

UNDERSTANDING THE EFFECTS OF COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS ON LARGE CORPORATE TAXPAYERS

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Coercion and persuasion are the two main approaches to increase tax compliance. The former attempts to promote tax compliance mainly by using penalty and tax audits, while the latter focuses on increased taxpayer services, simplified tax law and enhanced mutual understanding. There has been little attempt to provide a contextual explanation as to why an instrument fails or succeeds in boosting tax compliance of large corporations – a gap this paper attempts to fill. Using an empirical analysis, this research found that factors underlying the power of the coercive approach are the rationality and regularity of its application, along with its legal and financial imperatives. Reasons contributing to the appeal of the persuasive approach are a reduction in tax compliance costs, an improvement in accountability and a reduction in knowledge gaps, and coordination of the various tax laws. The research found that the explanation of tax compliance patterns is not straightforward, and in countries with different taxation and institutional systems, instruments tested would not be expected to yield similar outcomes. Therefore, verification of the study results in different contexts is essential.

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1. INTRODUCTION

To encourage income tax compliance a diverse set of measures are applied, depending on the size and nature of taxpayers and their contribution to public revenues. Financial penalties may be a useful action to influence the compliance behaviour of small and medium sized taxpayers, because of the small financial capacity they hold and the weak legal expertise they exert. For big businesses, such as Starbucks, a financial penalty or a tough tax audit may not bring the expected outcome; tough actions sometimes may have an undesirable effect on tax compliance. What should be the fitting approach to deal with the tax liabilities of big companies, since one size does not fit all, has been an area of major debate among policy makers, academics and tax professionals. As taxpayers, the large corporations are not only unique in terms of the tax revenues they provide, but also in terms of the level of risk they impose on the local tax system. For large multinational corporations (MNCs), however, this issue is not simple, since some countries exempt foreign-source income from home-country taxation, while others avoid resident-based taxation of foreign-source income, for example, the Netherlands, while still others subject foreign source income to both resident country and source country taxation.¹ Large corporations hold instrumental financial and political power and a wide range of professional expertise to influence the ‘service provider versus customer relationship’.² In addition, large corporations withhold taxes for individuals and work as the

¹ Joosung Jun, ‘The Impact of International Tax Rules on the Cost of Capital’, in Martin Feldstein, James R Hines and R Glen Hubbard (eds), *The Effects of Taxation on Multinational Corporations* (University of Chicago Press, 1995) 95.

² Penelope Tuck, *Remaking the Large Corporate Taxpayer into a Visible Customer Partner: The Changing Role of Tax Governance* 11 June 2011, 1 <<http://www2.warwick.ac.uk/fac/soc/wbs/projects/>>.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

main point of tax collection, which is ‘the equivalent of the customs barrier at the border’.³

To address the compliance issues of big companies, there has been general consensus that Responsive Regulatory Approach (RRA), placing collaborative soft action and trust-based relationships over threats and punishments, can be an effective model of taxation.⁴ The RRA advocates that tax agencies should increase tax compliance not through punishment but through education, encouragement and mutual cooperation.⁵ Accordingly, tax administrations across the globe – for example, the Australian Tax Office’s (ATO) Co-operative Compliance model or the Dutch Tax Administration’s Horizontal Monitoring Approach – have designed responsive enforcement models, the intention is to encourage good behaviours and to prevent errors. The Rwandan Revenue Authority’s (RRA) outreach programmes – developing tax curriculum in partnership with the Ministry of Finance and Tax Friends Clubs in the universities along with TV talk shows and taxpayers’ day helped grow tax culture and enhanced respectful communication with taxpayers.⁶

Thus the tax administration escalates to stringent actions only when the trust based responsive arrangement fails. Some of the stringent actions taken by the tax administration are civil penalties, tax audit and legal prosecution; whereas measures applied to influence the tax morale of taxpayers are increased

³ Richard M Bird, *Why Tax Corporations? Working Paper 96-2, Technical Committee on Business Taxation, Canada* 23 September 2011, 10<
<http://publications.gc.ca/collections/Collection/F21-4-96-2E.pdf>>.

⁴ Valerie Braithwaite, ‘Responsive Regulation and Taxation: Introduction’ (2007) 29 *Law and Policy* 3.

⁵ *Ibid.*

⁶ Attiya Waris and Hadija Murangwa, *Utilising Tax Literacy and Societal Confidence in a State: The Rwandan Model* 7 January 2014<
http://www.academia.edu/2419611/Utilising_Tax_Literacy_and_Societal_Confidence_in_a_State_The_Rwandan_Model>.

taxpayer services, simplified tax law and enhanced mutual understanding.

In nurturing tax compliance from such an important, powerful and risky taxpayer segment, it is worthwhile to ask this basic question – are penal actions or service measures more important, and why? Traditionally, coercive techniques have tended to dominate tax compliance literature, and tax-morale-based persuasive policies are still nascent.⁷ Tax agencies must decide whether to rely on stringent actions or to depend on persuasive and often less costly methods, such as motivation and respectful communication with taxpayers.⁸

With this purpose in mind, this paper attempts to identify the significance of soft and tough compliance instruments in creating tax compliance, using Bangladesh as a case study to determine whether these instruments are meaningful. The rest of the paper is organised as follows: Section two examines the extant literature on the coercive and persuasive tax compliance issues. Section three focuses on general issues of Bangladeshi tax systems. Section four looks at the background of Bangladesh Large Taxpayer Unit (LTU). Section five presents the research methodology. Section six discusses the analysis and findings, with section five as the final conclusion.

⁷ Zakir Akhand, *Coercion or persuasion: Making Large Corporations Tax Compliant in Bangladesh* (PhD Thesis, The University of Birmingham, 2012).

⁸ Elaine Doyle, Kieran Gallery and Mary Coyle, 'Procedural justice principal and tax compliance in Ireland: A preliminary exploration in the context of reminder letters' (2009) 8 *Journal of Finance and Management in Public Services*, 49; Marsha Blumenthal, Charles Christian and Joel Slemrod, 'Do normative appeals affect tax compliance? Evidence from a controlled experiment in Minnesota' (2001) 54 *National Tax Journal*, 122.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

2. COERCION VS. PERSUASION: APPROACHES TO TAX COMPLIANCE

Broadly, tax compliance approaches can be classified into two schools of thoughts; coercive and persuasive. By coercion, Commons⁹ refers to ‘a command, express or tacit, issued by a determinate person to enforce obedience on others by means of external material’, where persuasion does not induce compliance by material means, but by ‘direct psychic influence’. Theorists and scholars are sharply divided about the influence of these conflicting compliance paradigms, that is, coercion versus persuasion.

Neoclassical economists argue that coercion as a policy cannot exist for long; in the long run, only consensual exchange of resources will prevail.¹⁰ Market economists, on the other hand, think that the exchange of resources between economic agents is not fully coercive because individuals enjoy freedom of action within a limited set of choices.¹¹ And in a quite different vein, institutional economists state that coercion is inevitable and ubiquitous in every economy¹² and both the state and the market work as the repository of coercion. According to Tilly,¹³ coercion ‘includes all concerted application, threatened or actual, of action that commonly causes loss or damage to the persons or possessions of individuals or groups who are aware of both the action and the potential damage’. Tilly argues that extraction of resources and taxation depends on the

⁹ John R. Commons, ‘A Sociological View of Sovereignty’, in Malcom Rutherford and Warren J Samuels (eds), *John R Commons Selected Essays* (Routledge, 1996) 458, 470.

¹⁰ Warren J Samuels, ‘On the Nature and Existence of Economic Coercion: The Correspondence of Robert Lee Hale and Thomas Nixon Carver’, in Marc R Tool and Warren J Samuels (eds), *State, Society, and Corporate Power* (Transaction Publisher, 1989) 177.

¹¹ *Ibid.*

¹² *Ibid.*

¹³ Charles Tilly, *Durable Inequality* (University of California Press, 1999) 36.

accumulation and concentration of coercive power by the rulers, which is also a strong means of state formation.

The persuasive theory of tax compliance, which expects taxpayers to self-assess their taxes, relies on trust and taxpayers' behavioural co-operation. This approach assumes that taxpayers are not merely interested in utility maximisation. There is empirical evidence that taxpayers are honest and disclose their tax liability correctly, even when there is no chance of being caught.¹⁴ Maxwell¹⁵ finds that the revenue authority of Guatemala reduced its penalty rate for tax non-payment and earned huge voluntary tax payments from its taxpayers. In contrast, as Maxwell notes, the Costa Rica revenue authority increased its tax penalty and the probability of audit, and ended up with reduced compliance.¹⁶ And in Germany, research concludes that factors other than coercion improve tax compliance.¹⁷ Scholz¹⁸ points out that, 'without trust there is little basis for social cooperation and voluntary compliance with laws and regulations that could potentially benefit everyone'. However, in some ways, coercion and persuasion as compliance approaches carry equal weight, since both of them produce results through affecting the cost

¹⁴ Glen P Jenkins and Edwin W Forlemu, *Enhancing voluntary compliance by reducing compliance costs: A taxpayer service approach* 23 December 2009 <http://www.queensjdiexec.org/publications/qed_dp_109.pdf>; Brain Erard and Jonathon S Feinstein, 'The role of moral sentiments and audit perceptions in tax compliance' (1994) 49 *Public Finance* 70.

¹⁵ Sara Maxwell, *The Price is Wrong: Understanding What Makes a Price Seem Fair and the True Cost of Unfair Pricing* (John Wiley & Sons, 2008) 153.

¹⁶ *Ibid*, 153.

¹⁷ *Ibid*.

¹⁸ John T Scholz, 'Trust, taxes and compliance,' in Valerie Braithwaite and Margarete Levi (eds), *Trust and governance*, (Russell Stage Foundation, 1998) 135,137.

