2015

MALAYSIAN TAX SYSTEM AND INDIVIDUAL TAX KNOWLEDGE

NORAZA MAT UDIN

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(by Noraza Mat Udin)

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Introduction

In any tax system, taxpayers are significant parties as their contributions in terms of tax payments are the major source of the Government revenue. For instance, in 2012, 56.4 percent or RM117 million of the total Malaysian Federal Government revenue was contributed by tax collections from taxpayers (Malaysian Economic Report, 2012). Besides being revenue contributors, taxpayers are also the major players to assist the Government in implementing its taxation system. This is achieved when taxpayers carry out their responsibilities as manifested within each citizen’s role in nation building (Inland Revenue Board, 2008).

Individual is one of the main categories of taxpayers besides companies. Out of the total tax collected in 2008, contributions by individual taxpayers amounted to RM14.347 billion, which represented 15.83 percent of the total collections (Inland Revenue Board, 2008). Table 1 and Table 2 show the categories of taxpayers and the amount of tax collected in Malaysia from 2002 to 2004 and from 2005 to 2008 respectively. Prior to the implementation of self assessment system (SAS) in 2004, as presented in Table 1, individual taxpayers were the second highest contributors of the Government revenue from tax collections. Out of the total collections, 16 to 19 percent were collected from individual taxpayers.

However, as shown in Table 2, after the implementation of SAS, individual taxpayers fell to the third highest category in terms of tax contributions. The contributions by individual taxpayers decreased to about 15 percent of the total tax collections. The decrease in tax collections indicated that there are problems faced by individual taxpayers due to the implementation of SAS. Krishnamoorthy (2006) reported that there was an increasing number of people who did not pay their taxes after SAS was implemented as compared to the number under the official
assessment system (OAS). This phenomenon signalled various problems which existed relating to taxpayers such as submitting inaccurate tax return forms, unable to assess income and to calculate tax liability correctly as well as failure to comply with the due dates. These problems arose because SAS had transferred the responsibility to assess income from tax officers to taxpayers while taxpayers’ lack of tax knowledge in carrying out the required responsibilities.

Table 1
*Categories and Amount of Tax Collected in Malaysia*

<table>
<thead>
<tr>
<th>Categories</th>
<th>2002 (RM million)</th>
<th>2003 (RM million)</th>
<th>2004 (RM million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies</td>
<td>27,383</td>
<td>23,161</td>
<td>24,558</td>
</tr>
<tr>
<td>Individual</td>
<td>7,109</td>
<td>7,572</td>
<td>9,471</td>
</tr>
<tr>
<td>Petroleum</td>
<td>7,636</td>
<td>8,466</td>
<td>10,717</td>
</tr>
<tr>
<td>Stamp duty</td>
<td>1,769</td>
<td>2,007</td>
<td>2,377</td>
</tr>
<tr>
<td>Others ¹</td>
<td>426</td>
<td>1,613</td>
<td>1,511</td>
</tr>
<tr>
<td>Total</td>
<td>44,323</td>
<td>42,819</td>
<td>48,634</td>
</tr>
</tbody>
</table>


Table 2
*Categories and Amount of Tax Collected in Malaysia (After SAS implementation on Individual Taxpayers)*

<table>
<thead>
<tr>
<th>Categories</th>
<th>2005 (RM million)</th>
<th>2006 (RM million)</th>
<th>2007 (RM million)</th>
<th>2008 (RM million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Companies</td>
<td>28,058.05</td>
<td>30,415.40</td>
<td>37,574.55</td>
<td>46,902.04</td>
</tr>
<tr>
<td>Petroleum</td>
<td>14,676.45</td>
<td>20,673.78</td>
<td>20,453.02</td>
<td>24,191.04</td>
</tr>
<tr>
<td>Individual</td>
<td>10,222.92</td>
<td>10,409.65</td>
<td>11,592.18</td>
<td>14,346.52</td>
</tr>
<tr>
<td>Stamp duty</td>
<td>2,485.24</td>
<td>2,533.67</td>
<td>3,394.91</td>
<td>3,501.88</td>
</tr>
<tr>
<td>Others ¹</td>
<td>1,411.90</td>
<td>1,705.78</td>
<td>1,688.55</td>
<td>1,709.42</td>
</tr>
<tr>
<td>Total</td>
<td>56,854.56</td>
<td>65,738.28</td>
<td>74,703.21</td>
<td>90,650.90</td>
</tr>
</tbody>
</table>


