VAT Law was introduced in Bangladesh on 1 July 1991 amid government claims that it would help develop the overall economy and enhance transparency of the Bangladeshi taxation system.[30] The VAT replaced both excise duties on domestically produced goods and services, and sales tax on imported goods. Bangladesh's VAT is

[26] Cf F L Gardner and Z E Moore, 'Understanding clinical anger and violence: the anger of anger avoidance model' (2008) 32(6) *Behaviour Modification* 897–912; and J G Murphy, 'Forgiveness and Resentment' 7(1) *Midwest Studies in Philosophy* 503–16.

[27] L A Franzoni, 'Tax evasion and tax compliance' in B Bouckaertand and G DeGeest (eds), *Encyclopedia of law and economics* (Elgar, 2000) Vol 4, 52–94.

[28] A Alon and M A Hageman, 'The Impact of Corruption on Firm Tax Compliance in Transition Economies: Whom Do You Trust? (2013) 116 *Journal of Business Ethics* 479–94; F Méndez, 'Can corruption foster regulatory compliance?' (2014) 158 *Public Choice* 189–207.

[29] The roles played by psychological costs and corruption costs as part of overall compliance costs are explored further in section 3 below.

[30] Finance Minister Mohammad Saifur Rahman, 'Budget Speech 1991–92' (Speech delivered at the National Parliament House, Dhaka, Bangladesh, 1992).

consumption-based, with goods and services generally taxed at the point of destination, rather than the point of origin. VAT is imposed on goods and services sold at the manufacturing, wholesale and retail stages, as well as at the point of importation.[31] The National Board of Revenue's (NBR) is the government statutory body which administers the VAT system.

The VAT has collected on average 37 per cent of total tax revenue in last 15 years.[32] While the introduction of a VAT in Bangladesh has proved to be successful in terms of increasing tax revenues as well as expanding the tax base, some evidence suggests that there is potential for improvement.[33] For example, the tax base is narrow compared to other developing countries, and the tax revenue is still very low as a percentage of gross domestic product (GDP). In 2005, the average tax/GDP ratio in the developed world was approximately 35 per cent, while in developing countries it was 15 per cent and in the poorest of these countries, the low income countries, tax revenue was 12 per cent of GDP.[34] In 2005, the tax/GDP ratio was less than 10 per cent in Bangladesh and in 2011 to 2012 the ratio was 11 per cent.[35] The gap between potential VAT revenue and actual VAT revenue is estimated to be more than 40 per cent.[36]

In Bangladesh the standard rate of VAT for home consumption goods and services is 15 per cent, with exports and 'deemed exports' zero-rated. However, there are some other rates in practice that emerge due to different methods of calculation. The tax is generally imposed on the invoiced price, but where invoices are unavailable a so-called 'fixed value addition' on a 'truncated base' (in effect, a notional value added) is used to assess the appropriate VAT. For those businesses at wholesale and retail levels which do not declare any input tax credits, a deemed 1.5 per cent VAT (the so-called 'Trade VAT') is imposed on the total value of the goods or services sold, in lieu of the standard 15 per cent VAT.

Another variation is that small business suppliers, defined as those with an annual turnover is less than BDT6 million (USD80 000) have the option of paying a tax at 3 per cent of their annual turnover, in lieu of the standard 15 per cent VAT. However, choosing this option precludes the claiming of input tax credits.

In addition, small business 'consumers' (that is, purchasers) at the wholesale and retail level pay a fixed annual dollar amount of VAT, the quantum of which depends on the geographic location of their business. For example, if a small retail shop is based in the capital city (Dhaka) or one of the two major port cities (Chittagong or Khulna), it would pay BDT6000 (USD80) per year in deemed VAT. In contrast, a small retail shop based in a remote small town would pay BDT2400 (USD32) per year in deemed VAT. Firms in cottage industries – defined as those firms with annual turnovers of

[31] Finance Minister Mohammad Saifur Rahman, 'Budget Speech 2005' (Speech delivered at the National Parliament House, Dhaka, Bangladesh, 2005).

[32] N Faridy, *Progressivity of Value Added Tax (VAT) in Bangladesh* (Unpublished Master's Dissertation, Keio University, 2011).

[33] A M Saleheen, 'Presumptive Taxation under Bangladesh' (2012) 23(5) *International VAT Monitor* 316–21.

[34] C Fuest and N Riedel, 'Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the literature' (Paper prepared for UK Department for International Development, Oxford University Centre for Business Taxation, 2009).

[35] Finance Minister, above n9.

[36] Faridy, above n 22, 45.

less than BDT2.4 million (USD32 000) and capital machinery of up to BDT300 000 (USD4000) in value – and their consumers are exempt from VAT and turnover tax. Finally, for some taxable products listed in the NBR's 'special regulatory orders',[37] if the NBR considers that market prices have increased too much, it can determine and set a lower so-called 'tariff value' so that relevant market prices (and the VAT payable) are artificially reduced. Businesses which pay VAT on this tariff value are not entitled to claim input tax credits.

Under the same legislative provisions, the NBR also has the power to determine and set a higher tariff value if it considers that market prices have fallen too much.[38] Through this mechanism, the VAT payable is artificially increased for some taxpayers.

Another power delegated to the NBR is the power to produce secondary legislation.[39] Section 72 of the *Value Added Tax Act 1991* (*VAT Act*) confers upon the NBR the power to make rules 'for carrying out the purposes of this Act'. NBR has the power to make rules on a wide range of areas, including the determination, price declaration, assessment and collection of VAT. In addition to that, all VAT Officers (except the Assistant Revenue Officers at the operational level) have quasi-judicial powers to adjudicate offences committed under the *VAT Act*.[40]

Withholding VAT is another feature of the Bangladesh's VAT system. These withholding obligations are imposed upon government organisations, semi-government organisations, non-government organisations (NGOs) and limited companies in respect of acquiring some services including construction, printing, advertising, accounting and auditing services, and leasing professional services. While VAT replaced the excise duty, excise duty still applies to a limited range of items such as domestic air tickets and bank deposits.

The usual practice of paying the VAT due (that is, the excess of output tax over input tax) to the government is by registered taxpayers submitting a return at the end of each month on a self-assessment basis. The Bangladesh VAT has four distinct methods of paying VAT for different business transactions: advance payment through an Account Current, payment along with VAT returns, advance VAT for commercial goods at the importation stage, and as a withholding tax.

Consequently, the Bangladeshi VAT system is not just a simple 15 per cent rate, but rather is subject to a number of exceptions and qualifications. In addition, the NBR and its VAT Officers have a considerable discretionary power as to how it operates. Such characteristics could contribute to the VAT compliance costs in Bangladesh. While Faridy et al (2014) provided a detailed study about the VAT compliance costs of Bangladesh SMEs, they provided little evidence of psychological costs and how these potentially influenced compliance by this important sector.[41] The aim of this

[37] Products in this category include powdered milk, refined soybean oil, machine-made biscuits, tomato paste, fruit juice, hand-made cigarettes, LPG, petroleum bitumen imported in bulk, various types of paper, bricks, cold-rolled corrugated iron sheets, mild steel products produced from re-rollable scrap metal, and electrical transformers (GOB, 2013).

[38] Saleheen, above n 33.

[39] Saleheen, above n 21.

[40] Finance Minister, above n 30.

[41] Above n 22.

study is to provide some initial empirical evidence about the hidden costs of VAT, namely psychological and corruption costs. To do this, it is important to understand what psychological costs are, and what role corruption plays in a tax system.

3. PSYCHOLOGICAL COSTS AND CORRUPTION COSTS

As noted earlier, psychological costs and corruption costs form part of overall tax compliance costs. There are relatively few compliance cost studies that have considered psychological costs, and due to measurement problems, these are largely qualitative studies. Psychological costs are particularly important in the context of SMEs, for whom business owners and managers are often the same people, and psychological costs are likely to be borne by the owner directly, distracting them from their core business activities. In addition, in the case of transition economies, higher levels of corruption are associated with lower tax and regulatory compliance.[42]

The compliance costs of taxation have been defined by Sandford as follows:

> Tax compliance costs are the costs incurred by taxpayers in meeting the requirements laid on them by the tax law and the revenue authorities. There are costs over and above the actual payment of tax and over and above any distortion costs inherent in the nature of the tax. These costs would disappear if the tax law was abolished. They include the costs of collecting, remitting and accounting for tax on the products and profits of the business and on the wage and salaries of its employees, and also the costs of acquiring and updating the knowledge to enable this work to be done, including knowledge or legal obligations and penalties.[43]

Such costs may take the form of financial commitments for specialist staff and their associated resources; time costs associated with completing relevant forms and paperwork, and 'psychological' costs.

3.1 Psychological costs

According to Sandford,[44] three of Adam Smith's four maxims of taxation are concerned wholly or partly with compliance costs, and include 'psychological' costs of compliance.[45] For example, according to Smith's second maxim, the tax which each taxpayer is bound to pay ought to be certain and not arbitrary. The timing of, and manner in which outstanding tax needs to be paid, ought all to be clear and plain to the taxpayer and to every other person. Any uncertainty surrounding tax payments can create feelings of helplessness in taxpayers, which could be reflected in 'psychological costs'. Smith's third maxim states that feelings of 'inconvenience' associated with tax compliance may generate some kind of resistance and resentment among the taxpayers. These could be stated as the negative emotional feelings of 'psychological'

[42] A Alon and M A Hageman, 'The Impact of Corruption on Firm Tax Compliance in Transition Economies: Whom Do You Trust?' (2013) 116 *Journal of Business Ethics* 479–94; F Méndez, 'Can corruption foster regulatory compliance?' (2014) 158 *Public Choice* 189–207.

[43] C Sandford (ed), *Taxation Compliance Costs: Measurement and Policy* (Fiscal Publications, 1995) 1.

[44] C Sandford, 'The Costs of Paying Tax' (June 1986) *Accountancy* 108–11.

[45] A Smith, *An inquiry into the nature and causes of the wealth of nations* (William Benton, first published 1776, 1952 ed).

costs. Smith's fourth maxim is apposite for other key 'psychological' elements of compliance costs:

> [B]y subjecting the people to frequent visits and the odious examination of the tax gatherers, it may expose them to such unnecessary trouble, vexation and oppression; and though vexation is not, strictly speaking, expense, it is certainly equivalent to the expense of which every man would be willing to redeem himself from it.[46]

Smith notes that the 'insolence' and 'oppression' of the tax gatherer can be more burdensome than the tax itself. Overall, it must be appreciated that the 'psychological' cost of compliance is a multi-faceted notion reflecting many different characteristics that are perceived to be important. Feelings of uncertainty, powerlessness, inconvenience, trouble, vexation and oppression are things with which taxpayers would certainly prefer to not to have to deal. Such feelings can be classified into two sub-sets of 'psychological' cost, namely anxiety and resentment. The first factor of 'anxiety' relates to stress, fear and uncertainty. The second factor of 'resentment' concerns invasion of privacy, inconvenience, trouble, vexation and oppression.

