

Sources of Corporate Income Tax Compliance Costs: The Case of Malaysian Self-Assessment System

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Abstract—This study identifies the sources of income tax work for corporate taxpayers under the Self-Assessment System (SAS) environment. Utilizing the researcher administered survey, the sources of tax compliance costs is investigated. The internal-external costs ratio was 37:63, indicating that there is a heavy reliance on external sources. This study therefore concluded that tax compliance activities were mainly handled by external tax professionals. Comparative findings with existing studies provide further contributions to corporate tax knowledge, tax administration and practices.

Keywords— Tax Compliance Costs, Internal-External Sources, Self-Assessment System (SAS); Corporate Income Tax (CIT); Public Listed Companies (PLCs)

Source: Arif and Pope [2]

Non-economic costs are costs of stress and anxiety caused by tax compliance (psychological costs) which is difficult to quantify. They also identified miscellaneous costs under internal economic costs, which is basically some other costs incurred in complying with the tax laws (incidental costs). In Malaysia, the introduction of SAS, to replace the OAS, is a major reform of the taxation system since the inception of the ITA in 1967 [3]. The new assessment system imposes greater accountability in terms of computational, recordkeeping and filing requirements upon taxpayers. These additional reporting requirements might lead to a higher compliance costs incurred by corporations.

I. Introduction

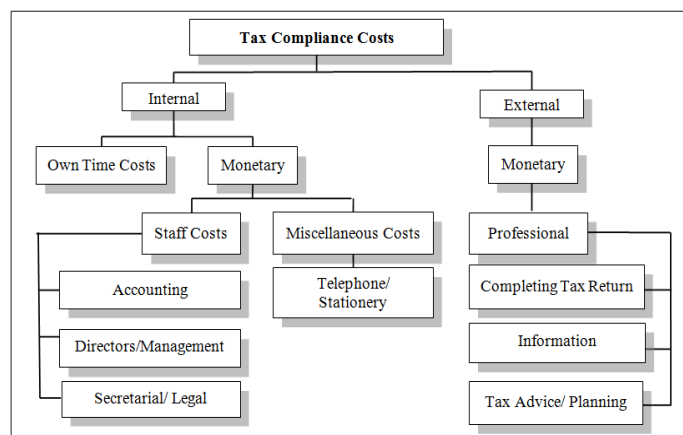
Corporation tax compliance costs refer to the value of resources expended by corporate taxpayers in complying with the tax regulation [1]. Tax compliance requirements for corporations include completing tax returns, maintaining proper records, and obtaining sufficient knowledge to enable these obligations to be accurately executed.

Arif and Pope [2] distinguished the taxation compliance costs into economic and non-economic costs. Economic costs are time and monetary costs which can be estimated (Figure 1).

This study identifies the sources (internal and external) of tax compliance costs for corporate taxpayers under the SAS regime. The tax compliance costs burden has been reported in detail for most countries in the advanced economies. However, the literature available from empirical studies conducted in those countries might not provide answers to some of the compliance costs issues in other economies [2]. The authors asserted that different forces were evident in the emerging economies, such as a large hidden economy, corruption, and inefficiency in tax collection.

Thus, the lack of studies conducted in Malaysia, and in the emerging economies generally, warrants more attention and focus towards conducting empirical studies that could provide insights to address some of the tax compliance costs issues. In this study, the analysis of tax compliance costs by sources of income tax work is provided.

Fig. 1. Economic Compliance Costs of Business Taxation



The rest of this paper is organized as follows. A survey of related literature is provided in Section II. Section III describes the research techniques employed in this paper. The result of the costs analysis by internal-external ratio is reported in Section IV. Section V provides comparisons of findings with prior studies and Section VI concludes this paper.

II. Literature Review

Awareness on compliance costs of taxation have moved from an unknown state to a more familiar position over the last decades. Currently, there is an extensive and varied literature available which deals with compliance costs issues

[4]. Apart from establishing many of the measurements and conceptual issues in estimating tax compliance costs, these studies have made important contributions in identifying major elements of tax compliance costs. The issues include allocating costs incurred for accounting or tax compliance costs, computational or tax planning costs, commencement or recurrent costs, as well as differentiating between social compliance costs and taxpayer compliance costs (See [5], [6], and [7]).

