TAX UNDERSTANDING AND COMPLIANCE OF MALAY CIVIL SERVANTS IN PENINSULAR MALAYSIA

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TAX UNDERSTANDING AND COMPLIANCE OF MALAY CIVIL SERVANTS IN PENINSULAR MALAYSIA

by

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LIST OF ABBREVIATIONS

ASB	Amanah Saham Berhad
ASNB	Amanah Saham Nasional Berhad
ASL	Average Sentence Length
ASW	Average Number of Syllables per Word
COLA	Cost of Living Allowances
e-Filing	Electronic Filing
EPF	Employees Provident Fund
F-KGL	Flesch–Kincaid Grade Level Readability
FRES	Flesch Reading Ease Readability Score
IRBM	Inland Revenue Board of Malaysia
ITA	Income Tax Act 1967
ITRF	Income Tax Return Form
MDTD	Monitoring Deliberate Tax Defaulters
MTD	Monthly Tax Deduction
OAS	Official Assessment System
PCB	Potongan Cukai Berjadual
PMR	Penilaian Menengah Rendah
RMCD	Royal Malaysian Customs Department
SAS	Self-Assessment System
SE	Standard Error
SOCSO	Contribution to the Social Security Organization
SPM	Sijil Pelajaran Malaysia
STAM	Sijil Tinggi Agama Malaysia

PEMAHAMAN DAN KEPATUHAN PEMBAYAR CUKAI DALAM KALANGAN PENJAWAT AWAM MELAYU DI SEMENANJUNG MALAYSIA

ABSTRAK

Bayaran cukai adalah wajib ke atas rakyat yang berpendapatan. Walaupun segelintir rakyat tidak berpuas hati dengan pembayarn cukai yang dikenakan oleh kerajaan, kutipan cukai ini sangat penting bagi menjana ekonomi negara. Prinsip percukaian menekankan bahawa cukai yang dikumpul harus menjana pendapatan bagi menyediakan perkhidmatan kepada rakyat, dan paling mustahak adalah ianya mesti disebarkan sebaik mungkin merentasi seluruh sektor ekonomi. Berdasarkan kepada kepentingan ini, isu pematuhan cukai dalam kalangan pembayar cukai individu adalah menjadi kebimbangan utama kerana ia memberi kesan kepada jumlah cukai pendapatan yang dikutip, dan juga perbelanjaan pembayar cukai. Kutipan cukai pendapatan berpotensi untuk mengurangkan perbelanjaan masyarakat, kerana cukai akan mengurangkan pendapatan boleh guna. Peningkatan ketidakpatuhan bayaran cukai dalam kalangan pembayar cukai semakin membimbangkan. Ini dapat dilihat berdasarkan pelaksanaan hukuman yang tegas, termasuk denda yang sangat tegas bagi pelarian cukai, dan kesalahan jenayah bagi sesiapa yang tidak melaporkan cukai. Oleh yang demikian, tujuan kajian ini adalah untuk menilai pemahaman pembayar cukai mengenai pembayaran cukai pendapatan, tahap pembacaan e-Filing pembayar cukai, pengisytiharan cukai pendapatan pembayar cukai, tahap pematuhan cukai individu dan faktor-faktor yang mempengaruhi tahap pematuhan mereka. Kajian ini menggunakan soal selidik sebagai instrumen untuk mengumpul maklum balas daripada penjawat

awam Melayu. Sejumlah 1000 kaji selidik dalam talian telah diedarkan kepada penjawat awam Melayu di Semenanjung Malaysia. *Logit* dan *ordered logit* analisis telah digunakan untuk menilai perisytiharan cukai pendapatan dan tahap pematuhan cukai. Hasil kajian menunjukkan bahawa pembayar cukai dalam kalangan penjawat awam Melayu di Semenanjung Malaysia tidak memiliki pengetahuan yang mencukupi berkaitan asas percukaian untuk mengemukakan penyata cukai mereka. Sementara itu, untuk pembacaan e-Filing, majoriti pembayar cukai individu mempunyai pemahaman sederhana mengenai e-Filing (59.6%) dan agak sukar untuk tahap kebolehbacaan (50.9%). Sebilangan besar penjawat awam Melayu telah mengisytihar pembayaran cukai pendapatan mereka, tetapi kebanyakan daripada mereka mempunyai pematuhan cukai yang rendah. Dua pemboleh ubah secara statistik dan signifikan mempengaruhi tahap pematuhan cukai iaitu, pemahaman mengenai pelepasan cukai dan pengalaman diaudit oleh LHDNM. Penemuan kajian ini berguna bagi kerajaan untuk memperbaiki sistem cukai sekarang bagi tujuan meningkatkan pematuhan cukai secara sukarela.

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TAX UNDERSTANDING AND COMPLIANCE OF MALAY CIVIL SERVANTS IN PENINSULAR MALAYSIA