¹ Consist of other taxes such as real property gains tax, co-operatives and Labuan offshore business activity.
Malaysian Tax Systems

Since the introduction of income tax in Malaya (before formation of Malaysia) on 1 January 1948 under the Income Tax Ordinance 1947, Malaysia adopted OAS which is also known as the Formal System. Under OAS, taxpayers were required to declare their income in the return forms and submit the completed forms to the tax authority i.e. Inland Revenue Board Malaysia (IRBM), together with the relevant supporting documents. The return forms were issued and sent by the IRBM to each and every registered taxpayer who was required to return the completed forms to the IRBM by the end of April each year. Under this system, the IRBM assumed that taxpayers lack the necessary knowledge in taxation to assess their income (Kasipillai, 2000). Therefore, they were only required to declare all income received in a particular year of assessment while the IRBM was responsible to raise the assessment on the income declared by the taxpayers to determine the tax liability.

After calculating the tax liability, the IRBM would issue and send to each taxpayer a Notice of Assessment, also known as Form J, stating the amount of the tax liability. Upon receiving the notice, taxpayers were required to pay the amount of tax stated in the notice within 30 days from the date of the notice. There were many critics on the OAS, especially in terms of its inefficiency, time consuming, costly and complex administrative procedures (Inland Revenue Board, 2001). Furthermore, OAS required large amount of IRBM personnel and office spaces to store all documents sent by taxpayers.

In addition, Loo (2006a) reported that there were also backlog of cases and delays in tax return forms issuance and income assessment. These problems had created delays in tax collections
and discouraged voluntary compliance with the tax law whereby, taxpayers failed to submit tax return forms before the due date and to a certain extent, individuals with taxable income failed to register themselves as taxpayers (Kasipillai, 2002). As a result, the Government decided on a tax reform in order to overcome problems under OAS by replacing it with SAS.

Introducing SAS is one of the common efforts of tax reform undertaken by the government of a country in order to strengthen the tax system and to improve compliance (Hasseldine & Li, 1999). Table 3 shows some countries that had introduced SAS on individual taxpayers and the year of implementation. In Malaysia, SAS was introduced for three reasons: (i) to modernise and streamline the tax administration; (ii) to produce a system with more efficient and faster collection of taxes; and (iii) to increase the level of tax compliance.

Table 3
_SAS Introduction to Individual Taxpayers in Various Countries_

<table>
<thead>
<tr>
<th>Countries</th>
<th>Year of SAS Implementation</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
<td>1913</td>
</tr>
<tr>
<td>Canada</td>
<td>1917</td>
</tr>
<tr>
<td>Japan</td>
<td>1947</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1972</td>
</tr>
<tr>
<td>Pakistan</td>
<td>1979</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1984</td>
</tr>
<tr>
<td>Australia</td>
<td>1992</td>
</tr>
<tr>
<td>Ireland</td>
<td>1988</td>
</tr>
<tr>
<td>New Zealand</td>
<td>1988</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>1996/97</td>
</tr>
<tr>
<td>Malaysia</td>
<td>2004</td>
</tr>
</tbody>
</table>

In the year 2004, which was the first year of the implementation of SAS for individual taxpayers, it was reported that 86 percent of Malaysian taxpayers were individuals, consisting of
57 percent non-business group and 29 percent business group (Inland Revenue Board, 2004). In terms of the number of taxpayers, in 2004, individual non-business group consists of about 2.2 million while the business group consists of about one million taxpayers. Since the non-business group taxpayers formed the largest segment of individual taxpayer category, it is important to ensure that with the implementation of SAS, they are able to perform their responsibilities as required by the tax law.

