Prior to the implementation of self assessment (SA) for individual taxpayers in Malaysia in 2004, income tax was assessed under the official assessment system (OAS).¹ When filing returns under the OAS, taxpayers only needed to truthfully disclose all the facts necessary for the Inland Revenue Board Malaysia (IRB)² to correctly assess their tax liability. That is, the onus was on the tax assessors to comprehend, interpret and correctly apply the relevant provisions of the tax law to the circumstances of the taxpayers. However, the rate of returns filed by taxpayers was unsatisfactory (Sheikh Obid 1996; Kasipillai et al 1999; IRB 2002; Mottiakavandar et al 2003; Shanmugam 2003) resulting in delays in revenue collections and loss of revenue. These undesirable outcomes were further exacerbated by the IRB’s inability to finalise assessments within the stipulated timeframe (Sheikh Obid 1996; Shanmugam 2003).

To address these shortcomings, SA³ was introduced to replace the OAS.⁴ The broad rationale of SA includes the improvement of taxpayers’ compliance rates; the speedier processing of assessments; the reduction of compliance costs and the facilitation of tax collections (Kasipillai 1998b; Singh & Bhupalan 2001; Somasundram 2003). Under SA, the responsibility for assessing tax liability lies with taxpayers (Butler 1993; Silvani & Baer 1997; Rehan 1998; Cowdroy 1998; Singh & Bhupalan 2001). On the surface, SA may be seen as a simple ‘do-it-yourself’ process (Cornell 1996:12), however,

"...SA goes far further than this simple concept. It significantly alters the taxpayer’s degree of responsibility by placing upon him the full responsibility for his compliance with the law. It also requires a total change in the way in which the revenue authorities carry out their functions... This involves...changes in attitudes of taxpayers towards their obligations under

¹ In Malaysia, the traditional assessment system is known as the official assessment system (OAS). The OAS was replaced with self assessment (SA). For companies, SA was first applied, effective from the year of assessment 2001. For individual taxpayers, including both salary and wage earners and those who are self-employed, SA was first applied effective from the year of assessment 2004.
² The Inland Revenue Board Malaysia (IRB) was previously known as the Inland Revenue Department.
³ The IRB’s objectives for adopting SA were: (1) to modernise and to coordinate tax administration, (2) to create a system that was more efficient and for a more timely collection of tax and (3) to enhance the rate of tax compliance (Loo & Ho 2005:46; IRB 2006).
⁴ See above n 1.
Chapter 1  Introduction

*the law and a change in attitude between taxpayer and tax gatherer*”
(Cowdroy 1998:2).

SA is an increasingly common phenomenon throughout the world as tax administrators seek to collect revenue as efficiently and cost effectively as possible. To be successful, SA relies on high levels of voluntary compliance by taxpayers. That is, SA requires taxpayers to understand the tax system and its procedures, to possess adequate tax knowledge, to be aware of their compliance obligations and to be prepared to comply. How taxpayers respond to SA has important implications on their compliance behaviour.

The introduction of SA for individual taxpayers in Malaysia in 2004 provided a unique opportunity to study the influence of SA on taxpayers’ compliance behaviour, which is the subject of this research. This research is presented in six chapters, namely Introduction, Literature Review, Research Design, Results, Analysis and Conclusions.

This first chapter begins with an introduction to the Malaysian income tax system and its evolution from inception to SA. This is followed by an overview of the current system of personal taxation in Malaysia, including details of the technical knowledge expected of individual taxpayers under SA. Against this background, the research problems pertaining to compliance behaviour resulting from the introduction of SA are discussed and a preliminary diagrammatic representation presented. The significance of the research problems to Malaysia, and the contributions that could potentially be made by this research are considered in the light of other contemporary research that is being conducted in Malaysia. This then leads to the identification of the objectives of the research. Finally, the chapter concludes with a brief outline of the contents of each of the chapters that follow.

1.1 An overview of the Malaysian income tax system

In Malaysia, income is currently assessable to tax under the Income Tax Act (ITA) (1967), which is the successor to the Income Tax Ordinance (1947) (Malaya); the Income Tax Ordinance (1956) (Sabah) and the Inland Revenue Ordinance (1960) (Sarawak). These three ordinances were introduced during the era of British colonial rule and influence (of nearly 180 years) which left its mark not only on Malaysia’s
constitutional and administrative structure (Gullick 1981), but also on its legal and tax system (Singh A 1982). As a consequence, the income tax system in Malaysia has its roots in the British System (Chin 1997).

1.1.1 Historical background of Malaysia

As one of the successor states to the former British colonies and protectorates in South East Asia, Malaysia today consists of Peninsular Malaysia, and the States of Sabah and Sarawak on the island of Borneo. Peninsular Malaysia and Singapore were previously divided into three British administrative territories namely, the Straits Settlements;\(^5\) the Federated Malay States;\(^6\) and the Unfederated Malay States.\(^7\) These three territories, excluding Singapore, emerged as a nation known as the Federation of Malaya\(^8\) and gained independence from Britain on 31 August 1957.\(^9\)

In North Borneo, Sarawak indirectly\(^10\) came under British influence when James Brooke, an Englishman, became its governor and independent ruler in 1846.\(^11\) The Brooke family ruled Sarawak until it was ceded to Britain in 1945. Sabah came under British influence when it was governed by the British North Borneo Company that was granted a British Royal Charter in 1881, until it became a British colony proper in 1946 (Shaikha 1986). The Federation of Malaysia\(^12\) was formed on 16 September 1963, with the merger of the Federation of Malaya, Singapore, Sabah and Sarawak. On 9 August 1965, Singapore was separated from the Malaysian Federation (Clutterbuck 1984).

