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Outsourcing Malaysia Federal Tax Audit: The Stakeholders' Views

(Penyumberan Luar Audit Cukai di Malaysia: Pandangan Pemegang Taruhan)

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ABSTRACT

This study investigates the feasibility of outsourcing tax audit work in Malaysian tax system to enhance administration efficiency, to curb tax evasion and abusive avoidance, and to improve revenue collection without introducing a new tax. The current tax audit, carried out by internal auditors of Inland Revenue Board of Malaysia, could only be performed on a small numbers of taxpayers due to high administrative cost in terms of audit cost and cost to employ and train more audit personnel. Nevertheless, without tax audit, tax non-compliance activity could not be curbed and government would be at high risk of losing its revenue. One of the possible ways to increase audit work is through strategic outsourcing. However, decision to outsource tax work should be critically examined because outsourcing of tax audit is a policy that could potentially affect every taxpayer. This paper discusses the views of the stakeholders (tax authorities, the taxpayers and tax agents) on the value of tax audit outsourcing. Using a mixed method approach, this study finds contradicting opinions on the idea of implementing external tax audit in Malaysia. While the tax authorities are hesitant to the idea, the companies as tax payers and the tax agents show favorable responds to the implementation of outsourced tax audit in Malaysia.

Keywords: Outsourcing; income tax; tax audit; tax compliance; Malaysia

ABSTRAK

Kajian ini mengkaji kesesuaian penggunaan penyumberan luar audit cukai dalam sistem percukaian di Malaysia untuk meningkatkan kecekapan pentadbiran, menyekat pengelakan dan pelarian cukai serta meningkat pendapatan tanpa perlu memperkenal cukai baru. Audit cukai semasa yang dijalankan oleh juruadit dalaman Lembaga Hasil Dalam Negeri Malaysia hanya boleh dilaksanakan ke atas sebilangan kecil pembayar cukai disebabkan kos pentadbiran yang tinggi merangkumi kos menjalankan audit dan kos menggaji dan melatih juruaudit baru. Walau bagaimanpun, tanpa audit cukai, aktiviti ketidakpatuhan cukai tidak akan dapat dibendung dan pihak kerajaan akan menanggung risiko kehilangan pendapatan yang tinggi. Salah satu cara untuk menambah bilangan audit adalah melalui penyumberan luar strategik. Namun, keputusan untuk memperkenalkan penyumberan luar audit cukai perlu diteliti kerana ia merupakan satu polisi yang boleh memberikan kesan kepada semua pembayar cukai. Artikel ini menggarap pandangan pemegang taruhan (pentadbir cukai, pembayar cukai dan agen cukai) terhadap nilai penyumberan luar audit cukai. Dengan menggunakan gabungan kaedah penyelidikan, kajian ini mendapati terdapat pendapat yang berbeza terhadap ide melaksanakan penyumberan luar audit cukai di Malaysia. Walaupun pentadbir cukai didapati kurang menyokong idea ini, syarikat sebagai pembayar cukai serta agen cukai didapati memberi respon yang positif terhadap pelaksanaan penyumberan luar audit cukai di Malaysia.

Kata kunci: Penyumberan luar; cukai pendapatan; audit cukai; pematuhan cukai; Malaysia

INTRODUCTION

Malaysia's income heavily depends on the tax revenue in sustaining the economic stability and development. Annual Report of the Inland Revenue Board of Malaysia (IRBM) shows that the tax revenue is the main source to the Malaysia income especially contributed by the collection of direct taxes. In 2010 alone, the revenue generated from direct taxes was RM86.50 billion. This figure was 53.35 percent of the total federal government revenue (Inland Revenue Board Malaysia 2010). From the total amounts of the direct taxes, the main contributor comes from corporate taxes with 50.64 percent from the total direct taxes. This percentage shows the importance of corporate taxes in contributing to the Malaysia's tax revenue.

In order to maintain this performance, tax audit becomes a core activity of IRBM to enhance voluntary compliance among taxpayers. IRBM is trying to enhance tax compliance through tax audit so that taxpayers either individuals or corporate will not escape from paying their taxes. The main objective of tax audit is to encourage taxpayers to voluntarily report the true tax liabilities in accordance to the tax laws. It is also an approach to educate and expose taxpayers towards their responsibilities and obligations as stated in Income Tax Act 1967.