Both of these factors are negative emotional responses to the particular fiscal environment that the taxpayer inhabits, although measuring them is problematic. The Meade Committee reported that the worry and anxiety borne by the taxpayers in relation to their tax affairs are almost impossible to value.[47] It is this valuation issue that is largely the reason behind the paucity of research in this area. Even so, the psychological cost of tax compliance may be very real for those affected.

Stress is not an easy concept to define or measure and most attempts to do so have originated from the field of health psychology and behavioural medicine, which includes psychological medicine. Literature suggests that there are some practical and theoretical limitations in seeking to measure the impacts of specific stressors. For example, there is evidence that people often misattribute their feelings of stress to a one source when the stress is actually caused by another source.[48]

The World Health Organisation (WHO) defines 'occupational or work-related stress' as the response people may have when presented with work demands and pressures that are not matched by their knowledge and abilities, and which challenge their ability to cope. For example, the need to frequently deal with new legislation and cope with new rules is considered a source of significant workplace stress.[49] Life events and difficulties both contribute to an individual's stress.[50] Cox argues that an individual's ability to deal with the mismatch between perceived demands and

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[46] Ibid 362.

[47] Meade Committee, *The Structure and Reform of Direct Taxation* (Allen and Unwin, 1978).

[48] I Gochman, 'Arousal, attribution and environmental stress' in I G Sarason and C D Spielberger (eds), *Stress and Anxiety* (Hemisphere, 1979) Vol 6, 67–92; J Keating, 'Environmental stressors misplaced emphasis' in I G Sarason and C D Spielberger (eds), *Stress and Anxiety* (Hemisphere, 1979) Vol 6, 55–66; S Worchel and C Teddlie, 'The experience of crowding: A two factor theory' (1976) 34 *Journal of Personality and Social Psychology* 30–40.

[49] R Woellner et al, 'Taxation or vexation – measuring psychological costs of tax compliance' in C Evans, J Pope and J Hasseldine (eds), *Tax Compliance Costs: A Festschrift for Cedric Sandford* (Prospects Media, 2001) 35–51.

[50] G Brown and T Harris, *Life and Illness*, (Unwin Hyman, 1989).

resources is an important factor when assessing stress levels.[51] It is recognised by researchers that positive events help neutralise the distress caused by negative events, and that life's daily hassles are better predictors of stress than major life events.[52] Kanner et al described concerns about owing money, financial responsibility, fear of rejection, and unexpected company as the daily hassles of life.[53] Epstein and Kanner et al noted that pleasant experiences and 'daily uplifts' can help to reduce and prevents anxiety and stress for both humans and infra-humans.[54] Cousins mentioned that positively toned experiences (such as uplifts) might serve as emotional buffers against stress disorders.[55]

In the context of compliance cost research, there is limited research into the psychological costs of tax compliance.[56] However, some attempts have been made for a qualitative assessment of such costs. For instance, Diaz and Delgado qualitatively measured psychological costs of taxation in Spain and found that older and retired taxpayers experience higher psychological costs because they find it more difficult to understand tax law.[57]

Smith cautioned that subjecting people to frequent visits by, and 'the odious' examinations of tax-gatherers may create unnecessary trouble, vexation, and oppression for taxpayers.[58] According to Smith, vexation has a cost, which is equivalent to the expense that every taxpayer would be willing to pay in order to be relieved of it. Based on this idea, an Australian survey undertaken by McKerchar found that experiences of stress and anxiety were very real for taxpayers.[59] Her survey asked respondents to indicate how much they would be willing to pay to have someone else complete their tax return. Some 29 per cent of respondents replied 'zero', whereas 55 per cent replied 'less than $100'. McKerchar concluded that the fact that a high percentage of taxpayers would choose not to incur monetary costs in order to complete their tax returns did not necessarily mean that they had no costs associated with anxiety and stress when completing the returns themselves.[60]

Lopes, Basto and Martins assessed individual income tax payers' psychological costs in the context of individual compliance costs in Portugal, by using a Likert scale to elicit respondents' anxiety levels before and after completion of their tax returns.[61]

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[51] T Cox, *Stress* (University Park Press, 1978).

[52] R Woellner et al, 'Can simplified legal drafting reduce the psychological costs of tax compliance? An Australian perspective' (2007) 6 *British Tax Review* 717–34.

[53] A Kanner et al, 'Comparison of two modes of stress measurement: daily hassles and uplifts versus major life events' (1981) 4 *Journal of Behavioral Medicine* 1–39.

[54] S Epstein, 'Anxiety, arousal and the self-concept' in I G Sarason and C D Spielberger (eds), *Stress and Anxiety* (Hemisphere, 1976) Vol 3, 185–224; Kanner et al, above n 53.

[55] N Cousins, 'Anatomy of an illness (as perceived by the patient)' (1976) 295 *New England Journal of Medicine* 1458–63.

[56] Woellner et al, above n 52.

[57] M Diaz and M Delgado, 'Personal income tax compliance costs in Spain' in C Sandford (ed), *Tax Compliance Costs – Measurement and Policy* (Fiscal Publications, 1995) 210–26.

[58] Smith, above n 45.

[59] M McKerchar, *The Impact of Complexity upon Tax Compliance: A Study of Australian Personal Taxpayers* (Research Study 39, Australian Tax Research Foundation, 2003).

[60] Ibid.

[61] C M Lopes, J Basto and A Martins, 'Compliance Costs of Individual Income Taxation: Some Empirical Evidence from Portugal' (2012) 12(4) *Journal of Higher Education Theory and Practice* 151–64.

Some 20 per cent of all taxpayers reported psychological costs, although 80 per cent of all taxpayers reported no psychological costs. At first glance, these results appear to indicate that taxpayers in Portugal experience relatively low levels of psychological cost in relation to tax compliance.[62] However, elderly taxpayers (those aged 56 years or more) and less educated taxpayers (particularly those with only a primary school education) incurred higher psychological costs than younger ones. None of the very young taxpayers surveyed (ie those aged 18–24 years) experienced any psychological costs with tax compliance, although this may be due to all of these respondents being dependents of taxpaying parents.[63]

Another recent study by Lopes and Martins qualitatively measured the stress and anxiety incurred by Portuguese income tax taxpayers when complying with their tax affairs.[64] They concluded that elderly and less educated taxpayers have higher psychological costs. However, the study did not consider the monetary value of psychological costs, due to valuation issues. In the context of VAT in Ethiopia, Yesegat found (in a semi-structured interview-based study) that psychological costs are a significant component of the total costs of VAT compliance in that country, although again no monetary value was given.[65]

Woellner et al conducted studies in Australia that evaluated psychological costs in a qualitative manner, relating to the behaviour and attitudes of taxpayers.[66] They concluded that using external tax assistance and advice decreases psychological costs for individual taxpayers, but increases the monetary costs of tax compliance. The study also indicated that a valuation of psychological costs is extremely difficult, but not impossible.[67] One such measure of psychological costs could be the price which people are prepared to pay in order to be rid of the trouble of interpreting and applying the law.[68]

The complexity of the tax system and uncertainties about tax law may increase compliance costs for taxpayers, as well as generate some anxiety in the process of paying taxes. As a result of tax complexity, psychological costs may increase and it is important to include them in the estimation of compliance costs. Psychological costs are influenced, however, not only by whether a tax system is enforced, but how it is enforced. Tax regulators commonly adopt one of two main approaches to enforcing the law: a stricter 'rule-based' approach, and somewhat softer 'principle-based' approach.[69] The first approach is the traditional 'enforcement' paradigm, in which regulators view taxpayers as prospective criminals whose potentially illegal behaviour must be detected through regular audits, and punished with strict penalties. The second approach is based on a less strict 'service' paradigm. It recognises that while enforcement necessarily has a role, tax authorities also need to take

[62] Ibid.

[63] All children aged 25 years or younger (with no dependents) are themselves treated as dependents in Portugal: see Lopes, Basto and Martins (2012, 160).

[64] C M Lopes, and A Martins, 'The Psychological Costs of Tax Compliance: Some Evidence from Portugal' (2013) 14(2) *Journal of Applied Business and Economics* 53–61.

[65] Yesegat, above n 14.

[66] Woellner et al, above n 49; Woellner et al, above n 52.

[67] They added that, in most cases, it is sufficient to identify taxpayers who incur this type of cost.

[68] Woellner et al, above n 49, at 40.

[69] E Kirchler, *The Economic Psychology of Tax Behaviour* (Cambridge University Press, 2007).

account of social or community norms that can be utilised to help encourage greater tax compliance through the administrative services provided by the tax authority.[70]

3.2 Corruption costs

Perceptions about fairness and corruption have been identified as crucial factors in tax compliance.[71] Feld and Frey argued that taxpayers show more willingness to comply with tax law when governments are seen to be fair, not corrupt, and to treat taxpayers respectfully.[72] Taxpayer willingness to comply with tax authorities' requirements is also related to the degree of satisfaction with public services.[73] Kirchler noted that mutual respect and trust between tax authorities and taxpayers has an important role in voluntary compliance. Trust is (inversely) related to perceptions of corruption.[74] In 2012, a survey of the European Commission revealed that 57 per cent Europeans believed that corruption is a major problem in Europe, and that bribery and the abuse of power for personal gain were widespread among the politicians. Corruption and tax evasion (intentional non-compliance) are certainly two major problems globally, which obstruct socio-economic progress in developing countries and erode welfare programmes in developed countries.[75] These two economic delinquencies sometimes occur together and sometimes substitute for one another, depending on the situation and economic condition of a country. Corruption and taxpayer non-compliance are significantly interrelated and reinforce each other in causing negative effects on government finances, growth and wealth distribution.[76] Prior literature on developing countries reveals that at least half of the taxes that could (or should) be collected by government authorities in those countries remains uncollected because of corruption and tax evasion.[77]

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[70] J Alm and J Martinez-Vazquez, 'Tax Morale and Tax Evasion in Latin America' (International Studies Program Working Paper 07-32, Andrew Young School of Policy Studies, Georgia State University, 2007).

[71] B Torgler, 'Tax Morale, Trust and Corruption: Empirical Evidence from Transition Countries' (Working Paper No 2004–05, Centre for Research in Economics, Management and the Arts, < http://www.crema-research.ch/papers/2004-05.pdf>, 2004); M Wenzel, 'Tax Compliance and the Psychology of Justice' in V Braithwaite (ed) *Taxing Democracy*: *Understanding Tax Avoidance and Evasion* (Ashgate, 2003)41–70;

[72] L Feld, and B Frey, 'Trust Breeds Trust: How Taxpayers are Treated' (2002) 3 *Economics of Governance* 87–99.

[73] J Alm et al, 'Taxpayer Information Assistance Services and Tax Compliance Behavior' (2010) 31 *Journal of Economic Psychology* 577–86.

[74] Kirchler, above n 69.

[75] O O Julius, 'Tax Evasion, Tax Avoidance, and Corruption: An Interface with Source of Revenue for Development in Nigeria' (The Third Emerging Scholar Colloquium, IPA, 2006) 1–59.

[76] A Litina and T Palivos, 'Explicating Corruption and Tax Evasion: Reflections on Greek Tragedy' (Discussion Paper Series, University of Namur, <http://www.fundp.ac.be/eco/economie/cred/CORRUPTION%20AND%20EDUCATION%20LITINA.pdf>) 1–31.

