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Complexity of the Malaysian income tax act 1967: Readability assessment

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Abstract

This study which examines the readability of the Income Tax Act 1967 (ITA 1967) and its associated Schedules is considered important as the materials are the main references for taxpayers who have intention to comply with their tax obligations. Using FRES and F-KGL analysis, it is found that the ITA 1967 and its Schedules are complex to understand. The findings indicate that the materials under study may need to be rewritten. It is hoped that the findings will contribute not only to the body of knowledge but also to the tax authority.

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1. Introduction

The Income Tax Act 1967 (ITA 1967) is the main source of reference governing the income tax system in Malaysia. The ITA 1967 was first enacted in 1967 and frequently amended to accommodate the rapid development in Malaysian taxation. Currently the ITA 1967 contains 13 Parts with 13 Schedules and 156 Sections. While the amendment effort is commendable yet this enormous number of sections in the ITA 1967 poses a question of simplicity of the tax legislation. Thus, this research is undertaken to examine the complexity of the taxation system in terms of the level of readability of its tax legislations. This is important as when the tax legislations are overly

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and unnecessarily complex, the taxpayers may have difficulty to understand the materials and as a result, they may not benefit from whatever tax incentives offered by the government. In this case, even the most attractive incentives will not be well-functioning as intended. The impact may get even worse when such a low level of readability of the tax rules leads to unintentional noncompliance of taxpayers, which in turn pull them to the penalty regimes as stipulated under Self-Assessment System (SAS). This effort hopefully serves as a stepping stone for more research on tax complexity in the future. This study is particularly relevant in respond to the survey findings by Mustafa (1996), Saad (2011) and Isa (2014) that taxpayers faced the problem of content complexity of the income taxation materials. From the practical point of view, the insights generated from this research may assist the Inland Revenue Board Malaysia (the IRBM) to review and improvise (if necessary) the relevant tax materials in their effort to optimize their services to their customers (i.e. taxpayers), and consequently meet the national ultimate objective of high compliance.

This paper is divided into five sections. The next section sets out a review of literature relevant to the study. This is followed by a section on research method. Section 4 discusses the results of the study before the paper concludes in section 5.

2. Literature review

The income tax system in Malaysia commenced in 1948 under the British colonization era. It was introduced to legitimize the collection of taxes from individuals and corporations. The first income tax legislation at that time was Income Tax Ordinance 1947. This Ordinance was substantially based on the Model Colonial Territories Income Tax Ordinance 1922 (United Kingdom) (Kasipillai, 2005). The Ordinance was subsequently repealed and replaced by the ITA 1967, which came into effect on 1 January 1968. The ITA 1967 is actually a consolidation of the three laws of income taxation namely the Income Tax Ordinance 1947, the Sabah Income Tax Ordinance 1956 and the Sarawak Inland Revenue Ordinance 1960. This consolidation is one of the significant effect of the formation of Malaysia in 1963. As supplementary materials to the ITA 1967, the IRBM has, from time to time, issued the relevant Public Rulings and the tax guidelines.

Since its inception, Malaysia had adopted an official assessment system (OAS) which requires taxpayers to furnish relevant information pertaining to their incomes and expenses to the IRBM. Under that system, the duty to compute the tax payable was with the IRBM, as taxpayers were assumed to have limited knowledge on taxation. However, with effect from 2001, a self-assessment system (SAS) was gradually implemented. Under the new system, the responsibilities to compute tax payable shifted from the IRBM to taxpayers. Unlike OAS, SAS requires taxpayers to be well-versed with the existing tax laws and provisions, since they are answerable to the tax authorities in the case of a tax audit. Another prominent attribute of SAS is voluntary compliance, as the tax returns submitted by taxpayers are deemed to be their notice of assessment. In other words, penalty mechanisms will be applied if taxpayers do not submit a correct tax return within the stipulated period. Thus, the issue of tax complexity is of relevant concern under SAS.