ABSTRACT

Paying tax is mandatory on all earning citizens. Even though many people complain about the tax levied by the government, collecting these taxes is vital for the national economy. The taxation principles emphasize that taxes should generate revenue for the provision of essential public services, and importantly, it must be shared with as much of the population and sectors of the economy as possible. Given its importance, the issue of tax compliance among individual taxpayers is a major concern since it affects the amount of income tax collected, and also taxpayers' spending. Income tax collection has the potential to decrease people spending, because taxes will reduce disposable income. The growth of non-compliant taxpayers across employment underscores the gravity of the issue. This can be seen through the implementation of strict punishments, including harsh penalties for underreporting, and criminal prosecution against non-filers of tax returns. Therefore, the purpose of this study is to assess the taxpayers' understanding of income tax payment, taxpayers' e-Filing readability levels, taxpayers' income tax declaration, the level of individual tax compliance and factors which affect their compliance level. This study employs a questionnaire as an instrument to collect responses from Malay civil servants. A total of 1000 online surveys was distributed to Malay civil servants in Peninsular Malaysia. Logit and ordered logit analysis were used to assess the income tax declaration and tax compliance levels. The findings show that Malay civil servants' taxpayers in Peninsular Malaysia did not possessed adequate basic tax knowledge to file their tax

returns. Meanwhile for e-Filing readability, majority of individual taxpayers having a medium understanding of e-Filing (59.6%) and fairly difficult for the readability level (50.9%). Majority of the Malay civil servants had declared their income tax payment, but most of them having low tax compliance. Two variables statistically and significantly affected tax compliance levels namely, understanding of tax relief and experience being audited by the IRBM. The findings of this study would be useful for the government to further improve the present tax system to increase voluntary tax compliance.

CHAPTER 1

INTRODUCTION

1.1   Introduction

Tax is a leading source of revenue for the government that assists in ensuring stable growth and providing a certain standard of living for citizens. Tax refers to a mandatory fee charged or levied by the government on a product, income or activity within a given country. The two broad categories of types are direct and indirect taxes. A direct tax is defined as a tax paid directly by those on whom it is levied to the government. One of the characteristics of direct tax is that the burden of tax cannot be shifted to someone else, such as income tax. Income can be derived from various sources, including salary from employment, businesses or profession, and income from property, and investment gains, among others.

Direct tax is progressive in which it increases with an increase in income or wealth and vice versa. The paying capacity of the person levied is taken into account, and the element of fairness uphold, i.e. the rich will be levied more than the poor. In Malaysia, the Individual Income Tax Rate was 25% in 2015 and 26% in 2013, and 2014. However, the Personal Income Tax Rate in Malaysia averaged 27.07% from 2004 until 2018, and reached an all-time high of 28% in 2005 and recorded a low of 25% in 2015.

Meanwhile, an indirect tax refers to charges on a person who consumes goods and services whereby the consumer indirectly pays the tax. Examples of indirect tax are Value Added Tax (VAT), service tax, excise duty, such as on cigarette and import levies. Contrary to a direct tax, the burden of indirect tax can be shifted to another person, and this tax is regressive where the amount of tax increases based on the

demand for the goods and services and vice versa. Every person is equally charged the tax regardless of whether they are rich or poor.

Despite many people complaining about the tax levied by the government (Saad, 2014; Listokin & Schizer, 2012; Palil & Mustapha, 2011; Alm et al, 2010) collecting these taxes is vital for the national economy. Governments cannot administer the nation without funds. These funds can be financed through revenue collection. Examples of revenue collection are the financial contribution from taxation, including direct or indirect taxes, which the government uses to execute various socio-economic development projects for the betterment of its citizens. These development projects include the construction of roads, schools, healthcare, national security, provision of salaries for civil servants and many more.

In Malaysia, income taxation is guided by the Income Tax Act 1967. The taxation principles emphasise that taxes collected should generate revenue for the provision of essential public services, and importantly, it must be spread across as many stakeholders as possible to reach the population and all sectors of the economy. Also, the enforcement of taxation will facilitate voluntary compliance from individuals and organisations, bearing in mind that it must burden all individuals in similar economic circumstances equally. A good taxation principle does not favour any group or sector over another.

Taxation is a controversial economic issue with different views and responses from individual taxpayers. The issue of tax compliance among individual taxpayers is a major concern since it affects the amount of income tax collected, and also affect taxpayers' spending. Income tax collection has the potential to decrease people spending, because taxes will reduce disposable income, such as a need to declare

business revenue (rental income, online business, dividends, and etcetera). Every citizen should have at least a minimum knowledge of tax to avoid potential problems when filing tax payments. Informed taxpayers are unlikely to face difficulty while filing their tax return forms compared to not well-informed taxpayers. Studies by Saad et al. (2014) and Loo et al. (2005) appreciated the importance of tax knowledge in compliance behaviour, and generally, compliant taxpayers are associated with tax knowledge which contributes to higher compliance rates (Kircher et al., 2008; Kasipillai & Abdul-Jabbar, 2006).

The absence of tax knowledge may reduce the compliance level of taxpayers. It influences taxpayers' decisions or responses to tax payments. A compliant taxpayer obeys all tax rules and regulations enforced by the tax authority (Mesele, 2018). If taxpayers have a good response towards income tax payment, therefore, it would result in fewer costs for the tax authority as well as to the taxpayers due to less surveillance from the tax authority.

Taxpayers can also respond through their non-compliant behaviour. Non-compliance refers to a failure to comply with tax obligations, such as not reporting the income tax, untimely filing and payment, and filing incorrect calculations of liability (tax evasion). This compliance behaviour may result from the complexity of tax provisions due to inadequate knowledge of the income tax payment process.

1.2 Payment Services by the IRBM

Besides tax audit and tax investigation, the IRBM has also executed other programmes to enhance tax payment methods and thus will increase voluntary compliance. Among the methods are the Monthly Tax Deduction (MTD) or *Potongan Cukai Berjadual* (PCB), Bank Counters, Internet Banking, and IRBM Payment Counter. MTD

collection is one of the higher contributions among individual income taxes. In the year 2014, MTD collection was RM19,763 million and RM20,684 million in 2015 (IRBM Annual Report, 2015). However, the increment of individual income taxes collection has not reached the maximum level, despite the many efforts by IRBM. The existence of non-compliant taxpayers has distorted the income tax revenue collection by IRBM. Enforcement compliance could attribute to non-compliance behaviour due to enforcement and not because of voluntary compliance.

