

**TAX COMPLIANCE INTENTION: A
MEDIATING ROLE OF TAX KNOWLEDGE
AMONG INDIVIDUAL TAXPAYERS IN KOTA
KINABALU, SABAH**

MOHANESWARI A/P RENGANATHAN



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UNIVERSITI MALAYSIA SABAH

**FACULTY OF BUSINESS, ECONOMICS AND
ACCOUNTANCY
UNIVERSITI MALAYSIA SABAH
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**THESIS SUBMITTED IN FULFILMENT OF THE
REQUIREMENTS FOR MASTER OF
ACCOUNTANCY**

**FACULTY OF BUSINESS, ECONOMICS AND
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DECLARATION

I hereby declare that the material in this thesis is my own except for quotations, excerpts, equations, summaries and references, which have been duly acknowledged.

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ABSTRACT

Increasing levels of non-received tax revenue due to tax non-compliance is a critical challenge faced by any government and Malaysia is no exception. Hence, the purpose of this study is to investigate the Tax Compliance Intention of individual taxpayers in Kota Kinabalu, Malaysia by using the Theory of Planned Behaviour (TPB) with three determinants: Tax Morale, Trust in Government and Tax Socialization. Tax Knowledge further mediates the relationships between these determinants on Tax Compliance Intention. This study collected survey data from 385 respondents in Kota Kinabalu in August 2022 and used convenience sampling for determining respondents from taxpayers. Data was analysed using regression analysis and Cronbach's alpha test was used to check the validity and reliability of the data set. In order to provide new insights on tax compliance research, this study employed Tax Knowledge as a mediator, unlike prior studies that mainly examined it as an independent variable. The study discovered that Tax Morale has an inverse direct effect on Tax Knowledge and Tax Knowledge mediates the relationship between Tax Morale and Tax Socialization on Tax Compliance Intention. Therefore, the findings of this study aids policymakers, in improving taxpayer compliance by leveraging taxpayer's knowledge, boosting taxpayer's morale, thus improving the current tax system in order to boost voluntary tax compliance. While the research is conducted in Kota Kinabalu, the implications extend beyond this specific region as it can shed light on fundamental behavioral aspects of tax compliance that are relevant to taxpayers across different regions in Malaysia and potentially in other countries as well.

Keywords: Tax Compliance Intention, Theory of Planned Behaviour, Tax Morale, Trust in Government, Tax Socialization and Tax Knowledge

ABSTRAK

NIAT PEMATUHAN CUKAI: PERANAN PENGANTARA PENGETAHUAN CUKAI DI KALANGAN PEMBAYAR CUKAI INDIVIDU DI KOTA KINABALU, SABAH

Prestasi pungutan hasil cukai semasa yang rendah dan kadar ketidakpatuhan cukai yang tinggi telah menjadi isu yang berlarutan di Malaysia. Justeru, tujuan kajian ini adalah untuk mendedahkan niat pematuhan cukai bagi penduduk cukai individu di Kota Kinabalu, Malaysia dengan menggunakan tiga komponen dalam Theory of Planned Behaviour (TPB), iaitu moral pembayar cukai (Tax Morale), kepercayaan kepada kerajaan (Trust in Government) dan sosialisasi percukaian (Tax Socialization). Faktor tahap pengetahuan pembayar cukai (Tax Knowledge) digunakan untuk mengkaji hubungan antara tiga komponen ini dengan niat pematuhan cukai (Tax Compliance Intention). Kajian ini telah mengumpulkan data daripada 385 responden di Kota Kinabalu pada bulan Ogos 2022 dengan menggunakan kaedah pensampelan kemudahan (convenience sampling) dan data dianalisis dikaji menggunakan analisis regresi. Sebagai sumbangan baru dalam penyelidikan pematuhan cukai, kajian ini menggunakan tahap pengetahuan pembayar cukai sebagai pengantara dan hasil kajian mendapati bahawa moral pembayar cukai mempunyai hubungan songsang terhadap tahap pengetahuan pembayar cukai. Hasil kajian ini akan berguna bagi kerajaan untuk memperbaiki sistem percukaian sekarang untuk meningkatkan pematuhan cukai secara sukarela. Walaupun kajian ini dijalankan di Kota Kinabalu, implikasinya boleh digunakan di seluruh Malaysia and negara-negara lain yang berkaitan kerana hasil kajian ini dapat memberi penerangan terhadap aspek tingkah laku pematuhan cukai yang asas dan relevan secara umum.

