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Lisa Marriott, John Randal and Kevin Holmes

TAX AGENT REGISTRATION AND REGULATION: A CROSS-TASMAN CONTRAST

Rodney Fisher

**THE TAXATION OF OFF-MARKET TENDER BUYBACKS
AND THE EFFECTS ON SHAREHOLDER BEHAVIOUR**

Keith Kendall and Adam Steen

**CORPORATE TAX AUDIT IN MALAYSIA:
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This Journal is found in:
• Westlaw International
• Brookers Tax Service

CITATION

(2010) Vol 16:4 NZJTLF {page}
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ABOUT THIS JOURNAL

This Journal is published on a quarterly basis and provides scholarly analysis of all aspects of taxation. All articles are subject to blind peer review by expert referees selected from the Editorial Board, Board of Advisors, or specialists in a particular field of study, prior to acceptance for publication. Feature articles vary in length from 10,000 to 20,000 words. This Journal is included on the DEST register of refereed Journals.

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ISSN 1322-4417. Printers: Astra Print.

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Corporate Tax Audit in Malaysia: An Exploratory Study Using Focus Groups

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This article aims to explore the major issues encountered by corporate tax auditors when discharging their duties under a self-assessment system (SAS). Data drawn from focus group interviews conducted in early 2009 involving 60 tax auditors from the Inland Revenue Board Malaysia (IRBM) indicated three key issues of concern, namely, the welfare of tax auditors, tax complexity and tax education. These findings can benefit tax authorities by providing some insights for future policy plans pertaining to tax audits and tax education programmes. In regard to the generalisation made based on these findings, this study has taken several precautions to ensure that the composition of the focus groups was representative of all auditors. The use of focus groups to explore the experience of corporate tax auditors provides a significant and extensive contribution to the current knowledge and literature on corporate taxpayers' compliance behaviour. The article concludes with some suggestions to overcome the central emerging issues.

1.0 INTRODUCTION

A self-assessment system (SAS) requires taxpayers to compute their own tax liabilities and make payments accordingly. Under the SAS, all returns submitted by taxpayers are accepted *prima facie* as correct. The objectives of this system include: improving tax collection, reducing administration costs and increasing voluntary compliance. To ensure the success of the system, tax education and enforcement programmes must be carried out by the tax authorities on an ongoing basis. A tax education programme is necessary in order to create tax awareness and to educate taxpayers about their rights and responsibilities under the SAS, while enforcement activities are required to provide a deterrence measure to ensure that taxpayers comply with the law, which indirectly improves voluntary compliance.

Despite the extensive literature on tax compliance, most studies on tax compliance have been carried out using only taxpayers and/or tax agents as subjects for research. Though tax compliance is an outcome of cooperation between taxpayers, tax agents, and tax authorities, the latter have been examined from a "curiously one-sided perspective".¹ McLure further claims that only a few studies have direct relevance to the ongoing task of tax administration, particularly in developing countries.²

¹ SB Long and JA Swingen, "Review: Taxpayer Compliance: Setting New Agendas for Research", (1991) Vol 25:3 *Law & Society Review* 637, p 669.

² CE McLure Jr, "The Crisis in Tax Administration", (2007) Vol 60:1 *National Tax Journal* 155.

For example, the focus of prior studies is not on tax authorities, but merely on the effects of their policies on taxpayers' compliance behaviour.³ As a result, an understanding of tax compliance behaviour from all parties' perspectives (particularly those of taxpayers, tax agents and tax officers) is very limited. The focus of this study is on tax officers from the Inland Revenue Board Malaysia (IRBM).

Moreover, it is noted that almost all studies centre on individual taxpayers. The reason researchers have devoted their studies to this group may have resulted from the fact that the tax revenue generated from this group of taxpayers represents a major single contribution to government. For example, in the United States,⁴ Australia,⁵ and the United Kingdom,⁶ individual tax contributes 50, 46 and 34 percent of the total tax revenue collection respectively. Fortunately, many tax researchers have acknowledged that prior tax compliance studies on individuals provide a formal framework for analysis of corporate tax compliance decisions.⁷ However, Kamdar argues that further work is necessary before drawing any conclusions on the determinants of corporate tax compliance.⁸ Other non-human factors that are applicable to corporate taxpayers need to be considered, such as business profile, industry, sociological, psychological and economic elements.⁹

This article aims to explore the major issues encountered by corporate tax auditors when discharging their duties under the SAS. Data is drawn from focus group interviews conducted in early 2009 involving 60 tax auditors from the IRBM. Findings from the study can benefit tax authorities by providing some insights for future policy plans pertaining to tax audits and tax education programmes. The article concludes with some suggestions to overcome the central emerging issues. The use of focus groups to explore the experience of corporate tax auditors provides a significant and extensive contribution to the current knowledge and literature on corporate taxpayers' compliance behaviour.

The following section briefly reviews previous studies conducted in the area of tax compliance and tax audits. Sections 3 and 4 provide an overview of taxation in Malaysia and a discussion on the research method employed for the study, respectively. Section 5 discusses the findings from the focus groups study, and section 6 makes some concluding comments.

2.0 LITERATURE REVIEW

2.1 Tax Compliance

There are a number of definitions of tax compliance, but the most commonly adopted in the tax literature is that of Roth et al, who assume that tax compliance takes place when taxpayers file all the

³ See, for example, A Snow and RS Warren, "Tax Evasion under Random Audits with Uncertain Detection", (2005) Vol 88:1 *Economics Letters* 97; S Yong, "A Critical Evaluation of the Economic Deterrence Model on Tax Compliance", (2006) Vol 12:2 *New Zealand Journal of Taxation Law and Policy* 87; JA Dubin, "Criminal Investigation Enforcement Activities and Taxpayer Noncompliance", (2007) Vol 35:4 *Public Finance Review* 500.

⁴ Internal Revenue Service, *Data Book, 2009*, (Washington, DC, 2010), p 3.

⁵ Australian Taxation Office, *Annual Report 2008-09*, (Canberra, 2009), Part 2: Report on Performance, p 14.

⁶ HM Revenue & Customs, *Departmental Report* (London, 2008), Review of the Year, p 8.

⁷ See, for example, J Slemrod, "Measuring Taxpayer Burden and Attitudes for Large Corporations: 1996 and 1992 Survey Results", (Working Paper 97-1, Office of Tax Policy Research, Ross School of Business, University of Michigan, 1997).

⁸ N Kamdar, "Corporate Income Tax Compliance: A Time Series Analysis", (1997) Vol 25:1 *Atlantic Economic Journal* 37, p 39.

⁹ Organisation for Economic Cooperation and Development, *Compliance Risk Management: Managing and Improving Tax Compliance*, (Paris, 2004), Ch 4: Analysing Compliance Behaviour, p 40.

required tax returns at the proper time and the returns accurately report tax liability in accordance with the rules, regulations and Court decisions applicable at the time at which the returns are filed.¹⁰ However, tax compliance may also refer to involuntary and voluntary compliance.¹¹ Hasseldine indicates that involuntary compliance exists when taxpayers pay additional tax detected through audits. He further divides voluntary compliance into specific and general voluntary compliance. Specific voluntary compliance refers to future voluntary compliance arising from a specific audit conducted on a taxpayer, while general voluntary compliance refers to future voluntary compliance arising from the existence of an audit programme. Thus, the definition suggested by Hasseldine is the most appropriate, and has been adopted for the purpose of this study.

