CONCLUSIONS AND RECOMMENDATIONS

Introduction

This chapter summarises the research objectives, research questions, hypotheses and findings and discusses appropriate recommendations. The study itself is in response to a legislative change to the Income Tax Act of 1967. The introduction of Section 114(1A), has brought about a new dimension to similar existing provisions, in that the liability of assistance providers or advisers in relation to tax submissions is only restricted to the extent of actions that are within the control of the service provider measured by a standard referred to as "reasonable care".

The new amendment is part of the Self-assessment system, which started with corporate taxpayers with effect from Year Of Assessment 2001. Chapter Two is dedicated to the discussion on events and policy changes that were envisaged prior to the introduction of this system. In addition to the pre enactment scenario, the post enactment events leading to the issuance of a public ruling on the provision related to wilful evasion is discussed in detail in Chapter Two. The discussion also brings forth the areas of discontent and disagreement between the authorities and the professional bodies that represent the tax professionals. Although this section does not refer to tax professionals alone, it is common knowledge that they will be the most affected. It will also not be erroneous to say that the section 114(1A) targets tax agents if comparison can be drawn from developments in other tax jurisdictions that have adopted the self-assessment system.

Research Objectives, Questions and Hypotheses

The objectives of the study are to identify tax agents level of understanding and perception of the concept of 'reasonable care', the perceptions of the fairness of the law, perceptions of imposing penal sanctions and adopting an aggressive reporting position in view of the increased penalties under the new provision. Additionally the study also sets out to identify whether the demographic variables of 'experience' and 'working environment' (big five or non-big five public accounting firms) affect the perception of the four variables mentioned above, i.e., 'perception of reasonable care', 'perception of fairness', 'perception on the imposition of penal sanctions' and 'perception on aggressive reporting'.

The research questions are: what is the tax agents level of understanding and perception of the four dependent variables of reasonable care, fairness, penal provisions and aggressive tax position in view of the introduction of section 114(1A)? Additionally, do the demographic variables of experience and environment (big-five and non big-five) affect their understanding or perception of the four variables mentioned above.

Towards this, eight null hypotheses were framed for testing. It was hypothesised that the perception of the four dependent variables do not significantly differ between tax agents of different levels of experience and agents from big-five and non big five public accounting firms.

Research Methodology and Findings

The use of two demographic variables of 'experience' and 'environment' to test for association between the perception of the dependent variables (of reasonable care, fairness, penal sanctions and aggressiveness) and the independent demographic variables makes this a causal relationship study. A

questionnaire survey instrument was posted, e-mailed and distributed through contacts to the subjects, i.e. tax agents in public practice. From a population of 1,600 Malaysian Institute of Taxation(MIT) members, 260 were targeted throughout peninsular Malaysia. The overall response rate was 48.5% with 126 questionnaires returned. Of the 126 questionnaires, 10 were discarded due to delayed response, incompleteness or for failing the consistency checks. The remaining 116 responses, which represent 44.6% of the sample was used for the analysis using the SPSS (version 9.5) statistical package.

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).

None of the eight null hypotheses tested were rejected. From the statistical analysis, there is insufficient evidence to reject the null hypotheses i.e, the findings were consistent with the null hypothesis. The results indicate that statistically there is no association between level of understanding and perception of the four dependent variables of reasonable care, fairness, imposition of penal sanctions and aggressive reporting and the demographic variables of experience and working environment i.e., tax agents working in big-five and non big five public accounting firms.

In the US the regulators and the professional tax practitioner community have vigorously debated the role of preparer penalties in curbing preparer aggressiveness. In 1989, this debate resulted in the American Congress' adoption of the first "accuracy-related" preparer penalties: penalties based on the subjective strength or level of support for a reporting position rather than the culpability or diligence of the preparer recommending the position. Legislation was subsequently introduced in Congress calling for a doubling of these penalties. However, there is no empirical evidence supporting the effectiveness of such penalties in curbing aggressiveness, and prior experimental studies

suggest their impact may be minimal (Anderson et. al. 2000). In Malaysia, the introduction of the self-assessment system has warranted the additional level of sanctions although else where, research shows that the effect on compliance is not significant.

