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RELATIONSHIP BETWEEN SIZE OF COMPANY, TYPE OF INDUSTRY AND
LEVERAGE WITH TAX NON COMPLIANCE: THE CASE OF SMALL
MEDIUM CORPORATIONS IN KUALA LUMPUR BANDAR BRANCH

By

SHAHINA SULAIMAN



Project Paper Submitted to
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(International Accounting)



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ABSTRACT

The increasing of tax non-compliance cases in Malaysia is a serious concern to tax authority in this country. Previous studies have shown that size of company, types of industry and leverage are among the factors that contributing to tax non-compliance. These three variables were chosen because they were among the major contributors to national revenue losses. Thus, this study examines the relationship between size of company, types of industry and leverage with tax non-compliance among small and medium corporations (SMCs) tax audited by Inland Revenue Board of Malaysia (IRBM). SMCs are chosen because they contribute immensely to Malaysian economic growth and indirectly will give impact to tax collection. Tax non-compliance indicator in this study is tax audit adjustment. The study used 2015 actual tax audit cases gathered from Department of Operation Tax, IRBM in Kuala Lumpur Bandar branch. Besides that, the data analysis techniques in this study comprise of descriptive analysis, correlation analysis and multiple regression analysis. It was found that company size and leverage have significant relationships with tax non-compliance. The finding also shows that type of industry have a relationship with tax non-compliance. The findings of this study may assist IRBM in identifying possible cases for audit in future.

Keywords: *tax non-compliance, company size, type of industry, leverage.*



ABSTRAK

Peningkatan kepada aktiviti ketidakpatuhan cukai di Malaysia menyebabkan penguatkuasa cukai di negara ini mengambil serius tentang perkara ini. Size syarikat, jenis industri dan leveraj adalah antara faktor yang menyumbang kepada ketidakpatuhan cukai. Ketiga-tiga pembolehubah ini dipilih kerana ia merupakan antara penyumbang utama kepada kerugian hasil negara. Oleh itu, kajian ini menyelidik tentang hubungan antara saiz syarikat, jenis industri dan leveraj dengan ketidakpatuhan cukai di kalangan Syarikat Kecil dan Sederhana (SKS) yang telah di audit oleh Lembaga Hasil Dalam Negeri Malaysia (LHDNM). SKS dipilih kerana ia adalah antara syarikat yang menyumbang kepada ekonomi negara dan secara tidak langsung memberi impak kepada kutipan cukai negara. Petunjuk ketidakpatuhancukai bagi kajian ini ialah pelarasan audit cukai. Kajian ini menggunakan data sebenar mengenai SKS yang diperolehi daripada Jabatan Operasi Cukai, LHDNM yang di audit oleh cawangan Kuala Lumpur Bandar pada tahun 2015. Teknik analisis data yang digunakan ialah analisis deskriptif, analisis korelasi dan analisis regresi berganda. Kajian mendapati bahawa saiz syarikat dan leveraj mempunyai hubungan yang signifikan dengan ketidakpatuhan cukai. Kajian juga mendapati jenis industri ada hubungan dengan ketidakpatuhan cukai. Penemuan kajian ini boleh membantu LHDNM dalam mengenal pasti kemungkinan kes audit pada masa akan datang.

Kata kunci: *ketidakpatuhan cukai, size syarikat, jenis industri, leveraj.*



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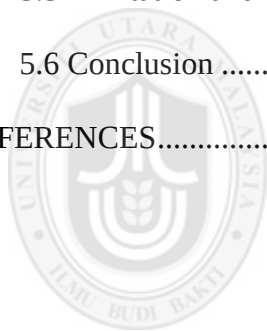


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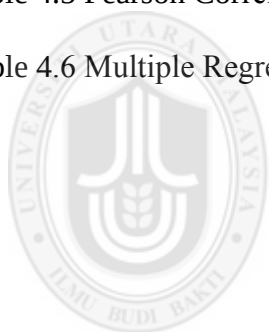
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CHAPTER 1

INTRODUCTION

1.1 Background of Study

The Inland Revenue Board of Malaysia (IRBM) is one of the main revenue collecting agencies of the Ministry of Finance (Ministry Of Finance Malaysia, 2014/ 2015). IRBM was established in accordance with the Inland Revenue Board of Malaysia Act 1995 to give it more autonomy especially in financial and personnel management as well as to improve the quality and effectiveness of tax administration. The Department of Inland Revenue Malaysia became a board on March 1, 1996, and is now formally known as IRBM. IRBM is responsible for the overall administration of direct taxes and the main Act is Income Tax Act 1967 (IRBM Annual Report, 2014).

This agency is responsible for the overall administration of direct taxes not only under Income Tax Act 1967 but also responsible in other acts namely Petroleum Income Tax Act 1967, Real Property Gains Tax Act 1976, Promotion of Investments Act 1986, Stamp Act 1949 and Labuan Business Activity Act 1990. In 2016, the direct taxes collected by IRBM are contributing 53.60 per cent of total federal government's revenue while in 2015; IRBM has contributed 55.34 per cent of the total federal government's revenue as at Table 1.1. However, the total direct tax collection had decreased from RM 121,236 billion in 2015 to RM 113,945 billion in 2016. It shows decreased of 3.69 percent compared to the previous year.

Table 1.1

Contribution of Gross Direct Taxes to the Federal Government's Revenue

Collection			2016	2015
			(RM Billion)	(RM Billion)
Federal Government Revenue			212,595	219,089
Gross Direct Taxes Collection			113,945	121,236
Percentage Collection	of	Gross	53.60%	55.34%

Source: IRBM Annual Report 2016

Total collection from direct tax component recorded RM 121,235.84 million in 2015 and RM 113,945.26 million in 2016 as shown in Table 1.2. The composition of direct tax collection relied heavily from corporate taxpayers accounted for 57.90 per cent. Meanwhile, the collection from individuals' income tax represents 25.98 percent, followed by petroleum income tax which stood at 7.39 percent of the federal government total revenue (IRBM Annual Report, 2016). Collection from companies' tax recorded RM 71,098.14 million in 2015 and RM 65,974.74 million in 2016. These figures show that corporate tax is the main contributor to total of tax collection.

Table 1.2
Direct Tax Component

Direct Tax Component	2016 (RM Billion)	2015 (RM Billion)
Companies	65,974.74	71,098.14
Petroleum	8,425.76	11,636.88
Individual	29,603.47	28,276.97
Cooperatives	89.71	81.49
Stamp Duty	5,674.04	6,016.25
Withholding Tax	2,549.36	2,329.74
RPGT	1,491.67	1,725.54
IOFC	80.92	36.88
Other Taxes	55.59	33.95
Total	113,945.26	121,235.84

Source: IRBM Annual Report 2016

The increase in total collection is due to tax audit activity as at Figure 1.1. Based on the figure, it shows that there were 18,384 of tax audit cases were completed in 2014 resulting in taxes and penalties amounted for RM 1,092.14 million compared to 13,452 cases with taxes and penalties totalling RM 740.62 million in 2013. It proves that tax audit activities play a crucial role in managing compliance as it gives a positive impact

on the taxpayers to be more aware of any non-compliance behaviours that would be monitored closely by the tax authorities.

