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Compliance Risk Management Strategies for Tax Administrations in Developing Countries: A Case Study of the Malaysian Revenue Authority

By

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A thesis submitted in partial fulfilment of the requirements for the degree of Doctor of Philosophy

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Declaration

This is to declare that:

- I am responsible for the work submitted in this thesis.
- This work has been written by the author.
- All verbatim extracts have been distinguished and the sources specifically acknowledged.
- This work has not previously been submitted within a degree programme at this or any other institution.
- During the preparation of this thesis a paper were prepared and presented as listed below.

Conference Presentations:

2012 “COMPLIANCE RISK MANAGEMENT STRATEGIES FOR MALAYSIAN TAX ADMINISTRATION”, 24th Australasian Tax Teachers Association Conference, 16-18 January 2012, the University of Sydney, Sydney, Australia.

- The remaining parts of the thesis are unpublished.

Signature: 

Date:

Abstract

The aim of this study is to achieve a better understanding of risk management as practised by tax administrations of developed countries and to ascertain what prevents the developing countries from managing risks efficiently and effectively. Tax administrations are faced with challenges to ensure voluntary compliance with the tax law. Compliance risk that is generally faced by tax administrations in relation to the implementation of the Self-Assessment System (SAS) is further explored. A well-designed risk management strategy enables tax administrations to manage risks efficiently whilst reducing administrative costs in the process. The empirical evidence indicates that, in developing countries, the level of compliance is generally low and the administrative capability of tax agencies is relatively poor. In an effort to increase tax compliance, tax administrations in developing countries tend to adopt a traditional approach to their duties by implementing a command-and-control mechanism.

The majority of tax compliance research has been written from the perspective of taxpayers. This study, in contrast, investigates the perspective of a tax administration in a developing country; hence the Malaysian Tax Administration, also known as the Inland Revenue Board of Malaysia (IRBM) has been selected as a case study. Compliance risk management by the IRBM is addressed in order to understand the agency's activities that are designed to encourage voluntary compliance and manage compliance risk. This qualitative research uses responsive regulation theory as a concept to underpin this investigation. This study also develops a conceptual framework which combines three major themes: tax compliance, risk management and responsive regulation. Responsive regulation in the tax administrations of developing countries is considered a new concept, thus warranting further study. Responsive regulation encourages a soft approach to handling non-compliant taxpayers, resorting to a hard approach only if taxpayers refuse to comply. Empirical data was collected through face-to-face interviews with senior officials of the IRBM and tax practitioners in Malaysia to elicit the interviewees' perceptions of risk and IRBM risk management practices. To enrich data collection, secondary data was collected from a range of published and unpublished printed materials from the IRBM.

Findings from this study suggest that IRBM risk management strategies conform to responsive regulation theory. Various education programmes are conducted by the IRBM to assist and encourage voluntary compliance. The study reveals that Malaysian taxpayers' compliance behaviour is influenced by tax knowledge, culture and their perceptions of the government administering the revenue. Knowledge gained from this study would provide insights for tax administrations in other developing countries of IRBM risk management practices in fostering voluntary compliance and self-regulation.

Abbreviations

APEH	National Tax and Customs Administration of Hungary
ATO	Australian Taxation Office
CATA	Commonwealth Association of Tax Administrators
CEO/DG	Chief Executive Officer/Director General
CETF	Cash Economy Task Force
CRO	Chief Risk Officer
CSD	Customer Service Department
CTSI	Centre for Tax System Integrity
EC	European Commission
HMRC	Her Majesty's Revenue and Customs, United Kingdom
IMF	International Monetary Fund
INTACTSG	Integrated Tax Assessment and Collection for SG and OG
IRBM	Inland Revenue Board of Malaysia
IRS	Internal Revenue Service, USA
OECD	Organisation for Economic Co-operation and Development
MDD	Managing Deliberate Defaulters
NTA	National Tax Agency Japan
NZIR	New Zealand Inland Revenue
SAS	Self-Assessment System
RMD	Risk Management Department

Notes:

OECD and IMF are the international institutions which have interest in studying the systems, policies and procedures of areas such as economics, social, environmental, financial including tax administration. The objectives of the studies are to compare policy and experiences amongst governments, seek answers to common problems and identify good practices. Then they would contribute ideas and recommendations on how to improve the administration so that tax authorities would run their organization more effectively and efficiently.

Chapter 1

Introduction

1.1 Research Objective and Motivation

The aim of this study is to achieve a better understanding of risk management in practice as conducted by tax administrations in developed countries and of the problems faced by developing countries that prevent them from managing risks efficiently and effectively¹. To understand the practice of managing risks, this research explores the potential compliance risks affecting revenue collection for tax administrations in developing economies generally, and the Malaysian tax administration, also known as the Inland Revenue Board of Malaysia (IRBM), in particular. The study also investigates risk management practices by the IRBM and obtains insights of IRBM officials' perceptions of these risk management strategies. Hence, this study seeks to fill the literature gap in risk management strategies for tax administration in developing countries. Furthermore, the objective of the research is to study the risk management systems and compliance models implemented by other countries and to analyse whether the systems or models are appropriate for the Malaysian tax administration.

This research focuses on tax administrations in the developing countries because, according to the literature (Trasberg, 2004; Katsios, 2006, Baurer, 2005, Bird and Zolt, 2008), there are many issues pertaining to internal or external risks faced by these tax administrations. Previous studies have presented the success that the Australian Taxation Office (ATO), Her Majesty's Revenue and Customs (HMRC) and the Internal Revenue Service of the USA (IRS) have had in increasing

¹ "An effective tax administration requires establishing an environment in which citizens are induced to comply with tax laws voluntarily, while efficient tax administration requires that this task be performed at minimum cost to the community" (Bird, 2004:138).

taxpayer compliance through their risk management strategies. By learning about their strategies and adopting some of them, tax administrations in developing countries may be able to improve taxpayer compliance in their own countries. As one of the developing countries, Malaysia is chosen as a case study for this research to explore how the IRBM manages compliance risk since the implementation of Self-Assessment Systems (SAS) to individual taxpayers for the 2004 assessment year.

At the time of study, to the best of my knowledge, there is no published study relating to the issue of risk management in Malaysian tax administration or the perceptions of IRBM officials towards managing compliance risks in the era of SAS. The lack of empirical evidence has shaped the motivation for this study, which sets out to fill the knowledge gaps related to risk management strategies by the IRBM. SAS has been implemented in Malaysia since the 2004 assessment year for individuals, businesses, partnerships and cooperative taxpayers. With nine years' (2004 to 2012) experience of running the SAS, it is time to explore how IRBM officials manage the internal and external risks which may impede the effectiveness of SAS.

Until 2008, according to my experience working in the IRBM, there was no formal risk management process formulated by the organisation. I was aware of the subject of risk management after reading an article published in a tax journal in Malaysia. Curiosity about risk management motivated me to explore this subject to find out if tax compliance activities conducted by the IRBM meet the criteria of the risk management process. When I started my PhD, I was interested to explore this subject in academia so I could bridge the knowledge gap in terms

of risk management in the Malaysian tax administration whilst conducting an empirical investigation of the internal and external risks faced by the IRBM and examining how risks are managed and how the IRBM officials perceive the risk management practices. Internal risks are risks or challenges faced by the IRBM resulting from factors within the organisation itself (Black, 2005; EC, 2006; OECD, 2001), whilst common external risks faced by revenue bodies (regulators) would be law and policies, stakeholders, customers, safety, security, economics, financial and politics, to name but a few (Black, 2005; OECD, 2010; EC, 2006; Braithwaite, 2003; Bird, 2004). Moreover, a more specific risk often faced by tax administration is compliance risk in relation to implementation of the SAS, which is explored in this study. Best practices in managing compliance risks by tax administrations, such as the ATO, the HMRC and the New Zealand Inland Revenue (NZIR) are described.

Appropriate regulatory response strategies by regulators may encourage taxpayers (regulatees) to cross-over the compliance boundary from non-compliance to compliance (Gracia and Oats, 2012). Thus, this study addresses the means by which the IRBM manages internal and external risks responsively. Findings from this study can inform other tax administrations, particularly from developing countries, about how Malaysia manages tax compliance risk. The findings can provide a platform for the IRBM and other tax administrations of developing countries to evaluate their existing risk management practice and to understand how the risk management concept can be applied to improve voluntary compliance in their administrations.

This chapter begins by describing the research questions of the study in Section 1.2. This is followed by Section 1.3, which outlines the empirical, methodological and conceptual contributions of the research. Next, Section 1.4 provides the research background of the study. The research methodology and methods for gathering data are described in Section 1.5, whilst Section 1.6 justifies the scope of this research. Finally, the chapter concludes with the structure of the remainder of the thesis, in Section 1.7.

1.2 Research questions

Empirically, this study places the focus on practices for managing compliance risk by tax administrations of developing countries. As this study investigates the IRBM current practice in managing compliance risk in its administration, it addresses the main research question: **“In what way does the IRBM manage tax compliance risks?”**

This question is concerned with understanding the potential strategies to be adopted by the IRBM to manage risks. In order to answer the main research question, three sub-questions were derived to explain the study further. The sub-questions are:

- i. **“What are the internal and external risks faced by the IRBM?”**
- ii. **“What are the perceptions of IRBM officials and Malaysian tax practitioners of Malaysian taxpayers’ behaviour?”**
- iii. **“How does the IRBM manage internal and external risks including non-compliance risk?”**

To the question of **“What are the internal and external risks faced by the IRBM?”** the study explores the internal and external risks faced by the administration, which are discussed in Chapters Five and Six. Interview data and secondary data are analysed to obtain answers to the research question, which seeks insight into the risk management practices in the IRBM and sets out to explore the officials’ perceptions of the current practice.

Further, the question **“What are the perceptions of IRBM officials and Malaysian tax practitioners of Malaysian taxpayers’ behaviour?”** explores participants’ understanding of the EC’s compliance pyramid and their views of how the IRBM should improve its risk management strategies. These findings are presented in Chapter Seven. During the interviews, it was found that one of the major activities undertaken by the IRBM to manage tax compliance risks is taxpayer education programmes. Hence, to provide answers to the final question, which is **“How does the IRBM manages internal and external risks including non-compliance risk?”** Chapter 8 discusses various educational activities designed to encourage voluntary compliance by Malaysian taxpayers.

Answers to the research questions comprise one contribution of the study. The next section lists other contributions of the research.

1.3 Contributions of the research

1.3.1 Empirical contribution

The study contributes to knowledge of how tax administrations operate in practice, particularly those in developing countries. Most of the empirical studies on tax administration in Malaysia are of tax education, tax compliance, tax evasion, taxpayer behaviour, and recently more technical subjects, such as transfer

pricing and forensic accounting. However, so far, there is no empirical study of risk management in Malaysian tax administration. This study fills the literature gap in relation to managing risk by tax administration in Malaysia. Moreover, the area of responsive regulation in tax administration warranted further study, particularly from the perspective of tax administration of developing countries. As this study also addresses responsive regulation extensively, the relationship between responsive regulation and risk management is highlighted in the study.

Furthermore, the vast majority of tax research in the Malaysian context has been written from the perspective of taxpayers, salaried earners as well as small-business or sole-proprietors taxpayers, to understand their compliance behaviour (Azmi and Perumal, 2008; Sapiei and Abdullah, 2008; Pope and Mohdali, 2010; Choong and Wong, 2011). However, this study provides an important insight and contributes to an understanding of how tax officials, particularly Malaysian tax officials, operate in the SAS environment. Interviews have been carried out to explore IRBM officials' perceptions of taxpayers' compliance behaviour and also of the risk management practices by the IRBM.

Previous research has made a small contribution to the literature based on interviews with revenue officials, such as that of Boll (2011) on Danish Tax and Customs Administration responses towards tax compliance, and Tuck (2007) on HMRC responses towards corporate tax compliance. ATO officials' were also interviewed to obtain their perceptions of the compliance pyramid and the responsive regulation approach when first introduced in Australia (Murphy, 2004; Job and Honaker, 2003; Hobson, 2005); whilst Morris and Lonsdale (2005) have studied the compliance model of NZIR. Thus, this study adds to the literature by examining Malaysian tax officials' perceptions of enforcement strategies to

increase voluntary compliance in Malaysia. As an IRBM officer, the author has privileged access to meet and interview senior executives of the IRBM and collect some internal documents for the study.

1.3.2 Methodological contribution

With reference to other studies conducted by IRBM officials and academic researchers in the Malaysian context, most of the researchers have used a quantitative approach in their studies (Palil, 2010; Sotimin, 2010; Sia, 2008; Ibrahim and Pope, 2011; Kasipillai and Abdul Jabbar, 2006). The use of surveys (Song and Yarbrough, 1978), questionnaires (Eriksen and Fallen, 1996) or laboratory experiments (Alm et al., 1992) is a common research design for data collection, particularly in tax research. There are very few qualitative studies that have been conducted in Malaysia for tax compliance related research. However, this study enriches the existing qualitative research by providing a methodological and empirical contribution using a qualitative approach.

Face-to-face interviews were conducted with IRBM officials and Malaysian tax practitioners to obtain insights into interviewees' perceptions of SAS and tax compliance in Malaysia as well as compliance risk management by the IRBM. The interview has been selected as a research method for this study because the author believes that rich information could be obtained through interviewing. The interviewer would be able to request participants to elaborate on their answers to gain in-depth information. Semi-structured interviews were used in preference to structured questions because the rigidity of the latter would deprive interviewers of the freedom to ask other questions. The semi-structured method, on the other hand, allows interviewers make a note beforehand of questions they might ask depending on the flow of the interview, and then add these questions

spontaneously, thus obtaining richer responses. To enrich data collection, secondary data was collected from a range of published and unpublished printed materials from the IRBM. The documents were then analysed to look for related themes and to establish findings for the study.

1.3.3 Conceptual framework contribution

Another contribution of the study is that it provides a conceptual framework which combines two main compliance risk management models from the EC (2010) and the OECD (2004). Both models are addressed in Sections 3.4.2 and 3.4.3 respectively. The OECD and EC models have been chosen as components of the framework as both provide guidelines to tax administrations in managing compliance risks, which is related to this study.

The risk management process incorporated in the models also applies the common or standard risk management steps suggested in the risk management literature (IRM, 2002; Black, 2005; Thompson, 2008). The conceptual framework integrates three main themes of this study: tax compliance, compliance risk management and responsive regulation. The pyramid shape of compliance model, which has been adopted by a number of tax administrations such as the ATO, HMRC and NZIR, has been modified into a lamp-shade shape to represent the size of the shadow economy, one of the main risks faced by developing countries. The conceptual framework is presented and discussed further in Section 8.8.

To understand further the objective of the study, the following section presents a general overview of the research background, such as the risks faced by tax administrations, especially in developing countries, and the concept of risk management. Furthermore, the section describes tax compliance risk as the type

of risk emphasised in this study. The section also introduces briefly the responsive regulation theory as a strategy for compliance risk management.

1.4 Research Background

1.4.1 Risk faced by tax administration in developing countries

Taxation plays a crucial role in promoting economic activity and growth. Through taxation governments ensure that resources are channelled towards the development and welfare of its people. For this reason, tax administrators shoulder a heavy responsibility to assist their government in bringing about this economic development. It is the expectation of stakeholders that tax administrators will be highly professional, skilful and competent in order to provide better delivery of service, effective compliance strategies and an increase in revenue collection. In the effort to achieve the targets set by the government to collect revenue, tax administrations are faced with various challenges, both internally and externally. Inefficient administration, technological change, corruption and the cash economy are among the high category risks identified in the literature that affect the efficiency of revenue administrations in developing countries (Trasberg, 2004; Katsios, 2006, Baurer, 2005, Bird and Zolt, 2008).

Developing countries, in the context of the present study, refer to those where citizens have an upper-middle-income², as listed by the World Bank. These countries fall into the same income group as Malaysia, hence a fair comparison can be made in terms of economic and financial ability to develop the country. However, other countries may learn from the experience of the Malaysian tax

² Economies are divided among income groups according to its gross national income (GNI) per capita for 2010, calculated using the World Bank Atlas method. The groups are: low income, \$1,005 or less; lower-middle income, \$1,006 - \$3,975; upper-middle income, \$3,976 - \$12,275; and high income, \$12,276 or more (World Bank, 2011)

administration and use its current practice of risk management as a platform to formulate or enhance risk management strategies in their administrations. This study explores the types of risk faced by tax administrations in developing countries in the following sections.

1.4.1.1 Poor administration

Low tax compliance is a serious concern for tax administrations of many developing countries since it affects revenue collection for state development (Das-Gupta et al., 2004; McCarten, 2006). One of the major challenges is how to foster voluntary compliance with the tax laws (Baurer, 2005), due to a number of factors that create inefficiency: corruption, a large informal sector, ambiguity in tax laws, a weak legal system, high marginal tax rates, insufficient information and a culture of non-compliance (Das-Gupta et al., 2004; McCarten, 2006; Alm et al., 2006). The literature (Song and Yarbrough, 1978; Torgler, 2003; Wenzel, 2002; Feld and Frey, 2005; Kirchler et al., 2008; Alm et al., 1992; Frey and Torgler, 2007) also suggests that tax non-compliance is influenced by various factors, such as culture, personal values, norms, government policies and demographics. In addition, tax administrations in developing countries appear weak because governments have deliberately chosen not to make them stronger (Bahl and Martinez-Vazquez, 1992, p.98) and have tended to resort to the traditional approach of enforcement (Braithwaite, 2005). McLure Jr. and Pardo further state that income tax laws that are recognised as impossible to administer, inviting the taxpayer to “cheat in self-defence, knowing that everyone else is cheating” (1992, p.127).

Many studies of tax administrations in developing countries acknowledge that these countries still lack an efficient administration (Bird, 2008; Brautigam, 2008;

Bahl and Martinez-Vazquez, 1992). Hogue (2004) points out that a government is unable to achieve the desired target in revenue collection if the operation of the tax administration of a country is inefficient. Bahl and Martinez-Vazquez (1992) and McCarten (2006) assert that outdated procedures, lack of enforcement activity and insufficient training for staff have resulted in inefficient tax administrations. Consequently, their objective to collect a targeted amount of revenue is not achieved and this has resulted in insufficient funds being amassed to strengthen their countries' economies.

Moreover, Baurer (2005) identifies numerous characteristics of tax administrations in developing countries, such as a lack of interest in implementing a self-assessment system; lack of specialization among the tax personnel; lack of attention to taxable non-filers (yet unnecessary attention towards registered taxpayers); inadequate controls to prevent corruption both internally and externally; inadequate written operating procedures as well as minimal taxpayer education and assistance. Other features include poor internal communication; lack of training for personnel; limited use of technology and the absence of identification numbers for taxpayers. Tax administrations are further characterised by inadequate numbers of staff and revenue offices; the lack of a strategic business plan from the management; political influence; lack of coordination between revenue bodies and other government agencies and large tax liabilities due to a focus on enforcement rather than collection, which is not aggressively pursued.

1.4.1.2 Corruption

Another risk faced by tax administrations, particularly those of developing countries, is corruption. Akdede (2006, p.141) defines corruption as “an illegal

activity of a government official to gain a personal benefit”, while Kunio Senga³, speaking at the ADB/OECD Initiative for Asia and the Pacific meeting in September, 2010, stated that “corruption challenges remain serious in the Asia and Pacific region”. Senga’s statement is consistent with those of Olken and Pande who claim that “corruption is high in developing countries” (2011, p.2), and Bridi who posits that “revenue administration is often ranked as one of the poorest performing public sectors in terms of corruption” (2010, p.1).

The literature suggests a number of elements that provide the opportunity for corruption in tax administration: poverty, poor leadership, low risk of punishment, poor internal detection and a low level of technological advancement (Bridi, 2010; Bird and Zolt, 2008, Kangave, 2005). Bridi (2010, p.1) attributes corruption to complex tax legislation, lengthy procedures, the high discretionary powers given to officials and the “low cost of punishment”. Bird (2010) further states that: “in some countries, bribery is so common that it is considered a regular part of the compensation of tax officials”. This unethical activity causes the country to suffer revenue leakages and creates a sense of distrust in the tax system on the part of the taxpayers. The Times of India (June, 2010) reports a statement made by an official of the World Bank that “corrupt practices are robbing the developing nations of as much as USD 40 billion annually”. Bridi (2010) also states that corruption leading to tax evasion has caused some tax administrations to lose revenue.

There is a mixed response in the literature over whether an increment in wages is a solution to the issue of corruption. An increase in the salaries of personnel is consistent with suggestions by Gill (2003), USAID (2007) and Abdullah (2008)

³ Director General of the Asian Development Bank’s Southeast Asia Regional Department.

that this may motivate staff to work harder and may prevent corruption. However, Fjeldstad (2005) argues that a higher salary might even encourage corruption as there may be an expectation from the community that an officer should earn more to help them.

Tax reforms may be a further step towards managing corruption risk if the automation of certain procedures reduces human intervention in the process (Bird and Zolt, 2008). However, Bridi (2010) finds that tax reform may not be possible in some tax administrations due to rampant corruption activities in the administration itself, as demonstrated in the early 1990s, when Indonesian tax officials (the main participants in corruption practices in the agency) protested against efforts to reform the Indonesian tax administration (Bridi, 2010, p.3).

This author reports an interesting conversation in January 2012, with an officer from the Bangladesh tax administration, whose statement is consistent with the Indonesian scenario. According to the officer, reform of the Bangladesh tax administration appeared to be difficult since a culture of corrupt practices had become the norm within the organisation. It might therefore be challenging to first reform the attitudes of the people before reform of the organisation could take place.

It has been further recommended that corruption may be reduced by practising transparency of access to information, and “enabling information about government actions, thus citizens can better monitor government officials” (Olken and Pande, 2011, p.30). Moreover, corruption is one of the elements hindering a country’s development since governments are dependent on revenue collection to

stimulate their country's economy. Consequently, tax administrations may need to develop efficient risk management strategies to manage the corruption risk.

1.4.1.3 Shadow Economy

Managing shadow economies presents another major challenge to tax administrations. The shadow economy - also known as the underground economy, the black market, the unofficial economy and the hidden economy - is a business activity operating outside the tax system (Russell, 2010a). Frey and Schneider (2000, p.2) note additional terms by which the shadow economy is known: "informal, irregular, parallel, second, underground, subterranean, hidden, invisible, unrecorded and/or moonlighting". The threat brought by the shadow economy has been addressed quite broadly in many tax administration conferences and seminars, such as the OECD conference, meetings of the IMF and the World Bank seminars, as well as the revenue authorities' own meetings.

As the shadow economy results in loss of revenue due to tax evasion, it is a major issue in both developing and developed nations (Frey and Schneider, 2000). However, in the developed nations, this is not considered to be too serious, due to stringent enforcement of punishments by the law and an effective system of tracking and monitoring such activities (Schneider, 2006).

Katsios (2006) divides shadow economy activities into two categories of activity, legal and illegal, both of which involve monetary and non-monetary transactions and eventually lead to tax evasion and tax avoidance. Various reasons, such as a high tax burden on individuals and companies, the onus of government regulations and weak tax administrations, have been attributed to shadow economy activities (Trasberg, 2004; Katsios, 2006).

In addition, Frey and Torgler (2007, p.144) assert that “a large shadow economy reduces the state’s ability to collect taxes and thus affects revenues that the government uses to provide public goods and to build trustworthy institutions”. The incentive for enterprise to evade tax increases and more bribes are paid in exchange for a promise of protection. Furthermore, according to Schneider (2006, p.5), the underground economy includes “all market-based legal production of goods and services that are deliberately concealed from the public authorities for reasons, such as avoiding payment of tax and social security contributions, avoiding having to meet certain legal labour market standards and avoiding compliance with certain administrative procedures.”

In order to curb the shadow economy, Frey and Schneider (2000) suggest deterrence as a more effective enforcement approach by imposing higher fines and imprisonment on those involved. They also assert that other measures should be taken “by improving the efficiency of public services, reducing the tax and social security burden imposed on labour and/or by raising civic virtue has been used only rarely” (Frey and Schneider, 2000, p.10). Also, Schneider and Buehn (2007, p.36) found that the shadow economy “increases corruption in low income countries”. Therefore, it is a responsibility of every government to formulate strategies to manage the shadow economy effectively so that such activities could be reduced and revenue increased.

1.4.1.4 Lack of sufficient information and communication technology

Most tax administrations encounter the same problems in their administration, such as an expanding workload, an increase in operational costs and high expectations from taxpayers for an improved service. Tax administrations of most developing economies still run their operations manually due to inadequate

financial resources to invest in modern technology, a lack of expertise in using the technology and insufficient infrastructure to accommodate the new technology (Gutierrez, 2002). The Commonwealth Association of Tax Administrators (CATA) encourages tax administrations in developing nations to introduce computerised information systems to improve customer service, facilitate information-gathering, increase tax compliance and save operational costs.

The World Bank (2000, p.1) notes “computerization to be an important element of capacity-building in revenue administration”. Even though many agree that technology is an efficient tool to enhance efficiency in an organisation, the high cost of obtaining and maintaining the hardware and software, including consultation fees, has delayed efforts to use modern technology in the administration (Bird and Zolt, 2008; Olken and Pande, 2011; Gutierrez, 2002).

Bird and Zolt (2008) identify a few problems faced by developing countries when considering the use of technology in their administration. One of these is resistance to change: when presented with a new challenge most existing staff are comfortable with current practices and refuse to cooperate with plans to change. Another issue is lack of personnel who are sufficiently trained and skilled in technology to ensure that technological innovation can be implemented successfully. Lack of political will is yet another element to cause failure in implementing technology in some tax administrations. Nevertheless, tax administrations, especially those in developing nations, are encouraged to use the Information and Communication Technology (ICT) to ensure efficiency in information processing, effectiveness in service deliveries and in reducing the administrative burden (OECD, 2010a).

Technology can be successfully employed to enable taxpayers to file their return forms through e-Filing, while modern call-centres can provide taxpayers with fast and easy access to tax information and, at the same time, improve communication between tax administration and taxpayers (OECD, 2010a). Improving system technology may also expedite the process and improve procedures whilst easing and simplifying compliance, which eventually facilitates effective revenue collection (World Bank, 2000). In addition, computerisation of work processes may improve efficiency in revenue collection, provide faster services such as refunds, and expedite enforcement activities in detecting non-compliant taxpayers and selection of cases for audit. But while computerisation seeks to enhance revenue, this should not be the sole objective of tax computerisation projects. Information technology can also increase the transparency of tax administrations and reduce corruption. It can improve taxpayer service and integrate communication between tax authorities and the private sector, as well as the exchange of data with other government agencies (OECD, 2010a).

This section discusses the type of risks identified by the literature. The next step is to learn about the process of managing risks by tax administrations. Thus, next section introduces one of the main themes of the study, which is risk management.

1.4.2 Risk management

One of the government's regulatory agencies is tax administration, which has the main role of collecting revenue for the development of the country. In the effort to achieve the objective of collecting revenue and fostering tax compliance, tax administration faces a variety of risks and challenges of its own. Unlike the army, the police or nuclear scientists, tax officials may not have to face a life-threatening crisis in their daily operation but there are certain risks that threaten the

administration's ability to achieve the desired objectives of increasing collection of revenue. Economic down-turns, financial crises and natural disasters, are among major threats that may result in taxpayers' inability to pay the taxes they owe. The 2007-2009 financial crises in the UK has resulted in the closure of many businesses and flooding in some areas has resulted in the loss of income to businesses and damage to financial documents. In such cases, the traditional approach of strict and harsh enforcement is not an appropriate method to be implemented to demand compliance (Ayres and Braithwaite, 1992; Black and Baldwin, 2010).

As agreed by the European Commission, "historically, many tax administrations have addressed compliance risks only in terms of enforcement programmes" (EC, 2010, p.19). When faced with circumstances beyond the control of the public, tax regulators are advised to be more understanding and sympathetic towards unforeseen events faced by taxpayers (Ayres and Braithwaite, 1992; Braithwaite et al., 2005; Black and Baldwin, 2010). While tax authorities need to carry out their responsibility of ensuring compliance, at the same time a softer approach can be applied to achieve compliance (Ayres and Braithwaite, 1992; Braithwaite et al., 2005) through negotiation for instalment payment or allowing extension of the due date for return forms submission, among other considerations. Through this responsiveness, revenue officers may gain more respect and trust from the public (Kirchler et al., 2008; Feld and Frey, 2005; Alm et al., 1992) whilst maintaining compliance in tax payment and tax form submission.

The OECD (2001) suggests that a systematic process needs to be developed to respond to these challenges should they recur in the future. These processes,

which are also known as risk management, ensure that the objectives of tax administrations are achieved and, at the same time, the safety of the revenue staff is protected (OECD, 2001). However, in their effort to meet objectives, tax administrations should: “use their limited resources in the most cost effective manner” (OECD, 2010d, p.3). A well-designed and properly planned risk management strategy may enable tax administrations to identify, assess, prioritise and treat the compliance risks faced by the administrations effectively (Thompson, 2008; IRM, 2002; EC, 2006; OECD, 2010a). Thus, the literature suggests that tax administrations should be proactive and innovative in looking for solutions to manage the risks (OECD, 2004; EC, 2006; Bird, 2004).

As discussed earlier, regulators in developing countries are faced with various constraints, such as human resources, financial resources, the shadow economy, the information technology system and inefficiency resulting from lack of technical knowledge, which can all result in weakness in their enforcement capabilities (McCarten, 2006; Bridi, 2010; Russell, 2010a; Bird and Zolt, 2008). Consequently, “many tax administrations in developing countries still resort to deterrent measures in their attempt to create fear among tax evaders to prevent future tax offenses” (Braithwaite et al., 2005).

Empirical evidence suggests that a stricter enforcement regime is likely to induce greater compliance (Andreoni, Erard and Feinstein, 1998; Slemrod and Yitzhaki, 2002; Sandmo, 2004). Enforcement tools such as penalty imposition and auditing probabilities may be effective methods of reducing tax evasion (Franzoni, 1998; Devos, 2007). Taxpayers who always comply with the law may regard the deterrent approach as fair treatment by the authorities towards non-compliance

and may increase their trust in the administration. However, eliciting compliance through enforcement measures involves high cost (Ayres and Braithwaite, 1992; Welsh, 2009) and therefore may not be an appropriate strategy to be employed by developing countries.

As suggested by the OECD (2010a), in the process of increasing voluntary compliance, tax administrations need to reduce administrative burdens as the government expects (OECD, 2010a). “Tax administrations must foster, and not simply enforce, tax compliance. This includes facilitating compliance, monitoring compliance and dealing with non-compliance” (EC, 2010, p.19). Therefore, to encourage voluntary compliance and foster self-regulation, the OECD (2004) and the EC (2006) recommend that tax administrations understand the attitudes of taxpayers that motivate them to comply or evade tax law. “Without knowledge about taxpayer behaviour and the effectiveness of treatment strategies, good decisions cannot be made” (EC, 2010, p.19).

Understanding taxpayer behaviour may assist regulators in encouraging taxpayers to comply voluntarily when dealing with their tax obligations, especially under the SAS which requires taxpayers to self-report and self-assess their tax liabilities. Failure of taxpayers to meet their tax obligations results in compliance risk (OECD, 2004). The next section discusses the compliance risk faced by regulators in the SAS environment.

1.4.3 Compliance risk in Self-Assessment System

Compliance risk appears to be the main risk faced by all tax administrations. It results in loss of revenue and consequently affects the economic contribution to the country (OECD, 2004). The literature suggests that non-compliance of tax

laws is due to non-lodgement; late lodgement of current returns; incorrect information declared in the returns and non-payments or late payments of tax liabilities (Alm, 1999; Franzoni, 1998; Kirchler et al., 2008). In addition, taxpayers who fail to provide updated details, such as their new address and other relevant information, are also considered as not complying with the laws (OECD, 2001). According to Walpole (2009), under the SAS environment, taxpayers may tend to understate their tax liability, thus opening up opportunities for dishonesty.

Many tax administrations in developed and developing countries, such as the USA, the UK, Australia, New Zealand, Pakistan, Indonesia and a few others, have adopted SAS into their administration to enhance voluntary compliance, simplify submission of tax return and minimise massive workload problems faced by the administrations (Walpole, 2009; Loo et al., 2009; Loo and Juan, 2005). Tax authorities encountered challenges during the early stage of implementation of SAS, such as taxpayers' lack of tax knowledge and the refusal to self-assess tax returns (Sarker, 2003; Kimura, 2006; Palil, 2010).

Japan's initial challenge with the introduction of SAS was the problem of sole-proprietor taxpayers failing to keep proper accounting books, thus making it difficult for them to report their tax liabilities correctly (Kimura, 2006). During the early stages of SAS implementation, the HMRC experienced similar issues, whereby taxpayers perceived that the SAS was too complex and they were confused by some of the tax terminology used in the tax return (Palil, 2010). This problem was also due to taxpayers' lack of tax knowledge and confidence in the new system. These problems are not unique to HMRC alone but other tax

administrations share similar issues as well (Loo et al., 2009; Kimura, 2006; Sarker, 2003).

From the perspective of the developing countries, among the challenges faced by Bangladesh during the early years of SAS implementation was “a lack of tax education among taxpayers, poor public relation activities by the Bangladeshi tax authority and inadequate penalty provisions for tax defaulters” (Sarker, 2003). Other developing countries such as Indonesia, Pakistan, Cambodia and Sri Lanka share the same challenges in the SAS regime, which are lack of tax knowledge in self-assessment tax returns, lack of understanding of the benefits of SAS and a refusal to embrace SAS.

There also remain misconceptions about the objective of SAS, which is to reduce the tax administration burden whilst increasing the taxpayer’s contribution, in addition to tax administration inefficiency in managing the new system. All these issues have resulted in low compliance and a lack of trust in the tax administration. Hence, it is a challenge for revenue bodies to formulate risk management strategies to educate taxpayers of their responsibilities towards tax systems in the country. In order to manage compliance risks, the literature suggests that responsive regulation could be one of the approaches taken. Thus, next section addresses how responsive regulation could be adopted by tax regulators to encourage voluntary compliance.

1.4.4 Responsive regulation

Responsive regulation was first introduced by Ayres and Braithwaite in 1992 in their book “Responsive Regulation: Transcending the Deregulation Debate”. This book has become a major reference by scholars and researchers when addressing

the topic of responsive regulation. The idea of responsive regulation “started out as a theory of business regulation and has now been applied to crime, peace building, and a wide range of other private and public governance applications” (Braithwaite, 2011, p.1).

The theory of responsive regulation is that compliance should be fostered through persuasion and not punishment (Ayres and Braithwaite, 1992; Braithwaite, 2007). Responsive regulation promotes the concept that regulators should make an attempt to adopt soft approaches in managing compliance rather than the traditional hard approach commonly enacted by regulators. As noted by Braithwaite (2011, p.489), “the job of responsive regulators is to treat offenders as worthy of trust, because the evidence is that when they do this, regulation more often achieves its objectives”. In order to be responsive to their conduct, regulators are encouraged to be “fair, open-minded, respectful, not stigmatizing, and persuasive and cooperative” in the effort to promote compliance (Nielsen and Parker, 2009, p.382).

Ayres and Braithwaite formulated an enforcement pyramid (Ayres and Braithwaite, 1992, p.35) which illustrates the enforcement of law through various strategies based on the compliance responses of regulatees, as shown by each layer of the pyramid. The idea of the pyramid is that enforcement should start from the base, where persuasion and education encourage compliance. The broad base of the pyramid illustrates the majority of taxpayers have the intention to comply with the law; however they still require assistance and encouragement from the authorities. When regulatees display an act of non-compliance, regulators move up to the next layers to demonstrate another enforcement

strategy. Finally, at the peak of the pyramid, punishment such as sanctions and prosecutions will be enacted upon serious offenders.

In the 1970's regulators were known for adopting deterrence to enforce compliance (Murphy, 2004). Normally, punishment and sanctions create fear and resistance to compliance (Murphy, 2004; Ayres and Braithwaite, 1992; Feld and Frey, 2005) and may affect future compliance (Murphy, 2005). Punishment also could be time consuming and expensive (Murphy, 2004; Welsh, 2009; Ayres and Braithwaite, 1992) due to punitive activities, such as sanctions, penalty imposition and litigation procedures. In view of the negative impact of the deterrence approach, such as high cost to the regulators and resistance to comply by regulatees, responsive regulation champions (Ayres and Braithwaite, 1992; Braithwaite, 2003; Murphy, 2004) argue that responsive approaches such as persuasion and encouragement promote the efficient use of resources and encourage voluntary compliance and cooperation.

A soft approach, as recommended by responsive regulation, appears to be a strategy to nurture compliance because people generally prefer to be persuaded to comply and resist hard approaches (Murphy, 2005). They may regard the soft approach as procedural fairness and be more likely to self-regulate themselves to comply (Ayres and Braithwaite, 1992; Braithwaite and Braithwaite, 2001; Murphy, 2004). While promoting soft approaches to encourage compliance, responsive regulation also allows for punitive mechanisms to be enacted as deterrence, but this should be the last resort.

According to the regulatory pyramid, hard-approaches or punitive actions are enacted at the peak of the pyramid, targeted at the high-risk group of offenders.

By focussing on a specific group of regulatees, the efficient use of resources, such as human resources, time and funding would be devoted to manage these high risk people (Scholz, 1984; Ayres And Braithwaite, 1992; Braithwaite, 2003; Murphy, 2004). However, enforcement mechanisms should not be seen as a form of punishment but as an education to correct or inform offenders of the offences they have committed (Scholz, 1984).

The concept of responsive regulation is applied, adopted and adapted as a regulatory policy in various fields, such as health, nursing homes, the environment, security and tax administration. Tax administrations, including the ATO, NZIR, HMRC and some European countries, have adapted responsive regulation in their administrations to replace the traditional deterrence mechanism previously applied (Murphy, 2004; Waller, 2007; Hobson, 2003).

Through this theory, tax administration may improve compliance strategies from a command-and-control approach to a more responsive approach based on taxpayers' compliance responses. The enforcement pyramid suggests a range of enforcement mechanisms from which to choose, depending on the compliance behaviour of taxpayers. From the description above, responsive regulation appears to be the most suitable enforcement mechanism to be adopted by tax regulators to manage compliance risk; as noted by Leviner (2009, p.1) "responsive regulation may therefore constitute a superior method for regulating compliance."

The responsive regulation theory was adopted by Valerie Braithwaite and the Cash Economy Task Force to develop a compliance pyramid model in 1998 (CETF, 1998). The compliance pyramid has further been used by the ATO in its compliance strategies to improve voluntary compliance in Australia. Prior to

implementation of the compliance pyramid, the ATO was accused of ‘bully-boy tactics’, ‘excessive and unfair use of power’, that it was ‘out of touch’, ‘lacked understanding’ and made ‘poor use of penalties’ (Murphy, 2004, p.12). Eventually, with the application of responsive regulation in its administration, the ATO managed to increase the voluntary compliance of Australian taxpayers and helped taxpayers to comply (Murphy, 2004; Hobson, 2003; Job and Honaker, 2003).

The Compliance Model focuses not only on the taxpayers’ perspective but also provides understanding and enables ATO officials to treat taxpayers responsively (Hobson, 2003; Job and Honaker, 2003). ATO compliance strategies have become best practice and been referred to by many tax administrations. The pyramid model has also been adopted and adapted by various tax agencies such as the HMRC, NZIR, Timor Lester Inland Revenue and Inland Revenue Authority of Singapore (IRAS) and used as a guide by the European Commission (EC, 2006).

The HMRC has adopted a customer-focused approach in their effort to apply the concept of responsive regulation concept to their service delivery to taxpayers. Use of the term ‘customer’ instead of ‘taxpayer’ is an initiative to improve regulatory relationship between HMRC and taxpayers, hence enhancing voluntary compliance (Tuck et al., 2011).

The concept of responsive regulation is further enhanced by Baldwin and Black (2007) through the idea of risk-based responsive regulation. According to Baldwin and Black (2007, p.12) “the key components of the approach are evaluations of the risk of non-compliance and calculations regarding the impact

that the non-compliance will have on the regulatory body's ability to achieve its objectives".

The advantage of the risk-based regulation approach is that it provides "a systematic framework that allows regulators to relate their enforcement activities to achieve the objectives. This approach enables resources to be targeted in a manner that prioritises highest risks and they provide a basis for evaluating new regulatory challenges and new risks" (Baldwin and Black, 2007, p.13).

The HMRC has adopted a risk-based approach to investigation and compliance to monitor and enforce compliance with regulations by business (Black, 2008; HMRC, 2012). This approach applies the idea of responsive regulation whereby resources are used effectively to manage high risk taxpayers. According to HMRC (2012), the risk-based approach "uses comprehensive risk assessment to concentrate resources in the areas that need them most". Furthermore, this approach appears to be "the most cost-effective way to control the risks"; in the HMRC context, of money laundering⁴ and terrorist financing⁵ and it "allows focus on efforts and resources where the risks are highest" (HMRC, 2012a).

As noted by Singh (1993, cited in Loo et al., 2010) IRBM officials appear to conduct a command-and-control approach by adopting audits and penalties to enforce compliance. This study attempts to elicit the perceptions of IRBM officials and tax practitioners to verify the claims. The research also explores the

⁴ 'Money laundering is the process by which criminally obtained money and other assets (criminal property) are exchanged for 'clean' money or other assets with no obvious link to their criminal origins. Criminal property may take any form, including money or money's worth, securities, tangible property and intangible property. It also covers money, however come by, which is used to fund terrorism' (HMRC, 2010, p.3).

⁵ 'Terrorist financing includes proliferation financing which is assisting in the financing and/or development of nuclear, biological, radiological, chemical weapons and/or their means of delivery' (HMRC, 2010, p.3).

adoption of responsive regulation in encouraging compliance by tax administrations of developing countries, particularly by the Malaysian Tax Administration. Previous research relating to responsive regulation is discussed further in Section 3.5.

1.5 Overview of Research Design

As stated in Section 1.3.2, a qualitative approach is adopted as the research methodology for this study. This approach is well suited to obtaining insights and understandings about risk management practices of the IRBM and Malaysian taxpayer compliance behaviour. In line with this qualitative approach, empirical data was collected through face-to-face interviews with officials of the IRBM and Malaysian tax practitioners to obtain insights into the interviewees' perceptions of SAS and tax compliance in Malaysia as well as compliance risk management by the IRBM.

According to Yin (2003), a qualitative approach appears to be a suitable form of investigation to obtain some answers to the 'how' and 'why' questions. This is due to the fact that these questions are more explanatory and a survey alone might not be able to provide sufficient answers or information to the study. During an interview, the researcher may ask participants to elaborate on her/his thoughts, beliefs and ideas so that in-depth and more meaningful data could be collected (Silverman, 2000; Denzin and Lincoln, 2005).

To enrich data collection, secondary data was collected from a range of published and unpublished printed materials from the IRBM. The primary and secondary data collected were then analysed and coded using NVivo, computer-aided data analysis software. In addition, a risk-based responsive compliance model was

developed as a conceptual framework of the study. This framework represents the convergence of the theoretical concepts of tax compliance, risk management and responsive regulation.

1.6 Scope of Study

The scope of the study would be too large if all groups of taxpayers in Malaysia were to be investigated. Therefore, this study is confined to individual taxpayers. The literature review and the recommendations focus on individual taxpayers, who include employed and self-employed taxpayers, also referred to as business-income taxpayers and sole-proprietors. Out of a total of 5.07 million taxpayers in Malaysia, 5.04 million are individual taxpayers and self-employed or sole-proprietors. In terms of tax collection, this group of taxpayers has contributed 20.58% of the total revenue collected in 2010 (IRBM, 2010). Even though the percentage of revenue collected from these taxpayers is lower than that of corporate taxpayers (50.64%), the majority of taxpayers lie within the individual taxpayer group. By instilling in this group of taxpayers the notion of voluntary compliance, their tax affairs can be administered efficiently and IRBM personnel can instead concentrate their efforts on tax education, audit and investigation. With the correct strategies, the IRBM would be able to reduce the number of personnel required to manage individual taxpayers whilst adopting an efficient strategy to monitor this group to ensure high level of compliance.

The literature suggests that individual taxpayers, especially self-employed ones, seldom pay much attention to their tax obligations as they perceive taxation as a complicated subject and most of them are reluctant to make the time and effort to learn more about taxation (Kirchler et al., 2011; Rothengatter, 2005; Chong and

Wong, 2011). As a result, there is a tendency for this group of taxpayers to evade tax. In contrast, even though the corporate tax structure is evidently more complicated than the individual tax structure, having tax consultants to manage their tax affairs has resulted in corporate taxpayers being more compliant and systematic in managing their tax liabilities. Further, Pope and McKerchar (2011, p.7) have argued that “individual tax compliance is well-recognised as a complex and widely-researched behavioural issue which contains considerable scope for further research.”

In this light, it is a challenge for tax administration to manage the individual taxpayers, who appear to have minimal knowledge of tax subjects. By understanding their responses towards tax compliance, tax administrations may be able to adopt suitable responsive approaches to manage them.

1.7 Structure of the Thesis

Following the introduction to the research, where the background to the problem is discussed in Chapter One, the thesis is presented in Chapters Two to Nine. The background of the IRBM and its administration reforms are described in Chapter Two.

Next, Chapter Three summarises the previous literature of key themes to emerge from the research, which are tax compliance, taxpayer behaviour and attitudes towards tax compliance. The chapter also includes a review of the literature of other major themes of the study, which are risk management and its processes, along with the concepts of responsive regulation and risk-based responsive regulation.

This is followed by Chapter Four, which describes the methodology adopted in this research and data collection methods as well as the data analysis process. The empirical findings of this thesis are presented in Chapters Five, Six, Seven and Eight, which are organised to answer the research questions. The conceptual framework which puts together the process of compliance risk management and the concept of risk-based responsive regulation are also introduced in Chapter Eight.

Finally, Chapter Nine is the concluding chapter which discusses the findings and the contributions of this research to risk management for tax administrations. It also incorporates the research limitations, suggestions for future research and policy implication for the IRBM.

Chapter 2

Background of Malaysian Tax Administration

2.1 Introduction

The previous chapter introduced the background of this study and highlighted the research objectives, its contribution, the questions it raised, the scope and design of the research and the structure of the thesis. This research has selected the Malaysian tax administration, as a case study, which offered a close examination of how it managed its own risks as a developing country. In Section 2.2, the history of taxation, the current taxation systems in Malaysia and their background problems are presented. The tax administration explored in this case study, the IRBM, is then introduced in Section 2.3. The tax systems, the scope of charges, the functions of IRBM and tax administration reforms in Malaysia are also explained in this section. In Section 2.4, the Self-Assessment System in Malaysia is described and its scope for individuals, tax compliance challenges and tax education programmes are discussed. A description of the functions of the Risk Management Department in IRBM follows in Section 2.5, and, finally, Section 2.6 summarizes the earlier discussion of this chapter.

2.2 Tax Administration in Malaysia

2.2.1 History of tax administration in Malaysia

During the era of the Melaka and Johor-Riau Sultanate, also known as the Malay rulers, in Malaya, there had been a tax administration system and structure in existence which related in particular to the maritime and harbour activities of local and foreign merchants. During that period all tax-related matters, including tax collection, were the responsibility of the Chief of the Exchequer (Wilkinson, 1935, cited in RMCD, 2009). The responsibility for collecting taxes was bestowed

on the Harbour Master, who was entrusted by the king with the power to enforce rules on the tax laws.

In the early nineteenth century, the British colonial government introduced a systematic tax administration in Malaya, whereby government agencies were established to collect taxes, administer land, provide services to the people and develop the states (RMCD, 2009). The Malay Peninsula achieved full independence from the British in 1957, and the formation of Malaysia followed in 1963, consisting of the Malay Peninsula, Sabah, Sarawak and Singapore. However, due to social unrest and political disputes, in 1965 Singapore was declared an independent republic.

2.2.2 Tax System in Malaysia

Income tax was first introduced in the Malay Peninsula in 1948, in Sabah in 1957 and in Sarawak in 1961. Before then, there had been a series of events which led to the establishment of the income tax system.

According to Kasipillai and Shanmugan (1996), the process of proposing the income tax in Malaya started in 1910, but it encountered strong opposition from the people until the drafting of the Income Tax Ordinance in 1947, which marked “the beginning of a new era in taxation on a permanent basis in Malaya”. Prior to 1967, the Malay Peninsula, Sabah and Sarawak each had its own tax laws which were administered by the Inland Revenue Department (IRD) (Mahfar, 1994). The Income Tax Ordinance of 1947 was the first legislation governing income tax, taking effect on 1 January, 1948. It was subsequently repealed and replaced by the Income Tax Act (ITA) in 1967, which came into effect on 1 January, 1968 (Singh, 1992).

2.2.3 Scope of charge

The Malaysian taxation system consists of the direct and indirect imposition of taxes. Direct taxes comprise Income tax, Real property gains tax, Petroleum income tax and Stamp duty. The stamp duty is a tax on certain types of documents such as land transfers, loan agreements and lease agreements.

Direct taxes are administered by the IRBM, while the indirect taxes, which are administered by the Royal Malaysian Customs, consist of excise duty, import and export duty, sales tax and service tax (Kasipillai and Shanmugam, 1996). In 2010, the direct tax contributed 50.6% towards the total federal government revenue, compared with the indirect tax, which contributed 19.0% (MER, 2010).

The direct tax is imposed on income accruing in or derived from Malaysia. Malaysia's taxes are also assessed on a current year basis and are regulated by a self - assessment system for all corporate and individual taxpayers. The Tax Department in the Ministry of Finance is responsible for drafting tax regulations and legislation, while the IRBM is responsible for the implementation of the regulations and legislation at state and district levels.

2.3 Case Study: Inland Revenue Board of Malaysia

The Inland Revenue Department of Malaysia (IRD) was formed in 1957, becoming a board on 1 March, 1996, and is now formally known as the Inland Revenue Board of Malaysia (IRBM) (also referred to as the 'Board' in this thesis). As an agent of the Malaysian government, it is one of the main revenue collecting agencies of the Ministry of Finance of Malaysia and provides services in administering, assessing, collecting and enforcing payment of all types of taxes. The mission of IRBM is "To provide taxation services with quality and integrity

towards promoting voluntary compliance” while its objective is “To create and implement a fair and effective tax management system” (IRBM website).

IRBM was established in accordance with the Inland Revenue Board of Malaysia Act, 1995, to give it more autonomy, especially in financial and personnel management, and to improve the quality and effectiveness of tax administration. IRBM is responsible for the overall administration of direct taxes under the various acts, including the Income Tax Act, 1967; the Petroleum (Income Tax) Act, 1967; the Real Property Gains Tax Act, 1976; the Promotion of Investment Act, 1986; the Stamp Act, 1949, and the Labuan Offshore Business Activity Tax Act, 1990 (IRBM website).

2.3.1 Functions of the IRBM

The government of Malaysia has entrusted IRBM with various functions and responsibilities to ensure that the administration of direct taxes in Malaysia is implemented efficiently and effectively. As stated on the IRBM website, the Board acts as an agent of the government to provide administrative services in assessing, collecting and enforcing payment of income tax, petroleum income tax, real property gains tax, estate duty, stamp duties and such other taxes as may be agreed between the government and the Board. IRBM also is required to advise the government on matters relating to taxation and to liaise with the appropriate Ministries and statutory bodies on such matters. Furthermore, the Board has to participate within or outside Malaysia in respect of matters relating to taxation. It should also perform such other functions as are conferred on the Board by any other written law. Finally, IRBM may act as a collection agent for and on behalf of any body for the recovery of loans due for repayment to that body under any

written law (IRBM website). In its effort to inculcate a corporate culture in its administration, IRBM has developed a vision to be a Leader in Tax Administration and a mission to provide taxation services with quality and integrity towards promoting voluntary compliance.

Its objective is to create and implement a fair and effective tax management system, while its slogan is 'Together We Develop the Nation'. IRBM has also introduced a quality policy which aims to work with integrity as its foundation, and to commit to giving the best service to its customers. Finally, the service motto, to provide 'The Best Service for You' (IRBM website), has been developed as a reminder to its personnel and also as a vow to the public on IRBM's highest commitment towards ensuring an efficient tax administration in Malaysia. The organisation structure of IRBM is shown in Appendix 1.

2.3.2 Tax Reform in IRBM

“Generally tax reform is a restructuring and improvement in the tax system that includes the removal of imperfections, faults, errors or shortcomings in the tax system and the change in the distribution of tax burden” (ADBI, 2006, p.3). IRBM has undergone various transformations in its administration to improve the standard of Malaysian tax system. Since the mid-1980s until recently such changes have included the restructuring of tax rates, tax reliefs and tax rebates. New tax incentives were introduced and former tax incentives were reviewed to promote investment (ADBI, 2006). Other reforms were made, for instance, to the data processing system and service delivery, as well as the enhancement of the database system and the establishment of new branches (Veerinderjeet, 2003).

A significant change was the transformation of data processing from stand-alone data processing in 1985 to widespread ICT in early 2000. With the introduction of SAS for corporate taxpayers in 2001 and individual and other groups in 2004, IRBM has moved forward in the tax reform process to improve its administration and to foster voluntary compliance.

To further enhance the simplicity of SAS, e-Filing was introduced in 2006 to ease and expedite self-assessment of tax returns by taxpayers. More electronic services such as e-Payment, e-Ledger and e-Stamping were introduced to increase the quality of service delivery to the public.

McCarten (2006, p.427) has suggested that tax administrations should improve their taxpayer services by providing a single point enquiry system, a unique identification number for registered taxpayers and a single and integrated accounting framework; he has also recommended enforced collection and audit, dedicated information processing operations and support functions such as ICT, human resources and training. As highlighted in the IRBM Annual Reports, the Board had already taken some initiatives to improve its service delivery:

- A call-centre was established in 2005 as a one-stop centre for taxpayers' enquiries through telephone calls, e-mails and walk-ins.
- A unique number called a Tax Reference Number (TRN) was allocated to new taxpayers. The TRN has been issued since the early 1980s when IRBM started to automate the process which hitherto had been manual.
- An integrated accounting system known as Standard Accounting for Government Agencies (SAGA) was applied, designed to meet all the

requirements of accounting and auditing standards set for financial reports; it is also being used by other public sectors in Malaysia.

- To ease payment of tax, taxpayers are provided with a few options such as IRBM payment counters at headquarters, the Kuching (Sarawak) branch and the Kota Kinabalu branch (Sabah), at five selected commercial banks and at post offices, as well as by postal payments and internet banking to IRBM.
- Audit activities were improved, using an audit tool known as Computerised Audit Selection (CASE) which is designed to facilitate the selection of taxpayers to be audited in accordance with predetermined criteria established in CASE. With CASE, the selection process for audit cases is faster, audit actions can be executed quickly and the number of cases to be audited has increased.
- To support various functions in IRBM, office-automation was introduced in the late 1990s as a means of communication among IRBM staff, in order to support various functions in IRBM
- The information system and data processing was transformed from electronic data processing in the 1980s to server-based data management in the 1990s and later, to the automatic data storage and retrieval in 2005.

This modernisation is evidence of IRBM's serious commitment to introduce reform to become an efficient tax administrator in Malaysia by delivering excellent customer service to its customers in its effort to increase voluntary compliance. The automation also has achieved one of its objectives, which is to reduce administrative costs in revenue collection. IRBM has successfully reduced these costs from MYR1.19 (£0.242) in 2007 to MYR1.17 (£0.238) in 2008; there

were further reductions to MYR1.04 (£0.212) in 2009 and 2010 (Administrative Cost, 2010).

