



**AN EXPLORATORY STUDY OF MALAYSIAN TAX
PRACTITIONERS' PERCEPTION ON THE PRACTICE
OF AGGRESSIVE TAX AVOIDANCE**

BY

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ABSTRACT

Malaysian tax research has put little attention on the tax morale of Malaysian tax environment. Therefore, the objective of this study is to explore the perception of Malaysian tax practitioners in giving tax advice to tax clients whether to promote aggressive tax avoidance or to promote tax compliance. It is accordance to the implementation of SAS which had given taxpayers freedom to declare their income and compute their own tax liability. This self-determination in tax assessment had given them the opportunity to manipulate the tax account which resulted to lower or minimum tax paid. Aggressive tax avoidance is a non-compliance behavior by exploiting tax law ambiguity, playing with accounting figures and transactions to reduce tax. Moreover, the SAS had increases the demand of tax practitioners services as most taxpayers especially from the corporate sector feel incompetence and unqualified to file their own tax affairs appropriately. A survey approach is used to obtain information from tax practitioners practicing in public accounting firms in urban towns. Tax practitioners who perceived leniently on the practice of aggressive tax avoidance signify a likelihood of aggressive tax avoidance participation. The finding of this study shows that Malaysian tax practitioners perceived aggressive tax avoidance as unethical behavior. The aggressive tax avoidance practice is contributed by the tax clients' incomplete documentation and competitive tax environment. However, the results also indicate that tax practitioners are at the state of dilemma whether to satisfy their tax clients request to minimize tax or to the society demand for a fair tax share. The results also indicate that there is a need for collaborative and collective effort from various parties such as taxpayers, tax practitioners and tax authority to shape and sustain a good environment of tax practices.

ملخص البحث

وقد وضعت المايزية للبحوث الضريبية اهتماما يذكر على معنويات ضريبة البيئة الضريبة المايزية. ولذلك، فإن الهدف من هذه الدراسة هو استكشاف مفهوم الممارسين الضريبة المايزية في تقديم المشورة للعملاء ضريبة من الضرائب سواء لتعزيز العدوانية التهرب من دفع الضرائب أو لتعزيز الالتزام الضريبي. فمن فقا لتنفيذ ساس الذي أعطى حرية دافعي الضرائب لاعلان الدخل وحساب المسؤولية الضريبية الخاصة به. وكان هذا حق تقرير المصير في تقدير ضريبة منحهم الفرصة للتلاعب في حساب الضرائب مما أدى إلى انخفاض أو دفع ضريبة الحد الأدنى. العدوانية التهرب من دفع الضرائب هو سلوك عدم الامتثال من خلال استغلال ضريبة غموض القانون، واللعب مع الأرقام المحاسبية والمعاملات للحد من الضرائب. وعلاوة على ذلك، كان SAS يزيد من الطلب على خدمات الممارسين ضريبة حيث أن معظم دافعي الضرائب ولا سيما من قطاع الشركات تشعر بعدم الكفاءة وغير المشروط لتقديم شؤونها الضريبية الخاصة بها بشكل مناسب. ويستخدم أسلوب المسح إلى الحصول على معلومات من الممارسين ضريبة ممارسة في شركات المحاسبة العامة في المدن الحضرية. الممارسين ضريبة الذي ينظر برأفة على ممارسة التهرب من دفع الضرائب العدوانية دلالة على وجود احتمال للعدوانية ضريبة تجنب المشاركة. الاستنتاج من هذه الدراسة تبين أن ممارسي الضريبة المايزية ينظر العدوانية التهرب من دفع الضرائب والسلوك غير الأخلاقي. وتساهم في التهرب من دفع الضرائب العدوانية الممارسة من قبل العملاء وثائق الضرائب "غير كاملة وتنافسية بيئة ضريبية. ومع ذلك، فإن النتائج تشير أيضا إلى أن العاملين في الضرائب في ولاية معضلة سواء لإرضاء العملاء ضريبة على طلبها للحد من الضرائب أو لطلب المجتمع للحصول على حصة عادلة من الضرائب. كما أشارت النتائج إلى أن هناك حاجة لجهد تعاوني وجماعي من مختلف الأطراف مثل دافعي الضرائب والعاملين في الضرائب ومصالحة الضرائب لتشكيل والحفاظ على بيئة جيدة من الممارسات الضريبية

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Science in Accounting.

