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The Role of Tax Officials in Mitigating Company's Tax Obstacles

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Abstract
This study aims to examine the role of tax official in mitigating the positive relation between firm's informal payment on tax obstacle. As the general discourses in tax avoidance, regulation, and compliance, the role of tax official is still had limited attention. In this regard, the examination based on the data of 229 firms from the World Bank Enterprise Survey 2019, specifically in two countries (i.e., Estonia and Latvia) which are listed as the top two countries with the highest International Tax Competitiveness Index. Accordingly, this study found that in the country well-established tax management, firm's informal payment is positively affecting the level of its tax obstacle, while professionality and transparency of tax official is reporting a negative effect. Interactionally, tax official is weakening the positive effect of informal payment on tax obstacle. In general, this denote and provide evidence for the important role of professional and transparent tax official in the tax management. Several discussions further been elaborated in both theoretical and practical to enrich the topic of tax management.

Keywords: Tax Officials; Company's Tax Obstacles; Informal Payment; International Tax Competitiveness Index

INTRODUCTION

Obstacles are tangible elements that frequently impact a company, which necessitates strategic considerations, solutions, and adjustments. These obstacles commonly emerge, particularly in administrative matters such as tax administration and tax rate. Tax administration is a system designed to facilitate tax payers, including companies, in comprehensive and compliant tax processes from tax record-keeping to tax payment (Septriliani & Ismatullah, 2021). However, many tax payers still deviate from tax regulations, leading to actions that directly impact a country's economic development, such as tax avoidance or in the worst case they do tax evasion (Mazurenko et al., 2021). These obstacles also happen when the tax rate is highly imposed on the companies in a country. In fact, companies aim to maximize profits by minimizing costs (Wiese & Wiese, 2021). As a consequence, they often find themselves faced with numerous obstacles, which lead to actions beyond tax regulations (Hanlon & Heitzman, 2010).

Considering these tax obstacles, companies are consistently confronted with a condition that ultimately necessitates informal payments when tax officials visit for inspections. Companies tend to resolve such issues by giving informal payments to the

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tax official to hide these obstacles. In the context of taxation, informal payments always lean towards negative implications, usually aimed at concealing obstacles caused by tax avoidance or tax evasion actions (Utami & Helmy, 2016). Unlike in Hungary, informal payments can be interpreted as gratitude payments. These payments express appreciation for the good services they received which were given by the patients to the workers (Gaal et al., 2006). On another hand, this "gratitude payment" can also bring into severe problems which might distort the care's structure (Julesz & Kereszty, 2023).

Nevertheless, the relationship between informal payment and obstacles can be mitigated by the performance of tax officials, which represent the professionality and transparency as well. Research conducted by Xiang (2021) indicates that informal payment had a positive and significant impact on the likelihood of companies encountering numerous obstacles. Based on that, we suspect that there might be another variable affecting the interaction between informal payment and company's tax obstacles. Therefore, the author has identified tax officials as another variable which can moderate the relationship between other variables. In addition, the tax system in a country also affects the company's tax obstacles. These tax obstacles are relevant when companies operate in a country that reaches out the tax competitiveness criteria. Companies that operate in such countries can evade tax obstacles because the country maintains consistently low and stable marginal tax rates (Tax Foundation, 2023).

Referring to Tax Foundation (2023), Estonia and Latvia stand out for their strong tax competitiveness index. Each country received an overall score; Estonia scored 100, and Latvia scored 88.5 in the tax category. Estonia's high ranking is attributed to four positive aspects of its tax system, including corporate tax rates, which paid only 20% on distributed income. Meanwhile, Latvia maintains its leading position in corporate taxation by adopting a similar tax rate structure to Estonia.

The purpose of this study is to determine the influence of tax officials' role in mitigating company's tax obstacles. This study is conducted considering the limited discussion on the importance of tax officials' role. Moreover, the previous study of Xiang (2021) utilized a proxy from one perspective, which only focused on tax administration as a tax obstacle. However, the existing tax obstacles can also be measured and viewed from various perspectives, such as tax rates. Therefore, in this study, we add and utilize the tax rates variable as another proxy in measuring company obstacles. In order to amplify the study's focus, we also used Estonia and Latvia Enterprises' data survey as they are ranked at the top two countries which have the highest points in the International Tax Competitiveness Index (ITCI).

