



**FACTORS AFFECTING THE EFFECTIVE TAX
RATE: CASE OF CORPORATE TAX EVADERS IN
MALAYSIA**

By

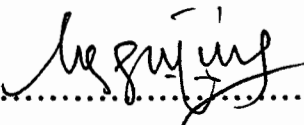
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Project Paper Submitted in Partial Fulfilment of the Requirement For the Degree of
Master of Business Administration
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DECLARATION AND COPYRIGHT

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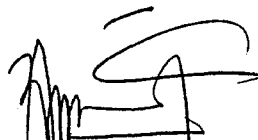
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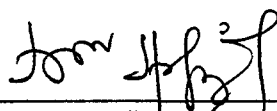
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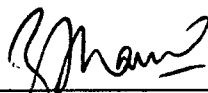
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CHAPTER ONE

INTRODUCTION

1.1 Overview

Tax collected by the Inland Revenue Board of Malaysia (IRBM) is significantly important to the development of the government's projects and the application of government preplanned strategies. In 2012, IRBM managed to collect a total amount of RM 59.31 billion as tax collection from Malaysian companies; this covers 47.48% of the total collection from direct tax collected for the Malaysian Revenue. Referring to the IRBM's 2012 annual report, the total tax collection for the year 2012 is RM 124.88 billion. This figure shows that the direct tax collection contributes a significant revenue to the federal government. Tax is a burden to companies in doing their businesses for instance acquiring new asset and dispose existing assets. Therefore, companies should assess any tax consequences of their action in running their businesses. However, some of the companies found by IRBM avoided tax through tax evasion. In 2012, based on the list given by the Operation Department of IRBM for the purpose of this study, there were 3,010 company tax cases resolved by the Corporate Tax branch of IRBM alone regarding tax evasion. With the significant figure of this case involved in tax evasion, there is a possibility that tax evasion could be an option for companies in Malaysia to enjoy all the profits made by them.

Tax is assumed to be a significant burden to companies in doing business. Although every country has a statutory tax rate (STR), the rate however does not completely reflect the tax burden of companies. It is because a tax base comprises of a lot of complexities and a variety of elements such as incentives given, acceleration of capital expenses can be claimed, a lower tax rate for certain sectors etc. To examine the burden

of tax on the companies, one should measure the Effective Tax Rate (ETR) (Rego, 2003; Hanlon, 2003; Desai and Dharmapala, 2006). Previous studies defined the ETR as the ratio of income taxes currently payable to tax authorities divided by pretax income (Rohaya et al., 2008). Therefore, in this study ETR is defined as the ratio of tax payable to pre-tax income of the companies.

In the Income Tax Act (1967), section 114 defines willful evasion as:

(1) Any person who willfully and with intent to evade or assist any other person to evade tax-

(a) omits from a return made under this Act any income which should be included;

(b) makes a false statement or entry in a return made under this Act;

(c) gives a false answer (orally or in writing) to a question asked or request for information made in pursuance of this Act;

(d) prepares or maintains or authorizes the preparation or maintenance of false books of account or other false records;

(e) falsifies or authorizes the falsification of books of account or other records; or

(f) makes use or authorizes the use of any fraud, art or contrivance

For the purpose of this study, the tax evaders selected are those included in the definition of paragraph (1) (b), (c), (d) and (e) as those are the evaders from the result of the field audit conducted by a branch in IRBM. It is mainly because the data and information of those taxpayers are readily available from the IRBM's mainframe database.

Tax evasion is defined as the ability of a firm to pay a lower amount of tax relative to its earnings. Thus, a tax evader company is a company which pays a lower amount of tax relative to its earnings. Tax evasion occurs when one deliberately fails to comply with their tax obligation (Franzoni, 1998). A previous study by Connelly (2004) found that, the ETR relates to tax evasion activities in United States of America.