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DECLARATION PAGE

I hereby declare that this dissertation is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

Nur Fikhriah Binti Takril

Signature

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PERCEPTION ON THE PRACTICE OF AGGRESSIVE TAX AVOIDANCE**

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LIST OF ABBREVIATIONS

AICPA	American Institute of Chartered Accountant
ATO	Australian Tax Office
CESR	Corporate Ethics and Social Responsibility
CPA	Certified Public Accountant
CTIM	Chartered Tax Institute of Malaysian
CY	Current Year
DE	Deontological Evaluation
DGIR	Director General of Inland Revenue
DOA	Department of Accounting
EQ	Experiential Questionnaire
FICPA	Florida Institute of Certified Public Accountant
H-V model	Hunt's and Vitell's ethical judgment model
IFAC	International Federation of Accountant
IUM	International Islamic University Malaysia
IRBM	Inland Revenue Board Malaysia
ITA	Income Tax Act
MES	Multi-Dimensional Ethics Scale
MIA	the Malaysian Institute of Accountant
MIT	Malaysia Institute of Taxation
MTD	Monthly Tax Deduction
NTC	National Tax Conference
OAS	Official Assessment system
PAYE	Pay As You Earn
PRESOR	Perceived Role of Ethics and Social Responsibility
PTPTN	Perbadanan Tabung Pendidikan Tinggi Negara
PY	Preceding Year
RCD	Royal custom Department
RO	Research Objective
ROC	Register of Companies
RQ	Research Question
SAS	Self Assessment System
SME	Small and Medium Enterprise
SPSS	Statistical Package for Social Sciences
STD	Scheduler Tax Deduction
TE	Teleological Evaluation
US	United States
YA	Year Assessment

CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

In this introductory chapter, section 1.2 illustrates the background of the study followed by motivation of the study in section 1.3. Subsequently, section 1.4 presents the research problem, the research objectives and research questions of the study. Section 1.5 describes the significance and contribution of the study and finally, this chapter ends with the structure of the study in section 1.6.

1.2 BACKGROUND OF THE STUDY

There seems to be a growing concern on the ethical conduct of tax practitioners in giving tax advice to taxpayers at large (Bobek et.al 2010, Scott & Yetmar, 2000, Shafer & Simmons 2008 and Cuccia 2000). The Deputy Financial Minister, Datuk Awang Adek had warned taxpayer not to cheat on their tax due amount as the Inland Revenue Board of Malaysia (IRBM) will multiply their effort in curbing the evasion and avoidance practice among tax payers (Berita Harian, March 2011). The warning shows that the government is concerned with the evasion and avoidance behaviour as it affected the amount of tax collected consequently slower the country's development. Tsakumis, Curatola and Porcano (2007) highlighted that even with the mechanism of tax audit and penalty, tax evasion is still a serious problem to many countries. Therefore, the government should formulate a more effective mechanism as a way to curb the irresponsible acts of tax evasion and aggressive tax avoidance

Over the years, the globalized market had given a progressive impact to the socio-economic development of Malaysia. The market exchange, import and export, merging businesses and others had given a significant impact to the administration of tax authority. Subsequent to the rapid development, the business sector also reforms to keep pace to the development of a more globalized business environment. It also generates more opportunities for companies to expand, thus increases tax complexity as the tax law need to revised and reformulated to suit the changes. The rapid development of the economic environment had driven the IRBM to issue and to formulate new tax policy and public rulings to supervise and guide businesses and taxpayers in filing tax return. The issuance of new policy and complexity affected the accounting entries; consequently increase taxpayers compliance cost such as more time need to be spent to plan and understand the changes in tax law, cost of purchasing books and materials related to the tax changes and other cost associated with tax compliance. Therefore, taxpayers especially from the business sectors seek for tax practitioners' assistantship to advice and manage their tax matters.