[77] P R Krugman et al, *Transforming the Philippine Economy* (APO Production Unit Inc, 1992); R Bird, *Tax Policy and Economic Development* (The Johns Hopkins University Press, 1992); J Alm, R Bahl and M N Murray, 'Tax Base Erosion in Developing Countries' (1991) 39(4) *Economic Development and Cultural Change* 849–72.

Flatters and Macleod have identified three agents in developing countries that can be involved in corruption.[78] They are the Minister of Finance (or government or President) who sets the revenue target; the collector who collects the revenue for the Ministry of Finance; and the taxpayer who pays the tax to the collector. The first agent might inadvertently facilitate or exacerbate the risk of corruption by formulating complex tax law and policies, while the last two agents might be directly involved in corruption and tax evasion.[79] In the case of most developing countries, tax officials can be lowly paid, the monitoring system is inefficient, and the taxation system is complex. In addition, the tax system can be manually operated and the tax collectors might overlook various types of intentional non-compliance activities in exchange for bribes from taxpayers.

Obid has examined the effect of corrupt tax administration on tax compliance.[80] She points out that a poorly paid tax official with poor ethics might choose to maximise personal benefit by colluding with taxpayers, including by utilising the complexities of the tax system and the inadequate resources of the tax administration to their advantage. She argues further that corruption negatively affects the equity and fairness of the tax system, as well as the efficiency of the tax administration.

Despite its importance, very little empirical research has been conducted to date on corruption and taxpayers' non-compliance in Bangladesh. Monir exposed the absence of a tax culture among income earners, inadequate taxpayer service, complexities and unfairness in income tax estimation, weak enforcement and the negative image of the income tax department work as influential driving forces for tax non-compliance.[81] The empirical findings of that study also revealed that corruption was facilitated by inappropriate relationships between self-interested, rent-seeking income tax officials, taxpayers and tax agents.[82] However, Monir's study was limited to income tax evasion in the socio-economic and administrative context of Bangladesh, and the extent to which her findings can be generalised to the issue of VAT non-compliance by SMEs in Bangladesh is uncertain.

With this in mind, this study sought to explore these two hidden costs – psychological and corruption costs – of VAT compliance for SMEs in a developing nation, Bangladesh.

4. METHODOLOGY

This study adopted a mixed methods approach, utilising quantitative and qualitative methods. This type of mixed methods approach is most likely to maximise, as far as is practically possible, the internal and external validity of the results.[83] While much of

[78] F Flatters and W B Macleod, 'Administrative Corruption and Taxation' (1995) 2 *International Tax and Public Finance* 397–417.

[79] F Alamgir, T Mahmud and Iftekharuzzaman, 'Corruption and Parliamentary Oversight: Primacy of the Political Will' (Paper presented at the Seminar on the International Anti-Corruption Day, Organised by Transparency International Bangladesh, 9 December 2006) 1–21.

[80] S N S Obid, 'The Influence of Penalties on Taxpayers' Compliance: A Comparison of the Theoretical Models' (2004) 12(1) *International Journal of Economics, Management and Accounting* 1–31.

[81] N R Monir, *Political Economy of Corruption: The Case of Tax Evasion in Bangladesh* (Unpublished PhD Thesis, Monash University, 2012).

[82] Ibid.

[83] S W Huck, W H Cormier and W G Bounds, *Reading Statistics and Research* (Harper & Row, 1974).

the earlier empirical literature on tax compliance costs and tax non-compliance utilised quantitative research methods, more recent studies have used a combination of quantitative and qualitative methods.[84]

Permission was obtained from the NBR to obtain lists of SMEs taxpayers that filed monthly VAT returns in financial year 2011–12. Participants were divided into three groups:

- SME taxpayers who have no non-compliance history and registered with VAT for at least three years (Referred to as Compliant VAT payers, and abbreviated to CT);[85]
- SME taxpayers who had VAT non-compliance cases decided against them and who had already paid the fines and penalties imposed on them (referred to as Non-Compliant VAT payers, and abbreviated to NCT);[86] and
- NBR's VAT Officials from field level to policy level and who have been working with the NBR at least for eight years (Referred to as VAT Officials, and abbreviated to VO).

The study was conducted in three stages. Stage 1 involved focus group discussions (FGD) with VAT payers of the SME sector (both CTs and NCTs) and VAT Officials. After completing the focus group discussions, a survey was designed through three stages: a first draft of the survey, pilot testing, and a revision of the initial draft survey. The revised survey was then submitted to independent readers for checking before commencing the actual survey. Stage 2 involved the mailing of a survey, seeking qualitative and quantitative data, from both complying and non-complying SMEs taxpayers. Participation was voluntary and no financial incentives were given for their time. Stage 3 involved in-depth semi-structured interviews with NBR officers and taxpayers. Those taxpayers who filled out a questionnaire in Stage 2 and who expressed their willingness to take part in in-depth interviews were included in the face-to-face interview in Stage 3. As this study used human subjects, it was necessary to ensure that ethics approval was received before commencement of each stage.

The overreaching research questions of this study are:

- Do Bangladeshi SME taxpayers' compliance costs include the costs of psychological impacts?

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[84] B Tran-Nam and J Glover, 'Estimating the Transitional Compliance Costs of the GST in Australia: a Case Study Approach' (2002) 17(4) *Australian Tax Forum* 499–536; J Glover and B Tran-Nam, 'The GST recurrent compliance costs/benefits of small business in Australia: a case study approach' (2005) 1(2) *Journal of Australasian Tax Teachers Association* 237–58; McKerchar, above n 59; E C Loo, 'Tax knowledge, tax structure and compliance: A report on a quasi-experiment' (2006) 12(2) *New Zealand Journal of Taxation Law and Policy* 117–40; Yesegat, above n 14.

[85] Compliant taxpayers (CTs) were those who had paid VAT to the NBR and who had no dispute in respect of their VAT payments; or taxpayers who had had a dispute with the NBR but had subsequently been vindicated by the NBR, the Tribunals, or the Courts.

[86] Non-compliant taxpayers (NCT) were those who had either not paid the correct amount of VAT to the NBR (as assessed by NBR's VAT Inspectors) and who had had a dispute in respect of their VAT payment but who ultimately lost their appeals through the NBR, the Tribunals, or the Courts. For ethical reasons, taxpayers who were still engaged in ongoing dispute with the NBR in respect of their VAT payment were excluded from the study.

- What is the value of any psychological costs, as a proportion of taxpayers' total compliance costs?
- What factors contribute to psychological costs among taxpayers?
- What effect does corruption have on VAT compliance cost?

It appears that most previous studies of psychological costs were qualitative in nature. In this study, an attempt has been made to estimate psychological costs both qualitatively and quantitatively. Having said that, our psychological cost estimates must be interpreted in the light of the myriad of difficulties faced by researchers seeking to measure them.

Surveys relating to tax non-compliance are also complicated by the sensitive nature of the topic and the threat of penalties, prosecution and stigmatization, which can induce taxpayers either to lie about their tax evasion behaviour, or refuse to take part in the study.[87] A number of strategies were adopted to try to minimise this. For example, many questions were raised in the third person rather than posed directly to the taxpayer; and participants were de-identified in all transcripts and responses.

4.1 Focus Group Discussions (FGDs)

The focus groups were conducted in Dhaka, the capital city of Bangladesh, because of the respondents' location. A total of 45 participants participated in the FGD, comprising 15 CTs (11 business owners and 4 VAT Directors of the businesses); 15 NCTs (12 business owners and 3 VAT consultants from selected enterprises); and 15 VAT Officials (9 Joint Commissioners of VAT and 6 Second Secretaries of VAT from the NBR). Because very few participants were fluent in English language, the discussions were conducted mainly in Bangla, the common language especially among SMEs. The discussions were recorded for transcription, although any identifying names or references were removed from the transcriptions. The confidentiality and anonymity of the recorded data was confirmed by coding the participant and not using participants' names. The findings of the FGDs are presented later in this article.

4.2 Survey design

In Stage 2 a survey was mailed to compliant and non-compliant SME taxpayers, with a view to gathering both quantitative and qualitative information on factors affecting VAT compliance, and for the estimation of VAT compliance costs. The questionnaire was designed using mainly closed-ended questions in order to gather numerical data, in the form of information which could be verified against documentation (such as the value of fees paid to professional advisers); in categorical form (such as tax rates applicable to different product categories); or in integer format (such as taxpayers' ratings of their perceptions on a 1–6 Likert scale). Other open-ended questions were also included in the survey, including those relating to taxpayers' perceptions of the integrity of VAT Officials and suggestions for improving the VAT in Bangladesh.

After the pilot test and refinement of the survey instrument, a total of 500 questionnaires were distributed to SMEs VAT payers from June 2013 to September

[87] J Houston and A Tran, 'A Survey of Tax Evasion Using the Randomized Response Technique' (2001) 13 *Advance Taxation* 69–94.

2013. The SME VAT payers were selected based on purposive sampling from NBR's taxpayers list. Out of this total, 200 questionnaires were distributed to NCTs group and remaining 300 questionnaires were distributed to CTs. Two reminders were sent to the taxpayers to improve the response rate. This process yielded 240 usable sets of responses (152 from CTs and 88 from NCTs). This represented an overall response rate of 48 per cent, comprising a response rate of 51 per cent from CTs, and a response rate of 44 per cent from NCTs.

Since VAT extends to the whole of Bangladesh, mail survey data were collected from the target population resident in the business regions of the city corporation area, as well as the district town and Upazilla areas. A summary of the participants' characteristics is shown in Table 3. Most of the respondents of mail survey were well qualified in terms of academic qualifications, 35 per cent holding a master's degree and 38 per cent holding a bachelor's degree. Some 50 per cent of respondents were from manufacturing business units and an average 45 per cent were sole business proprietors. Regarding their manner of keeping accounting records, 43.1 per cent from the compliant group and 34.1 per cent from the non-compliant group indicated that their systems were fully manual. The rest noted that either their accounting systems were fully or partially computerised, or their external accountants or tax advisors kept their accounting records.