Although tax audit has become one of the main objectives of IRBM, IRBM's Annual Report 2010 shows that some of the selected audit cases could not be resolved. For example, in 2009, out of the 13,619 cases being selected for audit, only 7,942 cases were resolved; while in 2010, from 15,813 cases audited only 8,119 were resolved. This statistic suggests that the current practice of tax audit is not sufficient to solve audit cases and tax administration problems. In addition, the problem on tax audit becomes more severe after the self-assessment system was introduced in 2001 for corporate tax because of the lack of competent tax audit officers. Thus, the aim to audit all taxpayers will not be achieved and the tax revenue collection for the country will be negatively affected (Pertubuhan Berita Nasional Malaysia 2006). Introducing a new tax should be the last alternative as a new tax is associated with a loss of individual freedom to dispose of one's own money the way one wishes (Williamson & Wearing 1996), thus would create resistance from the citizen and consequently would affect the popularity of that particular government (Kirchler 1997).

However, IRBM has to bear a high administration cost if it intends to audit all taxpayers. (Kamdar 1997). One of the possible ways to increase tax audit work is through strategic outsourcing. However, decision to outsource tax work should be critically examined because outsourcing of tax audit is a policy that could potentially affect every taxpayer, therefore many factors should be considered. As stated by Cross (1995), good outsourcing decisions can result in lower costs and increased competitive advantage, whereas poorly made outsourcing decisions can lead to a variety of problems such as increased costs, disrupted service and even organization failure. Previous research has acknowledged the effectiveness of tax audit outsourcing by providing evidence on higher tax compliance in countries where outsourcing is mandated (Lin 2000; Sen & Bala 2002).

This paper discusses the possibility of outsourcing the tax audit works from the views of its stakeholders namely tax authority, taxpayers and tax agents. The rest of the paper is organized in the following manner. The next section discusses the literature review on the outsourcing of tax works as practice by many countries including Malaysia. The literature review continues in the second section focusing on the tax audit outsourcing practices in other countries. The third section discusses the possibility of outsourcing tax audit in Malaysia based on interviews with tax authorities in Malaysia and surveys on companies and tax agents. Finally, the conclusion and limitation of this study are presented.

TAX SYSTEM IN MALAYSIA

Tax system in Malaysia follows a rather standard tax regime that is also practiced in most of its counterpart nations in the Asian region. Currently, taxes are levied to individuals and corporations in the forms of tax on occupational income, business income and investment income. Income tax in Malaysia is imposed only on income that is generated from Malaysian source except for banking, shipping, air transport and insurance industries where the global income rule is applied.

The country has implemented current year assessment since 2000 followed by self-assessment system in 2001. Under current year assessment, income earned during the basis period is taxed in that particular basis year. Thus, income received by the taxpayers is an after-tax income. However, due to multiple incomes received, different regulation applied to a particular income, and reliefs and rebates available, taxpayers are required to submit the final tax computations and pay the remaining tax liabilities after deducting the amount of tax paid earlier. This process by which taxpayers are required by law to determine the taxable income, calculate the tax liability and submit their tax returns based on tax laws, policies and guidelines issued by IRBM is known as a self-assessment system.

The IRBM has been given the authority to administer and regulate the laws, as passed by Parliament to ensure that they are carried into effect and to make the tax system works. The main purpose of its existence is to secure and collect revenue incomes for the government. In achieving this purpose, IRBM has engaged in many activities in promoting high level of tax compliance in Malaysia such as continuous tax education programs designed to provide exposure and awareness on taxation laws to IRBM's clients and future taxpayers. Besides educating the taxpayers, IRBM provides a forum to inform and update clients on their rights and responsibilities as taxpayers in order to increase the rate of voluntary tax compliance (IRBM 2010). Implementing an effective tax audit program serves as a key factor in ensuring that the level of tax compliance continues to improve and that taxpayers comply with the provisions of applicable tax laws and regulations, particularly within the environment of a self-assessment system.