Kata kunci: Niat Pematuhan Cukai, Moral Pembayar Cukai, Kepercayaan kepada Kerajaan, Sosialisasi Percukaian dan Tahap Pengetahuan Cukai

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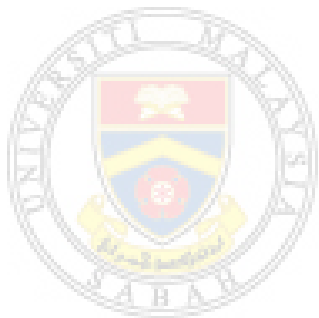
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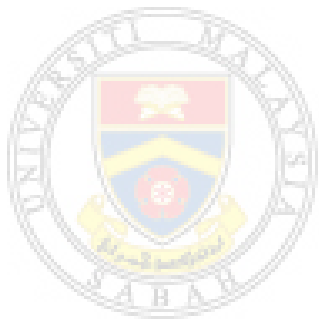


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LIST OF ABBREVIATIONS

ANOVA	-	Analysis of variance
ATO	-	Australian Taxation Office
BSH	-	Bantuan Sara Hidup
CEO	-	Chief Executive Officer
CRA	-	Canada Revenue Agency
COVID-19	-	Coronavirus Disease 2019
EDM	-	Economic Deterrence Model
FET	-	Fiscal Exchange Theory
GDP	-	Gross Domestic Product
HMRC	-	Her Majesty's Revenues and Customs
IMF	-	International Monetary Fund
IRBM	-	Inland Revenue Board Malaysia
ITA	-	Income Tax Act 1967
ITRF	-	Income Tax Return Form
OAS	-	Official Assessment System
OECD	-	Organization for Economic Co-operation and Development
PBC	-	Perceived Behavioural Control
RM	-	Ringgit Malaysia (Malaysian currency)
RMC	-	Royal Malaysian Customs
RPGT	-	Real Property Gains Tax
SAS	-	Self-Assessment system
SD	-	Standard Deviation
SME	-	Small and Medium-Sized enterprises
SPM	-	Social Psychology Models
SST	-	Sales and Service Tax
SVDP	-	Special Voluntary Disclosure Program
TCI	-	Tax Compliance Intention
TIG	-	Trust in Government
TK	-	Tax Knowledge
TM	-	Tax Morale

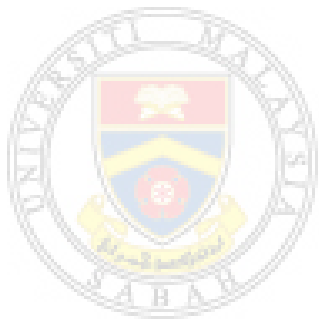
TS	-	Tax Socialization
TPB	-	Theory of Planned Behaviour
TRA	-	Theory of Reasoned Action
UK	-	United Kingdom
USA/US	-	United States of America
USD	-	United States Dollar
YA	-	Year of Assessment



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CHAPTER 1

INTRODUCTION

1.1 Introduction

Tax revenue collection has always been a major contribution to the government (Nawawi, Hamid, Yusop, Ghazali and Rashid, 2020). It is one of the most essential elements of revenue for the government and is strongly connected to government expenditure, which contributes to economic growth (Kim and Lee, 2020). The research from Dewi and Supadmi (2021) asserted that it is critical for the execution and advancement of national development in order to attain people's prosperity and wellbeing. Furthermore, the collection of income tax stabilises economies and alleviates states from public debt (Lois, Drogalas, Karagiorgos and Chlorou, 2019).

Malaysia is a developing country where the treasury department of the Ministry of Finance of Malaysia has classified the federal government revenue into four main categories, namely tax revenue, non-tax revenue, non-revenue receipts and revenue from federal territories, in which tax collection remains the primary source of revenue for the government. Tax revenue can be classified into two main types: direct and indirect taxes. Direct taxes can further be categorised into income tax and other direct tax. Income tax is derived from individuals, corporations, petroleum, withholding and others, whereas other direct taxes are derived from stamp duty, real property and gains tax (RPGT), Labuan business activity tax and others. On the other hand, export duties, import duties, tourism taxes, sales and service taxes (SST) are among the examples of indirect taxes (Fiscal Outlook and Federal Government Revenue Estimates, 2021).

