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ABOUT THE JOURNAL

The Journal of Tax Administration (JOTA) is a peer-reviewed, open access journal concerned with all aspects of tax administration. Initiated in 2014, it is a joint venture between the University of Exeter and the Chartered Institute of Taxation (CIOT).

JOTA provides an interdisciplinary forum for research on all aspects of tax administration. Research in this area is currently widely dispersed across a range of outlets, making it difficult to keep abreast of. Tax administration can also be approached from a variety of perspectives including, but not limited to, accounting, economics, psychology, sociology, and law. JOTA seeks to bring together these disparate perspectives within a single source to engender more nuanced debate about this significant aspect of socio-economic relations. Submissions are welcome from both researchers and practitioners on tax compliance, tax authority organisation and functioning, comparative tax administration and global developments.

The editorial team welcomes a wide variety of methodological approaches, including analytical modelling, archival, experimental, survey, qualitative, and descriptive approaches. Submitted papers are subjected to a rigorous blind peer review process.

SUBMISSION OF PAPERS

In preparing papers for submission to the journal, authors are requested to bear in mind the diverse readership, which includes academics from a wide range of disciplinary backgrounds, tax policymakers and administrators, and tax practitioners. Technical and methodological discussion should be tailored accordingly and lengthy mathematical derivations, if any, should be located in appendices.

MESSAGE FROM THE CHARTERED INSITUTE OF TAXATION

The Chartered Institute of Taxation is an education charity with a remit to advance public education in, and the promotion of, the study of the administration and practice of taxation. Although we are best known for the professional examinations for our members, we have also supported the academic study of taxation for many years and are pleased to widen that support with our involvement with this journal.

WEBSITE

The Journal of Tax Administration website can be found here: www.jota.website

SOCIAL MEDIA

We also have a Twitter account: https://twitter.com/jotajournal

EDITORIAL NOTE

This issue of JOTA presents a collection of research articles, practitioners' commentaries, and reviews. It also includes a section featuring research at the Chartered Institute of Taxation (CIOT).

The paper by Ferry, Chris Evans, and Binh Tran-Nam considers whether the introduction of presumptive income tax regimes for small and medium-sized enterprises (SMEs) can help to reduce the tax compliance costs that these businesses face. Considering Indonesia in 2019, the authors find that the use of such regimes can have a beneficial effect on such businesses. In particular, presumptive taxation significantly reduces explicit costs, and the psychological costs caused by tax disputes.

Chidozie Chukwudumogu analyses the implications for corporate taxation of three recent blueprints for destination-based taxation of profit—the OECD blueprint, the UN blueprint, and the destination-based cash-flow tax (DBCFT) blueprint. He argues that the implications will include the expansion of the source principle; diverging unilateral actions; avertible costs; and the risk of negative distributional impacts across countries.

The article by S. A. Mohan considers the Income Tax Appellate Tribunal (ITAT) in India, and the challenges to its adjudicatory function and its independence from proposed reforms of its operating procedures. The article stresses the need for reforms of the ITAT and gives recommendations as to the form these should take.

Omar Faruq Khan and co-authors investigate tax expenditure reporting in developing countries, with a case study for Bangladesh. Much of these tax expenditures are applied opaquely, mainly due to the unavailability of tax expenditure data. The authors quantify the extent of such expenditures in Bangladesh and propose recommendations for the reform of the tax expenditure policies of emerging economies like Bangladesh.

The paper by Tracy Gutuza considers the use of tax rulings by the South African tax authorities as a tool to provide legal and commercial certainty. The article focusses on areas in which the interpretation of tax law has been disputed either by taxpayers or the tax authority. The article finds that tax rulings and other South African tax administration publications play an important role in promoting certainty, even where the interpretation set out in the ruling is disputed.

In the final paper of the section, Daniel Taborda and António Martins ask how tax authorities can improve the success rate of their transfer pricing litigation. In Portugal, the focus of the article, the tax authority prevailed in just seven cases out of 52 between 2011 and 2019. The authors analyse six cases in detail to draw recommendations for improving rates of success. These include the need for changes to performance metrics, careful planning for transfer pricing audits, analysis of comparability issues in auditing work, and the dissemination of best practices in audit and litigation procedures.

A second analysis of presumptive taxation is to be found in the Commentary section, where Joel Mmasa considers its impact on household income distribution and poverty alleviation in Tanzania. Using a microsimulation model, the paper predicts that reforms to introduce presumptive taxation would result in increases in tax revenue and reduced inequality in household income.

In the CIOT section, Phyllis Alexander and co-authors investigate the determinants of tax awareness, tax literacy, and tax morale of young adults in the United Kingdom. These issues have grown in salience with policy increasingly focussing on the individual's responsibility to engage with taxpaying obligations and, at the same time, providing less state support and assistance. Using a bespoke two-stage qualitative survey, the authors find that gender, tax tuition, and employment experience significantly influence tax morale.

In the reviews section, Felix Wilson and Lynne Oats of the University of Exeter provide a timely review of the recent literature on a range of topics in tax administration, including tax morale and attitudes, tax compliance, and the tax profession.

Matthew Rablen and Stephen Daly
Managing Editors

PRESUMPTIVE INCOME TAXES AND TAX COMPLIANCE COSTS: POLICY IMPLICATIONS FOR SMALL AND MEDIUM-SIZED ENTERPRISES IN EMERGING ECONOMIES

Ferry[1], Christopher Charles Evans[2], Binh Tran-Nam[3]

Abstract

It has been suggested that the introduction of presumptive income tax regimes for small and medium-sized enterprises (SMEs) can help to reduce the tax compliance costs that these businesses face. Little evidence, however, is available to help us to evaluate whether this is indeed the case. This article discusses how a presumptive tax regime may impact upon the tax compliance costs of SMEs operated by individuals (individual SMEs) in Indonesia in 2019 and suggests that the use of such regimes can have a beneficial effect on such businesses. It considers all components of tax compliance costs, including explicit, implicit, and psychological costs. By applying a mixed-modes research method, two main findings are highlighted. First, the presumptive tax significantly reduces explicit costs, although it does not appear to influence the implicit and psychological costs incurred by individual SMEs in Indonesia. Secondly, the combination of explicit and implicit costs indirectly affects the psychological costs through the existence of tax disputes and tax stressors. Not only do the results provide us with a new understanding of aspects of tax compliance costs, they show how the components of the costs interact with each other. While the empirical application is country-specific, the conceptual framework developed in the study does not exclusively relate to taxpayers in Indonesia and can be applied to other countries or in other public regulation studies.

Keywords: Tax Compliance Costs, Presumptive Taxes, Small and Medium-Sized Enterprises, Mediating Effects, Opportunity Costs, Psychological Costs.

JEL classification: H21; H24; H25

1. INTRODUCTION

Small and medium-sized enterprises (SMEs) play a vital role in global economies. They comprise roughly 90% of the total number of enterprises and create more than 50% of employment worldwide (The World Bank, n.d.). As a result of their significant contributions, there has been considerable debate as to what may constitute the best policies to support SMEs' growth, with options including easy access to finance, simple entry regulations, and the development of a conducive tax environment (Beck et al., 2005; Engelschalk, 2005). It has been argued that the tax environment is the most challenging policy setting for any government, particularly in developing countries, where the work of tax authorities can be characterised by

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ineffective tax management, weak tax enforcement, large shadow economies,[4] and poor tax compliance (Awasthi & Engelschalk, 2018).

For these reasons, tax administrations in many emerging economies have introduced presumptive tax regimes[5] as an alternative way to tax SMEs (Engelschalk & Loeprick, 2016). In addition, given the practical and convenient nature of such regimes (Haque, 2013), the presumptive tax has often been considered to be a relevant policy measure, as the use of it can lead to reduced tax compliance costs for SMEs (Jaramillo, 2003).

Tax compliance costs are defined as the costs borne by taxpayers or other third parties in complying with their tax obligations (Sandford et al., 1989). These costs typically take various forms and may be explicit, in the form of monetary costs (such as payments made in return for guidance from a tax adviser) or implicit, in the form of time costs (such as those incurred when taxpayers or their unpaid helpers devote their time to comply with tax regulations). There may also be psychological costs, which include the stress, anxiety, and frustration experienced by individual taxpayers when complying with their tax obligations (Sandford et al., 1989).

This study considers the compliance costs incurred by SMEs in Indonesia and whether or not the tax compliance costs that arise from the presumptive tax regime available to SMEs are less than those that arise under the more conventional regimes for the taxation of SMEs.

SMEs in Indonesia contribute 63% to the Gross Domestic Product (GDP) and comprised 99.99% of the country's total enterprises in 2018 (OECD, 2020). To facilitate SMEs' participation in the tax system, a presumptive tax regime based on annual turnover was established in 2013 (The Government of the Republic of Indonesia, 2013). The government imposes a final tax rate limited to businesses that generate income of up to Rp4.8 billion (around US$320,595) per year.[6] Any SME with an annual income that falls below the threshold has the opportunity to select the tax regime they want to use (the presumptive or the conventional tax) whereas those with annual incomes on or above the threshold must apply the conventional tax.

Individual taxpayers, whether operating under the presumptive or the conventional regime, are by far the largest group (91% in 2018) of all taxpayers in Indonesia (Direktorat Jenderal Pajak, 2019), and so SMEs operated by individuals (individual SMEs)[7] in Indonesia have been chosen as the subject of the study.

This article compares the tax compliance costs that arise under the two different tax regimes (presumptive and conventional) for individual SMEs in Indonesia. The comparison considers the various elements of those tax compliance costs (including monetary, time, and psychological components), measures and evaluates those costs, and explores the key factors (e.g. tax law complexity or tax administrative requirements) that give rise to such costs.
To initiate the comparison, it is useful to provide some brief information about the choices faced by SMEs in Indonesia in 2019. The presumptive tax applies a single tax rate at 0.5% of

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[4] According to Schneider and Enste (2013), the shadow economy comprises all unreported economic activities that would generally be taxable were they reported to the tax authorities. Other terms for this include the informal, hidden, black, underground, grey, clandestine, illegal, and parallel economy (see Fleming et al., 2000).
[5] A presumptive tax is commonly a proxy for a regular or conventional tax (Pashev, 2006) that involves the use of some convenient alternative basis for estimating tax liability (Thuronyi, 2005).
[6] Exchange rate on 25 January 2023: US$1 = Rp14,972.15.
[7] A more familiar term in Australia and other countries for a business operated by an individual is "sole trader".

the annual turnover and, hence, taxpayers who choose this option are able to easily calculate tax liabilities by multiplying 0.5% of their turnovers. In contrast, the conventional tax applies progressive tax rates with respect to taxable income. As a result, taxpayers who select the conventional tax must complete a series of computations in order to determine their tax liabilities. The calculation involves reducing total income by reference to relevant deductible expenses, together with a tax-free threshold, in order to derive the taxable income. Taxpayers then need to identify the conventional tax rate applied to each income bracket of the taxable income so that the tax liabilities can be determined. For illustration, the tax rates for individual taxpayers are: 5% for those with taxable incomes of up to Rp50 million (around US$3,340); 15% for those with taxable incomes of above Rp50 million and up to Rp250 million; 25% for those with taxable incomes of above Rp250 million and up to Rp500 million; and 30% for those with taxable incomes above Rp500 million (around US$33,395).

The study is motivated by three growing concerns. First, it is evident that the presumptive tax regime has, as an alternative form of taxation, gained the interest of many policymakers and researchers from different tax administrations and various countries. However, efforts to evaluate the tax compliance cost implications of presumptive tax regimes are somewhat limited. Secondly, although considerable research has been undertaken into tax compliance costs, research that specifically examines the tax compliance costs of individual SMEs in Indonesia by reference to the presumptive and conventional tax regimes has not, to our knowledge, been undertaken. Moreover, such research, examining the impact of the alternative tax regimes, could be used as a reference point for the enhancement of the quality of public management and to improve tax policy settings in relation to the implementation of the presumptive tax regime.

Thirdly and finally, this study presents a broader perspective on tax compliance costs than is usually considered, providing a more consistently sustained analysis of the opportunity costs (both explicit and implicit tax compliance costs) and paying closer attention to the psychological costs. In particular, the study attempts to clarify the process by which the opportunity costs inform the psychological costs. This is crucial as the link between those two variables has been the subject of relatively little research.

2. THEORETICAL FRAMEWORK AND LITERATURE

Presumptive Taxes

As noted by Ahmad and Stern (1991), “the term presumptive taxation covers a number of procedures under which the ‘desired’ base for taxation (direct or indirect) is not itself measured but is inferred from some simple indicators which are more easily measured than the base itself” (p. 276). Presumptive taxes have a long history: early examples of the taxes date back to the sixteenth century in the form of hearth and window taxes (Oates & Schwab, 2015). They can, broadly, be classified into four categories: obvious signs of wealth; the value of specific assets or net wealth; estimated assessment methods; and gross turnovers (Tanzi & de Jantscher, 1987). The first three types of presumptive taxes have proved to be problematic in practice and so have not been widely used in recent years (Thomas, 2013). Consequently, only the last type has been widely used, given the obvious advantages such as minimal compliance obligations, relatively straightforward application, and the capacity to be universally recognised by even a small business taxpayer (The World Bank Group, 2007).

Presumptive taxes were designed to help small business taxpayers to meet their tax obligations (Terkper, 2003) and, in particular, to overcome their limitations in maintaining record-keeping practices (Evans et al., 2005). However, weak tax administration and the poor design of the presumptive taxes may cause inefficiency and higher compliance costs, as noted, for example, in Kenya (Ogembo, 2019), Pakistan (Memon, 2013), Ukraine (Serbinenko, 2016), and Zimbabwe (Dube & Casale, 2017). Furthermore, the regime may not necessarily improve SME compliance behaviour to any substantial extent or generate adequate tax revenue (Verberne & Arendsen, 2019).

In response, tax administrations have sought to improve their capacity to detect any non-compliance, for example: through the use of third-party reporting information, particularly when taxpayers use non-cash sales or electronic payment methods (Thomas, 2013);[8] by stipulating a specific period for taxpayers to be able to use the presumptive tax regime before being obliged to switch to the conventional tax regime (Bird & Wallace, 2005);[9] and through the judicious use of exemption thresholds in the implementation of presumptive tax regimes (Rajaraman, 1995).

In the case of Indonesia, individual SMEs are permitted a maximum period of seven years during which they can stay within the presumptive tax regime (The Government of the Republic of Indonesia, 2018).[10] An additional initiative for those who adhere to the presumptive tax was introduced in 2022: exemption from the tax when their annual income falls below Rp500 million or around US$33,395 (The Government of the Republic of Indonesia, 2021).

Tax Compliance Costs

Taxation inadvertently creates additional costs to the economy, including efficiency and operating costs. Efficiency costs are, broadly, those deadweight losses to society that occur when taxpayers change behaviour because of the tax burden, for example, through evasion, avoidance, and substitution toward other products or activities taxed at lower rates (Slemrod & Yitzhaki, 1996). Operating costs (Stiglitz & Rosenberg, 2015) involve administrative costs (costs incurred by revenue authorities when administering the tax system) and compliance costs (costs incurred by taxpayers in complying with their tax obligations).

This study focusses on compliance costs, which may be opportunity costs or psychological costs. Based on the nature of the costs, opportunity costs can be further classified as either explicit costs, such as payments made to hire tax advisers and remuneration paid to employees for dealing with the tax affairs of the business, or implicit costs, such the value of the time spent by business owners or their family and friends in order to complete the tax activities

[8] It has been argued that developed countries use third-party reporting information effectively to assist them in collecting tax revenues (see Kleven et al., 2016) whereas developing countries have limited capacity to collect such third-party reporting information. Consequently, developing countries have suffered the most as a result of the problems arising from the existence of the shadow economy (Besley & Persson, 2014).

[9] Bird & Wallace (2005) argue that the simplicity of the presumptive tax does not encourage taxpayers to develop effectively because they do not need to adopt appropriate record-keeping and accounting systems, as would normally be required under the conventional tax regime.

[10] The maximum period of seven years has been applied since the enactment of the rule (1 July 2018 - 30 June 2025).

(Tran-Nam et al., 2000).[11] Psychological costs refer to the perceived stress and anxiety that may arise when complying with tax law.

The article now explores the empirical literature related to tax compliance costs by reference to four broad thematic questions: what was the focus of the studies; where was the research conducted; how was the research conducted; and what were the key findings of the research?

Tax compliance costs research has covered a wide range of topics. It has considered not only a variety of taxes, such as personal income taxes (PIT) (Stark & Smulders, 2019), corporate income taxes (CIT) (Ariff et al., 1997), and value-added taxes (VAT) (Yesegat et al., 2017), but also various types of entity such as business taxpayers (Chunhachatrachai & Pope, 2012), non-business taxpayers (Chattopadhyay & Das-Gupta, 2002), employers (Godwin & Lawson, 2009), and tax practitioners (Smulders & Stiglingh, 2008).

In terms of its geographical spread, the study of compliance costs has gradually developed through three stages: first in North America during the 1930s to 1960s (Haig, 1935; Johnston, 1963); second,—the European phase—during the 1960s and early 1970s (Sandford, 1973; Strümpel, 1966); and the final international phase after the 1980s. The latter phase can be further subdivided into two sub-phases: research in developed countries (Diaz & Delgado, 1995) and research in developing countries (Shekidele, 1999). Thus, the spread of empirical applications of tax compliance cost research has become worldwide in scope over the years. Interestingly, international comparative studies have been growing in number (Cordova-Novion & De Young, 2001) despite concerns that international comparison should be conducted cautiously (Sandford, 1994).

Tax compliance costs studies have applied the full range of data collection and analysis methods, including survey studies: either questionnaires or interviews (Susila & Pope, 2012); time motion or case studies (Tran-Nam & Glover, 2002); archival research (Sandford et al., 1981); experimentation (Woellner et al., 2007); and simulations or modelling (Benzarti, 2020).

It is, therefore, a challenging task to summarise the key findings from all of the tax compliance costs literature that has taken place over time. The challenge arises because of the differences in the broad range and coverage of the studies and research designs. Nonetheless, three distinct broad findings of consensus have emerged from the literature: first, that tax compliance costs are significant (Chunhachatrachai, 2013); secondly, that they are regressive (Eragbhe & Modugu, 2014); and finally, that they are not decreasing over time (Slemrod, 2006).

Research Question and Hypotheses

From this brief analysis of the literature relating to the presumptive tax and tax compliance costs, we hypothesise that individual SMEs who applied the presumptive tax regime would incur, respectively, lower explicit costs (H1), lower implicit costs (H2), and lower psychological costs (H3). To detect the possibility of spurious associations, control variables,[12]

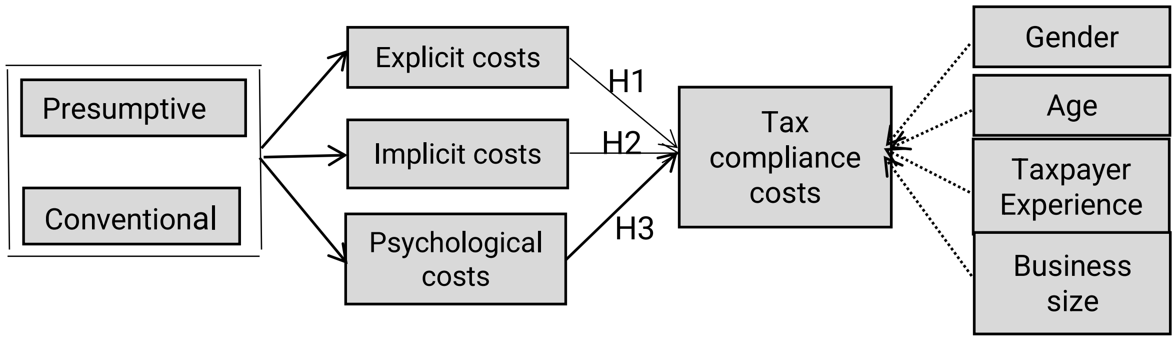
[11] Incidental expenses (non-labour costs for equipment and stationery etc.) are excluded in this study. In small businesses, the exclusion has been argued to be reasonable when the costs might only represent a miniscule portion of the total compliance costs (Allers, 1994).

[12] Aguinis and Vandenberg (2014) argue that control variables must have the following characteristics: robust conceptual explanations of why the variables were selected; robust conceptual explanations of how the variables may affect the predicted outcomes as well as the hypothesised correlations among them; and robust evidence related to the psychometric measurements.

such as gender, age, taxpayer experience, and business size, are included in the analysis (Blaufus et al., 2019).[13]

Figure 1 provides a summary representation of this conceptual model.

Figure 1: Conceptual Model of the Study



Source: Ferry (2022. p. 175).

The following additional hypotheses evaluate an underexplored aspect of tax compliance costs in the literature—the psychological costs of tax compliance.

Opportunity Costs and Psychological Costs

Estimating the association between opportunity costs and psychological costs, a priori it would appear to be justifiable to argue that the former might be capable of influencing the latter. The measures of opportunity costs and psychological burdens, respectively developed by Evans et al. (1997) and S. Cohen et al. (1983), are revised in this current study. Hence the following hypothesis is derived:

> Opportunity costs are positively correlated with the psychological costs of individual SMEs in Indonesia (H4).

The Mediating Role of Tax Stressors

Tax stressors refer to those continuous physical and psychological efforts related to tax compliance which may cause cognitive and emotional disturbance to taxpayers. Like the psychological burdens faced by entrepreneurs that are derived from the demands of the roles that they adopt as businesspersons (Shepherd et al., 2010), the psychological compliance burdens of taxpayers are derived from the tasks imposed upon them by the tax system. Some of the tax stressors are record-keeping for tax purposes and undertaking administration obligations related to tax compliance (Alexander et al., 2005).

[13] While gender has rarely been discussed in compliance costs studies, it has been considered to a far greater extent in the study of psychological burdens in general (Cohen & Janicki-Deverts, 2012).

It is therefore anticipated that opportunity costs give rise to tax stressors, which will eventually increase the psychological costs. Thus, opportunity costs also indirectly affect psychological compliance costs via the mediating variable,[14] tax stressors.

> The effect of opportunity costs on psychological costs of individual SMEs in Indonesia is mediated by tax stressors (H5).

The Mediating Role of Tax Disputes

The study further considers the role played by tax disputes in tax compliance costs, which represents an often-neglected aspect of tax compliance cost studies. As shown in the literature (Tran-Nam & Walpole, 2016), tax disputes can raise the level of tax compliance costs, including both opportunity and psychological costs, substantially. Given the critical role that tax disputes can play in the interaction between the tax revenue authority and taxpayers (Gangl et al., 2015), there is a possibility that tax disputes mediate the impact of opportunity costs on psychological costs.

Hence, a final hypothesis is posited, based upon the assumption that a tax dispute may mediate the indirect effect of opportunity costs on psychological costs.

> The effect of opportunity costs on psychological costs of individual SMEs in Indonesia is mediated by tax disputes (H6).

3. RESEARCH DESIGN AND DATA COLLECTION

In order to analyse tax compliance costs comprehensively and address the formulated hypotheses, the article adopts a positivist research framework and uses a mixed-methods approach (Creswell & Clark, 2017). It also applies two sequential approaches (qualitative —> quantitative) in collecting primary data via focus group discussions (FGDs) and surveys. The former is utilised to explore the psychological costs and to inform the development of the survey instrument (Molina-Azorín, 2011) whereas the latter is adopted to analyse the opportunity cost variables and the proposed multi-mediator model of psychological costs (Marcoulides & Falk, 2018).

Given the complex nature of the subject matter of the study, FGDs were used not only to assess taxpayers' attitudes towards and opinions about tax compliance costs, but also in order to establish a clear understanding of the broader context of the compliance costs burden faced by individual SMEs in Indonesia (Carey & Asbury, 2016).

Nine participants, comprising six tax advisers and three taxpayers, attended two FGDs in January and February 2020. They worked in Surabaya (a major city in East Java Province) and ranged in years of professional experience from 11 to 34 [mean (M) = 20; standard deviation (SD) = 6.9 years].

Based on the analysis from the FGDs, some of the survey questions (see Appendix 1 for a copy of the full questionnaire) were updated in order to better address the research questions―for example: Q52, Q58, Q59, and Q60 (tax enquiries).

[14] Mediation occurs when the effect of a predictor (X) on an outcome (Y) is transferred through a mediator variable (Baron & Kenny, 1986). Specifically, a mediator (M) explains why or how a correlation occurs between a predictor and an outcome (Hayes, 2018).

Prior to running the main survey that comprised the second phase of the study, pilot testing was conducted to establish content validity by evaluating the completion time, ensuring clarity, and enabling necessary improvements to be made to the main survey (de Vaus, 2014). The pilot survey was conducted in March 2020 with a mixed group of tax officers and individual SMEs.[15] The former were asked to respond as if they were managing their own businesses whereas the latter were not provided with any hint of the context in order to check the clarity of the survey.

The pilot survey confirmed that the survey had no problematic issues in relation to its contents and took a reasonable time to complete of between five to twenty minutes (M=9.3; SD=2.8). The internal reliability of the survey was tested using Cronbach's alpha (Cronbach, 1951) with results varying from 0.87 to 0.99 (M=0.95; SD=0.06). The results suggested that the questionnaire had robust reliability and was promising for further utilisation.

Another important consideration in ensuring that the study generated robust data related to sample size planning (MacCallum et al., 1996). Careful reviews revealed that the population under study was approximately two million individual SMEs and a minimum sample of 210 respondents was therefore required (J. Cohen, 1988).[16]

Individual SME owners in four provinces (Jakarta, West Java, Central Java, and East Java) in Indonesia were selected as potential sample respondents. Businesses from these provinces typically contributed more than half of the tax revenue collection from SMEs during the period 2013 to 2019. An equal number of taxpayers from both forms of tax regime (presumptive and conventional), representative of various business sectors of taxpayers, were targeted for the sample.

The questionnaire was administered as an e-survey.[17] To mitigate some of the issues that can be associated with e-surveys (Couper, 2008), the questionnaire had a straightforward design, with clear directions and brief, simple language (Dillman et al., 2014). The survey only allowed single responses and most of the attitudinal questions provided five answer "Likert" options (Likert et al., 1934).

During the three-month distribution period, 491 taxpayers responded to the survey. The questionnaire also informed potential respondents that they could leave the survey at any time and 265 respondents exercised this option, exiting prior to completion. A further 94 respondents did not satisfy the inclusion criteria, yielding a total of 132 complete and useable responses. Due to the limited responses, this paper includes effect size and power analysis (J. Cohen, 2013; Cumming, 2012) in each test of the hypothesis to ensure the validity and reliability of the results.

To analyse the collected data, the programs JASP, Lavaan, and G*Power were applied (Faul et al., 2009; Goss-Sampson, 2022; Rosseel, 2012). Preliminary analyses indicated that the data was free of non-response bias, but exhibited non-normal distribution (Armstrong & Overton,

[15] Ideally, pilot testing would have been undertaken among individual SMEs that were representative of the participants in the main survey. However, this was not feasible as a result of the COVID-19 pandemic.

[16] The study used G*Power (Faul et al., 2009), a versatile program that is available for free (www.gpower.hhu.de/en.html).

[17] The study used the Research Electronic Data Capture (REDCap) application to distribute the e-survey (Wright, 2016) during the period from July to October 2020. The DGT helped us to obtain a random list of individual SMEs' email addresses so that potential respondents could be contacted.

1977; Shapiro & Wilk, 1965). As a result, the study combined parametric and non-parametric approaches (Gibbons & Chakraborti, 2014; Tabachnick & Fidell, 2013).

These approaches included running Student's t-test, a Kruskal-Wallis analysis, and a regression analysis to test H1 to H3 (Kruskal & Wallis, 1952; Legendre, 1805; Student, 1908). The remaining three hypotheses were tested by applying structural equation modeling (SEM) with bootstrapping (Efron & Tibshirani, 1993).[18]

4. RESULTS

Key attributes of the 132 respondents, including demographic, business, and tax complexity perception, are presented in Table 1. As noted from the percentages in the right-hand column of the table, which identifies the proportion of any attribute of the respected row, the respondents were dominated by taxpayers who use the presumptive tax, are male, are aged between 36-55, and who completed a university education.

Table 2 shows the construction of the key dependent variables, such as the implicit, explicit, and psychological costs of tax compliance, as well as the definitions of these variables and the range of values recorded.

Measures

Opportunity costs were assessed using five items developed by Evans et al. (1997). Using a five-point scale ranging from 1 (less costly range of monetary units) to 5 (very costly range of monetary units), participants were asked to indicate the costs that they had incurred in the previous tax year as a result of complying with their tax obligations. A sample item was: "Please estimate the total payment (IDR) for the tax services (tax adviser) during the period January to December 2019." The coefficient alpha was 0.67.

Tax stressors were assessed using nine items motivated by the Job Demands–Resources (JD–R) model (Demerouti et al., 2001). In line with the literature on tax compliance, we combined a series of tax obligation activities, such as preparing and lodging tax returns (Yong, 2011). We then asked respondents to indicate how stressful they found these activities on a five-point scale ranging from 1 (not at all stressful) to 5 (extremely stressful). A sample item was: "Please indicate how stressful you would find lodging tax returns." The coefficient alpha was 0.93.

Tax disputes were assessed using four items informed by the FGD results. Following Eichfelder and Kegels (2014), we developed one item of the incidence of being audited by the tax revenue authority or lodging an objection/appeal, and three items of general interaction between the taxpayer and the tax office. A sample item of the interaction was: "Please indicate how often you have been asked for additional data related to your tax returns." Respondents were then asked to indicate their answers on a five-point scale ranging from 1 (never) to 5 (very often). The coefficient alpha was 0.79.

Psychological costs were assessed using ten items inspired by the Perceived Stress Scale (S. Cohen et al., 1983). Respondents were asked to indicate, on a five-point scale ranging from 1 (never) to 5 (very often), the perceived stress associated with managing their tax affairs. A

[18] Bootstrapping has been considered as a non-parametric technique by repeating the random sample to allow an appropriate estimation of the sampling distribution (Bollen & Stine, 1992).

sample item was: "Please indicate how often you experienced nervousness and stress because of the tax matters." The coefficient alpha was 0.85.

Table 1: Demographics, Business, and Tax Compliance Attributes of Respondents

	Attribute	Conventional	Presumptive	Percentage
Gender	Male	31	55	65
	Female	22	24	35
Age range	18 – 25	3	6	7
	26 – 35	8	27	27
	36 – 45	20	27	36
	46 – 55	17	15	24
	56 and above	5	4	7
Education	Primary school	2	1	2
	High school	4	12	12
	Vocational	5	10	11
	University	42	56	74
Business turnover	<= 500 million	21	47	52
	< 500 million - 1 billion	7	21	21
	< 1 billion - 2 billion	8	8	12
	< 2 billion - 4.8 billion	6	3	7
	> 4.8 billion	11	0	8
Financial reports	None	21	44	49
	Available	32	35	51
Tax experience	Less than a year	1	5	5
	1 - 2 years	10	23	25
	3 - 5 years	19	23	32
	6 - 10 years	13	16	22
	> 10 years	10	12	17
Tax adviser	None	32	68	76
	Available	21	11	24
Tax dispute	None	36	60	73
	Available	17	19	27
Perceived tax complexity	Not at all complicated	4	11	11
	Slightly complicated	16	26	32
	Moderately complicated	21	22	33
	Very complicated	8	17	19
	Extremely complicated	4	3	5

Table 2: Constructs of Implicit, Explicit, and Psychological Costs of Tax Compliance

	Measurement	Items in the Questionnaire°	Range of Value**
Implicit costs	Time costs of business owners, paid employees*, and unpaid helpers	Q29	1 to 5
Explicit costs	Tax adviser costs (excluding tax auditing, objection, and appeal) +	Q32	1 to 5
	Tax adviser costs when dealing with tax auditing +	Q34	1 to 5
	Tax adviser costs when lodging tax objections +	Q36	1 to 5
	Tax adviser costs when submitting tax appeals	Q38	1 to 5
Opportunity costs/ Gross tax compliance costs	Implicit costs + Explicit costs	Q29 + Q32 + Q34 + Q36 + Q38	
Tax compliance costs (net)	Opportunity costs +	Q29 + Q32 + Q34 + Q36 + Q38 +	
	Estimated compensatory payment for tax stressors –	Q56 –	1 to 5
	Recognised value of managerial benefits	Q46	1 to 5
Psychological costs***	Incidence of perceived psychological burdens when dealing with tax affairs	Q64 + Q65 + Q66 + Q67 + Q68 + Q69 + Q70 + Q71 + Q72 + Q73	1 to 5 ****

Notes:
° See the complete questionnaire in Appendix 1.
* Strictly speaking, the time costs of paid employees are explicit costs. However, for ease of data collection, payments to employees were included in time costs. Thus, the definition of implicit costs in this article was somewhat broader than purely implicit costs.
** Excluding psychological costs, the range of value options of the implicit, explicit, gross tax compliance, and net tax compliance costs are: 1 (0 to IDR50 mil), 2 (above IDR50 mil to 100 mil), 3 (above IDR100 mil to 150 mil), 4 (above IDR150 mil to 200 mil), 5 (above IDR200 mil).
*** Reverse-order points for Q67, Q68, Q70 and Q71 to mitigate response biases: the respondents' tendencies to respond systematically on different bases than the intended measurement designs (Paulhus, 1991).
**** 1 (never), 2 (almost never), 3 (sometimes), 4 (fairly often), 5 (very often).

Table 3 provides summary statistics of the construct measure. It can be seen that the maximum and average values of implicit costs for presumptive regime taxpayers were 3 and 1.23 respectively, whereas the corresponding values for conventional regime taxpayers were 5 and 1.47 respectively. Considering that each unit response in the tax compliance costs survey represents IDR50 million (see Appendix 1), those values indicate that the maximum and average implicit costs of tax compliance by presumptive regime taxpayers were IDR150 million (3 x IDR50 million) and IDR61.5 million (1.23 x IDR50 million) respectively. By way of comparison, the corresponding values for conventional regime taxpayers were IDR25 million (5 x IDR50 million) and 73.5 million (1.47 x IDR50 million) respectively. Similar interpretations apply for the explicit, opportunity, and tax compliance costs.