Tax audit is the audit of a taxpayer's accounting and other documentary evidences for the preparation of current tax returns. Tax audit in Malaysia is performed by internal tax auditors of the IRBM. Since companies in Malaysia are required to be audited by independent auditors under the Companies Act 1965, tax audit has become an extension of the "attest function" of the historical financial audit. In fact, only if the records and accounts produced by the taxpayer are insufficient or inadequate for the purpose of ascertaining his income, the Director General of IRBM may require that the taxpayer produces accounts audited by a professional accountant together with a report made by the accountant as stipulated in of the Companies Act 1965.

According to Tax Audit Framework of IRBM (2007), tax audit is defined as an examination of a taxpayer's business records and financial affairs to ascertain that the amount of tax due are reported and paid in accordance with tax laws and regulations. The main objective of the tax audit as stated in the framework is to encourage voluntary compliance with the tax laws and regulations and to ensure that a higher tax compliance rate is achieved under the self-assessment system. It is also one of the measures undertaken by IRBM to educate and create awareness of taxpayers towards their rights and responsibilities under the provisions of the Income Tax Act 1967.

However, the current tax audit could only be performed on a small numbers of taxpayers. Administrative cost in terms of audit cost and cost to employ and train more audit personnel have increased significantly since the adoption of self-assessment system. Nevertheless, without tax audit, tax non-compliance activity could not be curbed and government would be at a high risk of losing its revenue.

OUTSOURCING OF TAX WORKS

Outsourcing is referred to as a service requiring a contract with external party (Sanders et al. 2007) to provide products or services that could also be provided internally (Carey et al. 2006) and that it can give mutual benefits to the organization and the outsourced company (Juma'h et al. 1999). Similarly, Lee (2001) defines outsourcing as the process of turning over part or all of organization's functions to external service provider(s).

Outsourcing allows organizations to grow without investing in fixed assets, whether equipment, plants or personnel. By contracting the outside service providers especially on the activities viewed as secondary to their core business, organizations may simultaneously reduce their costs and at the same time maintain, or even improve, the quality of their outputs. However, outsourcing activity is also accompanied by a number of risks as well especially when it is the core function that is being outsourced (Selim & Yiannakas 2004; Peursem & Jiang 2008). Poor outsourcing practices can lead to an unintended loss of operational-level knowledge and thus, create dependence on the contractor. The outsourced contractor will have access to company assets and this would be a concern particularly if the company's information is confidential (Power, Bonifazi & Desouza 2004).

Outsourcing of tax work is not new especially amongst CPAs in United States. The tax activity commonly outsourced is the preparation of tax returns for companies or individual tax payers. CPA firms note that outsourcing the tax return preparation offers several potential benefits to their companies. It frees tax professionals' time from performing perfunctory duties such as form filing and data entry. The time saved can be used more productively on tax and estate planning. Tax outsourcing also lessens the need for temporary professional staff during the peak season as recruiting new accounting staff is increasingly competitive. Furthermore, outsourcing tax-preparation services especially to overseas can also improve service by speeding the delivery of completed returns. The use of web-based system would significantly reduce the volume of stored paper files.

In the US, the collection of tax is also outsourced in certain states. After a comprehensive review of the previous practices, in 2004, the US government through specific legislation allows its IRS to use private debt collection companies and private law firms to collect delinquent taxes (Resnick 2005). Despite there are many who strongly opposed the legislation, the Bush administration has strongly supported the implementation of a permanent program for the collection of tax debts. According to Resnick (2005), the collection of revenue by private debt collectors exist in the early history of the US. These collectors were a class of agents authorized in 1798 and they received a percentage of the money collected. In 1873, the activity was discontinued when investigation by Congress found that such contracts were improper. However, the issue reappeared when the federal government loses millions of dollars of potential revenue as a result of its failure to collect delinquent taxes each year. The IRB's inability to enforce debt collection does not only result in the lost revenue from the due debts but also increases lost revenue from future tax collection. Voluntary compliance is undermined when taxpayers believe that they can get away with not paying their taxes.

Earlier in 1995, the US Congress approved a pilot program to test the use of private law firms and debt collection agencies to help collect delinquent tax debts. This pilot program however fail to reap any financial benefits for the IRS, and the IRS cited lost-opportunity costs of about $17 million because it had to move collection personnel off line to work on the pilot (Resnick 2005). The failure was attributed to many reasons mainly the IRS's legal interpretation, difficulty in identifying, selecting and transmit cases to the contractors, and lack of performance measures in transferring techniques and practices employed by private collectors to IRS's own collection practices.

