6th UUM International Qualitative Research Conference (QRC 2024)
1-3 October 2024, [Online] Webinar

Assessing Tax Auditors' Understanding of Reinvestment Allowance in Malaysia

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Abstract

Tax auditing is one of the main activities in promoting tax compliance. Therefore, ensuring the highest standards of tax knowledge among tax auditors on issues such as reinvestment allowance (RA) incentive is crucial in achieving highest audit quality. Differing interpretations of the act by the tax auditors may lead to inconsistency in tax audit judgement. In relation to this issue, this study is conducted to investigate the level of understanding on RA among tax auditors in the Inland Revenue Board of Malaysia (IRBM). A qualitative method is utilised to achieve the study objective by conducting interviews with 20 tax auditors through an online platform. Through a thematic analysis, this research reveals various points of view, explaining the level of understanding on RA among the IRBM tax auditors. Findings show a variable level of understanding of RA among officers, with a notable disparity between those with years of experience in taxation and newer officers. The study concludes that while there is foundational awareness of RA among tax auditors in the IRBM, there is a need for enhanced and ongoing education to ensure comprehensive understanding and effective implementation of RA policies.

Keywords: Reinvestment Allowance, understanding, tax auditor, tax audit quality, IRBM

1. INTRODUCTION

Globally, countries use tax incentives as promotional tools to encourage spending from both foreign and domestic investors. Tax incentives are fiscal incentives provided by the government to qualified taxpayers or potential investors in order to undertake a qualified project with a lower or no effective tax rate. In the Malaysian manufacturing context, Reinvestment Allowance (RA) is offered to the Malaysian manufacturing sector continues to develop with continued productivity by way of a tax credit, given to businesses that invest in expanding, modernising, automating, or diversifying their existing manufacturing or approved agriculture businesses.

RA incentive is one of the favourite tax incentives amongst companies in the manufacturing sector because no prior approval is required from the relevant authorities for claiming this incentive. Indeed, RA is considered a relatively high audit risk, as companies may not fully understand the RA mechanism or accurately determine whether their activities qualify as manufacturing or agricultural under the RA definition and whether they fulfilled the condition of expanding, modernising, automating, or diversifying their existing. Additionally, the lack of planning and understanding of the RA requirements could lead to errors or misinterpretations during the claiming process. This combination of factors contributes to the complexity and potential challenges associated with utilising the RA incentive, despite its attractiveness to companies in the manufacturing sector due to its streamlined claiming process.

Moreover, in the 2024 Budget, the government has announced to expand the tax incentives for reinvestment to encourage existing companies to reinvest in high-value activities, employing a tiering mechanism in the form of an investment tax allowance of either 60% or 100% for a period of 5 years starting from 1 January 2024 until 31

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December 2028. This situation increases the risk of the businesses which plan to continue the RA of not following the conditions stipulated in the guideline.

Companies that are qualified to apply RA incentive should be a resident company in Malaysia and must be in operation for more than 36 months. In the same basis period of application, they should have incurred qualifying capital expenditure in undertaking expansion, modernisation, automation, and/or diversification in order to enjoy the tax incentive. The computation of RA incentive is based on qualifying capital expenditure where 60% of the capital expenditure incurred during the year of assessment (YA)is to be deducted against the statutory income with a restriction of 70% of statutory income for 15 consecutive years.

Investigation of the Inland Revenue Board of Malaysia (IRBM) internal records discovered that the total number of companies claiming RA in the Klang Valley was increasing from 2018 to 2022. The larger Taxpayer Branch and Multinational Tax Branch showed a considerable increase in the number of companies claiming RA over the years. With the increased number of businesses aiming to claim the RA incentive, the auditors' burden would also increase. As tax auditors' roles not only to detect non-compliance but also to educate the taxpayers (OECD, 2017), high level of understanding the RA incentive among tax auditors are crucial when conducting tax audit. Auditors should also be able to defend themselves when there is a dispute on the assessment related to RA is made.