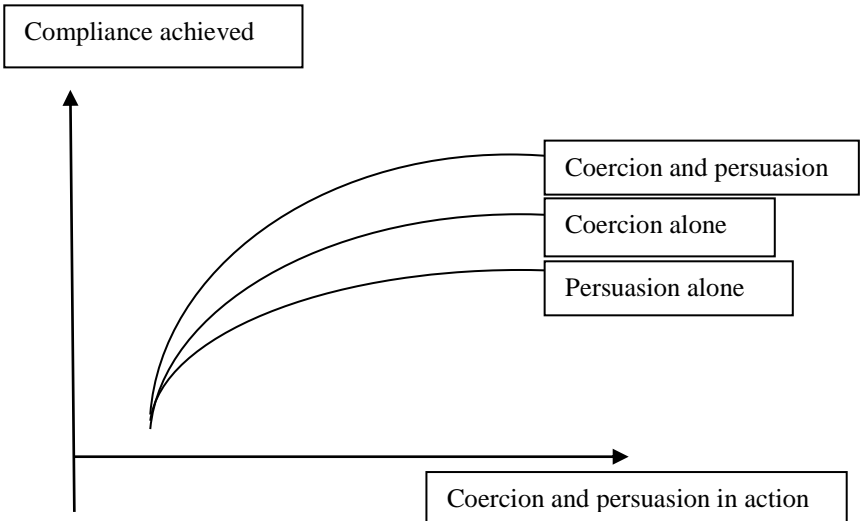
COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

and consequences of non-compliance activities.¹⁹ For instance, persuasive theory posits that taxpayers cannot be influenced towards tax obligations until they are convinced that the benefits they receive from tax compliance are higher than the costs they incur for it. The benefits taxpayers receive from paying taxes take both a direct and an indirect form. The direct benefit is the amount of punishment taxpayers avoid by not renegeing on a state obligation; and the indirect benefit is the goods and services supplied by the state free of charge. Due to information asymmetry, many taxpayers fail to perceive the benefits they derive from state-provided goods and services. Thus, the working of persuasive policies depends on facts and knowledge of how taxpayers benefit from state-provided services. The apparent dilemma discussed above shows that there are two ways of increasing revenues; increasing coercion to make non-compliance a costly decision, or increasing persuasion to demonstrate the benefits to taxpayers. A third option, argued to be the most practicable, is to blend these two, taking account of the nature of taxpayers and the needs of the tax administration.²⁰

¹⁹ Louis M Imbeau, 'Dissonance in Fiscal Policy: A Power Approach', in Louis M. Imbeau (eds) *Do They Walk Like They Talk? Speech and Action in Policy Processes* (Springer, 2009) 167.

²⁰ Valerie Braithwaite and John Braithwaite, 'An Evolving Compliance Model for Tax Enforcement' in Neal Shover and John Paul Wright (eds), *Crimes of Privilege: Readings in White Collar Crime* (Oxford University Press, 2001) 405; DFID 'Why Tax Matters for International Development and What DFID is Doing About it' 12 May 2010< <http://somo.nl/files/extern/td/why-tax-matters-for-international-development>>.

Figure 1: Relationship between tax compliance, coercion and persuasion



Source: Adapted from Imbeau, 2009

Imbeau²¹ also supports the idea that coercion or persuasion as standalone measures cannot fully incite tax compliance. Persuasion alone secures less tax compliance than coercion alone, but when persuasive instruments are mixed with coercive instruments, they yield better results than coercion alone, as shown in figure 1. The common core that brings taxpayers and tax administrations close, according to the persuasive compliance scheme, is trust and a sense of civic duty. Arrow (quoted in Slemrod and

²¹ Imbeau, above n 19.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

Katuscak) remark²²: ‘every commercial transaction has within itself an element of trust ... much of the economic backwardness in the world can be explained by the lack of mutual confidence’. Knack and Keefer²³ provide evidence that a trust-based society spends less in protecting people from exploitation by economic transactions and can produce more physical and social capital for the state. Kagan and Scholz²⁴ argue that irrational actions by regulators engender resistance to compliance in citizens. Tyler and Huo²⁵ opine that taxpayers paying taxes under coercion may revert to their prior behaviour once the threat of punishment is reduced or they become accustomed to it.

Indeed, it is difficult to distinguish whether taxpayers are complying due to the fear of coercion or the appeal of persuasion²⁶. Moreover, a sense of civic duty and trust are not equally present among taxpayers. Reliance on taxpayers’ sense of civic duty and trust may create problems of free-riding and horizontal inequality in the tax system.²⁷ This causes Hendrix²⁸

²² Kenneth Arrow, ‘Gifts and Exchanges’, in Joel Slemrod and Peter Katuscak, ‘Do Trust and Trustworthiness Pay Off?’ (2005) 40 *Journal of Human Resources* 621, 621.

²³ Stephen Knack and Philip Keefer, ‘Does Social Capital Have an Economic Payoff? A Cross-Country Investigation’ (1997) 4 *Quarterly Journal of Economics* 1251.

²⁴ Robert A Kagan and John T Scholz ‘The Criminology of the Corporation and Regulatory Enforcement Strategies’, in Keith Hawkins and John M Thomas (eds), *Enforcing Regulation* (Kluwer Nijhoff Publishing, 1984) 67.

²⁵ Tom R Tyler and Yuen J Huo, *Trust in the Law* (Russell Sage Foundation, 2002).

²⁶ Akhand, above n 7.

²⁷ Richard E Wagner, ‘Property, Taxation and the Budgetary Commons’, in Donald P Racheter and Richard E Wagner (eds), *Politics, Taxation, and the Rule of Law: The Power to Tax in Constitutional Perspective* (Kluwer, 2002) 33; Jeffrey F Timmons, *The Fiscal Contract: States, Taxes and Public Services* (University of California Press, 2004).

to suggest that, ‘tax compliance is in no sense voluntary; therefore the ruler has no incentive to deviate from a coercive equilibrium’. There is also a reverse causation to this argument in that taxpayers’ trustfulness and sense of civic duty depend on how trustful the state is to the taxpayers.²⁹

3. BANGLADESH’S TAX SYSTEM: A GENERAL OVERVIEW

Tax systems in Bangladesh were introduced by the British rulers in the undivided India of 1860 and were based on the Income Tax Act, 1860. Subsequently that statute underwent many amendments and reforms. After Bangladesh gained independence in 1971, tax law was majorly reformed in 1984 and the Income Tax Ordinance 1984 (ITO 1984) came into being. The ITO 1984 continues to be the main statute to govern direct taxes in Bangladesh, particularly corporate and individual income tax. The Income Tax Manual – the main source of all tax laws – is primarily divided into Part I and Part II. Part I is the Income Tax Ordinance, 1984; and Part II is the Income Tax Rules, 1984. Part I has 23 chapters with 184 sections, a large number of sub-sections and explanations, and seven schedules. As well as the Income Tax Manual, Parts I and II, there are SROs (Statutory Regulatory Orders), circulars and explanations issued by the NBR that further complicate the income tax laws.³⁰

²⁸ Cullen Stevenson Hendrix, *Leviathan in the Tropics? Environment, State Capacity, and Civil Conflict in the Developing World*, (UMI, East Eisenhower Parkway, 2008) 49.

²⁹ Maxwell, above n 15; Mick Moore, ‘Between Coercion and Contract: Competing Narratives on Taxation and Governance’ in Deborah Brautigam, Odd Helge Fjeldstad and Mick Moore (eds), *Taxation and State Building in Developing Countries: Capacity and Consent* (Cambridge University Press, 2008) 34.

³⁰ *Income Tax Ordinance of Bangladesh 1984*.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

The Jatio Rajassaw Board or the National Board of Revenue (NBR), under the Internal Resources Division (IRD) of the Ministry of Finance, is the central tax authority, which administers direct taxes in Bangladesh. Other than income taxes, the NBR is also responsible for administering, assessing, collecting and enforcing capital gain taxes, value added tax (VAT) and customs duties. The Customs, Excise and VAT is the government agency responsible for administering the nation's indirect tax policy. Hierarchically, the chairman of the NBR is the executive head of the income tax administration followed by members, tax commissioners, additional/joint commissioners, deputy commissioners, assistant commissioners and inspectors. The Commissioner of Taxes is the head of a territorial tax commissionerate, which is comprised of several tax circles. Besides the territorial and appeal commissionerates, there are specialised tax commissioners including Central Intelligence Cell (CIC), the Income Tax Inspection Directorate, the Bangladesh Civil Service (Taxation) Academy, the Central Survey Zone, the Large Taxpayers Unit (LTU), and the Tax Appellate Tribunal.

The total revenues and the Tax-GDP ratio in Bangladesh have increased over the years – from 6.5% and 5.5% respectively in FY1982 to 10.9% and 9.0% respectively in FY2010.³¹ Value added taxes (VAT) and income taxes are the two most significant sources that showed fairly sharp increases. Notably, around 30% of income tax revenue in Bangladesh is collected from a few large taxpayers. Non-compliance by these few hundred taxpayers may cause major difficulties in the revenue administration of Bangladesh.³²

³¹ Ahsan H Mansur and Mohammad Yunus, *An evaluation of the Tax system in Bangladesh* 7 March 2014<
[http://www.theigc.org/sites/default/files/Evaluation%20of %>](http://www.theigc.org/sites/default/files/Evaluation%20of%20).

³² Ibid.

As a tax-type revenue administration nearly all operational processes of the NBR are manual with a huge lack of taxpayer education and taxpayer services along with trained manpower and physical infrastructure. Currently, a modernisation project is under implementation, expected to be completed in 2016. About 20,000 cases involving an amount of USD 260 million are lying with the higher courts and to mitigate this issue the NBR introduced the Alternative Dispute Resolution (ADR) mechanism in 2011.³³

The personal tax rate structure in Bangladesh is effectively a progressive tax: rates stand at 10% to 25%. The tax rates are usually changed in a yearly budget which is presented by the Minister of Finance. There is a capital gain tax imposed in Bangladesh, the rates stand at 5% to 15% depending on nature and the difference between the year of acquisition and sale of the capital asset. Manufacturing corporations are charged tax at a rate of 27.5%. It is the lowest of all corporate tax rates. The corporate tax rate for manufacturing corporations whose shares are not traded publicly is 37.5%. The latter tax rate can be even lower if a manufacturing corporation declares dividends of more than 20% in a year. But for finance sector corporations, that is, banks and near banks the marginal tax rate is 42.5% in tax year 2013-14, while for mobile operators and cigarette companies the tax rate is 45%. For publicly traded mobile and cigarette companies the rate is 40%.

