

# *Complexity, Compliance Costs and Non–Compliance with VAT by Small and Medium Enterprises (SMEs) in Bangladesh: Is there a Relationship?*

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## **Abstract**

*Similar to many developing nations, Bangladesh’s small and medium sector enterprises (SMEs) constitute some 90% of all businesses and play an important role in the country’s economic growth and employment.<sup>1</sup> This study investigates the nature and extent of the relationships between the complexity of Bangladesh’s Value Added Tax (VAT) legislation, the costs of compliance with VAT in Bangladesh, and non–compliance (either intentional or unintentional) with the VAT legislation by Bangladeshi SMEs. These results could be important as it appears that SMEs are under–represented in terms of their contribution to Bangladesh’s VAT revenue collection,*

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1 Minto, A. A. (2004). SMEs in Bangladesh. TECH MONITOR, Sep-Oct, 44-56.

*which if other foreign studies<sup>2</sup> are relevant could be due in part to compliance costs. The current study is the first to empirically examine the relationships between the complexity of VAT legislation, compliance costs and non-compliance for SMEs in Bangladesh context. The study involved firstly a series of focus group interviews involving different types of SMEs taxpayers in Bangladesh. This was then followed by survey through a purposive sample of SMEs taxpayers in Bangladesh. The results suggest that a majority of the compliant SMEs taxpayers listed complexity in VAT law and compliance costs as the two important factors influencing VAT non-compliance in SMEs. On the other hand, non-compliant taxpayers emphasised more about the positive relationship between taxpayers and VAT officials for compliant behaviour. The likelihood of audits, penalties and sanctions were found to have less effect on VAT non-compliance for non-compliant taxpayers. In comparison, such monitoring and penalties would apparently improve compliant behaviour by compliant taxpayers. The findings of this research have practical policy implications, in that they can assist policy makers and administrators in their understanding of the potential interrelationships between legislative and regulatory complexity, the costs of complying with VAT legislation, and non-compliance with VAT legislation by SMEs. Having a robust and functioning VAT system is seen as an important attribute for a developing economy, so these findings may be important not only for Bangladesh, but also similar developing economies.*

Key words: Compliance Costs, VAT, Small and Medium Enterprises (SMEs), Bangladesh

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- 2 Ritchie, K. (2001). The Tax Compliance Costs of Small Business in New Zealand. In Chris Evans, Jeff Pope and John Hasseldine (Eds.), *Tax Compliance Costs: A Festschrift for Cedric Sandford* (pp. 297-315). Prospect Media Pty Ltd, St. Leonards, Australia. Abdul Jabbar, H. (2009). Income tax non-compliance of small and medium enterprises in Malaysia: Determinants and tax compliance costs. Degree of Doctor of Philosophy, Curtin University of Technology, Curtin.

# 1 Introduction

Small and Medium Enterprises (SMEs) are considered as a key engine of economic growth in developing countries.<sup>3</sup> Due to the importance of the SMEs 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.<sup>4</sup> Bangladesh is no exception where SMEs<sup>5</sup> create large scale and low-cost employment opportunities using mainly locally available inputs and technologies and develops entrepreneurship by mobilising small and scattered private savings.<sup>6</sup>

In Bangladesh, the 79,754 enlisted SMEs establishments<sup>7</sup> account for about 45% of the total value-added in manufacturing; 80% of industrial employment and about 25% of the total labour force.<sup>8</sup> Although SMEs constitute some 90% of all businesses<sup>9</sup> and play an important role in the country's economic growth and employment, SMEs appear to be under-represented in terms of their registration for Value Added Tax (VAT)<sup>10</sup> and their contribution to VAT revenue collected. For instance, only 11% of

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- 3 Shome, P. (2004). *Tax Administration and the Small Taxpayer*. Policy Discussion Paper No. PDP/04/2, The International Monetary Fund, Fiscal Affairs Department: Washington, D. C.
  - 4 Hansford, A., Hasseldine, J. D., and Horworth, C. (2003). Factors affecting the costs of UK VAT compliance for small and medium-sized enterprises. *Environment and Planning : Government and Policy*, 21, 479-492.
  - 5 In Bangladesh, SMEs are defined for governmental statistical purposes in terms of whether they are manufacturing-based or non-manufacturing-based. A "medium"-sized enterprise in a manufacturing sector in Bangladesh means an enterprise in which the value/replacement cost of durable resources other than land and factory buildings is between 15 million to 100 million taka ( as at 10/2/2014 exchange rates, one AUD is approximately equivalent to 70 taka). A "small" enterprise means an industry in which the value/replacement cost of durable resources other than land and factory building is less than 15 million taka. In a non-manufacturing context, a "medium"-sized enterprise means an enterprise in which 25 to 100 people work; and a "small" enterprise means an enterprise in which fewer than 25 people work (eg. family members working together in a cottage industry). See Bangladesh Bureau of Statistics (2005).
  - 6 Bangladesh Bank (2006-2007). Annual Report, Security Printing Press, Dhaka.
  - 7 Asian Development Bank. (2004). Report and Recommendation of the President to the Board of Directors on proposed Loans and Technical Assistance Grant to the People's Republic of Bangladesh for SMEs Development Program, Retrieved from the world wide web: [www.adb.org/Documents/RRPS/BAN/rrp-ban-35225.pdf](http://www.adb.org/Documents/RRPS/BAN/rrp-ban-35225.pdf)
  - 8 Government of Bangladesh (2011). Bangladesh Economic Review, Ministry of Finance, Dhaka
  - 9 Alam, S., and Ullah, A. (2006). SMEs in Bangladesh and Their Financing: An Analysis and Some Recommendations. *The Cost and Management*, 34(3), 57-72.
  - 10 Conceptually, a Value Added Tax is an indirect tax on consumption that is levied on the value addition of goods or services at each point in the supply chain from the raw material or input stage to final consumption. Bangladesh in fact has two conceptually distinct taxes which are, in common business nomenclature in Bangladesh, referred to as "VAT". The first is the official

total VAT revenue come from SMEs, while SMEs' share of revenue collected from turnover tax is a mere 0.03% of total VAT revenue collected.<sup>11</sup> To date there has been no study in Bangladesh concerning the low representation of SMEs in terms of VAT. It is important to understand this low participation as having an effective VAT system is seen as an important attribute to assist developing nations.<sup>12</sup>

The remainder of the paper is organised as follows. The next section provides an overview of VAT in Bangladesh. Section three briefly reviews the literature regarding the role of complexity and compliance costs in VAT non-compliance studies. This discussion is then followed by the outline of the methods used in this study comprising of focus group discussions and surveys. Next the findings of the study for both methods are provided. The subsequent section provides a general discussion of the overall findings. The final section concludes the paper and provides suggestions for future research.

## 2 Value Added Tax (VAT) in Bangladesh: An Overview

From the time of independence in 1971 until 1991, Bangladesh had a relatively complicated indirect tax system. Domestically produced goods were subject to a Bangladeshi excise system, which only taxed goods and not services. The excise tax base was very narrow, and there were a multitude of rates and exemptions. In addition there was tax cascading, as excise was payable at every stage of value adding in the supply chain, with no offsets for the tax payable at prior stages of production on those goods. Imports of raw materials and intermediate goods were also subject to an indirect sales tax. This sales tax on imports performed two main functions: revenue-raising and protecting local industries. This protection led to considerable economic inefficiencies, exacerbating Bangladesh's already adverse export and balance of payments position.<sup>13</sup>

In recognition of the complexity of this indirect taxation system in April 1979 the Government of Bangladesh established the Taxation Enquiry Commission (TEC), with a view to investigate and recommend viable alternatives to existing sales taxes and excise duties in Bangladesh. The TEC proposed introducing a VAT in Bangladesh

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VAT; the second is a turnover tax imposed on small business. There are two key differences between these two taxes. First, the official or true VAT in Bangladesh is generally imposed on all firms at 15%, subject to an exception for small businesses, who have the option of instead paying a turnover tax at the rate of 3%. Second, VAT taxpayers in Bangladesh can generally claim input tax credits to offset their VAT payable, whereas small businesses paying turnover tax generally cannot.

11 National Board of Revenue (2011). Annual Report 2009-2010. Security Printing Press, Dhaka.

12 IMF (2007). Taxation of Small and Medium Enterprises, Background Paper for International Tax Dialogue Conference, Buenos Aires, October 2007.

13 World Bank (1989). *Bangladesh: An Agenda for Tax Reform*. The World Bank, Washington, D.C.

to (a) bring transparency in the taxation system; (b) prohibit cascading taxation at different stages of production; (c) consolidate the tax administration; (d) activate the overall economy by mobilising more in internal resources; and (e) bring a consistency in the tax-GDP ratio. This led to the introduction of a VAT in Bangladesh as per *The VAT Act 1991* and *The VAT Rules 1991*. Initially VAT was extended to importation and manufacturing of goods and a handful of services and remained so until 1996 when the term ‘supply’ was re-defined to include all business transactions. In 1997 the VAT was then extended to cover the whole range of business transactions in an incremental way. Now in Bangladesh, all goods except those mentioned in the First Schedule to the *VAT Act* and all services except those mentioned in the Second Schedule<sup>14</sup> are taxable goods and services. It is mandatory for any business or a person dealing in any taxable goods and services and having an annual turnover of BDT 6 million (USD\$80,000) or more to register for VAT.<sup>15</sup>

In Bangladesh the standard rate of VAT for home consumption goods and services is 15% and exports and deemed exports are 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, although 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 the wholesale and retail levels that do not declare any input tax credits, a deemed 1.5% VAT (that is the so-called ‘Trade VAT’) is imposed, in lieu of the standard 15% VAT, on the total value of the goods or services sold.

Another variation is for small business suppliers (defined as those with an annual turnover is less than 6 million Taka - equivalent to approximately USD\$ 80,000 as of 2013) have the option of paying a tax of 3% on their annual turnover, in lieu of 15% VAT. Choosing this option excludes the claiming of input tax credits.

Also, 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, it would pay 6,000 Taka (USD\$76) per year in deemed VAT. In contrast, a small retail shop based in a remote small town would pay 2,400 Taka (USD\$30) per year in deemed VAT. Firms in cottage industries (defined as those firms with annual turnover of less than 2.4 million Taka (USD\$ 31,000) and capital machinery of up to 300,000 Taka (USD\$4,000) in value) and their consumers are exempt from VAT and turnover tax.

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14 The First Schedule is the list of exempt goods which are basically unprocessed agricultural products such as cattle, crops, fruits, seeds and primary products (raw hides and natural sand). Exempt services mentioned in the Second Schedule in belong to the following categories- basic services for living; social welfare services; culture related services; finance and financial activities related services; transport service; and other services.

15 Starting with a threshold of BDT 0.5 million in 1991, the VAT threshold underwent a number of upward revisions in last 20 years.

Finally, for some taxable products listed in the National Board of Revenue's (NBR) 'special regulatory orders', if the NBR considers that market prices have increased too much, the NBR 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 the basis of this tariff value are not entitled to claim input tax credits. Consequently, it can be appreciated that there are numerous methods in calculating the VAT, which may of itself add to the complexity of the system.

The usual practice of paying VAT due (that is, the excess of output tax over input tax) to the government is through a return at the end of the tax period on a self-assessment basis by the registered taxpayers. 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 finally, withholding.

VAT has existed for 22 years in Bangladesh and collecting on an average 37% of total tax revenue in last 15 years.<sup>16</sup> 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,<sup>17</sup> some evidence suggests that there is the potential for improvement. For example, the tax base is narrow in Bangladesh compared to other developing countries and the tax revenue in Bangladesh is still very low as a percentage of GDP. In 2005, the average tax/GDP ratio in the developed world was approximately 35%, in developing countries it was equal to 15% and in the poorest of these countries, the low income countries tax revenue was 12% of GDP.<sup>18</sup> In 2005, the tax/GDP ratio was less than 10% in Bangladesh and in 2011-2012 the ratio was 11%.<sup>19</sup> Still now the gap between potential VAT revenue and actual VAT revenue is estimated to be more than 40%.<sup>20</sup> Compared to other low-income countries the C-efficiency ratio<sup>21</sup> is very low in Bangladesh. In low income countries the average C-efficiency ratio is 38.0% but in Bangladesh it is only 23.4%.<sup>22</sup> The VAT efficiency (or Productivity) ratio is 15.92% in Bangladesh, whereas, according to International Monetary Fund (IMF) the average

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

17 Saleheen, A. M. (2012). Presumptive Taxation under Bangladesh. *INTERNATIONAL VAT MONITOR*, 23 (5),316-321.

18 Fuest, C., and Riedel, N. (2009). Tax evasion, tax avoidance and tax expenditures in developing countries: A review of the Literature, Paper prepared for UK DFID, *Oxford University Centre for Business Taxation*, Oxford.