Researchers generally agree that tax complexity arises due to the increased sophistication in the tax law (Richardson & Sawyer, 2001; Strader & Fogliasso, 1989). There are various forms of tax complexity: (i) computational complexity; (ii) forms complexity (American Institute of Certified Public Accountants, 1992); (iii) compliance and rule complexity (Carnes & Cuccia, 1996); (iv) procedural complexity (Cox & Eger, 2006); and (v) the low level of readability (Pau, Sawyer & Maples, 2007; Richardson & Sawyer, 1998; Saw & Sawyer, 2010; Tan & Tower, 1992).

In relation to the readability of tax legislations, the New Zealand government has actively undertaken various tax reforms since the mid-1980s (for details, see Hasseldine & Bebbington, 1991). However, Tan and Tower (1992) claimed that the efforts made by the tax authority at that time to simplify the tax law failed. In the study, the Flesch Reading Ease Index (FRES) was used to measure the readability level. The analysis was carried out on the New Zealand tax legislation, Tax Information Bulletins (TIBs) and Tax Return Guides. The FRES Index measures the difficulty ranging from zero (most difficult) to 100 (least difficult). Their findings indicate that there was no progress with simplification at that time, except for the Tax Return Guides. A later study by Pau et al. (2007), however, provides contrary evidence on tax simplification in New Zealand whereby significant improvements

were reported in respect of tax simplicity. Sawyer (2007) agreed that there have been some improvements in tax simplification but continual change to the legislation has to a certain extent delayed the rewrite program (and also delayed the benefits).

As an extension to the previous studies (Pau et al., 2007; Richardson & Sawyer, 1998; Tan & Tower, 1992), Saw and Sawyer (2010) examined the readability of a sample of the selected sections of the Income Tax Act 2007, TIBs and binding rulings using similar measures as in Pau et al. (2007). Overall the results suggested further significant success to the rewrite project, undertaken by the New Zealand government in its tax simplicity goals in the context of improved readability. Furthermore, the results also indicates that the percentage of people with an education level of Years 11-13 to understand the Income Tax Act 2007 has significantly increased.

Content complexity is also present in Australian tax legislations where it forces taxpayers to engage tax agents to deal with their tax matters (McKerchar, 2001; 2003). McKerchar (2003) further identified the most common problem faced by taxpayers is to understand the instructions in the Taxpack 2000. This is followed by the problems of understanding the rules, the tax return forms and other relevant written information provided by the tax authority.

In Malaysia, Mustafa (1996), who studied taxpayers' perceptions towards SAS which was to be introduced (at that time), suggested the presence of tax complexity in Malaysia, particularly in terms of record-keeping, too much detail in the tax law and ambiguity. The findings are partly consistent with the six potential causes of complexity labelled as: ambiguity, calculations, changes, details, forms and record keeping, identified by Long and Swingen (1987). Interestingly, a more recent survey undertaken among the salaried taxpayers also suggested the complexity of the contents of the income tax law (Saad, 2011), despite having less computation involved (compared to the business taxpayers) in complying with their tax responsibilities. Similarly, the most recent study undertaken by Isa (2014) also found the presence of tax complexity, which are categorized into tax computations, record-keeping and tax ambiguity. In that study, the author interviewed 60 tax auditors and surveyed a number of corporate taxpayers. While these three studies (i.e. Mustafa, 1996; Saad, 2011; Isa, 2014) are mainly based on perceptions, they provide an indication that the Malaysian taxation laws (in particular, the Act) are also having readability issue.

3. Research method

There are a number of Acts involve in complying with the income tax obligation, such as the ITA 1967, the Promotion of Investment Act 1986, the Partnership Act 1961, the Real Property Gains Tax Act 1976 (RPGT 1976), etc. In addition, various Public Rulings and guidelines have been issued to assist the taxpayers in this matter. However, for the purpose of this study, the focus is on the ITA 1967 and its associated Schedules. The reason being is that these documents are considered the primary source of reference to general taxpayers compared to the other Acts in meeting their tax obligations. While the ITA 1967 comprise of 13 Parts, only 12 Parts were examined since the first Part, which is the Preliminary section merely contains the definition of the terms used in the Act. With regard to Schedules, all 13 Schedules were selected under study. These documents were obtained from the IRBM website in pdf format and converted into Word document for data analysis purpose.

