MALAYSIAN INDIRECT TAX ADMINISTRATION SYSTEM: AN ANALYSIS OF EFFICIENCY AND TAXPAYERS' PERCEPTIONS

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ABSTRACT

This study examines the level of efficiency of the indirect taxes administration system. The level of efficiency was analysed through the trends of the cost-revenue ratio; arrears-revenue ratio; and revenue detected-collected ratio. Further investigation was carried out to see whether the Malaysian indirect tax system has all the characteristics of a good tax system as perceived by the taxpayers based on the tenets proposed by the Institute Chartered Accountants of England and Wales (ICAEW). The result of the study revealed that the Malaysian Customs Department has been collecting less indirect taxes revenue each year as compared to the costs incurred in the process of acquiring the revenue. An analysis on the ratio of total arrears to total revenue collected also indicated that uncollected indirect tax revenues is on the increasing trend. It shows that the rate of increase in the amount of overdue taxes is more than the amount of revenue collected each year. It was also revealed that on the average, only 60% of the revenue loss detected could be recovered for the period 1995 to 2001. The trend of collection has been rather stable even though the revenue detected had increased. Regarding the characteristics of a good tax system, based on the respondents surveyed, there are mixed responses for each characteristic as perceived by the taxpayers. The findings revealed that there is an existence of a good legislation under the tax system and the tax system is constant and regularly reviewed. However, they had disagreed that the present system is certain and simple; proper consultation has been made before any new legislation is issued; and that the overall system is fair. From all the characteristics suggested, the taxpayers ranked "statutory" as the highest and "proper consultation" as the lowest.

Keywords: *Globalisation; tax administration; indirect taxes; and efficiency.*

ABSTRAK

Artikel ini menilai tahap kecekapan sistem pentadbiran cukai tak langsung. Tahap kecekapan ini dianalisa melalui arah aliran nisbah kos-hasil; nisbah tunggakan-hasil; dan nisbah hasil dikesan-hasil dikutip. Kajian lanjut juga telah dijalankan untuk melihat sama ada sistem cukai tak langsung di Malaysia mempunyai semua ciri sistem percukaian yang baik daripada persepsi pembayar cukai. Ciri-ciri ini adalah berdasarkan apa yang dicadangkan oleh Institute of Chartered Accountants of England of Wales (ICAEW). Hasil kajian menunjukkan kadar kutipan hasil cukai oleh Kastam Diraja Malaysia semakin menurun setiap tahun jika dibandingkan dengan kos yang terlibat dalam proses mengutip hasil cukai tersebut. Analisa terhadap nisbah tunggakan hasil ke atas jumlah hasil yang dikutip juga menunjukkan bahawa hasil cukai tak langsung yang tidak dapat dikutip semakin meningkat. Analisa arah aliran ini juga menggambarkan bahawa kadar peningkatan dalam jumlah cukai tertunggak melebihi kadar kutipan hasil cukai setiap tahun. Ia juga memperlihatkan bahawa secara puratanya, hanya 60% daripada kehilangan hasil yang dikesan dapat diperoleh semula bagi tempoh 1995 hingga 2001. Arah aliran kutipan pula agak stabil walaupun hasil yang dapat dikesan meningkat. Berkenaan dengan ciri-ciri sistem percukaian yang baik daripada persepsi pembayar cukai pula, terdapat maklum balas yang bercampur-campur daripada responden yang disoal selidik. Hasil kajian mendapati pembayar cukai berpendapat bahawa sistem cukai tak langsung mempunyai perundangan yang baik; sistem tersebut adalah tetap dan dinilai semula dari semasa ke semasa. Walau bagaimanapun, mereka kurang bersetuju bahawa sistem tersebut adalah pasti dan mudah; perundingan yang sewajarnya telah dilakukan sebelum sesuatu undang-undang cukai dikeluarkan; dan keseluruhan sistem adalah adil. Daripada kesemua ciri-ciri sistem yang dicadangkan, pembayar cukai memberikan kedudukan tertinggi untuk 'perundangan' dan kedudukan terendah untuk 'perundingan yang sewajarnya'.

Kata Kunci: *Globalisasi; pentadbiran cukai; cukai tak langsung; dan kecekapan.*

INTRODUCTION

Malaysia, as a member of the ASEAN group, has the obligation to comply with the ASEAN Free Trade Agreement (AFTA) and also the ASEAN Framework Agreement in Services (AFAS). The 2005 dateline to implement AFTA and AFAS imposed by ASEAN to its members would be an important factor that might force the Malaysian Government to improve the present indirect tax system. Recently, the Malaysian Prime Minister during his Budget 2005 presentation

announced that the Goods and Services Tax (GST) system would replace the existing Sales Tax and Services Tax by the year 2007.

