

# A Comparative Study on the Burden of Tax Compliance Costs amongst GST Registered Companies in Malaysia and Abroad

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## Abstract

Tax compliance costs are the costs incurred by taxpayers in fulfilling their obligations according to tax rules and regulations. In an indirect tax mechanism such as GST, compliance cost is borne by GST registered companies as tax collectors at the point of sales of goods and services from consumer on behalf of the government. Tax literatures acknowledge the fact about tax compliance costs and how they burdened registered companies. Ever since the first day of implementation of GST in April 2015, the issue of the burden of tax compliance costs borne by GST registered companies has always remained a hot discussion amongst academics, politicians and businessmen. This paper examines the GST tax compliance costs incurred by registered GST companies in meeting their obligations as tax collectors from consumers to the government. This analysis is based on the experience of countries that had earlier experiences implementing GST. This paper then concludes by presenting data on the magnitude of compliance costs that are borne by the GST registered companies in those countries. This paper also shows the steps taken by the authorities in those countries to reduce the burden of tax compliance costs borne by the companies. The findings of this paper are useful for policy makers and decision makers for improvement and strengthening of policy implementation purposes.

*Keywords:* Tax compliance costs; Compliance behavior; Regressive tax; GST

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## ■ 1.0 INTRODUCTION

The Malaysian government has implemented a new tax system known as Goods and Service Tax (GST) since 1st April 2015. GST is a consumption based tax imposed on every supply of goods or services unless stipulated otherwise. Malaysia is not the first country in the ASEAN or Asia Pacific regions to introduce GST but rather amongst the last. Other developed and developing countries have indeed introduced and implemented GST much earlier. In those countries GST is sometimes known as Value Added Tax (VAT) as found in United Kingdom, United States of America, New Zealand, Philippines, Indonesia, Singapore, Australia, Nigeria, Egypt and European Union countries.

The implementation of GST is still in its early stages in Malaysia thus should be well monitored for effectiveness and efficiency purposes. This is important in promoting and ensuring that taxpayers continue to support government fiscal policy by paying their respective GST taxes. Among the issues that should be addressed accordingly by the authorities is the issue of tax compliance costs (hereinafter referred to as TCC) since it could significantly influence behavior of taxpayers in paying their GST tax, avoid tax frauds and save the government from any tax payment leakages. TCC are the costs incurred by taxpayers in discharging their responsibilities under the rules and regulation of GST. Despite its importance and the TCC issue is often ignored or unseen by the public.

This paper shall discuss about TCC as found abroad and in Malaysia, particularly in the post GST. The study is mainly based on secondary materials, thus descriptive in nature. Findings from available literatures on TCC serve as a preliminary finding in preparation for current and ongoing research for primary data collection on the same topic. The investigation on TCC revolves around the fourth of policy cycle, namely on the assessment of policy implementation and enforcement. The findings from both the preliminary and actual studies would inform policymakers and decision makers of other tangible and intangible problems faced by

suppliers and tax payers in discharging their legal and duties and tax obligations so that necessary steps could be taken to assist them, improve the system and in larger context, strengthen the implementation of government fiscal and economic policy implementation.

## ■ 2.0 TAX COMPLIANCE COST

Scholars generally share the same definition and opinion about TCC. Sanford (1995) defined TCC as the costs incurred by taxpayers to meet their prescribed obligations under the tax law and regulations other than the actual tax sum. While Tran-Nam, Evans and Walpole, (2000) stated TCC as the value of resources expended by taxpayers in fulfilling their tax obligations. According to Ariff and Pope (2002) TCC is the cost incurred by the taxpayer in meeting the conditions set out in the tax regime. This includes the preparation and submission of tax returns in accordance with the tax law of a country.

A more practical and comprehensive definition is provided by the European Commission's Directorate-General for Taxation and Customs Union (2013). The Commission described TCC as all costs incurred by corporate and private business institutions to comply with tax regulations, excluding the tax itself. Most of these costs are closely related to information processing activities such as record keeping and filing tax returns along with tax data. In all, TCC is actually a separate amount of sum that taxpayer have to bear as part of his preparation to pay the GST to the government. Being the case, TCC could be considered as the secondary or supplementary cost incurred in the tax payment process since taxpayer has to set-aside a certain amount of money for expenses incurred in meeting or fulfilling their legally mandatory tax obligations. As such, there is a high probability that the amount of TCC would differ greatly between sectors, industries or jurisdictions.

