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TAX COMPLIANCE COST AMONG SMES: EVIDENCE FROM THE SOUTHERN REGION OF MALAYSIA

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Abstract

Tax compliance costs are the costs incur by the taxpayers in order to comply with the tax law and regulations. It is an extra burden to the taxpayers especially if the taxpayers are small and medium enterprises (SMEs). The study examines the relationship between tax compliance costs and tax non-compliance behaviour among SMEs in the southern region of Malaysia. Besides, perceptions of SMEs towards these costs, which have been categorised into monetary and time costs, are also observed. 100 questionnaires were distributed to the respondents but only 68 responses received back. However, only 64 questionnaires are valid, hence led to 64% response rate. Spearman's Rho correlation coefficient is used to measure the relationship since the data is not normally distributed. Meanwhile, descriptive analysis is conducted to observe perceptions of taxpayers to tax cost of compliance. The analysis depict that there is a significant relationship between time consumed due to complexity of recording and tax non-compliance behaviour. In addition, most of the respondents agreed that training costs are important because it may add values to the employees.

1. Introduction

In Malaysia, the Self Assessment System (SAS) that has been introduced gradually since 2001 until 2004, requires the taxpayers to compute their chargeable income and tax return on their own before remitting the payment to Inland Revenue Board (IRB) (Kasipillai, 2009). The taxpayers need to observe accuracy, timeliness, and adequacy of the records in filing the tax return in order to ensure its completeness (Singh & Bhupalan, 2001). Since the taxpayers are responsible to understand, interpret and apply the law on their own, and the implementation of SAS relies heavily on the compliance behaviour, it is essential to identify the factors that may lead to tax non-compliance behaviour.

1.1. Non-compliance behaviour.

A study by Pope and Abdul Jabbar (2008a) reported that tax compliance is one of the difficulties faced by SMEs. This is because the obligation to comply will results to enormous burden and costs to the taxpayers regardless of the size of the business. In another study, Pope and Abdul Jabbar (2008b) found that major tax compliance issues in Malaysia are record keeping and documentation, tax complexity and cost of compliance. In addition, Abdul Jabbar and Pope (2008) identified the two most frequently incurred non-compliance behaviour among SMEs which are the under reporting of income and the overstating of deductions. Various factors may influence non-compliance behaviour. In a study towards individual taxpayers in New Zealand, Natrah (2014) suggested that tax knowledge and tax complexity are significant determinants of tax non-compliance. Meanwhile for companies, Mohd Yusof, Ming Ling and Bee Wah (2014) concluded that marginal tax rate and size of the company are significant determinants of non-compliance behaviour. This is consistent with the findings of Mohd. Nor, Ahmad and Mohd Saleh (2010) who found a negative relationship between firm's size and tax non-compliance. The impact of firm's size, which is normally measured by the number of employees and the annual sales turnover, indicates that costs; either financial (annual sales turnover) or non-financial (number of employees) are important determinants of non-compliance behaviour. In addition, Mohd Noor, Nor'Azam, Norashikin, and Alizan (2009) conducted a research to identify factors that indicated tax evasion and found that revenue, liquidity and leverage are factors that have significant relationship with tax non-compliance. This is further supported by Tabandeh, Jusoh, Nor, and Zaidi (2012) who found that income of the taxpayers is the most important determinant tax non-compliance, where most taxpayers are not willing to pay the tax if their income is low.

1.2. Tax compliance costs.

Tax compliance costs are the costs incurred by taxpayers in order to oblige with the tax law (Sanford, Godwin, & Hardwick, 1989). Sanford, Godwin, and Hardwick (1981) categorised costs of compliance into three separate elements, which are monetary, time, and psychological costs. Monetary costs include the start-up costs of a company, cost of employee to maintain the records, cost of expertise to update with the changes in rules and policies, cost of submitting the returns as well as the cost of tax consultancy. Meanwhile, time costs refer to the time spent to furnish the tax return due to its complexity, including the time spent at the Inland Revenue offices. Meanwhile, psychological costs refer to the anxiety in dealing with the tax matters, and this cost is more relevant to individual taxpayers. Since the focus of this study is on SMEs, only monetary and time costs are investigated. In their study towards SMEs in Malaysia, Pope

and Abdul Jabbar (2008b) found that 59 percent of the monetary cost for SMEs is computational costs, meanwhile another 41 percent is cost of planning. In a study towards bumiputera SMEs in Northern Region of Malaysia, Mansor and Hanefah (2008) found that 45% of the respondents agreed that the cost of compliance was a burden to them. The study also found that the tax compliance costs of SMEs were influence by the size of the enterprise, type of business, type of external advisors as well as the location of the business. However, Abdul Jabbar and Pope (2008) did not find any significant relationship between the size of tax compliance costs and the non-compliance behaviour. This finding is further supported by Sharoja and Kassipillai (2010) who concluded that the tax compliance costs was not a significant indicator of the underreporting of income or over-claiming of expenses.