In 2021, the federal government's revenue is expected to be RM236.9 billion, or 15.1% of gross domestic product (GDP) as per Fiscal Outlook and Federal Government Revenue Estimates Report. The higher revenue is largely attributed to better tax revenue collection, which is estimated to increase by 13.8% to RM174.4 billion. As a percentage to GDP, tax revenue constitutes 11.1% while non-tax revenue at 4%. This view is complemented with the statistics from the Ministry of Finance, where the projected income tax contribution of 54.1% to the government's funds in 2021 as shown in Figure 1.1, and is reported to be one of the country's most vital revenue sources.

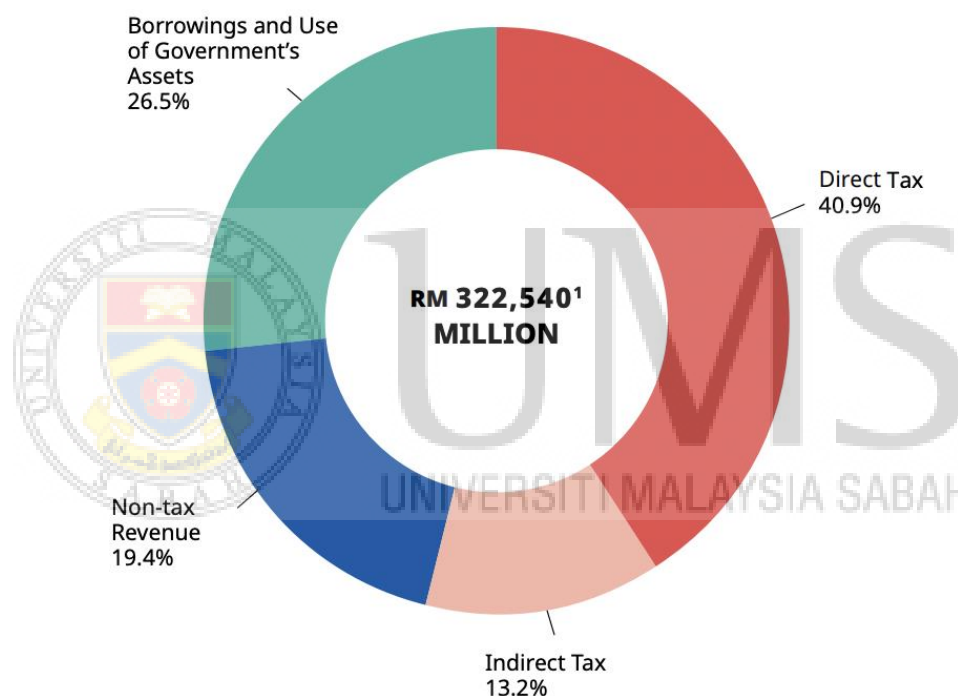


Figure 1.1 : 2021 Federal government budget of Malaysia

Source : Ministry of Finance, Malaysia

Marandu, Mbekomize and Ifezue (2015) asserted that tax revenue is utilised to solve immediate human development issues (e.g., outbreaks, emergency medical treatment) as well as long-term public infrastructure needs (roads, airports, hospitals, and schools). Likewise in Malaysia, the collection of tax is needed by the government to spend on the crucial projected expenditures in 2021 as demonstrated in Figure

1.2. The crucial expenditures, among others, include subsidies and social assistance, retirement charges, economic, COVID-19 Fund, debt service, and charges for supplies and services. Without the adequate contributions from the taxpayers, the government faces an obstructive revenue performance where the government will not be able to afford to aid the infrastructure development (Anwar and Simanjuntak, 2021).

