Monthly Tax Deduction as Final Tax: The Case of Malaysian Employees

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Abstract

Malaysia introduced Monthly Tax Deduction (MTD) as final tax system so that salaried earner can be excluded from reporting their employment income. However, the system is on voluntary basis and the take-up rate is low. So, this study was undertaken to examine the issues faced by employees on the implementation of MTD as final tax system in Malaysia. This study comprises a case study on MTD implementation at two institutions which remain anonymous due to confidentiality. Data was collected from 64 responses from open ended questionnaires to employees at both institutions. The data was analysed using thematic analysis. Findings from the analysis revealed that employees’ hesitation to such a system is more apparent. There are three main issues discovered from this study which are: lack of knowledge on MTD as final tax among employees; burden on claiming tax reliefs and the accuracy of MTD calculation; and employer’s readiness. The findings provide evidence to the IRBM and it will provide good foundation for the IRBM to strategize on mechanisms to enhance the implementation of the scheme. For instance, the information on low readiness among employers may call for roundtable discussion between the tax authority and employers. This would help both parties to discuss possible ways to resolve the issue. Other implications and recommendations for policy makers were also discussed in this paper.

Keywords

Introduction

Tax non-compliance in Malaysia is alarming, not only among the corporate taxpayers but also among the salaried group. In relation to this, many studies have been undertaken to investigate the underlying factors contributing towards such non-complying behaviour, which include tax complexity, tax knowledge and attitude of the taxpayers.

While altering the attitude of taxpayers is possible, it however requires more effort and time. Furthermore, this effort and time may equate to a huge cost for the Inland Revenue Board of Malaysia (IRBM). Thus, the IRBM has taken commendable efforts to simplify the tax filing system through the introduction of e-filing in 2006 for the personal taxpayers group. This proactive measure has been fruitful, especially among the salaried group, who viewed e-filing as relatively easy (Ibrahim, 2013).

Not with standing this, there are some taxpayers who believe that they do not have to file a arrival form because their incomes have been removed at source through monthly tax deduction (MTD) scheme by their employers, which is totally not true, at least in Malaysia.

In response to this scenario, the IRBM has introduced the MTD as final tax, beginning at the year of assessment 2014 to give option for some personal taxpayers for not filing a tax return. This motion had been tabled by the former Prime Minister, Dato’ Seri Najib Tun Razak during the year 2014 budget.

While MTD as final tax is undeniably commendable, the acceptance rate of such system is still very low. For the years 2014 and 2015, the take-up rates for MTD as final tax as reported by the IRBM is only about 11.3% and 9.8% respectively (Ramlı, 2017). It is of researchers’ concern on why the take-up rate of the system is low.

In proper research questions, this research tries to answer what are the issues faced by the salaried taxpayer towards MTD as final tax system. In tandem with this, taxpayers’ opinions were sought after to explore this scenario. This paper is divided into five main sections. Next section discusses literature on employment income withholding tax by looking at worldwide experiences. It is followed by methodology and result sections and finally the conclusion section.
Literature Review

Worldwide Experience on Employment Income withholding Tax

In many developed countries, maximum numbers of taxpayers not require to make their own income tax returns, instead their revenue authorities have made for them. Generally, there are two types of systems deal with employment income withholding tax, namely no-return system and pre-filled return system. Under no-return system, majority of salaried earners are excluded from tax system as the tax deducted from their salary is considered final due to a quality maintenance system at source (Evans, 2004). For instance, in the United Kingdom (UK) and New Zealand, a system called Pay-As-You-Earn (PAYE) system is implemented as a direct withholding tax at source that exclude majority of the salaried earners from filing tax returns annually. In whatever system, the use of third-party reporting for many types of income and deductions is extensively used by the developed countries (Gillitzer & Skov, 2018).

In a system of pre-filled return scheme, taxpayers just require to ensure and confirm tax returns arranged by the revenue body (Organisation for Economic Co-operation and Economic Development, 2006). This is characterized as 'an novel tax return arranged by the authority of revenue department for the taxpayer, utilizing data gathered from mediator and other third-party resources (for example., records of the revenue body)' (Highfield, 2006). The basic plan of such mechanisms is mainly to ease taxpayers’ concern and at the same time reducing tax avoidance and also rising the collection of revenue by increasing the use of technology (Ibrahim & Pope, 2011). The pre-filled return scheme was initiated in Denmark in 1988, pursued by other Nordic countries such as Sweden in 1995 and Norway in 1998 (Organisation for Economic Co-operation and Economic Development, 2008). Then the system turned into well conventional in other parts of the globe, along with Australia in tax year 2004-05 (Evans & Tran-Nam, 2010), the State of California in 2004 (Bankman, 2005), Singapore in 2005 (Inland Revenue Authority of Singapore, 2005) and Slovenia in 2006 (Klun, 2009).