Respectively, the psychological costs of tax compliance for presumptive and conventional regime taxpayers exhibited a small difference with regard to the average of the psychological disturbance (24.47 compared to 25.47). These numbers indicated that, on average, the psychological costs of presumptive regime taxpayers and those of conventional regime taxpayers were roughly similar.

Table 3: Summary Statistics of Implicit, Explicit, and Psychological Costs of Tax Compliance

	Min	Med	Max	Mean	SD
Implicit costs = Q29					
Presumptive	1	1	3	1.23	0.51
Conventional	1	1	5	1.47	0.93
All	1	1	5	1.33	0.72
Explicit costs = Q32 + Q34 + Q36 + 38					
Presumptive	0	0	10	0.72	1.58
Conventional	1	2	10	2.15	1.57
All	0	1	10	1.30	1.72
Opportunity costs = Q29 + Q32 + Q34 + Q36 + Q38 (Gross tax compliance costs)					
Presumptive	1	1	13	1.95	1.91
Conventional	2	3	14	3.62	2.20
All	1	2	14	2.62	1.89
Tax compliance costs (net) = Q29 + Q32 + Q34 + Q36 + Q38 + Q56 − Q46					
Presumptive	0	1	10	2.32	2.02
Conventional	2	4	14	4.47	2.69
All	0	2	14	3.18	2.54
Psychological = sum(Q64:Q73)*					
Presumptive	10	26	43	24.47	6.47
Conventional	10	26	44	25.47	7.17
All	10	26	44	24.87	6.75

Note: * Reverse-order points for Q67, Q68, Q70, and Q71.

The data was confirmed to be free from extreme multicollinearity, as the correlation coefficients (see Appendix 2) among the potential predictors are less than 0.8 (Benesty, 2009). The internal reliability was also satisfied, as the Cronbach's alpha of the measured constructs is ± 0.7 (Hair et al., 2014).

Focusing on three key variables under study, namely the explicit, implicit, and psychological costs, it is interesting to determine whether the difference in the mean of each of these variables between the two groups of taxpayers (presumptive regime and conventional regime) is statistically significant. To this end, various t-tests for differences between means were performed and the results are summarised in Table 4.

Table 4: Student's t-test Results

Construct	*t* (df)	p-value	Effect size	Power
Explicit (**H1**)	5.1(130)	<.001***	0.907	0.99
Implicit (**H2**)	1.9(130)	0.027*	0.345	0.49
Psychological (**H3**)	0.8(130)	0.202	0.148	–

Note: * p <.05, ** p <.01, *** p <.001.

The results in Table 3 indicate that, expectedly, the mean values of the explicit, implicit, and psychological costs for conventional regime taxpayers are higher than the respective means for presumptive regime taxpayers. Furthermore, and as shown in Table 4, the differences in the mean values of both explicit and implicit costs between the two types of taxpayer are statistically significant, i.e. on average, conventional regime taxpayers incur significantly higher explicit and implicit tax compliance costs than presumptive taxpayers. However, the difference in the mean value of psychological costs between the two taxpayer groups is not significant, i.e. the overall stress levels appear to be the same for both groups.

Note that, in the above analysis, the control variables are allowed to vary between the two taxpayer groups. To test H1, H2, and H3, it was necessary to determine the partial effect of tax regime selection on tax compliance costs, holding all control variables constant. To that end, three multiple regression analyses were performed, using the explicit, implicit, and psychological costs as dependent variables. Each of these dependent variables was, in turn, regressed on the tax regime choice (as the independent variable), controlling for gender, age, education, experience, and business size where the tax regime choice variable is a binary dummy (0 = presumptive tax regime; 1 = conventional tax regime). The results on the estimated coefficient of the tax regime choice variable are reported in Table 5 (see Appendix 3 for more complete information).

Table 5: Regression Analysis Results: Tax Regime as the Independent Variable

Dependent variable	Estimate	Std. Error	z-value	p-value	CI lower	CI upper
Explicit (**H1**)	0.984	0.197	4.982	0.000***	0.597	1.371
Implicit (**H2**)	0.137	0.12	1.138	0.255	-0.099	0.373
Psychological (**H3**)	-0.265	1.154	-0.23	0.818	-2.526	1.996

Note: * p <.05, ** p <.01, *** p <.001.

In the case of explicit costs, the estimated coefficient of the tax regime variable has the correct sign and is statistically significant. We thus accept H1, i.e. with all other things being equal, conventional regime taxpayers incur significantly higher explicit tax compliance costs than presumptive regime taxpayers. In the case of implicit costs, the estimated coefficient of the tax regime variable has the correct sign but is statistically insignificant. H2 is therefore not accepted, i.e. with all other things being equal, conventional regime taxpayers incur higher implicit tax compliance costs than presumptive regime taxpayers, but the difference is not statistically significant. In the case of psychological costs, the estimated coefficient of the tax regime variable has the incorrect sign and is statistically insignificant. H3 is therefore rejected, i.e. with all other things being equal, conventional and presumptive regime taxpayers suffer similar psychological costs arising from tax compliance.

Table 6 displays the results of supplementary analysis of the influence of the control variables (gender, age, education, turnover, and experience) upon explicit costs, implicit costs, and psychological costs. The results, overall, summarise whether there is a significant influence of the control variables on the explicit, implicit, and psychological costs. Among these possible factors, only turnover and education have significant effects, as the p-values are smaller than 0.05. While turnover affects both explicit and implicit costs, education influences only the psychological costs. However, the effect size of these factors is relatively small (less than 0.2), and the generated power is far below the threshold of large power values (0.8).

Table 6: Kruskal-Wallis Analysis Results

Factor	Stat(df)	p-value	Effect size[19]	Power
Gender —> Explicit	0.079(1)	0.779	0.00	–
Gender —> Implicit	0.006(1)	0.941	0.00	–
Gender —> Psychological	1.531(1)	0.216	0.01	–
Age —> Explicit	1.773(4)	0.777	0.01	–
Age —> Implicit	–	–	–	–
Age —> Psychological	6.057(4)	0.195	0.05	–
Edu —> Explicit	3.824(3)	0.281	0.03	–
Edu —> Implicit	4.352(3)	0.226	0.03	–
Edu —> Psychological	7.927(3)	0.048*	0.06	0.08
Turnover —> Explicit	24.319(4)	<.001***	0.19	0.37
Turnover —> Implicit	24.698(4)	<.001***	0.19	0.37
Turnover —> Psychological	4.572(4)	0.334	0.03	–
Experience —> Explicit	4.205(4)	0.379	0.03	–
Experience —> Implicit	4.31(4)	0.366	0.03	–
Experience —> Psychological	3.066(4)	0.547	0.02	–

Note: * p <.05, ** p <.01, *** p <.001.

To ensure the effect of the hypothesised factors on the psychological costs, a further regression analysis was performed (see Appendix 3). The results confirm the significant effect of education on the psychological costs. The findings are then carried forward to revise the hypothesised factors of the analysis of the psychological costs so that, among those factors, only education will be included to test the next hypotheses.

Table 7 summarises an SEM analysis (see Appendix 4 for the framework), which is performed to test the remaining three hypotheses. It can be seen that the fourth hypothesis about the direct effect of opportunity costs on psychological costs is rejected, as the p-value is bigger than 0.05, and the other (indirect) effects are accepted, as the p-values are smaller than 0.05. The results indicate a full mediation effect, which happens when the direct effect between a predictor (opportunity) and an outcome (psychological) is non-significant while the mediator variables (tax stressors and tax disputes) are present (Zhao et al., 2010).

Further power and confirmatory factor analysis (shown in Table 8) also verified that the proposed model resulted in a robust power effect and provided a good model fit (Miočević et al., 2018; Saris et al., 2009).

[19] An effect size has the range from 0, which means non-effects, to 1, which indicates strong effects (Tomczak & Tomczak, 2014).

Table 7: Multi-Mediators Analysis Results

Parameter	Label	Result	Est	Std. Error	z-value	p-value	CI lower	CI upper
Stressor —> Psychological	b1		0.396	0.063	6.262	0.000	0.269	0.515
Dispute —> Psychological	b2		0.532	0.166	3.197	0.001	0.206	0.862
Opportunity —> Psychological (**H4**)	c1	Not Supported	-0.089	0.207	-0.429	0.668	-0.521	0.306
Edu —> Psychological	c2		-1.458	0.480	-3.037	0.002	-2.441	-0.526
Opportunity —> Stressor	a1		1.321	0.341	3.869	0.000	0.771	2.131
Opportunity —> Dispute	a2		0.620	0.140	4.436	0.000	0.431	0.977
Stressor <—> Dispute			9.192	1.966	4.675	0.000	5.197	12.910
Ind_1 = a1*b1 (**H5**)		Supported	0.523	0.162	3.234	0.001**	0.270	0.908
Ind_2 = a2*b2 (**H6**)		Supported	0.330	0.135	2.449	0.014*	0.118	0.649
Tot_Ind = Ind_1 + Ind_2			0.853	0.227	3.753	0.000	0.515	1.404
Tot_Effects = Tot_Ind + c1			0.764	0.229	3.332	0.001	0.395	1.309
Effect size = Tot_Ind/ Tot_Effects = **1.12**								
Power = **1.00**								

Note: * p <.05, ** p <.01, *** p <.001.

Table 8: Confirmatory Factor Analysis Results

Fit index	Reference	Threshold	Coefficient
p-value	Kline (2016)	≥ 0.05	**0.692**
Comparative Fit Index (CFI)	Bentler (1990), Hu and Bentler (1999)	> 0.95	**1.000**
Goodness-of-Fit Index (GFI)	Jöreskog and Sörbom (1981)	> 0.95	**0.996**
Normed Fit Index (NFI)	Bentler and Bonett (1980)	> 0.95	**0.995**
Root-Mean-Square Error of Approximation (RMSEA)	Steiger (1990), Steiger and Lind (1980)	< 0.05	**0.000**
Standardised Root Means Square Residual (SRMR)	Jöreskog and Sörbom (1981)	< 0.05	**0.020**

Note: * p <.05, ** p <.01, *** p <.001; Delta method standard errors, bias-corrected percentile (5000) bootstrap confidence intervals, ML estimator.

The empirical results confirm that the presumptive tax regime has a significant impact on the tax compliance costs relative to the conventional tax regime, specifically in relation to the explicit costs. Further analysis reveals that during the period from January to December 2019, on average, an individual SME who applied the presumptive tax spent Rp77.5 million (around US$5,176) whereas a taxpayer who used the conventional tax disbursed Rp154.7 million (around US$10,333). Put simply, an individual SME who uses the conventional tax regime incurs roughly twice the tax compliance costs of one who uses the presumptive tax regime.

The results also confirm that business turnover is a significant factor in opportunity costs and this is consistent with previous studies (Eichfelder & Schorn, 2012) which suggested that business size is positively associated with the tax compliance costs. Similar analyses suggest that being the subject of tax audit (p-value <.001, power = 1.00) and hiring a tax adviser (p-value <.001, power = 0.99) significantly influence the explicit costs. In addition, the significant effects of tax complexity (p-value <.001, power = 0.40) and the use of a tax adviser (p-value 0.006, power = 0.11) on psychological costs are confirmed despite the likelihoods of detecting such effects correctly being only 40% and 11% respectively.

This article also provides an initial indication of the influence of tax stressors and tax disputes on the psychological burdens of tax compliance. More particularly, it demonstrates that there is no significant direct relationship between opportunity costs and psychological costs. Instead, the former give rise to the latter through the evidence of tax disputes and the presence of tax stressors. This finding emphasises the importance of minimising tax disputes and easing the burdens on taxpayers when they undertake the administration obligations of the tax law. Hence, the DGT may use this information when considering its role in public regulation.

From a public policy perspective, evaluating the impact of the presumptive tax on tax compliance costs provides us with a better understanding of the relationships between taxpayers and a particular advantage of the tax regime. The connection encourages those responsible for fiscal policy to prepare similar helpful initiatives that can improve tax compliance. The practical aspects of the presumptive tax regime also motivate taxpayers to play their roles in tax revenue collection and this helps to create conducive psychological processes that facilitate tax compliance.

5. CONCLUSIONS

The major findings of this study support the hypothesis that use of the presumptive tax regime, which is typically associated with a more practical and pragmatic approach to tax system design, leads to lower tax compliance costs. The study also demonstrates the underlying process that links opportunity and psychological costs through the mediation of tax stressors and tax disputes. The results enhance the existing knowledge about tax compliance costs for individual SMEs by examining various factors related to the tax compliance burden.

In this study, the evaluation of the impact of the presumptive tax regime on tax compliance costs is the most significant finding, as this is one of the earliest attempts to integrate opportunity costs and psychological costs based on the direct experience of Indonesian individual taxpayers. The empirical results confirm that the presumptive tax regime significantly reduces explicit costs. However, tax regime choice is not a significant determinant for implicit and psychological costs.

Opportunity costs were observed to indirectly affect psychological costs through two mediators. The results of this study substantiate the view that the psychological burdens of taxpayers can be derived from both administrative obligations (required by the tax law) and interactions with the tax office that lead to tax stressors and tax disputes. The conceptual framework in this paper further identifies the indirect relationships that exist among important tax compliance cost constructs in the public regulation setting.

Interestingly, the psychological costs of tax compliance are more or less identical, despite the alternative tax regimes in place in Indonesia. This may arise as a result of the fact that individual SMEs who use the presumptive tax regime need to prepare for conversion to the conventional tax regime in 2025, when the opportunity to use the presumptive tax expires. Hence, they may need to undertake similar record-keeping practices as those who use the conventional tax. Another factor may have been the timing of the survey, as it was distributed during the COVID-

19 pandemic, when the situation in Indonesia was particularly severe (World Health Organization Indonesia, 2020). As a result, all taxpayers may have experienced similar psychological conditions, notwithstanding their use of differing tax regimes.

However, this study, like all others, has theoretical and practical limitations. For example, the findings of this study are based on a stratified and limited random sample designed to consider the influence of the different tax regimes on the tax compliance costs of individual SMEs whose business premises are located in the four major provinces in Indonesia. Given the limitations, these participants do not represent all individual SMEs in Indonesia. As a result, these findings are considered indicative and must be interpreted with great caution, particularly where individual SMEs who are located outside of the selected provinces are concerned.

A further limitation is that the psychological costs are measured based on the perceived stress burdens. This article did not measure the actual stress, as perception is considered an appropriate predictor of actual anxieties (Lazarus & Folkman, 1984). Nevertheless, a reliable perceived stress might not transpire into an actual stress if taxpayers are otherwise motivated to comply with the tax law, for example, because they are satisfied with the efforts made by the government to provide public facilities (Kogler et al., 2015).

Further studies could replicate the conceptual framework applied in this paper and use it to evaluate the tax compliance costs associated with other public regulations, and in different sectors and various countries. Our understanding of the factors that influence the costs of tax compliance, particularly in the domain of public policy and governance, will also be improved by replicating the conceptual research model. Hence, the theoretical interactions identified in this paper can be applied to other taxpayer settings, such as corporate or large taxpayers, and will enhance the literature on tax compliance costs.

Notwithstanding these limitations and suggested areas for future research, this study has contributed to the literature on tax compliance costs by providing an insight into the underexplored aspects of the tax compliance costs incurred by individual SMEs in Indonesia (Alm, 2019), and by recognising the processes and mechanisms that help to explain the connection and relationship between opportunity costs and the psychological costs of tax compliance.

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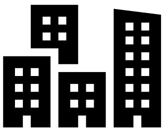
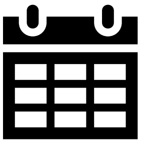
APPENDIX 1: SURVEY QUESTIONNAIRE

Section 1: **INCLUSION/ EXCLUSION CRITERIA**

1	What is your age range?	○ 17 or less ○ 18 – 25 ○ 26 – 35 ○ 36 – 45 ○ 46 – 55 ○ 56 and above
2	Is your income mainly derived from employment?	○ yes ○ no
3	What is the legal structure of your business?	○ sole proprietorship ○ other (e.g. firm, corporation, partnership, foundation, organisation, institution)
4	Please estimate the total gross turnover (IDR) of your business during the period from January to December 2019.	○ up to 500 million ○ more than 500 million and up to 1 billion ○ more than 1 billion and up to 2 billion ○ more than 2 billion and up to 4.8 billion ○ above 4.8 billion

Section 2: **Participant Information Statement and Consent Form**

5	Due to the anonymity requirement, instead of your name, please provide the name of the city where your business is located (e.g. Ambon, Bandung, Cirebon, Denpasar, etc).	
6	Date (click the icon for today's date)	

Section 3: **DEMOGRAPHY AND BUSINESS CHARACTERISTICS**

7	What is your gender?	○ female ○ male
8	What is your highest education level?	○ primary school or less ○ high school ○ vocational college ○ university

9	What is your book-keeping knowledge?	○ no book-keeping knowledge ○ basic book-keeping knowledge ○ intermediate book-keeping knowledge ○ advanced book-keeping knowledge
10	What is the main activity of your business?	○ agriculture, plantation, forestry, and fishery ○ mining and extraction ○ manufacturing ○ electricity, gas, and water supply ○ construction ○ retail and restaurant ○ transport and communication ○ finance and leasing ○ service ○ other (please describe)
11	What was the average total number of your full-time employees during the period from January to December 2019?	○ none ○ 1 – 2 persons ○ 3 – 5 persons ○ 6 – 10 persons ○ more than 10 persons
12	Does your business produce annual financial statements such as a balance sheet and an income statement?	○ yes ○ no
13	What does your business mostly use the annual financial statements for? (applied branching logic for the answer “yes” to Q12)	○ to achieve better management ○ to meet requirements from creditors e.g. banks, lenders ○ to satisfy business tender requirements ○ to comply with the tax law ○ other (please describe)
14	What type of book-keeping system does your business use?	○ no book-keeping system is used ○ paper based (without using a computer) ○ simple spreadsheet program e.g. Microsoft Excel ○ book-keeping software ○ assistance from an external book-keeper ○ other (please describe)

15	Did your business hire book-keeping employees during the period from January to December 2019? (applied branching logic for any answer **except** for the answer “no book-keeping system is used” to Q14)	○ yes ○ no
16	Please estimate the total remuneration (IDR) for your own book-keeping employees during the period from January to December 2019. (applied branching logic for the answer “yes” to Q15)	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million

Section 4: **TAX COMPLIANCE COSTS**

17	How long has your business been registered with a taxpayer identification number?	○ less than a year ○ 1 – 2 years ○ 3 – 5 years ○ 6 – 10 years ○ more than 10 years
18	How does your business normally submit tax payments?	○ electronically payment using e-billing (online) ○ physical payment through banks or post offices ○ using the Automatic Teller Machines (ATMs) ○ assistance from a tax adviser ○ other (please describe)
19	How does your business normally lodge the tax returns?	○ electronically lodging using e-filing (online) ○ physically lodge the tax returns at the tax office ○ using post or courier services ○ assistance from a tax adviser ○ other (please describe)

The next question asks about time spent on tax compliance activities. You should not include normal business activities, only tax compliance activities.

Normal business activities (**NOT** tax compliance activities) include:

1. processing customer invoices or cash received;
2. paying bills and debts;
3. calculating and paying wages;
4. checking stocks and inventories;
5. budgeting and investment planning;
6. other book-keeping activities.

For the next questions about the time spent on tax compliance activities, please exclude such activities.

Please estimate the monthly average of total hours spent on various tax compliance activities by your business during the period from January to December 2019 (include time spent by the business owner, unpaid helpers, and paid employees).

20	learning the tax law: attending tax workshop, studying tax from the DGT website or other sources	○ none ○ up to 12 hours per month ○ more than 12 and up to 24 hours per month ○ more than 24 and up to 38 hours per month ○ more than 48 and up to 96 hours per month
21	recording information needed for tax	○ none ○ up to 12 hours per month ○ more than 12 and up to 24 hours per month ○ more than 24 and up to 38 hours per month ○ more than 48 and up to 96 hours per month
22	determining taxable incomes and paying tax liabilities	○ none ○ up to 12 hours per month ○ more than 12 and up to 24 hours per month ○ more than 24 and up to 38 hours per month ○ more than 48 and up to 96 hours per month

23	preparing and lodging tax returns	○ none ○ up to 12 hours per month ○ more than 12 and up to 24 hours per month ○ more than 24 and up to 38 hours per month ○ more than 48 and up to 96 hours per month
24	dealing with the DGT, phone calls, emails, visits	○ none ○ up to 12 hours per month ○ more than 12 and up to 24 hours per month ○ more than 24 and up to 38 hours per month ○ more than 48 and up to 96 hours per month
25	dealing with your tax adviser	○ none ○ up to 12 hours per month ○ more than 12 and up to 24 hours per month ○ more than 24 and up to 38 hours per month ○ more than 48 and up to 96 hours per month
We would like to allocate those times (in per cent) between the various persons who spent the time on tax compliance activities (the sum of the allocation time must be 100 per cent).		
26	business owner	○ 0 ○ 20 ○ 40 ○ 60 ○ 80 ○ 100
27	unpaid helpers (spouse, relatives, friends)	○ 0 ○ 20 ○ 40 ○ 60 ○ 80 ○ 100
28	paid employees	○ 0 ○ 20 ○ 40 ○ 60 ○ 80 ○ 100

29	If those total hours spent on tax compliance activities are calculated in terms of money (IDR), how much is the equivalent during the period January to December 2019?	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million
30	Did your business hire an external tax adviser during the period from January to December 2019?	○ yes ○ no
31	Why did your business go to a tax adviser? (applied branching logic for the answer "yes" to Q30)	○ tax return is confusing ○ busy with the business ○ could not understand the tax law ○ tax officials are not helpful ○ other (please describe)
32	Please estimate the total payment (IDR) for the tax services (tax adviser) during the period January to December 2019 (exclude payment for services when being audited, lodging an objection, or submitting an appeal to tax court). (applied branching logic for the answer "yes" to Q30)	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million
33	During the period from January to December 2019, was your business audited by the tax office?	○ yes ○ no
34	How much were the additional costs (IDR) of tax advisers, lawyers, your own time or that of your staff, or other costs (such as transportation, stationery) related to the tax audit? (applied branching logic for the answer "yes" to Q33)	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million
35	During the period from January to December 2019, did your business submit a tax objection?	○ yes ○ no

36	How much were the additional costs (IDR) of tax advisers, lawyers, your own time or that of your staff, or other costs (such as transportation, stationery) related to the submission of the objection? (applied branching logic for the answer "yes" to Q35)	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million
37	During the period from January to December 2019, did your business submit a tax appeal?	○ yes ○ no
38	How much were the additional costs (IDR) of tax advisers, lawyers, your own time or that of your staff, or other costs (such as transportation, stationery) related to the submission of the appeal? (applied branching logic for the answer "yes" to Q37)	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million
In addition to various costs incurred while complying with the tax law, studies have shown that various benefits may be perceived by taxpayers. Therefore, in this section, please indicate how often your business perceived various benefits such as:		
39	improving the record-keeping of the business	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
40	maintaining more accurate records	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
41	improving the knowledge of the financial/ cash flow position of the business	○ never ○ almost never ○ sometimes ○ fairly often ○ very often

42	enabling the business to have some extra cash until tax is remitted to the state treasury account	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
43	improving the knowledge of the profitability of the business	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
44	enabling the business to have an accountant who is a good source of advice for the business	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
45	enabling the business to employ an external tax services/ tax adviser who is a good source of advice for tax matters	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
46	If those benefits were calculated in terms of money (IDR), how much would be the equivalent amount during the period from January to December 2019?	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million
The following questions ask you to indicate the psychological burdens associated with tax compliance activities. Please indicate how stressful you would find each of the following tax compliance activities:		
47	learning the tax law	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful

48	maintaining record-keeping for tax purpose	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful
49	calculating tax liabilities	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful
50	submitting tax payments	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful
51	lodging tax returns	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful
52	having been asked for clarifications or additional data by the DGT	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful
53	finding a reliable tax adviser	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful
54	experiencing changes in the tax law	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful
55	having been audited by the DGT	○ not at all stressful ○ slightly stressful ○ moderately stressful ○ very stressful ○ extremely stressful

56	If your stress burden were converted into money (IDR), how much would you ask to compensate for your stress burden during the period from January to December 2019?	○ up to 50 million ○ more than 50 million and up to 100 million ○ more than 100 million and up to 150 million ○ more than 150 million and up to 200 million ○ more than 200 million
The following questions seek information about the general interaction between your business and the tax office. Please indicate how often you found the following situations during the period from January to December 2019:		
57	receiving answers to your queries related to your business tax compliance	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
58	having been asked for clarifications by the tax office	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
59	receiving notifications related to your business tax compliance (e.g. reminder to lodge the annual tax returns)	○ never ○ almost never ○ sometimes ○ fairly often very often
60	having been asked for additional data related to your tax returns	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
61	perceiving various benefits from contacting the tax office (e.g. tax disseminations from the DGT)	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
62	Based on your knowledge, how complicated is the Indonesian tax system?	○ not at all complicated ○ slightly complicated ○ moderately complicated ○ very complicated ○ extremely complicated ○

63	Are you aware that after seven years of using the presumptive tax rate (0.5% of gross income), you must switch into the conventional tax regime* (based on the Government Ordinance No. 23 Year 2018)? * conventional tax regime is the tax rate based on the calculation of taxable income (gross income – costs of goods sold - operational expenses – tax threshold)	○ yes ○ no
Finally, this section asks you to let us know how you feel when you are complying with the tax law. Please indicate how often you experienced the following feelings during the period from January to December 2019.		
64	upset because of the tax obligations and tax matters that happened unexpectedly	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
65	were unable to control the tax matters in your life	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
66	nervous and stressed because of the tax matters	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
67	confident about your ability to handle your tax matters	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
68	considered that tax matters were going your way	○ never ○ almost never ○ sometimes ○ fairly often ○ very often

69	could not cope with all the tax matters that you had to do	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
70	able to control irritations when complying with the tax law	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
71	felt that you were on top of the tax matters	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
72	angered because of tax matters that were outside of your control	○ never ○ almost never ○ sometimes ○ fairly often ○ very often
73	overwhelmed by the level of difficulty in complying with your tax obligations	○ never ○ almost never ○ sometimes ○ fairly often ○ very often

APPENDIX 2: PEARSON'S CORRELATIONS BETWEEN VARIABLES

Construct	1	2	3	4	5	6	7	8	9	10
1. Gender	—									
2. Age	-0.08	—								
3. Education	0.01	-0.12	—							
4. Turnover	-0.05	0.17	0.00	—						
5. Experience	-0.15	0.32***	0.01	0.14	—					
6. Explicit	-0.04	-0.12	-0.06	0.36***	-0.01	—				
7. Implicit	-0.07	-0.07	-0.02	0.35***	0.03	0.54***	—			
8. Opportunity (α = 0.67)	-0.06	-0.12	-0.06	0.40***	0.00	0.96***	0.75***	—		
9. Stressor (α = 0.93)	0.07	-0.14	-0.09	0.18*	-0.02	0.32***	0.20*	0.32***	—	
10. Dispute (α = 0.79)	-0.01	-0.12	-0.03	0.19*	-0.06	0.43***	0.36***	0.46***	0.49***	—
11. Psychological (α = 0.85)	0.10	0.01	-0.22*	0.15	0.01	0.27**	0.14	0.26**	0.65***	0.49***

Note: * p <.05, ** p <.01, *** p <.001; Opportunity = Explicit + Implicit.

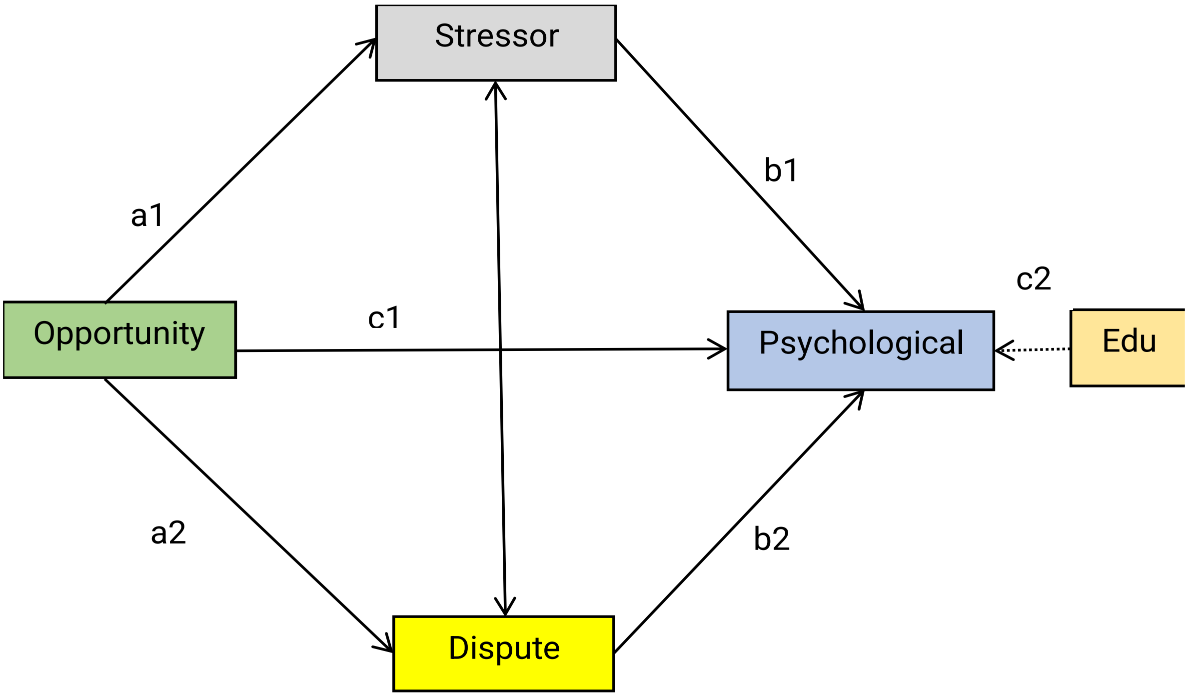
APPENDIX 3: SUMMARY OF REGRESSION ANALYSIS

Factor	Implicit	Explicit	Opportunity	Compliance costs	Psychological
Intercept	0.571	1.107	1.677	0.796	20.622
Gender	-0.072	-0.333	-0.405	-0.667*	1.432
Regime	0.137	0.984***	1.121***	1.457***	-0.265
Audited	0.152	1.573***	1.725***	1.582***	1.406
Adviser	0.092	1.705***	1.797***	1.815***	2.120
Age	-0.119*	-0.339***	-0.458***	-0.435**	-0.060
Education	-0.033	-0.145	-0.178	-0.106	-1.669**
Turnover	0.117*	0.095	0.212	0.309*	0.158
Experience	0.027	0.003*	0.029	-0.087	-0.044
Complexity	-0.005	-0.114	-0.119	0.296*	2.454***
Time	0.073***	0.094***	0.167***	0.164***	0.151
R-Square	0.314	0.681	0.623	0.620	0.293
VIF	< 5	< 5	< 5	< 5	< 5
White's test p-value	0.108	0.0121	0.00986	0.229	0.168

Note: * p <.05, ** p <.01, *** p <.001.
VIF < 5 signals that the model is free from extreme multicollinearity.
The White test p-value < 0.05 implies that the regression model violates the homoscedasticity assumption.

APPENDIX 4: LAVAAN SYNTAX

Framework



Source: Adapted from Ferry (2022, p. 305)

```
# dependent regression
Psychological ~ b1*Stressor + b2*Dispute + c1*Opportunity + c2*Edu

# mediator regression
Stressor ~ a1*Opportunity
Dispute ~ a2*Opportunity

# mediator residual covariance
Stressor ~~ Dispute

# effect decomposition
# y1 ~ x1
Ind_1 := a1*b1
Ind_2 := a2*b2
Tot_ind := Ind_1 + Ind_2
Tot_effects := Tot_ind + c1
```

DESTINATION TAXATION OF CORPORATE INCOME AND THE EMERGING IMPLICATIONS

Chidozie George Chukwudumogu[1]

Abstract

The international tax regime for the taxation of corporate income is undergoing reform and moving further towards destination taxation. This article highlights the new blueprints for the destination-based taxation of corporate profit, namely the Organisation for Economic Co-operation and Development (OECD)'s blueprint, the United Nations' (UN) blueprint and the destination-based cash-flow tax (DBCFT) blueprint. Furthermore, it examines the seemingly overlooked implications of these blueprints for international tax policy and for nation-states. Arguably, the current move towards the destination-based taxation of the corporate income of multinational enterprises (MNEs) will lead to: (a) the expansion of the source principle, diverging unilateral actions, and challenges to the standardisation of the expanded source principle; (b) avertible costs; (c) distributional impact without the resolution of inter-nation equity issues and (d) tax competition by affluent states for sales factors. These implications provide lessons for international tax policymakers and nation-states. International tax policymakers should coordinate the processes of incorporating destination taxation into the international tax system. Low-income states need to evaluate matters further before adopting any blueprint for destination taxation as part of their domestic legislation. Affluent market states may require expanded country-by-country reporting (CBCR) and anti-tax avoidance rules to regulate their tax competition for sales factors.

1. INTRODUCTION

International tax policymakers and scholars have proposed varying blueprints for the destination-based taxation of corporate income. The OECD's pillar one blueprint seeks to change the nexus and profit allocation rules, especially in favour of giving more taxing rights to market or user states (OECD, 2019a, 2020d). This blueprint results from historical efforts by the OECD and the Group of Twenty (G20), in the form of their Inclusive Framework on BEPS, to find a coordinated solution for the taxation of the digital economy (G20, 2021a, 2021b, 2021c; OECD, 1998a, 2015a[2], 2018, 2019a, 2019b, 2019c, 2019d, 2019e, 2020a, 2020b, 2020d, 2020e, 2021a, 2021b, 2022a, 2022b).[3] On the other hand, the UN modified its double taxation convention (DTC) model in 2021 to encompass a new Article 12B, another blueprint for the destination-based taxation of corporate entities exploiting the digital economy (UN, 2021). During its 22nd session, in April 2021, and following prior work and deliberations

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[2] "The digital economy is the result of a transformative process brought by information and communication technology (ICT), which has made technologies cheaper, more powerful, and widely standardised, improving business processes and bolstering innovation across all sectors of the economy" (OECD, 2015a, p. 11).

