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Income Tax Non-compliance of Small and Medium Enterprises in Malaysia: Determinants and Tax Compliance Costs

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DECLARATION

To the best of my knowledge and belief this thesis contains no material previously published by any other person except where due acknowledgment has been made.

This thesis contains no material which has been accepted for the award of any other degree or diploma in any university.

Signature:

Date: 11 August 2009

ABSTRACT

This study examines the influence of tax compliance costs on non-compliance behaviour, taken together with the business characteristics and managerial perceptions of corporate taxation. The study focuses on corporate Small and Medium Enterprises (SMEs) in Malaysia under the Income Tax Self-Assessment System (SAS). This is the first study on corporate income tax compliance in the Malaysian context and among the first to integrate tax compliance costs, tax attitudes and the likely compliance behaviour of corporations, both in Malaysia and internationally. Thus it makes a significant contribution given this dearth of international literature on corporate tax compliance.

The study adopts a traditional large-scale postal survey questionnaire technique that has been employed extensively by studies of both tax compliance and compliance costs studies internationally. Specifically, estimation of tax compliance costs largely follows the usual technique used by Pope, the 'father' of tax compliance costs studies in Australia and Asia. This estimation method was first established by Sandford, the 'grandfather' of modern tax compliance costs studies, and has been globally employed with some modification to the local context. On the other hand, tax attitudes and the likely compliance/non-compliance behaviour of SMEs are measured from a business managerial or respondent perspective. The above primary postal survey, as well as two additional surveys—a web survey of SMEs and a postal survey of tax professionals—have been undertaken as a measure of consistency of the primary postal survey.

The income tax compliance costs for Malaysian SMEs are estimated at RM9,295 per company, amounting to RM1,084 million in aggregate for the 2006 tax year. The findings of this study demonstrate that the average income tax compliance costs of SMEs under the SAS have decreased significantly by 58 percent in absolute terms. Despite this, the increasing composition of both external costs and computational costs, by 16 and 15 percent respectively, reveals that the role of tax professionals and routine tax works have become substantially greater under the SAS regime. The figure for compliance costs relative to tax revenue of eight percent is found to be similar to a pre-SAS Malaysian

study, and is also within the international range overall. As for the offsetting benefits, the value of tax deductibility is estimated to be almost RM1,700 per SME company, RM196 million in aggregate, or around 18 percent of the compliance costs, thus giving average net compliance costs of RM7,595 or RM888 million in total.

The current study provides evidence of the influence of tax complexity and probability of tax audit on corporate SME tax non-compliance in Malaysia. Compliance costs, in particular, together with two business characteristics, i.e. business size and tax level, and the managerial perceptions about tax fairness and the Inland Revenue Board (IRB) relationship, are found not to influence corporate tax non-compliance. On the other hand, the effect of the remaining four variables, i.e. business length, sector, tax rate and tax incentives, is inconclusive. In terms of international comparisons, the effects of business size on previous corporate tax compliance are mixed, but the business sector was found to influence corporate tax compliance.

Regarding tax compliance costs, the need to recognise the presence and regressivity of tax compliance costs upon SMEs should be, at this stage, recognised at the national level. Further, at a later stage, such issues should be systematically considered and assessed for any major change in tax policy. Findings regarding tax complexity suggest that the IRB should continue their tax simplification measures in a more comprehensive manner to significantly minimise the compliance burden for all business taxpayers, of any size. In terms of tax auditing, the IRB may want to increase substantially the magnitude of such activity, and should utilise such information effectively to lift taxpayers' levels of awareness about the likelihood of their businesses being selected for a tax audit.

Finally, it is acknowledged that there are several limitations of the current study, including those usually associated with self-reporting mail surveys, which may limit the interpretation of the current findings. Despite this, the study makes a significant contribution given the limited number of studies in the field of corporate tax compliance and tax compliance costs studies, particularly for Malaysian SMEs. Future research into

this area, including several extensions of this study, could make further valuable contributions in this area.

DEDICATION

This thesis is dedicated to my wife, Salmah Hassan and our children, Munirah, Noor Afnan and Noor Amnan.

Also dedicated to my late father, Abdul-Jabbar Shaik Mohamed (Al-Marhum); my mother, Ramjan Mohd Yusof; and my brothers—Sayeed Ibrahim, Hakim, Sarubuddin and Shajahan.

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The author of this thesis has jointly published articles during his doctoral study, either as a first-named author or a co-author. Additionally, several conference papers were presented and co-published in the relevant conference proceedings. The contribution of these publications are acknowledged in this thesis, updated and referenced accordingly. Any errors are the responsibility of the author. These publications are listed below:

Abdul-Jabbar, H & Pope, J 2008, 'The Effects of the Self-Assessment System on the Tax Compliance Costs of Small and Medium Enterprises in Malaysia', *Australian Tax Forum,* vol. 23, no. 3, pp. 289–307.

Abdul-Jabbar, H & Pope, J 2008, 'Exploring the Relationship between Tax Compliance Costs and Compliance Issues in Malaysia', *Journal of Applied Law and Policy,* vol. 1, no. 1, pp. 1–20.

Abdul-Jabbar, H & Pope, J 2009 (Forthcoming), 'Tax Attitudes and Compliance among Small and Medium Enterprises in Malaysia', *New Zealand Journal of Taxation Law and Policy,* vol. 15, no. 3.

Abdul-Jabbar, H & Pope, J 2009, 'The Effect of the Self-Assessment System on the Tax Attitudes and Behaviour of Small and Medium Enterprises in Malaysia', in the *21ˢᵗ Annual Conference of Australasian Tax Teachers Association*, Christchurch, 19–21 January.

Pope, J & Abdul-Jabbar, H 2007, 'Tax Simplicity and Small Business in Malaysia: Past Developments and the Future', in the *19th Annual Conference of Australasian Tax Teachers Association*, Brisbane, 22–24 January.

Pope, J & Abdul-Jabbar, H 2007, 'Small and Medium Enterprises in Malaysia: Issues of the Tax Compliance Burden', in the *7ᵗʰ Asian Academy of Management International Conference*, Penang, 21–25 May.

Pope, J & Abdul-Jabbar, H 2007, 'Small and Medium Enterprises and the Regulatory Burden in Malaysia: Alleviating the Compliance Costs of the Goods and Services Tax', in *4th Global Economy Conference*, Shah Alam, 9–10 July.

Pope, J & Abdul-Jabbar, H 2008, '*Tax Compliance Costs of Small and Medium Enterprises in Malaysia: Policy Implications*', Curtin Business School, Perth, Working Paper 2008.08.

Pope, J & Abdul-Jabbar, H 2008, 'Small and Medium-sized Enterprises and Tax Compliance Burden in Malaysia: Issues and Challenges for Tax Administration', *Small Enterprise Research: The Journal of SEAANZ*, vol. 16, no. 1, pp. 47–60.

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LIST OF ABBREVIATIONS

ANOVA	:	Analysis of Variance
ATAX	:	Australian School of Taxation, University of New South Wales
ATO	:	Australian Taxation Office
A$	:	Australian Dollar
BNM	:	Bank Negara Malaysia (Central Bank of Malaysia)
CPI	:	Consumer Price Index
CYA	:	Current Year Assessment
C$	:	Canadian Dollar
€	:	European Euro
GDP	:	Gross Domestic Product
GST	:	Goods and Services Tax (also known as Value Added Tax)
HK$	:	Hong Kong Dollar
HRK	:	Croatian Kunas
IRAS	:	Inland Revenue Authority of Singapore
IRB	:	Inland Revenue Board of Malaysia
IRS	:	Internal Revenue Service, US
ITA	:	Income Tax Act
MCAR	:	Missing Completely at Random
MIA	:	Malaysian Institute of Accountants
MIT	:	Malaysian Institute of Taxation (known as 'Chartered Tax Institute of Malaysia' since April 2009)
MSIC	:	Malaysian Standard Industrial Classification
NSDC	:	National SME Development Council
NZ$	:	New Zealand Dollar
OAS	:	Official Assessment System
OECD	:	Organisation for Economic Co-operation and Development
PAYE	:	Pay As You Earn
PAYG	:	Pay As You Go
PR	:	Public Ruling

PIA	:	Promotion of Investments Act
PYA	:	Preceding Year Assessment
RM	:	Malaysian Ringgit
RMC	:	Royal Malaysian Customs Department
R$	:	Brazilian Real
SAS	:	Self-Assessment System
SIT	:	Slovenian Tolar
SBDTF	:	Small Business Deregulation Task Force, Australia (also known as the Bell Committee)
SME	:	Small and Medium Enterprise
SMEs	:	Small and Medium Enterprises
SME Bank	:	SME Bank of Malaysia
SME Corp	:	Small and Medium Enterprises Corporation Malaysia (formerly SMIDEC), see SMIDEC
SMIDEC	:	Small and Medium Industries Development Corporation, Malaysia (now known as SME Corp), see SME Corp
SPSS	:	Statistical Package for the Social Sciences
STD	:	Schedular Monthly Tax Deduction
STFB	:	The Special Taskforce to Facilitate Business, Malaysia (also known as PEMUDAH)
S$	:	Singaporean Dollar
TCMP	:	Taxpayer Compliance Measurement Program
TDM	:	Total Design Method
TIS	:	Tax Impact Statement (also known as Regulatory Impact Statement or Compliance Costs Assessment)
TRP	:	Tax Review Panel, Malaysia
UK	:	United Kingdom
£	:	Pound Sterling
US	:	United States of America
US$	:	United States Dollar
UUM	:	University Utara Malaysia

KEY GLOSSARY

Additional Costs : Those compliance costs, other than staff time costs, usually incurred within the business, such as costs of printing, stationery, and communication costs. Also known as 'miscellaneous', 'other' and 'non-personnel' costs.

Administrative Costs : The costs incurred by the government in operating a tax system. These are the collection costs of the tax authority. The term 'management costs' is used in the Malaysian context.

Compliance Costs : The costs incurred by taxpayers, over and above their tax liability, in fulfilling their tax obligations. These are gross compliance costs and include three major components: money costs, time costs, and psychological costs.

Computational Costs : Those compliance costs that are unavoidable and which tend to be mostly routine, calculative and incurred on a yearly basis.

External Costs : Those compliance costs that are incurred outside of the business, comprising fees paid to external tax professionals such as accountants and lawyers.

Internal Costs : Those compliance costs that are incurred within the business, comprising mainly staff time costs that are incurred within the business, plus (non-staff) additional costs.

Net Compliance Costs	:	Compliance costs minus cash flow benefits, value for tax deductibility and value of managerial benefits. Regarding findings of this thesis, the term 'net compliance costs' refers to gross compliance costs minus the value of tax deductibility.
Non-compliance	:	Non-compliance signifies the failure to fulfil tax reporting requirements, either intentionally or unintentionally (e.g. by mistake or error). The current study focuses on intentional non-compliance. The term 'tax evasion' is also used interchangeably to indicate deliberate non-compliance.
Planning Costs	:	Those compliance costs that are avoidable in theory, but incurred by taxpayers to legally minimise their tax liability, particularly in the longer run.
Psychological Costs	:	Costs of the burden of taxpayers having to deal with tax affairs, such as stress and anxiety. These costs are not measured in the current study.
Ringgit Malaysia (RM)	:	The official currency of Malaysia. One unit of the Australian Dollar, United Kingdom Pound Sterling, United States Dollar, and European Euro are equal to RM2.84, RM5.79, RM3.52 and RM4.94 respectively (1 July 2009, Bank Negara Malaysia).

Tax Attitudes	:	Tax attitudes refer to business managerial perceptions of taxation. The current study measured six aspects of corporate income taxation: complexity, fairness, tax structure, tax audit, tax incentives and the relationship with tax authority.
Tax Compliance	:	Tax compliance means conforming to legal tax reporting requirements.
Tax Compliance Behaviour	:	This study measures tax compliance behaviour from a business managerial perspective, which corresponds to the likely compliance/non-compliance behaviour.

CHAPTER ONE

INTRODUCTION

1.1   BACKGROUND

Malaysia is one of the fastest growing developing countries in Asia, located specifically in the South East Asian region, with a land area of just over 330,000 square kilometers and a population of about 27 million (Department of Statistics Malaysia 2008). It incorporates two main regions, with 11 states in Peninsular Malaysia, and two in Northern Borneo. There are also three federal territories. Malaysia is a multi-racial country with mainly Malay (53 percent), Chinese (26 percent) and Indian (8 percent) ethnic groups. It is also a multi-religious country—predominantly Muslim (61 percent), but with strong numbers of Buddhists, Christians, and Hindus (Department of Statistics Malaysia 2005). As a former British colony, Malaysia is a member of the Commonwealth of Nations, practising a system of parliamentary democracy and a Constitutional Monarchy. His Majesty the *Yang di-Pertuan Agong* (King of Malaysia) is the Head of the country and the Prime Minister is the Head of government, who exercises the Executive power.

Economically, Malaysia has been transformed from being a largely agricultural economy to an increasingly industrialised economy that focuses on manufacturing and the services sectors—see, for example, Tan (1993, p. 62) and Embong (1996, p. 528). The growth of Malaysia's Gross Domestic Product (GDP) was recorded at 5.3 percent, 5.9 percent and 6.3 percent respectively for the years 2005, 2006 and 2007,[1] with a total contribution from the services and manufacturing sectors amounting to almost 90 percent, 83 percent and 84 percent for the corresponding years respectively (Treasury of Malaysia 2006, p. 29; 2007, p. 26; 2008, p. 38). In 2008 and 2009, GDP growth is expected to be 5.7 percent and 5.4 percent respectively (Treasury of Malaysia 2008, p.

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[1] As an overall comparison, Malaysia's GDP growth between 2005 and 2007 is about double that of Australia, the UK and the US, but lower than that of China, India and Singapore (Source of GDP data: International Monetary Fund 2009).

38). However, the impact of the 2008/09 global economic crisis is expected to lower these original forecasts slightly.

Like the rest of the world, taxation plays a vital economic role in Malaysia and remains a main source of government revenue. Taxation has been typically categorised into two main types—direct and indirect. The current study focuses on income tax, which is the main type of direct taxation in Malaysia, under the Self-Assessment System (SAS).

The income tax SAS was introduced in Malaysia to replace the Official Assessment System (OAS) in stages: first to companies from the year of assessment 2001; and, subsequently, to individuals and other taxpayers, i.e. club and co-operative societies, in 2004. The SAS involves a substantial shift of responsibility on to the taxpayers in terms of their compliance obligations and burden, particularly to business taxpayers. Government regulations, particularly taxation, are a major concern of the business sector internationally. The tax regulatory burdens appear to fall disproportionately on Small and Medium Enterprises (SMEs) worldwide (see for example Sandford, Godwin and Hardwick 1989; Pope 1995; Sandford 1995; Evans *et al.* 1997). This prevalence remains true regardless of the tax system or type of taxes. From the perspective of the Malaysian tax authority, that is, the Inland Revenue Board of Malaysia (IRB), concern about tax compliance is among the main reasons for introducing the SAS. This thesis addresses this concern by estimating income tax compliance costs, examining tax attitudes, and the likely compliant or non-compliant behaviour of corporate SMEs, from a business managerial perspective, in the SAS regime.

This chapter starts with an overall background for this research, by briefly highlighting the significance of income tax, the significance of tax non-compliance, and the importance of SMEs in Malaysia. The research objectives, together with the specific research questions, and significance of the study are presented next. This is followed by definitions of the key terms employed throughout this thesis. Finally, the structure of the thesis is outlined.

1.2 INCOME TAX, NON-COMPLIANCE AND SMALL AND MEDIUM ENTERPRISES IN MALAYSIA

1.2.1 Significance of Income Tax

Malaysia relies largely on taxes (particularly direct taxes) for its revenue. Direct taxes in Malaysia comprise income tax, petroleum income tax, real property gains tax and stamp duty.[2] It is evident that direct taxes in Malaysia contribute significantly towards federal tax revenue, as shown in Table 1.1. For example, in 2005, direct taxes accounted for almost two-thirds of tax revenue.

Table 1.1: Malaysian Federal Tax Revenue, 2002–2008

Year	Direct Taxes		Indirect Taxes		Federal Tax Revenue	
	RM million	Percent	RM million	Percent	RM million	Percent
2002	44,351	66	22,510	34	66,861	100
2003	43,016	66	21,875	34	64,891	100
2004	48,703	68	23,347	32	72,050	100
2005	53,543	66	27,051	34	80,594	100
2006 [a]	61,573	71	25,058	29	86,631	100
2007 [a]	70,116	73	26,080	27	96,196	100
2008 [a]	74,915	73	27,080	27	101,995	100

[a] Data for 2006, 2007 and 2008 represent the actual, revised and budget estimates respectively.
Sources: The Economic Report (Treasury of Malaysia 2005, 2006, 2007)
Exchange rate RM2.84 = A$1; RM3.52 = US$1; RM5.79 = £1; RM4.94 = €1 (1 July 2009, Bank Negara Malaysia).

Income tax is a major source of direct taxes in Malaysia, with corporate income tax representing the highest share of income tax revenue, as shown in Table 1.2. For example, the income tax collected from this sector was 73 percent, 69 percent and 70 percent respectively for the years 2005, 2006 and 2007. Likewise, the corporate sector's contribution to direct taxes, was 49 percent in 2005, 43 percent in 2006 and 44 percent in 2007; and federal tax revenue was 33 percent in 2005, 31 percent in 2006 and 32

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[2] See Chapter Three, subsection 3.2.1.

percent in 2007. Although the percentages fell slightly in 2006, the corporate sector continues to contribute the highest percentage of income tax, either measured as a percentage of income tax, direct tax or federal tax revenue.

Table 1.2: Malaysian Corporate Tax Revenue, 2002–2008

Year	Corporate Tax RM Million	Corporate Tax as a Percentage of		
		Income Taxes [a]	Direct Taxes	Federal Taxes
2002	24,642	71	56	37
2003	23,990	75	56	37
2004	24,388	70	50	34
2005	26,381	73	49	33
2006 [b]	26,477	69	43	31
2007 [b]	30,821	70	44	32
2008 [b]	34,806	70	46	34

[a] The Petroleum Income Tax is not included.
[b] Data for 2006, 2007 and 2008 represent the actual, revised and budget estimates respectively.
Sources: The Economic Report (Treasury of Malaysia 2005, 2006, 2007).
Exchange rate RM2.84 = A$1; RM3.52 = US$1; RM5.79 = £1; RM4.94 = €1 (1 July 2009, Bank Negara Malaysia).

1.2.2 Significance of Tax Non-compliance

Prior tax research (Kasipillai, Baldry and Prasada-Rao 2000; Abdul and Sheehan 2003) indicates that the tax gap in Malaysia could be significant. Kasipillai, Baldry and Prasada-Rao (2000, p. 25) estimated that income tax evasion accounts for an average of 20 percent of actual income tax collection per year in Malaysia over the period 1970 to 1994. Subsequent estimates for the years 1995 to 1997 were carried out by Abdul and Sheehan (2003). They estimated the taxable income gap was RM75.3 billion, RM92.7 billion and RM99.1 billion for the years 1995, 1996 and 1997 respectively (Abdul and Sheehan 2003, p. 33).[3] The methodological differences between these two studies, in

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[3] See subsection 1.5.4. for approximate exchange rates of the major currencies.

particular to the terms used, are worth considering.[4] No estimates of tax evasion are available in Malaysia since 1998. Kasipillai (2003, p. 13) claims that the prevalence of tax evasion is a major concern for the government. It is important to note that the work of Kasipillai, Baldry and Prasada-Rao (2000) and Abdul and Sheehan (2003) were carried out before the implementation of self-assessment. Under the mechanism of self-assessment, the magnitude of the tax evasion figure is probably higher.

From the perspective of the tax authority, there are no comprehensive estimates of tax evasion or non-compliance in Malaysia. However, the IRB publishes annual statistics on the amount of taxes and penalties recovered from IRB investigations and audit activities. The additional taxes and penalties cover mainly income tax and other direct taxes—for example, the real property gains tax and stamp duty. Kasipillai (1999, p. 48) claims that such data provide some evidence as to the magnitude of the problems of deliberate non-compliance in Malaysia. The amount of taxes and penalties recovered from investigation and audit activities approached almost RM500 million per year up to 2002, as shown in Table 1.3. In 2003, they had increased significantly to almost RM800 million, to just over RM1 billion in 2004, and to almost RM1.4 billion in 2005. The tax recovery amount, expressed as a percentage of direct and/or federal taxes, indicates a stable trend up to 2000, declining slightly in 2001 and 2002, and thereafter growing increasingly. In 2005, tax recovery amounts were 2.6 percent and 1.7 percent of direct taxes and federal taxes respectively.

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[4] Abdul and Sheehan used the term 'taxable income gap', which refers to the difference between taxable income (as estimated using national accounts) and taxable income (as assessed by the tax authority). On the other hand, tax gap refers to the difference between total tax collected and what should have been collected. The latter term is often used in the literature (see a review by McManus and Warren 2006).

Table 1.3: Additional Taxes and Penalties Recovered from Investigation and Audit Activities, 1996–2006

Year	Tax Compliance Activity		Total	Total as a % of	
	Investigations [a] (RM Million)	Audit [a] (RM Million)	(RM Million)	Tax Revenue [b]	Direct Taxes [b]
1996	426.1	n/a	426.1	0.9	1.6
1997	509.8	20.4	530.2	1.0	1.7
1998	362.1	100.4	462.5	1.0	1.5
1999	407.4	35.1	442.5	1.0	1.6
2000	428.1	41.4	469.5	1.0	1.6
2001	397.3	51.3	448.6	0.7	1.1
2002	386.5	77.0	463.5	0.7	1.0
2003	615.5	182.6	798.1	1.2	1.9
2004	620.3	429.3	1,049.6	1.5	2.2
2005	763.0	635.4	1,398.4	1.7	2.6
2006	903.2	692.7	1,595.9	1.8	2.6

[a] The data were obtained from the IRB Annual Report (2001a; 2002; 2003; 2004; 2005; 2007; 2008a). As at 1 July 2009, the subsequent report is yet to be published.
[b] Data on tax revenue and direct taxes were obtained from the Economic Report, Treasury of Malaysia (1999; 2000; 2001; 2002; 2003; 2004; 2005; 2006; 2007).
Exchange rate RM2.84 = A$1; RM3.52 = US$1; RM5.79 = £1; RM4.94 = €1 (1 July 2009, Bank Negara Malaysia).

The latest data is not available yet,[5] but the increasing trend is likely to continue despite the current economic recession, especially as percentages of tax revenue and direct taxes. If past experience was to be used, then an average of 20 percent of income tax collection (Kasipillai, Baldry and Prasada-Rao 2000) or a relative percentage of tax recoveries (as shown in Table 1.3) would seem to provide a reasonable indicator of income tax evasion overall, covering both business and non-business taxpayers. However, the approximate magnitude of tax evasion cannot be determined for SMEs due to inadequate data from the IRB and also lack of prior studies in estimating tax evasion by different categories of taxpayer (such as by business establishments or size

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[5] As at 1 July 2009, the 2007 report is yet to be published by the IRB.

of business). The above figures signify the overall importance of income tax evasion in Malaysia. The tax literature recognises that measuring the true extent of non-compliance is not possible, but estimates from the tax gap approach are generally used to indicate the possible sources and the level of non-compliance (see for example Graetz and Wilde 1985; Roth, Scholz and Witte 1989, p. 23; McManus and Warren 2006).

On the other hand, McKerchar (2002b, p. 8) argues that a better understanding of non-compliance is of greater priority rather than measuring the tax gap. She believes that this will contribute to a better tax system that eventually will reduce the tax gap. The current study does not attempt to estimate income tax evasion, but recognises its importance in Malaysia. Thus, this thesis examines the issue of income tax non-compliance in the context of Malaysian SMEs under the SAS regime.

1.2.3 The Importance of Small and Medium Enterprises

This section highlights the importance of the SME sector in Malaysia. Taxation of SMEs and major tax-related issues are presented in Chapter Three. Small and medium enterprises have played an important role in the economic growth of the nation, particularly in developing countries, such as Malaysia. In 2005, there were almost 520,000 SMEs, comprising around 99 per cent of all enterprises in Malaysia, contributing almost 48 per cent of the total value added of the business establishments and around 65 per cent of total employment (National SME Development Council 2006, pp. 19-23). Sole proprietorships account for the highest percentage of SME business establishments (69 percent), followed by private limited companies (21 percent) and partnerships (10 percent). In terms of size, micro businesses account for nearly 80 percent of SMEs, as shown in Table 1.4.

Table 1.4: Malaysian Small and Medium Enterprises by Size, 2005

Business size	Number	Percentage
Micro	411,849	79.4
Small	95,490	18.4
Medium	11,657	2.2
Total SMEs	518,996	100

Source: National SME Development Council (2006, p. 21).

As Malaysia aims to be a fully industrialised nation by the year 2020, SMEs will play a vital ongoing supportive role in this. Small and Medium Enterprises are also expected to complement the activities of the large enterprises through integration into the mainstream of the industrial development process (BT Online 1996). For these reasons, the SME sector has been continuously supported by the government (Osman and Hashim 2003). The importance of SMEs has been further recognised by the establishment of the National SME Development Council (NSDC); more importantly, the Council is chaired by the Prime Minister. The National SME Development Council was established in June 2004 as the highest policy-making body to chart the direction and strategies for comprehensive and coordinated development of SMEs across all sectors of the economy. At the time of its establishment, Bank Negara Malaysia (BNM) acted as the Secretariat to the NSDC. In July 2008, the Secretariat function was conveyed to the Small and Medium Industries Development Corporation (SMIDEC).[6]

In terms of tax revenue, the contribution of SMEs is unknown, since no data is publicly available. The annual report of the IRB published income tax collection by general categories of taxpayer (for example, individual, co-operatives and company) and not by size of the businesses. Further, the establishment of an SME could be in the form of an incorporated body (company) or unincorporated body (sole-proprietor or partnership). Considering this, the amount of income tax paid by SMEs would be included in company and individual taxpayers' assessments. Nonetheless, in recognising the

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[6] For further information, refer to the NSDC website at http://www.smeinfo.com.my. Recently, on 3 July 2009, the SMIDEC has been transformed into the SME Central Coordinating Agency, known as the Small and Medium Enterprises Corporation Malaysia (SME Corp).

importance of SMEs in Malaysia, it is presumed that SMEs, as taxpayers, could contribute significantly to income tax revenue (corporate tax and personal tax, depending on its establishment). Having recognised the significant role of SMEs and their contribution to national growth, particularly tax revenue, the current study estimates compliance costs and examines this and other factors (such as SME characteristics and attitudes) influencing the taxation compliance behaviour of SME companies in Malaysia.

1.3   RESEARCH OBJECTIVES

This study examines the determinants of non-compliance behaviour of small and medium-sized companies in Malaysia, with particular emphasis on income tax compliance costs under the SAS regime. Three research questions have been developed to meet the above overall research objective. First, what are the costs faced by SMEs in complying with corporate income tax laws in Malaysia for the tax year 2006? Secondly, to what extent do compliance costs influence the likely compliance behaviour of SMEs? Thirdly, what is the extent of the relationship between compliance costs and compliance behaviour, taken together with other variables i.e. characteristics of SMEs, attitudes of owner-manager and structure of tax systems?

1.4   SIGNIFICANCE OF THE STUDY

This study extends the scope of taxpayer compliance research to the area of corporate income taxation. This is the first study into corporate tax compliance in Malaysia and adds to the very limited international literature on corporate taxation. This study examines the determinants of non-compliance behaviour of corporations. Almost all prior tax compliance research focussed on the individual taxpayer, with only five studies (Rice 1992; Kamdar 1997; Mills 1998; Joulfaian 2000; Hanlon, Mills and Slemrod 2005) known to this author investigating the determinants of corporate tax

compliance behaviour. Additionally, there are also few theoretical papers or notes that relate to corporate tax evasion (Marrelli 1984; Kreutzer and Lee 1986, 1988; Wang and Conant 1988; Lee 1998). More importantly, these limited studies were predominantly carried out in the US. This study is also probably the first study on corporate tax compliance among developing countries and, more importantly, undertaken outside the US.

The current Malaysian study specifically focuses on corporate SME businesses. Out of the five US empirical studies above, only a study by Rice (1992) is confined to SME corporations. Thus, this study contributes more specifically in the context of SME taxation. Determinants of non-compliance are examined in this study, with particular emphasis directed to the influence of compliance costs on SME non-compliance. The international tax literature noted that there is a lack of research that relates compliance costs with taxpayer compliance behaviour. In a response to Richardson and Sawyer (2001, p. 207), and particularly to Hasseldine (2001, p. 11), this study applies behavioural research methods to investigating the linkages between taxpayer compliance research and tax compliance costs research.

A study by Chattopadhyay and Das-Gupta (2002b) was perhaps the first to merge both tax compliance costs and compliance behaviour in a single study. However, their findings are not conclusive, but rather tentative due to key methodological limitations (Chattopadhyay and Das-Gupta 2002b, p. iii, 25).[7] Another study, by Yesegat (2009), was also conducted at the same time as the current study. The study has used a better methodology by employing both quantitative and qualitative methods, but the relationship between compliance costs and compliance behaviour is analysed merely from experimental data, including the compliance costs figure.[8] The Indian study was confined to personal taxpayers and the Ethiopian study to value added taxpayers. The current study integrates both the tax compliance and compliance costs aspects in the context of corporate taxation, SMEs in particular.

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[7] See Chapter Two, subsection 2.2.1.
[8] See Chapter Two, subsection 2.2.1.

Further, the 2006 Malaysian experience of the postponement of the proposed Goods and Services Tax (GST) indicates a need for the introduction of Tax Impact Statements (TIS)[9] regarding major tax changes and/or new tax legislation, particularly those affecting SMEs. A lack of recognition of the burden imposed on businesses, regardless of size, is among the major reasons causing the indefinite postponement of the GST.[10] Consideration of the tax compliance burden through TIS is useful for the tax policy debate. This would be a similar policy to that adopted in the Organisation for Economic Co-operation and Development (OECD) countries (Evans and Walpole 1999).

This study is also significant in providing evidence on the issue of corporate tax compliance under the SAS regime. Prior studies show the importance of voluntary tax compliance in ensuring effective and efficient implementation of the SAS. Consideration of tax compliance costs, some understanding of the attitudes, and the likely compliance behaviour of business executives could provide direction to policy makers, particularly in enhancing voluntary tax compliance. The Malaysian tax authority, as well as foreign tax regimes which currently operate a SAS or intend to adopt the system in the future, may significantly benefit from this study.

1.5   ANALYSIS OF KEY TERMS

1.5.1   Tax Compliance or Non-compliance

Tax compliance, simply put, means adherence to tax reporting requirements; that is, that the taxpayer files all required tax returns at the proper time and that the returns accurately report tax liability in accordance with the tax laws, regulations, and court decisions applicable at the time the return is filed (Roth, Scholz and Witte 1989, p. 21). Non-compliance, on the other hand, signifies failing to meet tax reporting requirements. Non-compliance represents the most inclusive conceptualisation with respect to the

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[9] Also known as Regulatory Impact Statement (RIS) and Compliance Costs Assessment (CCA).

[10] As June 2009, the GST (also known as Value Added Tax) is yet to be implemented in Malaysia. It is anticipated that the government will initiate again it after the full recovery from the current economy climate.

failure to meet tax obligations, whether intentional or unintentional (Kinsey 1984, p. 2). Other terms used to describe tax non-compliance include tax evasion, cheating, errors and misreporting (Long and Swingen 1991). The term 'tax evasion' is often used interchangeably with non-compliance in the tax literature despite some differences, particularly with reference to intention. Tax evasion, in lay terms, means hiding taxable income from the tax authority (Pyle 1989, p. 111).

In Malaysia, non-compliance may take four main forms: failure to submit a tax return, understatement of income, overstatement of deductions, and failure to pay assessed taxes by the due date (Baldry and Kasipillai 1996). The extent of non-compliance by each of these categories is not known (Kasipillai 2003, p. 13), at least publicly. For business taxpayers, other forms of non-compliance include failure to perform a number of duties and responsibilities as required by the law.[11] Intentional non-compliance is among the most serious tax offences in Malaysia. It is subject to a fine of at least RM1,000 and up to RM20,000 or three years imprisonment, or both, plus a penalty of three times the amount of tax undercharged (Section 114, *Income Tax Act* (ITA) 1967).

The current study focuses on two forms of intentional income tax non-compliance, that is, understatement of income and overstatement of deductions.[12] A separate analysis of the various forms of non-compliance is urged by a number of tax researchers (see mainly Long and Swingen 1991, p. 664; Richardson and Sawyer 2001, p. 224). The term 'non-compliance' is used throughout this thesis, but the term 'tax evasion' can also be used interchangeably in the context of intentional non-compliance. This study adopts a taxpayer orientation by measuring the likely compliance/non-compliance behaviour from SME business managerial or respondent perspectives,[13] as such findings on compliance behaviour throughout this thesis refer to possible compliance/non-compliance. A similar approach is taken by a number of tax compliance researchers internationally e.g. Hite (1988); Reckers, Sanders and Roark (1994); Kaplan, Newberry and Reckers (1997); Chan, Troutman and O'Bryan (2000); Kasipillai, Mat-Udin and

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[11] See Chapter Three, subsection 3.2.2.
[12] See Chapter Four, subsection 4.4.3 and Section 4.5.
[13] See Chapter Four, subsection 4.4.3.

Zainol-Ariffin (2003). A few other authors also prefer to use the term 'compliant attitude' rather than 'tax compliance' or 'tax compliance behaviour' e.g. Hasseldine (1999); Tan and Chin-Fatt (2000); Abdul-Manaf, Hasseldine and Hodges (2005).

1.5.2   Tax Compliance Costs

Compliance costs of taxation are costs incurred by taxpayers, in addition to their tax liability in conforming to the tax requirements. Sandford, Godwin and Hardwick (1989, pp. 10-12) defined compliance costs as those costs incurred by taxpayers, or third parties such as businesses, in meeting the requirements laid upon them in complying with a given tax structure. For a business, the compliance costs include the cost of collecting, remitting and accounting for tax purposes; the costs of acquiring relevant tax knowledge and information; payments to external professionals; and also costs related to incidental and overhead costs (Sandford, Godwin and Hardwick p. 10).

Compliance costs of taxation include three major components, namely money costs, time costs and psychological costs to the taxpayer (Sandford, Godwin and Hardwick 1989, pp. 11-12). The money costs refer to an amount spent on tax advisers or professionals (i.e. tax agents, accountants, investment advisers, legal practitioners) and expenses relating to taxation guides, books, communication and other incidental costs. On the other hand, time costs are incurred on record keeping tax information, completing the tax form, or in preparing tax details for the tax professionals, as well as time spent on dealing with the tax authorities. Meanwhile, psychological costs refer to taxpayers having to deal with his/her tax affairs, such as the anxiety of handling complex tax matters.

Compliance costs are also categorised into their sources i.e. internal and external or types i.e. computational or planning (e.g. Pope, Fayle and Chen 1991). Internal compliance costs refer to both money costs and time costs that are incurred within the business. External compliance costs refer mainly to fees paid to external tax professionals, such as accountants and lawyers. Computational costs are mostly routine, calculative and incurred on a yearly basis. In contrast, planning costs relate to further

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efforts taken by taxpayers to legally minimise their tax liability, particularly in the longer run.

Additionally, Sandford, Godwin and Hardwick (1989, pp. 13-14) recognised cash flow benefits and managerial benefits as offsets to compliance costs. Consequently, the term 'net compliance costs' was in use representing compliance costs after offsetting benefits. Since managerial benefits cannot be easily measured quantitatively, the researcher normally deducts the cash value benefits only in arriving at net compliance costs (Sandford and Hasseldine 1992, p. 7). Benefits arising from tax deductibility have also been included and estimated as an offsetting benefit of compliance since the mid 1990s (Allers 1994, pp. 38-40; Evans *et al.* 1997).

This study estimates compliance costs, covering both the money costs and time costs, incurred by the SME companies in complying with corporate income taxation in 2006. The estimates are carried out both at the company level (disaggregate) and subsequently to a presumed population of SME companies in Malaysia (aggregate). Compliance costs are also analysed in terms of the internal/external and computational/planning classifications. The current study also estimates the net compliance costs after taking into account the value of tax deductibility, both at the firm and aggregate levels. Potential cash flow benefits are recognised in this study, but data availability does not permit estimation. Thus, the term 'net compliance costs' in this thesis refers to gross compliance costs minus a value for tax deductibility. More details on compliance costs estimates are presented in Chapters Four and Five.

1.5.3   Small and Medium Enterprises

This study adopts the standard national definition of SMEs established by the NSDC. This national definition was adopted in Malaysian on 13 September 2005 (National SME Development Council 2005). However, the definition was initially established by the NSDC on 1 December 2004 (Bank Negara Malaysia 2004) and was subsequently endorsed by them on 9 June 2005. It is important to note that this definition has been used earlier to classify SMEs in the SME Annual Report 2005 (National SME

Development Council 2006). Prior to 2005, there was no common definition of SMEs employed in Malaysia. Various measures have been used, including the number of full-time employees, annual sales turnover, amount of assets, shareholders' funds, paid-up capital, and combinations of these methods. For example, the SMIDEC, a primary government agency responsible for the development of SMEs in Malaysia, has defined SMEs as businesses with an annual sales turnover not exceeding RM25 million, and with full-time employees not exceeding 150.

Since 2005, the standard definitions for Malaysian SMEs are based on two criteria, either the number of employees or annual sales turnover (National SME Development Council 2005). Further, the SMEs have been categorised primarily into four sectors: manufacturing, manufacturing-related services (MRS), primary agriculture, and other services (including information and communications technology). The overall SME definitions, based on the number of full-time employees and annual sales turnover by sector, are shown in Table 1.5. Importantly, specific criteria, both in terms of staff number or turnover level, differ among the manufacturing/MRS sector and the services/primary agriculture sector. For example, the upper limit in terms of turnover level is RM25 million for SMEs in the manufacturing and MRS sectors compared to RM5 million in the services and primary agriculture sectors.

Table 1.5: National SMEs: Definition by Sectors and Criteria

Sectors	Criteria [a]	
	Number of Employees	**Annual Turnover (RM)**
Manufacturing		
Manufacturing-related services	≤ 150	≤ 25 million
Primary Agriculture		
Services	≤ 50	≤ 5 million

[a] Businesses are to meet either criteria.
Source: National SME Development Council (2005, pp. 3-5).
Exchange rate RM2.84 = A$1; RM3.52 = US$1; RM5.79 = £1; RM4.94 = €1 (1 July 2009, Bank Negara Malaysia).

The NSDC also further distinguishes between micro, small and medium-sized enterprises (see Appendix A). For example, in the manufacturing and MRS sectors, an enterprise with full-time employees of less than five or with annual turnover of less than RM250,000, is classified as a micro enterprise; with full-time employees of between 5 and 50, or annual turnover of between RM250,000 and less than RM10 million, as a small enterprise; and with full-time employees of between 51 and 150, or with annual turnover of between RM10 million and RM25 million, as a medium enterprise. Unfortunately, the upper limit for the lowest turnover level used to define SMEs into micro enterprises is different between the manufacturing/MRS sectors (i.e. less than RM250,000) and the services/primary agriculture sectors (i.e. less than RM200,000).

The current study standardised the turnover amount to RM250,000 so as to facilitate responses from all sectors into a single questionnaire. For staff criteria, no adjustment was made as the lowest number of staff among all the four sectors is the same, i.e. less than five.

1.5.4 Exchange Rate

All Malaysian monetary data, including compliance costs estimates, throughout this thesis are stated in Ringgit Malaysia (RM). As a general guide, one unit of the Australian Dollar (A$), United Kingdom Pound Sterling (£), United States Dollar (US$) and European Euro (€) are equal to RM2.84, RM5.79, RM3.52 and RM4.94 respectively (1 July 2009, Bank Negara Malaysia). Exchange rates for other currencies are given in a footnote, where applicable.

1.6   PRESENTATION OF THE THESIS

This study is organised into eight chapters, namely introduction, review of tax compliance and tax compliance costs studies, taxation of SMEs and major issues in Malaysia, research design and methodology, compliance costs estimates of SMEs, tax

attitudes and compliance behaviour of SMEs, comparison of findings and discussion, and conclusion and policy recommendations.

Chapter One provides the background of the study, research objectives and specific research questions, significance of the study, analysis of terms employed, and organisation of the remaining chapters. The background of the study highlights the likely magnitude of the tax gap, the significance of corporate income tax to federal government revenue, and the importance of SMEs in Malaysia.

Chapter Two provides a review of the literature on tax compliance and tax compliance costs, focusing on business taxpayers and corporations, in particular. Chapter Three presents an overview of income taxation in Malaysia and detailed discussion of income taxation of SMEs under the SAS regime. More importantly, the major income tax difficulties and issues surrounding the SME sector are highlighted in this chapter.

Chapter Four discusses the research design and methodology adopted in this study. This includes survey questionnaire design; survey implementation; population; and the sample and method of data analysis, covering mainly the primary postal survey and two additional surveys. This chapter also provides detailed discussion on the measurement issues and approach adopted in relation to compliance costs and compliance behaviour.

Findings of the study are presented in Chapters Five and Six. Chapter Five presents compliance costs estimates of SME companies, covering both the gross and net compliance costs, estimated mainly at the firm level, and at the aggregate corporate SME level. The analysis of compliance costs by business profiles (including distribution by turnover level), cost sources and cost types are also presented in this chapter. Chapter Six reports findings on tax attitudes and compliance of SME companies measured from a business managerial perspective. The chapter also examines the association among variables—that is, compliance costs, tax attitudes and tax behaviour—and, more importantly, considers the determinants of compliance behaviour. These two chapters (five and six) primarily cover the findings of the main

postal survey on SMEs. Findings of the two additional surveys, i.e. SME web survey and tax professionals' postal survey, are also presented, but in less detail, mainly to support the primary postal survey.

Chapter Seven compares key findings of the main survey and two additional surveys. This comparison broadly shows the consistency of the compliance costs estimates and findings on tax attitudes and compliance behaviour in the current study. This chapter also discusses the current findings to earlier relevant studies, both in Malaysia and internationally.

Finally, Chapter Eight summarises and discusses the major findings, major policy recommendations, limitations of the study, and possible directions for further research.

CHAPTER TWO

REVIEW OF STUDIES OF TAX COMPLIANCE AND TAX COMPLIANCE COSTS

2.1   INTRODUCTION

This chapter presents a literature review of the two key aspects of this thesis, namely tax compliance and tax compliance costs. These reviews are important in providing a theoretical background for this study as the current investigation integrates both taxpayer compliance and tax compliance costs into a single study. These two aspects are considered within both international and Malaysian settings, but focusing on business taxpayers. As there are a prolific number of studies internationally that focus on these two aspects with individuals, this area is presented broadly, but is followed by a detailed review of corporate tax studies. In Malaysia, prior tax compliance studies are restricted to individuals, but nearly all compliance costs studies are limited to corporations. As such, tax compliance studies cover business individuals in detail, with tax compliance costs including all studies. A review of major tax issues in SME corporations is presented in Chapter Three. Relevant literature on research methods is covered later in Chapter Four.

2.2   A REVIEW OF TAX COMPLIANCE STUDIES

2.2.1   International Tax Compliance Studies

Concern about voluntary tax compliance has led to numerous studies of tax compliance issues, particularly income tax. Comprehensive reviews of prior major tax compliance studies are provided by Jackson and Milliron (1986) and Richardson and Sawyer (2001), the former being well cited in the tax literature. Jackson and Milliron (1986) provide a review of 43 tax compliance studies carried out between the 1970s and 1985. Richardson and Sawyer (2001), in a similar way, provide a review and synthesis of more than 130 tax compliance studies published from 1985 to 1997 and, most

importantly, provide discussion on the progress made following suggestions given by Jackson and Milliron. Both reviews considered the key tax compliance variables, methods employed, issues and theory involved.

Specifically, their reviews identified a number of behavioural determinants of tax compliance behaviour. Fischer, Wartick and Mark (1992, p. 3) broadly classify them into four categories: demographic e.g. age, gender; proxy for non-compliance opportunity e.g. education, income level, income source and occupation; attitudinal e.g. ethics, tax fairness, peer influence; and structural e.g. tax complexity, revenue authority contact, sanctions, detection probability, and tax rates. The possibility of other factors—such as compliance costs, tax preparers, framing of tax decisions, and tax incentives—though recognised are examined less. Overall, the findings of many studies on the determinants of tax compliance behaviour of individual taxpayers are somewhat mixed, even when different research methods are employed (Jackson and Milliron 1986; Richardson and Sawyer 2001).

Besides these two comprehensive reviews, several other reviews are available—for example, Fischer, Wartick and Mark (1992); Cuccia (1994); Andreoni, Erard and Feinstein (1998) and Hasseldine and Li (1999). Overall these reviews also raise similar concerns over the variables influencing tax compliance behaviour. The detail of these tax compliance studies is not considered in this section as the current study focuses on corporate taxpayers rather than individuals. Nonetheless, relevant findings, mainly to business taxpayers, are discussed where appropriate. The fact that tax compliance studies predominantly centre on the income tax compliance of individual taxpayers is recognised in the literature (Long and Swingen 1991, p. 665; Rice 1992, p. 126; Kamdar 1997, p. 37), particularly individuals without a business.

Prior research generally adopts economic deterrence and/or fiscal psychology models in explaining the tax compliance behaviour of individuals (Hasseldine and Li 1999, p. 94). In terms of a model, the seminal work of Allingham and Sandmo (1972) applies a financial self-interest model in the context of tax compliance. This model is based on an

economics-of-crime approach introduced by Becker (1968). The model suggests that tax rate, detection probability and penalty structure are determining factors for compliance costs that affect compliance behaviour, as shown in Figure 2.1. Arguably, the model only considers the economic variables.

Figure 2.1: Financial Self-interest Model
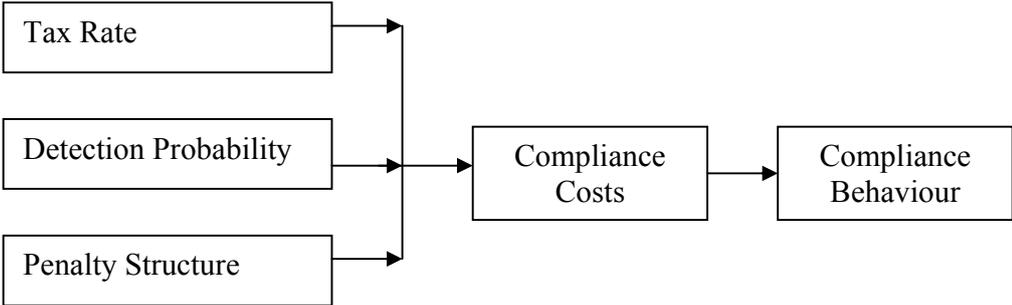
Source: Fischer, Wartick and Mark (1992, p. 3) derived from Becker (1968).

Fischer, Wartick and Mark (1992) expand the model to incorporate the sociological and psychological variables as well (Figure 2.2). This expanded model predicts that demographic variables indirectly influence tax compliance behaviour through their effects on non-compliance opportunities and attitudes.

Figure 2.2: Expanded Model of Taxpayer Compliance
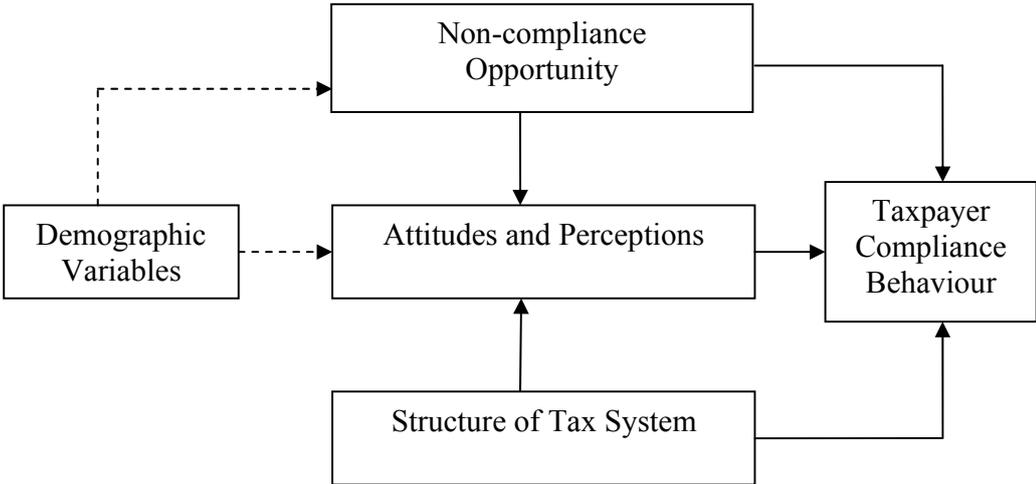
Source: Fischer, Wartick and Mark (1992, p. 4).

Many tax researchers have acknowledged that prior tax compliance studies on individuals provide a formal framework analysis for the corporate tax compliance decision, (see especially Pyle 1989, p. 87; Rice 1992, p. 127; Kamdar 1997, p. 38; Joulfaian 2000, p. 698). The remainder of this section focuses on business taxpayers, particularly corporate SMEs, as the main focus of this chapter. The literature review reveals that there are at least five tax compliance studies that are relevant to corporate tax compliance (Rice 1992; Kamdar 1997; Mills 1998; Joulfaian 2000; Hanlon, Mills and Slemrod 2005). A summary of these corporate tax compliance studies and their key findings are shown in Table 2.1.

The first empirical evidence on corporate income tax non-compliance was provided by Rice (1992). Rice used the 1980 Taxpayer Compliance Measurement Program (TCMP) database provided by the US Internal Revenue Service (IRS). He found no evidence to link firm size with tax compliance. However, the fact that this study was confined to medium-sized corporations must be noted.

Kamdar (1997, p. 39) argues that further work is necessary before drawing any conclusions on the determinants of corporate non-compliance. Kamdar conducted a time series analysis by utilising both the standard theoretical model of compliance and one extended to include a couple of variables to examine the extent and determinants of corporate income tax compliance. The basic compliance model assumes that the amount of income reported by a taxpayer is a function of true income, marginal tax rates, probability of detections for companies, penalties for non-compliance, and other socioeconomic features. Kamdar found that audit rates and profits have a positive and significant effect on compliance, suggesting that a greater audit coverage could lead to a substantial rise in tax revenues (Kamdar 1997, p. 46). Despite the fact that corporate tax evasion was not prevalent in his study, he emphasised that corporate compliance improvement could result in significant revenue increases (Kamdar 1997, p. 46).

Table 2.1: Summary of Corporate Tax Compliance Studies in the US

Author(s); year	Key Findings on Tax Compliance
Rice (1992)	• Public disclosure tends to improve tax compliance. • Profit performance influences tax compliance. • The marginal tax rate is negatively associated with compliance. • No evidence to link size with tax compliance.
Kamdar (1997)	• Greater audit coverage could lead to substantial rise in tax revenues. • Lowering marginal tax rate and increasing penalties would not necessarily enhance corporate compliance.
Mills (1996; 1998)	• Both the preliminary and the final analysis indicate that audit adjustments were found to be increasing as the excess of book income over taxable income increases.
Joulfaian (2000)	• Non-compliant firms are more likely to be managed by executives who have failed to comply with personal income tax than are compliant firms. • Marginal tax rates, income level, audit rate and firm size influence non-compliance behaviour. • Foreign ownership was found to be not significant in determining undeclared income.
Hanlon, Mills and Slemrod (2005)	• 55 percent of the firms have a tax adjustment and, in aggregate, the adjustment is 0.17 percent of aggregate assets and 0.22 percent of total sales. • Corporate non-compliance was 13.6 percent of the true tax liability. • Corporate characteristics (i.e. size, foreign/domestic controlled companies, multi-national/local business, private/public companies and industry type) determine corporate compliance behaviour. • Greater tax opportunities and executive compensation would lead to greater non-compliance, while quality of governance has no effect on corporate non-compliance.

Source: Adapted from Abdul-Jabbar and Pope (2009).

In another study, Mills (1998, p. 355) noted that the IRS audit adjustments increase as book-tax differences increase, which indicates likely non-compliance. She refers to book-tax differences as the differences between accounting income and taxable income. She asserts that the book-tax differences act as a possible sign of non-compliance. In her preliminary analysis, she measured the book-tax differences in two ways, i.e. pre-tax book income less taxable income and federal tax expense less tax declared on the return (Mills 1996, p. 424). Later, in 1998 (Mills, p. 346), the book-tax differences were also measured by using the US deferred income tax expense, particularly for public companies.

A study by Joulfaian (2000) also employed the corporate TCMP data. Joulfaian (2000, p. 698) argued that managerial preferences might determine corporate compliance behaviour. The understatement of personal income tax by managers was used as a proxy of managerial preferences. The undeclared amount of corporate net income (in excess of US$100) represents the dependent variable and is measured by the differences between corrected (through audit) and reported income. The independent variables include managerial preferences and other firm attributes—namely audit rate, marginal corporate tax rate, net income, sales and foreign ownership—as determinants of compliance behaviour. Joulfaian found that non-compliant firms are more likely to be managed by executives who have failed to comply with their personal income tax than are compliant firms. Thus, he urged tax researchers to incorporate managerial preferences as one of the determinants of corporate tax compliance (Joulfaian 2000, p. 701).

More recently, Hanlon, Mills and Slemrod (2005) explored the relationship between corporate non-compliance and corporate characteristics. Tax deficiencies proposed by the IRS upon audit were mainly used as a measure of non-compliance. In terms of corporate characteristics, firm size, industry, foreign ownership, multi-nationality, and public or private companies were among characteristics assessed in their study. Larger firms were found to be more non-compliant than smaller firms, but medium-sized businesses had the lowest rate of non-compliance, suggesting that corporate tax non-compliance was U-shaped. It is surprising that medium-sized businesses were more

compliant than small businesses. Hanlon, Mills and Slemrod acknowledged that such an inconsistent pattern is to be connected with the opportunity for non-compliance (Hanlon, Mills and Slemrod 2005, p. 27). As for other characteristics of companies, they found that foreign controlled companies were less non-compliant than domestic companies, multi-national and private companies had a greater deficiency relative to non-multinational and public companies respectively, and the overall industry effects were significant too. As for other variables, Hanlon, Mills and Slemrod (2005) demonstrated that greater tax opportunities and executive compensation would lead to greater non-compliance, and that the quality of governance has no effect on non-compliance, while no evidence was found to support effective tax rates influencing non-compliance.

Slemrod (2004a, p. 83) argued that the tax situation of both companies and owners is closely related, and urged researchers to analyse these simultaneously. He expected a similar connection between compliance/non-compliance and compliance costs,[14] and presumed that tax complexity led to non-compliance as well (Slemrod 2004a, p. 93). Up until early 2000, the possible association between compliance costs and tax compliance behaviour remained unidentified for either business or non-business taxpayers (Hasseldine 2001, p. 9; Richardson and Sawyer 2001, p. 207). An Indian study by Chattopadhyay and Das-Gupta (2002b) is perhaps among the first to integrate tax compliance costs and tax behaviour of personal taxpayers into a single study. However, the study is subject to major methodological shortcomings, mainly due to data incompleteness, low responses and sample representations.

More recently, Yesegat (2009) has also incorporated these two aspects of compliance in an Ethiopian study, but confined to VAT taxpayers. She has employed a mixed method approach by using a survey approach, i.e. face-to-face semi-structured questionnaire interviews of both taxpayers and tax practitioners, and experimentation with student subjects. Compliance costs were found to adversely affect tax compliance behaviour, but their relationship was statistically weak, suggesting that VAT compliance improves

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[14] See Section 2.3 for a review of tax compliance costs studies.

to some extent as the compliance costs are reduced.[15] A noteworthy aspect is that the relationship between compliance costs estimates and compliance behaviour is derived primarily from the experimental data, i.e. all variables, including compliance costs, are hypothetical in nature.[16] Nevertheless, Yesegat (2009, p. 213) believed that an attitude question in the semi-structured interview questions to taxpayers supported her overall finding.[17]

2.2.2   Malaysian Tax Compliance Studies

Despite growing problems of tax non-compliance and evasion in Malaysia,[18] very few studies have been carried out and not much is known about the extent and determinants of such problems, particularly since the implementation of the self-assessment regime in Malaysia in 2001. A review of mainly published studies (including conference papers) reveals that there are 20 Malaysian tax compliance studies for the period between 1994 and 2008.[19] These studies are either partly or wholly related to tax compliance behaviour. Income tax is the primary focus, with two exceptions (Tayib 1998; Abdul-Manaf 2004), both related to local government taxes.

Similar to international trends on compliance behaviour research, Malaysian studies also focused on individual taxpayers. Little attention has been paid to business taxpayers, and surprisingly none to the corporate sector. Out of 18 studies on income tax compliance behaviour, only one has solely focused on individuals with business income, either self-employed or from a partnership (Ramasamy *et al.* 2003), while the other seven studies had some respondents with a business income, mostly self-employed (Hanefah 1996; Kasipillai 1997; Kasipillai *et al.* 1999; Abdul 2003; Loo 2006a; Che Azmi and Perumal 2008; Sia *et al.* 2008). A few studies sought responses respectively from tax professionals (i.e. accountants or tax agents), and tax officers

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[15] Provided that the probability of detection also increased (Yesegat 2009, p. 214).

[16] Compliance costs were manipulated in terms of 5,000 laboratory tokens plus a certain percent of sales, i.e. 1, 5 and 10 percent. These tokens were converted into the Ethiopian currency during the analysis stage.

[17] Respondents were asked to indicate their agreement/disagreement to a single statement expressed as 'the burden of compliance costs discourages me from fulfilling my VAT obligations'.

[18] See Chapter One, subsection 1.2.2.

[19] Refer Appendix B, for a complete list and summary of these studies.

(Che-Ayub 1994; Kasipillai 1997; Singh 2003) and students (Kasipillai, Aripin and Amran 2003; Loo 2006b; Ahmad, Hanefah and Mohd Noor 2007) as well. In terms of research method, a survey approach, particularly the mail questionnaire, seems to be widely used in Malaysian studies. The first study was conducted by Che-Ayub (1994). However, she focused on the perceptions of tax officers and tax agents towards the tax administrative system and evasion determinants of individual taxpayers in Malaysia.

The study by Hanefah (1996) was probably the first to examine the tax compliance behaviour of the Malaysian individual taxpayer, including the self-employed. Hanefah investigated the efficiency and the productivity of the Malaysian tax administrative system, predominantly in the OAS, with a view to implementing a SAS in Malaysia. As part of his research, he studied the perceptions about the income tax administration system, tax fairness, and the tax law complexity of personal income tax. To achieve this, he adapted the expanded model of taxpayer compliance developed by Fischer, Wartick and Mark (1992). Meanwhile, other Malaysian studies partly examined a few factors and did not make comprehensive attempts to examine compliance behaviour— for example, the effects of education (Kasipillai, Aripin and Amran 2003), tax knowledge (Ramasamy *et al.* 2003; Loo 2006a, 2006b), tax fairness, effectiveness of the IRB, the compliant attitude of other taxpayers (Ramasamy *et al.* 2003), ethics (Kasipillai, Mat-Udin and Zainol-Arifin 2003) or selected demographic factors (Kasipillai and Abdul-Jabbar 2006) on tax compliance.

As there is no specific tax compliance study on corporate taxpayers, some of the major findings pertaining to individual business taxpayers are considered in more detail below. Studies by Ramasamy *et al.* (2003) and Abdul (2003) are of particular interest, as both studies are largely relevant to the business context. Additionally, studies by Hanefah (1996), Loo (2006a), and Sia *et al.* (2008) considered a substantial number of responses obtained mainly from the self-employed and few from partnership businesses. Individuals with business income comprised around 21 percent in Hanefah (1996), 37 percent in Loo (2006a) and between 22 and 94 percent in Sia *et al.* (2008). Studies by Kasipillai *et al.* (1999) and Che Azmi and Perumal (2008) also cover self-employed

taxpayers. However, both studies are not considered in this section as the former study had only around four percent of self-employed businesses, and the latter study was restricted to tax fairness and did not encompass tax compliance behaviour. The earlier findings in this regard are important as they provide a framework for this research.

A summary of key findings on Malaysian tax compliance studies on business individuals is shown in Table 2.2. Further details of these studies, together with other studies on non-business individuals, are presented Appendix B.[20]

Ramasamy *et al.* (2003) exclusively cover small business income taxpayers. Their study was conducted by way of an interview survey to examine factors influencing the compliance behaviour of small business entrepreneurs in the northern peninsular of Malaysia. Four independent variables were used to determine the compliance behaviour of individual entrepreneurs. The independent variables were the extent of tax knowledge of small entrepreneurs, attitudes towards compliance by other taxpayers, attitudes towards the effectiveness of the IRB, and attitudes towards fairness of the tax system. Three hundred and twelve individual entrepreneurs were selected by way of non-random sampling and interviewed. They had obtained a response rate of 62 percent.

Two main conclusions can be drawn from the Ramasamy *et al.* (2003) study. First, attitudes towards other taxpayers' compliance and attitudes towards tax fairness are positively related to small business compliance behaviour. Secondly, and surprisingly, the amount of tax knowledge and attitudes towards the effectiveness of the IRB have no relationship to the compliance behaviour of entrepreneurs. Ramasamy *et al.* (2003, p. 25) suggest that this is probably due to the limitations of the study—the inability to differentiate between intentional and non-intentional non-compliance. They argued that the reason for non-compliance could be due to ignorance of the tax laws or due to the inability to understand the complex nature of tax laws.

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[20] Other tax studies, i.e. not compliance-related, are outlined in Appendix C.

Table 2.2: Malaysian Tax Compliance Studies on Business Income Taxpayers

Author(s); year	Key Findings on Compliance Attitudes and Behaviour
Hanefah (1996)	• Tax law was perceived to be unfair and tax complexity existed. • Some knowledge and understanding of the tax system would enhance compliance.
Ramasamy *et al.* (2003)	• Attitudes towards others' compliance and fairness were positively related to compliance behaviour. • Tax knowledge and attitudes towards effectiveness of the IRB has no relationship to compliance behaviour
Abdul (2003)	• Non-compliance is severe in older persons, males with high taxable income levels and those who received non-salary income. • Tax officers believed that taxpayers' intention, role of tax agents, taxpayers' ignorance of tax law and financial strain were the main reasons for non-compliance.
Loo (2006a)	• Tax knowledge, tax structure, perceptions about tax fairness and perceptions about tax administration were found to influence tax behaviour, but tax knowledge had the most effect. • The financial constraints did not show any effect on compliance behaviour.
Sia *et al.* (2008)	• Compliant and non-compliant taxpayers had similar perceptions toward tax fairness, tax morals and peer influence.

Source: Abdul-Jabbar and Pope (2009).

Abdul (2003) is probably the first to use the official IRB data. She analysed the main characteristics of income tax non-compliance from the perspectives of both tax evaders (i.e. taxpayers that are found guilty by the IRB for the period 1995 to 1997) and tax officers. In scrutinising all 507 individual files of tax evaders, she observed that almost 99 percent of non-compliance was due to either the failure to declare income (68.2 percent) or the understatement of income (30.4 percent). The remainder (less than two percent) was due to either overstatement of deductions or expenses (Abdul 2003, p. 66).

An interview survey of 60 tax officers shows a slightly different finding. Tax officers believed that 63 percent of the non-compliance was due to both failure to declare income (30 percent) and understatement of income (33 percent). Another 25 percent and 12 percent were in regard to inflating expenses or over-claiming deductions respectively. Abdul (2003, p. 70) believed that the difference could be partly related to methodologies used for ranking. Tax officers were asked to rank type of non-compliance in order of importance. On the other hand, evidence on the types of non-compliance was extracted from the evader's tax file. Other possible reasons given are related to time frame (for example, the actual file data were relevant for the period between 1995 and 1997), while tax officers' responses were obtained from more than 80 percent of officers who had worked for at least 10 years.

In terms of factors influencing non-compliance, Abdul (2003, pp. 70-71) focused on four demographic variables, namely age group, gender, income level and income source. She observed that non-compliance was particularly severe in older persons (those aged 50 and above), males, individuals with high taxable income levels (RM50,000 and over per annum), and those who received income from sources other than wages and salaries, for example, sole-proprietors and the self-employed (Abdul 2003, p. 89). Her study also indicated that around 62 percent of the tax evaders provided no reasons at all, while around 34 percent gave reasons such as ignorance of tax law and forgetting to declare, or similar reasons, for their evasion (Abdul 2003, p. 91). From the perspective of tax officers, the main reasons for non-compliance were believed to be taxpayers' intentional evasion, the role of tax preparers (by way of omission or using

loopholes in the tax legislation) followed by taxpayers' ignorance of income tax law and financial strain (Abdul 2003, p. 94).

In an earlier study, Hanefah (1996) examined perceptions of the income tax administration system, tax fairness, and the tax law complexity of personal income tax. Overall, his findings indicate that tax law is perceived to be unfair and complex. He also provides evidence that some knowledge and understanding of the tax system is likely to enhance tax compliance. One of his main findings with regard to the self-employed taxpayer shows that there is a high tendency for them to appoint tax professionals in the SAS regime.

Recently, Loo (2006a) explored the influence of the implementation of the SAS in Malaysia on the compliance behaviour of individual taxpayers. She conducted a repeated survey design immediately before and after the implementation of the SAS. Five independent variables were included, namely assessment system, tax knowledge, tax structure, financial constraints and attitude towards tax. Tax compliance behaviour is measured by three independent income types: taxable income, exempt income and casual income. Overall, her findings indicate that the change from the OAS to the SAS has to some extent influenced the compliance behaviour of individual taxpayers. Specifically, tax knowledge, tax structure and attitude towards tax were found to influence income reporting behaviour; tax knowledge had the greatest effect. As for the other two types of compliance, only tax knowledge and tax attitudes were found to be significant in both cases. Financial constraints did not show any effect on all types of compliance behaviour.

