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# Determinants of Effective Tax Investigations in Malaysia

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*Whilst most tax authorities throughout the world publish their organisation's objectives and policies, hitherto, there is very little research investigating the attitudes of those at the 'front line', namely tax investigation officers. This qualitative study investigates the attitudes of 16 senior investigation officers from the Inland Revenue Board Malaysia (IRBM) who are also the directors of investigation branches and divisions throughout the country. The sensitive area of criminal tax investigations as opposed to civil investigations is also examined in this article. An individual semi-structured interview method was used for this research. It is found that the effectiveness of tax investigations is strongly influenced by the professional proficiency of the officers, which incorporates their knowledge and skills, ability to work independently, high integrity as well as their capacity for being a good team worker. In addition, the other factors that were found to be influential include tax penalties and the enforcement strategies of the IRBM. The degree of tax law complexity, whilst important, was found to be relatively less important than the foregoing factors. Although this research was based on Malaysian officers' experience, the study is placed in the context of international research, and uses Australian and Organisation for Economic Co-operation and Development (OECD) policies and recommendations as comparative reference points wherever possible.*

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## 1.0 INTRODUCTION

Self-evidently, most countries' revenue relies on income tax collections. As such, a good tax system needs to be efficient and effective. However, problems with tax compliance including tax evasion always exist no matter how good or efficient the tax system might be. There is a spectrum of perceptions of tax evasion – from one end where it is regarded by some as a petty crime, to the other end where others regard it as a serious crime that warrants a heavy sentence such as imprisonment. Nevertheless, tax evasion is not a victimless crime as it reduces revenue collections, which in turn affect social and economic equity.<sup>1</sup>

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<sup>1</sup> *Director of Public Prosecutions for the Commonwealth of Australia v Gregory* [2011] VSCA 145, (2011) 250 FLR 169, 83 ATR 336 at [51] and [52].

Furthermore, a culture of rampant tax evasion serves no justice for honest taxpayers who diligently pay their taxes. The following quote succinctly sums up this sentiment:<sup>2</sup>

If non-compliance by the few continues unchecked, the confidence of the many in our self-assessment system will be shaken and one of the cornerstones of our government weakened.

The quote also emphasises the great importance of a reliable tax system to ensure a sense of fairness among taxpayers because failure to do so will disrupt public confidence towards the tax system itself. In short, every tax system must have an effective enforcement system to ensure full compliance among its taxpaying citizens.<sup>3</sup> Up until now, though much international research has been undertaken on tax evasion, due to its complex and covert nature, the findings vary depending on the research scope and limitations. Thus, the literature on tax evasion arguably remains somewhat elusive and uncertain.

To put the size of the problem into context, Malaysia lost around MYR 745.35 million (almost equivalent to USD 250 million) in tax revenue in 2010 alone due to tax evasion.<sup>4</sup> Thus, a study like this is very significant from a revenue standpoint. It is also significant as it is the first to explore tax enforcement activities in Malaysia by attempting to establish the determinants for effective tax investigations of the IRBM. An exploratory study using a qualitative research method is adopted and the outcomes from this study should assist the IRBM (and other revenue authorities) to enhance their tax enforcement systems.

In order to place the findings in context with a developed OECD<sup>5</sup> country, Australia is preferred as a supporting benchmark for this study. There are many similarities between these two countries even though Australia is a developed country while Malaysia is in the advanced stage of being a developing country. Historically, both countries share many similar British legacies that include tax laws and both are using self-assessment for their tax systems. Geographically, they are neighbouring countries in the Asian region; demographically, multiracial; and politically, governed based on a constitutional mandate. In a tax compliance context, both Australia and Malaysia adopt the risk-based case selection for their enforcement activities.<sup>6</sup> One notable similarity is the adoption of the Australian Taxation Office (ATO) Compliance Model which is remodelled as an IRBM Responsive Compliance Model.<sup>7</sup>

This article is structured as follows. It starts by reviewing the key literature that covers overall issues which then allows the specific issues related to this research to be explored against the general background and context provided by the literature review. Secondly, the research methodology is presented to illustrate the steps that have been taken before, during and after the data collection phase. Next, the findings are presented on the factors that influence the effectiveness of the IRBM's tax investigation activities. Finally,

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<sup>2</sup> John F Kennedy, former President of the United States "Special Message to the Congress on Taxation" (20 April 1961) in *Public Papers of the Presidents of the United States: John F Kennedy; containing the public messages, speeches, and statements of the President, 1961-1963* (United States Government Printing Office, Washington, 1962-1964) 290 at 301; quote was cited in David B Porter and Robert W Wood "The IRS's New Emphasis-Tax Enforcement" (2005) 36 *The Tax Adviser* 541.

<sup>3</sup> Suzanne Scotchmer "Audit Classes and Tax Enforcement Policy" (1987) 77 *The American Economic Review* 229.

<sup>4</sup> Rahimy Rahim "Malaysia Loses \$250m in Tax Revenue" *McClatchy-Tribune Business News* (online ed, Chicago, 29 April 2011). Malaysia uses its own currency known as Ringgit Malaysia.

<sup>5</sup> The OECD is based in Paris, France and has 34 countries as its members that include Australia, Japan, New Zealand, the United States of America and the United Kingdom.

<sup>6</sup> IRBM *Tax Investigation Framework* (2007) at 4; ATO *Compliance Program 2012-13* (Canberra, July 2012) at 1.

<sup>7</sup> Marhaini Mahmood "Compliance Risk Management Strategies for Malaysian Tax Administration" (paper presented to the Australasian Tax Teachers Association Conference, Sydney, 16-18 January 2012) at 18; Cash Economy Task Force *Improving Tax Compliance in the Cash Economy* (Canberra, April 1998) at 23. The New Zealand Inland Revenue also uses a variant of the ATO's Compliance Model.

several limitations are acknowledged in the discussion on the findings together with concluding remarks that incorporate policy implications and future research directions.

## 2.0 BACKGROUND

### 2.1 Tax Compliance

In any tax system, the tax authority needs to have an enforcement system because in the absence of an enforcement element, it is difficult to ensure full compliance.<sup>8</sup> Non-compliance activities including tax evasion not only affect a government's economic stability but also inculcates a sense of unfairness and disregard of the law among its citizens.<sup>9</sup>

Tax evasion involves intentional actions by taxpayers to reduce their tax liability illegally.<sup>10</sup> This may include reducing taxation liabilities by concealing income or declaring expenses or tax offsets that do not exist. According to the ATO, tax evasion occurs when a taxpayer deliberately misleads the tax authority about his/her income activities with the intention to understate his/her tax liability.<sup>11</sup>

Tax avoidance involves any action by taxpayers to reduce their tax obligation based on rules and guidelines permissible under the tax laws.<sup>12</sup> The difference between tax evasion and tax avoidance depends on the provisions and requirements of the tax laws. Tax avoidance differs from tax evasion in that a person engaged in tax avoidance may comply with the letter of the law while at the same time trying to gain a taxation benefit not intended by the legislation. Simply, any tax saving treatment that does not fall under tax avoidance *per se* constitutes tax evasion.

Since the establishment of the seminal theory by Allingham and Sandmo,<sup>13</sup> there have been various studies conducted with research questions ranging from issues on how to reduce tax evasion, the reasons why tax evasion is committed, what motivates tax evasion and which category of taxpayers has the most tendencies to involve with tax evasion. In general, studies on tax compliance are classified into two main schools of thought. The first one involves studies from the economic point of view which is known as the economic deterrence model.<sup>14</sup> The second type of study involves studies on the psychological perspective

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<sup>8</sup> Joel Slemrod, Marsha Blumenthal and Charles Christian "Taxpayer Response to an Increased Probability of Audit: Evidence from a Controlled Experiment in Minnesota" (2001) 79 *Journal of Public Economics* 455 at 456.

<sup>9</sup> Edward AG Groenland and Gery M van Veldhoven "Tax Evasion Behavior: A Psychological Framework" (1983) 3 *Journal of Economic Psychology* 129.

<sup>10</sup> Agnar Sandmo "The Theory of Tax Evasion: A Retrospective View" (2005) 58 *Nat'l Tax J* 643 at 645; Agnar Sandmo, "An Evasive Topic: Theorizing About the Hidden Economy" (2012) 19 *International Tax and Public Finance* 5.

<sup>11</sup> ATO "What is tax evasion?" (March 2013) <[www.ato.gov.au](http://www.ato.gov.au)>.

<sup>12</sup> Frank A Cowell "The Economic Analysis of Tax Evasion" (1985) 37 *Bulletin of Economic Research* 163.

<sup>13</sup> Michael G Allingham and Agnar Sandmo "Income Tax Evasion: A Theoretical Analysis" (1972) 1 *Journal of Public Economics* 323.