To implement GST in Malaysia in 2007 is another issue that will involve careful planning before it can be put into practice. However, the most urgent matter at the moment is to analyse the present administrative system of the indirect tax to see whether the system is capable of coping with the new era of globalisation and trade liberalisation. The weaknesses of the present system were highlighted by the former Deputy Minister of Finance, Datuk Chan Kong Choy who disclosed the fact that the tax authorities were unable to collect a total of RM4.2 billion of taxes inclusive of the unpaid sales tax of RM75.7 million, services tax of RM46.8 million, customs duties of RM46.7 million and excise duties of RM0.57 million as of April 2002 ("Unpaid Taxes," 2002). A more recent report highlighted that the Government lost about RM1.2 billion of indirect tax revenue as at the end of the year 2002 due to poor enforcement ("Loss of Tax," 2003). The situation reflected the flaws in the present indirect tax administration, which is consistent with Surrey (1975), who stated, "the sign of ineffective tax administration is the presence of a very large number of delinquents in tax payments, for it indicates the lack of respect for the tax system."

Meanwhile, tax regimes around the world are constantly looking for ways and means to improve their tax revenue collections. It has been argued that the efficiency and productivity of the tax administrative system determines the amount of tax collected. If the tax administrative system were efficient and productive, collection of tax revenue would be high (Mustafa, 1996). The disclosure of the uncollected indirect taxes above reflects the ineffectiveness or inefficiency of the indirect tax administrative system. Many researchers highlighted that tax administration should be given a priority by the authority concerned to safeguard the basic philosophy of taxation as suggested by Smith (1776) a long time ago. The aim of this study is to examine the level of efficiency of the indirect tax administrative system. In addition, an investigation was also carried out to see whether the Malaysian indirect tax system has all the characteristics of a good tax system as perceived by the taxpayers.

This study is regarded as essential to provide strategic information to policy makers in the customs department to improve the efficiency of the indirect tax administrative system. The findings of this study could possibly explain the state of efficiency of the tax administrative system. Indeed, prior to this work, there was very little empirical work in this area, which made specific reference to the issue of the payment of indirect tax.

INDIRECT TAX CONTRIBUTION

The earliest introduction of taxation in Malaysia was in 1910, in the form of indirect taxes (Barjoyai, 1993). Indirect tax was considered as the most convenient tax for the purpose of revenue generation compared to the direct tax from the public. The Malaysian taxation system however, has come a long way from the normal tax features found in under developed and developing countries. In these countries, heavy reliance is on the indirect taxes for convenient tax revenue generation. The shift is then to direct taxes to achieve equity or income distribution objectives (Barjoyai, 1993). The above statement is further supported by the trend shown in Table 1 (refer column Total Indirect Tax) where Malaysia is going through a similar situation as experienced by advanced countries.

Table 1
Indirect Taxes Contribution
as Percentage of Federal Tax Revenue 1960 –2002

Year	Export Duties	Import Duties & Surtax	Excise Tax	Sales Tax	Other Indirect Tax	Total Indirect Tax
1960	29.2	40.0	0.9	-	6.4	78.4
1965	19.9	40.1	0.8	-	12.1	72.9
1970	14.0	27.9	12.5	-	10.6	65.0
1975	13.7	17.5	9.3	5.9	9.4	55.8
1979	20.4	15.9	10.1	5.7	5.5	59.1
1980	20.2	15.9	7.6	5.4	6.6	55.7
1981	16.5	16.1	7.5	5.2	5.5	52.7
1982	16.1	14.6	6.7	5.3	5.6	50.0
1983	11.6	15.9	8.4	7.8	4.0	51.7
1984	11.8	15.3	8.3	7.5	4.0	50.9
1985	10.0	14.9	8.3	7.4	7.8	48.4
1986	9.7	15.4	8.9	7.3	4.4	50.7
1987	10.2	15.8	11.4	8.5	4.0	49.9
1988	10.1	17.4	11.3	7.9	4.2	50.9
1991	8.3	16.2	11.1	9.8	3.3	48.7
1993	4.6	14.3	11.6	10.9	5.1	46.5
1995	2.0	13.5	12.7	11.7	5.6	45.5
1996	2.2	14.9	13.9	13.1	7.1	51.2
1997	2.2	15.0	14.6	14.5	7.6	53.7
1998	1.4	8.5	7.9	8.5	7.5	33.8
1999	1.5	10.4	10.4	10.0	7.7	40.0
2000	2.2	7.6	8.1	12.7	7.7	38.3
2001	1.4	5.2	6.7	12.0	6.3	31.6
2002	1.2	5.0	6.3	13.4	5.7	31.6

Source: Compiled from Annual Economic Reports of Malaysia (1960 – 2002)

There are four main types of indirect tax, which are sales tax, excise duties, service tax and customs duties. Sales tax is governed by the Sales Tax Act of 1972. It is a single stage ad valorem tax imposed on taxable goods manufactured locally and/or imported. It is also considered as a consumption tax and therefore under the system the onus is on the manufacturers to levy charges and collect the tax from their customers. For imported goods, sales tax is collected from the importer upon the release of goods from customs control. Sales tax is computed based on the value of taxable goods sold, used or disposed of, or imported. With effect from January 2003, the valuation method for locally manufactured goods will be based on the transaction value as determined by the World Trade Organisation's (WTO) method of valuation.

