CHAPTER 4

RESEARCH METHODOLOGY

Introduction

The focus in this chapter is to outline the research methodology adopted to perform this study. While the main objective is to study the perception of tax agents on the new law [Section 114(1A)], the various dependent variables identified from the existing literature review are observed in relation to certain demographic variables which act as independent variables. Thus this study can be classified as a causal relationship research.

Independent Variable

The independent variables are operationalised by the demographic factors of "level of experience" and "working environment". Working environment is divided into tax agents working in the "big five" accounting firms and non -"big-five" firms. This classification has been defined in the preceding chapters.

Dependent Variable

The dependent variable is operationalised by the "Perception of reasonable care", "Perception of fairness of the law", "Perception of penal sanctions" and "Aggressive recommendations" in consequence of the new section 114(1A). These variables have been discussed in the literature review. These concepts and other determinants that play a role in tax compliance have been discussed in the Literature Review and Chapter 3 on the background of the amendment of the Law.

Understanding of "reasonable care"

This concept has not been defined in the law. Initially the following definition was suggested by IRB in the draft ruling.

> "reasonable care means the exercise of due diligence that is expected of a normal person in a similar situation"

The professional bodies representing tax agents suggested the following definition, adopted by the Australian Tax Office:

> " Reasonable care means the care that a reasonable person would be likely to have exercised in a similar situation to fulfil his obligations"

The Public Ruling No 8 of 2001 eventually adopted the following definition:

> "Reasonable care" means the degree of care or conscientiousness in paying proper attention to a task that is expected, in a similar situation, of an ordinary person who, considering the circumstances and the foreseeable consequences, acts with reason, sound judgement and responsibility".

This research attempts to study the understanding of tax agents of this concept which is often used in most areas of common law especially when the courts have do decide on issues of negligence by professionals and lay persons under the law of "tort", i.e. where a civil wrong is committed resulting in a loss for another party as a result of one's action. It will not be within the scope of this research to attempt to define this scope.

It must also be borne in mind that the above definitions are nothing more than interpretations by the parties involved i.e. the IRB and the tax agents. As the law is enacted by Parliament, then it will be left to the courts to interpret such a concept in the event a dispute arises in a tax case.

Perception of Fairness of the Law

The law referred to here is the introduction of section 114(1A) to the Income Tax Act 1967. This variable has been included in view of the initial remarks and comments expressed by tax professionals who claimed that the law is not fair to them, as they do not owe a duty to the IRB but the taxpayers who engage them. Tax professionals see themselves as service providers who make the job of the IRB easier. However the Literature shows that they play a dual role in meeting tax compliance. While dealing with unambiguous situation, they contribute to improving tax compliance and while dealing with ambiguous situations; their loyalty is with the clients, thus leading to the conclusion that they also contribute to non-compliance. This has been dealt with in detail, in Chapter 3.

An important unknown in the research, finding fairness to be a significant variable is whether a feeling of inequity increases the propensity to evade or is a rationalisation for evasion. Existing research is about the impact of this variable on tax compliance as seen from the taxpayers' view and not by the tax professionals. This research however, seeks to study this impact on tax professionals. The professional bodies claimed that such an approach to impose penal sanctions has been strongly opposed in the Canadian tax jurisdiction. This led the tax authorities to review the approach to imposing penal sanctions on tax professionals. However in the Malaysian context, there was no consultation prior to enacting the law. Talks only took place after enacting the law. The professional bodies sought clarifications on the scope of the interpretation of the new provision, which could adversely affect tax agents. Some of their suggestions have been included in the Public Ruling Number 8 of 2001 which clarifies the IRB's interpretation of the provision.

The position as far as existing literature on the effect of "fairness of the law" on tax compliance is rather mixed as discussed seen in the earlier chapter.

Perception of Penal Sanctions

The penal provisions referred to here is the minimum (RM2,000) and maximum (RM20,000), monetary fines, and imprisonment of not more than three years or both upon conviction on anyone (including tax agents) who assist or advise taxpayers in return preparation and where such acts lead to understatement of tax liability under section 114(1A). Existing literature abounds on studies on the causal relationship of increased penalties and tax compliance.

In the US, there are specific penalties on tax preparers. Most studies refer to them as Preparer Penalties. As the proportion of returns submitted with the help of tax professionals is on the rise, the important role played by this group has been acknowledged in almost every study on the attributes or determinants of tax compliance.

