

Exploring the Factors that Contribute to Tax Compliance in Malaysia

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Introduction

Tax collection contributes more than 50% of the Malaysian government revenue and is considered the main source of income in Malaysia (Nor Aziah 2023; Norul et al. 2021). There are two categories of tax administration in Malaysia, namely direct taxes and indirect taxes. The Inland Revenue Board (IRB) is responsible for collecting direct taxes, while the Royal Malaysian Customs (RMC) handles indirect tax collection. The revenue collected from these two types of taxes is the main source and important instrument of government revenue. According to Hakim (2024), revenue collected from taxpayers, especially by authorities such as the IRB, is important for the development and stability of Malaysia.

As tax collection represents a primary source of revenue for the Malaysian government, any loss resulting from tax evasion by individuals may lead to substantial financial implications, thereby impacting the overall quality of life of the population. As noted by Norul et al. (2021), tax non-compliance is reflected in the yearly increase in penalty collections and the growing number of travel restrictions imposed on defaulters.

Although firm action has been taken by the IRB, the problem of tax non-compliance among individual taxpayers is still persistent (Norul Syuhada et al. 2023). In addition to data on individuals who were blocked from traveling abroad, the LHDN also managed to detect 31,598 entities that failed to report their actual income (23,751 were individuals) in 2022. This issue has led to the amount of leakage estimated at RM655 million and this situation has a negative impact on the national economy.

Based on this problem, tax compliance is an important agenda that is given attention by both tax administrators, whether it is the IRB or the RMC, especially after voluntary compliance through self-assessment is implemented.

Tax compliance is defined as the willingness of taxpayers to pay the taxes they must pay. Non-compliance is the failure of an individual to register, submit tax forms within the specified period, report the correct amount of income, claim the correct relief, deduction or rebate, and pay all taxes on time (Muhammad et al. 2016). Non-compliance affects the country's sources of finance because revenue collection will decrease.

Previous studies have identified several factors that influence tax compliance, including:

1. Tax Knowledge

Tax knowledge refers to a person's perception of their ability to comply with tax laws, which includes general and technical tax knowledge (Salawati et al. 2021). When society understands tax laws, then knowledge about the need to pay taxes can be increased. It is a situation where taxpayers fully understand that they need to pay taxes and comply with the law. Tax compliance can be increased by increased tax knowledge (Shahnaz et al. 2022). Individuals whose knowledge of taxes is higher are certainly different from lower knowledge. Taxpayers who have knowledge of tax procedures, processes and are aware of the existing tax system have more positive behaviour towards voluntary tax compliance.

2. Tax Education

Tax education is needed by every individual in terms of tax rates, deductions, exemptions, rebates before paying taxes (Nadiyah et al. 2022). Tax education is the main source for increasing tax knowledge in terms of laws and processes. Tax education is considered an important factor in ensuring tax compliance among taxpayers (Shahnaz et al. 2022). Tax education is a significant technique in increasing compliance in both present and future individuals who pay taxes. According to Abbas et al. (2021), tax education initiatives increase awareness of taxes and subsequently increase tax compliance. Through education, taxpayers can obtain better information, understand how the tax system works and subsequently produce more voluntary tax compliance (Yusri et al. 2021).

3. Tax Awareness

Ratnawati et. al (2019) explains tax awareness as an attitude that involves views, beliefs, reasoning and knowledge which will influence a person's attitude to comply with paying taxes. Tax awareness benefits taxpayers because it increases their knowledge of the tax system to calculate, declare income and pay taxes using the existing system. When tax awareness is low, the individual is likely to refuse or avoid paying taxes either intentionally or unintentionally. Mostly taxpayers are aware of many taxation issues especially changes in tax provisions and relief, due date of submission tax returns, tax avoidance and tax evasion. It is good when taxpayers have tax awareness because it can increase their understanding of the tax system, so they can declare their income, calculate and then pay taxes to the government. Moreover, individuals who are lack tax awareness are more likely to avoid paying taxes than those who have a high level of tax awareness. Due to lack of tax awareness, half of taxpayers do not report the tax amount correctly (Nadiyah et al. 2022).

4. Tax Morale

Tax morale refers to an individual's attitude and behavior towards paying taxes and complying with the tax system. Tax morale is described as one element in tax morale is religion because it is a motivation to pay taxes and increase awareness of paying taxes (Siti Fatimah et al. 2022). Taxpayers are intrinsically motivated to pay taxes or if they fail to do so they will feel guilty and ashamed. According to Siti Norhazwani et al. (2023), tax morale is measured by an individual's attitude towards paying taxes or evading taxes. Paying taxes reflects both a belief in the value of contributing to society and a feeling of moral duty. High tax morale will contribute to high tax compliance.

5. Penalty Enforcement

Penalties imposed are one of the strategies in most tax authorities to address tax non-compliance problems (Norul Syuhada et al. 2023). Tax penalties are fines imposed on individuals who do not comply with the implemented tax rules and regulations. Penalty enforcement has also been found to contribute to tax compliance behavior (Haryanti et al. 2024). Taxpayers do not care about the need to pay and do not comply with paying taxes if they are not aware of the offense. Taxpayers will fulfil their tax obligations if their level of awareness of penalties is higher.

6. Probability of Tax Audit

Audit is a review process or examination of an individual or organization's accounts and financial information. Soliha et al. (2022) defined tax audit as a systematic review of documents, business records and systems and commercial data stored by an auditee directly or indirectly involved in the tax payment process. This task is performed to ensure that taxpayers have reported correct information according to the tax laws and to verify the accuracy of the reported amount. According to Nivakan et al. (2023), taxpayers will be highly compliant with the tax system if they find that they will be highly caught or detected committing fraud.

Conclusion

Tax compliance has been an agenda to focus by government, tax authorities and society. For government, collection of tax is important to develop the nation and country. The issue of tax non-compliance can threaten the integrity of a country's tax system and affect the quality of services that will be enjoyed by the people. The main source of national revenue comes from tax collection to develop the country. Even though the issue of tax compliance cannot be completely curbed, efforts to ensure that taxpayers do not run away from paying taxes must be made to increase the rate of tax compliance among the people. By understanding determinants of tax comply among taxpayers, policy makers will positively benefit and reduce non-compliance issue. Better compliance will lead to greater revenue and lower administrative cost.

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