[3] See, on the definition of the digital economy, Oxford English Dictionary (n.d.): "an economy which functions primarily by means of digital technology, especially electronic transactions made using the internet."; Elliffe (2021), pp. 63-64 and 65-66, on the apparently most significant features of the digital economy; The International Monetary Fund [IMF] (2018) on p. 6.

at subcommittee level,[4] the UN Committee of Tax Experts on International Cooperation in Tax Matters incorporated Article 12B and its commentaries into the UN model DTC between developed and developing countries.[5] These efforts demonstrate that the international tax regime for the taxation of corporate profit is undergoing reform, which has implications for international tax policy and for nation-states. The goal of this article is not to consider which blueprint is optimal for any country. That would be beyond the scope of this article and is empirical, considering the specific needs of a nation-state. A nation-state may deem it appropriate to undertake this type of empirical analysis before exercising its sovereign right to choose any blueprint. The article aims to highlight and clarify these new blueprints for the destination-based taxation of corporate income. Furthermore, the article reveals and analyses the emerging implications of the reform given the publicly available documents on these blueprints and the current situation concerning the destination-based taxation of corporate income. Scholars have also proposed varying blueprints for the destination-based taxation of corporate income, including the permanent establishment (PE) blueprint,[6] the residual profit allocation by income blueprint,[7] the DBCFT blueprint,[8] a withholding tax blueprint,[9] and the data excise tax blueprint.[10] However, this article focusses on the blueprints that are most likely to be adopted in practice because they emanate from the OECD and the UN (policymakers and institutions that influence policymaking in international tax law).[11] The article also considers the scholarly blueprint (DBCFT), which aims to radically change the way in which MNEs are taxed in order to give a broader understanding of the implications of the destination-based taxation of corporate income.

This article argues that the current move towards the destination-based taxation of MNEs' corporate income has seemingly overlooked the implications for international tax policy and for nation-states. It identifies and discusses four implications. First, that the reform expands the source principle and is likely to encourage diverging unilateral actions, challenging the standardisation of the extended source principle. Second, that the current move results in avertible costs for in-scope taxpayers, consumers, and tax administrations. These costs, which arise from the concurrent existence of the OECD and UN blueprints, include (a) the over-taxation or double taxation of in-scope MNEs, (b) higher prices for the consumers of the products of in-scope MNEs, and (c) inefficiently high compliance and administrative costs. Third, that the distributional impact of the move towards destination taxation does not resolve inter-nation equity for the following reasons:

> (a) The OECD blueprint adopts an inadequate differentiated approach that does not necessarily help numerous low-income countries.
> (b) The UN blueprint does not adopt a differentiated approach and may have features that disadvantage many low-income countries.

[4] See UN Committee of Experts on International Cooperation in Tax Matters (2020), pp. 1-8; UN Committee of Experts on International Cooperation in Tax Matters (2021a), pp. 1-5. See, generally, the UN's tax committee sessions' reports (UN, n.d.-b).
[5] See UN Committee of Experts on International Cooperation in Tax Matters 2021(b) and (2021c), p. 1.
[6] See Cockfield (2020), pp. 351-352 and 373-390, on the quantitative economic presence permanent establishment (QEPPE) proposal; Hongler and Pistone (2015).
[7] See Devereux et al. (2021) at chapter 6.
[8] See Devereux et al. (2021) at chapter 7.
[9] See Báez Moreno and Brauner (2019), pp. 127-162.
[10] See Avi-Yonah et al. (2022), pp. 335-341.
[11] See Christians (2016), pp. 1614-1615, noting that some 3,000 DTTs follow the OECD, UN, and U.S. models).

(c) The DBCFT does not adopt a differentiated approach, and the fact that it relies purely on domestic consumption will most likely put many low-income countries at a disadvantage.

Fourth, the significant change will likely lead to tax competition by affluent states for sales factors. Sales factors include any element or component employed in order to sell and buy the products of in-scope MNEs. Sales factors change or add to the traditional objects of tax competition. According to the OECD blueprint, destination taxation can change the behaviour of targeted corporate taxpayers, thereby potentially encouraging tax competition by affluent market states. Tax competition by states for sales factors of in-scope MNEs can occur because proxies or reasonable approximations are likely to be used to determine customers'/consumers'/users'/purchasers' locations or source/market states. Customers are also expected to include business customers. The article submits that the international tax reform is likely building ground for a novel type of tax competition, namely tax competition for "sales factors". Implications one and two arise from the divergence of international tax policymakers' blueprints, while implications three and four are not the result of the variations between the OECD and UN blueprints. International tax policymakers and governments of nation-states ought to consider these consequences when adopting any blueprint for destination taxation.

The article proceeds as follows. Section 2 clarifies the meaning of destination taxation and highlights the diverging blueprints: the OECD blueprint, the UN blueprint, and the DBCFT. Section 3 reveals, discusses, and examines the potential consequences of destination taxation based on these blueprints. Section 4 concludes the article with some lessons for international tax policy and nation-states.

2. BLUEPRINTS FOR THE DESTINATION-BASED TAXATION OF CORPORATE INCOME IN THE INTERNATIONAL TAX SYSTEM

This section highlights the existing blueprints for the destination-based taxation of corporate income that have sufficiently built momentum for its adoption as part of the international tax system for the taxation of MNEs. Corporate residence and production location—the location of subsidiaries and PE—are the bases for taxing the profits of MNEs under the current international tax regime.[12] The destination-based taxation of corporate income adds the location of the demand side of the market to the list of places or bases for taxing the profits of MNEs.[13] This article defines destination taxation as the taxation of corporate income at the destination of sales or consumption of the corporate product rather than necessarily at the place of production. It is simply taxation on the demand side of the market, broadly defined to include the location of the purchaser, customer, consumer, or user.[14] This type of taxation can be contrasted with a situation in which corporate profit is taxed at the supply side of the market, i.e. the place of production. The concept anticipates that the sale and the consumption of the products of in-scope MNEs are critical components of the tax base in respect of how the profits of these MNEs will be taxed. The destination-based taxation of corporate income envisages that taxable presence will no longer be restricted to the physical presence of the relevant taxpayer. A non-resident entity may have a taxable presence in a state without having any physical presence therein. The destination-based taxation of MNEs raises a core interaction issue in that it may violate existing international obligations, such as double taxation treaties

[12] See Devereux et al. (2021) at chapter 3; Devereux and Vella (2018), p. 552.
[13] See also Plekhanova (2020), p. 372.
[14] See also Collier et al. (2021), pp. 406, 411-413, and 418.

(DTTs), World Trade Organization (WTO) rules, and European Union (EU) law.[15] Some commentators respond to the issue in the affirmative;[16] there is also a somewhat optimistic view about the compatibility of destination taxation with WTO rules.[17] Whether or not the destination-based taxation of corporate profits will violate existing international obligations will depend on how it is designed.[18] Alternatively, existing international obligations can be modified to accommodate the destination-based taxation of corporate profits.[19] The move towards destination taxation in the international tax system has been identified as one of the significant areas of change proposed in the 2020s compromise.[20] Blueprints for the destination-based taxation of corporate income can consist of either incremental or radical changes to the international tax system. The following subsections highlight these new blueprints and clarify three that diverge from each other: the OECD blueprint, the UN blueprint, and the DBCFT.

2.1. The OECD Destination Taxation Blueprint

The OECD destination taxation blueprint stipulates that a portion of the residual (non-routine) profits of in-scope MNEs is to be separated from the total profits of such MNEs and allocated to market/users' jurisdictions (Amount A).[21] The blueprint also includes Amount B which, arguably, envisages destination taxation.[22] However, this article focusses on Amount A because the crucial goal of Amount B is not necessarily to create a new type of destination taxation for MNEs' income, but to prevent transfer pricing disputes in respect of baseline marketing and distribution activities.[23] Amount A is restricted to apply to a specific scope of MNEs. According to the blueprint released in October 2020, the scope of Amount A would be determined by two tests, namely the activity test and the threshold test.[24] The July 2021 agreement (OECD, 2021a) and the October 2021 update (OECD, 2021b) from the substantial members of the OECD/G20's Inclusive Framework on BEPS override this. These documents change the threshold test by restricting in-scope taxpayers to MNEs "with global turnover above 20 billion euros and profitability above 10% (i.e. profit before tax/revenue)" (OECD, 2021a, p.1; OECD, 2021b, p.1). The October 2021 update adds that this threshold will be "calculated using an averaging mechanism" (OECD, 2021b, p. 1). Thus, the OECD destination taxation blueprint is concerned with very highly profitable MNEs. The July 2021 agreement and October 2021 update note that the "extractives and regulated financial services" sectors are

[15] See also OECD (2019d), p. 33, on compatibility with international obligations; Báez Moreno & Brauner (2019), pp. 148-153, analysing the interaction between their withholding tax (WHT) proposal with obligations under the following: WTO rules, EU law, and DTT law; Devereux et al. (2021), pp. 328-330 (two sets of international obligations that may conflict with the DBCFT are the DTTs and commitments under the WTO); Elliffe (2021), at pp. 121-164, on key restrictions on the imposition of new interim taxes.
[16] Schön (2016), arguing that the DBCFT may violate existing international obligations, including WTO and DTT rules; Avi-Yonah and Clausing (2017), pp. 235-247, arguing that the DBCFT, as proposed by the United States' of Representatives' Ways and Means Committee in 2016, may violate existing international obligations, including WTO and DTT rules; Mason and Parada (2020), pp. 183-203, arguing that, under EU law, taking unilateral and uncoordinated measures, e.g. digital service taxes (DSTs) when taxing the digital economy discriminates against non-resident, large, digital corporations.
[17] See Pirlot (2019), who concludes that the likelihood that the DBCFT would be found incompatible with international trade law is much lower than initially thought.
[18] See also Devereux et al. (2021), p. 330; Grinberg (2017), pp. 803-804 and 808-816, suggesting how the DBCFT can be drafted or designed to comply with WTO obligations.
[19] See also Devereux et al. (2021), p. 330.
[20] See Elliffe (2021), pp. 313-316, 214, and chapter 8.
[21] On Amount A, see OECD (2020d), at pp. 8, 11[7], 12, 13-15, 18, 212-220; Elliffe (2021), pp. 177-193.
[22] See OECD (2020d), pp. 15-16 [11-15], and chapter 8.
[23] See OECD (2020d), pp. 175 [710] and 160 [650-651]. See also Elliffe (2021), pp. 177, arguing that Amount B continues to require a physical taxable presence, the position under the current international tax regime.
[24] See OECD (2020d), p. 19 [21] and chapter 2.

excluded from the scope of Amount A (OECD, 2021a, p.1; OECD, 2021b, p.1). Limiting the scope of Amount A to these very highly profitable MNEs is a type of ring-fencing in respect of MNEs that earn supernormal profits. Devereux and Simmler (2021) find that 78 to 100 of the world's 500 largest companies would be affected. Historical works seem to be efforts to tax MNEs exploiting the digital economy (OECD, n.d., 2015a, 2019a, 2019b, 2019d, 2020d) but Amount A is a plan to tax MNEs that make supernormal profits. Are MNEs that make excess profits the only companies exploiting the digital economy? Empirical investigation beyond the scope of this article may be needed to determine this issue.

The OECD destination taxation blueprint proposes new nexus, sourcing, profit/tax base determination, and allocation rules in the era of digitalisation in order to give or reallocate more taxing rights to the market/user states.[25] The proposed nexus to give states taxing rights goes beyond having a physical presence in such nation-states.[26] The provision of nation-state taxing rights is a new/standalone nexus rule and is determined by the in-scope MNE's sales/market revenue indicating that it has active, significant, and sustained engagement with market states beyond the mere conclusion of sales.[27] According to the July 2021 agreement and the October 2021 update from the substantial members of the Inclusive Framework on BEPS:

> There will be a new special purpose nexus rule permitting allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least 1 million euros in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion euros, the nexus will be set at 250 000 euros.
>
> The special purpose nexus rule applies solely to determine whether a jurisdiction qualifies for the Amount A allocation. (OECD, 2021a, p. 1; 2021b, p. 1)

The OECD blueprint generally, and newly, adopts a transaction-by-transaction sourcing rule for in-scope MNEs to determine the source/market state.[28] This sourcing rule is further elaborated in section 3.4 of this article. According to the OECD destination taxation blueprint, the tax base of these MNEs is to be determined by the profits-before-tax (PBT) of a group (rather than on a separate entity basis), e.g. via the consolidated group financial accounts of in-scope MNE groups.[29] This tax base is an adjusted PBT, i.e. the financial accounting profit of the in-scope MNE after making specific adjustments and deducting net losses.[30] The OECD blueprint proposes that the "calculation and allocation of Amount A will be delivered through a formula that is not based on the" arm's length principle (ALP) (OECD, 2020d, p. 123).[31] That is, the profit allocation rules are proposed to now go beyond the current ALP for transfer pricing in order to include some form of formulary apportionment rule.[32] The blueprint envisages the calculation and allocation of Amount A to involve three distinct but connected components, namely: (a) a profitability threshold to isolate the residual profit potentially subject to reallocation; (b) a reallocation percentage to identify an appropriate share of residual profit that can be allocated to market jurisdictions under Amount A; and (c) an allocation key to distribute the allocable tax base amongst the eligible market jurisdictions (i.e. where nexus is established

[25] See OECD (2020d) at pp. 7-8 and chapters 3-6; OECD (2022a), pp. 5-8.
[26] See OECD (2020d) at chapter 3.
[27] See OECD (2020d), pp. 8, 22 [38], 65 [187], and 66 [194].
[28] See OECD (2022a), pp. 5-8.
[29] See OECD (2022a), pp. 100 [406-407] and 213, and, generally, chapter 5; OECD (2021a), p. 2; OECD (2021b), p. 2; OECD (2022b).
[30] See OECD (2022c), pp. 15-16.
[31] See, generally, OECD (2020d), chapter 6.
[32] See OECD (2020d), p. 217.

for Amount A); the allocation key will be "based on locally sourced in scope revenue" (OECD, 2020d, p. 123).[33] The OECD destination taxation blueprint clarifies the quantum of the components as follows: "For in-scope MNEs, between 20-30% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key" (OECD, 2021a, p. 2). In the October 2021 update, the 20-30 per cent of the residual profit is fixed at 25 per cent.[34] Where the in-scope MNE meets certain conditions, the amount derived by the formula, based on the three distinct components, is reduced by the marketing and distribution profits safe harbour adjustment.[35]

Policymakers seek to implement this blueprint based on sound policy rationales for the destination-based taxation of the corporate income of entities exploiting the digital economy. This OECD formulary apportionment destination taxation envisages implementing the changes via new domestic laws, multilateral convention, and guidance.[36] The taxation of the income of corporate entities under the international tax regime is built on the notion of equating taxable presence to a physical presence. However, within the digital economy, MNEs do not need a physical presence in the market location in order to engage substantially with potential consumers or customers.[37] This is a unique feature of the digital economy because the MNE does not necessarily need a middleman in order to engage substantially with potential consumers or customers in another foreign state.[38] Therefore, the policy rationales for the OECD destination taxation blueprint include the following: a) to update international tax rules to be in line with current reality, that an entity can "generate profits through participation in a significant/ active and sustained way in the economic life of a jurisdiction, beyond the mere conclusion of sales, with or without the benefit of local physical presence"; and b) to explicitly acknowledge that users/customers/consumers/purchasers in the market states create value for MNEs exploiting the digital economy.[39]

Commentators have articulated their views about the OECD blueprint. Elliffe (2021) argues that the OECD blueprint represents the most extensive reforms in a very long time because it creates more taxing rights for market states, overrides the physical presence test, and challenges the ALP. The African Tax Administration Forum (ATAF) criticises the limitation of Amount A to excess profits and prefers all profits of MNEs be included, stating: "We propose that the reallocation of profits which we refer to as "Amount D", would be calculated as a portion of the MNEs total profits instead of its residual profit" (ATAF, 2021). Relying on World Trade Organization (WTO) data, Cui (2022) challenges the traditional assumption that international income taxation is being undermined because more business transactions now take place remotely.[40] He submits that there is little evidence that the remote provision of services has grown at the expense of services trade via physical structures like branches and foreign

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[33] See also, OECD (2020d), pp. 126-129 and 217.
[34] See OECD (2021b), p. 2.
[35] See OECD (2022c), p. 17.
[36] See OECD (2020d), pp. 205-210 (and, generally, chapter 10); OECD (2021a), p. 3; OECD (2021b), pp. 3 and 6-7.
[37] See OECD (2015a), pp. 98 [246], 99 [248], 100 [253], 101 [256], 101-102, and 106 [273]; Mason and Parada (2020), p. 180; Cockfield (2020), pp. 352-353; Báez Moreno and Brauner (2019), pp.158, 159, and 153-162.
[38] See OECD (2015), pp. 98 [246], 99 [248], 100 [253], 101 [256], 101-102, and 106 [273]; Mason and Parada (2020), p. 180; Cockfield (2020), pp. 352-353; Báez Moreno and Brauner (2019), pp. 158, 159, and 153-162.
[39] See OECD (2020d), pp. 8 and 65. See also OECD (2015a), pp. 98-104, 99 [250] and 102 [262]; OECD (2019b), pp. 9-10 [16 21], 12-13 [30-39] and 19 [65]; Christians and Magalhaes (2019), pp. 1160-1163; Elliffe (2021), pp. 169-170, 171-173, 175 and 178-179 (on the policy rationales of the user participation proposal, market intangibles proposal, significant economic presence proposal, and Amount A proposal).
[40] See Cui (2022), pp. 204 and 209-216.

affiliates.[41] However, Cui's (2021) submission does not dispute the fact that the supply of services electronically via the internet is ongoing in a way that the current international tax rules are yet to capture. The OECD destination taxation blueprint has also been criticised for the complexity of its contents and the logistical challenges of implementing a multilateral tax agreement for many nation-states.[42] Whether or not the plan to implement the blueprint via ratification by a critical mass of countries will overcome the logistical challenge is an open question.[43] The next subsection highlights an alternative blueprint for destination taxation emanating from another policymaker in international tax law.

2.2. The UN Destination Taxation Blueprint

The UN destination taxation blueprint is embodied in Article 12B of the UN's model DTC between developed and developing countries (UN, 2021). Article 12B's scope is restricted to automated digital services (ADSs), and the nexus to determine taxation is payment for ADSs.[44] According to the blueprint, the market or source state is the location of the payer for ADSs, or the location of the payer's PE or fixed base connected to the obligation to pay for the ADSs.[45] ADS means "any service provided on the Internet or another electronic network, in either case requiring minimal human involvement from the service provider" (UN Committee of Experts on International Cooperation in Tax Matters, 2021c, p. 4). The blueprint further provides that ADSs include:

- Online advertising services;
- Supply of user data;
- Online search engines;
- Online intermediation platform services;
- Social media platforms;
- Digital content services;
- Online gaming;
- Cloud computing services; and
- Standardized online teaching services (UN Committee of Experts on International Cooperation in Tax Matters, 2021c, p. 4)

However, the commentary notes that if an activity appears on this list, it is merely an indication that it is an ADS and does not necessarily mean that it is one (UN Committee of Experts on International Cooperation in Tax Matters, 2021c). When determining whether or not the operations of a specific beneficial owner or MNE group are classed as ADSs, these operations must meet the requirements of the earlier definition of the term (UN Committee of Experts on International Cooperation in Tax Matters, 2021c). The commentary clarifies that the term ADS:

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41 See Cui (2022), pp. 204 and 209-216.

42 See Avi-Yonah et al. (2022), pp. 298-300; UN Committee of Experts on International Cooperation in Tax Matters (2020), p. 67 (Annex 4); ATAF (2021).

43 See OECD (2022c): the "critical mass of countries" includes:

> the residence jurisdictions of the ultimate parent entities of a substantial majority of the in-scope companies whose profits will be subject to the Amount A taxing right, as well as the key additional jurisdictions that will be allocated the obligation to eliminate double taxation otherwise arising as a result of the Amount A tax. (p. 5)

44 UN Committee of Experts on International Cooperation in Tax Matters (2021c), pp. 3-4 (Article 12B (1) (2) (9)).

45 UN Committee of Experts on International Cooperation in Tax Matters (2021c), p. 4 (Article 12B (9)).

> does not include:
>
> *i.* Customized professional services;
> *ii.* Customized online teaching services;
> *iii.* Services providing access to the Internet or to another electronic network;
> *iv.* Online sale of goods and services other than automated digital services; and
> *v.* Revenue from the sale of a physical good, irrespective of network connectivity ("internet of things"). (UN Committee of Experts on International Cooperation in Tax Matters, 2021c, p. 21)

In addition, the blueprint does not apply in two other scenarios: (a) where the payment qualifies "as "royalties" or "fees for technical services"" (UN Committee of Experts on International Cooperation in Tax Matters, 2021c, p. 4) and (b) in PE or fixed base scenarios where the payment is effectively connected to a PE or fixed base of the beneficial owner in the source/market state (UN Committee of Experts on International Cooperation in Tax Matters, 2021c).

The blueprint encompasses the gross taxation of corporate revenue or net taxation in specified instances (UN Committee of Experts on International Cooperation in Tax Matters, 2021c). It provides a general rule that the residence state may tax income from ADSs, i.e. income derived from underlying payments from the source/market state to a resident of the residence state. Article 12B then gives an exception that the source/market state, according to its laws, may also tax income from ADSs, i.e. income derived from underlying payments from the source/market state to a resident of the residence state (UN Committee of Experts on International Cooperation in Tax Matters, 2021c). The source/market state's taxation on the beneficial owner of such income shall not exceed a specific percentage "of the gross amount of the payments underlying the income from" ADSs (UN Committee of Experts on International Cooperation in Tax Matters, 2021c, p. 3). This specific percentage "is to be established by bilateral negotiations" between the residence and source/market states (UN Committee of Experts on International Cooperation in Tax Matters, 2021c, p. 3). Therefore, the UN blueprint for destination taxation encompasses the source/market state's WHT on gross income derived from ADSs. Furthermore, Article 12B provides that the beneficial owner of the income derived from ADSs may elect to avoid the gross basis taxation and choose its qualified profits from ADSs for the relevant fiscal year to be taxed according to the domestic laws of the source/market state (UN Committee of Experts on International Cooperation in Tax Matters, 2021c). Article 12B determines the qualified profit by applying 30% to the resultant amount of the profitability ratio of the ADS business segment to the gross annual revenue from ADSs derived from the source/market state (UN Committee of Experts on International Cooperation in Tax Matters, 2021c). Collier et al. (2021) explain this profitability ratio analysis as follows:

> This works on the basis that the profitability ratio (relevant annual profits divided by annual revenue) of the recipient is applied to the gross revenue arising in the source state, and 30% of the resulting net profit is then treated as the profit that is taxable in that state. This is equivalent to a form of formulary apportionment, in which 30% of the global profit is allocated in proportion to the sales in market countries. (p. 419)

The profitability ratio analysis of Article 12B is intended to be net basis taxation instead of gross basis taxation (UN Committee of Experts on International Cooperation in Tax Matters, 2021c). This net basis taxation is contingent on the availability of information about the profitability of the relevant MNE group. Where such profitability information is not available to the tax authority of the source/market state, gross basis taxation shall prevail over net basis taxation (UN Committee of Experts on International Cooperation in Tax Matters, 2021c).

Article 12B is to be implemented via changes to domestic law and DTTs based on policy rationale that appears arguably similar, but not the same as, the policy rationale(s) for the OECD blueprint for the destination-based taxation of corporate income. This similarity stems from the inadequacy of the current international tax rules. The policy rationale for Article 12B is "to preserve the domestic law taxing rights for States from which payments for automated digital services are made", i.e. the goal of protecting the taxing rights of states (especially developing countries) over digital business models that can engage in cross-border business activities without necessarily having a physical presence in the market jurisdiction (UN Committee of Experts on International Cooperation in Tax Matters, 2021c, p. 5). The source/market state may or may not choose to adopt domestic laws to exert the Article 12B taxing right.

As would be expected, commentators have expressed their opinions about the UN blueprint. It has been praised for its simplicity, contribution to the elimination of double non-taxation, ability to raise stable tax revenues, ease of implementation and compliance in respect of the gross taxation of business-to-business (B2B) scenarios, style of providing option for gross or net basis taxation, preservation of taxing rights, and protection of the tax base in the digital economy, especially from ADSs.[46] The blueprint has also been criticised for being difficult to implement in business-to-customer (B2C) transactions, for raising interpretational challenges, for its potential to result in excessive or double taxation, for creating tax planning opportunities that would make developing countries lose tax revenues, for providing an ineffective approach by which to address the tax challenges created by the digital economy via treaty, and for providing very limited coverage to only ADSs and lax robustness to tax avoidance.[47] Moreno argues that introducing Article 12B of the UN model DTT is unnecessary, undesirable, and counter-productive because, inter alia, the correct and non-restrictive interpretation of Article 12A of the UN model DTC on fees for technical services can encompass ADSs (Báez Moreno, 2021). The following subsection highlights a scholarly blueprint for destination-based taxation of corporate income of MNEs.

2.3. The Scholarly Destination Taxation Blueprint: The Destination-Based Cash-Flow Tax

The DBCFT blueprint is a proposal for a radical or fundamental change in how MNEs are taxed.[48] The DBCFT proposal seeks to replace the corporate income tax (CIT) with the DBCFT in a domestic tax system.[49] In the context of the domestic business taxation of MNEs, the DBCFT seeks to: a) replace the income tax with a cashflow tax, b) substitute depreciation allowances with immediate expensing of investment and c) abolish interest deductions for non-financial companies (Auerbach, 2017). With regard to the international business taxation of

[46] See Mpoha (2022), pp. 235-236; Avi-Yonah et al. (2022), p. 334-335. See also Magwape (2022), p. 451.
[47] See Mpoha (2022), pp. 236-240. See also Magwape (2022), p. 451.
[48] See Auerbach (2017); Devereux and Vella (2018a), pp. 555-557; Devereux et al. (2020), pp. 3 and 20-21, arguing that the DBCFT proposal is a better reform than the OECD GLoBE proposal for the purposes of addressing both profit shifting and tax competition; Devereux et al. (2021) at chapter 7.
[49] See Auerbach (2017) at 410; Avi-Yonah and Clausing (2017), at p. 231, n 1 (the DBCFT was proposed for adoption in the United States).

MNEs, the DBCFT is a territorial tax system on domestic activities alone, plus a border adjustment to deny deductions for imported inputs and relieve export receipts from taxation (Auerbach, 2017). The DBCFT is similar to a consumption tax or value added tax (VAT): a tax on only domestic consumption; a tax on domestic consumption net of returns to labour; or a tax that equates with a VAT and a wage subsidy at an equal rate (Auerbach, 2017).

The DBCFT aims to achieve: the equal tax treatment of debt and equity capital; simplicity by not requiring income measurement; to eliminate the tax on normal return to investment; to curb profit shifting by MNEs; and to curb tax competition by nation-states.[50] Other policy rationales for the DBCFT include the following:

- the ill-suited nature of the corporate income tax, which taxes business income based on mobile factors—corporate residence, location of profits, and location of production—which are easily manipulable by MNEs; and
- taxing a less mobile factor: domestic consumption and/or sales to third parties.[51]

This radical reform has its merits and demerits.[52] The DBCFT may be a more efficient way in which to tax corporate income in the global economy because it adopts a relatively immobile tax base.[53] In other words, the DBCFT will severely minimise the distortion as to the location and scale of investment; and corporations may find it more difficult to benefit from fiscal arbitrage or income shifting regarding income earned on the internet or in the digital economy.[54] The efficiency of the DBCFT model seems to align with the purist philosophy of international tax policy.[55] Notwithstanding, Cui (2017) comprehensively appraises two versions of the DBCFT proposal and concludes that the normative benchmarks (e.g. neutrality) supporting the proposal are insufficient, unsatisfactory, and modest.[56] He also notes that proponents of the two versions of the DBCFT have failed to describe a tax that is simultaneously non-distortionary, feasible, and a tax on corporate profits.[57]

3. WHAT ARE THE EMERGING IMPLICATIONS OF THE MOVE TOWARDS DESTINATION TAXATION?

The move toward destination taxation has potential consequences for nation-states and international tax policy. This section identifies and discusses four implications based on the blueprints highlighted in the previous section:

[50] See Auerbach (2017), pp. 411-419; Devereux and Vella (2018), pp. 551, 552, and 555-557; Devereux et al. (2021), pp. 170-171.
[51] See Auerbach (2017), pp. 411-419; Devereux and Vella (2018), pp. 551, 552, and 555-557; Devereux et al. (2021), pp. 170-171.
[52] See also Elliffe (2021), pp. 268-271.
[53] See Devereux et al. (2021), pp. 279-283, and 333.
[54] See Devereux et al. (2021), pp. 280, 290-294, 297, and 333. See also Gordon and Nielsen (1997), pp. 181-183, and 190 (at p. 190, finding less tax evasion via cross-border shopping under a VAT system than under an income tax system via income shifting); Mintz and Smart (2004), pp. 1150 and 1166, finding that it is more difficult for a corporation to employ certain financing techniques in order to engage in income shifting under a system where its total income is allocated according to a statutory formula based on the distribution of sales.
[55] See Cockfield (2007) on the dichotomy between the purist and contextualist analysis of international tax law.
[56] See Cui (2017), pp. 304-305 and 346 .
[57] See Cui (2017), pp. 304-305, 322-337, and 346-347.

1. The reform will expand the source principle in a diverging way that challenges the standardisation of the extended source principle.
2. The change in momentum will likely lead to avertible costs for in-scope taxpayers, consumers, and tax administrations.
3. The destination taxation blueprints have a distributional impact without resolving inter-nation equity.
4. The reform (the OECD blueprint) will likely lead to tax competition by affluent states for sales factors.

The initial two implications arise from the divergence of international tax policymakers' blueprints. In contrast, the subsequent two implications are not the result of the divergence between the OECD blueprint and the UN blueprint. The following subsections discuss these four implications seriatim.

3.1. Expanding the Source Principle, Encouraging Diverging Unilateral Actions, and Challenging the Standardisation of the Expanded Source Principle

The reform expands the source principle in a way that may encourage diverging unilateral actions because of the divergence of the blueprints of policymakers. This divergence may challenge the standardisation of the expanded source principle. Arguably, assigning taxing rights to the demand side of the market or market states via the destination-based taxation of MNEs' corporate income is an expansion of the source principle in the field of international tax policy and practice in respect of how nation-states tax the income of corporate taxpayers. The UN blueprint expands the source principle to include payments for the sale of ADSs (UN Committee of Experts on International Cooperation in Tax Matters, 2021c; see 2.2 above), while the OECD blueprint expands the source principle generally on a transaction-by-transaction basis determined by the in-scope MNE's "sale/market revenue indicating active, significant and sustained engagement with market states beyond the mere conclusion of sales" (quoted from 2.1 above). Conversely, the scholarly DBCFT restricts this expansion of the source principle to the domestic consumption of the products of companies or MNEs (see 2.3 above). The destination-based taxation of corporate income entails that in-scope corporations have assets in the location of the demand side of the market, even without having a physical presence therein.[58] This destination-based taxation of the digital economy expands the source principle because it connotes that a sale by the relevant taxpayer is now necessarily a basis for the taxation of business profit. This expansion has tax revenue implications. Expanding the source principle via the destination-based taxation of MNEs is likely to increase governments' tax revenues due to the expansion of the tax base caused by such destination taxation.[59] The

[58] See also Devereux et al. (2021), pp. 169-170, and:

> At the time of writing, the members of the OECD/G20 Inclusive Framework are considering allocating some partial taxing rights to the destination country, although some of those advocating this reform argue that this may be justified because the business owns valuable intangible assets there—thereby treating the place of sale as an origin country. (p. 32, n 26)

[59] See also OECD (2020c), p. 61, chapter 2, and:

> Pillar One would involve a significant change to the way taxing rights are allocated among jurisdictions, as taxing rights on about USD 100 billion of profit could be reallocated to market jurisdictions under the Pillar One rules. This would lead to a modest increase in global tax revenues. (p. 10)

OECD impact assessment finds that any global tax revenue increase arising from the implementation of the OECD blueprint is likely to be "modest" (OECD, 2020c, p. 10), i.e. "less than 1% of global" corporate income tax revenue (OECD, 2020c, p. 61). The OECD predicts that "about US $100 billion of profit" could be reallocated to the location of the demand side of the market annually under the OECD blueprint (OECD, 2020c, p. 10). Elliffe (2021) notes that, were this projection to be correct, the description of such revenue as modest might be an understatement.[60] The revenue implication of expanding the source principle via the destination-based taxation of the corporate income of MNEs suggests that nation-states will be eager to have a piece of the tax pie.