These literatures also covered several types of taxes, such as personal income tax (PIT), corporate income tax (CIT) and goods and services tax (GST), as well as different types of taxpayers, including individuals and corporations. This study focuses on the sources of CIT compliance costs; hence, this review of literature related to taxation compliance costs, with a focus on the issues pertinent to corporate taxpayers.

Sources of tax compliance costs can be divided into internal and external cost components [8]. The internal costs component is based on the time spent by the company staff in handling tax matters and the value of time spent. In addition, some incidental costs might be incurred by corporations in meeting tax compliance requirements. These costs may consist of stationery, forms, postage, telephone, utility bills, seminars, travel costs, office space, software maintenance and any other relevant costs. External sources of income tax work consist of fees paid to external tax professionals for the tax compliance activities of the company (See for example [9]).

Sources of tax compliance costs estimates have been reported in most countries in the advanced economies and some studies in the developing economies. The base papers from where the work has started are as listed in Table I.

Sandford, Godwin and Hardwick [10] found compliance costs of UK corporation tax in 1986-87 were £300 million in aggregate and half of the compliance costs incurred were fees paid to external tax professionals. Pope, Fayle & Chen [11] provided compliance costs estimates of Australian PLCs of between AUD646 and AUD1,341 million. Around 91% of PLCs used external advisers and 84% used a combination of internal and external sources. A seminal study in the US, reported an average compliance costs of USD1.57 million per company [12]. Approximately 84% of the costs were incurred internally. Slemrod and Venkatesh [13] analysis on large and mid-sized businesses, estimated the compliance costs in 2001 tax year to be USD254,451 per company. Around 75% of the mean compliance costs comprised of internal costs and the internal compliance activities include 38.8% for pre-filing, 50% for filing and 11.2% for post filing. In Canada, a report for the Technical Committee on Business Taxation by Erard [14], examined the tax compliance costs of Canadian large companies for the 1995 tax year. The report indicated average tax compliance costs of CAD507,000 per company and CAD250 million in aggregate, representing approximately 5% of taxes paid.

Ariff, Loh and Talib [15], study's furnished CIT tax compliance costs estimation of PLCs in Singapore for year of assessment 1994 and found average compliance costs of SGD78,396 per PLC. Only 6% of PLCs used entirely internal

staff and 94% used a combination. A similar Singapore estimate, conducted a year later utilizing 1995 data, discovered a significant decrease of tax compliance costs to SGD54,615 per PLC due to simplification in the tax system [16]. Similarly, around 6% used entirely internal staff and 94% used a combination. Comparable findings from a similar CIT tax compliance costs study in Hong Kong were also reported by Chan et al. [17]. The study, which was administered for fiscal year 1995, observed a large portion of compliance costs are related to external tax fees (70%).

TABLE I. SOURCES OF TAX COMPLIANCE COSTS

Author(s)(Year); Country	Sources (%)	
	Internal	External
Sandford et al. (1989); UK	53	47
Pope, Fayle & Chen (1991); Australia	50	50
Ariff, Loh & Talib (1995); Singapore	42	58
Ariff, Ismail & Loh (1997); Singapore	42	58
Slemrod and Blumenthal (1996); US	84	16
Slemrod and Venkatesh (2002); US	75	25
Erard (1997); Canada	80	20
Chan, Cheung, Ariff & Loh (1999); Hong Kong	30	70
Loh, Ariff, Ismail, Shamsher & Ali (1997); Malaysia	28	72
Klun (2004); Croatia	82	18
Blazic (2004); Slovenia	74	26
Hanefah, Ariff & Kasipillai (2001); Malaysia	75	25
Abdul-Jabbar (2009); Malaysia	59	41

There is a limited amount of research on tax compliance costs burden in the developing countries due to lack of experts in the area of tax compliance costs, aggravated by a lack of cooperation from tax authorities [18]. Bertolucci [19] examined compliance costs of Brazilian listed companies for 1999 tax year and found that tax compliance costs were BRL7.2 billion in aggregate representing 0.75% of GDP. Around 80% of the costs were internally incurred. Compliance costs of Slovenian companies in 2002 were estimated to be SIT1.5 million per company, 4.2% of tax revenue and 1% of GDP [18]. Blazic [20] found average tax compliance costs of HRK27,113 per company for all Croatian taxes for 2001/02. Internal sources accounted approximately 74% of the total compliance costs.