In functioning as the main collector of government's revenue especially in corporate tax, tax audit are carried out as to increase the level of voluntary compliance and to create awareness among taxpayers regarding to tax laws and regulations. Thus, tax voluntary compliance is important in making tax audit as one of the main activities of IRBM to make sure the collection of tax is optimum and in rightful collected. These tax audits activities have improve the compliance rate amongst taxpayers as well as assist them in preparing their correct annual return to IRBM. The main objective of tax audit is to encourage voluntary compliance with the tax laws and regulations in order to ensure that a higher tax compliance rate is achieved. By doing this, the tax audit officer should improve their competencies and skills in auditing process and making sure that IRBM can collect the correct amount of tax from tax non-compliance (IRBM Tax Audit Framework, 2015).

A fair, transparent and equitable tax administration system will enhance public confidence in the tax system. Compliance with tax laws must be strictly enforced and tax offences such as non-compliance, tax fraud and tax evasion should be penalized in accordance with the provisions of Income Tax Act 1967. Generally, this tax audit activity directed at enhancing voluntary compliance with the tax laws and regulations. A taxpayer can be selected for an audit at any time. However, it does not necessarily mean that a taxpayer who is selected for an audit has committed an offence (IRBM Tax Audit Framework, 2014). This is because the main objective of tax audit is just to identify non-compliance activity among taxpayer, focused solely to those who are involved in tax non-compliance.

Tax audit activity has become more vital after the implementation of Self-Assessment System (SAS). In the previous study conducted by Mohd Nor et al. (2010) had evidenced that tax non-compliance has been related or associated to SAS. They stated that SAS indirectly provide opportunities among taxpayers to commit tax non-compliance for the purpose of lowering the profit and subsequently reducing tax if the system done without proper monitoring mechanism. SAS was formed by the IRBM as a tax administration in Malaysia and was introduced in 2001. Tax administration under the implementation of SAS is merely based on the concept of pay, self-assess and file. The purpose of SAS is to modernise and upgrade the tax administrative system in the country. In line with this, it will create not only an efficient tax system but also speeds up the collection of tax and at the same time improves the rate of tax compliance.

As a tax administrator in Malaysia, IRBM plays a crucial role in protecting the tax system for the benefit of the society. It is suggested that the IRBM may increase its reporting on the enforcement activities so that the public will know what efforts have been taken to curb tax non-compliance (Ming et al., 2013). However, annual return in some firms or corporates is involved in tax non-compliance. Mohd Nor et al. (2010) depicts that tax non-compliance has become the important issue within the accounting profession. There are also companies and organizations engage in tax non-compliance in order to deceive or mislead investors and creditors through information in accounting statements (Rezaee, 2005).

Given that direct tax is the main component of government revenue and tax audit as a main activity of IRBM, this present study examines the relationship between size of

company, types of industry and leverage with tax non-compliance. These factors are considered important so that solution can be made in reducing the rate of non-compliance in this country in the near future.

1.2 Problem Statement

Taxpayers in Malaysia have freedom to declare their income under SAS but still required to submit their annual return accordance with regulations prescribed by the tax laws. However, many taxpayers in this country failed to comply voluntarily. Statistics in Figure 1.3 show that the total number of field audit case that was resolved increased from 28,676 cases in 2013 to 40,216 cases in 2014. IRBM Annual Report 2014 also demonstrates that the total amount of additional taxes and penalties collected under subsection 113(2) Income Tax Act (ITA) 1967 had increased from RM 740.62 million in 2013 to RM 1,092.14 million in 2014. It showed an increase of 47.46 per cent compared to 2013.

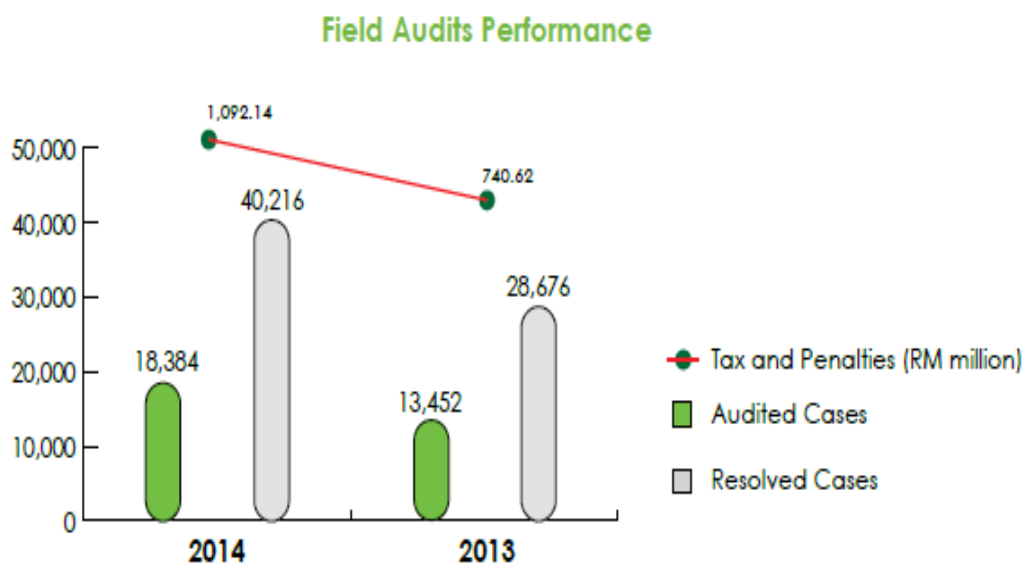


Figure 1.1
Field Audits Performance
 Source: IRBM Annual Report 2014

Nevertheless, Marshal et al.'s (1997) claimed that even though SAS able to motivate voluntary compliance but it may not be suitable to Malaysia's environment with a background of Asian culture. Consequently, this situation may result to tax non-compliance. Non-compliance companies would create big losses to the government given that the difference between the amount of tax legally owed and the amount that was actually collected by the audit activities. This phenomenon is often referred to as 'tax gap'. The tax audit activities carried out aggressively under the SAS provides motivation to investigate further to the factors that contributed to this problem. The purpose of tax administration is to collect the revenue needed to fund the public services and public goods accordance with the law. Getting this balance right can have a huge impact, both on the structural and sustainable collection of revenue and on the operation of the wider economy respectively.

Based on Table 1.3, it showed that the more audit visits were made, the higher the tax was collected. It also reflects the level of tax non-compliance by taxpayers in Malaysia. The tax authority should study the factors that led to the tax non-compliance activities so that preventive measures can be developed in order to prevent widening of the existing tax gap. Understanding these factors is important in reducing the rate of tax non-compliance among taxpayers in the future.

Following a study carried out by Mohd Nor et al. (2010), the present study investigates the relationship between the difference amount between the tax legally owed and the amount actually collected (i.e. tax non-compliance) with the size of the company, type of industry and leverage. In particularly, this study seeks to find an answer whether there is a relationship between size of company, type of industry and leverage with tax

non-compliance among SMCs in Kuala Lumpur Bandar branch under Income Tax Act 1967. Therefore, there must be some explanations in why this situation happens. This study is replicated and inspired from the previous study conducted by Mohd Nor et al. (2010). However, this study will be used an actual cases audited by the IRBM.

1.3 Research Questions

There are two research questions designed for this study which are as the following:

- 1) What is the level of tax non-compliance among SMCs in Kuala Lumpur Bandar branch?
- 2) What is the relationship between size of company, type of industry and leverage with tax non-compliance among SMCs in Kuala Lumpur Bandar branch?

