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FOREWORD

DONOVAN CASTELYN AND STEPHANIE BRUCE

This edition of the Journal holds special significance in the publication history of the Journal of the Australian Tax Teachers Association ('JATTA' or 'the Journal') and the legacy of the Australian Tax Teachers Association ('ATTA' or 'the Association').

Traditionally, the Association has held an Annual Conference each year since the Associations' inaugural conference in 1989 hosted by the University of New South Wales (UNSW). Moreover, an issue of the Journal has been published electronically each year, edited by certain members of the organising committee or University hosting the conference since the Journals' inception in 2005.

In 2021 however, for the first time in the history of the Association, the Annual Conference was postponed owing to the effects of the COVID-19 pandemic. Consequently, this issue of the Journal marks the first time the Editors of the Journal do not correspond with a host organisation and is devoid of a theme and keynote publications.

Accordingly, this edition of the Journal consists of seven papers traversing three broad key areas.

The first four papers broadly concern the impact — or influence — of taxation laws on various clarifications of taxpayers spanning multiple jurisdictions: Melissa Belle Isle and Brett Freudenberg, 'Taxing My Cash Flow: The Influence of Tax on Small Service Sector Business Cash Flow'; Mahmoud M. Abdellatif, Binh Tran-Nam and Boumediene Ramdani, 'The Simplified Tax Regime for Micro and Small Enterprises in Egypt: An Analysis of the Theoretical and Implementation Issues'; Richard Taylor, 'The Theory of the Firm: A Tool to Understand Company Taxpayer Compliance Behaviour in the Mining Sector'; and, Mahfoudh Hussein Mgammal, 'Does a Value-Added Tax Rate Increase Influence Company Profitability? An Empirical Study in the Saudi Stock Market'.

The next two papers consider the role of culture in organisational performance and the adequacy of taxation laws in the context of changing and exceptional times: Sri Andriani and Ahmad Djaluluddin Sismanto, 'Performance Measurement Based on Spiritual Culture in Excellent Service (Study at the Regional Office of the Directorate General of Taxes in East Java); Maria R.U.D. Tambunan, 'Rethinking of Tax Treatment During the Covid-19 Pandemic: A Note on Indonesia's Omnibus Law Job Creation Taxation Cluster'.

The final paper explores the efficacy of tax education and awareness in the Indonesian context and produces findings which may be relevant to other jurisdictions: Yulianti Abbas, Christine Tjen and Panggah Tri Wicaksono, 'Tax Education and Tax Awareness: A Study on Pajak Bertutur Indonesian Tax Education Program'.

Despite the obvious and unprecedented impact of the pandemic, which has resulted in a much slower production cycle and fewer number of publications, this issue nonetheless testifies to the resilience of the Association and its members and their ability to navigate change and overcome uncertainty.

We are confident that our members will enjoy reading the papers in this edition of the Journal and wish all members a safe and prosperous 2022.

Donovan Castelyn and Stephanie Bruce
Curtin Law School, Curtin University
21 February 2022

TAXING MY CASH FLOW: THE INFLUENCE OF TAX ON SMALL SERVICE SECTOR BUSINESS CASH FLOW

MELISSA BELLE ISLE* AND BRETT FREUDENBERG**

ABSTRACT

This article reports the findings of a multiple case study of the perception of small business owners in the service sector in relation to the effect taxation has on their business cash flow. In particular, the project investigates the potential cash flow effect due to Fringe Benefits Tax ('FBT'), Goods and Services Tax ('GST'), Income Tax, Pay as You Go ('PAYG') Withholding and Superannuation Guarantee ('SG'). The findings suggest that small business owners have the greatest concerns about GST and PAYG on cash flow stability, with less concern about the impact of FBT, SG and Income Tax. The impact of tax on cash flow is not identified primarily as a cash flow issue, instead other business factors appear to have a negative impact on the tax and cash flow relationship.

Keywords: cash flow, small business, tax, GST

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I INTRODUCTION

The ability to maintain a viable business can be challenging for business owners. This may be due to restricted cash flow which results in an inability to satisfy the businesses outgoings. Clearly, tax should influence the cash flow of a business, as tax can be an outflow of cash payment(s) by a business to the revenue authority, although it can also result in an inflow of cash.[1] To the extent that additional cash is held by a business through collecting tax from others — such as goods and services tax ('GST') — in theory this could aid the cash liquidity of the business for a period of time. Another way that tax could influence cash flow is in terms of the provisioning and timing of payments, as tax (similar to other liabilities) has to be managed and timed. Furthermore, in managing the tax obligations of a business this can result in compliance costs, and paying for these compliance costs could influence the overall cash flow of a business. While cash flow is an issue for all businesses regardless of their size, for small businesses — due to particular characteristics (including financing problems)[2] — cash flow is an important consideration. Relevantly, prior studies have observed that tax may have a negative impact on cash flow stability for small businesses.[3] However, some taxes may have a larger impact than others. Wallschutzky and Gibson,[4] who investigated the effect of taxation on small business in the early 1990's, identified the wholesale sales tax ('WST') as the only tax system that had a detrimental effect on cash flow. This was because the payment of the WST tax liability to the Australian Taxation Office ('ATO') was often due for payment before it was received from trade debtors. More recent research conducted by Belle Isle, Freudenberg and Copp[5] has supported the findings of Wallschutzky and Gibson[6] in terms of GST (recalling that the GST essentially replaced the WST). Small business owners ('SBOs') indicated that GST had a detrimental effect on cash flow given that the tax liability was often not received from sales before it was due to be paid to the ATO.[7] However, in both studies, it should be highlighted that paying the tax liability itself was not the sole cause of the cash flow constraints.

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1 This inflow of cash could occur when there is a refund of tax paid, or in relation to the goods and services tax ('GST') where the GST input tax credits are greater than the GST payable on taxable supplies (which could especially arise for those businesses that largely have GST Free supplies).

2 David Deakins, Alana Morrison and Laura Galloway, 'Evolution, Financial Management and Learning in the Small Firm' (2002) 9(1) *Journal of Small Business and Enterprise Development* 7.

3 Patrick Hutchinson, 'How Much Does Growth Determine SMEs' Capital Structure?' (2004) 12(1) *Small Enterprise Research* 81, 85.

4 Ian Wallschutzky and Brian Gibson, 'Small Business Cost of Tax Compliance' (1993) 10(4) *Australian Tax Forum* 511.

5 Melissa Belle Isle, Brett Freudenberg and Richard Copp, 'Cash Flow Benefit from GST: Is it Realised by Small Businesses in Australia?' (2014) 29(3) *Australian Tax Forum* 417.

6 Wallschutzky and Gibson (n 4).

7 If using the accruals method, the tax liability of the wholesale sales tax ('WST') and GST can be incurred at the time of sale and paid sometime in the future.

Research conducted in the United Kingdom ('UK') and France by Messina and Walton[8] suggested that taxes paid in advance have a negative impact on cash flow, whereas taxes held and paid at a later date result in a cash flow benefit, although, it should be acknowledged that the positive effect was marginal. Australian research appears to be inconsistent with findings in the UK and France, which could be due to differences in trading practices and/or the administration of tax systems, or to how cash flow benefits and constraints were measured in the differing studies. However, some studies have called into question the burden of tax on small businesses compared to other regulatory burdens, especially those that relate to employment.[9]

Currently, in Australia, the major Federal tax systems that most small businesses must comply with include (but are not limited to) fringe benefits tax[10] ('FBT'), GST,[11] income tax,[12] and pay as you go ('PAYG') withholding.[13] Additionally, there is the superannuation guarantee[14] ('SG') which is not a tax system, however, due to the reliance of the calculation of the SG based on PAYG withholding, and the regularity of reporting obligations, it is included in this research. Normally the tax liability for these tax systems is incurred and paid sometime in the future. Considering the findings of Wallschutzky and Gibson,[15] and more recent research conducted by Belle Isle, Freudenberg and Copp,[16] it could be implied that negative effects on small business cash flow cannot solely be explained by the timing of the payment of the tax liability.

This study seeks to gain a deeper understanding of how tax influences the cash flow of small businesses operating in the service sector, with a focus on the five Federal tax systems noted above. The study expands prior case study research which only focused on GST,[17] or was conducted nearly thirty years ago.[18] The reason for the focus on the service

8 Michel Messina and Peter Walton, 'The Impact of Government on Company Cash Flows in France and the United Kingdom' (1998) 7(2) *Journal of International Accounting, Auditing and Taxation* 273.

9 Board of Taxation, *Scoping Study of Small Business Tax Compliance Costs: A Report to the Treasurer* (Canberra, December 2007) [10.7]: 'Many businesses in industries such as manufacturing, and construction rated occupational health and safety (OH&S) and licensing rules as more significant causes of compliance burden than taxation.'

10 *Fringe Benefits Tax Assessment Act 1986* (Cth) ('*FBT Act*').

11 GST registration is mandatory for enterprises with a turnover of $75,000 or more, although voluntary registration is available to enterprises below this threshold, see *A New Tax System (Goods and Services Tax) Act 1999* (Cth) s 23-5 ('*GST Act*').

12 *Income Tax Assessment Act 1997* (Cth) ('*ITAA97*'); *Income Tax Assessment Act 1936* (Cth) ('*ITAA36*').

13 If the organisation is an employing entity. Non-employing entities are not required to adhere to PAYG.

14 *Superannuation Guarantee (Administration) Act 1992* (Cth) ('*SG Act*').

15 Wallschutzky and Gibson (n 4).

16 Belle Isle, Freudenberg and Copp (n 5).

17 Ibid. This prior research involved a case study with semi-structured interviews with 12 small businesses.

18 Wallschutzky and Gibson (n 4). This prior research involved a case study with semi-structured interviews with 12 small businesses.

sector is that it provides more than three-quarters of the economy's income[19] and employs more than 87% of all Australian private sector employees. Further analysis suggests that small businesses make up a large part of the service sector, employing 4,127,000 of the total service sector employment of 9,410,000. Considering the economic significance of the small business sector, it is important to investigate the factors that may influence their cash flow.

For this research project, the term 'small business' incorporates those businesses identified by their quantitative measures by the ATO and Australian Bureau of Statistics ('ABS') as being 'micro' and 'small', an annual turnover of $10 million or less and a full time workforce of 20 or fewer employees.[20]

This article is structured as follows: Part II will provide an overview of our understanding of the influence of tax on small business cash flow; Part III will provide the research methodology undertaken, which is followed by participants' demographics in Part IV; Part V will outline the results. Through the analysis of the results in Part VI, recommendations will be proposed, with future research being outlined in Part VII of the article before concluding in Part VIII.

II Small Business Tax and Cash Flow

Below is the discussion about our current understanding of cash flow management practices by small businesses, and how tax may influence a business' cash flow.

A *Cash Flow Management*

A critical issue for all businesses is maintaining a consistent cash flow; this can especially be acute for small businesses due to restricted access to finance. Cash flow is the extent of cash or near cash assets available for use, along with any inflow or outflow of cash related to these assets.[21] Therefore cash flow is any business activity that alters the balance of the cash accounts. Previous research in Australia suggests that SBOs have recognised that cash flow is of particular importance to their ongoing survival,[22] although it can be difficult for them to manage.[23]

[19] Note: Income for this research is reported as Gross Value Added ('GVA') as opposed to Gross Domestic Product ('GDP') due to the focus of the research on the service industry.

[20] Australian Bureau of Statistics, *Counts of Australian Businesses including Entries and Exits (Jun 2015 to Jun 2019)* (Catalogue No 8165.0, 2 February 2020); Australian Taxation Office, *Taxation Statistics 2015–16* (27 April 2018).

[21] Ignatius Ekanem, 'Liquidity Management in Small Firms: A Learning Perspective' (2010) 17(1) *Journal of Small Business and Enterprise Development* 123.

[22] Belle Isle, Freudenberg and Copp (n 5); Wallschutzky and Gibson (n 4) 527.

[23] Melissa Belle Isle and Brett Freudenberg, 'Calm Waters: GST and Cash Flow Stability for Small Businesses in Australia' (2015) 13(2) *eJournal of Tax Research* 492.

The reasons contributing to difficulty include that small businesses can be subject to seasonal variations in sales.[24] This can mean that rapid growth can be evident in one economic cycle followed by periods of contraction in subsequent cycles.[25] Businesses that receive a cash influx as a result of rapid growth should store this cash for future periods of contraction. However, research suggests that this is not a common practice followed by the small business community.[26] Cash received is either tied up in goods produced, spent on incidental items or held in outstanding debtor invoices.[27] Without cash at the ready, critical payments cannot be made, potentially resulting in business failure.[28] Those small businesses with a greater portion of liquid assets are less likely to run out of cash.[29] Cash inflow should be of the highest priority for small business, as they can survive for lengthy periods without profit although this is not the same outcome for trading without cash.[30] Due to the finance constraints on small business — such as reliance on owner equity for much of the capital and the reluctance of banks to provide credit — managing cash is critical. For example, a small business owner can use their own personal credit cards rather than accessing formal lines of business credit.[31] This may be due to their reluctance to do the formal paperwork for the bank loan, or to the perceived lack of availability of business loans to small businesses.

Cash flow management has been identified as one of the most important problems for businesses in the UK, United States of America and Australia.[32] Effective cash management is important to business survival irrespective of the size of the business.[33] When assessing small business liquidity it has been suggested that small business are less liquid and exhibit more volatility with cash flow and profit than their larger competitors.[34] SBOs should try to avoid extended cash shortages, as supply constraints affect the ongoing

24 John A. Welsh and Jerry F. White, 'A Small Business is not a Little Big Business' (1981) 59(4) *Harvard Business Review* 18, 26.

25 Ibid.

26 Ibid.

27 Ibid.

28 Chris Evans, Shirley Carlon and Darren Massey, 'Record Keeping Practices and Tax Compliance of SMEs' (2005) 3(2) *eJournal of Tax Research* 288, 292; Pedro J. García-Teruel and Pedro Martínez-Solano, 'Short-Term Debt in Spanish SMEs' (2007) 25(6) *International Small Business Journal* 579, 583; Michael J. Peel and Nicholas Wilson, 'Working Capital and Financial Management Practices in The Small Firm Sector' (1996) 14(2) *International Small Business Journal* 52, 52.

29 García-Teruel and Martínez-Solano (n 28) 583.

30 Ibid; Peel and Wilson (n 28) 58; Welsh and White (n 24) 29.

31 Department of Industry, Innovation, Science, Research and Tertiary Education, *Australian Small Business Key Statistics and Analysis* (Canberra, 2010).

32 Scott Holmes and Des Nicholls, 'An Analysis of the Use of Accounting Information by Australian Small Business' (1998) 26(2) *Journal of Small business Management* 57, 57; Peel and Wilson (n 28) 19.

33 Arthur R De Thomas and William B Fredenberger, 'Accounting Needs of Very Small Business' (1985) 55(10) *The CPA Journal* 14.

34 Peel and Wilson (n 28) 19.

operations of the business.[35] In order to reduce cash constraints and achieve better control of cash flow SBOs need to implement effective liquidity management practices.[36]

Inadequate SBO management skills can be especially concerning where SBOs struggle with the management of cash flow, as well as with the requirement to adhere to taxation and employer obligations. These 'employer obligations' can be a central issue, as a small business without employees is unlikely to grow and will be more likely to remain as a micro business that provides income for the owner.[37] These inadequate management skills could be exacerbated if the SBO also has limited taxation literacy as the cash flow of the business may also be impacted by tax liabilities that are due but have not been included in cash flow projections.[38]

B *Tax and Cash Flow*

Research into the effect of taxation on small business has been a popular research topic over the last three decades.[39] The majority of this research focused on the impact of compliance and administration costs for small businesses,[40] identifying that tax is burdensome for small business in terms of compliance costs. These compliance costs can impact cash flow as an outflow of cash in meeting the expenses, such as paying staff or external advisors. However, few studies have investigated the interplay of small business cash flow and taxation.[41] Research has suggested that the cash flow of small businesses is

35 Ekanem (n 21) 124–25.

36 Michael Peel, Nicholas Wilson and Carole Howorth, 'Late Payment and Credit Management in the Small Firm Sector: Some Empirical Evidence' (2000) 18(2) *International Small Business Journal* 17, 19–24.

37 Department of Industry, Innovation, Science, Research and Tertiary Education, *Australian Small Business Key Statistics and Analysis* (Canberra, 2012) 8.

38 Freudenberg et al, 'Tax Literacy of Australian Small Businesses' (2017) 18(2) *Journal of Australian Tax* 21.

39 Francis Chittenden, Saleema Kauser and Panikkos Poutziouris, 'PAYE-NIC Compliance Costs: Empirical Evidence from the UK SME Economy' (2005) 23(6) *International Small Business Journal* 635; Evans et al, 'Small Business and Tax Compliance Costs: A Cross-Country Study of Managerial Benefits and Tax Concessions' (2014) 12(2) *eJournal of Tax Research* 453; John Glover and Binh Tran-Nam, 'The GST Recurrent Compliance Costs/Benefits for Small Business in Australia: A Case Study Approach' (2005) 1(2) *Journal of Australasian Tax Teachers Association* 237; Philip Lignier and Chris Evans, 'The Rise and Rise of Tax Compliance Costs for the Small Business Sector in Australia' (2012) 27(3) *Australian Tax Forum* 615; Philip Lignier, Chris Evans and Binh Tran-Nam, 'Tangled Up in Tape: The Continuing Tax Compliance Plight of the Small and Medium Enterprise Business Sector' (2014) 29(2) *Australian Tax Forum* 217; Rametse et al, 'Estimating Start-Up Compliance Costs of the Malaysian Goods and Services Tax for Small- and Medium-Sized Enterprises' (2020) 26(6) *New Zealand Journal of Taxation Law and Policy* 153; OECD, *Taxation of SMEs in OECD and G20 Countries* (OECD Tax Policy Studies, 2015); Kate Ritchie, 'The Tax Compliance Costs of Small Business in New Zealand' in *Tax Compliance Costs: A Festschrift for Cedric Sandford* (Prospect Media Pty Ltd, 2001) 297–316; Cedric Sandford, Michael R Godwin and Peter J. W. Hardwick, *Administrative and Compliance Costs of Taxation* (Fiscal Publications, 1989); Wallschutzky and Gibson (n 4).

40 Ibid.

41 Eliza Ahmed and Valerie Braithwaite, 'Understanding Small Business Taxpayers Issues of Deterrence, Tax Morale, Fairness and Work Practice' (2005) 23(5) *International Small Business Journal* 539; Belle Isle, Freudenberg and Copp (n 5); Evans, Carlon and Massey (n 28); Wallschutzky and Gibson (n 4).

influenced by tax systems, both in Australia and throughout the world.[42] This influence could be both positive and negative.

Researchers have proposed that cash flow stability has a negative relationship with tax liabilities.[43] In the UK, the largest reported reason for small business failure was an inability to settle outstanding tax debts.[44] Of course, these businesses with outstanding tax debts could have been insolvent for years and had used their unpaid taxes to pay off other creditors. In a sense, the relevant tax authority can be used as an unofficial line of credit to support business operations. Businesses may choose not to pay their taxes when due and instead pay other creditors, especially those who are essential to the continuing operations of the business (such as those supplying inventory or materials). A study in New Zealand suggested that small businesses incur late tax payment penalties in an attempt to improve their business cash flow.[45] Findings in France and the UK suggest that cash flow is negatively impacted by tax systems that are paid in advance, whereas taxes that are held and paid at a later date could be beneficial to cash flow.[46] When taxes are held and paid sometime in the future, this could have a positive effect as it allows businesses to legitimately use their outstanding tax liabilities as an easy source of finance to fund other aspects of their operations (i.e., use of the GST collected to pay off other creditors).[47]

In Australia, the current evidence is conflicting in relation to the effect that taxation has on small business cash flow. While some research suggests that Australian small businesses are not unduly suffering from the impact of various forms of taxation,[48] opposing arguments suggest that cash flow is constantly impinged upon particularly when small businesses are responsible for paying their own taxes and collecting tax on behalf of others.[49] Other business factors can be a contributing force regarding whether cash flow is influenced by taxation such as terms of trade, industry, cash flow management and low profit margins.[50] Where tax liabilities are due and cash flow is short, small

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42 Ahmed and Braithwaite (n 41); Belle Isle, Freudenberg and Copp (n 5); Evans, Carlon and Massey (n 28); Lignier and Evans (n 39); Messina and Walton (n 8); Sandford et al, *Costs and Benefits of VAT* (Heinemann Educational Books, 1981); Wallschutzky and Gibson (n 4).

43 Margaret Drever and Patrick Hutchinson, 'Industry Differences in the Determinants of the Liquidity of Australian Small and Medium Sized Enterprises' (2007) 15(1) *Small Enterprise Research* 60, 64–65, 74; Karen Ness, 'Small Business Success Factors in Regional Queensland' (2004) 12(2) *Small Enterprise Research* 1; Mervi Niskanen and Jyrki Niskanen, 'Small Business Borrowing and the Owner-Manager Agency Costs: Evidence on Finnish Data' (2010) 48(1) *Journal of Small Business Management* 16, 17.

44 Ahmed and Braithwaite (n 41) 554; Evans, Carlon and Massey (n 28) 290.

45 Elisabeth Poppelwell, Gail Kelly and Xin Wang, 'Intervening to Reduce Risk: Identifying Sanction Thresholds Among SME Tax Debtors' (2012) 10(2) *eJournal of Tax Research* 403, 405.

46 Messina and Walton (n 8).

47 Belle Isle, Freudenberg and Copp (n 5); Poppelwell, Kelly and Wang (n 45).

48 Belle Isle, Freudenberg and Copp (n 5) 424; Evans, Carlon and Massey (n 28) 310.

49 Ahmed and Braithwaite (n 41); OECD (n 39) 90.

50 Belle Isle, Freudenberg and Copp (n 5) 424; Evans, Carlon and Massey (n 28) 310.

businesses have been known to use working capital funds to settle their tax liability.[51] SBOs have also suggested that the number of different tax obligations due within a short period of time is the cause of the cash flow problem, as they have to manage these different timings and obligations.[52] The extent of these problems may explain why, in 2017–18, small businesses earning less than $10 million were responsible for almost two-thirds of the total outstanding tax debt recognised with the ATO.[53]

In 1995, the Senate Economics References Committee ('SERC')[54] suggested that any tax would be an imposition on small business cash flow, although the study by Wallschutzky and Gibson[55] argued that SBOs perceived only that the WST caused cash flow problems. Participants did not feel negatively about other Federal tax systems in place at the time of the research. The Wallschutzky and Gibson study in the early 1990s involved a case study with semi-structured interviews of 12 small businesses, supplemented by interviews with some accountants and ATO staff.[56] Approximately twenty years later, in a case study with semi-structured interviews of 12 small businesses, Belle Isle, Freudenberg and Copp[57] solely focused on the effect of GST on cash flow, and found that payment practices and tight profit margins were more of a concern than the GST itself.

The prominent issue identified by Wallschutzky and Gibson,[58] and by Belle Isle, Freudenberg and Copp,[59] in relation to the WST and GST respectively, was that income is generally earned and recognised at the time of invoicing (commonly known as the accruals method). However, payment from the debtor is often not received until sometime in the future. The time delay in the payment of the invoice means that the portion of tax held in income earned is not always received when the obligation to pay the tax to the ATO arises. This is especially relevant to those businesses using an accruals (i.e., non-cash) method to account for their tax liabilities. In contrast, those businesses using the cash method of accounting would not recognise a GST liability until payment for goods and services supplied is received from the debtor. Thus, under the accruals method of accounting for GST, as opposed to the cash method of accounting for GST, businesses must submit the GST to the ATO irrespective of cash receipt, hence negatively impacting on their cash flow.[60] The impact on cash flow for those on a non-cash method can be further exacerbated by the 'sharp' payment practices of some debtors. For example, the Australian Small Business and Family Enterprise Ombudsmen found that debtors

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51 Evans, Carlon and Massey (n 28) 288.

52 Ibid 289; Messina and Walton (n 8).

53 Australian Taxation Office, *Management of Small Business Tax Debt* (30 May 2019).

54 Senate Economics References Committee, 'A Question of Balance: The Tax Treatment of Small Business' (28 June 1995) [7.1].

55 Wallschutzky and Gibson (n 4).

56 Ibid.

57 Belle Isle, Freudenberg and Copp (n 5).

58 Wallschutzky and Gibson (n 4).

59 Belle Isle, Freudenberg and Copp (n 5) 424.

60 Belle Isle, Freudenberg and Copp (n 5).

(particularly large businesses) would not pay their bills to small business creditors on time.[61]

In comparison, those businesses that collected tax at the point of sale still experienced difficulty complying with their tax obligations, although this appeared to be more a result of low profit margins on their goods and services, rather than the tax system being overly burdensome.[62] Determining the effect of trading practices on small business cash flow is problematic due to the diversity of businesses classified as service sector businesses. Trading practices are not specific to the service sector itself but are defined by the service classification that the business resides in. This means that trading practices throughout the service sector are a mixture of those who collect revenue at the point of sale and others who offer a line of credit, making it difficult to define any industry norms for the service sector.

However, GST is not the only tax that small businesses have to consider. The current Australian Federal tax systems that relate to the majority of small business taxpayers include FBT,[63] GST,[64] income tax,[65] PAYG withholding[66] and SG.[67] All of these tax systems have the liability incurred and held by the taxpayer or tax collector, and are paid sometime in the future.[68] However, a number of these tax systems require taxpayers to pre-pay amounts in advance in the form of instalments.[69] Part of the logic behind pre-instalments is to reduce the potential for a large tax liability to arise at the end of the reporting period by instead paying regular contributions towards a predicted tax liability throughout the year. The pre-instalment value can be based on previous earnings or tax liabilities from prior tax periods. Pre-instalments are required for income tax[70] and FBT[71] if a taxpayer has previously submitted a return for these tax systems. Also, a GST[72] instalment can be paid quarterly for complying entities. There is no known research into the effect that tax pre-instalments have on cash flow stability in Australia. Of further interest is the

61 Australian Small Business and Family Enterprise Ombudsman, *Payment Times and Practices Inquiry — Final Report* (Report, April 2017) <https://www.asbfeo.gov.au/sites/default/files/ASBFEO_Payment_Times_and_Practices%20Inquiry_Report.pdf>.

62 Belle Isle, Freudenberg and Copp (n 5).

63 *FBT Act* (n 10).

64 *GST Act* (n 11).

65 *ITAA97* (n 12).

66 *A New Tax System (Pay As You Go) Act 1999* (Cth) ('*PAYG Act*').

67 *SG Act* (n 14).

68 *GST Act* (n 11) ss 27-5, 27-10, 27-15, 27-30, 33-3, 33-5; PAYG Act (n 66) s 6-5(2); *FBT Act* (n 10); *ITAA97* s 5-5; *SG Act* (n 14) s 46.

69 *GST Act* (n 11) s 162-70; *PAYG Act* (n 66) s 6-5(3); *FBT Act* (n 10) ss 102, 103.

70 *PAYG Act* (n 66) s 6-5(3).

71 *FBT Act* (n 10) ss 102, 103. Note instalments for FBT are only payable if the entity's previous years FBT liability was greater than $3,000.

72 *GST Act* (n 11) s 162-70.

multitude of payments that are required to be made in order to adhere to the compliance requirements of the five Federal tax systems listed. As illustrated in Table 1 below, payments can range from being due 5 up to 26 times throughout each calendar year, dependent on whether businesses report annually, quarterly or monthly and whether they are affected by all five tax systems.

TABLE 1: TAX PAYMENT DATES DEPENDENT ON REGISTRATION STATUS OF BUSINESS

OBLIGATION	COMPLIED BY	DUE DATE
Activity Statement December	Monthly registered	21 January
FBT Third Instalment	Some FBT entities	21 January
SG October–December	All	28 January
Activity Statement January	Monthly registered	21 February
Activity Statement October–December	Quarterly registered	28 February
PAYG Instalment October–December	All employing	28 February
GST Instalment October–December	All GST registered	28 February
Income Tax Return	Self-preparing entities	28 February
FBT Third Instalment	For deferred BAS FBT payers	28 February
Activity Statement February	Monthly registered	21 March
Activity Statement March	Monthly registered	21 April
FBT Fourth Instalment	Some FBT entities	21 April
Activity Statement January–March	Quarterly registered	28 April
PAYG Instalment January–March	All employing	28 April
GST Instalment January–March	All GST registered	28 April
SG January–March	All	28 April
FBT Fourth Instalment	For deferred BAS FBT payers	28 April
Annual Fringe Benefits Payment	All affected by FBT	21 May
Activity Statement April	Monthly registered	23 May
Activity Statement May	Monthly registered	21 June
Activity Statement June	Monthly registered	21 July
FBT First Instalment	Some FBT entities	21 July
Activity Statement April–June	Quarterly registered	28 July
PAYG Instalment April–June	All employing	28 July
GST Instalment April–June	All GST registered	28 July
SG April–June	All	28 July
FBT First Instalment	For deferred BAS FBT payers	28 July
Activity Statement July	Monthly registered	21 August
Activity Statement August	Monthly registered	21 September
Activity Statement September	Monthly registered	21 October
FBT Second Instalment	Some FBT entities	21 October
Activity Statement July–September	Quarterly registered	28 October
PAYG Instalments – Final Payment	All employing	28 October
GST Instalment July–September	All GST registered	28 October
SG July–September	All	28 October
FBT Second Instalment	For deferred BAS FBT payers	28 October

Income Tax Return	Individual, Partnership and Trust	31 October
Activity Statement October	Monthly registered	21 November
Activity Statement November	Monthly registered	21 December

Notes: Adapted from the ATO website <https://www.ato.gov.au/business/reports-and-returns/due-dates-for-lodging-and-paying/>.

It should be highlighted that these obligations in Table 1 (above) relate only to the five tax systems in this project. Individual businesses may have a multitude of other tax obligations that could increase the frequency and variance of their business reporting and payment requirements. In overseas countries, cash flow difficulties in small businesses have been associated with the number of taxes that must be complied with, along with the multiple deadlines for tax payments in any given year.[73]

It is considered important to determine whether taxation is the primary issue for small business cash flow or whether there are other factors that influence cash flow, and whether taxation just aggravates those factors. Research prior to the introduction of the GST suggests that the timing of tax payments was not the primary issue for small businesses.[74] Instead the problem was that small businesses have poor cash flow management practices and record-keeping skills.[75] Evans, Carlon and Massey[76] propose that small business use the cash at bank balance as an indicator of business health, however, little consideration is given to the portion of tax liability that is held in that balance.

The current research expands substantially the research conducted by Belle Isle, Freudenberg and Copp[77] in 2014 which only investigated the effects of GST on cash flow. This research now considers the influence of taxation on cash flow by focusing on five of the Federal tax systems operating in Australia including FBT, GST, income tax, PAYG withholding and SG. The impact of tax reporting and payments is also analysed, with particular reference to prior theoretical propositions which consider the relationship between similar tax systems and small business cash flow.

III Research Methodology

It should be noted that this research was conducted mainly from September 2016 to June 2019 and therefore prior to the economic effects of COVID-19.[78] The research seeks to

73 OECD (n 39) 90.

74 Wallschutzky and Gibson (n 4).

75 Senate Economics References Committee (n 54) [7.34].

76 Evans, Carlon and Massey (n 28) 300.

77 Belle Isle, Freudenberg and Copp (n 5).

78 COVID-19 is a mild to severe respiratory illness that is caused by a coronavirus (*Severe acute respiratory syndrome coronavirus 2* of the genus *Betacoronavirus*), is transmitted chiefly by contact with infectious material (such as respiratory droplets) or with objects or surfaces contaminated by the causative virus, and is characterized especially by fever, cough, and shortness of breath and may

explore the perception of SBOs in the service sector in terms of their cash flow and the influence that tax may have on it. To address this a case study methodology was adopted, as it was seen as an efficient method for examining this phenomenon.[79] The case study has been a popular methodology used by tax researchers in prior studies to obtain an in depth understanding of the research problem and contribute to theory.[80] Yin's[81] case study design was the foundation for this project with replication of the same procedure undertaken for each case.[82] This suggests that data should be collected from participants within a specific time and while they are engaged in the same activity. To satisfy this requirement, the collection of data from all participants in the multiple case study was secured over a six-week period from 14 September 2016 to 31 October 2016. During this period, small businesses in Australia are likely to have many reporting and payment obligations due to the ATO (see Table 1 above).

The group that the research primarily focused on were individuals who operate small businesses in the service sector, and they were classified in accordance with ABS catalogue no. 1292.0 and ranged from a variety of service classifications.[83] Securing participants from the small business sector was a challenging exercise, which has also been acknowledged in other qualitative research projects completed in Australia to date.[84] As a result, purposive sampling techniques were used to ensure that volunteer participants were selected according to those service sector classifications[85] and to their adherence with the unit of analysis for the project. The unit of analysis required that participant SBOs had an annual turnover of $10 million or less and a full-time workforce of 20 or fewer employees.[86] SBOs who were engaged to participate in the multiple case study were sourced from a variety of platforms including social media platforms (i.e., Facebook and LinkedIn), by email distribution through accounting firm databases and by approaching personal, professional and university networks.

progress to pneumonia and respiratory failure, see Merriam Webster, 'COVID-19' (2021) <https://www.merriam-webster.com/dictionary/COVID-19>.

79 J. Clyde Mitchell, 'Case and Situation Analysis' in *Case Study Method: Key Issues, Key Texts* (Sage Publications, 7th ed, 2009) 165–186, 170; Wallschutzky and Gibson (n 4) 516; Robert Yin, *Case Study Research Design and Methods* (Sage Publications Inc, 4th ed, 2009) 9.

80 Belle Isle, Freudenberg and Copp (n 5); Belle Isle and Freudenberg (n 23); Glover and Tran-Nam (n 39); Ritchie (n 39) 304; Wallschutzky and Gibson (n 4).

81 Yin (n 79) 57.

82 Yin (n 79).

83 Australian Bureau of Statistics, *Australian and New Zealand Standard Industrial (ANZSIC)* (Catalogue No 1292.0, 26 June 2013).

84 Belle Isle, Freudenberg and Copp (n 5); Belle Isle and Freudenberg (n 23); Binh Tran-Nam and John Glover, 'Estimating the Transitional Compliance Costs of the GST in Australia' (2002) 17 *Australian Tax Forum* 499–536; Wallschutzky and Gibson (n 4).

85 Australian Bureau of Statistics (n 83).

86 Australian Bureau of Statistics (n 20); Australian Taxation Office, *Taxation Statistics 2015–16* (27 April 2018).

The benefits of including interviews in research are that they allow a more in-depth appreciation of the research problem, based on human actions and experiences.[87] For this project, semi-structured interviews were employed in the collection of data from SBOs in the multiple case study. Both qualitative and quantitative questionnaire formats were used.

To code the data, content analysis techniques were employed, which involves the manual identification of similar subject matter from the transcribed interview scripts.[88] Files are created based on the categories already established and the text satisfying each category from the transcripts is copied into the relevant file.[89] Once all transcripts have been thoroughly analysed and the data copied to the relevant files, the data is further analysed into sub-categories.[90] Sub-categories can include codes that were previously expected to be present and new codes uncovered from the data collection process.[91]

Content analysis in the current project initially involved reading over all transcripts before copying any data into files. Different colours were assigned to each category and highlighted text in the transcripts that satisfied individual categories. Some textual concepts addressed more than one category and therefore comments were made in the transcript document about the relevance of that text to the identified categories. A second reading of the transcripts was then carried out to ensure that the consistency of the analysis techniques was employed for all transcripts. Once this was completed, the highlighted text was copied to the relevant category file.

Then each file was read and identified sub-categories and relationships that appeared to be apparent in the data. Files were created for each sub-category and the process previously completed for categories was carried out again for the sub-categories. The category and sub-category documents assisted in determining how the results would be presented in the research documentation. Important quotations were also included where relevant.

IV Demographics

As a result of the sampling techniques utilised, seventeen SBO participants were engaged for the multiple case study. It was proposed that at least one business from each ANZSIC[92] service classification would be included in the case study. Unfortunately, it was not possible to satisfy this proposition. The participating SBOs engaged were classified into nine of the fifteen service groups. The classification groups that were not represented in the case study included categories D (Electricity, Gas, Water and Waste Services), F

87 Svend Brinkmann, *Qualitative Interviewing: Understanding Qualitative Research* (Oxford University Press, 2013) 47, 49.

88 Gubrium et al, *The Sage Handbook of Interview Research: The Complexity of the Craft* (Sage, 2nd ed, 2012) 198.

89 Ibid.

90 Ibid.

91 Brinkmann (n 87) 64; Gubrium et al (n 88).

92 Gubrium et al (n 88).

(Wholesale Trade), I (Transport, Postal and Warehousing), L (Rental Hiring and Real Estate Services), O (Public Administration and Safety) and R (Arts and Recreational Services).

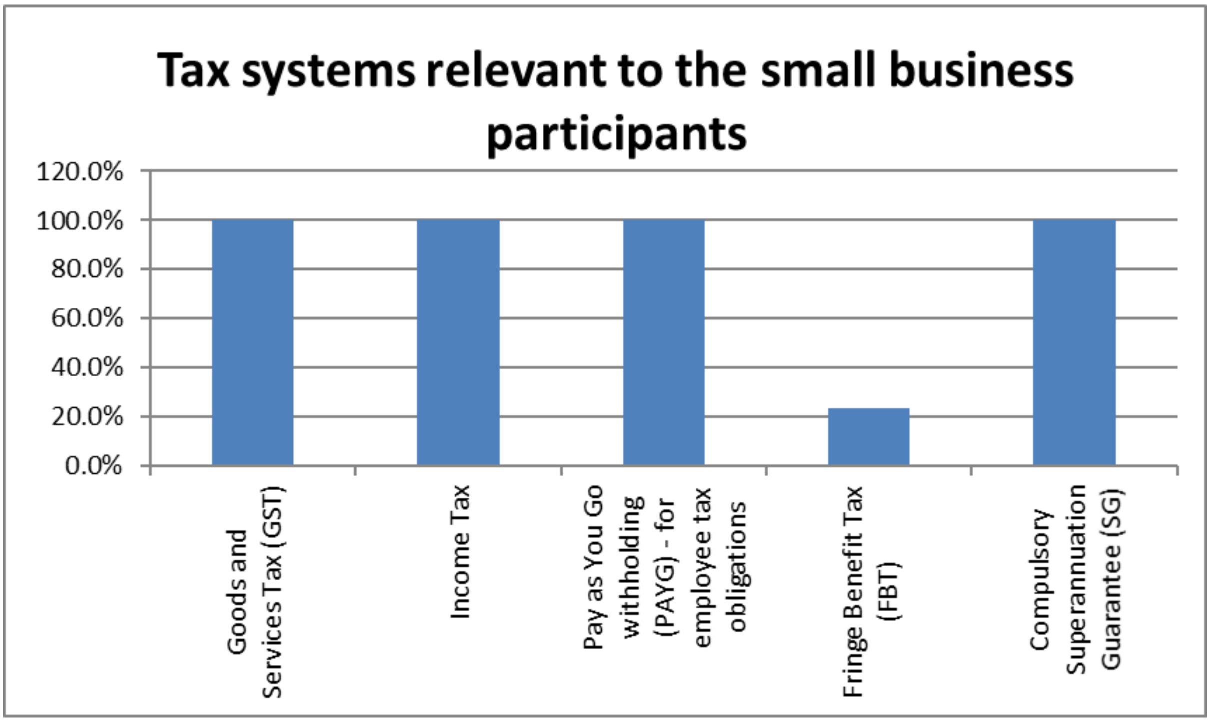
Table 2 below demonstrates an overview of the participating SBOs in terms of annual turnover, years trading, number of employees, business activity statement ('BAS') and PAYG reporting cycle, business form, trading partners, services provided, ANZSIC category, use and type of computer accounting software ('CAS'), preparation and lodgement of BAS and compliance with the five Federal tax systems within the study, including whether businesses had a requirement to pay a PAYG or a FBT instalment.

TABLE 2: PARTICIPANT DEMOGRAPHICS FOR MULTIPLE CASE STUDY

Participant No.	Annual Turnover ($)	Years Trading	F/T Employees	BAS Reporting	PAYG Reporting	Business Form	Consumer Sales (%)	Business Sales (%)	Service Provided	ANZSIC Category	Uses CAS	CAS Type	BAS Prepared By	BAS Lodged By	PAYG	FBT	SG	Income Tax	GST	Paid PAYG Instalment	Paid FBT Instalment
1	500,000 < 2,000,000	28	4	Qtrly	Qtrly	Discretionary Trust	100	0	Sale imported goods	G	N	Excel & Bank statements	Self	Accountant Tax Agent	Y	N	Y	Y	Y	Y	N/A
2	2,000,000 < 5,000,000	18	17	Qtrly	Mthly	Company Trust Combo	5	95	Commercial Plumbing	E	Y	SimPro and MYOB	Self	Self	Y	N	Y	Y	Y	N	N/A
3	< $250,000	10	1	Qtrly	Qtrly	Sole Trader	0	100	Bookkeeping	K	Y	MYOB	Self	Self	Y	N	Y	Y	Y	Y	N/A
4	$250,000 < $500,000	5	3	Qtrly	Qtrly	Company	80	20	Cleaning	MN	Y	MYOB	Bookkeeper	Bookkeeper	Y	Y	Y	Y	Y	Y	N
5	$500,000 < $2,000,000	17	2	Qtrly	Qtrly	Trust	100	0	Financial Planning	K	Y	Reckon 1	Bookkeeper	Bookkeeper	Y	Y	Y	Y	Y	Y	N
6	$2,000,000 < $5,000,000	2	18	Mthly	Qtrly	General Partnership	90	10	Fruit and Vegetables	G	Y	Xero	Accountant Tax Agent	Accountant Tax Agent	Y	N	Y	Y	Y	N	N/A
7	$2,000,000 < $5,000,000	2	20	Qtrly	Mthly	Dis Trust	100	0	Day-care Centre	P	Y	MYOB	Accountant Tax Agent	Accountant Tax Agent	Y	N	Y	Y	Y	N	N/A
8	<$250,000	3	1	Qtrly	Qtrly	Dis Trust	10	90	Account/Tax	M	Y	Xero	Self	Self	Y	N	Y	Y	Y	Y	N/A
9	$500,000 < $2,000,000	10	1	Qtrly	Qtrly	Company	100	0	Restaurant	H	Y	MYOB	Self	Bookkeeper	Y	N	Y	Y	Y	N	N/A
10	$500,000 < $2,000,000	5	6	Qtrly	Qtrly	Company	2	98	Software Development	J	Y	MYOB	Bookkeeper	Accountant Tax Agent	Y	N	Y	Y	Y	Y	N/A
11	$500,000 < $2,000,000	11	8	Qtrly	Mthly	Company	98	2	Take-away Food	H	Y	Xero	Accountant Tax Agent	Accountant Tax Agent	Y	N	Y	Y	Y	N	N/A
12	$500,000 < $2,000,000	1	1	Qtrly	Qtrly	Company	0	100	Technical Engineering	M	Y	Xero	Self	Self	Y	N	N	Y	Y	N	N/A
13	$500,000 < $2,000,000	2	3	Qtrly	Mthly	Company	5	95	Technical Engineering	M	Y	Harvest and Excel	Bookkeeper	Bookkeeper	Y	N	Y	Y	Y	Y	N/A
14	$2,000,000 < $5,000,000	5	11	Qtrly	Mthly	Company	0	100	Team Training	P	Y	MYOB	Bookkeeper	Bookkeeper	Y	Y	Y	Y	Y	Y	Y
15	$500,000 < $2,000,000	13	2	Qtrly	Mthly	Discretionary Trust	100	0	Psychology	Q	Y	Xero	Accountant Tax Agent	Accountant Tax Agent	Y	N	Y	Y	Y	Y	N/A
16	$500,000 < $2,000,000	30	2	Qtrly	Mthly	Company	2	98	Electrical Engineer	E	Y	Xero	Self	Accountant Tax Agent	Y	N	Y	Y	Y	Y	N/A
17	$500,000 < $2,000,000	30	10	Mthly	Mthly	Company	100	0	Dental	Q	Y	Reckon 1	Employee	Employee	Y	Y	Y	Y	Y	Y	N

Table 2 (above) and Figure 1 (below) illustrate that all participating SBOs reported for PAYG, income tax, GST and the SG. Four businesses or 24% reported for FBT. Of the four businesses complying with FBT, only one business (representing 25% of complying entities) paid an FBT instalment.

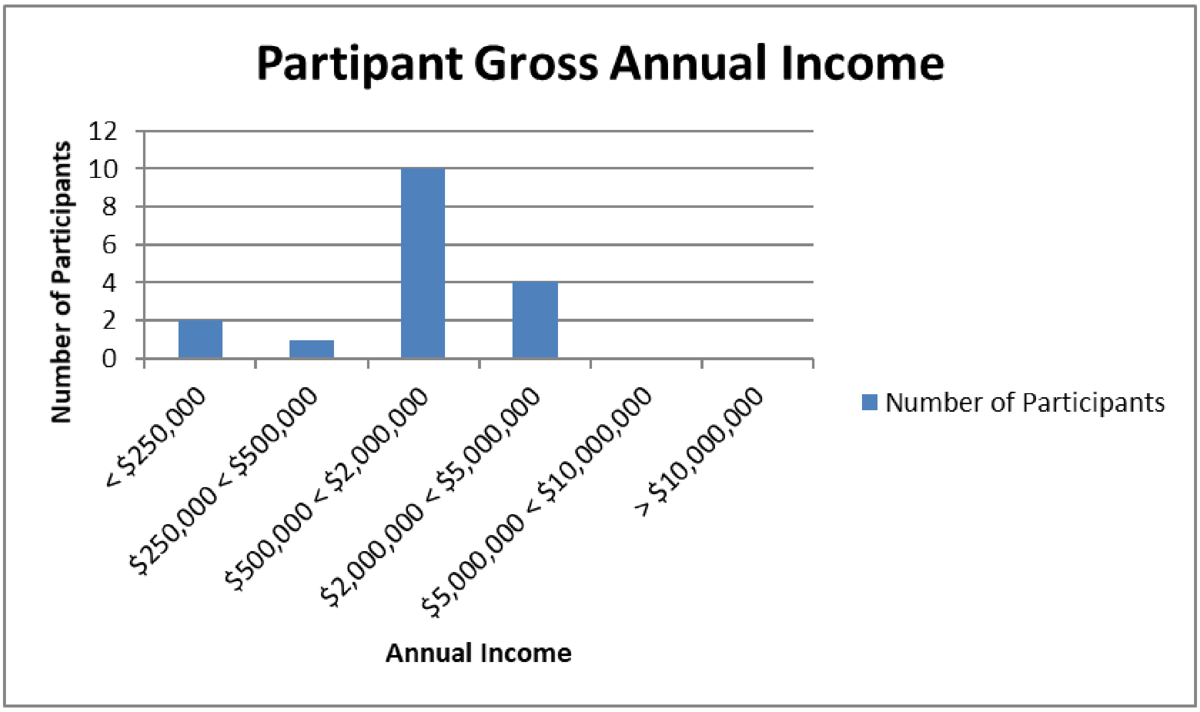
FIGURE 1: ILLUSTRATION OF THE TAX SYSTEMS RELEVANT TO SMALL BUSINESS PARTICIPANTS



In comparison, PAYG instalments were made by 65% of PAYG compliant entities. Quarterly reporting for both PAYG and BAS was most common among the participating businesses. Nine participants reported for PAYG and fifteen for BAS on a quarterly basis, in comparison to eight entities for PAYG and two for BAS reporting monthly. Most businesses had either a bookkeeper or an accountant/tax agent to lodge their BAS (12 entities), whereas only nine (53%) of the participating businesses used an external party to prepare their BAS ready for lodgement.

Figure 2 below illustrates that no participating SBOs that derived an annual turnover of between $5,000,000 and $10,000,000. This means that the experiences of more sizeable businesses ($5,000,000 – $10,000,000) are outside the scope of this stage of the research.

FIGURE 2: GROSS ANNUAL INCOME OF PARTICIPATE SMALL BUSINESSES



The information in Table 1 above illustrates that the trade relationships of the participating SBOs are almost even when comparing business-to-consumer trade and business-to-business trade. Nine participants predominantly carry out their business activities with consumers and eight participants conduct business primarily with other businesses.

Table 1 above also demonstrates that those businesses earning the largest annual income are mostly employing the greatest number of staff. The four SBOs generating an annual income of more than $2 million employ between 11 and 20 full-time employees. In contrast, those SBOs earning under $250,000 have only one full-time staff member. It is possible that these micro businesses are simply a vehicle for income generation for the owner. The annual income category of $500,000 < $2,000,000 has the greatest employment diversity. Full-time employment figures range from 1 to 17. This variation might be explained by the size of the annual income category. It is difficult to determine whether the full-time employment variation relates to the services provided by the business, as the employee numbers of those running professional businesses (Participants 15 and 17) differ considerably, with one business employing 2 full-time employees and the other employing 10. This circumstance is similar for the two businesses providing food services (ANZSIC Category 'H'). The restaurant employs one full-time employee, whereas the takeaway food provider employs 8 full-time employees. This demonstrates that income size does not necessarily relate to the number of full-time employees, or the services being provided.

Below is a presentation of the results in terms of the cash flow and the tax.

V RESULTS

The results are now discussed in terms of cash flow stability, the impact of taxation and the five Federal taxes considered.

A *Cash Flow Stability*

The interviews started with an initial broad question to provide greater integrity to the research, so as not to 'lead' the small business owner into identifying 'tax' as a cashflow issue. The SBO participants in the case study were asked: '*Does your business consistently meet its short-term cash commitments*?', as this prompts participants to consider overall the effectiveness of their cash flow management. Without this question it could be asserted that there is research bias or that the responses are being directed down a certain path. It is important to establish where tax is placed in terms of other possible constraints.

Eleven participants responded that they do meet their short-term cash commitments; nine responded with certainty that they pay their outstanding debts on time; the two remaining businesses were not as confident:

> Yes, actually we do because we have been in business for almost 28 years and we sort of have the experience of how to manage the cash flow and we also know what we are expecting and when payments are due so usually yes (Participant 1).

The six SBO participants who suggested that they did not or have not always paid their short-term commitments by the due date had varying reasons for not doing so. Five of the six business participants suggested it was a result of restricted cash flow, which were predominately a result of debtors not paying within trading terms. This is similar to the findings of Belle Isle, Freudenberg and Copp,[93] and those of the Australian Small Business and Family Enterprise Ombudsman,[94] who found that it is common practice in Australia to receive payments from debtors later than the trading terms offered. Other responses for not paying on time included restrictions on time, business growth and reduced revenue:

> The main reason would be cash flow regarding big multi-national organisations taking 90 days to pay us (Participant 14).
>
> Predominately the issue is cash flow. A lot of it is due to business growth, our business has grown, and we have had an increase in payroll and a lot of our revenue is subject to 60-day terms. Obviously, we have to pay our staff on time, so if cash is not received for 60 days our bills have to wait (Participant 4).

Overall, it appears from the limited sample that two-thirds of SBOs are meeting their short-term commitments. Those who suggested that they do not always satisfy their short-term cash commitments had varying reasons for not doing so with the most common response related to late payments from creditors. However, business growth was also evident. It could be possible that businesses in a growth stage incur expenses before they realise growth in revenue. From the feedback, it appeared that the initial

93 Belle Isle, Freudenberg and Copp (n 5).

94 Australian Small Business and Family Enterprise Ombudsman (n 61).

responses from SBOs did not raise concerns about the influence of taxation on cash flow.[95] The interviews were therefore used to explore further information relating to the possible taxation and cash flow relationship.

B *Cash flow and Taxation*

Questions posed to SBOs, in various formats to attempt to uncover SBOs general feeling regarding the tax and cash flow relationship. More specific questions were then posed about the five tax systems which were the focus of the research. Participants were asked a broad question: '*What does tax mean to your business*?' It was found that not all business owners were negative about the requirement to adhere to tax obligations, as some businesses saw taxes as just another payable and part of doing business:

> Taxes are just a payable, it forms part of a cash flow requirement (Participant 2).

Similar to findings of Wallschutzky and Gibson,[96] small business participants did not convey unfavourable comments about the majority of their tax obligations. The responses from the remaining seven participants were not as favourable. Participant comments related to the general burden of tax obligations:

> Taxes are a massive hindrance to my business (Participant 4).

More specific feedback was associated with the time and cost involved in complying. It appears from these comments that the issue may not be the amount of tax but the compliance costs and the complexity of tax:

> I think taxes are a bad thing. Just an imposition, none of it benefits me. It's an administrative overhead and there are accounting and bookkeeping costs too and my time (Participant 10).

Similar responses have been evident in compliance cost research since the introduction of the GST. SBOs are concerned about the heavy cost and time burden of tax on their business, particularly in comparison to their larger competitors.[97] These findings may suggest that there needs to be more focus on decreasing tax complexity and compliance costs for small businesses.

Small businesses were then asked several questions to attempt to explore any common themes associated with cash flow and taxation. The first question asked: '*Is there anything you would like to discuss as to how tax can influence your cash flow?*' Common responses related to the effect of tax on business growth and on the administration of taxes, each of which is discussed below.

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95 This is similar to the findings of Wallschutzky and Gibson (n 4).

96 Ibid.

97 Evans et al (n 39); Glover and Tran-Nam (n 39); Lignier and Evans (n 39); Lignier, Evans and Tran-Nam (n 39); Biagio Marco Pizzacalla, 'Developing a Better Regime for the Preferential Taxation of Small Business' (PhD Thesis, Monash University, 2014); Ritchie (n 39).

C *Business Growth*

At least six SBOs suggested that taxation limits the growth of their business. Comments related primarily to the costs associated with employment tax obligations:

> The more people we employ, the more tax we pay so there is no incentive to do so. (Participant 11).
>
> When I think about employing new people, I think two Australian employees are going to cost $50,000 per year in tax. I could instead use a computer system or offshore services and the cost is a lot less. I'd go with the cheaper way. This is not good for Australia. So, tax hinders business growth (Participant 8).

Three of these responses related to employing staff, which suggests that business growth is restricted due to the requirement to adhere to PAYG withholding or superannuation obligations. Part of the issue with growth might also be that it can involve employing staff who are an immediate cost, however, the income earnt from those staff may not be realised until sometime in the future. This feedback is concerning when considering that Australian employment is heavily reliant on the small business sector.[98] However, recent statistics about small business employment growth — 148% in 2016 when compared to the previous year — indicate that many small businesses are still employing new people despite the apparent discouragement of tax obligations.[99]

D *Administration and Timing of Tax payments*

Research conducted by the Organisation for Economic Co-operation and Development ('OECD')[100] proposed that overseas businesses experienced cash flow issues from taxation. These issues were related to the timing of the tax payment and the multitude of tax payments required throughout each financial year. The interviews uncovered similar experiences for the SBO participants. The participant responses related to administrative procedures in the first year of trading, to holding the tax liability on behalf of the ATO for lengthy periods of time and to the multitude of payments.

Respondents reflected on the cash flow issues they experienced after the first year of trading. They suggested that more education was required at business start-up in relation to what the likely tax obligations would be at the end of the first year. The cash flow issues related to not paying any tax in the first year of trading and having a large tax liability in the second year as a result:[101]

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[98] Australian Bureau of Statistics, *Australian Industry, 2018–19* (Catalogue No 8155.0, 29 March 2020); Australian Bureau of Statistics (n 20); Department of Parliamentary Service, *Are Small Businesses the Driving Force Behind Private Sector Employment and Total Industry Value Added?* (Research Paper Series, 17 November 2017).

[99] Department of Parliamentary Service (n 98).

[100] OECD (n 39).

[101] Note: In Australia, lodgement for Income Tax for sole traders, partnerships and trusts is due on 31 October and for self-reporting companies, 28 February, following the end of the financial year on 30 June. The PAYG instalment system does not become an automatic obligation until after businesses lodge their first income tax return (if they meet the threshold). As a result, a tax liability will not be due for start-up entities for up to 16 months for sole traders, partnerships and trusts, and 20 months

> Year one of business, I paid nothing all year and then I was hit with a massive tax bill. Now in year two, I prepay[102] some which is a lot better for cash flow (Participant 6).

Participant 12 indicated they were conscious of the fact that they would have a tax liability, and therefore had undertaken some planning (even if it was a rough estimate) to accommodate the tax liability that would be due in the future. Participant 6, in contrast, suggested that it was not until they experienced cash flow constraints that they realised the tax administration problem. It is acknowledged the ATO website suggests that new businesses should enter the PAYG instalment system voluntarily to avoid the situation of little or no cash to satisfy the tax liability at the end of the first year of trading.[103] Unfortunately, it is not apparent to what extent businesses are aware and/or follow this advice.

Other SBO participants suggested that being a tax collector for the ATO creates a cash-flow problem. With reference to the tax systems explored in this research, businesses are required to collect tax on behalf of the ATO for GST and PAYG withholding. SBOs highlighted cash flow issues arising from the tax liability being held for too long in the business bank account before remitting to the ATO. Comments appeared to refer to PAYG withholding, as they suggested that cash flow would be better supported if the tax liability was paid weekly or was consistent with each payroll cycle:

> I don't think it is the actual tax that is the problem. I think it is the time between incurring the tax and the time it is paid that is the issue. If it was not stored in your account for long periods and left weekly, I think cash flow would be easier to manage (Participant 16).

A number of SBOs expressed the requirement for an overhaul of the current tax system, although they were unsure of how the system should be readministered. Their frustrations related to the number of tax systems and the different reporting and payment dates for each system:

> There's IAS[104], BAS, super, FBT, company tax and payroll tax. It's quite complicated, there are so many touch points. FBT reporting in April, why is that? There is not much relief for small businesses on taxes (Participant 14).

Nearly thirty years ago in Wallschutzky and Gibson's[105] study SBOs suggested that only the WST had a negative impact on cash flow, whereas the SERC findings suggested that all tax systems would have unfavourable consequences on small business cash flow.[106] The current research, therefore, examined the perception of service SBOs about whether they believed that tax influenced their business cash flow. The following question was

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for companies. This could cause a restraint to cash flow if SBOs have not forecasted for such tax liability.

[102] Prepayment relates to PAYG instalment.

[103] See, eg, ATO, 'How to Start Paying Instalments' (2021) <https://www.ato.gov.au/general/payg-instalments/how-to-start-paying-instalments/?anchor=Voluntaryentry#Voluntaryentry>.

[104] IAS is an instalment activity statement used for reporting PAYG withholding tax on a monthly basis or used by taxpayers who are not registered for GST.

[105] Wallschutzky and Gibson (n 4).