The past thirty years have seen an increasing number of tax compliance studies. These studies have been conducted across many disciplines to examine the variables that affect compliance and non-compliance behaviour using various methodological approaches – surveys, laboratory and field experiments, analytical studies and regression models.¹² Jackson and Milliron review and synthesise 43 major tax compliance studies carried out between the 1970s and the mid-1980s.¹³ The authors identify the 14 tax compliance variables that are most commonly analysed in the tax literature,¹⁴ discuss methodological issues and explore theoretical areas that may be beneficial in developing a conceptual framework for future tax compliance studies.¹⁵ Included among their conclusions and recommendations for future research in the tax compliance field is the call for the replication and extension of existing studies, the use of mixed method approaches, and comparative analysis studies between different taxpaying countries.¹⁶

A subsequent study taking a similar approach was conducted by Richardson and Sawyer.¹⁷ The authors review and synthesise tax compliance studies published between 1986 and 1997, and discuss the progress made following suggestions given by Jackson and Milliron.¹⁸ Five additional tax compliance variables are also included in the latter review, namely, compliance costs, tax preparers, framing, positive inducements and amnesties. The authors conclude that despite extensive work carried out since 1985 to examine the variables that affect compliance, no conclusive findings have been derived relative to the earlier review. Such inconclusive findings may be due to the fact that there are

¹⁰ JA Roth, JT Scholz and AD Witte, *Taxpayer Compliance: An Agenda for Research*, (Philadelphia, University of Pennsylvania Press, 1989), p 2.

¹¹ J Hasseldine, "How do Revenue Audits Affect Taxpayer Compliance?", (July-August 1993) *Bulletin for International Fiscal Documentation* 424, p 426.

¹² For example, AD Cuccia, "The Economics of Tax Compliance: What Do We Know and Where Do We Go?", (1994) Vol 13 *Journal of Accounting Literature* 81; MJ Graetz and LL Wilde, "The Economics of Tax Compliance: Fact and Fantasy", (1985) Vol 38:3 *National Tax Journal* 355; E Kirchler, *The Economic Psychology of Tax Behaviour*, (Cambridge, Cambridge University Press, 2009).

¹³ BR Jackson and VC Milliron, "Tax Compliance Research: Findings, Problems and Prospects", (1986) Vol 5 *Journal of Accounting Literature* 125.

¹⁴ The 14 variables are: age, sex, education, income level, income source, occupation, peer influence, ethics, fairness, complexity, IRS contact, probability of detection, sanctions and tax rates.

¹⁵ The theoretical areas explored are the Prospect Theory, the Deterrence Theory, Cognitive Structures and the Agency Theory.

¹⁶ See n 13, p 156.

¹⁷ MA Richardson and AJ Sawyer, "A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects", (2001) Vol 16:2 *Australian Tax Forum* 137.

¹⁸ See n 13.

many different variables that have been tested using various research methods which make finding consistent results difficult. Richardson and Sawyer conclude, among other things, that:¹⁹

- There is an increase in certainty in revenue contact and sanctions;
- There is no increase in certainty found in other variables such as age, gender, education, income level, occupation, fairness, complexity and tax rates; and
- There is no change in certainty in relation to income source, ethics and detection probability.

Therefore, there remains considerable room for future research to provide additional insights into the relationship between the tax variables and compliance behaviour.

Tax complexity is identified as one of the variables that affect tax compliance.²⁰ Long and Swingen identify six dimensions of tax complexity:²¹

- (a) Ambiguity (uncertainties in tax laws that lead to more than one defensible position);
- (b) Computations (difficult computations need to be made);
- (c) Changes (frequent or recent changes in law);
- (d) Detail (numerous rules and exceptions to rules);
- (e) Record-keeping (detailed special records must be kept); and
- (f) Forms (format or instructions for forms are confusing).

Although this study is based on the expert judgments of tax professionals and not those of taxpayers, it provides a reliable and valid measurement for complexity to be undertaken in future studies. A subsequent study conducted by Long and Swingen in 1988 demonstrates that the particular dimension of complexity has an impact on the tax complexity measurement.²² In 2002, McKerchar used a multi-paradigm research method to examine the impact of complexity upon unintentional non-compliance.²³ She concludes that both unintentional and intentional non-compliance could be minimised by reducing tax complexity.²⁴

In Malaysia, Hanefah et al report that the Malaysian business tax system appears to be becoming increasingly more complex, especially with the introduction of the SAS.²⁵ Although the IRBM issues rulings and guidelines to assist taxpayers on the application of the tax laws, Pope and Abdul-Jabbar

¹⁹ MA Richardson and AJ Sawyer, "A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects", (2001) Vol 16:2 *Australian Tax Forum* 137, p 249.

²⁰ See BR Jackson and VC Milliron, "Tax Compliance Research: Findings, Problems and Prospects", (1986) Vol 5 *Journal of Accounting Literature* 125, pp 138-139, and n 19, pp 186-188.

²¹ SB Long and JA Swingen, "An Approach to the Measurement of Tax Law Complexity", (1987) Vol 8:2 *Journal of the American Taxation Association* 22, p 25.

²² SB Long and JA Swingen, "The Role of Legal Complexity in Shaping Taxpayer Compliance", in PJ van Koppen, DJ Hessings and G van den Heuvel (eds), *Lawyers on Psychology and Psychologists on Law*, (Amsterdam, Swets & Zeitlinger, 1988), as stated in MA Richardson and AJ Sawyer, n 19, p 186.

²³ M McKerchar, "The Effects of Complexity on Unintentional Noncompliance for Personal Taxpayers in Australia", (2002) Vol 17:1 *Australian Tax Forum* 3.

²⁴ See n 23, p 22.

²⁵ M Hanefah, M Ariff and J Kasipillai, "Compliance Costs of Small and Medium Enterprises", (2001) Vol 4:1 *Journal of Australian Taxation* 73, p 96.

point out that a growing list of Public Rulings may further increase the tax complexity.²⁶ In addition, Hanefah and Al-Mureshi show that Malaysian small and medium enterprises (SMEs) have difficulties in managing business laws and specifically in maintaining records for business and taxation purposes.²⁷ More recently, Richardson has conducted an Ordinary Least Squares (OLS) regression analysis examining the impact of 10 compliance variables based on data from 45 countries.²⁸ He finds, among other things, that complexity is the most important determinant of tax evasion across countries and tax compliance is low in a country with a complex tax system.²⁹

2.2 Tax Audits

For a system that relies on self-assessment, there is a need for rules (for tax audits, for example) to encourage voluntary compliance. With audits, the amount of income reported by taxpayers is checked by the tax authority, and fines are imposed on taxpayers if they are found to have underpaid their tax.³⁰ Tax audits perform a number of important roles that, if effectively carried out, can make significant contributions to improve the administration of the tax system. The roles include:³¹

- To promote voluntary compliance by taxpayers by reminding them of the risks of non-compliance, and by generating confidence in the broader community that serious abuses of tax laws will be detected and appropriately penalised;
- To identify areas of the law that require clarification and areas that cause confusions to large numbers of taxpayers;
- To identify improvements required for record-keeping and, thus, possibly contribute to improved compliance by taxpayers in the future; and
- To represent the “public face” (tax auditors) of a revenue body through their numerous interactions with taxpayers during the audits.³²

²⁶ J Pope and H Abdul-Jabbar, “Small and Medium-Sized Enterprises and Tax Compliance Burden in Malaysia: Issues and Challenges for Tax Administration”, (2008) Vol 16:1 *The Journal of SEANZ* 47, p 57.