<sup>14</sup> See n 13; James Andreoni, Brian Erard and Jonathan Feinstein "Tax Compliance" (1998) 36 *Journal of Economic Literature* 818; see also Joel Slemrod and Shlomo Yitzhaki "Tax Avoidance, Evasion and Administration" in Alan J Auerbach and Martin S Feldstein (eds) *Handbook of Public Economics* [Volume 3] (Elsevier Science Publishing, Amsterdam, 2002) 1423.

which covers social, psychological and demographical aspects of taxpayers.<sup>15</sup> The social psychology studies cover the behavioural aspects of taxpayers such as attitude, social norms, demography and perception of important tax variables. Fiscal psychology is the combination of variables from both economic and psychology models.<sup>16</sup> Generally, the fiscal psychology approach perceives that taxpayers' compliance behaviour is influenced by personal attitudes and accepted norms influence tax compliance.<sup>17</sup> In addition, it is perceived that behavioural problems are influenced by the ability of the tax authorities to regulate tax parameters such as tax penalties, probability of detection and tax rates.<sup>18</sup>

The studies on tax compliance have evolved over time and have attracted many researchers including those from the academe as well as from governments. As researchers come from various backgrounds, their perceptions and understanding on tax compliance issues may differ based on their knowledge, experience and academic judgment.<sup>19</sup> However, studies on tax evasion until today are yet to establish a comprehensive framework as there are so many knowledge gaps that have yet to be explored and explained.<sup>20</sup> Furthermore, it is not easy to gather data or information from respondents in surveys related to tax evasion because of its sensitive, often covert and potentially law-breaking nature.<sup>21</sup>

## 2.2 Tax Penalties

Past studies show that there is a mixture of results regarding the effect of tax penalties on taxpayers' compliance. Overall, studies postulate that penalties and sanctions serve as a punitive mechanism to deter wrongdoers and potential wrongdoers.<sup>22</sup> Under the economic deterrence model, there is a positive relationship between penalty rates and tax compliance.<sup>23</sup> However, Devos found that high penalties and sanctions had not produced a significant deterrent impact on tax offenders in the United Kingdom, Australia and New Zealand.<sup>24</sup>

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- <sup>15</sup> Ken Devos "An Investigation into Australian Personal 'Tax Evaders' – Their Attitudes Towards Compliance and the Penalties for Non-Compliance" (2009) 19 *Revenue LJ* 1; Jeff Pope and Margaret McKerchar "Understanding Tax Morale and Its Effect on Individual Taxpayer Compliance" [2011] *BTR* 587; Icek Ajzen "Martin Fishbein's Legacy: The Reasoned Action Approach" (2012) 640 *The Annals of the American Academy of Political and Social Science* 11; Raihana Mohdali "The Influence of Religiosity on Taxpayers' Compliance Attitudes: Empirical Evidence from a Mixed-Methods Study" (paper presented to the Australasian Tax Teachers Association Conference, Auckland, 23-25 January 2013).
- <sup>16</sup> John Hasseldine and Zhuhong Li "More tax evasion research required in new millennium" (1999) 31 *Crime, Law & Social Change* 91 at 94-96. See also Devos, above n 15, at 2.
- <sup>17</sup> Amy Bleakley and Michael Hennessy "The Quantitative Analysis of Reasoned Action Theory" (2012) 640 *The Annals of the American Academy of Political and Social Science* 28 at 29.
- <sup>18</sup> Margaret McKerchar and Chris Evans "Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy Makers and Revenue Authorities" (2009) 7 *eJournal of Tax Research* 171 at 173.
- <sup>19</sup> See Devos, above n 15, at 1.
- <sup>20</sup> James Alm "Measuring, explaining, and controlling tax evasion: lessons from theory, experiments, and field studies" (2012) 19 *International Tax and Public Finance* 54 at 55.
- <sup>21</sup> Nigar Hashimzade, Gareth D Myles and Binh Tran-Nam "Applications of Behavioural Economics to Tax Evasion" (2013) 27 *Journal of Economic Surveys* 941.
- <sup>22</sup> Mirko Bagaric, Theo Alexander and Athula Pathinayake "The Fallacy of General Deterrence and the Futility of Imprisoning Offenders for Tax Fraud" (2011) 26 *ATF* 511 at 512; Barak Ariel "Deterrence and Moral Persuasion Effects on Corporate Tax Compliance: Findings from a Randomized Controlled Trial" (2012) 50 *Criminology* 27 at 28.
- <sup>23</sup> See Allingham and Sandmo, above n 13, at 332; see also Shlomo Yitzhaki "Income Tax Evasion: A Theoretical Analysis" (1974) 3 *Journal of Public Economics* 201.
- <sup>24</sup> Ken Devos "The Role of Sanctions and Other Factors in Tackling International Tax Fraud" (2013) 42 *Common Law World Review* 1.

### 2.3 Complex Tax Laws

Complex tax laws involve various aspects of taxation that include how much tax should be paid, how those taxes should be collected, how to ensure compliance and how well taxation serves the nation's interest.<sup>25</sup> One of the main reasons that contribute to complex tax laws is the use of too much discretion in the interpretations of the tax laws.<sup>26</sup> As always, this will create many disputes and claims depending on which side of the law is being advocated. Other than taxpayers and tax practitioners, complex tax laws directly affect tax administrators as well.<sup>27</sup> From a legal perspective, Evans and Tran Nam<sup>28</sup> described tax law complexity based on its language, structure and content while Slemrod<sup>29</sup> termed tax law complexity through four factors: predictability, enforceability, difficulty and manipulability.<sup>30</sup>

Against this background, this study aims to establish whether tax law complexity has a significant influence on IRBM's investigation officers' professional performance. As complex tax laws add administrative costs for tax authorities, it is important to establish their relative significance.

### 2.4 Professional Proficiency

In order to keep up with the evolving and ever-changing global tax environment, tax administrators must ensure their officers are professionally competent because workers with inadequate knowledge generally struggle to perform their duties.<sup>31</sup> Therefore, it is important to find ways to identify and classify the attributes of a high-quality workforce because the costs to find, train and retain competent workers are not low.<sup>32</sup> Researchers have supported that a high grasp of knowledge improves performance and underwrites the future success of an organisation.<sup>33</sup>

Smith<sup>34</sup> described knowledge as a highly personalised human asset, representing a pool of expertise and networks. Even though it seems indefinable, knowledge forms part of an organisation's assets that include

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<sup>25</sup> Valerie Braithwaite "Responsive Regulation and Taxation: Introduction" (2007) 29 *Law & Policy* 3.

<sup>26</sup> Nye Perram "The perils of complexity: Why more law is bad law" (2010) 39 *AT Rev* 179 at 184.

<sup>27</sup> Margaret McKerchar "Tax Complexity and Its Impact on Tax Compliance and Tax Administration in Australia" in James Dalton and Martha Gangi (eds) *The IRS Research Bulletin: Proceedings of the 2007 IRS Research Conference* (Publication 1500, Washington, DC, 2007) 185.

<sup>28</sup> Binh Tran-Nam and Chris Evans "Towards the Development of a Tax System Complexity Index" (2014) 35 *Fiscal Studies* 341 at 343.

<sup>29</sup> Joel Slemrod "Complexity, Compliance Costs and Tax Evasion" in Jeffrey A Roth and John T Scholz (eds) *Taxpayer Compliance [Volume 2: Social Science Perspectives]* (University of Pennsylvania Press, Philadelphia, 1989) at 157.

<sup>30</sup> The terms "predictability" and "enforceability" are usually associated with the ability of the tax authority to read and enforce the tax laws. On the other hand, "difficulty" and "manipulability" refer to the ability of taxpayers to understand and respond to the tax laws.

<sup>31</sup> Elizabeth A Smith "The Role of Tacit and Explicit Knowledge in the Workplace" (2001) 5 *Journal of Knowledge Management* 311.

<sup>32</sup> Gary S Insch, Nancy McIntyre and David Dawley "Tacit Knowledge: A Refinement and Empirical Test of the Academic Tacit Knowledge Scale" (2008) 142 *The Journal of Psychology* 561.

<sup>33</sup> Shawn L Berman, Jonathan Down and Charles WL Hill "Tacit Knowledge as a Source of Competitive Advantage in the National Basketball Association" (2002) 45 *Academy of Management Journal* 13 at 18; see also Richard K Wagner "Tacit Knowledge in Everyday Intelligent Behavior" (1987) 52 *Journal of Personality and Social Psychology* 1236 at 1245.

<sup>34</sup> Louis Kaplow "Optimal Taxation with Costly Enforcement and Evasion" (1990) 43 *Journal of Public Economics* 221 at 235.

goodwill, brand identity and a good reputation.<sup>35</sup> Until today, people generally convey their knowledge to others through face-to-face and “hands-on” methods.<sup>36</sup>

## 2.5 Tax Enforcement Strategy

In order to ensure optimal compliance and engender a sense of fairness, a tax system must have a reliable and effective tax enforcement strategy.<sup>37</sup> Tax enforcement strategies are designed with the intention to reduce opportunities for potential tax evaders.<sup>38</sup> The process of determining what is an optimal tax enforcement strategy is not straightforward because there are many issues, features and options to consider which may vary from one tax system to another.<sup>39</sup> Generally, there are two designs for creating a tax enforcement strategy: the normative approach and the sanction approach. The normative approach focuses on persuasive approaches that encourage taxpayers to comply voluntarily (which could include the use of rewards) while the sanction approach emphasises the redistributive consequences of taxpayers’ noncompliance.<sup>40</sup>

Tax enforcement strategies include legal powers of the tax authority, tax penalties and organisational strategy.<sup>41</sup> The legal power constitutes the tax authority’s written statutory power to implement all tax enforcement activities. In addition, penalties for tax fraud or evasion also fall under the scope of legal power. In terms of organisational strategy, the establishment of a tax enforcement strategy depends very much on the general policy of each tax administration. For example, a tax authority may want to improve taxpayers’ compliance by increasing the number of audit activities because it might posit that an increase in the likelihood of being apprehended lowers the benefit of misreporting taxable income.<sup>42</sup>

## 2.6 Effective Tax Enforcement

A good tax system depends on effective tax enforcement because the main purpose of tax enforcement is to deter tax evasion activities and safeguard the interests of complying taxpayers.<sup>43</sup> Deterrence is described as the act of punishment that attempts to deter those who are punished for their wrongdoings and, at the same time, serves as deterrence for potential wrongdoers within the society.<sup>44</sup>

<sup>35</sup> Perry Pascarella “Harnessing Knowledge” *Management Review* (October 1997) 38.

