

# INSIGHTS

NEWSLETTER

**Does Higher Tax  
Knowledge Increase  
The Level Of Tax  
Compliance?**

**Self-Assessment  
System (SAS) Tax  
Regime And  
Taxpayers' Behaviour**

**New Emerging Tax  
Compliance Issue  
(Supports Deterrence  
Theory)**



## DOES HIGHER TAX KNOWLEDGE INCREASE THE LEVEL OF TAX COMPLIANCE?

In November 1789, the Founding Father Benjamin Franklin, a U.S publisher, entrepreneur, and diplomat, coined the ever-famous quote that 'nothing is said to be certain except death and taxes'. This quotation has reverberated worldwide ever since and more than 230 years on, nations across the globe had been involved as engrossing as ever in issues pertaining to economy and taxes given the birth of new literature in both areas, such as, transfer pricing, green taxes and lately, tax corporate governance.

But we cannot discount the contribution of a famous British economist, John Maynard Keynes ('the Keynesian') who contributed an idea, in the form of a quote that 'the avoidance of taxes is the only intellectual pursuit that carries any reward'.

Which leads us to a critical question whether, in Malaysia, as more people understand the tax laws governing their tax affairs, will the rate of tax compliance be better and hence, more revenue collected by the Government?



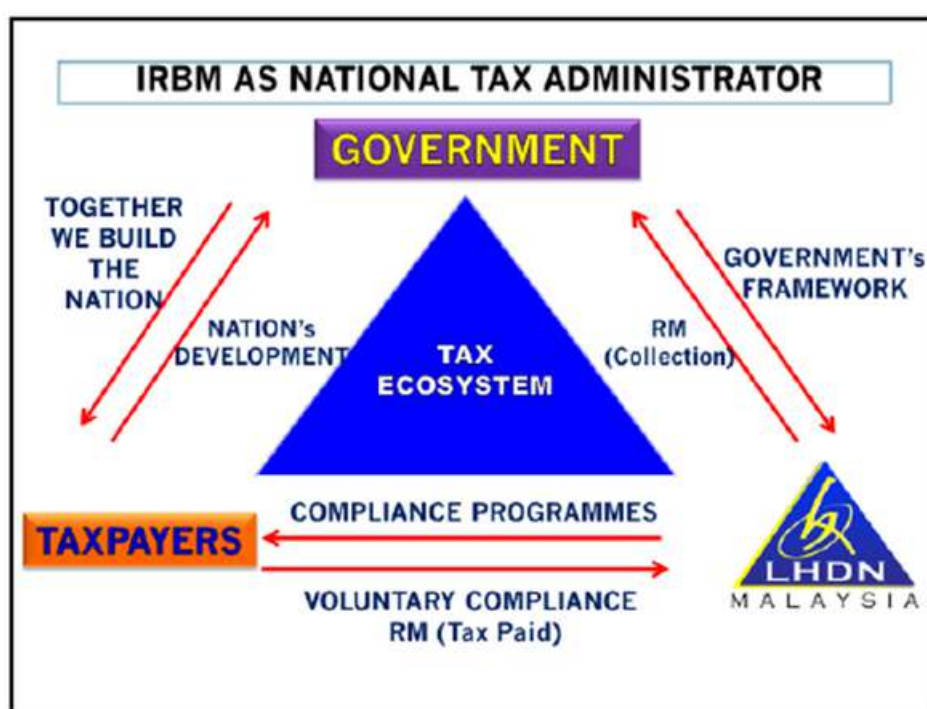
## SELF-ASSESSMENT SYSTEM (SAS) TAX REGIME AND TAXPAYERS' BEHAVIOUR

The Government had introduced the SAS since 2001 for corporations and in 2004 for individual and other taxpayers. The enduring objectives of SAS include creating a sustainable knowledge-based tax system whereby, taxpayers are intellectual enough to determine and calculate their tax liabilities and pay the right taxes based on accurate information, sound knowledge and understanding of the tax laws. This means taxpayers perform the 'decision-making' role in deciding which item of income and expenses to be self-declared based on their knowledge of the tax laws and eventually, determine the tax to be paid.

Two important characteristics relating to the taxpayers are evident here. Firstly, the tax knowledge that one possesses in order to calculate and determine the incidence of tax. As we would understand, the 'knowledge' on taxation can be very wide given the ever-growing literature and the discovery of new practices in tax. Such knowledge is specific, ever-changing and may present some loopholes while trying to be fair to other taxpayers. With the ICT advancement, taxpayers have the greatest opportunity to reinforce their arguments on contentious issues and, by drawing comparison between other jurisdictions on how the tax system and structure are developed, administered, tweaked and suited based on the current economic indicators to achieve fair distribution of wealth that facilitates an effective economic resource mobilisation.