2.4 The Self-Assessment System in Malaysia

The new assessment system is a challenge not only to the taxpayers but also for IRBM (Loo, McKerchar and Hansford, 2009). As a result of their new responsibility for completing the return forms themselves, the taxpayers are required to know and understand the law and to learn the new system. While IRBM officials need to study the new regulations and systems, they also have to adapt to changes in procedures because the previous focus was on raising the assessment, but in the new environment they have to concentrate on auditing and service delivery. The objectives for adopting self-assessment in Malaysia are “to reduce administration costs, improve voluntary compliance rates and facilitate tax collections” (Loo et al., 2009, p.181).

2.4.1 Self-assessment for individuals

The SAS requires taxpayers to keep records and documents properly, fill the returns correctly, compute the tax accurately and finally submit the return form on time with the final payment of tax (if any). Prescribed return forms such as BE (for salaried income), B (for business income) and M (for non-resident individuals) are issued to individual taxpayers in the January of the following year, or earlier, and the deadline for submission is by 30 April. For the business income earners, such as sole proprietors and partnerships, tax filing is due on 30 June each year (ADBI, 2006).

With regard to the filing process, taxpayers first have the options of using the electronic return form, whereby assessment is completed electronically through

the e-Filing system; printing a pre-printed form from IRBM's website; or obtaining a hard copy from the IRBM office.

Taxpayers are required to calculate their taxes and furnished the return to IRBM as per the due date⁶ mentioned in the Act according to the categories of taxpayers. Under the tax law, "the DGIR is deemed to have made an assessment on the day the return is filed, the return is deemed to be the notice of assessment and the notice of assessment is deemed to be served on the date the return is filed" (ADBI, 2006, p.8).

No notice of assessment will therefore be issued for completed returns received in time. However, for late returns the DGIR issues an assessment with a penalty for late lodgement. If the return is not filed by the due date, a penalty for late lodgement of return will be imposed. The amount of penalty depends on the number of offences that the taxpayer has committed. A range of offences, fines and penalties rates is attached in Appendix 2.

On submission of Form BE/B/M, the forms are deemed to be the notice of assessment for which tax is due and payable on the same date as the filing deadline. Under the SAS regime, IRBM monitors taxpayers' compliance with the law through a desk audit and, if necessary, would conduct a field audit to check on some of the documents.

As stated in the Tax Audit Framework, taxpayers are required by the law to keep for seven years all the financial documents or receipts for payments they have

⁶ "For companies, cooperative societies and trust bodies it has to be filed seven months from the date following the close of the accounting period. For other categories of taxpayers, the due dates are 30th April for those without business income and 30th June for those with business income." (ADBI, 2006, p.8)

claimed, for the purpose of tax relief (TAF, 2009). IRBM officials would request the receipts and documents if any claims being made by taxpayers are suspicious.

Payment of tax liability should be made at the latest on the due date, either 30 April or 30 June depending on the category of taxpayer (ADBI, 2006). However, to ease the burden of payment on taxpayers, they are allowed to pay in instalments. Non-business income taxpayers are allowed to pay through Monthly Tax Deduction (MTD) system from their payroll, while business-income tax payers are permitted to pay instalments every two months according to the instruction provided by IRBM under Section 107B of ITA, 1967.

The SAS relies primarily on voluntary compliance by taxpayers (D'Ascenzo, 2008). As one of the objectives for the implementation of SAS in Malaysia is to reduce the number of IRBM officials required to raise the assessment (Loo and Juan, 2005), the workforce can therefore concentrate on tasks related to education, compliance and investigation. The Board faces challenges in fostering voluntary compliance among individual taxpayers due to their lack of understanding of taxation. Most individuals feel that taxation is a complex matter and refuse to enhance their knowledge of the tax system (McKerchar, 2003). As SAS requires taxpayers' voluntary compliance and self-regulation, individuals need to have sufficient knowledge in taxation to assist them in completing their return forms accurately and in being aware of their tax obligations as well as tax laws.

Moreover, the sole-proprietor or business-sourced taxpayers present another challenge to IRBM. As noted by Rothengatter (2005), there is a greater possibility of tax evasion by sole-proprietors due to the nature of their business structure, especially in documenting invoices and recording business transactions and

income. In the formal sectors, these groups of self-employed taxpayers are the hard-to-tax individuals (Alm et al., 2006). Tax administrations thus need to increase their effort in enacting enforcement mechanisms upon these groups of taxpayers. Hiring tax practitioners would increase their compliance cost, hence their reluctance in having professionals to assist them in handling their tax matters. Efforts by IRBM to invite them to attend tax seminars were unsuccessful because of their refusal to spend time on learning about tax due to the demands of their business.

2.4.2 Tax compliance in SAS regime in Malaysia

The challenge of SAS is that there is a tendency by some taxpayers to understate their tax liability, and Malaysia, like any other country, also faces issues of tax non-compliance. Moreover, with the implementation of SAS, various compliance challenges have emerged that demand IRBM doubles its effort in managing such challenges and also in promoting voluntary compliance. Prior to implementation of SAS, taxpayers manually completed their return forms, which were assessed by tax officials who raised final assessment based on the data provided by taxpayers in their forms. However, this scenario created opportunities for bribery during the negotiation of the tax settlement between taxpayer and tax assessor (McCarten, 2006).

As part of the administrative reform at IRBM, automation has been embedded in SAS to help to reduce any possibility of corruption taking place between taxpayers and IRBM officials. At IRBM, the return forms had to undergo various processes, most of these completed electronically. This way, there was little or no opportunity for human intervention, in terms of corruption, since the system was secured with identifications and passwords and was restricted to a certain number

of staff from the outsourced company as well as from IRBM. Entrance into the premises was also controlled, whereby only members of staff possessing an access card are allowed to enter the building. Automation of return form processing in IRBM has not only expedited processing time and posting to taxpayers' accounts, but has also highlighted the transparency of the processing system and minimises opportunities for corruption within the organisation.

To facilitate further knowledge of the compliance issues, there have been a few empirical studies conducted by Malaysian researchers on tax compliance in the country. Literature suggests that the success of SAS in Malaysia, and also in other countries, is determined by taxpayers' attitudes towards tax compliance and their behaviour (Abdul Jabbar and Pope, 2008). Most recent studies are related to the implementation of SAS in Malaysia and taxpayer behaviour towards the new tax system. These include research by Palil and Lymer (2009) and Loo et al. (2009) on tax knowledge for SAS, Sia's study (2008) of taxpayer compliance behaviour under SAS, and an investigation by Loo and McKerchar (2009) on the challenges of SAS. Other Malaysian studies demonstrate that taxpayers' behaviour is affected by significant factors such as ethics (Kasipillai and Abdul Jabbar, 2006), compliance cost (Ibrahim and Pope, 2011; Abdul Jabbar and Pope, 2008), demography (Kasipillai and Abdul Jabbar, 2006) and religiosity (Pope and Mohdali, 2010).

Furthermore, Loo et al. (2009) note that, in a multi-racial country such as Malaysia, ethnicity might also be an important factor that affects tax compliance attitude and behaviour. Kasipillai and Abdul Jabbar's investigation (2006) and the findings of Loo et al. (2009) agree that culture and beliefs bear influence on

taxpayers' attitudes towards compliance. By understanding these factors, IRBM and other tax administrations may be able to formulate appropriate plans and strategies to enhance their tax education programmes in order to improve tax knowledge among members of the public and ultimately to maximise voluntary compliance by taxpayers. Identifying different categories of taxpayers based on their responses towards compliance may enable IRBM to adopt a regulatory responsive approach to encourage voluntary compliance. One of the latest mechanisms to provide responsive services to taxpayers is the introduction of e-Filing.

Many tax administrations have adopted e-filing of tax return forms, with the IRS being the first to implement the service in 1986 (Palil, 2010). This was then followed by the ATO in 1991, the CRA (Canada) in 1992, the IRAS (Singapore) in 1999 and the HMRC in 1997 (Palil, 2010). Other tax administrations adopting e-Filing include Brazil in 1997, Chile and Spain in 1999, Guatemala and France in 2001 and Argentina 2002 (Ibrahim, 2010). To promote voluntary compliance, IRBM has taken the initiative by introducing its e-Filing service to assist taxpayers in completing and filing their tax returns. The e-Filing is an electronic system whereby the taxpayer fills in the return form through an interactive on-line facility accessed from IRBM's website. The completed return form is then submitted electronically, using digital signature via the internet, to IRBM's e-Filing database. On submission of their forms, taxpayers receive an online acknowledgement as acceptance of the successfully filed return. IRBM launched e-Filing in 2002 for corporate taxpayers and subsequently enhanced the system for individual taxpayers in 2006. Further, in 2008, the system was improved and another module was designed for tax agents (IRBM website).

Since its implementation for individual taxpayers in 2006, e-Filing has reduced costs on printing, imaging, postage and storage of return forms as well as lowering taxpayers' costs in terms of time and money (IRBM CEO, 2010). When filing manually, taxpayers spent an average of MYR95 on postage and travelling expenses in order to submit their returns (Ibrahim and Pope, 2011).

A further benefit of e-Filing is that the system assists in accurate, automatic tax calculation and allows no error as it detects miscalculation and incomplete fields in the electronic forms. This system is available to taxpayers twenty-four hours a day, and is accessible from anywhere via the internet. Moreover, through e-Filing, taxpayers receive faster refunds - within two weeks to a month, compared with about three months when submission is made with hard copy return forms (IRBM CEO, 2010).

In addition, e-Filing increases productivity since it reduces workloads during the peak filing season, accelerates the processing of return forms and speeds up recovery of tax (OECD, 2011). The system is also secure and assures secrecy, validity and integrity via Public Key Infrastructure (PKI) and digital signature (IRBM CEO, 2010).

IRBM receives positive responses from taxpayers due to its cost effectiveness, fast submission and ease of usage. This wide acceptance of e-Filing is proven by the increase in electronic submissions since its inception in 2006, the number of submissions received then was 189,048; in 2007 this figure leapt to 875,051; to 1.19 million in 2008; 1.55 million in 2009; and increasing further to 1.90 million e-filers in 2010 (IRBM Annual Report 2006 - 2010).

An investigation by Loo, McKerchar and Hansford (2009) indicate that numerous errors in tax return forms prepared by Malaysian taxpayers are due to lack of tax knowledge. The new assessment system is a challenge not only to the taxpayers but also IRBM (Loo, McKerchar and Hansford, 2009). For the taxpayers, they are required to know and understand the law and learn the new system due to the new responsibility to fill in the return forms themselves. Most small business owners or traders appear to lack tax knowledge especially the SAS mechanism as there was no formal tax education in primary, secondary and tertiary levels in Malaysia (Choong and Wong, 2011). Only accountancy programmes at the universities in Malaysia incorporate taxation as one of their subjects to be learned only by accountancy students. Thus, it is a challenge for IRBM to foster voluntary compliance amongst individual taxpayers due to various factors which influence their compliance behaviour.

As reported by IRBM Annual Reports, tax non-compliance of individual and sole-proprietors in Malaysia in the SAS environment is illustrated by Table 1.

Table 1: Number of tax non-compliance cases in Malaysia

Enforcement activities	2007	2008	2009
Travel restrictions (number of taxpayers)	43,628	46,655	42,779
Civil Suits (number of taxpayers)	8,293	7,030	9,642
Desk Audit (number of cases)	272,316	1.04millions	1.39millions
Field Audit (number of taxpayers)	6,428	13,985	13,619

Source: IRBM Annual Report (2007-2009)

Travel restriction

As stated by Section 104, the Income Tax Act of Malaysia (ITA) 1967, taxpayers who have outstanding amount of tax unpaid will be issued of Section 104 notification to prevent them from leaving the country. According to the travel restriction procedure, when a delinquent taxpayer is invoked with Section 104, a copy of notification is sent to the Police Department and another copy to the Immigration Department. Even though the Act stated that notification to be sent to one of the departments, in practise IRBM delivers the notification to both agencies.

This sanction was introduced to ensure non-payment offenders settle their tax owed to IRBM before they plan to leave Malaysia. Table 1 shows that more than 40,000 tax offenders have been prevented from leaving the country since SAS was introduced in 2004. Even though there seems to be a slight increase in 2008, from 43,628 to 46,655, the number of taxpayers sanctioned under this section has reduced in 2009 to 42,779. This report suggests a rather large number of taxpayers still refuse to comply with payment of tax obligation.

Civil Suits

Under the ITA, a civil suit can be taken against a taxpayer who fails to pay taxes. Legal action is taken on a case-to-case basis to collect outstanding taxes, depending on the amount of taxes involved. In 2007, IRBM filed 8,293 civil suits in court for individual taxpayers. However, the number of cases taken to court in 2008 has reduced for 1,263 cases. But the decrease was temporary because in 2009, civil suits cases have risen to 9,642. The civil suit cases taken to court as depicted in Table 1 indicates that non-compliance of payment is still one of the major risks to be managed by IRBM.

Desk Audit

Under the SAS, tax audit is one of the main activities conducted by IRBM to ascertain higher compliance rate. Desk audit is an activity that requires officials to review taxpayers' tax reporting and accounts at IRBM premises. In 2009, IRBM has published a Tax Audit Framework to inform the public of tax audit procedures and requirement and "to ensure that tax audit is carried out in a fair, transparent and impartial manner" (TAF, 2009, p.1). The framework "aims to assist audit officers to carry out their tasks efficiently and effectively and assist taxpayers in fulfilling their obligations" (TAF, 2009, p.1). A desk auditor reviews all information on income, expenses and claims made by taxpayers in their tax return. The tax auditors may request some financial documents from taxpayers for verification, or taxpayers may be invited to IRBM office for additional information. For a specific desk audit case, it can be referred for field audit action, where taxpayer will be notified in writing of the action to be taken by a field audit team (TAF, 2009, p.3).

As reported by IRBM Annual Reports, the main objectives of desk audit are to review and raise additional assessments, to impose penalties on cases of underreporting, failure to report income, and making excessive claims, based on financial information submitted by the taxpayers and to manage refunds. Table 1 shows number of cases audited through desk auditing from 2007 to 2009. In 2008, 1,044,480 cases were audited, a sharp increase of 284% from the previous year. The number of cases continued to increase in the following year of about 350,000 cases.

Field Audit

Field audit is conducted to detect any tax-reduction measures taken by the audited taxpayers. At the same time, it is intended to create awareness among taxpayers who have not been audited on the possibility that they too may be selected to be audited in the future. Field audit takes place at taxpayers' premise which involves examination of the taxpayers' business records. "In the case of a sole-proprietorship or partnership, if the taxpayer's business records are incomplete it may involve the examination of non-business records such as personal bank statements, etc." TAF (2009, p.3). IRBM will notify taxpayers prior to a field audit. In 2008, number of cases audited was 13,985, an increase of 118% from 2007 whilst 2009 shows a slight decrease of 366 compared to 2008, in the number of taxpayers audited by IRBM (IRBM, 2009).

Looking at Table 1, it appears that IRBM still adopts traditional enforcement strategies as deterrence approaches such as travel sanction, civil suits, and auditing through desk audit or field audit. Even though this "punishment driven compliance" (Job and Honaker, 2003, p.117) is conducted every year, the table

shows that number of cases or taxpayers violating the law do not indicate any major improvement in the way IRBM enforcing compliance since implementation of SAS. Furthermore, IRBM may incur additional expenses and increase administration cost in terms of manpower, financial and time taken due to length of time, procedures and bureaucracy to process the sanctions, civil suit and auditing (Ayres and Braithwaite, 1992; Murphy, 2004; Scholz, 1984).

To be successful, SAS requires voluntary compliance and self-regulation from the taxpayers (Loo et al., 2010a; Walpole, 2009). Thus, sufficient knowledge in taxation enables taxpayers to file return forms correctly and accurately and aware of their tax obligations as well as tax laws. Further, appropriate regulatory responses by tax regulators are encouraged to motivate voluntary compliance by the regulatees (Ayres and Braithwaite, 1992; Sparrow, 2000; Braithwaite and Braithwaite, 2001). As noted by Loo et al. (2010a) from their study of individual taxpayers in Malaysia, and Kasipillai and Baldry (1998 cited in Loo et al. 2010), compliance behaviour was determined by taxpayers' experience during their encounter with tax officials.

Russell (2010, p.2) adds that voluntary compliance in SAS could be optimised through "an appropriate balance of taxpayer education and assistance, simple laws and procedures, and risk-based verification programs". Therefore, tax regulators responsive approach toward taxpayers may develop perception of fairness by taxpayers (McKerchar, 2003; Feld and Frey, 2005; Kornhauser, 2007) and likely to increase compliance. Nevertheless, tax non-compliance in Malaysia may not appear as alarming due to its high ranking position based on Riahi-Belkaoui's (2004) comparative study of taxpayer compliance among 30 countries as

illustrated in Table 2. From the table, it is shown that Malaysia is ranked 8th in tax compliance which indicates that tax compliance in Malaysia appears to be relatively high compared to its neighbouring countries such as Indonesia and Thailand, and surprisingly higher compared to some developed countries such as Canada, France, Japan and Germany.

Table 2: Tax Compliance Index amongst 30 countries

<u>Name of country</u>	<u>Tax compliance index*</u>
Singapore	5.05
New Zealand	5.00
Australia	4.58
UK	4.67
Hong Kong	4.56
Switzerland	4.49
USA	4.47
Malaysia	4.34
Chile	4.20
Japan	4.41
Norway	3.96
France	3.86
Canada	3.77
Denmark	3.70
Austria	3.60
Finland	3.53
Germany	3.41
Thailand	3.41
Philippines	1.83
Netherlands	3.40
Spain	3.29
Taiwan	3.25
Indonesia	2.53
Mexico	2.46
Argentina	2.41
Poland	2.19
Portugal	2.18
Turkey	2.07
Sweden	1.91
Italy	1.77

Source: Riahi-Belkaoui (2004)

*Tax compliance is measured by an assessment of tax compliance based on a scale from 0 to 6 where high scores indicate higher compliance (Riahi-Belkaoui, 2004, p.138).

Loo et al. (2010) also observe that Malaysian taxpayers have high ethics where tax compliance is concerned, hence contribute to high tax compliance index as indicated in Table 2. Nevertheless, IRBM may desire to increase voluntary

compliance which is now in-between 68% to 76% as shown by Table 3. Even though the table only illustrates compliance rates of return forms received against return forms issued, the data indicates that compliance rate in-terms of return forms submission is relatively good. Data on other compliances such as non-payment of tax or reporting errors are unavailable.

Table 3: Compliance rate of return forms received

Year	2004	2005	2006
Return Forms issued (million)	3.43	3.91	3.93
Return Forms received (million)	2.34	2.99	2.85
Compliance rate	68.22%	76.47%	72.52%

Source: IRBM Annual Report (2004, 2005, 2006)

Literature suggests responsive regulation approach to be adopted by tax regulators to encourage voluntary compliance and manage non-compliance (Ayres and Braithwaite, 1992; Braithwaite and Braithwaite, 2001; Andreoni et al., 2003). In an effort to manage compliance risk, IRBM has established a Risk Management Division to identify various risks encountered by IRBM and to formulate strategies to manage the risks.

2.5 Risk Management Division of IRBM

In line with current government efforts to improve the effectiveness of the delivery system of governance, the Malaysian government has found it essential to ensure that the best system of public service delivery can be achieved. A Guideline for Enhancing Corporate Governance in the Public Sector was therefore issued by the Secretary of State on 9 March, 2007. The guideline aims to institutionalize the principles and best practices of governance in the public sector

in order to enhance and strengthen its ability to achieve the National Mission towards particular missions of the organisation.

Since its inception in 2009, there have been various transformations in the structure of the Risk Management Department (RMD) to improve its functions and roles as risk administrator in IRBM. To ascertain risk management activities can be executed effectively, the RMD was removed from the Investigation Department and placed under the IRBM CEO's office on 1 July, 2011. Furthermore, to strengthen the role of RMD, one of the Deputy DG of IRBM is appointed as a Chief Risk Officer (CRO). The CRO is responsible to standardise implementation of a comprehensive risk management policy. He also monitors policies and directives related to risk are implemented efficiently by risk owners. The structure of functions of the RMD is depicted in Figure 1.

Figure 1: Organisation Chart of the Risk Management Division of IRBM



Source: Risk Management Division IRBM (RMD, 2012)

Figure 1 illustrates the roles and functions of various entities in the RMD organisation structure. The Board of Directors (BoD) conducts the monitoring of risk management at IRBM. It receives information and risk management reports from the Audit Committee (AC) which is responsible for certifying risk management reports and monitoring the compliance of risk management activities with pre-determined procedures. The top management of IRBM ensures that risk management is practised in all work processes at IRBM and supports the implementation of risk remedial action. In addition, the Risk Management Committee (RMC) acts as an advisor to top management in making strategic decisions in order to protect both the reputation of IRBM and government revenue.

The key player in the risk management process is the RMD team which is responsible for carrying out various risk management activities, some of which are listed below:

- Assist risk owners to manage risks at IRBM in a uniform and systematic way according to the Risk Management Plan based on the Risk Management Framework.
- Provide a Risk Management Framework, Risk Management Plan and Guidelines to the Department / Division / State / Tax Academy Malaysia for endorsement by the RMC.
- Coordinate all risk management activities, including training and awareness sessions, to handle risk management related to risk owners.
- As a Service Continuity Management, support organisations to manage holistically the risks related to critical functions of IRBM and to the impact of the threat of such risks, in order to ensure that regular services of the organisation can continue despite the disruption or disaster.

Finally, risk owners at IRBM departments, divisions and branches perform risk management activities at their respective levels and provide risk management reports to the RMD for analysis. Various functions of the RMD display its responsibility in monitoring and reporting to respective committees to ensure that the risk management framework is complied with effectively and efficiently.

2.6 Summary

This chapter first provides a general overview of the taxation system in Malaysia. The Malaysian tax administration is then selected as a case study in terms of its risk management strategies, and an explanation is given of various action plans that have been carried out by IRBM to ensure risks can be managed efficiently and effectively. Among the action plans are the reform of tax administration in terms of procedures and computerisation of processes which involves SAS return form submissions and processing of data electronically.

This chapter also highlighted some non-compliance issues faced by IRBM where non-payers of tax are prevented from leaving Malaysia whilst those involved in non-compliance in reporting of tax liabilities are subjected to desk-audit and field audit. Resorting to traditional approach of enforcement, does not appear to improve compliance as illustrated in Table 1. Thus, IRBM has established a Risk Management Division so that a special team is assigned to understudy risks faced by IRBM and to advice other risk owners of IRBM to manage the risks. The RMD monitors risk management strategies is implemented according to the guidelines and policies issued by the management of IRBM. The next chapter addresses a wide range of literature and previous studies pertaining to tax compliance behaviour, risk management and responsive regulation.

Chapter 3

Literature Review

3.1 Introduction

The previous chapter presents risks faced by regulators in developing countries. The backgrounds both of Malaysia and of the IRBM are also discussed in order to highlight IRBM's challenges during the implementation of SAS. In the present chapter, the thesis provides earlier research findings on three major underpinning themes of this study, namely, tax compliance, risk management and responsive regulation. Section 3.2 reviews the extensive prior research that has been conducted on tax compliance, while in Section 3.3 factors that influence the behaviour of taxpayers and their attitude towards tax compliance are examined. This discussion is followed by appraisals of risk and the management of risk in Section 3.4; the application of risk management by tax administrations in developed countries is also reviewed in this section. Further, the section highlights literature on the compliance pyramid models constructed and implemented by various tax authorities as a methodology of applying responsive regulation theory in regulatory administration. The main aspects of this literature, particularly responsive regulation, are drawn upon to construct a conceptual framework for this research.

Section 3.5 sets out responsive regulation literature and is structured on the basis of responsive regulation - how it originated, who created the idea, how the concept is used and the gaps in this theory. To emphasise the theory of responsive regulation, Section 3.6 lists compliance pyramids adopted by the ATO, HMRC, NZIR and EC. In Section 3.7, the gaps in responsive regulation concept are addressed. Finally, Section 3.8 concludes by establishing the relationship between

tax compliance, risk management and responsive regulation by addressing how responsive regulation theory can be applied by regulatory bodies to manage risk and to procure compliance.

3.2 Tax compliance

The main challenge confronting governments and tax authorities is non-compliance with tax rules and regulations (OECD, 2001): “Compliance has always been, and almost certainly always will be, a central problem in tax administration” (Mason, 2008, p.3). According to Leviner (2009), research has proven that “tax non-compliance is a serious and complex problem, subject to a wide range of causes and influences”. Most tax researchers, such as Allingham and Sandmo (1972), Andreoni et al. (1998), Jackson and Milliron (1986), James and Alley (2002), Franzoni (1998), Walpole (2009), Kirchler et al. (2003) and Eisenhauer (2008) agree that tax non-compliance is a universal problem faced by all administrators of tax.

Existing studies on taxation provide extensive discussion on this issue. Tax non-compliance is one of the risks which must be managed by tax administrations in order to meet their objective to collect revenue for their country’s development. In line with the viewpoint expressed by researchers, tax authorities also acknowledge the fact that not all taxpayers are willing to declare their income and to pay tax. In fact, studies have proven that there are taxpayers willing to do anything to avoid complying with tax laws (Braithwaite et al, 2005; Ayres and Braithwaite, 1992; Kirchler et al., 2003). By understanding tax compliance, it would be easy for tax authorities to find ways to address this issue and to plan for strategies to manage it.

As discussed in the literature, various definitions are proposed by researchers and institutions on tax compliance. However, these definitions are quite similar in their use of key words such as reporting, paying and tax law. The commonly cited definition of tax compliance is that “taxpayer files all required tax returns at the proper time, and the returns accurately report tax liability in accordance with the rules, regulations and court decisions applicable at the time the return is filed” (Roth, Scholz and Witte (1989), cited in Pope and Mohdali, 2010, p.371). Alms (1991, p.577) simplified the definition in “reporting all income and paying all taxes in accordance to the applicable laws, regulations and court decisions”.

Tax compliance is also defined as taxpayers paying the right amount of tax at the right time, filing the tax return accurately and submitting the return in time (OECD, 2001; Franzoni, 1998). Similarly, according to Mc KERCHAR and EVANS (2009, p.3), tax payers are complying with the tax law when they register with the revenue authority, file the return on time, report the tax liability accurately, pay any outstanding taxes due and maintain all records. Failure to comply with the requirement of tax law is known as tax non-compliance.

Other terms commonly used in a non-compliance context are ‘tax evasion’ and ‘tax avoidance’ (Silvani, 1992; OECD, 2008; Kirchler et al., 2003; Franzoni, 1998). Silvani further analyses tax evasion as evasion with fraud, i.e. having intention to cheat in tax reporting, while evasion without fraud are unreported taxes without committing fraud. Meanwhile, tax avoidance implies taxpayers’ behaviour which takes advantage of legal loopholes to under-report their taxes. Similarly, Kirchler et al. (2003) also divide tax non-compliance into tax evasion and tax avoidance. Literature suggests that tax avoidance is legal and moral, and

is associated with an intention to save taxes, with cleverness and with a good idea. Tax evasion, on the other hand, is perceived as illegal and immoral, and is associated with fraud, criminal prosecution, risk, tax-audit, and with penalty (Kirchler et al., 2003; Franzoni, 1998; James and Alley, 2002; Sandmo, 2004).

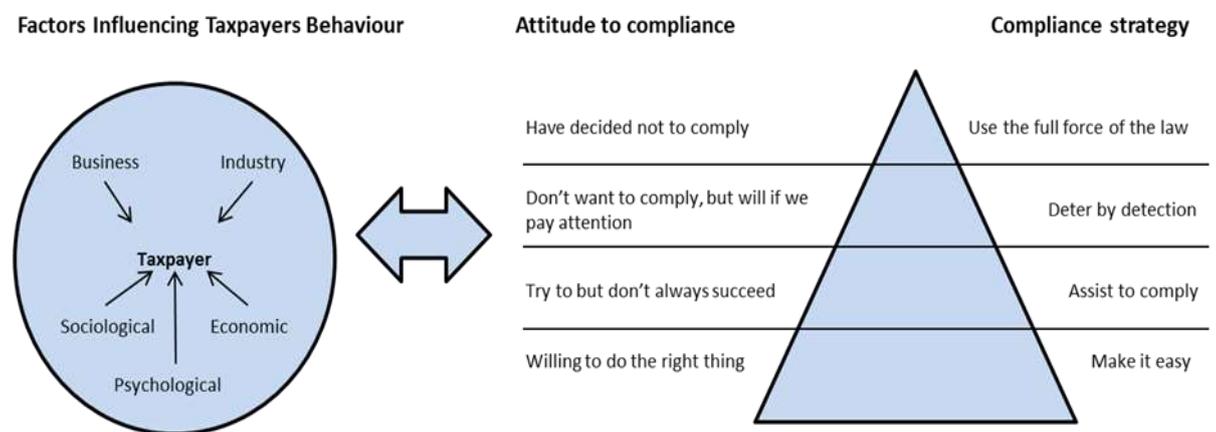
From previous empirical studies, it seems that most tax researchers agree that taxpayers are complying with tax law when they declare their income, pay their tax obligation and abide by tax law and regulation. As tax evasion is regarded as a serious matter (Franzoni, 1998), the public is to be informed that non-compliance may cause the government to receive less revenue than the actual amount due (Eisenhauer, 2008). Since revenue is important for the benefit of the society, controlling and discouraging non-compliance is not only the responsibility of the tax authority but also of society (Walpole and Evans, 2001; Brautigam, 2008).

Literature suggests that revenue authorities identify and understand the reasons which motivate taxpayer non-compliance in order that appropriate strategies are adopted and resources allocated to overcome these issues. Under SAS, voluntary compliance by taxpayers is crucial to ensure the success of self-assessment as it does not require taxpayers to enclose any financial documents to prove their claims in their return forms (Loo and McKerchar, 2009; Walpole, 2009; D'Ascenzo, 2008; James and Alley, 2002). Compliance risk management is underpinned by an understanding of the non-compliant behavioural factors influencing the decision of non-compliance, so that more effective regulatory responses can be implemented (OECD, 2010b). One of the steps in compliance risk management is the assessment of risk. In this context, assessment of risk includes understanding and analysing taxpayer compliance behaviour (OECD,

2010c). This response is in line with Braithwaite’s (2003) compliance pyramid which includes the BISEP model.

The BISEP model (see Figure 2 below), comprising Business, Industry, Sociology, Economy and Psychology, identifies factors influencing taxpayers’ attitude and behaviour towards tax compliance and relates this behaviour with their responses to compliance. BISEP was first introduced by the Cash Economy Task Force of Australia as a recommendation to the ATO to manage compliance issues pertaining to cash economy (OECD, 2010b; CETF, 1998). Subsequently, this model has been studied and used by other tax researchers and tax administrations to attain a better understanding of taxpayer compliance behaviour.

Figure 2: The BISEP Model



Factors influencing taxpayer behaviour and the spectrum of taxpayer attitudes to compliance.

Source: OECD, Tax Compliance and Tax Accounting System (OECD, 2010b).

Figure 2 depicts two major elements in the tax compliance regime, namely BISEP, which lies within the circle, and the compliance pyramid in the triangular shape. The circle illustrates factors influencing taxpayer behaviour, such as

Business, Industry, Sociology, Economy and Psychology and the motivation towards their attitude to compliance. Further, the compliance pyramid shows the compliance strategy to be adopted by regulators in order to respond to the regulatees' behaviour.

Promoting voluntary compliance is as important as punishing non-compliance (Silvani, 1992, p.292-293). Voluntary compliance means self-complying without the efforts of any parties, especially the tax authority (Kornhauser, 2007). In line with their goal and mission, all revenue bodies should aim to improve the overall level of 'voluntary compliance'⁷ and rely less on 'enforced compliance'⁸ OECD (2008).

As indicated in Section 3.4.3, under the SAS regime, voluntary compliance is crucial due to the systems requirement that taxpayers self-declare their income and compute their tax obligation in the tax return form. Taxpayers' perception of the tax system is therefore important because if a system is fair, it will instil compliant behaviour among taxpayers which will motivate them to complete their returns accurately and truthfully without the presence of tax authorities. With regard to tax administrations, understanding taxpayers' motivation and developing tax policies and strategies that can influence compliance may result in more revenue and incur less administrative cost to the tax authority (Che Azmi and Perumal, 2008; OECD, 2010a).

Further, McKerchar and Evans (2009, p.22-23) recommend three strategic propositions for tax administrations to improve tax compliance. Firstly, the credibility of revenue authorities needs to be established and enhanced; the goals

⁷ Compliance by taxpayers is achieved voluntarily (OECD, 2008)

⁸ Compliance by enforcement actions carried out by revenue body (OECD, 2008)

and objectives of tax reform should be clearly outlined; and a risk management approach should be adopted. They elaborate that good governance is essential in determining the credibility of a government as well as having a legitimate and responsive state to ensure the ‘consensual’ relationship between the state and the citizens, especially where taxation is concerned. Secondly, tax administrations should have a clear vision of where the tax reform is intended to lead and set the right policy to achieve this vision. Finally, by adopting risk management strategies, tax administrations would be able to develop different mechanisms to address different types of compliance behaviour (McKerchar and Evans, 2009).

Some of the strategies to be implemented by tax administrations seek to adapt the administration of the compliance model. A few compliance models have been developed by researchers and revenue authorities as a framework for strategic planning and policies aiming to reduce non-compliance and improve compliance among the taxpayers. The ATO, HMRC, NZIR and EC compliance pyramid models are discussed in Section 3.6.

There appears to be an evolution of tax compliance literature from Allingham and Sandmo’s equation model (1972) to the twin pyramids of supports and sanctions presented by Braithwaite (2011). According to Andreoni et al. (1998), Allingham and Sandmo’s model (1972) is one of the earliest and best-known models of tax compliance, which queries if higher tax or penalty rates generate more or less compliance and may influence taxpayers towards tax evasion. This command-and-control framework has been expanded in several different ways over the past twenty-five years. However, the weaknesses of the model are the assumptions that the probability of audit is constant and that taxpayers are risk neutral (Andreoni et

al., 1998). These compliance models promote responsive measures by regulators when dealing with taxpayers.

In addition, Riahi-Belkaoui's (2004) investigation of tax compliance from thirty countries reveals that tax compliance is highest in countries characterized by:

“high economic freedom, important equity markets, effective competition laws and low serious crime rates. It shows that a powerful deterrent to tax evasion is the creation of a tax morale or climate where citizens are guaranteed economic rights and safe lives. Where individuals can exercise their economic rights in terms of economic freedom, important equity markets and effective competition laws, in a safe environment that improves their quality of life, they are more prone to view tax compliance as less of a burden and more of a citizenship duty.” (Riahi-Belkaoui, 2004, p.141)

As moral considerations are highest where the tax morale is high (Riahi-Belkaoui, 2004), tax authorities should recognize and take into account both institutional and moral factors determining tax compliance. To ensure the success of SAS and to increase voluntary compliance, a better understanding of factors motivating taxpayers' compliance behaviour will assist tax administrations to design and implement responsive compliance strategies (Song and Yarbrough, 1978; Shaw et al., 2010; OECD, 2010a; Braithwaite, 2003).

The next section addresses taxpayer behaviour and attitude as motivational factors that contribute to tax compliance decision-making.

3.3 Taxpayer Behaviour and Attitude

Many tax researchers (Braithwaite, 2005; Ayres and Braithwaite, 1992; Hasseldine et al., 2007; Frey and Torgler, 2007; Wenzel, 2002; Song and Yarbrough, 1978) agree that the key task of any tax administration is to secure compliance with the tax rules. Non-compliance therefore poses a significant risk to the government revenues and has to be managed by tax administrations (Andreoni et al., 1998; McKerchar and Evans, 2009; Black and Baldwin, 2010;

OECD, 2010). Non-compliance is when a taxpayer fails to comply with the factors stated earlier, either deliberately or unintentionally.

In order to increase effectiveness and decrease non-compliance, LeBaube (1992, p.308-309) reports a study conducted for the IRS in which taxpayers are divided into four groups: those who understand and comply willingly with the law; those who want to comply but do not understand; those who understand but choose not to comply fully; and those who deliberately do not comply. Further, tax personnel should understand taxpayers' behaviour and move the taxpayers from one group to another (LeBaube, 1992) and then take necessary actions to overcome the problems according to the categories.

Different people demonstrate a variety of behaviours: there are those who are honest and consistently comply with the law, and there are also dishonest people who always look for an opportunity to cheat (Alm, 1999; Eisenhauer, 2008). The literature addresses a wide range of factors that influence a taxpayer's decision whether or not to comply with the tax law. Empirical study on tax non-compliance behaviour has found that various determinant factors are relevant in influencing tax evasion behaviour (Groenland and Veldhoven, 1983; Song and Yarbrough, 1978; Torgler, 2003; Wenzel, 2002; Feld and Frey, 2005; Kirchler et al., 2008; Alm et al., 1992; Frey and Torgler, 2007; Jackson and Milliron, 1986).

To improve compliance requires tax administrations to understand the motivating factors that influence taxpayer attitude, which then contributes to the non-compliant behaviour of taxpayers (Walpole, 2009; OECD, 2010c; Alm, 1999). In the context of attitude and behaviour, there appears to be a strong link with tax-

paying, and “people bring their attitudes in line with their behaviour” Hessing et al. (1993, as cited in Mitton, 2009, p.240).

Another aspect of the relationship between behaviour and attitude is provided by Song and Yarbrough (1978), who posit that there are two dimensions of tax ethics: attitudinal and behavioural. The attitudinal dimension is the taxpayers’ attitude towards their tax responsibilities, while the behavioural dimension is represented by taxpayers’ compliance behaviour towards the tax regulations. Song and Yarbrough’s analysis provides better understanding of the dimension of attitude and behaviour towards tax compliance.

Empirical evidence has proven that factors influencing taxpaying behaviour include ethics, perceived fairness, social norms, psychological orientation and tax morale (Wenzel, 2002; Alm and Torgler, 2006; Kornhauser, 2007; Walpole, 2009; Franzoni, 1998). Naturally, people do not like to part from their hard-earned money, particularly if they perceive that they do not receive any benefit or privilege in return for their contribution (Muehlbacher et al., 2008; Ho et al., 2006). However, people still report their income and pay taxes due to their fear of detection and punishment (Allingham and Sandmo, 1972; Kornhauser, 2007).

Prior studies of taxpayers’ behaviour indicate that there are various determinant factors which influence the behaviour of taxpayers to comply or evade the tax laws, and, if complying, whether to comply fully or partially (Franzoni, 1998). Findings from the empirical studies reveal that some of the factors affecting taxpayers’ behaviour include tax knowledge (Alm et al., 2010); punishment (Allingham and Sandmo, 1972); trusting the tax system and the government (Feld

and Frey, 2005; Kirchler et al, 2008); demographic factors (Jackson and Milliron (1986); tax morale (Feld and Frey, 2005; Kornhauser, 2007; Riahi-Belkaoui, 2004); and religiosity (Torgler, 2003; Pope and Mohdali, 2010), as well as economic factors such as compliance cost (Le Baube, 1992; Abdul Jabbar and Pope, 2008) and tax rates (Swenson, 1988; Sillamaa, 1999).

By determining factors affecting the behaviour and perception of taxpayers towards their tax obligation, tax administrations would, significantly, be able to find solutions to ensure that tax defaulters voluntarily comply with tax laws. However, before finding the solutions, tax administrations should first take the initiative to understand the behaviours and attitudes of taxpayers which influence their decision-making on tax compliance.

In addition to these factors, negative behaviour such as refusal to learn about taxation, cheating the tax system, failure in proper record keeping, and indifference towards tax regulations, are common attributes of taxpayers (Marti, Wanjohi and Magutu, 2010; Alm et al., 1992). To obtain further understanding of evidence given in other studies, these determinant factors influencing tax non-compliance are discussed further in the following section.

There is a wide range of discussion in the literature on factors that influence taxpayer decision-making in tax compliance. Reviews from the literature provide motivational factors that shape an individual's perception and judgement about whether to comply with or evade the tax law. It is therefore challenging for tax administrations to understand the various factors that influence compliant and non-compliant tax behaviour. An awareness of why people comply willingly - or

refuse to comply - will assist tax administrations in developing motivational strategies for voluntary compliance and at the same time to discourage non-compliant behaviour. In order to increase tax compliance, revenue bodies could plan and develop regulatory strategies through ‘persuasive appeals’ to increase an ethical approach to taxpaying (Wenzel, 2002). Wenzel’s suggestion is consistent with a responsive regulation regime where the first step to promote compliance is through persuasion and encouragement.

For the purpose of this study, only six determinant factors are selected for discussion in this section: trust in the tax system and in the government; the cost of compliance; education and knowledge; personal and social norms; and tax morale and deterrence. These factors are relevant to this study and will provide answers to the research questions. Furthermore, strategies to be implemented by tax administrations to manage these factors are addressed in depth in the empirical chapters.

3.3.1 Trusting the system and the government

Many researchers, including Kirchler et al. (2008), Braithwaite (1998, 2003); Alm et al. (1992), Feld and Frey (2005) LeBaube and Vehorn (1992), Franzoni (1998) and Wenzel (2002), agree that one of the factors affecting compliance is that of perceptions of transparency and fairness of tax administration. The trustworthiness of the government (Feld and Frey, 2005; OECD, 2006), and fair procedures and good governance (Feld and Frey, 2005; LeBaube and Vehorn, 1992) may encourage better tax compliance by taxpayers. Trust in the authorities will increase when the enforcers demonstrate efficient enforcement against non-complying taxpayers (Wenzel, 2002; Kirchler et al., 2008), thus “good

governance and fair procedures lead to higher tax compliance by taxpayers” (Feld and Frey, 2005, p.20).

Fairness of revenue agencies in their treatment of taxpayers is also a motivational factor that contributes to compliance. Literature describes fairness in three categories, namely, distributive fairness, procedural fairness or justice and retributive fairness (OECD, 2010c).

“Distributive fairness is the perception that the government acts as a good custodian and wise spender of tax revenues; procedural fairness is the perception that the revenue body adheres to the procedures that are fair in dealing with the taxpayers; and retributive fairness is the perception that the revenue body is fair in the application of punishment when the rules are broken.” (OECD, 2010c, p.6)

Voluntary compliance relies on reciprocity between regulators and regulatees. If the public trusts the enforcement institutions for their fair treatment and procedural justice, and recognises a high level of integrity among tax personnel, reciprocal trust may lead to self-regulation and voluntary compliance (Kornhauser, 2007; Alm and Torgler, 2006; Wenzel, 2002; Kirchler et al., 2003; Rothengatter, 2005).

Further, as noted by Alm et al. (2010), when taxpayers have greater interaction with the tax authorities and receive quality services from them, then this group of taxpayers may have a more accurate perception of tax administration and may increase their compliance with the tax law. Friendly interaction and supportive participation of regulators with small-business taxpayers may result in a feeling of respect and social trust on the part of the taxpayers and may encourage voluntary compliance among the business social network (Rothengatter, 2005).

McKerchar (2003, p.10) also finds that “perception of fairness would appear also to be influenced by how wisely taxpayers perceive government to be spending monies raised by taxation.” If they therefore perceive that the government spends the collected revenue wisely, then their perception of fairness would increase, hence there could be greater compliance. On the other hand, if taxpayers perceive failure by the government to spend the revenue wisely, then their perception of fairness would decrease, which eventually would lead to less commitment to comply.

Regulators may use their authority to achieve compliance; however, they would lose the trust of taxpayers who feel threatened by such power (Kirchler et al., 2008). On the other hand, if tax authorities treat taxpayers equally, responsibly and show respect, the taxpayer may learn to trust the government; thus could result in higher voluntary compliance rate (Kirchler et al., 2008). A psychological tax contract – a concept where “taxpayers and the tax authority treat each other like partners, that is, with mutual respect and honesty” (Feld and Frey, 2007, p.104) - is also one of the elements that contribute to compliance behaviour. Tax authorities are advised to use a psychological contract to analyse tax compliance where respectful treatment is an essential factor that determines tax compliance (Feld and Frey, 2005).

Previous studies have proven that taxpayers will be willing to comply when they receive public benefits and services from the government in return for the taxes they pay (Feld and Frey, 2007; Feld and Frey, 2005; Franzoni, 1998). These factors appear to motivate them to comply voluntarily even though there is no threat of punishment or sanction (Alm et al., 1992). However, if taxpayers believe

that the government is untrustworthy, they may consider cheating on taxes is justifiable (Frey and Torgler, 2007):

“If taxpayers think they are in a better position to monitor and control politician, their willingness to cooperate and pay taxes may increase. Therefore, a higher degree of satisfaction with a country’s democratic institution should lead to higher tax morale.” (Frey and Torgler, 2006, p.144)

Finally, compliance also relates to the power of the authority and trust in it (Kirchler et al., 2008). The Slippery Slope framework suggests the power of tax regulators and the level of trust in them may influence the level of tax compliance: if the authority’s power is weak and taxpayers trust is low, then the level of compliance is likely to decline.

According to Kirchler et al. (2008, p.212), “... tax compliance can be achieved through increasing levels of power and trust; however, the resulting compliance is enforced in the former case and voluntary in the latter case. The impact of changes in one dimension is assumed to depend on the level of the other dimension ...” Further, Kirchler et al. illustrate how the power of authorities, trust in them and tax compliance, are three dimensions which shape the Slippery Slope framework. Previous literature has indicated that voluntary compliance could be achieved if taxpayers have confidence in the government, a perception of fairness of the tax law and a psychological contract with their tax authority. Thus, it is suggested, revenue bodies to be fair, transparent and friendly in their conduct in order to gain the trust of the public and its cooperation.

3.3.2 Cost of compliance

As stated by Song and Yarbrough (1978, p.442), “taxation is an unwelcomed burden to be endured”. With the implementation of SAS, taxpayers may incur additional costs in order to comply with SAS laws, since self-assessment requires

them to manage their own tax affairs in keeping proper records and assessing their tax obligation by reporting their income, calculating the tax to be paid and paying the tax owed. Shaw et al. (2010, p.1106) state: "...taxpayers would still need to spend time and money finding their way through the increasingly complex maze of tax laws". Cost of compliance, also known as compliance cost, is the administrative cost incurred by taxpayers in the process of complying with tax regulation (OECD, 2010a). The process may consist of storing documents and information, reporting information in return form, reconciling the report with financial and other relevant documents, telephoning the revenue office, taking time to read instructions, and other activities related to return form submission and payment of tax (OECD, 2010a).

There is a wide range of literature on compliance cost and its influence on taxpayers' behaviour (Ibrahim and Pope, 2011; Shaw et al., 2010; Abdul-Jabbar and Pope, 2008; Evans, 2003; Le Baube, 1992). High compliance cost, which results in a financial burden on taxpayers, is one of the determinant elements that contribute to tax evasion (Franzoni, 1998; Song and Yarbrough, 1978; Shaw et al., 2010; OECD, 2010c). Some taxpayers, particularly small business taxpayers, may require tax practitioners to assist them in managing their tax matters due to the complexity of reporting the business (Hasseldine et al. 2007; Rothengatter, 2005; McKerchar, 2003; Choong and Wong, 2011). Thus, compliance cost may affect businesses, especially small firms, as it is part of their expenses and could therefore reduce their profit (OECD, 2010a; Rothengatter, 2005; Hasseldine et al., 2007). Compliance cost may therefore become one of the influencing factors that contribute to a lower level of voluntary compliance (Jenkin and Forlemu, 1993; Ibrahim and Pope, 2011; Abdul-Jabbar and Pope, 2008; Shaw et al., 2010; Evans,

2003). Similarly, McKerchar's mixed method research which seeks to understand the unintentional non-compliance demonstrated by Australian taxpayers suggests:

“Complexity and high levels of commitment caused personal taxpayers to experience high levels of compliance cost, which in turn reduced their perception of fairness of the income tax system. As the perception of fairness decreased, there was a decrease in commitment to compliance.” (McKerchar, 2003, p.9)

Tax administrations are advised to improve their enforcement strategies to simplify compliance activities by the taxpayers, which in turn may result in a reduction of compliance cost for the taxpayers and also minimise administrative cost for the revenue bodies (OECD, 2010b).

HMRC has taken the initiative to lessen the administrative burden of small business taxpayers by identifying interaction cost between taxpayers and HMRC. Once the cost and process involved during interaction with the taxpayers was identified, HMRC developed plans and strategies to “influence customer behaviour and attitudes to risk” by improving interactions with the taxpayers, hence facilitating them to comply with their tax obligation (OECD, 2010a, p.19).

Other tax administrations such as the IRS, Austria, Ireland and Canada have also adopted compliance cost assessment by re-engineering their administration for the purpose of reducing cost of compliance for their taxpayers. As the priority of revenue bodies is to enable taxpayer compliance with their tax obligation in order to reduce compliance cost, they have improved the process by simplifying and shortening the tax return form; further, they have increased the use of electronic submission and enhanced the employment of ICT (OECD, 2010a; Evans, 2003). Other tax administrations, especially in developing economies, may learn the best

practices used by their counterparts in order to take the necessary approaches to reduce compliance cost and thus encourage voluntary compliance.

3.3.3 Knowledge and Education

“The manner in which information is communicated to a taxpayer can have a major impact on his willingness to comply with the tax laws” (Kornhauser, 2007, p.609). Previous studies (Jackson and Milliron, 1986; Eriksen and Fallan, 1996; Torgler, 2003) suggest that taxpayers with a higher level of tax knowledge tend to adopt a positive attitude towards their tax obligation. More highly educated taxpayers may acquire more knowledge about tax law and would thus be in a better position to understand the requirement to comply (Torgler, 2003; Song and Yarbrough, 1978).

From their empirical survey, Eriksen and Fallan (1996) have discovered that tax ethics and perception of the fairness of the tax system can be improved by providing more tax information to the public, hence preventing the tendency for tax evasion. Similarly, Richardson’s cross-borders survey on tax compliance (2006) finds that the level of taxpayer education does influence their decision-making in tax compliance and tax evasion. Empirical evidence given by Alm et al. (2010) has proven that uncertainty reduces compliance while information or knowledge has a positive impact. On the other hand, Vogel’s survey findings (1974, p.500) indicate that less well-educated taxpayers have less access to tax compliance information, are less informed about relevant tax regulations, and require assistance more often. However, people with a higher level of education may be less compliant because they better understand the opportunities for evasion and may find ways to cheat the system.

Literature suggests that tax administrations to use communications as an effective tool to deliver relevant tax knowledge; continuous tax education programmes conducted by revenue bodies will encourage taxpayers to comply and deter them from non-compliance (Eriksen and Fallen, 1996; Kasipillai et al., 2003; Hasseldine et al. 2007; OECD, 2010c). Further, education programmes should not only facilitate urban taxpayers, but also extend to rural and hard-to-reach communities, thus improving cultural behaviour by creating awareness and providing knowledge that tax compliance is important for asset building (Robles, 2010).

3.3.4 Personal norms and social norms

“Norms, personal or social, are considered by revenue bodies to be the most important drivers of compliance” (OECD, 2010c, p.5). Individual actions are led by both personal and social norms (Feld and Frey, 2005; Wenzel, 2002). A taxpayer complies with the tax law if he/she perceives or anticipates that his/her fellow citizens declare their incomes truthfully (Sugden, 1984, cited in Feld and Frey, 2005, p.13). Individuals with strong personal tax ethics may be more compliant with the law and will avoid evasion (Wenzel, 2002). Personal tax ethics as part of personal norms are “the intrinsic motivations or the feeling of obligation which motivates a person without being forced or paid externally” (Mitton, 2009, p.23).

Taxpayers’ compliance decision-making is also likely to be influenced by social norms (Wenzel, 2002; Mitton, 2009) where some individuals will refer to their close relatives and friends in complying with the law (Franzoni, 1998; Sandmo, 2004; Torgler, 2003; OECD, 2010c). When people in the group or society are

against the law, then there will be people following this attitude, which may create a “non-compliance epidemic” (Franzoni, 1998, p.7). Franzoni’s point of view is supported by Frey and Torgler who note that:

”if many citizens pay their taxes, an individual taxpayer would also feel obligated to contribute and pay taxes. Alternatively, if many individuals evade taxes, an individual taxpayer will not feel obligated to pay taxes.” (Frey and Torgler, 2006, p.138)

Due to the complexity of income tax laws that are known to be impossible to administer, taxpayers may have the opportunity to cheat in self-defence, knowing that everyone else is cheating (McLure Jr. and Pardo, 1992, p.127). However, if it seems that a society comprises law-abiding citizens, then individuals within that society will be compliant (Torgler, 2003; Wenzel, 2002). Frey and Torgler (2007, p.142) agree that “if people believe that others are honest, their own willingness to pay taxes increases”.

Society is also influenced by the culture or life-style of people within a specific group. Some empirical evidence proves that culture also is another factor that may influence compliance decision-making. Further, individuals’ exposure to the tax system varies in different countries (Torgler, 2003; Muehlbacher et al., 2008; Richardson, 2008; Alm and Torgler, 2004). In his empirical studies on voluntary tax compliance among migrant small-business entrepreneurs in Australia, Rothengatter (2005) finds that a distinctive ethnic culture appears to have a different attitude towards tax compliance.

Furthermore, Yong’s investigation of the Maori and Pacific ethnic groups in New Zealand reveals that “Pacific and Maori placed their group obligations over their personal interests, resulting in more tax compliance difficulties” (2011, p.157).

Therefore, knowledge about the culture of certain ethnic groups may therefore assist regulators to formulate effective strategies to deliver compliance messages to them and encourage them to obey the law (Rothengatter, 2005; Robles, 2010; Yong, 2011). To promote a strong social norm to remain compliant, revenue bodies are advised to inform the public that most taxpayers are honest and compliant; otherwise the public will have the impression that non-compliance is the norm which may result in more non-compliance (OECD, 2010c, p.5).

3.3.5 Tax morale

Torgler and Schneider (2007) describe tax morale as the “moral obligation to pay taxes, a belief in contributing to society by paying taxes” whereby the intrinsic motivation to pay tax may come from the desire to be a good citizen or from the desire to contribute to the common good. Kornhauser (2007) defines tax morale as referring to taxpayer attitudes and beliefs, and not their behaviour. Further, Frey and Torgler address tax morale as:

“the intrinsic motivation to pay taxes. It measures an individual’s willingness to pay taxes, in other words, the moral obligation to pay taxes or the belief that paying taxes contributes to society.” (Frey and Torgler, 2007, p.140)

Prior literature also agrees that high tax morale has a significant impact on tax compliance (Torgler and Schneider, 2007; Frey and Torgler, 2007; Kornhauser, 2007; Eisenhauer, 2008). Moreover, “if taxpayers believe tax evasion to be common, tax morale decreases. Alternatively, if they believe others to be honest, tax morale increases” (Frey and Torgler, 2007, p.153). Tax morale also answers the question of “why people pay taxes instead of evading them” (Kornhauser, 2007; Torgler and Schneider, 2007; Frey and Torgler, 2007; Eisenhauer, 2008; Cummings et al., 2009).

It appears that tax morale also plays a major role in tax compliance. Both social norms (shared beliefs of how people should behave) and personal values (moral, ethics) affect tax morale (Kornhauser, 2007). Pope and McKerchar (2011) concur that revenue authorities need to understand taxpayer tax morale issues in order to increase voluntary compliance, especially in the SAS environment. By understanding personal and social norms, tax administration could formulate a compliance management policy to foresee and deter tax evasion in order to increase compliance (Franzoni, 1998; Kornhauser, 2007; Wenzel, 2002; Frey and Torgler, 2007).

A fuller understanding of the relationship between tax morale and the opportunity for either non-compliant or compliant behaviour may assist revenue authorities on how to adopt a responsive approach to improve compliance (Pope and McKerchar, 2011). Thus, responsive mechanisms could be adopted to manage non-compliance resulting from tax morale factor. Only when soft approaches fail to motivate taxpayer to comply, a stricter mechanism could be employed as deterrence to manage non-compliance.