<sup>36</sup> Morten T Hansen, Nitin Nohria and Thomas J Tierney “What’s Your Strategy for Managing Knowledge?” *Harvard Business Review* (March 1999) 106.

<sup>37</sup> See McKerchar and Evans, above n 18, at 173.

<sup>38</sup> John Baldry and Jeyapalan Kasipillai “Income Tax Enforcement” (1996) 2 *Asia-Pacific Tax Bulletin* 268.

<sup>39</sup> Louis Kaplow “Optimal Taxation with Costly Enforcement and Evasion” (1990) 43 *Journal of Public Economics* 221 at 235.

<sup>40</sup> John Hasseldine and others “Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors” (2007) 24 *Contemporary Accounting Research* 171.

<sup>41</sup> See Baldry and Kasipillai, above n 38, at 271-272.

<sup>42</sup> Jeffrey A Dubin “Criminal Investigation Enforcement Activities and Taxpayer Noncompliance” (2007) 35 *Public Finance Review* 500 at 512.

<sup>43</sup> Lidia Xynas “Tax Planning, Avoidance and Evasion in Australia 1970-2010: The Regulatory Responses and Taxpayer Compliance” (2010) 20 *Revenue LJ* 25.

<sup>44</sup> James Alm, Betty R Jackson and Michael McKee “Audit Information Dissemination, Taxpayer Communication, and Compliance Behavior” (Working Paper 06-44, Andrew Young School of Policy Studies, Department of Economics, Georgia State University, April 2006); Ken Devos “Measuring and Analysing Deterrence in Taxpayer Compliance Research” (2007) 10 *Journal of Australian Taxation* 182.

Most previous researchers perceive that taxpayers' compliance behaviour is influenced by two major variables of tax enforcement: the penalty rate and probability of detection.<sup>45</sup> However, tax enforcement is costly and may distort many decisions involving tax revenue collections and government expenditures.<sup>46</sup> Hence, it is vital for the tax authority to find ways to form an optimal taxation environment so that the direct expenditures from tax enforcement do not outweigh the benefits of tax collections.<sup>47</sup>

In other words, any tax system should not ignore tax enforcement because the threat of possible audits or investigations is important to ensure greater compliance among taxpayers.<sup>48</sup>

## 2.7 Previous Studies in Malaysia

Research on tax compliance in Malaysia has dominantly focused on individual taxpayers. Hanefah<sup>49</sup> was the first to explore individual taxpayers' perceptions of the tax administrative system, tax fairness and tax law complexity. The ensuing studies mostly focused on the social psychological aspects such as the exploration on factors that influence tax compliance behaviour of individual taxpayers such as perception of fairness,<sup>50</sup> tax knowledge,<sup>51</sup> usage of electronic filing<sup>52</sup> and religiosity.<sup>53</sup>

There have been only a few studies involving corporate taxpayers in Malaysia even though companies contribute the highest tax revenues annually.<sup>54</sup> First, Abdul Jabbar and Pope explored whether there was a significant relationship between compliance costs and compliance behaviour in small and medium

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<sup>45</sup> See Allingham and Sandmo, above n 13 and Andreoni, Erard and Feinstein, and Slemrod and Yitzhaki, above n 14. See also Agnar Sandmo "Income Tax Evasion, Labour Supply and the Equity-Efficiency Tradeoff" (1981) 16 *Journal of Public Economics* 265; Joel Slemrod and Shlomo Yitzhaki "The Optimal Size of a Tax Collection Agency" (1987) 89 *The Scandinavian Journal of Economics* 183.

<sup>46</sup> Louis Kaplow "Optimal Taxation with Costly Enforcement and Evasion" (1990) 43 *Journal of Public Economics* 221 at 223.

<sup>47</sup> Parkash Chander and Louis L Wilde "A General Characterization of Optimal Income Tax Enforcement" (1998) 65 *The Review of Economic Studies* 165.

<sup>48</sup> Valerie Braithwaite "A New Approach to Tax Compliance" in Valerie Braithwaite (ed) *Taxing Democracy: Understanding Tax Avoidance and Evasion* (Ashgate, Aldershot, 2003) 1.

<sup>49</sup> Hajah Mustafa Bin Mohd Hanefah "An Evaluation of the Malaysian Tax Administrative System, and Taxpayers' Perceptions Towards Assessment Systems, Tax Law Fairness, and Tax Law Complexity" (PhD Dissertation, Universiti Utara Malaysia, 1996).

<sup>50</sup> Natrah Saad "Fairness Perceptions and Compliance Behaviour: Taxpayers' Judgments in Self Assessment Environments" (PhD Thesis, University of Canterbury, 2011). See also Natrah Saad "Fairness Perception and Compliance Behaviour: The Case of Salaried Taxpayers in Malaysia after Implementation of the Self-Assessment System" (2009) 8 *eJournal of Tax Research* 32; Natrah Saad "Fairness Perceptions and Compliance Behaviour: The New Zealand Evidence" (2011) 17 *New Zealand Journal of Taxation Law and Policy* 33.

<sup>51</sup> Mohd Rizal Palil "Tax Knowledge and Tax Compliance Determinants in Self Assessment System in Malaysia" (PhD Thesis, University of Birmingham, 2010).

<sup>52</sup> Idawati Binti Ibrahim "Electronic Filing of Personal Income Tax Returns in Malaysia: Determinants and Compliance Costs" (PhD Thesis, Curtin University, 2013). See also Idawati Ibrahim and Jeff Pope "The Viability of a Pre-Filled Income Tax System for Malaysia" (2011) 17(2) *Journal of Contemporary Issues in Business and Government* 85.

<sup>53</sup> Nor Raihana Mohd Ali "The Influence of Religiosity on Tax Compliance in Malaysia" (PhD Thesis, Curtin University, 2013). See also Raihana Mohdali and Jeff Pope "The Effects of Religiosity and External Environment on Voluntary Tax Compliance" (2012) 18 *New Zealand Journal of Taxation Law and Policy* 119; Jeff Pope and Raihana Mohdali "The Role of Religiosity in Tax Morale and Tax Compliance" (2010) 25 *ATF* 565.

<sup>54</sup> *IRBM Annual Report 2010* (Malaysian National Library, Kuala Lumpur, 2011) at 18. In 2010, corporate taxpayers contributed 50.64 per cent (MYR 43.80 billion) of total tax revenue collections.

companies in Malaysia.<sup>55</sup> This study concluded that there was no statistical significance in the relationship. Isa then tried to establish the variables that influence corporate compliance behaviour in Malaysia and found that tax knowledge, tax complexity, tax agents and tax audits have a significant influence.<sup>56</sup> The most recent study involving corporate taxpayers was by Sapiei and Kasipillai who explored the impacts of the self-assessment system requirements in Malaysia.<sup>57</sup>

Studies on tax enforcement and deterrence have been equally limited in Malaysia. First, Kasipillai, Baldry and Rao tried to estimate the size and determinants of hidden income and tax evasion in Malaysia by adapting Tanzi's money demand approach.<sup>58</sup> They suggested that the decline of the hidden economy in Malaysia was probably due to the gradual reduction of the income tax rate from 1971 to 1994. In 2003, Kasipillai, Aripin and Amran<sup>59</sup> conducted further research in this area by evaluating the impact of tax education on tax avoidance and tax evasion among undergraduates in Malaysia. They found that there was a likelihood of a relationship between tax education and tax compliance.

Hitherto, IRBM has focussed on civil tax investigations that feature a penalty regime consisting of monetary tax penalties. Criminal tax investigations were introduced in 2003 with the intention of strengthening IRBM's tax enforcement and to create better deterrence among Malaysian taxpayers.<sup>60</sup> Based on data extracted from IRBM, there were 226 investigation officers throughout Malaysia in 2011 of which 205 were assigned to undertake civil tax investigations while 21 were assigned to conduct criminal tax investigations. As at 31 December 2011, IRBM managed to raise MYR 811 million of additional tax from 954 civil tax investigation cases while the Criminal Tax Investigation Division managed to progress 184 cases for prosecution in court even though there was no imprisonment involved.<sup>61</sup>

Based on the findings of previous studies, the current researchers noted that there have been no published research works in Malaysia on tax investigation and its importance towards the effectiveness of tax enforcement system.

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<sup>55</sup> Hijattulah Abdul-Jabbar and Jeff Pope "Exploring the Relationship between Tax Compliance Costs and Compliance Issues in Malaysia" (2008) *Journal of Applied Law and Policy* 1.

<sup>56</sup> Khadijah Mohd Isa "Corporate Taxpayers' Compliance Variables under the Self-Assessment System in Malaysia: A Mixed Methods Approach" (Phd Thesis, Curtin University, 2012).

