

Corporate Tax Administration in Malaysia: Managing and Improving Compliance

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Abstract—These tax administration and compliance incur significant costs respectively to the authority and taxpayers. Administrative costs are more complicated to be theorised due to their discontinuity and parallel directions with tax rates. Compliance costs, on the other hand, have been hypothesised to be positively associated with complexities, reliance on tax agents, SAS and pace of change in tax system. This explains the rise of tax compliance cost as a consequence of complicated tax systems or policy. By analysing the data hand-collected from IRBM's (Inland Revenue Board of Malaysia) annual reports, this study draws inferences about the parallel relationship between administration costs and tax revenue. This study also finds little evidence on tax collection incremental effects of IRBM's visit events. These findings motivate future studies to investigate the institutional determinants of the effectiveness of tax administration. From the authority context, in addition to the existing risk measurements, the IRBM should further assess the potential noncompliance of firms based on firm-specific characteristics and firm corporate governance conduct.

Index Terms—tax administration, tax compliance, corporate tax

I. INTRODUCTION

Tax administration is often perceived as related to tax policy. Previous studies document evidence on practical and technical issues when policy and administration interact to achieve optimality of tax structure and design [1]. Integrating administration and compliance is found as always lead to the authority's favour. Although both incur significant costs respectively to the authority and taxpayers, administrative costs are more complicated to be theorised due to their discontinuity and parallel directions with tax rates [1].

Compliance costs, on the other hand, have been hypothesised to be positively associated with complexities, reliance on tax agents, SAS and pace of change in tax system [2]. This explains the rise of tax compliance cost as a consequence of complicated tax systems or policy. Reference [3], using US data, however, find the compliance cost is to be decreasing along with the incremental fraction of revenue. This implies an adverse relationship between the compliance cost and the firm growth which suggests "the rich bears less". Political

cost hypothesis and political power theory underpin the debates [4], [5]. This issue lies on the effectiveness of a tax system, in particular relating to administrative and compliance costs [6], [7].

TABLE I. RETURN FORMS APPLICABLE TO COMPANIES

Form	Description
Form C	Return form of a company under Section 77A of the Income Tax Act 1967
Form R	Statement of revised 108 Balance under The Saving and Transitional Provisions of Finance Act 2007 (Act 683) and Finance Act 2009 (Act 693). The Form is as prescribed by Section 152 of the Income Tax Act 1967
Form CP204	Form for estimates of tax payables
Form CP204A	Form for revised estimates of tax payables
Form CP204B	Notification for change of accounting period
Form CP207	Remittance document of tax payments
Form CP14	Notice of appeal to the Special Commissioners of Income Tax
Form CP147 and Form CP147(1)	Remittance documents for payment of tax liability increment
Form CP600B	Notification of address update
Form C (RK-T)	Group relief form for claimant company
Form C (RK-S)	Group relief form for surrendering company
Form CP.15C	Application to the Director General of Inland Revenue for relief errors as stipulated by Subsection 131(1) of the Income Tax Act 1967
Form CP.15D	Application of appeal to the Special Commissioners of Income Tax under Section 109H Income Tax Act 1967 (Withholding Tax)
Form CP7	Notice to call for information under Section 81 of the Income Tax Act 1967 (Statement to Strike Off Defunct Company)

Source: <http://www.hasil.gov.my>

Corporate tax in Malaysia is administered by Inland Revenue Board of Malaysia (IRBM). Under SAS, companies are required to submit the return forms within seven months after the accounting year-end. The submission can be made online or through paper submission, without any supporting documents, to the Information Processing Department of the IRBM. For repayment cases, however, dividend vouchers have to be attached to the return form. Prior to completing the return form to determine the tax liability (Form C), companies

are required to submit Form CP204 to determine their tax estimates for a year of assessment, 30 days before the commencement of the basis period for that year of assessment. Tax payment is made in equal monthly instalments from the second month of a basis period of a year of assessment. Late payments will subject to a 10-percent penalty and a further five percent will be charged on the outstanding amount after 60 days from the submission due date. Forms related to companies are as listed in Table I.

II. TAX ADMINISTRATION RELATED CHALLENGES

Challenges faced by the tax administrators are argued as centred on managing and improving compliance. The IRBM, in its effort to minimise evasions, has developed anti-avoidance provisions and it is the focus of the Intelligence Division of the IRBM to gather and collect information relating to unacceptable avoidance or evasion. In fact, a reward is given by the authority in return for accurate and reliable information supplied.

Compliance challenge is a worldwide tax administration issue including in UK [8], Australia [9], Croatia [10] and New Zealand [11]. The issue is argued as crucial to be solved as corporate tax noncompliance affects provision of public goods and there is evidence that a large number of successful evasions causes a significant amount of loss of tax revenue to the government [12]. Administrative cost, as argued by reference [13], can always be portrayed through staff cost of an entity.