3.3.6 Deterrence

To change personal and social norms is not an easy task to be addressed by tax authorities. A stricter deterrent may therefore be a more suitable approach to enhance compliance (Franzoni, 1998). One of the motivational factors to ensure that taxpayers comply with the law is the threat of detection and punishment (Allingham and Sandmo, 1972; McKerchar and Evan, 2009; Cummings et al., 2009; Frey and Torgler, 2007). Prior literature suggests that taxpayers should face

the certain threat of punishment if they fail to comply with the tax laws. As “the way power of authorities is perceived by citizens can determine tax compliance” (Bergman, 2003), a stricter enforcement policy may result in a higher level of compliance (Sandmo, 2004, Devos, 2007). Furthermore, Andreoni, Erard and Feinstein (1998), and Slemrod and Yizhaki (2002) both predict that if punishment is higher, then there is less non-compliance. “Deterrence is based on the concept that the risk of detection and punishment will improve compliance behaviour” (OECD, 2010c, p.14).

Empirical evidence indicates that a traditional approach to enforcement using deterrence tools, such as auditing, investigation, imposition of penalty, prosecution and sanction implemented by tax authorities, may be an effective method to adopt in order to reduce tax evasion (Franzoni, 1998; Feld and Frey, 2005; Braithwaite, 2003; Hasseldine et al., 2007). “Tax evasion can therefore be mitigated if expected fines are sufficiently high to deter taxpayers from cheating” (Feld and Frey, 2005, p.5). If a taxpayer is found guilty of making a false declaration with the intention of cheating the authority, then an appropriate treatment, such as penalty imposition, should be rendered on him or her. On the other hand, if, for instance, the taxpayer has made mistakes in the calculation of tax liabilities, the tax authority should refrain from imposing harsh penalties, but instead should attempt to contact the taxpayer to obtain an explanation of the errors (Feld and Frey, 2005).

Literature indicates that penalty rate may have an influence on compliance. Allingham and Sandmo (1972), Sandmo (2004) and Devos (2009) suggest that a high rate of penalty may increase compliance. In addition, low fines for minor tax

evasion and high penalties for tax fraud may influence tax morale and is likely to instil a sense of responsibility to obey the rules (Feld and Frey, 2005; Alm et al. 1992; Sandmo, 2004; Eisenhauer, 2008).

In the context of auditing, compliance among low- and middle-income taxpayers is increased by threatening them with scrutiny of their returns, but among high-income taxpayers compliance decreases (Slemrod, Blumenthal and Christian, 2001 cited in Kirchler et al., 2008). This is due to taxpayers' perceptions of mistrust in the authorities. By strengthening tax audit capabilities, the tax authority would be able to identify taxpayers' intention when submitting their return forms, so appropriate steps should be taken. The deterrent treatment adopted by tax authorities towards taxpayers is important for compliance in order to manage those who tend to violate the law.

Revenue bodies are therefore advised to use audit as a deterrent rather than as a means of revenue collection (Franzoni, 1998). Franzoni also suggests that audit strategy is a cost-effective enforcement approach since the audit activities are conducted on the basis of specific information obtained from taxpayers and their tax liability. Audit probability should therefore vary for different taxpayers. However, Hasseldine et al. (2007) disagree that tax audit by tax agencies would be cost-effective because the authorities would need to spend more on auditing, involving additional operational cost and less revenue collection.

James and Alley (2002) also argue against an enforcement approach since it 'too readily' imposes a penalty for non-compliance, which may result in a low rate of voluntary compliance, particularly under the SAS regime. Similarly, Braithwaite

et al. (2005) and Ayres and Braithwaite (1992) also concur that threat and enforcement should only be the last action to be taken by the revenue authorities after education and persuasion has failed. A harsh enforcement mechanism may defeat the purpose of ensuring voluntary compliance and affect taxpayers' willingness to comply (James and Alley, 2002).

Other than imposing a penalty, adopting a shaming approach to publicise law offenders among the public may improve compliance (Makkai and Braithwaite, 1994; Kornhauser, 2007; Murphy, 2008; Devos, 2009). People perceive punishment as humiliating; they may therefore resist complying in the future or resent the regulators for the punishment (Ayres and Braithwaite, 1992; Murphy, 2008). On the other hand, a friendly service-oriented method is far more effective in influencing behaviour and encouraging voluntary compliance because "education and support of taxpayers are more promising than control and unreasonable severity in persuading taxpayers to comply" (Kirchler et al., 2008, p.220).

By understanding the variety of behaviours and attitudes of taxpayers, tax administrations require a more flexible regulatory approach which considers different compliance levels of taxpayers but at the same time works towards upholding the tax laws. The alternative approach to the traditional enforcement regime may encourage positive behaviour, and thus may have a positive influence on taxpayer compliance decision-making. This may also improve taxpayers' perceptions about the government's policies and tax system, and thus may in turn increase voluntary compliance and discourage non-compliance (Braithwaite et al., 2005; Ayres and Braithwaite, 1992; Feld and Frey, 2005; Alm, 1999).

As addressed earlier, previous literature on tax compliance and taxpayer behaviour indicates a number of factors, including tax morale, norms and trust in the government, which could influence taxpayers in deciding whether or not to comply with the tax law. Additionally, considerations such as corruption, culture and ineffective tax administration within developing countries, have also been addressed in Chapter 1. Attention has previously been drawn to the ways in which different people exhibit a variety of behaviours; there is therefore no single approach to manage non-compliance issues (Alm et al., 1992). By understanding taxpayers' behaviour and motivation, tax administrations would be able to develop tax policies and compliance risk strategies to gain taxpayers' cooperation in voluntary compliance.

In an effort to understand determinant factors motivating taxpayer attitude and behaviour, the ATO took the initiative to conduct a study in 2000/2001 (Niemiowski et al., 2003) when a survey was undertaken on non-business taxpayers to understand their compliance behaviour. Behavioural indicators provided by this study enable the ATO to identify and develop compliance strategies to improve compliance behaviour, which ultimately may increase greater compliance. Other tax administrations are encouraged to learn from the ATO so that similar research can be conducted to understand taxpayers' compliance behaviour and thus improve compliance.

As deterrence requires "intrusive, tough-minded inspections, stringent prosecution of even minor violation, expedited sanctioning procedures and other deterrence-based actions" (Scholz, 1984, p.396), the cost incurred to implement these enforcement measures would be higher. On the other hand, cooperation by

regulatees would not only reduce compliance costs for the taxpayers, but also help regulators to minimise their enforcement cost. Commitment by both parties may bring more revenue to the states as well as reduce the administrative costs in handling non-compliance. As suggested by previous studies, when regulators can identify risk factors that influence taxpayers' compliance behaviour, they may be able to develop strategies to manage those risks effectively and efficiently. The next section presents definitions of risk, the risk management process and risk-based approaches to manage risks.

3.4 Risk management

'Risk is inherent to life. The future is always uncertain and the outcomes of events unpredictable' (Wilson-Grau, 2003, p.1). In the literature, risk is identified variously as uncertainty, threat, hazard, the unknown, challenges, danger, phenomenon and jeopardy (Bernstein, 1996; Vesper, 2006; Wilson-Grau, 2003; Power, 2004; Murphy, 2008). The word 'risk' has its roots in the old French word *risqué*, which means "danger, in which there is an element of chance" (Littre, 1863, as cited in Vesper, 2006, p.1). According to Bernstein (1996) "risk doesn't mean danger; it just means not knowing what the future holds". However, while Vesper suggests that the word 'risk' has French origins, Bernstein (1996) notes that it derives from the early Italian word *risicare* which means 'to dare'. As stated by Bernstein, risk is a choice rather than a fate which means we dare to take action based on the decision which we have made. Meanwhile, Murphy (2008, p.39) defines risk as "the danger of future loss". He adds that risk is "any phenomenon which could affect our ability to meet our objectives". Similarly, TDC (2009) looks at risk as "the chance or possibility of loss, damage, injury or failure to achieve objectives caused by an unwanted or uncertain action or event".

Another reference to risk as ‘uncertainty’ was made by OECD, which defined it as an “uncertain consequence of an event or activity with respect to something that has human value” (OECD, 2010, p.18).

Such definitions endow risk with negative connotations, entailing uncertainty of current or future events that may prevent achievement of objectives. Power (2004) points out that, since the mid-1990s, risk has become a major concern in both private and public sectors in the UK, where the concept of risk is introduced to monitor outcomes and performance of the sectors. In the private sector, the focus is to achieve organisational objectives in control activities (Power, 2009), while in the public sector the concern is about managing risk in order to improve the delivery service to the public (OECD, 2010). Black (2005) further elaborates the meaning of risk in the public sector as failure of government departments to achieve their objectives or to deliver public services.

Research has shown that “people are not very good at estimating risks and our ability to make sense of risk is limited” (Hutter, 2005, p.73). By having knowledge and understanding about potential risk in our daily work activities, the risks or uncertainties could be managed in an effective manner. The process of dealing with different kinds of uncertainty is called ‘risk management’ (Vesper, 2006, p.10). Vesper adds that knowledge acquired through responding to hazards and incidents has contributed to the evolution of risk management. Over a period of time, organisation is therefore able to identify and control hazards and eventually it develops measures to prevent recurrences.

By identifying the external and internal risk factors of the organisation, risk managers may use risk management as guidance to assist decision-making on certain strategies suitable for specific types of risks (Bernstein, 1996; Power, 2004; Holt, 2004; Vaughan, 2005; Hutter, 2005; Black, 2005; TDC, 2009). Risk management is also a process which ensures that undesirable events do not occur (Power, 2004). Ideally, risk management should provide some activities to be taken in anticipation of unforeseen events, rather than a response to them as they occur. Further, it enables risk managers to decide about when to avoid and minimize the negative risks, and how to take up opportunities with some positive risks (Power, 2004; Thomson, 2008). As noted by Hopkin (2010, p.4), “the key benefit of risk management is to enhance the efficiency of operations within the organisation.” This is to ensure that decisions are made correctly to achieve objectives of the organisation (Hopkin, 2010, p.4)

3.4.1 Risk management processes

As proposed by Bernstein (1996, p.3), “to discover the nature of risk, organisations should have the ability to define what may happen in the future and to choose among alternatives as strategies to manage the risk”. Furthermore, what had occurred in the past could be used to anticipate what would happen in the future (Bernstein, 1996). Efficient risk management takes place when resources are used effectively to address challenges faced by an organisation (Vesper, 2006; Thomson, 2008; IRM, 2002). It entails the implementation of several processes to be successful: risk identification, risk analysis, risk assessment, risk treatment and risk evaluation (Black, 2005; Thompson, 2008; IRM, 2002; EC, 2006; OECD, 2004). However, different organisations may have more or less processes depending on their culture, environment and requirements.

To further enhance the effectiveness of risk management planning, previous studies (Black, 2005; Thompson, 2008; IRM, 2002; EC, 2006; OECD, 2010a) propose that regulators adopt regulatory enforcement strategies so that compliance risk management can be enforced efficiently.

3.4.2 Compliance Risk Management

Compliance Risk Management is described by the European Commission (EC) as:

“a systematic process in which a tax administration makes deliberate choices on which treatment instruments could be used to effectively stimulate compliance and prevent non-compliance, based on the knowledge of all (taxpayers’ behaviour) and related to the available capacity.” (EC, 2010, p.5)

A Compliance Risk Management model was introduced by the EC in 2006 to provide a risk management guide to the EC members in managing risks particularly in tax administrations including the customs and excise. However, in 2010, the EC has published an updated guide where the focus is more on influencing behaviour of taxpayers (EC, 2010, p.2) compared to the 2006 version which emphasised on the risk management processes. The latest Risk Management Guide keeps abreast with recent developments in managing risk, in particular compliance risk based on behaviour of taxpayers.

The Compliance Risk Management model, illustrated in Figure 3 below, comprises various activities such as risk identification, risk analysis, risk assessment, risk prioritization and risk evaluation.

Figure 3: The European Commission Compliance Risk Management Model



Source: European Commission: Compliance Risk Management Guide for Tax Administration (EC, 2010, p.8)

As illustrated by Figure 3, ‘context’ appears to be the centre of the model. EC (2010, p.8) defines context as “circumstances that surround an organisation” or as “the environments in which the tax administration operates”. The next level in the model is the ‘objectives’ of the organisation. For tax administration, common objectives are mainly to collect revenue and increase compliance and at the same time to reduce non-compliance (OECD, 1988; EC, 2010). The third factor in the circle of the model is ‘strategy’, which lists the five steps to be taken, namely, Identification, Analysis, Prioritisation, Treatment and Evaluation, to manage compliance risks. The compliance risk management strategies suggested by the EC are similar with the basic risk management process discussed in Section 3.4.2.1. The EC guideline notes:

“Context can be viewed as the playing field together with the rules of the game. This is the framework that compliance risk management is applied within. The objectives describe the purpose of the game, what to achieve. The strategy describes how to play the game in order to reach the objectives.” (EC, 2010, p.9)

As stated above, the strategy comprises of five steps in a cycle which indicates that managing risks is a continuous and iterative process. Risk identification is the first step in the process to identify lists of potential risks (EC, 2010, p.25). EC

states that risk identification is an important step because ‘if risks are not identified here, they are unlikely to be identified, and therefore, may not be covered’ (EC, 2010, p.25). The second step is risk analysis, where risk which has been identified is analysed based on ‘frequency (the number of risks/risky traders), the likelihood (the chance that the risk materialises) and consequence (for example, how much money is involved)’ (EC, 2010, p.31). It was also suggested by EC that during the risk analysis process, the tax administration should explore reasons for non-compliant behaviour so that the risks can be assessed and treated efficiently and effectively. The third stage is risk prioritisation, the main objective of which is to treat risks related to taxpayer behaviour. In this phase, risk assessment is the major activity to assess risks that has been analysed. According to EC (2010), risk treatment is a process where risks which have been assessed are treated effectively and efficiently. The EC (2010) suggests risk treatment to be undertaken through taxpayer education, supporting tax compliance and treating non-compliance.

Finally, risk evaluation evaluates impact (effect) and process: “An *impact* evaluation estimates how much a programme, policy or intervention has caused an observed outcome or change. In contrast, a *process* evaluation asks how or why it works (or doesn’t work)” (EC, 2010, p.51). Even though evaluation is the final process in the risk management cycle, EC suggests risk evaluation could be implemented at each stage of the process. The OECD has also developed a compliance risk management model as a guideline to its member countries. The model is presented in the next section.

3.4.3 OECD Compliance Risk Management Model

In addition to EC guides on compliance risk management (2010), the OECD has also improved its 2004 compliance risk management guideline. Compliance risk management is based on understanding and identifying factors that influence taxpayers' behaviour and their attitudes to comply and to implement effective responses to manage non-compliant behaviour (OECD, 2010).

Prior to that, in 2004 OECD had produced a set of compliance risk management guidance notes to promote a systematic approach to managing compliance risk. The process outlined a series of iterative steps for the systematic identification, assessment, ranking and treatment of tax compliance risks to support improved decision-making (OECD, 2004, p.9), as illustrated in Figure 4. In addition, activities such as evaluating compliance outcomes and monitoring performance against plans are also being taken. OECD (2010) suggests that the CRM process may be applied by a revenue body as a systematic process for compliance risk management.

As depicted in Figure 4, OECD suggests that the first step to be taken by a tax administration is to establish an Operating Context. The main component of the Operating Context is the organisation's objectives of tax administration, particularly in managing compliance risk (OECD, 2004). OECD notes that internal risks within tax administration and external risks outside the administration may be factors affecting the context; tax administrations may therefore need to look into these factors in order to manage risks effectively and efficiently (OECD, 2004).

Figure 4: The OECD Compliance Risk Management Process



Source: OECD: Forum on Tax Administration: Compliance Sub-Group Information Note Managing and Improving Compliance: Recent Developments in Compliance Risk Treatments, March 2009. (OECD, 2009, p.10)

The first process of managing risk as suggested by OECD (2004) is to identify risks in determining categories of non-compliant behaviour and the type of risks involved through characteristics of taxpayers and amount of tax involved to reflect the level of risk posed by taxpayers (OECD, 2004). By exploring potential high-risk taxpayers, a variety of treatments could be given to different categories of taxpayers (OECD, 2004).

In the second stage, risks which have been identified are assessed to separate major and minor risks. Prioritisation of risks is necessary since the tax administration may not be able to address all risks; OECD (2004) therefore advises priority be given to treat major risks that may affect the tax administration to achieve its objectives. Action taken at this stage is in line with Black and Baldwin's (2010) really responsive regulation whereby prioritization of major risk and minor risk is recommended so that major risks could be managed effectively.

Next, in the third stage, OECD (2004) suggests that taxpayer compliance behaviour be analysed to identify economic factors, namely, “financial burden, the cost of compliance, disincentives and incentives”; while behavioural analysis has interest in “individual differences, perceived inequity, perception of minimal risk and risk taking” (OECD, 2004, p.37).

After compliance risks are analysed, the following step is to determine strategies to treat the risks. OECD (2004) recommends various strategies be adopted by the tax administration. OECD agrees with Feld and Frey (2005), Kirchler et al. (2008) and Wenzel (2002) that the tax authority should treat taxpayers respectfully and fairly in order to gain respect and trust from them. OECD (2004) also recommends that the tax administration adopt Braithwaite’s model of compliance in order to understand factors influencing taxpayer behaviour, so that an appropriate response could be made based on taxpayers’ compliance behaviour. Tax administrations are advised to take some initiatives to ensure taxpayers understand clearly their tax obligations where information delivered is “transparent, easy to understand, simple and non-confusing” (OECD, 2004, p.48). Further, tax administrations are recommended to improve service deliveries such as providing electronic services, simplifying forms and procedures and developing less burdensome regulations. Other strategies suggested by OECD (2004) include informing the public through media coverage of successful prosecution cases and court decisions on matters of tax law and practice, to warn them of the power of authority by tax administrations. These suggestions are consistent with Kornhauser’s (2007) reviews that a shaming approach, in particular on high-profile individuals, may be an effective strategy in order to inform them of the

repercussions of non-compliance to the public and thereby to encourage compliance with the law.

Revenue authorities are also encouraged by OECD to provide incentives to taxpayers to manage non-compliance risk; it cites HMRC's experience in introducing an incentive scheme to improve compliance related to businesses' failure to register for VAT (OECD, 2004, p.52). OECD notes that a unique identifier such as a Taxpayer Identification Number or Employer Identification Number is important for tax authorities in order to match data against areas of potential non-compliance (OECD, 2004, p.52). OECD also believes that a withholding system is an effective method of tax collection because it enables tax to be collected at the same time as income is earned; tax administrations are therefore encouraged to have such systems to improve compliance. Improved record-keeping by taxpayers is a strategy to manage cash economy risk, while an audit trail of transaction records is an effective mechanism to prevent money laundering and tax evasion (OECD, 2004). OECD therefore suggests tax administrations should promote these mechanisms to manage non-compliance risk.

Another strategy is to build partnerships with tax practitioners, industries and other community groups to develop trust and cooperation from the community, which may enhance compliance (OECD, 2004). Finally, OECD recommends the adoption of sanctions such as field audits, investigations, higher penalties and prosecution for serious non-compliance (OECD, 2004, p.57). In order to implement these strategies, the next process is the allocation of human resources,

expenditure and capital effectively in order to maximize the utilization of limited resources, particularly for taxpayer programme (OECD, 2004).

After these five processes are implemented, OECD (2004) advises that the outcome of the treatment strategy should be measured to evaluate its success; thus determining the effectiveness of the compliance programme. OECD (2004) also recommends an evaluation framework be developed to improve the treatment compliance strategy. The final phase in managing compliance risk is to monitor the performance of compliance strategy. As this model is an iterative process, the phase may not be the last stage of the process and can continue with identifying new risks.

The risk management models promoted by EC and OECD are practical guides that provide knowledge and assistance to tax administrations in managing risks systematically. The steps involved in the process are similar to those suggested by Black (2005), Holt (2005), Vaughan (2005), Hutter (2005), Power (2004), Bernstein (1996) and Hopkin (2010). Furthermore, risk management can be incorporated as a set of strategies to enforce compliance by regulators, as presented in the next section.

3.4.4 Regulatory Enforcement Strategies

Compliance risk appears to present a major challenge to most regulatory agencies (Baldwin and Black, 2007; Ayres and Braithwaite, 1992; OECD, 2010). A wide range of enforcement strategies are in place and implemented by regulatory agencies to foresee that compliance of the law is established. These enforcement strategies, namely, responsive regulation and the compliance pyramid (Ayres and Braithwaite, 1992; Braithwaite et al., 2005), risk-based regulation (Hampton

Report, 2005; Black, 2005), really responsive regulation (Baldwin and Black, 2007) and risk-based responsive regulation (Black and Baldwin, 2010), are among the regulatory enforcement approaches adopted by regulators as their risk management plan to enforce compliance. Literature pertaining to these strategies addresses the way they have been adapted depending on their suitability and applicability to the agencies' requirements. In this section, each strategy is discussed and the strengths and weaknesses of each mechanism are highlighted.

3.4.4.1 Really responsive regulation

The concept of 'really responsive regulation' is promoted by Baldwin and Black (2007) in their effort to overcome shortcomings in other enforcement strategies such as responsive regulation and risk-based regulation. Really responsive regulation entails five functions to be implemented: the detection of non-compliant behaviour; response to the behaviour through tools and strategies; enforcement of tools and strategies; assessment of their success or failure; and modification of the tools and strategies (Baldwin and Black 2007, p.25). These functions accord with the risk management process as discussed in Section 3.4.1, whereby, in general, the process comprises risk identification, risk analysis, risk assessment, risk treatment and risk evaluation. However, in contrast with other enforcement approaches, really responsive regulation emphasises the development of tools and strategies to identify, respond to and enforce non-compliance. The recommended tools can be technologies or equipment used by the regulators and the strategies would be the enforcement actions to be taken to identify, respond to and enforce the risks and challenges, such as inspections and sanctions.

A further aspect emphasised by Baldwin and Black (2007) is the importance of measuring performance in order to determine the success or failure of the enforcement strategy. Really responsive regulation requires regulators to measure their performance in “detection, response tool development, enforcement, assessment and modification” (p.43). The results from this measurement will be used to determine the success or failure of the method carried out and further to improve the method accordingly. Moreover, regulators are able to evaluate the strengths and weaknesses of the measuring systems (p.37) and to take appropriate action to optimise the strengths or to improve the weaknesses.

Another advantage of really responsive regulation is that the approach suggests a switch in “regulatory direction” in order to respond to changes in “circumstances, priorities and objectives, including organisational culture” (Baldwin and Black, 2007, p.24). This implies that really responsive regulation is a flexible approach to enforcement whereby the direction can be shifted to accommodate changes that may occur during the course of action. These changes may be driven by external and internal factors of the regulatory bodies. Really responsive regulation thus draws the attention to the capability of regulators to respond to the changes by assessing the need for change, by understanding the implications of the change and, finally, by making improvements to adopt the changes (p.40).

Application of the really responsive regulation regime by the UK National Audit Office on Defra⁹'s regulation of sea fishing is addressed in detail by Baldwin and Black in their Really Responsive Regulation literature (Baldwin and Black, 2007, p.25). In adapting this approach, regulators should be responsive to five elements:

⁹ Defra: The UK Department for Environment, Food and Rural Affairs (Baldwin and Black, 2007, p.25)

regulatees' behaviour, attitude and culture; constraints and opportunities within regulators' institutional environments; interactions of regulators' regulatory tools and strategies; regulators' performance measurement; and adaptation to changes of these elements (Baldwin and Black, 2007; Black and Baldwin, 2010). Therefore, in order to be a really responsive regulator, literature suggests enforcement bodies to be responsive to the internal and external surrounding of the organisation.

3.4.4.2 Risk-based regulation

As discussed previously, a responsive regulation approach enables enforcement agencies to secure compliance and mitigate risk. According to Baldwin and Black,

“the key components of the approach are evaluations of the risk of non-compliance and calculations regarding the impact that non-compliance will have on the regulatory agency's ability to achieve its objectives.” (Baldwin and Black, 2007, p.12)

Risk-based regulation is another enforcement strategy adopted by regulatory bodies to manage non-compliance, whereby the focus is on risks and not rules (Black and Baldwin, 2010; OECD, 2010). This approach was first introduced in the 1990s during the “regulatory crises” in UK industrial society (Hutter, 2005a). Black (2005, p.3) provides two definitions of risk-based regulation. The first refers to regulators “to determine whether or not an activity should be regulated, or what level of preventive measures firms should take”. The second refers to “risk to agency itself that it will not achieve its objectives” (Black, 2005, p.3). Further, Black (2005, p.3) proposes that a risk-based regulator should develop frameworks and procedures to “prioritise regulatory activities and the deployment of resources, principally inspection and enforcement activities, organised around an assessment of the risks that regulated firms pose to the regulator's objectives.” The idea of this mechanism is to analyse, control, communicate and monitor risks

(Hutter, 2005a). The advantage is that it provides a systematic framework that guides regulators to target their regulatory resources towards highest risks and also to measure new risks and future challenges (Baldwin and Black, 2007; Wood et al. 2010; OECD, 2010).

Furthermore, when adopting the risk-based regime, regulators are advised to start the enforcement process by analysing and selecting risks that need to be managed and controlled. By prioritising the highest risks, regulators are able to concentrate on the most challenging event that may bring higher value in return and at the same time reduce enforcement cost because attention was given to specific risks rather than to all risks in general.

As noted by Black and Baldwin (2010), the Hampton Review recommends the UK regulatory agencies to adopt this approach as their enforcement strategy, especially during the 2007-2009 financial crises, to cope with regulatory problems. The objective is to ensure focus on the outcome rather than on the process approach to regulation (Hampton, 2005, p.20). Hence, Hampton suggests regulators to utilise resources where they can benefit most and “end unnecessary inspections or data requirements on less risky businesses, identify businesses that need more inspection, and release resources to improve broader advice services” (Hampton, 2005, p.4).

According to Black (2005, p.3), many regulators in the UK, namely “the Health and Safety Executive, the Environment Agency, the Financial Services Authority, the Food Standards Agency, HMRC, the Scottish Care Commission, the Housing Corporation, the Gaming Board, the Commission for Social Care Inspection and the Occupational Pensions Regulatory Authority” have adopted this approach in

their regulatory activities. However, the limitation of such an approach is that the focus of enforcement would be on the highest risk (Hampton, 2005) and thus less attention would be given to the lower risks, which may in turn create further risk; for lower risks, if not attended to, may lead to more serious risks (OECD, 2010).

3.4.4.3 Risk-based responsive regulation

Earlier discussion has drawn attention to the responsive regulation approach which enables enforcement agencies to secure compliance and manage risk. Compliance risk appears to be a major challenge faced by most regulatory agencies. According to Baldwin and Black (2007, p.12), “the key components of the approach are evaluations of the risk of non-compliance and calculations regarding the impact that the non-compliance will have on the regulatory body’s ability to achieve its objectives”. Further, Baldwin and Black suggest that the advantage of a risk-based regulation approach is that it provides

“a systematic framework that allows regulators to relate their enforcement activities to achievement of objectives. This approach enables resources to be targeted in a manner that prioritises highest risks and they provide a basis for evaluating new regulatory challenges and new risks.” (Baldwin and Black, 2007, p.13)

These regulatory regimes to enforce compliance can be used as tools to guide regulatory agencies in implementing effective risk management in their institutions. Risk-based responsive regulation suggests a combination of two or more approaches and selecting the best methods from these to produce those that are the most suitable for regulatory strategy (Black and Baldwin, 2010). By mixing the methods from really responsive regulation and risk-based regulation, regulators may achieve a “really responsive risk-based regulation”, an approach which is highly recommended by Black and Baldwin (2010). While risk-based regulation normally works when combined with other strategies to mitigate risks, in contrast, really responsive risk-based regulation entails interacting logics of

different regulatory strategies and tools to understand various behaviours, cultures or institutional environments of other regulators (Black and Baldwin, 2010). This is crucial as a pre-emptive measure to respond to the risks and to ensure an effective risk management strategy.

Command-and-control strategy might work during a crisis (Baldwin and Black, 2007), but under different circumstances, this method should be abandoned for a more cooperative style of crisis management (OECD, 2003). For example, in a major catastrophe, a command-and-control mechanism might be the most suitable approach to be taken to respond to the emergency (Baldwin and Black, 2007) whereby instructions will be given by the authority and must be obeyed by the victims instantly. There is no time for persuasion and back-patting because attention should be given to save more lives which might be threatened under the circumstances. On the other hand, during a hostage crisis, persuasion and ‘sweet-talking’ with the criminals would be the best way to cope with the critical situation at that moment. That is why in most hostage crises, the presence of a negotiator is required to persuade the criminal to release the hostages and to negotiate the criminals’ terms and demands for the release. Risk managers should be able to decide the best mechanism to adopt when faced with threats and to undertake the best solution in order to save more lives and to avoid additional damage to the crisis (IRM, 2002).

The risk-based regulatory regimes discussed above can be applied to a variety of disciplines, including finance, health, security and environment (Black, 2005). These disciplines have shown interest in understanding and managing risk in response to crises which may jeopardise organisations’ ability to achieve their

objectives (Hutter and Power, 2005). In addition to these fields, tax administration has begun to show serious commitment to risk in the area of taxation.

As a summary, Table 4 illustrates the differences between really responsive regulation, risk-based regulation and risk-based responsive regulation.

Table 4: Key features of Regulatory Enforcement Strategies

Regulatory Enforcement Strategies	Key Features
really responsive regulation	<ul style="list-style-type: none"> • Develops tools and strategies to identify, respond and enforce non-compliance risk • Measures performance to determine the success or failure of the enforcement strategies. • Switches regulatory direction to respond to changes in the situation or behaviour to comply.
risk-based regulation	<ul style="list-style-type: none"> • Prioritises the highest risks. • Targets regulatory resources towards specific risks rather than to all risks in general. • Focuses on the outcome of regulation rather than the process to regulate.
risk-based responsive regulation	<ul style="list-style-type: none"> • Adopts risk-based responsive approaches to manage risks. • Entails interacting logics of different regulatory strategies/tools to understand risks. • Combines several strategies to respond to risks

3.4.5 Risk management in tax administration

The main objective of tax administration is to collect revenue for state development (Brautigam, 2008). In order to achieve their target for revenue collection, the revenue authorities should focus on encouraging high levels of voluntary compliance and to minimise compliance costs. Taxpayers comply with tax law and regulation when they register in the system; file or lodge requisite taxation information promptly; report complete and accurate information; and pay

taxation obligations on time (OECD, 2004). Failure to meet the obligations would create non-compliance risk to tax administrations.

Arlinghaus (1998, as cited in Wunder, 2009, p.16) acknowledges that no universal definition of the term 'tax risk' exists, but offers the following: "the likelihood that tax outcome differs from what is expected, due to a variety of reasons, for example, the judicial process, changes in the law, changes in business assumptions, an increased intensity of audits, and uncertainty in the interpretation of the law; and any action emanating from the tax function that subjects the company to adverse publicity". It seems that most of the factors stated by Arlinghaus (1998) are external factors which have become risks or threats to the organisations. Tax administrations, along with other regulators, encounter internal and external challenges to enforce compliance with the regulation (OECD, 2010; EC, 2006; Thomson, 2008). External risks are identified as economic activities, industry changes and business structures; complex legislation related to tax laws and government policies; and taxpayers' behaviour and perceptions toward tax authorities and government (EC, 2006; OECD, 2001; Thomson, 2008; IRM, 2002). Internal factors involve organisation culture and structure; financial constraints; staff incompetency and technology infrastructure (EC, 2006; OECD, 2001; Thomson, 2008; IRM, 2002).

Based on the definition of risk provided in Section 3.3.1, risk can, in the context of tax administration, be considered as any event that will have an impact on the tax administration's objectives (TDC, 2009). Other risks that tax agencies have to face are "tax shelters, large-scale fraud, tax code complexity, customer service, e-commerce and globalization requiring consideration and response" (Hasseldine, 2007, p.4). Effective risk management is therefore imperative to assist tax

administration in order to identify, respond to and address current as well as future risks efficiently (Baldwin and Black, 2007; OECD, 2010; EC, 2006; Hasseldine, 2007).

Tax administrations in countries such as Australia, the UK, the US and the EC have also shown their concern about the effect brought by risks related to taxation which may affect their goal to increase revenue collection. These tax authorities have started to formalize strategies to understand and manage risks in their organisation. For example, in 2006 the ATO published *Large Business and Tax Compliance*, which addresses tax risk concepts (ATO, 2006); the IRS with its LMSB (IRSAC, 2008); the HMRC with its approach to compliance risk management for large business (HMRC, 2007); and the EC with its risk management guide for tax administration (EC, 2006).

The IRS of the USA began its process of risk management by defining tax risk as:

”any event, action, or inaction in tax strategy, operations, oversight reporting, or compliance that either adversely affects LMSB¹⁰’s collection or business objectives, or results in an unanticipated or unacceptable level of oversight reprimands, lost appeals, diminished collections, harm to reputation, lost opportunities or reporting exposure.” (IRSAC¹¹ Report, 2008)

As ‘an evolutionary process’, the implementation of risk management is monitored by internal audit in the effort to measure its effectiveness and efficiency and, further, to improve the process (IRSAC, 2008). Continuous attention from the senior managers and leadership of the IRS are the crucial elements of an effective risk management plan.

¹⁰ The Large and Medium –sized Business Subgroup (LMSB) is a division in the Internal Revenue Service (IRS) of USA which handles tax profiles of large and medium size business taxpayers.

¹¹“The Internal Revenue Service Advisory Council (IRSAC) provides an organized public forum for IRS officials and representatives of the public to discuss relevant tax administration issues. The Council advises the IRS on issues that have a substantive effect on federal tax administration.” (IRSAC, 2008)

Furthermore, the ATO (2009) has identified various risks that they must manage in order to overcome the non-compliance issues as well as to improve compliance. These risks are: environmental factors that influence decisions and behaviour of taxpayers (business, industrial, sociological, environmental and psychological factors); attitudes of taxpayers to compliance; and compliance strategies. To achieve long-term compliance, one of the strategies undertaken by the ATO is the compliance pyramid model - a strategic framework for compliance improvement. The compliance pyramid model is developed to encourage taxpayers to voluntarily meet their future taxation obligations. The risk management executed by the ATO requires a balanced approach to moderate any loss and ensure the best return to the revenue (ATO, 2009).

The UK HMRC implemented a risk-based approach to benefit from a more cost-effective use of resources and effective use of resolution of issue (HMRC, 2007). Thus the implementation of an audit approach which focuses on key risks is the HMRC's response to compliance risk management for large businesses taxpayers. This action is in line with the suggestion from OECD (2010) that, when faced with limited resources and relatively large numbers of taxpayers to administer, revenue authorities require a systematic risk-based approach for identifying which taxpayers to audit. In the same way as the ATO, the HMRC also uses the compliance pyramid model as a strategy to mitigate risk and foster compliance.

The EC has also adopted a risk-based compliance pyramid (EC, 2006) in an effort to manage risk and improve compliance. Various regulatory strategies such as marketing, education, audit and enforcement are executed as the risk management plan to reduce risk in its administration. In addition to the risk management plan,

the EC risk-based compliance pyramid also studies the behaviour of taxpayers in order to understand determinant factors that influence taxpayers' decisions about compliance. Russell (2010) suggests that to encourage voluntary compliance, tax administrations need to "identify and respond to the most significant risks in the tax system through a range of measures aimed at the underlying causes of the noncompliant behaviour" (p.3). Therefore, regulators may need to prioritise high profile risks and develop suitable strategies to manage non-compliance taxpayers.

Various studies have been conducted by tax researchers (Bird, 2004; Silvani and Baer, 1997; Braithwaite, 2006) and institutions (World Bank, 2004; OECD, 2004) on the tax administrations of developing countries. The researches investigate challenges faced by these tax administrations and recommend a systematic process for managing tax compliance risks as well as some improvement in the procedures and systems (OECD, 2004; World Bank, 2004; Bird, 2004). Cooperation among tax administrations is crucial in managing risk, and is achieved by sharing information on risk or threats faced by other tax administrations (OECD, 2003). Learning from the best practice of others in responding to the risks would reduce enforcement cost and improve regulatory strategies, particularly for tax administrations in developing countries. Risk management could be a strategic tool to assist organisations to control or mitigate the chance of failure and to enhance the possibility of success. These challenges are not unique to IRBM, since tax administrations in other countries face similar pressures and uncertainty. The next section will address the responsive regulation concept as a set of strategies to manage compliance risk.

3.5 Responsive regulation

Various challenges and risks confronted by regulatory agencies in practice, particularly in the developing world, were highlighted in Chapter 1. These challenges and risks have resulted in non-compliance, which affects the extent to which regulators achieve their goals in supporting the government to develop the country. Scholars such as Bird (2008), Brautigam (2005) and Braithwaite (2006), and organisations such as OECD (2004) and the World Bank (2004) have urged regulatory agencies in developing economies to overcome the challenges by reforming their administration. In this context, regulatory agencies are the law enforcers, including the police, customs and revenue officials, the municipal council and other agencies that have law enforcement responsibilities to secure compliance of the law and regulation.

According to OECD and World Bank, reform of tax administration is vital to enable regulators to encourage regulatees in complying with the regulation, in order to achieve their objective to procure compliance and at the same time to manage risks. While most regulatory agencies in developed economies have reformed and introduced responsive administration (OECD, 1988; Brautigam, 2008; Braithwaite, 2006), regulators in developing countries are known for their traditional regulatory approach in enforcing compliance (Braithwaite, 2006). The old practice of enforcement was an authoritative interaction when communicating with the public, and a resort to punishing offenders by imposing penalties, prosecuting and proceeding to court. Although these punitive mechanisms may force regulatees to comply with the law, it appears to be an expensive course of action (Ayres and Braithwaite, 1992; Welsh, 2009; Braithwaite, 2007) in terms of human resources, financial resources and time.

Furthermore, this ‘hard approach’ (Braithwaite, 2003) may not be a long-term solution for self-regulation and voluntary compliance due to resentment [ibid] on the part of the offenders towards the regulators. Thus, regulatory bodies in developing countries have been advised to reform by developing a responsive administration in order to improve their relationship with the public. Through administrative responsiveness, where regulatory agencies have the ability to respond to the need of the public (OECD, 1988), services to customers are to be delivered professionally, courteously, fairly and in a friendly manner to motivate the public to comply. Reciprocally, regulatory bodies will earn the trust, cooperation, and respect of the community (Braithwaite, 2003; Kirchler et al., 2008; Mitton, 2009). The reform of responsiveness in the regulatory approach by the administration is also known as responsive regulation.

The basic idea of responsive regulation is that regulatory agencies should be “responsible for the conduct of those they seek to regulate and law enforcers should be responsible for how effectively citizens are regulating themselves before they intervene” (Ayres and Braithwaite, 1992). In the past, most regulatory agencies are known to operate in a ‘command-and-control’ manner to achieve their objective (Braithwaite, 2007; Leviner, 2009; Baldwin and Black, 2007). Command-and-control is an approach where regulators use direct enforcement or regulation to conduct the law (Braithwaite et al. 2005).

Within a command-and-control mechanism, regulators ‘command’ regulatees to observe the law and ‘control’ regulatees’ behaviour with the threat of punishment (Sinclair, 1997). However, it is no longer considered appropriate to implement such a traditional approach of enforcement through use of the law and threat of

prosecution to force regulatees to comply. This change of attitude is due to cost factors, inefficiency, change in organisational culture, and the expectation from both the government and the public for more responsiveness in service delivery to the public (OECD, 1988; Jenny Job et al., 2007; Sinclair, 1997). Law enforcers should therefore investigate moving from command-and-control to a responsive approach of regulation; Sparrow (2000) highlights that responsive regulation is about how regulators should behave rather than how regulation should be changed. The idea is that, during interaction with regulatees, responsive regulation requires regulators to conduct in a responsive, respectful and professional manner.

Through responsive regulation, compliance can be fostered, not through punishment, but through persuasion, education, encouragement and assistance. These 'soft approaches' (Braithwaite, 2003) would be a better strategy to be adopted by regulators since they may result in cooperation from the regulatees and achieve the goal of responsive regulation "to stimulate maximum levels of regulatory compliance" (Welsh, 2009, p.2). As noted by Braithwaite (2011, p.489), "the job of responsive regulators is to treat offenders as worthy of trust, because the evidence is that when they do this, regulation more often achieves its objectives."

As noted by Welsh (2009, p.2), "responsive regulation recognises that it is not possible for any regulatory agency to detect and enforce every contravention of the law that it administers". Thus, regulators should be able to motivate regulatees to voluntarily comply with the regulations and encourage self-regulation (Braithwaite, 2007; Ayres and Braithwaite, 1992; Welsh, 2009). Responsive

regulation also helps regulators to decide when to use ‘stick’ or ‘carrot’ to persuade regulatees based on their behaviour and responses towards compliance.

The ‘carrot and stick’ approach has been discussed quite extensively by Andreoni, Harbaugh and Vesterlund (2003) and by Ayres and Braithwaite (1992) who recommend that enforcement agencies take appropriate action based on the type of public they are dealing with. ‘Carrot’ is a symbol of reward for those who comply with the law while ‘stick’ is a punishment to those who fail to comply (Andreoni, Harbaugh and Vesterlund (2003) and Ayres and Braithwaite (1992). Regulators are advised to use either carrot or stick according to the situation (Braithwaite, 2002; Andreoni, Harbaugh and Vesterlund, 2003). Various enforcement strategies could be enacted through the responsive regulation approach, as illustrated by the Regulatory Pyramid introduced by Ayres and Braithwaite, addressed in the next section.

3.5.1 The Regulatory Pyramid

The guidelines to enforce compliance, which applies the concept of responsive regulation, can be observed in the regulatory pyramid designed by Ayres and Braithwaite (1992), and depicted in Figure 5 below. The regulatory pyramid is the most distinctive part of responsive regulation and the epitome of compliance pyramids adopted by regulatory agencies in many countries. The regulatory pyramid, which is expanded from the responsive regulation theory posited by Ayres and Braithwaite, provides guidelines to regulators on how to foster compliance effectively through hierarchical levels of the pyramid starting from the base and moving up to the peak of the pyramid.

Figure 5: The Enforcement Pyramid



Source: Responsive Regulation: Transcending the Deregulation Debate (Ayres and Braithwaite, 1992)

As illustrated in Figure 5, the multi-tiered pyramid displays enforcement strategies implemented at various stages, depending on responses from the regulatees. According to Ayres and Braithwaite, the regulatory pyramid, also known as the enforcement pyramid, draws attention to the base of the pyramid where most regulatory action occurs to encourage compliance. The pyramid also shows when persuasion does not work, when regulators move up to the next level of the pyramid and warning letters will be issued. Should the warning fail to encourage the regulatees to comply, then the next strategy is to escalate to the next level of the pyramid where civil monetary penalties will be imposed. If this enforcement fails to secure compliance, then criminal prosecution will take place. Moreover, if this also fails, the licence to operate will be suspended temporarily. The final level of enforcement, which is at the peak of the pyramid, is permanent revocation of licence. From this enforcement pyramid we can learn that different types of enforcement mechanisms are suitable for specific regulatory fields.

The hierarchical strategies begin at the base and escalate through higher levels of the pyramid depending on the responses from the regulatees. This shows that

responsive regulation educates regulators about the need to be flexible, to escalate or de-escalate the enforcement pyramid, in their action against offenders, and they should resort to strong enforcement only after persuasion fails and the offenders refuse to comply with the law. This strategy is called a ‘tit-for-tat’ approach (Scholz, 1984; Ayres and Braithwaite, 1992).

3.5.2 Tit-For-Tat

According to Ayres and Braithwaite (1992), adopting punishment as an enforcement measure may not be an effective approach to encourage voluntary compliance. Braithwaite (2006) also argues that punishment may not be a suitable mechanism to be adopted, particularly for developing economies, since it is expensive. Ayres and Braithwaite further suggest that a soft approach such as persuasion is a cheaper means of enforcement. However, both studies agree that punishment can be adopted after soft approaches fail to be effective in maintaining compliance. Ayres and Braithwaite therefore recommend the ‘tit-for-tat’ strategy (TFT) which posits that persuasion and punishment is more likely to be an effective approach in both fostering voluntary compliance and preventing non-compliance.

To apply the strategy effectively, a TFT approach recommends that regulators begin enforcement at the bottom of the pyramid and then “respond tit-for-tat to the regulatee’s response” (Nielsen and Parker, 2009, p.387). In the context of this study, TFT is about how regulators’ response would depend on regulatees’ compliance behaviour. This means, if a regulatee is being cooperative, the regulator would respond with soft strategies. However, when a regulatee refuses to cooperate, then a harsher approach would be enacted by the regulator (Scholz, 1984; Ayres and Braithwaite, 1992; Murphy, 2004). When regulatee responds

cooperatively to comply, then the regulator should de-escalate down the pyramid to a lower level strategy to promote future compliance (Nielsen and Parker, 2009). Furthermore, TFT encourages regulators to be flexible in their regulatory enforcement by escalating up or de-escalating down of the pyramid depending on regulatees' motivation to comply (Nielsen and Parker, 2009).

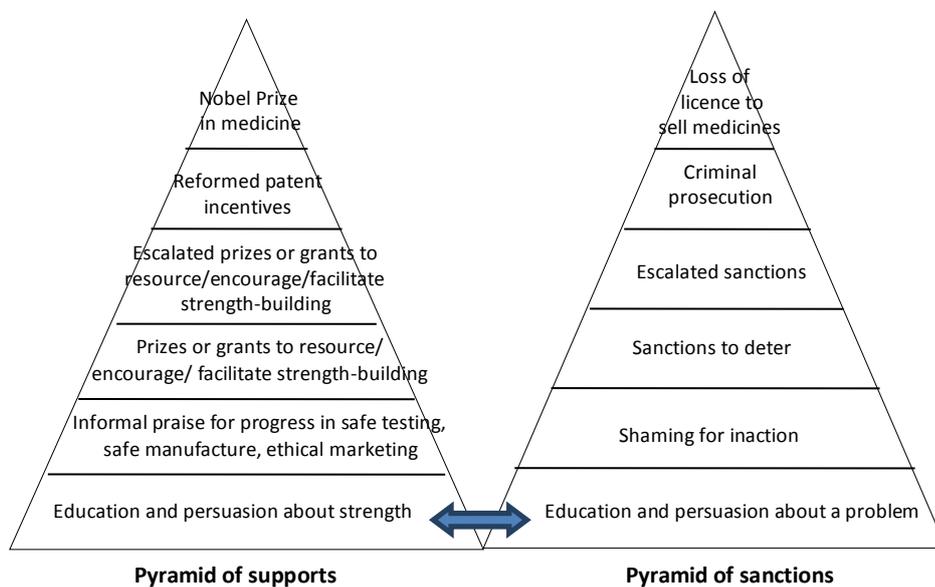
The TFT strategy promotes cooperation by regulatees which may result in low compliance cost compared with paying for a higher cost for being prosecuted for violating the law (Scholz, 1984). However, due to its flexibility, Braithwaite et al. (2005, p.37) admit that responsive regulation has been criticised for its lack of consistency in enforcement; the traditional mechanism is more consistent in that all offenders would be punished for breaking the law. In practice, the flow may not be as simple and straightforward as consistently moving up from one level to another. Depending on the circumstances and the responses from the regulatees, the movement of the escalation may not flow. For example, in some circumstances, cooperation may be hard to obtain as expected because "dialogue and persuasion may be more difficult to accomplish for common crime offenders" (Daly, 2003). Nielsen and Parker also admitted that:

"In real life it is quite difficult for regulators to be perceived to be behaving in a way that is tit-for-tat responsive, even if they are trying to behave tit-for-tat responsively." (Nielsen and Parker, 2009, p.389)

3.5.3 The Pyramids of Supports and Sanctions

In 2011, Braithwaite, with Dukes and Maloney, expanded the regulatory pyramid and developed the Pyramids of Supports and Sanctions, as illustrated in Figure 6 below. Although these twin pyramids were established for the regulation of medicines (Braithwaite, 2011, p.482) they may also be applied to other regulations.

Figure 6: Pyramids of Supports and Sanctions



Source: The Essence of Responsive Regulation (Braithwaite, 2011, p.482)

As depicted by Figure 6, regulators are advised “to engage in, and exhaust, a pyramid of supports prior to accessing the pyramid of sanctions” (Sarra, 2011, p.792). Braithwaite (2011) proposes that regulators escalate or de-escalate the pyramid sanctions to apply appropriate responses to support compliance. Thus, to encourage compliance, Braithwaite advises regulators take the first step at the base of the pyramid of supports, which is to educate and persuade regulatees. Then, by moving further up the pyramid, approaches are adopted to promote and encourage regulatees to comply. At the peak is the highest acknowledgement or

reward for high achievers. Only after all efforts to support compliance are exhausted and non-compliance still persists, may regulators then proceed to employ enforcement mechanisms, as illustrated in the pyramid of sanctions, in order to prevent future non-compliance and to turn resistance into cooperation.

Again, Braithwaite issues a reminder that enforcement measures through persuasion may incur lower cost than a punitive approach, which should be imposed only when persuasion fails; as implied by the pyramid, “if you violate, it is going to be cheap for us to hurt you (because you are going to help us hurt you” (Braithwaite, 2011, p.487). On the other hand, the pyramid of sanctions highlights responsive strategies that can be employed to manage problems or non-compliance, starting in the same way as the supports approach, with education and persuasion on relevant issues. Consistent with the enforcement pyramid shown in Figure 6, as the steps escalate, more serious enforcement mechanisms are enacted, ending with strict punitive action at the top of the pyramid. The pyramid of supports, which applies responsive regulation concepts, appears to promote self-regulation, while the pyramid of sanctions initiates self-punishment. As suggested by Braithwaite, the pyramid warns non-compliers:

“Unless you punish yourself for law-breaking through an agreed action plan near the base of the pyramid, we will punish you more severely higher up the pyramid.”
(Braithwaite, 2011, p.487)

Further, in ‘The Essence of Responsive Regulation’, Braithwaite also advocates nine principles of responsive regulation, listed in Box 1 below, to simplify and clarify the theory of responsive regulation:

Box 1: Principles of Responsive Regulation

1. *Think in context; don't impose a preconceived theory.*
2. *Listen actively; structure dialogue that:*
 - a. *Gives voice to stakeholders*
 - b. *Settles agreed outcomes and how to monitor them;*
 - c. *Builds commitments by helping actors find their own motivation to improve;*
 - d. *Communicates firm resolve to stick with a problem until it is fixed.*
3. *Engage those who resist with fairness; show them respect by construing their resistance as an opportunity to learn how to improve regulatory design.*
4. *Praise those who show commitment:*
 - a. *Support their innovation*
 - b. *Nurture motivation to continuously improve;*
 - c. *Help leaders pull laggards up through new ceilings of excellence.*
5. *Signal that you prefer to achieve outcomes by support and education to build capacity.*
6. *Signal, but do not threaten, a range of sanctions to which you can escalate; signal that the ultimate sanctions are formidable and are used when necessary, though only as a last resort.*
7. *Network pyramidal governance by engaging wider networks of partners as you move up a pyramid.*
8. *Elicit active responsibility, resorting to passive responsibility when active responsibility fails.*
9. *Learn; evaluate how well and at what cost outcomes have been achieved; communicate lessons learned.*

Source: The Essence of Responsive Regulation (Braithwaite, 2011, p.476).

3.5.4 Self-regulation

“The hallmark of responsive regulation is the pursuit of cooperation by the regulatee with the regulator” to promote self-regulation and voluntary compliance (Burton, 2007, p.74). Ayres and Braithwaite’s regulatory pyramid provides practical guidelines for regulators to apply responsive regulation theory in their enforcement practice. Regulators should initiate the practice by identifying categories of regulatees by their responses and behaviour towards compliance. The best approach is to begin at the base of the pyramid where tax authorities treat those who are willing to comply in a fair and supportive manner. Willingness to cooperate with the authority and to comply voluntarily is also known as self-regulation¹².

Self-regulation motivates regulatees to control and regulate their responses to achieve goals (Baumeister and Vohs, 2007); which in the context of this study is to follow the rules. To promote self-regulation, the authority is advised to provide assistance and guidance to regulatees in order to enhance their compliance. With reference to the enforcement pyramid, activities at the base of the pyramid suggest self-regulation, whereby taxpayers are responsible for regulating their tax compliance behaviour (Murphy, 2004). However, support and cooperation from tax regulators is desirable to ensure simplicity of procedures for taxpayers to comply (Murphy, 2004).

¹² *Self-regulation* is “the self’s capacity for altering its behaviours. It greatly increases the flexibility and adaptability of human behaviour, enabling people to adjust their actions to a remarkably broad range of social and situational demands. It is an important basis for the popular conception of free will and for socially desirable behaviour. It provides benefits to the individual and to society, and indeed good self-control seems to contribute to a great many desirable outcomes, including task performance, school and work success, popularity, mental health and adjustment, and good interpersonal relationships” (Baumeister and Vohs, 2007, p.1)

Self-regulation appears to be the most suitable method to foster compliance, especially for regulatory agencies with limited and insufficient resources (Sinclair, 1997). When the majority of the community becomes self-regulated, the resources of regulatory agencies can be channelled to manage non-compliance at the peak of the pyramid; thus, law enforcers can focus their enforcement strategy towards hard-core offenders. The principle of responsive regulation entails guiding law enforcers towards making decisions about when to punish and when to persuade (Ayres and Braithwaite, 1992). However, regulators should not abandon the self-regulated community who still require assistance, guidance and encouragement. Responsive customer service will motivate them to continue to be self-regulated in their compliance affairs so that long-term voluntary compliance can be established. Otherwise, this section of the self-regulated community will feel neglected by the regulators and may change their responses towards enforced self-regulation (Braithwaite, 2003), which in turn may result in additional enforcement cost to the regulators.

Relevant information and education should be provided to those who wish to cooperate but who lack knowledge in the relevant area. When a regulatee has the inclination to cooperate but is reluctant in complying, then the regulator should move up to the next level of the pyramid to persuade and advise the person in order to secure compliance. Self-regulation enables regulatory agencies to deploy their “regulatory resources to address the recalcitrant few rather than the compliant majority” (Sinclair, 1997, p.537).

Further, the final step is for regulators to deploy resources to enforce those who clearly disregard the law and refuse to comply despite efforts at persuasion (Braithwaite, 2003; Ayres and Braithwaite, 1992; Burton, 2007). This is when the

traditional regulatory approach, using punishments such as penalty imposition, prosecution and imprisonment, is exercised to improve compliance. Nevertheless, law enforcers should be flexible in their courses of action and willing to move down the level of the pyramid in their regulatory practice if the response of the regulatees changes to a willingness to cooperate (Healy and Braithwaite, 2006). If appropriate approaches are exercised, not only will regulators be able to manage current non-compliance, but they can also prevent future offences from occurring. Nevertheless, Sinclair (1997, p.532) has observed that “in the vast majority of circumstances, neither pure self-regulation nor strict command and control will be appropriate; rather, some combination of the two will provide the optimal regulatory solution”. Regulatory agencies will therefore be able to adapt responsive regulation concepts in a manner suitable to various circumstances in the community.