Table 3: Summary of Stage 2 Participants' Characteristics

Characteristics	Compliant (N=152) n (%)	Non-Compliant (N=88) n (%)
Location of business / enterprise		
City corporation area (Dhaka)	33 (21.7)	35 (39.8)
City corporation area (Other)	60 (39.5)	26 (29.6)
District town	33 (21.7)	15 (17.1)
Upazilla area	26 (17.1)	12 (13.6)
Primary business / enterprise		
Manufacturing	75 (49.3)	44 (50.0)
Construction Units	16 (10.6)	12 (13.6)
Service Rendering Units	36 (23.7)	16 (18.2)
Traders (local, importers, exporters, commercial importers)	25(16.4)	16(18.2)
VAT related record keeping practice		
A manual / paper system	65 (43.1)	30 (34.1)
A partially computerised system	58 (38.41)	39 (44.3)
A fully computerised system	18 (11.9)	18 (20.5)
Tax adviser / external accountant	10 (6.6)	1 (1.1)
Average monthly VAT paid in FY 2011–12 (BDT)		
Under 400 000 (Under USD5172)	45 (29.6)	28 (31.8)
400 001–600 000 (USD5173–USD7759)	27 (17.8)	11 (12.5)
600 001–800 000 (USD7760–USD10 345)	12 (7.9)	10 (11.4)
800 001–1 0000 000 (USD10 346–USD12 930)	19 (12.5)	10 (11.4)
More than 1 000 001 (More than USD12 930)	49 (32.2)	29 (33.0)
Education level		
Below SSC	0	1 (1.14)
HSC	19 (12.5)	14 (15.90)
Certificate	2 (1.32)	3 (3.41)
Diploma	11 (7.24)	7 (7.95)
Bachelor's degree	58 (38.15)	33 (37.50)
Master's degree or above	60 (39.47)	24 (27.27)
Others (CA, LLB, MBA, PhD)	2 (1.32)	5 (5.68)

4.3 In-depth interviews

A face-to-face in-depth interview was chosen for Stage 3, consistent with Patton's fundamental principle of interviewing – namely, to provide a framework within which respondents can express their own understandings in their own terms.[88] Guest, Bunce and Johnson suggest that for data collection using interviews, the minimum sample is 12 participants and if the sample is highly homogenous, a sample of 6 interviews could be sufficient to enable a meaningful theme to appear.[89] To better understand the issues of psychological costs faced by SME taxpayers in Bangladesh, 12 in-depth interviews were conducted with VAT Officials. In addition, 14 SME taxpayers were interviewed to better appreciate their perceptions about the psychological costs of VAT.

5. FINDINGS

To explore the issue of VAT compliance costs, the findings for the focus groups (Stage 1), the survey (Stage 2) and the in-depth discussions (Stage 3) are presented below.

The general results of this survey are reported elsewhere, but the focus of this article is to analyse and present in-depth results relevant to psychological costs and corruption.[90] The general results suggest that a majority of compliant SME taxpayers considered complexity in VAT Law and compliance costs as two important factors influencing VAT non-compliance by SMEs. On the other hand, NCTs emphasised the positive relationship between VAT Officials and taxpayers who exhibited compliant behaviour. The likelihood of audits, penalties and sanctions were found to have less effect on VAT non-compliance for NCTs. In comparison, greater monitoring and penalties were viewed as ways of encouraging even greater compliance by compliant taxpayers.[91]

5.1 Estimate of psychological costs

During the FGDs, there were some statements that suggested that participants from the taxpayers' group had not previously considered the potential psychological costs of VAT:

> I think the majority of the general taxpayers have no idea. There'd be a small portion who understand it, but I think as many as 90 per cent have no idea. **(CT 9)**

> I think there are a lot of taxpayers out there who don't even know the exact definition of VAT compliance costs, let alone the psychological costs of VAT. **(VO 5)**

To try to tease out further discussion, possible psychological costs of taxation were discussed. This generated discussions about complexity in the VAT Law, taxpayer

[88] M Q Patton, *Qualitative Research & Evaluation Methods* (Sage Publications, 2002).

[89] G Guest, A Bunce and L Johnson, 'How many interviews are enough? An experiment with data saturation and variability' (2006) 18(1) *Field Methods* 59–82.

[90] Above n 28.

[91] Ibid.

dependency on the VAT consultants, the nature and extent of connections with the NBR and political parties, the honesty (and dishonesty) of the VAT Officials, surprise visits by NBR Officials, the discretionary power of VAT Officials, and the nature of VAT audits.

Complexity of the VAT law was considered by most of the participants (CT and NCT) in the FGDs to be one of the main drivers of the psychological costs of VAT compliance. This was supported by in-depth interviews in Stage 3. The CTs expressed that the VAT Law in Bangladesh is very complex and difficult to understand. A few compliant participants stressed that they could not cope with the changes to the law. Price declarations, complicated rebates and refund procedures that required many accounts to be maintained, made the VAT Law very complex and stressful for participating SMEs. The following statement is indicative of the 'uncertainty' underpinning taxpayer anxiety:

> If the VAT record-keeping system were less complicated with a simpler payment system, compliance costs and mental pressure would be lower. I think then the business community would deposit the right amount of VAT owing. **(CT 1)**

A strategy adopted to reduce this complexity was to employ VAT advisors and VAT accountants to assist with VAT obligations. Gaining assistance from advisors or accountants was seen as providing some relief from tension or anxiety, although it clearly increased VAT compliance costs in monetary terms:

> As the VAT Law is complicated in Bangladesh, I usually get help from VAT consultants. An experienced consultant can help us with price declarations and getting proper refunds. So their fees are very high. I don't mind to pay higher salary to VAT consultants, as they are helping me to get a hassle-free business life. I can concentrate more on my business now. **(CT 8)**

> My VAT advisor looks after everything to do with my VAT affairs and all the costs related to VAT. But I think the extra cost related to VAT is higher than other tax-related payments. Although my advisor is helping me to keep away from tension and anxiety, I think I would have invested more money into my business if I didn't have to pay my VAT advisor. **(CT 4)**

This notion of employing others is consistent with the notion of paying others to remove the stress of compliance.[92]

Some respondents during the Stage 3 in-depth interviews took the view that psychological costs related to 'resentment' were (or should be) included in VAT compliance costs. They reported that 'hassles' from VAT Officials, 'financial dealings' with VAT consultants and revenue officials, and 'worries' about NBR decisions added to the level of stress of their lives. Some NCTs admitted that dealing with higher VAT Officials in relation to objections for non-compliance was the most unpleasant thing for them. Fear of confrontation and rejection, or the possibility of losing money through fines or penalties, triggered psychological pressure for taxpayers. To cope with feelings of resentment, some taxpayers bribed officials to 'make the problem go away':

[92] McKerchar, above n 59.

> VAT Officials are unfriendly and unfair. If you don't maintain a lawful relationship with them, you feel rejected. I had a bitter experience with them over a VAT audit case. Irregularities were raised on the basis of whim, rather than on substantial grounds. Whenever I raised the issue, they became arrogant with me. I felt so disgraceful that I needed to consult with a psychiatrist twice to forget that incident. Finally, I thought it might be better to give them some money and settle the case 'unofficially'. **(NCT 4)**

Taxpayers also resented how they were treated at a basic level:

> Last year I had a hearing with the Commissioner of VAT in his office. I had to wait an extra five hours to meet with him. The Commissioner was so rude, saying that I am not a taxpayer, I am a thief. I was shocked. I realised that I made a mistake in my tax planning. I should have employed a VAT consultant to mitigate the case. It would have cost me more, but I might have been saved from this disgraceful behaviour. I think VAT compliance costs include this type of adverse psychological effect, which actually costs a lot. **(NCT 1)**

Half of the taxpayers in Stage 3 (7 out of 14) indicated that they had encountered problems in dealing with the VAT Law and had employed a VAT consultant. It was apparent that, from the perspective of the respondents, complexity existed and increased the VAT compliance costs along with psychological costs. For many to reduce their anxiety over VAT compliance, they employed others. The participants considered that the psychological costs of a business owner should include the costs of tax professionals and also psychiatrists:

> I use a consultant to achieve the feeling of confidence that my VAT return has been completed and submitted correctly. I also feel that to get assistance from a consultant is time-effective and less worrying for me. **(CT 5)**

> I have always lodged my VAT return on time every month since I started my business. Last month I was busy due to my business's relocation. Consequently, my VAT return submission was late. I am very surprised the Divisional office did not value my previous record and my unintentional delay. I received a phone call from a VAT Officer with an angry voice. I found myself feeling threatened. It surprised me, because I know of others who haven't ever submitted VAT return on time and have been rarely chased up by the VAT Officer. One of my close friends suggested I go on a monthly arrangement with the local VAT Office for a hassle-free business, or hire a consultant to contact the VAT Office on my behalf. I think that, to get rid of all these unwanted hassles, we have to accept extra costs. These costs should include the psychological costs of VAT. **(CT 4)**

The employment or engagement of an advisor was also used to put the taxpayers on a more equal footing with tax officials:

> The NBR assumes taxpayers are guilty of tax evasion until the taxpayer proves himself innocent. I pay an accountant in my business do my VAT-related work and VAT returns, because it assists me to prove my innocence to the NBR and keep myself mentally peaceful. The VAT system is loaded against SME taxpayers. **(NCT 3)**

One important issue is apparent from the above comments that many taxpayers want to comply with the VAT Law and relief from stress is a significant issue for them. They are ready to pay VAT consultants and sometimes VAT Officials to get relief from anxiety and stress.

The importance of VAT consultants was also evident from the mail survey (Stage 2). In this survey, 55 per cent of the CTs and 42 per cent of NCTs paid an external adviser to assist with VAT compliance. Reasons for using VAT consultants included the complexity of the VAT Law (72 per cent of CTs, and 69 per cent of NCTs agreed or strongly agreed). It appears that CTs are more motivated to comply, as 70 per cent of CTs (compared to 54 per cent of NCTs) agreed or strongly agreed that they used external help to ensure compliance with VAT obligations.

5.2 Sector Wide Psychological Costs

This study sought to estimate the psychological costs, if any, associated with VAT compliance. Woellner et al described psychological costs of tax compliance as the negative experiences (such as anxiety and frustration), or stress, caused by tax compliance.[93] In developed economies, people who suffer from the psychological effects of stress or anxiety may self-medicate through alcohol and/or smoking; consult a psychologist or psychiatrist; possibly take prescribed medication; or, in some cases, take illicit drugs. Due to Bangladesh being predominately a traditional Muslim country, Bangladeshis experiencing stress or anxiety tend not to drink. The empirical indicators used to try to estimate psychological costs associated with the VAT compliance were the average annual cost per taxpayer of sleeping pills, tobacco, consulting psychologists or psychiatrists or similar medication used to relieve the symptoms of anxiety or stress connected with such compliance. While this is not a perfect indicator of the psychological costs, it does provide some important initial evidence in this regard.

In this analysis, VAT taxpayers were divided into five categories, namely small firms which paid less than BDT400 000 in VAT (Group 1); intermediate SMEs which paid BDT400 001-–600 000 in VAT (Group 2), and BDT600 001–800 000 (Group 3); and large SMEs which paid BDT800 001–1 000 000 in VAT (Group 4), and BDT exceeding 1 000 000 (Group 5). Respondents were also divided into different sectors, namely manufacturing, construction, services and traders. Sector-specific monthly average psychological costs, based on the monthly VAT paid by compliant and non-compliant SME taxpayers, are presented in Table 4 and Table 5.

[93] Woellner et al, above n 49; Woellner et al, above n 52.

Table 4: Average Psychological Costs of CTs

Group	VAT Payment Group (expressed in BDT)	Sector wide Psychological Costs of VAT for CTs			
		Manufacturing Units (BDT / USD)	Construction Units (BDT / USD)	Service Rendering Units (BDT / USD)	Traders (BDT / USD)
1	Under 400 000	6 995 / 93	3732 / 50	2362 / 31	5643 / 75
2	400 001–600 000	16 222 / 216	13 125 / 175	12 500 / 166	13 409 / 179
3	600 001–800 000	16 666 / 222	none	14 305 / 191	14 389 / 192
4	800 001–1 000 000	24 259 / 323	13 125 / 175	21 666 / 289	20 833 / 278
5	More than 1 000 001	41 585 / 554	36 250 / 483	34 881 / 465	32 023 / 427

Psychological costs in the Table are quoted first in BDT, and then in USD (the relevant exchange rate being 1 USD = 75 BDT). Thus, for example, psychological costs for compliant taxpayers in the manufacturing sector paying less than BDT400 000 in VAT during the relevant period averaged BDT6995 or USD93.