International tax policymakers have given nation-states diverging routes by which to have a portion of this tax pie. The issue of how the OECD blueprint and the UN's Article 12B can be coordinated or reconciled remains. The OECD blueprint requires "the removal of all existing digital services taxes" (DSTs) "and relevant similar measures with respect to all companies, as well as a commitment not to enter into such measures in the future (OECD, 2022c, p. 5). This stipulation neither mitigates the concern about diverging unilateral actions by sovereign entities nor reconciles with UN Article 12B. For at least three reasons, UN Article 12B, concurrently existing with the OECD blueprint, may act as a precursor to countries enacting diverging forms of destination taxation, e.g., DSTs, DST-like domestic laws, WHTs, and formulary apportionment-like domestic laws. First, the July 2021 agreement (OECD, 2021a) and October 2021 update (OECD, 2021b) did not arise from a consensus agreement by the Inclusive Framework on BEPS. As of 09 June 2023, (a) 139 members of the Inclusive Framework on BEPS had agreed to the OECD blueprint, and (b) four members—Kenya, Nigeria, Pakistan, and Sri Lanka—had yet to agree to the OECD blueprint (OECD, 2023a; 2023b). As of 15 November 2023, 140 out of the now increased 145 members of the Inclusive Framework on BEPS—including Kenya and Nigeria—had approved a July 2023 outcome statement to proceed with the OECD blueprint, implying that five members—Belarus, Canada, Pakistan, Sri Lanka and Russian Federation—were yet to approve this outcome statement (OECD, 2023a; 2023b; 2023c). This first reason is buttressed by the expectation that the multilateral convention to implement the blueprint "will enter into force only upon ratification by a critical mass" of nation-states (OECD, 2022c, p. 5). This expectation suggests that countries that are not part of the critical mass may not have an obligation to ratify or implement the OECD blueprint or Amount A tax. These countries are free to consider other blueprints for the destination-based taxation of corporate income but could be encouraged to adopt the OECD blueprint due to the ratification by the critical mass. Second, some UN member states are not members of the Inclusive Framework on BEPS. The UN has 193 member states (UN, n.d.-b), suggesting that at least 48 countries are not members of the Inclusive Framework on BEPS. These 48 countries may choose the UN blueprint or OECD blueprint for the destination-based taxation of MNEs.

Third, the UN's destination taxation is a DST in substance because it seeks to tax ADSs via a WHT or net basis taxation[61] and sovereign entities have histories of adopting unilateral measures. Despite having made efforts to reach a consensus on how to tax the digital economy in a coordinated way, sovereign entities have started to take uncoordinated and unilateral actions to tax the digital economy in ways that are similar to the pending blueprints for the

[60] See Elliffe (2021), pp. 212 and 316.
[61] See also Jefferson VanderWolk (2021). Compare with Báez Moreno (2021), p. 532, (concluding that (a) WHT on ADSs is not a unilateral measure where the source state's taxing rights are preserved by a provision in a DTT; and (b) the argument that WHT on ADSs is a measure similar to DST is a difficult argument because such WHT is income tax creditable in principle in the residence state.

destination-based taxation of corporations exploiting the digital economy.[62] These are similar to the pending blueprints because they expand and link the tax base with regard to how the income of non-resident enterprises are taxed in order to encompass the location of the demand side of the market.[63] For example, in 2018, the European Commission proposed a common system of digital services tax within the EU (European Commission, 2018).[64] In May 2021, the European Commission resuscitated its call for a digital levy on digital corporations (European Commission, 2021). In July 2021, the EU decided to postpone the publication of the digital levy on digital corporations (Vela, 2021). It has been reported that the implementation of the digital levy is still on the EU's agenda.[65] DSTs have been introduced in the United Kingdom and France.[66] An equalisation levy on online advertisement services by non-residents now applies in India.[67] In 2020, Nigeria adopted the Significant Economic Presence (SEP) test to tax non-resident companies (Federal Government of Nigeria, 2004, 2019, 2020; PwC Nigeria, 2020). Nigeria has also stated that when a multilateral agreement to which it is a party is reached on a coordinated solution, such agreement will supersede Nigeria's new SEP test to tax non-resident companies in Nigeria.[68] Will Nigeria discard its SEP test because of its approval of the July 2023 outcome statement to proceed with the OECD blueprint? It remains to be seen what steps Nigeria and other countries in a similar situation will take in the coming future. The options include:

(a) eventually signing the multilateral agreement based on the OECD blueprint; or
(b) adopting the UN blueprint in their domestic laws; or
(c) continuing with the SEP test.

Presumably, these diverging, uncoordinated, and unilateral actions have been caused by the desire of these states and the EU to protect and legalise a profitable tax base, and raise tax revenues in the absence of a consensus on a coordinated solution.[69] Given that DSTs are like tariffs on imported services,[70] unilateral DSTs and DST-like laws may impede cross-border trade because of the likelihood of retaliatory measures/tariffs being taken by states (e.g. the United States) that are not satisfied with the DSTs.[71] Cui (2022) observes that such retaliatory tariffs are likely to violate WTO rules, may hurt U.S. consumers and small countries may avoid such tariffs because they do not sufficiently export goods to the United States.[72] Furthermore,

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[62] See OECD (2018), pp. 134 [341-343], 159, and, generally, chapter 4.
[63] See OECD (2018), pp. 134 [341-343] and 159, and, generally, chapter 4.
[64] See also Mason and Parada (2020), pp. 177, and 181-182.
[65] See Avi-Yonah et al. (2022), pp. 282, n 12.
[66] See HMRC (2020); Mason and Parada (2020), pp. 182-183.
[67] See OECD (2018), p. 142.
[68] See Federal Government of Nigeria (2020), Section 1(3).
[69] See also OECD (2018), p. 134; Magwape (2022) on the challenges and opportunities of taxing the digital economy in Africa.
[70] See Lockwood (1993): "the tax on the imported good is exactly like a tariff" (p. 144). See also Lockwood (2001), pp. 282, 283, and 311, noting that, due to spillover, tax reforms that lower taxes on imports are generally desirable in respect of destination taxation.
[71] See Mason and Parada (2020), pp. 192-195, arguing that DSTs may be taken as discriminatory taxes against U.S. MNEs because most digital corporations are U.S.-based. See also Martin (2021), stating that the United States Trade Representative has found that "DSTs enacted in Austria, Spain, and the UK discriminate against US companies within the meaning of Section 301 of the US Trade Act of 1974"; Butani and Jain (2021) on the finding by the United States Trade Representative that the Indian 2020 equalisation levy is discriminatory against US companies; BBC News (2021), which reports that the United States has announced the temporary suspension of any retaliatory tariffs.
[72] Cui (2022), pp. 220 and 222 n 91.

Avi-Yonah et al. (2022) submit that the U.S. tariffs have had no impact in deterring French DSTs.[73] In summary, diverging DST-like domestic laws may eventually co-exist with the OECD destination taxation blueprint because of (a) the lack of unanimous consensus on the OECD blueprint, (b) the fact that some UN member-states are not members of the Inclusive Framework on BEPS, (c) the DST nature of the UN blueprint, and (d) the history of sovereign entities in adopting unilateral measures. Cognisance is taken of the political challenges from the legislative arm of government in the United States with regard to the implementation of the OECD blueprint.[74] Even if the United States fails to implement the blueprint and the political/gentleman's agreement about it collapses, the momentum built around the existing, diverging, policymakers' blueprints is likely to propel nation-states to adopt diverging unilateral actions like DSTs, DST-like domestic laws, WHTs, and formulary apportionment-like domestic laws.

This likely diverging outcome questions or challenges the standardisation of the newly expanded source principle in international tax policy. What is the extent or standard of this newly expanded source principle in international tax policy? Given the diverging tax base, nexus, and sourcing rules of the OECD and UN blueprints, is the newly expanded source principle in international tax policy the UN's nexus/sourcing rule, the OECD's nexus/sourcing rule, or both? If only one blueprint existed or the blueprints did not diverge, this standardisation issue would not arise. The correct answer to this standardisation issue will be revealed as nation-states begin to legally adopt blueprints for the destination-based taxation of corporate income. States should consider the implications of adopting new, unstandardised source principles within their international tax legislation. The next subsection discusses the avertible costs of the built-up momentum.

3.2. Avertible Costs

This subsection focusses on the avertible costs arising due to the policymakers' diverging blueprints.[75] These diverging blueprints have cost implications for taxpayers (MNEs), consumers, and tax administrations. The likely costs include: (a) costs as a result of over-taxation or double taxation, (b) higher prices for the consumers of in-scope MNEs' products and (c) inefficiently high compliance and administrative costs. The concurrent existence of the OECD and UN blueprints is likely to lead to the over-taxation or double taxation of the corporate income of non-resident, in-scope MNEs.[76] For example, a state where the relevant MNE has no physical presence may adopt UN Article 12B's gross taxation because it is not satisfied with the OECD's destination taxation.[77] In this instance, there will likely be over-taxation or double taxation, especially where (a) the targeted MNE eventually incurs a loss in deriving such corporate income, (b) the relevant corporate income is also likely to be taxed by another country adopting the OECD's destination taxation, and (c) the targeted MNE gets no relief for gross taxation because its resident state does not recognise UN Article 12B. Plausibly,

[73] See Avi-Yonah et al. (2022), p. 330.
[74] See Avi-Yonah et al. (2022), p. 299, on the political challenges in the United States. See also Davison (2022); Rappeport (2022); Rappeport and Tankersley (2022).
[75] See also UN Committee of Experts on International Cooperation in Tax Matters (2020), p. 67. The DBCFT also raises cost implications, as mentioned below in subsection 3.3.
[76] See also UN Committee of Experts on International Cooperation in Tax Matters (2020), p. 67; VanderWolk (2021), p. 2; Mason and Parada (2020), pp. 201-202, n 126 and n 128, arguing that DSTs may result in unrelieved double taxation; OECD (2018), p. 159 [368], which notes that uncoordinated interim initiatives are likely to generate some economic distortions, double taxation, and associated compliance costs for businesses operating cross-border.
[77] See also OECD (2018), p. 141 [362].

the relevant MNE, faced with the risk of over-taxation, has a choice between continuing sales or stopping sales in this location of the demand side of the market (market state). If it chooses to continue selling in the relevant market state, it may increase the price of the products that it sells there, making consumers/customers in this market state bear the real burden of the tax. In-scope corporations that face the risk of over-taxation may shift the costs of over-taxation to consumers[78] (unless those MNEs are making excess profits and would not mind paying extra taxes).[79] The issue remains as to how much tax burden these MNEs would be willing to bear vis-á-vis any excess profit. In any event, this likely shift of the cost/incidence of the gross taxation to consumers/customers may lead to higher prices for the consumers of the targeted MNEs' products. These consumers/customers can either consume such products together with bearing the real burden of the gross tax or choose not to consume such products. The UN destination taxation blueprint recommends a modest WHT rate of 3% or 4% and refers to factors that should be considered when determining the precise level of the WHT.[80] These factors include:

- the possibility of non-resident service providers passing the cost of a high WHT rate on to customers in the source/market country;
- the likelihood of a high WHT rate deterring investment, especially if such rate is higher than the foreign tax credit limit;
- the likelihood that a high WHT rate may be excessive on net income derived from ADSs, given that some non-resident service providers incur high costs in providing ADSs;
- revenue and foreign exchange consequences for the source/market country from the reduction of the WHT rate; and
- relative flows of payments for ADSs.[81]

Some of these noted factors align with the concerns about over-taxation and the negative consequences therefrom.

Compliance and administrative costs may also arise from the OECD and UN blueprints. Corporations opting for net taxation under the UN Article 12B model may have higher compliance costs as they will need to comply with the two types, rather than one type, of destination taxation if different locations of the demand side of the market or market states adopt Article 12B and the OECD destination taxation blueprint. An example of higher compliance costs can be seen in terms of higher reporting costs. In-scope taxpayers or corporations may be required to file tax returns in source/market states, i.e. states in which they are not currently tax residents and have no physical presence. Do corporations have reporting obligations in the location of the demand side of the market (source/market states) in which they have no physical presence? Usually, such corporations have reporting obligations in states in which they are tax residents because these are states in which they are obligated to file their

[78] See Sweet (2020), reporting that Amazon is seeking to increase fees for U.K. sellers in response to the United Kingdom's DST.

[79] See Fox (2020), who argues, from his empirical study using U.S. corporate tax return data covering 1957 to 2013, but with emphasis on 1995-2013, that (1) the CIT burden fell largely on economic rents (excess profits); (2) given that economic rents are so profitable that investors will not respond to tax increases on them, the CIT burden is less likely to be shifted to labour; and (3) therefore, the real burden of the CIT fell on capital owners during the period studied.

[80] See UN Committee of Experts on International Cooperation in Tax Matters (2021c), p. 11; UN Committee of Experts on International Cooperation in Tax Matters (2020), pp. 13-14.

[81] See UN Committee of Experts on International Cooperation in Tax Matters (2021c), p. 11; UN Committee of Experts on International Cooperation in Tax Matters (2020), pp. 13-14.

tax returns.[82] In order for the destination-based taxation of corporate income to be workable, these companies may have to register in market states where they have no physical presence.[83] Alternatively, the implication of the destination-based taxation of corporate income may be that corporations will be required to file tax returns or have reporting obligations in source/market states in which they have no physical presence. The OECD blueprint provides that the coordinating entity of the in-scope MNE would file a single Amount A self-assessment return with its tax authority.[84] This tax authority then validates the assessment and exchanges information with other affected tax authorities.[85] Article 12B net basis taxation is contingent on the source/market state's tax authority having information about the relevant MNE group's profitability.[86] MNEs are likely to incur additional compliance costs if they have to file Amount A self-assessment returns and Article 12B profitability information because (a) they are operating in different market states imposing the OECD and UN blueprints, and (b) they opt for the net taxation under the UN Article 12B blueprint. Taxpayers (MNEs) facing higher compliance costs are likely to look for ways in which to optimise and mitigate their costs, including shifting the costs to local consumers. Another way by which to mitigate additional compliance costs is to employ one report for Amount A and Article 12B purposes if both require similar information. Tax administrations are also likely to incur higher administrative costs when administering the new destination taxation. Suppose that the cost of administering the new destination-based taxation of corporate income is substantially higher than the tax revenue derived; this will be inefficient, violating the efficiency principle endorsed for the taxation of electronic commerce.[87]

If some source/market states adopt the OECD destination taxation blueprint and others adopt the UN destination taxation blueprint, there are likely and avertible cost implications for taxpayers (MNEs) and consumers. As previously noted, the adoption of any destination taxation blueprint has cost implications for tax administrations.

VanderWolk (2021) observes that:

> Article 12B is unlikely ever to apply to payments to the large, global companies at whom digital services taxes are aimed. Most of those companies are based in the U.S., and the U.S., which opposes digital services taxes and uses its own model tax treaty in any case, would almost certainly never agree to a provision like Article 12B.

This observation seems to suggest that the UN destination taxation blueprint may be an almost toothless bulldog, given that most relevant MNEs are U.S. residents. However, at least two important points ought to be noted, namely: (a) not all relevant MNEs are resident in the United States;[88] (b) the UN destination taxation is a DST in substance and this sends a signal to the source/market countries without DSTs to adopt such or similar measures within their domestic laws (VanderWolk, 2021). There are cost implications if countries that do not agree with, or have changed their minds about, the OECD blueprint heed this signal.

[82] See Tax Administration Act 1994 (New Zealand), part 2A, s 15B, "Taxpayer's tax obligations".
[83] See Devereux et al. (2021), p. 187.
[84] See OECD (2020d), p. 220. See also OECD (2021a), p. 3; OECD (2021b), p. 3.
[85] See OECD (2020d), p. 220. See also OECD (2021a), p. 3; OECD (2021b), p. 3.
[86] See UN Committee of Experts on International Cooperation in Tax Matters (2021c), p. 14 [42] (Draft commentary on Article 12B (3)(4)).
[87] See OECD (1998a), p. 4 [9].
[88] See Devereux and Simmler (2021), pp. 4-5 and 9-10.

3.3. Distribution Impact Without Resolving Inter-Nation Equity

The destination-based taxation of MNEs has a distributional impact or momentum that does not resolve inter-nation equity for the following reasons:

> a) The OECD blueprint adopts an inadequate differentiated approach that does not necessarily help numerous low-income countries;
> b) The UN blueprint does not adopt a differentiated approach and may have features that disadvantage many low-income countries; and
> c) The DBCFT does not adopt a differentiated approach and its reliance purely on domestic consumption will most likely put many low-income countries at a disadvantage.

Amid an inefficiently and inequitably situated global society of nation-states, the few affluent market states seem comparatively better off via the distributional impact of destination taxation. The current global society is unfairly and inefficiently situated because: (a) investment pattern concentrates excess wealth or financial capital in few affluent states globally;[89] and (b) multidimensional poverty exists in vast areas of the global society, especially within low and lower-middle income states.[90] Locations of the demand side of the market or market states are likely to be the primary beneficiaries of the distributional impact of the existing types of destination taxation, as these provide more taxing rights to these states.[91] Given that affluent states have the largest consumer markets, there will likely be more distribution in favour of these few states with large and financially buoyant populations.[92] In other words, the ongoing changes to the international tax regime seem to make these few affluent states comparatively better off via destination taxation. Those that gain less from the destination-based taxation of MNEs include the following: (a) states with comparatively small populations because a small population may equate with comparatively low consumption; and

[89] See Clausing (2016), pp. 921, 922, and 923 (deducing from the 2012 Forbes Global 2000 list of the world's largest corporations that the headquarters of 72 per cent of the world's most profitable firms are in OECD states); Murphy et al. (2021), who note that the United States dominates as the location for the world's largest public companies; Ogrean and Herciu (2016) p. 95, noting that, as of 2015, most of the top 100 non-financial MNEs were in the United States; UN Conference on Trade and Development (2016), p. 152, with regard to: (a) the ownership of MNE affiliates by share of direct owners—the United States and European Union had 84%, developing Asia had 29%, Latin America and the Caribbean had 19%; and Africa had 18%; and (b) the ownership of MNE affiliates by share of ultimate owners—the United States and European Union had 72%; developing Asia had 24%, Latin America and the Caribbean had 11%, and Africa had 8%.
[90] See van Apeldoorn (2019), p. 561.
[91] See also OECD (2020a): "Preliminary findings suggest that the combined effect of *Pillar One* and Pillar Two would lead to a significant increase in global tax revenues as well as *a redistribution of taxing rights to market jurisdictions* [emphasis added]" (p. 19).
[92] See Christians and Magalhaes (2019), pp. 1154-1157 and 1173-1176. In particular, they state that:

> As a starting point, available OECD and World Bank data from 2017 provide a fairly clear picture of which states are the largest consumer markets. They are the United States, Europe, and China by a wide margin, followed by Japan, India, and Brazil, with Canada and Australia another step removed. (p. 1174)

They also note that: (a) "a focus on the consumer base as the market is a metric that, by definition, tends to favour the biggest consumer markets in relation to small-market, low-income countries" (p. 1175); and (b) "given the disparate levels of consumption across the globe, a market-based system would mostly benefit relatively more affluent countries and, in the best-case scenario, some emerging ones" (p. 1176).

(b) poor/low-income states because poverty may equate with low purchasing power for consumption.[93]

Hence, inter-nation equity is an apt principle by which to fairly safeguard the tax revenue of other nation-states, especially disadvantaged or low-income ones. Inter-nation equity raises two distinct issues, namely (a) what fair principles are to be applied in dividing and taxing gains/losses from cross-border transactions; and (b) the redistribution of tax revenue globally, especially in favour of low-income states.[94] Treating unequal nation-states differentially when allocating taxing rights among states can advance inter-nation equity which can, in turn, promote international distributive justice, and help to resolve global poverty and inequality (Ozai, 2020). For example, the allocation of more income to low-income countries under a formulary apportionment proposal will be a redistributive transfer of the right to tax.[95] The redistribution of income and wealth is recognised as one of the standard objectives of fiscal policy,[96] and adopting this objective in international tax policy is reasonable in an inefficiently and inequitably situated global society.

The OECD destination taxation blueprint reflects an awareness of the distributional impact and these inter-nation equity concerns but does not address these issues. It adopts a lower threshold of taxing nexus or rights for small, developing economies.[97] To fairly tax gains, the OECD blueprint arguably adopts a differentiated nexus principle by suggesting that, for smaller states with GDP below 40 billion euros, the taxing nexus should be the MNE deriving at least 250, 000 euros from such states.[98] In contrast, the taxing nexus for other market-states will be the MNE deriving at least one million euros from these states.[99] On the second inter-nation equity issue, the following question arises: is preventing wealthy states from taxing at the lower threshold redistributive towards low-income states? The answer to this question does not seem to be in the affirmative because this differentiated nexus approach does not necessarily allocate more income or taxing rights to low-income countries but does make it less burdensome for small, developing economies to claim taxing rights under the emerging destination-based taxation of MNEs' corporate income.[100] Furthermore, the published documents on this differentiated approach do not elaborate on how a GDP below 40 billion euros was chosen as the benchmark for small, developing economies. This lack of elaboration raises the question of whether the selected benchmark is appropriate.

In any event, the low-income jurisdiction allocation key provided in the sourcing rule of the OECD blueprint neither allocates more taxing rights to low-income states nor advances global

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[93] See also Christians and Magalhaes (2019), pp. 1174-1176.
[94] See Chukwudumogu (2021), pp. 109-110. Musgrave and Musgrave (2002); Avi-Yonah (2020), pp. 1649-1651.
[95] See Benshalom (2014), pp. 355-357, noting that another example of redistributive transfer is the inclusion of a minimum tax rate requirement to reduce tax competition for mobile MNE capital investments. See also Benshalom (2014), pp. 326-327, 328-343, and 351-354.
[96] See Dietsch and Rixen (2019), pp. 503.
[97] See OECD (2020d), pp. 67 [197 & 198] and 69 [213]; OECD (2021a), p. 1; OECD (2021b), p. 1.
[98] See OECD (2021a), p. 1; OECD (2021b), p. 1.
[99] See OECD (2021a), p. 1; OECD (2021b), p. 1.
[100] See also OECD (2020d):

> For the smallest jurisdictions (e.g. jurisdictions with GDP less than USD 5 billion), *the analysis suggests that many MNE groups may not have a nexus in these jurisdictions if a single threshold is set at EUR 5 million or above* [emphasis added]. On that basis, and the considerations further discussed below, a possibility is to have two separate market revenue thresholds. (p. 67)

redistribution.[101] World Bank data is used to define low-income jurisdictions as low-income economies or lower-middle income economies.[102] The sourcing rule does not necessarily prioritise the sourcing of revenue to low-income jurisdictions, as it provides that:

> After the application of paragraph B(3)(a), any remaining Revenues (the "Tail-End Revenues") shall be treated as arising in [a Jurisdiction] using the Low Income Jurisdiction Allocation Key, provided that [a Jurisdiction] is a Low Income Jurisdiction. In the event that the Covered Group demonstrates that Revenues did not arise in any Low Income Jurisdiction, the Tail-End Revenues shall be treated as arising in [a Jurisdiction] using the Global Allocation Key. (OECD, 2022a, p. 13 [B3b])

Sourcing for a low-income state is in "proportion to the percentage of its share of the final consumption expenditure as published by the United Nations Conference on Trade and Development" (OECD, 2022a, p. 14). In other words, sourcing for low-income states is secondary and tied to final consumption expenditure, suggesting that these states may not be better off when compared to the few affluent market states. Low-income states have low purchasing power and allocating taxing rights based on their final consumption expenditure is equivalent to giving them comparatively small taxing rights.

The UN destination taxation blueprint does not adopt a differentiated approach and may be deficient in inter-nation equity. The blueprint submits that it seeks to preserve developing states' domestic taxing rights over digital business models.[103] However, this submission ought to be taken with a caveat. States adopting the UN blueprint may end up taxing local consumers under the guise of taxing MNEs exploiting the digital economy, given the above-mentioned point in subsection 3.2. Furthermore, Chand and Vilaseca (2021) argue that the UN blueprint ranks low from the perspective of the tax policy principles discussed in the Ottawa framework and is not really in the interest of developing countries for reasons including:

> (a) it does not cover consumer facing businesses (CFBs) and developing countries may be deprived of the tax revenues from these;
> (b) it does not provide for revenue thresholds for ADSs and this may result in disproportionate administrative burdens for tax administration;
> (c) gross WHT dissuades cross-border activities, and the real cost of gross-basis taxation may be passed on to the local consumer in the market state;
> (d) the impracticality of collecting the WHT in a B2C context;
> (e) issues with the net basis taxation option e.g. no guidance is provided for calculations and there is no mention of how loss will be treated;
> (f) its sourcing rule (ADS income sourced to payer's residence) would lead to lower tax revenues for developing countries in some instances such as: online advertising, where substantial viewers of the advert are located in a developing country but the payer for the advert is resident in a developed state; and sale of user data where user data is located in a developing country, but the payer for such data is resident in a developed state;
> (g) the enforcement of Article 12B via DTT raises issues with regard to limited DTT networks in developing economies suggesting that they have to negotiate new DTTs or adopt domestic DSTs in the very likely event that OECD member states

[101] See OECD (2022a), pp. 13, 14, and 28.
[102] See OECD (2022a), p. 28.
[103] United Nations Committee of Experts on International Cooperation in Tax Matters (2021c), p. 5 [1 and 2].

> (resident states to most ADSs businesses) refuse to introduce Article 12B in their DTTs because of the issues surrounding it and the time-consuming process of having to renegotiate existing DTTs that may lead to non-uniform practice.[104]

Considering the likely implications of adopting the UN destination taxation blueprint, adopting states should evaluate their tax bases, tax incidence, and potential tax revenues. They ought to determine that the blueprint or potential law is likely to tax the targeted tax base. Alternatively, adopting states may limit it to instances where the targeted MNEs have a physical presence in the state or there is a means to effectively collect the tax from them.[105] States can effectively collect the tax via third-party financial intermediaries that customers employ to pay for the products of the targeted MNEs.[106]

The inter-nation equity deficiency of destination taxation is additionally underscored if the DBCFT is adopted by the entire global society asymmetrically consisting of advantaged and disadvantaged states. Given that affluent states have the largest consumer markets,[107] inter-nation equity is likely to be negatively impacted if all states are coordinated to adopt a DBCFT model as the only means for taxing corporate profits. States that are disadvantaged in terms of having small populations and populations with low purchasing power are likely to gain comparatively less amid an already inefficiently and inequitably situated global society of nation-states.[108] In other words, global adoption of the DBCFT may not fit under the contextualist philosophical view of international tax policy.[109]

Proponents of the DBCFT seem to acknowledge equity challenges to the blueprint[110] but also advance a counter-argument that small states or countries with small markets may not

[104] See also Mpoha (2022), who concludes that UN Article 12B is not a simplified solution for developing countries with regard to the taxation of income derived from the digital economy.
[105] See also Collier et al. (2021), pp. 420-421.
[106] See UN Committee of Experts on International Cooperation in Tax Matters (2021c), pp. 23-24 [63-65]. The note articulates the self-assessment and financial intermediary models of the collection of the WHT on ADSs.
[107] See Christians and Magalhaes (2019), pp. 1154-1157 and 1173-1176.
[108] See also Andersson (2019):

> Attributing one third of the allocation to sales raised concerns that countries with small domestic markets would not be interested in the CCCTB since they might easily lose tax revenues. This led to the conclusion that the importance of sales should be limited so that small countries would not lose revenues". (p. 499)

and:

> When a corporate tax system is designed, eliminating possibilities to manipulate the tax base is of course a major concern, but it should not be the only concern. One policy prescription that some promote as a means to avoid manipulation of the tax base is levying the corporate tax where the goods or services are consumed. Proponents argue that their prescription works because it is very difficult for corporations to manipulate the location of the consumer. *However, this would tend to shift taxation rights unduly to larger economies* (emphasis added) and countries with trade- and current account deficits". (p. 501)

Compare this with IMF (2019), stating that the implications of the DBCFT "for developing countries remain unclear, but, with source taxation retained for natural resources, these are not necessarily adverse" (p. 31) and p. 41, where it is indicated that the DBCFT has a medium low suitability to circumstances of low-income countries.
[109] See Cockfield (2007) on the contextualist analysis of international tax law.
[110] See Devereux et al. (2021):

necessarily be the losers under the DBCFT because: (1) under the current system, small states may have limited real activities that give them taxing rights; (2) there will be less revenue loss via profit shifting under the DBCFT than under the current system; (3) tax competition under the current system will make it increasingly difficult for these small states to raise revenue. DBCFT will reduce or eliminate tax competition.[111] The counter-argument continues as follows:

> Switching from an origin-based tax to a destination-based tax, the effect on the distribution of taxing rights depends (amongst other things) on the balance of trade. Under a DBCFT, for example, moving from an origin to a destination basis would mean that each country would forego tax on its exports, but collect tax on its imports. Where trade was balanced, these effects would net out. In the short and medium term, and ignoring all other factors, a country with a trade deficit would see a rise in its tax base, whilst a country with a trade surplus would see a fall. (Devereux et al., 2021, p. 172)

The DBCFT proponents posit that developing countries that are not resource-rich will be beneficiaries of a switch to DBCFT; maintaining origin taxation for natural resources, countries whose imports exceed their exports would likely increase their tax base and tax revenue by a switch to DBCFT for non-resource trade.[112]

The above counter-argument does not necessarily resolve the inter-nation equity concerns. First, the literature suggests that, under the current system, small, well-organised states gain from tax competition.[113] Profit shifting under the current system has made some small states (e.g. tax havens) economically prosperous.[114] These points seem to suggest that if a small low-income country is well-organised, it may gain from tax competition under the current system.[115] Second, disadvantaged states have fewer owners of economic rent than advantaged states and the incidence of the DBCFT is domestic owners of capital (or economic rent) in the destination state.[116] Given that these domestic owners of economic rent are shareholders of MNEs that are mostly resident in developed rich states, disadvantaged states are likely to gain less by a move towards the global adoption of the DBCFT.[117]

> So, although there may be questions about fairness, these are rather more general than applying only to destination-based taxes. As argued above, the case for a destination basis instead is based on its performance with respect to the criteria of economic efficiency, robustness to avoidance, and incentive compatibility. (p. 173)

See also Devereux et al. (2021), pp. 171, 182, 283-290, and 333.

[111] See Devereux et al. (2021), p. 172.

[112] See Devereux et al. (2021), p. 288.

[113] See Genschel and Seelkopf (2016), arguing that the winners of tax competition include the governments and workers of small, well-governed democracies. See also Dietsch and Rixen, (2014), p. 161, on the success of Ireland; Rixen (2011), pp. 453-454, noting that tax havens profit from tax competition and the world's tax havens are mostly small countries or dependent territories.

[114] See Hines Jr. (2005), pp. 65-67, 75-78, 79-92, and 94-95 on the economic prosperity of tax haven states; Rixen (2011), pp. 453-454.

[115] See Chukwudumogu (2021), arguing for a regulatory approach to tax competition in preference to the prohibitory approach in an asymmetrical global context.

[116]See Devereux et al. (2021):"And a DCBFT would also fall on the owners of capital, albeit in the destination country rather than the country of the owners of the business"(p. 172). See also Devereux et al. (2021), pp. 283-285.

[117] See UN Conference on Trade and Development (2016), p. 152.

Third, the DBCFT seems to redistribute more tax base to states that import more than they export, but the number or quantity of imports and purchasing capacity of the people matter. For example, a state with ten people imports for the needs of ten people, while a state with one hundred people imports for the needs of one hundred people. The purchasing capacity of the people should also be considered in any analysis of the DBCFT favouring states with trade deficits. Import being more than export cannot be enough to assess how the DBCFT will make low-income states comparatively better off; this trade deficit has to be analysed in relation to the number of people in such a state and the purchasing power of the people in such a state. A state with more people willing and capable of buying appears to gain from the DBCFT more than a state with fewer people or people who have low purchasing capacity. In any event, the political feasibility of the universal adoption of a DBCFT is still uncertain because of those more productive states that export more than they import. Devereux et al. (2021) submit two factors showing why the DBCFT may be right for these net exporting states:

> First, net trade positions change over time, albeit extremely slowly in some cases, and net exporting states might find themselves closer to a balance of trade or even net importers in years to come. Second, countries which seek to tax on an origin basis because of the benefit principle might in time find themselves simply unable to do so. Competitive forces will continue driving down corporate tax rates under the current system and businesses will respond by moving their real activity. (p. 286)

Two points ought to be noted: (a) the futuristic conjecture of the first factor is feasible, but countries may remain or subsequently become net-exporting states, and (b) policymakers can regulate tax competition in a way that allows states to tax income effectively.[118]

Fourth, there is uncertainty surrounding how the gains and losses of the DBCFT, as compared to those of the current system, will pan out for low-income countries. The current system may have its problems, but can one submit, with accurate conviction, that the problems arising under the DBCFT will be fewer than those arising under the current system when the DBCFT has not been put into practice as the means for taxing corporate profits? Arguably, the potential costs of introducing the DBCFT in developing states include transition costs,[119] new administrative costs,[120] the loss of potential gains from tax competition, and any unforeseen and unintended costs of moving to a fundamentally new system. The potential gains from the DBCFT include more tax on imports and less BEPS/tax avoidance.[121] The costs of the current international system for taxing corporate profits include BEPS/tax avoidance, too many complex laws (e.g. anti-avoidance rules), and potential losses from tax competition.[122] Who can accurately articulate how these gains and costs will net out for low-income states? Perhaps, there is a real challenge involved in accurately assessing the outcome.[123]

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[118] See Chukwudumogu (2021), pp. 169-174, on the regulation of tax competition via more enhanced transparency; OECD (2020a), on the regulation of tax competition via global minimum tax rules.

[119] See Devereux et al. (2021) at pp. 179-181 and 187. See also Titus (2021), pp. 41-42, arguing that the transitional costs of a switch to the DBCFT would be prohibitive in the context of an African developing country.

[120] See Devereux et al. (2021), pp. 179-181, 294, and 298. See also Morse (2010), pp. 631-636, on the administrative and compliance costs of introducing a global destination sales-based formulary apportionment.

[121] See Devereux et al. (2021), pp. 279-295 and 333, evaluating the DBCFT if universally adopted and concluding that its potential benefits are substantial.

[122] See Devereux et al. (2021), pp. 113-127 and 130, evaluating the existing system for taxing MNEs' international profits and concluding that it is very costly to run.

[123] Compare with Devereux et al. (2021):"it is hard to see the outcome of a DBCFT as being any less fair than the existing system" (p. 333).

For these four reasons, the scholarly DBCFT seems deficient through the lens of inter-nation equity, raising doubts about its suitability for use in an asymmetrical global context. The likely and severe inter-nation equity implication of the global adoption of the DBCFT may suggest that the destination-based taxation of MNEs' corporate income via policymakers' incremental changes to the system may be less disadvantageous to low-income states than the radical DBCFT. Drawing from the discussion in this subsection, the blueprints for destination taxation do not resolve inter-nation equity and the distributional impact of the reform will likely favour affluent market states more. Arguably, these states are likely to engage in new forms of tax competition, especially where the OECD blueprint is adopted on a large scale.