There is evidence in the literature that shows, low levels of penalty sanctions influence compliance behaviour. Webley et al.(1991) conclude that the evidence that suggests higher penalties produce more compliance than lighter penalties is quite limited, and that there is need to know much more about individual differences in the personal consequences of penalties. Klepper and Nagin (1989) argue that one reason many researchers have found that the severity of penalties does not impact compliance is that the personal costs of even mild penalties are heavy. Thus the lack of results does not mean that penalty sanctions are not a deterrent. Alm (1991) concluded that increase in penalty sanctions are effective at increasing compliance. However, Roth et. al. (1989) state that most studies have concluded that variation in the severity of sanctions does not affect the level of compliance, but that here is some evidence that suggests increases in penalty sometimes may increase compliance when the perceived probability of detection is sufficiently high. Roth et.al's conclusion suggests that there may be an interactive effect between detection risk and penalty sanctions on tax compliance.

Recommendation of Aggressive Positions

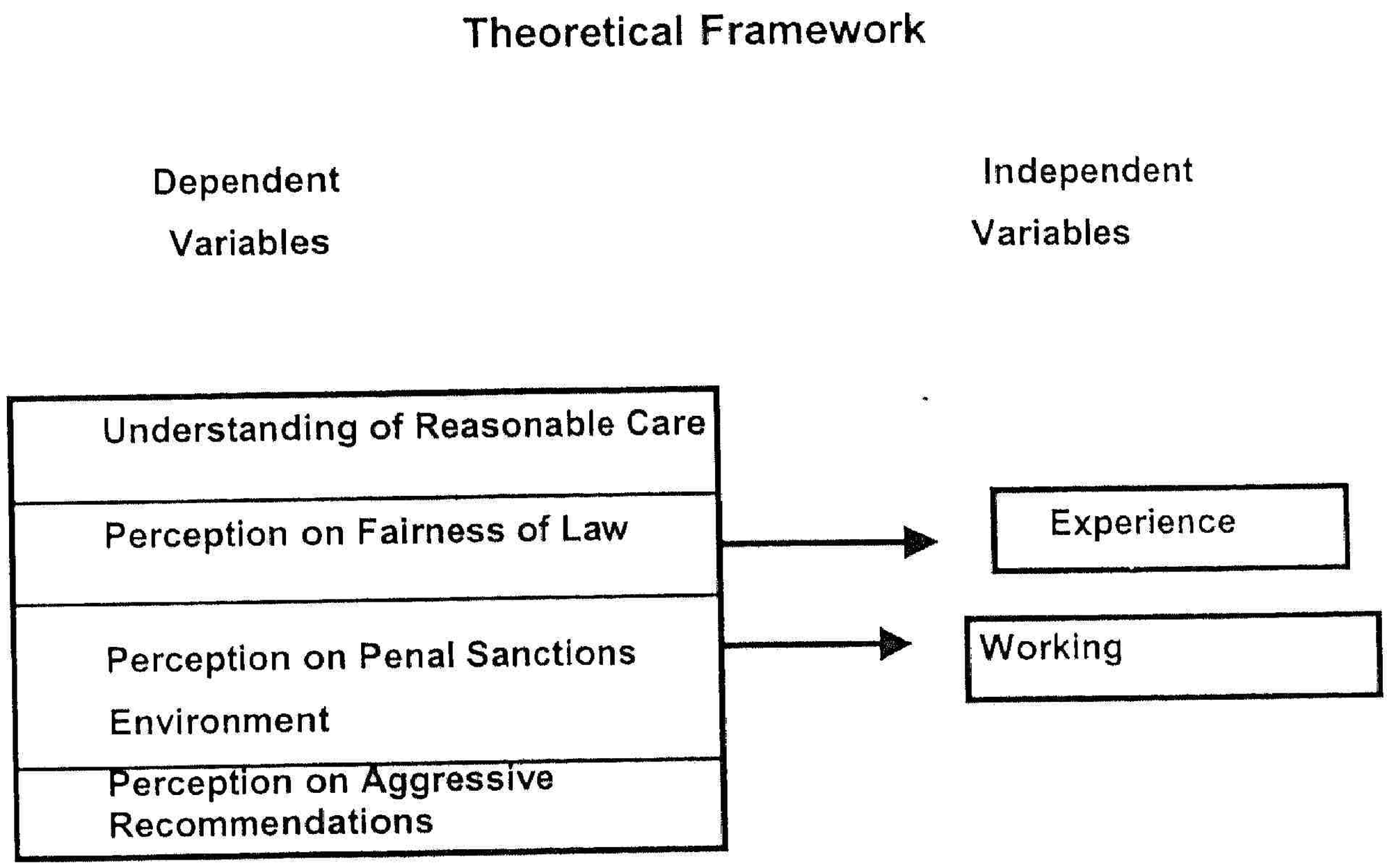
An aggressive position can be defined as a stand taken by the tax agent on behalf of the taxpayer, which results in a lower tax liability.

