Corporate Tax Strategy vis-à-vis Corporate Governance in Bangladesh: An Empirical Review

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ABSTRACT

This paper examines the tax payment behavior of a company under its tax strategy/policy in the corporate governance framework practiced in Bangladesh. It is found that listed companies in Bangladesh follow different traditional and modern tax strategies devised by their finance executives having professional authority of tax laws or sometimes borrowing expert opinion from the professional public accountants. Being considered as confidential, these strategies are kept outside public disclosure. The regulatory framework on corporate governance lacks the explicit provision on any fiscal aspect. For that reason, a survey on a small sample of 18 listed companies shows that all the companies properly comply with the Securities and Exchange Commission's corporate governance guidelines. No uniformity has been found over income tax estimates and measurement, presentation and disclosure. Both estimates and random judgment have been applied to compute the tax provision. Use of deferred tax concept is encouraging. But significant departure has been found in providing tax computation disclosure as well as tax status report by which the level of fiscal governance can be easily gauged. The 'comply or explain' basis corporate governance framework should be revised to incorporate the tax matters and then the intersection between tax and corporate governance would be more meaningfully interactive.

Keywords: Taxes, Corporate Tax Strategy, Corporate Governance

INTRODUCTION AND STATEMENT OF THE PROBLEM

Researches on corporate governance are few in number in the context of Bangladesh and existing literature shows that those are usually on such issues which are rarely related to corporate taxation or tax strategies. For instance, main focuses of some of such studies are on corporate governance disclosure in published annual reports (Khan, Siddiqui, & Hossain, 2004; Al-Amin & Tareq, 2006; Hossain & Khan, 2006; Bhuiyan & Biswas, 2007), while others encompass the role of corporate governance in solving agency problem (Biswas & Bhuiyan, 2008), effects of corporate ownership structure on governance (Habib, 2004) and corporate governance in general (ICAB, 2003; Sobhan & Werner, 2003; Chowdhury, 2004; Afroze & Jahan, 2005; Ahmed, 2006; Talukdar, 2007). The comprehensive paper by Imam & Malik (2007) is also on a non-tax issue, which examines how corporate governance is practiced through ownership structure and how firm's performance as well as its dividend payout policy is influenced by different ownership pattern. However, taxes and corporate governance can intersect in various aspects since taxation as a cost-factor works as an incentive or disincentive for management behavior and can, therefore, be used by the legislator for influencing managerial decisions (Friese, Link, & Mayer. 2008). In this regard, Schön (2008) has stated that tax authorities around the world have become aware of the potential influence of corporate governance rules on the tax strategy of an enterprise and "tax in the Boardroom" has become a keyword for a movement which tries to employ company law and securities law as a tool for governments to fight corporate tax avoidance (Schön, 2008). Thus, as a maiden attempt in Bangladesh perspective, this paper tries to delineate the interactive role of tax strategy followed by a corporate entity on its governance.

OBJECTIVES OF THE STUDY

The principal objective of the study is to examine the tax payment behavior of a company under its tax strategy/policy in the corporate governance framework practiced in Bangladesh. However, the study has the following specific purposes:

1. To give a brief overview of the corporate tax strategy/policy in its traditional sense and also the modern perspective thereof.
2. To delineate the linkage between the corporate governance framework and the corporate tax strategy/policy.
3. To review the regulatory framework of corporate governance in Bangladesh in the context of corporate tax matters.
4. To empirically examine the extent of observance of corporate governance in the context of issues relevant to corporate tax strategy/policy followed by Bangladeshi companies.

METHODOLOGY OF THE STUDY

The study is based mainly on the review of the published contents of the annual reports of a number of listed companies and some experience survey of the concerned finance directors/managers in charge of accounting and finance matters including the tax affairs. For this purpose, 18 listed companies' annual reports (including four banks) have been scrutinized to find out the corporate behavior on tax-payment on the basis of the tax-related disclosure in the overall contents of the reports. Since randomness is not followed in selecting the sample companies, generalization of the findings is supplemented by the experience survey to remove the constraints to a large extent. *Appendix-I* shows the list of 18 companies (3 pharmaceuticals, 4 cement, 4 banks, 1 food, 1 automobile and 5 other manufacturing companies), annual reports of which have been surveyed and the year of the annual reports. Since each individual annual report of a company shows comparative information of two consecutive years (current and preceding years), average has been computed for certain findings on the basis of information over 36 firm-years (11 companies' annual reports of calendar year 2009 covering 2008 and 2009 calendar years; 6 companies' annual reports of financial year 2008-09 covering financial years 2007-08 and 2008-09; and 1 company's annual report of year ending 31 March 2009 covering the years April 2007-March 2008 and April 2008-March 2009). For the review of the regulatory framework of corporate governance, relevant statutes, and the circulars and notifications issued by the regulatory bodies have been examined. A number of five finance executives (two finance directors and three finance managers) have been interviewed informally to survey their experience on formulation and use of tax strategy/policy and how that affects corporate governance.