**Individual Tax Knowledge**

Earlier discussions in the previous sections had emphasised the importance of individual tax knowledge. In Malaysia, tax knowledge had become the focus of discussions by researchers when the government intended to introduce SAS (Bardai, 1992). The issue of whether taxpayers possessed relevant and ample knowledge in taxation had attracted researchers to evaluate whether taxpayers were ready to carry out their responsibilities under SAS. This is because SAS requires taxpayers to take over the responsibilities of filing tax return forms and handling of their own tax matters from the IRBM tax personnel. As such, the amount of annual tax collection received by the government would be based on the calculations made by taxpayers themselves. Knowledge concerning tax liability computation is one of the most important aspects to enable taxpayers to calculate their tax liabilities correctly. The following sections outline discussions on tax knowledge studies carried out in various tax regimes.
**Tax Knowledge Concept and Measurements**

Generally, tax knowledge refers to the understanding or awareness of the basic rules and regulations stipulated by the income tax law in respect of taxpayer’s responsibilities in filing their tax return forms (Bardai, 1992; Eriksen & Fallan, 1996; Kasipillai, 1997). On the basis of this general understanding, various interpretations of tax knowledge concept had been used by researchers to suit the focus of their studies. As a result, various definitions of tax knowledge had been proposed by researchers (Eriksen & Fallan, 1996; Groenland & Veldhoven, 1983; Kasipillai, 1997; Song & Yarbrough, 1978).

Based on these varied definitions, different tax knowledge measurements had been used by researchers to measure tax knowledge (Eriksen & Fallan, 1996; Groenland & Veldhoven, 1983; Kasipillai, 1997; Song & Yarbrough, 1978). In the light of these variations, findings relating to tax knowledge in taxpaying context were incomparable. Furthermore, the difficulty in determining the aspects of measuring tax knowledge had also led to the inconsistent findings in tax knowledge research (Devos, 2005; Richardson & Sawyer, 2001; Saad, 2011). Therefore, there is a need for an acceptable and specific measurement of individual taxpayer’s knowledge variables in order to provide meaningful and comparable research findings (Churchill, 1979).

Prior to 1970, tax knowledge was defined as the level of education to represent the level of taxpayer’s knowledge in taxation (White, Curatola, & Samson, 1990). Later, researchers defined tax knowledge using four different bases, either the general degree of fiscal knowledge, knowledge involving evasion opportunities, general educational attainment or knowledge of tax law (Devos, 2005; Jackson & Milliron, 1986). The fiscal aspects used to define tax knowledge
were in terms of federal budget deficit, programmes to reduce the rate of unemployment, and comparison of federal income tax and state sales tax (Song & Yarbrough, 1978).

Similar aspects had been used in Groenland and Veldhoven (1983). Specifically, they defined tax knowledge as the degree of general fiscal knowledge and knowledge on opportunity to commit fiscal frauds. This definition was in relation to the structure of income tax and value-added tax, including questions with respect to income and deduction possibilities. In addition, tax knowledge was also referred to knowledge on government tax policy.

Cullis and Lewis (1985) defined and categorised tax knowledge into three aspects: (i) sources of government’s revenue, (ii) government’s decision to fix the amount to spend within the present level of tax collection or to increase taxes to improve public services, and (iii) if the government needs to increase taxes, either to impose additional taxes on income earned or on goods purchased. Harris (1989) observed the impact of each type of knowledge on fairness perceptions and categorised tax knowledge into fiscal awareness and technical knowledge. In the study, fiscal awareness was defined as exposure to fiscal policy reasons underlying selected tax provisions, while technical knowledge was defined as exposure to the technical explanation of selected tax provisions.

In the early 1990s, researchers defined tax knowledge based on knowledge of tax law. Initially, tax knowledge was not defined specifically, but it was observed on the effects of certain behaviours of a person before and after attending formal tax classes (Christensen, Weihrich, & Gerbing Newman, 1994; Kasipillai, Aripin, & Amran, 2003; White et al., 1990). Similar ways
of defining tax knowledge were found in Eriksen and Fallan (1996), but in their study, tax knowledge of individuals was directly observed before and after attending the tax class and not by assessing the change in the person’s behaviour (Eriksen & Fallan, 1996). On the other hand, Hughes & Summers (2004) defined tax knowledge based on nine different principles of Adam Smith’s Canon of Taxation (Smith, 1776). The principles were duty to others/society, equity/proportionality, correction/control, accountability, accepted behaviour, certainty, flexibility, convenience and tax base.

