

## HOW WELL-INFORMED ARE TAXPAYERS ON THEIR INCOME TAX PAYMENT?

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### Abstract

*This paper aims to assess the taxpayers' understanding of income tax payment that should be declared in the tax returns. The basic knowledge of income tax payment significantly influences individuals' compliance decision. Inadequate taxation knowledge will affect the amount of tax declaration, and subsequently may lead to unintentional non-compliance. A survey was conducted with 30 respondents from the administration and academic staff in UiTM Kedah. The dichotomous questions YES and NO were established and divided into THREE (3) sub-sections, namely taxable income, tax relief and tax rebates. The respondents were asked to tick YES or NO to assess if they are well-informed on income tax payment. The results pointed out that the respondents have poor knowledge on the types of income for tax declaration especially regarding extra and other income, and did not really informed about it. Higher educational background did not reflect the taxpayer's level of understanding.*

**Keywords:** *Income tax payment, understanding level, unintentional non-compliance*

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### Introduction

The influence of a specific knowledge on the tax compliance decision is assumed to be important for the tax compliance behaviour. An inadequate level of tax knowledge could result in inaccurate tax returns, and other negative consequences, including unintentional non-compliance, and unfortunately this may lead to false tax computation among individual taxpayers.

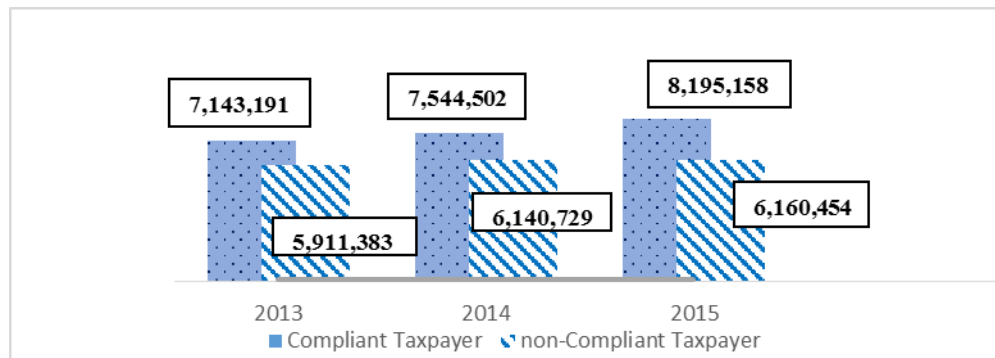
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Therefore, research on the taxpayer's knowledge and understanding level may significantly help individual taxpayers to really understand what should be declared in their income tax payment.

The increasing of registered individual taxpayers in the country (Figure 1), could be a contributing factor to non-compliance behaviour and unintentional non-compliance. To overcome non-compliance behaviour, the Inland Revenue Board of Malaysia (IRBM) extensively worked to combat non-compliance behaviour. By implementing various plans, including the Monitoring Deliberate Tax Defaulters (MDTD) or *Pemantauan Pembayar Cukai Gagal Patuh*, it helps to reduce the number of non-compliance behaviour (IRBM, 2016). Unfortunately, this action does not include unintentional non-compliance among individual taxpayers. This will be a terrifying for those who have low tax knowledge, especially during income tax computation.



Source: Analytical Data and Statistics Department, IRBM (2016)

**Figure 1: Registered Individual Taxpayers (Compliant and Non-Compliant) in 2013, 2014, and 2015**

Based on the Figure 1, the registered taxpayers as well as the non-compliant taxpayers gradually increased between 2013 and 2015. This number included unintentional non-compliant taxpayers, and it would be unfair if they have to pay for the penalty. A taxpayer may unintentionally underreport their tax obligations, because of memory lapses, miscalculations, and inadequate knowledge and understanding of tax laws. This indicates that unintended non-compliance is a significant problem. As surveyed by Kasipillai (1999), unintentional non-compliance among individual taxpayers is likely to be concentrated on new taxpayers, whose income does not exceed RM36, 000 per year. These people are basically married female taxpayers.

This hurdle can be overcome by engaging them with taxation knowledge and awareness. The application of self-assessment in the tax payment has pushed individual's taxpayers to compute their own tax personally. This would require tax knowledge. Inadequate knowledge during the filing process would lead to missed declaration of income tax. There are a number of individual taxpayers who hire a tax agents to compute their tax. Hiring a tax agent would help them to reduce tax complexity and overcome their tax knowledge inadequacy.

A taxpayer should learn to know the types of income, reliefs and rebates that have to be declared during the filing process. In general, a taxpayer is required to pay tax on all of their earnings, comprising income from employment, dividends, interest, discounts, rent, royalties, premiums, pensions, annuities and others. For the tax reliefs, a taxpayer can reduce the tax liability, for example medical expenses and insurance. If the tax liability is less than the taxes paid, the taxpayer can claim for a tax refund. All of these are linked with tax knowledge, and an understanding of the filing process is deemed important.