1.1.2 Historical background of taxes in Malaysia

In 1910 the British made the first attempt to introduce income tax in part of what is now Malaysia. However, the attempt was aborted due to strong local opposition

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\(^5\) The Straits Settlements were the British Crown Colonies of Penang, Malacca and Singapore.

\(^6\) The Federated Malay States were Perak, Selangor, Pahang and Negeri Sembilan.

\(^7\) The Unfederated Malay States were Kedah (including Perlis which was then part of Kedah), Johor, Kelantan and Terengganu.

\(^8\) The three territories, excluding Singapore were known as Malaya, not Malaysia.

\(^9\) Singapore then remained a British colony until 1963 (Shaikha 1986) (see n 12).

\(^10\) As the result of helping to put down rebellions against the Sultan of Brunei, the Sultan ceded the territory under Brooke's rule to Brooke and his family, and not to the British Crown (Nicol 1977, reprint 1982).

\(^11\) Although the British Royal Navy assisted James Brooke against the rebels in Sarawak (see above n 10) and pirates in and around the waters of Sarawak, the British Government still did not recognise James Brooke as the ruler, or make Sarawak a British protectorate (Turnbull 1989).

\(^12\) A summary of the formation of the Federation of Malaysia is presented in Appendix I.
Chapter 1 Introduction

(Chin 1997). Income tax, in its present form, was first introduced in Malaya\textsuperscript{13} in 1947; in the State of Sabah\textsuperscript{14} in 1956 and in the State of Sarawak\textsuperscript{15} in 1960. These three income tax statutes\textsuperscript{16} were subsequently repealed and replaced with the current Income Tax Act (1967) (Act 53), which now applies to the whole of Malaysia with effect from the year of assessment (YA) 1968 (Subramaniam & Teo 1989).

Prior to the introduction of British rule, traditionally the largest political unit in the peninsular was the State, each ruled by a Sultan.\textsuperscript{17} In addition, a chief, whose main source of power was the freedom to raise revenue, ruled each district.\textsuperscript{18} With British colonial rule, the British took over the functions that were previously performed by the district chiefs, including the collection of revenue (Emerson 1964; Butcher 1979).

Before attempts were made to introduce a tax on income in the early 1910s, authorities in the Straits Settlements had to rely on excise revenue, raised almost entirely from the sale of opium, arak toddy\textsuperscript{19} and other commodities (Turnbull 1989). Gambling farms\textsuperscript{20} and the opium monopoly were the major sources of revenue throughout the 19\textsuperscript{th} century (Sadka 1970). Stamp duties were introduced in 1863, but were abolished in 1867 (Turnbull 1989). In the Federated Malay States, the principal sources of revenue were port dues and river tolls, export and import duties, and excise duties (Emerson 1964). The bulk of revenue came from tin export duties (Turnbull 1989) and from import duties on opium, the preparation of cooked opium, sale of spirits, running of spirits, gambling and pawn shops (Sadka 1970; Butcher 1979). In the Unfederated Malay States, the principal sources of revenue were import duties and the sale of opium and land (Emerson 1964).

In Sarawak, until World War II, most revenue came from excise on opium farms\textsuperscript{21} and on spirits, royalties on minerals, and from poll taxes (Andaya & Andaya 1982; Turnbull 1989). Sabah, under the administration of the British North Borneo

\textsuperscript{13} Income Tax Ordinance (1947) (Malaya).
\textsuperscript{14} Income Tax Ordinance (1956) (Sabah).
\textsuperscript{15} Inland Revenue Ordinance (1960) (Sarawak).
\textsuperscript{16} This is referring to n 13, n 14 and n 15.
\textsuperscript{17} A Sultan is a Malay Ruler.
\textsuperscript{18} For the purpose of administration, a State was divided into several districts.
\textsuperscript{19} Arak Toddy is an alcoholic drink made from the sap obtained from the pods of coconut palms.
\textsuperscript{20} Gambling were prohibited unless these activities were carried out in legally licensed establishments, which were referred to as ‘gambling farms’. The government would issue licenses to private operators to operate such establishments from which taxes were collected.
\textsuperscript{21} Sale and consumption of opium were prohibited unless these activities were carried out in legally licensed establishments, known as ‘opium farms’.
Chapter 1 Introduction

Company, was managed avowedly for profit. Taxes were minimal and were based on the production of minerals, extraction of forest products and plantation crops such as tobacco and rubber. Tariffs were imposed on imports, such as on imported rice in 1885, but were lifted in 1903 (Tate 1979).

A Bill was introduced in the Straits Settlements Legislative Council to impose a tax on income, effective from 1912, but was withdrawn. During the First World War, the British Colonial Government was successful in introducing income tax in the Straits Settlements, but not in the Federated Malay States (Lee 1972b).