It has been hypothesized that the threat of preparer penalties causes tax professionals to be more conservative in the tax positions recommended to clients and reduces their willingness to sign returns in which a questionable position has been taken. The results indicated that preparer penalties would be ineffective in altering practitioners' behaviour. The findings were based on practitioners' perceptions about penalties rather than behavioural experiments.

The current trend in US is toward increased preparer penalties and restriction of preparers' latitudes in tax law interpretations. The present research suggests that increased penalties may prove to be effective in improving compliance provided that the sanctions are not idle threats. In order for sanctions to be effective deterrents, tax practitioners must be aware of their existence.

As noted by Hite and McGill (1992), past compliance studies have failed to consider the impact of the preparer on the compliance decisions. Hite and McGill and Collins et. al. (1990) found that taxpayers want preparers to assume an enforcer role. Collins et al. found approximately 70 percent of taxpayers surveyed used preparers to file an accurate return, but only 25% of the sample indicated that minimising taxes was their primary goal. Likewise, Hite and McGill found taxpayers tend to agree with the conservative advice from a preparer but disagree with aggressive advice.

Theoretical Framework



Hypotheses

HO_1 : There is no significant difference in the understanding of the concept of **reasonable care** under section 114(1A) between tax agents of different levels of **experience**.

HO_2 : There is no significant difference in the understanding of the concept of **reasonable care** under section 114(1A) between tax agents from the "big five" category and the non "big-five" **category** .

HO_3 : There is no significant difference in the perception of

fairness of section 114(1A) between tax agents of different levels of **experience**.

HO_4 : There is no significant difference in the perception of **fairness** of section 114(1A) between tax agents from the "big-five" category and the non "big-five" **category**.

HO_5 : There is no significant difference in the perception of imposing **penal sanctions** on tax agents under section 114(1A) between tax agents of different levels of **experience.**

HO_6 : There is no significant difference in the perception of imposing **penal sanctions** on tax agents under section 114(1A) between tax agents from the "big-five" category and non "big-five" category.

HO_7 : There is no significant difference in the perception of tax agents in recommending aggressive positions, between tax agents of different levels of **experience** in view of the increased penalties under section 114(1A).

$H0_8$: There is no significant difference in the perception of tax agents in recommending aggressive positions, between tax agents from the "big-five" and non "big-five" **category** in view of the increased penalties under section 114(1A).

Variables and Measurement

Independent Variable

The independent variables in this study are basically two demographic variables i.e experience and environment. The demographic details in the questionnaire survey were utilised for this purpose. Respondents stated their experience on a continuous scale. The years of experience was categorised into three levels, thus converting the continuous data into interval data. Experience was categorised into Less Experienced Tax Agents(experience of 4 years and below) ,Medium Level Experienced Tax Agents(five to 9 years) and Very Experienced Level (10 and above). This enabled a t-test and ANOVA (Analysis of Variance) to be done.

The environment variable was dichotomised into big-five accounting firms and the non big-five firms. The justification for considering this classification is based on audit quality literature which states that Big Five Firms(which were previously big-six) are expected to explicitly develop and maintain reputation for quality and thus have a greater incentive to protect their brand name reputation than non big-five firms [Klein et al. (1978) and DeFond (1992).

Summary of the Measurement of Variables

Variable	Measurement	Nature
Experience	Questionnaire (demographic details)	Continuous, Interval
Environment Big Five vs Non- Big Five	Questionnaire (demographic details)	Dichotomous 1 as non Big-Five 2 as Big-Five

Dependent Variable

The questionnaire is designed to measure these variables based on the responses to direct questions and several vignettes. Vignettes are short concrete stories to which subjects respond or interpret. The vignettes in this study have been designed based on the researcher's experience in tax work for the last 18 years. Many vignettes used in studies in the U.S.A. are not suitable for the Malaysian environment. As such, the vignettes and questionnaire had to be specifically designed for the Malaysian situation taking into account Malaysian tax legislative requirements.