On the other hand, excise duties are levied on selected products manufactured locally, such as cigarettes, liquors, playing cards, mahjong tiles, petrol, diesel and motor vehicles. The rate of duty to be levied is determined by the Minister of Finance and published in the gazette as stipulated in Section 6 of the Excise Act of 1976. The rates are either specific or ad valorem rates.

Next, the Service Tax Act was introduced by the Government in March 1975 to allow the department to collect taxes from businesses providing services and goods which are taxable under the Second Schedule of the Services Tax Regulations of 1975. Service tax has to be charged and levied on the taxable service provided by the taxable person based on various rates. It is also a single stage tax levied on any taxable service provided by any taxable person in places such as restaurants, hotels, and health centres. Since 1992, the scope of the service tax has expanded vastly to include professional services such as lawyers, accountants, engineers, architects, private hospitals, etc.

Finally, the last type of indirect tax is customs duties. They are levied on goods imported into or exported from Malaysia and are paid by the importer or exporter. Duties that are imposed on imports into Malaysia are called import duties and duties imposed on exports from Malaysia are called export duties. Custom duties are levied under the Customs Duties Order of 1996 issued under the Customs Act of 1967. Meanwhile, the Customs (Prohibition of Imports) Order of 1988 and the Customs (Prohibition of Exports) Order of 1988, prohibit the import and export of specific goods into or from Malaysia. Import duties are levied on a large number of imports and are imposed either at an ad valorem or specific rates. The ad valorem rates of import duties vary from 2% to 300% (CBU motorcars). Meanwhile, an export duty is leviable on the goods to be exported. Column fire (5) of the first

schedule to the Custom Duties Order of 1996 indicates the rate of export duty is applicable for particular types of goods. Generally, not many goods are levied under the export duties. This is because the government always encourages the development of export-oriented industries.

EFFICIENCY OF THE TAX ADMINISTRATIVE SYSTEM

The main objective of the establishment of the Royal Customs Malaysia is to collect the country's indirect taxes efficiently and effectively. As far as this study is concerned, there is no work done in Malaysia to find out whether the present system of indirect tax has achieved the stated purpose. Meanwhile, the weaknesses of the present system were highlighted by the reports that the government lost about RM170 million of indirect tax revenue as of April 2002 and about RM1.2 billion at the end of the year 2002 due to poor enforcement as previously discussed. This reflects the inefficiency of the indirect tax administrative system. Furthermore, researchers suggested that the effectiveness of tax systems does not rely solely on high taxpayer compliance but also on the efficiency and productivity of the administrative systems supporting that tax (Tayib, 1998; Mustafa, 1996; Jackson, 1994; Kelly & Oldman, 1973).

Efficiency is defined as the quality of being able to do a task successfully and without wasting time or energy (BBC English Dictionary, 1993). Kelly and Oldman (1973) defined an efficient tax administrative system as a system that involves an effort to achieve the maximum outputs, with regards to revenue income, equity and other goals of the tax, with limited human and material resource inputs available to the tax gathering system. Productivity, on the other hand is defined as the rate at which goods are produced, or the amount of goods produced by each worker (BBC English Dictionary, 1993). Therefore, the productivity of the tax administrative system is more focused on the productivity of the tax authority personnel, which is not included in the scope of this study.

In Malaysia, a few studies attempted to assess the efficiency of the tax administrative system. Barjoyai (1993) for example, evaluated the impact of the 1988 Malaysian Tax Reform in terms of three basic criteria namely the efficiency implication, the distribution of tax burden (equity) and tax revenue generation. He used the general equilibrium analysis that was very sophisticated, extensive and technical as compared to other efficiency studies on the tax system in Malaysia. His study found that corporate tax was the most efficient and

productive instrument while payroll tax, on the other hand, was found to be inefficient and unproductive. Another study was carried out by Mustafa (1996), who adopted Ishi's (1993) approach in measuring the efficiency of the Japanese tax administration. Mustafa's study was to determine whether the income tax administrative systems practised in Malaysia was efficient as compared to other developed countries such as Japan, the USA, Canada, the UK, Australia, New Zealand and Indonesia. He measured efficiency by comparing the relative size of the administrative costs with tax revenue. Using trend analysis, he found that the Malaysian tax administrative system was moderately efficient and productive when compared to Japan, Australia and New Zealand. However, it was not as efficient when compared to Indonesia and the USA. The trend analysis in his study also indicated that administration costs were on the rise and productivity was declining.