According to Asher and Rajan (2001) the globalization process has changed the level of accountancy firms' services such as audit and assurance, taxation, financial advice, tax planning and the manner of their administration and compliance. Sikka and Hampton (2005) pointed out that until 1960s, accounting and auditing services were the only core business for accountancy firms but the globalization had pushed this profit making organization to expand the related services to a wider prospect including tax advisory services. Hence, these diversifications of accounting services particularly in Malaysian taxation context are mostly due to the demand from the public to attend to the Self Assessment System (SAS) tax return. Indeed, it is supported by Kasipillai (2003) that the introduction of SAS had anticipated taxpayers,

particularly the business community to appoint tax practitioners to complete the company's tax return on behalf of their responsibility. It signifies that tax practitioners are trusted by taxpayers to manage their tax matters due to the technical expertise, familiarity with the tax law administration and professional experience as compared to ordinary taxpayer. Taxpayer will eventually shift the tax burden of SAS to be managed by tax practitioners.

Moreover, the services provided by tax practitioners are comprehensive services starting from the filing, record maintaining, aligning tax with authority and others. Besides, tax practitioners also solve taxpayers' tax anxiety by providing advice and consultation in managing and minimizing tax liabilities. Minimizing tax or the tax game playing requires skills and expertise and must be within the legal constraint. Therefore, tax practitioners play a significant role in the collection of taxes as the advice and suggestion may influence taxpayers' decision making.

Malaysia Income Tax Act 1967 (ITA 1967) under section 114 (1A), stated that any person who assists in or advises in the preparation of any return of another person should exercise reasonable care in giving the advice. If a person fails to do so, and if this results in an understatement of the tax liability, such person is liable to a court fine of between RM2, 000 to RM20, 000 or imprisonment of not more than 3 years, or both. Therefore, SAS seems to be benefitting the tax consulting firms since many taxpayers either from corporate sector, small and medium enterprise (SME) or individual taxpayers acquired their professional justification to convince their tax submission. This phenomenon had turned tax practitioners to become client advocates unlike auditor who needs to be independent of their clients in giving opinion (Bobek, Hageman and Hatfield, 2010).

In Malaysia, currently there are 1,827 registered tax agents with Inland Revenue Board Malaysia (IRBM) of which 49% are located in the Klang Valley. Other than the registered agent, chartered accountants with audit licenses are also eligible to sign tax return and act on behalf of taxpayers. It is stated under section 153(3) of the Income Tax Act 1967 that no person holding himself out as a tax agent, tax accountant or tax adviser (or under any other like description) shall be permitted to act in Malaysia on behalf of any person for any of the purposes of this Act unless he is a tax agent as defined in this section. Therefore, as the role of tax practitioners is crucial in determining and influencing taxpayers' compliance, the IRBM should think of the mechanism on how to supervise and guide the tax practitioners to act on behalf of the government and not to satisfy their clients' needs.

1.3 MOTIVATION OF THE STUDY

The importance of the role played by the tax practitioners has motivated this present study to explore the perception of Malaysian tax practitioners towards the practice of aggressive tax avoidance. In this study, attention is given on the tax compliance focusing on tax practitioners' tax morale i.e. on the practice of aggressive tax avoidance in advising tax clients. This is because; tax practitioners are persons who are acting on behalf of taxpayers. The unethical tax practitioners will utilize the loopholes or the grey area in the tax law to minimize their clients' tax liability. Kirchler (2007, p.5) in his book, mentioned that tax laws are not always clear and it is further highlighted by Slemrod, Blumenthal and Christian (2001), that although legality can assert the differences between evasion and avoidance, in practice the line is indistinguishable either because the law is clear but not known by to the taxpayers or due to the tax administration's ignorance.