1.4 Research Objectives

The objectives of this study are twofold which are:

- 1) To investigate the level of tax non-compliance among SMCs in Kuala Lumpur Bandar branch
- 2) To examine the relationship between size of the company, type of industry and leverage with tax non-compliance among SMCs in Kuala Lumpur Bandar branch

1.5 Significance of the Study

This study is an extension of the previous study by Mohd Nor et al., (2010) in order to obtain more evidence for the current period. This study used real tax audit cases audited by IRBM in Kuala Lumpur Bandar branch in 2015. Past studies mostly focused on survey data by employing various model or proxy to measure non-compliance.

This research may help IRBM in implementing of tax policy reform and developing on tax audit activities. Consequently, the quality of tax audit activities done by tax officer will increase given that the new indicators (company size, types of industry and leverage) that auditors can be applies in tax audit activities. It is important for tax authority to study the factors that led to non-compliance activity among taxpayers. It is because it will give huge losses to the government. Besides, hopes to provide some insight to all parties that involved in tax legislation in Malaysia because this study using the actual data so can describe the real situation of tax non-compliance in this country.

Moreover, this research is significant as it uses Malaysian's companies as evidence for investigating the relationship between tax non-compliance with size of company, type of industry and leverage. The aims of the study are to gain knowledge into tax non-compliance and SMCs characteristics namely, the size of company, type of industry and leverage. In addition, this study would contribute to existing tax non-compliance literature and company characteristics literature.

1.6 Scope of the Study

This study focuses on three SMCs characteristics which are size of the company, types of industry and leverage. Moreover, the period of the study is a focus on the year of 2015. This study is designed to contribute an in-depth understanding of the relationship between size of company, type of company and leverage with tax non-compliance with the use of secondary data.

The sample of this study is solely based on corporate audit cases that had been finalized in 2015 with tax adjustment completed in 2015. This sample is limited to the SMCs cases audited and resolved in 2015 which focused on the case from IRBM of Kuala Lumpur Bandar (KLB) branch. The IRBM of KLB branch is selected due to the fact that the branch is one of the biggest branches in handling the SMCs cases. Hence, the results from this study cannot be generalized to SMCs in other state of Malaysia.

1.7 Key Terms Definition

Key term definition is definition that used in this study. This study used key term definitions which are as follows:

1.7.1 Tax non-compliance

“Tax non-compliance” means any activities that are not regulated with tax law. Tax non-compliance for companies in Malaysia are classified into seven categories namely understatement of sales, overstatement of purchase, inventories adjustment, unallowable expenses, allowances adjustments transfer pricing and other adjustment.

1.7.2 Self-Assessment System (SAS)

“SAS” is a system that introduced to increase voluntary tax compliance in Malaysia.

1.7.3 Inland Revenue Board Malaysia (IRBM)

“IRBM” is a body under Ministry of Finance in Malaysia to collect direct tax as revenue to the government.

1.7.4 Tax Audit Activity

“Tax audit activity” is an examination of a taxpayer’s business records and financial affairs to ascertain that the right amount of income should be declared and the right amount of tax should be calculated and paid are in accordance with tax laws and regulations. IRBM carries out two types of audit namely, desk audit and field audit.

1.7.5 Small Medium Corporations (SMCs)

“SMCs” is a company incorporated in Malaysia with paid-up ordinary share capital of not more than RM2.5 million at the beginning of the basis period for a year of assessment (Ministry of Finance, Budget 2003).

1.8 Organization of the Study

This study is structured into five chapters. This chapter evolved from a background of the study that gives an insight about essential of tax noncompliance towards company characteristics. It also provides a problem statement, research objectives, and research questions, scope of study and significance of the study.

Chapter two deals with empirical literature related to tax noncompliance, size of company, type of industry and leverage. In addition, the research hypothesis is established to determine the relationship between size of the company, type of industry and leverage.

Chapter three provides the research methods and design used in the study. It explains the source of data used and justification for selecting the sample, data collection method, the definition, and measurement of the independent variables and the dependent variable, research framework and some related instrumental variables.

Chapter four reports the results of the empirical findings that examine the relationship between size of the company, type of industry and leverage with tax non-compliance. Descriptive, correlation and regression analysis are also presented in this chapter.

Chapter five summarises the overall findings, conclusion, implication on practice and policy and limitation and recommendation for future research.

CHAPTER 2

LITERATURE REVIEW

2.1 Introduction

This chapter consists of the relevant literature which related to tax non-compliance. This chapter also discusses three main elements that related to tax non-compliance which are size of company, type of industry and leverage. Subsequently, the hypotheses are developed based on previous study. The first section of this study discusses SMCs under section 2.2 while section 2.3 describes tax non-compliance. Next, section 2.4 discusses about the relationship between size of company and tax non-compliance whereby in section 2.5, it explains about the relationship between type of industry and tax non-compliance while relationship between leverage and tax non-compliance are discusses in section 2.6. Last but not least, section 2.7 will concludes this chapter.

2.2 SMCs in Malaysia

SMCs is a company incorporated in Malaysia with paid-up ordinary share capital of not more than RM2.5 million at the beginning of the basis period for a year of assessment (Ministry of Finance, Budget 2003). However in 2013, Small Medium Enterprise (SME) Corporation Malaysia gives a details definition of SMCs in Malaysia which are as follow:

Table 2.1
Definition of SMCs by SME Corporation

	Manufacturing	Service and Other Service
Medium	Sales turnover: RM15 million < RM50 million OR Employees: From 75 to < 200	Sales turnover: RM3 million < RM20 million OR Employees: From 30 to < 75
Small	Sales turnover: RM 300,000 < RM15 million OR Employees: From 5 to < 75	Sales turnover: RM300,000 < RM3 million OR Employees: From 5 to < 30
Micro	Sales turnover: < RM300,00 OR Employees: < 5	Sales turnover: < RM300,000 OR Employees: < 5

Source: SME Corporation Annual Report, 2014

SMCs in Malaysia have performed very well with growth exceeding that of the overall economy. In the recent period from the year of 2011 to 2015, SMCs grew at an average annual rate of 6.7 per cent versus the overall growth of the Malaysia's economy. As a result, the GDP contributed by SMCs in 2015 is 36.3 per cent in comparison to a figure slightly below 30 per cent in 2005 (SME Corporation Annual Report, 2015). Thus, SMCs remain a priority to the government due to taking part actively in SMCs growth

in maintaining the momentum of the country's economy. SMCs in Malaysia are not only contributes to GDP, but also it opens up job opportunities to the public.

As one of main character in Malaysia economy, the tax rate of SMCs is at the highest level of guarantee to make sure the growth of SMCs in this country is continuously. The tax rate for SMCs where the company does not control and is not controlled by another company which has a paid up ordinary share capital of more than RM 500,000 are eligible for a preferential rate of 20 per cent, while the remaining chargeable income was maintained at 25 per cent since year of assessment 2009 until year of assessment 2015. Company with paid-up capital more than RM2.5 million will be charged 25 per cent (Income Tax Act, 1967). With the high volume of growth, the taxation of SMCs has become a vital and significant attention in Malaysia.

SMCs contribute in social and economic development of developing countries including Malaysia. A large number of SMCs are in finished goods and services sector. SMCs also growth in manufacturing sector, service and agriculture sector as well as in information communication technology (ICT) sector. These contributions give a greater impact to the Malaysian economy as a whole and indirectly will increase tax collection. However SMCs have their own characteristics (Mohamad et al, 2018). It is a dynamic in nature and usually it has a simple management structures because of the small number of employees and the owners' have low level of education. SMCs also managed and controlled by the same individual when at the same time. For example, an owner may also be an employee. SMCs in suburban area that has no tax agent are prone to involve in tax non-compliance activity. The larger companies have better internal control and good corporate governance compared to SMCs. Because of these

characteristics and weaknesses of SMCs are differs from larger companies, SMCs tend to lead in tax non-compliance activity.

