



INDIVIDUAL AND ORGANISATIONAL FACTORS
AFFECTING GST COMPLIANCE AMONG
MALAYSIAN SMEs

BY

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A thesis submitted in fulfilment of the requirement for the
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ABSTRACT

Hiring SMEs to be employed as GST collecting agent and documenter may affect their major economic contribution to the world due to its limitations in terms of informal routine, lack of financing, low productivity resources and less information. GST documentation increases the administration time for the SMEs even though no requirement to pay tax. Still, SMEs prefer to be registered even though voluntarily as registration enables them to obtain tax credits, avoid to lose clients and able to issue tax invoice. Hence, various issues have been raised to solve the administration burdens, refunds and reporting errors which at last can injure the cash flows of SME businesses. 120 responses on the questionnaire from Malaysia GST-registered SMEs are generated from this study via purposive sampling and snowball method. Our study on the individual and organisational factors towards GST compliance by SMEs revealed the negative relationship between GST complexity and GST compliance. Hence, higher GST complexity will lower GST compliance.

ملخص البحث

إن التعاقد مع الشركات الصغيرة والمتوسطة الحجم سيستخدم ضريبة السلع والخدمات لجمع الوكالات والوثائق التي قد تؤثر في إسهاماتها الاقتصادية الرئيسة في العالم بسبب أوجه القصور فيها؛ من حيث الروتين غير الرسمي، والافتقار إلى التمويل، وبسبب تدني الموارد الإنتاجية، وقلة المعلومات. إن وثائق ضريبة السلع والخدمات تزيد في أوقات الإدارة للمؤسسات الصغيرة والمتوسطة حتى ولو ليس هناك شرط لدفع الضرائب. وعلى الرغم من ذلك لا تزال الشركات الصغيرة والمتوسطة تفضل أن تكون مسجلة حتى ولو طوعا كتمكين التسجيل للحصول على ائتمانات ضريبية، وتجنب فقدان العملاء ولتكون قادرة على إصدار الفاتورة الضريبية. ومن ثم، أثرت قضايا مختلفة لحل أعباء الإدارة، والمبالغ المستردة وأخطاء التقارير التي يمكن أن تصيب في الماضي التدفقات النقدية للأعمال التجارية للمشاريع الصغيرة والمتوسطة. لقد تمّ الحصول على (120) استجابة على الاستبيانات من ماليزيا حول ضريبة السلع والخدمات التي سجلتها الشركات الصغيرة والمتوسطة عن طريق أسلوب كرة الثلج وأخذ عينات عشوائية. وكشفت دراستنا عن العوامل الفردية والتنظيمية كالامتثال لضريبة السلع والخدمات من جانب المؤسسات الصغيرة والمتوسطة، والعلاقة السلبية بين تعقيد ضريبة المبيعات وضريبة السلع والخدمات والامتثال للضريبة. ومن ثم، سيخفض تعقيدات ضريبة السلع والخدمات الامتثال لضريبة السلع والخدمات.

APPROVAL PAGE

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

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CHAPTER ONE

INTRODUCTION

1.1 INTRODUCTION

This chapter serves an introduction on the background of the study, problem statement, motivation of the study, research scope, objectives and questions, its significance and organisation of the study.

1.2 BACKGROUND OF THE STUDY

The limitation of small businesses or commonly called Small and Medium Enterprises (SMEs) capabilities in satisfying the financial needs, productive staff supply, formal documentation, advance technology and high profitability has been raised by many researchers. Restricted access to finance and loan, insufficient skills and talented staff, underutilization of government services and scarce data and information are synonyms with SMEs (Egyptian Banking Institute, 2011). Thus, with the announcement of GST implementation in 2014 Malaysian Budget, SMEs expressed their fear of getting with more routine documentation, upgraded software with GST terms, training employees, familiarisation with the new GST terms and laws and better cash flows. Within 17 months before GST was implemented, substantial SMEs admitted the difficulties to understand GST laws and information on the registration (New Straits Times Online, 2014). However, after one-year of GST implementation, Royal Malaysian Customs Department (RMCD) has received various reports concerning SMEs mistakes and non-compliances.

