HAWKERS AND THE SELF-ASSESSMENT TAX SYSTEM: SURVEY EVIDENCE FROM MALAYSIA

by

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Abstract

This study aims to investigate if Malaysian hawkers understand the mechanism of the self-assessment tax system ('SAS') and to solicit the problems, if any, faced by these hawkers in tax compliance and tax audit in the era of the SAS. A questionnaire was designed to collect data. The questionnaire gathers background information of the hawkers and solicits their tax compliance experience and feedback in respect of tax audit and tax related matters. From this information we found that most hawkers faced difficulties in filling up the tax return forms ('Form B') and calculating their tax liabilities. The services rendered by the IRB officers were found to be at a satisfactory level. Findings also indicated that the hawkers generally did not mind paying tax agents for the services rendered if the cost was reasonable and that many hawkers did not have the required knowledge on tax matters.

INTRODUCTION AND MOTIVATION TO STUDY

On 1 January 2005, the Inland Revenue Board Malaysia ('IRBM') implemented the self-assessment tax system ('SAS') on individual taxpayers with the intention of promoting voluntary tax compliance. Under the SAS, an individual who has income accruing in or derived from Malaysia is required to disclose taxable income honestly, compute tax payable correctly, file tax return forms and pay taxes on a timely manner. The key feature of the SAS is that tax return forms are deemed the notice of assessment (ie, the Form J). In a nutshell, under the SAS, the onus to assess tax liability is on the taxpayers
themselves. As a result, taxpayers must have sufficient tax knowledge in order to assess their tax liability correctly and to file tax return forms on time. For salaried individuals, they must submit their income tax return forms and pay the balance of tax liability by 30 April every year. For those who have business income, the submission and payment deadlines are by 30 June every year.

If individual taxpayers fail to submit tax returns, the IRBM will derive their own assessment based on an estimate and issue notices of assessment. Non-submission of tax return forms and late payment of taxes will attract monetary penalty; and for repeated offences, the court will impose a term of imprisonment. Under s 112(1) of the Income Tax Act 1967 (‘the Act’), the penalty on failure to furnish tax returns by the stipulated deadline is a fine ranging from RM200 to RM2,000 or imprisonment not exceeding six months or both fine and imprisonment. Individual taxpayers who fail to make income tax payments for a year of assessment within 30 days from the date of issue of the notice of assessment or deemed assessment are charged a 10% increase on the tax or outstanding tax balance. If the tax or tax balance is still unpaid after 60 days from the date the 10% increase is imposed, a further 5% increase will be charged on the tax outstanding, as stipulated in s 103(3) and (4) of the Act.

In view to further intensify voluntary tax compliance, the IRBM instituted a tax audit and investigation system. In January 2007, the tax audit framework and tax investigation framework were published to serve as a guide to taxpayers, tax agents and IRBM tax auditors. The probability of an individual taxpayer being selected to tax audit is once in every five years. Any irregularities from the audit findings will be classified either as an incorrect return under s 113 or willful evasion under s 114. Penalties ranging from 100% to 300% and/or imprisonment up to three years will be imposed on tax defaulters.

It was reported that since the implementation of the SAS, the number of Malaysian tax defaulters had increased by almost 10 times within two years, from 25,160 in 2003 to 239,666 in 2005 (Krishnamoorthy, 2006a). The offences included failure to submit returns, declaring false returns and not providing sufficient information etc. According to the then chief executive officer of the IRBM, Tan Sri Zainol Abidin Abdul Rashid, around one-third of Malaysians eligible to pay tax did not do so, in 2005, and 1.3m potential taxpayers did not file their tax returns (Krishnamoorthy, 2006b). Related to this, it was estimated that the Malaysian Government has lost approximately RM307.7m due to tax non-compliance.