3.5.5 The responsive regulation approach

Reward and punishment is an important concept to motivate compliance (Andreoni and Harbaugh, 2002). This concept, also known as the carrot-and-stick approach, implies that those who comply with the law will be rewarded and, naturally, those who refuse to cooperate will be punished (Andreoni et al., 2003; Leviner, 2009; Braithwaite, 2003). Responsive regulation promotes a soft, or carrot, approach, when dealing with the public. The soft approaches, which employ persuasion, education, encouragement and negotiation, appear to be effective in promoting self-regulation and voluntary compliance with the law by regulatees (Ayres and Braithwaite, 1992; Braithwaite, 2007, Andreoni et al., 2003). The responsiveness in the regulators’ treatment towards regulatees may improve services provided by the regulators, which in turn will increase the

public's confidence in the system and their level of respect towards the regulators (OECD, 1988). The stick can only be used after efforts in using carrots fail to persuade regulatees to comply. However, even though the stick should rarely be used, it is an important and necessary tool to encourage cooperation in order to foster compliance. Interestingly, a further, and significant, feature of responsive regulation is that it may lessen psychological resentment by regulatees towards regulators. As highlighted by Brown (2001, cited in Welsh, 2009):

“a driving motivation of this approach is to reduce the psychology of resentment, the prospect that firms and individuals confronted with inflexible commands and harsh punishments adopt a critical, non-cooperative posture toward compliance goals and enforcement personnel.” (Brown, 2001, cited in Welsh, 2009)

This concurs with Bardach and Kagan (1982, cited in Ayres and Braithwaite, 1992) who posit that “one of the problems of punitive policy is that it fosters the culture of resistance to regulation”. They therefore recommend that, if persuasion is conducted first and is successful, “more resources are left to expand regulatory coverage” (p.25). The concept of responsive regulation motivates regulators to adopt a soft approach in order to instil cooperation from the regulatees. As discussed earlier, regulatees can be coaxed through persuasion, education and negotiation into complying willingly. If regulators fail to comply with the responsive regulation principle by employing the stick enforcement strategy, the effect is that, although regulatees may comply, they will harbour resentment against the authorities and thus the objective for self-regulation and voluntary compliance may be difficult to achieve. In order to achieve the compliance objective, regulators should realise that, when dealing with regulatees, the action taken should be ‘non-confrontational’ [ibid] to obtain their voluntary cooperation.

3.5.6 Application of responsive regulation

Literature draws on a wide range of scenarios relating to the application of responsive regulation, ranging from the health care sector (Healy and Braithwaite, 2006; Herbert and Buckley, 2006; Walshe, 2001) and justice (Braithwaite, 2002), to children and family policy (Adams and Chandler, 2004). It appears that responsive regulation theory has been adopted by various regulatory agencies throughout the world (Wood et al., 2010; Welsh, 2009; Braithwaite et al. 2005; Baldwin and Black, 2007) to improve customer service, manage risk and secure compliance. Wood et al. (2010) refer to the application of responsive regulation in the administration of various regulatory bodies in Australia, Britain, Canada, New Zealand, the European Union, Indonesia, the Netherlands and the USA.

Practitioners of the responsive regulatory principle discussed by Wood et al. include Australia's Productivity Commission with their "movement towards more responsive and self-regulatory strategies" (2010, p.5); the Queensland Health Quality and Complaints Commission, which aims to "bring together our two core roles – complaints and investigation management and standard-setting and quality improvement" (2010, p.10); the Office of Transport Security, which seeks "to ensure industry compliance with the law and regulations by effecting changes in industry participant behaviour towards their regulatory obligations" (2010, p.22); and the South Australian Environment Protection Agency, aiming "to protect, restore and enhance the quality of the environment" (2010, p.26).

In the UK, Wood et al. have addressed the attempt by both The Hampton Review and The Macrory Review for the UK government to adopt responsive regulation in their enforcement strategies. While Hampton advises the UK regulatory agencies to be responsive in their enforcement strategies and to prioritise the

highest risk, Macrory suggests that the agencies should be flexible, efficient and responsive (Wood et al., 2010) in order to encourage compliance with the law.

Responsive regulation is also applied in the enforcement of environmental crimes to educate firms about environmental rules and to assist them to comply (Welsh, 2009). The health sector is one of the regulatory sectors which have applied responsive regulation in their administration. Many studies have been conducted to explore and understand the reasons behind the adoption of responsive regulation theory within the health sector (Healy and Braithwaite, 2006; Herbert and Buckley, 2006; Walshe, 2001; Braithwaite et al., 2005). According to Healy and Braithwaite (2006), changes in health care sectors - new technology and new global diseases - demand effective mechanisms to manage the risk.

Literature has noted significant success achieved by NHS agencies that have reformed their regulatory practice and applied responsive regulation in their administration. The adoption of a regulatory mechanism by the health sectors has improved performance efficiency, the quality and safety of patient care and health management in the NHS (Healy and Braithwaite, 2006; Walshe, 2001; Herbert and Buckley, 2006). From the literature, it appears that most regulatory bodies agree that in order to establish an effective regulatory system, they should focus on the need for a responsive regulatory approach whereby persuasion and education are the best methods to foster compliance. While sanctions should be imposed on recalcitrant offenders, the responsive regulation principle suggests that strict enforcement should be acted upon only as the last step of enforcement action if regulatees have no intention to comply with the law. Regulatory agencies are also encouraged to initiate better regulation administration by formulating

policy such as ‘Regulatory Management Policy’ by the Nova Scotia Department of Environment, and The Hampton and Macrory Reviews (Wood et al., 2010).

The main purpose of these documents and policies is to secure compliance through responsive practice. Furthermore, the regulatory bodies agree that regulators should be flexible in their enforcement strategies by escalating through various levels of the pyramid according to the responses of regulatees. However, they also should be willing to de-escalate (Healy and Braithwaite, 2006; Nielsen and Parker, 2009) to the lower levels of the pyramid and repeat the action if the mechanism undertaken at the level above fails to coerce the offender to comply.

Responsive regulation also requires regulators to acquire “excellent communication and relational skills in order to convey a complex set of messages about the threat of regulatory enforcement and the possibility of cooperation in a contextually sensitive way” (Nielsen and Parker, 2009, p.394). The skills are necessary so that regulatees and the public will be aware of the repercussions of violating the law and at the same time are persuaded to comply with the regulation. As the theory of responsive regulation promotes education, persuasion, negotiation and cooperation, such strategies could only be carried out successfully if regulators acquire excellent communication and relational skills to communicate the objective of regulatory enforcement.

There are also many references in the literature about the application of responsive regulation theory in tax administration (Braithwaite, 2003; Braithwaite, 2007; Burton, 2007; EC, 2006; OECD, 1988; Kirchler et al., 2008). The core business of tax administration is to ensure compliance so that revenue can be collected for the government to develop the country and provide services

to the public (Brautigam, 2008). To secure compliance is a major challenge to any tax administration because taxation is complex (Braithwaite, 2007; OECD, 2001; Andreoni, Erard and Feinstein, 1998; Frey and Feld, 2002) and, as noted by Alm et al. (1992) people naturally find it hard to part with their hard-earned income and will therefore try to evade paying tax. To procure compliance, manage non-compliance risk and improve service delivery to taxpayers, Braithwaite (2007), Leviner (2009), Kirchler et al. (2008) and Feld and Frey (2005) recommend responsive regulation as the most suitable approach to guide a tax authority in its enforcement practice. The regulatory pyramid proposed by Ayres and Braithwaite (1992) can be referred to as a guideline to the responsive regulatory approach to foster and maintain compliance, while the ATO compliance model has been adapted by a number of tax administrations.

3.5.7 Responsive regulation for developing countries

Ayres and Braithwaite (1992, p.26) imply that “persuasion is cheap and punishment is expensive”. This is supported by Welsh (2009) who states that if the first choice of action, i.e. punishment, is at the peak of the pyramid, then the strategy would be “unaffordable, unworkable, and counterproductive”. In promoting compliance, the enforcement mechanisms undertaken should start from the base of the pyramid, with persuasion or education (Ayres and Braithwaite, 1992; Welsh, 2009; Braithwaite, 2007). As most of the regulatees are categorised as willing to cooperate, they are located at the base of the pyramid, and only a small portion of the offences are grouped at the peak of the pyramid (Braithwaite, 2003). Only when persuasion fails to gain cooperation as desired, the next strategy is to move up to the next level of the pyramid. In addition, Wood et al. (2010, p.37) discusses the Advertising Standards Authority (ASA) of New Zealand

commenting that enforcement strategies that comply with responsive regulation result in a “cost-effective, timely and efficient regulatory regime”.

As addressed in Section 1.4, regulators in developing countries encounter various constraints, such as human resources, financial resources, information technology systems and expertise in technical knowledge, causing inefficiency in their administration. Regulatory agencies in developing countries also appear to be weak in their enforcement capabilities (Braithwaite, 2006) due to these constraints. These arguments indicate that the responsive regulation concept may be the most appropriate strategy to be adopted by regulatory agencies, particularly in developing countries (Braithwaite, 2006).

Responsive regulation theory allows regulators to prioritise their enforcement strategies on high risk cases (Braithwaite, 2007, Baldwin and Black, 2007). This approach may reduce enforcement cost for regulatory agencies because resources will be allocated appropriately to areas of highest concern to meet overall objectives where the result may produce higher returns. To overcome the problems faced by developing countries, Braithwaite (2006, p. 884) advises developing countries adopt responsive regulation as they have “less regulatory capacity than developed countries”. By shifting to responsive regulation, the authorities would have more discretion to prevent corruption and to improve their operations.

3.5.8 Responsive regulation for tax administration

Leviner points out that “responsive regulation may constitute a superior method for regulating tax compliance” (2009, p.381). For a tax administration to make a successful response, four major components should be taken into account,

namely, the public, the tax personnel, the decision-makers of tax administrations and finally the government (OECD, 1988). These components are inter-related and are dependent on each other in order to operate efficiently. The government needs the tax administration to provide services to the public so that revenue can be collected from the public. On the other hand, the public requires responsive services from tax officials in order for them to understand their responsibility to declare their income and pay taxes. Tax administrations should reform their enforcement strategy from the command-and-control approach (Braithwaite, 2007) to a responsive regulatory regime. As OECD has asserted:

“... it is neither effective nor efficient for tax offices to place too much emphasis on enforcement to the exclusion of service when collecting taxes, as this will alienate the public rather than involve them. Similarly, the extent to which taxpayers accept their responsibility of providing accurate information to the authorities impacts on attitudes within tax administrations.” (OECD, 1988, p.20)

As a result of responsive regulation in taxation¹³, compliance can be fostered by way of education, encouragement and assistance, rather than through punishment for non-compliance. Ayres and Braithwaite suggest that a regulatory agency should be able to provide diverse enforcement approaches according to the nature of compliance. This should be illustrated through an enforcement pyramid which contains a different mechanism for enforcement at each level of the pyramid. The idea of responsive regulation is not to punish the offenders but rather to gain their cooperation to prevent the offences from recurring (Nielsen and Parker, 2009).

¹³ Responsive regulation in taxation means “influencing the community's commitment to pay tax through respectful treatment, through attending to resistance and reforming faulty processes, through fairly directed and fully explained disapproval of non-compliant behaviour, through preparedness to administer sanctions, and capacity to follow through to escalate regulatory intervention in the face of continuing non-compliance” (Braithwaite, 2007, p. 3).

3.6 Compliance Pyramid

The principle of responsive regulation is an appropriate strategy that can be adopted by the tax administration as a regulatory body to enforce compliance on tax return forms submission and payment of taxes. The ATO is the pioneer among tax administrations in implementing a responsive regulation approach in its compliance strategies, working with Valerie Braithwaite to develop the well-known Compliance Pyramid, which has served as an important reference for other tax administrations in order to formulate compliance strategies within their organisation. Other tax administrations which have followed suit in adopting this responsive regulation-based compliance pyramid are the HMRC, the New Zealand Inland Revenue and The East Timor Revenue, while the European Union has adapted the pyramid model to become a risk-based compliance model implemented by the Customs Agency.

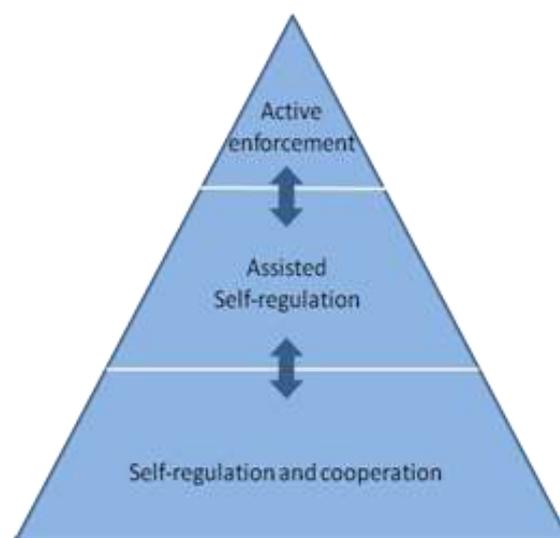
According to Braithwaite (2007), responsive regulation is an effective approach that assists tax administrations in fostering institutional integrity and developing an amiable relationship with the public. OECD (1988) discusses administrative responsiveness when addressing the need for tax administration (the regulators) to deliver services to taxpayers efficiently and effectively to satisfy their clients' needs.

3.6.1 The ATO Compliance Pyramid Model

There is a wide range of literature pertaining to the ATO compliance model (Braithwaite, 2003; Braithwaite, 2007; Murphy, 2004; Job et al., 2007; Hobson, 2003). The ATO has applied responsive regulation theory through their Compliance Pyramid model (Figure 7) to illustrate the key aspects of the

regulations. The triangular setup of the model with its wide base illustrates that most people are generally complying with the tax regulations, thus indicating self-regulation through voluntary compliance, persuasion and education. However, the narrow apex of the pyramid implies that only a small number of people are involved in non-compliance, hence the need for “the big stick” enforcement approach (Leviner, 2009, p.423).

Figure 7: The ATO Compliance Pyramid



Source: Cooperative Compliance: Working with Large Business in the New Tax System (ATO, 2000)

In 1998 the ATO Compliance Model was created by the Cash Economy Task Force to investigate tax non-compliance cases that were the result of cash economy activities. BISEP was used as a tool to study and understand taxpayers’ behaviour towards tax compliance, which was later adopted and adapted by other tax jurisdictions in the UK, New Zealand, Timor Leste, Indonesia, and Pennsylvania within the U.S. (Braithwaite, 2007, p.2). The Compliance Model is “a key instrument in the ATO’s approach to risk management” (D’Ascenzo, 2008).

The theory of responsive regulation is enforced in this model whereby different strategies are implemented depending on the responses of the taxpayers. At the base of the pyramid, tax authorities work on strategies to educate and encourage taxpayers toward voluntary compliance and self-regulation. At the middle level, tax officials provide assistance to persuade taxpayers for self-regulation. Eventually, if deterrence is required, the command-and-control approach is actively enforced by the authorities, as shown at the peak of the pyramid. For the responsive regime to be accepted and appreciated by ATO staff, responsive regulation principles were incorporated into the ATO's training programmes, corporate plans and daily operations (Job et al., 2007).

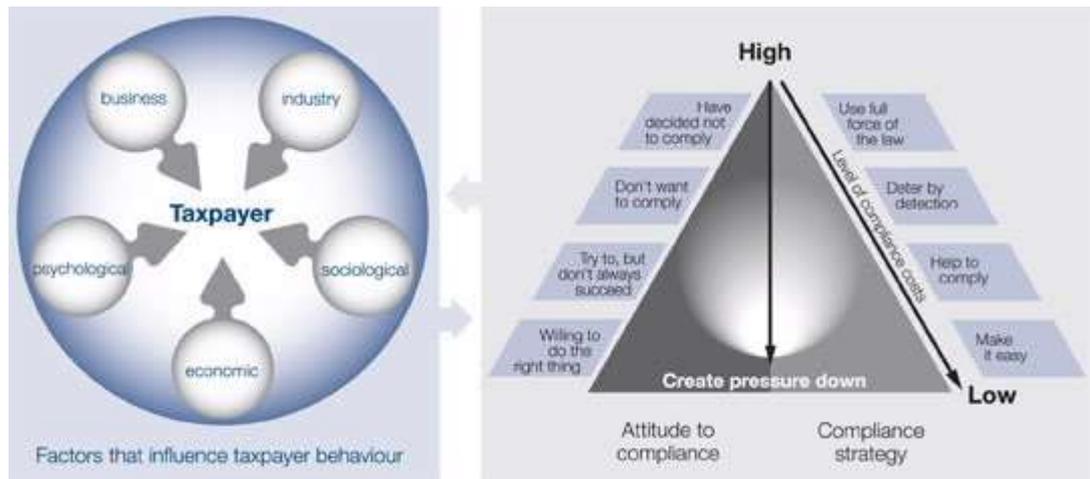
3.6.2 ATO Compliance Model and Risk Management Framework

From the pyramid model which originated from the Cash Economy Task Force proposal, the ATO has further improved the compliance model by incorporating BISEP as part of the compliance model. The pyramid model is also enhanced with additional factors such as taxpayer attitude to compliance and regulator strategies to enforce compliance. BISEP illustrates factors, i.e. business, industry, sociology, economy and psychology, which may influence taxpayer behaviour; while the compliance model shows a continuum of taxpayer attitude towards compliance and regulators' compliance strategies to respond to their attitude.

Figure 8 below shows the link between BISEP and the compliance strategy whereby the regulator will 'make it easy' when taxpayers are 'willing to do the right thing' (ATO, 2009). If taxpayers have the desire to comply but seldom succeed, then regulators will help them to comply. Finally, for taxpayers who have decided not to comply, then the regulator will use sanctions to enforce the law, as depicted at the top of the pyramid (ATO, 2009). In order to collect revenue

and encourage voluntary compliance, the compliance model and risk management framework present the idea that a range of mechanisms could be adopted by tax regulators depending on taxpayers' attitude to compliance.

Figure 8: ATO Compliance Model and Risk Management Framework



Source: ATO Compliance Programme 2008-2009 (ATO, 2009)

Application of responsive regulation and Compliance Model by the ATO

The ATO has been known to have a deterrent effect on taxpayers (Devos, 2009; Murphy, 2004). Eventually, with the application of responsive regulation in its administration, the ATO has managed to increase voluntary compliance by Australian taxpayers (Murphy, 2004; Hobson, 2003; Job and Honaker, 2003). The Compliance Model not only focuses on the taxpayers' perspective but also provides understanding and enables ATO officials to respond to taxpayers (Hobson, 2003; Job and Honaker, 2003). ATO's compliance strategies have become best practice and are referred to by many tax administrations.

A few studies have been conducted by researchers to explore the effectiveness of responsive regulation application by ATO and to elicit the views of ATO staff on the implementation of the responsive enforcement approach. Murphy (2004) presents a study by the Centre for Tax System Integrity (CTSI), undertaken two and a half years after ATO started to apply the Compliance Model. In-depth interviews with twenty-five senior officials of ATO were conducted to elicit their perception and their degree of acceptance of the new model. The study found that ATO “has made a good policy decision” (Murphy, 2004, p.22) when it moved from the enforcement approaches of threat and sanctions to compliance strategies by adopting various responsive approaches, as depicted in the Compliance Model.

Moreover, Hobson (2003) examines the champions of the ATO Compliance Models in order to understand their motivation and desire to promote the Compliance Model to ATO staff members. According to Hobson, the CTSI selected interviewees from ATO officials by using a ‘snow-balling’ method, whereby interviewees were asked to recommend other staff for the interviews (Hobson, 2003, p.135). One-to-one semi-structured interviews were conducted with twenty-two participants to obtain information about their experience during the implementation of the model, as well as their perceptions of other staff members and suggestions for improvement.

From the investigation, Hobson finds that the Compliance Model champions appeared to symbolise and embrace the principle of the model which involves behavioural change on the part of taxpayers, thus conveying their perception of how the change brought by the model could help to shape the ATO. The

champions also provided lip service in promoting the concepts of the model to other ATO staff members (Hobson, 2003).

Another important finding by Hobson is that the champions agreed that the Compliance Model allowed them to respond to taxpayers and that public appeared to be content with the services provided by ATO. Furthermore, Job and Honaker (2003) seek to gain insight into the perception of ATO staff of their early experiences when responsive regulation was first introduced to ATO. A number of staff who had completed the Compliance Model course had undergone semi-structured telephone interviews in which their attitude, perceptions and acceptance of the Compliance Model were explored (Job and Honaker, 2003). Job and Honaker report mixed results from these interviews. Some members of staff were willing to accept the new idea and were eager to share their experiences using the model. On the other hand, there were members of staff who were dissatisfied and reluctant to change the way they performed their job.

The study also finds that the ATO staff did not have the necessary skills to work with the model. Job and Honaker therefore recommend that “ATO staff need to be given the time and encouragement to practice the skills of responsive regulation, using story-telling, problem-solving and the design of new methodological tools” (2003, p.127).

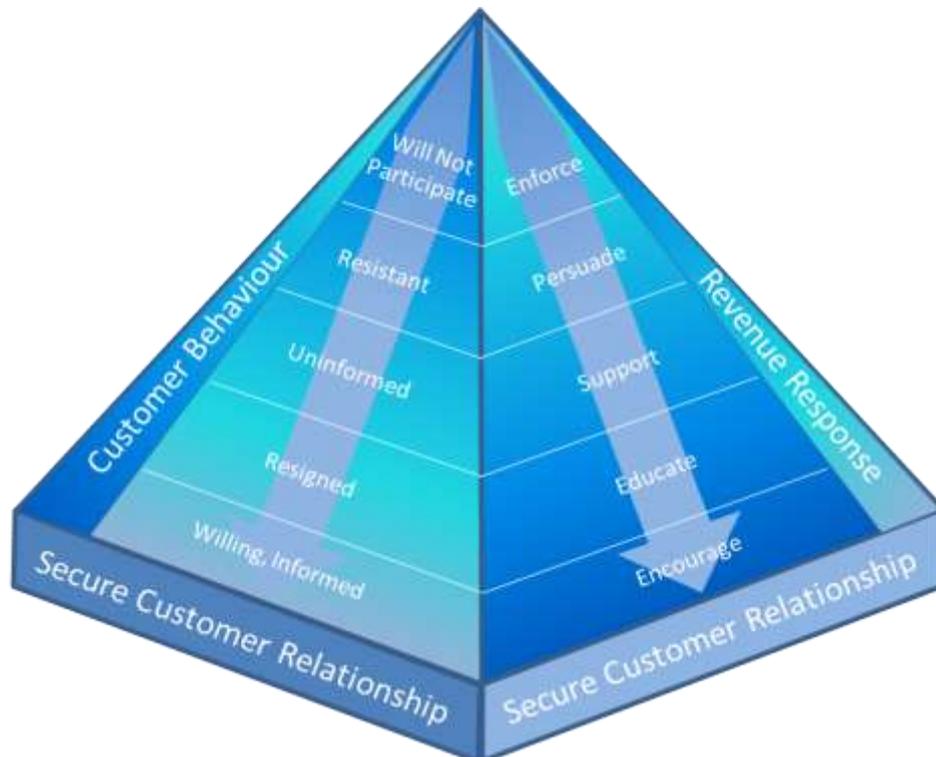
These three studies provide insights into ATO’s experiences when the Compliance Model and responsive regulation were implemented in Australia. Such experience contributes to the knowledge of responsive regulation practice conducted by ATO and may provide a platform for other tax administrations to

understand the issues which may arise during the early stages of implementing the Compliance Model in their administration. The HMRC has also adopted the Compliance Model in its administration. The next section presents HMRC's experiences and efforts in applying a risk-based approach to manage compliance risks in the UK.

3.6.3 The HMRC Compliance Model

Based on the ATO compliance pyramid, the HMRC has developed its compliance model (Figure 9) expanding it into a three-dimensional pyramid and adding features such as Customer Behaviour, Revenue Response and Secure Customer Relationship.

Figure 9: The HMRC Compliance Model



Source: HMRC approach to compliance risk management for large businesses (HMRC, 2007)

The purpose of implementing this risk-based approach is to manage compliance risk for large business taxpayers. On the left side of the pyramid, various types of customer behaviour toward tax compliance are depicted. The behaviours are divided into five levels: the base represents the taxpayers' willingness to cooperate; the second level denotes taxpayers resigned to comply with the law; this is followed by uninformed taxpayers who need to be educated in order to comply; the top two levels indicate resistance to comply and refusal to participate with the authority (HMRC, 2007).

The right side of the pyramid illustrates the HMRC's responsiveness depending on the taxpayers' behaviour, demonstrating how HMRC has applied the concept of responsive regulation by undertaking different strategies to overcome the diversity of circumstances posed by taxpayers. Starting from encouragement at the base of the pyramid in response to those who are willing to cooperate, tax enforcers move up to the next level to educate those who are resigned to comply. For those uninformed taxpayers, the regulatory strategy is to provide education to inform taxpayers of their responsibility to legal requirements. Another step forward is to persuade those who resist compliance. Finally, the command-and-control approach is undertaken to enforce punishment to those who refuse to participate with the regulation. The success of this approach depends both on the cooperation of the taxpayer and on encouragement as well as education from the revenue authorities (HMRC, 2007).

3.6.3.1 HMRC's risk-based approach

In its effort to improve management of risk in its administration, HMRC has introduced a risk-based approach with an objective to manage risks from money laundering¹⁴ and terrorist financing¹⁵. A guideline of the approach was published in 2010 by HMRC in a document entitled 'Anti-Money Laundering Guidance for Money Service Business', which provides guidance to businesses¹⁶ supervised by HMRC "on implementing the legal requirements for measures designed to deter, detect and disrupt money laundering and terrorist financing" (HMRC, 2010, p.1). Unlike the compliance risk management models suggested by OECD (2004) and EC (2010), which are intended to be applied by tax administrations, the risk-based approach is developed for implementation by businesses in managing the money laundering and terrorist financing risks they face. The approach consists of a number of steps (HMRC, 2010, p.10):

- Identify the money laundering and terrorist financing risks that are relevant to the business; categorise level of risk, i.e. high, medium or low; and allocate customers and products to risk categories.
- Assess the risks presented by the particular types and behaviours of customers, products and services; by delivery channels, e.g. cash over the counter, electronic or wire transfer, or cheque; and by geographical areas of operation, e.g. location of business premises, source or destination of customers' funds.
- Design and implement controls to manage and mitigate these assessed risks.
- Monitor and improve the effective operation of these controls.
- Record appropriately what has been done, and why.

¹⁴ Money laundering is "the process by which criminally obtained money and other assets (criminal property) are exchanged for clean money or other assets with no obvious link to their criminal origins" (HMRC, 2010, p.3)

¹⁵ Terrorist financing is "all dealings with funds or property which are likely to be used for the purposes of terrorism, even if the funds are clean in origin" (HMRC, 2010, p.3)

¹⁶ Businesses supervised by HMRC such as "proprietors, directors, managers, employees and Nominated Officers of Money Service Business" (HMRC, 2010, p.1)

Nevertheless, HMRC (2010) encourages businesses to decide for themselves how to implement the risk-based approach, depending on the nature of their business, the type of their products and the categories of their customers. By adopting these strategies, a business may be able to manage money laundering and terrorist financing risks more cost-effectively (HMRC, 2010).

HMRC also plays a supervisory role to ensure that businesses comply with anti-money laundering and terrorist financing regulation, and has therefore adopted “the principles of good regulation in the Regulators Compliance Code” (HMRC, 2012, p.1) which outlines the following:

- Regulators should allow or encourage economic progress and only interfere when protection is necessary.
- Comprehensive risk assessment should be used by regulators so that resources can be allocated more efficiently.
- Regulators should “provide authoritative, accessible advice easily and cheaply” (HMRC, 2012, p.1).
- Regulators should not carry out any inspection if there is no reason to do so.
- Regulators should not request businesses for information if they have previously provided the same information, nor should they ask for unnecessary information.
- Non-complying businesses should be identified quickly and sanctions imposed on them.
- Regulators “should be accountable for the efficiency and effectiveness of their activities, while remaining independent in the decisions” (HMRC, 2012, p.1).

HMRC has formulated a wise risk management strategy by issuing guidelines for businesses to adopt, and at the same time carry out supervisory action to ensure that compliance of the law is achieved.

3.6.3.2 HMRC's deterrence approach to non-compliance

In addition to the risk-based approach to manage the money laundering challenge, HMRC has also adopted a command-and-control strategy to enforce non-compliance. In February, 2011, it launched a new programme to manage tax evaders in its effort to reduce tax non-compliance. The programme, entitled 'Managing Deliberate Defaulters' (MDD), "placed individual taxpayers and businesses which have been caught attempting to evade tax liabilities of GBP 25 000 or more, under greater scrutiny of HMRC authorities for a period of five years" (MDD, 2011). HMRC sends out letters to approximately nine hundred taxpayers with a warning that they are now in the MDD programme:

"Taxpayers chosen for the programme will face much stricter and more intrusive compliance requirements, including unannounced inspection visits with checks of their financial records, extra information requirements in their tax returns, and higher levels of cross checking between the taxpayer's business activities." (MDD, 2011)

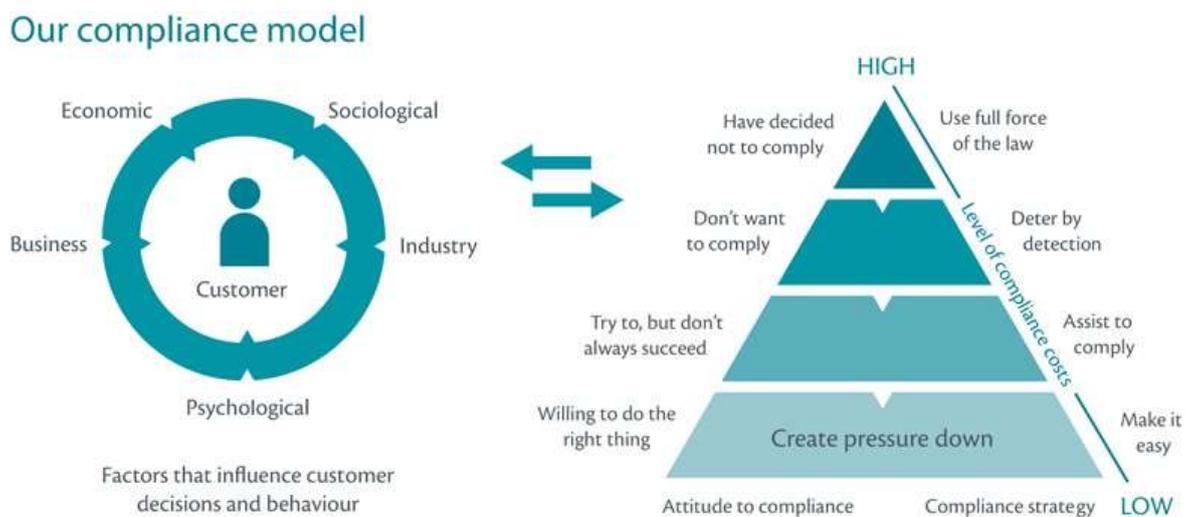
The deterrent programme seeks to improve tax compliance behaviour across the UK, and to "deter known tax evaders from repeated offenses, dissuading potential future tax defaulters, and to provide assurance to compliant taxpayers that the HMRC is willing to take action against non-compliance" (MDD, 2011).

It appears that HMRC has adapted the concept of responsive regulation to manage compliance risk in its administration. The risk-based approach is applied to manage money laundering and terrorist financing risks, while the stick approach is adopted to manage high-risk tax defaulters. The next section addresses the implementation by the New Zealand tax administration of strategies to increase compliance by understanding factors influencing taxpayer's behaviour and their decision to comply.

3.6.4 The NZIR Compliance Model

The New Zealand Inland Revenue (NZIR) initiated the introduction of responsive regulation in their administration in 2001 through its strategic document entitled “The Way Forward”. The aim is to simplify work processes, promote compliance, enhance staff capabilities and improve its administration (Job et al., 2007; Morris and Lonsdale, 2005). The responsive regulation theory is further illustrated by the construction of a compliance model adapted from the ATO compliance model, the purpose being to change the enforcement culture of NZIR from the traditional punishment approach to one based on responsive regulation (Job et al., 2007).

Figure 10: The NZIR Compliance Model



Source: Helping you get it right: Inland Revenue’s compliance focus 2012-13. Inland Revenue Te Tari Taake. IR 504. August 2012. (NZIR, 2012)

To understand factors influencing both taxpayer behaviour and responsive strategies to manage this behaviour, NZIR adopts ATO’s compliance model, as illustrated in Figure 10 above. The triangle represents the attitude of the taxpayers and the compliance strategy enforced by NZIR, while the circle, which uses

BISEP, illustrates factors that influence taxpayers' decisions and behaviour. The model was developed to understand factors that influence taxpayers' decision-making in compliance and to determine appropriate strategies to secure long-term compliance (Morris and Lonsdale, 2005; NZIR, 2012). It displays Economic, Sociological, Industry, Psychological and Business factors that influence taxpayers' behaviour and decisions, namely, do the right thing, try to do the right thing, not want to comply or decide not to comply at all. By understanding the factors and the attitude of the taxpayers to comply, the tax authority's compliance strategies may vary, depending on the taxpayers' attitude, whether to make it easy to comply, to provide assistance, to deter by detection or to use full force of law.

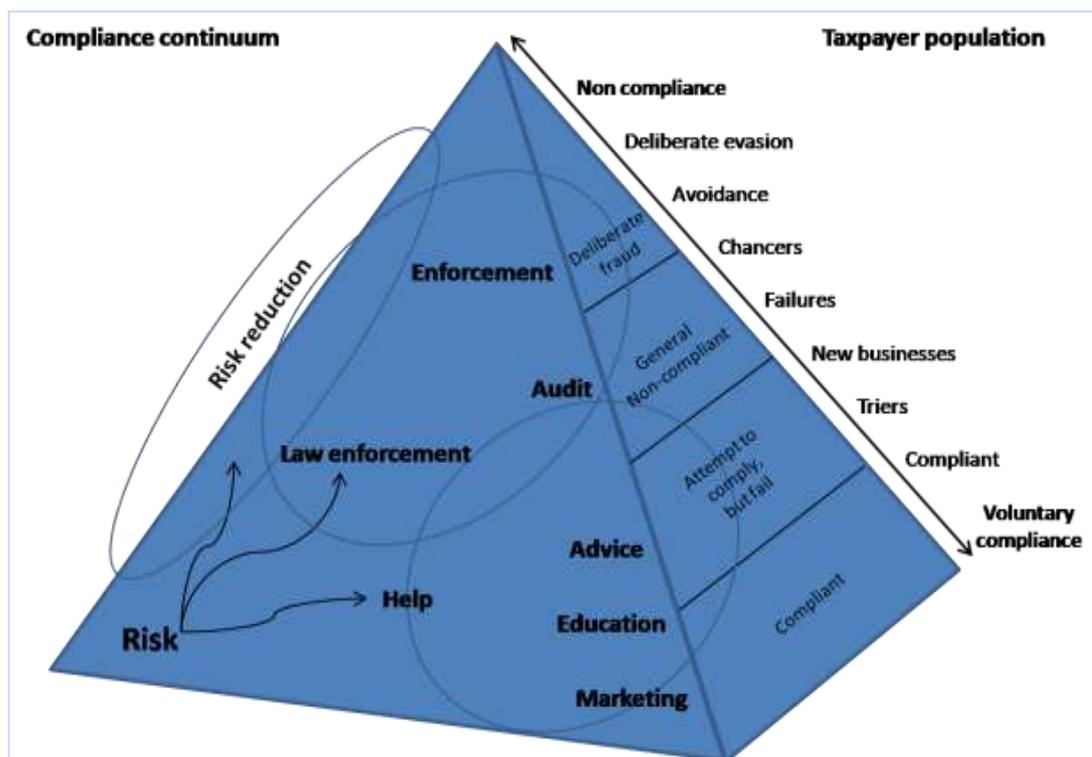
3.6.5 ETRS Responsive Regulation System

Under the UN administration, the administration of East Timor has been reformed to overcome administrative issues such as corruption, inflation, and breakdown in civil society (Job et al., 2007). During the implementation of the new administration, responsive regulation was introduced and incorporated. To further enforce this concept, a compliance model based on the ATO model was adopted by the East Timor Revenue Service (ETRS). As observed by Job et al. (2007, p.91), "the responsive regulation and restorative justice principles built into the ATO compliance model seemed to fit with the culture of the indigenous East Timorese employees from the ETRS". Nevertheless, the regulatory strategies undertaken by ETRS were implemented according to the local culture. Job et al. have concluded that the new regulatory approach succeeded in changing the organisational culture of ETRS to reduce corruption, and, as a result, the relationship between ETRS and the local community has improved.

3.6.6 The EC risk-based compliance model

This model is used by the European Commission (EC) as part of their risk management guide. The compliance model in Figure 11 below illustrates a two-dimensional pyramid which displays risk reduction strategies on the compliance continuum side and compliance behaviour on the taxpayer population side.

Figure 11: The EC Risk-based Compliance Pyramid



Source: European Commission- Risk Management Guide for Tax Administrations (EC, 2006)

As depicted by the pyramid model, there are various types of taxpayer behaviour, such as voluntary compliance, compliance, triers, new businesses, failures, chancers, avoidance, deliberate evasion and finally non-compliance. Triers are those who always make an attempt to comply with the law; ‘new businesses’ indicates lack of knowledge in the tax system; while chancers are those who like

to take opportunities and try their luck in avoiding the law (EC, 2006). These behaviours are further grouped in four categories whereby voluntary compliance and compliance are 'compliant', triers and new businesses 'attempt to comply but fail', failures and chancers are 'general non-compliant' and deliberate and non-compliance are considered as 'deliberate fraud'.

Responsive regulation theory assists the authority in making the decision to formulate strategies to treat taxpayers according to these categories. The responsive regulatory regime is an appropriate approach because, due to limited resources and manpower, tax authorities should take measures to reduce existing risks and prevent future risk from occurring through a risk reduction approach, in which specific measures are taken to manage specific categories of taxpayers. Marketing the tax system is the best approach to be implemented to inform taxpayers who always comply. Education and advice are suitable strategies for assisting taxpayers who make an attempt to comply but normally fail to do so because of insufficient knowledge or lack of motivation to abide the rules.

Generally non-complying taxpayers should be audited to review their level of non-compliance and at the same time to alert them of the repercussions of failure to comply. Finally, for the deliberate fraud category, enforcement is the most appropriate command-and-control action to punish this group of taxpayers for deliberately refusing to comply with the law. The EC introduced a Compliance Risk Management (CRM) guide in 2010 to improve the risk management process and to assist member countries to plan, develop and manage compliance risk in their administrations. The EC CRM guide is addressed in Section 3.4.2.

3.7 The gaps in responsive regulation

Despite the advantages of regulatory agencies adopting responsive regulation theory to enhance compliance and manage risk, as noted by much of the literature on the subject, there has been some criticism of it. For instance, Healy and Braithwaite (2006) comment on the lack of published reports to benchmark the performance of responsive regulation implemented by regulatory agencies. Reports would enable other agencies to learn from the application of a responsive regime and to develop their own regulatory practice. Similarly, Baldwin and Black (2007) are rather sceptical that responsive regulation is able to assist regulatory agencies to address challenges in practice, while Baldwin and Black (2007) disagree with the step-by-step approach of the enforcement pyramid. They argue that, when faced with a specific risk, it would be more appropriate to undertake an immediate action to overcome that risk, perhaps by jumping to the peak of the pyramid, rather than adopt the step-by-step approach suggested by responsive regulation. Another matter of concern is the waste of resources when enforcement is conducted on the basis of responsive regulation because some offenders will comply effectively when threatened with sanctions [ibid].

Welsh (2009) supports Baldwin and Black's argument, noting an assertion by the Australian Securities and Investments Commission (ASIC) that a step-by-step approach may be inappropriate in enforcing the law. She suggests that, in the case of ASIC, regulators may prefer to adopt criminal sanctions rather than civil penalties in order to prosecute criminals. Furthermore, Welsh claims that responsive regulation "does not adequately address the influence that such external pressures have on the strategies adopted by a regulator" (2009, p.17).

This is due to external bureaucratic pressures such as political, social and public intervention, which may influence regulatory decisions.

In addition, Fuhr and Bizer (2007) argue that “there is a need for greater incentives to support the self-responsibility regulative approach”. With reference to the reward and punishment theory, it appears that regulators may need to reward regulatees when they cooperate in order to motivate them towards compliance in the longer term. In her study of the application of responsive regulation in a civil penalty regime, Welsh (2009, p.88) reports some commentators’ arguments that “responsive regulation assumes that the regulated community is made up of rational decision-makers who are in on-going relationships with the regulator.”

Baldwin and Black (2007) agree that responsive regulation simply takes a responsive relationship between regulators and regulatees for granted, and assumes that each party understands the other’s roles and responsibilities and complies with them. Further, Daly (2003) criticises Braithwaite’s assumption (2002) that there is some “goodness” in everyone. Daly (2003) and Welsh (2009) posit that the theory of responsive regulation may not be seen as straightforward in practice as it appears in Ayres and Braithwaite’s regulatory pyramid. Nevertheless, Ayres and Braithwaite (1992, p.25) also agree that the limitation of the persuasion model is that the theory assumes that “people are basically good, thus they are motivated to abide by the law”.

3.8 Summary

This chapter presents a review of three strands of literature: tax compliance, risk management and responsive regulation. Literatures suggest that tax

administrations in developing countries should understand the motivational factors that result in higher compliance in the developed countries, and therefore become aware of the push factors that result in non-compliance in their own countries. By understanding taxpayers' behaviour and attitudes, developing countries may implement risk-based responsive strategies to encourage voluntary compliance and self-regulation and thus improve their tax administration.

This research focuses on an exploration of the types of internal and external risks faced by tax administrations of developing countries in general and of IRBM in particular. Furthermore, the EC and OECD have proposed a Compliance Risk Management framework as a guideline for tax administrations to manage risk. Various literatures have reported on the application of the concept of responsive regulation in tax administrations in developed countries, particularly in Australia, and the adoption of the compliance pyramid model, from which Ayres and Braithwaite's responsive regulation theory was first generated.

However, there is a need to address a gap in the adaption of the responsive regulation theory by tax administrations in developing countries. The implementation of a responsive approach in regulatory services by the ATO, HMRC, IRS, NZIR and the EC can be considered as best practice for developing countries to follow. The major aspects of tax compliance, risk management and responsive regulation, which involve taxpayer behaviour and attitude and the responsive approaches of tax regulators, are drawn upon to construct a conceptual framework for the present study. Further, the methodology of this research is discussed in Chapter 4 which follows.

Chapter 4

Research Methodology

4.1 Introduction

The previous chapter has addressed the existing literature relating to the key themes of the research, which are tax compliance, taxpayer compliance behaviour, risk management and responsive regulation. This following chapter provides an overview of the methodology adopted for this research. As a qualitative research methodology is being adopted, the chapter begins with a discussion of this subject in Section 4.2, explaining the reasons for adopting this methodology. In Section 4.3, a justification of the research design and the case study approach is provided. Furthermore, Section 4.4 presents the research method for the study. There are two methods of data gathering: face-to-face interview and secondary data collection. This section also highlights the interview process and explains how participants are selected for the interviews.

Next, the data analysis process is described in Section 4.5. In this section, the processes such as interview transcription, document content analysis, along with the identification and the coding of themes are looked at in detail. Finally, this chapter concludes with a summary of the methodology in Section 4.6.

4.2 Qualitative research

As this research explores participants' points of view, beliefs and experiences pertaining to risk management in Malaysia and because data is collected through interviews to gain insight into IRBM practices in managing risks, a qualitative approach is a methodology well suited to the study. "The word qualitative implies

an emphasis on the quality of entities and processes and meanings that are not experimentally examined or measured in terms of quantity, amount, intensity or frequency” (Denzin and Lincoln, 2005, p.10).

While quantitative research stresses measurement and investigates the causal relationship between variables, qualitative research places the emphasis on seeking answers to questions which focus on how experience is “created and given meaning” [ibid]. Silverman (2000) considers that the methods used by qualitative researchers provide a greater in-depth understanding of social phenomena than that produced by a quantitative approach. Furthermore, according to Kalof et al. (2008), qualitative researchers argue that the use of statistics or numbers alone is insufficient to develop an in-depth understanding of people’s thoughts, feelings and behaviour. Furthermore, according to Denzin and Lincoln (2005, p.29), “qualitative researchers report on their own observations of the social world, including reports his/her experiences and experiences of others through interviews and life story, personal experience, and case study documents”.

In qualitative research, data can be collected by various methods, including interviews, observation, case study, document analysis and ethnography (Silverman, 2000; Denzin and Lincoln, 2005; Kalof et. al., 2008; McKerchar, 2008). Using such data collection methods, a qualitative approach attempts to obtain answers to research questions without attempting to prove any hypothesis or analyse the data using Likert scales (McKerchar, 2008). In summary, McKerchar (2008) notes that the researcher’s creativity and insights into the investigation may determine the success of a qualitative research study.

Previous research supports the view that a qualitative approach is suitable for this study. Data collection from interviews and IRBM documents enables in-depth information to be obtained to address the research questions. In this study, the author's experience of working at the IRBM, and prior knowledge of some interviewees are discussed and presented as a contribution to an understanding of the risk management strategies used by the Malaysian tax administration. The next section presents the research design for the qualitative methodology used in this study.

4.3 Research Design

The research design for this study comprises a case study in which the unit of analysis is an organisation, the IRBM. The IRBM background and compliance issues faced by the IRBM authority have been addressed in Chapter 2. This section discusses literature on case study and rationale for IRBM to be selected as a case study.

4.3.1 Case Study

In order to perform data collection activities, a researcher should be able to identify the method (s) to be used so that the data collected can be optimized and valuable findings derived from the study. To determine the methods to be used, a researcher should understand the functions and purpose of each method so that the best results could be obtained from the data collected. A researcher can use various methods, such as surveys, experiments, observations, interviews and case studies to collect data. A case study is a well-established method used in qualitative research (Stake, 2005; Silverman, 2000; Yin, 2003). According to Yin (2003), the case study has been a common research strategy in psychology,

sociology, political science, social work, business, community planning and even economics. Yin (2003) and Stake (2005) define it as a process of inquiry about a case and then reporting on it. It is a qualitative method which requires the researcher to focus on a single case or multiple cases in order to study and understand the phenomena of interest. This method may be suitable for a researcher to adopt, depending on the research design and research questions (Yin, 2003). However, according to Yin, some researchers have argued that case studies have been conducted with “insufficient precision, objectivity and rigor”. This is because they feel that a case study is appropriate only for “the exploratory phase of an investigation”. They also believe that case studies are “only a preliminary strategy and cannot be used to describe or test propositions” (Yin, 2003, p.3). However, despite these misgivings, case studies have been used extensively in social science research (Yin, 2003).

As this study aims to gain understanding and insights from tax officials and tax practitioners who have experience of non-compliance issues, a case study approach is chosen as a method to collect data for this investigation. Many of the case studies in tax research have been carried out by Richard Bird in his quest for information on reforms in tax administration in developing countries (Bird, 2004, 2008). Other studies have been conducted by the OECD and the IMF to understand the issues and problems faced by some tax administrations in developing countries (OECD, 2004; Silvani and Baer, 1997). There are also researchers who have selected some tax administrations, such as the ATO, as a case study to learn about their compliance model and to share this knowledge with other tax administrations. As noted by Stake (2005), a case study method is

chosen ‘to optimize understanding the case rather than to generalize beyond it’. Hence, by gathering information about practices in the IRBM, the knowledge gained from this study about compliance strategies, education programmes and the challenges faced by them can be shared with other tax administrations.

4.3.2 Case Selection: Inland Revenue Board of Malaysia

As suggested by Stake (2005), a researcher should choose a case that offers the most to be learned from the study. Furthermore, Stake adds that most researchers would take a case that is accessible, with good opportunities to obtain information (p.451). Even though this research comprises a single-case study, the data obtained has the potential to inform the practices of other revenue agencies since all revenue authorities have similar goals and practices when it comes to tax administrations, as noted by the OECD (2001, p.11). Any findings or conclusions from this research would provide meaningful knowledge not only to the IRBM, but also to other tax administrations with a similar background or environment. As the research question is examining *how* management of risk is conducted in the IRBM, a case study approach appears to be a suitable approach (Rogers and Oats, 2012).

I have been working with the IRBM for almost 17 years, during which time I have been attached to various departments in the organisation. Being an insider is an advantage to this research in the sense that I can have easy access to data and the organisation. An inside researcher is a person who belongs to the community under study (Bishop, 2005, p.110-113). Merriam et al. (2001) cited by Bishop (2005, p.411) note some assumptions, including the view that an insider is unable to be objective, tends to be biased and is too close to the culture to ask critical

questions. However, Merriam et al. (2001) cited by Bishop (2005, p.411) also argue that the inside researcher is “more sensitive and responsive” to the culture of the organisation. Besides having easy access to the people and the organisation, I also have the ability to ask meaningful questions about the practices and strategies formulated and to probe for further explanations to the answers given.

Having worked for the IRBM for such a long time and understanding the culture and the values surrounding Malaysian tax administration, I believe that this research enables me to search for in-depth answers to my research questions. My rapport, personally or professionally with the officials would make interactions and access to the organisation easier and faster. As noted by Stake (2005), a case research study is “not to represent the world, but to represent the case”. Hence, by having the IRBM as a case for this study and investigating the activities pertaining to compliance, tax education and administration of the organisation, I have been able to obtain relevant information and knowledge, to analyse the data and to provide answers to the research questions.

4.4 Data Collection

As mentioned earlier, data was collected through semi-structured interviews and secondary data from the IRBM. My previous experience has enabled me to understand the problems and helped me to identify pre-conceived themes and questions to ask in the interviews. The participants’ willingness to disclose some confidential and sensitive information to me, even though they said that the information was ‘off-the-record’, shows that they were comfortable with me as an insider. Furthermore, my request for some internal documents, such as memos and audit reports, was granted without much difficulty; from my working experience,

such documents would not have been passed on to outside researchers. Even though the IRBM participants treated me as an insider, I placed myself in the position of an outsider during the interview process. As a researcher, I have conducted the interviews in an objective manner and disallowed my sentiment as an IRBM official to interfere with my judgement during data analysis and in concluding the thesis.

The study investigates the perception and understanding of risk by those involved in the policy and decision making in the IRBM and examines how decisions, policies and strategies are formulated. Two main research methods have been employed to collect these data, which are document analysis and semi-structured interviews. The use of multiple data sources is called triangulation (Kalof et al., 2008; Stewart, 1998; Hammersley, 1992; Hammersley and Atkinson, 2007). Kalof et al. (2008, p.136) point out that the advantage of triangulation of data sources is that it “can help offset the limitation of any one approach”. Furthermore, by having multiple modes of data collection, the information gathered and analysed can be used effectively to support the conclusions of the research (O’Reilly, 2005; Stewart, 1998; Hammersley, 1992; Hammersley and Atkinson, 2007). As noted by Rist (1984) cited in Hammersley (1992, p.125), the use of multiple sources of evidence will overcome the issue of “relying on a single, possibly biased, source”.

4.4.1 Document Analysis

One of the methods used for this study is document analysis. This method is another data gathering source to enrich data collection (O’Reilly, 2005; Stewart, 1998; Hammersley, 1992) by learning about the processes, rules and procedures related to the research questions. Silverman argues that, even though some

quantitative researchers appear to have little confidence in textual analysis, analysed texts represent “official or common-sense versions of social phenomena” (2011, p.230), which adds to the richness of the data. As documents provide texts in a naturally occurring setting, the data could influence the ways in which readers see the world and act in it (Silverman, 2011; Hammersley and Atkinson, 2007). Also, the availability of documents may ease the data collection process and enable researchers to start the analysis process earlier (Silverman, 2011).

For this study, documents are used as secondary data to support the findings from the interviews and they may enhance the conclusions of the study. Thus, a range of published and unpublished printed materials prepared by the IRBM has been collected, including reports, minutes of meetings, circulars, directives and statistics. The information contained in the documents, as well as the subjective meanings and perceptions generated by those documents, are noted and analysed. The main documents analysed in the study are as follows.

- IRBM annual reports

The reports contain useful information on the IRBM activities, including the results and performance of those activities in respective years. Also, to highlight compliance issues faced by the IRBM, some statistical records are extracted from the annual report, such as audit activities, prosecution cases and other enforcement activities.

- Internal memos

An internal memo notes compliance problems from one of the IRBM branches.

- Minutes of Dialogue between IRBM and Associations of Accountants and Tax Practitioners (AATP)

Notes of meetings between the IRBM senior officials with the members of the AATP provide insights into operational and technical issues brought out by the AATP.

- Tax Audit framework (TAF, 2009)

A policy paper or framework issued by the IRBM which outlines the rights and responsibilities of audit officers, taxpayers and tax agents in respect of a tax audit.

- Tax Investigation Framework (TIF, 2007)

A policy paper or framework issued by the IRBM which outlines the rights and responsibilities of an investigation officer, the taxpayer and the tax agent/representative in respect of a tax investigation.

- IRBM Integrity Plan.

A comprehensive, policy book issued by the IRBM designed to strengthen IRBM ethics and the integrity of IRBM staff.

- IRBM Strategic Planning 2009-2013

A book published by the IRBM which informs about its direction and future planning for the year 2009 to 2013 to improve its performance internally and externally.

The documents were analysed using the document analysis methodology, whereby the contents of textual data were interpreted and the themes identified. The themes were informed by the extensive literature review required to address the research questions. Unlike the interview data, where it was planned for taped conversation to be translated and transcribed in their entirety, the document contents were not translated and transcribed in their entirety. Only important data

and texts which provided input to the study and relevant to potential themes were gathered. The themes were then coded and stored in NVivo for further analysis.

4.4.2 Interview

It is not enough to collect data through documentary analysis alone. In order to obtain rich data and information, interviews were conducted on selected participants. Researchers such as Silverman (2001), Kvale (2007) and Fontana and Frey (2005) agree that the interview is one of the best, most powerful and most popular methods to gather qualitative research data. Interviews are a far more personal form of research than questionnaires as the interviewer will have direct and interactive communication with the respondents. Researchers have the opportunity to obtain details and stories about the topics of interest by interviewing people who have experience of or who are connected to the subjects (Valenzuela and Shrivastava, 2007). O'Reilly (2005) also agrees that interviews allow for in-depth information around the topic to be pursued and for respondents to be probed for more answers and clarification about how, what or why they did certain activities.

An individual, face-to-face question and answer session was used as a research method as it was a suitable way of seeking the opinions or views of participants and it has been shown to be an effective way of ascertaining their impressions of the questions being asked (Silverman, 2006; Denzin and Lincoln, 2005; Fontana and Frey, 2005). The type of interview conducted was a semi-structured, conversational interview in which pre-determined questions were used as a guide. The open-ended approach allowed free responses from the respondents and it also allowed me to probe more deeply into the answers given (Berg, 1998).

During the interviews, interviewees were asked to clarify the meaning of specific terms used by them. Questions asked during the interviews were open-ended. One of the advantages of an open-ended question is that, during the interview, a researcher might explore other questions that had not been considered at the planning stage with the result that new, valuable insights are discovered and rich information obtained.

According to Silverman (2006, p.114), open-ended questions used during an interview are the most effective way to understand people's experiences, attitudes and values, which could not be established through a formal questionnaire. From the interviews, the interviewees' opinions, feelings, thoughts, beliefs and experiences can be recorded and analysed. As pointed out by Yin (2003), the advantage of using interviews for data collection is that a researcher could focus directly on the topic of interest by asking specific questions directly related to the research topic. Furthermore, unlike mail surveys, the interviews provided the opportunity to probe for further clarification, ask follow up questions and request that interviewees elaborate on their explanation. Another advantage of interviews is that they can support the conclusions of the study as the researcher is able to use the participants' quotes "to enhance the validity of the results" (Adler and Adler, 1998).

Considering that the aim is to conduct an in-depth exploration of the perceptions of the tax administration system in Malaysia, the semi-structured interview appears to be the most suitable interview type for this research. Thus, the semi-structured interview was selected as the method for data gathering in this investigation. A conversational type of interview was adopted, with pre-

determined questions used as a guide. This allowed interviewees the opportunity to talk openly and gave them freedom to give their perceptions of the topics of interest (Berg, 1998).