2. Problem Statement

There is no doubt that SMEs is one of the major contributor of tax revenue in Malaysia. In 2015, 97.3% of business in Malaysia are SMEs and they have contributed 36.3% towards the gross domestic product (GDP). Tax compliance is one of the most common challenges faced by the SMEs (Pope & Abdul Jabbar, 2008). This might be due to the characteristics of those SMEs. In Malaysia, National Small and Medium Enterprises Development Council (SMIDEC) defined SMEs into micro, small and medium enterprises based on their number of employees and the annual sales turnover. In 2015, 77% of the SMEs are micro enterprises, which the sales turnover is less than RM300,000 and with the number of employees of less than 5 persons. This is consistent with the study by Ayanda and Laraba (2011) in Nigeria, who concluded that most SMEs are usually small size, manage only by the owner or family members and providing basic necessities. These characteristics results to lack of organisational and management structure (Olorunshola, 2003)**.** Hence, most SMEs do not have specific expertise including in managing their tax compliance, which later will result to tax non-compliance behaviour. Listed below is the criteria for different types of SMEs based on the definition by SMIDEC, Malaysia:

Table 01. Criteria of SMEs

Types of SMEs	Manufacturing	Services and other sectors
Micro	Sales turnover of less than RM300,000, OR Number of employees less than 5 persons	Sales turnover of less than RM300,000, OR Number of employees less than 5 persons
Small	Sales turnover from RM300,000 to RM15 million OR Number of employees from 5 to 75 persons	Sales turnover from RM300,000 to RM3 million OR Number of employees from 5 to 30 persons
Medium	Sales turnover from RM15 million to RM50 million OR Number of employees from 75 to 200 persons	Sales turnover from RM3 million to RM20 million OR Number of employees from 30 to 75 persons

3. Research Questions

The focus of this study is SMEs in southern region of Malaysia, which comprises of three states, namely Johor, Melaka and Negeri Sembilan. The study is interested to observe whether the costs of tax

compliance influence the tax non-compliance behaviour among these SMEs. Therefore, the study has come out with the following research questions:

- Is there any significant relationship between perception on monetary costs and tax non-compliance behaviour?
- Is there any significant relationship between perception on time cost and tax non-compliance behaviour?
- What are the perceptions of SMEs towards tax compliance costs

4. Purpose of the Study

The objective of this study is to investigate whether the perceptions of SMEs towards the tax compliance costs influence their tax non-compliance behaviour. Besides, the research also would like to observe the perceptions of SMEs towards these costs of compliance. In this study, monetary costs are further divided into cost of training (Lubua, 2014), tax administration and computation costs (Lignier & Evans (2012), Abdul Jabbar & Pope (2008) and tax planning costs (Palil et al., 2013). Meanwhile, the time spent is measured based on the perceptions towards the complexity of filing the tax return (Pope & Abdul Jabbar, 2008; Isa, 2014). Therefore, the study are interested to test on the following research hypotheses:

H1(a): There is a significant relationship between cost of training and tax non-compliance behaviour.

H1(b): There is a significant relationship between tax administration and computation costs and tax non-compliance behaviour.

H1(c): There is a significant relationship between tax planning costs and tax non-compliance behaviour.

H2: There is a significant relationship between time spent due to the complexity of the system and tax non-compliance behaviour.

5. Research Methods

5.1. Research sampling and data collection.

The study is conducted towards SMEs in the southern region of Malaysia, which covers three states, namely Johor, Malacca and Negeri Sembilan. 100 questionnaires were distributed based on purposive sampling. 68 responses received, however four responses have to be excluded because of the incompleteness of the responses. Hence, the response rate for this survey is only 64 percent.

The data collected in this study is primary data where the responses from the sample are gathered by using questionnaires. There are two methods of distributing the questionnaires, which are direct distribution at the taxpayers' premises as well as online distribution via google form. However, most of the responses received are through direct distribution. Responses received through google form contributed only 3 percent of the total responses.

5.2. Research instruments and measurement of variables.

The questionnaire used in this study consists of four parts. The first part measures the demographic profile of the respondents, where the types of data is either nominal or ordinal. On the other hands, the other parts of the questionnaire measure the level of agreements of the respondents towards monetary costs, time costs, as well as perception towards tax non-compliance. All of these variables are measured by using the four point likert-scale, as being used by Dumas and Redish (1999). The use of point point likert scale is relevant in order to avoid neutral responses among the respondents. The questionnaire is adapted from various sources as follows:

Table 02. Measurement of variables

Variables	Definitions	Measurements	Sources
Tax non-compliance (DV)	Level of tax non-compliance by SMEs	On scale of 1-strongly disagree, 2-disagree, 3-agree and 4-strongly agree (Dumas & Redish, 1999)	Abdul Jabbar and Pope (2008)
Costs of training (IV)	The cost incurred by the company to improve tax skills and knowledge of respective personnel		Lubua (2014)
Administrative and computation costs (IV)	Administrative cost: a public costs to ensure tha tax legislation is obeyed. Computation costs: the cost of having proper accounting system to compute the tax		Abdul Jabbar and Pope (2008); Lignier and Evans (2012)
Tax planning costs (IV)	The cost to minimise or avoid tax payments in a legal manner		Pope and Abdul Jabbar (2008); Isa (2014

6. Findings

Several analysis have been conducted in this study. Initially, descriptive analysis is performed in order to observe the profile of the respondents as well as perceptions of respondents towards tax compliance costs. Normality and reliability analysis also have being conducted in order to measure the normality and reliability of the data. Finally, Spearman Rho correlation coefficient has being conducted to examine the relationship between independent variables and dependent variable.