There are a number of factors that make Bangladesh important for this study of tax compliance, especially in a self assessment system. Bangladesh introduced a Self-Assessment System (SAS) for individuals in 1981, followed by a SAS for companies in 2007. SAS has now been in

³³ Ibid.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

force for 32 tax years for individuals and 7 tax years for companies, giving a sufficient amount of time to inquire into the extent to which compliance behaviour has improved.

4. THE BANGLADESH LTU AND LARGE CORPORATE TAXPAYERS

The level of tax revenue in Bangladesh is among the lowest in the world. In 2002, before the LTU was introduced, the ratio of revenue to GDP, at 9.7%, was low compared with other countries in the region³⁴. To increase tax revenues from the biggest taxpayers, the National Board of Revenue – the apex revenue authority of Bangladesh established the Large Taxpayers Unit (LTU) in November 2003³⁵. Establishing an LTU has been crucial since around 30% of income tax revenues are collected from a few large taxpayers and non-compliance by them may consequently cause problems in the revenue administration of Bangladesh.

At the organisational level, four basic functions – taxpayer service, revenue accounting and return processing, collection enforcement, and tax audit – have been designated as the purpose of the LTU. When the LTU was established in 2003, the NBR placed 254 large corporate taxpayers under its jurisdiction. Subsequently, in tax year 2011-2012, the number increased to 317. There are an additional 706 large individual taxpayers, all directors of those large corporations. Large finance sector corporations constitute the mainstream corporate taxpayers, along with pharmaceutical and cement corporations.³⁶ A primary

³⁴ Trading Economics, *Bangladesh Inflation Rate* 4 Oct 2015> <http://www.tradingeconomics.com/bangladesh/inflation-cpi>>.

³⁵ National Board of Revenue, *Project Evaluation Report on Reforms in Revenue Administration* (Internal Resources Division, 2005).

³⁶ Large Taxpayer Unit, *Annual Report - 2011*, (LTU Commissionerate, 2011).

review to the usefulness of LTU model of tax compliance can be made by comparing the 2003 and 2009 data, pre and post LTU performance indicators. Figures show that returns submitted by corporate taxpayers fell during the 2003-2009 period, although tax collections increased due to the increased tax payments at the filing stage.

An increase in tax payments may be attributed to increased corporate profits and/or corporate marginal tax rates, or to decreased exemptions. Another reason for this might be the tough enforcements of coercive action. or the gentle use of persuasive actions; which this research seeks to explore. The average real growth rate of income taxes paid by corporate and non-corporate taxpayers in the LTU during the period 2004-2009 was 24.01%, against growth in real GDP of 5.73% over the same period.³⁷ The LTU, with the start of its fully-fledged operation in April 2004, showed a massive improvement in income tax collection. In each subsequent year, the targeted budget was achieved with surplus revenues, although the amount of the surplus fell gradually from 2004.³⁸ In the fiscal years 2006-2007 and 2008-2009, surplus tax collections had fallen, as compared with previous years, by USD 5.84 and USD 10.37 million respectively.³⁹ Notably, revenue growth in nominal and real terms had gradually decreased over the years. The real growth rate of tax collection, after making adjustment for inflation, fell to 10.1% in the financial year 2008-2009 from 45.5% in financial year 2005-2006. A striking feature of LTU revenue collection is its increasing share to national tax revenues. In 2004, the total income tax collection from large

³⁷ Central Intelligence Agency, *The World Fact Book – Bangladesh* 9 April 2011 <<https://www.cia.gov/library/publications/the-world->>.

³⁸ Large Taxpayer Unit, above n 36.

³⁹ *Ibid.*

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

corporate taxpayers was USD 186.78 million. In 2009, it rose to USD 608 million.⁴⁰

The change in tax revenues as discussed above can also be attributed to the tax audit actions undertaken each year. Audit cases in the Bangladesh LTU are selected on the basis of pre-determined audit rules approved by the NBR.⁴¹ Audits are of two kinds mainly – desk verification and comprehensive audit.⁴² The amount of audit demands and collections from these have decreased over the years, except in tax year 2005-06. In tax year 2003-04, as reported in the LTU annual report, additional tax of USD 67.59 million was demanded from the tax audits of 80 files, that is, per file audited tax demand was USD 84 million. In 2005-06, per file audit demand decreased to USD 0.20 million, and in 2007-08 it decreased to USD 0.01 million.

Declining audit demands may have two potential explanations: first, audit actions have been successful in reducing the amount of income underreporting. Second, the deterrence effect of tax audits has fallen in the face of complicated game-playing techniques by the corporations. It should be noted that roughly half of the demands created in every tax year remained uncollected. Aside from enforcement measures, political instability and the quality of institutions might be associated with the tax compliance and audit of the large companies.⁴³

⁴⁰ Ibid.

⁴¹ Ibid.

⁴² Ibid.

⁴³ George C Tsibouris, Mark A. Horton, Mark J Flanagan and Wojciech S Maliszewski, *Experience with Large Fiscal Adjustments* (IMF, 2006).

5. RESEARCH METHODOLOGY

Data for the research were collected from multiple sources. Qualitative data for this research was collected through open-ended in-depth interviews and from LTU administrative records. The respondents for the interviews were asked to explain the importance of, and the nature of the relationship between the selected coercive and persuasive instruments and corporate tax compliance. In total 27 respondents were interviewed: 14 from the National Board of Revenue and the Large Taxpayer Unit and 13 from the corporate world. In a tax compliance study like this, as Hasseldine et al⁴⁴ argue, field interviews enable the researcher to probe attitudes to sanctions and motivational issues, and to understand the research problem well. Since qualitative research does not aim at generalisation of findings based on statistical significance, a purposive sampling, a non-probabilistic sampling method was applied to identify the interviewees. When selecting the first interviewees, the Chamber of Commerce and Trade; the Bangladesh Tax Lawyers Association; the Association of Chartered Accountants and the officials from the NBR were consulted. This provided an idea about which people would be useful sources of information on corporate tax issues.

In analysing interview data, and to give meaning to respondents' observations, an interpretational approach, also called interpretivism, were followed. In defining interpretivism, Holloway⁴⁵ states that, 'the experiences of peoples are essentially context-bound and not free from time, location or the mind of the human actor'. Interpretivism emphasises the researcher's understanding and the marrying of

⁴⁴ John Hasseldine, Peggy Hite, Simon James and Marika Toumi, 'Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors' (2007) 24 *Contemporary Accounting Research* 171.

⁴⁵ Immy Holloway, *Basic Concepts for Qualitative Research* (Blackwell Publishing House, 1997) 93.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

the social construction of the organisation with individual behaviours.⁴⁶ This approach focuses not only on the individual, but also on the *unique individual context* to explain and predict human experiences.⁴⁷ This makes the interpretivist approach a naturalistic inquiry – a method where data is collected in a way that demonstrates its interrelationship with the research context, unlike a laboratory or controlled experiment.⁴⁸ Naturalistic paradigm assumes that the reality reveals itself in multiple forms which cannot be understood through the analysis of data only, rather the researcher has to grapple the research context well to explore the research problem. In a naturalistic inquiry data is gathered in a way that minimises the researchers' manipulation of the study setting.⁴⁹

The rationale for using an interpretivist approach in this study was that it would involve discussions with those participants who were directly involved in the research context and was able to influence their immediate surroundings. For quantitative data, figures on return filing, tax audit adjustments, appeal and court cases, the LTU database was the only source. In the LTU there were 275 large corporations, of which 147 belonged to the finance and leasing sector corporations. Of the remainder, 76 corporations belonged to the manufacturing sector, including cement, pharmaceuticals, and textiles; and 52 belonged to the service sector. To determine the sample size of

⁴⁶ Coleen C Capper, *Educational administration in a pluralistic society* (The State University of New York Press, 1993).

⁴⁷ Holloway, above n 45.

⁴⁸ David A Erlandson, Edward L Harris, Barbara L Skipper, Steve D Allen, *Doing Naturalistic Inquiry: A Guide to Methods* (Sage Publications, 1993).

⁴⁹ Egon G Guba and Yvonna S Lincoln 'Competing Paradigms in Qualitative Research', in Norman K Denzin and Yvonna S Lincoln (eds), *Handbook of Qualitative Research*, (Sage Publication, 1985) 105; Michael Patton, *Qualitative Evaluation and Research Methods* (Sage Publications, 1990).

quantitative data used in the study the standard sampling equation, suggested by Israel⁵⁰, was applied.⁵¹

6. ANALYSIS AND FINDINGS

The analysis of data begins with breaking down interview excerpts into meaningful pieces, then comparing and contrasting them to figure out the patterns in the respondents' arguments. Themes arising from the narratives were worked through to establish how and why they contributed to the stance of the respondents. In generating the codes, themes and patterns, Nvivo-9 was employed. The respondents mentioned 64 different nodes in explaining the role of coercive and persuasive instruments with respect to tax compliance behaviour of large corporations. Of the 27 respondents, 18 discussed coercive instruments and the frequency of reference to the coercive instruments by the respondents was 41. Similarly, persuasion as a topic was discussed by 19 taxpayers, and the frequency was 35. This means there were some respondents who focused on both coercion and persuasion as possibilities for improving tax compliance. Again, tax administration as a free node was referred to by 24 respondents and these respondents attempted to link tax administration inefficiencies with corruption, accountability, confidence building, mutual understanding and tax laws. Frequency of reference, however, does not bear much significance in the qualitative understanding of a problem.