19 Government of Bangladesh (2012). *Bangladesh Economic Review*. Ministry of Finance, Dhaka

20 Faridy, above n 16, at 45.

21 C-efficiency ratio is defined as a share of the VAT in consumption divided by the standard VAT rate.

22 IMF (2011). *Revenue Mobilization in Developing Countries*. International Monetary Fund , Washington, D.C.

worldwide VAT efficiency ratio is 34%.<sup>23</sup> These figures would tend to indicate that there is potential for greater VAT collections.

According to the 2003 economic census the total number of Bangladeshi businesses was 3,674,971 of which 1,127,613 were registered with the trade licensing authorities.<sup>24</sup> In 2011, the number of businesses registered under VAT system was 480,467, which is very low compared to the above figures.<sup>25</sup> Of the 480,467 registered VAT payers, only 16.15% of registered VAT payers (or 77,615 firms) submitted their monthly VAT returns to local VAT authority on time. This means that approximately 84% of VAT taxpayers failed to lodge their returns on time. Anecdotal evidence suggests that only large VAT taxpayers registered with the NBR's Large Taxpayer Unit (LTU) regularly submit their VAT returns. Overall, these figures suggest an under-representation by SMEs in the VAT revenue collected by government may be due to significant non-compliance by SMEs with Bangladesh's VAT Law. In addition to that, there is some 60.24 billion Taka (USD\$0.8 billion) in outstanding VAT yet to be collected from the VAT payers in respect of the 2009-10 fiscal years.<sup>26</sup>

Whether SMEs' non-compliance with the VAT legislation is intentional or unintentional is unclear. One possible cause of SMEs' non-compliance with the VAT legislation could be that Bangladesh's VAT Law is too complex, so that they find the (private) costs of compliance (to them) to be excessive. Another cause of SMEs' non-compliance could be the fact that under the legislation the Bangladeshi Government has power to determine and set regulated prices, and therefore affect VAT amounts for many products. Thus many taxpayers may fail to pay VAT initially themselves, simply because they know that the government will dictate to them how much to pay later. A further cause could be a lack of monitoring or enforcement on the part of authorities<sup>27</sup> such as the NBR. To date there has been no study to explore the specific reasons of non-compliance with VAT by SMEs in Bangladesh. Against this backdrop, this paper aims to explore the reasons of non-compliance of VAT by SMEs in Bangladesh and examines whether complexity of VAT law and compliance costs lead to SMEs taxpayers' non-compliance. The findings of this research may be insightful for other developing nations trying to ensure that their VAT system is robust.

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23 Smith, A. M. C., Islam, A. and Moniruzzaman, M. (2011) "Consumption Taxes in Developing Countries – The Case of the Bangladesh VAT, Working Paper No. 82." Victoria University of Wellington, available at <http://www.victoria.ac.nz/sacl/cagtr/working-papers/WP82.pdf>.

24 BBS. (2012). "Statistical Highlights of Economic Census, 2001 & 03, Bangladesh." Retrieved November 21, 2013, from [http://www.bbs.gov.bd/WebTestApplication/userfiles/Image/Economic%20Census/h\\_b\\_new.pdf](http://www.bbs.gov.bd/WebTestApplication/userfiles/Image/Economic%20Census/h_b_new.pdf).

25 NBR, above n 11, at 51.

26 NBR, above n 11, at 59.

27 Kirchler, E.(2007). *The Economic Psychology of Tax Behaviour*. Cambridge University Press Cambridge, UK.

### 3 Complexity, Compliance Costs and Non-compliance of VAT

Simplicity is one of the commonly accepted key tenets of any sound taxation system. Simplicity – or conversely, reducing complexity – in a taxation system *cet. par.* reduces compliance costs, administrative costs, and thereby taxpayer uncertainty. Such an outcome could lead to improved levels of voluntary compliance.<sup>28</sup> Highlighting the importance of simplicity in a tax system, the report of The Australian Government Tax Road Map<sup>29</sup> stated:

Simplicity is the major aim of the Governments tax reform. A tax system buried in red tape and complexity will reduce investment, stifle innovation and risk taking and ultimately reduce productivity and economic growth. Complexity in the tax system will reduce the time an individual or company has for other pursuits, and detract from further participation in the work force. It also makes the system unfair, as it imposes a higher burden on lower income households.

Miller<sup>30</sup> points to three main types of complexity inherent in many taxation systems: technical complexity, compliance complexity and structural complexity. The first two types of complexity in particular would appear to be problems in Bangladesh, given the general population's relatively low educational standards and low levels of financial literacy.<sup>31</sup> Complexity is a universal problem and has been cited as the most serious problem by the United States of America (USA) income taxpayer.<sup>32</sup> Excessive complexity increases filing and administrative costs and it has impact on voluntary compliance,<sup>33</sup> although several studies have failed to document such a relationship.<sup>34</sup> In a recent empirical study in Australia (albeit in the context of personal income tax), the level of complexity was found to be directly related to taxpayer compliance costs

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28 Kasipillai, J.(2005). *A Comprehensive Guide to Malaysian Taxation: Current Year Assessment*, McGraw-Hill, Kuala Lumpur.

29 The Treasury. (2012). *Tax Reform: Road Map*. Commonwealth of Australia (available at [www.budget.gov.au](http://www.budget.gov.au)),p.5.

30 Miller, A. J. (1993). Indeterminacy, Complexity, and Fairness: Justifying Rule Simplification in the Law of Taxation. *Washington Law Review*, 68(1),1-78.

31 Government of Bangladesh (2009). *Bangladesh Economic Review*. Ministry of Finance, Dhaka.

32 Oveson, W. V. (2000). *National Taxpayer Advocate's Annual Report to Congress*. Office of Taxpayer Advocate, Washington D. C.

33 Collins, J. H., Milliron, V. C., and Toy, D. R. (1992). Determinants of tax compliance: A contingency approach. *Journal of the American Taxation Association*, 14, 1–29. Vogel, J. (1974). Taxation and Public Opinion in Sweden: An Interpretation of Recent Survey data. *National Tax Journal*, 27( 4), 449-513.

34 Porcano, T. M. (1988). Correlates of Tax Evasion. *Journal of Economic Psychology*, 9, 47-67. Yankelovich, S., and White, I. (1984). *Taxpayer Attitudes Study: Financial Report*. Public Opinion Survey Prepared for the Public Affairs Division, *Internal Revenue Service*, New York.

and thence to taxpayers' commitment to compliance.<sup>35</sup> A similar empirical result was found in a Malaysian income tax context by Pope and Abdul-Jabbar.<sup>36</sup>

It is argued that complexity has a greater effect on small businesses, as they can be more severely affected by red tape than large businesses.<sup>37</sup> This can be due to small businesses being less proficient in dealing with the complexities of regulations and are unable to spread the costs of compliance across large-scale operations.<sup>38</sup> However, to-date the role of complexity (perceived or actual) in explaining taxpayer non-compliance with the VAT Law in Bangladesh has not yet been investigated.

It has been stated that the more complex the tax legislation and regulation the greater the knowledge gap – or information asymmetry – between legislators and taxpayers, and the greater the costs to the taxpayer of complying with the legislation.<sup>39</sup> However the costs of complying with taxation legislation are not limited to taxpayers. Where the tax authorities have a legal duty to monitor and enforce the legislation (as does the NBR in Bangladesh), the tax authorities themselves face costs of discharging their duties in accordance with the legislation. In a very real sense, these too can be regarded as compliance costs, not the 'private' compliance costs of the taxpayer, but the publicly funded compliance costs for the tax regulator.

In the context of the Bangladeshi VAT, the private costs to a taxpayer of complying with the VAT Law can encompass not only the direct costs of collecting documentation; accounting for VAT; the fees paid to professional tax advisers; and remitting VAT on products but also indirect costs. These indirect costs include the value of labour time associated with the completion of VAT returns; the investment costs associated with acquiring intellectual capital necessary to enable this work to be done and even psychological costs that many taxpayers experience when trying to comply with tax legislation and regulation.<sup>40</sup>

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35 McKerchar, M. (2003). *The Impact of Complexity upon Tax Compliance: A Study of Australian Personal Taxpayers*, Australian Tax Research Foundation, Sydney.

36 Pope, J., and Abdul-Jabbar, H. (2007). Tax Simplification and Small Business in Malaysia: Past Developments and The Future, 19th Conference of Australian Tax Teachers Association, Brisbane.

37 Shome, above n 3.

38 Chittenden, F., Kauser, S. and Poutziouris, P.(2003). Tax Regulation and Small Business in the USA, UK, Australia and New Zealand. *International Small Business Journal*, 21 (1), 93-115.

39 Sandford, C. (Ed.). (1995). *Taxation Compliance Costs: Measurement and Policy*. Fiscal Publications, Bath, UK.

40 Sandford, C. (1973). *Hidden Costs of Taxation*. University of Bath, Institute for Fiscal Studies, Bath, UK. Cléroux, P. (1992). Small business and the cost of paperwork: the goods and service tax. *Journal of Small Business and Entrepreneurship*, 9(4), 27-40. Evans, C. (2003). Studying the Studies: An Overview of Recent Research into Taxation Operating Costs. *e-Journal of Tax Research*, 1(1), 64-92. Klun, M. (2004). Compliance Costs for Personal Income Tax in a Transition Country: The Case of Slovenia. *Fiscal Studies*, 25(1), 93-104. O'Keefe, J.,

The first comprehensive study on the compliance costs of VAT was conducted by Sandford et al.<sup>41</sup> for the year 1977-78 in the United Kingdom. However, the first modern study of compliance cost was conducted by Haig<sup>42</sup> in the USA about the federal taxes separated from the states and local government taxes. 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.<sup>43</sup>

The World Bank Group (WBG) conducted large-scale semi-structured questionnaire-based studies into tax compliance costs in transitional and developing countries (e.g., South Africa, Vietnam, Ukraine, Yemen, Peru, Nepal, Uzbekistan, Kenya) from 2006 - 2011, not only in relation to the time and costs spent on compliance with VAT, but also with income tax and payroll tax. Semi-structured questions were used to ask taxpayers about 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. These studies also found that tax compliance costs are regressive in nature.<sup>44</sup>

In Bangladesh, Saleheen conducted a field survey in 2012 and showed that 49% of the surveyed population considered that VAT Law in Bangladesh were not clear at all and 45% of them found VAT law is not trade friendly and complex. Furthermore, 41% respondents claimed that VAT is a complicated process. However, this study didn't explore the relationship between complexity and non-compliance.<sup>45</sup>

The regressivity in tax compliance costs may influence the competition of SMEs with large businesses, as small businesses may have compliance cost around 2% of their

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and O'Hare, P. (2008). Increased compliance costs: VAT and place of supply of services. *International Tax Review*, 27-31. Barbone, L., Bird, R., and Vázquez- Caro, j. (2012). *The Costs of VAT: A Review of the Literature*, CASE Network Report No. 106/2012, Warsaw, Poland.

- 41 Sandford, C., Godwin, M., Hardwick, P., Butterworth, M. (1981). *Costs and Benefits of VAT*. London, UK: Heinemann Educational Books.
- 42 Haig, R. M. (1935). The cost to business concerns of compliance with tax laws. *Management Review*, November, 232-333.
- 43 Cnossen, S. (1994). Administrative and Compliance Costs of VAT- a review of the evidence. *Tax Notes International*, 8, 1649-1668. Coolidge, J. (2012). Finding of tax compliance cost surveys in developing countries. Paper presented at the *10th International Tax Administration Conference, Sydney, 2<sup>nd</sup> & 3<sup>rd</sup> of April, 2012*, at p. 13-28.
- 44 IFC (2011). *IFC Tax Perception and Compliance Cost Surveys: A Tool for Tax Reform*, World Bank Group, March 2011. Available at: [https://www.wbginvestmentclimate.org/uploads/TPCCS\\_Consolidated\\_Web.pdf](https://www.wbginvestmentclimate.org/uploads/TPCCS_Consolidated_Web.pdf). (Accessed 14.3.13).
- 45 Saleheen, A.M. (2013). *Taxation and Good Governance: The Case of Value Added Tax in Bangladesh*. Unpublished PhD Thesis, Flinders University, Australia.

total turnover, where it can be lower as a fraction for the large businesses.<sup>46</sup> Therefore, higher compliance costs and complex tax legislations can discourage voluntary compliance and encourage tax non-compliance among SME sector.

Franzoni<sup>47</sup> identified that businesses may create a kind of resentment against tax authorities for high levies and too complex of a tax system. These may cause intentional non-compliance activities by the taxpayers. Furthermore, because of the complexity of the tax system, the businesses may engage expert tax professionals to help them with sophisticated tax planning to minimize tax payments. 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. The study outlined in this paper seeks to explore whether complexity - perceived or actual - plays a role in explaining taxpayer non-compliance with the VAT Law in Bangladesh. These results may be relevant to other developing nations, as a sound VAT system is seen as a fundamental cornerstone to provide adequate tax revenue for public spending.

