A nation may fall into decay through taxation in two ways. In the first case, when the amount of the taxes exceeds the powers of the nation and is not proportioned to the general wealth. In the second case, when an amount of taxation, proportioned on the whole to the powers of the nation, is viciously distributed.

Pietro Verri

Tax is never a strange issue in Malaysia. During the great ruling of the Sultans taxes were collected from the people either in terms of money or property. At that time however, there was no systematic way of determining the taxes rates and collecting them. The Sultans appointed their trusted ministers to collect the taxes on their behalves; the ministers on the other hand delegated the duties in the hands of their strong men to ensure taxes were collected on time with the amount agreed upon by the ministers. While the tax collection did benefit the society, most of the time it provided undue burden to the taxpayers particularly the farmers and the fishermen.
When Islam arrived in Malaya, tax collection was also introduced to the followers of the religion. Taxes paid by the Muslims are known as zakat. Zakat can be categorised to zakat fitrah, earnings zakat, wealth zakat, and also business zakat. Muslims pay zakat to fulfil one of the five pillars of Islam.

When Malaya was under the colonisation of the British, taxes were also collected but at that time it was made systematically and formally. In 1947, the first Income Tax Ordinance was introduced in Peninsular Malaysia. Later, in 1956, Sabah Income Tax Ordinance was introduced, followed by Sarawak Inland Revenue Ordinance in 1960.

With the formation of Malaysia in 1963, one standard enactment of taxation policy involving Peninsular Malaysia, Sabah, and Sarawak was introduced. It is known as the Income Tax Act 1967 and is still used until now.

The principal statutes of the Income Tax Act 1967 are as follows:

1. Income Tax Act 1967 (Act 53)
2. Promotion of Investment Act 1986 (Act 327)
7. Sales Tax Act 1972 (Act 64)
9. Customs Act 1967 (No 62)

The main concern of this paper is to look at the first statute that is the Income Tax Act 1967. Specifically, the paper will delve into the personal income tax policy. Inland Revenue Department is the department being responsible in dealing with matters concerning the personal income tax policy. Inland Revenue Department became a statutory board on March 1st, 1996 and is now formally known as the Inland Revenue Board (IRB) of Malaysia. IRB was formally established under the Inland Revenue Board of Malaysia Act 1995. Being a responsible body to collect the revenue on behalf of the government, IRB has set up several objectives as guidance in performing its daily activities.

The main objective of the department is to establish and to administer an efficient tax system that upholds justice and equity. IRB also sets up three operational objectives. The objectives are:

- To assess and collect the correct amount of revenue as provided under the law in the most effective and efficient manner at minimum cost
- To instil public confidence in the fairness and integrity of the tax system
- To encourage voluntary compliance
Having understood these objectives, few people actually questioned on whether any of the objectives are actually accomplished. Most people are only concerned about paying their income taxes as soon as possible to avoid the penalty of IRB. These are also concern in figuring out ways to avoid taxes and trying to pay the taxes as low as possible. There are very few people that are actually concern on whether everybody is paying his or her own share. Very few people too are concerned on the effectiveness of the policy towards the development of the nation and individuals. This study attempts to clarify certain issues that have been raised. Hopefully, the results of this research will provide insights to those interested parties.

1.1 Scope of study

This research paper intends to delve into Malaysian fiscal policy that is the issue of the personal income tax policy. The starting year of the analysis is the year 1977 that is 10 years after the implementation of the income tax policy. The 10-year gap is necessary to actually see the impact of the policy on the economy and society.
1.2 Research Objectives

The main objective of the research is

'to evaluate the impact and effectiveness of the Malaysian personal income tax policy on excess burden, poverty level, income distribution, savings level and progressivity for the year 1977 - 1997'

Specifically, the objectives are

1. to evaluate whether Malaysian personal income tax policy actually lessen or burden the tax payers
2. to determine whether Malaysian personal income tax policy is an optimal policy to alleviate poverty
3. to measure the incentive of savings under the given personal income tax policy
4. to validate the progressivity or regressivity of the personal income tax policy
5. to conclude on whether the policy and the revenue generated actually meet the objectives of the Inland Revenue Board
1.3 Research Significance

It is hoped that the findings of the study will lead to:

- a better understanding of the taxation system
- awareness of the importance of the personal income tax policy
- determining whether Malaysia is practising a good fiscal policy

1.4 Some Caveats

Limitations of the analysis mainly come from the limitations of the resources availability. Analysis on income distribution, which was thought to be included in the research, could not be carried out due to the unavailable data of the net income (gross income minus personal income tax). The only data available was data on gross income provided by the Economic Planning Unit (EPU). Results might also be affected with the calculations due to rounding errors and underlying assumptions of the linear regression models.

1.5 Sources of Data

The main source of data would definitely come from the Inland Revenue Board. Data of the income tax collected from individuals for the year 1977 -
1997 will be compiled. In addition data on the net collection of the direct taxes collected by the Inland Revenue Board for the period of study will be collected too. The data collected at the Inland Revenue Board will then be associated with other data to generate certain results. Thus, achieving the above mentioned objectives.

Another set of data to be compiled for analysis is the data on the income distribution obtained from the Economic Planning Unit. Since the data on income distribution according to class of households are only available for certain years that are 1980, 1985, 1987, 1990, 1993, 1995, and 1997, this data have to be carefully sorted out. Data on poverty level is also obtained from the Economic Planning Unit.

1.6 Outline of the Study

Chapter Two deals with the previous studies conducted all around the world by researchers and economists. Different kinds of theories and observations are compiled from the research to help designing the research methodology of the paper. The methodology focuses on the quantitative methods that are the regression analysis and the Suits' Progressivity Index. The regression analysis will use the E-views software.
Chapter Three gives the details on the personal income tax policy. This chapter is more descriptive in describing the structure of the policy as well as the routine of assessments and payments, and the tax rates for the years of study 1977 – 1997. This chapter will provide the current information and policies on tax for the past twenty years.

Chapter Four is the central core of the research. It provides the results of the analysis conducted under the underlying assumptions stated. Each analysis is tested against the appropriate hypotheses to produce the results wanted. Remedial measures are offered to all models that are suspected to have problems. Although these sections seem to be more quantitative and technical, qualitative explanations are provided to support each model for better understanding of the results produced.

Chapter Five wraps up the entire discussion and analysis of the research. It concludes the findings of the research on whether they meet the specified objectives in Chapter One. If the findings differ tremendously from the expected results, explanation is provided to ensure that the findings are still valid and reliable that they do not alter the entire gist of the research.