### **Tax Assessment Barriers**

The movement from the official assessment system (OAS) to the Self-Assessment System (SAS) have challenged the existing knowledge of the taxpayers. OAS is an assessment made by IRBM, where the notice of assessment (or known as Form J) will be sent to taxpayers and they have to pay based on the amount of tax due for a particular year of assessment. Taxpayers are not required to have necessary knowledge on how to compute their own tax payable. This is because taxpayers receive their annual tax returns from IRBM and they have to declare all the necessary particulars and information pertaining to their income and expenses for that particular year of assessment. The onus was on the tax assessors in comprehending, interpreting, and appropriately applying relevant provisions of the tax law. For the year of assessment 2004, OAS was no longer applicable for assessing individual taxes, and it was replaced by the new system known as SAS.

Since SAS required tax knowledge during computing tax payment, it turns out to be difficult for those who are unfamiliar with the tax payment. The concept of tax administration under SAS is based on three thrusts, which are (1) pay, (2) self-assess, and (3) file. The pay is defined as monthly salary deductions made for individuals having no business income. Self-assess is the situation where taxpayers compute their own taxes. File refers to the Income Tax Return Form (ITRF) that is submitted to IRBM together with the payment for the balance of the income tax payable to tackle any shortfall in the monthly payment, or a claim for repayment if there is an overpayment to IRBM.

### **Knowledge Attainment**

Tax knowledge is crucial for all citizens, especially for eligible taxpayers, and assumed to be important for preferences and attitudes towards taxation (Bătrâncea et al., 2012; Normala, 2007; Kassipillai, 2003). In order to have proper tax knowledge, it can be done through tax education. Tax education enables taxpayers to understand the existing tax system such as the tax laws, tax planning, and the Tax Act. Marziana et al. (2010) and Eriksan and Fallan (1996) pointed out that a proper tax education would encourage people to be more compliant and willing to respect the tax system, consequently it would resist engaging in tax non-compliance such as tax evasion. Furthermore, tax knowledge improves an individual's awareness and ethics, thus reducing the tendencies of tax non-compliance and producing more competent taxpayers in the future, however, it is not to be expected that knowledgeable taxpayers would comply.

As studied by Loo and Ho (2005), salaried individuals in Malacca did not possess sufficient knowledge on personal taxation and surprisingly, they had tertiary education. Shockingly, they were not aware of their personal tax reliefs, rebates, entitlement, and exemptions. These findings were well-supported by Amrizah and Nero (2005), in which working salaried adults in East Malaysia possessed average tax knowledge on personal taxation. Thus, these taxpayers would probably file incorrect tax returns and indirectly affects tax revenues. This alarming situation might impact the readiness of taxpayers to exercise the existing tax system (SAS). Individual taxpayers in Kota Kinabalu, Malaysia, were found unwilling to participate in SAS because of the complexity of the system such as difficulties in filling up tax returns and calculating the tax payable (Junainah, 2002).

Contradictory, studies by Chan et al, 2000; Singh, 2003; Robert et al, 1994, agreed that those with higher education level are more likely to have a higher level of attitude that make them comply more. In general, tax knowledge has a very close association with the taxpayers' ability to understand the tax laws and regulations. White et al (1990), had done an experimental study on tax students, and found their tax knowledge about the law and appreciation of fiscal policy goal were enhanced through tax education. Although educated taxpayers are aware of non-compliance opportunities, their potentially better understanding of the tax system and sufficient on tax knowledge will promote a more favourable taxpayer attitude thus encouraging greater compliance. Education plays a vital part in moral development and ethics, thus producing more competent taxpayers.

### **Methodology**

A total of 30 respondents were selected from Universiti Teknologi MARA (UiTM) Kedah, from different educational backgrounds and job titles, purposely to assess their level of tax understanding. A stratified random sampling was employed by dividing respondents into administration ( Rector Office, Quality Unit, Corporate Communication Unit, Information Technology Unit, Academic Affairs Department, Islamic Affair Unit, Administration Department, Bursary Department, and Students Affair Department), and academic staff (Accountancy, Art and Design, Banking, Business Management, ACIS, Computer Science, Economics, Information Management, Language Studies, Law, Mathematical Science, Administrative Science and Policy Studies).

To assess the taxpayers' understanding of income tax payment, the dichotomous questions *YES* and *NO* were established. The questions were divided into THREE (3) sub-sections, namely taxable income, tax relief and tax rebates. The respondents were asked to tick *YES* or *NO* to test if they are well-informed on their income tax payment. The level of understanding is important to assist people in comprehending the reality underlying taxation and it also associated with compliance behaviour (Eriksen & Fallan, 1996).

From *YES* and *NO* answers (Table 1), it will be calculated based on respondents' correct answers. In order to identify whether respondents really understand or not about the types of taxable income, tax relief and tax rebates, the survey has been categorized into four-point scales and two types of levels, namely (1) well-informed and (2) not-informed as follows:

**Table 1: Level of Understanding on Income Tax Payment**

Scores (Correct Answer)	Percentage (%)	Understanding of Income Tax payment	Level of Understanding*
0-10	1-50%	Very Poor	Not-informed
11-20		Poor	
21-30	51% -100%	Good	Well-informed
31-40		Very Good	

\* A previous study by Eriksen and Fallan (1996) used yes, no and do not know questions and was divided into well-informed, un-informed and mis-informed.