In 1916 a proposal was put forward to supplement the contributions towards the Imperial War Expenditure by means of an income tax. This led to the passing of a Bill, which became Ordinance No. 8 (1917), to impose a tax based on income, effective from 1 January 1917. For the following two years, taxes on income were levied under the War Tax Ordinance of 1918 and that of 1919. From 1920 to 1922, the ‘war tax’ was replaced with an income tax. The public protested, and given that the war had ended, income tax was abolished and did not reappear until 1940.

In 1940, two Bills modelled on the War Tax Ordinance (1919) were passed, one for the Straits Settlements and the other for the Federated Malay States, their objective being to defray war expenditure. The Bills allowed for the imposition of a tax on profits and income for only one year effective from 1 January 1941. With the same objective, similar Bills were passed in December 1941 for the imposition of income tax in 1942.

Under the Japanese occupation during World War II, the military regime did not ‘introduce’ any income tax. However, a Joint Income Tax Organisation was set up to recover arrears of the ‘war taxes’ that were assessed in 1941; and to collect the remaining unassessed taxes for 1941.

In 1946, after the Japanese surrender in August 1945, the British colonial governments in Malaya and Singapore set up a Select Committee to consider the possibility of re-introducing a tax on income in the two respective colonial territories. The governments of the two territories appointed R.B. Heasman as their adviser (Lee 1972b). In February 1948, the governments of the two territories accepted the
Chapter 1 Introduction

Heasman Report\(^{22}\) which led to the re-introduction of income tax in Malaya and Singapore respectively by passing the Income Tax Ordinance No. 48 (1947) and the Income Tax Ordinance No. 39 (1947). Both the ordinances that came into effect on 1 January 1948 were based on the Colonial Territories Model Income Tax Ordinance (1922) (Singh V 2003a). In Sabah and Sarawak, income taxes were introduced respectively with the passing of the Income Tax Ordinance (1956) and Inland Revenue Ordinance (1960).

On 16 September 1963, the four territories, consisting of the Federation of Malaya,\(^ {23}\) Singapore, Sabah and Sarawak merged into a single nation state, known as the Federation of Malaysia. From the mid 1950s until the formation of Malaysia, tax policies and amendments to the tax ordinances in the four territories took different, but not very diverse, paths (Lee 1972a).

Under the Malaysian Federal Constitution, income tax is a matter for the Federal Government,\(^ {24}\) but for a brief period, the Federation of Malaysia was governed by four different tax ordinances. Thus, a process to harmonise the taxation systems in the four territories was put into motion, with the introduction of The Modification of Laws (Income Tax) Order (1964). Although Singapore was separated from Malaysia on 9 August 1965, the policy towards harmonisation of the taxation systems continued in the remaining three territories of the Federation of Malaysia.

1.1.3 Direct taxes in Malaysia

For the purpose of tax administration in Malaysia, all direct taxes\(^ {25}\) are administered by the IRB. The direct taxes currently being imposed in Malaysia are Income Tax, Petroleum Income Tax, Stamp Duty and Real Property Gains Tax. Other direct taxes that had been previously imposed but subsequently revoked include Land Speculation Tax, Share Transfer Tax, Development Tax, Excess Profit Tax, Tin Profits Tax, Timber Profits Tax, Estate Duty and Film Hire Duty (Singh V 1993a).

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\(^{22}\) R.B. Heasman, a tax expert from the United Kingdom, was appointed to advise the Government of the Malayan Union and Singapore and to study the possibility of the re-introduction of income tax in the two territories.

\(^{23}\) The Federation of Malaya gained political independence from the British on 31 August 1957. (Also see above n 9 and n 12).

\(^{24}\) The Malaysian Federal Constitution, Article 96 states that “No tax or rate shall be levied by or for the purposes of the Federation except by or under the authority of federal law”.

\(^{25}\) Indirect taxes are administered by the Royal Customs and Excise Department.
Currently, income tax in the Federation of Malaysia is governed by the ITA (1967) which came into effect on 1 January 1968 and imposed income tax on a ‘World Income Scope’ basis. In 1974, the ‘World Income Scope’ was replaced with the ‘derived’ and ‘remittance’ basis.\textsuperscript{26} Under the ‘derived’ and ‘remittance’ basis, tax was charged on income derived in Malaysia and on income received in Malaysia from outside Malaysia.\textsuperscript{27} However, for non-resident taxpayers, income received in Malaysia from outside Malaysia would be exempt from income tax.\textsuperscript{28}

The ‘derived’ and ‘remittance’ basis was in place until the ‘remittance’ basis was removed in stages from YA 1995. As a consequence, income received in Malaysia from outside Malaysia by all resident companies became exempt from tax.\textsuperscript{29} Effective from YA 1998, all resident companies and unit trusts are subject to tax only on income derived from Malaysia.\textsuperscript{30} Finally, effective from the YA 2004, all income received in Malaysia from outside Malaysia became exempt from tax.\textsuperscript{31} This effectively placed the scope of taxation on the ‘derived basis’ for all taxpayers (except for income derived from air or sea transport operations, and banking and insurance businesses).\textsuperscript{32}

Income taxes in Labuan\textsuperscript{33} are governed by the Labuan Offshore Business Activity Tax Act (1990) and the ITA (1967). Under the Labuan Offshore Business Activity Tax Act, for any year of assessment, an offshore company\textsuperscript{34} deriving income from offshore trading activities may opt to be taxed at either 3 per cent of the audited net profit or at a fixed sum of RM20,000.\textsuperscript{35} Income derived from non-offshore trading activities and from non-business sources is taxed under the ITA (1967).