## 4 Methodology

The overarching research problem which underlies this study is to ascertain why some SMEs comply with the VAT Law in Bangladesh, while others do not. In order to undertake this investigation, the research explores the extent of any associations between the complexity of the VAT Law, VAT compliance costs and SME non-compliance with the VAT in Bangladesh. A mixed methods approach was adopted utilising quantitative and qualitative methods. This type of mixed methods approach is most likely to maximize, as far as is practically possible, the internal and external validity of the results.<sup>48</sup> While much of 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.<sup>49</sup>

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46 Pope, J. (2001). Estimating and Alleviating the Goods and Services Tax Compliance Cost burden upon Small Business. *Revenue Law Journal*, Volume 11(1), 2- 23.

47 Franzoni, L. (1999), Tax Evasion and Tax Compliance. in Bourckaert, E. (Ed.), *Encyclopaedia of Law and Economics* (pp. 52-94), University of Bologna, Edward Elgar, Italy.

48 Huck, S. W., Cormier, W. H., and Bounds W.G. (1974). *Reading Statistics and Research*, Harper & Row, New York.

49 Tran-Nam, B., and Glover, J. (2002). Estimating the Transitional Compliance Costs of the GST in Australia: a Case Study Approach. *Australian Tax Forum*, 17(4), 499- 536. Glover, J., and Tran-Nam, B. (2005). The GST recurrent compliance costs/benefits of small business in Australia: a case study approach. *Journal of Australasian Tax Teachers Association*, 1(2), 237-258. McKerchar, M. (2003). *The Impact of Complexity upon Tax Compliance: A Study of Australian Personal Taxpayers*, Australian Tax Research Foundation, Sydney. Loo, E. C. (2006). Tax knowledge, tax structure and compliance: A report on a quasi-experiment. *New Zealand*

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:

- i. The SMEs 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);
- ii. SMEs taxpayers who have a completed and decided VAT non-compliance cases against them and already paid the fines and penalties imposed on them (Referred to as Non-Compliant VAT payers, and abbreviated to NCT); and
- iii. 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 two stages. Stage 1 involved focus group discussions with VAT payers of the SME sector (both CT and NCT) and VAT officials. Stage 2 involved the mailing of a questionnaire, seeking qualitative and quantitative data, to both complying and non-complying SMEs taxpayers. Early versions of the survey materials were used in both a pre-test and pilot-test and the content of the survey was submitted to independent readers for checking before commencing the actual survey. Participation was voluntary and no financial incentives were given for their time. As this study used human subjects, it was necessary to ensure that ethics approval was received before commencement of the focus groups and survey.

It needs to be acknowledged that surveys relating to tax non-compliance are complicated by the sensitive nature of topic and the threat of penalties, prosecution and stigmatization, which can induce taxpayers either to lie about their tax evasion behaviour, or refusal to take part in the study.<sup>50</sup> A number of strategies were adopted to try to minimise this. For example many questions were raised as the 3<sup>rd</sup> person rather than directly at the taxpayer, also any personal identification of participants were removed from the transcripts and responses.

#### 4.1 Focus group discussions

The power of focus group discussions as a research tool lies in its group dynamics. Advantages such as synergy, snowballing, stimulation, spontaneity and serendipity can occur as part of a focus group.<sup>51</sup> As a fast and cost-effective technique for eliciting

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*Journal of Taxation Law and Policy*, 12(2), 117–140. Yesegat, W.A. (2008). Value added tax in Ethiopia: A study of Operating costs and Compliance. Unpublished PhD Dissertation, University of New South Wales.

50 Houston, J., and Tran, A. (2001). A Survey of Tax Evasion Using the Randomized Response Technique. *Advance Taxation*, 13, 69-94.

51 Stewart, D. W., and Shamdasani, P. N. (1990). *Focus Groups: Theory and Practice*. SAGE Publications, Newbury Park.

views and opinions, focus group has been found appropriate for obtaining insights into target audience perceptions. Discussions were conducted with focus groups of SME taxpayers about their perceptions of why some SME taxpayers comply with the VAT Law in Bangladesh, and others do not.

The focus group were conducted in Dhaka, the capital city of Bangladesh because of the respondents, location. A total of 45 participants participated the focus group discussions consisting of 15 from compliant taxpayers (11 were business owners and 4 were Director VAT of the enterprises), 15 from the non-compliant taxpayers (12 were business owners and 3 were VAT consultants from the selected enterprises) and 15 from tax officials (9 were Joint Commissioners of VAT and 6 were Second Secretaries of VAT from the NBR). For many of them, the topic being researched was a matter of great interest for its potential to contribute to the improvement of the Bangladesh's tax culture and they also considered it an opportunity to share their opinion on the different aspects of VAT with a researcher. However, a couple of VAT officers declined to participate in the discussions as they thought that they should not talk 'on the record' to a researcher.

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 and any identifying names or references were removed from the transcription. The confidentiality and anonymity of the recorded data was confirmed by coding the participant and not using the participants' names. The findings of the focus groups are presented later in this article.

## 4.2 Survey development

Focus group discussions with VAT payers' and VAT officials helped to improve the wording of, and the meaningfulness of the survey questions (to both researcher and respondents) in the subsequent questionnaire mailed to taxpayers of both compliant and non-compliant. The completion of focus group in this way also served to maximise response rates and ensure that meaningful data are recorded at Stage 2 of the study.<sup>52</sup> In Stage 2 a questionnaire was mailed to compliant and non-compliant SME taxpayers, with a view to gathering both quantitative and qualitative information on factors affecting VAT non-compliance, and to gather data necessary 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 questionnaire, to enable the gathering of information which was not readily reducible to numerical form. These types of questions included those relating to

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52 Robson, C. (2002). *Real world research: a resource for social scientists and practitioner researchers*(2nd ed.). Blackwell Publishers, Oxford, UK.

taxpayer's perceptions of the integrity of the VAT officials; suggestions for improving the ways in which VAT in Bangladesh is designed or administered; and suggestions for the other reforms of law and practice. A summary of the English version of survey questionnaire is presented in **Appendix A**. Another version was also distributed that was written in Bangla, the official language of Bangladesh.

Before the final survey was undertaken 20 questionnaires were sent to SMEs taxpayers as a pilot survey to determine if the drafted questions were easily understandable to the respondents or not. After a two week period, eight completed responses were received, a response rate of 40%. After the pilot test and refinement of the survey instrument, a total of 500 questionnaires were then distributed to SMEs VAT payers from June 2013 to September 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 non-compliant taxpayers group and remaining 300 questionnaires were distributed to compliant taxpayers. Two reminders were sent to the taxpayers to improve the response rate. Finally the usable responses were 240 (152 from compliant taxpayers and 88 from non-compliant taxpayers). Giving an overall response rate was 48%, representing 51% response rate from CT and 44% response rate from NCT. .

Since VAT extends to the whole of Bangladesh, mail survey data were collected from the target population resident in the business regions of city corporation area, district town and Upazilla area. A summary of the participants' characteristics is shown in Table 1. Most of the respondents of mail survey were well qualified in terms of academic qualifications, 35% holding a Masters and 38% holding a bachelor degree. 50% of the respondents were from manufacturing business unit and an average of 45% were a sole proprietorship business. Regarding the manner of keeping accounting records, 43.1% from compliant group and 34.1% from non-compliant group of respondents in the mail survey 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 1: Summary of participants' characteristics**

| <b>Characteristics</b>                              | <b>Compliant<br/>(N=152)<br/>n (%)</b> | <b>Non-Compliant<br/>(N=88)<br/>n (%)</b> |
|---|--|---|
| <b>Location of business / enterprise</b>            |  |   |
| 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)                                 |
| <b>Primary business / enterprise</b>                |  |   |
| Manufacturing                                       | 75 (49.7)                              | 44 (50.0)                                 |
| Construction and real estate                        | 16 (10.6)                              | 12 (13.6)                                 |
| Wholesale, retail trade, hotels and restaurants     | 28 (18.5)                              | 19 (21.6)                                 |
| Professional services                               | 3 (2.0)                                | 4 (4.6)                                   |
| Transport, storage and communication                | 18 (11.9)                              | 2 (2.3)                                   |
| Others  | 11 (7.3)                               | 7 (8.0)                                   |
| <b>Business form</b>                                |  |   |
| A sole proprietorship                               | 63 (42.6)                              | 40 (45.5)                                 |
| A cooperative                                       | 1 (0.7)                                | 0 (0.0)                                   |
| A partnership                                       | 10 (6.7)                               | 8 (9.1)                                   |
| A private limited company                           | 65 (43.9)                              | 35 (39.8)                                 |
| A share company                                     | 2 (1.4)                                | 3 (3.4)                                   |
| Others (public limited company)                     | 7 (4.7)                                | 2 (2.3)                                   |
| <b>VAT related record keeping practice</b>          |  |   |
| A manual / paper system                             | 65 (43.1)                              | 30 (34.1)                                 |
| A partially computerized system                     | 58 (38.41)                             | 39 (44.3)                                 |
| A fully computerized system                         | 18 (11.9)                              | 18 (20.5)                                 |
| Tax adviser / external accountant                   | 10 (6.6)                               | 1 (1.1)                                   |
| <b>Average monthly VAT paid in 2011-12 (in BDT)</b> |  |   |
| Under 400,000                                       | 45 (29.6)                              | 28 (31.81)                                |
| 400,001 to 500,000                                  | 23 (15.1)                              | 15 (17.1)                                 |
| 500,001 to 600,000                                  | 10 (6.6)                               | 4 (4.6)                                   |
| 600,001 to 700,000                                  | 3 (2.0)                                | 5 (5.7)                                   |
| 800,001 to 900,000                                  | 3 (2.0)                                | 2 (2.3)                                   |
| 900,001 to 10,00,001                                | 19 (12.5)                              | 5 (5.7)                                   |
| More than 10,00,001                                 | 49 (32.2)                              | 29 (33.0)                                 |
| <b>Education level</b>                              |  |   |
| Junior high school                                  | 0                                      | 0   |
| 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 degree                                     | 58 (38.15)                             | 33 (37.50)                                |
| Masters degree or above                             | 60 (39.47)                             | 24 (27.27)                                |
| Others (CA, LLB, MBA, PHD)                          | 2 (1.32)                               | 5 (5.68)                                  |

## 4 Findings

The findings for both the focus groups (stage 1) and the survey (stage 2) are presented below.

### 5.1 Focus Groups

There can be a perception that taxation in general will always have the problem of compliance,<sup>53</sup> with people generally not liking to pay tax. However, the findings from the compliant taxpayers revealed that the duties as a citizen to the country and the contribution to build-up the state can be one of the main factors in influencing them to comply with the VAT law:

It's our duty as citizens and also our responsibility to The State to comply with the VAT Law as The State is providing us necessary services. I see paying VAT and comply with the VAT Law as a duty of a business man. (CT 8)

The State has provided us with some opportunities which enable us to do our business such as infrastructure. Even if you think the State as a company, it has provided some services and facilities for us. We need to pay the price for the State's services. If we pay the right amount of VAT, it's a contribution to The State to build its future. (CT 15)

In comparison, the most common influence for complying with the VAT from the non-compliant taxpayers was that VAT as an obligation to the businessmen and to avoid conflict with the VAT officials. Three female enterprise owners gave their opinion that most of the business person want to run his or her business according to the law, to avoid any hazard and obstruction from the tax officials. This was especially the case as a large percentage of their wealth is invested in the business, so it may be very costly if they are subjected to any penalties from the tax officers:

I don't want any conflict with my local VAT offices and also I want to avoid any sort of legal trouble with the NBR which may be very costly for me. So I try to pay my VAT timely. (NCT 13)

I firstly understand my duty when any kind of tax is mentioned. Paying VAT and abiding by the VAT Law cannot be enjoyable for people but if I can calculate my VAT correctly, paying the rightful amount of the taxes is a good job actually. I feel secure if I maintain a good relationship with the VAT offices. I think some SMEs taxpayers comply with the VAT law to maintain a good relationship with VAT offices and to get co-operation from them. (NCT 9)

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53 Adams, C., and Webley, P. (2001). Small business owners' attitudes on VAT compliance in the UK. *Journal of Economic Psychology*, 22, 195-216.