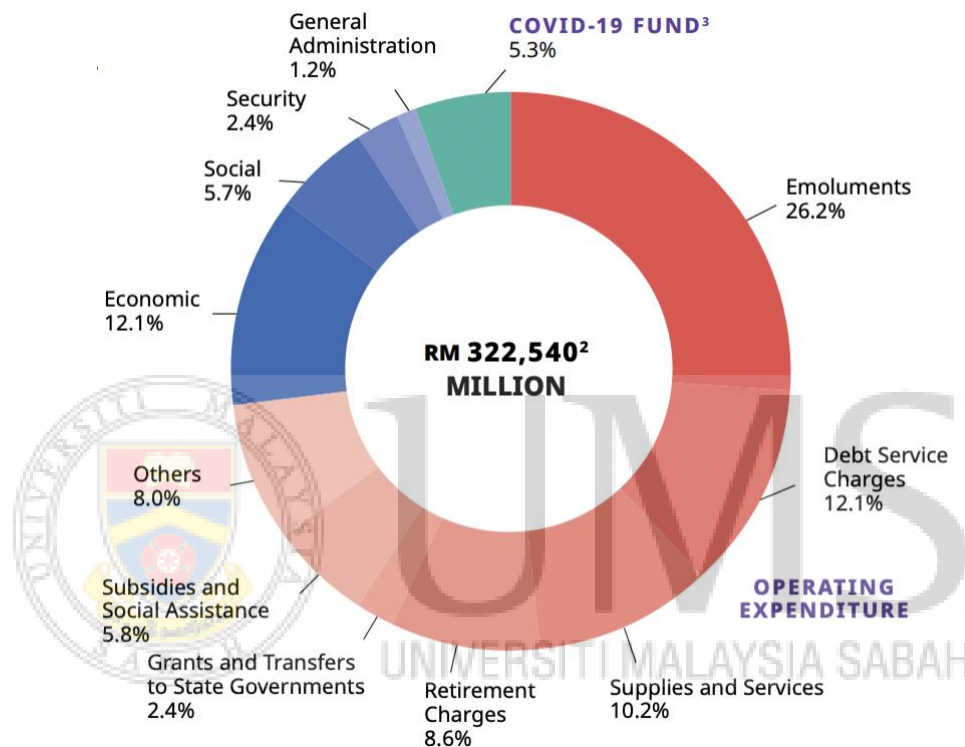


Figure 1.2 : 2021 Federal government projected expenditures of Malaysia

Source : Ministry of Finance, Malaysia

1.2 Background of the Research

Revenue is used by the government to govern and manage Malaysia and its development expenditure. The government allocated and spent tax collections for the purpose of national security, physical development and infrastructure such as roads, hospitals, schools as well as economic and social development such as health services, education and welfare of the people (IRBM, 2022). For instance, three

million low-income Bantuan Sara Hidup (BSH) or Cost-of-Living-Aid beneficiaries are receiving financial support from the government, which stems from tax revenue (The Star, 2019). Furthermore, collecting tax revenue helps to stabilise economies and relieve states of debt. In Malaysia, tax non-compliance has been a constant issue faced by Inland Revenue Board Malaysia (IRBM) (i.e., Malaysia's tax authority), according to the Chief Executive Officer (CEO) of IRBM (Malaysian Institute Of Accountants, 2019).

Safian and Ngah (2020) also stated that tax non-compliance has been deteriorating rather than improving. It is a continual challenge for all tax authorities to persuade all taxpayers to follow the laws of a tax system and it has never been easy. The statistics from Fiscal Outlook and Federal Government Revenue Estimates (2021) reported that individual income tax is anticipated to dramatically decline by 4% to RM35.9 billion compared with the original estimates of RM37.4 billion in 2020. IRBM stated the definition of tax non-compliance by IRBM is in line with legal practice by most overseas tax administrators and tax-related institutions; such as among others, Australian Taxation Office (ATO), Her Majesty's Revenues and Customs (HMRC), Canada Revenue Agency (CRA) and the International Monetary Fund (IMF). Collectively, it is stated that the non-compliance scenario occurs when the taxpayer has committed one of the following actions, for instance, not submitting tax forms, not reporting sources of income properly and not fully paying tax liabilities (IRBM, 2020).