A tax evasion strategy that defers revenue and accelerates deductions for tax purposes but not for financial reporting purposes will result in lower ETRs. This is because timing is crucial in tax chargeability. The longer the firm can defer the income recognition, the longer that income is subject to tax. Furthermore, the timing also would give an effect on the rate. For instance, the statutory tax rate in Malaysia was reduced from 28% to 25% for three consecutive years of 2007 to 2009. Motivation for tax evasion includes perception of a high tax rate (Walpole, 2009). Thus, ETR could be used to measure the tax liability to a company (Rohaya, Nor'Azam and Barjoyai, 2008).

Therefore, this study will look at the behavior of the ETR of the corporate tax evaders in Malaysia and later look at the factors that affecting the ETR for the corporate tax evaders. Using archival data from the tax authority in Malaysia i.e. Inland Revenue Board of Malaysia (IRBM), the findings of this study may contribute to additional research on the ETR in Malaysia.

1.2 Problem Statement

The Inland Revenue Board of Malaysia (IRBM) is the sole agent of the government in collecting direct taxes. It has been facing mountains of challenges in order to meet the yearly financial target set by the Ministry of Finance of Malaysia. Every fiscal year, IRBM always trying to find the best way to collect the taxes. One of the proactive way is to suggest to the government on the best statutory rate to be imposed to the taxpayers. The rate should be at the ideal and satisfactory level which is not too high and not too low. Furthermore, Malaysia will soon be implementing Goods and Services Tax (GST) to substitute the current Sales and Service tax. Such imposition will bring major changes for companies in doing their businesses. Therefore an attractive statutory tax rate could be introduced to make sure that the amount of direct taxes collected after the implementation of the GST will not in a declining state. This study hopefully will be able to give the slight idea on the next best statutory tax rate.

IRBM is always looking for the most effective and efficient ways to conduct audit. While conducting the field audits at the taxpayers' premises, IRBM's officers are allowed to use personal mode of transportation if the IRBM's branches or offices lack of it. Such transportation expenses are then allowed to be claimed by the auditors. The longer the time taken to conduct the audit, the higher the cost will be. Therefore, by studying the determinants of ETR among the tax defaulters, this study will be able to help the authority to carefully plan and focus their audit process. A risk or event triggered mechanism can be created to help the auditors to focus during audit and to minimize the time to conduct the field audit. Hence, the most cost effective and efficient way to conduct field audit can be materialized.

The study is to find the link between ETRs characteristic and tax evasion is motivating because of two reasons. First, tax evasion can be complex and difficult. It incurs a lot of cost and is time consuming. To get the 'advice' on tax evasion strategies, companies will have to seek or hire somebody who are really have the inside and outside knowledge about tax matters in Malaysia. These people are usually scarce in numbers and most probably have been attached to other companies. The cost of hiring such person is extremely high. Tax evasion activities too need a thorough and careful design of processes. The processes usually incur a lengthy of time and as a result, the costs of the processes will go up. Secondly, tax evasion involves a significant uncertainty. It may not bring immediate benefits to a company's performance. Instead there is a risk of being detected by the tax authority. By understanding how ETRs characteristic are related to tax evading companies, it would give a better understanding on how the firm's performance in the long term as well as in the short term. Knowing the tax evading companies' attributes would help stakeholder to determine whether company profit reports comply with the tax law. As a result, stakeholders will get a clear picture on the firm's performance. Thus, they can use this reliable information for making decisions on that company.

In 2001, all companies in Malaysia were required to declare their income taxes using the Self-Assessment System (SAS). Under this new regime, all companies must compute their own tax. Previously, IRBM will make the assessment and issue notices to the companies. The new tax system gives an absolute discretion to companies on how much they want to estimate for paying tax; but it must be done within ITA, 1967 provisions and other tax rules compliance. In accordance with Section 107 ITA 1967, companies should furnish the estimate tax payable within thirty days before the beginning of the basis period for that year of assessment. Therefore, the ETR will reflect how companies manage their income tax matters. Whereas in the formal assessment system, due to final assessment subjected to IRBM's assessment, the companies have to wait for the notice of assessment issued by IRBM. Therefore, companies have no control other than reporting everything because the final assessment will be done by IRBM. Rohaya et al. (2008) used data for the year immediately after formal assessment ended in 2000. On the other hand, this study used data 11 years after the new tax regime to get a clear picture on how Malaysian companies react in managing their tax matters in the new era of tax system. In the midst of the rapid development in taxation administration in Malaysia specifically with the introduction of SAS in 2001 and current year assessment in 2000, there is a need to examine Malaysian companies' ETR using recent data to get a better picture on what happened to corporate taxation in Malaysia after a few years of the new regime being implemented especially in evading their taxes.

