

## The Role of Tax Authorities in Public Acceptance of Indirect Tax in Malaysia

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### ABSTRACT

From 1<sup>st</sup> September 2018, the reimplementing of the Sales and Service Tax (SST) was due to take effect replacing the Goods and Service Tax (GST). The nation opposed GST as they argued that it was an added burden to their already high living cost. As the government had to find an alternative source to collect tax revenue, the best solution will be implementing the Sales and Services Tax. In contrast to GST which was carried on a value-added concept, this new charge is only imposed at manufacturer stages. Therefore, the supply chain would result in higher charges, shifting from manufacturers to retailers and consumers. Although the Consumer Price Index (CPI) basket is taxable, it is just 38 per cent of the total products and services. According to the National Worry Index conducted by Emir Research Malaysia, most respondents believe that Sales and Services Tax failed to reduce the prices of goods and services. Hence, acceptance is vital to ensure the success of indirect tax. Therefore, the present study aims to examine tax authorities' role and public acceptance of SST in Malaysia. Data from 180 people living in Klang Valley were collected through a survey. To examine calculation and structural models, the Partial Least Square - Structural Equation Model (PLS-SEM) approach was adopted. This study's findings suggested that tax authorities' effectiveness, namely, the Royal Malaysian Customs Department (RMCD) and the Ministry of Domestic Trade and Consumers Affairs (KPDNHEP), influenced public acceptance. Furthermore, the adoption of SST requires tax transparency and public confidence in the government. The understanding of the government, in particular, is a critical problem because, as an acknowledgement of the SST, it goes beyond the direct range of the taxation authorities. The public should perceive that tax authorities are effective, transparent, and trustworthy in executing indirect tax. Malaysians would be more accepting if the government declares the revenues from the tax obtained, as well as spending the tax income wisely on public amenities. These findings have important implications for the government to understand public acceptance in SST. Transparency will enhance public confidence in the government. Malaysians have to perceive that the Malaysian tax authorities are useful and the tax must be transparent to give their full trust to the government.

**Keywords:** Acceptance, Goods and Services Tax, GST, Sales and Services Tax, SST, Tax Authorities

## INTRODUCTION

There are two components to the Malaysian tax system: direct and indirect taxes. The Inland Revenue Board of Malaysia (IRBM) managed the direct taxes. All direct taxes such as income tax (individual and corporate), petroleum income tax, real estate gains tax, and stamp duty shall be billed by the IRBM. In the meantime, indirect taxes were administered by the Royal Malaysian Customs Department (RMCD). The taxes are customs duties, excise duty, sales tax, tax on services and tax on goods and services (GST). Tax collections in 2017 represented nearly 80% of all income from the federal government. The key source was a direct tax which added to the overall income by 53.1 per cent. The second is an indirect tax, with a 26.9% share. Taxation is the central source of wealth in most countries (Bidin & Sinnasamy, 2018). An exemplary system of taxation will improve quality of life and contentment because the government has enough budget to provide its people with better infrastructure (Soseco, 2016).

Malaysia has seen an indirect shift in taxes from GST to the Sales and Services Tax. The public has been pessimistic about the introduction of GST in Malaysia. This is expressed in the survey carried out among 1,200 household members in the Consumer Sentiments Index (CSI), on their impressions of the general economy of Malaysia. The survey shows low people's trust between 2014 and 2017 (MIER, 2017). Amongst other reasons contributing to their frustration is the rise in living costs and the implementation of GST. The rising prices of goods led to a perception that indirect tax implementation is unfair (Ling, Osman, Muhammad, Yeng, & Jin, 2016). In general, consumers were concerned with the burden imposed on them with GST implementation (Syazwani, Fadzillah, & Husin, 2016). The Minister of Finance's announcement in the 2019 Budget revealed the RM19.4 billion GST refund kept by the previous government. This is one of the disappointments experienced by Malaysians as they discovered that businesses took advantage of the loopholes in indirect tax and the tax authorities.