CORPORATE TAX STRATEGY

In its common parlance, corporate tax planning/strategy means dealing with the tax matters of a corporate entity with a view to minimizing taxes with adoption of tax shelters. However, tax reduction strategies are often tainted with legality. Income tax statutes have provisions for charging tax on "any income, profits or gains, from whatever source derived" under section[2] (u/s) 2(34)(a) of the Income Tax Ordinance 1984 and hence, according to the spirit of this provision, legality of the source may not be questioned if tax is duly paid. Suffice

[2] Any section reference in the paper, if specifically not mention with any statute, is from the Income Tax Ordinance 1984.

it to say, in the Income Tax Ordinance 1984, there were several sections up to 30 June 2010 (assessment year 2010-11) and presently only one section [section 19C under which investment can be made in Bangladesh Infrastructure Finance Fund (BIFF) Bond during the period between July 1, 2010 and June 30, 2012 by paying 10% tax on undisclosed income], where investment out of undisclosed income can be legalized by paying tax at a stipulated rate and the tax rate is often very low (10% tax rate for investment in BIFF Bond vis-à-vis 25% highest individual tax rate). Income by way of winnings from "card games and other games of any sort or from gambling or betting" referred to in section 19(13) is subject to a source-tax of 20% (u/s 55) and this tax deducted at source is a "final discharge of tax liability" u/s 82C(4). Given these moral issues (whitening illegal or undisclosed income by paying tax at lower rate; or making tax law provision on income from 'gambling', for the prevention of which the government is constitutionally liable under Article 18 of the Constitution), while dealing with any sort of strategy regarding tax, we must be aware about the distinctions among tax evasion, tax avoidance and tax strategy.

Tax evasion has the objective of reduction of tax illegally. Sometimes, it is referred to as "tax cheating" through acts of commission or omission. Deceit, concealment, and/or misrepresentation are common elements in most illegal tax plans (Sommerfeld *et al.*, 1980). *Tax avoidance* and tax evasion usually both have same objective of reduction of tax, but tax avoidance encompasses only legal means of achieving the objective. Tax avoidance involves 'every attempt by legal means to prevent or reduce tax liability which would otherwise be incurred, by taking advantage of some provision or lack of provision in the law ... it presupposes the existence of alternatives, one of which would result in less tax than the other' (Report of the Royal Commission of Taxation 1966; *vide* Webley *et al.*, 1991). Lakhotia & Lakhotia (1998) have mentioned tax avoidance as "the art of dodging taxes without breaking the law." To them, "......tax avoidance means of traveling within the framework of the law or acting as per the language of the law only in form, but murdering the very spirit of the law and thus acting against the intention of the law and defeating the purpose of the particular legal enactment" (Lakhotia & Lakhotia, 1998). However, *tax strategy* is legal, desirable for the fiscal policymakers and ethical from moral perspective. In a narrow sense, tax *strategy* and tax avoidance are used interchangeably. But for tax avoidance purpose, usual means are the exploiting the 'tax loopholes', or getting the advantages of tax law ambiguity, and hence it is often distinguished from tax *strategy*. According to Lakhotia & Lakhotia (1998), tax strategy/planning "takes maximum advantage of the exemptions, deductions, rebates, reliefs and other tax concessions allowed by taxation statutes, leading to the reduction of the tax liability of the tax payer."

In the words of Scholes & Wolfson (1992), *tax strategy* is the effective tax planning. As stated by them, "Traditional approaches to tax planning fail to recognize that effective tax planning and tax minimization are very different things. The reason is that in a world of costly contracting, implementation of tax-minimizing strategies may introduce significant costs along *nontax* dimensions. Therefore, the tax-minimization strategy may be undesirable. After all, a particular easy way to avoid paying taxes is to avoid investing in profitable ventures" (Scholes & Wolfson, 1992). Thus, tax strategy means not to minimize tax, but to maximize after-tax rates of return on assets.

In case of non-compliance or evasion of tax, a corporate entity may face different types of enforcements by the tax authority, disallowances of unlawful tax deductions and exemptions of income, imposition of fine and penalty interest and also prosecution for extreme violation of tax provisions. For these reasons, the company may be involved with litigations for which it might seek appeals, revision and references to Supreme Court. But everything is costly and is subject to not only pecuniary costs, but also political and psychic costs.

Below is a brief description of corporate tax strategies from two perspectives: traditional tax strategy (tax minimizing schemes) and modern tax strategies (the Scholes-Wolfson Paradigm and SAVANT Framework).

Traditional Tax Strategy

Traditional tax strategy is equivalent to tax avoidance with the main purpose of legal reduction of tax liability. This starts with finding the critical variables for which a simple tax formula as follows may help:

Line No.		*Item*
1		Aggregate Income
2	–	Exclusions
3	=	Gross Income
4	–	Allowable Deductions
5	=	Taxable Income *['Total Income' is the legal term used as tax-base]*
6	×	Tax Rate(s)
7	=	Gross Tax
8	–	Tax Credit, Tax Rebate, & Tax Relief
9	=	Tax Payable

Since the ultimate objective of traditional tax strategy is the minimization of the bottom line–that is, the minimization of the net tax payable–the rules of simple arithmetic suggest that tax strategy must necessarily involve the maximization of tax credits/rebates/reliefs, the minimization of the applicable tax rate(s), and the maximization of deductions and/or exclusions. In other words, the items on all even-numbered lines in the above formula constitute the critical variables in tax strategy.

An alternative way of viewing traditional tax-strategy opportunities is to observe that income tax is constrained by *time*, *entity*, and *accounting method*. Since income tax rates "start over" with each new tax year and because very few taxpayers have a constant level of taxable income in each year, there tend to be high-tax years and low-tax years. The 'tax value' of a deduction is directly dependent on the marginal tax bracket of the party reporting it. Obviously, therefore, taxpayers tend to recognize losses and other deductions in high-tax years and to defer the recognition of taxable income to low-tax years. To the extent that a taxpayer can control tax timing, s/he should do so only after giving full considerations to the time value of money. Sometimes the financial cost of deferral is greater than the tax benefit (Sommerfeld *et al.*, 1980).

Modern Tax Strategies

Modern tax strategies focus not on tax-minimization, rather their objective is tax-optimization. Given the voluntary tax compliance, here the actions involve the ways and means how disposable post-tax income can be maximized. Two popular tax strategies–the Scholes-Wolfson Paradigm and SAVANT Framework–have been discussed below.