As mentioned earlier, the ETR is measured as the ratio of tax payable to pretax income. Hence, the underlying question is why some firms pay effective tax rates closer to the statutory tax rate and others pay virtually none, or some cases received tax refunds.

The research questions for this study are:

- 1.1 What was the level of effective tax rate of Malaysian tax evader companies during the year 2012?
- 1.2 What were the relationship between firms' characteristics and ETR?

1.3 Objective of the Study

The objective of this study is to examine the attributes of Malaysian tax evader companies using archival data from the IRBM from the year 2012.

The specific objectives of the study are:

- (1) To examine the level of ETR for the corporate tax evaders.
- (2) To examine the level of relationship between the ETR and the tax evaders.

1.4 Significance of the Study

This study would be important to all parties who are involved in tax matters in Malaysia e.g. policy makers, tax administrators, and corporate firms. Further details are as below;

1.4.1 Policy Maker

Effective corporate tax rates are important for different reasons. Firstly, comparing statutory and effective tax rates gives an idea on how tax incentives are enjoyed by companies. Differences among the ETRs might reflect the effect of the incentives as well as the weakness in the tax system. Secondly, the comparison of effective tax rates across industries gives suggestions whether there are significantly different tax treatments of companies with different industries even though they have the same characteristics. These figures can show whether a large distribution in statutory tax rates may hide little differences in effective taxation. In fact, countries with high statutory rates can lower the base and/or decrease tax enforcement.

1.4.2 Tax Administration

This study is hoping to make contributions to the literature on corporate tax evasion. The study should help to contribute to the understanding of the relationship between the tax evasion and firms' ETRs characteristics. Specifically, it provides evidence on how those ETR variables affect the ETRs for example, whether the size of a company will influence the ETR.

This study also gives the evidence on the attributes of the firms that systematically evaded income taxes during the year 2012. Additional evidences are provided on the impact of tax provisions on firms' ETRs. Hence, the outcomes of this study may assist the tax authority in their tax investigations and field audit

This study also would help the tax authority to widen its tax enforcement base. The tax authority could examine all sectors with low ETR with an assumption that there are practices of tax evasion activities. In the dawn of the new era of the self-assessment system, the amount of tax declared by the taxpayers should be taken seriously and further clarifications are needed if the declaration seems illogical. Therefore, perhaps, this study could help the tax authority to focus on some sectors which pay less tax.

Furthermore, the study is relevant to the IRBM because it contributes to understanding the overall effect of the recent tax enforcement and other regulatory changes on corporate tax evasion. Thus, it will provide feedback to the changes made by the government in tax matters.

1.4.3 Corporate Firms

A good and efficient tax system is important for every country's economy. Since taxes affect economic agents' decisions, it is vital to compare tax systems. To the best of the researcher's knowledge, nearly all surveys come up with the question by comparing

statutory corporate tax rates. However, given the complexities and the variety of elements creating the tax base, this method has been considered to be unsatisfactory. Statutory rates do not perfectly reflect the tax burden of companies. Thus, economists have to find the most effective way in dealing with the corporate taxation.

This study observes the firm's behavior in conducting their tax matters for example through investment activities. The finding from this study will provide empirical results on the method used by companies in Malaysia to reduce their tax burdens. Furthermore, with the challenging economy in today's business climate, every firm will put more effort to reduce their unnecessary cost. Hence, this study provides the firm with actions to fight in the challenging world, for instance, to enjoy the incentives offered by the government.