Later, Tayib (1998) focused on the efficiency of the "assessment tax" collection system in Malaysian local authorities. He also used a similar method of comparing administrative costs with tax revenue as Mustafa to measure efficiency in his study. He examined the efficiency of local authorities with different levels of assessment tax collection performance. His study showed that the authorities with high collection performance were more efficient and productive when compared to authorities with medium and low tax collection performances. However, none of these studies examine the administrative efficiency of the indirect taxes in Malaysia. Therefore, this study explores the level of administrative efficiency of Malaysian Customs Department using the same method as Mustafa and Tayib by comparing administrative costs against tax revenue. In addition, this study also uses trend analysis to compare tax arrears against tax revenue and the deficiency in revenue detected and collected.

ELEMENTS OF A GOOD TAX SYSTEM

The elements of an efficient and good tax system have been proposed by many studies. It can be traced back to as early as Smith's (1776) "cannon of taxation", which stressed on equality, certainty, convenience of payment, and economy of collection as the main principles of tax system. Then, the Meade Report (1978) recommended that a good tax structure should have several characteristics namely incentives and economic efficiency; distributional effects; international aspects; simplicity and costs of administration and compliance; flexibility and stability, and transitional problems. The HMSO (1981), a Green Paper, suggested that a local tax system requires practicality, fairness, accountability, low cost of administration, fiscal dimensions, and

financial control. Later, the O'Brien Report (1982) advised that equity, efficiency, simplicity, and low administrative and compliance costs as criteria for a tax system. A study by Ridge and Smith (1991) listed administrative feasibility, economic efficiency, equity, and accountability as the criteria for a local tax. Jackson (1994) stated that an efficient tax system should at least be simple and easily understood, minimise distortion, requiring individuals to contribute according to their ability, certain, easy to collect the tax, difficult to evade paying the tax, and low compliance and collection costs. Then, in 1999, the Tax Faculty of the Institute of Chartered Accountants of England and Wales (ICAEW) launched a discussion paper, which summarises ten principles required for a better tax system. These points are:

- Statutory – all tax rules must be enacted

- Certainty – applications of all tax rules must be certain

- Simplicity – the tax rules must be understandable and clear in their objectives

- Easy to collect and calculate – to ensure minimal compliance and administrative costs

- Properly targeted – anti-avoidance legislation should be properly targeted to close specific loopholes

- Constant – there should be minimum changes to underlying rules

- Consultation – adequate time should be given and full consultation sought to ensure that legislation is properly drafted

- Regular review – rules should be reviewed regularly to ensure their continuing relevance

- Fair and reasonable – powers should be exercised fairly and reasonably with appropriate rights of appeal

- Competitive – taxes while essential for raising funds for the government, should also be competitive and framed to encourage investment

This study adopts the principles suggested by the ICAEW (1999) as the variables required in the structure of an efficient tax system. These principles are more comprehensive and cover wider scopes such as statutory requirement, consultation on tax legislation, and public review of tax rules as compared to the elements proposed in previous studies. However, three of the 10 principles, namely, easy to collect and calculate; properly targeted; and competitive are not included in this study. This is because these principles are deemed more relevant to the tax authority. Since the objective of the study is to gauge the perception of the taxpayers with regards to the characteristics of the

existing indirect tax system, only principles that are specifically related to them will be incorporated in the questionnaire. The principle of easy to collect and calculate for example, suggested that the tax payable should be easy to calculate and straightforward and cheap to collect. This is more related to the task of the tax authority and would not be appropriate to get the feedback from taxpayers. As for the properly targeted principle, it is pointed out that anti-avoidance legislation passed should be properly targeted and due regard should be given to maintain the simplicity and certainty of the tax system by targeting specific loopholes. This is also more related to the tax authority since the policy maker should be the one to know why certain anti-avoidance legislation is issued and which group of taxpayers is targeted for that particular legislation. The third principle excluded, which is competitive, recommended that tax rules and rates should be framed so as to encourage investment, capital and trade in and within the country. It is excluded since it is more concerned with the government policy relating to the attractiveness of the tax rules and rates and the effect of its measures on its international competitiveness.

RESEARCH DESIGN

This study measures the level of efficiency of the tax administrative system by computing a cost-revenue ratio where the total administrative costs are compared to total revenue, as previously adopted by Ishi (1993), Mustafa (1996), Tayib (1998), and Vlassenko (2001). James and Nobes (1983) also suggested that the most useful way of presenting the administrative costs of the indirect taxes is as a percentage of the revenue collected. They further added that it is then possible to compare the costs of collecting taxes, and to see how these costs have been changing over time. According to them, the administrative cost should include wages and salaries of the staff and the full cost of the accommodation and materials used by the staff.