²⁷ See, for example, M Hanefah and A Al-Mureshi, “Accounting in Small and Medium Enterprises”, (January 1991) *Akauntan Nasional*, pp 14-15, and J Kasipillai and R Liew, “The Small and Medium Enterprise under a GST Regime”, (2004) Vol 17:10 *Accountants Today* 10.

²⁸ G Richardson, “Determinants of Tax Evasion: A Cross-Country Investigation”, (2006) Vol 15:2 *Journal of International Accounting, Auditing and Taxation* 150.

²⁹ See n 28, p 160.

³⁰ J Alm and M McKee, “Tax Compliance as a Coordination Game”, (2004) Vol 54:3 *Journal of Economic Behavior and Organization* 297.

³¹ Organisation for Economic Cooperation and Development, *Strengthening Tax Audit Capabilities: General Principles and Approaches*, (Paris, 2006), Ch 1: The Roles of the Taxpayer Audit Program, pp 8-9.

³² Organisation for Economic Cooperation and Development, *Strengthening Tax Audit Capabilities: Auditor Workforce Management – Survey Findings and Observations*, (Paris, 2006), Summary, p 5.

A number of empirical studies have been conducted on the impact of audit rates,³³ penalties,³⁴ the probability of being audited³⁵ and the audit selection process.³⁶ Generally, these studies suggest that tax audits, to a certain extent, have significant effects on tax compliance. Moreover, Kamdar argues that audit rates have a positive and significant effect on compliance.³⁷ Alm concludes that the findings of the above studies are consistent with a significant, though diminishing, deterrent effect of higher audit and penalties rates.³⁸ Zimring and Hawkins distinguish between absolute deterrence and marginal deterrence, while Bentham differentiates between specific deterrence (discourages offender from repeating his offence) and general deterrence (dissuades potential offender from committing an offence).³⁹ There is also some evidence of a “spill over effect” from audits,⁴⁰ which refers to improved voluntary compliance among taxpayers surrounding an area of particular taxpayers who have been audited by the tax authority.

In summary, the literature provides factors that may affect compliance and these include tax complexity. Moreover, the economic deterrent models of tax compliance highlight the influence of tax audits on an individual’s compliance behaviour. As tax audits are necessary for a tax system that relies on self-assessment, many tax authorities employ tax audits as a major tool to increase tax compliance. However, the majority of the existing studies are conducted on individual taxpayers. Further research is needed to examine the significance of tax audits on corporate taxpayers.⁴¹

3.0 TAXATION IN MALAYSIA

3.1 Tax Revenue

In Malaysia, the collection of tax revenue is entrusted to two main government agencies: the Royal Malaysian Customs (RMC) and the IRBM. While the RMC is responsible for administering the country’s indirect tax⁴² policy, the IRBM is required to manage all types of direct taxes.⁴³ For 2002 to

³³ JA Dubin, MJ Graetz and LL Wilde, “The Effect of Audit Rates on the Federal Individual Income Tax, 1977-1986”, (1990) Vol 43:4 *National Tax Journal* 395; A Snow and RS Warren, “Ambiguity about Audit Probability, Tax Compliance, and Taxpayer Welfare”, (2005) Vol 43:4 *Economic Inquiry* 865.

³⁴ K Devos, “Penalties and Sanctions for Taxation Offences in Selected Anglo-Saxon Countries: Implications for Taxpayer Compliance and Tax Policy”, (2004) Vol 14 *Revenue Law Journal* 32.

³⁵ See, for example, CM Fischer, M Wartick and MM Mark, “Detection Probability and Taxpayer Compliance: A Review of the Literature”, (1992) Vol 11 *Journal of Accounting Literature* 1.

³⁶ J Alm, R Bahl and MN Murray, “Audit Selection and Income Tax Underreporting in the Tax Compliance Game”, (1993) Vol 42 *Journal of Development Economics* 1; J Alm, C Blackwell and M McKee, “Audit Selection and Firm Compliance with a Broad-Based Sales Tax”, (2004) Vol 57:2 *National Tax Journal* 209; J Alm, MB Cronshaw and M McKee, “Tax Compliance with Endogenous Audit Selection Rules”, (1993) Vol 46:1 *Kyklos* 27; J Hasseldine and A Hansford, “The Compliance Burden of VAT: Further Evidence from the U.K.”, (2002) Vol 17:4 *Australian Tax Forum* 369.

³⁷ N Kamdar, “Corporate Income Tax Compliance: A Time Series Analysis”, (1997) Vol 25:1 *Atlantic Economic Journal* 37, p 46.

³⁸ J Alm, “Administrative Options to Close the Tax Gap”, (2007) Vol 117:5 *Tax Notes* 495.

³⁹ FE Zimring and GJ Hawkins, *Deterrence: The Legal Threat in Crime Control*, (Chicago, University of Chicago Press, 1973); and J Bentham, *Principles of Penal Law* (Edinburgh, W Tait, 1843).

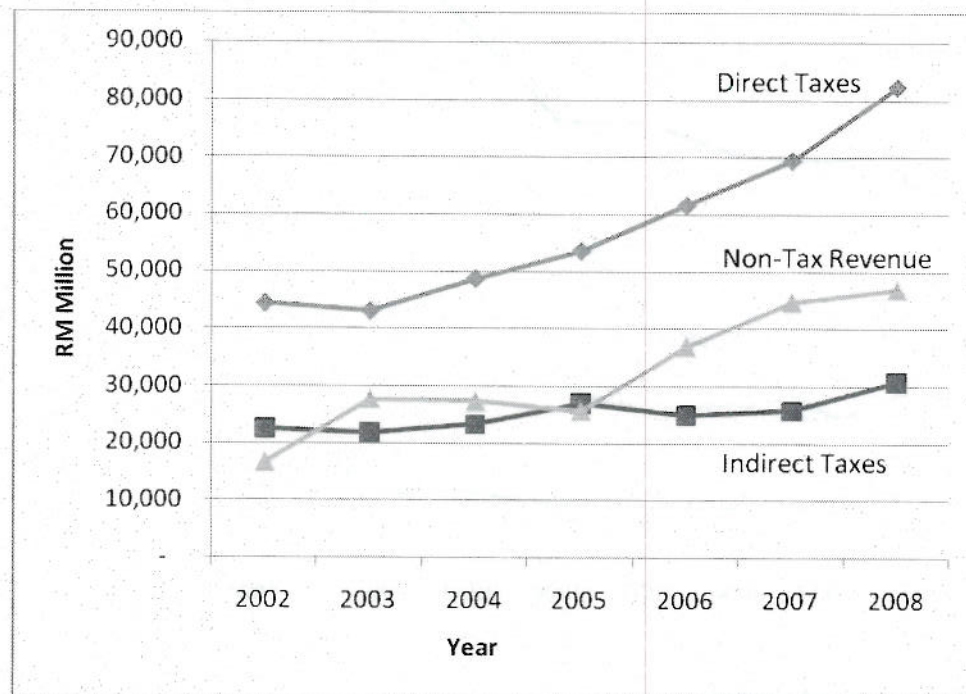
⁴⁰ JA Dubin and LL Wilde, “An Empirical Analysis of Federal Income Tax Auditing and Compliance”, (1988) Vol 41:1 *National Tax Journal* 61.