The Scholes-Wolfson Paradigm (*vide* Scholes *et al.*, 2002)

Myron S. Scholes, the 1997 Nobel Winner in Economics as the co-originator of the Black-Scholes option pricing model and a partner of Oak Hill Capital Management and Mark A. Wolfson, a managing partner of Oak Hill Capital Management, have jointly developed a paradigm for tax strategy in 1992 through their book titled *Taxes and Business Strategy: A Planning Approach*. They have adopted a contractual perspective for their paradigm and suggested three key aspects of tax strategy globally: all parties, all taxes, all costs. Under Scholes-Wolfson paradigm, taxing authority is always an uninvited party to all contracts.

Contractual terms that taxing authority imposes on its joint venture are the tax rules, which result from a variety of socioeconomic forces: (i) finance public projects, (ii) redistribute wealth and (iii) encourage economic activities. Government ensures objectives of the tax rules by *designing to discriminate* *among different economic activities*. This has been done through two things: progressive taxation (for redistributing wealth) and subsidy (for encouraging economic activities). Tax rules provide also to arrange taxpayer's affairs to keep the tax bite as painless as possible. Thus, progressive taxation, subsidy and provision to arrange taxpayer's affairs to minimize tax-bite give rise to marginal tax rate (MTR) that widely varies: (1) from one contracting party to the next; (2) for a given contracting party over time; and (3) for a given contracting party over different economic activities.

Scholes-Wolfson tax strategy depends on identification of *tax clientele*, which is based on implicit tax and also the adoption of *tax arbitrage*. *Implicit tax* arises because the pre-tax investment returns available on tax-favored assets are less than those available on tax-disfavored assets. Taxpayers wishing to obtain the tax-favored treatment offered by the investment bid up the price of the investment lowering the pre-tax return. Thus, a desperate effort to avoid tax might emphasize only to reduce explicit tax by adopting tax-favored treatments, might reduce the after-tax return and hence there will be a decrease in after-tax return, which is nothing but an implicit tax. *Implicit tax rate* is the difference in pretax returns on a given asset, and the benchmark asset (usually, "fully taxable bonds" taken as benchmark asset). Taxpayers who are indifferent between purchasing two equally risky assets, the returns to which are taxed differently, are called the *marginal investors*. Taxpayers that prefer one investment over another are referred to as the **tax** *clientele* for the preferred investment. Unless investors correctly identify their proper tax clientele, they will not maximize their after-tax rates of return. Usually to identify the proper tax clientele, one way is to compute the implicit tax on tax-favored investment based on a fully taxable investment, then clientele of the fully taxable investment will be the taxpayers having "marginal explicit tax rates" (METR) below the implicit tax found.

Tax arbitrage is the purchase of one asset (a "long" position) and the sale of another (a "short" position) to create a sure profit despite a zero level of net investment. Through tax arbitrage, one can maximize after tax return effectively without adopting easy and desperate tax-minimization strategies which might introduce significant nontax costs. But tax arbitrage may be prevented by *tax-rule restrictions* and *frictions*. *Tax-rule restrictions* are the restrictions imposed by the taxing authority, which prevent taxpayers from using certain tax arbitrage techniques to reduce taxes in socially undesirable way (e.g., placing limits by tax authority on taxpayer's ability to deduct interest only from the income out of investment by the borrowing) and *frictions* are the direct transaction costs. Although tax-rule restrictions and frictions may impede employment of tax arbitrage technique, but it is these frictions and tax-rule restrictions that make potential returns to tax strategy so high.

SAVANT Framework (*vide* Karayan, Swenson & Neff, 2002)

Karayan, Swenson, and Neff (2002) have suggested a strategic framework for corporate tax strategy, what they refer to SAVANT, which is an acronym for how tax planning/strategy fits into business decisions: through Strategy, Anticipation, Value-Adding, Negotiating, and Transforming. According to dictionary meaning, a *savant* is an exceptionally knowledgeable person. The SAVANT framework organizes tax principles and their applications and this framework helps nontax specialists see tax savings opportunities and also helps managers to apply tax principles to make better decisions. SAVANT works as follows: To add maximum value to each transaction, decision makers need to stay focused on the firm's *strategic plan*, *anticipating tax impacts* across time for all parties affected by the transaction. Managers *add value* by considering these impacts when *negotiating* the most advantageous arrangement, thereby *transforming* the tax treatment of items to the most favorable status. Expert managers (and consultants) use these concepts, derived from economic policy and tax law, to maximize shareholder value. Under SAVANT framework, tax savings strategies usually fall into one of four types: (1) *creation* (involves plans that take advantage of tax subsidies, such as moving an operation to a jurisdiction that imposes lower taxes), (2) *conversion* (entails changing operations so that more tax-favored categories of income or assets are produced), (3) *shifting* (involves techniques that move the tax base to more favorable tax-accounting periods), and (4) *splitting* (entails spreading the tax base among two or more taxpayers to take advantage of differing tax rates).

CORPORATE GOVERNANCE

Corporate governance is "the way that companies are governed or run" (Prabhakar, 2007). In other words, it is "the systems and processes put in place to direct and control an organization in order to increase performance and achieve sustainable shareholder value" (Fahy, Roche, & Weiner, 2005). As mentioned by Shelton (2001), in a *narrow sense*, corporate governance involves a set of relationships between a company's management, its board of directors, shareholders, and other stakeholders. These relationships, which involve various rules and incentives, provide the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Key aspects of good corporate governance include the transparency of corporate structures and operations; the accountability of managers and boards to shareholders (including foreign shareholders); and corporate responsibility towards employees, creditors, suppliers, and the local communities where the corporation operates. In a *broader sense*, however, good corporate governance–the extent to which companies are run in an open and honest manner–is important for overall market confidence, the efficiency of international capital allocation, the renewal of countries' industrial bases, and ultimately nations' overall wealth and welfare (Shelton, 2001).

