

Factors that Influence Tax Evasion among Individual Taxpayers (Employment) in Malaysia

WONG PUI-SAN
KHO GUAN-KHAI
LAI SIEW-FONG
NG HUI-CHEN

Faculty of Accounting Finance and Quantitative Studies
Asia Pacific University of Technology and Innovation, Malaysia
(A.P.U)

BENJAMIN CHAN YIN-FAH
Centre for the Study of the Economics of Ageing, A.P.U

Abstract:

Tax evasion has become an issue of concern for many governments around the world. In order to address the problem of tax evasion, some governments have attempted wide array of measures, including the recent implementation of Foreign Account Tax Compliance Act by the US government. Past literatures suggested that Malaysia is encountering severe problems of tax evasion. Therefore, it is important to figure out the factors that influence tax evasion among the taxpayer. This paper aims to study the factors that will affect tax evasion among individual taxpayers in Malaysia. 50 participants were invited to participate in this study. Data were collected through questionnaires that were developed based on the research objectives. Besides, demographic profiles were also asked and analysed. Findings showed that awareness of penalties and fairness of the tax system has a significant relationship with tax evasion. The results provided better understanding to the government on tax evasion and more appropriate measures could be adopted to solve the problems. The conclusion, recommendation, directions for future research and limitation were also discussed.

Key words: tax evasion, individual taxpayers, Malaysia

1.0 Introduction

Tax is one of the important components of government revenues as it is able to provide funding for the government expenditures. (Tabandeh et al, 2012). In addition, tax revenue is crucial in every country as with sufficient tax revenue the government able to function and carry on their projects such as building highways and public infrastructures (Yalama et al, 2013).

Since the beginning of the tax system, it has brought a lot of problems to the government especially in the tax evasion matters. (Leu, Kinzer, Coiro, Cammacks, 2004). Tax evasion can be considered as one of the most serious financial crimes as it will threaten the country's economy, reduce the government coffers and resulted in a budget deficit subsequently. (Tarek, Abdul, 2013). In fact, when the government was highly relying on borrowing, the government might accumulate a significant amount of debts which will bring negative impact towards the country. When the government did not have sufficient revenue, they have to borrow money from other financial institutions in order to finance the public expenditures. Apart from that, the tax authority has to bear high expenses on auditing and rewarding in order to detect tax evasion. (Ralph and Matthias, 2004). Inland Revenue Board of Malaysia (IRB) has established an investigation department to assist the government to detect and combat tax evasion. (Quah, 2005). This department required high labour force which subsequently increased the tax authority expenses.

There are many reasons which led the taxpayers to evade tax and one of it was the taxpayers' preference to save money for their own purposes instead of declaring their wealth to the Inland Revenue Board of Malaysia. (Tabandeh et.al, 2012). Therefore, there were some taxpayers were trying to make their conditions of works and their earnings become undetectable and invisible to the tax officials in order to evade

tax. (Nagy, 2011). Nevertheless, tax evaders will face tough penalties in the form of fines, imprisonment and seizure of assets as stipulated by Malaysia Income Tax Act 1967.

Based on the findings from past studies, Malaysia has approximately 6.4 million of registered taxpayers. However, there were only 2.4 million people who really paid income taxes (Rashvinjeet S. Bedi, 2011). In other words, there were four million taxpayers are evading tax. Therefore, it is of paramount importance to explore the factors that influence tax evasion among individual taxpayers in Malaysia in order to improve the tax collection to the Malaysian government.

2.0 Significant of the Study and Objective

Despite the fact that there were many developed countries have done numerous studies related to tax evasion, nonetheless, there were very few studies which have been done in the developing countries such as Malaysia. (Tabandeh et.al, 2012). Tax evasion studies at developing countries were conducted usually based on the tax evaders behaviour. However, this paper can state that many peoples who were evading tax were because of lack of tax knowledge. This study will be valuable to the tax authority which is the Inland Revenue Board of Malaysia because it enables them to develop further strategies and mitigate the tax evasion in Malaysia. (Venter, 2011). Furthermore, this study also highlighted there is a necessary to educate the individual taxpayers about the seriousness of tax evasion in Malaysia where it able to put our country's financial system and the public interest in Malaysia into risks. (Tarek, 2013). Apart from that, this research will enable the tax authority to have a better understanding of the perceptions of the taxpayers on tax evasion. At the same time, this research also able to help the tax authority to have better awareness of the relationship between the tax penalties, fairness and tax evasion.