<sup>57</sup> Noor Sharoja Sapiei and Jeyapalan Kasipillai "Impacts of the Self-Assessment System for Corporate Taxpayers" (2013) *3 American Journal of Economics* 75.

<sup>58</sup> Jeyapalan Kasipillai, Jonathan Baldry and DS Prasada Rao "Estimating the Size and Determinants of Hidden Income and Tax Evasion in Malaysia" (2000) *8(2) Asian Review of Accounting* 25; see also Vito Tanzi "The Underground Economy in the United States: Annual Estimates, 1930-80" (1983) *30 IMF Staff Papers* 283.

<sup>59</sup> Jeyapalan Kasipillai, Norhani Aripin and Noor Afza Amran "The Influence of Education on Tax Avoidance and Tax Evasion" (2003) *1 eJournal of Tax Research* 134.

<sup>60</sup> *IRBM Annual Report 2003* (Malaysian National Library, Kuala Lumpur, 2004).

<sup>61</sup> The data was obtained from the IRBM's Investigation Department in Cyberjaya, Malaysia in December 2012.



## 2.8 Relevant Australian Literature and Experience

Australia has generated many tax research studies involving compliance costs,<sup>62</sup> compliance behaviour,<sup>63</sup> tax evasion,<sup>64</sup> tax deterrence,<sup>65</sup> tax morale,<sup>66</sup> tax complexity,<sup>67</sup> and tax administration.<sup>68</sup> For the purpose of this study, the researchers succinctly review previous studies on tax enforcement, tax evasion and deterrence as this is of most relevance to this research.

Devos<sup>69</sup> has comprehensively examined important related issues such as the effects of tax penalties on deterrence, tax evasion behaviour and demographic factors of individual taxpayers as well as seeking to measure deterrence and tax compliance behaviours of individual tax evaders in Australia. In 2004, Devos<sup>70</sup> investigated whether the introduction of new criminal taxation laws which intended to impose heavier penalties than the existing ones had a significant effect on the non-compliance behaviour of taxpayers selected from Australia, the United Kingdom and New Zealand. This study suggested that penalties, either maintained or increased, have no direct effect on taxpayers' non-compliance behaviour in the selected Anglo-Saxon countries. In fact, penalties for tax offences are known to be harsher in Australia than in other Anglo-Saxon countries.<sup>71</sup> Bagaric, Alexander and Pathinayake supported the perception on the severity of penalties because in the absence of empirical justification, harsh penalties for tax offences that include imprisonment and high monetary fines would not necessarily improve taxpayers' compliance.<sup>72</sup> In addition, the feelings of resentment play an important role on Australian tax offenders' subsequent compliance behaviour because those offenders who perceive the ATO's treatment as stigmatic would tend to evade their future taxes and those who perceive the ATO's treatment as compassionate would likely comply subsequently.<sup>73</sup> Based on these studies, it can be concluded that the imposition or increase of taxation penalties forms only one part of many important determinants of an effective tax enforcement strategy even though their importance should not be underestimated.

A study by Williams on tax offenders in Australia suggested that a deterrence approach through severe punishment and penalties can deter potential recidivism even though the compliance rates subside

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62 Jeff Pope "Compliance Costs of Taxation: Policy Implications" (1994) 11 ATF 85.

63 Julie Susan Ashby and Paul Webley "Exploring the Existence of Distinct Occupational Taxpaying Cultures" (2010) 25 ATF 29.

64 IG Wallschutzky "Possible Causes of Tax Evasion" (1984) 5 Journal of Economic Psychology 371.

65 See Devos, above n 24; Mirko Bagaric, Theo Alexander and Athula Pathinayake "The Fallacy of General Deterrence and the Futility of Imprisoning Offenders for Tax Fraud" (2011) 26 ATF 511.

66 Benno Torgler *Tax Compliance and Tax Morale: A Theoretical and Empirical Analysis* (Edward Elgar Publishing, Cheltenham, 2007); Jeff Pope and Margaret McKerchar "Understanding Tax Morale and Its Effect on Individual Taxpayer Compliance" [2011] BTR 587.

67 Binh Tran-Nam and Stewart Karlinsky "Small Business Tax Law Complexity in Australia: A Further Study" (2010) 16 New Zealand Journal of Taxation Law and Policy 153.

68 John Wickerson "Measuring Taxpayer Compliance: Issues and Challenges Facing Tax Administrations" (1994) 11 ATF 1.

69 Dr Ken Devos is a Senior Lecturer in Taxation Law, Department of Business Law and Taxation, Monash University. He was an officer with the ATO prior to joining the University.

70 Ken Devos "Penalties and Sanctions for Taxation Offences in Selected Anglo-Saxon Countries: Implications for Taxpayer Compliance and Tax Policy" (2004) 14 Revenue LJ 32 at 83-84.

71 Lisa Marriott "Does Tax Crime Pay? A Trans-Tasman Comparison of Penalties for Serious Tax Offences" (2013) 28 ATF 875.

72 See Bagaric, Alexander and Pathinayake, above n 65, at 539.

73 Kristina Murphy "Enforcing Tax Compliance: To Punish or Persuade?" (2008) 38 Economic Analysis and Policy 113 at 127.

significantly years after the initial threat of deterrence.<sup>74</sup> In 2007, Devos further recommended that the combination of selected variables from demographic variables with the ones from the economic deterrence model would improve the deterrence impact among taxpayers.<sup>75</sup> In a later study, he explored the attitudes and behaviour of Australian individual tax evaders and concluded that penalties are not effective in influencing their tax compliance behaviour.<sup>76</sup>

The above findings suggest that a tax authority should adopt procedural justice such as compassionate and fair treatment towards tax offenders so that most likely they will be tax complying in the future. Further, it appears that tax evaders are not really deterred by fines or penalties but rather would be more likely to comply if the ATO re-engages with them rather than stigmatising them.<sup>77</sup>

The most high profile tax enforcement activity in Australia in recent times has been Project Wickenby, which combines the workforce and expertise from eight government agencies. The ATO was assigned to lead this cross-agency project with a common intention to track down tax evaders and make them accountable. The basic impetus for Project Wickenby was the susceptibility of secrecy provisions involving Australia's public finances that allows the ATO to share useful information with the other participating government agencies.<sup>78</sup> Since its introduction in 2006, Project Wickenby has raised more than AUD 1.5 billion in tax liabilities from 3,383 audits and reviews. Up until 30 January 2013, 69 individuals have been charged in court and 34 of them have been convicted with imprisonment.<sup>79</sup>

The above findings from the academic literature suggest that deterrence strategy through severe punishment and penalties serves as the last possible approach used in Australia. This is reflected through the ATO's compliance model which focuses highly on friendly and persuasive approach to improve voluntary tax compliance. The outcomes from some academic studies in Australia also support that tax compliance would not necessarily improve with the introduction of high penalties.

### 3.0 RESEARCH DESIGN, METHOD AND OBJECTIVES

#### 3.1 Data Collection Method and Sample of Study

This study adopts a mixed-method approach by applying both qualitative and quantitative methodologies. The mixed-methods approach is suitable for many research areas because the usage of one method will validate or compensate the shortcomings of another.<sup>80</sup> Theoretically, mixed-methods research consists of a research process that involves both qualitative and quantitative approaches of a study with a common focus

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<sup>74</sup> Robert Williams "Prosecuting Non-Lodgers: To Persuade or Punish?" (Working Paper 12, Centre for Tax System Integrity, Australian National University, Canberra, 2001).

<sup>75</sup> Devos, above n 44. The economic deterrence model consists of variables such as tax rates, tax penalties, probability of being audited/investigated and probability of detection while demographic variables from socio-psychology models include gender, age, education, occupation and personal ethics.

<sup>76</sup> See Devos, above n 15, at 35; see also Devos, above n 24.

<sup>77</sup> Kristina Murphy and Nathan Harris "Shaming, Shame and Recidivism: A Test of Reintegrative Shaming Theory in the White-Collar Crime Context" (2007) 47 *Brit J Criminol* 900 at 910.

<sup>78</sup> "Project Wickenby continuing to deliver results" ATO *Targeting tax crime 8* (Australia, March 2013) at 8.

<sup>79</sup> At 7.

<sup>80</sup> Margaret McKerchar "Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation" (2008) 6 *eJournal of Tax Research* 5 at 20.

to achieve a better understanding of research problems.<sup>81</sup> The main purpose of the mixed-methods approach is to gain a better understanding and justification of a study undertaken.<sup>82</sup>

This article presents only the qualitative part of the larger study as the quantitative part of the study was yet to be done. As this study is an exploratory research, the quantitative study should be conducted after the completion of the qualitative study. A qualitative study is generally inductive and interpretive in nature even though a deductive approach can still be adopted based on previous studies in the particular research field.<sup>83</sup> The researcher interpreted all information gathered based on research resources available and through personal observations.<sup>84</sup>

The scope for this research covered the directors of investigation from the IRBM who in practice act as the senior investigation officers in their respective investigation branches. The researchers consider that they are the best resource persons for a study of this nature because they are directly involved in tax investigation cases. In addition, they are also involved with the implementation of tax policies and the planning of enforcement strategies in the IRBM.