[106] Senate Economics References Committee (n 54) [7.1].

posed to the interviewees: '*Do you think it is the tax itself or some other influence that causes the cash flow problem*'? Only two respondents suggested that it was the tax itself that caused a problem for cash flow. Those respondents were from varying ANZSIC[107] service industries. One business resides in category 'N' Administrative and Support Services and the other offers Education and Training classified under category 'P'. Their comments are presented below:

> I mean obviously, the tax itself is probably the main issue (Participant 3).
>
> Yes, the payroll tax is the issue (Participant 7).

It should be acknowledged that the response from Participant 7 relates to payroll tax which is a State tax system and outside the scope of this research, but it should be noted that payroll tax can relate to the cost and complication of employing someone.

In contrast, four participants proposed that restrictions in cash flow are not related to tax obligations. Instead, cash flow restrictions were seen to be a consequence of reduced profit margins, a decline in revenue or the health of the economy and trade partners. Respondents 9 and 11, whose businesses both reside within the ANZSIC[108] category 'H' of Accommodation and Food Services, attributed their cash flow constraints to reduced profit margins. This may be a result of their trading partners, as both participants 9 and 11 are involved in business-to-consumer transactions, and prior research by Belle Isle, Freudenberg and Copp[109] found that small businesses with consumers as trade partners appear to have problems settling tax liabilities due to low profit margins:

> Profit margins are not large enough at all and everything has increased especially food prices. I look at menus from 10 years ago, we have probably increased a pasta dish by $2 in 10 years. (Participant 9).

Participant 1, who also trades with consumers (classified under category 'G' Retail Trade), suggested that cash flow is inhibited by a decline in revenue or the health of the economy and not the tax itself:

> I think it is consumer appetite for spending and the overall economy. If the economy is not healthy then people don't spend. Also, our trading is seasonal. We are very busy over Christmas but quiet when school goes back. We still have wages, rent and other overheads to pay (Participant 1).

The last remaining SBO (Participant 13) who did not consider tax as the cash flow problem suggested that their choice of trading partners was the problem. In contrast to Participant 9 and 11, who trade with consumers, Participant 13 trades with other businesses, offering Technical Services (Category M) for the Mining Industry:

> Tax is not the big issue for my cash flow, the problem is that I deal 95% with business customers. Extremely large businesses in the Mining Sector. Although they are on 60-day payment terms, we are not receiving funds until six months later. That could equate to an invoice for $130,000 (Participant 13).

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[107] Australian Bureau of Statistics (n 83).

[108] Australian Bureau of Statistics (n 83).

[109] Belle Isle, Freudenberg and Copp (n 5).

This response from Participant 13 appears to be an example of issues experienced by other small businesses, as reported in the Payment Times and Practices Inquiry.[110] Large businesses have been associated with delaying payments to small entities for longer periods than is specified in the small business trading terms.

The remaining businesses indicated that cash flow problems are experienced due to the combination of tax obligations and other outgoings associated with running a business. Two participants associated cash flow problems to tax and terms of trade. For example:

> We are tendering a $55,000 contract. If we get that contract our payroll goes up straight away for new staff and we will need new equipment. The money has to come from somewhere and it will be 45 days before we get paid for the work (Participant 4).

Other participants stated that it is a multitude of business transactions that together hinder cash flow. This combination of issues included repairs and maintenance costs, variations in revenue, fixed costs and taxation.

In summary, initial responses from SBO participants in the interviews indicated that the cash flow of most of the case study businesses is stable. Two-thirds of participants reported that they settle their short-term debts on time. Similar to the findings by Welsh and White,[111] those businesses that expressed concerns with settling short-term debts proposed that this was associated with cash being held in overdue debtor invoices.

The interview was then used to investigate how participants viewed taxation generally and in connection with their cash flow. One-quarter of service SBOs gave favourable feedback in relation to taxation, believing that tax obligations are a normal part of operating a business, treated like any other liability. The remaining participants had opposing views on taxation, implying that it was a burden for their business, resulting in extra time and cost in order to comply.

The case study identified that SBOs were not inspired to grow their businesses due to the influence that tax would have on their cash flow, especially in relation to employment related taxes. Concerns for cash flow also related to the timing of tax payments and the multitude of tax obligations.

Whether it was the tax or some other business factor that was affiliated with restrictions in cash flow, the results indicate that the majority (15 out of 17 participants) did not consider taxation as being the sole cause of cash flow problems. Consistent with research by Belle Isle, Freudenberg and Copp[112] trade partners (low profit margins and/or extended trade terms) appear to be of more concern to cash flow. Other business factors, such as variations in revenue, repairs, maintenance and fixed costs plus taxation, were considered to cause restrictions to cash flow.

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[110] Australian Small Business and Family Enterprise Ombudsman (n 61).

[111] Welsh and White (n 24) 26.

[112] Belle Isle, Freudenberg and Copp (n 5).

E *Federal Tax Systems and Cash Flow*

Following the generalised questions relating to taxation and cash flow, SBO participants were asked more specific questions associated with the five Federal tax systems focused on for this research project. Participants were asked '*Do some taxes affect your cash flow more than others?*' and *'Can you rank them from having the most to the least effect on cash flow and discuss why?*'[113] Some respondents suggested that it was the combination of all five of the tax systems, while other replies focused on specific tax systems.

1 *The Combination of All Five Tax Systems*

Responses relating to the aggregate effect on cash flow of all five tax systems primarily focused on being a tax collector for the ATO. For GST there is some theoretical contention that the tax collected should create a cash flow benefit for the collecting entity.[114] However, research suggests that small businesses rarely recognise any benefit because of market conditions or late payment by trade debtors.[115] Responses from SBO participants supported prior research, as service SBOs emphasised their concerns about the impact on cash flow coming from being a tax collector. Further concerns related to the tax component that would be due to the ATO at a later time, giving service SBOs a false impression of cash flow levels of the business (it should be recalled that many small businesses just use the balance of the cash at bank as an indicator of the health of their business)[116]:

> A combination of all of those taxes affects cash flow. When you're collecting money for the Government, it's not set up to benefit small business. It would be better if that money never came in. It makes life very difficult (Participant 4).

The combination of all taxes may also relate to the fact that with multiple taxes to manage (with different tax rules and different due dates) there may need to be more skill required of the service SBO to manage the multiple taxes as opposed to just one or two taxes. The remaining comments by service SBOs regarding effects on cash flow were more specific to one or more of the individual tax systems within the research. Details are discussed below.

2 *PAYG Withholding*

The largest number of SBOs in the case study perceived PAYG withholding and GST to have the greatest impact on their cash flow. Participants 2 and 5 could not differentiate between the two tax systems, and suggested that they both impede their cash flow. For example:

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113 It was explained to participants that these questions only related to the Federal tax systems involved in the research project.

114 Peter Costello, 'Tax Reform: Not A New Tax, A New Tax System' (Australian Government, 1998) Foreword; Cedric Sandford, 'Minimising the Compliance Costs of a GST' (1998) 14(2) *Australian Tax Forum* 125.

115 Belle Isle, Freudenberg and Copp (n 5).

116 Evans, Carlon and Massey (n 28) 300.

> It's a toss-up between GST and PAYG withholding. Both have a large effect on my cash flow (Participant 2).

Five SBOs indicated that PAYG withholding had the largest impact on their cash flow. A common response, even from those who did not report PAYG withholding as having a significant impact, was that PAYG withholding should be paid out regularly to avoid disruption to cash flow:

> PAYG is most difficult, but I pay it monthly which is good because it allows it to be spread out rather than having it all in one hit (Participant 15).

This comment also has a nexus about being a tax collector for the ATO. PAYG withholding is a tax collected on behalf of employees and paid sometime in the future to the ATO. These findings support prior literature suggestions that collecting tax on behalf of others can have negative consequences for the cash flow of small businesses.[117]

The extent of the PAYG withholding liability was another concern for some service SBOs. Those participants who discussed the magnitude of the PAYG withholding liability all employed eight or more full-time staff:

> To run our store, we have a lot of staff so our PAYG per month is between $6,000 and $10,000. So just when you think you're making headway, there goes another $10,000 because we have to pay PAYG (Participant 11).

In summary, SBO participant responses indicate that those businesses with large numbers of employees reported having difficulty managing cash flow due to the size of the tax PAYG withholding liability. Other SBO participants were concerned with the frequency of remitting the PAYG withholding liability to the ATO. Feedback suggests that cash flow could be easier to maintain if the PAYG withholding liability is paid more frequently to the ATO, reducing the 'shock' of a big tax payment.

3 *Goods and Services Tax*

As already noted, GST emerged as one of the most concerning taxes for the SBOs involved in the case study. As found in research by Belle Isle, Freudenberg and Copp[118] restrictions on cash flow appear to be associated with low profit margins, absorbing the GST on sales and not receiving the GST liability from invoices prior to the date that the tax liability is remitted to the ATO:

> GST has the most effect on cash flow because it is such a huge amount. For small business, GST is a lot of money every quarter. There is so much competition in our sector that we can't charge higher prices, so we are not making as much to cover all of our taxes easily (Participant 9).

> I'd say GST most affects my cash flow. I was late paying once because a debtor hadn't paid me on time. I had to use other cash to keep the place running (Participant 8).

As for prior research, the limited sample indicates that compliance with the GST affects the cash flow of small businesses This could be attributed to other business factors'

[117] Ahmed and Braithwaite (n 41) 539; Evans, Carlon and Massey (n 28) 290; OECD (n 39) 90.

[118] Belle Isle, Freudenberg and Copp (n 5).

market competition, the incidence of the tax liability, the variability of incoming revenue and the trade partners of the SBOs.[119]

4 *Fringe Benefits Tax*

Just under one quarter (four of seventeen) of participant SBOs reported for FBT. Apart from Participant 14 giving unfavourable feedback about the difference of the reporting year for FBT in comparison to other taxes, there were no other negative responses about complying with FBT. None of the FBT complying businesses made any comments about the effect of FBT on their cash flow. This may be due to the small number of SBO participants who comply, or it could be that FBT has minimal consequences to small business cash flow. The requirement to pay an FBT instalment was adhered to by only one of the four complying entities. The effect that FBT instalment has on cash flow did not appear to be of major concern to this participant, as there was no mention of it having any positive or negative impact to that participant's business. This finding suggests that the requirement to pay tax in advance has minimal or no impact on small business cash flow, which contradicts research conducted in the UK.[120] Alternatively, the results could be a consequence of the low amount of FBT liability required to be paid by the complying SBO participants. The payment of tax in advance is explored further below regarding income tax.

5 *Income Tax and PAYG Income Tax Instalment*

Four business participants recollected their experiences with income tax. Only one participant suggested that income tax had the largest effect on their cash flow, in comparison to the other taxes. The remaining comments were all associated with the PAYG income tax instalment. An equal number of negative and positive comments were made about the PAYG instalment. Two participants suggested that the PAYG income tax instalment was beneficial to their cash flow position. For example:

> Certainly, income tax affects our cash flow the most. If I wasn't paying throughout the year, I'd get a giant chunk of tax owing at the end of the financial year. The quarterly instalment actually made my cash flow look better (Participant 3).

The comments from the remaining two participants were not as favourable. It appears that the instalment payment made it easier to satisfy the obligation at the end of the financial year. However, participants were concerned that the instalment amount was based on previous income and noted the missed opportunity to earn interest on the money paid throughout the financial year. For example:

> From an income tax perspective, I think it is more the tax instalment that creates a cash flow problem. I know it is better to have some money sitting elsewhere over that year that we can access later to satisfy our final income tax bill, but that money once paid to the ATO is of no benefit to my business. It benefits the ATO. They will earn interest on that money and if it isn't needed at the end of the financial year because our obligation

[119] Ibid 424; Evans, Carlon and Massey (n 28) 310.

[120] Messina and Walton (n 8).

> wasn't as large as expected then that money would have been more useful in our bank account (Participant 16).

The data indicates that service SBOs agreed that paying an income tax instalment was of some benefit in helping them manage their cash flow in order to settle their income tax liability at the end of the financial year. The only unfavourable feedback related to paying an instalment amount that may not be indicative of current earnings of the business, and the opportunity foregone by not having the income earning interest in the bank account of the SBO.

6 *Superannuation Guarantee*

The impact of SG on cash flow did not appear to be a major concern for case study SBO participants. Only three participants commented on SG and of those participants, only one service SBO suggested that SG created a financial burden on their business.

> Every three months there goes another $15,000–$20,000 because of super (Participant 11).

The remaining two SBO participants were more concerned with the administration of SG. One participant was concerned about the requirement to transfer funds to a Superannuation Clearing House up to five days before the due date, in order for the money to be received, and in turn to be able to claim the tax deduction. The other participant suggested that if SG was remitted more frequently it would be easier to manage.

> I think super should be paid more often than quarterly as it is easier to manage cash flow that way. It should be monthly or automatically go at the time of paying employees (Participant 16).

These findings suggest that there is minimal concern regarding SG, when compared to the other four tax systems within the research project.

7 *Summary of the Relationship Between Cash Flow and Taxation*

Analysis of the data collected in the semi-structured interviews suggests that SBOs have minimal concerns for their cash flow when complying with their tax obligations for FBT, income tax and SG. In contrast to prior research in the UK, SBOs in Australia found benefits from paying tax in advance. Respondents identified the payment of a PAYG instalment as a useful tool in managing cash flow throughout each tax year. Common responses from SBO participants suggest that more regularity in making payments would assist them to keep control of cash flow, especially in regard to employment related taxes.[121] Other business factors were recognised as adding to the financial burden of the GST include the choice of trade partners, the market competition and the incidence of the tax liability. Overall, the tax systems reported to be causing the greatest disruption to cash flow were PAYG withholding and GST. SBOs with PAYG withholding and GST obligations are effectively collecting tax on behalf of the ATO. This could suggest that the PAYG

[121] Superannuation and PAYG withholding.

withholding and GST compliance burden impacts service SBOs ability to manage cash flow.

F *Relationship Between the Small Business Demographics and the Case Study Findings*

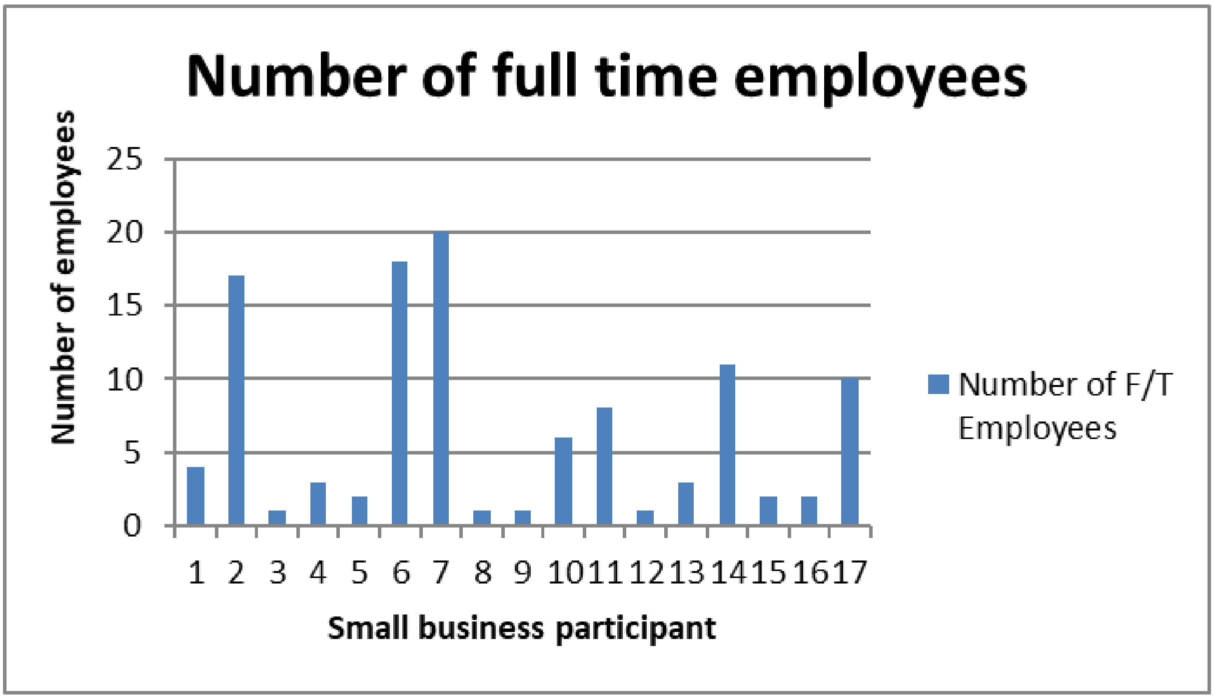
1 *Demographics and SG, FBT and Income Tax*

Due to the limited sample of SBOs in the case study and the limited feedback given about the effect of SG, FBT and income tax on cash flow, comparative analysis with participant demographics is limited to PAYG Withholding and GST.

2 *Demographics and PAYG Withholding*

Those businesses employing the highest number of full-time employees seem to have their greatest concern with PAYG withholding. However, this assumption cannot be fully satisfied because the second largest employing participant (Participant 6) suggested that GST and income tax were as burdensome as PAYG withholding. Figure 3 below illustrates the number of full-time employees engaged in each business. SBO participants 2, 5, 7, 11, 15 and 17 were concerned that cash flow was restricted as a result of PAYG withholding. Analysis of Figure 3 below demonstrates that only three of those participants (2, 7 and 17) employ 10 or more full time employees. This suggests that regardless of the number of employees, PAYG withholding may be restricting the cash flow of SBOs. It may be that as a business grows, in terms of employee numbers, more sophisticated measures are adopted to help manage cash flow, in terms of PAYG withholding and SG.

FIGURE 3: THE NUMBER OF FULL-TIME STAFF EMPLOYED BY SMALL BUSINESS PARTICIPANTS



3 *Demographics and GST*

Analysis of the demographics and data collected suggests that the GST hinders cash flow more than any other tax system in the research. It should be acknowledged that the SBO participants who reported concerns about cash flow and the GST were entities that would generally be required to charge GST on the services they provide. With participants 1, 2, 5, 8, 9, 10, 14 and 16, who reside in categories G, E, K, M, H, J, P and E respectively, all charge GST on their services.

In comparison to those who reported PAYG withholding as having the greatest influence to cash flow stability, three of the seven participants SBOs reside in industries where their services are GST Free.[122] Participants 7, 15 and 17, which provide Early Education, Psychological and Dental services respectively have businesses in the ANZSIC categories of Education and Training, Health Care and Social Assistance. Health Care and Education are predominantly GST-Free industries in Australia.[123] Therefore it would be unlikely that these SBOs would perceive the GST to have a significant negative influence on their cash flow, as they are likely to be getting a refund of GST input tax credits on purchases.[124] It could therefore be suggested that the GST recorded the highest number of unfavourable comments regarding its effect on cash flow. Eight of the fourteen (57%) SBOs that charge GST on their services, perceived the GST to affect their cash flow on a larger scale than any of the other taxes in the research. It is likely that GST liability on taxable supplies[125] for these businesses would exceed their GST input tax credits,[126] therefore giving them a net GST liability to the ATO. These results are consistent with research conducted by Wallschutzky and Gibson[127] in the 1990s. As noted earlier, the tax system causing the greatest burden to small business cash flow at that time was the WST, which was replaced by the GST.

G *Summary of the Tax and Cash Flow Case Study Findings*

From the demographic data it was found that all participants reported for PAYG withholding, income tax, GST and SG. However, only four participants lodged a fringe benefits tax return. Initially the perception of service SBOs was explored in terms of their ability to meet their short-term cash commitments. One-third of the SBO participants suggested that they faced constraints in paying their short-term obligations on time. The common response for this inability was because of their trading partners paying outside of payment terms. Taxation was not a cause of concern for the ability of SBOs to settle short-term commitments. It therefore seems that the ability of service SBOs to manage their trading terms and trading partners could be more important than tax.

122 *GST Act* (n 11) Div 38.

123 Ibid.

124 Ibid s 11-5.

125 Ibid s 9-5.

126 Ibid s 11-5.

127 Wallschutzky and Gibson (n 4).

The general perception that service SBOs had towards taxation was then examined to determine whether cash flow of Australian small businesses is influenced by tax obligations. Most participants viewed it as a business obligation and part of carrying on an enterprise. Service SBOs proposed that tax can be administratively difficult, especially the number of tax obligations for businesses in each tax year. Taxation was also identified as being an inhibitor to business growth. Service SBOs suggested that taxation was a deterrence to employing staff, due to the requirement to pay SG and PAYG withholding.

The five Federal tax systems within the research were then explored. Service SBOs were asked if any of the taxes have a greater influence on cash flow than the other tax systems. A small number of SBO participants suggested that the overall tax obligation was detrimental to their business cash flow, whereas other participants focused on specific tax systems. In particular, GST and PAYG withholding were identified as having the greatest detrimental effects on cash flow, which are taxes collected by businesses on behalf of the ATO. In contrast, the PAYG instalment was seen to be a beneficial cash management tool which allowed service SBOs to stay abreast of their tax liabilities. The majority of the SBO participants proposed that cash flow constraints cannot be solely explained by the obligation to pay tax. Other factors involved in the tax and cash flow relationship include business trading terms, profit margins, market competition and revenue restrictions.

Comparative analysis of the demographic information and the data collected in the interviews suggests that the majority of the SBOs recognised cash flow concerns from complying with the GST, with the exception of those SBOs that reside in industries that are predominantly GST Free or who are suppliers of services that are input taxed.

Overall, taxation can be seen as an inhibitor to growth, especially with the tax obligations around employing staff and the multitude of administration requirements around complying with FBT, GST, income tax, PAYG withholding and SG. The influence of specific tax systems on SBO cash flow is evident. GST is followed by PAYG withholding in being viewed as the most problematic tax systems for SBO cash flow. In contrast, PAYG instalments are considered to be a beneficial mechanism for managing and preventing cash flow constraints.

Overall, the research findings suggest that, regardless of the tax system, SBOs believe that taxation has minor consequences for small business cash flow. The research outcomes identified that some components of tax administration can create cash flow constraints including the requirement to comply with multiple tax systems, rather than being related to the obligation to pay the tax liability.

VI RECOMMENDATIONS

Given that it appears that the findings suggest that it is not 'tax' itself that is the core problem to cash flow, but the practices and management of cash flow broadly, which tax is just one part of. This would tend to suggest that initiative of the ATO of developing the Cash Flow Coaching Kit for advisors to support their business clients makes sense.[128]

The findings of the research have also emphasised that improved trading terms and/or adherence by debtors to the payment terms appears to be very important for small businesses. If small businesses are not paid on time then they could be liable for tax payments prior to receiving actual payment. This would indicate that the recommendations by the Australian Small Business and Family Enterprise Ombudsman should be given careful consideration, such as the establishment of the National Payment Transparency Register to highlight Australian businesses that pay small business suppliers in 30 days or less, and provides performance against payment practices.[129] Other recommendations are industry codes which regulate business to business transactions to include best payment practices including set payment times for particular industries.[130]

Additionally, it appears that during times of business expansion tax can be problematic for cash flow, which can include the appointment of employees. Appointment of employees can cause cash flow restraints given that the potential increase in revenue could take a while to be received while employment expenses can increase more immediately. Also, employment can lead to increased compliance time and cost for the business. To address this, consideration should be given as to whether there is a way to alleviate the additional tax impost and compliance cost for employing someone by a small business. It may be that the lower corporate tax rate should be only available to those corporations that meet a certain employee threshold, as the engagement of employees is a good indicator of a business contributing to the economy, as well as addressing the additional employer obligations that can arise when employing someone. Currently, the low corporate tax rate is freely available to corporations meeting the income threshold and with at most 20% passive income.[131] Providing an additional 'employment' requirement may provide for a better targeted concession, as well as providing some compensation for the additional compliance and regulatory costs involved in employing someone.

Also, consideration should be given to whether the number of tax obligations could be condensed so there are less reporting and payment dates for small businesses. Given advances in technology and reporting obligations, consideration should be given to the possibility for small businesses to make real time instalments of GST and income tax on

[128] See, eg, ATO, 'Cash Flow Coaching Kit' (2021) <https://www.ato.gov.au/Tax-professionals/Support-and-communication/In-detail/Cash-flow-coaching-kit/>.

[129] See Australian Small Business and Family Enterprise Ombudsman (2021) <https://www.asbfeo.gov.au/sites/default/files/documents/ASBFEO-NPTR-240718.pdf>.

[130] Australian Small Business and Family Enterprise Ombudsman (n 61).

[131] From the 1 July 2017 income year, the lower corporate tax rate is available for 'base rate entities', now defined to exclude corporate tax entities that have more than 80% of assessable income that is passive income (such as interest, dividends, rent, royalties and net capital gains). The entity's aggregated turnover must also be less than the relevant threshold for the year in question ($25 million in 2017–18 and $50 million in 2019 to 2024).

receipt of payment from debtors to the ATO. In conjunction with this, it should be explored whether a 'tax bank account' could be held through the ATO. Such a tax bank account would be entitled to interest and would not be immediately accessible to the ATO. In this way, such money is held separate to the businesses' other trading funds but is still available to the business if need be. This account then could be used to formally pay the ATO at the required payment time.

Given the concerns raised about GST, it may be that businesses need more awareness of the cash basis for GST, so they can better match their tax payments to when they actually receive the funds. This is important, as all of the participants in the current study would appear to be eligible to account for GST on the cash basis given that their turnover is less than $10,000,000. In this way, a business may report GST on a cash basis and then income tax on an accrual basis. However, this mixture of derivation methods could itself add complexity.

Also, there needs to be greater awareness that a business in its first year of operation can voluntarily enter into the PAYG instalment system in terms of paying an estimated income tax liability. There appears to be low awareness that this currently exists, as recently the Ombudsman called for this reform even though it is already in existence.[132] This could involve the ATO contacting new ABN registrants in the first six months of registering about the option to voluntarily make PAYG instalments. Fundamentally, if a small businesses tax reporting and payment can become a natural part of the process of the business this will aid compliance, and the ability to manage tax as part of the business cash flow.

VII Limitations and Future Research

There are a number of limitations of this study that should be acknowledged. Firstly, the study only explored the perception of SBOs, the actual practices or consequences of tax on cash flow for small service sector businesses could be different. Also, this research is based on sensitive information related to small business management practices, and SBOs may have felt inclined not to be fully frank with their answers. Additionally, the study focused on those businesses in the service sector and does not explore other sectors including Manufacturing, Agriculture, Forestry and Fishing or Mining. The participant small businesses also were not representatives of all service sector classifications. While the sample size is small, the case study provided some rich data that may be the basis for future research, such as an expanded qualitative study replicating the case study method used in this project. This could address the limitations recognised for the small number of participants, the exclusion of businesses not residing in the service sector and the service sector classifications not covered in the existing research. Research could also explore other variables that may influence cash flow, being the ability of SBOs to

[132] Australian Small Business and Family Enterprise Ombudsman, *A Tax System that Works for Small Business* (Canberra, 2021) Recommendation #10(b).

implement effective cash flow management practices and the level of tax literacy of the SBO.[133]

VIII CONCLUSION

In terms of cash flow, research has suggested that Australian SBOs do not believe that taxation is particularly concerning.[134] The findings emphasised that other business factors, including trading partners, competitive markets and cash flow management abilities were relevant to being able to pay the tax liability when it was due and payable. Although the previous WST did have some concerns for SBOs, more recent research into the GST,[135] also raised concerns about the ability to maintain a consistent cash flow as a result of complying with GST obligations.[136]

Service SBOs in the case study reported that GST, PAYG withholding, and SG can have negative consequences for cash flow stability. In particular, the amount of the tax liability for PAYG withholding and SG, when paid to the ATO each quarter, can result in cash flow constraints. These employment-related business taxes were also identified as being inhibitors for growth, as service SBOs explained that they were hesitant to employ new people due to the associated employment costs. Service SBOs expressed that their greatest concern for cash flow came from complying with GST. However, it should be acknowledged that, as in prior research,[137] the negative impact of GST on cash flow is due to a combination of business factors that includes market competition, the variability of incoming revenue and the non-receipt of payments from trade debtors before the GST liability is due to the ATO.

It would appear that overall small businesses need some assistance in managing their cash flow. While tax can influence cash flow in some adverse ways, it is other business factors that appear to have a greater detrimental effect, especially non-adherence to payment terms. With this understanding a number of recommendations were formulated to assist small businesses manage their cash flow, and thereby improve their stability and ability to add to the economy.

[133] Belle Isle and Freudenberg (n 23); Freudenberg et al (n 38).

[134] Wallschutzky and Gibson (n 4).

[135] The successor of the WST.

[136] Belle Isle, Freudenberg and Copp (n 5).

[137] Ibid; Wallschutzky and Gibson (n 4).

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THE SIMPLIFIED TAX REGIME FOR MICRO AND SMALL ENTERPRISES IN EGYPT: AN ANALYSIS OF THE THEORETICAL AND IMPLEMENTATION ISSUES

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ABSTRACT

Unlike previous studies focusing on the tax regimes of small and medium enterprises ('SMEs'), this article examines and analyses simplified tax regimes for micro, small and medium enterprises ('MSMEs'). Very recently, a simplified MSME tax regime was introduced in Egypt under the Micro, Small and Medium Enterprises (MSMEs) Law No 152 of 2020. This article employs an analytical and positive approach to assess these tax measures against the criteria of a good tax system and also evaluates the related implementation issues. The new tax measures include granting conditional tax exemption for capital gains and a dividend tax. Further, a separate MSME tax regime was introduced replacing the income tax provisions under the Income Tax Law No 91 of 2005. The MSME tax regime imposes a lump sum tax on micro businesses and an annual turnover tax at progressive rates on small businesses. The theoretical analysis and assessment of the MSME tax regime reveals the following: (i) the regime satisfies the economic efficiency criterion as it reduces the tax burden on SMEs, thus allowing to them to compete with larger businesses; (ii) it simplifies tax compliance procedures but is limited only to MSMEs registered with the MSME authority; (iii) the regime is inequitable as it discriminates between registered and non-registered MSMEs, and it does not consider their heterogeneity; (iv) there will be a decline in tax revenue collected from MSMEs, which represents a tax expenditure arising from the MSME regime; (v) there is a need for coordination of the regime with the Value-Added Tax Law; and, (vi) it is critical to establish measures that minimise resistance to the new system.

Keywords: micro and small enterprises, tax

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I Introduction

Designing a simplified tax regime for micro and small enterprises ('MSEs') is a common practice in many developed countries, as governments generally endeavour to stimulate the expansion of micro, small and medium enterprises ('MSMEs') through specific policies that include developing a friendly business environment, streamlining access to finance, and designing specific tax measures.[1] The overall tax burden on MSMEs includes both the legal tax liability and the tax compliance costs. Countries are keen to achieve the dual objectives of reducing the legal tax liability through preferential tax measures for MSMEs and simplifying tax compliance to minimise the tax compliance costs which are known to be regressive for MSMEs.[2] Some countries find that designing a specific tax regime for MSMEs may help to serve both objectives. These tax measures often deal with income tax and consumption tax (e.g., Value-Added Tax ('VAT') or Goods and Services Tax ('GST')) which are the main taxes for most countries. Furthermore, the specific tax regimes for MSMEs are often imposed separately from the regular tax measures of the tax system.

Recently Egypt ratified the new Micro, Small and Medium Enterprises (MSMEs) Law No 152 of 2020 ('MSME Law 2020'), which sets out comprehensive legislation covering a range of matters including registration, finance, and taxation. The new tax measures under the MSME legislation deviate from the standard income tax measures under Income Tax Law No 91 of 2005 ('ITL 2005'), raising the following research question: 'does the new MSME tax regime in Egypt align with the principles of a good tax system and are there any specific implications arising from its provisions?' This article seeks to answer this question through an analytical and positive approach which includes: (i) assessing the MSME tax regime against the principles of good tax system (e.g., efficiency, equity, simplicity, and revenue adequacy); and, (ii) identifying the implementation challenges of the new regime. Accordingly, this article will review previous research on MSME tax regimes, explain the new MSME tax regime in Egypt, analyse and assess the new regime against the principles of a good tax system, identify the implementation challenges of the new regime, and, in light of this analysis, provide specific policy recommendations to enhance the effectiveness of the new tax regime.

The remainder of this article is set out as follows. Part II briefly reviews previous studies on MSME tax regimes. Part III then discusses the new MSME tax regime in Egypt. In Part IV, an analysis and assessment of the new MSME tax regime in Egypt and its challenges is provided. Then Part V concludes with some summary remarks.

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1 This article builds upon a previous study conducted by the first two authors entitled 'The Tax Treatment of SMEs in Developed and Developing Countries: A Comparative Analysis of Australia and Egypt', which those authors are currently also seeking to have published in another taxation journal.

2 Evans et al, 'Small Business and Tax Compliance Costs: A Cross-Country Study of Managerial Benefits and Tax Concessions' (2016) 12(2) *eJournal of Tax Research* 543.

II Brief Literature Review

A *Previous Studies*

Designing a preferential tax treatment for MSMEs has attracted the attention of many scholars from different perspectives.[3] The preferential tax treatment for MSMEs deviates from the normal tax treatment for business taxpayers and therefore often requires strong justification. As a result, researchers have sought to provide specific reasons for deviating from the regular tax rules to provide preferential tax treatment for MSMEs.

In the above context, most studies have focused on the tax treatment of SMEs, under which micro enterprises are included within the small business category. Nevertheless, it is important to explicitly consider micro businesses, because they include self-employed activities and micro family businesses which make a significant contribution to job creation, especially in developing countries.

It has been argued that taxes may have either a positive or negative impact on MSMEs, influencing their business activities in different ways.[4] A negative perception of taxes will generally have an impact on starting a new business, discouraging entrepreneurs and start-ups from launching new businesses.[5] Moreover, a recent study by the International Monetary Fund ('IMF') considers taxation to be one of the main factors discouraging the conduct of a business through formal channels.[6] On the other hand, taxes may have a positive impact on MSMEs through provision of preferential tax treatment, representing an incentive to start new businesses which can in this way encourage more new businesses to be launched.[7]

Tax researchers have identified that a higher cost burden (e.g., tax) on MSMEs can result from number of factors. The first of these is uneven market competition with large businesses which may result in the failure of MSMEs in the market. The second relates to barriers to obtaining loans from banks due to the lack of sufficient collateral and the lack of accounting records in their early stage. Therefore, the majority of MSMEs use equity finance rather than debt which does not provide them with a privilege of deducting interest from taxable income. This in turn increases the MSMEs tax burden and can be

3 For further discussion relating to the taxation of SMEs, see, eg, E Gordon Keith, 'The Impact of Taxation on Small Business' (1959) 24(1) *Law and Contemporary Problems* 98; Douglas Holtz-Eakin, 'Should Small Business Be Tax-Favoured?' (1995) 48(3) *National Tax Journal* 387; William Gale and Samuel Brown, 'Small Business, Innovation, and Tax Policy: A Review' (2013) 66(4) *National Tax Journal* 871; Philip Lignier, Chris Evans and Binh Tran-Nam, 'Tangled Up in Tape: The Continuing Tax Compliance Plight of the Small and Medium Enterprise Business Sector' (2014) 29(2) *Australian Tax Forum* 217.

4 Gale and Brown (n 3).

5 Burçin Bozdoğanoğlu, 'Factors that Effect Taxation of Small and Medium Sized Enterprises (SMEs)' (2016) 4(2) *International Journal of Humanities and Management Sciences* 176, 177.

6 Leandro Medina and Friedrich Schneider, 'Shadow Economies Around the World: What Did We Learn Over the Last 20 Years?' (International Monetary Fund Working Paper WP/18/17, January 2018) 34–35 <https://www.imf.org/en/Publications/WP/Issues/2018/01/25/Shadow-Economies-Around-the-World-What-Did-We-Learn-Over-the-Last-20-Years-45583>.

7 Bozdoğanoğlu (n 5) 176.

considered as a form of market imperfection.[8] Thirdly, MSMEs do not enjoy economies of scale in the same way as large business which also reflects the market failure issue.[9]

The second dimension of the tax burden on MSMEs of tax compliance costs has also attracted the attention of many authors, including Hansford and Hasseldine,[10] Lignier, Evans and Tran-Nam,[11] Engelschalk and Loeprick,[12] Mahangila,[13] and Eichfelder and Hechtner.[14] Hansford and Hasseldine examined the tax compliance costs of SMEs in the United Kingdom through circulating a questionnaire among professional accountants. They found that SMEs bear high compliance costs relative to their size, confirming the regressive nature of tax compliance costs.[15] Lignier, Evans and Tran-Nam carried out a similar study to assess SME tax compliance costs in Australia during the period 1995 to 2012. They found that tax compliance costs are increasing, and are estimated to be, on average, around 9% of a business's annual turnover. They attributed the increasing compliance costs to the complexity of tax legislation which requires business taxpayers to hire professional tax advisers and maintain accounting records to comply with tax law provisions.[16] Mahangila conducted another study to assess the tax compliance costs and compliance behaviour of SMEs in developing countries in 2017. In that study, SME tax compliance costs in Tanzania were examined through an experimental method. The author found that tax compliance costs are regressive for SMEs, and negatively affect their tax compliance behaviour. The high compliance costs were attributed to a number of factors including: (i) the complexity of tax law; (ii) insufficiency of resources to hire a professional for obtaining a professional advice; and, (iii) high costs for maintaining accounting records.[17]

The above factors encourage governments in developed and developing countries to introduce specific measures to simplify tax legislation, in order to improve tax compliance

8 Saša Petković, Clemens Jäger and Boban Sašić, 'Challenges of Small and Medium Sized Companies at Early Stage of Development: Insights from Bosnia and Herzegovina' (2016) 21(2) *Management* 45.

9 Martin Bergner et al, 'The Use of SME Tax Incentives in the European Union' (ZEW Discussion Papers 17-006, ZEW- Leibniz Centre for European Economic Research, 2017) 2–3.

10 Ann Hansford and John Hasseldine, 'Tax Compliance Costs for Small and Medium Sized Enterprises: The Case of the UK' (2012) 10(2) *eJournal of Tax Research* 288.

11 Lignier, Evans and Tran-Nam (n 3).

12 Michael Engelschalk and Jan Loeprick, 'MSME Taxation in Transition Economies: Country Experience on the Costs and Benefits of Introducing Special Tax Regimes' (World Bank Group WPS/449, 2017) <https://documents1.worldbank.org/curated/en/399741468197376971/pdf/WPS7449-REVISED-MSME-taxation-in-transition-economies.pdf>.

13 Deogratius Ng'winula Mahangila, 'The Impact of Tax Compliance Costs on Tax Compliance Behaviour' (2017) 3(1) *Journal of Tax Administration* 57.

14 Sebastian Eichfelder and Frank Hechtner, 'Tax Compliance Costs: Cost Burden and Cost Reliability' (2018) 46(5) *Public Finance Review* 764.

15 Hansford and Hasseldine (n 10).

16 Lignier, Evans and Tran-Nam (n 3) 246–47.

17 OECD, *Taxation of SMEs in OECD and G20 Countries* (OECD Tax Policy Studies No 23, OECD Publishing, 2018) 90–91 <http://ifuturo.org/documentacion/taxation%20of%20smes.pdf>.

among SMEs. Furthermore, international institutions such as the World Bank, IMF and the Organisation for Economic Co-Operation and Development ('OECD') have all issued guidelines for designing specific tax measures for SMEs.[18]

B *Specific MSME Tax Measures*

1 *Overview*

Many developed and developing countries provide specific tax measures for MSMEs in order to reduce their tax burden. As previously discussed, there are two sources of costs contributing to a high tax burden on MSMEs, namely, the legal tax liability and the tax compliance costs, which require designing specific tax measures for MSMEs that mainly cover income tax and consumption tax (e.g., GST and VAT). Governments are often concerned to design specific tax measures for MSMEs addressing both liability and compliance cost issues through either preferential tax rules, or simplified tax measures.[19]

2 *Preferential Tax Measures*

Preferential tax measures for MSMEs involve tax incentives aimed at minimising the tax burden of MSMEs whether embodied in the income tax law or other laws. Bergner et al. have classified these types of tax incentives into three types: (i) tax incentives for the business entity or its owners, where the former type entail granting tax incentives to a business entity regardless of its legal form — for example, whether it is an unincorporated or incorporated business entity — while the latter entail tax incentives are available to a business's owner, such as a self-employed person or sole proprietor; (ii) tax incentives that influence tax liability and/or tax compliance, the former including various incentives aimed at mitigating the tax burden, and the latter including specific measures which simplify tax compliance; and, (iii) input-based tax incentives and output-based tax incentives,[20] where input-based tax incentives are incentives that affect the tax base and consequently minimise a business's taxable income, such as investment tax allowances, accelerated depreciation, and tax credits, and output-based tax incentives minimise the tax due through implementing a reduced tax rate or providing tax exemption or a tax holiday.[21]

The tax incentives for MSMEs in many developed countries often take the form of input or output tax incentives which aim to minimise the tax burden. For example, Belgium, Germany, the United Kingdom and France grant input tax incentives including accelerated depreciation, investment allowances, and tax credits. Further, Belgium, France, and Spain provide output tax incentives including reduced tax rates and tax exemption.[22] In the

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[18] Engelschalk and Loeprick (n 12).

[19] Marco Marchese, 'Preferential Tax Regimes for MSMEs: Operational Aspects, Impact Evidence and Policy Implications' (International Labour Organization Working Paper No 33, 17 June 2021) 11 <https://www.ilo.org/global/publications/working-papers/WCMS_803925/lang--en/index.htm>.

[20] Bergner et al (n 9) 4–5

[21] Ibid.

[22] Petković, Jäger and Sašić (n 8).

Oceania region, Australia's *Income Tax Assessment Act 1997* (Cth) and related legislation provides for reduced tax rates on small corporations which represent output tax incentives. Furthermore, a conditional research and development ('R&D') tax offset is also provided.[23] Researchers have found that developed countries often provide preferential tax treatment (tax incentives), while developing countries often provide specific tax regimes for SMEs.[24] As a specific instance of the latter case, this article will in Part III review and assess the specific tax regime which has been enacted in Egypt.

3 *Simplified Tax Measures for MSMEs*

Simplified tax measures for MSMEs are an important channel for minimising the tax burden and simplifying tax compliance for MSMEs, thus encouraging them to conduct their business as part of the formal economy.[25] Many developed and developing countries alike use such measures to stimulate the creation and growth of MSMEs. In addition, international institutions such as the World Bank and IMF always recommend simplification of tax measures for countries facing a low level of MSME tax compliance since these countries do not have the administrative capabilities to implement the more complex and unsimplified tax measures.[26] Simplified tax measures include, for example, presumptive taxes, cash accounting taxes and VAT special measures, each of which is discussed further in turn below.[27]

(a) Presumptive Income Tax

Many tax researchers have reviewed and assessed the presumptive taxes for MSMEs that have been enacted by many developing countries and also by a few developed countries such as Austria, Belgium and Italy.[28] A presumptive tax is a system that is used in place of the regular income tax rules to assess tax liability based on specific criteria or indicators.[29] Engelschalk has classified presumptive tax systems into four types, namely: (i) lump sum taxes; (ii) turnover taxes; (iii) indicator-based taxes; and, (iv) agreement-based taxes.[30] A

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[23] Board of Taxation, *Review Of Small Business Tax Concessions: A Report to The Treasurer* (Report, March 2019) 25 <https://taxboard.gov.au/sites/taxboard.gov.au/files/migrated/2019/12/RSBTC-report.pdf>.

[24] OECD (n 17) 64–65.

[25] Jacqueline Coolidge and Fatih Yılmaz, 'Small Business Tax Regimes', *Viewpoint* (World Bank Group Note, February 2016) <https://openknowledge.worldbank.org/bitstream/handle/10986/24250/Small0business0tax0regimes.pdf?sequence=1&isAllowed=y>.

[26] Ibid.

[27] Michael Engelschalk, *Designing a Tax System for Micro and Small Businesses: Guide for Practitioners* (World Bank Group, 2007) 43–58 <http://documents.worldbank.org/curated/en/980291468158071984/Designing-a-tax-system-for-micro-and-small-businesses-guide-for-practitioners>.

[28] Valeria Bucci, 'Presumptive Taxation Methods: A Review of the Empirical Literature' (2020) 34(2) *Journal of Economic Surveys* 372.

[29] OECD (n 17) 93.

[30] Engelschalk (n 27) 58–61.

similar classification was provided by the OECD in 2015.[31] Further details in relation to each of these types of taxes can be noted as follows:

1) *The lump sum tax/patent*: this is a simple tax regime that imposes a fixed amount of tax on eligible businesses based on specific criteria. It is also called a patent system, which often targets micro businesses with annual turnover not exceeding a specific threshold. Coolidge and Yılmaz studied this regime in a number of developing countries and found that more than 90% of businesses in many of the countries involved use such a system.[32] Engelschalk and Loeprick have also found that many transition countries in Eastern Europe and Central Asia (such as Albania, Hungary, Georgia and Kosovo) have lump sum taxes in place. These countries use a number of indicators to assess the annual turnover threshold, such as the area of the business, business location, etc. Further, these indicators are often subject to review in order to minimise abuse.[33]

2) A lump sum tax regime achieves three objectives which governments endeavour to achieve: it causes no behavioural distortions, can facilitate a low tax burden and entails low tax compliance costs. Nevertheless, there are risks involved in using such systems relating to: (i) possible abuses by ineligible businesses as they may also seek to use the system to minimise their tax burden; (ii) adverse effects in deterring micro businesses from growth, as growth may cause them to be required to migrate to the regular tax system; and, (iii) the possible negative impact on collected tax revenues.[34]

3) *The turnover-based tax*: this is the most common type of presumptive tax system and is used by many countries, both developing and developed,, such as France, Germany, Latvia, Armenia, Belarus, etc.[35] There are two methods for imposing a turnover tax; the first method subjects the annual turnover to tax under a flat or progressive tax rate schedule up to a specified turnover threshold, while the second method calculates the taxable income through first multiplying the annual turnover by a specific profit margin and then calculating the tax due by applying flat or progressive tax rates to that amount.[36] The simplest form of turnover tax is based on imposing a flat tax rate on a business's annual turnover under a specified threshold. This is also the most common method and is used by many countries in Eastern Europe and Central Asia.[37] The single flat rate of turnover tax is generally applicable to all business sectors, irrespective of the differences in profit margin from one industry to another, and the heterogeneity of small businesses. Thus, sectors with a low profit margin will be disadvantaged. Further, if the tax rate (as

[31] OECD (n 17) 93–99.

[32] Coolidge and Yılmaz (n 25) 1–2.

[33] Engelschalk and Loeprick (n 12) 24–28.

[34] Coolidge and Yılmaz (n 25) 2–3.

[35] OECD (n 17) 96–97; Engelschalk and Loeprick (n 12) 34–35.

[36] OECD (n 17) 96.

[37] Engelschalk and Loeprick (n 12).

a percentage of annual turnover) is high, it may discourage many businesses from enrolling in the system or properly complying.[38] For instance, Indonesia imposed a turnover tax on MSMEs at an annual tax rate of 1% in 2013 and, because of the low compliance rate, reduced the turnover rate to 0.5% in 2018.[39]

4) *The indicator-based tax*: this system involves using a specific indicator to work out business income and consequently the tax base and the resulting tax liability. The indicators include, for example, number of employees, electricity/water usage (e.g., for workshops), business area (e.g., restaurant area and number of tables). It is essential to set a good indicator which is easy to verify and difficult to manipulate and comprises a good measure of income. This system is implemented by many countries such as Spain, Italy and Argentina.[40]

5) *The agreement-based tax*: this tax is based on concluding an agreement between a tax authority and a taxpayer. This system typically applies to businesses of a specific nature. However, there is a high probability of corruption which may increase the compliance costs or may negatively affect government revenue.[41]

(b) Cash Accounting

Accounting systems normally apply on an accrual basis in the measurement of income and expenses. Such systems are complex and require professional accountants to implement, and are thus difficult and costly for MSMEs to use. For this reason, a country's tax legislation may allow small businesses to use a cash accounting system as a simple alternative to accrual accounting. Cash accounting systems use gross takings and payments in cash to measure business income. In this way, the use of cash accounting differs from application of a presumptive tax as it will still depend on the normal tax rules for determining income, as measured on the basis of cash inflow/outflow. This system is again implemented by many countries, both developed and developing, such as Austria, Canada (farming sector), Chile, Sweden and Turkey.[42]

(c) VAT Measures for MSMEs

The VAT now represents the main indirect tax in most countries around the world. The design of the VAT implies that the ultimate consumer bears the VAT burden through the following mechanism: (i) businesses pay VAT to suppliers on their purchases of goods and services (input tax); (ii) businesses also charge VAT on their sales of goods and services to customers (output tax); and, (iii) businesses deduct input tax from output tax and remit the difference to tax authority, or claim a refund where input tax exceeds output tax. This mechanism theoretically entails that businesses (including MSMEs) do not bear the

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38 Coolidge and Yılmaz (n 25) 2–3.

39 Herni Kurniawati and Septian Bayu Kristanto, 'The Taxation Constraints and Potential Solutions for Indonesian MSMEs' (2021) 15(4) *International Journal of Innovation, Creativity and Change* 968.

40 Engelschalk (n 27) 68.

41 Ibid 72–74.

42 OECD (n 17) 99–100.

burden of the VAT.[43] Thus, it is expected that MSMEs will not pay VAT but will work as intermediaries between consumers and the tax authority.[44] This role as an intermediary raises a compliance issue, and as VAT compliance has been considered a critical challenge facing MSMEs a number of studies to date have focused on methods for simplifying this MSME tax compliance role in order to minimise the compliance costs involved.[45]

In the above context, governments employ a number of measures to mitigate the VAT compliance burden on MSMEs. One such measure involves setting a high threshold for registration to bring a business within the VAT system so as to exclude SMEs from the VAT net, an approach that is implemented by many countries such as France, Ireland, Poland and the United Kingdom.[46] In this situation, unregistered businesses pay VAT on their inputs but do not charge VAT on their sales of goods and services, and as a result VAT is considered as a normal cost element, which raises the prices of their goods and services.[47]

A number of other approaches can also be taken to simplify VAT compliance for MSMEs such as simplified bookkeeping systems, use of cash accounting, reduced filing frequency, etc. These mechanisms may overlap with simplification of compliance with regard to income tax, which will be discussed in detail in the Egyptian case in the next Part.

III The Egyptian MSME Tax Regime

A *Main Features of the MSME Tax Regime*

1 *MSME Definition*

The starting point for providing preferential tax treatment or designing a specific tax regime for MSMEs is to establish a definition of the MSMEs that are to be eligible for the preferential rule or subject to the specific regime. Countries employ a number of criteria for defining MSMEs, such as paid-in capital, annual turnover and number of employees. These criteria may be implemented differently among countries or as between one industry and another within a particular country. Furthermore, there may be different definitions of an MSME for different purposes in the one country, as there may be a definition for statistical purposes and another for tax purposes.[48]

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43 Alan A. Tait, *Value Added Tax: International Practice and Problems* (International Monetary Fund, 1988).

44 I. Dickson, 'The New Zealand GST Policy Choice: An Historical and Policy Perspective' in Richard Krever and David White (eds), *GST in Retrospect and Prospect* (Thomson Brookers, 2007) 45–48.

45 OECD (n 17).

46 For further discussion about the setting of an optimal VAT and GST threshold, see Yige Zu, 'VAT/GST Thresholds and Small Businesses: Where to Draw the Line?' (2018) 66(2) *Canadian Tax Journal* 309.

47 Tait (n 43) 53–58.

48 OECD (n 17) 18.

In Egypt's case, the new MSME Law 2020 and the executive regulations made under it provide a specific definition of MSMEs, as set out in Article 1 of that Law. This definition of MSMEs is based on two alternative criteria of paid-in capital or turnover, the application of which also varies across different industrial activities. Table 1 below summarises this definition of MSMEs for Egyptian tax purposes.

TABLE 1: MSME CLASSIFICATIONS

BUSINESS SIZE	BUSINESS TYPE	PAID-IN CAPITAL (EGP)	ANNUAL TURNOVER (EGP)
Micro	Non-Industrial	less than 50,000	Less than 1,000,000
	Industrial	50,000	
Small	Non-Industrial	50,000 – 3,000,000	1,000,000 – 50,000,000
	Industrial	50,000 – 5,000,000	
Medium	Non-Industrial	3,000,000 – 5,000,000	50,000,000 – 200,000,000
	Industrial	5,000,000 – 15,000,000	

Source: MSME Law 2020 (Egypt).

The MSMEs that meet the criteria in Table 1 above are required to register with the MSME authority in accordance with Article 54 of the MSME Law 2020. The annual registration fees for businesses in each size category are as follows: (i) micro businesses, up to EGP 500; (ii) small businesses, up to EGP 2,000; and, (iii) medium businesses, up to EGP 5,000. Article 20 of the executive regulations provides further details about registration fees for each size of business based on their paid-in capital.

2 *Tax Incentives for MSMEs*

The MSME Law 2020 provides a number of tax incentives for MSMEs as set out in Articles 27 to 31. These tax incentives are:

1) MSMEs are exempted from stamp duties, business registrations fees, and contract registration fees for informal businesses, when they become registered as a formal business in accordance with Article 27. MSMEs are required to obtain a certificate from the MSME authority granting the abovementioned exemption according to Article 80 of the executive regulations.

2) Plant and machinery items imported by MSMEs are subject to 2% customs tariffs in accordance with Article 28. It is expected that the Minister of Finance will issue a decree stating the terms for enjoying this reduced customs tariff according to Article 81 of the executive regulations.

3) Capital gains derived by MSMEs from the sale of capital assets are exempt from income tax when the sale proceeds are used in acquiring other capital assets pursuant to Article 29. Nevertheless, an eligible business is required to keep a regular account book in accordance with Article 82 of the executive regulations. If the business fails to satisfy this condition, its capital gains will be taxable according to the normal income tax provisions.

4) Dividends paid by one-person companies are exempt from income tax according to Article 31.

Furthermore, Article 83 of the executive regulations states that an eligible business is required to keep regular account books to enjoy any of the abovementioned incentives. The required account books are: (1) general journal; (2) stocktaking book; (3) sales book; and, (4) purchasing book. MSMEs are allowed to use a computerised accounting system to maintain these books.

B *The Specific Tax Regime for MSMEs*

The MSME Law 2020 introduces a specific tax regime for MSMEs replacing the income tax provisions under the Income Tax Law 2005. The specific tax regime for MSMEs imposes a lump sum tax on micro businesses and turnover tax on small businesses.

1 *Lump Sum Tax on Micro Businesses*

According to Article 93 of the MSME Law 2020, micro businesses with an annual turnover of less than EGP 1 million are classified into three categories based on the annual turnover and each category pays a lump sum tax based on the annual turnover amount. The lump tax for each category is shown in Table 2 below.[49]

TABLE 2: LUMP SUM TAX ON MICRO BUSINESSES (EGP)

BUSINESS TURNOVER		ANNUAL LUMP SUM
1	Less than 250,000	1,000
2	From 250,000 to less than 500,000	2,500
3	From 500,000 to less than 1 million	5,000

The lump sum tax is imposed on micro businesses based only on annual turnover which deviates from the definition of micro business provided by Article 1 of the MSME Law 2020 setting out both paid-in capital and annual turnover criteria. As the MSME tax regime provides tax treatment to micro businesses and small businesses which have

[49] MSME Law 2020 (Egypt).

annual turnover less than EGP 10.0 million, small businesses which will have a turnover more than the thresholds in Table 2 are excluded from the lump sum tax as well as medium businesses.

2 *Annual Turnover Tax for Small Businesses*

The turnover tax is imposed on small businesses with annual turnover of less than EGP 10.0 million and is imposed at progressive rates. In this context, Article 93 of the MSME Law 2020 imposes a turnover tax on small business in three categories as follows:

- a business with turnover of EGP 1.0 million or more and less than EGP 2.0 million is subject to a turnover tax at 0.5% of annual turnover;
- a business with a turnover of EGP 2.0 million or more and less than EGP 3.0 million is subject to a turnover tax at 0.75% of annual turnover; and
- a business with a turnover of EGP 3.0 million or more and less than EGP 10.0 million is subject to a turnover tax at 1.0% of annual turnover.

As a result of the above provisions, small businesses with annual turnover of EGP 10.0 million or more are not eligible to apply the turnover tax (even though the main definition of small business under Article 1 of the MSME Law 2020 includes all businesses with a turnover of EGP 1.0 million or more and less than EGP 50.0 million).

3 *General Provisions of the MSME Tax Regime*

The MSME Law 2020 has specific provisions for determining the annual turnover of eligible businesses (taxpayers). Article 95 states that the annual turnover is determined based on one of the following measures:

- the last tax assessment year's income tax liability issued by the Egyptian Tax Authority (ETA);
- the reported annual turnover amount disclosed in the first tax return filed by a taxpayer at the date of enactment of the law; and
- the amount in an annual tax return filed after enactment of this law.

The annual turnover under this specific tax treatment will be used as a basis for the tax assessment of eligible businesses for a period of five years subject to the outcome of a tax audit that is carried out by the ETA.

The MSME tax regime exempts eligible MSMEs from keeping regular accounting books and related documents according to Article 97 of the MSME Law 2020. Nevertheless, the Minister of Finance has the right to issue a simple bookkeeping system requirement that is suited to their specific nature.

An eligible taxpayer (eg, micro, or small business) is allowed to terminate their operations using the MSME tax regime and start implementing the provisions of the ITL 2005 according to Article 98 based on the following terms:

1) if a taxpayer realises losses during the taxable period; or

2) if a taxpayer finds that its tax liability is going to be lower under the ITL 2005 provisions compared with the MSME tax regime.

In either of the abovementioned cases, a taxpayer may exit the MSME tax regime after notifying the ETA. However, a taxpayer cannot then return to the MSMEs tax regime for at least five years.

IV Assessing and Analysing the MSME Tax Regime

A *Overview*

The MSME Law 2020 introduces new tax measures which deviate from the ITL 2005. In order to assess the specific tax regime for MSMEs, it is essential to shed light on the main differences between these measures and the ITL 2005. There are four main such differences:

1) The MSME tax regime imposes a lump sum tax on micro businesses and turnover tax on small businesses irrespective of their legal form, whether self-employed, sole proprietor, partnership, etc. However, the ITL 2005 differentiates between individual taxpayers and taxpayers taking other legal forms ('legal persons') such as partnerships, a limited liabilities companies, corporations, etc.
2) The ITL 2005 imposes progressive tax rates on individual taxpayers and a flat tax rate on legal persons. According to Law No 26 of 2020, amending the ITL 2005, individual tax rates apply starting from a 0.0 rate on income bracket EGP 1.0 to EGP 15,000 and rising to 25% on income above EGP 1.0 million. Legal persons are subject to a flat tax rate of 22.5%.[50]
3) Dividends paid by legal persons are subject to withholding tax at a 10% rate according to Article 56a of the ITL 2005. However, as noted previously dividends paid by a one-person company (e.g., micro, small businesses), are exempt from tax according to Article 31 of the MSME Law 2020.
4) Individuals or legal persons who are subject to the MSME Law 2020 are exempt from the bookkeeping requirements under the ITL 2005. According to Article 78 of the ITL 2005, all legal persons are required to keep regular accounting books. Furthermore, business taxpayers conducted by individuals with either paid-in capital of at least EGP 50,000, or with an annual turnover of at least EGP 250,000, are also required to keep regular accounting books.