⁴¹ C Lavermicocca, “Impact of the Corporate Structure on an Understanding of Taxpayer Compliance Behaviour”, in M Walpole and C Evans (eds), *Tax Administration: Safe Harbours and New Horizons*, (Birmingham, Fiscal Publications, 2008), 211.

⁴² Indirect taxes include service tax, excise duty, sales tax and customs duties.

2008, tax revenue represents 68 to 80 percent of the total revenue, with the balance generated from non-tax revenue.⁴⁴ For instance, 20 percent and 50 percent of total revenue collected in 2008 were derived from indirect and direct taxes respectively.⁴⁵ Federal Government revenue for the years 2002 to 2008 is shown in Figure 1.

Figure 1: Federal Government Revenue⁴⁶



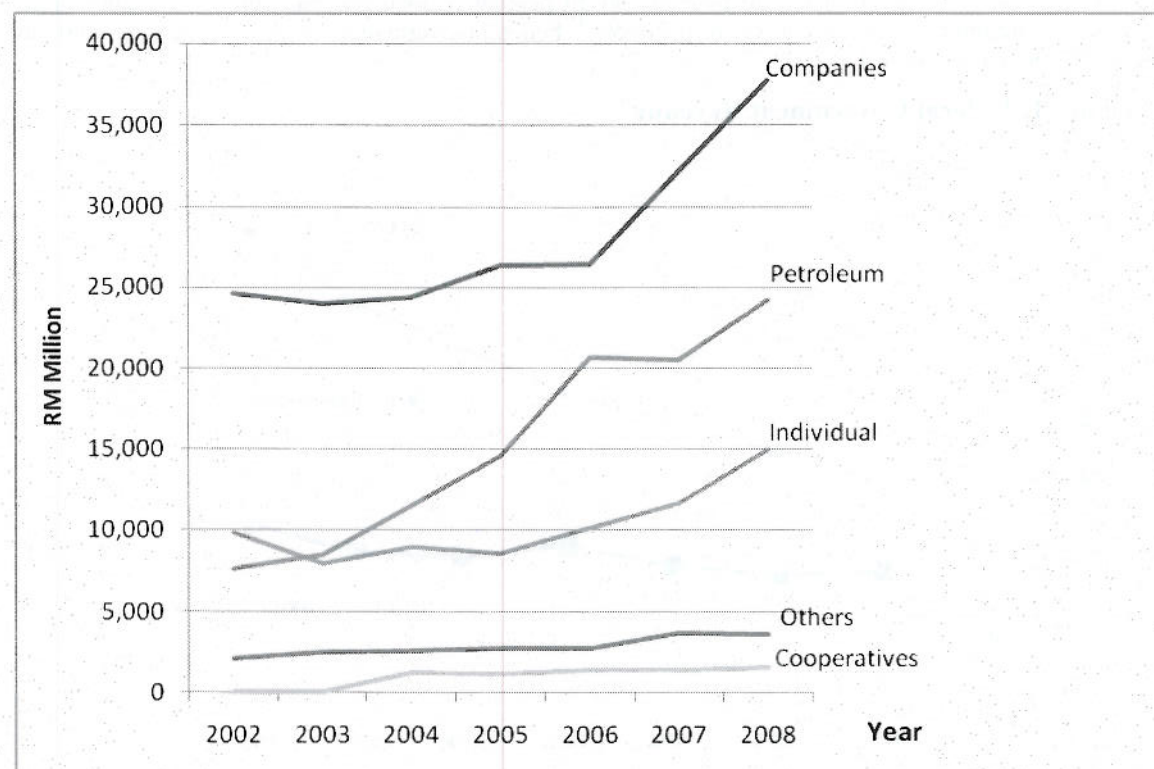
Direct tax continues to be the highest component of revenue. Indeed, corporate income tax represents the highest portion of direct taxes collected by the IRBM annually. It contributes an average of 47 percent of the total IRBM collection throughout the seven-year period. Petroleum income tax continues to be the second largest contribution to the IRBM collection (28 percent), followed by individual/personal income taxes (19 percent). The remaining six percent is generated from cooperative and other taxes. In short, corporate tax continues to contribute the highest percentage of income, either measured as a percentage of income tax, direct tax or federal government revenue. Regrettably, in spite of representing the greatest contributor of income tax revenue, the corporate sector in Malaysia has largely been neglected by prior tax compliance research. A detailed summary of the IRBM's collection for the years 2002 to 2008 is presented in Figure 2.

⁴³ Direct taxes include income tax, real property gains tax (RPGT), stamp duty and petroleum income tax.

⁴⁴ Non-tax revenue includes government commercial undertakings, interests and returns on investments, licences, services fees, road tax, fines and forfeitures, rental revenue from Federal Territories, contribution from foreign governments and international agencies, and petroleum royalties/gas cash payments.

⁴⁵ Treasury Malaysia, *Economic Report 2009/2010*, (Putrajaya, 2009).

⁴⁶ Data taken from the *Economic Reports* of Treasury Malaysia for 2002/2003 to 2009/2010.

Figure 2: The IRBM's Revenue Collection⁴⁷

3.2 The Self-Assessment System

Malaysia commenced to move over to the SAS in 2001, starting with corporations and followed by other types of taxpayers in stages, and this move was completed in 2005. Choong explained that, under the SAS regime, corporate taxpayers have the legal burden of estimating their own income tax payable for the current year of assessment, informing the tax authorities of the estimate, paying the tax via monthly deductions and submitting a tax return within the specified time period (that is, within six months after the end of their financial accounts).⁴⁸ As the SAS relies on high levels of voluntary compliance, it is essential that effective tax education programmes and enforcement activities are in place.

Several tax educational programmes are conducted by the IRBM to encourage voluntary tax compliance and to inform taxpayers of their rights and responsibilities under the SAS. These programmes include SAS briefings, workshops and talks held at the IRBM branches or at taxpayers' premises. The programme modules are specially designed according to the taxpayers' category to ensure that appropriate information is communicated. Interview sessions on the topic of taxation are

⁴⁷ Data taken from the *Economic Reports of Treasury Malaysia* for 2002/2003 to 2009/2010.