More recently, Sia *et al.* (2008) compared the factors affecting the compliance behaviour of both compliant and non-compliant individual taxpayers. It is worth mentioning that both groups of respondents were selected from the IRB database. A mail survey was used to gather information from both compliant and non-compliant taxpayers. Non-compliant taxpayers are those who had previously received additional assessment following tax audits. On the other hand, compliant taxpayers are assumed to

be from those who have not been audited. Their study obtained an overall response rate of almost 10 percent. Interestingly, just over 94 percent of the non-compliant respondents were those from self-employed or partnership businesses. Meanwhile, about 22 percent of the compliant respondents came from this group. Overall, the study by Sia *et al.* (2008) indicates that both groups of taxpayers had similar perceptions toward tax fairness, tax morale and others' compliance.

Similar to the international studies, these Malaysian studies also broadly indicate that the attitudes of individual taxpayers, particularly towards tax fairness, tax rate structure, and tax administration, influence their tax compliance behaviour. Thus, the current study considers these three variables in the context of corporate SME taxation. Perceptions towards corporate tax complexity and probability of tax audit are also included so as to recognise the relevance of these factors in the SAS regime. Having acknowledged the importance of tax incentives to the SME sector internationally (see especially Freedman 2003; Crawford and Freedman 2008),[21] attitudes to such tax incentives are also examined. The above review shows that no prior Malaysian studies examined the effect of tax compliance costs on tax compliance behaviour, even for non-business individuals. The current study emphasises and contributes to this potential linkage in particular. A review of tax compliance costs studies internationally and in Malaysia is presented in the section below.

2.3   A REVIEW OF TAX COMPLIANCE COSTS STUDIES

2.3.1   International Compliance Costs Studies

The financial self-interest model suggests that tax rate, detection probability and penalty structure are determining factors of compliance costs that eventually affect tax compliance behaviour. The importance of compliance costs in influencing compliance behaviour and the lack of empirical research in examining this relationship has been

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[21] See also Chapter Three, subsection 3.4.4.

discussed succinctly above.[22] Nonetheless, evidence shows that international research into estimating tax compliance costs has grown strongly since the 1990s (Sandford, Godwin and Hardwick 1989; Pope 1995; Sandford 1995; Evans *et al.* 1997). Compliance cost estimates in the modern era have been conducted internationally, mainly in the UK, the USA, Australia and Canada for over 20 years, and now cover other countries, including Netherlands, Spain, Croatia, New Zealand, Singapore, Malaysia, Hong Kong, India, South Africa, and more recently Ethiopia. Currently, the requirement of a Tax Impact Statement (also known as Regulatory Impact Statement and Compliance Costs Assessment) for tax law changes is a normal practice in Organisation for Economic Co-operation and Development (OECD) countries, including Australia, the European Union, New Zealand, the UK and the US (Evans and Walpole 1999, p. 21).

The development of earlier research on tax compliance costs has been discussed in three phases by Sandford, Godwin and Hardwick (1989, pp. 27-34), covering the period between the 1930s and early 1980s. Earlier attempts were carried out in the 1930s to 1960s in North America, followed by the Europe phase from the 1960s to 1970s, and finally a worldwide phase from the 1980s onwards. More recent studies that have been conducted since the 1980s to early 2002 are outlined by Evans (2003b). Studies that have been carried out thereafter include those in Australia (Board of Taxation 2007; Lignier 2008), the UK (Chittenden, Kauser and Poutziouris 2005; Chittenden *et al.* 2005; Kauser *et al.* 2005; Mathieu, Waddams and Antwi 2007), the US (Guyton *et al.* 2003; DeLuca *et al.* 2005; Guyton *et al.* 2005), Canada (Vaillancourt and Clemens 2008), Croatia (Blazic 2004), Slovenia (Klun 2004a, 2004b), South Africa (SBP 2005) and the newest in Ethiopia (Yesegat 2009). Broadly, these studies cover a range of taxes, with income tax and VAT/GST being the largest in number. The current study focuses on business income tax and SME corporations in particular, thus key findings of the relevant studies are discussed in this section. Notwithstanding this, overall findings of comprehensive studies of all major taxes are given where applicable.

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[22] See Section 2.2.

The first study on taxation compliance costs was carried out by Haig (1935) about 75 years ago on large corporations using a mail survey covering all federal and state taxes in the US. In the UK, a systematic and exhaustive study on compliance costs was carried out by Sandford (1973). Sandford used a survey method in collecting responses mainly from individuals, including the self-employed, on personal income tax. His main finding reveals that compliance costs amounted to between 1.9 and 3.4 percent of total tax revenue. He also noted that low income taxpayers had higher compliance costs (on the average) as a fraction of income compared to higher income taxpayers. This provides evidence of the presence of regressivity. Thereafter, following a number of pioneering UK compliance costs studies by Sandford, Godwin and Hardwick (1989), a considerable number of studies have been undertaken globally. This includes comprehensive studies of all federal taxes in Australia (Pope *et al.* 1990 – 1994; Evans *et al.* 1997), New Zealand (Sandford and Hasseldine 1992) and the Netherlands (Allers 1994).

Recently, Evans (2003b), in reviewing prior studies in taxation operating costs, has highlighted that there are at least 100 published studies into compliance costs, administrative costs or both. Out of these, Evans added that more than 60 publications have taken place since 1980 to early 2002. Evans (2003b, p. 66) noted that the first study in the Asia–Pacific region was only published in Australia in 1990, following pioneering work by Pope, Fayle and Duncanson (1990). Subsequently, Pope headed a series of four compliance costs studies on major Australian federal taxes, covering a wide range of taxes, including personal income tax, company income tax (Pope, Fayle and Chen 1991; 1994), fringe benefits tax (Pope, Fayle and Chen 1993a) and wholesale sales tax (Pope, Fayle and Chen 1993b). The compliance costs of these federal taxes were estimated at A\$7,873 million in 1990/91,[23] representing 11.9 percent of the total tax revenue from those federal taxes and 2.1 percent of GDP (Pope 1995, p. 103). A review of all five studies by Pope *et al*. indicates that compliance costs in Australia are significant, regressive and politically sensitive in nature, especially towards smaller

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[23] A\$1 = RM2.84 (1 July 2009, Bank Negara Malaysia).

businesses. These findings in particular have focussed government attention onto the issue of the compliance burden in Australia (Rimmer and Wilson 1996).

Since a series of studies by Pope *et al.*, a number of studies have been conducted in Australia, including the comprehensive study of compliance costs by Evans *et al.* (1997). This study (often referred to as the ATAX study) provides further evidence on the regressivity of tax compliance costs on small businesses in particular. In 1994/1995, tax compliance costs of small business, irrespective of their legal entity, measured per A$1,000 of turnover, were at least nineteen times greater than for both medium and large business (Evans *et al.* 1997, pp.79-80).[24] The remainder of the Australian studies were conducted by Wallschutzky and Gibson (1993), Rametse and Pope (2002), CPA Australia (2003), Evans (2003a), Tran-Nam and Glover (2002a), Evans, Tran-Nam and Jordan (2002), Glover and Tran-Nam (2005), and more recently specific studies on small business (Board of Taxation 2007; Lignier 2008). Evans (2003b, p. 69) observed that most studies on business operating costs are not specific to any one sector, but take account of all business segments. However, studies on small businesses tend to focus on the GST (Wallschutzky and Gibson 1993; Rametse and Pope 2002; Tran-Nam and Glover 2002a; CPA Australia 2003; Glover and Tran-Nam 2005).

In New Zealand, tax compliance costs of business taxes were estimated to be almost NZ$1.9 billion, with income tax compliance costs amounting to just over NZ$1.2 billion or 19 percent of tax revenue in 1990–91 (Sandford and Hasseldine 1992, p. 107).[25] Recently, Brunton (2005) estimated tax compliance costs for SMEs,[26] covering four types of taxes, i.e. income tax, GST, PAYE and Fringe Benefit Tax (FBT). The average costs incurred by the SMEs in complying with such taxes were NZ$4,024, with almost 90 percent related to income tax (51 percent) and the GST (39 percent). Besides these, an annual survey has also been carried out by Business New Zealand/KPMG since 2003, covering all business compliance costs, including tax-related, employment-related and environmental-related costs. Tax compliance costs consistently made up the

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[24] Refer Evans *et al.* (1997), Table 5.11 p.79, for details.
[25] NZ$1 = RM2.28 (1 July 2009, Bank Negara Malaysia).
[26] Only internal time costs and external costs were computed in Brunton (2005).

largest share of compliance costs, for example around 40 percent for the years 2005 to 2007 (Business New Zealand/KPMG 2005, 2006, 2007) .

In the Netherlands, total compliance costs to business in 1989 were estimated at Gld7.2 billion[27] or four percent of tax revenue (Allers 1994, p. 124).[28] The use of a single question postcard survey to assess the non-response bias is one substantial contribution made by this author to the methodology of estimating tax compliance costs.

In the US, a number of studies, in particular by Slemrod and his colleagues (Slemrod and Sorum 1984; Blumenthal and Slemrod 1992; Slemrod and Blumenthal 1996; Slemrod and Venkatesh 2002) have been undertaken since the mid-1980s. Other US studies include those by Little (1988), Lassila and Smith (1997), Guyton *et al.* (2003; 2005), and a recent specific study on small businesses (DeLuca *et al.* 2005).[29] Regarding the US studies, Pope (2005, p. 206) observed that the business compliance costs studies in the US tend to emphasise larger corporations.[30] For overall compliance costs, few US estimates are available, i.e. by Halls (1993), Slemrod (2004b) and Moody, Warcholik and Hodge (2005). Slemrod (2004b) estimated that the US federal tax compliance costs in 2004 amounted to US$125 billion or 13.4 percent of tax revenue, comprising US$85 billion and US$40 billion (or 11 percent and 24 percent of corresponding tax revenue) for individuals (including those with a business income) and other business taxpayers respectively.[31]

The recent estimates by Moody, Warcholik and Hodge (2005, p. 2), however, indicated a much higher figure for 2004,[32] i.e. US$244 billion or 24 percent of tax revenue. Vaillancourt and Clemens (2008, pp. 59-60) argue that the differences between these US estimates are largely methodological, in particular the hourly rate used in valuing

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[27] The Guilder (Gld) was the national currency at the time of study. Since 1999, the Netherlands, as a member of the European Community (EU) adopted the Euro Dollar (€).
[28] Covers all business taxes, including income tax (both individuals and corporations) and VAT. No separate details available for income tax.
[29] Findings reported in this conference paper are preliminary in nature.
[30] See the latter part of this section for details.
[31] US$1 = RM3.52 (1 July 2009, Bank Negara Malaysia).
[32] These estimates cover a period of between 1990 and 2015.

taxpayer time. Further, the 2004 Slemrod estimates were based on his (and his colleagues') prior surveys; on the other hand, Moody, Warcholik and Hodge (2005) relied on the IRS time estimates that were then converted into dollar values. Nonetheless, both estimates indicated the same findings regarding an increasing trend of compliance costs and its distributional effect on low income earners or smaller businesses.

In Canada, despite a number studies focusing on specific taxes having been conducted since 1989 (Vaillancourt 1989; Plamondon and Associates Inc 1993; Erard 1997a), only recently total estimates of all tax compliance costs, including for business taxes, were available (Charron, Chow and Halbesma 2008; Vaillancourt and Clemens 2008). The estimated compliance costs of all taxes in 2005 was between C$16.2 billion and C$25.0 billion, with business tax compliance costs amounted to C$13.0 billion or 1.0% of GDP (Vaillancourt and Clemens 2008, pp. 73-74).[33] Specific ratios relative to business taxes are not reported separately by the authors, but the overall ratio indicates that total compliance costs comprise between 3.0 percent and 4.7 percent of all federal, provincial and local total revenues or between 1.2 percent and 1.8 percent of GDP in 2005 (Vaillancourt and Clemens 2008, p. 78). In 2008, costs for the business sector to comply with all types of taxes[34] amounted to C$12.6 billion or 2.7 percent of total tax revenue (Charron, Chow and Halbesma 2008, pp. 13-14 and 19-20).

In Asia, a couple of business tax compliance costs studies were conducted in Singapore (Ariff, Loh and Talib 1995; Ariff, Ismail and Loh 1997), and subsequently followed by similar studies in Hong Kong (Chan *et al.* 1999), and Malaysia (Loh *et al.* 1997; Hanefah, Ariff and Kasipillai 2001).[35] A comparative analysis of these Asian studies undertaken by Ariff and Pope (2002, p. 25) indicate that compliance costs, as per 1,000 corresponding currency units of turnover, incurred by small companies are almost ten times higher than for large companies. One noteworthy aspect is that all the Asian

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[33] C$1 = RM3.03 (1 July 2009, Bank Negara Malaysia).
[34] Comprising payroll taxes, business income tax, GST or harmonized sales tax (HST), provincial sales taxes and property taxes.
[35] Further analysis of these Asian studies is provided by Ariff and Pope (2002) in a single reference. See subsection 2.3.2 below for details on the Malaysian studies.

studies focussed on the corporate sector, with nearly all on public companies and only one on SMEs. More importantly, all these studies estimated compliance costs at the company disaggregate level only. In Singapore, Ariff, Ismail and Loh (1997, p. 1258) provided evidence of a significant decrease of tax compliance costs per public listed company, from S$78,396 (in 1994) to S$54,615 (in 1995).[36] The average tax compliance costs per public listed company in Hong Kong were estimated at HK$346,483 for the tax year 1995–1996 (Chan *et al.* 1999).[37] Recently, a couple of Asian studies were conducted in India (Chattopadhyay and Das-Gupta 2002a, 2002b), covering both individual and corporate taxpayers. These Indian studies did not report the overall average compliance costs in monetary terms either for individuals or companies, but rather expressed it as a percentage of turnover, fixed assets and/or costs per employee. All these Asian studies have conclusively supported the presence of a fixed costs effect on smaller firms and ensuing regressivity.

A more detailed account of tax compliance costs studies is not provided in this chapter;[38] interested readers should refer mainly to Sandford (1995), Evans, Pope and Hasseldine (2001), Ariff and Pope (2002), Evans (2003b) and Pope (2005). One remarkable aspect is the incidence of a fixed cost effect irrespective of business size. Nearly all prior studies outlined above indicate that business tax compliance costs fall heavily to smaller firms when expressed as a percentage of turnover or tax paid. The same pattern applies for a single type of tax and over all taxes i.e. at the aggregate level for all types of business taxes. Further, key findings of all major studies, both earlier and recent studies up to 2002, continue to indicate that the compliance costs are high, very regressive (especially towards smaller firms and/or in the case of GST) and increasingly attracting political attention (Pope 2005, p. 210; 2007, pp. 522-523).

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[36] S$1 = RM2.43 (1 July 2009, Bank Negara Malaysia).
[37] HK$1 = RM0.45 (1 July 2009, Bank Negara Malaysia).
[38] Other than details and discussion of the relevant international studies on corporate business income taxation (see next paragraph) and all Malaysian studies (see subsection 2.3.2 below).

As the current study is confined to SME companies, a summary of compliance costs studies on corporate taxation in particular is presented in Table 2.3.[39] The first UK study on corporations was conducted for the tax year 1986-87, and indicated that compliance costs were estimated at £300 million or 2.2 percent of corporate tax revenue (Sandford, Godwin and Hardwick 1989, p. 140).[40] In a later study, but confined to UK listed corporations, total compliance costs were estimated at £265 million, which showed an increase of around 34 percent in the period 1991–1996 (KPMG 1996). More recently, specific estimates on SME companies under the SAS regime conducted by Kauser *et al.* (2005, pp. 21-22) indicate that the aggregate compliance costs of SME companies in the UK amounted to £608 million. This study did not report the average compliance costs, but analyses compliance costs in percentile terms by business size in contrast to the 1989 Sandford findings. Their findings indicate that the regressivity of compliance costs upon small business remains an important concern (Kauser *et al.* 2005, p. 21).

In Australia, there were two studies on corporate compliance costs—the first on public companies (Pope, Fayle and Chen 1991) and the second covering all companies (Pope, Fayle and Chen 1994)—with findings from the former study superseded by the latter study. The 1990-91 compliance costs of companies' income taxation were estimated at A$3,246 million or 22.9 percent of companies' income tax (Pope, Fayle and Chen 1994, p. 13), representing the largest compliance costs portion (41 percent) of all income taxes (Pope 1995, pp. 103-104).[41]

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[39] This summary covers studies undertaken since the late 1980s until recently. More details are presented in Appendix D. For earlier studies, including those on corporate businesses, refer Sandford, Godwin and Hardwick (1989, pp. 225 - 230).
[40] £1 = RM5.79 (1 July 2009, Bank Negara Malaysia).
[41] A$1 = RM2.84 (1 July 2009, Bank Negara Malaysia).

Table 2.3: Summary of Corporate Tax Compliance Costs Studies Worldwide [a]

Authors(s); (year)	Country	Key Findings on Compliance Costs [b]
Sandford, Godwin and Hardwick (1989)	UK	Compliance costs in 1986–87 were £300 million or 2.22 percent of corporate tax revenue.
Pope, Fayle and Chen (1991)	Australia	Compliance costs of public companies in 1986–87 were between A$646 million and A$1.341 million, or 11.4 percent to 23.7 percent of corporate tax revenue.
Pope, Fayle and Chen (1994)	Australia	Compliance costs of companies' income tax in 1990–91 amounted to A$3,245.9 million or 22.9 percent of tax revenue.
Ariff, Loh and Talib (1995)	Singapore	In 1994, the average compliance costs per listed company were S$78,396.
Slemrod and Blumenthal (1996)	US	Compliance costs for large companies in 1992 were US$1.57 million in average, and US$2.08 billion in total i.e. 3.2 percent of revenue yield.
KPMG (1996)	UK	Compliance costs of listed companies in 1995–96 were £265 million.
Slemrod (1997)	US	In 1996, the average compliance costs for large companies increased to US$1.9 million (1992: US$1.57 million), indicating an 8.1 percent increase in real terms.
Ariff, Ismail and Loh (1997)	Singapore	The 1995 average compliance costs per listed company decreased significantly to S$54,615 (1994: S$78,396).
Erard (1997a)	Canada	The combined federal-provincial income and capital tax compliance burden for the top 500 corporations in 1995 was estimated at C$507,000 per company, C$250 million in aggregate, or about 5 percent of taxes paid.
Chan *et al.* (1999)	Hong Kong	The average tax compliance costs per public listed company in 1995–96 were estimated at HK$346,483.
Slemrod and Venkatesh (2002)	US	The compliance costs per company in 2000 were US$254,451, between US$21 billion and US$22.3 billion in aggregate, or between 28 percent and 29.6 percent of tax revenue.
Bertolucci (2002)	Brazil	The total compliance costs were R$7.2 billion.
Chattopadhyay and Das Gupta (2002a)	India	The corporate compliance costs for 2000–01 were around 5.6 percent to 14.5 percent of tax revenues.
Klun (2004b)	Slovenia	In 2002, compliance costs per company were SIT 1.5 million or 4.2 percent of tax revenue; 1.00 percent of GDP.
Blazic (2004)	Croatia	Compliance costs for 2001-02 were HRK27,113 per company and HRK2,038.6 million in aggregate level, representing around 1.2 percent of the GDP.

[a] Refer Appendix D, for more details. Studies in Brazil, Slovenia and Croatia also included other business taxes paid by corporations. Studies that cover corporations as part of a comprehensive study on all business taxes and/or taxpayers were not included. These include studies in New Zealand (Sandford and Hasseldine 1992), the Netherlands (Allers 1994) and Australia (Evans *et al.* 1997).
[b] Compliance costs refer to gross compliance costs, stated in relevant national currency.

In the US, the income tax compliance costs of large companies in 1992 were estimated at US$1.5 million per company, and US$2 billion in aggregate or around 3.2 percent of tax revenue (Slemrod and Blumenthal 1996, pp. 481, 421).[42] In 1996, the compliance costs of US large companies increased to US$1.9 million per company, which is equal to 8.1 percent of real increase in average compliance costs (Slemrod 1997, p. 7). In 2000, compliance costs for both large and medium sized-companies were estimated at US$254,000 per company, around US$22 billion in aggregate terms, i.e. 29 percent of tax (Slemrod and Venkatesh 2002, pp. 24-27). Thereafter, compliance costs estimates of corporations take into account partnerships as well, i.e. Slemrod (2004b) and Moody, Warcholik and Hodge (2005).

Compliance costs for the largest Canadian corporations were estimated to be C$507,000 per company, amounting to C$250 million in aggregate or five percent of tax revenue (Erard 1997a, pp. 4-5).[43] Another Canadian study by Erard (1997b) specifically considered medium-sized corporations, but was concerned with perceptions about the compliance burden and thus did not estimate the compliance costs.

The most recent studies on corporations, i.e. for the tax year 2001-02, were conducted in Croatia (Blazic 2004) and Slovenia (Klun 2004b). For Asian countries, nearly all studies estimated compliance costs on corporations; with estimates for Singapore, Hong Kong and India presented in the above section,[44] while prior Malaysian estimates are discussed below.

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[42] US$1 = RM3.52 (1 July 2009, Bank Negara Malaysia).
[43] C$1 = RM3.03 (1 July 2009, Bank Negara Malaysia).
[44] For a comprehensive review, refer Ariff and Pope (2002).

2.3.2 Malaysian Compliance Costs Studies

Compliance costs studies, in a similar trend to compliance behaviour, also have long been ignored in Malaysia. Prior literature indicates that, to date, there are only three published studies on the costs of compliance in Malaysia. The first study, conducted by Loh *et al.* (1997) in 1995, examined the income tax compliance costs of public listed companies in Malaysia. The second study, conducted by Hanefah, Ariff and Kasipillai (2001) in 2000 focused on SMEs. The third study was conducted by Mansor, Saad and Ibrahim (2003) in 2001. This study is probably the first study conducted under the SAS regime. However, it does not measure compliance costs in monetary terms; instead it focuses on the relative increase in the time spent on various tax compliance activities. In addition to these three studies, a study by Sapiei and Abdullah (2008) is probably the first on tax compliance costs of individual taxpayers. However, the study only estimated tax compliance costs, partially in monetary terms and the remainder in time spent. A summary of the major findings of these Malaysian compliance costs studies is shown in Table 2.4.[45]

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[45] Additional details are provided in Appendix E.

Table 2.4: Earlier Income Tax Compliance Costs Studies in Malaysia

Author(s); (year)	Respondents (year of study)	Main Outcomes [a]
Loh *et al.* (1997)	Public Listed Companies (1995)	• The average compliance costs per public listed company was RM68,836 with 72 percent of the compliance costs external in nature. • Compliance costs decrease as company size increases. • Computational costs (61%) forms a major portion of compliance costs.
Hanefah, Ariff and Kasipillai (2001)	SME Companies (1999)	• The average compliance costs per SME company was RM21,964, with 75 percent of the costs derived internally. • Computation costs form 59 percent, while the remaining (41%) was planning cost. • Compliance costs were four times more regressive than listed company.
Mansor, Saad and Ibrahim, (2003)	SME Companies (2002)	• The major source of increase in compliance costs (measured in terms of relative increase of time spent) was time spent with tax agents (78.83%), followed by time spent in learning tax law changes (55.4%).
Sapiei and Abdullah (2008)	Individuals, including self-employed (2007)	• The average time spent on compliance activities by individual taxpayers was 70.6 hours per annum. • The average money cost per taxpayer was RM187.90. • A large majority of taxpayers (71%) prepared their own tax return.

[a] See Appendix E for additional details.
Source: Abdul-Jabbar and Pope (2008b, p. 8).

Due to their methodological similarities, it is useful to compare the results of the first two studies, both of which were conducted prior to the introduction of the SAS. The average compliance costs of SMEs in absolute values are almost one-third of the large companies,[46] as shown in Table 2.5. Hanefah, Ariff and Kasipillai (2001) emphasised that the composition of both internal and external costs, as measured by costs percentage, of SMEs were completely different for large companies. Hanefah, Ariff and Kasipillai (2001) found that SMEs rely heavily on internal resources to comply with the tax laws. On the contrary, large companies depend on the use of external advisers (Loh *et al.* 1997). More importantly, both studies confirmed the regressive nature of tax compliance costs among smaller companies in Malaysia. Hanefah, Ariff and Kasipillai (2001) observed that the fixed cost effect of compliance costs is substantially greater for SMEs compared to the public listed companies studied by Loh *et al.* (1997).

Table 2.5: Compliance Costs in Malaysia prior to the Self-Assessment System

Costs Components	Large Company [a]		SME Company [b]	
	RM	Percentage	RM	Percentage
Internal	19,176	28	15,493	75
External	49,660	72	5,210	25
Overall	68,836	100	20,703 [c]	100

[a] 1995 Loh *et al.* (1997) figures.
[b] 1999 Hanefah, Ariff and Kasipillai (2001) figures.
[c] The total was less than the overall mean costs of RM21,964 due to differences in the response number.
Source: Adapted from Pope and Abdul-Jabbar (2008, p. 53 - Table 5).

Arguably, Ariff and Pope (2002) show that the tax compliance costs incurred by Malaysian companies, either large or small firms, are substantially low compared with other Asia–Pacific countries, as shown in Table 2.6. For example, the average compliance costs for smaller firms in Malaysia is only six percent of compliance costs of larger firms, compared to 17 percent and 19 percent in Singapore and Hong Kong

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[46] The inflation rate, as measured by the Consumer Price Index (CPI) change over the period 1995 to 1999 was between 2.6 and 3.5 percent per annum, except for 5.2 percent in 1998 (Treasury of Malaysia 1999, 2000, 2002, 2003, 2004).

respectively. It must be emphasised that a comparative analysis by Ariff and Pope only considered public listed companies in the respective three countries.

Table 2.6: Average Costs of Complying with Corporate Income Tax: Listed Firms

Countries (Currency)	All	Small	Medium	Large
Hong Kong (HK$)	346,483	85,950 (0.19)	272,410 (0.60)	456,339 (1.00)
Malaysia (RM)	68,836	15,048 (0.06)	43,848 (0.17)	253,920 (1.00)
Singapore (S$)	78,396	36,446 (0.17)	61,715 (0.28)	216,575 (1.00)

Source: Ariff and Pope (2002, p. 41 - Table 2.5). Ratios in parenthesis are added by the author.
Exchange rate HK$1 = RM0.45; S$1 = RM2.43 (1 July 2009, Bank Negara Malaysia).

Interestingly, in contrast to tax behavioural studies, the Malaysian tax compliance costs studies have tended to emphasise the corporate sector rather than the individual taxpayer. The current study also focuses on the corporate sector under the SAS regime; however, it specifically targets the SME sector due to its importance in the national economy.[47]

2.4   CHAPTER SUMMARY

The literature review above shows that although a large number of studies on individual tax compliance behaviour exist, there is a paucity of research on the corporate sector, with no study yet to be undertaken in the Malaysian setting. The current study targets the corporate sector, specifically the SMEs, as recognition of their importance to the Malaysian economy.   Further, the lack of research examining the effect of tax compliance costs on tax compliance behaviour is observed for all taxpayers, including both individuals and businesses. This gap is apparent both at the international level and in Malaysia. Thus, compliance costs, in particular, have been chosen as among the key

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[47] See Chapter One, subsection 1.2.3.

determinants of tax compliance in the current study. Other influences included are business characteristics (such as business size, sector and the length in business), tax attitudes and perceptions (such as on complexity, fairness and structure of tax system) from a business managerial perspective.[48]

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[48] See Chapter Four, subsection 4.10.4 and Chapter Six, Section 6.7, for more details on other variables.

CHAPTER THREE

TAXATION OF SMALL AND MEDIUM ENTERPRISES

AND MAJOR ISSUES IN MALAYSIA

3.1   INTRODUCTION

This chapter starts with an overview of Malaysian taxation and highlights recent major income tax changes (including for tax year 2009), with particular emphasis on SME taxation under the SAS regime. Discussion of the major income tax difficulties and issues facing the SME sector is the central aim of this chapter. Understanding the tax issues surrounding SMEs is imperative as it offers some background and motivation regarding the current study. Unless otherwise stated, this chapter primarily covers relevant provisions under the ITA 1967 that are applicable to the year of assessment 2006 and onwards.

3.2   MALAYSIAN INCOME TAXATION UNDER SELF-ASSESSMENT

3.2.1 Overview

The Malaysian federal government's tax revenue comprises direct and indirect taxes. Direct taxes are under the administration of the IRB. On the other hand, indirect taxes are administered by the Royal Malaysian Customs Department (RMC). Both tax authorities are under the responsibility of the Ministry of Finance. The IRB was established in accordance with the *Inland Revenue Board of Malaysia Act 1995*, which allows autonomy in the administration and effectiveness of direct taxes. On the contrary, the RMC is a government agency. A summary of direct and indirect taxes in Malaysia is presented in Table 3.1. All the taxes are administered under different Acts of Parliament. For example, income tax is governed by the ITA 1967, real property gains tax is under the *Real Property Gains Tax Act* (RPGTA) 1976, whilst sales tax and service tax are covered by the *Sales Tax Act 1972* and *Service Tax Act 1975* respectively.

Table 3.1: Types of Federal Taxes in Malaysia

Direct tax	Indirect Tax
Income Tax Charged on individuals, companies and other entities (such as clubs and associations) deriving income from businesses, employment, dividends, interest, rents, royalties, pensions, annuities and other periodical payments.	**Sales Tax** A single stage tax levied on certain imported and locally manufactured goods. The general rate of sales tax is 10 percent.
Petroleum Income Tax Charged on businesses deriving income from petroleum operations.	**Service Tax** Imposed on certain goods and services provided in certain prescribed establishments. Service tax is charged and levied at the rate of five percent.
Real Property Gains Tax [a] A capital gains tax imposed on the disposal of real property and/or shares in a real property company.	**Excise Duties** Levied on selected products manufactured in Malaysia. For example cigarettes, liquor and motor vehicles.
Stamp Duty A transaction based tax imposed on instruments, such as tenant agreements, purchases and transfers of property.	**Customs Duties** Comprised of export and import duties. The customs duties vary according to the type of goods imported or exported.

[a] Gains from disposals from 1 April 2007 are exempt from the Real Property Gains Tax.
Source: Pope and Abdul-Jabbar (2007), Table 2, updated for recent tax changes.

Typically, income tax constitutes a major federal tax liability both for business and non-business taxpayers. The chargeability of other forms of direct and indirect taxes depends mainly on the nature of the business and/or transaction. For example, service tax is levied on certain goods and services provided in certain prescribed establishments and stamp duty is a transaction-based tax on instruments. In addition to federal government taxes, businesses are required to comply with the state and local

government taxes, which include property taxes (assessment tax and land tax) and various business permits and licensing. This chapter is confined to income taxation of SMEs.

3.2.2 Duties and Responsibilities of Business Taxpayers

Business taxpayers, regardless of their size, are required by law (i.e. ITA 1967), essentially, to file an annual tax return (Sections 77 and 77A), and to keep sufficient records and documentation (Sections 82 and 82A). Corporate taxpayers are required to observe further additional tax requirements (e.g. Sections 107, 107B, 107C and 108). Businesses are also required to implement the Schedular Tax Deduction (STD) Scheme (Section 107(1) and *Income Tax–Deduction from Remuneration Rules 1994*) and to furnish certain returns on behalf of their employees (Section 83). Further, in the case of tax audit, taxpayers are required to provide reasonable assistance and facilities to the IRB officers (Section 80). Each of these duties is discussed in detail below.

Section 77 of the ITA 1967 requires business taxpayers to give notice of chargeability of income tax by way of filing an annual tax return. Generally, the filing of tax returns depends on the category of the taxpayer. Corporate taxpayers (including trust bodies and co-operative societies) are required to furnish a tax return for each year of assessment within seven months after the financial year-end (Section 77A). On the other hand, individuals have to submit their tax returns not later than 30 April in the year following the relevant year of assessment (Section 77). Non-compliance to this provision could lead to a penalty of between RM200 and RM2,000 and/or imprisonment of up to six months (Section 112). Taxpayers are also required to ensure the correctness of their tax return. Further penalties apply in the case of non-compliance (Sections 113 and 114).

As for documentation, Section 82 of the ITA 1967 requires every business taxpayer to keep adequate business records for seven years. For this purpose, records include books of account recording receipts and payments or income and expenditure, invoices, vouchers, receipts and other relevant documents to verify the accounting entries

[Section 82(9)]. The Act also requires businesses with an annual turnover exceeding RM150,000 to issue serially printed receipts and retain a duplicate copy of each receipt [Section 82(1)(b)]. The IRB has issued three public rulings pertaining to keeping sufficient records, shown in Table 3.2. A public ruling (PR) is issued by the IRB to provide guidance to taxpayers and revenue officers as well with a view to minimise ambiguous interpretations of tax law. In 2003, Section 82A extended the duty to keep documents to all taxpayers (i.e. regardless of their business turnover), specifically in ascertaining chargeable income and income tax payable. Documents in this provision refer to documents as statements of income and expenditure, and invoices, vouchers, receipts and other relevant documents to verify the tax return [Section 82A(6)]. Failure to maintain adequate records and documents makes one liable to a fine between RM300 and RM10,000 or to imprisonment for a period of up to one year, or both (Section 119A).

Table 3.2: Public Rulings on Records and Documentations

Title	Number	Date of Issue
Keeping sufficient records (companies and co-operatives)	PR 4/2000	30 June 2001 [a]
Keeping sufficient records (individuals and partnerships)	PR 5/2000	30 June 2001 [a]
Keeping sufficient records (persons other than companies and co-operatives)	PR 6/2000	30 June 2001 [a]

[a] These rulings are the revised versions of earlier rulings issued on 1 March 2000.
 Source: Inland Revenue Board (2001b).

Corporate taxpayers are required to observe additional requirements that were introduced since the implementation of the SAS, and due to the corporate imputation system, these requirements are applicable to resident companies. Since the SAS, Section 107C requires companies to furnish an advance estimate of tax (Form CP 204) and make instalment payments to the IRB (Form CP 205).[49] Effective 2008, new SME companies are exempted from this requirement during their first two years of

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[49] For details refer the IRB website at http://www.hasil.org.my.

operation.[50] The amount of the tax estimate shall not be less than 85 percent of the previous year's tax payable and shall be made in advance (i.e. by no later than 30 days before the beginning of the basis period for that year of assessment). The estimated tax shall be paid in 12 equal instalments commencing from the second month of the basis period (on or before the 10th day). Revision is allowed in the sixth and/or ninth month of the basis period. Regarding the imputation system, companies will continue to comply with the relevant provisions under Section 108; for example, maintaining dividend franking account (Form R) that needs to be furnished together with their annual tax return (Form C). Though the imputation system was replaced by the single tier system commencing in 2008,[51] it must be emphasised that the current study covers the 2006 tax year where the imputation system was in effect. Failure to comply with these provisions may lead to a penalty (between RM200 and RM2,000) and/or imprisonment (up to six months) for each offence (Section 120).

Apart from specific duties relating to their own business taxation, businesses are further required to execute additional duties on behalf of their employees (i.e. third party tax). The STD was introduced in 1995 and is comparable to pay as you earn (PAYE) and pay as you go (PAYG) in the UK and Australia respectively. Under the STD scheme, employers are required to deduct monthly tax on behalf of their employees' employment income and forward the amounts to the IRB by the 10th of the month following the month when the tax deduction is made. The deduction depends on the personal circumstances of each employee and requires businesses to keep their employees' records up-to-date. Penalties (up to RM1,000 or imprisonment for a period of up to six months, or both) are imposed on those failing to comply with the requirements (Rule 17, *Income Tax–Deduction from Remuneration Rules 1994*). Businesses are also required to provide the IRB with annual returns (Form E and CP 8A) relating to their employees (Section 83). The return is to be made yearly on all employment income. Further, the businesses also need to notify the IRB on the

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[50] See subsection 3.2.3 for details.
[51] Refer subsection 3.2.3 for details.

appointment of new employees, of employees ceasing employment and/or leaving Malaysia.[52]

In the case of a tax audit, a taxpayer must provide reasonable assistance and facilities to the IRB officers. A public ruling entitled 'providing reasonable assistance and facilities' was issued by the IRB (2000a) in this regard (PR 7/2000). Nonconformity to this provision may mean a taxpayer is liable to a fine between RM1,000 and RM10,000 or to imprisonment for a term of up to one year, or to both (Section 116).

3.2.3 Recent Major Business Income Tax Changes

In the year 2000, two major reforms took place in Malaysia, namely, the move from the preceding year assessment (PYA) to current year assessment (CYA) and the introduction of the SAS. Another recent major reform, a single-tier company income tax system, was introduced to replace the corporate imputation system in 2008. Besides the above general and company-specific tax reforms, two particular changes apply to SME companies only, namely, the introduction of dual corporate tax rates (in 2003) and exclusion from advance tax estimates and monthly payments (effective in 2008).

The SAS was implemented in stages, starting with companies from the year 2001 and subsequently to other taxpayers (i.e. individuals, partnerships and co-operatives) in 2004. Prior to years of assessment 2001 (for companies) and 2004 (for personal and other taxpayers), income tax in Malaysia was assessed under the OAS. Under the OAS system, taxpayers were required to submit their annual tax returns by a stipulated period—within 30 days from the issuing date of notice of assessment or within six months after the business year-end respectively for the individual and corporate taxpayer. The IRB then issued a notice of assessment, payable within 30 days. Since 2005, income tax in Malaysia has been fully administered under the SAS regime. The introduction of the SAS involved a substantial shift of responsibility on to the taxpayers in terms of their compliance obligations. A tax audit will be conducted by the IRB to

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[52] Details of these requirements and relevant forms are available on the website of the IRB at http://www.hasil.org.my.

ensure that taxable income has been duly recognised and expenses properly claimed. Any understatement of tax will result in heavy penalties being imposed by the IRB. Generally, in the SAS, taxpayers are required to compute and pay their income tax. Companies are required to observe additional requirements. These requirements include an advance estimation of the tax liability and payment of monthly tax instalments (also in advance) as provided for in the new Section 107C of ITA 1967.[53]

Following the SAS, a number of significant amendments have been made. A number of public rulings have also been issued since 2000. The simplification of the business basis period, re-categorisation of capital expenditure for capital allowance purposes, and the full capital allowance for small value assets are some of the major income tax simplifications that have been introduced since the implementation of the SAS. Regarding simplification of the business basis period, all individual business taxpayers are required to close their accounting year on 31 December each year. By contrast, a basis period for a company will follow the financial year-end. Sections 20 and 21 of the ITA 1967 have been amended and a new section, 21A, has been introduced. Additionally, three related public rulings were issued in the year 2000 and consequently superseded by the later version in 2001, shown in Table 3.3.

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[53] See subsection 3.2.2.

Table 3.3: Public Rulings on Basis Period

Subject	Number	Date of Issue
Basis period for a non-business source	PR 1/2000 [a]	1 March 2000
Basis period for a business source (companies and co-operatives)	PR 2/2000 [a]	1 March 2000
Basis period for a business source (individuals and persons other than companies and co-operatives)	PR 3/2000 [a]	1 March 2000
Basis period for a non-business source (individuals and persons other than companies/co-operatives)	PR 4/2001	30 April 2001
Basis period for a business source (co-operatives)	PR 5/2001	30 April 2001
Basis period for a business source (individuals and persons other than companies/co-operatives)	PR 6/2001	30 April 2001
Basis period for business and non-business sources (companies)	PR 7/2001	30 April 2001

[a] These rulings were superseded by the four subsequent rulings (i.e. PR4/2001–PR7/2001).
Sources: Inland Revenue Board (2000b; 2001c).

For capital allowances, the simplification is made by re-classifying 16 capital expenditures under the plant and machinery category to only three sub-categories, i.e. heavy machinery and motor vehicles, plant and machinery, and furniture and office equipment. Accordingly, a large variety of capital allowance rates were reduced to three rates only. Another simplification of capital allowance took place in 2006, which allows small value assets of up to RM1,000 each to be given a 100 percent allowance in the purchased year. Nonetheless, a sum of such allowance is restricted to a maximum of RM10,000 per year.[54] A public ruling entitled 'special allowances for small value assets' was issued on 27 March 2008 (Inland Revenue Board).

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[54] Starting 2009, this restriction is not applicable to SME companies (Ministry of Finance Malaysia 2008).

Effective 2008, the corporate tax imputation system was replaced by a single-tier company income tax system. Under this single-tier system, the corporate tax is imposed at the corporate level (and represents a final tax) and the dividends distributed to shareholders are exempted from tax. The single tier system certainly would simplify the procedures (Section 108) for effecting dividend distributions and arguably would reduce both the administrative costs (to the tax authority) and tax compliance costs (to the taxpayer) that together comprise tax operating costs.

Specifically to the SME sector, but confined to a company, two additional measures have been introduced. The first is dual corporate tax rates in 2003. Under this structure, SME companies, with paid-up capital of up to RM2.5 million, are subject to a tax rate of 20 percent for the first RM500,000 (from 1 January 2004; RM100,000 in 2003) of taxable income and the remaining income is subject to the normal corporate tax rate of 25 percent (from 1 January 2009; 26 percent in 2008; 27 percent in 2007). The most recent amendment relates to the estimation of tax payable and payment of a monthly tax instalment. In order to relieve the cash flow constraints faced by SMEs, in particular during the initial stages of operation, SME companies are not required to furnish an estimate of tax payable or make instalment payments for their first two years from business commencement.

3.3 KEY FEATURES OF INCOME TAXATION FOR SMALL AND MEDIUM ENTERPRISES

Small and Medium Enterprises in Malaysia are subject to income tax, either as individual (unincorporated businesses) or as corporate taxpayers (incorporated businesses), depending on the business establishment. The income taxation of both incorporated and unincorporated businesses are governed by the ITA 1967, with similar tax provisions. Generally, unincorporated SMEs are treated as individuals, hence subject to progressive tax rates and eligible for personal reliefs and rebates. On the contrary, incorporated businesses, either SMEs or large enterprises, are treated in similar ways, with a few exceptions or incentives. For example, SME companies are given a deduction for pre-incorporated expenses. A summary of major differences in income tax treatment for corporate and individual taxpayers is shown in Table 3.4. For example, an individual taxpayer is subjected to progressive tax rates and eligible for personal reliefs and rebates. On the other hand, depending on the size of the company, corporate taxpayers are subject to either a flat rate (for large companies) or dual tax rates (for SME companies), without any personal reliefs and rebates. SME companies with paid-up capital of up to RM2.5 million are eligible for the dual corporate tax rates introduced in 2003.[55] Under this structure, SME companies are subject to a tax rate of 20 percent for the first RM500,000 (RM100,000 prior to 2004) of taxable income and the remaining income is subjected to a normal corporate tax rate.

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[55] Effective 2009, SME companies that are controlled by another company with a paid-up capital exceeding RM2.5 million do not fall within the meaning of SME companies for tax purposes (Ministry of Finance Malaysia 2008).

Table 3.4: Major Differences between Corporate Business and Individual Taxation

Aspects	Corporate	Individual [a]
Tax rate(s)	Corporate tax rate is 25 percent (from 1 January 2009; 26 percent in 2008; 27 percent in 2007; 28 percent in 2006). A dual rate applies for SME companies since 2003, i.e. the first RM500,000 of taxable income is taxed at 20 percent (from 1 January 2004; RM100,000 in 2003) and the remaining income is subject to the normal corporate tax rate.	Individual is subject to progressive tax rates of between 0 and 28 percent. Non-residents are subject to a flat rate of 28 percent. Starting 2009, the highest tax rate for both resident and non-resident individuals has been reduced from 28 percent to 27 percent.
Basis of assessment	Financial year-end	Calendar year
Availability of reliefs and rebates in ascertaining taxable income	Not eligible	Eligible
Availability of certain tax deductions, including a double deduction under the ITA 1967.	Available to some SME companies	Not applicable
Requirements relating to the imputation system. [b]	Yes	Not applicable
Requirements with regards to the SAS, specifically to: • estimate tax liability • make monthly payment • submit a tax return	Yes [c] Yes [c] Yes	Not applicable Not applicable Yes
Availability of tax incentives, such as pioneer status and investment tax allowance under the *Promotion of Investments Act (*PIA), 1986.	Available for certain sectors, mainly to manufacturing, agricultural, tourism and high-technology companies.	Not available, except for agricultural sectors

[a] Applicable to resident individuals only, unless stated otherwise.

[b] The corporate imputation system applies up to year of assessment 2007. A single-tier company income tax system applies starting from 2008 (see discussion above in subsection 3.2.3).

[c] Starting 2008, SME companies are exempted from this requirements for their first two years from business commencement (see discussion above in subsection 3.2.3).

Source: Pope and Abdul-Jabbar (2007), Table 4, updated for recent tax changes.

3.4   MAJOR INCOME TAX DIFFICULTIES AND ISSUES FOR SMALL AND MEDIUM ENTERPRISES

3.4.1   Overall Perspective

The regulatory nature of duties and obligations of taxpayers, more importantly under the SAS, places an enormous burden and cost upon the business sector, particularly to SME sectors. The income tax regulatory burden upon businesses, regardless of their form and/or size, is among key business regulatory concerns for the business sector globally (Pope 2008). The international experiences often indicate the difficulties faced by SMEs in managing government laws and regulations (Fernandez and Oats 1998, p. 162), particularly in maintaining proper records for management and taxation purposes (Small Business Deregulation Task Force 1996, p. 2; Evans, Carlon and Massey 2005, p. 289). The issues facing small businesses in relation to regulatory costs are a worldwide phenomena and almost identical globally (Chittenden, Kauser and Poutziouris 2003) and in Malaysia (Hanefah and Al-Mureshi 1991; Kasipillai and Liew 2004). These include a lack of understanding of the regulatory requirements, frequent changes in regulations, and high fixed costs (Chittenden, Kauser and Poutziouris 2003, p. 110).

From an overall business perspective Malaysian SMEs face many problems and constraints, which mainly include financial, managerial and technological aspects (Hashim 2007). Adding to this core business concern and also existing business regulatory requirements, the regular amendments to the various laws, taxation in particular, the introduction of the SAS and increasing complexities of the tax system may have further adverse impacts on SMEs. The following subsections highlight the issues concerning business record keeping, complexity of tax law, legal forms of business entities, and more importantly, compliance costs arising from tax regulatory requirements.

3.4.2 Record Keeping and Documentation

The difficulties of Malaysian SMEs in managing business laws (Kasipillai and Liew 2004), and specifically in maintaining appropriate records for business and taxation purposes (Hanefah and Al-Mureshi 1991), are evident. More than 15 years ago, Hanefah and Al-Mureshi (1991) observed that the predominant services provided by accounting firms to small business clients are book-keeping and taxation. The lack of proper records could cause small businesses to fail to comply with business taxation requirements (Abdul-Jabbar 1996). On the contrary, Hanefah and Al-Mureshi (1991) hypothesised that medium-scale enterprises may not have as many problems in this aspect, but to what extent this remains true in the SAS environment has not been researched.

Prior to the implementation of the SAS to individual taxpayers (i.e. before 2005), a number of studies had been conducted which included self-employed taxpayers (see for example Kasipillai *et al.* 1999; Ramasamy *et al.* 2003; Palil 2005a), and SMEs (Hanefah and Al-Mureshi 1991). Overall, these studies showed that the issues relating to book-keeping and documentation for tax purposes remain relevant. Even a salary earner with a simple tax situation may have difficulties (Loo and Ho 2005; Palil 2005a), and particularly self-employed business persons (small business) need to consider obtaining external tax advice. The same may also apply to medium-sized firms, but not as much to small firms. Thus, it is anticipated that additional record keeping requirements (Section 82A) that were introduced since the implementation of the SAS could further add to the existing record keeping responsibility (Section 82) of the SMEs, small business in particular. More interestingly, with a government plan to introduce the GST,[56] maintaining additional records and documentation were completely essential.

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[56] In February 2006, the proposed GST was postponed indefinitely (Ministry of Finance Malaysia 2006b). See also Chapter One, Footnote 10.

3.4.3 Tax Complexity

Some degree of tax complexity for individual taxpayers, including those with business income, was evident in Malaysia under the OAS (Hanefah 1996). Later, immediately prior to the implementation of the SAS, Hanefah, Ariff and Kasipillai (2001, p. 96) argued that the Malaysian business tax system appeared to be becoming increasingly complex. Nonetheless, Ariff and Pope (2002) believed that some tax simplification measures implemented towards the end of the 1990s and early 2000s had been of some relief for Malaysian taxpayers, and thus considered the level of tax complexity in Malaysia (determined by its compliance costs) as very low compared with other Asia–Pacific countries, such as Australia, Hong Kong and Singapore (Ariff and Pope 2002, p. 9). The extent of tax complexity is yet to be examined under the SAS regime. However, Kasipillai (2005, p. 26) observed that there is a growing list of deductions for various forms of relief (such as deduction for reading materials and a relief for education, serious disease, and parent medical expenses) for individuals, including small business owners. He raised concern over the possible difficulties faced by taxpayers in interpreting and taking advantage of the amendments.

A number of public rulings have been issued by the IRB since the SAS. Regrettably, some of the rulings, for example, rulings on the basis period, have been revised and amended within just a year of their initial introduction. The fact that a growing list of public rulings may increase the tax complexity should be recognised. Chittenden, Kauser and Poutziouris (2003, p. 110), in their review of the tax compliance cost studies within small businesses in the US, the UK, Australia and New Zealand, noted that the incompetency of small business (in particular) in dealing with complex tax regulations has affected them more severely than large firms. A straightforward approach to lessen such tax complexity issues, at least from the business taxpayer's perspective, is by outsourcing tax obligations to tax professionals, but this generally increases tax compliance costs.[57] Pope (1993b, p. 70) asserts that high costs of tax compliance are the product of the complex nature of the tax system and low costs indicate otherwise.

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[57] See subsection 3.4.5.

3.4.4 Business Legal Form

Small and Medium Enterprises in Malaysia take three forms: self employed, partnerships and companies. However, for income tax purposes, SMEs are treated either as personal or as corporate taxpayers, depending on the business establishment. Partnership businesses are not taxed directly, but their individual partners are subject to personal income tax based on their income portion from the partnership business. A brief summary of income tax treatment for corporate and personal taxpayers has been presented earlier in this chapter.[58] Arguably, the choice of business form is somewhat troublesome to the SME sector as they need to consider the best business form to suit their circumstances (see mainly Freedman 2003; Crawford and Freedman 2008), particularly during the early stages of business establishment. From a taxation perspective, consideration may entail two aspects, namely, the effective tax rates and the investment incentives.

First, the effective tax rate of SME companies with a taxable income up to RM500,000 is 20 percent (2003 onwards). On the other hand, business individuals with a taxable income (i.e. income after deductions of personal and other reliefs) of more than RM179,000 will exceed 20 percent (2003 onwards). Secondly, corporate firms are often entitled to various tax incentives in Malaysia. The incentives are available under the *Promotion of Investments Act* (PIA) 1986 (such as pioneer status and investment tax allowance) and ITA 1967 (such as reinvestment allowance and a deduction for pre-incorporated expenses). Most of these incentives are not available for unincorporated businesses, except in the agricultural sectors. The mechanism of incentives vary depending on a number of factors, e.g. type of incentive, business sector and whether a small-scale company or not. Regrettably, most of the incentives are mutually exclusive, thus requiring an analysis of costs and benefits. For example, a company enjoying pioneer status could not apply for other types of incentives. Businesses need to consider a number of options that best suit their circumstances. Such numbers of tax incentives almost certainly increases the complexity of the tax laws and ensuing tax compliance costs.

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[58] See Section 3.3—Table 3.4.

Despite general tax advantages to personal business taxpayers, in terms of effective tax rates (when taxable income is less than RM179,000) and to corporate taxpayers, in terms of both tax rates (when taxable income exceeds RM179,000) and tax incentives, it must be emphasised that the nature, duties and responsibility of all business taxpayers[59] are similar regardless of their business form and size. In Malaysia, SMEs in the form of companies seem to have relatively more tax advantages. Thus, the favourable tax policy to corporate businesses is not surprising. In practice, however, the choice of business form is not solely dependent on tax aspects. A number of business regulations and cost considerations are probably essential. For example, the *Companies Act 1965* requires financial statements of Malaysian corporate entities, regardless of their size, to be audited annually, thus incurring compliance costs in terms of financial reporting.

Complicating factors in considering and designing [income] tax provisions for small businesses have been discussed by a number of authors (see mainly Freedman 2003; Chittenden and Sloan 2007; Crawford and Freedman 2008). This includes the role and effect of market failure; size disadvantages (which covers the compliance costs issue); keeping the small business intact; and political economy considerations (Crawford and Freedman 2008). They argue that favourable policies for small businesses are acceptable primarily in the case of market failure, and to some extent due to compliance costs considerations (Crawford and Freedman 2008). They found that the tax system has a significant impact on the choice of business form in the UK. The UK experience also shows that policy makers tend to overlook unincorporated entities (Freedman 2003, p. 34) in this regard. Overall, a simple tax system (Freedman 2003), which focuses on minimising tax compliance costs and lowering tax rates for all businesses (Pope 2008, p. 34), is preferable to too many special provisions, which potentially leads to tax complexity (Freedman 2003, p. 15) and distortion of the choice of business legal form (Freedman 2003; Crawford and Freedman 2008).

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[59] See subsection 3.2.2.

3.4.5 Tax Compliance Costs

Malaysian businesses incur costs to comply with all mandatory tax requirements,[60] and related considerations,[61] which are additional to their tax liability. The introduction of the SAS was mainly motivated by the aim of increasing the collection rate, to reduce the cost of collecting taxes, and to increase voluntary compliance (Kasipillai 2005, pp. 26-27). The SAS environment involves a substantial shift of responsibility on to taxpayers in terms of their compliance obligations, with tax professionals expected to play a significant role in providing services to taxpayers in complying with the tax laws. Consequently, compliance costs are expected to increase significantly during the early years of the SAS implementation (Hanefah, Ariff and Kasipillai 2001; Ariff and Pope 2002; Mathieu, Waddams and Antwi 2007). In the longer term, the relative level of compliance costs will depend upon a range of factors, particularly the complexity of the tax laws and frequency of tax changes. As discussed in Chapter Two,[62] prior to the SAS, there were only two published studies on the cost of tax compliance in Malaysia (Loh *et al.* 1997; Hanefah, Ariff and Kasipillai 2001). More importantly, both confirmed the regressivity of tax compliance upon smaller business. The effect of the SAS upon the compliance costs of Malaysian businesses is yet to be investigated. This study updates compliance costs estimates for SMEs under the SAS regime.

3.5   CHAPTER SUMMARY

This chapter has presented details on income taxation, duties and responsibilities of business taxpayers under the SAS regime. This covers the overall business perspective and issues specific to the SME business sector. The burden of tax compliance, in particular concerning business record keeping, the level of tax complexity, the choice of legal entity, and more importantly the incidence of tax compliance costs, are among the major income tax issues that face Malaysian SMEs.

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[60] See subsections 3.2.2 and 3.4.2.
[61] See subsections 3.4.3 and 3.4.4.
[62] See Chapter Two, subsection 2.3.2.

CHAPTER FOUR
RESEARCH DESIGN AND METHODOLOGY

4.1   INTRODUCTION

This chapter focuses on various features of the research plan and methodology adopted in this study. As described in Chapter One, this study consists of two parts: the first estimates the compliance costs of SME companies in Malaysia; the second examines the determinants of corporate income tax compliance behaviour, with particular emphasis on income tax compliance costs. The current study followed a positivist paradigm to research, employing quantitative methods. The paradigm relies on deductive reasoning, whereby researchers seek knowledge based on observed facts. Most existing research in taxation has adopted a positivist approach (Abdul-Manaf 2004). The current research was carried out by way of the survey method, employing a large-scale mail survey (primary survey) and two additional surveys. The next section provides a brief background on the survey method in the context of social sciences, and more specifically in the area of tax research. This is followed by a discussion on the method of data collection adopted in this study. The questionnaire development and the pilot interviews are then discussed, followed by a detailed explanation of the survey implementation procedure undertaken. Particulars with regards to population of the study, the sampling process and the issue of non-response bias are provided also. The final section outlines the analytical methods adopted in this study.

4.2   SURVEY RESEARCH DESIGN

Survey research is the most widely employed method in the social sciences (Babbie 1989). The major advantage of survey research is the feasibility of obtaining a wide range of standardized information from a large population, which is cost beneficial (Babbie 1989, p. 258; Kerlinger and Lee 2000, p. 613). However, survey research does have some key limitations, which include the lack of in-depth information, the fact that

it is demanding in terms of resources (Kerlinger and Lee 2000, pp. 613-614), and that it may be lacking in realism (Babbie 1989, p. 258). Despite these limitations, the survey method remains a popular method in the social sciences. Thus, it is not surprising this method is the most commonly used in business research (Baruch 1999; Griffis, Goldsby and Cooper 2003, p. 237), including small business (Dennis 2003; Bartholomew and Smith 2006) and tax research as well. The latter includes studies on tax attitudes and behaviour (Jackson and Milliron 1986; Richardson and Sawyer 2001) and tax compliance costs (Sandford, Godwin and Hardwick 1989, p. 52).

In the tax compliance literature, a comprehensive review of Jackson and Milliron (1986) and Richardson and Sawyer (2001) noted four methods that are mainly employed in tax compliance studies: surveys, experiments, analytical approaches and regression modelling. Up to 1985, the survey method was the most frequent method used in the tax literature (Jackson and Milliron 1986). Thereafter, the trend continued but with a slight increase in the experimental method. Nevertheless, the survey method remained a popular method amongst tax compliance researchers (Richardson and Sawyer 2001). It is possibly still the most popular research design in the tax compliance literature. A recent publication by Torgler (2007) is also largely based on the survey research method. During the period 1986 to 1997, the progress in the experimental method was relatively significant and it became more popular than the survey method (Richardson and Sawyer 2001). The most significant factor in this growth is the increased realism in the experimental setting (Richardson and Sawyer 2001, p. 235).[63]

The methodological issues and the advances made in all four methods since 1985 have been fully discussed by Richardson and Sawyer (2001, pp. 223-240). It suffices to say that all four methods remain utilised in tax research and are subject to measurement difficulties to some extent. The most alarming concerns the honesty and validity of self-responses (Jackson and Milliron 1986; Richardson and Sawyer 2001).[64] Nevertheless, no empirical support exists to assert that one method is more accurate than the others

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[63] Realism could be incorporated into survey methods as well via hypothetical tax scenarios. See further discussion in Section 4.4.3.

[64] Section 4.4.3 provides a brief discussion of the issue of self-reporting.

(Long and Swingen 1991). Likewise, the survey method is largely employed in researching compliance costs, both internationally (Sandford, Godwin and Hardwick 1989; Pope 1995; Evans *et al.* 1996) and in the Asia–Pacific countries (Ariff and Pope 2002).

This study has incorporated both the tax compliance costs and tax compliance/non-compliance issues into one study, although the emphasis is on the former. In view of this, a survey research method is employed to obtain data on tax compliance costs and attitudinal information on a number of tax aspects i.e. fairness, complexity and behaviour. The introduction of the SAS has further influenced this current study to be undertaken in the form of a large-scale survey. Malaysia is still in the initial phase of developing compliance costs of taxation as a policy area. Sandford (1995, p. 402) strongly asserts that, for the process of convincing the government of the importance of tax compliance costs, a large-scale survey is the best starting point.

4.3   DATA COLLECTION METHOD AND STRATEGY

Survey data can be obtained in different ways, which include interviews (either face-to-face or telephone), questionnaires (either administered personally, by mail, e-mail or web) and panel discussion groups. The relative advantages and disadvantages of these methods in social sciences, in particular the mail questionnaires, and personal and telephone interviews, are discussed by Babbie (1989, pp. 253-254) and Miller (1991, pp. 141-167). Broadly, a personal interview is superior to the other methods, but is the most expensive and, perhaps, a difficult form of securing information (Miller 1991, p. 168; Kerlinger and Lee 2000, p. 601). On the contrary, mail questionnaires have considerable advantages in terms of cost and ease of getting information (Miller 1991, p. 140). Arguably, each of these data collection methods has its own advantages and disadvantages. But evidence shows that surveys are more often carried out by mail than by other approaches (Dillman 1991; Bartholomew and Smith 2006). As a general guide, it is recommended that researchers weigh up the advantages and disadvantages of the

available methods in relation to their research context and resources (Babbie 1989; Miller 1991; Sandford 1995, p. 386; Evans *et al.* 1996, pp. 24-15).

As a result, it is common for researchers to use any method, or a combination of methods, that fit their specific circumstances and constraints. Numerous survey approaches have been utilised in tax research, including mail questionnaires (Wallschutzky 1984; Porcano 1988; Collins, Milliron and Toy 1992; Hite and McGill 1992; Reckers, Sanders and Roark 1994; Wartick 1994; Hasseldine 1999; Wenzel 2002; Hasseldine and Hite 2003), self administered questionnaires (Song and Yarbrough 1978; Chan, Troutman and O'Bryan 2000; Webley, Cole and Eidjar 2001), face-to-face interviews (Dornstein 1987), telephone interviews (Hite 1997) or a combination of at least two approaches (Long and Swingen 1987). However, the use of mail surveys is predominant. A similar trend is also observable in Malaysia.[65] Apart from the coverage, speed and cost factors, this predominance is also due to the realism of the approach, as almost all tax authorities worldwide tend to rely on the mail system to communicate with taxpayers (Wartick 1994; Hasseldine 1999).

As for specific tax compliance costs studies, Sandford, Godwin and Hardwick (1989 p. 52) have discussed the advantages and disadvantages of seven methods of estimating compliance costs (1989, pp. 52-54): (i) highly structured questionnaires/interview schedules; (ii) semi-structured or unstructured interviews; (iii) time and motion studies; (iv) participant observation/action research; (v) other types of case study, e.g. studies of the comprehensibility of tax forms; (vi) archive research by using records of government department, tax advisers, etc; and (vii) simulation or modelling exercises.

Largely, tax compliance costs studies also use large-scale mail questionnaire studies (Sandford, Godwin and Hardwick 1989; Sandford 1995, p. 378; Pope 2000, p. 10; Evans 2003b, p. 71; Slemrod 2004a, p. 81) and are often supplemented by face-to-face interviews and/or telephone interviews (Sandford, Godwin and Hardwick 1989, p. 52; Sandford 1995, p. 404). The advantages and disadvantages of these methods,

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[65] See Appendix B column three.

particularly mail surveys and interview surveys, in tax compliance costs studies are fully considered by Sandford, Godwin and Hardwick (1989, pp. 52-53) and Sandford (1995, pp. 378-386).

Suffice it to say, cost-effectiveness is frequently cited as a key advantage of mail questionnaires over interview surveys (Babbie 1989; Sandford, Godwin and Hardwick 1989; Miller 1991; Sandford 1995; Evans *et al.* 1996). Moreover, a mail survey adds more weight in a sensitive area such as taxation, as the approach provides genuine anonymity and eliminates the bias of the interviewer (Sandford 1995, p. 384; Evans *et al.* 1996, p. 24). Additionally, the mail survey is also often preferred given the practical difficulties of scheduling interviews with geographically scattered business respondents (Vaillancourt 1989, p. 5). On the contrary, major weaknesses of mail surveys include that they are distinctly centred on the response rate and the quality of responses (Miller 1991, p. 141; Sandford 1995, p. 378; Evans *et al.* 1996, p. 24; Kerlinger and Lee 2000, p. 603). The importance of assessing whether non-respondents could differ in their responses is largely acknowledged in the behavioural research literature (see for example Armstrong and Overton 1977; Kerlinger and Lee 2000, p. 603).[66] A similar trend is also observable for both tax compliance (Jackson and Milliron 1986; Richardson and Sawyer 2001) and tax compliance costs (Sandford, Godwin and Hardwick 1989; Allers 1994; Pope 1995; Sandford 1995, p. 378; Evans *et al.* 1996, p. 24) studies. Nonetheless, a number of measures are available to minimise those possible shortcomings, mainly response-related.

In the social sciences, more specifically in the field of business and organisational research, the Total Design Method (TDM)[67] developed by Dillman (1978) is often used to gain fully the benefits of a mail survey. The TDM was subsequently expanded and known as the Tailored Design Method (Dillman 2000). The expansion was made to adapt the original TDM to different survey situations, including business surveys.

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[66] The issue of a non-response bias is addressed in Section 4.9. In tax compliance costs study, Allers (1994) is the first to address the issues of non-response statistically.
[67] Dillman (2007, Chapter 10, pp. 323-351) discussed a number of differences between individual and business surveys and stressed the importance of placing additional concern on the context of business studies.

Dillman (2007, pp. 323-351) discussed a number of differences between individual and business surveys and stressed the importance of placing additional concern on the context of business studies. The TDM strategy provides comprehensive guidance focusing on three major specific survey areas, namely, principles for writing questions (pp. 32-78), principles for designing the questionnaire (pp. 79-148) and detailed implementation procedures (pp. 149-193). The approach in general consists of the following five key elements: (i) a respondent-friendly questionnaire, (ii) repeated mailings of up to five contacts with the respondent, (iii) an inclusion of stamped return envelopes, (iv) a personalised correspondence, and (v) a prepaid financial incentive.

In the context of small business, Forsgren (1989) recommends the researcher use altruistic appeal in the covering letter, consider proper design of the questionnaire and assure anonymity for a sensitive study as further measures that could possibly increase the response rate. In another recent development, Dennis (2003) argues that not all measures had improved the response rate. Dennis recognises only four specific measures, namely follow-ups and reminders, monetary incentives, university sponsorship and stamped return envelopes, as consistently improving the response rates.[68]

As for specific tax research, strategies to improve response rates and quality are frequently highlighted in the tax compliance costs literature as compared to tax compliance research. A review of major international tax compliance costs studies, mostly undertaken in the late 1980s and early 1990s, by Sandford (1995, pp. 378-379) highlighted the following 17 considerations as improving the rate and quality of the responses:

i.   Clear wording of the questions.
ii.   Careful layout and design of the questionnaire.
iii.   Questionnaire length being as short as possible.
iv.   Backing of relevant people and organisations.

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[68] For a detailed list, particularly of the other two categories, refer Table 1 in Dennis (2003, p. 282).

v.   Personalising the cover letters for the questionnaire.

vi.   Providing a reply paid envelope.

vii.   Promising confidentiality and anonymity.

viii.   Carrying out a pre-pilot test.

ix.   Carrying out a pilot survey very carefully.

x.   Appropriate timing of the survey.

xi.   Sending two reminders, and enclosing a further copy of questionnaire in the second reminder.

xii.   Scrutinizing and validating the responses.

xiii.   Selecting an advisory committee.

xiv.   Obtaining advance publicity.

xv.   Sending photo-montage press cuttings with the reminder.

xvi.   Using a telephone reminder.

xvii. Making available a pre-paid telephone help line.

