

**FACTORS AFFECTING MALDIVIAN TAX AUDITORS'  
CONCILIATORY STYLE IN TAX AUDIT DISPUTE  
RESOLUTION**

**BY**

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the degree of Master of Science (Accounting)**

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## **ABSTRACT**

Tax auditing is a tool which is used by taxation authorities not only to detect non-compliance but also to help on improving future compliance. As such, in reaching an audit outcome, tax auditors are required to resolve all the disputes with the taxpayer. Previous researches show that tax auditors prefer conciliatory approach of interaction in resolving tax audit disputes because it hastens the audit settlement and promotes long-term compliance. This research to examine the conciliatory approach used by tax auditors in the Maldives. As such, the primary focus of this research was to investigate the personal characteristics of the tax auditors and external factors influencing the conciliatory style of Maldivian tax auditors in resolving tax audit disputes. The variables among the personal characteristics are tax auditor's attitude towards achieving organisational goals, experience of the tax auditor in the field of tax audit and ethical ideologies of the tax auditor. Cooperation of the taxpayer during the process of tax audit and managerial control over the tax auditor are the variables examined as external factors. The research methodology used was questionnaire, and the questionnaire was adopted from a previous study conducted in Malaysia. Samples for this research were collected through questionnaire distributed among the tax auditors of Maldives Inland Revenue Authority (MIRA). All 67 responses received were usable for data analysis. Data was analysed using the Statistical Package for the Social Sciences (SPSS) software. The findings of the study do not support the findings of previous studies in this area. The results indicate that no variables have a significant impact on use of the conciliatory style by tax auditors in resolving tax audit disputes. This study finds that personal characteristics of the tax auditors and external factors have no influence on the tax auditors' conciliatory style. The scope of this study is limited to three personal characteristics of tax auditor's and two external factors, while there might be other factors which may be relevant in use of conciliatory style in tax audit dispute resolution process. Despite these findings, this research provides an in depth understanding on tax auditors and an insight on taxation in the Maldives, and is expected to be instrumental for MIRA and relevant government bodies. Furthermore, due to a limited number of respondents, generalizability of the results may be limited. Thus, future studies may be conducted with different sampling strategies and with increased sample size, to examine various other factors alongside these factors, in the Maldives and other Asian countries to better understand the behaviour of tax auditors.

## خلاصة البحث

التدقيق الضريبي هو أداة تستخدمها السلطات الضريبية ليس فقط للكشف عن عدم الامتثال ولكن أيضا للمساعدة في تحسين الامتثال في المستقبل. على هذا، للوصول إلى نتيجة التدقيق، يحتاج مدقق الضرائب إلى تسوية جميع النزاعات مع دافعي الضرائب. يهدف هذا البحث إلى فحص استخدام الأسلوب التصالحي لمراجعي الضرائب في جزر المالديف. على هذا، كان التركيز الأساسي لهذا البحث هو التحقيق في الخصائص الشخصية لمدققي الضرائب والعوامل الخارجية التي تؤثر على الأسلوب التصالحي لمراجعي الضرائب في الدولة. المتغيرات بين الخصائص الشخصية هي موقف مدقق الضرائب تجاه تحقيق الأهداف التنظيمية، خبرة مدقق الضرائب في مجال التدقيق الضريبي والأيدولوجيات الأخلاقية لمدقق الضرائب. إن تعاون دافع الضرائب أثناء عملية التدقيق الضريبي والرقابة الإدارية على مدقق الضرائب هي المتغيرات التي تم فحصها كعوامل خارجية. وكان منهج البحث المستخدم هو الاستبيان، واعتمدت الاستبانة من دراسة سابقة أجريت في ماليزيا. جُمعت عينات من هذا البحث من خلال الاستبيان الذي وزع على مدققي الضرائب في هيئة الإيرادات الداخلية في جزر المالديف. كانت جميع الردود (67 ردا) التي تلقيها قابلة للاستخدام لتحليل البيانات. تحلل البيانات باستخدام برنامج SPSS. لا تدعم نتائج الدراسة نتائج الدراسات السابقة في هذا المجال. تشير النتائج إلى أنه لا توجد متغيرات لها تأثير كبير على استخدام الأسلوب التصالحي من قبل مدققي الضرائب في حل منازعات التدقيق الضريبي. توصلت هذه الدراسة إلى أن الخصائص الشخصية لمراجعي الضرائب والعوامل الخارجية ليس لها أي تأثير على أسلوب المدققين الضريبي التصالحي. يقتصر نطاق هذه الدراسة على ثلاث خصائص شخصية لمدقق الضرائب وعاملين خارجيين، في حين قد تكون هناك عوامل أخرى قد تكون ذات صلة في حل نزاع التدقيق الضريبي. على الرغم من ذلك، يوفر هذا البحث فهماً عميقاً لمدققي الضرائب ونظرة وبصيرة بشأن الضرائب في جزر المالديف، ومن المتوقع أن يكون مفيداً لهيئة ميرا والهيئات الحكومية ذات الصلة. بالإضافة إلى ذلك، نظراً لعدد محدود من المستجيبين، قد تكون قابلية تعميم النتائج محدودة. وبالتالي، يمكن إجراء دراسات مستقبلية باستخدام إستراتيجية مختلفة لأخذ العينات وزيادة حجم العينة، لفحص عوامل أخرى مختلفة إلى جانب هذه العوامل، في جزر المالديف ودول آسيوية أخرى لفهم سلوك مدققي الضرائب بشكل أفضل.