Understanding SMEs challenges and limitations to comply with GST are salient since SMEs act as the largest contributor and have most dominated

establishment. Their contributions encompass employment opportunities, gross domestic product (GDP) and tax diversified revenues (Aris, 2007; Iraj & Besnik, 2011). SMEs compliance towards GST may be driven by several factors such as GST sanctions, GST fairness, social norms, personal norms, GST complexity, GST knowledge, GST accessibility, and mental accounting. For this study, only five factors are used which includes GST sanctions, GST fairness, personal norms, GST complexity and mental accounting.

SMEs pay taxes because of the fear of detection and punishment enforced by the sanctions (Riahi-Belkaoui, 2004). Although this power is criticized by most researchers for being firm, there is a minimum effectiveness of coercive power to shape greater compliance due to fear of getting caught and detection probability (Evan, 2009). Fairness of the GST system is depended on the burden faced by the SMEs in respond to the tax requirements (Tan & Chin-Fatt, 2005). Leventhal (1980) describes fair procedures as to be consistent, accurate, free of mistakes, representative, ethical, and correctable. The incapacity of the firms to adhere to the GST administration duty for accuracy and prompt submission are caused by the complexity of the GST requirements (Robinson & Saviano, 2011). The complexity has caused larger costs for SMEs to accommodate more administrative works and human resources thus impair voluntary compliance. Furthermore, SMEs with low mental accounting will be reluctant to pay GST money to the RMCD since it is perceived as business ownership.

With the constraints faced by the SMEs, it is interesting to investigate their compliance towards GST especially after one-year of its implementation to observe their adaptability and resilience with GST requirement. Kirchler et al. (2012) also claimed that limitations may encourage SMEs for non-compliance activities. Since

SMEs are less observed as compared to large companies due to less tax contribution, it will be a waste to the government if the potential income is not secured for needed projects (Atawodi & Ojeka, 2012). Thus, more research is needed to understand about these firms' compliance factors towards GST. Two theories of economic deterrence and psychology are employed in this study to provide an insight on the relationship between individual and organizational factors with GST compliance.

1.3 STATEMENT OF THE PROBLEM

After one-year of GST implementation, RMCD has received various reports concerning on the mistakes in the tax invoices, misclassification of taxable supply goods and omitting GST revenues (AHK Malaysia, 2015). Filing errors are found in the declaration of output tax amount as sales amount and misclassification of zero-rated or standard-rated supply and 60 per cent of the late GST input refunds are caused by the filing mistakes from the companies (The Star Online, 2015). Moreover, about 503 GST-registered SMEs in Perak failed to submit the GST 0-3 tax returns by the due date of 31 May 2015 thus it is extended further to 15 June 2015 and another 81,000 out of 240,000 companies under the GST second group with the three-month taxable period are urged by RMCD to file their GST statements (The Sun Daily, 2015).

These mistakes arise from the transitional period faced by businesses specifically SMEs to upgrade the software, understand the complex GST codes, adhere to substantial GST requirement for tax invoices and operations and further issues waiting for confirmation from RMCD (AHK Malaysia, 2015). SMEs have to consider for a quarterly GST reporting rather than previous annual basis, regular accounting advice as compared to none prior to GST, variation in charts of account

versus simple accounts, and a proper credit control (Hastraa Consulting Services, 2014). One possible reason for postponing GST implementation in Malaysia from year 2005 to 2015 is also because of the SMEs non-readiness to alter the business planning, financial reporting and administration to the newly complex GST (Mansur & Ilias, 2013).