⁴⁸ KF Choong, "Tax Audit and Tax Investigations", (2003) Vol 16:10 *Accountants Today* 32.

aired on radio and television from time to time. These activities are used to disseminate current information to taxpayers as well as to other viewers and listeners.⁴⁹

Enforcement activities are also carried out concurrently as deterrence measures, which include conducting street surveys,⁵⁰ Scheduler Tax Deduction (STD) audits,⁵¹ compliance audits and investigations. The objectives of these activities are to increase the compliance rate and to provide a deterrence measure to ensure that taxpayers comply with the law, which indirectly improves voluntary compliance. Tax audits have become the main function of the IRBM under the SAS.⁵² Tax audits have been carried out by the IRBM on both individuals and corporate taxpayers, even before the SAS was fully implemented in 2005. However, the number of tax audits has increased significantly since the SAS was introduced in 2001. For example, there were only 568 corporate tax audits in 2001, but the number has increased gradually from year to year. By 2006, corporate tax audits had increased by more than 300 percent to 2,427 cases.⁵³ Similarly, tax audits on individual taxpayers increased steadily, reaching a peak in 2005. There are several possible explanations for the trend, which include 2005 being the year in which the SAS was fully implemented for all types of taxpayers, and thus the IRBM needed to portray a picture of deterrence among taxpayers that, under the SAS, any taxpayer who abuses the tax laws will be detected and appropriately penalised. Another possible explanation is that the trend may indicate that the IRBM recognises the importance of a tax audit programme under the SAS. In addition, as individual assessments of taxpayers' returns by the IRBM are no longer applicable under the SAS, substantial tax office staff are now focused on enforcement activities such as tax audits that are designed to improve compliance and catch tax offenders. Tax audits conducted by the IRBM for the years 2001 to 2006 are shown in Figure 3.

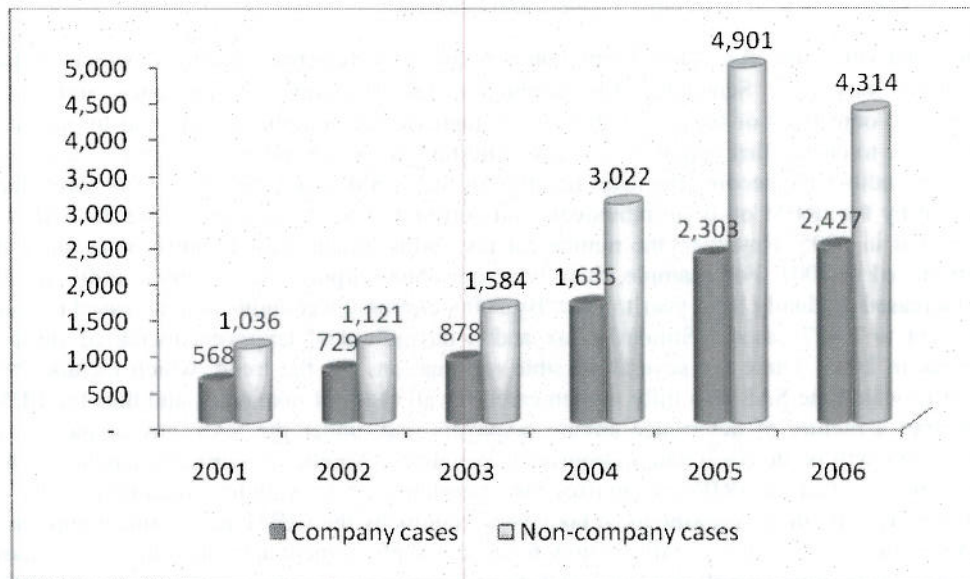
⁴⁹ Lembaga Hasil Dalam Negeri Malaysia (Inland Revenue Board Malaysia), *Laporan Tahunan 2006 (Annual Report 2006)*, (Kuala Lumpur, 2006), Ch 3: Prestasi LHDNM, pp 46-48.

⁵⁰ The Street Survey Operation (SSO) is carried out through visits by IRBM officers to the business premises of taxpayers at certain areas, namely, those in new businesses, high-risk strategic areas, and areas identified through feedback from the economic zone mapping at every IRBM branch.

⁵¹ STD audits are aimed at ensuring that every employer makes and remits tax deductions from their employees' monthly pay according to the Income Tax (Deduction from Remuneration) Rules, 1994 (Malaysia). The STD audits are carried out by examining employees' salary records at the employers' premises. In 2006, 26 percent of employers visited were found to have failed to comply with the applicable regulations.

⁵² See n 49, Ch 3: Prestasi LHDNM, p 50.

⁵³ Inland Revenue Board Malaysia, *Annual Report 2004*, (Kuala Lumpur, 2004); Inland Revenue Board Malaysia, *Annual Report 2005*, (Kuala Lumpur, 2005); Inland Revenue Board Malaysia, *Annual Report 2006*, (Kuala Lumpur, 2006).

Figure 3: Tax Audit Activities by the IRBM from 2001 to 2006⁵⁴

The IRBM issues the Tax Audit Framework, which outlines the rights and responsibilities of tax auditors, taxpayers and tax agents in respect of an audit.⁵⁵ The Framework aims to assist tax auditors to carry out their duties efficiently and effectively and to guide taxpayers in fulfilling their obligations. In early 2009, the IRBM published a revised version of the Framework.⁵⁶ The Framework also suggests that a tax audit case should be settled within a period of three months from the commencement of the audit.⁵⁷

The National Audit Office (NAO) conducted an audit on the Corporate Tax Audit Department of the IRBM in 2005. The NAO report indicates that, out of 687 corporate cases audited by them, 585 cases had been resolved and 102 were still under review.⁵⁸ However, only 42 percent of the completed cases were resolved within a time frame of three months. The remaining 58 percent was settled between four months to six years. The report indicates that the possible reasons for the failure to settle those cases in time was because of taxpayers not giving cooperation or delaying the provision of requested information, complicated cases, inexperienced tax auditor and the high burden of workload handled by each auditor, among others.

The IRBM aims to audit 20 percent of all active registered taxpayers annually⁵⁹ on the theoretical basis of undertaking an audit on all active registered taxpayers every five years. However, the IRBM

⁵⁴ Data taken from the *Annual Reports* of the IRBM for 2004 to 2006..

⁵⁵ Inland Revenue Board Malaysia, *Rangka Kerja Audit Cukai (Tax Audit Framework)*, (Kuala Lumpur, 2007).

⁵⁶ Inland Revenue Board Malaysia, *Tax Audit Framework*, (Kuala Lumpur, 2009).

⁵⁷ See n 56, p 9.

⁵⁸ Treasury Malaysia, *National Audit Report 2006*, (Putrajaya, 2006), pp 81-82.

⁵⁹ Detail obtained from a personal communication between the first researcher of the present article with an IRBM officer in November 2008. This audit rate target is very ambitious and its rationale and justification questionable.

generally conducts less than one percent in a year. To illustrate this scenario, in 2005, there were about 275,000 companies registered with the IRBM (based on issuances of income tax returns forms). Of these, the IRBM conducted only 2,300 audits, or 0.84 percent. One possible explanation for the variance might be a shortage of staff. The NAO report showed that the ratio of corporate tax cases resolved in 2005 to each corporate tax auditor is between five and ten cases.⁶⁰ To meet the 20 percent target set by the IRBM, at the current level of audit resources, each tax auditor has to handle between eight and 18 corporate tax cases annually. This is seen as too much of a burden for each auditor to execute. Therefore, the NAO report has suggested that the IRBM recruit additional tax auditors to handle the audit workload.⁶¹

In summary, tax education and tax audit programmes are significant tools under the SAS. Tax education programmes conducted by the IRBM are utilised as a platform upon which to inform taxpayers of their rights and responsibilities under the SAS, which then may improve their compliance level. Tax audit programmes may improve voluntary compliance as a result of specific audits conducted on taxpayers, or merely due to their existence by deterring taxpayers from evading tax. As tax auditors interact directly with taxpayers during the conduct of an audit, their perspective is another area that may need to be explored to better understand taxpayers' compliance behaviour.