In the Australian context, Pope (1995, pp. 110-111) emphasised a number of other specific aspects that are worth considering, which include: using a single page questionnaire of four pages (printed in coloured paper and folded into a booklet format); discussing the questionnaire with tax experts, tax officials and tax academics; investigating attitudes and opinions (using a five-point or seven-point Likert scale); offering respondents an opportunity to express their views (by asking a few open-ended questions at the end of the questionnaire); and also giving respondents the option of providing their contact details. Another major recent comprehensive Australian study by Evans *et al.* (1996, p. 25) also provide incentives in order to address the issue of possible low responses.

To a large extent, all the above specific measures in the area of small business and tax studies are comparable to the TDM strategy. All tax compliance costs studies in Singapore, Malaysia and Hong Kong tended to benefit from Pope's approach (Ariff and Pope 2002). Even a recent study by Rametse (2006) in the Australian GST context followed Pope's approach.

It is apparent that the above discussions tend to substantiate the use of a large-scale mail survey in the current study from several research perspectives, namely SMEs, tax compliance behaviour, and tax compliance costs. Specifically, a mail survey approach appears to be the most appropriate method, mainly on the ground that the study covers a large population of SMEs nationwide, which can be achieved within reasonable cost and speed. Additionally the current study deals with corporate business taxation. A mail survey approach as recommended by Sandford (1995, p. 385) was therefore adopted. However, recognising that there are a few major pitfalls to large-scale mail surveys, additional measures and strategies have become pre-requisites to improving the response rate, the quality of the response, and to reduce non-responses as well. Accordingly, this study is conducted with a careful consideration of the measures highlighted above. Broadly, the following specific measures were adopted in this study:

i. Questions were worded carefully, were kept as short as possible and were easy to respond to.

ii. Questionnaire layout and design was based on a technique mainly suggested by Pope (1995) and Dillman (2007), including bold print for questions, light print for answer choices, and white boxes for answer spaces.

iii. A separate covering letter, which was hand signed, was used in both initial mail outs and in the second reminders.

iv. The support of SMIDEC was obtained and was stated in the covering letter.

v. The study was conducted with the University Utara Malaysia (UUM) affiliation.

vi. The official stationeries of the UUM (i.e. letter head, outgoing envelopes, and reply paid envelopes) were used in all mailings, except for postcards, which were printed using the UUM logo.

vii. Anonymity is assured in both the covering letter and in the questionnaire.

viii. The covering letters and outgoing envelopes are personalised as possible in all three mailings.

ix. A two reminders system was used, with a further copy of the questionnaire enclosed in the second reminder.

x. A stamped return envelope was provided.

xi. Appropriate timing of the survey was considered.

xii. A pilot survey via personal interviews with tax experts and tax academics was conducted.

xiii. Contact details of the researcher, both official (telephone, address and e-mail address) and a personal mobile number were made available for any queries.

xiv. Attitudes and opinions were investigated using a five-point Likert scale.

xv. Respondents were given an opportunity to express their views to a number of open-ended questions.

xvi. Respondents were given the option of providing their contact details.

xvii. Responses were scrutinized and validated.

More details with regards to the above measures are incorporated in the later three subsections,[69] covering the development of the questionnaire, pilot interviews and survey implementation. Sandford strongly urged researchers to consider some interviews, particularly in the initial stage (i.e. before carrying out mail survey), to be followed by a further interview, mainly to clarify responses (Sandford 1995, p. 404). Accordingly, this current study also used a personal interview approach during the pilot stage and a telephone follow-up interview during the data validation stage.

Besides the above mail survey (main survey), a web-survey has been undertaken by an e-mail invitation to all corporate SMEs with an e-mail address. Having acknowledged that the web survey could be carried out to increase the sample size, and most importantly, with no significant additional costs, the additional web survey is employed in the current study. The findings of the web survey can be used as a measure of the consistency of the mail survey.[70]

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[69] See Sections 4.5, 4.6 and 4.7.
[70] See subsection 4.11.1 for further details of the web survey.

4.4 MEASUREMENT ISSUES AND APPROACH

4.4.1 Estimating Compliance Costs

Estimating tax compliance costs seems straightforward, perhaps in theory. In a simple form, the compliance costs of a taxpayer are equal to internal costs plus external costs.[71] Unfortunately, this raises a few measurement concerns in practice (Sandford, Godwin and Hardwick 1989), which are associated with the valuation of internal time, treatment of overheads or joint costs, the unit of measurement (either physical quantity, monetary or costs ratio), the validity of survey estimates, measurement of psychological costs, and the possible offsets and benefits of compliance (Sandford, Godwin and Hardwick 1989, p. 14 and pp. 35-39; Pope 1993a, pp. 43-59; Allers 1994, pp. 51-56; Pope, Fayle and Chen 1994, pp. 27-28; Sandford 1995, pp. 394-400; Evans *et al.* 1996, pp. 15-16).[72] These issues have been of considerable concern to tax compliance costs researchers, especially during the early years of modern tax compliance costs research (1980s and 1990s). Currently, the issues are still relevant and perhaps impossible to resolve completely. However, to a large extent, suggestions made and approaches adopted to address these issues are now providing clearer direction and guidance in estimating compliance costs.

The main issues relate to internal time valuations and joint costs (Sandford 1995, p. 394), which are highlighted by almost all key tax compliance costs researchers (Sandford, Godwin and Hardwick 1989; Allers 1994; Pope, Fayle and Chen 1994; Evans *et al.* 1996). The issue of time valuation is noticeably debatable in the case of personal income tax, including those with business income, but does not arise for corporate business taxpayers (Pope, Fayle and Chen 1994, p. 27), since the appropriate wage rate could be imputed in the estimates (Allers 1994; Pope, Fayle and Chen 1994). Specifically, Pope, Fayle and Chen (1994) and Allers (1994) use respondents' estimates of time spent and hourly wage rate (for various personnel levels) to value the internal time costs, whereas, Evans *et al.* (1997, pp. 38 - 40) exploit the market rate as a basis

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[71] See definition of compliance costs in Chapter One, subsection 1.5.2.
[72] For a detailed discussion, refer to these references.

for their valuation. Both approaches add reliability to the estimates as those rates could be checked against internal or external information (Sandford and Hasseldine 1992, p. 25; Sandford 1995, p. 398), which consequently permit extreme values adjustment (Allers 1994, p. 54; Pope 1995, p. 114) as well.

The current study deals with corporate business taxpayers and, thus, for the first issue, follows a similar approach (respondents' estimates of time spent and hourly wage rate) advocated by Pope, Fayle and Chen (1994) in valuing and estimating the internal time costs spent by companies. The technique was successfully applied in all prior studies in the Asia–Pacific countries, including Malaysia (Ariff and Pope 2002).

The second issue is associated with the treatment of overhead costs, particularly for joint costs. Theoretically, the relevant portion of the costs should be included as part of the compliance costs (Sandford, Godwin and Hardwick 1989, p. 14; Sandford 1995, p. 396). However, a common practice in tax compliance studies is to exclude the overhead costs. Sandford (1995, p. 396) and Evans *et al.* (1997, p. 29) assert that excluding overhead costs is perhaps reasonable to small businesses, given that the effect could be insignificant. Normally, prior studies excluded the overhead costs, either by requiring the respondents to exclude the overhead costs and/or by necessitating them to consider entirely a direct cost on specific activities or taxes (Sandford, Godwin and Hardwick 1989, p. 268; Sandford and Hasseldine 1992, p. 132; Pope, Fayle and Chen 1994; Evans *et al.* 1997; Rametse 2006). As for the other costs, i.e. overhead costs, Sandford *et al.* (1989, p. 268), Pope *et al.* (1994, question 14) and more recently Rametse (2006, question 15), had also asked respondents to state the cost's nature and the amount involved. The current study pursued a similar approach to Sandford *et al.* (1989) and Pope *et al.* (1994) in dealing with the joint costs issue. Specifically, the respondent is asked to exclude the overhead costs while considering their internal time spent on tax work, but a further question is asked to elicit information on other non-staff (additional) costs.

Other issues, such as measuring psychological costs, though recognised in the literature (Allers 1994, p. 55; Pope, Fayle and Chen 1994, p. 26; Sandford 1995, p. 400) are highly debatable and yet to be established. Moreover, psychological costs are considered as not part of the 'pure' compliance costs (Evans *et al.* 1997, p. 3). Hence, the current study omitted psychological costs.

4.4.2   Benefits of Tax Compliance

As presented earlier,[73] the tax compliance literature recognises three offsetting benefits of tax compliance: managerial benefits, tax deductibility and cash flow benefits (Sandford, Godwin and Hardwick 1989, pp. 13-14). Compliance costs were further broken into gross compliance costs and net compliance costs.[74] The approach adopted with regards to these benefits is discussed next.

Managerial Benefits

Managerial benefits for companies are less considerable, as a company is required to carry out record keeping activities mainly for financial purposes (Sandford, Godwin and Hardwick 1989, p. 144). Thus, it is normal to exclude managerial benefits in the corporate tax compliance costs study (Sandford, Godwin and Hardwick 1989) and even in the study of other taxes (such as VAT and income tax of business individuals) as well due to measurement difficulties (Sandford, Godwin and Hardwick 1989, p. 14; Pope, Fayle and Chen 1994, p. 28; Tran-Nam 2001). Nonetheless, two UK studies (Sandford *et al.* 1981; National Audit Office 1994) have estimated the value of managerial benefits for VAT taxpayers. In Australia, two recent studies (Rametse 2006; Lignier 2008) have also attempted to quantify managerial benefits to their sample of business taxpayers.[75]

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[73] See Chapter One, subsection 1.5.2.
[74] See Chapter One, subsection 1.5.2.
[75] It must be emphasised that valuation of managerial benefits is not the main aim of their respective studies.

Tax Deductibility

Allers (1994) and Evans *et al.* (1997) highlighted that part of the compliance costs, which are directly associated with taxable profits, is tax deductible. The deductibility of external and incidental costs is justified (Allers 1994, p. 40; Evans *et al.* 1997, p. 12). On the other hand, the deductibility of internal time costs is somewhat arguable (see Allers 1994, p. 40), especially in the case of personal taxpayers. As a result, previous studies normally consider internal time spent as disallowable in the case of personal taxpayers, including those with business income (Allers 1994; Evans *et al.* 1997). Allers adopted a conservative approach by disallowing internal time costs even for a business taxpayer (1994). Conversely, Evans *et al.* (1997, p. 12) argue that all tax compliance costs are tax deductible. In the case of corporate SMEs, it is reasonable to assume that the work of an owner-manager and/or their employees is often business-related. As demonstrated by Evans *et al.* (1997), it is best to treat the internal time costs as tax deductible. Following this, the current study considered all three tax compliance cost components (i.e. internal time costs, external tax fees and additional non-staff costs) as tax deductible. However, similar to Evans *et al*, (1997) non-taxable SMEs are assumed to gain only 50 percent of the tax deductibility benefit.

Cash Flow Benefit

Under the SAS, income tax is charged on a current year basis and corporate income tax is payable in 12 advance monthly instalments plus a final payment (if any) within six months after the end of the accounting period. It is normal to assume that profits are accruing evenly throughout the accounting period and the cash flow benefit dates from when the profit is actually earned (Sandford, Godwin and Hardwick 1989, p. 144; Pope, Fayle and Chen 1994, p. 70). As such, no cash flow benefits are presumed for a monthly tax instalment as the instalments are related to their relevant profit period. However, a cash flow benefit (or loss) may arise if there is a final payment (or a refund situation). The cash flow benefits value is largely dependent on the amount of final tax payment, the time interval between profit derivation and tax payment, and the relevant interest rate. It is important to note that the monthly instalment is dependent on the estimated tax liability of each company and the amount is allowed to be revised further, either in

the sixth or ninth month. The actual tax liability will be available only after the end of the accounting period, but before the end of a further six months period. Theoretically, the timing of this study permits the gathering of such information. But, on the other hand, it is most likely that requiring such detailed information on tax payments could significantly affect the response rate of the study. Thus, respondents are required only to estimate their range of tax liability (not the actual amount). As a result, data availability does not permit estimates of the value of the cash flow benefit (or loss). Even if all necessary data is available, the value of cash flow benefit (or loss) is most likely to be very small as the majority of SMEs' respondents in the current study estimated their tax level at either nil (24 percent) or up to RM100,000 (60 percent).

4.4.3 Measuring Compliance Behaviour

Measuring tax compliance behaviour is extremely difficult and the most challenging task in the field of taxation (Long and Swingen 1991, p. 655; Webley *et al.* 1991, p. 29; Hasseldine and Li 1999, p. 98). Tax compliance literature largely noted three approaches in measuring the non-compliance behaviour of an individual taxpayer; namely, self-reports, experimental and tax audits (Long and Swingen 1991, p. 657; Elffers, Robben and Hessing 1992, p. 546). The self-report and experimental methods are taxpayer-oriented, whereas tax auditing is return-oriented. Under the self-report method, taxpayers are asked to report their filing behaviour, which could be asked directly (first person) and/or indirectly (third person). The experimental method requires taxpayers to make compliance decisions in an experimental setting (normally in a lab setting). On the other hand, tax auditing relies on actual facts and data from the tax authorities that are available within, and/or compiled through, audit activities (for a comprehensive discussion refer to Long and Swingen 1991, pp. 657–664).

Self reporting is the most common method in tax research (Webley *et al.* 1991, p. 30; Elffers, Robben and Hessing 1992, p. 546; Fischer, Wartick and Mark 1992; Hasseldine and Li 1999, p. 98) and is relatively easy, less costly, with less ethical concerns, and most importantly, perhaps the best available practical option (Weigel, Hessing and Elffers 1987, p. 217). On the contrary, Collins, Milliron and Toy (1992, p. 6)

acknowledged the fact that no single approach is superior to others. Despite some methodological limitations, for example, some form of distortion and social desirability bias (Long and Swingen 1991; Webley *et al.* 1991; Elffers, Robben and Hessing 1992), self-reporting has been extensively used in measuring tax non-compliance, both internationally and in Malaysia. It is often operationalised either by requiring responses to past evasion behaviours and/or hypothetical or experimental tax scenarios. Kirchler and Maciejovsky (2001, p. 181) assumed that the use of a scenario describing possible actions of a third party (indirect measure) can reduce the possible social desirability bias. A summary of prior studies of individual taxpayers who had used the self-reporting method, either relating to taxpayers' past evasion behaviour, hypothetical tax behaviour, or both, is presented in Table 4.1.

Table 4.1: Self-reporting Measurement in Prior Tax Compliance Studies

Researcher(s)	Type of Tax Behaviour	
	Past	Hypothetical
International Studies:		
Mason and Calvin (1978; 1984)	√	
Wallschutzky (1984)		√
Elffers, Weigel and Hessing (1987) [a, b]	√	
Hite (1988)		√
Porcano (1988)	√	√
Violette (1989)		√
Klepper and Nagin (1989) [c]		√
Collins, Milliron and Toy (1992)	√	
Elffers, Robben and Hessing (1992) [d]	√	
Hite and McGill (1992) [c]		√
Fischer (1993)	√	√
Hasseldine, Kaplan and Fuller (1994)	√	
Reckers, Sanders and Roark (1994)		√
Kaplan, Newberry and Reckers (1997) [c]		√
Hasseldine (1999)	√	√
Chan, Troutman, and O'Bryan (2000)		√
Kirchler and Maciejovsky (2001)		√
Webley, Cole and Eidjar (2001)	√	√
Wenzel (2002) [c]	√	√
Hasseldine and Hite (2003)		√
Wenzel (2005a)		√
Wenzel (2005b)	√	
Malaysian Studies:		
Ramasamy *et al.* (2003) [c]		√
Kasipillai, Mat-Udin and Zainol-Arifin (2003) [c]		√
Kasipillai and Abdul-Jabbar (2006)	√	√
Sia (2008)		√

[a] Also appeared as Hessing, Elffers, and Weigel (1988).
[b] Measured non-compliance by way of both self-reporting and tax audit approaches.
[c] Responses obtained from both direct (first person) and indirect (third person) measures. Other studies mostly have used a direct measure.
[d] Measured non-compliance by way of all three approaches, i.e. self-reporting, experiments and tax audits.

As for corporate taxpayers, an earlier discussion on corporate compliance behaviour[76] highlighted five studies that targeted the corporate sector (Rice 1992; Kamdar 1997; Mills 1998; Joulfaian 2000; Hanlon, Mills and Slemrod 2005). All those five studies were conducted in the US, and mainly using data from the IRS to measure corporate tax behaviour.

In Malaysia, no micro data is available publicly for either individual or corporate taxpayers. Generally, tax data is published by the IRB (by way of an annual report) and the Treasury or Central Bank (by way of economic reports). Other government agencies, particularly the Department of Statistics, normally reproduce this general data. Thus, the audit-based approach is almost impossible without the full cooperation of the IRB. Up until now, perhaps only two studies have used the IRB official data, but confined to individual taxpayers. Both studies were carried out by IRB officers (Abdul 2003; Sia *et al.* 2008). Therefore, researchers are left with a taxpayer-oriented approach, either the self-report or experimental methods. To what extent these options could be applied to the context of the company as a taxpayer is debatable. Slemrod (2004a, p. 83) argued that the tax situation of both companies and owners is closely related, particularly in small business. Along the same lines, Joulfaian (2000, p. 698) drew the conclusion that non-compliant firms are more likely to be managed by executives who have failed to comply with personal income tax (measured using TCMP data) than are compliant firms. He has urged tax researchers to incorporate managerial preferences into the study of corporate tax compliance (Joulfaian 2000, p. 701).

The concept of managerial preferences assumes that the corporate behaviour of SMEs is influenced by actions and preferences made by their executives. Following suggestions by Joulfaian (2000) and Slemrod (2004a), this study utilised the concept of managerial preferences as a proxy to measure corporate compliance behaviour. However, as discussed earlier,[77] a large-scale mail survey was considered from several possible research and methodological perspectives. An experimental method was not employed

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[76] Refer Chapter Two, subsection 2.2.1.
[77] See Section 4.3.

as all previous studies have tended to use students as experimental subjects, which solely relates to individual taxpayers. Accordingly, self-reporting is considered the most appropriate technique as the current study focused exclusively on the corporate tax behaviour of Malaysian SMEs. It is important to note that the use of hypothetical tax scenarios in the survey increased realism by incorporating one of the key elements of the experimental method, to some extent. Indeed, Hasseldine and Hite (2003, p. 522) described this approach as a mail field experiment.

Having decided to measure non-compliance behaviour via the self-reporting method, the specific types of non-compliance to be measured and the hypothetical scenarios to be given are considered next. The tax literature strongly emphasised the need for a separate analysis of the various forms of non-compliance (Long and Swingen 1991, p. 664; Richardson and Sawyer 2001, p. 224). There are relatively more studies that have measured both understatement of income and overstatement of deductions in a single study, as shown in Table 4.2. The Malaysian studies, though very few in number, show a similar pattern.

Table 4.2: Specific Types of Non-compliance in Prior Tax Compliance Studies

Researcher(s)	Specific Behaviour Measured	
	Understatement of Income	Overstatement of Deductions
International Studies:		
Mason and Calvin (1978; 1984) [a]	√	√
Wallschutzky (1984)	√	
Elffers, Weigel and Hessing (1987)	√	√
Hite (1988)	√	
Porcano (1988) [a]	√	√
Klepper and Nagin (1989)	√	√
Violette (1989)	√	
Collins, Milliron and Toy (1992)	√	√
Elffers, Robben and Hessing (1992)	√	√
Hite and McGill (1992)		√
Fischer (1993)	√	√
Hasseldine, Kaplan and Fuller (1994)	√	√
Reckers, Sanders and Roark (1994)	√	
Kaplan, Newberry and Reckers (1997)	√	
Hasseldine (1999)	√	√
Chan, Troutman and O'Bryan (2000)	√	√
Kirchler and Maciejovsky (2001)	√	√
Webley, Cole and Eidjar (2001)	√	√
Wenzel (2002)	√	√
Hasseldine and Hite (2003)	√	
Wenzel (2005a)		√
Wenzel (2005b)	√	√
Malaysian Studies:		
Ramasamy *et al.* (2003) [a]	√	√
Kasipillai, Mat-Udin and Zainol-Arifin (2003) [a]	√	√
Kasipillai and Abdul-Jabbar (2006)	√	√

[a] The study also measured failure to submit a tax return as specific non-compliance behaviour.

As for the tax scenario or context, as shown in Table 4.3, prior studies tend to provide a hypothetical scenario that relates to either self-employed or additional cash income situations. It is possible that non-compliance is often widespread, mainly in a self-employed situation (Wallschutzky 1984, p. 381; Violette 1989, p. 94; Kaplan, Newberry and Reckers 1997, pp. 44-45). The current study considers corporate tax behaviour from a business respondent view, thus a self-employed scenario is appropriate.

Table 4.3: Non-compliance Context in Prior Tax Compliance Studies

Researcher(s)	Tax Context			
	Self Employed	Extra Cash Income	Work-related Expenses	Other
International Studies: [a]				
Hite (1988)	√	√		
Porcano (1988) [a]		√		
Klepper and Nagin (1989)	√			
Violette (1989)		√		
Hite and McGill (1992)			√	
Reckers, Sanders and Roark (1994)	√			
Kaplan, Newberry and Reckers (1997)	√			
Hasseldine (1999)		√	√	
Chan, Troutman and O'Bryan (2000)	√			
Kirchler and Maciejovsky (2001)	√			
Webley, Cole and Eidjar (2001)				√ [b]
Wenzel (2002)			√	
Hasseldine and Hite (2003)		√		
Wenzel (2005a)			√	
Malaysian Studies:				
Ramasamy *et al.* (2003)	√	√		√ [c]
Kasipillai, Mat-Udin and Zainol-Arifin (2003)	√	√		√ [c]
Kasipillai and Abdul-Jabbar (2006)		√	√	

[a] The study by Wallschutzky (1984) was not listed as it could be linked to either self-employed or extra cash receipts situations.
[b] Respondents were asked to state their views with regards to opportunities to pay less tax.
[c] This study also includes other non-compliance situations, such as failure to file a return and failure to make payment within the due dates.

4.5   QUESTIONNAIRE DESIGN

This section discusses the survey instrument used in the current study. To a large extent, the advice and suggestions made by a number of authors in the field of survey methods (mainly Dillman 1978; Fowler 1995, pp. 78-103; Dillman 2007) and tax compliance costs research (mainly Pope 1993a; Sandford 1995; Evans *et al.* 1997) were considered in writing and designing the questionnaire. Additionally, a number of available questionnaires (in part or in full) from both tax compliance (Christensen, Weihrich and Gerbing 1994; Roberts 1994; Hanefah 1996; Hasseldine 1999; Ramasamy *et al.* 2003; Abdul-Manaf 2004) and compliance costs (Sandford and Hasseldine 1992; Hanefah, Ariff and Kasipillai 2001; Slemrod and Venkatesh 2002) studies were also considered carefully. A copy of the survey questionnaire used is available in Appendices F (the English version) and G (the Malay version). The final survey questionnaire was divided into four sections, referred to as Sections A to D.

Section A of the questionnaire (questions 1 to 8) was designed to obtain the characteristics of an SME company, which among other things includes the company's sector, size (by both sales and staff criteria) and the estimated tax liability. Section B (questions 9 to 13) was designed to obtain information that was used to estimate the income tax compliance costs. Respondents were required to estimate their compliance costs to all three cost components, i.e. internal time spent (and appropriate wages rate by staff category), additional non-staff costs, and external tax fees. This section also elicited information with regards to tax-related difficulties faced by the company, the main reason for using external tax professionals and the approximate proportion of income tax routine and planning work. The section mainly drew on the prior business income tax compliance costs surveys, in particular studies by Pope, Fayle and Chen (1994) and Hanefah, Ariff and Kasipillai (2001). The Pope *et al.* study was considered as an important reference since it is a specific compliance cost study on companies. The study by Hanefah *et al.* is confined to Malaysian SME companies. All requested information, for both Sections A and B, is related to the financial year and/or tax year 2006.

Section C (questions 14 to 16) is concerned with the perceptions and opinions towards a number of tax aspects and behaviours. Pope (1995, p. 110) noted that taxpayers' attitudes and opinions could be investigated in a tax compliance study so as to provide respondents an opportunity to express their views. Specifically, respondents in the current study were asked for their perceptions and opinion (15 items in question 14) on the fairness (5 items), complexity (4 items) and tax rate structure (3 items) of the corporate tax system, their relationship with IRB officials (1 item), the probability of a tax audit (1 item) and incentives (1 item). The questions used for attitudinal aspects in the current study were developed from a number of previous tax compliance studies, as shown in Table 4.4. All these items were measured by way of a five-point Likert scale. The Likert scale has been used extensively in the area of tax compliance research, both internationally (for example, Fischer, Wartick and Mark 1992; Christensen, Weihrich and Gerbing 1994; Hasseldine, Kaplan and Fuller 1994; Reckers, Sanders and Roark 1994; Richardson 2005), and in Malaysia (see Hanefah 1996; Ramasamy *et al.* 2003; Abdul-Manaf 2004). Out of 15 items, 11 items were measured using a response scale of 'strongly disagree to strongly agree', the remaining used a scale of 'much less taxes to much more taxes' and 'much less fair to much more fair' (two items respectively).

Table 4.4: Main References in Developing Questions for Attitudinal Aspects

Aspects	Number of Items	Source(s) [a]
Corporate tax fairness	5	Roberts (1994)
Corporate tax complexity	4	Christensen, Weihrich and Gerbing (1994)
Corporate tax rate	3	Christensen, Weihrich and Gerbing (1994)
Relationship with the IRB	1	Pope, Fayle and Chen (1994)
Probability of tax audit	1	Abdul-Manaf (2004)
Tax incentives for SMEs	1	Abdul-Manaf (2004)

[a] Adapted to suit the corporate income tax context.

As for compliance behaviour, two types of non-compliance behaviour, namely understatement of income (question 15) and overstatement of deductions (question 16), were measured by presenting an independent hypothetical tax scenario respectively. Both tax scenarios deal with a self-employed business situation and required three responses (i.e. sub questions a, b and c) for each scenario. Indirect (third person) responses were required for sub-questions (a) and (c). On the other hand, sub-question (b) necessitated a direct (first person) response. A combination of both direct and indirect measures was recommended by Kaplan, Newberry and Reckers (1997) to mitigate the sensitive nature of the study. As for an indirect response, respondents were asked to judge the probability of non-compliance behaviour of the person (third person) described in the scenario. The probability ranges from zero to 100 percent, with a 10 percent interval for each, and adapted from prior studies (Violette 1989; Hasseldine and Kaplan 1992; Kaplan, Newberry and Reckers 1997). For a direct (first person) answer, the respondents were asked to indicate their extent of agreement and/or disagreement by way of a five-point Likert scale between strongly disagree (1) and strongly agree (5) to the possible action of non-compliance behaviour of the person described in the scenario. The earlier Malaysian studies also used a similar response category (Kasipillai, Mat-Udin and Zainol-Arifin 2003; Ramasamy *et al.* 2003).

Section D covers general comments and suggestions with regards to the tax compliance burden. This section solicited respondents' views on the relative level of compliance costs (mainly to test non-response bias),[78] given the possible amount of the claim from government that could compensate compliance costs incurred by the their companies, and also specific suggestions to reduce SMEs' tax preparation work, plus other comments and/or suggestions relating to the taxation of SME companies. This section also requested respondents to indicate their position in the company. This procedure has enabled the researcher to make follow-up phone calls in the process of data validation.[79]

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[78] The issue of non-response bias was addressed specifically in Section 4.9.
[79] See Appendix P.

A respondent-friendly questionnaire is one of the five elements of the TDM method. Dillman had stressed the importance of questionnaire design, in particular with regards to a self-administered questionnaire (2007, p. 95). He urged researchers to consider a number of principles with regards to writing (pp. 50-77) and designing the questionnaire (pp. 96-134). Major writing principles that have been adopted in the current study include the use of simple words, question wordings similar to previous studies (but modified to suit the current study), use of a five-point Likert scale, emphasis on specific time referents (i.e. tax year 2006), and eliminating respondents from making unnecessary calculations. As for questionnaire design, among major principles that have been employed are the use of bold print for questions, light print for answer choices, white colour box for answer spaces, background colours (either shaded or otherwise), blank spacing between questions and answer choices, providing instructions in the appropriate section of the questions, and most importantly the use of a consistent format throughout the questionnaire.

Having considered the above factors, the final survey questionnaire was prepared in English and another translated version was made available in the Malay language. It is common in Malaysia to make available both versions, mostly in a single printout. Generally, for business-related surveys, the main language is English, which is visible in a normal font. The Malay language is included as an italic font (for example in Abdul-Manaf and Abdul-Jabbar 2006; Kasipillai and Abdul-Jabbar 2006). However, a review of Malaysian tax studies [80] revealed that only studies by Hanefah (1996) and Abdul-Manaf (2004) reported the use of two separate sets of questionnaires, one in English, the other in Malay language. The current study employed two separate versions of the questionnaire. The dual version was considered necessary to substantially reduce the length of the questionnaire and, most importantly, to obtain a reasonable response rate. The printing of background colour differentiated the English (printed in orange) and the Malay (printed in blue) versions of the questionnaire. The respondents were given the option of responding to either version. This option was clearly stated in the covering letter. A single-page of questionnaire, more specifically A3 size paper folded

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[80] A list of studies reviewed is provided in Appendix B.

into A4 size paper, was among the main design layouts recommended by Dillman (1978; 2007) to increase the response rate. The single page design was successfully implemented in nearly all of Pope *et al.*'s studies (1990; 1993a; 1993b; 1994) and recently by Rametse (2006).

4.6   PILOT INTERVIEWS

Initially, two phases of the pilot study were conducted to ensure the questionnaire was well understood. The first phase involved a personal interview with three tax professionals and five tax academics in the northern region and four universities respectively. The view of both tax professionals and tax academics are essential to add validity to the survey instruments. Prior to the actual interview, structured interview questions, together with a covering letter emphasising the importance of the study, were distributed. The approach was considered as a way of preparing the experts for the interview. The draft instrument was built upon earlier tax compliance costs and behavioural studies.[81] Secondly, a pilot study was conducted by way of a personal interview among a small sample of SME companies in the northern region of Malaysia. The interview was conducted with the help of the SME Bank of Malaysia (SME Bank). Similar to a pilot interview of tax experts, the structured interview questions and the covering letter highlighting the value of the study were distributed in advance to 18 SMEs. The covering letter was addressed to managing directors of those SMEs and was personally delivered by the SME Bank. A week after, a follow-up call was made to seek their appointment to the study. However, only 11 SMEs agreed to participate in the study. The remaining seven SMEs were unable to participate due to either their head office being located elsewhere, not having commenced their operations, or refusing to take part. The final interview was conducted successfully with only nine SMEs due to the busy schedule of the other two SMEs.

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[81] See Section 4.5.

Following pilot interviews, two key modifications plus a few adjustments were made to ensure that the questionnaire was easily understood by the respondents. The main alterations were related to internal time spent and wages (question 9), and to both tax scenarios (question 15 and 16). Firstly, in relation to the internal time spent and wages, the basis for responses was standardised to a monthly basis. The pilot interview questions asked respondents to estimate their internal time spent on income tax activities on a yearly basis and the appropriate average wage rate on an hourly basis. During the interview, the author noted that a number of SMEs had to compute the hourly wage rate for relevant staff categories, as the basis of employment-related payment in Malaysia is on a monthly basis. The change was crucial so as to avoid respondents making unnecessary computations (Dillman 2007, pp. 77-78). As a measure of consistency, the basis for time spent was also changed from a yearly to a monthly basis. Secondly, simplifications to the tax scenarios were essential so as to make them short and straightforward. Additionally, following the tax experts' views, the amount involved in each scenario was increased from RM5,000 to RM10,000. The other adjustments made were mainly on the presentation and layout of the questionnaire for ease of response.

Additionally, during the pilot study, both tax professionals and tax academics highlighted the importance of the tax professional's role in the Malaysian SME context. Evidence also indicates that at least 91 percent of Malaysian SMEs employ tax professionals to manage their tax affairs (Hanefah, Ariff and Kasipillai 2001, p. 91; Mansor, Saad and Ibrahim 2003). Thus it would be useful to examine whether there is any difference between tax professionals and SMEs with regards to both tax attitudinal and behavioural aspects. As such, a supplementary survey was carried out among the tax professionals.[82]

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[82] See subsection 4.11.2 for further details of the survey of tax professionals.

4.7   SURVEY IMPLEMENTATION

The importance of the implementation procedure is demonstrated in research on business (Dillman 2007), small business (Forsgren 1989; Dennis 2003) and even taxation (Pope 1995; Sandford 1995; Evans *et al.* 1996). In fact, almost all suggestions made by them for improving mail survey weaknesses are implementation-related. For example, four out of five TDM elements and 11 out of 17 of Sandford's suggestions are implementation-related.[83] Accordingly, the current study places a greater emphasis on the implementation procedures by integrating many of these suggestions. However, this study was able to adapt four key elements of TDM and 12 elements of Sandford. A few other options, though considered, were not implemented due to mainly financial constraints.

The actual survey was carried out with the support of SMIDEC and relates to the tax year 2006. The data collection period spanned three months, between July 2007 and September 2007. The survey period was considered the most appropriate as all SMEs were expected to have completed their corporate income tax submission for the tax year 2006. The deadline for corporate tax returns in Malaysia varies according to their financial year-end, specifically within six months after the financial year-end. For example, a company that ends their financial year on the 31 December 2006 is required to furnish their tax return by 30 June 2007.

The survey questionnaire was mailed to 1,300 targeted respondents in SME companies in peninsular Malaysia. A survey of this nature is possibly best answered by the owner-manager or a person most responsible for the financial affairs of the SME. However, it is most likely that the financial role in SMEs may not be linked to a specific post due to its characteristics. Accordingly the survey targeted a chief executive officer or managing director. The survey package was personalised with their name and position in the company appearing on both the cover letter and outgoing envelope. However, not all SMEs in the sample had such details. Accordingly, the survey was personalised to

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[83] Refer Section 4.3 for more details.

the next available name on the sample list by stating their post as well, provided that it had some link to an accounting-related function. For the remaining SMEs without specific contact details, or contact details that were not related to an accounting role, the survey was addressed to 'Manager/Accountant'. As shown in Table 4.5, the large majority of the sample (71 percent) was personalised, with almost 58 percent either addressed to a chief executive officer or managing director.

Table 4.5: Mail-out Personalisation

	Number of SMEs	Percentage
Personalised [a]		
Chief Executive Officer	153	11.8
Managing Director	594	45.7
Director/Executive Director	18	1.4
Accountant, Finance Manager or Equivalent	44	3.4
General Manager/Manager	112	8.6
Sub-total	921	70.8
Non-personalised		
Manager/Accountant	379	29.2
Overall	1,300	100.0

[a] Both name and position of respondent appears in all outgoing mails.

As shown in Table 4.6, three mailings have been used in the current study. The initial mailing was made on 5 July 2007, followed by a postcard reminder three weeks later and a final reminder four weeks after the first reminder. These intervals are a bit longer than recommended by Evans *et al.* (1996), but considered appropriate in the Malaysian context.[84]

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[84] All mailings were based in Kedah. It is important to allow for different working days in seven (out of nine) states in peninsular Malaysia. The weekend in Kedah, Kelantan and Terengganu is on Friday, while in other states the weekend is on Sunday.

Table 4.6: Mailing Pattern of the Study

Mailing Pattern	Mailing Date	Mailing Number
Initial Mailing	5 July 2007	1,300
First Reminder [a]	26 July 2007	1,174 [b]
Final Reminder [a]	22 August 2007	1,124 [b]

[a] Reminders were sent to the entire sample.
[b] Less than 1,300 due to the exclusion of undelivered mailings during the earlier mail out.

The initial mailing included a personalised covering letter, the questionnaire in both English and Malay versions, and a stamped return envelope. The covering letter explained the purpose of the study, emphasised that the study was independent and conducted with the support of SMIDEC. The letter was printed on the original stationery of UUM and was hand-signed by the researcher.[85] UUM stationery was also used for both the outgoing and reply envelope. Although the use of original stationery is costly, it was important to obtain a good response rate. No identification number was made on all outgoing mail as taxation is a sensitive area and, most importantly, in order to offer complete anonymity. As a result, both reminders were sent to the entire sample, but excluded a number of undelivered mailings, mainly due to change of address.[86]

The first reminder was sent via a postcard.[87] The postcard thanked those who had already responded and called for a reply from those who had not responded. The final reminder[88] was sent together with a further copy of the full questionnaire,[89] a single question survey,[90] so as to determine any non-response bias, with a new stamped reply envelope. The size of the reply envelope sent with the second reminder was slightly different from the initial mailing in order to allow for better monitoring of response waves. Similar to the first mailing, the reminder letter sent was personalised.[91]

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[85] See Appendix H.
[86] See Chapter Five, Table 5.2.
[87] See Appendix I.
[88] See Appendix J.
[89] See Appendix F.
[90] See Appendix K.
[91] See paragraph above Table 4.5.

4.8   POPULATION AND SAMPLE OF THE STUDY

The study focused on corporate income taxation, but was confined to small and medium-sized companies in peninsular Malaysia. There is no comprehensive list of taxpayers publicly available in Malaysia. The current study used the SME directory available via the SME information portal managed by the Secretariat to the National SME Development Council. The portal was recently launched in early 2006 and is publicly accessible via http://www.smeinfo.com.my. The directory was considered as the most suitable list of population as it is based on the new national definition of SMEs. As at 15 June 2007, there were 14,388 SMEs registered with the NSDC. The gross population of the current study was derived at 9,912 companies after excluding SMEs in Eastern Malaysia, namely in Sabah, Sarawak and the Federal Territory of Labuan, and non-corporate SMEs, as shown in Table 4.7. Further, recognising a low number of representations in the primary agriculture and mining sectors, the net population of the study was further reduced to 9,669.

Table 4.7: Gross and Net Population of the Study

		Number of SMEs
Gross Population as at 15 June 2006		14,388
Less : SMEs in Eastern Malaysia [a]		
Sabah	570	
Sarawak	601	
Federal Territory of Labuan	40	(1,211)
Less: Non-corporate SMEs		(3,265)
Total SMEs in peninsular Malaysia		9,912
Less: Sectors with low numbers		
Primary agriculture	215	
Mining	28	(243)
Net Population		9,669

[a] Inclusive of non-corporate SMEs.

Having decided on the population for the study, the sampling size and selection are considered next. Hair *et al.* (1998, p. 12) advised researchers to be fully aware of the impact of sample size on the statistical test. From a different perspective, Garson (n.d.) noted that the sample size does not depend on the population size and contended that a sample size over 1,500 is hardly ever needed. Nonetheless, Krejcie and Morgan (1970), developed a scientific table for determining sample size by taking into account population size. The table suggests a sample size of 370 and 375 for a given population of 10,000 and 15,000 respectively. Roscoe (1975), for instance, argues that a sample size of more than 30 and less than 500 is appropriate for most research.

The views presented above suggest that a sample size of anywhere between 372 and 1,500 is adequate. However, in the specialist field of tax compliance costs studies, particularly for business taxpayers, many studies use greater sample sizes—for example, 1,870 public companies (Pope, Fayle and Chen 1991), 9,094 Value Added Tax traders in the UK (Sandford *et al.* 1981), 9,541 GST/business taxpayers (Sandford and Hasseldine 1992), 3,000 companies (Pope, Fayle and Chen 1994), 1,329 companies (Slemrod and Blumenthal 1996) and 2,500 companies in the US (Slemrod and Venkatesh 2002), 8,039 business taxpayers in Evans *et al.* (1997), and more recently, 4,000 small businesses in Rametse and Pope (2002). It is important to note that most of these studies, to varying extents, received funding from external organisations; for example, the Australian Tax Research Foundation (for Pope *et al.* studies), the Economic and Social Research Council (for the UK studies) and the Tax Foundation and Inland Revenue Services (for the US studies).

In view of mainly financial constraints,[92] the current study considered a sample size of around 1,000 (i.e. 10 percent of the net population) to be reasonable. Nevertheless, the final sample size was increased to 1,300 so as to allow for the possibility of returned or undelivered mail. This study used a stratified proportionate sampling technique and random selection respectively to obtain a representative sample. A proportionate sample

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[92] Financial assistance sought from a number of research institutes in Malaysia failed, mainly due to the doctoral nature of the study.

was drawn from each category of the business sector. The population and sampling frame of the current study is presented in Table 4.8.

Table 4.8: Population and Sample Size by Stratified Proportionate Sampling

Sector	Number of Companies	Percentage of Population	Sample Size
Manufacturing	5,239	54	702
Services	2,158	22	286
Manufacturing-related services	848	9	117
Construction	734	8	104
Others	690	7	91
Overall	9,669	100	1,300

4.9   NON-RESPONSE BIAS

Having recognised the typically low response rate in mail surveys, it is imperative to examine the possibility of non-response bias. Researchers in the social sciences, including business, accounting and economics, normally investigate the presence of non-response bias by comparing responses received from early and late respondents (Armstrong and Overton 1977; Wallace and Mellor 1988; Graham and Harvey 2001; Nelson, Elliott and Tarpley 2002; Beattie, Goodacre and Thomson 2006; Brau and Fawcett 2006). If repeated mailings are used, wave analysis is used to compare responses between mailings or waves (Armstrong and Overton 1977). Under this approach, the late respondents are assumed to be proxies for non-respondents.

The approach is also adopted by a number of tax compliance researchers (for example in Abdul-Manaf 2004; Lai, Sheikh-Obid and Meera 2004; Evans, Tran-Nam and Andrew 2007). However, in the specific field of tax compliance costs studies, the use of a single question survey in a postcard, as introduced by Allers (1994), is the most common practice nowadays (for example, Evans *et al.* 1997; Rametse and Pope 2002;

Blumenthal and Kalambokidis 2006). Accordingly, the current study measured the issue of non-response bias using both approaches, the first by using a single question survey in the reminder and the second by employing wave analysis.

The first approach involved comparing the responses to a single key question (question 17) in both the full questionnaire survey and the single postcard survey.[93] A total of 94 respondents, or 8.4 percent of the net sample, replied to the single question survey. As shown in Table 4.9, both groups of respondents perceived compliance costs almost identically, with a similar trend. Initially, a number of responses showed an increasing trend as the perceived level of compliance costs increases, but the trend decreases immediately after the perceived level is about neutral. This indicates that the non-respondents would have similar perceptions as respondents.

Table 4.9: Comparative Perceived Level of Compliance Costs

Level of Compliance Costs	Full Survey		Single Question Survey	
	Frequency	**Percent**	**Frequency**	**Percent**
Very Low	4	2	5	5
Low	20	12	7	7
Neutral	82	47	46	49
High	40	23	20	21
Very high	27	16	16	17
	173 [a]	100	94	100 [b]
Overall Mean [c]	3.38		3.37	

[a] Number of respondents equals to 175, with two missing items.
[b] Does not total up to one hundred percent due to rounding.
[c] Out of five.

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[93] See Appendices F, G and K.

For the purpose of wave analysis, responses received were divided into three waves: those who responded after the initial mailing but before a first reminder, those who responded after the first reminder but before a second reminder was sent, and those who responded after the second reminder. A comparison is made between the waves on a number of key variables to determine whether responses changed significantly between those periods. The variables are the sector (question 2), number of staff (question 4), annual turnover (question 6), the perceived level of compliance costs (question 17), possible behaviour of underreporting (question 15b) and possible behaviour of overstating deductions (question 16b). The variables include both categorical (questions 2, 4 and 6) and ratio (questions 15b, 16b and 17). Chi-square and one-way analysis of Variance (ANOVA) tests were conducted for three categorical variables and three ratio variables respectively. No significant differences were found for all six variables, suggesting no bias was present in all three waves of responses.

Thus, both approaches suggest fairly similar responses between respondents and non-respondents, thereby removing the possibility of significant non-response bias in this study.

4.10 METHOD OF DATA ANALYSIS

4.10.1 Overall Approach

Data are analysed mainly using descriptive statistics, correlation and regression analyses. For this purpose, all data were entered into the Statistical Package for the Social Sciences (SPSS). Frequency and means analysis were used mainly in analysing the profile of the responding SMEs and compliance costs estimation respectively. Mean analysis was also used in analysing perceptions and opinions towards a number of tax attitudinal aspects and tax behaviours. The next subsections explain specific methods of data analysis by type of research questions.[94]

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[94] See Chapter One, Section 1.3.

4.10.2 Compliance Costs Estimation

The compliance costs of taxation (research question one) was estimated and analysed, mainly following methodology established by Sandford, the 'grandfather'[95] of tax compliance cost studies and consequently adapted in the pioneering work of Pope *et al.* (1991–1994) in Australia, and later further advanced by Evans *et al.* (1997) in Australia. It is important to note that the current study also benefited from other tax compliance research as well (e.g. Allers 1994, Hanefah Ariff and Kasipillai 2001). Recognising this study targeting corporate taxpayers, more specific consideration was given to a study by Pope, Fayle and Chen (1994) on companies' income taxation. Some of the major measurement difficulties were discussed earlier.[96]

Apart from those, one noteworthy aspect to consider in the Malaysian context is with regards to size of measure to be used. In Malaysia, the size of SMEs is based on a mixture of both turnover and staff measures.[97] However, the NSDC definition varies between sectors and measures too, which possibly could lead to distortion. Almost all major prior studies analyse business compliance costs mainly in terms of firm size, mostly proxies by turnover level (Sandford, Godwin and Hardwick 1989; Sandford and Hasseldine 1992; Allers 1994; Pope, Fayle and Chen 1994; Evans *et al.* 1997). The other proxies used are category of annual tax remittance (Pope, Fayle and Chen 1994),[98] and employment size (Allers 1994). Almost a similar trend was observed in the Asia-Pacific studies as well (Ariff, Loh and Talib 1995; Ariff, Ismail and Loh 1997; Chan *et al.* 1999; Hanefah, Ariff and Kasipillai 2001). Despite various measures, the firm size was found to be strongly and consistently related to the level of tax compliance burden of business taxpayers (Allers 1994; Slemrod and Blumenthal 1996; Evans *et al.* 1997;

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[95] As acknowledged by Tran-Nam and Evans (2002) in recognition of Sandford's scholarly contribution to the tax compliance costs discipline. See also Evans, Pope and Hasseldine (2001).
[96] See subsection 4.4.1.
[97] See Chapter One, subsection 1.5.3.
[98] The primary analysis of Pope, Fayle and Chen (1994, p. 54) uses annual tax remittance categories being a proxy for firm size, as the measure corresponded to published Australian Taxation Office (ATO) statistics.

Slemrod and Venkatesh 2002; Hanlon, Mills and Slemrod 2005).[99] The same holds true even within small business taxpayers (DeLuca *et al.* 2005, p. 80).

Accordingly, the turnover level is considered of primary interest, and it is also comparable to previous studies. Additionally, compliance costs are analysed in terms of alternative size measures, namely number of staff employed and the NSDC definition. The compliance costs were further analysed in terms of other SMEs' characteristics, such as business sector and business length. Apart from analysing compliance costs at the total company level, compliance costs distribution was analysed in terms of its type (either computational or planning), and their sources (either internal or external). Additionally, the aggregate compliance costs of SME companies in Malaysia are estimated by multiplying the average compliance costs to SME populations. Due to data availability on the population of SME companies, the current study assumed that the average compliance costs are the same, regardless of their specific sizes, either micro, small and medium companies. Further details are presented in Chapter Five.[100]

This study also estimated the possible values of offsetting benefits of tax compliance, namely tax deductibility.[101] Subsequently, compliance costs, after allowing for offsetting benefits of tax compliance, were computed, both at the firm and overall levels.

4.10.3 Relationship between Compliance Costs and Compliance Behaviour

Having outlined tax compliance costs estimation, it would be useful to examine the effects of compliance costs on corporate tax behaviour. The current study measured two types of non-compliance behaviour, namely underreporting of income and overstatement of deductions. As presented earlier,[102] it is important to remember that

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[99] The US studies tend to conduct a statistical analysis/test to establish the relationship between firm size and the tax compliance burden, whereas researchers in other parts of the world (with the exception of Allers in the Netherlands) generally carry out comparisons with firm size to investigate the regressive nature of tax compliance costs. Nonetheless, the ultimate idea remains the same, namely that firm size relates to the tax compliance burden.
[100] See Chapter Five, Section 5.9.
[101] See Chapter Five, Section 5.10.
[102] See subsection 4.4.3.

both tax behaviours were measured by way of two independent hypothetical tax scenarios. The relationship between compliance costs and both types of compliance behaviour (research question two) was analysed descriptively and by way of correlation analysis, as well as employing other comparative analysis (mainly t-tests or ANOVA). Additionally, in a similar way, a relationship between compliance costs and other tax attitudinal tax aspects, namely fairness, tax complexity, and other structural features of tax systems was carried out as well.

4.10.4 Determinants of Compliance Behaviour

And finally, factors influencing non-compliance behaviour of SME companies (research question three) was carried out by way of multivariate regressions. A number of prior studies in tax compliance had used regression (for example Mason and Calvin 1984; Hasseldine, Kaplan and Fuller 1994; Webley, Cole and Eidjar 2001; Wenzel 2002) in their analysis. Details of the model specification in the current study, covering both dependent and independent variables, and findings are presented in Chapter Six.[103]

4.11 ADDITIONAL SURVEYS

4.11.1 Web Survey

As presented earlier,[104] the main survey questionnaire was also carried out by way of a web survey. The web survey considered almost 42 percent of the net population[105] or 4,033 SMEs having an e-mail address. The web survey follows a similar approach to the mail survey,[106] except that a slightly different questionnaire layout,[107] and additional number of contacts are used. A different layout of the questionnaire was considered to suit the web survey context. In terms of contact, advanced e-mail notification,[108] and three reminders (as compared to two in the mail survey) were adopted in the web

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[103] See Chapter Six, Section 6.7.
[104] Refer end of Section 4.3.
[105] See Table 4.7 in Section 4.8.
[106] Refer Sections 4.5 to 4.7.
[107] See a print copy of the web questionnaire in Appendix L.
[108] Advance e-mail notifications are sent through an email group created for the purpose of the current study.

survey.[109] The third and the final reminder requested respondents to complete a single question web survey.[110] These two additional reminders are considered essential in order to address a comparatively low response rate in a web survey, and more importantly no additional costs were involved.

The web survey was conducted by an e-mail invitation to 3,535 SME companies. This sample frame is derived after excluding a number of duplicate email addresses[111] and SMEs that had been selected in the mail survey. The web sampling frame by sector is shown in Table 4.10.

Table 4.10: Sample Size of Web Survey

Sector	Number of Companies	Percentage
Manufacturing	708	20.0
Services	1,396	39.5
Manufacturing-related services	581	16.4
Construction	387	10.9
Others	463	13.1
Overall	3,535	100.0 [a]

[a] Does not total up to one hundred percent due to rounding.

The survey was implemented five weeks after the initial mail-out of the postal survey with the assistance of the Computer Centre of UUM. The e-mailing pattern of a web survey is summarised in Table 4.11. The intervals of web-contacts of between one and two weeks were shorter than the mail survey as no lead time is required in a web-survey.

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[109] See the content of the advanced e-mail notification, initial email and reminders in Appendix M.
[110] The single question in the web survey is the same as for the primary postal survey (refer Appendix K).
[111] See Appendix N, Table N.1 for details.

Table 4.11: E-mailing Pattern of the Web Survey

Mailing Pattern	E-mailing Date	E-mailing Number
Advanced Notification	9 August 2007	3,535
Initial emailing	16–30 August 2007 [a]	3,516 [b]
First Reminder	6 September 2007	3,446 [b]
Second Reminder	18 September 2007	3,417 [b]
Final Reminder	4 October 2007	3,401 [b]

[a] Due to a technical failure, initial emails were sent during the two week period.
[b] Less than 3,535 due to exclusion of replied and out of frame responses.

In terms of personalisation, just over 91 percent of the contacts are non-personalised e-mails addressed to 'Manager/Accountant', as shown in Table 4.12. Due to availability of contact details, personalised e-mails were sent to 309 SMEs only, mainly to either the Chief Executive Officer or Director.

Table 4.12: Personalisation in the Web Survey

	Number of SMEs	Percentage
Personalised [a]		
Chief Executive Officer/Managing Director	111	3.1
Director	107	3.0
Accountant, Finance Manager or Equivalent	15	0.4
General Manager/Manager	76	2.1
Sub-total	309	8.7 [b]
Non-personalised [c]		
Manager/Accountant	3226	91.3
Overall	3,535	100.0 [d]

[a] Emails are sent to either a specific officer or relevant position address of the SMEs.
[b] The sub-total does not add up to 8.7 due to rounding.
[c] Emails are sent to the general company or inquiry address of the SMEs.
[d] Does not total up to one hundred percent due to rounding.

A non-response test, similar to the primary mail survey[112] and conducted through a single questionnaire survey and wave analysis, indicates similar findings between respondents and non-respondents.[113] The findings are presented in Chapters Five and Six.[114]

4.11.2 Survey of Tax Professionals

As briefly discussed earlier,[115] considering tax professionals' views is important with regards to corporate SME taxation. A survey of tax professionals was carried out to validate and support corporate SME respondents' views on some tax attitudinal and behavioural aspects. The questionnaires were mailed to 300 tax professionals who are members of the Malaysian Institute of Taxation (MIT). As at early August 2007, there were 2,504 MIT members in Malaysia.[116] As the MIT members' details are not available publicly, the random selection of 300 tax professionals and the mailings were carried out by the MIT personnel. The survey questionnaire, together with a reply stamped envelope, was distributed by the MIT in their third quarterly correspondence (second week of September) to members. A lack of correspondence details does not allow any follow up procedure to be carried out.

Similar to the main mail survey, a single page questionnaire, folded into booklet form, was adopted. The covering letter explaining the purpose of the study was printed on the top of the first page of the questionnaire. The survey questionnaire was divided into four sections, referred to as Sections A to D.[117] Section A was designed to obtain brief demographics and background information of tax professionals; Sections B and C relate to external tax fees and perceptions on tax attitudes and behaviour of tax professionals respectively; and finally Section D covers comments and suggestions. This questionnaire survey was built upon the main postal SME survey questionnaire,

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[112] See Section 4.9.
[113] A comparative analysis of the perceived level of compliance costs in a full and single question is provided in Appendix N, Table N.10.
[114] See Sections 5.12 and 6.8.
[115] See Section 4.6.
[116] Personal communication with the Malaysian Institute of Taxation, 16 August, 2007.
[117] The survey questionnaire is provided in Appendix O.

discussed earlier,[118] but modified to suit the tax professional context. This survey questionnaire was prepared in the English version only as the English language is widely used in the business of tax professionals. The survey findings are reported in Chapter Six.[119]

4.12   CHAPTER SUMMARY

This chapter has presented the various aspects of research design and methodology adopted in this study. The strengths and weaknesses of each design and method have been compared succinctly, both in the context of social sciences and specific tax research. A number of measurement issues and approaches adopted pertaining to both tax compliance costs and compliance behaviour have been discussed. Questionnaire development, pilot interviews, and the actual survey implementation undertaken have been described in detail. These cover the main SME postal survey, and two additional surveys—the SME web survey and the tax professionals' survey. Information with regard to population, sampling process, and non-response bias has been addressed as well. Finally, the methods of data analysis employed in this study have been explained. The findings and analysis are presented in the next two chapters.

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[118] See Section 4.5.
[119] See Section 6.9.

CHAPTER FIVE
COMPLIANCE COSTS ESTIMATES
OF SMALL AND MEDIUM ENTERPRISES

5.1   INTRODUCTION

This chapter presents the findings of the analysis obtained through the postal survey, the primary survey instrument. The analyses start with overall responses and outline the profile of the sample SMEs. The main part of this chapter presents compliance costs estimates of Malaysian SMEs for the survey year 2006. The estimates cover both gross and net compliance costs, conducted mainly at firm level, but also aggregate level. Overall, the chapter covers analyses of Sections A and B of the survey questionnaire. An analysis of Section C is presented in Chapter Six. Additionally, the compliance costs estimates of the web survey and relevant analysis, conducted using the same survey instrument,[120] are presented to add support to compliance costs estimates from the main postal survey.

5.2   RESPONSES AND RATE

Out of 1,300 questionnaire sent, a total of 175 useable questionnaires were returned, which represents an overall response rate of 15.7 percent of the net sampling frame. Detailed information of responses, taking into consideration the gross sample, out of frame, useable and unusable responses, is presented in Table 5.1.

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[120] See Section 4.11.

Table 5.1: Sample Frame and Response Rate for Postal Survey

	Number of SMEs
Gross Sample Frame	1,300
(-) Out of Frame [a]	176
(-) Unusable Responses	8
Net Sample Frame	1,116
Useable Responses	175
Useable Response Rate (%)	15.7

[a] See Table 5.2 for details.

The net sample frame, as shown in Table 5.1, totalled up to 1,116 SMEs, after allowing for out of frame and unusable replies. A total of eight responses were discarded due to incompleteness (four cases), non-SMEs' response (three cases) and an extreme outlier (one case). The out of frame replies were largely due to change of business addresses (82 percent) and/or invalid addresses (9 percent). Further details are shown in Table 5.2.

Table 5.2: Out of Frame Responses

	Number of SMEs	Percentage
Change of address	145	82.4
Invalid address	15	8.5
Refused to participate	9	5.1
Dormant/ceased business	6	3.4
Large company	1	0.6
Total	176	100.0

Out of 175 useable responses, the large majority of SMEs responded to the English version (142 responses or 81 percent) and the remaining to the Malay version (33 responses or 19 percent). Nearly half of the respondents are either Chief Executive Officers or Managing Directors of SMEs, followed by Managers at just more than one-quarter, as shown in Table 5.3.

Table 5.3: Respondents' Position

	Number of Respondents	**Percentage**
Chief Executive Officer	18	10.3
Managing Director/Director	59	33.7
Manager	46	26.3
Accountant	15	8.6
Other	37	21.1
Total	175	100.0

The majority of responses received from Chief Executive Officers and Managing Directors is not surprising as almost 60 percent of the survey is addressed personally to them.[121] Responses from Accountants comprised nearly nine percent. The remaining one-fifth fall within the 'other' category; a detailed breakdown is shown in Table 5.4.

Table 5.4: Position of 'Other' Respondents

	Number of Respondents	**Percentage**
Accounting Staff	17	46.0
Non-Accounting Staff	15	40.5
Not Mentioned	5	13.5
Total	37	100.0

Seventeen and fifteen respondents are accounts-related staff (i.e. accounting or finance clerks, executives or supervisors) and non-accounting staff (i.e. administrative clerks, executives or officers) respectively. Unfortunately, another five respondents did not

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[121] See Section 4.7, Table 4.5.

disclose their positions. Overall, it is reasonable to assume that the survey was predominantly completed by a person who has some financial knowledge of their respective business.

All responses were scrutinised for validity and a number of telephone follow-up calls were made (to respondents with telephone numbers) to address the issue of possible incorrect or extreme responses, and to address any missing items (see Appendix P).

5.3   PROFILE OF RESPONDING SMALL AND MEDIUM ENTERPRISES

This section presents a business profile of the responding SMEs, both by general business and specific size measures. General business profile includes financial year-end, business sector, and business length. Business size measures consist of staff, turnover and the National SME Development Council (NSDC) criteria. Additionally, the way the SMEs manage their corporate income tax affairs, either internally, externally or both, is presented. Nearly 70 percent of the SMEs end their business either on the 31 December (55 percent) or 30 June (14 percent), as shown in Table 5.5. The remainder, 30 percent, end their accounts on dates other than 31 December and 30 June.

Table 5.5: SMEs by Financial Year-end

Financial Year-end	Number of SMEs	Percentage
31 January	2	1.1
28 February	5	2.9
31 March	5	2.9
30 April	5	2.9
31 May	5	2.9
30 June	24	13.7
31 July	3	1.7
31 August	8	4.6
30 September	13	7.4
31 October	2	1.1
30 November	6	3.4
31 December	97	55.4
Total	175	100.0

The variation in the financial year-end of SMEs is not surprising as the tax year for a corporate taxpayer is based upon their financial year-end. More importantly, the tax year is not contingent on business size. For example, a company having its financial year-end on 30 June 2006 is subject to tax for the year of assessment 2006.

As for the main business sector, the highest response was from the services sector (44 percent), followed by the manufacturing (21 percent), as shown in Table 5.6. Comparing the sample responses to the overall SME population in Malaysia is, unfortunately, problematical. This is because the population as a whole was not available at the point of survey. As discussed earlier,[122] the sample was drawn from a list of SMEs that registered with the NSDC. This probably represents a low proportion of the true Malaysian SME population. However, some indication of the representativeness of the survey responses may be obtained by way of a comparison

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[122] See Chapter Four, Section 4.8.

with the sample population itself and other official data i.e. the Department of Statistics
and the Malaysian Treasury.

Table 5.6: SMEs by Main Business Sector

Business Sector	Number of SMEs	Sample Percentage	SMEs Population [a]
Manufacturing	37	21.1	54.2
Manufacturing-related Services	32	18.3	8.8
Services	77	44.0	22.3
Construction	27	15.4	7.6
Other	2	1.1	7.1
Total	175	100.0 [b]	100.0

[a] From Table 4.8 in Chapter Four. The percentages are adjusted to two decimal points.
[b] Does not total up to one hundred percent due to rounding.

The highest number of responses were received from the services sector (44 percent),
followed by manufacturing, manufacturing-related and construction, as shown in Table
5.6. Survey responses received from all sectors were not comparable to a proportion of
the population used in this study. The responses received from the services,
manufacturing-related and construction sectors were almost twice as high, but the
manufacturing sector was around half when compared to the sample population. As the
manufacturing sector is often targeted as a research subject in Malaysia, the lack of
responses from this sector is not surprising. It is also possible that SMEs are confused
about differentiating the manufacturing-related and services sectors.[123] It is likely that
some respondents, who are not sure of their sector, may have indicated 'other sector'.[124]
Thus the manufacturing sector could be under-represented and the other three sectors
are likely to be over-represented.

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[123] The annual national economic report issued by the Malaysian Treasury does not specify
manufacturing-related services as a separate sector.
[124] The actual response received from this sector was 25, but was reclassified using the respondents'
remarks about their specific business nature. For example, SMEs engaged in trading, wholesaling, health
and hotel were re-categorised as services sector, which is in line with the classification of economic
activities across sectors based on Malaysian Standard Industrial Classification (MSIC) 2000 codes (see
Appendix 2 of the National SME Development Council definitions for small and medium enterprises in
Malaysia—attached in Appendix A).

From an overall population perspective, the Department of Statistics (2007, p. 9) reported that the services sector is the largest SME sector (representing 86.6 percent) in Malaysia, followed by the manufacturing sector (7.2 percent). Both the services and the manufacturing sectors also have been significant contributors to Malaysian economic growth. For example, in 2007, the national GDP growth was recorded at 6.3 percent, with the services and manufacturing sectors contributing 5.0 and 1.0 percentage points respectively (Treasury of Malaysia 2008, p. 38, Table 3.1). The data also shows that the contribution from the services sector is gradually increasing. Over the period of between 2002 and 2007, except for 2003 and 2004, the services sector registered higher growth compared to manufacturing (Treasury of Malaysia 2003, 2004, 2005, 2006, 2007, 2008). The gradual shift in the structure of the Malaysian economy in recent years from manufacturing to services is acknowledged (Treasury of Malaysia 2007, p. 25). The services sector is expected to contribute significantly to the national economy in 2008 and 2009 (Treasury of Malaysia 2008, p. 38). It is therefore reasonable to assume that the proportion of responses received in the current study is broadly representative of the Malaysian SME population.

Regarding business length, Table 5.7 reveals that almost 95 percent of responding SMEs have been in business for at least two years, with 78 percent of them for more than five years. This indicates that the responding SMEs have had tax-related experience for some time.

Table 5.7: SMEs by Length of Business

Business Length	Number of SMEs	Percentage
Less than 2 years [a]	8	4.6
2 to 5 years [a]	30	17.1
More than 5 years	137	78.3
Total	175	100.0

[a] These categories are combined into a single category of up to five years throughout the remainder of this thesis.

As for business size, the newly approved definition of Malaysian SMEs is based on either the number of employees or annual sales turnover. The SME profiles, based on these individual measures, are presented in Tables 5.8 and 5.9 respectively, and later by NSDC definition in Table 5.10.

Table 5.8: SMEs by Number of Staff Employed

Number of Staff	Number of SMEs	Percentage
4 or less	35	20.0
5 to 19	85	48.6
20 to 50	40	22.9
51 to 150	14	8.0
151 or more	1	0.6
Total	175	100.0 [a]

[a] Does not total up to one hundred percent due to rounding.

In terms of employment size, as shown in Table 5.8, 92 percent of respondent companies have up to 50 personnel employed, with almost 49 percent of all companies having staff in the '5 to 19' category. As for turnover level, Table 5.9 shows that almost 75 percent of the respondents are from the first three categories, with about the same number of respondents for each category. The remaining respondents are in the next three levels of turnover, with about equal representation in each category. More importantly, responses in the last three levels of turnover are small. Hence, primary compliance costs analysis throughout this thesis is carried out by combining all these responses (n = 44) into a turnover level of between RM5 million and above.

Table 5.9: SMEs by Turnover Level

Turnover Level	Number of SMEs	Percentage
Less than RM250,000	37	21.1
RM250,000 to RM999,999	48	27.4
RM1,000,000 to RM4,999,999	46	26.3
RM5,000,000 to RM9,999,999 [a]	17	9.7
RM10,000,000 to RM24,999,999 [a]	14	8.0
RM25,000,000 or more [a]	13	7.4
Total	175	100.0 [b]

[a] These categories are combined into a single category of RM5 million or more throughout the remainder of this thesis.
[b] Does not total up to one hundred percent due to rounding.