B *Assessing Egypt's MSME Regime Against the Criteria of a Good Tax System*

1 *Economic Efficiency*

As highlighted in Part IIA, MSMEs face a number of challenges specific to them including market failure and market imperfection issues which require government intervention through corrective measures in order to achieve economic efficiency. In general, it has

[50] Income Tax Law No 91 of 2005 (as amended) (Egypt).

been established that taxation creates distortions which reduce economic efficiency. However, in a case of market failure/imperfection which is attributed to negative or positive externalities, taxation can play an important role to correct such market failure through corrective tax measures, which are known as Pigouvian taxes.[51] The MSME tax regime in Egypt introduces new measures, which aim to minimise the tax burden on micro and small businesses, as discussed in Part IIIB. These new tax measures impose a lump sum tax on micro business, which satisfies the economic efficiency criterion of a good tax system.[52] Furthermore, small businesses with a turnover of EGP 1 million or more and less than EGP 10 million are subject to low progressive tax rates on their annual turnover compared with tax rates under the regular ITL 2005 as will be explained later in this Part and in Table 4. This reflects the interest of policymakers to address the specific nature of small business and the need to minimise their tax liability through imposing a low tax rate, which satisfies the Pareto efficiency requirement.[53] Accordingly, the MSME tax regime satisfies the economic efficiency criterion. We also note that the lump sum tax imposed on micro businesses is known to be highly efficient as it does not distort taxpayers' behaviour.

2 *Equity/Fairness*

The modern equity criterion means that a tax system imposes tax liability on taxpayers according to their ability to pay. More specifically, there are two types of equity, namely vertical and horizontal. Vertical equity means that taxpayers who differ in their ability to pay should bear a different tax burden through a progressive tax schedule. Horizontal equity implies that taxpayers with a similar ability to pay should bear the same tax burden.[54]

The equity criterion in the case of the MSME tax measures implies that businesses of a similar size (in terms of turnover, number of employees, etc.) should bear the same tax burden. Nevertheless, the tax system may, in many cases, indirectly favour specific type of MSMEs, while disadvantaging other types of MSMEs. This results in a lack of fairness or equity in taxing some types of MSMEs.

In order to analyse the MSME tax regime in Egypt from an equity perspective, it can be noted that there are a number of situations in which the new MSME tax regime lacks equity, as set out further here.

1) The ITL 2005 has specific provisions for measuring taxable income arising from commercial activities. Nevertheless, there are different measures between individuals and legal person taxpayers, especially relating to the tax rate. The new

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51 Alan Randall, 'The Problem of Market Failure' (1983) 23(1) *Natural Resources Journal* 131.

52 Alan J. Auerbach and James R. Hines Jr, 'Taxation and Economic Efficiency' in Alan J. Auerbach et al (eds), *Handbook of Public Economics* (North-Holland, 1985–2013) vol 3, 1347.

53 Brito et al, 'Pareto Efficient Tax Structures' (1990) 42(1) *Oxford Economic Papers* 61.

54 Richard M. Bird and J. Scott Wilkie, 'Designing Tax Policy: Constraints and Objectives in an Open Economy' (International Center for Public Policy Working Paper 12–24, Andrew Young School of Policy Studies, Georgia State University, April 2012) <https://icepp.gsu.edu/files/2015/03/ispwp1224.pdf>.

MSME regime applies to micro and small business irrespective of their legal forms, as demonstrated in scenario 1 below.

2) Further, in order to implement the MSME tax regime, micro or small businesses are required to register with the MSME authority and pay the registration fees. As a result, if there are two businesses with the same turnover, one may be registered with the MSME authority and the other not.[55] The former is going to pay tax in accordance with the MSME tax regime, while the latter will be subject to the ITL 2005. Therefore, the registered business will bear a lower tax burden compared with unregistered business. Further, if the unregistered business is a legal person paying tax under the ITL 2005 it is going to bear a high tax burden. This indicates a lack of horizontal equity, as scenario 1 below demonstrates.

3) Thirdly, small businesses are heterogeneous as they work in different industries with different profit margins. Accordingly, if there are two businesses in two different industries, the first may be a business with a high profit margin and the second a business with a low profit margin. As a result, the first will have a high taxable income and it will pay a high tax liability under the ITL 2005 and the second will have a low taxable income and consequently it will pay a low tax liability under the ITL 2005. Nevertheless, under the new MSME tax regime both will pay the same lump tax or turnover tax. This indicates that the new system lacks vertical equity. This will be elaborated in scenario 2.

(a) Scenario 1: Lump Sum Tax

i) Assume that we have businesses of three different sizes (based on annual turnover), and that the businesses of each size are also in the following three situations (A, B, and C) respectively (for a total of nine businesses): A is a micro business eligible to apply the MSME tax regime; B is an individual taxpayer subject to the ITL 2005, and C is a legal entity that is subject to the ITL 2005.

ii) Assume further that for all of situations A, B and C, annual turnover is EGP 200,000 for three of the businesses and the profit margin is 10%; taxable income is then going to be EGP 20,000. As a result, according to the MSME Law, business A is subjected to a lump sum tax and the other two cases (B and C) are going to pay tax based on their taxable income according to the ITL 2005. These outcomes are set out in row 1 of Table 3.

iii) Next assume the annual turnover is EGP 400,000 for the three cases and the profit margin is 10%, so that taxable income is going to be EGP 40,000. According to the MSME Law business A is subject to a lump sum tax (micro business) and the other two (B and C) cases are going to pay tax based on their taxable income according to the ITL 2005; see row 2 of Table 3.

[55] Initially, any micro or small business can formally conduct its business through obtaining commercial registration and a tax file number on the basis of its existence at the time. Nevertheless, registration with the MSME authority is necessary to obtain various services or enjoy incentives granted by the MSME Law 2020.

iv) Then assume annual turnover is EGP 900,000 and the profit margin is 10%, so that taxable income is EGP 90,000. According to the MSME Law business A is subject to the lump sum tax and the other two cases (B and C) are going to pay tax based on their taxable income according to the ITL 2005; see row 3 of Table 3 below.

Table 3: Comparative Table of Tax Payable under Three Cases, Lump Sum Tax and ITL 2005 (EGP)

Size Category	Annual Turnover	Case A (MSME Law)	Case B (ITL 2005, Individual)	Case C (ITL 2005, Legal Person)
1	200,000	1,000	125	4,500
2	400,000	2,500	625	9,000
3	900,000	5,000	6,375	20,250

Table 3 above shows that the MSME Law imposes a lower tax burden in case (A) compared with the ITL 2005 in case (C) for all turnover amounts. However, for individual taxpayer (B), the tax burden is lower under the ITL 2005 in rows 1 and 2 compared with the MSME tax regime in case (A). However, the tax burden of case A in row 3 is lower under the MSME regime compared with the ITL 2005 in cases B and C in row 3. This indicates the MSME tax regime has advantaged the legal person in all cases and has disadvantaged individual taxpayers (B) with an annual turnover less than EGP 500,000. This scenario generally reflects a lack of horizontal equity as between MSME legal entities eligible for the MSME tax regime and legal entities subject to the ITL 2005. In addition, the system lacks vertical equity as a result of the heterogeneity of MSMEs and different profit margins between industries as previously explained.

(b) Scenario 2: Turnover Tax

i) Assume there are further businesses of different size categories which are individual and legal person taxpayers. Under each size, there are the three possibilities D, E and F: micro/small business (D) is eligible to the MSME tax regime, individual taxpayer (E) earns income from professional services, and legal entity (F) is subject to the ITL 2005.

ii) Assume further that the annual turnover is EGP 1,500,000 for the three cases and the profit margin is 10%, so that taxable income is EGP 150,000. According to the MSME Law, business D is subject to tax of 0.5% on turnover and the other two cases (E and F) are going to be taxed according to the ITL 2005; see row 1 of Table 4.

iii) Next assume that the annual turnover is EGP 2,000,000 for the three cases and the profit margin is 10%, so that taxable income is EGP 200,000. According to the MSME Law, business D is subject to tax of 0.75% on turnover and the other two (E and F) cases are going to pay tax based on their taxable income according to the ITL 2005; see row 2 of Table 4.

iv) Then assume that the annual turnover is EGP 6,000,000 for all three cases and the profit margin is 10%, so that taxable income is EGP 600,000. According to the

MSME Law, business D is subject to tax of 1.0% on turnover and the other two cases are going to pay tax based on their taxable income according to the ITL 2005; see row 3 of Table 4 below.

TABLE 4: COMPARATIVE TABLE OF TAX PAYABLE UNDER THREE CASES, TURNOVER TAX AND ITL 2005 (EGP)

SIZE CATEGORY	ANNUAL TURNOVER	CASE D (MSME LAW)	CASE E (ITL 2005, INDIVIDUAL)	CASE F (ITL 2005, LEGAL PERSON)
1	1.5 million	7,500	22,125	33,750
2	2.0 million	15,000	32,125	45,000
3	6.0 million	60,000	12,7125	135,000

Table 4 above indicates that the micro/small businesses of all three sizes are going to pay less tax under the turnover tax (column 3) compared with the taxpayers subject to the ITL 2005 provisions (columns 4 and 5). This reflects the lack of horizontal equity where taxpayers earning the same income are not bearing the same tax burden. Further, as previously discussed, vertical equity is not attained due to the heterogeneity of MSMEs.

Based on the above-mentioned analysis, the MSMEs is generous, which is reflected in the low levels of the lump sum tax and rates of turnover tax has resulted in creation of a regime that is inequitable as between different types of taxpayers and is also unproductive in terms of revenue collected. As a result, it is necessary to consider the equity criteria and tax expenditures relating to the system, which will require frequent assessment of the system in terms of its costs and benefits.

3 *Simplicity*

Simplicity is an essential criterion of a good tax system since it plays a critical role for tax compliance and enforcement of tax law. It refers to legal provisions and regulations which are unambiguous and comprehensible by taxpayers, professionals, and tax administrators. Thus, simplicity helps taxpayers to minimise their compliance costs and the tax authority to minimise tax collections costs, which together result in lower operating costs of a tax system.[56]

(a) Legal Simplicity

The MSME tax regime aims to simplify tax compliance for MSMEs through introducing new measures for both micro and small businesses to work out their tax base and pay their tax liability. This implies reducing the number of procedures for assessing the tax

56 Chris Evans, Philip Lignier and Binh Tran-Nam, 'Tax Compliance Costs for the Small and Medium Enterprise Business Sector: Recent Evidence from Australia' (Tax Administration Research Centre Discussion Paper No 003-13, University of Exeter Business School, 2013) https://tarc.exeter.ac.uk/media/universityofexeter/businessschool/documents/centres/tarc/publications/discussionpapers/13_09_24_Evans_Tax_compliance_costs_in_SMEs_Exeter.pdf>.

liability for micro and small businesses so as to achieve procedural simplicity.[57] Furthermore, it is expected that the assessment of tax liability under the new regime will be simple as there is a clear-cut indicator for imposing tax on annual turnover. This will result in reduction of tax disputes and encouragement of MSME growth. Further, tax assessments of micro or small business will be applicable for five years, minimising both tax compliance costs and tax collection costs, and as a result lowering the operating cost of the tax system.[58]

Nevertheless, the MSME tax regime does not meet the criteria for legal simplicity in relation to the requirements to obtain tax incentives under Articles 27 to 31, as previously discussed in Part IIIB. MSMEs are required to maintain regular accounting books according to Article 38 of the MSME Law and the executive regulations if they wish to claim tax exemption for capital gains or dividends. These conditions do not contribute to meeting the simplicity criterion, and it may be difficult for MSMEs to satisfy such conditions which would also make the tax incentives ineffective.

(b) Accessing the System

Generally, the new system eliminates several procedures involved in tax assessment and reduces the number of procedures for working out taxable income and tax liability. Nevertheless, in order to implement the MSME special regime, a taxpayer needs to register with the MSME authority, even though it may already be operating as part of the formal economy. So, requiring registration with the MSME authority for existing businesses is going to complicate the system, and discriminates between registered and non-registered taxpayers as discussed in Part III.B above.

To sum-up the MSME tax regime needs to be accessible by all micro and small businesses through the ETA, when they meet the turnover condition. It is also important that the tax authority be given full control in managing the system without intervention from a third party in order to minimise any potential complexity of the system and reduce the scope for tax disputes.

(c) E-Filing

In 2019, legal person taxpayers commenced lodgement of their VAT and income tax returns online using the ETA's online platform. From January 2021, all individual taxpayers, regardless of their business size or type, are required to lodge their tax return online according to Minister of Finance Decree No 296 of 2020. Pursuant to Article 29 of the Unified Tax Procedures Law No 206 of 2020, all taxpayers are obliged to use e-filing for their income tax or VAT return. This reflects the interests of ETA to simplify the process of tax compliance for all taxpayers including MSMEs. Nevertheless, technological illiteracy represents a challenge to e-filing of tax returns, especially for MSMEs. A report issued by USAID/Egypt in 2020 identifies that technological illiteracy is a critical

[57] Chris Evans and Binh Tran-Nam, 'Managing Tax System Complexity: Building Bridges Through Pre-Filled Tax Returns' (2010) 25(2) *Australian Tax Forum* 245, 249.

[58] Evans, Lignier and Tran-Nam (n 56).

challenge for financial inclusion and digital transformation of MSMEs.[59] Therefore, the ETA is required to provide support for micro and small businesses to use online filing in order to effectively simplify their tax compliance. Furthermore, taxpayers will pay registration fees for using the ETA's online platform according to Minister of Finance Decree No 21 of 2021. This is going to increase tax compliance costs and will impose a further burden on micro and small businesses. Thus, it is recommended that free access be provided to the ETA online platform for micro and small businesses.

To sum-up, implementation of e-filing of tax returns should take into account the technological illiteracy of many MSME owners and managers, and the difficulty for them in using online services, forcing them to use professional services and consequently increasing their tax compliance costs. As a result, it is necessary for new ways to be found to help MSMEs to comply smoothly with the regime at a minimum cost.

4 *Revenue Adequacy*

An important function of a tax system is to collect targeted revenues to finance government expenditures, which reflects the productivity of a tax system. Sneed has stated that revenue adequacy is an important criterion of a good tax system, revenue adequacy referring to the productivity of the tax system in terms of collected revenues.[60] Revenue adequacy is affected by both the design of the tax law and the rates of tax. As a result, it is expected that the design of the MSME tax regime will have an impact on tax revenue in Egypt and therefore also the government expenditures financed by that revenue. This impact can be assessed through comparing the tax burden of MSMEs under the ITL 2005 and the new MSME tax regime. Referring to the two scenarios previously discussed in Part IVB2, it can be seen that there is a significant reduction of the tax due from the micro and small business legal person taxpayers under the MSME tax regime compared with the regular ITL 2005 (as illustrated in Tables 3 and 4). A similar outcome arises for individual taxpayers in a case of a business with a high turnover under the lump sum tax and businesses under the three categories of size for the turnover tax as also illustrated in Tables 3 and 4. This indicates that the MSME tax regime will have a negative impact on tax revenues. Therefore, under the new system the collected taxes are going to be lower than was the case under the regular ITL 2005.

The reduction in tax revenue as a result of implementing the MSME tax regime can be considered as a kind of subsidy to MSMEs, known generally as a tax expenditure.[61] As a result, the revenue adequacy criterion for assessing the MSME tax regime is less important than considering the potential positive externalities from MSMEs and related spill over effects. Nevertheless, it is important to assess the tax expenditure results from this type of tax incentive in order to assess its effectiveness to stimulate MSMEs in the future.

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59 USAID/Egypt, *Private Sector Landscape Assessment* (USAID/Egypt, October 2020) 40–41 <https://www.integrallc.com/portfolio-item/egypt-private-sector-landscape-assessment/#top>.

60 Joseph T. Sneed, 'The Criteria of Federal Income Tax Policy' (1965) 17(4) *Stanford Law Review* 567, 569–570.

61 Lanre Kassim and Mario Mansour, 'Tax Expenditures Reporting in Developing Countries: An Evaluation' (2018) 26 *Revue D'Économie du Développement* 113.

To sum up, it is necessary to make tax assessment under the regime an annual process in view of the scope for changes in circumstances of individual businesses, overall economic changes, and inflation rates. This ensures that tax revenues collected will be pro-cyclical with economic and business circumstances and that acceptable levels of tax revenues can be secured from micro and small businesses.

C *Implementation Issues of the MSME Tax Regime*

1 *MSMEs under the VAT Law*

The MSME Law of 2020 provides specific definitions for the three business sizes, namely, micro, small and medium, as was discussed in Part IIIB1. Micro businesses are those businesses with annual turnover less than EGP 1 million, which are subject to the lump sum tax. Accordingly, they are not required to maintain regular accounting books according to the ITL 2005. By contrast, the VAT as introduced by Law No 67 of 2016 ('VAT Law 2016')[62] has a registration threshold of EGP 500,000 for any business whether it provides goods or renders services in accordance with Article 16 thereof. The registration threshold implies that a micro business with an annual turnover EGP 500,000 is required to be VAT registered with ETA according to Article 16 of the VAT Law 2016. Thus, they must fulfil the VAT compliance requirements which include three main commitments: (1) issuing an invoice for each sale transaction in accordance with Article 12 of the VAT Law 2016; (2) keeping regular accounting books in accordance with Article 13 of the VAT Law 2016; and, (3) filing monthly VAT returns in accordance with Article 14 of the VAT Law 2016. These are ongoing commitments under the VAT Law which are inconsistent with the MSME tax regime, especially for micro businesses, and as a result greater coordination between the MSME Law and VAT Law is required. Such coordination could include the following: (1) increasing the VAT registration threshold to EGP 1.0 million so as to exclude micro businesses from the VAT net and consequently minimise their compliance burden; (2) imposing a unified measure for bookkeeping requirements for VAT and income tax with regard to small businesses with turnover of EGP 1.0 million or more; and, (3) minimising the filing frequency for small businesses so that returns are only required on a quarterly basis.

2 *Inherited Practice Issues*

There are a number of inherited practices developed prior to enactment of the tax MSME regime which may negatively influence the implementation of that regime, as set out further below.

1) The first type of inherited practices relates to poor administrative practices which led to the failure of implementation of self-assessment as specified by Article 89 of the ITL 2005. As a result, Article 94 of the law was amended in 2013 by Law No 11 of 2013 in order to authorise the tax authority to conduct tax audits of all taxpayers, except those taxpayers who maintain regular accounting books.

[62] The VAT Law No 67 of 2016 abolished the former sales tax which was imposed under General Sales Tax Law No 11 of 1991.

Accordingly, all taxpayers who do not have regular accounting books are audited, but as a result of the very large number of micro and small taxpayers,[63] the conduct of tax audits is arbitrary and consequently there is an increasing number of disputes between the tax authority and taxpayers. This indicates the need to improve the tax practices of the tax officers irrespective of any tax legislation. This entails focusing more on improving tax compliance and developing a tax compliance strategy for MSMEs.

2) The second type of such practices relates to the 'losers' from implementing the new system, that may include tax professionals. According to the ITL 2005, there are many procedures involved in tax compliance, from filing the tax return, through to tax audits and possible tax disputes which increases the tax compliance costs borne by MSMEs. However, simplifying the system may reduce the payments to tax professionals and increase the resistance of enrolling in the new system.

3) The third type of such practices relates to the possible resistance that may arise from corrupted officers given that greater complexity of the tax system increases the discretionary power of tax officials and leads to an increased opportunity of corruption. Thus, simplifying the tax system will reduce the corruption opportunity, which may result in resistance to proper implementation from corrupted officers.[64]

Overcoming the negative impacts of inherited practices requires finding new approaches to bring about the following changes: (1) bureaucratisation of the mindset for drafting administrative rulings; (2) inclusion of tax professionals within the change process to minimise their resistance to change; and, (3) as an essential matter, gaining the support of tax officials and minimising corruption through developing proper measures for rewarding such officers financially based on increased MSME tax compliance.

To sum-up, a critical element for the successful implementation of any new tax legislation, including an MSME tax regime, is building the capacity of the tax authority and developing a strategic plan for improving MSME tax compliance.

V Concluding Remarks

Numerous tax researchers have identified the distinctive nature of MSMEs and the importance of designing favourable policies and drafting specific legislation to support them. This includes, for example, designing a specific tax regime or other tax measures to stimulate MSME growth and minimise their tax burden and tax compliance costs. Accordingly, many developed and developing countries have ratified specific MSME tax measures or regimes targeting micro and small businesses. In this context, in late 2020 Egypt introduced comprehensive legislation for stimulating micro, small and medium

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[63] According to the OECD, there were 3.8 million micro and small enterprises in Egypt in 2017. For further detail, see OECD, *The Mediterranean Middle East, and North Africa 2018: Interim Assessment of Key SME Reforms* (OECD Publishing, 2018) 97 (ch 7, 'Egypt').

[64] OECD, *OECD Investment Policy Reviews: Egypt 2020*, OECD Investment Policy Reviews (OECD Publishing, 2020) 23.

enterprises under Law No 152 of 2020. That Law introduces various measures governing MSMEs including tax and non-tax incentives and a specific tax regime for MSMEs.

This article assesses Egypt's MSME tax regime against the principles of a good tax system and identifies the potential implementation challenges. It utilises a positive and analytical approach to assess the new MSME tax regime. Based on that approach, the following results are obtained:

1) The MSME tax regime is designed to serve the specific nature of MSMEs and to help them to overcome the market failure and market imperfection issues they face. In doing so, the MSME tax regime provides a number of tax incentives. Moreover, a specific MSME tax regime was introduced including a lump sum tax and turnover tax replacing for MSMEs the income tax provisions under the ITL 2005. It is known that the lump sum tax is an efficient form of tax and does not create economic distortions, and the tax on annual turnover also applies at a low rate. Accordingly, both the tax incentives and new tax measures are going to minimise the tax burden on MSMEs, thus satisfying the economic efficiency criterion.

2) The lump tax and turnover tax are also important tools for simplifying a tax system. Use of these taxes will minimise MSME tax compliance costs. Nevertheless, in order to broaden the scope of the new MSME tax regime, the requirement for registration with the MSME authority should be removed and the system made available to all micro and small businesses when they satisfy the turnover condition. This can be directly implemented by the ETA and will further minimise tax compliance costs. Also, the ETA should be responsible for managing all elements of the system in order to avoid any potential legal issues which may result from a tax audit. For example, a small business taxpayer may obtain a certificate from the MSME authority that it is eligible to implement the MSME tax regime. However, when the ETA conducts a regular tax audit, it may find that the taxpayer's turnover is above the MSME tax regime threshold and it is subject to the regular tax provisions of the ITL 2005. In such a situation, a tax dispute will arise between taxpayer and the ETA. Therefore, the ETA should have full control of the MSME tax regime.

3) Assessing the system from an equity perspective indicates that the system favours micro and small businesses registered with the MSME authority irrespective of their legal form as against other businesses which are not so registered, which does not satisfy the horizontal equity criterion. There is also vertical inequity due to the fact that the tax is imposed based on annual turnover regardless of the industry in which the taxpayer operates, while profit margins will differ from one industry to another. As a result, micro and small businesses in industries with a high profit margin are advantaged and vice versa.

4) Assessing the system from the perspective of revenue adequacy (productivity) indicates that the tax liabilities of micro and small business taxpayers will be lowered which result in a significant reduction in taxes paid taxes and consequently tax revenue collected. The reason for this anticipated decline in tax revenue relates to the low level of the lump sum tax and low rates of turnover tax, which reflect the substantial scale of the tax incentives to micro and small businesses. In this context, it is essential that the tax expenditure made through

implementing the MSME tax regime is measured so that the cost of the regime can be compared with the benefits.

5) A further issue affecting revenue adequacy relates to the provision for assessments of the tax liability of eligible micro and small businesses to be used for a period of five years, which ignores two important facts, namely the potential growth of businesses during that period which increases their annual turnover so that it may exceed the eligibility threshold, and the annual rate of inflation in the economy. As the annual inflation rate in Egypt has averaged around 10% over the period 2011–2020,[65] meaning that the tax burden of eligible micro and small businesses is declining in real terms under the MSEs tax regime. While government expenditures are increasing annually, tax revenue from micro and small business is declining.

6) Assessing the MSME tax regime from a practical perspective indicates the need for coordination of the regime with the VAT Law 2016. This implies increasing the VAT registration threshold to EGP 1 million in order to exclude micro business from the VAT net, as it is known that the bulk of micro business are owned by self-employed individuals or family businesses which are resource-constrained in complying with VAT requirements. For small businesses with a turnover EGP 1 million or more and less than EGP 10 million, minimising the frequency of filing VAT returns so as to be quarterly instead of monthly is also recommended. Also, the bookkeeping requirements should be unified under MSME tax regime and VAT Law 2016.

7) In order to minimise the resistance of tax professionals to the new system, it is essential that they be involved specific mechanisms developed to secure their support. In the meantime, any potential revenue losses from the implementation of the new system need to be minimised. In addition, it is necessary to handle any expected resistance resulting from corruption, through setting a financial reward system to tax officers based on an increased rate of MSME tax compliance.

[65] More information about the inflation rate in Egypt is available here, see Central Bank of Egypt, 'Inflation Historical' (Web Page, 2021) <https://www.cbe.org.eg/en/EconomicResearch/Statistics/Pages/Inflationhistorical.aspx>.

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THE THEORY OF THE FIRM: A TOOL TO UNDERSTAND COMPANY TAXPAYER COMPLIANCE BEHAVIOUR IN THE MINING SECTOR

RICHARD TAYLOR*

ABSTRACT

This article considers whether the theory of the firm can be used to understand company taxpayer compliance behaviour in the mining sector. The theory of the firm can provide insights into how companies behave and has been used, largely by economists, to address questions such as why companies exist, what strategies they employ and how they grow. The survey method was used to gather data to test whether mining company taxpayer compliance behaviour reflected simple profit maximisation or if it diverged. Aspects of the theory of the firm were used to explain divergence. More than 200 mining executives were asked to consider how a mining company would respond to several tax scenarios. The results indicated that compliance behaviour was not uniformly profit maximising and that understanding a company's strategy, management and individual circumstances were relevant to understanding how different companies would respond to tax changes. This article is significant for its use of the theory of the firm to understanding taxpayer compliance behaviour.

Keywords: theory of the firm, company behaviour, mineral taxation

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I INTRODUCTION

This article considers whether the theory of the firm can be used to understand taxpayer compliance behaviour in the mining sector. The mining sector was selected due to the substantial impact the sector can have on national economies, including Australia and other mineral dependent countries.[1]

The theory of the firm was developed by economists as a way of explaining why much of society's economic activity is organised in companies; understand differences between companies; and to predict company behaviour.[2] The theory of the firm was selected for this research because of its potential to explain why individual mining companies may respond differently when faced with the same mineral taxation changes.

While taxpayer compliance behaviour has sometimes been narrowly framed as the decision not to declare income and pay tax, known as tax evasion,[3] or tax avoidance, covering legal tax minimisation strategies,[4] in this article,[5] taxpayer compliance behaviour follows the broader formulation of Ohms et al: 'tax compliance [is defined as] the actions of a taxpayer in engaging in the set of statutory obligations cast upon them in respect of their annual total tax liability.'[6] The Ohms et al definition focuses on the taxpayer's broader behaviour and provides a wider scope to consider not only tax evasion and avoidance but also other taxpayer responses, including tax mitigation. Tax mitigation includes behaviour that can change income and tax liabilities such as structuring transactions, reducing investment or even closing operations.

In order to answer the research question, data was gathered on mining taxpayer compliance behaviour using the survey method. A questionnaire was constructed and administered to mining executives, and then analysed using the theory of the firm. The survey questions aimed to identify the potential effect of different agendas, assets, organisation structures and availability of information on company behaviour. Each of these areas was drawn from different branches of the literature on the theory of the firm, as explained in the methodology section of this article. The results indicated that mining

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1 Ross Garnaut, 'Principles and Practice of Resource Rent Taxation' (2010) 43(4) *Australian Economic Review* 347, 355; For an approach to estimating mineral dependence and the role of mining in dependent economies see International Council on Mining and Metals (ICMM), *The Role of Mining in National Economies: Mining's Contribution to Sustainable Development* (2016) 3–4.

2 David J. Teece, 'Theory of the Firm' in Mie Augier and David J Teece (eds), *The Palgrave Encyclopedia of Strategic Management* (Palgrave Macmillan UK, 2016) 1, 1741–1742.

3 Michael G. Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 1(3) *Journal of public economics* 323, 323.

4 Valerie Braithwaite and John Braithwaite, 'An Evolving Compliance Model for Tax Enforcement' in Neal Shover and John Paul Wright (eds), *Crimes of Privilege: Readings in White-Collar Crime:* (Oxford University Press, 2001) 406.

5 Richardson and Sawyer set out a starting proposition that all studies in this area 'should clearly set out the definition of tax compliance they have adopted.' Maryann Richardson and Adrian J. Sawyer, 'A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects' (2001) 16 *Australian Tax Forum* 137, 772.

6 Chris Ohms, Karin Oleson and Natalie Khin-Carter, 'Taxpayer Compliance Models: A Literature Review and Critique' (2015) 21 *New Zealand Journal of Taxation Law and Policy* 427, 428.

company taxpayer compliance behaviour was not uniform and when confronted with the same scenario, mining executives could respond in various ways, depending on the circumstances of their company at the time of the change rather than any compliance variables relevant to the individual.

This article follows a structure over several parts. Part II examines literature on taxpayer compliance behaviour and the theory of the firm. Part III sets out the research methodology. Part IV discusses the results from the survey. Part V uses the theory of the firm as a tool to analyse the survey results. Part VI concludes with the significance of using the theory of the firm to understanding company taxpayer compliance behaviour. The research contributes to the literature on individual taxpayer behaviour by considering companies, rather than individuals, and extends the application of the theory of the firm to taxpayer compliance behaviour.

II Literature on Taxpayer Compliance Behaviour and the Theory of the Firm

Studies into taxpayer compliance behaviour have mainly focussed on individuals[7] and tax evasion, defined as the decision whether to declare income and pay tax.[8] Although some studies have sought to extend research to include corporate behaviour[9] or expand behaviour beyond tax evasion to tax avoidance or mitigation,[10] there has not been extensive research into theories of company behaviour that might explain and predict tax mitigation behaviour by companies in response to tax changes.[11]

7 James Alm, 'Measuring, Explaining, and Controlling Tax Evasion: Lessons from Theory, Experiments, and Field Studies' (2012) 19(1) *International Tax and Public Finance* 54, 75.

8 See, eg, Allingham and Sandmo (n 4) 323; Erich Kirchler, Erik Hoelzl and Ingrid Wahl, 'Enforced versus Voluntary Tax Compliance: The "Slippery Slope" Framework' (2008) 29(2) *Journal of Economic Psychology* 210, 210–211.

9 See, eg, Catriona Lavermicocca and Jenny Buchan, 'Role of Reputational Risk in Tax Decision Making by Large Companies' (2015) 13(1) *eJournal of tax research* 5 that examined reputational effects of tax non-compliance on company behaviour; Jo'Anne Langham, Neil Paulsen, and Charmine E. J. Härtel, 'Improving Tax Compliance Strategies: Can the Theory of Planned Behaviour Predict Business Compliance?' (2012) 10(2) *eJournal of tax research* 364 which looked at mostly small businesses and their income declaration intentions.

10 Braithwaite and Braithwaite (n 5) 406; Elea Wurth and Valerie Braithwaite, *Tax Practitioners and Tax Avoidance: Gaming through Authorities, Cultures and Markets* (No 119, ANU School of Regulation and Global Governance (RegNet), 2016) 3.

11 The conclusion was reached after a year-by-year manual review of 12 of the major taxation journals in Australia, Europe and North America over a 12-year period was undertaken. The 12 years chosen were 2008-2020. The year range covers the majority of the publications where behavioural approaches have been utilised. The review identified 44 articles that looked at behavioural approaches to taxation, mainly individual compliance and only two (Lavermicocca and Buchan; Langham) that considered it from a company perspective separate from individuals or ownership.

A *Taxpayer Compliance Behaviour*

The importance of understanding taxpayer behaviour has been a feature of economic thought from its origin as a discipline.[12] However, it was not until the late 20th Century that models of individual taxpayer compliance behaviour emerged that sought to explain how non-compliance could fit within the assumption of rationality that underpinned the dominant classical and neoclassical economic schools of thought.[13] It was work by economists such as Gary Becker on rational choice and criminality[14] that paved the way for the Allingham and Sandmo model of tax evasion in 1972[15] which framed tax evasion as a decision under uncertainty. The taxpayer's decision whether to evade tax was a function of the probability that under-reporting income would be detected and the likely penalty that would be applied. However, subsequent empirical studies indicated that tax evasion was far less prevalent than the Allingham and Sandmo model might suggest, even where the likelihood of being caught or the penalties were low.[16] Work on the Compliance Pyramid developed by Braithwaite and the Australian Tax Office[17] sought to explain the difference by recognising different attitudes towards compliance held by taxpayers and recognising that many taxpayers are motivated to comply rather than evade tax. Kirchler's Slippery Slope model extended this to explain the motivation to comply as a combination of the power of tax authorities and the trust society has in those tax authorities.[18]

The literature on individual tax compliance behaviour is extensive and has been collated and analysed in several influential papers over the past 35 years.[19] Research into individual tax compliance has considered variables such as: age, gender, education,

12 See Smith's discussion on precious metal smuggling: Adam Smith, *The Wealth of Nations (1776), Ed. Andrew Skinner* (Penguin, 1999) 274.

13 The works of economists Adam Smith [1723–1790], John Stuart Mill [1806–1873], Thomas Malthus [1766–1834] and David Ricardo [1772–1823] form the basis of classical economics. Classical economists were concerned with how wealth was created, maintained and distributed. See Thomas Sowell, *On Classical Economics* (Yale University Press, 2006) 22–23. The neoclassical school which built on these works included Alfred Marshall [1842–1924] as one of its main contributors. Neoclassical economics focussed on the mechanism by which supply and demand resulted in a market outcome, a concept referred to as equilibrium analysis. The main assumptions underpinning neoclassical economics are that economic participants are rational, that they profit maximise and they are fully informed of all information. See Roy Weintraub, *The Concise Encyclopaedia of Economics* (online at 10 November 2019) 'Neoclassical Economics'.

14 Gary S. Becker, 'Crime and Punishment: An Economic Approach' (1968) 76(2) *The Journal of Political Economy* 169.

15 Allingham and Sandmo (n 4); See also discussion in Simon James, 'Taxation and the Contribution of Behavioral Economics' in *Handbook of Contemporary Behavioral Economics* (Routledge, 2006) 591.

16 Kirchler, Hoelzl and Wahl (n 9) 211.

17 Braithwaite and Braithwaite (n 5) 413; *Improving Tax Compliance in the Cash Economy: Report to Commissioner of Taxation* (Report, Australian Taxation Office and Cash Economy Tax Force, 1998) 53.

18 Kirchler, Hoelzl and Wahl (n 9) 211.

19 Betty R. Jackson and Valerie C. Milliron, 'Tax Compliance Research: Findings, Problems, and Prospects' (1986) 5 *Journal of Accounting Literature* 125; Richardson and Sawyer (n 6); Sue Yong et al, 'Tax Compliance in the New Millennium: Understanding the Variables' (2019) 34(4) *Australian Tax Forum* 766.

income level, income source, occupation, peer influence, ethics, fairness, complexity, revenue authority contact, sanctions, probability of detection, tax rates, compliance costs, tax preparers, framing, positive inducements and tax amnesties.[20] To this list of variables Yong et al added a further 19 concepts and variables, including trust, power, culture and religion among others.[21]

These approaches utilise insights from behavioural economics to explain taxpayer behaviour.[22] Behavioural economics has been described as the 'combination of psychology and economics that investigates what happens in markets in which some of the agents display human limitations and complications.'[23] Behavioural economics can be used to try to explain why some taxpayers do not engage in tax evasion regardless of the likelihood of consequences[24] or why perceptions of fairness can mean 'the difference between a successful tax and a failed one.'[25]

These behavioural economic approaches and techniques have been applied predominantly to individual taxpayers, small individual run businesses or entrepreneurs, rather than companies where ownership and control are separated and decision making delegated to a management team.[26] The behaviour of groups as opposed to individuals is subject to different psychological phenomena and requires the application of different tools from behavioural economics to examine such behaviour.[27] The theory of the firm is one such tool originating from a branch of behavioural economics concerned largely with group behaviour in a company.

B *Origins of the Theory of the Firm*

Before the theory of the firm, the focus in economics was on the determination of prices in markets. In the classical and the early neoclassical schools of economic thought, the role attributed to companies was limited to 'a passive conduit'[28] ensuring the efficient

20 Yong et al (n 20) 789.

21 Ibid.

22 Simon James, 'Behavioural Economics and the Risks of Tax Administration' (2012) 10(2) *eJournal of Tax Research* 345, 357.

23 S. Mullainathan and R.H. Thaler, 'Behavioral Economics' in Neil J. Smelser and Paul B. Baltes (eds), *International Encyclopedia of the Social & Behavioral Sciences* (Pergamon, 2001) 1094, 1094.

24 James Gordon, 'Individual Morality and Reputation Costs as Deterrents to Tax Evasion' (1989) 33(4) *European Economic Review* 797, 797; J.C. Baldry, 'Tax Evasion Is Not a Gamble: A Report on Two Experiments' (1986) 22(4) *Economics Letters* 333, 333.

25 James (n 23) 356.

26 Yong et al, for example, found only 9% of papers dealing with tax compliance concepts mentioned 'business taxpayer': Yong et al (n 20) 793.

27 Alm (n 8) 62; Irving L. Janis, 'Groupthink' (1971) 5(6) *Psychology Today* 43, 43.

28 Philip L. Williams, *The Emergence of the Theory of the Firm: From Adam Smith to Alfred Marshall* (Springer, 1978) 11.

allocation of resources, leading Coase, one of the founders of the theory of the firm, [29] to describe the corporation in economics at that point as being left as a 'black box.'[30]

C *The Theory of the Firm*

1 *Differences in Agenda*

Coase wrote his most significant contributions to the theory of the firm in the second half of the 20th Century.[31] His main contribution was the transaction-cost based theory of the firm. The transaction-cost theory provides a basis for a company to have objectives that differ from those that an individual owner, contractor or entrepreneur might have. According to Coase, the rationale for organising activity inside a company, and the ultimate size of a company, relates to the relative efficiency of employing people when compared to the transaction costs of individually contracting for each activity. This led to a distinction between two aspects of a company, its technical production capability and its institutional components managing the employment of others.[32] The transaction-cost theory provided a theoretical foundation to consider what the existence of these different groups and their different agendas could mean for company behaviour.

With Coase's institutional component came the principal and agent problem. Pitelis summarised the problem as:

> Whenever there exists a 'principal–agent' relationship, like for example employer–employee, or shareholder– manager, and when the interests of the two parties are not ex-ante fully aligned, agents may have discretion to pursue their own interests.[33]

These different interests and their degree of alignment have implications for the way decisions are made. Holstrom highlights that 'firm behavior is the result of a complex joint decision process within a network of agency relationships.'[34]Alvarez more poetically describes companies as 'deep pools of conflicting motives and interests—only some of which are purely economic in nature.'[35]

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29 Frank H. Knight, *Risk, Uncertainty and Profit* (Houghton Mifflin, 1921).

30 Ronald H. Coase (Lecture to the Memory of Alfred Nobel, December 9 1991).

31 Oliver Hart, 'An Economist's Perspective on the Theory of the Firm' (1989) 89(7) *Columbia Law Review* 1757, 89–90.

32 Bengt R. Holmstrom and Jean Tirole, 'The Theory of the Firm' in *Handbook of Industrial Organization* (Elsevier, 1989) 61, 63.

33 Christos Pitelis, 'Edith Penrose, Organisational Economics and Business Strategy: An Assessment and Extension' (2005) 26(2) *Managerial and Decision Economics* 67, 76 ('Edith Penrose, Organisational Economics and Business Strategy').

34 Holmstrom and Tirole (n 33) 63.

35 Alvarez et al, 'Developing a Theory of the Firm for the 21st Century' (2020) 45(4) *Academy of Management Review* 711, 713.

The different motivations of groups within a company could manifest in different corporate strategies. Baumol[36] and Marris,[37] sought to explain strategies that departed from traditional assumptions of profit maximisation, such as sales and growth maximisation, as reflecting management's 'preoccupation'[38] with growth and the benefits a growing, larger company provided management. However, there were limits to how far strategies could diverge from creating profits. According to Dixon, there was a level of 'under-performance that make even the most sedentary manager subject to scrutiny'[39] Dixon described this distance from the optimum as 'epsilon-optimisation' near enough to be good enough but not far enough away to fail a 'survival test' for those involved.[40]

2 *Differences in Assets*

For simplicity, economics has often treated all companies in an industry or sector as having the same assets, without considering the implications of what differences in assets can mean for the company and its response to external changes.[41] The implications of the different assets held by companies has been explored by a branch of the theory of the firm, known as the 'resources-based view of the firm.'[42] According to Barney, company resources are 'all assets, capabilities, organizational processes, firm attributes, information, knowledge etc controlled by a firm that enable the firm to conceive of and implement strategies that improve its efficiency and effectiveness.'[43] Resources can be used to create a 'sustained competitive advantage'[44] which is linked to the long term success of a company.

In the resource-based view, special attention has been given to knowledge as a resource, particularly a company's ability to generate and retain it. Edith Penrose's work on the 'theory of growth of the firm'[45] was a starting point.[46] Penrose viewed knowledge and its flow on to increased managerial expertise as the main source of long-term growth for

36 William J. Baumol, 'On the Theory of Expansion of the Firm' (1962) 52(5) *The American Economic Review* 1078, 1085.

37 Robin Marris, 'A Model of the "Managerial" Enterprise' (1963) 77(2) *The Quarterly Journal of Economics* 185, 209.

38 W.J. Baumol, 'On the Theory of Expansion of the Firm' in Charles K Rowley (ed), *Readings in Industrial Economics: Volume One: Theoretical Foundations* (Palgrave Macmillan UK, 1972) 34, 34.

39 Huw Dixon, 'Almost-Maximization as a Behavioral Theory of the Firm: Static, Dynamic and Evolutionary Perspectives' (2019) 56(2) *Review of Industrial Organization* 237, 238.

40 Ibid 239.

41 Jay Barney, 'Firm Resources and Sustained Competitive Advantage' (1991) 17(1) *Journal of Management* 99, 100.

42 Ibid.

43 Ibid 101.

44 Barney (n 42).

45 Edith Penrose, *The Theory of the Growth of the Firm* (Oxford University Press, 3rd ed, 1995).

46 Nicolaï Foss and Nils Stieglitz, 'Modern Resource-Based Theory(Ies)' (Edward Elgar Publishing, 2012) 257.

companies.[47] Liebskind extends this to other intangibles as important 'such as organizational learning, brand equity, and reputation.'[48]

The only limit in the resource-based view on which assets can found a sustainable competitive advantage is that the asset must be 'valuable, rare and costly to imitate and substitute.'[49] The fortunes and strategic options of companies with and without sustainable competitive advantages differ and may change over time. Companies with advantages try to protect them and those without them trying to imitate or acquire them.[50] The assets a company starts with, both physical and intangible, influence the strategies that are open to them and in turn the behaviours they exhibit.

3 *Differences in Organisation*

The theory of the firm has considered not just company assets as relevant to decision making but also how the organisation of the company has evolved and what external forces continue to shape it.[51] The way an organisation has grown, its organisational strengths and its processes and routines create differences in organisation leading to different options and ways companies can respond to change. As Phelan says

> Even if two managers were given identical bundles of resources, they would tend to use them in different ways. The result is that, over time, a firm's…assets will diverge.[52]

The main tool with which a company's management can influence how it uses assets is through planning and the development of strategy. Michael Porter looked at the strategic options available to companies through his Five Forces strategic framework[53] Porter described the five forces as: 'the threat of new entrants, the bargaining power of customers, the bargaining power of suppliers, the threat of substitute products or services (where applicable), and the jockeying among current contestants.'[54] These external forces and their impact on the strategic choices shape company behaviour. To the extent that successful strategy can be replicated over many time periods, Nelson and Winter's evolutionary theory of change provides insight into how the routines, processes and rules

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47 Penrose (n 46) 55.

48 Julia Porter Liebeskind, 'Knowledge, Strategy, and the Theory of the Firm' (1996) 17(S2) *Strategic Management Journal* 93, 93.

49 Barney (n 42) 105–106; as described in Foss and Stieglitz (n 47) 258.

50 Barney (n 42) 107.

51 Ibid 108.

52 Steven E. Phelan and Peter Lewin, 'Arriving at a Strategic Theory of the Firm' (2000) 2(4) *International Journal of Management Reviews* 305, 313.

53 Michael E. Porter, 'How Competitive Forces Shape Strategy' (1979) 57(2) *Harvard Business Review* 137, 137.

54 Ibid.

within companies can transmit success from one time period to the next through the 'replication of existing routines.'[55]

4 *Differences in Information*

The theory of the firm has also been used to consider the implications of recognising that companies do not all have the same information, there is a cost in acquiring information and that companies may stop short of seeking perfect information before making a decision. Herbert Simon is credited for introducing the concepts of bounded rationality and 'satisficing.'[56] Bounded rationality concerns decision making by using enough information and not pursuing all available information before making a decision. Simon's work influenced many, including Cyert and March's The Behavioral Theory of the Firm[57] which looked at the mechanics of company decision making and the factors that lead to non-profit maximising outcomes, introducing concepts such as 'organisational slack', 'satisficing behaviour' and 'external information search'[58] 'to open up the 'black box' of the internal workings of organizations [and see] decisions … as produced by collections of individuals with different interests, information, and identities.'[59]

As can be seen by the preceding discussion, the theory of the firm provides insights into company behaviour that may explain company taxpayer compliance behaviour in response to mineral taxation changes. Young describes the role the theory of the firm can play as follows:

> If institutions are the rules of the game, and firms and individuals are the teams and players, then a theory of the firm provides the basic 'playbook' that shows the strategic choices available and provides theoretical explanations of how different plays can score a goal and win the game. Thus, the theory of the firm can be used to see how strategic choices are framed for managers.[60]

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55 R. Nelson and S. Winter, 'An Evolutionary Theory of Economic Change (1982) Cambridge' *MA: Belknap Press of Harvard University* 99.

56 H.A. Simon, *Models of Bounded Rationality* (MIT Press, 1982); Herbert A. Simon, 'Bounded Rationality' in John Eatwell, Murray Milgate and Peter Newman (eds), *Utility and Probability* (Palgrave Macmillan UK, 1990) 15; Matteo Cristofaro, 'Herbert Simon's Bounded Rationality' (2017) 23(2) *Journal of Management History (2006)* 170, 172.

57 James G. March and Richard M. Cyert, *A Behavioral Theory of the Firm*, vol 43 (Prentice-Hall, 1963). See also Liu et al, 'The First 50 Years and the Next 50 Years of *A Behavioral Theory of the Firm*: An Interview With James G. March' (2015) 24(2) *Journal of Management Inquiry* 149. Linda Argote and Henrich Greve, 'A Behavioral Theory of the Firm – 40 Years and Counting: Introduction and Impact' (2007) 18(3) *Organization Science* 337.

58 External search is the way in which firms seek to acquire solutions to problems in the absence of perfect information. Nelson and Winter describe search 'search as a rubric for the variety of processes, mostly intentional but some not, by which rule changes take place.' Nelson and Winter (n 56) 171. Organisational slack refers to the spare resources captured by the firm and distributed to coalition members that increases in good times and vice versa above a certain satisficing level of return. See Argote and Greve (n 57) 340.

59 Argote and Greve (n 57) 344.

60 Young et al, 'Strategy in Emerging Economies and the Theory of the Firm' (2014) 31(2) *Asia Pacific Journal of Management* 331, 336.

III RESEARCH METHODOLOGY

The survey method was used to gather data around the question of whether the theory of the firm could be used to understand taxpayer compliance behaviour in the mining sector. The mining sector was chosen due to its economic importance in some countries, the application of sector specific taxation arrangements and the level of industry concentration making data availability and its quantum manageable. The survey involved several tax change scenarios and questions regarding variables that the theory of the firm indicated could be relevant to explaining and predicting company behaviour. The theory of the firm was then used to analyse the results.

Survey research is defined as 'the collection of information from a sample of individuals through their responses to questions.[61]' Surveys have the advantage of being an efficient and flexible means of gathering information from a large group of people.[62] There are some limitations to using surveys as a research method. For example, when interpreting survey results it can be difficult to determine 'causality[63]' from a participant's response without greater context. Causality or causation refers to whether the dependent variable changed because of the other variable changing, or whether the change was due to some other factor. Participant's may also find questions difficult to answer; may have poor recall of historical events; or they may be deceptive, for example, where tax minimisation or avoidance may be at issue.[64] Despite its limitations, surveys have consistently been used to study mining companies' and their executives' perceptions of mining jurisdictions, including mineral taxation. For example, surveys were developed by Johnson for the East West Centre in 1990[65] and have been used annually by the Fraser Institute to understand mining executives' perceptions of investment attractiveness.[66]

Questions were included that asked about company strategy, management objectives, impact of uncertainty and the importance of external factors on decision making as it related to a company's response to the different tax scenarios. The literature review highlighted how the theory of the firm can provide four areas to explain company behaviour through differences in: agenda, assets, organisational structure and information, as follows.

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61 Joseph Check and Russell K. Schutt, *Research Methods in Education* (SAGE Publications Inc., 2012) 160 <http://methods.sagepub.com/book/research-methods-in-education>.

62 Priscilla Glasow, *Fundamentals of Survey Research Methodology* (No MP 05W0000077, Mitre, 2005) 28, 1–2.

63 Pamela L. Alreck, *The Survey Research Handbook* (McGraw-Hill/Irwin, 3rd ed, 2004) 6.

64 Ibid 102.

65 Charles J. Johnson, 'Ranking Countries for Minerals Exploration' (1990) 14(3) *Natural Resources Forum* 178.

66 Fraser Institute, 'Fraser Institute Annual Survey of Mining Companies', *Fraser Institute* <https://www.fraserinstitute.org/categories/mining>.

A *Differences in Agenda*

Drawing on transaction-cost theory of the firm and the behavioural theory of the firm, questions were developed to test whether there was evidence to suggest different agendas might exist between shareholders and management, reflecting the principal and agent problem. The survey asked about the respondent's perception of their employer's company strategy and whether it was focused on profit, sales, growth, costs or other measures such as employment. The survey also asked about whether performance-based remuneration was practiced by the company and whether this was tied back to corporate, group or individual goals to test the level of alignment of goals.

B *Differences in Assets*

Drawing on the resources-based view of the firm and the strategic theory of the firm, respondents were asked whether their responses to tax scenarios would change based on asset specific information, such as whether the mine was new or old, had a long or short mine-life or whether the mine was pivotal to the achievement of goals held by one or more internal stakeholder group. In the context of individual taxpayer compliance behaviour, the characteristics of the source of income have been identified as a variable that effects behaviour,[67] in the company context the nature of the asset from which income is derived is of potential interest. The questions focussed on whether the different assets of firms could explain any non-uniformity in survey responses.

C *Differences in Organisational Structure*

Drawing on the theory of growth of the firm and evolutionary theory of the firm, the survey included questions on whether different institutional arrangements, learning processes and managerial expertise, built up over a company's history, could lead to different responses in the survey. Respondents were asked about their company's approach to learning from other organisations, or competitors, and whether they engaged in benchmarking. Respondents were asked about the degree of internationalisation of the company in general and the executive, in particular, to see whether exposure to different business climates and multi-national presence could explain differences in a company's response to tax scenarios. Respondents were also asked how important company culture was in decision making in order to examine whether any parallels exist with the importance of ethics in the individual taxpayer context.[68]

D *Differences in Information*

Drawing on the behavioural theory of the firm, the survey included questions on whether information asymmetry, external volatility or the degree of uncertainty present could explain different outcomes. The tax scenarios embedded uncertainty in the form of introducing commodity price increases and investment incentives alongside tax changes to compare how this effected the survey results.

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[67] Richardson and Sawyer (n 6) 47.

[68] Ibid 148.

E *Survey Participants and Administration*

The survey questionnaire was developed in early 2020 and pilot tested in May 2020. Pilot or 'pre-testing' was needed to identify ambiguous, difficult of multiple interpretations of questions.[69] A formal ethics approval process was initiated and approval granted. The surveys were sent by email to more than 600 senior executives and mining industry bodies in Australia and a selection of mineral dependent countries in the Asia-Pacific (Laos, Indonesia and Papua New Guinea). Participants were recruited via email or social media from executives that had work history with major mining operations in target countries. The survey was translated into Lao and Indonesian. Some participants and industry organisations provided contact details of other potential participants or distributed through their networks. Professional industry bodies were used to increase coverage.

The survey comprised 29 closed questions and two open questions, where participants could provide extended or free form responses. A copy of the survey questions can be found in Appendix A. The survey received more than 200 responses and a response rate of 33% from those contacted, slightly higher than average for studies on taxpayer compliance behaviour.[70] Alreck recommends that the minimum number of responses required in a survey of this nature is between 100 and 300.[71] The response rate achieved is considered to meet the quantum requirements for a representative sample.

TABLE 1: CHARACTERISTICS AND EXPERIENCE OF RESPONDENTS

	RESPONDENTS	PERCENTAGE (%)
GENDER		
Male	182	85
Female	32	15
Total	214	100
EDUCATION		
Secondary	12	6
Undergraduate	72	34
Postgraduate	129	61
Total	214	100
INTERNATIONAL EXPERIENCE		
None	17	8
1-3 Years	12	6
3-5 Years	9	4
5+ Years	176	82
Total	214	100
CURRENTLY EMPLOYED AS AN EXPATRIATE/DOMESTIC		
Expatriate	82	38
Domestic	103	48
Not in Role	29	14
Total	214	100

69 P. Visser, J. Krosnick and P. Lavrakas, 'Survey Research' in *Handbook of Research Methods in Social and Personality Psychology* (Cambridge University Press, 2000) 223, 241.

70 Richardson and Sawyer (n 6) 225.

71 Alreck (n 64) 63.

CURRENTLY WORKING FOR MULTINATIONAL/DOMESTIC		
Multinational	170	81
Domestic	39	19
Total	209	100

The background of the respondents was also examined to see whether they met the target seniority and experience levels usually associated with senior mining roles involved in decision making. Table 1 shows respondents were highly educated with 129 holding postgraduate qualifications and a further 72 undergraduate degrees. Respondents also had significant international experience, with 82% having more than five years outside their home jurisdiction and experience in multiple countries. Data was also collected on the respondent's occupation and current role. Most respondents described their role as being as an executive or manager (54%). A number of respondents described their current role as a consultant or advisor (22%) to resources companies. Other technical leads, such as lawyers, senior engineers and principal geologists, that may not directly manage others but are involved in strategic decision making, were also strongly represented.

The responses of domestic and international respondents were analysed using multivariate regression analysis to examine whether there were any statistically significant differences. No statistically significant relationship was established. The high level of international mobility and interchange of the executive cohort between countries may explain the lack of differentiation between domestic and international respondents. The lack of significant differences between these groups supports treating domestic and international responses as drawn from a similar mining executive population. Overall, the respondents exhibited many of the qualitative traits that would be expected of an executive cohort.

5 *Analysis*

Survey data was analysed using IBM SPSS software. The data was analysed using descriptive statistics and multivariate stepwise regression.[72] Open question responses were analysed through a coding process using Nvivo software to identify patterns within the responses.

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72 Multivariate step wise regression analysis refers to statistical techniques that measure the degree to which the change in one or more variables is linearly related to the change in another variable. Regression analysis was used to test whether variable information such as gender, education, profession or other variables gathered from survey participants were explanatory of the mining executives' responses. The variables were chosen because of their value in the individual taxpayer compliance literature. A finding that one of these variables was significant in the way executives viewed company behaviour would have been valuable. However, no statistically significant variables resulted from the regression analysis. Importantly for this study, company behaviour appears from these results to follow factors other than those that may have a bearing on how individual executives approach taxation.

IV Results

In the main tax scenario, participants were asked: 'How would your company respond to an increase in mineral taxation rates?' While there was a trend towards reducing investment and exploration, the response was not uniform and the largest number of responses said they would only do so 'about half of the time'.

Table 2: Percentage of Respondents Reducing Investment and/or Exploration

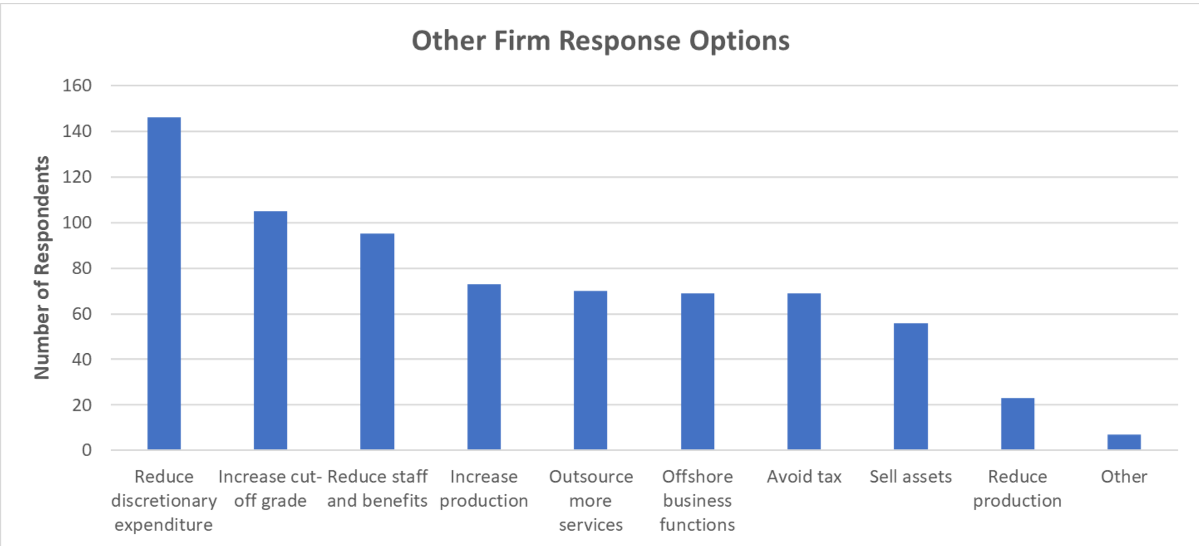
	Never	Almost Never	About Half the Time	Most of the Time	Always
Reduce Investment	6%	18%	40%	33%	3%
Reduce Exploration	6%	22%	34%	33%	5%
Total					**100%**

Table 2 shows that in response to a tax increase only 36% said they would mostly or always reduce investment and 38% responded that they would reduce exploration.