As an alternative source of revenue for the country, the Prime Minister, Tun Dr Mahathir Mohamad explained that the government had to reimplement SST to replace GST (EY, 2018). There are various disputes regarding SST implementation. It burdens the public, on the one hand; but taxes are required for infrastructure and operating expenditures, on the other. The implementation of indirect tax in Malaysia received much attention worldwide as Malaysia is the only country that reverts to SST. GST was burdensome to the citizens and caused the overturned of the previous government in the last election. In other words, most in Malaysia rejected GST. Yet, in order to maximize income production, the new government needs to enact an indirect tax. Public acceptance of the implementation is essential to ensure its success. The tax system should be perceived as acceptable to encourage public acceptance. The Finance Minister, Mr Lim Guan Eng contended that SST is reimplemented because Malaysians' well-being is the government's main priority. Just 5,612 goods under the SST are subject to a 10% sales tax and 793 products to a 5% tax. Compared to GST, a total of 11,1197 number of goods were taxed at 6%. The government also agreed to increase the threshold for eateries from RM500,000 to RM1.5 million. Thus, prices at eateries are not hiked up (Kaos & Chu, 2018).

Recently, the Emir Research conducted a survey and found that more than half of the respondents thought SST failed to reduce the living costs. The prices of goods and services continue to increase even though GST was zero-rated. The survey findings are quite alarming as it contradicts the primary factor why the government reverted to SST. The Customs Department told media, only around 80,000 businesses had to pay SST compared to 472,000 businesses during GST. Therefore, the prices of goods and services should be lower under SST. Unfortunately, the real situation does not reflect what is on paper. Scholars, experts and the rest of society are discussing the introduction of indirect tax in Malaysia, in particular on how SST influences goods prices generally. End users fear that the costs of basic commodities are rising dramatically. The substantial rises in prices triggered by SST were seen as another public burden with the increasingly high cost of living.

The community approval of the tax implementation is a must to prevent rebellion, says Smith (1776). On paper, SST is explained better than GST in terms of the number of goods and services subjected to tax. In addition, the number of taxable businesses shrunk as well. The consumers pay taxes that are embedded in the prices of goods and services. The actual taxpayers for SST are manufacturers. The credibility of tax authorities is vital to ensure that SST implementation is smooth and efficient. This study focused on tax authorities' role in examining the perception of the public of indirect tax implementation in Malaysia. Since SST has been reintroduced recently, public adoption is constrained by empirical evidence. The 14<sup>th</sup> general election in Malaysia revealed the rejection of GST by Malaysians. Therefore, to cover the nation's income, the Government had to replace GST with SST. The results of the analysis should be revised on the adoption of indirect tax by the public. The information gathered from the survey among respondents on their perceptions of tax authorities may be useful for the government.

## **LITERATURE REVIEW**

### **Indirect Tax Authorities in Malaysia**

The two authorities involved in implementing the SST system are the Royal Malaysian Customs Department (RMCD) and the Ministry of Domestic Trade and Consumers Affairs (KPDNHEP).

#### **Royal Malaysian Customs Department (RMCD)**

One of the functions of RMCD is to formulate, implement and collect the National Indirect Tax. In addition, RMCD reviews the sales tax policy for the consideration of the Minister of Finance and makes decisions on implementation issues. RMCD also controls and monitors the implementation of SST, which includes registration and payment as well as monitoring revenue to ensure that each registrar complies with the provisions of the law. Furthermore, RMCD analyses industry risk by providing guidance as well as provides performance analysis of each industry using analytic data.

#### **Ministry of Domestic Trade and Consumers Affairs (KPDNHEP)**

This ministry's scope of work is not limited to determine and monitor the prices of essential goods, selling and supplying vital products and petroleum is regulated and supervised by the ministry as well. KPDNHEP also carries out consumer education, awareness and protection programs. Since 1<sup>st</sup> January 2017, KPDNHEP has enforced the Price Control and Anti-Profiteering (Mechanism to Determine Unreasonably High Profit for Goods) Regulations 2016 to curtail profiteering activities. The profit rate for the goods traded or sold is not fixed under this Legislation. The Ministry, however, has the framework to ensure that sellers' profit based on company data is fair.

For two types of commodities: foods and drinks, and household products; the Ministry has now enforced the regulations. Household commodities include non-durable products, including items for personal care. Priority is given to these goods as it impacts household expenses and the people's cost of living directly. However, the ministry will expand its enforcement on other goods and services according to need and suitability. Anyone who commits the act of making a disproportionately high profit is liable to be charged under the Price Control and Anti-Profiteering Act 2011 for profiteering. If convicted, an individual is liable to a fine not exceeding MYR100,000 or imprisonment for a term not exceeding three (3) years or both for the first offence. For second or subsequent offences, the offender is fined not exceeding MYR250,000 or imprisoned for a term not exceeding five (5) years or both.