6.1. Profile of the SMEs.

Based on the descriptive analysis conducted, most of the SMEs are either micro businesses (43.8%) or small businesses (40.6%). Only 15.6 percent are considered as medium enterprises. This analysis indicates that most of the SMEs are very small in size, where the size of SMEs are measured by the annual turnover or the number of employees. Micro businesses are considered as the smallest SMEs with the sales turnover of less that RM300,000 per annum and number of employees of less than 5 persons.

Table 03. Types of SMEs

Types	Numbers	Percentage
Micro	28	43.8
Small	26	40.6
Medium	10	15.6

The descriptive analysis conducted also shows that most of the SMEs prepared their tax return on their own (46.9%). However, quite a number of them (37.5%) manage to hire professionals to do the computations for them. On the other hands, 10% of the respondents prepared the tax return with the assistant of friends. The results indicate that most of the respondents have the required knowledge to fill in the tax return, and the high percentage of preparation by tax professionals also indicates the financial capabilities of the respondent.

Table 04. Preparer of the tax return

Preparer	Numbers	Percentage
Business/ In-house	30	46.9
Tax agents/ audit firm	24	37.5
Assist by friends	10	15.6

6.2 Relationship between tax compliance costs and tax non-compliance behaviour.

In order to examine the relationship between tax compliance costs and tax non-compliance behaviour, correlation analysis has been conducted. Spearman rho correlation coefficient has been used in this study since the data is not normally distributed. The results are depicted in the table 05 as below:

Table 05. The relationship between tax compliance costs and tax non-compliance behaviour

Tax compliance costs	Relationship with tax non-compliance behaviour	
	Significant level (2-tailed)	Correlation coefficient
Training costs	.238	.149
Administration and computation costs	.478	.090
Tax planning costs	.057	.239
Time spent	.023	.284*

*Correlation is significant at the 0.05 level (2-tailed)

The results indicate that only the time spent due to the complexity of the system have a significant positive relationship with the tax non-compliance behaviour. In other word, the level of non-compliance is higher among the SMEs if they perceived that they have to spend more time to compute the tax due to the complexity of the tax system. This finding indicates that most of the SMEs feel that the computation of tax is complicated, hence might influence their non-compliance behaviour. However, the degree of relationship is not very strong, where the correlation coefficient is only 28.4%. This finding is consistent with Tran-Nam and Evans (2010) who found that tax complexity have significant impact towards tax compliance. The study however, did not find any significant relationship between monetary costs and tax non-compliance behaviour. The results indicate that most of the SMEs perceived that the cost incurred to oblige

with the tax rules and regulations are not significantly influence their tax non-compliance behaviour. Therefore, only H2 is supported in this study, meanwhile other hypotheses are not supported.

6.3 Perceptions on the tax costs of compliance.

Beside from examining the relationship between tax costs of compliance with the tax non-compliance behaviour, the study also observed the perceptions of SMEs towards those cost of compliance. Descriptive analysis conducted indicates that most of the SMEs perceived that training add values to employees (mean: 3.19). In terms of administration and computation, most SMEs agreed that consultation with tax agents or authorities may enhances their understanding (mean: 2.95). They also agreed that tax planning will consume a lot of time (mean: 2.98). Besides, SMEs also agreed that the time spent to have accurate and sufficient records may reduce possible tax penalty. The findings of this observation are summarised in Table 06 below:

Table 06. Perceptions on tax costs of compliance

Tax compliance costs	Most agreed items (mean)
Training costs	Training add values to employees (3.19)
Administration and computation costs	Consultation with tax agents or authorities enhances understanding (2.95)
Tax planning costs	Planning consumes a lot of time (2.98)
Time spent (complexity)	Time spent to have accurate and sufficient records may reduce tax penalty (3.06)

7. Conclusion

In conclusions, most SMEs agreed that complexity of the tax system might influence their tax non-compliance behaviour since they have to spend more time in furnishing their tax returns. This is consistent with Tran-Nam and Evans (2010) that tax complexity may influence tax compliance. However, the study did not find any significant relationship between monetary costs and tax non-compliance behaviour. This is consistent with Abdul Jabbar and Pope (2008) who did not find any significant relationship between cost of compliance and tax non-compliance behaviour.

7.1 Limitation of the study.

Due to the limited sample size and areas, the findings of this study is not robust and cannot be generalised to all SMEs in other parts of Malaysia. In addition, the study also only focusing on few types of tax compliance costs and did not observe any other costs involved.

7.2 Recommendation for future research.

It is interesting to suggest that future research in this area look into other types of compliance costs that may incurred by SMEs. It is also commendable to further examine if there is any significant differences in the tax non-compliance behaviour among different types of SMEs (micro, small and medium).

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