3.4. Tax Competition for Sales Factors

The OECD blueprint for the destination-based taxation of corporate income is likely to encourage the mobility of sales factors, leading to the emergence of tax competition. Although the adoption of the UN and DBCFT blueprints may cause other issues relating to tax competition to arise,[124] this subsection focusses on tax competition for sales factors. A key driving force that causes tax competition to emerge or to be readily perceived is the mobility of the object of tax competition.[125] This mobility argument is further supported by economists who recognise that the mobility of consumers or cross-border shopping can encourage tax competition within destination taxation models.[126] In instances where the destination taxation model is directed at the income of MNEs, the consumers' mobility will likely be replaced by the mobility of sales factors. Sales factors include any element or component employed to sell and buy the products of in-scope MNEs. These sales factors change or add to the traditional objects of tax competition, which is defined as how states employ their tax systems to attract and retain factors of production or potentially taxable events.[127] In other words, sales factors are a category of other potentially taxable events for which states may start to engage in tax competition.

Novel tax competition is likely to emerge from the destination-based taxation of corporate income, as in-scope MNEs are likely to modify their behaviour in response to such taxation. The destination-based taxation of corporate income appears similar to a formulary

[124] The UN blueprint may likely lead to tax competition via the WHT rate if adopted on a large scale. See IMF (2019), pp. 28 and 31, arguing that if a few states of the world adopt the DBCFT, tax competition is still likely to occur because these states will have a competitive advantage in terms of the location of the corporations' production activities; Auerbach (2017), pp. 418-419, noting the competitive advantage of only the United States adopting the DBCFT, i.e. the competitive advantage in terms of the location for the production activities of corporations—in other words, the United States may become a location tax haven if it unilaterally adopts the DBCFT; Devereux et al. (2021):

> In effect, replacing an origin-based tax on profit with a DBCFT could be seen as an aggressive move in the existing tax competition game. Origin-based taxes on business income would continue in other countries, giving businesses an incentive to locate, or relocate, their activities to countries adopting the DBCFT. This would be true irrespective of where the product was destined to be sold. (p. 296)

See also Devereux et al. (2021), pp. 23-28, 50, 72, 75, n 110, 270, 272, 278, 293-291, 296-298, and 324-325, raising issues of tax competition and the DBCFT where the customer/consumer is another business, as tax rates differ and losses/expenditures are treated/relieved differently among states.

[125] See Chukwudumogu (2021), pp. 6-12.

[126] See Agrawal and Mardan (2019); Devereux et al. (2021), pp. 15 and 284-285.

[127] See Chukwudumogu (2021), p. 7.

apportionment proposal that relies solely on the sales factor.[128] Roin (2008) submits that this formulary apportionment proposal is not a remedy for tax competition because taxpayers can, under this regime, reduce their tax liability by relocating the sales factor from high-tax to low-tax jurisdictions.[129] Therefore, based on the OECD destination taxation blueprint, in-scope MNEs are likely to re-engineer or restructure their transactions to show more sales in low or favourably taxed states.[130] In-scope MNEs and other relevant businesses are likely to shift or move sales factors from one location to another.[131] Sales factor shifting is also likely to lead to tax competition, which can cause real economic distortion because it entails shifting real activities (sales activities) from one place to another.[132] It must be noted that economic theory has observed that MNEs tend not to shift tax burden or cost when they earn an excess profit, economic rent, or residual profit (Fox, 2020). The OECD destination taxation blueprint/Amount A is about taxing residual profit. Therefore, one may submit that in-scope MNEs are unlikely to re-engineer their transactions to show more sales in low or favourably taxed states. Notwithstanding, Roin (2008) notes that "tax savings must outweigh the costs of achieving them for real world taxpayers to find tax-minimizing schemes attractive" (p. 233). Devereux et al. (2021) also submit that "if a business must choose amongst mutually exclusive options, then it is likely to choose that option which earns the highest post-tax economic rent" (p. 28). In the events described by Roin (2008) and Devereux et al. (2021), the relevant MNEs can re-engineer their sales in a way that encourages or causes tax competition among states.

Re-engineering by MNEs can arguably occur when the final destination of sales cannot be accurately determined and administrable proxies for the location of the final consumers have to be employed.[133] Such proxies may not work well when attempting to accurately determine the place of final consumption in cases such as services, intellectual property, and business to business sales.[134] With regard to a proposed destination sales formulary apportionment, Morse (2010) observes that MNEs can manipulate the location and structure of their purchasing and selling operations or functions in order to minimise their tax liabilities.[135] She continues as follows:[136]

> Despite its asserted inelasticity, sales has been "viewed as a highly mobile factor," not because the residence of the customer is elastic, but because it is relatively easy to manipulate the proxies, such as the place of delivery, that the tax system must use to determine the destination of sales. (Morse, 2010, p. 634)

Grubert (2015) articulates:

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[128] See Roin (2008), pp. 215-217 and 221-235. The formulary apportionment proposal was as proposed by Clausing and Avi-Yonah (2007) .
[129] See Roin (2008), pp. 203-204.
[130] See also Roin (2008), pp. 207-209.
[131] See also Ting (2010), pp. 100 and 134, arguing that the Common Consolidated Corporate Tax Base (CCCTB), which mirrors the multilateral formulary apportionment model, will create new opportunities for tax avoidance by MNEs: "multinational groups may refocus their tax strategies from income-shifting to "factor- shifting", that is, manipulating the location and valuation of factors used in the allocation formula" (p. 100).
[132] See Roin (2008), p. 203.
[133] See Morse (2010), p. 618.
[134] See Morse (2010), pp. 618 and 619. See also Morse (2010), pp. 620-624 and 630, on re-engineering and restructuring in business-to-business sales; Roin (2008), pp. 208-209, on the difficulty of determining the location of the ultimate/final buyer of services.
[135] See Morse (2010), pp. 620-621, 619, and 634.
[136] See Morse (2010), p. 634.

> But where is the consumer located for airplanes sold to a Bermuda leasing company, for microprocessors sold to a low-tax computer company, or for copper sold on the London Metal Exchange? Identifying the final consumer is difficult or impossible in the case of capital goods like airplanes, components like microprocessors or business software, and commodities like petroleum sold on a forward market or through a swap agreement. Capital goods present a particular problem because the destination of the final consumers may change over time. (pp. 53-54)

Benshalom (2009) argues thus: "Tax authorities cannot counter the ability of MNEs to incorporate subsidiaries in low-tax jurisdictions through which they may channel sales and purchasing operations" (p. 638). For example, a semi-conductor or microchip manufacturer that hardly contracts with final users may sell via its subsidiary in a low-tax (favourably taxed) state to subsidiaries of computer manufacturers in such state; such sale would increase the sale factor in such a low-tax state without significantly altering the way in which the relevant MNE conducts business.[137] In-scope MNEs can also sell or ship consumer-facing goods destined for high-tax states via unrelated intermediaries located in low-tax states.[138] These intermediaries may not be in-scope MNEs subject to the existing destination-based taxation. Alternatively, an in-scope MNE may divert income to a non-adopting low-tax jurisdiction.[139] Sales factor shifting is likely to exist because of the destination-based taxation of corporate income, especially in instances where proxies are employed in order to determine the final place of consumption, because of the difficulty involved in determining such a place. It is submitted that this sales factor shifting is likely to encourage tax competition among market states in respect of the selling and purchasing operations/functions of MNEs and other businesses (unrelated intermediaries).

Although the OECD blueprint seems to solve the sales factor shifting problem via its proposed sourcing rules, the adopted approximation standard to determine the source/market state allows some sales factor shifting. As a starting point, the blueprint features a transaction-by-transaction based sourcing rule in order to determine the source/market state.[140] This type of sourcing rule is further supported by specific provisions depending on the particular revenue from the specific product of the in-scope MNE.[141] For example, the source/market state for finished goods sold to final customer is also the goods' place of delivery.[142] Second, in-scope MNEs are expected to use reliable indicators or a range of reasonable factors in order to determine the source/market state from which the revenue for the particular product is derived, based on the available information about the transaction.[143] Reliable indicators by which to determine the place of delivery of such finished goods include the delivery address of the final customer and the place of the retail storefront selling the finished goods to the final customer.[144] Third, an allocation key providing a reasonable approximation of the source/market state is used to source any remaining revenue that cannot, despite reasonable efforts having been made,

[137] See Benshalom (2009), pp. 637-638; Morse (2010), p. 620.
[138] See Morse (2010), p. 634; Roin (2008), pp. 207-208 and 231; Chand et al. (2020), p. 606.
[139] See Roin (2008), p. 226.
[140] See OECD (2022a), pp. 5-6.
[141] See OECD (2022a), pp. 6-7.
[142] See OECD (2022a), pp. 6 [5] and 12.
[143] See OECD (2022a), pp. 3, 10, and 11.
[144] See OECD (2022a), pp. 12-13.

be sourced on a transactional basis.[145] In other words, the OECD blueprint recognises the challenges involved in transactionally determining the source/market state for (a) third-party distribution arrangements, (b) components, (c) certain services, and (d) intangible property.[146] Therefore, the OECD blueprint seems to have solved the challenge raised above by Benshalom (2009) in respect of components by determining the location of the final customer or the place of delivery of the finished goods into which the component is incorporated to be the source/market state.[147] This sourcing rule seems to solve the sales factor shifting problem relating to the sale of components like semi-conductors or microchips used in the manufacture of computers. However, in-scope MNEs are likely to continue to plan strategies by which to mitigate their tax liabilities, especially where indicators or reasonable approximations, such as the location of an intermediary/"independent" distributor/reseller or place of use of a B2B service, are used to determine the market or source state.[148] MNEs seek ways by which to optimise the costs of doing business, including tax costs.[149] In-scope MNEs and other relevant businesses may be incentivised to locate and perform their sales and purchasing functions in favourably taxed or low-tax states. Therefore, states may begin to compete to be the location of sales factors that include business customers using cloud computing services, customers enjoying or using in-scope MNEs' services, and purchasers/intermediaries buying in-scope MNEs' goods or services.

Which states are likely to seek to attract and retain this novel object (sales factor) and how will they do so? Arguably, the tax competition for sales factors may be predominantly amongst symmetrically advantaged or wealthy/affluent states because: (a) the major consumer markets are in these states, (b) the in-scope MNEs are the few highly profitable ones, and (c) shifting the sales factors of an MNE to a disadvantaged state or market with low purchasing power would obviously result in questions being asked about the intention of such a move. The second issue mentioned in this paragraph borders on the elements or means of tax competition. The means of tax competition under the OECD blueprint are likely to include tax rates, tax base,

[145] See OECD (2022a), pp. 3, 26 [2], 28 [22], and 30 [35]. The report also states that: "despite best efforts, a Covered Group may not be able to isolate the source for every transaction (e.g. tail-end revenue, components, B2B services), and in such case an allocation key is provided" (p. 6, n 3); and:

> "Allocation Key" means the Regional Allocation Key, the Low Income Jurisdiction Allocation Key, the Global Allocation Key, the Aggregate Headcount Allocation Key, the Cargo Air Transport Allocation Key, the Cargo Non-air Transport Allocation Key, the Headcount Allocation Key, the Passenger Air Transport Allocation Key, and the Passenger Non-air Transport Allocation Key. (p. 26 [7])

The global allocation key employs a country's percentage share of final consumption expenditure as published by the UN Conference on Trade and Development or an approximation of such final consumption expenditure using the country's population.

[146] See OECD (2022a), p. 3.

[147] See OECD (2022a), pp. 6 [7] and 15 [A].

[148] See OECD (2022a), pp. 7 [h], 13 [B], 15 [A], 21 [H], and 23 [iii]. Compare this with OECD (2022c), p. 67. The OECD (2022c) demonstrates an awareness of the likelihood of sales factor shifting via intermediaries. The report also provides that, to the extent to which the covered group knows, or reasonably concludes, that its finished goods that are sold through an independent distributor are primarily delivered to final customers located outside of the location of the independent distributor, the covered group's revenue will not be treated as arising from the location of the independent distributor. This article submits that this provision is subjective and may be prone to exploitative interpretation by covered groups that intend to optimise their tax costs.

[149] See Cui (2017), p. 308, arguing that one of the margins in investment decisions taken by MNEs is the choice of where to book profits once profits on investments are realised. This choice is affected by countries' statutory tax rates. See also Christians (2018), pp. 17 and 19, on the costs of imposing tax.

tax incentives, and administrative practice.[150] Tax competition via low or favourable tax rates can occur in the event of the destination-based taxation of corporate income. Market states can engage in tax competition via the CIT rate that is to be applied to their portion of Amount A, i.e. by reducing their CIT rates in order to attract the sales factors of in-scope MNEs and other relevant businesses.[151] For example, states may use the tax rate to compete for unrelated intermediaries through which in-scope MNEs sell their products to high-tax states. States can also generate and respond to tax competition by narrowing the tax base of the destination-based taxation of corporate income.[152] Tax competition via the narrowing of the tax base may occur as a result of some types of in-scope MNEs being taxed more favourably than others. For example, in-scope MNEs at the top of the excess wealth pyramid may be given preferential tax treatment not available to in-scope MNEs at the bottom of the excess wealth pyramid. Market states may also develop novel tax incentives and administrative practices to compete for sales factors.

This subsection has submitted that the move towards the destination-based taxation of corporate income will likely lead to novel tax competition for sales factors. In other words, implementation of the OECD's destination taxation blueprint may lead to behavioural changes amongst in-scope MNEs and other relevant businesses. This, in turn, is likely to result in tax competition that can cause real economic distortion because sales factor shifting entails shifting real activities (sales activities) from one place to another. The concluding section includes suggestions as to how international tax policymakers and affluent market states should react to this likely shifting of sales activities and the resultant tax competition. It also highlights additional lessons that can be learned from the other implications discussed.

4. CONCLUSION: LESSONS FOR INTERNATIONAL TAX POLICYMAKERS AND NATION-STATES

This article highlights policymakers' blueprints and a scholarly blueprint for the destination-based taxation of MNEs' corporate profits. As nation-states consider which blueprint to adopt and legalise, they should take the emerging implications of these blueprints into account. Therefore, this article also reveals and examines these implications, namely: (1) expanding the source principle, diverging unilateral actions, and the challenge to the standardisation of the newly expanded source principle in international tax; (2) avertible costs; (3) distributional impact that does not resolve inter-nation equity; and (4) symmetrical tax competition for sales factors. Section 3 elucidates and discusses these overlooked consequences of destination taxation based on the blueprints highlighted in the article. What lessons do these implications have for stakeholders, namely international tax policymakers and nation-states?

Implications one and two suggest that international tax law policymakers need to coordinate in order to ensure that the international tax system is coherent with regard to its approach to the destination-based taxation of MNEs' corporate income and to prevent avertible costs. The reform imposes avertible costs on taxpayers, consumers/customers/users/purchasers, and tax administrations. International tax policymakers need to coordinate the process of incorporating destination taxation into the international tax system in order to prevent both diverging unilateral actions by sovereign entities and unstandardised source principles. Why do states send representatives to two different institutions—the UN and the Inclusive Framework on BEPS—to concurrently negotiate the resolution of the same critical policy issue of how the

[150] See Chukwudumogu (2021), pp. 8-11.
[151] See also Eden (2021) on differences in CIT rates triggering new tax avoidance games by MNEs.
[152] See also Belan and Gauthier (2009), p. 654.

exploitation of the digital economy by MNEs can be taxed when the respective representatives can reach different solutions or outcomes?[153] Understandably, negotiating via different institutions has the advantage of resulting in the creation of a fallback plan perchance negotiation in one institution fails to yield favourable outcomes. However, it must be noted that this concurrent negotiation strategy could cause avertible costs to arise as a result of inconsistent, uncoordinated, or diverging outcomes. A better and more refined approach to negotiating the resolution of a critical global policy issue would be to choose a genuinely representative, multilateral, and competent institution for the negotiation of, and deliberation about, such an issue so as to avoid inconsistent, uncoordinated, or diverging outcomes with attendant costs. Alternatively, international tax policymakers need to coordinate the processes of incorporating destination taxation into the international tax system.

Implication three suggests that low-income countries need to evaluate any destination taxation blueprint that they plan to adopt into their domestic legislation more than other nations. The non-resolution of inter-nation equity by built-up momentum indicates that low-income countries need to evaluate more before legally adopting any blueprint. A low-income country opting for either the OECD or UN blueprint should evaluate its tax base, tax incidence, and potential tax revenue. For example, it should determine whether or not the UN blueprint or potential domestic law will likely tax the targeted tax base. The UN blueprint may be adopted or limited to instances where the targeted MNEs have physical presences in the state or there is a means of effectively collecting the tax from them. States can effectively collect the tax via third-party financial intermediaries that customers employ to pay for the targeted MNEs' products. If the adoption of the UN destination taxation blueprint is not likely to raise tax revenue efficiently, it may be desirable to adopt the OECD destination taxation blueprint. This implication also suggests that, when international tax policymakers are significantly reforming the international tax system, inter-nation equity should be considered so that numerous low-income states are not excluded and enticed to deviate from the reformed system.

Implication four suggests that an expanded CBCR and anti-tax avoidance rules may be apt or needed by affluent market states in order to respond to the likely symmetrical tax competition. The CBCR requires (a) relevant MNE groups to report on their sales activities and (b) details about each MNE, including a "description of the main geographic markets for the group's products and services" (OECD, 2015b, p. 25); and purchasing or procurement, sales, marketing and distribution business activities.[154] This comprehensive reporting mechanism of the CBCR is a tool with which to address the sales factor shifting and symmetrical tax competition. Hence, it is advisable that policymakers consider employing the CBCR reporting mechanism for Amount A purposes. Policymakers may expand the CBCR to include "all markets (sales and purchases) of the group's products and services" rather than merely "the main geographic markets". This expanded CBCR should be incorporated into the multilateral agreement and model domestic legislation being finalised in order to implement the OECD's destination taxation blueprint. This expanded CBCR may also address the reporting challenge created by the non-comprehensive "single Amount A self-assessment return", which does not show all the sales and purchasing functions/activities of the in-scope MNE. Chand et al. (2020) have also called for the amendment/expansion of the CBCR and automatic exchange of information among tax administrations so as to implement a simplified, modified, residual profit split

[153] See UN Economic and Social Council (2021), noting that the 25 members of the Committee of Experts on International Cooperation in Tax Matters act "in their personal capacity" and are "nominated by governments"/member states of the UN (p. 1). Nomination by their governments suggests that the governments have the influence or power to direct the works of these 25 members.
[154] See OECD (2015b), pp. 15, 16, 25, 27, and 30.

method.[155] These commentators suggest the modification of the current version of the CBCR documentation to include the collection of business line-level aggregated data on profits, losses, and the locations of sales, i.e. a change that requires MNEs to report information at the business line level based on global consolidated income.[156]

The expanded CBCR is a readily available regulatory instrument for the regulation of tax competition for sales factors. The CBCR may deter states from being used excessively for sales factor shifting because of the reputational crisis that such use could cause. However, if these states are not deterred, how will a high-tax state respond, given the use of the CBCR as a tool for the regulation of tax competition? The expanded CBCR is expected to report comprehensively on the sales activities of MNEs. Hence, a high-tax state can employ this instrument in order to discover whether or not an MNE group is engaging in excessive sales factor shifting and identify the recipient states of the sales factor. With such information, the high-tax states can deter MNEs from sales factor shifting via the denial of deductions for costs arising from such sales activities, especially if the source/market state is also the resident state of an in-scope MNE engaging in sales factor shifting. The high-tax state may also reduce its taxes so that sales functions can be located therein (i.e. generate and respond to tax competition).

The expanded CBCR has a limitation and, therefore, needs to be supported by anti-tax avoidance rules because of symmetrical tax competition. For example, a high-tax state may be a source state and not a residence state. This high-tax state may choose not to generate and respond to tax competition. In this instance, it may be difficult for such a high-tax state to react in order to counteract tax competition from low-tax states, even if it is equipped with CBCR information. Some may argue that these source/market states "find themselves in 'a prisoners' dilemma' where they would be better off collectively by not offering incentives but each feels compelled to offer the incentive to maintain a competitive business environment" (OECD, 1998b, p. 34). This assertion may be valid if the states involved are symmetrically situated.[157] This article projects that tax competition for sales factors is likely to occur symmetrically among affluent market states.[158] This indicates that there may be no need to employ tax competition in order to rectify inefficiency and inequity.[159] Such symmetrical tax competition would likely cause real economic distortion because the shifting of sales factors entails the movement of real (sales) activities from one location to another.[160] In these circumstances, a narrow regulatory response may be apt.[161] It may be appropriate to penalise the shifting of sales factors in order to curb such symmetrical tax competition and mitigate real economic distortion. How can sales factor shifting be penalised in the multilateral instrument and how can the model domestic legislation be finalised? The incorporation of anti-tax avoidance rules within the forthcoming multilateral instrument and accompanying domestic legislation may be a mechanism by which to penalise sales factor shifting.[162] The use of such rules may also address

[155] See Chand et al. (2020), pp. 608-610.
[156] See Chand et al. (2020), pp. 608-610.
[157] However, where states involved are not symmetrically situated, the validity of the assertion becomes doubtful. See Chukwudumogu (2021), arguing that, in an asymmetrical global context, the approach to tax competition ought to be regulatory rather than merely curbing or prohibitory.
[158] See above at subsection 3.4.
[159] Compare with Chukwudumogu (2021), arguing that, in an asymmetrical global context, tax competition can correct market failure globally. Hence, a wide regulatory response is apt in this circumstance.
[160] See above at subsection 3.4.
[161] This contrasts with a wide regulatory response if the scenario were asymmetrically involving advantaged and disadvantaged states.
[162] See also Chand et al. (2020), p. 606.

the situation in which an in-scope MNE splits (Ralston, 2021), thereby making the resultant MNEs not liable for Amount A tax. Therefore, an expanded CBCR accompanied by anti-tax avoidance rules is an apt response to sales factor shifting and the resultant symmetrical tax competition by affluent market states. International tax policymakers and affluent market states should consider employing these tools when finalising the multilateral instrument and adopting domestic legislation for the OECD's destination taxation blueprint.

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INCOME TAX APPELLATE TRIBUNAL IN INDIA – CHALLENGES AHEAD

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Abstract

The 82-year-old Indian Income Tax Appellate Tribunal (ITAT) is regarded by taxpayers as an efficient and fair forum. This article describes challenges faced by the ITAT, for example, growing pains due to its rapid expansion during the past three decades, recent changes to the tenure of its adjudicating members and to the eligibility criteria for appointing such members, and anticipated challenges in light of the proposed changes to its operating model. The article relies primarily on interviews with retired tax officials, former ITAT adjudicators, retired judges, and tax practitioners.

1. INTRODUCTION

The first level of appeal for taxpayers in India against the Income Tax Department (ITD) is before the Commissioner of Income Tax (Appeals) [CIT(A)], a quasi-judicial authority (Deloitte, 2020). The next level of appeal for taxpayers wishing to challenge the CIT(A)'s decisions is before the Income Tax Appellate Tribunal (ITAT), which is independent of the ITD and is the first level of appeal for the ITD against the CIT(A)'s orders (Deloitte, 2020). Unlike the CIT(A), who is a senior ITD official, the ITAT is under the Ministry of Law and Justice, which is independent of the Ministry of Finance (Butani, 2016). The ITD and the Central Board of Direct Taxes (CBDT) fall under the Ministry of Finance.[2] Decisions made by the ITAT can be appealed to the jurisdictional High Court, whose judgments can be appealed to the Supreme Court, which is the highest court in India (Deloitte, 2020).

This article begins with a description of the research methodology, followed by an introduction to the ITAT. The challenges faced by the ITAT to its adjudicatory function and its independence are then described. A brief discussion of challenges anticipated due to proposed changes to the ITAT's operating model follows. To the best of the author's knowledge, based on a review of academic literature, the discussion undertaken in this article is the first of its kind in academic literature. This article makes a case for reforming the ITAT and lays the foundation for further research. The article concludes with recommendations to improve the selection of ITAT adjudicators and to preserve the independence of the ITAT's functioning.

[1] The author is grateful to the interviewees for their time and thoughts. The author is also grateful to a retired income tax official for reviewing a draft of the manuscript and providing insightful comments. The views of interviewees are their personal views and do not represent the views of any of the organisations that the interviewees worked for in the past. The author is also grateful to two anonymous reviewers for their comments and feedback, and to the editors of the Journal of Tax Administration for their support during the article submission process.
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[2] The CBDT is the apex decision-making body for income tax matters in the ministry and oversees the ITD.

2. RESEARCH METHODOLOGY

This research, which is part of a larger project that studied the tax appeal system in India, refers to 33 interviews, including interviews with eight former income tax officials, 18 tax practitioners, including seven lawyers, seven chartered accountants, and four tax practitioners with both legal and chartered accountancy qualifications, and former adjudicators, including eight former ITAT adjudicators, three former High Court judges, and a retired Supreme Court judge.[3] Ethics approval was secured for the larger project to collect data using interviews.[4]

Semi-structured interviews were employed to gather the thoughts of the interviewees, as this method allows an interviewer to manage the interview in a manner that achieves the goals of the interviewer and the research while respecting the right of interviewees to share their perspectives. According to Qu and Dumay (2011), "the semi-structured interview involves prepared questioning guided by identified themes in a consistent and systematic manner interposed with probes designed to elicit more elaborate responses" (p. 246). The breadth of the interview guide helps the interviewer to conduct the interview without prompting interviewees with specific questions, whereas the probes enable interviewees to recount their experiences during the interview.[5] Semi-structured interviews were used in this research project as they helped the researcher to elicit details that would have been difficult to obtain using, for example, a written questionnaire or a survey. Furthermore, semi-structured interviews enable the use of follow-up questions and provide the researcher with an opportunity to connect different parts of the interview in real time.

Interviewees were selected using convenience and snowball sampling, with the initial interviewees identified through the author's personal and professional networks. The author contacted all of the potential interviewees identified through their networks as well as by the interviewees.[6] More than three-quarters of those contacted agreed to be interviewed. Interviews were conducted online between December 2020 and June 2021, with interviewees located in Bengaluru, Chennai, Delhi, Mumbai, and Hyderabad. The interviews took around an hour and a half on average and were transcribed verbatim. These transcripts were coded and analysed using NVivo. After the data had been categorised using descriptive coding, thematic coding was used to develop themes across categories, with some themes straddling categories (Gibbs, 2007; Saldaña, 2014).

Given that the sample of interviewees was not random but was instead based on convenience and snowball sampling, the qualitative results of this research cannot be generalised. However, to the author's knowledge, based on a review of academic literature, this research, especially with regard to the challenges faced by the ITAT, is the first of its kind and therefore develops the groundwork for further qualitative, as well as quantitative, research.

The next section introduces the ITAT and describes its functions and operations.

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[3] To preserve the confidentiality of interviewees, their names have been replaced by codes corresponding to their professional backgrounds. A legend of these code names is included in Appendix A.
[4] Ethics approval for the research project was given by the Human Ethics Committee of Victoria University.
[5] See Qu and Dumay (2011), pp. 246-47.
[6] The author approached all tax professionals known to them as well as those who were referred to the author by others, including interviewees. Although the author took care to avoid introducing a bias into the selection process, the pool of interviewees is not immune to the bias introduced by interviewees when suggesting other potential interviewees. This is a limitation of the process of snowball sampling.

3. THE INCOME TAX APPELLATE TRIBUNAL

The ITAT was established in January 1941 and is a quasi-judicial institution (ITAT, n.d.-a). It is known as the "Mother Tribunal" and its success led to the institution of many other tribunals in India, such as the Customs, Excise, Service Tax Appellate Tribunal (CESTAT) and the Central Administrative Tribunal (CAT) (ITAT, n.d.-a). Originally consisting of six adjudicating members, also known as "ITAT members", and three benches, it now has "63 benches in 27 different stations, covering almost all the cities having a seat of the High Court" (ITAT, n.d.-a).

The ITAT's motto is "Nishpaksh Sulabh Satvar Nyay", which means "impartial, easy and speedy justice" (ITAT, n.d.-a). The organisation has a reputation for delivering justice efficiently and in a cost-effective manner. A senior tax practitioner asserted that the "ITAT is a fantastic forum" where justice can be sought.[7] Even retired ITD officers have a high regard for the ITAT.[8] 70% of the ITAT's orders are accepted by both parties, with only 6% of the orders being accepted for review by the High Courts, and around 30% of the reviewed orders being overturned (Shivaram, 2017). A tax practitioner who had previously served as an adjudicating member on ITAT benches remarked that "objective, judicious, conscientious, fair, and reasonable" orders are rendered by the ITAT.[9] In addition, tax practitioners have observed that the ITAT expeditiously disposes of appeals.[10] One tax practitioner remarked that the ITAT benches "have been doing a brilliant job, both in terms of quality of justice and speed of justice" and that it "is really the first stage where one can expect some justice".[11] For this reason, many taxpayers consider the ITAT to be their first, not second, level of appeal following the ITD's assessments.[12]

Most of the appeals at the ITAT are heard by division benches comprising two adjudicating members: an accountant member and a judicial member (Income Tax Appellate Tribunal (n.d.-b).[13] An accountant member is drawn from pools of chartered accountants or serving senior ITD officials and a judicial member is selected from the bar (i.e. a practising lawyer) or the judiciary (Income Tax Appellate Tribunal, n.d.-b). Tax practitioners and retired ITD officials note that recruitment from the above streams is conceptually quite good, as it builds diversity of experience among ITAT members.[14] Given that appeals before the ITAT may involve questions of fact or law, accountant members provide expertise vis-à-vis factual accounting issues and judicial members contribute legal or judicial expertise.[15] Retired ITAT members, tax practitioners, and retired ITD officials note that the judicial member brings to the bench

[7] Interview with A5, a tax accountant practitioner (January 2021). The ITD is colloquially referred to as the revenue.
[8] Interview with IT2, a retired ITD official (January 2021); Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
[9] Interview with IM4, a former ITAT adjudicator (January 2021).
[10] Interview with L3, a tax lawyer practitioner (February 2021).
[11] Interview with TP4, a tax practitioner (January 2021).
[12] Interview with IM6, a former ITD official and a retired ITAT adjudicator (December 2020).
[13] The ITAT also constitutes single member benches (SMCs) to decide issues of fact of lesser importance. For example, SMCs decide disputes that amount to less than Rs.500,000 and are staffed with experienced members. See "Steps for reduction of pending cases in ITAT" (2001).
[14] Interview with IM6, a former ITD official and a retired ITAT adjudicator (December 2020); Interview with IT5, a former ITD official and a retired CBDT member (December 2020).
[15] Interview with IM2, a retired ITAT adjudicator (April 2021).

judicial principles that accountant members may not be familiar with.[16] Decisions of division benches require the concurrence of members ("Steps for reduction of pending cases in ITAT", 2001).[17] When the two bench members have different opinions, the matter is referred to a third ITAT member and the majority view is pronounced as the final decision ("Steps for reduction of pending cases in ITAT," 2001). The combined experience of the division benches leads to quick decision making, thereby contributing to the ITAT's efficiency.[18]

The following section presents the results of a qualitative analysis of case law and data collected from interviews with the income tax professionals described in detail in section 2.

4. THE ITAT'S CHALLENGES

When the ITAT was established (prior to India's independence), it was first placed under the Finance Department, the predecessor to today's Ministry of Finance, which also houses the ITD, one of the litigants in every appeal.[19] Following public opposition over the lack of independence of the ITAT from the ITD, as both shared the same parent ministry, the ITAT was soon shifted to the Legislative Department, the predecessor to today's Ministry of Law and Justice.[20] Over the years, the ITAT's challenges primarily dealt with preserving its independence from the Ministry of Law and Justice (its administrative parent), as well as from the Ministry of Finance and the ITD. For example, a secretary of the Ministry of Law and Justice tried to interfere in the workings of the ITAT, which led to a case being filed against him by the ITAT.[21] The Supreme Court rebuked the secretary for illegal interference in the ITAT's adjudicatory function and penalised him for contempt.[22] This is because the Ministry of Law and Justice is only a nodal ministry for administrative purposes and cannot interfere in the adjudicatory function of the ITAT.[23] A senior tax practitioner noted that the Ministry of Finance would also like the ITAT to "toe their line and their way of thinking" instead of being independent.[24] A former ITAT member and retired High Court judge concurred, citing past attempts made by the Ministry of Finance to undermine the ITAT.[25] For example, the Ministry of Finance tried to replace the Ministry of Law and Justice as the ITAT's administrative parent, but the then formidable Minister of Law and Justice scuttled that attempt.[26] In addition, via amendments made through the Ministry of Finance to the Income Tax Act 1961 (India), the ITD tried to curtail the ITAT's discretion to stay matters as well as to admit fresh evidence.[27]

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[16] Interview with IT6, a former ITD official and a retired CBDT member (December 2020); Interview with IT5, a former ITD official and a retired CBDT member (December 2020); Interview with IM2, a retired ITAT adjudicator (April 2021).
[17] Interview with IM1, a retired ITAT adjudicator (April 2021).
[18] Interview with IM2, a retired ITAT adjudicator (April 2021).
[19] See "Appointment of ITAT members for only five years will undermine the independence of the ITAT: AIFTP" (2017); Interview with TP2, a tax practitioner (February 2021).
[20] See "Appointment of ITAT members for only five years will undermine the independence of the ITAT: AIFTP" (2017).
[21] See *Income Tax Appellate Tribunal v K. Agarwal & Another*, [1998] SC Writ Petition (Civil) No. 2350 of 1996 (17 November 1998) (Supreme Court of India); Interview with TP2, a tax practitioner (February 2021).
[22] Interview with TP2, a tax practitioner (February 2021).
[23] Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[24] Interview with L3, a tax lawyer practitioner (February 2021).
[25] Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[26] Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[27] Interview with IM3, a retired ITAT adjudicator (February 2021); Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021).

