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An Exploratory Study Of Malaysian Tax Auditors' Enforcement Regulatory Styles

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Abstract

Since the implementation of the self-assessment system in 2001, tax audit has become a major compliance program used by the Inland Revenue Board of Malaysia (IRBM). From 2002 to 2010, the IRBM finalised 4,486,946 audit cases and collected RM11,050.3 million of additional taxes and penalties (IRBM, 2002–2010). However, the public often conveys frustrations when dealing with the IRBM auditors. Tax agents perceive that IRBM auditors have the intention or aim of finding fault in order to impose penalties for incorrect returns or understated income, were not happy with taxpayers' explanations, abused their power by issuing additional tax assessments, and closed cases without being able to explain their reasons to taxpayers (Choong and Lai, 2009; Choong *et al.*, 2012). However, there is no published study on IRBM auditors in conducting audit programs and communicating with the public. This study explores the IRBM auditors' enforcement regulatory styles. It adopts grounded theory methodology, which analyses tax auditors' actual beliefs and experiences in resolving audit settlement disputes. Consistent with enforcement regulatory theory, the analysis of data shows that tax auditors apply different enforcement regulatory styles—firm, explain and educate, bargaining and threatening. This study also has identified 'avoiding' as tax auditors' enforcement regulatory style when dealing with the public. The results of this study further the call for more studies on tax auditors' behaviour because their behaviour is so intimately intertwined with taxpayers' compliance and tax administration efficiency.

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1. Introduction

Tax auditors are a tax authority's 'public face' (OECD, 2006). They are the ones who implement the audit policy, interact with the different behaviours of taxpayers and determine audit outcomes (Bahl and Bird, 2008; Long and Swingen, 1991). They possess a great deal of discretionary power; in many instances, tax auditors are in effect prosecutor, judge and jury in tax assessments matters (Roberts, 1995). Tax auditors' tasks might become complicated when audit issues encroach on the grey area separating evasion and acceptable tax avoidance—for example, the issue of transfer pricing (Reynolds, 2007) and lack of audit evidence due to a paperless system (Gilbert *et al.*, 2001). These issues require tax auditors to understand

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taxpayers' business intentions and use suitable audit strategies in determining the correct amount of tax. In Malaysia, the public often conveys frustrations when dealing with Inland Revenue Board of Malaysia (IRBM) auditors.

2. Review of Literature

2.1 *The public's perceptions of the IRBM auditors*

In regular meetings between the IRBM and members of the Chartered Tax Institute Malaysia (CTIM), the CTIM made several complaints to the IRBM regarding its auditors (CTIM, 2003). The CTIM claimed that the audit process conducted by the IRBM auditors lacks transparency and consistency. Moreover, the CTIM perceived that the IRBM's tax auditors do not carry out tax audits in a professional manner, adopt different treatments for the same subject matter, refuse to accept commercial justification even when supporting documents are provided, lack accounting and business knowledge, and are unable to provide convincing rationale for tax audit adjustments (CTIM, 2003). Findings from empirical studies by Choong and Lai, 2009, and Choong *et al.*, 2012, supported the CTIM's complaints. They found that tax agents felt the tax audit process took too long to finalise. The main problems faced by tax agents were that tax auditors were not happy with taxpayers' explanations and that taxpayers had to provide tax auditors with various documents that were not used or reviewed. Tax agents believed that tax auditors intend to find fault to impose penalties for incorrect returns or understatements of income during the tax audit. The studies also reveal several tax audit weaknesses, particularly regarding the tax audit approach, audit processes and tax auditors' competency and mentality (Choong *et al.*, 2012; Choong and Lai, 2009).

A study by Isa and Pope, 2011, found that corporate taxpayers perceived IRBM tax auditors as being more interested in finding fault and penalising a company for wrongdoing than helping them comply with tax law. Complaints from the public and negative perceptions of Malaysian tax auditors signify that it is imperative for the IRBM to address issues regarding tax auditors' efficiency to gain the public's respect and confidence. One particular aspect that needs attention is tax auditors' enforcement regulatory behaviour, which this study aims to explore.

2.2 *Enforcement regulatory styles*

Enforcement regulatory style can be defined as the general approach assumed by enforcement officials in the course of performing their regulatory duties (Bardach and Kagan, 1982; Hawkins, 1984; Reiss, 1984). Originally, two major styles were discerned: legalistic (also sometimes called deterrence); and conciliatory (sometimes called cooperation) (Kagan, 1994; Reiss, 1984). The legalistic style is based on coercion and compulsion and is concerned primarily with the application of punishment for breaking a rule and doing harm (Bardach and Kagan, 1982; Hawkins and Thomas 1984). The punishment acts to deter regulatees from violating the law (Becker, 1986; Gunningham, 1987; Kagan, 1994). In contrast, the conciliatory style relies primarily on techniques of education, advice, persuasion and negotiation (Hawkins, 1984; Hutter, 1989). It is fostered when the agent and the regulatee understand each other better and work together towards compliance. This suggests a role for agent discretion and using persuasive methods rather than sanctions (Kagan and Scholz, 1984; Reiss, 1984). Early research largely followed this dichotomy.

However, in reality, approaches to enforcement are far more subtle, with enforcement styles being mixed and multifaceted. A closer inspection reveals several underlying elements that combine to become enforcement styles (Ayres and Braithwaite, 1992; Kagan, 1994; May and Winter, 1999). Hence, the newer scholarship addressing enforcers' behaviour pays attention to different modes of public action at the front lines of service delivery. Scholars argue that auditors often make choices on the spot about the best mode of action

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