In Malaysia, most studies defined tax knowledge based on the specific knowledge in taxation i.e. knowledge of the tax law in relation to the calculation of tax liability. Specifically, tax knowledge was assessed on the aspects in relation to the basic rules and regulations pertaining to individual residence status, taxable receipts, allowable expenses, capital allowances, statutory income, personal and other relief, own tax bracket, tax rebate and tax credit (Bardai, 1992; Mohd Hanefah, 1997; Loo, 2006b). The items tested on taxable receipt relating to individual taxpayer were salaries and wages, monthly allowances, housing allowances, entertainment allowances, accommodation and motor vehicles provided by employers for employees, travelling and lodging claims, compensation for loss of office, gratuity and capital receipts from the employees provident fund. For allowable expenses, the items were travelling expenses, clothing expenses, entertainment expenses, membership fees paid to professional bodies, interest expenses on housing loans and expenses to maintain rented properties.

Although these two aspects of tax knowledge, i.e. taxable receipts and allowable expenses were both used in Bardai (1992) and Eriksen and Fallan (1996), however the way they were assessed
was different. The former used multiple-choice quiz questions while the latter employed Likert-type perception statements. Similar aspects to define tax knowledge was used by Mohd Hanefah (1997). However, one of the limitations of the study was that tax knowledge was not captured and measured as a separate variable. Rather, it was measured indirectly as part of the other variables i.e. perceptions towards tax fairness, tax administrative system and tax law complexity.

The use of quiz questions in relation to tax law to measure tax knowledge was also employed in Kasipillai (1997). The measurement used in the study was adapted from the measurement introduced by Price (1992). Price’s (1992) measurement was designed to assess taxpayers’ knowledge on basic tax responsibilities in filing and paying federal income taxes by taxpayers in Texas, United States. The tax knowledge measurement consisted of 20 test items, with seven multiple-choice and 13 true-false questions. The measurement used in Kasipillai (1997), termed as taxpayer’s understanding and knowledge index (TUKI) was to assess the understanding and knowledge of Malaysian income tax law, specifically on taxable income, allowable deductions, tax rebates and tax administrative aspects. It contained 15 items with three multiple-choice and 12 true-false questions. Of the 15 multiple-choice questions, there were three questions which consisted of several parts, therefore in total the measurement consisted of 26 items.

A different tax knowledge measurement was employed in Palil (2005). The study measured tax knowledge using 33 statements regarding general income tax administration, business income, employment income, dividend and interest income, personal relief and rebates. Respondents were asked to choose ‘Yes’ if a statement was correct and ‘No’ if it was incorrect or the
respondents could choose ‘Do not know’ if they were uncertain. Each correct answer was given one mark or else zero i.e. wrong answer or the respondent chooses ‘do not know’. The maximum mark was 33 which represent the maximum total score for the test.

Similarly, Loo and Ho (2005) measured tax knowledge of salaried and non-business income earners using specific knowledge in taxation. The measurement covered relief, rebates, tax credits, types of assessment, chargeability of income and exemptions. The approach used to elicit responses on tax knowledge was similar to that of Palil’s (2005) i.e. requiring respondents to indicate ‘Yes’, ‘No’ or ‘Not sure’ to a particular statement. Loo and Ho (2005) also measured knowledge on tax liability computation, chargeable income remitted to Malaysia and the correct year to charge bonus income. However, these aspects were measured using three scenario questions. The respondents were required to indicate ‘Yes’, ‘No’ or ‘Not sure’ for the first two scenarios while for the third scenario, they were asked to state the correct year to charge bonus income presented in the scenario.

Loo, McKerchar and Hansford (2009) defined tax knowledge as a taxpayer’s ability to correctly report his or her taxable income, claim relief and rebates and compute tax liability. The study used six items to measure tax knowledge construct: (i) understanding of joint assessment and Section 46 relief and rebates, (ii) disabled child relief and others, principally Section 46 relief, (iii) child relief, (iv) understanding of a joint assessment, rebates and tax computation, (v) knowledge on extension (of deadline) and deduction and (vi) relief for unmarried child, education fees, rebates on levy and deduction.
Measuring tax knowledge based on knowledge of the tax law was further examined in a recent study by Palil (2010). Tax knowledge was measured using 37 statements relating to: (i) taxpayer’s general responsibilities and rights, (ii) employment income, (iii) dividend and interest income, (iv) personal reliefs, (v) child reliefs, (vi) rebates, and (vii) awareness of offences and penalties. A five-point Likert-scale was used to measure the level of knowledge for each statement relating to the seven aspects. The level of tax knowledge was determined using total score of the responses on the 37 statements.