Furthermore, the compliance costs of GST are higher for the SMEs (Pope & Rametse, 2002; Cnossen, 1994). 80 per cent of the respondents from the 2016 Associated Chinese Chambers of Commerce and Industry of Malaysia (ACCCIM) SME Taxation Report claimed incremental costs associated with GST operation (ACCCIM, 2016). The costs include preparation for more staff, documentation, accounting advice and cash flow savings to pay GST returns for credit transactions. For instance, The National ICT Association of Malaysia (PIKOM) in their GST Survey Release 2014 discovered limited financial resources claimed by SMEs to prepare themselves for the GST thus looking for more assistance from government agencies and banks. Consequently, SMEs are unable to cope with those costs without abundant resources (Gupta et al., 2012). Even though e-Voucher of RM1,000 was granted to SMEs to minimise preparation cost for GST, only 52 percent utilized it. Due to that, the ACCCIM Survey Report (2015) found that this incentive as not cost-beneficial to the SMEs.

Breen (2002) found that GST caused cash flow problems because debtors were slow in paying and general economic conditions has hindered. This situation is worsen by the delay in GST refund from the Customs Department due to GST filing errors by SMEs (Chartered Secretaries Malaysia, 2016). Thus, SMEs have to pay to the government in advance before the actual cash received from credit transactions even though with insufficient fund (The Sun Daily, 2014). Besides, SMEs also aware that

customers are likely to deal with GST-registered companies than non-GST registered (Kasipillai & Baldry, 2000). Hence, most SMEs still prefer to be registered voluntarily as registration induces producers to purchase goods from GST-registered businesses to obtain tax credits, avoid losing clients and to be able to issue tax invoices (Bain et al., 2015).

Due to that, the government was requested to halt the implementation of GST to solve the administration burdens, refunds and reporting errors that eventually can injure the cash flows of business especially to the SMEs (The Star Online, 2015). The long year postponement of GST implementation has depicted the readiness and capabilities of SMEs to comply with GST to be taken as prominent consideration. Giles and Caragata (1999) also proved high non-compliance from SMEs as compared to large businesses due to their incapacities and constraints. Thus, the issue of GST compliance among SMEs shall be addressed to avoid disruption on the collection of GST revenue mainly in the Malaysia current deficit and oil drop prices.

1.4 MOTIVATION OF THE STUDY

Tax compliance research still need to be extended for more discovery of innovative compliance solution from the efforts made by Australian government for various changes on its tax system over the past 20 years ago since 1986 with self-assessment system until in the year 2000 with GST implementation (Torgler & Murphy, 2004). Further, these tax policy changes have provided positive impact to the tax morality of the taxpayers (Torgler & Murphy, 2004). In the 2010/2011 Australian budget, more compliance alternatives are structured to minimise the non-reporting rates, prevent tendency to undermine GST system, increase deterrence solutions, and widen GST collection (Wearne, 2013). Funding has also been extended for yearly budget

including the recent three-year extension of fund for GST compliance activities as well as research which was announced in the 2015/2016 budget (Pitcher Partners, 2015). Besides, Barbuta-Misu (2011) even opined on the necessity for further approaches to boost compliance instead of solely dependent to the enforcement power.

For Malaysia in particular, it can be part of the learning curve to adapt with the tax reformation operational issues and transition (AHK Malaysia, 2015). Since SMEs are the majority business taxpayers in most developing countries like Malaysia, their compliance levels have direct effects on tax revenue collections (Bodin, 2008). Thus, SMEs compliance is salient. Indeed, greater compliance increases government revenues. In addition, Teo (2015) admitted the influence of GST revenues for better domestic economy thus secures more employment opportunities.

1.5 SCOPE OF THE STUDY

This study focuses on the SMEs in Malaysia which formed the major economic contributor to the country. SMEs by definition comprise of micro, small and medium enterprises (National SME Development Council (NSDC), 2005). Micro enterprise has turnover less than RM300,000 and less than five employees, small enterprise with turnover RM300,000 up to RM15 million with less than 75 staff and medium enterprise with turnover exceeding RM15 million till RM 50 million accompanied with staff of less than 200. With different resources, less productivity, simple management structure, lack of financing, limited knowledge, high compliance costs and informal routine, SMEs response to the GST requirement may differ as compared to large businesses.