As shown in Figure 1.1, the number of individual taxpayers in Malaysia for the years 2013, 2014, and 2015 gradually increased. In 2013, the total individual taxpayers were 13,054,574, and in 2014 and 2015, they were 13,685,231 and 14,355,612 respectively. With the increment of registered taxpayers, the number of individual taxpayers involved in non-compliant activities also gradually increased. Based on the figure above, the number of non-compliant taxpayers for three years was 5,911,383, 6,140,729, and 6,160,454. The increment of non-compliant taxpayers from 2013 to 2014 was (+) 2,293, and 2014 to 2015 was (+) 19,725, which indicates that non-compliant taxpayers in Malaysia are a growing issue.

With the high numbers of registered taxpayers from 2013 to 2015, the chances of non-compliance behaviour should be taken into consideration, such as tax evasion through inaccurate report tax liability. The statistical data by IRBM 2016 could be an indication for the seriousness of non-compliance behaviour among individual taxpayers.[1]

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[1] Due to informational privacy, the IRBM only provides three years of data (2013, 2014, 2015)
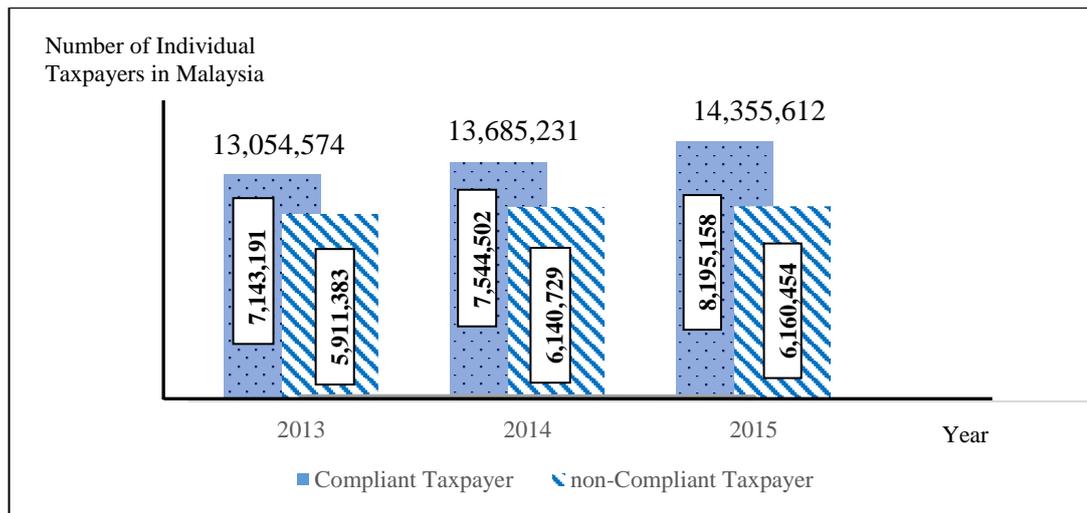
Figure 1.1. Number of registered individual taxpayers (Compliant and Non-Compliant) in 2013, 2014, and 2015

Source: IRBM (2016)

In the case of non-compliance behaviour, statistics showed an increase in individual income tax loss from RM 83,875,931.42 to RM136,929,012.35, which rose to RM160,130,240.85 in the year 2013, 2014 and 2015 respectively (Figure 1.2). In conjunction with the individual income tax loss, tax and penalties also showed a rapid increment, which indicates the gravity of the issue. The tax and penalties in 2013, 2014, and 2015 were RM124,086,064.33, RM193,267,616.17, and RM220,529,798.33 respectively. The individual income tax loss (revenue loss) for both public and private sectors was calculated based on the number of settled cases, comprising individual salary (income from employment, such as basic salary) and others (income business such as an online business). Meanwhile, for the tax penalties collection, the calculation was derived based on individual salary and other income (numbers of settled cases). These can be seen in Figure 1.2.[2]

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[2] Due to informational privacy, the IRBM only provides three years of data (2013, 2014, 2015)
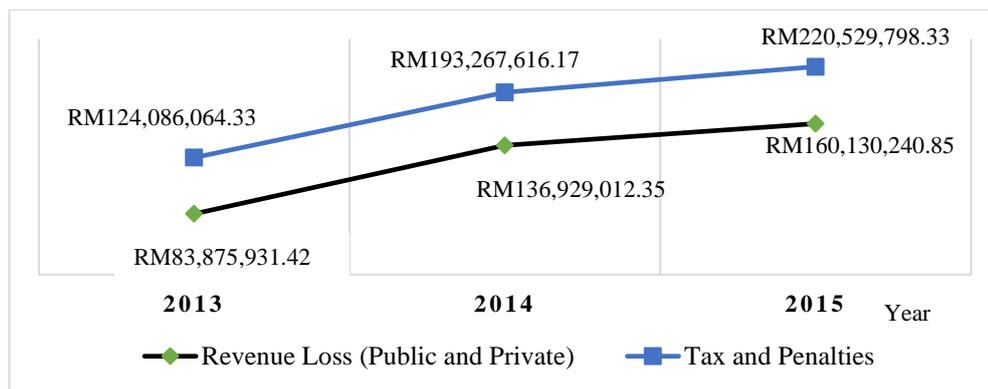
Figure 1.2. Individual Income Tax Loss and Tax Penalties in 2013, 2014, and 2015
Source: IRBM (2016)