The vignettes are hypothetical scenarios which may provide a more accurate assessment of compliance tendencies since they present understatement or non-compliance opportunities under less incriminating circumstances than those related to self-reports of compliance behaviour. Typically, tax compliance research has been criticised for relying solely on self-reports of behaviour (Lewis, 1982). Information provided by subjects on actual compliance behaviour is sensitive and potentially incriminating and thus likely to be misrepresented. As noted by Kaplan et.al, (1988), subjects are more likely to provide truthful responses to hypothetical cases. Further, by using vignettes, situations can be created or re-enacted which closely resemble actual work-related practices.

The perception and understanding of the four dependent variables are on the "concept of reasonable care"; "fairness of the law"; "aggressive recommendation" and "penal sanctions". The respondents were asked to state their agreement, neutrality or disagreement to the researchers statement on each question or scenario on a five point Likert scale.

a. Understanding of "Reasonable Care"

Understanding of reasonable care was based and measured from the responses to three vignettes and four other related questions. The following issues were tested:

(i) Aiding and abetting where there is no reasonable basis.
(ii) Where the tax agent's employee is negligent.
(iii) Lack of full knowledge and returns not qualified.
(iv) Vagueness of the concept.
(v) Liability where the tax agent makes estimation.
(vi) Onus of proof.
(vii) Liability of tax agents on their employees' actions.

A score was given for each right answer. The maximum score is seven. The interpretation given in the IRB Public Ruling 8/2000 was relied on to determine the correct answer. The continuous data was also converted into interval scale by classifying it into three categories of low score, medium score and high score. From the raw continuous data, a scatter plot and correlation test was done. After categorising the data Chi-Square test was done.

b. Perception of Fairness.

Perception of fairness of the law was based on and measured from the responses to five related questions. The following areas were tested:

(i) The penalties impose additional burden.
(ii) Penalties do not vary according to severity of offence.
(iii) Wide Scope

(iv) Tax agents have to incur additional costs

(v) Tax agents need additional safeguarding measures.

The responses were collapsed into categories as fair(coded 1) and unfair(coded 0). Then the counts for all the 5 question were totalled. So the range should be from 0 to 5, with 0 indicating totally unfair. A Chi-Square test was done to test for association with the "experience" variable and the "environment" variable

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c. Perception on Penal Sanctions

Two direct questions were asked. The first question sought response on the role of penalties to improve general tax compliance and the second question sought a response on imposing penalties on tax agents as a measure to increase tax compliance. Since both questions largely elicited responses in the opposite directions they were considered as two separate scenarios for analysis.

The responses were dichotomised into two categories. The variables were added together to measure the level of positive effect. A range of 0,1, and 2 was given. A cross tabulation was done to check whether perception on reducing aggressiveness depends on level of experience

The responses for the two questions were cross-tabulated to perform the chi-square test. The responses for both the questions were collapsed into three categories, i.e Agree, Disagree and Neutral. It was further reduced into two categories by dropping the neutral category. The Chi-Square test was performed for both. The above three categories of results were cross-tabulated with the independent variables to test for the existence of any association.

d. Perception on aggressive recommendation

Two direct questions were asked on the perception of tax agents on the position of recommending aggressive positions in the face of the new penalties. The first question postulated that increased penalties will reduce the aggressiveness of tax planning advice while the second question postulated that penalties will affect general tax advice which is not related to the submission of tax returns.

The responses were dichotomised into two categories. The variables were added together to measure the level of positive effect. A range of 0,1, and 2 was given. The results were cross-tabulated with the independent variables of experience and environment.

Demographic Information

To understand the responses in proper perspective, the following demographic information was included in the questionnaire.

- Age
- Gender
- Designation in Firm
- Professional affiliation
- Working Environment
- Years of Experience

Other demographic information such as race, and qualification were not included. Race was not included as the profession has a conspicuous ethnic bias. Qualification was not included as the MIT membership list would have ensured that the respondents are suitably qualified.

Questionnaire Design

A mail questionnaire was used to collect data. The questionnaire was developed to measure the dependent and the independent variables. The issues identified in the questionnaire were gathered from minutes of meetings between the professional bodies (which are circulated to members and posted in the MIA website) and the Inland Revenue Board, commentaries in the news paper and tax periodicals such as the CCH Tax Briefing and Tax Nasional, and comments observed in seminars attended by the researcher since the introduction of the Finance Bill 1999.