Prior to the introduction of the ITA (1967), companies deriving income from ‘petroleum operations’ and ‘non-petroleum operations’ were taxed on income under

\textsuperscript{26} However, income derived from sea or air transport operations, banking and insurance businesses of resident taxpayers continues to be charged to income tax on the ‘world scope basis’.
\textsuperscript{27} Paragraph 28, Schedule 6, ITA (1967) as at the YA 1974.
\textsuperscript{28} Section 3C, ITA (1967). Section 3C was later repealed (see n 30).
\textsuperscript{29} Income Tax Exemption (No 48) Order (1997). Section 3C was repealed and exemption provisions pertaining to resident companies were incorporated in this exemption order.
\textsuperscript{30} Paragraph 28, Schedule 6, ITA (1967), amended as at 2004.
\textsuperscript{31} See above n 26.
\textsuperscript{32} Labuan is a 92 kilometre\textsuperscript{2} island in the South China Sea, about 18 kilometres off the coast of Sabah. Labuan is a tax haven and was established as an International Offshore Financial Centre in 1999 (Choong 2006a).
\textsuperscript{33} An ‘offshore company’ is a company incorporated under the Offshore Companies Act (1990).
\textsuperscript{34} Section 7(1), Labuan Offshore Business Activity Tax Act (1990).
the respective income tax ordinances. When the unified ITA (1967) was introduced, a separate statute, known as the Petroleum (Income Tax) Act (1967) was legislated to impose tax on income derived from petroleum operations (Selvendran 1982). That is, any person deriving income from petroleum operations in Malaysia is not subject to tax under the ITA (1967), but instead is subjected to tax under the Petroleum (Income Tax) Act (1967). The basis of taxation under the Petroleum (Income Tax) Act is very similar to that of the ITA (1967) (Singh V 2003a).

Prior to 6 December 1973, there was no tax on capital gains in Malaysia; although there was an attempt in 1964 to introduce one (Subramaniam 1982). However, a law to impose tax on capital gains was enacted and came into force on 6 December 1973. Unlike the current tax on capital gains in the United Kingdom (UK), the Malaysia capital gains tax, known as the Real Property Gains Tax, is imposed only on capital gains arising from the disposal of “chargeable assets”.

1.1.4 Income tax: current status

Given its history, the Malaysian income tax statute is very much influenced by the principles practised in the UK and other countries and territories of the British Commonwealth. Further, references are often made to judicial decisions of these other countries (Singh A 1982). Although such judicial decisions are not binding on the Malaysian judicial system, they nevertheless do have persuasive authority (Singh V 1993a), and thus have contributed to the development of tax principles and practices in Malaysia.

Although the ITA (1967) imposes a tax on income, the Act does not define the meaning or scope of ‘income’. However, it does set out the classes of income upon which income tax is chargeable, namely:

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36 Persons chargeable to Petroleum Income Tax were not subjected to Development Tax and Excess Profits Tax.

37 ‘Chargeable assets’ are real properties situated in Malaysia, shares of controlled companies and of real property companies. A controlled company is defined as a company with not more than 50 shareholders, and controlled by not more than 5 shareholders. Generally, only shares received as consideration for the transfer of any real property by existing shareholders to the controlled company are classified as ‘chargeable assets’. A real property company is defined as a controlled company holding at least 75 per cent of its total assets in the form of real properties or shares in another real property company.

38 Section 4, ITA (1967).
a. Gains or profits from a business for whatever periods of time carried on;
b. Gains or profits from an employment;
c. Dividends, interest or discount;
d. Rents, royalties or premiums;
e. Pensions, annuities or other periodical payment; and
f. Gains or profits not mentioned above.

By virtue of the last category, i.e. 'gains or profits not mentioned above', the scope of the classes of income is very wide. Essentially, any gain or profit that is revenue in nature and derived from Malaysia would be assessable to income tax.

Prior to the year 2000, income tax was assessed on the preceding year basis. However, since then, and under the SA regime, income tax is assessed on the current year basis. The basis of taxation of a person's\textsuperscript{39} chargeable income for a YA is ascertained by reference to the income derived in the basis period for that YA. Generally, for income from non-business sources, and for sole proprietor businesses, the basis period for a YA is the calendar year that coincides with the YA.\textsuperscript{40} However, in the case of companies whose accounting years do not end on 31 December, the basis period for a YA would be the accounting year that ends in that YA.\textsuperscript{41}

1.1.5 Ascertainment of chargeable income

The chargeable income of a person\textsuperscript{42} for a YA is ascertained in the following manner:\textsuperscript{43}

a. First ascertain the basis period for each of the person's sources of income for that year;
b. Next, ascertain the gross income from each source for the basis period for that year;

\textsuperscript{39} A 'person' includes individuals and companies.
\textsuperscript{40} Section 21, ITA (1967) and Public Rulings No. 3/2000 and 6/2001.
\textsuperscript{42} See above n 39.
\textsuperscript{43} Section 5, ITA (1967).
c. Next, ascertain the adjusted income from each source for the basis period for that year;

d. Next, ascertain the statutory income from each source for the basis period for that year;

e. Next, ascertain the aggregate income and then the total income for that year; and

f. Next, ascertain the chargeable income for that year.