Hence, the main objective is to study the factors that influence tax evasion among individual taxpayers in Malaysia. It is important for the government to pay attention on the factor lead the individual taxpayer to evade tax as high number of tax evasion will eventually bring the country into the losses.

3.0 Literature Review

In most of the countries, tax revenues are the primary income sources for the government. When there were sufficient tax revenues, it enabled the government to elect more officials and politicians to remain in office longer in order to serve the publics who need help from the government. (Yalama et al, 2013). It is essential for the government to have sufficient tax revenue, so that the states of the county can be continued sustain. (Prichard & Bentum, 2009). In today's globalizing economic environment, there is a trend where the demand for different kinds of public services and programs are increasing. Nonetheless, there were some countries have increased their tax revenue rates, but these revenues fall short of to finance those necessary public spending. Apart from that, there was a phenomenon where most of the countries have a significant difference between potential and actual tax revenues. Generally, according to the legal or tax law, the potential tax revenues of a country were usually more than the actual tax revenue which the government collected. As a matter of fact, there were many factors that may lead the difference between potential and actual tax revenues. The common factors were inefficiencies, inadequate tax collection ability and personal management issues derived from the tax collecting agencies. (Yalama et al, 2013).

According to Richardson, tax evasion can be defined as "intentional illegal behaviour or activities involving direct violation of tax law to evade the payment of tax". (Richardson, 2008). It is not a new issue as this has been practiced by most

of the taxpayers around the world. (Hasan, 2013). Basically, tax evasion meant that the taxpayers have the intention of non-compliance, which caused the payments of taxes become lower than actually owed. (Jeyapalan, Norhani & Noor, 2003). According to Prebble and Prebble, tax evasion was considered as a violation of law. Tax evasion derived when the taxpayer intentionally violates and breaches of the tax legislation in order to reduce their tax burden. (Prebble & Prebble, 2010). In addition, tax evasion existed when the taxpayers were using some of the ways in order to reduce the taxable income, such as the revenues are not fully declared or generated fake expenses. As a result, when the taxpayers were not fully declaring their taxable income, they were considered participating in a criminal activity and might prosecute by the government. There was also another researcher indicated that even though the taxpayer was taking advantage from tax evasion, but in future their activity will be revealed. (Sandmo, 2005).

The penalty can be various forms of the penalty rate by different tax subjects or different structure of penalty rate by the types of taxpayer. Thus, individual income tax, capital income tax and value added tax, each may have a different penalty rate. In the meantime, the penalty rate for different type of tax evasion such as non-filing and timely filing, but under reporting may have differences of penalty rates. (Misu, 2011). Certainly, the penalty rate is much higher if the taxpayer evades the tax intentionally as compared to those unintentional evasions. (Hyun, 2005). The enforcement strategy which widely used by Malaysia is penalties system and this has created attentions, stress and dissatisfaction among the taxpayers. (Yong, 2005). Previous researchers which identified that tax compliance behaviour was affected by the penalty rates. At the same time, the awareness of offence among the taxpayers will also have a significance influence to the tax compliance behaviour. There were some competing models presented in the existing literature in order to answer

the question where tax penalties able to motivate the taxpayer. The standard deterrence model indicated that the taxpayers will comply with their tax obligations in order to prevent penalties or punishments from the tax authority. (Doran, 2009).

The awareness of offence among the taxpayers will also have a significance influence to the tax compliance behaviour. The taxpayers might reduce their tendency to evade tax when they aware of the offences they were committing. In addition, they may also have the awareness on the consequences of being non-compliant taxpayers. On the contrary, the taxpayers might have the intention to evade tax when they did not aware of the consequences of being dishonest and cheat the tax authority as they assumed that they might not be caught or detected and at the same time they able to save money. Thus, it is crucial for the tax authority to provide ample education to the taxpayer so that it is able to keep them well informed with the punishments or penalties of being a tax evader. In other words, there is always prevention measure is better than cure. (Mohamad et. al, 2011).