Under the pre-filled return framework, the income authority is in control for gathering pay and other information from outsiders and different sources, for example, businesses, annuity reserves, banks, associations and venture firms. According to this information, the income body at that point makes a pre-filled annual government form, which will be given to every close to home citizen. Citizens just require to ensure and confirm that the data in the gave pre-filled return is right. In Denmark, amendments can be completed via phone or by means of the web (Danish Ministry of Taxation, 2008). In California's pilot
undertaking of the framework (which is alluded to as Ready Return framework), just chose representatives are included. Citizens were chosen dependent on data in earlier years which incorporates people who were single, have no wards, don't separate and have wage pay just from a solitary manager (Dircksen, 2005). Despite the fact that the framework was from the outset gotten constrained use, however citizens were accounted for anticipating utilize the framework (Bankman, 2005).

The pre-filled return system is not the same as a no-arrival framework, for example, PAYE in the UK. In a no-arrival framework, an enormous weight is forced on businesses since they need to compute the assessment retained as close as conceivable to the last tax threat (Gale & Holtzblatt, 1997). Though, under a pre-filled return framework, tax retaining doesn’t need to be definite. Any distinctions in tax retained and last tax risk as determined in a pre-filled return will bring about a tax refund or tax payment, estimated by the tax authority utilizing progressed coordinating and handling frameworks. Nearly, the pre-filled return framework is considered as more loose and doesn’t put an extraordinary weight on employers and other outsiders in contrast with a precise retention framework (All-Party Parliamentary Taxation Group, 2009). Consequently, the pre-filled return scheme is believed as additional attractive as compared to a no-return or exact withholding system.

The pre-filled return framework benefits the two citizens and the assessment head. The advantages for the previous incorporate decrease of consistence time and costs, expanded sureness and quicker discounts for overpaid charge (Organization for Economic Co-activity and Economic Development, 2006). Davidson (2009)argues that the pre-filled return framework diminishes the consistence trouble which incorporates record-keeping costs, time taken to fill in the assessment form and the expense of utilizing a paid preparer to do as such. Leigh (2006) states that, by wiping out those necessities, Australians would have an extra open occasion (in view of the evaluated consistence time made by Evans, Ritchie, Tran-Nam, and Walpole (1997). In Slovenia, consistence costs were assessed to be around 73% lesser below a pre-filled return framework (Klun, 2009), despite the fact that this appears to be fairly a huge decrease and the discoveries might be sketchy. That creator likewise demonstrated that the execution of the pre-filled return framework in Slovenia began with significant changes in charge law, for example, diminished duty sections and unstandardised charge findings. The means are viewed as significant in an effective execution of a pre-filled return framework to guarantee right measure of retaining charge (Organization for Economic Co-activity and Economic Development, 2006).
Among the advantages to the income body incorporate quicker handling of a citizen's arrival, snappier discounts of overpaid assessment to a citizen and diminished authoritative weight, which will at last outcome in an upgraded picture for the income body (Highfield, 2006). These advantages mirror the rate reserve funds as far as time and HR for the duty executive. What's more, the pay that is dependent upon outsider announcing as in the pre-filling framework will diminish the pace of tax avoidance (Kleven, Knudsen, Kreiner, Pedersen, and Saez, 2010). In this manner, (Abdul, 2001) recommends that the association of businesses (as the outsider) in revealing pay and derivations is important to lessen tax avoidance. Strikingly, the mental impact on citizens could be huge as citizens might be astounded to perceive the amount of data the income body prepares about him/her (Evans and Tran-Nam, 2011).

