

## **Investigating the Effectiveness of Tax Penalties in Ardebil, Iran**

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### **Abstract**

Correctly implementing the provisions of direct tax law is of the most important objectives of Tax Affairs Organization; accordingly, tax penalty system is among the most crucial guarantees for enforcement of this law. On the other hand, since tax is of long standing in Iran, compared to the majority of developing countries and some developed ones, the performance of tax system is an indicative of weaknesses with respect to law efficiency. Reluctant acceptance, and inefficiency of the previous tax law as well as the penalty system belonging to it, has caused to be revised and reformed. Reformation of the pervious law and creation of the existing one were aimed at accomplishing the objectives of development program in tax sector. However, with regard to what should have been materialized according to the anticipations, the country's tax law suffers from significant drawbacks with some existing articles and paragraphs. The present paper investigates two domains of jobs and companies in Ardabil province, and reveals the ineffectiveness of penalty system in these two tax sources.

**Keywords:** tax penalties, tax sources, tax culture

### **Introduction**

In 2001, in order to adopt new tax policies, the considered penalties were improved with regard to some aspects in comparison with those of previous years. On one hand, many cases of taxpayers' violation were introduced and presented. On the other hand, most of violations included criminal penalties, in addition to financial penalties, and the controlling power of penalties increased. Furthermore, by offering more reasonable prices concerning more widespread cases of taxpayers' carelessness, such as not submitting declaration and financial statements and legal registers, submitting false declaration, and presenting unreal registers, efficiency and effectiveness were taken into consideration more than ever (Magsoudi, 2005, 8).

Considering the above-mentioned conditions, because exemptions are granted and tax penalties are imposed, in an inappropriate ways, and, full payment of tax penalties is overlooked, today we observe that, sometimes just for prompt payment of the tax, penalties are waived or exemptions are granted and penalties are eliminated on certain occasions, which, in addition to confusion, causes some taxpayers to hope for future economic decisions and financial liabilities. Therefore, it hinders the immediate payment of tax. For example, waiving the penalties on certain occasions, especially final months of the year, exerts negative effects on the taxpayers who have paid their taxes immediately (Mousavi, 2007, 33).

### **Examining the effectiveness of tax penalties**

In Iran, a one-year interval in receiving the taxes occurs because of various factors such as legal permits (a four-month reprieve after the end of the year to submit declaration, and following the time passed for compiling and distributing regional value and tax coefficients of the previous year and issuing an order for starting to check and also a one-year reprieve for tax-related examination of the received statements and sometimes a five-year reprieve for checking the performance of the taxpayers who have not submitted declaration), vagueness concerning rules and

regulations (lawful exemptions and contradictory viewpoints about qualifying for the exemptions), extension of checking steps and finalizing the taxes, not exploring new economic activities, legal gaps, etc.

Concerning direct tax law, to shorten the respite, Iran, as the majority of countries do, uses certain anticipated tools, like penalties enacted in March 1987 and amendments following it, which state how penalties are imposed on taxpayers who have not fulfilled their legal duties pertaining to declaration and payment of taxes. With the exception of the penalty for not submitting declaration by legal entities (companies) and people subjected to the paragraphs 1 and 2 of Article 95 of direct tax law, as well as, the penalties of the issue of Article 169 repeated of this law (the amendment of 2001), all penalties with reference to Article 191 of the mentioned law can be exempted. According to Article 190 of direct tax law, a delay in paying tax would be subjected to a fine of 2.5 % per month from the expiration date of the deadline for submitting declaration or the maturity for paying the tax. On the other hand, with reference to Note 2 of the same law, charging a fine more than one year will not be possible. Consequently, even if the authority of the exemption of penalties of the issue of Article 191 of direct tax law is ignored, lengthening the predictable checking stages and ineffectiveness of the mentioned fine in shortening the respite are likely to happen. Levying fines has always been associated with violation, and charging it leads to a conflict between taxpayers and the county's tax system, which can make taxpayers, with the help of a variety of interpretation on rules and regulations, put in a request for the exemption of the penalties based on tax organization's authorities and not consider the fine of delay or not fulfilling legal duties as a materialized view for themselves.

### **Hypotheses**

Hypothesis 1: Tax penalties affect taxpayers in jobs domain.

Hypothesis 2: Tax penalties affect taxpayer in company's domain

Sub-Hypotheses:

Delay penalty affects taxpayers concerning jobs domain.

The penalty for not submitting declaration affects taxpayers in jobs domain.

The penalty for not giving registers and financial statements affects taxpayers in jobs domain.

The penalty for rejecting the registers affects taxpayers in jobs domain.

The penalty for not submitting salaries list affects taxpayers in jobs domain.

The delay penalty affects taxpayers in company's domain.

The penalty for not submitting declaration affects taxpayers in company's domain.

The penalty for not giving registers and financial statements affects taxpayers in company's domain.

The penalty for rejecting the registers affects taxpayers in company's domain.

The penalty for not submitting salaries list affects taxpayers in company's domain.

The penalty for not submitting the contract affects taxpayers in company's domain.

### **Variables**

Independent Variable: Tax penalties are considered as an independent variable for explaining the factor effective in taxpayers in domains of jobs and companies.

