THE DRIVERS OF TAX AVOIDANCE IN MALAYSIA

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Introduction

Tax avoidance refers to the legal practice of using various strategies and mechanisms to minimise the amount of taxes owed to the government. This is achieved by exploiting loopholes, deductions, exemptions, and other provisions in tax laws to reduce taxable income. Unlike tax evasion, which involves illegal activities such as under-reporting income or inflating deductions, tax avoidance operates within the boundaries of the law.

Tax avoidance has been a persistent issue in Malaysia because it involves legal strategies that let taxpayers reduce their tax payments (Hamzah et al., 2021). Each year, tax avoidance cases in Malaysia have increased, leading to lower national revenue (Mohamad Ariff et al., 2024). To combat this, Lembaga Hasil Dalam Negeri (LHDN) has set higher tax collection targets and increased audits of individuals and companies (LHDN, 2017). The government has also introduced fines and penalties to reduce tax avoidance and encourage compliance, as these measures effectively control tax avoidance and evasion (Hassan et al., 2021). Incorrect tax filings, like under-reporting or over-reporting income, can result in fines and penalties. However, the Income Tax Act 1967 does not impose fines or penalties for tax avoidance, as it is considered legal tax planning.

Tax avoidance is a significant issue in Malaysia, as highlighted in an article from the New Straits Times titled "IRB: 80,000 individuals did not pay tax" (dated 13 Nov 2018). The article reveals that many taxpayers do not comply with tax laws and engage in tax avoidance and evasion. Understanding the factors that drive such behaviour is essential for developing effective tax policies and enforcement strategies.

In addition, the tax evasion provision still allows for planning through tax avoidance schemes, as demonstrated in the 1999 case of the Inland Revenue Board (IRB) director general versus Rakyat Berjaya Sdn Bhd. The federal court judge clearly expressed this.

> 'Everyone is trying his best within the law to pay as little tax as possible. All kinds of schemes are thought of. No commercial person in his right sense will carry out commercial transactions except on the footing of paying the smallest amount of tax involved. There is nothing wrong with a company organising its affairs in such ways as to minimise tax.'
> (Sunday Star, 2021)

The statement suggests that tax avoidance is considered a legal method of decreasing the amount of income tax individuals or businesses must pay. However, tax avoidance can be classified as aggressive tax planning, which can lead to significant government tax revenue losses, as Prof Emeritus Dr Barjoyai Bardai from Universiti Tun Abdul Razak emphasised. The most extreme form of tax planning is "willful evasion," as defined in section 114 of the Income Tax Act 1967.

Literature Review
The factors affecting tax avoidance can be broadly categorised into several key areas:

- High Tax Rates and Compliance
  John and Enoch (2013) argue that high tax rates are a primary factor influencing taxpayers' reluctance to comply with tax laws. When tax rates are perceived as too burdensome, individuals and businesses may seek ways to legally minimise their tax liabilities through tax avoidance or even resort to illegal tax evasion. This behaviour undermines the effectiveness of the tax system and reduces the government's revenue.

- Transparency and Government Spending
  Another crucial factor is the transparency of government spending. John and Enoch (2013) suggest that a lack of transparency in how collected taxes are utilised can drive tax avoidance. Taxpayers are more likely to comply with tax laws when they perceive clear benefits from their tax contributions. If the government does not effectively communicate how tax revenues are being used to benefit the public, taxpayers may feel justified in avoiding taxes.

- The Role of Tax Education and Knowledge
  Tax education and knowledge are also critical in preventing tax avoidance. Research by Ghani et al. (2021) and Remali et al. (2020) indicates that a lack of tax knowledge leads to unawareness of the consequences of non-compliance. Educating taxpayers about their obligations and the importance of tax compliance can reduce instances of tax avoidance. When individuals understand the impact of their contributions to public services and infrastructure, they are more likely to comply with tax laws.

- Complexity of the Tax System
  The complexity of the tax system is another significant factor influencing tax avoidance. According to Leon et al. (2020) and Deyganto (2018), a complicated tax system can discourage compliance. When tax laws are difficult to understand, and the e-filing process is cumbersome, as noted by Ibrahim (2016), taxpayers face higher compliance costs. These costs can be a burden, leading individuals and businesses to seek ways to avoid taxes.

- Compliance Costs
  High compliance costs are a notable factor driving tax avoidance. Studies by Eragbhe and Modugu (2014) and Marimuthu and Lee (2022) show that the burden of complying with complex tax regulations can lead to increased tax avoidance. When the cost of complying with tax laws outweighs the perceived benefits, taxpayers are more likely to engage in avoidance behaviours.

Conclusion
Various factors, including high tax rates, lack of transparency in government spending, insufficient tax education, and the tax system's complexity, influence tax avoidance in Malaysia. Addressing these issues requires a multi-faceted approach, including simplifying tax regulations, improving taxpayer education, increasing transparency in government spending, and adjusting tax rates to balance revenue needs with taxpayer compliance. By tackling these, Malaysia can enhance tax compliance and reduce the prevalence of tax avoidance. In addition, understanding these factors is also crucial for policymakers to design effective tax systems and enforcement strategies that minimise tax avoidance and ensure fair and efficient tax collection that creates a good and friendly environment in tax planning.

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