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Examining the Role of Increased Penalties on Tax Advisers in Improving Tax Compliance under the Self-Assessment System

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ABSTRACT

This study is motivated by a recent amendment to the Income Tax Act, 1967 as part of the tax reform under the Self-Assessment System. Section 114(1A) now imposes criminal sanctions against those who are negligent in advising and assisting in income tax returns which result in an understatement of tax liability if they do not exercise reasonable care.

This study empirically examines the perception of tax agents on the introduction of section 114(1A) in relation to their understanding and perception of the concept of reasonable care. It further examines perceptions with regards to the fairness of this provision; perception on the imposition of criminal sanctions and perceptions on aggressive reporting positions in the face of criminal sanctions against negligence. The perception of these four dependent variables is examined in a causal relationship with two independent demographic variables, i.e. 'level of experience' and 'environment' as represented by tax agents from big-five public accounting firms against the rest of the tax agents in practice.

A questionnaire survey response of 116 tax agents were used to analyse these perceptions and test eight hypotheses for an association between the dependent and independent demographic variables. No evidence was found to reject all the eight null hypotheses. The findings of the study indicate that there is no association between these variables and 'experience' and 'environment'. The perception of the concept of reasonable care, the perception on fairness of the law, perception on the imposition of criminal sanctions and aggressive positions does not depend on level of experience and whether tax agents are from the big-five or non big-five firms.

Extant literature shows that tax agents play an important role in tax compliance among many other variables. There is no conclusive evidence from

literature that indicates that increased penalties play a deterrent role, in line with the Deterrence Theory. Experience is also seen as an important variable in the judgment decision-making in tax planning. 'Reasonable Care' is a legal concept from common law and there is no definition under the law. The study shows that it is not well understood by the respondents and they are divergent in their views. The fact that it is a new concept in the tax legislation has not helped in understanding this concept. The imposition of criminal penalties is seen as an unfair intrusion into tax practice as tax agents perceive themselves as service providers who are engaged by their clients. Unlike company auditors, their role is not statutorily defined. The legislation is perceived to be unfair regardless of level of experience or type of tax agent as negligence is now punishable with equal severity as wilful evasion.

It is recommended that the authorities consider reviewing the provision by introducing penalties in accordance with culpable conduct as adopted in other jurisdictions. The professional bodies who represent these tax agents should be proactive in adopting practice standards which will be of help to tax agents and even the courts in adjudicating disputes concerning the 'reasonable care' concept. In America, such standards have also been made enforceable. The strongest argument for such enforceable standards is that the profession is better served when it regulates itself rather than having third parties do it. Even the courts have relied on these standards when interpreting this concept. As there is no single body that represents tax agents in practice, it is also recommended that the government license all tax agents to better regulate the tax profession. Changes to the law must be accompanied by contemporaneous rulings or circulars.

In view of the important role played by tax agents in improving tax compliance in meeting the revenue collection aspirations of the nation, serious attempts should be made in reducing any ambiguity in the law and practice in this

area both by the authorities and the professional bodies that represent the tax agent fraternity.

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DEDICATION

To the centerpiece of my life,

my wife,

Tulasi,

&

our children

Theinamuthan

&

Batmaanjelee

CONTENTS

Page

CHAPTER ONE: INTRODUCTION

What is Tax ? 1
Role of Taxation 3
Role of Tax Professionals 6
Services Provided by Tax Advisers 9
Motivation for the Study 12
Research Objectives 15
Research Questions 16
Research Hypotheses 17
Scope of Study 18
Limitations of the Study 19
Organisation of the Study 20

CHAPTER TWO: SELF-ASSESSMENT SYSTEM & S.114(1A)

Improving Tax Administration 23
The Present System 24
Prelude to SAS 24
What is SAS 25
Weaknesses in the Official Assessment System 28
Introduction of SAS in Malaysia 32
Issues Under SAS 36
Section 114(1A) 43
Additional Information under SAS 44
Onus of Determining Chargeable Income 44
Deemed Notice of Assessment 45
Is it confined to Tax Agents alone ? 45
The Concept of Reasonable Care 46
Understatement of Tax Liability 48
Tax Evasion and Tax Avoidance 48
Compounding of Section S.114(1A) Offence 50
Draft Public Ruling on S.114(1A) 51
Public Ruling No. 8 of 2000 55
Legal Effect of a Ruling 64
Summary of Chapter 2 65

CHAPTER THREE: LITERATURE REVIEW

Introduction 66
Tax Compliance Research 69
Theoretical Framework 70
Expected Utility Theory 71

Prospect Theory 71
Deterrence Theory 75
Exchange Theory 80
The Role of Tax Professionals in Tax Compliance 81
Determinants of Tax Compliance 88
Key Tax Compliance Variables 93
Summary of Chapter Three 112

CHAPTER 4 : RESEARCH METHODOLOGY

Introduction 114
Independent Variable 114
Dependent Variable 114
Understanding of 'Reasonable Care' 115
Perception of Fairness of Law 116
Perception of Penal Sanctions 117
Recommendation of Aggressive Positions 118
Theoretical Framework 119
Hypotheses 119
Variables & Measurement 120
Dependent Variable 122
Demographic Information 125
Questionnaire Design 125
Unit of Analysis 126
Population & Sample Size 127
Data Collection Method 128
Statistical Testing and Analysis 129

CHAPTER 5: DATA ANALYSIS & RESULTS

Introduction 130
Summary Statistics of Respondents 130
Null Hypothesis One 131
Null Hypothesis Two 141
Null Hypothesis Three 143
Null Hypothesis Four 146
Null Hypothesis Five 149
Null Hypothesis Six 157
Null Hypothesis Seven 161
Null Hypothesis Eight 164
Summary of Research Results 166

CHAPTER SIX: CONCLUSIONS and RECOMMENDATIONS

Introduction 168
Research Objectives, Questions and Hypotheses 169

Research Methodology & Findings 169

Understanding and Perception of Reasonable Care 170
Difficulties in Proving "Wilful Evasion' 171
Recommendations 173
Contributions of the Study 178
Suggestions for Future Research 178

BIBLIOGRAPHY 179

APPENDICES

Appendix A : Survey Instrument
Appendix B: IRB Draft Ruling on Section 114(1A)
Appendix C: IRB Public Ruling 8 / 2000