The open-ended questions could be adapted to suit each interviewee's nature and experience, following a sequence from general to specific questions. However, to ensure that the conversation was running smoothly, during the interview, I "went with the flow" as suggested by Valenzuela and Shrivastaza (2007). The open-ended approach allowed free responses from the respondents and also allowed me to probe more deeply into the answers given. Throughout the interviews, the interviewees were asked to clarify the meaning of specific terms (language) used by them. The interactive nature of the semi-structured interview enabled me to develop a good rapport with the participants. This situation encouraged the interviewees to feel comfortable in sharing their stories, experiences and challenges.

Being an insider was indeed an advantage as it was easy to understand the terminology and jargon used by the interviewees (Mulligan, 2012). Most of the time they uttered 'You know' or 'You know how it works...' because they knew that I understood the subjects they were talking about. Nevertheless, I always asked for confirmation to ascertain that their explanation was consistent with my understanding of their responses. This is the advantage of qualitative research, whereby researchers are free to ask for clarification and probe for further explanation of the subjects with follow-up questions such as "What do you mean by...?", "Could you please elaborate further...?" or "Why do you think...?"

(Sandberg, 2005; Silverman, 2006; Denzin and Lincoln, 2005). Consequently, researchers may obtain richer information about the phenomenon under study.

4.4.3 Respondent selection

Semi-structured interviews were conducted on two groups of people: inside participants from the IRBM and outsiders, who are tax practitioners working in tax consulting firms in Malaysia. The reason for including tax practitioners in the interviews was to obtain richer information from people outside the IRBM who have direct links with the taxation system and also direct interaction with taxpayers. Thus, I believed that the tax practitioners would be able to provide valuable information and alternative perspectives of tax administration in Malaysia.

Internal participants

Having received the letter from the CEO/Director General of IRBM consenting to the interviews, I e-mailed 30 top and middle level executives involved in the policy and decision making in the operations and administrations of the IRBM, inviting them to be interviewed. These employees are top level executives, state directors, department directors, branch directors, desk/field auditors and department officials. They were selected based on the departments to which they were attached. The functions of these departments were related to the risk management practices investigated in this study. From the 30 officials who agreed to be interviewed, two were unable to attend the interview due to other urgent commitments. However, they agreed to answer my questions in writing. Therefore, I sent the guided questions via e-mail to them and they returned the questionnaires with the answers. Of officials I interviewed, 12 were female

officials while the rest were male officials. The managerial scope of the interviewees ranged from the most senior levels to IRBM scale Grade 41 (junior middle management). However, the majority were from the ranks of top middle management and senior management.

From 14 states in Malaysia, I visited five to meet the officials for interviews; out of 36 branches of the IRBM, seven branches were selected for inclusion. These seven were chosen because they are the branches with the biggest number of individual and sole-proprietors taxpayers (the central region), whilst the northern and southern regions also have their respective branches in those regions. The state and branch directors implement the decisions made at the headquarters and, at the same time, they also have some authority and decision making power within their jurisdiction. To determine that sufficient information could be gathered from the respondents selected and to avoid saturation, a sufficient range and number of respondents was chosen to provide information relevant to the research questions. Analysis of interview transcripts also indicates relatively similar responses to the questions by participants from the different branches. The reason being that, as stated earlier, branches implement policies formulated and directed by the HQ; thus, it is the responsibility of each branch to adhere to the policies and report their achievements regularly to HQ.

External participants

To get another, possibly contrasting, view or perspective, interviews were conducted with non-IRBM officials. Bird (2008, p.20) suggests that, for the revenue authorities to “develop good ideas and to implement them effectively,... good tax policy planning should also involve taxpayers, tax practitioners, and tax

agents”. Furthermore, Salter and Oats (2011, p.2) note HMRC’s recognition of “the positive impact that good tax agents may have on tax compliance by represented taxpayers”. Thus, improvements in working relationships with tax agents may increase compliance by taxpayers represented by the tax agents (Salter and Oats, 2011; OECD, 2008a).

In order to elicit more ideas, suggestions and recommendations on risk management, another series of semi-structured interviews was conducted with six tax practitioners working in tax and accounting firms in Malaysia. Two of the tax practitioners were from the Big-Four accounting companies, whilst the rest were partners of tax consulting companies. Initially, invitations to interview were e-mailed to six selected tax practitioners. However, only three people replied and agreed to participate in the interview sessions. I was informed that the rest were reluctant to be interviewed because they did not wish to be seen to criticize any government agencies. Even though they were assured that their identity would remain anonymous and the answers given would be used for the purpose of this research only and treated as strictly confidential, they were still unconvinced and refused to be interviewed. Hence, the remaining three tax practitioners were invited for interview. However, one of them was willing to provide written answers only and would not be interviewed face-to-face, whilst two of them agreed to be interviewed with the tape on. I managed to persuade three more tax practitioners to participate in the interview where two participants agreed to written answers and one agreed for a face-to-face interview but without using the tape recorder.

A list of internal and external participants interviewed is displayed in Appendix 3.

4.4.4 Interview Instrument

An interview question guide was designed on the basis of the research objectives, the research questions and also from the literature. There were two types of interview guide: one was designed for the IRBM officials and the other was for the tax practitioners. The guides were structured in three parts. The first part consists of preparation before the interview, which includes choosing the place for the interviews, explaining the purpose and format of the interview and allowing the interviewees to clarify any doubts about the process.

The second part of the guide contains the interview questions, starting with general questions about the interviewees and followed by more specific questions. The main topics of the questions were about the challenges faced by the interviewees in their work-related activities, the taxpayers' education, compliance issues and strategies, implementation of the self-assessment system in Malaysia, and self-regulation of tax administration in Malaysia. Also, other general topics being discussed included tax administration in developing countries and compliance models. Lastly, the final section of the guide summarizes the interview. The interview guide is attached as Appendix 4 for IRBM officials and Appendix 5 for tax practitioners.

4.4.5 Interview process

The interviews were conducted at the interviewees' offices in the IRBM premises in Malaysia, for privacy as well as for the respondents' comfort. All interviews took place on a one-to-one basis except for one case in which three participants were present at one session. To overcome the interviewees' reluctance to share

information freely, they were all assured that the information obtained would not be distributed to any third parties and their identity would not be revealed. Interview scripts were prepared as a guide to the questions. The questions were open-ended to obtain information about the interviewees' views, experiences and the organisation's practices in relation to the topic.

A digital tape recorder was used to tape the interviews. Silverman highlights a few advantages of using a tape recorder during interviews: it captures data better than field notes; it can be replayed, hence transcription can be improved and it preserves the sequence of the conversation (2011, p.278). However, from 36 interviewees, 16 agreed to the interview being taped, five preferred to answer in writing; the rest preferred not to have the interview taped, by which they implied that they might say something sensitive or confidential. To conduct the interview without recording it on tape was a very challenging process because several activities needed to be done simultaneously, such as asking questions, listening, and jotting down the answers whilst trying to comprehend what was being said by the interviewees. Being unable to capture all the words uttered by the respondents was quite frustrating because some important data conveyed by the interviewees might be missed. However, to ensure that I remembered the answers given, immediately after the interviews were over, the full answers were written to the guided questions. At that time, I would still be able to capture in writing the most important points raised during the interviews.

The average time taken for each interview was two hours, even though the initial plan had been to spend about one hour on each interview. However, four of the interviews took three hours to complete. Even though the questions set were in English language, most of the interviewees were comfortable to speak in the

Malaysian national language, which is called the Malay language. Therefore, during transcription process, the conversation was translated from Malay to English and later transcribed into text. The process of translation and transcription took between eight hours and three days, depending on the length of the interview. The interview sessions were in two parts: the first part was about challenges (risk) for the IRBM, non-compliance issues and managing the challenges, whilst the second part of the session was about risk-based compliance models.

All interviewees had given full cooperation and responded positively to all questions posed to them. Most interviewees managed to provide answers about the global picture of the IRBM current practices and future planning. However, there were a few participants who were unable to provide feedback on certain queries, such as the pyramid compliance model, as they were unaware of the existence of the model.

A face-to-face interview is an interesting research method to adopt; during the interview, a researcher is able to observe the participants' reactions. Most of the participants, especially those who knew me personally, appeared to be comfortable and relaxed throughout the interview process. Those who had no previous professional dealings with me appeared somewhat rigid, officious and uncomfortable. They answered the questions directly without trying to elaborate, unless encouraged by me. Nevertheless, the interview sessions achieved the objective of obtaining rich data and answers to the research questions. The responses from the interviews also facilitated the emergence of themes, pre-determined and newly emerged, which can be related to the conceptual framework

discussed in Section 8.8. Data gathered from documents and interviews were then analysed for findings and these are presented in the following section.

4.5 Data Analysis

In this study, the interview data and documents collected were processed for further analysis. The process involved transcribing, discovering themes, the analysis of documents and coding. This data analysis process had the aim of interpreting the meanings of the qualitative data collected and understanding the phenomena being investigated. The analysis process has been a continuous and iterative activity. During this process, there was on-going correspondence, via e-mail, with the interviewees to obtain further explanation and clarification of their replies from the first interview.

4.5.1 Interview and Document Transcription

The transcription of interview data and document content is necessary to develop textual data that can be analysed effectively (Bailey, 2008; Hammersley and Atkinson, 2007). Interview data needs to be listened to repeatedly so that the transcription of the interview can be prepared (Silverman, 2011). Although the questions set for this investigation were in English, most of the interviewees were more comfortable speaking in Malay. Therefore, during the transcription process, the conversation was translated from Malay to English. On-line Malay-English translation software was used to ensure the quality of the translation. The translated texts were then fully transcribed into English. Even though a one-hour interview would take, on average, four to six hours to transcribe an average of three days were taken to transcribe a two to three hours interview on account of the two processes of translating and transcribing needing to be done. Furthermore,

data from the interviews were interpreted and major themes identified and categorised.

For document analysis, documents such as internal memos and the Integrity Plan, written in Malay, were translated and transcribed for ease of analysis; other documents, such as annual reports, audit report, minutes of meetings and other internal documents were not translated. As in the case of the interview data, document content also requires repeated reading to comprehend and interpret the meanings presented in the text (Silverman, 2011; Welsh, 2002). Subsequently, the contents were analysed and coded. To assist in data management and facilitate data analysis, pre-defined themes and newly emerged themes were coded and stored in a qualitative software tool called QSR NVivo for further analysis and future reference.

4.5.2 Identification of Themes

Prior to embarking on this study, some pre-conceived ideas or themes, such as Tax Compliance, Risk, Taxpayer Education and Challenges had emerged, which require answers from this research (Basit, 2003). When the research started, more themes were discovered from the literature. The discovery of themes is one of the main tasks in qualitative data analysis (McKerchar, 2010; Silverman, 2011; Ryan and Bernard, 2003). When I started the investigation, more themes emerged from the literature, such as Self-regulation, Taxpayers' Behaviour, Organisational Cultures and others. Sub-themes were also identified, which developed to make the analysis more detailed and more focused. In addition, from the interview data, I gained a better understanding of the context of the themes and subsequently developed additional sub-themes, such as Financial Resources, Insufficient Information, Integrity and others. As the process continued, the themes and sub-

themes were refined and re-categorised so that they were grouped into the right codes and categories (McKerchar, 2010). The list of the themes induced before, during and after the data collection process, is shown in the table in Appendix 6.

4.5.3 Coding

According to McKerchar (2010, p.227) “coding is usually undertaken as a precursor to data analysis”. As noted by Bryman (2008, cited in McKerchar, 2010, p.228) “coding is not analysis, it is just the first step in taking meaning from the data and reducing it to a more manageable size for the purpose of analysis”. Thus, the purpose of coding is to organise data into categories based on themes or concepts to ease data analysis (McKerchar, 2012). The transcripts were read line by line to identify the important and meaningful segments relating to the research questions (Oats, 2012). In the process, segments were marked and coded with appropriate themes. To get a more detailed coding, some of the texts were further segmented to create 1st level sub-themes and 2nd level sub-themes. This process continued until all transcripts were fully coded and the themes were refined to be more relevant to the research.

NVivo 8, a qualitative data analysis software package was used to ease management of the data during the coding process. Sub-themes generated during reading were further revised by referring to the number of times the segments were uttered by participants. The segments or issues with high word counts were then determined as sub-themes. Furthermore, to answer the research questions in the empirical chapters, appropriate quotations were extracted from the coding and later discussed as part of the findings of this study. The coding process was run iteratively to refine the themes and the meanings of the data, hence to provide

credibility to the findings, which may convince readers of the merits of this research (McKerchar, 2012).

4.6 Summary

This chapter has presented an overview of the research methodology adopted in the study. The section began with a discussion of the qualitative research methodology adopted for the study. Research design using a case study approach has been addressed, whereby the IRBM was selected as a case study for the investigation. Then, two research methods of data gathering, namely face-to-face interview and secondary data collection, were presented. Some participants refused to be interviewed and opted for providing written answers to the interview guide.

This section also described the interview process and the selection of participants, the IRBM officials and Malaysian tax practitioners, for the interviews. It also identified and described the key data analysis processes, such as interview transcription, document analysis, theme identification and coding of themes. In order to produce a transcription of an interview, the conversations stored in the tape recorder were translated into English and transcribed. Some documents were translated, and data supporting the research questions were extracted from the documents. Written answers were also translated and transcribed. In the next step, NVivo was used for coding and theme identification. Finally, this chapter concludes with a summary of the methodology. The next four chapters present and address the findings of the research.

Chapter 5

Internal risk factors in Malaysian tax administration and strategies to manage them

5.1 Introduction

The previous chapter discussed the methodology adopted in this research, and the three major themes - Tax Compliance, Risk Management and Responsive Regulation - that emerged during the analysis were used to develop the conceptual framework for this study. The study has attempted to link these themes by analysing the strategies adopted by IRBM to manage the risk it faced. The present chapter analyses and presents the findings in relation to the research: “What are the internal risks faced by the IRBM?” In order to answer the question, first, the thesis discusses internal risks and external risks faced by IRBM. Internal risks are presented in this chapter, whilst external risks in Chapter 6. In order to explore internal risks faced by IRBM, participants were asked relevant questions pertaining to the challenges and risks faced by IRBM. The participants’ views of the internal risks in IRBM are analysed and discussed in Section 5.2. Findings from the study reveal various types of internal risks encountered by IRBM. Finally, Section 5.3 summarizes this chapter.

5.2 Internal risk

As stated in Chapter 4, reference has been made to IRBM internal documents as secondary data, and interviews conducted with participants in order to obtain information related to internal risks faced by the Board. Both these sources have revealed internal risks such as financial constraints and a lack of professionalism, technical knowledge and integrity among the staff, as well as a shortage of human

resources and information technology systems. Gill (2003, p.5) posits that “lack of adequate resources may impose serious constraints on the revenue administration in managing voluntary compliance and countering tax evasion. It may also limit its ability to upgrade its operations to improve performance.”

5.2.1 Financial constraint

As presented in Section 1.4.1, one of the common constraints of any organisation, including tax agencies, especially from developing countries, is an insufficient budget to improve infrastructure and expand capacity. IRBM faced a similar predicament when its operational budget for 2010 was reduced by the Ministry of Finance due to global financial crises in 2008-2009. RL2 and RL8 commented:

“And as it is with this year’s cut in budget, it is a challenging year for me this year, what’s more, that the award that we got, we have to prove, to justify that award. And of course the government also recognises me by giving me this title, so I have to also keep justified, meeting the government’s expectation, so this is a challenging year.” (Interview: RL2)

“We are very short of funds this year, badly affected by the 15% cut. Therefore we don’t do much advertising this year, but what we did was, we managed to get cooperation from radio station, Sinar FM.” (Interview: RL2)

“We have a budget constraint. Because of the budget constraint we have to curb our projects. Also for education, even the Ministry cannot participate and collaborate on programmes like speech competition, so it has to be shelved off because they don’t have the budget. But a lot more can be done if the budget is there. We have lined up various projects but one thing is budget wise; the other is bureaucracy. That one [bureaucracy] is a bit slow; because we have to go through Ministry of Education and the Ministry of Education has their departmental regulation before they can come over to us and allow us to proceed with the plan.” (Interview: RL8)

As with other tax administrations, IRBM was also confronted with financial budget constraints which would impede its desire to improve performance (Hasseldine, 2012; Gill, 2003). As a result, projects such as advertising and the introduction of educational activities were kept on hold. Insufficient funds also gave rise to other problems, including an inability to increase the number of staff for compliance activities such as street surveys, desk audits and field audits, and a failure to upgrade technology systems in order to improve internal processes

(Hasseldine, 2012). These complications are further discussed in Sections 5.2.5 and 5.2.6. As IRBM relied on the Treasury Department in the Ministry of Finance to provide a budget allocation, the Board could do little when its allocated budget was reduced. However, as suggested by Hasseldine (2012), the senior management of IRBM should have provided a strategic plan to guide the future direction of the organisation and maximise the usage of limited resources to achieve better results. Consistent with Hasseldine's suggestion, IRBM has established the IRBM Strategic Planning which has listed strategies to improve performance in terms of human resources, revenue collection and service delivery for the year 2009-2013.

5.2.2 Professionalism

The minutes of the dialogue between tax professionals, their dialogue partners and IRBM (TD, 2006, p.1) state that there appears to be “lack of transparency and consistency in the IRBM's approach to tax audits.” This is due to the varying treatment given by different tax officials to similar tax issues (TD, 2006). Further, it has been reported that IRBM officials demonstrated unprofessional conduct, whereby they seemed to have “a preconceived mind-set that the taxpayers are already guilty and their visit is more to confirm the offence” (TD, 2006, p.1). The dialogue partners' points of view are in line with Kirchler et al (2008) where tax regulators are known of adopting a ‘cop-and-robber’ approach. This approach indicates regulators perception that taxpayers always have the intention to evade the law.

Meanwhile, RT2 noted that IRBM officials were not customer-friendly:

“The IRB should be more taxpayer-friendly and tax agent-friendly. Sometimes it is an issue of who is more capable of interpreting the tax law; the IRB will feel challenged when some technical issues are interpreted, treated and argued differently by tax agents, but some hold water. As the IRB officials normally feel they are right, then the relationship will turn ‘not so nice’ between them in future cases.”
(Interview: RT2)

As well as adopting an unfriendly attitude, IRBM was also accused of being unprofessional and inconsiderate, as stated by RT5:

“Very often, when there is a technical issue, the taxpayers present their case in detail supported by case laws, and when the revenue authority rejects the appeal with a single sentence the appeal is rejected without giving reasons.” (Interview: RT5)

“The attitude of some officials is that they are not willing to listen when taxpayers present their case; their inefficiency has caused much dissatisfaction amongst taxpayers. For example, threatening taxpayers that if their proposals are not accepted, the best judgment assessments would be issued without discussing the issues raised.”
(Interview: RT5)

The tax practitioners gave an assurance that taxpayers would show increased cooperation and compliance if IRBM officials were more professional, friendly and consistent in their conduct during tax audits. Further, RT6 hoped for “consistently fair and reasonable action on the part of IRBM officials”. From his experience in daily operations, RL3 also admitted that there were a small number of officials who demonstrated unprofessional conduct and who simply refused to entertain taxpayers’ requests or appeals. However, he believed that the majority of IRBM officials did offer a professional service to the taxpayers. RT3 told of his experience when dealing with tax officials with a ‘bad’ attitude, quoting a challenge made by an officer: ‘If you don’t like it, take it to court’. Nevertheless, although RT3 was unhappy with this unprofessional and disrespectful attitude, he agreed with RL3 that the overall administration of IRBM was commendable.

Statements from the dialogue and responses from the participants both reflected unprofessional attitudes displayed by some of the IRBM officials during their conduct with taxpayers and tax agents. Although the interviewees agreed that the

majority of the officials treated taxpayers professionally, a small number of ‘bad attitude officials’ or ‘bad apples’ might become a risk factor with the potential to tarnish the good image of IRBM. This was consistent with findings by the EC (2006), OECD (2001) and Thompson (2008) that internal factors such as staff professionalism might have an impact on IRBM’s objective to foster voluntary compliance. Furthermore, as suggested by Murphy (2008a, p.127) the unreasonable behaviour of IRBM officials “can generate resistance to compliance and disrespect for authority”.

5.2.3 Technical knowledge

A few tax practitioners stated that during meetings with IRBM officials, some of the officials are unable to provide satisfactory answers to their technical queries. In their opinion, this was due to lack of technical knowledge on the part of the officials:

“Knowledge – there is apparently a lower level of technical competence and lack of practical experience.” (Interview: RT4)

“The openness in discussion and explanation that existed in the Revenue Authority before is lacking. This probably is due to the lack of technical expertise.” (Interview: RT5)

Meanwhile, RT6 noted that IRBM officials were lacking of knowledge in industry which led to inability to make just and reasonable decisions. RT6 observation concurred with Minutes of the dialogue between IRBM and tax practitioners, which indicated that there were IRBM officials with inadequate knowledge in book-keeping transactions and accounting principles. This is due to a lack of understanding of certain industries, especially those that are newly-established:

“There are also instances where some of the IRBM officials tend to treat different companies in the same manner notwithstanding the different nature of the business and the industry/commercial environment in which the taxpayers are involved.” (Document: Technical Dialogue (TD, 2006))

RT1, RT3 and RT6 agreed that technical training of IRBM officials was not well tuned in to actual practice, thus the need for improved training. It was observed by RT3 during meetings with IRBM officials that their technical knowledge was poor and that they lacked understanding of business practices:

“They need to enhance their technical ability. Of course you can ask IRBM and they would say that their officials are fine. I’ve been in discussion with them, and I’m quite amazed that I found the officials are quite narrow-minded and not willing to see the reality, and just going by the book; actually they should go by the spirit of the law.” (Interview: RT3)

RT3’s observation was consistent with investigations by Lai and Choong (2009) of tax practitioners’ perceptions of SAS compliance complexities in Malaysia. Their study finds that IRBM’s staff “lack technical knowledge on complex business matters and that tax advice is not sufficiently accessible” (Lai and Choong, 2009, p.1).

RL1 agreed that IRBM officials should be more professional and change their mind-set with a new focus on customer service, as well as their core function as revenue collector. She felt that the officials should be multifunctional, performing multiple tasks such as customer service, auditing and assessment, in order to resolve taxpayers’ tax matters speedily, even though the problems involved other departments. RL1 also believed that IRBM should continue to instil amongst its staff a high standard of professionalism, efficiency, knowledge and discipline:

“Sometimes when taxpayers come to our office, they were not so conversant in conveying their needs or their problems. the taxpayer does not need to come many times to address a few issues just because it involves other units or department. That kind of approach we need to instil in our staff. That means that they have to be multifunctional. ... to be knowledgeable in all aspects and to go the extra mile to help the taxpayers. We must ensure that this visit is enough for us to settle, they don’t need to come again. And on our part, if it involves another unit, we get in touch with the other unit to explain to them and then give them a result in a short time.” (Interview: RL1)

On the other hand, in an effort to enhance professionalism, technical knowledge and skills in tax audits, it was also stated that officials had received a very

systematic training - they were required to attend preliminary and advanced taxation courses, for example, as well as undergo training in field audit and specialization in industries, as highlighted by RL20:

“Taxpayers are getting smarter and more knowledgeable. Our officials have to be smarter to tackle non-compliant taxpayers. New industries are emerging and IRBM officials have to learn and become knowledgeable about these industries.”
(Interview: RL20)

RL4 not only agreed that officials’ knowledge of industries was inadequate, but also admitted that, having considered the statistics¹⁷, most branches were not yet well acquainted with field audit. She therefore felt that the Tax Academy and Audit Training Centre should provide both academic and on the job training to enhance the officials’ knowledge, but especially on-going desk training. It was explained by RL1 that IRBM also sent officials to other more developed countries to learn from them. Further, RL4 highlighted that, with recent changes in the financial reporting standards and the introduction of new packages in the accounting system, IRBM officials had to acquire the necessary knowledge in the relevant area in order to attain the new levels required. She added that IRBM as a whole should therefore raise its own standards in that direction. As noted by RL9:

“In auditing, every business is different; therefore officials are required to have sufficient knowledge about the business and the industries for them to work efficiently.” (Interview: RL9)

RL5, however, asserted that, while not all staff had achieved a good level of expertise, there was a pool of industry specialists in every area of IRBM. As stated by RL9, if this was the case, then taxpayers would respect their authority and the compliance rate might increase (RL9).

¹⁷ Field audit statistics were prepared monthly by IRBM branches in order to report their audit performance to the HQ. However, the statistics were considered confidential and were unavailable to the researcher.

Findings from the interviews and secondary data therefore suggested that a lack of technical knowledge among IRBM officials presented another internal risk faced by IRBM which might result in taxpayers losing respect and confidence in its ability to advise wisely on tax matters. As noted by Alm et al. (2010), Kornhauser (2007) and Rothengatter (2005), when taxpayers receive quality services and supportive participation from the authorities, this may foster a feeling of respect and trust and may encourage voluntary compliance.

5.2.4 Integrity

To gain public trust in the tax authorities, the tax administration requires personnel with high integrity to enforce the tax law (Kornhauser, 2007; Alm and Torgler, 2004; Wenzel, 2002; Kirchler et al., 2003), and IRBM faces the same issues as other tax administrations in developing countries (addressed in Chapter 1). Corruption is an important challenge to be met by any tax administration, although the interviews with IRBM officials and tax practitioners indicated that corruption in the company was relatively low and under control compared with other public sectors in Malaysia:

“And as for corruption, I have heard of it but it was just hearsay. I don’t know if there is any member of staff who was prosecuted for it.” (Interview: RL17)

“Officially IRBM is never in the top 100. I think this issue is very much under control. Those taken to task with evidence from the ACA (Anti-Corruption Agency), I think the most were one or two (cases). Integrity-wise we are still very good. Even though we are also an enforcement organisation, like the police, we don’t hear of any here (corruption cases). Maybe there are some black horses but it’s very isolated. But our level of integrity is very good.” (Interview: RL4)

“So far there’s no case for field audit. We heard people talking about it, but there is no proof. We have the Integrity Plan to follow. According to the transparency index, IRBM is ranked second after the judiciary.” (Interview: RL15)

Indeed, RL1 related enthusiastically her feelings about fewer cases of corruption in IRBM:

“I’m very proud that IRBM has so far not even a hint of corruption that we hear of. If it is at the lower level, it’s more of, not so much of corruption in that sense, but rather misappropriation; there are instances of that. We do hear of isolated cases of some, at some stamp offices and a member of staff who misappropriated, yes. Maybe some lower rank staff who probably fell to temptation because of financial difficulty. But if we are talking about all levels of IRBM, I am confident it’s not (happening). If it happened at the lower level, maybe it’s for a little bit of pocket money here and there to provide faster services probably, but in fact there is no necessity (to bribe). We invite criticism and suggestions from the public and access (to our office) is very easy. Our service in most instances is very fast and if taxpayers are not happy they can complain to the PRO. So because of that the public can get service quite easily from us. There is no barrier such that they have to pay their way up. Probably we have to look out because our officials who go out to do audits outside, they may be exposed to offerings. Not that they asked for it, but it’s the other way round. Because there are some taxpayers who have the perception that if they pay their way, the path will be easier for them. That I do hear; the public, the businessmen who have tried to offer. But as far as I know our officials had turned down (the offers) and corrected them and said that this is something which is not tolerated by IRBM.” (Interview: RL1)

From RL1 observation, it appears that IRBM is not only faced with possibility of its officials involved in misappropriation, but the officials are also exposed to offers by taxpayers to influence the officials’ decision during audit activities.

Another interesting observation about the public perceptions of corruption among IRBM officials was made by RL3:

“I would like to relate one of my experiences when I accompanied my sister to rent an apartment for her. I asked the estate agent whether the house was purchased with cash or mortgage. He didn’t know that I’m a tax man. He said, ‘Of course, through mortgage; if by cash the IRBM will catch me’. Then I asked him, ‘Why are you scared of the IRBM?’ and he said, ‘Sir, I can handle the police, I can handle the Customs, I can handle the road transport (people) but never with the income tax people, never’. So it seems that our integrity is high and they respect us. Compliance can be improved if taxpayers respect and trust our system.” (Interview: RL3)

It was asserted that tax practitioners were in a dilemma about disclosing details of corruption for fear of being subjected to serious consequences from IRBM officials in the future:

“The biggest challenge in the case of corruption is the fact that the tax practitioners are not willing to come out with details due to fear of repercussions. (Therefore), IRBM has to monitor the audit cases and the audit officials closely to ensure that this is kept under control.” (Interview: RT5)

Because information about corruption was not always disclosed, it would be difficult for IRBM to take action against it, as stated by RL2, RL3 and RL5:

“I won’t say there’s none, but the fact that it doesn’t come to me, there is none. But I think there are down there, but how many (cases)? To what extent? We need feedback. So far the feedback was from outside. They said that it’s our officials; we receive letters; even tax agents said it. I said (to them) if you give me names then I would investigate. They won’t give names because it will affect their livelihood.” (Interview: RL2)

“As for corruption, I dare not say there isn’t any. But it’s under control. We don’t really know, we don’t have any proof yet but we did hear people talking about it. It’s just that people don’t want to report. Maybe people are scared to report to the authorities. It is quite disappointing not knowing or else we could take action on those involved. They can just complain but don’t want to make any report on the so-called corruption. We are disappointed about this because we want to know if our staffs are involved and we want to take action against these people. There are cases where outside people disguise themselves as a tax officer and demand money. This will tarnish our image.” (Interview: RL3)

“To say we don’t have any at all would be too simplistic. To say we have that as a problem, it’s overstating it. But suffice to say the element is there, always happening from time to time, it’s there. We heard stories about it. But no one dares even to prove it. Many times I offered people to come up with evidence so that we can take action but many times they refused to do so. It is just that they want to say that it happened, or is it because they are afraid of cooperating?” (Interview: RL5)

Some interviewees stated that, according to a report by the Malaysia Transparency Index, IRBM was ranked in second place in 2010 as the public sector with most integrity, one step behind the Judiciary Department¹⁸. Nevertheless, all interviewees agreed that IRBM should take tough measures to prevent its officials from being involved in corruption. According to them, there had been some reforms, such as the introduction of more secure computer systems for the approval of refunds, appeals and other processes; the establishment of an audit team of three officials for field audit; the implementation of the IRBM Integrity Plan (IIP, 2009); and an increase in the salary of IRBM officials. RL9 noted:

“Corruption is something about perception. To eradicate it is quite hard. It happens when someone has a low salary, like the police. In IRBM, we are paid quite well; I haven’t heard of any [corruption case]. There used to be, a long time ago. But [those were] isolated cases. Now we have been successful in our image. From the management point of view, in terms of their education, income, their life-style, their car, where they live, their houses. In Malaysia, people are committed at an early age. That’s not a good sign for corruption. Easy to get credit cards, they spend more than their earnings. That one we have to monitor. If that is ok, then everything would be ok, but we have to monitor it.” (Interview: RL9)

¹⁸ The interviewer had requested some printed evidence of the IRBM rank in the transparency index. However, the interviewees reported that they recalled reading it only in a newspaper and had not kept any printed evidence. Data from research through public domain was also unavailable.

The increase in the salaries of personnel was consistent with suggestions by Gill (2003), USAID (2007) and Abdullah (2008) that such an increase will motivate staff to work harder and may thus prevent corruption. Although it can be argued that a higher salary may not guarantee that corruption could be averted, an increase in wages is one of the anti-corruption strategies help to improve the living standard of workers and be an incentive to work honestly and avoid corruption, as noted by Gill, USAID and Abdullah.

Nevertheless, RL2 expressed a wish that IRBM would one day be able to inculcate high morals and trustworthiness among its officials to perform their duty honestly:

“So that’s why when we sent our officials to the ground, we sent more than one, normally three in a team, to avoid allegations against our officials. If one officer goes it’s easy to allege. But if it’s three, you’ll need three to collaborate your story. And normally we change the team to avoid it. Not that we don’t trust our officials, we want to make sure that we don’t have unnecessary allegations. Therefore we need to have two or three officials. I hope our officials understand that. Integrity risk is number one risk in our department. Not just audit officers but officials from the other departments as well. Down the level we really don’t know ... It’s not our officials alone, but the public. The public complain about corruption, but they are the ones who condone it. Probably, they are paying for it. That’s why they know.”
(Interview: RL2)

In its effort to promote and strengthen integrity within its administration, IRBM adopted the following practical approaches, as stated by the Board in the CATA¹⁹ (2006) meeting:

- Formulation and implementation of code of ethics in IRBM;
- Formulation of clients’ charter and system or work procedures;
- Restructuring of organisation to enhance and monitor internal controls;

¹⁹ The Commonwealth Association of Tax Administration (CATA) is a Commonwealth organisation for tax administrators. It helps member countries through training programmes, technical conferences and knowledge-sharing to develop effective tax administrations that promote sustainable development and good governance over the long-term. CATA, with forty-eight member countries, is presently the largest organisation of tax administrators in the world (CATA, 2006).

- Monitoring of activities by various departments such as the Compliance Department to monitor audit activities;
- Establishing the Investigation Department to monitor investigation activities and the Inspectorate; and
- Establishing the Internal Audit Department which monitors quality assurance and ensures strict observance of the principles of ethics and integrity outlined.

RL7 explained:

“To me, the issue of corruption is under control. We have officials who, I would say, have a very high integrity level. They don’t commit a specific crime to commit corruption. Because I think they are highly trained and our internal control is very high. Our system control is where you can’t simply do something as you like. The system will control all the IDs. Then internally we have checkers - approver I, approver II. So it is not easy to have corrupt practice in IRBM.” (Interview: RL7)

It therefore appeared from the interviews that corruption might not be one of the major risks to be addressed by IRBM. However, as noted by the interviewees, a continuous effort was made by the Board to ensure that its officials maintained a high level of integrity with the introduction of many initiatives, as highlighted earlier. Such initiatives were in line with suggestions by Hasseldine (2012) that strong internal controls are required, and by Bird and Zolt (2008), Gill (2003) and OECD (2010e) that technology is important to improve a system’s procedures and security in order to increase the integrity of the people and the process.

5.2.5 Shortage of human resources

As the number of taxpayers grew every year, so did the responsibilities of IRBM to manage the taxpayers. In order to be efficient and to provide faster services, IRBM required a sufficient number of personnel to perform the tasks of customer services, recovery, auditing, investigation and others to meet the increased demands from customers. The following responses were given during the interviews:

“When we started with Audit, they said our audit [system] was quite good. Nigeria came to learn [auditing] from us. They asked how many people you have, I said three. Do you know how many they have? Three hundred! And they have just started! We don’t have the luxury of having [many] people.” (Interview: RL4)

Because of this issue, IRBM was unable to perform certain tasks, and as a result failed to achieve its objective to provide faster services to taxpayers:

“So although initially there was a lot of apprehension from our staff, because, first of all we have to process almost 500,000 refunds, almost 600,000 because of the backlog, the number of staff is still the same, we have constraints of staff.” (Interview: RL2)

“Our intention is to let taxpayers know that we are after them, sooner or later we’ll catch up with them; then that will deter those evaders. Compliance-wise, I think at the moment we are having problems because of lack of staff. Maybe if we have more staff, then our field audit can go out more often. And they can solve the cases fast so that things don’t drag.” (Interviews: RL8)

“... because we actually don’t know who is not caught within the tax bracket. What we have is who comes to us and who we may go after during one of our rounds. Like those times when we used to go for street surveys, but because of lack of staff and lack of funds, we stopped the street survey.” (Interview: RL8)

However, it was not easy to recruit new IRBM personnel to overcome this issue.

As stated by RL7, it was impossible to increase the number of personnel frequently to meet the demands and expectations from the growing number of taxpayers. New staff recruitment cannot be based simply on the total number of registered taxpayers, because IRBM has to undergo various processes to apply for new staff, whereby application should be submitted to the Public Service Department (PSD) for approval:

- The PSD may take a few months, or sometimes years, to go through the application in considering budget allocation by the government.
- Once approved by the PSD, IRBM needs to advertise the post in the country’s major newspapers.
- Then the process of short listing and interviewing has to be conducted before the new members of staff are recruited.
- While waiting for additional positions and employees, the existing branch officials are remobilised according to job priority and urgency.

RL7 described the short term strategies undertaken by IRBM in its operation which was implemented annually. From January to June, officials from the Recovery Unit were deployed to assist the Revenue Refund Unit, while from July to December staff members from the Refund Unit were instructed to work at the Recovery Unit.

RL4 voiced her opinion that staff shortages might be due to misallocation of staff within the wrong departments:

“The manpower in some departments is not enough. Not enough people to handle operations in the branches. So they are supposed to take the action requested by the branch. I’m still waiting for my proposal to be approved. Things are not moving as we wish it to be. I see there are a lot of officials in Customer Service Department. But they are not doing the things that we wish them to do. They have twenty over G7²⁰ and twenty over G9. With that number we can do a ‘PCB’ audit²¹ and go to court. To me, with this number of people, you can do education very well. But in the Operation Department, to me, people to take care of certain areas are not there, there are so many things to handle. So, to me, they should have more people to get it moving faster.” (Interview: RL4)

This suggestion was supported by RL10:

“We have to know how to maximise our resources. Even though we don’t have enough staff, it’s a common problem. There is a lot of redundancy in the job functions among government agencies. If we co-operate with other agencies, we will be more efficient. If we have a proper system, we would be able to be excellent. Why do the Japanese and the Australians go to field audit alone? We are still doubtful about our staff. Maybe in a few years’ time, we will be able to trust them.” (Interview: RL10)

As a temporary measure to manage the risk of insufficient numbers of staff, there were plans made by some state directors:

“When we do the restructuring study, we don’t have enough officials for revenue collection activities and civil suit activities. In terms of audit, this was new, about nine years ago. So we can’t recruit audit officials at the same time. It’s just that, in terms of collection, we don’t need in-depth training; previously IRBM was not focussed enough on the collection activities, except for the last few years we started to allocate more resources to the collection unit to monitor tax payment and to collect tax. Now we have improved a lot. Even the companies file in KL (Kuala Lumpur), the branch files are still in KL. We can’t decentralize yet because we don’t have enough collection staff.” (Interview: RL6)

“...which means we have to know how to prioritize our resources. We give more

²⁰ Grade 7 official (G7) is a junior level manager position; Grade 9 is a junior executive position.

²¹ ‘PCB’ or Monthly Tax Deduction (MTD) Audit is an audit practice on employers who fail to comply with the MTD obligation.

priority to compliance, such as desk audit and field audit. Only during the filing season, we allocate more staff for customer service and assist taxpayers on how to use the e-Filing system. The staff need to be multi-tasking so that they can be assigned to various tasks should the need arise.” (Interview: RL14)

“Now the focus is on auditing. Due to shortage of staff, they have to be multi-tasking.” (Interview: RL15)

RL9 also agreed with RL14 and RL15 that the internal issues might be solved by developing a multi-skilled workforce and by building a culture of working as a team. Multi-skilling was very valuable as officials were capable of performing various duties which might help to overcome the shortage of manpower in the branches. RL19 also emphasised the importance of team work: each branch had set a specific target for their revenue collections every year; if a single unit in the branch therefore exceeded this target but other units did not reach the target, the whole branch would be considered as having failed to achieve the goal. Thus RL19 felt that there existed a sense of belonging among IRBM personnel in each branch and that there was a spirit of mutual assistance for the realization of targets set for each branch. Such an *esprit de corps* among staff was encouraged, not only to improve the performance of both branch and organisation, but also to promote an excellent working culture at the same time.

IRBM may have referred to HMRC’s strategy to overcome shortage of staff due to down-sizing and decentralisation, with the introduction of New Public Management (Currie and Procter, 2003). With the formation of teamwork, the organisation and management of HMRC staff and work processes are changed. Currie and Procter (2003) refer to team working as a combination of team members’ allocation so that the team works collectively from allocations which are grouped together. Currie and Procter (2003) note that the team working approach resulted in improvements in work processes in HMRC’s administration.

RL14 admitted that it was very difficult to provide an objective assessment of how adequately all the strategies were implemented. However, he felt that the compliance model was an effective strategy that could be applied to address the problem of taxpayer non-compliance. On the whole, he suggested certain actions should be considered in the process of practising good risk management: to coordinate and collaborate with partners and stakeholders for productive results; to conduct research on taxpayer behaviour towards non-compliance; to update tax databases; and to strengthen the organisational structure of IRBM.

From these responses, it appeared that IRBM encountered shortages of staff due to increased workload, length of time to process new recruitment, the misallocation of staff, and redundancy in performing jobs in certain departments. As a result of these risks, many compliance activities such as street surveys, field audits and overpayment refunds were put on hold or were conducted less frequently than previously. Initiating teamwork and remobilising staff were a temporary solution in order to handle current and urgent matters. However, in the long run, as suggested by many researchers, efficient and effective technology or computer systems may provide a better solution to manage a heavy workload and overcome the issue of insufficient staff (Gill, 2003; Bird and Zolt, 2008; Olken and Pande, 2011).

5.2.6 Lack of efficient computer system

As discussed in Section 1.4.1, another internal risk faced by public sectors, particularly those in developing economies, is that presented by inadequate computer systems or a lack of efficient information technology (IT) to run the operation. The importance of IT in IRBM is acknowledged by RL6:

“The challenge to ensure that organisations such as IRBM are more efficient and effective, especially in Malaysia, is first the change in technology or ICT. Because the technological change will affect how we do business and also how we do our work. Because we are able to see now that with the rapid technology changes we found that many business or business models have also changed. Whereby we ourselves come to a stage that we are not very sure whether the business model, the way they obtain the income, and the way they pay the tax, whether they can cater for the law now..... But if IRBM does not give the focus on these technology changes, there will be a chance that we will be left behind compared to the way the taxpayers do their business. Even the government of Malaysia will be left behind in amending the law to cater for the technology change. The current generation or future generation have to be prepared to look into it.” (Interview: RL6)

RL7 pointed out that there were a number of computer systems being developed for various purposes for different departments and divisions to help expedite the work of officials and branches. However, for him, the most challenging aspect of adopting a technology was if the system that was expected to support the work, fails to support. This concern is also expressed by RL15:

“It’s not helping much with our work. We have given a lot of feedback to them [the IT department].” (Interview: RL15)

RL14 further added his complaint about the system:

“Now we have e-Filing, SAS system, audit system. But as with any new system, it’s not stable yet. So we have problems like slow response time. There are times we have to do the work manually because the system is so slow.” (Interview: RL14)

Moreover, six interviewees found that the absence of system integration complicated daily operations in terms of review of information or data between systems. Nevertheless, the absence of integration was likely to be temporary because from time to time the Head Office would take action to overcome this problem. It was suggested that the delay in the implementation might be due to a lack of financial provision. With enough budget allocation, IRBM would be able to enhance system integration among the departments. It was stated by RL8 that the integration system for IRBM would be developed under the 10th Malaysian Plan - a research paper pertaining to this plan was presented in 2010.

A further issue relating to how IT staff could keep up with technological change within the organisation was raised by RL1, RL6 and RL8:

“The other challenge as an agency is to get staff to be in our transformation process, to be in tune to changes that come along, the technological changes, e.g., the new technology used in the office, to be comfortable in using the technology. The younger ones are not grumbling, but those in their late 40s and 50s, they may not be so adapt in using the computer. They have to change that, to be willing in learning. Learning is a continuous process.” (Interview: RL1)

“The challenge is to have the senior officials to be efficient doing work through the system. But to the young ones, they know how to do it; they will copy, paste, and create in other files. It’s not that easy to the seniors, but it is faster doing it through the system. They just key-in the figure; the system will do the computation. The problem is we have reached the maximum capacity of the system, so sometimes the response time is quite slow. We have requested additional budget from the government, but we have to wait.” (Interview: RL6)

“The latest challenge for us to achieve the paradigm shift of taxpayers’ mind-set from manual to automation, technological change. Also to the staff from manual (work) and now on SAS, comes e-Filing and all the technological changes. So it’s more of keeping up with the changes and time so that whatever service we give follows what the people want.” (Interview: RL8)

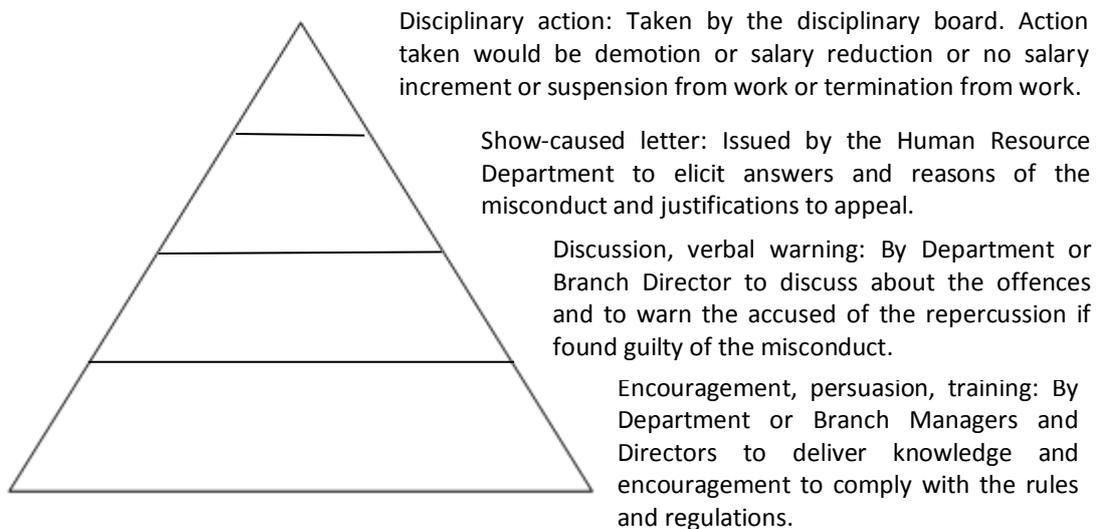
From the interviews, it can be concluded that IRBM faces issues related to IT: lack of system integration, slow system response time, technological change management and the training of computer illiterates were all identified. In order to enhance the performance of the technology, a vast amount of financial resources is required. Section 5.2.1 addresses the insufficiency of funds as a further barrier restricting the growth of development in IRBM, while Section 1.4 explains that the lack of financial resources is a common limitation in developing countries which hinders an organisation “to upgrade its operation to improve performance” (Gill, 2003, p.5).

The interviews indicated that weaknesses of technology systems in IRBM seem to be relevant only to its internal computer systems, prompting remarks from the interviewees about “lack of integration between division and units”. Even though IRBM has invested a huge sum of money for development of e-Services to improve service delivery to the public, its senior managers should not forget that members of staff are also customers (internal) of the organisation, thus they should respond to their complaints. Productivity may be increased if the infrastructure

within the organisation and staff well-being is taken care of (Hasseldine, 2012; Gill, 2003; OECD, 2011).

It is interesting to note the comment made by RL14 that, even though the pyramid model was originally developed as a strategy to address the problem of taxpayer compliance, it could also be applied to manage internal risk within an organisation. He provided an example whereby a discipline problem among staff could be perceived as one of non-compliance. For IRBM staff who deliberately breached office regulations, a deterrence mechanism could be applied. On the other hand, IRBM could provide incentives to motivate other personnel who were always compliant with the rules and also to encourage future compliance. Risk-based responsive regulation can thus be used as a tool, not only to implement effective risk management on taxpayer compliance (Black and Baldwin, 2010), but also to manage internal risk within an organisation (RL14). RL14's remark about the internal enforcement strategy can be illustrated by adapting Ayres and Braithwaite's enforcement pyramid (1992), as presented in Figure 12.

Figure 12: Enforcement Pyramid for IRBM Disciplinary Board



Source: Adapted from Ayres and Braithwaite Enforcement Pyramid (1992)

From literature, it appears that a risk-based responsive regulation approach fits well with the current IRBM risk management framework. Findings also suggest that responsive regulation could be applied by IRBM to enforce compliance of organisation rules. In this context, the senior management would represent the regulators while the personnel would be the regulatees. By applying the theory of responsive regulation and the enforcement pyramid, senior managers may begin to encourage compliance from the bottom of the pyramid. The ATO has set a good example of complying with responsive regulation, whereby the managers supported and encouraged the staff members in accepting the change during the introduction of the compliance pyramid in their administration (Job and Honaker, 2003). Based on Ayres and Braithwaite's enforcement pyramid, a regulatory pyramid was drawn to illustrate the internal responsive regulatory mechanism adopted by IRBM to manage internal risk in its organisation.

5.3 Summary

This chapter has addressed findings which identified internal risks of IRBM as financial constraint, lack of staff professionalism, technical knowledge, integrity, a shortage of human resource and the lack of an efficient computer system. To manage the internal risks, IRBM has established short-term and long-term solutions which include conducting seminars and courses to enhance staff professionalism and technical knowledge; publishing an Integrity Plan to avert integrity issues; remobilising staff in order to overcome staff shortages; planning upgrades of internal IT systems to improve performance; and producing a Strategic Planning book to provide information about IRBM's strategic direction for the next five years (2009-2013). Further, this chapter demonstrates application of Ayres and Braithwaite's Enforcement Pyramid Model in the disciplinary

procedure by IRBM. While this chapter establishes internal risks encountered by IRBM, next chapter presents external risks to be managed by IRBM.

Chapter 6

External risk factors in Malaysian tax administration and strategies to manage them

6.1 Introduction

Previous chapter addressed internal risks which affects effectiveness in administration of IRBM. To answer the research question, “What are the external risks faced by the IRBM?” this chapter discusses external risks faced by IRBM. During the interviews, participants were asked about external challenges that they faced in their daily routine. Many were of the opinion that shadow economy and taxpayers’ behaviour were the main external risks faced by the company. By understanding the external challenges, IRBM and other tax administrations would be prepared to meet the changing demands of the external environment and provide strategic measures to manage those challenges. This chapter begins with Section 6.2 which presents reports on the problem of shadow economy in Malaysia and interviewees perception of this issue. This is followed by Section 6.3, which addresses the research question on the perceptions of IRBM officials of Malaysian taxpayers’ behaviour. Further, tax practitioners’ perceptions of behaviour of Malaysian taxpayers are elicited and discussed in Section 6.4. Finally, Section 6.5 summarizes this chapter.

6.2 Shadow economy

One of the greatest challenges for IRBM is how to tackle shadow economy activities. Shadow economy is not a threat to revenue agencies alone, but also as a national threat because some of the activities may involve criminal activities such as smuggling, illegal trading, and immoral practices. According to Schneider

(2006), the size of shadow economy in Malaysia in 2002/2003 was 32.2% of GDP. Hence, this activity had resulted in fewer revenue collections not only to IRBM, but also to other public agencies namely the Customs, Registrar of Business, or the business license authority.

RL4 described her interesting observation of underground activities in her area of jurisdiction.

“... we had not put into effort to really attack this area, the underground economy. Especially in [the name of the branch], it is more. Because here we have smugglers, Along (illegal money lenders), 4 ekor haram (illegal lottery), TOTO, all the illegal businesses. Because I think the biggest Chinese taiko (great leader) is here. The godfather of all is here. The Indian one is in [name of a place in the branch area]. So we do encounter a lot of taxpayers where their business is very small but the ins and outs of their bank statements are millions [Ringgit Malaysia]. For audit they won't disclose, as we are dealing with investigation so we cannot seize all their documents. It's very difficult. They do not wish to inform us, we can only guess here and there because there are a lot of missing links here and there. And as their business is illegal, they won't disclose. And then you can even observe it with your own eyes at certain areas suddenly there are a few businesses up, but actually they are not having business at all. It was just money laundering. Because out of the blue suddenly we have a mini market, they hardly have any customers, but this actually is an eye-wash money laundering. Especially my [branch] area is so huge that we have to visit deeper site of the plantation. We find there are robust kinds of business going on inside there; a lot of these.” (Interview: RL4)

Further, RL4 added her predicament in handling underground economy cases due to procedural issues between audit division and investigation department.

“One thing is we are at the disadvantage because if they say they are a company, we can't touch. It's a company file. So unless it's a sole proprietor, then ok we can take care. A lot of cases we have to see it and let go. This is not only peculiar to my branch. I think somebody has to look into this. If not, I doubt our compliance will go up.” (Interview: RL4)

From RL4's comments it appears that underground economy could be major illegal activities that could continue to operate without being detected by the authority. There also appears to be some misunderstandings between audit division and investigation department when it comes to handling corporate cases. Hence, this matter needs to be discussed among relevant parties so that a clear guideline could be issued to ensure such cases are conducted efficiently. The

bottom line is IRBM to prevent tax evasion through underground economy. Therefore, either the branch or other department of IRBM need to be responsible in handling shadow economy so that compliance can be secured and revenue can be collected from these activities.

Further, RL12 reported that in order to ensure those involved would not escape the law, IRBM had established collaboration with various public agencies such as the Malaysian Central Bank and the Royal Malaysian Police to prevent money laundering, claims for refugee status and tax evasion. Inter-agency cooperation also involved the Malaysian Security Commission, the Immigration Department, the Customs Department and other enforcement agencies. In addition, RL12 suggested that an integrated mechanism in the exchange of information between these agencies enabled tracking of shadow economy activities to be implemented more effectively.

A few of the interviewees, namely RL4, RL16, RL20 and RL29 admitted that managing hidden economy presented a major challenge to IRBM due to a lack of information on the underground activities and the shortage of staff to investigate them. They also agreed that the lack of system integration and information-sharing among public sectors added to the problems. Desk and field auditors (RL22, RL23, RL24, RL25 and RL26) commented that the Street Survey activities conducted by IRBM branches, where IRBM officials visited street vendors and traders, need to be improved so that more underground businesses could be detected. It was noted by both RT3 and RT4 that shadow economy issues were relatively new in the Malaysian tax administration; as a result, it was necessary to conduct further studies to explore and understand this issue so that IRBM could manage it effectively.

With advance technology in this era, many businesses are operated through online transaction. This business activity is known as e-commerce and has become major issues for all tax administrations to detect the activities and ensure compliance with the law. According to RL27, the Tax Compliance Department of IRBM has recently established an e-Commerce Unit to detect businesses operated through online transaction. It is an effort to get this group of potential taxpayers in the tax system and ascertain that they register, file tax return and pay their tax liabilities.

The shadow economy is a major challenge faced not only by IRBM but also by tax administrations all over the world. This concern should be managed effectively as it implies non-compliance of tax law and would result in inadequate tax collection (Frey and Togler, 2006; Katsios, 2006; Trasberg, 2004). The lampshade model presented by the Risk-based Responsive Compliance Model in Section 8.8, illustrates the shadow economy as a major issue to be addressed by tax administrations especially in developing countries. Although the shadow economy is stated by the interviewees to be a long-running activity, it is considered a new external risk to be addressed by IRBM. They therefore suggested that further research should be undertaken by IRBM in order to gain understanding of this aspect. IRBM may need to set-up a unit to specifically handle the shadow economy issues. The shadow economy relates to taxpayer irresponsible behaviour to evade paying tax in order to maximise their profit. There was general consensus that one of the most effective approaches to manage the problem of non-compliance was through understanding taxpayer behaviour. Next section describes taxpayer behaviour as perceived by IRBM officials and tax practitioners.

6.3 Taxpayer Behaviour

Naturally people do not like to part from their money especially if they perceive that they do not receive any benefit or privilege in return for their contribution. Under SAS, voluntary compliance by taxpayer is important to ensure the success of this scheme, which does not require taxpayers to enclose any financial documents to prove their claims made in their return forms. However, Malaysian tax administration practice requires taxpayers to keep relevant documents for seven years since it may be necessary for IRBM to refer to these should there be any doubts on the tax declaration submitted by the taxpayer (TAF, 2009).

IRBM faces several risks of non-compliance: incorrect reporting of tax obligation, late or non-submission of the return form and non-payment of tax due. These non-compliance risks arise from attitudes of taxpayers towards their tax obligation, which is addressed in Section 3.3. Further, the EC (2010) and OECD (2009) suggest that an effective and efficient compliance risk management strategy may prevent non-compliance and encourage voluntary compliance and self-regulation.