4.0 RESEARCH DESIGN

4.1 Background

In carrying out their audit activities, tax auditors face a range of challenges and take up the best available opportunities to handle these challenges while, at the same time, undertaking their jobs effectively. To explore the issues faced by the tax auditors while performing their duties, a qualitative methodology in the form of focus groups was adopted. Focus group interviews are in-depth, interactive, and yield qualitative data.⁶² Focus groups possess elements of participants' observations and individual interviews, and are primarily a means of listening to people's views on a specific area of inquiry in a non-threatening setting.⁶³ Krueger defines a focus group as a "carefully planned discussion designed to obtain perceptions in a defined area of interest in a permissive, non-threatening environment".⁶⁴

The origins of focus groups are generally ascribed to opinion-gathering in market or political research. The focus groups method was considered for this study based on a number of broad advantages, including being an economical way of tapping the views of a group of people at one time, rather than one by one.⁶⁵ Moreover, a sense of group membership and cohesiveness supports and empowers the 'dynamics' of attitudes and opinions in the context of the interaction that occurs between participants as well as encourages a greater degree of spontaneity in the expression of views.⁶⁶

⁶⁰ See n 58, pp 74-75.

⁶¹ See n 58, p 76.

⁶² JM O'Donnell, "Focus Groups: A Habit-Forming Evaluation Technique", (1988) Vol 42:7 *Training and Development Journal* 71.

⁶³ DL Morgan, RA Krueger and JA King, *Focus Group Kit*, (Thousand Oaks, Sage Publications, 1998).

⁶⁴ RA Krueger, *Focus Groups: A Practical Guide for Applied Research*, (Newbury Park, Sage Publications, 1988), p 18.

⁶⁵ J Sim, "Collecting and Analysing Qualitative Data: Issues Raised by the Focus Group", (1998) Vol 28 *Journal of Advanced Nursing* 345, p 346.

⁶⁶ See RA Krueger, *Focus Groups: A Practical Guide for Applied Research*, (Newbury Park, Sage Publications, 1988); DL Morgan, RA Krueger and JA King, *Focus Group Kit*, (Thousand Oaks, Sage Publications, 1998); J Seymour, G Bellamy, M

However, as focus groups are qualitative inquiry, findings cannot be projected to the larger population (as can be done from a survey). Nevertheless, Fern has stressed that focus groups are a well-established methodology because they have long been employed in anthropology, ethnography and qualitative social science.⁶⁷

Most focus groups consist of between 6 to 12 people. Merton et al suggest that “the size of the group should manifestly be governed by two considerations “... it should not be so large as to be unwieldy or to preclude adequate participation by most members nor should it be so small that it fails to provide substantially greater coverage than that of an interview with one individual”.⁶⁸ Morgan further argued that the number of groups depends on the different subgroups required. If there are several distinct population segments, then the researcher may want or need to run separate groups in each segment.⁶⁹

4.2 The Participants

Meetings with the Director of the Compliance Department of the IRBM resulted in four focus group sessions being conducted in early 2009 at state branches in Negeri Sembilan, Johor, Penang and Pahang. These state branches represented a mix of small (Negeri Sembilan), medium (Pahang) and large branches (Johor and Penang). Another four sessions were held at the Corporate Tax Branch in the Kuala Lumpur head office based on specific groups, namely Large Company, Specialised Industry, Small and Medium Enterprises (SMEs) and Desk Audit. In total, eight focus group sessions were held with tax auditors from the IRBM. An average of eight persons participated in each group. In total, 60 tax auditors participated in this study, comprising 45 from field audit and 15 from desk audits. Two-thirds of the participants were female. Each focus group session was conducted for three hours. Further information is presented in Table 1.

Gott, H Ahmedzai Sam and D Clark, “Using Focus Groups to Explore Older People’s Attitudes to End of Life Care”, (2002) Vol 22 *Ageing and Society* 517; and n 65.

⁶⁷ EF Fern, *Advanced Focus Group Research*, (Thousand Oaks, Sage Publications, 2001).

⁶⁸ RK Merton, M Fiske and PL Kendall, *The Focused Interview: A Manual of Problems and Procedures*, (New York, The Free Press, 1990, 2nd ed), p 137.

⁶⁹ DL Morgan, RA Krueger and JA King, n 66.

Table 1: Key Profiles of Focus Groups Composition

Focus Group Session	Number of Participants	Field Audit	Desk Audit	Gender
Seremban (in the State of Negeri Sembilan)	5	2	3	2 males, 3 females
Johor Bahru (in the State of Johor)	10	10	0	5 males, 5 females
Penang	8	8	0	6 males, 2 females
Kuantan (in the State of Pahang)	8	4	4	4 males, 4 females
Kuala Lumpur (Large Corporation)	6	6	0	6 females
Kuala Lumpur (Specialised Industries)	8	8	0	1 male, 7 females
Kuala Lumpur (SMEs)	7	7	0	2 males, 5 females
Kuala Lumpur (Desk Audit)	8	0	8	8 females
Total	60	45	15	20 males, 40 females

The distribution of participants' ages indicates that 15 percent are below 30 years, 38 percent are between 30 to 40 years, and 47 percent are older than 41 years old. However, only 30 percent of the participants have more than six years audit experience in the IRBM, and the remainder have less than six years audit experience. Most of the tax auditors with less than six years experience have a degree in accounting and represent staff that are newly employed by the IRBM to meet the need for additional audit resources.

All sessions followed a semi-structured interview format and similar issues were discussed at each focus group. There were two major themes:

- (a) Experiences in conducting tax audits; and
- (b) Tax auditors' perception of the attitudes of taxpayers and tax agents.

The first author of this article served as the moderator for all focus group sessions; the moderator is responsible for building rapport within the group.⁷⁰ The moderator commenced the focus group session by introducing herself, and providing a brief explanation of the research and how the results will be used. This acted as a guide to how the focus group would proceed. The participants were then invited to likewise introduce themselves, indicating their names and positions, and working experience prior to joining the IRBM and the tax audit department.

Notes were taken at all sessions by a research assistant, and all sessions were tape-recorded as a means of verifying and augmenting the notes, as well as enabling the moderator to engage with the

⁷⁰ JM O'Donnell, "Focus Groups: A Habit-Forming Evaluation Technique", (1988) Vol 42:7 *Training and Development Journal* 71, p 72.

group discussion. In addition, transcriptions of all the recorded sessions were carried out at the end of the sessions. After each session, the moderator summarised the major points of discussion and briefly explained the steps to be undertaken by the researcher with the data collected from the focus group sessions.

A study by Manning points out that the most crucial technique for establishing the ‘credibility’ of qualitative research data is through ‘member checks’, in which those who participate in research are invited to comment on the interpretation made by the researcher.⁷¹ To do this effectively, the researcher conducted three separate short meetings with representatives from all focus group interviews conducted in Kuala Lumpur to discuss the validity and implications of the analyses with the participants. During the meetings, the researcher provided summaries and findings from the focus groups discussions. The summaries and findings were welcomed by the representatives and also generated much interest and further discussion. They were judged to be good summaries of the discussion, and enabled the participants to compare the views of their respective group with those of other groups. This exercise also improved the validity of the focus groups and gave the participants opportunities to raise several issues about which they provided more information and clarification, and this generated valuable ideas for the researcher.