Taxation is one of the methods to raise the government coffers. Through the collection of tax, the government will distribute the wealth to the public for the benefit of the society for example, by providing medical care, education and other facilities. Taxation is also seen as the tool to maintain the stability of the economy where lower tax collected will affect the country's development progress. The emphasis on the importance of maximizing tax collection for the country development and public welfare has motivated this study to look at the perception of Malaysian tax practitioners towards the aggressive tax avoidance practice. The concerns are given on the position of clients in influencing the ethical judgment of tax practitioners in providing tax advisory services and the position of tax practitioners whom act as the intermediaries between taxpayers and IRBM. Added by D'Ascenzo (2005) tax practitioners are able to influence compliance behaviour among taxpayers as they are the intermediaries between clients and the authority.

The increasing globalisation of business and the raise of business structure, financial transaction and nature of financing complexity have made the services of tax practitioners are in demand. Corporate sectors look for tax practitioners' services in order to reduce the uncertainty due to the tax law complexity, and at the same time save time and effort. Nevertheless, Slemrod, Blumenthal and Christian (2004) wrote that, tax practitioners' effects on taxpayers compliance is evident as "rule enforcers but ambiguity exploiters". Some of tax practitioners will utilize their expertise to aggressively minimize their clients' tax liability by exploiting tax law ambiguity, playing with accounting figures and transactions in order to satisfy the demands from clients to reduce tax. The creative tax design will eventually increase the profit of the tax firm. As noted by Kirchler (2007, p.5), business will make use of the loopholes and grey areas in the tax law and find ways and means to reduce tax, even moving into

concealing income or inflating expenses by creating fictitious figure. Therefore, the services of the expertise are indeed helpful in realizing the aims. Barber and Odean (2004) further added that, individuals are “tax savvy” as avoiding taxes legally or creatively avoiding taxes and at the same time sound legal to the authorities (as cited by Kirchler,2007).

The role of tax practitioners is very influential in maximizing voluntary tax compliance among taxpayers. Shafer and Simmons (2008) underlined that it is important to investigate the effect of deceitful and manipulative attitude of tax practitioners on the willingness to participate in aggressive tax avoidance schemes. Shafer and Simmons further added that, tax advisors are largely less concern on ethics and social welfare due to the in favour of commercialism and client advocacy. Sharing the same views are, Reckers,Sanders and Wyndelts (1991), where they found that clients’ position and importance to the accounting firm also have an influence in the aggressiveness of tax practitioners when giving advice or signing return. Therefore well regulated tax practitioners can play a critical role in an efficient and effective operation of the tax system.

Collectively, this research is intended to explore the perception of Malaysian tax practitioners in giving tax advice to clients whether to promote aggressive tax avoidance or to promote tax compliance in attending to their clients’ tax affairs. It is accordance to the implementation of SAS promoted to taxpayers where by the system had given taxpayers freedom to declare their income and compute their own tax liability. This self-determination in tax assessment had given them the opportunity to manipulate the tax account which resulted to lower or minimum tax paid. Moreover, based on experience and interview made with some of tax practitioners the aggressive tax avoidance had been practices in the market. Furthermore, numbers of taxpayers

engaging tax practitioners had increase by two fold since the implementation of SAS. Due to the critical role played by tax practitioners in the market had motivates the current study to investigate the perception on the aggressive tax avoidance practice among tax practitioners.

1.4 PROBLEM STATEMENT

Basically, there are two types of tax resistance which are tax avoidance and tax evasion, the former is legal and the latter is an illegal action. According to Kassipilai (2003) tax avoidance denotes the ingenuity to arrange tax affairs in a proper manner as to reduce tax payable, while tax evasion is a deliberate action of non-compliance resulting in lower tax payment. Therefore, it can be suggested that tax practitioners are professions that stimulate the tax evasion to tax avoidance by aggressively minimize clients' tax liabilities by manipulating the loopholes and tax laws ambiguity using their expertise and knowledge in tax accounting.