2.3 Tax Non-Compliance

The tax non-compliance does not only happen in Malaysia but also happens in other countries in the world. Tax non-compliance can categorize in two groups that is tax evasion and tax avoidance. Tax non-compliance for companies in Malaysia are classified into seven categories namely understatement of sales, overstatement of purchase, inventories adjustment, unallowable expenses, allowances adjustments transfer pricing and other adjustment. Tax non-compliance is normally found by tax officer when tax audit is carried out by tax officer. Tax non-compliance may be in the form of misstatement or non-reporting of some income, non-submission of tax return form within stipulated time and non-payment of tax indicated in the return form (Mohd Nor et al. 2010).

There is no standard definition of tax non-compliance in section 2 of Income Tax Act (ITA), 1967. Under section 112 of ITA 1967 stated that “failure to furnish a return without reasonable excuse, be guilty of an offence”. Meanwhile, in section 113 of ITA 1967 stated that “any person who makes an incorrect return by omitting or understating any income which he is required under this Act to make a return on behalf of himself or another person; or gives any incorrect information in relation to any matter affecting his own chargeability to tax or the chargeability to tax of any other person, be guilty of an offence”.

Meanwhile Roth et al. (1989) defined tax compliance as filing all requires tax returns at the proper time and that the returns accurately report in accordance with the tax

code, regulations and court decisions applicable at the time in the field. In Malaysia there are several forms of non-compliance such as failure to pay assessed taxes by the due date, under declared income, overstatement of deductions and failure to submit a tax return within the stipulated period or no submission has been made (Kasipillai & Abdul Jabbar, 2006).

Md Noor et al. (2009) have come up with a study about examining corporate tax non-compliance behaviour and their study investigated the possible indicators of tax non-compliance. Tax non-compliance is a failure of the taxpayer to declare income, claiming of deduction to which the taxpayer are aware that they are subjected to no legitimate entitlement (Kasipillai, 2012). Kasipillai (2012) asserted that non-compliance arise from activities such as failure to file tax returns, under reporting of taxable income either through under reporting of income or overstating deductions, failure to pay taxes assessed and failure to remit instalment payment on time.

The amount of concealed income unearthed during tax audit indicates clearly that there is widespread tax non-compliance in Malaysia and the quantum of tax lost through non-compliance is quite high. The study by Mohd Yusof et al. (2014) used 375 actual tax audit cases finalized by IRBM in 2011. The information obtained from the tax authority (IRBM) which is reflective of the actual situation. This study complements the scant existing literature by empirically evaluating the factors that influenced corporate tax non-compliance in a developing country like Malaysia (Mohd Yusof et al. 2014).

Isa and Pope (2012) stated that tax compliance under the SAS is highly dependent on voluntary compliance such as honesty of the taxpayers in computing their tax payable and another significant aspect of the SAS is tax audits. Tax audit is an examination of

taxpayers' business record and financial affairs to ensure taxpayers have computed their tax payable in accordance with the tax laws and regulations (IRBM, 2009). Isa and Pope (2012) examined that tax audit experience among corporate taxpayers in Malaysia. Three aspect of audit are analysed incorporating audit experience, tax auditors' professional proficiency and audit perception. Findings from their study demonstrate that taxpayers' audit experience was reasonably satisfactory, while the level of tax auditors' professional proficiency was identified as moderate and that the taxpayers were found to have a strong negative perception towards auditing.

Ming et al., 2013 analysed the profiles of transgressors (detected evaders); (2) examine reason(s) that triggered a tax audit, causes of tax evasion, audit timeframe and tax penalty charged; and (3) to assess if tax auditors followed the guidelines as stated in the Tax Audit Framework when conducting tax audits. On the other hand, there is no clear evidence to suggest that the extent of tax non-compliance problem is decreasing in Malaysia. However, in view that tax non-compliance has an adverse impact on the economy; tax non-compliance must be detected and penalized to enhance public confidence in the tax system.

Mohamad et al. (2016) in their study said that many methods can be used to legally avoid paying taxes. The most common strategies by SMCs in Malaysia are income deferral and income tax deduction. Income deferral involves businesses that use the accrual basis of accounting. Meanwhile, the use of tax deduction affects the total income by reducing it, which decreases the amount of taxes that are due.

The definition on tax non-compliance that used in this study are classified into seven categories namely understatement of sales, overstatement of purchase, inventories adjustment, unallowable expenses, allowances adjustments transfer pricing and other

adjustment. It measured by tax audit adjustment and exist when tax audit are carried out. By auditing the probability that non-compliance were discovered and resulted in additional assessment with penalty issued under subsection 113(2) of the ITA 1967. Subsection 113(2) ITA 1967 mentioned in the Act; where a person; (a) makes an incorrect return by omitting or understanding any income of which he is required by this Act to make a return on behalf of himself or another person; or (b) gives any incorrect information in relation to any matter affecting his own chargeability to tax or the chargeability to tax of any other person.

2.4 Size of Company and Tax Non-compliance

This section explained on the development of hypothesis related to the size of the company. Size is also associated with the companies' level of internal control. An increase in size will also increase the level of internal control in a company (Icerman and Hillison, 1990). If this assumption is true, an increase in firm size will result in more of tax non-compliance activity in the company. There are mixed findings of the studies between size of company and tax non-compliance. Smaller companies are more likely to involve in tax non-compliance activity compared to larger companies (Nur-Tegin, 2008; Tedds, 2010). Smaller companies normally reported a lower income or revenue to their tax authority because smaller companies used more cash in transaction (Gauthier & Gersovitz, 1997).

Nonetheless, some previous study found a positive relationship between company size and tax non-compliance (Rice, 1992; Hanlon et al., 2007; Mohd Nor et al., 2010). According to Zimmerman (1983), companies that have high number in revenue will attract tax administration to conduct a field audit. In other words, there should be a

positive relation between size of company and tax non-compliance. Wallace (2002) said that tax authority tend to aimed at attracting larger companies due to a larger for findings that will affect tax collection.

Study by Md Noor et al. (2009) examining corporate tax non-compliance behaviour investigated that there is a possible indicators of tax non-compliance. This study found that company size has significant effects on tax non-compliance activities through fraudulent financial report. There was a significant positive relationship between size of company and tax non-compliance at the 1 per cent level. These findings indicated that companies with higher sales may be associated with higher tax non-compliance. The sample of companies used in this study is companies subjected to tax investigation during the years of 2001 to 2005.

Study in Malaysia investigating corporate tax non-compliance behaviour conducted by Mohd Nor et al. (2010) have analysed 396 resolved corporate tax audited cases by the IRBM after the implementation of a self-assessment system in 2004 in order to identify the relationship between tax non-compliance and firms' characteristics, (i.e. size, types of industry and leverage). This study has found that larger firms are more compliant than smaller firms. The sample of companies used in this study is unlisted companies and the results are not generalizable to listed companies. Listed companies may have more stringent rules for listing and have better corporate governance mechanism within the company as control. Their study is also the first empirical that uses real tax cases where the non-compliance with the Malaysia statues and tax laws are used as the measurement of the fraudulent financial reporting (Mohd Nor et al., 2010).