In an effort to collect tax arrears, the IRBM has imposed a ban on tax defaulters from leaving the country and prosecuting them. The
Taxpayers need to be tax literate. In a study conducted by Siwar and Jani (2007) on the socio-economic standards of hawkers in Malaysia, it was found that the education level of hawkers was low with only 87.2% of their sample having completed either primary, lower or mid-education. At minimum, individual taxpayers need to possess some basic knowledge of personal taxation, with respect to the taxability of income, deductibility of expenses, entitlements, reliefs, rebates and exemptions. For those who operate a business, they must have some basic understanding of taxability of income from business and non-business sources and the deductibility of expenditure. However, in the Malaysian education system, only accounting and some business management students are exposed to taxation at tertiary levels. Many young Malaysians (the future taxpayers) are not formally exposed to taxation in schools. What makes it worst is that Malaysian tax laws are inherently voluminous and complex and the constant changes make it difficult even for tax officers, tax academics and tax practitioners to keep abreast of the latest developments, let alone ordinary people such as the hawkers.

At the time of this study, there is no official statistics of the number of hawkers in Malaysia; a conservative estimate is about 200,000. Although the contribution of hawkers to the tax revenue is relatively small, nonetheless, they may be the victims of the SAS and will be subject to tax audit and investigation due to the inherent nature of their businesses. Notably, Malaysian hawkers have the following peculiar characteristic: (a) their business transactions are normally on a cash basis. Their business receipts are usually in cash terms and the payment for supplies ordered is also usually in cash; (b) the business annual turnover is generally less than RM300,000; hence it is not economical to employ a full time accounting staff to keep records or to seek professional help on tax matters; (c) on average, the education level of hawkers is low or most of them are illiterate; (d) a hawkers business fluctuates on a daily basis as a great extent of the business depends largely on the national economics and weather. It is very common for hawkers to set up their stalls at the road sides, on a
On a sunny day and operate their business for about 12 hours a day, however on rainy days they may not be able to run their businesses at all because of their inability to provide shelter; (e) the IRBM will select them for tax field audit, as it is reasonable to suspect that hawkers have under-reported their taxable income or not reported their income at all since the business transaction is on a cash basis; and (f) it is observed that professional accounting/tax firms are reluctant to do the tax reporting for hawkers because firstly, by nature, the accounting records of hawkers are incomplete, secondly, tax practitioners are doubtful of the accuracy of the information provided, consequentially this might expose the tax firm to a higher tax risk, and last but not least, the tax agent fees that tax firms could charge hawkers for the tax filing service is very minimum, ranging from RM500 to RM1,200.

Under the SAS, hawkers have the following six obligations, namely:

1. to keep sufficient records related to business income, expenses and cost of doing business, so that the profit or loss from the hawker business can be correctly ascertained. Under the SAS, the business records must be kept for 7 years for tax audit purposes;
2. the business transactions must be recorded within 60 days of the business operations having taken place;
3. to pay the estimated income tax payable in six bi-monthly installments to the IRBM starting from the month of March. The estimated income tax payable will be computed by the IRBM based on the preceding year’s income tax payable;
4. to prepare the business profit or loss account for year ended 31 December and to compute the income tax payable correctly;
5. to submit the income tax return form (i.e., Form B) of the relevant year of assessment by 30 June in the following year; and
6. to pay the balance of the tax or the outstanding tax for the current year of assessment by 30 June of the following year.

It is reasonable to assume that the annual turnover of a majority of the hawkers in Malaysia is less than RM300,000 and that they operate as sole proprietors or as a partnership. Hence, there are entitled to the several tax benefits, for example, (a) business expenses can be deducted against the gross income; (b) capital allowance can be claimed on motor vehicle, phone, furniture, equipment and other plant and machinery used in business; (c) personal reliefs; and (d) tax at a scale rate of 0% to 28%.

The success of the SAS depends largely on whether the taxpayer has accepted the new changes together with the possible shortcoming of the SAS and the tax audit system. The hawkers are selected as the primary focus of this study. It is reasonable to assume that hawkers are