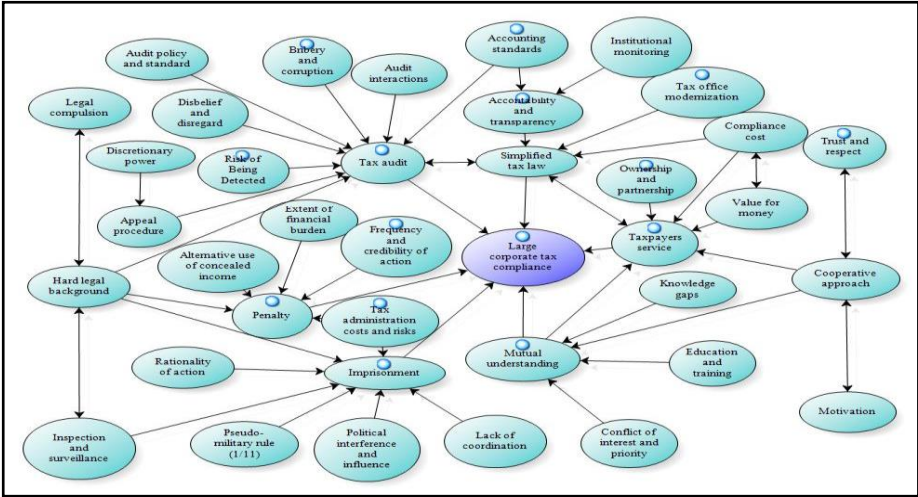
⁵⁰ Glenn D Israel, '*Determining sample size*', 11 March 2010 <<http://edis.ifas.ufl.edu/pd006>>.

⁵¹ To determine the sample size for a given population, Israel suggests to the formula, $n = N / [1 + N(e)^2]$, where, n= sample size, N= population, e = alpha level. Using this formula, the sample size derived for the study is: $n = 275 / [(1+275(.05)^2)] = 162$. In social science research, the alpha level applied in determining sample size is either 0.05 or 0.01, with 0.05 used more commonly, and for categorical data the standard margin error being five per cent.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

Qualitative research concerns itself with making a contextual interpretation and meaning of data. Based on the links among the free nodes, the major patterns of respondent arguments have been modelled in Figure 2.

Figure 2: Patterns of major themes related to the creation of tax compliance



The figure shows that there is a common thread among the free nodes that creates the major pattern and theme of the respondents’ arguments on why a tax compliance instrument is significant to an understanding of tax compliance. For example, tax audit, penalty and imprisonment as coercive instruments emerge from the need for serious legal action. Other similar issues indicative of the need for coercive action are inspections and surveillance on compliance activities within a strong regulatory framework. Persuasion as a policy tool is argued to produce higher compliance if it can encourage taxpayers by means of quality financial and accounting standards, modernised taxpayer services, inter-office networking and connectivity, and building confidence in the tax system. The pattern reveals that trust and motivation are the fundamental

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

incentives for persuasion, which in turn is linked to the effectiveness of taxpayer services or tax simplification. In the next section each of the compliance instruments and their probable effects are discussed.

7. TAX PENALTY: DOES IT MATTER FOR LARGE CORPORATE TAX COMPLIANCE?

As regards the impact of penalties on tax compliance, conflicting evidence has been found in the literature. Minor⁵² and Tittle⁵³ found that penalty had no impact on tax compliance; while Grasmick and Scott⁵⁴ found it had a great effect. Friedland's⁵⁵ experimental research of 1982, found that low and high penalties at a given probability of detection had approximately the same level of impact on tax compliance. However, in another study, Friedland et al⁵⁶ found that large fines with a low probability of detection had a greater impact on tax compliance than low fines with a high probability of detection. Therefore, penal action has been found to make both positive and negative contributions to the creation of tax compliance.

⁵² William Minor, 'Deterrence Research: Problems of Theory and Method', in James A Cramer (eds), *Preventing Crime*, (Sage Publication, 1978) 21.

⁵³ Charles R Tittle, *Sanctions and Social Deviance: The Question of Deterrence* (Praeger, 1980).

⁵⁴ Harold G Grasmick and Wilbur J Scott, 'Tax Evasion and Mechanism of Social Control: A Comparison of Grant and Petty Theft' (1982) 2 *Journal of Economic Psychology* 213.

⁵⁵ Nehemia Friedland, 'A Note on Tax Evasion as A Function of the Quality of Information about the Magnitude and Credibility of Threatened Fines: Some Preliminary Research' (1982) 12 *Journal of Applied Psychology* 54.

⁵⁶ Nehemia Friedland, Shlomo Maital and Aryeh Rutenberg 'A Simulation Study of Income Tax Evasion' (1978) 10 *Journal of Public Economics* 107.

7.1 Certainty of application versus financial burden

Two issues, according to the respondent observations, identified as having a strong effect on the effectiveness of penalty are certainty of its application and the extent of financial burden it leaves on the taxpayer. As one respondent observed, the large corporations ‘are certain that failure to submit a return and to pay taxes on time will end in an immediate fine’ (Respondent 4). To verify this argument, the tax penalty register of the LTU was examined which showed that the penalty imposition rate for non-filing of returns had been 100% since 2004. The ‘certainty of application’ argument seems meaningful when the use of other penal actions, for example, freezing of bank accounts, shutting down of business premises or legal prosecution, are compared. Freezing of bank accounts as a penal action is used only occasionally, with imprisonment and the shutting of business premises also being rare. On the contrary some respondents argued that it is not certainty, but the amount of financial burden a penalty imposes that is important. Referring to the tax penalty structure in Bangladesh, some respondents noted that non-filing without reasonable cause is subject to a fine not exceeding 10% of the last assessed taxes (Tax Code 124). And for non-payment of taxes the fine is an amount not exceeding the amount of underpaid taxes (Tax Code 125), or 25% of the amount of underpayment (Tax Code 127). Such penalty rates are exorbitant for big companies, who are assessed at a marginal corporate tax rate varying from 27.5% to 45% on the generated profit.

One respondent specifically observed that:

The penalty chargeable for non-submission of return or non-payment of taxes is so huge that it’s like a double taxation on profit. No corporation will take the risk of making

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

unreasonable delays in paying taxes and being penalised with a rigorous financial burden (Respondent 7).

A review of the relevant literature demonstrates that between severity and probability, the latter is more important in understanding the influence of penalty on tax compliance.⁵⁷ In studying the effect of severity versus probability of penalty in reducing crime among homeless young people, Baron and Kennedy⁵⁸ found that the threat of financial burden failed to reduce violent crimes. William⁵⁹ found that large fines do not produce a higher rate of tax return filing among Australian taxpayers.

7.2 Alternative Use of Underreported Income

Penal actions may fail as compliance instruments if there exists a profitable alternative use of underreported income and the possibility of winning a favourable appeal judgement especially in a reporting non-compliance case. A 10% penalty (Tax Code 128) on underreported income is much lower than the interest rate charged on bank deposits and borrowing in Bangladesh, usually 12% to 14% on fixed deposits and 16% to 18%, per annum, on bank borrowing in the recent years. For corporations, it is economically more profitable to underreport income, and either to deposit the money in commercial banks or to service debts.⁶⁰

⁵⁷ Varma Kimberly and Anthony Doob, 'Deterring Economic Crimes: The Case of Tax Evasion' (1998) 40 *Canadian Journal of Criminology* 165.

⁵⁸ Baron W Stephen and Leslie W Kennedy, 'Deterrence and Homeless Male Street Youths' (1998) 40 *Canadian Journal of Criminology* 27.

⁵⁹ Roberts William, 'Prosecuting Non-Lodgers: To Persuade or Punish?' *Working Paper No.12, 2001, Centre for Tax System Integrity, Australian National University* 22 April 2010 <<https://digitalcollections.anu.edu.au/handle/1885/41630>>.

⁶⁰ Akhand, above n 7.

The respondents added that the fundamental difference between the nature of payment and reporting non-compliance can provide further explanation for the ineffectiveness of penalty. Payment non-compliance is measured on the basis of declared or settled income. Once income is determined, calculating payment obligation is comparatively easy and less ambiguous. As a result, penal actions are successful in curbing non-payment. On the other hand, to penalise undisclosed income, the tax authority has to garner definite information of hidden income, which is far more difficult and less likely. One respondent commented that the possibility of unearthing undisclosed income by the tax authority is much weaker than the possibility that it can calculate taxes on declared income correctly. It is therefore rational for tax evaders, particularly large ones, to choose an act of non-compliance where the probability of being detected and penalised is comparatively low.

7.3 Biased Appeal Judgements

Other respondents had a different explanation, arguing that the success of any coercive action depends on how neutral the appeal courts are and how much discretionary power the appellate judges enjoy in settling non-compliant cases. As reported in Table 1 a total of 85 large corporations lodged appeal applications of which 69 related to reporting non-compliance, which is much higher than for filing (8 appeals) and payment non-compliance (31 appeals). This suggests that filing non-compliance is comparatively low among large companies.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

Table 1: Appeals cases lodged by different type of non-compliant taxpayers

Compliance Type	Compliance Outcome	Did the taxpayer appeal?			
		Yes	No	No Ground	Total
Filing	Tax compliant	8	3	13	24
	Tax non-compliant	77	5	48	130
	Total	85	8	61	154
Reporting	Tax compliant	69	2	0	71
	Tax non-compliant	16	6	61	83
	Total	85	8	61	154
Payment	Tax compliant	31	7	0	38
	Tax non-compliant	54	1	61	116
	Total	85	8	61	154
Overall	Tax compliant	76	8	13	97
	Tax non-compliant	9	0	48	57
	Total	85	8	61	154

One respondent said:

It is difficult to win non-filing and payment cases at the appeal court, since the tax law involved is straightforward and the scope for applying discretionary power is limited. But for non-reporting cases, appellate authorities enjoy enormous discretionary power (Respondent 9).

This ample scope for winning a favourable judgement on reporting non-compliance in the appeal courts makes large corporate taxpayers indifferent to the penal action undertaken by the LTU. This argument is supported by the finding of the international tax compliance literature – an independent appeal mechanism is needed to limit the discretionary power of tax officials and to make tax compliance actions meaningful.⁶¹ It seems that the financial burden penalties impose is fairly similar across taxpayers, and there is no reason for large corporate taxpayers to feel financially more affected than the others. What makes sense is the high probability that a penalty is unavoidable for filing and payment delays, since large corporations cannot remain undetected by the tax authority when it comes to the statutory obligation of registering with the LTU. It seems more justifiable to argue that the opportunity to make alternative use of underreported income and the relaxed appeals process further weakens the possibility that penalty can bring a positive change in taxpayers' sense of their reporting obligations.