In order to answer the objective of this study, this research adopts two measures of readability, namely FRES and F-KGL. These measures have been widely used by previous researchers to measure the readability of written documents in taxation studies (e.g. Saw & Sawyer, 2010; Pau et al., 2007; Smith & Richardson, 1999).

FRES measures the readability of technical writing, rates texts on a 100-point scale, where higher scores indicate easier-to-read materials whilst lower scores mark harder-to-read materials. A score between 60-70 is considered to be acceptable. The formula for the FRES is as follows:

$$FRES = 208.835 - 0.846(ASW) - 84.6 (ASL) \text{ where:}$$

ASW = is the total syllables/total words = average number of syllables per word

ASL = is the total words/total sentences = average sentence length

The calculation can be derived using a computer program. Thus, for this study, the calculation is carried out using Microsoft Words 2000. Using the formula, the scores obtained are matched against the general reading ease

scale as highlighted in Table 1.

Table 1. FRES scores description.

FRES	General reading ease scale
Below 30	Very difficult
30 - 50	Difficult
50.1 - 60	Fairly difficult
60.1 - 70	Standard
70.1 - 80	Fairly easy
80.1 - 90	Easy
90.1 - 100	Very easy

Source: Flesch (1948)

F-KGL on the other hand, translates the 0-100 raw FRES into a school grade level, which may indicate the number of years of education generally required to understand the materials (refer Table 2). The formula is as shown below:

$$F-KGL = 0.39 (\text{words/sentence}) + 11.8 (\text{syllables/word}) - 15.59$$

Table 2. F-KGL description.

FRES	F-KGL readability score	Corresponding education level*
Below 30	17 and above	Postgraduate
30 – 50	13.1 – 16.9	Undergraduate
50.1 – 60	12.1 – 13	Matriculation/STPM/Diploma
60.1 – 70	9.1 – 12	SPM
70.1 – 80	7.1 – 9	PMR
80.1 – 90	6.1 – 7	Primary School Leaver
90.1 – 100	1 – 6	Primary School

* Based on corresponding education system in Malaysia. Source: Flesch (1948)

4. Results and discussions

As mentioned earlier, this study analyses the readability of the ITA 1967 including Schedules to the ITA 1967. Therefore, this section discusses the results of the readability analysis of the documents beginning with the ITA 1967 and followed by the Schedules.

4.1 ITA 1967

The ITA 1967 is divided into 12 Parts as shown in Table 3. The FRES analysis on the ITA 1967 reveals an average score of 33.5. This score falls behind the acceptable readability score of between 60 and 70, thus indicates low readability of the ITA 1967. Observing the scores for each Part of the legislation, it appears that all 12 Parts fall in the 'difficult material' category with scores between 30 and 50. Further the Table 3 highlights that the most difficult Part with a score of 30.7 is Part 11: Supplemental.

Table 3. Readability of ITA 1967.

Parts	FRES	F-KGL	Corresponding Education Level
Average Score	33.5	16.3	Undergraduate level
Part 2: Imposition and General Characteristics of the Tax	41.8	13.2	Undergraduate level
Part 3: Ascertainment of Chargeable Income	34.0	16.0	Undergraduate level
Part 4: Persons Chargeable	35.9	15.6	Undergraduate level
Part 5: Returns	35.9	15.9	Undergraduate level
Part 6: Assessments and Appeals	35.9	16.1	Undergraduate level
Part 7: Collection and Recovery of Tax	34.2	16.8	Undergraduate level
Part 7A: Fund for Tax Refund	41.6	14.8	Undergraduate level
Part 8: Offences and Penalties	36.7	14.8	Undergraduate level
Part 9: Exemptions, Remission and Other Relief	40.5	13.9	Undergraduate level
Part 9A: Special Incentive Relief	43.1	11.1	SPM level
Part 10: Supplemental	32.0	15.6	Undergraduate level
Part 11: Supplemental	30.7	16.1	Undergraduate level