The cost-revenue ratio of the Customs Department for a time span of 11 years will be used. Besides the cost-revenue ratio, the study also examines the level of efficiency of the tax administrative system by conducting a longitudinal study on the trends of arrears-revenue ratio and revenue detected-collected ratio for several periods. The details are explained in the data analysis section. The aim is to "…research the dynamics of the problem by investigating the same situation or subjects several times, or continuously, over the period in which the problem runs its course" (Hussey & Hussey, 1997).

Hence, it may be possible for this study to suggest the likely reasons from an examination of the trends or patterns that emerges during the period of study.

The existence of the principles of an efficient tax system was investigated using primary data. Questionnaires were distributed to the taxpayers to find out their perceptions towards the present indirect tax system. The questionnaire was constructed based on the report by ICAEW (1999). The formulation of the questionnaire is based on a survey of the Australian tax system of tax scheme investors (Murphy & Byng, 2002), which also tested the variables related to our study.

The data collection method and research sample will be discussed in the following section.

Data Collection Method and Research Sample

There are two main sources of data collected for this study, i.e. primary and secondary data. To investigate the level of efficiency of the tax administrative system, secondary data was used. For this study, secondary data was obtained from the annual reports (1991 to 2001, inclusively) and other related documents of the Royal Customs Malaysia.

As for the taxpayers' perception, a survey method was used to obtain primary data. This is basically the process of questioning those who are believed to possess the required information (Cox, 1979). For this type of study, the field survey method was considered as the most suitable method in collecting the data (Kerlinger, 1973). The respondents to investigate the taxpayers' perception towards the indirect tax system in this study are the taxpayers registered with the Customs Department of Wilayah Persekutuan Kuala Lumpur (KL). The rationale for selecting KL as the research sample is simply because the department has the highest internal indirect tax contributors and the second highest contributor for the total indirect taxes in Malaysia for the past years. In addition, the department collects all types of indirect taxes, hence it is more appropriate to be studied as compared to the smaller states where not all types of indirect taxes are administered or collected. Furthermore, the department is located at the heart of the business activities in Malaysia.

The questionnaires were posted to a random sample of 280 taxpayers who pay indirect taxes to the tax authority in KL. From the sample,

only 30 respondents replied to the mailed questionnaire. This represented about 11% of the total sample. A summary of the demographic factors of the respondents in this study is shown in Appendix 1.

Data Analysis

Statistical tests were used in analysing the data collected, which includes reliability and validity tests, descriptive statistics and the t-test. The reliability and validity tests were carried out to examine the reliability and validity of the questionnaire used to obtain the primary data. Descriptive tests were used to analyse the data collected from the respondents to achieve the objectives of the study.

**Reliability and Validity of the Questionnaire**

The reliability and validity tests were performed on the questionnaire for taxpayers' perceptions towards the indirect tax system. The reliability and validity tests results are shown in the Appendix 2(a) and (b).

On the subject of the reliability of the questionnaire, Sekaran (2000) suggested that scores for Cronbach's α in the range of 0.7 are considered acceptable and less than 0.6 are considered poor. As for the construct validity, Coakes and Steed (2001) mentioned that the acceptable level for the measure of sampling adequacy is greater than 0.6. For all the set of questions having more than one factors under the factor analysis, the Pearson Correlation tests show that the dimensions for each construct are significantly correlated with each other. Therefore, the results indicate considerable evidence of reliability and validity of the questionnaire used in this study.