## 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 (Accounting).

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## DECLARATION

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 currently submitted as a whole for any other degrees at IIUM or other institutions.

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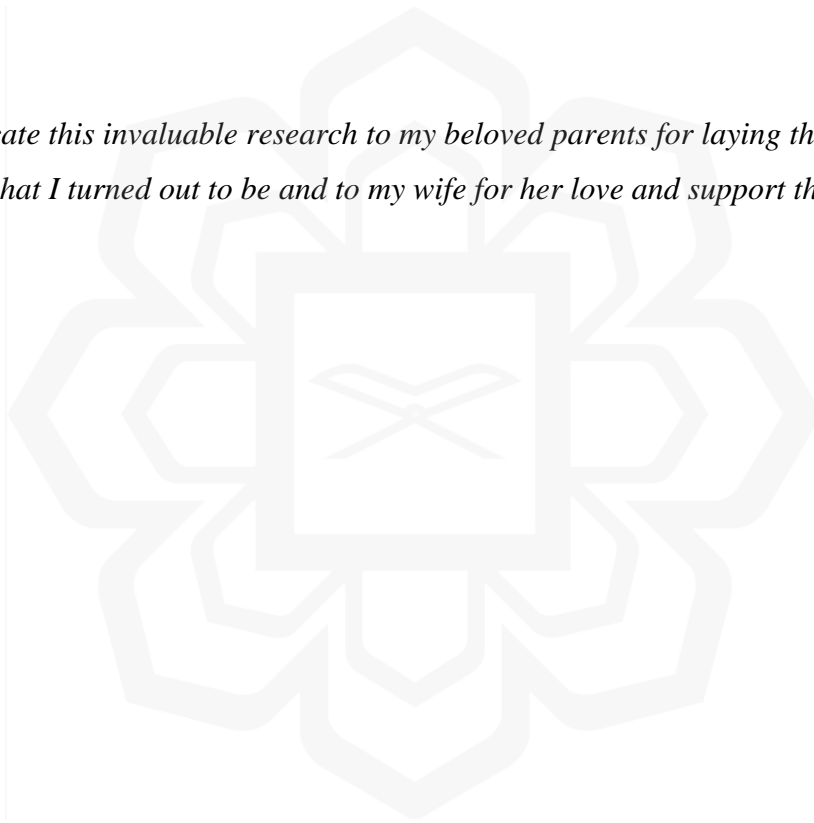
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*I dedicate this invaluable research to my beloved parents for laying the foundation of what I turned out to be and to my wife for her love and support throughout.*





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# **CHAPTER ONE**

## **INTRODUCTION**

### **1.1 INTRODUCTION**

This chapter provides an overall outline of the research subject. The first part of this chapter specifies a clear background of the study. Then, the chapter includes the problem statement, followed by research objectives and research questions. Accordingly, motivation and significance of the study are highlighted before giving a conclusion to this chapter.