This study could also provide the information to the management of the companies to expand their business in certain sectors. If companies know which sector had a less tax burden, of course, it would help them to maximize their profits and invest their money in the profitable sector. Given that there are a lot of incentives offered by government e.g. pioneer status; investment allowance etc, any action taken regarding the investment decision would reduce the cost of the companies. Hence, it would facilitate companies to maximize their profit.

In general, the study complements and extends Rohaya et al.'s (2008) empirical analyses by examining the ETRs characteristics using a sample of public listed firms in Malaysia. Using a different set of data, this study looks at a wider perspective in ETR development studies in the Malaysian tax environment particularly in the context of tax evasion.

1.5 Scope of the Study

The current study used archival data from IRBM. It consisted of the firm level financial data to measure the corporate tax behavior of 903 Malaysian firms in 2012. Specifically, effective tax rate measure being used is effective tax rate which is defined as total tax payable divided by pre-tax income. There are six accounting variables used as alternatives to observe the relationship between corporate ETRs and their characteristics which are firm size, leverage, return on assets, capital intensity, inventory intensity and receivable. These characteristics will be explained further in the next chapter.

1.6 Organization of the Study

This dissertation has five chapters. Chapter one provides the introduction, objectives and motivation of the study. Chapter two presents the relevant literature on the tax evasion, ETR and ETR determinants together with the hypothesis development. Chapter three will outline the research framework, methodology used in this study, sample selection and ETRs measurement. Chapter four discusses the data analysis and findings. Finally, chapter five presents the key findings as well as recommendations for future research, contribution of the study and limitations of the study.

CHAPTER TWO

LITERATURE REVIEW AND RESEARCH FRAMEWORK

2.1 Introduction

This chapter discusses relevant literature related to this study. Section 2.2 provides the background and the tax reforms in the Malaysian tax system. Section 2.3 explains about tax evasion. Then it is followed by section 2.4 on the discussion on the hypothesis development. Section 2.5 shows the regression model. Section 2.6 illustrates the research framework. Finally, the chapter would be concluded in section 2.7.

2.2 Tax Reform in Malaysia

2.2.1 The History of Direct Taxation in Malaysia – Prior 1967

“Income tax was imposed in Malaya effective from 1st January 1917 when the Bill for ‘imposing a Tax on Income’ was duly passed. Although income tax was originally imposed and defended solely for the purpose of contributing to the war, an attempt was made in 1922 to maintain the income tax for general revenue purposes. This attempt had led to fierce opposition from the public and the business community. The public demonstration forced the government to abandon the proposal. Therefore, the first attempt to impose tax on income, then ended in failure” (Ahmad and Hingun, 1994).

The reintroduction of income tax took place during the Second World War in 1941. Then, the Income Tax Ordinance of 1947 was implemented. The ordinance was based substantially on the English tax law, subject to amendments to suit local circumstances and after taking into account the changes that had taken place in Britain, on the Colonial Territories Model Income Tax Ordinance of 1922, prepared for all colonial territories by the British Commissioners on Inland Revenue.

2.2.2 The History of Direct Taxation in Malaysia – After 1967

The 1947 Ordinance was later merged into the Malaysian Income Tax Act 1967 (Act 53) in which for the first time it brought equivalence in income tax law to all the regions in Malaysia. Although the Act reproduced some of the wordings of the English Statutes, it has nevertheless been interpreted by the Malaysian Courts according to the local context (Ahmad and Hingun, 1994).

According to the Act, any person and companies are chargeable for tax on income derived from Malaysia (Section 3, ITA 1967). For world base businesses like banking, insurance, air and sea transport companies, they are taxed based on worldwide income. All income can be adjusted based on deduction allowed. For instance, interest payments on finance business activities are tax-deductible.

In 1986, a new tax legislation was introduced to give more deduction to the promoted business in Malaysia. The new Act was the Promotion Investment Act 1986. This act gave special tax treatment and tax incentives for businesses which were qualified. For example pioneer status, investment tax allowance etc.