RESULTS AND DISCUSSION

Efficiency of the Indirect Tax Administrative System

Figure 1 shows the comparative analysis of the Customs Department's administrative cost against total indirect tax revenue for eleven years (1991 – 2001). It could be seen from Figure 1 and also Table 2 that the ratio of cost to revenue went up in 1992 but then declined steadily for three years in a row from 1993 to 1995.
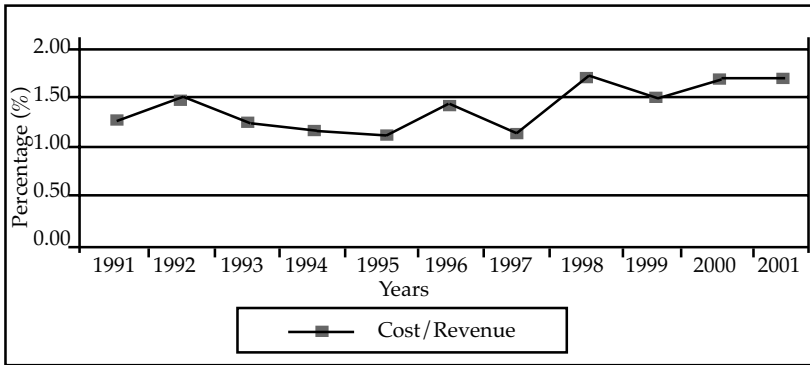
Figure 1
Total administrative cost as a percentage
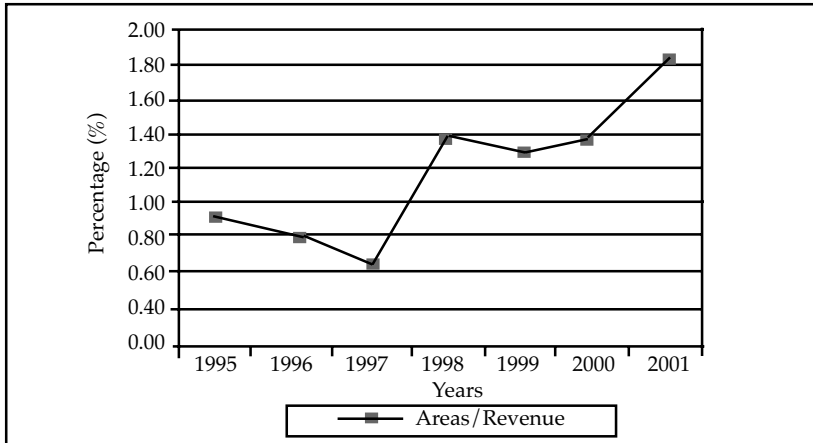of total indirect tax revenue (1991 – 2001)

The decline could be due to the impressive economic growth experienced by Malaysia i.e. an average of 8.5% annually (Ministry of Finance, Malaysia, [MFM], 1991-1995). After 1997, i.e. when the financial crisis experienced by the South East Asian region including Malaysia had taken its toll, the ratio had been increasing ever since. This may indicate the level of efficiency of the indirect tax administrative system. The increasing trend could infer that the Customs Department had been incurring more costs each year in the process of collecting the indirect tax revenue.

Table 2
Total Administrative Cost and
Total Indirect Tax Revenue (1991 – 2001)

Year	Administrative Cost RM (million)	Total Indirect Tax Revenue RM (million)	Ratio
1991	162.96	12,580	1.30
1992	191.77	13,369	1.43
1993	195.97	14,830	1.32
1994	212.38	17,327	1.23
1995	225.63	18,972	1.19
1996	299.49	21,421	1.40
1997	270.33	23,195	1.17
1998	264.25	15,320	1.73
1999	270.24	18,100	1.49
2000	310.75	18,017	1.73
2001	340.80	19,393	1.76

Source: Annual Reports, Royal Customs Malaysia (1991 – 2001)

In addition to the above analysis, a comparison of the total indirect tax arrears as a percentage of total indirect tax revenue was carried out as shown in Figure 2 and Table 3. The duration of this study is seven years (1995 – 2001). The reason for not including the years before 1995 is because of the unavailability of data for arrears from the Royal Customs Malaysia prior to 1995.

Figure 2
Total indirect tax arrears as a percentage of
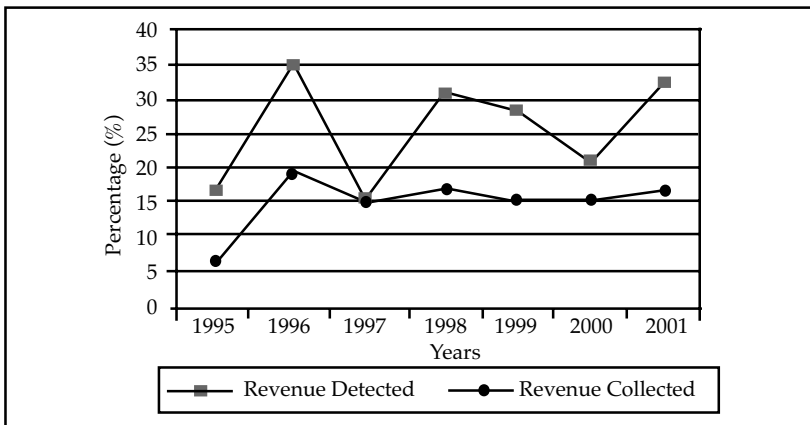total indirect tax revenue (1995 – 2001)

Figure 2, depicts that the trend of uncollected tax revenue as compared to total tax revenue had suffered a drastic increase in 1998. Again, the reason could be related to the financial crisis experienced by Malaysia as described earlier. The financial crisis could have slowed down the business activities during that period. Therefore, the amount of taxes unable to be submitted by the business operators to the Customs Department had increased. However, even after 1998, the uncollected tax is still on the increasing trend. This could also reflect that the Customs Department needs to improve its efficiency in collecting indirect tax revenue from business operators.