Kirchler<sup>54</sup> stated that a positive relationship between the tax authority and taxpayer may influence the level of voluntary compliance. However, in developing countries an antagonistic relationship may exist between these two groups, similar to a ‘cops and robbers’ game. Tax authorities perceive the taxpayers as ‘robbers’ who try to evade whenever they can and need to be monitored all time. Similarly taxpayers perceive tax authorities as ‘cops’ and feel it their right to hide.<sup>55</sup> Supporting this literature, participants from VAT officials’ considered better enforcement and strong monitoring by NBR is the most influencing factor to improve VAT compliance, not the civic duty:

Civic duty or contributions to The State are not the main factors. The most important things are strong monitoring and enforcement. They are tax fearing people; they are not tax loving people. (VO 3)

Participants were then asked to discuss the reasons for non-compliance with the VAT Law by Bangladesh SMEs. Some non-compliant taxpayers considered VAT as a burden and extra costs for SMEs. In addition to that, the higher VAT rate (15%) with supplementary duty and tariff value make VAT costly to the SMEs taxpayer in Bangladesh. Seven non-compliant participants stated that VAT rate is very high in Bangladesh and the business owners outside the VAT net are in a better position than the taxpayers within the VAT net. Majority of the non-compliant participants expressed that they are aware of VAT that they are obliged to pay, but considered that the government is not using taxpayers’ money wisely and taxpayers are not getting sufficient return from the government in terms of infrastructure or social security schemes. These various perceptions were used as justification to non-comply:

VAT is an extra cost for my business. I always want to minimise my cost. The VAT becomes a burden for me. (NCT 1)

I am not paying the VAT from my own pocket. I am collecting VAT from the customers. If I collect it and do not deposit the right amount to the Treasury I can make 15 percent more profit than my business competitors. So why do I have to pay VAT and comply with the Law? (NCT 11)

Businesses that do not file or pay taxes are in a much better situation than businesses that pay regular taxes. Businesses registered for VAT are often subjected to NBR’s audits and inspections but the NBR do not give extra effort for the businessmen who are not registered for VAT. (NCT 4)

Some of the non-compliant VAT participants’ expressed that they are aware about their duties and they have sufficient knowledge about the VAT Law. A few of the non-compliant taxpayers admitted that the unfairness in the tax system encourage them to get involve with tax evasion and tax avoidance schemes. Furthermore, they complained about VAT authorities’ attitude that is affecting the fairness in the tax system:

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54 Kirchler, above n27, at 189.

55 Braithwaite, V. (2003). A New Approach to Tax Compliance. In V. Braithwaite (Ed.), *Taxing Democracy: Understanding Tax Avoidance and Tax Evasion* (pp. 1-11). Ashgate Publishing, Aldershot.

VAT officials are unfriendly, unfair and corrupt. They maintain unlawful relationship with the powerful businesses and give more cooperation to large enterprises - big businesses can pay less VAT than SMEs. Some of the VAT officials behave so badly with us, that we feel afraid to go to the VAT offices. If I saw less corruption by the VAT officials, I would actually comply more with the VAT Law and pay more VAT. (NCT 5)

Literature<sup>56</sup> supports this, as if taxpayers find the burden of taxes unfair, he or she is more likely to evade. In contrast with the non-compliant participants, compliant participants pointed that complex tax system, multiple rates of VAT, highly complicated language and frequent changes in the VAT Law all around the financial year discourage taxpayers to comply with the VAT law. Literature suggests that simplifying tax systems and improving taxpayers' knowledge about tax laws can encourage voluntary compliance.<sup>57</sup> Participants from both groups of taxpayers (CT and NCT) also mentioned that NBR is not providing sufficient induction or educational programs for SMEs taxpayers to raise awareness and to inform them of changes in VAT law. Therefore, SMEs are mainly relying on themselves, their tax advisors, professional bookkeepers and accountants or common practices of market:

The NBR and local VAT offices are not informing us enough about the VAT Law. We do not know about our responsibilities and the new things about the VAT Law. To be honest it is (the VAT law) changing very frequently, so it is hard for us to track changes. If the VAT authority does not inform us properly about the changes in the VAT Law how can we comply the Law properly and accurately? We want to comply the VAT Law but the communication gap between taxpayers and the VAT offices makes us unintentionally non-compliant. (CT 15)

The above comments demonstrate that there could be multiple of reasons for non-compliance by SME VAT payers in Bangladesh. The VAT officials stressed that SMEs taxpayers do not comply with the tax law and not pay the right amount of VAT on their extra business profit. Compliant taxpayers find complex tax system; multiple rates of VAT, highly complicated language and frequent changes in the VAT Law discourage taxpayers to comply with the VAT Law. Compliant taxpayers also expressed that the discretionary power of NBR and VAT officials are an important factors contributing to complexity and thereby non-compliance. On the other hand non-compliant taxpayers pointed that along with higher VAT rate, an unfriendly attitude of the VAT offices, corruption, red tape are the main reasons behind non-compliance with VAT Law in Bangladesh.

Complexity of the VAT Law was also considered one of the main reasons of non-compliance by most of the participants. The compliant taxpayers group gave their opinion that VAT Law in Bangladesh is very complex and difficult to understand. Few compliant participants stressed that they cannot cope up with the changes in the law.

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56 Andreoni, J., Erard, B., and Feinstein, J. (1998). Tax compliance. *Journal of Economic Literature*. 36, 818-860. Kirchler, above n27, at 87.

57 Lewis, A. (1982). *The Psychology of Taxation*. St. Martin's Press, New York.

Price declarations, complicated rebates and refund procedures which required many books to be maintained make the VAT Law very complex and costly for the SMEs:

The multiple VAT rates, frequent changes in VAT law and its highly complicated language make the law complex. The VAT law has given discretionary power to NBR and VAT officials to exempt any goods or services for any special purpose, fix tariff value of any goods for the assessment of VAT, to select goods or services for withholding and advance payment of VAT or to determine turnover threshold and bring any goods or services under VAT irrespective of their turnover. These discretionary powers are misused by the NBR officials. Continuous changes in the law also make the VAT Law complex. (CT 5)

Both compliant and non-compliant VAT payers discussed that that sometimes the law itself, the rules, office orders and Statutory Regulatory Orders (SRO) are inconsistent and contradictory. However, the majority of non-compliant participants expressed that the VAT Law in Bangladesh is not very complex and difficult to understand. They indicated that if someone gave extra effort to understand the VAT Law and track the changes, then the law is reasonably understandable to the taxpayers:

The VAT Law is not too complex as we think. If we have sufficient tax education and we give some extra effort to understand the VAT Law, the VAT Law seems easier to understand for the SMEs. (NCT 8)

On the other hand, a majority of participants from the VAT officials expressed that the VAT Law in Bangladesh is reasonably understandable. This may be because the VAT Law is drafted by the VAT officials and they work with the law consistently. Some of the compliant and non-compliant participants raised the point that VAT officials should be more knowledgeable and should have clear concept about the VAT Law. They explained that, sometimes the law is not so complex but the lack of in-depth knowledge about the law and misinterpretation of law by the VAT officials make the VAT system complex in Bangladesh. On the other hand, VAT officials claimed that the taxpayers are sufficiently aware of their liabilities though they are unaware about the VAT incentives:

SMEs taxpayers believe that they are only paying VAT. Most of them don't have a clear idea that they are only collecting VAT as an agency from the customers. They are also unaware about the VAT incentives that they are enjoying from the NBR. They should think positively about the incentives or the opportunities that the government provides for SMEs. Always thinking negatively about paying the VAT makes the law complex and unfriendly for them. (VO 3)

The impact of complexity on compliance decision was also acknowledged by most of the participants. Consistent with the literature, many of them believed that complexity of the VAT Law affects the SMEs taxpayers more than the large taxpayers and complexity increases the cost of complying with tax laws and therefore may

increase the non-compliance.<sup>58</sup> However the awareness on VAT compliance costs seems to be lower among the participants. In other words, their association of their costs to comply with VAT law is not evaluated collectively. The majority of them admitted they have not considered these compliance costs with VAT before and they usually calculate the costs related to tax for their own business planning. These costs include customs duty, income tax and VAT altogether. Some argued that they couldn't remember the exact figure about VAT compliance costs but felt that VAT compliance costs was higher compared to other taxes.

Most of the participants stated that they employed a VAT adviser and/or accountant to assist with VAT which increased their VAT compliance costs. VAT advisers are considered as an effective figure with SME's tax compliance.<sup>59</sup> Studies suggest that tax advisors can act as advocates to their clients and also as an intermediary to the government.<sup>60</sup> Moreover, as a result of complexity of tax legislation, tax advisors might become an enforcer or exploiter of the tax law.<sup>61</sup> A majority of the participants agreed that they could not give exact figure about the VAT compliance costs as their VAT advisor or VAT consultant would calculate such cost. However, some of that commented that their costs are not lower than 2% their annual turnover. While some of them claimed that it might be more than 1% of their annual turnover but not more than 5%. Obviously these are not exact estimates and are at best a rough estimate:

I never thought about these costs in this way before; I basically calculate all the costs related to customs duty, income tax and VAT together. (CT 10)

My VAT advisor looks after everything about my VAT affairs and all the costs related to VAT. But I think that the extra cost related to VAT is higher than other tax related payments. Although my advisor is helping me to keep away from tensions 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)

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- 58 Lignier, P., and Evans, C. (2012), The rise and rise of tax compliance costs for the small business sector in Australia, Paper presented at the 10<sup>th</sup> *International Tax Administration Conference*, Sydney, 2<sup>nd</sup> & 3<sup>rd</sup> of April, at 5-7. The survey was completed by 159 small businesses in Australia.
- 59 Jackson, B. R., and Milliron, V. C. (1986). Tax compliance research: findings, problems and prospects. *Journal of Accounting Literature*, 5, 125-161. Richardson, M. and Sawyer, A. (2001). A Taxonomy Of Tax Compliance Literature: Further Findings Problems And Prospects. *Australian Tax Forum*, 16(2), 137-320.
- 60 Tan, L. M., and Sawyer, A. J. (2003). A synopsis of taxpayer compliance studies: overseas vis-a-vis New Zealand. *New Zealand Journal of Taxation Law and Policy*, 9(4), 431-454. Tomasic, R., and Pentony, B. (1991). Taxation law compliance and the role of professional tax advisers. *Australia & New Zealand Journal of Criminology*, 24, 241-257.
- 61 Klepper, S., and Nagin, D. (1989). The Role of Tax Preparers in Tax Compliance. *Policy Sciences*, 22,2167-194.

Jenkins and Forlemu<sup>62</sup> stated that reducing compliance costs through simplification of the tax system and enhanced taxpayer services would reduce the level of taxpayer non-compliance and would increase voluntary compliance. Although 11 out of 15 of the compliant VAT payers agreed that SMEs would pay more VAT if the costs of complying with VAT were less, some of them argued that some SMEs taxpayers will never pay more VAT even if VAT compliance costs are less:

Taxpayers who want to pay less tax will never pay more tax if compliance cost is less than before. They will search for new ways for tax evasion. Paying more or less never depends on tax compliance costs. It depends on tax morale. It should come from within. (CT 7)

However some non-compliant participants considered that higher VAT compliance costs have an impact on tax compliance attitudes, most of them (12 out of 15) agreed that there are other factors that influenced the compliance decision. The positive attitude of VAT officials' towards SMEs was considered an important factor for compliance:

Compliance cost is not a leading factor about paying taxes. There are other factors with compliance costs. Audit, penalties and sanctions play a vital role in changing their [taxpayers] attitude towards VAT non-compliance. It also serves as a deterrent to them. So after auditing, penalties and sanctions taxpayers have been exposed and they will give a second thought of being intentionally non-compliant. (NCT 11)

SMEs taxpayers are not big shots. They always try to listen to the VAT officials. An Assistant Commissioner is enough to motivate SMEs taxpayers of his or her jurisdiction to pay right amount of VAT. It depends on his or her efficiency to motivate taxpayers. (NCT 9)

A majority of the VAT Officials participants (12 out of 15) argued that the threat of punishment, fines and penalties, cancellation of VAT registration, likelihood of audits and surprise check-up by VAT officials are more influential factors for compliance decisions rather than compliance costs:

Audit can make the taxpayers realise if there is any weakness in their understanding and record keeping for VAT. Again, penalties and sanctions have deterrent effect for the taxpayers concerned and other taxpayers. The result is a better understanding and better compliance of VAT Law. (VO 10)

Almost all the participants from VAT Officials group agreed there is no strong relationship between complexity of law, compliance costs and VAT non-compliance. The strong beliefs to pay VAT and positive tax paying attitude are emphasised to be the dominant factor to increase voluntary compliance. In contrast, some of the non-compliant VAT payers considered that being highly positive mentality does not necessarily guarantee that they would voluntarily comply with the VAT Law. The non-

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62 Jenkins, G. P., and Forlemu, E. N. (1993). Enhancing voluntary compliance by reducing compliance costs: A taxpayer service approach. Development discussion paper No. 448, International Tax Program, Harvard Law School, Harvard University.

compliant VAT payers strongly argued that most of the VAT payers are intentionally or un-intentionally non-compliant, and it is the failure of NBR and local VAT administration that they can't find out the non-compliant taxpayers efficiently.