## ■ 3.0 GST COLLECTION MECHANISM

GST is an indirect tax because the actual payment of tax is paid through traders or suppliers instead of directly to the government. The traders or suppliers are considered as tax collectors from consumers through the sale of goods and services provided. In this context the tax is paid when the consumer purchases goods or services from the supplier. At this point, when the supplier presented the bill for payment for services rendered or goods purchase for customer, the supplier has already beforehand included the taxable GST amount of money in the said bill. Such inclusion is usually marked as “GST /payment 6 percent” and easily seen at the bottom part of in any standard bill of payment. The supplier later on will transfer the tax collected to the government within a certain period of time.

Not everybody can collect or shall pay GST tax as the Goods and Services Tax Act 2014 (GST Act 2014) has specifically specify certain conditions to be satisfied first. Firstly, only traders who sell taxable goods or provide taxable services are obligated to do so. The Act refers them as a supplier or making a supply. Secondly, they must be registered as GST registered companies. As business entities, they must earn at minimum sum of RM500 thousand a year from their taxable supply. Once these conditions are fulfilled, the GST registered companies are required to charge GST tax for each supply made. The tax is collected for a specific period of time before it is transferred to a government account through the submission of tax returns and payments.

As GST registered company, they are responsible to comply with all the rules set out in the GSTA 2014 and the Goods and Services Tax Regulations 2014 (GST Rules 2014). Among the responsibilities of a registered GST company are (i) to issue sales invoices in accordance with the prescribed procedures (section 33), (ii) keep proper record of every transaction involving sales and purchases and subsequently their accountings (section 36), (iii) submit tax returns within the prescribed period and (iv) pay the correct amount of tax (Section 41). Failure to comply with the stipulated rules will result in the company being fined and penalized.

## ■ 4.0 THE HIDDEN COST OF TCC

In his book titled 'The hidden costs of Taxation ' Sandford, (1973), describes TCC as a hidden tax expense. This is due to the nature of the cost that is intangible and often overshadowed by the actual tax sum. Often the society in general bound to overlook the fact that traders or suppliers have to pay TTC out of their pockets and not the customers. This happens even when they are just collecting the tax on behalf of the government (Sandford, Godwin and Hardwick, 1989). Pope (1993) who agrees with Sanford's view adds that

the TTC is and should be calculated separately from the actual tax sum. This is mainly due to the fact that the TCC is not claimable. GST registered companies could not expect customers to pay them as TCC is not part of the purchase or service charges. Likewise, they too cannot ask for repayment or reimbursement from the government either. In short, in term of accounting and easy management purposes, TCC would be continuously regarded and calculated as the real expenditure of the GST registered companies have incurred or have to incur every year. It would not diminish, but must be absorbed by GST registered companies until and unless there is a policy change on the subject matter.

The TCC comes from various activities since GST is an evidence oriented tax system. The Customs Department as the tax collection body expects the GST registered companies to show the trails of their claims so that the re-payment could be apportioned and repaid accordingly between them. As such a registered GST company may have to create or change existing work processes to ensure that tax-related matters are well documented and organized. Being the case the company may need to purchase new equipment or apparatus, subscribes certain computer software for accounting purposes. Not stopping there, the company may need to attend courses, introduce a change in the company's standard operation procedures, employs accountants or experience employees to maintain and update tax records, prepare tax returns and payments including training of related staff (Eichfelder and Vaillancourt, 2014). Without much choice, the GST registered company have to incur some costs in terms of finance, time, resources and mental preparation in fulfilling their legal responsibilities above or face the possibilities of being charged in courts of law for tax avoidance or infringement (Pope & Hijattulah, 2008). As discussed above, these incurring expenses are not seen of felt by others except the registered GST companies (Hafizah & Mustafa, 2008).

## ■ 5.0 COMPONENTS OF TAX COMPLIANCE COSTS

Eichfelder & Vaillancourt, (2014); Tran-Nam et al., (2000) outlines three main key components of TCC. They are (i) external costs, (ii) internal costs and (iii) psychological costs.

External cost covers any financial expenses incurred by the company. Tran-Nam et al. labelled such cost as additional costs and it is regarded as part of the external cost. It is regarded as an external cost because it is the extra financial cost especially allocated for the purpose of tax compliance. The said sum incurred outside or on top of the usual and normal payment allocated to pay salary of staff, utility bills, rents and so on. This includes payment for obtaining tax advice from tax advisors, accountants and lawyers. For example, the appointment of an external accountant for accounting work in relation to GST tax payments. The company may also need to purchase new office equipment such as an automated cashier machine, books, printing of new receipt books that shows the trail of GST, computers, compatible software, reference books, other reading materials on tax and GST, staff training, travelling expenses to and from the tax office or elsewhere and many others. Though burdensome, but such decision is necessary in ensuring the paper works are in order and in compliance.