In spite of the considerable number of advantages, the pre-filled return framework has been reprimanded. (Youthful, 2010) contends that the expense authority ought not go about as the assessment preparer simultaneously in light of the fact that this circumstance can make an irreconcilable situation. Youthful especially alluded to the PAYE sans return framework in the UK where 15 percent of mistakes discovered are agreeable to the legislature. It is likewise battled that a framework, like PAYE, will make the issue of imbalanced consistence costs for enormous and little firms as the outsiders to gracefully the data to the duty authority (All-Party Parliamentary Taxation Group, 2009). Like discoveries comparable to personal assessment consistence costs, this lopsided weight on huge and little firms is because of the financial aspects of scale impact. There are fixed costs that the little firms would bring about and the extent of the fixed expenses to their pay would be higher than for the huge firms. This weight could be out of line as little firms normally need resources. Slemrod (2006) proposes that the pre-filled return framework isn't private as citizens let their boss know their own issues (for instance, conjugal status, number of dependants and different reliefs asserted). He has additionally contended that the innovative methodology may dissolve citizen comprehension of tax collection matters (Slemrod, 2004).

Studies on the relationship between a pre-filled or direct withholding employment tax system, indicate mixed findings. In the situation where a pre-filled return system is on voluntary basis, taxpayers may choose to be save by making over deduction of withholding tax, which is referred to as “illiquid excess tax payment” because they can later claim for tax refunds (Gelman, Kariv, Shapiro, & Silverman, 2019). Doxey, Lawson, and Stinson (July 2019) on the other hand, found that pre-filled returns lowered the compliance behaviour when the pre-filled returns do not estimate undocumented source of income. Although direct withholding tax from employment income ease both tax
administrator in reducing burden of collecting employment tax, and taxpayers by making automatic payment (Boning, 2018), in the case of excessive refunds, it will increase the administrative costs. Therefore, government should consider the best way to collect tax as mentioned by Jean-Baptiste Colbert (1619 – 1683) that “the art of taxation consists in so plucking the goose as to procure the largest quantity of feathers with the least possible amount of hissing.”

Employment Income Tax in Malaysia

In Malaysia, as salary is normally paid monthly, a system called monthly tax deduction (MTD) is implemented to decrease the weight of taxpayers to pay a lump sum quantity of tax at the tax year end. Monthly tax deduction is a method in which employers subtract monthly tax payments from the service income of their workers. Employers depend on an employees’ private information surrendered to their Human Resource (HR) department to compute the MTD. These monthly deductions are derived after deducting own assistance, aid for partner with zero income, child relief and zakat payments using MTD Schedule or a computerised system (IRBM, 2019).

Notwithstanding this, there are several taxpayers who believe that they do not have to file a revisit form because their profits have been subtracted at source via MTD by their employers, which is totally not true, at least in Malaysia. Apparently, this confusion indicates the inadequate knowledge of tax among taxpayers. Also, this may imply that for some salaried group taxpayers, they had unintentionally not filed their tax returns annually due to their ignorance. In response to this scenario, the IRBM has initiated the MTD as final tax, start at the year of assessment 2014. This motion had been tabled by the former Prime Minister, Dato’ Seri Najib Tun Razak during the year 2014 budget. The MTD as final tax implemented in Malaysia is not compulsory. Taxpayers who opt for this system do not have to file their returns and assumed their monthly deduction as final. Meanwhile, those who prefer to file their tax return in order to accurately calculate their tax liability are also acceptable.

Specifically, starting from the Assessment Year 2014 (tax filed in 2015), taxpayers who have been subjected to MTD may opt for MTD as final tax. Under the MTD as closing tax system, employees who have deducted accurate MTD will no longer require filing their income tax. All reliefs and rebates should be claimed as incurred using a specified form to facilitate the computation of MTD as final tax by the Finance Division. The employer will have to concern the amount taken to the IRBM each month in accordance with Income Tax (Deduction and Remuneration) Rules 1994. There are five criteria that must be met in
order to elect for MTD as final tax system, which are: (1) employees must get their employment profits as mentioned under Section 13 of the Income Tax Act 1967; (2) the MTD of such employees must be made under the Income Tax (Deduction from Remuneration) Rules 1994; (3) such employees must work under the same employer for a period of 12 months in a calendar year (i.e. 1st January – 31st December); (4) employees must choose a separate assessment from their spouse; and (5) tax liability is not borne by the employer.

As per the Section 2 of the Income Tax Act 1967(ITA 1967), employment means there exist a relationship between employer and employee; and related to appointment or post, either public or not and either there is or no relationship, where remuneration must be paid. Section 4(b) of ITA 1967 states that an employee is taxed on employment income got for service done in Malaysia despite of where the payment is made. Employment income includes salary, allowances, and perquisites, benefits in kind, tax reimbursements, and rent-free accommodation provided by the employer.