Generally, the gross income of a person from a source is ascertained in accordance with Section 22 of the ITA (1967). However, specific provisions are applicable in ascertaining gross income from specific classes of income.

The adjusted income from each source is derived by deducting from the gross income all outgoings and expenses wholly and exclusively incurred in the production of gross income for that source,\(^44\) but subject to the prohibition of deductions\(^45\) as specified under the ITA (1967).

For income from a business source, an adjusted loss will arise in the event where the allowable deductions exceed the gross income. The statutory income from a business source is then arrived at by adding balancing charges to, and deducting capital allowances from, the adjusted income.

For income from a non-business source, should allowable deductions exceed the gross income, the adjusted income is deemed to be zero, as losses are not recognised by the ITA (1967). No balancing charges or capital allowances are applicable to income from non-business sources, thus the adjusted income will also be the statutory income.

The statutory income from each business source is then aggregated, and from such aggregated statutory income, any unabsorbed business adjusted loss or losses brought forward from the previous years are deducted to arrive at the 'net statutory income' from all business sources. The aggregate income is then ascertained by aggregating

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\(^{44}\) Section 33, ITA (1967) generally spells out that only outgoings and expenses wholly and exclusively incurred in the production of gross income are allowed for deduction.

\(^{45}\) Section 39, ITA (1967) generally spells out outgoings and expenses that are specifically prohibited for deduction.
the 'net statutory income' from all business sources with the statutory income from all non-business sources. The total income is arrived at by deducting the following\textsuperscript{46} from the aggregate income:

- Business adjusted loss or losses (of the basis period)
- Schedule 4 Deduction (Abortive Expenditure on Prospecting Operations)
- Schedule 4A Deduction (Capital Expenditure on Approved Agriculture Projects)
- Schedule 4B Deduction (Qualifying Pre-operational Business Expenditure)
- Schedule 4C Deduction for Approved Food Production Projects
- Gifts/Donations to the Government or Approved Institutions

Generally, for taxpayers other than resident individuals, their total income is also their chargeable income. A more detailed discussion of personal taxation is presented in the following sections.

1.2 An overview of personal taxation in Malaysia

Personal taxation in Malaysia refers to the administration of income taxes that are applicable to those individuals who are self-employed (SE) as well as those who are salary and wage earners (SW). Individual taxpayers in these two categories are required to file their annual tax returns based on income derived during each calendar year.

SW are those individuals who derived income from employment. They may also derive income from other non-business sources, such as dividend, rent, interest, royalties and pension. SE taxpayers are those who derived income from business operations and perhaps also from sources similar to that of the SW. However, for individuals who are either SW or SE, exemptions\textsuperscript{47} are available in relation to income derived from Malaysia in respect of employment, dividend, interest, royalties and pension income.

\textsuperscript{46} Schedule 4B and Schedule 4C deductions are available only to resident companies, while expenditure under Schedule 4 is unlikely to be incurred by self-employed (SE) individuals.

\textsuperscript{47} See Appendix II for exemptions available.
1.2.1 Personal relief

For individuals who are residents, personal relief are allowed to be deducted from their total income to arrive at their chargeable income. Non-resident individuals are not eligible to claim personal relief, thus their total income is also their chargeable income.

The types and amount of personal relief available to a resident individual would depend on factors such as the individual’s marital status; the number of dependents; and in the case of a husband and wife (or wives), on their option for joint or separate assessment. For the year 2004, briefly, the following types of relief are available:

<table>
<thead>
<tr>
<th>Types of relief and conditions applicable to YA 2004</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1(a) Relief for self</td>
<td>RM8,000</td>
</tr>
<tr>
<td>1(b) Medical expenses of parents</td>
<td>Actual sum incurred or RM5,000 whichever is lower</td>
</tr>
<tr>
<td>1(c) Expenses incurred on purchase of basic supporting equipment for the taxpayer, spouse, children or parents who are disabled persons</td>
<td>Actual sum incurred or RM5,000 whichever is lower</td>
</tr>
<tr>
<td>1(d) Relief for disabled taxpayer</td>
<td>RM5,000</td>
</tr>
<tr>
<td>1(e) Fees for education of taxpayer for approved courses</td>
<td>Actual sum incurred or RM5,000 whichever is lower</td>
</tr>
<tr>
<td>1(f) Medical expenses of taxpayer, spouse or children who are suffering from serious diseases</td>
<td>Actual sum incurred or RM5,000 whichever is lower (but inclusive of a maximum of RM500 incurred for a complete medical examination)</td>
</tr>
<tr>
<td>1(g) Expenses incurred on purchase of books, magazines and journals for taxpayer, spouse or children</td>
<td>Actual sum incurred or RM500 whichever is lower</td>
</tr>
<tr>
<td>1(h) Interest on loan to acquire first residential property</td>
<td>Actual sum incurred or RM3,000 whichever is lower</td>
</tr>
</tbody>
</table>