On the other hand, compliant participants claimed that complexity of the VAT and compliance costs have a positive relationship with VAT non-compliance. Most of them believed that larger firms don't bother about complexity of law and compliance costs as they have different strategies to evade VAT. However, evidence demonstrates that larger firms are more compliant with tax laws due to better internal control, proper accounting system and higher tax knowledge as compared to smaller firms and their compliance costs are proportionally lower compared to SMEs.<sup>63</sup> Table-2 illustrates the possible relationships between complexity, compliance costs and VAT non-compliance as raised in the focus group discussions.

The focus group findings show that differentiated rates and undermining the statutory single rates of 15%, value declaration, complicated rebates and refund system and frequent changes in VAT Law could be the main reasons behind VAT complexity in Bangladesh. The findings from non-compliant VAT payers indicate that there is an apparent lack of trust between the VAT authority and taxpayers in SME sector. Despite many negative features of VAT system of Bangladesh mentioned by the compliant and non-compliant participants, majority of them agreed the situation is improving and prejudice of VAT authority is easing (although fairly slow). Finally some participants admitted government's attitude towards SME sector is changing positively in last few years. Nevertheless, despite the government's intention to support SME sector, the goal is not yet realised, because they claimed VAT officials is not familiar with the SME environment.

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63 Juahir, M. N., Norsiah, A., and Norman, M.S. (2010). Fraudulent financial reporting and company characteristics: Tax audit evidence. *Journal of Financial Report and Accounting*, 8(2), 1985-2517. Tedds, L. M. (2010). Keeping it off the books: An empirical investigation of firms that engage in tax evasion. *Applied Economics*, 42(19),2459-2473.

**Table 2: Possible Relationship between complexity of VAT law, compliance costs and non-compliance**

| Theme                            | Sub-Theme                             | Example Quotations  |
|----------------------------------|---------------------------------------|---|
| Apparent Weak or No Relationship | Civic Duty and positive tax mentality | <p>“Not all VAT payers who are highly compliant have lower compliance costs. They also face complexity with the law. But their strong civic duty influences more than the compliance costs and complexity of law. To me, the biggest reason of paying VAT and being compliant is to contribute the State”. (CT 2)</p> <p>“Paying VAT is a duty of citizenship rather than the outcome of a cost benefit calculation for my business”. (CT 11)</p>   |
|                                  | Demonstration and Deterrent Effect    | <p>“It’s not complexity and compliance costs. Significant promotion of the NBR’s prosecutions of non-compliant taxpayers increases psychological pressure among other SME taxpayers and therefore increases voluntary compliance and enforced compliance among other SME taxpayers”. (VO 13)</p>  |
|                                  | Fair tax system                       | <p>“If I believe the VAT system is fair and neutral, I would be willing to pay more VAT though the Law is complex. I want to add, business friendly relationships between taxpayers and VAT officials are the most important factor than others”. (NCT 14)</p> <p>“If I saw less corruption by the NBR officials and Local VAT administration, I would be willing to pay the correct amount of VAT. To me, corruption is more important than complexity or compliance costs”. (NCT 4)</p> |
| Apparent Strong Relationship     | Record keeping                        | <p>“If VAT record keeping was less complicated with simpler payment system, compliance costs will be lower and business people would be willing to deposit the right amount of VAT”.(CT 6)</p>  |
|                                  | External Advice                       | <p>“Professional VAT experts, bookkeepers and accountants are too expensive. If the VAT law was less complex and we would not need to keep so many books and records for VAT purpose - we don’t need to hire professionals. This would decrease our compliance costs and would make us more compliant”. (NCT 11)</p>  |
|                                  | Statutory or regulatory language      | <p>“The Bangladeshi VAT Law is full of complicated and cumbersome language and there are some inconsistencies between Law/Rules/SROs/Office orders. All these make the law complex and results in higher compliance cost. I think if we can draft a law with simplified language, this will increase voluntary compliance and decrease unintentional non-compliance”. (VO 9)</p>  |

## 5.2 Findings: Survey

Based on the findings of the focus groups and to test some of notions raised, stage 2 involved the mailing of a questionnaire, seeking qualitative and quantitative data, to both complying and non-complying SME taxpayers. Alm et al. stated that people comply with the obligation to pay taxes as they understand that the public goods they receive need to be financed by their taxes.<sup>64</sup> Aaron and Slemrod argued that people pay taxes and comply with the tax law as a duty of citizenship.<sup>65</sup> On the other hand, Cowell argued that a taxpayer's motivation to pay taxes comes not only from their rational equation of outcome maximisation, but also from evaluation of the extent to what the exchange between taxes and services are equitable.<sup>66</sup> However, as demonstrated in the focus group, the compliant and non-compliant VAT payers appeared to have different opinions about the reasons for compliance. This potential difference was further explored in the survey as can be shown in Table 3. For example, 97% of compliant VAT payers strongly agreed or agreed that paying the correct amount of VAT is their civic duty, while only 24% of non-compliant VAT payers thought similarly.

One of the key findings of this study is that the perceptions of fines and penalties with compliance behaviour. Allingham and Sandmo predict that both probability of detection and the severity of penalties will affect evasion; if detection is likely and penalties are severe people will be more compliant.<sup>67</sup> This positive relationship between penalties and non-compliance appears to contradict with the non-compliant VAT payers in Bangladesh.

Only 32% of non-compliant VAT payers strongly agreed or agreed that the likelihood of penalties and sanctions encourage them to comply with the VAT law. This may be due to the fact that non-compliant taxpayers tend to be risk-takers in making compliance decision, as penalties and fines imposed by the VAT authority is not serious. Alternatively, it may be because non-compliant VAT payers do not think there is a great risk of detection from the NBR, as less than 28% thought the likelihood of audits would encourage compliance. In comparison, 73% of compliant VAT payers considered the likelihood of penalties and sanctions influence to compliance behaviour positively.

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64 Alm, J., McClelland, G. and Schulze, W. D. (1992). Why do people pay taxes? *Journal of Public Economics*, 48, 21-38.

65 Aaron, H. J. and Slemrod, J. Eds. (2004). *The Crisis in Tax Administration*. Brookings Institution Press, Washington D.C.

66 Cowell, F. A. (1992). Tax Evasion and Inequity. *Journal of Economic Psychology*, 13(4), 521-543.

67 Allingham, M. G., and Sandmo, A. (1972). Income tax evasion: A theoretical analysis. *Journal of Public Economics*, 1(3/4), 323-338.

**Table 3: Reasons for Compliance**

| Why do SMEs comply with VAT Law?   | CT<br>(N=152)<br>n (%) | NCT<br>(N=88)<br>n (%) |
|--|------------------------|------------------------|
| <b>Paying the correct amount of VAT is our civic duty</b>  |                        |                        |
| Not Sure   | 1 (0.65)               | 3 (3.41)               |
| Strongly Disagree  | 0                      | 0                      |
| Disagree   | 0                      | 53 (60.23)             |
| Neutral  | 3 (1.97)               | 11(12.5)               |
| Agree  | 90 (59.21)             | 21 (23.86)             |
| Strongly Agree   | 58 (38.15)             | 0                      |
| <b>Paying the correct amount of VAT is an important contribution to the development of Bangladesh</b>              |                        |                        |
| Not Sure   | 1 (0.66)               | 9 (10.22)              |
| Strongly Disagree  | 0                      | 6 (6.82)               |
| Disagree   | 0                      | 10 (11.36)             |
| Neutral  | 4 (2.63)               | 14 (15.91)             |
| Agree  | 90 (59.21)             | 30 (34.10)             |
| Strongly Agree   | 57 (37.50)             | 19 (21.59)             |
| <b>Taxpayers paid the correct amount of VAT when there was greater enforcement and monitoring by VAT Authority</b> |                        |                        |
| Not Sure   | 10 (6.58)              | 6 (6.82)               |
| Strongly Disagree  | 9 (5.92)               | 20 (22.73)             |
| Disagree   | 15 (9.87)              | 20 (22.73)             |
| Neutral  | 14 (9.21)              | 8 (9.09)               |
| Agree  | 71 (46.71)             | 23 (26.13)             |
| Strongly Agree   | 33 (21.71)             | 11 (12.50)             |
| <b>The likelihood of penalties and sanctions encourage me to comply with the VAT law</b>                           |                        |                        |
| Not Sure   | 3 (1.97)               | 6 (6.82)               |
| Strongly Disagree  | 2 (1.32)               | 19 (21.59)             |
| Disagree   | 11 (7.24)              | 23 (26.14)             |
| Neutral  | 24 (15.79)             | 12 (13.64)             |
| Agree  | 78 (51.32)             | 24 (27.27)             |
| Strongly Agree   | 34 (22.36)             | 4 (4.54)               |
| <b>The likelihood of audits encourage me to comply with the VAT law</b>  |                        |                        |
| Not Sure   | 9 (5.92)               | 6 (6.82)               |
| Strongly Disagree  | 2 (1.32)               | 22 (25.00)             |
| Disagree   | 8 (5.27)               | 27 (30.68)             |
| Neutral  | 26 (17.10)             | 8 (9.09)               |
| Agree  | 71 (46.71)             | 20 (22.73)             |
| Strongly Agree   | 36 (23.68)             | 5 (5.68)               |

In terms of whether the complexity of the Bangladesh VAT influences compliance, the findings from the survey provides some evidence of the importance of less complexity. Similarly, both a large percentage of compliant (67.1%) and non-compliant VAT payers (78.42%) considered that the VAT Law in Bangladesh is overly complex: Table 4. 45.47% of non-compliant VAT payers strongly agreed or agreed that their core business suffered as VAT is complicated in Bangladesh, fewer non-compliant VAT payers agreed (30%). This may be because compliant VAT payers are generally compliant and have a concept in their mind that the law requires payment of taxes as wilful failure to pay taxes warrants penalty.

Perceptions about unregistered VAT businesses seem an important factor for non-compliance. 70% of the non-compliant VAT payers believed that businesses that are not registered with VAT and don't pay VAT are in a better situation than registered businessman. Similarly 75% of non-compliant and 55% of compliant VAT payers agreed that businesses registered for VAT are often subject to NBR's audits and objections: Table 4. Literature states that if taxpayer find the burden of taxes are unfair and a non-compliant taxpayer is in a better position than compliant taxpayers, the former may be discouraged to pay taxes.<sup>68</sup> It appears that non-compliant VAT payers consider that by becoming VAT registered, businesses are more likely to come to the attention of the NBR, whereas it may be better to stay outside of the VAT system altogether and operate in the 'cash economy'.

The discretionary and judicial power of VAT Authority is considered an important factor of non-compliance. 69.07% of compliant taxpayers and 59.01% of non-compliant taxpayers agreed or strongly agreed that the discretionary and judicial power of VAT Authority discourages them to pay VAT. Saleheen shows that the presence of excessive discretionary powers in Bangladeshi VAT law creates lack of trust between taxpayers and tax officials.<sup>69</sup> Therefore business organisations are always vocal to a reduction of the discretionary power of VAT officials to reduce burdens on their business and to improve voluntary compliance.<sup>70</sup>

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68 Kirchler, above n 27, at 77-79.

69 Saleheen, A.M. (2013). Reining Tax Discretion: A Case Study of VAT in Bangladesh. *Asia-Pacific Journal of Taxation*, 16(2),77-91.

70 Financial Express. (2012). FBCCI for Reducing VAT Officials' Discretionary Power. Retrieved May 12, 2013, from [http://www.thefinancialexpress-bd.com/more.php?page=detail\\_news&date=2013-05-12&news\\_id=129179](http://www.thefinancialexpress-bd.com/more.php?page=detail_news&date=2013-05-12&news_id=129179).