A similar approach is also employed in the collection of indirect taxes. Under the Uniform Sales and Use Tax Administration Act of the US, engaging an agent known as a certified service provider (CSP) to collect tax is also possible in many states. The collection of indirect taxes in the regulating states such as Nebraska is outsourced to CSP. A CSP is an agent of a seller with whom the CSP has contracted for the collection and remittance of sales and use taxes (Moore 2003).

Another outsourcing activity of tax work is the tax audit. Country such as Taiwan has outsourced successfully the tax audit function to independent public accountants (Lin 2000). This external tax audit is performed on selected companies based on their sizes. Other countries such as the US (Cameron et al. 2004), Pakistan (Sidiki 2010) and India (Sen & Bala 2002) have also implemented external tax audit but the outsourced functions are tailored to the countries' needs and methods.

In an effort to increase efficiency in data management and document processing, the IRB of Malaysia also engages in outsourcing activity. When Malaysia introduced the self-assessment system in 2001 and started to use e-filling system, there was a period of transition that allows the taxpayers to submit their tax forms manually if they are not capable to use internet filing. The work of uploading the manual data into the system through a process known as imaging and data capture are outsourced to a private company. The hand writing, typed or printed web forms are converted into electronic form that will be used for intelligent data capture that includes proofing and verification stages, resulting in a high level of accuracy in the data capture and conversion process. The IRBM also outsources some of its IT projects due to lack of certain in-house expertise and cost effectiveness. Some of the outsourced tasks are operations and infrastructure, communications and a few applications development. In order to ensure the project success, selected IRBM officers are attached to the outsourced project to enable effective and timely deliverables, efficient project monitoring, knowledge sharing and securing the confidentiality of internal information (IRBM 2011).

TAX AUDIT OUTSOURCING

THE RELATIONSHIP BETWEEN TAX AUDIT AND COMPLIANCE

Past studies suggest that the possibility of being audited by tax authorities is a significant factor determining the level of a firm's compliance (Rice & Slemrod 1992; Kamdar 1997). The group of companies under the tight control of law such as banks and financial institutions has a higher compliance rate compared to companies that are not controlled by laws since these companies are always monitored and audited by the authorities. Accordingly, Rice and Slemrod (1992) conclude that the decision regarding company's taxes that need to be reported to tax authorities was made based on the tax liabilities, penalties for possibilities being traced due to under-reporting income, and probabilities of being audit.

By using cross sectional data from 1977 to 1985, Dubin and Wilde (1990) support that tax rate and audit rate have significant deterrence effects on noncompliance. According to Beck et al. (1991) tax compliance improve when penalty rate and probability audited increase, but no tax rate effect on tax compliance. Kamdar (1997) in his study using time series analysis finds that tax audit rate has a positive and significant relation with tax compliance. By studying the effect of tax schemes on reported income, Collins and Plumlee (1991) discover that tax audit can reduce underreported income notwithstanding the schemes used. The findings from other researchers such as Alm et al. (1992) also reveal that taxpayers will report high taxable income with aggressive tax audit and penalty. A more recent study by Hoopes, Mescall and Pittman (2012) provides more evident that corporate tax avoidance decreases with stricter tax administrator monitoring. Their study shows that with an increase probability of being audited, the firms' effective tax rates increase. This suggests that US public firms undertake less aggressive tax positions when tax enforcement is stricter. Similarly, an increase in enforcement activities by the tax administrator is also associated with an improvement in financial reporting quality evidence from a better mapping of accruals to cash flow (Hanlon, Hoopes & Shroff 2012).

In practical, it is difficult for tax authorities to capture a complete and accurate assessment of what is owed. The goal of the revenue agent is to look beyond the superficial appearance as presented in the tax forms and the supporting documentation. Since financial records can be forged and manipulated, so the revenue agent must adopt a skeptical stance by performing audit on the firms (Pentland & Carlile 1996). From the government perspective, tax audit plays an important role in safe guarding what to be the government revenue to finance its activities. As citizens, we are obliged to provide financial support for the activities of our government through tax payment. As pointed by Clotfelter (1983), tax non-compliance not only create losses to government revenue but also depicts the ignorant attitude of citizens toward their responsibilities and worst of all it signifies a threat to voluntary compliance.

