

A Study on Self-Assessment Tax System Awareness in Malaysia

Choong Kwai Fatt and Edward Wong Sek Khin

Faculty of Business and Accountancy, University of Malaya, Kuala Lumpur, Malaysia

Abstract: This study seeks to explore and identify the key dimensions that determine the service quality of the Inland Revenue Board, Malaysia (IRBM) under the new Self-Assessment tax system. The scope of this study is based on the perceptions of individual taxpayers (comprising government employees, private sector employees and self-employed businessmen) and tax agents. First, this study aims to investigate if Malaysian petty traders understand the mechanism of self-assessment tax system, and secondly, to solicit the problem faced by Malaysian petty traders in tax compliance and tax audit in the era of Self-Assessment tax system (SAS). The empirical study was undertaken by conducting a questionnaire survey based on convenient sampling of 310 respondents, that is, 193 male petty traders and 117 female petty traders from 12 states in Malaysia. Findings from this study reviewed that the Self-Assessment tax system places an onerous responsibility on petty traders to comprehend the new system and to comply with the tax administration aspects as to the computations, payment of taxes, and record keepings. It is suggested that the IRBM to impose penalty discretionary, to take into account of the educational background, financial position, the amount of tax understated, the frequency of tax defaults of the petty traders. This study provides an important insight that the Malaysian tax policy makers and the IRBM ought to seriously consider a simpler and pragmatic tax assessment system, tailor make for petty traders to achieve tax administrative compliance efficiency, particularly on the taxpayers' awareness and the services needs have some implications for tax planners and policy makers.

Key words: Self-assessment system, Tax auditors, Tax evasion

INTRODUCTION

On 1 January 2005, in order to promote voluntary tax compliance, the Inland Revenue Board Malaysia (the IRBM) has implemented the self-assessment tax system (the SAS) on individual taxpayers. Under the SAS, individual who has income accruing in or derived from Malaysia are required to disclose taxable income honestly, compute tax payable correctly, file tax return form and pay tax on a timely manner. The key feature of SAS is that tax return form is deemed the notice of assessment (i.e., the Form J). In a nutshell, under SAS, the onus to assess the tax liability is on the taxpayers. As a result, taxpayers must have sufficient tax knowledge in order to assess their tax liability correctly and to file tax return forms on time. For salaried individuals, they must submit their income tax return forms and pay the balance of tax liability by 30 April every year. For those who have business income, the submission and payment deadlines are by 30 June.

If individual taxpayers fail to submit tax return, the IRBM will derive their own assessment based on estimate and issue notice of assessment. Non submission of tax return form and late payment of taxes will attract monetary penalty; and for repeated offences, imprisonment will be imposed by the Court. Under section 112 (1) of Income Tax Act 1967 (the Act), the penalty on failure to furnish tax return by the stipulated deadline is a fine ranging from RM200 to RM2,000 or imprisonment not exceeding 6 months or both fine and imprisonment. Individual taxpayers who fail to make income tax payments for a year of assessment within 30 days from the date of issue of the notice of assessment or deemed assessment are charged a 10% increase on the tax or outstanding tax balance. If the tax or tax balance is still unpaid after 60 days from the date the 10% increase is imposed, a further 5% increase will be charged on the tax outstanding, as stipulated in section 103(3) and (4) of the Act.

In view to further intensify voluntary tax compliance, the IRBM instituted tax audit and investigation system. In January 2007, the tax audit framework and tax investigation framework were published to serve as a guide to taxpayers, tax agents and IRBM tax auditors. The probability of individual taxpayer being selected

Corresponding Author: Choong Kwai Fatt, Faculty of Business and Accountancy, University of Malaya, Kuala Lumpur, Malaysia

to tax audit is once in every five years. Any irregularities from the audit findings will be classified either incorrect return under section 113 or willful evasion under section 114. Penalties ranging from 100% to 300% and/or imprisonment up to 3 years will be imposed on tax defaulters.