Table 5: Average Psychological Costs of NCTs

Group	VAT Payment Group (expressed in BDT)	Sector Wide Psychological Costs of VAT For NCTs			
		Manufacturing Units (BDT / USD)	Construction Units (BDT / USD)	Service Rendering Units (BDT / USD)	Traders (BDT / USD)
1	Under 400 000	5138 / 69	4166 / 55	4583 / 61	7234 / 96
2	400 001–600 000	8250 / 110	7666 / 102	6333 / 84	6439 / 86
3	600 001–800 000	18 750 / 250	15 000 / 200	15 277 / 204	13 289 / 177
4	800 001–1 000 000	19 723 / 263	16 666 / 222	12 500 / 166	18 724 / 250
5	More than 1 000 001	41 666 / 556	33 208 / 443	27 600 / 368	33 323 / 444

Again, psychological costs in the Table are quoted first in BDT, and then in USD (the relevant exchange rate being 1 USD = 75 BDT). Thus, for example, psychological costs for non-compliant taxpayers in the manufacturing sector paying less than BDT400 000 in VAT during the relevant period averaged BDT5138 BDT or USD69.

These results indicate that the psychological costs of VAT in Bangladesh in the year under consideration were generally higher for the manufacturing sector than other sectors.[94] There are five main reasons why greater psychological costs are generally likely to be incurred by VAT payers in the manufacturing sector than traders or other businesses. First, more NBR and taxpayer discretions apply to manufacturing than other sectors (eg, in relation to valuations for VAT purposes[95]), and uncertainty about how these discretions might be applied by the NBR are likely to generate anxiety. Partly because of these manufacturing-specific discretionary powers, NBR Officials tend to visit and audit manufacturers more frequently than traders or other businesses, creating further stress for manufacturers.

Second, manufacturers, many of which are foreign-owned, are more likely to engage (and be able to afford) a tax accountant in order to transfer the stress of VAT compliance away from management (a cost which taxpayers therefore include in the psychological costs of VAT compliance).[96]

Third, manufacturers typically pay more in bribes than traders and other businesses in Bangladesh because more things can go wrong with VAT calculations and assessments in manufacturing, which is more complex than many other businesses in Bangladesh; and because they need to deal harmoniously with more stakeholders (see below).

Fourth, manufacturers typically claim for refunds and rebates more than traders and other businesses in Bangladesh, who tend not to make such claims, and manufacturers' anxiety (and possibly resentment levels) increase when NBR Officials question these claims. Because all claims processing at the NBR is performed manually, manufacturer-taxpayers must travel to the nearest VAT Office in order to have their refunds and rebates processed. In comparison, traders and other businesses that do not claim refunds or rebates need not travel to VAT offices, thereby avoiding the stress associated with such visits.

Fifth, as a socio-cultural phenomenon, manufacturers (often foreign-owned) are more likely to pay bribes to local political leaders (and sometimes local police) to facilitate business (eg, for town planning applications to extend a factory) than traders or other

[94] This is subject to one exception, namely that non-compliant manufacturers paying less than BDT400 000 in VAT reported lower psychological costs than traders. These traders were mainly owners of 'super shops' in city areas ('super shops' being smaller versions of the discount supermarkets found in many western economies). These traders paying less than BDT400 000 were legally required to maintain both manual and computerised records (although traders in higher VAT payment brackets needed only to keep computerised records). Group 1 traders' efforts to maintain both manual and computerised records resulted in record-keeping discrepancies between the two sets of accounts (manual and computerised). As a result, these traders were considered non-compliant by the NBR and their anxieties over this, together with their anxiety about the costs of settling their cases with the NBR over their alleged non-compliance, are likely to be reasons for these traders' higher psychological costs.

[95] For example, the suppliers of VAT-able goods in Bangladesh, before making a supply, have to make a declaration, on a prescribed form, of the selling price of their goods. The declared price is supposed to be the price for the assessment of VAT. The prescribed value declaration Form (Mushak-1) requires the supplier to provide information to the VAT office with a description of the goods, the unit of supply, the name and quantity of raw materials and packaging materials used for each unit of the good along with the percentage of wastage, cost of inputs including customs duty, supplementary duty, letter of credit fees and other charges, as applicable.

[96] See the discussion after Table 6 below.

businesses, and some manufacturers believe that such costs of doing business are (or should be) part of the psychological costs of VAT compliance, or even that these costs should be reflected in the VAT they pay.[97]

Further in this regard, during an in-depth interview one respondent claimed that the owners of manufacturing firms also have to tolerate extra costs, both monetary and psychological, in order to run a manufacturing unit because of the larger number of stakeholders involved:

> As I am the owner of a manufacturing firm, I have to look after so many things related to VAT. We not only have to satisfy the VAT Officials. We have to think about income tax issues. I have also to talk with my income tax consultant before submitting my monthly VAT return. We have to satisfy the local political leaders and in some cases local police also to run my business smoothly. I can't show them in black and white. So I think VAT compliance costs and psychological costs related to VAT are relatively higher in Bangladesh for manufacturers. **(CT 1)**

The discretionary power of VAT Officials was acknowledged as one of the main reasons for manufacturers' higher psychological costs in Bangladesh:

> The discretionary power of VAT Officers is really terrifying to me. They can set our prices, seize our products any time at any place, they can visit your business premises even at midnight. How powerful are they? I think most taxpayers feel very worried when they visit us. My psychological cost of VAT becomes higher when I submit my price declaration documents to them. **(CT 7)**

Such sentiments reflect not only anxiety (given the inconvenience and trouble caused for taxpayers), but also resentment (eg, from a perceived invasion of privacy or even oppression). It may be no coincidence that, despite living in a developing economy where many taxpayers could presumably ill-afford it, 19 per cent of respondents (ie almost one in five) had consulted a psychologist or psychiatrist because of stress in relation to VAT.[98]

Other drivers of taxpayer (manufacturer) anxiety over VAT issues were also reported. Another respondent claimed that they have to go the VAT offices five times on average to manage the VAT Officials to get the approval of value declaration, input tax credit or for refund. The need for, and frequency of, such visits cause higher VAT compliance costs for manufacturers in Bangladesh. In addition, some of the CT respondents indicated that their concerns about VAT are increased by 'estimated assessments' which are far in excess of the actual liability, or by surprise visits from local VAT Officials or the audit team. This could be due to an unequal power between VAT Officials and SMEs, which can foster anxiety and resentment. One way to manage such stress is to 'transfer' it by hiring VAT consultants:

> We, the taxpayers, do not often go to the VAT experts for tax savings; we come mostly to lift the burden of worrying about VAT. **(NCT 5)**

[97] See the discussion following Table 6 below.

[98] Taxpayer responses regarding the types of remedies they took in order to reduce their stress and anxiety from VAT issues are explored below.

Our findings about stress arising from the discretionary power of VAT Officials are consistent with previous literature. Because of a general belief that VAT Officials wield very strong powers and sometimes use all the powers at their disposal to obtain outstanding VAT, business organisations such as the Federation of Bangladesh Chambers of Commerce and Industries (FBCCI) and the Dhaka Chamber of Commerce and Industries (DCCI) have proposed that VAT Officials' discretionary powers be curtailed in the new VAT Law, in order to reduce the compliance burden for business.[99] The majority of NBR Officials believed that these powers were necessary to maximise compliance and to act as strong deterrents.[100] However, a few (2 out of 12) NBR Officials believed that excessive power was not effective in preventing intentional non-compliance as long as those taxpayers have few ethical concerns about not paying the correct VAT:

> I believe we should have some discretionary power to handle the non-compliant taxpayers. But ethics is very important for voluntary compliance. As long as the taxpayers are not willing to pay VAT ethically, the situation will not improve. I think complexity, compliance costs, ethics and some discretionary powers of VAT Officials all are equally important to make taxpayers interested in paying the right amount of taxes. (**VO 8**)

The FBCCI and DCCI proffered their proposed amendments to the VAT Law in 2012. Since that time, the VAT Law has been amended to curtail somewhat the discretionary powers of NBR Officials, and the new VAT legislation is being implemented from 1 July, 2015. Examples of the NBR's curtail discretionary powers include a truncated base for assessment of the VAT, and removal of the power of determination of turnover taxes. However, discretions around the provision of tariff values, the use of stamp and *banderole*, the input-output coefficient for manufacturers, and section 26 of the existing VAT Law (ie the power of make 'surprise' visits to taxpayers' premises) will continue. Moreover, the NBR will now have vested additional powers to recover VAT, including freezing a tax debtor's bank accounts, placing a lien on the tax debtor's property, and holding company directors liable for paying unpaid taxes. Thus, while some action has been taken to implement the FBBCI's and DCCI's 2012 proposals to curtail the NBR's discretionary powers, the risk remains that NBR Officials might continue to misuse their powers and perpetuate alleged corruption.

Respondents were asked to indicate the types of remedies that they took to reduce stress and anxiety in relation to VAT. The most common ways in which taxpayers coped with the psychological costs of VAT compliance were taking medicine such as sleeping pills (27 per cent), taking tobacco (22 per cent), consulting with a psychologist or psychiatrist (19 per cent), or self-medicating (7 per cent).[101] Out of the remaining 25 per cent of respondents, 13 per cent took part in activities such as

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[99] Financial Express, *FBCCI for Reducing VAT Officials' Discretionary Power* (10 May 2012) <http://print.thefinancialexpress-bd.com/old/more.php?date=2012-05-10&news_id=129179>; Finance Minister Abul Maal Abdul Muhith, 'Budget Speech 2013–2014' (Speech delivered at the National Parliament House, Dhaka, Bangladesh, 2013)

[100] A M Saleheen, 'Presumptive Taxation under Bangladesh' (2012) September/October *International VAT Monitor*, , 316–21.

[101] In developed Western economies, people who suffer from the psychological effects of stress or anxiety may self-medicate through alcohol and/or smoking; consult a psychologist or psychiatrist; possibly take prescribed medication; or, in some cases, take drugs that are not prescribed. In Bangladesh, the findings have some similarities regarding consulting with a psychologists or psychiatrist, as 19 per cent of respondents took this as a remedy from psychological pressures of the VAT.

vacations, being with family, socialising, eating out, shopping, travelling, entertainment, and using alcohol. Some 12 per cent pointed out that their use of a VAT adviser meant they never felt any stress or anxiety, as they thought their VAT consultants were very efficient in relation to VAT. This supports an inference that, for many, using VAT advisers is a way of mitigating the psychological costs of VAT compliance.

In addition to the measure of psychological costs, VAT taxpayers were asked to consider the question: 'If you could claim from the VAT Authority for your stress or anxiety in the 2011–12 financial year about complying with VAT for your business, how much would you have claimed?'