Further, the responsibility of employer is explained under Section 83 of the ITA 1967, as well as under the Income Tax (Deduction from Remuneration) Rules 1994. The responsibilities of employer include making MTD from the remuneration of employees in each month or the relevant month and furnish a complete and accurate employees' information in a return form when submitting MTD payments or additional deductions to the IRBM. Under MTD as final tax system, employers need to also keep the CB/TP1 Form (individual deduction and rebate claim form) by employees for seven years from the year the claim was made and provide to the IRBM upon request. However, the employer is not required to verify the amount claimed against receipt or any supporting documents. Employees on the other hand, need to complete the form PCB/T1 when making claims on reliefs and rebates and provide to the employer without receipts or supporting documents. Employee has the responsibility to keep all receipts or documents relating to the claims, together with a copy of the Form CP1 for seven years from the year the claim are made.

The main advantage of the MTD as final tax scheme is that it removes the burden to annually file an income tax return form (either by e-filing or manual filing) by the employees. However, the current implementation of the scheme is inconvenient to both employers and employees. This is due to the need to manually submit monthly reliefs claimed by employees through Form TP1 to the employer and employer need to recalculate the MTD when there is a change. This increases both employers and employees compliance costs and may result in rejection of such system. Moreover, the current law also is not very supportive in the sense that there are so many reliefs available
to claim and many tax brackets for individual progressive tax rates (Ibrahim & Pope, 2011). The more options available, the more time will be consumed to arrange tax matters (Evans, 2008). Moreover, it will affect the accuracy of MTD calculation if not reported.

**Methodology**

This study employed a case study method on two institutions which remained anonymous due to confidentiality. The two institutions were chosen because both have implemented the MTD as final tax system. Data for this paper was extracted from the open ended questionnaires to the employees at the institutions. Questionnaires were distributed to 150 employees but the usable answers for data analysis were 64 cases. This study utilised thematic analysis to analyse the data. It is a technique that finds, analyses and informs patterns within data. This thematic investigation was executed in six phases following the step-by-step guide by Braun and Clarke (2006). The phases include data familiarisation, initial code generation, themes search, review of themes, defining the themes and naming the themes. The results found from the analysis were discussed in the next section.

**Results**

There are three main issues discovered in this study faced by employees under MTD as final tax system. The issues are (1) lack of knowledge on MTD as final tax; (2) burden on claiming tax reliefs and the accuracy of MTD calculation; and (3) perceived employer’s readiness.

**Lack of Knowledge**

While there are mixed views on the MTD as final tax, the hesitation to such a system is more apparent. Based on the open-ended questions, the respondents expressed their concerns that hinder them from accepting MTD as final tax. Firstly, the rejection is due to lack of knowledge on MTD as final tax itself. Some of the comments were:

‘I am not sure what do we mean by MTD as final tax’
(Participant 18)

‘I have limited exposure to what is MTD as final tax’
(Participant 23)

‘It is not fair to implement MTD as final tax, when public are not fully aware of the scheme’
(Participant 75)

‘Amount of relief fluctuates from year to year, so difficult to implement’
(Participant 17)
As a result, the respondents suggested the IRBM should improve or doubled their effort on sharing of information to the public. It is important to note that tax matters are not easy to digest by everyone. Hence, it requires clear understanding of the matters before taxpayers may be willing to accept a new system such as MTD as final tax system. This is clearly indicated in the following comments:

‘More information should be shared with public, particularly the salaried earners’

(Participant 28)

‘Detailed and comprehensive information should be given to the taxpayers’

(Participant 34)

‘Disseminate clear and detailed information in the IRBM website on MTD as final tax’

(Participant 96)

Burden to Claim Tax Reliefs and the Accuracy of MTD Calculation

Second issue is related to claiming tax reliefs and the accuracy of MTD calculation. As for year of assessment 2019, there are more than ten types of personal reliefs available to be claimed by personal taxpayers to reduce their tax liability.

To ensure that the calculation of MTD is as accurate as possible, employees need to inform their employers on reliefs that want to claim as and when it is incurred. This situation may increase burden of claiming reliefs by the employees when there is no proper computerized system.