Generally, there are two points related to tax avoidance, first, it occurs across the tax spectrum and is not a peculiar to any tax types and second, the legislation that addresses the avoidance is imprecise. The lacks of imprecision will in turn create uncertainty and therefore motivate tax avoidance practices. Nevertheless, the practices of aggressive tax avoidance can easily be considered as tax evasion as according to Marshall, Smith and Armstrong (2006) aggressive tax avoidance refers to events that tax practitioners choose to report situations favorable to the clients when that position is ambiguous.

It is a crucial element to recognize the moral issue in communicating and presenting truthful data in disclosing tax information to the government and the public. As pointed out by Sikka and Hampton (2005) the moral issue needs to be

acknowledged when couched with accounting context because the ability to those with knowledge to manipulate to the desired end without deliberation is immense. Ethical issue arises among the tax practitioners are mainly related to the need to satisfy clients' request to minimize tax and at the same time to protect the interest of the government and the public. As highlighted by Alm and Mckee (2004), the needs to satisfy multiple interest groups lead to ethical conflict among the accountants. It indicates that tax practitioners are at the state of dilemma whether to serve the demand of the clients or to fulfill the responsibilities to the government and the public by promoting tax compliance among taxpayers.

Aggressive tax avoidance practice among the accountancy firms usually is rationalized as helping the clients to reduce their tax responsibility. However, it is at the expense of reducing government tax collection. As noted by Sikka and Hampton (2005), that accountancy firms are identical as the key players in the rules avoidance industry. Therefore, the aggressive tax avoidance practice is compromising tax practitioners' ethical conduct and jeopardizes the government tax collection.

1.4.1 Research Objectives (RO) and Research Questions (RQ)

The study is intended to have an insight on the perception of Malaysian tax practitioners which focuses on the key issue of aggressive tax avoidance practices. As a result it brings out the research objectives as follows:-

RO1 To explore the perception of Malaysian tax practitioners towards the practice of aggressive tax avoidance.

RO2 To seek Malaysian tax practitioners' perception on tax clients documentation as a factor in influencing the aggressive tax avoidance practices.

RO3 To seek Malaysian tax practitioners' perception on the advocacy of competitive tax environment as a factor in influencing aggressive tax avoidance practices.

RO4 To seek Malaysian tax practitioners' perception on the advocates of revenue law in practicing aggressive tax avoidance.

RO5 To identify the action taken by Malaysian tax practitioners in attending to clients tax issues.

To meet the objectives of the study, five research questions were developed to explore the ethical conduct of Malaysian tax practitioners in giving advice and consultation to the clients. The research questions are as follows:

RQ1. What is the perception of Malaysian tax practitioners' towards the practice of aggressive tax avoidance?

RQ2. Does taxpayers' proper documentation influences Malaysian tax practitioners' practices?

RQ3. Do tax practitioners take into consideration of competitive tax environment in practicing aggressive tax avoidance?

RQ4. Do tax practitioners take into consideration of revenue law in practicing aggressive tax avoidance?

RQ5. What are the actions taken by the tax practitioners in attending to taxpayers tax issues?

1.5 CONTRIBUTION OF THE STUDY

Based on the past studies, despite the fact that IRBM had streamlined the tax administration such as SAS and e-filing, thus far, there are no empirical studies conducted to investigate the perception of Malaysian tax practitioners towards the

practice of aggressive tax avoidance in giving tax advice. Wider concerns are given to the taxpayers' compliance, compliance cost and tax education in Malaysia (see Pope and Hijatullah (2008), Noor and Mazni (2007), Roshidi et al (2005), Loo et.al (2005), Normala (2004), Kasipilai et al (2003), Kasipilai (1999). Therefore, the researcher expects that this study will give contribution to the improvement of Malaysian tax administration system.

Firstly, this study provides additional information to understand the ethical conduct of tax practitioners as they are the person who has a direct contact with taxpayers and in turn has the potential to influence the compliance decision making. The information from the findings of the study can give an insight to the perception of tax practitioners on the practice of aggressive tax avoidance and consequently can measure the likeliness of participation on such aggressive avoidance schemes.