Results showed that the figures which taxpayers would claim (if they could) from the NBR for stress or anxiety (Table 6) were higher, by a factor of 8 to 10, than their previous estimates of psychological costs as set out in the preceding Tables 1, 2, 4, and 5. For example, while Group 1's estimates of psychological costs for VAT were BDT4648, the amount they would like to claim (if they could) from the NBR was BDT35 000. This is an amount greater than their total VAT compliance costs. Indeed, the amount that Groups 4 and 5 would like to claim (if they could) from the NBR was almost double their total VAT compliance costs (Table 6).

Table 6: Difference between Psychological Costs and Taxpayers' Claims to NBR

Components of Average Compliance Costs	**Average Money Spent by CTs (BDT)**				
	Group 1	Group 2	Group 3	Group 4	Group 5
Psychological costs for VAT	4648	13 521	11 495	22 861	31 176
Total VAT Compliance Costs (monetary costs plus psychological costs)	32 470	75 149	86 110	117 439	210 441
The amount taxpayers would claim to VAT authority for stress and anxiety	35 000	50 000	65 000	250 000	400 000
	Average Money Spent by NCTs (BDT)				
	Group 1	Group 2	Group 3	Group 4	Group 5
Psychological costs for VAT	6622	7985	16 273	19 444	33 045
Total VAT Compliance Costs (monetary costs plus psychological costs)	41 713	61 836	91 273	122 344	260 700
The amount taxpayers would claim to VAT authority for stress and anxiety	50 000	63 000	85 000	275 000	520 000

At first glance, this discrepancy appears to betray inconsistency in the way taxpayers perceive and value the psychological costs of their VAT compliance. For example, it could be that taxpayers are inconsistent in their estimates of psychological costs if they are asked to estimate total amounts holistically (a top-down approach), rather than individual cost components (a bottom-up approach). On closer reflection, however, it is more likely that the responses given are driven by the way in which the question was framed. If taxpayers are asked what amounts they would claim for stress from the NBR, it would be rational for them to interpret the question as meaning 'If you find the entire process of VAT compliance stressful, how much would you be

willing to pay to make this entire process go away if you knew the NBR would reimburse you?' 'Psychological' cost estimates by taxpayers could then understandably include the costs of engaging VAT advisors or accountants to transfer the stress away from taxpayers,[102] as well as the value of bribes or 'speed money' paid to VAT Officials to progress matters. It is also possible that the figures which taxpayers report they would claim (if they could) from the NBR for stress or anxiety are simply ambit claims, although this seems unlikely given the level of candour and transparency exhibited by respondents.

This result is supported by findings from FGDs and in-depth interviews when the respondents were asked to indicate how much they would be willing to claim from the VAT authority for their stress or anxiety. Most of their responses were, 'The amount I paid my VAT Consultant, VAT advisor, or the "speed money" I paid the VAT Officials'. However, about 20 per cent of CT respondents and 21 per cent of NCTs noted that they did not want to claim anything from the VAT authority. This was because they thought that stress is part of running a business or is compensated by 'getting it right':

> I know doing VAT-related work by me is disappointing, but I find no means to pay others from my business's profit. I faced problems while doing this, but it's my duty as a businessman. I don't want to claim anything from NBR. **(CT 7)**

> There is no doubt that I had stress and anxiety for my tax-related work. I had to spend lots of hours to complete those. But when I finished everything, I felt very relaxed. I realise that I can argue with the VAT Officials if they chase me. I have that confidence within me. I don't believe in the concept of claiming from the VAT authority for my stress and anxiety. I think good behaviour or a compliment from the VAT Officials is enough for me. **(CT 4)**

It was found that psychological costs appear to account for 15.5 per cent of total VAT compliance costs in Bangladesh. The results suggest that psychological costs may be a substantial component of VAT compliance costs for SMEs in Bangladesh, with little difference between CTs and NCTs. However, it was not possible to compare whether 15.5 per cent (being an estimate of psychological costs as a proportion of total VAT compliance costs) has changed significantly over time, since there is no prior study on the monetary value of psychological costs in Bangladesh.

Woellner et al report that simplified legal drafting reduces the psychological costs of tax compliance.[103] Regarding the stress and anxiety (psychological costs) that VAT causes, Yesegat points out those Ethiopian taxpayers perceived the burden of psychological costs to be high and very high.[104]

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[102]In this context, the costs of engaging external advisors, while they may be useful in transferring stress or anxiety away from taxpayers, would appear to boost taxpayers' cost estimates considerably. The cost of external advisers is reflected in the fact that only 17 per cent of the SMEs in Group 1 used assistance from external VAT consultants, whereas 72 per cent of the SMEs in Group 4 and Group 5 used external advice for compliance. One interpretation is that only relatively wealthy taxpayers can afford the cost of external advice.

[103]Woellner et al, above n 52.

[104]Yesegat, above n 14.

In the present study six attitudinal statements were included in the survey relating to psychological costs (stress and anxiety) of VAT compliance, as shown in Table 7.

Table 7: Psychological Costs of VAT

Psychological Costs of VAT (CT = 152, NCT = 88)	Agree / Strongly Agree		Disagree / Strongly Disagree		Not Sure / Neutral	
	CTs	NCTs	CTs	NCTs	CTs	NCTs
There are no psychological costs (stress/anxiety/ sleepless nights) in complying with VAT.	18%	13%	63%	73%	19%	14%
Psychological costs have significantly affected the amount of time and effort that I can put into my business.	64%	82%	18%	4%	18%	16%
The psychological costs relating to VAT are excessive when compared to other taxes in Bangladesh.	40%	62%	37%	11%	23%	27%
The VAT authority's timely information and friendly attitude towards taxpayers can reduce psychological costs.	82%	85%	3%	10%	15%	5%
Significant promotion of NBR prosecutions of non-compliant taxpayers would increase psychological costs among other SME taxpayers.	68%	61%	4%	22%	28%	17%
Significant promotion of NBR prosecutions of non-compliant taxpayers would increase compliance among other SME taxpayers.	72%	36%	5%	42%	23%	22%

The results demonstrate that only around 15 per cent of respondents felt there were no psychological costs in complying with VAT. The taxpayers who were either fully compliant or had competent hands to deal with VAT matters might not feel any stress or anxiety about VAT compliance. Moreover, non-compliant taxpayers might underestimate the psychological costs of VAT, or feel that they can manage everything by bribing the VAT Officials.

About half of the respondents agreed or strongly agreed that the psychological costs relating to VAT are excessive when compared to other taxes in Bangladesh. This may be because in Bangladesh, income tax returns have to be submitted once a year, so that income taxpayers get sufficient time for income tax calculation and return preparation. On the other hand, registered Clearing and Forwarding Agents (C&F Agents) look after the customs-related activities on behalf of importers for import taxation. In the case of VAT, in order to submit a monthly VAT return, all transactions of sales need to be included. Input tax credits, record keeping, and the collection of VAT at different stages of production also result in more formal paper work. Because many Bangladeshi SMEs do not utilise computerised accounting systems in their businesses, the record-keeping required for VAT can be burdensome. As noted, only 15 per cent of respondents had a fully computerised record-keeping practice (Table 3). In addition, variability in the calculation of Bangladesh's VAT across taxpayers and the uncertainty surrounding such determinations could create higher stress in relation to VAT than that for other taxes. Stress in relation to VAT could also be increased by

VAT Officials' surprise visits to business premises and on-the-spot examinations, which could generate greater stress and anxiety for SME taxpayers compared to other taxes. Overall, about 63 per cent of compliant and 73 per cent of non-compliant VAT payers disagreed or strongly disagreed with the notion that 'There are no psychological costs (stress/anxiety/sleepless nights) in complying with VAT'.

In relation to the six attitudinal statements in Table 7, the significant differences between responses by CTs and NCTs may be because psychological costs impact NCTs (82 per cent) more than CTs (64 per cent) – this could be due to NCTs having to go through an audit and/or appeal process, and may also be because they know they are at fault. It appears one way to possibly reduce psychological costs is for the VAT authority to provide timely information and have a friendly attitude towards taxpayers, as 82 per cent of compliant and 85 per cent of non-compliant VAT payers strongly agreed or agreed with this. The importance of co-operation of VAT Officials was also apparent in respondents' comments during in-depth interviews:

> I felt less confused, less frustrated, more confident and more satisfied when I got proper attention from local VAT offices and VAT Officials. I think the simplification of VAT Law is not sufficient to reduce our stress, anxiety or sleepless nights; professional co-operation from the revenue administration is very important to make the taxpayers more compliant. **(NCT 5)**

> I felt calmer when I had successful interactions with the VAT Officials. I know they (VAT Officials) have discretionary powers. To maintain a good relationship with them is really important for me to keep myself stress-free. **(CT 7)**

This may be because establishing a better relationship between the taxpayers and NBR can encourage voluntary compliance and help businesses manage their level of tax-related worries effectively. Strengthening relationships between tax inspectors and taxpayers is seen as a way of encouraging taxpayers to fulfil their obligations willingly.[105]

The survey results also indicated similar perceptions among CTs and NCTs: 68 per cent of CTs and 61 per cent of NCTs strongly agreed or agreed that the significant promotion of NBR prosecutions of NCTs would increase psychological costs among other SME taxpayers (Table 7). However, different taxpayer groups had different opinions about the effects of significantly promoting NBR prosecutions on compliance. For example, 72 per cent of CTs agreed or strongly agreed that significant promotion of NBR prosecutions of non-compliant taxpayers would increase compliance among other SME taxpayers, while only 36 per cent of non-compliant VAT payers thought similarly. This may be due to the fact that NCTs tend to be risk-takers in making compliance decisions, because penalties and fines imposed by the VAT authority are seen as risks worth taking. Alternatively, it may be because NCTs do not think there is a risk of detection by the NBR (eg, because they can bribe NBR Officials).

[105]Kirchler, above n 69.

5.3 Role of VAT officers with psychological costs and corruption

Casanegra de Jantscher observed that in developing countries, tax administration is largely seen as tax policy.[106] Senior-level officers from NBR have the unique opportunity of playing the dual role of policy formulator and implementer.[107] However, such concentration of power could lead to opportunism and/or corruption. Interviews with NBR officials working both at the policy and implementation levels reveal that there is a growing awareness about the importance of VAT compliance costs within the policy levels. During FGD, most of the VAT Officials mentioned that they are always concerned to keep the compliance burden minimal for the taxpayers. However, a majority of the VAT Official participants (12 out of 15) argued that sometimes they were powerless to make the taxpayers compliant unless they used the threat of fines and penalties or a surprise visit to their business premises. While these initiatives may cause worry and anxiety to taxpayers, the VAT Officials perceived these steps to be more effective than others:

> In my 15 years of service life with the VAT department, I had never seen a taxpayer wanting to deposit the right share of VAT willingly. Most of the times they want to avoid our requests to pay VAT. Finally when they are given threat by the VAT Officials about an audit, surprise visit or stock check, they get worried and conscious and then pay VAT. But in most cases, they pay a little more than before, not the right amount. **(VO 5)**

VAT Officials were aware of cash flow problems by some SMEs in meeting their VAT obligations, although they saw it as their duty to collect the right amount:

> I don't understand exactly why the taxpayers' behaviour is so disappointing when I am very gentle and cool to make them understand to pay the right amount of VAT. They are ringing the same bell year after year that their businesses are running very hard. But when I am bothered and adamant to collect the right share of VAT and visit their business premises frequently, they became compliant. **(VO 12)**

Deterrent theory is seen as an influential factor with the tax compliance decision.[108] Penalties and punishment by a legal system communicate to the individual that the legal system views intentional tax non-compliance as a crime. Some taxpayers may be more sensitive to the threat of penalties than others. For them, the penalties must be demonstrated in concrete sentences that they perceive as relevant to their own lives. The VAT Officials interviewed strongly agreed that the NBR's firm position against VAT evasion creates psychological pressure amongst taxpayers, and that significant deterrent effects from NBR prosecutions of NCTs increase the psychological costs to other taxpayers. However, this was seen as the price for greater overall compliance:

> It's not the complexity of the VAT Law and compliance costs. Significant promotion of the NBR's prosecutions of non-compliant taxpayers increases psychological pressure among other SME taxpayers and therefore increases

[106] M Casanegra de Jantscher, 'Administering the VAT' in M Gillis, C Shoup and G P Sikat (eds), *Value Added Taxation in Developing Countries: A World Bank Symposium* (World Bank, 1990).