The role of corporate governance is addressed by the Blue Ribbon Committee (New York Stock Exchange and National Association of Securities Dealers, New York) as: "Good governance promotes relationships of accountability among the primary corporate participants to enhance corporate performance. It holds management accountable to the board and the board accountable to shareholders ... A key element of board oversight is working with management to achieve corporate legal and ethical compliance" (BRC, 1999; *vide* Rezaee, Olibe, & Minmier, 2003).

CORPORATE TAX STRATEGY AND CORPORATE GOVERNANCE

The OECD (Organisation for Economic Co-operation and Development) Principles of Corporate Governance (2004) state: "Corporate governance requirements and practices are typically influenced by an array of legal domains, such as company law, securities regulation, accounting and auditing standards, insolvency law, contract law, labor law and *tax law*. Under these circumstances, there is a risk that the variety of legal influences may cause unintentional overlaps and even conflicts, which may frustrate the ability to pursue key corporate governance objectives. It is important that policy-makers are aware of this risk and take measures to limit it" (*vide* Friese, Link, & Mayer. 2008). Thus, the OECD Principles of Corporate Governance makes clear why it is useful to analyze the interaction of tax systems and corporate governance issues. From the tax perspective, one may add that the mentioned overlaps and conflicts not only may frustrate the pursuit of key corporate governance objectives, but also those of a sound and efficient tax system and economic neutrality (Friese, Link, & Mayer. 2008).

As Chirinko (2008) stated, while corporate governance problems are known, their impacts on tax policy evaluations remain largely unknown. Chirinko has mentioned three cases: (1) interpretations of the movement in the user cost in response to tax policy changes may be inaccurate in the presence of corporate governance problems; (2) whether firms are neoclassical or finance constrained has a major impact on tax policy evaluations; and (3) the response of dividend decisions to taxes is important for discriminating between the traditional and new views of dividend taxation. However, dividends also play a role in attenuating agency problems by forcing misbehaving managers to release cash to shareholders. This additional role compromises tests of taxes and dividend behavior. The multiple ways in which governance problems can distort tax policy evaluations remain to be studied (Chirinko, 2008).

Good corporate governance principles should extend to the corporation's attitude towards its tax liabilities. This is not a question of whether or not a corporation should seek to minimize its tax burden, but more an issue of the board's responsibility to assess the financial and reputation risks associated with any particular tax strategy. Aggressive tax planning can create significant financial risks (adjustments and penalties). It can also create risks in terms of reputation. It is a striking fact that while taxes often represent a very significant portion of a company's profits and potentially huge risks (tax adjustments may sometimes lead a company to bankruptcy), there is generally, in practice, limited involvement of the board and even more limited involvement of the shareholders in the management of a corporation tax strategy. There are both direct and indirect impacts of tax rules on corporate governance. Direct impacts include non-deductibility of bribes and other illegal payments to foreign officials, thus increasing the cost of such payments. Indirect impacts include structuring certain transactions responding to tax principles and considerations without taking their implications on corporate governance issues into account (e.g., the granting of extensive stock option plans may encourage individual employees to behave in a manner which is contrary to the interest of the company and/or of its shareholders; due to preferential tax treatment to income in the form of capital gains on shares, as opposed to dividend distributions, when problems of corporate performance arise, there might be an incentive for shareholders to avoid adequate monitoring of corporate management). Tax considerations may in some instances encourage management to make fiscal decisions on behalf of the shareholders that are contrary to the longer term interests of the company (e.g., in the context of business reorganizations where the tax treatment of termination costs may in some instances encourage shareholders to decide in favor of plant closures, irrespective of the longer term interests of the company and other stakeholders). Tax and financial accounting and income reporting rules also raise corporate governance issues through shifting income from one period to another. Thus it is important that the interaction between tax and financial accounting rules be examined in the context of any review of corporate governance (Owens, 2008).

Based on US experience, Friese, Link, and Mayer (2008) have opined that tax provisions with corporate governance purposes are generally not sophisticated and fact specific enough. Furthermore, they can often easily be circumvented or ignored. In some cases provisions on the taxation of executive remuneration in the United States in fact lead even to increased payments. Most importantly, they cannot distinguish between harmful and beneficial takeover situations. In addition, both in the case of greenmail and golden parachutes taxation[3] (in USA), the tax penalty is not linked to the actual harm (possibly) caused by the targeted conduct. As a result, it seems inappropriate to use tax legislation as a policy tool with respect to takeover transactions. It would be preferable to develop more sophisticated systems that distinguish between situations that result in a benefit for the shareholders and those which are to their detriment. One possibility is to subject management support for takeovers to shareholder approval (Friese, Link, & Mayer, 2008).