Data collection for this research was conducted through face-to-face personal interviews based on semi-structured questions. Face-to-face interview is one of the most common data collection modes used for a qualitative study where a researcher can easily adjust interview questions according to the situation and clarify uncertainties. This approach also helps the researcher to observe the body language and expression of the interviewees.<sup>85</sup> In addition, a semi-structured interview is more flexible and the questions can be adapted accordingly to suit the interview circumstances.<sup>86</sup>

In order to assist in data collection, this study started with one main question for the interview protocol: “What are the factors that influence the intention of [the] IRBM to have an effective tax investigation in Malaysia?” Based on this main question, the first-named researcher then proceeded with the formation of interview protocol through nine primary questions and subsequently, these nine primary questions were dispersed into 18 secondary questions that were going to be used for interviews. The 18 questions consist of investigative or probing questions that try to obtain in-depth and better responses from the participants. An interview protocol is important because it serves as a systematic and specific guide for researchers in finding answers for their research questions.<sup>87</sup> In order to confirm the flow, appropriateness and comprehensiveness of the questions, the final set of interview questions was pilot-tested on one of the participants. The questions were verified with some amendments made, and later used for the interviews.<sup>88</sup> Finally, the usual ethical protocols were adhered to as required.

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<sup>81</sup> John W Creswell and Vicki L Plano-Clark *Designing and Conducting Mixed Methods Research* (Sage Publications, Thousand Oaks, 2007) at 5.

<sup>82</sup> R Burke Johnson, Anthony J Onwuegbuzie and Lisa A Turner “Toward a Definition of Mixed Methods Research” (2007) 1 *Journal of Mixed Methods Research* 112 at 123.

<sup>83</sup> John W Creswell *Research Design: Qualitative, Quantitative, and Mixed Methods Approaches* (3rd ed, Sage, Los Angeles, 2009) at 208-209.

<sup>84</sup> See Mc Kerchar, above n 80, at 10.

<sup>85</sup> Uma Sekaran *Research Methods for Business: A Skill Building Approach* (4th ed, John Wiley & Sons, New York, 2006) at 232.

<sup>86</sup> Mark Saunders, Philip Lewis and Adrian Thornhill *Research Methods for Business Students* (Pearson Education, Harlow, 2003).

<sup>87</sup> Patrick Dilley “Conducting Successful Interviews: Tips for Intrepid Research” (2000) 39 *Theory into Practice* 131 at 133.

<sup>88</sup> A copy of the information and consent forms, and the questions used during the interviews, is set out in Appendices 1 and 2 to this article.

### 3.2 Data Analysis

In this study, thematic analysis was used to analyse and interpret all data gathered from the interviews. Thematic analysis involves several stages starting with data transcription (the process of transferring raw data information such as field notes or audio-visual data into written transcripts), coding and finding themes from this data.<sup>89</sup>

As for reliability checks, the researchers have repeatedly read the transcripts and compared them with the raw data recorded in the field notes.<sup>90</sup> Further, the validity of the research findings was verified through a checking procedure whereby several interview participants were asked to check whether the data transcribed was consistent with their answers during interviews.<sup>91</sup>

### 3.3 Research Objectives and Questions

The main objectives of this study are to determine the principal factors that influence the effectiveness of tax investigations in Malaysia and to establish the factors that have a significant influence on tax deterrence in Malaysia from the IRBM's perspective. Based on the research objectives, four key questions need to be answered in order to provide a clearer direction for this study.

First, this study intends to determine whether complex tax laws have a significant influence on the IRBM's intention to achieve an effective tax investigation in Malaysia. Research in the taxation field has found that complex tax laws have a relatively significant influence on taxpayers' compliance behaviour.<sup>92</sup> Thus, complex tax laws may have an impact as well on the IRBM investigation officers' performance.

Second, this study tries to establish the extent of the IRBM investigation officers' knowledge and skills in influencing the intention to achieve an effective tax investigation. Previous studies supported the proposition that all tax officers must possess proficiency such as technical knowledge, audit skills and tacit knowledge to ensure the efficacy of the tax enforcement system.<sup>93</sup>

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<sup>89</sup> Virginia Braun and Victoria Clarke "Using Thematic Analysis in Psychology" (2006) 3 *Qualitative Research in Psychology* 77 at 86.

<sup>90</sup> Philip Burnard "A Method of Analysing Interview Transcripts in Qualitative Research" (1991) 11 *Nurse Education Today* 461 at 464.

<sup>91</sup> See n 90, at 465; Saunders, Lewis and Thornhill, above n 86; Braun and Clarke, above n 89, at 91; Creswell, above n 83.

<sup>92</sup> Margaret McKerchar "The Study of Income Tax Complexity and Unintentional Non-Compliance: Research Method and Preliminary Findings" (ATAX Discussion Paper Series 6, University of New South Wales, October 2001); Margaret McKerchar and Chris Evans "Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy Makers and Revenue Authorities" (2009) 7 *eJournal of Tax Research* 171; Khadijah Mohd Isa "Corporate Taxpayers' Compliance Variables under the Self-Assessment System in Malaysia : A Mixed Methods Approach" (PhD Thesis, Curtin University, 2012).

<sup>93</sup> Jacqui McManus "Enhancing tax auditors' capability: Tackling non-compliance head on" in Margaret McKerchar and Michael Walpole (eds) *Further Global Challenges in Tax Administration* (Fiscal Publications, Birmingham, 2006) 227 at 228; Khadijah Isa and Jeff Pope "Corporate Tax Audits: Evidence from Malaysia" (2011) 2 *Global Review of Accounting and Finance* 42 at 48.

The third research question is to establish to what extent the IRBM's enforcement strategy influences the intention to achieve effective tax investigations in Malaysia. An optimal enforcement strategy is important because all tax authorities have to assess the potential benefits of tax enforcement against the costs of implementing it.<sup>94</sup>

The fourth question explores whether high monetary tax penalties have a significant effect on tax offenders' deterrence. In the previous literature, there have been mixed results regarding the impact of monetary tax penalties on taxpayers' compliance and deterrence.<sup>95</sup>

## **4.0 FINDINGS**

### **4.1 Interviews**

The first-named researcher interviewed 16 participants in December 2012. Prior to the interviews, all participants were informed about the objectives and the significance of this research. Subsequently, they agreed to be interviewed voluntarily.

The participants were able to talk about their experiences and organisation, particularly regarding the intention to have effective tax investigations in Malaysia. The interview sessions took approximately 90 minutes each. Due to the delicate nature of this study and as a sign of mutual respect, there was no recording using any electronic device. All responses were noted down through handwriting and were subsequently transcribed on the same day or the day after to ensure all data was accurately recorded.

### **4.2 Profile of Interview Participants**

The key profiles of the participants are shown in Table 1. The gender composition clearly shows a male dominance and it is obvious that all participants are highly experienced because all have more than 20 years' working experience with the IRBM. In addition, eleven (69 per cent) of them have more than 15 years' experience in tax investigations while the rest have more than 10 years' working experience.

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<sup>94</sup> Joel Slemrod and Shlomo Yitzhaki "The Optimal Size of a Tax Collection Agency" (1987) 89 *Scandinavian Journal of Economics* 183 at 184; Louis Kaplow "Optimal Taxation with Costly Enforcement and Evasion" (1990) 43 *Journal of Public Economics* 221 at 234; Janet G McCubbin "Optimal Tax Enforcement: A Review of the Literature and Practical Implications" (2003) 96 *Proceedings: Annual Conference on Taxation and Minutes of the Annual Meeting of the National Tax Association* 16 at 17.

<sup>95</sup> Paul J Beck and Woon-Oh Jung "Taxpayer Compliance under Uncertainty" (1989) 8 *Journal of Accounting and Public Policy* 1 at 18; Gary Kleck and others "The Missing Link in General Deterrence Research" (2005) 43 *Criminology* 623 at 654; James Alm and Michael McKee "Audit Certainty, Audit Productivity, and Taxpayer Compliance" (2006) 59 *Nat'l Tax J* 801 at 814.

**Table 1: Profile of the Interview Participants**

	<b>Number of Participants</b>	<b>Percentage (%)</b>
<b>Gender</b>		
Male	15	94
Female	1	6
<b>Number of years working with the IRBM</b>		
Less than 20 years	0	0
More than 20 years	16	100
<b>Number of years doing tax investigation</b>		
Less than 10 years	0	0
10 to 15 years	5	31
More than 15 years	11	69
<b>Number of investigation officers in branch</b>		
Less than 10	8	50
10 or more	8	50
<b>Type of tax investigation done in branch</b>		
Civil tax investigation only	10	62
Both civil and criminal tax investigation	6	38

### 4.3 Discussions on the Findings from Interviews

#### 4.3.1 Overview

This study has adopted a deductive approach by deriving the important variables of effective tax investigations based on previous studies of tax enforcement. However, due to the exploratory nature of this study, an inductive approach was adopted as well to improve on new ideas. After the interviews, the participants' views were analysed to assess whether they support the anticipated variables. Based on this approach, the researchers perceive that there are four major variables or factors that influence the effectiveness of tax investigation namely complexity of the tax laws, knowledge and skills of the investigation officers, the IRBM's enforcement strategy, and tax penalties. These variables are now discussed further.

#### 4.3.2 Complexity of Tax Laws

Complexity of tax laws has been studied and discussed in previous tax literature with most of the focus being on its influence on taxpayers' compliance. Even though most previous studies have found that complexity of tax laws influences taxpayers' compliance behaviour, there have been mixed results regarding the degree of influence on this behaviour. However, this is not a major issue because there are many differences in the studies in terms of tax systems, tax laws, research methods, population of the studies, sampling methods, socio-economic factors, culture and many more factors that would have resulted in different inferences.