**Table 4: Possible reasons for non-compliance**

| <b>Why do SMEs not comply with the VAT Law in Bangladesh?</b>                             | <b>CT (N=152)<br/>n (%)</b> | <b>NCT (N=88)<br/>n (%)</b> |
|---|-----------------------------|-----------------------------|
| <b>VAT is just an expense of the business that we try to minimise</b>                     |                             |                             |
| Not Sure  | 7 (4.61)                    | 1 (1.14)                    |
| Strongly Disagree   | 39 (25.66)                  | 6 (6.81)                    |
| Disagree  | 59 (38.81)                  | 40 (45.45)                  |
| Neutral   | 17 (11.18)                  | 8 (9.09)                    |
| Agree   | 23 (15.13)                  | 24 (27.27)                  |
| Strongly Agree  | 7 (4.61)                    | 9 (10.59)                   |
| <b>The VAT rate is high</b>   |                             |                             |
| Not Sure  | 0                           | 1 (1.14)                    |
| Strongly Disagree   | 2 (1.32)                    | 0                           |
| Disagree  | 39 (25.66)                  | 4 (4.56)                    |
| Neutral   | 12 (7.89)                   | 3 (3.42)                    |
| Agree   | 39 (25.66)                  | 33 (37.50)                  |
| Strongly Agree  | 60 (39.47)                  | 47 (53.38)                  |
| <b>The VAT Law and regulation is overly complex</b>                                       |                             |                             |
| Not Sure  | 0                           | 1 (1.14)                    |
| Strongly Disagree   | 4 (2.64)                    | 5 (5.68)                    |
| Disagree  | 34 (22.37)                  | 6 (6.81)                    |
| Neutral   | 12 (7.89)                   | 7 (7.95)                    |
| Agree   | 68 (44.73)                  | 45 (51.14)                  |
| Strongly Agree  | 34 (22.37)                  | 24 (27.28)                  |
| <b>Businesses that do not file or pay VAT are in a much better financial situation</b>    |                             |                             |
| Not Sure  | 15 (9.86)                   | 13 (14.77)                  |
| Strongly Disagree   | 6 (3.96)                    | 1 (1.14)                    |
| Disagree  | 56 (36.84)                  | 9 (10.23)                   |
| Neutral   | 17 (11.18)                  | 3 (3.41)                    |
| Agree   | 26 (17.11)                  | 20 (22.73)                  |
| Strongly Agree  | 32 (21.05)                  | 42 (47.72)                  |
| <b>Businesses registered for VAT are often subject to NBR's audits and objections</b>     |                             |                             |
| Not Sure  | 11 (7.24)                   | 4 (4.55)                    |
| Strongly Disagree   | 4 (2.63)                    | 1 (1.13)                    |
| Disagree  | 48 (31.58)                  | 4 (4.55)                    |
| Neutral   | 5 (3.29)                    | 4 (4.55)                    |
| Agree   | 59 (38.81)                  | 33 (37.50)                  |
| Strongly Agree  | 25 (16.45)                  | 42 (47.72)                  |
| <b>Other aspects of our business suffer due to pressure of VAT, as VAT is complicated</b> |                             |                             |
| Not Sure  | 6 (3.95)                    | 2 (2.27)                    |
| Strongly Disagree   | 12 (7.89)                   | 6 (6.81)                    |
| Disagree  | 75 (49.34)                  | 30 (34.09)                  |
| Neutral   | 14 (9.21)                   | 10 (11.36)                  |
| Agree   | 39 (25.66)                  | 25 (28.41)                  |
| Strongly Agree  | 6 (3.95)                    | 15 (17.06)                  |
| <b>The discretionary and judicial power of VAT Authority discourages me to pay VAT</b>    |                             |                             |
| Not Sure  | 18(11.84)                   | 10(11.36)                   |
| Strongly Disagree   | 2(1.32)                     | 7(7.95)                     |
| Disagree  | 16(10.55)                   | 8(9.09)                     |
| Neutral   | 11(7.24)                    | 11(12.50)                   |
| Agree   | 67(44.07)                   | 25(28.41)                   |
| Strongly Agree  | 38(25.00)                   | 27(30.68)                   |

A main aim of this study was to consider whether compliance costs lead to SMEs taxpayers' to non-comply with the VAT Law. It has mentioned earlier that compliance costs<sup>71</sup> include three major components, namely monetary costs, time costs and psychological costs to the taxpayers where monetary costs include money spent on tax professionals and expenses relating to taxation guides, books, communication and other incidental costs. Time costs are incurred by the taxpayer mainly on record keeping for tax purposes, completing the tax return and preparation of tax details for the tax authorities or for tax professionals. The psychological costs of taxation are the net economic costs of the pressure, anxiety and stress encountered when taxpayers seek to submit their tax returns in a timely and correct manner.<sup>72</sup>

Empirical indicators of VAT compliance costs for this study are the average monthly value (in Taka) and average monthly hours spent for accountants', bookkeepers' and VAT advisors' fees paid to ensure compliance with the legislation; the average monthly taka costs and hours used to produce VAT returns; the value of time taken to complete VAT returns each month; the average taka value and average hours spent travelling to the local VAT Office to file returns; and the monthly average costs and hours of audits and appeals. The monthly average compliance costs based on monthly VAT paid by compliant and non-compliant VAT payers is presented in Table 5, 6 and 7 respectively.

Woellner et al. described psychological costs of tax compliance as the negative experiences (such as anxiety and frustration), or stress, caused by tax compliance.<sup>73</sup> "Stress" is not an easy concept to define or measure and most attempts to do so have originated from the fields of health psychology and behavioural medicine which includes psychosomatic medicine. In developed Western economies, people who suffer from the psychological effects of stress or anxiety may self-medicate through alcohol, smoking; consult a psychologist or psychiatrist; possibly take prescribed medication; or, in some cases, take drugs that are not prescribed.

On the whole previous tax compliance cost studies have not tried to measure psychological costs, as an experimental/preliminary design this study should to try to estimate these psychological costs in a Bangladeshi context. While rudimentary, some of these factors were utilised to try to estimate psychological costs.

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71 Pope, J. (2001). Estimating and Alleviating the Goods and Services Tax Compliance Cost burden upon Small Business. *Revenue Law Journal*, Volume 11(1), 2- 23.

72 Pope, J., Fayle, R., and Chen, L. D. (1994). *The Compliance Costs of Companies' Income Taxation in Australia*. Sydney: *Australian Tax Research Foundation*. Evans, C., Pope, J., & Hasseldine, J. (2001). *Tax Compliance Costs: A Festschrift for Cedric Sandford*. Prospect Media, St. Leonards, Australia.

73 Woellner, R., Coleman, C., McKerchar, M., Walpole, M. and Zelter, J. (2001). Taxation or vexation- measuring psychological costs of tax compliance. In Chris Evans, Jeff Pope and John Hasseldine (Eds.), *Tax Compliance Costs: A Festschrift for Cedric Sandford* (pp. 35-51). Prospects Media, St. Leonards, Australia.

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, consult 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 preliminary evidence in this regard. The monthly average compliance costs based on annual VAT paid by compliant and non-compliant SMEs VAT payers is presented in Table 5, 6 and 7 respectively.

**Table 5: Average Compliance Costs of Compliant Taxpayers**

| Group | VAT Payment Group (expressed in Taka) | VAT Compliance Costs for CT |                          |                           |
|-------|---------------------------------------|-----------------------------|--------------------------|---------------------------|
|       |                                       | Monetary Costs (BDT)        | Time Costs (Total Hours) | Psychological costs (BDT) |
| 1     | Under 400,000                         | 27,822                      | 97                       | 4,648                     |
| 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 10,00,001                  | 92,947                      | 189                      | 19,238                    |
| 7     | More than 10,00,001                   | 1,79,265                    | 336                      | 31,176                    |

**Table 6: Average Compliance Costs of Non-compliant Taxpayers**

| Group | VAT Payment Group    | VAT Compliance Costs for NCT |                          |                           |
|-------|----------------------|------------------------------|--------------------------|---------------------------|
|       |                      | Monetary Costs (BDT)         | Time Costs (Total Hours) | Psychological costs (BDT) |
| 1     | Under 400,000        | 35,091                       | 113                      | 6,622                     |
| 2     | 400,001 to 500,000   | 52,466                       | 276                      | 6,916                     |
| 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 10,00,001 | 1,09,800                     | 451                      | 19,166                    |
| 7     | More than 10,00,001  | 2,27,655                     | 448                      | 33,045                    |

**Table 7: Comparison of VAT Compliance Costs of CT and NCT**

| Group | VAT Payment Group    | Total VAT Compliance Costs                       |   |
|-------|----------------------|--|---|
|       |                      | Total Monetary & Psychological Costs (BDT) of CT | Total Monetary Costs & Psychological (BDT) of NCT |
| 1     | Under 400,000        | 32,470   | 41,173  |
| 2     | 400,001 to 500,000   | 67,242   | 59,382  |
| 3     | 500,001 to 600,000   | 83,272   | 92,083  |
| 4     | 600,001 to 700,000   | 79,527   | 98,125  |
| 5     | 800,001 to 900,000   | 92,554   | 109,916   |
| 6     | 900,001 to 10,00,001 | 112,185  | 128,966   |
| 7     | More than 10,00,001  | 210,441  | 260,700   |

The above results indicate that the VAT compliance costs in Bangladesh in the year under consideration are found to be higher for non-compliant than compliant VAT payers. This trend is generally consistent for both monetary and psychological costs. Part of the explanation for these extra costs for non-compliant VAT payers may be due to their non-compliant behaviour. They are spending extra money on objections, appeal and VAT related court appeal and paying extra money for external advisors or lawyers. The results suggest that psychological costs are a large component of VAT compliance costs for SMEs in Bangladesh and higher for the non-compliant taxpayers.

Woellner et al. report that simplified legal drafting reduces the psychological costs of tax compliance.<sup>74</sup> Regarding the stress and anxiety (psychological costs) that VAT causes, Yesegat points out those Ethiopian taxpayers perceived the burden of psychological costs is high and very high.<sup>75</sup> However, in this study five attitude statements in the taxpayer survey related to the psychological costs (stress and anxiety) of VAT as can be shown in Table 8. About 63.15% of compliant and 72.72% percent of non-compliant VAT payers strongly disagreed or disagreed with the statement “there are no psychological costs (stress/anxiety/sleepless nights) in complying with VAT”. Furthermore, 62.29% of the compliant and 71.82% of the non-compliant VAT payers expressed the view that psychological costs have significantly affected the amount of time and effort that they can put into their business. Similarly, 60% of compliant and 62.50% non-compliant VAT payers expressed the psychological costs relating to VAT are excessive when compared to other taxes in Bangladesh.

74 Woellner, R., Coleman, C., McKerchar, M., Walpole, M. and Zelter, J. (2007). Can simplified legal drafting reduce the psychological costs of tax compliance? An Australian perspective. *British Tax Review*, 6, 717-734.

75 Yesegat, above n 49, at 226.

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 81% of compliant and 85% of non-compliant VAT payers strongly agreed or agreed with this.

**Table 8: Psychological Costs of VAT**

| <b>Psychological Costs of VAT</b>   | <b>CT<br/>(N=152)<br/>n (%)</b> | <b>NCT<br/>(N=88)<br/>n (%)</b> |
|---|---------------------------------|---------------------------------|
| <b>There are no psychological costs (stress/anxiety/sleepless nights) in complying with VAT.</b>                      |                                 |                                 |
| Not Sure  | 4(2.63)                         | 3(3.42)                         |
| Strongly Disagree   | 23(15.13)                       | 37(42.04)                       |
| Disagree  | 73(48.02)                       | 27(30.68)                       |
| Neutral   | 24(15.79)                       | 9(10.22)                        |
| Agree   | 18(11.84)                       | 9(10.22)                        |
| Strongly Agree  | 10(6.58)                        | 3(3.42)                         |
| <b>Psychological costs have significantly affected the amount of time and effort that I can put into my business.</b> |                                 |                                 |
| Not Sure  | 8(5.26)                         | 3(3.42)                         |
| Strongly Disagree   | 6(3.95)                         | 2(2.27)                         |
| Disagree  | 38(25.0)                        | 2(2.27)                         |
| Neutral   | 19(12.5)                        | 9(10.22)                        |
| Agree   | 52(43.21)                       | 47(53.41)                       |
| Strongly Agree  | 29(19.08)                       | 25(28.41)                       |
| <b>The psychological costs relating to VAT are excessive when compared to other taxes in Bangladesh.</b>              |                                 |                                 |
| Not Sure  | 17(11.18)                       | 12(13.64)                       |
| Strongly Disagree   | 10(6.58)                        | 4(4.54)                         |
| Disagree  | 46(30.26)                       | 6(6.48)                         |
| Neutral   | 19(12.5)                        | 11(12.5)                        |
| Agree   | 46(30.26)                       | 33(37.50)                       |
| Strongly Agree  | 14(9.21)                        | 22(25.0)                        |
| <b>Psychological effects influence my private cost of seeking to comply with VAT.</b>                                 |                                 |                                 |
| Not Sure  | 13(11.84)                       | 10(11.36)                       |
| Strongly Disagree   | 8(5.26)                         | 2(2.27)                         |
| Disagree  | 28(18.42)                       | 4(4.54)                         |
| Neutral   | 26(17.10)                       | 10(11.36)                       |
| Agree   | 60(39.48)                       | 36(40.91)                       |
| Strongly Agree  | 17(11.18)                       | 26(29.54)                       |
| <b>The VAT authority's timely information and friendly attitude towards taxpayers can reduce psychological costs.</b> |                                 |                                 |
| Not Sure  | 10(6.58)                        | 3(3.42)                         |
| Strongly Disagree   | 1(0.66)                         | 2(2.27)                         |
| Disagree  | 4(2.63)                         | 7(7.95)                         |
| Neutral   | 12(7.89)                        | 1(1.14)                         |
| Agree   | 77(50.66)                       | 42(47.73)                       |
| Strongly Agree  | 48(31.58)                       | 33(37.50)                       |

An objective of this research was to examine whether there are any potential inter-relationships between complexity of VAT Law, VAT compliance costs and VAT non-compliance, and to find whether there are other factors contributing to VAT non-compliance by SMEs in Bangladesh. Table 9 reports the attitudes of taxpayers about the relationship between complexity, compliance costs and VAT non-compliance in Bangladesh.