8. TAX AUDIT: DOES IT ALWAYS WORK?

Tax audits have strong direct and indirect effects on tax compliance.⁶² Tax audit has a general deterrent effect on all

⁶¹ Benno Torgler and Friedrich Schneider, *Shadow Economy, Tax Morale, Governance and Institutional Quality: A Panel Analysis* 3 February, 2012 <http://www.yale.edu/leitner/resources/docs/paper_1_torgler_schneider.pdf>.

⁶² Alan H Plumley, *The Determinants of Individual Income Tax Compliance Estimating the Impacts of Tax Policy, Enforcement, and IRS Responsiveness* 6 August 2011 <<http://www.irs.gov/pub/irs-soi/pub1916b.pdf>>; James Andreoni, Brian Erard and Jonathon Feinstein, 'Tax Compliance' (1998) 36 *Journal of Economic Literature* 818; James Alm, Gary H McClelland and William D Schulze, 'Why Do People Pay Taxes?' (1992) 48 *Journal of Public Economics* 21.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

taxpayers, called ‘the ripple effect’⁶³, and an effect in succeeding tax years, called ‘the subsequent year effect’.⁶⁴ The extant literature shows that both audit possibility and book-tax difference and audit adjustment matter in tax compliance. On the audit possibility side, it is argued that endogenous audit rates have stronger effects on tax compliance than exogenous audit rates, provided that the threat of audit action is real.⁶⁵ On a similar yet different note, Andreoni et al⁶⁶ argue that audit rates or audit probability are a function of reported income. When it comes to the question of tax audit impact, there are both positive and negative outcomes. Beron et al⁶⁷ found a positive relationship between audit and tax compliance, although the deterrent effect was weak.

8.1 The Interactive Audit Process

The big business audit process starts with sending a formal letter notifying the taxpayer of the audit selection criteria and the documents needed to meet the audit requirements (See LTU tax audit in figure 3). In most cases, the large corporations provide all documents required for the audit and discuss the audit issues with the LTU audit team, preferably in the LTU office. Alternatively, the LTU audit team is invited to visit the taxpayer’s office and examine the documents if the document check-up is vast and time-consuming. This interactive audit

⁶³ Plumley, above n 63, 2.

⁶⁴ Ibid, 2.

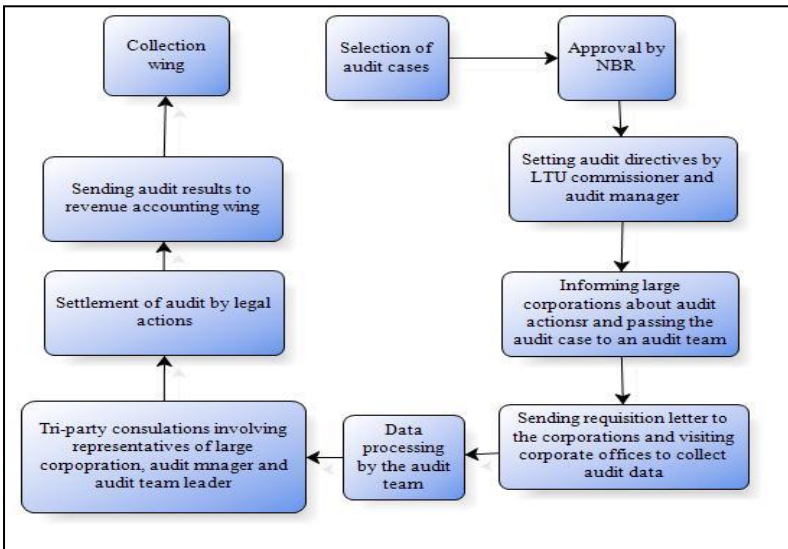
⁶⁵ Nipoli Kamdar, ‘Corporate Income Tax Compliance: A Time Series Analysis’ (1997) 25 *Atlantic Economic Journal* 37.

⁶⁶ Andreoni, Erard and Feinstein, above n 63.

⁶⁷ Kurt Beron, Helen V Tauchen and Ann Dryden Witte, *A Structural Equation Model for Tax Compliance and Auditing*, National Bureau of Economic Research 9 April 2012<
http://www.nber.org/papers/w2556.pdf?new_window=1>.

process keeps large corporate taxpayers well connected with the LTU management and binds them to fulfil the first step in tax compliance (i.e., return filing). Again, the audit process is designed in a way that increases the risk of being selected for audit examination when return filing is delayed. An LTU official explained this point in the following way: ‘a timely submitted return with all taxes paid is *less likely* to be audited than a return submitted beyond the time limit with obvious mistakes’ (Respondent 21).

Figure 3: Tax audit flow in the LTU



Source: LTU Annual Report, 2011

Delayed filing has implications for the interactive and strategic relationship between large corporate taxpayers and the tax authority; delays may damage the positive image of a good complier and increase the severity of an audit

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

adjustment. LTU audit records show that large corporations audited at least once in the previous three years usually submitted their tax return on time. Even if they failed, they would notify the tax office in advance to avoid the risk of audit selection. The filing register illustrates that of 42 non-filers in the 2008-2009 tax year, 24 had received some audit adjustments in one or more of the previous three years. All these 24 late-filers informed the LTU in advance of their failure to submit return and applied for extensions. The other 18 non-filers, who had had no audit adjustments during the previous five years, did not apply for extensions. There is evidence in the literature to support the above argument. Pentland and Carlile⁶⁸ argue that; ‘in filing a return, the taxpayer makes the first control moves in the expression game ... at this level, from the taxpayer’s point of view, the game consists of a single question: “will I get audited if I include (or omit) this information on my return?”’

The conclusion from the above discussion is non-filing of a return increases the possibility of being selected for audit and the subsequent threat of being caught with undeclared income and extra tax owing. In other words, large corporations file on time just to protect other non-compliances, for example, reporting non-compliances where the opportunity to make a profit out of other non-compliances is much higher.

8.2 Defective and Sub-Standard Accounts

Tax audits however may backfire as a means of improving the compliance of large corporate taxpayers. According to the respondent observations, major explanations include falsified audited financial reports, mutual disbelief and disrespect and rampant tax audit corruption.

⁶⁸ Brian T Pentland and Paul Carlile, ‘Audit the taxpayer, not the return: Tax auditing as an expression game’ (1996) 21 *Accounting, Organizations and Society* 269, 277.

Analysis of respondent observations reveals that most tax officials and certified public accountants believe that the audited financial reports are defective and sub-standard. One tax official commented: ‘for the weak regulatory bodies, many large corporate taxpayers prepare more than one audit report to misrepresent facts on income and expenditure’ (Respondent, 8). In the same vein, a chartered accountant added: ‘Neither local nor international accounting standards are followed with respect to income reporting and tax payment. The common misrepresentation for manufacturing concerns is over-valuation of inventory to raise the cost of goods sold’ (Respondent 25). According to respondent observations, falsified, sub-standard audited financial reports cause audit failure in two ways. First, large corporate taxpayers do not feel alarmed by tax audit findings because an audit demand based on a falsified audit report can be managed by further falsification of documents. Second, aggressive audit adjustments by the audit team, due to their belief that the audited accounts are baseless, make corporate taxpayers even more reckless about complying with audit actions.

However, some respondents refuted this argument, saying that sometimes conflicting local and international accounting practices create reporting and payment non-compliance. The CFO of a large multinational corporation explained this conflict with a vivid example:

As a multinational corporation we use the MIP software, compiled by the US-GAAP [Generally Accepted Accounting Principles], for internal reporting with our parent corporation in Canada. MIP requires gross sales to be reported as turnover and trade discounts as administrative expenses. However, according to the Bangladesh Accounting Standards [BAS] turnover is gross sales net of trade discount. Despite the treatment differences, the effect

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

on net profit is the same, which the LTU authority seldom understands (Respondent 17).

8.3 Tax Audit Corruption

Many respondents cited tax audit corruption as the single most important reason for audit failure. Any money spent as bribes to meet the illegal demands of the tax auditors is itself a reason to understate or falsify the accounts. One respondent, a qualified chartered accountant, raised the following question: ‘will it ever be possible to claim bribery as an allowable expense in the audited accounts? If not, then who will bear this expense? A natural consequence therefore is a concocted audit report and audit failure’ (Respondent 26). This statement was supported by a former tax commissioner, who said that, ‘the pervasive corruption in our tax system deprives us of most of its benefits. The audit measures fail because the tax audit team easily succumbs to their desire for personal financial gain, instead of undertaking a systematic and rigorous audit action’ (Respondent 12). Tax audit corruption, however, is not a tax administration issue only. The large corporate taxpayers are equally, or in some cases more, interested in the connivance process. One respondent said, ‘the corrupt large firms are free birds in society, not accountable to anybody for their corrupt business activities. There is much evidence that corporate managers and directors have recourse to bribes to suppress facts and tax liabilities’ (Respondent 9).

In the international literature, tax audit corruption is a much researched issue. The Bureau of Inland Revenue (BIR) in the Philippines finds that 96% of its audit cases are settled with corruption.⁶⁹ In the Ugandan LTU, as the World Bank⁷⁰ states

⁶⁹ Edna A Co, Millard O Lim, Maria Elissa, Jaima Lao and Lilibeth J Juan, *Minimizing Corruption: Philippine Democracy Assessment* (Friedrich-Ebert-Stiftung, 2007).

that ‘in 2003... five senior officers attached to large taxpayer units (LTUs) were involved in a major corruption scandal’. Phillips⁷¹ adds that, ‘even if a business keeps proper books and its accounts are audited by an accredited auditor, the tax official disregards this and makes an assessment based on informal negotiation’. Tanzi⁷², however, claims that a substantial part of tax evasion arises because taxpayers deliberately manipulate their accounts. Bergman and Armando⁷³ state that, ‘cheaters further non-comply after audits, while moderate compliers appear to take audit threats more seriously’. This tendency among corporate taxpayers indirectly fosters tax audit corruption and undermines the success of audit action. Therefore, Calder⁷⁴ cautions corporate taxpayers not to take advantage of a weak tax audit, since exploitation of a weak tax audit may cause it to become increasingly aggressive.

8.4 Tax Audit is Expensive

The high cost of tax audit is another reason for this instrument failing to make a positive contribution to reporting and payment compliance. The cost of tax audit includes not only bribery and other illegal expenses but also

⁷⁰ World Bank, *A Handbook for Tax Simplification* (World Bank Washington, 2009) 158.