Afterall, many jurisdictions including the UK, Canada, Japan and Singapore had reaped considerable fiscal benefits from the application of SAS and, as an effort in reforming the tax system, the SAS had also contributed towards increasing the knowledge of the taxpayers in understanding the tax laws, rules, regulations and, had even caused higher level of public engagements in forums, seminars and discussions. In Malaysia, two major tax authorities namely, the Inland Revenue Board, Malaysia (IRBM) and Department of Customs (RMCD) are actively involved in public engagements which proves to be beneficial to the taxpayers in terms of more accurate and updated tax information and clarity on tax operational SOPs. In addition, the IRBM and RMCD are the major catalysts and players that champion the use of electronic medium in tax filing, apps. and other digital applications for a more efficient and effective customer-centric national tax services across the country.

**Pic. 1** summarises the relationship between tax knowledge, revenue and structure to support a healthy tax ecosystem in Malaysia adopted by IRBM.

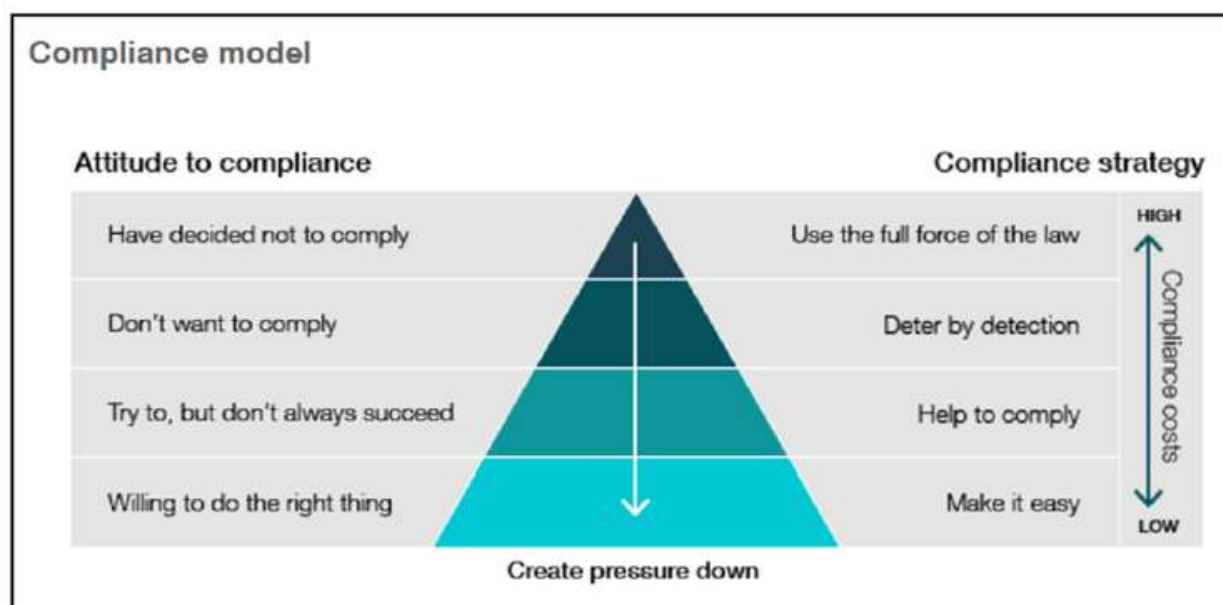


**Pic. 1:**  
Relationship between tax knowledge, revenue and tax structure in Malaysia

From the illustrations in **Pic.1**, we can deduce that under the SAS, a good and healthy tax ecosystem should strike a balance between the interests of taxpayers and the Government i.e. taxpayers need to perform the national duty of reporting their tax affairs truthfully, while the tax authorities will assist the taxpayers in fulfilling their national duty through tax education programs to support timely dissemination of current changes in tax, statutory tax advices and beefing-up the examination (audit and investigation) activities. Arguably, this relationship model is similar to the tax ecosystem model as developed by the National Tax Agency (NTA), Japan.

Secondly, with sound tax knowledge, one can expect to act rationally by complying with the tax reporting and adequacy of payment as stipulated under the SAS regime. Numerous seminal articles of research had reported 'a significant positive association between tax knowledge and tax compliance level'[1]. This association explains a positive rational behaviour that with increased knowledge tax, the taxpayers will behave rationally by complying with tax provisions (i.e. truthful reporting and payment of the tax in full).

