

Title of Project

English: Could a Tax Credit Rating System create a Spillover Effect to reduce the Tax Avoidance of Peer Firms?

Chinese: 納稅信用評級制度能否產生減低同業避稅的外溢效應？

**Abstract of Research Comprehensible to a non-specialist**

Tax revenue is a critical financial resource for governments to carry out their governance functions. Tax avoidance threatens a government's ability to collect proper amounts of tax revenue according to tax laws. Therefore, the question of how to better protect and collect tax revenue is an important challenge that needs to be addressed continuously by governments.

Governments can use both carrots and sticks in revenue collection. Attention from professional practice and academic literature has focused mostly on the use of tax audits and penalties to enforce tax compliance. Not much attention has been devoted to the use of incentives to entice compliance. The main objective of the proposed research is to shed light on the efficacy of an incentive-based scheme coordinated and implemented by the Chinese tax authorities intended to reduce tax avoidance.

Specifically, we propose to investigate whether a tax credit rating system that classifies companies based on a variety of factors related to tax payments (with A-rated firms being the best compliant) and has the ratings publicized can effectively reduce corporate tax avoidance. We also investigate whether non-A-rated firms lose out resources such as the ability to obtain bank loans and issue corporate bonds because of the inter-agency cooperative agreements orchestrated by the Chinese tax authorities. Such a loss of resources can motivate non-A-rated firms to reduce their tax avoidance for an improved rating.

We posit that the publicized rating for A-rated firms and the loss of resources for non-A-rated firms provide incentives for non-A-rated firms to reduce their tax avoidance in an effort to gain a better compliance rating. If so, we should observe a spillover effect created by A-rated firms for peer firms in the same industry to reduce tax avoidance.

The proposed research studies a new development in tax administration practices. Furthering our understanding of this new development provides opportunities for future administrative innovations. The research results should have significant policy implications for tax authorities, corporate management, investors, auditors, and relevant public policy makers. As this incentive system represents an important new development in tax administration, if proven effective, it can also serve as a useful model for tax authorities internationally, particularly those in developing economies, to enhance corporate tax compliance.