5.0 FINDINGS AND DISCUSSION

5.1 Welfare of Tax Auditors

Many tax auditors raised the issue of their working welfare that it is not being considered accordingly by the IRBM in terms of their safety, travelling expenses, workload and security of their property. Most tax auditors (among which many are female)⁷² are concerned about their safety. Due to the nature of their jobs, tax auditors are regarded as enemies by taxpayers as they are perceived to be more interested to find fault and to penalise the company for wrong-doings, than to help the company to do the right things. Moreover, tax auditors are required to examine taxpayers’ business records at the taxpayers’ premises. Some of these premises are located in business areas, while others are remotely located in industrial/rural areas. As a result, tax auditors take risks and face dangers such as car hijacking, car break-ins and theft when conducting the audits, especially in industrial/rural areas.

In addition, travelling expenses incurred by tax auditors are not fully reimbursed by the IRBM. Often, tax auditors have to travel to taxpayers’ premises using their own vehicles. Frequent usage of the vehicles during their working hours resulted in speedier wear and tear relative to normal personal usage. In extreme cases, some of the auditors’ vehicles are vandalised at the taxpayers’ premises. Although the tax auditors can claim reimbursement for travelling expenses, such as fuel, tolls, and parking charges, wear and tear of the vehicles is not covered by the IRBM. Thus, tax auditors have to bear the cost of repair and maintenance of these vehicles themselves.

Finally, a shortage of staff has resulted in an excessive workload for some tax auditors. To illustrate, as the IRBM has put a target on the number of cases to be audited annually,⁷³ tax auditors are generally required to carry out a minimum number of 40 audit cases yearly. In many instances, although tax auditors handle several audit cases, some of the cases are not resolved. Even if the cases are resolved,

⁷¹ K Manning, “Authenticity in Constructivist Inquiry: Methodological Considerations without Prescription”, (1997) Vol 3:1 *Qualitative Inquiry* 93, p 102.

⁷² This is supported by the profiles of the focus groups participants, which indicate that two-thirds of them are female. Refer to Table 1.

⁷³ See n 59.

the quality of the audit is compromised as tax auditors are working under pressure. Due to excessive workload, tax auditors have to work extra hours and during the weekends to meet the deadlines.⁷⁴ For example, many tax auditors in the city have to spend additional hours in their office after working hours and/or to come to their office during the weekends to enable them to work on their audit cases. As all tax auditors are professional workers, no additional pay is given for their extra working hours (overtime) spent in their office.

To the best of the current researchers' knowledge, the working welfare of tax auditors has never been dealt with in any study. As tax audits are essential under the SAS, the welfare of tax auditors should also be considered accordingly. The researchers propose that the IRBM investigate this matter urgently. This proposal includes providing the necessary insurance policy coverage for the safety of tax auditors while performing their fieldwork. In addition, tax auditors should also be provided with official IRBM vehicles to safely transport them to taxpayers' premises.

In terms of staff workload, the problem has been identified in the NAO report in 2006.⁷⁵ Although the report suggested that the IRBM recruit additional staff to reduce the burden of the heavy workload borne by tax auditors,⁷⁶ the shortage of tax auditors in the IRBM still prevails to date. It is important for the IRBM to consider this matter and to provide information to the relevant authority, such as the Public Service Department, in order to enable the IRBM to recruit additional staff to carry out its audit activities. For the SAS to succeed, tax audit activity has to be carried out effectively, and this can only be achieved with sufficient and competent staff.

5.2 Tax Complexity

Tax auditors identify tax complexity as a major problem faced by many corporate taxpayers, particularly in terms of tax computations, tax ambiguity and record-keeping. First, it is surprising to note that many corporate taxpayers have difficulty in preparing tax computations. Generally, the financial accounts of corporate taxpayers comply with the accounting standards, but not with the tax laws. For instance, the financial accounts of insurance providers are highly regulated by Bank Negara (Central Bank of Malaysia) and comply with the Bank Negara, internal, and external auditors' requirements. However, when the accounts are audited by tax auditors, many are found to be not compliant with the tax laws. A possible reason for this tax law non-compliance is that taxpayers find tax computation difficult to prepare as it requires a comprehensive understanding of the rules and exceptions to the rules. As a result, tax computations seem to be very difficult and consequently discourage them to acquire the relevant tax knowledge.

Second, ambiguity of tax laws resulted in unintentional and/or intentional non-compliance.⁷⁷ Different interpretations of the tax law are an issue commonly raised by tax auditors, especially those from the financial and contractor/developer sub-group. The IRBM issued special provisions and/or general guidelines in May and July 2009 for the two groups respectively.⁷⁸ Even though these guidelines are helpful in guiding the principles with clear and detailed explanations, there is no specific regulation to be followed by the respective groups of taxpayers. As a result, this invites diverse

⁷⁴ See Inland Revenue Board Malaysia, *Tax Audit Framework*, (Kuala Lumpur, 2009), p 9.

⁷⁵ See Treasury Malaysia, *National Audit Report 2006*, (Putrajaya, 2006), pp 81-82.

⁷⁶ See n 75.

⁷⁷ See M McKerchar, "The Effects of Complexity on Unintentional Noncompliance for Personal Taxpayers in Australia", (2002) Vol 17:1 *Australian Tax Forum* 3.

⁷⁸ See the list of public rulings at <<http://www.hasil.gov.my/goindex.php?kump=5&skum=5&posi=3&unit=1&sequ=1>>.

interpretations of the terms, which lead to unintentional and/or intentional non-compliance among taxpayers. Generally, most corporate taxpayers (especially the small and medium-sized companies) are highly reliant on tax agents for their tax compliance activities.⁷⁹

Third, tax auditors raise the problem of record-keeping among the majority of corporate taxpayers. A large proportion of small and medium-sized taxpayers (such as contractors, developers, sundry shops and restaurants) in Malaysia are cash traders. Often, cash receipts or invoices are not issued on most business transactions. There are also a few cases of missing documents and various excuses are given by taxpayers: the documents were destroyed in a fire, lost in a flood, eaten by termites, and lost/misplaced during an office relocation. In other circumstances, many of the taxpayers do not use a computerised accounting system and/or do not maintain proper accounting records that are needed for audit examination. In some cases, though accounting records are properly kept, preparation of the accounts is not standardised across the industries. Each company has its unique way of recording its business transactions. Tax auditors have to spend time to learn and comprehend the accounting treatments for every transaction before an analysis of accounts can be performed.

This study indicates that tax complexity, in particular, the tax computation, ambiguity and record-keeping dimensions, are still relevant in Malaysia and may be the root of non-compliance among corporate taxpayers in Malaysia. These findings support previous compliance studies that link complexity and compliance.⁸⁰ Previous studies suggest that reducing the burden to comply with the tax laws may encourage taxpayers to comply and may reduce their compliance costs. Therefore, corporate tax compliance may be improved if the IRBM could formulate clearer tax laws that reduce tax ambiguity and simplify the preparation of tax computations and recordkeeping. For example, the IRBM may consider using a pre-filled form for tax submission and providing a minimal standardisation requirement for record-keeping to all corporate taxpayers.