Tax studies in Malaysia are very limited especially on the tax compliance costs estimations. Loh, Ariff, Ismail, Shamsher and Ali [21] examined the costs of complying with income tax among PLCs, estimated the average compliance costs to be MYR68,836 per company, which is MYR0.26 per MYR1,000 sales turnover. Around 72% of the costs were paid to external tax advisers. Hanefah, Ariff, and Kasipillai, [22] estimated the costs of complying with income tax by small and medium enterprises (SMEs), found the average SME's compliance costs were MYR20,703 amounting to approximately 4% of the tax liability. The internal-external compliance costs ratio was 75:25. Abdul-Jabbar [23] evaluated compliance costs estimations for corporate SMEs under the SAS environment, discovered a much lower average of MYR9,295 per company. Around 41% of the costs were paid to external tax advisers.

This study represents the most recent estimation of internal-external sources of tax work. Almost 63% of the total compliance costs were incurred in engaging external tax professionals and only 37% were spend internally in dealing with corporate tax affairs.

III. Research Method

The sample of companies was drawn from the ‘Malaysian Top 500 Largest Listed Corporations 2008-2009’ published directory. Companies in Eastern Malaysia, namely Sabah and Sarawak and sectors with less number of companies were excluded from the main sample due to budgetary and time constraints.

The development of research instruments for this study comprised two sequential steps involving questionnaire design and pre-testing. The instruments were pre-tested on a group of academics and practitioners to ensure that the questionnaires were both clear and understandable. In this study, the measurement of tax compliance costs estimate applied most of the techniques employed by established researchers who have carried out studies in this field (for example Sandford et al. [10]) (Table II).

The internal staff costs estimation was based on the time spent by a company’s internal staff in handling tax matters and the value of time spent. The cost was estimated using a mathematical formula adapted from the study by Evans, Ritchie, Tran-Nam and Walpole [24]. Concerning the internal staff time, the survey respondents were requested to provide the number of staff who handled tax matters in their company and estimation of the time spent entirely for income tax purposes. Similar to the study by Evans et al. [24], a standard wage rate approach was utilized in this study to value the internal time spent. External tax fees are payments made to acquire services of external tax professionals on tax related matters from outside the company. The method employed by earlier relevant studies were by requesting from respondents the tax fees incurred by their company for the corporate income activities in the respective tax year.

TABLE II. COST COMPUTATIONS AND QUESTIONNAIRE ITEMS

Source	Cost Computations	Questionnaire Items
Internal Costs	Computed by multiplying annual time spent on tax activities to their respective hourly wage rate. Include incidental compliance costs incurred.	Internal costs of complying with the income tax law relating to company: <ul style="list-style-type: none"> ▪ Time spent by staff in handling tax activities ▪ Incidental costs and nature of expenses ▪ Percentage of computational and planning costs
External Costs	Money cost charged by external tax professionals solely on tax activities	External costs of complying with the income tax law relating to company: <ul style="list-style-type: none"> ▪ Engage external tax professional – Yes/No ▪ External tax fees ▪ Percentage of computational and planning costs

Data collection for this study utilized a researcher-administered questionnaire survey method. Estimation of tax compliance costs has generally relied on self reports using postal survey [4], which raises the question of accuracy and reliability. In addition, a survey using postal questionnaires would likely result in a low response rate [25], [26]. A researcher-administered survey method can address these shortcomings, as according to Hanefah et al. [22], a representative population using personal data collection, will yield a higher response rate, as well as result in more reliable responses. By utilizing this method, questionnaires can be personally distributed which provides the opportunity for researchers to emphasize verbally on the importance of the study and the appreciation for the individuals’ collaboration.

In most cases, the potential respondents of each firm were contacted by telephone to outline the purpose of the survey, to confirm whether the firm satisfied the selection guidelines and to ascertain the person’s willingness to participate in this study.