A source from the Dispute Resolution Department, IRBM, signified that the total number of appeal submissions related to RA issues in the Klang Valley increased substantially from 7 in 2018 to 20 in year 2021. In 2022, it totaled to 35, with the majority of these submissions originating from the Larger Taxpayer Branch. There were also some cases that went to the courts for judicial determination. Overall, the data offers insights into the aspect of the IRBM monitoring mechanism for incentivised companies, namely the set of company disclosures that could be used in the creation of an audit case. This data could also be indicative of varying levels of compliance by the companies enjoying the RA incentive as well as the enforcement actions taken by the IRBM's tax auditors during audit. The situation could be related to the level of understanding of the RA auditors and warrant further investigation.

Therefore, this study aims to determine the current level of understanding of RA incentive among IRBM tax officers in the Klang Valley. The research question is: What is the current level of understanding of RA among IRBM tax officers in the Klang Valley? Next section discusses some related literature. It is followed by the methodology utilised for this study, findings, discussion and conclusions.

2. LITERATURE REVIEW: TAX KNOWLEDGE AND TAX OFFICERS

Tax knowledge is the understanding of experience and expertise in a variety of components of taxation, including tax laws, rules, filing requirements, and compliance procedures. Tax knowledge is often referred to as "tax savvy." It comprises the information that individuals and organisations possess regarding their respective tax duties and the methods by which they can efficiently manage their tax affairs within the confines of the legal system. Bornman and Ramutumbu (2019) found that there are three elements of tax knowledge, namely, general, procedural and legal tax knowledge. General tax knowledge relates to a need to have fiscal awareness; procedural tax knowledge refers to understanding tax compliance procedures; and legal tax knowledge pertains to a need to understand regulations.

According to Groenland and Veldhoven (1983), tax knowledge refers to the level of general fiscal knowledge as well as an understanding of the possibility of committing fiscal fraud. This definition is also utilized by current studies such as Fauziati et al. (2020) and Appiah et al. (2024), Tax knowledge is an essential component of a voluntary compliance tax system (Kasipillai & Hanefah, 2000), in particularly when it comes to determining a certain tax liability (Palil, 2005; Saad, 2014).

The taxpayer is said to have a certain amount of tax knowledge if they have a certain level of awareness or sensitivity to tax regulations. Tax knowledge refers to the process by which taxpayers become familiar with tax law and other pertinent tax-related information. Similarly, a lack of tax knowledge can result in non-compliant behaviour among taxpayers, intentional or unintentional. This is postulated by Bardai (1992), Eriksen and Fallan (1996), Kasipillai & Hanefah (2000), tax knowledge refers to the understanding or awareness of the fundamental rules and regulations stated by the income tax legislation with relation to the duties of taxpayers in submitting their tax return forms.

In Malaysia, there is documented evidence of individual taxpayers unintentionally making mistakes in their tax return forms (Loo et al., 2009). The level of tax knowledge also influences taxpayers' attitudes regarding the accuracy of their tax returns (Eriksen & Fallan, 1996; Kirchler et al., 2008). Understanding tax laws and regulations helps taxpayers meet their legal duties, including timely filing, providing accurate information, and accurately calculating their tax liabilities. (Loo et al., 2009).

In analysing relevant literature, it was discovered that tax scholars interpret the term "tax knowledge" differently. The term is used in a variety of ways, ranging from an umbrella term for various tax knowledge categories to a one-dimensional interpretation. The term "tax knowledge" refers to an individual's level of basic financial literacy as well as their awareness of possible instances of tax evasion which can relate to an individual's overall level of financial literacy, their familiarity with various methods of tax evasion, their educational level in general, or their familiarity with tax legislation (Groenland & Veldhoven, 1983).

Certain researchers have posited that the fusion of information regarding tax regulations with financial expertise is the essence of specialized tax knowledge. This combination makes it feasible to assess the economic repercussions for taxpayers (Palil, 2005). Ordinary people's comprehension of taxation is referred to as subjective tax knowledge (Kirchker et al., 2008). Tax knowledge refers to the degree to which an individual taxpayer is alert to or sensitive to changes in tax law. The term "tax knowledge" refers to the steps that taxpayers go through in order to become aware of tax legislation and other information relevant to taxes (Hasseldine et al., 2011). According to Wong et al. (2015) the perception of one's capacity to comply with tax laws, which includes technical tax knowledge and general tax knowledge about the tax system and tax compliance, is referred to as tax knowledge.