The need for tax audit lies on the fact that the tax payers and the tax authority have different and conflicting financial interest on the relevant information in the income tax return. Manipulation or misstatement of information in the tax return may reduce tax liability to the preparer but consequently may also reduce revenue to the tax authority. Frequent tax audits can improve companies' fair and exemplary taxation habits but also violate tax payers' rights and further increase administration's financial burden. Moreover, frequent tax audits are accompanied by growing demand in budget and human resources. Therefore, tax audit could only be performed on a small numbers of taxpayers. In 2005, only 1.84 percent of Korean companies received a corporate tax audit, a figure that was 0.81 percent higher than the United States but much lower than Japan's 4.94 percent during the same period (Hyeon-ji 2007). In Malaysia, there were 2.9 percent of companies that were audited and resolved in 2009 and 2010.

TAX AUDIT OUTSOURCING IN OTHER COUNTRIES

In Taiwan, financial information of medium and big companies together with its related tax form must be tax-audited (Lin 2000). The outsourcing of tax audit work to independent CPA is an effort to reduce the workload of the tax authorities in Taiwan, and to assist firms in meeting their tax obligation. Article 102 of Taiwan's Income Tax Law prescribes that a firm may entrust a certified public accountant to prepare, attest and file its business income returns. In preparing an attested tax return, the entrusted CPA is responsible for checking the firm's accounting records and related documentary evidence, adjusting the accounting income to taxable income based on the tax law, and attaching a signed 'tax return attestation report' to the tax return.

As an encouragement, for those firms whose tax returns are attested by a CPA, the law provides various tax incentives including additional deductibility of entertainment expenses, the carry forward of net losses, and an extension of filing dateline. While there are certain specific firms that are required by the tax law to use CPA attested tax returns, other firms can also elect to use CPA attested returns and thus enjoy those tax advantages made available as a means of encouraging tax attestation. Lin (2000) examines the results of the tax audit made by tax inspectors about the two kinds of returns declarations, tax and non-tax audited by certified accountant. Empirically, Lin (2000) demonstrates that Taiwan attested tax returns are more compliant with the tax law than non-attested tax returns, and therefore suggests that the tax authorities should continue to promote the use of attested tax returns by the certified public accountant. However, the attestation system is not widely employed by firms in Taiwan even though there are many incentives and tax advantages attached to that system. In 1994, CPA attested returns only accounted for 8.2% of all tax returns reported or a ratio of approximately 12:1 in favor of non-attested returns (Lin 2000). Lacks of enforcement such as no penalty exist for non-compliance to attestation requirement may contribute to the low compliance activities.

Similarly, in the United States, states such as Florida and Texas currently have optional privatization of state sales tax audit programs that allow CPAs to compete directly for sales tax audit services (Cameron et al. 2004). This program allows businesses to hire certified auditors to audit their sales tax compliance in lieu of subjection to an audit by the state and transfer the actual delivery of services from governmental units to the private sector. The sales tax function is traditionally performed by auditors employed by the state government with audits conducted under internal rules prescribed by the state. By outsourcing this function, accountants are allowed to compete in the market place for the opportunities to provide the audit service.

Some countries such as Pakistan, India and Bangladesh, the government engages CPAs to carry out tax audit on a certain taxpayers identified by the tax administrators. The Federal Board of Revenue Pakistan has decided to hold audit of taxpayer companies through external auditors or chartered accountant firms in 2010 (Sidiki 2010). In India, tax audit was introduced with effect from 1 April 1984 for every person carrying on business or profession having total sales, turnover or gross receipts exceeding the specified limit. The maximum period of audit is four months and should be articulated by means of prescribed form for audit report and related statements (Sen & Bala 2002). Likewise, Sen and Bala (2002) propose that Bangladesh, which has a low taxes to GDP ratio that indicates lack of ability to tap resources from a growing economy, to exercise the practice of tax audit as prescribed under section 35(3) and section 82 of the Income Tax Ordinance.

In general practices, outsourcing the tax audit does not eliminate the need for tax audit by the tax authorities. However, the tax audit performed by an independent CPA is believed to enhance the reliability of the information submitted to the tax authority in measuring tax obligation of the companies. The tax authorities at their discretion may perform counter-audit on the attested return if they have any reason to do so or just as the normal routine audit procedure by random selection.