The internal cost refers to time costs of the company in preparing the works for tax compliance activities. In that context, every second, minute, hour, day, week or month spends on the preparation towards tax compliance would be included, counted and converted in terms of money. For example the number of employees required to do the tax-related work and number of hours each officer spends in completing their works. Such work or assignment must be specifically related to tax compliance activities. It could cover works such as updating records, checking reconfirmation and validation of data, maintenance of tax records, filing tax returns, paying taxes and dealing with tax authorities. In such circumstances the monthly salary of each employee, payment for their overtimes, if any, and extra wages payable to hire extra helping hands would be regarded as internal cost of the company.

Psychological costs refer cost of emotional cost faced by the company as a business entity in relation to tax compliance activities. Usually it refers to fears, stress and anxiety often faced by the company or its staff when dealing with tax matters (Evans, Lignier, & Tran-Nam, 2013). For example, individual staff may have certain anxiety and nervousness when several indicators indicate that they may not be able to complete their jobs within stipulated dateline. Anxiety could be traced when there is a likelihood that the business entity could be fined with heavy penalties in the event of a sloppy quality of work, mistake, and oversight when preparing a tax return. In many contexts, psychological costs are very abstract and subjective. They could be interpreted differently by different groups of people, thus rather difficult and quite impossible to measure. (Hijattulah, 2009; Tran-Nam et.al, 2000). According to Hijatullah (2009) and Evans, (2008) until 2009, measurement of psychological costs has yet produced reliable and consistent findings.

## ■ 6.0 ISSUES AND BURDENS OF TAX COMPLIANCE COSTS

As stated above, TCC obviously creates extra costs on traders and suppliers as taxpayers and to certain extent may impose on them indirect burden. Such issues have been the subject of interests amongst many quarters in the society locally and internationally. As far as Malaysia is concerned, it is still unknown the average TCC for GST registered companies, what is the impact of TCC on large, medium or small scale companies. It is not confirmed whether the TCC is more burdening on small and medium size companies as compared to large companies or the reverse. In other words, there is yet empirical data to confirm whether TCC of GST has a regressive effect on small and medium companies or not. It is also unknown to what extent TCC could affect or influence a non-compliance behavior amongst GST registered companies or whether TCC could potentially affect the price of goods and services. Pope & Hijatullah, (2008) believe TCC places enormous burden upon the business sector and due to its regressivity nature, the burden of TCC may fall harder for small companies (Noor Sharoja, Mazni, & Noor Adwa, 2014). In the long run the same may negatively affect their tax compliance behavior (Hijatullah, 2009).

## ■ 7.0 TCC ABROAD AND LOCALLY

The findings of previous studies on TCC abroad indicate that taxpayers have to incur a rather huge amount of money, time and efforts for tax compliance activities and purposes.

Table 1: The findings of tax compliance costs studies internationally

Researcher, (year)	Country	Research findings on TCC
Sandford, Godwin, & Hardwick, (1989)	UK	Tax compliance costs in 1986-87 were £ 300 million or 2.22 percent of government corporate tax revenue.
Ariff, Loh and Talib, (1995)	Singapore	In 1994, the average tax compliance costs per public listed company were S\$ 78,396.
Slemrod & Blumenthal, (1996)	US	The average tax compliance costs per company in 1992 was US \$ 1.57 million, and US \$ 2.08 billion in total, accounting for 3.2 percent of the revenue collected..
Chan, Cheung, Ariff, & Loh, (1999).	Hong Kong	The average tax compliance cost per public listed company in 1995-96 was estimated at HK \$ 346,483.
Bertolucci, A (2002)	Brazil	The total tax compliance costs was R \$ 7.2 billion
Chattopadhyay & Das Gupta (2002)	India	Corporate tax compliance costs for 2000-01 were around 5.6 to 14.5 percent of tax revenue.
Blažić, (2004)	Croatia	The compliance cost in 2001-02 is HRK 27,113 per company and the total amount was HRK 2,038.6 million, which is 1.2 per cent of the country's GDP.
Evans et al., (2013)	Australia	The average cost of tax compliance costs for each SME in 2012 was A \$ 13,313.
Blaufus, Eichfelder, & Hundsdoerfer, (2014)	German	The total tax compliance costs of individual income tax in 2007 were estimated to be between € 6 to € 9 billion, ranging from 3.1 to 4.7 percent of tax revenue.

As seen from table 1 above, the TCC has regressive effects on the business entities surveyed. It is noted too that the TCC is increasing from every study to the next. This is regardless of jurisdictions, territory or size of companies. From the data, the regressive nature of TCC also appears in every study. In short, it is acknowledged that TCC is imposing more burden on smaller companies than larger companies. Apparently regressivity is part

nature of TCC. They are intertwined and seemingly unavoidable. Cumulatively the tax authorities abroad together with their governments have taken into consideration this issue seriously and been introducing means to reduce them (Noor Sharoja et al., 2014).