In this study, it is found that complex tax laws do affect the performance of the investigation officers, especially in the interpretation of certain vague or unclear tax law provisions which may make the time for case settlement much longer. Nevertheless, 12 participants (75 per cent) perceived that complex tax laws should not have a significant influence on the overall performance of the investigation officers. According to the interviewees, the IRBM has its own resource persons either from the Tax Policy Department or from the Legal Department who can assist the investigation officers in the clarification and explanation of difficult tax laws. The following responses support the above perceptions:

Difficult tax laws may affect the performance a bit but I don't think this is a major factor that affects investigation officers' performance because we have a lot of avenues to seek help to interpret difficult tax laws such as the Legal Department or the Tax Policy Department. We have the resource persons to seek legal advice [from]. Furthermore, the investigation officers have no choice but must learn to the very best to master the understanding of tax laws. That's part of the job before you can think of enforcing the tax laws. (Participant 4)

Yes, sometimes difficult tax laws can affect the investigation officers' performance but I think it is not as significant as you think because we in [the] IRBM have many resource persons to seek advice [from] regarding difficult tax laws. (Participant 11)

Ten participants (63 per cent) perceived that the complexity of the tax laws is not associated with the intention to have effective tax investigations in Malaysia, which implies that the intention to have effective tax investigations can be achieved whether or not the tax laws are complex. Supporting quotes include:

Our intention to achieve effective tax investigation has nothing to do [with] whether our tax laws are simple or not. We can always have an effective tax investigation even if the tax laws are bloody complex. (Participant 7)

Of course it is good to have simple tax laws but having said that, a simple tax law has nothing to do with our intention to achieve effective tax investigation. We can always achieve effective tax investigation even though our tax laws are not simple. (Participant 13)

### **4.3.3 Knowledge and skills**

Knowledge and skills in this study refer explicitly to the knowledge and skills of the IRBM's investigation officers in their tax investigation work. The fundamental criteria for knowledge and skills include high proficiency in tax laws, comprehensive knowledge of tax investigation working procedures, high expertise in investigation skills, capability of exercising intuitive skills to detect tax fraud, good negotiation skills, high level of practical accounting knowledge and being highly competent in conducting tax investigation cases.

In common terms, knowledge and skills fall under the competency variable that includes integrity, academic qualifications, leadership qualities, interpersonal skills and trustworthiness. In this study, however, the terms knowledge and skills specifically comprise those indicators related to the work performance of investigation officers such as knowledge of relevant tax laws, tax investigation skills, interpersonal skills and practical knowledge related to tax investigations (such as accounting and relevant laws).

All participants in this study firmly supported the view that all investigation officers must possess the highest possible knowledge and skills. This is because knowledge and skills are directly related to the quality of tax investigation work where high quality tax investigation work would lead to an effective tax investigation. The focal points gathered from this study are the ability of the investigation officers to detect tax fraud and the ability to sustain the overall quality of their investigation work. The participants also unanimously agreed that highly knowledgeable and skilful investigation officers are vital in order to optimise the ability to detect tax fraud and perform tax investigation tasks expertly.

Knowledge and skills in tax investigation are very important as a base for our enforcement system to achieve effective tax investigation. When an investigation officer has a lack of tax investigative knowledge and skills, the quality of his/her tax investigation will be affected as well. I handle this issue at my branch by mixing the senior and junior investigation officers in respective groups. By doing this, I hope they will learn and share their knowledge and experience together. I believe by doing this also, the quality of tax investigation is enhanced and sustained. (Participant 5)

If all investigation officers are highly knowledgeable and skilful, automatically our quality of tax investigation will be enhanced. This will help us to achieve a highly effective tax investigation. In my branch, I encourage my officers to share their knowledge especially on new issues related to tax fraud. I normally choose one of my officers to present his/her new knowledge during our monthly meeting. (Participant 6)

The other point, which emerged during the interviews, relates to the working culture in the IRBM's tax investigations area, which stresses a strong collective team ethos that involves officers working in groups. All participants supported that teamwork is very important in conducting tax investigations and considered this matter seriously. This is because any enforcement system must have the elements of good teamwork to ensure its success.

I prefer working in groups because we can share our knowledge and expertise better, we can do our jobs effectively and efficiently in groups and also be seen as united and strong in a group. At the end of the day, working in [the] tax investigation branch is all about teamwork. (Participant 12)

Of course in groups because in groups we can share our expertise and knowledge. We can also have [checks and balances] in our [work] and tend to settle our cases faster in groups. (Participant 15)

It is also interesting to note that all investigation branches in Malaysia have a mixture of experienced and new investigation officers. In order to ensure high quality tax investigation work, all interviewees shuffle their investigation officers by mixing those who are experienced with new ones in groups so that they can continuously learn 'on the job' and share their expertise and experiences. The interviewees also noted the importance of continuous intensive courses and assessments related to investigation officers' jobs to ensure that they keep up with the latest trends in taxation issues.

#### **4.3.4 Enforcement strategy**

The IRBM's objectives since the inception of the self-assessment system in 2001 are to minimise the costs of tax collection, to enhance tax compliance and to establish an effective tax enforcement system.<sup>96</sup> It is apparent that one of the objectives is to have a sound tax enforcement system, which acts as a counter-measure for voluntary tax compliance.

As taxpayers' compliance behaviour can be influenced by many factors, it is not easy to achieve full voluntary tax compliance without first having an effective enforcement system. In the self-assessment system, tax enforcement forms the yardstick to provide a check and balance on taxpayers' compliance and also to ensure the perception of fairness towards the country's tax system. This is because even though the IRBM accepts taxpayers' reporting of income in good faith, it is equally important to ensure or confirm all taxpayers report their income as required by the tax laws.

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<sup>96</sup> IRBM *Annual Report 2001* (Kuala Lumpur, 2002); Ern Chen Loo "The Influence of the Introduction of Self Assessment on Compliance Behaviour of Individual Taxpayers in Malaysia" (PhD Thesis, University of Sydney, 2006) at 25; Mohd Rizal Palil "Tax Knowledge and Tax Compliance Determinants in Self Assessment System in Malaysia" (PhD Thesis, University of Birmingham, 2010) at 35; Mohd Isa, above n 56, at 22.



Based on the participants' feedback, the main objective of tax investigations in Malaysia is to instil deterrence among taxpayers, especially possible tax evaders. In order to achieve high deterrence, tax investigations must be highly effective. Thus, one of the determinants for effective tax investigation is the enforcement strategy of the IRBM. According to all interviewees, the IRBM's enforcement strategy involves the deployment of investigation officers throughout the 17 branches in Malaysia, assigning them to undertake civil and criminal tax investigations. The investigation officers are assigned to undertake tax investigation cases based on planned annual targets in terms of case settlements and tax collections. The objective of the tax enforcement strategy is to enforce the tax laws on tax evaders with the intention to deter tax evaders and potential tax evaders.

This study found that 15 participants (94 per cent) believed that the IRBM's tax enforcement strategy is consistent with the IRBM's objective to inculcate voluntary compliance among Malaysian taxpayers and they collectively agreed that high deterrence and compliance are the outcome of an effective tax enforcement system.

Of course our tax enforcement strategy is consistent with [the] IRBM's objective to inculcate voluntary compliance among taxpayers ... (Participant 13)

Our current enforcement strategy is satisfactory and practical because all the while for the past 20 years or more, we have been doing civil tax investigation. So, everything should be at the finger tips. But, I am not clear about our future direction in tax investigation because for your information, we have announced that we are going to fully implement the criminal tax investigation in 2013. (Participant 6)

However, it is interesting to note that 13 participants (81 per cent) perceived that even though the current tax enforcement is feasible within the Malaysian tax environment, it is still not in full force yet. Criminal tax investigations, which were first introduced in 2003, have been quite elusive in practice because the focus has always been on civil tax investigations. Nevertheless, it is important to note that 14 interviewees (88 per cent) mentioned that full implementation of criminal tax investigations commenced in 2013 and this gradual rollout may explain the current and continuing emphasis on civil investigations.

Based on the interview participants' feedbacks, a few factors may have caused delay in the full implementation of criminal tax investigations in Malaysia. First, the delay was due to a lack of tax crime experts. This has also contributed to a slow learning and transition process from civil tax investigation to criminal tax investigation. Practically, it needs time to train the investigation officers on criminal tax investigation.

We have introduced criminal tax investigation a few years ago without updating or upgrading our own Income Tax Laws to suit the criminal tax investigation working procedures. (Participant 4)

We could not proceed fully with criminal tax investigation for the last few years because our tax laws are not [strengthened] yet and our officers are also not equipped with criminal tax investigation knowledge. (Participant 6)

Second, the delay was due to the unhurried enactment of the relevant income tax laws to suit the criminal tax investigation working procedures. This delay was also influenced by other factors such as the Malaysian socio-economic and political aspects.