Nevertheless, even though tax knowledge was measured based on knowledge of tax law, Saad (2011) divided and measured tax knowledge into three types: (i) general knowledge, (ii) legal knowledge, and (iii) technical knowledge. Different statements were used to measure the three types of tax knowledge. General knowledge was assessed using two statements related to: (i) the income tax system as a legitimate way for the government to collect revenue to manage an economy; and (ii) individual’s income tax rate. As for legal knowledge, three statements were used as measurements: (i) whether non-compliant taxpayers could be imprisoned if found guilty of evading tax; (ii) whether individuals could be prosecuted for not complying with the Income Tax Act; and (iii) whether the deadline for the submission of tax return form is only a guideline or a compulsory requirement under the tax law.

In terms of technical knowledge, four statements were used to measure this type of knowledge: (i) everyone who earns income sourced in this country needs to register with the IRBM, regardless of whether that person is a resident or not; (ii) person who receives interest income on money deposited in a bank account in Malaysia is not required to file a tax return form as the
income will be subject to tax at source; (iii) to my knowledge, I can deduct all personal expenses in calculating my tax liability; (iv) the allowable deductions that can be claimed in the computation of tax liability. For each statement, respondents were asked to indicate the degree of agreement or disagreement on a seven-point Likert scale. A higher mean value indicated better knowledge in taxation. Table 4 summarises tax knowledge measurements of Malaysian individual taxpayers in prior studies.

Table 4
_Tax Knowledge Measurements_

<table>
<thead>
<tr>
<th>Author/s (year)</th>
<th>Tax Knowledge Measurements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bardai (1992)</td>
<td>Taxable receipts and allowable expenses</td>
</tr>
<tr>
<td>Kasipillai (1997)</td>
<td>Taxable income, allowable deductions, tax rebates and tax administration aspects</td>
</tr>
<tr>
<td>Palil (2005)</td>
<td>General income tax administration, business income, employment income, dividend and interest income, personal relief and rebates</td>
</tr>
<tr>
<td>Loo and Ho (2005)</td>
<td>Relief, rebates, tax credits, types of assessment, chargeability of income and exemptions, tax liability computation, chargeable income remitted to Malaysia, chargeability of bonus income</td>
</tr>
<tr>
<td>Loo et al. (2009)</td>
<td>Types of assessment, relief, rebates, deadline</td>
</tr>
<tr>
<td>Palil (2010)</td>
<td>Taxpayer’s general responsibilities and rights, employment income, dividend and interest income, personal reliefs, child reliefs, rebates, awareness of offences and penalties</td>
</tr>
<tr>
<td>Saad (2011)</td>
<td>General knowledge (income tax as government revenue; individual’s income tax rate), legal knowledge (imprisonment for evading tax,</td>
</tr>
</tbody>
</table>
From the discussions, it is noted that there is a lack of a standard definition of tax knowledge and measurement which limits the comparison of research findings. Thus, it is viewed that a standard and acceptable definition for tax knowledge is needed to assess the level of knowledge of individual taxpayers in the context of SAS. This is because under SAS, the assessment of income is carried out by the taxpayers themselves and relevant knowledge is required for the performance of such a task. Therefore, tax knowledge should be defined and measured specifically based on the aspects needed to perform the assessment tasks accurately.

**Evolution of Tax Knowledge Studies**

Studies on tax knowledge received continuous interest among researchers in several tax regimes (Eriksen & Fallan, 1996; Groenland & Veldhoven, 1983; Lewis, 1982; Loo, 2006b; Loo & Ho, 2005; Loo et al., 2009; Palil, 2010; Song & Yarbrough, 1978). There were various issues and focus of tax knowledge studies such as determining the level of knowledge possessed by taxpayers, highlighting the importance of tax knowledge under SAS, examining the impact of tax knowledge on tax ethics, taxpayers’ attitude towards taxation, fairness of the tax system and compliance behaviour.