Even though company in Malaysia is allowed to engage a tax agent to help in its tax matters, the role of tax agent as prescribed by ITA 1967 is only to help the taxpayers in preparing their income tax returns based on the information given by the taxpayers. It does not serve the purpose of expressing an opinion as to the fairness of the accounts examined by the auditor, or to certify the financial statements for the tax purposes. Therefore, no opinion about the degree of correspondence between the information contained in the tax return and the regulatory provisions of tax laws is provided.

METHODOLOGY

This study is carried out to find out stakeholders' views on the possibility of outsourcing tax audit in Malaysia. This study adopts a concurrent mixed method design approach. In providing a comprehensive analysis based on multiple viewpoints, the application of mixed methodologies is appropriate. Furthermore, this study has many distinct target groups of respondents; companies, tax agents and tax administrators from IRBM. Two methods are performed in the collection of data; in-depth interviews on tax administrators, and surveys on companies and tax agents.

The respondents for the in-depth interviews comprise the top management team from IRBM selected based on purposive sampling technique. The respondents were selected because of their positions as directors or deputy director general of IRBM. A total of four respondents participated in the interviews. They were interviewed individually and each interview lasted for about 40 minutes to an hour. The interviews were transcribed verbatim and analyzed using NVivo 7 software.

The sample for the survey consists of two groups of respondents; tax agents and companies. There were a total of 864 tax agents operating in Selangor and Federal Territory according to the IRBM website. Of this, a total of 265 tax agents were sampled for this study. For companies, samples selected were small and medium sized companies. A total of 285 companies were selected to participate in this study.

The multiple methods of collecting data will allow triangulation of data in the study that can yield a more meaningful basis of answering the research question and more compelling information to support the research conclusion and recommendation.

POSSIBILITY OF OUTSOURCING TAX AUDIT IN MALAYSIA

The study is premised on outsourcing literature since it involves an outsourcing arrangement whereby a third party is introduced to the relationship between taxpayers and the tax authority. Engaging external party other than the tax authority to perform the federal tax audit work also falls under the concept of outsourcing since it involves a third party external to the organization. Various factors including benefits and risks of outsourcing need to be considered before adopting this new service. This is important to ensure proper implementation of the new service.

The results of the study are discussed in two separate topics based on the similar data collected; interview on tax administrators' views and surveys on companies' and tax agents' views.

TAX ADMINISTRATORS' VIEWS

We carried out interviews on four top executive positions in IRB of Malaysia. These executives are responsible in every decision made by their divisions and report directly to Director General of Inland Revenue of Malaysia. The interviews took a period of about one to one and a half hour at the executives' offices. In general, the results of the interviews are not inclined towards the idea of outsourcing the tax audit works. In the interviews, the arguments on risks associated with outsourcing activities overshadow the benefits that could be gained from this activity. The arguments against outsourcing are presented in three areas: statutory, economic and policy.

Statutory Arguments The tax authorities believe that the current companies' tax returns submitted to them are sufficient enough to present the fair view of the companies' tax position.

"…We believe our tax payers, so we need to minimize the proportion of companies being audited to gain public trust. If the tax payers willingly submitted their tax returns, we should not intervene because if we do, they will not trust us in the future"

(Respondent 1)

Currently, under section 174(1) and (2) of the Companies Act 1965, financial statements audit of companies is mandated for every company in Malaysia including the small and medium size businesses. In submitting their tax returns, most of the companies submit together the audited financial statements. According to the director, if the tax return is subjected to another external audit even though for different purposes, it will be redundant. Since most companies have their financial statements audited by the independent auditors, so the tax returns are also prepared based on the audited financial statements. The fact that the financial statements submitted to IRBM have been audited financially, thus cause redundancy is also commented by the other two directors.

However, there is no requirement to submit audited financial statements under the Income Tax Act 1965. Section 82(5) of the Act only requires companies to submit audited financial statements if the Director General of IRBM believes that the accounts or records produced by the tax payers are insufficient or inadequate for that purpose. Specifically, Section 82(5) prescribes as follows:

"Director General, if he is of the opinion that any accounts or records produced by any person to the Director General for the purpose of ascertaining the income of a person are insufficient or inadequate for that purpose, may by notice under his hand require that person to produce, in respect of any period or periods specified in the notice and within a time so specified (that time not being less than thirty days from the service of the notice), accounts audited by a professional accountant together with a report made by that accountant which shall contain, in so far as they are relevant, the matters set out in section 174(1) and (2) of the Companies Act 1965."