According to Susyanti and Askandar (2019), tax understanding encompasses the taxpayer's comprehension or awareness of taxation-related matters. Building upon this, (Satria, 2017) further elaborated that tax understanding also encompasses the taxpayer's perception of their own knowledge regarding taxation. Tax understanding is the level of knowledge and ability of taxpayers concerning the enactment and implementing of tax law regulations both in content and administration. Previous research from (Adiasa, 2013; Agustiningsih & Isroah 2016) concluded there is a relationship between tax understanding and tax compliance.

Malaysia tax laws are of such complexity that they are challenging to understand, and their frequent changes create difficulties not only for tax officers, tax academics, and tax practitioners but also for ordinary individuals like sole proprietors (Fatt & Khin, 2011). When tax laws are criticised for their complexity, it is likely that the level of tax knowledge is perceived to be relatively low (Kirchler et al, 2008). It is important to keep in mind that the level of tax knowledge held by different tax officers might vary widely. It is mostly based on the nature of their specialised training, the length and breadth of their professional experiences, and the difficulty level posed by the tax system of the nation where they work. Continuous training and ongoing professional development opportunities are frequently made available to employees in the tax industry, with the goals of enhancing their existing tax knowledge and ensuring that they remain current with the most recent changes to tax legislation and administration practices.

In addition, research on measuring the level of tax knowledge in Malaysia is insufficient. Furthermore, no studies have been conducted to determine the level of tax knowledge among IRBM tax officers, factors affecting the tax officers themselves and contributing to tax knowledge.

3. METHODOLOGY

This study adopts a qualitative research design to explore the subjective viewpoints and experiences of IRBM officers regarding RA. Qualitative research is deemed appropriate as it allows for an in-depth understanding of the phenomenon under investigation, capturing the richness and complexity of tax officers' perspectives on RA.

Interviews were conducted from 5 February 2024 until 9 February 2024. In the interview process, a combination of open and structured questionnaires is used to gather data. The purpose of the research is explained to the respondents and emphasize the confidentiality of the answers. The interviews were conducted in English and Bahasa Malaysia to cater the respondents' language preferences.

The respondents were selected from five different localities within the Klang Valley, consisting of IRBM Selangor, Wilayah Persekutuan Kuala Lumpur, Wilayah Persekutuan Putrajaya, the Large Taxpayer Branch, and the Multinational Tax Branch. A purposive sampling technique is applied to conduct the survey, selecting respondents who possess relevant knowledge and experience in administering RA within the IRBM in the Klang Valley. The sample includes tax officers from various levels of seniority and departments involved in assessing and enforcing RA provisions from various background units, including Company units, Other Than Company units, and Individual Units. This approach ensures representation from different segments of tax officers, which allows for a comprehensive understanding of the knowledge concerning the RA among the officers across different units.

4. FINDINGS: CURRENT LEVEL OF UNDERSTANDING OF RA AMONG IRBM TAX OFFICERS

The RA is a special tax incentive that is available to a company that is based in Malaysia and has been operating for a period of at least 36 months. Furthermore, the company needs to have invested in a factory, plant, or machinery in Malaysia for a qualifying project, as mentioned in paragraph 8(a) of Schedule 7A of the ITA. Respondents need to explain how they understand the reinvestment allowance in accordance with Schedule 7A, ITA 1967.

The questions are open-structured so they can explain their understanding without limitations. Based on their explanation, the respondent's level of understanding is measured accordingly. The data gathered revealed that respondents overall understand the RA policies, the implementation process and the importance of RA claimed. Currently, there are varying interpretations among IRBM tax officers while handling audit cases related to RA, but most of the respondents achieve the required level of understanding by IRBM; however, improvement is still needed in order to reach the highest level of understanding in enhancing the effectiveness and quality of tax audits related to RA claims.