During the interview, RL9 provided an interesting analogy between self-regulation and playing golf:

“Compliance should be self-enforced. Everybody should enforce the law themselves. We must give the message to the public to enforce the law themselves. Like the game of golf. Golf is a game based on sincerity. Golf is the game where there is handicapping and sincerity. The law is very stringent, very strict. But enforcement is based on you yourself without being supervised. It is also about integrity.”
(Interview: RL9)

Responsive regulation theory fosters a good relationship between the regulators and regulatees by encouraging mutual respect on the part of both parties (Braithwaite, 2003; Job et al., 2007; Welsh, 2009). Through the reciprocal relationship, taxpayers may be encouraged to express their problems and

grievances concerning the services provided and at the same time the authority is respectful of the taxpayers and attentive to their complaints. From this dynamic partnership between tax authority and taxpayers, taxpayers may respond positively over their tax obligation and self-regulate to comply with the law, while the tax authority could respond respectfully and yet firmly when dealing with taxpayers. However, as argued by Burton (2007), it is difficult to form partnerships to achieve tax compliance because regulators and regulatees may have a different interpretation of the tax laws and disagreement on mutual goals of compliance. Burton's argument is supported by most of the officials interviewed, the majority of IRBM officials and tax practitioners stating that Malaysians are not ready to be self-regulated:

"I don't think Malaysian taxpayers are ready to be self-regulated. For instance, as it is now with SAS we can see that they are not telling the truth, so how are they going to be self-regulated? ... I think they are not ready to be self-regulated themselves, we need to monitor, we have to have sufficient numbers in this organisation to do a constant audit. Then we can move to self-regulation." (Interview: RL2)

"Malaysians are not ready yet. If they comply it is because they are afraid of the enforcement, not because they voluntarily want to comply." (Interview: RL20)

"(Self-regulation) is still quite low. They need to be reminded about their tax obligation. Maybe in five years' time (it will improve) if our education programme is getting better." (Interview: RL19)

"We need another five years for them to be ready for self-regulation." (Interview: RL11)

"It seems very slow, even though there are some who really comply voluntarily - the majority, even though they comply, they may not comply 100%. Some may still understate or overstate. That is very common as we see from the desk audit programme." (Interview: RL7)

"The (tax responsibility) awareness is not low, sometimes it's quite high. But to be proud of the nation, we should be proud of paying tax. So we will voluntarily come forward. But now what we see is they are proud of evading paying tax. But we need time to educate them. It means that we have to make them know that taxation is important for their own good." (Interview: RL10)

"It is still premature for self-regulation in Malaysia. They are not ready. It could take another generation through tax education to change the mind-set of taxpayers." (Interview: RT5)

These remarks, made from the perspective of IRBM officials and tax practitioners, make it clear that Malaysian taxpayers were still unprepared to be self-regulated towards their tax obligation. As stated by RT6 humorously, “Malaysian taxpayers will be ready for self-regulation only when they are all saints!” To encourage self-regulation, RL27 suggested IRBM to award taxpayers who have shown great track records in voluntary compliance, with letter of appreciation. Many interviewees suggested that tax education was required to motivate taxpayers to comply voluntarily and self-regulate on taxation matters.

In an effort to inform taxpayers, IRBM has offered various educational activities to members of the public, one of which is to create a Business Support Unit (BSU) in every branch of IRBM. The purpose of the BSU is to provide a Business Support Service (BSS) as a formal training and support to business-income taxpayers, especially those operating small businesses that cannot afford to hire a tax practitioner to manage their tax account. Educating traders and business-income taxpayers may therefore extend their knowledge and increase compliance. The BSS, a free-of-charge training is beneficial for business taxpayers who have no basic knowledge of managing their tax obligation, such as the type of records to be kept and the type of documents to furnish when confronted by tax audit. However, even though IRBM has sent out invitations to attend the training, the very low attendance indicates that taxpayers have no interest in participating, as the comments below illustrate:

“They are not on that mentality level to accept that we are doing this for them. It is not that we don’t want to do it (training the public for about tax), it is just that taxpayers don’t want to learn to do it.” (Interview: RL4)

“Those parties who we try to reach never came back to us. Sometimes we conducted (seminars) for the chamber of commerce but which are also very specific to small businesses....but do they bother to learn about it? No.” (Interview: RL5)

Responses from the interviews indicated that IRBM officials encountered problems in attempting to educate the taxpayers. The issue was not that members of the public found it difficult to learn and understand about taxation, but rather they were unwilling to do so and to commit towards their tax responsibility. The following responses highlight this challenge:

“Malaysians, most of them are highly educated....but the challenge to educate is not because they are not smart, but they simply don't want to learn. They don't want to accept.” (Interview: RL6)

“They are aware of tax, but they are playing hide and seek, catch me if you can, trying with their luck; those who are caught, they'll try other means. So it's the attitude that they still do not see tax as something important for the country.” (Interview RL2)

“They expect a simple system for them to pay without having to do any computation. That's why they don't like SAS. They don't want to know about taxation so that they don't have to comply.” (Interview: RL3)

Moreover, RL5 explained that there were a number of people who remained ignorant of the requirement and also those who have a wrong perception of tax law obligation. For example, some taxpayers believed that, because they had already made their payment each month through Monthly Tax Deduction (MTD) for employees, they had fulfilled their obligation and shown compliance; they failed to see the necessity of submitting return forms to declare their income, i.e. they failed to realize that payment of tax and filing a tax return were two different obligations. For RL5, ignorance on the part of the taxpayer resulted in non-compliance. IRBM was thus responsible for informing these people of their duty not only to pay tax but also to report their income accurately to the authorities. As RL10 commented, IRBM also should educate taxpayers as to their obligation as responsible citizens:

“At the lower level (of taxpayers), the awareness is low. Look at when we go to the hospital. We need to pay only MYR1.00 (about £0.21). And yet we get to see a specialist doctor and take home a handful of medications. If we go to the private hospital we need to spend hundreds of Ringgit. But at a government hospital, we can get the medication with a very minimum amount. So where does the money come from? They need to think. If we don't give the explanation, they don't see. To them

it's a burden to pay tax. They should be proud to contribute to the nation.”
(Interview: RL10)

The majority of IRBM officials who were interviewed expressed disappointment over the attitude of some taxpayers, especially the business-income taxpayers who refused to cooperate with IRBM to be educated on taxation matters. As suggested by Jackson and Milliron (1986), Eriksen and Fallan (1996) and Torgler (2003), taxpayers with a higher level of tax knowledge tend to show a more positive attitude towards their tax obligations. Lack of interest in acquiring sufficient tax knowledge may therefore lead to negative attitudes towards tax compliance which may in turn result in non-compliance. Understanding the importance of educating the public about their obligations, IRBM has designed a variety of educational activities to encourage tax compliance.

The reasons for non-compliance offered by interviewees were mainly based on taxpayers' behaviour, which demonstrated:

- Ignorance of the law;
- Refusal to take responsibility for submitting their return form or reporting correct income or paying the taxable amount due;
- Lack of trust in the tax system and in the government as a whole;
- Unwilling to incur additional cost to the business.

However, some participants viewed IRBM officials' presumption that all taxpayers tend to cheat in their reporting as defeating the spirit of SAS. They were of the opinion that IRBM should trust the information provided by taxpayers, a point of view that is consistent with responsive regulation theory that “rests upon mutual trust but can provide an appropriate background for a relationship of trust” (Freedman, 2011, p.3). The mutual trust would eventually develop into a reciprocal relationship between IRBM and taxpayers which may lead to a better

perception of IRBM and which has the potential to increase voluntary compliance (Kornhauser, 2007; Alm and Torgler, 2004; Feld and Frey, 2005; Wenzel, 2002; Kirchler et al., 2003).

Meanwhile, according to Choong and Wong (2011, p.885), 39% of their respondents admitted that they have sought assistance from IRBM officers to fill up the return form. Majority of them were quite satisfied with the services provided by IRBM. However, only 33% of their respondent is willing to attend to IRBM seminars on taxation whilst 67% is not interested to attend. According to Choong and Wong (2011), most tax agents charged about MYR500-1200 (£100-240) for preparing tax return form. In their study Choong and Wong (2011, p.885) find that only 9.3% willing to pay MYR301-500 (£60-100) and less than 1% willing to pay more than MYR1000 (£200). As the traders' annual turnover is quite low, they are unwilling to spend more on tax assistance. From Choong and Wong's observation, it appears that willingness to comply and compliance cost are other factors that may influence taxpayers to comply. Choong and Wong's study affirms IRBM officials' point of view that taxpayers, especially the self-employed ones, were unlikely to attend to any education programmes provided by IRBM to enhance their taxation knowledge and at the same time refuse to ensure correct reporting by hiring tax agents due to high compliance cost.

Another concern arises from the interviews were taxpayers' perception towards government may influence their payment for Zakat (tithe). Zakat is "a specific obligation of giving a portion of an individual's wealth and possessions for primarily charitable purposes" (Wahid and Abdul Kader, 2010, p.462). Paying

Zakat by Muslims is the third pillar²² in Islamic teaching. In Malaysia, Zakat collection is administered by Islamic agencies of State Government. The funds collected from Zakat are then distributed to the poor or the needy Muslims to improve their livelihood. Malaysia tax law allows a rebate to be granted for any payment of which is obligatory namely Zakat or any other Islamic religious dues in order to release Zakat/tax payers from the burden of “double taxation” on the same income (The Star, April 15, 2012). Zakat payers are required by tax law to keep Zakat payment proofs such as receipts or payment statement issued by the Zakat authorities, should it be required for audit purpose.

With regards to tax compliance, RL10 stated his observation,

“Another thing is Zakat; no doubt it is mandatory in Islam. But in Islam, Zakat to be paid is only 2.5% from your income, so the balance should be paid to the rulers. But they [taxpayers] pay all to the Zakat authority. We need to have a dialogue with the Islamic scholars about this. The taxpayers said that they don’t want their money to go to the government because the government is corrupt. But the government still needs the money for development. Maybe we need to have another Act on that. But of course there will be protest on this matter.” (Interview: RL10)

Comments by RL10 suggested that even though they are required to pay only 2.5% of their income, a large number of Malaysian Muslim taxpayers pay the amount equivalent to tax charged, hence they obtain full rebate which resulted in nil tax payable. As noted by RL10, some Zakat payers contributed more than 2.5% so that they will obtain rebate and therefore they need not pay to the government, whom they perceived as corrupt. Comments by RL10 are consistent with findings by Abu Bakar and Abdul Rashid (2010, p. 81) who indicated that “...what matters more to them is that they would get tax rebate out of the Zakat on

²² Five pillars of Islam are the foundation of Muslim life: Belief the oneness of Allah (the God) and Muhammad is the messenger of Allah; Pray five times a day facing the direction of the Kaaba in Mecca; Pay 2.5% of earning for Zakat; Fast in the Islamic month of Ramadhan; and Perform Haj, pilgrimage to Mecca at least once in a lifetime (to those who are financially and physically able).

income paid.” Further, RL9 agreed with RL10 that even though they have contributed to Zakat, at the same time they should also pay tax to the government: “Of course you have to pay Zakat because it’s an obligation, but at the same time you also pay what is due to you for the public” (RL9). Both RL9 and RL10 views suggested that responsible taxpayers may need to fulfil their obligations toward religious commitment as well as national commitment as funds collected from both obligation is necessary for building better life for the people.

From the interviews, it appears that religiosity is another factor which may influence tax compliance in Malaysia. It may be difficult to determine if the motivation for paying Zakat is related to a person’s high level of piety, or to their perceptions of the government, or for other reasons only known to them. As noted by Pope and Mohdali (2010, p.386) “Taxpayers may well react to the benefit of tax deductions by contributing more religious giving because the real cost of this is lower and not because they have high religious beliefs.” However, according to Loo et al. (2010a), a subject of their study refused to claim Zakat rebate on the tax return form because “the payment of Zakat was regarded as moral and religious obligation” (p.19). Both literatures (Pope and Mohdali, 2010; Loo et al., 2010a) indicated contradictory findings on the motivation of tax payers to pay Zakat, which could be either for the tax rebate or for reasons of religiosity.

Apart from paying Zakat as ibadah (an act of worship), trust in the government is another determinant factor of non-compliance (Kirchler et al., 2008; Feld and Frey, 2005; Wenzel, 2002). Some participants commented that taxpayers may choose not to pay income tax as they refuse to contribute revenue to the government due to their perception that the government is misusing the funds for political and personal agendas. These comments are consistent with a study by

McGee et al. (2012) which indicates that taxpayers tend to evade tax “if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends” (p.5). In this regard, the author has observed similar perceptions from relatives and close friends. The study observes that many participants suggested that the Malaysian public needs to be instilled with the awareness that tax revenue is essential to develop the nation and thereby be of benefit to the people. The public would thus realize their responsibility to pay tax while paying Zakat, regardless of their political views or their sentiments towards the government. While Zakat is a religious obligation, income tax is a national requirement; hence, both are important for improving the quality of living and should not be perceived as a burden to Muslims as a payment of double tax. Nevertheless, this finding implies that to gain trust from taxpayers, the government could be fair and transparent in its administration, adopt good corporate governance and manage public funds wisely.

The above sections have addressed perceptions of IRBM officials that relate to the shadow economy as well as taxpayers’ attitudes to compliance in Malaysia. Most interviewees agreed that Malaysian taxpayers, especially the business-income taxpayers, were unprepared to voluntarily comply with their tax obligations. For them, as income from business is more important, they are unwilling to spend time attending tax education session prepared by IRBM. Being unconcerned on their tax responsibility have resulted in their refusal to obtain tax agent advisory service to ensure tax returns are completed correctly. The study also finds that a lack of trust in the government also resulted in some Muslim taxpayers resorted to pay more towards Zakat which enables them to be exempted from paying income tax. The next section gives an account of interviews conducted with tax

practitioners to obtain opinions from outside parties and to elicit their perceptions of taxpayers' behaviour.

6.4 Perceptions of tax practitioners on taxpayer behaviour in Malaysia

To strengthen findings for this study, tax practitioners in Malaysia were also interviewed to obtain insights from a different perspective of the phenomena under study. All tax practitioners agreed that among the challenges that they had to confront when representing their clients were ignorance of the law and poor record-keeping of business transactions. As reported by RT2, "taxpayers do not keep proper records and ask us to simply estimate their tax payables". RT5 agreed that the taxpayer's ignorance of tax laws and poor record-keeping were some of the complexities faced by tax practitioners. He also observed that, "generally, those who encountered problems in business tended to neglect their tax responsibilities as they needed first to address their bread and butter issues". Further, according to RT5, based on his experience as a tax practitioner, small businessmen had the tendency not to comply due to ignorance of the law. This finding seems to be consistent with the observation made by the IRBM officials which found that small business-income taxpayers were those in the non-compliance group who refused to comply due to lack of knowledge about the tax law.

These perceptions of both tax practitioners and IRBM officials are consistent with literature that suggests small business-income taxpayers have a tendency to non-compliance due to lack of taxation knowledge (Hasseldine et al., 2007; Rothengatter, 2005; OECD, 2010c; Niemirowski et al., 2003; Choong and Wong, 2011). This group also cannot afford to hire tax professionals to manage their tax

matters because of high compliance costs (Hasseldine et al., 2007; Rothengatter, 2005; OECD, 2010c; Choong and Wong, 2011). To further exacerbate the situation, they refused to attend free training conducted by IRBM to assist them in understanding their duties as taxpayers.

RT1 was also disappointed with the attitude of taxpayers who were less interested in the tax education programme organised by IRBM. According to him, normally those who attended the programme were tax practitioner staff. Similarly, RT4 commented on the attitude of small-business taxpayers:

“Well, number 1 is we are Asian countries, we are not actually developed. Unless you give assistance to every taxpayer, I don’t think everybody knows what the law looks like. Our businessmen, some actually are illiterate. So before IRBM enforce, they must come up with all sorts of rulings. As there are very few rulings, until then, possibly, politically, you cannot do this. Because these people, they come and say we can comply but the IRBM is not giving us the assistance. It will take a while. Even developed nations like the US and others; they have a very long history. We (taxation in Malaysia) are just about thirty to forty years, very short, very young.” (Interview: RT4)

The attitude of taxpayers described by the interviewees confirms the idea that some taxpayers are reluctant to learn more about taxation matters and rely on tax practitioners to handle their tax affairs. RT4’s statement that some self-employed taxpayers are illiterate is consistent with Choong and Wong (2011, p.885) findings that 14.5% of petty traders surveyed indicated they were unable to understand the Malay language as the form is written in the national language. The tax practitioner’s comment concurred with IRBM desk and field auditors (RL21, RL22, RL23, RL24, RL25 and RL26) who agreed that a high percentage – between 75% to 90% of taxpayers audited are of Chinese ethnicity. According to the auditors, most Chinese traders claimed that they do not understand the instruction written in Malay or English as they only speak and understand Chinese. This is confirmed by RL25 who noted a taxpayer’s remark during an audit session; “I’m only a China man, I don’t understand anything about tax”.

It appears that the language barrier is one of the reasons for non-compliance among Chinese self-employed taxpayers. However, due to the government's policy in using the Malay language for official business, it may not be possible for the Board to provide return forms in Chinese²³ and it may therefore need to devise other approaches to educate this group of taxpayers. For instance, IRBM may take the initiative to publish translations of return forms in Chinese on its website, as well as providing continuous tax education in the Chinese language newspapers to enable taxpayers to learn aspects of taxation.

With reference to the list of tax agents published on the IRBM website, a large number of tax practitioners are of Chinese ethnicity, and thus facilitate dissemination of information about tax obligation by tax practitioners to taxpayers. However, as discussed in Section 6.3, although the majority of tax agents are Chinese, this does not help greatly since most self-employers or small traders refuse to engage tax agents to handle their tax matters due to the additional operational cost to their business. Even though IRBM provides facilities by conducting BSS, due to time-constraints and a non-committal attitude, these taxpayers refuse to attend the tax education seminars. IRBM officials may therefore consider adopting an educational tactic, whereby instead of waiting for the taxpayers to approach IRBM, Chinese-speaking officials could visit them at their work location. Face-to-face interaction may be helpful to educate these taxpayers of their tax responsibilities.

IRBM officials may need to understand other factors underlying non-compliance behaviour. Social norms, for example, may be an influence, because if people with whom they come into contact do not comply, then self-employers may

²³ Return forms in English are provided for non-Malay speaking taxpayers, especially expatriates.

follow suit (Yong, 2011, Rothengatter, 2005). Moreover, it would be interesting to find out if culture also plays a role in determining tax compliance. In Malaysia, Chinese are known as business-oriented people who work hard. One may speculate if their culture would thus encourage them to understand their obligation to support the government in developing the country by abiding the tax law.

There also appears to be a gap in the system for teaching the Malay language. This study has found that many Malaysian citizens, other than the indigenous Malays, are less conversant with the national language. For long-term acquisition of the Malay language, the government of Malaysia may need to examine the education system to ensure that all Malaysian citizens, regardless of ethnicity, acquire a good command of the Malay language, in both oral and written forms. The vernacular education system²⁴ in Malaysia could be studied as it may affect fluency in Malay among students at school. For example, for a Chinese child studying in a Chinese national school and living in a Chinese-dominated community, it would not be surprising if that child is less fluent in the Malay language, since, during most of his or her life, Chinese is spoken in school, at home and within the surrounding area.

Findings indicate that non-compliance within this group of taxpayers is the result of a lack of knowledge, the language barrier, attitudes towards complying with the law and unwillingness to hire tax practitioners to manage their accounts due to the high cost. Other factors which may influence their decision to comply include differences in social and cultural norms and the extent to which taxpayers trust the

²⁴ In Malaysia, there are three types of public school: the national school (the medium of instruction is the Malay language), the Chinese national school (the medium of instruction is the Chinese language) and the Tamil national school (the medium of instruction is the Tamil language) (Jamil and Raman, 2012).

government. These factors are consistent with arguments presented in Section 3.3 which highlight factors that determine taxpayers' decisions in compliance. Further studies may therefore be required in order to understand why other ethnicities in Malaysia fail to comply. The findings from this study will help to inform both IRBM and the tax practitioners of the measures to be taken to assist, regulate and encourage compliance amongst these groups. In addition, the Ministry of Education could investigate strategies for improving the Malay language education system in the Malaysian education syllabus.

Pressure exerted by clients to cheat on reporting their tax liabilities presents yet another challenge to tax practitioners. RT3 related that sometimes tax practitioners were threatened by clients who warned, "Look, if you don't do this, then I won't give you the job". According to RT3, this created difficulties, especially for small-scale tax practitioners who needed the business to make a living, yet at the same time had to handle ethical issues:

"So sometimes you get this push and pull factor. So my guess is that there are people who were affected by that, clients pressure you, and you generally say, let's try that and let's wait for an audit." (Interview: RT3)

It is unfortunate to discover that some of the taxpayers are not only being dishonest with the authority, but are also trying to gain the cooperation of the tax practitioners to help them to cheat the tax system. However, RT3 asserted that all tax practitioners were bound by ethical rules governed by guidelines for professional bodies. Nevertheless, RT6 agreed the possibility of unregistered tax agents resorted to unethical conduct to reduce their clients' tax liability. RT6's opinion is consistent with RL25's experience when auditing taxpayers where a few of them admitted to work together with their tax agents to reduce tax to be paid.

From the scenarios revealed by the tax practitioners during the interviews, it can be suggested that taxpayers will seek opportunities to cheat the system and to be dishonest not only with tax authorities but also with tax practitioners. This scenario is similar to the UK taxpayers represented by tax practitioners, as reported by HMRC based on their analysis of SAS return forms (Salter and Oats, 2011). Responses from the interviewees reflect the challenge faced by tax practitioners to play an advisory role in order to educate taxpayers about their tax responsibilities rather than focussing solely on the aspects of business. However, it is a responsibility of tax practitioners to display professional and ethical conduct and at the same time remain unaffected by pressure from their clients (OECD, 2006). Tax practitioners play an important role as representatives of taxpayers to ensure compliance of the law (OECD, 2008a; Marshall, Armstrong and Smith, 2006).

Even though IRBM and tax practitioners have to handle ignorant and unethical behaviour on the part of taxpayers, both parties “need to coordinate with each other” (Hasseldine, 2012, p.363) to educate taxpayers. The data suggests that IRBM “increase collaborative relationships” (Niemiowski et al., 2003, p.162) with tax practitioners to work together in order to understand the source of the compliance problem and to arrive at suitable solutions to address these issues. The collaboration may ensure the success of SAS and eventually may improve compliance (OECD, 2008a; Thomson, 2008; Niemiowski et al., 2003). IRBM and tax practitioners could take the opportunity during their annual meetings to discuss these matters, to look for weaknesses in tax compliance programme and seek ways of improving compliance in Malaysia.

6.5 Summary

This chapter presents findings with regard to external risks where the most challenging external risks faced by IRBM are shadow economy and taxpayer behaviour. As shadow economy has only recently gained the attention of the Board, participants have suggested that this subject needs further investigation. As for the behaviour of Malaysian taxpayers, the study noted, consistent with literature, that non-compliance risks in Malaysia are instigated by language barrier; lack of taxation knowledge; an unwillingness to learn; distrust of the tax system, IRBM and the government; and simply ignoring the law and risking the chance of getting caught.

To obtain responses from other perspectives, tax practitioners' viewpoints were elicited. Challenges they faced when dealing with taxpayers were ignorance of the tax law; poor record-keeping; dishonesty in reporting income; and threatening tax practitioners to cheat on reporting to IRBM. Nevertheless, both parties - IRBM and tax practitioners - agreed that collaboration between them might enhance compliance and ensure the success of SAS. The next chapter presents IRBM officials' perceptions of the Board efforts in managing both internal and external risks as discussed in this chapter and Chapter 5.

Chapter 7

Discussions of IRBM internal documents and perceptions of IRBM officials of current risk management practice

7.1 Introduction

The previous two chapters presented internal and external risks faced by IRBM. This chapter analyses and presents findings from IRBM internal documents and also to answer the research questions on perceptions of IRBM officials of the current risk management practices. During the interviews, the IRBM officials were shown the EC compliance pyramid model (see Figure 11). Therefore, Section 7.2 addresses the participants' views of the risk-based responsive model and how it can be applied in the current enforcement strategies by IRBM. In this chapter, the IRBM Integrity Plan is presented in Section 7.3, whilst the IRBM Strategic Plan is highlighted in Section 7.4. This is followed by discussion of the electronic services provided by IRBM to facilitate taxpayer compliance in Section 7.5. The establishment of a Risk Management Department is delivered in Section 7.6. This is then followed by discussion of adopting a risk-based compliance model for IRBM in Section 7.7. Finally, in Section 7.8 this chapter concludes with summary conclusions that may be useful for both IRBM and other revenue agencies contemplating a shift to risk management regime.

7.2 Risk-based Compliance Model

When questioned on the pyramid model, 26 IRBM officials acknowledged their awareness of the ATO compliance pyramid, while four officials admitted they had not previously seen any compliance model. The officials from RMD agreed that the model would be beneficial and would assist them in formulating strategies for

their department; another interviewee stated that the model was already used to guide compliance strategies in IRBM. The interviewees also agreed that the model exhibited a systematic strategy in administering non-compliance, and was able to assist IRBM to increase tax compliance among members of the public. The compliance model assists regulators to identify categories of taxpayer through their compliance responses and to formulate enforcement strategies to treat these taxpayers.

Due to limited resources and manpower, explained in Section 5.2, and also suggested by the EC (2006), IRBM could take measures to manage and reduce existing and future risk from occurring by adopting a risk-based approach. The concept of a compliance model may assist IRBM in planning and implementing its strategies. All interviewees agreed that a well-designed training programme was required to equip IRBM officials with the required skills and knowledge in order to perform a variety of actions for different compliance categories of taxpayers, as depicted by the model. They therefore suggested that the Malaysian Tax Academy and other training centres of IRBM should take the necessary measures to ensure that knowledge and skills, tailored to their particular needs, were incorporated in the training syllabus and programme.

There was consensus among RL1, RL2, RL7 and RL19 that the compliance model could be adopted by the IRBM, with some adjustments (if necessary) to complement scenarios in the Malaysian tax administration as well as the requirement for Malaysian taxpayers. They also agreed that the greatest risk to any tax authority was that of revenue, due to compliance risk (Andreoni et al, 1998; Walpole, 2009; OECD, 2010d). RL8 and RL19 added that, in terms of

legislation and regulations, rulings were issued from time to time to reduce ambiguity and confusion and to provide a detailed explanation of the new legislation. IRBM also took steps to simplify tax law so that the public would find it easy to understand and follow. It would assist them in complying with tax rules and in trusting the system.

The interviewees also asserted that habitual defaulters, deliberate tax avoiders and tax evaders must be dealt with punitively to reflect the perceived fairness in the tax system to law-abiding citizens. Their opinions are consistent with suggestions from Allingham and Sandmo (1972), Scholz (1984) and Franzoni (1998) that sanction is likely to be a more effective enforcement mechanism to enhance compliance.

The participants, such as RL1, RL2, RL7, RL8, RL12 and RL19, believed that trust in the tax system and procedural justice might increase if fair treatment was exercised by IRBM and tax evaders were punished appropriately (Kirchler et al., 2008; Franzoni, 1998). In this respect, RL7, RL12 and RL19 praised IRBM for its remarkable efforts in promoting compliance. To promote integrity and transparency and steer towards excellent achievement in the future, IRBM has taken the initiative to introduce two key plans to be applied by its officials - the IRBM Integrity Plan and IRBM Strategic Planning 2009-2013. The integrity plan and strategic planning can be applied to the compliance model to encourage the public to trust the integrity of IRBM officials as well as confident in the Board's effort to determine future direction for revenue collection is planned strategically. The next section presents the integrity plan while section 7.4 highlights the strategic planning.

7.3 IRBM Integrity Plan

In 2009 IRBM introduced the IRBM Integrity Plan (IIP) to be continuous with the government's National Integrity Plan²⁵. An IIP book was published in December 2009, to deliver an integrity message to strengthen ethics and integrity among IRBM staff. This study refers to the IIP book as a secondary data to obtain additional information on IRBM strategies in managing risks. The book outlines comprehensive IRBM programmes and activities with regard to integrity and emphasises core values of trust, truth, wisdom, fairness, transparency and gratitude, values that it is desirable to inculcate in each member of IRBM. The IIP also discusses strategies to be implemented by IRBM officials in order to manage the risk involved in its administration. Six of these strategies, listed below, aim to form a strong community which features a high standard of morality and ethics, requiring that members adhere to religious and spiritual values and are anchored by a noble character:

1) Enhance the effectiveness of good governance

The first strategy is to enhance the effectiveness of good governance, which comprises of revisions and reinforcement of the vision, mission and objectives of IRBM; the development and re-evaluation of the KPI; and the formulation and update of policies of administration and taxation, the Work Procedures Manual & Desk-Work procedures and the Client Charter. Strategy 1 also emphasises the update of ethical codes; the preparation and exhibition of the work flow chart for general information; the expansion and enhancement of the use of ICT; the

²⁵ National Integrity Plan (NIP) was formulated by incorporating the spirit and principles of the Constitution, based on the fact that the lives of Malaysians of various races and religions are a gift and present advantages to be utilized. The NIP also absorbs the philosophy and tenets, namely, building a united, just, democratic, liberal and progressive organisation, as well as adhering to five principles, or state pillars. The NIP is also guided by the philosophy of Vision 2020 to create a developed nation in its own mould by 2020. As a birth plan in line with the aspirations of the people and implemented for their welfare, the NIP reflects the specific features of society and the nation of Malaysia. In addition, the NIP takes into account international developments, the experience of other countries, and the impact of globalization. In short, the NIP is a continuation and translation philosophy, with principles and goals to be achieved in the Federal Constitution, while taking into account various new developments and challenges (National Integrity Institute, 2009).

improvement of the internal control system; and the enhancement of the effectiveness of management of integrity.

2) Enhance the effectiveness of service delivery

Strategy 2 of the IIP enhances the effectiveness of service delivery systems, by improving the quality of services, expanding facilities and increasing awareness and education, especially for taxpayers.

3) Strengthen the awareness programme to prevent corruption, malpractices and abuse of power

Strategy 3 seeks to strengthen awareness programmes to combat the crimes of corruption, malpractices and abuse of power.

4) Strengthen the administration of justice system

Strategy 4 aims to strengthen the administration of the justice system by improving the enforcement of laws against non-compliant taxpayers to provide fairness to all taxpayers.

5) Strengthen the management of human resources

The fifth strategy creates a more comfortable work environment conducive to strengthening the management of human resources. To the same end, it seeks to strengthen the screening system in the appointment of officers; to improve placements and staff exchanges; to enhance the effective implementation of job rotation; to enrich educational programmes; to improve the management system for officers' career development; to upgrade management remuneration and benefits for staff; to develop the performance appraisal system; to promote bilateral relations between management and officials at various levels; and to conduct meetings between management and the employees' union.

6) Strengthen the integrity of the General Approach

The final strategy enhances integrity through a number of components, including the family institution, the community, civil society and socio-cultural, religious and economic institutions.

RL19 supported the idea of IIP and commented:

“IRBM should be more transparent so that the public would not question our integrity; hence they would trust the system and might want to comply.” (RL19)

According to RL4, integrity programmes implemented by IRBM focussed on four approaches, i.e. education, prevention, strengthening and punishment. RL21 stated these approaches were in line with enforcement strategies in the compliance model where education is delivered to the category of taxpayer at the base of the pyramid. Through education, non-compliance could be prevented and compliance strengthened; these two approaches could thus be used to handle taxpayers in levels two and three of the pyramid.

For the category of taxpayers at the top level, RL21 felt that sanction was the most appropriate action to be taken to deal with recalcitrant taxpayers. RL21's statement is consistent with Andreoni et al. (2003) and Leviner (2009) that those who refuse to comply should be punished. RL21 also believed the IIP could be related to the pyramid model, where three of the six strategies could be implemented and used for risk reduction.

RL8 supported RL21's opinion that the pyramid model could be applied to IRBM with adjustments in order to tailor it to the Malaysian tax environment. Furthermore, RL8 felt that IRBM needed to deliver specific aspects in terms of education and coaching advice to clients and potential taxpayers to raise awareness of their tax responsibilities. With the implementation of IIP, the management of IRBM wishes that its staff will become employees of high integrity who able to avoid corruption, improve their standard of work and provide quality customer services to taxpayers (IRBM, 2009). These values are required to ensure the success of the IRBM strategic plan, as presented in the next section.

7.4 The IRBM Strategic Plan 2009-2013

The IRBM Strategic Plan 2009-2013 (ISP) was developed as a guide to IRBM's role, functions and responsibilities that translated into essential actions for the future. As reported by IRBM (2009), it identifies areas of focus and perspective for comprehensive planning for the next five years, and determines the direction and vision of IRBM. This approach will contribute to the more efficient control and allocation of limited resources that is consistent with the need to implement programmes and activities involving the revenue and productivity of each core function. The ISP consists of five strategies focusing on customers, finance, internal process, learning and expansion (IRBM, 2009), as outlined below:

- Collect the correct amount of tax in a fair and equitable manner
- Instil public confidence in the fairness and efficiency of tax administration
- Broaden the tax base
- Modernize systems and procedures in line with current needs
- Produce human capital that is competent, professional, committed and of high integrity

Based on the ISP, IRBM's responsibilities in tax administration will become more tactical as it focuses on strategic networks and factors that determine the success of the organisation. These factors contribute to IRBM's responsive approach to improve the quality of high-impact services to its users. As noted by the CEO/DG of IRBM,

“The Strategic Plan acts as a vehicle, towards achieving our desired future state. Under these main thrusts, I believe that IRBM, will be able to quantum leap itself, into becoming the leader in tax administration alongside the nation, as it achieves a high income and developed nation status, in the year 2020. In other word, the Strategic Plan ensures that, IRBM is moving on its right track, in accordance with the transformation's framework, laid down by the government.” (IRBM CEO, 2012)²⁶

²⁶ Opening Address at the National Tax Conference 2012, Kuala Lumpur Convention Centre, 17 July 2012.

IRBM's initiative in developing the ISP indicates its commitment to steer the Board and staff towards future direction of the organisation. The study finds that the ISP spells out strategies to achieve objectives of the Board which are to increase revenue collection, to widen the tax base and improve service delivery as well as enhancing human resource development within the organisation. Consistent with the responsive regulation approach, the ISP encourages the staff to regulate responsively in their enforcement approach to develop confidence and trust of the public on IRBM ability to administer tax affairs in Malaysia.

During the interviews, when discussing of future strategies, 24 participants referred to the ISP as a guidance which has led them to future path to ascertain achievement of organisation desired aim. It appears that the aim of ISP to motivate the staff has achieved its objective when in 2011, IRBM has successfully exceeded the target set by the government whereby the revenue collected reached a three-digit figure: RM109billion, a record in the history of tax collection in Malaysia. In his appreciation letter to IRBM, the Malaysian Deputy Prime Minister agreed that IRBM's strategic planning has resulted in achievement not only to the revenue collection aspect but also on efficient administration of tax system in the country.

“This excellent achievement of highest tax collection ever recorded (in the history of Malaysia) is the result of solid planning, effective management, and implementation of effective strategies as well as collaboration between IRBM staff, which is nurtured by integrated work culture with the spirit of 1Malaysia.” (Deputy Prime Minister of Malaysia, March 2012)

Analysis of the content of the ISP indicates the document also is formulated to manage future risks and uncertainties and to provide high quality and integrity services to taxpayers working towards increasing voluntary compliance. Technology-assisted systems had been developed by IRBM to improve services to

the public, such as e-Services – these include e-Filing, which won a National Award for Best System in 2010. Electronic services provided by IRBM are further addressed in the next section.

7.5 e-Services

Findings by Alm et al. (2010) on laboratory experiments to test the effectiveness of taxpayer service programmes in enhancing tax compliance suggest that an enforcement strategy should not be the only method to increase compliance. Instead, other administrative policies such as services could be provided as a tool to deliver better service to customers as a strategy to improve compliance.

Similarly, the OECD (2011) encourages tax agencies to provide efficient and user-friendly e-Services to facilitate taxpayers so that compliance may increase if they are satisfied. IRBM has taken a large number of initiatives to keep up-to-date with technological change, at the same time enhancing its e-Services.

This section highlights some of the e-Services it has implemented, such as e-Filing, e-Payments, e-Stamps, e-Daftar, PCB Kalkulator, e-SPC and MySMS. The function of each service is outlined below:

- e-Filing: electronic submission of tax return forms for individuals, companies and tax agents
- e-Payments: electronic payment through internet banking with seven local and international banks in Malaysia, by individuals, companies and employers
- e-Stamps: electronic processing of instruments for transfer of property
- e-Daftar: an online facility that allows new taxpayers to register for a tax reference number
- PCB Kalkulator: an online, computerised system to assist individuals and employers to compute the amount of monthly tax deductions

- MySMS: a text messaging facility that provides information such as address, telephone number and fax number of IRBM Branch and Service Centres.

Empirical studies on e-Filing in Malaysia indicate that it has a number of limitations. It was found, for instance, that if taxpayers felt that electronic tax submission is risky then their perception on its usefulness will decrease, with the result that fewer people will wish to use the system (Ng, 2008). To promote usage of e-Filing, Ng (2008) therefore suggests that IRBM should assure taxpayers that it is a secure and reliable system, thereby building their trust and confidence. It has been further recommended that IRBM authorities should consider ‘the intended users’ technological readiness’ (Hansford et al., 2006) to change from manual submission to e-Filing. Furthermore, Hansford et al. (2006) also recommend that e-Filing system should be “user-friendly, easy to gain access to and easy to use”. IRBM also needs to understand both the taxpayers’ perception of the usefulness of the system and their behaviour in deciding to adopt e-Filing (Kamarulzaman and CheAzmi, 2010; Illias et al., 2009).

Lai and Choong (2008) have discovered that 21% of those who failed to e-file successfully indicated that either IRBM’s server was not responding properly or they abandoned their effort before the end of the session. Other reasons given were that the system was slow, the network service was unreliable or they were unable to sign the tax return form electronically. Overall, Lai and Choong (2008, p.342) report that 73.3% of the survey respondents “had no confidence in the electronic administrative capability of the IRBM”. Previous literature suggests that, in order to promote e-Filing, IRBM could improve and upgrade its e-Filing system to meet taxpayers’ expectation of an easy, convenient, fast and secure

system of filing. Furthermore, IRBM may need to strengthen and increase its awareness programme in order to educate taxpayers, especially those who are new and inexperienced, so that they will be encouraged to use the electronic system to submit their tax forms.

IRBM's provision for e-Services is consistent with OECD (2010a) which states that the development of electronic tools is to expedite the business process and to ease compliance, so that taxpayers are comfortable with the reformed tax administration in Malaysia and may have the desire to contribute to higher tax compliance. In an attempt to improve its service delivery system, IRBM is also cooperating with other government agencies, including the Companies Commission of Malaysia, the Social Security Organisation, the Employee Provident Funds and other public sector bodies, to provide such online services as Electronic Government (MyEG), Company Registration (MyCoID), and Stamps (The Land Office). As well as seeking to improve the delivery system, these electronic services are perceived to contribute to higher tax compliance from taxpayers who are comfortable using the systems for their fast responses and easy usage. It is thus likely that taxpayers should have some confidence in the efficiency of the tax administration (Bird, 2010).

7.6 Establishment of the Risk Management Department

Since its inception in 2009, according to RL19, there has been various improvement to RMD where the current focus is toward Enterprise Risk Management (ERM). The aim of ERM is to monitor and advise the Board on disaster recovery strategies, protect the organisation from reputation risk and monitor compliance of occupational safety and healthy activities by risk owners. The risk management process throughout the organisation was thus to be more systematic and orderly; and information about the actions, the monitoring and the effectiveness of actions would be published for the attention of all risk owners in the organisation. Each risk owner would therefore be aware of the risks faced by the organisation and could develop strategies to manage, prevent and reduce the impact of identified risks (RL19).

With regard to internal and external factors, RL19 described strategies formulated by IRBM to ensure the effective and efficient use of human and financial resources to carry out all major activities of the organisation, namely: filing returns; taxpayer service and education; compliance; widening tax base and revenue collection. According to RL19, priority was given to critical factors that might impact on the duties entrusted to IRBM to practise a fair and equitable tax system and to ensure that the revenue would be collected in a timely manner.

In implementing IRBM's responsibilities, the best practices from the tax bodies in this region in particular and the world in general were studied. Human and financial resources were allocated according to the priorities and needs of the critical areas of operation. RL19 believed that the strategies implemented so far could be considered successful, based on:

- the achievement of targets laid out by the stakeholders of each year;
- the government's recognition of the services provided to customers through various awards received by IRBM;
- the innovation and modernisation of service delivery systems such as e-Services were well received by the taxpayer; and
- the increase in number of taxpayers using the new services.

In the context of IRBM as an organisation that administers taxes, there are risks that involve loss of revenue, known as revenue risk. In RL19's view, the actions of the taxpayer, whether the result of ignorance, negligence, weakness, evasion or the weakness of tax administration, would lead to revenue risk. Thus the RMD has developed a risk management process which is based on established principles of risk management (RMD, 2009):

- to develop follow-up actions to be taken to streamline the regulatory system currently in use;
- to document actions such as a Risk Management Plan (RMP) by divisions and departments in IRBM;
- to determine the implementation of the RMP and the timeframe of the implementation successfully conducted; and
- to monitor the progress of the RMP implementation.

These principles are in line with the standard risk management process implemented by other organisations (Thompson, 2008; IRM, 2002; EC, 2006; OECD, 2010a).

From RL19's explanation, the RMD in IRBM emphasises ERM in its risk management plans which relates to operational risk, reputation risks, strategic risks and other organisational related risks. At the time of the study, the department has not yet established any plans towards tax compliance risk. As IRBM is an enforcement agency that ensures taxpayer compliance, the RMD may

need to start looking into identifying tax compliance risks in order to manage those risks effectively.

It appears that IRBM had been innovative in developing strategic plans and integrity plans to ensure that its future direction was well-designed in order to avoid potential risks, and to ascertain that the ethics and integrity of IRBM personnel were secured. These steps were in keeping with the ‘really responsive regulation’ proposed by Black and Baldwin (2010, p.182) relating to “a strategy of applying a variety of regulatory instruments in a manner that is flexible and sensitive to a series of key factors.”

The responses of interviewees indicated that a responsive regulation approach had been adopted by IRBM, whereby the present focus shifted from enforcement to education, promoting seminars and dialogue, as well as adopting a persuasive approach through customer service. To ensure that responsive regulation works efficiently, risk-based regulation could be operated alongside other strategies (Black and Baldwin, 2010). Thus, next section presents a possibility of adopting a risk-based compliance model for IRBM.

7.7 A risk-based compliance model for Malaysian tax administration

“We use our compliance model to guide our compliance work and better understand why people are not complying.” (ATO, 2006)

Currently, risk management in the Compliance Department of IRBM is applied to a limited extent; in particular, there is a risk analysis process that focuses mainly on case selection for tax audits. The EC (2006) has noted that risk management approach has evolved and its application has become more structured.

RL17 and RL20 agreed that such a model was suitable for use in the current practice of their department. They also reported that they were in fact in the process of developing a similar model for their department. There was agreement among RL2, RL17 and RL20 that IRBM should adopt the model since it would be beneficial and would assist IRBM in formulating and guiding its compliance strategies. RL20 added that most of the strategies in the model could be applied by IRBM. However, it might differ on the degree in implementation, based on the percentage of compliance or non-compliance taxpayers in different countries.

Further, RL17 emphasised that the advantage of this model lay in the strategies it proposed to support an increase in tax compliance among members of the public, and IRBM would have systematic strategies in administering non-compliance issues. RL1 also felt that the model would be helpful to IRBM as the strategies would guide its response to taxpayers according to their level of compliance. According to RL1, if there were enough promotions, such as education and marketing, there were possibilities that IRBM could encourage those at the bottom of the pyramid to comply. However, for the determined non-compliers at the top of the pyramid, RL1 felt they would still refuse to comply even if sufficient education and services were provided. He asserted that IRBM needed to deal severely with them. Black and Baldwin (2010, p.1) advise that “risk-based regulation prioritizes attention to the highest risks.” Consequently, IRBM could prioritize its strategies towards high risk taxpayers at the top of the pyramid.

RL1, RL3 and RL6 commented that even though IRBM did not use this model, the Board nevertheless applied the basic strategies listed in it. According to RL3, the percentage of submitted return forms indicated that filing compliance was

relatively good. However, there is no empirical evidence to suggest that the increase in filing compliance is due to IRBM's responsive enforcement. Further, as suggested by literature in Section 3.3, and findings in Section 6.3, there are various factors that influence taxpayers' compliance behaviour. Yet it can be said that encouraging compliance through soft approaches does enable voluntary compliance and self-regulation, as proven by CETF (1998), Niemiowski et al. (2003) and Murphy (2004) in their studies of taxpayer compliance and responsive regulation in Australia.

Furthermore, in an effort to prioritize non-compliance cases, IRBM also concentrates on high risk taxpayers and covers areas where risk factors may exist. RL3 agreed that all levels in the pyramid should be monitored so that enforcement strategies could be enacted to respond to taxpayer compliance behaviour. If focus is given only to the highest risk taxpayers at the peak of the pyramid, those at the lower or middle level may feel neglected by the regulators, hence the tendency to resist compliance (Freedman, 2011; Black and Baldwin, 2010). When this incident occurs, taxpayer compliance behaviour may change, which in turn may affect the shape of the compliance model (Kirchler et al., 2008).

As it was undetermined that the pyramid model was based on the number of taxpayers or on the amount of tax paid, RL3 suggested that a study should first be conducted of the model before a decision could be made about whether or not it was suitable for adoption by IRBM. RL1 noticed the lack of such a model in IRBM's administration, and explained that the current services provided by IRBM were similar to the activity displayed at the base of the pyramid. While the middle level was the existing audit process by IRBM, the top level appears to be the

investigation procedure conducted by IRBM:

“The only thing now is awareness among the public of our effort; our focus is not there. The awareness of the public is not there. Because I think by nature we like to work quietly but efficiently. That is our culture. We do our work quietly but sometimes we may have to inform the public. That will make the public aware that those who have not been a good citizen will face such kinds of consequences.”
(Interview: RL1)

In addition, RL6 and RL19 addressed the measures taken by IRBM to manage non-compliance issues. According to RL6, even though the model had not been used officially by IRBM, unofficially the Board did apply its concepts. It was pointed out by RL19 that, in the current practice, taxpayers were identified according to services required by taxpayers. There were taxpayers who needed to be educated, those who required assistance, those who should be audited and the determined non-compliers to be investigated and taken to court. RL6 added that, for those taxpayers who should be reminded of their responsibility to make payment, the IRBM call centre would remind them of their tax obligation, while the investigation team would deal with the hard core offenders. It was evident that most interviewees believed that, even though IRBM had not adopted any compliance model, the concept was nevertheless applied by the Board in its compliance activities. It was interesting to note RL5’s view of the model:

“Academically, we have this so-called pyramid in compliance. The vast majority will comply. It is at the lower end of the pyramid. As you move higher, of course the number will be lesser. But they become more and more stubborn. Not that they don’t want to, they were just waiting to be persuaded. Because at the very top of the pyramid are those who have decided from the start, they don’t want to comply. No matter what we do. There are those somewhere in the middle, who with a bit of persuasion will comply. So it’s the human factor. Of course there may be individuals who have tax experience, who refuse for whatever reason they may have, whether it’s real or perceived. It’s only human to say when you are caught wrong, it’s not my mistake, it was someone else’s mistake, so it was human factors.” (Interview: RL5)

Even though the model was relevant to IRBM, RL5 cautioned that its application might present a challenge. Identification needed to be carried out at each level of the pyramid to categorize types of taxpayers, and then the risks at each level also

should be analysed. The higher the level, the greater the risk and therefore more attention needed to be given to the taxpayers in the group. Those at the top of the pyramid were serious offenders, and so should be sanctioned. Further, RL5 referred to the necessity for IRBM to create a profile of taxpayers, starting with high-profile taxpayers to whom IRBM should give more attention than to other groups of taxpayers. By identifying the category of taxpayers, IRBM could devise strategies to manage them. RL5 added that, even though at present there were high-profile taxpayers in IRBM's system, it still lacked proper organisation and needed to be enhanced.

RL13 also agreed that application of the model would provide a more systematic perspective both for IRBM and for taxpayers in terms of managing non-compliance. Referring to compliance, RL13 posited that there tended to be those who would evade the law. The problem of recalcitrant taxpayers is faced not only by IRBM but also by other tax administrations, non-compliance being a universal risk confronting all tax authorities (Allingham and Sandmo, 1972; Andreoni et al., 1998; Jackson and Milliron, 1986). RL13 therefore felt that this issue had to be dealt with wisely and that IRBM should be able to use its authority judiciously to manage compliance risk and to take appropriate action on high-risk taxpayers. Otherwise, the shape of the pyramid would change in that the broad base would be smaller and the higher levels would widen. The statement by RL13 is consistent with 'slippery slope' framework proposed by Kirchler et al. (2008) which relates to the power of the tax authority and trust in it. A 'slippery slope' framework suggests that, if the authority's power is weak and taxpayers' trust in it is low, then the level of compliance is likely to decline.

Before IRBM makes any decision to adopt the compliance model, it should take

heed of Black and Baldwin's suggestion (2010) that the process should begin "by identifying the risks they are seeking to manage, not the rules they have to enforce". Naturally, the authorities always refer to the rules in order to perform their duties. However, due to lack of manpower and financial resources, they would not be able to enforce these rules on all non-compliant taxpayers. They therefore need to be selective in the cases to be handled, and priority given to the highest risks. When identification of high-risk actors (Black and Baldwin, 2010) was made, the management of IRBM would be able to allocate resources for appropriate strategies in managing the risk, as suggested by some interviewees.

7.8 Summary

This chapter has provided findings of the perception of IRBM officials of the current risk management practice in IRBM. The chapter has also discussed the possibility of adopting a risk-based compliance model by the Board. To obtain answers to both problems and to explore the feasibility of adapting a risk-based compliance model to suit the Malaysian context, empirical data was collected through interviews to elicit the interviewees' perceptions of the EC compliance model. Internal documents from IRBM, namely, the IRBM Integrity Plan, the IRBM Strategic Plans and the Risk Management Plan of the RMD, were also used to obtain supplementary data to support the opinions of interviewees.

Findings from the interviews and secondary data suggest that the concept of responsive regulation has been adopted by IRBM, whereby the present focus has changed from the traditional strategy of enforcement to a softer approach which includes education through seminars and dialogue, and assistance and persuasion through customer service. IRBM has been innovative in developing strategic

plans and integrity plans to ensure that its future direction is well-designed in order to avoid potential risks, and to ascertain that the ethics and integrity of IRBM personnel are secured. Understanding the importance of managing tax compliance risks efficiently and effectively, IRBM has set up RMD as a department responsible for managing risk at IRBM.

This chapter presents participants views on adopting a risk-based compliance model by IRBM. Most participants agreed that the model would be useful and could assist IRBM to formulate strategies to manage compliance risks. This chapter addressed risk, risk management and the application of responsive regulation within the IRBM organisation. The next chapter presents an analysis of IRBM's application of the concept of responsive regulation in managing external risk, namely, compliance risk, through various education programmes.

Chapter 8

IRBM's taxpayer education programmes as responsive measures to manage compliance risk

8.1 Introduction

The previous chapter addressed IRBM's strategies to manage internal and external risks and the application of responsive regulation within IRBM's organisation. In this chapter, responsive regulation strategies to manage compliance risk by IRBM are highlighted, which addresses the research question: "How does the IRBM manage internal and external risks including non-compliance risk?" As the concept of responsive regulation promotes soft approaches and only resorts to a hard approach to encourage voluntary compliance, the chapter addresses education programmes conducted by IRBM to inform members of the public of their tax obligation. In Chapters Six and Seven, every participant agrees that taxpayer education is the most important activity to be taken to encourage taxpayers to comply voluntarily with the tax rules. A significant amount of the literature also suggests education to enhance compliance. Further, in conforming to responsive regulation concept, education is to be the first action to be taken to assist and guide taxpayers in relation to tax matters. Hence, this chapter presents taxpayer education activities conducted by IRBM as responsive approach to promote voluntary compliance.

Firstly, education programmes conducted by IRBM are discussed in Section 8.2. Participants' viewpoints of issues pertaining to the education programme are presented in Section 8.3, while Section 8.4 addresses the instruction of compliance obligation, whereby various activities were conducted by branches of

IRBM to deliver tax knowledge to taxpayers in order to encourage voluntary compliance. Next, early education programmes delivered by IRBM involving young students are discussed in Section 8.5, followed by an account of education as a sanction to deter non-compliance and prevent future non-compliance in Section 8.6. In this section, the IRBM penalty imposition, IRBM's difficulty in enforcing regulation and taking soft approaches to foster voluntary compliance are also addressed. The findings of this chapter that provide a relationship between responsive regulations, tax education and compliance risk management by IRBM are described in Section 8.7. Following this, Section 8.8 provides a conceptual framework designed by the author in this study. The framework, which has been derived from three strands underpinned the study, namely tax compliance, risk management and responsive regulation, is described. Justification of the chosen framework is also discussed in this section. Finally, Section 8.9 summarises these findings.

8.2 IRBM educational activities

As stated in IRBM's Annual Report and in the interviews, various educational programmes have been implemented by IRBM, including seminars and discussions, printed hand-outs, publicity through the mass media, the appointment of Tax Relation Officers and IRBM Tele Info. The activities conducted by IRBM officials are presented below:

- Discussions conducted by IRBM on SAS and e-Filing.
- Education through national television, national radio and exclusive interviews on the television.
- Publishes leaflets and magazines in a simpler and easy-to-understand format. These printed hand-outs are distributed to the public through IRBM customer service counters at all branches of IRBM.

- Members of the public can also obtain information about taxation, and perform certain activities on their personal tax matters, through the official website of IRBM.
- The latest initiative introduced by IRBM is the appointment of Tax Relation Officers (TRO) representing various public and private sectors. The TRO serves as a liaison in providing information that can help workers to improve their knowledge of tax to discharge their tax obligations.
- Another move initiated by IRBM was the launch of IRBM Tele Info in 2008. The Tele Info line operates twenty-four hours a day, seven days a week to allow taxpayers to obtain tax information at their convenience. Thirty lines are provided and are able to receive thirty calls simultaneously at any one time (IRBM, 2008).

The interviews and secondary data suggest that IRBM is committed to educating taxpayers through various instructional activities carried out by its officials. As all the programmes are provided free-of-charge, taxpayers need to seize the opportunity to enhance their knowledge of their responsibilities as taxpayers.

8.3 Issues in information dissemination

Despite careful planning, there appear to be concerns about the implementation of these educational activities. For instance, RL1, commenting on the issue of promoting education through effective channels, related the frustration she experienced when she was seeking information on the IRBM website only to find that it was unavailable. Even though she found this information in one of the pamphlets prepared by IRBM, she felt that all relevant material should be on the website since people seeking tax information would refer to it first.

RL1's opinion was consistent with the tax practitioners' view that the IRBM website was out-of-date and less user-friendly (TD, 2006). It was also noted during a meeting between IRBM officers and tax practitioners that some newly-

released information - for example, the latest issue of Public Ruling - was not updated onto the website (TD, 2006). A further complaint was voiced that information which had been administered by IRBM was not found on its own website and could only be obtained on that of the Ministry of Finance (TD, 2006).