Secondly, the result of the study gives a better picture to the management of IRBM on the importance of the role played by tax practitioners in boosting tax collection. The data provides information to the tax authority to streamline the effort to improve tax compliance among taxpayers. Besides that, the study also helps tax administration to understand the effectiveness of strategies in promoting higher compliance and will result in effective and efficient tax management. The IRBM also can improve the effectiveness of tax education given to taxpayers. At the moment, the tax education is only given by means of brochures, booklets and by organizing taxpayers' education months.

Thirdly, the study provides information on perception of aggressive tax avoidance and the ethical conduct of Malaysian tax practitioners. As discussed earlier, tax practitioners play a significant role between taxpayers and tax authority by promoting tax compliance practice. Therefore, tax practitioners' good ethical conduct

will assist tax officers to reduce administrative cost and time thus increases the efficiency of tax administrative system. This synergistic relationship will benefit both tax practitioners as well as the government. As pointed out by D'Ascenzo (2005), there are obvious benefits for the tax administration by incorporating with tax practitioners as allowing it to leverage on a 'deal with one agent, impact on many taxpayers.

1.6 STRUCTURE OF THE STUDY

The dissertation will comprise of seven chapters. The structure is as follows:

Chapter 1: Introduction outlines the introductory part which is the background of the study, motivation of the study, research problem and contribution of the study.

Chapter 2: Transformation of Malaysian tax system covers history and development of Malaysian tax system and its effects to Malaysian tax environment.

Chapter 3: Literature review that covers the aggressive tax avoidance practice among tax practitioners worldwide which looks at the factors that influence the aggressive tax reporting advice among tax practitioners. The issues of tax clients position and importance, organized and complete clients' documentations, competitive tax environment and revenue law were the issues highlighted in the past studies.

Chapter 4: Research methodology illustrates the methodology used in this study. This chapter discusses the research design, sample selection, questionnaire development and data analysis.

Chapter 5: Findings and data analysis present the result and findings of the study, begins with demographic data analysis followed by the descriptive results based

on the research questions on the factors that influenced the aggressive tax avoidance practices among Malaysian tax practitioners.

Chapter 6: Conclusion wraps up the study by summarizing the result of the study, discussing the implication of the result and provides the limitation and also suggestion for future research.

CHAPTER 2

TRANSFORMATION OF MALAYSIAN TAX SYSTEM

2.1 INTRODUCTION

This chapter presents the background and development of Malaysian tax system in which the study is conducted. Malaysian tax system has evolved from the Official Assessment System (OAS) where tax official assessed taxpayers' tax due based on the document submitted to IRBM offices to Self Assessment System (SAS) in which taxpayers have full control on the amount to pay tax based on the stipulated tax laws. However, the "pay as you earn" (PAYE) system had transferred the tax authority's responsibilities onto taxpayers' shoulder; as a result taxpayers need to be alert and updated on the changes of tax laws. In order to capture a more comprehensive and in depth understanding on the Malaysian tax system, the development and past researches are reviewed and discussed.

This chapter is presented in the following manner, section 2.2 present the scenario of Malaysian tax system prior to SAS implementation. Next, section 2.3 provides the transformation process of Malaysian tax system under the SAS and Current Year System (CYS) followed by section 2.4 which review and discussed past studies conducted in understanding the nature and the operation of Malaysian tax system and section 2.5 concludes.

2.2 SCENARIO OF MALAYSIAN TAX SYSTEM PRIOR TO SAS

One of the primary roles of tax collection is to provide revenue for the government to facilitate the growth and development of the country and the nation. According to Sigh (2001), the Concise Oxford Dictionary defines tax as a contribution levied on persons, property or business for the support of government. In other words, tax is a form of fund raising by the government through the contribution of the nation which is enforceable by law. The collection of tax will be used as one of the economic tools for the country development