Having analysed SMEs on the basis of both staff and turnover measures separately, it is important to classify them into the NSDC classification of SMEs. However, technical difficulties arise as different criteria (by staff and/or turnover) apply for manufacturing and manufacturing-related sectors on the one hand, and the non-manufacturing sector (services, construction and others) on the other. For example, a SME company with between 20 and 50 personnel would be classified as a small business in the manufacturing sector, but as a medium business in the non-manufacturing sector. Even within the same sector, different criteria may result in different sized SMEs. For example, a company could be categorised as micro-sized by staff criteria and as small-sized by turnover criteria. In such cases, the lower criterion is employed, as adapted by the NSDC (personal communication, 16 October 2007). Table 5.10 presents responses from SMEs based on the NSDC classification.

Table 5.10: Size of Business by the NSDC Definition

Business Size	Number of SMEs	Percentage
Micro	54	30.9
Small	98	56.0
Medium	23	13.1
Total	175	100.0

Table 5.10 shows that all 175 companies are within the definition of SMEs in Malaysia, with more than half being small companies, followed by nearly one-third being micro companies. In addition to these business characteristics, the survey requested respondents to indicate their company's paid-up capital. This information is important as SME companies are eligible for certain tax incentives (e.g. dual tax rates) only if their paid-up capital is equal or less than RM2.5 million. More than 93 percent of respondent companies had paid-up capital of up to RM2.5 million, as shown in Table 5.11. The remaining seven percent though would not qualify as SME companies for tax purposes, but are still within the definition of SMEs as per the NSDC classification. As a result, those companies are included in the analysis throughout this thesis.

Table 5.11: SMEs by Paid-up Capital

Paid-up Capital	Number of SMEs	Percentage
RM500,000 or less	105	60.3
RM500,001 to RM2,500,000	58	33.3
RM2,500,001 or more	11	6.3
Total	174 [a]	100.0 [b]

[a] Number of respondents equals 174. There was one missing value.
[b] Does not total up to one hundred percent due to rounding.

Finally, respondents are asked to provide information pertaining to two tax aspects: first, their estimated tax liability; and secondly, on the possibility of a tax refund. The large majority of SMEs estimated their 2006 tax liability to be either nil (24 percent) or up to RM100,000 (60 percent), as shown in Table 5.12. Further, 15 percent provide estimates of between RM100,000 to less than RM1 million. Only two companies estimated a tax liability of RM1 million and above. As expected, consistent with their turnover levels,[125] the last four levels registered a small number of responses. Thus, for the purpose of the compliance costs analysis later, these are merged to form a new level of RM100,000 and above (n = 28).

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[125] See Table 5.9.

Table 5.12: Estimated Tax Liability, 2006

Estimated Tax Liability	Number of SMEs	Percentage
No tax	42	24.4
RM1 to RM99,999	102	59.3
RM100,000 to RM249,999 [a]	12	7.0
RM250,000 to RM499,999 [a]	9	5.2
RM500,000 to RM999,999 [a]	5	2.9
RM1,000,000 or more [a]	2	1.2
Total	172 [b]	100.0

[a] These categories are combined into a single category of RM100,000 or more throughout the remainder of this thesis.
[b] Number of respondents equals 172. There were three missing values.

Since the introduction of the SAS in Malaysia, all companies, regardless of size, are required to estimate their tax liability in advance and to pay their taxes in advance in equal monthly instalments. Under this system, a tax refund is possible if the total instalments paid exceed the actual tax liability that is determined after the year-end. Only around 25 percent of the SMEs (or 43 respondents) expect a tax refund. The remaining large majority (76 percent or 132 respondents) did not expect a tax refund for the year of assessment 2006. The possible tax refund amount varies widely, from as low as RM333 to as high as RM100,000, with an average refund of RM31,452, as shown in Table 5.13.

Table 5.13: Tax Refunds, 2006

	Mean	Minimum	Maximum	Standard Deviation
Tax Refund (RM)	31,452	333	100,000	35,323

Number of respondents equals 37. There were six missing values.

However, the use of average tax refund amounts may not be generalised to the taxpaying population as the actual refund depends on each individual SME. Broadly, the possible tax refund for each tax level is shown in Table 5.14.

Table 5.14: Tax Refunds by Tax Liability, 2006

Estimated Tax Liability	Number of SMEs	Average Tax Refund (RM)
Nil (No tax)	6	18,083
RM1 to RM99,999	18	14,946
RM100,000 or more [a]	12	57,182
Overall	36 [b]	29,548 [c]

[a] This is a merged category. For details refer Table 5.12.
[b] Number of respondents equals 37. There was one missing value.
[c] Due to the missing value (note [b]), the amount is lower than RM31,452 as cited in Table 5.13.

Finally, in terms of sources of income tax work, a specific question (question 13) was asked on the usage of external advisors. As for internal tax work, this is implied from their responses towards internal time spent on tax activities (question 9). Nonetheless, it is fortunate that respondents specifically stated they had outsourced their tax affairs in the space provided. An analysis of these two questions into source of income tax work is summarised in Table 5.15.

Table 5.15: Source of Income Tax Work in 2006

	Number of SMEs	Percentage
Internal and External	159	90.9
No External (i.e. internal only)	10	5.7
No Internal (i.e. external only)	6	3.4
Total	175	100.0

Nearly 91 percent of the SMEs performed their income tax work by using both their internal resources and paid external advisors, as shown in Table 5.15. The remaining nine percent revealed that no income tax work is conducted either internally (six companies) or externally (ten companies). This small proportion is realistic as there may be some SMEs who fully outsourced their tax-related work. On the contrary, some other SMEs who have expertise in this regard can conduct their own tax affairs.

5.4   INTERNAL COSTS OF COMPLIANCE

5.4.1   Tax Difficulties faced by the Small and Medium Enterprises

As presented earlier,[126] respondents were asked to indicate tax-related difficulties in complying with corporate income taxation. Respondents were given the option to select more than one area. The most highly ranked difficult areas are 'estimating income tax payable' (17 percent), 'understanding the income tax legislation' (14 percent), and the 'increasing burden of record keeping requirements for tax purposes' (14 percent), as shown in Table 5.16. The least ranked difficult area is 'dealing with external tax professionals' (five percent). Surprisingly, 'maintaining records for income tax purposes' is ranked eight (out of nine). It seems that maintaining records was not perceived as a major problem for SMEs. But concern on the increasing burden of record keeping requirements is evident. Specific responses for each of the problem areas are shown in Table 5.16 (right column). For example, 65 percent of the SMEs indicate having problems pertaining to estimating their income tax payable.

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[126] See Chapter Four, Section 4.5.

Table 5.16: Tax-related Difficulties for SMEs in 2006

	Number of Responses	Overall Percent	Percent of Cases
Estimating Income Tax payable	106	16.8	65.0
Understanding Income Tax legislation	87	13.8	53.4
Increasing burden of record keeping for tax purposes	87	13.8	53.4
Implementing the Income Tax changes	81	12.9	49.7
Cash flow position to pay monthly tax instalments	78	12.4	47.9
Short period of time to lodge the tax return	58	9.2	35.6
Dealing with the tax authority	53	8.4	32.5
Maintaining records for Income Tax purpose	49	7.8	30.1
Dealing with external tax advisers	31	4.9	19.0
Total	630 [a]	100.0	-

[a] Total responses exceed 175 as each respondent was allowed to select more than one aspect.

5.4.2   Internal Staff Time

Respondents were required to estimate their monthly average time spent in relation to four different categories of personnel on tax activities and their corresponding wage rates. However, for the purpose of analysis, monthly hours are converted to a yearly basis and adopted throughout this thesis. A summary of yearly hours spent on tax activities is shown in Table 5.17.

Table 5.17: Yearly Hours Spent on Tax Activities by Staff Categories, 2006

Staff Categories	Mean	Minimum [a]	Maximum	Standard Deviation
Manager/Accountant	126	0	552	129
Accounting Staff	229	0	1,200	266
Administrative Staff	133	0	1,200	225
Other Staff	87	0	1,008	178
Overall	575	0	3,000	511

[a] Six respondents spent no internal time (see Table 5.15). Around 75 percent of respondents estimated time spent as a combination of staff, namely, two (28 percent), three (14 percent) and four (33 percent) categories.

The average internal time spent on income tax activities for the tax year 2006 is 575 hours, as shown in Table 5.17. At the firm level, time spent ranges from zero time (i.e. no internal time) to 3,000 hours. Specifically, time spent by 'manager/accountant' ranges from none to 552 hours per annum, while accounting and administrative staff spend up to 1,200 yearly hours respectively, and the other staff spend up to 1,008 yearly hours.

5.4.3 Time Valuation

Appropriate wage rates of relevant staff categories are presented in Table 5.18. This information is crucial in converting total time spent to internal time cost. The average monthly wage rate for 'manager/accountant' is almost RM3,500, which ranges widely between RM1,000 and RM7,000, as shown in Table 5.18. The variation may relate to their business characteristics. It is also possible that some respondents, particularly owner-managers, may be responsible for several functions in their company. For example, in addition to their general management function, owner-managers may perform an accounting role as well. As for accounting staff, the average rate is just over RM1,500, specifically ranging between RM400 and RM3,200. The remaining two categories of staff receive an average of almost RM1,000 and RM750 respectively. The actual rate for both of these categories ranges between RM300 and RM1,600.

Table 5.18: Monthly Wage Rates (RM) by Staff Categories, 2006

Staff Categories [a]	Mean	Minimum	Maximum	Standard Deviation
Manager/Accountants (130)	3,445	1,000	7,000	1,458
Accounting Staff (133)	1,541	400	3,200	700
Administrative Staff (101)	978	350	1,600	410
Other Staff (75)	741	300	1,600	458

[a] The number of respondents is given in parenthesis. The actual number was less than 175 since wage rates only apply if there was time spent in the respective staff categories.

5.4.4 Mean Internal Costs

The internal staff costs are computed by multiplying the internal time spent on tax activities by their relevant staff categories with their respective hourly wage rates. For this purpose, the internal time spent and their appropriate wages, as presented above in Tables 5.17 and 5.18, are used. The internal time spent is straightforward annual hours spent. However, the wage rates are on a monthly basis. As a result, wages are converted into hourly wage rates. The hourly wage rates are computed by dividing monthly wage rates by monthly working hours. The *Malaysian Employment Act 1955* (Section 60I) stipulated 26 days is to be used as the number to determine an hourly wage rate. A normal working day is eight hours, which at 26 days is 208 hours per month. Accordingly, respective wage rates were divided by 208 hours to derive an hourly rate. Internal costs of taxation are then derived by a summation of internal staff costs of all four categories of staff. Importantly, the computation is carried out at the disaggregate level, i.e. for each SME. The results of this procedure are presented in Table 5.19. The average internal costs of SMEs are estimated at RM4,862, with a maximum cost of almost RM30,000.

Table 5.19: Internal Time Costs, 2006

Cost Category	Mean	Minimum [a]	Maximum	Standard Deviation
Internal Costs (RM)	4,862	260	29,839	4,949

[a] Excluding six SMEs that have no component of internal costs (see Table 5.15).

5.5 EXTERNAL COSTS OF COMPLIANCE

5.5.1 Mean External Tax Fees

As presented earlier,[127] almost 95 percent of SMEs have used external tax professionals in managing their corporate tax affairs for the year of assessment 2006. External costs of compliance are a straightforward monetary cost charged by external tax professionals solely on tax activities. It is common in Malaysia to have tax fees charged separately from financial audit or other fees. However, it is possible that some SMEs may refuse to indicate their actual tax fees. Thus, respondents were asked to provide or estimate their external tax fees for the financial year 2006. The average tax fee paid by SME companies in 2006 is RM3,786, with the lowest and highest fee being RM150 and RM15,000 respectively, as shown in Table 5.20.

Table 5.20: A Summary of External Tax Professional Fees, 2006

Cost Category	Mean	Minimum [a]	Maximum	Standard Deviation
Tax Fees (RM)	3,786	150	15,000	3,945

[a] Excluding ten SMEs that have no component of external costs (see Table 5.15).

5.5.2 Reasons for Using External Services

The respondents were asked to indicate the main reason for using a paid external tax professional. As it is possible that there could be a number of reasons, respondents were given a choice to select more than one response. The most stated reason is the lack of technical knowledge internally (28 percent), followed by the complexity of the tax laws (23 percent) as shown in Table 5.21. Specifically, almost 81 percent and 67 percent of the respondents indicate a lack of technical knowledge and tax law complexity respectively as their main reason for using tax professionals. The lowest response is for the purpose of income tax planning, where just over 39 percent have identified this reason.

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[127] See Table 5.15.

Table 5.21: Main Reason for using External Tax Professionals in 2006

Main Reason	Number of Responses	Overall Percent	Percent of Cases
Technical knowledge is not readily available internally	129	28.1	80.6
Income tax matters are too complicated	105	22.9	65.6
External opinion was required	86	18.7	53.8
It is more cost-effective to use external tax professionals	76	16.6	47.5
For income tax planning	63	13.7	39.4
Total	459 [a]	100.0	-

[a] Total responses exceed 175 as each respondent was allowed to select more than one aspect.

5.6   ADDITIONAL COSTS OF COMPLIANCE

5.6.1   Mean Additional Costs

Broadly, additional non-staff costs are incurred both within a company and by external professionals. In Malaysia, it is common for tax professionals to reimburse those costs from their tax clients. The amount is included in the tax invoice, but shown separately from tax fees. A similar approach is practiced in the context of financial auditing. Just over 37 percent of the respondents (or 65 respondents) incurred other non-staff additional costs in meeting their corporate income tax requirements. The remaining large majority (63 percent or 110 respondents) did not spend any amount of additional costs in 2006. Additional non-staff costs range widely from RM20 to RM6,000, as shown in Table 5.22.

Table 5.22: A Summary of Estimated Additional Non-staff Costs, 2006

Cost Category	Mean	Minimum [a]	Maximum	Standard Deviation
Additional Costs (RM)	646	20	6,000	1,583

[a] Excluding 110 SMEs that spent no additional costs.

5.6.2   Nature of Additional Costs

As for the nature of costs, 60 respondents (out of 65) provided details to an open-ended question on the nature of their non-staff additional costs. The respondents stated between one and four cost items. Four cost items, namely postage and courier, stationery, travelling and printing, comprise more than 90 percent of responses, as shown in Table 5.23. Specifically, for individual cost items, the most stated cost is postage and courier (57 percent), followed by stationery (52 percent), travelling cost (47 percent) and printing and documentation (25 percent).

Table 5.23: Nature of Additional Costs in 2006

Cost Description	Number of Responses	Overall Percent	Percent of Cases
Postage and Courier	34	28.6	56.7
Stationery	31	26.1	51.7
Travelling	28	23.5	46.7
Printing & Documentation	15	12.6	25.0
Communication (Telephone/Fax)	3	2.5	5.0
Software-related	1	0.8	1.7
Miscellaneous	7	5.9	11.7
Total	119 [a]	100.0	-

[a] Number of respondents equals 60. Another five have missing values. Total responses exceed 60 as respondents were allowed to select more than one aspect.

5.7 MEAN COMPLIANCE COSTS

5.7.1 Overall Mean Compliance Costs

Compliance costs estimation in this thesis mainly follows similar approaches used by earlier studies in Australia, Malaysia, Singapore and Hong Kong (Pope, Fayle and Chen 1994; Hanefah, Ariff and Kasipillai 2001; Ariff and Pope 2002). The compliance costs estimation is derived by totalling all three cost components, namely internal time costs, external tax fees, and additional non-staff costs. For this purpose, the average costs of each component are used. Almost all major prior tax compliance costs studies have used the average cost method (e.g. Sandford, Godwin and Hardwick 1989; Pope, Fayle and Chen 1994; Sandford 1995; Evans *et al.* 1997). One exception is in the context of personal taxpayers, where Evans *et al.* (1997), have utilised a 'trimmed mean' after eliminating the largest and the lowest five percent of the values respectively. For business taxpayers, they have used the average approach (Evans *et al.* 1997, p. 8). Evans *et al.* argue that the presence of extreme values is less likely in the context of business taxpayers. It is prudent to take a cautious approach and therefore remove the effects of outliers at the data validation stage (see Appendix P).

Following the average approach, the mean compliance costs of Malaysian SME companies by costs component are summarized in Table 5.24. The average compliance cost is almost RM9,300 per company. The largest portion of the average compliance costs is associated with the internal time cost (52 percent), and another 41 percent is a direct monetary cost paid to external advisors. The remaining seven percent is related to additional non-staff costs to comply with the tax laws.

Table 5.24: Estimated Mean Compliance Cost by Components, 2006

Cost Component	Mean Costs (RM)	Cost Breakdown (%)
Internal Costs	4,863	52
External Costs	3,786	41
Additional Non-staff Costs	646	7
Total	9,295	100

At the individual SME level, a detailed analysis revealed that compliance costs estimates range from just over RM600 to almost RM38,000, as shown in Table 5.25.

Table 5.25: Estimated Compliance Costs at SME level, 2006

	Mean	Minimum	Maximum	Standard Deviation
Compliance Costs (RM)	9,295	612	37,773	7,116

For the purpose of a sensitivity analysis, the computation was carried out for the 135 complete cases only, i.e. excluding 40 cases which have at least one missing item. Using this approach, compliance costs are increased to RM9,715 or by only 4.5 percent. This increase is not surprising since the missing pattern is considered as missing completely at random (MCAR) and the mean substitution for missing values is conservative in nature (Hair *et al.* 1998). Thus, it is reasonable to assume the estimates are about the same, regardless of the missing items replaced. As a result, subsequent analysis of the current study will be primarily based on all 175 cases.

5.7.2 Compliance Costs by Small and Medium Enterprise Profile

Having estimated mean compliance costs at the overall SME level, compliance costs are now analysed in terms of the specific characteristics of SMEs, focusing on the absolute dollar amount, at least initially. The distribution effect of compliance costs is discussed later in subsection 5.7.3.

Table 5.26: Mean Compliance Costs by Turnover, 2006

Turnover Level	Number of Respondents	Mean Costs (RM)
Less than RM250,000	37	8,162
RM250,000 to RM999,999	48	7,086
RM1,000,000 to RM4,999,999	46	9,673
RM5,000,000 and more [a]	44	12,262
Overall	175	9,295

[a] This is a merged category. For details refer Table 5.9.

There is a trend of increasing compliance costs as the turnover level increases, as shown in Table 5.26.[128] An exception is noted for SMEs with a turnover level of between RM250,000 and RM1 million, with this category having the lowest compliance costs. Although this exception may suggest a U-shaped trend, this is not supported statistically. Specifically, a post hoc test reveals that significant differences exist between SMEs in the first two turnover levels (up to RM1 million) and the last turnover level (at least RM5 million).

An alternative measure of size is the number of staff employed. Compliance costs (in absolute value) increase as the size (measured by staff) becomes larger, as shown in Table 5.27. However, the ANOVA test did not reveal any significant differences (f = 2.341, p = 0.057) in terms of staff levels.

Table 5.27: Mean Compliance Costs by Staff Level, 2006

Number of Staff [a]	Number of Respondents	Mean Costs (RM)
4 or less	35	7,466
5 to 19	85	8,981
20 to 50	40	10,609
51 to 150	14	10,937
Overall	174 [a]	9,295

[a] Number of respondents equals 175. A respondent with more than 151 staff was excluded.

Compliance costs are further analysed by business sector, length in business and paid-up capital. For the business sector (Table 5.28), compliance costs for the manufacturing and construction sectors are relatively higher compared to the other sectors. However, an ANOVA test did not reveal any significant mean differences within business sectors.

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[128] The compliance costs differences among turnover levels are supported by an ANOVA test (f = 4.734, p = 0.003).

Table 5.28: Mean Compliance Costs by Sector, 2006

Business Sector [a]	Number of Respondents	Mean Costs (RM)
Manufacturing	37	10,428
Manufacturing-related services	32	9,701
Services	77	8,219
Construction	27	10,473
Overall	173 [a]	9,295

[a] Number of respondents equals 175. Two respondents in the 'other' category were excluded.

Small and medium enterprises having paid-up capital of up to RM500,000 have the lowest mean compliance costs of RM8,069 compared to the other two categories of capital, as shown in Table 5.29. The ANOVA test shows a statistical difference (f = 4.362, p = 0.014) between groups, suggesting that the compliance costs of smaller SMEs (companies with paid-up capital of up to RM500,000) are lower in absolute terms.

Table 5.29: Mean Compliance Costs by Paid-up Capital, 2006

Paid-up Capital	Number of Respondents	Mean Costs (RM)
RM500,000 or less	105	8,069
RM500,001 to RM2,500,000	58	11,395
RM2,500,001 or more	11	10,373
Overall	174 [a]	9,223 [b]

[a] Number of respondents equals 174. There was one missing item.
[b] The total was not equal to RM9,295 due to differences in the response number.

In terms of length in business (Table 5.30), SMEs that have been in business for up to five years appear to have lower compliance costs compared to those SMEs that have been in business for at least five years. Similar to the business sector (Table 5.28), no significant differences are evident for business length.

Table 5.30: Mean Compliance Costs by Length in Business, 2006

Years in Business	Number of Respondents	Mean Costs (RM)
Up to 5 years [a]	38	7,980
More than 5 years	137	9,659
Overall	175	9,295

[a] This is a merged category. For details refer Table 5.7.

Compliance costs were then analysed by size as per NSDC criteria. Similar to the other size measures, tax compliance costs increase as the size of SMEs increase, as shown in Table 5.31. Unfortunately, the ANOVA test did not reveal any significant differences in terms of the NSDC size.

Table 5.31: Mean Compliance Costs by SMEs as per NSDC Criteria, 2006

Business Size	Number of Respondents	Mean Costs (RM)
Micro	54	7,741
Small	98	9,777
Medium	23	10,888
Overall	175	9,295

As noted earlier,[129] compliance costs by size (that is measured by turnover groups) indicate a significant statistical difference between turnover levels, but not by size as per the NSDC classification. The results are not surprising since the NSDC classification of a SME into micro, small and medium is somewhat mixed with both turnover and staff criteria, and more importantly different specific levels apply among different sectors.[130]

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[129] See paragraph below Table 5.26.
[130] See Chapter One, subsection 1.5.3.

5.7.3 Distribution of Compliance Costs

The distribution of compliance costs of Malaysian SMEs by size, expressed as a percentage of turnover, follow the usual regressive pattern, as shown in Table 5.32. Tax compliance costs as a percentage of turnover for SMEs in a less than RM250,000 level are 6.5 percent, followed by about one percent of those in the turnover level of RM250,000 to RM1 million, and 0.32 percent for those in the RM1 million to RM5 million turnover category. Compliance costs for SMEs having turnover of at least RM5 million are only 0.08 percent. It is apparent that the relative costs, as a percentage of turnover, fall significantly as the turnover level increases. As an extreme comparison, the compliance costs percentage for SMEs in the lowest turnover level is as much as 82 times higher than for the highest level of turnover. The compliance costs for SME companies, taken as a single category, are estimated to be around 0.19 percent of their average weighted turnover level.

Table 5.32: Mean Compliance Costs as Percentage of Turnover, 2006

Turnover Level [a, b]		Compliance Costs	
		Mean (RM)	Percentage of Turnover
Less than RM250,000	(37)	8,162	6.53
RM250,000 to RM999,999	(48)	7,086	1.13
RM1,000,000 to RM4,999,999	(46)	9,673	0.32
RM5,000,000 and more	(44)	12,262	0.08
Overall	(175)	9,295	0.19 [c]

[a] The number of respondents is given in parentheses.
[b] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[c] The denominator used for the overall SME turnover category is RM5 million. This denominator is derived by weighting all the midpoints of the turnover level, rounded to the nearest million. Weighting using the original turnover levels (see Table 5.9) also results in a similar figure.

A similar trend is evident even when compliance costs distributions are analysed in terms of all three cost components (internal, external and additional costs), as presented in Tables 5.33, 5.34 and 5.35. The internal costs for SMEs in the less than RM250,000 turnover level are as much as six times higher in percentage terms as the next level

(Table 5.33). At an extreme comparison, the internal costs percentage in the lowest turnover level is as much as 95 times higher than for the highest level.

Table 5.33: Mean Internal Costs as Percentage of Turnover, 2006

Turnover Level [a, b]		Internal Costs	
		Mean (RM)	Percentage of Turnover
Less than RM250,000	(37)	4,721	3.78
RM250,000 to RM999,999	(48)	4,174	0.67
RM1,000,000 to RM4,999,999	(46)	5,081	0.17
RM5,000,000 or more	(44)	5,503	0.04
Overall Internal Costs	(175)	4,862	0.10 [c]

[a] The number of respondents is given in parentheses.
[b] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[c] The denominator used for the overall SME turnover category is RM5 million. See also Table 5.32.

As for the regressivity of the external costs, SMEs in the less than RM250,000 level are as much as 49 times higher than the last level of turnover (Table 5.34). This finding shows that the regressivity of internal costs are almost double compared to external costs.

Table 5.34: Mean External Costs as Percentage of Turnover, 2006

Turnover Level [a, b]		External Costs	
		Mean (RM)	Percentage of Turnover
Less than RM250,000	(37)	2,445	1.96
RM250,000 to RM999,999	(48)	2,521	0.40
RM1,000,000 to RM4,999,999	(46)	4,156	0.14
RM5,000,000 or more	(44)	5,909	0.04
Overall External Costs	(175)	3,786	0.08 [c]

[a] The number of respondents is given in parentheses.
[b] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[c] The denominator used for the overall SME turnover category is RM5 million. See also Table 5.32.

Finally, a similar regressive pattern towards smaller SMEs is also evident for additional costs percentage, as shown in Table 5.35. Overall, as expected, compliance costs as a percentage of turnover, either measured by overall costs, internal costs, external costs or additional costs, shared one major similarity, which is the incidence of the fixed costs effect.

Table 5.35: Mean Additional Costs as Percentage of Turnover, 2006

Turnover Level [a, b]		Additional Costs	
		Mean (RM)	Percentage of Turnover
Less than RM250,000	(37)	996	0.800
RM250,000 to RM999,999	(48)	391	0.060
RM1,000,000 to RM4,999,999	(46)	436	0.014
RM5,000,000 or more	(44)	850	0.006
Overall Additional Costs	(175)	646	0.013 [c]

[a] The number of respondents is given in parentheses.
[b] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[c] The denominator used for the overall SME turnover category is RM5 million. See also Table 5.32.

In terms of absolute value, only the external costs increase as the turnover level increases. The significant mean difference between turnover levels was confirmed by way of an ANOVA test (f = 8.405, p = 0.000). A further examination with a post hoc test reveals that considerable differences exist between SMEs in the first two turnover levels (up to RM1 million) and the last turnover levels (at least RM5 million). On the other hand, both the internal and additional costs are found to be similar, regardless of the turnover levels. Though a direct comparison indicates a possible U-shaped trend, the ANOVA tests suggest no statistical mean differences among turnover levels to both internal costs (f = 0.591, p = 0.622) and additional costs (f = 1.661, p = 0.177) respectively. Analysis with regards to overall compliance costs was discussed earlier.[131]

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[131] See previous subsection 5.7.2.

5.7.4　Compliance Costs Analysis by Internal-External Ratio

The internal-external compliance costs ratio is computed by dividing the means of internal and external costs respectively to derive an overall mean for compliance costs. The approach adapted was similar to that used in earlier studies (Pope, Fayle and Chen 1994; Ariff, Ismail and Loh 1997; Hanefah, Ariff and Kasipillai 2001). For analysis purposes, as in all previous studies, additional costs are considered to be incurred internally. In Malaysia, broadly, additional costs are incurred mainly within the company and to some extent by the external professional. The current study did not attempt to measure this specifically as it is too demanding to obtain such detailed information via a survey.

Overall, the internal and external component of compliance costs is 59 and 41 percent respectively, suggesting relatively more tax compliance activities were conducted internally. It is useful to scrutinize the internal-external costs ratio by turnover and other key SME profiles. The internal-external compliance costs ratio analysed by turnover level, as shown in Table 5.36, indicates that the internal costs (external costs) ratio is decreasing (increasing) as the turnover level increases. The internal costs ratio of SMEs in the lowest turnover level (less than RM250,000) is six, 13 and 18 percent higher than the second, third and the highest turnover levels respectively, or 11 percent higher than the overall internal costs ratio of 59 percent. An ANOVA test reveals that the mean differences are significant at the five percent significant level (f = 2.715, p = 0.022). The findings suggest that the smaller the SMEs, the higher their internal costs ratio and the lower the external costs respectively, suggesting a considerable reliance on the internal costs component.

Table 5.36: Mean Internal-External Costs Ratio by Turnover, 2006

Turnover Level [a]		Sources of Costs (%)	
		Internal Costs [b]	External Costs
Less than RM250,000	(37)	70	30
RM250,000 to RM999,999	(48)	64	36
RM1,000,000 to RM4,999,999	(46)	57	43
RM5,000,000 or more	(44)	52	48
Overall	(175)	59	41

[a] The number of respondents is given in parentheses.
[b] Inclusive of additional non-staff costs. See Tables 5.33 and 5.35 for the separate details.

A similar trend is also evident in terms of the alternative size measures, as shown in Table 5.37. The internal-external ratio differences among alternative size measures are relatively small compared to the ratio by the turnover level. The smallest SMEs measured by turnover level indicate an internal-external ratio of 70:30 (Table 5.36), compared to 65:35 and 67:33 in terms of employment size and the NSDC size measures respectively (Table 5.37). Nonetheless, regardless of the size measures, the association between size of the SME and their internal-external costs ratio is clear.

Table 5.37: Mean Internal-External Costs Ratio, 2006 (by Alternative Size Measures)

Size Measure [a]		Sources of Costs (%)	
		Internal Costs [b]	External Costs
Staff level			
4 or less	(35)	65	35
5 to 19	(85)	61	39
20 to 50	(40)	57	43
51 to 150	(14)	47	53
SME by NSDC size			
Micro	(54)	67	33
Small	(98)	60	40
Medium	(23)	44	56
Overall	(175)	59	41

[a] The number of respondents is given in parentheses.
[b] Inclusive of additional non-staff costs. See Tables 5.33 and 5.35 for the separate details.

As for business length, Table 5.38 indicates that SMEs that have been in business for less than five years have relatively higher internal reliance, expressed as a percentage of compliance costs, compared to SMEs that have been in business for more than five years. However, it must be emphasised that, in absolute terms,[132] both internal and external cost components of newer SMEs are low compared to older firms.

Table 5.38: Mean Internal-External Costs Ratio by Business Length, 2006

Years in Business [a]		Sources of Costs (%)	
		Internal Costs [b]	External Costs
Less than 5 years	(38)	64	36
More than 5 years	(137)	58	42
Overall	(175)	59	41

[a] The number of respondents is given in parentheses.
[b] Inclusive of additional non-staff costs. See Tables 5.33 and 5.35 for the separate details.

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[132] See Table 5.30.

As for the business sector, the construction sector has a relatively high internal reliance of 65 percent compared to other sectors, as shown in Table 5.39. This is perhaps due to differences in the accounting practices, in particular income recognition-related, that have led the construction sector to rely more on their internal sources compared to other sectors. On the other hand, services and manufacturing-related services have as much as a nine percent higher external costs ratio compared to the construction sector. The result is not surprising as a large majority of SMEs in the manufacturing-related services (94 percent) and services sector (68 percent) have been in business for more than five years. This finding is supported by a Pearson Chi square test at 10 percent significant level (p = 0.067). A relatively higher external ratio is as expected as the costs breakdown analysis by business length (Table 5.38) indicates this tendency. Nonetheless, this general finding must be interpreted cautiously because of the low response number in the construction sector.

Table 5.39: Mean Internal-External Costs Ratio by Business Sector, 2006

		Sources of Costs (%)	
Turnover Level [a, b]		**Internal Costs** [b]	**External Costs**
Manufacturing	(37)	62	38
MRS	(32)	56	44
Services	(77)	56	44
Construction	(27)	65	35
Overall	(173)	59	41

[a] The number of respondents is given in parentheses. The 'other' sector has two respondents, and thus is excluded.
[b] Inclusive of additional non-staff costs. See Tables 5.33 and 5.35 for the separate details.

In terms of tax liability, Table 5.40 shows that the internal-external costs ratio for SMEs without tax liability is at a 10 percent margin compared to an overall ratio of 59:41. It is apparent that the higher the tax liability, the lower (higher) are their internal (external) costs ratio.

Table 5.40: Mean Internal-External Costs Ratio by Estimated Tax, 2006

Turnover Level [a]		Sources of Costs (%)	
		Internal Costs [b]	External Costs
No tax	(42)	69	31
RM1 to RM99,999	(102)	58	42
RM100,000 or more [c]	(28)	54	46
Overall	(172)	59	41

[a] The number of respondents is given in parentheses. Three respondents did not indicate their tax level.
[b] Inclusive of additional non-staff costs. See Tables 5.33 and 5.35 for the separate details.
[c] This is a merged category. For details refer Table 5.12.

5.7.5 Compliance Costs Analysis by Computational-Planning Ratio

This section analyses compliance costs by its nature, either computational or planning. Computational costs are mostly routine, calculative, and centred on a yearly basis. In contrast, planning costs relate to additional efforts taken by taxpayers to legally minimise their tax liability, particularly in the longer run. The respondents were requested to estimate their approximate percentage of income tax computational and planning work for both internal and external components.

The overall breakdowns of computational and planning costs were 76 percent and 24 percent respectively. The approach adapted in this study was similar to that used in Pope, Fayle and Chen (1994) and Hanefah, Ariff and Kasipillai (2001), except the percentile was requested for the overall internal and external components. Interestingly, a similar breakdown was recorded for both internal and external tax work. Nonetheless, differences exist at the SME level as the nature of tax work conducted internally and externally may differ substantially. Accordingly, using the breakdown given by the respondents, it is possible to calculate computational and planning costs for internal and external costs separately. These figures were then used to derive computational and planning percentages respectively. The computational-planning costs ratio was analysed by turnover levels and other key SMEs profile.

The computational-planning costs ratio, analysed by turnover level, is shown in Table 5.41. The computational (planning) costs range between 69 percent (31 percent) and 76 percent (24 percent) of the compliance costs of SMEs. Overall, the computational-planning costs ratio is about the same regardless of the turnover levels. An exception is observed for the SMEs with a turnover level of less than RM250,000. However, the fact that this turnover level has only 23 responses must be treated with some caution.

Table 5.41: Mean Computational-Planning Costs Ratio by Turnover, 2006

Turnover Level [a]		Types of Costs			
		Computational		Planning	
		RM	Percent	RM	Percent
Less than RM250,000	(23)	5,941	69	2,684	31
RM250,000 to RM999,999	(37)	5,302	75	1,769	25
RM1,000,000 to RM4,999,999	(40)	7,666	75	2,496	25
RM5,000,000 or more [b]	(44)	9,638	76	3,074	24
Overall	(134)	7,217	74	2,474	26

[a] The number of respondents is given in parentheses. Forty-one respondents did not indicate their estimated percentage for at least one of their computational or planning costs.
[b] This is a merged category. For details refer Table 5.9.

Computational-planning costs ratio, analysed by staff number and the NSDC definition (Table 5.42), indicate a slight increase (decrease) in the computational (planning) ratio as the size becomes larger, particularly over the smallest SMEs. Some caution is necessary in interpreting this overall trend as a few categories, particularly the highest level, have less than 30 responses.

Table 5.42: Mean Computational-Planning Costs Ratio by Other Size Measures, 2006

Size Measure [a]		Types of Costs			
		Computational		Planning	
		RM	Percent	RM	Percent
Staff level [b]					
4 or less	(21)	5,005	71	2,011	29
5 to 19	(65)	6,668	74	2,302	26
20 to 50	(33)	9,110	77	2,731	23
51 to 150	(14)	8,195	75	2,742	25
SME by NSDC size					
Micro	(32)	5,395	69	2,382	31
Small	(80)	7,586	76	2,425	24
Medium	(22)	8,528	75	2,787	25
Overall	(134)	7,217	74	2,474	26

[a] The number of respondents is given in parentheses. Forty-one respondents did not indicate their estimated percentage for at least one of their computational or planning costs.
[b] One respondent with more than 151 staff was excluded.

By business sector (Table 5.43), the services sector has the highest computational cost breakdown (79 percent) and the ratio was significantly different from other sectors (between 71 and 74 percent).[133] This partly could be explained by the business length. It was found that almost one-third of the respondents in the services sector were less than five years old.[134] On the other hand, manufacturing and construction sectors have as much as an eight percent higher planning costs ratio compared to the services sector. Similar to findings with regards to internal-external costs ratio, income recognition policy may have led the construction sector to focus more on tax planning aspects compared to other sectors. As for the manufacturing sector, a large number of respondents (86 percent) have been in business for more than five years. It is likely that older businesses might pay more attention to tax planning aspects rather than to the

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[133] Supported by ANOVA test at the five percent significant level (f = 2.646, p = 0.036).
[134] Chi-square was significant at 10 percent level (p = 0.067).

usual tax computation issues. For example, a careful consideration is certainly needed pertaining to any tax incentive, unutilised capital allowances and/or business losses during the previous year(s).

Table 5.43: Mean Computational-Planning Costs Ratio by Sector, 2006

Business Sector [a]		Types of Costs			
		Computational		Planning	
		RM	Percent	RM	Percent
Manufacturing	(26)	7,894	71	3,238	29
MRS	(24)	8,423	74	2,974	26
Services	(62)	6,326	79	1,666	21
Construction	(21)	7,734	71	3,217	29
Overall	(133)	7,217	74	2,474	26

[a] The number of respondents is given in parentheses. Forty-one respondents did not indicate their estimated percentage for at least one of their computational or planning costs. Additionally, two respondents from the 'other sector' are excluded.

Regardless of their length in business, SMEs are found to have a similar computational-planning costs ratio (Table 5.44). A statistical t-test confirms this pattern being at the five percent significant level.

Table 5.44: Mean Computational-Planning Costs Ratio by Business Length, 2006

Years in Business [a]		Types of Costs			
		Computational		Planning	
		RM	Percent	RM	Percent
Less than 5 years	(28)	5,925	75	1,972	25
More than 5 years	(106)	7,559	74	2,607	26
Overall	(134)	7,217	74	2,474	26

[a] The number of respondents is given in parentheses. Forty-one respondents did not indicate their estimated percentage for at least one of their computational or planning costs.

As for tax liability, Table 5.45 shows that the cost percentages are similar for SMEs who are either in the tax level of up to RM100,000 or do not have a tax obligation. On the other hand, SMEs who are in the combined tax level of more than RM100,000 have a relatively higher computational costs ratio. The findings suggest that the computational ratio is relatively higher as the tax level increases.

Table 5.45: Mean Computational-Planning Costs Ratio by Estimated Tax, 2006

Estimated Tax [a]		Types of Costs			
		Computational		**Planning**	
		RM	Percent	RM	Percent
No tax	(27)	5,752	72	2,199	28
RM1 to RM99,999	(79)	6,617	73	2,425	27
RM100,000 or more [b]	(26)	10,651	79	2,821	21
Overall	(132)	7,235	75	2,457	25

[a] The number of respondents is given in parentheses. Forty-one respondents did not indicate their estimated percentage for at least one of their computational or planning costs. Additionally, two respondents failed to indicate their estimated tax level.
[b] This is a merged category. For details refer Table 5.12.

To sum up, it is apparent that the high level of compliance costs is associated with computational components and the remaining are planning-related. The highest percentage of computational cost (79 percent) is for SMEs in the services sector and for SMEs with an estimated tax liability of more than RM100,000. The differences between services and non-services sectors are evident statistically at the five percent level (p = 0.036). By contrast, micro SMEs (69 percent) have the lowest computational costs ratio.

5.8 POSSIBLE COMPENSATION AND COMPLIANCE COSTS

The respondents were asked to estimate the possible amount of compensation that they would claim from the government for the time and money spent by their company in complying with tax laws (Appendix F, question 18) in order to check the consistency of the tax compliance costs estimation. One hundred and six respondents (out of 175) provided an answer to this question. A detailed check revealed that missing items were prevalent among smaller companies, in particular 28 percent in the turnover level of less than RM250,000, followed by 25 percent in the RM250,000 to RM1 million category.

The average compensation amount that would be claimed by SMEs is RM7,334, as shown in Table 5.46. Specifically, the possible compensation ranges from as low as RM100 to as high as RM20,000.

Table 5.46: Possible Compensation Amount, 2006

	Mean	Minimum	Maximum	Standard Deviation
Compensation (RM)	7,334	100	20,000	6,849

Number of respondents equals 106. Sixty-nine respondents did not indicate their expectation level.

The findings show that the average compensation amount of RM7,334 is 21 percent lower than the average compliance costs estimate of RM9,295 in the current study, suggesting lower compensation expectations. However, it must be acknowledged that the difference could be due to differences in the response number (106 compared to 175 in compliance costs estimates). Compliance costs for the 106 cases gave a re-estimate of RM9,545, which is just 2.6 percent higher than the average compliance costs estimate (RM9,295). Thus, it is appropriate to assume that the compliance costs estimation for this study is reasonable, which adds reliability to current estimates overall.[135]

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[135] See also Section 5.11.

Table 5.47: Compensation by Turnover Levels and as Percentage of Turnover, 2006

Turnover Levels [a, b]		Compensation	
		Mean (RM)	**Percentage of Turnover**
Less than RM250,000	(18)	3,572	2.86
RM250,000 to RM999,999	(31)	6,000	0.96
RM1,000,000 to RM4,999,999	(30)	7,150	0.24
RM5,000,000 or more [c]	(27)	11,577	0.08
Overall	(106)	7,334	0.15 [d]

[a] The number of respondents is given in parentheses. See also table note 5.46.
[b] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[c] This is a merged category. For details refer Table 5.9.
[d] The denominator used for the overall SME turnover category is RM5 million. See also Table 5.32.

A similar compensation trend is evident also in terms of turnover levels, as shown in Table 5.47. It appears that the amount of possible monetary compensation increases as the turnover levels increase. However, expressed as a percentage of turnover, the possible claim is higher for smaller SMEs, which provides evidence of the regressivity of compliance costs. These findings are similar to the tax compliance costs estimate (see Table 5.32). Similar findings, both in terms of the magnitude and regressivity of expected compensation, were also reported by Rametse (2006) for start-up GST compliance costs in an Australian context.

5.9   AGGREGATE GROSS COMPLIANCE COSTS ESTIMATES

In estimating aggregate gross compliance costs, the established practice in compliance costs studies is to use the mean compliance costs (derived from sample) to the revenue population data (Sandford, Godwin and Hardwick 1989; Sandford and Hasseldine 1992; Pope, Fayle and Chen 1994). To ensure that the estimate reflects the population as a whole, multiplication is carried out for each category of the taxpaying population to arrive at an overall weighted aggregate cost. A number of measures have been used in

categorising the business taxpaying population, and include taxable turnover (Sandford, Godwin and Hardwick 1989), turnover (Sandford and Hasseldine 1992), annual tax remittance (Pope, Fayle and Chen 1994), and gross income category by business size and legal form (Evans *et al.* 1997). In the case of data unavailability, researchers normally make assumptions about and/or adjustments to taxpaying population based on the best available data. For example, Sandford, Godwin and Hardwick (1989, p. 138) and Sandford and Hasseldine (1992, p. 85) adjusted the available GST population to arrive at the business income tax and corporation tax population respectively. Having succinctly discussed the practice of estimating aggregate compliance costs, the following paragraph highlights the approach adopted in the current study.

In 2005, there were 116,650 or 21.3 percent SME companies in Malaysia (Department of Statistics Malaysia 2007). Thereafter, no updates are available, including those of the total number of SMEs in Malaysia. Even the recent 2007 SME annual report, published by the NSDC (2008), referred to the earlier 2005 figure. Due to data availability, the current study assumes that the number of SME companies in 2005 and 2006 are the same.[136] It is recognised that there is a possibility that both new companies and deceased (or insolvent) companies would affect the total number of SME companies. However, it is less likely there will be significant changes in just one year. Thus, for the purpose of estimation, the figure of 116,650 companies is assumed as the total population.

Having established a population figure for SME companies in 2006, it is crucial to have the appropriate percentage of SME companies by any size measure. Unfortunately, such details are not available. The IRB, through their annual report, only provide monetary data in terms of tax revenue by types of taxes. Thus, further distinction in terms of company size is not achievable. The researcher is left with the assumption that all 116,650 SME companies are a single category.[137] Following this assumption, the

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[136] Malaysia's economy growth rate, as measured by the Gross Domestic Product (GDP) change, in 2005 and 2006 was 5.2 and 5.8 percent respectively (Treasury of Malaysia 2006).
[137] Another alternative is to use the sample proportion of business size (as shown earlier in Table 5.9). However, this possibility is not considered further, because the extent to which the sample proportion

aggregate compliance costs of SME companies in Malaysia is estimated at RM1,084 million for the tax year 2006. The computation is made as follows:

Aggregate compliance costs

= Mean compliance costs x number of SME companies

= RM9,295   x   116,650

= RM1,084,261,750   Equation 5.1

5.10   ESTIMATION OF OFFSETTING BENEFITS

The tax compliance costs literature recognises three compliance benefits as offsets to compliance costs: cash flow benefits, managerial benefits, and tax deductibility. As discussed in Chapter Four,[138] managerial benefits do exist, but do not add benefits to the corporate sector. Thus, in the context of SME companies, the value of cash flow benefits and tax deductibility are relevant. Unfortunately, due to data availability, the current study was not able to determine the value of cash flow benefits.[139] As a result, the current study only estimates the value of tax deductibility. The estimates of tax deductibility are presented below.

Benefits arising from tax deductibility have been recognised as early as in 1963 (Johnston 1963), but only a few prior studies (Allers 1994, pp. 38-40; Evans *et al.* 1997; Tran-Nam and Glover 2002b), and more recently Rametse (2006), have estimated the value of tax deductibility, which is normally estimated following a few assumptions. For example, Evans *et al.* (1997) assumed that taxable businesses would have full benefits of tax deductibility, while non-taxable businesses would only benefit from 50 percent of the amount. Rametse (2006), on the other hand, has used a slightly modified approach, similar to Tran-Nam (2000), by estimating a tax deductibility value to the

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represents the population distribution (by turnover level) is not known and could not be checked due to data limitations.
[138] See subsection 4.4.2.
[139] See subsection 4.4.2.

monetary compliance costs only (i.e. by excluding internal time cost). The modification is made due to the non-taxability of some GST traders, such as non-profit organisations, government departments, and universities.

The Rametse approach is not considered in the current estimates, as the approach is possibly more relevant in the context of GST. Further, the current study focuses on the corporate sector, which is legally taxable. Therefore, Evans *et al.*'s approach is considered more relevant to this study. The Evans *et al.* (1997, p. 31) approach, in a mathematical form, reads as follows:

Value of tax deductibility benefits	=	[0.5 (1 + p) t] CC		
Where:	p	=	percentage of taxable business	
	t	=	Average marginal tax rate	
	CC	=	Aggregate compliance Costs	Equation 5.2

The Evans *et al.* approach (the aggregate approach) in the current Malaysian study is applied at the firm or disaggregate level[140] by multiplying firm compliance costs by a marginal tax rate of 20 percent for taxable SMEs or 10 percent (i.e. half of the benefits) for non-taxable SMEs. The taxability of SMEs is determined based on their estimates of tax liability.[141] Following this approach (the firm approach), the value of tax deductibility ranges between RM61 and RM7,555, with an average of RM1,677 per SME, as shown in Table 5.48.

Table 5.48: Average Value of Tax Deductibility, 2006

	Mean	Minimum	Maximum	Standard Deviation
Tax Deductibility (RM)	1,677	61	7,555	1,446

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[140] Evans *et al.* (1997) computed the value of tax deductibility at the aggregate level.
[141] See Table 5.12.

The aggregate tax deductibility benefits for Malaysian SME companies in 2006 are estimated at RM196 million, which is derived as follows:

Aggregate value of tax deductibility
$$=\quad \text{Mean value of tax deductibility} \quad \text{x} \quad \text{number of SME companies}$$
$$=\quad \text{RM1,677} \quad \text{x} \quad 116,650$$
$$=\quad \text{RM195,622,050} \hspace{4cm} \text{Equation 5.3}$$

Alternatively, following the aggregate approach, the value of tax deductibility would be RM190 million, derived as follows:

Aggregate value of tax deductibility
$$=\quad [0.5\,(1 + p)\,t]\,CC$$
$$=\quad [0.5\,(1 + 0.756)\,0.20]\,\text{RM1,084,261,750}$$
$$=\quad \text{RM190,396,363} \hspace{4cm} \text{Equation 5.4}$$

In applying the aggregate approach in the Malaysian context, two assumptions are made. First, the percentage of taxable SMEs is assumed to be 75.6 percent. Due to a lack of official data on taxable SMEs in Malaysia, this percentage is taken from the current survey.[142] Secondly, the average marginal corporate tax rate is assumed to be 20 percent.[143]

By comparison, the value of tax deductibility derived from the firm approach (RM196 million) is relatively higher than the value determined by employing the aggregate

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[142] Refer Table 5.12.

[143] As presented in Table 5.12, 102 (or 78.5 percent) of taxable SMEs (130) are subject to a tax rate of 20 percent. While the remaining 21.5 percent, in addition to a tax of 20 percent for their first RM500,000 of taxable income, are also subject to a normal corporate tax rate of 28 percent (in 2006) for any amount exceeding RM500,000. If this average rate is used, then a weighted average tax rate would be 21.72 percent (i.e. [78.5 (20) + 21.5 (28)] percent). If this marginal alternative tax rate is used, the value of tax deductibility following the aggregate approach would be RM206.78 million (or around 8.6 percent higher than RM190.4 million).

approach (RM190 million). The small difference of around 2.7 percent is technically not surprising due to the slight measurement difference. As a measure of consistency, a similar approach is adopted in estimating aggregate compliance costs of SME companies (i.e. firm approach),[144] so the value of tax deductibility is estimated at RM195.62 million. Specifically, these estimates are multiplied by the average dollar value/costs to the SME population number.

5.11   NET AGGREGATE COMPLIANCE COSTS ESTIMATES

The net corporate tax compliance costs for the tax year 2006, both at the company and aggregate level, is estimated at RM7,618 and RM889 million respectively, as shown in Table 5.49. Specifically, the tax deductibility benefits for Malaysian SME companies comprised around 18 percent of total compliance costs in 2006. At the SME level, it is apparent that the net compliance costs of RM7,618 is similar to the possible compensation amount of RM7,334,[145] which adds consistency to the overall estimates of the current study. As discussed earlier,[146] it must be emphasised that these estimates do not take into account the possible cash flow benefits for SME companies due to data availability and the insignificance of the amount.

Table 5.49: Estimated Compliance Costs of SME Companies, 2006

	Per SME (RM)	Aggregate (RM million)
Gross Compliance Costs	9,295	1,084.3
(-) Tax Deductibility	1,677	195.6
Net Compliance Costs	7,618	888.7

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[144] See Section 5.9.
[145] See Table 5.46.
[146] See Section 5.10. See also Chapter Four, subsection 4.4.2.

5.12 THE WEB SURVEY

5.12.1 Overall Responses and Business Profile

A total of 75 useable questionnaires were returned, which represents an extremely low response rate of around two percent of the net sampling frame. Relevant details of the sampling frame and responses are presented in Appendix N, Table N.1. This subsection highlights the key profile of the responding SMEs in the web survey. Also highlighted are the tax-related difficulties faced by the SMEs and their reason for engaging tax professionals. Details of these responses are summarised in Appendix N, Tables N.2 to N.6.

For the general business profile (Table N.3), two-thirds of the SMEs end their business on 31 December, followed by 12 percent on 30 June. The most frequently stated sector is service (54 percent), followed by manufacturing (20 percent) and manufacturing-related (18 percent). The vast majority of respondents have been in business for more than five years (64 percent), or at least for two years (22 percent). Almost 78 percent of the responding companies carried out income tax work both internally and externally. As for business size (Table N.4), almost half and one-third of the respondents are in the category of between 'five and 19' and 'four or less' categories of employees respectively. A large majority of the responding sample (87 percent) estimated their 2006 tax liability as either none (30 percent) or up to RM100,000 (57 percent).

The most highly ranked tax difficulty area is 'estimating income tax payable' (19 percent), with 70 percent of the SMEs indicating they have problems pertaining to estimating their income tax payable, as shown in Table N.5, Appendix N. Difficulties with regard to cash flow (17 percent) is ranked second, followed by 'increasing burden of record keeping requirements for tax purpose' (13 percent), and 'maintaining tax records' (12 percent). The least ranked difficult aspects are 'dealing with the tax authority', 'deadlines for submitting tax return', and 'dealing with tax professionals'. Finally, the main reason for SMEs employing tax professionals (Table N.6) is the lack

of technical knowledge internally (30 percent), followed by the cost-effective factor (27 percent) and tax complexity (21 percent).

5.12.2 Compliance Costs Estimates

The average compliance costs of SME companies for the web survey, estimated by a similar approach to the mail survey,[147] amounted to RM9,282. A summary of the detailed costs component and their corresponding lowest, highest, and standard deviation is shown in Table 5.50. The average internal costs are estimated at RM6,194, with a minimum and maximum cost of RM87 and nearly RM40,000 respectively. Refer to Appendix N for a summary of yearly internal time spent on tax activities (Table N.7) and their corresponding average wage rates (Table N.8) respectively. The average external costs amount to almost RM2,800. The lowest external costs in the sample are RM200, and the highest fees are RM10,000. As for additional non-staff costs, the average costs are just over RM300, ranging between RM200 and RM5,000.

Table 5.50: Compliance Cost Estimation by Components, 2006 (Web Survey)

Costs Type	Mean	Minimum	Maximum	Standard Deviation
	RM	RM [a]	RM	RM
Internal	6,194	87	39,693	8,016
External	2,784	200	10,000	2,545
Additional Non-staff	304	200	5,000	768
Overall	9,282	455	46,846	9,193

[a] Excluding SMEs with no components of internal, external and additional costs respectively.

In terms of the costs component, the highest components consist of internal costs of 70 percent, inclusive of additional non-staff costs, and the remaining 30 percent are external costs. As for their cost nature, the computational and planning costs are 75 and 25 percent respectively. The detailed analyses of compliance costs by business characteristics, both in terms of sources (i.e. internal-external) and nature (i.e. computational-planning), are not considered in more detail due to the low number of

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[147] See Section 5.7.1.

responses (see Appendix N, Tables N.3 and N.4). A summary of mean compliance costs analysed by business characteristics at the overall level, cost sources and cost types, is presented in Table N.9, Appendix N.

5.12.3 Compliance Costs Distribution

Tax compliance costs, as a percentage of turnover, decreased significantly from 4.3 percent to only 0.1 percent as the turnover level increases (Table 5.51). This implies the incidence of a fixed costs effect on the smaller SMEs. However, caution needs to be taken as the number of responses to each turnover level is less than 30. For the overall SME category, the compliance costs are estimated at 0.19 percent of the weighted turnover level.

Table 5.51: Compliance Costs as Percentage of Turnover, 2006 (Web Survey)

Turnover Level [a, b]		Compliance Costs	
		Mean (RM)	**Percentage of Turnover**
Less than RM250,000	(19)	5,398	4.32
RM250,000 to RM999,999	(21)	9,629	1.54
RM1,000,000 to RM4,999,999	(24)	9,531	0.32
RM5,000,000 and more	(11)	14,780	0.10
Overall Compliance Costs	(75)	9,282	0.19 [c]

[a] The number of respondents is given in parentheses.
[b] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[c] The denominator used for the overall SME turnover category is RM5 million. See also Table 5.32.

Similar findings are also observed for all three components of compliance costs, as shown in Table 5.52.

Table 5.52: Costs Component as Percentage of Turnover, 2006 (Web Survey)

Turnover Level [a]	Costs Component As a Percentage of Turnover		
	Internal	**External**	**Additional**
Less than RM250,000	2.72	1.34	0.26
RM250,000 to RM999,999	1.08	0.41	0.04
RM1,000,000 to RM4,999,999	0.21	0.11	0.005
RM5,000,000 or more	0.07	0.03	0.005
Overall [b]	0.12	0.06	0.01

[a] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[b] The denominator used for the overall SME turnover category is RM5 million. See also Table 5.32.

5.12.4 Possible Compensation and Compliance Costs

The average compensation amount that could be claimed by SMEs in the web sample is RM7,042 (Table 5.53). The amount of possible compensation increases as the turnover levels increase, but the difference is statistically not significant. Further, the amount of expected compensation is around 24 percent less than the overall compliance cost estimates of RM9,282 for the web survey. A similar trend is reported by Rametse (2006, p. 143) in the Australian GST start-up costs context.

Table 5.53: Compensation by Turnover Levels and as Percentage of Turnover, 2006 (Web Survey)

Turnover Levels [a, b]		Compensation	
		Mean (RM)	**Percentage of Turnover**
Less than RM250,000	(15)	2,936	2.35
RM250,000 to RM999,999	(16)	6,981	1.12
RM1,000,000 to RM4,999,999	(16)	8,906	0.30
RM5,000,000 or more	(7)	11,714	0.08
Overall	(54)	7,042	0.14 [c]

[a] The number of respondents is given in parentheses. There were 21 missing cases.
[b] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.
[c] The denominator used for the overall SME turnover category is RM5 million. See also Table 5.32.

A comparative analysis between compliance costs (Table 5.51) and compensation amounts (Table 5.53), by the turnover levels, indicates that SMEs in all four turnover levels expected lower compensation. The highest difference is observed for the SME in the turnover level of less than RM250,000. The expected compensation of RM2,936 is around 46 percent lower than their compliance costs estimates of RM5,398. Though the findings indicate a considerable difference between compliance costs estimates and the expected compensation, the presence of a fixed cost effect is evident in terms of percentage of turnover. The usual limitation applies as a response to each turnover level being less than 30.

5.12.5 Tax Deductibility and Aggregate Compliance Costs

The value of tax deductibility for the web survey is estimated at RM1,637 per SME company (Table 5.54). More specifically, the amount is estimated as being as low as RM80 to as high as RM9,400 per company.

Table 5.54: Average Value of Tax Deductibility, 2006 (Web Survey)

	Mean	**Minimum**	**Maximum**	**Standard Deviation**
Tax Deductibility (RM)	1,637	80	9,369	1,740

Following a similar approach to the primary survey,[148] the gross and net aggregate tax compliance costs amounted to RM1,083 million and RM892 million respectively, as shown in Table 5.55. At the firm level, the net compliance costs are estimated to be RM7,645. Overall, tax deductibility covers around 18 percent of gross tax compliance costs of SME companies.

Table 5.55: Compliance Costs Estimates, 2006 (Web Survey)

	Per SME (RM)	**Aggregate (RM million)**
Gross Compliance Costs	9,282	1,082.7
(-) Tax Deductibility	1,637	191,0
Net Compliance Costs	7,645	891.7

5.13   CHAPTER SUMMARY

This chapter has presented an analysis of the response and compliance costs estimates for the main postal survey questionnaire. The estimated average income tax compliance costs for the tax year 2006 are almost RM9,300 per SME company. Fifty two percent of the average compliance costs are internal time costs, forty one percent tax fees paid to external professionals, and additional costs (non-staff) accounts for seven percent. Computational and planning costs ratios account for 74 and 26 percent of all costs respectively. The usual regressive nature of compliance costs for Malaysian SMEs has been confirmed. As for the offsetting benefits, the value of tax deductibility is estimated to be almost RM1,700 per SME company. At the aggregate level, the compliance costs of SME companies in Malaysia are estimated to be RM1,084 million for the tax year 2006. The estimated total value of tax deductibility amounts to RM196 million, representing approximately 18 percent of the gross compliance costs. Overall, SME companies incurred net aggregate compliance costs of RM888 million in 2006. Analysis

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[148] See Sections 5.9 to 5.11.

of a separate web survey confirms the reliability of the estimates made in the main postal survey. A further comparative analysis is made in Chapter Seven.

CHAPTER SIX

TAX ATTITUDES AND COMPLIANCE BEHAVIOUR
OF SMALL AND MEDIUM ENTERPRISES

6.1   INTRODUCTION

This section mainly draws on Sections C and D of the survey questionnaire. Additionally, compliance costs estimates (derived from Section B of the questionnaire)[149] are used in measuring the association between compliance costs and both tax attitudes and the likely tax behaviour. Tax attitudes and behaviour of corporate SMEs are measured from a business managerial or respondent perspective. Similar to the previous chapter, the primary analysis of this chapter is obtained from the postal survey. Additionally, findings from both the SME web survey and the tax professionals' postal survey are presented.

6.2   TAX ATTITUDES OF SMALL AND MEDIUM ENTERPRISES

6.2.1   Assessment of Reliability and Validity

As presented in Chapter Four,[150] respondents were asked to state their perceptions towards 15 tax attitudinal statements. All these statements are grouped into six aspects: tax complexity, tax rate structure, tax law fairness, relationship with IRB officials, probability of a tax audit, and incentives to SMEs. As the measurements of tax complexity, tax rate structure and tax law fairness involved more than one item for each aspect, both a reliability and validity test was performed.

The measurements used in this study are considered reliable and consistent as the alpha coefficients were above the acceptable value of 0.7 (Nunnally 1978; Hair *et al.* 1998; Sekaran 2003), as shown in Table 6.1.

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[149] See Chapter Five, Section 5.7.
[150] See Chapter Four, Section 4.5. See also Table 4.4.

Table 6.1: Reliability Coefficient of Tax Attitudinal Aspects

Tax Aspects	Number of Items	Alpha Coefficients
Complexity [a]	3	0.725
Fairness	5	0.717
Rate	3	0.702
IRB Relationship	1	-
Audit	1	-
Incentives	1	-

[a] One item was taken out to get an acceptable alpha coefficient.

As for validity, the views of both tax professionals and tax academics were considered in the questionnaire design.[151] For tax attitudinal aspects with more than one item, a factor analysis confirmed that all items measure perceptions towards tax complexity, tax fairness and the tax rate respectively. The SPSS output on the rotated component matrix is shown in Appendix Q.

All tax attitudinal items were measured using a five-point Likert scale.[152] However, for analysis purposes, SMEs who responded 'strongly disagree' and 'disagree' were grouped as a single category. Similar treatment applies for SMEs who indicated 'strongly agree' and 'agree'. The 'neutral' responses remained as indifferent. The re-coding is necessary so as to address low responses in either the 'strongly agree' or 'strongly disagree' category. A number of previous studies both internationally (see for example Webley, Cole and Eidjar 2001; Torgler 2007) and in Malaysia (see Hanefah 1996; Kasipillai *et al.* 1999; Abdul-Manaf 2004) have adopted this approach. Additionally, a mean score analysis is also used in analysing each attitudinal aspect. Findings on all six attitudinal aspects of corporate income tax are presented next. For tax complexity, tax fairness and the tax rate structure, findings are presented both for each statement and overall aspects, respectively. All 15 tax attitudinal statements and their respective variable name used throughout the thesis are shown in Table 6.2.

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[151] See Chapter Four, Section 4.6.
[152] See Chapter Four, Section 4.5.

Table 6.2: Tax Attitudinal Statements

Wording of the Statements	Variable Name
Personally I consider corporate Income Tax return preparations difficult.	Comp 1
Corporate Income Tax law is relatively simple.	Comp 2
Complexity in the Income Tax law is necessary so that companies are treated fairly.	Comp 3
Corporate Income Tax is so complicated that only people who can afford to pay tax professionals can take advantage of most legal ways to save much taxes.	Comp 4
I believe that each company's officers have a moral obligation to report all of their company's income and pay the correct amount of Corporate Income Tax.	Fair 1
Do you believe that the move to self-assessment system made the corporate tax laws more or less fair?	Fair 2
Overall, has the move to the self-assessment system made the distribution of the Corporate Income Tax burden among small, medium and large companies more or less fair?	Fair 3
Do you believe that as a result of changes in the Corporate Income Tax during the past five years SME companies are paying more or less taxes?	Fair 4
Do you believe that as a result of changes in the Corporate Income Tax during the past five years large companies are paying more or less taxes?	Fair 5
A fair tax rate should be the same for every company, regardless of their size (small, medium, or large).	Rate 1
Large companies have greater ability to pay Income Tax, so it is fair that they should pay a higher rate of tax than small and medium companies.	Rate 2
It is fair that high-profit companies should pay a higher rate of tax than low-profit companies.	Rate 3
I believe that the relationship with the Inland Revenue Board officers has improved since the implementation of the self-assessment system.	IRB Relationship
The chances of being audited (tax audit) are so low that it is worthwhile trying to 'cut corners' a little on corporate income taxes for various reasons.	Audit
I believe that compared to large companies, more favourable tax treatments should be given to small and medium-sized companies.	Incentives

For analysis purposes, Comp 2 and Fair 4 are reverse coded.

6.2.2 Tax Complexity

This subsection presents respondents' views on corporate income tax law complexity. A summary of findings is shown in Table 6.3. The first statement relates to corporate income tax return preparation (Comp 1). Nearly 55 percent of the respondents indicated that a corporate income tax return preparation is difficult, compared to less than eight percent who indicated otherwise, while the remaining 38 percent indicated a neutral view. As for the second statement, nearly half of the respondents disagreed that corporate income tax law is relatively simple (Comp 2), another two-thirds and one-tenth indicated a neutral and in agreement view respectively. The third item claims that the complexity in the income tax law is necessary so that companies are treated fairly (Comp 3). More respondents (42 percent) regarded the complex nature of tax law as being necessary than otherwise (24 percent), and another 34 percent indicated a neutral view. For the fourth and last statement, just over 58 percent of the respondents agreed that only people who can pay for tax professionals can exploit tax benefits legally (Comp 4), followed by another 12 percent who disagreed, with another 30 percent being indifferent.

Table 6.3: Attitudes towards Corporate Income Tax Complexity

	Mean	Median	Standard Deviation	Disagree/ Strongly Disagree	Neutral	Agree/ Strongly Agree
Comp 1	3.59	4.00	0.82	13 (7.4)	66 (37.7)	96 (54.9)
Comp 2	2.51	2.0	0.80	88 (50.3)	69 (39.4)	18 (10.3)
Comp 3	3.15	3.00	0.99	42 (24.0)	60 (34.3)	73 (41.7)
Comp 4	3.60	4.00	0.91	21 (12.0)	52 (29.7)	102 (58.3)
Complexity [a]	3.56	3.67	0.68	-	-	-

Number of respondents equals 175. The percentage of responses is given in parentheses.
[a] Comp 3 was taken out to get an acceptable alpha (see Table 6.1). Comp 2 is reverse coded. The reversed mean is 3.49.