The Questionnaire was divided into the following four parts:

Section A: Penalties to Improve Tax Compliance
Section B: Perception of Section 114(1A)
Section C: Application / Impact of Section 114 (1A)
Section D: Demographic Information

The 5-point Likert Scale was used to draw responses from the respondents for the first three sections. The sequence was from 1 indicating Strong Agreement, to 5, indicating strong disagreement and 3 as neutral. The sequence was reversed in the third section to ensure the "conditioning effect", i.e. to ensure that responses are genuine.

In the last section, the respondents were asked to state the age and experience (years) on a continuous scale. Two columns were provided to state gender. For professional affiliation, the members were asked to confirm MIT membership, and state other Professional affiliation. In the analysis, the professional affiliation was coded as MIT, MIA, MACPA, ACCA and others. Working environment was classified into Sole Practitioner, Small Practice, Medium Practice and Big-Five Category. The respondents were left to decided

themselves as how they regarded themselves. Designation was identified as Partner/Proprietor Director, Manager, Assistant Manager and Others.

Given the sensitive nature of the responses on the perception of the penal provisions of the amendment, the following procedures were employed to ensure anonymity: (1) no names of respondents or their firms were required in the questionnaire: (2) the completed questionnaires were placed in self-addressed envelopes sealed by the respondents, and (3) assurances of complete anonymity were provided in a cover late and as a footnote at the end of the Questionnaire.

Unit of Analysis

The unit of analysis is tax agents who are recognised under the law. Each usable respondent is treated as a valid unit of analysis.

Population and Sample Size

The membership list of the Malaysian Institute of Taxation was used to select the sample. The membership list is issued to all members of which the writer is one. The membership of the MIT is approximately 1,600. However this alone does not represent those who are qualified under the law as tax agents. As explained in Chapter One, there are four categories of professionals who can act as tax agents. Except for approved tax agents, not all licensed auditors, registered accountants and advocates are in tax practice. In the absence of a single professional body that represents all tax agents or a regulatory body governing them, it is difficult to quantify the actual number of tax agents who are in public practice. Thus the Membership List of the MIT is used as the population for this study. A total of 260 MIT members representing all states in peninsular Malaysia was selected to represent the tax agents in public practice. This represents 16.25 percent of the population.

However in view of the bigger number of tax agents practising in Klang Valley, about 60 percent of the questionnaire survey were mailed to Klang Valley tax agents. Out of the 260, half of it was sent to big-five tax agents and the other half to non- big five tax agents for a representative sample. Thus a stratified random sample method was used to select the sample.

Data Collection Method

Thirteen questionnaires were hand delivered to tax agents who were known to the researcher for a pilot test. This represented 5 percent of the sample. The purpose was to test the suitability, complexity, consistency and relevance of the research instrument. The selected respondents faced no difficulty in addressing the issues and pointed out several language mistakes to be rectified. On the whole the comments were very positive. One eminent respondent with 35 years of experience and who is also an author and examiner of an Advance Taxation examination of a professional Accountancy Body had the following to say:

> " The questions are well selected and tax agents should take this survey seriously, in view of the far reaching implications of the amendment and I hope you will have a good response".

The initial responses were also included in the acceptable responses for analysis. The following methods were used to deliver the remaining questionnaires:

	Number Sent	**Number Returned**	**Return Rate(%)**
Personal Delivery	70	66	94.2%
E-Mail	25	8	32%
Postal	165	52	31%
Total	260	126	48.5%

The bulk of the questionnaires delivered personally by the researcher was to the big-five accounting firms. The help of contacts and acquaintances were sought to distribute and collect the questionnaires in these firms. As a follow up, telephone calls were also made to seek the cooperation of the prospective respondents. A friendly greeting note was also attached to some prospective respondents who were known to the researcher.

Of the 126 questionnaires returned, 10 were discarded due to delayed response, incompleteness and for failing the consistency checks. The remaining 116 responses, which represent 44.6% of the sample was used for the analysis.

Statistical Testing and Analysis

The data obtained from the study was analysed by using the SPSS (version 9.0) statistical package. Factor analysis was carried to identify any coherent relationship of the questions in each section, but no statistical significance was found. The various hypotheses were tested via cross tabulation for Chi-Square and Fisher Exact Test. Other tests carried out were Correlation tests, Scatter Plot, t-tests and ANOVA (Analysis of Variance).