4.1 Understanding on RA Policies within the Context of ITA 1967

RA is a special tax relief policy started in 1980 that offers manufacturing companies with a 60% tax exemption for qualified capital expenditures related to business expansion, diversification, automation, and modernization. Basically, all respondents are aware of RA, but there are still some respondents who do not fully understand the RA policy. This leads to diverse interpretations among tax officers.

The respondents highlighted RA as an incentive for manufacturing companies, suggesting a basic understanding of its purpose and the beneficiaries it aims to serve. The majority of respondents mentioned the 15-years term associated with RA, which appears to indicate a general understanding of the incentive's duration. On the other hand, the respondents also mentioned the requirement for additional clarification concerning the particular characteristics of RA eligibility and usage beyond the duration of the term. This has been explained by the respondents:

"RA is an incentive under Schedule 7A, ITA 1967, given to a manufacturing company that fulfils its manufacturing activities." [Respondent 9]

"RA gives an additional 60% of plant and machinery expenses. The company has fully claimed all of its capital allowances. The RA claims will last 15 years in consecutive years." [Respondent 12]

RA has been extended several times to encourage producers who have exhausted the first 15 years to invest in their companies. An extra three years of RA from YA 2016 to YA 2018 (ADDITIONAL RA). The National Economic Recovery Plan (PENJANA RA) reintroduced the Special RA in the Finance Act 2020. The 2020 Finance Act provides a special RA period from 2020 to 2022. The Finance Act 2021 extends the PENJANA RA until YA 2024.

The fact that only one of the respondents noted the availability of ADDITIONAL RA extensions after the initial 15-year period suggests that there may be a lack of information regarding additional incentives for businesses that are qualified for them, while only one respondent brought up the PENJANA RA and the most recent RA extensions, intended for businesses engaged in high-value activities, indicating a limited awareness of recent RA initiatives among the respondents. This is evidenced by one of the respondents:

"When we talk about RA, the first thing I'll do is request an audited report and tax computation. Based on this document, I will determine whether any incentive claims such as RA are made, and if so, I will need the RA claim form to confirm when the first RA claim was made, considering there are now ADDITIONAL RA and PENJANA RA." [Respondent 2]

The fact that one of the respondents highlighted the historical evolution of RA since its introduction in 1980 suggests a deeper awareness of the policy's development and continuous improvement over time. Despite multiple respondents noting the definition of manufacturing in Schedule 7A of the ITA, only one respondent mentioned agricultural RA. This suggests that the level of understanding of eligibility for RA varies across industries. This is evidenced by one of the respondents:

"The RA policy was introduced by the government in 1980, and this policy has been continuing from year to year to this day." [Respondent 5]

Overall, the first objective which aimed to assess the level of understanding of IRBM tax officers could be seen regarding the RA policies. The findings revealed a varied level of understanding among the officers, with most possessing a basic understanding of RA. However, there were notable instances where officers demonstrated a low level of understanding, particularly concerning recent amendments to the RA provisions and the specific sections of the ITA relevant to RA.

4.2 Understanding on How RA Policies are Implemented in Practice

The understanding level could also be determined from the implementation aspect. Most respondents are able to explain the basic calculation for claiming RA in practice. The allowances are an additional incentive that the company already claimed 100% of on capital allowances. For RA purposes, companies can enjoy up to a 60% deduction from qualifying expenditures, restricted to 70% of statutory income. Indeed, to claim the RA, the company must fill out and keep the RA forms. In this form, the company must detail the qualifying capital expenditures incurred during the year and demonstrate compliance with the eligibility criteria. RA is a self-claim incentive, so the company must meet the eligibility criteria, as mentioned. This was particularly stated by two respondents:

"RA is a self-claim incentive given to a company that engages in a qualified activity (manufacturing). The RA is an extra incentive to the capital allowance. Taxpayers benefit from two advantages: they can claim capital allowance at a 100% rate, and the same asset can also claim RA at a 70% rate of capital expenditure." [Respondent 1]