Observing the endless research-endeavor of the scholars of corporate governance concerning the board of directors and shareholders, Coffee (2006) has mentioned his belief in a thesis: "all boards of directors are prisoners of their gatekeepers.[4] No board of directors–no matter how able and well-intentioned its members–can outperform its professional advisors. Only if the board's agents properly advise and warn it, can the board function efficiently" (Coffee, 2006). Thus, since dispersed shareholders and part-time directors depend on gatekeepers, effective corporate governance requires a chain of actors: directors, managers, and gatekeepers. No chain is stronger than its weakest link and findings suggest that during the 1990s gatekeepers (auditors, attorneys, securities analysts, credit-rating agencies and investment bankers) became the weakest link in the USA (Coffee, 2006). Gatekeepers, the reputational intermediaries, failed mostly due to the conflicts of interest, and the declining threat of enforcement (Coffee, 2006). In this respect, the premise held by Coffee (2006) is that: corporate governance does

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3 ***Greenmail*** refers to a hostile bidder's sale of shares of the targeted firm back to that firm at a premium. In order to deter the payment and acceptance of such payments, in the USA, a 50% tax is imposed on the gains resulting from such a sale of stock. The *greenmail tax* reduces the return from greenmail payments and accordingly the expected returns from hostile takeover attempts (Friese, Link & Mayer, 2008: 374). ***Golden parachutes*** can be described as generous payments to top managers in the event of a substantial change in ownership or a change of control, or upon termination of the officials' contracts as a result of such a change. The payments must also have a present value equal to or in excess of an amount of three times the average income of the executive. The tax code restricts deductibility as well as imposes a direct tax penalty on payments in connection with takeover situations. It affects both the bidding company (by increasing the costs of the payment) and the receiving manager (limiting the profit of the recipient of the payment). The result of both tax penalties is that the after-tax costs of a takeover are increased. Consequently, these payments are less attractive for both the bidding company and the management of the target (Friese, Link & Mayer, 2008: 372).

4 The term 'gatekeeper' typically connotes some form of outside or independent watchdog or monitor–someone who screens out flaws or defects or who verifies compliance with standards or procedures. Within the corporate context, the term 'gatekeeper' is usually used to mean an independent professional who plays one of two distinct roles, which tend to overlap in practice. First, the gatekeeper may be a professional who is positioned so as to be able to prevent wrongdoing by withholding necessary cooperation or consent. A second and superior definition of the gatekeeper is an agent who acts as a reputational intermediary to assure investors as to the quality of the 'signal' sent by the corporate issuer. These gatekeepers are the professional agents of the board and the shareholders, who inform and advise them: auditors, attorneys, securities analysts, credit-rating agencies and investment bankers (Coffee, 2006: 1-2).

not work, nor can management be held accountable, in the absence of a system that makes gatekeepers reasonably faithful to the interests of investors (Coffee, 2006).

When the gatekeepers work as tax consultants, which is the usual case for many public accountants, the corporate governance issues become threatened by tax motivation. As per Kahle and White (2004), tax professionals (including accountants) have been found to be highly susceptible to biases towards the client preference (Kahle & White, 2004; *vide* Marnet, 2008). The fall of Enron in the USA (founded in 1985 and filed for bankruptcy on December 2, 2001) acknowledges that the company's corporate governance exhibited serious failures of monitoring, which can be traced back to conflicts of interest on the part of board members and its auditors (Deakin & Konzelmann, 2006). The name of Arthur Andersen (established in 1913 and licenses of Certified Public Accountants surrendered in 2002) came as the auditor of Enron. Gordon (2002) points to the bundling of auditing plus tax planning, due to what he perceives as the carryover mindset from tax planning into accounting planning. It is quite revealing that Enron paid virtually no corporate taxes in the five years prior to its demise, despite reporting nearly US$2bn in earnings from 1996 through 2000 (*vide* Marnet, 2008).

EMPIRICAL PERSPECTIVE OF BANGLADESH

A Review of the Regulatory Framework of Corporate Governance in Bangladesh

Corporate governance (CG) in Bangladesh is to some extent a recent issue. The issue came into light in the wake of stock market debacle in the 1996[5] and then it was mainly a popular topic of discussion in seminars, conferences and round-table sessions organized under the initiative of the Organisation for Economic Co-operation and Development (OECD), the Securities and Exchange Commission (SEC) and other scholars of corporate culture (Talukdar, 2007). Bangladesh Bank,

[5] The secondary share markets showed unprecedented volatility during July-November, 1996. During this period, share price multiplied by nearly four times. Market capitalization went up by 265%. Average Daily Turnover increased by over 1000%, and Price Index jumped by 260%.The Market Capitalization jumped from 8% to around 20% of GDP, and the Price Earnings ratio soared to 80. Since mid-November 1996, the share prices moved downward, while the Price Index continued to be low. In December 1996, a high powered Enquiry Committee was set up to investigate the unusual behaviour of the Stock Market for restoring Investors confidence. It submitted its Report in March 1997. Based on this Report, the SEC has filed cases against several Broker Firms and Issuers (The SEC's *Annual Report July 1996-June 1997*, published in May, 1998, p. 7).

the central bank of Bangladesh and the regulatory authority of the banking sectors, issued BRPD (Banking Regulation & Policy Department) Circular No. 09 dated 17 September 1996 to impose restrictions in respect of responsibilities and accountabilities of the board of directors and the CEO (chief executive officer) of private bank with a view to ensuring good and corporate governance in the bank management. In July 2003, Bangladesh Bank rescinded its 1996 BRPD Circular No. 09 and issued another revised and updated BRPD circular No. 16, dated 24.07.2003, on same issues that contains: (1) Responsibilities and authorities of the board of directors; (2) Responsibilities of the chairman of the board of directors; (3) Responsibilities of the adviser; and (4) Responsibilities and authorities of the CEO. In the similar way, DFIM (Department of Financial Institutions and Markets) Circular No. 7 dated 25.09.2007 has been issued by Bangladesh Bank on principles in respect of responsibilities and accountabilities of the board of directors, chairman and the CEO/managing director of financial institutions. For the circulars' same objectives of ensuring good and corporate governance in the management of bank/financial institution and due to its public disclosure requirement, they are often known as the 'corporate governance' (CG) guidelines for banks/ financial institution (www.bangladesh-bank.org).