The data supports the view that while some executives would reduce investment and exploration, the decision-making process is complex and it provides space for the factors highlighted by the theory of the firm to explain points of departure.

A follow-up question was asked of respondents in relation to this tax increase scenario where they were also asked 'How else would you expect mining companies to respond to an increase in mineral taxation?' Figure 1 shows that, 65% of respondents indicated their company would reduce discretionary expenditure in response to a mineral taxation increase. If cutting costs was an available option prior to the tax change, an economically rational assumption would be that cost cutting should occur regardless of intervening factors. The responses potentially reveal the existence of unrealised potential or spare capacity in the companies, possible evidence of enduring non-optimising behaviour.

Figure 1: Frequency Range of Company Responses to Mineral Taxation Increases



In the next tax scenario, the aim was to test the effect of changes in commodity prices on mining company behaviour. Survey respondents were asked 'If commodity prices were increasing, how would you expect mining companies to respond to an increase in taxation rates?'

TABLE 3: PERCENTAGE OF RESPONDENTS REDUCING INVESTMENT AND/OR EXPLORATION AFTER TAX AND COMMODITY PRICE INCREASES

	NEVER	ALMOST NEVER	ABOUT HALF THE TIME	MOST OF THE TIME	ALWAYS
REDUCE INVESTMENT	10%	48%	32%	10%	1%
REDUCE EXPLORATION	11%	46%	29%	13%	1%
TOTAL					**100%**

Table 3 shows only 11% of respondents said they would reduce investment and 14% would reduce exploration, either most of the time or always. This means that for the respondents to the survey, any negative effects on investment or exploration from tax increases are almost completely offset by a rising commodity price environment, even when the quantum of such a rise is not specified.

After commodity price, respondents were asked about a range of other factors that could impact the way an executive would respond to a mineral taxation increase. Respondents were asked to rate 'What factors may change the way you would expect a mining [company] to respond to an increase in mineral taxation?' Respondents were asked to rate whether a factor would be material from 'never' to 'always' with the middle outcome being 'about half the time.' The middle outcome had a score of three on the Likert scale used.

TABLE 4: FACTORS THAT MAY AFFECT COMPANY RESPONSE

FACTOR	RANK	MEAN
Mine is a core asset	1	4.07
Mine newly commissioned	2	3.87
Mine nearing closure	3	3.52
Shareholding structure	4	3.38
Executive Remuneration	5	3.33
Mine is a non-core asset	6	2.95

The responses in Table 4 indicate that if the mine was a core asset or newly commissioned, this may also lead to a change in the way the executive would respond. The responses imply that core assets are not as likely to see reductions in investment and exploration from a mineral taxation increase than other assets. A mine nearing closure was also seen as a potential factor for changing the way a respondent answered the question. Reducing investment and exploration for a mine nearing closure could bring forward substantial closure costs.

Respondents were then asked to consider a scenario where a tax decrease or incentives were offered in the mining sector.

TABLE 5: PERCENTAGE OF RESPONDENTS INCREASING INVESTMENT AND/OR EXPLORATION AFTER TAX DECREASE

	NEVER	ALMOST NEVER	ABOUT HALF THE TIME	MOST OF THE TIME	ALWAYS
INCREASE INVESTMENT	4%	6%	22%	58%	12%
INCREASE EXPLORATION	2%	5%	21%	60%	13%
TOTAL					**100%**

Table 5 shows respondents were far more certain of what they would do in response to tax incentives or a tax decrease rather than a tax increase, 69% or respondents said they would increase investment; and 72% said they would increase exploration 'most of the time' or 'always.' Potentially, this differing approach to positive and negative changes supports similar findings from earlier research, which suggests people approach outcomes differently when they are framed as losses or windfalls.[73]

Respondents were also asked an open question: 'In a hypothetical country, the government announces that it will be increasing taxes on the mining sector. If you were the executive responsible for responding to the proposed changes, what would you do?' The open question allowed respondents to highlight other aspects of the decision-making process surrounding company response to tax changes. The open responses were coded using Nvivo software and the results are shown in Table 6.

TABLE 6: SURVEY QUESTION ON HYPOTHETICAL SCENARIO

CODE	SUB-CODE	RESPONSES	EXAMPLE
1. Lobby	1.1 Lobby (general)	117	'Regardless, argue against change'
	1.2 Emphasise impacts	40	'Document the long-term investment, employment and broader economic impacts of the tax increases.'
	1.3 Build coalitions	33	'Look for multiple mining operators & band together to provide a general front against increases.'
	1.4 Seek exemption	30	'Review the mining lease agreement and determine a course of action to mitigate potential losses.'
	1.5 Outline benefits	8	'Outline the significant benefits already received'
2. Minimise impact	2.1 Minimise impact (general)	56	'Restructure finances and operations to minimise the additional tax'
3. Reduce Investment	3.1 Reduce investment (general)	16	'Consider reducing activity levels (exploration, investment)'
	3.2 Exit jurisdiction	9	'If the increase is substantial, reconsider jurisdiction to move elsewhere.'
4. Reduce Exploration	4.1 Reduce exploration (general)	5	'Very likely to impact on exploration investment'

73 Daniel Kahneman and Amos Tversky, 'Prospect Theory: An Analysis of Decision under Risk' (1979) 47(2) *Econometrica* 263; In the individual taxpayer compliance literature, Prospect Theory has been used to examine possible differences in behaviour between taxpayers who expect to receive a refund or are required to pay: Richardson and Sawyer (n 6) 214.

5. Comply	5.1 Comply (general)	8	'Increasing taxes doesn't equate to a negative as long as it is reasonable.'

Notes: # denotes number of references in open coded responses.

The free-form responses broadly confirmed the quantitative data gathered in the response to the scenarios. There was a strong hierarchy of response favouring lobbying as the immediate action, followed by impact mitigation measures and then consideration of reduction in investment and exploration, including in severe cases divestment and a company exiting the jurisdiction. However, the strength of response diminished substantially from initial actions to longer term actions, involving more substantial decisions, such as exiting the jurisdiction. The wording also became less certain with the increased frequency of qualifiers such as 'review' and 'consider.'

The second open question focused on the most important considerations for the company in shaping its response to a mineral taxation change. The coding is shown in Table 7.

TABLE 7: CONSIDERATIONS SHAPING COMPANY RESPONSE CODED IN NVIVO

CODE	SUB-CODE	RESPONSES	EXAMPLE
1. Strategic asset/country	1.1 Strategic asset or country (general	19	'Importance of country to its portfolio'
	1.2 Life-of-mine	23	'Life of mine'
	1.3 Country risk	12	'Country stability and track record regarding the minerals sector compared to other countries with similar mineral potential'
	1.4 International Competitiveness	25	'Comparison with competing jurisdictions'
2. Stakeholder relations	2.1 Stakeholder relations (general)	43	'Relationships with government and community'
	2.2 Share price/investor relations	8	'Investor reaction to increases'
	2.3 How tax will be used	15	'Fairness and longevity. Is the deal and tax paid fundamentally fair or not?'
3. Impact	3.1 Financial performance	71	'Significance of the impact it will have on revenue and cash flow for the business as a whole.'
	3.2 Magnitude of change	11	'Exit strategies if the change is material enough that proves reward is too close to risk.'
	3.3 Ability to walk back	12	'Can we offset this tax with seeking reductions in costs in other areas?'
4. Future prospects	4.1 Views on the company's future prospects	22	'Investment, production and exploration outlook'

Notes: # denotes number of references in open coded responses.

The responses Table 7 highlight the complexity of the task on executives and companies in determining the long-term response to a mineral taxation change. The responses show the interaction of company strategy, international competitiveness and calculations about the economic future. The responses go some way to explaining factors that may change how companies respond and why there is only weak support in the survey for the proposition that mining companies respond to a tax increase by reducing investment and exploration.

V ANALYSIS

The survey results show that a company's response to mineral taxation changes is complex and cannot be reduced to a binary profit maximising outcome such that if taxes increase company investment and exploration will fall. The results suggest that the theory of the firm can provide insights into why one company may respond quite differently in the same situation based on the different agendas, assets, organisation and information available to the company and its decision makers.

A *Differences in Agenda*

The survey responses reveal potential differences in agenda that may explain the varied responses from executives to tax changes. The evidence for differences in agenda derives from the reluctance of respondents to reduce investment and exploration, the potential existence of spare capacity to absorb changes and concern by executives about how their actions will be perceived by others. The theory of the firm suggests executives are preoccupied by growth and expansion due to the increase in opportunities this provides executives.[74] This may explain the reluctance to reduce growth by cutting investment. Respondents to the survey also appear to be concerned about how their actions will be perceived, by investors, stakeholders and governments.[75] Concern for reputation may affect an executive's performance based remuneration, future employability and promotion prospects.[76] The theory of the firm also suggests management can engage in satisficing rather than optimisation behaviour and the use of spare capacity can contribute to a more comfortable existence for managers where the pressure to perform at the margin is reduced.[77]

B *Differences in Assets*

The survey responses show that the differences in assets that a mining company has may influence how the company responds to tax changes. Strategic assets that provide or contribute to a company's sustainable competitive advantage are less susceptible to tax increases because their value to the company is greater than viewing the asset in isolation. Strategic assets may be new mines with long time horizons, a mine with large margins that have an ability to remain profitable after changes, or a mine that generates knowledge or training opportunities that provides benefits beyond the asset itself. The

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74 Olivier Weinstein, 'Managerial Theories: Baumol and Marris' (Edward Elgar Publishing, 2012) 92.

75 Brian J. Loasby, 'Management Economics and the Theory of the Firm' (1967) 15(3) *The Journal of Industrial Economics* 165, 170.

76 Robin Marris, *The Economic Theory of Managerial Capitalism* (Macmillan, 1967) 47.

77 Loasby (n 76) 176.

theory of the firm recognises companies as having asset heterogeneity[78] and the conditions for recognising when an asset may be strategic[79] and company response may change as a result.[80]

C *Differences in Organisational Structure*

The survey results indicate that companies have different abilities to influence their external environment and face different levels of competition and other forces that may limit or expand the ways in which a company can respond to tax changes. The theory of the firm divides the company into its technical and institutional components. The institutional capability of an organisation can differ in the same way one company's assets can differ to another.[81] The theory of the firm can explain the strategic options available to a company, how the options differ to others in the same sector and how these forces influence the development of a company.[82] For example, the theory of the firm can explain survey respondents focus on lobbying to remove the tax in the open question responses perhaps to achieve an 'easier life' and avoid the impact.[83] Companies with large operations, significant impact on the national economy and ability to lobby senior government members may have different responses to tax changes than others.

D *Differences in Information*

The theory of the firm can explain the reluctance of executives to reduce investment and exploration in response to tax increases in terms of the complexity and uncertainty of the decision facing executives.[84] The survey respondents identify uncertainty around the impact of the tax, the relative international competitiveness of the country, the direction of commodity prices and the longevity of the changes. In response to uncertainty and information search, the theory of the firm suggests that firms are not going to seek all information but enough to make a decision,[85] are likely to satisfice rather than optimise[86] and opt to wait and see before making large decisions with long term implications.[87]

78 S. A. Lippman and R. P. Rumelt, 'Uncertain Imitability: An Analysis of Interfirm Differences in Efficiency under Competition' (1982) 13(2) *The Bell Journal of Economics* 418, 418.

79 Barney (n 42) 105–106; as described in Foss and Stieglitz (n 47) 258.

80 Michael E. Porter, 'Towards a Dynamic Theory of Strategy' (1991) 12(S2) *Strategic Management Journal* 95, 106.

81 Ibid 102.

82 Ibid 106.

83 Holmstrom and Tirole (n 33) 88.

84 Dixon (n 40) 257.

85 March and Cyert (n 58); Nelson and Winter (n 56) 171.

86 Loasby (n 76) 176.

87 Dixon (n 40) 257.

VI Significance and Conclusion

The mining sector has particular importance to mineral dependent economies and understanding taxpayer compliance behaviour is important to understanding revenue flows from the sector. The theory of the firm is one theory that has been used by economists to understand company behaviour. Surveying mining executives about how they and their company would respond to mineral taxation changes has shown that company response is not simply to reduce or increase investment as taxes rise or fall but instead the response is complex and not uniform. The survey results show that almost as many mining executives would increase investment if mineral taxation increased as world reduce it. Factors that could change the way an executive responded to the question included increases or decreases in commodity prices, whether there was capacity in the company to reduce costs and whether the asset was high margin or was strategic to the company's future. The survey also revealed that company response would firstly consist of lobbying against any unfavourable changes, then looking at ways to mitigate the impact of any change and, only when these avenues were exhausted, looking to reduce investment and exploration.

The theory of the firm provided four areas that could explain differences in response. These areas were differences in agendas, assets, organisational structure and information. The survey demonstrated that the theory of the firm could assist in understanding taxpayer compliance behaviour in the mining sector and is significant for applying the theory of the firm to company taxpayer compliance behaviour.

The field of individual taxpayer compliance behaviour has been extensively studied and the understanding of the variables that contribute to compliance outcomes has progressed significantly as a result. Further work is needed to understand the changes in variables when moving from individual to company taxpayers if knowledge in this area is to become as sophisticated as that of individual taxpayer compliance behaviour. This research is the result of a focus on one industrial sector and respondents were largely drawn from the Asia Pacific region, further work would be needed to ensure the findings are relevant outside of the mining sector and the jurisdictional reach increased in order to validate that the findings are of general relevance to understanding company taxpayer compliance behaviour.

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APPENDIX A

SURVEY ON MINING COMPANY RESPONSE TO MINERAL TAXATION CHANGES

Q1 *Do you identify as male or female?*

(1) Male (2) Female (3) Other

Q2 *Please describe the highest education level you have obtained.*

(1) Primary (2) Secondary (High School) (3) Undergraduate Degree (4) Postgraduate Degree

Q3 *Are you currently in a role that is domestic only (national role) or expatriate?*

(1) Domestic (National) (2) Expatriate (3) Not currently in a role

Q4 *Please describe your level of international work experience*

(1) None (2) 1-3 years (3) 3-5 years (4) 5 years+

Q5 *Which mining regions are you familiar with?* (You can select multiple regions)

(1) Australia (2) Africa (3) Asia (4) North America (5) South America (6) Europe

Q6 *Have you ever worked in these countries?* (You can select multiple countries)

(1) Australia (2) Indonesia (3) Lao PDR (Laos) (4) Papua New Guinea (5) None of These

Q7 *Which mining country are you most familiar with?*

(1) Australia (2) Indonesia (3) Lao PDR (Laos) (4) Papua New Guinea (5) Other

Q8 *Please select which profession best describes your qualifications*

(1) Geologist (2) Engineer (3) Accountant (4) Trade (5) Lawyer (6) Management (7) Other

Q9 *What category best describes your current role?*

(1) Operator (2) Supervisor (3) Superintendent (4) Manager (5) Executive (6) Consultant (7) Other

Q10 *What, if any, professional bodies are you a member of?* (Select all that apply)

(1) AusIMM (2) CPA/CA (3) Engineers Australia (4) Law Society (State) (5) Geological Society of Australia (6) Australian Institute of Company Directors (7) Society for Mining, Metallurgy and Exploration (8) Other (9) None

Q11 *Where do you get most of your information from about developments in the mining industry?* (You can select multiple options)

(1) Professional Bodies (2) Corporate Intranet (3) Industry Media (Mining News etc) (4) Internet - Online (5) Colleagues (6) Professional Training Courses (7) Other

Q12 *For the company where you are currently or formerly employed, does the company only operate in one country or is it multinational?*

(1) Domestic (One Country Only) (2) Multinational

Q13 *For the company where you are currently or formerly employed, what is the main commodity focus?* (if the focus is evenly split you may select more than one)

(1) Gold (2) Copper (3) Other base metals (lead, zinc, nickel etc) (4) Bulk metals (iron ore, bauxite etc) (5) Bulk energy (oil, gas and coal) (6) Industry (non-mining) (7) Not applicable

Q14 *For the company where you are currently or formerly employed, which professional bodies is the company a member* (You can select multiple memberships)

(1) ICMM - International Council on Mining and Metals (2) MCA – Minerals Council of Australia (3) EITI – Extractive Industries Transparency Initiative (4) Local Chamber of Mines (5) None of these

Q15 *Mining companies have different strategies. In your view, rank the importance from 1 to 6 these elements of strategy for the company where you are currently or formerly employed*

(1) Profit Maximisation (2) Production maximisation (3) Growth maximisation (4) Cost minimisation (5) Social benefit maximisation (6) Employment maximisation

Q16 *If the company you are currently or formerly employed, has performance-based remuneration, what form does it take?*

(1) No performance-based remuneration (2) Individual performance – bonus linked to satisfaction of individual goals (3) Group performance – bonus linked to satisfaction of group or section goals (4) Company performance – bonus linked to company performance (5) A mixture of individual, group and company performance

Q17 *The company where you are employed or formerly employed has a structured and dedicated approach to benchmarking i.e. learning from competitors. To what extent do you agree with this statement.*

(1) Strongly agree (2) Somewhat agree (3) Neither agree nor disagree (4) Somewhat disagree (5) Strongly disagree

Q18 *From the list below, rank the biggest challenges facing the mining sector at present?*

(1) Access to capital (2) Social licence to operate (3) Environmental issues (Climate Change) (4) Mineral Taxation (5) Commodity prices (6) Regulatory delays (7) Other

Q19 *In the country you are most familiar working in, what is your view of the taxes (corporate taxes, royalties etc) paid by mining companies when compared to other countries?*

(1) Far above average (2) Somewhat above average (3) Average (4) Somewhat below average (5) Far below average

Q20 *In the country you are most familiar working in, are you aware of whether mineral taxation has increased in the last 10 years?*

(1) Yes (2) Maybe (3) No

Q21 *How did or would your company respond to an increase in mineral taxation rates?*

(1) Increase Investment (2) Increase Exploration (3) Reduce Investment (4) Reduce Exploration (5) Cut Costs (6) Lobby Government (7) No Change (8) Other. Rank from (1) Never (2) Almost Never (3) About Half the Time (5) Most of the Time (6) Always

Q22 *If commodity prices were also increasing, how would you expect mining companies to respond to an increase in taxation rates?*

(1) Increase Investment (2) Increase Exploration (3) Reduce Investment (4) Reduce Exploration (5) Cut Costs (6) Lobby Government (7) No Change (8) Other. Rank from (1) Never (2) Almost Never (3) About Half the Time (5) Most of the Time (6) Always

Q23 *What factors may change the way you would expect a mining company to respond to an increase in mineral taxation?*

(1) Mine is nearing closure (2) Mine is newly commissioned (3) Mine is a core asset (4) Mine is a non-core asset (5) Executive remuneration targets tied to production (6) Shareholding structure i.e. state-owned or stock exchange listed. Rank from (1) Never (2) Almost Never (3) About Half the Time (5) Most of the Time (6) Always

Q24 *How else would you expect mining firms to respond to an increase in mineral taxation?* (Mark all that apply)

(1) Increase cut-off grade i.e. high grade (2) Increase production (3) Reduce production (4) Reduce discretionary expenditure (5) Reduce staff and benefits (6) Outsource more services (7) Offshore business functions (8) Sell assets (9) Avoid tax (10) Other

Q25 *How did or would your company respond to a DECREASE in mineral taxation rates?*

(1) Increase Investment (2) Increase Exploration (3) Reduce Investment (4) Reduce Exploration (5) Cut Costs (6) Lobby Government (7) No Change (8) Other

Rank from (1) Never (2) Almost Never (3) About Half the Time (5) Most of the Time (6) Always

Q26 *How important do you believe Corporate Social Responsibility (CSR) and reputation factors are to determining how a company responds to mineral taxation changes?*

(1) Extremely important (2) Very important (3) Moderately important (4) Slightly important (5) Not at all important

Q27 *How important do you believe environmental issues (e.g. mine closure, land disturbance or climate change) are to determining how a company responds to mineral taxation changes?*

(1) Extremely important (2) Very important (3) Moderately important (4) Slightly important (5) Not at all important

Q28 *How important do you believe corporate culture to determining how a company responds to mineral taxation changes?*

(1) Extremely important (2) Very important (3) Moderately important (4) Slightly important (5) Not at all important

Q29 *How important do you believe government relations i.e. politics is to determining how a company responds to mineral taxation changes?*

(1) Extremely important (2) Very important (3) Moderately important (4) Slightly important (5) Not at all important

Q30 *In a hypothetical country, the government announces that it will be increasing taxes on the mining sector. If you were the executive responsible for responding to the proposed changes, what would you do?*

Q31 *What are the considerations that you think are the most important for a company determining how it will respond to mineral taxation?*

DOES A VALUE-ADDED TAX RATE INCREASE INFLUENCE COMPANY PROFITABILITY? AN EMPIRICAL STUDY IN THE SAUDI STOCK MARKET

MAHFOUDH HUSSEIN MGAMMAL*

ABSTRACT

This study aims to estimate the consequences of a value-added tax ('VAT') rate increase on the profitability of the Kingdom of Saudi Arabia ('KSA') non-financial companies. Using statistical empirical approaches such as Ordinary Least Squares, Wilcoxon-signed-rank test and Difference-in-Differences, the analysis targets data before and after the VAT rate increase as well as the discovery of COVID-19. The findings support the hypothesis that after-VAT rate increase firms are, on average, less profitable. The imposed 10% VAT rate increase has caused, on average, a -2.16% decrease in profitability of Saudi firms. The results explore the notion that government debt negatively influenced firm profitability in 2020 which means that will affect Saudi companies' growth in the long term. This paper recommends implementing some VAT incentives in the tax system and conducting further studies on VAT incentives efficiency using data in the long term.

Keywords: value-added tax, taxation, total assets, shareholders' equity, profitability

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I INTRODUCTION

According to the World Bank,[1] in reply to COVID-19, the Saudi Arabian government has introduced financial stability and company sector aid measures, including measures to support lending to Small-Medium Enterprises. Growth in many oil-exporting countries will be severely constrained by further political restrictions in relation to oil production. In Saudi Arabia and other Gulf Co-Operation Council ('GCC') economies, lower oil prices, heightened ambiguity related to further possible spikes in COVID-19, and household-wide effects of primary budget adjustments (such as a value-added tax ('VAT') rise, wage restrictions) should significantly impact non-oil activities.

Sixty years back, the VAT was only rarely taught of in some professional texts and external to France. VAT, a wide base tax on expenditure, is new and one of the utmost significant foundations of revenue for governments.[2] Since its introduction in over 170 nations, VAT has generally increased 20% or more of all tax income. Broadly implemented in sub-Saharan Africa and the Middle East, among others, implementation of a VAT has been the cornerstone of tax improvement in numerous developing nations.[3]

In Saudi Arabia, the authority responsible for taxation is the General Authority of Zakat and Tax, which has the following functions to: collect taxes from taxpayers in accordance with the applicable laws, rules and regulations; offer high-quality services to taxpayers in order for them to meet their obligations; follow-up on taxpayers to ensure the collection of tax claims; educate taxpayers; and, exchange information with regional and international organisations and specialised institutions[4]. In this context, it has been said that numerous developing countries with limited tax capability have switched to VAT, and the optimality of this reform relies on the efficacy of VAT collection. In the Kingdom of Saudi Arabia ('KSA'), the General Authority of Zakat and Tax, in 2017, argued that the development of the tax system will support the KSA to convert and become further companionable with the global system. The VAT was officially introduced on 1 January 2018 with an average rate of 5%.[5] The KSA introduced VAT to decrease its dependency on oil reserves. Recently, due to the effects of the COVID-19 pandemic in the world, the KSA — as one country to have adopted some economic reforms to reduce these COVID-19 consequences — increased its VAT from 5% to 15%on 1 July 2020. For clarity, the 5% VAT is a standard rate, with the 15% VAT rate introduced and applicable to all other

1 World Bank, 'Global Economic Prospects, June 2020' (Report, June 2020).

2 See Bibek Adhikari, 'Does a Value-Added Tax Increase Economic Efficiency?' (2020) 58(1) *Economic Inquiry* 496–517.

3 See Michael Keen and Ben Lockwood, 'The Value Added Tax: Its Causes and Consequences' (2010) 92(2) *Journal of Development Economics* 138–151.

4 General Authority of Zakat and Tax, 'ZATCA's Role' (2021) <https://zatca.gov.sa/en/AboutUs/Pages/default.aspx#:~:text=%E2%80%8B%E2%80%8BZATCA's%20role,comply%20and%20fulfill%20their%20obligations>.

5 General Authority of Zakat and Tax, 'Value Added Tax' (2021) <https://gazt.gov.sa/en/RulesRegulations/VAT/Pages/default.aspx>.

taxable activities.[6] Accordingly this study aims to examine the effects of this VAT rate increase.

VAT is oftentimes defined as a regressive tax since it taxes consumption and the set to consume tends to reduce as income increases.[7] Other tax frameworks have numerous issues and in some countries, a VAT might be introduced to lessen another ineffective implicit tax — for example, stamp duties, excise taxes and tariffs — or to marginally diminish explicit taxes — for example, the corporate revenue tax rate and individual revenue tax rate. However, these progressions are slight when contrasted with the substitution of sales taxes by VAT.[8] In the KSA and hand-in-hand with its 2030 vision, this type of approach gives the government adaptability and therefore it does not have to rely so heavily on oil income alone. Similarly, it turns out to be less of a burden for the end consumer since it is the first type of tax framework presented in the KSA.

Recently, Alhussain[9] studied the influence of the VAT implementation on Saudi banks. The study revealed a small decrease in overall liabilities, overall assets, current accounts and customer deposits. Furthermore, there was an important reduction in retained earnings and total operating expenses following the implementation of the 5% VAT. There was also small growth in overall income and an important rise in net operating revenue.

Moreover, there are no statistically important differences with other variables under the study, except reserved profits after and before the implementation of the 5% VAT. The present research question in this paper explores what the situation is after imposing a 15% VAT on non-financial[10] Saudi listed companies. Relevantly, there is another study conducted by Bogari[11] which examined the social and economic impact of the implementation of the 5% VAT in the KSA. The results of that study indicate that the implementation of the 5% VAT raises the country's financial resources. Also, Bogari found an undesirable social influence and several other challenges. It recommended a need to redesign the nature of the execution of the on-VAT rules of determining the tax base in the 'General Guidelines of VAT' via developing the proficiency and viability of workers in the General Authority of Zakat and Tax, and streamlining tax systems until the beneficial outcomes on the financial and social side bounce back.

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6 General Authority of Zakat and Tax, 'VAT Law' (2021) <https://zatca.gov.sa/ar/RulesRegulations/Taxes/Documents/SaudiVATlaw-bilingual%20(Logo)%2001%20copy.pdf>.

7 Masayuki Tamaoka, 'The Regressivity of a Value Added Tax: Tax Credit Method and Subtraction Method—A Japanese Case' (1994) 15(2) *Fiscal Studies* 57–73.

8 Adhikari (n 2).

9 Meshari Alhussain, 'The Impact of Value-Added Tax (VAT) Implementation on Saudi Banks' (2020) 12(1) *Journal of Accounting and Taxation* 12–27.

10 The designation of non-financial firms means that they are primarily involved in the production of non-financial goods and services: Organisation for Economic Co-Operation and Development ('OECD'), 'Understanding Financial Accounts' (Report, 2017).

11 Adel Bogari, 'The Economic and Social Impact of the Adoption of Value-Added Tax in Saudi Arabia' (2020) 4(2) *International Journal of Economics, Business and Accounting Research* 62–74.

According to the Organisation for Economic Co-Operation and Development ('OECD') study entitled 'Consumption Tax Trends 2020', the VAT accounts for more than 20% of total tax revenue in OECD countries. Moreover, recent outcomes noted within another study conducted by the OECD under a Taxation Working Paper prepared by Thomas[12] and entitled 'Reassessing the Regressivity of the VAT' indicates that a roughly proportional VAT can still have significant equity inferences for poor people, possibly resulting in several families entering poverty. This highlights the importance of confirming the progressivity of the tax-benefit system to offset poor families for the cost in buying power from repaying VAT.

In relation to the COVID-19 crisis, the results of these OECD studies suggest that there may be scope in many countries for VAT reform to address revenue requirements. Notwithstanding that in many countries the regular VAT rates is high, OECD evidence displays that possibility exists to extend VAT. However, any VAT increases, including VAT base expansion that influences the poor, should be accompanied with compensation for poorer families, for example benefit payments or targeted tax credits.[13] This provides further motivation for conducting this study in order to discover the influence of imposing the new VAT of 15% on non-financial Saudi listed companies.

We address abovementioned issues in the case of the KSA's economy. Nowadays, the government has introduced wide economic developments intended to decrease the Kingdom's dependence on oil income. The government applied a main reform and economic program called the 2030 Saudi Vision, which aims to revoke the country out of its reliance on oil income while differentiating its economy. This vision is specifically based on a transition from growth to non-oil activities and the private sector. It persists to work for constructing a helpful environment for competitiveness and business investment. While simultaneously assisting the combination of its economy into the new universal economy. Since there was no VAT in KSA before 1 January 2018, its participation in international trade pushes it to apply numerous fundamental policies in order to vary its economic resources. Therefore, the KSA implemented a 5% VAT on goods and services as of 1 January 2018, and due COVID-19 the Kingdom on 1 July 2020 increase the VAT from 5% to 15%.

The consequence of Saudi Arabia's weighty dependence on the oil income is that its income subsidises to more than 50.4% of its GDP. Inasmuch the Saudi economy is a mono exporter economy founded mostly on oil, any important deterioration in prices of oil will affect the economy of the KSA. The Kingdom's foreign trade ('FT') reliance on oil returns accounts for 72% of the nation's entire exports and closely 70% of regime income. Subsequently, these incomes are gathered by the public governance which rises public spending and results in numerous influences on macro-economic collections. Therefore, some studies display that the VAT is influenced by actual variables such as total income

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12 Alastair Thomas, 'Reassessing the Regressivity of the VAT' (Working Paper, OECD Publishing, 2020).

13 Ibid.

and government debt variables. Hence, it is interesting to evaluate the effect of imposing the new VAT on Saudi listed companies.

In this regard, this study contributes to the VAT and taxation literature. It is one of the few that investigate the VAT effect in the KSA, then an additional encouragement to complete this article is to observe the effect of imposing the new 15% VAT on the profitability of non-financial Saudi listed companies. This paper is related to the empirical works that assess the effects of different VATs through time. The relationship is closer to those papers that investigated economic efficiency from different perspectives. However, previous studies do not examine the role of the VAT per se, and, more importantly, whether the design of how taxes are collected affects growth. Thus, this study focuses on examining the following question: Does imposing the 15% VAT affect profitability of Saudi companies? Using a time series sample of non-financial listed Saudi companies as one of the G20, OECD and GCC countries over two periods of time 2019–2020.

Moreover, this investigation has a varied realistic implementation for investors, businesses, economic analysts and policymakers. To the best of our knowledge, it is the first article considering the latest VAT execution in the KSA which proposes to examine the consequences of such interventions for the non-financial companies' sectors. The outcomes are significance for policymakers and should be taken into consideration by the KSA government by knowing the consequences of previous interventions before carrying out the next move of government interventions in the economic sectors of the Kingdom. Accordingly, this paper proceeds to describe the evident policy influence which can be employed not solitary to the KSA, but to other smaller countries considering a significant reform to their VAT rates. Ultimately, this is the reason why this development would be of interest to policymakers. Despite the fact we offer robust suggestions of the substantial negative influence of the VAT rate rise on company profitability, it is significant to edge that the scale of the influence could be exaggerated by out-of-control reasons.

The remainder of the paper is as follows. Part II explores related literature, Part III outlines the research design and analyses, Part IV explores the additional tests and Part V provides a brief conclusion.

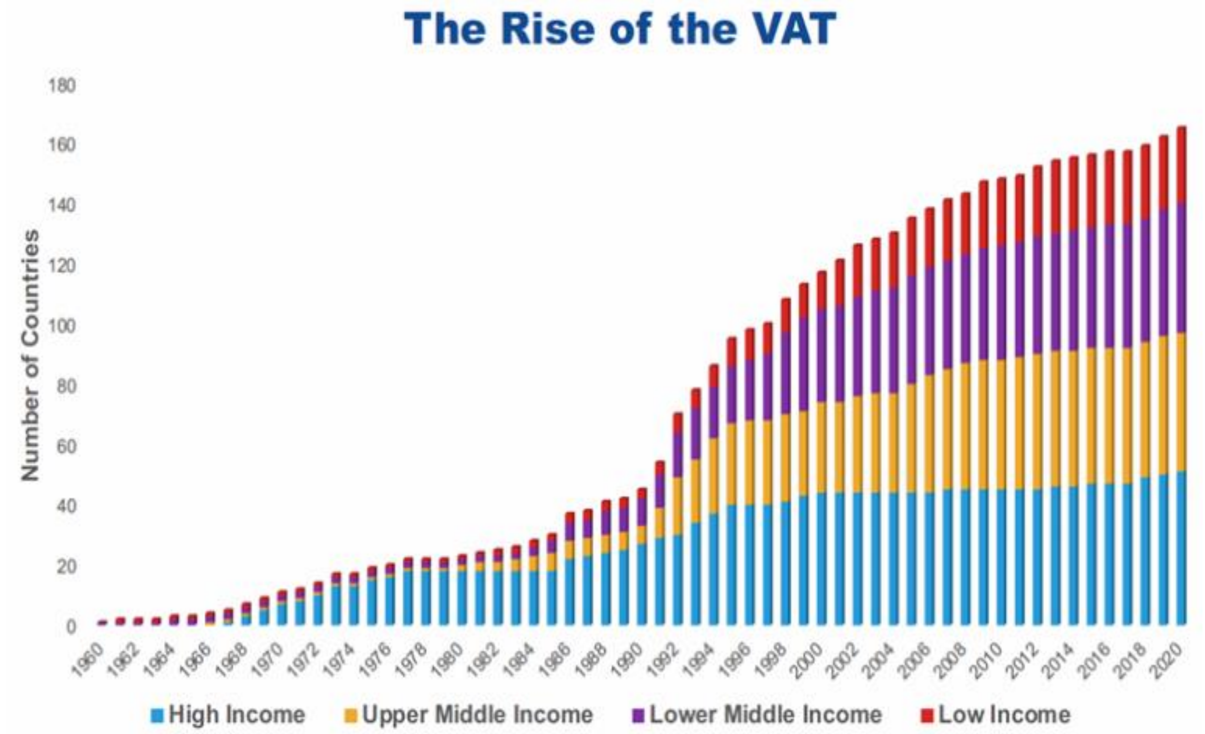
II RELATED LITERATURE

The shifting economic circumstances of worldwide growth at the end of 2019–2020 result in a need to guarantee the efficacy and functioning of the tax system in any country. The process of globalisation of economic models identifies the requirement to change the tax management in any country to these by confirming the capability and comprehensiveness of the revenue base of each country to diminish the underground economy, expand the tax base and improve the main tax instruments. These circumstances need constant enhancement and strengthening of global tax administration in the face of various challenges related to tax transparency, counting through the fast growth of business and commerce on the internet.[14] VAT is a modern tax; as of 2020, over 160 countries around

[14] Aleksy Kwilinski, Henryk Dzwigol and Vyacheslav Dementyev, 'Model of Entrepreneurship Financial Activity of the Transnational Company Based on Intellectual Technology' (2020) 24 *International*

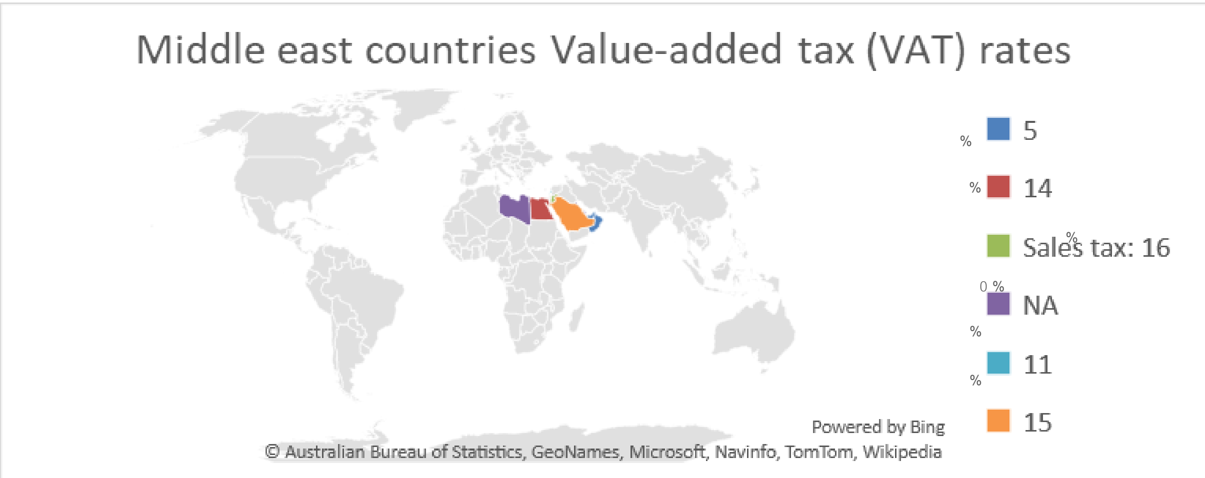
the globe have implemented a VAT. Some countries refer to the tax as General Sales Tax or Goods and Services Tax. Figure 1 below shows the dramatic change and increases to VAT over time and Figure 2 (further below) illustrates the VAT rates of Middle Eastern countries.

FIGURE 1: THE RISE OF THE VAT



Source: IMF Internal International Tax Rates Database.

FIGURE 2: MIDDLE EAST VAT RATES



Source: IMF Internal International Tax Rates Database

Journal of Entrepreneurship 1–5; Abramova et al, 'The Ecosystem of VAT Administration in E-Commerce: Case of the Eastern Europe Countries' (2021) 39(5) *Studies of Applied Economics* 1–15; Dubyna et al, 'Transformation of Household Credit Behavior in the Conditions of Digitalization of the Financial Services Market' (2021) 14(1) *Journal of Optimization in Industrial Engineering* 97–102; Shkarlet et al, 'Infrastructural and Regional Development: Theoretical Aspects and Practical Issues' (2021) 38(4) *Studies of Applied Economics*.

The spirit of the VAT is that it is charged on all transactions however, being credited alongside tax due on dealers' sales, eventually occurs to carry if the crediting chain is steady, and tax exactly levied on imports and remitted on exports merely on the last consumption.[15]

At all periods of the development of tax relationships, tax management has been explained as the construction of situations for the voluntary compliance with tax commitments, consequently, the payment of taxes and duties. In the event of non-compliance with the law, the application of corresponding penalties arises. Its main objective has been and remains to attain the effectiveness (low tax cost) and efficiency (integrity of the mobilisation of tax duties) of the work of the tax system[16].

Moreover, prior studies[17] recommend that the divergence of C-efficiency from unity in developed economies is mostly because of the VAT that is not levied as a consequence of exemptions, decreased rates or compliance issues. However, Acosta-Ormaechea and Morozumi,[18] argue that in the long-term, a boost in C-efficiency, maybe indicating the augmentation of the VAT base throughout small number of exemptions and a more uniform-rate structure with less decreased rates, has a growth-promoting influence relative to an increase in the VAT standard rate that declines the efficacy gains. As those VAT design characteristics, that have been common in many developed economies involving EU countries, change resource distributions extensively.

In an inclusive, neutral, and operative way the VAT has been designed to tax the production chain and individual consumption. The VAT remained the utmost extensive tax reform worldwide throughout the subsequent semi of the 20th century and has verified to be a key underpinning of government incomes. The VAT is widely utilised in developing and developed countries.[19] The rule of the VAT — mostly the individuals' personal consumption, for example is measured via the value paid for services and goods. The implementation of VAT aids exports since exported goods are exempted from tax. Further, to the benefit of tax exception in the final step, it is conceivable to regain all the tax paid in the prior exporting steps, and thus the VAT helps the affordability of local

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15 Keen (n 3).

16 Наталія Сергіївна Орлова and Алла Іванівна Іващенко, 'Comparative Analysis of Some EU and EU Associated Countries to Identify the Phenomenon of Business Development in Post-Socialist Countries' (2017) 163(1) *Економічний часопис-XXI* 22–25; Grigoraș-Ichim et al, 'Shaping the Perception and Vision of Economic Operators from the Romania-Ukraine-Moldova Border Area on Interim Financial Reporting' (2018) 173 *Economic annals-XXI*; Bondarenko et al, 'Risk Management of Enterprise Restructuring Strategy' (2020) 11(5) *International Journal of Advanced Research in Engineering and Technology*; Kholiavko et al, 'Comprehensive Methodological Approach to Estimating the Research Component Influence on the Information Economy Development = Комплексний методичний підхід до оцінювання впливу дослідницької компоненти на розвиток інформаційної економіки' (2020) 178(4) *Naukovyi Visnyk Natsionalnoho Hirnychoho Universytetu*.

17 Ebrill et al, The Modern VAT (Report, 2001, International Monetary Fund); Michael Keen, 'The Anatomy of the VAT' (2013) 66(2) *National Tax Journal* 423–446.

18 Santiago Acosta-Ormaechea and Atsuyoshi Morozumi, 'The Value-Added Tax and Growth: Design Matters' (2021) *International Tax and Public Finance* 1–31.

19 Alan Schenk, Victor Thuronyi and Wei Cui, *Value Added Tax* (Cambridge University Press, 2015).

goods in overseas markets. Moreover, measures of VAT obedience rates are appreciated for classifying problem areas in VAT execution.[20]

Entirely tax rules are self-growing to some level and solitary of the core causes to practice the synthetic-control-method to measure its capability to account for unnoticed heterogeneity and further agreeably than matching techniques or old-style panel regressions. The context of the VAT implementation affords an exceptional exogenous set to evaluate the influence of tax improvements on economic effectiveness.[21] In this context, Zou, Shen and Gong,[22] discovered a clear drop in liability proportions after the VAT reform, in their study of the influence of China's 2007 VAT reform on company leverage. That drop in liability percentage was more significant amongst private firms than public firms and foreign companies, which may be described by the fact that private firms typically face tighter financing restrictions.

VAT choices are regularly impacted by outside powers that are ostensibly external to the inner circumstances of the restructuring countries. Numerous scholarly and non-academic foundations characterise the job of multifaceted associations, particularly the European Union ('EU') and the International Monetary Fund ('IMF'), in affecting the boost-up choice of VAT. The EU necessitates that part statuses embrace VAT on entrance to the EU.[23] Along these lines, any nation becoming a member of the EU or trying to join the EU desires to implement a VAT.[24]

Likewise, the IMF is a robust supporter of the VAT and regularly places the implementation of VAT as solitary of the settings for assistance and financing a mortgage. Accordingly, nation's that want the IMF's support have an abundant advanced likelihood of implementing a VAT.[25] For example, the VAT a 25% upper opportunity of implementing one in the year afterward in countries that enter a non-crisis program exclusive of a VAT, which verifies the prevalent discernment that the IMF has played an important function in the extension of the VAT. Ebrill et al,[26] estimate that nations that familiarised a VAT throughout the 1980s and 1990s utilised the IMF's guidance in implementing the VAT.[27]

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[20] James Giesecke and Nhi Hoang Tran, 'A General Framework for Measuring VAT Compliance Rates' (2012) 44(15) *Applied Economics* 1867–1889.

[21] Adhikari (n 2).

[22] Jingxian Zou, Guangjun Shen and Yaxian Gong, 'The Effect of Value-Added Tax on Leverage: Evidence from China's Value-Added Tax Reform' (2019) 54 *China Economic Review* 135–146.

[23] Adam et al, 'A Retrospective Evaluation of Elements of the EU VAT System: Final Report' (Report No TAXUD/2010/DE/328, FWC No TAXUD/2010/CC/104, Institute for Fiscal Studies, 2011).

[24] Keen (n 3); Adhikari (n 2).

[25] Keen (n 3).

[26] Ebrill (n 17).

[27] Keen (n 3); Alex Ufier, 'Quasi-Experimental Analysis on the Effects of Adoption of a Value Added Tax' (2014) 52(4) *Economic Inquiry* 1364–1379; Pavel Čížek, Jinghua Lei and Jenny E. Ligthart, 'Do Neighbours Influence Value-Added-Tax Introduction? A Spatial Duration Analysis' (2017) 79(1) *Oxford Bulletin of Economics and Statistics* 25–54.

According to previous studies,[28] the plan of the VAT construction in one locale impacts the plan of assessment constructions in neighbouring territories. If nations implement a VAT because of the impact of their neighbours, at that point such tax reform is progressively external to the financial state of the implementing nation than a change persuaded by their interior economic circumstances. The presentation of the VATs without a doubt pursued regional waves.[29] For example, more than 11 other European nations received VAT inside five years of France's choice to implement a VAT. Correspondingly, 11 supplementary Latin American nations presented the VAT inside a time of Brazil's choice to implement a VAT. The copycat conduct is especially solid in Eastern Europe, where 18 nations implemented VAT inside five years of Hungary's VAT implementation. A comparative example is additionally discovered in the creating nations of Asia and sub-Saharan Africa. The impressionist conduct in VAT appropriation is likewise shown in increasingly methodical studies.[30] In this context, we disagree with what Case et al[31] and Besley and Case[32] have stated as that is not the only reason for many other European countries introducing VAT after France, there are some European countries that introduced a VAT after Hungary (another member of the EU) and countries in Asia have introduced VAT/GST at various times, not necessarily at similar times.

Practically, the entirety of the nations implemented VAT to supplant sales taxes (i.e., manufacturing tax, whole-sale tax, or sales tax). In some nations, they additionally utilised a VAT prologue to diminish further unproductive indirect taxes, or to some extent decrease direct taxes. This holds as a rule too, and not simply in the nations canvassed in other studies.[33] For example, in the example of 88 nations for which the author could gather information, Panama and Japan are the main two nations that had no broad sales taxes beforehand the VAT appropriation. Japan altogether decreased different extract taxes e.g., vehicles sales tax as of 23% to 6% and Panama fundamentally diminished different stamp duties once they implemented a VAT. Hence, these VAT changes provide a perfect set to assess the effect of changing sales and sales taxes through VAT on economic effectiveness.[34]

In relation to micro-enterprise (new-energy industry) a semi common analysis investigated the impact of new energy VAT incentives on the microenterprise level. Utilising the Differences-in-Differences ('DiD') method and a monetary board

28 Anne C. Case, Harvey S. Rosen and James R. Hines, 'Budget Spillovers and Fiscal Policy Interdependence' (1993) 52(3) *Journal of Public Economics* 285–307; Timothy Besley and Anne Case, 'Does Electoral Accountability Affect Economic Policy Choices? Evidence from Gubernatorial Term Limits' (1995) 110(3) *The Quarterly Journal of Economics* 769–798.

29 Ibid.

30 Richard E. Krever, *VAT in Africa* (PULP, 2008). See also above n 27.

31 Case (n 28).

32 Besley (n 28).

33 Alex Ufier, 'The Effect of VATs on Government Balance Sheets' (2017) 24(6) *International Tax and Public Finance* 1141–1173.

34 Adhikari (n 2).

informational collection of China's listed organisations, it discovered that in 2008 China's VAT incentives (e.g., VAT refunds) for new-energy sectors (basically alludes to nuclear-power and wind-power) are ineffectual in animating company return on equity ('ROE'). The study recommended, tax encouragements for terminal use must be supported to alleviate the overloading in the new-energy sector. That means a VAT increase influences a company's profitability when there are no VAT incentives to stimulate and increase the demand for goods then the company's profitability decreases. Economic incentives must be familiarised to evade the market alteration and spiteful struggle of the new-energy sector. Encouraging research and development ('R&D') motivations is favourable for improvement in renewable energy technologies. Comparing supportive measures for the improvement of the new-energy sector must be executed in China's listed firms.[35]

VAT is an indirect tax in the tourism industry, alike the United States ('US'). Turnover tax, levied on tourism services and goods on the VAT at different steps of manufacturing. Bistros, cafes and hotels in the EU,[36] accumulate VAT for the government.[37] VAT can be considered as a macroeconomic instrument for tourism administration, meanwhile it raises the prices that face visiting tourists. Core outcomes specify that VAT raises have non-negative influences on the tourist stream. This suggests that as a macroeconomic instrument, governments can deliberate VAT growth in their plans, as to account for essential infrastructure creation to control boosted tourist inflow.[38] Thus, given that a VAT does not make a destinations less attractive and for governments the general marginal rise in VAT does not influence tourism, and hence maybe a possible choice.

'With (VAT) approach, income from capital would not be taxed until it is ultimately consumed'.[39] According to Golob,[40] the VAT has a positive effect on stock prices. This type of tax would disregard taxes on capital gains and dividends, but stock prices would rise a little less, meanwhile firms would still be taxed with different taxes. This is due to the reduction of the available income to be taxed. However, VAT taxes expenditure, for registered companies, the VAT generally has a revenue neutral influence, as they are entitled to input tax credits on taxable inputs. An instance of the influence of VAT is what

35 Chuanwang Sun, Yanhong Zhan and Gang Du, 'Can Value-Added Tax Incentives of New Energy Industry Increase Firm's Profitability? Evidence from Financial Data of China's Listed Companies' (2020) 86 *Energy Economics* 104654.

36 HOTREC, 'European Trade Association of Hotels, Restaurants and Cafes' (2021) <https://www.hotrec.eu/>.

37 Helga Kristjánsdóttir and Paula Remoaldo, 'Tourism in a Remote Nordic Region: VAT, internet, Oil, English, Distance, Hofstede, and Christianity' (2019) 5(1) *Cogent Social Sciences* 1709346.

38 Helga Kristjánsdóttir, 'Tax on Tourism in Europe: Does Higher Value-Added Tax (VAT) Impact Tourism Demand in Europe?' (2020) *Current Issues in Tourism* 1–4.

39 United States Congress Senate Committee on Banking, Housing and Urban Affairs, *United States Trade Policy and the Economy: Hearings Before the Committee on Banking, Housing, and Urban Affairs*, United States Senate, One Hundred and Second Congress, Second Session, to Review Some of the Major Causes of Our Current Economic Difficulties, and to Suggest Steps that the United States Can Take Now to Deal with These Problems (US Government Printing Office, 1992) vol 102.

40 John E. Golob, 'How Would Tax Reform Affect Financial Markets?' (1995) 80 *Economic Review — Federal Reserve Bank of Kansas City* 19–40.

Asogwa and Nkolika[41] found in their study about the VAT's influence in Nigeria, which included stocks. This study found that there was an optimistic influence of VAT on stocks and on investments, and in general in the KSA there is a normal impact of VAT on stock prices. As a financial exchange record is the thing that quantifies the general action and execution of each stock in the securities market.[42] Financial exchanges, often have a main index which clarifies how most organisations in the economy are doing, which can be influenced by any inside or outer components, including any tax activities. In addition, the securities exchange can give an extremely away from of how the economy is getting along. Actually, VAT generally does not apply to investments and financial supplies are generally exempt from VAT. Where the issues augmented by VAT and financial investments maybe the utmost questioning of all VAT and financial supplies to resolve.[43]

In this context, like the Dow Jones or the S&P500, the main index for the Saudi Arabian securities exchange is Tadawul[44] All Shares Index ('TASI'). TASI measures the Saudi securities exchange and can trace the status of each stock. Stocks typically clarify how a firm is doing based on their revenue and sales. This guides to a good association between stock prices and consumption levels. Which supposed to be influenced by VAT meanwhile taxes were continuously influencing the economy. This is another encouragement to conduct this study in order to measure the effects of implementing the new 15% VAT that was imposed from 1 July 2020 in non-financial[45] KSA listed companies[46] in Tadawul.

III Research Design

A *Methodology, Sampling and Data Sources*

In general, the experimental investigation of the economic impacts of VATs is horrifically irregular. It tends to be separated into two classes: decreased structure analysis and general equilibrium analysis. The primary preferred position of displaying general equilibrium is that it gives an away from and a pure line between the hypothetical and practical aspects of fiscal policy investigation. However, they likewise have significant impediments. For example, they build solid and impromptu suspicions about the

41 F. O. Asogwa and Okeke Mercy Nkolika, 'Value Added Tax and Investment Growth in Nigeria: Time Series Analysis' (2013) *IOSR Journal of Humanities and Social Science*.

42 Maureen Burton and Bruce Brown, *Financial System of the Economy: Principles of Money and Banking: Principles of Money and Banking* (Routledge, 2014).

43 Richard E. Krever, 'VAT and Financial Investments' in *VAT and Financial Services* (Springer, 2017) 189–197.

44 'The Saudi Exchange is a completely owned subsidiary by Saudi Tadawul Group and was established in March 2021 following the transformation of the Saudi Stock Exchange (Tadawul) into a holding firm, Saudi Tadawul Group.'

45 In this regard, there are also previous studies investigating the effects of VAT on KSA Banks which are excluded from our sample, for example, Alhussain (n 9); Ahmad Alkhodre et al, 'A Blockchain-Based Value Added Tax (VAT) System: Saudi Arabia as a Use-Case' (2019) 10(9) *Int. J. Adv. Comput. Sci. App*l 708–716.

46 Listed company means approved in the Exchange.

utilitarian types of the model, the sort of adaptability, the tax treatment, the structure of the market, the kind of innovation, and so on, that are commonly not kept up in reality[47].

All published equilibrium papers utilise data from high revenue nations like the US, Canada, Germany and Norway.[48] They found an optimistic influence of VAT on economic effectiveness and supplementary macroeconomic factors. Nevertheless, when they integrate inadequacies originate in reality VATs in their models, the effectiveness expansions attained by implementing a VAT meaningfully reductions. For example, Bye et al,[49] found that counting selective-services in the VAT basis decreases prosperity paralleled to non-counting selective-services in the VAT basis or counting all facilities in the VAT basis.[50]

Our article utilises a periodic dataset from a big section of registered companies in Saudi Arabia from 2019 before imposing the new VAT rate to 2020, after imposing the new VAT rate. The sample framework was chosen due to the time of implementing the new 15% VAT rate and the public access to information about VAT of non-financial companies, where Tadawul force all listed companies to publish their financial statements publicly quarterly and annually on the TASI website. TASI includes 192 publicly traded firms separated into 11 main sectors. The foremost segments are consumer discretionary, information technology, energy, consumer staples, materials, health care, industrials, communication services, real estate, utilities, and financials. Financial companies excluded from the sample framework as the have special treatments and some previous studies investigated the effects of VAT on KSA Banks, the final sample framework is 131 listed companies as clearly depicted in Table 1 below.

47 Adhikari (n 2).

48 Charles L. Ballard, John Karl Scholz and John B. Shoven, 'The Value-Added Tax: A General Equilibrium Look at its Efficiency and Incidence' in *The Effects of Taxation on Capital Accumulation* (University of Chicago Press, 1987) 445–480; Piggott, John and John Whalley, 'VAT Base Broadening, Self Supply, and the Informal Sector' (2001) 91(4) *American Economic Review* 1084–1094; Boeters et al, 'Economic Effects of VAT Reforms in Germany' (2010) 42(17) *Applied Economics* 2165–2182; Brita Bye, Birger Strøm and Turid Åvitsland, 'Welfare Effects of VAT Reforms: A General Equilibrium Analysis' (2012) 19(3) *International Tax and Public Finance* 368–392.

49 Bye (n 48).

50 Ballard (n 48).

TABLE 1: VAT RATE AND SAMPLE FOR SAUDI'S NON-FINANCIAL COMPANIES CLASSIFIED BY INDUSTRIES

SECTOR	5% IMPLEMENTATION PERIOD*	15% IMPLEMENTATION PERIOD*	NUMBER OF COMPANIES
Energy	From 1 January 2018 to 1 July 2020	From 1 July 2020, ongoing	5
Materials			42
Commercial and Professional Service			3
Transportation			5
Consumer Durables and Apparel			6
Consumer Services			10
Media and Entertainment			2
Retailing			8
Food and Staples Retailing			4
Food and Beverages			12
Health Care Equipment and Service			7
Pharma, Biotech and Life Science			1
Software and Services			2
Telecommunication Services			4
Utilities			2
TOTAL			**113**

Note: * In the KSA, VAT was first introduced in all industries as a 5% VAT on goods and services as of 1 January 2018 and because of COVID-19 the KSA on 1 July 2020, increased the VAT to 15%.

B *Profitability Analysis*

Table 2 below presents an initial overall profitability analysis of the sample selected, as it reports the mean, standard deviation, median, maximum, profitability percentile in 25%, 50% and 75% for the sample selected in 2019 and 2020 financial years. The selected sample as highlighted before comprises 226 (113*2) firm-year observations over the period 2019–2020 before and after tax increased.

Generally, it is observed that for the same sample, in 2020 KSA companies are less profitable than they were in 2019. This is clearly apparent in the table as the mean net income in 2019 was 3,169.31 billion which decreased to 1,813.003 billion in 2020. Since the companies were exposed to COVID-19 crises which led to significant increase in VAT. Moreover, maybe the reason why firms are less profitable in 2020 than in 2019 is not merely to do with a rise in the VAT rate, but also COVID-19 and other factors which is beyond the scope of this paper. For instance, resultant increases in the prices of goods and services reduced demand which leads to decrease the company's profitability. Thus, additional analysis is required to understand the discrepancies between these values.

TABLE 2: OVERALL PROFITABILITY ANALYSIS

2020								
VARIABLE	**OBS**	**MEAN**	**STD. DEV.**	**MIN**	**MAX**	**PERC25%**	**PERC50%**	**PERC75%**
*EBITDA/T	113	0.0475005	0.0871319	-0.2104513	0.4120229	0.0000612	0.0400477	.1037356
*EBIT/T	113	0.0226953	0.075097	-0.2220433	0.1892432	-0.0062535	0.0213612	0.0710064
*EBTExclUnu~s/T	113	0.0343528	0.1460593	-0.2215373	1.332865	-0.006998	0.0217555	0.0708684
EAT2020	113	1813.003	17420.56	-3781.13	184926	-0.0119662	0.0264552	0.0706598
2019								
EAT2019	113	3169.31	31119.4	-1676.32	330816	-0.0187827	0.0219593	0.0595443
Change(%)inEarn	113	2.973124	25.42851	-16.4361	264.1	-0.4129	0.0953	0.9172

All the measures of profitability are scaled by total assets and include earnings before interest, taxes, depreciation and amortisation (EBITDA/T), earnings before interest and taxes (EBIT/T), earnings before taxes (Earn2020T) and earnings after taxes (Earn2020T).