### **1.2 BACKGROUND OF THE STUDY**

Fairness, professionalism, integrity, neutrality and transparency are the five core values of MIRA (also known as Maldives Inland Revenue Authority), as mentioned on their website. Hence, all the work done by the authority, from revenue collection service to tax audits, are centered to these principles in order to ensure that its “vision” and “mission” are achieved. In the five years’ strategic plan from 2015 until 2019, MIRA has stated that its auditing capability would be strengthened to avert the possible “abuse of the tax system” in the Maldives, by addressing the tax avoidance and tax evasion cases via tax audits.

The amount of revenue collection gained by a tax authority could be increased by conducting effective tax audits, thus more tax audits leads to more revenue for the government (Mirera, 2013). The statistics of tax audits by MIRA supports the claim above as the tax audits conducted resulted in additional tax. For instance, MIRA had collected MVR 613.5 million in additional tax from 1,817 tax audits conducted in 2017, which was an 88% increase from the previous year’s figure (refer to Table 1.1).

Table 1.1 Tax Audit Cases conducted and Additional Tax assessed by MIRA.

<b>Year</b>	<b>No. of Audit Cases</b>	<b>%of change in audit case</b>	<b>Additional Tax assessed in million (MVR)</b>	<b>% of change in additional tax assessed</b>
2017	1817	3%	613.5	88%
2016	1772	38%	326.42	-27%
2015	1282	15%	448.34	143%
2014	1113	-50%	184.16	-56%
2013	2240	155%	420.35	260%

Source: [www.mira.gov.my](http://www.mira.gov.my)

Hence tax audits play a key role in boosting the potential revenue generation of a tax authority. A mixed method research (quantitative and qualitative) conducted in Ghana found out that tax audit plays a significant role in improving the revenue generation and also suggests that tax audit is the most important function of the tax administration in the country (Opoku, 2015). The main function of tax audits in a self-assessment tax system is assessing the self-ascertained tax amount of the taxpayers. Tax audits, if effectively conducted, can play an impactful role in educating taxpayers and promoting voluntary compliance (OECD, 2006b). Hence, tax auditing involves more than merely increasing the revenue for the government. The function of tax audit should assist taxpayers to improve voluntary compliance by educating them on tax regulations.

Accordingly, the tax authority assigns the responsibility of reaching the aforementioned goals (assessing the self-ascertained tax amount, educating taxpayers, and promoting voluntary compliance) on the hands of the tax auditors. Tax auditors represent and act as a public face of the tax authority via the audit work: examination of tax returns and verification of the declared tax liability (Nordin et al., 2017b). These representatives of the tax authority implement the tax regulations and tax policies during their interactions with the taxpayers. Hence, for tax auditors, factors such as training, education, experience,

communication skills and independence of tax auditors, as well as a healthy relationship with taxpayers are crucial for an effective tax audit (Chalu & Mzee, 2018).

A huge responsibility in conducting an effective tax audit is on the tax auditor as he is the one directly dealing with the taxpayer. The approaches tax auditor use in negotiating with taxpayers can have effect on the audit conclusion, and thus these dealings are of central importance in resolving tax audit settlement disputes (Nordin et al., 2017b). A study conducted in the State of Oregon, the United States, the taxpayers participated in the survey had a negative impression towards the rough treatment of “honest” taxpayers by the Oregon Department of Revenue (Stalans & Lind, 1997).

Taxpayers who have been audited by the revenue authority, expected dignified treatment from the tax auditors whenever they were approached during the tax audit (Stalans, 1992). A study in Malaysia found that professional accountants in the field of tax had expressed that a number of tax auditors have the “objective of finding mistakes” just to charge penalties for incorrect returns and understatement of income (Choong & Lai, 2009). In the same study, it has also been highlighted that the tax audit process used by the tax auditors were not transparent and that some tax auditors were not “happy” with the explanations provided by the taxpayers (Choong & Lai, 2009). The above studies support the claims that, the interaction between the tax auditor and the taxpayer is vital to conduct an effective tax audit.