Tax practitioners recommended that IRBM should update its website regularly so that the latest information was available. In addition, RL1 suggested that IRBM should maximise its effort in publishing tax information through its own website since this was the cheapest method of advertising, as well as being the most effective means of reaching an unlimited number of taxpayers. This suggestion is consistent with a recommendation from OECD (2010e) that the tax administration should enhance its service delivery to the public through electronic services. Section 7.5 highlights IRBM's initiatives in providing various e-Services to the public. RL1 advises that:

“Taxpayers should also take advantage of free e-Services to learn more about tax matters through the website because most of the information that a taxpayer needs to know, such as registration and filing requirements, tax payment, audit and investigation procedure, as well as other useful information, is published on the website.” (Interview: RL1)

A number of interviewees expressed their concern over the e-Filing promotion in 2010, which was aired on radio and television only during the last week of the submission deadline. RL1 commented: “Indirectly it gives a message for the people to do (e-Filing) last minute”. Similarly, RL4 emphasised the importance of promoting e-Filing much earlier through the media, especially radio and television, in order to alert and encourage taxpayers to also submit their e-file earlier. Although IRBM had taken the initiative to implement a number of education programmes, RL9, RL17, RL18 and others believed that the Board should enhance the education programmes to reach more taxpayers, especially

those living in remote areas, since there remained many who were unaware of their responsibilities regarding filing tax returns and paying tax. As suggested by Loo et al. (2010, p.21), IRBM could reach out to taxpayers in “all geographical locations in Malaysia” to deliver tax knowledge.

One of the initiatives recommended by responsive regulation is to adopt soft approaches in order to minimise operational cost. Comments by the participants imply that important information or news could not be distributed to the public in time. It is clear, therefore, that disseminating information through the IRBM website is a method by which news can be broadcast more easily, faster and effectively, particularly if it is kept up-to-date by an active website team.

8.4 Education about compliance obligations

“Tax knowledge is positively related to tax compliance” (Kirchler et al., 2008, p.216). Prior research on tax knowledge and tax compliance in Malaysia (Kasipillai, Aripin and Amran, 2003; Ahmad, Mohd Hanefah and Mohd Noor, 2003; Mohamad, Ahmad and Deris, 2010) indicates that tax knowledge is very important for the successful implementation of SAS and has significant influence on tax compliance behaviours. All branches of IRBM understand the importance of education in fostering compliance and play a significant role in disseminating information to the public at district and state level. According to RL7 and RL18, the branches carried out educational activities such as Business Support courses to educate traders on accurate record-keeping and on customer services during the Taxpayer Service Month, and to train Tax Relation Officials (TRO) as agents to educate the employees and employers on tax matters.

A few IRBM branches had taken proactive approaches in educating the taxpayers

within their regions. For example, RL10 sent the branch's Public Relation Officer (PRO) to the local radio station to gain a slot on the radio channel. Through the radio, information on taxation, including guidance on how to fill in return forms, the types of relief which could be claimed and the methods of submitting the forms, was easily transmitted to the radio listeners. This method was effective in disseminating tax education to a wider range of people. The branch also worked closely with District Officers (DOs) and Members of Parliament (MPs) so that information could be communicated to the highest level of officers. The DOs and MPs would then issue directives to their subordinates to comply with the tax laws. Similarly, RL6 reported that his branch also visited the dignitaries, the Chief Ministers, the Executive Council and senior government officers at state level.

During these visits, IRBM officials delivered information on the tax system and taxpayers' responsibilities to the state senior officers. RL6 considered this approach to be an effective way of conveying information to the public sectors. However, RL4 felt that the educational activities would be more effective if implemented by the Customer Service Department (CSD) at headquarters level (HQ) so that "the speed of dissemination is faster, rather than we do it ad-hoc, because in branches the manpower is very limited."

The interviewees' responses indicated that both the executives at HQ level and directors at the branch level held a similar perception of the importance of education to increase tax compliance. This is because both parties share the same objectives: to disseminate information and knowledge to taxpayers; to encourage them to comply with tax law; and at the same time to reduce tax non-compliance. The only difference is in the role of the executives at HQ and branch level: HQ

level is involved in policy-making and strategy design and delivers instructions to branches to be implemented, while the branches have the responsibility of carrying out the instructions received from HQ to ensure the desired objectives are achieved.

It is interesting to note from the findings that some interviewees representing the branches appeared to be suggesting that certain activities should be executed by HQ, i.e. they were implying indirectly that they were incapable of performing as expected by HQ due to the limited resources at the branches, as highlighted in Chapter 5. They also felt that if education was delivered at national level, information could reach more people. On the other hand, members of HQ staff held a different view. They considered that, as branches were located closer to where the taxpayers lived, it would be much easier for them to approach taxpayers and deliver the required information. Nevertheless, from the feedback, officials at both levels appeared to have carried out their role successfully, through various educational activities, to ensure that education was extended to the desired group of taxpayers. Feedback from branch officials indicated that their views were near identical, due to the implementation of activities at branch level based on planning and decisions from HQ through regular internal orders such as IRBM Operation Circulars and Directives and Audit Directives.

8.5 Early education about taxation obligations

Recognising the importance of raising tax awareness among school students, IRBM has taken the initiative to collaborate with the Ministry of Education to organise awareness campaigns at school level, one of which is an Inter-School Essay Competition. This competition, which commenced in 2002, invites

participation from secondary school students in writing an essay on subjects such as taking responsibility for paying taxes and the importance of taxes for national development (IRBM, 2002). To further enhance knowledge of taxation and to evaluate the students' understanding of taxation matters, a Revenue Speech Competition was introduced in 2003 for Form 6 students who were asked to deliver a speech on a given topic (IRBM, 2003). When attending the competition in 2007, the author was impressed by the success in which students delivered speeches and their basic knowledge of the tax system and tax administration. Both the essay writing and the speech competition have become an annual event and have received an overwhelming response from schools throughout the country. Most of the interviewees agreed that IRBM had successfully achieved its objectives to raise awareness and cultivate interest in taxation among the younger generation through these events.

One of the major educational activities conducted by IRBM is within the field of early childhood tax education. The importance of early childhood education has been highlighted in several studies (Elliot, 2006; Woodhead, 2006; Currie, 2001) which indicate that children's brains are able to absorb new information. Consistent with findings from these studies, eight interviewees concurred that awareness about taxation should be incorporated into the school curriculum for younger children. It is important for them to understand the significance of tax from an early age, so that they will grow up to be tax-literate adults and realise that tax is necessary for the development of the country (Kornhauser, 2007; Elliot, 2006). RL2, RL5, RL6 and four others believed that taxpayer education should begin at primary school as its students were potential taxpayers in the future; indeed, IRBM's latest plan is to educate the younger generation. According to

RL8:

“To create awareness on taxation in Malaysia, the pupils will be introduced to the IRBM logo, what it stands for, and why the government needs to collect tax. To make the education more interesting and easy to understand, the information will be delivered in cartoon format.” (Interview: RL8)

However, RL8 observed that the impact of childhood tax education would only be seen when these students entered employment in fifteen to twenty years' time. Nevertheless, this 'human capital investment' (Weisbrod, 1962) is essential to develop a future society that is knowledgeable about tax.

Currently, educational activities are maximised during the 'Tax Payers Service Months' from April to June every year, which marks the period of return form submission by individual taxpayers in the country. As suggested by RL1, RT5, RL12 and RL18, tax education should be carried out continuously throughout the year and on a nationwide basis, so that it could be accessed by more people. Furthermore, since tax was a subject that interested only a few people and was difficult to understand, RL5 and RL12 recommended that information be conveyed in a layman's format to encourage engagement.

“Format of return form needs to be simplified so that it is easier for the taxpayers to fill out the form.” (Interview: RL19)

The interviewees agreed that continuous educational programmes and greater ease of filing returns might facilitate tax compliance. Their opinions were consistent with Loo et al. (2010), McKerchar (2003) and Choong and Wong (2011) who advise that voluntary compliance should be fostered, and that the tax administration should simplify not only the format of the return form but also the tax system and the tax law to make them easier to understand (Russell, 2010a).

8.6 Education about sanctions to act as deterrent

As an enforcement agency, IRBM has two methods for delivering education: the soft (carrot) approach and the hard (stick) approach (Braithwaite, 2002; Andreoni et al., 2003). This section discusses hard approaches conducted by IRBM to educate those who refuse to abide by the laws. From the interviews, majority of the participants agreed that penalties, raids and legal actions are among the enforcement strategies to be adopted by IRBM as education to deter non-compliance.

A few interviewees agreed that IRBM should highlight to the public the consequences for failure to comply with the law. RL1 admitted that IRBM had not explicitly informed members of the public about the likely punishment if they were convicted of tax offences. As there are many penalty regimes under the 1967 Income Tax Act, RL7 emphasised the importance of creating awareness of the penalties imposed on certain offences.

“(There are) so many penalties. So we have to tell the taxpayers that they must be aware of all the enforcement issues. (If) you fail to submit, you would be penalised under section 112(3). Not only for failure to submit return, but also to tell them, even though you submit your return, but if you don’t report properly, you’ll be penalised under section 113(2). If they submit the return but they don’t pay, they’ll be penalised under section 103. Apart from that there are other penalties on instalment.”
(Interview: RL7)

Similarly, RL13 believed that the public should also be informed about imprisonment for failure to make any payment. At present it seemed that a large number of taxpayers were still unaware that tax evasion could lead to imprisonment. The importance of knowledge about enforcement was emphasised by RL20 and others:

“We should highlight the enforcement activities so that the public is aware that we are serious about managing non-compliance. There should be more information on enforcement, penalties, punishment. Enough talk, now we have to take action.”
(Interview: RL20)

“Hard approaches such as raiding operations and prosecution might be necessary to prevent the tax offenders from committing tax crime again. The purpose is not to create fear to the public but to educate them about their responsibility and the repercussions if they fail to fulfil their duty.” (Interview: RL19)

“We have done enough education for the public. We should focus on enforcing the law and we need to take harsh action on non-complying taxpayers.” (Interview: RL16)

“IRBM should take tougher and more serious action on those in default by implementing a comprehensive enforcement for each segment of taxpayers.” (Interview: RL8)

In their interviews, participants emphasised that enforcement activities such as field audit and investigation should be strengthened so that taxpayers who failed to provide IRBM with correct information were penalised. These responses highlighted that some IRBM officials were still comfortable with the traditional approach in enforcing compliance, and resisted change to the responsive regulatory approach. This attitude is consistent with the findings by Job and Honaker (2003), who reported a complaint from one of their interviewees from the ATO about the Compliance Model:

“The Compliance Model is irrelevant in ninety five per cent of dealings with clients. We should start again...go back to audit and refine the way we do audits. We could have refined the audit process. [Instead] we just said it wasn't working.” (Job and Honaker, 2003, p.119)

Job and Honaker (2003) note that staff involved in traditional approaches such as long-term investigation have a tendency to be resistant toward accepting new enforcement approaches as suggested by the Compliance Model. However, to encourage understanding and acceptance of the new responsive approach by this group of people, champions should be appointed to promote the concept to their colleagues (Hobson, 2003).

However, as posited by Scholz (1984), Feld and Frey (2005) and Franzoni (1998), when taxpayers resist the soft approach, then the hard approach is to be enacted to enforce compliance. A range of enforcement activities conducted by IRBM are

outlined below (IRBM, 2009):

- penalty imposition based on offences
- sanction from leaving the country due to non-payment
- tax audit (desk audit and field audit)
- investigation
- prosecution (civil suit and criminal suit)
- imprisonment

Among the enforcement activities, tax audit receives the most complaints from the public, especially from tax practitioners. The minutes of the meeting between IRBM and tax practitioners indicate that tax practitioners in Malaysia find IRBM to be less transparent in its conduct:

“There is a lack of transparency and consistency in the IRBM's approach to tax audits. There are cases where different treatments were adopted on the subject matter which is handled by different officials. The professional bodies have also been informed that the IRB officials have been known to have reversed their past confirmations and verbal promises made during the course of tax audits.”
(Document: Technical Dialogue (TD, 2006))

In the context of tax audit, the purpose of auditing taxpayers' accounts is to educate and assist taxpayers to comply in completing their return forms truthfully and in paying their tax obligation on time. Tax practitioners therefore urged IRBM officials to give taxpayers the benefit of the doubt in genuine cases, instead of adopting a pre-conceived mind-set that taxpayers were under-declaring their tax liability. In this regard, Feld and Frey note:

“Tax evasion can therefore be mitigated if expected fines are sufficiently high to deter taxpayers from cheating.” (Feld and Frey, 2005, p.5)

On the other hand, if a taxpayer made errors, for instance, in the calculation of tax liabilities, as suggested by Feld and Frey (2005), the tax authority should refrain from imposing harsh penalties and instead make an effort to contact the taxpayer for an explanation. This soft approach may encourage taxpayers to reciprocate by complying voluntarily (Feld and Frey, 2005; Alm and Torgler, 2004; Wenzel,

2002).

8.6.1 Penalty imposition

Penalty imposition is one of the traditional approaches practised by IRBM for deterring tax evasion. Other enforcement activities imposed on tax defaulters include compounds, prosecution and sanctions. Most of the interviewees agreed that the penalty rates imposed by IRBM were quite high. As illustrated in Appendix 2, a range of penalties are imposed on various types of offences. This information can be easily accessed by the public from the IRBM website. As noted earlier, enforcement should not be seen as a punitive action but rather for the purpose of education and deterrence. RL2 and RL8 hoped the public would understand that the threat of a penalty would prevent them from committing the offence and would inform others of the repercussions for failing to abide the rules; future compliance would thus be fostered (Hasseldine, 2012):

“That’s why we have the penalty regime to address this. But we don’t want to penalise people. The penalty is there to prevent you from doing this; we don’t want you to do this. But since you do this, we have no choice but to penalise you. So these are the things that we need to address.” (Interview: RL2)

“Penalty should be seen as deterrence for non-compliance and not as punishment on taxpayers. Though it may appear to be a harsh way of educating taxpayers, they need to be informed that due to their failure to comply they have to face the consequences.” (Interview: RL8)

The above statements demonstrated fairness in the way in which IRBM enforced the law and reflected procedural justice to honest taxpayers. As a result, IRBM and the tax system will gain trust and respect from taxpayers. Kirchler et al. (2008, p.214) posit that “seeing dishonest taxpayers punished would increase trust on behalf of the honest taxpayers”.

According to RL2 and RL17, due to insufficient personnel and financial resources, IRBM was unable to enforce the law effectively, especially when

conducting field audit on taxpayers who appeared to have submitted dubious reports in their return forms. The main purpose of auditing is to educate taxpayers in the correct way to report their income and expenses. Interviewees RL1, RL3, RL9 and RL15 all asserted that, because of constraints faced by IRBM, auditing could not be conducted on a regular basis and could focus only on clear-cut non-compliance cases.

As stated by RL13, “actually our tax law is very strong but the problem is, implementation is very weak”. Interview responses indicated that the number of penalty rates was considered high for Malaysian society, but due to the weakness on the part of IRBM personnel in implementing the enforcement of the rules, non-compliance could not be curbed effectively. Weak implementation could again be attributed to the internal risk presented by the shortage in manpower for conducting desk audit and field audit, as stated in Section 5.2.

The study has identified mixed responses from the interviewees regarding penalty rates. Some indicated that the structure of rates should be improved to avoid imposing hefty penalties on taxpayers, which may result in a heavy financial burden to pay the tax due as well as the penalty amount. For instance, RL8 cautioned that if the penalty was too high, then IRBM’s intention to promote voluntary compliance would be difficult to achieve, while it was RL8’s experience, being involved in the education programmes, that

“...taxpayers were more concerned about the amount of penalties than submission procedures or registering new accounts, hence their reluctance to come forward to declare their income.” (Interview: RL8)

RL8 also foresaw the possibility of taxpayers resorting to ‘under-the-table’ transactions with tax officers or tax consultants in order to avoid fines, thus

creating an opportunity for corruption. This concern was echoed by RL9, who agreed that the penalty rate should not be too high, although high enough for unscrupulous taxpayers to ‘feel the pinch’. In contrast, RL25 agreed that penalty is high. He came across a few taxpayers who, when imposed on penalty, uttered “Oh! The rate is higher now! I have to make sure I report accurately next year”. This shows that enforced compliance may increase compliance, however it may create dissatisfaction amongst taxpayer due to having to pay more for tax.

According to RL4, most penalty rates, fines or compounds in Malaysia were imposed on a flat-rate basis. For example, if an employer made less deduction or made a late payment for the Monthly Tax Deduction (MTD) payment, such offences were treated identically, even though they were different. RT4 and RT5 suggested that penalty rates should be based on the degree of the offence, whereby minor offences would receive a lower penalty rate while serious offences deserved higher rates. Taxpayers would appreciate the justice of this approach, and thus they would be willing to comply with the law. A further example was offered by RT4:

“... mistakes were made when completing return forms. Some of the mistakes were careless mistakes in terms of miscomputation whilst others were obvious mistakes that showed taxpayers have the intention to cheat. Hence, penalty rates should be in accordance with the seriousness of offences so that fair treatment is rendered to tax offenders.” (Interview: RL4)

However, RT5 believed that the current penalty rates were sufficient. According to him, the common complaints from taxpayers were not about the rates but about the fact that the penalties were imposed late, sometimes after a few years. RT5 advised that the penalty imposition process would be more effective if penalties were in more timely manner, which in turn might improve compliance.

The mixed views expressed by the participants conform to previous research on literature which indicates a varied response about the implication of penalty rates on compliance behaviour. Allingham and Sandmo (1972) and Sandmo (2004) suggest that a high rate of penalty may increase compliance; in contrast, empirical evidence provided by Papp and Takats (2008) find that a lower tax rate increases compliance. Furthermore, Kirchler et al. (2008) posit that a degree of trust determines the impact of tax rates on compliance: “The impact of the tax rate would depend on the degree of trust”.

When trust is low, a high tax rate results in low compliance; on the other hand, when trust is high, the same level of tax rate results in higher compliance. However, findings by Palil (2010), Devos (2009) and McKerchar (2003) have concluded that the penalty rate has no significant relationship with tax compliance. Devos suggests that “penalties should be used in combination with other measures such as taxpayer education and services in order to achieve greater compliance” (2009, p.36).

As proposed by RL5 and RL6, there was a need to identify why enforcement was easier to implement in tax administrations of developed countries compared with those of developing countries. RL5 presumed that developed countries might have adopted specific schemes of legal tax avoidance. He also claimed that Malaysian’s penalty regime was too lenient, while in the West it was too rigid, hence the higher compliance rate. According to RL5, this depended on society and circumstances:

“Not all the West has done was right and applicable to our society.” (Interview: RL5).

RL5 implied that not all aspects of implementation by developed nations can be

instigated by developing nations. Regulators in developing countries are confronted by various constraints, such as a lack of human and financial resources, inferior information technology systems, and a lack of expertise in technical knowledge, all of which result in an inefficient administration (OECD, 2011; Braithwaite, 2006; Gill, 2003). Similar constraints are faced by IRBM (discussed in Chapter 5). Moreover, due to these limitations, the regulatory agencies in developing countries are incapable of conducting compliance enforcement effectively and efficiently (Braithwaite, 2006; Gill, 2003; OECD, 2011).

Responsive regulation theory allows regulators to prioritise their enforcement strategies on high risk cases (Braithwaite, 2007; Baldwin and Black, 2007). If a persuasive approach is first adopted and proves successful, where the cost of a regulatory strategy is lower at the base than at a higher level then there will be more resources to be used toward fostering compliance (Braithwaite, 2003). This approach may reduce the cost of enforcement for tax authorities because resources will be allocated appropriately to areas of highest concern in order to meet overall objectives where the result may produce higher returns (Braithwaite, 2006; Braithwaite, 2003; Baldwin and Black, 2007; Freedman, 2011). To overcome enforcement constraints faced by developing countries, Braithwaite (2006, p.884) suggests developing countries adopt responsive regulation as they “have less regulatory capacity than developed countries”.

8.6.2 Difficulty in prosecuting delinquent taxpayers

A few interviewees, including RL2, RL7, RL13 and RL19, claimed that it was not easy for IRBM to implement certain rules, such as taking tax offenders to prison,

even though the tax law stated that this treatment was allowed. This was due to such factors as political interference, court rulings and public perceptions that should be considered. According to RL9 and RL13, it was part of Malaysian culture to offer sympathy and never use punishment, which was a further strong factor affecting success in enforcement. They felt that taxpayers might be alerted through taxpayer education to their responsibilities and eventually might change their perception to comply with the tax law:

“It’s not that we (IRBM) are weak, but sometimes we (Malaysians) are sympathetic; our culture can’t accept it, so it caused political interference. When we want to impose something, want to imprison someone, it’s difficult.” (Interview: RL13)

With regard to the imprisonment of tax offenders, there was consensus among RL2, RL5, RL7, RT1 and RT4 that courts in Malaysia had not imposed the penal provision whereby people who were charged for tax evasion were imprisoned:

“Even though the Malaysian tax law is sufficient to prosecute tax defaulters, IRBM has to get cooperation from the court in order to implement the law.” (Interview: RT4)

“It was due to most people’s perception that tax non-compliance is not a serious offence such as murder or rape. That may be the reason where even though a taxpayer was found guilty by the court of tax fraud, the tax offender will receive a very minimum fine.” (Interview: RL2)

“A long time ago there used to be one or two cases from the Criminal Investigation Department where taxpayers were imprisoned, however nowadays there are no cases of imprisonment by the court.” (Interview: RL5)

These responses indicated that regulators, especially in developing countries, faced another challenge to enforcing regulation due to interference from outside parties such as politicians, wealthy individuals and even the court. In this regard, Prichard (2010) and Uslaner (2010) posit that in some African countries, and even in Russia, regulators have been prevented in enforcing the law because of interference from politicians using their influence, and from wealthy individuals through such corruption activities as bribery and misappropriation of power. However, there is no implication on the part of this study that the court’s decision

not to imprison tax offenders is due to any corruption activities, but rather to reasons known only to it. Further investigation could be conducted in order to explore the court's perception of imprisonment for tax offenders.

8.6.3 Soft approach with big stick

Literature suggests that enforcement is part of an education which can be implemented based on a carrot-and-stick approach. The 'carrot' approach is a soft educational method to motivate and encourage the public to comply, while the 'stick' approach is a hard method of education which aims to punish those who fail to conform with the law (Braithwaite, 2002; Andreoni et al., 2003). RL7 advocated the carrot-and-stick approach should be adopted by IRBM because it may have both a direct and an indirect effect on taxpayers:

“For example, a taxpayer is investigated due to failure to declare his or her income correctly. The direct effect from this enforcement activity will be the taxpayer will learn a lesson and may not dare to evade tax again. The reason being penalty for the first offence is 45% whilst for subsequent offences, the penalty increases from 10% to 100%, or the taxpayer will be charged in court with a criminal offence. As for the indirect effect, other taxpayers who are aware of such action against non-compliance will not dare to evade tax. Through publicity other taxpayers will be informed of IRBM actions on tax offenders; this may spur them to voluntarily declare their tax correctly.” (Interview: RL7)

This opinion concurs with Kirchler et al. (2008) that taxpayers may trust the system and procedural justice when they find out authorities take action, such as tax audit and court action, on taxpayer who failed to comply. Thus, the trust may increase their motivation to comply. In this context, a field audit by IRBM could be considered to be a soft approach to provide information of tough enforcement to be enacted while wielding the big stick (Ayres and Braithwaite, 1992). This is based on the practice of field audit when visiting 'suspected' tax offenders, whereby financial documents and other related evidence are requested by IRBM auditors for further scrutiny. The visit also serves as a warning that if they are caught intentionally misreporting tax liability, then a severe penalty will be

imposed.

“In Malaysia, the way the people is educated is wrong. We don’t give complete information to the taxpayers. We must let the public know that paying tax is their liability to the country, not their responsibility. It means that taxpayers owe government the tax. Tax is a payment for the product they used in the country. In the USA, within ten days of the assessment, payment has to be made immediately. If they don’t pay tax, it is considered you owe the government. So while you are driving, your car could be confiscated from you immediately. Our authority needs to get judgment from the court before we can caveat taxpayers’ assets. The public think that the law is harsh.” (Interview: RL13)

There appears to be a lack of publicity about educating those who contravene the law. Both RL1 and RL13 expressed their frustration in that IRBM had not issued enough information to the public regarding the impact of non-compliance of tax law.

During the desk audit activities, it appeared that many taxpayers were not reporting truthfully on their income or were making false claims. Four interviewees believed it might take at least five years for the public to be self-regulated. In order to encourage self-regulation, all interviewees agreed that IRBM should do more to enhance educational programmes, improve tax administration and establish an efficient tax system.

To encourage voluntary compliance from taxpayers, RL3, RL13, RL19 and other auditors recommended that IRBM to simplify reporting procedures so that taxpayers such as traders, who had no knowledge of preparing business records but who could not afford to hire a tax practitioner, were allowed to present a simple business report to IRBM. They also suggested that IRBM to be proactive in learning and understanding the nature of the business in order to ascertain how the business operated and how profit was derived. If IRBM penalised them without understanding the business nature, then the taxpayers would believe that they were being treated unfairly, and would therefore be reluctant to comply

voluntarily.

As noted by Alm et al. (2010), even though punishment is one of the important tools to fight against non-compliance, a 'kinder and friendlier' service for taxpayers should be emphasised to encourage them to comply. For responsive regulation to work efficiently, tax administrations could adopt a flexible mechanism to educate and accommodate different requirements by different type of taxpayers (Ayres and Braithwaite, 1992). By identifying different categories of taxpayers and prioritising the highest risk taxpayers, this approach would enable IRBM to target educational resources toward the groups of taxpayers who most need information about tax.

A few interviewees referred to the need for IRBM to highlight to the public the consequences of failing to comply with the law. RL1 admitted that IRBM had not explicitly informed the public of the various types of punishment they could incur if convicted of tax offences. She felt that there was a need for the Board to provide information about penalties for non-compliance. As there are many penalty regimes under the 1967 Income Tax Act, RL7 emphasised the importance of creating awareness of the penalties imposed for certain offences. Some interviewees, including RL1, RL13, RL17 and RL19 also highlighted the importance of informing the public about punishments for failure to comply with the law. Their opinions were consistent with Leviner (2009), Feld and Frey (2005) and Scholz (1984) in that strict punishment from the authority might influence compliance with the law.

The interviewees believed that the public should be made aware of the penalties that could be imposed if they failed to submit or pay on time or to report correctly,

as well as being informed of other offences which might lead to imprisonment. However, they suggested that punishment should not be viewed as threatening and aggressive on the part of IRBM but rather as educative and as a deterrent to non-compliance. If other soft approaches failed, the hard approaches might be appropriately adopted to manage non-compliance, as suggested by empirical evidence that fear of being detected and penalised may induce greater compliance by the taxpayers (Feld and Frey, 2005; Braithwaite, 2003; Franzoni, 2009).

In line with the carrot and stick approach described by Braithwaite (2002) and Andreoni et al. (2003), RL9 also spoke of the soft and hard approaches to taxpayer education. Most of the educational activities implemented by IRBM, such as talks, seminars and training, are perceived as soft. In the context of educating non-compliant taxpayers, consistent with responsive regulation theory, RL9 suggested that hard approaches such as investigation and prosecution might be necessary to prevent tax offenders from re-committing tax crimes. The purpose was not to create fear but to educate the public about their tax responsibility and the repercussions if they failed to fulfil their duty.

RL9's point of view was consistent with Sandmo (2004), Andreoni et al., (1998), Slemrod and Yizhaki (2002) and Scholz (1984) who assert that taxpayers should be threatened with a certain type of punishment if they failed to comply with the tax laws; this may in turn influence higher compliance. The interviewees proposed that field audit should be undertaken more frequently to encourage greater awareness among taxpayers of IRBM's seriousness in tackling non-compliance, and that they (the taxpayers) would not be able to escape from the authority if they failed to comply. Similarly, Freedman (2011) refers to regulators allocating

audit and enforcement resources based on risk encountered during enforcement. The interviewees furthermore agreed that such action was essential to do justice to the taxpayers who were compliant and also to alert taxpayers that tax non-compliance was morally wrong. This hard approach is also consistent with responsive regulation theory whereby the command-and-control approach is appropriate for high risk taxpayers who refuse to comply with the regulation (Braithwaite, 2003; Ayres and Braithwaite, 1992; Andreoni et al (1998); Feld and Frey, 2005).

The interviews demonstrated that all participants agreed the most effective way to improve tax compliance was through taxpayer education. Research also suggests that knowledge of taxation obligations may increase taxpayers' ability to comprehend the system and to enable them to voluntarily carry out their duties as taxpayers (Alm et al., 2010; Richardson, 2006; Murphy, 2004). Prosecution should only be implemented as the last resort after all other efforts to educate, remind, assist and encourage are exhausted. The interviewees and the literature are consistent that prosecution should not be seen as a punishment but more as a corrective measure to educate the public about the impact of non-compliance. This action sends a signal to the public that they may not be able to escape from the law if they evade from it.

As the literature suggests (Frey and Torgler, 2007; Feld and Frey, 2005; Kirchler et al., 2008; Devos, 2009), punishment may also portray transparency and fairness of procedural conduct by the authorities, and hence may build up public trust towards the system and the government.

This chapter highlighted various education programmes undertaken by IRBM.

The dissemination of information and current news on the IRBM website and through the national radio is intended to distribute information more widely to the public. Those who seldom refer to the website may still obtain information through the radio. Nevertheless, IRBM may need to devise other strategies to reach a further group of taxpayers who neither use the website nor listen to radio broadcasts.

Further, approaching young students to expose them to tax knowledge is a smart step taken by IRBM in an attempt to educate these future taxpayers of their responsibility as law-abiding citizens. This programme could be implemented continuously so that the students grow up in the knowledge that complying with tax law is important, thus encouraging them to become compliant voluntarily.

As suggested by the Compliance Pyramid Model, desk audit to review suspicious reporting is another soft approach conducted by IRBM. This strategy is introduced to respond to taxpayer behaviour at the third level of the pyramid. However, for those who deliberately and continuously ignore the law, hard approaches such as field audit, penalties, investigations and court actions would then be taken.

This section presents various enforcement mechanism enacted by IRBM to enhance knowledge to taxpayers with regards to their tax obligations. The next section discusses relationship between compliance behaviour of taxpayers, risk management and responsive regulation.

8.7 Relationship between taxpayer compliance behaviour, compliance risk management and responsive regulation

At present, IRBM provides various approaches to disseminating knowledge to taxpayers. As stated earlier, there are educational activities to cater for the needs of different groups of public and taxpayers. Childhood education is for the benefit of future taxpayers; programmes through the mass media are aimed at the general public; seminars and visits to premises are promoted to employed taxpayers; and the BSS is directed at business-income taxpayers. Moreover, taxpayers who have a particular problem relating to tax matters may contact an IRBM call-centre to obtain a relevant explanation for their query. The call-centre agents provide assistance and advice on specific issues.

The accounts of higher risk taxpayers found to be committing errors when completing their return form, either intentionally or unintentionally, will be audited by IRBM and they will be subjected to penalties. Further, for those who are found to be evading the law, their case will be placed under investigation and, if proven guilty, they may be prosecuted by the court. This approach is consistent with the Compliance Pyramid Model which displays the different levels of activity provided for different levels of taxpayer.

It appears that, through its education programme, IRBM has conformed to the ethos of responsive regulation in managing compliance risk by classifying different types of taxpayers and providing varied types of education for them. By identifying taxpayers' education requirements and the target group, IRBM would be able to design an education plan to communicate sufficient information to relevant parties. In the current economic situation, in which the financial resources of the organisation are somewhat limited, "a well-organised programme would

reduce the administrative cost to tax administrations as well as minimising compliance cost to taxpayers” (OECD, 1988).

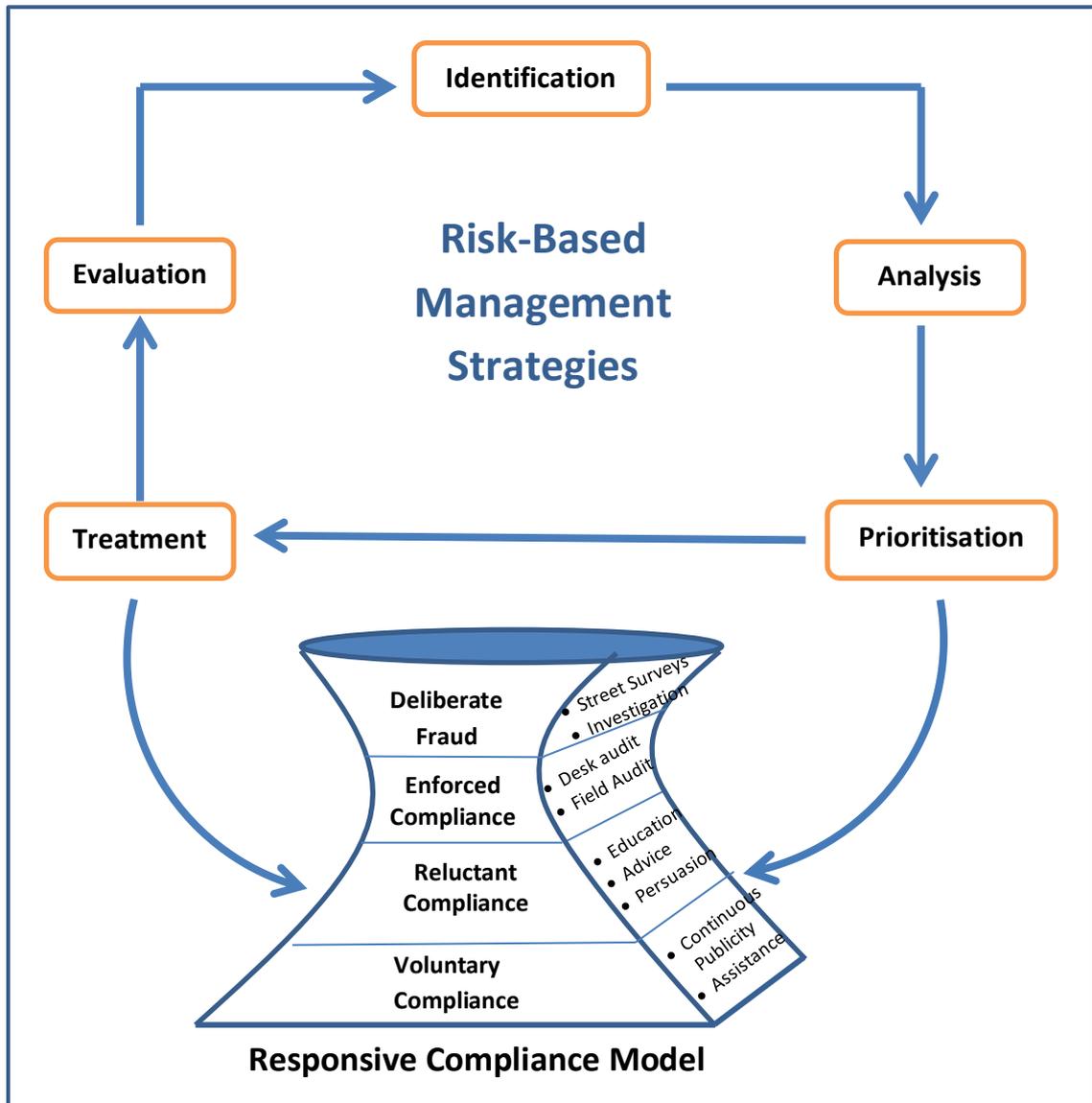
This study indicates that there is a relationship between responsive regulation, risk management and tax compliance which implies that a responsive approach such as education may have an impact in managing compliance risk in Malaysia. The relationship is further illustrated in the conceptual framework designed in this study and discussed in the following section.

8.8 Conceptual Framework

This section discusses a conceptual framework that overarches the two models adopted in this study, combining a compliance risk-based responsive regulation model and a risk management model.

The conceptual framework known as the ‘Responsive Compliance Risk Management Framework’ has been designed and developed by the author, for this study, in order to illustrate the relationship between risk management and responsive regulation. This concept, which could be applied by regulators to enforce compliance through risk-based compliance management, is consistent with Russell (2010a, p.3) who noted that high risks could be identified through “a range of measures” – as depicted by the risk management framework, “to respond to significant risks” caused by non-compliance behaviour – in relation to the compliance pyramid model. This section explains how the framework is designed and the processes it involves, and justifies the ‘lamp-shade’ shape of the framework which replaces the familiar pyramid model.

Figure 13: Conceptual Framework: Responsive Compliance Risk Management Framework



A revised framework for the research adopted from EC (2010) Compliance Risk Management Model and ATO (2000) Compliance Pyramid Model.

The EC's risk management model (EC, 2010) is the most suitable model to provide a description and an explanation of the risk management process, whilst the EC's risk-based compliance pyramid (EC, 2006) identifies relevant strategies in response to taxpayer compliance behaviour. Hence, both are chosen as models for the conceptual framework of this research. As addressed in Section 3.4.3, the process of managing risk involves a number of activities, namely risk

identification, risk analysis, risk prioritisation, risk treatment and risk evaluation. However, the process does not stop at evaluation alone, but continues as an iterative loop to improve the process and to deal with new risks (EC, 2010). The five steps are undertaken as strategies to meet the objectives of tax administration within the context of the organisation.

8.8.1 Risk-based Management Strategies

During the risk identification process, the EC (2010) and the OECD (2009) suggest that potential risks could be identified, such as risk in the filing of tax returns, risk when declaring income and risk of non-payment of tax due. Meanwhile, risks also can be identified according to high, medium or detailed level, which may assist in setting priorities when managing risks. Moreover, several sources, such as society support, new legislation, information from third parties, random audits, pioneer investigations and tax officials' personal encounters with risks, would be useful to assist with risk identification (EC, 2010). Risks which have been identified are then analysed to explore the reason for non-compliant behaviour.

The EC (2010) suggests that tax administration could use a range of computer assisted tools, such as computer systems, data mining and data warehousing techniques to analyse risks efficiently. Risks that have been analysed are prioritised so that effective treatment can be offered. In the risk prioritisation phase, the Responsive Compliance Model illustrated in Figure 13 is used to determine appropriate strategies to treat specific risks, which in this case are taxpayers' behaviour and responses towards tax compliance. In this way, effective treatment may be given to risks that have been prioritised. Furthermore, this stage will produce a plan laying out risks to be treated and treatment options. This is the

first process in which risk-based management strategies are linked with the compliance model.

In the next phase, risks that have been assessed are treated. This process also refers to the Responsive Compliance Model, which highlights appropriate responses by tax officials, depending on the level of compliance. As tax administration, especially in developing countries, appears to have limited resources (EC, 2010; Ayres and Braithwaite, 1992), the EC suggests that some of the risks could be transferred to other parties, such as financial institutions and other public agencies who may have more resources and may be more able to manage the risks efficiently. Risks could also be reduced through limiting opportunities for error by improving legislation or providing better services. Additionally, to reduce unintentional and intentional errors, tax administration is advised to provide taxpayer education through various methods, namely mass media, the internet, the telephone, help desks, electronic services and physical guidance. Finally, risks can be treated through risk covering to manage intentional non-compliance by adopting a policy of strict enforcement towards tax offenders (EC, 2010). Enforcement strategies such as field audits, inspections, penalties and imprisonment could be used as strict enforcement methods for those evading the law. Again, the risk-based compliance model displays appropriate strategies to be adopted by regulators in order to treat intentional non-compliance.

The final process in the conceptual framework involves the evaluation of risk to ensure the objectives are achieved. The EC suggests that risk evaluation should be implemented at each stage of the process. However, the EC also argues that it may not be possible to evaluate all compliance activities due to high cost of resources.

Furthermore, there may be differences between compliance activities in terms of the complexity of the environment and the availability of data. Thus, the EC suggests that the evaluation of compliance activities could be done internally or externally.

8.8.2 Responsive Compliance Model

As discussed in Section 3.6.6, the risk-based compliance model illustrates various strategies that could be adopted by tax officials, based on taxpayers' responses to compliance. As noted by Schneider (2006, p.8), "countries (the developed nation) with a better rule of the law, which is financed by tax revenues, also have smaller shadow economies". However, in developing countries, the model is not quite suitable for adoption. Figure 13 shows that the shape of the compliance model differs from the pyramidal shape introduced by Ayres and Braithwaite (1992) or the ATO's and the EC's compliance pyramid. Figure 13 shows that the shape at the top of the model is wider, which suggests the number of cases of deliberate fraud may be larger than those at other levels of compliance.

Schneider (2006) argues that in developing countries the size of shadow economies or cash economies is larger and perhaps exceeds the number of taxpayers who are compliant. Therefore, the author believes that the compliance model could be in the shape of a 'lamp-shade' or an 'hour-glass', depending on number of shadow economy cases in certain countries. For example, Schneider's (2006, p.23) shadow economy table for the year 2002/2003 for the Asian region shows that the rate of the shadow economy in Malaysia is 32.2% of GDP, which is lower than that of the Philippines (45.6%) and Thailand (54.1%). Thus, the top

shape of the model for Malaysia would be smaller than that of the Philippines and Thailand, but bigger than Singapore (13.7%).

The 'lamp-shade' model presented above suggests regulatory responses adopted by the IRBM in managing non-compliance risk. The model illustrates various educational activities undertaken by the IRBM that reflect taxpayers' different attitudes towards compliance. For the majority of taxpayers who comply voluntarily, on-going education through publicity and assistance is provided by the Customer Service Department (CSD), branch officials and call-centres. However, continued attention is necessary for this group so that they remain compliant on a voluntary basis; otherwise the problem may escalate and that they may become reluctantly compliant.

Reluctantly compliant taxpayers are those who wish to comply but, due to various reasons such as a lack of knowledge, lack of motivation, uncertainty and mistrust of the tax system, they may become reluctant to comply. It is possible that they also comply reluctantly due to a fear of being punished by the IRBM or pressured by peers and the society in which they live. Hence, this group of taxpayers needs encouragement and support from the IRBM so that they become voluntary taxpayers.

The Zakat payers discussed in Section 6.3 as well as the Chinese self-employed taxpayers highlighted in Section 6.4 could fall in this category: they may want to comply but, due to their perceptions of the government or language constraints, they are unable to comply. Therefore, encouragement and support through the IRBM education programmes such as the BSS sessions, visits to taxpayers'

premises and regular talks on national radio and television appear to be effective responses to enhance compliance among this group of taxpayers.

Although no empirical study has been done by the IRBM to evaluate the effectiveness of the education programmes, increases in the amount of revenue collected, the number of return forms submitted and the number of new taxpayers registered from the introduction of SAS in 2004 until 2012 (Appendix 7) indicate that efforts by the IRBM have managed to enhance compliance among taxpayers in Malaysia. Complaints by taxpayers about IRBM services, either received directly from taxpayers, through the Public Complaints Bureau or through the mass media, have been addressed to improve the quality of service offered to the public.

The next level represents responses towards the enforced compliance group of taxpayers. This group of taxpayers comprises those who have submitted returns but have failed to report the details correctly, or where the IRBM auditors were suspicious of claims, reliefs and expenses reported in the returns. Thus, the traditional approaches towards enforcement, such as desk audit and field audit are necessary to identify and assess the type and level of non-compliance so that appropriate treatment, such as advice, requests for additional documents and the imposition of penalties, can be enacted by officials from the Department of Tax Compliance and branch auditors.

At the top level, taxpayers who deliberately attempt to evade their tax responsibilities would face stricter enforcement mechanisms from the investigation teams. The IRBM may be able to identify them from activities such as street-surveys, whereby IRBM officials visit business premises and street

vendors to obtain information about their business operation, the income generated and whether they have registered with the IRBM.

From the conceptual framework, it appears that there could be a relationship between taxpayer compliance behaviour, compliance risk management and responsive regulation, whereby risk management and responsive regulation are the two main remedies for non-compliance behaviour as well as the fostering of voluntary compliance. The framework covers key aspects of risk management by highlighting the steps to be taken to manage risk and, at the same time, applying enforcement strategies responsively in the process. It would be interesting to see the framework tested in a real scenario of tax administration.

8.9 Summary

Data from the interviews and documents reveals that, in managing compliance risk, IRBM has provided various educational and training activities to taxpayers in order to promote tax knowledge to the public. The findings are consistent with the theory of responsive regulation where a soft approach, i.e. educational activity such as that conducted by IRBM, appears to be an appropriate regulatory strategy to communicate information to taxpayers and to increase their knowledge, thus to manage compliance risk. The interviewees further agreed that taxpayers' lack of tax knowledge might influence their behaviour in tax non-compliance. Moreover, IRBM has shown an exemplary initiative in educating students at school to create awareness of taxation for future taxpayers.

The research findings also reveal that, although the IRBM HQ and its branches have adopted different roles in managing compliance, officials at both levels have carried out their roles effectively, through various educational activities, to ensure

that education is extended to desired groups of taxpayers. Even though most participants agreed that the soft approach through education was the most effective method to encourage compliance, the study has discovered that some IRBM officials remained satisfied with the traditional approach in enforcing compliance and resisted a change to the responsive regulatory approach. They preferred to use punishment to enforce compliance rather than adopt a soft approach. There was a mixed response on penalty rates in the Malaysian tax system in that some participants believed that the rate was high while others considered it to be relatively low.

From the interviews, the study finds that IRBM appears to be confronted by some constraints in enforcing the law due to interference from politicians. Malaysia is not the only country that faces this predicament - previous research indicates that third party interference is also experienced by other regulatory agencies, especially in transitive and developing countries. Further, this study suggests that there is a strong relationship between the major themes it explores, namely, taxpayer behaviour, compliance risk management and responsive regulation. The relationship is further illustrated through the conceptual framework developed in this study, with the lamp-shade shape model emphasising the size of shadow economy in developing countries. The following chapter provides conclusions for the findings of the investigation. Limitations of the study, together with recommendations for future research, are also addressed in this final chapter.

Chapter 9

Conclusion

9.1 Introduction

As described in Chapter One, this study aims to conduct an empirical investigation into the internal and external risks faced by the IRBM and to obtain insights into its current practice in managing risk in its administration. The study also explores the application of responsive regulation in securing voluntary compliance by the IRBM. Findings from the study reveal that the IRBM appears to comply with responsive regulation theory through the implementation of various educational programmes to educate, assist and encourage taxpayers to comply with SAS requirements.

The study contributes to the current knowledge of compliance risk management practice in tax administration. In spite of the research being in a Malaysian context, there are implications of relevance to other tax administrations. The findings provide a platform for the IRBM and other tax administrations in developing countries to evaluate their existing risk management practices and to understand how the concept of risk-based responsive regulation can be applied to improve voluntary compliance in their administrations. The study is still relevant for the future as tax administrations would be looking at responsive regulation and using ideas from the compliance pyramid to improve their service. As this study also focuses on tax non-compliance risks and taxpayer behaviour, tax administrations in other countries might be interested to learn how the Malaysian tax administration manages its non-compliance risks and the activities involved in taxpayer education programmes.

This chapter begins with Section 9.2, which summarises the key findings and implications of this research. This is followed by Section 9.3 which highlights the contributions provided by this study. Next, the limitations of the study are presented in Section 9.4, whilst recommendations for future research are described in Section 9.5. Section 9.6 addresses the policy implications to suggest improvements in the risk management strategies of the IRBM to minimise non-compliance. Finally, Section 9.7 concludes the thesis.

9.2 Discussion of Findings

Tax administrations encounter various forms of risk that threaten their organisational objectives. Understanding the importance of systematic measures to manage the risks, the OECD (2009) advises revenue bodies to develop an efficient system to manage risks effectively. However, as drawn from the literature, most revenue bodies in developing countries appear to have limited capabilities, resources, knowledge and experience to develop and deploy sufficient frameworks to support risk management strategies. In this thesis, Ayres and Braithwaite's (1992) concept of responsive regulation is considered as a strategy to manage not only compliance risk but also internal risks faced by the IRBM.

Applying the concept of responsive regulation to the risk management process involves a mixture of soft and hard approaches to treat the actors of non-compliance and to encourage them to comply voluntarily. At the same time, this concept promotes on-going assistance and support to those who comply regularly. A responsive regulation strategy appears to have been successfully implemented by the ATO (Job and Honaker, 2003). Learning from the ATO, other revenue

bodies have emulated the concepts according to their organisational requirements. However, a participant of this study commented that whatever is good for western countries may not be so well suited to the developing countries on account of a number of limitations. As the scope of responsive strategies may be very wide, tax administrations with few financial or human resources may select activities of the greatest strategic importance to their overall success criteria.

Tax administrations, especially in the developing countries, could switch from command and control to responsive regulation because of the advantages gained by this approach. By adopting a risk-based responsive concept, tax administrations also could change from the traditional approach, which involves aggressive treatment of taxpayers and the threat of penalties, to a softer approach. Taxpayer education could be adopted as a strategy to improve the understanding of tax obligations, whilst assistance and support are provided to enhance voluntary compliance.

However, responsive regulation may not be applied easily and in a straightforward manner in developing countries. This is due to factors which may influence tax agencies to take certain actions against taxpayers. Unlike developed nations, politicians or high profile individuals in developing countries may intervene in the decision making of government agencies. Also, a responsive approach, which assumes that regulators and regulatees have a good relationship, may not be a suitable course of action in some developing countries where people's behaviour may be influenced by culture, language, social beliefs and perceptions of the government.

Nevertheless, in the case of some risk management strategies, the step-by-step, bottom-up approach of responsive regulation may not be applicable and a firm approach may need to be adopted first, especially when handling an emergency or crisis situation.

In relation to the topic of the research – compliance risk management strategies by the IRBM, feedbacks from participants and data from secondary documents show that different strategies are initiated by the IRBM to manage compliance risks. Discussions in Chapters Seven and Eight have highlighted both carrot and stick approaches practiced by the IRBM according to different categories of response by taxpayers. These measures are in line with the concept of risk-based responsive regulation (Figure 13), whereby the IRBM regulates according to types of compliance risks and compliance responses. Section 3.2 describes compliance risks as non-registration, non-reporting, incorrect reporting and non-payment or late payment of tax liabilities. The following sections discuss the findings from the study of the IRBM's regulatory strategies to manage these risks.

9.2.1 Strategies to manage non-registrant taxpayers

Some taxpayers fail to register in the tax system due to ignorance of the requirement of law and some intentionally choose not to register for the purpose of evading their tax obligations. In its effort to manage and treat this type of risk, the IRBM has conducted various educational programmes for the general public as well as a specific group of potential taxpayers. Collaboration with the Ministry of Education and schools has enabled the IRBM to offer the opportunity to gain an early initial understanding of the tax system in Malaysia and the public responsibility to contribute to the nation's development. Thus, early education programmes appear to be part of an on-going proactive effort by the IRBM to

create awareness among students and to inform future taxpayers of their responsibility to become compliant taxpayers. With this effort, today's children may register voluntarily as taxpayers when the time comes for them to fulfil their duty as responsible citizens and self-regulated taxpayers.

For employed citizens, the IRBM works together with employers to ensure that newly recruited employees who have taxable income are registered and MTD is deducted from their monthly remuneration. IRBM officials perform regular visits to employers' premises to educate employers of their responsibilities in registering their employees, recording up-to-date information about their employees and submitting electronic reports every March. A TRO is appointed by employers as a contact person of the company to be trained by the IRBM so that information can be delivered efficiently to employers and employees.

Meanwhile, to manage the risk of non-registration by business-income taxpayers, a street survey is conducted by the IRBM with visits to taxpayers' businesses and checks on their business records. To establish that this activity is not an enforcement activity but an educational one, the activity is no longer called Street Survey but has been rebranded as 'Lawatan Mesra Hasil' (IRBM Friendly Visit). During the visit, IRBM officials verify taxpayers' compliance as a registered taxpayer in the tax system. If they are found to be non-registered, they will be advised to register and their details are delivered to desk audits for further review. However, the study finds some shortfalls in the visits. All tax auditors commented that the activity could be improved to obtain more information about taxpayer compliance habits. As this is the only opportunity for the revenue officials to meet

taxpayers, they could optimise the meeting by providing education and advice about taxpayers' responsibility to ensure that business records are kept in order.

The study has found that taxpayers refuse to leave their business to attend IRBM workshops and, as the officials are already present at the business premises, they could allocate appropriate time to providing basic lessons about preparing a tax return, keeping basic business accounts, methods of paying tax liabilities and other tax related information.

It would appear that further improvement by the IRBM is needed to ensure that the visits produce fruitful outcomes in terms of widening the tax base, educating taxpayers and creating awareness that the IRBM will occasionally be present to ensure compliance by taxpayers. If taxpayers refuse to seek the IRBM's advice the organisation could then take the initiative to meet taxpayers. From the visit, underground economies may be detected effectively. However, this would be time consuming, requiring a large number of personnel and high allocation of financial resources. Therefore, the IRBM may need to set up effective measures to ensure the activity would be implemented regularly at reasonable cost to 'catch' non-registered taxpayers, especially those involved in underground businesses.

This study also raises concerns about the minimal effort made by the IRBM to pursue shadow economy activities, which obviously lead to a reduction in revenue collection. Even though the IRBM is aware of the threat brought by the shadow economy, this non-compliance activity could not be carried out due to insufficient numbers of staff. An IRBM recent initiative in setting up an e-commerce unit is an applauded effort to identify and explore businesses operated through online sales or auctions such as eBay, Facebook, blogs and websites. This process of risk

identification is an effective effort to identify non-registered businesses as well as non-registered taxpayers.

The IRBM has also provided an electronic service, e-Daftar (e-Register) to enable taxpayers to register online. The website also furnishes various pieces of information about taxpayers' tax obligations and highlights the e-Services available to help with tax matters. The service, which is available through the IRBM official website, allows taxpayers to register online. Moreover, with the establishment of two call-centres, in Kuala Lumpur (West Malaysia) and Kuching (East Malaysia), taxpayers may call the IRBM to obtain the information they may require. To those who are more comfortable writing to the IRBM, dedicated email addresses are provided to facilitate the sending of emails by taxpayers to specific IRBM officials.

The Corporate Service Department is also available at HQ level to assist taxpayers in their tax matters, whilst at every branch of the IRBM there is a Customer Care Unit to help resolve taxpayers' tax issues.

In terms of general education programmes, the IRBM organises annual tax seminars to provide up-to-date information related to changes in taxation law. The seminars, which are conducted at various locations nationwide, are attended by tax practitioners, company owners, employers, professional bodies and the public. The IRBM continues to disseminate tax awareness and knowledge to the public with publicity through the media, including TV and radio programmes, major national newspapers and publications. These education campaigns are part of the strategy to manage non-registration compliance risk, whereby the public is informed of their role in working together with the government to build the nation

so that they realise that revenue is important to provide public services and welfare.

In addition to e-Daftar, as described in Section 7.5, the IRBM has developed various e-Services to improve service delivery to the public. Electronic services appear to be cost effective measures to the public as well as the IRBM in terms of information gathering, a paperless environment and faster information delivery. Furthermore, the services expedited data processing, shortened manual processes and improved the IRBM responses to the public. As information is now readily available the public may have fewer excuses to claim ignorance of tax law in Malaysia. In March 2012, the IRBM introduced 'm-filing', which offers taxpayers an additional method to submit tax return forms, through mobile telephones. The IRBM is aware that the use of technology helps in reducing the risk of non-registration and provides faster and more efficient services to taxpayers.

9.2.2 Strategies to manage non-filing compliance risk

For taxpayers who have registered but fail to file their returns, the IRBM system is able to identify such cases and a penalty for non-filing under Section 112(1) Malaysian ITA 1967 is applicable; if convicted, the person is liable to a fine not less than RM200 (£40) and not more than RM2, 000 (£400) or imprisonment for a term not exceeding six months or both. The penalty imposed for this offence is to prevent the occurrence of future non-filing risk whilst demonstrating fairness and justice to compliant taxpayers.

Meanwhile, during the filing season every year, which is from March to June, taxpayers are constantly reminded through radio, TV and major newspaper of the submission date. The IRBM also sets up many e-Filing counters at all IRBM

branches to assist taxpayers in the submission of returns electronically. Taxpayers are given the option to file electronically or manually according to convenience, and IRBM officials at the counters will assist them with completing the forms to ensure that reporting is done correctly. In 2012, the CEO of IRBM extended the submission date of tax return forms for individuals as a ‘carrot’ for those who used e-Filing to file their returns.