It was reported that since the implementation of SAS, the Malaysian tax defaulters has increased by almost 10 times within two years time, from 25,160 in 2003 to 239,666 in 2005 (Krishnamoorthy, 2006a). The offences included failure to submit returns, declaring false returns and not providing sufficient information etc. According to the then chief executive officer of the IRBM, Tan Sri Zainol Abidin Abdul Rashid, around one-third of Malaysians eligible to pay tax did not do so, in 2005, and 1.3 million potential taxpayers did not file their tax returns (Krishnamoorthy, 2006b). Related to this, it was estimated that the Malaysian government has lost approximately RM307.7 million due to tax non-compliance.

In an effort to collect tax arrears, the IRBM has imposed a ban on tax defaulters from leaving the country and prosecuting them. The ban from leaving the country is made under section 104 of the Act. In 2005, the number of individuals banned from leaving the country totaled 10,933, with outstanding tax payments of RM281.27 million (The IRBM, 2005). In 2007, the number of individuals banned from leaving the country increased to 39,867, involving RM1.4 billion in outstanding taxes (Nan Yang Siang Pau, 2007).

Scholars such as Veerinderjeet and Renuka (2002) and Chow (2004) opined that the implementation of SAS in Malaysia poses enormous challenges on individual taxpayers. Fundamentally, the success of the SAS relies heavily on the full cooperation of taxpayers. To be tax compliant, taxpayers need to be tax literate. At minimum, individual taxpayers need to possess some basic knowledge of personal taxation, with respect to the taxability of income, deductibility of expenses, entitlements, reliefs, rebates and exemptions. For those who operate a business, they must have some basic understanding of taxability of income from business and non-business source and the deductibility of expenditure. However, in the Malaysian education system, only accounting and some business management students are exposed to taxation at tertiary levels. Many young Malaysians (the future taxpayers) are not formally exposed to taxation in schools. What make it worst is the Malaysian tax laws are inherently voluminous and complex; and the constant changes make it difficult even for tax officers, tax academics, tax practitioners to keep abreast of the latest development, let alone the ordinary people such as the petty traders.

At the time of study, there is no official statistics of number of petty traders in Malaysia; a conservative estimate is about 200,000. Although petty traders' contribution to tax revenue is relatively small, nonetheless, they may be the victim of SAS and will be subject to tax audit and investigation due to the inherent nature of their businesses. Notably, Malaysian petty traders have the following peculiar characteristic: (a) the business transactions are normally in cash basis. The business receipts are in cash terms and the payment for supplies is also in cash; (b) the business annual turnover is generally less than RM300,000; hence it is not economical to employ a full time accounting staff to keep records or to seek professional help on tax matters; (c) on average, the education level of petty traders is low or most of them are illiterate; (d) Petty trader's business fluctuates daily, to a greater extent, the business depends largely on the national economics and weather. In particular, for those have a petty traders stalls operate at the road sides, on a sunny day, they generally operate their business for about 12 hours a day, however, on a rainy day; they will not be able to run their business at all; (e) the IRBM will select them for tax field audit, as it is reasonable to suspect petty traders to under report taxable income or not reporting of income as the business transaction is in cash basis; and (f) it is observed that professional accounting/tax firms are reluctant to do the tax reporting for petty traders because firstly, by nature, the accounting records of petty traders are incomplete, secondly, tax practitioners are doubtful of the accuracy of the information provided, consequentially, might expose tax firm to higher tax risk, and last but not least, the tax agent fees that tax firms could charge petty traders for tax filing service is very minimum, ranging from RM500 to RM1,200.

Under the SAS, petty traders have the following six obligations, namely (1) to keeping sufficient records related to business income, expenses and cost of doing business, so that the profit or loss from the petty trader's business can be correctly ascertained. Under SAS, the business records must be kept for 7 years for tax audit purposes; (2) the business transactions must be recorded within 60 days of the business operations took place; (3) to pay the estimated income tax payable in six bi-monthly installments to the IRBM starting the month of March. The estimates income tax payable will be computed by the IRB based on the preceding year income tax payable; (4) to prepare the business profit or loss account for year ended 31 December and to compute the income tax payable correctly; (5) to submit the income tax return form (i.e., Form B) of the relevant year of assessment by 30 June in the following year; and (6) pay the balance of tax or outstanding tax for the current year of assessment by 30 June of the following year.