While all Parts of the ITA 1967 are considered the backbones of the income tax system, Parts 3-9 would be more applicable to greater range of taxpayers, including salaried individuals, business taxpayers and companies as they relate to the whole process of computing, filing and paying tax. Thus, it is expected that these Parts to be written in a more readable manner. However, Table 3 clearly sets out the FRES scores of below the acceptable benchmark range of 60 to 70, indicating low readability level.

Results obtained from the F-KGL index provide a similar outcome with an average score of 16.3 for all Parts. A major concern is the number of Parts that recorded an average F-KGL index of above 12 which indicates that the document is difficult and has low readability level.

Relating the F-KGL scores with education level, it is found that only Part 9A is considered readable and understandable by the secondary school leavers with Malaysian Education Certificate (SPM) qualification. The other Parts of the ITA 1967 require undergraduate level of education to be able to understand the contents. These findings are considered unsatisfactory especially when compared to Malaysian statistics on the number of citizens receiving university education of only 28.2% of the population (UNESCO, 2013). Furthermore, the taxpayers may include people from various education backgrounds.

Overall, the results on the readability of the ITA 1967 using the FRES and F-KGL analysis indicate that the tax legislation is complex and difficult to be understood by the average Malaysian taxpayers. The results are consistent with Saad (2011) who explored the views of taxpayers on the complexity of the tax system.

4.2 Schedules to the ITA 1967

There are 13 Schedules in the ITA 1967 as listed in Table 4. The FRES analysis on all Schedules reveals an average score of 29.6. This score falls behind the acceptable readability score of between 60 and 70, which indicate low readability of the Schedules. Specifically, the scores for each Schedule highlight that the most difficult Schedule with a score of 20.7 is Schedule 3: *Capital Allowances and Charges*. This is worrying as this Schedule is considered important reference for businesses in their computation of tax liability. Referring to each scores of the Schedules, it appears that 7 Schedules of the ITA 1967 (54%) fall within the category of difficult materials (scores between 30 and 50) while 6 Schedules (46%) are classified as very difficult (scores below 30).

Relating the F-KGL scores with education level, it is found that only Schedule 8: *Repeals* is considered readable and understandable by the secondary school leavers with Malaysian Education Certificate (SPM) qualification. The other Schedules require undergraduate and postgraduate level of education to be able to understand the contents. Again, the findings are considered unsatisfactory when compared to Malaysian statistics on the number of citizens receiving university education of only 28.2% of the population (UNESCO, 2013).

Table 4. Readability of ITA Schedules.

Schedules	FRES	F-KGL	Corresponding education level
Average Score	29.6	17.6	Postgraduate level
Schedule 1: Rates of Tax	32.5	16.0	Undergraduate level
Schedule 2: Deductions for Capital Expenditure on Mines	26.6	19.9	Postgraduate level
Schedule 3: Capital Allowances and Charges	20.7	21.6	Postgraduate level
Schedule 4: Abortive Expenditure on Prospecting Expenditures	20.9	23.1	Postgraduate level
Schedule 4A: Capital Expenditure on Approved Agricultural Projects	32.1	17.6	Postgraduate level
Schedule 4B: Qualifying Pre-Operational Business Expenditure	23.0	19.9	Postgraduate level
Schedule 4C: Deduction for Approved Food Production Projects	35.7	13.7	Undergraduate level
Schedule 5: Appeals	38.1	16.5	Undergraduate level
Schedule 6: Exemption from Tax	30.0	15.9	Undergraduate level
Schedule 7: Double Taxation Relief	28.2	18.9	Postgraduate level
Schedule 7A: Reinvestment Allowance	30.9	15.9	Undergraduate level
Schedule 7B: Investment Allowance for Services Sector	25.1	20.1	Postgraduate level
Schedule 8: Repeals	41.0	9.3	SPM level