When it comes to a corporation, it is liable to a fine not exceeding MYR500,000 for the first offence. While for the second or subsequent offences, a fine not exceeding MYR1.0 million.

### **Public Acceptance of Indirect Tax**

Indirect tax survivability depends on approval by the public (Asmuni, Yusoff, & Ses, 2017). History reveals we have never learned from all the errors we made. The uprising of the indirect tax reform happened in the 18th century when Henry David Thoreau was imprisoned for refusing to pay a poll tax (Casal, Kogler, Mittone, & Kirchler, 2016). The Greeks revolt against ENFIA in 2015 with the slogan, "Have Not, Pay Not" (Johardy Ibrahim, 2018). In Malaysia, a powerful government coup carried out tax rebellion because of GST resentment (Wong & Kee, 2018). The public disapproval of indirect fiscal adjustment was seen to be significant in this rejection. To fund national spending, tax is required to boost government revenues (Tabandeh, Jusoh, & Zaidi, 2012). A similar goal has been shared by most tax reforms worldwide. In order to promote the construction of infrastructure such as education, medicine, transport and communication, tax collections are essential (Riese, 2017). On 1<sup>st</sup> September 2018, SST replaced GST after the declaration of zero-rate tax on 1<sup>st</sup> June 2018. In the zero-rate era, the government lost a considerable amount of income. The government has re-introduced SST in Malaysia to fund many infrastructure projects. Many Malaysians yet again lament that the SST was reintroduced.

Malaysia's indirect tax reform to replace SST with GST may be considered a flop. GST's loss is mostly attributed to poor approval of the public (Wong & Kee, 2018; Talib, A.B., & Ishak, 2018). In order to ensure the survival of SST 2.0, the government should encourage success stories of tax reforms in other countries. For several years now, the United Kingdom's Value Added Tax (VAT) and New Zealand's GST exist. The principal explanation for this achievement was successful consultation in both countries to understand the issues and provide the public with well-versed tax knowledge (S. James & Alley, 2008). The governments of the United Kingdom and New Zealand provides the public with enough advantages with revenues from GST/VAT. VAT and GST were seen as being reasonable to the general public in the United Kingdom and New Zealand since their governments seemed transparent in declaring income profit and expenditures. Casal et al. (2016) also note that the openness of tax authorities will improve public acceptance. The Nigerian government has proposed that it reform its taxation structure in accordance with good tax policies to increase the generation of taxes (Aminu and Eluwa, 2014).

The nature of acceptance can be viewed from two different perspectives: optimistic and pessimistic. Optimism is a condition where the public positively accepts the implementation of tax by the government. A positive individual will take the tax as a more constructive outlook which gives more to society, instead of thinking taxes as an undesired bill (Thornton, Akin, Branscombe & Helliwell, 2019). On the other hand, pessimistic people are those who overestimate the tax burden imposed on them. They view any tax implementation negatively and burdensome to their cost of living. A study by Saira, Zariyawati and May (2010) found that Malaysians have low confidence in implementing the indirect tax. This negative view has continually caused misconceptions on tax requirements, mainly when new tax reform is introduced (Shamsuddin et al., 2014). Therefore, the government should take further action to boost public acceptance of SST. The government might, for example, clarify why SST is being implemented and the financial advantages for the country.

### **Effectiveness of Tax Authorities**

According to AICPA (2017), the tax authorities' effectiveness can be measured by tax collection cost. This comprises administrative cost, which includes overhead expenses. Smith (1776) relating to the efficiency maxim, expressed that, every tax should be designed to remove and keep out the people's pockets as little as possible beyond that which it enters the public state treasury. Riese

(2017) offers the best justification for this maxim, arguing that the cost of collecting taxes should be smaller as the extra costs equal to additional expenses. This indicates specifically how GST has been introduced in Malaysia, which has exploited the input tax refund. Consumers had to pay for the costs of a late input tax refund as companies raised the prices. Saad (2011) found that the Malaysians' concern about enforcing income tax in Malaysia was administrative fairness. The Malaysians were not pleased about the tax authorities' implementation as non-compliance was not able to be identified by the mechanisms.