⁷¹ Max Everest-Phillips, ‘Business Tax as State-Building in Developing Countries: Applying Governance Principles in Private Sector Development’ (2008) 8 *International Journal of Regulation and Governance* 123, 147.

⁷² Vito Tanzi, ‘Corruption and the Budget’ in Arvind K Jain (eds), *Economics of Corruption* (Springer, 1998) 111.

⁷³ Marcelo Bergman and Nevarez Armando, ‘Do audits enhance compliance? An empirical assessment of VAT enforcement’ (2006) 59 *National Tax Journal* 817.

⁷⁴ Jack Calder, ‘Resource Tax administration, Functions, procedures and institutions’ in Philip Daniel, Michael Keen and Charles McPherson (eds), *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (Routledge, 2011) 340.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

the huge cost of assembling the massive number of records and documents and the professional fees paid to accountants and advisors. To recover some of this cost, large corporations either conceal income or inflate expenses. In this connection, it is worth quoting an LTU official: ‘businessmen never share their profits. All audit compliance costs are recorded in the accounts under true or false heads of expenditure, sometimes as “miscellaneous”’ (Respondent 9). The respondent believed that audit actions would be more successful if compliance costs could be reduced. This concern is supported in the relevant literature. Slemrod et al⁷⁵ state that, ‘the true tax base is not costlessly observable to the tax collection agency, although known to the taxpayer. Then, under certain circumstances, the taxpayer may be tempted to report a taxable income below the true value’. Kopczuk⁷⁶ clarifies this point with reference to large corporations in the following lines: ‘there is at least a possibility that a very high probability of audit (such as for large corporations that are almost continuously audited) can backfire when audits are themselves costly’.

Review of the above responses and explanations suggests that tax audit corruption is the fundamental reason for tax audit to backfire. Corruption, however, is not restricted only to the tax authorities. Rather, all the parties concerned in the tax audit process have an equal interest and role in it. Mutual disbelief and disrespect centre on the money-making aspect of audit actions. The other aspect of the matter is the lack of audit standards, the result being almost all audit adjustments end in dispute and litigation.

⁷⁵ Joel Slemrod, Marsha Blumenthal and Charles Christian, ‘Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota’ (2001) 79 *Journal of Public Economics* 455, 457.

⁷⁶ Wojciech Kopczuk, ‘Tax Simplification and Tax Compliance: An Economic Perspective’, in Mark Sawicky (eds), *Bridging the Tax Gap, Addressing the Crisis in Tax Administration* (Economic Policy Institute, 2006) 111, 129.

9. CAN IMPRISONMENT RAISE TAX COMPLIANCE?

It is argued that criminalising non-compliance requires an adequate and efficient institutional infrastructure, along with the political will and motivation⁷⁷. In relation to the debate on severity versus probability of punishment, Klepper and Naggin⁷⁸ argue that it is always the frequency or the probability of detection that makes an impact, rather than the size of the penalty. Looking at the experience of Ecuador, Aparicio and others⁷⁹ argue that weak institutional capacity weakens the credibility of imprisonment. However, the outcome of imprisonment or its tangible effect on evaders depends on the extent to which the tax administration is corrupt. In a corrupt tax administration, the severity of imprisonment further increases the opportunity for corruption because of the tax inspectors' increased capacity to solicit bribes.

9.1 Imprisonment suffers Rationality

In-depth interviews with survey respondents showed that imprisonment as a coercive action is a mismatch to tax non-payment. Respondents argued that the goal of the punishment system should not be to destroy the steady income stream of a taxpayer, which is an essential condition to the payment of taxes. It is argued that large corporate taxpayers are rarely found to be payment non-compliant if the claim is undisputed. Respondents commented that the

⁷⁷ Asian Development Bank, 'Process Map on the Criminal Prosecution of Tax evasion in the Philippines: Manila', (2009) Asian Development Bank.

⁷⁸ Steven Klepper and Daniel Nagin, 'Tax Compliance and Perceptions of the Risks of Detection and Criminal Prosecution' (1989) 23 *Law and Society Review* 209.

⁷⁹ Gabriela Aparicio, Paul Carrillo and Shahe Emran, *Taxes, Prisons, and CFOs: The Effects of Increased Punishment on Corporate Tax Compliance in Ecuador* 22 December 2011 <
http://www.gwu.edu/~iiep/assets/docs/papers/Carrillo_IIEPWP2011-02.pdf>.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

only reason that large corporations would not pay was conflict on legal issues or severe financial crisis. One tax advisor observed: ‘imprisonment as a tax compliance instrument raises the question of rationality. The tax authority should not imprison its own people and be inimical towards them over taxes. Rather the tax authority should build confidence among large corporate taxpayers’ (Respondent 19).

The respondents further added that in terms of likely impact on large corporate business, imprisonment differs from penalty and tax audit. Penalty and tax audit adjustments represent a financial risk to large corporations; but imprisonment causes both financial and reputational risk. Imprisonment of a key corporate director or an employee involved in tax non-payment may destroy the public image of a corporation and may drive it out of the tax-base completely. Respondents claim it is more justifiable to impose monetary fines if the corporation is sufficiently financially sound to bear the tax burden, rather than pursuing a criminal prosecution.

9.2 Inequity and Credibility of Threat

Equity and proportionality are the two vital features of any compliance instruments if such instruments are to be successful. One of the reasons that imprisoning taxpayers violates these basic principles is that prosecution, in many developing countries, is the outcome of politicisation of the tax administration. In a politicised tax administration, imprisonment as an action, as respondents observed, is used more as a political instrument than a tax policy instrument. For example, respondents cited the massive criminal investigation and imprisonment drives during the time of the military backed caretaker government of 2008-2009, popularly known as 1/11 in

Bangladesh politics.⁸⁰ A major tool of this vengeful government was to implicate political leaders in tax corruption cases.⁸¹ Other taxpayers guilty of the same level of non-compliance were not prosecuted.⁸² In some cases, taxpayers were prosecuted for non-filing of returns, which did not match the level of the offence committed and could be seen as a violation of the rule of proportionality. The underlying reason for such a violation is political favour and persecution, as was explained by an LTU official: ‘in a country like ours, where political vengeance is rampant, you have to maintain a relationship with the political power. Once you are liked and patronised by a certain political party, you are less likely to face unequal treatment’ (Respondent 21).

Other respondents indicated that a leading issue affecting the working of imprisonment is the credibility of threat it represents. Making imprisonment a real threat depends on many factors, especially enforcement skills, risk and cost involved in criminal proceeding. As far as the enforcement skills of the LTU’s Enforcement and Collection Wing (ECW) are concerned, there is strong doubt among the respondents about its enforcement capacities. Neither the officials nor the staffs have the legal expertise or sound knowledge necessary to conduct a criminal case. On this point, one respondent had this to say: “To initiate a criminal proceeding you must give a hearing to the defendant; but in most cases the ECW wing does not follow the procedure

⁸⁰ Elora Shehabuddin, ‘Gender and democratic politics in Bangladesh’ in Leela Fernandes (eds), *Routledge Handbook of Gender in South Asia* (Routledge, 2014) 70.

⁸¹ Ibid.

⁸² Mobasser Monem and Hasan Muhammad Baniamin, ‘Public service ethics and corruption in Bangladesh’, in Meghna Sabharwal and Evan M. Berman (eds), *Public Administration in South Asia: India, Bangladesh, and Pakistan* (CRS Press, 2013) 237.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

properly". Inefficient application of the law enables large corporate taxpayers to challenge and outmanoeuvre a criminal prosecution easily. A large corporate taxpayer escaping a criminal investigation becomes less fearful of the tax authority and will tend to be more non-compliant in the future (Respondent 23).

9.3 Cost and Administrative Impediments

To tax officials, seeking prison terms for wrongdoers is ineffective because of the cost and administrative burden it imposes on the tax administration. A tax commissioner informed that in the recent past, the tax administration had been expected to bear all expenses involved in the litigation and imprisonment process. In terms of the scant yearly budget allocated to the LTU, undertaking criminal prosecutions becomes a white elephant for the tax administration. Again, in fighting non-compliance prosecutions, large corporate taxpayers could appoint the best lawyers and bear as much financial burden as necessary,⁸³ whereas the lawyers appointed by the tax authority in Bangladesh were professionally less competent.⁸⁴ It was argued by respondents that unequal financial and professional expertise were the main impediments to the successful application of imprisonment as a coercive tool.

The international tax compliance literature supports the arguments that inequitable application of imprisonment and lack of credibility of threat it represents can negatively affect its success. In relation to the debate on severity versus probability of punishment, Klepper and Naggin⁸⁵ argue that it is always the frequency or the probability of detection that makes an impact,

⁸³ Doreen McBarnet, 'Legitimate rackets: Tax evasion, tax avoidance, and the boundaries of legality' (1992) 3 *Journal of Human Justice* 56.

⁸⁴ Shakhawat Liton, The perils of prosecution, *The Daily Star*, Dhaka, 7 July 2015.

⁸⁵ Klepper and Nagin, above n 78.

rather than the size or severity of punishment, because the size is the same for all corporations, small or big. It can also be maintained that imprisonment is a less effective measure if taxpayers are financially capable of meeting their tax obligations. Aparicio and others⁸⁶ claim that non-monetary punishment like imprisonment is most suitable if the offence is grave and repeated, and the taxpayer is not financially capable of bearing a monetary fine.

There is some truth in the argument that the politicisation of criminal investigations undermines their capacity to contribute to the achievement of higher tax compliance. But the politicisation of criminal prosecutions does not happen in isolation. Politicisation is an integral part of a corrupt tax system where the political masters and large corporate taxpayers are in a symbiotic relationship to maximise each other's economic interests. In addition, the failure of imprisonment as a policy tool can be understood to some degree as the result of poor coordination between the judiciary and the tax administration.

10. TAXPAYER SERVICE: DOES IT IMPROVE TAX COMPLIANCE?

Taxpayer service is one of the leading instruments for tax compliance, although it is difficult to prove in many cases.⁸⁷ In general, taxpayer service refers to extending outreach and tax education activities, for example hosting tax fairs⁸⁸ and to

⁸⁶Aparicio, Carrillo and Emran, above n 79.

