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The compliance time costs of Malaysian personal income tax system: E-filers vs. manual-filers

Idawati Ibrahim*

School of Accountancy, Universiti Utara Malaysia 06010 UUM Sintok, Kedah, Malaysia

Abstract

The main objective of this study is to estimate compliance costs for personal income tax (PIT) system in Malaysia and to investigate the effect of e-filing on compliance costs of PIT system in Malaysia. It is found that, on average, e-filing consumed about 10 hours while manual filing took about 13 hours. However, statistically, the difference is not significant. The findings suggest that e-filing is only a tool to facilitate the filing process. It is not meant to reduce the whole burden of annual filing for personal income taxpayers.

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1. Introduction

The imposition of taxes by government in order to finance public services should be achieved in the least costly manner possible either on the part of the administrator or on the taxpayers' side (Vaillancourt & Clemens, 2008, p. 55). This is because the costs can reduce the resources available to the citizen and distort their behaviour. The costs to taxpayers are referred to as income tax compliance costs.

Estimates of compliance costs are imperative in order to measure the economy of collection as proposed by Adam Smith (1776). Slemrod (2004, p. 44) argues that compliance costs are the most informative measure of tax

* Corresponding author. Tel.: +604-9287252.
E-mail address: idawati@uum.edu.my

complexity compared to other ways such as cutting the number of pages or words in the tax code or forms. Increased complexity in the tax system has been recognised as a factor that may lead to non-compliance and impede good decision-making (Australian Treasury, 2008, p. 306). In addition, compliance costs affect voluntary compliance behaviour (Jenkins & Forlemu, 1993, pp. 1-2). Therefore, to be competitive in a global market, governments must have a concern about the level of compliance costs and an objective to reduce them.

However, most prior studies related to compliance costs focused heavily on developed nations, such as the US, the UK, Canada and Australia (see, for example, Sandford, 1973; Slemrod & Sorum, 1984; Pope, 1989; Vaillancourt, 1989; Blumenthal & Slemrod, 1992; Pope, 1992, 1993b; Slemrod & Blumenthal, 1996; Evans, Ritchie, Tran-Nam, & Walpole, 1997; Evans & Walpole, 1997; Evans, 2001; Pope, 2002; Slemrod & Venkatesh, 2002; Pope, 2005; Vaillancourt & Clemens, 2008; Vaillancourt, 2010). Although they provide valuable insights, such findings and estimations of compliance costs may not be relevant for developing nations such as Malaysia. Moreover, most of the studies did not focus on the effect of electronic filing (e-filing).

The main objective of this study is to estimate compliance costs for PIT system in Malaysia and to investigate the effect of e-filing on compliance costs of PIT system in Malaysia.

2. Literature review

The tax compliance costs research for personal taxpayers was started by Sandford (1973). Among the important findings were that the self-employed were the group with the highest compliance costs and that the compliance costs were inequitable and regressive. One main feature of PIT in the UK is that most PIT payers are subject to an exact withholding tax system, known as PAYE. Under this system, most salaried taxpayers do not need to file an income tax return annually.

Research on the compliance costs of PIT carried out in the US includes studies by Slemrod and Sorum (1984) and Blumenthal and Slemrod (1992) on the federal income tax base of Minnesota households. Using the sample from Minnesota households, Slemrod and Sorum (1984) estimated that the average compliance time spent was 26.7 hours and the average money costs were USD61. They found that record-keeping was the activity with the highest time spent (Slemrod & Sorum, 1984, p. 472). More recent studies in the US include a study by Arthur D. Little Inc. (1988) and a later study by Guyton, O'Hare, Stavrianos, and Toder (2003). Both studies contributed to the methodology in estimating tax compliance costs in the US and were carried out with the support of the Internal Revenue Services (IRS).

The most prominent compliance costs study in Australia was carried out by (Pope, 1993a). On PIT compliance costs, Pope, Fayle, and Duncanson (1990, p. 23) found that on average, Australians spent 10.7 hours completing PIT requirements. Another notable study in Australia was by Evans et al. (1997) for the tax year 1994/95. Evans and colleagues estimated that the average time spent by Australians was 8.5 hours, with an overall compliance costs estimate of 4.0 percent of net tax revenue. The estimates were lower than those made by Pope et al. (1990), and were made shortly after the SAS had been introduced. However, none of them investigated the effect of e-filing on compliance costs.