Criminal tax investigation has been introduced but so far we have not seen any enhancement in the income tax laws to state this intention. The ones we have in our income tax laws now are quite unclear and may be subject to challenges in the future. But, I think we have done a lot of cases involving criminal prosecution for the last few years. (Participant 1)

I frankly think our criminal tax investigation is still very weak because we have a (sic) very few, if any experts on criminal tax investigation. Some of our Standard Operating Procedure on criminal tax investigation are also

not as clear-cut as you think. Tax crime is not like the normal crime where the investigator starts investigating from the crime scene and move backwards to establish a case. In tax investigation, we are dealing with historical documentations ie there is no crime scene to start from and who to accuse for committing the crime. (Participant 3)

In addition, the interviewees stated that the IRBM now has extensive statutory power to investigate suspected money laundering activities under the provision empowered by the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (Malaysia).<sup>97</sup> This law empowers the IRBM to request the Malaysian Central Bank to freeze all bank accounts of taxpayers suspected in operating illegal business activities inside and outside Malaysia.

#### 4.3.5 Tax penalties

In this study, the focus is to explore from the tax authority's perspective whether a high amount of tax penalty has a significant deterrent effect on tax offenders. In other words, this study tries to establish whether a high amount of tax penalty supports the intention to achieve effective tax investigations, which subsequently instils high deterrence among taxpayers. The findings show that all participants perceived that high monetary penalties have no significant deterrent effect especially on habitual tax evaders. The findings are supported by the following participants' views:

Thirty years ago high penalties in terms of monetary (sic) would surely have deterred tax evaders and potential tax evaders but not now anymore. The penalties are just money for them. Even if they get caught, they will pay and continue to commit tax frauds again [in] the years after. (Participant 15)

As for the habitual tax evaders, high penalties in terms of monetary fines will not have any significant deterrent impact on them. This is based on my own experience where in the subsequent period of investigation, the tax frauds/tax crimes are still being committed and sometimes, [on] a larger [scale]! I believe it is the right time now we enforce in full the criminal tax investigation and also utilise actively the provision for the anti-money laundering activities. (Participant 14)

This indicates that high deterrence is not necessarily achieved through heavy penalties *per se* but also relies on other approaches such as practice of procedural fairness, show of general respect for taxpayers and fairness in the enforcement of the tax laws.

Overall, the IRBM's tax investigations seem to have an insignificant deterrent effect on taxpayers because of the remoteness of their operations and publicity.<sup>98</sup> All participants pointed out that almost all tax investigation cases undertaken have tax fraud issues which highlight the sign of low deterrence. There are two possible reasons for this: first, the tax case selection through intelligence work is effective; second, general taxpayers do not feel the deterrent effect of tax investigations at all.

Regarding the first possible reason above, it seems that there is an important judgment on the effectiveness of the IRBM's intelligence component<sup>99</sup> where 11 participants (69 per cent) critically pointed out that the Intelligence Department is not operationally functioning as expected.

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<sup>97</sup> This Act was originally known as the Anti-Money Laundering Act 2001 (Malaysia) that came into force in January 2002. It was amended in 2003 to include measures to fight terrorism financing and was subsequently renamed as the Anti-Money Laundering and Anti-Terrorism Financing Act 2001 (Malaysia).

<sup>98</sup> Under s 138 of the Income Tax Act 1967 (Malaysia), IRBM officers shall treat all taxpayers' material and information as confidential. Thus, no taxpayers' information shall be disclosed to any other party for other purposes.

<sup>99</sup> The Intelligence Department is a department in the IRBM whose main function is to do surveillance and intelligence tasks that include looking for potential tax investigation cases.

Overall, we are OK and on the right track. The only area that needs to be improved is the Intelligence Department because in criminal tax investigation, we rely heavily on good cases provided by this Department. If good cases are provided, of course we will produce high quality investigation cases. (Participant 2)

Our current tax investigation system is generally ok. The only areas that need improvement to get ourselves ready for the criminal tax investigation are our Intelligence Department and our Database & Profiling of Information. If these two are strong, automatically our tax investigation's quality will be enriched and systematic. (Participant 9)

The other factor that needs to be improved is our information/database system which has to be strong and reliable. So, our Tracking Unit and Intelligence Department need to be boosted up professionally and functionally. (Participant 13)

In addition, all participants agreed that most investigation branches have to rely on their own appointed intelligence officers who, at the same time, function as investigation officers.

As for the second possible reason above, 10 participants (63 per cent) agreed that the number of tax investigation cases taken is too low to leave a significant deterrent impact on taxpayers. This assessment corresponds with the traditional deterrence model that a low probability of being audited or investigated will lower the tax compliance level. Based on the explanation above, the existence of tax fraud issues in most of the cases suggests that there is a lack of deterrent effect among Malaysian taxpayers.

#### **4.4 Effective Tax Investigations**

Effective tax investigations are posited to be influenced by investigation officers' competency, enforcement strategy, complex tax laws and the tax penalty regime. Based on the interview findings, 13 participants (81 per cent) defined effective tax investigation as a complete process of tax investigation from the first day of investigation until the day of case settlement. Subsequently, the spillover impact is felt by many other taxpayers, that is, those who are deterred by the outcome of the tax investigation cases. In other words, effective tax investigations instil deterrence indirectly on taxpayers and directly on tax evaders who have been investigated. Nine out of the 13 participants above added that effective tax investigation contributes to high compliance among tax evaders who are deterred by the outcomes of their tax investigation cases. Based on this premise, taxpayers' compliance will likely increase if they are deterred by an effective and sound tax enforcement system.

[The number] of cases settled and [the] amount of tax collected are just secondary to me. For me an effective tax investigation is when there is high deterrence among taxpayers. A proven case for deterrence is when we find no tax fraud/tax issues when we investigate a taxpayer. (Participant 5)

For me, a tax investigation is considered effective if there is a high level of compliance and deterrence on all taxpayers. The other thing, an effective tax investigation occurs when the investigation officer is satisfied with his/her own investigation cases ie he/she has [checked] everything, [tested] everything and [supported] everything about his/her cases. (Participant 8)

Another key finding from seven participants pointed that in order to achieve high deterrence, one of the strategies that should be adopted by the IRBM is increasing the volume of tax investigation cases. This is based on the perception that an increase in the volume of tax investigation cases is equivalent to an increase in the probability of being investigated from the taxpayers' point of view.

#### **4.5 Tax Deterrence in Malaysia**

As mentioned above, 10 interview participants perceived that the number of taxpayers selected for tax investigation annually is very low and this hinders the IRBM's intention to inculcate high tax deterrence

among the taxpayer population in Malaysia. The perceptions of two interview participants in this respect illustrate the point:

I don't think our current tax enforcement has any significant deterrent impact on the whole Malaysian taxpayers' population. One of the factors that contribute to this is our limited number of taxpayers that have been taken for tax investigation [where] the percentage is lower than 0.5 per cent of the total taxpayers' population annually. In addition, when we conduct any raid for tax investigation, we are not allowed to publicise this matter in the media or to the public ... so, who will notice our work if we perform it silently. (Participant 8)

I think human resource is our problem now because we have [fewer] than 300 investigation officers all over Malaysia to cover [...] more than five million registered taxpayers (individual and companies). This ratio is ridiculous if we talk about trying to send the deterrence message to taxpayers through tax investigation activities when we only investigate less than 0.5 per cent of taxpayers annually. The other factor that might affect the effectiveness of tax investigation is [the] IRBM's information/data bases which are currently not user-friendly and very limited. We need more reliable and expansive [databases] so that our tax investigation will become more thorough and effective. (Participant 12)

It is evident that general tax deterrence among Malaysian taxpayers is relatively low due to an insignificant presence of tax investigation intensity from the IRBM. However, in fairness to the IRBM, many other factors that are beyond the IRBM's control influence this issue such as lack of human resources and lack of political will to increase its efforts in this regard.

The other issue that has been explored by the researcher is whether tax investigation activities in Malaysia have a significant deterrent effect on hardcore or habitual tax evaders. It is somewhat remarkable to note that the current tax enforcement that focuses more on civil tax investigations has no significant effect on hardcore tax evaders or offenders. This aspect is worth exploring further by researchers:

No, high penalties in terms of monetary fines will not have [a] significant deterrent impact on the hardcore/habitual tax evaders. I have experienced this from my own branch where the same tax evaders will still commit the same tax frauds even after being investigated before. These are the taxpayers who deserve to be punished and sentenced [to] jail to serve as deterrence. (Participant 6)

High penalties in term of monetary fines I believe do not have any significant effect on habitual tax evaders. Maybe because our tax investigation is not thorough enough to uncover/detect all tax frauds or these tax evaders simply have the 'I pay and will do it again' attitude. These hardcore tax evaders have to be taught a lesson in the way of criminal tax investigation ... ie [the] IRBM is not interested in your money anymore but is going to put you in jail or shame you in court. (Participant 10)

The other reason that may contribute to low deterrence among taxpayers in Malaysia is the ability of the IRBM to detect and select worthy cases for either audit or investigation. Eleven interview participants (69 per cent) who lamented mentioned this point about lack of information and knowledge-based data to assist their investigation branches in performing tax investigation tasks. In their statements, these eleven participants also pointed out about the intelligence element in the IRBM's tax enforcement which, in their opinion, is still lagging operationally.

## 5.0 CONCLUDING REMARKS

This article has sought to explore the determinants of effective tax investigations and perceptions of the influence of effective tax investigations on tax deterrence from the tax authority's point of view. There are many previous studies on the determinants of tax deterrence from the taxpayers' perspective but there is scarcely any from the tax authority's perspective. To the authors' knowledge, this is the first study in the Asian region that investigates the probable factors that influence the effectiveness of tax investigations from

the perspective of a tax authority. In addition, the data obtained from the tax professionals within the tax authority has also significantly contributed to the base of tax research knowledge in this area.