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48 The residence status of an individual is determined in accordance with Section 7(1) of the ITA (1967).
49 Personal relief are allowed in accordance to Sections 46-49 of the ITA (1967).
50 Effective from YA 2005, this relief has increased from RM500 to RM700.
<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>2(a)</td>
<td>Relief for wife – available to husband in the event of joint assessment under his name</td>
<td>RM3,000 [see 2(b) below]</td>
</tr>
<tr>
<td>2(b)</td>
<td>For a male taxpayer who pays alimony to his ex-wife</td>
<td>Actual sum incurred or RM3,000 whichever is lower. The maximum sum available for relief under 2(a) and 2(b) is restricted to RM3,000</td>
</tr>
<tr>
<td>2(c)</td>
<td>Relief for spouse – available to a wife in the event of joint assessment under her name</td>
<td>RM3,000</td>
</tr>
<tr>
<td>2(d)</td>
<td>Relief for disabled spouse – available either to the husband or wife in the event of joint assessment either under his or her name</td>
<td>RM2,500(^{52})</td>
</tr>
<tr>
<td>3(a)</td>
<td>Relief for maintenance of unmarried children, under 18 years of age</td>
<td>RM1,000 in relation to each child</td>
</tr>
<tr>
<td>3(b)</td>
<td>Relief for maintenance of unmarried children who are still receiving full time education</td>
<td>RM1,000 in relation to each child</td>
</tr>
<tr>
<td>3(c)</td>
<td>Relief for maintenance of unmarried children who are still receiving full time education at tertiary level in Malaysia</td>
<td>RM4,000 in relation to each child</td>
</tr>
<tr>
<td>3(d)</td>
<td>Relief for maintenance of unmarried, disabled children</td>
<td>RM5,000 in relation to each child</td>
</tr>
<tr>
<td>4(a)</td>
<td>Contributions to the Employees’ Provident Funds and payment of life insurance premium of the taxpayer or spouse</td>
<td>Actual sum contributed/ paid or RM5,000 whichever is lower(^{53})</td>
</tr>
<tr>
<td>4(b)</td>
<td>Payment of education or medical insurance premium of the taxpayer, spouse or children</td>
<td>Actual sum paid or RM3,000 whichever is lower</td>
</tr>
<tr>
<td>4(c)</td>
<td>Payment of annuity insurance premium to the Employees’ Provident Funds by taxpayer</td>
<td>Actual sum paid or RM1,000 whichever is lower</td>
</tr>
</tbody>
</table>

* Note: In the case of separate assessment, for a husband and wife, either he or she may opt to claim the child relief in relation to each child.

\(^{51}\) It should be noted that interest incurred on loans are allowed over three years (YA 2003, 2004 & 2005) where the amount of deduction shall be a maximum of: i) RM5,000 for the YA 2003; ii) RM3,000 for YA 2004; and iii) RM2,000 for YA 2005.

\(^{52}\) Effective from YA 2005, this relief has increased from RM2,500 to RM3,500.

\(^{53}\) Effective from YA 2005, this relief has increased from RM5,000 to RM6,000.
1.2.2 Tax rebates and tax chargeable

Non-resident individuals are charged to tax at 28 per cent on their chargeable income.\(^{54}\) No rebate is available to non-resident individuals. For individuals who are residents, a progressive tax rate\(^ {55}\) ranging from zero to 28 per cent is applicable and in addition, the following rebates\(^ {56}\) are available to offset against the tax chargeable:

<table>
<thead>
<tr>
<th>Types of rebates and conditions applicable to YA 2004</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 If the taxpayer’s chargeable income does not exceed RM35,000</td>
<td>Rebate of RM350</td>
</tr>
<tr>
<td>2 If the taxpayer’s chargeable income does not exceed RM35,000 and the taxpayer is entitled to a relief for wife or relief for spouse</td>
<td>Rebate of another RM350 will be available to him or her</td>
</tr>
<tr>
<td>3 Mandatory payment of zakat(^ {57}) (religious tithe) by Muslims</td>
<td>Actual sum of zakat paid</td>
</tr>
<tr>
<td>4 Purchase of computers for personal use. Available to the taxpayer or spouse, but only once every five years</td>
<td>Rebate of RM400(^ {58})</td>
</tr>
<tr>
<td>5 Fees paid to the Malaysian Immigration Department for application of Employment Permit for foreigners</td>
<td>Actual sum paid</td>
</tr>
</tbody>
</table>

1.2.3 S110 Tax credit

For individual shareholders who derived dividend income from resident companies in Malaysia where tax has been withheld at source, the amount of tax so withheld will be available to the individuals as a tax credit\(^ {59}\) to be offset against their respective tax liabilities.

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\(^{54}\) Schedule 1, Part 2, ITA (1967).

\(^{55}\) Schedule 1, Part 1, ITA (1967).

\(^{56}\) Schedule 6A and 6C, ITA (1967).

\(^{57}\) Zakat is a mandatory religious tithe payable annually by Muslims.

\(^{58}\) Effective from YA 2005, this rebate has increased from RM400 to RM500.

\(^{59}\) Section 110, ITA (1967).
1.2.4 Joint and separate assessment

The issue of joint or separate assessment is only applicable to the administration of personal taxation for a husband and his wife (or wives). Joint assessment is a process whereby the income of a husband and that of his wife (or wives) are combined to determine their joint tax liability, while under a separate assessment, the income tax liabilities of the husband and that of his wife (or wives) are determined separately.

Prior to the YA 1975, the ITA (1967) provided only for joint assessment, whereby the income of the wife (or wives) would have to be aggregated with that of her (or their) husband and be jointly assessed under his name. The wife (or wives) would than be deemed to have no income.