The major compliance cost studies on PIT in Canada were conducted by Vaillancourt (1989) for the 1986 tax year, Vaillancourt and Clemens (2008) for the 2004 and 2005 tax year and Vaillancourt (2010) for the 2007 tax year. Vaillancourt estimated that compliance costs in 1986 for PIT represented 3.0 percent of PIT revenue or between CAD5.0 billion and CAD5.5 billion. Meanwhile, Vaillancourt and Clemens reported that compliance costs in 2004 and 2005 were between 1.7 percent and 3.3 percent of PIT revenue or between CAD2.9 billion and CAD3.9 billion; lower than the previous estimate. This is probably because Vaillancourt and Clemens carefully distinguished between the percentage of taxpayers who used e-filing or standard paper filing and the percentage of those who used a tax preparer or discounter.

A study on compliance costs for PIT was carried out by Klun (2004, 2009) in Slovenia. Klun studied the effect of tax reform, e-filing and a fully pre-filled return system on PIT compliance costs, showing a reduced trend. The findings on compliance costs indicate the effect of tax reform, including the use of the e-filing system.

In Malaysia, Sapiei and Abdullah's (2008) research was probably the first published study to explore the compliance costs of personal taxpayers under the income tax system. They discovered that the average time spent

was about 70 hours per taxpayer with the highest time devoted to record-keeping. They argued that the implementation of an SAS increased the compliance costs for individual taxpayers. Nonetheless, they also did not examine the effect of e-filing on compliance costs.

According to Evans (2008, p. 457), three main findings have emerged from compliance costs studies. Firstly, compliance costs have been found to be high and significant for PIT. Secondly, compliance costs have been found to be regressive as a proportion of income. This indicates that compliance costs were higher for low income groups and lower for higher income groups. Thirdly, it has been found that compliance costs are not reducing over time, despite attempts by many governments to reduce the burden on taxpayers. In addition to Evans conclusion, it can also be concluded that the effect of e-filing is not much well examine in the estimation of PIT system compliance costs.

3. Methodology

Sample for this study comprised of PIT payers from entire Malaysia. The sample selection was made by the assistance of the Inland Revenue Board of Malaysia (IRBM) to include e-filers and manual filers in Malaysia. Data collection was performed in 2010. 2,600 respondents were selected and the response rate was about 10 percent after removing the incomplete or unusable responses. Mail survey questionnaire was utilised in gathering the data for this study. The questionnaire was pilot tested before main data collection was performed.

Time costs refer to the time spent by respondents for several filing activities in order to complete their income tax obligations. These time estimates were then converted into dollar values using mean reported value. The activities included in the total time spent are presented in Table 1.

Table 1. Compliance Time Components and Explanation.

	Components	Explanation
1.	<i>learntime</i>	Learning about tax before filling in income tax return.
2.	<i>keeptime</i>	Keeping or obtaining records, such as receipts and statements of remuneration from employers.
3.	<i>looktime</i>	Looking at tables or notes to find eligible deductions, reliefs and rebates or tax rates.
4.	<i>advicetime</i>	Getting advice from someone else to fill in income tax return.
5.	<i>completetime</i>	Completing the income tax return, including filling in, revising and making corrections.
6.	<i>submittime</i>	Submitting or lodging the final income tax return.
7.	<i>paytime</i>	Paying tax liability for the relevant year, if taxable.
8.	<i>supplytime</i>	Supplying information to a tax agent, if a tax agent was employed.
9.	<i>plantime</i>	Planning financial affairs in order to minimise tax liability.
10.	<i>helptime</i>	Free help from someone else to do or assist in the completion of tax returns.

4. Results

Overall, the average time spent by respondents in meeting their income tax obligations was about 11.7 hours per respondent. E-filing consumed 9.84 hours while manual filing took 13.24 hours. This means that, on average, e-filing saved about 3.4 hours of time or a saving of about 26 percent.

Comparison of time costs indicated that, using the mean as the value of time, e-filing saved about RM118 or about 25 percent from manual filing time costs. Further statistical analyses using the Mann-Whitney U test are presented in later sections to examine whether the differences were statistically significant or otherwise. The average compliance time costs using mean and median values by filing methods are shown in Table 2.

Table 2. Average Compliance Time Costs, 2010.