In addition, a study was conducted by Md Yassin et al. (2010) who examined factors that influence tax non-compliance behaviour among SMCs in Malaysia reported that by using 1,365 observations from 1,075 corporations, which had been audited and investigated by the IRBM, they found that size is the key factors that influence corporate tax non-compliance behaviour. Md Yassin et al. (2010) has made comprehensive attempts to examine compliance behaviour among SMCs in Malaysia.

On the other hand, Giles (1998) has conducted a study to develop risk-profiling model of taxation compliance and tax non-compliance on the part of New Zealand firms and he found that larger firms are efficient and those firms which used tax-minimization instruments tend to be significantly more compliant.

Because of the pervasiveness of tax non-compliance remains a serious concern to most tax authorities around the world; Mohd Yusof et al. (2014) examined the determinants of corporate tax non-compliance among small-and-medium-sized corporations (SMCs) in Malaysia and they have revealed that company size is one of the main factors in tax non-compliance.

Ming et al. (2013) conclude that inconclusive to provide evidence that firm size correlate with tax evasion, even so, that the audit timeframe taken to settle audit cases appears to be too long, and generally, tax auditors did follow the guidelines as stated in the Tax Audit Framework in audit selection, settlement and penalty imposition.

Mohamad et al. (2016) also found that tax non-compliance is also influenced by the size of company. They also found that 95 per cent of the 2,849 observations did not appoint tax agent. Meanwhile 75 per cent are located in urban areas with 25 per cent in suburban areas. In their study, service sector has the greatest tendency to avoid taxes, followed by the manufacturing and agriculture sectors. SMCs located in

suburban areas with sales less than RM 250,000 (micro sized) or bigger than RM 1,000,000 (medium-sized) have great number of tax non-compliance.

This study found that size of company has significant effects on tax non-compliance activities. Despite there are mixed findings from previous study relating to the size of company and tax non-compliance, this study proposed the following hypothesis, stated as below:

H₁: There is a positive relationship between company size and tax non-compliance among SMCs.

2.5 Type of Industry and Tax Non-compliance

A type of industry is also likely to be associated with the tax non-compliance. Review from previous study found mixed finding regarding the relationship between type of industry and tax non-compliance. According to Mohd Yusof et al. (2014), services and construction industries were noted to be predominant industries engaged in tax non-compliance activity. This is because different industries may have different characteristics and strategies to develop various strategies to involve in tax non-compliance. Their study also shows that types of industry are the main factor influencing tax non-compliance. They have found that there is a significant positive relationship between types of industry and tax non-compliance of SMCs at 90 per cent confidence level. This study also initiates that the service industry is less compliant than the real estate industry at the 5 per cent significant level.

To engage in tax non-compliance the incentives more likely goes to industry that is heavily based on cash transaction. It is not easy for the tax authority to trace the source

of income in cash transactions because of low visibility features. Business income which commonly used cash transaction tends to undeclared their income (Bankman, 2007).

Previous study also focused on the relationship between type of industry and tax non-compliance among corporate taxpayers. The service oriented industry is more compliant than other industry (Rice, 1992). While, Chan and Mo (2000) said that service oriented industry is less compliant than the manufacturing industry in China whereas in Malaysia, it was found that the construction industry is positively associated with fraudulent financial reporting (Mohd Nor et al., 2010).

Mohamad et al. (2016) have found that the type of industry do not significantly affect the tax non-compliance among SMCs in Malaysia in the year 2011. Their study used propriety tax audit data from the IRBM in the 2011 tax returns of SMCs. Based on the uneven findings, this study suggest the following hypothesis as below:

H2: There is a relationship between the type of industry of the company and tax non-compliance among SMCs.

2.6 Leverage and Tax Non-compliance

The definition of leverage is the ratio of a company's loan capital (debt) to the value of its ordinary shares (equity). Briefly, leverage can also refer to the amount of debt used to finance assets. There is mixed evidence on leverage and tax non-compliance. A study by Dechow et al. (1996) claimed that companies with high debt will have no motivation to manipulate their income while, Zainudin et al. (2016) findings claimed that there is a positive relationship between leverage and tax non-compliance and

significant at 1 per cent level. The higher in leverage will results in the higher in tax non-compliance. This study used the Logit Model to identify firms with tax non-compliance.

The companies that are highly leveraged may be at risk of bankruptcy if they are unable to pay their debts (Spathis, 2002). A high debt structure may increase tax non-compliance because it shifted risk equity owners and managers to owners of debt (Spathis, 2002). Spathis (2002) also found there is a positive relationship between leverage and fraudulent financial reporting. A company's management may manipulate its financial statement if there is a need to meet certain debt covenants (Zainudin et al., 2016).

Mohd Noor et al. (2009) also found that there is a significant relationship between leverage and tax non-compliance. This study has a final sample of 73 companies and it was subjected to tax investigation during the years of 2001 to 2005. It was positive and highly significant at the 1 per cent level that there is a relationship between leverage and tax non-compliance. This indicated that firms with a high total debt to total assets value had an increased probability of being associated with tax non-compliance. Financial distress may provide the motivation for management fraud.

A review of literature found that there is relationship between leverage and fraudulent financial reporting. Zainudin et al. (2016) found that a higher level of debt may increase the probability of manipulation of income reporting. Past studies suggested that companies may have incentives to manipulate financial statements to meet their specific goals, both internal and external. Thus, based on these findings taken from the previous studies, this study suggests the third hypothesis which is as follow:

H₃: There is a positive relationship between the leverage of the companies and tax non-compliance among SMCs.

2.7 Summary

This chapter discuss the literature review of tax non-compliance study. There are many factors caused tax non-compliance such as size of company, type of industry and leverage. The relationship between size of company, type of industry and leverage are discovered as the main contributors in tax non-compliance. These three variables were chosen because they were among the major providers to national revenue losses and resulting in the possible under funding of public's service and also an unfair burden on honest citizens.



CHAPTER 3

RESEARCH METHODOLOGY

3.1 Introduction

This chapter covers the methodology of the research work to test the relationship between size of company, types of industry and leverage with tax non-compliance based on the established hypotheses. This chapter is divided into ten sections. It starts with the explanations on the research framework in Section 3.2 and followed by the research design in Section 3.3. Section 3.4 provides brief description on the operationalized definition while section 3.5 explained sampling procedure and followed by data collection technique in Section 3.6. Section 3.7 presents measurement or instrumentation whereby in Section 3.8, it discusses on data analysis used in this research. Data analysis techniques will be discussed in Section 3.9 and the summary of the chapter is presented in Section 3.10.

3.2 Research Framework

The suggested framework for this present study is illustrated in Figure 3.1. Independent variable is represented by three variables which consist of the size of the company, type of industry and leverage of the company. Dependent variable on the other hand is represented by tax non-compliance.