All statements, except 'Comp 3', have a mean score of between 3.49 and 3.60, which reveals a strong agreement towards the presence of tax complexity. The overall mean score for tax complexity is 3.56, which demonstrates the complex nature of corporate income tax as perceived by the respondents. Tax complexity analysed by respondents' business characteristics reveal that a significant mean difference is observed only in terms of the estimated tax levels. A relatively lower complexity level is perceived by SMEs without tax liability (3.32) compared to those who are subjected to tax (3.61).

6.2.3   Tax Fairness

Respondents' perceptions toward corporate income tax fairness is summarised in Table 6.4. To the first statement on fairness (Fair 1), a large majority of the respondents (76 percent) agreed that each company's officers have a moral obligation to report all of their company's income and pay the correct amount of corporate income tax. The second (Fair 2) and third (Fair 3) statements relate specifically to the SAS. More than half of the respondents indicated a neutral view with regards to both corporate tax laws fairness (57 percent) and corporate income tax burden among small, medium and large companies (59 percent). The last two statements (Fair 4 and 5) also relate indirectly to the SAS. The fourth statement asked respondents as to whether SME companies are paying more or less taxes (Fair 4), and the fifth statement asked a similar question in the context of large companies (Fair 5). The majority of respondents indicated a neutral view to both statements. The remaining respondents were roughly divided between respondents who agreed or disagreed.

Table 6.4: Attitudes towards Corporate Tax Fairness

	Mean	Median	Standard Deviation	Disagree/ Strongly Disagree [a]	Neutral	Agree/ Strongly Agree [a]
Fair 1	3.86	4.00	0.88	12 (6.9)	30 (17.1)	133 (76.0)
Fair 2	3.12	3.00	0.74	28 (16.0)	99 (56.6)	48 (27.4)
Fair 3	3.06	3.00	0.81	32 (18.3)	103 (58.9)	40 (22.9)
Fair 4	2.94	3.00	0.77	46 (26.4)	95 (54.6)	33 (19.0)
Fair 5	3.01	3.00	0.72	33 (19.1)	105 (60.7)	35 (20.2)
Fairness [b]	3.22	3.20	0.53	-	-	-

Number of respondents equals 175. Total responses of less than 175 are due to missing value(s). The percentage of responses is given in parentheses. Total percentage for Fair 3 is not equal to 100 due to rounding.
[a] Slightly different response category was used for Fair 2 and 3 (much less fair to much more fair) and Fair 4 and 5 (much less taxes to much more taxes) respectively.
[b] Fair 4 is reversed coded. The reversed mean equals 3.06.

The overall mean score of 3.22 indicates that the corporate tax system is perceived to be relatively fair. A further analysis in terms of all business characteristics reveals no statistical difference between the respondents.

6.2.4 Tax Rate

Respondents' views regarding fairness of the corporate tax rate were obtained on three tax rate structures: flat (Rate 1), proportional (Rate 2) and progressive (Rate 3). A summary of responses is presented in Table 6.5. Just over 45 percent agreed to a flat rate structure (Rate 1) compared to 55 percent who indicated agreement on both the proportional (Rate 2) and progressive rate (Rate 3) structures. A mean comparison indicates that the proportional (Rate 2) and progressive (Rate 3) tax rates are perceived to be fairer than a flat rate (Rate 1), which has rather a neutral view.

Table 6.5: Attitudes towards Corporate Tax Rate Structure

	Mean	Median	Standard Deviation	Disagree/ Strongly Disagree	Neutral	Agree/ Strongly Agree
Rate 1	3.13	3.00	1.16	60 (34.3)	36 (20.6)	79 (45.1)
Rate 2	3.41	4.00	1.14	42 (24.0)	37 (21.1)	96 (54.9)
Rate 3	3.48	4.00	1.05	36 (20.6)	42 (24.0)	97 (55.4)
Tax Rate	3.34	3.33	0.88	-	-	-

Number of respondents equals 175. The percentage of responses is given in parentheses.

An overall mean average of 3.34 indicates that the corporate tax rate structure is perceived to be relatively fair. Further, analysis of the mean reveals a similar perception, regardless of their specific business characteristics.

6.2.5 Other Attitudinal Aspects

In addition to the above three aspects of corporate income tax, respondents were asked for their perceptions on three other tax attitudinal aspects, namely, their relationship with IRB officials, the probability of a tax audit, and finally tax incentives to SMEs. Almost half of the respondents indicated a neutral view as to whether to their relationship with the IRB officers has improved since the introduction of the SAS, as shown in Table 6.6. Just over one-third of the respondents agreed about the improved relationship with the IRB officers and the remaining one-fifth disagreed. Overall, a mean score of 3.15 indicates a relatively better relationship with the IRB under the SAS regime.

Table 6.6: Other Tax Attitudinal Aspects

	Mean	Median	Standard Deviation	Disagree/ Strongly Disagree	Neutral	Agree/ Strongly Agree
IRB Relationship	3.15	3.00	0.90	32 (18.3)	84 (48.0)	59 (33.7)
Audit	2.75	3.00	0.98	72 (41.1)	63 (36.0)	40 (22.9)
Incentives	4.15	4.00	0.75	5 (2.9)	19 (10.9)	151 (86.3)

Number of respondents equals 175. The percentage of responses is given in parentheses. For tax incentives, the total percentage does not equal 100 due to rounding.

As for tax audits, relatively more respondents (41 percent) disagree that the probability of a tax audit is low, compared to those who demonstrate agreement (23 percent) or an indifferent view (36 percent). Broadly, a mean score of 2.75 indicates that the respondents were somewhat uncertain with regards to the probability of their company being subjected to a tax audit. Regarding tax incentives, a large majority of respondents (86 percent) believed that more favourable tax treatments should be given to SME companies. A mean score of 4.15 is the highest mean score in the current study, suggesting respondents' very strong agreement about more tax incentives to SMEs. For all three aspects, ANOVA tests fail to indicate any significant mean differences, suggesting similar perceptions regardless of their business profile.

6.3 TAX COMPLIANCE BEHAVIOUR OF SMALL AND MEDIUM ENTERPRISES

As discussed in Chapter Four,[153] two types of non-compliance behaviour, namely understatement of income and overstatement of deductions, are measured by way of both indirect and direct responses for each hypothetical scenario. Nonetheless, the direct response was primarily used in the current study.[154] Similar to tax attitudinal aspects, responses to a five-point Likert scale were simplified into three categories: those who are in agreement (strongly agree and agree), those who are in disagreement (strongly disagree and disagree), and neutral responses (remain indifferent).

Nearly 60 percent of the respondents indicated disagreement to the possible action of underreporting behaviour, as shown in Table 6.7, suggesting more compliant behaviour. Another 23 percent were indifferent. Overall, respondents were inclined towards compliance. As for overstating deductions, around 41 percent of the respondents indicated disagreement to the possible action of overstating deductions, suggesting compliant behaviour. About 29 percent were indifferent. The remaining 30 percent tended to support overstating deductions. Broadly, relatively more respondents (60 percent) were compliant towards underreporting behaviour as compared to overstatement of deductions (41 percent).

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[153] See subsection 4.4.3. See also Section 4.5
[154] See Chapter Four, Section 4.5.

Table 6.7: Respondents' Views towards Non-compliance Behaviour

	Mean	Median	Standard Deviation	Disagree/ Strongly Disagree	Neutral	Agree/ Strongly Agree
Understatement of Income	2.28	2.00	1.22	102 (59.3)	39 (22.7)	31 (18.0)
Overstatement of Deductions	2.76	3.00	1.31	71 (41.3)	50 (29.1)	51 (29.6)
Both Non-compliance [a]	2.52	2.50	1.11	-	-	-

Number of respondents equals 172. The percentage of responses is given in parentheses.
[a] This refers to the combined category of both understatement of income and overstatement of deductions.

In terms of income reporting, an overall mean score of 2.28 indicates that the respondent leans towards tax compliance. However, for overstating behaviour, an overall mean score of 2.76 indicates that the large majority of SMEs are likely to show compliant or neutral behaviour. Comparatively, compliance in terms of income reporting is better than tax deductions. The median scores of 2.00 and 3.00 for income reporting and tax deductions demonstrate this trend as well. At the firm level, a combined mean score of 2.52 for both non-compliance situations indicates likely compliance behaviour too.

Further, respondents were asked to indicate their view on the possibility of not complying to only part of the RM10,000 stated for both scenarios. The specific amount is not stated but left to the respondent to judge, which mathematically could be worth less than RM10,000. Respondents were given three options (yes, no, unsure) on the likely non-compliance of the person stated in the scenario. The results of the possible partial non-compliance are shown in Table 6.8.

Table 6.8: Respondents' Views towards partial Non-compliance Behaviour

Possibility of Non-compliance	Partial Understatement of Income		Partial Overstatement of Deductions	
	Number of Respondents	Percentage	Number of Respondents	Percentage
Yes	41	23.8	52	30.2
No	66	38.4	72	41.9
Unsure	65	37.8	48	27.9
Total	172 [a]	100.0	172 [a]	100.0

[a] Number of respondents equals 172. Three values are missing.

The highest percentage of respondents, i.e. 38 percent and 42 percent for understating and overstating behaviour respectively, rejected the possibility of partial non-compliance, as shown in Table 6.8. On the other hand, nearly 24 percent and just over 30 percent of the respondents view that there is a possibility of partial non-compliance behaviour for income understating and deduction overstating behaviour respectively. In contrast to non-compliance involving the full amount of the gross transaction (see Table 6.7), relatively more respondents are likely to comply in terms of partial deductions rather than to partial income reporting. The result is as expected, since partial non-compliance, mainly with regards to deductions, could be exposed to a much higher risk of detection during a tax audit. As for income reporting, some caution is necessary as 'unsure' responses in the sample are about equal to compliant SMEs (both 38 percent).

6.4 RELATIONSHIP OF TAX ATTITUDES AND TAX BEHAVIOUR

The relationship between each tax attitudinal aspect and likely tax compliance behaviour is examined by way of correlation analysis. As tax complexity, tax fairness and the tax rate structure consisted of more than one item, the mean for the three respective items was used. As for the remaining three tax attitudes, they were left in their original form of a five-point Likert scale. The summary results of the correlation analysis are shown in Table 6.9.

Table 6.9: Tax Attitudinal Aspects and Tax Behaviour: Correlation Analysis

	Understatement of Income	Overstatement of Deductions	Both Non-compliance
Complexity	+ 0.150 [b]	+ 0.232 [a]	+ 0.220 [a]
Fairness	- 0.043	- 0.050	- 0.053
Rate	+ 0.149	+ 0.071	+ 0.124
Incentives	+ 0.023	+ 0.049	+ 0.041
Audit	+ 0.152 [b]	+ 0.211 [a]	+ 0.208 [a]
IRB relationship	+ 0.104	- 0.024	+ 0.043

Positive (+) or negative (-) signs denote a direct or indirect relationship respectively.
[a] Significant at the one percent level. [b] Significant at the five percent level.

Tax complexity and probability of an audit are found to be consistently and positively correlated with understatement of income, overstatement of deductions and combined types of compliance, shown in Table 6.9. The statistical significance is higher (one percent level) for accuracy of deductions and both non-compliances as compared to income reporting (five percent level). This finding indicates that an increase in the complexity level will increase the possibility of non-compliance. The likely non-compliance is also expected to increase if the chances of being audited are perceived to be too low. Though the relationships are significant, the correlation coefficient (around 0.2) indicates a weak association among tax complexity and tax audit to both types of non-compliance behaviours, either measured according to types (two independent behaviours) or at the SME level (combined).

The finding also shows that both understatement of income and overstatement of deductions are highly correlated (correlation coefficient equal to 0.535); more importantly, both are at the 99 percent confidence level. This suggests that those who are compliant in terms of income reporting (or tax deductions) would probably be compliant with regards to tax deductions (or income reporting).

Overall, the direction of the associations between the compliance types and all six attitudinal aspects are similar, except for the perceived IRB relationship. A direct association is observed between the perceived IRB relationship and income reporting behaviour, indicating the better the perceived relationship between respondents and the IRB, the more likely this is to increase the possibility of non-compliance. On the other hand, an indirect relationship is evident for tax deductions behaviour (and combined tax behaviours), suggesting the better the perceived relationship with the IRB, the lower the likelihood of the overstatement of deductions (and combined non-compliance).

As for tax fairness and tax incentives, their relationship to likely compliance behaviour is in the expected direction. A better perceived fairness is likely to decrease the possibility of non-compliance and vice versa. As for tax incentives, the stronger anticipation of tax incentives is likely to increase the possibility of non-compliance. It is possible that a few available incentives during the survey period were not sufficient. As such, the respondents may compensate themselves by performing non-compliant activities. However, an unanticipated direction is noted for the tax rate structure. A positive perception on the tax rate structure is likely to increase the possibility of non-compliance, which is supposed to be to the contrary. Nonetheless, perceptions towards tax fairness, the tax rate, tax incentives and the IRB relationship are not statistically associated with the likely compliance behaviour.

6.5   RELATIONSHIP OF TAX ATTITUDES AND COMPLIANCE COSTS

The relationship between six tax attitudinal aspects and mean compliance costs is investigated through correlation analysis. Following a similar approach as in Section 6.4, the respective combined averages are used for aspects that have more than one item, and the remaining attitudes were left to be in the original form of a five-point Likert scale. The relationship with the IRB official is the only aspect that indicates a significant association to compliance costs, as shown in Table 6.10. A positive sign indicates a direct association between the perceived IRB relationship and compliance costs estimates, suggesting the better relationship could lead to higher compliance costs.

Table 6.10: Tax Attitudes and Compliance Costs: Correlation Analysis

Tax Attitudinal Aspects	Compliance Costs
Complexity	+ 0.022
Fairness	- 0.088
Rate	+ 0.056
Incentives	+ 0.084
Audit	- 0.075
Relationship	+ 0.178 [a]

Positive (+) or negative (-) signs denote a direct or indirect relationship respectively.
[a] Significant at the five percent level.

A further analysis of compliance costs estimates between response categories, as shown in Table 6.11, demonstrates that compliance costs are 41 percent higher for those who perceived a better IRB relationship compared to those who perceived otherwise. On the other hand, the compliance costs of those who are indifferent to the IRB relationship are quite similar to those who do not perceive an improved relationship.

Table 6.11: Perceived IRB Relationship and Compliance Costs

Perceived Better Relationship [a]		Mean Compliance Costs (RM) [b]
Yes	(59)	11,596
No	(32)	8,240
Neutral	(84)	8,081
Overall	(175)	9,295

[a] The number of respondents is given in parentheses.
[b] Compliance costs between response categories is significant at the one percent level.

As for the other aspects, both positive and negative associations are evident (see Table 6.10 above). Positive associations are observed for tax complexity, the tax rate structure and tax incentives. The findings suggest that the higher the tax complexity level, the better perceived the tax rate structure and the higher the expectation for tax incentives, this would lead to higher compliance costs respectively. On the other hand, a negative association for tax fairness and tax audits indicates that a low fairness level and a low chance of a tax audit would possibly lead to higher compliance costs. However, with the exception of the perceived IRB relationship, a lack of statistical significance provides an unconvincing association between compliance costs and the other five tax attitudinal aspects.

6.6 RELATIONSHIP OF TAX BEHAVIOUR AND COMPLIANCE COSTS

The relationship between compliance costs and likely tax compliance behaviour is measured by way of correlation analysis. Similar to tax attitudes, responses to the likely tax behaviour remained in their original form of a five-point Likert scale. The correlation coefficients for understatement of income, overstatement of deductions, and to both non-compliance suggest a very weak direct association between compliance costs estimates and non-compliance behaviours, as shown in Table 6.12. An increase (or decrease) in compliance costs would probably lead to non-compliance (or compliance) behaviour. Though the direction of both relationships is in the expected direction, this study fails to provide any statistical significance.

Table 6.12: Tax Behaviour and Compliance Costs: Correlation Analysis

Non-compliance Type	Compliance Costs
Understatement of Income	+ 0.002
Overstatement of Deductions	+ 0.009
Both Non-compliance [a]	+ 0.007

Positive (+) sign denotes a direct relationship.
[a] This refers to the combined category of both understatement of income and overstatement of deductions.

Further, compliance costs are analysed by way of the three response categories, i.e. SMEs with compliant, non-compliant and neutral views. This analysis is carried out to get an impression on the magnitude of compliance costs towards compliance behaviour. The mean compliance costs by both the underreporting of income and overstating of deductions respectively are presented in Table 6.13.

Table 6.13: Understatement of Income and Mean Compliance Costs

Tax Behaviour [a]		Mean Compliance Cost (RM)
Complying SMEs	(102)	9,620
Non-complying SMEs	(31)	10,269
Neutral	(39)	7,424
Overall	(172)	9,239 [b]

[a] The number of respondents is given in parentheses.
[b] The costs are less than the reported mean compliance costs of RM9,295 due to differences in the response number.

Complying SMEs with likely reporting behaviour tend to have relatively lower compliance costs (RM9,620) than those with likely non-complying behaviour (RM10,269), as shown in Table 6.13. Those with neutral responses have the lowest costs (RM7,424). The results seem to suggest that SMEs with higher compliance costs possibly tend to not comply in terms of income reporting. However, mean comparisons by way of the statistical t-test did not indicate any significant association between compliance costs and understatement of income, at the five percent significant level.

On the contrary, no clear trends of compliance costs are noticeable in the case of overstating deductions, as shown in Table 6.14. This finding suggests that the compliance costs are about the same as their overall mean compliance costs regardless of their likely tax behaviour. The statistical t-test[155] also suggests a lack of a significant relationship between overstatement of deductions and compliance costs level.

Table 6.14: Overstatement of Deductions and Mean Compliance Costs

Tax Behaviour [a]		Mean Compliance Cost (RM)
Complying SMEs	(71)	9,293
Non-complying SMEs	(51)	9,389
Neutral	(50)	9,010
Overall	(172)	9,239 [b]

[a] The number of respondents is given in parentheses.
[b] The costs are less than the reported mean compliance costs of RM9,295 due to differences in the response number.

Additionally, the relationship between compliance costs and likely tax compliance behaviour is investigated for the non-compliance involving part of the RM10,000 as well. A similar finding is observed for partial non-compliance as well, as shown in Table 6.15. The likely complying respondents to both reporting behaviour and deduction behaviour have lower compliance costs (RM7,794 and RM8,884 respectively) than those who are likely not to comply (RM10,609 and RM9,690 respectively).

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[155] At the five percent significant level.

Table 6.15: Partial Non-compliance Behaviour and Mean Compliance Costs

Tax Behaviour	Understatement of Income [a] Mean (RM)		Overstatement of Deductions [a] Mean (RM)	
Complying SMEs	7,794	(66)	8,884	(72)
Non-complying SMEs	10,609	(41)	9,690	(52)
Neutral	8,760	(65)	8,948	(48)
Overall [b]	9,239	(172)	9,239	(172)

[a] The number of respondents is given in parentheses.
[b] The costs are less than the reported overall mean compliance costs of RM9,295 due to differences in the response number.

Overall, having observed a lack of a statistical relationship between compliance costs and possible compliance behaviour independently, for both compliance situations (whether measured for the full RM10,000 and/or part of the amount for each tax situation), it is important to analyse non-compliance behaviour at the SME level. For this purpose, only respondents with likely compliance behaviour to both underreporting and overstating situations are categorised as complying SMEs. Non-complying SMEs are those respondents with non-compliance to one or both situations. Additionally, there were also SMEs that chose to be indifferent for both non-compliance situations.

Compliance costs by these classifications are summarised and presented in Table 6.16. Although complying SMEs seem to have relatively higher compliance costs (RM9,776) than non-complying SMEs (RM9,233), the margin is reasonably small, i.e. less than six percent. The statistical t-test also failed to indicate an association between compliance costs and compliance behaviour at the SME level.[156]

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[156] At the five percent significant level.

Table 6.16: Compliance Behaviour and Mean Compliance Costs: Firm Level

Tax Behaviour [a]		Mean Compliance Cost (RM)
Complying SMEs	(60)	9,776
Non-complying SMEs	(88)	9,233
Neutral	(24)	7,919
Overall	(172)	9,239 [b]

[a] The number of respondents is given in parentheses.
[b] The costs are less than the reported mean compliance costs of RM9,295 due to differences in the response number.

Overall, the current study does not indicate any significant statistical relationship between compliance costs and likely compliance behaviour. Regardless of the amount in consideration, either RM10,000 or part of the RM10,000, a similar finding is evident.

6.7 DETERMINANTS OF COMPLIANCE BEHAVIOUR

A regression analysis was carried out to examine the determinants of SME income tax non-compliance. Two main regression analyses were carried out separately for each of the two likely behaviours: understatement of income (Model 1) and overstatement of deductions (Model 2). Additionally, a third regression analysis was also conducted by combining both types of non-compliance at the SME level (Model 3). The independent variables included were those relating to SME business characteristics, tax attitudinal aspects and compliance costs estimates. Business characteristics include four variables: sector, length, size, and tax liability. The annual turnover criterion is used as the primary size measure. Further regression analyses were performed for all the three models by employing the staff and NSDC size measure respectively. Technically, the regression model takes the following form:

Non-Compliance Behaviour

$$= \partial_0 + \beta_1 \text{Sector} + \beta_2 \text{Year} + \beta_3 \text{Size} + \beta_4 \text{Tax} + \beta_5 \text{Complexity}$$
$$+ \beta_6 \text{Fairness} + \beta_7 \text{Rate} + \beta_8 \text{Relationship} + \beta_9 \text{Audit} + \beta_{10} \text{Incentives}$$
$$+ \beta_{11} \text{Costs} + ei$$

Equation 6.1

Where:

Dependent Variables: Non-compliance Behaviour

Types of Tax Behaviour		**Measurement**
Understatement of Income [Model 1]	:	Agreement towards underreporting of income was obtained via a five-point Likert scale. Higher scores indicate likely non-compliance behaviour.
Overstatement of Deductions [Model 2]	:	Agreement towards overstatements of deductions was obtained via a five-point Likert scale. Higher scores indicate likely non-compliance behaviour.
Both Non-compliances [Model 3]	:	An average of scores from Model 1 and 2.

Independent Variables:

Business Sector [Sector]	:	There are five sectors: manufacturing, manufacturing-related services, services, construction, and other. The 'other' sector had two respondents and thus were excluded. For the purpose of regression analysis, three dummy variables were used with the services sector as the reference sector.

Business Length [Year]	:	Business length was reclassified into two categories: up to five years and more than five years. A category of less than two years in the actual survey was merged due to low responses.

Business Size   :   (to use one proxy at one time)

Annual Turnover [Turnover], or

The original six levels of turnover were classified into four levels due to the low number of responses in the last three categories. For regression purposes, three dummy variables were created with a turnover level of between RM250,000 and RM1 million as the reference level.

Number of Staff [Staff], or

Only four levels of staff are considered. The fifth level was excluded since it has only one response. For regression purposes, three dummy variables were used with number of staff between five and nineteen as the reference staff group.

Size NSDC [NSDC]

Responding companies were re-classified into micro, small and medium enterprises following the NSDC definition. For the purposes of regression analysis, two dummy variables were created with small enterprises as a reference category.

Estimated Tax [Tax]	:	The original six levels of the estimated tax were reduced to three so as to recognise a low number of responses in the last four levels. For the purpose of regression analysis, two dummy variables were used with the tax level of between RM1 and RM100,000 as a reference level.
Tax Complexity [Complexity]	:	Three statements were used to measure tax complexity via a five-point Likert scale. Higher scores indicate higher tax complexity.
Tax Fairness [Fairness]	:	Five statements were used to measure tax fairness via a five-point Likert scale. Three types of response scale were employed: strongly agree to strongly disagree; much less fair to much more fair; and much less taxes to much more taxes. Higher scores indicate higher tax fairness.
Tax Rate [Rate]	:	Three statements were used to measure the tax rate perception via a five-point Likert scale. Higher scores indicate higher tax rate fairness.
IRB Relationship [Relationship]	:	The perceived relationship with the IRB was measured via a five-point Likert scale to a single statement. Higher scores indicate a better relationship with the IRB official.
Tax Audit [Audit]	:	A single statement was used on the probability of tax audit via a five-point Likert scale. The higher the scores, the greater the likelihood of tax auditing.
Tax Incentives [Incentives]	:	A single statement was used to measure views related to tax incentives via a five-point Likert scale. Higher scores indicate agreement towards further incentives.

Compliance Costs : Compliance costs estimation was made up of internal staff

[Costs] costs, external tax fees and other non-staff costs on tax

activities. The compliance costs range from RM612 to

RM37,773 (see Chapter Five, Table 5.25). For regression

purposes, compliance costs estimates were transformed into

log10 to reduce the skewness of the variable (skewness).

Assessments of the assumptions underlying regression analysis revealed that all the four assumptions, i.e. normality, linearity, multicollinearity, and heteroscedasticity, were not violated. Further details are presented in Appendix R. A summary result of regressions analysis, by using turnover as a primary business size proxy, is presented in Table 6.17. Detailed results are presented in Appendix S, Table S.1.

Table 6.17: Summary of Results of Multiple Regressions

	Understatement of Income (Model 1)	Overstatement of Deductions (Model 2)	Both Non-compliance (Model 3)
Results:			
R^2	0.122	0.176	0.172
Adjusted R^2	0.029	0.089	0.084
Standard Error	1.204	1.250	1.059
F-value	1.315	2.016	1.958
P-value	0.195	0.015 [a]	0.019 [a]

[a] Significant at the five percent level.

The regression models were statistically significant (at the five percent level) in relation to overstatement of deductions and to both types of non-compliance, as shown in Table 6.17. Around nine percent of the variability of overstatement of deductions is accounted for by the independent variables in Model 2. Three variables, namely sector, tax complexity, and tax audit, were found to be significant determinants of overstating behaviour. The results suggest that SMEs with a high perceived complexity level, low

likelihood of tax audit, and SMEs in the construction sector were likely to be non-compliant in terms of accuracy of tax deductions.

As for the combined non-compliant model (Model 3), the same three variables (business sector, level of tax complexity, and likelihood of tax audit) are found to be determinants of both types of non-compliance behaviour. Additionally, business length is found to be a significant determinant, suggesting that SMEs with less than five years in business were likely to demonstrate non-compliant behaviour. As for understatement of income (Model 1), similar variables (tax complexity, tax audit and business length) are found to be among significant indicators of income reporting behaviour as well. Nonetheless, the income reporting model (Model 1) is not significant at the five percent level

Similar findings are also observed for the alternative business size measures. Additionally, business length is also found to be a significant determinant of overstating behaviour in terms of the NSDC size measure. A detailed result of multiple regressions by the alternate size measure (staff and NSDC) is presented in Appendix S, Table S.2. Overall, regressions analyses suggest that tax complexity, probability of tax audits, business sector and business length have a significant influence on the accuracy of tax deductions and overall tax reporting behaviour at the SME level.

6.8 FINDINGS OF THE WEB SURVEY

6.8.1 Introduction

The attitudinal aspects of corporate income tax and the likely compliance behaviour of the respondents in a web survey are presented at the overall mean scores. All analysis presented in this section follows a similar approach to the postal survey, except with regard to each specific response. Analysis for each attitudinal aspect and behavioural item is not considered in more detail as recognition of the low number of responses in the specific response category. Details of responses are presented in Appendix N, Table

N.11. Similar to the postal survey, the measurements used are considered adequate, both in terms of reliability and validity.

6.8.2 Tax Attitudes

Key findings on all six attitudinal aspects are shown in Table 6.18. For tax complexity, a mean score of 3.60 illustrates the perceived complex nature of corporate income taxation. In terms of tax structure, mean scores of 3.45 demonstrate the corporate tax rate is perceived to be relatively fair. A similar finding is observed in terms of tax law fairness. For tax incentives, a mean score of more than four indicates a high expectation of tax incentives for SMEs. However, a neutral view is evident for the relationship between the IRB and SMEs. Similarly, a mean score of 2.90 indicates an almost neutral view with regards to the probability of a company being selected for a tax audit.

Table 6.18: Tax Attitudes in the Web Survey

Tax Aspects	Mean	Median	Standard Deviation
Complexity	3.60	3.67	0.80
Fairness	3.34	3.40	0.67
Rate	3.45	3.67	1.11
Incentives	4.12	5.00	1.28
Audit	2.90	3.00	1.42
IRB Relationship	3.04	3.00	1.09

Number of respondents equals 75.

Additionally, analysis of tax attitudes by respondents' business characteristics reveals no statistical difference between respondents, except for tax fairness at the ten percent significant level. Small and Medium Enterprises that are subjected to a tax of more than RM100,000 perceived corporate income taxation as fair (3.67) compared to those not subjected to tax (3.12).

6.8.3 Tax Behaviour

Analysis of mean scores indicates that respondents lean towards compliance in terms of income reporting, but are indifferent for deduction of expenses, as shown in Table 6.19. A combined mean score of 2.78 for both non-compliance situations demonstrates that SMEs are prone to compliant behaviour.

Table 6.19: Respondents' Views towards Non-compliance Behaviour (Web Survey)

Non-compliance Type	Mean	Median	Standard Deviation
Understatement of Income	2.48	3.00	1.35
Overstatement of Deductions	3.06	3.00	1.33
Both Non-compliance [a]	2.78	3.00	1.20

Number of respondents equals 72. Three values are missing.
[a] This refers to the combined category of both understatement of income and overstatement of deductions.

In terms of non-compliance for part of the RM10,000, the highest response received (nearly 39 percent, as shown in Table 6.20) indicates an indifferent view for both situations, followed by compliant behaviour. However, caution needs to be taken as all the three response categories had less than 30 responses each.

Table 6.20: Respondents' Views towards Partial Non-compliance Behaviour (Web Survey)

Possibility of Non-compliance	Partial Understatement of Income		Partial Overstatement of Deductions	
	Number of Respondents	Percentage	Number of Respondents	Percentage
Yes	18	25.0	20	28.6
No	26	36.1	23	32.9
Unsure	28	38.9	27	38.6
Total	72 [a]	100.0	70 [a]	100.0

[a] Number of respondents less than 75 due to missing cases.

6.8.4 Relationship of Tax Attitudes, Behaviour and Compliance Costs

The relationship between tax attitudes and likely tax behaviour is presented first, followed by the relationship of both tax attitudinal and behavioural aspects towards compliance costs. The tax rate structure and tax audits are significantly associated with each and both types of non-compliance behaviour in a positive direction, as shown in Table 6.21. Additionally, tax complexity and tax incentives are associated with understatement of income and overstatement of deductions respectively. Tax incentives are also positively correlated to combined non-compliance behaviour. A significant correlation is observed as well between the two types of tax behaviour, suggesting compliance in terms of one aspect is very likely to influence the other behaviour, as shown in Table 6.21.

Table 6.21: Tax Attitudes and Behaviour: Correlation Analysis (Web Survey)

	Understatement of Income	Overstatement of Deductions	Both Non-compliance
Tax Attitudes:			
Complexity	- 0.280 [b]	- 0.24	- 0.197
Fairness	- 0.29	+ 0.13	+ 0.002
Rate	+ 0.296 [b]	+ 0.268 [b]	+ 0.321 [a]
Incentives	+ 0.183	+ 0.305 [b]	+ 0.257 [a]
Audit	+ 0.407 [a]	+ 0.265 [b]	+ 0.394 [a]
IRB relationship	+ 0.085	+ 0.050	+ 0.075
Tax Behaviour:			
Understatement of Income	-	+ 0.566 [a]	+ 0.893 [a]
Overstatement of Deductions	+ 0.566 [a]	-	+ 0.884 [a]

Positive (+) or negative (-) signs denote a direct or indirect relationship respectively.
[a] Significant at the one percent level. [b] Significant at the five percent level.

On the contrary, all tax attitudinal aspects and tax behaviour (by each type and combined non-compliance) are found to be not statistically associated to compliance costs of taxation, as shown in Table 6.22. This finding fails to provide the relevancy of compliance costs in the context of tax attitudes and likely tax behaviour of SMEs.

Table 6.22: Tax Attitudes, Behaviour and Compliance Costs: Correlation Analysis (Web Survey)

	Compliance Costs
Tax Attitudes:	
- Complexity	+ 0.092
- Fairness	+ 0.006
- Rate	- 0.086
- Incentives	- 0.061
- Audits	+ 0.078
- IRB Relationship	- 0.063
Tax Behaviour:	
- Understatement of Income	+ 0.006
- Overstatement of deduction	+ 0.072
- Both Non-compliance [a]	+ 0.039

Positive (+) or negative (-) signs denote a direct or indirect relationship respectively.
[a] This refers to the combined category of both understatement of income and overstatement of deductions.

6.8.5   Determinants of Compliance Behaviour

Regression analysis indicates that all three models (i.e. understatement of income, overstatement of deductions, both non-compliances) are significant; however, at a different statistical level, as shown in Table 6.23. The adjusted R^2 suggest that 21 percent, 17 percent and 25 percent of the variations are explained by the independent variables in the Models 1, 2 and 3 respectively. Probability of tax audits and perception towards the tax rate are the two variables found to be significant in all three models. Further, tax complexity and tax incentives are also significant in Model 2 and the other two models (1 and 3) respectively. Detailed results are presented in Appendix N, Table N.12.

Table 6.23: Summary of Results of Multiple Regressions (Web Survey)

	Understatement of Income (Model 1)	Overstatement of Deductions (Model 2)	Both Non-compliance (Model 3)
Results:			
R^2	0.394	0.373	0.428
Adjusted R^2	0.208	0.169	0.252
Standard Error	1.198	1.218	1.035
F-value	2.115	1.825	2.431
P-value	0.022 [b]	0.055 [c]	0.008 [a]

[a] Significant at the one percent level. [b] Significant at the five percent level. [c] Significant at the 10 percent level.

As for alternative size measure, regression analyses indicate almost identical findings with regards to the statistical significance of the models, and also in terms of factors influencing tax non-compliance. Detailed regression results by the alternative size measure are presented in Appendix N, Table N.13. Evidence shows that the probability of tax audits and tax rate fairness are significant in all three models' analyses by alternative size measures as well. Additionally, tax complexity and tax incentives are significant in some models respectively, e.g. tax complexity in Models 1 and 3; tax incentives in Models 2 and 3. Other variables, such as sector and tax level, are also significant in Model 2.

6.9 FINDINGS OF THE PROFESSIONAL SURVEY

6.9.1 Responses and Profile

The sample population comprised of 300 members of the Malaysian Institute of Taxation (MIT).[157] Thirty-one respondents completed the questionnaires giving a response rate of 10.3 percent. This response rate is considered low, but reasonable, as no follow-up procedures were carried out and accessing a professional accountant is

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[157] See Chapter Four, subsection 4.11.2.

usually difficult. The profile of respondents is presented in Table 6.24. A large majority of the respondents (84 percent) work either in a non big-four firm or tax firm, and the remainder (16 percent) work in a big-four accounting firm. Around 65 percent of the respondents are partners, followed by 23 percent of managers. A large number of respondents indicated having specific-tax experience for more than 10 years (71 percent) or at least for five years (19 percent).

Table 6.24: Profile of Responding Tax Professionals

	Number of Respondents	**Percentage**
Workplace		
Big-four Firm	5	16.1
Non Big-four Firm	15	48.4
Tax Firm	11	35.5
Position		
Partner	20	64.5
Manager	7	22.6
Supervisor	1	3.2
Senior	3	9.7
Tax Experience		
Less than 5 years	3	9.7
5 to 10 years	6	19.4
More than 10 years	22	71.0
Overall	31	100.0

Number of respondents equals 31.

In terms of tax clients, responding professionals indicate that on average, 81 percent of their tax clients are SMEs, with around 81 percent of those SME clients in the form of companies, as shown in Table 6.25. In other words, almost two-thirds of all tax clients of the responding tax professionals are SME companies.

Table 6.25: Average SME Tax-client: All Firm-types and Companies

SME tax client	Mean	Minimum	Maximum	Standard Deviation
All firm-types (%)	81	25	100	21
Companies (%)	81	30	100	19

Number of respondents equals 31.

Section B of the tax professional survey requested responses on three aspects: first, the average tax fees charged by tax professionals to SME companies in 2006 and its computational-planning costs percentages; secondly, tax-related difficulties faced by SME companies; and, thirdly, the main reason for SME companies employing tax professionals. Both the second and third aspects are requested from the tax professional's perspective.

Tax professionals were specifically asked to state both their lowest and highest range of tax fees charged to SME companies. Overall, the lowest fees charged range between RM200 and RM5,000 and the highest fees range from as low as RM500 to as high as RM15,000. These figures are used to compute the overall average fees charged by the responding tax professionals. Thus, at the respondent level, the overall average tax fee is estimated at RM3,023, as shown in Table 6.26.

Table 6.26: Average Tax Fees, 2006: Tax Professionals' Views

	Mean	Minimum	Maximum	Standard Deviation
Tax Fees (RM)	3,023	375	9,000	2,500

Number of respondents equals 31.

Tax professionals appear to indicate a high computational component of compliance costs. Specifically, the average computational and planning costs were estimated at 85 and 15 percent of compliance costs respectively, as shown in Table 6.27.

Table 6.27: Tax Fees Composition into Computational and Planning Costs: Tax Professionals' Views

Cost Nature	Mean	Minimum	Maximum	Standard Deviation
Computational (%)	85	50	100	15
Planning (%)	15	0	50	15

Number of respondents equals 31.

Estimating income tax payable and understanding income tax legislation are ranked as the main tax-related difficulties faced by the SME companies, with almost 78 percent of the respondents indicating those possibilities respectively, as shown in Table 6.28. The third difficulty is expanding the record keeping requirements for tax purposes (61 percent). The least ranked difficulty, as expected, is dealing with external advisors.

Table 6.28: Tax-related Difficulties for SMEs: Tax Professionals' Views

	Number of Responses	Overall Percent	Percent of Cases
Estimating Income Tax payable	24	16.1	77.4
Understanding Income Tax legislation	24	16.1	77.4
Increasing burden of record keeping for tax purposes	19	12.8	61.3
Cash flow position to pay monthly tax instalments	19	12.8	61.3
Implementing the Income Tax changes	18	12.1	58.1
Dealing with the tax authority	18	12.1	58.1
Maintaining records for Income Tax purpose	17	11.4	54.8
Short period of time to lodge the tax return	8	5.4	25.8
Dealing with external tax advisers	2	1.3	6.5
Total	149 [a]	100.0	-

[a] Number of respondents equals 31. Total responses are higher as respondents were allowed to select more than one aspect.

Nearly 97 percent of the respondents believed that the lack of technical knowledge within the SME is the main reason for SMEs employing tax professionals, as shown in Table 6.29. The next stated reason is the complexity of the tax laws (65 percent), followed by cost factors (55 percent) and tax planning purposes (55 percent). The least ranked reason is a demand for an external opinion (48 percent).

Table 6.29: Main Reason for SMEs using Tax Professionals: Tax Professionals' Views

	Number of Responses	Overall Percent	Percent of Cases
Technical knowledge is not readily available internally	30	30.3	96.8
Income tax matters are too complicated	20	20.2	64.5
It is more cost-effective to use external tax professionals	17	17.2	54.8
For income tax planning	17	17.2	54.8
External opinion was required	15	15.2	48.4
Total	99 [a]	100.0	-

[a] Number of respondents equals 31. Total responses are higher as respondents were allowed to select more than one aspect.

6.9.2   Tax Attitudes and Behaviour from Tax Professionals' Viewpoints

A survey of professionals has six attitudinal aspects (similar to postal and web survey) plus another aspect on the benefit of record keeping. Findings on tax attitudes are presented at the overall mean scores for each of the seven aspects respectively. Mean analysis of each individual statement is presented in Appendix T, Table T.1. As for tax behaviour, analysis follows a similar approach to the postal and web survey. A detailed analysis of response categories is not considered in this section due to the low number of responses, both in the overall and specific response categories.

The highest mean score is observed for record keeping benefits (3.87), followed by tax incentives (3.84), as shown in Table 6.30. This suggests the respondents' recognition of record keeping benefits and agreement about more tax incentives for SMEs. In terms of fairness, an average score of 3.32 demonstrates that the corporate tax system is perceived to be relatively fair. The lowest score for tax audits (2.48) signifies that tax professionals were somewhat doubtful with regards to the probability of their SME client being subjected to a tax audit. For the remaining attitudes, a mean score of around 3.00 indicates that tax professionals are generally indifferent in terms of tax complexity, the tax rate structure, and the IRB relationship.

Table 6.30: Tax Professionals' Views towards Tax Attitudes

Tax Aspects	Mean	Median	Standard Deviation
Complexity	3.19	3.33	0.56
Rate	3.06	3.00	0.67
Fairness	3.32	3.40	0.41
Incentives	3.84	4.00	0.97
Audit	2.48	3.00	1.09
IRB Relationship	2.94	3.00	1.09
Record Keeping Benefit	3.87	4.00	0.58

Number of respondents equals 31.

Regarding tax behaviour, mean scores of around two indicate that tax professionals lean towards tax compliance in all three cases, as shown in Table 6.31. Further, correlation analysis indicates that tax professionals that are compliant in terms of income reporting (or tax deductions) would probably be compliant with regards to tax deductions (or income reporting) as well.

Table 6.31: Tax Professionals' Views towards Non-compliance Behaviour

Non-compliance Type	Mean	Median	Standard Deviation
Understatement of Income	2.10	2.00	1.27
Overstatement of Deductions	2.19	2.00	1.30
Both Non-compliance	2.14	2.00	1.21

Number of respondents equals 31.

The relationship between tax attitudinal aspects and likely compliance behaviour examined by way of correlation analysis revealed no statistical association between any attitudinal aspects and any types of compliance behaviour. Similarly, regression analysis revealed none of the tax attitudes are statistically significant to any type of compliance behaviour from the tax professionals' viewpoints. The independent variables considered only six tax attitudinal aspects, plus perception towards record keeping benefits. A summary of correlation and regressions analysis is presented in Appendix T, Tables T.2 and T.3.

6.10   CHAPTER SUMMARY

This chapter has analysed the tax attitudes and likely tax behaviour of a business managerial respondent based on responses to the SME postal survey. Overall, the findings have shown that the Malaysian corporate tax system is perceived to be complex yet relatively fair in terms of tax laws and tax rate structure. Business respondents are anticipating more tax incentives from the government and believe that their relationship with the IRB has improved since the implementation of the SAS. One noteworthy aspect is that the respondents seem uncertain about the likelihood of the IRB performing tax audits on SMEs.

In terms of likely compliance behaviour, SME companies are largely compliant towards both income reporting and tax deductions behaviour, either measured for the full amount of RM10,000 or part of the RM10,000. In terms of the relationship, the findings

indicate that the complexity of the corporate tax law and the probability of tax audits are statistically associated with both types of tax behaviour. The possibility of non-compliance behaviour increases as the tax complexity level increases and the probability of tax audits decreases. Further, non-compliance in terms of income reporting (or tax deductions) could possibly affect the accuracy of the deductions (or income reporting). However, no statistical relationship is evident between tax compliance costs and the compliance behaviour of SMEs, measured both in terms of income reporting, tax deductions and at the SME level. Analysis of findings from a separate SME web survey and tax professionals' postal survey have also been presented. Overall, both surveys support findings of the main SME postal survey. A further comparative analysis is made in Chapter Seven.

CHAPTER SEVEN
COMPARISON OF FINDINGS AND DISCUSSION

7.1   INTRODUCTION

This chapter compares key findings of the main SME postal survey and the SME web survey. A comparison is also made to the relevant findings in the tax professionals' surveys. This chapter mainly focuses on the similarities and differences within the two SME surveys and with the tax professionals' survey. This chapter also compares current findings with prior relevant findings, both in Malaysia and from an overall international perspective.

7.2   COMPLIANCE COSTS ESTIMATES

7.2.1   Comparison with Web Survey

The compliance costs in both the SME postal and web surveys resulted in almost similar estimates of RM9,300 per SME company, as shown in Table 7.1. This comparable finding adds reliability to compliance costs estimates in the current study. The computational and planning costs percentages were also comparable between the surveys. However, the internal costs (or external tax fees) percentage in the postal survey was 11 percent lower (or higher) than the web survey. This difference may be partly due to the amount of tax expertise or knowledge available within the firm's personnel.

Evidence shows that more tax works were conducted by the Manager/Accountant in the web survey. The average internal time spent in the web survey (616 hours) is 41 hours higher than in the postal survey (575 hours),[158] with relatively more hours (on average 37 hours) spent by either the Manager or Accountant. Internal time costs in such occurrences are definitely high (as higher wage rates apply) compared to companies that

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[158] See Table 5.17 and Appendix N, Table N.7.

rely on other staff categories. The average wage rates are also relatively higher in the web survey in all four staff categories. For example, the average hourly wage rate for the Manager/Accountant in the web survey (RM3,591) was RM146 higher than the postal survey (RM3,445).[159] At the same time, external tax fees are likely to be lower as more tax works, particularly computational in nature, are performed internally. It is important to note that the average wage rate used in the current study is based on the respondents' figures (similar to Pope, Fayle and Chen 1994), thus varying between companies in the survey sample. The current study was mainly interested in the compliance costs estimates at the firm level. Thus, a standard wage rate approach, similar to the study by Evans *et al.* (1997) and Rametse (2006), was not employed.

Table 7.1: Compliance Costs Estimation by Survey Method, 2006

	Postal Survey	**Web Survey**
Tax Compliance Cost (RM) [a]		
- Average per Firm	9,295	9,282
Component of Costs (RM) [a]		
- Computational	7,217 [b] (74)	7,362 [b] (75)
- Planning	2,474 [b] (26)	2,409 [b] (25)
Sources of Costs (RM) [a]		
- Internal [c]	5,509 (59)	6,498 (70)
- External	3,786 (41)	2,784 (30)

[a] All monetary values are in current year prices. The percentage is given in parentheses.
[b] Total costs were not equal to average compliance costs due to differences in the response number.
[c] Inclusive of non-staff additional costs.

A comparable finding is evident as well in terms of costs distribution. The usual regressive pattern of compliance costs is confirmed, in both the postal and web survey, as shown in Table 7.2. The regressive nature of compliance costs upon small businesses is revealed with the lowest turnover level being around two percent more severe in the postal survey. Nonetheless, it must be noted that all turnover categories in the web

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[159] See Table 5.18 and Appendix N, Table N.8.

survey have less than 30 responses in each level. For the SME companies, overall compliance costs expressed as a percentage of turnover in both surveys result in the same figure, i.e. 0.19 percent.

Table 7.2: Compliance Costs Distribution by Survey Method, 2006

Turnover Level [a]	Postal Survey	Web Survey
	Compliance Costs **as a Percentage of Turnover**	
Less than RM250,000	6.53 (37)	4.32 (19)
RM250,000–RM999,999	1.13 (48)	1.54 (21)
RM1,000,000–RM4,999,999	0.32 (46)	0.32 (24)
RM5,000,000 or more	0.08 (44)	0.10 (11)
Overall	0.19 (175)	0.19 (75)

[a] The number of respondents is given in parentheses. The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used, because the actual mean size of the turnover is not available.

The gross and net aggregate compliance costs for the Malaysian SME companies indicate comparable estimates as well, as shown in Table 7.3.

Table 7.3: Aggregate Compliance Costs by Survey Method, 2006

	Postal Survey (RM million)	Web Survey (RM million)
Gross Compliance Costs	1,084.3	1,082.7
(-) Tax Deductibility	195.6	191.0
Net Compliance Costs	888.7	891.7

Largely, findings indicate that the compliance costs estimates in the postal survey, both in terms of amount (at the SME and aggregate level) and costs distribution, are consistent and supported by the web survey.

7.2.2 Comparison with Prior Malaysian Studies

This section compares compliance costs estimates to the Malaysian SME companies under the SAS regime (i.e. current study) with an earlier pre-SAS study by Hanefah, Ariff and Kasipillai (2001). The comparison is realistic as a similar approach was adopted in both studies,[160] which was mainly based on Pope, Fayle and Chen (1994) in Australia, especially in terms of methodology.

The average compliance costs of RM9,295 in the current study is almost 58 percent lower than the RM21,964 in the pre-SAS study, as shown in Table 7.4. The 16 percent increase in the proportion of external work demonstrates that tax professionals, as expected, play a significant role in the SAS regime. The increasing nature of routine or computational income tax work, from 59 percent to 74 percent, also corroborates the current estimate.

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[160] The main difference is with regard to SME definitions. The pre-SAS study defines SMEs as companies with employees not exceeding 150 and with annual sales turnover not exceeding RM250 million. The current study adopts the newly standardised national definition (see Chapter One, subsection 1.5.3).

Table 7.4: Compliance Costs of Malaysian Small and Medium Enterprises

	Prior Study [a]	Current Study [b]
Tax year	1999	2006
Scope	Corporate Income Tax	Corporate Income Tax
Coverage	Northern region of Peninsular Malaysia	Peninsular Malaysia
Tax Compliance Cost (RM) [c] - Average per Firm	21,964	9,295
Component of Costs (RM) [c] - Computational - Planning	12,960 (59) 9,004 (41)	7,217 [d] (74) 2,474 [d] (26)
Sources of Costs (RM) [c] - Internal - External	15,493 [d] (75) 5,210 [d] (25)	5,509 (59) [e] 3,786 (41)

[a] Source: Hanefah, Ariff and Kasipillai (2001). The useable responses equal 67.
[b] Data from the current study. The useable responses equal 175.
[c] All monetary values are in current year prices. The percentage is given in parentheses.
[d] This total is not equal to overall mean costs due to differences in the response number.
[e] Inclusive of non-staff additional costs.
Source: Adapted from Abdul-Jabbar and Pope (2008a, p. 305 - Table 9).

A relatively high proportion of both external tax fees and computational costs is theoretically and practically reasonable in the SAS regime. However, the overall decrease in the compliance costs is contrary to the presumed expectation. To some extent, these cost decreases may be because it has been more than six years since the implementation of the SAS in Malaysia. The previous study related to the tax year 1999 and the data was collected in 2000. It is important to highlight that there were two major tax changes announced in 1999 (Ministry of Finance Malaysia), namely the introduction of the SAS and the application of a current year basis to replace the existing preceding year basis.[161] Another possible explanation for the compliance costs decline may relate to the economic climate when the previous study was conducted. A major Asian financial crisis during the period of the prior study by Hanefah, Ariff and Kasipillai

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[161] See Chapter Three, subsection 3.2.3 for details.

(2001) may have encouraged Malaysian SMEs to grossly overstate their compliance costs. The timing of the current study is perhaps suitable given that no major income tax changes took place during the study period, i.e. 2007 or tax year 2006. Moreover, the possibilities of high initial costs or start-up effects have been removed as the SAS has been in place for more than six years in 2007.

A similar trend was evident in Australia. Evans *et al.* (1997) indicates that compliance costs (on the basis of tax revenue and gross domestic product) were found to be relatively lower, either at individual, business or overall levels, as compared to a series of studies lead by Pope (Pope, Fayle and Duncanson 1990; Pope, Fayle and Chen 1991, 1993a, 1993b; Pope, Fayle and Chen 1994) prior to the SAS in Australia. However, methodological differences should be observed when comparing these studies in Australia.[162] The fact that studies led by Pope were conducted prior to the SAS which began in 1992, and the study by Evans *et al.* (1997) was carried out during the SAS, is often overlooked and not highlighted in the literature (Mathieu, Waddams and Antwi 2007, p. 2). As a result, and citing several other key compliance costs studies internationally, Mathieu, Waddams and Antwi (2007, pp. 2-3) emphasised the possibility of high total tax compliance costs in countries where the SAS is well established, low costs where the SAS is not implemented, and of intermediary costs for countries where the SAS has recently been introduced. The compliance costs level from these theoretical points of view and the current study is illustrated in Table 7.5.[163] From this perspective, compliance costs estimates in the current study should be relatively higher than the pre-SAS study, at least initially.

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[162] For example, Evans *et al.* (1997) did not make comparison, either at the disaggregate level or in absolute terms, but rather expressed compliance costs at the aggregate level both as a percentage of tax revenue and GDP.
[163] Compliance costs expressed in different terms, i.e. to tax revenue or GDP, may result in a different interpretation, especially in terms of costs distribution (Ariff and Pope 2002, p. 42).

Table 7.5: Comparative Tax Compliance Costs Level [a]

Stages of the SAS [b]	International [c]	Asia–Pacific [d]	Malaysia [e]
Pre-SAS	Low	Low	Low
SAS (introduction)	Intermediate	High	- [f]
Post-SAS (short term)	- [f]	Intermediate/High [g]	Very Low
Post-SAS (long term)	High	Low/Intermediate [g]	- [h]

The hyphen mark (-) indicates a period in which no study has been carried out, or is yet to be carried out.
[a] In absolute dollar terms. See also Footnote 163.
[b] Mathieu, Waddams and Antwi (2007) classifies countries in three stages: without the SAS (pre-SAS), recently implemented SAS (SAS) and well established SAS (post-SAS). The current author further divided post-SAS into short term and long term, as substantial periods of time are likely to be needed for the SAS to be well established.
[c] Overall, covering all types of taxpayers (source: Mathieu, Waddams and Antwi 2007).
[d] Mainly on public companies, covering Australia, Malaysia, Singapore and Hong Kong (source: Ariff and Pope 2002).
[e] SME companies only (sources: Hanefah, Ariff and Kasipillai 2001; and the current study).
[f] Possibly 'intermediate' or 'high'. See also note [b].
[g] The level depends on the effectiveness of the SAS implementation (Ariff and Pope 2002).
[h] Possibly 'low' or 'intermediate'.

As discussed in Chapter Two,[164] there were two compliance costs estimates of Malaysian SMEs conducted immediately prior to the SAS, and importantly after the government plan to introduce the SAS was announced. Unfortunately, no estimates were undertaken during the initial implementation of the SAS in Malaysia. It is likely that during the early stages of the SAS there could be a substantial increase in compliance costs and, eventually (i.e. after six years of SAS implementation), the costs decrease, as evident in the current study.

The possible increase in the compliance costs, at least during the early years of the SAS implementation, was also anticipated in the Asia–Pacific countries, including Malaysia (Ariff and Pope 2002). For subsequent years, Ariff and Pope (2002, p. 277) stressed the likelihood of costs declining in the longer run, provided that the SAS was implemented effectively. Accordingly, they recommended further research to be undertaken to examine the compliance costs trend. Despite being contrary to the international trend (Mathieu, Waddams and Antwi 2007), the current lower estimates of compliance costs

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[164] See subsection 2.3.2.

provide support to the possible decreasing trend as anticipated by Ariff and Pope (2002).

The significant decline is likely due to the effectiveness of the SAS implementation, mainly as a result of numerous simplification measures taken by the IRB. The most important of these include the substantial reduction of capital expenditure categories for capital allowance purposes, the simplification of the business basis period, the introduction of dual tax rates for SMEs, and permitting 100 percent capital allowance for small value assets during the relevant purchased year (effective from years of assessment 2000, 2002, 2003 and 2006 respectively).[165] A similar trend is evident in Singapore. Ariff, Ismail and Loh (1997, p. 1258) found a significant decrease of 30 percent in the tax compliance costs was evident just one year (1994 to 1995). They strongly believed that the decrease was primarily attributable to the simplification measures taken by the Inland Revenue Authority of Singapore (IRAS). Therefore, it is most likely that the numerous efforts taken by the IRB have resulted in significant benefits for the business community in Malaysia, SMEs in particular. Despite the low compliance costs finding in the current study, the regressive nature of compliance costs for SME business is even greater in the current estimates, as shown in Table 7.6.

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[165] See Chapter Three, subsection 3.2.3.

Table 7.6: Compliance Costs Distribution of Malaysian Small and Medium Enterprises

Prior Study [a]		Current Study [b]	
Turnover (RM Million)	Compliance Costs as a Percentage of Turnover [c]	Turnover (RM Million)	Compliance Costs as a Percentage of Turnover [d]
Less than 5	1.20	Less than 0.25 0.25 – 1 1- 5	6.53 1.13 0.32
5–50	0.07	5 or more	0.08
More than 50	0.02		
Overall	0.10	Overall	0.19

[a] 1999 figures from Hanefah, Ariff and Kasipillai (2001).
[b] 2006 data from the current main postal survey.
[c] Computed using a similar approach to the current study as the information is not available in the previous study. These figures, however, should be treated cautiously. The denominator used is the midpoint of the turnover category, except for a category of more than RM50 million, where RM55 million was used. For the overall category, RM23 million is used, which is derived by weighting the midpoints of the turnover level, rounded to the nearest million.
[d] The denominator used is the midpoint of the turnover category, except for the largest, where RM15 million is used. The denominator used for the overall category is RM5 million (see Table 5.32).

Tax compliance costs expressed as a percentage of tax revenue also suggested a similar concern, as shown in Table 7.7. Compliance costs relative to tax liability have possibly grown slightly from almost eight percent during the OAS to just over nine percent under the SAS. However, these figures, which are derived under certain assumptions,[166] should be treated cautiously as the corresponding actual tax revenue is not available in both studies. A simple direct comparison, even within the same country, could be misleading (Evans *et al.* 1998, p. 110); thus a number of companies in the previous study (i.e. SME with turnover of over RM50 million), which certainly would not be considered as SMEs under the current definitions, were excluded in deriving the 1999

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[166] Refer note [a], Table 7.7.

figures.[167] Further, it must be emphasised that a lower tax rate applied in 2006 due to a tax rate deduction and the formation of dual tax rates for corporate SMEs.[168]

Table 7.7: Compliance Costs Relative to Tax Liability [a]

Tax Year	Compliance Costs (RM)	Tax Liability [b] (RM)	Compliance Costs as a percentage of Tax Liability
1999 [c]	1,400,787	18,038, 015	7.77
2006 [d]	1,626,593	17,325,000	9.39

[a] Based on sample companies.
[b] Actual tax liability is not available. Data for 1999 refers to estimated tax as declared by the respondents. The tax liability in the current study is the sum of the midpoints of the estimated tax level as reported by the 172 respondents (see Table 5.12). For the tax level of RM1 million and above, RM1.5 million is used as a midpoint.
[c] Figures from Hanefah, Ariff and Kasipillai (2001, p. 93 - Table 8), adjusted by excluding figures from respondents with turnover of over RM50 million. Some respondents in the turnover level between RM5 million and RM50 million that may have exceeded RM25 million are not excluded due to lack of details.
[d] Data from the current study.

Despite a significant decline (58 percent) in average tax compliance costs in absolute terms, the regressive nature of compliance costs upon Malaysian small businesses remains an important area in tax policy considerations. Tax compliance costs as a percentage of tax liability raised further concern. The IRB is expected to continue its efforts in introducing further tax simplification measures to all business taxpayers. This policy is in line with recommendations made by Freedman (2009). The IRB may want to consider a specific policy on the compliance costs of SMEs in addressing their regressive nature in a more systematic and comprehensive approach.[169]

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[167] Refer note [b], Table 7.7.
[168] In 1999, the corporate tax rate was 28 percent. In 2006, SME companies with a taxable income of up to RM500,000 were subject to a tax rate of 20 percent, and 25 percent to the remainder. See also Chapter Three, subsection 3.2.3. Compliance costs percentage is sensitive to factors affecting tax revenue, particularly tax rates (Sandford and Hasseldine 1992, p. 111).
[169] See Chapter Eight, Section 8.3.

7.2.3   Comparison with International Studies

Despite many differences, both in terms of taxation (e.g. structure, types and rates) and methodology (e.g. data quality, sample frame, response rates and timing of survey), international comparisons of the compliance costs estimates are useful to support the overall findings between countries (see especially Sandford 1995, pp. 405 - 408) and also within the same country (Evans *et al.* 1998, p. 109). A direct comparison of estimates may not be useful, thus researchers often employ compliance costs as proportions of tax revenue (Sandford 1995, p. 406) and/or GDP (Pope, Fayle and Chen 1994, p. 85). The former is common in almost all international comparisons, but the latter has been suggested as a better measure (Pope 1994, p. 100; 2003, p. 70). Overall, tax compliance costs studies undertaken between the early 1980s and 2002 imply that compliance costs of a specific tax, e.g. personal income tax, corporate income tax, GST, are normally between two percent and 10 percent of the revenue yield from those taxes, or up to 2.5 percent of GDP (Evans 2003b, p. 71).

Comparison of the Malaysian SME compliance costs estimates with relevant earlier international findings is useful in this context. Unfortunately, no previous international study focuses specifically on estimating tax compliance costs of SME companies,[170] but mostly targets listed companies, with one study also including medium-sized companies.[171] The earlier Malaysian study (Hanefah, Ariff and Kasipillai 2001) was the first to consider SME companies and the current study is probably the second.[172] As such, a comparison is carried for relevant studies on corporate income taxation. Other major international studies that include corporations as part of their comprehensive studies on business income taxation, for example, those of New Zealand (Sandford and Hasseldine 1992) and Australia (Evans *et al.* 1997) though useful to some extent, are not considered in detail in this comparison.

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[170] A Canadian study by Erard (1997b), although focused on SMEs, was concerned with SME perceptions about the compliance burden and did not estimate compliance costs.
[171] See Chapter Two, subsection 2.3.1. See also Appendix E.
[172] See earlier subsection 7.2.2 for comparison of these two Malaysian studies.

For this purpose, all prior studies in other Asian countries (Hong Kong, Singapore and India) are included as illustrative of developing countries, with only India adopting the SAS. Studies in Australia, the UK, the US and Canada represent corporate compliance costs in developed countries, with the US and Canada adopting the SAS since the early 1940s, Australia in 1992, and more recently the UK implementing the SAS in 1996/1997. All three Asian countries, Australia, the UK and Canada are Commonwealth Countries (and formerly part of the British Empire), which shared similar income tax provisions, particularly during the early years of their independence. Studies in Slovenia and Croatia are also compared in lieu of transitional countries. A summary of the key findings on corporate compliance costs in the current study in a comparison between selected countries is shown in Table 7.8.

Overall, the current Malaysian study shows that computational components (in contrast to planning costs) are high compared to others corporate compliance costs studies, with two exceptions, namely Hong Kong and Australia. This finding is expected as the current Malaysian study is undertaken in the SAS regime. In terms of sources, an internal component also shows a similar trend, with a comparable high percentage observed in the US and transition countries. Under the SAS regime, the high trend of internal costs is expected, especially within SME companies. Nonetheless, a high internal component in the 1992 US study (Slemrod and Blumenthal 1996) is surprising as this study was confined to big corporations.

Table 7.8: Comparison of Corporate Compliance Costs Studies by Main Findings [a]

Country [b]	MAS			SING		HKG	IND	AUS		US			CAN	UK	SLO	CRO
Tax Year	2006	1999	1995	1995	1994	1995/ 1996	2001/ 2002	1986/ 1987	1990/ 1991	1992	1996	2001	1995	1986/ 1987	2002	2001/ 2002
Assessment System [c]	SAS	OAS	OAS	OAS	OAS	OAS	SAS	OAS	OAS	SAS	SAS	SAS	SAS	OAS	SAS	SAS
Tax Rate (%)	20 [d]	28	30	27	27	16.5	38.5	49	39	39.1 [e]	39.9 [e]	40 [e]	[f]	35 [g]	25 [g]	20
Compliance Costs: By Component (%)																
- Computational	74	59	61	50	51	74	n/a	55	76	n/a	n/a	n/a	[h]	n/a	n/a	n/a
- Planning	26	41	39	50	49	26	n/a	45	24	n/a	n/a	n/a	[h]	n/a	n/a	n/a
By Sources (%)																
- Internal	75	59	28	42	42	30	n/a	50 [i]	48	84	82	75	80	53	74	82
- External	25	41	72	58	58	70	n/a	50 [i]	62	16	18	25	20	47	26	18
Relative to: - Tax revenue (%)	9.3	3.7 - 7.7 [j]	0.4	0.3	0.4	n/a	5.6 - 14.5	11.4 - 23.7	22.9	3.2	n/a	28.0 - 29.6	5	2.2	4.2 [k]	11.8
- GDP (%)	0.19 [l]	n/a	n/a	n/a	n/a	n/a	n/a	0.25 - 0.53	0.86	n/a	n/a	n/a	n/a	0.08	1.00	1.20

[a] See Appendices D and E, for other details, including the full references. This comparison only covers specific studies on corporation and income taxation. However, a recent UK study on SME companies (Kauser *et al*. 2005) is not included as data needed for this table is not available (refer Chapter Two, subsection 2.3.1).

[b] Malaysia (MAS), Singapore (SING), Hong Kong (HKG), India (IND), Australia (AUS), the United States (US), the United Kingdom (UK), Slovenia (SLO) and Croatia (CRO).

[c] During the study period, Self-Assessment System (SAS) or Official Assessment System (OAS). Australia implemented full SAS in 1992; the UK in 1996/1997.

[d] This rate applies for SME companies having taxable income up to RM500,000. Any remainder income will be subject to the normal corporate rate of 26%.

[e] This figure was taken from Mintz and Weichenrieder (2007).

[f] Canadian corporations are subjected to both federal and provincial taxes. In 1995, the federal tax rate on large corporations was 21% and 28% for manufacturing and other sectors respectively, plus a surtax amounting to 1.12%. Provincial taxes range from 9% to 17%, with a special rate applying for the manufacturing sector in some jurisdictions (Erard 1997b).

[g] A reduced rate applies for some companies.

[h] This Canadian study classified compliance costs into three components: keeping records and filing; research and planning; and audit, appeals and litigation.

[i] Pope, Fayle and Chen (1991, p. 103) stated that external costs account for around half of total estimated compliance costs. No actual proportions were given.

[j] Adjusted to represent the current definition of SMEs. See also Table 7.7, note [b].

[k] This figure represents costs for all three types of taxes paid by Slovenian corporations.