In Malaysia, studies on tax knowledge can be traced, especially to the initial intention by Government in 1995 to replace the OAS with SAS. The announcement made by the
Government had inspired researchers to investigate tax education and taxpayer knowledge in taxation prior to the implementation of SAS, as the new system shifts the responsibility to assess income from the tax specialist officers to lay taxpayers (Bardai, 1992; Mohd Shukor, 1994). After the implementation of SAS in 2004 for individual taxpayers, studies on tax knowledge shifted the focus from examining the importance of tax knowledge and determining taxpayers’ knowledge level to investigating the impacts of tax knowledge (Loo, 2006b; Palil, 2010; Saad, 2011).

Tax knowledge had been proposed as an essential element if SAS were to be implemented in Malaysia (Bardai, 1992). A nationwide survey was carried out to include respondents from farmers, students, lower and higher-ranked officers, business income earners, professionals, lecturers and teachers who represent the occupational status of the Malaysian population. The findings revealed that at least between 30 to 50 percent of Malaysian taxpayers in the period of the study were tax illiterate. Even though more than 50 percent of the taxpayers could be considered as tax literate, but they were actually functionally tax illiterate.

In other words, even if a taxpayer possessed some basic knowledge in taxation but as time passed by, the knowledge became out dated and therefore he/she would not be able to use the knowledge effectively to determine the correct tax liability. The study found that taxpayers had an understanding about taxable receipts, allowable expenses, personal and other relief and tax credit. However, they knew less about residence status, tax bracket, tax rebates and capital allowances and most of the taxpayers did not know the concept of statutory income. Furthermore, taxpayers with business income sources were lacking in the knowledge on capital
allowances, losses carried forward, statutory income and dividend franking. Due to the lack of knowledge, business income earners and higher-ranked officers did not declare the benefits-in-kind received in a particular year of assessment which represented non-compliance with the tax law.

Another study which determined the level of taxpayers’ knowledge was by Ahmed Razman and Bany Ariffin (2000). This study replicated Bardai’s (1992) study to gauge the tax literacy level among taxpayers in the Klang Valley\(^2\). Later, Palil (2005) also reported that the level of tax knowledge possessed by taxpayers was still considered low. The seriousness of the lack of tax knowledge among Malaysian individual taxpayers was highlighted again in Loo and Ho (2005). The respondents were white-collar salaried individuals and the study was carried out in 2003, just before the implementation of SAS in 2004 for individuals in Malaysia.

The findings revealed that with the level of knowledge possessed by taxpayers, it was doubtful whether they could competently carry out their responsibilities under SAS. This is because white-collar salaried individuals failed to identify correctly the assessment year for taxable income, the eligible deductions, exemptions, relief, rebates and tax credits. As Loo and Ho’s (2005) study was carried out on white-collar salaried taxpayers, the results of the study gave rise to concern as to how other individual taxpayers in the lower education groups would be able to carry out their assessment tasks and to determine the correct tax liabilities under SAS. This is because Madi (1999) suggested that taxpayers’ academic qualifications were associated with the level of tax knowledge.

\(^2\) Klang Valley is situated in Selangor state and covers Kuala Lumpur i.e. the capital of Malaysia.
However, Madi’s (1999) suggestions was inconsistent with Palil’s (2010) which documented that there was no significant difference between individual’s education level and tax knowledge. Palil (2010) reported that the Malaysian Education Certificate/Malaysian Higher Education Certificate (SPM/STPM) holders had significantly higher tax knowledge than those with bachelor/professional or equivalent qualifications. After the implementation of SAS, the characteristics of knowledgeable taxpayers in Malaysia had been described in Palil (2010). The study suggested that taxpayers who are male, Malay, grouped in the older category, earned middle and high income, had attended a tax course and resided in the north east of Peninsular Malaysia (i.e. Kelantan) followed by Sabah/Labuan and Perlis/Kedah were more knowledgeable in taxation.