The government's major focus is on the intention of taxpayers refusing to pay their tax obligations as a result of poor tax compliance (Oktaviani, Kurniaa, Sunartoa and Udin, 2020). Lois et al. (2019) mentioned that when the estimated tax revenues are far greater than those collected, the discrepancy may be attributed to factors related to taxpayer behaviour. The study of Mesele and Tesfahun (2016) depicted that reducing non-compliance can be successful if the reasons for non-compliance by taxpayers is well understood, which can be an useful tool to tax authorities by giving them information and assisting them in determining the most appropriate and effective approach for increasing tax compliance.

1.3 A Review of Malaysian Tax System

In general, IRBM and the Royal Malaysian Customs (RMC) are the two main authorities in charge of enforcing Malaysian tax regulations. The IRBM is in charge of enforcing tax regulations concerning income tax, real property gains tax (RPGT), stamp duty, petroleum income tax and in charge of collecting withholding tax on payments made to non-residents for interest, royalties, contract payments, specific classifications of income and revenue from public entertainers. RMC, on the other hand, is in charge of customs duties (both import and export), excise duty and SST (Saad, 2011).

Tax systems in Malaysia were introduced by the British into the *Federation of Malaya* in 1947 and were based on *Heasman's Report* (Singh, 1999:138). Initially, the *Income Tax Ordinance 1947* was gazetted as the main act but subsequently reformed and replaced by *Income Tax Act 1967* (ITA) which took effect on January 1, 1968. Presently, ITA 1967 remains the primary law governing direct taxes in Malaysia, including corporate and individual income tax. Malaysia's first income tax collecting system, which is known as the "Official Assessment System" (OAS) was designed in such a way that Malaysian tax officers assessed the taxpayers and collected the revenue due. Taxpayers were not needed to know how to calculate their own due tax under OAS as they receive their yearly tax returns from IRBM and were obliged to report all relevant information related to their income and spending for that assessment year. In summary, the onus was on the tax assessors to understand, interpret, and apply the applicable tax legislation correctly. However, the pace at which taxpayers submitted returns was poor, leading to longer revenue collection delays and revenue loss (Shanmugam 2003; Mottiakavandar, Ramayah, Haron, and Ang, 2003).

As reported in the Annual Report of IRBM (2001), the manual preparation of the OAS was changed into a new system named "Self-Assessment System" (SAS) for both business sectors and individuals. It was implemented in 2001 for corporations, 2003 for partnerships and sole proprietorships and 2004 for individual income taxpayers. E-filing was first introduced in 2003 and is an online system introduced by

IRBM that allows taxpayers to submit tax returns online, which is an alternative to the usual manual form submission. To this date, individual taxpayers are given an option to submit the ITRF via e-filing or manually, even though there are numerous benefits of using e-filing such as it is accessible anytime and anywhere, accurate tax calculation, no loss of form and secured data (IRBM, 2022).

Every person in the country will calculate their own tax payables and receivables and determine if they are qualified and eligible for exemptions and reliefs under SAS system (Sritharan and Salawati, 2019). SAS is conducted to reduce the country's troublesome administrative load and it also assumes all information supplied by the taxpayer is valid and that IRBM officials are not required to check it (Jaidi, Noordin and Kassim, 2013). In this context, the tax authorities place a high value on taxpayer morale while completing the tax return because the taxpayer is trusted and given accountability, the conduct of each individual taxpayer affects the country's degree of tax compliance behaviour.

Malaysian SAS has its own goals, which are to collect the precise tax amount in an efficient manner, to maintain Malaysian taxpayers' confidence and honesty, and to encourage voluntary compliance behaviour. It is undeniable that governments all around the world spend a great deal of thought into tax collection. As a result of the significant differences in the SAS mechanism, especially with regard to filing processes (no supporting documents attached), assessments (no detailed scrutiny assessments), and a competency issue (tax knowledge), it is anticipated that these significant changes (to an SAS) could potentially make tax knowledge a much more important factor when determining the accuracy of tax returns and thus more directly affect tax compliance. In summary, to fulfil one's tax obligations in Malaysia, taxpayers are required to submit Income Tax Return Form (ITRF) through e-filing or by manual, declare their income and expenses, compute income tax payable, keep records for audit purposes and pay income tax payable before the due date (Lembaga Hasil Dalam Negeri, 2020).