With the efforts made by the IRBM in providing the filing system, additional service counters, an extended submission deadline and extended hours for customer services, taxpayers do not have excuses for failing to file, unless it is their intention to evade their tax obligations.

9.2.3 Strategies to manage compliance risk due to failure to report accurately

As discussed in Section 2.4.2, for cases of failure to report, the IRBM carries out desk audits and field audits to examine taxpayers report their tax obligation accurately. During a desk audit, tax auditors may request that taxpayers provide additional documentation to support their claims or reports. Taxpayers may also be invited to the IRBM office to attend interviews if the auditors require additional information or seek to verify certain claims. When a field audit is conducted, taxpayers are notified by the IRBM prior the audit visit to the taxpayers’ premises. During the visits, auditors will request some financial documents and business reports to be verified against taxpayers’ reports in their return form. If they are found to be committing tax fraud, then a penalty is imposed on the taxpayers and additional assessment is raised. Meanwhile, for high-profile defaulters, a tax investigation is carried out by the IRBM tax

investigators whereby intentional tax evaders have high penalties imposed or are prosecuted in court.

In Section 8.6, participants agreed that the enforcement measures conducted by the IRBM are not to be considered as punishment but to educate taxpayers of their responsibilities under the law to report their tax liabilities accurately. The study finds that most participants agreed that a penalty should be imposed on tax defaulters to prevent future compliance risk. From the enforcement approach, compliant taxpayers may believe in the tax system and trust in IRBM officials to regulate their duties in a fair and just manner. The findings are consistent with Ayres and Braithwaite's (1992) compliance pyramid, which illustrates that the traditional enforcement approach is enacted at the peak of the pyramid as a sanction to deter taxpayers from non-compliance. Therefore, tax regulators may respond tit-for-tat towards taxpayer compliance behaviour to ensure compliance is regulated effectively.

9.2.4 Strategies to manage non/late payment compliance risks

Non-payment compliance risk is committed when taxpayers fail to pay tax due to the IRBM or make the payment later than the stated date. The IRBM provides several payment mechanisms to assist taxpayers in paying their tax due. For employees, tax payment is made through MTD by employers, whilst for business-income taxpayers an instalment schedule is issued so that payments can be made by instalment. In addition, various payment methods have also been introduced by the IRBM to facilitate payment of tax.

Taxpayers can choose any method of payment convenient to them, such as at IRBM counters, through appointed bank counters, by mailing cheques or postal

orders to the IRBM and through internet banking. Call-out Centre staff are assigned to call taxpayers to remind them to settle outstanding taxes, to inform of enforcement measures to be taken if they fail to comply and to assist those in financial difficulty to reschedule their instalment plan. These are soft approaches initiated by the IRBM to encourage taxpayers to comply voluntarily with their tax payment obligations. With all the facilities provided, when taxpayers fail to pay various actions are then taken to manage these non-payment compliance risks. When taxpayers fail to pay or are late in making payments, they are subjected to a 5% and 10% penalty under Section 103 ITA. Furthermore, a civil suit action is taken against taxpayers where the judgement may involve writs of confiscation or sale, debtor summonses or bankruptcy orders.

Section 104 (S104) of the Malaysian tax law disallows taxpayers who fail to settle their tax liabilities from leaving the country until they settle the amount due. This uncompromising approach may be perceived by the public as unduly aggressive action by the IRBM. However, the enforcement measures are taken only after assistance, advice and warnings have been given to taxpayers. The author has experience of handling taxpayers with S104 cases where their outstanding tax debt was worth millions of Ringgit. Only when they were prevented from leaving the country, then they would visit the IRBM office to appeal for revocation, where finally they have to settle the debt before being allowed to travel abroad. This indicates that some taxpayers fail to comply not because they are ignorant or in financial difficulty, but as commented by a number of participants, they wanted to see if they could escape the law without being detected by the IRBM. Therefore, the author and other participants believe that sanction from leaving the country is an effective approach because taxpayers who are stopped at the airport by

immigration officials would immediately make the payment so that the IRBM would revoke their case and they are allowed to leave the country.

While the S104 enforcement mechanism maybe suitable for some other countries to apply, some western countries may believe that the action is against human rights policy. This is the comment received by the author from some acquaintances in the UK when they were informed of the S104 law in Malaysia. The measures taken to manage the non-payment risks should be seen as education or warning to others of the repercussion of failure to comply with the law.

Taxpayers, who were prevented from leaving the country or those who were penalised, would probably have informed close friends and relatives of the incidents (Franzoni, 1998; Sandmo, 2004; Torgler, 2003). This information would be a 'free advertisement' for the IRBM to make society aware of the repercussions of evading the law. As stated in the literature (Feld and Frey, 2005; Wenzel, 2002; Yong, 2011), an individual's tax compliance is also influenced by social norms and cultural behaviour. When a member of society is sanctioned by the law, it is possible that others within the community may be affected by the action. As a result, they would be influenced to comply in order to avoid being penalised for non-compliance.

9.2.5 Strategies to manage internal risks in the IRBM

While earlier discussion concerns findings relating to external compliance risks and strategies undertaken by the IRBM to manage these risks, the study also highlights a number of key internal risks which have impact upon the IRBM's organisational capabilities to achieve the desired objective. Internal risks faced by the IRBM, including financial constraints, a shortage of human resources, lack of

staff professionalism and technical knowledge and the lack of an efficient computer system, are consistent with the literature produced on the internal risks faced by other tax administration, particularly in developing countries.

The IRBM also encounters resistance by a number of staff to change from a traditional approach to a responsive approach. As a regulatory body, IRBM staffs are accustomed to a command-and-control attitude when dealing with taxpayers and they may behave in an unfriendly, arrogant or threatening manner. This behaviour is unacceptable as it could result in the reputation of the IRBM being placed at risk. Similarly, the ATO was faced with this issue when the responsive regulation concept was first introduced in the office. In an effort to adopt the concept of responsive regulation in the administration, the Board encourages staff to treat taxpayers as 'customers' to deliver services responsively and in a friendly manner. Through continuous efforts to instil positive attitudes in staff and emphasise the importance of portraying a good image of the organisation to the public, resistance from staff could be reduced. From this study, risk-based responsive regulation (Black and Baldwin, 2010) which promotes the development of tools to manage risks appears to be applied by the IRBM.

In its effort to manage internal risks in its organisation, the IRBM has demonstrated various tools, such as the IIP and ISP, to minimise risks and to control mismanagement of power in the IRBM. The IIP functions as a means of internal control to maintain personnel of high-integrity in the household of IRBM, working together towards the future direction of the organisation driven by the ISP. The IIP strengthens awareness programmes to combat corruption, malpractice and abuse of power within the IRBM, whilst the ISP provides

strategic planning to ascertain clear direction to accomplish organisational objectives within the time frame of the next five years. The motivation documented in both booklets is not only written as theory, but has proven effectiveness and ‘workability’, since the IRBM has successfully collected RM109.67 billion for the fiscal year 2011, which is RM23 billion more than the target set by the Ministry of Finance. The collection has broken through the two-digit figure of past years’ tax collection into the new zone of three-digit revenue from direct taxes. This achievement was made possible through the IRBM’s focussed strategies on compliance, collection and publicity activities running simultaneously as inspired by the ISP and IIP.

Findings also suggest that responsive regulation is applied by the IRBM to enforce compliance with organisation rules. In this context, the senior management represent the regulators while the personnel are the regulatees. By applying the theory of responsive regulation and the enforcement pyramid, senior managers may begin to encourage compliance from the bottom of the pyramid. Staffs who always comply with organisational expectations are rewarded with written appreciation, higher annual income increments and better chances for promotion. For those who fail to comply with the organisation rules, as suggested by responsive regulation, strict measures are applied through disciplinary actions, such as no annual income increment, no promotion or termination of services with the IRBM.

9.2.6 Perception of Malaysian tax practitioners

The study observes that tax practitioners encounter challenges from both IRBM officials as well as taxpayers. Unprofessional treatment by a number of IRBM officials, lack of knowledge in taxation technical aspects and lack of knowledge

of the industry, have led to lack of trust in the Board's efficiency to deliver services to their customers, the tax practitioners. A lack of efficient record keeping by taxpayers, demands by clients to reduce tax liabilities and threats by clients to withdraw business contracts appear to be challenges to tax practitioners in managing their clients. The study also finds that a number of unethical tax practitioners cooperate with their clients to understate income and overstate claims in their reporting.

Tax practitioners play important roles as intermediaries between revenue bodies and taxpayers to ascertain that compliance is in accordance with tax laws and regulations. Thus, unethical tax practitioners appear to be another external risk to be managed by the IRBM. Cooperation between these two parties is essential to ensure that the integrity of the tax system in Malaysia is upheld. The study suggests that both bodies continue to meet regularly to discuss any predicaments faced by them. Current jointly organised seminars between the Board and the tax practitioner association appear to be developing the relationship between them to meet the common objective of fostering voluntary compliance.

9.2.7 Perception of Malaysian taxpayer compliance behaviour

With respect to taxpayer behaviour, Section 3.3 highlights the various factors, such as trusting the tax system, compliance cost, tax knowledge, personal and social norms, tax morale and fear of punishment, which may influence taxpayers' decision making with regard to compliance. In relation to the compliance behaviour of the Malaysian taxpayer, the study found that Chinese self-employed taxpayers, particularly street vendors, grocery or hardware stores owners, petty traders and food suppliers, appear to be the group of taxpayers with a high

percentage of non-compliance. The literature on traders in Malaysia also finds evidence consistent with this claim. The IRBM may need to disseminate tax knowledge in Chinese and other major languages through publications or the media so that the information can reach this group of taxpayers. Even though the majority of tax agents are Chinese, this does not help much because most self-employed or small traders refuse to engage tax agents to handle their tax matters due to the additional operational cost to their business.

The findings indicate that non-compliance within this group of taxpayer is the result of lack of knowledge, the language barrier, attitudes towards complying with the law and unwillingness to hire tax practitioners to manage their accounts due to the high cost. Social norms, culture and trusting the government perhaps would be other factors which influence their decision to comply. Therefore, further studies may be required to understand the failure of other ethnicities in Malaysia to comply. The findings from this study will help inform the IRBM and also tax practitioners of the measures to be taken to assist, regulate and encourage compliance amongst this group.

Findings from the study also indicate that self-regulation in the Malaysian tax scenario may not be able to materialise in the near future as taxpayers are unwilling to embrace the concept. This is because most of them comply out of fear of punishment and mistrust the government with regard to spending the country's revenue appropriately. The Malaysian ITA allows Muslim taxpayers to obtain a tax rebate after payment for Zakat. The study finds that there are two factors influencing Muslim taxpayers in Malaysia to pay Zakat: religious obligation and perceptions of government handling (or mishandling) of revenue.

Even though Islamic law requires Muslims to pay only 2.5% of their income for Zakat, the findings indicate that most Zakat payers contributed the amount equivalent to the tax charged. As a result, taxpayers are eligible to claim full rebate; hence less revenue goes into the government's coffers.

Some participants commented that taxpayers have chosen not to pay income tax as they refuse to contribute revenue to the government due to perception that the government is misusing the funds for political and personal agendas. The study observes that many participants suggested that the Malaysian public needs to be instilled with the awareness that tax revenue is essential to develop the nation and thereby of benefit to the people. Therefore, the public would realize their responsibility to pay tax while paying Zakat, regardless of their political views or their sentiments towards the government. While Zakat is a religious obligation, income tax is a national obligation; hence, both are important for improving the quality of living of the people and should not be perceived as burden to Muslims as payment of double tax. However, as the subject of Zakat is not within the scope of this research, a study may also be conducted of Malaysian Muslim taxpayer compliance behaviour towards Zakat and income tax.

In understanding the culture of Malaysia, any discussion relating to ethnicity and religiosity would be regarded as sensitive matters. However, findings from the study are to be regarded from an academic point of view to provide empirical knowledge of how revenue bodies could secure compliance through an understanding of taxpayer compliance behaviour.

The results of the study, as presented above, discuss the IRBM's strategies in managing internal and external risks. Although IRBM has not fully established the

risk management strategies in its compliance risk programmes, the Board appears to apply the guidelines and concepts of risk management set by the OECD and the EC. Based on feedback by the interviewees about taxpayers' lack of knowledge of their tax obligations, an extensive educational campaign is needed to inform the public about the role of tax in developing the nation and how the revenue is spent by the government.

In addition to education, any government projects or programmes of benefit to the public are to be highlighted through mass media so that the people realize that they also play a part in contributing to the projects. Consequently, this would raise their tax morale and encourage them take pride in being a good citizen, promoting their willingness to pay tax in future. Nevertheless, there would be taxpayers who may disagree with the projects and believe that the government is wasting their money (Kornhauser, 2007). As a result, this may decrease their tax morale and eventually decrease their willingness to comply.

Risk management strategies and responsive regulation theories portray a 'perfect picture' in regulating responsively to secure voluntary compliance. In fact, these concepts have proved to be effective and have been implemented by a number of tax administrations, namely the ATO, NZIR, HMRC and some EC member countries. However, for tax administration in developing nations, limitations of a financial nature and those relating to the workforce may reduce the success rate of the strategies to manage compliance risks, as well as other internal and external risks, efficiently.

Through his regular speeches in the IRBM portal and during monthly staff assemblies, the present CEO of the IRBM motivated staff to work hard to improve

tax administration, increase tax collection and instil public confidence in the IRBM by delivering excellent services to the customers and stakeholders. He also reminded staff that a lack of human and financial resources is not to be seen as limitation but as a challenge to be overcome by the staff by shaping up and putting all their energies into providing the best service to taxpayers. Hence, through effective strategies in managing risks, revenue bodies may be able to deliver services efficiently and most importantly to minimise compliance risk and maximise revenue collection.

9.3 Research Contribution

This study provides a number of significant contributions to knowledge empirically, methodologically and conceptually. At an empirical level, this study involves:

- An investigation from the perspective of tax administration rather than most studies, which investigate from the taxpayer's point of view. From this study, the IRBM officials' responses were obtained to find out their views of IRBM risk management practices and Malaysian taxpayers' behaviour.
- This study adds to the tax administration literature by examining Malaysian tax officials' perceptions of how the IRBM manages internal and external risk and also their perceptions of Malaysian taxpayers' behaviour. Participants agreed that most of the enforcement strategies adopted by the IRBM are consistent with the concept of responsive regulation. However, they believed that the IRBM could enhance its

approach towards the management of non-compliance by emphasising a softer approach.

- The study finds that the tax administrations of developing countries are faced with similar internal risks, such as financial limitations, a lack of automated processes and corruption. In terms of external challenges, tax administrations are faced with underground economies and non-compliance behaviour from taxpayers. From the interviews, it was discovered that non-compliance behaviour is influenced by a lack of knowledge about tax obligations, attitudes towards complying with the law, language barriers and also attitudes towards the current government.
- This study also adds to the literature on risk management in tax administration by highlighting the IRBM's strategies to foster voluntary compliance, in particular the use of education programmes as a soft approach by providing relevant information to the public. It informs of the early education strategies introduced to primary and secondary schools to create awareness about the taxation system in Malaysia.
- The study also finds that the IRBM had implemented a number of strategies, such as enhancing its education programmes and improving services to taxpayers by providing many e-Services such as e-Filing, e-Payment, e-Stamping, e-register, text messaging facilities and other e-Services. It appears that the education programmes conducted by the IRBM are comparable to those of tax administrations in the developed countries. The study also highlights the soft approaches as well as the hard approaches adopted by the IRBM, as presented in Section 9.2.

Methodologically, this study is unique in terms of:

- Looking at the Malaysian tax authority using face-to-face interviews.
- The IRBM was chosen as a case study because, as an insider, the author had easy access to information and documents which may not be accessible to outside researchers.
- A qualitative approach through face-to-face interviews and document analysis, as described in Chapter Four, provides a new and rich perspective on risk management practices in Malaysia.
- The studies of internal documents, the Integrity Plan and the Strategic Plan, have contributed supporting information to the study.

In addition, conceptual contributions from the study involve:

- This study extends the literature on responsive regulation by showing how it can be applied in the context of a developing country.
- Information gathered from literatures, interviews and secondary data were used to develop a conceptual framework, illustrated in Figure 13. A lamp-shade shaped model, rather than a pyramid shaped model, explains the relationship between taxpayer behaviour, risk management and responsive regulation. It also informs of the IRBM's responsive strategies in managing taxpayers' compliance behaviour.

As stated in Section 1.4.1 and further addressed in Chapter 5, developing countries appear to have internal risks, such as shortages of human resources, financial resources and technological expertise. Therefore, it would be a challenge for the implementation of the risk-based compliance management to be fully successful. By learning from other tax agencies' experience in implementing

responsive regulation in their administrations, some important knowledge would be gained to then be adapted to suit their own administration. Nevertheless, it may not be necessary for developing countries to copy-and-paste all that has been implemented by their developed counterparts. As “one size does not fit all” (Russell, 2010, p.1), those from developing economies may need to adopt the concept of risk-based compliance management according to the culture, people, economy, infrastructure and other challenges relevant to their country.

Tax administrations in developing countries, such as Brazil, South Africa, Turkey and other upper-medium-income countries, as well as other tax administrations, may be interested to learn of the compliance risk management strategies suggested in this study, and might carry out similar activities based on the suitability for their administration. In addition, other enforcement agencies, such as the Customs Department, Police Department, Companies’ Registrar and other regulatory agencies may also benefit from the study in terms of responsive strategies to manage compliance with their customers.

This section presents the empirical, methodological and conceptual contributions of this study so that the knowledge can be shared with other regulatory body especially the tax administration. However, the author acknowledges that there are a number of limitations encountered while conducting the research.

9.4 Limitations of the research

As noted by Scandura and Williams (2000) cited in Yong (2011, p.167), “it is impossible to create a perfect study that can be considered the final answer to a research problem”. There are a number of limitations to this study which are acknowledged in this section.

As stated in Section 4.4.3, seven branches of the IRBM were visited for the interviews with officials. Even though the study finds that all branches provided similar perceptions of risk management practice in the IRBM, richer data could be obtained if further study is conducted as below.

- More branches were selected for the interviews, especially those branches with special characteristics. For example, the east coast region is known to have a population with a high-level of religious values; hence religiosity might be a factor to influence the compliance behaviour of taxpayers in the region. Also, in branches in East Malaysia, where the majority of the population is comprised of indigenous ethnic groups and where the culture and language are different from those in Peninsular Malaysia, a study of compliance behaviour may add to the literature about the determining factors that motivate compliance.
- The interviewees comprised senior and middle-level managers. To obtain richer data, IRBM personnel from various ranks could be interviewed to provide responses from different perspectives.

The study noted a small sample size of tax practitioners interviewed whereby only six tax practitioners were interviewed. Section 4.4.3 explains the reluctance of tax practitioners to be interviewed. Nevertheless, a larger number of tax practitioners being interviewed might provide richer and more in-depth insights into tax practitioners' perceptions of the IRBM's performance in terms of risk management. Tax practitioners also could be selected from different categories, such as those from the Big-4 companies, small companies and self-employed practitioners.

The study involves interviews with tax officials to discuss the IRBM's performance, with the result that a one-sided perspective is obtained. For that reason, tax practitioners were involved in the interviews to gain a different perspective for data collection. However, seeking the perceptions of taxpayers towards the IRBM's performance would establish a more dynamic triangulation for data collection. In order to obtain data from taxpayers, a mixed method approach could be adopted whereby the perceptions of taxpayers were obtained from surveys, a quantitative approach. Through surveys, a large number of taxpayers could be included to add value to the data collection.

Another limitation of the study is the qualitative approach adopted in this research. Due to time constraints, data collection methods undertaken by this study involved interviews of IRBM personnel and tax practitioners in Malaysia as well as data obtained from internal IRBM documents. Richer data could have been obtained through observation, with the researcher present at customer service counters to observe how IRBM staffs provide services to customers. The author could also have joined the audit teams and the investigation teams during visits and raids to taxpayers' offices or homes. From these visits/raids, reactions from taxpayers and responses to the situation by IRBM customer service staff/auditors/investigators could have been observed clearly; hence richer data could have been obtained from this method.

The qualitative approach, through semi-structured interviews, does have limitations. Some of the weaknesses of this data collection method are as follows:

- Selected participants were reluctant to be interviewed face-to-face for fear of disclosing sensitive or confidential information.

- A few participants were cautious in their responses, again for the reason stated above. This is proven in Appendix 3 where 15 interviewees had requested that the interviews were conducted without being taped.
- Interviews are time-consuming as well as labour and resource intensive. Long hours were taken to transcribe the interviews verbatim. In addition, travelling to meet interviewees involved considerable expense.
- Interviewing non-English speakers was another challenge because the interviews had to be translated into English before the transcription could be done.

The next limitation noted by the author is that being an insider has its own implications too. The limitations are as follows:

- As explained in Section 4.5, even though various steps were taken to ensure analysis of the data was conducted professionally, the experience and knowledge gained while working in the organisation may influence the researcher's thoughts and feelings in writing the thesis; this may result in potential bias in data analysis.
- In discussing the findings of a study, researchers should be honest and unbiased in reporting the findings on the basis of the data collected and analysed. However, for an insider, it was somewhat difficult to be critical of one own employer, even though the objective is to produce academic findings, rather than express a personal opinion.
- Another limitation of being an insider was the predicament in deciding whether certain issues highlighted by participants could be reported in the thesis. In the Malaysian context, some issues may appear to be sensitive,

particularly if comments about religion and ethnicity are concerned. However, as an academic researcher, the author has sought to be professional and transparent in discussing the findings of the study and to report them from an academic perspective.

- Some participants appeared to provide brief answers. This may have been because they thought that, as an insider, the author would have been aware of the issues relating to the study. Therefore, the author had to request clarification and explanation of their feedback so that the data collected could come from the interviewees, not from the author's own assumptions; thus validity of the data collected and analysed is guaranteed.

The limitations of the study as discussed above can be overcome by undertaking a number of actions suggested for future research in the following section.

9.5 Suggestions for future research

The area of compliance risk management and responsive regulation theory, particularly in a Self-Assessment System, offers opportunities for additional research to extend the findings. This section provides several suggestions as follow: Firstly, the present study presents IRBM officials' and Malaysian tax practitioners' perceptions of current practice in managing risks. Further research may be undertaken to explore the perceptions of taxpayers towards the IRBM regulatory responses. Future study may find that the IRBM's educational activities are sufficient to educate taxpayers and hence able to increase voluntary compliance.

Secondly, as noted in Section 1.6, individual and sole-proprietor taxpayers have been chosen for their lack of knowledge of taxation and resistance to acquire more

knowledge about taxation, especially business income taxpayers with financial, time and language constraints. Future study may look into managing non-compliance risk by large businesses. Even though the corporate tax structure is more complicated than the individual tax structure, the use of tax consultants to manage their tax affairs has resulted in corporate taxpayers being more compliant and systematic in managing their tax liabilities. Hence, future study might draw our attention to large taxpayers' compliance behaviour, considering whether the risk management strategies carried-out on this group of taxpayers are similar to those for sole-proprietors or whether a different approach would be desired.

Thirdly, this research's conceptual framework demonstrates steps to manage compliance risks whilst applying enforcement strategies responsively in the process. It is suggested that future research could test the framework to the IRBM's actual practice. This would provide insights into the practical application of risk-based concepts into the risk management processes suggested by the EC and the OECD to determine whether the conceptual framework could be put into operation not only by the IRBM but also other tax administrations.

Fourthly and finally, going global, empirical investigation of tax administration in developing countries within the same region, such as Indonesia, Thailand, and Philippines, could be carried out for future research. This would establish whether the findings from this study are applicable in terms of risk management strategies and responsive regulation adoption in their administrations. Future studies from these countries may also ascertain if taxpayers from each country share similar non-compliance behaviour and attitudes; it would be interesting to explore the motivations behind the decision to evade the tax law.

9.6 Policy and practical recommendations

Findings from the study support views from the previous literature that voluntary compliance is influenced by efficient risk management strategies which adopt responsive enforcement approaches when responding to taxpayers' compliance behaviour. These findings could help the IRBM and other tax regulators to identify compliance risks and to carry out effective risk management strategies to improve compliance and ultimately increase revenue collection. The study proposes some risk-based measures that could be implemented by the IRBM, such as enhancing education programmes, improving procedures, establishing smart-partnerships with other agencies and adopting a shaming approach.

9.6.1 Enhancing education programmes

The literature suggests that trusting the government and the tax system may increase tax compliance. In this regard, the IRBM needs to demonstrate its competence to gain trust from the public regarding the efficiency of officials' when dealing with taxpayers. Thus, training and retraining of tax personnel are necessary to enhance their knowledge and skills regarding procedures and services to the taxpayers. The literature and data from interviews have highlighted the importance of IRBM officials upgrading and updating their technical knowledge and their treatment of taxpayers. The conceptual model designed in this study suggests responsive approaches to be adopted by IRBM personnel based on compliance risks posed by taxpayers. Tax personnel who treat taxpayers respectfully and discuss technical matters fluently may earn the respect and trust of taxpayers, a reciprocity effect which may contribute to improving compliance. Meanwhile, training should focus not only on providing technical knowledge of tax laws to the officials but also on applying the concept of responsive regulation

when dealing with taxpayers by maintaining interpersonal values such as professionalism, fairness, respect, friendliness and politeness. However, as suggested by the responsive regulation concept, officials could respond tit-for-tat and be firm in their conduct when dealing with recalcitrant taxpayers. The on-going and continued training may increase the competency of IRBM personnel and subsequently may gain the trust and respect of the public. Generally, people have a tendency to respond to other people in the way in which they were treated (Feld and Frey, 2005; McKerchar, 2003). Responsive treatment of taxpayers would establish reciprocity in taxpayers' positive response towards the IRBM.

As discussed in Chapter Eight, IRBM has taken the initiative to conduct various educational programmes to promote tax knowledge to the public. As education activities should be on-going and season-less activities, the IRBM could continue with the education programmes so that a wider range of taxpayers and locations could be included. As some participants commented, due to the insufficient number of staff, there are many remote locations which the IRBM is incapable of exploring to reach people. Media publicity, either through newspapers, radio, TV or websites, is the best channel of communication to distribute information about taxation to the public. Dissemination of knowledge through the mass media enables information to cover a wide range and to reach the most people.

In addition to media publicity, IRBM personnel could continue the education programmes by visiting taxpayers' premises to deliver tax education in person and to encourage face-to-face communication with the public. Taxpayers should also be informed of the policy and procedures implemented by the IRBM so that they are well-informed of any action it conducts and know what to expect from the

process. This information could also be delivered through other avenues, such as workshops and seminars as on-going educational activities to foster tax compliance. As business-income taxpayers are perceived as high-risk categories for non-compliance, tax education as facilitated by the BSU workshops is to be continued. Low attendance at the workshops indicates a lack of motivation on the part of taxpayers. To attract them to participate voluntarily in the education activity, ‘carrots’ could be used as incentives to motivate them.

9.6.2 Establishing collaboration with other agencies

With limited financial resources and workforce, it is rather difficult for the IRBM to ensure that detection of non-compliance can be implemented all over the nation. As suggested by the EC (2010) and discussed in Section 5.2, the IRBM may consider joining forces with other third parties to reach the public. By identifying organisations and associations which represent members who earn taxable income, the IRBM could obtain information about the members of the association for detection and education. In addition, networking with other agencies may assist in disseminating tax information to members of the association. Thus, the IRBM could work closely with associations representing traders, such as the Malay Chambers of Commerce, the Chinese Chambers of Commerce and other similar associations as most of the potential taxpayers, in fact high income earners, are within these groups.

Furthermore, to approach farmers and rubber tappers, the IRBM could collaborate with relevant associations, such as the Federal Land Development Authority (FELDA) and the Rubber Industry Smallholders' Development Authority (RISDA) which are responsible for the oil palm smallholders and rubber industry

smallholders respectively. With the increase in oil palm and rubber prices, the income earned by most oil palmers and rubber tappers was more than that earned by civil servants. Besides catching these people in the tax net, the imposition of tax on these groups of people may perhaps increase the tax morale of civil servants and other taxpayers; this treatment by the IRBM appears to be one of procedural justice and IRBM personnel would appear to treat all taxpayers fairly (Feld and Frey, 2005).

Nevertheless, the IRBM may consider setting-up a small unit to initiate an exploration of cash economy activities in Malaysia. To overcome the issue of insufficient manpower, the IRBM may jointly organise exploration activities with other relevant public agencies, such as the Customs Department which investigates smuggling activities, the Immigration Department which investigates activities where foreign individuals are involved and the Small-Business Registrar Division which ensures that businesses are registered. Collaboration between the Central Bank of Malaysia, the Malaysian Royal Customs Department and the IRBM in 2011 to eradicate money laundering and illegal operations has proved that such cooperation is necessary to prevent tax evasion. As depicted by the conceptual model (Figure 13), the shape of the lamp-shade may grow wider at the top if the IRBM fails to act on shadow economy non-compliance, which in future may grow bigger and become more difficult to manage.

As a government agency, the IRBM could initiate government-to-government interaction by sharing information about taxpayers. IRBM could request that the government introduces a policy whereby other public sectors, such as the Road Transport Department, the Land Offices, the Housing Department and other relevant agencies, channel information to the IRBM online when members of the

public are involved in selling and purchasing luxury vehicles or dealing in sales and purchases of land and properties.

Furthermore, tax practitioners are the people who work closely together with taxpayers and are responsible for advising their clients on their tax obligation. By having good relationships between IRBM and tax practitioners, the IRBM could take the opportunity to influence tax practitioners to encourage their clients to report accurately and pay promptly.

Recognising the importance of having third-parties to support the IRBM in its mission to improve tax administration in this country, the Board could take the initiative to identify suitable partners to form these smart-partnerships and establish strategic alliances in improving the tax system in Malaysia.

9.6.3 Improving procedures

The IRBM could review and revise some of its procedures regularly to improve its service delivery. Taxpayers satisfaction with the services rendered may influence their tax morale and may contribute to an increase in compliance. Some of the work processes, such as the refund of overpayments, could be executed faster so that taxpayers would not only be happy to get their money back, but would also trust and respect the IRBM for its efficient service. Subsequently, these taxpayers would always be willing to pay their tax obligation in future and would submit their return promptly because they trust that the system will return their money faster if there is any credit available.

With the introduction of e-Filing in 2006, the time taken to process refunds has improved tremendously. Prior to e-Filing, the average time taken to process refunds was about three months, but with e-Filing, the time taken has been

reduced to one month. The IRBM could reduce the time taken to make refunds if more research on the refund process is done. Another suggestion by participants was the simplification of return forms to ease the form filling process for taxpayers. To promote voluntary compliance, the IRBM could constantly review and simplify the tax rules and procedures to help taxpayers comply with the regulation easily and effortlessly.

9.6.4 Adopting a shaming approach

It is interesting to note that shaming techniques (Kornhauser, 2007; Devos, 2009; Braithwaite, 2011) implemented by a few tax agencies, especially in the United States, have proved an effective means to ‘punish’ delinquent taxpayers for failing to comply with the law. Even though this approach may appear harsh because the publicity may tarnish the good image of the taxpayer, other taxpayers may begin to trust the tax system and respect the tax authority for being fair in their treatment. Moreover, this technique will be more effective if the person ‘shamed’ by the publicity is a public figure, such as a politician, celebrity, or sportsperson. Even though this action may appear to discriminate against the taxpayer, it may also instil awareness in the public that the law is fair and gives equal treatment to all, regardless of social status.

To the developed countries, the shaming mechanism may be a common action to be practiced by the authorities. However, this method may not be suitable for implementation by tax administrations in developing countries. This is due to a different culture and public perceptions towards defaming people in the public (Yong, 2011). Shaming politicians may be a major concern in some societies and bad publicity for a celebrity may upset her/his fans, which may lead to the public condemning the tax authorities for their ‘inhumane’ treatment, and eventually

may reduce tax compliance. In the Malaysian context, for the IRBM to pursue the shaming approach, further study needs to be conducted, especially on Section 138 of the ITA, which concerns publicising a person's details that are considered to be classified.

9.7 Conclusion

The present study has attempted to add to the existing literature through discussion of the Malaysian tax administration's management of risk after implementation of SAS. This study particularly explores the internal and external risks faced by the IRBM and provides important insights and knowledge on how risks are managed by the Board. The study of the IRBM current risk management practice provides a platform for other tax administrations, particularly in developing countries, to obtain insights into how the Malaysian tax administration applies a responsive approach, such as taxpayer education programmes, to encourage voluntary compliance in SAS in Malaysia.

Findings from the study also establish that the IRBM, as a responsive regulator, uses appropriate responsive risk management strategies to cross the compliance boundary and move taxpayers into the compliance zone. Further, the study has shed light on the responsive relationship between key actors in the Malaysian tax administration: the IRBM, tax practitioners and taxpayers, which shape the fairness, efficiency and integrity of the tax system in Malaysia.

Finally, the 'lamp-shade' model developed in this study portrays appropriate responses by regulators in managing compliance risks by regulatees. The conceptual framework shows the links between the three major strands of the study: tax compliance, risk management and responsive regulation. The study

indicates a significant relationship between the themes which are essential to ensure a higher tax compliance rate under the SAS. Contributions of this study may add knowledge to other regulators in formulating enforcement strategies to encourage voluntary compliance in their organisation.

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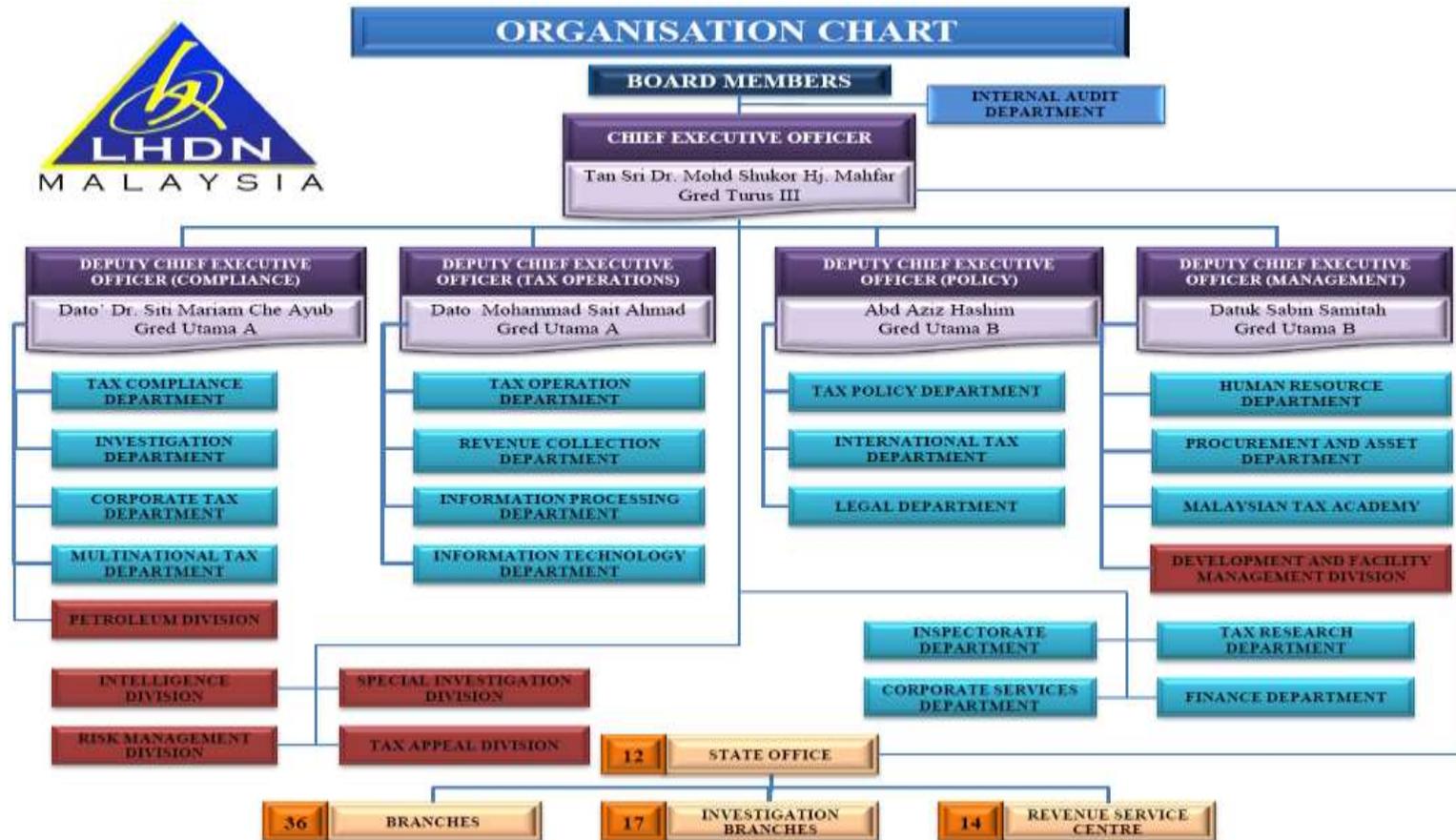
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Appendix 1: Organisation Chart of the Inland Revenue Board of Malaysia



Appendix 2: Offences, Fines and Penalties

Type Of Offences	Provisions Under ITA 1967	Amount of Fine (RM)
Failure (without reasonable excuse) to furnish an Income Tax Return Form.	112(1)	200 to 2,000 / imprisonment / both
Failure (without reasonable excuse) to give notice of chargeability to tax.	112(1)	200 to 2,000 / imprisonment / both
Make an incorrect tax return by omitting or understating any income.	113(1)(a)	1,000 to 10,000 and 200% of tax undercharged
Give any incorrect information in matters affecting the tax liability of a taxpayer or any other person.	113(1)(b)	1,000 to 10,000 and 200% of tax undercharged
Wilfully and with intent to evade or assist any other person to evade tax.	114(1)	1,000 to 20,000 / imprisonment / both and 300% of tax undercharged
Assist or advise (without reasonable care) others to under declare their income.	114(1A)	2,000 to 20,000 /imprisonment / both
Attempt to leave the country without payment of tax.	115(1)	200 to 2,000 /imprisonment / both
Obstruct any authorized officer of IRBM in carrying out his duties.	116	1,000 to 10,000 / imprisonment / both
Fails (without reasonable excuse) to comply with an order to keep proper records and documentation.	119A	300 to 10,000 / imprisonment / both
Fails (without reasonable excuse) to comply with a notice asking for certain information as required by IRBM.	120(1)	200 to 2,000 /imprisonment / both
Fails (without reasonable excuse) to give notice on changes of address within 3 months.	120(1)	200 to 2,000 /imprisonment / both

Payment of Income Tax

Type of Offences	Source of Income	Provisions Under ITA 1967	Penalties
Pay taxes after 30th April.	Non-Business	103(3)	a. 10% increment from the tax payable, and b. Additional 5% increment on the balance of (a) if payment is not made after 60 days from the final date
Pay taxes after 30th June.	Business	103(4)	

Payment of Estimated Income Tax (For Business Income)

Type of Offences	Provisions Under ITA 1967	Penalties
Pay instalments after 30 days of the date set.	107B(3)	10% on instalment due
Actual tax 30% higher than the revised estimate of tax.	107B(4)	10% of the difference in actual tax balances and estimated tax made

Source: Income Tax: Offences, Fines & Penalty. (URL: http://incometax.my/law/Offences_Fines_and_Penalties.htm)

Appendix 3: List of Interviewees

	Interviewees	Code name	Data Capture
1	State Director	RL1	T
2	Senior Executive HQ	RL2	T
3	State Director	RL3	T
4	Branch Director	RL4	T
5	Department Director	RL5	T
6	State Director	RL6	T
7	Branch Director	RL7	T
8	Department Director	RL8	T
9	State Director	RL9	T
10	Branch Director	RL10	T
11	Unit Head	RL11	T
12	Tax Auditor	RL12	W
13	Senior Executive HQ	RL13	T
14	Deputy Branch Director	RL14	T
15	Branch Director	RL15	T
16	Department Director	RL16	NT
17	Deputy Head of Division	RL17	NT
18	Unit Head	RL18	W
19	Head of Division	RL19	NT
20	Division Executive	RL20	NT
21	Head of Division	RL21	NT
22	Desk auditor	RL22	NT
23	Field auditor	RL23	NT
24	Field auditor	RL24	NT
25	Desk/Field auditor	RL25	NT
26	Field auditor	RL26	NT
27	Executive	RL27	NT
28	Head of Division	RL28	NT
29	Department executive	RL29	NT
30	Division executive	RL30	NT
1	Tax Practitioner	RT1	W
2	Tax Practitioner	RT2	W
3	Tax Practitioner	RT3	T
4	Tax Practitioner	RT4	T
5	Tax Practitioner	RT5	W
6	Tax Practitioner	RT6	NT

Data Capture: Interview recorded on tape – T
 Interview without the tape on – NT
 No interview but written responses were submitted – W

Appendix 4: Guide for interview with IRBM officials

1. Before the interview

- Choose a suitable place for interview.
 - Interviews will be held at the interviewees office room
- Explain the purpose of the interview
- Assure about confidentiality
- Explain about the format of the interview
 - A one-hour interview
 - A conversational interview
 - Ask permission to use tape recorder
- Allow interviewee to clarify any doubts about the interview
- Get the tape ready

2. During the interview

Interview questions

A. Preliminary questions

- How long have you been in service with IRBM? And how long are you in this current post?

- As a how would you describe the work you do?

- Could you please tell me a bit about your previous post and experience?

B. Challenges

- What are the types of taxpayers or activities that caused major concerned for you in your daily working activities?

- Would you explain how you handled the issues?

- Is there any procedure or pre-plan action that you refer to?

-
- Do you anticipate any work-related challenges which might occur in the near future?

- If yes, please explain what are the challenges?

- Do you make any preparation in anticipation of the challenges?

C. Taxpayers' education

- What is your view on the taxpayers' education programs organized by IRBM?
-

- Do you feel that the activities are enough, or more should be done?
-

- In your opinion, do you think the objective of the programs is achieved?
-

- From the year the programs started until now, which is for years, do you feel there is any changes in the taxpayers perception towards tax education, is there any increase in compliance due to the education activities?
-

- Are you satisfied with the education programs?

- If yes, details? If no, why not?

- In what way do you think that it can be improved?
-

- Is there any education programs/activities implemented by your department/branch other than those conducted by the HQ level?
-

D. Compliance

Before we discuss further about compliance, let's have the same understanding of what compliance means.

- In your daily practice, what do you think compliance means?

- In your branch, what is the rate of non-compliance?

- Do you think the rate is high or low or acceptable? Why?

- What type of non-compliance that has the highest %; and why do you think the ... type is higher compared to other types of non-compliance?

- Why do you think taxpayers refuse to comply with the tax regulations?

- Do you feel that what is done by IRBM now is enough or more should be done?

- What do you think we should do to encourage compliance?

- Does IRBM identify different categories of taxpayers in its compliance strategies?
 - If yes, what are the categories? What special strategies are taken for each category?

 - If no, why are the taxpayers not categorized into different types of compliance?

 - The ATO, HMRC, NZIR and other tax administrations have identified different types of taxpayers so that different strategies can be taken for different types of taxpayers. Do you feel it is necessary for IRBM to take similar actions?

- What do you think the taxpayers would require from the IRBM in order to comply with the tax regulation?

- How do you allocate resources for taxpayer education and taxpayer compliance?
 - How do you decide who get prioritised?

E. Self-Assessment System

- Some literature note that SAS leads to poorer tax compliance because it opens the opportunity for taxpayers to under declare their income and understate their tax liability. What is your opinion of this statement?

- IRBM has implemented SAS for individual taxpayers for 5 years now. In your opinion, is there any improvement in taxpayers' compliance compared to the Formal Assessment System?
 - If yes, what are the improvements?

- If no, why is there no improvement?

- What more are needed to be done?

- With the introduction of self-assessment system and e-Filing, is there any changes in your practise?

- One of the elements which contribute to the success of SAS implementation in Japan is a very efficient computerized system for data processing and data

storage. Do you think IRBM's computer system is as efficient and helpful in the implementation of SAS?

- If no, what is lacking?
-

- According to the e-Filing statistics, 31% of taxpayers submitted the form online. What do you think should be done more by IRBM to encourage 69% of taxpayers to submit through e-Filing?
-

F. Self-regulation

- What do you think would make a good relationship with the IRBM?
-

- Do you think by having a good relationship with the taxpayers, non-compliance can be reduced?
-

- In your view, by having a relationship with the taxpayers, they will be more cooperative?
-

- Will enforcement be hard to do if you have good relationship with the taxpayers?
-

- Is there any difference in calling the taxpayer a 'customer' than a 'taxpayer'?
-

- What is your opinion of self-regulation in Malaysia tax administration?
-

- Do you think Malaysia taxpayers are ready for self-regulation?

- If not, when do you think they will be ready?
-

- What do you anticipate from the self-regulation?
-

- What need to be done by IRBM to encourage self-regulation?
-

- How do you view the taxpayers would think of the situation?
-

G. Tax administration in developing countries

- Most of the research on taxpayer compliance and behaviour has been done in western countries. In your opinion, do you think Malaysia has different problems from the western countries?

- If yes, what are the differences?
-

- In some developing countries, non-compliance is a serious problem due to insufficient tax services and enforcement activities. Do you think Malaysia also has these issues?
-

- What do you think make IRBM different from tax administrations in other developing countries?
-

- One of the reason that determine the high level of compliance in some western countries and Japan is the active utilization of penalty provisions on delinquent taxpayers, compared to some developing countries which applied the provision inconsistently. Hence the lower rates on compliance in those

countries. Do you think IRBM is similar with other developing countries in the penalty imposition context?

- If yes, why do you think it is difficult to apply the penalty provision in this country?
-

- Do you feel that penalties imposed are tough enough for taxpayers who refuse to comply?

- If no, what are your suggestions?
-

- Many researchers discover that other issues faced by tax administrations in developing countries are corruption, inefficient administration, inefficiency in allocation of resources, complex tax systems and lack of professionalism, among other things. Do you agree with these findings?

- Do you think IRBM has similar issues?
-

- If yes, what do you think should be done to overcome these issues?
-

- If not, what make IRBM different?
-

H. Compliance model

- Have you ever come across or aware of any compliance model used by other tax administrations?
-

- If yes, ask which models that they have seen?

- Do you see the compliance model as relevant to IRBM generally and to your work in particular?

-
- Do you use its principles in your current practice?
-

- Do you think IRBM should adopt the model?
-

- What can be improved from the model to conform to Malaysia environment?
-

- If not, explain briefly about the compliance model.
 - In your opinion, what will be the advantages by having a model?
-

- Do you think IRBM needs to have a compliance model?
-

I. Others

- If you could give your own impressions as to how things are going now, compared to the past 5 years, in terms of taxpayers compliance and revenue collection?
-

- What likely do you think would happen in the next 5 years?
-

- What do you think could be done differently?
-

3. After the interview

- Check the list to see if there is any question not asked.
- Ask if they have any questions or would like to add further on the subject discussed before.
- Get their approval to be contacted later either through telephone or e-mail if further clarification is required.

Appendix 5: Guide for interview with tax practitioners

Thank you for agreeing to spend your time to answer the questions. Rest assured that your identity will be anonymous and the answers given will be used for the thesis only and will be treated as strictly confidential.

Interview questions

Preliminary questions

- Please tell me the post that you are holding now and how long have you been holding the current post?

- As a how would you describe the work you do?

- Could you please tell me a bit about your previous post and experience?

A. Tax practitioner

- As a tax practitioner, what are your roles toward your clients?

- It was said that since the implementation of SAS, tax practitioners are having bigger roles to play in tax compliance.
 - Do you agree with this claim?

- What are the additional roles that you have to play?

- A survey on Malaysia SAS has reported that 95% respondents said that SAS for corporate taxpayers has not been implemented effectively in Malaysia.
 - Do you agree with this report?
 - If yes, why do you think that the implementation is not effective?

- What would you like to recommend to the IRBM so that SAS would be more effectively managed?

- Do you feel that SAS for individual taxpayers has the same issues?

- The survey also indicated that the relationship between tax authorities and tax practitioners has not improved.

- Why do you think the relationship has not improved?

- Normally, what are the issues arises when dealing with the IRBM?

- What do you think should be done between both parties to improve the relationship?

- Studies have shown that one of the factors that influence tax practitioners' behaviour is clients' pressure on tax practitioner to act unethically to reduce their tax liability.

- What is your opinion of this finding?

- Practitioners have a duty both to their clients and to the system to insure taxpayers are complying with tax laws and filing complete and accurate tax returns.

- What is your comment on this statement?

- What are tax compliance complexities faced by tax practitioners when representing their clients?

B. Challenges

- What are the types of taxpayers or activities that caused major concern for you in your daily working activities?

- Would you explain how you handled the issues?

- Is there any procedure or pre-plan action that you refer to?

- Do you anticipate any work-related challenges which might occur in the near future?
 - If yes, please explain what are the challenges?

Do you make any preparation in anticipation of the challenges?

C. Taxpayers' education

- What is your view on the taxpayers' education programs organized by IRBM?

- Do you feel that the activities are enough, or more should be done?

- In your opinion, do you think the objective of the programs is achieved?

- From the year the programs started in 2001 until now, which is for 9 years, do you feel there is any changes in the taxpayers perception towards tax education, is there any increase in compliance due to the education activities?
-

- Are you satisfied with the education programs?
 - If yes, details? If no, why not?
-

- In what way do you think that it can be improved?
-

D. Compliance

Before we discuss further about compliance, let's have the same understanding of what compliance means.

- In your daily practice, what do you think compliance means?

- Why do you think taxpayers refuse to comply with the tax regulations?

- Do you feel that what is done by IRBM now is enough or more should be done to encourage compliance?

- As a tax practitioner, what do you think should be done to encourage compliance?

- The ATO, HMRC, NZIR and other tax administrations have identified different types of taxpayers so that different strategies can be taken for different types of taxpayers. Do you feel it is necessary for IRBM to take similar actions?

- What do you think the taxpayers would require from the IRBM in order to comply with the tax regulation?

E. Self-Assessment System

- Some literature note that SAS leads to poorer tax compliance because it opens the opportunity for taxpayers to under declare their income and understate their tax liability. What is your opinion of this statement?

- IRBM has implemented SAS for individual taxpayers for 5 years now. In your opinion, is there any improvement in taxpayers' compliance compared to the Formal Assessment System?

- If yes, what are the improvements?

- If no, why is there no improvement?

- What more are needed to be done?

- With the introduction of self-assessment system and e-Filing, is there any changes in your practice?

- One of the elements which contribute to the success of SAS implementation in Japan is a very efficient computerized system for data processing and data storage. Do you think IRBM's computer system is as efficient and helpful in the implementation of SAS?

- If no, what is lacking?

- According to the e-Filing statistics, less than 50% of taxpayers submitted the form online. What do you think should be done more by IRBM to encourage more taxpayers to submit through e-Filing?
-

F. Self-regulation (voluntary compliance)

- What do you think would make a good relationship between the taxpayers and the IRBM?
-

- Do you think by having a good relationship with the taxpayers, non-compliance can be reduced?
-

- In your view, by having a relationship with the taxpayers, they will be more cooperative?
-

- Do you think enforcement would be hard to do if IRBM has a good relationship with the taxpayers?
-

- Is there any difference in calling the taxpayer a ‘customer’ than a ‘taxpayer’?
-

- What is your opinion of self-regulation in Malaysia tax administration?
-

- Do you think Malaysia taxpayers are ready for self-regulation?
 - If not, when do you think they will be ready?
-

- What do you anticipate from the self-regulation?

- What need to be done by IRBM to encourage self-regulation?

- How do you view the taxpayers would think of the situation?

G. Tax administration in developing countries

- Most of the research on taxpayer compliance and behaviour has been done in western countries. In your opinion, do you think Malaysia has different problems from the western countries?
 - If yes, what are the differences?

- In some developing countries, non-compliance is a serious problem due to insufficient tax services and enforcement activities. Do you think Malaysia also has these issues?

- What do you think make IRBM different from tax administrations in other developing countries?

- One of the reason that determine the high level of compliance in some western countries and Japan is the active utilization of penalty provisions on delinquent taxpayers, compared to some developing countries which applied the provision inconsistently. Hence the lower rates on compliance in those countries. Do you think IRBM is similar with other developing countries in the penalty imposition context?

If yes, why do you think it is difficult to apply the penalty provision in this country?

- Do you feel that penalties imposed are tough enough for taxpayers who refuse to comply?

- If no, what are your suggestions?
-

- Many researchers discover that other issues faced by tax administrations in developing countries are corruption, inefficient administration, inefficiency in allocation of resources, complex tax systems and lack of professionalism, among other things. Do you agree with these findings?

- Do you think IRBM has similar issues?
-

- If yes, what do you think should be done to overcome these issues?
-

- If not, what makes IRBM different?
-

H. Compliance model

- Have you ever come across or aware of any compliance model used by other tax administrations?
-

- If yes, ask which models that they have seen?

- Do you see the compliance model as relevant to IRBM generally?
-

- Do you think IRBM should adopt the model?
-

- What can be improved from the model to conform to Malaysia environment?
-

- In your opinion, what will be the advantages by having a model?
-

- Do you think IRBM needs to have a compliance model?
-

I. Others

- If you could give your own impressions as to how things are going now, compared to the past 5 years, in terms of taxpayers compliance and revenue collection?
-

- What likely do you think would happen in the next 5 years?
-

- What do you think could be done differently?
-

- Please add, if you have any additional information to talk about.
-

Thank you so much for your time and contribution.

Marhaini Mahmood
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Appendix 6: List of Themes

Major Themes	1st Level Sub-Theme	2nd Level Sub-Theme
Risk Management	Challenges	<ul style="list-style-type: none"> • Financial resources • Insufficient information • Shortage of staff
Tax Compliance	Compliance	<ul style="list-style-type: none"> • Non-Compliance issues • Compliance pyramid • Encouragement
Risk Management	Operational issues	
Risk Management	Organizational Culture	<ul style="list-style-type: none"> • Integrity • Professionalism • Skills • Staff attitude
Risk Management	Risk	<ul style="list-style-type: none"> • New industries • Shadow economy • Technology
Risk Management/ Responsive Regulation	Risk-based Regulation	<ul style="list-style-type: none"> • Risk-based strategies • Risk-based tools/models
Risk Management/ Responsive Regulation	System	<ul style="list-style-type: none"> • e-Filing • Information Technology • Penalty provision • Self-assessment
Risk Management/ Tax Compliance	Tax administration	<ul style="list-style-type: none"> • Developed countries • Developing countries • Malaysia
Tax Compliance	Tax practitioners	<ul style="list-style-type: none"> • Duties • Ethics • Issues with IRBM
Tax Compliance	Taxpayer behaviour	
Responsive Regulation	Taxpayer education	<ul style="list-style-type: none"> • Education programmes • Publicity • Taxpayers friendly

Appendix 7: Amount of tax collected, Number of return forms received and number of registered: Individual Taxpayers*

Year	Total revenue collected (RM billions)	Total number of return forms received (millions)	Total number of newly registered
2004	9.47	2.06	NA
2005	10.22	2.73	NA
2006	10.41	2.64	285,008
2007	11.59	2.64	230,658
2008	14.35	2.48	296,873
2009	15.57	2.59	250,228
2010	17.08	2.66	331,826
2011	19.38	2.74	446,200
2012	22.96	2.93	606,872

*For employment-income and business-income taxpayers

NA- Not Available

Source: i) Internal report (2013) from Tax Operation Department, IRBM.
ii) IRBM Annual Report (2005, 2006, 2010).