[107] Saleheen, above n 33.

[108] M Allingham, and A Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1 *Journal of Public Economics* 328–38.

> voluntary compliance and enforced compliance among other SME taxpayers. **(VO 13)**

However, some NCTs questioned whether these fines and penalties were genuine or just 'hype':

> Fines, penalties and sanctions have a deterrent effect for the taxpayers concerned and other taxpayers. The result is a better understanding and better compliance of VAT Law. But in Bangladesh all [fines, penalties and sanctions] are show-off [hype]. **(NCT 3)**

As noted, fines and penalties appeared to have greater influence on CTs rather than NCTs. In this regard, a number of focus group participants (taxpayers) also confessed that they had paid more income tax and VAT during the 2007–2008 period due to tremendous pressure from the NBR, and because of media reports that influential business owners were victimised by the military-backed government. The revenue-collection scenario from the caretaker government and some of the initiatives taken by that government, such as the Citizen Charter of the NBR, were acknowledged by Saleheen in his paper regarding good governance and the VAT in Bangladesh:[109]

> We have watched TV and read newspapers reporting that some of the civil officials are openly assaulted by army officers. As they [army personnel] can be so rude to the civil servants, they can go to any extent with the general taxpayers. Naturally, I was afraid and deposited more VAT than before, even though I had a loss in my business at that time. **(NCT 8)**

Brennan and Buchanan argue that any country's laws and regulations are likely to be ineffective if citizens perceive that their politicians and bureaucrats are corrupt.[110] This can mean that taxpayers who bribe politicians and civil servants are not afraid of the enforcement agencies. Some participants recognised that business owners' illegal associations with the NBR and political parties reduced the deterrent effects and psychological pressures among taxpayers. For instance, a businessperson who evades VAT may be approached by a VAT inspector with demands for bribes in exchange for a promise of protection. Official corruption, primarily bribery, reduces the likelihood of punishment and consequently the effectiveness of punishment as a deterrent.[111] Comments from participants in in-depth interviews supported this, but noted that SMEs may not have the financial resources for bribes:

> I think there would be strong demonstration and deterrent effect in our taxation sector if political institutions worked properly. Connections with NBR and political parties allowed the old and more established groups to totally dominate and monopolise markets. These groups can buy anyone. We, the SME taxpayers, may fear the NBR, but the large taxpayers are not afraid of violating the Law. They know that money can buy anyone in Bangladesh. **(CT 14)**

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[109] Saleheen, above n 21.

[110] G Brennan and J M Buchanan, *The Reason of Rules: Constitutional Political Economy* (Cambridge University Press, 1985).

[111] C Moskos, 'How to Clean up Foreign Militaries: Subsidize and Control their Pay and Pension' (1998) December–January *U S News & World Report* 51–2.

It appears that bribes reduce the effectiveness of audits and prosecutions:

> In Bangladesh, roles and relationships prevail over rules and regulations. Informal relationships are more important than formal rules and regulations. When a VAT official is paid informally by a businessman, the latter will never be afraid of the former. We know that we can manage them [VAT Officials] anyhow. Therefore, significant demonstration effects from NBR prosecutions of non-compliant taxpayers usually do not increase psychological costs among other taxpayers. **(NCT 10)**

Much of the discussion with respondents indicated that the deterrent effect could be improved in Bangladesh if the NBR and other enforcing agencies could be appropriately constrained by law and be free of corruption. However, the Bangladeshi political system, judiciary, and revenue department appear to be subject to a high level of corruption. For example, the Transparency International Bangladesh (TIB) report noted that that 76 per cent of the respondents thought corruption in the public sector was the major problem, while 40 per cent thought personal relationships were more important in getting public service.[112] These findings are consistent with prior literature which demonstrates that most of the citizens in developing African countries are not afraid of the enforcing agencies because their politicians, civil servants and legal systems are generally corrupt.[113]

To tease out perceptions of corruption and VAT compliance, a number of questions were asked: Table 8. It appears that the reduction of corruption would have the biggest influence on complying taxpayers,[114] although it would still have some positive impact on non-complying taxpayers. This impact of corruption is at all levels from big business, government officials, VAT Officers and politicians.

[112]Transparency International Bangladesh, *Annual Report 2013* (Transparency International Bangladesh, 2013).

[113]J M Mbaku, 'Bureaucratic Corruption and Policy Reform in Africa' (1994) 19(2) *Journal of Social, Political and Economic Studies* 149–75.

[114]As noted, compliant taxpayers (CTs) were those who had paid VAT to the NBR and who had no dispute in respect of their VAT payments; or taxpayers who had had a dispute with the NBR but had subsequently been vindicated by the NBR, the Tribunals, or the Courts. Thus the 86 per cent figure in Table 8, representing compliant taxpayers who would be willing to pay the 'correct' amount of VAT if they saw less corruption by government officials, could include taxpayers who had not paid the VAT amount initially required by the NBR (but whom a court, tribunal or an NBR review panel nevertheless later vindicated). These taxpayers might perceive the initial VAT assessment by the NBR (later found to be incorrect) as somehow tainted by corruption.

Table 8: Corruption and Voluntary Compliance

Statement about Corruption (CT= 152, NCT= 88)	Agree / Strongly Agree		Disagree / Strongly Disagree		Not Sure / Neutral	
	CTs	NCTs	CTs	NCTs	CTs	NCTs
If I saw less corruption by Bangladeshi big business, I would be willing to pay the correct amount of VAT.	78%	53%	10%	27%	12%	20%
If I saw less corruption by government officials, I would be willing to pay the correct amount of VAT.	86%	55%	10%	16%	4%	29%
If I saw less corruption by VAT Officials, I would be willing to pay the correct amount of VAT.	85%	69%	12%	9%	3%	22%
If I saw less corruption by Bangladeshi politicians, I would be willing to pay the correct amount of VAT.	83%	49%	14%	27%	3%	17%

It appears that a reduction in corruption would have the biggest positive influence on CTs, although it would still have some positive impact on NCTs. In particular, less corruption by VAT Officials could have the largest influence for both CT (85 per cent) and NCT (69 per cent), followed by less corruption of government officials. It is interesting that more than 20 per cent of NCTs are in the position of 'not sure' or 'neutral' about the statements relating to corruption, whereas only 10 per cent of the CTs are in this position. This may be because a larger portion of NCTs did not want to comment about the corruption of VAT Officials or politicians, as they had taken part in the corruption process to gain favour. Only 11 per cent of CTs and 20 per cent of NCTs disagreed or strongly disagreed that less corruption on the part of politicians, civil servants (ie government officials and VAT officials) and big businesses would increase voluntary compliance among taxpayers. These findings that the corrupt practice of politicians, government officials, VAT Officials and big businesses encourage VAT non-compliance are consistent with prior literature based on income tax corruption in Bangladesh.[115] Overall, the findings also suggest that perceived corruption by VAT Officers, politicians and other government officials reduces the effectiveness of audits and fines and penalties and decrease the level of voluntary compliance.

Auditing emerged as an important theme relating to the deterrent effect and psychological costs of VAT in Bangladesh. Auditing plays a crucial role in deterrence. Economic theories of tax compliance suggest that taxpayers are in general amoral utility-maximisers: that is, a taxpayer's decision to pay or evade taxes depends on the probability of detection and the consequences thereof.[116] The Bangladeshi VAT Law has specific provision for carrying out audits of business transactions. In addition, the NBR has issued a number of general orders detailing the audit

[115]N R Monir, *Political Economy of Corruption: The Case of Tax Evasion in Bangladesh* (Unpublished PhD Thesis, Monash University, 2012).

[116]L O Marti and M SWanjoh, 'Taxpayers Attitudes and Tax Compliance Behaviour in Kenya' (2010) 1 *African Journal of Business & Management* 112–23.

mechanism in 1999 and then published an Audit Manual in 2006. According to the VAT Audit Manual, each VAT unit [registered business] is supposed to be audited at least once in three years.[117] However, as with many other developing countries that have adopted VAT, auditing is yet to evolve as an effective monitoring mechanism in Bangladesh. Less than 1 per cent of VAT businesses were audited in 2012.[118] While audit is a major tool of tackling non-compliance in most developed countries, in Bangladesh the reverse scenario appears to be the case. Saleheen found a taxpayer who indicated that audits would be effective if audit officers were highly skilled and honest. However, they found that many officers are arrogant and discourteous.[119]

According to the respondents from the taxpayers' group in Stage 3, auditing appears yet to take professional shape in Bangladesh. Taxpayers discussed how the Audit wing has a low social standing. In Bangladesh, a posting in the Audit division of the NBR or the Audit Directorate is considered to be a 'punishment posting'.[120] In addition, comparatively inefficient inspectors and superintendents are posted to this division, due to the job's low status. The Audit division has a poor image among taxpayers, who are well aware that officers in the division are neither as efficient nor knowledgeable as their counterparts in other divisions of the NBR. This can mean that taxpayers do not regard VAT auditing as an effective tool for compliance:

> Before starting business, the word 'audit' struck fear in my mind. But my business has not been audited by the VAT department for the last four years. I know the loopholes of my business. But I am doubtful about their [the VAT audit team's] efficiency. It's true if there was any meritorious officer in that team, I might be caught. So I am continuing to be in a very good relationship with the local VAT Office. I hope they will inform me before they start any audit, so that I can get enough time to arrange everything. **(CT 3)**[121]

It may be that VAT Officers do not have sufficient training to conduct audits or knowledge of the VAT law:

> My enterprise was audited last year. The problem was that, from the beginning of the audit, the team commenced with an attitude that they had come to catch a thief. At the beginning I was very worried. I even needed to visit a psychiatrist. But sorry to say, when I understood two of the members of that team had minimum knowledge about VAT law, I became relaxed. My VAT consultant helped them to write their report. I realised from that time that we should not be afraid of VAT audits. **(NCT 6)**

These deficiencies are even acknowledged by VAT Officers:

> It is a fact that there have been always some meritorious detection of irregularities, but many of the objections were ill-conceived, without an adequate understanding of VAT rules and regulations. So in most of the

[117]NBR, *Audit Manual* (National Board of Revenue, 2006).