As such, it comes with no surprise that the tax authorities will devise their compliance strategies based on taxpayers' behaviour. This will mean that the tax authorities' approach is more 'targeted' dealing with taxpayers' behaviour rather than adopting the 'one-size-fits-all strategy'. In the 1990s, the Australian Tax Office (ATO) had undergone a series of reforms that set the stage for a new proactive role in building a voluntary taxpaying culture and had developed the world-famous tax compliance model named 'ATO Compliance Model' as shown in **Pic. 2**.



**Pic. 2 The ATO Compliance Model**

The ATO compliance model is an ingenious tax compliance model which is still relevant till today as far as the tax administration is concerned and addresses taxpayers' behaviour which are 'mapped' to the suggested action to be taken by the tax authorities and also the associated perception of the compliance costs. Arguably, this model suggests that in general, the taxpayers have a high willingness level to do the right thing of complying with the provision of the tax laws. As such, the tax authorities would need to focus on efforts to assist the taxpayers in fulfilling their duties by providing an efficient, impeccable tax services and disseminating relevant tax information through various educational programs and the use of social media platform.

[1] The writer notes on other demographic factors that may influence the behavioral level of taxpayers such as level of general compliance in the economy, technology, age, education level and other sociological factors. This article discussed on factors relating to knowledge and present a conclusion based on the premise of Deterrent Theory.



It is observed that the IRBM has been adopting this compliance methodology in carrying out their duties. It is worth however, to assert that the taxpayers need to understand that under the SAS regime and, through the adoption of a comprehensive compliance model that reflects and addresses the behavioural factor affecting tax compliance, the compliance activities (tax audit and investigation) would increase significantly as much as the frequency of tax educational programs. Afterall, as new discoveries relating to the 'best tax practices' made known through various study groups across the globe such as, the OECD, IMF and World Bank it can be said surely that the traditional tax infrastructure of law, penalties, debt collectors, and court cases needs to be reformed for a much better way of administering tax in Malaysia.



## NEW EMERGING TAX COMPLIANCE ISSUE (SUPPORTS DETERRENCE THEORY)

Despite the above arguments, the country had been riddled with frequent news coverage on discovery of tax avoidance and tax evasion cases alike. Apart from the revelations by the 'Pandora Paper' involving high profile Malaysians, a more recent case involving the discovery of more than 30,000 taxpayers (all classes) by IRBM that had committed tax misreporting. In addition, elements of tax evasion are detected in almost any case involving misappropriation of public funds, corruption as well as money-laundering as reported in the Malaysian mainstream media which is not a welcomed news particularly for a developing nation like us which relies, to a large extent, on an efficient Government machinery, a progressive tax system and near-zero corruption to attract FDIs.

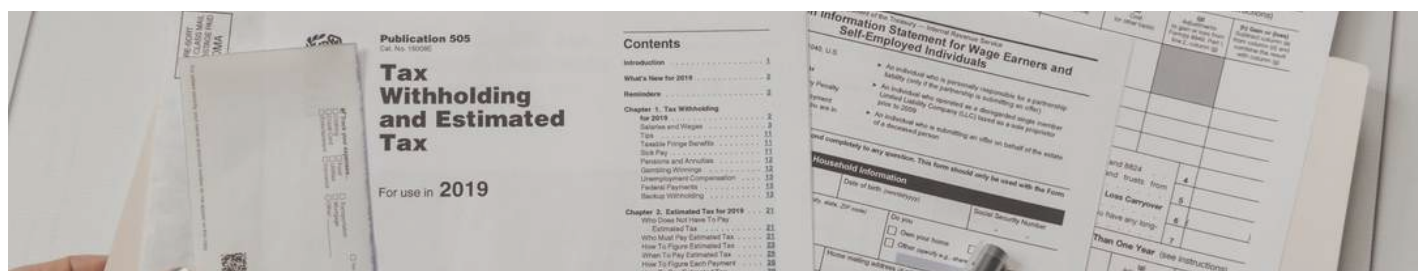
This is puzzling as the SAS had been implemented more than 20 years ago with a primary objective of an efficient, sustainable tax systems and is envisaged to increase the voluntary compliance level.

If the arguments above are rational, logical and supported by empirical studies (rather than being rhetorical), then why taxpayers who are considered to be 'tax learned' exhibit behaviour of non-compliance? What is (are) the motivation(s) behind this?

A recent review of seminal texts by scholars suggests that the perceived increased tax knowledge that is envisaged to contribute to higher compliance rate is a 'a double edge sword' convention. While it can be deduced that increased in tax knowledge and awareness will cause taxpayers to react in the rational way, recent empirical studies have revealed an insignificant relationship between tax knowledge and tax compliance behaviour. This means that taxpayers with a higher level of tax knowledge have shown tendency to be those who are flouting the tax laws.