It is reasonable to assume that the majorities of the petty traders in Malaysia are having annual turnover of less than RM300, 000, and operate as sole proprietor or partnership. Hence, there are entitled to the several tax benefits, for example, (a) business expenses can be deducted against the gross income; (b) capital allowance can be claimed on motor vehicle, phone, furniture, equipment and others plant and machinery used in business; (c) personal reliefs; and (d) tax at scale rate of 0% to 28%.

In view of the success of SAS depends largely on taxpayer acceptance to the new changes and to highlight the possible shortcoming of the SAS and tax audit system, hawkers are selected as the primary focus of this study. It is reasonable to assume that hawkers are at higher risk of being selected for tax audit and investigation as the nature of transactions are in cash terms which are more prone to under reporting of income, couple to the facts that they do not usually keep a complete set of accounts. In addition, having long operating hours, they would not have much time and efforts to deal with book keeping and tax matters. Hence, petty traders may be the prime target for tax audit. At the time of study, to the best of our knowledge, there is no published study related to petty traders and their experience in tax compliance and tax audit in the era of SAS. The lack of empirical evidence shaped the motivation of study. Hence, this study has emerged to fill up a knowledge gap.

The Research Objectives:

This study aims:-

1. to investigate if Malaysian petty traders understand the mechanism of self-assessment tax system;
2. to solicit the problem faced by Malaysian petty traders in tax compliance and tax audit in the era of SAS.

Methodology:

A questionnaire was designed to collect data. The questionnaire gathers background information of the petty traders and solicits their tax compliance experience and feedback in respect of tax audit and tax related matters. The data collection was carried out nationwide over a period of three months from July to September 2007. A total of 311 usable questionnaires were collected.

RESULTS AND DISCUSSION

Table 1 presents the respondents' profiles. The findings showed that the respondents represented a wide geographical coverage of Malaysia. The proportions of responses from each state somewhat reflect the reality in Malaysia that Selangor Darul Ehsan, Penang and Wilayah Persekutuan notably have a bigger number of hawkers than Terengganu and Sarawak. About 62.4% of the respondents were males and 37.6% were females. The majority of the petty traders surveyed were Chinese (55.9%), and the remainders were Malays (37.3%), Indian (5.5%) and other races (1.3%). In respect of education, 5.5% of the respondents indicated that they had never been to school, 37% had primary education, 47.3% had secondary education, 7.7% had a certificate or diploma, whilst, 1.6% had a bachelor degree and 1% had other qualifications.

About 14.8% of the respondents have been in the business for less than 1 year, 39.2% (between 1-5 years) and 46% (more than 5 years). In respect of the location of business, 26.4% run the business at food court, 31.5% at shop lot or coffee shop, 33.1% operated their business at the roadsides and 9% at other premises. The findings somewhat reflect the real life phenomenon in Malaysia that a substantial majority of petty traders run their business at the roadsides. As for the types of business, the survey found 15.4% of the respondents sell food such as chicken rice and mixed rice, 15.8% sell noodles, 27% sell other types of food such as satay, nasi lemak, roti canai, and other Malaysian delicacies. The remainders sell both food and beverages (25%), beverages only (11.3%) and fruits (4.8%). About 26.4% earned average daily sales of less than RM100, 32.5% earned between RM101-200, 18.6% (between RM201-350), 11.6% (between RM351-500), just 10.9% earned more than RM500 daily.

Tax Compliance in the Era of SAS: Petty Traders, Perspectives:

Several questions were designed to canvas the petty traders' feedback in tax compliance and tax audit in the era of SAS. At the outset, we asked if they were aware of the implementation of SAS in Malaysia on individual taxpayers with effect from YA 2004. Figure 1 reports that half of the hawkers surveyed indicated that they were aware of SAS, whilst another half indicated that they were not aware of the new regime. When asked if they have filed income tax returns before, the results as presented in Figure 2 shows that more than 51% provided an affirmative answer and 49% indicated a "no". To further probe the issue, we asked the

Table 1: The Respondents Profiles.