1.3   Tax Compliance

Paying tax is mandatory on all earning citizens. The state and tax authorities seek to produce compliant taxpayers, which behave based on the tax rules, regardless of the motives for compliance. From the perspective of tax law, there is no precise definition of compliance because it represents the most inclusive and neutral terms for taxpayers' willingness to pay taxes (Kirchler & Wahl, 2010). It is a very complex phenomenon that obliges legal inspection because it relates to individual tax behaviour. A general definition of tax compliance is filing all required tax returns within the allotted time and reporting tax liability accurately in accordance with the tax code and tax regulations at the time the return is filed (Kasipillai & Abdul-Jabbar, 2006; Roth & Scholz, 1989). The above definition identifies three important requirements of compliance as record keeping, timely and accurate filing of tax returns, and the payment of all taxes owed (Sour, 2004). The definition is also in line with the three types of voluntary compliance recognised by the Internal Revenue Services (IRS), namely filing compliance, reporting compliance, and payment compliance.

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Accordingly, tax compliance can be measured using three elements, (1) within the stipulated time, (2) reporting tax liability accurately, and (3) accordance with the tax code and tax regulations.

In contrast, non-compliance is the failure to meet tax obligations by underreporting and overreporting taxes (Sour, 2003). Tax avoidance is avoiding paying taxes using legal loopholes, such as income splitting, and postponement of taxes (James & Alley, 2002; Rosen et al., 2010). Tax compliance can be categorised as voluntary compliance and enforced by the tax authorities (Kirchler & Wahl, 2010).

1.3.1 Voluntary Tax Compliance

Voluntary compliance is the principle that taxpayers will comply voluntarily with tax law and accurately and honestly report their income (Kirchler & Wahl, 2010). This voluntary action should be done without surveillance from the tax authority (Singh, 2003), and be free of tax cheating. Voluntary compliance results from good interaction between taxpayers' trust in authorities and authorities' power to monitor taxpayers (Kirchler & Wahl, 2010). Based on political legitimacy theory, tax compliance is influenced by the extent to which taxpayers believe and trust the government (Kirchler, Hoelzl, & Wahl, 2008; Tayler, 2006). Taxpayers' recognition and acceptance of the tax authorities representing the government have a significant impact on their tax behaviour.

The perception of government spending plays an important part in income tax payment decisions. The government is assumed as a caretaker of the public money through wise spending, which will enhance public trust. However, if taxpayers believe that the government spends tax revenue imprudently, they will lose trust in the

government and avoid paying income tax (Palil & Mustapha, 2011; Fjelstad & Ranker, 2003).

1.3.2 Enforced Tax Compliance

Contrary to voluntary compliance, enforced compliance is where taxpayers comply because they are afraid of punishment and being audited. As enforced in Malaysia, under Section 112 (1) of the Income Tax Act 1967, failure to provide tax returns on time will be fined with an amount between RM200 and RM2,000 or imprisonment not exceeding six months or both. According to the Income Tax Act 1967 (114 - 1), the penalty imposed on individuals who willfully and with intent evade or assist any other person to evade tax amounts to RM1,000 to RM20,000 or imprisonment or both and 300% of the tax undercharged.

Nevertheless, despite the penalties, taxpayers' compliance remains questionable. This situation has raised a heated debate as to whether to pay taxes honestly or to evade tax. In the previous discussion on direct tax, the possibility of evasion is higher, because people will pay their tax as enforced by the tax authority, but at the same time, they can also evade tax. Furthermore, by evading tax, taxpayers still enjoy the same benefits as voluntary taxpayers. Tax evasion or underreporting tax are defined as failing to pay legally due to taxes and a form of direct violation of the tax law (Alabede et al., 2011; Rosen et al., 2010; Richardson, 2008; Adbul, 2001). Examples of tax evasion are a failure to register with the tax authority by any potential taxpayers, failure to submit a tax return by the due date, incorrect declaration or assessment of tax liability in the submitted tax return, and non-payment or partial payment of tax liability after the due date (IRBM, 2015).

1.4   Tax Non-Compliance

As discussed in section 1.2, non-compliance is defined as the failure to meet tax obligations by underreporting and overreporting taxes (Sour, 2003). Meanwhile, non-compliant taxpayers are those who do not comply with the tax law, such as inaccurately reporting tax liability (James & Alley, 1999; Roth & Scholz, 1989). Non-compliance is the intentional or unintentional failure of the taxpayers to fulfil their tax obligations (Sour, 2004; McKerchar & Evans, 2009).

Unintentional non-compliance occurs when the taxpayers fail or use an intermediary on behalf of the taxpayers to remit the stated amount of tax to the authorities probably due to complexity, or inconsistencies in the tax legislation or administrative procedures (Alabede, Ariffin, & Idris, 2011; Kesselman, 1994). It may arise due to inadequate efforts by taxpayers or may also stem from the complexity of tax provision (Adbul, 2001). The complexity of tax provision could be due to inadequate knowledge of taxpayers in understanding the income tax payment process such as the incompetence of taxpayers to fill in the form appropriately or misinterpreting tax provision which requires guidance from the tax authority. In Malaysia, the problem of unintentional tax non-compliance became more significant with the implementation of the Self-Assessment System (SAS) (Hai & See, 2011). The complexity of SAS has led to frustration and confusion and has reduced tax compliance (Loo, 2006; Hanefah, 1997).