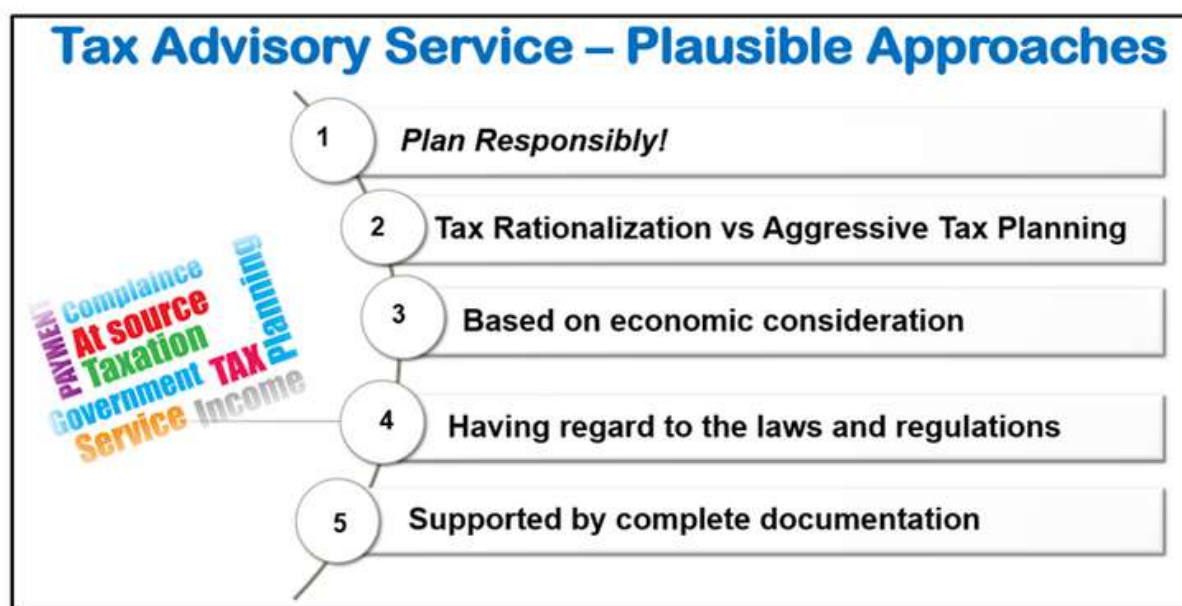
The theory supports the findings that with higher tax knowledge, taxpayers are presented with the opportunity to perform 'profit maximisation' exercise by weighing the 'risk and returns/cost and benefit' from the evasion malpractices. If the returns outweigh the risks (being caught and penalized by the authorities), then there is a high tendency (probability) that the taxpayers will commit the act of tax evasion. Thus, it is the economic return in terms of maximised profit that motivates the evaders.

This emerging finding in Malaysia is interesting in particular, as the finding places both the taxpayers and tax authorities in a dicey dilemma; for the taxpayers whether to miss out on maximizing profit or to risk the hefty penalties and criminal proceedings or, for the IRBM whether to increase the level of deterrence which will increase the cost of collecting an extra RM1 of tax revenue or, to risk being unfair to those who comply.



## ADVISING THE ADVISABLE

This is where tax consultancy can benefit the taxpayers. Following the arguments of 'cost-benefit' consideration under the Deterrence Theory, a tax consultancy service provider is in the best position to provide high quality and relevant tax advisory service which is much needed by the taxpayers in order to optimize their tax affairs as well as avoiding potential pitfalls between tax planning and tax evasion.



**Pic. 3 : Tax Advisory service – Plausible approaches**

Although many precedents cases have relied on the legality of tax planning, based on current development in taxation, it can be argued that the planning must be supported by economic considerations impacting the business (for example, the existence of tax incentives or avoiding the continuing losses) rather than 'pure planning' for the sake of mitigating the incidence of tax or simply, a scheme to pay less tax. The writer asserts that the management of tax affairs should be shifted to 'tax rationalization' instead of using the terminology 'tax planning'[2] which may not be welcomed by the IRBM who may later invoke the provision of anti-avoidance under Section 140 Income Tax Act 1967.

As depicted in **Pic. 3**, the plausible approaches suggested are envisaged to provide a harmonised approach between the expectations of taxpayers who are presented with the opportunities of mitigating the incidence of tax in accordance with the law.