Understanding and Perception of 'Reasonable Care'

The purpose of imposing penalties for breach of the reasonable care standard is evident under the Self-assessment System. With the increased responsibilities placed on taxpayers, increased penalties are called for on the taxpayer and anyone who assists or advises him in relation to tax submissions to ensure compliance. While under the previous Official Assessment System, each and every return is scrutinized; in the self-assessment system only a small proportion of the returns will be subject to scrutiny annually. As taxpayers and tax advisers become aware that the audit probability under the Self-assessment system is drastically reduced, they might soon begin to gamble on that probability by manipulating their reporting positions.

The common law definition of 'reasonable care' may be too wide, as it does not provide for the peculiarities of the tax field where there are subjective interpretations due to the complexity and ambiguity in the tax law. In a way, tax professionals earn their income by probing the loopholes in the law and getting around the provisions of the law. Tax savings for the taxpayer is translated as professional fees for the tax agents. On the other hand the government is bent on removing such loopholes to meet the policy of maximising tax collections. As such the law must provide for standards such as the 'reasonably arguable positions' before penalising tax agents.

Difficulties in Proving Wilful Evasion

Any action to prosecute offences under section 114(1A) will have to surmount some legal obstacles. One of the key powers of the Director General of

Inland Revenue is the power to assess the taxpayer and place the onus of proof on that taxpayer to demonstrate the assessment is wrong or excessive. The onus of proof is on taxpayers in the case of their underlying tax liability and the lower level penalties. The onus shifts to the Director General in the case of best judgement assessments (estimated assessments), evasion, hindrance and criminal penalties.

Contravening section 114(1A) is a criminal offence. Any attempt to successfully convict a wrongdoer will require a greater burden of proof as compared to a civil offence.

Perhaps what is most intriguing here is the introduction of "reasonable care" as a line of defence for the alleged wrongdoer, as, such a standard of care, is usually imposed in civil cases rather than criminal offences against the State, with the exception of strict liability cases. As in all criminal offences the burden of proof beyond reasonable doubt lies with the prosecution. Section 114 itself is entitled "Wilful Evasion". Therefore it falls upon the authorities to show "intent" on the part of the wrongdoer. On the other hand having a standard of care against the wrongdoer, which is "reasonable care", does not require "intent" on the part of the wrongdoer. As such there appears to be an anomaly in the law. It is submitted here that wilful evasion penalties do not apply if the taxpayer is merely negligent or ignorant of the tax law. The IRB must prove by clear and convincing evidence that the taxpayer engaged in intentional wrongdoing and with specific intent to avoid the tax due. The burden of proof is higher for criminal fraud than for civil fraud: The court requires clear and convincing evidence of a civil fraud, which may be proved by the introduction of circumstantial evidence and reasonable inferences (e.g., the taxpayer failed to file tax returns, did not maintain adequate records, concealed assets, and failed to cooperate with the IRB). In a criminal case, the IRB must prove each element of a crime beyond a reasonable doubt.

Furthermore the authorities may need the cooperation of the taxpayer to successfully convict a tax agent or else incriminating evidence against the tax agent or anyone else may not be forthcoming. The cordial relationship or otherwise between the two may have a bearing.

RECOMENDATIONS

1. Adopt Standards of Tax Practice

The Malaysian professional bodies should emulate the American Institute of Certified Public Accountants in formulating acceptable standards for tax practice. Unlike in Malaysia, the US tax practice is highly regulated. The AICPA issued standards known as Statements on Responsibilities in Tax Practice (SRTPs) between 1964 and 1991. This was followed by the Statements on Standards for Tax Services (SSTSs) from October 1991. Following eight years of debate, the AICPA tax executive committee voted in July 2000 to adopt eight SSTSs as **enforceable standards** for AICPA members. While this means that previously voluntary standards are now enforceable, the rules themselves are little changed.