[l] Estimated 2006 total compliance cost of SME companies of RM1,084 million divided by the 2006 GDP figure of RM572,555 million (current prices). The GDP amount is derived from the Economic Report (Treasury of Malaysia, 2007, Statistical Table 2.1).

n/a - not available

The Malaysian SME compliance costs expressed in terms of a percentage of tax revenue (nine percent) seems relatively high compared to almost all studies, with the exceptions of Australia at 23 percent (Pope, Fayle and Chen 1994) and Croatia at 12 percent (Blazic 2004), and the recent US 2001 study at 28–30 percent (Slemrod and Venkatesh 2002). The fact that tax compliance costs of Australian companies were highly significant compared with other countries (as shown in Table 7.8) is not surprising as an international comparison on corporate compliance costs (Pope, Fayle and Chen 1994, pp. 99-100) and business compliance costs (Evans *et al.* 1997, pp. 75-76) indicated such a trend earlier. Comparison with the US 2001 study should be treated more cautiously as this study included a sample population that pays no taxes,[173] which elevated the compliance costs ratio as a result of lower tax revenue (i.e. the denominator).[174]

The tax compliance costs relative to tax revenue in the earlier US study (Slemrod and Blumenthal 1996) was 3.2 percent. As a useful comparison, income tax compliance costs of all businesses—including corporations—as a percentage of tax revenue, ranged from as low as 2.8 percent in the UK (Sandford, Godwin and Hardwick 1989), four percent in the Netherlands (Allers 1994) to as high as 15.8 percent in Australia (Evans *et al* 1997) and 19.6 percent in New Zealand (Sandford and Hasseldine 1992). Overall, the current Malaysian estimate of around nine percent, although it could be of some concern, is within the international range of between two percent and 10 percent of tax revenue as observed by Evans (2003b, p. 71).

In terms of GDP, with the exception of the UK study, the 2006 Malaysian corporate SME compliance costs of nearly 0.2 percent is the lowest when compared to companies in Australia (0.9 percent), Slovenia (one percent) and Croatia (1.2 percent). Comparison with earlier Asian studies unfortunately is not possible, as the current study is the first to estimate total compliance costs in Malaysia. In terms of all businesses, including corporations, an international comparison of major studies in the UK (Sandford,

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[173] Slemrod and Venkatesh (2002) referred to this firm as 'a pass-through entity' and argued that the costs portion would be significantly lower if the effects of these entities are excluded.
[174] See Slemrod and Venkatesh (2002, p. 27) for full details.

Godwin and Hardwick 1989),[175] New Zealand (Sandford and Hasseldine 1992), the Netherlands (Allers 1994) and Australia (Evans *et al* 1997) indicates a ratio of income tax compliance costs of between one and two percent of corresponding GDP.

Despite some similarities among these studies, especially for companies, analysis should be made cautiously due to differences in company size, tax features and methodology. More importantly, the considerable lag between those studies should be noted. For example, the lag between the current study and the 1986/1987 UK (Sandford, Godwin and Hardwick 1989) and 1986/1987 Australian (Pope, Fayle and Chen 1991) studies is over 20 years, and over 10 years for most of the other studies. It seems that only four studies have been conducted since 2000, including the current study. It is observed that most of the recent international compliance costs studies (with the exception of Asian studies) tend to focus on VAT/GST payers (see for example, Hasseldine and Hansford 2002; Rametse and Pope 2002; Yesegat 2009). This trend is not surprising due to the introduction of GST/VAT in many countries and, more importantly, as a result of high compliance costs and its regressivity towards GST/VAT payers (Sandford 1995, p. 5). The GST is yet to be introduced in Malaysia. As discussed in Chapter One,[176] the current study emphasises corporations, as tax revenue from this sector is highly significant in Malaysia.

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[175] The percentage for the UK was cited in Pope (1994, p. 100 - Table 9).
[176] See Chapter One, subsection 1.2.1.

7.3 TAX ATTITUDES

7.3.1 Comparison with Web Survey

Tax attitudes of respondents in both SME surveys largely illustrated similar perceptions, as shown in Table 7.9. Comparatively, mean scores are slightly higher for tax attitudinal aspects in the web survey, except for tax incentives and the IRB relationship. The ranking of mean scores also indicated similar patterns in both surveys. The highest score for the web survey is recorded for tax incentives (4.12) and the lowest mean for tax audit (2.90). Despite some small variations, the overall findings show that corporate income tax laws are complex, but relatively fair in terms of both tax law and tax rate structure. More tax incentives are anticipated to the SME sector. The SME relationship with the IRB is perceived to be somewhat neutral since the implementation of the SAS. Finally, respondents are leaning towards disagreement or an almost neutral view about the low chances of tax auditing in the SMEs.

Table 7.9: Tax Attitudes by Survey Method

Tax Aspects	Postal Survey		Web Survey	
	Mean	Median	Mean	Median
Tax Complexity	3.56	3.67	3.60	3.67
Tax Rate	3.34	3.33	3.45	3.67
Tax Fairness	3.22	3.20	3.34	3.40
Tax Incentives	4.15	4.00	4.12	5.00
IRB Relationship	3.15	3.00	3.04	3.00
Tax Audit	2.75	3.00	2.90	3.00

7.3.2 Comparison with Tax Professionals' Survey

Perceptions of SME respondents regarding all tax attitudinal aspects differ slightly from the responding tax professionals. Mean scores in the tax professionals' survey (see Table 7.10) are relatively lower, except for fairness of tax law. Despite this trend, the order of mean scores indicated a similar pattern, with the highest and lowest score recorded for tax incentives (3.84) and tax audits (2.48) respectively. The lower score in a few aspects has resulted in different interpretations. SME respondents perceived corporate income taxation as complex but relatively fair in terms of both tax law and the tax rate structure. Comparatively, tax professionals perceived corporate taxation to be less complex, fairer, but neutral with regards to the tax rate structure. Recognising their knowledge and expertise in the area of taxation, a lower tax complexity level and higher tax fairness as perceived by the tax professionals is not surprising. A neutral view on the tax rate structure is comprehensible as tax professionals may not be concerned too much about the tax rate of their client. Perhaps the amount of tax paid, or more importantly tax savings, is more relevant to their role as an advisor.

In terms of tax audits, professionals are more inclined towards disagreeing with the likely low chances of tax auditing in SMEs compared to SME respondents who disagree but lean slightly to an indifferent view. Tax professionals are regularly in touch with the IRB officers on behalf of their SME clients. Thus, practically, they might have more knowledge with regards to tax auditing data from the IRB.

Table 7.10: Tax Attitudes of SMEs and Tax Professionals

Tax Aspects	Postal Survey		Professional Survey	
	Mean	Median	Mean	Median
Tax Complexity	3.56	3.67	3.19	3.33
Tax Rate	3.34	3.33	3.06	3.00
Tax Fairness	3.22	3.20	3.32	3.40
Tax Incentives	4.15	4.00	3.84	4.00
IRB Relationship	3.15	3.00	2.94	3.00
Tax Audit	2.75	3.00	2.48	3.00

However, acknowledging the role of tax professionals, a few differences in tax attitudinal aspects are in the expected direction. Thus, perceptions towards all six tax attitudinal aspects in the current study (i.e. main postal survey) have been reasonably supported in the survey of tax professionals.

7.3.3 Comparison with Prior Malaysian Studies

As discussed in Chapter Two,[177] all prior Malaysian tax compliance studies focussed on individual taxpayers, with only one study entirely confined to self-employed business individuals and a few others that included some self-employed business respondents. As a result, a straightforward comparison of findings is not possible. However, some comparison to prior studies with some business respondents is valuable in the context of the current study of SME corporate taxpayers.

The finding of the current study with regards to the complexity of corporate tax laws is as anticipated. The perceived complexity of the income tax laws has been evident in Malaysia even before the commencement of the SAS. Hanefah (1996) provided evidence on the presence of some degree of tax complexity of personal taxpayers in Malaysia. In 2001, Hanefah, Ariff and Kasipillai (2001) judged that the level of tax complexity in Malaysia was on an increasing trend following major amendments being made to existing income tax law or the introduction of a SAS. The difficulties or uncertainties faced by taxpayers in interpreting and taking advantage of the amendments are among the indicators of tax complexity (Kasipillai 2005, p. 26). The current study shows that almost 95 percent of SMEs employed tax professionals in complying with corporate tax laws in 2006.[178] An examination of respondents' reasons for using paid external tax professionals shows that almost 81 percent and 66 percent of them indicated lack of technical knowledge and tax law complexity as their main reasons for employing tax professionals respectively.[179] Thus, the presence of tax complexity is supported from this perspective as well.

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[177] See subsection 2.2.2.
[178] See Chapter Five, Table 5.15.
[179] See Chapter Five, Table 5.21.

Regarding tax fairness, the current study shows that respondents' perceptions towards tax law are inclined towards fairness, suggesting optimistic perceptions in this regard. Findings of prior Malaysian studies are somewhat mixed, nonetheless sound and realistic, considering the assessment system used during the study period. Hanefah (1996) observed that tax law was perceived to be unfair during the pre-SAS era. However, recent studies conducted during the SAS regime demonstrated a moderate view (Che Azmi and Perumal 2008) and a rather neutral view (Sia *et al.* 2008). From this trend (i.e. from unfair to a moderate or neutral view), the findings of the current study (i.e. prone towards fairness) are considered reasonable. Interestingly, both studies used a similar measurement for fairness, i.e. adapted from the original work of Gerbing (1988), and subsequently used in a number of international studies (see for example Christensen, Weihrich and Gerbing 1994; Richardson 2006). Some of the questions used in the Hanefah study were also adapted from Gerbing. On the other hand, the measurement used in the current study was adopted from Roberts (1994). This and other methodological differences between these three prior studies and the current studies should be noted.

In terms of tax rate structure, the current study shows that respondents are prone towards fairness. This finding is similar to prior studies (Che Azmi and Perumal 2008; Sia *et al.* 2008), both conducted during the SAS regime. One noteworthy aspect is that the measurement used for tax rate fairness in all three studies in the SAS regime, including the current study, was adapted from the work of Gerbing (1988). Nonetheless, other methodological differences between the studies should be noted. A comparison with the pre-SAS study is not possible, as Hanefah (1996) did not examine tax rate fairness separately.

The view of SMEs in regard to tax incentives is as expected, as tax incentives will offer some balance in facing business and financial challenges and constraints. A similar finding is reported by Abdul Manaf (2004), however in the context of individual land taxpayers. It is acknowledged that tax authorities worldwide are often willing to provide incentives to SMEs, particularly to small businesses (Freedman 2003, 2006).

Small and Medium Enterprises perceive that their relationship with the IRB has fairly improved during the SAS. No straightforward comparison is possible as previous studies focused either on the effectiveness of the tax administration (Hanefah 1996) or the IRB (Ramasamy *et al.* 2003) and not on the perceived relationship between taxpayer and tax officers. Both studies were carried out under the previous OAS system. Hanefah (1996) demonstrated that the Malaysian tax administration is fairly efficient, and thus suggested that the SAS be implemented so as to further improve the efficiency of the Malaysian tax system. However, a study by Ramasamy *et al.* (2003) failed to provide evidence of the influence of IRB effectiveness on tax compliance decisions made by individual business taxpayers. More recently, though, Loo (2006a) included a question on IRB relationships, but it was merely part of a series of questions that measure attitudes toward taxation, and thus it was not reported as a specific item. Under the SAS regime, the current researcher believes that taxpayer perceptions of their relationship with the IRB is an important aspect in enhancing attitudes towards the effectiveness of the IRB, which subsequently could lead to higher voluntary compliance.

In terms of the issue of a tax audit arising in the SAS environment, findings of the current study suggest that respondents are unsure about the probability of their SME business facing tax auditing. Since the introduction of the SAS, Loo (2006a; 2006b) was probably the first to consider tax audits as amongst tax structure features that could determine tax compliance behaviour. Unfortunately, the study does not report the level of perceptions on tax audits specifically (the effect of tax audit on tax compliance behaviour is discussed later).[180] The low score on tax audits is possibly due to tax audit information not being publicly available. Currently, there are some details in the annual report of the IRB on the number of tax audit cases and the corresponding amount recovered from audit activities. However, the probability of taxpayers being selected for audit purposes is not publicly available or highlighted. The IRB may want to consider appropriate measures to change this perception. A further discussion and related specific recommendations are presented in Chapter Eight.[181]

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[180] See subsections 7.6.1 and 7.6.3. See also Chapter Six, Section 6.7.
[181] See subsection 8.3.3.

7.3.4   Comparison with International Studies

As discussed in Chapter Two,[182] a study by Joulfaian (2000) was among the first to adapt a framework of tax compliance study on individuals into the corporate sector. The understatement of personal income tax by managers was used as a proxy of managerial preferences of corporations. On the other hand, the remaining limited number of international studies on corporate taxation normally assesses the influence of corporate characteristics, such as business size, tax rates and audit coverage on corporate tax compliance. The current study is among the first to consider corporate tax attitudes from a business managerial perspective.

To some extent, it is possible to compare previous international findings on individual taxpayers, but this approach is not adopted here mainly due to the structural differences of tax systems between countries (such as assessment system and the tax rate structure) and/or methodological differences among studies (measurement-related in particular). The effect of the latter is often emphasised in the tax compliance literature—see especially Long and Swingen (1991)—and the former is also regarded as an important concern (Gilligan and Richardson 2005). Gilligan and Richardson were probably the first to compare perceptions of individuals (regarding tax fairness) in two different tax jurisdictions, Australia and Hong Kong. A similar instrument for measuring tax fairness (adopted from Gerbing 1988) was adopted in their study. Their findings indicate that perceptions of Hong Kong individuals are slightly better than the Australian, with significant differences being observed, particularly in terms of general fairness and personal fairness. The fact that a different tax system applies in both countries (i.e. SAS in Australia and OAS in Hong Kong) was believed to be the main reason for their findings (Gilligan and Richardson 2005).

Given the above methodological concern, the international comparison of tax attitudinal aspects is not pursued here, but these attitudes are discussed later within the overall research objective of the current study, i.e. to establish whether tax attitudes from a business managerial point of view could be linked to corporate tax behaviour.

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[182] See subsection 2.2.1.

7.4 COMPLIANCE BEHAVIOUR

7.4.1 Comparison with Web Survey

Mean scores of the respective tax behaviour are slightly higher in the web survey, as shown in Table 7.11. A similar trend is observed for tax attitudes in the web survey as well (see Table 7.9). The likely non-compliance behaviour, measured at both the non-compliance type or at the SME level, broadly indicates a similar view, with one exception. Respondents in the web survey are noticeably indifferent with regards to overstatement of deductions.

Table 7.11: Tax Behaviour by Survey Method

Likely Tax Behaviour	Postal Survey		Web Survey	
	Mean	Median	Mean	Median
Understatement of Income	2.28	2.00	2.48	3.00
Overstatement of Deductions	2.76	3.00	3.06	3.00
Both Non-compliance [a]	2.52	2.50	2.78	3.00

[a] This refers to the combined category of both understatement of income and overstatement of deductions.

7.4.2 Comparison with Tax Professionals' Survey

Tax professionals have relatively better compliance behaviour than SME respondents, as shown by lower mean scores in the tax professionals' survey, as shown in Table 7.12. The compliance behaviour among tax professionals is rather obvious in relation to overstatement of deductions.

Table 7.12: Tax Behaviour of SMEs and Tax Professionals

Likely Tax Behaviour	Postal Survey		Professional Survey	
	Mean	Median	Mean	Median
Understatement of Income	2.28	2.00	2.10	2.00
Overstatement of Deductions	2.76	3.00	2.19	2.00
Both Non-compliance [a]	2.52	2.50	2.14	2.00

[a] This refers to the combined category of both understatement of income and overstatement of deductions.

Overall, the above finding is practically appropriate as tax professionals are expected to provide tax advice with reasonable care. They are subjected to a penal structure in the case of assisting their tax clients in the understatement of tax liability. In such cases, tax professionals may be liable to a fine of between RM2,000 and RM20,000, or to imprisonment of up to three years, or to both [Section 114 (1A)].

7.4.3   Comparison with Prior Malaysian Studies

The current study shows that the respondents are inclining towards tax compliance, in terms of income reporting, but are likely to register between compliant and neutral behaviour for tax deductions. These findings are consistent with prior studies in Malaysia, which largely indicated compliance behaviour in most tax situations (Kasipillai, Aripin and Amran 2003; Kasipillai, Mat-Udin and Zainol-Arifin 2003; Kasipillai and Abdul-Jabbar 2006) and a neutral view in some other cases (Kasipillai and Abdul-Jabbar 2006). It must be emphasised that a number of studies have examined tax compliance behaviour and some determinants of individual taxpayers in Malaysia.[183] However, most studies have tended to focus their discussion on the determinants of compliance behaviour (see for example Ramasamy *et al.* 2003; Loo 2006a). Regrettably, only a few studies reported their findings on both the level of compliance and its determinants (Kasipillai, Aripin and Amran 2003; Kasipillai, Mat-Udin and Zainol-Arifin 2003; Kasipillai and Abdul-Jabbar 2006). Even a study by Loo (2006a) in the SAS regime did not report the level of tax compliance separately.

More recently, despite the fact that a study by Sia *et al.* (2008) relates to tax compliance, tax compliance behaviour is not measured. Instead, they assumed that those who are subjected to tax audits were non-compliers, and non-audited taxpayers were compliers. As such, a comparison is only possible with those former three studies (i.e. studies by Kasipillai, Aripin and Amran 2003; Kasipillai, Mat-Udin and Zainol-Arifin 2003; Kasipillai and Abdul-Jabbar 2006), which were carried out prior to SAS, but are subject to some methodological differences within the studies; for example, the nature of tax scenarios, their measurement, and the amount of consideration used are different.

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[183] See Chapter Two, subsection 2.2.2.

7.4.4 Comparison with International Studies

Similar to tax attitudes,[184] comparing the level of tax compliance among countries would be misleading. All prior studies on US corporations measured 'actual' non-compliance by employing the IRS audit data, especially the TCMP.[185] On the other hand, the current study employs the survey approach to hypothetical tax scenarios,[186] which merely measures 'possible' non-compliance behaviour of corporate SMEs from a managerial perspective and not the actual.[187] Nonetheless, the determinants of corporate tax compliance, both in Malaysia and internationally, are useful for tax policy consideration and are thus discussed latter.[188]

7.5 THE RELATIONSHIP AMONG TAX ATTITUDES, BEHAVIOUR AND COMPLIANCE COSTS

A comparative analysis of the relationships among tax attitudes, tax behaviour and compliance costs mainly in the SMEs surveys and some relevant findings of the tax professionals' survey are presented in this section. The survey of tax professionals concerned external compliance costs only, thus the relationship between part of the compliance costs and tax attitudes or tax behaviour is not analysed further. Out of six attitudinal items, the perceived IRB relationship is the only aspect that was found to have a very weak direct association with compliance costs in the postal survey, as shown in Table 7.13. The current study also fails to confirm the directions of the relationships as the findings are mostly contradicted among both SME surveys. Taken as a whole, the findings of both the postal and web surveys did not signify a statistical association between tax attitudes and compliance costs. Similarly, compliance costs are also not statistically associated with tax behaviours in both surveys.[189]

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[184] See subsection 7.3.4.
[185] See Chapter Two, Section 2.2.1.
[186] See Chapter Four, subsection 4.4.3.
[187] See Chapter Eight, Section 8.4, for details on this and other limitations.
[188] See subsections 7.6.3. and 7.6.4
[189] See Chapter Six, Tables 6.12 and 6.22.

Table 7.13: Tax Attitudes and Compliance Costs: Correlation Analysis

Tax Attitudinal Aspects	Postal Survey	Web Survey
Complexity	-	-
Fairness	-	-
Rate	-	-
Incentives	-	-
Audit	-	-
IRB Relationship	$\sqrt{}$ [a] (+)	-

[a] Significant at the five percent level. Positive (+) sign denotes a direct relationship.

As for the relationship between tax attitudes and tax behaviour, Table 7.14 shows similar survey findings with regards to tax audit and tax fairness. A tax audit is the only aspect that was found to be positively associated with both types of tax behaviour in both forms of surveys and, more importantly, in similar directions. On the other hand, tax fairness has no correlation to tax behaviours. Further, tax complexity is also largely associated with tax behaviour, with one exception in the web survey for the overstatement of deductions.

Table 7.14: Tax Attitudes and Tax Behaviour: Correlation Analysis

Tax Attitudes	Understatement of Income		Overstatement of Deductions	
	Postal Survey	Web survey	Postal Survey	Web survey
Complexity	$\sqrt{}$ [b] (+)	$\sqrt{}$ [b] (-)	$\sqrt{}$ [a] (+)	-
Fairness	-	-	-	-
Rate	-	$\sqrt{}$ [b] (+)	-	$\sqrt{}$ [b] (+)
Incentives	-	-	-	$\sqrt{}$ [b] (+)
Audit	$\sqrt{}$ [b] (+)	$\sqrt{}$ [a] (+)	$\sqrt{}$ [a] (+)	$\sqrt{}$ [b] (+)
IRB relationship	-	-	-	-

[a] Significant at the one percent level. [b] Significant at the five percent level.
Positive (+) or negative (-) signs denote a direct or indirect significant relationship respectively.

Overall, findings of the main postal survey are generally supported by the web survey, although some variation is noted in the web survey. However, from the perspective of tax professionals, all six tax attitudinal aspects are found to have no statistical relationship with likely tax behaviour.[190] It must be emphasised that the survey of tax professionals had 31 responses only. This finding should be treated as tentative subject to a further study. Regarding prior studies, the combined effect of a number of variables (i.e. multivariate analysis) is essential, and it is often emphasised in previous studies that just the relationship among two variables (i.e. bivariate relationship) is insufficient. Comparative findings and discussion with regards to multivariate analysis is presented in Section 7.6 below.

7.6   DETERMINANTS OF COMPLIANCE BEHAVIOUR

7.6.1   Comparison with Web Survey

The importance of each independent variable in the respective three models, in both surveys, is presented in Table 7.15. The tax audit is the only variable that constantly influences the likely tax behaviour of SME respondents in all three models in both postal and web surveys. Another five variables, namely business size, estimated tax level, amount of compliance costs, perceived fairness and perceived IRB relationship consistently indicated otherwise (i.e. non-determinants). In most cases, tax complexity also influences tax complying behaviour. Despite the above similarities, a few inconsistent findings are observed between the postal and web surveys. Business length and business sector (i.e. construction) are also found to be a significant determinant in some models in the postal survey. On the other hand, in the web survey the tax rate and tax incentives influenced tax behaviour in all three models and two of the models respectively.

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[190] See Appendix T, Table T.2.

Table 7.15: Significance of Independent Variables in the Regression Models

	Likely Tax Behaviour					
	Understatement of Income		Overstatement of Deductions		Both Non-compliance [a]	
Survey Type	Postal	Web	Postal	Web	Postal	Web
Variables:						
Audit	√ [d]	√ [b]	√ [b]	√ [c]	√ [b]	√ [b]
Complexity	√ [c]	√ [b]	√ [b]	-	√ [b]	√ [c]
Rate	-	√ [c]	-	√ [c]	-	√ [c]
Length	√ [d]	-	-	-	√ [d]	-
Sector: Construction	-	-	√ [c]	-	√ [d]	-
Incentives	-	-	-	√ [c]	-	√ [c]
Size	-	-	-	-	-	-
Tax	-	-	-	-	-	-
Compliance Costs	-	-	-	-	-	-
Fairness	-	-	-	-	-	-
IRB Relationship	-	-	-	-	-	-

[a] This refers to the combined category of both understatement of income and overstatement of deductions.
[b] Significant at the one percent level.
[c] Significant at the five percent level.
[d] Significant at the ten percent level.

Overall, the findings of the web survey, to a large extent, add consistency to the postal survey. The current study provides evidence that two aspects (tax audits and tax complexity) have an influence on tax complying behaviour, that five variables (business size, tax level, compliance costs, fairness and IRB relationship) do not, and that the effect of the remaining four variables (length, sector, rate and incentives) is unfortunately indeterminate.

7.6.2   Comparison with Tax Professionals' Survey

From the tax professionals' perspective, none of the tax attitudinal aspects influence their tax compliance behaviour. The fact that the survey of tax professionals has just 31 responses, and the regression analysis considered tax attitudinal items only, limits the value of these findings.

7.6.3   Comparison with Prior Malaysian Studies

The current study is the first to consider corporate tax compliance behaviour in Malaysia; thus, this section discusses relevant current findings with previous studies on individuals that include a number of business respondents.[191] Although findings of a postal survey are a central concern in this study, it is useful to consider the determinants of tax behaviour in both postal and web surveys. Overall findings of both surveys have shown that two factors, i.e. tax complexity and tax audit, consistently influence likely tax behaviour; five factors, i.e. business size, tax level, compliance costs, tax fairness and the perceived IRB relationship, do not; and the remaining four factors, i.e. business length, business sector, tax rate and tax incentives, vary between the surveys and types of non-compliance.[192]

A straightforward comparison of the current study to previous Malaysian studies is of limited use. This is due to the differences in the assessment system (either OAS or SAS) and/or the methodology in particular, including factors that have been subjected to examination. Even within the previous studies, only four equivalent factors, i.e. tax knowledge, tax fairness, compliance of other taxpayers' and the perceived IRB administration have been examined in at least in two studies, with tax fairness often being investigated, as shown in Table 7.16. The current study replaces individual demographics with corporate SME characteristics. Compliance costs estimates and tax incentives are the new two variables, with the former investigated for the first time, while the latter has been employed earlier in a Malaysian land tax study by Abdul Manaf (2004).

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[191] See Chapter Two, subsection 2.2.2. For a list of studies see Table 2.2.
[192] See subsection 7.6.1.

Table 7.16: Determinants of Tax Compliance for Malaysian Businesses [a]

Author(s)	Hanefah	Ramasamy *et al*	Abdul	Loo	Sia *et al*	Current
Publication Year	1996	2003	2003	2006a	2008	2009
Assessment System		OAS		OAS/ SAS	SAS	SAS
Business Taxpayers: [b] Individual (IND)/ Corporate (CORP)	IND	IND	IND	IND	IND	CORP
Determinants [c]						
Business Characteristics:						
Size						N
Length						M
Sector						M
Tax Level						N
Tax Knowledge	D [d]	N	-	D	-	-
Attitudes/Perceptions:						
Tax Fairness	D [d]	D	-	D [e]	N	N
IRB Relationship	-	N	-	D [e]	-	N
Tax Rate	D [d]	-	-	-	N [f]	M
Tax Complexity	D [d]	-	-	-	-	D
Tax Audit	-	-	-	N [g]	-	D
Tax Penalty	-	-	-	D [g]	-	-
Others' Compliance	-	D	-	-	N	-
Incentives	-	-	-	-	-	M
Morale	-	-	-	-	N	-
Financial constraint	-	-	-	N	-	-
Compliance Costs	-	-	-	-	-	N

D denotes determinants, N non-determinants, and M inconclusive factors due to mixed findings between the survey types and types of non-compliance.

[a] See Table 2.2 for key findings and Appendix B for other relevant details.

[b] Studies, other than Ramasamy *et al*, also include non-business individuals. This study focuses on SME businesses.

[c] Demographic factors were excluded as these were unrelated to corporations. Corporate characteristics were not relevant to earlier studies on individuals and thus appear in shaded boxes.

[d] Hanefah (1996) argued that these factors influence tax behaviour. He did not directly measure their influence on tax behaviour but rather analysed perceptions by demographic factors. See subsection 2.2.2.

[e] Tax fairness and the perceived IRB relationship were measured as part of attitudes toward taxation.

[f] Tax rate dimension is one of the five dimensions of fairness measured in this study.

[g] Tax audit and penalty were measured as part of tax structures features.

Out of 11 variables examined in the current corporate study, only five are comparable to previous studies, i.e. tax fairness, tax complexity, the tax rate, tax audits, and the perceived IRB relationship. A comparative analysis indicates consistent findings regarding tax complexity, contrary results concerning tax audits, and mixed results for the remaining three factors, i.e. tax fairness, the tax rate and the IRB relationship.

Similar to personal income taxation (Hanefah 1996), the current findings indicate that complexity is also an important concern within corporate tax compliance. A contradictory finding for tax audits is probably justified, as the concept of a tax audit is rather new to individual taxpayers during the study period, but not to corporate taxpayers.[193]

The findings regarding tax fairness contradict three earlier studies (Hanefah 1996; Ramasamy *et al.* 2003; Loo 2006a), but are consistent with the most recent study (Sia *et al.* 2008). Apart from fundamental differences between corporate and individual taxation, and also other methodological differences, this inconsistent result is probably linked to the type of tax assessment system. Two of the three former studies were conducted during the previous OAS regime, with the remaining study during the transitional period. On the other hand, studies by Sia *et al.* (2008) and the current researcher were conducted under the SAS regime.

On the tax rate structure, inconclusive findings are not surprising, for this seems to support previous contradictory findings on individuals (Hanefah 1996; compared to Loo 2006a). The differences in the tax rate structure between corporate and individual taxation may also have contributed to this outcome. Findings about the perceived IRB relationship are similar to Ramasamy *et al.* (2003) in the pre-SAS study, but contradict Loo's (2006a) in the conversion period. However, the fact that the perceived IRB relationship forms part of the measurement of overall tax attitudes in the Loo (2006a)

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[193] The concept of a tax audit is an important aspect in the SAS implementation. The SAS was introduced first to companies in 2001 and subsequently to individuals in 2005 (tax year 2004).

study must be noted. It is also possible that perceptions on the tax rate structure depend on specific types of non-compliance.

The current study, in general, provides evidence on the effect of the above five factors—complexity, audits, fairness, the tax rate structure, and the IRB relationship—in the context of corporation taxation, SMEs in particular. Some inconsistency observed in the current study is not surprising as it is often evident in the context of individual taxpayers internationally (Jackson and Milliron 1986; Richardson and Sawyer 2001) and even within Malaysian studies. For example, tax knowledge is found to be a significant factor in two previous studies (Hanefah 1996; Loo 2006a), but otherwise in the Ramasamy *et al.* (2003) study. This demonstrates the importance of a few key determinants of tax compliance in the context of Malaysian corporate SMEs. Despite some basic differences between individual and corporate taxation, it is fully acknowledged that methodological differences, in particular, should always be an important concern in evaluating tax compliance studies.

7.6.4 Comparison with International Studies

As discussed in Chapter Two, all five corporate tax compliance studies were conducted in the US,[194] and more importantly in a developed economy. The current Malaysian study is probably the first in developing countries. Despite this and other key tax structural and methodological differences, discussion regarding determinants of corporate tax compliance internationally is valuable in policy considerations. For this purpose, similar to a comparison of Malaysian studies,[195] the overall findings of both postal and web surveys are considered.

The current study indicates that the managerial perceptions about tax complexity and tax audits influence corporate tax compliance. Unfortunately, the former was not considered empirically (at least as a determinant of corporate compliance) in the prior studies and the latter was measured in terms of audit rates and not perceptions. Despite

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[194] Subsection 2.2.1.
[195] Subsection 7.6.3.

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this, some evidence of the possible association between complexity and corporate tax compliance is discussed below.

In the context of individuals, including businesses, the negative impact of complexity upon tax compliance is commonly acknowledged (Cuccia and Carnes 2001; McKerchar 2002a). Several studies on corporations have investigated the problem areas of tax compliance (Erard 1997a, 1997b) and their specific sources of complexity (Slemrod and Blumenthal 1996; Slemrod and Venkatesh 2002). The Canadian studies, on both SMEs (Erard 1997b) and large (Erard 1997a) corporations, found that tax complexity is among the frequently cited compliance problems by businesses of all sizes (large and SMEs). The US study on large and medium corporations (Slemrod and Blumenthal 1996, p. 428; Slemrod and Venkatesh 2002, p. 30) found that the depreciation rules and the alternative minimum tax provisions were the most frequently cited areas that increase tax complexity and the compliance burden. The impact of tax complexity is also believed to be among the major problems of small businesses in the US (Ashby 2000; Slemrod 2004a).

Regarding the remaining ten variables, only two factors examined in the current Malaysian study are comparable to the previous US studies, i.e. business size and business sector, as shown in Table 7.17. A number of other business features, such as public/private, national/multinational, domestic/foreign ownership, are likely to be relevant to large corporations in Malaysia but not to corporate SMEs. Business size is not an influencing factor in the current study. This result is similar to the earliest study on corporations (Rice 1992), but contradicts two later studies (Joulfaian 2000; Hanlon, Mills and Slemrod 2005). Focusing on a specific group of business taxpayers and on differences in the proxies used to measure business size may contribute to this variation.

Table 7.17: Determinants of Corporate Tax Compliance Internationally [a]

Author(s)	Rice	Kamdar	Mills	Joulfaian	Hanlon Mills & Slemrod	Current
Publication year	1992	1997	1998	2000	2005	2009
Country	US					Malaysia
Determinants:						
Business Characteristics:						
Size [b]	N	-	-	D	D	N
Profit/Income	D	D	-	D	-	-
Marginal tax rate	D	-	-	D	-	-
Tax level	-	-	-	-	-	N
Foreign ownership	-	-	-	N	D	- [c]
Industry/Sector	-	-	-	-	D	M
Public/Private	-	-	-	-	D	- [c]
Multi-Nationality	-	-	-	-	D	- [c]
Length of Business	-	-	-	-	-	M
Audit Rate	-	D	-	D	-	-
Public Disclosure	D	-	-	-	-	-
Book-tax difference	-	-	D	-	-	-
Managerial Preferences:						
Non-compliance manager	-	-	-	D	-	-
Managerial Attitudes:						
Complexity	-	-	-	-	-	D
Fairness	-	-	-	-	-	N
Tax Rate	-	-	-	-	-	M
Audit	-	-	-	-	-	D
Relationship tax authority	-	-	-	-	-	N
Incentives	-	-	-	-	-	M
Compliance Costs	-	-	-	-	-	N

D denotes determinants, N non-determinants, and M inconclusive factors due to mixed findings between the survey types and types of non-compliance.
[a] See Table 2.1 for key findings and the full sources.
[b] Various size proxies were employed; assets and/or sales in the US and three alternatives, i.e. turnover, staff number, and a combination of both, in the Malaysian study.
[c] These factors are not likely to be relevant to corporate SMEs in Malaysia.

A study by Rice (1992) was confined to medium-sized corporations, i.e. assets between US$1 million and US$10 million; Joulfaian (2000) covers both small and medium-sized corporations, i.e. assets of US$10 million or less; on the other hand, Hanlon, Mills and Slemrod (2005) focus on large and medium-sized corporations, i.e. assets between US$10 million and over US$5 billion.[196] For a size proxy, Rice (1992) considered total value of assets; Joulfaian (2000) employed annual sales level; Hanlon, Mills and Slemrod (2005) considered both assets and sales measures; and the current study examined this in terms of three alternatives, i.e. turnover, staff number, and a combination of both criteria, as established by the NSDC.

Regarding business sectors, the current findings provide some evidence of the influence of business sectors on overstatement of deductions, but not of the understatement of income or the overall compliance at the firm level. These findings, especially the effect of the business sector on the overall tax compliance (firm level) contradict earlier findings by Hanlon, Mills and Slemrod (2005). Apart from fundamental differences between these studies and the size of corporations, differences in the classification of business sector between the Malaysian and the US study could be a reason. The current Malaysian study categorised businesses into four main sectors compared to eight sectors in the US study.

7.7   CHAPTER SUMMARY

This chapter has shown similar estimates of compliance costs of RM9,300 per SME company in both postal and web surveys. The computational-planning costs breakdown is also similar, but a slight difference has been observed in terms of the internal-external costs proportion. However, overall, the current 2006 estimates have shown that the income tax compliance costs of SMEs have decreased significantly compared to earlier 1999 estimates during the pre-SAS regime. One noteworthy aspect is that the regressive nature of compliance costs on small businesses remains an important area in tax policy

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[196] US$1 = RM3.52 (1 July 2009, Bank Negara Malaysia).

considerations, as evident in both pre-SAS (1999 estimates) and post-SAS (the current 2006 estimates) surveys. As for international comparisons, the Malaysian corporate SME compliance costs of nine percent and 0.2 percent relative to tax revenue and GDP respectively are within the international range in both terms.

In terms of tax attitudes and the likely compliance behaviour, overall, both the primary SME postal and web surveys demonstrated similar perceptions, while perceptions of tax professionals are slightly better, as would be expected. Findings regarding determinants of tax non-compliance are also comparable in both surveys, with the following overall patterns: tax complexity and tax audits as determinants; business size, tax level, compliance costs, tax fairness and the perceived IRB relationship as non-determinants; and, the length in business, sector, the tax rate and tax incentives as inconclusive. However, compared to earlier Malaysian studies on individuals, the current corporate SME study provides support for the influence of tax complexity, indicating to some extent conflicting results concerning tax audits, and demonstrating mixed results in terms of perceptions of tax fairness, the tax rate and the IRB relationship. In terms of international comparisons, the effect of business size is uncertain, as the current findings are similar to Rice (1992), but contradict studies by Joulfaian (2000) and Hanlon, Mills and Slemrod (2005). On the other hand, this thesis contradicts the study by Hanlon, Mills and Slemrod (2005) that finds the business sector as a determinant of tax compliance. Overall, the current study offers preliminary evidence in the context of Malaysian corporations, SMEs in particular. Conclusions and policy recommendations arising from this study, together with major limitations, are presented in Chapter Eight.

CHAPTER EIGHT

CONCLUSIONS AND POLICY RECOMMENDATIONS

8.1   INTRODUCTION

This chapter presents conclusions on the overall corporate SME income tax compliance costs estimates and corporate SME business managerial perceptions about tax attitudes and likely tax compliance behaviour. The overall objective of this study is to examine the determinants of non-compliance behaviour of corporate SMEs, with particular emphasis on income tax compliance costs under the SAS regime. For this purpose, a review of the key findings is discussed by reference to three research questions.[197] Policy recommendations arising from the compliance costs estimates, in particular, and other key findings, are then presented. Major limitations of this research are discussed next. This is followed by suggestions for future research. The final section presents the author's concluding remarks on this thesis.

8.2   THE SUMMARY OF KEY FINDINGS

8.2.1   Compliance Costs Estimates

The first research question of this study is to estimate the corporate income tax compliance costs for Malaysian SMEs under the SAS regime. This study has shown that the average income tax compliance costs are RM9,295 per SME company, amounting to RM1,084 million in aggregate for the tax year 2006. The ratios of internal-external costs and computational-planning costs are 59:41 percent and 74:26 percent of compliance costs respectively. In terms of costs distribution, measured as a percentage of business turnover, the usual regressive nature of compliance costs for Malaysian SMEs has been confirmed under the SAS regime. The compliance costs percentage for SMEs in the lowest turnover level is as much as six times, 20 times and 82 times higher

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[197] See Chapter One, Section 1.3.

than the second, third and fourth levels respectively, and over 43 times higher than the overall SME compliance costs distribution of 0.19 percent.

The average 2006 estimate of RM9,295 per company shows that compliance costs of SME companies are around 58 percent lower compared to the 1999 pre-SAS figure of RM21,964. The income tax simplification measures taken by the IRB, a period of relative stability in both the economic climate and tax system for the past six years or so, and the likely removal of high start-up compliance costs are among major possible reasons for the significant decline in the compliance costs in this study. Notwithstanding the above, the ratios of both external to internal costs and computational to planning costs increased, as would be expected under a SAS regime.

Despite a significant reduction in compliance costs, compliance costs expressed as a percentage of tax revenue indicate a slight increase from eight percent in 1999 to nine percent in 2006. Thus, compliance costs relative to tax revenue before and after the SAS are considered about equivalent. In terms of GDP, income tax compliance costs for corporate SMEs are estimated to be around 0.2 percent in 2006. Unfortunately, comparison is not possible with prior studies as the current study is the first to estimate aggregate compliance costs in Malaysia, and probably even in Asia as whole.

For international comparison, the current estimates of tax compliance costs of around nine percent to tax revenue and nearly 0.2 percent to GDP are within the international range, i.e. two to 10 percent of tax revenue and up to 2.5 percent of GDP respectively as pointed out by Evans (2003b, p. 71). Within the Asian countries, having acknowledged the differences in the targeted company size and the other usual methodological and structural concerns, the fact that the Malaysian SME cost-ratio to tax revenue is high compared to Hong Kong and Singapore, and within the Indian estimates, is not surprising. This is because both Hong Kong and Singapore continue to adopt the OAS, while India has moved to the SAS. But the fact that Malaysian costs estimates (relative to tax revenue) were previously higher, even in the pre-SAS regime, should be recognised. However, in terms of GDP, the compliance costs of Malaysian SME

companies of around 0.2 percent is considered low compared to the overall international ratio of less than two percent. As an overall comparison, the 2006 Malaysian corporate SME compliance costs, expressed in GDP terms, are high compared to the 1986/87 UK estimates, but the lowest when compared to ratios in Australia, Slovenia, and Croatia. Tax compliance costs relative to GDP for other countries, including Asian and developed countries, i.e. Canada, and the US, unfortunately are not available.

Two forms of offsetting benefits of tax compliance are recognised for Malaysian corporate SMEs, i.e. tax deductibility and cash flow benefits, but the availability of data only allows estimation of the former. The estimated value of tax deductibility is almost RM1,700 per SME company or 18 percent of tax compliance costs, amounting to RM196 million for the corporate SMEs in 2006. Taking into account this benefit, the average net compliance costs per SME company are almost RM7,600, amounting to RM888 million in aggregate. A comparison between net compliance costs estimates (RM7,600) and the compensation amount that is expected by the respondents (RM7,300) demonstrates comparable results that add reliability to the estimates. Further, an analysis of a separate web survey also confirms the consistency of the estimates made in the primary postal survey.

Overall, the current estimates demonstrate that compliance costs at the SME level have decreased substantially in current value terms, are identical in relation to tax revenue, and the effect of fixed costs remains an important concern.

8.2.2   The Relationship between Compliance Costs and Compliance Behaviour

The second research question addresses the extent to which tax compliance costs influence the likely compliance behaviour of corporate SMEs. Compliance costs are estimated to address research question one. As for compliance behaviour, this study, as measured by two independent hypothetical tax scenarios from a business managerial perspective, shows that SME companies are largely compliant towards both income reporting and tax deductions behaviour, either measured for the full amount of RM10,000 or part thereof.

For the full amount of RM10,000, relatively more SME companies (59 percent) are compliant towards reporting behaviour than to the correctness of their deductions (41 percent). This finding suggests that non-compliance through overstatement of deductions probably needs further attention in the Malaysian SME context, particularly in selecting companies for a tax audit. On the contrary, for partial consideration, more respondents are compliant in terms of deductibility of expenses (42 percent) as compared to income reporting (38 percent). The outcome is not surprising given that the much higher risk of detection is possibly recognised by the respondents in case of partial non-compliance.

Theoretically, tax compliance costs are expected to influence the complying behaviour of taxpayers. The findings of this study show that the relationship is in the expected direction, i.e. higher compliance costs may lead to non-compliance. This is applicable either to understatement of income, overstatement of deductions, or the combined non-compliance at the SME level. Unfortunately, both the mean comparison and the correlation analysis failed to indicate a statistically significant relationship between tax compliance costs and the likely compliance behaviour of SMEs, and more importantly, regardless of the amount involved. The same conclusion is drawn from the separate analysis in the web survey. The effect of compliance costs on tax compliance, taken together with other factors, is discussed in the next section.[198]

A lack of a relationship between compliance costs and the likely compliance behaviour is possibly due to the fact that the current study focuses on homogeneous business size. In corporate tax compliance studies, significant differences in tax behaviour were evident when researchers covered all business sizes (Hanlon, Mills and Slemrod 2005), and contrary findings were identified when a specific business size was targeted (Rice 1992). From this perspective, it is possible that there may be a significant association between compliance costs and compliance behaviour among different business sizes i.e. small, medium and large.

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[198] Subsection 8.2.3.

8.2.3 Determinants of Tax Compliance Behaviour

The third research question examines the influence of tax compliance costs on compliance behaviour, taken together with corporate SME characteristics and business managerial attitudes regarding corporate taxation. Eleven determinants are examined in this study, with business characteristics comprising four factors—size, sector, length in business and estimated tax amount, and managerial perceptions—obtained for six tax attitudinal aspects, namely complexity, fairness, rate structure, incentives, audits and the IRB relationship. For business size, three alternative measures, i.e. turnover level, number of staff employed and the combined criteria under the NSDC definition are used, with the turnover criteria as the primary size measure. Three main regression analyses were carried out separately for each of the three compliance behaviour, i.e. understatement of income (Model 1), overstatement of deductions (Model 2) and the combined non-compliance (Model 3), with further regressions undertaken by using the other two alternative size proxies for all three dependent variables.

Overall, the current study provides evidence that tax complexity and tax audits influence the likely tax compliance behaviour of SMEs, with the possibility of non-compliance increasing as the perceived tax complexity increases and the probability of tax audit decreases. Five factors, i.e. business size, tax level, fairness, IRB relationship, and more importantly, compliance costs, have no effect on tax behaviour. The effect of the remaining four variables (length, sector, rate and incentives) is inconclusive due to mixed findings between types of compliance and surveys. It is also evident that non-compliance in terms of income reporting (or tax deductions) possibly affects the accuracy of the deductions (or income reporting).

Findings in the context of individual businesses are considered for comparative purposes as there is no previous study on corporate businesses. For this purpose, only five out of eleven factors are comparable to prior studies, i.e. tax fairness, tax complexity, the tax rate, tax audits, and the perceived IRB relationship. Overall, the effect of tax complexity is supported fully; the contradictory effect of a tax audits is fairly supported; and there are mixed effects for the remaining three factors, i.e. tax

fairness, the tax rate, and the IRB relationship. The mixed effects are, to some extent, sensible as contradictory findings are often evident in tax compliance research internationally (Jackson and Milliron 1986; Richardson and Sawyer 2001).

For international comparison of compliance research, analysis within the limited number of corporate tax compliance studies suggests that only two factors examined in the current study are equivalent to the previous US studies, i.e. business size and business sector. In the Malaysian corporate SME context, the former is found not to influence tax behaviour, and the effect of the latter is somewhat mixed. The finding regarding business size is similar to the first study on corporate tax compliance (Rice 1992), but is contradicted by two recent studies (Joulfaian 2000; Hanlon, Mills and Slemrod 2005). Targeting different company sizes and, more importantly, adopting different size measures may partly explain these diverse findings. As for business sectors, differences in the classification of sectors between Malaysia and the US could be among possible justifications. Above all, it is recognised that the fundamental differences in the tax system and methodology may have contributed to this trend. Notwithstanding this, the current study offers preliminary evidence in the context of corporate Malaysian SMEs. Further research in this area of corporate tax compliance is needed, both in Malaysia and internationally.

8.2.4   Other Key Findings

This study also assessed the business managerial attitudes about corporate SME taxation regarding complexity, fairness, rate structure, audits, incentives and the IRB under the SAS regime. Corporate taxation for SMEs is perceived to be complex and fair both in terms of tax laws and the tax rate structure. Corporate SMEs are expecting more tax incentives, are uncertain about the likelihood of audit, and consider that their relationship with the IRB improved to some extent during the SAS regime.

In terms of the relationship between tax attitudes and compliance, the correlation analysis shows that only complexity of the corporate tax law and probability of a tax audit are statistically connected to both types of non-compliance, either measured

separately or jointly. This suggests that the possibility of non-compliance increases as the perceived level of tax complexity increases and the chances of a tax audit decreases. Regarding compliance costs, only the perceived IRB relationship indicates a significant association. Unfortunately, the direction of the relationship is not conclusive due to contradictory findings in the postal and web surveys.

8.3   MAJOR POLICY RECOMMENDATIONS

8.3.1   Institutional and Policy Recognition of Tax Compliance Costs

The importance of SMEs has been evident in Malaysia, particularly over the last five years, and this has led to the establishment of the NSDC in 2004 and, more recently, the transformation of SMIDEC into the SME Corp.[199] Unfortunately, the issue of compliance burden, particularly the tax burden surrounding SMEs and even large businesses in Malaysia, is yet to be recognised fully or explicitly.

On 7 February 2007, the Special Taskforce to Facilitate Business (STFB, or known as PEMUDAH) was established to address the issue of bureaucracy in business-government dealings, including taxation.[200] The aim of the STFB is to improve Malaysia's competitive position internationally (The Special Taskforce to Facilitate Business 2008), and this demonstrates the early recognition of business regulatory concerns at the national level. In terms of its membership, the STFB comprises 23 members from both the private and public sectors, including the chief executive officer of SMIDEC,[201] but the absence of SME business involvement is noteworthy.

In earlier developments specifically applying to taxation, the establishment of the Tax Review Panel, or TRP, (Ministry of Finance Malaysia 2004) seems to have been mainly

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[199] See Chapter One, Footnote 6.
[200] Focus Group on Paying Taxes is one of the five focus groups (2007; six in 2008) under the Working Group on Efficiency Issues (The Special Taskforce to Facilitate Business 2008, 2009). The membership of this focus group, unfortunately, is not available.
[201] The membership of the Taskforce and other details, are available at http://www.pemudah.gov.my.

directed towards the proposed GST,[202] with the absence of SME participation being notable. The IRB's recognition of the extent of the small business compliance burden may be considered rather limited, especially at the time of the initial stages of the current study (mid-2006). For example, the Small Traders' Support Service Unit provides assistance and advice on taxation issues to small traders that are not represented by tax professionals, i.e. the self-employed. On the other hand, a number of preferential tax treatments have been introduced to corporate SMEs, including dual tax rates and, more recently, the exclusion of advance tax estimation provisions during the first two years from business commencement.[203]

One of the IRB objectives is to collect taxes without imposing an excessive burden (compliance costs) on the public with a minimal cost to the government. The average tax administrative costs (known as management costs in Malaysia) per year just exceed one percent of the direct tax collection, as shown in Table 8.1. This ratio is comparable to those of Australia and the UK, but more than two times higher than the US (OECD 2004, p. 65). The ratios need to be interpreted with caution due to significant differences between countries, for example, differences in tax rates, tax structure and the nature of taxes administered by tax authorities. As for private sector costs, such yearly estimates of tax compliance costs are practically impossible. No country estimates yearly tax compliance costs, but the practice of tax authorities elsewhere (such as in Australia, the UK, the US) indicates that they normally require a Tax Impact Statement prior to any major tax changes.

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[202] Since the postponement of the proposed GST, unfortunately the current status and progress of TRP is not available publicly (Singh 2007).
[203] See Chapter Three, subsection 3.2.3.

Table 8.1: Tax Management Costs [a] for Direct Taxes in Malaysia, 2000–2006

Year	Tax Management Costs (RM million) [b]	Tax Management Costs as a Percentage of Tax Collected
2000	328 [c]	1.13 [c]
2001	359	0.86
2002	544	1.23
2003	532 [c]	1.18
2004	565	1.17 [c]
2005	640	1.07 [c]
2006	701	0.97

[a] This term is as used by the IRB. The usual term used in the international tax compliance costs literature is 'tax administrative costs'.
[b] Includes all operating costs, with staff costs comprising around two-third. For 2003 and onwards, total figures are not shown in the IRB reports, thus computed by the author.
[c] Figures in the latest report are used. The actual figures reported in the relevant annual report were slightly different.
Sources: Inland Revenue Board (2003; 2004; 2005; 2007; 2008a).
Note: As at 1 July 2009, the 2007 report is yet to be published.

Since the operation of the SAS, the IRB has implemented a number of measures for business taxpayers, including tax simplification.[204] This indicates an increasing recognition of the burden upon the business sector primarily and, to some extent, to SMEs. Nonetheless, the current estimates of compliance costs, expressed as a percentage of turnover, continue to serve as an indicator of the usual disproportionate nature of the income tax burden faced by small businesses.

Little is known of the extent to which relevant parties, particularly the IRB, TRP, NSDC, professional accountants, as well as SME related organisations, have acknowledged specifically the compliance burden of SMEs.[205] General SME business issues, such as financing problems, staff training, usage of technology, and problems in business operations, are frequently highlighted (see especially National SME Development Council 2006, pp. 31-34). Taxation only arises as a minor issue and the SMEs usually urge the government to provide more tax incentives in order for them to

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[204] See Chapter Three, subsection 3.2.3.
[205] Other than overall recognition of business regulations by the STFB (discussed earlier in this section).

remain competitive in the market (National SME Development Council 2006, p. 34). There needs to be a much greater specific focus on taxation issues and on ensuring the SME tax compliance burden is minimised. The above background suggests that explicit recognition of the 'real' tax compliance burden to businesses, SMEs in particular, is essential for policy consideration.

Theoretically, Sandford, Hardwick and Godwin (1989, p. 209) stressed the importance of tax compliance costs for government in four areas: to recognise the importance of compliance costs explicitly; not to reduce the administrative costs at the expense of compliance costs; to minimise compliance costs, especially for small business; and finally, to compensate for compliance costs. However, convincing the government to consider the tax compliance burden as a policy area is not simple in practice. Pope (1993b, pp. 71-73) identified six stages in the development of the compliance costs of taxation as a policy area: non-recognition or lack of interest in the subject area (stage 1); qualitative recognition by the professionals (stage 2); estimation and evaluation (stage 3); policy recognition (stage 4); effective policy measures (stage 5); and continual monitoring of compliance costs (stage 6). From this perspective, Malaysia is possibly in stage one, with some development in stages two and three having taken place during the late 1990s.

The current compliance costs estimates in the SAS regime contribute mainly to stage three, which is valuable for government policy consideration (stage 4). As the current study is confined to corporate SMEs, further studies on compliance costs are possibly essential to convince the IRB in this regard. Currently, the IRB does not have a specific policy on the compliance costs of SMEs. However, it is acknowledged that tax simplification measures taken by the IRB do reduce compliance costs, in absolute value, as is evident in this study. At this stage, it is recommended that the first and most important policy area that should be addressed is to recognise fully the compliance burden of the SMEs at the national level.

Accordingly, the establishment of a relevant investigative committee to undertake a comprehensive review of SME income taxation in Malaysia is recommended. This is similar to the Beddall Committee (1990) or the Small Business Deregulation Task Force, the SBDTF (1996),[206] in Australia. In the context of Malaysian SMEs, the establishment of a committee with a composition similar to that of the SBDTF is probably much better.[207] It should be emphasised that having greater consultation with small business organisations in the process of tax reform is among key recommendations (No. 25) made in the Beddall Report (1990). As such, the proposed committee in Malaysia should be comprised of members mainly from the SME business sector, with appropriate representation by industry groups and organisations, and the chairman or a representative from the NSDC, SME Corp, TRP, STFB and the Small and Medium Industry Association of Malaysia. The committee should also include representatives from tax professionals, including the Malaysian Institute of Accountants, the Malaysian Institute of Taxation, lawyers, and academics with expertise in the taxation of SMEs. The proposed committee would be expected to provide a list of specific policy recommendations for SMEs.

Subsequently, the potential impact of any tax reforms or changes, particularly to SMEs, is worth assessing by requiring a government TIS, similar to that which has been implemented in OECD countries decades ago (Evans and Walpole 1999). Even presently, tax compliance costs remain as an important consideration in tax policy development (Hansford, Hasseldine and Howorth 2003, p. 489). The recent Malaysian experience on the GST postponement demonstrated the importance of TIS in tax policy debate. At this point of time, an impact study could be problematic due to data availability. The proposed committee would be a significant development in this regard.

8.3.2 Tax Simplification and Compliance Costs Minimisation

The current findings are evidence of the effects of tax complexity and tax audits on the likely non-compliance behaviour of corporate SMEs. Thus, measures to improve the

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[206] Also referred to as the Bell Committee.
[207] The members of the SBDTF were mostly from the business sector, including accountants and lawyers. On the other hand, the Beddall Committee was comprised only of Members of Parliament.

voluntary tax compliance of corporate SMEs should address these two aspects. This section presents a discussion of the overall policy and provides specific recommendations regarding tax complexity. Policy suggestions on tax audits are presented in the next subsection.[208]

Tax complexity is 'a mirror image' of tax simplicity (Tran-Nam 1999), with the high costs of compliance demonstrating a complex tax system and vice-versa (Slemrod 1992, p. 53; Pope 1993b, p. 70). Kasipillai (2005, p. 26) insists that tax law should be systematically simplified for three reasons, namely, to lower both compliance costs and administrative costs, to reduce uncertainty faced by taxpayers (tax complexity), and to improve the level of voluntary compliance. Tax simplification measures are likely to minimise tax compliance costs (Pope 1993b, p. 81), improve voluntary tax compliance behaviour, and ensure higher tax revenue (Pope 1993a, p. 284).

Various tax simplification measures, largely based on overseas practice, have been introduced since the year 2000.[209] These simplification measures are likely to contribute to lower tax compliance costs based on the current compliance costs estimates.[210] The most recent income tax change for companies, i.e. from the imputation tax system to a single tier tax system,[211] will remove the corporate SMEs' burden substantially. Apart from this recent measure, further income tax simplification is needed to lessen the tax compliance burden of SMEs.

Until recently, Malaysia seems to have adopted an incremental approach to tax simplification. This trend is not surprising as the tax compliance burden is yet to be recognised fully. Sandford (1993, pp. 201-205) provides a comprehensive discussion on the advantages and disadvantages of the incremental and package approaches, but asserts that the success of tax reform is more likely to be achieved by way of the latter approach (p. 228). Thus, further income tax simplification for Malaysian businesses in a

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[208] See subsection 8.3.3.
[209] See Chapter Three, subsection 3.2.3.
[210] See Chapter Seven, subsection 7.2.2
[211] See Chapter Three, subsections 3.2.2 and 3.2.3.

more comprehensive and systematic manner, preferably involving all business sizes,[212] is strongly recommended.

Future tax simplification measures should take account of the views of business taxpayers, past experiences in Malaysia, the lessons learnt from other tax regimes (both developed and developing countries) and, more importantly, specific suggestions to be made by the proposed national investigative committee.[213] These considerations are expected to benefit all business taxpayers, regardless of business sector or size. Effective measures to improve tax compliance should take into account the level of tax complexity and tax compliance costs simultaneously; therefore, a package approach is highly recommended.

Overall, the current study has highlighted the importance of considering the tax compliance burden of the SME sector in tax policy development. A full list of suggestions and recommendations would be provided following a comprehensive review by the proposed committee. Some of the suggestions made by the respondents in this survey include simplification of the tax form, further tax incentives and a reduction in tax rates.[214] This and other areas for consideration through income tax simplification (preferably in the near future) for corporate SMEs are as follows:

Standardisation of the Small and Medium Enterprise Definition for Tax Purposes and Extension of Incentives

Since 2005, Malaysia has adopted a national definition for SMEs.[215] Regarding income tax, currently there are at least three definitions that are in force for different purposes covering companies only, with three different proxies used to measure the size of the company: paid-up capital, shareholder's fund and authorised capital, as shown in Table 8.2.

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[212] A similar suggestion has been recently made by Freedman (2006; 2009).

[213] See subsection 8.3.1.

[214] Respondents were asked, by way of two open-ended questions, to provide specific suggestions on how to reduce the tax preparation work of SMEs (Question 19–Appendix F) and to provide overall comments on the taxation of SMEs as a whole (Question 20–Appendix F). Unfortunately, only a few responded to these questions, as shown in Appendix U.

[215] See Chapter One, subsection 1.5.3.

Table 8.2: Examples of Different Definitions of SMEs for Tax Purposes

Types of Incentives/deductions	Definition of Small and Medium Enterprises
Dual corporate tax rates.	Company (resident in Malaysia) with an ordinary paid-up capital up to RM2.5 million at the beginning of the basis year.
Deductions for pre-incorporation expenses.	Company (incorporated in Malaysia) and having authorized capital of not more than RM2.5 million.
Pioneer status or investment tax allowance.	A small-scale company (incorporated in Malaysia) with a shareholder's funds not exceeding RM500,000.

Source: Adapted from Pope and Abdul-Jabbar (2007).

As a measure of standardisation and simplification, a uniform definition of SMEs should be considered for tax purposes. Moreover, a lower tax rate and various tax incentives (mainly pioneer status and investment tax allowance) eligible to certain SME companies could be extended to include all SME companies. Measures that have been implemented in other developing countries, such as Singapore, are worthy of consideration. For example, the IRAS provides a tax exemption scheme for new companies during their first three years of operation (Ong and Imm 2007). However, from an IRB perspective, the trade-off between losses of tax revenue and benefits of tax simplification would be of particular concern.

Reduce the Issuance of Public Rulings and Encourage Private Rulings

Since the implementation of the SAS system, there is a growing list of Public Rulings issued, with an average of six per year.[216] However, a growing list of Public Rulings may increase tax complexity (Pope and Abdul-Jabbar 2007). The right to request a Private Ruling similar to Australian legislation (Crist 2004) would be a better measure, particularly for specific tax issues. A government plan to introduce Advance Rulings was first announced in the 2007 Budget (Ministry of Finance Malaysia 2006a), and

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[216] A number of Public Rulings relevant to this thesis are discussed in Chapter Three, subsections 3.2.2. and 3.2.3.

almost one and half years later, the Guidelines on Advance Rulings were issued by the IRB (2008b). The IRB commitment to the issuing of an advance ruling within sixty days from the date of application is encouraging, but the imposition of fees (RM500 for application and reimbursement for external advice and other costs), could be burdensome to SMEs in particular. Charging a fee for a private ruling is a normal practice in most countries, including Canada, New Zealand, the US (The Australian Treasury 2004b, p. 6) and Singapore, with the exception of Australia (The Australian Treasury 2004a, p. 23). The Australian approach not to charge fees is worth considering for Malaysian SME businesses.

Simplify the Record Keeping Requirements for Small Businesses

Simplifying record keeping for small business would allow businesses to allocate more resources to doing business. This includes a substantial reduction in the length of tax-related forms and all accompanying supporting documents. For example, in Singapore, the IRAS has simplified income tax returns for all business taxpayers by reducing the number of pages; income tax returns for companies were reduced from eight to five pages in 2004 (Ong and Imm 2007, p. 7).

Apart from the above, the IRB in particular, and relevant business authorities in Malaysia, should continuously and actively encourage small businesses to maintain good record keeping (Singh 2002, p. 277). The positive side of tax compliance, such as managerial benefits arising from tax compliance, needs to be repeatedly emphasised.

8.3.3 Publicising Tax Audit Information

The current study provides evidence that the possibility of non-compliance increases as the probability of a tax audit decreases. Overall, the respondents were somewhat uncertain about the possibility of their company being subjected to a tax audit as probably no information is available in this regard. There are some details in the annual report of the IRB on the number of tax audit cases and the corresponding amount

recovered from audit activities.[217] However, the probability of taxpayers being selected for audit purposes is not publicly available or highlighted.

During the initial years of SAS, the IRB has emphasised preparing both taxpayers and tax officials to the new system by way of education and training respectively. It has been more than eight years since the implementation of the SAS to the corporate sector in Malaysia, so it is now the right timing for the IRB to highlight some general details of their audit activities publicly. Available academic data suggest that the current corporate tax audit rate appears to be rather low, i.e. less than half of one percent for the year 2007 (Pope and Mohd Isa 2009). It is likely that the IRB will increase gradually the corporate audit rate. At this stage, the IRB may want to publicise (including using the website effectively) more of their audit activities and, to some extent, their basic data at the aggregate level, including the number of audit cases and the amount of revenue recovered from their audit activities. This measure is expected to effectively inform taxpayers (Singh 2007) if undertaken on a timely basis (Singh 2008) and, more importantly, increase the level of tax audit awareness among businesses, which is important as a deterrent to non-compliance.

8.3.4   Overall Tax Administration in Malaysia

Apart from income tax simplification, changes to tax administrative processes are among the ten main lessons identified by Ariff and Pope (2002, pp. 279-289) as a policy guide for developing countries. Modernisation of tax administration must take place primarily with a view to simplifying the tax rules, making them taxpayer-friendly, and reducing both administrative and compliance costs, with a particular emphasis on the small business sector (Ariff and Pope 2002).

Currently, administration of direct taxes and indirect taxes are governed by two government authorities, i.e. the IRB and RCM respectively, with both bodies responsible to the Ministry of Finance.[218] It is timely that the government should consider seriously a

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[217] See Chapter One, Table 1.3.
[218] See Chapter Three, subsection 3.2.1.

suggestion made by Kasipillai and Baldry (2004) regarding merging the administration of both direct and indirect tax administrations into a single agency. This has been a common practice in most countries, including Australia, New Zealand, Singapore, the US, and recently, the UK. Kasipillai and Baldry (2004) believed that the compliance task of business will be simplified and, for tax authorities, the compliance enforcement tasks can be carried out more efficiently. The TRP in particular could lead the initial move towards a single tax authority in Malaysia.

Probably, a specific national committee on tax administration, preferably similar to the UK O'Donnell Committee (2004), should be considered to conduct a detailed study and provide recommendations accordingly. Relevant parties, such as the IRB, RMC, and representatives from business sectors and professionals (such as accountants and lawyers) as well as other national bodies, including the STFB and NSDC, should take part in the process. Further, the proposed committee may consider the fundamental features of leading modern tax administrations, as recently outlined by Hasseldine (2008, p. 16). This includes concern over cost efficiency and effectiveness, engagement with stakeholders, introduction of technology applications, and factors that influence the behaviour of both taxpayers and tax professionals.

8.4   LIMITATIONS OF THE STUDY

This study provides empirical evidence and has contributed to the body of tax knowledge in the context of corporate income taxation. This covers both areas of tax compliance behaviour and compliance costs in a single study, with particular attention to the SME sector. Despite this, the results of the current study should be interpreted as being subject to several limitations.

First, this study has obtained an effective response rate of 16 percent in the primary postal survey. Despite many recommendations, especially by Sandford (1995), Pope

(1995) and Dillman (2007), being adopted into the current study,[219] the number of responses received is considered low in the context of international tax studies, which typically have a rate of around 25 percent to 30 percent. Nonetheless, it is broadly comparable to a response rate of around 14 percent to 26 percent, and about 10 percent to 20 percent in a number of Asian tax and business studies respectively (Abdul-Jabbar and Pope 2008a, p. 297). It is also comparable to the average response rate of just over 21 percent for the 16 international corporate tax compliance costs studies reviewed in this thesis,[220] with five studies having a response rate of less than 16 percent. Further, analyses of non-response bias suggest fairly similar responses between respondents and non-respondents, thereby removing the possibility of significant non-response bias in this study.[221]

Secondly, it is acknowledged that evaluating the sample responses to the overall SME population in Malaysia is difficult due to availability of data, but the representation of the sample is reasonably supported by reference to a sample population and available government data.[222] Thus, the generalisation of the current findings to Malaysian corporate SME taxation is satisfactory. However, the generalisation into SME companies in other tax jurisdictions may be subject to further study; more importantly, additional caution is necessary as different measures apply in defining the SME sector.