In contrast, another study argued against the claim on tax auditors that they are harsh and always trying to detect faults (Muhammad, 2013a). Accordingly, the study suggests that tax auditors’ behaviour is altered based on the environment they work in and the conducts of the people that they interact with during the audit process (Muhammad, 2013a). Further study on tax auditors of Inland Revenue Board of Malaysia demonstrates that in resolving disputes, majority of tax auditors agree to use the conciliatory style strategies such as educating, providing advice, negotiating, using flexibility and persuasion (Nordin et al., 2017a).



A study based on grounded theory among the tax auditors of the IRBM was conducted with the aim of determining the factors that influence the enforcement regulatory styles applied by the tax auditors in resolving tax audit disputes. The researcher conducted 49 comprehensive interviews with tax auditors of the IRBM in Klang Valley in the state of Selangor. The analysis of the data collected proposes that the various strategies of enforcement regulatory styles are adapted by tax auditors in resolving tax audit disputes, which includes negotiation, educating, bargaining and strict enforcement (Muhammad, 2013b).

The study also suggests that various factors have an impact on the use of these enforcement regulatory styles and establishes those factors as personal characteristics of tax auditors', taxpayers characteristics and cooperation, managerial control, characteristics of tax agents', amount of tax adjustment and the complexity of the issue in dispute (Muhammad, 2013b). The study also concludes that the Malaysian tax auditors "tried their best" to implement conciliatory style in dispute resolution process while having a positive attitude towards the taxpayers and tax agents (Muhammad, 2013b), as an agreement between both parties over the tax audit outcome would result in less work (such as litigation process) for the tax authority as well as improvement in future compliance.

Furthermore, the above-mentioned grounded theory was empirically tested in Malaysia by other study. In their study, the researchers selected various external factors which are beyond control of the tax auditor (Nordin et al., 2017a) and the personal characteristics of the tax auditors that may influence the use of enforcement regulatory style in resolving tax audit disputes (Nordin et al., 2017b). These studies have used questionnaire survey and are specifically focused on tax auditors' conciliatory style which is one of enforcement regulatory styles. The study found that out of the factors examined, two external factors (managerial control and tax complexity) have a significant impact on the tax auditors' conciliatory style. It suggests that taxpayers' cooperation does not have a significant relationship to the tax auditors' conciliatory style. In other words, the finding suggests that tax auditors emphasize on negotiating and educating taxpayers regardless of the fact that the taxpayers are cooperative or not (Nordin et al., 2017a). The analysis of the

data regarding the personal characteristics of the tax auditors show that the personal characteristics studied (attitude towards achieving organisational goals, experience, ethical idealism and relativism) are significantly related to the tax auditors' conciliatory style in resolving tax audit disputes (Nordin et al., 2017b).

### **1.3 STATEMENT OF PROBLEM**

The concept of "tax auditing" have been evolved and it is no longer considered as merely a revenue maximization tool for tax authorities. According to OECD, the audit function of a tax authority makes a noteworthy contribution to enhance the administration of the tax system, and to promote voluntary compliance of the tax laws by cautioning taxpayers the risk of non-compliance, that it will be caught and judiciously penalized (OECD, 2006).

The purposes of tax audits are wider than assessing the tax liability, as it not only provides deterrence effect, but also enhance the trust of the taxpayers as well as the community, and additionally it helps the tax authority to identify general issues in the tax system (OECD, 2017). An audit of a taxpayer can have a significant impact on other taxpayers who have not been selected for the audit, if the audit is well planned and is effectively implemented (Biber, n.d.). These impacts can be of three types: corrective (rectification of non-compliance issues), deterrent (affects a group of taxpayers to improve the future compliance) and preventive (convince the society to be compliant) (Biber, n.d.).

However, tax laws are complex and equivocal which may lead into disputes between the tax authority and the taxpayers in relation to the declared tax liability and assessed tax liability (Yoon, Yoo, & Kim, 2011). The tax auditors' behaviour and interactions with the taxpayer during the complete process of tax audit is significant for the tax authority to promote voluntary future compliance. Hence, tax authorities need to emphasize on improving tax auditors' technical and business knowledge as well as communication and audit skills through continuous training and development (Isa & Pope, 2011).