Today, the ITAT faces new challenges. First, the ITAT has grown considerably over the past three decades and this rapid growth has brought with it some growing pains ("Steps for reduction of pending cases in ITAT," 2001). Second, the Government of India changed the role of an ITAT member from a permanent position to a fixed tenure posting and altered the ITAT member application eligibility requirements, resulting in potential challenges to the independence of the ITAT. In addition, the fact that the ITAT is under the Ministry of Law and Justice has traditionally preserved its independence from the Ministry of Finance, which oversees the ITD.[28] However, a tax practitioner has expressed concern that there appears to be growing interference by the government, possibly at the behest of the ITD, in the adjudicatory function of the ITAT.[29]

A. The ITAT's Growing Pains

The rapid increase in the number of ITAT benches, from 28 to 63, in the past few decades is said to have adversely impacted the recruitment and training of new ITAT members. The quality of ITAT members is also said to have suffered as a result.[30] Several tax practitioners agree that the ITAT has lost some of its sheen during this period.[31]

1. Member recruitment

(a) Selection committee

ITAT members used to be selected by a committee that included a sitting Supreme Court judge nominated by the Chief Justice of the Supreme Court,[32] the President of the ITAT, and a secretary of the Ministry of Law and Justice.[33] The committee made its selection based on interviews and a review of the candidates' backgrounds and achievements.[34] A former ITAT member and a retired ITD official said that selecting a person for the senior position of an ITAT member primarily based on a personal interview, which lasts anywhere between 15 minutes and an hour, may not be the most appropriate selection mechanism.[35] A key concern is that, once appointed, being quasi-judicial authorities, ITAT members cannot easily be held accountable for their decisions and are difficult to remove.[36] The quality of the selection process thus impacts the quality of the members and, consequently, their orders.[37] A former ITAT member and a retired High Court judge observed that "if your recruitment is bad, then,

[28] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021); Interview with L4, a tax lawyer practitioner (February 2021).
[29] Interview with L2, a tax lawyer practitioner (April 2021).
[30] Interview with A3, a tax accountant practitioner (February 2021); Interview with A1, a tax accountant practitioner (March 2021); Interview with L2, a tax lawyer practitioner (April 2021); Interview with A7, a tax accountant practitioner (January 2021); Interview with L6, a tax lawyer practitioner (January 2021).
[31] Interview with A3, a tax accountant practitioner (February 2021); Interview with A1, a tax accountant practitioner (March 2021); Interview with L2, a tax lawyer practitioner (April 2021); Interview with A7, a tax accountant practitioner (January 2021); Interview with L6, a tax lawyer practitioner (January 2021).
[32] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
[33] Interview with IM6, a former ITD official and a retired ITAT adjudicator (December 2020).
[34] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
[35] Interview with IM4, a former ITAT adjudicator (January 2021); Interview with IT3, a retired ITD official (January 2021).
[36] Interview with IT3, a retired ITD official (January 2021).
[37] Interview with IM4, a former ITAT adjudicator (January 2021); Interview with SCJ, a former High Court judge and a retired Supreme Court judge (March 2021); Interview with A6, a tax accountant practitioner (January 2021).

if the seed sown is bad, then, you can't really complain that the fruit is rotten. It'll be rotten".[38] However, some believe that this selection process is quite rigorous and adequate.[39]

The Government of India changed the composition of the ITAT member selection committee in 2017, and further restructured the committee in 2020 (Kanzarkar, 2020). In the changes made through rules based on the Finance Act 2017 (India), the government added a nominee of the Ministry of Law and Justice to the committee along with up to two other nominees of the government (Government of India, 2017; Kanzarkar, 2020). Another change made in 2017 was the removal of the sitting Supreme Court judge from the committee that selects accountant and judicial adjudicating ITAT members from the applicant pool, leading to there being no representation of the judiciary on the committee (Government of India, 2017; "New ITAT members to get marginal salary hike but limited 3 year term for members, VPs and President", 2017). The removal of the involvement of the judiciary in selecting ITAT members, whose orders are subject to review by the judiciary, attracted criticism from the bar (Shivaram, 2017), as did the change introducing up to two nominees of the government into the selection committee.[40] In *Rojer Mathew v South Indian Bank Limited & Others* (2020),[41] the Supreme Court struck down the rules to appoint tribunal members, noting that "the role of the judiciary" was "virtually absent", "in direct contravention of the doctrine of separation of powers", and "an encroachment on the judicial domain'" (*Rojer Mathew v South Indian Bank Limited & Others*, 2020, paragraphs 152-153). The Court added that "exclusion of the Judiciary from the control and influence of the Executive is not limited to traditional Courts alone, but also includes Tribunals since they are formed as an alternative to Courts and perform judicial functions" (*Rojer Mathew v South Indian Bank Limited & Others*, 2020, paragraph 153). The Court reasoned that the rules amounted to "excessive interference of the Executive" and "would undoubtedly be detrimental to the independence of judiciary besides being an affront to the doctrine of separation of powers" (*Rojer Mathew v South Indian Bank Limited & Others*, 2020, paragraph 84). The Court concluded that the rules were "an attempt to keep the judiciary away from the process of selection and appointment" (*Rojer Mathew v South Indian Bank Limited & Others*, 2020, paragraph 157).

In light of the above Supreme Court decision, the government reversed these two changes in rules framed in 2020[42] but, strangely, added a secretary of the Ministry of Finance to the original selection committee that existed prior to 2017 (Kanzakar, 2020). Given that the ITD, which falls under the Ministry of Finance, is a constant litigant in appeals before the ITAT, this addition introduces a conflict of interest. For example, the Supreme Court stated previously that "[t]he Executive is a litigating party in most of the litigation and hence cannot be allowed to be a dominant participant in judicial appointments" (*Rojer Mathew v South Indian Bank Limited & Others*, 2020, paragraph 157). The low success rate of the ITD before the ITAT further adds to this concern (Ministry of Finance, Government of India, 2018). In fact, a senior lawyer observed that the composition of the selection committee prior to 2017 was free from the interference of the Ministry of Finance, thereby leading to "complete freedom from the finance ministry" with respect to "the constitution of the tribunal".[43] The Supreme Court

[38] Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[39] Interview with IT2, a retired ITD official (January 2021).
[40] Interview with IM2, a retired ITAT adjudicator (April 2021), who was concerned about political interference in the process.
[41] *Rojer Mathew v South Indian Bank Limited & Others*, [2020] 6 SCC 1 (Supreme Court of India). https://indiankanoon.org/doc/36423291/
[42] Government of India (2020).
[43] Interview with L7, a tax lawyer practitioner (January 2021).

ultimately decided that a secretary of the sponsoring or parent department, e.g. a secretary of the Ministry of Finance in this case, "cannot have a say in the process of selection" and would therefore function without a vote (*Madras Bar Association v Union of India & Another*, 2020).[44] The government incorporated the Supreme Court's decision to limit the role of a secretary of the Ministry of Finance to a non-voting member-secretary in an ordinance promulgated on 4 April 2021.[45]

(b) Applicant pool

The rapid growth of the ITAT has been accompanied by a perceived dilution in the selection of new ITAT members, especially in the new millennium.[46] When the ITAT was founded in 1941, only eminent tax practitioners were appointed as members.[47] Tax practitioners express concern that the quality of new ITAT members in the recent past has suffered due to the rapid increase in the number of benches.[48] Previously, there were fewer benches and a smaller ITAT member pool was required, so perhaps five to ten members would be recruited in one drive.[49] However, a doubling of the size of the ITAT member pool from fewer than 60 to more than 120 members meant that recruitment drives sometimes needed to result in the selection of up to 30 members.[50] Naturally, candidates who would previously not make the cut to become ITAT members now had the opportunity to be appointed.[51] A senior tax practitioner shared their views about the quality of recent ITAT member recruits as below:

> I don't think I would appoint half the members who get appointed because some of them really don't have the quality, especially the newer appointments. … But the approach is, and it's sad, but the approach is, let's fill up the vacancies even with not the best of candidates. So, … one should not compromise competence for just filling up vacancies. Run with a smaller strength, use that strength more efficiently, but have good quality. (Interview with IM2, a retired ITAT adjudicator, April 2021)

A former ITAT member and a retired High Court judge agreed that the ITAT should only recruit good members and, when such candidates are not available, it should run at lower strength instead of filling vacancies with undeserving candidates.[52] A retired ITAT member concurred and remarked that sometimes the selectors recruit undeserving candidates from the initial applicant list instead of calling for a fresh list of applications.[53]

The pool of well-qualified and successful tax practitioners who would be interested in the position of an ITAT member has also shrunk over the past two decades. First, the post of the ITAT member carries with it a drawback in that candidates selected for the post are not usually posted in their domicile.[54] Second, like most government officials, ITAT members are

[44] *Madras Bar Association v Union of India & Another*, [2020] SCC Online SC 962 (27 November 2020) (Supreme Court of India).
[45] The Tribunals Reforms (Rationalisation and Conditions of Service) Ordinance 2021 (India).
[46] Interview with L2, a tax lawyer practitioner (April 2021).
[47] Interview with IM3, a retired ITAT adjudicator (February 2021).
[48] Interview with TP3, a tax practitioner (January 2021).
[49] Interview with IM2, a retired ITAT adjudicator (April 2021).
[50] Interview with IM2, a retired ITAT adjudicator (April 2021).
[51] Interview with IM2, a retired ITAT adjudicator (April 2021).
[52] Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[53] Interview with IM2, a retired ITAT adjudicator (April 2021).
[54] Interview with L4, a tax lawyer practitioner (February 2021).

transferred from one location to another every three to five years.[55] These constraints mean that ITAT members have to relocate their families frequently.[56] Tax practitioners who have spent most of their lives in their city of practice may be reluctant to do this.[57] Third, the pool of tax practitioners has always been small to begin with and tax law has become a lucrative practice, especially in the past two decades, resulting in successful practitioners being less interested in the post of an ITAT member.[58] For example, the remuneration of ITAT members, while fairly good by the standards of pay among government positions, pales in comparison to the earnings of tax practitioners in private practice or the private sector.[59] This has led to non-tax practitioners applying for ITAT member posts and a dilution in the extent of tax experience on ITAT benches.[60] In addition, some who become ITAT members despite "the disparity between what a professional earns and what a tribunal member earns" may have an agenda,[61] e.g. corruption. Lastly, ITAT members are often not afforded proper facilities, such as infrastructure (court rooms and technology) and staff (stenographers), that would enable them to work effectively.[62] The above factors have greatly reduced the attractiveness of the position of an ITAT member.

For lawyers, there is a drawback to becoming an ITAT member. A retired ITAT judicial member claimed that lawyers "who would aspire to be [a] judge of the High Court would avoid" being a member of the tribunal because "their chances of elevation to [the] High Court are reduced".[63] This is due to the unwritten quotas that determine the percentage of High Court judges selected from the bar (around 40%) and the lower judiciary (around 60%).[64] ITAT members do not fall under either of these categories and therefore find themselves elbowed out by other applicants. Moreover, due to frequent transfers, ITAT members are not as visible to the High Court judges as lawyers and lower judiciary officials would be.[65] This further reduces the chances of ITAT members being appointed as High Court judges as the endorsement of appointments by sitting High Court judges carries a lot of weight. A retired ITAT member remarked that "only a person who is noticed by a Supreme Court judge or may be a Chief Justice of India … is picked up from the tribunal", which is a "very rare" occurrence, adding that one can "count on fingers how many people have been appointed as High Court judges from the [income tax appellate] tribunal".[66] A senior tax practitioner, quoting a former ITAT

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[55] Interview with L4, a tax lawyer practitioner (February 2021).
[56] Interview with L4, a tax lawyer practitioner (February 2021).
[57] Interview with IT4, a retired ITD official (December 2020).
[58] Interview with L4, a tax lawyer practitioner (February 2021).
[59] Interview with L4, a tax lawyer practitioner (February 2021); Interview with L3, a tax lawyer practitioner (February 2021); Interview with IT4, a retired ITD official (December 2020); Interview with A7, a tax accountant practitioner (January 2021); Interview with TP4, a tax practitioner (January 2021).
[60] Interview with L4, a tax lawyer practitioner (February 2021); Interview with L3, a tax lawyer practitioner (February 2021); Interview with IT4, a retired ITD official (December 2020); Interview with A7, a tax accountant practitioner (January 2021); Interview with TP4, a tax practitioner (January 2021). L2, a tax lawyer practitioner also remarked that "today, the appointments on the judicial member side are people who've probably never practiced tax in their lives" and added that tax lawyers are no longer interested in taking up ITAT member posts.
[61] Interview with L3, a tax lawyer practitioner (February 2021); Interview with TP4, a tax practitioner (January 2021).
[62] Interview with A1, a tax accountant practitioner (March 2021); Interview with IM4, a former ITAT adjudicator (January 2021); Interview with L2, a tax lawyer practitioner (April 2021).
[63] Interview with IM2, a retired ITAT adjudicator (April 2021).
[64] Interview with IM2, a retired ITAT adjudicator (April 2021). Lower judiciary refers to non-tax judicial fora below the level of the High Court, e.g. district courts.
[65] Interview with TP2, a tax practitioner (February 2021).
[66] Interview with IM2, a retired ITAT adjudicator (April 2021).

member and a retired High Court judge, stated that fewer than 40 ITAT members may have been appointed as High Court judges in the past 80 years.[67]

The diminishing allure of the post of an ITAT member has led to a decline in the quality of recent ITAT member recruits as per practitioners, who are concerned about the downturn.[68] A retired member of the CBDT agreed that the quality of the ITAT members who have been appointed to the ITAT in the recent past is "leaving much to be desired".[69]

2. Member training

The ITAT usually trains new members by pairing them with experienced members.[70] A senior tax practitioner explained that "there is a glide path for [new] members" as they are "slowly blooded" over a couple of years before they are fully ready to take up all types of matters.[71] For example, new members are tasked with drafting simple orders until they are ready to take up the more complex matters.[72] This on-the-job training of new members is critical because not all member recruits come with a knowledge of income tax law, which is complex to begin with.[73] The ITAT's rapid growth made such training difficult to offer as there may not always have been enough experienced members to pair with the new ones.[74] This further impacted the quality of newly recruited members as well as their adjudication.

3. Quality of decisions

A consequence of the inevitable compromises in the recruitment and training of ITAT members is a perceived decline in the quality of orders passed by ITAT benches.[75] For example, inconsistent ITAT decisions have increased over time. Traditionally, in cases where the analysis of an earlier ITAT bench on a point of law was not palatable to a subsequent bench, the latter bench would request the president of the ITAT to convene a special bench in order to resolve the disagreement.[76] In such cases, the ITAT's president subsequently convenes a special bench comprising three or five ITAT members,[77] and the decision of the special bench becomes binding precedent for all ITAT benches.[78] A retired ITAT member commented that, at least until the early years of this century, by and large, the ITAT benches used to follow the precedent laid down by the other benches, in line with High Court and Supreme Court decisions insisting on such adherence.[79] Another former ITAT member added that, at least until 2010, judicial discipline was mostly adhered to among the ITAT benches, who respected the

[67] Interview with L1, a tax lawyer practitioner (April 2021). This translates into fewer than 10% of the number of past and present ITAT members (around 500) of the ITAT having been appointed as High Court judges.
[68] Interview with L1, a tax lawyer practitioner (April 2021).
[69] Interview with IT6, a former ITD official and a retired CBDT member (December 2020).
[70] Interview with TP2, a tax practitioner (February 2021); Interview with IM2, a tax lawyer practitioner (April 2021).
[71] Interview with TP2, a tax practitioner (February 2021).
[72] Interview with TP2, a tax practitioner (February 2021).
[73] Interview with TP2, a tax practitioner (February 2021).
[74] Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[75] Interview with L1, a tax lawyer practitioner (April 2021).
[76] Interview with IM3, a retired ITAT adjudicator (February 2021); Interview with IM4, a former ITAT adjudicator (January 2021).
[77] Interview with IM3, a retired ITAT adjudicator (February 2021).
[78] Interview with IM3, a retired ITAT adjudicator (February 2021); Interview with TP1, a tax practitioner (January 2021).
[79] Interview with IM3, a retired ITAT adjudicator (February 2021).

decisions of other ITAT benches for the most part.[80] However, this interviewee argued that members recruited over the past decade or so do not appear to have the same regard for judicial discipline vis-à-vis decisions of other benches, leading to inconsistent ITAT bench decisions becoming more and more frequent.[81]

A tax lawyer explained that "in many cases, … the tribunal will … somehow distinguish" the cases on fact, with the result that similar issues "are decided differently", and noted that the reasons for such inconsistency are not always clear.[82] A retired chief commissioner of the ITD added that some ITAT members even contradict their own decisions sometimes.[83] Another retired chief commissioner concurred.[84] A tax lawyer had a similar experience and suggested that such ITAT members may have integrity issues.[85] The second retired chief commissioner recommended that ITAT members who contradict their own decisions should be subject to an investigation,[86] alluding to the idea that corrupt practices may be involved. On a separate note, a retired ITAT member stated that an ITAT bench may sometimes disregard the ITAT precedent if they doubt the integrity of the ITAT members comprising the precedent bench but insists that judicial discipline be adhered to.[87] A senior tax lawyer concluded that conflicting ITAT decisions have now become "very common".[88]

When ITAT members disagree with precedent, they have the prerogative to ask the president of the ITAT to constitute a special bench, but they do not have the "power to decide" a case contrary to the ITAT precedent.[89] Retired ITAT members advocate judicial discipline[90] and suggest that not following this is not only wrong[91] but also immoral.[92] A retired ITAT member advised that "strong administrative action" should be "taken against those members who disobey judicial discipline".[93] However, another retired ITAT member said that questioning an ITAT member, who is a quasi-judicial official, may be a difficult proposition [94] unless the legal contradiction or inconsistency is irreconcilable. Tax practitioners urge the president of the ITAT to constitute a special bench to resolve the conflict among such decisions[95] as the

80 Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
81 Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021). A retired member of the CBDT (IT6) agreed that there is, at times, a divergence among the legal conclusions of different ITAT benches. A former ITAT member who retired as a High Court judge (HJ2) concurred that ITAT benches sometimes contradict decisions made by other benches.
82 Interview with L4, a tax lawyer practitioner (February 2021).
83 Interview with IT3, a retired ITD official (January 2021); Interview with L2, a tax lawyer practitioner (April 2021).
84 Interview with IT1, a retired ITD official (March 2021).
85 Interview with L2, a tax lawyer practitioner (April 2021).
86 Interview with IT1, a retired ITD official (March 2021).
87 Interview with IM1, a retired ITAT adjudicator (April 2021).
88 Interview with L7, a tax lawyer practitioner (January 2021).
89 Interview with IM2, a retired ITAT adjudicator (April 2021).
90 Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021); Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021); Interview with IM2, a retired ITAT adjudicator (April 2021).
91 Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021); Interview with IM2, a retired ITAT adjudicator (April 2021).
92 Interview with IM2, a retired ITAT adjudicator (April 2021).
93 Interview with IM2, a retired ITAT adjudicator (April 2021).
94 Interview with IM1, a retired ITAT adjudicator (April 2021).
95 Interview with L7, a tax lawyer practitioner (January 2021); Interview with TP1, a tax practitioner (January 2021); Interview with L4, a tax lawyer practitioner (February 2021).

president has the power to suo moto constitute a special bench if they identify a conflict among the decisions of different ITAT benches.[96]

The growing pains of the ITAT, including issues with the quality of selection as well as the training of ITAT members, have therefore taken some of the sheen off of the ITAT and introduced inconsistency into the quality of its orders as well as its precedent.

B. Member Tenure Criteria

During most of the ITAT's history, ITAT members have held permanent posts and have typically worked until retirement.[97] Currently, the retirement age for ITAT members is 62 years.[98] However, recently, the Government of India changed the ITAT member role from that of a permanent position to a fixed tenure position ("New ITAT members to get marginal salary hike but limited 3 year term for members, VPs and President", 2017). The only other time when ITAT members were hired for a fixed tenure instead of on a permanent basis was in 1941, when the ITAT was established (with three benches and six members).[99] However, that initial five-year tenure-based posting did not prove to be "workable",[100] leading to it transitioning to a permanent role-based posting from 25 February 1950 ("Appointment of ITAT members for only five years will undermine the independence of the ITAT: AIFTP", 2017). The return to a fixed-term posting echoes the past unsuccessful experiment,[101] but it has larger ramifications today as the ITAT fields 63 benches which, at full strength, require 126 members.

A former ITAT member asserted that a fixed tenure posting will not "augur well" for the growth of the ITAT.[102] Even prior to this change, attracting the best talent to the ITAT was a difficult proposition, as explained above.[103] Some retired members claim that this change may render the position of ITAT member even less attractive to tax practitioners, i.e. chartered accountants and lawyers who apply for the roles of accountant and judicial members respectively.[104] For example, the recruitment of ITAT members may pose problems due to the uncertainty that a fixed tenure brings to career prospects of new members.[105] Moreover, a chartered accountant or a lawyer who leaves their practice to become an ITAT member will effectively have lost their clients by the time they have completed their fixed-term posting, so it will be necessary for them to build a practice from the scratch after leaving the ITAT.[106]

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[96] Interview with L7, a tax lawyer practitioner (January 2021); Interview with IM2, a retired ITAT adjudicator (April 2021).
[97] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
[98] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
[99] Interview with L5, a tax lawyer practitioner (February 2021).
[100] Interview with L5, a tax lawyer practitioner (February 2021); Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021).
[101] Interview with L5, a tax lawyer practitioner (February 2021).
[102] Interview with IM4, a former ITAT adjudicator (January 2021); Interview with IM1, a retired ITAT adjudicator (April 2021).
[103] Interview with L7, a tax lawyer practitioner (January 2021); Interview with L6, a tax lawyer practitioner (January 2021).
[104] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
[105] Interview with TP3, a tax practitioner (January 2021); Interview with L5, a tax lawyer practitioner (February 2021); Interview with IM2, a retired ITAT adjudicator (April 2021).
[106] Interview with L5, a tax lawyer practitioner (February 2021); Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021); Interview with IM2, a retired ITAT adjudicator (April 2021).

Furthermore, ITAT members are not allowed to practice before the ITAT after they leave, so ex-members have fewer career options.[107] A senior practitioner said that a successful chartered accountant would not apply for the position of an ITAT member given that they would be barred from practising before the ITAT after leaving it.[108] Unlike lawyers, who can at least appear in the High Courts after leaving the ITAT, chartered accountants can only appear before the CIT(A) after leaving the ITAT, but not in the ITAT and High Courts.[109] However, those interested in the charm of government service and the prestige associated with being a government functionary may apply,[110] perhaps towards the end of their careers. In addition, given that an ITAT member will typically be posted in a city other than their domicile, practitioners may not be keen on uprooting their family for a short, fixed tenure posting.[111] Due to these constraints, a tax practitioner with a good practice may not be interested in serving in the ITAT for a short tenure,[112] which may be as low as five years (*Madras Bar Association v Union of India & Another*, 2020; *Rojer Mathew v South Indian Bank Limited & Others*, 2020). In fact, the Supreme Court said that "it will be illusory to expect a practising advocate to forego his well-established practice" in order to become a member of a tribunal for a short tenure (*Rojer Mathew v South Indian Bank Limited & Others*, 2020, paragraph 176).

Consequently, those on the verge of retirement from government or judicial service may apply to be ITAT members.[113] Senior tax practitioners remarked that the ITAT will become a "parking lot" for government or judicial officials who primarily want to pass time before they retire.[114] A retired ITAT member concurred, adding that those "at the fag end of their career" may not take the role as seriously as those in earlier stages of their career.[115] Alternatively, Indian Revenue Service officials from the ITD or Indian Legal Service (ILS) officers from the Government of India may be appointed as accountant and judicial ITAT members respectively for a fixed tenure, and they would subsequently return to their bureaucratic positions.[116] A tax practitioner argued that those holding short, fixed tenure positions "will be at the beck and call of the law ministry", the nodal ministry for appointing ITAT members, particularly if the fixed term is renewable.[117] For example, in *Rojer Mathew v South Indian Bank Limited & Others* (2020), the Supreme Court noted that a "short tenure" may increase "the influence and control of the Executive over Members of Tribunals, thus adversely affecting the impartiality of the Tribunals" (paragraph 175). A dearth of independent ITAT members would sound a death knell to the independence of the ITAT.[118] Lastly, the view of practitioners and former ITAT members is that there is no need to fix something that is not broken ("Appointment of ITAT members for only five years will undermine the independence of the ITAT: AIFTP", 2017).

[107] Interview with L5, a tax lawyer practitioner (February 2021).
[108] Interview with A4, a tax accountant practitioner (February 2021).
[109] Interview with A4, a tax accountant practitioner (February 2021).
[110] Interview with A4, a tax accountant practitioner (February 2021).
[111] Interview with IM3, a retired ITAT adjudicator (February 2021).
[112] Interview with IM2, a retired ITAT adjudicator (April 2021).
[113] Interview with L5, a tax lawyer practitioner (February 2021); Interview with IM1, a retired ITAT adjudicator (April 2021).
[114] Interview with TP2, a tax practitioner (February 2021); Interview with L5, a tax lawyer practitioner (February 2021).
[115] Interview with IM1, a retired ITAT adjudicator (April 2021).
[116] Interview with IM3, a retired ITAT adjudicator (February 2021), who remarked that members of the ILS should not even be recruited as judicial ITAT members because they do not have experience in judicial matters and mostly do legal work.
[117] Interview with L2, a tax lawyer practitioner (April 2021).
[118] Interview with IM3, a retired ITAT adjudicator (February 2021).

Training will also become a challenge. As discussed above, it takes around two years of on-the-job training for a new ITAT member to be able to handle all types of matters.[119] If around half of the fixed tenure is lost to training the new members, going forward, the ITAT will benefit from the full experience and expertise of each new member for around half of their term.[120] This portends inefficient and, possibly, ineffective functioning of the ITAT, likely leading to larger pendency and more appeals to High Courts.

Tax practitioners also express concern that a fixed tenure post may adversely impact the judicial discipline and the independence of ITAT members.[121] For example, a member with a fixed tenure post may be anxious about their future career prospects[122] and may act in a manner that increases the chances of their tenure being renewed for another fixed term, e.g. by favouring the government in appeals.[123] In this context, a retired High Court and Supreme Court judge made the following comment on the need for independent ITAT members:

> If the tenure of a member is dependent on the whims of the employer, they become … bonded labourers. … [T]he tendency would be to [say], … why take a risk, whatever be the law, I will save my skin and decide in favour of the revenue. That should not happen. (Interview with SCJ, a former High Court judge and a retired Supreme Court judge, March 2021)

Alternatively, ITAT members may not invest adequate time and effort to do justice to a transitory role that is only for four years, leading to the quality of adjudication suffering.[124] A senior practitioner also expressed concern that a fixed tenure may "open the floodgates to people … with ulterior motives" applying for the post of an ITAT member.[125] The senior practitioner added that the fixed tenure "is an ATM" for those who apply to become ITAT members with the objective of earning a pension for the rest of their life during the short, fixed term,[126] ostensibly through corrupt practices, which are not unheard of in the ITAT.[127]

Some retired ITAT members and senior tax practitioners object to the argument that the government changed the permanent role of an ITAT member to a fixed tenure posting to harmonise the tenure of members of different tribunals in the country, on the grounds that the

[119] Interview with TP2, a tax practitioner (February 2021).
[120] Interview with TP2, a tax practitioner (February 2021). For example, the Supreme Court of India advised that "prescribing such short tenures precludes cultivation of adjudicatory experience and is thus injurious to the efficacy of Tribunals" (*Rojer Mathew v South Indian Bank Limited & Others*, 2020, paragraph 175).
[121] Interview with L4, a tax lawyer practitioner (February 2021); Interview with L3, a tax lawyer practitioner (February 2021); Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[122] Interview with L4, a tax lawyer practitioner (February 2021).
[123] Interview with IM3, a retired ITAT adjudicator (February 2021); Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[124] Interview with L4, a tax lawyer practitioner (February 2021).
[125] Interview with TP2, a tax practitioner (February 2021); Interview with IM3, a retired ITAT adjudicator (February 2021); Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
[126] Interview with TP2, a tax practitioner (February 2021).
[127] Interview with A1, a tax accountant practitioner (March 2021); Interview with IT1, a retired ITD official (March 2021); Interview with IT3, a retired ITD official (January 2021); Interview with IT2, a retired ITD official (January 2021); Interview with L3, a tax lawyer practitioner (February 2021); Interview with L2, a tax lawyer practitioner (April 2021); Interview with L6, a tax lawyer practitioner (January 2021); Interview with A6, a tax accountant practitioner (January 2021).

ITAT stands apart from the remaining tribunals.[128] For example, the ITAT deals with tax, a complex and specialised subject, and therefore needs its members to be experts in either law or accounting.[129] In addition, as discussed above, new ITAT members need to be trained for at least two years before they are fully equipped to deal with all types of tax matters.[130] This is not the case with most of the other tribunals, where such expertise or training is not critical. Moreover, the ITAT has 63 benches, unlike most of the other tribunals, which have one or two benches ("Appointment of ITAT members for only five years will undermine the independence of the ITAT: AIFTP", 2017). Lastly, the ITAT is the final fact-finding authority in tax matters ("Appointment of ITAT members for only five years will undermine the independence of the ITAT: AIFTP", 2017). These reasons justify taking a "horses for courses" approach instead of just seeking uniformity for the sake of it.[131] However, some believe that the fixed tenure system may have some merit. A retired ITD official commented that a fixed tenure system will enable corrupt ITAT members to be fired and new ITAT members to be hired more easily than a system consisting of permanent positions.[132] A tax practitioner also said that a fixed tenure system enables the government to retain the flexibility to either ramp up or scale down ITAT benches in order to dispose of the backlog of appeals.[133]

Nevertheless, tax practitioners and retired ITAT members argue that the disadvantages of the fixed tenure system appear to overshadow any advantages that it may have. The Supreme Court struck down a fixed four-year tenure proposal, noting that the rules were:

> not in compliance with the principles of law… in respect of the tenure of the members of the Tribunals in spite of this Court repeatedly holding that short tenure of members is detrimental to the efficiency and independence of the Tribunals. (*Madras Bar Association v Union of India & Another*, 2020, paragraph 35)

However, the government's Tribunals Reforms (Rationalisation and Conditions of Service) Ordinance 2021 (India) did not give effect to the Supreme Court's decision, leading to the Court again striking down the four-year tenure rule as being "void and unconstitutional" (*Madras Bar Association v Union of India & Another*, 2021, paragraph 55).[134]

C. Member Eligibility Criteria

The Government of India recently revised the experience level criteria for potential ITAT members. The minimum experience level required for practising chartered accountants and lawyers wishing to apply to become ITAT members was increased from 10 years to 25 years. A former ITAT accountant member and current tax practitioner said that this increase in experience level is "arbitrary" and does not "augur well" for the growth and development of

[128] *Rojer Mathew v South Indian Bank Limited & Others* (2020); Interview with TP2, a tax practitioner (February 2021); Interview with IM3, a retired ITAT adjudicator (February 2021); "Appointment of ITAT members for only five years will undermine the independence of the ITAT: AIFTP" (2017). In *Rojer Mathew v South Indian Bank Limited & Others* (2020), the Attorney General of India submitted to the Supreme Court of India that the tenure of ITAT adjudicators was reduced to a fixed term to rationalise the functioning of tribunals.
[129] Interview with IT3, a retired ITD official (January 2021).
[130] Interview with TP2, a tax practitioner (February 2021).
[131] Interview with TP2, a tax practitioner (February 2021).
[132] Interview with IT1, a retired ITD official (March 2021).
[133] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
[134] *Madras Bar Association v Union of India & Another*, [2021] SC Writ Petition (Civil) No. 502 of 2021 (14 July 2021) (Supreme Court of India), 70.
https://main.sci.gov.in/supremecourt/2020/16100/16100_2020_35_1501_24869_Judgement_27-Nov-2020.pdf

the ITAT.[135] A retired ITAT judicial member concurred, noting that "members should be selected at an early [age], at 40-45" as "that is the right age for the person to join the tribunal" in order to learn and to develop their adjudicatory skills.[136] Those joining the ITAT much later in their careers may be less inclined to adapt and learn, possibly leading to a further deterioration in the quality of orders. A retired ITAT member also asserted that the new criteria may reduce the independence of the ITAT by making the post of an ITAT member unattractive to independent professionals, leading to retired government officials or those on the verge of retirement being appointed.[137] This is because practitioners may be unwilling to leave their practices at the peak of their careers. Interestingly, the Supreme Court asserted that:

> as the qualification for an advocate of a High Court for appointment as a Judge of a High Court is only 10 years, we are of the opinion that the experience at the bar should be on the same lines for being considered for appointment as a judicial member of a Tribunal. (*Madras Bar Association v Union of India & Another*, 2020, paragraph 41)

However, in the Tribunals Reforms (Rationalisation and Conditions of Service) Ordinance 2021 (India), the government tried to get around the Supreme Court's decision above by setting the minimum age for being able to apply to the post of a tribunal member at fifty years, in effect increasing the experience level required of tax practitioners, i.e. lawyers or chartered accountants, to 25 years or even more. This led to the Supreme Court striking down this requirement as being "in violation of the doctrine of separation of powers" (*Madras Bar Association v Union of India & Another*, 2021, paragraph 49). The Court explained the basis for its ruling as follows:

> Fixing a minimum age for recruitment of Members as 50 years would act as a deterrent for competent advocates to seek appointment. Practically, it would be difficult for an advocate appointed after attaining the age of 50 years to resume legal practice after completion of one term, in case he is not reappointed. Security of tenure and conditions of service are recognised as core components of independence of the judiciary. Independence of the judiciary can be sustained only when the incumbents are assured of fair and reasonable conditions of service, which include adequate renumeration and security of tenure. (*Madras Bar Association v Union of India & Another*, 2021, paragraph 49)

The following section discusses recent amendments (made in 2021) to the operating model of the ITAT proposed by the Government of India and explores their likely impact on the ITAT.