In line with the claim, this study uses staff cost as a proxy of administrative cost spent by the authority. The data for this analysis is hand-collected from IRBM’s annual report. To understand the trend of the authority’s spending on administration compared to the revenue from 2000 to 2010, Fig. 1 exhibits the movement of the IRBM’s staff cost and revenue throughout the sample period. The percentages shown beside the high-low lines in between the gaps of the cost and the revenue points indicate the proportion of the staff cost to the authority’s revenue across years.

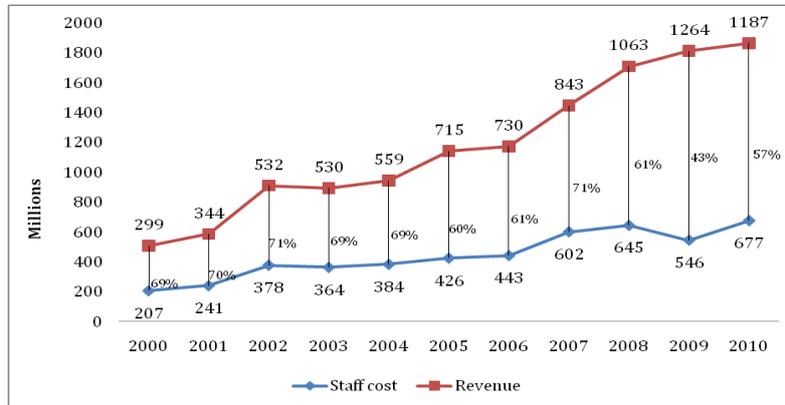


Figure 1. Comparisons between staff cost and IRBM's revenue.

The highest proportion of the staff cost to the revenue (71 percent) is documented in 2003 and 2007 whilst at the other end, 43 percent of the revenue was spent by the IRBM in 2009 for the staff cost. The movement of the administration cost, in general, is parallel with the movement of the revenue. This agrees with matching concept of accounting pillars [14]. The graph also exhibits a negative theoretical relationship between the cost-revenue gap with the proportion of the administration cost to the revenue suggesting the smaller the administration cost incurred, the larger the variations between the spending and the turnover are, which supports the matching concept discussed above.

III. BUSINESS PREMISES VISITED AND PROPORTION OF NONCOMPLIANCE

IRBM, in its effort to manage and improve compliance amongst businesses, has visited business premises by focusing on new business location, risky strategic areas and areas determined based on feedbacks from IRBM’s branches. Although improving compliance is the main

objective of the visits, IRBM also intends to educate and provide advices to the operators.

TABLE II. BUSINESS PREMISES VISITED AND PROPORTION OF NONCOMPLIANCE

Year	Number of visited business premises I	Failure to submit return forms (Proportion to number of visited premises) II	Noncompliance to shedular tax deduction ruling (Proportion to number of visited premises) III
2000	13,811	4.8%	9.7%
2001	18,211	2.0%	10.0%
2002	26,638	1.6%	11.6%
2003	46,501	1.7%	8.0%
2004	60,648	0.9%	4.2%
2005	74,829	0.8%	2.9%
2006	83,207	0.9%	1.9%
2007	51,711	0.4%	1.7%
2008	36,438	0.3%	1.1%
2009	37,845	2.0%	0.4%
2010	26,298	0.3%	0.1%

Table II presents the descriptive statistics of the output of the visit. The data comprises outputs from the IRBM's business survey from 2000 to 2010, available from IRBM's annual reports. Column I, II, III respectively explains number of visited business premises during the year, proportion of failure to submit return forms to the number of visited premises and proportion of noncompliance to shedular tax deduction ruling, to the number of visited premises. The authority has visited the most in 2006 and the least in 2000. Comparing noncompliance in terms of non-submission of return forms and schedular tax deduction ruling, the later form of noncompliance is observed to be higher for the first nine years and the trend is reversed in the later two years.

Analysing the correlation between both noncompliance types indicates a significant positive correlation suggesting similar directions of increment (decrement) of failure in submitting the return forms and noncompliance to schedular tax ruling ($\beta=0.626, p<0.05$), perhaps due to similar entities that incur both noncompliance offences. A common intuition would anticipate a positive correlation between the numbers of visit with the noncompliance.

The analysis, however, indicates insignificant correlations between the numbers of visited premises with each noncompliance type, *i.e.* for non-submission, the $\beta=-0.475$ at $p>0.10$; and for noncompliance to schedular tax ruling, the $\beta=-0.516$ at $p>0.10$. The results also find the mean difference between all correlations is

statistically and significantly different from zero, *i.e.* between both noncompliance types $t=-2.982, p<0.05$, between the numbers of visited premises with non-submission $t=6.350, p<0.01$, and between the numbers of visited premises with noncompliance to schedular tax ruling $t=6.349, p<0.01$. These results confirm the significant difference of the number of visit ($t=6.350, p<0.01$), proportion on non-submission ($t=3.665, p<0.01$) and proportion of noncompliance to schedular tax ruling ($t=3.622, p<0.01$) with zero at the univariate level.