Previous studies on the area of enforcement regulatory styles have found that the general public prefers persuasive strategies rather than strict enforcement to comply with

the law (Mahmood, 2012). Persuasive strategies such as educating and negotiating come under the conciliatory style. Conciliatory style is a type of social control in which the parties involved work together with the help of third parties if necessary, bargain and negotiate to reach a mutually acceptable outcome (Horwitz, 1990). Furthermore, the application of conciliatory style can result in improved long-term compliance as well as building a mutual trust between the enforcers and regulated parties while it also helps in maintaining a good relationship and cooperation between the two parties in resolving disputes (May & Winter, 1999).

In a self-assessment tax system, tax authorities are not only concerned with check and balance mechanism to reduce the 'tax gap', but also improving the long-term voluntary tax compliance among the taxpayers. One of the methods to achieve long-term voluntary tax compliance is effective tax audit dispute resolution with both parties reaching an agreement over tax audit findings. The literature suggests that the use of conciliatory style helps to effectively resolve disputes and improves future compliance which consequently save time and cost for the enforcers in future. However, the enforcement regulatory style adapted by the tax auditors are influenced by various factors and the impact these factors have on the tax auditors' conciliatory style (one of the enforcement regulatory style) need to be examined to improve voluntary compliance level. Currently, there seems to be no literature in Maldivian tax auditors' conciliatory style and this study will hopefully fill the gap by analyzing the factors affecting Maldivian tax auditors' conciliatory style in resolving tax audit disputes.

#### **1.4 RESEARCH OBJECTIVE AND RESEARCH QUESTION**

The focus of the study is to explore the behaviour of tax auditors in relation to dispute resolution. Previous studies conducted on this area have reported that two main styles of dispute resolution are adapted by tax auditors to resolve tax audit disputes. Those are legalistic approach and conciliatory approach. Tax auditors could either be controlling and commanding strict-enforcers (legalistic) or persuasive and accommodative with cooperation (conciliatory). In conciliatory approach, tax auditors use persuasion,

negotiation and bargaining rather than ‘intimidating’ on strict enforcement actions such as punishment for non-compliance.

As identified from prior studies, various factors are believed to have an impact on the application of conciliatory style by tax auditors in resolving tax audit disputes. This research is expected to identify the relationship between the five independent variables and the dependent variable. Hence, the objective of this research is to investigate the personal characteristics of tax auditors and the external factors that are influencing the conciliatory style of tax auditors in Maldives, in resolving tax audit disputes. In addition, the research examines the differences of demographic characteristics of tax auditors and the application of conciliatory style in resolving tax audit disputes. The objectives of this research are listed below:

1. To examine the differences of demographic characteristics of tax auditors and the application of conciliatory style in resolving tax audit disputes
2. To examine factors that influence the application of conciliatory style in resolving tax audit disputes.

To realize these objectives, the research questions are as follows:

1. Is there a difference between the demographic characteristics of tax auditors (gender, age, education level, job position, and work experience) and the application of conciliatory style in resolving tax audit disputes.
2. Is there a relationship between the attitude of tax auditors and the application of conciliatory style in resolving tax audit disputes.
3. Is there a relationship between the experience of tax auditors in the tax audit field and the application of conciliatory style in resolving tax audit disputes.
4. Is there a relationship between the ethical idealism of tax auditors and the application of conciliatory style in resolving tax audit disputes.

5. Is there a relationship between the cooperation of the taxpayer and the application of conciliatory style in resolving tax audit disputes.
6. Is there a relationship between the managerial control of the superior and the application of conciliatory style in resolving tax audit disputes.

## **1.5 MOTIVATION AND SIGNIFICANCE OF THE STUDY**

The small South Asian island nation has never heard of modern taxation a decade ago. The income for the Government was generated through various fees levied on businesses and tax on bank profit until the modern taxation regime was introduced in the country with the establishment of MIRA during the year 2010. Hence, the Maldives could be considered as still 'new' to modern taxation, especially to self-assessment tax system.

A numerous academic literature has focused on taxation and tax auditing. Out of such studies, many researchers have focused on tax auditors' behavior. However, to be specific, only three published studies have focused tax auditors' behavior in resolving tax audit disputes. This study is expected to add to the limited literature in this field of study.