* Scaled by total assets

We analysed per year the values for EAT which reflected net income per a year. Therefore, we selected this measure of profitability since it is calculated after interest, tax, amortisation and depreciation as it cannot be different at the same country, also company size etc.). Figure 3 below shows the percentage of EAT (Earnings after taxes) per year for Saudi firms for the period 2019–2020. It clearly shows that in 2019 the average net income is high in the year before the adoption of the new VAT rate in KSA. Starting from Q2 of 2020, the impact of the recent financial crisis of COVID-19 is observable in a steady decline in the average profitability.

FIGURE 3: SAUDI COMPANIES' EAT IN 2019 AND 2020

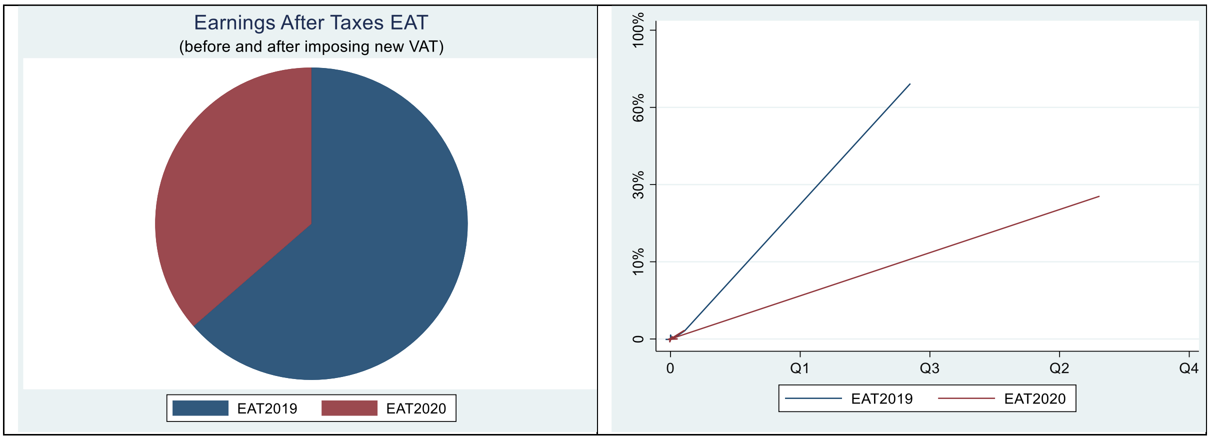


Table 3 reports Profitability by year of a sample using WilcoXon rank-sum and Wilcoxon signed-rank test[51] to compare values of average profitability for 2019 versus 2020 for each firm size and year. Superscripts indicate statistical significance at 0.01 (*), 0.05 (**) and 0.10 (***) percent levels. P-values are reported in parenthesis. We test the null hypothesis that two independent samples (2019 and 2020) are the same against an alternative hypothesis that a particular population tends to have larger values than the other. A significant Z value indicates there is confidence evidence of significant differences across companies and the null hypotheses are rejected. Overall, the results support the hypothesis that in 2020 firms are, on average, less profitable than in 2019. Interestingly, after the VAT increase in Q4 2020 firms profitability became even a little bit different, the results are statistically significant and show lower Z- statistic.

TABLE 3: WILCOXON SIGNED-RANK TEST

	OBS	SUM RANKS			
Signrank EAT2019 = SIZE2019	Positive = 75	4581	Ho: EAT2019 = SIZE	z =	3.898***
	Negative = 38	1860		Prob > |z| =	(0.0001)
Signrank EAT2020 = SIZE2020	Positive = 75	4471	Ho: EAT2020 = SIZE	z =	3.582***
	Negative = 38	1970		Prob > |z| =	(0.0003)

[51] Non-parametric test used foe matched-paired data analysis, for a single sample, or based on differences. The null-hypothesis is that the individual, or differences observations in the single sample case, have a distribution centred about zero: R. F. Woolson, 'Wilcoxon Signed-Rank Test' (2007) *Wiley Encyclopedia of Clinical Trials* 1–3.

C *Descriptive Statistics*

Table 4 below reports the summary statistics of dependent and independent variables defined in the previous section. GvD2020 and GvD2019 are measured as Government Debt to GDP, the average government debt to GDP was higher for sample in the 2020 analysed than 2019. The table represents mean, median, and standard deviation for 2019 before VAT increase and 2020 after VAT increase. SIZE2019 and SIZE2020 are measured as the natural logarithm of total assets. Moreover, the 25th and 75th percentiles for the abovementioned variables.

TABLE 4: DESCRIPTIVE STATISTICS

VARIABLE	OBS	MEAN	STANDARD DEVIATION	MIN	MAX	PERC 25%	PERC 50%	PERC 75%	WILCOXON SIGN-RANK TEST (Z-STATISTIC)
ProFtEBITDA	113	0.0000475	0.0000871	-0.0002105	0.000412	6.12e-08	0.00004	0.0001037	5.456***
ProFtEBIT	113	0.0000227	.0000751	-0.000222	0.0001892	-6.25e-06	0.0000214	0.000071	3.451***
ProFtEBTUnu	113	0.0000344	.0001461	-0.0002215	0.0013329	-7.00e-06	0.0000218	0.0000709	3.683***
2019 (BEFORE TAX REFORM)									
EAT2019	113	0.0000842	0.0007884	-0.0006502	0.008303	-0.000018	0.0000214	0.0000586	3.259***
SIZE2019	113	6.402416	0.7762833	4.799299	9.600352	5.889565	6.336924	6.657192	_____
GvD2019	113	2.224271	8.346027	0.0095256	7.217121	0.117262	0.3284856	0.6867278	_____
2020 (AFTER TAX REFORM)									
EAT2020	113	0.0000171	0.0000853	-0.0002951	0.0002637	-0.000012	.0000265	0.0000707	2.944***
SIZE2020	113	6.401014	0.7646444	4.63827	9.274225	5.867576	6.351831	6.67686	_____
GvD2020	113	1.27e+14	7.60e+14	1.79e+11	7.75e+15	3.04e+12	9.27e+12	1.96e+13	_____
Chg(ERN)	113	2.973124	25.42851	-16.4361	264.1	-0.4129	0.0953	0.9172	_____

Note: the statistical significance at 0.01 (*), 0.05 (**) and 0.10 (***) percent levels.

The WilcoXon signed rank test is performed to test statistical significant differences in mean values for 2019 and 2020. In this regard, Wilcoxon signed-rank test used as a nonparametric statistical hypothesis test that compares two closely related samples to see if their population mean ranks differ. Results revealed less significant in 2020 sample the year of the VAT increase as it drops from 3.259*** to 2.944***.

D *Models, Multivariate Results and Discussions*

We analysed profitability in general in the above section. In this section, we examine the effect of the VAT rise on company profitability levels in 2020. So, the dataset of 2019 can be utilised to predict and/or expect the outcomes of the recently proposed equivalent VAT increase in 2020.

In the first model we ran the OLS regression to determine the effects of independent variables on a profitability which was measured by EBITDA.

$ProFtEBITDA = \beta_0 + \beta_1\ SIZE2020 + \beta_2\ EAT2020 + \beta_3\ GvD2020 + \beta_4\ EAT2019 + \beta_5\ SIZE2019 + \beta_6\ GvD2019\ (1)$

TABLE 5: VARIABLES DEFINITIONS AND MEASUREMENTS

VARIABLES	DEFINITION	MEASUREMENT
ProFtEBITDA	Company Profit	Measured by earnings before interest, taxes, depreciation, and amortisation (EBITDA) and scaled by total assets*
SIZE2020	Company Size in 2020	Measured by the natural logarithm of total assets**
EAT2020	Company Earnings after tax in 2020	measured by subtracting all expenses and income taxes from the revenues the business has earned
GvD2020	Government Debt 2020	Measured as government debt over GDP
EAT2019	Company Earnings after tax in 2019	Measured by subtracting all expenses and income taxes from the revenues the business has earned
SIZE2019	Company Size in 2019	Measured by the natural logarithm of total assets
GvD2019	Government Debt 2019	Measured as government debt over GDP

Notes: * All the measures of profitability are scaled by total assets and include: earnings before interest, taxes, depreciation and amortisation (EBITDA), Earnings before interest and taxes (EBT), Earnings before taxes (EBT) and Earnings after taxes (EAT). ** We expect a positive relationship among firm size

Initially, we grasp the question of whether a company's specific characteristics (IVs), affect profitability in 2019 and 2020. The results are reported in models 1, 2 and 3 — in each model we use different measurement of profitability. Table 6 below shows the findings of the independent variables on profitability measured by earnings before interest, taxes, depreciation, and amortisation (EBITDA) and scaled by total assets. R-squared equal (0.6052) which means that ProFtEBITDA level explained 61% of the total variance in ProFtEBITDA. Furthermore, this illustrates that the level of ProFtEBITDA has a good level of explanatory power. All company's specific characteristics variables in the two period are statistically significant at 1% level (p-value below 0.01). In addition, a company's specific characteristics variables in 2020 have a higher sign then 2019. For 2020, in contrast to 2019, as companies grow older, their profitability seems to decline due to the COVID-19 crisis. In this model the outcomes strongly approve that raised levels of public debt in 2020 provided by the government to the economy negatively affect company profitability measured by EBITDA with (t = -2.66***).

In the second model, and as denoted in Table 7 below, we ran the OLS regression to determine the effects of independent variables on a profitability measured by EBIT.

$$ProFtEBIT = \beta_0 + \beta_1\ SIZE2020 + \beta_2\ EAT2020 + \beta_3\ GvD2020 + \beta_4\ EAT2019 + \beta_5\ SIZE2019 + \beta_6\ GvD2019 \quad (2)$$

TABLE 6: OLS REGRESSION RESULTS DV= PROFTEBITDA MODEL 1

PROFTEBITDA	COEF.	ROBUST STD. ERR.	T	P>T	[95% CONF.	INTERVAL]
EAT2019	0.1106933	0.0455473	2.43	0.017***	0.0203913	0.2009953
SIZE2019	0.0001276	0.0000615	2.08	0.040***	5.79e-06	.0002495
GvD2019	1.14e-13	4.37e-14	2.60	0.011***	2.72e-14	2.01e-13
SIZE2020	-0.0001571	0.0000617	-2.55	0.012***	-0.0002794	-0.0000348
EAT2020	0.7282002	0.1034695	7.04	0.000***	0.5230618	0.9333387
GvD2020	-1.30e-19	4.87e-20	-2.66	0.009***	-2.26e-19	-3.29e-20
_cons	0.0002219	0.0000485	4.58	0.000***	0.0001258	0.0003181
R-squared =	0.6052					

ENHANCED CORRELATION MATRIX (PWCORRS)[52]

	PROFTE~A	SIZE2020	SIZE2019	GVD2020	GVD2019	EAT2020	EAT2019
ProFtEBITDA	1.0000						
SIZE2020	-0.0837 0.3778	1.0000					
SIZE2019	-0.0883 0.3521	0.9936* 0.0000	1.0000				
GvD2020	-0.0859 0.3656	0.5048* 0.0000	0.5353* 0.0000	1.0000			
GvD2019	-0.1268 0.1809	0.5671* 0.0000	0.5619* 0.0000	0.3448* 0.0002	1.0000		
EAT2020	0.7276* 0.0000	0.1844* 0.0505	0.1634* 0.0837	0.0825 0.3850	-0.0107 0.9106	1.0000	
EAT2019	0.0213 0.8229	0.3940* 0.0000	0.4246* 0.0000	0.9431* 0.0000	0.0448 0.6378	0.1799* 0.0566	1.0000 0.8229

52 The PWCORRS command is an improved version of Pearson's correlation matrix (PWCORR) and Spearman's rank correlation (SPEARMAN) that combines the features of both commands into single command that has enhanced formatting.

TABLE 7: OLS REGRESSION RESULTS DV= PROFTEBIT MODEL 2

PROFTEBIT	COEF.	ROBUST STD. ERR.	T	P>T	[95% CONF.	INTERVAL]
EAT2019	0.0696276	0.0394949	1.76	0.081**	-0.008675	0.1479301
SIZE2019	0.0000464	0.00005	0.93	0.356	-0.0000529	0.0001456
GvD2019	6.91e-14	3.74e-14	1.85	0.067	-4.99e-15	1.43e-13
SIZE2020	-0.0000551	0.000049	-1.12	0.264	-.0001523	0.0000421
EAT2020	0.6917655	0.0874201	7.91	0.000***	.5184466	0.8650845
GvD2020	-8.52e-20	4.19e-20	-2.03	0.044***	-1.68e-19	-2.19e-21
_cons	0.0000666	0.0000391	1.70	0.092**	-0.000011	0.0001442
R-squared=	0.6924					

Where: ProFtEBIT is a company profit measured by earnings before interest, taxes (EBIT) and scaled by total assets

ENHANCED CORRELATION MATRIX (PWCORRS)

	PROFTE~T	SIZE2020	SIZE2019	GVD2020	GVD2019	EAT2020	EAT2019
ProFtEBIT	1.0000						
SIZE2020	0.0597 0.5301	1.0000					
SIZE2019	0.0446 0.6391	0.9936* 0.0000	1.0000				
GvD2020	-0.0452 0.6346	0.5048* 0.0000	0.5353* 0.0000	1.0000			
GvD2019	-0.0628 0.5084	0.5671* 0.0000	0.5619* 0.0000	0.3448* 0.0002	1.0000		
EAT2020	0.8181* 0.0000	0.1844* 0.0505	0.1634* 0.0837	0.0825 0.3850	-0.0107 0.9106	1.0000	
EAT2019	0.0534 0.5740	0.3940* 0.0000	0.4246* 0.0000	0.9431* 0.0000	0.0448 0.6378	0.1799* 0.0566	1.0000

Secondly, Table 7 shows the findings of the independent variables on ProFtEBIT measured by earnings before interest, taxes (EBIT) and scaled by total assets. R-squared equal (0.6924) which means that ProFtEBIT level explained 69% of the total variance in ProFtEBI. Moreover, this illustrates that the level of ProFtEBIT has a good level of explanatory power and higher then ProFtEBITDA explanatory power in model one by 9%.

Furthermore, all company's specific characteristics variables in the two period are statistically significant at 1% level (p-value below 0.01). In contrast to model 1, this model when we use EBIT as measurement for profitability, we found that firm size in the two periods is statically unsignificant with positive sign coefficient in 2019 and negative sign coefficient in 2020. But, other a company's specific characteristics variables in 2020 have a higher sign then 2019 equal to model 1.

For 2020, in contrast to 2019, their profitability seems to decline due to the COVID-19 crisis. In model 2, the outcomes also strongly approve that raised levels of public debt in 2020 provided by the government to the economy less negative t-value affect company profitability measured by EBIT with (t = -2.03***) which confirms the effect of the COVID-19 crisis on Saudi companies' profitability in 2020.

In the third model we ran the OLS regression to determine the effects of independent variables on a profitability which was measured by *EBTUnu*.

$$ProFtEBTUnu = \beta_0 + \beta_1\ SIZE2020 + \beta_2\ EAT2020 + \beta_3\ GvD2020 + \beta_4\ EAT2019 + \beta_5\ SIZE2019 + \beta_6\ GvD2019, (3)$$

TABLE 8: OLS REGRESSION RESULTS DV= PROFTEBIUNU MODEL 3

PROFTEBTUNU	COEF.	ROBUST STD. ERR.	T	P>T	[95% CONF.	INTERVAL]
EAT2019	0.027959	0.0704643	0.40	0.692	-.1117433	0.1676613
SIZE2019	0.0000335	0.0000718	0.47	0.642	-0.0001089	0.000176
GvD2019	4.09e-14	6.20e-14	0.66	0.511	-8.20e-14	1.64e-13
SIZE2020	-0.0000568	0.0000784	-0.72	0.471	-0.0002123	0.0000987
EAT2020	0.7840316	0.1005927	7.79	0.000***	0.5845968	0.9834664
GvD2020	-3.64e-20	7.69e-20	-0.47	0.637	-1.89e-19	1.16e-19
_cons	0.0001691	0.000101	1.67	0.097**	-0.0000311	0.0003694
R-squared =	0.2098					

Where: ProFtEBTUnu is a company profit measured by EBT Excl. Unusual Items which represents EBT Before non-recurring Items and scaled by total assets

ENHANCED CORRELATION MATRIX (PWCORRS)

	PROFTE~U	SIZE2020	SIZE2019	GVD2020	GVD2019	EAT2020	EAT2019
ProFtEBTUnu	1.0000						
SIZE2020	-0.0272 0.7750	1.0000					
SIZE2019	-0.0353 0.7104	0.9936* 0.0000	1.0000				
GvD2020	-0.0365 0.7009	0.5048* 0.0000	0.5353* 0.0000	1.0000			
GvD2019	-0.0530 0.5771	0.5671* 0.0000	0.5619* 0.0000	0.3448* 0.0002	1.0000		
EAT2020	0.4428* 0.0000	0.1844* 0.0505	0.1634* 0.0837	0.0825 0.3850	-0.0107 0.9106	1.0000	
EAT2019	0.0170 0.8583	0.3940* 0.0000	0.4246* 0.0000	0.9431* 0.0000	0.0448 0.6378	0.1799* 0.0566	1.0000

Finally, in the third model in Table 8 (below), when the dependent variable is 'profitability' measured by EBTUnu, only one variable is significant which is earning after tax in 2020. This means that a company profit measured by EBT Excl-Unusual Items which represent EBT Before non-recurring Items and scaled by total assets is not a suitable measurement of profitability. This is due to the variance between the variables used and the structure of the study framework, thus we did not analyse these deeply as it appeared to not be a worthy measurement in our sample but it could be used in another setting. Notwithstanding, researchers receive advantages from our findings related to this measurement of profitability as they can rely on this information when they choose the right measurement of company profitability.

In general, regarding government debt ('GvD'), previous studies approve a lagged negative relationship between company profitability and government debt levels is expected.[53] They stated that high levels of public debt are expected to be harmful to firm growth and strength henceforth negatively influence firm profitability. This is important as Saudi government debt has risen considerably in the last years as it is obviously clear in Figure 4 and Figure 5 below in relation to annual and quarterly impacts respectively. However, results referred that the effect of GvD2019 in above three models on profitability (with three different measurements) were positive and statistically insignificant which means before the VAT rise and the level of GvD was normal, the effects of GvD on profitability were normal too.

On the other hand, our results of GvD2020 are in line with previous studies, as we found in models 1 and 2 the GvD2020 variable with high negatively influenced firm profitability which means that it will affect Saudi companies' growth in the long term. In model 3 when we use EBTUnu as a measurement of company profitability, the relationship coefficient was still negative, but insignificant that confirms the two measurements in models 1and 2 is more appropriate at reflecting firm profitability. Consequently, based on the outcomes, we assume that the significant reduction in company profitability in 2020 was not pushed by the change in the government debt in 2020. We believe this was due to COVID-19 crisis consequences and the significant increase in the VAT.

[53] Cesario Mateus and Irina B. Mateus, 'Does a VAT Rise Harm the Tourism Industry? Portuguese Evidence' (2021) 83 *Tourism Management* 104234.

FIGURE 4: YEARLY SAUDI ARABIA GOVERNMENT DEBT TO GDP

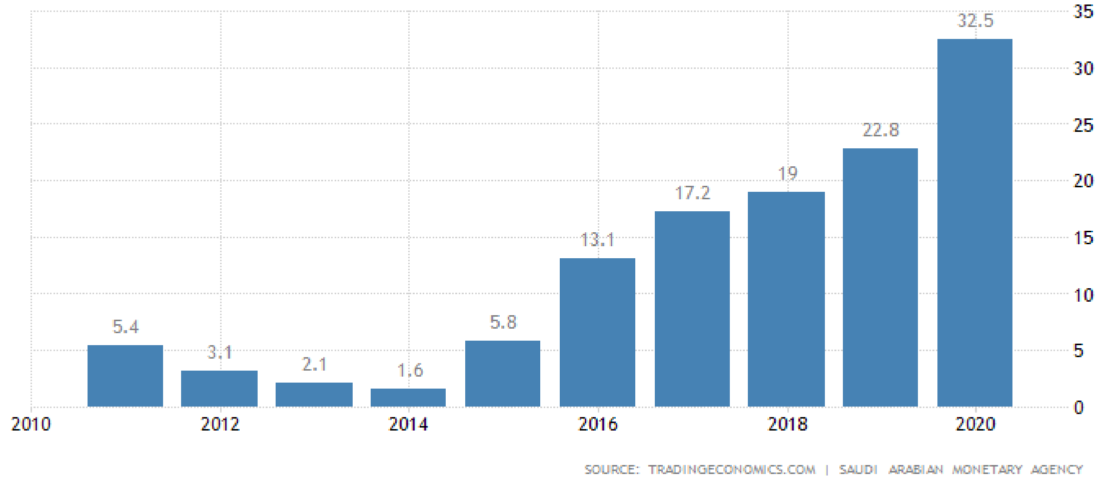
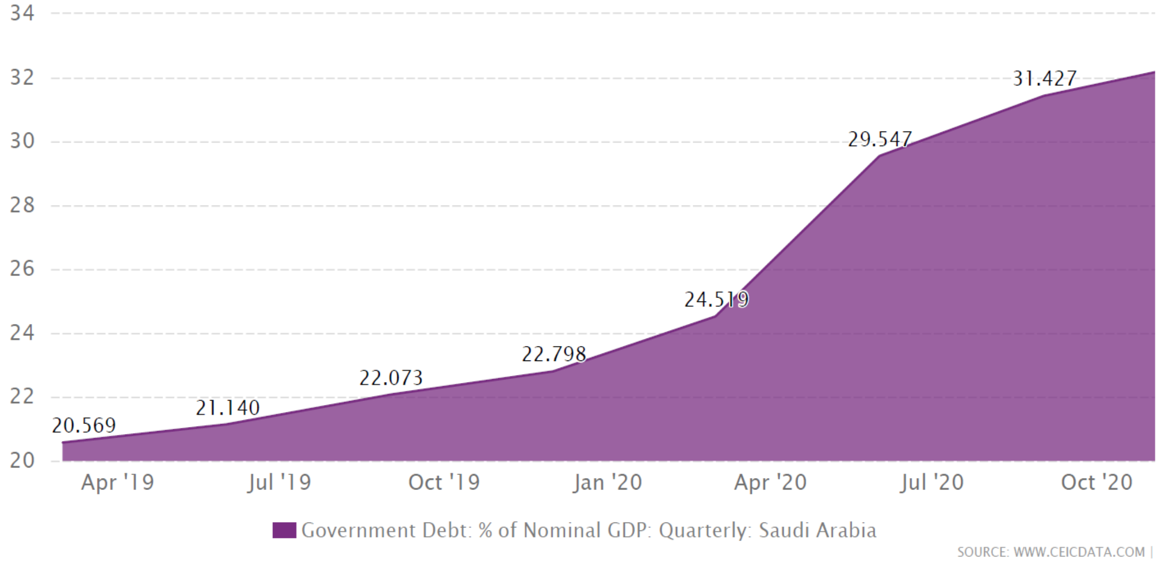


FIGURE 5: QUARTERLY SAUDI ARABIA GOVERNMENT DEBT TO GDP



IV ADDITIONAL TESTS

A *Difference in Differences Estimator*

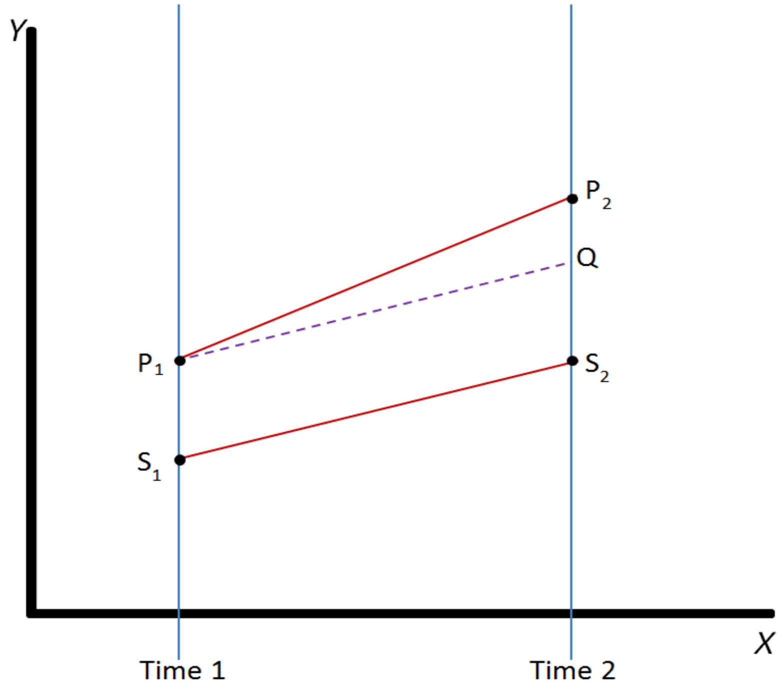
Matching techniques cannot explain the biases produced by unnoticed confounders as King and Nielsen[54] suggested to replace propensity score matching with other research designs as the tendency score matching regularly exacerbates these biases e.g., the DiD technique. This approach allows to control for both year and country fixed effects thus, we can control that all time invariant differences across years and shocks common to all years in the same country. Nevertheless, detecting the effects of a VAT employing DiD needs the paths of the outcome variable between, before and after imposing the VAT to be parallel; this assumption needs to control for specific time tendencies. Though,

[54] Gary King and Richard Nielsen, 'Why Propensity Scores Should Not Be Used for Matching' (Pt Cambridge University Press) (2019) 27(4) *Political Analysis* 435–454.

according to the Wolfers,[55] and Meer and West[56] studies, the controlling for time tendencies employing DiD possibly biased estimations in the incidence of a dynamic treatment effect and the influence of the VAT will be homogeneous across reforming periods. Therefore, it does not allow to discover whether the influence of the VAT systematically diverges across years affording to their capability to correctly implement and design it.

We applied the DiD approach which requires data measured from a control group and a treatment group at two diverse periods, precisely in our study one time period before imposing the 15% VAT and one time period after imposing the 15% VAT. In Figure 6 below, the result in the control group is signified via the S line and the result in the treatment group is signified via the P line.

FIGURE 6: DATA TIME PERIODS



B *COVID-19 and VAT Change Using DID*

We used binary variables to measure the effect during the COVID-19 crisis, pre- and post-VAT change periods on firm profitability and the probability of bankruptcy. The first binary variable (VAT2019) and the second binary variable (VAT2020) is equal to one for 2020 and zero otherwise. The change of VAT rate from 5% to 15% was implemented in 1 July 2020.

55 Justin Wolfers, 'Did Unilateral Divorce Laws Raise Divorce Rates? A Reconciliation and New Results' (2006) 96(5) *American Economic Review* 1802–1820.

56 Jonathan Meer and Jeremy West, 'Effects of the Minimum Wage on Employment Dynamics' (Pt University of Wisconsin Press) (2016) 51(2) *Journal of Human Resources* 500–522.

Therefore, the full effect of such increase reflected in 2020, since VAT has almost an immediate impact on prices. This is because in KSA, the tax period can be monthly or quarterly, depending on the business owner's annual turnover. In Figure 7 below, there are two groups of taxpayers: companies with annual taxable sales of more than 40 million SAR, who are required to file monthly returns, and companies with annual taxable sales of less than 40 million SAR, who are required to file a quarterly tax return.

FIGURE 7: SAUDI COMPANIES TAX PERIOD

Moreover, the VAT return must be submitted by Saudi companies for each tax period between the first day and the last day of the month following the end of the tax period. For example: To file a VAT return for the January–March 2020 quarter, you must file before 30 April 2020, see Figure 8 below.

FIGURE 8: SAUDI COMPANIES TAX PERIOD DATES

Quarterly VAT Return schedule

Tax Period Dates	Return and Payment Due	Tax Period Dates	Return and Payment Due
January 1- March 31	April 30	July 1- September 30	October 31
April 1- June 30	July 31	October 1- December 31	January 31

According to Gautier and Lalliard,[57] 50% of price varies in the month of the new VAT introduction and 40% in the following month. Berardi, Gautier, and Le Bihan[58] afford suggestion that price variations are abundant more repeated in the quarter one. Hence the "first" escalation in prices in our study is expected in the third quarter of 2020. However, in line with , we claim that firms may take the functional option to recognize some of the VAT rise into their margins to prevent an extreme crash in demand and consequently be able to survive in the competitive environment. Hence, we anticipate a negative influence of such years on firm profitability. In this context, we estimate our models again in order to perform the DiD regression properly as follows:

Model 1a. DV is profitability which measured by EBITDA before and after VAT.

$$Y_i\ (ProFtEBITDA) = \beta_0 + \beta_1\ SIZE2019 + \beta_2\ SIZE2020 + \beta_3\ SIZE2019 * SIZE2020 + \beta_4\ EAT2019 + \beta_5\ EAT2020 + \beta_6\ EAT2019 * EAT2020 + \beta_7\ GvD2019 + \beta_8\ GvD2020 + \beta_9\ GvD2019 * GvD2020 + \varepsilon_i$$

Model 2a. DV is profitability which measured by EBIT before and after VAT.

$$Y_i\ (ProFtEBIT) = \beta_0 + \beta_1\ SIZE2019 + \beta_2\ SIZE2020 + \beta_3\ SIZE2019 * SIZE2020 + \beta_4\ EAT2019 + \beta_5\ EAT2020 + \beta_6\ EAT2019 * EAT2020 + \beta_7\ GvD2019 + \beta_8\ GvD2020 + \beta_9\ GvD2019 * GvD2020 + \varepsilon_i$$

Model 3a. DV is profitability which measured by EBTUnu before and after VAT.

$$Y_i\ (\mathrm{ProFtEBTUnu}) = \beta_0 + \beta_1\ SIZE2019 + \beta_2\ SIZE2020 + \beta_3\ SIZE2019 * SIZE2020 + \beta_4\ EAT2019 + \beta_5\ EAT2020 + \beta_6\ EAT2019 * EAT2020 + \beta_7\ GvD2019 + \beta_8\ GvD2020 + \beta_9\ GvD2019 * GvD2020 + \varepsilon_i$$

Model 4a. DV is profitability which measured by EBITDA before and after VAT using different sample (226 company years observations).

$$Y_i\ (\mathrm{ProFtEBTUnu}) = \beta_0 + \beta_1\ SIZE + \beta_2\ EAT + \beta_3\ GvD + \varepsilon_i$$

Where:

Y_{i} = is a linear function of the treatment

ε_i = Error

Other variable definitions are contained in Table 9 below.

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57 Erwan Gautier and Antoine Lalliard, 'How do VAT Changes Affect Inflation in France?' (2013) (32) *Bulletin de la Banque de France* 5–27.

58 Nicoletta Berardi, Erwan Gautier and Hervé Le Bihan, 'Les Ajustements Individuels de prix à la Consommation en France: De Nouveaux Résultats sur la Période 2003–2011' (2013) 460(1) *Economie et Statistique* 5–35.

TABLE 9: DID FRAMEWORK AND VARIABLE DEFINITIONS

Before Imposing VAT		After Imposing VAT
Independent variables IVs		**Measurements of DV**
1. *EAT2019* 2. *SIZE2019* 3. *GvD2019*		1. *ProFtEBITDA* 2. *ProFtEBIT* 3. ProFtEBTUnu
Where: EAT: Company Earnings after tax SIZE: Company Size GvD: Government Debt	**Implementing the new 15% Value Added Tax (VAT)** **In 1frst July 2020**	Where: 1. is a company profit measured by earnings before interest, taxes, depreciation and amortisation 2. is a company profit measured by earnings before interest, taxes 3. a company profit measured by EBT Excl
		1. *EAT2020* 2. *SIZE2020* 3. *GvD2020*

C *Analysis and Discussion*

Table 10 below presents the results of four models DiD regressions. In four model, we perform the DiD estimator to measure the impact of the VAT rise in 2020 compared to 2019. One can infer that the variables EAT2019 and EAT2020, which captures the average difference in profitability for Saudi firms in 2019 versus 2020, is not statistically significant. This finding confirms the results from Table 10 where differences in the impact of the VAT rises on firm profitability using different measurements for 2019 and 2020 in order to make sure that the effect is real and exist as the time of our sample is short were almost identical (in 2019, model 1a: 0.498, model 2a: 0.448, model 3a: 0.808 but in 2020, 0.000 highly significant in all models, respectively). However, differences were observed from testing firm profitability with the interaction variable of both years E19_E20 of earnings after tax which is required by DID regression assumptions in model 2a negatively significant with profitability measured by *EBIT*. This is conforming our expectations of the negative effects of unusual rise of VAT in 2020.

TABLE 10: DID REGRESSION MODELS

IVS	TIME SIRES' SAMPLE MODEL 1A DV=PROFTEBITDA* PROB > F = 0.0000		MODEL 2A DV= *PROFTEBIT*** PROB > F = 0.0000		MODEL 3A DV=PROFTEBTUNU*** PROB > F = 0.0014		PANEL DATA SAMPLE MODEL 4A DV= PROFTEBITDA PROB > F = 0.1433		
	T	P>|T|	T	P>|T|	T	P>|T|	IVS	T	P>|T|
SIZE2019	3.05	0.003***	1.19	0.237	0.70	0.483	ContVAT	-2.16	0.032***
SIZE2020	0.42	0.673	-0.20	0.840	0.26	0.795	EAT	1.22	0.223*
S19_S20	-2.17	0.032***	-0.64	0.526	-0.63	0.532	SIZE	-0.56	0.579
EAT2019	0.68	0.498	0.76	0.448	-0.25	0.805	GvD	-0.21	0.832
EAT2020	9.21	0.000***	11.50	0.000***	4.16	0.000***	_cons	1.45	0.148*
E19_E20	-1.18	0.242*	-1.93	0.056***	-0.96	0.340	-	-	-
GvD2019	1.17	0.243*	0.10	0.920	0.17	0.863	-	-	-
GvD2020	0.45	0.656	0.27	0.784	0.77	0.441	-	-	-
D19_D20	-0.79	0.433	-0.05	0.960	-0.47	0.636	-	-	-
_cons	-1.82	0.072**	-0.48	0.635	-0.48	0.629	-	-	-
Df= 122	R-squared = 0.6394	Adj R-squared = 0.6078	R-squared = 0.7096	Adj R-squared = 0.6842	R-squared = 0.2235	Adj R-squared = 0.1557		R-squared = 0.030	Adj R-squared = 0.0129

**ProFtEBITDA*: is a company profit measured by earnings before interest, taxes, depreciation and amortisation
***ProFtEBIT"* is a company profit measured by earnings before interest, taxes
****ProFtEBTUnu*: a company profit measured by EBT Excl

R^2 is a number vary between zero to one, and this number shows the percentage change in the profitability of companies in the study models. Moreover, R^2 illustrates the regression analysis of the profitability value, the variable which we are trying to predict, our DV was measured in model 1a using EBITDA. In our case, R^2 is equal to 0.64 and Adj R2 equal to 0.61, which is close to the one, that means the regression analysis model is powerful and enables to calculate the value of profitability in a way that is very close to the characteristics of the company under study. Moreover, in model 1a results indicated that size of company in 2019 effect significantly the firm profitability in the contrary, in 2020 is insignificant.

However, the interaction variable S19_S20 where found has significant effect on from profitability that means there different between two years happened due to the current circumstances' companies going through. Regarding government debt results in three models with their interaction variable too, where with insignificant effect on profitability of the firm, that means the effect of the emergency support for the emerging companies do not appear yet cause it needs time to observe that effect unlike VAT effects which appear immediately in the short term as the previous study have said.

In model 2a our DV was measured in this model using EBIT. In this regard, R^2 is equal to 0.71 and Adj R2 equal to 0.68 higher than model 1a, that means the regression analysis model is very powerful and allows to estimate the value of profitability in a way that is very close to the company's characteristics under study. Results confirm that when we measure profitability using earnings before interest and taxes the associations between IVs and DV high. On the contrary of model 1a, model 2a and 3a results indicated that size of company in 2019 and 2020 also the interaction variable S19_S20 effect insignificantly the firm profitability. Regarding government debt in model 2a and 3a results in three models with their interaction variable too, where with insignificant effect on profitability of the firm.

In Model 4a we modify our sample and analysis to be suitable for treatments effects and continues outcomes. The sample consists of 226 firm-year observations as panel dataset over the period 2019–2020. Differences were observed from testing firm profitability between the two period for the years 2019–2020 after the VAT rate increase in 2020. The results are displayed in Model 4a, the results show that the years 2020 were, in general, the worst form the biggening as the crisis of COVID-19 start its effects on companies even before rise VAT. After rising VAT, a more relevant and significant finding is the negative impact on the profitability of Saudi firms arising after controlling for the VAT change.

Indeed, the negative coefficient for the variable ContVAT shows, on average, a decrease in profitability of Saudi firms of -2.16% (statistically significant at 1 percent level in years 2020 versus 2019). We specifically control the impact on KSA firm profitability for each of the years, 2019 and 2020. We found that the negative impact on KSA firms was more realized in the year 2020, the first year after the implementation of the VAT change 0.032, statistically significant at 1% level with the effect disappearing in 2019 not significant .

V CONCLUSION

The aim of this study was to estimate the consequences of imposing the new 15% VAT on the profitability of the KSA listed non-financial companies in various sectors. This study investigated that influence and the consequences using various statistical empirical approaches such as OLS, Wilcoxon signed-rank test and DiD. Within the analysis, data associated with 2019 was considered before the VAT increased and also prior to the discovery of COVID-19. Data from 2020 was then considered after the new 15% VAT was imposed and during the COVID-19 crisis. The outcomes of this paper explore the effects of the extraordinary rise of the KSA's VAT, asking whether it has verified an exclusively operative system of taxation in the KSA.

There are some policy implications for results of this paper, its outcomes were the extending of the theoretical and practical requirements for the VAT system. It is supported that VAT on transactions of commerce is however an tool of the macroeconomic impact on the budget revenues foundation. Previous studies outcomes designate that the hypothetical benefits of VAT do not essentially explain into exercise. In precise, in Saudi Arabia we hypothesis that the impression of the VAT on economic effectiveness be influenced by on the stage of advancement of the country. As global studies findings designated that the status of the advancement is extremely associated with reasons such as informal economy, tax evasion and tax capacity, which can rigorously undercut the efficacy of VAT. In this context, our findings support the hypothesis that in 2020 firms are, on average, less profitable than in 2019. Which means that a dramatic VAT increase significantly affects Saudi firm profitability in 2020, the effect even maybe more in the future due the continuous crisis of COVID-19. The imposed 10% VAT rise in 2020 has caused on average, a decrease in profitability of Saudi firms of -2.16%.

Moreover, previous studies cited that VAT is habitually born in mind as a solution that can replace raise much-needed revenue and the distortionary taxes for community expenditure, particularly in the developing countries[59]. In this context, our findings shows also that KSA used the VAT as a solution for COVID-19 consequences as KSA as one of the fastest emerging developing countries.

We underline the requirements to updating tax systems with VAT implementation, in order to advantage from the properties effectiveness of VAT in KSA. These implications constant with prior studies on development and taxation maintaining that the actual system of tax is not that which is conceded as regulation, but that which is managed .

Thus, it is critical to conduct this study to confirm that the management and employment of VAT in KSA obtain some attention as the implementation of VAT does, specifically since prior outcomes designate large gains in economic effectiveness from accepting a well-designed and well-enforced VAT. Our valuation of the impact of VAT increase on firms' profitability will be useful for governments and corporations to not only adjust their budget spending, but will also allow them to better regulate the markets and managing companies to observe tax system health. The government interventions accompanied

[59] Abramova et al (n 14).

with a steady and dependable investment strategy, are critical to the confidence of firms in times of uncertainty which help companies plan their future investments to make proper decisions.

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Performance Measurement Based on Spiritual Culture in Excellent Service (Study at the Regional Office of the Directorate General of Taxes in East Java)

Sri Andriani and Ahmad Djalaluddin Sismanto*

Abstract

This paper explores the influence of performance based on spiritual culture in the context of excellent service to realise community satisfaction. Spiritual culture develops a general conceptual model of the relationship between life integration, worship integration, relationship integration and excellent service — primary data and secondary data through the distribution of questionnaires, document collection and interviews were used in this study. The data was descriptive, by taking documents and questionnaires on employee descriptions. Quantitative data was analysed using Partial Least Square ('PLS') analysis against 300 employees as a sample at 10 Tax Service Offices under the Regional Office of the Directorate General of East Java. Our findings contribute to understanding how the integration of relationships will affect the integration of worship when there is a life integration variable. Organisational culture will continuously affect one's worship to provide excellent service that impacts community satisfaction.

Keywords: spiritual culture, principles of taxation, performance

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I INTRODUCTION

In this era of globalisation, Indonesia still struggles with crises and it does not know when these will end. Notwithstanding, there have been many changes and improvements through reform. Various macroeconomic and political indicators of Indonesia also show encouraging data and the evolution of new leadership will give optimistic hope in the future. But on the other hand, Indonesia will have an extraordinarily heavy task in the future; pursuing a deadline to prepare everything related to the global era, economic recovery and domestic political stability which all need extreme attention and substantial financial support.

Then, the role of taxes and the State Treasury was again examined. In 2011, the tax target of Rp 875 trillion (78% of the total revenue target of the State Budget) until 9 August 2011, has reached Rp 380.5 trillion (54.4%), becoming a source of revenue for the Indonesian government. Since the implementation of tax reform in Indonesia starting in 1983 and which then continued again in 1994–2000 before, in 2008, tax modernisation was carried out until now, the role of tax sector revenues has increased in filling the State Budget. To that end, efforts to intensify and extensively reform tax regulations continue to be carried out. One of these efforts is to simplify tax regulations and modernise the tax system.

As part of the State Finance issues, as regulated in the 1945 Constitution Article 23 paragraph (2), all taxes for state purposes are held in law. It means that a tax levy becomes valid if it has gone through the enactment of regulations. Thus, the starting point for the strategic role of taxes begins with the preparation of law, including formulating the rules under it through a hierarchy: the 1945 Constitution, Laws, Government Regulations, Presidential Decrees and other regulations.

To support this strategic role, regulatory reform that provides convenience in the field of taxation is necessary. This can be demonstrated by updating regulations in the field of taxation so that they are easily understood and accepted by the public. Therefore, tax regulations intended to support increased tax revenues must also comply with the principles of taxation. If this is fulfilled, it is hoped that the taxation system and associated procedures will become an effective and efficient means of tax administration. For this reason, the principle of simplicity must be considered in drafting a regulation, including the principle of justice. The focus of justice can be realised in the public policymaking process by the government and the DPR through, for example, discussions and public hearings with the community, practitioners and academics.

Suppose the law that has been formulated follows these tax principles. In this case, the application of the tax law's implementation is required, while the party spearheading the performance of the law is the tax authority. Taxpayers as a society based on law are obliged to pay taxes, but on the other hand, taxpayers also have the right to get satisfactory tax services. Meanwhile, as a public institution, the Directorate General of Taxes is required to provide an excellent service to the community.

Seeing the paradigm shift in looking at the community's needs by emphasising the increasingly tight competition matrix is the easiest way to maintain institutional performance. Institutional performance is a function of changes in external conditions and a synergy of internal and external changes. Therefore, it would be wiser if an institution continues to make internal improvements without waiting for demands or changes from external parties.

Internal improvements are essential for institutions that want to compete and be accepted by the public. Institutions must achieve a high level of quality (quality level), not only in output but also regarding all aspects of the institution (total quality). The principle of total quality management ('TQM') is the main factor in the development of an institution. With TQM, a service can be of quality if it can meet all community needs or exceed community expectations. This can be achieved by providing complete satisfaction.[1]

Efforts to monitor and measure complete satisfaction are essential because these steps can provide feedback for developing and implementing strategies to increase community satisfaction. Accordingly, as stated by Zeithaml et al, community satisfaction is the community's evaluation of an institution's product or service in terms of whether the product or service has met the needs and expectations of the community.[2] Customer/community satisfaction is a function of perceived performance with expectations. In addition, according to Tjiptono, customer/community satisfaction is the level of one's feelings after comparing the perceived performance/results compared to their expectations.[3] It applies to all types of companies, both services, manufacturing and public institutions. Excellent service is one of the standards for measuring public sector performance (Menpan Decree No. 63/KEP/M.PAN/7/2003). Excellent service standards demand fast, transparent and accountable public services to the community.

On the other hand, service to the community requires standards, rules, strategies and beliefs to provide the best. Services based on spiritual culture are needed in people's lives with increasingly higher complexity. Spirituality is a common thread that brings together ritual aspects with social and material elements in Islam. Rituals are prescribed for spiritual enrichment, and spirituality is essential in navigating social and content life. Therefore, prayer is considered to reach its maqashid (goal) when giving birth to positive spirituality in social and material life (QS. Al Ankabut: 45). In measuring the performance of spiritual, cultural factors, it is one of the factors that needs to be considered along with the standard of public service.

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1 Ahmad Firman, 'Pengaruh Total Quality Managemet (TQM) terhadap Keunggulan Bersaing pada PT Toyota Kalla Cabang Alauddin Makassar' (2017) 6(1) *Jurnal Bisnis dan Kewirausahaan* 1–16.

2 Zeithaml et al, 'Service Marketing Integrating Customer Focus Across the Firm' (McGraw Hill, 3rd ed, 2003) hal. 86.

3 Fandy Tjiptono, 'Perspektif Manajemen dan Pemasaran Kontemporer' (*Yogyakarta: Andi Publisher*, 2004) hal. 52.

By searching the results of several previous studies examining tax crime[4] and tax compliance behaviour,[5] factors can affect taxpayer compliance.[6] Some researchers try to link religious issues with tax compliance, such as the economics of religion in several perspectives,[7] the impact of religion on tax compliance,[8] Muslim consumers' perceptions of tax deductions on income zakat,[9] the attitude of sharia (Islamic Law) regarding the imposition of taxes on goods and services.[10] While Accounting Standard 21 does not mention interest tax protection from debt even though the benefits are contrary to the principles of social justice in Islam.[11]

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4 Umut Turksen and Adam Abukari, 'OECD's Global Principles and EU's Tax Crime Measures' (2020) 28(2) *Journal of Financial Crime* 406–419 <https://doi.org/10.1108/JFC-09-2019-0118>.

5 Jennifer Anna Stark and Erich Kirchler, 'Inheritance Tax Compliance – Earmarking with Normative Value Principles' (2017) 37(7–8) *International Journal of Sociology and Social Policy* 452–467 <https://doi.org/10.1108/IJSSP-07-2016-0086>; Ibn e Hassan, Ahmed Naeem and Sidra Gulzar, 'Voluntary Tax Compliance Behavior of Individual Taxpayers in Pakistan' (2021) 7(1) *Financial Innovation* <https://doi.org/10.1186/s40854-021-00234-4>.

6 Aqmarina Vaharani Paramaduhita and Elia Mustikasari, 'Non-Employee Individual Taxpayer Compliance' (2018) 3(1) *Asian Journal of Accounting Research* 112–122 <https://doi.org/10.1108/ajar-06-2018-0007>.

7 Aleksandar Tomic, 'Nations, Taxes and Religion: Did Mohammad Have it Right?' (2010) 142(3) *Public Choice* 461–464 <https://doi.org/10.1007/s11127-009-9532-x>.

8 Jinghua Wang and Jiankun Lu, 'Religion and Corporate Tax Compliance: Evidence from Chinese Taoism and Buddhism' (2021) 11(2) *Eurasian Business Review* 327–347 <https://doi.org/10.1007/s40821-020-00153-x>; Robert W. McGee, 'Three Views on the Ethics of Tax Evasion' (2006) 67(1) *Journal of Business Ethics* 15–35 <https://doi.org/10.1007/s10551-006-9002-z>; Mohammad Nurunnabi, 'Tax Evasion and Religiosity in the Muslim World: The Significance of Shariah Regulation' (2018) 52(1) *Quality and Quantity* 371–394 <https://doi.org/10.1007/s11135-017-0471-1>; Raihana Mohdali and Jeff Pope, 'The Influence of Religiosity on Taxpayers' Compliance Attitudes: Empirical Evidence from a Mixed-Methods Study in Malaysia' (2014) 27(1) *Accounting Research Journal* 71–91 <https://doi.org/10.1108/ARJ-08-2013-0061>; Emmanuel Carsamer and Anthony Abbam, 'Religion and Tax Compliance among SMEs in Ghana' (2020) *Journal of Financial Crime* <https://doi.org/10.1108/JFC-01-2020-0007>; Ioana Alexandra Horodnic, 'Tax Morale and Institutional Theory: A Systematic Review' (2018) 38(9–10) *International Journal of Sociology and Social Policy* 868–886 <https://doi.org/10.1108/IJSSP-03-2018-0039>.

9 Abdullah Al-Mamun, Ahasanul Haque and Muhammad Tahir Jan, 'Measuring Perceptions of Muslim Consumers Toward Income Tax Rebate Over Zakat on Income in Malaysia' (2020) 11(2) *Journal of Islamic Marketing* 368–392 <https://doi.org/10.1108/JIMA-12-2016-0104>.

10 Burhanuddin Lukman and Saba Radwan Jamal Elatrash, 'The Goods and Services Tax (GST) on Takāful Products: A Critical Sharīʿah Appraisal' (2017) 9(2) *ISRA International Journal of Islamic Finance* 205–209 <https://doi.org/10.1108/IJIF-08-2017-0027>.

11 Mark Brendan Mulcahy, 'Purifying Islamic Equities: The Interest Tax Shield' (2014) 7(4) *International Journal of Islamic and Middle Eastern Finance and Management* 473–484 <https://doi.org/10.1108/IMEFM-11-2013-0120>.

In addition, further research has focused on the factors that influence tax avoidance and disobedient behaviour,[12] tax avoidance ethics,[13] tax evasion,[14] small and medium business owner-manager tax non-compliance behaviour,[15] less tax avoidance military experience than other managers,[16] the effect of good corporate governance on tax avoidance,[17] corporate social responsibility and tax avoidance,[18] and implementation and challenges of transfer pricing in Indonesia.[19]

Relevantly, the study of tax compliance is a contemporary issue. Previous studies have focused on Western philosophy, which sees obedience from a rational perspective but lacks social, cultural and religious values. People in Eastern countries strongly believe in cultural and religious philosophies rather than embracing state identity. On the other hand, the spirit of religion and culture inclusively leads the internal motivation of the Indonesian people to obey religious rules that are mutually agreed upon and preserved[20]. Therefore, the attribute allows for voluntary compliance rather than coercion. On the other hand, public policies that are not born of social values affect obedience behaviour that cannot be morally instilled. Furthermore, tax compliance is only a partial compliance study that is generally limited to rational compliance.

Tax compliance is influenced by holistic factors such as personal economic rationale, social consensus and spiritual beliefs. As for spiritual factors, paying taxes is seen as a

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12 Ken Devos and Metin Argan, 'Factors That Influence Tax Evasion Perceptions in Australia and Turkey: A Structural Equation Model Study' (2019) 14(1) *Journal of the Australasian Tax Teachers Association* 1–28.

13 Robert W. McGee and Zhiwen Guo, 'A Survey of Law, Business and Philosophy Students in China on the Ethics of Tax Evasion' (2007) 2(3) *Society and Business Review* 299–315 <https://doi.org/10.1108/17465680710825488>.

14 Robert Bird and Karie Davis-Nozemack, 'Tax Avoidance as a Sustainability Problem' (2018) 151(4) *Journal of Business Ethics* 1009–1025 <https://doi.org/10.1007/s10551-016-3162-2>.

15 Lutfi Hassen Ali Al-Ttaffi, Hijattulah Abdul-Jabbar and Saeed Awadh Bin-Nashwan, 'Does Religious Perspective Influence Tax Non-Compliance? Evidence from Yemen' (2021) 37(2) *International Journal of Ethics and Systems* 222–244 <https://doi.org/10.1108/IJOES-04-2020-0062>.

16 Kelvin K. F. Law and Lillian F. Mills, *Military Experience and Corporate Tax Avoidance*, *Review of Accounting Studies* (Springer US, 2017) XXII <https://doi.org/10.1007/s11142-016-9373-z>.

17 Vivi Adeyani Tandean and Winnie Winnie, 'The Effect of Good Corporate Governance on Tax Avoidance: An Empirical Study on Manufacturing Companies Listed in IDX period 2010-2013' (2016) 1(1) *Asian Journal of Accounting Research* 28–38 <https://doi.org/10.1108/ajar-2016-01-01-b004>.

18 Chih Wen Mao, 'Effect of corporate Social Responsibility on Corporate Tax Avoidance: Evidence from a Matching Approach' (2019) 53(1) *Quality And Quantity* 49–67 <https://doi.org/10.1007/s11135-018-0722-9>.

19 Maria R.U.D. Tambunan, Haula Rosdiana and Edi Slamet Irianto, 'Minimising Potential Tax Avoidance by Strengthening Tax Policy on Transfer Pricing in Indonesia' (2019) 14(1) *Journal of the Australasian Tax Teachers Association* 1–22.

20 D. Fidiana and I. Triyuwono, 'Non-Compliance Behavior in the Frame of IBN Khaldun' (Seventh Asia Pacific Interdisciplinary Research in Accounting Conference, 2013) hal. 1–18.

religious obligation such as zakat that must be paid to achieve spiritual alleviation.[21] In addition, other research on tax compliance is related to the cost-and-benefit aspect. The economic crime prevention or crime model,[22] for example, is a vivid example of the study of tax compliance from a partial economic perspective. The model is only from a rational or cognitive perspective. Therefore, the mind is positioned as the only determining factor whether someone will comply or refuse taxes. At the same time, the spiritual aspect is ignored because it is considered that is does not to play a role in shaping tax compliance behaviour.

This paper aims to determine a prototype of performance measurement based on the spiritual culture in the context of excellent service to students within the Regional office of the Directorate General of Taxes East Java III and to analyse the spiritual culture of the Regional Office. Thus, this research contributes to the overall picture of spiritual-based performance so that it has an impact on excellent service.

II RESEARCH METHOD

This type of research relates to correlational study and is causal through descriptive analysis, using primary data and secondary data through questionnaires, document collection and interviews. Stratified Random Sampling was used in the sampling of the research. The target of this research is service to taxpayers in 12 Tax Service Offices in the Regional Office of the Directorate General of Taxes East Java III, the performance of tax employees from all parts of the tax office, from the head of the office to technical personnel. In this study, samples were taken from the population, namely 300 employees as a sample of the total employees (head office to technical staff) at 10 Tax Service Offices under the Regional Office of the Directorate General of Taxes East Java III and Regional Offices of the Directorate General of East Java III. Sampling was done by stratified random sampling.

Data analysis was carried out by quantitative research and descriptive analysis. The data analysis techniques is elaborative in more detail below.

Descriptive data, by taking documents and questionnaires on employees. Quantitative data were analysed by using Partial Least Squares ('PLS'), using the SmartPLS software version 2.0.M3.

The stages of data analysis carried out are as follows:

1) Test Validity and Reliability: Validity and reliability tests were carried out to test instruments used in the research.
1) P analysis *least Square art*: P analysis *least Square art* with the indicator model in the description use *Reflection Indicator Model* or principal factor model where the

21 Fidiana, 'Compliance Behaviour from the Holistic Human Nature Perspective' (2020) 11(5) *Journal of Islamic Accounting and Business Research* 1145–1158 <https://doi.org/10.1108/JIABR-11-2016-0142>.

22 Michael G. Allingham and Agnar Sandmo, 'Income Tax Evasion: A Theoretical Analysis' (1972) 3 *Taxation: Critical Perspectives on the World Economy* 323–338.

covariance of the indicator measurement is influenced by the latent construct or reflects the variation of the latent construct. With the analysis construct consisting of:

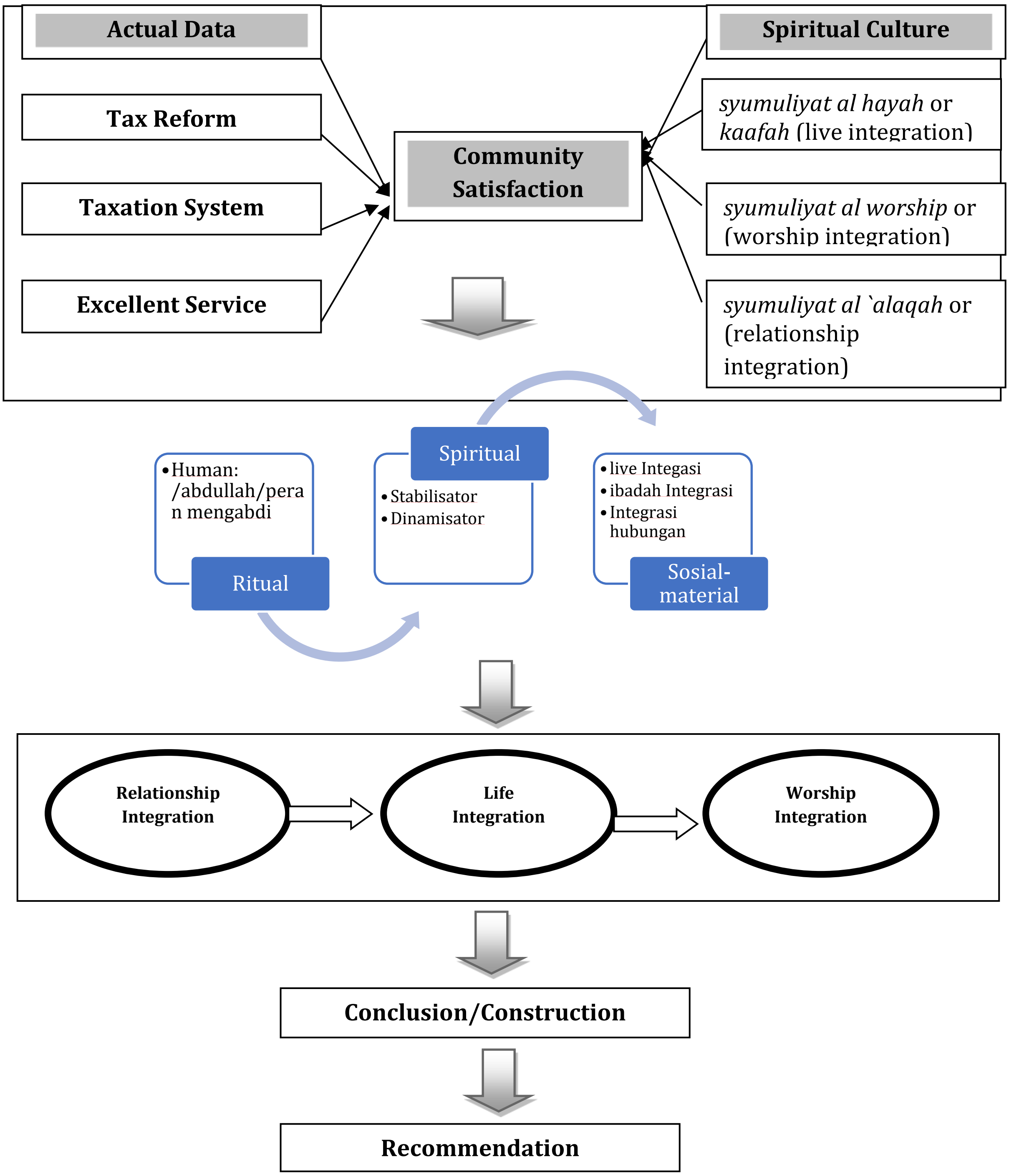
X: Spiritual Culture

X_1: *Syumuliyat al hayah* or kaafah (living integration)

X_2: *Syumuliyat al worship* (worship integration)

X_3: *Syumuliyat al `alaqah* (relationship integration)

FIGURE 1: RESEARCH CONCEPT FRAMEWORK



A *Research Hypothesis*

Based on the research concept, the following hypotheses can be drawn:

> Hypothesis 1: It is suspected that relationship integration affects life integration.
>
> Hypothesis 2: It is suspected that the integration of life affects the integration of worship.
>
> Hypothesis 3: It is supposed that the integration of relationships involves the integration of worship, with the intervening variable being the integration of life.