In one of the exposure drafts, a strong case for the SSTSs is laid out in their preface, which says:

> " Practice standards are the hallmark of calling one's self a professional. Members should fulfil their responsibilities as professionals by instituting and maintaining standards against which their professional performance can be measured. Compliance with professional standards of tax practice also confirms the public's awareness of the professionalism that is associated with CPAs as well as the AICPA."

In malpractice cases against CPAs, for example, the courts viewed the SRTPs as the standards to which CPAs were actually held. Defence attorneys said the lack of enforceability made the SRTPs a sword (plaintiffs could cite allegations of failure to comply as evidence a practitioner had not exercised due professional care), but not a shield (when a practitioner followed the SRTPs,

plaintiffs—or more precisely, their attorneys-would dismiss them as irrelevant, arguing they were merely educational).

The AICPA Statements on Standards for Tax Services provide enforceable guidelines for tax practitioners regarding ethical issues and practice responsibilities (See "Statements on Standards for Tax Services: An Examination and Overview," The CPA Journal, December 2000). The US Treasury Department Circular No. 230 provides similar prohibitions and accompanying sanctions, and tax preparer penalties might also apply under Internal Revenue Code(IRC) section 6694. However they do not provide the depth of guidance found in the SSTSs. 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. (Swails,Edward J, 2000). Hume's (1999) study also indicates that when faced with ethical dilemmas, the majority of the practitioners have relied on these standards.

The more relevant provisions of these statements are summarised below:

- A CPA should not recommend any tax return position to a client unless there is a **realistic possibility** that the position has sufficient merit to be administratively or judicially sustained if challenged. Nonetheless, positions that do not meet this standard can be recommended if they are not frivolous and are adequately disclosed on the return.

- A CPA should not prepare or sign a return that he or she knows adopts a position that does not meet the realistic possibility standard. Positions that are not frivolous and that are adequately disclosed do not preclude a CPA from preparing and signing the return.

- Under no circumstances should a CPA recommend a position for the purpose of exploiting the audit selection process or establishing a mere

arguing position for later negotiations with the IRS. For example, a CPA should not prepare or sign a return that contains a **frivolous position** partly or wholly on the basis that the IRS is unlikely to audit the return or, perhaps because the position is undisclosed, detect the frivolous position.

- As a general rule, a CPA can rely on information furnished by a client or a third party and is not required to independently verify the accuracy of the information. If the information appears incomplete, incorrect, or in some way inconsistent with other information (e.g. a prior year's return), however, the CPA should **make reasonable inquiries**. Failure to make reasonable inquiries may preclude the CPA from signing the tax return. The signature is a declaration under penalties of perjury that to the best of the preparer's knowledge, the return and accompanying schedules and statements are "true, correct, and complete."

- CPAs can prepare returns that contain estimates if it is impracticable to obtain actual data. However, the **estimates must be reasonable**. Furthermore, the estimates should not be presented on the return in such a way to imply more exactness than actually exists.

- A CPA should promptly notify the client of any significant error in a prior year's return, whether or not the CPA should recommend the appropriate measures to be taken to correct the error. If the client fails to correct the error, the CPA should consider **withdrawing from the engagement.**

2. Amend Section 153 to License all Tax Practitioners

In Malaysia, one cannot identify a tax profession or practice or one single body that represents the profession. Such a situation is not uncommon even in America and Australia. Even after a decade since the formation of the Malaysian

Institute of Taxation(MIT) under the Malaysian Institute of Accountants' umbrella there is gradual progress in attracting the majority of practising accountants who also carry out tax work. In view of the differences that exist among the professional bodies, such a single body that will represent all tax professionals is unlikely to materialise. As long as the law recognises various classes of professionals under section 153 of the Income Tax Act, the problem will continue to exist.