This research is motivated due to lack of literatures and studies in relation to the taxation in the Maldives. Only a handful of researches have been conducted regarding taxation in the Maldives by some international organisations such as the Organisation for Economic Co-operation and Development (OECD), but there has been no academic attention given to the country's tax system. Though academic researchers have published literatures on the Maldives economy, an academic research is yet to be published with regard to the taxation in Maldives, let alone tax audits and compliance.

The mission of MIRA is to establish a highly committed and competent organisation, delivering effective and fair administration of the tax laws, promoting voluntary compliance and providing quality services to taxpayers. Hence, promoting voluntary compliance is one of the main targets of the authority which this study is mostly focused on. This research would help MIRA to understand more on the area of voluntary

compliance, particularly through one of its core functions, i.e.; tax audits. Through this research, the factors influencing MIRA's tax auditors' conciliatory style will be analysed thus helping the authority and its stakeholders to understand the behaviour of tax auditors in dispute resolution. Overall, it is expected that this study will be of beneficial in various ways for MIRA, the Government of the Republic of Maldives, the policy-makers and the academics.

## 1.6 ORGANISATION OF THE DISSERTATION

The organisation of the dissertation is divided into the following chapters:

Chapter One: **Introduction:** This chapter discusses the study's background, problem statement, objectives, questions, motivations, and significance.

Chapter Two: **Literature review:** The aim of this chapter is to provide historical and critical elaborations of previous literatures in the area of the study. The first section of this chapter provides an overview of taxation and the tax system in the Maldives. In the second section, the concepts of tax compliance, tax audit, tax audit dispute, taxpayers' behaviour, and tax audit procedure as well as enforcement regulatory styles are reviewed. The third section of this chapter discusses in detail about the impact of tax audit on the taxpayers' compliance behaviour as well as the factors that effects on the tax auditors' conciliatory style in resolving tax audit disputes.

Chapter Three: **Research Methodology, Theoretical framework and hypotheses:** This chapter provides the theoretical background of the study and the development of both the study's conceptual framework and hypotheses. In this chapter, the research instrument and procedures that ensure the work remains professional are addressed alongside the sample size and data analyses.

Chapter Four: **Data analysis and the results:** In this chapter, the data collected were analysed using Statistical Package for the Social Sciences (SPSS) and the results are highlighted and compared to prior literature.

Chapter Five: **Conclusion:** This chapter summarizes the study, its limitations, and then provides suggestions of future research in this area.

## **1.7 SUMMARY**

This chapter began with an overall background about the impact of tax audits on voluntary tax compliance and thereby discussed the evolving concept of ‘tax audit’ where this “tool” is used as an approach to improve long-term voluntary compliance among taxpayers. The statement of problem, research objectives and research questions are detailed, followed by the motivation and significance of the research.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 INTRODUCTION**

The first part of this chapter will provide an overview of the tax system in the Maldives. The next part will provide a brief review of literature on tax compliance and tax audit. Subsequently, a further discussion about literature on tax audit dispute and tax audit dispute resolution behaviour. The enforcement regulatory theory and tax audit dispute resolution behaviour in audit settlement theory will both be highlighted in this chapter. This chapter is then concluded with a quick summary of its content.

#### **2.2 OVERVIEW OF THE TAX SYSTEM IN THE MALDIVES**

##### **2.2.1 The Tax Reform and the Beginning of Modern Taxation**

A tax reform, ‘once in a generation’ transformation, plays an important role in strengthening the revenue collection mechanism. It can be debatable whether the modernization of tax system and emergence of more taxes prompt to increased revenues for the Government. The political changes in the late 2000s had led to major economic changes in the tourism-dependent nation. In the ‘pre-tax reform’ era, the Maldives had witnessed the enactment of various tax legislations since 1970, and numerous taxes including Tourism Tax, Bank Profit Tax, Petroleum Companies Profit Tax, Import Duty and non-tax revenues/fees have been collected by the government of the Maldives.

Apart from the above revenues being imposed by various laws, they were also not governed by a single independent body. Instead, taxes and duties were regulated by respective administrators such as the Customs Service, Ministry of Tourism, and Department of Inland Revenue which was administered under the Ministry of Finance. Moreover, none of the tax related legislations which existed then had a clearly stated formal