To shed more lights on the significance of administrative costs incurred by the IRBM for improving and increasing compliance of the businesses, Fig. 2 shows the trend of the movement of the staff cost per visited business premise throughout 2000 to 2010. Clearly, the cost per visited premise diverges from the numbers of visit beginning from 2003 to 2007. This could be either due to a decrease in total cost spent by the authority or an increase in numbers of visit during the period. The trend of the two lines is likely to merge towards the last two years suggesting incremental effect of administration cost of the compliance activities carried by the authority. The findings could also be interpreted as to be consistent with the IRBM's serious efforts in increasing compliance and combating tax evasion amongst business operators to ensure future developments of the country [15], [16].

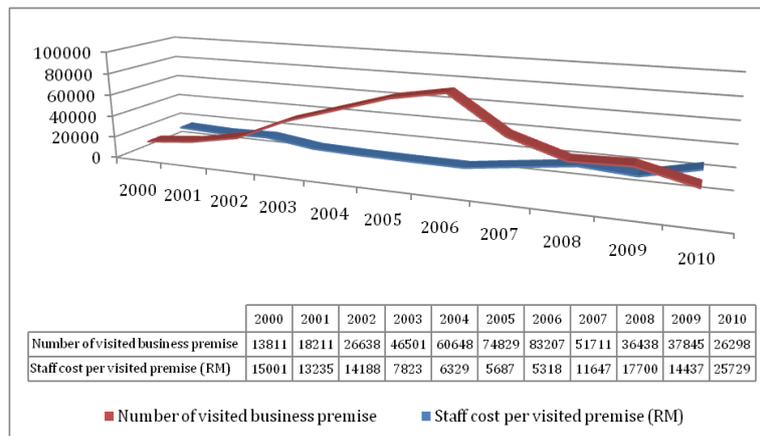


Figure 2. Staff cost per visited business premise.

TABLE III. CORRELATIONS OF THE IRBM'S COMPLIANCE ACTIVITIES

	Number of visited premise	Corporate tax collection	New business registration
Number of visited premise	1.000	0.218	0.964**
Corporate tax collection	0.088	1.000	0.045
New business registration	0.947**	-0.110	1.000

** Indicates significant at 5% level

Table III displays correlations between the numbers of visited premise, corporate tax collection and new business registration subsequent to the visits. The upper diagonal coefficients are related to non-parametric correlation analysis while the lower displays parametric correlation coefficients. Although compliance activities held by the authority are claimed as to be able to warn the corporations on tax compliance, the positive correlation between the numbers of visited premise and corporate tax collection is not statistically significant ($p>0.10$). Similarly, corporate tax collection is also not significantly ($p>0.10$) related to number of new business registration *ex-post* the visit events. As one of the objectives of the visit is to encourage compliance, the number of new

registration is found positively and significantly correlated with the numbers of visit ($p < 0.05$) suggesting the effectiveness of the IRBM's compliance enhancement activity. These findings are consistent between both parametric and non-parametric analyses.

IV. THE WAY FORWARD

Studies in the area of corporate tax compliance find mix results on the relationship between the firm-specific characteristics and level of compliance. Compliance discussed in this text is a generic term as to refer to activities described by researchers as "tax avoidance", "tax evasion", "tax aggressiveness", "tax shelter" and "tax planning". These tax compliance-related expressions are often quantitatively measured using effective rates and book-tax gap.

Positive relationship between size and corporate tax is justified by reference [5] as due to public scrutiny and thus implying political cost borne by the firms. Reference [17], in contrast, argues his finding of negative association between size and tax expense as a result of greater resources used by the larger firm to influence the political cost. In line with reference [17], reference [18], using Malaysian data, find evidence on a negative association between firm size and corporate tax. Other characteristics documented to be related with corporate tax include leverage [18], capital intensity [19] and sector effect [18].

Corporate governance has also raised attention amongst scholars, in particular surrounding the question of whether the corporate governance conduct influences corporate tax decision. Recent publications in corporate tax area find mix directions of the relationships between the extent of corporate tax and firms' corporate governance [20]-[23]. These publications, in line with reference [24], argue noncompliance risks as related to size, industrial membership and other firm characteristics (including governance) that create opportunity for noncompliance within corporate entities. The authority, therefore, in addition to the existing risk measurements, should assess the potential noncompliance of firms based on firm-specific characteristics and firm corporate governance conduct.

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