⁸⁷ Robert A LeBaube and Charles A Vehorn, 'Assisting Taxpayers in Meeting Their Obligations Under The Law', in Richard Miller Bird and Milka Casanegra Jantscher (eds), *Improving tax administration in developing countries* (IMF, 1992) 312.

⁸⁸ Francisco Durand and Rosemary Thorp 'Reforming the State: A Study of the Peruvian Tax Reform', (1998) 26 *Oxford Development Studies* 133.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

improving response time and communication facilities with the purpose of reducing compliance costs. In the case of large corporations, taxpayer service, largely refers to the interpretation of complex tax laws and the refund of overpaid taxes.⁸⁹

10.1 Poor Value for Money

A strong reason for taxpayer service to bring any change in the level of tax compliance is to ensure value for money. Respondents argued that taxpayer service – good or bad quality – should enable taxpayers to reduce the financial and psychological costs of tax compliance. There were strong doubts among respondents as to whether the quality taxpayer service by the LTU reduced tax compliance costs at all. The chief accountant of a large corporation explained that, ‘there is an opportunity to discuss our problems at LTU level, but unfortunately services like this in most cases end in disagreement and in loss of money and time (Respondent 3). However, this view was challenged by a tax official who argued that whether taxpayer service creates value or not, and whether the service is good or bad in quality, the contribution of taxpayer service to tax compliance is always minimal. The reason is that taxpayers do not face any financial liability for enjoying the service and refusing tax payment in return.

The international tax compliance literature demonstrates that large corporate taxpayers, as consumers of taxpayer service, are interested in three things: service quality,

⁸⁹ John Brondolo, Carlos Silvani, Eric Le Borgne, and Frank Bosch, ‘Tax administration reform and fiscal adjustment: The case of Indonesia (2001–07)’ (2008) *IMF Working Paper 08/129* 4 May 2011> <https://www.imf.org/external/pubs/ft/wp/2008/wp08129.pdf>>.

responsiveness and value for money.⁹⁰ This reflects the fact that taxpayer service is treated like other public services, for example, the service patients expect from hospitals. Taxpayer services become effective in producing the desired result only when the service provider-customer relationship between the tax administration and the taxpayer is well accepted by both sides. There are examples of large corporate taxpayers not being happy with the service-provider-customer relationship. Tuck quotes the tax director of a UK multinational corporation as stating:

I told [a previous director of LBO] quite vociferously that we aren't customers. In my view the customer of the Inland Revenue is the Treasury and we are not customers, we are taxpayers ... clearly to the extent they are regulators we are taxpayers then we have to pay up and face the consequences.⁹¹

10.2 Taxpayer Service Not Needed

Some respondents argued that taxpayer service might not be an important requirement at all to increase large corporate tax compliance. This is because these corporations have their own tax departments, staffed by qualified and efficient accountants and advisors. A tax advisor, an influential former president of the Income Tax Association of Bangladesh, said: 'taxpayer service is not a firm requirement to improve tax compliance for large corporations, because these corporations have well-equipped in-house tax departments that never lack taxpayer service.'

⁹⁰ John Clarke, Jenet Newman, Nick Smith, Elizabeth Vidler and Loiuise Westmarland, *Creating Citizens-Consumers: Changing Publics and Changing Public Services* (Sage Publication, 2007).

⁹¹ Tuck, above n 2, 4.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

Taxpayer service is only likely to be an important factor for the individual and small taxpayers, for whom services are out of reach' (Respondent, 10). The same argument was made by a high official of the LTU:

The potential for increased large corporate tax compliance through quality taxpayer service is questionable. The big corporations don't talk about service. Give all service they want and see what happens. There will be no change in their compliance levels. If service could help, we would not need the constitution, the power or enforcement groups. Basically, no corporation wants to pay taxes (Respondent 7).

10.3 Tax Administration Attitude

To provide quality taxpayer service, the tax authority has to abandon its risk-averse attitude and the bureaucratic inertia that cause taxpayer service not to work. One respondent specifically said that, 'if the LTU does not change its basic attitude to service provision, it will alienate itself from the large corporations and taxpayer service will fail to achieve the intended results' (Respondent 21). It is argued that lack of partnership and friendly relationships between taxpayers and the tax administration is one reason that taxpayer service fails to improve tax compliance. A tax official commented that:

High quality service, for example, telephoning taxpayers, visiting their premises, having tea or lunch together, has a role to play in addressing compliance issues. The service rendering process and frequent visits and informal meetings make taxpayers a part of the tax system and move tax compliance positively (Respondent 6).

The above respondent, however, cautioned that relationship-building should not depend on taxpayer service alone. In the

background, stringent corporate tax law must be set up to make sure that the non-compliers are punished. The respondent suggested that taxpayer service might produce good results if there were tough legal consequences for denying compliance obligations once the relevant services had been provided to facilitate compliance. A respondent made this point clear by stating that, ‘some corporations view service provision as a weakness of the LTU enforcement mechanism. They think that the LTU does not have the power and the legal capacity to catch tax dodgers and punish them’ (Respondent 22). Another respondent argues that tax compliance is a legal obligation and therefore should be handled with coercion rather than by persuasion (Respondent 25).

On the point of negative tax administration attitude and its adverse effect on tax compliance, Snavely⁹² argues that the principle objective of taxpayer service is to convey a message to taxpayers that the tax department’s attitude to them has shifted from toughness to softness, and in exchange the taxpayers should fulfil their tax obligations. Similarly, Bodin⁹³ argues that unless the historically entrenched colonial mind set of tax officials and their organisational culture is changed, taxpayer service, however good, is unlikely to improve tax compliance. The extant literature however supports the argument that the success of any legal obligations is more linked with coercive techniques than with persuasion. This is because violation of legal obligations can be challenged in the courts of law.

⁹² Keith Snavely, ‘Government Policies to Reduce Tax Evasion: Coerced Behaviour versus Services and Values Development’ (1990) 23 *Policy Sciences* 57.

⁹³ Jean Paul Bodin, *LTU Case Studies* (Harvard University Press, 2003).

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

Disregard for taxpayer service is not a matter of right that can be pursued in the courts.⁹⁴

11. WHY IS SIMPLIFIED TAX LAW IMPORTANT TO TAX COMPLIANCE?

The importance of simplified tax laws makes it the central focus to the integration of the coercive and persuasive paradigms.⁹⁵ The grievance that tax law is complex is a valid reason for taxpayers to be non-compliant. Many argue that reducing uncertainty and perfecting justice breeds much of the tax complexity and tax non-compliance.⁹⁶ Measuring tax complexity however is difficult, as it involves measuring the resources consumed by the tax agencies in collecting taxes, which include the value of taxpayers' time and money and all other hidden (for example, psychological) and obvious costs.⁹⁷

⁹⁴ Ronald Dworkin, Taking Right Seriously in A J Menendez, *Justifying Taxes: Some Elements for a General Theory of Democratic Tax Law* (Kluwer Academic Publisher, 2001).

⁹⁵ Victoria Perry, 'Experience and Innovation in other Countries', in Henry J Aaron and Joel Slemrod (eds), *The Crisis in Tax Administration* (The Brookings Institution Press, 2004).

⁹⁶ Joel Slemrod, 'The Return to Tax Simplification. An Econometric Analysis' (1985) NBER Working Paper No 1756, MIT, Cambridge.

⁹⁷ Ibid.

11.1 Reduced Compliance Cost

Simplified tax law can reduce tax compliance costs. Reduction in compliance costs may encourage and enable large corporate taxpayers to better honour their compliance obligations. Reduction of this cost means increased financial capacity to meet tax payments. The following comments of the respondents reveal the relationship between compliance costs and simplified tax law:

Complex tax laws make it difficult and expensive to manage the accounts as laid down in the tax law. Many corporations employ one or two officers, instead of a fully-fledged income tax and accounts department, to reduce tax compliance costs. The money so saved helps indirectly to curb the tax burden and enables higher overall compliance (Respondent 15).

Complex tax laws affect the process of confidence building, because they help tax auditors, legal advisors and tax officials to make illegal extra money from the large corporations. We can better honour our tax liabilities if the law is easier to understand (Respondent 23).

Simplified tax laws also reduce the chances of misrepresentation and corruption – a major barrier to tax compliance. A related reason why simplified tax law can raise tax compliance is because it widens the base of withholding taxes. In Bangladesh, around 52% of the taxes from large corporations are collected from withheld taxes, and here simplified tax law can be particularly helpful. Some respondents argued that simplified tax law could reduce compliance costs by reducing the cost of litigation caused by ambiguous tax laws. The other way simplification reduces compliance costs is the complementary role it plays to other compliance instruments. Penalties, for example, are sometimes so blindly imposed that corporate conditions are

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

never considered. Some corporate non-compliance may be unintentional and simply require clarification and proper understanding of the tax laws, rather than the severe application of a penalty or audit adjustment. Respondents argued that the tax authority had the moral right to apply a harsh law only when the tax law was easily digestible and unambiguously understandable.

11.2 Enhanced Accountability and Coordination

Simplified tax law, as large corporations believe, can encourage accountability among commercial tax auditors and tax advisors. Commercial tax auditors and tax advisors are major players in the non-compliance game, but their accountability under the tax laws is not well defined. The CFO (Respondent 18) of a large corporation said that, ‘sometimes we are punished for an offence of our commercial auditor or the tax return preparers’. The respondent mentioned that tax compliance gaps could be closed up if the tax law clearly defined the roles and responsibilities of tax professionals. Also it is important to coordinate and synchronise the different tax obligations of large corporations. To achieve this goal in many LTUs around the world, for example in Australia and New Zealand, income tax, employment taxes, VAT, and customs are administered under a single LTU administration based on a single tax code. In Bangladesh, a single LTU for all taxes, income tax, VAT and Customs has yet to be done, although the VAT and income tax LTUs have been set up close to each other to allow an easy flow of information. In this context, an LTU official argued that a certain amount of non-compliance in the LTU arises from the differences in which the VAT and income tax departments treat revenue and expenditure. Collaboration and reconciliation between the VAT and income tax laws has become an objective

for the large corporations in the LTU. The World Bank⁹⁸ states that, ‘it is a good practice to consolidate all laws with tax implications into one code ... large taxpayer units (LTUs) that administer most or all of the taxes for large businesses under one roof have been introduced in many countries’.