It is recommended that the Government license all existing tax professionals in practice under one category without any cost. A fee may be imposed for all future registrations. The relevant legislations need to be amended to accommodate the change. The licensing should be handled by the Treasury which remains as the policy making body up to the current date. The Treasury can then co-ordinate a sub-committee comprising members of the various professional bodies and the government agencies such as the IRB and the Royal Customs and Excise Department to draft ethical standards of practice that are enforceable in line with those adopted by the American Institute of Certified Public Accountants. Such a suggestion is made in light of the failure of the professional bodies to set their own standards. The introduction of the self-assessment system was an expected development. The professional bodies by not being proactive, now cannot blame the government for introducing section 114(1A).

3. Impose Penalties based on Culpable Conduct

The IRB should consider imposing penalties based on culpable conduct as seen in the Australian and American tax legislations. Australia demarcates penalties according to the severity of the conduct. Penalties for tax shortfall differs depending on whether it is due to : failure to take reasonable care; negligence, lacking reasonably arguable position; recklessness and intentional disregard of the law.

In America, The Internal Revenue Code (IRC), Section 6663 imposes a 75% penalty for civil tax fraud, while section 7201 provides penalties for criminal tax fraud (up to $100,000 for individuals, $500,000 for corporations, and up to five years in jail). Taxpayers may be subject to other penalties, such as a 20% accuracy-related penalty under section 6662 for negligence, intentional disregard of rules or regulations, substantial understatement of tax, or valuation understatements. Generally, the tax law prevents the "stacking" of penalties (e.g., the 20% accuracy-related penalty is not imposed if the civil fraud penalty applies). (Philips et.,al. 2001).

4.Contemporaneous Rulings and Practice Guidelines

The authorities should issue rulings and practice guidelines at the time of introducing any legislation and not much later. The Public Ruling No.8/2000 issued with regards to section 114(1A) also covers section 114(1) and section 113 which existed from the legislation of the Act. As such it does not reflect the intention of the legislation contemporaneously as far as the explanation and examples for section 113 and 114 are concerned. The Board's rulings or circulars issued at the time of any new law has greater sanctity on the principle of ***contemporanea expositio***, as one which explains the intention behind the law at a time contemporaneous with the law itself. But where a circular is issued much later, it cannot be said to be a contemporaneous interpretation with the result that it does not have the same degree of authenticity as one issued at the time of the introduction of law. This was the view taken in *Warren Tea Ltd. V Union of India [1999] 236 ITR 492 (Cal).* In this case the court held that the circular issued in 1991 in respect of a provision made in 1983 cannot command the same respect as otherwise, with the result that the court was free to consider the issue with reference to judicial precedents and came to a conclusion different from the one enjoined by the circular.

Contributions of this Study

Any provision that affects the personal liability of tax agents will not be perceived favourably if it is not done in consultation with those who represent them. Apart from highlighting some anomalies in the legislation, the findings of this study provide evidence that it is best that provisions affecting tax professionals are enacted after considering extensive representations and consultations with the professional bodies in line with the smart partnership concept propagated by the government. This will enable the stakeholders to reduce the ambiguity in the law that is prevalent in most tax legislations.

It is also pointed out that if the professional bodies have been proactive in adopting their own practice standards, tax agents can rely on them in the face of ethical dilemmas in their practice.

To reduce any ambiguity in the law, it must be accompanied by contemporaneous practice guidelines or rulings. Although these rulings are not law, the interpretation of the government is made known.

Suggestions for Future Research

Further research should be carried out on the interpretation of the concept of "reasonable care" in other jurisdictions where the self-assessment system has been introduced much earlier. Studies should also be carried out on the understanding of this concept among revenue officers, as this will show the congruence of the interpretation of this concept among the enforcers and implementers of the law as compared to those of the tax agent fraternity who will be on the receiving end. The authorities should pioneer tax policy studies and compliance research to determine the tax compliance variables that are peculiar to this country. The results of studies carried out outside Malaysia may not reflect the cultural peculiarities in this country.