

THE EFFECTIVENESS OF MALAYSIAN PERSONAL INCOME TAX POLICY

(1977 – 1997)

BY:

SAIDATULAKMAL MOHD

(EGA 98004)

SUBMITTED TO THE FACULTY OF ECONOMICS AND ADMINISTRATION,
UNIVERSITY OF MALAYA IN PARTIAL FULFILLMENT OF THE
REQUIREMENT FOR THE DEGREE OF MASTER OF ECONOMICS
(COURSEWORK)



OK

ABSTRACT

This research aims to evaluate the effectiveness of the Malaysian Personal Income Tax Policy for the year 1977 – 1997. The areas of concentration are tax burden, poverty level, savings incentives, progressivity index and Inland Revenue Board's objectives. The methodologies to accomplish the mission are regression analysis, mathematical calculation, and index of progressivity. The research concludes that there is no significant relationship to explain any kind of relationship between the tax rates and the poverty level. Another finding shows that Malaysian personal income tax policy seems to be a good policy to induce private savings. Regression analysis, both under the Classical Linear Regression Model assumptions and relaxation of the assumptions, shows that there is a significant positive relationship between private savings and interests being exempt from taxes. The findings of this research confirm the Inland Revenue Board's statement that Malaysia is practising a progressive personal income tax policy. From the analysis, it can be concluded that the degree of progressivity is very mild that it does not burden taxpayers. This research also reveals that the objectives set up by the Inland Revenue Board has yet to be accomplished. Inland Revenue Board needs to further improve the current situation. In short, the research concludes that Malaysia is not practising an effective personal income tax policy.

ACKNOWLEDGEMENT

Alhamdulillah, thanks to Allah the almighty.

Millions of thanks to Abah, Mak, Kak Aida, Kerry, and Boy for their endless support and guidance.

Thank you to the Mr. Mat Tasir Abd. Hamid from Economic Planning Unit, Mr. Siah Ket Yi of Bank Negara, Miss Hanizah Shuib of the Inland Revenue Board, and Staff of the Ministry of Rural Affair for the valuable information and warm welcome at their agencies. Special gratitude to my supervisor Prof. Madya Dr. Siti Rohani Yahya for her support and time. Not forgetting my warmest thoughts to the Universiti Sains Malaysia.

Last but not least, thanks to my friends and families for their critical comments and ideas to help me finish this paper. Special thanks to my very dearest friend, Philippe, for his countless advice, support, time, and resources.

Ida Mohd

03-03-2000

TABLE OF CONTENTS

Chapter One – Introduction	1
1.1 Scope of Study	4
1.2 Research Objectives	5
1.3 Research Significance	6
1.4 Some Caveats	6
1.5 Sources of Data	6
1.6 Outline of the Study	7
Chapter Two – Literature Review and Research Methodology	
2.1 Literature Review	9
2.2 Theoretical Framework	19
2.2.1 Regression Analysis	20
2.2.2 Mathematical Calculation	22
2.2.2.a. Calculation of Marginal Tax Rates	22
2.2.2.b. Calculation of Suits’ Index of Progressivity	23
Chapter Three – Development and Structure of Personal Income Tax Policy	
3.1 Definition of Income	25
3.2 Basic Structure	27
3.2.1 Basis Year	29
3.2.2 Assessment	30
3.2.3 Tax Payment	32
3.3 Tax Rates	35
3.4 Deductions	36
3.4.1 General expenditure	36
3.4.2 Specific Deductions	36

3.4.3	Personal Relieves	37
3.5	Fiscal Incentives For Savings	39
3.6	Example Computation of An Employment Income	41

Chapter Four – Analysis of Result

4.1	The Impact of Personal Income Tax Policy on Poverty Level	42
4.1.1	Regression Interpretation	43
4.1.2	Hypothesis Testing	44
4.1.2.a.	Significance of Regression Model	44
4.1.2.b.	Individual Regression Coefficients	48
4.1.3	Relaxing the Classical Assumptions	49
4.2	The Impact of Personal Income Tax Policy on Savings Level	53
4.2.1	Limitation of Analysis	53
4.2.2	Assumptions	53
4.2.3	Regression Interpretation	54
4.2.4	Hypothesis Testing	54
4.2.4.a	Significance of Regression Model	54
4.2.4.b	Individual Regression Coefficient	56
4.2.4.c	Relaxing the Classical Assumptions	57
4.3	The Impact of Personal Income Tax Policy on Progressivity and Tax Burden	63
4.4	The Impact of Personal Income Tax Policy in Meeting IRB objectives	65
4.5	Summary of The Analysis of Results	69

Chapter Five – Conclusions and Recommendations

5.1	Conclusions	70
5.2	Recommendations	73

Bibliography78
Appendices80