5. ANTICIPATED CHALLENGES

On 1 February 2021, the Government of India, through the Finance Bill 2021 (India), proposed amendments to the portion of the Income Tax Act 1961 (India) corresponding to the ITAT (referred to as "Appellate Tribunal" in the Bill and the Act). Through these amendments, which became part of the Finance Act 2021 (India), on 28 March 2021 (TG Team, 2021), the government proposed a new operational model for the ITAT, in which adjudication would be performed electronically (Vaitheeswaran, 2021). In 2020, the government had made adjudication at the level of the CIT(A), against whose orders appeals are filed to the ITAT

[135] Interview with IM4, a former ITAT adjudicator (January 2021).
[136] Interview with IM1, a retired ITAT adjudicator (April 2021).
[137] Interview with IM3, a retired ITAT adjudicator (February 2021).

electronically, without any right to a physical or a virtual hearing (Vaitheeswaran, 2021). As the results of this experiment are not yet available for evaluation, some feel that extending the experiment to the ITAT at this time is premature.[138]

A former ITAT member and retired High Court judge doubted the validity of the framing of faceless appeal procedures by the government because the ITAT is an independent body that has the power to frame its own rules without interference by the government.[139] In addition, many believe that a faceless system will violate the principle of natural justice relating to the opportunity to be heard (audi alteram partem, i.e. "to hear the other side", or "let the other side be heard as well").[140] However, some believe that an electronic hearing provides the opportunity to be heard and that such an opportunity need not be provided in person.[141] The author discussed, in detail, many of the arguments against the faceless system and some in favour of the faceless system in a separate article that was published in December 2021 (Mohan, 2021).

In response to the argument that the faceless appeal process is being introduced in order to combat corruption,[142] retired ITAT members, tax practitioners, and retired judges responded that corruption is a problem that ails not only the ITAT but also the High Court, the Supreme Court, and the government, as well as the larger society, and questioned whether the faceless system would be acceptable to the government or to the High Court or the Supreme Court.[143] In addition, senior tax practitioners remarked that the government should have fully tested the faceless system at the level of the CIT(A) before applying that model to the ITAT,[144] which is the final fact-finding body and the first stage at which taxpayers expect to secure justice.[145] Former ITAT members thus feel that the faceless system is not apt for an institution like the ITAT.[146] However, some retired ITAT members and practitioners accept virtual hearings via video conferencing even though they do not find faceless hearings appealing.[147] Others note that a faceless system is acceptable, provided that an opportunity to be heard through a virtual hearing is afforded to the taxpayer as a safeguard.[148]

The above faceless amendments were proposed without any prior consultation with relevant stakeholders, e.g. the tax bar, ITAT members, High Court judges, and taxpayers.[149]

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[138] Vaitheeswaran (2021); Interview with A3, a tax accountant practitioner (February 2021).
[139] Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021).
[140] Interview with L4, a tax lawyer practitioner (February 2021); Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021), who noted that an oral hearing is mandatory according to, at least, the Delhi High Court.
[141] Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021); Interview with A6, a tax accountant practitioner (January 2021); Interview with A2, a tax accountant practitioner (March 2021).
[142] Interview with A6, a tax accountant practitioner (January 2021).
[143] Interview with IT1, a retired ITD official (March 2021); Interview with IM4, a former ITAT adjudicator (January 2021); Interview with TP2, a tax practitioner (February 2021); Interview with IM3, a retired ITAT adjudicator (February 2021).
[144] Interview with A3, a tax accountant practitioner (February 2021).
[145] Interview with TP4, a tax practitioner (January 2021).
[146] Interview with IM3, a retired ITAT adjudicator (February 2021); Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021).
[147] Interview with L4, a tax lawyer practitioner (February 2021); Interview with IM3, a retired ITAT adjudicator (February 2021).
[148] Interview with L2, a tax lawyer practitioner (April 2021).
[149] Interview with L4, a tax lawyer practitioner (February 2021).

6. RECOMMENDATIONS

Retired members of the CBDT, the apex body for income tax matters, a retired ITD official, and a tax practitioner recommended that, to improve the quality of recruitment of new ITAT members, the criteria for selection of members should be clear, e.g. experience level, and proposed better vetting of the background of ITAT applicants to validate their abilities and achievements.[150] A senior practitioner agreed, noting that the appointment of ITAT members should be "tightened" and made "more robust",[151] e.g. via a multi-level screening and filtration process.[152] A former ITAT member and a retired ITD official suggested that, in addition to personal interviews, a more objective mechanism, e.g. a written test, should be used to assess the knowledge of applicants and reduce the subjectivity of the process.[153] We believe that the selection of ITAT members should be based on both objective and subjective criteria. Objective criteria may include: a written test; the number of cases won by ITAT applicants in their practice, especially before the ITAT; qualifications and credentials indicating academic excellence in law or accountancy; academic or professional publications authored by the applicants; and the size and the stature of the applicants' clientele. Subjective criteria may include interviews and formal recommendation letters.

One suggestion for attracting better talent from the tax practitioner pool is to post the recruited ITAT members in their domiciles.[154] If a permanent posting in a member's domicile is infeasible for administrative reasons, their initial posting can be in their domicile, as is typically done for High Court judges. In addition, the frequency of transfers should be reduced, again taking inspiration from the fairly lower frequency of transfers of High Court judges. Another recommendation is to increase the compensation of ITAT members in order to attract better talent.[155] The infrastructure available to members should also be improved, e.g. by modernising courtrooms and providing adequate secretarial and staff resources.

To better train new members, especially when there is a paucity of senior and experienced ITAT members to train them on the job, the ITAT should institute a formal training programme. A formal training programme may help to overcome the constraint of the number of new ITAT members exceeding the number of experienced ITAT members. For example, the knowledge and experience of retired ITAT members could be leveraged in order to train new members using a case study approach of reviewing past cases, with the new members discussing the arguments and counterarguments for each case. Retired accountant members could train new accountant members and retired judicial members could train new judicial members initially to orient the new members' accountancy and judicial skills respectively to the rigours of the role. This could be followed by a joint training programme. Mock trials could also be enacted, with new members deciding cases to further their training.

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[150] Interview with IT6, a former ITD official and a retired CBDT member (December 2020); Interview with SCJ, a former High Court judge and a retired Supreme Court judge (March 2021); Interview with IT5, a former ITD official and a retired CBDT member (December 2020); Interview with IT4, a retired ITD official (December 2020).

[151] Interview with TP3, a tax practitioner (January 2021).

[152] Interview with IT3, a retired ITD official (January 2021).

[153] Interview with IM4, a former ITAT adjudicator (January 2021); Interview with L4, a tax lawyer practitioner (February 2021). However, in India, examinations are viewed unfavourably because the questions repeat over a period of time and examinees try to game the system by preparing for all of the questions asked in the past instead of earnestly learning the subject being examined.

[154] Interview with L2, a tax lawyer practitioner (April 2021).

[155] Interview with TP4, a tax practitioner (January 2021).

In addition, when ITAT members disregard precedent even after being given robust training, they should be sent back to training, perhaps at half pay, as a former ITAT adjudicator suggested.[156] As ITAT members have the option of referring a case to a special bench when they disagree with existing ITAT precedent, the only legitimate reason for members to disregard precedent is their inability to find, or properly apply, the precedent to the issues in a case. These inabilities point to a need for more training. Moreover, when ITAT members negligently or deliberately disregard precedent, sending them back to training at half pay may disincentivise members from doing this.

With regard to the fixed tenure posting of ITAT members, a senior tax practitioner noted that the government will have the flexibility of hiring and removing ITAT members in order to manage the pendency of appeals.[157] While a fixed tenure posting may enable optimal staffing, the flipside is that the independence of ITAT members is likely to be adversely affected. A permanent posting protects adjudicators from the vagaries of the government of the day and enables them to independently decide cases without fear or favour. The federal judges in the United States of America are appointed with life terms for this simple reason (The Federal Judicial Center, n.d.). We feel that, to preserve the independence of the ITAT, the permanent posting system should be restored. In addition, we propose an increase in the retirement age of ITAT members from 62 to 65 years.

As a senior tax practitioner rightly noted, "having an un-independent or an executive tribunal, if I may use the expression, is self-defeating".[158] Therefore, attempts by either the ITD or the government to constrain the independence of the ITAT should be avoided. Such actions will lead to more appeals proliferating at the level of the High Courts,[159] which already have a long pendency of cases, and will further cripple the justice delivery system. However, retired ITAT members feel that the government does not want an independent ITAT.[160] A retired ITAT member and a former ITAT member who retired as a High Court judge both noted that a separate law for the ITAT along the lines of the separate statute for CAT may further improve the independence of the ITAT by allowing the ITAT to formulate its own rules and procedures, akin to an independent and autonomous institution like the judiciary.[161] A fair and independent ITAT is, in our opinion, a sine qua non for its efficiency and effectiveness.

7. CONCLUSION

The ITAT has overcome challenges to its independence in the past. However, in the last few years, new challenges have been have brought to fore. These include changes to the eligibility criteria and the tenure of ITAT members. Such changes will further hamper the ITAT's ability to attract independent tax experts to its benches, thereby further lowering the quality of its adjudication. Due to the rapid growth of the ITAT over the past two decades, the quality of recruitment appears to have suffered and this has had an adverse impact on the quality of the ITAT's orders. The quality of recruitment over the past two decades has also suffered due to factors such as compensation levels and the drawback that judicial members of the ITAT are at a disadvantage when compared to practicing lawyers when it comes to appointment to the High Courts. In addition, as voiced by the Supreme Court, there are legitimate concerns that

[156] Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021).
[157] Interview with A4, a tax accountant practitioner (February 2021).
[158] Interview with L1, a tax lawyer practitioner (April 2021).
[159] Interview with IM3, a retired ITAT adjudicator (February 2021).
[160] Interview with IM3, a retired ITAT adjudicator (February 2021).
[161] Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).

changes to the eligibility criteria of ITAT members, the ITAT member selection committee, and the tenure of ITAT members may adversely impact the independence of ITAT members. In fact, the Supreme Court struck down changes to the tribunal selection committee that were aimed at increasing the grip of the government over the selection process for violating the doctrine of separation of powers and undermining the judiciary. Furthermore, the Court declared that the regressive changes made to the member eligibility criteria and the tenure of ITAT members were unconstitutional. The Government of India should consider reverting to the composition of the selection committee that existed prior to the changes made since 2017, and reverse the changes to the eligibility criteria and the tenure of ITAT members. The government should instead consider increasing the retirement age of all ITAT members to 65 and improving their compensation in order to attract the best talent to the ITAT, so that the ITAT can regain its past glory.

In addition, the process for selecting new ITAT members should be made more robust. For example, objective selection criteria should be introduced, formal training programmes should be instituted in the ITAT to supplement the on-the-job training of new ITAT members, and appropriate infrastructure and qualified staff should be provided to all ITAT members. Therefore, there is a need to reform the ITAT without impinging on its independence.

Before implementing the proposal to make the ITAT faceless, the government should consult relevant stakeholders, including retired members. Until then, the ITAT should optimise virtual courtrooms and leverage virtual hearings to the fullest. Furthermore, faceless ITAT appeals should not impinge on the independence of the ITAT. Independence in the dispensation of justice is a sine qua non of any adjudicatory system, and an independent ITAT is critical for the efficient and effective delivery of justice to taxpayers.

A. Limitations of Research

This research is mostly based on interviews with lawyer and accountant practitioners, retired tax officers, former ITAT members, and retired judges. Other sources used included news articles, case law, and reports. As this article is based on a limited number of interviews, the details referred to from the interviews are not conclusive but only indicative. Furthermore, the interviews do not constitute a random sample and the interview sample is not representative of the population of tax practitioners, retired tax officers, former ITAT members, or retired judges.

B. Further Research

This article was written prior to the implementation of changes to both the eligibility criteria and tenure of ITAT members. We intend to undertake follow-up research to understand the challenges faced by the ITAT in recruiting new members subsequent to such changes. This follow-up research will also track developments with regard to faceless ITAT.

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APPENDIX A

Interview with L1, a tax lawyer practitioner (April 2021).
Interview with L2, a tax lawyer practitioner (April 2021).
Interview with IM1, a retired ITAT adjudicator (April 2021).
Interview with IM2, a retired ITAT adjudicator (April 2021).
Interview with IT1, a retired ITD official (March 2021).
Interview with SCJ, a former High Court judge and a retired Supreme Court judge (March 2021).
Interview with HJ1, a former ITAT adjudicator and a retired High Court judge (March 2021).
Interview with A1, a tax accountant practitioner (March 2021).
Interview with A2, a tax accountant practitioner (March 2021).
Interview with HJ2, a former ITAT adjudicator and a retired High Court judge (March 2021).
Interview with IM3, a retired ITAT adjudicator (February 2021).
Interview with A3, a tax accountant practitioner (February 2021).
Interview with L3, a tax lawyer practitioner (February 2021).
Interview with L4, a tax lawyer practitioner (February 2021).
Interview with A4, a tax accountant practitioner (February 2021).
Interview with IT2, a retired ITD official (January 2021).
Interview with TP1, a tax practitioner (January 2021).
Interview with L5, a tax lawyer practitioner (February 2021).
Interview with TP2, a tax practitioner (February 2021).
Interview with IT3, a retired ITD official (January 2021).
Interview with IM4, a former ITAT adjudicator (January 2021).
Interview with TP3, a tax practitioner (January 2021).
Interview with A5, a tax accountant practitioner (January 2021).
Interview with IM5, a former ITD official and a retired ITAT adjudicator (January 2021).
Interview with A6, a tax accountant practitioner (January 2021).
Interview with L6, a tax lawyer practitioner (January 2021).
Interview with L7, a tax lawyer practitioner (January 2021).
Interview with TP4, a tax practitioner (January 2021).
Interview with A7, a tax accountant practitioner (January 2021).
Interview with IT4, a retired ITD official (December 2020).
Interview with IT5, a former ITD official and a retired CBDT member (December 2020).
Interview with IM6, a former ITD official and a retired ITAT adjudicator (December 2020).
Interview with IT6, a former ITD official and a retired CBDT member (December 2020).

TAX EXPENDITURE REPORTING IN DEVELOPING COUNTRIES: A CASE STUDY ON BANGLADESH

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Abstract

Tax expenditures are government policy instruments that provide preferential tax incentives and exemptions instead of direct budget support. They are frequently applied in order to prioritise particular sectors and to attract foreign investment. Interestingly, most of these tax expenditures are applied opaquely in developing or emerging economies, mainly due to the unavailability of tax expenditure data. This study proposes a customised model in order to address this gap and recommends that Bangladesh uses the revenue forgone (RF) approach to tax expenditure estimation based on Gross Domestic Product (GDP). Developing economies like Bangladesh can replicate this method where gaining access to information is challenging. Using the recommended method of computation, we find that Bangladesh's tax expenditure for the 2018/2019 financial year is 2.28 per cent of its GDP value. Finally, we make a few recommendations with regard to the reform of the tax expenditure policies of emerging economies like Bangladesh.

Keywords: Tax Expenditure, Revenue Forgone Method, Developing Economies, Bangladesh, Fiscal Policy.

1. INTRODUCTION

Tax expenditures are policy mechanisms used by governments in order to reduce individual and corporate taxpayers' tax burdens (Mansour & Heady, 2019). Governments could, alternatively, expense these amounts directly to taxpayers. They make policy decisions about whether they want to spend the tax that they collect directly on developing particular industries or individuals or allow these sectors or individuals to pay less or no tax. Their decisions depend on their policies and financing sources (Greve, 1994). In most developing or emerging economies like Bangladesh, the primary source of government expenditure is tax. Therefore, such a country's tax expenditure policy will need to be rigorously analysed and integrated with the national vision.

The history and tradition of income tax in Bangladesh is an anthology of what to tax. The Income Tax Ordinance, 1984 (ITO-1984) is a veritable record book of all tax bases from which revenue has been forgone in lieu of allowances, rate reductions, exemptions, and so on. However, as a part of the increased demand for the mobilisation of more domestic resources,

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the United Nations (UN) published its sustainable development goals (United Nations, 2018). Like developing countries' governments, the government of Bangladesh is also looking for ways in which to increase its tax base, as its generous tax expenditure regime is under scrutiny. This study reviews the existing legal provisions related to tax expenditure, how much tax revenue the government loses due to tax expenditure, and the methodology used to compute tax expenditure. It also includes recommendations as to how to expand the tax base by curtailing tax expenditure provisions.

In this age of globalisation, when there is an increase in the illicit mobility of capital and international tax competition in order to attract foreign direct investments, revisiting the tax expenditure regime in a developing country like Bangladesh is a sensitive matter. For the government of a developing economy, operating a shrinking tax expenditure regime is like walking on a tight rope; in addition to purely economic considerations, there are also many political-economic considerations embedded in tax expenditure. Hence, any stroke of the pen that curtails tax expenditure in order to expand the tax base may translate into the loss of the tax-generating base altogether. For instance, if the government has already accorded tax holidays for a certain number of years in a particular industry, and a company in this industry has calculated the marginal cost of its production based on this, it will be demoralising for the company if the government suddenly wakes up to the reality of the payable tax regime. The company may stop production or, if it is of foreign origin, choose to syphon its investment into a more favourable tax regime.

In order to study tax expenditure, it is necessary to convert the tax provisions into direct expenditure. However, without examining millions of tax returns submitted by all kinds of taxpayers (individuals, corporates, and others), it is impossible to discover which taxpayers have availed themselves of which types of tax allowances, exemptions, tax credits and so on, and how much revenue has been lost as a result. It is also impossible to study tax expenditure in its purest form due to data generation challenges. The best alternative is to study tax expenditure within a group of taxpayers with specific tax allowances, such as power generation companies. This sector enjoys tax benefits in Bangladesh. In order to justify the decision to provide tax benefits, we need to answer the following key questions: what are the financial conversions of such benefits, and how much tax revenue is forgone due to the implementation of these benefits? This is possible but is outside of the scope of this study. Future researchers may contribute to these areas.

2. LITERATURE REVIEW

2.1. Theoretical Background

Tax policy is one of the critical pillars of a country's fiscal policy, so taxation is closely related to economic progress. Different economic models describe the correlation between economic growth and taxation in different ways. According to the neoclassical growth model theory, taxes temporarily affect economic growth, but endogenous models postulate that taxes affect growth in the long run (Karagianni et al., 2012). Conversely, the Keynesian growth model suggests that the relationship between tax and economic growth depends on total demand. An increase (decrease) in taxes will decrease (increase) disposable income, reduce (increase) consumption, and will, ultimately, decrease (increase) the aggregate demand (Ananiashvili & Papava, 2012).

A government finances its expenditure through taxes or debt. However, debt is associated with an additional cost (interest), so taxation is the preferred source of government spending, especially in developing or underdeveloped economies. Researchers have different opinions about the correlation between government expenditure and taxes. Friedman (1978) believes that imposing tax reduces expenditure, while Buchanan and Wagner (1977, as cited in Hondroyiannis & Papapetrou, 2001) argue that expenditure increases taxes. Interestingly, Baghestani and McNown (1994) postulate that tax is not related to government expenditure. However, when governments want to develop or promote a sector, or want to invest in the welfare of their citizens, they almost always increase expenditure in the chosen sector or allow it tax relief. It is commonly believed that tax relief will attract foreign investment (Gómez Sabaini & Velasco, 2010). Therefore, many countries allow high tax expenditure in order to attract investments. However, researchers have found that most developing or emerging economies use tax expenditure tools inefficiently, mainly because they do not engage in in-depth tax expenditure analysis or reporting (Polackova Brixi et al., 2004).

Tax expenditure reporting originated in the United States in 1968, but it has gained wide popularity in the wealthiest western countries (Craig et al., 2001). Most countries that are members of the Organisation for Economic Co-operation and Development (OECD) require their governments to publish annual tax expenditure reports (TERs). The TER is globally accepted as a critical tool that can measure a country's financial policy accountability and transparency. Many countries have integrated TERs within their budget cycle frameworks. However, reporting tax expenditure has placed extra administrative burdens on most developing countries in the form of additional labour force and technical expertise requirements, together with increased financial costs (Philipps, 2012).

Tax expenditure

Avram (2018) notes that prior studies have used the term "tax expenditure" to refer to the tax revenue that is forgone when governments provide beneficial tax treatment to particular taxpayers. No univocal agreement exists as to which rules should be classified under tax expenditures (Avram, 2018). According to Avram (2018), decisions about "what to include and what not has been based on particular historical conjunctures or on specific political or administrative views" (p. 273). The federal tax law of the United States notes that, in law, tax expenditures are "revenue losses" through special exclusions, exemptions, deductions, credits, and preferential tax rates (U.S. Department of the Treasury, 2021).

According to the OECD (2010), tax expenditures shift public resources by relaxing the tax burden from the benchmark tax rate. Governments can provide this support in the form of direct payments or reduced tax rates for investments. The first option is called outlay expenditure and the second is known as a tax expenditure. In absence of tax exemptions, tax benefits or reduced tax rates government can collect estimated revenue from an existing "benchmark tax system" (Burton & Stewart, 2011). Tax expenditure includes:

- Tax exemptions: "amounts excluded from the tax base" (OECD, 2010, p. 12).
- Tax holidays: amounts excluded from the tax base according to the sunset clause[6].
- Allowances: amounts that can be deducted from the tax base before applying the tax rate.

[6] A "sunset clause" refers to a provision that sets a predetermined expiration date or time limit for a tax incentive or exemption.

- Credits: “amounts deducted from tax liability” (Anderson, 2008, as cited in OECD, 2010, p. 12).
- Reduced rates: taxes applied at a lower rate than the benchmark rate.
- Tax deferrals: “a delay in paying tax” (OECD, 2010, p. 12).

Tax gap versus tax expenditure

The tax gap is the difference between the amount of taxes that would be collected in a fully compliant environment and the actual taxes that have been collected. Its main means of measurement is the amount of tax evasion resulting from different forms of non-compliance and the components of the tax system as a whole. It is an essential management tool for tax administration (Tiutiunyk et al., 2019). At the same time, tax expenditures are government policy instruments for public spending or regulatory programmes (U.S. Department of the Treasury, 2021). Therefore, unlike the tax gap measurement, tax expenditure estimation does not include amounts lost through tax evasion.

Measurement of tax expenditure

The critical challenge that we face when trying to define tax expenditure is the subjectivity involved when outlining the benchmark tax system. Benchmark tax systems differ from country to country due to differences in governments’ missions, visions, and priority development policies, but they are always based on “the principles of neutrality, efficiency, and equity” (Heady & Mansour, 2019, p. 2).

There are three principal ways in which tax expenditure can be measured. The first is the RF approach, an ex-post measure that indicates the cost of allowing a tax concession. The fundamental assumption made with this approach is that taxpayer behaviour remains unchanged. The second is the revenue gain approach, which is the opposite approach to the RF method. It estimates the revenue that could have been earned without tax benefits. The third is the outlay equivalence approach. This method measures the direct expenditure needed to provide a benefit equivalent to the tax expenditure.

Multilateral development partners and other advocacy groups encourage developing economies to use the RF method of tax expenditure estimation (Heady & Mansour, 2019). Mansour and Heady note that “this approach quantifies the direct revenue loss associated with the provision under consideration, relative to the benchmark system, which has no such provision” (p. 8). They suggest that this method involves three critical assumptions. The first is that there is no dynamic effect. That means the taxpayer’s behaviour will remain unchanged after the withdrawal of the tax expenditure. The second is that the compliance level will remain unchanged. Lastly, it assumes the tax expenditures are interdependent. Removing one tax expenditure will not alter the revenue lost from another tax expenditure (Heady & Mansour, 2019).

Heady and Mansour (2019) state that:

> These properties of the revenue-forgone method are essential to the appropriate interpretation of the numbers in a tax expenditure review. Alternative methods have occasionally been used by countries, but often as part of a more comprehensive cost-benefit analysis of tax expenditures that requires additional information and analysis, typically of a much more advanced nature. Absent such sophisticated methods and models, a tax expenditure analysis based on the revenue-forgone method provides very valuable information in the overall assessment of the desirability of certain tax provisions. (p. 9)

This study has analysed the sectorial analysis of Bangladesh's GDP and the corresponding tax legislation (income tax and corporate tax). The tax policy of Bangladesh has allowed multiple tax exemptions to apply to different sectors of the economy. These exemptions have narrowed the base of the revenue sources, leaving the tax authority with a reduced GDP as the tax base.

2.2. Tax Administration in Bangladesh

Bangladesh's primary sources of government revenue are income tax (direct tax) and value-added tax (indirect tax). The scope of this research is limited to income tax. The main income tax administration and policymaking authority in Bangladesh is the National Board of Revenue (NBR). The NBR fixes the tax rate for personal and corporate taxpayers each financial year according to the Income Tax Ordinance, 1984 (ITO-1984). The parliament approves the tax rate and legal amendments of the tax law each year during the budgetary session and sets benchmarks for tax expenditure in the corresponding financial year. ITO-1984 includes several sections that allow special tax treatments for different sectors through exemptions, tax holidays, tax rebates, allowances, credits, and deferral payment. Chapter VI (Exemptions and Allowances) of ITO-1984 provides the legal basis for tax expenditure. The government also issues Statutory Regulatory Orders (SROs) and declarations about special economic zones in order to provide tax expenditure benefits.

The critical philosophy behind tax expenditure policy in Bangladesh stems from the motivation to accelerate industrialisation, attract foreign direct investment (FDI), implement the government's political commitments, and ensure the social security and welfare of low-income and middle-income people. The Bangladesh government has allowed tax expenditure in many industries, including the business, agriculture, fisheries, power generation, information technology, public services, communications, and social security sectors.

2.3. Tax Expenditure Reporting in Bangladesh

Bangladesh has achieved tremendous growth in the revenue sector in the last couple of decades. The government has facilitated the growth of different economic sectors through tax exemptions and reduced tax rates in order to attract FDI but does not publish TERs as part of the budget management cycle. Many researchers have attempted to estimate the country's tax expenditure, but none could come up with a concrete result, mainly due to a lack of available information.

Dio (2015) measured the tax expenditure of Bangladesh based on some specific sections of ITO-1984, i.e. sections 45, 46, and 46(A). He calculated tax expenditure from the number of tax holidays and exemptions granted in a particular year. However, the results do not provide a complete picture, as they were only based on three sections of ITO-1984, ignoring other legal provisions and SROs that allow for tax expenditure.

Prior to this, Mortaza and Begum (2006), from the Policy Analysis Unit of Bangladesh's Central Bank, published a more comprehensive study and found that, in the 2005 financial year, Bangladesh's total tax expenditure was BDT93.45 and its direct tax expenditure was BDT10.28 billion. They used 55 measures for direct tax expenditure estimation and 51 measures for indirect tax expenditure. They stated that they collected data from NBR field-level offices, but did not provide details of the expenditure calculation method or measures that they used for the calculation (Mortaza & Begum, 2006). Moreover, the collection of such data is not part of the usual record-keeping processes used in NBR field offices, so the data quality and the type of sampling used in the study were ambiguous. Therefore, according to different empirical studies, the study is not a complete TER (Geourjon et al., 2019).

Our study is unique in several ways. Firstly, we collected the primary data directly from the NBR field offices, so it is authentic. Secondly, we conducted the study with the collaboration of the NBR's tax policy wing, Bangladesh's primary tax policy formulation body. Therefore, the scope of the study has covered all significant areas of tax expenditure, e.g. exemptions, holidays, reduced rates, SROs, and others. Thirdly, we propose a new approach to tax expenditure reporting for a country in which tax return information is not digitally preserved. Finally, this study includes a proposal detailing how comprehensive TERs can be produced in Bangladesh.

3. DATA AND METHODOLOGY

3.1. Data

We conducted the study using both primary and secondary sources of data. Most of the secondary data was collected from the publications or websites of different government agencies, as mentioned in Table 1. The primary data was collected through purposive sampling directly from the field offices of the NBR in collaboration with its tax policy wing. We have kept the particulars of the taxpayers confidential, according to the purview of section 163 of ITO-1984. In addition, we have conducted focus group discussions (FGDs) with tax officials with at least seven years of experience.

We chose 2018/2019 as the base year for sector by sector GDP allocation to make the study simplistic but complete. Similar data for the financial year 2019/2020 had not been officially published when our research took place. In addition, there were some unique tax benefits in the 2019/2020 financial year due to the outbreak of COVID-19, so we did not consider the macroeconomic data from that year for forecasting. The critical justification behind the use of the 2018/2019 data selection is that it is complete, there is no abrupt deviation from earlier years, and the data seems consistent and smooth. Therefore, the percentage allocation can safely be used for data analysis.

Table 1: List of Data Sources for the Study

Data Type	Data Source
Tax collection under different sections of ITO-1984	Tax Policy Wing, NBR
Macro-Economic Indicators	Ministry of Finance, Bangladesh (2020)
Agricultural Income	Report on Agriculture and Rural Statistics, a publication of the Bangladesh Bureau of Statistics (BBS)
Production of Major Industrial Goods	www.bbs.gov.bd, the website of the Bangladesh Bureau of Statistics (BBS)
Ready-Made Garments (RMG) Export	www.bgmea.com.bd, the website of the Bangladesh Garment Manufacturers and Exporters Association (BGMEA)
Other Central Export Receipts	www.bb.org.bd , the website of the Bangladesh Bank
Electricity Generation	www.bpdb.gov.bd, the website of the Bangladesh Power Development Board
Capital Gains (Land Sales)	Return Data from Taxes Zone 15, Dhaka

3.2. Methodology

In this study, we primarily followed the methodology suggested by the International Monetary Fund (IMF), as follows:

- **Benchmark system definition:** This involves identifying and utilising relevant "policy design criteria" (Heady & Mansour, 2019, p. 3)
- **Identifying any deviation from this benchmark:** The IMF recommends preparing "a list of all tax laws and any laws with tax provision" and then listing any "deviation from the benchmark system" for each one (Heady & Mansour, 2019, p. 3).
- **TE cost estimation:** According to the IMF, the data sources for the tax expenditures should then be identified and data templates should be prepared. In addition, estimation methods should be developed for each tax expenditure or tax expenditure group, and templates should be prepared (Heady & Mansour, 2019).
- **Preparing the TER:** Different people/groups can produce different sections of the TER (Heady & Mansour, 2019).

3.2.1 Benchmark tax system definition

According to Heady and Mansour (2019), a "benchmark tax system serves as a basis for identifying tax expenditure" and should be "grounded in the principles of neutrality, efficiency, and equity" (p. 4). They add that "benchmark tax systems typically include such aspects as the actual rate structure of taxes and the concept of income or spending that is used in the actual law" (Heady & Mansour, 2019, p. 4).

The benchmark tax system of Bangladesh can be defined in light of the following characteristics:

Personal income tax (PIT)

The PIT benchmark is defined as the existing statutory tax regime system without any tax benefits. Any deduction or benefit from PIT is considered to be tax expenditure. The personal tax rate in Bangladesh is progressive and spans from 0 per cent to 30 per cent (Finance Act, 2019). The PIT and corporate tax rates for Bangladesh in the 2018/2019 financial year are shown in tables 2 and 3.

Table 2: Personal Statutory or Benchmark Income Tax Rate (Financial Year 2018/2019)

Income Slab	Tax Rate (%)
Up to first BDT250,000	0
Next BDT400,000	10
Next BDT500,000	15
Next BDT600,000	20
Next BDT3,000,000	25
Balance amount	30

Source: Finance Act (2019).

Corporate income tax (CIT)

According to Heady and Mansour (2019):

> Under a standard CIT, the benchmark should be based on the prevailing tax on profits with a single rate of tax (that is, the general rate) and no tax relief other than for usual business expenses. However, if a higher corporate tax rate (or rates) applies on some sectors because of location-specific rent (for example, oil and gas production), this should be disregarded when identifying the highest rate for defining the benchmark applied to sectors without location-specific rent. (p. 5)

According to the Finance Act (2019), during the 2018/2019 financial year, the corporate tax rate for companies in Bangladesh that were listed on the stock exchange was 25 per cent, while for non-listed companies, it was 35 per cent. The benchmark tax rate for capital gains was 15 per cent. However, the applicable rate for publicly-trading corporate taxpayers was reduced, while banks and tobacco manufacturers were charged higher rates.

Table 3: Corporate Income Tax Statutory or Benchmark Rate (2018-2019)

Type of Taxpayer	Tax Rate (%)
Listed Company	25
Non-listed Company	35
Listed Bank	37.5
Non-listed Bank	40
Merchant Bank	37.5
Tobacco Manufacturer	45
Listed Mobile Operator	40
Non-listed Mobile Operator	45
Co-operative Society	15

Source: Finance Act (2019).

3.2.2. Identifying any deviations from the benchmark

The NBR provides tax exemptions, tax holidays, allowances, credits, and reduced rate facilities through different provisions of the ITO-1984. There are also numerous SROs that provide different types of tax relief. In addition, during the budget session, the Bangladesh Parliament sets the tax rates for different items through a finance bill. Therefore, for this study, we compiled all the relevant provisions of ITO-1984, the most significant SROs, and finance bills in order to compute the deviation from the benchmark rate.

3.2.3. Tax expenditure cost estimation

The three different methods of tax expenditure estimation may yield significantly different results (The Treasury, Australian Government, 2019). However, most OECD countries use the RF method for tax expenditure calculation. From equation 1, we get the basic formula of the RF method (Mansour & Heady, 2019):

$$RF_i = I_i\,(r_{Ni} - r_{Ei}) \quad \dots \dots \dots \dots \dots \dots \dots \dots \dots (1)$$

Where,
i = (1,2, … n) indicates mutually exclusive sectors of the economy
RF_i = Revenue forgone due to tax expenditure from sector i
I_i = Total income from the sector i
r_{Ni} = Nominal (benchmark) tax rate for sector i
r_{Ei} = Effective tax rate for sector i

We get the total tax expenditure using equation 2; the tax expenditure of each sector needs to be calculated using equation 1:

$$\textit{Total Tax Expenditure} = \sum_{i=1}^{n} RFi \quad \dots \dots \dots \dots \dots (2)$$

3.2.4. Preparing TERs for Bangladesh

The tax law of India, Bangladesh's neighbouring country, has similar origins to the tax law of Bangladesh. Both countries report their tax expenditure and annual union budgets using the RF method with microsimulations of taxpayers' data. Therefore, they can report tax expenditure for different types of taxpayer, e.g. individual, corporate, Association of Person (AoP), firm, and Hindu Undivided Family (HUF) taxpayers, and even report expenditure according to different provisions of tax law or tax benefit-related SROs (Ministry of Finance, India, 2022). However, this type of reporting is quite challenging in Bangladesh, as the tax return filing system is still not fully online. Hence, to calculate tax expenditure with such precision requires a large sample volume, and additional working hours and resources.