1.6 RESEARCH OBJECTIVES

There are five research objectives highlighted in this study:

- R0₁** To assess the effect of GST sanctions on the GST compliance by Malaysian SMEs.
- R0₂** To investigate the effect of GST fairness on the GST compliance by Malaysian SMEs.
- R0₃** To analyse the effect of GST complexity on the GST compliance by Malaysian SMEs.
- R0₄** To examine the effect of mental accounting on the GST compliance by Malaysian SMEs.
- R0₅** To measure the effect of personal norms on the GST compliance by Malaysian SMEs.

1.7 RESEARCH QUESTIONS

These research questions were designed to fulfil the research objectives. Thus, five research questions are illustrated as follows:

- RQ₁** What are the effect of GST sanctions on the GST compliance by Malaysian SMEs?
- RQ₂** What are the effect of GST fairness on the GST compliance by Malaysian SMEs?
- RQ₃** What are the effect of GST complexity on the GST compliance by Malaysian SMEs?
- RQ₄** What are the effect of mental accounting on the GST compliance by Malaysian SMEs?

RQ₅ What are the effect of personal norms on the GST compliance by Malaysian SMEs?

1.8 SIGNIFICANCE OF THE STUDY

This study has several implications for research. First, there is scarce research analysing compliance by the small business sectors or SMEs. As of now, most studies pursue the income tax compliance by individual taxpayers rather than SMEs. Besides, most studies describe the tax compliance issues in general rather than specifying to VAT/GST. To note, small businesses specifically can be the potential tax evader due to its limited capabilities and possible mistakes (Kirchler et al., 2012). Therefore, this study fulfils the current calls for studying the factors influencing GST compliance from SMEs. For this reason, it can provide new insights and guidance for government mainly to enforce effective tax compliance tools.

Second, in the view of the researcher, it is the right time to study the challenges or difficulties faced by the businesses to comply with GST even after one year of implementation. To the best knowledge of the researcher, Malaysia is a little behind in implementing GST as compared to other 160 countries. Still, it does not prevent researcher from analysing the GST scope in Malaysia as the plan for GST has been discussed since Budget 2005. Indeed, GST is not a new tax mechanism as it replaces sales and services tax. For this reason, it reflects the Malaysia readiness for the GST and the needs for GST to increase revenues. However, the current situation of oil price and the fall of Ringgit Malaysia can be a challenge to the businesses in upholding responsibility to comply GST besides striving for business survival.

Third, the influence of mental accounting on GST compliance was found by Adam and Webley (2001), Woodward and Tan (2015) as well as Webley et al. (2002)

in their studies although in small evidence and relatively new. It is believed that high mental accounting can encourage voluntary compliance (Duggan, 2016). Thus, by using this mental accounting as one of the independent variables, it can extend prior authors' discoveries on the new branch of psychological factor towards GST compliance accompanied with other compliance factors.

1.9 ORGANISATION OF THE DISSERTATION

The study is organised as follows:

Chapter One is the introduction of the thesis which highlights the background, research problem, motivation of the study, scope of the study, objectives and research questions as well as the significance of the study.

Chapter Two describes SMEs in Malaysia. This chapter provides an overview regarding Malaysian Small and Medium Enterprises (SMEs). This chapter discusses on its definitions, characteristics and contributions to the Malaysian economy.

Chapter Three depicts Literature Review on GST. This chapter provides a general review on prior studies regarding the GST in general, countries implementing GST, merits and demerits of GST, factors influencing GST and literature gap for this study.

Chapter Four highlights the Theoretical Framework and Hypotheses Development. This chapter illustrates economic deterrence theory and psychological theory of tax compliance with five independent variables to be tested; GST sanctions, GST fairness, GST complexity, mental accounting and social norms. The relationship of independent and dependent variables is drafted.