Particulars		Frequency	Percentage (%)
State	Selangor Darul Ehsan	79	25.4
	Pulau Pinang	50	16.1
	Wilayah Persekutuan	46	14.8
	Johor	28	9.0
	Perak	24	7.7
	Pahang	24	7.7
	Negeri Sembilan	19	6.1
	Kedah	15	4.8
	Malacca	13	4.2
	Kelantan	7	2.3
	Terengganu		3
	1.0		
	Sarawak	3	1.0
Gender	Male	194	62.4
	Female	117	37.6
Race	Chinese	174	55.9
	Malay	116	37.3
	Indian	17	5.5
	Others	4	1.3
Education level	Never been to school	17	5.5
	Primary school	115	37.0
	Secondary school	147	47.3
	Certificate/diploma	24	7.7
	Tertiary	5	1.6
	Others	3	1.0
Length in the business	Less than 1 year	46	14.8
	1-5 years	122	39.2
	More than 5 years	143	48.0
Types of business	Rice (chicken rice, mixed rice)	48	15.4
	Noodles	49	15.8
	Other food (satay, roti canai, Malaysian delicacies etc)	8	27.0
	Food and beverages	80	25.7
	Beverages only	35	11.3
	Fruits only	15	4.8
Location of business	Food court/hawker centre	82	26.4
	Shop lot/coffee shop	98	31.5
	Roadside stalls	103	33.1
	Others	28	9.0
Average daily sales	Less than RM100	82	26.4
	Between RM101-200	101	32.5
	Between RM201-350	58	18.6
	Between 351-500	36	11.5
	More than RM500	34	10.9
Total		311	100%

respondents if they have paid income tax for YA 2004, Figure 3 reports that merely one third indicated 'yes', whilst two third indicated 'no'. Next, when asked if they have ever faced any problem for not filing income tax form, 15% of the respondents indicated that they had experienced some problems for not filing income tax form, and the majority (85%) indicated never (see Figure 4).

Petty Traders' Tax Filing Experience:

Of those who had filed tax return before. To further probe the tax compliance issue, we solicited their tax filing experience. Figure 5 reports that merely 15% of the respondents felt that personal tax return form (i.e., Form B) is simple to fill up, and the majority of respondents (85%) indicated otherwise. When asked if they faced any problem in filing out Form B, Figure 6 reports that more than one third (36%) indicated they did, whilst 24% indicated a 'no', and 40% did not response to this question. Of those who had indicated facing problem in filling Form B, we asked the respondents what were the underlying problems. Table 2 reports that 14.5% of the petty traders surveyed indicated they don't understand Bahasa Malaysia as Form B is written in the national language, 23.8% indicated that they didn't know how to fill up Form B, meanwhile, about 14.5% indicated that Form B asked too much information, and some proportion of the respondents indicated that Form B was too technical (20.6%) and too complicated (7.7%) for ordinary people, like petty traders.

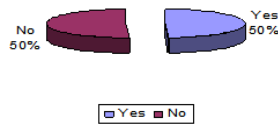


Fig. 1: Aware of the implementation of SAS in YA2004.



Fig. 2: File income Tax Return Before.

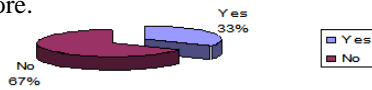


Fig 3: Pay income Tax for YA 2004.

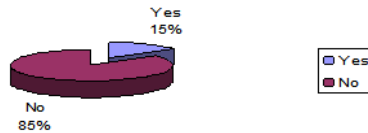


Fig. 4: Faced problem for not filling income tax return.

Table 2: What are the problems faced when filling up Form B?

Type of problem faced	Frequency (%)*
1 Do not understand Bahasa Malaysia	14.5
2 Do not know how to fill up the Form B	23.8
3 Asking for too many information	14.5
4 Too technical	20.6
5 Too complicated	7.7
6 Others	1.1

* Noted that the total frequency distribution did not add up to 100%, as the respondents were allowed to indicate more than one problem faced related to filing up Form B, whilst some did not response to this question.