Thirdly, compliance costs are derived based on estimates gathered through self-reporting surveys. The external costs and additional costs are straightforward monetary costs to estimate as compared to valuation of internal time, which is a possible area of concern. This study categorises staff into four groups: manager/accountant, accounting staff, administrative staff, and other staff. The borderline between income tax compliance work and other work may not be easily understood by respondents. Further, it is possible that respondents were not able to recall their internal time spent accurately. The fact that compliance costs estimates are merely a measure of the magnitude of

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[219] See Chapter Four, Section 4.3.
[220] See Appendix D.
[221] See Chapter Four, Section 4.9.
[222] See Chapter Five, Section 5.2, paragraphs below Table 5.6.

compliance costs (Sandford, Godwin and Hardwick 1989; Sandford 1995) is fully acknowledged.

Fourthly, the tax attitudes and non-compliance of SME companies are measured from the managerial or respondent perspectives, which are assumed to indicate tax attitudes and likely compliance/non-compliance of corporate SMEs. In practice, corporate tax returns are mostly lodged by tax professionals on behalf of their corporation clients. Overall, the separate survey of tax professionals indicates comparable perceptions to SME respondents. The survey of tax professionals in the current study has been carried out for a small sample size of 300, with only 31 responses. Thus, comparable perceptions between SME respondents and tax professionals should be treated as tentative.

Fifthly, the current study measured tax non-compliance by way of hypothetical tax scenarios. It is acknowledged that the actual judgment of the respondents may vary. Further, the scenario is restricted to two specific types of non-compliance behaviour, more specifically involving two single transactions of RM10,000 each. Further, the scenarios were stated in the context of self-employment. The findings therefore should be treated with caution with regard to other types of non-compliance and/or other specific amounts for consideration.

Finally, other usual self-reporting mail survey limitations are to be recognised, especially in the sensitive area of tax compliance. Apart from the honesty of the respondents, it is possible that the survey questionnaire may be interpreted differently by the respondents.

8.5 RECOMMENDATIONS FOR FUTURE RESEARCH

The current study is likely to act as a base for future tax compliance research, involving corporations and covering both compliance costs and compliance behaviour. However

due to constraints discussed above,[223] it is strongly recommended that future research take the following points into consideration.

In the future, researchers may select samples from the actual population of business taxpayers. Such an approach would provide valuable comparison findings. Another prospect of examining this area lies in the context of analysing compliance costs estimates and managerial perceptions of actual compliant and non-compliant business taxpayers, similar to Sia *et al*. (2008), but confined to individuals. However, the fact that the true population and the actual compliant/non-compliant taxpayers are not publicly available means that this would not be possible without the full cooperation of the tax authority. For example, a review of prior Malaysian studies undertaken in this thesis, indicates that there are only three studies that have used the IRB data, all of these having been carried out by staff/former staff of the IRB (i.e. Che-Ayub 1994; Abdul 2003; Sia *et al.* 2008). Nonetheless, a more recent development indicates that the IRB has started allowing other researchers (i.e. Pope and Mohd Isa 2009) to use their tax data, to some extent. This trend is motivation for tax academics to undertake further tax research in Malaysia.

This study has focussed on two types of hypothetical tax behaviour—understatement of income and overstatement of income—specifically in the context of the self-employed. Measuring non-compliance through other alternative approaches, such as using official data and experimentation, is strongly recommended. Future studies may include other specific types of non-compliance behaviour as well. If hypothetical tax scenarios are to be used, other business contexts and, more importantly, a sensitivity analysis involving different amounts, are also worth considering. Further, investigating a specific area of taxation that is complex for the SME sector is also recommended, and this would be in alignment with studies in Australia and the US (e.g. McKerchar 2005; McKerchar, Ingraham and Karlinsky 2005; Tran-Nam and Karlinsky 2008). Similar studies could also include other business taxpayers, such as the self-employed, partnerships and large companies, with considerable attention towards tax compliance costs.

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[223] See Section 8.4.

Finally, more studies of corporate tax compliance in other tax jurisdictions are needed. Replication or several extensions of this study—taking into account limitations and suggestions above—to both developed and developing countries could make further contributions to corporate tax knowledge, tax administration and practices.

8.6   CONCLUDING REMARKS

This study has been among the first to integrate tax compliance costs, tax attitudes and the likely compliance behaviour of corporations, Malaysian SMEs in particular, and this, more importantly, from a business managerial perspective. The usual regressivity of tax compliance costs is evident, with both tax complexity and tax audit found to influence corporate tax behaviour. Thus, at this stage, the IRB is urged to continue tax simplification measures that would be expected to significantly minimise the compliance burden of all taxpayers, including businesses of all sizes. The magnitude of tax audit activities should be increased substantially, and important information derived from such activities should be utilised effectively to enhance the awareness of business taxpayers.

To sum up, it is hoped that the issue of the income tax compliance burden of businesses will be recognised fully at the national level and, at a later stage, be considered as an important element for any future tax policy decision-making in Malaysia, especially involving the SME sector.

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APPENDIX A

Definitions for Small and Medium Enterprises in Malaysia

DEFINITIONS FOR
SMALL AND MEDIUM ENTERPRISES IN MALAYSIA

(Approved for Adoption by National SME Development Council on 9 June 2005)

Issued by:
Secretariat to National SME Development Council
Bank Negara Malaysia
13 September 2005

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1. RATIONALE FOR STANDARD DEFINITIONS FOR SMALL AND MEDIUM ENTERPRISES

1.1 Presently, there is no common definition of small and medium enterprises (SMEs) in Malaysia. Different Agencies define SMEs based on their own criteria, usually benchmarking against annual sales turnover, number of full-time employees or shareholders' funds. In addition, present definitions focus mainly on SMEs in the manufacturing sector.

1.2 The establishment and adoption of standard definitions for SMEs will facilitate better identification of SMEs across sectors, thus enabling more effective formulation of SME policies and implementation of SME development programmes, and provision of technical and financial assistance. It will also allow better monitoring of SME performance and their contribution to the economy.

1.3 The National SME Development Council has, on 9 June 2005, approved the common definitions of SMEs across economic sectors, for adoption by all Government Ministries and Agencies involved in SME development, as well as financial institutions. Details on the Council are provided in Appendix 1.

2. COVERAGE OF DEFINITIONS FOR SMEs IN MALAYSIA

2.1 For wider coverage and applicability, definitions of SMEs will be based on two criteria, namely:

2.1.1 Number of employees; or

2.1.2 Annual sales turnover.

Therefore, an enterprise will be classified as an SME if it meets either the specified number of employees or annual sales turnover definition.

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2.2 The definitions will apply for the following sectors:

2.2.1 Primary Agriculture;

2.2.2 Manufacturing (including agro-based);

2.2.3 Manufacturing-Related Services (MRS); and

2.2.4 Services (including Information and Communications Technology).

2.3 For consistency and comparability of data across sectors, the **working definition for SMEs in the mining and quarrying sector, and construction sector** will be based on the SME definition for the services sector (as per paragraph 3.3 below).

2.4 To ensure comparability of data from the various sources and to facilitate data harmonisation across the various providers of SME statistics, **classification of economic activities will be based on the Malaysian Standard Industrial Classification (MSIC) 2000 codes**. Appendix 2 provides the list of economic activities under the various sectors.

2.5 The following list of approved SME definitions is **not exhaustive** and may be amended or expanded by the National SME Development Council from time to time to reflect changes in operating and business conditions.

3. APPROVED SME DEFINITIONS

3.1 Primary Agriculture

General Definition

3.1.1 A small and medium enterprise in primary agriculture is an enterprise with full-time employees not exceeding 50 or annual sales turnover not exceeding RM5 million.

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Specific Definitions

3.1.2 A micro enterprise in primary agriculture is an enterprise with full-time employees of less than 5 or with annual sales turnover of less than RM200,000;

3.1.3 A small enterprise in primary agriculture is an enterprise with full-time employees of between 5 and 19 or with annual sales turnover of between RM200,000 and less than RM1 million; and

3.1.4 A medium enterprise in primary agriculture is an enterprise with full-time employees of between 20 and 50 or with annual sales turnover of between RM 1 million and RM5 million.

3.2 Manufacturing (including agro-based) and MRS

General Definition

3.2.1 A small and medium enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees not exceeding 150 or with annual sales turnover not exceeding RM25 million.

Specific Definitions

3.2.2 A micro enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees of less than 5 or with annual sales turnover of less than RM250,000;

3.2.3 A small enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees of between 5 and 50 or with annual sales turnover of between RM250,000 and less than RM10 million; and

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3.2.4 A medium enterprise in manufacturing (including agro-based) and MRS is an enterprise with full-time employees of between 51 and 150 <u>or</u> with annual sales turnover of between RM10 million and RM25 million.

3.3 <u>Services (including ICT)</u>

General Definition

3.3.1 A small and medium enterprise in services is an enterprise with full-time employees not exceeding 50 <u>or</u> annual sales turnover not exceeding RM5 million.

Specific Definitions

3.3.2 A micro enterprise in services is an enterprise with full-time employees of less than 5 <u>or</u> with annual sales turnover of less than RM200,000;

3.3.3 A small enterprise in services is an enterprise with full-time employees of between 5 and 19 <u>or</u> with annual sales turnover of between RM200,000 and less than RM1million; and

3.3.4 A medium enterprise in services is an enterprise with full-time employees of between 20 and 50 <u>or</u> with annual sales turnover of between RM1 million and RM5 million.

3.4 The table below summarises the approved SME definitions based on number of full-time employees:

Sector / Size	Primary Agriculture	Manufacturing (including Agro-Based) & MRS	Services Sector (including ICT)
Micro	Less than 5 employees	Less than 5 employees	Less than 5 employees
Small	Between 5 & 19 employees	Between 5 & 50 employees	Between 5 & 19 employees
Medium	Between 20 & 50 employees	Between 51 & 150 employees	Between 20 & 50 employees

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3.5 The table below summarises the approved SME definitions based on annual sales turnover:

Sector / Size	Primary Agriculture	Manufacturing (including Agro-Based) & MRS	Services Sector (including ICT)
Micro	Less than RM200,000	Less than RM250,000	Less than RM200,000
Small	Between RM200,000 & less than RM1 million	Between RM250,000 & less than RM10 million	Between RM200,000 & less than RM1 million
Medium	Between RM1 million & RM5 million	Between RM10 million & RM25 million	Between RM1 million & RM5 million

4. APPLICATION OF APPROVED SME DEFINITIONS

4.1 The approved definitions are to be adopted by all the relevant stakeholders dealing with SMEs. These include Ministries and Agencies at Federal and State levels (including Statutory Bodies and local authorities), as well as financial institutions.

4.2 The scope of application should, among others, encompass data collection; formulation of SME policies and programmes; and identification of eligibility status for SME financial assistance and support programmes. However, additional eligibility requirements can be applied based on specific development objectives of respective stakeholders.

4.3 For purposes of data collection, all relevant Ministries, Government Agencies and financial institutions should maintain data on companies and businesses **based on both annual sales turnover and number of full-time employees**.

4.3.1 However, stakeholders that are unable to collect and maintain data based on both criteria should notify the Secretariat on the criteria used, that is, either annual sales turnover, or number of full-time employees.

4.4 All stakeholders involved in SME development are required to harmonise their data collection procedures based on the size and sectoral classifications above.

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This will enable comparability of data across institutions and provide valuable statistics to better understand the status, issues and development needs of SMEs across all sectors.

5. USAGE OF COMMON IDENTIFIER

5.1 For ease of verification and to facilitate cross-referencing across databases, all stakeholders should also adopt a common identifier, that is, **business or company registration number** in SME data collection and maintenance.

6. SECRETARIAT TO THE NATIONAL SME DEVELOPMENT COUNCIL

6.1 If you have any queries, please contact Cik Lim Hsin Ying at 03-2694 7342 or Cik Juita Jamaluddin at 03-2694 7349.

6.2 The address of the Secretariat to the National SME Development Council is as follows:

> The Secretariat
> National SME Development Council
> c/o Development Finance and Enterprise Department
> 9th Floor, Block C
> Bank Negara Malaysia
> Jalan Dato' Onn
> 50480 Kuala Lumpur

Secretariat
National SME Development Council
13 September 2005

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NATIONAL SME DEVELOPMENT COUNCIL

NATIONAL SMALL AND MEDIUM ENTERPRISE DEVELOPMENT COUNCIL

1. The National SME Development Council (NSDC) was established in June 2004 as the highest policy-making body to chart the direction and strategies for comprehensive and coordinated development of SMEs across all sectors of the economy.

2. The objectives of the NSDC are:

    2.1.1 Formulate broad policies and strategies, as well as provide direction for comprehensive and coordinated development of SMEs across all sectors; and

    2.1.2 Oversee and guide overall SME development initiatives to ensure effectiveness in policy implementation and outreach.

3. The Ministries and Agencies represented in the NSDC are:

    I. The Prime Minister **(Chairman)**
    II. Minister of International Trade and Industry
    III. Minister of Domestic Trade and Consumer Affairs
    IV. Minister of Entrepreneur and Cooperative Development
    V. Minister of Agriculture and Agro-Based Industries
    VI. Minister of Human Resource
    VII. Minister of Finance II
    VIII. Minister of Energy, Water and Communications
    IX. Minister of Plantation Industries and Commodities
    X. Minister of Science, Technology and Innovations
    XI. Minister of Tourism
    XII. Minister of Rural and Regional Development
    XIII. Minister of Education
    XIV. Minister of Higher Education
    XV. Minister of Housing and Local Government
    XVI. Minister in The Prime Minister's Department (Y.B. Dato' Mustapa Mohamed)
    XVII. Governor of Bank Negara Malaysia

XVIII. Director-General of the Economic Planning Unit

XIX. Chief Executive Officer of the Multimedia Development Corporation

4. Bank Negara Malaysia serves as the Secretariat to the Council.

CLASSIFICATION OF ECONOMIC ACTIVITIES
ACROSS SECTORS BASED ON MSIC 2000

Economic Activities under Broad Sectors
for Approved and Working SME Definitions

Based on MSIC 2000 divisions and descriptions:

i. **Primary Agriculture**:
   - Agriculture, Hunting and Related Service Activities
   - Forestry, Logging and Related Service Activities
   - Fishing, Operation of Fish Hatcheries and Fish Farms; Service Activities Incidental to Fishing

ii. **Manufacturing (including Agro-Based)**:
   - Manufacture of food products and beverages
   - Manufacture of tobacco products
   - Manufacture of textiles
   - Manufacture of wearing apparel; Dressing and dyeing of fur
   - Tanning and dressing of leather; Manufacture of luggage, handbags, saddlery, harness and footwear
   - Manufacture of wood and products of wood and cork, except furniture; Manufacture of articles of straw and plaiting materials
   - Manufacture of paper and paper products
   - Publishing, printing and reproduction of recorded media
   - Manufacture of coke, refined petroleum products and nuclear fuel
   - Manufacture of chemicals and chemical products
   - Manufacture of rubber and plastic products
   - Manufacture of other non-metallic mineral products
   - Manufacture of basic metals
   - Manufacture of fabricated metal products, except machinery and equipment
   - Manufacture of machinery and equipment n.e.c.
   - Manufacture of office, accounting and computing machinery
   - Manufacture of electrical machinery and apparatus n.e.c.
   - Manufacture of radio, television and communication equipment and apparatus
   - Manufacture of medical, precision and optical instruments, watches and clocks
   - Manufacture of motor vehicles, trailers and semi-trailers
   - Manufacture of other transport equipment
   - Manufacture of furniture; Manufacturing n.e.c.
   - Recycling

iii. **Manufacturing Related Services** (based on 5-digit MSIC 2000 codes):
   - 73101   Research & experimental development services on physical sciences
   - 73102   Research & experimental development services on chemistry and biology
   - 73103   Research & experimental development services on engineering and technology
   - 73104   Research & experimental development services on agricultural sciences
   - 73105   Research & experimental development services on medical sciences and pharmacy
   - 73109   Research & experimental development services on other natural sciences
   - 60212   Factory bus services
   - 60230   Freight transport by road
   - 60300   Transport via pipelines
   - 61102   Freight transportation by sea-going & coastal water vessels
   - 61202   Inland water freight transport services
   - 62109   Other scheduled air transport (e.g. helicopter services) n.e.c.
   - 62209   Other non-scheduled air transport n.e.c.
   - 63011   Stevedoring services
   - 63020   Storage and warehousing services
   - 63091   Activities of freight forwarding / forwarding agencies
   - 63099   Activities of other transport agencies n.e.c.

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–	74950	Packaging services on a fee or contract basis
–	74300	Advertising
–	74130	Market research and public opinion polling
–	74142	General management consultancy services
–	74143	Public relations consultancy services
–	74149	Other business consultancy and management consultancy services n.e.c.
–	92201	Printed news supply services
–	92209	Other news agency services
–	22190	Other publishing
–	71230	Rental of office machinery and equipment (including computers)
–	71302	Rental of furniture
–	90003	Industrial waste collection and disposal services
–	37101	Recycling of tin
–	37109	Recycling of other metal waste and scrap
–	37201	Recycling of textile fiber
–	37202	Recycling of rubber
–	37209	Recycling of non-metal waste and scrap
–	74212	Engineering consultancy services
–	27310	Casting of iron & steel
–	27320	Casting of non-ferrous metal
–	28910	Forging, pressing, stamping and roll-forming metal; powder metallurgy
–	28920	Treatment and coating of metals, general mechanical engineering on a fee or contract basis
–	28999	Manufacture of other fabricated metal products n.e.c.
–	29220	Manufacture of machine tools
–	74220	Technical testing and analysis

iv. **Services**:
- Electricity, Gas and Water Supply
- Wholesale and Retail Trade; Repair of Motor Vehicles, Motorcycles and Personal and Household Goods
- Hotels and Restaurants
- Transport, Storage and Communications
- Financial Intermediation
- Real Estate, Renting and Business Activities
- Education
- Health and Social Work
- Other Community, Social and Personal Service Activities

v. **Mining and Quarrying**:
- Mining of Coal and Lignite; Extraction of Peat
- Extraction of Crude Oil and Natural Gas; Service Activities Incidental to Crude Oil and Natural Gas Extraction Excluding Surveying
- Mining of Uranium and Thorium Ores
- Mining of Metal Ores
- Other Mining & Quarrying

vi. **Construction**:
- Construction

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APPENDIX B

Summary of Tax Compliance Studies in Malaysia 1994–2008

Summary of Tax Compliance Studies in Malaysia 1994–2008

Authors(s); (year)	Subject(s)	Method	Sample size (sampling method)	Response number (and/or Rate)	Main outcomes (relevant to compliance behaviour)
Che-Ayub (1994)	(i) Tax officers (ii) Tax agents	Survey (mail questionnaire)	(i) 358 (ii) 359 (random)	(i) 307 (85.7%) (ii) 124 (35.0%)	- Tax officers believed tax evasion occurs due to taxpayer attitudes or there is an opportunity for non-compliance - Tax agents alleged that taxpayers' lack the ability to comply. - Tax administrative reform shall be in place to enhance voluntary compliance.
Hanefah (1996)	Individuals (including business)	Survey (personally administered)	300 (stratified)	248 (82.7%)	- Malaysian tax administrative system was generally seen as efficient and productive - Tax law was perceived to be not fair and tax complexity existed. - Some knowledge and understanding of the tax system would enhance compliance. - The compliance costs of owner-manager taxpayers are higher than other individual taxpayers.
Kasipillai (1997)	(i) Tax professionals (ii) Individuals	(i) Survey (mail) (ii) Survey (personally administered)	(i) 80 (convenient) (ii)150 (convenient)	(i) 60 (75%) (ii) 120 (80%)	- Tax evasion was estimated for an average of 20 percent of income tax collection for the period 1971 to 1994. - Taxpayers generally have a reasonable level of understanding of many aspects of the tax laws. - Knowledge differences are noted for some group of taxpayers; taxpayers with low education levels and unskilled occupations groups have a relatively low score on tax knowledge. - Top five sectors generating hidden income were construction sector, professions (doctors, engineers, etc), cuts and kickbacks on contracts, multinational companies and restaurants.
Tayib (1998)[b]	Individuals (land taxpayer)	Survey (mail)	324 (not reported)	305 (94%)	- Financial information disclosure influenced compliance attitudes.

Author(s); (year)	Subject(s)	Method	Sample size (sampling method)	Response number (and/or Rate)	Main outcomes (relevant to compliance behaviour)
Kasipillai *et al.* (1999)	Individuals (including business)	Survey (mail)	900 (random)	153 (17%) 147 (16.4%)	- Respondents are able to compute their own taxes provided that minimal guidance is given by the Inland Revenue Board.
Singh (2003)	Accountants	Survey (mail)	180 (purposive)	119 (66.1%) [useable 103/62.8%]	- Moral reasoning does play a significant role in the tax compliance decision making process. - Size of tax deductions is a major explanatory variable in the tax compliance decision making process.
Abdul (2003)	(i) Individuals (including business) (ii) Tax officers	(i) File review (ii) Survey (interview)	(i) 507 file (relevant file) (ii) 60 officers (purposive)	(i) 507 file (ii) 60 officers	- Four types of non-compliance were evident, i.e. fail to declare income, under-declaring income, over-claiming deductions and over-claiming expenses. - Non-compliance is severe in older persons, males with high taxable income levels and those who received non-salary income. - Tax officers believed that taxpayers' intention, role of tax agents, taxpayers' ignorance of tax law and financial strain were the main reason of non-compliance
Kasipillai, Aripin and Amran (2003)	Individuals (Students)	Survey (administered in class)	Stage 1 - 560 Stage 2 390 560 (convenience)	Stage 1 553 (98.8%) Stage 2 551 (98.4%)	- A positive relationship exists between tax knowledge and tax compliance - Significant perceptions existed in terms of ethnic groups.
Ramasamy *et al.* (2003)	Individuals (Small business entrepreneurs)	Survey (interview)	500 (non-random)	312 (62.4%)	- Attitudes towards others' compliance and fairness positively related to compliance behaviour. - Tax knowledge and attitudes towards effectiveness of the IRB has no relationship to compliance behaviour.

Author(s); Year	Subject(s)	Method	Sample size (sampling method)	Response number (and/or Rate)	Main outcomes (relevant to compliance behaviour)
Kasipillai, Mat-Udin and Zainol-Arifin (2003)	Individuals (including business)	Survey (mail)	800 (random)	270 (34%) [useable 219/29.2%]	- Tax compliance is perceived to be an ethical issue. - Moral values do influence tax compliance behaviour.
Abdul Manaf (2004)[b]	Individuals (land taxpayer)	Survey (mail)	750 (not relevant) [c]	179 (24%)	- Age, race, education, income, occupation and ethics strongly influence land tax compliance attitudes. - Tax fairness, tax knowledge, incentives and location also influence land tax compliance.
Palil (2005a; 2005b)	Individuals (Part-time students)	Survey (administered in class)	153 (convenience)	153 (100%)	- Level of tax knowledge was found to be below the average. - Tax knowledge is a major factor in determining the accuracy of tax return.
Loo and Ho (2005)	Individuals	Survey (administered in a meeting)	250 (random)	106 (42.4%)	- Taxpayers do not possess sufficient tax knowledge, and thus may not be competent to compute their personal income tax during self-assessment system.
Kasipillai and Abdul-Jabbar (2006)	Individuals	Survey (personal interview)	500 (random)	153 (30.6%)	- Male and females have similar attitudes toward tax compliance. - Gender together with education level and tax preparer determines compliance attitudes. - Compliance attitudes and having cash income influenced understatement behaviour of taxpayer.
Abdul Manaf and Abdul-Jabbar (2006)[a]	Individuals	Survey (personally administered)	1,168 (not relevant) [d]	404 (34.6%)	- Tax evasion items were perceived to be a least serious offence compared to the other 29 crimes and violations.
Loo (2006a)	Individuals (including business)	Survey (mail)	Stage 1 2,500 Stage 2 3,500 (random)	Stage 1 350 (14%) Stage 2 589 (17%)	- Change from OAS to SAS had to some extent influenced compliance behaviour of taxpayers. - Tax knowledge, tax structure, perception towards tax fairness and perception towards tax administration were found to influence tax behaviour, but tax knowledge had the most effect. - Financial constraints did not show any effect on compliance behaviour.

Author(s); year	Subject(s)	Method	Sample size (sampling method)	Response number (and/or Rate)	Main outcomes (relevant to compliance behaviour)
Loo (2006b)	Individuals (students)	Experimental	125 (not reported)	125	- Specific tax knowledge had an influence on tax behaviour of participants. - Audit rates and tax rates had significant interactions with tax knowledge of the participant.
Ahmad, Hanefah and Mohd Noor (2007)	Individuals (students)	Experimental	Experimental group 42 (quota) Control group 46 (stratified random)	41 44	- Tax knowledge had influence on tax compliance behaviour of subjects. - Subjects with tax knowledge had better compliance behaviour.
Sia et al. (2008)	Individuals (including business)	Survey (mail)	2,500 (not reported)	247 (9.9%)	- Compliant and non-compliant taxpayers had similar perceptions toward tax fairness, tax morals and peer influence.
Che Azmi and Perumal (2008)	Individuals (including business)	Survey (administered in the IRB office)	500 (convenience)	390 (78%)	- Tax system was perceived to be moderately fair. - Tax fairness is distinguished in three dimensions: general fairness, tax rate structure and self interest.

[a] The main focus of study is tax evasion.

[b] The study focuses on local government taxes.

[c] All individuals with a complete mailing address from the list of land taxpayers were chosen.

[d] All individuals in the selected organisation were chosen.

APPENDIX C

Other Tax Studies (not compliance-related) in Malaysia

Other Tax Studies (not compliance-related) in Malaysia

Author(s); (year)	Focus of study	Subject(s)	Method	Sample size (sampling method)	Response number (and/or Rate)	Main outcomes
Palil (2004)	Income Tax (e-commerce)	(i)Tax academic (ii) Tax practitioners	Survey (mail)	(i) 40 (ii) 300	(i) 22 (55%) (ii) 82 (27.3%)	- The derived and remittance basis of taxation may no longer be appropriate in an e-commerce environment.
Kasipillai and Hanefah (2000)	Income Tax	Tax practitioners	Survey (mail)	280 (random)	85 (30%) [83 useable]	- Tax professionals believe that their clients prefer the SAS.
Lai, Sheikh-Obid and Meera (2004)	Income Tax (e-filing)	Tax practitioners	Survey (mail)	572 (systematic)	192 (33.6%)	- Tax practitioners have high usage intentions of the e-filing system. - The level of technology readiness is positively related to the usage intentions towards e-filing system.
Othman and Hanefah (2006)	Income Tax (e-commerce)	Tax experts and officers	Interview	20	20	- Existing criteria used to define permanent establishment needs to be reviewed to cater for e-commerce trading.
Hanefah, Hassan and Othman (2008)	Income Tax (e-commerce)	(i) Tax practitioners (ii) Tax academics (iii) Tax officers	Survey (Mail) [a]	(i) 625 (ii) 20 (iii) 10 - total 625	60 (9%)	- The possible inefficiency of tax administration and tax evasion are regarded as potential tax problems posed by e-commerce. - The Malaysian attitudes towards potential tax-related problems are similar to that of other countries.

[a] A survey of tax officers was administered personally.

APPENDIX D

Summary of Major Compliance Costs Studies on Corporate Income Taxation

Summary of Major Compliance Costs Studies on Corporate Income Taxation, 1980s until recently [a]

Authors(s); (year)	Subject(s); (country)	Method	Sample size; response number (response rate)	Main Findings
Sandford, Godwin and Hardwick (1989)	Corporation (UK)	Survey (mail)	3,000 680 (24%)	- Compliance costs in 1986-87 were UK£300 million or 2.22% of corporate tax revenue, with around half of the costs being fees paid to external advisors.
Pope, Fayle and Chen (1991)	Public companies (Australia)	Survey (mail)	1,837 298 (16%)	- Gross compliance costs of public companies in 1986-87 were between A\$646 million and A\$1.341 million, or between 11.4% and 23.7% of corporate tax revenue. - Cash flow benefits were estimated to be A\$954 million or 16.9% of corporate tax revenue.
Pope, Fayle and Chen (1994)	Companies (Australia)	Survey (mail)	2,531 571 (23%)	- Gross compliance costs of companies' income tax in 1990-91 were A\$3,245.9 million or 22.9% of revenue yield. - Cash flow benefits were estimated to be A\$1,194 million or 8.4% of corporate tax revenue. - Net compliance costs of companies' income tax were A\$2,052 million or 14.5% of corporate tax revenue.
Ariff, Loh and Talib (1995)	Listed companies (Singapore)	Survey (mail)	200 65 (33%)	- In 1994, the average compliance costs per listed company were S\$78,396; with external costs portion being higher (58%) than internal costs time costs (42%). - The computational and planning costs portion is almost equal.
Slemrod and Blumenthal (1996)	Largest corporation (US)	Survey (mail)	1,329 365 (27%)	- In 1992, the average compliance costs per company were US\$1.57 million. - The estimated aggregate cost for all 1329 companies equals US\$2.08 billion or 3.2 percent of revenue yield.

Authors(s); (year)	Subject(s); (country)	Method	Sample size; response number (response rate)	Main Findings
KPMG (1996)	Listed companies (UK)	Survey (mail)	1,200 266 (22%)	- Compliance costs of listed companies in 1995-96 were UK£265 million.
Slemrod (1997)	Largest corporation (US)	Survey (mail)	1,697 309 (18%)	- The average compliance costs per company in 1996 were US$1.90 million. - In real terms (i.e. inflation-adjusted), the 1996 estimate is 8.1 percent higher than the 1992 estimates.
Ariff, Ismail and Loh (1997)	Listed companies (Singapore)	Survey (mail)	234 62 (26%)	- Compared to the earlier estimates in 1994, the 1995 average compliance costs per listed company decreased significantly to S$54,615. - The decrease was mainly due to income tax simplification measures.
Erard (1997a)	Largest corporation (Canada)	Survey (mail)	250 59 (24%)	- The combined federal-provincial income and capital tax compliance burden for the top 500 Canadian corporations in 1995 was estimated at C$507,000 per company, amounting to C$250 million in aggregate or about 5 percent of taxes paid.
Chan *et al.* (1999)	Listed companies (Hong Kong)	Survey (mail)	496 75 (15%)	- The average tax compliance costs per public listed company were estimated at HK$346,483 for tax year 1995-1996. - A large portion of the average compliance costs (70%) are external fees. - There is a positive link between business size and its compliance costs.

Authors(s); (year)	Subject(s); (country)	Method	Sample size; response number (response rate)	Main Findings
Slemrod and Venkatesh (2002)	Large and mid-size corporations (US)	Survey (mail)	2,499 225 (9%)	- The estimated average compliance costs per company are US$254,451 and between US$21 billion and US$22.3 billion in aggregate, i.e. between 28 and 29.6 percent of tax revenue. - Almost 75 percent of average total compliance comprised of internal costs (personnel costs and non-personnel costs). - Companies committed an average of 50 percent of their internal spending time to filing activities, 38.8 percent to pre-filing activities, and 11.2 percent to post-filing activities.
Bertolucci (2002) [b]	Listed companies (Brazil)	Survey (mail and e-mail)	211 25 (12%)	- The total compliance costs were R$7.2 billion, with internal costs comprising around 80% of all costs.
Chattopadhyay and Das Gupta (2002a)	Companies (India)	Survey (mail)	3,913 45 (1%)	- The gross corporate compliance costs for 2000-2001 were estimated around 5.6% to 14.5% of corporate tax revenues. - The net corporate compliance costs, i.e. after taking into consideration tax deductibility and cash flow benefits, were expected to be reduced/increased between – 0.7% and + 0.6% of corporate tax revenues.
Klun (2004b) [c]	Companies (Slovenia)	Survey (mail, plus interviews)	200 126 (64%)	- In 2002, compliance costs per company were SIT 1.5 million or 4.2 percent of tax revenue; 1.00 percent of GDP. - The above compliance costs represent costs for complying with corporate income tax (23%), VAT (67%) and taxes deduced from wages (10%).

Authors(s); (year)	Subject(s); (country)	Method	Sample size; response number (response rate)	Main Findings
Blazic (2004) [d]	Companies (Croatia)	Survey (interviews)	1200 339 (28%)	- Compliance costs for 2001/2002 were HRK27,113 per company and HRK2,038.6 million in aggregate level, representing around 1.2% of the GDP. - Tax compliance costs, measured as a percentage of relevant tax revenues, were 4.47 percent for VAT, 2.90 percent for wage taxes including social security, and 11.76 for profit tax.
Kauser et al. (2005)	SME Companies (UK)	Survey (mail and e-mail)	8,000 [e] 131 (< 2%)	- The aggregate compliance costs of SME companies in 2001 amounted to UK£608 million, with more than half internal in nature.

[a] This summary includes studies that primarily focussed on corporation and income tax. Studies that cover corporations as part of a comprehensive study on all business taxes and business taxpayers were not included. These include a major study in New Zealand (Sandford and Hasseldine 1992) and in Australia (Evans et al, 1997). Sandford and Hasseldine (1992, p. 94—Table 7.12), reported mean compliance costs by turnover levels only and not the overall compliance costs of corporation. The Australian study reported the compliance costs amounted to A$7,291 per company and A$3,813 million at the aggregate level (Evans et al. 1997, p 52 –Table 4.12).

[b] This study covers other business taxes as well.

[c] This study estimated compliance costs for companies on three types of taxes i.e. corporate income tax, VAT and social security contribution with payroll tax.

[d] This study estimated compliance costs for companies for all types of taxes (i.e. profit tax, VAT, wage taxes and social security contributions), but excluded customs and excise duties.

[e] This is an approximate number reported in Kauser et al. (2005).

APPENDIX E

Summary of Costs of Compliance Studies in Malaysia

Summary of Costs of Compliance Studies in Malaysia (Additional Details [a])

Authors (year)	Taxes (focus)	Subject	Method	Sample Coverage	Sample size (sampling method)	Response number (and/or rate)
Loh *et al.* (1997)	Income Tax (Corporate)	Public Listed Companies	Survey (mail)	Nationwide	300 (random)	80 (27%) [useable 48/16%]
Hanefah, Ariff and Kasipillai (2001)	Income Tax (Corporate)	SME Companies [b]	Survey (mail) [c]	Northern Peninsular (Perlis, Kedah and Penang)	300 (random)	67 (22.3%)
Mansor, Saad and Ibrahim (2003)	Income Tax (Corporate)	SME Companies [b]	Survey (mail)	Northern Peninsular (Perlis, Kedah and Penang)	Not reported (convenience sampling)	56 (not available)
Sapiei and Abdullah (2008)	Income Tax (Individual)	Individuals [d]	Survey (mail)	Klang-valley (Selangor and Kuala Lumpur)	500 (not reported)	144 (29%)

[a] Key Details and findings are presented in Chapter Two, Table 2.4.

[b] Similar SME definition was employed in both studies, i.e. company with employees not exceeding 150 with an annual turnover not exceeding RM250 million.

[c] Plus face-to-face interviews.

[d] Including self-employed business taxpayers.

APPENDIX F

Primary Postal Survey Questionnaire (English Version)

Survey of the Tax Compliance Burden
of Small and Medium-Sized Companies in Malaysia

Note:
- All questions relate to the financial year and/or year of assessment 2006 (or substituted year).
- All responses will be kept strictly confidential and anonymous.

SECTION A: GENERAL INFORMATION

Please tick one box or fill in the appropriate details as requested.

1. The financial year end of your company in 2006 was: ☐☐☐☐ Day Month

2. The main business activity of your company is: (Please tick one box)

   Manufacturing (including Agro-based)…….…... ☐

   Manufacturing-related Services...................... ☐

   Services (including Information and Communication Technology) .... ☐

   Construction ……………………………….. ☐

   Other, please state _____

3. The period your company has been in business is: (Please tick one box)

   Less than 2 years ☐   2 to 5 years ☐   More than 5 years ☐

4. The average number of staff (full time) employed by your company in 2006 was: (Please tick one box)

   4 or less ☐   5 to 19 ☐   20 to 50 ☐   51 to 150 ☐   151 or more ☐

5. The paid up capital of your company at the beginning of financial year 2006 was:(Please tick one box)

   RM500,000 or less ……………………………. ☐

   RM500,001 to RM2,500,000 ……………………. ☐

   RM2,500,001 or more ……………………………. ☐

6. The turnover of your company in financial year 2006 was: (Please tick one box)

   Less than RM250,000 …………………………. ☐

   RM250,000 to RM999,999 ……………………. ☐

   RM1,000,000 to RM4,999,999 ……………… ☐

   RM5,000,000 to RM9,999,999 ……………… ☐

   RM10,000,000 to RM24,999,999 …………… ☐

   RM25,000,000 or more …………………………. ☐

7. The estimated tax liability of your company for the year of assessment 2006 was: (Please tick one box)

   Nil (no tax liability) ………………………….... ☐

   RM1 to RM99,999 ……………………………….... ☐

   RM100,000 to RM249,999 …………..............… ☐

   RM250,000 to RM499,999 …………………….... ☐

   RM500,000 to RM999,999 …………................... ☐

   RM1,000,000 or more ………………………....…... ☐

8. Since the company is paying income tax by advance monthly instalments, would your company expect a tax refund for the year of assessment 2006?

   YES ☐   NO ☐

   If 'YES', please estimate the possible amount of tax refund.

   RM _____

SECTION B: TAX COMPLIANCE COSTS

Internal Costs

Kindly fill in an approximate estimate of time, monetary amounts and/or breakdown of the following internal costs of complying with corporate income tax:

9. Please ESTIMATE the time spent and monthly wage rates by these people working exclusively on Income Tax activities (exclude usual book keeping and overhead costs) within the company in 2006.

	Total Hours	Average Wage Rate
Managers/accountants	per month	RM per month
Accounting staff	per month	RM per month
Administrative staff	per month	RM per month
Other staff	per month	RM per month

10. Does your company incur any other additional non-staff costs (e.g. stationery, postage, travelling, etc.) in meeting the income tax requirements for the year of assessment 2006?

    YES ☐   NO ☐

    If 'NO', continue to question 11.
    If 'YES', please respond to the following question:
    Briefly describe the nature of the costs.

    _____

    Please estimate the additional costs involved in 2006.

    RM _____

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11. Of all the time spent and costs incurred internally in complying with corporate income tax laws for 2006, state approximately how much (in percentage) was related to the following work:

	Breakdown
Routine Income Tax Return work (for annual return)	%
Income Tax Planning work (longer term)	%
Other (please state)	%
Total	100 %

12. In which of the following areas is your company facing difficulties?
(Please tick more than one box if appropriate)

Estimating income tax payable .... ☐

Understanding income tax legislation .... ☐

Implementing the income tax changes .... ☐

Maintaining records for income tax purpose .... ☐

Increasing burden of record keeping for tax purpose .... ☐

Cash flow position when paying monthly tax instalments .... ☐

Short period of time to lodge the tax return .... ☐

Dealing with the tax authority .... ☐

Dealing with external adviser (such as tax agents) .... ☐

Other (please state) ☐

☐

External Costs

Kindly please tick one box or provide an appropriate response to the following questions related to external costs of complying with corporate income tax:

13. Does your company employ external tax professionals (such as accountant and/or tax agent) to handle income tax matters in 2006?

YES ☐   NO ☐

If 'NO', please go to Section C (Question 14).
If 'YES', please continue.

The main reason for the external advice was:
(Please tick more than one box if appropriate)

Technical knowledge is not readily available internally .... ☐

Income tax matters are too complicated .... ☐

External opinion was required .... ☐

It is more cost-effective to use external tax professionals .... ☐

For income tax planning .... ☐

Others (Please state) ☐

☐

Please **PROVIDE** or **ESTIMATE** the external **TAX FEES** for the corporate income tax activities in the financial year 2006.

RM _____

Please **ESTIMATE** the percentage breakdown between routine income tax preparation and income tax planning work conducted by the external tax professionals.

	Approximate Breakdown
Routine Income Tax Return work (for annual return)	%
Income Tax Planning work (longer term)	%
Other (please state)	%
Total	100 %

SECTION C: PERCEPTIONS AND OPINIONS

14. Kindly respond to the following statements to indicate your opinion (by way of a tick on a 5 point scale) to each of the statements. There are no right or wrong answers. All responses are absolutely anonymous. Tick one box for each statement.

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	1	2	3	4	5
Personally I consider corporate income tax return preparations difficult.	☐	☐	☐	☐	☐
Corporate income tax law is relatively simple.	☐	☐	☐	☐	☐
Complexity in the tax law is necessary so that companies are treated fairly.	☐	☐	☐	☐	☐
Corporate income tax is so complicated that only people who can afford to pay tax professionals can take advantage of most legal ways to save much in taxes.	☐	☐	☐	☐	☐
A 'fair' tax rate should be the same for every company, regardless of their size (small, medium or large).	☐	☐	☐	☐	☐
Large companies have a greater ability to pay income tax, so it is fair that they should pay a higher rate of tax than small and medium	☐	☐	☐	☐	☐
It is fair that high-profit companies should pay a higher rate of tax than low-profit companies.	☐	☐	☐	☐	☐

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	1	2	3	4	5
I believe that compared to large companies, more favourable tax treatments should be given to small and medium-sized	☐	☐	☐	☐	☐
The chances of being audited (tax audit) are so low that it is worthwhile trying to 'cut corners' a little on corporate income taxes for various	☐	☐	☐	☐	☐
I believe that the relationship with the Inland Revenue Board officers has improved since the implementation of the	☐	☐	☐	☐	☐
I believe that each company's officers have a moral obligation to report all of their company's income and pay the correct amount of corporate income tax.	☐	☐	☐	☐	☐

	Much Less Fair	Less Fair	About the same	More Fair	Much More Fair
	1	2	3	4	5
Do you believe that the move to self-assessment made the corporate tax laws more or less fair?	☐	☐	☐	☐	☐
Overall, has the move to self-assessment made the distribution of the corporate income tax burden among small, medium and large companies more or less	☐	☐	☐	☐	☐

	Much Less Taxes	Less Taxes	About the same	More Taxes	Much More Taxes
	1	2	3	4	5
Do you believe that as a result of changes in corporate income tax during the past five years *small and medium companies* are paying more taxes or less taxes?	☐	☐	☐	☐	☐
Do you believe that as a result of changes in corporate income tax during the past five years *large companies* are paying more taxes or	☐	☐	☐	☐	☐

15. Read the following and kindly indicate your opinion (by way of a tick) to the following scenario based on your experience:

Mr. A, a self-employed businessman is considering not including a cash sale of RM10,000 as his business income in his 2006 tax return. Legally, the cash receipts of RM10,000 should be included as a business income. However, he is almost certain that the tax authority will not audit him and would not know if the amount is not reported.

a) What is the probability that Mr. A will **not** report the RM10,000 of cash sale on his business income?

10%	20%	30%	40%	50%	60%	70%	80%	90%	100%

b) Taking into account all known and likely business circumstances, to what extent do you agree with Mr. A's possible action of not reporting the cash sale of RM10,000 as his business income?

	1	2	3	4	5	
Strongly Disagree	☐	☐	☐	☐	☐	Strongly Agree

c) Would he be likely to report only part of the RM10,000 as business income?

Yes ☐   No ☐   Unsure ☐

16. Read the following and kindly indicate your opinion to the following scenario based on your experience:

Mr. B, a self-employed businessman, had incurred RM10,000 to repair his personal van. In preparing his 2006 tax return, he is thinking about claiming the costs of repair as if the van was used in his business. Legally, such a claim is not allowable, but he is almost certain that he will not be audited and that the

a) What is the probability that Mr. B will claim the RM10,000 cost of repair as his business deduction?

10%	20%	30%	40%	50%	60%	70%	80%	90%	100%

b) Taking into account all known and likely business circumstances, to what extent do you agree with Mr. B's possible action of claiming RM10,000 as his business deduction?

	1	2	3	4	5	
Strongly Disagree	☐	☐	☐	☐	☐	Strongly Agree

c) Would he be likely to deduct only part of the RM10,000 as a business deduction?

Yes ☐   No ☐   Unsure ☐

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SECTION D: COMMENTS AND SUGGESTIONS

The following questions are about general and overall issues on the tax compliance burden faced by small and medium sized companies.

17. Compared with other companies in your industry, the estimated level of income tax compliance burden of your company is:
    (Please tick one box)

    | | 1 | 2 | 3 | 4 | 5 | |
    Very Low ☐ ☐ ☐ ☐ ☐ Very High

18. If your company could claim from the government for the time and money spent (both internally and externally) by the company in dealing with corporate income tax for the financial year 2006, how much would you claim as fair compensation?

    RM [   ]

19. Please state if you have any specific suggestions for reducing tax preparation work and documentation in respect of corporate income tax for small and medium-sized companies.

    [   ]

20. Please state if you have any other comments and/or suggestions regarding taxation on small and medium-sized companies.

    [   ]

21. What is your current position in the company?
    (Please tick one box)

    Chief Executive Officer .... ☐
    Managing Director .... ☐
    Manager .... ☐
    Accountant .... ☐
    Other (please specify) [   ]

If you are willing to answer any further questions that may arise from this questionnaire, or participate further, please provide contact details. Your response will be treated with strict confidence and solely for the purpose of this study.

(Leave blank if you wish to maintain anonymity)

Name [   ]

Telephone [   ]

Thank you for your kind assistance in completing this questionnaire.

Kindly return this questionnaire in the self-addressed envelope provided to:

Hijattulah Abdul Jabbar
Faculty of Accountancy
06010 UUM Sintok
Kedah

APPENDIX G

Primary Postal Survey Questionnaire (Malay Version)

Kajian Beban Kerja Pematuhan Cukai
ke atas Syarikat Kecil dan Sederhana di Malaysia

Nota:
- Semua soalan adalah berkaitan dengan tahun kewangan/tahun taksiran 2006 (atau tahun sebelum).
- Semua respons adalah sulit dan tidak boleh dikenalpasti (*anonymous*).

BAHAGIAN A: MAKLUMAT UMUM.

Sila tanda satu pilihan sahaja atau isi butiran seperti yang dikehendaki.

1. Tahun kewangan syarikat anda pada tahun 2006 berakhir pada: ☐☐ ☐☐
   Hari   Bulan

2. Aktiviti utama syarikat anda:
   (Sila tanda satu pilihan)

   Pembuatan (termasuk berasaskan tani) .... ☐
   Perkhidmatan berkaitan pembuatan .... ☐
   Perkhidmatan (termasuk teknologi maklumat
   dan komunikasi) .... ☐
   Pembinaan .... ☐

   Lain-lain, sila nyatakan ☐

3. Tempoh masa syarikat anda menjalankan perniagaan:
   (Sila tanda satu pilihan)

   Kurang 2 tahun ☐   2 hingga 5 tahun ☐   Lebih 5 tahun ☐

4. Purata bilangan pekerja (sepenuh masa) syarikat anda dalam tahun 2006:
   (Sila tanda satu pilihan)
   4 atau kurang ☐   5 - 19 ☐   20 - 50 ☐   51 - 150 ☐   151 atau lebih ☐

5. Modal saham berbayar syarikat anda pada awal tahun kewangan 2006:
   (Sila tanda satu pilihan)

   RM500,000 atau kurang .... ☐

   RM500,001 hingga RM2,500,000 .... ☐

   RM2,500,001 atau lebih .... ☐

6. Perolehan syarikat anda pada tahun kewangan 2006:
   (Sila tanda satu pilihan)

   Kurang dari RM250,000 .... ☐

   RM250,000 hingga RM999,999 .... ☐

   RM1,000,000 hingga RM4,999,999 .... ☐

   RM5,000,000 hingga RM9,999,999 .... ☐

   RM10,000,000 hingga RM24,999,999 .... ☐

   RM25,000,000 atau lebih .... ☐

7. Nyatakan anggaran liabiliti cukai syarikat bagi tahun taksiran 2006:
   (Sila tanda satu pilihan)

   0   (tiada liabiliti cukai) .... ☐
   RM1 hingga RM99,999 .... ☐
   RM100,000 hingga RM249,999 .... ☐
   RM250,000 hingga RM499,999 .... ☐
   RM500,000 hingga RM999,999 .... ☐
   RM1,000,000 atau lebih .... ☐

8. Memandangkan syarikat membayar ansuran cukai pendapatan secara bulanan, adakah syarikat anda menjangkakan pemulangan cukai *(tax refund)* bagi tahun taksiran 2006?

   YA ☐   TIDAK ☐

   Jika 'YA', berapakah anggaran cukai yang mungkin dikembalikan?
   RM ☐

BAHAGIAN B: KOS PEMATUHAN CUKAI

Kos Dalaman
Sila nyatakan anggaran masa, amaun dan pecahan kos yang dilibatkan secara dalaman bagi mematuhi peruntukan cukai pendapatan syarikat.

9. Sila ANGGAR masa yang diambil dan kadar upah bulanan bagi setiap staf berikut yang dilibatkan semata-mata dalam melaksanakan aktiviti cukai pendapatan syarikat bagi tahun 2006 (tidak termasuk aktiviti simpan kira rutin dan kos overhed).

	Jumlah Jam	Purata Kadar Upah
Pengurus/Akauntan	☐ Sebulan	RM ☐ Sebulan
Staf perakaunan	☐ Sebulan	RM ☐ Sebulan
Staf pentadbiran	☐ Sebulan	RM ☐ Sebulan
Staf-staf Lain	☐ Sebulan	RM ☐ Sebulan

10. Adakah syarikat anda membelanjakan sebarang kos tambahan selain daripada kos staf di atas (seperti belanja alatulis, pos, perjalanan) dalam mematuhi keperluan cukai pendapatan bagi tahun taksiran 2006?

    YA ☐   TIDAK ☐

    Jika 'TIDAK', sila ke soalan 11.
    Jika 'YA', sila respons kepada soalan berikut:
    Jelaskan bentuk perbelanjaan secara ringkas:
    ☐

    Nyatakan anggaran kos tambahan tersebut bagi tahun 2006.
    RM ☐

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11. **Daripada jumlah masa dan kos yang dilibatkan secara dalaman untuk mematuhi peruntukan cukai syarikat 2006, berapakah anggaran masa dan kos (dalam peratusan) yang berkait dengan kerja-kerja berikut:**

	Peratus
Kerja rutin cukai pendapatan (kerja-kerja tahunan)	%
Kerja perancangan cukai pendapatan (jangka panjang)	%
Lain-lain (sila nyatakan)	%
Jumlah	100 %

12. **Nyatakan aspek yang menjadi kesukaran kepada syarikat anda?**
    (Jika bersesuaian, sila tanda lebih dari satu)

Menganggar cukai pendapatan perlu bayar ....

Memahami undang-undang cukai pendapatan...............

Melaksanakan pindaan dalam cukai pendapatan ....

Menyimpan rekod untuk tujuan cukai pendapatan ....

Penambahan beban rekod untuk tujuan cukai pendapatan

Aliran tunai ketika membayar ansuran cukai bulanan.......

Tempoh masa pengembalian borang yang singkat ....

Berurusan dengan pihak berkuasa cukai ....

Berurusan dengan penasihat luaran (seperti agen cukai) …

Lain-lain (sila nyatakan)

Kos Luaran
Sila tandakan pilihan yang bersesuaian berhubung kos pematuhan luaran dalam mematuhi peruntukan cukai pendapatan syarikat:

13. **Adakah syarikat anda menggunakan khidmat profesional cukai luaran (seperti akauntan cukai dan/atau agen cukai) untuk mengendalikan urusan cukai pendapatan 2006?**

    YA ☐   TIDAK ☐

    Jika 'TIDAK', sila ke Bahagian C (Soalan 14).
    Jika 'YA', sila sambung soalan berikut:

    Apakah sebab utama mendapatkan khidmat luaran?
    (Jika bersesuaian, sila tanda lebih dari satu)

Tiada kepakaran teknikal secara dalaman ....

Urusan cukai pendapatan adalah amat rumit ....

Pandangan bebas / luaran diperlukan ....

Kos efektif jika menggunakan khidmat profesional cukai luaran ....

Bagi tujuan perancangan cukai ....

Lain-lain (sila nyatakan)

Sila NYATA atau ANGGARKAN jumlah YURAN CUKAI luaran bagi urusan cukai pendapatan syarikat bagi tahun kewangan 2006.

RM ☐

Sila nyatakan ANGGARAN peratusan kerja berikut yang dijalankan oleh agen cukai luaran anda.

	Anggaran Peratusan
Kerja rutin cukai pendapatan (kerja tahunan)	%
Kerja perancangan cukai (jangka panjang)	%
Lain-lain (sila nyatakan)	%
Jumlah	100 %

BAHAGIAN C: PERSEPSI DAN PANDANGAN

14. **Sila nyatakan pendapat anda (berdasarkan skala 5) bagi setiap pernyataan di bawah. Tiada pilihan yang betul atau salah. Semua respons anda tidak dapat dikenalpasti (anonymous). Sila tanda satu pilihan bagi setiap pernyataan.**

	Sangat Tidak Setuju	Tidak Setuju	Neutral	Setuju	Sangat Setuju
	1	2	3	4	5
Secara peribadi, saya beranggapan bahawa penyediaan borang nyata cukai pendapatan syarikat adalah sukar.	☐	☐	☐	☐	☐
Secara relatif, undang-undang cukai pendapatan syarikat adalah mudah.	☐	☐	☐	☐	☐
Undang-undang cukai perlu kompleks supaya syarikat dilayan sewajarnya.	☐	☐	☐	☐	☐
Cukai pendapatan syarikat amat rumit sehinggakan hanya mereka yang mampu menggunakan khidmat profesional cukai sahaja boleh menikmati penjimatan cukai secara	☐	☐	☐	☐	☐
Kadar cukai yang 'adil' perlu dikenakan ke atas setiap syarikat, tanpa mengambilkira saiz syarikat (kecil, sederhana atau besar).	☐	☐	☐	☐	☐
Syarikat besar berupaya membayar cukai pendapatan yang lebih, maka adalah wajar kadar cukai syarikat berkenaan lebih tinggi daripada syarikat kecil	☐	☐	☐	☐	☐
Syarikat yang berkeuntungan tinggi wajar dikenakan kadar cukai yang tinggi berbanding syarikat yang berkeuntungan	☐	☐	☐	☐	☐

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	Sangat Tidak Setuju	Tidak Setuju	Neutral	Setuju	Sangat Setuju
	1	2	3	4	5
Saya percaya bahawa lebih banyak insentif cukai perlu ditawarkan kepada syarikat kecil dan sederhana berbanding syarikat besar.	☐	☐	☐	☐	☐
Peluang untuk diaudit (audit cukai) adalah terlalu rendah, maka syarikat wajar berusaha untuk mengurangkan sebahagian daripada cukai pendapatan	☐	☐	☐	☐	☐
Saya percaya bahawa hubungan syarikat dengan Lembaga Hasil Dalam Negeri semakin baik sejak pelaksanaan sistem taksir sendiri.	☐	☐	☐	☐	☐
Saya percaya setiap pegawai syarikat mempunyai tanggungjawab moral untuk melaporkan semua pendapatan syarikat dan membayar cukai pendapatan syarikat yang	☐	☐	☐	☐	☐

	Semakin Kurang Adil	Kurang Adil	Lebih Kurang Sama	Lebih Adil	Semakin Lebih Adil
	1	2	3	4	5
Adakah anda percaya bahawa perubahan sistem taksiran kepada sistem taksir sendiri telah menjadikan undang-undang cukai syarikat lebih atau kurang adil?	☐	☐	☐	☐	☐
Secara keseluruhan, adakah sistem taksir sendiri telah menyebabkan agihan beban kerja cukai pendapatan syarikat di kalangan syarikat kecil, sederhana dan besar lebih	☐	☐	☐	☐	☐

	Semakin Kurang Cukai	Kurang Cukai	Lebih Kurang Sama	Lebih Cukai	Semakin Lebih Cukai
	1	2	3	4	5
Adakah anda percaya, disebabkan pindaan cukai pendapatan syarikat sepanjang lima tahun lalu, kini *syarikat kecil dan sederhana* membayar lebih atau kurang cukai?	☐	☐	☐	☐	☐
Adakah anda percaya, disebabkan pindaan cukai pendapatan syarikat sepanjang lima tahun lalu, kini *syarikat besar* membayar lebih	☐	☐	☐	☐	☐

15. **Berdasarkan pengalaman anda, nyatakan pandangan anda berhubung senario berikut:**

> Encik A, pemilik perniagaan sendiri sedang menimbangkan untuk tidak memasukkan jualan tunai sebanyak RM10,000 sebagai pendapatan perniagaan beliau dalam borang nyata cukai tahun 2006. Berdasarkan undang-undang, jualan tunai sebanyak RM10,000 tersebut perlu dilaporkan sebagai pendapatan perniagaan. Namun, beliau yakin pihak berkuasa cukai tidak akan mengaudit dan tidak akan mengetahui jika amaun

a) Nyatakan peratus kemungkinan Encik A tidak akan melaporkan jualan tunai RM10,000 tersebut dalam pendapatan perniagaan beliau?
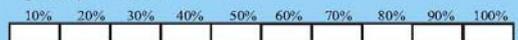
10%	20%	30%	40%	50%	60%	70%	80%	90%	100%

b) Selepas mengambilkira semua situasi perniagaan, sejauhmanakah anda bersetuju dengan tindakan Encik A tidak melaporkan jualan tunai RM10,000 sebagai pendapatan perniagaan beliau?

	1	2	3	4	5	
Sangat Tidak Setuju	☐	☐	☐	☐	☐	Sangat Setuju

c) Adakah mungkin beliau hanya melaporkan sebahagian sahaja daripada jumlah RM10,000 sebagai pendapatan perniagaan?

Ya ☐   Tidak ☐   Tidak Pasti ☐

16. **Berdasarkan pengalaman anda, nyatakan pandangan anda berhubung senario berikut:**

> Encik B, pemilik perniagaan sendiri telah membelanjakan RM10,000 untuk membaiki van milik persendirian beliau. Dalam menyediakan borang nyata cukai tahun 2006, beliau sedang melihat kemungkinan untuk menuntut perbelanjaan tersebut, seolah-olah van tersebut digunakan dalam perniagaan. Tuntutan sebanyak RM10,000 tersebut adalah tidak sah di sini undang-undang. Namun, beliau yakin pihak berkuasa cukai tidak akan mengaudit dan tidak akan mengetahui

a) Nyatakan peratus kemungkinan Encik B menuntut belanja pembaikan RM10,000 sebagai perbelanjaan perniagaan beliau?

10%	20%	30%	40%	50%	60%	70%	80%	90%	100%

b) Selepas mengambilkira semua situasi perniagaan, sejauhmanakah anda bersetuju dengan tindakan Encik B menuntut belanja pembaikan RM10,000 sebagai perbelanjaan perniagaan beliau?

	1	2	3	4	5	
Sangat Tidak Setuju	☐	☐	☐	☐	☐	Sangat Setuju

c) Adakah mungkin beliau hanya menuntut sebahagian sahaja daripada jumlah RM10,000 sebagai perbelanjaan perniagaan?

Ya ☐   Tidak ☐   Tidak Pasti ☐

BAHAGIAN D: KOMEN DAN CADANGAN

Soalan berikut adalah berkait dengan isu-isu umum berhubung beban pematuhan cukai yang dihadapi oleh syarikat kecil dan sederhana.

17. Tahap anggaran beban kerja pematuhan cukai syarikat anda berbanding syarikat lain dalam industri yang sama adalah:
    (Sila tanda satu pilihan)

    Sangat Rendah [1] [2] [3] [4] [5] Sangat Tinggi

18. Jika syarikat anda dibenarkan untuk menuntut pampasan daripada kerajaan ke atas masa dan wang yang dibelanjakan (sama ada secara dalaman atau luaran) bagi urusan cukai pendapatan syarikat 2006, berapakah amaun yang dirasakan munasabah sebagai pampasan?

    RM _____

19. Sila nyatakan, jika anda ada sebarang cadangan khusus bagi mengurangkan beban kerja penyediaan cukai dan dokumentasi berhubung cukai pendapatan syarikat bagi syarikat kecil dan sederhana.

    [   ]

20. Sila nyatakan, jika anda ada sebarang pandangan dan/atau cadangan berhubung cukai ke atas syarikat kecil dan sederhana.

    [   ]

21. Nyatakan jawatan anda di syarikat ini.
    (Sila tanda satu pilihan)

    Ketua Pegawai Eksekutif............................ [   ]
    Pengarah Urusan .... [   ]
    Pengurus .... [   ]
    Akauntan .... [   ]
    Lain-lain (sila nyatakan) [   ]

Jika anda bersedia untuk menjawab sebarang soalan tambahan berhubung soal selidik ini, sila berikan maklumat berikut. Semua respons adalah sulit dan hanya untuk tujuan kajian ini semata-mata.

Nama [   ]

Telefon [   ]

Terima kasih kerana membantu mengisi soal selidik ini.

Sila kembalikan soal selidik ini bersama sampul bersetem yang dikepilkan kepada:

Hijattulah Abdul Jabbar
Fakulti Perakaunan
06010 UUM Sintok
Kedah

APPENDIX H

Covering Letter to Postal Survey

UNIVERSITI UTARA MALAYSIA

06010 UUM Sintok, Kedah Darul Aman, Malaysia. Tel: 604 - 928 4000

5 July 2007

Dear Sir/Madam

SURVEY OF THE TAX COMPLIANCE BURDEN OF SMALL AND MEDIUM-SIZED (SME) COMPANIES IN MALAYSIA

This survey is an independent research study conducted in response to many concerns expressed by small and medium-sized (SME) companies in Malaysia regarding the considerable burden imposed on business by government regulations, particularly in the area of taxation. As the objective is to investigate the nature and extent of income tax compliance costs, it is also crucial to assess how these may be reduced significantly, both in the short and long run.

The study is conducted in collaboration with the Small and Medium Industries Development Corporation (SMIDEC). SMIDEC believes that findings from this survey are expected to provide valuable information, and this may influence government policy with regards to SME companies.

I request your kind assistance in this regard by completing the attached questionnaire and returning it promptly in the reply-paid envelope provided. The questionnaire is expected to take only about 15 minutes to complete. Please be assured that all information obtained will be treated with strict confidence and used solely for the purpose of this study.

If you would like to discuss this questionnaire or need any help in completing particular questions, please do not hesitate to phone 019-663 9340 and/or e-mail me at hijat@uum.edu.my.

Thank you so much for your kind cooperation and assistance.

Yours Faithfully

HIJATTULAH ABDUL JABBAR (Mr)
Faculty of Accountancy
Universiti Utara Malaysia
06010 UUM Sintok
Kedah, Malaysia
Tel: 019- 663 9340
Fax: +604 928 5762
e-mail: hijat@uum.edu.my

* Enclosed also a Malay version, if you wish to respond in Malay language.

APPENDIX I

Postcard First Reminder

SURVEY OF THE TAX COMPLIANCE BURDEN OF SMALL AND MEDIUM-SIZED (SME) COMPANIES IN MALAYSIA

Dear Sir/Madam

Recently I sent you a questionnaire on the costs of complying with corporate income tax laws. As the study is expected to provide valuable input for the government in providing greater assistance to SME companies, your contribution towards the study is highly appreciated.

If you have already returned the questionnaire, I would like to thank you for your participation and please kindly disregard this reminder.

If you are still yet to complete it, I would be grateful for your cooperation in doing so and then returning the questionnaire (an additional copy could be printed from http://www.fpk.uum.edu.my/hijat/SurveyonSME/Forms/Print.htm). If you would like to discuss the questionnaire or need any help in completing particular questions, please call me on 019-6639340 or e-mail me at hijat@uum.edu.my.

Thank you so much for your kind cooperation and assistance.

Hijattulah Abdul Jabbar (Mr)
Faculty of Accountancy,
06010 UUM Sintok, Kedah

APPENDIX J

Second Reminder to Postal Survey

UNIVERSITI UTARA MALAYSIA

06010 UUM Sintok, Kedah Darul Aman, Malaysia. Tel: 604 - 928 4000

Malaysiaku Gemilang

22 August 2007

Dear Sir/Madam

SURVEY OF THE TAX COMPLIANCE BURDEN OF SMALL AND MEDIUM-SIZED (SME) COMPANIES IN MALAYSIA

Recently I sent you a questionnaire on the costs of complying with the corporate income tax laws. If you have already returned the questionnaire, I would like to thank you for your kind contribution in providing valuable information that could influence government policy with regards to SME companies.

If you are still yet to complete it, please re-consider (the questionnaire is attached) and returning it promptly in the reply-paid envelope provided. Your response is vital in ensuing that the issue of the tax compliance burden of SME companies is properly considered by the government and other SME agencies. If you have any questions or concerns, please call me on 019-6639340 or e-mail me at hijat@uum.edu.my. I look forward to your contribution towards the study.

I appreciate your precious time and I apologise for any inconvenience caused.

Thanking you for your kind cooperation and help.

Yours Faithfully
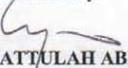
HIJATTULAH ABDUL JABBAR (Mr)
Faculty of Accountancy
06010 UUM Sintok
Kedah, Malaysia
Tel: 019- 663 9340
Fax: +604 928 5762
e-mail: hijat@uum.edu.my

If you do not wish to fill in the form, your contributions towards tax compliance costs are still important. I would therefore be grateful if you would just complete the single question in the attached card and returning it in the reply-paid envelope provided.

APPENDIX K

Single Question Postcard Survey

**SURVEY OF THE TAX COMPLIANCE BURDEN OF
SME COMPANIES IN MALAYSIA**

Dear Sir/Madam

If you do not wish to complete the survey questionnaire, I would be very
grateful if you could respond to a single question as follows:

**Compared with other companies in your industry, the estimated
level of income tax compliance burden of your company is:**
(Please tick one box)

Very Low	☐
Low	☐
Average	☐
High	☐
Very High	☐

Thank you for your kind contribution.

Hijattulah Abdul Jabbar, UUM.

APPENDIX L

Questionnaire for Web Survey (printable version)

Survey of the Tax Compliance Burden of Small and Medium-sized Companies in Malaysia

Note:

* All questions relate to the financial year end/or year of assessment 2006 (or substituted year).