Dependent Variable: The ratio of penalties to total taxes of taxpayers subjected to a penalty is considered as a dependent variable for investigating the effectiveness of penalties. This ratio includes all of ratios of the mentioned penalties in direct tax law, as it has been elaborated in sub-

hypotheses. To explore the effectiveness of the penalties, we examined taxpayers' penalties over two successive years using a paired-sample T-test at a 95% confidence interval.

### Sampling Method

Statistical population comprises tax sources of jobs and legal entities of Adabil province which are studied in a two-year period (2006-2007). Regarding the high number of taxpayers, to select samples using ranked random sampling, with  $\alpha = 0.01$  and  $t = 2/58$ ; according to the table of sample size determination of Bartlette, Kotrlik, and Higgins (2001) with level of error = 0.03, the number of samples from each tax sources in Ardabil, Parsabad, and Bilesavar was determined.

### Results

Since penalties for not submitting the contract, not deducing and depositing withholding taxes in samples in jobs domain as well as penalty for not deducing and depositing withholding taxes in samples in company's domain were not observed, sub-hypotheses pertaining to those penalties were not confirmed.

The results obtained from testing Hypothesis 1, predicting that tax penalties affect taxpayers in jobs domain, and its sub-hypotheses are displayed in Table 1:

**Table 1: Results from testing H1 (jobs domain)**

| Independent Variable                 | Dependent Variable   | Limit  |       | t      | P-value | Result      |
|--------------------------------------|--|--------|-------|--------|---------|-------------|
|                                      |  | Low    | High  |        |         |             |
| Penalties' effectiveness*            | Ratio of penalties to tax  | -0.030 | 0.105 | 1.0879 | 0/279   | Ineffective |
| Penalty's effectiveness <sup>1</sup> | Ratio of delay penalty to all penalties                                | -0.089 | 0.148 | 0.491  | 0/624   | Ineffective |
| Penalty's effectiveness <sup>2</sup> | Ratio of penalty for not submitting declaration to all penalties       | -0.064 | 0.132 | 0.685  | 0/494   | Ineffective |
| Penalty's effectiveness <sup>3</sup> | Ratio of penalty for not giving the register to all penalties          | -0.122 | 0.024 | -1.325 | 0/187   | Ineffective |
| Penalty's effectiveness <sup>4</sup> | Ratio of penalty for rejecting the registers to all penalties          | -0.001 | 0.198 | -1     | 0/319   | Ineffective |
| Penalty's effectiveness <sup>5</sup> | Ratio of penalty for not submitting the salaries list to all penalties | -0.013 | 0.004 | -1     | 0/319   | Ineffective |

\* Testing H1

**Sub-hypotheses**

The results obtained from examining Hypothesis 2, predicting that tax penalties affect taxpayers in company's domain, and its sub-hypotheses are displayed in Table 2:

**Table 2: Results from testing H2 (companies domain)**

| Independent Variable                 | Dependent Variable   | Limit  |       | t      | P-value | Result      |
|--------------------------------------|--|--------|-------|--------|---------|-------------|
|                                      |  | Low    | High  |        |         |             |
| Penalties' effectiveness*            | Ratio of penalties to tax  | -0.047 | 0.12  | 0.870  | 0/387   | Ineffective |
| Penalty's effectiveness <sup>1</sup> | Ratio of delay penalty to all penalties                                | -0.002 | 0.095 | 0.491  | 0/624   | Ineffective |
| Penalty's effectiveness <sup>2</sup> | Ratio of penalty for not submitting declaration to all penalties       | -0.293 | 0.039 | -1.52  | 0/131   | Ineffective |
| Penalty's effectiveness <sup>3</sup> | Ratio of penalty for not giving the register to all penalties          | -0.046 | 0.1   | 0.734  | 0/465   | Ineffective |
| Penalty's effectiveness <sup>4</sup> | Ratio of penalty for rejecting the registers to all penalties          | -0.027 | 0.062 | 0.771  | 0/443   | Ineffective |
| Penalty's effectiveness <sup>5</sup> | Ratio of penalty for not submitting the salaries list to all penalties | -0.001 | 0.032 | 1.802  | 0/076   | Ineffective |
| Penalty's effectiveness <sup>6</sup> | Ratio of penalty for not submitting the contract to all penalties      | -2.587 | 1.955 | -0.329 | 0/751   | Ineffective |

\* Testing H2

**Conclusion**

The results achieved from evaluating the hypotheses indicate ineffectiveness of tax penalties system in Ardabil province, which reveals that in Ardabil, in an inappropriate way, exemptions are granted and tax penalties are imposed, additionally, full payment of tax penalties is overlooked. Today, sometimes only because of prompt payment of tax, penalties are waived or exemptions are granted and penalties are eliminated on certain occasions, which, in addition to confusion, cause prompt taxpayers to become disappointed. Moreover, because of a double-digit inflation in the country's economy, tax penalties system with small percentages cannot act as a prohibitory factor effective in taxpayers' behavior. It is to be noted that lack of the right tax culture in the country and other cultural, political, and even religious conditions, has contributed to the ineffectiveness of tax

system, which demands the cooperation of administrators of these domains more than ever for improving the tax system.

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