Another interesting issue that could be highlighted here is the amount of indirect tax revenue detected by the department but was unable to be collected as discovered (see Figure 3 and Table 4). From the table, we can see the total deficiency in revenue detected by the Customs Department, as compared to the amount actually collected from the loss of revenue detected. This may signal that something needs to be done to the present system of indirect tax managed by the Customs Department. This uncollected detected revenue will further add to the total accumulated arrears that is already at a high level.

Table 3

Total Indirect Tax Arrears and
Total Indirect Tax Revenue (1995 – 2001)

Year	Total Indirect Tax Arrears RM (million)	Total Indirect Tax Revenue RM (million)	Ratio
1995	176.40	18,972	0.93
1996	164.70	21,421	0.77
1997	147.40	23,195	0.64
1998	209.97	15,320	1.37
1999	231.20	18,100	1.28
2000	248.12	18,017	1.38
2001	355.98	19,393	1.84

Source: Annual Reports, Royal Customs Malaysia (1995 – 2001)

Figure 3

Total deficiency in indirect tax
revenue detected and collected (1995 – 2001)

The Customs Department, through their account investigation unit, managed to detect an amount of revenue loss each year due to tax evasion by the existing licensees. Then they tried to collect the tax from these licensees. The trend of revenue detected and collected could be assessed in Figure 3 and Table 4. The trend shows that on the average, they managed to collect only about 60% of the revenue detected. The tendency of the revenue amount able to be collected seems to be stable as compared to the revenue detected. This could signify that the Customs Department could improve their capability of collecting more revenue from the amount detected, and increase their effort to gain back the revenue loss in line with their ability to identify the tax collector accounts that were due.

Table 4
Total Deficiency in Indirect Tax Revenue
Detected and Collected (1995 – 2001)

Year	Revenue Detected RM (million)	Revenue Collected RM (million)	Ratio (Collected/Detected)
1995	16.33	6.57	40.23
1996	35.18	19.20	54.58
1997	16.76	16.26	97.02
1998	31.37	15.72	50.11
1999	28.34	15.11	53.32
2000	21.24	14.53	68.41
2001	32.37	16.20	50.05

Source: Annual Reports, Royal Customs Malaysia (1995 – 2001)

Table 5
Frequencies and Means Analysis of the Respondents

	Frequency		Mean	Std. Deviation
	No.	(%)		
Statutory			3.20	0.96
a. Disagree	11	36.70		
b. Neutral	4	13.30		
c. Agree	15	50.00		
Certain and Simple			2.88	0.81
a. Disagree	15	50.00		
b. Neutral	5	16.70		
c. Agree	10	33.30		
Proper Consultation			2.48	0.78
a. Disagree	21	70.00		
b. Neutral	2	6.70		
c. Agree	7	23.30		
Constant and Regularly Reviewed			3.12	0.55
a. Disagree	10	33.30		
b. Neutral	4	13.30		
c. Agree	16	53.30		
Fairness			2.87	0.68
a. Disagree	14	46.70		
b. Neutral	2	6.70		
c. Agree	14	46.70		

(Scale: 1=Strongly Disagree 2=Disagree 3=Neutral 4=Agree 5=Strongly Agree)

Taxpayers' Perceptions towards the Existence of an Efficient Indirect Taxation System

Table 5 shows the results of the taxpayers' perceptions towards the existence of an efficient tax system in Malaysia. Generally, based on the respondents surveyed, there are mixed responses for each characteristics as perceived by the taxpayers. The findings revealed that there is an existence of a good legislation under the tax system; and the tax system is constant and regularly reviewed. However, they disagree that the present system is certain and simple; proper consultation has been made before any new legislation is issued; and that the overall system is fair. From all the characteristics suggested, the taxpayers ranked "statutory" as the highest and "proper consultation" as the lowest. A similar result was also revealed by a survey carried out by ICAEW (1999). They found that there are mixed views on the score for all the 10 characteristics analysed which ranged from 0 to 7 out of 10. From the characteristics, "statutory" is the highest and "fairness" is the lowest characteristics ranked [see ICAEW (1999) for details]. It is therefore suggested that the ICAEW's 10 tenets should be the target for all tax systems even though for the time being it is still far from being achieved.

SUMMARY, CONCLUSION AND FUTURE RESEARCH

The result of the cost-revenue trend analysis to find out the level of efficiency of the tax administration as a whole reflected that the Malaysian Customs Department has been collecting less indirect taxes revenue each year as compared to the costs incurred in the process of acquiring the revenue. The cost to revenue ratio of the department has been increasing, indicating that the cost of collecting the indirect tax is on the rising trend. In other words, it could be said that the efficiency of the indirect tax administration needs to be improved as a preparation to face the major challenge of a borderless economy.