The initial study on TCC by Hijatullah (2009) amongst business entities in Malaysia also indicated the same pattern, as in table 2 below.

Table 2: The findings of tax compliance costs studies locally

<b>Researcher, (year)</b>	<b>Respondent</b>	<b>Research findings TCC</b>
Loh, Ariff, Zubaidah, Shamsar, and Ali (1997)	Public listed companies	The average tax compliance costs per public listed companies in 1995 was RM68, 836 and constituted 72 percent of the external cost.
Mustafa, Mohamed, & Jeyapalan, (2001).	Small and Medium Enterprises	The average cost of compliance for SMEs in 1999 was RM21,964 and represents 75 percent of total internal costs.
Hafizah & Mustafa, (2008)	Small and Medium Enterprises	The average corporate tax compliance cost for 2003 was RM22,003. Small SMEs bear a high percentage of tax compliance costs based on tax revenue of 2.57 times more than the large SMEs.
Mohd Rizal, Rosiati, Ahmad Fariq, & Norul Syuhada, (2013).	Small and Medium Enterprises	The average corporate tax compliance cost in 2010 was RM28,406 per company. Estimated average cost after GST is increased by RM6,336.

It must be stated here that the studies on TCC conducted locally are carried out during the pre-GST. To date there is no study yet on TCC in the post-GST. Based on the experiences and findings of studies below, it is safe to assume that there is a high probability that TCC in the post-GST shall be equally burdening too. The study by Mohd Rizal, Rosiati, Ahmad Fariq, & Norul Syuhada in 2013 has much earlier predicted the TCC in the post GST would be higher than what the companies used to bear. The estimated extra cost of RM6,366 is indeed burdensome for small companies especially start-ups as they may have to set aside or allocate extra money from their annual budget for TCC. As explained above, the extra cost for TCC would come from the purchase of apparatus, change of standard business operations, record keepings, documentation and hiring of skill and experienced staff, whenever needed.

Based on their studies and findings, the researchers have basically agreed on several points regarding the TCC. Among them are:

1. The TCC is high and significant, therefore needs to be addressed best by business entities.
2. The TCC is regressive, small businesses bear higher expenses than bigger businesses. However it is admitted that regresivity is part and parcel of TCC and seemingly unavoidable. Thus the system must look for solutions to address this problems.
3. The TCC has an influence on tax compliance behaviour. The higher the TCC then the lower the expectation of the voluntary compliance level.
4. The TCC do not diminish in the absence of a policy change by the government.

All the authors above are agreeable that the more time and resources business entities spend on tax compliance; they shall have and spend fewer resources available for core business activities. It is therefore important for the government and the tax authorities to seek solution so that the burden of TCC could be reduced.

The government of some countries mentioned above has started to pay their attentions to the TCC problems seriously. The governments have begun to impose a legal requirement in demanding tax authorities to make a tax impact assessment study, including TCC estimates before a new tax scheme is implemented. For example, it is now mandatory and a must for tax authorities in the UK, Australia, New Zealand and USA to conduct a nationwide impact study before introducing a new tax scheme or law. Such exercise has indeed become a pre-requisite condition before any new tax scheme or law is approved (Pope & Hijattullah, 2008; Tran-Nam et al., 2000). The pre-emptive measure is necessary to prepare the government or tax authorities in making better planning or strategizing policy implementation, especially in dealing with TCC.

Learning from the experiences of developed countries on TCC, the Malaysia government has to date introduced several soft approaches to soften the blow of TCC. Among those measures are providing GST-

related courses for free, GST-compliant accounting software at subsidized rates as well as reducing corporate tax rates. Such approaches are important and seen as part of government's effort in encouraging and increasing the number of taxpayers and tax compliance. Their large and high numbers could be construed as their support for the GST tax scheme. The money generated from GST could later on be used for internal economic social and developmental programs.

## ■ 8.0 WAY FORWARD

Taxes, TCC, regresivity of TCC and tax compliance behavior are synonymous. They are usually intertwined closely. TCC in particular presents problems in its own right to taxpayers and government. It is only fair for the government to look for solution as part efforts in reducing the burden and improvements of tax mechanism to encourage a higher rate of tax compliance behavior. It is also proposed that the tax authorities and the government of Malaysia to follow the footsteps of developed countries above in introducing the tax impact studies as a pre-emptive measure best before the introduction of any new tax scheme or law. It is also important for tax authorities or the government to be engaged with business entities and communities in looking for more workable options and alternatives in place. Bearing in mind that TCC would not reduce over time, the engagement efforts for new and workable measures to reduce the TCC must be conducted continuously.

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