The Securities and Exchange Commission (SEC) issued, in January 2006, its first corporate governance guideline as an order [Order No. SEC/CMRRCD/2006-158/Admin/02-06 dated 9th January, 2006]. But the SEC superseded this order within six weeks before its compliance. Then the SEC issued in February 2006, its notification on corporate governance [Notification No. SEC/CMRRCD/2006-158/Admin/02-08 dated 20th February, 2006], on 'comply or explain' basis, in order to enhance 'corporate governance' (CG) in the interest investors and the capital market. The companies listed with any stock exchanges in Bangladesh should comply with the conditions mentioned in the CG guidelines or shall explain the reasons for non-compliance through 'Reporting the Compliance in the Director's Report' (SEC, 2007). The CG guidelines have been imposed on the listed companies under issued under section 2CC of the Securities and Exchange Ordinance, 1969 and they are obligatory for them. Under these guidelines, in the formal report on CG, a company has to 'comply or explain' 32 row items as 'Complied' (3rd column), 'Not complied' (4th column) and 'Explanation for non-compliance with the condition' (5th column) (SEC, 2007). But nowhere taxation has been specifically mentioned as an issue concerning corporate governance. However, there are few points in the CG guidelines where 'taxation' might come as a component of its broader scope. For example, the Audit Committee's reporting to the Board of Directors contains the following (SEC, 2007):

- Report on conflicts of interests [Condition No. 3.3.1(ii)(a)]: Taxation services provided by the external auditor might be mentioned as a case of conflict of interest, but no company mentions it as such because auditors do not assume it as a conflict of interest according to their code of ethics (see below).

- Suspected or presumed fraud or irregularity or material defect in the internal control system [Condition No. 3.3.1(ii)(b)]: Internal control refers to "the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, and *compliance with applicable laws* and regulations" (ICAB, 2009). Thus, under the broad framework of 'internal control', compliance with taxation laws are covered. But due to this remoteness of meaning, tax laws are not at all an issue here.
- Suspected infringement of laws, including securities related laws, rules and regulations [Condition No. 3.3.1(ii)(c)]: Although, here the term 'laws' has been explicitly used, but no company so far has reported the violation of tax laws.

In the above SEC's CG guidelines of February 2006, to avoid the conflicts of interests, external/statutory auditors should not be engaged in some non-audit services [Condition No. 4.00]. Here is a list of seven non-audit services (appraisal or valuation services or fairness opinion, financial information systems design and implantation, book-keeping or other services related to accounting records or financial statements, broker-dealer service, actuarial services, internal audit services, and any other services determined by the audit committee) for non-engagement by auditors, but taxation services are not enumerated in this list (SEC, 2007).

With respect to "Provision of Taxation Services to Financial Statement Audit Clients" by a practicing auditor, in the *Code of Ethics for Professional Accountants* in Bangladesh, there is a lone paragraph (whereas there are 14 paragraphs in the International Federation of Accountants' *Code of Ethics for Professional Accountants*; see IFAC, 2010) as follows:

"In many jurisdictions, the firm may be asked to provide taxation services to a financial audit client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Such assignments are generally not seen to create threats to independence" (ICAB, 2008).

But if auditors, one of the gatekeepers, once accept and become dependent upon employment as tax advisers and consultants for their clients, their independence from their clients is compromised (Coffee, 2006). In the *Code of Ethics for Professional Accountants* of the International Federation of Accountants (IFAC), out of the various taxation services, all have been mentioned as a threat to the auditors' independence, except the tax return preparation service if management takes responsibility for the returns including any significant judgments made, and the tax-related valuation services. Even the preparation of calculations of current and deferred tax liabilities (or assets) for an audit client (that is not a public interest entity) is seen to create a self-review threat; and this service is prohibited for audit clients that are public interest entities, except in emergency situations. Tax planning and other tax advisory services (such as advising the client how to structure its affairs in a tax efficient manner or advising on the application of a new tax law or regulation) are also thought to create a self-review threat. But the valuation services, which are provided for tax purposes only and the result of the valuation will not have a direct effect on the financial statements, are generally considered to create no threats to independence. Auditor's assistance in the resolution of tax disputes is also thought to create an advocacy or self-review threat (IFAC, 2010).

The Companies Act 1994 (effective from 1 January 1995) has a disclosure requirement in this regard as follows:

"6. The profit and loss account shall further contain or give by way of a note detailed information in regard to amounts paid to the auditor, whether as fees or otherwise for services rendered–

a. as auditor;
b. as advisor, or in any other capacity, in respect of–(i) taxation matters; (ii) company law matters; (iii) management services; and
c. any other manner" (Clause 6 of the "Requirements as to Profit and Loss Account" in Part-II of Schedule-XI of the Companies Act 1994; *vide* Dhar, 1998).

Thus, the Companies Act 1994 has at least an intention to bring the auditor-provided taxation services into light through its disclosure in the annual report of a company. This might work as a deterrent on auditors in providing taxation services to their direct audit clients, but they are not legally constrained to provide taxation services to any clients, whether audit-client or not.

Survey Findings

Findings of the survey of 18 companies' annual reports show that over the 36 firm-years, the average amount of current tax provision is found at Tk. 349.4 million per annum (92.7 percent of total provision) and the annual average provision for deferred tax expense at Tk. 27.4 million (7.3 percent of total provision). Out of this tax provision, tax has been paid to the extent of 81.7 percent of current tax provision or 75.8 percent of total tax provision. But the companies have reported annual average balance of advance tax to the tune of Tk. 510.8 million. Thus, a gap between estimated tax liability (as tax provision) and the tax payment is visible in terms of under-payment and at the same time, they have unadjusted advance tax in their favour, which is around 78 percent higher than the tax already paid. This mismatch might be an indicator of ad hoc tax policy on continuing tax payment along with the inability in adjusting advance tax somehow paid through withholding.