### Yes and No Questions

<b>A</b>	<b>Types of Income</b>	<b>3</b>	<b>Other Income</b>
<b>1</b>	<b>Fixed Employment Income</b> <ul style="list-style-type: none"> <li>Basic Monthly Salary</li> </ul>		<b>(a) Interest Received</b> <ul style="list-style-type: none"> <li>Up to RM100,000</li> <li>More than RM100,000</li> </ul>
<b>2</b>	<b>Extra Income from Additional Employment</b> <p><b>(a) Rental Income</b></p> <ul style="list-style-type: none"> <li>Rent from personal property (e.g. vehicles or equipment)</li> </ul> <p><b>(b) Self-Employment Income</b></p> <ul style="list-style-type: none"> <li>Online Business Income</li> <li>Babysitting</li> <li>Catering Jobs</li> <li>Car Service (e.g. Uber)</li> </ul> <p><b>(c) Wages from Odd Jobs</b></p> <ul style="list-style-type: none"> <li>Overtime Payment</li> <li>Security Guard</li> <li>Fast Food Restaurant</li> </ul> <p><b>(d) Income from Registered Business</b></p> <ul style="list-style-type: none"> <li>Consultancy</li> </ul>		<b>(b) Dividend Received</b> <ul style="list-style-type: none"> <li>Amanah Saham Nasional Berhad (ASNB)</li> <li>Amanah Saham Berhad (ASB)</li> </ul> <p><b>(c) Allowances</b></p> <ul style="list-style-type: none"> <li>Cost of Living Allowances (COLA)</li> <li>Mileage claims/travelling allowances</li> <li>Housing and civil servants allowance</li> </ul> <p><b>(d) Royalty</b></p> <ul style="list-style-type: none"> <li>Publications (e.g. Books, Copyrights, Patents)</li> </ul> <p><b>(e) Donations</b></p>

<b>B</b>	<b>Types of Relief</b>	<b>(f) Honorarium</b> <ul style="list-style-type: none"> <li>Honorarium links with a business which normally expect to be paid</li> <li>Honorarium that does not expect any reward for the activities</li> </ul>
<b>1</b>	<b>Insurance</b> <ul style="list-style-type: none"> <li>Life insurance for self</li> <li>Life insurance for family</li> <li>Insurance for education</li> <li>Insurance for medical benefits</li> </ul>	
<b>2</b>	<b>Medical Expenses</b> <ul style="list-style-type: none"> <li>Self</li> <li>Parents</li> </ul>	

	<ul style="list-style-type: none"> <li>• Children</li> </ul>
<b>3</b>	<b>Other Expenses</b> <ul style="list-style-type: none"> <li>• Purchase of books, journals, magazines and publications</li> </ul>
	<ul style="list-style-type: none"> <li>• Purchase of personal computer (once in every 3 years)</li> </ul>
	<ul style="list-style-type: none"> <li>• Purchase of sport equipment for sport activities</li> </ul>
	<ul style="list-style-type: none"> <li>• Alimony payment</li> </ul>
	<ul style="list-style-type: none"> <li>• Disable wife/husband</li> </ul>
	<ul style="list-style-type: none"> <li>• Contribution to the Social Security Organization (SOCSO)/</li> </ul>

<b>C</b>	<b>Types of Rebates</b>
<b>1</b>	<b>Separate Assessment</b> <ul style="list-style-type: none"> <li>• Wife</li> </ul>
	<ul style="list-style-type: none"> <li>• Husband</li> </ul>
<b>2</b>	<b>Combined Assessment (Wife and Husband)</b>
<b>3</b>	<b>Zakat/Fitrah</b> (applicable for Muslim only)

### Result and Discussion

The results showed that the respondents have poor knowledge on the types of income for tax declaration, especially for extra and other income. For the administration staff, a number of them were confused with the extra income from additional employment, such as wages from odd jobs. It might be happening due to the nature of the respondents' working sector. The public sector does not allow its employees to have other income during office hours. This could be an obstacle for them to be involved in any odd jobs and make them unfamiliar with this kind of taxable income. Meanwhile, a small number of the academic staff mistakenly ticked NO for both honorarium (this might happen to those who are not involved in any professional services).

In order to reduce the number of non-compliant taxpayers, especially unintentional non-compliance, it is suggested to both employers and employees to precisely list down the types of income so that they are aware of taxable income that should be declared. This survey can also be done through UiTM websites to educate members on tax knowledge, because tax knowledge cannot be gauged by educational level, but more on information awareness. Furthermore, this helps to prevent potential and novice taxpayers from being involved in unintentional non-compliance.

### Conclusion

The tax laws and policies in Malaysia have gone through several changes, including income classification, deductions, tax relief, and tax rates. For that reason, tax knowledge from the past years can be considered as obsolete. This disadvantage will affect to those with less tax knowledge. Therefore, tax knowledge and awareness are important tools to guarantee tax compliance behaviour and encourage more correct tax filing among individual taxpayers.

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