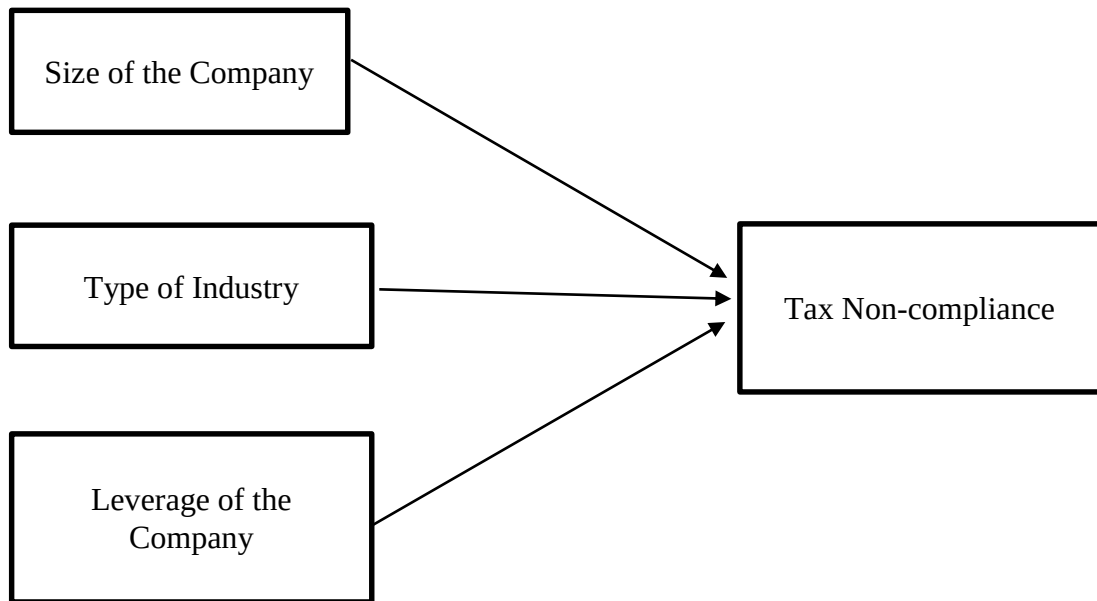


Figure 3.1
Theoretical Framework of Study

3.3 Research Design

This research is using quantitative data in order to collect the data. The secondary data is gathered from the Department of Tax Operation, Inland Revenue Board Malaysia (IRBM). The population of this research is among the corporations registered in Malaysia that had been audited by the IRBM. In practice, the detailed tax audit findings are keyed and stored in the IRBM's Case Management Case (CMS) at the head office. The sample of this study is corporate audit cases that had been finalized in 2015 with tax adjustment completed in 2015. Given that tax adjustment will show non-compliance activity, tax audit adjustment will be the measurement of dependent variable in this study. With official permission, tax audit findings of all 279 resolved cases in 2015 are obtained.

3.4 Operationalized Definition

This study categorized variables into independent variables and dependent variable. The independent variables are size of the company, type of industry and leverage. While dependent variable such as non-compliance is measured through tax audit adjustment. Size of company is measured by the total sales of company. While type of industry categorized into two groups; 1 is for manufacturing and 0 is non-manufacturing company. Next, leverage is the ratio of a company's loan capital (debt) to the value of its ordinary shares (equity).

3.5 Sampling Procedure

This study examines the cases that held by Kuala Lumpur Bandar Branch based on 279 cases which were resolved in 2015. This study used Kuala Lumpur Bandar branch as the sample of this study due to this branch is one of the largest branches of IRBM (Memo from IRBM Tax Compliance Department, 2015) so that the data that will be used in this study can be generalized to the other big branch of IRBM. The total amount of files in Kuala Lumpur Bandar branch were 1,455 files (CMS Statistic Data, 2014).

Given that most companies are audited for several years of assessment, only those firms being audited in the latest assessment of year 2015 are examined to avoid the overlapping of case. Tax audit in the latest year assessment would usually take into consideration all the adjustment from previous year of assessment (Mohd Nor et al., 2014).

3.6 Data Collection Technique

This study uses real tax cases that was audited in 2015 by tax officers where the non-compliance with the law and regulation under Income Tax Act (ITA), 1967. The secondary data is collected from the Department of Operation Tax, IRBM in 2015. The permission to get data is obtained from the Department of Operation Tax in relation to audit adjustment which used in this study.

3.7 Measurement / Instrumentation

The measurement for the dependent variable, tax audit adjustment ratio (TAAR) is the MISSTATE_AMOUNT divided by the TRUE_INCOME. The total amount of all these misstatements or tax audit adjustment is denoted as MISSTATE_AMOUNT. To obtain the total income without misstatement (TRUE_INCOME), the total amount of misstatements (MISSTATE_AMOUNT) are added back to the unaudited income and considered as additional income. This is because the sample comprises small and medium-sized companies, there is no transfer pricing offence discovered during tax audit since there is no inter-company transaction within the company's group. Transfer pricing strategy is more likely to happen in multinational organizations and when there are inter-company transactions within a group. Therefore, transfer pricing is omitted in this study (Mohd Nor et al., 2014).

Meanwhile, measurement for independent variables is total sales of the SMCs in particular year to indicate size of company. While types of industry is measured by 1 for manufacturing company and 0 referred to non-manufacturing company (i.e. agricultural, mining and quarrying, electricity supply, water supply, construction,

wholesale and retail trading, transportation and storage, accommodation, food and beverage activities, information and communication, finance and insurance or takaful, real estate, professional, scientific and technical activities, administration activities, education and medical activities and entertainment activities. Leverage will be measured by total debt divided by asset of SMCs.

3.8 Data Analysis

This study uses secondary data that obtained from Department of Operation Tax, IRBM. The empirical model to test the hypotheses in this study is as follows:

$$\text{MISSTATE_RATIO}_i = \alpha_0 + \alpha_1 \text{SIZE}_i + \alpha_2 \text{IND}_i + \alpha_3 \text{LEVERAGE}_i + \varepsilon$$

Where:

$$\text{TAAR}_i = \text{MISSTATE_AMOUNT} / \text{TRUE INC}$$

MISSTATE_AMOUNT = Total amount of misstatement/ Tax audit adjustment

TRUEINC = Total income + MISSTATE_AMOUNT

SIZE_i = Company size (sales)

TYPE_i = Type of industry (manufacturing=1, non-manufacturing=0)

LEVERAGE_i = Total debt / Total asset

3.9 Data Analysis Techniques

The data were recorded in EXCEL spread sheet before transferred into Statistical Package for Social Science Software (SPSS) for analysis. The study examines the skewness and kurtosis to confirm the normality of the data.

3.9.1 Descriptive Analysis

Descriptive statistics provide the profiles of the collected sample such as mean, median, standard deviation and maximum value. This information is needed in order to choose the right of statistical techniques to be adopted in analysing the data.

3.9.2 Correlation Analysis

The study employs Pearson correlation coefficient statistics to determine the relationship between size of company, type of industry and leverage with tax non-compliance. It explains the relationship between two variables.

3.9.3 Multiple Regression Analysis

The study also employs multiple regression analysis to measure the level which the independent variables explain or influence the dependent variable in the study. The multiple regression analysis of study provides the adjusted r-square, the significance level, standardized beta, and t-values. Descriptive analysis and correlation are further conducted in this study. Besides, multicollinearity is also being observed to ensure two

or more independent variables in multiple regression model are not highly correlated. While normality test was done to analyse the tabulation of independent variables and the dependent variable to ensure that all the data are normally distributed and reliable (Garson, 2012).

3.10 Summary

This chapter has discussed the research methodology adopted in this study. The research is a quantitative research which used secondary data obtained from Department of Tax Operation, IRBM. 279 cases with audit adjustment that was held by Kuala Lumpur Bandar branch in 2015 are used as the samples of this study. In addition, regression framework has been developing based on the regression model.



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CHAPTER 4

RESULTS AND DISCUSSION

4.1 Introduction

This chapter presents the results of this study that determines the relationship between size of the company, type of industry and leverage with tax non-compliance. This chapter provides descriptive analysis, Pearson correlations and the regression among SMCs in Kuala Lumpur Bandar branch. This chapter will be divided into sub-topics such as Section 4.2 explains the summary of SMCs data while Section 4.3 refers to a descriptive analysis of the study. Section 4.4 explained assumption testing and divided into two groups that is 4.4.1 that explained normality test while Section 4.4.2 explained multicollinearity statistic. Next Section 4.5 refers to correlation analysis while Section 4.6 described regression analysis to test the relationship between size of company, type of industry and leverage with tax non-compliance and Section 4.7 is explained conclusion of this chapter.