* All responses will be kept strictly confidential and anonymous.

SECTION A: GENERAL INFORMATION
Please click one circle or fill in the appproriate details as requested.

1: The financial year end of your company in 2006 was:

Please choose **only one** of the following:

- ☐ 31 March 2006
- ☐ 30 June 2006
- ☐ 30 September 2006
- ☐ 31 December 2006
- ☐ Other (please state)

2: The main business activity of your company is:

Please choose **only one** of the following:

- ☐ Manufacturing *(including Agro-based)*
- ☐ Manufacturing-related Services
- ☐ Services *(including Information & Communication Technology)*
- ☐ Construction
- ☐ Other (please state)

3: The period your company has been in business is:

Please choose **only one** of the following:

- ☐ Less than 2 years
- ☐ 2 to 5 years
- ☐ More than 5 years

4: The average number of staff (full time) employed by your company in 2006 was:

Please choose **only one** of the following:

- ☐ 4 or less
- ☐ 5 to 19
- ☐ 20 to 50
- ☐ 51 to 150
- ☐ 151 or more

5: The paid up capital of your company at the beginning of financial year 2006 was:

Please choose **only one** of the following:

- ☐ RM500,000 or less
- ☐ RM500,001 to RM2,500,000
- ☐ RM2,500,001 or more

6: The turnover of your company in financial year 2006 was:

Please choose **only one** of the following:

- ☐ Less than RM250,000
- ☐ RM250,000 to RM999,999
- ☐ RM1,000,000 to RM4,999,999

☐ RM5,000,000 to RM9,999,999
☐ RM10,000,000 to RM24,999,999
☐ RM25,000,000 or more

7: The estimated tax liability of your company for the year of assessment 2006 was:
Please choose **only one** of the following:
☐ Nil (no tax liability)
☐ RM1 to RM99,999
☐ RM100,000 to RM249,999
☐ RM500,000 to RM999,999
☐ RM1,000,000 or more

8: Since the company is paying income tax by advance monthly instalments, would your company expect a tax refund for the year of assessment 2006?
Please choose **only one** of the following:
☐ Yes
☐ No

[Only answer this question if you answered 'Yes' to question '8 ']
8.1: Please estimate the possible amount of tax refund. (RM)
Please write your answer here:

SECTION B1: TAX COMPLIANCE COSTS (Internal Costs)
Kindly fill in an approximate estimate of time, monetary amount and/or breakdown of the following INTERNAL COSTS of complying with corporate income tax:

9: Please ESTIMATE the *time spent* by these people working exclusively on income Tax activities (exclude usual book keeping and overhead costs) within the company in 2006.

AVERAGE TIME SPENT ON INCOME TAX ACTIVITIES (HOURS/MONTH)
Please write your answer(s) here:
Managers/accountants:

Accounting staff:

Administrative staff:

Other Staff (if any) :

9(b): Please ESTIMATE the *monthly wage* rates for these people within the company in 2006.

AVERAGE WAGE RATE (RM/MONTH)
Please write your answer(s) here:
Managers/Acountants:

Accounting Staff:

Administrative Staff:

Other Staff (if any) :

10: Does your company incur any other additional non-staff costs (e.g. stationery, postage, travelling, etc.) in meeting the income tax requirements for the year of assessment 2006?

Please choose **only one** of the following:

☐ Yes

☐ No

[Only answer this question if you answered 'Yes' to question '10 ']

10.1: Briefly describe the nature of the costs.

Please write your answer here:

[Only answer this question if you answered 'Yes' to question '10 ']

10.2: Please estimate the additional costs involved in 2006. (RM)

Please write your answer here:

11: Of all the time spent and costs incurred internally in complying with corporate income tax laws for 2006, state approximately how much (in percentage) was related to the following work:

(total percentage shall equal to 100)

Please write your answer(s) here:

Routine Income Tax Return work (for annual return) (%):

Income Tax Planning work (longer term) (%):

Other [please state the nature and %]:

12: In which of the following areas is your company facing difficulties?

Please choose **all** that apply:

☐ Estimating income tax payable

☐ Understanding income tax legislations

☐ Implementing the income tax changes

☐ Maintaining records for income tax purpose

☐ Increasing burden of record keeping for tax purpose

☐ Cash flow position when paying monthly tax instalments

☐ Short period of time to lodge the tax return

☐ Dealing with the tax authority

☐ Dealing with external advisers (such as tax agents)

Other (please state): _____

SECTION B2: TAX COMPLIANCE COSTS (External Costs)

Kindly please click one circle or provide an appropriate response to the following question(s) related to EXTERNAL COSTS of complying with corporate income tax:

13: Does your company employ external tax professionals (such as accountant and/or tax agent) to handle income tax matters in 2006?

Please choose **only one** of the following:

☐ Yes

☐ No

[Only answer this question if you answered 'Yes' to question '13 ']

13.1: The main reason for the external advice was:

Please choose **all** that apply:

☐ Technical knowledge is not readily available internally

☐ Income tax matters are too complicated

☐ External opinion was required

☐ It is more cost-effective to use external tax professionals

☐ For income tax planning

Other (please state): [_____]

[Only answer this question if you answered 'Yes' to question '13 ']

13.2: Please PROVIDE or ESTIMATE the external tax fees for the corporate income tax activities in the financial year 2006. [RM]

Please write your answer here:

[_____]

[Only answer this question if you answered 'Yes' to question '13 ']

13.3: Please ESTIMATE the percentage breakdown between routine income tax preparation and income tax planning work conducted by the external tax professionals.

(total percentage shall equal to 100)

Please write your answer(s) here:

Routine Income Tax Return work (for annual return)[%]:

Income Tax Planning work (longer term)[%]:

Other [please state the nature and %]:

SECTION C1: PERCEPTIONS AND OPINIONS

14:

Kindly respond to the following statements to indicate your opinion (on a 5 point scale) to each of the statements. There are no right or wrong answers. All responses are absolutely anonymous.

Tick one number for each statement. [Strongly Disagree (1) -> Strongly Agree (5)]

Please choose the appropriate response:

Personally I consider corporate income tax return preparations difficult.	☐1	☐2	☐3	☐4	☐5
Corporate income tax law is relatively simple.	☐1	☐2	☐3	☐4	☐5
Complexity in the tax law is necessary so that companies are treated fairly.	☐1	☐2	☐3	☐4	☐5

Corporate income tax is so complicated that only people who can afford to pay tax professionals can take advantage of most legal ways to save much in taxes. ☐1 ☐2 ☐3 ☐4 ☐5

A 'fair' tax rate should be the same for every company, regardless of their size (small, medium or large). ☐1 ☐2 ☐3 ☐4 ☐5

Large companies have a greater ability to pay income tax, so it is fair that they should pay a higher rate of tax than small and medium companies. ☐1 ☐2 ☐3 ☐4 ☐5

It is fair that high-profit companies should pay a higher rate of tax than low-profit companies. ☐1 ☐2 ☐3 ☐4 ☐5

I believe that compared to large companies, more favourable tax treatments should be given to small and medium-sized companies. ☐1 ☐2 ☐3 ☐4 ☐5

The chances of being audited (tax audit) are so low that it is worthwhile trying to 'cut corners' a little on corporate income taxes for various reasons. ☐1 ☐2 ☐3 ☐4 ☐5

I believe that the relationship with the Inland Revenue Board officers has improved since the implementation of the self-assessment system. ☐1 ☐2 ☐3 ☐4 ☐5

I believe that each company's officers have a moral obligation to report all of their company's income and pay the correct amount of corporate income tax. ☐1 ☐2 ☐3 ☐4 ☐5

SECTION C2:PERCEPTIONS AND OPINIONS

15:

Kindly respond to the following statements to indicate your opinion to each of the statements. Tick one number for each statement.

Indicate your opinion on a 5 point scale - Much Less Fair (1) - Much More Fair (5).
Please choose the appropriate response:
Do you believe that the move to self-assessment made the corporate tax laws more or less fair? ☐1 ☐2 ☐3 ☐4 ☐5

Overall, has the move to self-assessment made the distribution of the corporate income tax burden among small, medium and large companies more or less fair? ☐1 ☐2 ☐3 ☐4 ☐5

15(b):

Indicate your opinion on a 5 point scale- Much Less Taxes (1)-Much More Taxes (5).

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Please choose the appropriate response:

Do you believe that as a result of changes in corporate income tax during the past five years *small and medium companies* are paying more taxes or less taxes?   ☐1 ☐2 ☐3 ☐4 ☐5

Do you believe that as a result of changes in corporate income tax during the past five years *large companies* are paying more taxes or less taxes?   ☐1 ☐2 ☐3 ☐4 ☐5

SECTION C3: PERCEPTIONS AND OPINIONS

16:

Read the following and kindly indicate your opinion to the following scenario based on your experience:

Mr. A, a self-employed businessman is considering not including a cash sale of RM10,000 as his business income in his 2006 tax return. Legally, the cash receipts of RM10,000 should be included as a business income. However, he is almost certain that the tax authority will not audit him and would not know if the amount is not reported.

What is the probability that Mr. A will not report the RM10,000 of cash sale on his business income?

Please choose the appropriate response:

	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
Probability	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

16 (b): Taking into account all known and likely business circumstances, to what extent do you agree with Mr. A's possible action of not reporting the cash sale of RM10,000 as his business income?

Please choose the appropriate response:

Strongly Disagree (1) to Strongly Agree (5) ☐1 ☐2 ☐3 ☐4 ☐5

16 (c): Would he be likely to report only part of the RM10,000 as business income?

Please choose **only one** of the following:

☐ Yes
☐ No
☐ Not Sure

SECTION C4:PERCEPTIONS AND OPINIONS

17:

Read the following and kindly indicate your opinion to the following scenario based on your experience:

Mr. B, a self-employed businessman, had incurred RM10,000 to repair his personal van. In preparing his 2006 tax return, he is thinking about claiming the costs of repair as if the van was used in his business. Legally, such a claim is not allowable, but he is almost certain that he will not be audited and that the tax authority would not be able to detect the deduction.

What is the probability that Mr. B will claim the RM10,000 cost of repair as his

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business deduction?

Please choose the appropriate response:

	10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
Probability	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

17 (b): Taking into account all known and likely business circumstances, to what extent do you agree with Mr. B's possible action of claiming RM10,000 as his business deduction?

Please choose the appropriate response:

Strongly Disagree (1) to Strongly Agree (5) ☐1 ☐2 ☐3 ☐4 ☐5

17 (c): Would he be likely to deduct only part of the RM10,000 as a business deduction?

Please choose **only one** of the following:
☐ Yes
☐ No
☐ Not Sure

SECTION D: COMMENTS AND SUGGESTIONS
The following questions are about general and overall issues on the tax compliance burden faced by small and medium sized companies

18: Compared with other companies in your industry, the estimated level of income tax compliance burden of your company is: (Please tick one box)

Please choose the appropriate response:

Very Low (1) - Very High (5) ☐1 ☐2 ☐3 ☐4 ☐5

19: If your company could claim from the government for the time and money spent (both internally and externally) by the company in dealing with corporate income tax for the financial year 2006, how much would you claim as fair compensation? (RM)

Please write your answer here:
[   ]

20: Please state if you have any specific suggestions for reducing tax preparation work and documentation in respect of corporate income tax for small and medium-sized companies.

Please write your answer here:

[   ]

21: Please state if you have any other comments and/or suggestions regarding taxation on small and medium-sized companies.

Please write your answer here:

22: What is your current position in the company?
Please choose **only one** of the following:
☐ Chief Executive Officer
☐ Managing Director
☐ Manager
☐ Accountant
☐ Other (please state)

23: If you are willing to answer any further questions that may arise from this questionnaire, or participate further, please provide contact details. Your response will be treated with strict confidence and solely for the purpose of this study. (Leave blank if you wish to maintain anonymity)
Please write your answer(s) here:

Name:

e-mail address:

| **Submit Your Survey.** |
| Thank you for completing this survey. Please fax your completed survey to: 04-928 5762. |

APPENDIX M

E-mail Correspondence for the Web Survey

First Contact: Advance E-Mail Notification/Initial E-Mail

Survey on SME Companies in Malaysia

Dear [Name and/or Position],
[Name of the Company]

Within the next few days, you will be invited to participate in a brief online web survey on the regulatory compliance burden of small and medium-sized (SME) companies in Malaysia. The study is being conducted by Universiti Utara Malaysia (UUM) in collaboration with the Small and Medium Industries Development Corporation (SMIDEC) in response to many concerns expressed by SME companies in Malaysia regarding the considerable burden imposed on business by government regulations, particularly in the area of taxation.

I would greatly appreciate it if you are able to take the few minutes necessary to complete the online survey. I look forward to your contribution toward the study in helping the relevant authorities provide further assistance to the SME sectors.

Thank you in advance for your help.

Second Contact: Invitation to Participate in a SME Survey

Dear [Name and/or Position],
[Name of the Company]

I am referring to my previous e-mail sent a few days ago about a survey on SME companies in Malaysia conducted by UUM in collaboration with SMIDEC.

You have been invited to participate in this survey. The survey is expected to take only about 15 minutes to complete. If you have any questions or concerns, please call me on 019-6639340 or e-mail me at hijat@uum.edu.my. I look forward to your contribution towards the study.

To participate, please click on the link below.

[Address of the Web Survey] [a]

Thank you so much for your kind cooperation and assistance.

[a] The first page of the web survey contain the same covering letter as for the primary postal survey (refer Appendix H).

Third and Fourth Contact: First and Second Reminder about SME Survey

Dear [Name and/or Position],
[Name of the Company]

Recently I invited you to participate in a survey. As the study is expected to provide valuable input for the government in providing greater assistance to SME companies, your contribution towards the study would be greatly appreciated.

If you are yet to complete it, I wish to inform you that the survey is still available should you wish to take part.

The survey is titled: "Survey of the Tax Compliance Burden of Small and Medium-sized Companies in Malaysia". To participate, please click on the link below:

[Address of the Web Survey] [a]

[a] The first page of the web survey contain the same covering letter as for the primary postal survey (refer Appendix H).

Fifth Contact: Third Reminder about SME Survey

Dear [Name and/or Position],
[Name of the Company]

Recently I sent you a questionnaire on SME survey. I note that you have not yet completed the survey. If you do not wish to fill in the form, I would be grateful if you would just respond to ONE question only.

Your response is vital in ensuing that the issue of the tax compliance burden of SME companies is properly considered by the government and other SME agencies.

Please click here to answer ONE question only.

[Address of the Web Survey].[a]

[a] The single question in the web survey is the same as for the primary postal survey (refer Appendix K).

APPENDIX N

Respondents' Profile and Details of Key Findings in the Web Survey

Table N.1: Sample Frame and Response Rate (Web Survey)

	Number of SMEs
Population with e-mail address	4,033
(-) Duplicate e-mail address [a]	111
(-) Selected in mail sample	387
Gross Sample Frame	3,535
(-) Out of frame [b]	83
(-) Unusable responses [c]	3
Net Sample Frame	3,449
Useable Response	75
Useable Response Rate (%)	2.17

[a] SMEs sharing similar e-mail address belong to the same group or management.
[b] These are largely due to undelivered email as a result of insufficient space in the respondent's mailbox (74 percent), followed by a refusal to participate (16 percent). The remaining 10 percent is due to other reasons, such as a dormant or new business and automated vacation reply.
[c] Responses discarded due either to incompleteness (two cases) or to not being within the definition of SMEs (one case).

Table N.2: Respondents' Position (Web Survey)

	Number of Respondents	**Percentage**
Chief Executive Officer	10	13.3
Managing Director/Director	35	46.7
Manager	18	24.0
Accountant	7	9.3
Other [a]	5	6.7
Total	75	100.0

[a] Comprising one accounting and three non-accounting staff respectively. The single remainder did not expose his/her position.

Table N.3: Business Profile of Responding SMEs (Web Survey)

	Number of SMEs [a]	Percentage [b]
Business Year-end		
28 February	1	1.3
31 March	4	5.3
31 May	1	1.3
30 June	9	12.0
31 July	1	1.3
31 August	5	6.7
30 September	3	4.0
30 November	1	1.3
31 December	50	66.7
Main Business Sector		
Manufacturing	15	20.0
Manufacturing-related Services	13	17.3
Services	41	54.0
Construction	6	8.0
Business Length		
Less than 2 years [c]	11	14.9
2 to 5 years [c]	16	21.6
More than 5 years	47	63.5
Source of Income Tax Work		
Internal and External	58	77.3
No External (i.e. internal only)	12	16.0
No Internal (i.e. external only)	5	6.7
Overall	75	100.0

[a] Total respondents of less than 75 for some sections due to missing case/s.
[b] Total percentage of less than one hundred for some sections due to rounding.
[c] Similar to the postal survey, these categories are combined into a single category.

Table N.4: Size of Responding SMEs (Web Survey)

	Number of SMEs [a]	Percentage [b]
Number of Staff Employed		
4 or less	21	28.8
5 to 19	34	46.6
20 to 50	11	15.1
51 to 150	7	9.6
Turnover Level		
Less than RM250,000	19	25.3
RM250,000 to RM999,999	21	28.0
RM1,000,000 to RM4,999,999	24	32.0
RM5,000,000 and more [c]	11	14.7
NSDC Size		
Micro	26	34.7
Small	38	50.7
Medium	11	14.7
Business Paid-up Capital		
RM500,000 or less	52	71.2
RM500,001 to RM2,500,000	17	23.3
RM2,500,001 or more	4	5.5
Estimated Tax liability		
No tax	22	29.3
RM1 to RM99,999	43	57.3
RM100,000 and more [c]	10	13.3
Overall	75	100.0

[a] Total respondents of less than 75 for some sections due to missing case/s.
[b] Total percentage of less than one hundred for some sections due to rounding.
[c] Similar to the postal survey, this is a combined category.

Table N.5: Tax-related Difficulties for SMEs, 2006 (Web Survey)

	Number of Responses	Overall Percent	Percent of Cases
Estimating Income Tax payable	49	19.2	70.0
Cash flow position to pay monthly tax instalments	43	16.9	61.4
Increasing burden of record keeping for tax purposes	32	12.5	45.7
Maintaining records for Income Tax purpose	31	12.2	44.3
Understanding Income Tax legislation	29	11.4	41.4
Implementing the Income Tax changes	24	9.4	34.3
Dealing with external tax advisers	17	6.7	24.3
Short period of time to lodge the tax return	16	6.3	22.9
Dealing with the tax authority	14	5.5	20.0
Total	255 [a]	100.0 [b]	-

[a] Total responses exceeds 75 as respondents were allowed to select more than one aspect.
[b] Does not total up to one hundred percent due to rounding.

Table N.6: Main Reason for using External Tax Professionals, 2006 (Web Survey)

	Number of Responses	Overall Percent	Percent of Cases
Technical knowledge is not readily available internally	47	29.7	75.8
It is more cost-effective to use external tax professionals	42	26.6	67.7
Income tax matters are too complicated	33	20.9	53.2
External opinion was required	23	14.6	37.1
For income tax planning	13	8.2	21.0
Total	158 [a]	100.0	-

[a] Total responses exceeds 75 as respondents were allowed to select more than one aspect.

Table N.7: Yearly Hours Spent on Tax Activities by Staff Categories (Web Survey)

Staff Categories	Mean	Minimum [a]	Maximum	Standard Deviation
Manager/Accountant	163	0	960	236
Accounting Staff	306	0	1,920	467
Administrative Staff	131	0	960	250
Other Staff	15	0	432	61
Overall	616	0	3,840	759

[a] Five respondents spent no internal time (see Table N.3). Around 71 percent of respondents estimated time spent as a combination of staff, namely; two (32 percent), three (30 percent) and four (9 percent) categories.

Table N.8: Monthly Wage Rates (RM) by Staff Categories (Web Survey)

Staff Categories [a]	Mean	Minimum	Maximum	Standard Deviation
Manager/Accountants (63)	3,591	500	7,000	1,217
Accounting Staff (58)	1,670	300	3,200	643
Administrative Staff (41)	1,169	500	1,600	429
Other Staff (19)	811	200	1,600	550

[a] The number of respondents is given in parentheses. This number was less than 75 as wage rates only apply if there was time spent in the respective staff categories.

Table N.9: Mean Compliance Costs by Business Characteristics (Web Survey)

Business Characteristics [a]	Mean Costs	Cost Sources		Costs Types	
		Internal [b]	External	Computation	Planning
	RM	Percent	Percent	Percent	Percent
Business Sector					
Manufacturing	10,217	66	34	73	27
Manufacturing-related Services	11,101	74	26	71	29
Services	8,166	69	31	79	21
Construction	10,630	75	25	67	33
Business Length					
Up to 5 years [c]	9,102	76	24	76	24
More than 5 years	9,346	66	34	75	25
Number of Staff Employed					
4 or less	6,704	71	29	80	20
5 to 19	9,905	69	31	78	22
20 to 50	7,568	68	32	71	29
51 to 150	17,729	73	27	66	34
Turnover					
Less than RM250,000	5,398	69	31	88	12
RM250,000 to RM999,999	9,629	73	27	75	25
RM1,000,000 to RM4,999,999	9,531	66	34	75	25
RM5,000,000 or more [c]	14,780	72	28	68	32
NSDC Size					
Micro	6,418	70	30	78	22
Small	10,668	74	26	75	25
Medium	11,261	58	42	67	33
Overall	**9,282**	**70**	**30**	**75**	**25**

[a] Refer Tables N.3 and N.4 for details pertaining to the number of respondents. For cost types, number of responses is equal to 62 as 13 respondents did not indicate their estimated percentage for at least one of their computational or planning costs.
[b] Inclusive of additional non-staff costs.
[c] Similar to a postal survey, this is a combined category.

Table N.10: Comparative Perceived Level of Compliance Costs (Web Survey)

Level of Compliance Costs	Full Web Survey		Single Web Question Survey	
	Frequency	**Percent**	**Frequency**	**Percent**
Very Low	3	4.1	3	1.8
Low	7	9.6	19	11.6
Neutral	32	43.8	66	40.2
High	17	23.3	46	28.0
Very high	14	19.2	30	18.3
	73 [a]	100	164	100 [b]
Overall Mean [c]	3.44		3.49	

[a] Number of respondents equals to 73, there were two missing values.
[b] Does not total up to one hundred percent due to rounding.
[c] Out of five.

Table N.11: Details of Responses for Tax Attitudes and Tax Behaviour in a Web Survey

Description	Mean	Median	Standard Deviation	Disagree/ Strongly Disagree	Neutral	Agree/ Strongly Agree
Tax Attitudes: Comp 1	3.61	4.00	1.01	9 (12.0)	25 (33.3)	41 (54.7)
Comp 2	2.25	2.00	0.96	48 (64.0)	19 (25.3)	8 (10.7)
Comp 3	3.19	3.00	1.07	15 (20.3)	33 (44.6)	26 (35.1)
Comp 4	3.45	4.00	1.09	15 (20.0)	22 (29.3)	38 (50.7)
Fair 1	4.04	4.00	1.02	4 (5.3)	19 (25.3)	52 (69.3)
Fair 2	3.18	3.00	0.98	14 (18.9)	34 (45.9)	26 (35.1)
Fair 3	3.12	3.00	0.95	13 (17.6)	40 (54.0)	21 (28.4)
Fair 4	3.03	3.00	0.76	11 (16.7)	40 (60.6)	15 (22.7)
Fair 5	3.37	3.00	0.84	6 (9.2)	35 (53.8)	24 (36.9)
Rate 1	2.93	3.00	1.45	27 (36.5)	20 (27.0)	27 (36.5)
Rate 2	3.73	4.00	1.41	18 (24.7)	9 (12.3)	46 (63.0)
Rate 3	3.71	4.00	1.46	15 (20.5)	12 (16.4)	46 (63.0)
IRB Relationship	3.04	3.00	1.09	14 (19.7)	36 (50.7)	21 (29.6)
Tax Audit	2.90	3.00	1.42	28 (38.9)	19 (26.4)	25 (34.7)
Tax Incentives	4.12	5.00	1.28	11 (14.7)	6 (8.0)	58 (77.3)
Tax Behaviour: Understatement of Income	2.48	3.00	1.35	36 (49.3)	23 (31.5)	14 (19.2)
Overstatement of Deductions	3.06	3.00	1.33	22 (31.4)	23 (32.9)	25 (35.7)

Number of respondents equals 75. Total responses of less than 75 for some items is due to missing cases. The percentage of responses is given in parentheses. Total percentage of less than 100 for some items is due to rounding.

Table N.12: Detailed Results of Multiple Regressions in a Web Survey

(Turnover as Primary Size Measure)

Model/ Independent Variables	Understatement of Income (Model 1)	Overstatement of Deductions (Model 2)	Both Non-compliance (Model 3)
Turnover:			
- Less than RM250,000	0.028	- 0.059	- 0.033
	(0.177)	(- 0.356)	(- 0.215)
- RM1,000,000 – RM4,999,999	0.018	0.134	0.066
	(0.119)	(0.844)	(0.449)
- RM5,000,000 or more	0.067	- 0.079	- 0.011
	(0.444)	(- 0.499)	(- 0.072)
Sector:			
- Manufacturing	- 0.099	- 0.206	- 0.178
	(- 0.789)	(- 1.563)	(- 1.456)
- Manufacturing-related	- 0.007	- 0.008	- 0.012
	(- 0.061)	(- 0.067)	(- 0.102)
- Construction	0.117	- 0.003	0.034
	(0.881)	(- 0.022)	(0.265)
Year	- 0.117	- 0.188	- 0.189
	(- 0.825)	(- 1.221)	(- 1.377)
Tax:			
- No Tax	- 0.029	- 0.071	- 0.030
	(- 0.221)	(- 0.518)	(- 0.232)
- RM100,000 or more	- 0.080	- 0.162	- 0.143
	(- 0.583)	(- 1.126)	(- 1.075)
Compliance Costs	- 0.023	0.122	0.044
	(- 0.181)	(0.951)	(0.360)
Complexity	- 0.370 [a]	- 0.182	- 0.319 [b]
	(- 2.900)	(- 1.374)	(- 2.577)
Fairness	- 0.048	0.110	0.029
	(- 0.397)	(0.860)	(0.248)
Rate	0.260 [b]	0.280 [b]	0.288 [b]
	(2.110)	(2.091)	(2.409)
Incentives	0.200	0.269 [b]	0.248 [b]
	(1.632)	(2.094)	(2.083)
Audit	0.418 [a]	0.314 [b]	0.415 [a]
	(3.630)	(2.573)	(3.706)
IRB	- 0.086	- 0.101	- 0.115
	(- 0.673)	(- 0.747)	(- 0.925)
R^2	0.394	0.373	0.428
Adjusted R^2	0.208	0.169	0.252
Standard Error	1.198	1.218	1.035
F-value	2.115	1.825	2.431
P-value	0.022 [b]	0.055 [c]	0.008 [b]

Number of respondents equals 69, except 66 in Model 2. T-value is given in parenthesis.
[a] Significant at the one percent level. [b] Significant at the five percent level. [c] Significant at the 10 percent level.

Table N.13: Detailed Results of Multiple Regressions in a Web Survey

(Alternate Size Measure)

Model/ Independent Variables	Understatement of Income (Model 1)		Overstatement of Deductions (Model 2)		Both Non-compliance (Model 3)	
Proxy for Business size	Staff	NSDC	Staff	NSDC	Staff	NSDC
Staff: - 4 or less	- 0.043	-	- 0.098	-	- 0.082	-
	(- 0.307)		(- 0.653)		(- 0.608)	
- 20–50	- 0.095		- 0.131		- 0.131	
	(- 0.734)		(- 0.943)		(- 1.048)	
- 51 to 150	0.046		0.082		0.071	
	(0.286)		(0.479)		(0.459)	
NSDC: - Micro	-	- 0.126	-	- 0.076	-	- 0.127
		(- 0.858)		(- 0.480)		(- 0.889)
- Medium		0.026		0.138		0.083
		(0.202)		(1.021)		(0.676)
Sector: - Manufacturing	- 0.097	- 0.113	- 0.236 ^{c}	- 0.232 ^{c}	- 0.190	- 0.200 ^{c}
	(- 0.756)	(- 0.994)	(- 1.744)	(- 1.823)	(1.541)	(- 1.733)
- Manufacturing-related	0.007	- 0.006	0.007	0.020	0.080	0.004
	(0.059)	(- 0.052)	(0.054)	(0.157)	(0.071)	(0.035)
- Construction	0.121	0.115	0.038	0.026	0.061	0.057
	(0.968)	(0.920)	(0.281)	(0.271)	(0.502)	(0.469)
Year	- 0.125	- 0.059	- 0.252	- 0.194	- 0.222	- 0.152
	(- 0.901)	(- 0.421)	(- 1.668)	(- 1.275)	(- 1.655)	(- 1.116)
Tax: - No Tax	- 0.026	- 0.010	- 0.083	- 0.082	- 0.043	- 0.028
	(- 0.205)	(- 0.082)	(- 0.608)	(- 0.607)	(- 0.350)	(- 0.227)
- RM100,000 or more	- 0.079	- 0.072	- 0.278 ^{c}	- 0.282 ^{b}	- 0.203	- 0.201
	(- 0.513)	(- 0.556)	(- 1.704)	(- 2.067)	(- 1.366)	(- 1.612)
Compliance Costs	- 0.040	- 0.061	0.091	0.102	0.024	0.013
	(- 0.302)	(- 0.487)	(0.667)	(0.784)	(0.189)	(0.108)
Complexity	- 0.375 ^{a}	- 0.347 ^{a}	- 0.208	- 0.165	- 0.342 ^{a}	- 0.303 ^{b}
	(- 3.020)	(- 2.847)	(- 1.567)	(- 1.275)	(- 2.857)	(2.565)
Fairness	- 0.065	- 0.034	0.026	0.058	- 0.022	0.015
	(- 0.558)	(- 0.292)	(0.211)	(0.476)	(- 0.194)	(0.138)
Rate	0.276 ^{b}	0.236	0.296 ^{b}	0.261 ^{c}	0.312 ^{b}	0.267 ^{b}
	(2.194)	(1.929)	(2.167)	(1.971)	(2.565)	(2.254)
Incentives	0.201	0.214 ^{c}	0.284 ^{b}	0.273 ^{b}	0.259 ^{b}	0.261 ^{b}
	(1.613)	(1.746)	(2.133)	(2.092)	(2.150)	(2.195)
Audit	0.420 ^{a}	0.412 ^{a}	0.288 ^{b}	0.286 ^{b}	0.406 ^{a}	0.401 ^{a}
	(3.594)	(3.695)	(2.322)	(2.390)	(3.601)	(3.707)
IRB	- 0.096	- 0.064	- 0.156	- 0.105	- 0.150	- 0.105
	(- 0.770)	(- 0.517)	(-1.170)	(- 0.796)	(-1.252)	(- 0.878)
R^2	0.402	0.401	0.369	0.364	0.444	0.438
Adjusted R^2	0.218	0.232	0.163	0.174	0.273	0.279
Standard Error	1.190	1.180	1.222	1.214	1.020	1.016
F-value	2.184	2.366	1.793	1.911	2.598	2.751
P-value	0.018 ^{b}	0.011 ^{b}	0.060 ^{c}	0.045 ^{b}	0.005 ^{a}	0.003 ^{a}

Number of respondents equals 69, except 66 in Model 2. T-value is given in parenthesis.
[a] Significant at the one percent level. [b] Significant at the five percent level. [c] Significant at the 10 percent level.

APPENDIX O

Questionnaire for Tax Professionals

A SURVEY OF TAX PROFESSIONALS' VIEWS ON THE TAX COMPLIANCE BURDEN OF SMALL AND MEDIUM-SIZED COMPANIES IN MALAYSIA

Dear Sir/Madam

A SURVEY OF TAX PROFESSIONALS' VIEWS ON THE TAX COMPLIANCE BURDEN OF SMALL AND MEDIUM-SIZED COMPANIES IN MALAYSIA

This survey is an independent study conducted in collaboration with the Small and Medium Industries Development Corporation (SMIDEC). The study is in response to many concerns expressed by SME companies in Malaysia regarding the considerable burden imposed on business by government regulations, particularly in the area of taxation. SMIDEC believes that findings from this survey will provide valuable information, and this may influence government policy with regards to SME companies.

I request your kind assistance in this regard by completing the attached questionnaire and returning it promptly in the reply-paid envelope provided. The questionnaire is expected to take less than 15 minutes to complete. Please be assured that all information obtained will be treated with strict confidence and used solely for the purpose of this study.

I believe that your extensive experience in the field of accounting, taxation in particular, to the SME companies will provide valuable input to the success of this study. If you would like to discuss this questionnaire or need any help in completing particular questions, please do not hesitate to phone 019-663 9340 and/or e-mail me at hijat@uum.edu.my.

Thank you so much for your kind cooperation and assistance.

Yours faithfully

HIJATTULAH ABDUL JABBAR (Mr)
Faculty of Accountancy
06010 UUM Sintok

Note on SME definition:

- A company is classified as an SME company if it meets **either** the specified number of employees or annual sales turnover definition. The following table summarizes the general SME definitions by sector.

Sectors/Criteria	Employees (not exceeding)	Annual turnover (not exceeding)
Manufacturing / Manufacturing-related services	150	RM25 million
Services / Primary Agriculture	50	RM 5 million

SECTION A: GENERAL INFORMATION

Please tick one box or fill in the appropriate details as requested.

1. **Where do you work or practice?**
   (Please tick one box)

   Big-Four firm....................................... ☐
   Non Big-Four firm.............................. ☐
   Tax firm/tax agent............................. ☐
   Other, please state ☐

2. **What is your current position in the firm?**
   (Please tick one box)
   Partner... ☐
   Manager... ☐
   Supervisor... ☐
   Senior.. ☐
   Other, please state ☐

3. **How many years of experience do you have in tax?**
   (Please tick one box)

   Less than 5 years .... ☐
   5 to 10 years .... ☐
   More than 10 years .... ☐

4. **For the past three years, what is the approximate percentage of SME tax clients engaged by your firm?**
   (Please state the approximate percentage)

   ☐ %

5. **For the past three years, how much of your SME tax clients are in the form of company?**
   (Please state the approximate percentage)

   ☐ %

SECTION B: SMALL AND MEDIUM ENTERPRISE (SME)& CORPORATE TAX

Kindly fill in an approximate details or tick a box (or boxes) as requested.

6.Please state the range of AVERAGE TAX FEES charged to the SME companies for their corporate income tax activities in the financial year 2006.

Between

RM _____

and

RM _____

7.Please ESTIMATE the percentage breakdown between routine income tax preparation and income tax planning work conduced for SME companies.

	Approximate Breakdown
Routine Income Tax Return work (for annual return)	___ %
Income Tax Planning work (longer term)	___ %
Other (please state) _____	___ %
Total	100 %

8. In your opinion what are the main reasons for SME companies to engage tax professionals?
(Please tick more than one box if appropriate)

Technical knowledge is not readily available internally........ ☐
Income tax matters are too complicated................................ ☐
External opinion is required.. ☐
It is more cost-effective to use external tax professionals..... ☐
For income tax planning... ☐
Other (please state) _____

9. In which of the following areas are your SME tax clients facing difficulties?
(Please tick more than one box if appropriate)

Estimating income tax payable... ☐
Understanding income tax legislations............................ ☐
Implementing the income tax changes............................. ☐
Maintaining record for income tax purpose.................... ☐
Increasing burden of record keeping for tax purposes.... ☐
Cash flow position when paying monthly tax instalments ☐
Short period of time to lodge the tax return.................... ☐
Dealing with the tax authority... ☐
Dealing with tax professionals (such as tax agents)....... ☐
Other (please state) _____

SECTION C: PERCEPTIONS AND OPINIONS

10. Kindly respond to the following statements to indicate your opinion (by way of a tick on a 5 point scale) to each of the statements. There are no right or wrong answers. All responses are absolutely anonymous. Tick one box for each statement.

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	1	2	3	4	5
Personally I consider corporate income tax return preparations difficult.	☐	☐	☐	☐	☐
Corporate income tax law is relatively simple.	☐	☐	☐	☐	☐
Complexity in the tax law is necessary so that companies are treated fairly.	☐	☐	☐	☐	☐
Corporate income tax is so complicated that only people who can afford to pay tax professionals can take advantage of most legal ways to save much in taxes.	☐	☐	☐	☐	☐
A 'fair' tax rate should be the same for every company, regardless of their size (small, medium or large).	☐	☐	☐	☐	☐
Large companies have a greater ability to pay income tax, so it is fair that they should pay a higher rate of tax than small and medium companies.	☐	☐	☐	☐	☐
It is fair that high-profit companies should pay a higher rate of tax than low-profit companies.	☐	☐	☐	☐	☐
I believe that compared to large companies, more favourable tax treatments should be given to SME companies.	☐	☐	☐	☐	☐
The chances of being audited (tax audit) are so low that it is worthwhile trying to 'cut corners' a little on corporate income taxes for various reasons.	☐	☐	☐	☐	☐

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	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
	1	2	3	4	5
I believe that the SME client relationship with the Inland Revenue Board officers has improved since the implementation of the self-assessment system.	☐	☐	☐	☐	☐
I believe that each company's officers have a moral obligation to report all of their company's income and pay the correct amount of corporate income tax.	☐	☐	☐	☐	☐
I believe that record keeping helps SME companies to manage their businesses more effectively.	☐	☐	☐	☐	☐
I believe that good record keeping may reduce the compliance costs of SMEs.	☐	☐	☐	☐	☐
I believe that good record keeping may not reduce the likelihood of the tax audit.	☐	☐	☐	☐	☐

	Much Less Fair	Less Fair	About the same	More Fair	Much More Fair
	1	2	3	4	5
Do you believe that the move to self-assessment made the corporate tax laws more or less fair?	☐	☐	☐	☐	☐
Overall, has the move to self-assessment made the distribution of the corporate income tax burden among small, medium and large companies more or less fair?	☐	☐	☐	☐	☐

	Much Less Taxes	Less Taxes	About the same	More Taxes	Much More Taxes
	1	2	3	4	5
Do you believe that as a result of changes income tax during the past five years *SME companies* are paying more taxes or less taxes ?	☐	☐	☐	☐	☐
Do you believe that as a result of changes in corporate income tax during the past five years *large companies* are paying more taxes or less taxes?	☐	☐	☐	☐	☐

11. **Read the following and kindly indicate your opinion (by way of a tick) to the following scenario based on your experience:**

> Mr. A, a self-employed businessman is considering not including a cash sale of RM10,000 as his business income in his 2006 tax return. Legally, the cash receipts of RM10,000 should be included as a business income. However, he is almost certain that the tax authority will not audit him and would not know if the amount is not reported.

a) What is the probability that Mr. A will **not** report the RM10,000 of cash sale on his business income?

10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

b) Taking into account all known and likely business circumstances, to what extent do you agree with Mr. A's possible action of not reporting the cash sale of RM10,000 as his business income?

Strongly Disagree	1	2	3	4	5	Strongly Agree
	☐	☐	☐	☐	☐	

c) Would he be likely to report only part of the RM10,000 as business income?

Yes ☐   No ☐   Unsure ☐

12. **Read the following and kindly indicate your opinion to the following scenario based on your experience:**

> Mr. B, a self-employed businessman, had incurred RM10,000 to repair his personal van. In preparing his 2006 tax return, he is thinking about claiming the costs of repair as if the van was used in his business. Legally, such a claim is not allowable, but he is almost certain that he will not be audited and that the tax authority would not be able to detect the deduction.

a) What is the probability that Mr. B will claim the RM10,000 cost of repair as his business deduction?

10%	20%	30%	40%	50%	60%	70%	80%	90%	100%
☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

b) Taking into account all known and likely business circumstances, to what extent do you agree with Mr. B's possible action of claiming RM10,000 as his business deduction?

Strongly Disagree	1	2	3	4	5	Strongly Agree
	☐	☐	☐	☐	☐	

c) Would he be likely to deduct only part of the RM10,000 as a business deduction?

Yes ☐   No ☐   Unsure ☐

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SECTION D: COMMENTS AND SUGGESTIONS

The following questions are about general and overall issues on the tax compliance burden faced by small and medium sizes companies.

13. In your opinion, what is the estimated level of income tax compliance burden of SME companies in Malaysia.
(Please tick one box)

	1	2	3	4	5	
Very Low	☐	☐	☐	☐	☐	Very High

14. If your SME client could claim from the government for the time and money spent (both internally and externally) by them in dealing with corporate income tax for the financial year 2006, how much would you view as fair compensation?

RM _____

15. Please state if you have any specific suggestions for reducing tax preparation work and documentation in respect of corporate income tax for small and medium-sized companies.

16. Please state if you have any other comments and/or suggestions regarding taxation on small and medium-sized companies.

If you are willing to answer any further questions that may arise from this questionnaire, or participate further, please provide contact details. Your response will be treated with strict confidence and solely for the purpose of this study.

(Leave blank if you wish to maintain anonymity)

Name _____

Telephone _____

Thank you for your kind assistance in completing this questionnaire.

Kindly return this questionnaire in the self-addressed envelope provided to:

Hijattulah Abdul Jabbar
Faculty of Accountancy
06010 UUM Sintok
Kedah

APPENDIX P

Data Validation

DATA VALIDATION

All returned questionnaires were assessed for their completeness of individual questions. The response rates for individual questions were almost 100 percent, except for eight items, as shown in Table P.1. Nonetheless, the overall missing percentage of less than five percent suggests that the issue of missing items is not a serious concern in the current study. Almost all questions with missing values were requiring respondents to provide similar kinds of estimates (either monetary, percentage or hours). All responses, in particular for all the three questions on compliance costs (i.e. questions 9, 10-3 and 13-3), were scrutinised for validity and a few questionnaires with extreme outliers and missing values were replaced by imposing a realistic maximum value and imputed mean value respectively.

Table P.1: Question (and sub-question) with Missing Items

Question Number	Description	Questionnaire		Missing Percentage
		Total [a]	Completed	
18	Compensation amount	175	106	39
13-4 [b]	Breakdown of external work	165	113	32
11	Breakdown of internal work	169	120	29
10-3 [b]	Additional non-staff cost	65	53	18
9	Internal time spent and wages	175	147	16
8-2 [b]	Possible refund	43	37	14
13-3 [b]	External tax fees	165	152	8
10-2 [b]	Nature of additional cost	65	60	8

[a] Does not total up to 175 cases due to non-applicability to some respondents.
[b] The sub-question's number is not indicated in the survey questionnaire. The number refers to the position of the question. For example, question 13-4 refers to the fourth sub-question in question 13.

Overall, 40 cases had missing values, at least for one of its compliance cost components, mainly for internal time spent and wages (28 cases). Out of 175 respondents, 147 provided answers to one or more of four staff categories, but left other category(s) blank. In such cases, a 'blank' response was treated as zero. The fact that not all categories of staff are involved in tax-related work must be acknowledged. If questions were left blank (i.e. not answered), then such cases were treated as missing items (28 cases). Missing values for the three costs component

were replaced by their respective mean value. Following mean substitution, the average compliance costs are estimated at RM9,295.[224]

A few questionnaires with extreme outliers were replaced by imposing a realistic maximum value. The reference value for wages (for relevant equivalent position) was obtained from the Annual Salary Survey 2006 (Federation of Malaysian Manufacturers 2007). Broadly, it is also comparable to a Salary and Fringe Benefits Survey 2006 conducted by the Malaysian Employers Federation (2007). The reference value for tax fee was obtained from a separate survey of tax professionals (see Chapter Four, subsection 4.11.2 and Chapter Six, subsection 6.9.1). No appropriate reference values are available for internal time spent by staff categories and for non-staff additional costs. Accordingly, the researcher's best judgment was used in handling extreme outliers for those variables. This approach is reasonable, since the main objective of imposing a maximum value is to take out the gross effect of an extreme value. Replies for the remaining questions (i.e. other than compliance cost components) have no implication on the compliance cost computation. Available responses sufficed for general descriptive purposes, provided that the effects of extreme outliers (if any) are removed. Similar to additional costs, extreme outliers for tax refund (four cases) and possible compensation claim (five cases) were replaced. As for breakdown of routine and planning work (for both internal and external), a few incorrect and/or illogical responses (i.e. a total percentage was not equal to/more than 100 percent) were re-computed based on the given percentage, an approach similar to that adopted in Slemrod and Venkatesh (2002).

A similar approach was adopted for the web survey. The case of outliers is less marked and, broadly, missing percentages are lower in the context of the web survey. Relative to the mail survey, a higher missing percentage was observed for two questions, i.e. additional non-staff costs (28 percent—seven cases) and external fees (11 percent—seven cases). As for additional cost, a detailed check on the nature of additional cost indicates that six respondents described a non-tax related cost as an additional cost. Accordingly, these responses were changed to having no additional cost.

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[224] If the Expectation-Maximization substitution approach is to be used to impute the missing values, the compliance costs would be reduced to RM9,264 or by only 0.3 percent.

APPENDIX Q

Rotated Component Matrix for Factor Analysis

Rotated Component Matrix for Factor Analysis

	Tax Attitudinal Aspects		
	Complexity	Fairness	Rate
Personally I consider corporate Income Tax return preparations difficult. *[Comp 1]*	.807		
Corporate Income Tax law is relatively simple. *[Comp 2—Reverse Coded]*	.745		
Complexity in the Income Tax law is necessary so that companies are treated fairly. *[Comp 3]*	-		
Corporate Income Tax is so complicated that only people who can afford to pay tax professionals can take advantage of most legal ways to save much taxes. *[Comp 4]*	.844		
I believe that each company's officers have a moral obligation to report all of their company's income and pay the correct amount of Corporate Income Tax. *[Fair 1]*		.574	
Do you believe that the move to self-assessment system made the corporate tax laws more or less fair? *[Fair 2]*		.776	
Overall, has the move to self-assessment system made the distribution of the Corporate Income Tax burden among small, medium and large companies more or less fair? *[Fair 3]*		.746	
Do you believe that as result of changes in the Corporate Income Tax during the past five years SME companies are paying more or less taxes? *[Fair 4—Reverse Coded]*		.666	
Do you believe that as result of changes in the Corporate Income Tax during the past five years large companies are paying more or less taxes? *[Fair 5]*		.632	
A fair tax rate should be the same for every company, regardless of their size (small, medium, or large). *[Rate 1]*			.606
Large companies have greater ability to pay Income Tax, so it is fair that they should pay a higher rate of tax than small and medium companies. *[Rate 2]*			.872
It is fair that high-profit companies should pay a higher rate of tax than low-profit companies. *[Rate 3]*			.872

Note: Extraction Method: Principal Component Analysis; rotation method: varimax with Kaiser Normalization. Items 'Comp 2' and 'Fair 4' are reversed coded. The Kaiser-Meyer-Olkin statistic was 0.631, signifying sample size in the current study was reasonable. Bartlett's Test of Sphericity was significant ($p = 0.00$), suggesting the survey data were suitable for factor analysis.

APPENDIX R

Regression Analysis: Assessment of Assumptions

Regression Analysis: Assessment of Assumptions

Assessment of the four assumptions underlying regression analysis (normality, linearity, homoscedasticity, and multicollinearity) is presented in this section. The normality of a data set is assessed through normal probability plots. Hair *et al* (1998) regarded the approach to be more reliable compared to a histogram approach. The normal distribution forms a straight diagonal line. Significant departures from this straight line indicate violation of the normality assumption. For all three dependent variables, Figure R.1 shows that the normal probability plots closely follow the diagonal line. Thus, the data set is considered approximately normal.

Figure R.1: Normal Probability Plot
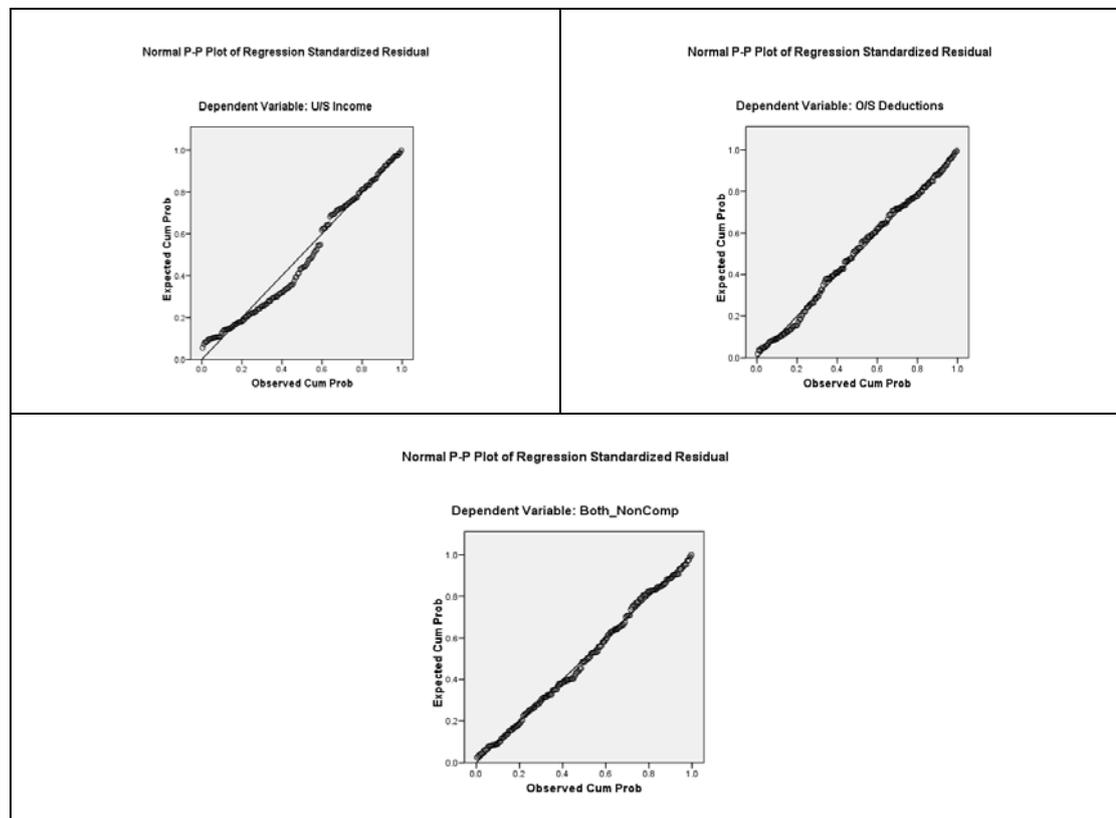
Source: SPSS output of the current study

The assumption of linearity is examined through a scatterplot diagram between standardized residual values (ZRESID) and standardized predicted values (ZPRED). Linearity means that there is a straight line relationship between the independent variables and the dependent variable. Figure R.2 shows that a scatterplot of residuals indicates no evidence of non-linearity for all of the three dependent variables.

Figure R.2: Scatter Plot Diagram
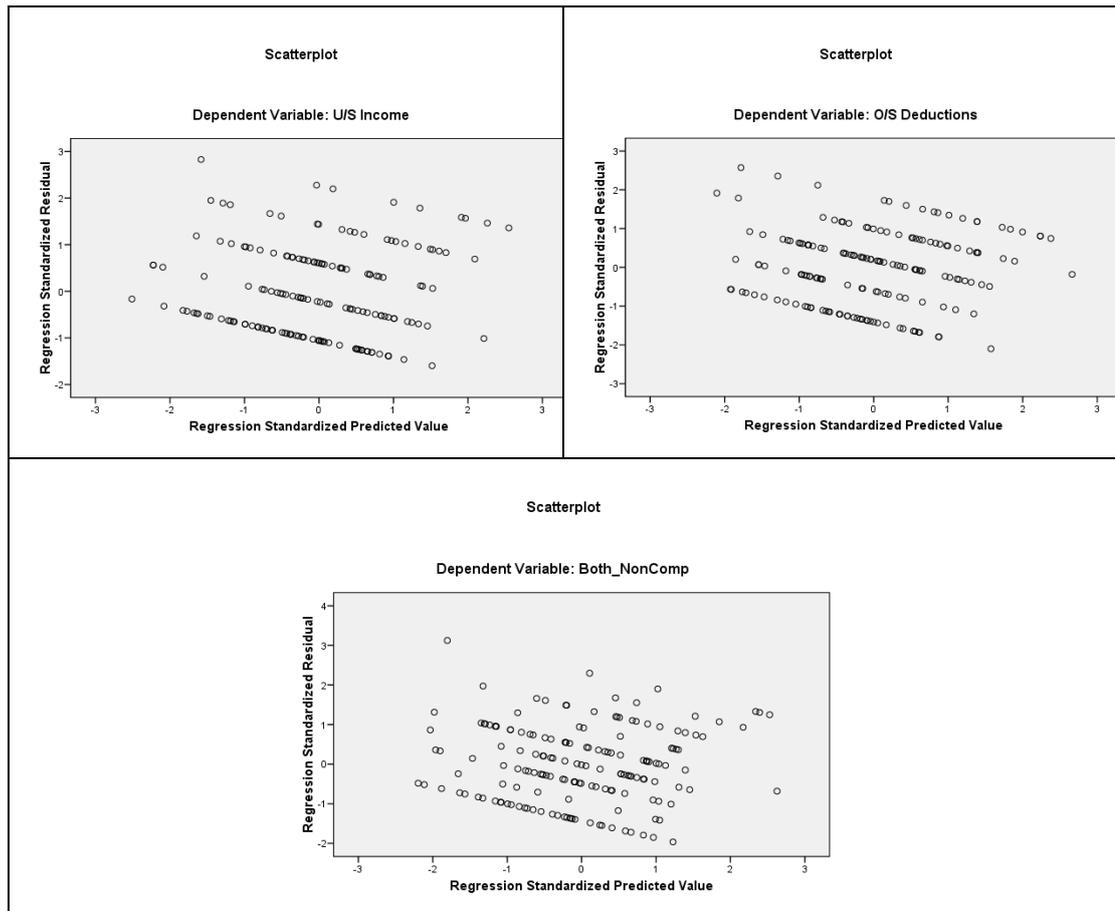
Source: SPSS output of the current study

The same scatterplot diagram is used to assess the assumption of homoscedasticity. Homoscedasticity refers to the assumption that the dependent variable exhibits similar amounts of variance across the range of values for an independent variable. Graphical patterns, such as cones or diamonds, exhibit departures of the assumption of homoscedasticity (Hair *et al.* 1998). The scatter plot diagrams, as shown in Figure R.2, show no clear evidence of unequal variances (heteroscedasticity) and thus exhibit homoscedasticity.

Finally, the potential effect of multicollinearity is assessed through the variance inflation factor (VIF) measure. Multicollinearity occurs when independent variables in the regression model are more highly correlated with other independent variables than with the dependent variable. A VIF of more than 10 indicates a high degree of multicollinearity (Myers 1990; Hair *et al.* 1998). The VIF recorded in the current study ranges between one to less than two, thus rejecting the severity of multicollinearity in this study.

Overall, the researcher is satisfied that all the four underlying assumptions for multiple regressions were not violated. The above assessment primarily used turnover as a business size measure. A similar finding is obtained in terms of the other two size proxies, i.e. by staff number and NSDC definition. Assessments of assumptions in a web survey indicate similar results.

APPENDIX S

Detailed Results of Multiple Regressions

Table S.1: Detailed Results of Multiple Regressions (Turnover as Primary Size Measure)

Model/ Independent Variables	Understatement of Income (Model 1)	Overstatement of Deductions (Model 2)	Both Non-compliance (Model 3)
Turnover:			
- Less than RM250,000	- 0.101	- 0.096	- 0.113
	(- 1.091)	(- 1.067)	(- 1.250)
- RM1,000,000–RM4,999,999	- 0.119	0.038	- 0.043
	(- 1.272)	(0.423)	(- 0.473)
- RM5,000,000 or more	- 0.110	- 0.087	- 0.113
	(- 1.071)	(- 0.875)	(- 1.126)
Sector:			
- Manufacturing	0.100	0.115	0.123
	(1.136)	(1.356)	(1.446)
- Manufacturing-related	0.069	0.140	0.121
	(0.796)	(1.656)	(1.430)
- Construction	0.081	0.173 [b]	0.147 [c]
	(0.952)	(2.094)	(1.778)
Year	- 0.137 [c]	- 0.107	- 0.139 [c]
	(- 1.671)	(- 1.346)	(- 1.744)
Tax:			
- No Tax	- 0.23	0.80	0.035
	(- 0.267)	(0.959)	(0.414)
- RM100,000 or more	0.108	0.096	0.116
	(1.194)	(1.094)	(1.325)
Compliance Costs	0.061	0.072	0.076
	(0.716)	(0.883)	(0.928)
Complexity	0.168 [b]	0.267 [a]	0.251 [a]
	(2.086)	(3.416)	(3.203)
Fairness	- 0.028	- 0.002	- 0.016
	(- 0.34)	(- 0.020)	(- 0.205)
Rate	0.114	0.029	0.080
	(1.444)	(0.380)	(1.045)
Incentives	- 0.043	- 0.005	- 0.027
	(- 0.546)	(- 0.067)	(- 0.350)
Audit	0.155 [c]	0.251 [a]	0.234 [a]
	(1.899)	(3.174)	(2.953)
IRB	0.065	- 0.071	- 0.006
	(0.788)	(- 0.888)	(- 0.076)
R^2	0.122	0.176	0.172
Adjusted R^2	0.029	0.089	0.090
Standard Error	1.204	1.250	1.059
F-value	1.315	2.016	1.958
P-value	0.195	**0.015** [b]	**0.019** [b]

Number of respondents equals 172, t-value is given in parenthesis.
[a] Significant at the one percent level. [b] Significant at the five percent level. [c] Significant at the 10 percent level.

Table S.2: Detailed Results of Multiple Regressions (Alternate Size Measure)

Model/ Independent Variables	Understatement of Income (Model 1)		Overstatement of Deductions (Model 2)		Both Non-compliance (Model 3)	
Proxy for Business size	Staff	NSDC	Staff	NSDC	Staff	NSDC
Staff:						
- 4 or less	0.072 (0.846)	-	- 0.041 (- 0.501)	-	0.015 (0.185)	-
- 20—50	- 0.037 (- 0.439)		- 0.001 (- 0.013)		- 0.021 (- 0.258)	
- 51 to 150	0.035 (0.364)		0.077 (0.827)		0.065 (0.697)	
NSDC:						
- Micro	-	- 0.025 (- 0.284)	-	- 0.127 (- 1.513)	-	- 0.089 (- 1.054)
- Medium		0.037 (0.444)		- 0.015 (- 0.183)		0.012 (0.145)
Sector:						
- Manufacturing	0.096 (1.091)	0.097 (1.103)	0.127 (1.501)	0.125 (1.476)	0.129 (1.511)	0.128 (1.499)
- Manufacturing-related	0.033 (0.379)	0.072 (0.825)	0.087 (1.028)	0.131 (1.546)	0.070 (0.826)	0.117 (1.382)
- Construction	0.082 (0.969)	0.079 (0.931)	0.164 [b] (2.005)	0.165 [b] (2.012)	0.143 [c] (1.740)	0.141 [c] (1.717)
Year	- 0.125 (- 1.508)	- 0.150 [c] (- 1.831)	- 0.126 (- 1.578)	- 0.141 [c] (- 1.784)	- 0.144 [c] (- 1.795)	- 0.166 [b] (- 2.096)
Tax:						
- No Tax	- 0.023 (- 0.266)	- 0.014 (- 0.158)	0.103 (1.239)	0.105 (1.248)	0.049 (0.583)	0.055 (0.646)
- RM100,000 or more	0.109 (1.092)	0.080 (0.893)	0.067 (0.691)	0.071 (0.814)	0.100 (1.032)	0.086 (0.989)
Compliance Costs	0.032 (0.378)	0.044 (0.528)	0.044 (0.549)	0.056 (0.692)	0.044 (0.541)	0.057 (0.709)
Complexity	0.182 [b] (2.252)	0.171 [b] (2.117)	0.279 [a] (3.560)	0.268 [a] (3.437)	0.266 [a] (3.394)	0.253 [a] (3.234)
Fairness	- 0.026 (- 0.323)	- 0.028 (- 0.344)	- 0.012 (- 0.151)	- 0.015 (- 0.192)	- 0.022 (- 0.274)	- 0.024 (- 0.309)
Rate	0.089 (1.115)	0.112 (1.414)	0.010 (0.130)	0.024 (0.317)	0.055 (0.713)	0.076 (0.993)
Incentives	- 0.064 (- 0.798)	- 0.050 (- 0.621)	- 0.001 (- 0.011)	- 0.002 (- 0.026)	- 0.036 (- 0.461)	- 0.029 (- 0.370)
Audit	0.177 [b] (2.154)	0.157 [c] (1.920)	0.281 [a] (3.526)	0.269 [a] (3.414)	0.264 [a] (3.318)	0.246 [a] (3.108)
IRB	0.050 (0.614)	0.074 (0.914)	- 0.093 (-1.175)	- 0.063 (- 0.797)	- 0.027 (-0.346)	0.004 (0.051)
R^2	0.123	0.111	0.180	0.172	0.178	0.166
Adjusted R^2	0.030	0.024	0.092	0.090	0.084	0.084
Standard Error	1.200	1.207	1.248	1.249	1.053	1.059
F-value	1.319	1.271	2.056	2.106	2.029	2.019
P-value	0.192	0.227	**0.013** [b]	**0.012** [b]	**0.015** [b]	**0.017** [b]

Number of respondents equals 172, t-value is given in parenthesis.
[a] Significant at the one percent level. [b] Significant at the five percent level. [c] Significant at the 10 percent level.

APPENDIX T

Details of Key Findings of the Survey of Tax Professionals

Table T.1: Tax Professionals' Views towards each Tax Attitudinal Item

Description	Mean	Median	Standard Deviation
Comp 1	2.68	3.00	0.91
Comp 2	2.61	3.00	0.80
Comp 3	3.19	3.00	0.91
Comp 4	3.52	4.00	1.09
Fair 1	4.13	4.00	0.76
Fair 2	3.16	3.00	0.64
Fair 3	3.16	3.00	0.69
Fair 4	3.10	3.00	0.94
Fair 5	3.26	3.00	0.73
Rate 1	3.06	3.00	1.06
Rate 2	3.26	3.00	1.06
Rate 3	2.87	3.00	1.19
IRB Relationship	2.94	3.00	1.09
Tax Audit	2.48	3.00	1.09
Tax Incentives	3.84	4.00	0.97
Tax Benefit 1	4.16	4.00	0.82
Tax Benefit 2	4.13	4.00	0.67
Tax Benefit 3	3.32	3.00	0.83

Number of respondents equals 31. Description used is similar to postal and web survey but in the context of survey professionals. Refer Appendix O for the exact wording in the questionnaire. An additional three descriptions apply in the survey of professionals: Benefit 1 (I believe that record keeping helps SME companies to manage their businesses more effectively), Benefit 2 (I believe that good record keeping may reduce the compliance costs of SMEs) and Benefit 3 (I believe that good record keeping may reduce the likelihood of the tax audit).

Table T.2: Tax Attitudinal Aspects and Tax Behaviour:

Results of Correlation Analysis of Tax Professional Survey

	Understatement of Income [a]	Overstatement of Deductions [a]	Both Non-compliance [a]
Tax Complexity	- 0.120	- 0.098	- 0.116
Tax Fairness	+ 0.015	- 0.072	- 0.031
Tax Rate Structure	+ 0.110	- 0.168	- 0.033
Tax Incentives	+ 0.094	+ 0.184	+ 0.149
Tax Audit	+ 0.253	+ 0.307	+ 0.299
IRB relationship	- 0.139	- 0.108	- 0.132
Tax Benefits	- 0.164	- 0.277	- 0.236

Number of respondents equals 31. Positive (+) or negative (-) signs denote a direct or indirect relationship respectively.

Table T.3: Results of Multiple Regressions of Tax Professional Survey

Model/ Independent Variables	Understatement of Income (Model 1)	Overstatement of Deductions (Model 2)	Both Non-compliance (Model 3)
Complexity	- 0.230	- 0.296	0.251
	(- 1.044)	(- 1.387)	(3.203)
Fairness	0.152	0.089	- 0.016
	(0.728)	(0.442)	(- 0.205)
Rate	0.130	- 0.257	0.080
	(0.590)	(- 1.210)	(1.045)
Incentives	0.078	0.295	- 0.027
	(0.356)	(1.393)	(- 0.350)
Audit	0.337	0.171	0.234
	(1.210)	(0.636)	(2.953)
IRB	- 0.282	- 0.218	- 0.006
	(- 1.305)	(- 1.042)	(- 0.076)
Tax Benefits	0.043	- 0.101	- 0.006
	(0.154)	(- 0.378)	(- 0.076)
R^2	0.169	0.224	0.185
Adjusted R^2	0.084	0.012	0.063
Standard Error	1.327	1.309	1.243
F-value	0.667	0.950	0.744
P-value	0.697	0.489	0.638

Number of respondents equals 31; t-value is given in parenthesis.

APPENDIX U

Summary of Suggestions Made by Respondents

Table U.1: Respondents' Suggestions for Reducing Tax Preparation Work

	Number	Percent
Simplify tax return form	13	50.0
Less documentation to furnish	3	11.5
Reduced record keeping year	3	11.5
Less changes to tax laws	2	7.7
Free tax updates from the IRB	2	7.7
Tax exempt for first three years	2	7.7
Free tax software	1	3.9
Total	26	100.0

Number of respondents equals 23. A number of respondents had more than one suggestion.

Table U.2: Respondents' Suggestions on Overall SME Taxation

	Number	Percent
More tax incentives and low tax rates	28	43.1
Abolish advanced tax estimates	7	10.8
Tax relaxation (i.e. later deadline and cash basis for taxing SMEs)	7	10.8
More free seminars	6	9.2
Lower tax fees	3	4.6
Exempt financial audit on SMEs	3	4.6
Low penalties	4	6.2
Eliminate ambiguous law on deduction	2	3.1
Others (1 each)	5	7.7
More government assistance		
Focus on educating and not to punish		
More friendly tax officer		
Reduce number of indirect taxes		
Rebate for good taxpayer		
Total	65	100.0 [a]

Number of respondents equals 33. A number of respondents had more than one suggestion.
[a] Total percentage does not total up to one hundred due to rounding.