5.3 Tax Education

The findings from the focus group sessions show that the current measures taken by the IRBM to educate taxpayers on the SAS may not be effective. Although tax learning and publicity programmes are widely implemented by the IRBM,⁸¹ corporate taxpayers generally seem unable to acknowledge their rights and responsibilities under the SAS and the objectives of tax audits. In addition, many taxpayers perceive tax auditors as only interested to find fault in their accounts during the visit. This finding lends support to a study conducted by Choong and Ling that reported that more than 50 percent of their respondents seem to have a misconception that tax audits are aimed at detecting tax liability,

⁷⁹ K Isa and J Pope, "Corporate Taxpayers' Compliance Variables: Findings from a Study of Focus Groups in Malaysia", in B Tran-Nam, K Bain and K Datt (eds), *International Tax Administration: Building Bridges*, (Sydney, CCH, 2010).

⁸⁰ See SB Long and JA Swingen, "An Approach to the Measurement of Tax Law Complexity", (1987) Vol 8:2 *Journal of the American Taxation Association* 22; SB Long and JA Swingen, "The Role of Legal Complexity in Shaping Taxpayer Compliance", in PJ van Koppen, DJ Hessings and G van den Heuvel (eds), *Lawyers on Psychology and Psychologists on Law*, (Amsterdam, Swets & Zeitlinger, 1988); M McKerchar, "The Effects of Complexity on Unintentional Noncompliance for Personal Taxpayers in Australia", (2002) Vol 17:1 *Australian Tax Forum* 3; M Hanefah, M Ariff and J Kasipillai, "Compliance Costs of Small and Medium Enterprises", (2001) Vol 4:1 *Journal of Australian Taxation* 73; J Pope and H Abdul-Jabbar, "Small and Medium-Sized Enterprises and Tax Compliance Burden in Malaysia: Issues and Challenges for Tax Administration", (2008) Vol 16:1 *The Journal of SEANZ* 47; M Hanefah and A Al-Mureshi, "Accounting in Small and Medium Enterprises", (January 1991) *Akauntan Nasional*, pp 14-15; J Kasipillai and R Liew, "The Small and Medium Enterprise under the GST Regime", (2004) Vol 17:10 *Accountants Today* 10; and G Richardson, "Determinants of Tax Evasion: A Cross-Country Investigation", (2006) Vol 15:2 *Journal of International Accounting, Auditing and Taxation* 150.

⁸¹ See Inland Revenue Board Malaysia, *Annual Report 2006*, (Kuala Lumpur, 2006), Ch 3: Prestasi LHDNM, pp 46-48.

recovering more tax or penalising non-compliance rather than helping taxpayers meet their tax obligations.⁸²

The negative perceptions and reactions experienced by tax auditors during audits resulted in minimal cooperation from taxpayers. This has also contributed to the failure of tax auditors to settle cases within the required time frame. Taxpayers' negative perceptions to tax audits may result from a lack of tax education. This finding is in agreement with previous studies suggesting that tax education is positively associated with tax perceptions and tax compliance.⁸³

The findings from this study indicate that better targeted educational tax campaigns in the mass media are needed to educate taxpayers on the SAS and the primary objectives of tax audits. Tax awareness should be promoted not only to the taxpaying public, but also to all students at the secondary and tertiary education levels.⁸⁴ Thus, the IRBM may need to amplify the tax learning and publicity programme to ensure that tax education and awareness reaches the majority of taxpayers. Higher general education and improved specific tax knowledge may lead to higher participation and compliance from taxpayers.⁸⁵

6.0 CONCLUDING COMMENTS

This article aims to explore the major issues encountered by corporate tax auditors of the IRBM when discharging their duties under the SAS. Data drawn from focus group interviews conducted in early 2009 involving 60 tax auditors from the IRBM indicated three key issues, comprising tax auditors' welfare, tax complexity and tax education. It should be noted that the findings here are indicative and are based on a relatively small percentage of all auditors at the IRBM. The findings from this study suggest that the IRBM should review its internal policy in order to take into account the welfare of their tax auditors on duties. Secondly, the degree of tax compliance may be improved if the IRBM could reduce the complexity of the tax laws, in particular, the tax computations (such as using a pre-filled form), tax ambiguity and record-keeping dimensions. Finally, it may be necessary for the IRBM and other institutions to amplify tax awareness programmes and to educate Malaysian taxpayers about their rights and responsibilities under the SAS, and the objectives of tax audits.

The use of focus groups to explore the experience of tax auditors in conducting corporate tax audits is an important extension to the literature and may be applied to other studies elsewhere in the world. Moreover, this study explores our understanding of the issues faced by tax auditors in discharging their duties. Despite the issues raised by tax auditors, tax audit activities may be viewed as effective, specifically in educating corporate taxpayers in the preparation of tax computation and in identifying areas of the tax law that require clarification and attention. Nonetheless, the findings from the focus groups need to be treated cautiously in terms of generalisation, despite the steps that have been taken to ensure that the composition of the focus groups is representative of all auditors.

Further research is needed to examine the role of tax education in enhancing voluntary compliance. Also, research is required to determine the effectiveness of tax audit programmes among taxpayers who

⁸² KF Choong and LM Ling, "Tax Practitioners' Perception on Tax Audit and Tax Evasion: Survey Evidence in Malaysia", (Paper presented at the 8th International Business Research Conference in Dubai, United Arab Emirates, 2008), p 5.

⁸³ E Kirchler, E Hoelzl and I Wahl, "Enforced versus Voluntary Tax Compliance: The 'Slippery Slope' Framework", (2008) Vol 29:2 *Journal of Economic Psychology* 210, pp 216-217.

⁸⁴ P Hite, "Identifying and Mitigating Taxpayer Non-compliance", (1997) Vol 13 *Australian Tax Forum* 155, pp 169-175.

⁸⁵ See MA Richardson and AJ Sawyer, "A Taxonomy of the Tax Compliance Literature: Further Findings, Problems and Prospects", (2001) Vol 16:2 *Australian Tax Forum* 137, p 162.

have been audited by the IRBM, as it may be necessary to examine their feedback and suggestions,⁸⁶ which may assist the IRBM in evaluating and improving its tax audit programme. However, the total cooperation of the tax authority is essential in order to focus on audited taxpayers. In addition, the influence of the morale of tax auditors upon taxpayers' compliance and also other compliance variables such as fairness and procedural justice issues may be further investigated in the future. Findings from future studies may provide insights into the need to amplify the two main mechanisms employed to ensure the success of the SAS: tax education and tax audits. Adopting the above recommendations would further assist the IRBM in developing and administering the Malaysian tax system.

Accepted for publication on 10 August 2010

⁸⁶ This survey work was currently being undertaken by the authors.

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 - 3 See n 2, p 539.
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 - 2 Sir Ivor LM Richardson, "Countering Tax Avoidance", (2004) Vol 10:4 *New Zealand Journal of Taxation Law and Policy* 301, p 303.
 - 3 See n 1, pp 33-34.
 - 4 OECD, *The OECD's Project on Harmful Tax Practices: The 2004 Progress Report*, (Paris, 2004), p 11, see also <http://www.oecd.org/dataoecd/60/33/30901115.pdf> (as at 1 March 2005).

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