To empirically examine the extent of observance of corporate governance in the context of issues relevant to corporate tax strategy/policy followed by Bangladeshi companies, 10 issues have been checked from the annual reports of the sample 18 listed companies. Findings have been summarized in a table (Table-I).

Table I: Findings on Tax-Related Corporate Governance (CG) Issues

Sl.	Tax-related CG Issues	Frequency (*f*) Yes	YED	No	NDT	N/A	Total
1.	Whether have a disclosure under 'Significant Accounting Policies' for Current tax and Deferred Tax?	12 (66.7)	4 (22.2)	2 (11.1)	0 (0.0)	0 (0.0)	18 (100.0)
2.	Whether provide tax computation disclosure?	2 (11.1)	0 (0.0)	15 (83.3)	1 (5.6)	0 (0.0)	18 (100.0)
3.	Whether disclose deferred tax computation?	0 (0.0)	0 (0.0)	18 (100.0)	0 (0.0)	0 (0.0)	18 (100.0)
4.	Whether provision has been kept for:						
	Current tax	15 (83.3)	0 (0.0)	2 (11.1)	0 (0.0)	1 (5.6)	18 (100.0)
	Deferred tax	11 (61.1)	0 (0.0)	6 (33.3)	0 (0.0)	1 (5.6)	18 (100.0)
5.	Whether provide any tax status report?	7 (38.9)	0 (0.0)	11 (61.1)	0 (0.0)	0 (0.0)	18 (100.0)
6.	Is there any disclosure regarding Contingent liabilities?	16 (88.9)	0 (0.0)	2 (11.1)	0 (0.0)	0 (0.0)	18 (100.0)
7.	Is there any contingent liability regarding disputed tax?	1 (5.6)	0 (0.0)	15 (83.3)	0 (0.0)	2 (11.1)	18 (100.0)
8.	Is anything mentioned in Chairman's report regarding tax compliance?	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
9.	Is anything mentioned in Director's report regarding tax compliance?	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)
10.	Whether complied with the SEC's Corporate Governance Notification of February 2006?	18 (100.0)	0 (0.0)	0 (0.0)	0 (0.0)	0 (0.0)	18 (100.0)

Note: YEDT = Yes except deferred tax; NDTL = Nil due to loss; N/A = not applicable. Figures in parentheses show percentage.

Source: Compiled from the published annual reports of the sample companies.

Findings show that around 11 percent companies have not at all disclosed any taxation policy, although as per paragraph 120 of IAS 1 *Presentation of Financial Statements*, the users of financial statements would expect an entity subject to income taxes to disclose its accounting policies for income taxes, including those applicable to deferred tax liabilities and assets (IASB, 2010). The taxation strategy/policy, as discussed earlier, in the form of a traditional tax avoidance strategy or a modern one (Scholes-Wolfson Paradigm and SAVANT Framework) is thought to be a confidential issue and the results of the experience survey show that the companies usually apply, in addition to the routine tax avoidance means, different types tax-shifting strategies across time through discretionary accruals or restructuring revenue-related or expense-related transactions through recognition or derecognition and obviously after taking the legal and fiscal implications into considerations and also keeping the potential audit-objections in mind against any accounting treatments where questions may be raised by the auditors for any irregular application of any tax law provision. However, tax consultancy is sometimes borrowed from the external auditor or other the professional public accountants to ensure the legality of any tax-induced transactions. The companies, which have disclosed the tax policy, have given a note-disclosure about how they provide for their routine income tax liability, but these are not at all the strategic aspects of the fiscal policy of the companies. For example, in Note-10.00, Fu-Wang Foods Ltd. has given the following taxation policy-related disclosure:

Taxation is provided in accordance with fiscal regulations applicable. The company is publicly traded company as per Income Tax Ordinance, 1984. In spite of the company qualifies for being treated as a "Publicly Traded Company" for which the rate of tax at 27.50% has been applied for while making provision for income tax, as the company proposed stock dividend @ 10%.

Transactions relating to Income Tax have been disclosed in conventional manner following previous practice on consistent basis for which disclosure requirement under Para 79-88 of BAS-12[6] could not be complied with (*Annual Report 2008-09* of Fu-Wang Foods Ltd.).

Fu-Wang Foods Ltd. has also disclosed a separate note on "Compliance with local laws" as: "The financial statements have been prepared in compliance with requirements of the Companies Act, 1994, the Securities and Exchange Rules, 1987 and other relevant laws and rules" (Note No. 2.00 in *Annual Report 2008-09* of Fu-Wang Foods Ltd.). But the tax laws have not been explicitly cited here.

Regarding tax computation disclosure, more than 83 percent of the companies did not show anything. Of the companies, around 61 percent showed deferred

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6 BAS-12 stands for Bangladesh Accounting Standard 12 *Income Taxes*, which is the adopted version of International Accounting Standard (IAS) 12 *Income Taxes*.

taxation, but no company did not disclose any calculations. However, except for losing companies, all the companies have kept provision for current income tax. Only around 39 percent of the companies have provided a tax status report. Although around 89 percent of companies have reported some contingent liabilities, but only a lone company have shown a contingent liability regarding disputed tax. This might be a good gesture towards corporate governance on tax matters. A fact is to some extent astonishing that no company has not mentioned anything in Chairman's report or in Director's report regarding tax compliance. But another fact might be hardly believable that all the companies have properly complied with the SEC's Corporate Governance Notification of February 2006. Because, as stated above, if the spirit of some of the individual conditions are checked by justifying the substance-over-form, then some sort of irregular behavior on fiscal law compliance might be found.

