

Losing Sleep: The Psychological Costs of VAT - Evidence from SMEs in Bangladesh

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Abstract

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 (Pope, 1994; Stanford et al, 1989; Evans et al, 2001; and Hasseldine and Hansford, 2002). The issue of psychological costs has been a largely neglected area of tax research and there are very few empirical studies which seek to estimate the costs particularly in the small and medium enterprises (SMEs) (Barbone et al, 2012). To address this, a study was undertaken to try to estimate the psychological costs of Value Added Tax (VAT) for SMEs in Bangladesh and to identify the factors that influence process.

This article presents the results of a first independent survey of VAT compliance costs along with psychological costs of Bangladeshi SMEs for the 2012 fiscal year. The results indicate that 62% of compliant and 72% of the non-compliant VAT payers expressed the view that psychological costs have significantly affected the amount of time and effort that they could put into their business. Similarly, 60% of compliant and 63% non-compliant VAT payers expressed that the psychological costs relating to VAT are excessive when compared to other taxes in Bangladesh. However, approximately 20% respondents from both cohorts reported that they didn't have any psychological costs related to VAT. The findings also suggest that psychological costs are a large component of VAT compliance costs for SMEs, accounting for 15% of total VAT compliance costs in Bangladesh.

The findings of this study provide valuable insight about the psychological costs of VAT in Bangladesh. This issue is important for tax policy researchers, policy makers and VAT administrators in Bangladesh and in other developing countries. The findings of this study will help to design an effective but simplified VAT system which will reduce anxiety and frustration or stress, caused among the VAT payers to improve the voluntary compliance level.