11.3 Legal Discrimination and Inequity

Respondents stated that the non-compliance of large corporations is often caused by discriminatory and unequal tax laws, which is a direct result of tax complexity. Respondents argued that special tax treatments (such as tax holidays, deductions and credits) allowed to taxpayers gave rise to much tax non-compliance, and this could be solved only by simplifying the tax law, not by penalty or imprisonment. In-depth interviews with respondents demonstrated that the more the tax law is simplified, the better corporations will feel about equity and fairness issues, and the higher tax compliance will be.

Kopczuk⁹⁹ argues that simplified tax laws make the imposition of penalty and audit actions easier and more acceptable to taxpayers. This argument is supported by the findings of Ingraham and Karlinsky¹⁰⁰ in their study of tax law complexity and its impact on small-business, where they comment that tax law simplification has strong links with tax compliance through its influence on fairness, equity and so forth. A further reason, as claimed by the World Bank¹⁰¹ is that the simpler the tax law, the higher the dependence on withholding taxes. Tax law complexity not

⁹⁸ World Bank, above n 70, 70.

⁹⁹ Kopczuk, above n 76.

¹⁰⁰ Laura R Ingraham and Stewart Karlinsky, ‘Tax Professionals’ Perception of Small-Business Tax Law Complexity’ (2005) 107 *Tax Notes* 79.

¹⁰¹ World Bank, above n 70.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

only makes the compliance process expensive, it lessens taxpayers' interest in visiting tax office and paying taxes in a timely and full manner. The money spent on record keeping can be offset by some payment non-compliance, which is one reason for simplified tax law to encourage higher tax compliance. This argument prevails over other arguments because tax compliance involves expenditure for corporate taxpayers. Any persuasive instrument that cuts some of that expenditure is likely to boost the compliance process. The other benefits of simplification, establishing accountability and supplementing the imposition of coercive action, seem to have an indirect role in improving the compliance environment.

12. MUTUAL UNDERSTANDING: WHY CAN'T IT PROMOTE LARGE CORPORATE TAX COMPLIANCE?

In tax compliance literature, mutual understanding refers to the expectation that all related parties will behave themselves according to the tax laws. This requires, as Alink and Kommer¹⁰² state, 'better understanding of, and addressing the expectations of, large taxpayers, including commercial awareness, impartiality, openness and dialogue, consistency and certainty and early settlement and speedy resolution of issues'. If there is good conduct between the parties, trust and transparency will grow between them and compliance costs will be minimal¹⁰³. Mutual understanding and control, however, are not mutually exclusive, in the sense that control can be achieved through coordination, transparency and relationship-building.

¹⁰² Matthijs Alink, van Kommer Victor, *Handbook on Tax Administration* (IBFD, 2011) 275.

¹⁰³ Marcel Kucher and Lorenz Götte 'Trust Me: An Empirical Analysis of Taxpayer Honesty' (1998) 55 *Public Finance Analysis* 429.

12.1 Conflict of Interest and Priority

Both the large corporations and the tax authority know, and perhaps believe that the interests of business and the interest of revenue are largely different and are, therefore, hard to balance with mutual respect and understanding. For example, delays on the part of the taxpayers are generally subject to warnings and penal actions, and attempts are often made to resolve these situations through mutual talks and discussions. One respondent argued:

The LTU view and the corporation view of business differ widely. The LTU's main concern is mobilising tax revenues, but our priority is to maximise the income and profit of the corporation. Unfortunately, the tax authority doesn't understand this and sends us legal notices when the filing of returns is delayed by even a week (Respondent 3).

The respondents expressed frustration that the LTU does not understand the pressure large corporate taxpayers are under from the regulatory inspection and surveillance of accounts preparation. The finance director of a large commercial bank stated:

The accounts of commercial banks are prepared on the basis of huge and complex documents gathered from numerous branches, which are time and resource consuming to work through. In our own interest, we want to make the accounts as perfect as possible. However, the tax authority smells something else when the accounts preparation is delayed (Respondent 5).

12.2 Litigation Prone Compliance Environment

Until very recently, mutual understanding as a policy has no legal basis, and usually remains outside the volumes in which tax law is published. Respondents argued that legal

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

obligations should always be addressed with legal means because mutuality of interest and understanding is a vague concept, and arriving at a concrete decision is beyond its scope. Many respondents take the huge volume of appeals cases lodged by large corporate taxpayers as an indication of the failure of mutual understanding. A sector-specific distribution of appeals cases, as reported in Table 2, shows that finance sector corporations are the most likely to be involved in litigation, with 68% of them disagreeing with audits findings and assessments, although audit adjustments are made through mutual agreement.

Table 2: Cross-tabulation of appeals cases by corporate sector for tax year 2008-09

Corporate sectors	Did the corporation appeal?			Total
	Yes	No	No grounds for appeal	
Finance	55	3	22	80
Manufacturing	18	2	23	43
Service	12	3	16	31
Total	85	8	61	154

Source: LTU Appeals and tribunal records

The reasons for litigation are two-fold: first, there is no legal obligation on the large corporations to obey audit adjustments arrived at through discussion. One respondent showed me written declaration from a large banking corporation that the tax agreed on through mutual understanding would be honoured. However, a few weeks later the corporation filed an appeal with the tax courts and refused to pay the taxes. Second, at the appellate level there are opportunities to manipulate and reduce taxes by collusion.

12.3 Lack of Tax Knowledge and Training

Lack of professional knowledge and understanding by the LTU gives rise to many instances of reporting and payment non-compliance. An investigation was carried out into the taxation and accounting knowledge of tax officials which many respondents identified as a potential barrier to mutual understanding. Out of 14 tax officials interviewed, only four had academic knowledge of accounting and taxation; the others had only in-service training on tax law.

Almost all tax professionals have accounting or business degrees. Four per cent of tax professionals have no qualification in accounting. All respondents having 25 or more years of experience have degrees in accounting, but respondents in the other two experience groups, mostly tax officials, have lesser qualifications in business and accounting. Of the eight respondents in the below-15-years-experience group, only four have accounting degrees, one of which is a tax professional. In the 15-25 year experience group only three out of nine have accounting degrees, most of which are tax officials. Addressing this huge gap in accounting and tax knowledge, the respondents insisted that local and international financial and tax accounting standards must be in unison, to reduce confusion among LTU officials. This respondent continued to say that sometimes LTU officials failed to observe the spirit of the tax law because of lack of understanding. This gap in understanding creates a huge number of reporting and payment non-compliances each year. On this point, other respondents stated that the problems of misunderstanding emerged from two sources: first grey tax laws; and second poor knowledge of accounting and taxation.

Mutuality of interest as a concept does not succeed in securing tax compliance because the interest of the businesses and the interest of the tax administrations are different and varied. The tax authority's objective is to

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

maximise revenue, whereas the large corporate taxpayer's goal is to keep tax payments to the minimum, legally or illegally. No tax administration would risk its present tax collections for the sake of establishing friendship with large corporate taxpayers, although this might increase the long-term potential of tax collection. It also seems that mutual understanding works better in a tax compliance environment of negotiation than in an environment where compliance is measured in terms of strict application of laws.

13. CONCLUSIONS

This work has provided explanations for the importance of coercive and persuasive instruments to the understanding of large corporate tax compliance. Instruments applied to increase tax compliance may have adverse effect if both the tax administration and taxpayer's context are not carefully considered.

Findings suggest that how frequently a coercive instrument is applied is more important than the financial burden it imposes on the taxpayer. The burden of financial penalty, however huge, can be managed if there are profitable alternative uses for the funds saved by non-compliance. It has been argued that the probability of being caught for alleged non-compliance is always a factor in the success of a coercive instrument, as was discussed in the influence of tax audit on return filing. The single most important factor that undermines the likelihood of a coercive instrument detecting an offence is widespread corruption in the preparation of audited financial reports and the arrangement of tax audit.

The paper found that imprisonment as a policy tool failed, largely due to the politicisation of the criminalisation process, huge tax administration costs and uncertainty about prison

terms. Arguably, favouring politically well-connected corporations and vilifying others, as was the case during the army-backed caretaker government in Bangladesh of 11 January 2007 to 29 December 2008,¹⁰⁴ upholds the political economy model of tax compliance.

Persuasive instruments can be effective in improving large corporate tax compliance if they fit to the needs of large corporate taxpayers and provide real value for money by reducing some of the cost of tax compliance. It was found that persuasion through increased mutual understanding fails because business and tax administration interests and priorities are different: the large corporate interest is to maximise profit, whereas the tax administration's is to mobilise tax revenues. This paper has argued that a knowledge gap between tax officials and large corporate taxpayers is one of the fundamental reasons for the failure of persuasive measures. Persuasive instruments sometimes work if there is a tough coercive environment. In other words, the success of persuasion as a policy tool to some extent depends on the existence of coercive instruments in the background.

The findings of this research show that there are some circumstances in which inducing large corporate tax compliance through quality taxpayer service and mutual understanding seems less impressive than inducement through simplification of tax laws. The above argument carries additional weight when tax law simplification is argued to be successful if it reduces tax compliance costs by reducing the need for extensive accounting and paper work, dependence on tax professionals, and scope for corruption and misinterpretation of tax laws. However, the argument that a positive tax administration attitude may improve the

¹⁰⁴ Shehabuddin, above n 80.

COERCIVE AND PERSUASIVE TAX COMPLIANCE TOOLS

effectiveness of taxpayer service corresponds to the intention theory. According to this theory tax morale or a sense of civic duty among tax officials can resolve much of the latter's bureaucratic inertia and risk-averse mind-set.

More generally, the success of coercive instruments should not be attributed only to the toughness of the action taken; tough actions must be amenable to reason. The reason penalty, audit and imprisonment fail is not totally financial or due to the genuineness of the threat of their application, but also to the lack of capacity that constrains the tax agencies from confronting them.