Chapter Five illustrates Research Methodology. This chapter involves a discussion of the research design used in the study. It explains the methodology applied in the study which includes population and sample size and selection of the study, development of questionnaires, data collection process and location. Data analysis explanations such as descriptive statistics, correlation and multi-regression concluded this section.

Chapter Six summarizes Findings and Discussions. In this chapter, the findings are analysed and discussed whether the results support the hypotheses or otherwise.

Chapter Seven provides a Conclusion. This chapter concludes the overall study. It provides a brief summary of the results and findings. It also illustrates the limitations of the study, implications of the study and suggestions for future research.

1.10 CHAPTER SUMMARY

This chapter briefly highlights the current GST compliance issues and problems by outlining the background of the study, motivation of the study, problem statement, objectives of the study, research questions, significance of the study, and followed by the organisation of the study. Next section will describe the scope of SMEs in Malaysia.

CHAPTER TWO

SMALL AND MEDIUM ENTERPRISES (SME) IN MALAYSIA

2.1 INTRODUCTION

This chapter is designed to provide an overview of the Malaysian SMEs in terms of its definition, common term use in previous studies, contributions of SMEs and examples of government assistance on GST towards SMEs in Malaysia.

2.2 THE DEFINITION OF SME

The definition of small and medium business may differ based on the benchmark sets by agencies. Gibson and Vaart (2008) highlighted the debate on faulty definitions of SMEs due to inconsistencies among official SME definitions, the use of number of employees rather than general business turnover and various SMEs definition by countries in various stages of developed and developing economies. These definitions can possibly distort the potential role of SMEs to the economy if wrongly classified. As for Malaysia, small and medium business is measured by number of employees and annual turnovers for both old and new definition of SMEs (NSDC, 2005; NSDC, 2013).

Table 2.1
Definition of SME (NSDC, 2013)

Size/Sector	NSDC (2005)			NSDC (2013)	
	Primary Agriculture	Manufacturing	Services and other Sectors)	Manufacturing	Services and other Sectors)
Micro	Sales turnover less than RM200,000 OR full-time employees less than 5	Sales turnover of less than RM250,000 OR full-time employees less than 5	Sales turnover less than RM200,000 OR full-time employees less than 5	Sales turnover of less than RM300,000 OR full-time employees less than 5	
Small	Sales turnover from RM200,000 to less than RM1 million OR full-time employees from 5 to less than 19	Sales turnover from RM250,000 to less than RM10 million OR full-time employees from 5 to less than 50	Sales turnover from RM200,000 to less than RM1 million OR full-time employees from 5 to less than 19	Sales turnover from RM300,000 to less than RM15 million OR full-time employees from 5 to less than 75	Sales turnover from RM300,000 to less than RM3 million OR full-time employees from 5 to less than 30
Medium	Sales turnover from RM1 million to not exceeding RM5 million OR full-time employees from 20 to not exceeding 50	Sales turnover from RM10 million to not exceeding RM25 million OR full-time employees from 51 to not exceeding 150	Sales turnover from RM1 million to not exceeding RM5 million OR full-time employees from 20 to not exceeding 50	Sales turnover from RM15 million to not exceeding RM50 million OR full-time employees from 75 to not exceeding 200	Sales turnover from RM3 million to not exceeding RM20 million OR full-time employees from 30 to not exceeding 75

The above Table 2.1 summarizes the definition of SMEs in Malaysia based on Circular made in the year 2005 and 2013 and three categories of SMEs such as micro, small and medium enterprise are defined based on different turnover and number of employees. Based on the circular provided by NSDC (2005), SMEs are differentiated based on three sectors which are primary Agriculture, combined manufacturing (including agro-based) with Manufacturing-Related Services (MRS) and services (including Information and Communications Technology). In latest amendment by