In sum, the purpose of this study addresses the following inquiries: Firstly, it seeks to determine the positive effect of informal payments on perception related to the company's tax obstacles. Secondly, it examines the significant negative effect of tax officials on perception related to the company's tax obstacles. Lastly, this study also proposes the moderating role of tax officials in mitigating the positive effect of informal payment on perception related to the company's tax obstacles.

LITERATURE REVIEW

Company's Tax Obstacles

The company tends to be followed by certain problems in its environment, which gare enerally called obstacles. Kresic et al. (2017) mentioned that the obstacle is identified as the main source that can hinder the company's operations. The companies will face various challenges and barriers in their operational and strategic activities. For instance, regulatory challenges, which directly pose significant barriers to business' environment where the regulations are very complex and unpredictable (Carreira & Teixeira, 2016). In addition, Kresic et al. (2017) also implied that most manufacturing companies are likely to experience the effect of severe obstacles which includes several indicators.

The obstacles can be defined as internal and external factors that affect a company's survival and failure as well (Ardianti, 2013). As Olawale & Garwe (2010) mentioned in their previous study, the economic environment is one of the most obstacles faced by the company as an external factor. This economic environment includes indicators such as tax rates and tax administration. To be more specific, types of company obstacles can be seen in table 1 which was collected through the World Bank Enterprise Survey (Wang, 2016).

Table 1. Obstacles for SMEs

	Summary	
	Freq.	**Percent**
Non-response	6.011	6,00%
Access to finance	14.272	13,51%
Access to land	3.281	3,10%
Business licensing and Permits	2.781	2,63%
Corruption	6.880	6,51%
Court System	1.037	0,98%
Crime, theft and disorder	5.249	4,87%
Customs and Trade Regulations	2.607	2,47%
Electricity	11.760	11,13%
Functioning of the courts	57	0,00%
Inadequately educated workforce	6.338	6,00%
Labor Regulations	3.174	3,00%
Macroeconomic instability	3.397	3,21%
Political instability	7.938	7,51%
Practices of competitors	11.933	11,29%
Tax administration	3.662	3,47%
Tax rates	11.735	11,10%
Telecommunications	220	0,21%
Transportation	3.343	3,00%
Total	105.675	100%

Source: Wang (2016)

Informal Payment on Company's Tax Obstacles

In different contexts, informal payment has a wide range of interpretations. In the health sector, patients may engage in informal payment to ensure they receive priority medical treatment or to express gratitude during the treatment (Gaal et al., 2021). Meanwhile, in the specific taxation sides, informal payments often emerge as the sole solution when the company will be inspected by the tax officials to speed up the inspection process. This clearly indicates that the company may have undisclosed matters or information it seeks to conceal or keep hidden from the government. Therefore, as the company increasingly resorts to informal payments during inspections, it reflects the significant number of obstacles within the company. This opinion is supported by the research conducted by Xiang (2021), which revealed the evidence that intense visits by tax officials could result in significant tax administration obstacles for the company.

Informal payments can also influence tax administration in various ways. On one hand, these payments can expedite bureaucratic procedures, reduce red tape, and facilitate quicker resolutions of tax related issues for businesses (Owenvbiugie & Owenvbiugie, 2020). This is particularly evident in environments where bureaucratic inefficiency is prevalent, and businesses themselves seek to navigate through cumbersome tax procedures. Typically, these payments are considered as a necessary evil in businesses to smooth the way for any informal transactions, yet it will cause detriment to economic development and business activities as continuing implications. (Adegboyo et al., 2021)

The presence of informal payments leads to unpredictable tax enforcement and personal decision-making by tax officials to make things done under the table. When firms rely on bribes to get things done, it undermines the rule of law and creates uncertainty. Businesses cannot predict when and how much they will need to pay in bribes, making it difficult to plan and budget for these costs. This uncertainty can be a significant deterrent to investment, as investors prefer stable and transparent environments where they can accurately assess risks and returns (Wei, 2000). The unpredictability of informal payments also affects business continuity and long-term planning, as firms may suddenly face increased demands for bribes or changing expectations from corrupt officials. Based on the explanation above, the first hypothesis is as follows as:

H1: Informal Payment has a positive effect on Company's tax obstacles

The Effect of Tax Official on Company's Tax Obstacles

Tax officials play a pivotal role in influencing the business environment, particularly through their impact on regulatory compliance and administrative efficiency. The behavior of tax officials is important in determining how regulatory compliance impacts businesses by providing clear guidance and ensuring consistent application of tax laws (Besley & Persson, 2020). Another recent study showed that training tax officials in ethical behavior significantly improved compliance rates and reduced the administrative burden on businesses (Carrillo et al., 2022). Therefore, this may allow the companies to allocate more resources to productive activities rather than navigating the complex regulatory landscapes.

The result of the study revealed by Alvin (2014) shows the positive and significant effect of tax officials' performance on corporate taxpayer compliance. The result indicates that tax officials are able to influence the company compliance with its tax obligations. Therefore, the more compliant a company is in paying taxes, the fewer obstacles it will face. Based on this previous research, the professionality and transparency of tax officials are highly contributed to the probability that companie will reduce the obstacles within the administration process. This opinion above is in line with the cooperative compliance approach introduced by the Organization of Economic Cooperation and Development (OECD), where tax officials and tax payers (companies) are able to emphasize the trust and transparency with each other (Haniv, 2020). Based on the explanation above, the second hypothesis is as follows as:

H2: Tax Officials has a negative effect on Company's tax obstacles

The Role of Tax Official as Moderator

Tax officials play a critical role in the relationship between informal payments and company obstacles. The behavior and integrity of tax officials can either amplify and mitigate the impact of informal payments. By accepting the informal payments from the company, tax officials can amplify the negative effects on companies by demanding higher continuously. Therefore, the financial burdens as well as the corruption will be increased (Djankov et al., 2010). On another hand, tax officials who represent the high ethical standards of the regulations impartially might help the reliance on informal payments be reduced, thereby alleviating some of the associated obstacles (De Simone & Sansing, 2019).

According to recent studies, informal payments are prevalent in taxation scenarios where companies encounter substantial to severe operational obstacles. Consequently, these findings suggest that incidence of obstacles escalates when companies are compelled to engage directly in informal payments to avoid penalties (Seck, 2020). On another hand, tax officials play the important role as the tax authorities who have the authority to do the inspection in a professional and transparent manner (Battaglini et al., 2020). The performance of tax officials can bring the positive as well as the negative impacts of informal payments, which depend on how professional and transparent the performance of tax officials is. Therefore, the relationship between informal payment on the company's obstacle may be alleviated by the presence of competent tax officials. Based on the explanation above, the third hypothesis is as follows as:

H3: Tax Official moderates the effect of Informal Payment on Company's tax obstacles

Principal-Agent Theory

Additionally, The Principal-Agent Theory offers a robust framework for understanding the role of tax officials in moderating the relationship between informal payments and business obstacles related to tax administration and tax rates. This theory, rooted in economics and organizational studies, explores the challenges that arise when one party (the principal) delegates work to another party (the agent), who performs that work (Hu et al., 2023).

In the context of tax administration, the company represents the principal, and tax officials are the agents. The principal-agent problem arises because the goals of the company (principal) may not always align with the objectives of tax officials (agent), especially since the company can fully control the tax administration process. The principal-agent problem is characterized by information asymmetry between the company and tax officials. Information asymmetry occurs when the company has more information about their actions and behaviors related to administrative matters, such as reducing tax expenses. However, an inspection will be processed for the company if there is something suspicious regarding the tax or financial report of the company. However, tax officials are required to be professional and transparent without receiving any informal payments during the inspections.

METHODOLOGY

This study adopts a quantitative approach, utilizing secondary data sources from the World Bank Survey conducted in 2019. The survey aims to provide an objective interview of the experiences of companies in the private sector, particularly focusing on the manufacturing industry. The population for this study comprises manufacturing companies which are based in Estonia and Latvia, both of which rank highly in terms of tax competitiveness.

The initial population consisted of 677 companies. However, after excluding responses categorized as 'spontaneous', 'do not know', and 'missing data' through random sampling methods, only 229 companies' data were eligible for processing. These samples are considered representative and can be tested for further analysis.