Intentional non-compliance consists of two categories namely, tax evasion (Alabede et al., 2011; Rosen et al., 2010; Richardson, 2008; Adbul, 2001) and tax avoidance (James & Alley, 2002; Rosen et al., 2010). As pointed by Sour (2004), intentional non-compliance individual taxpayers failed to comply may occur either

because he or she intended to evade his tax liabilities, and less probability of being audited. Regardless of whether a person pays tax voluntarily, being enforced, or intentionally, there is a tendency of non-compliance activities among individual taxpayers.

1.5 Roles of the Inland Revenue Board of Malaysia

The Inland Revenue Board of Malaysia (IRBM) is a trusted agency under the Ministry of Finance in collecting revenue of the country. IRBM was established in accordance with the IRBM Act 1995, and has been given the power and autonomy in financial and personnel management, and also to improve the quality and effectiveness of tax administration in the country. The main functions IRBM are to act as an agent for the government in providing services such as administration, assessment, collection, and enforcing payment of income tax.

Improving taxpayers' service is generally regarded as an important element to maintain and secure voluntary compliance. IRBM is moving towards implementing an integrated and transparent taxation system, increasing operational effectiveness through innovative processes and information technology, such as by providing e-Filing facilities for the submission of the Income Tax Return Form, and enhancing a competent workforce (IRBM, 2016). These efforts will facilitate the process of voluntary compliance among Malaysian taxpayers.

1.5.1 Tax Audit Prevention

In order to increase income tax revenue and secure compliant taxpayers, IRBM has given more priority to a tax audit, because the potential amount of revenue that a tax authority can raise depends on the effectiveness of the audit (Daly & Gravelle, 2005). Tax audit is an essential tool for ensuring tax compliance, especially in enforced

compliance since they comply because of being afraid of punishment or being audited. The concern is to ensure the income that ought to be reported and calculated in line with the tax laws and regulations. The audit process generally requires the tax authority to examine taxpayers' records and tax affairs to determine whether taxpayers had filed correct liability with the correct amount (IRBM, 2009).

Under tax audit, IRBM has the power to amend taxpayers' original tax returns and impose penalties on taxpayers if the find taxpayers did not comply with tax payment (OECD, 2007). For example, the IRBM had collected RM2, 870.62 million, which approximately USD 920.67 penalties in 2010 (IRBM, 2010). The IRBM reported that tax audit collection contributed 3.6% or RM79.54 billion to total net direct tax collection each year (IRBM, 2010). This makes audit an important tool to prevent non-compliance behaviour among taxpayers.

1.5.1(a) The Monitoring Deliberate Tax Defaulters

The Monitoring Deliberate Tax Defaulters (MDTD) or *Pemantauan Pembayar Cukai Gagal Patuh,* is a tax audit initiative. It intends to strengthen the existing detection of non-compliant taxpayers. MDTD was created to monitor taxpayers who have failed to comply with the tax laws and regulations. Another initiative is the Monthly Tax Deduction (MTD) audit to enhance the level of tax compliance. It intends to examine employers' compliance rate in imposing tax deductions from employees' salaries.

1.5.2 Tax Investigation

Besides tax audit, tax investigation is vital to enhance individual tax compliance. It is an enforcement initiative undertaken by IRBM in order to combat tax evasion. To strengthen this initiative, it is included in the procedure of criminal investigation, and prosecution action will be enforced on non-compliant taxpayers. Under Section 112

(1) of the Income Tax Act 1967, failure to provide tax return on time will be fined with an amount between RM200 and RM2,000 or imprisonment not exceeding six months or both.

The seriousness of non-compliance activities in Malaysia had forced IRBM to take thoughtful actions. Thus, in 2013, IRBM introduced strict punishments for non-compliance, including harsh penalties for underreporting, late submission, late payment, and criminal prosecution against non-filers of tax returns, meaning the IRBM can now detain tax evaders. This shift from treating non-compliance as a civil to a criminal offence demonstrates the seriousness, which reduces the state's revenues.

The criminal offence can be defined as a failure to declare income within the stipulated period, and failure to declare the correct amount of income or known as fictitious claims in the Income Tax Return while the civil offence is described as a failure to pay income tax within the stipulated time, which is 30 April every year (IRBM, 2016). IRBM must improve the tax compliance among individual taxpayers, and it is a prerequisite to the success of the Self-Assessment System (SAS). In a move towards assisting Malaysian taxpayers in obtaining correct taxation information, IRBM continuously implemented programmes, including taxation briefings, workshop, and lectures (IRBM, 2014).

1.5.3 Self-Assessment System (SAS)

The Malaysian taxation system was introduced in 1984 in West Malaysia, then later in Sabah in 1957, and Sarawak in 1961. The system shifted from traditional assessment to modern assessment. The former is known as the Official-Assessment System (OAS) and the latter the Self-Assessment System (SAS). Under OAS, taxpayers were not required to have knowledge on how to compute their payable tax. Taxpayers

received their annual tax returns from the IRBM and were required to declare all necessary information pertaining to their income and expenses for that particular year of assessment. In short, the onus was on the tax assessors in comprehending, interpreting and appropriately applying the relevant tax law. However, the rate of returns filed by taxpayers was unsatisfactory (Shanmugam, 2003; Mottiakavandar, Ramayah, Haron, & Ang, 2003; IRBM, 2002) resulting in delays in revenue collections, as well as the loss of revenue.

These problems were aggravated further by the inability of tax assessors (IRBM) to finalise assessments within the stipulated timeframe (Shanmugam, 2003). The introduction of the Self-Assessment System (SAS) by the IRBM between 2001 and 2004 for companies and individuals was designed to reduce the problematic administrative burden of the state. Under the SAS implementation, the tax management' liability has been transferred from the IRBM to the taxpayers (Tallaha, Shukor & Hassan, 2014). Individual taxpayers have to calculate, determine, file and pay income tax by their means. The implementation of the SAS aims to reduce the processing cost of tax collection and also to increase tax compliance (IRBM, 2007).