Filing Method	Average Compliance Time (hr)	Hourly Value of Time (RM)		Time Costs (RM)	
		Mean	Median	Mean	Median
All	11.17	36.16	20.00	403.91	223.40
E-filing	9.84	36.33	20.00	357.49	196.80
Manual filing	13.24	35.89	20.00	475.18	264.80
Difference (hr/RM)	(3.4)			(117.69)	(68.00)
Difference (%)	(25.68)			(24.77)	(25.68)

Investigations of mean and median hours by compliance time components between e-filing and manual filing revealed that in total, the average compliance time for e-filing (9.84 hours) was less than manual filing (13.24 hours) by about 3.4 hours or 26 percent. The components with the highest difference were *helptime* (about 50 minutes). Specifically, the e-filers spent about four times longer for *helptime* than the manual filers. This is probably due to the system is still new. However, the e-filers spent a shorter time for most of other time components, especially for *submittime*, *paytime*, *completetime* and *looktime*. The details of time spent between manual and e-filing according to ten time components are presented in Table 3.

Table 3. E-Filing and Manual Filing by Time Components.

Time Component	E-Filing (N=147) (Hours)	Manual Filing (N=95) (Hours)	Difference	
			In Hours	In Percentage**
<i>learntime</i>	0.83	1.22	-0.39	-2.95
<i>keepertime</i>	2.18	2.43	-0.25	-1.89
<i>looktime</i>	0.64	1.13	-0.49	-3.70
<i>advicetime*</i>	0.54	0.57	-0.03	-0.23
<i>completetime</i>	1.01	1.79	-0.78	-5.89
<i>submittime*</i>	0.42	1.46	-1.04	-7.85
<i>paytime</i>	0.81	1.79	-0.98	-7.40
<i>supplytime</i>	1.20	1.56	-0.36	-2.72
<i>plantime</i>	1.16	1.07	0.09	0.68
<i>helptime*</i>	1.04	0.21	0.83	6.27
Total Time	9.84	13.24	-3.40	-25.68

Note: *Significant difference at $p < 0.005$.

**Difference in percentage is based on the total manual filing time.

The analysis of average time spent by e-filers and manual filers indicated that the e-filers spent about 3.4 hours less than the manual filers' time. Although statistically the difference was not significant, this represented a saving of about 26 percent from a manual filer's time. The effect of e-filing time saving will be more obvious if it is grossed up for the whole PIT payer population (that is 4.8 million for YA2009). The wasted time could be allocated to other activities.

Only three of compliance time components had statistically significant effects due to the e-filing system for all categories of taxpayers. They were: time to get advice (*advicetime*), free helper's time (*helptime*) and time to lodge or submit the e-file (*submittime*). The time for completing the return (*completetime*), which is expected to be less under the e-filing system, was only found to be significantly different among the lowest educational attainment group.

5. Conclusion

In conclusion, the findings of this study suggest that:

1. E-filing needed extra time for getting advice compared with manual filing;
2. E-filing needed more time from free helpers compared with manual filing;
3. E-filing could not help reduce the prime time-spent activities such as time for record-keeping (*keepertime*) and supplying information to a tax professional (*supplytime*);
4. Only time to lodge an e-file (*submittime*) was the best time saving method provided by the e-filing system;

5. There could be a gap of complexity within the lowest educational attainment group. E-filers' time was less than manual filers' time for this group, which indicates that the majority of e-filers had simpler tax affairs.

The high *advice time* and *helptime* required by e-filers is probably due to the age of the system itself. Since it was launched in February 2006, it had only been implemented for four years in duration in the year the data collection for this study was carried out. At this early stage, advice and help are necessary, especially by considering taxpayers' characteristics such as age, level of education and employment status (which represent the complexity of tax affairs). Another possible reason may be due to the experience of the e-filers. It is found that those who were new to the e-filing system spent more time than those who already have much experience doing e-filing. It is hoped that this effect is temporary and the time spent for advice and by free helpers will be reduced through experience.

The last two findings above suggest that e-filing is only a tool to facilitate the filing process. It is not meant to reduce the whole burden of annual filing for PIT payers. The *keep time* and *supply time* may possibly be reduced by changes in the tax law requirements. Even the latest technology (for example, a pre-filled return system) could not reduce the record-keeping burden as long as it is required by law. This is supported by Klun (2009, p. 229), who states that the compliance costs reduction in Slovenia in 2008 was not solely due to a fully pre-filled return system being implemented by the government, as many reforms to tax law had been introduced prior to implementation of the pre-filing system. However, her findings also indicated that e-filing did save taxpayers time and therefore is a convenient way to file a tax return as compared to manual filing.

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