In this study, there are three variables that will be analyzed. The first variable is the company's tax obstacles which represent it as a dependent variable. The definition of the company's obstacle in this context is specifically limited to taxation scenarios. These obstacles involve the complex administration process and the high tax rates that companies will face, which subsequently affect the compliance costs and the profitability. For further analysis, the company's tax obstacles are measured by the obstacles that the company faced related to their tax settlement, which also consist of obstacles in both administration and rates. The data were based on a scale which ranged from 0 (no obstacles) to 4 (very severe obstacles). The average of both obstacles (i.e., administration and rates) produced to represent to a variable of obstacles.

The second variable is informal payment as an independent variable. This informal payment will be limited to the payment that company paid during the inspection. Informal payment will be measured by the percentage of total annual sales paid by the companies as informal payment. This measure is derived from responses in the survey by the companies. Companies that indicated 'no payment or gifts are paid' are valued 0.

The third variable is tax officials. Tax officials will be defined as the tax authorities who have the authority to do the inspection in a professional and transparent manner. The measurement of tax officials is based on two proxies: professionality and transparency. The data were analyzed using a Likert scale which ranges from 1 (strongly disagree) to 4 (strongly agree), where respondents indicate their level of agreement with statements about tax officials' professionality and transparency. This method is aligned with the study conducted by Atmoko (2021), which also used a Likert scale for measuring the variables.

To make the model robust, the author also utilizes one control variable to this analysis. The selected control variable is firm age, which represents the common characteristic of the company. By controlling for firm age, the model aims to isolate the effect of the primary independent on dependent variable, which indicates to improve validity and reliability of the findings (Haltiwanger et al., 2013).

The data were analyzed using the Hierarchical Moderated Regression Model. This method is employed to simultaneously and interactively examine the interactions of informal payment and tax officials on the company's tax obstacles. The analysis was conducted in a hierarchical manner to provide clear understanding of these relationships. This approach has been successfully applied in similar research models, such as the study by Devi & Suryarini (2020), which examined the moderating variables' influence on the relationship between other variables.

RESULTS AND DISCUSSION

Table 2 provides the summary of statistics descriptive for the variables used, including the multicollinearity test results. Accordingly, the VIF scores for age, informpay, and taxoff are all less than 2.5, which convey that the variables used are safe from multicollinearity. However, according to the correlation matrix which can be seen in Table 3, the correlation between all the main variables are reported to have low correlation, excluding the correlation between taxoff and obstacles, which reported to have moderate correlation.

The results of the CFA presented in Table 4 demonstrate high factor loadings, indicating a strong correlation between the variables and their respective factors, thereby affirming the reliability and robustness of the factor structure. In addition, the reliability test using Cronbach alpha was acceptable, where all the variables (i.e. taxoff and obstalces) scored above 0.6. Furthermore, the AVE scores were also acceptable, which reported to have scores above 0.5 (Table 5).

Table 2. Statistic Descriptive

Variable	Obs	Mean	Std. dev.	Min	Max	VIF	1/VIF
(1) age	229	19.978	14.607	3	193	1.01	0.986
(2) informpay	229	-	0.676	0	10	1.01	0.988
(3) taxoff	229	-	0.772	1	4	1.01	0.986
(4) obstacles	229	-	1.220	0	4	-	-

Table 3. Correlation Matrix

Variables	(1)	(2)	(3)	(4)
(1) age	1.000			
(2) informpay	-0.0727	1.0000		
(3) taxoff	0.0849	0.0755	1.0000	
(4) obstacles	-0.0157	0.0518	-0.3050***	1.0000

Observations: 229 (****p<0.01, **p<0.05, *p<0.1*)

The regression analysis aimed to present the relationship among the variables and their interaction. Table 6 presents the results from four regression models constantly, which started by examining age as a control variable in the analysis of Model 1, continued to add up two variables; informal payment and tax officials in Model 2 and 3. Finally, the complete model in Model 5 which contained all variables, including control, antecedent, and the interaction variables simultaneously.