There is no digital record of taxpayers' information in Bangladesh, so to prepare a TER, one must manually collect data from each tax file. In addition, a large sample is required for unbiased microsimulation. Therefore, individual and household-level microsimulations may not be feasible in Bangladesh. Macrosimulation is the method of choice for many countries with rich sources of secondary microdata, including sectorial data from national income accounts, and this may be the best option for countries with nonreliable survey data.

In the existing scenario, Bangladesh's tax expenditure can be approximated using sector by sector tax benefit to GDP analysis. From the components of GDP, the percentage contribution of different sectors can be used to estimate the sector by sector revenue forgone due to tax exemptions or tax benefits. The effective tax rate for each GDP sector can then be determined by analysing the existing tax benefits. Therefore, the tax expenditure to GDP ratio can be found using equation 3:

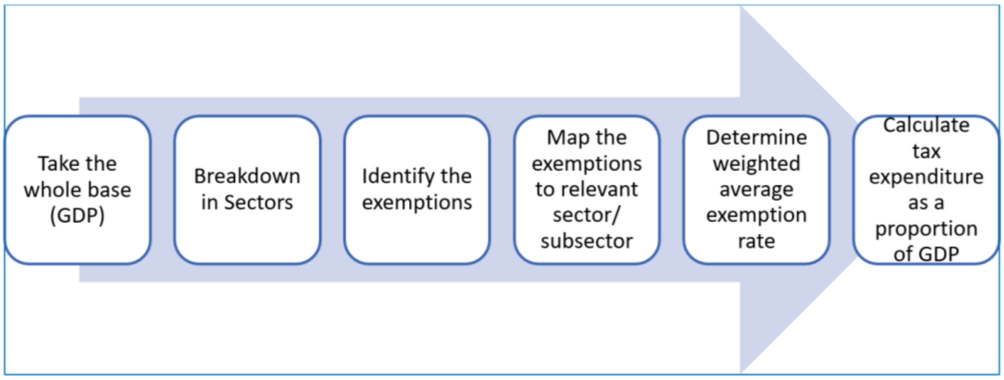
$$\text{TEG (\%)} = \frac{\sum_{i=0}^{n} C_i * \frac{(r_{Ni} - r_{Ei})}{r_{Ni}}}{\sum_{i=0}^{n} C_i} \quad \ldots \ldots \ldots \ldots \textit{(3)}$$

Where,

TEG = Tax expenditure to GDP ratio
C_i = Percentage contribution in GDP from sector *i*
r_{Ni} = Nominal (benchmark) tax rate for sector *i*
r_{Ei} = Effective tax rate for sector *i*

In this study, we customised the IMF model of tax expenditure reporting (Mansour & Heady, 2019) according to Bangladesh's socio-economic context. We followed the steps shown in Figure 2 to calculate the tax expenditure. We limited our scope to determine income tax expenditure only. Tax evasion and tax gap calculation is outside of the scope of this study. We assumed that the rate of tax evasion would be the same if the exempted portion of GDP could be brought to the tax base by modifying the tax law.

Figure 2: Tax Expenditure Computation Process



Source: The authors

4. MAPPING THE MODEL INTO DATA

A TER can be presented in several ways. For instance, it can be presented according to different sections of tax law or SROs that allow tax expenditure, by income range, by taxpayer type, or even according to sectors of the GDP (Ministry of Finance, India, 2022). For this study, based on data availability, we have adopted the GDP approach of reporting tax expenditure as presented by many OECD countries (OECD, 2010; OECD & the National Tax Office, 2021). The GDP calculation for Bangladesh is based on 15 different macro sectors. The data used for each sector includes income from wages, income from independent activities or professions, agricultural income, and income from business activities (as shown in Table 4).

However, another essential head of income, capital gains, cannot be calculated using the GDP approach, so we computed tax expenditure from capital gains income separately.

4.1. Tax Expenditure Estimation Using Sector by Sector GDP

The following assumptions are made when estimating tax exemptions for each sector:

a. The reported GDP sectors and the corresponding tax exemption provisions may not precisely match. The analysis will be based on subjective economic relevance.
b. Where primary data was unavailable, assumptions were made after conducting FGDs with experts.
c. The sectors are divided into many subsectors and their relative weights in the sector are approximated.
d. For seemingly overlapping sectors/subsectors, subjective judgment was applied.

4.1.1 Agriculture & Forestry

According to the Bangladesh Economic Review 2019, 40.60 per cent of Bangladesh's labour force is involved in agriculture (Ministry of Finance, Bangladesh, 2020). The government has supported this sector with several exemptions and reduced tax benefits.

Paragraph 29 of the sixth schedule of part A of ITO-1984 exempts BDT200,000 on agricultural income if that is the sole source of income for the taxpayer. Paragraph 46 of the same schedule allows a special exemption for specific products (e.g. corn, maize, and sugar beet). Moreover, paragraph 27 excludes all economic activities carried out by a hillman in a hill tract district from taxation (ITO-1984).

According to the BBS (2019), 16.56 million households are involved with, and 9.09 million households depend on, agriculture. Therefore, 54.92 per cent of households depend only on agriculture income rather than agriculture and other income sources. The average amount of household income earned just from agriculture is BDT73,921 (BBS, 2019). Therefore, from these secondary sources of data, we can conclude that 54.92 per cent of people whose income is earned only from agriculture are exempted from the tax base as their average income (BDT73,921) is lower than the BDT200,000 exemption threshold set in paragraph 29 of the sixth schedule in part A of ITO-1984. However, let us consider the income to be normally distributed and assume that the standard deviation is high (due to income inequality). The percentage of taxpayers who receive this tax-exempted income benefit is lower than the total population of taxpayers who only receive income from agriculture. This study assumes that two-thirds of the total population of taxpayers who only receive income from agriculture receive the tax exemption benefit laid out in paragraph 29 of the sixth schedule in part A of ITO-1984. Therefore, this provision of ITO-1984 contributes to an exemption rate of about 35 per cent in this subsector. In addition, paragraphs 46 and 27 of the sixth schedule in part A of ITO-1984, and SRO 199/2015 (NBR, 2015a) on tax exemption or reduced tax rate benefits on crops, horticulture, poultry feed, floriculture, mushroom, and other agriculture income, cause the tax exemption rate in this sector to be 45 per cent.

With regard to animal farming, SRO 254/2015 (NBR, 2015b) allows an extraordinary rate (0 to 10 per cent based on income) to apply to poultry farming. Poultry farming and animal husbandry make a significant contribution to this subsector. The reduced tax rate allowable as a result of this SRO is shown in Table 5.

In the absence of such an SRO, income from these heads would have been taxed at the individual level at the progressive tax rate mentioned in Table 2 (statutory tax rate). Thus, the average exemption rate is higher for animal farming than for regular crop production. However, there is no such additional exemption for forestry. Therefore, we have considered a 25 per cent general exemption in this subsector.

Table 4: Income Heads under Different Sectors of GDP

S/N	GDP Sectors	Major Income Heads
1.	Agriculture & Forestry	Wages, Agriculture Income
2.	Fishing	Wages, Agriculture Income
3.	Mining & Quarrying	Wages, Business and Professional Income, Other Income
4.	Manufacturing	Wages, Business and Professional Income, Other Income
5.	Electricity, Gas, Water Supply	Wages, Business and Professional Income, Other Income
6.	Construction	Wages, Business and Professional Income, Other Income
7.	Wholesale & Retail Trade	Wages, Business and Professional Income, Other Income
8.	Hotel & Restaurant	Wages, Business and Professional Income, Other Income
9.	Transport, Storage, & Communications	Wages, Business and Professional Income, Other Income
10.	Financial Intermediaries	Wages, Business and Professional Income, Income from Securities, Other Income
11.	Real Estate & Renting	Wages, Business and Professional Income, Other Income
12.	Public Administration & Defence	Wages, Business and Professional Income, Other Income
13.	Education	Wages, Business and Professional Income, Other Income
14.	Health & Social Work	Wages, Business and Professional Income, Other Income
15.	Community, Social & Personal Services	Wages, Business and Professional Income, Other Income

Source: Sections 20 to 34 of the Income Tax Ordinance, 1984 (ITO-1984).

Table 5: Reduced Tax Rate On Poultry Farming Income, SRO 254/2015 (NBR, 2015b)

Amount of Income from Poultry	Income Tax Rate (%)
First BDT1,000,000	0
Next BDT1,000,000	5
Balance Amount	10

4.1.2. Fishing

Historically and traditionally, the fishing sector has been granted a significant tax exemption. SRO 255/2015 (NBR, 2015c) allows a reduced tax rate (of 0 to 10 per cent) to apply to fishing income. This is shown in Table 6.

According to primary data, the average regular tax rate (ATR) is 28 per cent, while the effective rate applicable to fisheries income is about 7 per cent. Therefore, the effective exemption rate in this sector is 75 per cent.

Table 6: Reduced Tax Rate on Fishing Income, SRO 255/2015 (NBR, 2015c)

Amount of Income from Fisheries	Income Tax Rate (%)
First BDT1,000,000	0
Next BDT1,000,000	5
Balance Amount	10

4.1.3. Mining & Quarrying

Although this sector comprises an insignificant portion of Bangladesh's total GDP, tax exemption is allowed in some instances. Companies that have signed Production Sharing Contracts (PSCs)[7] are granted tax exemptions on their Bangladesh income (see paragraph 36 of the sixth schedule, part A of ITO-1984). In the absence of such an exemption, the statutory tax rate for this sector would be 25% for a publicly listed company and 35% for other businesses. Therefore, we have only taken the PSC contract exemptions and, as a result of FGDs, general exemptions of just 20 per cent into consideration.

4.1.4. Manufacturing

The manufacturing sector is the most crucial contributor, with a share of GDP of more than 24 per cent. This sector is divided into two parts: large and medium-scale manufacturing, and small-scale manufacturing.

According to paragraph 39 of the sixth schedule of part A of ITO-1984, the income of a small manufacturing firm with a turnover of less than BDT500 thousand is exempt from tax. Moreover, the export of handicrafts is also exempt from tax according to paragraph 35 of the sixth schedule of part A of ITO-1984. The Finance Act (2019) also applies a special rebate for any small or cottage business that operates in a less or least developed area. Small manufacturing businesses comprise about 4 per cent of the total national GDP base. We have taken a 90 per cent exemption in the small manufacturing subsector into consideration.

We analysed the tax exemptions in the subsectors within the large and medium-scale manufacturing sector, and summarised these in Table 7.

[7] Specific contracts agreed between some foreign contractors in the gas and oil production sector and the government of Bangladesh.

The regular rate is calculated from the taxpayer's income statement with RMG business, which is close to the benchmark rate that we have opted for. In addition to these exemptions, there are special tax treatments for businesses based in the Bangladesh Economic Zone Authority (BEZA), a ten-year exemption for businesses based in Hi-Tech parks, and a five to seven-year area-wise exemption for businesses based in Export Processing Zones (exemptions from 25 per cent to 100 per cent) according to SRO 219/2012 (NBR, 2012). For other export-based industries, where no reduced rates are applicable, a specific 50 per cent exemption is allowed according to paragraph 28 of the sixth schedule of part A of ITO-1984. The overall exemption rate for the large manufacturing subsector (shown in Table 8) is 44 per cent.

Table 7: Exemptions for Different Manufacturing Industry Subsectors

Industry	Statutory Tax Rate (%)	Benchmark Tax Rate (%)	Exemption (%)
Garments Industry	15	35	57
Jute Manufacturing	10	35	71
Knitwear	12	35	66
Woven Garments	12	35	66
Active Pharmaceuticals Ingredients	0	35	100
Cement	Reduced TDS*	--	--
Mild Steel Rod	Reduced TDS*	--	--
Rice Bran Oil	--	--	25-100

*TDS = Tax deduction at source.
Source: Authors' calculations based on data from NBR (2017c), NBR (2017d), and NBR (2019c).

Table 8: Exemption Computation for the Large Manufacturing Subsector

Industry	Contribution to Large Manufacturing	Average Exemption Rate	Weighted Average
(1)	(2)	(3)	(4) = (2) * (3)
RMG* (Excl. EPZ**)	43%	65%	0.28
Jute Manufacture	2.5%	71%	0.02
EPZ Export	10%	75%	0.08
Other Export	9%	50%	0.04
Other Than Export	5.5%	35%	0.02
Total	**68%**	**64%**	**0.44**

*RMG = Ready-made garments.
**EPZ = Export Processing Zone, a specialised geographical area where export-oriented industries are established.
Source: Authors' calculations based on chapter 8 of Ministry of Finance, Bangladesh (2020).

4.1.5. Electricity, gas, and water supply

The benchmark tax rates for businesses involved in the electricity, gas and water supply industry are 25% for publicly listed companies and 35% for other companies. However, tax exemptions can be applied for businesses involved in electricity production in accordance with SRO 213/2013 (NBR, 2013b). A 15-year exemption can be applied for coal-based power plants. Additional exemptions in respect of royalties, technical know-how, and technical assistance fees are also applicable in the electricity generation sectors. SRO 212/2013 (NBR, 2013a) exempts the income of private power generation companies other than coal-based companies (from 25 per cent to 100 per cent) that began production after 2016. Special tax exemption is also allowed for countries where nuclear power plants are under construction. The special power plants rented by the government in order to produce electricity rapidly to meet needs during the power crisis also enjoy tax benefits under certain conditions. Renewable energy production companies are included in the tax holiday scheme according to section 46CC of ITO-1984.

When considering the sources of electricity generation (gas, coal, nuclear, and renewables) and the relevant exemptions, we estimated the exemption on electricity production (shown in Table 9) to be 41 per cent.

Table 9: Exemption Computation for the Electricity Production Subsector

Source	% of Total Production	Average Exemption (%)	Weighted Exemption (%)
(1)	(2)	(3)	(4) = (2) * (3)
Coal	6	100	6
Gas & Oil (Private)	44	75	33
Nuclear	0	100	0
Renewables	1.5	100	1.5
Total	**52**	**78**	**41**

Source: Authors' calculation based on chapter 10 of the Ministry of Finance, Bangladesh (2020).

4.1.6. Construction, transport, storage, and communications

Bangladesh is now a developing country in a transitional phase of economic growth. The lion's share of its GDP contribution comes from government expenditure, and the government is undertaking several megaprojects in order to expedite economic growth. However, ITO-1984 states that the following physical infrastructure facilities can enjoy the tax holiday facility at a 10 to 90 per cent exemption rate for the first ten years of the construction:

(i) deep sea port;
(ii) elevated expressway;
(iii) export processing zone;
(iv) flyover;
(v) gas pipe line;
(vi) Hi-tech park;
(vii) Information and Communication Technology (ICT) village or software technology zone;
(viii) Information Technology (IT) park;
(ix) large water treatment plant and supply through pipe line;
(x) Liquefied Natural Gas (LNG) terminal and transmission line;
(xi) mobile phone tower or tower sharing infrastructure;
(xii) mono-rail;
(xiii) rapid transit;

(xiv) renewable energy (e.g solar energy plant, windmill);
(xv) sea or river port;
(xvi) toll road or bridge;
(xvii) underground rail;
(xviii) waste treatment plant; or
(xix) any other category of physical infrastructure facility as the Government may, by notification in the official Gazette, specify. (Section 46CC).

When taking the large scale of the land communication projects into consideration, and based on the financial value addition of the tax-exempted items mentioned in section 46CC, it is estimated that about 40 per cent of the contribution to GDP made by the construction sector is excluded from taxation.

Almost 8 per cent of the country's GDP comes from land and water transport. According to SRO 214/2019 (NRO, 2019a) and SRO 215/2019 (NRO, 2019b), this sector can opt to pay presumptive tax. Under the presumptive tax scheme, vehicle owners must pay a lump sum tax for every vehicle unit regardless of how much they earn during the year. For example, a 52-seated bus owner must pay BDT11,500 per year under the presumptive income tax scheme. This amount is significantly low, considering the average income generated from a bus, truck, or marine vessel. From FDGs, we assume that if there were no such schemes, businesses in these subsectors would pay about 50 per cent more tax.

4.1.7. Public administration

According to paragraph three of the sixth schedule of part A of ITO-1984, the income of local government authorities, such as district offices, sub-district offices, and union offices are tax-exempt, SRO 211/2017 (NBR, 2017b) also provides that all allowances and benefits received by government employees are exempted from tax. Various SROs allow for public services to be VAT-exempt. A 70 per cent general exemption is thus estimated as a result of FGDs.

4.1.8. Education

Most of the income earned by public universities is tax-exempt as a result of the following provisions:

- ITO-1984, sixth schedule, part A, paragraph 37: The income of any agricultural college/university is fully exempt.
- ITO-1984, sixth schedule, part A, paragraph 52: The income of an educational institution under MPO is exempt.
- ITO-1984, sixth schedule, part A, paragraph 59: The income of an educational/training institution for persons with disabilities is exempt.
- SRO 268/2010 (NBR, 2010): 15 per cent tax rate for private universities, medical/dental colleges, engineering, and IT.

Hence, it is approximated from the FDGs that about two-thirds of the education sector's income is exempt from tax.

4.2.9. Health and social work

The health and social work sectors have the following types of exemptions according to ITO-1984:

- Sixth schedule, part A, paragraph 1A: No tax on service charges can be derived from micro-credit operations.
- Sixth schedule, part A, paragraph 2: The income earned by religious and charitable institutions is tax-exempt.
- Sixth schedule, part A, paragraph 58: The income earned by old people's homes and day-care facilities is tax-exempt.

Moreover, full tax exemptions apply to donations made to various social work institutions. As these donations constitute the institutions' income, these exemptions indirectly narrow the tax base. A general 25 per cent exemption is estimated in this sector as a result of FGDs.

4.1.10. Community, social and personal services

Small-scale personal services (for example, a local hairdressing salon) with income under the general tax exemption limit are intentionally kept out of the tax net. The Pareto principle works almost perfectly here: around eighty per cent of businesses providing social and personal services will fall into this category but, as these are small-scale businesses, they will only generate around 20 per cent of the total income earned in this sector.

Moreover, paragraph 33 of the sixth schedule of part A of ITO-1984 exempts all income from different types of IT businesses (including companies providing software development and other services, digital content and website services, IT support and maintenance, call centre services, IT process outsourcing, cyber security services, and others) until 2024. Revenue from this sector is about BDT84 billion (USD1 billion), which is about 4 per cent of the total output (GDP) of this sector (Bangladesh Association of Software and Information Services, 2021). Taking this data and our FGDs into consideration, we approximate tax exemption in this sector to be 30 per cent.

The other sectors of GDP are very small and have minimal effects on the tax base, so they are not considered in our study.

4.2. Tax Expenditure and Capital Gains

There are other forms of tax expenditure that are out of the scope of GDP contribution. For example, capital gains make a limited contribution to GDP, but there are areas in which tax policy allows a lower rate of tax to apply to certain capital gains. We took tax expenditure relating to the transfer of land into consideration because transfers of land or property are the most significant capital gains in Bangladesh. Section 82C(2)(d) of ITO-1984 effectively reduces the tax rate on such transfers. The rate is between one and four per cent (based on the location of the land) of the deed value. This tax is collected at the source and considered to be the taxpayer's final tax liability. We take the average of 2.5% as the effective tax rate on such a transfer.

Tax deducted at source under section 53H in 2018-19	: 18.17 billion BDT
Total estimated deed value	: 1,817/2.5% = 726.80 billion BDT
Total cost of acquisition (estimated)	: 72.68 billion BTD
Total capital gain on transfer of land	: (726.80–72.68) = 654.12 billion BDT
Benchmark tax rate on capital gain	: 15%
Regular tax on such capital gain	: 654.12 x 15% = 98.12 billion BDT
Tax expenditure	: 98.12 – 18.17) = **79.95 billion BDT**

A few other tax expenditures of a similar nature exist, but these are intentionally omitted due to the limited scope of this study.

5. DISCUSSION ABOUT THE RESULTS

After analysing all the related exemptions in the particular sectors, we have estimated that about 36 per cent of total GDP was effectively excluded from taxation in Bangladesh in the 2018/2019 financial year (as shown in Table 10). We know that, during that financial year, Bangladesh's total GDP was BDT25,424.83 billion, while income tax revenue was BDT1,028.94 billion (Ministry of Finance, Bangladesh, 2020). Therefore, the tax expenditure for the 2018/2019 financial year was BDT578.78 billion and the ratio of tax expenditure to GDP was 2.28 per cent. In addition, tax expenditure from capital gains (the sale of land) was BDT79.95 billion.

The exemption proportion by sector is depicted in Figure 3. We find that the fishing sector enjoys the highest percentage (75 per cent) of exemption in Bangladesh, followed by the public administration and defence sectors (70 per cent) and the education sector (65 per cent). The hotel and restaurant sector and the wholesale and retail trade sector do not benefit from any tax exemptions. Tax exemptions of 51 per cent and 40 per cent tax respectively are applicable in Bangladesh's manufacturing and construction sectors, which can attract foreign investment.

From the percentage of exemption shown in Table 10, we computed the effective tax rate for each sector. The summary of the effective tax rate and corresponding benchmark tax rate is shown in the Table 11.

Table 10: Sector By Sector Tax Exemption Summary

S/N		Sector	% of GDP* Sub-sector	% of GDP* Overall	Tax Exemption Exists?	% Exemption** Sub-sector	% Exemption** Overall
1	**Agriculture & Forestry**			**10.15**			**45**
	1.1	Crops & Horticulture	7.06		Yes	50	
	1.2	Animal Farming	1.47		Yes	50	
	1.3	Forestry & Related	1.62		Yes	20	
2	**Fishing**			**3.5**	Yes		**75**
3	**Mining & Quarrying**			**1.74**	Yes		**20**
4	**Manufacturing**			**24.08**			**51**
	4.1	Large & Medium	20.21		Yes	44	
	4.2	Small Scale	3.87		Yes	90	
5	**Electricity, Gas & Water Supply**			**1.55**			**35**
	5.1	Electricity	1.34		Yes	41	
	5.2	Gas	0.12		No	0	
	5.3	Water	0.09		No	0	
6	**Construction**			**7.63**	Yes	40	**40**
7	**Wholesale & Retail Trade**			**13.92**	No		**0**
8	**Hotel & Restaurant**			**0.74**	No		**0**
9	**Transport, Storage & Communications**			**11.01**			**35**
	9.1	Land Transport	7		Yes	50	
	9.2	Water Transport	0.68		Yes	50	
	9.3	Air Transport	0.1		No	0	
	9.4	Support & Storage	0.64		Yes	5	
	9.5	Post & Telecom	2.58		No	0	
10	**Financial Intermediaries**			**3.42**			**1**
	10.1	Banks	2.95		No	0	
	10.2	Insurance	0.29		No	0	
	10.3	Others	0.18		Yes	20	
11	**Real Estate, Renting**			**6.13**	Yes	20	**20**
12	**Public Administration & Defence**			**3.65**	Yes	70	**70**
13	**Education**			**2.44**	Yes	65	**65**
14	**Health & Social Work**			**1.89**	Yes	25	**25**
15	**Community, Social & Personal Services**			**8.15**	Yes	30	**30**
	Total			**100**			**36**

**GDP contribution* figures taken *from the Bangladesh Economic Review, 2019 (Ministry of Finance, Bangladesh, 2020)*
*** Percentage* exemption *estimated in this study*

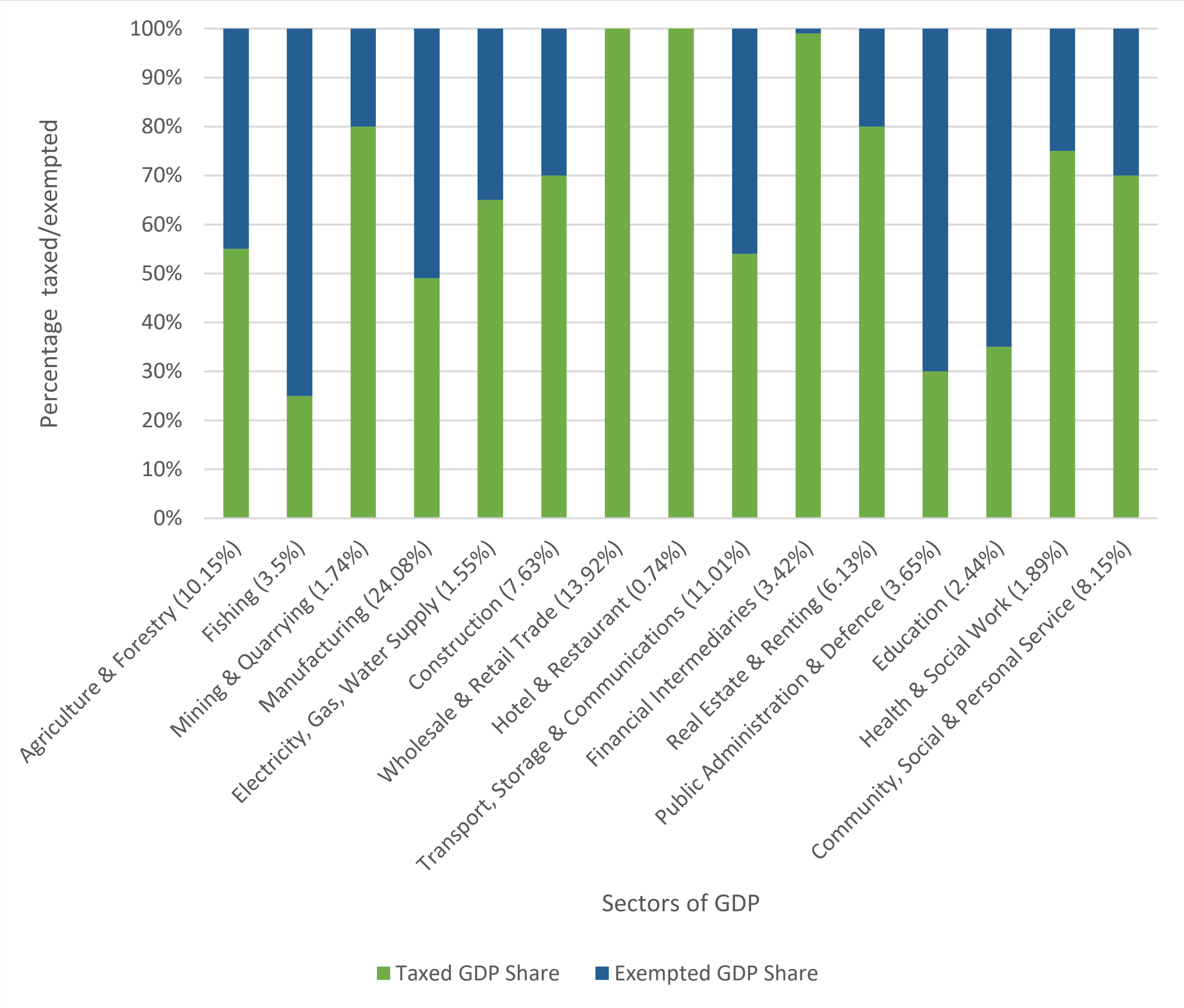
Table 11: Sector By Sector Benchmark and Effective Tax Rate Summary

S/N	**Sector**			**Benchmark Tax Rate**	**Effective Tax Rate**
1	**Agriculture & Forestry**				
	1.1	Personal		Progressive Rate: (0% to 30%)	55% of the ATR
	1.2	Corporate	Publicly Listed	25%	13.75%
			Non-Publicly Listed	35%	19.25%
2	**Fishing**				
	2.1	Personal		Progressive Rate: (0% to 30%)	25% of the ATR
	2.2	Corporate	Publicly Listed	25%	6.25%
			Non-Publicly Listed	35%	8.75%
3	**Mining & Quarrying**				
	3.1	Corporate	Publicly Listed	25%	20%
			Non-Publicly Listed	35%	28%
4	**Manufacturing**				
	4.1	Personal		Progressive Rate: (0% to 30%)	49% of the ATR
	4.2	Corporate	Publicly Listed	25%	12.25%
			Non-Publicly Listed	35%	17.15%
5	**Electricity, Gas & Water Supply**				
	5.1	Corporate	Publicly Listed	25%	16.25%
	5.2		Non-Publicly Listed	35%	22.75%
6	**Construction**				
	6.1	Personal		Progressive Rate: (0% to 30%)	60% of the ATR
	6.2	Corporate	Publicly Listed	25%	15%
			Non-Publicly Listed	35%	21%
7	**Wholesale & Retail Trade**				
	7.1	Personal		Progressive Rate: (0% to 30%)	Same as ATR
	7.2	Corporate	Publicly Listed	25%	25%
			Non-Publicly Listed	35%	35%
8	**Hotel & Restaurant**				
	8.1	Personal		Progressive Rate: (0% to 30%)	Same as ATR
	8.2	Corporate	Publicly Listed	25%	25%
			Non-Publicly Listed	35%	35%
9	**Transport, Storage & Communications**				
	9.1	Personal		Progressive Rate: (0% to 30%)	65% of ATR
	9.2	Corporate	Publicly Listed	25%	16.25%

			Non-Publicly Listed	35%	22.75%
10	**Financial Intermediaries**				
	10.1	Corporate	Publicly Listed	37.5%	37.13%
			Non-Publicly Listed:	40%	39.60%
11	**Real Estate & Renting**				
	11.1	Personal		Progressive Rate: (0% to 30%)	80% of ATR
	11.2	Corporate	Publicly Listed	25%	20%
			Non-Publicly Listed	35%	28%
12	**Public Administration & Defence**				
	12.1	Personal		Progressive Rate: (0% to 30%)	30% of ATR
	12.2	Corporate	Publicly Listed	25%	7.50%
			Non-Publicly Listed	35%	10.50%
13	**Education**				
	13.1	Personal		Progressive Rate: (0% to 30%)	35% of ATR
	13.2	Corporate	Publicly Listed	25%	8.75%
			Non-Publicly Listed	35%	12.25%
14	**Health & Social Work**				
	14.1	Personal		Progressive Rate: (0% to 30%)	75% of ATR
	14.2	Corporate	Publicly Listed	25%	18.75%
			Non-Publicly Listed	35%	26.25%
15	**Community, Social & Personal Services**				
	15.1	Personal		Progressive Rate: (0% to 30%)	70% of ATR
	15.2	Corporate	Publicly Listed	25%	17.50%
			Non-Publicly Listed	35%	24.50%

Source: Authors' calculations.

Figure 3: Tax Exemption Ratios By Sector



6. LIMITATIONS OF THE STUDY

Studying tax expenditure is always challenging, even in a developed economy and analyses of the effects and effectiveness of tax exemptions around the world have been imperfect. The challenge is more apparent in a developing economy than in developed ones due to the lack of sufficient data, proper documentation, and resources.

The method used in this analysis measures the tax expenditure originating from tax legislation. It does not measure the tax gap that results from tax evasion or the administrative weakness of the tax authority. The method mathematically assumes that the portion of GDP exempted from tax policy would generate the same proportion of tax evasion if taxed at the same rate.

We have taken GDP to be the measure of total income and profit generated within a country in a given year. However, this measurement is subject to uncertainty as GDP calculations have their own limitations and are subject to error. The probability that the GDP calculation may be different from the actual GDP was considered when producing the study's results. As GDP computation is often subject to academic criticism, we have imposed additional uncertainty on our research findings.

The macroeconomic analysis undertaken within this study was heavily dependent on the sectoral composition of the GDP. The weighted average tax exemption within a particular sector is often qualitatively measured and this is one of the primary limitations of the study. We use macroeconomic analysis due to the unavailability of relevant data at the intra-sector level. In some cases, the data was available but could not be collected due to a lack of resources. As a result, the economic justification provided in the report is only subjective.

The purposive sampling method was used to deduce broad base statistical inference, so the study's result should be treated as an overview that has been provided with the intention of giving policymakers a bird's eye view of the situation.

Due to the lack of available micro-data in developing economies, we opted to use subjective approximations throughout the study. Therefore, this study should be seen as an effort to estimate tax expenditures rather than accurately calculate them, and the tax expenditure values should be treated as indicative numbers.

7. CONCLUSION AND RECOMMENDATIONS

In summary, a customised method was used to determine income tax expenditure in Bangladesh by sector. All assumptions were made in order to accommodate the trade-off between simplicity and accuracy. A 2.28 per cent tax expenditure to GDP ratio can apply in a growing economy like Bangladesh. The study results can be used at the policy level, where a moderate significance level is acceptable. This result can also be considered to be valid in the medium term if no drastic policy shift has occurred. The following recommendations are made based on the results and tax expenditure analysis.

- The amount of tax expenditure is significantly large when compared to the NBR's tax revenue. Before allowing any exemption to apply, the government needs to ensure that it can protect against moral hazards and ensure that no adverse selection will occur. Moreover, every tax exemption must be justified by the following questions, as suggested by Ireland's Department of Finance (2014, as cited in Parliamentary Budget Office, Ireland, 2018):

    1. What objective does the tax expenditure aim to achieve?
    2. What market failure is being addressed?
    3. Is a tax expenditure the best approach to address the market failure?
    4. What economic impact is the tax expenditure likely to have?
    5. How much is it expected to cost? (p. 15).

- No arbitrary or discriminatory exemptions should be made. A policy for granting tax exemptions needs to be formulated based on macroeconomic variables. The cost-benefit analysis should not focus on revenue collection alone. The area of exemptions must be narrow and well-defined, and the exemptions should only apply for a limited period.
- Numerous SROs allow tax exemptions or reduced tax rates. Each of these need to be reviewed and, if there is no further economic requirement for a particular SRO, it should be cancelled.
- The NBR needs to know the amount of revenue forgone as a result of each tax exemption. It should establish a comprehensive research unit and digitalise taxpayers'

information. It will then be able to conduct more accurate tax expenditure reporting, on a regular basis, using the microsimulation analysis method.

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