Previous research shows that tax evasion is usually negatively associated with the fairness of taxes levied on a taxpayer. (Jackson & Milliron in Richardson, 2006). In other words, when the taxpayer perceived that they were being unfairly taxed, they might tend to evade tax. Hence, it is essential to the tax authority to understand the perceptions and behaviour of every taxpayer. (Sandmo, 2005). There were some experiments which have justified that the taxpayers were more willing to choose an option which able to treat them fairly even though there was no reward rather than choosing an option which has rewarded but unable to treat them fairly. (Braithwaite, 2009; Delaney and Harmon, 2009). In addition, there was always a relationship between trust and legitimacy to fairness. (Walsh, 2012).

According to Wenzel and OECD, they have justified that there were three areas of fairness from the taxpayer's perspective, such as distributive justice, procedural justice and retributive justice. (Wenzel, 2003; OECD, 2010). Basically, distributive justice or distributive fairness was the perception of the taxpayer to the government on how they spent the tax revenues (OECD, 2010) or viewed as the exchange of resources such as benefit and cost. (Wenzel, 2003). On the other hand, procedural fairness or procedural justice was the process of resource distribution (Wenzel, 2003) and it was also the point of view of the taxpayers towards the tax administration on whether they were fair enough when dealing with taxpayers. (OECD, 2010).

4.0 Methodology

This is an explanatory study, target on individual taxpayers who were under the category of employment (working adults). Moreover, the sample sizes for this research were 50 participants. It was supported that the results from the sample size of 50 or 200 will not be significant different, hence 50 samples sizes will be sufficient in this research. (Glenn, 2014). Primary research and secondary research were used throughout this research. The sources for the secondary data in this paper were academic journal, newspapers, articles and the sources from the websites. The questionnaire has been used in order to collect the primary data. The questionnaire consisted of demographic variables such as age, income and gender. Other than that, the questionnaires also included the independent variables. The responses in the questionnaires which provided by the respondents were keyed into Statistical Package for the Social Science (SPSS) in order to conduct data analysis. Afterwards, the data which generated from the SPSS has presented in graphical such as pie chart, bar chart and histogram. Moreover, the Pearson Moment Correlation test

was conducted so that it able to determine the correlations between the independent and dependent variables.

5.0 Research Findings

5.1 Respondent's profile

In this study, 58% of the respondents are female and about 74% of the total respondents are aged between 20 to 29 years old. In the meantime, there are 16% of them age range from 30 to 39 years old and 10% of the respondents are aged range 40 and above. Looking into the education level, there are 54% of the total respondents are degree holders, 14% are master holders, 26% with professional qualifications and 6% are not in these three categories. For the marital status, 70% of the respondents are single and 30% are married. A closer inspection of the income group distribution revealed that 16% of the total respondents' income level are below RM1,000; 6% of the total respondents' income level are RM1,000 – RM2,000; 24% of the respondents' income is RM2,000 – RM3,000 and 54% of the respondents' income is RM3,001 and above.

5.2 Tax Evasion and Awareness of Penalties

In overall, 80% of the respondents understand the meanings of tax evasion while 20% of the respondents do not understand the meaning of tax evasion. Among the respondents who understand the meaning of tax evasion, 60% of them are female and 40% of them are male. Results shown that 54% of the total respondents disagreed the tax authority has provided sufficient information on the consequences of being tax evaders while 24% of them agreed and 22% of them were neutral. The study further revealed that 72% of the respondents agreed penalties were the main reasons for the taxpayers to pay tax liabilities to the government. 16% of them disagreed penalties were the main reasons to pay tax liabilities and 12% of them were neutral.

A closer inspection of the penalty rate imposed by the authority as the major instrument to curb tax evasion, 46% of the total respondents disagreed with the statement, 32% of the respondents agreed while 22% of the respondents were neutral. 86% of the total respondents agreed tax authority should provide amber tax awareness campaign and workshop as it can effectively enhance the public awareness such as penalties rates or periods of imprisonment if become tax evaders; 12% of the respondents disagreed and 2% of the respondents were neutral. Pearson Moment Correlations Test indicated that there is significant correlation between awareness of penalties and tax evasion as P value of the variable was $0.037 \leq 0.05$.

5.3 Fairness of Tax System

The study revealed that 88% of the total respondents agreed that tax authorities play an important role in practicing fairness tax system; 10% of the respondents disagreed while 2% were neutral.