This study measured tax administration efficiency based on the enforcement activities (Abd Hamid N, Assar, Rashid, Azali, & Ghazali, 2019; K., James, 2015; Badinski & Bakija, 2014; Guyton, Manoli, Payne, & Guyton, 2018). As of 2021, Malaysia has introduced two forms of consumption taxes over the years, namely Goods and Services Tax (GST) and Sales and Services Tax (SST). Consumers were upset about the rising costs of goods and services during the introduction of GST. The GST mechanism, therefore, argued that, because of an input tax transaction, some of the goods could be cheaper. The uncommon modern system is a typical problem faced by tax administration (Othman et al., 2017). Thus, administrative workers may need more time to become acquainted with the whole structure and review their approach to managing the growing concerns (Takril & Sanusi, 2014; Shagari, 2014). Research in Indonesia has found that a small number of taxpayers, lack of modern administration, and high degree of evasion are the product of the dysfunctional tax system. This was attributed to the present, inefficient collection and archaic system (Amir, Asafu-Adjaye, & Ducpham, 2013). Thus, this study indicates the following hypothesis:

H1: Effectiveness of tax authorities is positively related to public acceptance of indirect tax implementation in Malaysia.

## Transparency

Adam Smith (1776) believed that the tax that a citizen is expected to pay should be certain, not unreasonable. For the creditor and each other, the time, the manner and the amount of the transaction need to be clear and straightforward. Transparency of taxation helps assess the efficiency of the tax system and the credibility of governments (Campuzano, 2015). Transparency is a situation in which a tax exists, and how and when the tax is imposed (AICPA Tax Division, 2017).

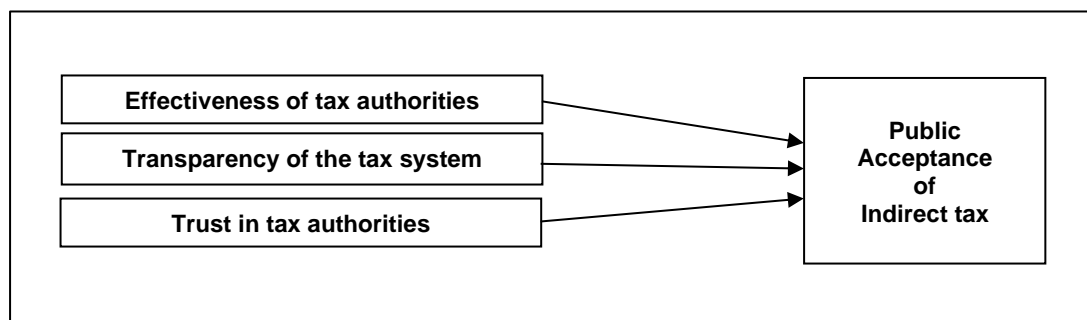
After the product or service subject to GST has been charged, the amount of the charge is explicitly specified (Othman et al., 2017). RMCD issued a list of goods and services excluded from regular tariffs, null prices and taxes. Consumers were able to analyse whether corporations levied a tax on the right products by applying GST. Transparency was confined to corporations and the tax authorities (Saat, Bahador, & Faiz, 2017). When the previous SST was introduced, the RMCD discovered that firms have reported under-revenue through activities such as under declaration of products or purchase prices, commodity declassification or their tariff codes, and the manufacture of fake invoices (Abd Hamid N. et al., 2019). From 2012 to 2014, this tax deficiency persisted. GST accountability also showed an unfavourable public view. The supply chain problem, which paid 6 per cent of the tax rate, ended up putting a strain of up to 24 per cent GST on end-users (Wong & Kee, 2018). The amount of GST rate appeared on payment receipt even threatens customers. This is because, the price of goods and services was included in the SST (Alappatt & Junaid, 2014). The following hypothesis is extracted from the idea:

H2: Tax transparency is significantly related to public acceptance of indirect tax implementation in Malaysia.