Between the YA 1975 and YA 1990, some form of partial separate assessment was provided for under the ITA (1967). When separate assessment was first introduced in the YA 1975, a wife was given the option to be assessed separately only on her income from employment. Income from non-employment sources were still jointly assessed with that of her husband.

In the YA 1978, a wife was given the option to have her income from employment and from exercising a recognised profession assessed separately. However, her income from other sources would still be jointly assessed with that of her husband. Between the YA 1975 and YA 1990, should a wife have not opted for separate assessment, all her income was jointly assessed with that of her husband.

Effective from the YA 1991, all the income of a wife were automatically assessed separately, unless she opted for a joint assessment with her husband. When a wife opted for joint assessment, she was deemed to have no income, and all her income was assessed under the name of her husband. However, a husband was not given any option to have his income jointly assessed with that of his wife until the YA 2000.

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60 Section 45, ITA (1967) governs the process of joint and separate assessment for a husband and his wife/wives.
61 A wife’s employment income could only be separately assessed if her employment income was not derived from her employment in a business controlled by either her husband, herself or both.
62 Recognised profession includes a "...qualified accountant, advocate and solicitor, architect, dentist, engineer, medical practitioner, or pharmacist registered under any written law, or from the exercise of any profession, the practice of which requires such registration and approved by the Minister of Finance..." (Ludin 1978:25).
With effect from the YA 2001, all income of both the husband and his wife (or wives) is assessed separately, unless any one of them opts for joint assessment. However, where no spouse exercises the option for joint assessment, their respective tax liabilities are assessed separately.

**1.3 Research problem statement**

The objective of this research is to investigate the influence of the introduction of SA on the compliance behaviour of individual taxpayers in Malaysia. The previous section provided an overview of personal taxation in Malaysia. With the introduction of SA in Malaysia, all taxpayers will be required not only to file their respective tax returns, but also to assess their own income tax liability. The implementation of SA will require taxpayers to have a thorough understanding of compliance rules underlying the Malaysian income tax law and, at the same time, the administration will need to understand the compliance behaviour of individual taxpayers. Hence, in this context, tax compliance is an important issue for both administrators and taxpayers.

Compliant taxpayers would submit or file their returns within the stipulated deadlines, truthfully and accurately report all relevant information pertaining to their tax liabilities and in accordance with the tax law, and pay the taxes due without the need for further enforcement by the tax agency (Alm 1991; Singh V 2003a). Taxpayers who are non-compliant may make intentional or unintentional decisions about their behaviour that may result in over (McKerchar 2002) and under compliance. Findings of research had indicated that the SE tend to comply less as compared to the SW (Andreoni, Erard & Feinstein 1998). The former may be more likely intentionally non-compliant compared to the latter whose non-compliance may more likely be unintentional.

The introduction of SA, coupled with other causes, could possibly affect the compliance behaviour of these two categories of individual taxpayers in Malaysia. In the following chapter the literature on the influences on compliance behaviour is reviewed in detail. At this stage of the research, it was expected that these influences
or 'other causes' would fall into five categories,\(^{63}\) namely the 'assessment system', 'tax knowledge', 'tax structure features', 'financial constraints' and 'attitudes towards tax'. A brief discussion follows on the rationale of each of these categories.

Factors incorporated in the category of 'assessment system' include taxpayers' attitudes towards the change from the OAS to the SA system and their tax knowledge (which may affect how well they coped with the SA system in terms of compliance). Tax knowledge encompasses the quantitative aspects of deriving one's tax liability. Perhaps more importantly, it includes having an understanding of the income tax law including the complexity of its provisions and its frequent changes, and further, being certain of its requirements (Wallschutzky 1992; Kasipillai & Baldry 1998; Cuccia & Carnes 2001: Forest & Sheffrin 2002).

Factors in the category of 'tax structure features' include tax rates, the probability of being audited and penalties for non-compliance (Allingham & Sandmo 1972; Tauchen & Witte 1985; Butler 1993; Wallschutzky 1992; Kasipillai & Baldry 1998; Slemrod, Blumenthal & Christian 2001). Factors included in the category of 'financial constraints' are the financial commitments likely to be experienced by taxpayers that are attributable to their income level, the quantum of tax burden and the financial needs of dependents such as spouse and children (Becker 1968; Andreoni, Erard & Feinstein 1998).

Finally, factors in relation to 'attitudes towards tax' include personal attitudes, prior experience in dealing with tax administrators and perceptions towards tax and the tax administration (Ajzen & Fishbein 1980; Song & Yarbrough 1978; Lewis 1982b; Fischer, Wartick & Mark 1992; Eriksen & Fallon 1996; Wenzel 2004). In addition to these five categories of causes, demographic variables provide another dimension (as moderating variables) to the analysis of compliance behaviour. Based on the literature, these demographic variables commonly include age, gender, level of education and ethnic background (Jackson & Jaouen 1989; Fallon 1999; Chan, Troutman & O'Bryan 2000; Chung & Trivedi 2003). That is, the demographic variables could be expected to be moderating factors within each of the five categories of causes of taxpayers' compliance behaviour.

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\(^{63}\) At this early stage, the researcher can only theorise on the five categories of causes that may influence the compliance behaviour of individual taxpayers in Malaysia. The appropriateness of these categories of causes will be reviewed at the end of Chapter 2.
Diagrammatically, the above problem statement can be presented in Figure 1.1.