"Companies eligible to claim capital allowances of 100% receive an additional incentive known as RA (self-claim). For the same assets, the company is entitled to claim RA at the rate of 60% deduction of capital expenditures, limited to 70% of statutory income." [Respondent 14]

However, some respondents are unable to clearly explain the RA claim process because they have never handled RA audit cases. This is because they are currently not working in the company's audit unit, as mentioned by one of the respondents:

"Honestly, I don't understand explicitly about RA because it's not used in my day-to-day tasks. All I know about RA is that this company can be a form of grant given by the government, subject to some conditions. I have been studying, but I can't remember it." [Respondent 13]

The findings of this study show that the idea of RA among the respondents is basically aligned with the policy and practice. This is perhaps due to the earlier exposure to RA while attending a mandatory course. However, the inability to perform tasks related to RA audit is a factor contributing to a lack of understanding. Hence, a focus training and development programs that provide respondents with the knowledge and skills required to understand and clarify the RA claim process, independent of their prior experience. Furthermore, providing respondents with tools, mentorship opportunities, and hands-on learning experiences may help bridge the knowledge gap and empower them to carry out their tasks efficiently.

4.3 Understanding the Importance of Reinvestment Allowance

In response to a question regarding the significance of RA, all of the respondents agreed that RA policies play an essential part in fostering investment and economic expansion. RA policies offer financial incentives to companies that choose to reinvest their revenues back into their operations rather than distribute them to shareholders in the form of dividends. This encourages firms to make long-term investments in capital assets like machinery, equipment, and infrastructure, potentially boosting productivity and competitiveness. This has been explained by the respondents:

"In terms of boosting the country's economic growth, I do agree, because the RA itself aims to attract Foreign Direct Investment and Domestic Direct Investment, but I think there is another issue to think about: the revenue system is not balanced with what the company gets compared to what the country gets back; it takes a long time." [Respondent 5]

The respondents were also in agreement that greater investment as a result of RA policies has the potential to result in the creation of jobs in a variety of economic sectors. Furthermore, when businesses continue to modernize and innovate, they may find that they require a trained workforce. This could lead to investments in employee training and development, potentially contributing positively to the overall growth of human capital. This was explained by the respondent:

"When companies are eligible for RA incentives, the company will make existing business expansions to increase production capacity and indirectly increase employment opportunities." [Respondent 2]

5. DISCUSSION AND CONCLUSION

The study indicates that IRBM tax officers in the Klang Valley had different degrees of understanding about RA policies, which are influenced by characteristics such as years of service, prior experience handling RA cases, training, and sharing knowledge from senior officers. The majority of respondents perceive RA as a motivating factor for manufacturing businesses, given a duration of 15 years and a deduction of 60% from eligible expenses. Furthermore, manufacturing companies assert the claim of RA in conjunction with capital allowances.

However, there is a gap in understanding the claim process and recent initiatives, with no respondent mentioning additional RA extensions beyond the initial 15-year period. Some respondents lack familiarity with handling RA audit cases or are not working in the company's audit unit, indicating a need for further education and training. Only two respondents mention RA as a self-claim incentive, emphasizing the importance of understanding eligibility criteria and the responsibility of companies to meet them. This aspect of RA may need more emphasis in educational materials or training sessions.

Notwithstanding this, it is consistent among all respondents that RA policies have a crucial role in stimulating investment, generating employment opportunities, and fostering human capital development. This indicates a collective recognition of the wider economic advantages linked to motivating enterprises to allocate their revenues towards productive activities.

As a conclusion, this study is conducted to determine the current level of understanding of RA among IRBM tax officers in the Klang Valley. Interviews were carried out with an interviewee in order to collect their thoughts, issues, and suggestions. It is revealed and supported that the IRBM's tax officers have a consistently higher level of capability to handle tax audits related to RA claims by addressing knowledge gaps and enhancing training. Finally, the researcher believes that by conducting this research, IRBM's upper management would better grasp how to develop strategies to improve RA understanding and assure consistent audit quality. Specifically, a practical training approach with a focus on RA is crucially required. This approach could assist IRBM’s tax officers in having a real scenario and thinking on into decision-making based on current judgment.

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