Since the tax burden has been transferred directly from the IRBM to taxpayers, the IRBM put an effort to provide a proper method to ease the tax management of taxpayers. As a result, e-Filing was introduced in the year 2006. Starting in 2006, Malaysian taxpayers can choose their most convenient methods of filing tax, i.e. electronic filing or manual filing. E-Filing is an electronic service to assist Malaysian taxpayers to file tax return forms electronically. There are many advantages of e-Filing, such as simplifying and expediting the tax filing process, and a more efficient filing process (IRBM, 2015). Manual filing is the traditional method in which

taxpayers need to fill in the tax return form by hand. However, the complexity of SAS has led to frustration and confusion and reduced tax compliance (Loo, 2006; Hanefah, 1997). Some studies indicated a negative relationship between complexity and taxpayers' performance (O'Donnell, Koch & Boone, 2005; Tan & Kao, 1999; Chang, Ho & Liao, 1997).

1.5.4 Readability of Electronic Filing

Readability of electronic filing or e-Filing is vital to influence voluntary compliance. Various educational levels of taxpayers should easily understand it. Readability is the simplicity of the text that can be read and comprehend and is a pre-conditional feature of understandability (Umar & Saad, 2015; Urbanic & Hsu, 2007). The quality of language used and comprehensible meaning is important. Moreover, the competency of the taxpayers in using SAS, specifically e-Filing, is questioned (Marshal, Smith & Armstrong, 1997).

As revealed by Sakurai and Braithwaite (2003), 36% of Australian taxpayers were not competent to carry out their tax filing, and about 70% of them had hired tax agents to handle their tax matters. In the United Kingdom, taxpayers' performance in SAS is below the expected level, and it sought to increase the percentage of individuals who are filing their tax returns on time to at least 93% by 2007-2008. This shows that the performance of taxpayers was not satisfactory.

Following the first year of e-Filing implementation, the usage of this service increased more than 368% in 2007 compared to 2006 (IRBM, 2007). Usage increased at an average of approximately 20% per annum between 2007 and 2010 (IRBM, 2007; IRBM 2010). With the positive feedback from individual taxpayers, the IRBM intended to discontinue the manual tax return form. Unfortunately, there was resistance

from many individual taxpayers. This action could threaten low literacy taxpayers, especially those who have limited accessibility, such as limited internet service and computers (Mohamad-Fikri, 2006).

Irrespective of whether the taxpayer decides to use electronic or manual applications, taxpayers are required to have sufficient tax knowledge to file their tax returns. Previous studies revealed that the low acceptance of e-Filing among individual taxpayers (IRBM, 2011; Azmi & Bee, 2010; Schaupp, Carter & Hobbs, 2009; Hung, Chang & Yu, 2006; Teo & Wong, 2005) were due to lack of tax knowledge, and it was a norm among Malaysian taxpayers (Latiff, Noordin, Omar & Harjito, 2005; Kamaluddin & Madi, 2005). After the fourth year of e-Filing implementation, only 1.25 million taxpayers were reported to have filed their tax return via e-Filing (Bernama, 2009).

Even though e-Filing promises efficiency in the filing process, it has opened up more opportunities for non-compliant taxpayers to underreport their income tax (Palil, 2010; Walpole, 2009). For example, the number of non-compliant taxpayers increased almost ten-fold within two years of the implementation of SAS from 25,160 in 2003 to 239,666 in 2005 (IRBM, 2006). These higher figures could be attributed to many factors, including the complexity of e-Filing, and individual taxpayers' readability.

The complexity of e-Filing has the potential for non-compliance behaviour (Mustafa & Hanefah, 1996; Saad et al., 2014; Saad, 2011; Long & Swingen, 1987). The complexity can be due to the difficulty of record keeping, multiple categories of income tax forms (Alm et al., 2010), and vague terms, such as statutory income,

perquisites, and gratuity. Besides the e-Filing complexity, income tax readability among individual taxpayers can trigger non-compliance activities.

To measure the readability level of e-Filing, many researches applied the Flesch Reading Ease Readability (FRES) and Flesch–Kincaid Grade Level Readability (F-KGL). The application of FRES and F-KGL are well-established by previous studies to measure the readability of written documents in technical taxation writing (Saad et al., 2014; Saw & Sawyer, 2010; Smith & Richardson, 1999). It is important to identify the knowledge gap of the taxation system and what exactly taxpayers understand. To be a compliant taxpayer, the readability of the written documents is significantly important.

1.6 Problem Statement

The issue of tax compliance among individual taxpayers is a major concern since it affects the amount of income tax collected, and also taxpayers' spending. Income tax collection has the potential to decrease people spending, because taxes will reduce disposable income. The growth of non-compliant taxpayers across employment underscores the gravity of the issue. This can be seen through the implementation of strict punishments, including harsh penalties for underreporting, and criminal prosecution against non-filers of tax returns. However, this effort should be consistent with the tax information possessed by individual taxpayers. This is because a significant number of existing taxpayers failed to meet their tax obligations, suggesting that they do not understand their income tax payment. Tax knowledge is a prerequisite to the success of voluntary tax compliance. Besides, readability of electronic filing or e-Filing is vital to influence tax compliance. The simplicity of the text that can be read and comprehend is a pre-conditional feature of understandability, significantly

influence the compliance level. There are many factors that contribute to tax compliance such as tax knowledge, readability of e-filing, tax experiences, social influences, economic and institutional factors. This motivates the present study to analyse tax compliance among individual taxpayers in Peninsular Malaysia, whether they are complying or non-complying with income tax payment. Gaining a better understanding of why individual taxpayers comply, and at what level they comply with their income tax payment is vital to maintain and secure voluntary tax compliance.