Besides determining the level of tax knowledge and its importance under SAS, researchers found that there was a relationship between tax knowledge and tax ethics as well as taxpayer’s attitudes towards taxation (Cullis & Lewis, 1985; Eriksen & Fallan, 1996; Lewis, 1982; Song & Yarbrough, 1978). Knowledge of fiscal matters besides race, marital status and home-ownership do influenced the level of tax ethics (Song & Yarbrough, 1978). Individuals with higher fiscal knowledge possessed more positive tax ethics than those with lower fiscal knowledge.

Besides tax ethics, tax knowledge also affected attitudes towards taxation. Individual with low fiscal knowledge showed negative attitudes towards taxation (Lewis, 1982). The author suggested that there was insufficient knowledge about tax regulations which had led to negative economic effects. Cullis and Lewis (1985) examined the preferences of taxpayers with knowledge in fiscal matters to seek information about taxation. The study showed that there was a high visibility of income tax and broad ignorance of government sources of revenue. Although
the respondents preferred to maintain the level of taxation and expenditure, however if taxes were to be increased by the Government, they preferred the increase to be on expenditure rather than on income. The findings indicated that individuals will seek information about taxation only if they believed it will benefit them.

Eriksen and Fallan (1996) examined the relationship of specific tax knowledge on attitude towards taxation using quasi-experimental design on two groups of students. Their study found that after taking a tax course, students with tax law knowledge showed significant changes in their attitudes towards taxation, specifically towards their own tax evasion and fairness of the tax system as compared to their counterparts without tax law knowledge. In contrast to Eriksen and Fallan (1996), Hughes and Summers (2004) found no relationship between tax knowledge and attitudes towards taxation. The authors suggested that the significant difference between the findings of the two studies was due to the level at which attitudinal data was elicited. The former study focused on attitudes towards tax crime and other crimes with some questions relating to the fairness of the tax system while the latter’s focus was more concrete rather than theoretical in nature. Thus, the different effects of tax knowledge on attitudes were due to the different measurements used in both studies.

Besides tax ethics and attitudes towards taxation, researchers found that tax knowledge also affects tax evasion behaviour. Groenland & Veldhoven (1983) carried out a study in the Netherlands and revealed that tax evasion behaviour was affected indirectly by individual personality and situational characteristics via knowledge in the tax system. People with higher fiscal knowledge had more opportunities in relation to tax compensation and tend to commit
fiscal offences easily as compared to people with low tax knowledge. However, inconsistent findings were reported by Kasipillai et al. (2003). The study found that there were existence of the relationships between tax knowledge and tax avoidance and evasion behaviour, but after attending formal tax class and possessed higher level of tax knowledge, undergraduate students demonstrated changes in attitudes towards meeting the requirements of the tax law or less likely to evade tax. As both studies differed in many aspects, such as different measurements, respondents and tax regimes, the findings limit the possibility of making an appropriate comparison.

The relationship of tax knowledge and attitude towards fairness was another focus in tax knowledge studies. Harris (1989) reported that tax knowledge influenced individual’s fairness perception. In the study, tax knowledge was measured using fiscal awareness and technical knowledge. Using an experimental design approach, White et al. (1990) investigated whether individuals’ attitudes towards fairness of the tax system were influenced by information gathered in a formal tax class. As similar to Harris (1989), the study reported that an increased in federal income tax knowledge changed individuals’ fairness perceptions towards the tax system. This was consistent with that of Christensen et al. (1994) who also documented that the knowledge of tax law changed the subjects’ perceptions on fairness towards overall and personal payment level significantly. However, with the increased in tax knowledge, the subjects perceived the tax system to be more complex. There were other studies that established the effects of tax knowledge on fairness perception, such as Schisler (1995) and Fallan (1999).
However, Loo, McKerchar, & Hansford (2008) reported inconsistent findings with the general contention that increased in tax knowledge resulted in a negative impact on exchange fairness. Individuals with high knowledge in taxation felt that they were not receiving their fair share of the benefits funded by tax revenue. Another study which revealed inconsistent findings on tax knowledge and fairness perception relationship was by Tan and Chin-Fatt (2000). The study was conducted in New Zealand which involved tertiary students enrolled in an introductory taxation course. The authors suggested that the used of students as proxies for taxpayers to a certain extent contributed to the contradictory findings.