Prior to the meeting, a covering letter and explanatory statements specifying the purpose of the research and assuring anonymity of the respondent, as well as the questionnaire, were e-mailed to respondents. This was to prepare them for the survey and to establish the authenticity of the person meeting the respondents [22]. The target respondents were the CFO or tax director of PLCs in Malaysia. It was deemed acceptable as these groups appeared to possess significant work experience and appropriate professional qualifications which would enable them to provide reasonable information for the purposes of this study. An overall response rate of 20.7% was obtained and it was conducted on a fairly representative PLCs population although quite a large number of companies were not able to respond due to time constraints. The respondents involved in this study were mainly finance and tax managers.

The highest response was gathered from the services sector (33.7%), followed by the manufacturing (31.6%) and the property and construction (21.4%) sectors. As for the size of business, the highest response was from the companies with annual sales turnover level of between MYR100 and MYR500 million (36.7%); followed by the annual sales turnover level of less than MYR100 million (31.6%). The majority of responding companies (55.1%) had been in operation for at least 15 years and 23.5% had been in operation for more than 30 years, which signified that the sample respondent companies had adequate experience in dealing with tax related issues. Nearly one-half of companies (48%) estimated their tax liability to be less than MYR5 million and the remaining percentage was in the category of MYR5 million or more (42.8%).

With respect to sources of income tax work, some companies handled their tax affairs internally, some completely outsourced their tax-related activities and a large proportion of corporate taxpayers made use of both sources (Table III). Almost 95% of the respondent companies employed external tax professionals and more than 70%

utilized both the internal resources and the external tax professionals to deal with their income tax matters. Twenty-four (24) companies completely outsourced their tax-related activities and only five companies were totally dependent on their internal tax expertise.

TABLE III. SOURCES OF INCOME TAX WORK

Sources	Number of companies	Percentage
Internal only	5	5.1
External only	24	24.5
Internal and External	69	70.4
Total	98	100

IV. Costs Analysis by Internal-External Ratio

This section examines the tax compliance costs in terms of sources of costs (internal-external ratio).

Internal-external ratio is derived by dividing the means of internal and external compliance costs respectively [16]. Adapting the approach of similar previous studies, incidental costs were included under internal costs component. In this study, the internal-external compliance costs ratio was 37:63, indicating that tax compliance activities were mainly handled by external tax professionals. The internal-external costs ratio was further analyzed by PLCs characteristics, namely sales turnover, business sector and length of business.

The internal-external compliance costs ratio analyzed by turnover level indicated a heavy reliance on external tax professionals for PLCs in the lowest and highest levels (Table IV). Companies in the middle range of sales turnover between MYR100 and MYR500 million however seemed to have almost an equal proportion of dependence on internal staff (52%) and external tax professionals (48%). However, an ANOVA test did not reveal any significant mean differences of internal-external compliance costs ratio by sales turnover.

TABLE IV. INTERNAL-EXTERNAL COMPLIANCE COSTS RATIO BY SALES TURNOVER

Turnover Level (Million) ^a		Compliance Costs Ratio (%)	
		Internal ^b	External
Less than MYR100	(31)	29	71
MYR100 - MYR500	(36)	52	48
More than MYR500	(31)	29	71
Overall	(98)	37	63

^a Number of respondents is given in parentheses.

The findings of internal-external compliance costs ratio by business sector are presented in Table V.

TABLE V. INTERNAL-EXTERNAL COMPLIANCE COSTS RATIO BY BUSINESS SECTOR

Business Sector ^b		Compliance Costs Ratio (%)	
		Internal ^c	External
Manufacturing	(31)	39	61
Services	(33)	38	62

Property and Construction	(21)	17	83
Finance and banking	(6)	51	49
Plantation and agriculture	(6)	58	42
Technology	(1)	22	78
Overall	(98)	37	63

^b Number of respondents is given in parentheses.