1.7   Research Questions

Based on the issue identified, the study proposes to address the following research questions:

1.   How well do taxpayers understand their income tax payment?

2.   What is the readability level of e-Filing and how does this match with the individual understanding?

3.   Do individual taxpayers declare their income tax, and what are the factors that influence their decision to declare?

4.   What is the level of individual tax compliance, and how do different socio-economic, socio-demographic, e-Filing understanding, tax experience, social influences, economic, and institutional factors affect the compliance level?

1.8   Research Objectives

Based on the research questions, the objectives of this study are as follows:

1.   To assess the taxpayers' understanding of income tax payment.

2.   To measure e-Filing readability levels and its relationship with an individual's understanding.

3.   To assess an individual's tax declaration and analyse factors influencing their income tax declaration.

4.   To assess the level of individual tax compliance and analyse factors that affect the compliance level.

1.9   Scope of the Study

The scope of the study explains the boundaries of this research. It has been defined by the following dimensions:

1.9.1   Level

The level of this study refers to Malay civil servants in Peninsular Malaysia with the minimum monthly income (after Employees Provident Fund (EPF) deduction) of RM2,851 for single individuals and RM3,851 for a married individual with an unemployed spouse (IRBM, 2016). The study focuses on the civil servant because the civil servant's salaries come from taxes. The amount collected from income tax, along with other taxes and revenues, would be used to run the country and most importantly to give back to the society. The breakdown of the civil servants in year 2014 to 2018 shows that the Malay civil servants make up 79.45% as compared to Indian civil servants and Chinese civil servants which is 3.35% and 1.72% respectively, while Bumiputera of Sabah (7.79%), Bumiputera of Sarawak (5.59), Orang Asli (0.24%) and 1.86% is others (Berita Harian, 2019). The respondents are all professionals in management (grades 41 to 54).

1.9.2   Territory

The study limited to Malay civil servant taxpayers in peninsular Malaysia. The main purpose of choosing individual taxpayers from Peninsular Malaysia is due to the higher

number of individual registered taxpayers at 88% compared with Sabah and Sarawak with only 12% (IRBM, 2016 - Analytical Data and Statistics Department).

1.9.3   Time

The study was conducted in year 2015 to 2018.

1.9.4 Methodology

The study used four different analysis to answer research objectives. The descriptive analysis (mean value) was used to answer research objective one (RQ1), while Flesch Reading Ease Readability (FRES) and Flesh-Kincaid Grade Level Readability (FKGL) were used to answer research objective two (RQ2). Logit and ordered logit analysis were used to answer research objective three (RQ3) and research objective four (RQ4) respectively.

1.10   Significance of the Study

This research contributes significantly to the existing body of knowledge, especially in the Malaysian context. Through this study, the level of tax compliance has been discovered and could give a clear picture of the tax compliance behaviour among Malay civil servants. Besides, a new tax compliance level, this study also emphasises taxpayers' understanding. It is pertinent to assess the taxpayers' understanding (their basic understanding of taxable income, tax relief, and tax rebate) so that the issue of unintentional non-compliance can be avoided. The study also provides an alternative measurement of e-Filing by comparing the FRES/F-KGL with the current individual taxpayers' understanding of e-Filing (comparing existing e-Filing documents and means from the survey).

1.11 Organisation of the Study

The organizations of the study are structured into five chapters. To explain the further insight of this research, the remaining sections of the research are as follows:

Chapter 2 reviews the literature by examining the main theories and identifying the gaps in the literature which frame the conceptual framework of this research. This chapters also offers a review of the previous studies and literature that deduces of this study.

Chapter 3 details the methodology of the research by describing the research process, research design, operationalisation, instrument development, pilot study, and data collection procedures.

The findings of the study are discussed in chapter 4 and includes the profile of the respondents, and results for each research objective.

Chapter 5 presents a summary of the key findings of the thesis, implications of the study, limitations of the research as well as suggestions for future research.

CHAPTER 2

LITERATURE REVIEW

2.1   Introduction

This chapter aims to identify the gaps in the body of knowledge in tax compliance and theoretical framework of the study. Therefore, the theoretical foundation of tax compliance has been discussed in section 2.2, while section 2.3 is the theoretical framework, traditional deterrence approach (section 2.3.1) and the social and fiscal psychological approach (section 2.3.2). A review of empirical studies on tax compliance is presented in section 2.4, while section 2.5 is the conceptual framework of the study. Section 2.6 and 2.7 are the research gap and summary of chapter 2.

2.2   Taxpayers' Compliance: Theoretical Foundations

Explanations of variations in taxpayers' compliance tend to reflect two major theories, which are summarised as the (1) traditional deterrence approach (economic deterrence model) used frequently to measure tax evasion and compliance from a theoretical perspective (Jackson & Milliron, 1986), and (2) social and fiscal psychological approaches which incorporate the wider behavioural approaches (Frey & Feld, 2002). The social and fiscal psychological approaches are discussed by linking them to social influence theory, comparative treatment theory, fiscal exchange theory and political legitimacy theory. Collectively, these theories might be viewed as the most pertinent drivers of inter-individual differences in tax compliance. These theories have their strengths and weaknesses in explaining individual tax compliance decisions.