All Malaysian firms are taxed at the same statutory rate. In the 1980s, the corporate tax rate in Malaysian stood at 40%. A change in government policy reduced it to 35% in 1990. The tax rate was further reduced in stages and by the 1998 assessment year, the rate stood at 28%. This rate was reduced to 27% for the year of assessment 2007, 26% for year of assessment 2008 and 25% for year of assessment 2009 till 2013.

2.2.3 Self-Assessment System Era

The year 2000 marked the first year of the new tax assessment system under the implementation of the Current Year Assessment on the income tax returns. In the beginning of the current year of assessment for year of assessment 2000, company

taxpayers were required to submit their income tax return according to the date of their companies' closure of accounts (Section 77A, ITA 1967).

Table 2.1 shows the effective year for implementation self-assessment system in Malaysia based on chargeable person (ITA, 1967).

Table 2.1: Effective Year for Implementation of SAS

Category	Year of Implementation
Companies	2001
Business, partnership and co-operatives	2004
Salaried employer	2004

The SAS was initially imposed on company taxpayers in 2001, and has been extended to taxpayers other than companies in 2004. The basis of the SAS introduced lies in voluntary compliance, and based on the concept of “self-assess, pay and file”.

Previous studies indicate that SAS is one of the most important principles that stand behind the procedures and system of modern tax administration (Toye and Morre, 1998; Tanzi, 2000; Guttentag, 2000). The SAS is essentially a process by which taxpayers are required to determined their taxable income, compute their tax liability and submit their tax return based on various tax laws, policy statement and guideline issued by the tax authority. The IRBM formulates strategies that make it easy and convenient for taxpayers to comply with taxation laws and regulations. Although the method of calculation under the SAS is not different from the previous provision, changes to work procedures and processes are necessary in respect to reporting, payment and assessment to ensure that taxpayers are able to perform the relevant tasks themselves with minimum help from tax agents or the IRBM. Therefore, it is hoped to create a good tax system in Malaysia.

Generally, tax returns will not be subject to detailed technical scrutiny of the IRBM. However, the IRBM checks and verifies tax returns on post-assessment basis by way of

A lot of progress has been done to improve Malaysian tax administration e.g. changes from imputation system to single tier system (Section 108, ITA 1967). The public ruling which is used to educate and give IRBM perspective on certain issues regarding tax matters was introduced (Section 138A, ITA 1967). Advance ruling is also available to be requested by the taxpayer. From the enforcement side, there are a few framework implemented to make tax enforcement more transparent e.g. tax audit and tax investigation framework. For the purpose of this study, the samples selected are those who were imposed with the non-disclosure (discovery during audit) offences and repeated offences. Therefore, the samples comprise of audited companies with at least 45% of penalties being imposed. Such matter will be discussed in further detail in the Research Methodology chapter.

The statutory tax rate also has been changing starting from 28%. The rate was reduced to 27% for the year of assessment 2007. Subsequently it was reduced to 26% for the year of assessment 2008 and it was fixed at 25% starting from 2009 till 2013. For the small and medium enterprise with a paid up capital of less than RM2.5 million, tax rate is capped at 20% for the first RM500,000 of the taxable income. The balance thereafter is imposed at a statutory tax rate. This is an initiative taken by the government to reduce tax rate based on the size of companies. Therefore, it will help these companies to sustain in the challenging era.

Tax reform in Malaysia has shown that there is a tremendous tax development. This indicates that the Malaysia government facilitates the business regarding tax matters. Therefore, anything which happens in the corporate world will affect tax policy. That is why this study examines the ETR in Malaysian companies in order to get more information on how corporate companies especially tax evader companies react against the tax policy implemented by the government.