Table 4. Confirmatory Factor Analysis

	Component	
	Factor 1	**Factor 2**
taxoff_prof	0.8966	
taxoff_trans	0.9030	
obs_taxrates		0.9001
obs_taxadmin		0.8900

Extraction Method: Principal Component Analysis.
Rotation Method: Orthogonal Varimax (Kaiser Normalization: Off)

Table 5. Average Variance Extracted and Cronbach's Alpha

	AVE	Cronbach's Alpha
taxoff	0.810	0.794
obstacles	0.801	0.782

As outlined in hypothesis 1, informal payments have a positive effect on the company's tax obstacles, which accordingly align with the result. The coefficient for 'informpay (informal payments) is positive and significant in Models 2 (β=0.092, p<0.01), 3 (β=0.138, p<0.01), and 4 (β=0.452, p<0.01), indicating a robust positive relationship between both of variables. Based on the result, when companies behave highly to informal payment, it indicates that the company faces severe obstacles.

Meanwhile, the coefficient for taxoff (tax officials) seen in Model 3 (β=0.092, p<0.01) and 4 (β=0.092, p<0.01) shows that tax officials have negative and significant effect on company's tax obstacles, supporting the hypothesis 2. This indicates that the more professional and transparent tax officials as inspectors, the less obstacles will be faced by the company, which also explains that companies will minimize the obstacles since they need to deal with tax officials when it comes to inspection.

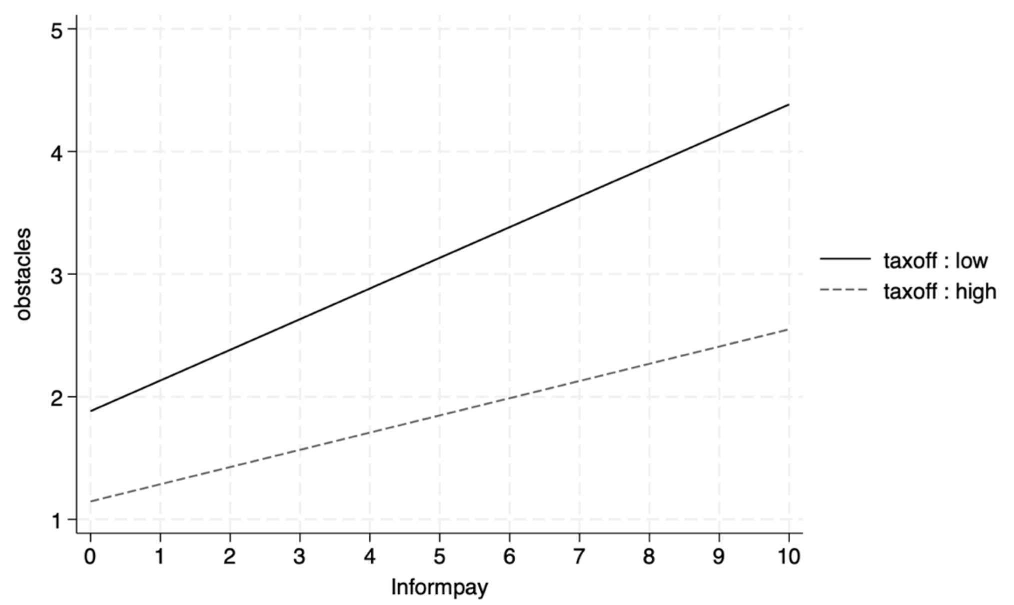
Moreover, the substitution effect of tax officials in the relation between informal payment to company's tax obstacles as outlined in hypothesis 3 was aligned. The result shows the interactional effect of tax officials between informal payment on company's tax obstacles was negative and significant at the 10% level.

Table 6. Regression Analysis

	(1)	**(2)**	**(3)**	**(4)**
	obstacles	obstacles	obstacles	obstacles
age	-0.001	-0.001	0.001	0.001
	(.004)	(0.004)	(0.004)	(0.004)
informpay		0.092***	0.138***	0.452***
		(0.017)	(0.017)	(0.171)
taxoff			-0.493***	-0.493***
			(0.102)	(0.103)
informpayXtaxoff				-0.079*
				(0.042)
_cons	1.546***	1.534***	3.041***	3.039***
	(0.117)	(0.118)	(0.336)	(0.337)
Observations	229	229	229	229
R-squared	0	0.003	0.099	0.099
Adjusted R-squared	-0.004	-0.006	0.087	0.083