At current stage, employees need to fill in TP1 Form manually. Moreover, the inaccuracy in MTD calculation makes taxpayers prefer to opt for filing the income tax return at the end of the year to get refunds. As a result, the respondents have suggested that it is a need to update the relief and relevant information in a timely manner, taxpayers should be given flexibility to adjust their MTD at the end of the tax year and the use of online system for claiming reliefs, as indicated below:

‘Computation of relief should be done on real-time bases’  (Participant 7)

‘Taxpayers should still be given the flexibility to adjust their relief at the end of the year even though they have opted for MTD as final tax’  (Participant 9)

‘Expenses eligible for claims can be recorded online as and when they were incurred’
Perceived Employer’s Readiness

The third issue as perceived by the employees is the readiness of employers. As indicated earlier, MTD puts the burden on employers to compute tax on behalf of their employees. For that purpose, employers should be well-equipped with the proper system and manpower. Otherwise, it may not be successfully implemented. This was highlighted by some of the respondents as follows:

‘Need reliable and efficient system to ensure no disruption during declaration period’

(Participant 48)

‘The MTD amount deducted must be correct to ensure no over-payment by taxpayers’

(Participant 49)

‘Person-in-charge on MTD as final tax (employer’s side) should be competent and knowledgeable about tax changes and always provide feedback to employees’

(Participant 53)

Conclusion

This study examine the issues faced by employees in two institutions in Malaysia on the MTD as final tax system that is implemented in order to reduce the burden of filing income tax returns among employees. Although the system may exclude some salaried taxpayers from filing annual tax return but current implementation need to consider the findings of this study in order to increase the take-up rate. Three issues that may hinder the adoption of MTD as final tax system found in this study are lack of knowledge on MTD as final tax system among employees; high burden for employees to claim tax reliefs and inaccuracy of MTD calculation; and perceived lack of employers’ readiness.

In terms of knowledge, other country experience such as California State in the United States, indicated that lack of knowledge and publicity are the reasons for limited acceptance in the California Ready Return pilot project (Bankman, 2005). Due to this, it is
suggested that Malaysia government and the IRBM specifically, to increase the publicity of the system to increase awareness on the system and to strategise on how to disseminate knowledge on MTD as final tax especially on targeted taxpayers.

The burden of MTD as final tax system would be less for annual filing process, however, the hassle of informing and claiming reliefs and rebates using manual form as current situation is a burden to employees. Moreover, due to the probability of employees may not update some reliefs or rebates to their employers, the calculation of MTD would be inaccurate and most of the time, it is higher than it should be. Therefore, employees may choose to file their annual tax return form instead to claim for refunds. Managing refunds will actually increase administration costs by the tax authority (Boning, 2018). The unsupportive law system which includes too many reliefs and rebates is probably need to reform as discussed in Ibrahim and Pope (2011) so that only standardised reliefs and rebates are available such as the case of Slovenia (Klun, 2009). It is also suggested to use third-party reporting (such as insurance companies and zakat institution) besides only employer as implemented in other countries such as Australia and Nordic countries to reduce the burden of reporting by employees (Doxey et al., July 2019; Evans & Tran-Nam, 2010; Organisation for Economic Co-operation and Economic Development, 2006, 2008). The third parties should directly report to the IRBM on timely manner and the IRBM should be able to pre-filled the information in the employees tax return.

The perceived lack of employers’ readiness is probably due to lack of information dissemination on MTD as final tax from employers to employees and no available channel that ease the informing or claiming of reliefs and rebates. The reason that may justify this issue is probably because the employers themselves seen MTD as final tax as a burden for them (Gale & Holtzblatt, 1997). This is because they need to entertain request from employees that intent to choose MTD as final tax and to recalculate their MTD every time the employees submit their claims for reliefs. The suggested solution for this issue is, for large employers especially, to utilised good technological system that can cater for quick response time and quick recalculation of MTD.

This study contributes in several ways. Theoretically, this study adds to the literature on salary withholding tax system that is on the appropriateness of a monthly tax deduction as final tax and the issue faced by employees on such system. This study is different from most tax compliance studies in a highly regulated environment (Bobek & Hatfield, 2003; Bobek, Hatfield, & Wentzel, 2007; Saad, 2011) as MTD as final tax in Malaysia at the moment is on voluntary basis. Practically, the results of this study would provide insights to the IRBM on the issues that need further attention to improve the acceptance of such
system. Future studies may employ a survey method to include many institutions so that the results can be generalised to a larger population.

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