III LITERATURE REVIEW

A *Taxation System and Reform*

Tax reform is carried out with three essential agendas, namely (1) the field of administration, modernisation of tax administration, (2) the field of regulation, the field of amendments to the taxation law, (3) the field of supervision, the national data bank. Meanwhile, the areas that are targeted for reform are by providing excellent service. Based on the policies that have been determined, the Tax Service Office has eight excellent service programs in meeting the community's needs, especially in the field of taxation. There are eight programs that are featured at the Tax Office[23] including:

1) Achievement of businessman redemption.
2) Completion of VAT refunds.
3) Issuance of Order to Pay Excess Tax.
4) Application to tax determination.
5) Free Income Tax Collection Article 22 (import).
6) Land and Building Tax.
7) Completion of NPWP registration applications.

The tax reforms that have been built and considered by the public to be quite good in the last few years have been badly injured to restore them. Public trust is declining, and it will take more time to rebuild it. This is because there are cases of tax officials, such as Gayus Tambunan. The supervision system in continuing tax reform is another study that must be focused on. Mapping reforms in supervision is a focus that must be completed to eliminate the opportunity for individuals to commit bad deeds. The author believes two factors can lead to a case or an act that is not good. First, there is an opportunity, and second, the will of the person himself.

Willingness is generally more influenced by factors within a person (faith or spiritual factors) and the surrounding community. At the same time, the opportunity is a supervisory factor that is arranged in a monitoring system. Opportunities that arise that are often exploited by individuals need to be anticipated in preparing the form of supervision of the tax reform process.

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[23] Tambunan, Rosdiana and Irianto (n 19).

In terms of tax administration modernisation, computer-based technology improvement programs are the third most crucial element in the current tax reform process. When the Directorate General of Taxes introduced the PINTAR (Project for Indonesian Tax Administration Reform) program in 2009, the public considered it very appropriate. Improving the tax administration will certainly minimise the opportunity for unscrupulous individuals to take actions that are not commendable. But we have to be patient because the new PINTAR will be completed in 2012.

Equally important is the mapping of the process of providing tax services, both the audit process (including the examination of preliminary evidence indicated by a tax crime), tax collection, tax refund process, objection appeal, and review process, as well as other tax services, becoming an essential plan for review. Repeat. In the view of the taxpayer, the service of the tax audit process is often a burdensome and sometimes inconvenient process for taxpayers. The reprocessing of audits and other tax services requires a different pattern. The impression of taxpayers must be wrong, must be avoided. Creating a system of supervision and tax audit services requires a much different breakthrough. These are the studies and challenges that need to be considered. As time goes by, remapping tax reform into the preliminary plan must be carried out immediately to provide better community services. The participation of various parties is undoubtedly very much needed. Dialogue with experts in supervision and experts in other areas needs to be carried out continuously.

B *Performance Measurement*

1 *Definition of Performance Measurement*

Performance measurement is a system that aims to help public managers assess the achievement of a strategy through financial and non-financial measurement tools. Performance measurement can be used as an administrative control tool because performance measurement is strengthened by establishing a reward and punishment system.[24] Mardiasmo explained, 'performance measurement is an assessment that aims to help managers assess strategy achievement through financial and non-financial measurement tools, without compromising the 3E's (Economical, Effective, and Efficiency)'.[25]Performance measurement is used to assess the success/failure of implementing activities/programs/policies according to the goals and objectives set to realise the mission and vision of government agencies. Performance can be interpreted as an achievement that the organisation can achieve in a certain period. The achievement in question is the effectiveness of the organisation's operations, both in terms of managerial and operational economics.

2 *Purpose and Benefits of Public Sector Performance Measurement*

According to Mardiasmo, in general, the objectives of performance measurement are:

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[24] J. R. Robinson, S. A. Sikes and C. D. Weaver, 'Performance Measurement of Corporate Tax Departments' (2010) 85 *The Accounting Review* 1035–1064.

[25] Mardiasmo, 'Perpajakan, edisi revisi' (Yogyakarta: Andi Publisher, 2009) hal. 121.

- To better communicate strategy (top-down and bottom-up)
- To measure financial and non-financial performance in a balanced manner so that strategy achievement can be tracked.
- To accommodate the understanding of the interests of middle and lower-level managers and motivate them to achieve goal congruence.
- To achieve satisfaction based on a rational individual approach and collective ability.[26]

Furthermore, according to Mardiasmo, there are several benefits of measuring public sector performance, including:

- Provide an understanding of the measures used to assess management performance
- Provide direction to achieve the set performance targets
- To monitor and evaluate performance achievements and compare them with performance targets and take corrective actions to improve performance
- As a basis for giving rewards and punishments.[27]

3 *Differences in Performance Measurement of the Public Sector and the Private Sector*

Performance measurement in business organisations (profit-oriented organisations) is more accessible than public sector organisations (non-profit-oriented organisations). In business organisations, the performance of the implementation can be done by, for example, looking at the level of profit that has been obtained. If the measurement is to be improved again, this can be seen by assessing various other things such as solvency, profitability, return on investment, etc. In public sector organisations, the measurement of success is more complex because the things that can be measured are more diverse and sometimes abstract, so measurement cannot be done using only one variable.

4 *Performance Indicators*

(a) Understanding Performance Indicators

Performance indicators are qualitative and quantitative measures that describe the level of achievement of the goals and objectives that have been set by showing indicator elements consisting of inputs, outputs, outcomes, benefits, and impacts.[28]

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26 Ibid 122.

27 Ibid.

28 Indra Bastian, 'Akuntansi Sektor Publik di Indonesia' (Yogyakarta: BPFE, 2001) hal. 337.

(b) Ideal Indicator Requirements

Performance indicators can be different for each organisation, but there are general requirements for realising an ideal hand. According to the Financial and Development Supervisory Agency ('BPKP'), the perfect indicator requirements are as follows:

- Specific and clear so that it can be understood and there is no possibility of misinterpretation.
- It can be measured objectively, quantitatively, and qualitatively, i.e., two or more measuring performance indicators have the same conclusion.
- Relevant performance indicators must address the relevant objective aspects.
- Achievable, essential, and must be helpful to demonstrate the success of inputs, outputs, results, benefits, impacts, and processes.
- It must be flexible enough and sensitive to changes/adjustments to the implementation and results of implementing activities.
- Effective. Data/information related to the relevant performance indicators can be collected, processed, and analysed at available costs.[29]

(c) Types of Performance Indicators

- Input indicators are everything that is needed so that the implementation of activities can take place to produce outputs. This indicator measures the number of resources such as budget (funds), human resources, equipment, materials, and other inputs used to carry out activities.
- Process indicator (process). In process indicators, the organisation formulates activity measures, both in terms of speed, accuracy, and accuracy of the implementation of these activities.
- The output indicator is expected to be directly achieved from an activity that can be in the form of physical and non-physical. Output indicators or benchmarks are used to measure the outputs resulting from an action.
- Indicators of results (outcomes) are everything that reflects the functioning of activity outputs in the medium term (direct effects). Measurement of outcome indicators is often confused with output indicators.
- Benefit indicators are something related to the ultimate goal of implementing activities. Benefit indicators describe the benefits derived from the outcome indicators.
- Indicators of impact (impact) are the influence caused, either positive or negative.

[29] Badan Pengawas Keuangan and Pembangunan BPKP, 'Pedoman penyusunan Anggaran Berbasis Kinerja (Revisi)' (Direktorat Pengawasan Penyelenggaraan Keuangan Daerah Wilayah 3, 2005).

C *Spiritual Culture-Based Performance Measurement*

Spirituality is a common thread that brings together ritual aspects with social and material elements in Islam. Rituals are prescribed for spiritual enrichment, and spirituality is essential in navigating social and content life. Therefore, prayer is considered to reach its maqashid (its goal) when giving birth to positive spirituality in social and material life (QS. Al Ankabut: 45). Fasting will be accepted if it gives birth to honesty in social interactions and material transactions (see HR. Bukhari). And Hajj is said to be 'mabrur' if it gives birth to positive spirituality in life after fulfilling the 5th pillar of Islam.

This spirituality emphasises the character of Islam, which does not recognise a dichotomy between aspects of life. Therefore, there is a strong connection between the ritual area mosque and the market (goods or services market) (Surah Al Jumu'ah: 10). The Koran also does not prohibit if, in the middle of the pilgrimage, the pilgrims on the sidelines of their worship earn sustenance, meet their material needs (Surah Al Baqarah: 198).

The spirituality created through these ritual teachings, when implemented in the world of work in the context of measuring performance, is expected to be able to provide the following meanings:

1 *Syumuliyat al Hayah or Kaafah (Integration of Life).*

When the Qur'an commands humans to convert to Islam in a kaafah (Surah Al Baqarah: 208), the expected response from humans is as stated in verse: 'Say: 'Indeed, my prayer, worship, life, and death are for Allah, Lord of the worlds, He has no partner; ...'. (Surah Al An'am: 162-163). Through the concept of integration of life, a Muslim worker will be faced with questions such as:

1) Is it driven by natural circumstances or by Islamic teachings? (QS. Al-Tawbah: 105)
2) Does he work solely for the sake of the world or as part of devotion to God? (QS. Al An'am: 162-163)
3) Does he believe that Allah is always watching his behavior? (QS. Al An'am:103)
4) Does he believe that his material activities will be accounted for before Allah SWT? (QS al-Anbiya`: 23)
5) Does he realise the importance of earnestness in ritual worship, as well as seriousness in pursuing the world? (QS Al-Qasas: 77)
6) Does he make his profession as a field to get a reward? 'A believer will be rewarded in doing anything, including a bite of rice that is put into his wife's mouth' (HR. Ahmad).

2 *Syumuliyat al Ibadah (Worship Integration)*

Worship for a believer is not merely a ritual activity. But worship is every word and deed approved by Allah SWT, even though what is done in worldly activity. In the book 'Al

Ibadah fi al Islam,' Qardhawi[30] notes at least five conditions that must be met for worldly activities to be of worship and reward:

1) Should the work that is occupied is masyru` (legal under Islamic law)
2) The result should be based on good intentions
3) The work should be carried out with itqan (professional)
4) The worker should obey Allah's rules that bind the profession, and he is not unjust and not treacherous.
5) His worldly activities should not make him negligent of his religious obligations

The above conditions can be derived from the following questions:

1) Do they pay attention to the legal/illegal (Syariah) choice of profession to be pursued?
2) Does he realise the necessity of fulfilling his own and household needs with halal and tayyib sustenance?
3) Does he work to provide for himself and his family?
4) Has the result of his work (salary) ever been used to do things forbidden by religion?
5) Is he grateful when he sees his colleagues excel at work?
6) Does he understand the character of the task for which he is responsible?
7) Does he know the job that is his obligation?
8) Does he have the skills required by his duties and jobs?
9) Does he understand the religious rules related to his type of profession?
10) Does he commit to obey the religious rules related to his profession?
11) Can his institution for specific tasks trust him? (Narrated by Bukhari and Muslim, the characteristics of a hypocrite, including: cannot be trusted)
12) Does he pray before carrying out his duties? (QS an-Nur: 37-38)
13) Does he immediately perform the prayer when the time comes? (QS an-Nur: 37-38)
14) Does he pay zakat when his income reaches the mishap? (QS an-Nur: 37-38)
15) Does he set aside some of his income to share with others? (QS an-Nur: 37-38)

3 *Syumuliyat al `Alaqah (Relationship Integration)*

The Qur'an requires spiritual culture not only to be transcendental but also to include aspects of humanity, as stated in the Qur'an, 'They are filled with humiliation wherever

30 Yusuf Al Qardhawi, 'Al Ibadah fi al Islam,' *Maktabah Wahbah, Kairo*.

they are, unless they hold on to the rope (religion) of Allah and the rope (covenant).) with humans…' (Surah Ali Imran: 112)

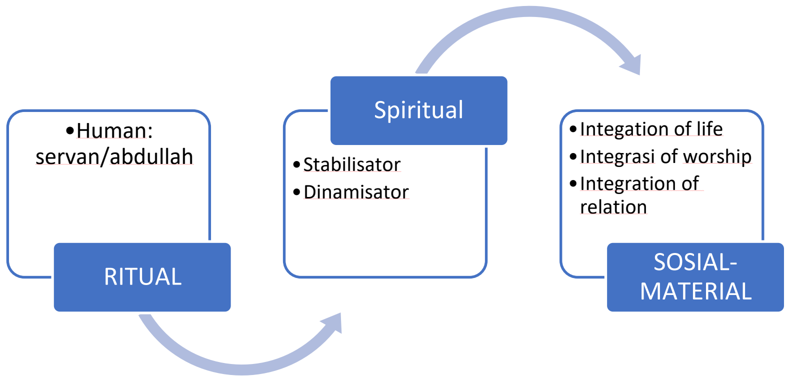
Human relations in the professional world require harmonious interactions between a Muslim worker and his colleagues and with the users of his services. With his colleagues, the spiritual values that should be developed are:

1) Ta`aruf (knowing each other) (QS. Al Hujurat: 13)
2) Ta'awun (collaborating to realise the vision and mission of the institution) (QS. Al Maidah: 2)
3) Takaful (helping each other) (QS. al-Hashr: 9)
4) Takamul (complementary in optimising tasks) (QS. Thaha: 29-34)
5) Tawashau (reminding each other to commit to truth and patience) (QS. Al Asr:1-3)

As for the relationship with the user, the culture that should be built is 'give each one their rights proportionally' (the culture of serving), as mentioned by the Prophet Muhammad in his hadith narrated by Imam Bukhari (a'thi dzi haqqin haqqahu).

The above grand theory can be illustrated in the following chart:

FIGURE 2: THE EMERGENCE OF INTEGRATION IN SPIRITUAL CULTURE



The integration of life, the integration of worship, and the integration of the relationship can be explained that humans as servants of God have a role to serve God, this can be seen in the ritual symbols that are carried out, through spiritual possessions they can become human stabilisers and dynamists so that in the end they will be formed. Which, in the future, can be the motivation, implementation, and results that humans will expect.

I understood that spiritual culture has an essential role in the world of work: First, stabiliser. Work spirituality awakens the perpetrators to involve the presence of God from the beginning of the work, the process, and the result. In other words, instilling that the work motive is because of Allah, and in the process, it must be following transcendental values. All the results must be grateful for, evaluated for future improvements (QS. Al Hasyr: 18). Second, dynamics. Spiritual culture will mean that work is worldly, which is pragmatic in the short term and contains ukhrawi. It will give birth to a sense of responsibility in this world and the hereafter.[31]

D *Performance Measurement Based on Excellent Service*

Excellent service is a translation of service excellence which means good service or the best service. Excellent service is developed based on the A3 concept, namely attitude, attention, action. Service is a sequence of activities that occur in direct interaction with people or physical machines and provide customer satisfaction. This applies to public or private companies. Variables used in the behaviour of public sector service excellence.[32] Whereas according to PP. No. 65 in 2005 concerning guidelines for the preparation and application of minimum service standards with items that have been initiated in 1995 based on the Decree of the Minister of Administrative Reform (MENPAN) in its decision No: 81/1995, which consists of simplicity, clarity, and certainty, security, openness, efficiency, economy, equitable justice, punctuality.

Service Prime according to LAN, was developed based on the A3 concept, namely Attitude (Attitude), Attention (Attention), action (action). Excellent service based on the idea of attitude includes: (1) Serving customers based on a polite and harmonious appearance, (2) Serving customers with positive thinking and logic, (3) Serving customers with respect.[33]

Service prime based on attention includes: (1) Listening and understanding seriously the needs of customers, (2) Observing and appreciating the behaviour of customers, (3) Devoting full attention to customers. Service Prime based on action includes (1) Recording every customer order, (2) Recording customer needs, (3) Reaffirming customer needs, (4) Realising customer needs, (5) Expressing gratitude with hope customers want to come back.

Service by which is total quality service, have indicators: (1) Reliability, the ability to provide services in accordance with the promises offered, (2) Responsiveness, responsiveness or alertness of employees in helping customers and providing fast and responsive service (3) Assurance, the ability of employees to have product knowledge, courtesy, and the trustworthy nature of the employee staff, so that customers are free from risk, therefore this dimension is a combination of the Competence/Competence dimension which means the skills and knowledge possessed by the employees in providing services, the Courtesy dimension which includes friendliness, attention and attitudes of employees as well as Credibility, namely matters relating to trust in the company such as reputation, achievements and so on, (4) Empathy, a sense of care/attention to provide convenience in making relationships, the ability of employees to communicate well, and the company's efforts to understand the needs and desires of its customers. This dimension is a combination of the Access dimension, namely the ease of utilising the services offered, such as the ease of smooth and easy communication

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31 Muhammad Djakfar, 'Etika Bisnis: Menangkap Spirit Ajaran Langit dan Pesan Moral Ajaran Bumi,' (Jakarta: Penebar Plus, 2012) hal. 28.

32 LAN, 'Pelayanan Prima, Lembaga Administrasi Negara' (Soetopo, 2001).

33 LAN, 'Penyusunan Standar Pelayanan Publik, Lembaga Administrasi Negara' (2003).

channels, the location of the facility is easy to reach, and the service time is not too long. Communication/Communication is the ability to communicate to deliver information in a language that is easy to understand, listen and pay attention to criticism or suggestions from customers. Knowing or Understanding the Customer includes efforts to understand customer needs and recognise the characteristics of their customers (5) Tangibles/Evidence Direct, physical appearance facilities such as buildings and rooms from the Front Office to other rooms and facilities, availability of parking spaces, cleanliness, neatness, and comfort of the room, completeness of equipment and availability of communication facilities, as well as the neat appearance of employees.[34]

E *Community Satisfaction*

Tjiptono stated that customer satisfaction or dissatisfaction is the customer's responsibility to evaluating the perceived discrepancy between previous expectations and the actual perceived performance after its use.[35] Satisfaction is the overall attitude shown by consumers to goods or services after consumers obtain and use them. Zeithaml et al. suggest that there are five dimensions in determining the quality of service satisfaction, namely: *reliability*, responsiveness, assurance, empathy, tangibles (Direct Evidence).[36] Meanwhile, community satisfaction based on excellent service (PP No. 65 yrs. 2005) consist of:

TABLE 1: INSTRUMENT OF COMMUNITY SATISFACTION

INSTRUMENT	INFORMATION
Simplicity	service procedures are carried out in an easy, smooth, fast, and uncomplicated manner and are easy to understand and implement
Clarity and Certainty	(a) Procedures for public services, (b) Requirements for public services, both technical and administrative, (c) Work units or officials responsible for providing public services, (d) Details of fees/tariffs for public services and payment procedures, (e) schedule for completion, (f) Rights and obligations of both providers and recipients of public services based on evidence of receipt of application/completeness, as a tool to ensure the processing of public services, (g) Officials who receive customer complaints (public)
Security	The process and results of public services can provide security and comfort and can provide legal certainty
Openness	procedures, requirements, work units/officers in charge of public service providers, time of completion, and details of costs/tariffs and other matters related to the public service process must be informed openly so that they are easily known and understood by the public, whether requested or unsolicited

34 Tjiptono (n 3).

35 Tjiptono (n 3) 24.

36 Zeithaml et al (n 2).

Efficient	(a) Requirements for public services are only limited to matters directly related to the achievement of service goals while still taking into account the integration between requirements and the products of public services provided, (b) Preventing repetition of fulfilling the completeness of requirements, if the service process requires completion of requirements from other relevant government work units/agencies
Economical	The imposition of public service fees must be determined reasonably by taking into account (a) The value of goods or public services without demanding unreasonably high costs, (b) Conditions and ability of customers (community) to pay in general, (c) Provisions of laws and regulations -applicable invitation
Justice	The scope or reach of public services must be sought as wide as possible with equitable distribution and treated fairly
Punctuality	implementation of public services can be completed within the specified time

IV DISCUSSION

A *Overview of Research Objects*

1 *Tax Reform and Organisational Structure*

Tax reforms, especially in tax administration, have made the organisational structure more streamlined but with more precise job descriptions. The services provided since 1999 along with tax reform are one-stop services, namely services provided to taxpayers based on the area where the taxpayer is registered with various tax problems. In addition, the tax administration has provided many conveniences to taxpayers such as tax deposits, tax reporting with e-Registration, e-SSP, e-SPT through the online system from the official website Director General of Taxes (www.pajak.go.id).

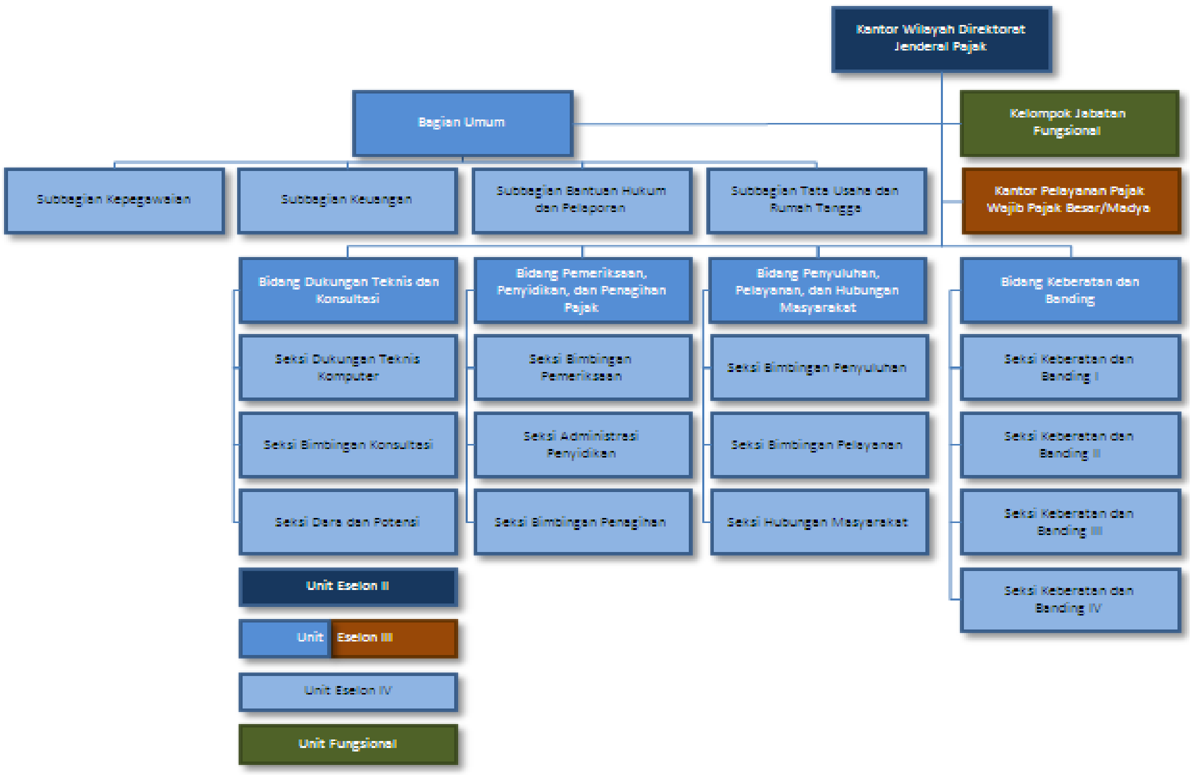
The organisational structure looks as follows:

- Headquarters
  - Secretariat of the Directorate General
  - Directorate of Tax Regulations I
  - Directorate of Tax Regulation II
  - Directorate of Inspection and Billing
  - Directorate of Intelligence and Investigation
  - Directorate of Extensification and Assessment
  - Directorate of Objections and Appeals
  - Directorate of Potential Compliance and Revenue

  - Directorate of Extension, Service and Public Relations
  - Directorate of Tax Information Technology
  - Directorate of Internal Compliance and Transformation of Apparatus Resources
  - Directorate of Information and Communication Technology Transformation
  - Directorate of Business Process Transformation
- Taxation Data and Document Processing Center
- Large Taxpayer Regional Offices and Special Jakarta
- Regional Offices other than Regional Offices for Large Taxpayers and Special Jakarta
- Tax Service Office for Large and Middle Taxpayers
- Primary Tax Service Office
- Tax Service, Counselling and Consulting Office

In this study, the research object is the East Java Regional Tax Office III, consisting of 1 Regional Tax Office, 1 Large and Middle Tax Service Office, and 14 Primary Tax Service Offices.

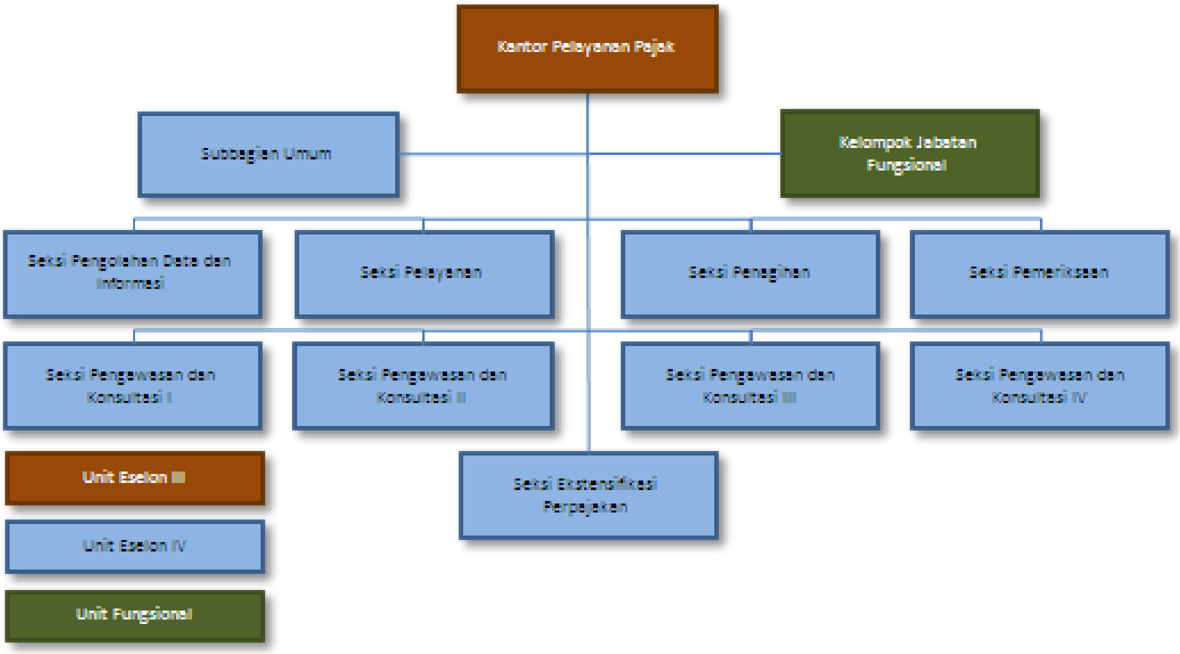
CHART 4: ORGANISATIONAL STRUCTURE OF REGIONAL OFFICES OF THE DIRECTORATE GENERAL OF TAXES



Source: Directorate General of Taxes

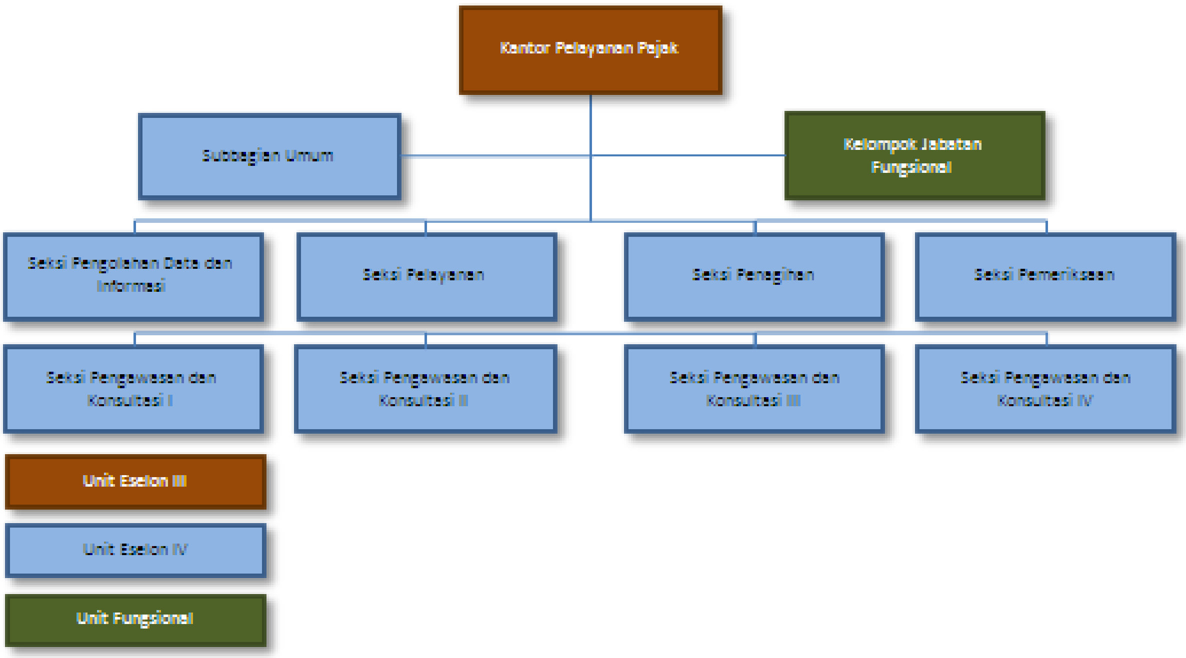
The organisational structure of the Regional Office of the Directorate General of Taxes that distinguishes it from the tax service office is that in the regional office, there is no direct service to taxpayers. Still, the functional section group is the objection and appeal section, which does not exist in the working section group at the primary service office. While in the service office provides direct services to taxpayers.

CHART 5: ORGANISATIONAL STRUCTURE OF MIDDLE TAX SERVICE OFFICE



Source: Directorate General of Taxes

CHART 6: ORGANISATIONAL STRUCTURE OF THE PRIMARY TAX SERVICE



Source: Directorate General of Taxes

From the chart above, it can be seen that each tax office has a specific function from the head office to the technical staff. In the Pratama tax service office, the general section is the section that handles internal affairs. At the same time, the functional position group is the section that is directly related to services to taxpayers.

2 *Services at the Tax Office*

Standard Operating Procedures ('SPO') for the Ministry of Finance's leading tax services consist of:

1) Service for Completion of Applications for Registration of Taxpayer Identification Numbers ('NPWP')
2) Service for Settlement of Applications for Confirmation of Taxable Entrepreneurs ('PKP')
3) Service for the Settlement of Applications for the Return of Value Added Tax ('VAT') Excess Payments
4) Issuance of Orders for Paying Excess Taxes ('SPMKP')
5) Service for Settlement of Objections to the Determination of Income Tax, Value Added Tax, and Sales Tax on Luxury Goods
6) Service for Completion of Free Certificate ('SKB') for Collection of Article 22 Import Income Tax
7) PBB Reduction Application Settlement Service
8) New Tax Object Registration Service with Office Research
9) Mutation Settlement Service for All UN Objects and Subjects
10) Service for Completion of Applications for Free Certificate ('SKB') withholding Income Tax Article 23
11) Service for Completion of Applications for Free Certificates (''SKB) Withholding Income Tax on Interest on Deposits and Savings as well as SBI Discounts Received or Obtained by Pension Funds whose establishment has been approved by the Minister of Finance
12) Service for Completion of Applications for Free Certificate ('SKB') of Income Tax on Income from the Transfer of Rights to Land and Buildings
13) Service for Completion of Applications for Free Certificate ('SKB') of VAT on Certain Taxable Goods ('BKP')
14) Land and Building Tax Objection Settlement Services
15) Service for Settlement of Applications for Reduction or Elimination of Administrative Sanctions
16) Service for Settlement of Incorrect Tax Assessment Reduction or Cancellation Applications

B *Research Data Description*

1 *Research Respondents*

This study uses primary data to distribute questionnaires to tax employees by sampling with stratified random sampling. From the existing population, namely tax employees in the Regional Office of the Directorate General of Taxes, East Java III, 35% (300 respondents) were taken as samples. Questionnaires were distributed to tax officials at the Regional Office of the Directorate General of Taxes III East Java, KPP Madya Malang, and the Primary Service Office ('KPP') at Regional Office III East Java.

Based on data that cannot be published in full, it shows that tax officials from the Head of the Office to the Technical Section accompanied by their respective names and sections indicate that there is information disclosure from the tax office. Tax employee data and analysis data are as follows:

TABLE 2: DATA ANALYSIS OF RESPONDENTS IN EACH TAX OFFICE

No.	Office Name	Amount Employee	Questionnaire Spread	Response Rate	Questionnaire No Back	Questionnaire Cannot be analysed	Questionnaire Can be analysed
1	KPP Pare	78	30	30	0	6	24
2	KPP Blitar	76	30	30	0	2	28
3	Regional Office III East Java	100	30	30	0	5	25
4	South Malang KPP	77	30	30	0	4	26
5	North Malang KPP	77	30	28	2	2	26
6	KPP Pasuruan	77	25	25	0	3	22
7	KPP Madya Malang	110	25	25	0	2	23
8	KPP Singosari	77	25	22	3	1	21
9	KPP Kepanjen	77	25	22	3	3	19
10	KPP Batu	79	25	22	3	4	18
11	KPP Proboolinggo	76	25	15	10	1	14
TOTAL		**904**	**300**	**279**	**21**	**33**	**246**

Source: Primary Data, Processed

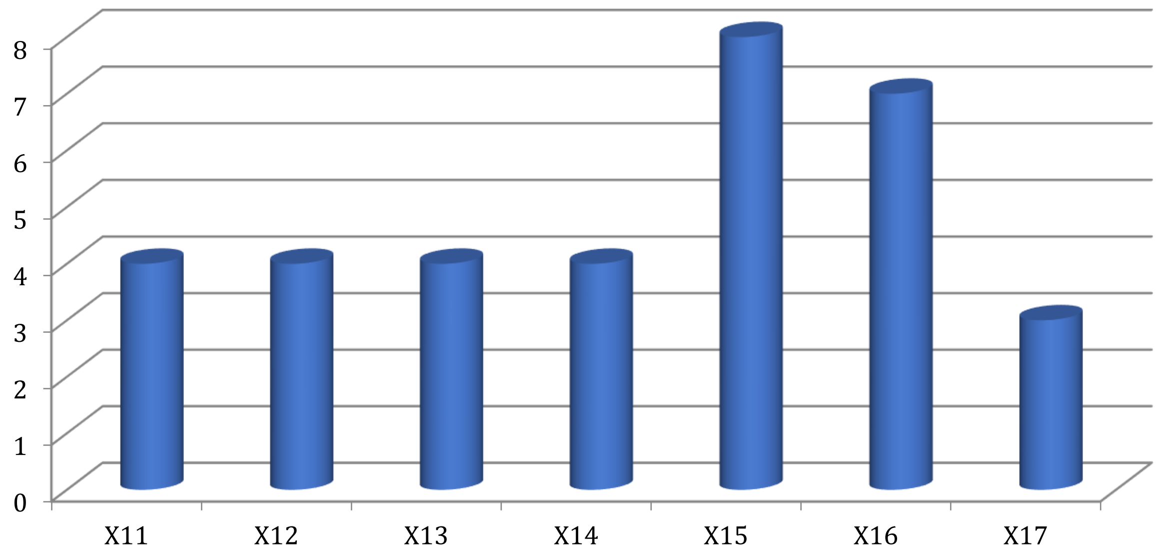
The tax employees who became the population in this study were 904 employees, based on the distribution of each section relatively the same, namely for the Tax Service Office between 76–110 office employees who were evenly distributed in sections/sections. The areas in each office are as follows:

1) Head office
2) General Subsection
3) PDI Section
4) Service Section
5) Billing Section
6) Examination Section Seksi
7) Extensification Section

8) Seksi Waskon I
9) Waskon Section II
10) Waskon Section III
11) Section IV
12) KP2KP
13) Tax Audit Functional
14) Executor
15) UN Assessor Supervisor
16) Security Guard/Driver/Cleaning Service

Based on the table above, it appears that the respondent's response rate is very high, namely 93% (279 respondents from 300 questionnaires distributed). Meanwhile, from the response rate, 88.2% (as many as 246 respondents) can be analysed, and 11.8% (as many as 33 respondents) the respondent's data cannot be analysed, this is because the respondents did not answer the questions ultimately/not all were responded to, choosing >1 answer. The distribution of respondents who did not answer for each instrument in this study (life integration, worship integration, and relationship integration) is shown in the following graph:

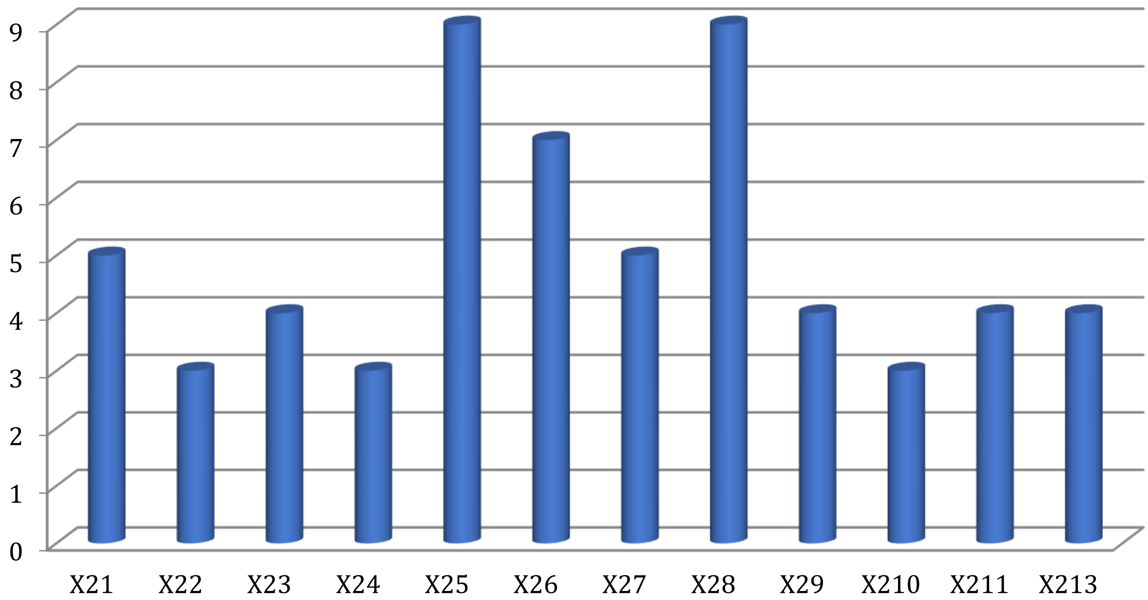
FIGURE 1: INSTRUMENTS UNANSWERED QUESTIONS ON LIVE INTEGRATION TAX OFFICER RESPONDENT



Source: Primary Data, Processed

From the Live Integration graph, it appears that the question X_{15} (Seriously in worship, such as/more than seriousness in work) Most of the unanswered questions from the returned questionnaires were eight respondents. This shows that there is confidence in tax officials not to lie to themselves because there is a lack of confidence that tax employees can worship seriously beyond the sincerity of their work.

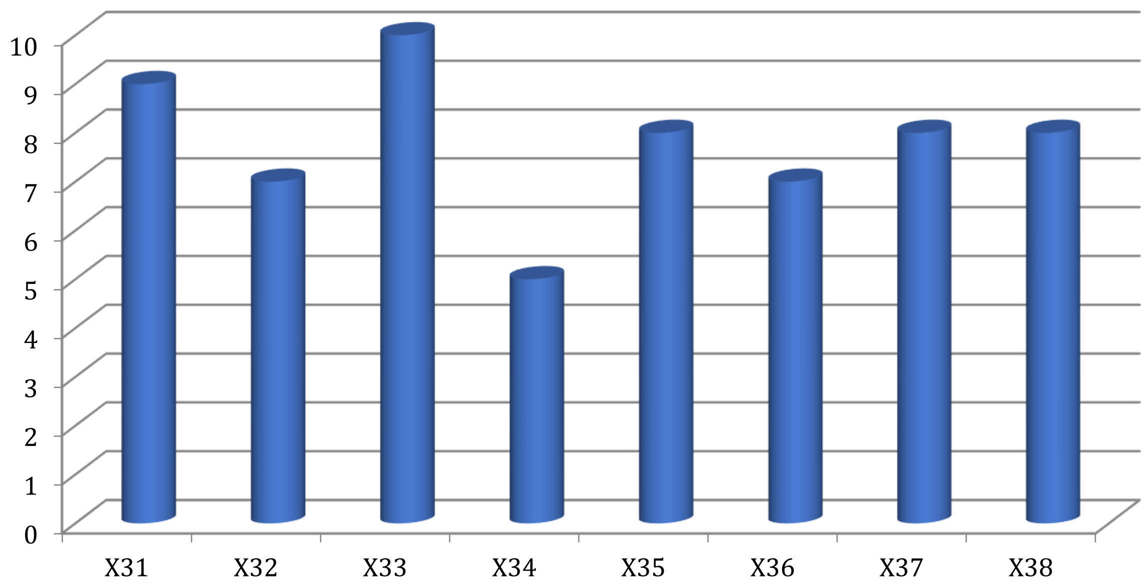
FIGURE 2: INSTRUMENTS UNANSWERED QUESTIONS ON WORSHIP INTEGRATION TAX OFFICER RESPONDENT



Source: Primary Data, Processed

From the Worship Integration graph, it appears that the questions X_{25} (Keep promises given to taxpayers) and X_{28} (Trusted by agencies for specific tasks), most of which were not answered from the returned questionnaires, namely nine respondents. It is because all employees already have clear duties. All of their duties will be related to employee performance measurement, which is correlated with employees' compensation in terms of placing an appointment with a taxpayer. It has been regulated in standard operating procedures for each service provided.

GRAPH 3: INSTRUMENTS QUESTIONS THAT ARE NOT ANSWERED ON TAX EMPLOYEE RESPONSIVE RELATIONS INTEGRATION



Source: Primary Data, Processed

From the Live Integration graph, it appears that the question X_{33} (Making taxpayers part of the successful team of the agency's vision and mission). Most of the unanswered questions from the returned questionnaires were ten respondents. Based on the uncertainty of tax officials on the participation of taxpayers in the success of the agency's vision and mission, because from the definition of tax, it appears that tax is a mandatory contribution levied by the government to the community/taxpayer based on the law with no direct contra-achievement to the taxpayer

2 *Respondent Data Analysis*

The description of respondent data consisting of 246 respondents based on several criteria, namely age, gender, education, years of service, employee status, group, religion, section/section, and occupation, as shown in the following interpretation:

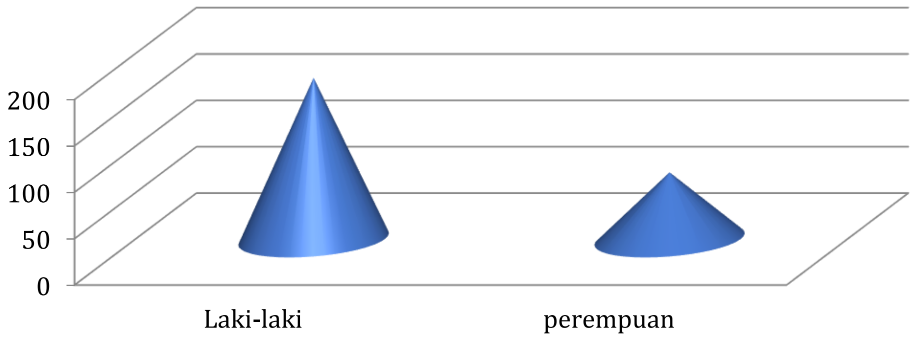
(a) Respondent Data by Gender

Respondent data based on gender in this study showed that as many as 174 (71%) male respondents and 72 (29%) female respondents, it is shown in the following tables and graphs to make the illustration easier.

TABLE 3: RESEARCH RESPONDENT DATA BY GENDER

No.	Gender	Amount	Percentage (%)
1	Man	174	71
2	Woman	72	29
	Total	**246**	**100**

GRAPH 4: RESPONDENT DATA BY GENDER



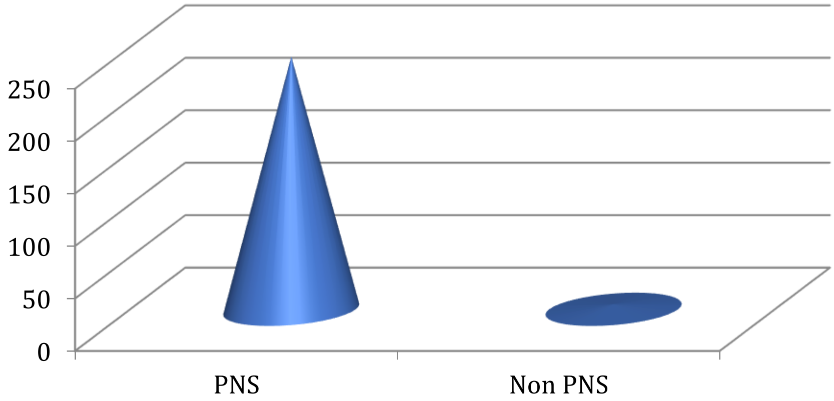
(b) Respondent Data Based on Employee Status

Data on respondents based on employee status in this study showed that as many as 241 (98%) respondents were Civil Servants (PNS), and as many as 5 (2%) respondents were non-PNS employees.

TABLE 4: RESEARCH RESPONDENT DATA BASED ON EMPLOYEE STATUS

NO.	EMPLOYEE STATUS	AMOUNT	PERCENTAGE (%)
1	Civil Servant	241	98
2	Non Civil Servant	5	2
	TOTAL	**246**	**100**

GRAPH 5: RESPONDENT DATA BASED ON EMPLOYEE STATUS



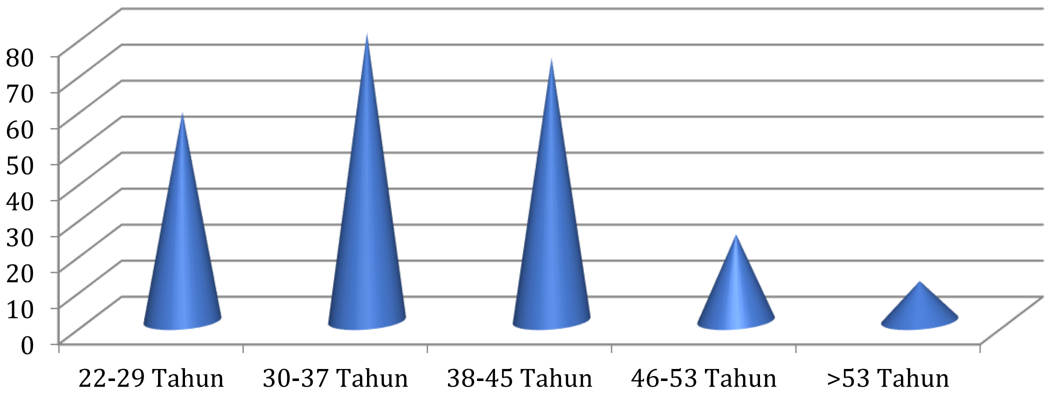
(c) Respondent Data Based on Age

Data respondents based on age in this study showed that most of them were 80 (33%) respondents aged 30-37 years, and as many as 73 (30%) respondents were aged 38-45 years. So that the largest average age of employees was productive age, and 4 % of respondents have entered retirement, to make it easier for the illustration to appear in the following table and graph.

TABLE 5: RESEARCH RESPONDENT DATA BASED ON AGE

NO.	AGE	AMOUNT	PERCENTAGE (%)
1	22–29 Years	58	24
2	30–37 Years	80	33
3	38–45 Years	73	30
4	46–53 Years	24	10
5	>53 Years	11	4
	TOTAL	**246**	**100**

GRAPH 6: RESPONDENT DATA BASED ON AGE



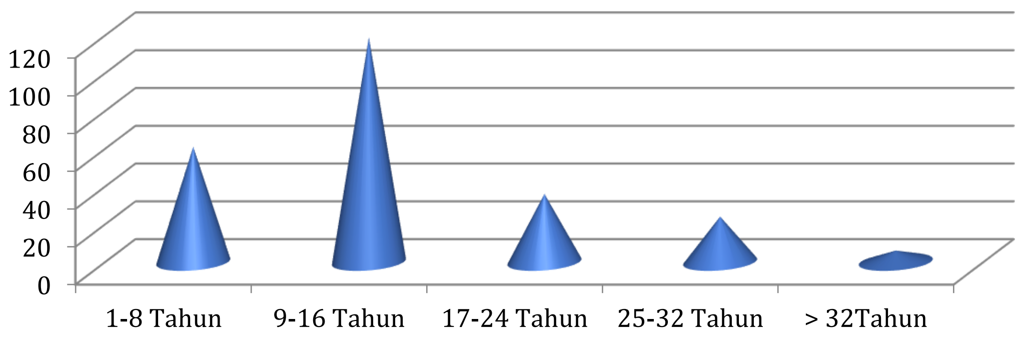
(d) Respondent Data Based on Working Period Masa

Respondent data based on years of service in this study showed that 119 (48%) respondents worked between 9-16 years, and more than 50% of respondents had a service period of > 10 years. The illustration is easier to see in the following tables and graphs.

TABLE 6: RESEARCH RESPONDENTS DATA BASED ON YEARS OF SERVICE (YEARS)

NO	YEARS OF SERVICE	AMOUNT	PERCENTAGE (%)
1	1–8 Years	61	25
2	9–16 Years	119	48
3	17–24 Years	36	15
4	25–32 Years	24	10
5	> 32 Years	6	2
	TOTAL	**246**	**100**

GRAPH 7: RESPONDENT DATA BASED ON WORKING PERIOD MASA



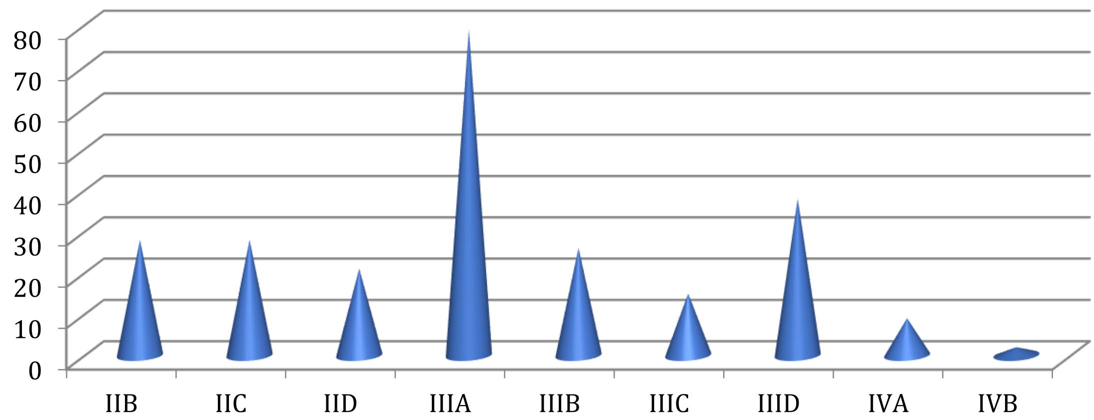
(e) Respondent Data by Group

Respondents' data based on groups in this study showed that 79 (32%) were in class IIIA, and 50% were average employees in class III. It is in line with the educational level of the average bachelor and master, with a tenure of > 10 years. So, if viewed from the decision of the minister of finance on compensation (income) given to tax class III employees, it has provided eligibility to get better performance. The illustrations are shown in the following tables and graphs.

TABLE 7: RESEARCH RESPONDENTS DATA BASED ON GROUP STATUS/RANK

NO	EMPLOYEE STATUS	AMOUNT	PERCENTAGE (%)
1	IIB	28	11
2	IIC	28	11
3	IID	21	9
4	IIIA	79	32
5	IIIB	26	11
6	IIIC	15	6
7	IIID	38	15
8	IVA	9	4
9	IVB	2	0.8
	TOTAL	**246**	**100**

GRAPH 8: RESPONDENT DATA BY GROUP



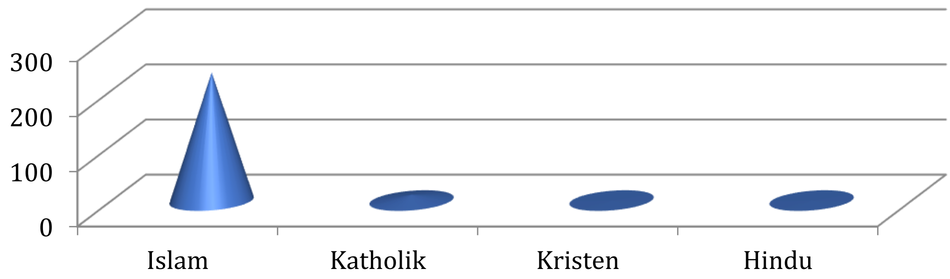
(f) Respondent Data Based on Religion

Data on respondents based on religion in this study shows that most respondents are Muslim, as many as 233 (95%), 5% of other religions. This data is the same as the data in the existing sample, i.e., 95% of employees in the East Java Regional Office III tax office are Muslim to make the illustration easier. It is shown in the following table and graph.

TABLE 8: RESEARCH RESPONDENT DATA BASED ON RELIGION

NO	AGE	AMOUNT	PERCENTAGE (%)
1	Islam	233	94.7
2	Catholic	11	4.5
3	Christian	1	0.4
4	Hindu	1	0.4
	TOTAL	**246**	**100**

GRAPH 9: RESPONDENT DATA BASED ON RELIGION



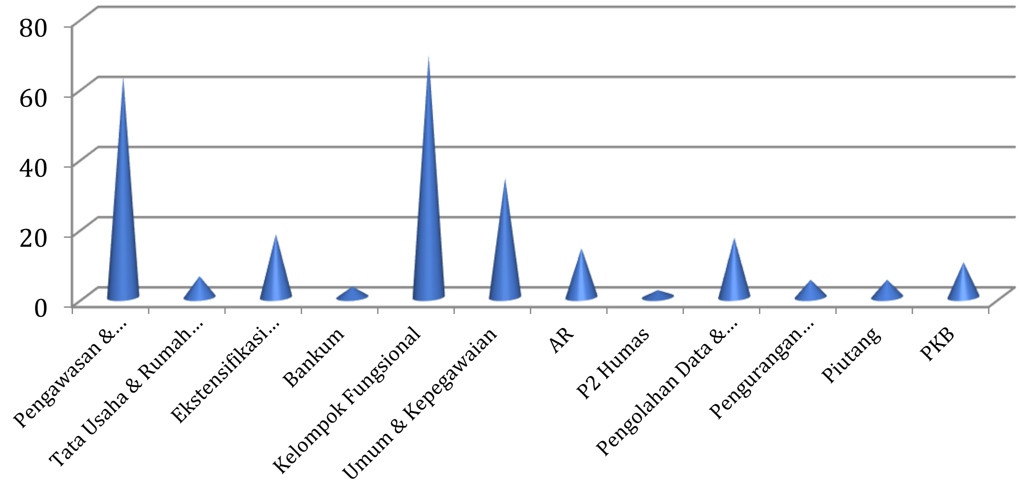
(g) Respondent Data Based on Job Section/Section

Respondent data based on sections in this study indicate that as a large functional group (including Waukon, AR, reduction of objections and appeals), there are 151 (61%) respondents, this is in line with the vision and mission of the Directorate General of Taxes to be able to provide full service to taxpayers. In addition, functional groups are the spearhead in achieving tax targets, and this is in line with the modernisation of Taxation that has been launched, namely a one-stop service. The illustrations are shown in the following tables and graphs.

TABLE 9: RESEARCH RESPONDENT DATA BASED ON OCCUPATIONAL SECTION/SECTION

NO	AGE	AMOUNT	PERCENTAGE (%)
1	Supervision and Consulting/Wascon	63	26
2	Administration and Household	6	2
3	Tax Extensification	18	7
4	Bank	3	1
5	Functional Group	69	28
6	General & Staff	34	14
7	Representative Account	14	6
8	P2 Public Relations	2	1
9	Data and Information Processing	17	7
10	Reduction of Objections and Appeals	5	2
11	Receivables	5	2
12	PKB	10	4
	TOTAL	**246**	**100**

GRAPH 10: RESPONDENTS' DATA BASED ON JOB SECTION/SECTION



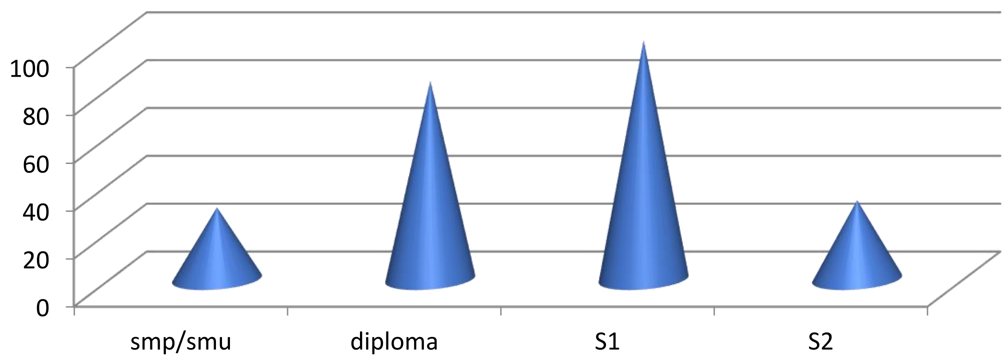
(h) Respondent Data Based on Education

Data on respondents based on education in this study showed that 100 (42%) respondents had a bachelor's degree, or 54% had bachelor's and master's degrees. While diploma education consists of D1-D4 98% graduates of tax diplomas, employee competence does not need to be doubted in serving taxpayers and Taxation. The illustrations are shown in the following tables and graphs.