[118]NBR, *Annual Report 2010–2011* (National Board of Revenue, 2012).

[119]Saleheen, above n 21.

[120]A M Saleheen and N A Siddiquee, 'Tax Innovation or Excise Duty in Disguise? Deviations and Distortions in Value-Added Tax in Bangladesh' (2013) 36(6) *International Journal of Public Administration* 381–96.

[121]It would appear that this complying taxpayer could be non-complying but is yet to be audited.

> cases, we can't establish our claims. So taxpayers are not very much concerned about VAT audits. **(VO 9)**

While it appears that many taxpayers use tax advisors to decrease their psychological cost and help them to comply, the NBR believes the use of tax advisors actually increases compliance costs due to the complex tax-minimising strategies implemented. In addition, it appears that the NBR believes tat taxpayers should rely on the NBR's advice, rather than external advice:

> A very small percentage of SME taxpayers in our country rely on the VAT office. They are always finding a tax consultant or lawyer who can minimise their VAT paid, someone who can take advantages the grey areas of VAT Law. They (taxpayers) are always looking for a consultant who is well networked, and a well-networked VAT consultant usually charges more than others. But taxpayers can easily get proper help from the local VAT office. We are not so bad that they assert. I don't think anyone has passed sleepless nights for tax. They are exaggerating the issue. **(VO 8)**

These attitudes and responses from taxpayers and VAT Officials suggest that there exists an antagonistic climate and a lack of trust between the two groups in matters of VAT compliance. This could explain why some taxpayers seek external help, rather than taking assistance from VAT Officials. Even though SME taxpayers are aware of the cost of a VAT consultant, they are willing to pay this in order to feel secure and comfortable that they have met their VAT compliance obligations. Indeed, some taxpayers could consider the value of the fees paid to a VAT professional to be included in the psychological costs of VAT compliance:

> I am not losing my sleep due to tax. I am paying sufficient money to my VAT consultants to keep myself away from all stress and anxiety. I think the fees of VAT consultants should be included in the psychological costs of VAT. **(NCT 5)**

Overall the findings suggest that while psychological costs are difficult to quantify, they are very real for many taxpayers in Bangladesh. Indeed, the use of VAT advisors is seen by many taxpayers as an effective way to mitigate psychological cost, even though this results in a direct monetary expense. In addition, perceived corruption by VAT Officers contributes to compliance costs, reduces the effectiveness of audits, and impairs the relationship between the NBR and taxpayers.

6. RECOMMENDATIONS

Given these findings, there are a number of possible recommendations relating to discretionary powers, corruption, NBR communication, knowledge and complexity. Each of these is discussed below.

6.1 Decrease discretionary power

Given the findings of this research, it is important that the discretionary powers of VAT Officials be curtailed. These discretionary powers not only add to psychological costs, but are perceived to result in opportunities for corruption. This recommendation is supported by the International Monetary Fund (IMF), which suggested that the

NBR's power to set tariff values for VAT concentrates too much power in the hands of the NBR and its officials.[122] The IMF argues that, without other legislative checks and balances, this aspect of Bangladesh's VAT system is vulnerable to political and bureaucratic opportunism.[123] This is supported by the country's apex chamber, the Federation of Bangladesh Chambers of Commerce and Industry (FBCCI), which proposed a reduction of the discretionary power of VAT Officials in a bid to improve business conditions.[124] Under the new VAT Law, some of the existing discretionary power will be eliminated. For example, the price declaration provision, the truncated base for assessment of VAT, and the power of determination of turnover taxes will be removed. However, discretions around the provision of tariff values, the use of stamp and *banderole*, the input-output coefficient for manufacturers, and section 26 of the existing VAT Law (ie the power of make 'surprise' visits to taxpayers' premises) will continue. In addition, under the new VAT Law, the NBR will have additional powers to recover VAT, including freezing a tax debtor's bank accounts, placing a lien on the tax debtor's property, and holding company directors liable for paying unpaid taxes. While the removal of some discretion is constructive, there continues the possibility of misusing this additional power and perpetuating the alleged corruption of VAT officials. It is therefore recommended that there be greater checks and balances around these discretionary powers, including taxpayer rights to appeal NBR decisions. In addition, a corruption hotline and more stringent disciplinary procedures for corrupt VAT officials could be introduced.

6.2 Reduce corruption

Corruption appears to be part of the administration of VAT in Bangladesh, and is in part due to the NBR's discretionary powers discussed above. It is critical that measures are introduced to reduce corruption of VAT Officials. Measures could include disciplinary proceedings, better education, and better employment conditions. In addition, it is important that disciplinary proceedings are made transparent to the public, in order to improve public perceptions of the integrity of the NBR and its staff. Indeed, corruption at all levels – big business, government officials, VAT Officers and politicians – needs to be addressed. To lessen the temptation for corruption, one possible reform could be to improve the wages and conditions for NBR Officers. Any increase in wages would need to be accompanied by the prosecution of corrupt VAT officials. Special service rules and regulations for NBR officials also need to be reinforced in order to ensure the provision of punishment for any corruption by public officials.

6.3 NBR communication

It is important that there should be a long-term goal for an improved tax culture between the NBR and taxpayers, since such an improvement could increase voluntary compliance. The NBR should set up a better exchange of information with taxpayers to help taxpayers understand that NBR audits and surprise visits to ensure proper VAT record-keeping are not only legal, but also a safeguard of transparency. When conducting such visits or communicating, VAT Officials should be respectful and timely.

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[122] IMF, *Bangladesh: Selected Issues* (IMF Country Report No. 07/230, 2007), 1–84.

[123] Ibid.

[124] Financial Express, above n 99.

The NBR has recently established a help desk at all VAT commissionerates and local VAT offices, with the aim of providing services to assist taxpayers in complying with the VAT Law. The NBR's use of this help desk concept should be extended in order to increase the collection rate, to reduce the cost of collecting taxes, and to increase voluntary compliance by SME taxpayers. The NBR should also consider establishing a SME businesses 'Support Service Unit' to provide assistance and advice on VAT issues to SME taxpayers who are not represented by VAT consultants. In doing so, they should be sensitive about the power differential between the NBR and SMEs.

6.4 Improve VOs' VAT knowledge

It appears from the study that a substantial portion of taxpayers are not comfortable with the VAT Officials, and consider VAT Officials' knowledge about the VAT Law to be lacking. The level of knowledge at the NBR needs to be improved by recruiting skilled officers and by giving intensive training to Officials, not only to enhance their expertise, but also to improve their communication skills when explaining VAT matters to SME taxpayers. As a corollary, rules and regulations need to be enforced if key weaknesses and loopholes in the VAT system in Bangladesh are to be properly addressed.

The NBR should consider treating the two taxpayer groups (compliant and non-compliant) differently. Compliant taxpayers should be given more assistance from NBR and local VAT offices. This includes being more understanding about inadvertent breaches. However, the NBR should be stricter with NCTs by undertaking regular audits or imposing fines and penalties to increase pressure on them to be compliant. However, the extent to which this would be effective is questionable, given NCTs' attitudes towards risk and compliance.

6.5 Decrease complexity

The complexity of the VAT law was acknowledged by most taxpayers as a key contributor to their psychological costs. A simplified VAT Law for SMEs would allow these operators to allocate more resources to operational areas of their businesses, rather than those resources being used for meeting the compliance burden of a VAT which is arguably too complex for SME taxpayers. In a developing economy such as Bangladesh's, it is therefore critical that the VAT system be reviewed in order to determine ways in which the VAT Law and its administration could be simplified for SMEs.

7. LIMITATIONS AND AVENUES FOR FUTURE RESEARCH

As in all research, there are limitations that must be acknowledged. Each of these limitations provides guidance for researchers about potential topics for future investigation. As this is the first study of the estimation of psychological costs of VAT in Bangladesh and it does not cover multiple years, it is unknown whether the psychological costs of SMEs in Bangladesh are decreasing or increasing over time. In addition, any international comparison needs to be treated with caution because of

differing tax systems, tax cultures, the different years in which studies were undertaken, and different socio-economic characteristics.[125]

Another limitation is the estimation of compliance costs, which may not be entirely accurate insofar as they are self-reported and historical estimates.[126] Furthermore, it is acknowledged that the measures used for psychological costs are rudimentary, but given the paucity of practical measures available, they nevertheless provide interesting material for reflection.

This study did not include those SMEs operating solely within the 'cash economy' – that is, those SMEs not currently within the VAT system, even though registration may be mandatory for them. It could be that these cash economy SMEs have different motivators than the non-complying VAT payers surveyed. Finally, the psychological costs investigated here are those of SMEs only. The psychological costs of VAT for large taxpayer units, as well as customs duty or individual taxpayers, need to be explored to obtain a more thorough picture of the tax compliance costs of Bangladeshi taxpayers.

8. CONCLUSIONS

As with other countries, SMEs are an important part of Bangladesh's economy and future prosperity. Unfortunately issues surrounding the burden of tax compliance, particularly the VAT compliance burden surrounding SMEs and even larger businesses, are largely unknown in Bangladesh. To address this gap, this study researched important components of VAT compliance costs, being the psychological and corruption costs of VAT for the SME sector in Bangladesh.

The findings of this study provide some insights into how respondents judge the Bangladeshi VAT system. The NBR and SME taxpayers did not demonstrate a positive attitude towards each other, with dealings between the two marked by a clear sense of frustration. This frustration appeared to have been more influential than other factors in contributing to the psychological costs of Bangladesh's VAT. The findings also demonstrated that some people in business did not pay their 'fair share' of VAT because they had very little respect for the NBR. Indeed, they bribed VAT Officials in order to manage their VAT compliance.

It was also revealed that taxpayers engaged tax consultants not only for compliance purposes, but also to reduce the psychological costs of worrying about VAT compliance. Analysis of the survey results suggested that psychological costs of VAT in Bangladesh in the year under consideration were found to be higher for the manufacturing sector than other sectors. Part of the reason for this could be the high level of discretion in this sector in terms of the value to which VAT applies. The

[125] B Susila and J Pope, 'The tax compliance costs of large corporate taxpayers in Indonesia' (2012) 27(4) *Australian Tax Forum* 719–72.

[126] While it would have been useful to further triangulate the data (ie more than by using survey and interview responses to cross-check results), this was not practicable. In terms of data triangulation, the absence of prior data made comparisons over time impossible; and in terms of investigator triangulation, resource and language constraints made the use of multiple investigators impracticable (only one field investigator, rather than multiple investigators, could be employed in Bangladesh).

findings also suggest that psychological costs are a substantial component of VAT compliance costs for SMEs in Bangladesh at around 15 per cent.

The findings of this study are important for tax policy researchers, policy makers and VAT administrators in Bangladesh and in other developing countries when designing an effective but simplified VAT system. It is important to acknowledge the hidden costs of VAT compliance, since without acknowledging these the VAT system may not be achieving its goal of providing an efficient revenue base for governments to be able to improve the prosperity of their countries.