Looking into whether the fair distribution of tax revenue for country wellness will enhance tax compliance, 78% of the total respondents agreed with this statement, 12% of the respondents disagreed and 10% of the respondents were neutral. 76% of the total respondents agreed that fairness is essential for the integrity of the tax system, 14% of the respondents disagreed and 10% of the respondents were neutral that fairness is essential for the integrity of the tax system.

When relate to taxpayer perception about a fair tax system is able to enhance the tax compliance rate, 84% of the total respondents agreed that the tax compliance rate will be increased if there is a fair tax system; 12% of the respondents disagreed and 4% of the respondents were neutral. Pearson Moment Correlations Test indicated that there is significant correlation between fairness of tax system and tax evasion as P value of the variable was $0.033 \leq 0.05$.

6.0 Conclusion

The research was conducted to ascertain the factors that influence tax evasion among individual taxpayers (employment) in Malaysia. Finding of this study shows that there is a significant relationship between awareness of penalties and fairness of the tax system with tax evasion. This result further confirmed the findings from previous studies that awareness of penalties and fairness of tax system influence the tendency to evade taxes.

In order to reduce the rate of tax evasion, the researcher recommends several measures to the government. Presently, social media is one of the pathways which allow the information to be reached to the public quickly. The IRB should make good use of the social media such as Twitter and Facebook to deliver the information about tax in order to enhance the tax awareness of the public. Apart from that, IRB should engage closely with Human Resource Department of the companies before the month of tax submission to disseminate appropriate tax information to their employees. Seminars and talks could be conducted to assist the staff of the companies to understand tax matters better, especially on the penalties of tax evasion. Nowadays, most of the taxpayers in Malaysia are concerning about the transparency of the tax system and how the government spend the tax collection towards the society. The government should follow the steps of US government to declare how they spent the money of the taxpayers during the end of the government financial year. For instance, every year the federal government of US will declare how it spent the tax revenue which collected from the taxpayers. Meanwhile, the finding of this study could assist the future researchers as well. The focus group of this research was only limited to working adults which have been registered as taxpayers in Malaysia. Hence, future researches could study about business entities. At the same time, future researchers could also expand the

number of variables in the study to ensure a comprehensive study on this topic.

Last but not the least, the accuracy and reliability of this research are dependent on the honesty and the willingness of the respondent to disclose the information. Most of the researches would encounter certain percentage of errors. Moreover, time constraints were another limitation faced in this research. The errors and bias would be reduced if questionnaires could be distributed to more respondents.

REFERENCES

- Bedi, R. 2011. Silver lining behind the GST. [Online]. Available at: <http://www.thestar.com.my/story.aspx/?file=%2f2011%2f7%2f10%2fnation%2f8881720&sec=nation>. [Accessed 15 February 2014].
- Braithwaite, V. 2009, *Defiance in Taxation and Governance: Resisting and Dismissing Authority in a Democracy*, UK, Cheltenham: Edward Elgar.
- Delaney, L. and Harmon, C. 2009, *Behavioural Economics and Taxation*, memo
- Doran, M 2009. Tax Penalty and Tax Compliance. [Online]. Available at: <http://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=1918&context=facpub>. [22 February 2014].
- Glen, 2014. Determining Sample Size. [Online]. Available at: <http://edis.ifas.ufl.edu/pdffiles/pd/pd00600.pdf>. [Accessed 11 October 2014].
- Hasan, R. 2013. The Tendency toward Tax Evasion in Bangladesh. [Online]. Available at: http://www.wbiworldconpro.com/uploads/dhaka-conference-2013/economics/1387255933_214-Rashedul.pdf. [Accessed 16 February 2014].