1.4 Research in Malaysia

To achieve a higher rate of voluntary compliance, the IRB traditionally recognises the deterrence effect of penalties and enforcement activities (Singh & Bhupalan 2001) including the undertaking of criminal proceedings against errant taxpayers (Shanmugam 2004)\textsuperscript{64} rather than negotiating for settlements (Yong K 2005).\textsuperscript{65} Such strategies may be appropriate in addressing non-compliance that is intentional, but there may be other causes\textsuperscript{66} influencing taxpayers’ compliance behaviour for which these strategies are inappropriate. The IRB appears not to be focusing on the necessity for it to identify, evaluate and take cognisance of these causes, particularly in light of the introduction of SA.

Further, there is minimal research and reports on tax compliance in Malaysia, particularly in relation to personal income tax under the SA regime. Among these are studies on factors influencing the compliance behaviour of small business entrepreneurs (Mottiakavandar \textit{et al} 2003); on the influence of education (Kasipillai, Aripin & Amran 2003); of moral values on compliance behaviour (Kasipillai, Mat Udin & Ariffin 2003); and on the competency and readiness of salaried individuals in coping with the SA system (Madi & Kamaluddin 2003; Loo & Ho 2005). Other tax compliance research has focused on corporate income tax compliance costs (Loh \textit{et al} 1997); compliance costs of small and medium enterprises (Saad, Mansor & Ibrahim 2003); tax evasion (Kasipillai 1997; Somasundram 2003); ethical decision making of tax professionals (Singh V 2003b) and on the tax gap that was attributable to non-compliance (Abdul & Sheehan 2003, 2004).

\textsuperscript{64} The IRB “...has recently announced that...criminal proceedings may be undertaken to act as deterrence for taxpayers to evade tax and breach of trust under the SA system. In other words, the IRB wants a ‘pound of flesh’ instead of a monetary settlement” (Shanmugam 2004:17).

\textsuperscript{65} The Director General of the IRB was reported to have announced that the IRB would see taxpayers in court and that taxpayers “...can forget about negotiating for settlements” (Yong K 2005:23).

\textsuperscript{66} In this research, five possible causes were identified for investigation – see 1.3.
Figure 1.1: Diagrammatic representation of research problems
It is expected that the findings of this research could provide insights into the causes associated with compliance under SA and the influence that the change to SA has had on the compliance behaviour of individual taxpayers in Malaysia. Such insights would be beneficial to, and should be considered by the IRB when devising strategies to achieve higher rates of voluntary compliance by way of enhancing taxpayers’ awareness of their tax compliance obligations and their understanding of tax law. In addition, this research may also throw new light on yet unknown and unidentified deficiencies in the formulation of tax policies, the implementation of such policies and the general administration of the tax machinery in Malaysia in relation to taxpayers’ compliance obligations. The findings of this research would then be able to contribute towards mitigating such deficiencies and could be beneficially used as inputs by tax policy makers in Malaysia.

1.5 Objectives of study

Based on the research problem, the following are the research objectives of this research:

1. To identify the causes that may have influenced taxpayers’ compliance behaviour associated with the introduction of SA system in Malaysia.

2. To investigate whether, and to what extent, the five main categories of causes (i.e. the ‘assessment system’, ‘tax knowledge’, ‘tax structure features’, ‘financial constraints’ and ‘attitudes towards tax’) influence compliance behaviour; and the extent to which the moderating variables impact on the compliance behaviour of individual taxpayers in Malaysia.

3. To identify whether there are any significant differences in the causes and their influence on compliance behaviour between the two categories of Malaysian taxpayers, namely SW taxpayers and SE taxpayers.

1.6 Outline of research

The research is organised in the following manner. Upon the conclusion of Chapter 1, the next chapter (i.e. Chapter 2) contains a review of the literature, including the implementation of SA in Malaysia and the readiness of individual taxpayers to cope
with the new system. The operation of SA in eight other tax regimes is also reviewed, the aim of which is to identify the lessons that may be beneficial to the IRB in administering SA in Malaysia. Chapter 2 then includes a broader review of models underlying compliance behaviour (such as the economic and sociological-psychological models) and the factors associated with compliance behaviour. Based on the literature review and given the objectives of the research, a set of research questions is then developed and a theoretical model of tax compliance behaviour constructed to provide a framework for research and investigation in the context of Malaysia.

The research design, drawing from both the quantitative and qualitative paradigms, is developed in Chapter 3. This chapter also includes the rationale for the mixed method design used in this research (comprising a survey, an experiment and a case study), and discussion on data collection for each method and the respective data analysis techniques. In Chapter 4 the findings derived from each of the three research methods adopted are systematically and independently reported. In Chapter 5 a cross-method analysis of the findings is undertaken, the aim of which is to triangulate the outcomes of the three research methods into a more comprehensive view and thereby address each of the six research questions (that were derived in Chapter 2). Based on the overall findings, a model of personal income tax compliance for individual taxpayers in Malaysia is then presented. The final chapter (i.e. Chapter 6) contains an overview of the research as a whole, its major findings and its limitations. The policy implications are discussed, the contribution to the body of knowledge identified, and finally, recommendations are made for future research.