TABLE 10: RESEARCH RESPONDENT DATA BASED ON EDUCATION

NO	AGE	AMOUNT	PERCENTAGE (%)
1	SLTP/SLTA	30	12
2	Diploma	83	34
3	S1	100	41
4	S2	33	13
	TOTAL	**246**	**100**

GRAPH 11: RESPONDENT DATA BASED ON EDUCATION



Respondents in this study whose data can be analysed are 246 respondents with a heterogeneous distribution of answers for each spiritual culture instrument. It can be seen from the distribution of responses in which all answers must be answered. None of the respondents' answers are homogeneous, meaning choosing answers with the same scale in all questionnaires. The following is the distribution of respondents' answers for each integration in spiritual culture:

(i) Live Integration

The integration of life is the embodiment of human beings in a kaffah manner, and Koran supports this. Al Baqarah: 208 explains that 'when the Qur'an commands humans to convert to Islam in a kaafah, then the expected response from humans is as stated in verse: 'Say: 'Verily my prayer, worship, life, and death are only for Allah, the Lord of the worlds. He has no partner; ...'. (QS. Al An'am: 162-163).

From the respondents' answers which show that 32% of respondents agree, even 58.9% strongly agree, and none of the respondents disagree, it can be concluded that every human being at work believes that the concept of integration of life is essential. Respondents agreed more than 80% that there is life afterlife globally, and everything that humans do must return to God. An illustration of calculations from the descriptive analysis is shown in the following table.

TABLE 10: DATA DISTRIBUTION OF LIFE INTEGRATION ANALYSIS OF TAX EMPLOYEES

ANSWER	LIFE INTEGRATION INSTRUMENTS							
	X11	**%**	**X12**	**%**	**X13**	**%**	**X14**	**%**
Strongly Disagree	0	0	0	0	1	0	0	0
Do not Agree	5	2	4	2	1	0	1	0
Normal	11	4	19	8	6	2	4	2
Agree	106	43	89	36	48	20	60	24
Strongly Agree	124	50	134	54	190	77	181	74
TOTAL	**246**	**100**	**246**	**100**	**246**	**100**	**246**	**100**

Source: Primary data, Processed

TABLE 10: LANE

ANSWER	LIFE INTEGRATION INSTRUMENTS							
	X15	**%**	**X16**	**%**	**X17**	**%**	**TOT**	**TOTAL (%)**
Strongly Disagree	1	0	7	3	0	0	9	0.5
Do not Agree	6	2	11	4	5	2	33	1.9
Normal	22	9	32	13	21	9	115	6.7
Agree	85	35	78	32	85	35	551	32.0
Strongly Agree	132	54	118	48	135	55	1014	58.9
TOTAL	**246**	**100**	**246**	**100**	**246**	**100**	**1722**	**100**

Source: Primary Data, Processed

(j) Worship Integration

Integration of Worship for a believer is interpreted as a ritual activity of worship. Still, worship is every word and deed that is blessed by Allah SWT, even though what is done is a world activity (Al Qardhawi, 1405/1985). In the book 'Al Ibadah fi al Islam,' Qardhawi notes at least five conditions that must be met so that worldly activities are of worship value and reward: (1) The work that is occupied is masyru` (legal according to Islamic law), (2) It should be the work is based on good intentions, (3) the work should be carried out with itqan (professional), (4) the worker should obey God's rules that bind the type of profession, and he is not unjust and not treacherous, (5) his activities should be worldly done not make him negligent of religious obligations.

From the respondents' answers, 35.7% of respondents agreed, and 6.3% of respondents said they were normal, and no one stated strongly agrees/strongly disagree. Accordingly, it can be concluded that the integration of worship is essential even though not most respondents expressly agree or strongly agree. However, it is still something that needs to be considered with a percentage of 42%. The complete data illustration is in the following series of tables.

TABLE 11: DATA DISTRIBUTION ANALYSIS OF TAX EMPLOYEE WORSHIP INTEGRATION

ANSWER	WORSHIP INTEGRATION INSTRUMENTS									
	X21	%	X22	%	X23	%	X24	%	X25	%
Strongly Disagree	0	0	0	0	0	0	0	0	1	0.4
Disagree	1	0.4	2	0.8	0	0	0	0	0	0
Normal	2	0.8	5	2	5	2.0325	15	6.1	13	5.3
Agree	42	17	48	20	65	26.423	98	40	100	41
Strongly Agree	201	82	191	78	176	71.545	133	54	132	54
TOTAL	**246**	**100**	**246**	**100**	**246**	**100**	**246**	**100**	**246**	**100**

Source: Primary Data, Processed

TABLE 11: (CONTINUED)

ANSWER	WORSHIP INTEGRATION INSTRUMENTS									
	X26	%	X27	%	X28	%	X29	%	X210	%
Strongly Disagree	0	0	1	0.4	0	0	1	0	0	0
Disagree	1	0.4	2	0.8	2	1	1	0	0	0
Normal	16	6.5	17	6.9	40	16	26	11	13	5.3
Agree	110	45	113	46	118	48	94	38	107	43
Strongly Agree	119	48	113	46	86	35	124	50	126	51
TOTAL	**246**	**100**	**246**	**100**	**246**	**100**	**246**	**100**	**246**	**100**

Source: Primary Data, Processed.

TABLE 11: (CONTINUED)

ANSWER	WORSHIP INTEGRATION INSTRUMENTS					
	X211	%	X212	%	TOT	TOTAL (%)
Strongly Disagree	1	0.4	0	0	4	0.1
Disagree	3	1.2	1	0.4	13	0.4
Normal	14	5.7	19	7.7	185	6.3
Agree	71	29	87	35	1,053	35.7
Strongly Agree	157	64	139	57	1,697	57.5
TOTAL	**246**	**100**	**246**	**100**	**2,952**	**100**

Source: Primary Data, Processed

(k) Relationship Integration

Relationship integration is a form of integration that provides understanding to humans that spiritual culture includes aspects of humanity, which are implemented in: (1) Ta'aruf (knowing each other) (Surat Al Hujurat: 13), (2) Ta'awun (work together to realise the vision and mission of the institution) (QS. Al Maidah: 2), (3) Takaful (helping each other) (QS. Al Hasyr: 9), (4) Takamul (complementary in optimising tasks) (QS. Thaha: 29-34), (5) Tawashau (reminding each other to commit to truth and patience) (QS. Al-Asr: 1-3).

From the results of respondents' answers which showed 48.3% of respondents agreed and 38.1% of respondents stated strongly agree, and 0.5% of respondents stated strongly disagree, especially for the X_{31} indicator (Knowing the taxpayer is not just a name and address dan) and X_{35} (Assisting taxpayers in completing their obligations). This shows that there are respondents who strongly disagree with the direct relationship between taxpayers and tax officers. The complete data illustration is in the following table.

TABLE 11: DATA DISTRIBUTION OF TAX EMPLOYEE RELATIONS INTEGRATION ANALYSIS

ANSWER	RELATIONSHIP INTEGRATION INSTRUMENTS									
	X31	**%**	**X32**	**%**	**X33**	**%**	**X34**	**%**	**X35**	**%**
Strongly Disagree	5	2.0	0	0	0	0	0	0	4	1.6
Disagree	15	6.1	0	0	0	0	0	0	8	3.3
Normal	81	32.9	11	4.47	34	14.2	26	10.6	43	17.5
Agree	99	40.2	130	52.8	121	50.4	130	52.8	123	50.0
Strongly Agree	46	18.7	105	42.7	85	35.4	90	36.6	68	27.6
TOTAL	**246**	**100**	**246**	**100**	**240**	**100**	**246**	**100**	**246**	**100**

Source: Primary Data, Processed

TABLE 11: DATA DISTRIBUTION OF TAX EMPLOYEE RELATIONS INTEGRATION ANALYSIS

ANSWER	RELATIONSHIP INTEGRATION INSTRUMENTS							
	X36	**%**	**X37**	**%**	**X38**	**%**	**TOT**	**TOTAL (%)**
Strongly Disagree	0	0	0	0	0	0	9	0.5
Disagree	0	0	0	0	0	0	23	1.2
Normal	14	5.7	10	4.07	17	6.9	236	12
Agree	114	46.3	111	45.1	119	48.4	947	48.3
Strongly Agree	118	48.0	125	50.8	110	44.7	747	38.1
TOTAL	246	100	246	100	246	100	1962	100

Source: Primary Data, Processed

C *Data Analysis*

The analytical method in this study uses Partial Least Square (PLS) to find a prototype/testing of a spiritual-based performance measurement model. Partial Least Square analysis is used because the researchers have not tested. No previous researchers have tried the possibility of a correlation or influence of the variables used in measuring performance based on spiritual culture. This model is suitable for use in this study because, in PLS, it is allowed to test the development of the model. This model consists of three latent variables that have a reflexive relationship with the indicator. The number of data samples that were processed from the study was 246 respondents.

1 *Measurement Model (Outer Model)*

The measurement model (outer model) uses convergent validity and discriminant validity, and composite reliability. The analysis shows that this measurement model shows the specification of the relationship between latent variables and their indicators. In this study, there are three latent variables: the integration of life, relationships, and worship. This study uses a reflexive measurement model, each of which is evaluated measured by the convergent validity and discriminant validity of the indicators and composite reliability for the indicator block.

Evaluation of the measurement model for convergent validity that the individual reflexive measure is high if it has a correlation of more than 0.7 with the constructor with the latent variable that you want to measure, and the lowest limit is 0.5–0.6 in early-stage research. The table below shows the results of the calculation of the convergent validity of the study.

Table 12: Test result in *Convergent Validity* Spiritual Culture for Life Integration, Worship Integration, and Relationship Integration

Variable	Original Sample Estimate	Mean of Subsamples	Standard Deviation	T-Statistic
Life				
X_{11}	0.788	0.790	0.059	13,403
X_{12}	0.779	0.783	0.071	11,031
X_{13}	0.710	0.704	0.109	6.485
X_{14}	0.758	0.758	0.069	10,970
X_{15}	0.729	0.719	0.108	6,724
X_{16}	0.507	0.489	0.190	2,669
X_{17}	0.727	0.735	0.083	8,714
Worship				
X_{21}	0.519	0.537	0.119	4.349
X_{210}	0.784	0.785	0.058	13,581
X_{211}	0.625	0.655	0.105	5,930
X_{212}	0.729	0.694	0.097	7.516
X_{22}	0.608	0.609	0.119	5.096
X_{23}	0.671	0.679	0.092	7.322
X_{24}	0.758	0.727	0.091	8,329
X_{25}	0.725	0.737	0.095	7,674
X_{26}	0.641	0.650	0.09	7.156
X_{27}	0.783	0.796	0.055	14.116
X_{28}	0.712	0.700	0.076	9,354
X_{29}	0.770	0.759	0.076	10,150
Connection				
X_{31}	0.592	0.566	0.124	4.761
X_{32}	0.752	0.744	0.048	15,619
X_{33}	0.757	0.750	0.057	13.182

X_{34}	0.782	0.761	0.068	11.474
X_{35}	0.652	0.636	0.090	7.269
X_{36}	0.697	0.674	0.087	8026
X_{37}	0.720	0.715	0.093	7,705
X_{38}	0.740	0.682	0.102	7.237

Source: Primary Data, Processed

The results testing table above shows that all of the outer loading construct indicators have values above 0.5, and the t-statistic value is greater than the t-table value, which is > 1.96. So it can be concluded that this measurement meets the requirements of convergent validity. Based on the statistical prices of the results of the Partial Least Square analysis as presented in table 5.13 then the results of the relationship test between the variables of integration of life, integration of worship, and integration of relationships are given as follows:

The indicator with the largest loading indicates that the indicator largely determines a latent variable. Discriminant validity of the measurement model with reflexive indicators is assessed based on cross-loading measurements with constructs. If the indicator correlation with the construct is greater than the indicator correlation with other variable constructs, it means that the construct has a good discriminant validity value. Discriminant validity can be seen from the cross-loading. The results of the discriminant validity test are presented in the table below.

TABLE 13: CROSS LOADING LIFE INTEGRATION, WORSHIP INTEGRATION AND RELATIONSHIP INTEGRATION

	LIVE INTEGRATION	WORSHIP INTEGRATION	RELATIONSHIP INTEGRATION
X_{11}	0.788	0.509	0.441
X_{12}	0.779	0.473	0.485
X_{13}	0.710	0.325	0.27
X_{14}	0.758	0.359	0.276
X_{15}	0.729	0.609	0.468
X_{16}	0.507	0.491	0.305
X_{17}	0.727	0.507	0.625
X_{21}	0.248	0.519	0.235
X_{22}	0.314	0.608	0.332
X_{23}	0.299	0.671	0.379
X_{24}	0.497	0.758	0.587
X_{25}	0.442	0.725	0.594
X_{26}	0.323	0.641	0.531
X_{27}	0.564	0.783	0.658
X_{28}	0.511	0.712	0.741
X_{29}	0.553	0.770	0.68
X_{210}	0.422	0.784	0.625
X_{211}	0.432	0.625	0.405
X_{212}	0.479	0.729	0.511
X_{31}	0.324	0.494	0.592
X_{32}	0.307	0.425	0.752

X_{33}	0.428	0.610	0.757
X_{34}	0.369	0.514	0.782
X_{35}	0.370	0.401	0.652
X_{36}	0.253	0.402	0.697
X_{37}	0.285	0.399	0.720
X_{38}	0.369	0.458	0.740

Source: Primary Data, Processed

From the table above shows the correlation of latent variables with measurement indicators is greater than the size of other latent variables. That is, latent variables predict their block size better than the block sizes of other variables. Thus, this study has met discriminant validity.

Other methods can also be used by looking at the average variance extracted ('AVE') root for each latent variable and comparing it with the correlation between latent variables. Based on the test results validity of the instrument in a table, the value is 0.746 with the AVE root value of 0.864, which is greater than 0.5. So, it can be concluded that the construct meets the criteria of discriminant validity. Composite reliability aims to test the reliability of the instrument in a research model specifically for reflexive indicators. The results of the composite reliability test are presented in the following table:

TABLE 14: COMPOSITE RELIABILITY TEST RESULTS

	AVERAGE VARIANCE EXTRACTED (AVE)	COMPOSITE RELIABILITY	INFORMATION
Life	0.518	0.881	Reliable
Worship	0.488	0.919	Reliable
Connection	0.510	0.892	Reliable

Source: Primary data, Processed

Based on the table above, the results of the composite reliability test show a satisfactory value. All latent variables are reliable because all latent variable values have a combined reliability value of 0.7. This means that the questionnaire used as a tool in this study has been reliable or consistent. Thus, it can be concluded that all indicators are indeed a measure of their respective constructs.

2 *Structural Model Testing (Inner Model)*

Structural modelling is done to see the magnitude of the coefficient of the structural path. I tested the Goodness of Fit structural model on the inner model using the predictive-relevance (Q^2) value. The R^2 value of each endogenous variable in this study can be seen in the table below.

TABLE 15: R^2 VALUE OF ENDOGENOUS VARIABLES

VARIABLE	R-SQUARE
Live Integration	0.228
Worship Integration	0.614
Relationship Integration	

The predictive-relevance value is obtained by the formula:

$Q^2 = 1 – (1 – R12) (1 – R22)$

$Q^2 = 1 – (1 – 0.614) (1 – 0.228)$

$Q^2 = 0.702$

Results calculation the predictive-relevance (Q2) value of 0.702 explains that 70.2% of the variation in the variables of worship integration, life integration, and relationship integration is defined by the variables used in this case Life integration (X11–X17), Worship integration (X21–X212), and Relationship Integration (X31–X38). Thus, the model is said to be feasible to have relevant predictive value.

3 *Hypothesis Testing Results*

The test hypothesis was carried out using the t-test (t-test) on each path of influence between the independent and dependent variables. The path coefficient values and t-statistics can be seen in partial Least Square results on results for inner weights. The results of hypothesis testing in this study can be shown in the table below.

TABLE 16: RESULTS FOR INNER WEIGHTS

	ORIGINAL SAMPLE ESTIMATE	MEAN OF SUBSAMPLES	STANDARD DEVIATION	T-STATISTIC
Relationship → Life	0.478	0.555	0.110	4.335
Life → Worship	0.429	0.377	0.134	3.191
Relationship → Worship	0.483	0.520	0.108	4.452

The estimation results of the SmartPLS calculation can be written in the structural equation as follows:

Live Integration = 0.478 Relationship Integration

Worship Integration = 0.429 Life Integration + 0.483 Relationship Integration

the table above explained that the decision to accept or reject the hypothesis by comparing the t-table with t-count at the level of 5%, t-count > from t-table, namely t-count> 1.96. Thus, from the three regression coefficients formulated, it can be concluded that it is acceptable at a significance level of 5%. In this model, it can be interpreted that the integration of good relationships will be a driving factor for increasing the integration of life. It will help to form a good integration of worship. Test Results with using the Smart-PLS analysis tool in full and the form of the modelling graph looks as follows:

CHART 4: PARTIAL LEAST SQUARE ESTIMATION RESULTS

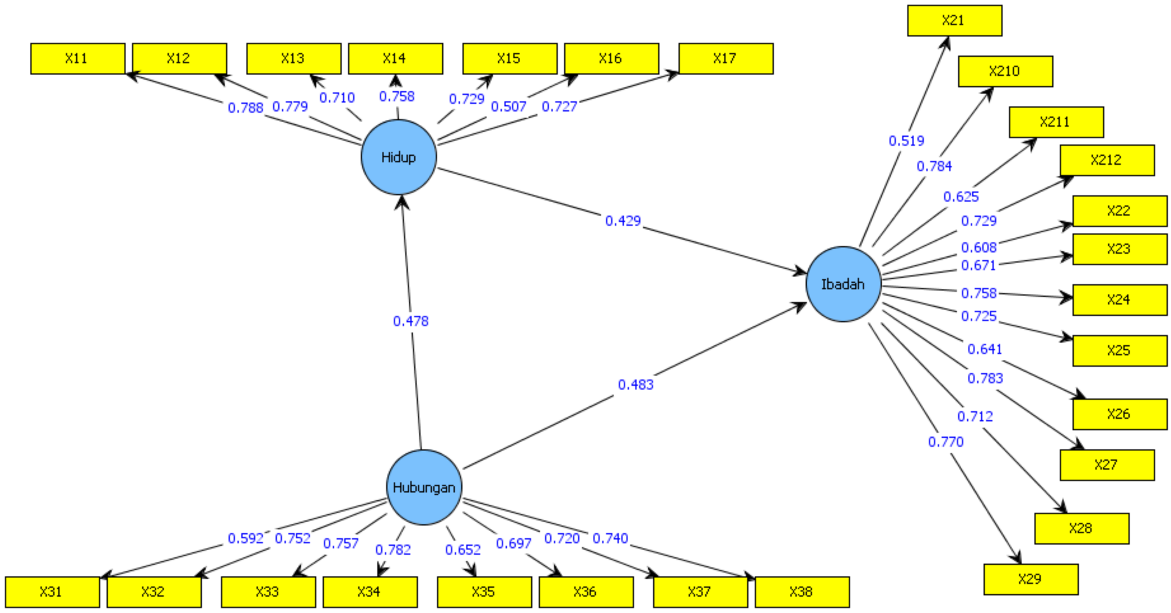
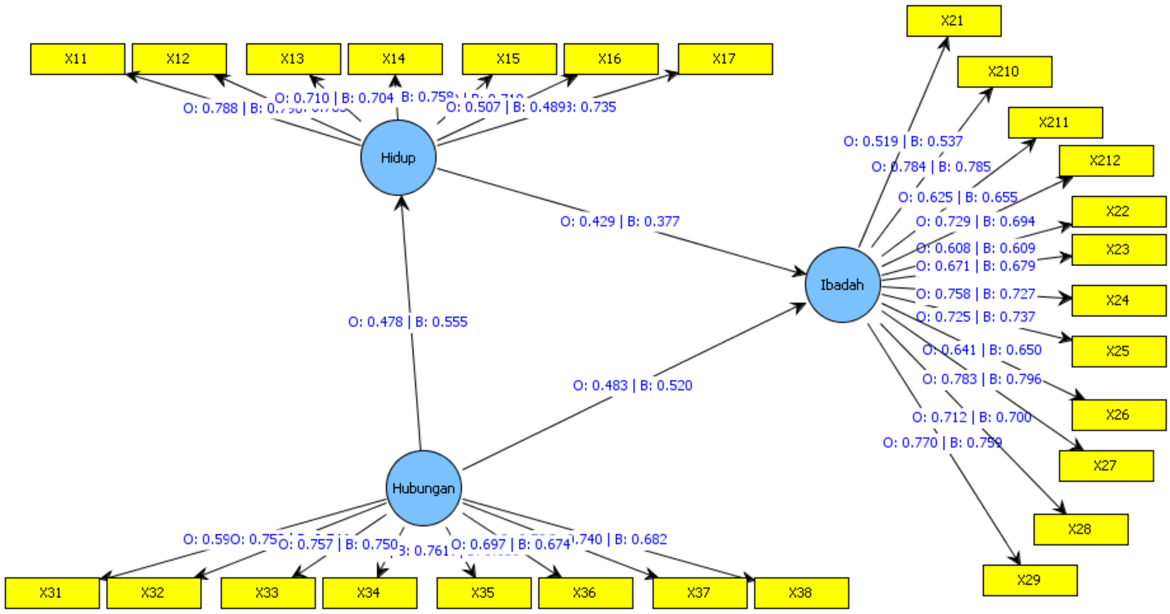


CHART 5: PARTIAL LEAST SQUARE BOOTSTRAPPING RESULTS



Based on the results of modelling analysis on the variables of integration of life, integration of worship, and integration of relationships, it can be interpreted that good relationship integration will initially be a driving factor for increasing integration of life. It will help form good worship integration. In other words, the independent variable that appears as a variable that affects other variables is Relationship Integration. Still, to see the effect of relationship integration on worship integration, the dependent variable will have a more excellent coefficient value if there is no life integration variable as an intervening variable.

So the variable that becomes the intervening variable becomes the correlation of the integration of relationships will affect the integration of worship when there is a life integration variable. So that organisational culture (how humans communicate and interact) will continuously affect one's worship when its integration has been well-formed.

V CONCLUSION

Based on the results of the modelling analysis on the variables of integration of life, integration of worship, and integration of relationships, it can be concluded that good relationship integration can increase life integration and help form good worship integration. Relationship integration will affect worship integration when there is a life integration variable so that organisational culture will continuously affect one's worship when the integration has been well-formed.

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RETHINKING TAX TREATMENT DURING THE COVID-19 PANDEMIC: A NOTE ON INDONESIA'S OMNIBUS LAW JOB CREATION TAXATION CLUSTER

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ABSTRACT

The Indonesia Omnibus Law Job Creation was released during the COVID-19 pandemic as a shortcut to revise laws, with the aim of realising a welcoming investment climate. The tax treatment in the Omnibus consists of a reduction of corporate income tax rate; tax relief on dividend; a reduction of the tax penalty; the imposition of VAT collected by an assigned foreign supplier; and the repackaging of tax incentives by adding local tax and charges as additional tax incentives. The reduction of corporate income tax has brought Indonesia to a deep tax revenue shortfall, which is added to by tax relief on dividend. However, the reduction of the tax penalty seems to lead to the proportionality principle of sanction. The assignment of foreign suppliers to collect VAT may contribute to VAT revenue, but its potential still could not be met. Finally, the government still has the confidence to offer tax incentive packages, in order to attract investment.

Keyword: omnibus law, tax facilities, income tax

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I INTRODUCTION

At the end of 2020, a very controversial Bill, the Job Creation Bill was approved as the 'Job Creation Omnibus Law' (hereafter called as 'Omnibus Law') by the Indonesian House of Representatives. This is also known as 'Law No. 11 of 2020 on Job Creation'.[1] The government initiated the Bill in 2019,[2] in order to ease business activities and be able to realise a welcoming investment climate by simplifying current complex regulation and offering certain kinds of fiscal and non-fiscal instruments, including the offer of tax incentives.[3] From the government and parliament members' perspectives, the Omnibus Law was considered to be a progressive breakthrough, which would overcome the multisectoral problems.[4] The Head of the Investment Coordinating Board claimed that the Omnibus Law would increase investment by about 0.2 to 0.3 per cent at the beginning of its implementation.[5] In fact, the Bill was considered to be quite controversial and even flawed due to a lack of transparency. During the discussion in the House of Representatives it was quickly concluded that the time to conclude the Bill was in fact, illogical.[6] The government justification was that this Bill functioned as a solution to regulatory problems,[7] which had resulted in a less welcoming business environment.[8] Indeed, regulatory overlapping was found to have existed following research conducted by Center for Law and Policy Study, which revealed that there were 7,621 ministerial regulations between 2014–2018. This resulted in the World Bank ranking Indonesia 92

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1 The Omnibus Job Creation Bill consists of the drafting of several Bills, with the main amendment created through the Draft Bill on Employment Creation; the Draft Bill on Development and Strengthening of the Financial Sector; and the Draft Bill on Tax Provision and Facilities for Economic Engagement. See: Ricca Anggraeni and Cipta Indra Lestari Rachman, 'Omnibus Law in Indonesia: Is That the Right Strategy to Advance?' (2020) 140 *Economics, Business and Management Research* 180.

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8 Analisis Alqadri, 'RUU Omnibus Law Perpajakan Terhadap Pemungutan Pajak Daerah' (2020) 4(2) *Tanjungpura Law Journal* 117–132.

out of 193 between 1966–2017.[9] It also was driven by the relatively long duration of time involved in revising the draft of the previous Law. Thus, this Act could be seen as an efficient short-cut to the legislative work required to meet the President's target and its immediate implementation as a measure of economic recovery.

The concept of omnibus in simple terms means 'numerous objects or items at once; many things or having various purposes'. Thus, the Omnibus Law combines several measures together into one and transforms a diverse range of subjects into a single law. The Omnibus Law is therefore known as a statutory act, which is legislated to revoke or change several laws at once for the purpose of simplicity.[10] In February 2021, the Ministry Secretariat announced 49 regulations to be implemented, consisting of 45 Government Regulations and 4 Presidential Regulations,[11] to be implemented in accordance with the many other technical guidelines, which are commonly released under ministry regulation.

With regard to the Taxation cluster, even though overall the Omnibus Law Job Creation is quite controversial, a number of stakeholders including investors and tax consultants supported this new law. The drafting of the taxation cluster in the House of Representatives became part of the agenda amidst the discussion process. Initially, the taxation cluster was not actually one of the priority subjects on Parliament's list in the first place.[12] However, Parliament was able to get the necessary support from government and business, in order to finalise the draft. They claimed this newly implemented law would improve the investment climate due to both the simplicity of the new regulations and a reduction of tax burden, as part of the content of the law. Furthermore, the government claimed that this law could be used as an instrument to accelerate tax reforms, which had previously not gone anywhere.[13] In addition, the government and members of parliament claimed that the Omnibus Law was a breakthrough as a measure for economic recovery on account of the impact of the COVID-19 pandemic.[14] In fact, with this newly stipulated rule, the potential tax revenue, which must be collected by the government would be considerably reduced. On the other hand, schemes detailing how the government will recapture the potential of tax revenue loss are still unavailable.[15]

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9 Anggraeni and Rachman (n 7) 180.

10 Ibid 182.

11 Secretariat of Ministry, Public Affairs Department, 'Daftar Tautan 49 Aturan Pelaksana UU Cipta Kerja' (online, 2021) <https://setkab.go.id/daftar-tautan-49-aturan-pelaksana-uu-cipta-kerja/>.

12 A.G. Victoria, 'Kontroversi Masuknya Aturan Pajak Dalam Omnibus Law UU Cipta Kerja' (Web Page, 2020) <https://katadata.co.id/agustiyanti/finansial/5f7ed578789f9/kontroversi-masuknya-aturan-pajak-dalam-omnibus-law-uu-cipta-kerja>.

13 'Membedah Klaster Perpajakan dan Investasi dalam UU Cipta Kerja', *Hukumonline* (Web Page, 2020) <https://www.hukumonline.com/berita/baca/lt5fe2dd46ca02d/membedah-klaster-perpajakan-dan-investasi-dalam-uu-cipta-kerja-/>.

14 'Kepala BKF Kemenkeu: Omnibus Law Modal Pemulihan Ekonomi 2021', *Sindonews* (online, 2020) <https://nasional.sindonews.com/read/188670/94/kepala-bkf-kemenkeu-omnibus-law-modal-pemulihan-ekonomi-2021-1602051020>.

15 With regard to the recapturing of tax revenue shortfall, in an interview, the spokesperson of Ministry of Finance could not explain in detail how to gather tax expenditure as the result of overwhelming tax

This shows that the Indonesian government has decided to place a reduction in tax as an attractive way to improve investment climate, along with additional tax arrangements. Such a choice in policy would affect tax revenue expenditure with an 'uncertain quantitative multiplier effect'.[16] Notwithstanding this, many studies in the last decade have shown no clear empirical evidence of sacrificing tax expenditure through various types of tax instrument, in order to result in an economic impact.[17] Conversely, this kind of tax instrument is still a popular policy in developing countries,[18] including in Indonesia. This article is intended to discuss the fundamental changes of tax policy prior to the release of Omnibus Law as a mode of economic climate improvement. Further, this article also is aimed to discuss the possible challenges must be tackled by the government due to the release of Omnibus Law taxation cluster.

II RESEARCH METHOD

This research uses a qualitative approach, and the type of this research is descriptive, which aims to provide 'a specific description of the situation, phenomenon or social phenomenon'.[19] This research aims to review the process of legislating the Omnibus Law and the challenges of implementing Omnibus Law Job Creation, specifically with respect to taxation clusters. This research is being completed for academic purposes, with the results used for scientific purposes only. This is also expected as input for non-academic consideration. This research is classified as a cross-sectional study because it was conducted in a certain time period and only took one approach from the social phenomena, which occurred in that one time period.[20] Data collection techniques in this study used qualitative techniques in the form of literature studies, documentation, literature and citation of interviews conducted by the third party with informants. The literature study further examines secondary data obtained from various sources, including books, articles, and electronic publications.

incentives. See: (YouTube, 2020) <https://www.youtube.com/watch?v=luXENcq9uCU> (in Indonesian language).

16 Klemm and Parys, 'Empirical Evidence on the Effect of Tax Incentives' (IMF Working Paper WP/09/136, Fiscal Affairs Department, 2009).

17 Nathan – MSI Group, 'Effectiveness and Economic Impact of Tax Incentives in the SADC Region', (Technical Report, 2004); Alfiansyah, 'The Study of the Impact of Fiscal Incentives on Foreign Direct Investment Flows in Industrial Sectors of Indonesia' (Master Thesis, University of Indonesia, 2017); Herdiyati and Wahyudi, 'Tax Holiday and Foreign Direct Investment in Indonesia (2020) 7(2) Economics, Social and Development Studies 240–259.

18 Sebastian James, 'Incentives and Investments: Evidence and Policy Implementations, Investment Climate Advisory Services of the World Bank Group' (Report, 2009); Saila Naomi Stausholm, 'Rise of Inefficient Incentives: New Empirical Evidence on Tax Holiday in Developing Countries' (Report, 2017).

19 Bach, 'Qualitative Research Method Summary' (2014) *Journal of Multidisciplinary Engineering Science and Technology* 21, 25.

20 Raimundo et al, 'Research Methodology Topic: Cross Sectional Studies' (2018) *Journal of Human Growth and Development* 356, 360.

III OMNIBUS LAW IN INDONESIA

In many studies, it was found that the frequency in overlapping regulation in Indonesia led to sub-optimal results in economic activities and the provision of public services. It also resulted in a less friendly investment climate.[21] The World Bank gave a score of 74 to Indonesia on the 'Ease of Doing Business Index' in 2019.[22] Several studies suggest that this score has remained stagnant for several years and that it therefore it needs a progressive work to increase the level.[23] When comparing to Indonesia to its neighbour developing countries, the World Bank's 'Ease of Doing Business Index' ranked Malaysia as 12, Thailand as 21 and Vietnam as 70. It is clear that, Indonesia needs to improve its investment climate, in order to attract investment. This can be achieved by reducing the amount of over-lapping regulation and establishing a strong fundamental basis that will ensure certainty for investors, as a means of improving the investment climate. Notwithstanding this, the reformulation of investment-related law should be done in a transparent manner, which considers the rights and interests of society, as well as the sustainable development.

The Omnibus Job Creation Law has successfully revised 79 Law and 1.288 Articles from the previous regulations.[24] However, with such complex regulation which will affect the activities of multi-stakeholders, the legislation process of this Omnibus Law is considered logically too short and lacking in transparency and public participation. As there are many revisions needed, it would be prudent to bring relevant groups of interest to discuss the changes. The timeline of the stipulation of Omnibus Law is as follows.

TABLE 1: TIMELINE OF THE OMNIBUS LAW LEGISLATION

NO	DATE	ACTIVITIES
1.	20 October 2019	The elected president, Joko Widodo mentioned the harmonisation of regulation in the second term of his administration
2.	16 December 2019	The Omnibus Law Working Group was established and held by the Coordinator Ministry of Economics and the Chief of the Indonesian Chamber of Commerce and Industry
3.	January 2020	Two Omnibus Package proposed by the government (Executive body)
4.	2 April 2020	The Presidential Letter regarding the Omnibus Bill officially was announced in the House of Representatives. The Parliament assigned the Legislative Committee to start the discussion and drafting process.
5.	14 April 2020	The Legislative Committee officially announced the first meeting to draft Omnibus Bill

[21] Eko Noor Kristiyanto, 'Urgensi Omnibus Law dalam Percepatan Reformasi Regulasi dalam Perspektif Hukum Progresif' (2020) *Jurnal Penelitian Hukum De Jure* 233–244.

[22] World Bank, 'Ease of Doing Business Index — Indonesia' (Report, 2019) <https://data.worldbank.org/indicator/IC.BUS.EASE.XQ?locations=ID>.

[23] Tomi Sentianto, 'Ease of Doing Business in Indonesia: A Long Road' (2020) 10(2) *Jurnal Ekonomi and Pembangunan* 87-96. Abiyoso, 'Improving the Ease of Doing Business in Indonesia: Problems Related to Contract Enforcement in the Court' (online 2018) <https://iopscience.iop.org/article/10.1088/1755-1315/175/1/012032/pdf>.

[24] Prakarsa, 'Ecocide Crimes and Omnibus Law: Review of International Law and Its Implication on Indonesia Law' (2020) 12(2) *Dinamika HAM* 14–20.

6.	24 April 2020	The President postponed the Omnibus Bill on Labor Cluster
7.	20 April 2020 – 30 October 2020	The discussion and drafting process of Omnibus Law (which took place over 64 meetings).
8.	3 October 2020	The Legislation Committee finished and agreed with the draft of the Omnibus Bill. The Omnibus Bill reached the final stage in the legislation process before the official stipulation. The agreement about the Omnibus Bill was criticised by the public.
9.	5 October 2020	The House and the government officially stipulated the Omnibus Bill become Omnibus Law Job Creation. The Omnibus Law Job Creation consists of 15 Chapters and 174 Articles. After the Omnibus Law officially was announced by the House, four types of drafts were distributed. Type 1 (5 October, 905 pages), type 2 (October 9, 1,052 pages), type 3, (12 October morning 1,035 pages) and type 4 (12 October, 812 pages). The government announced the official Omnibus Law ran for a total of 812 pages.

Source: Akbar Bayu Tamtomo (2020);[25] Zakki Amali (2020).[26]

Selecting the Omnibus as a method to avoid disharmony in tax regulation is consistent with the concept of 'one drafting for all'. An Omnibus Bill is defined as 'a draft law before a legislature, which contains more than one substantive matter or several minor matters, which have been combined into one bill, ostensibly for the sake of convenience'.[27] The Omnibus Bill was therefore undertaken, in order to harmonise the regulation on a cluster of policies, which were similar policy in nature. This includes, for example, regulation related to budget implementation. Thus, on a conceptual level, the Omnibus must not be drafted to encompass a wide range of regulation as it will only raise further problems.

In fact, the current Omnibus Law in Indonesia has revised many aspects of law, which are related to business activities.[28] It has reshaped rules on the investment ecosystem, in terms of business; labour; protection to small and medium enterprises; ease of doing business; research and innovation' land acquisition and management; the economic zone; government investment and the acceleration of government projects; administrative affairs; and the penalty of the law related to the prevailing rule. However, the release of the law comes has been driven by a simplistic analysis, which places investor interest over public interest. The central position of development is placed in the hands of the capital

[25] Akbar Bayu Tamtomo, 'INFOGRAFIK: Rekam Jejak Omnibus Law UU Cipta Kerja' (online, 2020) <https://www.kompas.com/tren/read/2020/10/07/190500565/infografik--rekam-jejak-omnibus-law-uu-cipta-kerja>.

[26] Zakki Amali, 'Kronologi Omnibus Law Disahkan hingga Jokowi Terima UU Cipta Kerja' (online, 2020) <https://tirto.id/kronologi-omnibus-law-disahkan-hingga-jokowi-terima-uu-cipta-kerja-f5YM>.

[27] Duhaime, *Omnibus Bill Definition* (Web Page) <http://www.duhaime.org/LegalDictionary/O/OmnibusBill.aspx>.

[28] The Omnibus Law eliminates the several requirements needed to establish a Limited Corporation with capital sourced from foreign investor. This includes for example: the elimination of negative lists of investment; an enlargement in the variants of non-permanent contracts for workers; a reduction in sanctions for environment degradation; a myriad of tax incentives; and a reduction in business responsibility, in order to provide an environmental feasibility report. See: 'Catatan Kritis dan Rekomendasi RUU Cipta Kerja' (Gadjah Mada University Working Paper, March 2020).

owners, who are the main actors and who obtain a myriad of privileges in accordance with the law. This situation could be viewed as being very detrimental to the community and to the environment. While the Omnibus Law has a strong economic approach, the law itself has not been enacted in such a way as to ensure justice in society.[29]

In November 2020, the Faculty of Law Gadjah Mada University Indonesia published the working paper as a critical note to the Law No. 11/2020. It was expected that this publication would be considered by Parliament and would strive to deliver 'another view' to the public. There were several key criticisms of the law. Firstly, the Omnibus Bill contained the critical issues with the methodological, paradigmatic and substantive policy with which it proposed to deal. Secondly, it is well understood that the principle of sustainable development should not be infringed, in order to improve the investment climate. Thirdly, the problems of the over-regulation and over-lapping of previous investment and economic activities were not solved by the Omnibus Law, as this contains 500 regulated items. This could potentially result in new and complex hyper-regulation. Finally, there should have been careful drafting of the law, as it has the potential to affect people's economic activities.[30]

However, the argument posed by groups who support the Omnibus Law is that it is a progressive piece of legislation, which incorporates existing rules.[31] With all of these facts, the legislation of Omnibus Law seems heavily reliant on the interests of certain limited groups.

A *The Series of Tax Facilities during the Pandemic until the Release of Omnibus Law*

In 2016, Indonesia offered a tax amnesty through the implementation of Law No. 11, which provided a quantifiable measure to collect information about the taxpayer activities that might normally remain undisclosed. This was therefore used as a mode to collect tax revenue.[32] Unfortunately, that has been no clear follow up program with respect to the tax amnesty and thus, it may have only been a short-term program, which was implemented solely to cover the expenses during fiscal year. Certainly, the government revenue during the amnesty period was increasing but the designed program could be considered as a failed project because it did not fulfil the main goals; repatriation of resident asset's kept outside Indonesia and the data collection to enhance the compliance system.[33] The non- continues of follow-up program of tax amnesty is really recognised by the government, saying that the trade-off between compliance and amnesty

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29 Anggono and Firdaus, 'Omnibus Law in Indonesia: A Comparison to the United States and Ireland' (2020) 7(3) *Lentera Hukum* 319–336.

30 Faculty of Law Gadjah Mada University (Policy Paper, 5 November 2020) <https://rispub.law.ugm.ac.id/2020/11/06/kertas-kebijakan-catatan-kritis-terhadap-uu-no-11-tahun-2020-tentang-cipta-kerja/>.

31 Kristiyanto (n 21) 238.

32 Budi Ispriyano, 'Keberhasilan Kebijakan Pengampunan pajak (Tax Amnesty) di Indonesia' (2019) 2(1) *Administrative Law and Governance Journal* 47–59.

33 Ibid 54.

on tax obligation did not exist, but it also has not been sufficient reconsidered by the government prior to the Omnibus Law proposal submitted to the parliament.[34] Using a simple measure, Indonesia tax ratio in each year before and after-tax amnesty are as follow 2014 (13.1%), 2015 (11.6%), 2016 (10.8%), 2017 (10.7%), 2018 (11.6%) and 2019 (10.69%). The tax ratio increased slightly only during the year of the tax amnesty and then decreased again in 2019.[35]

The COVID-19 had a profound effect on the economy. Consequently, the Indonesian government granted several fiscal incentives, in order to support homes and businesses. For this reason, the government exempted the requirement to pay personal income tax for people with a certain category of income. In terms of business, the government granted an exemption on import duties; the reduction of instalments payable for corporate income tax; and eased VAT refunds, as mandated by the Ministry of Finance Regulation No. 23 in 2020. Furthermore, the Legislative also enacted Law No. 2 (2020), which related to the national budget stability in response to the handling of COVID-19 pandemic. This law came in effect on 18 May 2020 and the tax incentives became one of its instruments. As stated in the Art 6 of Law No. 2 (2020), the main feature of the tax incentives are the following:

a) That the tax rate on corporate income tax was reduced to 22% in 2020 and 2021, then to 20% in 2023 and beyond;

b) That the domestic tax subject in the form of (a) public entities; (b) paid capital traded on the Indonesia stock exchange at a minimum of 40%; (c) eligibility on the basis of certain criteria would be granted at 3% lower than the prevailing rate.

However, in mid-November 2020, the Ministry of Finance discovered that only 31.6% of the amount of total incentives granted to all of the targeted entities was given. Then, the Omnibus Law added even more comprehensive tax incentives to the Law No. 2 (2020), which significantly changed Indonesia's taxation landscape.

The Ministry of Finance classified the Omnibus Law's taxation cluster into six pillars. Pillar one related to a corporate income tax rate reduction and a reduction of income tax as a means of increasing of investment volume. Pillar two related to the application of a territorial system through the exemption of dividends remitted to the Indonesian government if the money was invested in Indonesia. Pillar three dealt with the option available to Indonesian citizens who reside outside of Indonesia more than 183 day per year to be considered as a foreign tax subject and thus, be exempt from paying tax in Indonesia. Pillar four concerned the reduction in penalty for non-compliance with interest payments from 2% per month to a maximum of 24 months or 48%. This followed rate of the market interest, in addition to a small percentage imposed by the DGT as an administrative sanction. Pillar five related to digital economics. Under this pillar, the

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[34] The statement based on interview made by Asumsi Journalist with Ministry of Finance spokesperson in February 2020.

[35] Directorate General of Taxes, 'Rasio Pajak (Tax Ratio) dari Masa ke Masa' (online, 2021) <https://www.pajak.go.id/id/86-rasio-pajak-tax-ratio-dari-masa-ke-masa>; Directorate General of Taxes, *No. KEP-389/PJ/2020 Regarding Strategic Plan for Directorate General of Tax 2020-2024* (Report, 2020) <https://pajak.go.id/sites/default/files/2020-09/KEP-389PJ2020.pdf>.

government appointed VAT collectors for businesses which are not permanently established in Indonesia but have been recorded as having a certain volume of transactions in Indonesia. Finally, pillar six offered incentives such as tax holidays, super deductions, tax allowances and the establishment of a special economic zone, as well as other types of local tax incentives. The Indonesian Tax Authority, Directorate General of Taxes ('DGT') referred to these six pillars as the 'Cluster Ease of Doing Business ('EODB') in Taxation.

The Omnibus Law taxation cluster amends three taxation laws; (1) General Tax Procedures; (2) Income Tax Law and (3) Value Added Tax Law. The Omnibus Law taxation cluster will be implemented through three Government Regulations. While these are still in the processed of being drafted, these will consist of: (a) GR for supporting ease of doing business through use of the tax instrument known as 'GR No. 9 (2021)'; (b) GR as the basis of Local Tax and User Charge incentives to enhance investment; and (c) GR as the basis of supporting investment fund institutions. Recently, the Ministry of Finance released the technical guide to GR for supporting the ease of doing business through use of the tax instrument known as the 'Ministry of Finance Regulation No. 18/PMK.02/2021'.

The detail of the taxation cluster — EODB is the following:[36]

TABLE 2: THE TAXATION CLUSTER – EASE OF DOING BUSINESS

INCREASING INVESTMENT	ENCOURAGING VOLUNTARY COMPLIANCE	INCREASING LEGAL CERTAINTY	PROMOTING EQUAL BUSINESS CLIMATE WITHIN THE NATIONS
Gradual reduction of the CIT rate 22% (2020 – 2022) and 20% (2023 and beyond) Reduction of the CIT rate for public taxpayers Elimination of CIT on outbound dividends Exclusion of inbound dividends and profit after tax from CIT objects in so far as they are invested in Indonesia Not subject to CIT for earning shares in cooperatives and hajj funds managed by BPKH Adjustment for CIT art. 26 for interest	Relaxing of input tax crediting rights for taxable entrepreneurs Adjustment on regulations (a) tax administrative penalties and (b) interest	Determination of an individual tax resident (a) Indonesia citizen or foreign citizen residing > 183 days in Indonesia becomes a tax resident of Indonesia (b) Indonesia citizen residing in Indonesia < 183 days may become foreign tax resident (T&C) applicable) IIT for foreign tax resident with specific expertise in receiving income from Indonesia Regarding VAT (a) sale of coal is included as the sale of taxable goods (b)	Tax on electronic transactions: (a) the appointment of the VAT collectors, (b) a foreign tax resident is subject to tax in Indonesia for the electronic transaction conducted in Indonesia ID Number substitutes the TIN of the buyer in tax invoices in case of not having TIN

[36] PwC Indonesia Omnibus Flash, Omnibus Law – Major Changes to Tax Laws (2020) <https://www.pwc.com/id/en/publications/omnibus/omnibus-flash-2020-02.pdf>.

"Imbreng" not subject to VAT		consignment is excluded from the taxable goods transaction An excess of social & religious funds is not subject to income tax No issuance of tax assessment letter for the concluded tax crime Issuance of notice of tax collection (STP) expires in 5 years STP can be issued to collect interest returns Application of only one administrative penalty Termination of the preliminary examination and tax crime investigation Refund of credited input tax

Source: Directorate General of Taxes (2020)[37]

IV Results and Discussion

Since the Omnibus Law was officially released to the public, the media has focused on the positive impact of the newly stipulated laws, despite the fact that many civil society organisations and academics protested its release. In fact, The Director General of Taxes stated that the reduction in corporate income tax itself will gradually decline from 25% (2019), to 22% (2020–2022), and finally to 20% (2023 and beyond)[38]. The implementation of territorial system has brought a reduction of tax revenue loss in

37 'The Taxation Cluster — Ease of Doing Business' (online, November 2020) <https://www.pajak.go.id/sites/default/files/2020-11/EODB%20Cluster%20Taxation%20%28english%29.pdf>.

38 Formerly, the corporate income tax rate would be reduced to 20% in 2022, however the government announced that in 2022 the corporate income tax in 2022 will still 22%. Yusuf Iman Santoso and Tendi Mahdi, 'Pemerintah Batal Turunkan Tarif PPh Badan pada 2022' (2021) <https://nasional.kontan.co.id/news/pemerintah-batal-turunkan-tarif-pph-badan-pada-2022-pengamat-cukup-mengejutkan>.

Indonesia to the amount of IDR 80T in 2020.[39] Furthermore, given the types of tax concessions offered as a result of the COVID-19 pandemic, as well as the Omnibus Law, the tax revenue shortfall increased to IDR 334 T for the fiscal year in 2020. This was a much greater shortfall than that in 2019, which amounted to IDR 240T.[40] With this in mind, the government is recommended to revise the target of the tax revenue collection following the new tax architecture and, accordingly, to enlarge the budget deficit.[41]

The impact of income tax on Indonesia's growth long-run was such that income tax alone did not exert a statistically significant impact during the period of 1984–2015.[42] Thus, instead of setting types of tax incentives, the policy maker should focus on improving tax administration and redistribution of equity.[43] The main changes to the taxation system on account of the Omnibus Law, will now be discussed.

A *Reduction of the Income Tax Rate*

The reduction of 3% of corporate income tax in 2020/2021 and 2% in 2022 and beyond has ensured that the government will lose an amount of IDR 57-IDR 78T.[44] Unfortunately, this potential shortfall will only prolong Indonesia's revenue shortfall, which has been affected for more than one decade. However, the government has described this shortfall as the 'new normal'.[45] With current the tax ratio being below the average of an ASEAN member, this act would be a flawed strategy if the government's goal is solely to attract investors through tax incentives. Given that taxation is not considered to be one of the main reasons that draws investors to invest in Indonesia, this increased shortfall would result in unnecessary costs to the government, due to inefficient allocation of capital.[46] Both the stakeholder and the tax administrator were in agreement that the tax rate reduction has been a trend recently. As the average income tax rate has declined,

39 'Omnibus Law Perpajakan, Salah Satu Cara Pemerintah Optimalisasi Penerimaan Tahun 2020', Ministry of Finance (Web Page, 2020) <https://www.kemenkeu.go.id/publikasi/berita/omnibus-law-perpajakan-salah-satu-cara-pemerintah-optimalisasi-penerimaan-tahun-2020/>.

40 Saran Revisi and Target Pajak, 'CITA: Potensi Shortfall Tembus Rp. 334 T', *Center for Indonesia Taxation Analysis (2020)* (online, 2020) <https://cita.or.id/sarankan-revisi-target-pajak-cita-potensi-shortfall-tembus-rp-334-triliun/>.

41 The Audit Board of the Republic of Indonesia, 'Target Penerimaan Pajak 2021 Diturunkan' (2020) <https://jdih.bpk.go.id/wp-content/uploads/2020/12/4-Target-Penerimaan-Pajak-2021-Diturunkan.pdf>.

42 H. Iswahyudi, 'Do Tax Structures Affect Indonesia's Economic Growth?' (2018) 33(3) *Journal of Indonesia Economy and Business* 216–242.

43 Ibid.

44 Santoso, 'Bila PPh Badan terus diturunkan, negara brepotensi kehilangan Rp. 87 Triliun' (online, 2019) <https://nasional.kontan.co.id/news/bila-pph-badan-terus-diturunkan-negara-berpotensi-kehilangan-rp-87-triliun>.

45 'Interview of Asumsi Journalist with Ministry of Finance Spokesperson' (YouTube) <https://www.youtube.com/watch?v=luXENcq9uCU>.

46 W.A. Putri, 'Insentif Pajak dalam Membentuk Keputusan Investasi' (2017) 4(2) *Jurnal Moneter* 132, 188.

Indonesia has joined the trend.[47] The spokesperson for the Ministry of Finance confirmed that taxation is not the main consideration in investment decisions. Moreover, in terms of taxation itself, the rate of corporate income tax is not a factor generally taken into consideration by the investor. Instead, they would be more concerned about tax administration simplicity, tax law certainty and the ease of tax refunds.[48] On average, the world corporate tax rate is around 21.4% (2019), while the ASEAN has an average of 22.35%. With this in mind, the income tax rate in Indonesia is below the world average corporate income tax and below the ASEAN average corporate income tax.[49]

It is critical to examine factors including: to what extend the investment volume will increase; how the investment attraction strategy will increase the investment volume driven by government measures other than a reduction of corporate income; what and how the government creates alternative sources of revenue to replace potential tax revenue that has not been clearly disseminated to the public. However, research has shown that a reduction in the tax rate would not result in a competitive market, in order to attract investment. Even without a reduction in the income tax rate, Indonesia has continuously experienced a shortage of tax revenue. However, the reduction in tax expenditure will require the government to closely monitor whether tax incentives increase business productivity.

B *Application of a Semi-Territorial System with the Non-Imposition of Tax on Dividends Generated from Domestic and Foreign Business*

The implementation of the Omnibus Law changed what was formerly a world-wide taxing system, into one that was semi-territorial in nature. The application of semi-territorial system by the government is based on the premise that the non-imposition of tax on dividends received from foreign jurisdictions will encourage those in receipt of such dividends to repatriate their money to Indonesia for investment purposes.[50] The government argued that the non-imposition or exemption of tax on dividends will activate the use of non-productive retained earnings held in foreign entities and that this will result in increasing business productivity in Indonesia.[51] As mentioned in Article 7 of the

[47] Danny Darussalam Tax Centre (YouTube, 2020) <https://www.youtube.com/watch?v=wEebgi9fkTc>.

[48] Ministry of Finance Spokesperson (YouTube, 24 February 2020) <https://www.youtube.com/watch?v=luXENcq9uCU>. In this video, the spokesperson stated that the government understands that the reduction of the corporate tax rate is not an appropriate solution for the lack of investment problems. But the government indicated that Indonesia remains attractive for investment and aims to compete with other jurisdictions. Additionally, the government spokesperson also stated that the ease of administration is not a 'tangible' incentive, however, in conjunction with the corporate tax reduction policy, this mode of investment marketing could be categorised as actual hard selling.

[49] OECD, *Corporate Income Tax Statistics* (OECD Publishing, 2019).

[50] This policy resembles another mode of tax amnesty, which was implemented through Law No. 11 year 2016.

[51] Y. I. Santoso, 'Ini 5 Dampak Pembebasan PPh atas DIviden' (2020) <https://nasional.kontan.co.id/news/ini-5-dampak-pembebasan-pph-atas-dividen-menurut-ddtc>.

Ministry of Finance Regulation No. 21/PMK.18/2021, the exemption of dividend applies for foreign entities abroad, who would invest that dividend through stock exchange or through an alternative certain investment mode. Furthermore, the government contended that the world trend of taxing income has been transformed into territorial in nature,[52] including where ASEAN members have found Indonesia to be 'relevant' as an attractive location.[53] This is despite the fact that in 2017, the Fiscal Policy Office report stated that an exemption of withholding tax on financial investments was not relevant and would potentially lead to revenue loss.[54]

In addition, the government stated that the change to this semi-territoriality system is driven by the trend, which has resulted in a number of countries applying territoriality. Indonesia has moved towards the international trend with the implementation of a tax calculation that does not differentiate between the corporation and individual as a different tax subject.[55] Thus, dividends received from domestic corporations will not be taxed. The government emphasised that the dividend received should be invested on the Indonesian stock exchange or in other formal sectors. However, there must be measures to monitor whether the income invested has complied with the Law. Moreover, if the income generated as a result of the dividend remains solely in the financial instrument, it will deliver even less immediate direct impact on economic growth, in relation to the ongoing sacrifice of tax expenditure.

The government move to a non-imposition of tax on dividends is also based on the argument that it will result in a reduction in the distortion of business financial decisions between capital financing and debt-financing schemes.[56] Research has also indicated that the taxation of dividends negatively influences economic growth, although the effect was quite different where it concerned the taxation of labour and corporate income. However, this research was conducted by using panel data from 1990 to 2008 with respect to18 European countries. As there related to a specific group of countries with similar characteristics, it was therefore not applicable to other regions.[57] With the current policy, the reduction of tax rate could result in a regressive effect amongst taxpayers, who

52 In 2018, 17 members out of 34 members of the OECD applied a taxing system. By 2018, only 6 the OECD members still applied it.

53 Redaksi Ortax, 'Rezim Beralih ke Sistem Teritorial' (online, 2019) <https://www.ortax.org/ortax/?mod=berita&page=show&id=16689&q=&hlm=>.

54 Fiscal Policy Office Pusat Kebijakan Regional dan Bilateral, 'Analisis Pembebasan Withholding Tax atas Investasi Keuangan Lintas Negara di Kawasan ASEAN dan ASEAN +3' (Report, 2017) <https://fiskal.kemenkeu.go.id/data/document/2018/kajian/analisis_pembebasan_withholding_tax.pdf>.

55 Interview with Ministry of Finance Spokesperson.

56 Septriadi Darussalam and Kristiaji Darussalam, 'Policy Note: Omnibus Law Ketentuan and Fasilitas Perpajakan untuk Penguatan Ekonomi: Suatu Catatan, *DDTC Fiscal Research* (Report, 2020).

57 Margareta Dackehag and Asa Hansson, 'Taxation of Dividend Income and Economic Growth', *The Knutt Wicksell Centre for Financial Studies Lund University School of Economics and Management* (online, April 2016) <https://www.lusem.lu.se/media/kwc/working-papers/2016/kwcwp2016-4.pdf>.

generate money solely as active income, as well as generating greater rewards for passive income earners.

It is certain that the non-imposition of dividends generated from domestic business will lead to a loss of tax revenue. The Indonesian tax authority has released information about how to get the benefit of an exempted dividend as regulated in Ministry of Finance Regulation No. 18/PMK.03/2021. The exempted dividend should be invested in regulated form of investments, including both direct investment and portfolio investment. The recipient of the exempted dividend is expected to submit a report concerning the method and realisation of the investment.[58] Even though there is a requirement that the dividend received should be invested into different kinds of investment instruments, without a proper plan and sufficient monitoring, the benefit of its economic effect in proportion to the tax revenue lost cannot be quantified. Yet, as a result of this situation, employment income, which is considered as active income, will be levied at a higher tax rate than that of dividends, which are passive income. This is exacerbated by the fact that a large proportion of dividend recipients come from wealthy backgrounds. The middle class in Indonesia will therefore bear the brunt of the tax burden, as they comprise the largest percentage of the population. Thus, this raises issued of fairness concerning the application of the law.

C *The Reduction of the Tax Sanction*

The reduction of the tax penalty was a government concern prior to the release of Omnibus Law. Most tax systems rule out interest and tax penalty regimes. Where tax payments are late or underpaid, the calculation of the interest payable is intended to protect the present value of tax in the government budget. As such, the penalty is intended to deter taxpayers from defaulting on their tax obligations and to give punishment, in order to achieve horizontal equity in tax compliance.[59] Since the beginning of tax reforms in 1983 and during the period prior to the Omnibus Law era, the percentage of interest on tax payable had remained the same, with a fixed rate of 2%. After the introduction of the Omnibus Law, the interest on tax payable took into account the market interest rate plus a certain percentage of penalty based on the failure. The sanction in form of the interest rate has resulted in the change from a fixed rate towards a more flexible rate. Several conditions that reduce the tax penalty of the former law, 'General Provision and Tax Procedure and Omnibus Law Job Creation' is outlined as follows:

TABLE 3: THE CHANGE OF TAX PENALTY

CONDITION	GENERAL PROVISION AND TAX PROCEDURE	OMNIBUS LAW JOB CREATION
The revision of the tax return before tax audit	2% per month interest based on tax payable	The interest based on Ministry of Finance Regulation, which refers to

[58] R. B. Latuputty, 'Mau Dividend Bebas Pajak? Segera Lakukan Ini' (2021) <https://www.pajak.go.id/id/artikel/mau-dividen-bebas-pajak-segera-lakukan-ini>.