## Trust in Tax Authorities

The consumers' acceptance is vital in ensuring the success of implementing the indirect tax. When taxpayers fulfil their direct tax responsibilities, it is called tax compliance (Aktaş Güzel, Özer, & Özcan, 2019). The government may impose penalties for non-compliant taxpayers that fail to pay direct tax. As for indirect tax, no matter how perfect the regulations, the government still depends on public trust. Trust is crucial as this will enhance public acceptance of indirect tax (Damayanti & Martono, 2018). If the public were to mistrust the government, tax implementation would be disrupted (Wong & Kee, 2018). This happened in 2018 when the public rebelled and used their voting rights to overturn the ruling government. The people will be more ready to fulfil their tax commitments when trust is high (Torgler, 2003). There is more confusion about how the government invests taxpayers' money when people do not believe the government. When they consider government as efficient, the public will accept tax-related decisions, but they will not back these decisions if they do not have the trust (Aktaş Güzel et al. 2019). Public confidence in the government increases public approval of the financial system and its tax payment commitment (Jimenez & Iyer, 2016). Saad (2011) indicated that most Malaysians were dissatisfied with how the government was spending the country's revenues. The respondents claimed that the revenue was not spent wisely on health, education or public transportation. They believed that the government channeled funds for bureaucratic purposes. The following theory about government confidence variable is formulated following a considerable literature review:

H3: Trust in tax authorities will increase public acceptance of the implementation of indirect tax in Malaysia.



**Figure 1: The relationship between the elements in tax authorities and tax system with public acceptance.**

Figure 1 above illustrates the relationship that can be concluded between the crucial elements in tax authorities and tax system with the acceptance of the public regarding the indirect tax employed by the Malaysian government. To gain public trust concerning the application of indirect tax, the tax authorities such as the Ministry of Domestic Trade and Consumers Affairs and the Royal Malaysian Customs Department must be seen efficient to handle the tax. The tax system must be transparent enough in order to gain the acceptance of the Malaysians. The source revenue of the tax and its subsequent spending should be tabulated in details so that the public know how the government is managing the tax revenues. When the trust in tax authorities is established, the public will and can start to accept the indirect tax implementation as they know that the public monies are handled wisely.

## MATERIALS AND METHODS

### Data Collection and Research Instruments

Practical random sampling was used for selecting samples in the present study. A total of 180 respondents, mainly from Klang Valley, Malaysia, were interviewed via structured questionnaires a year after the reimplementation of SST. The sets of questionnaires were distributed randomly to the general public without any significant preferences regarding their demographic details, as long as they are Malaysian individuals. This analysis aims to gather the perception regarding the effectiveness of tax authorities, transparency of indirect tax system, and trust in the administration that will enhance the acceptance of SST. The questionnaire comprises of four sections. In the case of a 7-point Likert scale (1 = "strongly disagree" to 7= 'strongly agree), the respondents must determine their response. The measurements for this analysis are built on credible sources such as five items on efficiency (AICPA Tax Division, 2017; Slemrod, 2015), four on transparency (AICPA Tax Division, 2017), five elements on trust (Ya'u & Saad, 2018; Chandarasorn, 2012) and eight items on acceptance (Syazwani et al., 2016; Shamsuddin et al., 2014). Included were demographic features such as gender, age, education and monthly income. To analyse the connections between the research system variables, demographic data analysis is carried out using IBM SPSS statistics and 3.0 (PLS) software (Ringle, Wende, & Becker 2015). The reason for using PLS is to explore at the same time the direct and indirect relationship between latent variables and endogenous variables.

**Table 1: Respondents' Demographic Features**

Item	Option	Frequency	Percentage (%)
Gender	Male	110	61.2
	Female	70	38.8
Age	18 – 29	71	39.5
	30 – 39	40	22.4
	40 – 49	39	21.7
	50 – 59	26	14.5
	60 and above	4	2
Education level	SPM / STPM	53	29.7
	Diploma	54	30.4
	Professional certificate	4	2
	Bachelor's Degree	33	18.2
	Master Degree	28	15.5
	PhD	3	1.4
	Others	5	2.7
Monthly income	RM3,000 and below	121	67.5
	RM3,001 – RM6,000	33	18.5
	RM6,001 – RM9,000	18	9.9
	RM9,001 – RM12,000	5	2.6
	RM12,000 and more	3	1.3

### Convergent Validity

Upon review of the results, it was discovered that the average construct validity with a significant loading value varied from 0.742 to 0.949, well above the suggested loading value of 0.5. (Hair, Black, Babin, & Anderson, 2010). Notably, objects below 0.5 have been deleted. The results of the measurement model by convergent validity are shown in Table 2 below. Examples of loadings, average variance extracted [AVE], and composite reliability [CR]. AVE ranged from 0.648 to 0.820 and suggested the proper validity of the convergent. The CR values varied between 0.824 and 0.945.