4.2 Summary of Data

Table 4.1 presents the breakdown of the final sample of 279 SMCs that used in this study. The samples for this study are mainly from non-manufacturing. Of 279 SMCs tax non-compliance cases audited and resolved in 2015, only 13.26 per cent were from manufacturing company while 86.74 per cent were from non-manufacturing company.

Table 4.1
Summary of SMCs Data

Characteristics	Total Company (n)	Total Company (%)
<i>Major industry</i>		
Wholesale and Retail	79	28.32
Professional, Scientific and Technical Activities	53	19.00
Manufacturing	37	13.26
Human Health and Social Work Activities	17	6.09
Construction	12	4.30
Real Estate Activities	7	2.51
Administrative and Support Service Activities	7	2.51
Information and Communication	6	2.15
Other Service Activities	5	1.79
Transportation and Storage	4	1.43
Education	3	1.08
Financial and Insurance	3	1.08
Agriculture, Forestry and Fishing	3	1.08
No Data Given	43	15.40
<i>Size based on total sales/ revenue</i>		
Between RM1,000,001-RM2,000,000	45	16.13
Between RM2,000,001-RM3,000,000	93	33.33
Between RM3,000,001-RM4,000,000	74	26.52
Between RM4,000,001-RM5,000,000	67	24.02

From the summary of SMCs data in Table 4.1, it can be seen that the largest industry involved in tax non-compliance is the wholesale and retail trade (28.32 per cent or 79 cases) and followed by professional, scientific and technical activities (19.00 per cent or 53 cases) in respect of size company, measurement based in total sales or revenue. The summary of SMCs data shows that 93 companies being audited which equal to 33.33 per cent of SMCs had total sales between RM 2,000,000.00 to RM 3,000,000.00. This indicates that the IRBM focused tax audit on SMCs with smaller total sales.

4.3 Descriptive Analysis

Table 4.2 highlights the descriptive results of the sample of SMCs tax audit cases in Kuala Lumpur Bandar branch. Descriptive analysis summarizes the sample of 279 SMCs tax audit cases in Kuala Lumpur Bandar branch for the year of 2015.

Table 4. 2
Descriptive analysis

		Year 2015			
Variables	N	Minimum	Maximum	Mean	Standard Deviation
TAAR	279	0.01	0.48	0.05	0.07
Size	279	5.09	7.86	6.38	0.47
Industry	279	0.00	1.00	0.16	0.37
Leverage	279	0.01	4.71	0.85	0.58

The tax audit adjustment ratio (TAAR) is the proxy of tax non-compliance. The mean value of TAAR is 0.05 with a minimum value is 0.01 while the maximum value is 0.48 and the standard deviation was 0.07. The results show that the average level of tax non-compliance among SMCs tax audit cases in Kuala Lumpur Bandar branch is low by only 0.05 occurred during the year 2015. The maximum level of tax non-compliance occurred is 0.48 which means that the situation of tax non-compliance still in control but cautious action has to be made by strengthening voluntary tax compliance in order to mitigate the tax non-compliance.

The average of size of company is at 6.38 while standard deviation recorded at 0.47. Both minimum value and maximum value is at 5.09 and 7.86 respectively. The average type of industry among the SMCs recorded 0.16 with a standard deviation of 0.37. The maximum type of industry in the sample is 1, while the minimum in the sample is 0.00. The leverage is equal to debt-to-equity ratio. The debt-to-equity ratio is a measure of the relationship between the capital contributed by creditors and the capital contributed by owners. It also shows the extent to which shareholder' equity can fulfil a company's obligations to creditors in the event of liquidation. The average value of leverage ratio is 0.85 with a standard deviation of 0.58, the minimum percentage in the sample is 0.01 while the maximum is 4.71.

4.4 Assumption Testing

Assumption testing is to assume some certain characteristics about the data. There are two assumptions testing used in this study that is normality test and multicollinearity statistics.

4.4.1 Normality Test

The normality test was done to analyse the tabulation of independent variables and the dependent variable to ensure that all the data are normally distributed and reliable (Garson, 2012). The SPSS normality result of skewness and kurtosis. Normality result of kurtosis should not exceed ± 10 ; while skewness should be less than ± 3 (Kline, 1998). The statistics for the year from Table 4.3 shows that the value of kurtosis or skewness is in the range of to ± 10 or ± 3 ; hence, the data is normal for regression analysis.

Table 4. 3
Normality test

	Skewness	Kurtosis
Tax audit adjustment ratio	2.961	9.856
Size	0.239	0.250
Type	1.787	1.202
Leverage	2.395	9.837

Table 4.3 explains the normality test results of the sample of SMCs tax audit cases in Kuala Lumpur Bandar branch. The value of skewness for tax audit adjustment ratio is 2.961 and 9.856 for kurtosis. While size of company value for skewness and kurtosis is 0.239 and 0.250. Next, the type of company value for skewness and kurtosis is 1.787 and 1.202. Meanwhile 2.395 and 9.837 is value of skewness and kurtosis for leverage.

4.4.2 Multicollinearity Statistics

The degree of relationship between two or more variables is being indicated by term multicollinearity. Multicollinearity exists when independent variables are strongly correlated with each other (Pallant, 2007). An extreme case of multicollinearity exists when two or more variables are perfectly interrelated which is also known as singularity (Mayer, 1999). In examining for any multicollinearity effects, the variance inflation factor (IVF) is used to present the study.

To determine whether or not this effect occurs, the average points for the tolerance value must be greater than 0.10 and the VIF value should not exceed 10, as explained by Hair, Sarstedt, Ringle, and Mena (2012), and Sekaran and Bougie (2013). In this study, the VIF value of the variables is 1.063 for size, 1.062 for type of industry and 1.009 for leverage. Respectively, the tolerance value range between 0.941 and 0.991. The tolerance value for size is 0.941, while type of industry is 0.942 and 0.991 for leverage. The value indicate that the tolerance value is substantially greater than 0.10 and the VIF is less than 10. Thus, it can be concluded that there is no multicollinearity among the variables of this study. The details of Variance Inflation Factor for the independent's variables are provided in Table 4.4.

Table 4.4
Multicollinearity statistic

	Tolerance	VIF
(Constant)		
Size	0.941	1.063
Industry	0.942	1.063
Leverage	0.991	1.009

4.5 Correlation Analysis

Table 4.5 reports the correlation matrix, which indicates the existence and level of the relationship between the independent variables and dependent variable.

Table 4. 5
Pearson Correlation

	Misratio	Size	Industry	Leverage
Misratio	1			
Size	-0.387	1		
Industry	0.102	-0.235	1	
Leverage	0.174*	-0.077	0.070	1

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).

Table 4.5 presents the correlations among the dependent variables and independent variables, which are size of the company, type of industry and leverage. The significant correlation is between mis ratio and leverage with positive correlation, $\beta = 0.174$, it shows that leverage is correlated to tax non-compliance. Though, correlations for types of industry shows that there is relationship between types of industry and tax non-compliance, $\beta = 0.102$. Meanwhile, correlation size of the company have negative relationship between size of the company and tax non-compliance, $\beta = -0.387$.