**Table 9: Relationship between Complexity, Compliance costs and VAT Non-compliance**

| <b>Is there a relationship between complexity, compliance costs and non-compliance with VAT?</b>                                  | <b>CT<br/>(N=152)<br/>n (%)</b> | <b>NCT<br/>(N=88)<br/>n (%)</b> |
|---|---------------------------------|---------------------------------|
| <b>Compliance with VAT Law is excessively burdensome and costly for taxpayers</b>   |                                 |                                 |
| Not Sure  | 16 (10.53)                      | 2 (2.27)                        |
| Strongly Disagree   | 6 (3.95)                        | 2 (2.27)                        |
| Disagree  | 36 (23.68)                      | 5 (5.68)                        |
| Neutral   | 17 (11.18)                      | 2 (2.27)                        |
| Agree   | 44 (28.95)                      | 34 (38.64)                      |
| Strongly Agree  | 33 (21.71)                      | 43 (48.87)                      |
| <b>The VAT compliance costs of our business are insignificant</b>   |                                 |                                 |
| Not Sure  | 15 (9.87)                       | 6 (6.82)                        |
| Strongly Disagree   | 8 (5.27)                        | 21 (23.86)                      |
| Disagree  | 60 (39.48)                      | 36 (40.91)                      |
| Neutral   | 12 (7.89)                       | 7 (7.95)                        |
| Agree   | 53 (34.87)                      | 14 (15.90)                      |
| Strongly Agree  | 4 (2.63)                        | 4 (4.54)                        |
| <b>The burden of compliance costs discourages the owners to fulfil VAT obligations</b>  |                                 |                                 |
| Not Sure  | 3 (1.97)                        | 7 (7.95)                        |
| Strongly Disagree   | 11 (7.24)                       | 1 (1.14)                        |
| Disagree  | 42 (27.63)                      | 14 (15.91)                      |
| Neutral   | 25 (16.45)                      | 6 (6.82)                        |
| Agree   | 46 (30.26)                      | 35 (39.77)                      |
| Strongly Agree  | 25 (16.45)                      | 25 (28.41)                      |
| <b>Simplified VAT Law and reasonable compliance costs would increase voluntary compliance among SMEs VAT payers in Bangladesh</b> |                                 |                                 |
| Not Sure  | 7 (4.61)                        | 6 (6.82)                        |
| Strongly Disagree   | 1 (0.66)                        | 22 (25.00)                      |
| Disagree  | 7 (4.61)                        | 16 (18.18)                      |
| Neutral   | 27 (17.76)                      | 12 (13.64)                      |
| Agree   | 65 (42.76)                      | 24 (27.27)                      |
| Strongly Agree  | 45 (29.61)                      | 8 (9.09)                        |

During the focus group some participants' emphasised that VAT legislation is complex and the VAT system is complicated in Bangladesh. Few participants stressed that they became confused with the inconsistency between law/rules/SROs and frequent changes in law made the VAT law complex to them. Only 45% of the compliant and 64% of the non-compliant VAT payers strongly disagreed or disagreed with the statement "The VAT compliance costs of our business are insignificant". When the respondents were asked about the specific relationship between complexity, compliance costs and non-compliance through the survey instruments, 72% of the compliant VAT payers strongly agreed or agreed that simplified VAT Law and reasonable compliance costs would increase voluntary compliance among SMEs VAT payers in Bangladesh (Table 9). In contrast, only 36% of non-compliant VAT payers shared this view. It appears that there is a stronger view held by NCT that VAT compliance costs are excessively burdensome (88%), compared to compliant VAT payers (51%). Also, there is a stronger opinion by non-compliant VAT payers that compliance costs discourage owners to fulfil their VAT obligations (68%) compared to that of compliant VAT payers (47%). However, it does not appear that non-compliant VAT payers see a likely increase in VAT compliance by SMEs in Bangladesh if the VAT law was simplified with reasonable compliance cost (36% strongly agreed or agreed). In contrast, compliant VAT payers had a stronger opinion that there would be greater voluntary compliance (73%).

Therefore, it appears that complicated VAT legislation and higher compliance costs could be important factors for VAT non-compliance by compliant VAT payers in the SME sector in Bangladesh, but not so for non-compliant VAT payers. Prior literature in the contexts of personal income taxpayers of some developed and developing countries support these findings.<sup>76</sup>

Taxpayers have the rights to expect a tax department to be accountable; treat a taxpayer fairly and reasonably; treat a taxpayer as being honest unless a taxpayer acts otherwise and respects a taxpayers' right to make a compliant. Similarly taxpayers' have the obligation to be truthful; pay by the due date; keep the required records and be co-operative.<sup>77</sup> This study has revealed that non-compliant taxpayers appear not to be too concerned about the fines and penalties or audit. Most of the taxpayers believe the relationship between taxpayers and NBR are not friendly and professional. VAT

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76 Erard, B. (1997). The Income Tax Compliance Burden on Small and Medium-sized Canadian Businesses. WORKING PAPER 97-12 Prepared for the Technical Committee on Business Taxation. John Hasseldine, 'Linkages between Compliance Costs and Taxpayer Compliance Research' in Chris Evans, Jeff Pope and John Hasseldine (eds), *Taxation Compliance Costs: A Festschrift for Cedric Sandford* (2001) 3, 3. Colmar Brunton Social Research Agency, New Zealand, (2005) "Measuring the tax compliance costs of small and medium-sized businesses - a benchmark survey" <http://www.taxpolicy.ird.govt.nz/news/archive.php?year=2005&view=383>. USAID (2008), "Formal SMME Tax compliance Survey Report: Prepared for National Treasury Republic of South Africa", available at: [http://www.fias.net/ifcext/fias.nsf/Content/Pubs\\_BusinessTaxation](http://www.fias.net/ifcext/fias.nsf/Content/Pubs_BusinessTaxation).

77 Australian Tax Office (2010). *Taxpayers' Charter* A.T. Office, Australian Tax office, Canberra.

authority's antagonistic treatment with the taxpayers' affect the affects the latter's tax morale, and therefore their willingness to comply.

## 5 Limitations

The study has a number of limitations that should be considered when evaluating the findings of the research. First, this research was based on a sensitive topic and non-compliant taxpayers groups were involved in all stages of research as respondents. Consequently, the participants may have felt uneasy and embarrassed to respond to the researcher's questions during the discussion process, as well as the survey. While measures were taken to assure participants of their anonymity, their responses may not have been totally accurate. Second, the VAT Officers involved in this study may have felt cautious about their responses. While this group was happy to talk, was lively and confident in their opinions, some of them had concerns about voice recording during discussion as they are government employee and may face any trouble for their opinion. While re-assurances were provided, this situation may have influenced responses.

Another limitation is the estimation of compliance costs, as they may not be accurate due to being self-reported and historical estimates. Furthermore, it is acknowledged that the measures use for psychological costs are rudimentary, but given the paucity of measures, they provide an interesting reflection. Also, this survey did not include those SMEs not currently within the VAT system even though registration may be mandatory for them (known as the cash economy). It could be that these cash economy SMEs have different motivators than the non-complying VAT payers surveyed.

Finally, this research investigated here are those of SMEs only. The large taxpayers unit of VAT need to be explored to obtain a more thorough picture of the tax compliance study of Bangladeshi taxpayers. Future studies could explore these areas.

## 6 Conclusion

A good tax system must satisfy four principles: simplicity, equity, ability to pay and efficiency.<sup>78</sup> A tax system or its basics should be understood by the majority of the citizens. It must also be simple to operate, so that the collection of taxes (administrative costs and compliance costs) is inexpensive. Taxpayers should not be subject to frequent changes on rates or bases and the costs of compliance for tax payers and of collection for the governments should be minimal. The increasing complexity in the tax system in many countries, together with the growth of the importance of SME sector has raised the awareness concerning simplified tax law, compliance costs and voluntary compliance for SMEs. However, a fundamental difficulty in analysing anything with tax non-compliance is the lack of reliable information on taxpayers' compliance.

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78 Musgrave, A. R., and Musgrave, B. P. (1989). *Public Finance in Theory and Practice*, 5th ed., McGraw Hill, New York.

This is the first study to estimate the VAT compliance costs of SME sector in Bangladesh and indeed is the first study aimed to explore the reasons for VAT non-compliance by SMEs in Bangladesh.

One of the key strength of this study is a large (albeit purposive) sample of from non-complying SMEs who are liable to pay VAT in Bangladesh and to compare the findings of compliant and non-compliant VAT payers of SME sector in Bangladesh. The WBG studies emphasise a need to, if practicable, obtain data from the relevant tax authorities themselves, even though this is often difficult.<sup>79</sup> Another key strength of this research includes access to key NBR management to ascertain their observations concerning taxpayer compliance behaviour. Very few VAT related studies in developing countries took into account the view of VAT authority and their observation about the causes of VAT non-compliance<sup>80</sup> of SME sector. Estimation of psychological costs is another sphere of the study. Psychological costs has previously received little attention from researchers and a very few empirical studies which seek to quantify these psychological costs.<sup>81</sup> One exception, albeit in the context of VAT in Ethiopia, is Yesegat who, in a semi-structured interview-based study, concluded that psychological costs were a significant component of the total costs of VAT compliance in that country.

The study found that majority of the compliant participants' listed VAT law complexity and compliance costs for non-compliance. On the other hand, while non-compliant VAT payers agreed VAT law is overly complex in Bangladesh, they emphasised more about the positive relation between taxpayers and VAT officials for compliant behaviour. However, to get non-compliant VAT payers to comply appears to be multi-faceted issues, as the likelihood of audits, penalties and sanctions were found to have less effect on VAT non-compliance for non-compliant VAT payers. In comparison, such monitoring and penalties would apparently improve compliant behaviour by compliant VAT payers. Also, reducing compliance cost would not necessarily increase compliance by non-compliant VAT payers, whereas it might for compliant VAT payers.

The findings of this study provide valuable insight about the complexity, compliance costs and VAT non-compliance in Bangladesh. This issue is important for tax policy researchers, policy makers and VAT administrators in Bangladesh and in other developing countries in designing an effective but simplified VAT system which will reduce the compliance burden to improve the voluntary compliance level.

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79 IFC, above n 44

80 Yesegat (2008) had some interviews with the VAT authorities in her study based on operating cost of VAT in Ethiopia and Feld and Frey (2002) sent a letter to Swiss tax authorities asking legal background of income tax evasion (see, cited at Feld and Frey, 2007, p. 114). Saleheen (2013) took some in-depth interviews and focus group discussions about VAT and good governance in Bangladesh.

81 Barbone, L., Bird, R., and Vázquez- Caro, J. (2012). *The Costs of VAT: A Review of the Literature*, CASE Network Report No. 106/2012, Warsaw, Poland.

## Appendix A

### Survey Questionnaire



## Complexity, Compliance Costs and Non-Compliance with VAT by Small and Medium Enterprises (SMEs) in Bangladesh: Is there a Relationship?

### Participant Information

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### Introduction

Due to the importance of the Small and Medium Enterprises (SMEs) in the Bangladesh economy it is important to know about the complexity of the VAT law and the compliance costs of your business. The objectives of this thesis are to estimate the VAT compliance costs for SMEs in Bangladesh and consider whether there is any relationship between the complexity of the VAT law (real or perceived) and VAT compliance costs for SMEs in Bangladesh. The other objectives are to examine whether, in respect of SMEs in Bangladesh, there are any potential inter-relationships between VAT compliance costs and VAT non-compliance, including the extent to

which higher compliance costs are likely to lead SME taxpayers failing to comply with VAT law, or whether there are other factors (eg. a lack of enforcement) contributing to VAT non-compliance by SMEs in Bangladesh.

## **What you will be asked to do**

You have to fill out a survey questionnaire and it is estimated to take 25-30 minutes for you. The questionnaire has three parts. First part is the general information of your business, the second part is based on your perceptions and attitude of VAT compliance and the third part consists of VAT compliance costs and related issues. The final part is based on your perceptions and attitudes about the relationship between complexity, compliance costs and VAT non-compliance. After completing the questionnaire, I may request you for a follow up face-to-face in-depth interview for further clarification. If you are interested for a face to face interview in the next stage, I will contact with you later.

## **Consent to Participant**

Your participation in this project is voluntary and you are not under any obligation to consent or participate in this research. Non-participation will not involve any penalty. If you choose to participate, you may discontinue participation at any stage without penalty or without providing any explanation. It is hoped that the findings of this research may be useful to design an effective VAT system for SMEs in Bangladesh. It is also envisaged that the findings of this research will fortify current theory as well as building a stronger framework for further studies on VAT reform in Bangladesh.