The framework of this study tries to establish that effective tax investigations play an influential role in instilling deterrence among tax evaders and taxpayers. Based on the findings of this study, it is suggested that there are two variables that significantly influence the effectiveness of tax investigations in Malaysia. The first variable is the professional proficiency of investigation officers, which includes their knowledge and skills, ability to work independently, high integrity and their capacity to be a good team worker. All participants in this study strongly supported that professional proficiency has a significant positive influence on the effectiveness of tax investigations. This indicates that the recruitment and appointment of investigation officers who possess high professional proficiency is the essence of a highly effective tax investigation system. On the other hand, any misjudgement in the selection and recruitment of investigation officers may impede the tax investigation system, which eventually has an impact on the intention to instil deterrence through effective tax investigation.

The other important variable established in this study is the tax enforcement strategy of the IRBM, which can be divided into operational and statutory parts. On the operational side, all participants supported that the number of tax investigation cases undertaken should be increased (that is, increase the probability of being investigated for taxpayers) so that the presence of tax enforcement activities can be generally felt by all taxpayers. This ideally could be achieved by increasing the number of investigation officers but, in reality, it may not necessarily be possible due to the limited resources made available for the IRBM. On the statutory side, it is beyond the scope of this study because the current researchers perceive that the statutory part of tax enforcement strategy involves more with the policy makers or the government.

Despite this, there are some positive responses from the participants on how to make this process easier and potentially increase the number of tax investigation cases. First, the number of investigation cases settled can be expedited by having simpler procedures on the application of the tax laws. For example, all participants envisaged that the current tax penalty scheme for tax investigation cases could be made simpler by setting straightforward penalty rates and by application for all cases undertaken by investigation branches. Second, most of the participants agreed that the operational function of tax investigation would be more effective and efficient if support from within the IRBM is fully applied. For example, tax investigations need as much relevant information from as many databases as possible to provide documentary evidence for any case undertaken. In addition, this study also highlights the importance of the Intelligence Department in the IRBM as the main provider for quality investigation cases.

This study shows that complex tax laws have an influence on the effectiveness of tax investigations even though it is not as significant as knowledge and skills in tax investigation. On the other hand, the scarcity of human resources is noted because currently there are fewer than 300 investigation officers throughout Malaysia who are expected to perform their duties in relation to approximately 5.7 million registered Malaysian taxpayers.<sup>100</sup> Thus, it may be the right time for the policymakers to provide more resources that are needed by the IRBM to properly discharge its functions. This study also indicates that high monetary penalties do not necessarily instil deterrence, especially among habitual tax offenders.

As this study is qualitative in nature, the findings cannot be generalised as they are only part of a mixed-methods study. Thus, this research is unable to offer a comprehensive understanding on the issues explored. However, it has indicated the need for possible future research in tax enforcement, especially in

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<sup>100</sup> IRBM *Annual Report 2010* (Malaysian National Library, Kuala Lumpur, 2011) at 38.

Malaysia. First, there is a possibility to study further on the perceptions of taxpayers and tax practitioners on tax enforcement in Malaysia. Second, this study also paves the way for a triangular study between tax authorities, tax practitioners and taxpayers on tax enforcement activities in Malaysia.

The researchers conclude that there are some impediments for the IRBM to instil deterrence among taxpayers in Malaysia. This is because on the one hand, it anticipates the spillover effects from tax investigation to deter other taxpayers while on the other hand, the IRBM is prohibited under the Income Tax Act 1967 (Malaysia) from disclosing details such as the names and particulars of taxpayers under tax investigation. The prohibition extends to settled tax investigation cases as well. This seems to detract from the purpose of making the spillover effects as successful as they might otherwise be. However, the IRBM has shown positive initiatives to move forward with the intention to strengthen its tax enforcement through criminal tax investigation. The researchers also suggest that the IRBM consider looking at other tax authorities like those in Australia and New Zealand to find better ways to strengthen its tax enforcement system.

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## APPENDIX 1



### PARTICIPANT INFORMATION SHEET

#### **Tax Investigation And Determinants Of Its Effectiveness In Malaysia From Inland Revenue Board's Perspective.**

Dear Participant,

I am a Doctoral Research Student at the Tax Policy Research Unit, School of Economics and Finance, Curtin University, Western Australia. As part of the requirements to accomplish my PhD journey, I am conducting a qualitative research to explore the probable factors that affect the effectiveness of tax investigation in Malaysia.

The main purpose of the study is to determine the factors that influence the effectiveness of tax investigation in Malaysia in achieving high tax deterrence among taxpayers.

Thus, I kindly request your cooperation and support in this qualitative research by participating in the interview. The interview will take approximately 45 minutes at a time and date convenient to you. You are kindly acknowledged that your participation is voluntary whereby all interview responses are confidential and anonymity is fully assured. On the other hand, you may also withdraw from the study at any time without obligation.

Once you have read through this information sheet and confirmed your participation in this study, please **sign the Consent Form** attached.

Should you need any further clarification regarding this study, please feel free to contact my academic supervisor, Professor Jeff Pope via email: [Jeff.Pope@cbs.curtin.edu.au](mailto:Jeff.Pope@cbs.curtin.edu.au)

This interview exercise has been approved by the Curtin University Human Research Ethics Committee (Approval No: E&F/06/2012). Should you wish to lodge a complaint about any matter pertaining to this study, please contact:

Secretary  
Human Research Ethics Committee  
Office of Research and Development  
P.O. Box U1987  
Perth WA 6845 Australia  
[hrec@curtin.edu.au](mailto:hrec@curtin.edu.au)

I really appreciate your kind consideration and support. Thank you very much.

John Tensay Peter Raig  
Doctoral Research Student  
School of Economics and Finance  
Curtin Business School  
Curtin University



**CONSENT FORM**

**Tax Investigation And Determinants Of Its Effectiveness In Malaysia From Inland Revenue Board's Perspective.**

The following consent form is provided with respect to the interview session.

I have read the information sheet and understand the purpose of the study and have been given the opportunity to ask any related questions. I understand that I may withdraw from the study at any time without obligation.

I understand that all information provided by me is strictly confidential and shall be used for academic purpose only. Hence, any published material hereafter will not include my name or other identifying information. I understand that written records from this interview will be kept for a period of 5 years from this date in a secured place at Curtin University.

On the basis of the above, I agree to participate in this study.

Name : .....

Signature : .....

Date : .....



**APPENDIX 2: INTERVIEW QUESTIONS FOR INVESTIGATIONS OFFICERS OF  
THE INLAND REVENUE BOARD MALAYSIA**

1. General questions that is years' experience, number of investigation officers in own branch, scope/type of work in own branch et cetera. Please answer the one applicable to you only.
2. The interpretation and application of certain tax laws are always subjected to disputes even among the IRBM's own officers. Please give your opinion on this matter (what and why).
3. Tax investigation performance is affected by investigation officers' difficulty to explain and dispute ambiguous tax laws with taxpayers/tax agents. What is your view on this matter?
4. Do you think simple and unambiguous tax laws help in enhancing the performance of investigation officers and support their intention to achieve effective tax investigation?
5. Knowledge and skills are very important in detecting tax fraud, whereas lack of knowledge and skills distorts the performance of investigation officers towards achieving effective tax investigation. Please comment on how you handle this issue at your branch/department.
6. Different levels of knowledge and skills among investigation officers produce different abilities to detect tax fraud as well. This may result in varying quality of tax investigation. What is your opinion about this perception and how do you rectify this matter?
7. In your opinion, what are the basic requirements of a highly knowledgeable and skilful investigation officer?
8. Can you suggest any idea/way to enhance the investigation officers' expertise so that all of them will be highly regarded and respected?
9. The IRBM's enforcement strategy involves investigation on tax evaders with the objectives of collecting additional tax and inculcating deterrence. What is your opinion about the IRBM's current tax enforcement strategy (whether realistic, practical and consistent with the IRBM's intention to inculcate voluntary compliance among taxpayers)?
10. In your opinion, how do you define an effective tax investigation from the IRBM's point of view (that is, by number of cases settled, amount of back duty collected, high deterrence, high compliance)?
11. What is your perception on the IRBM's current and future commitment on the intention to have a highly effective tax enforcement system (that is, any plan to improve or to strengthen tax enforcement)?
12. Do you think the IRBM's tax enforcement through tax investigation has a significant deterrent impact on the whole Malaysian taxpayers' population?
13. Do you think the IRBM's tax investigation with high penalties in terms of monetary fines has a significant deterrent impact on the tax evaders who have been investigated? Please elaborate.
14. Criminal tax investigation has been introduced in Malaysia few years ago and so far we have not seen many (if any) blatant tax evaders being prosecuted, charged and sentenced by the court (that is, imprisonment, court prosecution, criminal sanctions et cetera). What is your opinion on this matter?

15. In your opinion, do you prefer investigation cases to be conducted in groups or individually among your subordinates? Why?
16. Should you have problems related to teamwork among your subordinates, what action normally do you take?
17. Beside factors involving complex tax laws, knowledge and skill, and enforcement strategy, what are the other factors (such as lack of human resources, lack of third-party cooperation, unwarranted interferences) that might affect the effectiveness of tax investigation in Malaysia? Please state your assessment regarding this matter.
18. Please give your assessment about the IRBM's current tax investigation system and suggest which area/areas need to be improved in order to achieve a highly effective tax investigation in Malaysia.