Seeking the IRBM’s staff for Assistance in Filing Tax Return Form:

In turn, we asked if the respondents had ever sought the IRBM staff in helping them to fill up Form B. Figure 7 reports that about 39% indicated that they had. Of those who had sought the IRBM’s staff for help, we further probe if they found the IRBM’s service satisfactory on a ten-point scale anchored on 1 (extremely not satisfactory) to 10 (very satisfactory). The results show a mean score of 6.27 on a ten-point scale (significant at $p < 0.001$), thus indicates overall, for those who had sought the IRBM’s assistance in filling up tax form, the majority were quite satisfied with the quality of tax service provided. When asked if they were willing to attend the IRBM’s briefing, just one third (33%) indicated that they were willing, whilst two third (67%) indicated otherwise (see Figure 8).

About Tax agents’ Service and Fees:

Figure 9 shows that about 58.8% of the respondents were willing to pay tax agent to fill out tax return form for them, however, 41.2% were not willing. In respect of the amount of tax agent fees that they were willing to pay, more than 80% were willing to pay less than RM300, about 9.3% were willing to pay between RM301 to 500, and less than 1% were willing to pay more than RM1,000 (see Table 3).

Familiarity with Tax Exemptions and Record Keeping Requirement:

To be tax compliant and to avoid paying unnecessary tax, it is of paramount important for the petty traders to be aware of tax exemptions available for small businesses such as petty traders. As expected, Figure 10 reports that only 21.1% of the respondents indicated they were family with tax exemptions available to them.

Table 3: How much are you willing to pay to have your tax return completed by experience tax agent per year?

	Frequency	Percentage (%)
Less than RM300	250	80.4
Between RM301-500	29	9.3
Between RM501-1,000	9	2.9
More than RM1,000	2	0.6
No response	21	6.8
Total	311	100%

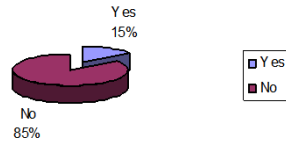


Fig. 5: Thought form B is simple to fill up.

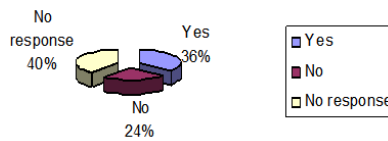


Fig. 6: Faced problem in filling up the form B.



Fig. 7: Sought the IRBM's staff Assistance in filling up tax return form.

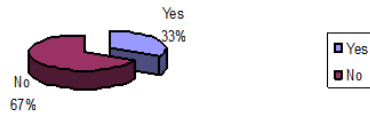


Fig. 8: Willing to attend briefing by the IRBM.



Fig. 9: Willing to pay tax agent.

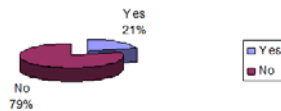


Fig. 10: Familiar with tax exemptions.

79% of the respondents admitted that they were not familiar about tax exemptions. In addition, under the era of self-assessment, taxpayers are required to keep tax records and the supporting business document for 7 years for tax audit purposes. The survey found about 28.6% knew that they need to keep business records for 7 years, whilst the remainder 71.4% did not know about this record keeping requirement (Figure 11). To probe the issue further, the survey found about 33.1% indicated that they kept business record for 7 years, 66.9% indicated that they did not do so (Figure 12). Nearly 65% of the hawkers surveyed expressed that it is difficult for them to keep all business record for 7 years (Figure 13).

Petty Traders' Response towards Tax Audit:

In the era of SAS, taxpayers will be audited once in every five years. Surprisingly, merely 36% of hawkers surveyed were aware of tax audit and just 43% of them were ready for tax audit (see Figure 14 and 15 respectively). When asked if they were worried of the IRBM staff to conduct a tax audit on them for YA 2004. Figure 16 reports that about one third indicated they were worried, whilst 66% indicated otherwise.

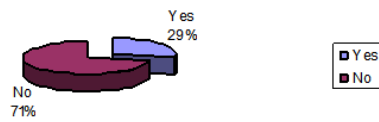


Fig. 11: Aware of the requirement to keep record for 7 years.