An analysis on the ratio of total arrears to total revenue collected also indicated that uncollected indirect tax revenues is on the increasing trend. It shows that the rate of increase in the amount of overdue taxes unable to be collected is more than the amount of revenue collected each year, hence showing that the administration in overdue tax revenue collection also requires enhancement to be more efficient and effective.

Another trend that was observed in this study is the amount of loss in revenue due to tax evasion discovered through the licensees' accounts

investigation by the Customs Department, as compared to the revenue actually collected from the discovery. It was found that on the average, only 60% of the revenue loss detected could be recovered for the period 1995 to 2001, and the trend of collection has been rather stable even though the revenue detected had increased. It demonstrated that the Customs Department should enhance its effort in improving the efficiency of the revenue collection by strengthening the enforcement action on non-compliance cases.

Even though the trend analysis has been used in other studies to measure the efficiency of tax administrative system, the results of the trend analysis in this study could not totally determine whether the Malaysian indirect tax administrative system is efficient or not. This is because there is no benchmark available or the performances of other countries to compare with since all of the related studies are in the area of direct taxes. Therefore, the trend analysis in this study showed the level of efficiency of the indirect tax administrative system based on the year-to-year performance. The Customs Department needs to improve its efficiency as the trends revealed that the performance of the current system is declining. The results showed that the department has been collecting less revenue each year as compared to the costs incurred; the total arrears of tax has been on the increasing trend; and no apparent improvement on the revenue collection from the tax evasion detected.

Based on the respondents surveyed, the study reveals that there are mixed responses towards the existence of the characteristics of an efficient indirect tax system as perceived by the taxpayers. Among the seven characteristics surveyed (statutory; certain and simple; proper consultation; constant and regular reviewed; and fairness), only "statutory" and "constant and regularly reviewed" are considered to be in place by the respondents of the study. The results are also found to be consistent with the ICAEW's findings on similar characteristics surveyed by them. Interestingly, ICAEW had revealed that the same characteristics, i.e. "statutory" and "constant and regular reviewed" scored high marks in their survey (7 and 5 out of 10 respectively). However, the generalisation of the results of this study is limited since the number of respondents is small due to the low response rate even though necessary steps have been taken to increase the number of returned questionnaires.

Although this study is considered as preliminary in nature, it gives an opportunity to understand the state of efficiency of the Malaysian indirect tax system. Further studies are needed to be carried out in order to obtain a greater understanding of the state of efficiency of the

indirect tax by including all the ten tenets and also both the taxpayers and the indirect tax authority. Apart from this, the sample of respondents should be extended to cover all the states in Malaysia. Therefore, it will give a fair generalisation about the state of efficiency of the indirect tax in Malaysia.

The findings of this study may potentially provide strategic information to the government in explaining the behaviour of the efficiency and effectiveness of the indirect tax system and an input to the present literature on the efficiency and effectiveness of an indirect taxation system.

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Appendix 1

Demographic Factors of the Respondents for
Taxpayer' Perceptions

Variables	Frequency	
	No. of Respondents	(%)
Status of business		
a) KLSE main board	3	10.00
b) KLSE second board	0	0.00
c) Not listed	27	90.00
Type of business		
a) Bhd	3	10.00
b) Sdn Bhd	20	66.70
c) Firm	5	16.70
d) Sole Proprietor	2	6.70
Type of industry		
a) Consumer product	13	43.30
b) Industrial product	3	10.00
c) Construction	1	3.30
d) Services	9	30.00
e) Infrastructure	1	3.30
f) Hotels	2	6.70
g) Technology	1	3.30
Annual turnover		
a) RM100,000 – RM200,000	1	3.30
b) RM200,001 – RM300,000	1	3.30
c) RM300,001 – RM400,000	2	6.70
d) RM400,001 – RM500,000	2	6.70
e) Above RM500,000	24	80.00
Type of tax paid		
a) Sales tax	5	16.70
b) Service tax	10	33.30
c) Two type of taxes	5	16.70
d) Three type of taxes	9	30.00
e) All type of taxes	1	3.30

Appendix 2(a)

Results of Reliability Tests for Taxpayers' Perceptions

Principles	Reliability Coefficients for Alpha
Statutory	0.77
Certain and Simple	0.85
Proper Consultation	0.80
Constant and Regularly Reviewed	0.70
Fairness	0.91

Appendix 2(b)

Results of Validity Tests for Taxpayers' Perceptions

Principles	No. of Item	No. of Factor	KMO Value
Statutory	4	1	0.65
Certain and Simple	5	1	0.74
Proper Consultation	5	2	0.70
Constant and Regularly Reviewed	6	2	0.60
Fairness	9	2	0.76