Interestingly, the findings of both ITA 1967 and its associated Schedules are favourable as compared to the

Australian ITA 1976, i.e. before the rewriting effort of which 100% were regarded as very difficult. However, the legislation which has undergone the rewrite process, has now become more readable with at least 4% are considered as fairly easy, 12% reaches standard level and 23% fairly difficult (Saw & Sawyer, 2010). Similarly, the New Zealand Income Tax legislation also experienced improvement after the rewrite process, with 23% of the Sections are regarded as fairly difficult, 8% reaches the standard level and 2% are fairly easy (Saw & Sawyer, 2010). Hence, comparing the Malaysian ITA 1967 with the current Income Tax legislations of New Zealand and Australia, the ITA 1967 is far behind in terms of the level of readability.

5. Conclusion, limitations and future research

This study examines the complexity of Malaysian Income Tax system through the readability perspective. For that purpose, the ITA 1967 and the Schedules to the ITA 1967 were analysed using two established readability measures namely the FRES and F-KGL. The results from FRES and F-KGL scores for the ITA 1967 and the Schedules indicate that the level of readability of Malaysian tax legislations and supplementary materials is low and the materials can only be well understood by those who studied at undergraduate and postgraduate level. This is unfortunate since the statistics issued by UNESCO (2013) shows that only 28.2% of Malaysian population possess tertiary education. Furthermore, it is worth to note that these tax legislations are to be read by various parties such as tax agents, business owners, salaried individuals and tax officials in order to assist them with tax matters. However, in reality, these people may not receive such tertiary education that may hinder them from understanding the income tax matters.

These findings on the readability of the tax legislations may provide new knowledge to the literature. The existing studies on tax complexity in Malaysia have been focusing on taxpayers' perceptions (which is subjective in nature) whilst this study investigates the complexity using the well established measures to examine the complexity level in a more objective manner. Based on the research findings, it is proposed that the ITA 1967 and the Schedules should be re-written by taking into consideration the level of readability of the documents. The documents should be drafted using simple words and shorter sentences so that they can be understood by the majority of the public. In relation to this, the Inland Revenue Board Malaysia should form a working committee representing various groups of Malaysian population in drafting the income tax related documents. A similar re-writing exercise has been conducted in Australia, New Zealand and the United States and they have proven the success of such effort. Thus, it is about time for Malaysian government to consider this exercise to ensure greater compliance among the taxpaying public. Research has evidenced that the level of tax law complexity has significant association with the degree of compliance.

Although the two readability measures used in this study has provided good indication of the readability of tax legislations, they are not without their limitations. For instance, Redish and Selzer (1985) claimed that these readability measures are inadequate since they did not consider the content, organization and layout of the reading materials. Notwithstanding this, prior research has confirmed the usefulness of this readability formulae to assist in predicting the readability of business and legal documents (e.g. Tan & Tower, 1992; Richardson & Sawyer, 1998; Smith & Richardson, 1999). In addition to this, the present study only concentrates on the readability aspect of the legislations while complexity may be attributable to various perspectives. It is also worth noted that this analysis was conducted on the English version only. No analysis was undertaken on the Malay version considering the formulae was developed based on the English language documents.

Future research should adopt a more comprehensive readability measures such as Cloze Procedure testing to enhance the readability of the materials. In addition, a comparative analysis on the readability of the tax legislations among countries may provide good indication of the nation's rating. Apart from readability aspect, a wider scope of complexity should be explored. Furthermore, it is worth to address the issues of readability based on specific provision in the Act or specific Act related to the ITA 1967. For example, provisions related to investment incentives in the ITA 1967 together with the Promotion Investment Act.

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