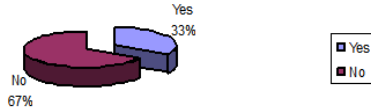


Fig. 12: Kept business record for 7 years.

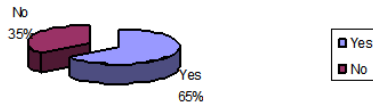


Fig. 13: Difficult to keep record for 7 years.

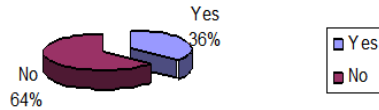


Fig. 14: Aware of tax Audit.

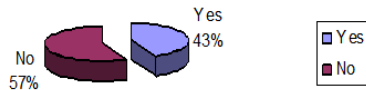


Fig. 15: Ready for tax audit.

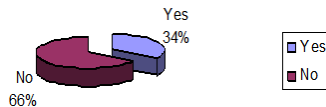


Fig. 16: Worry if the IRBM conduct tax audit for YA 2004.

To probe the issue on tax audit further, we asked why they were worried about tax audit, some of the replies were (i) “do not have any supporting document, scared will be penalized”, (ii) “because never paid income tax, “worry because ignorance of certain tax rules”, (iii) “worry that could be errors or mistakes occurred in the income tax which he declared before”, (iv) “I thought only big business need to pay tax, hawker no need to pay”, (v) “I don’t have enough information about this tax thing”.

When probe further on why they were not worried about tax audit, some of the responses were as follows, (i) “The tax agent will manage the document”, (ii) “the income is very small, won’t be subject tot tax”, (iii) “because I declared the accurate income tax to the IRB”, (iv) “business small, no need to worry. Did not earn much money”, (v) “income is low, so not taxable”, (vi) “because I kept all the records and asked tax agent to fill up the form”

Implications of Findings:

The survey found in general, the hawkers surveyed did not have a good knowledge about the mechanism of SAS, and they were apprehensive of tax audit. The plausible explanation was due to lack of formal tax education in primary, secondary and tertiary levels in Malaysia. The findings somewhat indicate that in the era of SAS, it is imperative for all individuals (taxpayers and future taxpayers) to be formally exposed to tax education, so as to enable them to understand the mechanism of SAS and to equip them with some basic tax knowledge. It is worth noting here that knowing the importance of tax education; the Japanese government has introduced tax education even at kindergarten level because students are the future taxpayers (Sarker, 2003).

The Government may consider to simplifying the system of tax computation for petty traders. It is suggested to impose taxation of 7% on the gross receipts of the petty traders having turnover of less than RM300,000 annually to be their deemed statutory income. These will relief them from keeping detailed record

of income and expenses for 7 years and complex computation of taxable income. Currently, these petty traders just do not have the time let alone the cash resources to voluntarily comply with SAS. Hence, a simplified tax will attract more voluntary compliance from petty traders.

Tax agent firms who assist the petty traders to file their tax should be given incentive to subsidize the cost of doing a national duty. They should not be penalized for any irregularity found if hawkers' accounting records are incomplete. It is suggested that a 50% on the fees received should be given to tax exemption, as provided in export incentives.

Limitations of the Study:

This study has several limitations. Firstly, it is an exploratory study. Secondly, the data was collected based on convenience sampling. Thirdly, self-reported data was used for data analysis; hence, they could be over-reported. Last but not least, this study only sampled those petty traders that involved in selling processed food, and excluded those petty traders that traded in unprocessed goods, durables and service. Bearing in mind of the above limitations, care must be exercised in interpreting the results and to generalize the findings to the populations.

Conclusion:

The SAS places an onerous responsibility on hawkers to comprehend the new system and to comply with the tax administration aspects as to the computations, payment of taxes, and record keepings. It is suggested that the IRBM to impose penalty discretionary, to take into account of the educational background, financial position, the amount of tax understated, the frequency of tax defaults of the petty traders. This study provides an important insight that the Malaysian tax policy makers and the IRBM ought to seriously consider a simpler and pragmatic tax assessment system, tailor make for petty traders to achieve tax administrative compliance efficiency.

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