2.3 Tax Planning, Tax Avoidance and Tax Evasion

The tax evasion activity distorts allocation of economic resources (Walpole, 2009). Tax

evasion activity diverts resources away from the government towards other parties like tax agents, accountants, lawyers and others who develop a tax evasion method. Therefore, it is stated in the tax act that whoever assists a person to evade the tax, that person is making an offence and could be punished under the tax acts (Section 114, ITA 1967). The main beneficiary of the tax evasion activities is the company itself, definitely. It contributes to the increase in the earning of the company. Makar and Pearson (2002) suggested that the earnings manipulation will become unlawful when companies intentionally provide material misstatement

Tax payers are tempted to lower their liability for income tax (Walpole, 2009). A well informed tax payer is perfectly justified both legally as well as ethically in saving tax by making use of provisions of tax laws. One of the methods to minimize the tax is through the implementation of tax planning activities. Tax planning is a critical component of business projection. It is an ongoing process. Tax planning should not be regarded as a tool for the purposes of tax saving or tax mitigation only. It should be used to make business transactions tax effective and efficient as well as to avoid problems with the tax authority.

Tax planning is crucial and for it to be successful, it must be ongoing and not intermittent. To obtain maximum benefits, structuring and planning the flow of income and expenses should be done in advance. Good tax planning reaps more benefits in the long run. To ensure that the planning scheme can withstand the anti-avoidance provisions, it has to be done within the framework of the law. Therefore, it is necessary for everyone who wishes to undertake a tax planning exercise to understand the basic fundamentals of the laws and be able to identify all the legislative “loopholes” and possible “traps”. Tax planning is basically making use of all concessions and exemptions afforded under the taxing acts (Ong, 2005).

However, tax planning activities would fall into tax evasion if it is done beyond the tax jurisdictions. The general perception of tax evasion is illegal. Nevertheless, the tax planning is legal. The planning can be wrong if one does not consider applying the

provisions of the tax legislation correctly and effectively. In Malaysian tax legislation, the IRBM can invoke the anti-avoidance provision if the scheme is seen to be for the avoidance of tax (Section 140, ITA 1967). If tax planning is right, it would have denied the IRBM the privilege of invoking the anti-avoidance provisions.

Generally, the IRBM will invoke Section 140 where an agreement or arrangement has the purpose and effect of altering the incidence of taxation. It also enforces a scenario where such agreement or arrangement relieves any person from liability to pay tax or making return under the tax act. Similarly to the situation of defeating, avoiding or evading any duty or liability imposed on any person under the act or preventing the operation of the tax act in any way could invite IRBM to invoke this section. Section 140 gives broad powers to the IRBM to disregard or vary any arrangement so as to counter any tax advantage obtainable under the arrangement. Thus, companies should take reasonable actions before making an arrangement regarding their business activities to avoid falling under tax evasion.

Drawing the line between legal tax avoidance and illegal tax evasion is sometimes difficult. Tax avoidance comprises activities which exploit loopholes in the tax system but run counter to the purpose of the law, whereas, tax evasion describes illegal activities that involve elements of concealment (Slemrod and Yitzaki, 2002). Tax evasion arises where there is opportunity (Walpole, 2009). According to Walpole, small businesses are more prone to tax evasion than large companies because large businesses usually rely on a wider network of respectability and honesty in order to attract clients. Tax evasion must surely involve a degree of knowledge. Particularly, it must involve the absence of an honest belief that a person is not liable to a particular tax. If a taxpayer cannot show that he has an honest belief that he is not liable to the tax that seems *prima facie*, to fall within the scope of tax evasion.

From this perspective, some company activities such as non-declaration or under-declaration of income or over claiming of expenses would clearly be classified as tax

evasion. Thus, a company should know what the limit is to implement the planning activities. There will always be some room for choices in which firms may exploit to reduce their tax burden. Using these choices are not necessarily a violation of the law, and this would be classified as tax planning.

Badertscher et al. (2006) found that, firms generally manage earnings in ways that minimize their current tax cost. Thus one way to minimize cost is through tax planning. Improper tax planning could affect companies to fall under tax evasion activities. The U.S Treasury's report (1999) cites the pressure to keep the firm's effective tax rate (ETR) low and in line with competitor benchmarks and increase shareholders value as the driving force behind the recent wave of corporate tax planning. Motivated by policy debates on corporate tax burdens, especially surrounding the Tax Reform Act 1986 (TRA86) in the United States, several studies examine the relation between ETR and tax planning e.g. Shevlin and Porter (1992); Gupta and Newberry (1997). These studies measure tax planning using firms' ETRs. The ETR variable used in these previous studies is the size of the firms.