[59] Waerzeggers, Hillier and Aw, 'Designing Interest and Tax Penalty Regimes' (Tax Law IMF Technical Note 1/2019, IMF Legal Department, 2019).

		the market interest rate +5% /12 x tax payable
The taxpayer discloses the failure to comply the reliable tax return	Audited by the tax auditor, however the process does not require any tax investigation with regard to tax fraud Penalty = 150% x tax payable	The tax auditor undertakes a tax investigation with regard to tax fraud before the case is handed over to the state attorney Penalty = 100% X tax payable
The taxpayer discloses a flaw in their tax return, which is audited by the tax auditor, but without a tax notification being released	Penalty = 50% x tax payable	The interest is based on the Ministry of Finance Regulation, which refers to the market interest rate +10%/12 x tax payable
Tax payable paid after the due date	2% per month interest based on tax payable	The interest based on the Ministry of Finance Regulations, which refers to the market interest rate +5%/12 x tax payable
Underpayment due to the released of Notice of Tax Underpayment Assessment, Notice of Additional Tax Underpayment Assessment, Decision on Appeal and Decision on Case Review	2% per month counted from the due date	The interest is based on the Ministry of Finance Regulations, which refers to market interest rate/12

Source: Directorate General of Taxes (2020).

The re-regulation to the sanction has decreased the penalty for failing to comply with tax obligations. The new law sounds raises concepts of proportionality. Although the sanction given is based on taxpayer behaviour, the determination of the interest rate in the current market is also relevant to determining the economic conditions. Sanctions should be legitimate, which means that they should be proportional to the failure or aggressiveness of the taxpayer.[60] The proportional sanction will be more relevant in increasing tax compliance, as this also takes into account other relevant factors such as the effectiveness of exchange of information; the availability of analytical detection models; use of data matching and risk profiling capacities; and effective tax audits.[61]

D *The Appointment of Foreign VAT Collectors on Digital Based Products/Services Supplied to Indonesia*

One of important improvements to the current VAT regulation which was stipulated in the amid of pandemic is the collection of VAT on the digital economic transaction. In the beginning of 2020, the government released the 'Government Regulation in Lieu Law of Republic of Indonesia (Perppu) No. 1 year 2020', which then became Law No. 2 in 2020. This law was titled, 'The Public Finance and National Financing Stability toward Handling of Covid-19 Pandemic and/or Facing the National Economic Threat'. In Article 6(1) it

60 Alex Raskolnikov, 'Crime and Punishment in Taxation: Deceit, Deterrence and the Self-Adjusting Penalty' (2006) 106(3) *Columbia Law Review* 569–642.

61 Ibid.

states that tax treatment in trading activities through an electronic system (or *Perdagangan Melalui Sistem Elektronik*) shall be done with through the imposition of VAT on the utilisation of Intangible Taxable Goods and/or Taxable Services from outside the Customs Area or within the Customs Area through Trade Through Electronic Systems. The Omnibus Law on Taxation Cluster therefore strengthens the legal basis on which to impose VAT on electronic transactions and for the government to propose a digital provider abroad, who will take part as a VAT collector.

Overseas business sales made to the Indonesian market, which meet the criteria will be appointed as VAT collectors by the Indonesian Government and be responsible for charging VAT on the sale of digital products. This will require the making of a monthly payment to the Indonesian Government and for a quarterly VAT return to be submitted to the Indonesian Directorate General of Taxes (DGT). The criteria to be appointed as VAT collectors are that the value of transaction with buyers in Indonesia exceeds IDR 600 Million in a year or IDR 1 Million in a month and/or the amount of traffic or access in Indonesia exceeds 12,000 in a year or 1,000 in a month[62].

Taxing the digital economy by appointing foreign collectors is intended to locate potential revenue. It also aims to create a level playing field with respect to domestic and foreign business. As emphasised by the OECD in the BEPS Project Action 1, the inequality between the domestic supplier and foreign supplier due to the difference of VAT burden could create market distortion. The appointed VAT collectors consist of: overseas traders, service providers and e-commerce operators or domestic e-commerce operators. The VAT will be imposed on the supply of digital goods, including but not limited to '(a) movies, music, and other audio-visual content; (b) computer software, mobile app and games; and (c) electronic books, magazines, and comics'. It will also be applied to digital services, including but not limited to '(a) web hosting; (b) videoconferencing services; (c) other services delivered through computer network'.[63]

Sellers of digital products who might need to charge Indonesian VAT to Indonesian customers include (a) foreign or online merchants who sell digital products to Indonesian consumers; (b) overseas operators of online marketplaces who supply digital products to Indonesian consumers; and (c) Indonesian operators of online marketplaces who supply foreign digital products to Indonesian customers. A customer will be considered to be an Indonesian customer if they (a) provide an Indonesian billing address or mailing address; and (b) use payment facilities such as credit or debit cards issued by Indonesian financial institution, and/or places orders using an Indonesian IP address or country calling code.

TABLE 4: LIST OF ASSIGNED VAT COLLECTORS

NO	VAT COLLECTORS	BATCH (PERIOD)
1.	Amazon Web Services Inc., Google Asia Pacific Pte. Ltd, Google Ireland Ltd., Google LLC, Netflix International B.V. and Spotify AB.	1 (1 August 2020)

62 Darussalam (n 73).

63 Directorate General of Taxes, 'VAT on Sales of Digital Product to Indonesian Customers' (online, 2020) <https://pajak.go.id/sites/default/files/2020-05/the%20VAT%20on%20imported%20digital%20products.pdf>.

2.	Facebook Ireland Ltd., Facebook Payment International Ltd., Facebook Technologies International Ltd., Amazon.com, Services LLC, Audible, Inc., Alexa Internet, Audible Ltd., Apple Distribution International Ltd., Tiktok Pte. Ltd, and the Walt Disney Company (Southeast Asia) Pte. Ltd.	2 (1 September 2020)
3.	LinkedIn Singapore Pte. Ltd, McAfee Ireland Ltd, Microsoft Ireland Operations Ltd., Mojang SB, Novi Digital Entertainment Pte. Ltd, PCCW Vuclip (Singapore) Pte. Ltd., Skype Communication SARL, Twitter Asia Pacific. Ltd., Twitter International Company, Zoom Video Communication, Inc., PPT Jingdong Indonesia Pertama and PT. Shopee International Indonesia	3 (1 October 2020)
4.	Alibaba Cloud (Singapore) Pte Ltd., GitHub, Inc., Microsoft Corporation, Microsoft Regional Sales Pte. Ltd., UCWeb Singapore Pte. Ltd., To The New Pte. Coda Payment Pte. Ltd., and Nexmo Inc.	4 (1 November 2020)
5.	Cleverbridge AG Corporation, Hewlett-Packard Enterprise USA, Softlayer Dutch Holding B.V. (IBM), PT. Bukalapak.com, PT Ecart Webportal Indonesia (Lazada), PT. Fashion Eservices Indonesia (Zalora), PT. Tokopedia, PT. Global Digital Niaga (Blibli.com), Valve Corporation (Steam), and beIN Sports Asia Pte Limited	5 (1 December 2020)
6.	Etsy Ireland Unlimited Company, Proxima Beta Pte. Ltd., Tencent Mobility Limited, Tencent Mobile International Limited, Snap Group Limited, and Netflix Pte. Ltd.	6 (1 January 2021)
7.	eBay Marketplace GmbH dan Nordvpn S.A.	7 (1 February 2021)
8.	Amazon.com.ca, Inc, Image Future Investment (HK) Ltd, Dropbox International Unlimited Company, Freepik Company S.L.	8 (April 1, 2021)
9.	Epic Games International S.à r.l., Bertrange, Root Branch, Expedia Lodging Partner Services Sàrl, Hotels.com, L.P., BEX Travel Asia Pte Ltd, Travelscape, LLC, TeamViewer Germany GmbH, Scribd, Inc., Nexwat Sasu,	9 (4 May 2021)
10	TunnelBear LLC, Xsolla (USA), Inc. Pluralsight, LLC, Automatic Inc, Woocommerce Inc. Bright Market LLC, PT Dua Puluh Empat Jam Online.	10 (3 June 2021)
11	PT. Fashion Marketplace Indonesia (Zalora), Pipedrive OU	11 (12 July2021)
12	Shutterstock, Inc, Shutterstock Ireland, Ltd, Fenix International Limited, Bold LLC, High Morale Develompent Limited, Aceville Pte Ltd.	12 (4 August 2021)

Source: Directorate General of Taxes (2021).[64][65]

The current study with regard to the VAT collection on cross-border digital goods and supplies suggests that assigning foreign tax subjects as a collector has been a feasible way to deal with the existing condition of borderless economic activities[66]. This method of collection of VAT has seemingly been a common practice, as several countries have applied a similar mechanism in assigning the intermediary as a VAT collector. This

[64] Directorate General of Taxes, 'DJP Tunjuk Amazon sebagai Pemungut PPN PMSE' (Report, 2021) <https://www.pajak.go.id/siaran-pers/djp-tunjuk-amazon-sebagai-pemungut-ppn-pmse>.

[65] SMConsult, 'Daftar Nama Lengkat Perusahaan yang Ditunjuk sebagai Pemungut PPN PMSE Per Agustus 2021' (online, August 2021) <https://smconsult.co.id/id/daftar-lengkap-perusahaan-yang-ditunjuk-sebagai-pemungut-ppn-pmse-per-agustus-2021/>.

[66] Schenk and Oldman (2007) 'Value Added'.

includes countries such as Australia[67], Japan and India[68]. The OECD has also released a study about the role of using a digital platform in the collection of VAT/GST on online sales in 2019.[69]

Based on the information published by Ministry of Finance, it would appear that the volume of seven types of overseas electronic transaction in 2017 reached IDR 103,31 T.[70] Thus, it should bring about IDR 10,3T to the government revenue on the basis of a calculation, which uses information from 2017. In fact, the volume of transactions had increased considerably in 2020 to about 29,6%, as compared to the previous year.[71] This number shows the potential of the collection of VAT revenue, should the government choose to propose that foreign digital providers take a part as VAT collectors. However, acquiring data and information with regard to the real potential of cross-border e-commerce transaction is needed, in order to measure whether the collection effort has been optimum. In this case, the government must not solely rely on the collection activities performed by assigned foreign VAT collectors. In December 2020, the Ministry of Finance announced that in the period up until December 2020, the VAT collectors remitted IDR. 566.16 million to the government, which was gathered from 46 VAT collectors.[72] The means that the realisation of potential revenue is 5,39%, following the volume of transactions recorded in 2017. The government initiative to assign foreign VAT collectors to collect VAT might be a progressive step, however, it still less than optimal. In fact, even if the potential revenue from VAT was fully collected, it still would not cover the potential loss due to a reduction in corporate income tax.

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67 ATO, 'GST on Imported Services and Digital Products' (online, 2020) <https://www.ato.gov.au/business/international-tax-for-business/gst-on-imported-services-and-digital-products/>.

68 Mifahudin and Irawan, 'Alternatif Kebijakan PPN atas Konsumsi atau Pemanfaatan Konten dan Jasa Digital dari Penyedia Luar Negeri' (2019) 1(2) *Jurnal Kajian Ilmiah Perpajakan di Indonesia* 131–148.

69 OECD, 'The Role of Digital Platforms in the Collection of VAT/GST on Online Sales' (2021) <https://www.oecd.org/tax/consumption/the-role-of-digital-platforms-in-the-collection-of-vat-gst-on-online-sales.pdf>.

70 The seven types of electronic transaction consisted of (1) software system and application IDR. 14,07 T; (2) Game, Video and Music IDR. 0,88 T; (3) Film Cinema IDR. 7,65T; (4) Software Specialist (engineering, design, etc.) IDR. 1,77 T; (5) Handphone Software IDR. 44,75T; (6) Pay TV/ Broadcast Rights IDR. 16,49T; (7) Fast OTT and social media IDR. 17,07 T. Ministry of Finance, 'Naskah Akademik Rancangan Undang-Undang tentang Ketentuan dan Fasilitas Perpajakan untuk Penguatan Perekonomian' (online, 2019) <https://lokataru.id/wp-content/uploads/2020/02/Naskah-Akademik-RUU-Omnibus-Law-Perpajakan.pdf>.

71 Other sources of information stated that the transaction volume is higher than information, which was officially published by Ministry of Finance. Others source of information, which cited the data from the Indonesian Central Bank can be retrieved through the following site: <https://databoks.katadata.co.id/datapublish/2021/01/29/nilai-transaksi-e-commerce-mencapai-rp-2663-triliun-pada-2020>.

72 Wildan, 'Penerimaan PPN Produk Digital PMSE Tembus Setengah Triliun' (online, 2020) <https://news.ddtc.co.id/penerimaan-ppn-produk-digital-pmse-tembus-setengah-triliun-26061?page_y=0>.

E *Overwhelming Tax Incentives*

The Omnibus Law re-regulates tax incentive packages. The new law includes added local tax and user charge instruments as other new types of tax incentives, in addition to former tax incentive packages. The government's creation of regulation is to offer a package of a comprehensive tax incentives underpinned by a stronger legal basis. Before the release of this law, the government had offered a myriad of tax incentives since 2019 and had released the 16 Economic Policy Package,[73] in order to boost economic growth and as a measure to attract investors[74]. Six out of sixteen of those economic packages were related to tax incentives. Other than those economic packages, various economic zones with tax facilities were also established. These economic zones consisted of the following:

TABLE 5: THE ESTABLISHMENT OF ECONOMIC REGION IN INDONESIA

TYPE OF REGION	LAW BASIS	OBJECTIVE	INSTITUTION THAT MANAGES THE ZONE	FACILITIES
Bonded zone	PP No.33/1996, jo. PP 32/2009	A region with boundaries functioning as the location for the manufacturing of imported supplies for export purposes	The operator and the business agents of the bonded zones with the legal institution	Customs and excise facilities in the form of customs exemption Tax facilities in the form of tax incentives and easy access to permits
Industrial zone	Keppres No. 41/1996 jo. PP 24/2009	Industrial region managed by the companies permitted to locate in the region	Regional government	No specific fiscal facility
Integrated Economic Development Area (KAPET)	PP No. 26/2007	A region which has the potential to grow faster than other regions due to its superior sector and capacity for higher investment return	The development agency is led by Coordinating Minister of Economic Affairs The development agency is organised by the Governor's technical team	Exemption of customs, non-collected VAT, sales tax on luxury goods and non-collected prepaid income tax (art 22)

73 The Sixteen Economic Policy Package emphasises three aspects. Firstly, the expansion of tax facilities such as reduction of corporate income tax and the expansion of tax holiday subject. Secondly, the list of reduction on negative list investments and thirdly, the management of national revenue generated from natural resources. See: Cabinet Secretary Public Affairs, 'Pemerintah Umumkan Paket Kebijakan Eknomi ke-16' (Report, 2018) <https://setkab.go.id/pemerintah-umumkan-paket-kebijakan-ekonomi-ke-16/>.

74 Rosdiana et al, 'Review of Implementation of the Inclusive Framework on Base Erosion and Profit Shifting in Indonesia' (2019) 47(6)–(7) *Intertax* 635–651.

Free Trade Zone and Free Port (KPBPB)	UU No. 37/2000 jo. PP 46, 47, 48/2008	A certain area separated from the customs territory, which has limited imposition of income tax, VAT and excise tax	The National Council led by the Coordinating Minister of Economic Affairs Regional Council from the government	Exemption of customs, VAT and sales tax on luxury goods; and excise for goods that enter and leave from the KPBPB through free ports and airports selected; and under the supervision of the customs office Exemption of customs, VAT, sales tax on luxury goods, and exercise on consumption goods from outside the customs office territory for the needs of citizens inside the KPBPB
Special Economic Zone (KEK)	UU No.39/2009, Perpres No.33/2010, Kepres No.8/2010	A certain location within Indonesia territory used for carrying out economic function with some facilities provided Until 2020, Indonesia has established 16 location of KEK	The National Council led by the Coordinating Minister of Economic Affairs Regional Council led by the Governor Administrator Business entity	Fiscal facilities; tax, customs and excise, trade, immigration and human resources Non-fiscal facilities in the form of easy access to business permits, business activities, banking, capital, industries, trade, free port and security.

Source: Rosdiana, Tambunan & Irianto, 'Review of Implementation of the Inclusive Framework on Base Erosion and Profit Shifting in Indonesia' (2019) 47(6)–(7) 635.

The government's argument in response to the overwhelming tax incentives is that the reduction of the tax burden will, in fact, encourage the tax compliance. However, this is questionable, even though the imposition of a high tax burden will tend to result in the taxpayer seeking to avoid paying taxes. However, the study that supports this finding is inconclusive[75]. Instead of offering a large number of tax facilities, the more established instrument of anti-avoidance rules would appear more crucial in this circumstance and might be more effective in preventing profit shifting practices[76]. It is therefore necessary to examine how the government will compensate the tax revenue loss under the new broadened tax base, and how they will adopt practices, which convert the loss of revenue into quantifiable economic enhancement.

In recent time, research assessing the impact of tax incentives on foreign direct investment (FDI) in Indonesia reaches a different conclusion to that of the Indonesian Government. The research used the FDI data from 1999-2018, regarding the 22 countries

[75] Darussalam, Septriadi and Kristiaji, 'Policy Note: Omnibus Law Ketentuan and Fasilitas Perpajakan untuk Penguatan Ekonomi: Suatu Catatan', *DDTC Fiscal Research* (Report, 2020).

[76] Ibid.

that invest most in Indonesia. It concludes that as tax incentives increase, the FDI flow has decreased significantly. However, the corporate income tax rate effect is in line with the hypothesis that the lower CIT rate, that the greater FDI will flow. Interestingly, the research further showed that foreign investors are more interested in other factors than tax incentives. This research also highlights that tax incentives might be disadvantageous for the home countries as it could cause higher tax to be paid, when they actually have a lower foreign tax credit policy[77].

Moreover, should there have been an analysis of how taxpayers behave in conditions where there are a myriad of tax incentives, it is likely that such tax incentives would not achieve their aim. Information regarding taxpayer behaviour in Batam,[78] an island established as Free Trade Zone, shows that even where there is a preponderance of tax incentives, many MNEs have successfully avoided paying corporate income tax. This was the case even though the government had relieved VAT, excise and import duty. Ultimately, the sacrifice of potential tax revenue through tax incentives did not result in Batam becoming a centre for economic growth, even in the province where Batam was located.[79]

With respect to the current overwhelming tax incentives, the government must also enhance the monitoring mechanism, in order to determine the extent of the tax incentives offered and to therefore minimise any unnecessary tax expenditure.[80] The procedural and administrative aspects of implementing such tax incentives will not further optimise any rent seeking activities. However, it is expected to lead to an improvement in accountability and effectiveness of tax incentives, as a result of implementing the regulation [81]

In May 2021, the government made public its plan to increase and adjust the VAT rate The increase of VAT was intended to create new source of revenue due to a deep shortfall in the budget.[82] Furthermore, the issue to broaden the VAT objects, which was disseminated to the public, included the potential supply of certain 'premium basic needs'[83] and

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77 R. A. Siregar and A. Patunru, 'The Impact of Tax Incentives on Foreign Direct Investment in Indonesia' (2021) 4(1) *Journal of Accounting Auditing and Business* 66, 66–80.

78 Batam has been established as a Bonded Zone, which has served to relieve Value Added Tax, Tax on Luxury Goods, Import Duty and Excise since 1987. This is based on the Decree of Minister of Finance No. 47/KMK.01/1987 (26 January 1987). Until recently, Batam is still as an industrial location with a myriad of tax incentives (Free Trade Zone and Free Port).

79 Tambunan and Sinaga, 'Transfer Pricing and Profit Shifting Practices in a Free Trade Zone: A Case in Batam, Indonesia, Based on Tax Court Decision' (2020) 48(11) *Intertax* 1030, 1030–1044.

80 Ibid.

81 David Matkin, 'Designing Accountable and Effective Economic Development Tax Incentives' (2010) 34(2) *Public Performance and Management Review* 166–188.

82 Jatmiko, 'Wacana Kenaikan PPN Ditolak Sejumlah Pihak' (Web Page, (2021) <https://money.kompas.com/read/2021/05/06/090712926/wacana-kenaikan-ppn-ditolak-sejumlah-pihak?page=all>.

83 'Finance Ministry Clarifies VAT Importation Solely on Premium Basic Necessities', *Medcom.id* (Web Page, 20 June 2021) <https://www.medcom.id/english/business/RkjWXQ3K-finance-ministry-clarifies-vat-imposition-solely-on-premium-basic-necessities>.

education-related services.[84] Formerly, Indonesia implemented a single VAT rate at 10%.[85] However, the government's plan to adjust the rate of VAT and the Tax on Luxury Goods through the Omnibus Law has triggered much debate. This is especially the case regarding the plan to impose VAT on education services. This policy choice could be seen as sacrificing the interests of many, in favour of 'rolling out the red carpet' to the capital owner.

V CONCLUSION

The Omnibus Law Taxation Cluster is the amendment to three taxation laws: (1) General Provision and Tax Procedures Law; (2) Income Tax Law; and (3) Value Added Tax Law. Important changes to the former tax policy, which have become part of Omnibus Law Taxation Cluster consist of (i) a reduction in income tax rate; (ii) the application of a semi-territorial system; (iii) a reduction in tax penalties; (iv) the appointment of foreign VAT collectors on digital-based products/services; and (v) the offer of tax incentives as a package of tax facilities.

The new tax policy set by the government and Parliament seems to be following the 'world trend. However, in an attempt to be 'relevant' in the global world of tax, the Indonesian Government has failed to sufficiently calculate the impact of the implemented tax policy on revenue obtained solely as a result of investment. Without certain new sources of revenue, this policy may not be financially viable and it may therefore impact on the budget formerly allocated for provision of public goods and public services, in terms of both quantity and quality.

The reduction of the corporate income tax rate has resulted in a significant shortfall in tax revenue, even when taking into account that such a reduction will attract investors. However, there was no clear calculation provided prior to enacting this policy. With this incentive, the government should be able to monitor the tax incentives must bring the increasing on the business productivity. Then, the application of semi-territorial system also was based on the consideration of dividend reinvestment. With this policy, it has no clear monitoring mechanism whether the dividend has been invested into certain sector even though the government has proposed the list of sectors to invest. Similarly, no clear calculation has been brought to public while drafting this policy. Therefore, the availability of monitoring system and the review to the report of investment realisation should be developed.

The reduction of tax penalty has seemingly followed the market interest as formerly, the interest rate for the tax penalty was 2% flat. The proportionality of the sanctions issued if the taxpayer fails to fulfil its tax obligation is expected able to bring fairness to the process and moreover, to increase the tax compliance. The appointment of VAT collectors on digital based products/services is a measure, which will bring potential revenue and in

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[84] Riana Friski, 'VAT on Education Services; Threats of Commercialization and School Dropouts' (Web Page, 2021) <https://en.tempo.co/read/1472699/vat-on-educational-service-threats-of-commercialization-and-school-dropouts>.

[85] Article (7)(1) VAT Law states that the VAT rate is 10%. However, Article (7)(3) also mentions that the VAT rate can be adjusted to between 5% and 15%.

addition, will create a fair and level playing field in domestic and foreign business in terms of tax burden. This appears to be progressive step, even though further steps are needed to enhance its implementation. The government is expected to develop tax revenue data, which will show the real potential of the laws, as well as providing details of the remitted VAT revenue. On the basis of this data, the government could implement further strategies as a means of optimising the VAT revenue, so that it is not solely reliant on the appointed foreign VAT collectors' efforts. Finally, the release of Omnibus Law re-regulates tax incentive packages and offers former tax incentive packages, in addition to local tax and user charge instruments as other new types of tax incentives. Indeed, these overwhelming tax incentives will likely result in potential loss, even though the effectiveness of this instrument is questionable. Therefore, the government also must enhance the monitoring mechanisms of the extent of the tax incentives offered, in order to minimise the unnecessary tax expenditure by the business. In conclusion, the Omnibus Law has been released without the provision of detailed economic calculations. Given the insufficient detail provided, it will be necessary to monitor the efforts of the government and to hold them accountable. This will ensure that the laws are implemented in accordance with its objective and will address any consequences to the provision of general public goods and public services.

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TAX EDUCATION AND TAX AWARENESS: A STUDY ON THE PAJAK BERTUTUR INDONESIAN TAX EDUCATION PROGRAM

YULIANTI ABBAS,* CHRISTINE TJEN** AND PANGGAH TRI WICAKSONO***

ABSTRACT

This study aimed to examine the effectiveness of 'Pajak Bertutur', a tax education program in Indonesia. We analysed whether there were differences in students' tax awareness before and after the program, and whether the results of the program were influenced by students' familiarity with taxation. We distributed an online survey questionnaire to all students participating in the 2020 tax education program, resulting in a total of 693 responses, 461 for pre-survey and 232 for post-survey. Using multivariate regression analysis, our results suggest that students' tax awareness levels increased after the tax education program. We also found that the increase in tax awareness was greater for students who are familiar with the tax authority website and those who have learned about taxation before the event. Therefore, these findings indicate that the effectiveness of the tax education program is influenced by the students' prior knowledge and emphasising that a continuous tax education program is necessary to improve tax awareness.

Keywords: tax education, tax awareness

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I Introduction

Taxes are the major source of revenue for the Government of Indonesia. On average, tax revenues contribute around 85% of the total government revenue. Despite this great reliance on taxes, the Indonesian tax ratio remains very low. Based on the Organisation for Economic Co-Operation and Development's ('OECD') 2020 report, the Indonesian tax ratio of 11.9 per cent is the lowest among countries located in the Asia and Pacific region.[1] Relevantly, the Indonesian tax ratio is lower when compared to neighbouring countries, such as Malaysia (12.2%), the Philippines (15.7%), or Thailand (16.5%).[2] Accordingly, raising the tax ratio becomes a priority in the Indonesian medium-term fiscal policy system.

Raising a tax ratio has indeed been a problem in most developing countries. Prior studies suggest that to raise tax revenues, governments in developing countries should not focus only on detection and punishment, but also on improving the actual motivations of people to pay taxes.[3] Strengthening the social norms is viewed as important as the efforts to improve the tax administration.[4] Efforts to improve the intrinsic motivation to pay taxes thus are essential to increasing tax compliance.[5]

Prior studies suggest that positive attitudes towards taxation are associated with tax knowledge — a higher level of tax knowledge is associated with more positive attitudes towards taxation.[6] Similarly, it is suggested that people are more likely to comply with tax laws if they have sufficient knowledge of taxation.[7] On this point, Kwok and Yip argue that a lack of understanding of the tax law and its application can lead to non-compliant behaviour.[8] Accordingly, these prior studies stress the importance of tax education, which

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1 Organisation for Economic Co-Operation and Development (OECD), *Revenue Statistics in Asian Pacific Economies 2020* (OECD Publishing, 2020) <https://doi.org/10.1787/d47d0ae3-en>.

2 Ibid.

3 James Alm and Jorge Martinez-Vazquez, 'Tax Morale and Tax Evasion in Latin America' (Working Paper No 07-32, International Studies Program, Andrew Young School of Policy Studies, Georgia State University, December 2007) <https://icepp.gsu.edu/files/2015/03/ispwp0732.pdf>.

4 Ibid.

5 James Andreoni, Brian Erard and Jonathan Feinstein, 'Tax Compliance' (1998) 36(2) *Journal of Economic Literature* 818; Benno Torgler and Friedrich Schneider, 'What Shapes Attitudes Toward Paying Taxes? Evidence from Multicultural European Countries' (2007) 88(2) *Social Science Quarterly* 443.

6 Knut Eriksen and Lars Fallan, 'Tax Knowledge and Attitudes Towards Taxation: A Report on a Quasi-Experiment' (1996) 17(3) *Journal of Economic Psychology* 387; Pauline Niemirowski, Steve Baldwin and Alexander J. Wearing, 'Tax Related Behaviours, Beliefs, Attitudes and Values and Taxpayer Compliance in Australia' (2003) 6(1) *Journal of Australian Taxation* 132.

7 Jeyapalan Kasipillai, Norhani Aripin and Noor Afza Amran, 'The Influence of Education on Tax Avoidance and Tax Evasion' (2003) 1(2) *eJournal of Tax Research* 134; Adrian Furnham, 'Understanding the Meaning of Tax: Young Peoples' Knowledge of the Principles of Taxation' (2005) 34(5) *The Journal of Socio-Economics* 704.

8 Betty Yuk Sim Kwok and Rita Wing Yue Yip, 'Is Tax Education Good or Evil for Boosting Tax Compliance? Evidence from Hong Kong' (2018) 32(4) *Asian Economic Journal* 359.

is paramount to developing tax knowledge.[9] In a study looking at university students' level of tax knowledge, Putro and Tjen find a substantial difference in tax knowledge between students who have received tax education and students who have not.[10] The importance of tax education is also proposed by other studies. For example, Morgan and Castelyn found that a majority of the participants in their study agreed that formal tax education should be introduced into the secondary school curriculum and, as a corollary, would assist taxpayers in their interactions with Australia's taxation system.[11] Similarly, Sarker explains that the Japanese government has introduced tax education to school students because they are considered to be potential future taxpayers.[12] Furthermore, Barjoyai emphasises that all future taxpayers need to have an adequate tax education in schools or colleges so that they are more tax conscious when they grow up.[13]

Our study is intended to analyse the tax education program in Indonesia. In 2014, as part of an effort to increase the tax ratio, the Indonesian government established a Tax Education program, known as the Tax Awareness Inclusion program. This program primarily aims to build tax awareness amongst young people, targeting students in all levels of education, including elementary schools, middle schools, high schools and universities. One of the flagships in the Tax Awareness Inclusion program is the annual 'Pajak Bertutur ('Patur')'[14] program, which was established in 2017. The Patur program involves a one-day visit from tax officials to schools during which the tax officials deliver various educational activities related to tax awareness to students. Since the program targets tax awareness, the educational materials include a basic understanding of taxes, the importance of taxes in the Indonesian economy, and how taxes contribute to enhancing the quality of life of citizens. It is expected that the program will increase students' awareness as well as build a positive attitude towards taxation among students, who will be future taxpayers.

Despite the Patur program having been held annually since 2017, whether and to what extent the program improves students' tax awareness is still widely unknown. There is also limited literature discussing a country's tax education program. It is the authors' understanding that only Sarker[15] has explained the tax education of school students in Japan. Similarly, research analysing the association between tax education and tax

[9] Ming Ling Lai, Yaacob Zalilawati, Mahat Mohd Amran and Kwai Fatt Choong, 'Quest for Tax Education in Non-Accounting Curriculum: A Malaysian Study' (2013) 9(2) *Asian Social Science* 154.

[10] Bernardus Bayu Ryanto Prakoso Putro and Christine Tjen, 'Analysis of Tax Education and Tax Knowledge: Survey on University Students in Indonesia' (2020) 15(1) *Journal of the Australasian Tax Teachers Association* 232.

[11] Annette Morgan and Donovan Castelyn, 'Taxation Education in Secondary Schools' (2018) 13(1) *Journal of the Australasian Tax Teachers Association* 307.

[12] Tapan K. Sarker, 'Improving Tax Compliance in Developing Countries via Self-Assessment Systems – What Could Bangladesh Learn from Japan?' (2003) 9(6) *Asia-Pacific Tax Bulletin* 1.

[13] Bardai Barjoyai, 'Tax Illiteracy in Malaysia: Problems and Solution' (1992) 11(2) *ACCAMADIA, Journal of School of Accountancy, MARA Institute of Technology* 6.

[14] The general English translation of the term Pajak Bertutur is 'Tax Speaks'.

[15] Sarker (n 12).

awareness is also limited. These prior studies also do not specifically analyse a national tax education program. Accordingly, it is this lack in prior research and the importance of tax education programs in a developing country that motivates the authors to examine the effectiveness of the Patur program in Indonesia. The authors conducted two broad analyses. First, the authors analysed whether there is a change in students' tax awareness after the program. If the program meets its objectives, a higher student tax awareness should be observed after the program. Second, the authors analysed whether the results of the program would be influenced by students' familiarity with taxation. Despite its role in every country's economy, tax is a complex subject. Thus, students would develop their understanding of taxation gradually. It is the authors conjecture that it would be easier for students with familiarity in taxation to understand the information in the tax education program. More specifically, the authors asked whether the impact of the program would be more prominent if the students were familiar with taxation. Students' familiarity with taxation was measured by assessing (1) whether the student has ever received any taxation lesson(s), (2) whether the student is aware of the tax authority website, and (3) whether the student has a family member that understands taxation.

In answering the research questions, the authors utilised a survey that was distributed to all participants of the Patur program before and after the program in 2020. Information was also collected regarding students' demographics and their access to taxation information. Due to the COVID-19 pandemic, the 2020 Patur program was conducted virtually via Zoom video conferencing software. The use of online platforms limits our sample to students who had adequate access to technology. However, despite this sample limitation, there was enough variation in students' characteristics that we used to observe the impact of the program.

Confirmatory factor analysis ('CFA') was used in the structural equation modelling to measure the tax awareness variable. A multivariate regression analysis was then applied to measure the changes in tax awareness before and after the Patur program. Finally, a difference-in-differences setting was adopted to test whether students' familiarity with taxation moderates the changes in students' awareness after the program.

The empirical results of this study indicate that there is a significant difference in students' tax awareness before and after the Patur program. It was also found that the increase in tax awareness is greater for students who are familiar with the tax authority website and students that have learned about taxation prior to the program. Our results thus indicate that the effectiveness of the tax education program is affected by the students' familiarity with taxation, implying that a continuous education program is necessary to increase tax awareness.

This paper continues with a review of the relevant literature on tax education and tax awareness and an explanation of the Indonesian tax education program. The paper then proceeds to describe the study's data, research design, and descriptive statistics, prior to exploring the empirical results and findings. Finally, a conclude is provided that discusses these findings and future research direction.

II PRIOR LITERATURE AND HYPOTHESIS DEVELOPMENT

A *Tax Education and Tax Awareness*

In a self-assessment system, taxpayers have responsibilities to calculate, pay, and report their taxes to the government.[16] The inability to fulfill these responsibilities properly will be detected as a failure, and the tax authority will take necessary actions, such as imposing penalties based on the tax laws.[17] Thus, taxpayers should be aware of their tax obligations and should be knowledgeable to comprehend the applicable tax laws.[18] Since knowledge of taxation is essential, the tax authority is responsible to provide taxpayers with education and assistance so that taxpayers can understand and apply the relevant tax laws.[19] It is argued that providing a tax education program is an essential feature of the self-assessment system.[20]

Prior studies support the importance of tax knowledge and tax education in achieving tax compliance. It is found that tax knowledge positively correlates with positive attitudes towards taxation.[21] It is also suggested that people who earn taxable income are more likely to comply with tax laws if they have sufficient knowledge of taxation.[22] Moreover, Kwok and Yip argue that a lack of understanding of the tax law and its application can lead to non-compliant behaviour.[23] Thus, tax education is essential to provide tax knowledge, as supported by Kurniawan who finds that tax education increases tax knowledge.[24] Besides, Morgan and Castelyn state that the level of tax education obtained by taxpayers is an important factor that contributes to the understanding of taxation requirements.[25] Thus, tax education can lead to tax compliance. This is supported by Kwok and Yip who find that tax education positively impacts tax compliance.[26] It is suggested that tax

16 Andrew Okello, 'Managing Income Tax Compliance Through Self-Assessment' (Working Paper No WP/14/41, International Monetary Fund, March 2014) <https://www.imf.org/external/pubs/ft/wp/2014/wp1441.pdf>.

17 Ibid.

18 Ern Chen Loo and Juan Keng Ho, 'Competency of Malaysian Salaried Individuals in Relation to Tax Compliance Under Self Assessment' (2005) 3(1) *eJournal of Tax Research* 45.

19 Ern Chen Loo, Margaret McKerchar and Ann Hansford, 'An International Comparative Analysis of Self Assessment: What Lessons Are There for Tax Administrators?' (2005) 20(4) *Australian Tax Forum* 669; Okello (n 16).

20 Loo, McKerchar and Hansford (n 19).

21 Eriksen and Fallan (n 6); Niemirowski, Baldwin and Wearing (n 6).

22 Kasipillai, Aripin and Amran (n 7); Furnham (n 7).

23 Kwok and Yip (n 8).

24 Dedi Kurniawan, 'The Influence of Tax Education During Higher Education on Tax Knowledge and Its Effect on Personal Tax Compliance' (2020) 35(1) *Journal of Indonesian Economy and Business* 57.

25 Morgan and Castelyn (n 11).

26 Kwok and Yip (n 8).

education can instil tax compliance behaviour, especially through improving the ability/readiness to comply and enhancing morality.[27]

Tax education should not only target people who have registered as taxpayers, but also those who have yet become taxpayers. Morgan and Castelyn suggest that tax education should be given to students in secondary education,[28] while Bahari and Ling propose that university students, regardless of their discipline, should also be exposed to tax education.[29] Moreover, Putro and Tjen find that there is a significant difference in the level of tax knowledge between students who have received tax education and those who have not.[30]

Further, the implementation of tax education for students can probably be influenced by many factors, including the characteristics of the students. Furnham, who conducted interviews with children ranging from 10 to 15 years old, finds that the knowledge of taxation increases with age.[31] However, Furnham finds that the majority of the 15-year old's still do not have full comprehension of the questions, suggesting that young people probably do not completely comprehend how their country's tax system functions until they are in their late teenage years.[32] In addition, Furnham also finds that children from poorer families have more understanding about how the government spends its tax revenues, because their parents may have discussed the taxation issue more and are more likely to be recipients of the government support.[33] This implies that family background may affect the tax knowledge of students.

Our study focuses on examining tax awareness that is one type of tax knowledge, according to Bornman and Ramatumbu's framework.[34] Bornman and Ramatumbu propose a framework of tax knowledge since the term 'tax knowledge' has not been well defined in the taxation literature.[35] The framework describes that tax knowledge consists of three categories, namely general tax knowledge, legal tax knowledge, and procedural tax knowledge.[36] General tax knowledge relates to having a fiscal awareness, which includes the understanding of the aims of governmental fiscal strategies and having financial literacy. Legal tax knowledge is defined as understanding legislative provisions, which includes understanding how people are taxed (technical) and understanding the

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27 Ibid.

28 Morgan and Castelyn (n 11).

29 Anis Barieyah Mat Bahari and Lai Ming Ling, 'Introducing Tax Education in Non-Accounting Curriculum in Higher Education: Survey Evidence' (2009) 7(1) *Journal of Financial Reporting and Accounting* 37.

30 Putro and Tjen (n 10).

31 Furnham (n 7).

32 Ibid.

33 Ibid.

34 Marina Bornman and Pusheletso Ramutumbu, 'A Conceptual Framework of Tax Knowledge' (2019) 27(6) *Meditari Accountancy Research* 823.

35 Ibid.

36 Ibid.

terminology of the complex tax legislation (conceptual). Procedural tax knowledge relates to understanding tax compliance procedures. Although Bornman and Ramatumbu suggest these three elements of tax knowledge, the importance of each element as a factor influencing tax compliance is not examined, and they suggest future studies to investigate this to further enhance the framework.[37] It is also suggested that not only should tax education provide technical and procedural tax knowledge, but it should also be able to increase awareness to ensure a voluntary compliant attitude.[38]

Nevertheless, many prior studies seem to use the terms 'tax knowledge' and 'tax awareness' interchangeably, which is probably due to the unclear definition of both terms. In the context of this study, we use the term 'tax awareness' to correspond with the main purpose of Indonesia's Patur program, which is to raise awareness of young people towards taxation. Following Bornman and Ramatumbu's (2019) framework, we argue that the term 'tax knowledge' is too general and less appropriate for the context of this study, because Patur program does not cover technical and procedural aspects of taxation.

B *Tax Education Program in Indonesia*

Indonesia's Directorate General of Taxes ('DGT') has implemented a tax education program, named Tax Awareness Inclusion, since 2014. This program primarily aims to build tax awareness of young people, targeting students in all levels of education, including elementary schools, middle schools, high schools, and universities. Through this program, students are expected to have more awareness of taxation, so they can be compliant taxpayers in the future. The DGT has created a long-term roadmap for the program in building tax awareness in Indonesia. According to the roadmap, it is expected that Indonesian citizens will have a high level of tax awareness after 2060, and taxes will contribute to the optimal welfare for Indonesian citizens.[39]

The main objective of the Tax Awareness Inclusion program is to introduce taxation to students as early as possible, starting from the elementary school up until college. For the college student education, the Indonesian Tax Authority works with colleges and universities to integrate taxation discussion into their curriculum. For the K-12 students, the Tax Awareness Inclusion program includes integrating taxation in the national curriculum and providing materials/books discussing the taxation concepts. For these activities, the Indonesian Tax Authority works with the Ministry of Education and the efforts are currently still in progress. Aside from the national-wide program to insert taxation concept into K-12 education system, the DGT also organises some supporting programs. One of the regular and well-known programs is the Patur program, which is a campaign of the Tax Inclusion Awareness Program in Indonesia. In the Patur program, the tax offices visit schools in their region to introduce taxation by delivering tax-related materials to students. As the main objective of Patur program is to build tax awareness of students, the materials focus on providing general knowledge about taxation and do not

37 Ibid.

38 Ibid.

39 Directorate General of Taxes, *Inklusi Kesadaran Pajak dalam Pendidikan* (Directorate General of Taxes, 2020) <https://edukasi.pajak.go.id/images/materi_publikasi/Booklet-Inklusi-Kesadaran-Pajak.pdf>.

include topics related to procedural or technical aspects of taxation (e.g., how to calculate taxes). The main purpose of the materials is to promote positive perceptions of the students towards taxation, such as how taxes are used to finance public infrastructure that is used by the students and their families. These materials are delivered by the tax offices using various methods, such as active lecturing, video presentation, and educational games. Both teaching materials, and delivery methods, were prepared by adjusting with the student's level of education (i.e., elementary schools, middle schools, high schools), so the materials could be understood better by students at a particular level of education.

The Patur program is conducted under the philosophy that students, as a young generation, need to be instilled with positive values, which include an understanding of taxation. By participating in this event, it is expected that students can have a greater awareness of taxation, which is important in building their positive attitudes towards taxation. In the first three years (2017-2019), the events were conducted offline, where the DGT visits schools and universities. However, the 2020 event was conducted virtually by Zoom video conferencing due to the COVID-19 pandemic.

Despite the event has been conducted annually since 2017, the effectiveness of the program is still widely unknown. To the best of our knowledge, no research has investigated whether and to what extent the program improves the tax awareness of students. Thus, this motivates us to examine whether providing tax education through the Patur program can increase students' tax awareness.

C *Hypothesis Development*

The primary aim of this study is to investigate whether tax education, which is in the form of the Patur program, changes the tax awareness of students. Eriksen and Fallan suggest that tax knowledge can shape people's positive attitudes towards taxation.[40] In addition, Kurniawan finds that tax education increases tax knowledge.[41] This is also supported by Putro and Tjen who find that students who have received tax education tend to have more tax knowledge than students who have not been exposed to tax education.[42] Kwok and Yip also find that tax education has a positive association with tax compliance.[43] Thus, by providing tax education, it is expected that tax awareness can increase, which can ultimately affect tax compliance. Therefore, the first hypothesis for this study is as follows.

H1: The tax education program improves students' awareness of taxation.

To further enhance this study, we also examine whether students' familiarity with taxation has impact on how the tax education program improves their tax awareness. We analyse three conditions to describe students' familiarity with taxation: (1) whether a student has received any taxation lesson prior to the tax education program, (2) whether a student is aware of the tax authority website, and (3) whether a student has a family

[40] Eriksen and Fallan (n 6).

[41] Kurniawan (n 24).

[42] Putro and Tjen (n 10).

[43] Kwok and Yip (n 8).

member that understands taxation. We hypothesise that the impact of the tax education program on improving tax awareness will be higher for students with better familiarity with taxation as measured by the access to these three sources of information. Thus, the next hypotheses are as follows.

H2: The impacts of the tax education program on increasing students' tax awareness are higher for students with prior lessons on taxation.

H3: The impacts of the education program on increasing students' tax awareness are higher for students who have awareness of the tax authority website.

H4: The impacts of the tax education program on increasing students' tax awareness are higher for students whose family member(s) understand taxation.

III Research Method

A *Sample*

1 *Overall Sample*

We surveyed students who participated in the 2020 Patur event. We received a total of 693 responses, 461 responses were collected before the event and 232 responses were collected after the event. The demographic characteristics of our sample are shown in Table 1.

Table 1: Descriptive Statistics

Variables	(1) N	(2) Mean	(3) Std. Dev.	(4) Min.	(5) Max.
Male	693	0.278	0.449	0	1
High school	693	0.478	0.500	0	1
Has received taxation lesson	693	0.703	0.457	0	1
Know the existence of tax authority website	693	0.385	0.487	0	1
Has family that understand taxation	693	0.522	0.500	0	1

Based on the data from 693 responses, 27.8% of the responses are males. About 48% of the responses are from high school students, which also means 52% of the responses are from middle-school students. We asked the respondents whether they have received any lessons about taxation. About 70% of the responses acknowledged having received taxation lessons. We also asked our respondents their source of information about taxation. About 49% of responses acknowledged the existence of a tax authority website as the source of information, and around 52% of the responses stated they have family members who understand taxation.

2 *Matching Sample*

Based on the identifier in the questionnaire, we matched the responses from the same respondent before and after the event. We got 294 matched responses from 147 respondents. The demographic characteristics of the matched sample are shown in Table 2.

TABLE 2: DESCRIPTIVE STATISTICS — MATCHING SAMPLE

VARIABLES	(1) N	(2) MEAN	(3) STD. DEV.	(4) MIN.	(5) MAX.
Male	294	0.238	0.427	0	1
High school	294	0.412	0.493	0	1
Has received taxation lesson	294	0.670	0.471	0	1
Know the existence of tax authority website	294	0.306	0.462	0	1
Has family that understand taxation	294	0.568	0.496	0	1

Our matched sample consists of 23.8% males and 41.2% high school students. Sixty-seven% of the respondents acknowledged that they have received taxation lessons. About 30% of the respondents acknowledged the existence of a tax authority website as the source of information, and around 57% of the responses stated they have family members who understand taxation.

B *Research Methodology*

We distributed the same questionnaire to participants before and after the event. The questionnaire consists of six questions that measure tax awareness and five questions that measure the characteristics of the respondents. The questions are measured using a 1–4 Likert scale. A score of 1 represents highly disagree and a score of 4 represents highly agree. The questions were:

Question 1	Tax is the main source of Indonesian government revenues
Question 2	Government may enforce tax to all citizens
Question 3	Everybody should pay tax on their income
Question 4	Students do not need to pay taxes (reverse question)
Question 5	Not paying taxes is a better attitude compared to stealing (reverse question)
Question 6	Indonesian citizens benefit greatly from their tax payments

Since the tax awareness variable is a latent variable, we use confirmatory factor analysis ('CFA') in the structural equation modelling to measure the magnitude of the variable.

In the first analysis, we analyse whether students' tax awareness improves after the Patur event. Using the overall sample, we estimated a multivariate regression as follows:

$$\text{Tax Awareness}_{it} = \beta_0 + \beta_1 \text{ Post} + \beta_2 \text{ Male}_{it} + \beta_3 \text{ High School}_{it} + \beta_4 \text{ Lesson}_{it} + \beta_5 \text{ Website}_{it} + \beta_6 \text{ Family}_{it} + \beta_k \, \Sigma\text{Location}_{it} + \varepsilon_{it}$$

Variable Description:

Tax Awareness = Level of tax awareness, measured using confirmatory factor analysis of the six tax awareness questions

Post = Period after the tax event

Male = Whether the respondent is male

High School = Whether the respondent is a high school student

Lesson = If the respondent has received taxation lesson

Website = If the respondent identified tax authority website as a source of information about tax

Family = If the respondent identified family members as a source of information about tax

Location = Dummy variables showing the provinces where the respondent resides. The overall sample includes respondents from nine provinces.

We expect the coefficient of β_1 to be positive, which indicates the tax awareness post-event is higher than pre-event. Our analysis includes robust standard error to deal with heteroscedasticity.

Our second analysis evaluates whether the impact of the tax education program differs between respondents with different familiarity with taxation. For this analysis, we used the matched sample to control for unobservable characteristics of the respondents that might be associated with access to tax knowledge. To test the hypothesis, we use a difference-in-differences setting, as follows:

$\text{Tax Awareness}_{it} = \beta_0 + \beta_1 \text{ Post*Condition} + \beta_2 \text{ Post} + \beta_3 \text{ Male}_{it} + \beta_4 \text{ High School}_{it} + \beta_5 \text{ Lesson}_{it} + \beta_6 \text{ Website}_{it} + \beta_7 \text{ Family}_{it} + \beta_k \text{ }\Sigma\text{Location}_{it} + \varepsilon_{it}$

Variable Description:

Post*Condition = Interaction between Post (period after the event) and Condition (respondent's access to taxation knowledge)

We define 'Condition' as respondents' familiarity with taxation as measured by their access to tax knowledge, which is (1) whether the respondent has received any taxation lesson (Lesson), (2) whether the respondent is aware of the tax authority website (Website), and (3) whether the respondent has a family member that understands taxation (Family). Our coefficient of interest is β_1 that shows the tax awareness difference between respondents under condition X and other respondents after the event. A positive β_1 indicates a higher tax awareness after the event for respondents under condition X compared to other respondents, ceteris paribus. For example, if condition X is defined as whether a respondent has received a taxation lesson, the coefficient β_1 shows the tax awareness differences between respondent that has received taxation lesson and other respondents after the event. A positive β_1 indicates the impact of the tax education event is higher for respondents that have received taxation lessons. All of our analyses include robust standard error to deal with heteroscedasticity.

IV RESEARCH RESULTS

A *Descriptive Analysis*

Table 3 shows the summary of the tax awareness questions for all respondents. In general, our respondents have a positive tax awareness (most average score > 2). Question 6 (whether Indonesian citizens benefit greatly from their tax payments) has the highest average score, and question 4 (whether students need to pay taxes) has the lowest average score. We observed an increase in the average scores for questions 3, 4, 5, and 6, although none of the changes is statistically significant. We, however, observed a decrease in the average scores for questions 1 and 2.

TABLE 3: MEAN AND STANDARD DEVIATION OF TAX AWARENESS QUESTIONS — ALL SAMPLE

QUESTION	PARAMETER	PRE	POST	T-STAT
Question 1	Mean	3.062907	3.017241	0.871
	Std. Dev.	0.02971	0.044459	
Question 2	Mean	2.715835	2.681034	0.5492
	Std. Dev.	0.037473	0.049327	
Question 3	Mean	2.91974	2.952586	-0.625
	Std. Dev.	0.030866	0.04154	
Question 4	Mean	1.856833	1.969828	-1.8106
	Std. Dev.	0.035454	0.052691	
Question 5	Mean	2.516269	2.590517	-1.2015
	Std. Dev.	0.03628	0.04889	
Question 6	Mean	3.158351	3.181034	-0.456
	Std. Dev.	0.029412	0.038732	
N		461	232	

Our previous analysis shows the differences in the average score for all respondents. Next, using the matching sample, we analyse the average score of all questions. Our results in Table 4 shows an increase in scores after the event, although none of the changes is statistically significant.

TABLE 4: MEAN AND STANDARD DEVIATION OF TAX AWARENESS QUESTIONS — MATCHING SAMPLE

QUESTION	PARAMETER	PRE	POST	T-STAT
Question 1	Mean	2.993197	3.034014	-0.5759
	Std. Dev.	0.049691	0.050545	
Question 2	Mean	2.646259	2.687075	-0.4543
	Std. Dev.	0.066743	0.060133	
Question 3	Mean	2.884354	2.918367	-0.5194
	Std. Dev.	0.045807	0.046807	
Question 4	Mean	1.789116	1.891156	-1.1245
	Std. Dev.	0.061986	0.066271	
Question 5	Mean	2.55102	2.55102	0
	Std. Dev.	0.068385	0.059651	
Question 6	Mean	3.14966	3.183673	-0.5289

	Std. Dev.	0.047639	0.043193
N		147	147

B *Regression Analysis*

1 *Tax Awareness Before and After the Tax Education Program*

In our first analysis, we measure whether the tax awareness level changed after the tax education event. Our regression results involving the overall sample are shown in Table 5. The Post variable has a positive coefficient, which indicates the tax awareness level after the event is higher compared to before the event. This result is statistically significant at a 90% level of confidence.

The analysis of our control variables shows a meaningful association between some respondent characteristics and tax awareness. First, we found that high school students have higher tax awareness compared to junior high students. Second, we found that students that acknowledged that they have received taxation lesson have higher tax awareness compared to their peers. Lastly, we found that students who are familiar with the tax authority website have higher tax awareness compared to their peers. In sum, the results of our first analysis suggest that there is a significant difference in tax awareness before and after the event, and students' access to tax knowledge is associated with their degree of tax awareness.

TABLE 5: REGRESSION RESULTS — TAX AWARENESS BEFORE AND AFTER THE TAX EDUCATION PROGRAM

VARIABLES	(1) COEFFICIENTS
Post	0.303* (0.172)
Male	-0.232 (0.195)
High School	1.203*** (0.226)
Lesson	0.570*** (0.177)
Family	0.0297 (0.156)
Website	0.471** (0.184)
2. Location	-2.607*** (0.494)
3. Location	-0.726* (0.421)
4. Location	-0.310 (0.485)
5. Location	-0.579

	(0.526)
6. Location	-1.320***
	(0.405)
7. Location	1.265***
	(0.472)
8. Location	3.852***
	(0.472)
9. Location	-0.298
	(0.543)
Constant	15.83***
	(0.452)
Observations	693
R-squared	0.159

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

2 *The Impact of Tax Education Program on Tax Awareness Based on Students' Familiarity with Taxation Concept*

Next, using the matching sample, we analyse the impact of tax education events on tax awareness by taking into account students' familiarity with taxation. We hypothesise that students with greater familiarity with taxation (greater access to taxation information) will benefit more from the tax education event. The reason is tax involves complex knowledge that might require time for students to understand. Prior knowledge and familiarity with tax concepts thus affect the effectiveness of a tax education program.

The results of our analysis are shown in Table 6. Our variable of interest is Post*Condition. We identified three conditions that represent students' familiarity with taxation, which are (1) familiarity with tax authority website, (2) having learned about taxation, and (3) having a family member that understands taxation.

Column 1 shows the results for familiarity with the tax authority website. We found that the increase in tax awareness is greater for students that are familiar with the tax authority website compared to other students. Similarly, column 2 shows that the increase in tax awareness is greater for students that have learned about taxation compared to other students. We, however, do not find a significant result for students who identified family members as the source of information about taxation. In general, our results indicate that the effectiveness of the tax education program is affected by students' familiarity with taxation. Our results thus indicate that a tax education program should involve a sequence of lessons that gradually shape students' understanding and awareness of taxation.

TABLE 6: REGRESSION RESULTS — CROSS-SECTIONAL VARIATION IN STUDENTS' PRIOR TAXATION KNOWLEDGE

CONDITION	(1)	(2)	(3)
		CONDITION	
	WEBSITE	LESSON	FAMILY
Post*Condition	0.219**	0.153**	-0.115
	(0.0965)	(0.0744)	(0.0775)
Post	-0.0177	-0.0618	0.111*
	(0.0400)	(0.0553)	(0.0631)
Male	-0.150***	-0.138***	-0.138***
	(0.0523)	(0.0522)	(0.0523)
High School	0.151***	0.153***	0.151***
	(0.0447)	(0.0453)	(0.0448)
Lesson	0.0508	-0.0114	0.0569
	(0.0391)	(0.0521)	(0.0384)
Family	0.0701*	0.0831**	0.145**
	(0.0393)	(0.0390)	(0.0580)
Website	0.0377	0.118***	0.137***
	(0.0601)	(0.0450)	(0.0445)
2. Location	-0.227**	-0.0363	-0.147*
	(0.0975)	(0.0956)	(0.0832)
3. Location	0.134***	0.135***	0.131***
	(0.0381)	(0.0509)	(0.0377)
4. Location	0.246***	0.241***	0.248***
	(0.0757)	(0.0790)	(0.0733)
6. Location	-0.0607	-0.0407	-0.0350
	(0.0542)	(0.0600)	(0.0507)
7. Location	0.358***	0.306***	0.352***
	(0.0512)	(0.0601)	(0.0526)
9. Location	0.127	0.139	0.135
	(0.0820)	(0.0881)	(0.0820)
Constant	-0.269***	-0.277***	-0.358***
	(0.0631)	(0.0698)	(0.0677)
Observations	294	294	294
R-squared	0.211	0.204	0.200

Robust standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

V CONCLUSION AND FUTURE RESEARCH

Our study is intended to analyse 'Patur', a tax education program in Indonesia. As the Indonesian government has been struggling to increase the country's tax ratio, a national tax education program is considered a key solution. This education program targets school children as future taxpayers and is intended to increase the students' tax awareness. In the long run, it is expected that tax awareness will be translated into tax compliance.

We conducted a pre- and post- survey on Patur program's participants in 2020. In our first analysis, we found that students' tax awareness levels changed after the Patur event. More specifically, we found that on average, students' tax awareness is higher after the Patur program. In our second analysis, we took into account students' access to taxation information to proxy students' familiarity with taxation. We found that the increase in tax awareness is greater for students that are familiar with tax authority website experience compared to other students. We also found the increase in tax awareness is greater for students that have learned about taxation compared to other students. In sum, our results indicate that the effectiveness of a tax education program will be affected by students' familiarity with taxation. Our results thus suggest that a continuous education program is necessary to increase tax awareness.

This study only focuses on the 2020 program that was conducted online. Further research can investigate the offline tax education program in the future to see whether there are any differences in the results between an online and an offline program. Moreover, the post-survey in this study was conducted right at the end of the event, while awareness can change over time. In order to investigate whether students' tax awareness changes since their participation in the tax education program, further studies may also conduct follow-up post-survey several months after the program. Furthermore, other than conducting survey, future studies may also employ other methods to examine students' tax awareness before and after a tax education program, such as interviews and focus group discussions. Although these methods might not be able to involve more participants than a survey, these methods allow researchers to explore students' views on taxation more deeply. On top of the above, further research also can be conducted on the broader context of the Indonesian Tax Awareness Inclusion program, whether in the primary level, secondary level, or university level of education. Lastly, this study focuses on the Indonesian tax education program. Further research discussing a comparison between the Indonesian tax education program and tax education programs in other countries would be beneficial to understand how different institutional setting affects the effectiveness of a tax education program. Future studies focusing on other countries would benefit tax educators and regulators to understand the variety of tax education program among countries.

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