- Hyun, J. K. 2005. Tax Compliances in Korea and Japan: Why are they different?. Preliminary version for APEA, 2005.
- Jackson, B. R., & Milliron, V. C. (1986). Tax Compliance Research, Findings, Problems and Prospects. *Journal of Accounting Literature*, 5, 125-165.
- Kasipillai, J. and Hijattulah, A. (2006). Gender and Ethnicity Differences in Tax Compliance. *Asian Academy of Management Journal*, 11(2), pp.73-88.
- Kasipillai, J., and Jabbar, H.A. 2003. Tax compliance attitude and behaviour: Gender and ethnicity differences of Malaysian taxpayers. *Malaysian Accountant*. February, pp. 2-7.
- Leu, D. J., Kinzer, C. K., Coiro, J. L., & Cammack, D. W. 2004. Toward a theory of new literacies emerging from the Internet and other information and communication technologies. *Theoretical models and processes of reading*, 5, 1570-1613. pp 1573.
- Mohamad Ali, R., Mohd Hanefah, B. and Mohd Noor, A. 2011. The Effects of Knowledge On Tax Compliance Behaviour', Faculty Of Business And Economics, University Utara Malaysia, *International Journal Of Business And Social Science* Vol. 2 No. 7; [Special Issue –April 2011].
- Misu, N. 2011. A Review of Factors For Tax Compliance. [Online]. Available at: http://www.ann.ugal.ro/eco/Doc20011_1/Nicoleta_Barbut_aMisu.pdf. [Accessed 18 February 2014].
- Nagy, Z.I. 2011. The Fight against Income Tax Evasion in Hungary. [Online]. Available at: http://www.uni-obuda.hu/journal/Nagy_28.pdf. [Accessed 14 February 2014].
- OECD, 2013. Building Tax Culture, Compliance and Citizenship: A Global Source Book on Taxpayer Education. [Online]. Available at:

- <http://www.oecd.org/ctp/tax-global/sourebook-taxpayer-education.pdf>. [Accessed 17 January 2015].
- Prebble, Z. & Prebble, J. 2010. The Morality of Tax Avoidance. *Creighton Law Review*, 43(3): pp. 693-745.
- Prichard, W. and Bentum, I. (2009). Taxation and Development in Ghana: Finance, Equity and Accountability, Ghana Report; Tax Justice Network and ISODEC Public Agenda, Business News of Monday,
- S.H, Quah, 2005. Perspective of Inland Revenue Board of Malaysia: Combating Tax Evasion. [Online]. Available at:
<http://www.adbi.org/files/2005.09.12.cpp.combating.tax.evasion.pdf>. [Accessed 16 February 2014].
- Ralph. C, Matthias Sutter, 2004. The excess burden of tax evasion-an experimental detection-concealment contest. [Online]. Available at:
<http://www.economics.adelaide.edu.au/research/papers/doc/wp2004-07.pdf>. [Accessed 15 February 2014].
- Sandmo, A. 2005. The Theory of Tax Evasion: A retrospective view. *National Tax Journal*, 58(4): pp. 643-663.
- Tarek S A. Elgaroshi, Dr. Abdul Samat Musa, 2013. Control of Income Tax Evasion in Islamic (Shariah) and Malaysian Law (Comparative Study). [Online]. Available at:
<http://www.ajbasweb.com/ajbas/2013/April/770-780.pdf>. [Accessed 12 February 2014].
- Tabandeh, R. J, Mansur, Md. Nor Ghani, Zaidi, Mohd Azlan, (2012). Estimating Factors Affecting Tax Evasion in Malaysia: A Neural Network Method Analysis. Available at:
http://www.ukm.my/fep/perkem/pdf/perkemVII/PKEM2012_5D4.pdf/ [Accessed 12 February 2014]
- Venter, J. 2011. Factors Influencing Tax Evasion. [Online]. Available at: <http://upetd.up.ac.za/thesis/submitted/etd-03062012-153138/unrestricted/dissertation.pdf>. [Accessed 16 February 2014].

- Walsh, K. 2012. Understanding Taxpayer Behaviour- New Opportunities for Tax Administration. [Online]. Available at: http://www.esrc.ac.uk/hmrc/images/Understanding%20Taxpayer%20Behaviour_tcm19-20102.pdf. [Accessed 20 February 2014].
- Wenzel, M. 2003. Tax Compliance and the Psychology of Justice: Mapping the Field. In V. Braithwaite (Ed.). *Taxing Democracy: Understanding Tax Avoidance and Evasion*. Aldershot, UK: Ashgate.
- Yalama, G., Gumus, E 2013. Determinants of Tax Evasion Behavior: Empirical Evidence from Survey Data. [Online]. Available at: <http://www.cscanada.net/index.php/ibm/article/viewFile/j.ibm.1923842820130602.1085/pdf>. [Accessed 29 December 2013].
- Yong, K. 2005. Malaysia's first self-assessment year for individual taxpayers. *Tax Nasional*, 2, pp. 22-24.