Prior research also finds that ETRs vary cross-sectionally with firms' tax planning opportunities (Gupta and Newberry, 1997). For example, firms with a greater capital intensity tend to have lower ETRs as a result of tax preferences associated with investments in capital assets (Gupta and Newberry, 1997). Similar as Gupta and Newberry (1997), Rego (2003) provided evidence that ETRs vary based on differences in firm opportunities to engage in tax planning. Gupta and Newberry (1997) and Rego (2003) both used ETRs to proxy for firms' tax planning activities. Therefore, it could show that ETR is one of the main tools used to examine tax planning activities by the firms.

This study uses local data to determine whether the situation in other countries has a similarity in context of Malaysia. Assuming that these local companies implement the tax planning activities at the first place, but due to lack of knowledge or expertise this

tax planning activities could be turn into tax evasion activities.

2.4 Hypothesis Development

2.4.1 Effective Tax Rate

Previous studies by Rohaya et al. (2008) used ETR as a measurement for tax burden for companies. The measurement of ETR is important for policy makers to know the effect of tax policy on corporate business. On the other hand, this figure is also important for academic researchers in doing their research on tax in certain countries. Generally the effective tax rate is a measure of the average rate at which a company is taxed on its pre-tax profits, expressed as a percentage.

To make comparisons among companies, it is easier using ETR. It shows the difference between some companies even though they are in the same industry. Although trends in effective tax rates over time can provide information about corporate operating performance and income, one should note that some factors like managerial decisions and choices in accounting methods can also have considerable effects on the components of this measure. As with most financial measures, comparison of effective tax rates is generally the most meaningful among companies within the same industry (Rohaya et al., 2008).

In general, the ETR can be divided into two categories i.e. average ETR and marginal ETR. Marginal ETR is mainly used on a particular investment project to study on the effect of taxation. Meanwhile an average ETR is usually used by the corporate level as an empirical study of the income tax rate. ETR usually refers to the average income tax expense. It consists of the amount of tax that needs to be paid by companies. Therefore this study uses average ETR based on its objectives as explained in Chapter One. Consistent with the previous study, the ETR could give a better result on the situation on how the tax burden is to be measured.

Meanwhile some studies were carried out using Malaysian data such as Kim and Limpaphyom (1998), Derashid and Zhang (2003), Adikari et al. (2006) and Rohaya et al. (2008). Kim and Limpaphyom (1998) dealt with different ETR among countries in Asia. Derashid and Zhang (2003) studied the relevant data in Malaysia for a specific industry policy. Their research results showed that big corporations have a relationship with ETR especially companies in certain industries because they are abode by the tax policy in that industry. Rohaya et al. (2008) examined the ETR characteristics in public listed companies and they found that size, leverage, and capital intensity influence ETR of Malaysian public listed companies.

Previous studies suggested that the ETR may also be influenced by additional variables. Gupta and Newberry (1997), Porcano (1986), and Stickney and McGee (1982), all suggested that a firm's leverage can influence the ETR. The leverage was measured by total debt divided by total assets. This is because interest payment is deductible for tax computation. Therefore, it will reduce the firm's tax as well as lower the ETR.

The above studies also found that a firm's capital intensity which is measured by property and plant and machinery divided by total assets may reduce its ETR. The reason is accelerated depreciation is relative to actual asset lives. Thus it will reduce the firm's tax. Therefore, current study examines some of variables used in the previous study to determine whether these variables have an effect on ETR in Malaysian companies particularly in the context of tax evader companies.

Generally, it is important to know whether there is a difference between ETR and statutory tax rate. Statutory tax rate is fixed at 25% during the period of the study. Therefore, the study examined the difference between statutory tax rate and ETR for the year of 2012. Thus, a hypothesis has been developed regarding ETR as below:

H1: The effective tax rate is significantly different from the statutory tax rate.