**Table 2: Assessment of Measurement Model on Convergent Validity**

Variables	Items	Loadings	AVE	CR
Acceptance	PA1	0.810	0.674	0.931
	PA2	0.742		
	PA3	0.864		
	PA4	0.820		
	PA5	0.866		
	PA6	0.829		
	PA7	0.793		
	PA8	0.835		
Effectiveness	EA1	0.874	0.734	0.913
	EA2	0.898		
	EA3	0.821		
	EA4	0.863		
	EA5	0.826		
Transparency	TV6	0.849	0.820	0.824
	TV7	0.797		
	TV8	0.814		
	TV9	0.758		
Trust	TR10	0.949	0.648	0.945
	TR11	0.883		
	TR12	0.893		
	TR13	0.863		
	TR14	0.937		

### Discriminant Validity

Discriminant validity explores the disparity between the association of one structure and the representation of indicators in a construction (Hair et al., 2010). A contrast of the square root of AVE ( $\sqrt{AVE}$ ) with the latent variable correlation shall determine the discriminant validity. To assess appropriate discriminant validity in constructs, the  $\sqrt{AVE}$  should surpass all correlations (Chin, 2010). The result for correlation with  $\sqrt{AVE}$  in bold is illustrated in Table 3. The R<sup>2</sup> value is 0.566, which means that EA, TV and TR can explain 56.6 per cent of the difference in public acceptance. EA is positively related to Acceptance ( $\beta = -0.188$ ,  $p < 0.003$ ), and so is TV ( $\beta = 0.503$ ,  $p < 0.000$ ). Other than that, TR ( $\beta = 0.452$ ,  $p < 0.000$ ) is positively related to Acceptance. Table 4 summarizes the findings of the hypotheses. Notably, H1, H2 and H3 are supported.

**Table 3: Assessment of Discriminant Validity**

Variables	1	2	3	4
Acceptance	<b>0.821</b>			
EA	0.460	<b>0.857</b>		
TV	0.699	0.634	<b>0.805</b>	
TR	0.666	0.728	0.697	<b>0.905</b>

Note: Diagonal (in bold) represents the  $\sqrt{AVE}$ , while others represent the correlation.

### Path coefficient and hypothesis testing

**Table 4: The results of the hypotheses**

Hypothesis	Relationship	Coefficient	t-Value	Supported
H1	EA -> Acceptance	-0.188	2.738	Yes
H2	TV-> Acceptance	0.503	7.749	Yes
H3	TR -> Acceptance	0.452	6.550	Yes



## CONCLUSION

This study aims to study the role of public acceptability and taxation authorities in SST in Malaysia. The results of this study have shown that the effectiveness of tax authorities, the tax accountability and the government's public confidence are critical for accepting SST. The understanding of the government, in particular, is a critical issue because, as an acknowledgement of the SST, it goes beyond the direct control of the taxation authorities. The findings are consistent with Kiow, Salleh and Kassim (2017), Eisenberg (2018), and Ya'u and Saad (2018), where it is found that if the public perceived the tax authorities to be efficient in executing the tax system and the government spends revenue wisely; this may strengthen acceptability. On the other hand, the findings also reflect the government's responsibilities. The government should view the findings as a sign to wisely spend indirect tax collection and fulfil the nation's basic needs, including infrastructure, medical allocations, and education. This is to increase public acceptance of SST (Palil, Hamid, & Hanafiah, 2013).

The issue with GST input tax refund cultivates public rejection towards indirect tax. Failure to refund the input tax caused losses to businesses. Consequently, the public was burdened due to the increment in embedded prices of goods. Majority of respondents in this study were classified under the Poverty Line Income (PLI) with a monthly income of RM3,000 and below. The public's changes in spending pattern not only limited to the necessity goods such as foods, but also healthcare, education, and transportations. In order to achieve Sustainable Development Goals in 2030, the government is focusing on making a comfortable standard of living. Along with it, the mechanism of SST is hoped to be transparent. The transparency should help reduce the prices of goods and help to minimize the impact of the tax burden to the public. Furthermore, tax transparency would enhance confidence among the public. Hence, this would increase public acceptance. The public also struggles with the accountability of government records, particularly in procurement, including providing more complete information on the amount of tax received and spent. Smith (1776) encouraged tax transparency in any tax implementation to hinder confusion and doubt. It is widely acknowledged that acceptance depends on public trust in the government. As the public perceived tax authorities to be effective and the tax system transparent, they will trust the execution of SST. When the public believes the government to be trustworthy in managing SST and its revenues, they will, in turn, accept the tax system.

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