As similar to Tan and Chin-Fatt (2000) and Loo et al. (2008), Saad (2011) also found no effect of tax knowledge on fairness perceptions. However, when fairness perceptions were divided into different dimensions such as general fairness, exchange fairness and administrative fairness, tax knowledge was found to have effects on exchange fairness and administrative fairness. The author suggested that the contradicting findings were due to the majority of the respondents who possessed high tax knowledge and who felt that they did not receive sufficient benefits in return for their tax paid.

Tax knowledge and its impact on taxpayer’s attitude were also examined in terms of attitude towards fair tax rate structure (Roberts, Hite, & Bradley, 1994). In their study, subjects were exposed to two versions of questions i.e. concrete questions and abstract questions which represent different level of knowledge regarding progressive tax rate. The subjects demonstrated lower preference for progressive tax rate when given concrete questions, but they showed higher preference for progressive tax rate when the questions were in the abstract version. Initially,
questions in the concrete version provided more knowledge about progressive tax rate structure as compared to the abstract version. Thus, higher knowledge changed the subjects’ attitudes towards the fairness of progressive tax rate structure.

Apart from the above discussions, there were studies that examined the relationship of tax knowledge and taxpayer’s compliance behaviour as researchers believed that tax knowledge is positively related to tax compliance (Ahmad et al., 2007; Kirchler, Hoelzl, & Wahl, 2008). Mohd Hanefah (1997) claimed that taxpayers with knowledge of the tax law and system or possessed some understanding about tax matters would be more compliant than those without such attributes. As a result, the author suggested that knowledge and understanding should be included as separate variables in taxpayer compliance model.

Similar perspective had been reported in Loo (2006b). The study investigated the relationships of tax knowledge together with some features of tax structure, i.e. tax rates, audit rates and penalty rates, and tax compliance. The results supported the findings in prior studies (e.g. Mohd Hanefah, 1997; Kasipillai et al., 2003) which revealed that the increased in tax knowledge significantly improved compliance behaviour.

However, Loo (2006b) emphasized that the accumulated effects of tax knowledge and features of tax structure differed for different categories of taxpayers (i.e. salaried and self-employed) within various level of the features. The effect of tax knowledge on tax compliance behaviour was also documented in Park and Hyun (2003) and Palil (2010). Both studies support prior findings that tax knowledge has a positive impact on compliance behaviour under SAS. In addition, providing
tax knowledge to taxpayers was found to be an effective way to induce them to be more compliant (Park & Hyun, 2003).

On the other hand, there were also studies which reported that tax knowledge together with level of education were found to have negative impact on compliance behaviour (Collins, Milliron, & Toy, 1992). The study was carried out using mail survey to examine effects of the contingency factors of taxpayer objectives (i.e. correct return or minimize taxes) and tax preparation mode (i.e. self-prepared or use of a professional preparer) on the relation between taxpayer characteristics and non-compliance behaviour. Tax knowledge was included as one of the taxpayer’s characteristics. As predicted, the findings showed that tax knowledge had contributed towards non-compliance behaviour.

In contrast, Kasipillai (1997) investigated the impact of taxpayer’s knowledge on non-compliance of the tax law due to the taxpayers’ ignorance. The findings indicated the tendency of taxpayers to commit unintentional non-compliance due to lack of knowledge in taxation. Taxpayers’ ignorance was measured using taxpayers’ understanding (awareness) and knowledge (facts) of the basic income tax law and responsibilities in filing and settling their income taxes. However, a study by Mottiakavandar, Ramayah & Haron (2003) reported that tax knowledge had no effect on taxpayer’s non-compliance behaviour.

**Conclusion**

This chapter covers discussions on individual taxpayer aspects in Malaysian tax system. Individual tax knowledge is the major concern in ensuring the successful implementation of
SAS. Thus, this chapter includes the evolution of various focuses of tax knowledge studies. However, the used of different measurements had restricted the comparisons of the findings in prior studies (Saad, 2011). Most of the studies carried out in Malaysia highlighted the problem of individual taxpayers’ low level of tax knowledge and stressed on the importance of tax knowledge under SAS.
References


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