## ENDGAME: ENSURING SUCCESS

In tandem with the arguments above and central to the tax advisory service, are 3 (three) major critical areas which are argued to exert significant impacts on the success of the clients' businesses as shown in **Pic. 4** :



**Pic. 4 : 3 (three) critical areas that contribute to business success**

Arguably, there are many formula for success depending on the nature of surrounding, the availability of resources and external support. As such, it is vital that the tax advisory services offered address the problems faced by clients' business apart from the value propositions. This will ensure the clients' businesses are benefitting from those value-adding services offered. This is critical as the ultimate goal of managing tax risk exposure is to ensure the business establishment is not exposed unnecessarily to uncertainties in tax treatment, penalties, fines and legal proceedings which could disrupt business operations and, for public-facing business, will cause the image to be eroded that will drive the value into financial abyss. That is the endgame.

[2] See further <https://www.facebook.com/175758065825322/posts/5091037714297308/?d=n>

## REFERENCES:

- Bloomquist, Kim (2003). "Tax Evasion, Income Inequality, and Opportunity Costs of Compliance." Presented at 96th Annual Conference of the National Tax Association.  
<<http://www.irs.gov/pub/irs-soi/bloomq.pdf>>
- Kasipillai, J. (2002). Investigations and tax audit under the self-assessment system. The Chartered Secretary Malaysia, 16(22).
- Kasipillai, J., & Baldry, J. (1998). What do Malaysian taxpayers know?. Malaysian Accountant, 2(7).
- Kasipillai, J., Aripin, N., & Amran, N. (2013). The Influence of Education on Tax Avoidance and Tax Evasion. eJournal of Tax Research, 1(2).
- M Sharipudin, Arief Putera, (2017, May 22-23). Towards Efficient Debt Management in IRBM [Paper Presentation]. The Third FTA Advanced Analytics Conference 2017, Dublin, Ireland.
- Slemrod, J., Blumenthal, M., & Christian, C. (2001). Taxpayer response to an increased probability of audit: evidence from a controlled experiment in Minnesota. Journal of Public Economics, 79(3). [https://doi.org/10.1016/S0047-2727\(99\)00107-3](https://doi.org/10.1016/S0047-2727(99)00107-3)
- Slemrod, Joel (2007). "Cheating Ourselves: The Economics of Tax Evasion." Journal of Economic Perspectives, 21(1).



**ARIEF PUTERA HJ M SHARIPUDIN**  
*DIRECTOR, TAXATION*



arief.tax@pkfmalaysia.com



016-211 1011



# ABOUT PKF MALAYSIA

PKF Malaysia is a member firm of the PKF International Limited family of legally independent firms. Our membership means that we can, through collaboration with other member firms, offer sound advice on a range of international issues. Worldwide, the member firms have around 20,000 professionals working out of 480 offices in 150 countries. Our office in Malaysia is headquartered in Kuala Lumpur, with branch offices currently in Penang, Ipoh, Kota Bharu, Kota Kinabalu, Labuan and Sandakan.



**Main Office**  
Level 33, Menara 1MK,  
Kompleks 1 Mont' Kiara,  
No.1, Jalan Kiara, Mont' Kiara,  
50480 Kuala Lumpur



[general@pkfmalaysia.com](mailto:general@pkfmalaysia.com)



+603 6203 1888

**Penang Office:**

No 416, Jalan Dato Keramat,  
10460 Georgetown Penang.

**Ipoh Office:**

No. 62, Persiaran Greentown 2,  
Pusat Perdagangan Greentown,  
30350 Ipoh, Perak.

**Kota Kinabalu Office:**

Lot 23-1, 1st Floor, Lintas Plaza,  
Lorong Lintas Plaza, 88300 Kota Kinabalu.

**Sandakan Office:**

1st Floor, Lot No.8, Block 18,  
Bandar Indah Mile 4, North Road,  
90000 Sandakan, Sabah.

**Labuan Office:**

Level 1, Lot 8, Block F,  
Saguking Commercial Building,  
Jalan Patau-Patau, 87000 Labuan F.T.

**Disclaimer**

This publication is provided gratuitously and without liability. It is intended as a general guide only and the application of its contents to specific situations will depend on the particular circumstances involved. Readers should seek appropriate professional advice regarding any particular problems that they encounter, and this tax update should not be relied on as a substitute for this advice. Accordingly, PKF Malaysia assumes no responsibility for any errors or omissions it may contain, whether caused by negligence or otherwise, or for any losses, however caused, sustained by any person that relies on it. Should further information, clarification or advice be required on any of the contents stated herein, please feel free to contact our team.