

Size-dependent VAT, Compliance Costs, and Firm Growth

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Abstract

We examine how firms react to a size-dependent tax policy. To do so, we exploit the VAT in Japan that gives firms exemption from taxation when their sales is below a threshold. Using a large-scale firm-level dataset, we obtain the following findings. First, low-productivity firms are more likely to bunch just below the threshold than high-productivity firms. Second, among low-productivity firms, firms are less likely to bunch as their compliance cost measured by the tax accounting fee is lower and as their trade partners are located in less-bunching areas. The latter finding indicates that the knowledge that reduces compliance costs transmits through supplier-customer relationships.

Keywords: Size-dependent tax policy; Compliance costs; Firm growth; Knowledge spillover

JEL classification: H32, H26, L25