These findings show that the construction sector was highly dependent on external tax professionals to handle the company's tax matters (83%). As suggested by Abdul-Jabbar [23], this may perhaps be due to the differences in the accounting practices of the construction sector, especially in terms of the revenue-recognition. To a lesser degree, technology (78%), services (61%) and manufacturing (60%) sectors also depended more heavily on external sources. In contrast, finance and banking (49%) sectors, along with plantation and agriculture (42%) sectors, had a lower reliance on external sources, where these companies entrusted tax matters more on their internal staff. An ANOVA test conducted, however did not find any significant mean differences of internal-external compliance costs ratio by business sector.

With regards to business length, the internal-external compliance costs ratio increased with the length of time that a business had been operating (Table VI). The longer the PLCs had been in business, the higher the internal-external compliance costs ratio, suggesting a greater reliance on internal sources. Similar with the earlier findings of sales turnover level and business sector, the ANOVA tests suggested no statistical mean differences for business length.

TABLE VI. INTERNAL-EXTERNAL COMPLIANCE COSTS RATIO BY BUSINESS LENGTH

Business Length ^c		Compliance Costs Ratio (%)	
		Internal	External
Less than 15 years	(21)	29	71
15 to 30 years	(54)	35	65
More than 30 years	(23)	48	52
Overall	(98)	37	63

^c Number of respondents is given in parentheses.

v. Comparisons of Findings with Prior Studies

Findings on sources of costs in terms of internal-external costs ratio found a 9% increase in the proportion of internal sources of costs as compared to the prior PLCs study by Loh et al. [21]. The findings of this study, however, did not support those of Abdul-Jabbar's [23] study on SMEs, which found a 16% decrease in the proportion of internal work under the SAS. He argued that the increase demonstrated that tax professionals played a more significant role in the SAS regime.

This contradictory result may be due to a varying group of respondents employed in each study. This study focused on

PLCs, where an increase in the proportion of internal sources of costs may not indicate that external tax professionals were no longer playing a significant role in the SAS regime. Instead, it might demonstrate that more companies were taking tax issues seriously by having their own tax department to handle tax affairs. The possibility of companies establishing facilities and expertise to handle their tax activities internally due to the additional compliance requirements under SAS, is another possible explanation for the increase in reliance on internal sources.

Internationally, Malaysian internal-external costs ratio scored lower than countries in the advanced economies. One possibility is because Malaysia is yet to establish an expertise in handling corporate tax activities internally. Hence, it might be more economical for companies to outsource their tax work as compared to managing their own tax departments.

vi. conclusion

This paper examines CIT compliance costs in terms of sources of costs (internal and external) for the Malaysian PLCs. Specifically, the study's research objective is stated as follows: "To assess the sources of tax compliance costs incurred by Malaysian corporate taxpayers under the self assessment system (SAS)".

With regards to internal-external sources of tax work, 63% of the total compliance costs were incurred in engaging external tax professionals to deal with companies' tax affairs. This suggests a greater reliance on external sources, in handling corporate tax matters such as preparing tax returns form and for purposes of tax documentation.

Components of internal and external sources as a percentage of annual sales turnover were U-shaped, implying that PLCs in the lowest and highest size levels utilised greater external resources compared to medium-sized companies. The medium-sized PLCs, with annual sales turnover value of between MYR100 and MYR500 million, did not show much difference between the internal-external sources of tax work.

This study makes contributions to the body of knowledge especially when one takes into consideration the very limited tax studies in the emerging economies. The overall conclusions from this study's research findings are broadly in line with existing studies in these areas. Thus, the findings of this study add to research evidence from countries in emerging economies, which according to Ariff and Pope [2], have weaker tax policy and structures and less transparent tax system than those in the advanced economies. In addition, this study also meets the call made by Evans [4], in seeking more evidence from countries in emerging economies on corporate taxpayers' compliance costs burden.

Practically, the findings arising from this study provide valuable information on corporate tax compliance costs, which are very beneficial for policy makers in the area of taxation, as well as to the taxation profession and the management of companies. This study contributes to the aim of providing

information in order that policy decisions may be based on reliable data through research findings. Thus, findings of this study provide important elements for future tax policy decision making in Malaysia and in the emerging economies generally, where tax studies are very limited. Future studies should explore the feasibility of replicating or extending this study in other tax jurisdictions, perhaps through collaborations with researchers of the respective countries.

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