Thus, a critical observation of the annual reports of the sample companies shows that there is no uniformity over income tax estimates and measurement, presentation and disclosure. A few company kept provision on the basis of estimated income where some other kept on lump sum basis. Most of the companies considered deferred tax concept except a few where they did not disclose the rationale for non-consideration. Most of the companies did not provide tax computation disclosure as well as tax status report by which a user can get information regarding compliance and non-compliance issues, tax provision, advance tax, settled assessment year, appeal stage and its reasons, disputed claim etc. at a glance. But in case of contingent liability for tax, most of the companies are found compliant.

CONCLUSION AND POLICY IMPLICATIONS

Tax planning/strategy as a tax favored activity should be devised in such a way, so that ultimate after-tax rate of return can be maximized. Then the trade-off between extra income and tax cost can be achieved. In cases of business decisions having dichotomous alternatives, tax provision is favorable only for one. For instances, deciding on centralized vs. decentralized management, opening a branch vs. establishing a subsidiary, buying resources from local supplier vs. foreign supplier, dividend distribution vs. retention, raising capital through issuing equity vs. debt securities, repatriation vs. reinvestment (in case of multinational subsidiary), tax is one of the most influential factors that should be evaluated critically. Sometimes, a hassle-free provision may not be favorable to some taxpayers (e.g. treating tax deducted at sources as final discharge of tax liability under section 82C is not desirable for losing business enterprises). Absence of any provision may be utilized as a tax loophole to exploit its benefit (e.g., absence of provision to compute 'loss under the head Capital Gains' can be used to show never a capital loss, which cannot be set off against other income). But for tax strategy purpose, thorough background of accounting, finance, economics and fiscal regulations are also equally needed to make the plans and strategies successful.

Dave Hartnett, the UK Permanent Secretary of Tax, is of view that by bringing tax within statements of corporate responsibility principles and by bringing those principles to life in the way tax issues are managed, corporate taxpayers can convince tax administrators that a more trusting tax environment is possible, and high levels of suspicion occurring in tax administrations can be reduced (Hartnett, 2008). Hartnett's suggestion is that the tax administrators have to change themselves if they want to leverage corporate responsibility to increase tax compliance, create greater transparency and disclosure, and promote dialogue. According to Hartnett, to improve the corporate governance aspect of fiscal decisions, corporates wants tax administrations that are: (i) tough on non-compliance, (ii) consistent in their actions, (iii) constantly producing good guidance on new initiatives and access to specialists who understand complex issues, (iv) with clarity of roles, responsibility and accountability, (v) providing more openness and ready to work in "real time" to resolve issues, (vi) providing faster responses leading to faster settlement of issues, and (vii) ready to share risk assessment (Hartnett, 2008).

As suggested by Warren Buffet, "In looking for people to hire, you look for three qualities: integrity, intelligence and energy. And if they don't have the first, the other two will kill you" (*vide* Fahy, Roche, & Weiner, 2005). To improve the corporate fiscal behavior within a good governance scheme, the corporate board and management should consist of men of character with a transparent and stated tax policy. On the other hand, the taxing authority should behave honestly and lawfully in their enforcement on corporates with a relationship full of belief and trust, which will ultimately contribute towards the achievement of a desired level of corporate governance.

In Bangladesh, listed companies are following different traditional and modern tax strategies devised by their finance executives having professional authority of tax laws. Sometimes even the professional public accountants are hired to obtain the expert opinion on the legal aspect of tax policies. But these are considered as confidential and not disclosed at all.

Based on the analysis and empirical observation, following policy recommendations may be put forward for ensuring good corporate governance with respect to tax matters and to bring uniformity and consistency for presentation and disclosures:

- A company should give a disclosure in its critical accounting policies regarding current tax and deferred tax, its applicable tax rate along with effective rate etc.
- A company should give a disclosure regarding income tax computation and deferred tax computation as accounting profit differs from taxable profit and should keep appropriate provision.
- Income tax provision and advance tax should be kept under separate head until or unless settlement of the tax case for that year.
- A company should provide a tax status report showing in details the provision, advance tax, appeal status and its reasons, assessment completion year, refund or payable etc.
- A disclosure should provide whether there is any contingency for pending tax cases or not etc.
- A clause should be enclosed in Chairman's report and Director's report regarding tax compliance and non-compliance or any other tax issue.
- The SEC's notification on corporate governance guidelines should be revised through incorporating various tax compliance points, particularly, non-engagement condition on external/statutory auditor should include 'taxation services'.

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APPENDIX I

List of the Sample Companies & the Year of Their Annual Reports

Sl.	Company Name	Year-end of Annual Report
1	Beximco Pharmaceuticals Ltd.	31 December 2009
2	Square Pharmaceuticals Ltd.	31 March 2009
3	Ambee Pharmaceuticals Limited	31 December 2009
4	Meghna Cement Mills Ltd.	31 December 2009
5	Confidence Cement Limited	31 December 2009
6	Heidelberg Cement Bangladesh Ltd.	31 December 2009
7	Niloy Cement Industries Ltd.	30 June 2009
8	Olympic Industries Limited	30 June 2009
9	National Tubes limited	30 June 30 2009
10	Fu-Wang Foods Ltd.	30 June 30 2009
11	Atlas Bangladesh Limited	30 June 30 2009
12	Bangladesh Thai Aluminum Ltd.	31 December 2009
13	Aftab Automobiles Limited	31 December 2009
14	Eastern Cables Ltd.	30 June 2009
15	National Bank Ltd.	31 December 2009
16	Bank Asia Ltd.	31 December 2010
17	Mercantile Bank Limited	31 December 2009
18	Dutch-Bangla Bank Limited	31 December 2009