## **Confidentiality**

The data collected from this research will be reported in general terms and will not involve any identifying feature. All information will be kept confidential and a unique identification number will be allocated to all participants. The correlation between number and participant will be kept securely only within the research team. All data will be stored securely for five years before being destroyed. The information collected is confidential and will not be disclosed to third parties without your consent, except to meet government, legal or other regulatory authority requirements. A de-identified copy of this data may be used for other research purposes. However, your anonymity will at all times be safeguarded. For further information consult the University's Privacy Plan at <http://www.griffith.edu.au/privacy-plan> or telephone +61 (07) 3735 4375.

A report of the collective findings from this study will be made available to participants upon request. Requests are to be made by email to the student researcher: Ms Nahida Faridy at [nahida.faridy@griffithuni.edu.au](mailto:nahida.faridy@griffithuni.edu.au). Should you have concerns regarding this research please feel free to contact with the Chief investigators or with the student researcher over phone or by email listed above.



## **Risks to you**

This research is conducted for the student researcher. Nahida Faridy's PhD thesis at Griffith University, Australia and is only for academic purpose. This research poses no risk to you and will not cause any stress to you. This will not affect your relation with the National Board of Revenue (NBR) under any circumstances. On the other hand, the person conducting the survey is not involved with the VAT authority at present and has no influence to your VAT cases (if any) as it is already judicially settled.

## **The ethical conduct of this research**

Griffith University conducts research in accordance with the National Statement on Ethical Conduct in Human Research. If you have any concerns or complaints about the ethical conduct of this research you should contact the Manager, Research Ethics at Griffith University on +61 ( 7) 3735 4375 or [research-ethics@griffith.edu.au](mailto:research-ethics@griffith.edu.au).

## **Questions about this research**

The Chief Investigators for this research projects are Dr. Richard Copp, A/Prof Brett Freudenberg, and Dr Tapan Sarker of Griffith University, Australia. This research forms part of a Doctoral Degree being undertaken by Nahida Faridy (Student Researcher) in her capacity as a Griffith University PhD Student. If you have any questions regarding this research please feel free to contact with the Chief investigators or with the student researcher over phone or by email listed above. If you decide to participate, please take your time and proceed.



Id no \_\_\_\_\_

## Questionnaire

### Section 1: Background

**1. What is the location of your business/enterprise?**

(✓ tick ONE appropriate box)

- Dhaka city corporation area
- Other City Corporation Area
- District Town
- Upazilla Area
- Other – please describe \_\_\_\_\_

**2. What is your main business/enterprise activity?**

(✓ tick ONE appropriate box)

- Manufacturing
- Construction and real estate
- Wholesale, retail trade, hotels and restaurants
- Professional services
- Transport, storage and communication
- Other – please describe \_\_\_\_\_

**3. What type of business form do you use to conduct your enterprise?**

(✓ tick ONE appropriate box)

- A sole proprietorship (individual ownership)
- A cooperative
- A partnership
- A private limited company
- A share company
- Other – please describe \_\_\_\_\_



**4. When did your business/enterprise first register for VAT?**  
\_\_\_\_\_ (Year)

**5. Approximately, how long did it take for you to receive the VAT registration number from the VAT Office?**  
\_\_\_\_\_ (Days/Months/Year)

**6. How do you keep your VAT related records?**

(✓ tick ONE appropriate box)

- A manual/paper system
- A partially computerised system
- A fully computerised system
- Tax adviser/external accountant keeps the tax records
- Other – please describe \_\_\_\_\_

**7. For the 2011-12 fiscal year how much average monthly VAT did your business/enterprise pay?**

(✓ tick ONE appropriate box)

- Under BDT 400,000
- BDT 500,001 to 600,000
- BDT 600,001 to 700,000
- BDT 700,001 to 800,000
- BDT 800,001 to 900,000
- BDT 900,001 to 10,00,000
- More than BDT 10,00,001



**8. What is your highest level of education attained?**

(✓ tick ONE appropriate box)

- Junior High School
- SSC
- HSC
- Certificate
- Diploma
- Bachelor degree
- Masters degree and/or higher
- Other – please describe \_\_\_\_\_

**9. In the 2011-12 fiscal year, have your business been visited by a VAT officer?**

- No
- Yes – if yes please complete specify:
- How long did the visit last? \_\_\_\_\_(hours)
- When was the visit:
- During the last month
- 1 to 3 months ago
- 3 to 6 months ago
- More than 6 months ago
- Do you have any comments about the visit:

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## Section 2: Compliance

| 10. Please indicate to what extent you agree or disagree with the following statements: |   |          |                   |          |         |       |                |
|---|---|----------|-------------------|----------|---------|-------|----------------|
| SMEs COMPLY with the VAT law in Bangladesh, because...:                                 |   | Not sure | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|   | Paying the Correct amount of VAT is our civic duty  |          |                   |          |         |       |                |
|   | Paying the correct amount of VAT is an important contribution to the development of Bangladesh    |          |                   |          |         |       |                |
|   | Taxpayers paid the correct amount of VAT when there was greater enforcement and monitoring by VAT |          |                   |          |         |       |                |
|   | The likelihood of penalties and sanctions encourage me to comply with the VAT law.                |          |                   |          |         |       |                |
|   | The likelihood of audits encourage me to comply with the VAT law                                  |          |                   |          |         |       |                |
|   | Other – please specify _____  |          |                   |          |         |       |                |

  

| 11. Please indicate to what extent you agree or disagree with the following statements: |   |          |                   |          |         |       |                |
|---|---|----------|-------------------|----------|---------|-------|----------------|
| Small and medium businesses do NOT COMPLY with VAT law in Bangladesh because ... :      |   | Not sure | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|   | VAT is just an expense of the business that we try to minimise                  |          |                   |          |         |       |                |
|   | The VAT rate is high  |          |                   |          |         |       |                |
|   | VAT law and regulation is overly complex  |          |                   |          |         |       |                |
|   | Businesses that do not file or pay VAT are in a much better financial position  |          |                   |          |         |       |                |
|   | Businesses registered for VAT are often subject to NBR's audits and inspections |          |                   |          |         |       |                |
|   | Other aspects of business suffer due to pressure of VAT, as VAT is complicated  |          |                   |          |         |       |                |
|   | The discretionary and judicial power of VAT Authority discourages me to pay VAT |          |                   |          |         |       |                |
|   | Other – please specify _____  |          |                   |          |         |       |                |



### Section 3: Cost of Compliance

**12. Do your business/enterprise employ an external adviser (eg accountant or a specialist tax adviser) to do the VAT work of your business?**

(✓ tick ONE appropriate box)

Yes – if yes, estimate the amount you paid for the 2011/12 financial year to external advisers to complete your VAT activities (exclude other taxes): \_\_\_\_\_BDT

No – if no, do you do it yourself?

Yes

No



| 13. Please estimate your business's/enterprise's average MONTHLY cost incurred by in-house staff dealing with the following VAT activities during the 2011-12 financial year: | Estimate of average monthly BDT cost  |           |
|---|---|-----------|
|   | Recording information needed for VAT  | _____ BDT |
|   | Keeping all physical receipts in an organized manner (such as sales slips, invoices, receipts)                  | _____ BDT |
|   | Calculating VAT, completing VAT return and paying VAT   | _____ BDT |
|   | Keeping the forms and registers related to VAT  | _____ BDT |
|   | Preparing and making VAT monthly returns  | _____ BDT |
|   | Dealing with the NBR (phone calls, emails, visits)  | _____ BDT |
|   | Dealing with external VAT adviser, including providing information to them                                      | _____ BDT |
|   | Learning about VAT law, including reading newsletters, NBR website, bulletins                                   | _____ BDT |
|   | Preparing for price declaration documents for VAT offices   | _____ BDT |
|   | Working time spent on VAT refund preparation and execution, preparing and submitting VAT refund document to NBR | _____ BDT |
|   | Preparing for the VAT audits by VAT Authority   | _____ BDT |
|   | Working time spent on objections, appeal and VAT-related court appeal   | _____ BDT |
|   | Other expenses – please specify<br>_____  | _____ BDT |



|  |  |
|--|--|
| <p>14. Please estimate your business's/enterprise's average MONTHLY 'TIME' spent by in-house staff dealing with the following VAT activities during the 2011-12 financial year (include time spent by owners/partners/directors/paid employees):</p> | <p>Estimate of average monthly hours<br/>(Use decimals for fraction of hours (ie 0.5 hours for half an hour). Only include hours once, so if you include hours under 'Recording' please do not count the same hours towards so 'Learning')</p> |
|  | <p>Recording information needed for VAT _____ hours</p>  |
|  | <p>Keeping all physical receipts in an organized manner (such as sales slips, invoices, receipts) _____ hours</p>  |
|  | <p>Calculating VAT, completing VAT return and paying VAT _____ hours</p>   |
|  | <p>Keeping the forms and registers related to VAT _____ hours</p>  |
|  | <p>Preparing and making VAT monthly returns _____ hours</p>  |
|  | <p>Dealing with the NBR (phone calls, emails, visits) _____ hours</p>  |
|  | <p>Dealing with external VAT adviser, including providing information to them _____ hours</p>  |
|  | <p>Learning about VAT law, including reading newsletters, NBR website, bulletins _____ hours</p>   |
|  | <p>Preparing for price declaration documents for VAT offices _____ hours</p>   |
|  | <p>Working time spent on VAT refund preparation and execution, preparing and submitting VAT refund document to NBR _____ hours</p>   |
|  | <p>Preparing for the VAT audits by VAT Authority _____ hours</p>   |
|  | <p>Time during actual VAT audit _____ hours</p>  |
|  | <p>Working time spent on objections, appeal and VAT-related court appeal _____ hours</p>   |
|  | <p>Other expenses – please specify _____ hours</p> <p>_____</p>  |



| 15. Please indicate to what extent you agree or disagree with the following statements: |   |          |                   |          |         |       |                |
|---|---|----------|-------------------|----------|---------|-------|----------------|
| In relation to the PSYCHOLOGICAL COSTS of VAT compliance ...:                           |   | Not sure | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|   | There are no psychological costs (stress/ anxiety/sleepless nights) in complying with VAT                     |          |                   |          |         |       |                |
|   | Psychological costs have significantly affected the amount of time and effort that I can put into my business |          |                   |          |         |       |                |
|   | The psychological costs relating to VAT are excessive when compared to other taxes in Bangladesh              |          |                   |          |         |       |                |
|   | Psychological effects influence my private cost of seeking to comply with VAT                                 |          |                   |          |         |       |                |
|   | The VAT authority's timely information and friendly attitude towards taxpayers can reduce psychological costs |          |                   |          |         |       |                |

  

| 16. Please indicate to what extent you agree or disagree with the following statements: |   |          |                   |          |         |       |                |
|---|---|----------|-------------------|----------|---------|-------|----------------|
| To COPE with the PSYCHOLOGICAL COSTS of VAT compliance ...:                             |   | Not sure | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|   | I consult a psychologists or psychiatrist |          |                   |          |         |       |                |
|   | I self-meditate                           |          |                   |          |         |       |                |
|   | I take tobacco                            |          |                   |          |         |       |                |
|   | I take medication, such as sleeping pills |          |                   |          |         |       |                |
|   | Other expenses– please specify            |          |                   |          |         |       |                |



**17. Please estimate your monthly psychological costs related to VAT in the 2011-2012 financial year?  
\_\_\_\_\_ (BDT)**

**18. 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?  
\_\_\_\_\_ (BDT)**

**Section 4: Relationship between Complexity, Compliance Costs and Non-Compliance**

| 19. Please indicate to what extent you agree or disagree with the following statements about the relationship between complexity of VAT law, compliance costs and non-compliance: | Not sure | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|---|----------|-------------------|----------|---------|-------|----------------|
| Compliance with VAT Law is excessively burdensome and costly for SME taxpayers  |          |                   |          |         |       |                |
| The VAT compliance costs of our business are insignificant  |          |                   |          |         |       |                |
| The burden of compliance costs discourages the owners to fulfil VAT obligations   |          |                   |          |         |       |                |
| Simplified VAT Law and reasonable compliance costs would increase voluntary compliance among SMEs VAT payers in Bangladesh  |          |                   |          |         |       |                |
| Other – please specify _____  |          |                   |          |         |       |                |



**20. Are you interested in being involved in a face-to-face interview in the next stage of the research to clarify some issues? (Please note your percentage)**

- No: Thank you for taking the time complete this survey. Please return the survey (details below)
- Yes – Please provide your contact details:

**Contact Details:**

End of Survey: Please send the completed survey back to

Nahida Faridy,

Customs, Excise and VAT, Dhaka South, IDEB Bhaban, Kakrail, Dhaka-1000 or

Send it to, [nahida.faridy@griffithuni.edu.au](mailto:nahida.faridy@griffithuni.edu.au)

If you want to receive a summary copy of this research finding please give me a call or sent me a mail. If you have any other comments, please feel most welcome to provide them.

*Thank You*