4.6 Regression Analysis

A regression analysis was used in this research by analysing the relationship between independent variables and independent variable. In this analysis, Durbin-Watson statistic should not be less than 1.5 or above 2.5. The analysis shows that Durbin-

Watson value is 1.679 as shown in Table 4.6. This table also exhibits the model summary of R square. The adjusted R square for this model is 0.161. This means that 16.1 per cent of the variation in tax non-compliance can be explained by the chosen independent variables.

Table 4.6 exhibits the multiple regression result. Size of the company is measured by total sales of the company. Size is expected to have a positive relationship with tax non-compliance. However, value of the significant coefficients in the model for size of company is -0.062 (significant at 95 per cent confidence level). Thus, the results show a significant negative association between size and tax non-compliance. This means that the higher in sales of the company during the year, the lower tax non-compliance in companies. These findings are in consistent with the previous studies conducted by Mohd Nor et al. (2010) which have reported that if the number of sales increases, it will reduce the tax non-compliance. Larger SMCs are more compliant possibly because they have better internal control, proper accounting system and better corporate governance as compared to smaller SMCs. H_1 is not supported.

The type of industry is represented by the industry, whereby 1 is manufacturing company and 0 is non-manufacturing company. Industry is expected to have a relationship with tax non-compliance. The value of the significant coefficients in the model for type of industry is 0.001. The finding shows there is a relationship between type of industry and tax non-compliance. The results are reliable with the previous study carried out by Mohd Yusof et al. (2014). This study has found that there is a relationship between types of industry and tax non-compliance in Malaysia. Overall, the findings support prior study conducted by Mohd Nor et al. (2010) whereby they

have found that types of industry have significant relationship with tax non-compliance. Thus H₂ is supported.

Leverage is the ratio of a company's loan capital (debt) to the value of its ordinary shares (equity). Leverage is expected to have a positive association to fraudulent financial reporting. The value of the significant coefficients in the model for leverage is 0.019 (significant at 90 per cent confidence level). The finding shows that there is a positive significant relationship between leverage and tax non-compliance. Hence, if leverage is high, tax non-compliance will be high too. The significant results of this study are supported by prior study carried out by Zainuddin et al. (2016). This result also supported the study conducted by Mohd Noor et al. (2009) that indicates there is a relationship between leverage and tax non-compliance. Hence, H₃ is supported.

Table 4.6
Multiple Regression

Variables	B	Standard Error	t	Sig.
(Constant)	0.434	0.061	10.953	0.000
Size	-0.062	0.009	-6.618	0.000**
Industry	0.001	0.012	0.075	0.940
Leverage	0.019	0.007	2.624	0.009*
R ²				0.171
Adj R ²				0.161
F-Statistics				18.846
Durbin-Watson				1.679

* Significant at the 90% confidence level

** Significant at the 95% confidence level

4.7 Summary

In this chapter, descriptive analysis used to see the composition of size of company, type of industry and leverage towards tax non-compliance. Regression analysis is used to study the relationship between size of company, type of industry and leverage with tax non-compliance. The result shows that size of company during the year has significantly negative associated with tax non-compliance while leverage is significantly positive related to tax non-compliance. The result also shows that type of industry have relationship with tax non-compliance.



CHAPTER 5

CONCLUSION AND RECOMMENDATION

5.1 Introduction

This chapter emphasizes on the summary and conclusion of the empirical investigation based on the results discussed earlier in Chapter four. The results of the relationship between size of company, type of industry and leverage with tax non-compliance are discussed. Section 5.2 involves the overview of the study, followed by section 5.3 that contains a summary of the findings. Section 5.4 presents implication on practise and policy while section 5.5 presents the limitations of the study and proposes some suggestion for future research. Section 5.6 presents the conclusion of the study.

5.2 Overview of the Study

Issues related to tax non-compliance has become an interesting topic among accounting and taxation researchers (Mohd Nor et. al, 2010). Size of company, type of industry and leverage are the tools or factors that the management of IRBM can be used as an indicator in case selection of tax audit. IRBM has collected about RM 1,092.14 million in additional taxes and penalty from field audit activities in 2014 compared RM 740.62 million in 2013.

This amount has become a direct evident that shows there is a pervasive tax non-compliance in Malaysia and the significant of tax lost through tax non-compliance is quite high. It shows that field audit activities as the main activity is still relevant in

IRBM. This is because the statistics shows a very significant increase 47.4 per cent of total amount of tax and penalties from the year of 2013 to 2014.

5.3 Summary of Findings

The study addressed two objectives; to investigate the level of tax non-compliance among SMCs in Kuala Lumpur Bandar branch and to investigate the relationship between size of the company, types of industry and leverage with tax non-compliance among SMCs in Kuala Lumpur Bandar branch. The level of tax non-compliance among SMCs in Kuala Lumpur Bandar branch is in medium range. The findings show that smaller SMCs contribute in tax non-compliance rather than larger companies. Based on the findings in chapter four, it clearly shows that tax non-compliance exists but still remains in controllable level. Size of the company and leverage is the most important independent variables that significant to tax non-compliance while type of industry has a significant relationship with tax non-compliance.

5.4 Implication of Practise and Policy

This study is expected to contribute to tax non-compliance study especially in SMCs in Malaysia in relation to tax non-compliance with size of company, type of industry and leverage. Practically this study proves that the company size and leverage has played important roles to tax non-compliance. The significant negative relationship between the size of company and tax non-compliance will help the auditors to detect non-compliance activities among SMCs in Malaysia. In other words, the smaller companies are more likely to engage in tax non-compliance.

Though it has small involvement to knowledge in this area and has less consequence on the result; it is hoped that developing implication might be appropriate as a recommendation to the top management of IRBM. Nonetheless, the results do indicate an associate link between size of the company, type of industry and leverage with tax non-compliance. This study shows that leverage have significant relationship with tax non-compliance. This study suggested auditors of IRBM need to emphasize on financial ratio analysis when they want to do their audit because leverage can be used as red flag in tax audit activity. Apart from that, management of IRBM may also need to do some investment in developing new computer software as main tools in auditing cases. There is a need to continue tax audit activity in smaller firm because SMCs dominate the business population in Malaysia (SME, 2014).

5.5 Limitation and Suggestion for Future Research

In the course of this study, several limitations have been identified. The sample of companies used in this study was only focus on SMCs cases. Thus, the results are not generalizable to non-SMCs because non-SMCs may have more stringent rules for non-SMCs and have better corporate governance mechanism within the company as control. Besides that the director of non-SMCs also has no internal control directly to the company so the results may differ from SMCs. Moreover, the samples of this study only narrow to the SMCs cases that audited and resolved by auditors from Kuala Lumpur Bandar branch in the year of 2015. Thus, the results could not be generalized to the whole SMCs in Malaysia.

It is suggested that future researcher should focus more on SMCs for each industry so that IRBM can be prone more on coming up with a strategies to implement aggressive

tax audit activities in order to identify tax non-compliance in SMCs for future research. By doing this, it will help auditors of IRBM in monitoring companies that involved in tax non-compliance in every SMCs.

5.6 Conclusion

In conclusion, this study was done to discover relationship between size of company, type of industry and leverage to tax non-compliance among SMCs in Kuala Lumpur Bandar branch. Throughout the findings, it clearly shows that there is a significant negative relationship between size of the company and tax non-compliance while type of company has a significant relationship with tax non-compliance. It also illustrates that leverage has a positive significant relationship with tax non-compliance. Hopefully, this study will help the audit officer in doing their task in identifying tax non-compliance in the future.

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