Note:
Robust standard errors are in parentheses
(****p<0.01, **p<0.05, *p<0.1*)

Figure 1. Interaction of Informal Payment and Tax Official on Company's Tax Obstacles



As the main purpose of this study is to examine the role of tax officials in mitigating the company's tax obstacles, this study provides the visualization of the interactional plot for hypothesis 3, which can be seen in Figure 1. To enhance the understanding, there were two different levels of tax officials. One standard deviation above the mean and one below, representing the professionality and transparency of tax officials and inversely. This explains that the effect of informal payments on the company's tax obstacles is lower when tax officials are professional and transparent. Oppositely, the effect will be higher when the level of professionality and transparency is lower.

In this study, we discussed and analyzed the substitution effect of tax officials in the relationship between informal payment and company's tax obstacles. This study also emphasizes on the role of tax officials which represent the professionality and transparency in mitigating the company's tax obstacles. Based on the result, all the hypotheses are proven and aligned. We proposed the relation between informal payments and tax officials on the company's tax obstacles, then continued to propose the tax officials in affecting the interaction between informal payments on company's tax obstacles.

The positive and significant effect of informal payment on company's tax obstacles were successfully proven. In fact, the company wants to hide their obstacles with informal payment, while it turns out to be the worst case since informal payments build the long-term implications, especially the business activities as Adegboyo et al. (2021) stated.

The effect of tax officials on company's tax obstacles occur to be negative and significant. This indicates when the tax officials have the high level of ethical standard, there are no bribes happening during the inspection, thereby the company will be strict to the regulations and reduce their tax related obstacles.

Professionality and transparency among tax officials are fundamental to creating a trustworthy and reliable tax environment. When tax officials adhere to high ethical standards, they reduce the occurrence of bribery and informal payments during inspections. This, in turn, encourages companies to comply strictly with tax regulations, thereby reducing the administrative and financial burdens associated with tax-related obstacles. The consistent and fair application of tax laws ensures that all companies are treated equally, which promotes a level playing field and enhances overall business confidence in the tax system (Chiarini et al., 2020).

The role of tax officials in affecting the interaction between informal payment and company's tax obstacles is significantly negative. This finding suggests that the presence of professional and transparent tax officials diminishes the adverse effects of informal payments on the company's tax obstacles. Professional and transparent tax officials are less likely to solicit or accept bribes, thereby decreasing the necessity for companies to engage in informal payments. This reduction in corrupt practices leads to a more predictable and stable business environment. Companies can focus more on complying with established regulations rather than dealing with the erratic requirements of corrupt officials. Consequently, the administrative burden and compliance costs associated with tax-related obstacles are minimized (Chiarini et al., 2020).

CONCLUSION

This study examines the significant roles of tax officials in moderating the relationship between informal payments and company's tax obstacles. These findings indicate that higher ethical standards among tax officials substantially reduce the positive effect of informal payments on company's related to tax. Specifically, professional and transparent tax officials diminish the necessity for bribes, thereby fostering a more predictable and stable business environment. This improvement reduces the administrative and financial burdens on companies, promoting compliance with tax regulations and enhancing operational efficiency. The study underscores the importance of integrity in tax administration and suggests that policy interventions aimed at improving the professionality and transparency of tax officials can yield significant benefits for businesses and the overall economy.

There are at least two limitations in this study. Firstly, this study focuses on the role of tax officials as moderator in mitigating the company's tax obstacles. This might not account for all possible moderator variables that could influence the relationship between informal payment and company's tax obstacles. Factors such as organizational culture, leadership styles, or regional economic conditions could potentially moderate the effects observed but were not considered in this analysis. Secondly, the specific population we used in this study only focused on manufacturing companies. Future research could benefit from exploring other sectors such as technology, healthcare, service, or industries. This would enhance the generalizability of findings across different organizational contexts and provide a more comprehensive understanding of how management practices and operational strategies impact outcomesThe contribution of this study supplies the empirical evidence related to tax officials' role and how they can help mitigate informal or unethical actions within a company's operations. Furthermore, this study also offers empirical evidence that can be used to improve the quality and training of tax officials who have the authority to conduct inspections.

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