2.3   Theoretical Framework

There are two approaches used to explain tax compliance among taxpayers namely, (1) traditional deterrence approach, and (2) social and fiscal psychological approaches. These theoretical foundations constitute a lens through which this study evaluates the research problem and research questions. Both theories should be used to explain tax compliance because they cannot stand alone. Therefore, the combination of the economic deterrence model and the social and fiscal psychological model can be more effective in explaining tax compliance among individual taxpayers.

Figure 2.1 shows the theoretical framework of individual compliance based on the selected theories. The traditional deterrence approach which consists of economic deterrence model (Allingham & Sandmo, 1972; Srivivasan, 1973; Yitzhaki, 1974), and the social and fiscal psychological approaches (McKerchar & Evan, 2009; Kirchler, Hoelzl, & Wahl, 2008; Tayler, 2006) which consist of the comparative treatment theory, the social influence theory, the fiscal exchange theory, and the political legitimacy theory. From these theories are generated the independent variables of the study.

The variables generated from the economic deterrence model are tax rates, tax audit, and penalty, meanwhile institutional factors are focused on good governance, government spending, and budget transparency as the combination of the political legitimacy theory, fiscal exchange theory, and comparative treatment theory. The social influence theory represents peers, social media, and personal perception. Tax compliance is the dependent variable and can be measured using three components which are (1) within the stipulated time, (2) accurate report tax liability, and (3)

accordance with the tax code and tax regulations. These measurements are based on
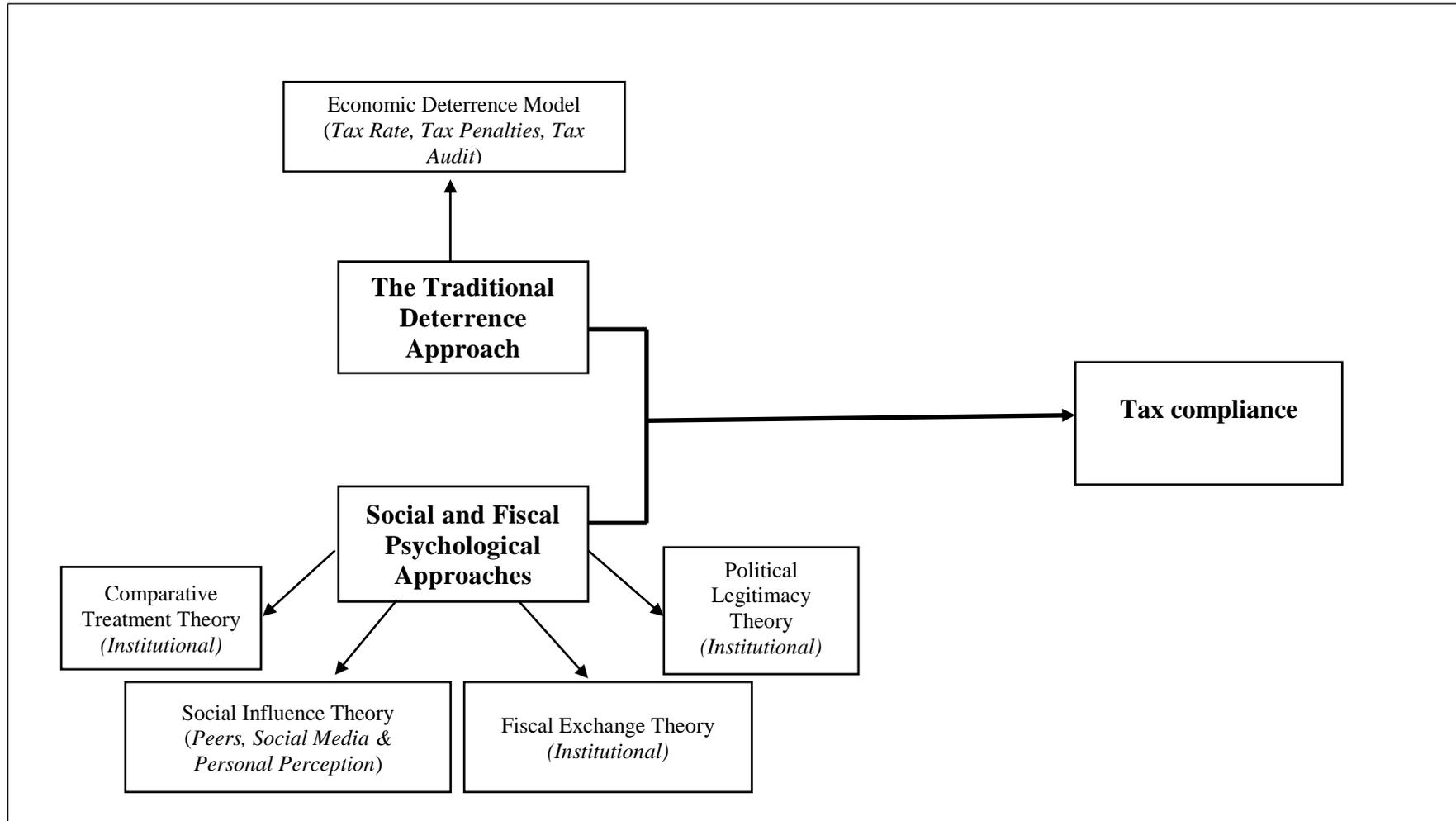
Kasipillai and Abdul-Jabbar (2006) and the IRBM (2015).

Figure 2.1. Theoretical Framework of Individual Taxpayers Compliance

Source: Adapted from Ali et.al. (2014) and Allingham and Sandmo (1972)