The interviews reveal that most of the companies either employ in-house tax experts or engage tax consultants, tax agents or tax advisors to prepare their tax returns. Under section 153(3) of the Act, tax agent means any professional accountant or person, approved by the Minister of Finance to act on behalf of any person for any of the purposes of the Act. However, the role of these tax agents is only to help the taxpayers in preparation of submission of tax returns. If any act of non-compliance is detected during audit, the taxpayer is liable since the agent only prepares the tax returns based on the information given by the taxpayer.

Economic Arguments Corbett (2004) identifies that cost saving is the main reason an organization chooses whether to use outsourcing service for its activity. For example, tax authorities in USA appoint private tax collection agency service to collect tax return on behalf of government in order to overcome high collection costs after the government suffers lost from that activity (Braunchli 2008). Meanwhile, expertise, experience, and qualification offered by external auditor encourage most organization to use external auditor to operate their internal audit in public firms (Carey et al. 2006).

However, in the government organization such as the IRBM, the revenue collected is not for the limited shareholders such as in the public firms. Therefore, one of the concerns of the tax authority is the role of the external tax auditors. Whose interest will they protect; taxpayers or the government? Since IRBM has the responsibility to assess and collect revenue to finance the government expenditure, every single cent of tax raised belongs to the government. If the external auditor is an audit firm, a profit making organization, then its interest is questionable as pointed by one of the director;

"…if you outsource (the tax audit), this outsource company will have to be a government linked company (GLC). Not to the profit making company. I don't think so, because the ultimate aim (of IRBM) is to get money for the country, for the government. GLC may be. Company under ROC (Registrar of Company), I don't think because their aim is always profit motive."

(Respondent 4)

Another director commented on the same issue, "*Breach of trust is also present in audit. That means, there is no guarantee… When public pays for the service, of course they want some tax saving.*" The concern over the issue of safeguarding the national income is raised quite many times by these directors. Their concerns might be justifiable since a few research reveal that auditors become more lenient towards the client's preferred accounting method when they report a high level of motivation to avoid conflict with client (Koch, Weber & Wustemann 2009).

The cost of audit is also one of the economic concerns raised in the interviews. If the external tax audit is implemented, who will bear the cost? According to the directors interviewed, the IRBM unquestionably will not bear the cost. Among the pledges of the IRBM directors are to collect the amount of taxes due according to the laws of the country and to instil public trust in the fairness and excellence of the tax administration. One of the directors argued;

"…we (IRBM) are not going to pay because we already raise the amount of tax. In our pledge, we are going to collect not one cent more or not one cent less. So, if we are going to outsource (the tax audit), who is going to bear the cost?"

(Respondent 1)

The cost of external audit should not be an extra burden to the taxpayers since the taxpayers have suffered multiple cost of compliance under the self-assessment regime. The costs include the cost incurred by individuals in acquiring sufficient knowledge to meet their legal obligations, the cost of compiling the necessary receipts and other records and of completing tax returns; payment to professional tax advisers and return preparers; and incidental coats of postage, telephone, and travel in order to communicate with advisors or tax authorities (Turner, Smith & Gurd 1998).

The extensive use of tax preparers should not be taken lightly. Previous studies on relationship between tax preparers and clients show that in general professionally prepared tax returns have lower tax liabilities than individually prepared returns (Christian, Gupta & Lin 1997; Stephenson 2007) and some evidence suggests that the lower tax liability is associated with increased non-compliance or aggressive tax planning.

Another economic consideration concerns public jobs. The outsourcing of tax audit would seem like replacing the government paid employees with private paid employees. Section 134, ITA 1967 prescribes that the care and management of the tax shall be on the Director General of Inland Revenue. The Director General may delegate certain functions but only to the public officers or employees of the IRBM (section 136, ITA 1967). Results of the interviews reveal that efforts are being made by IRBM to improve field-auditing skills of all auditors via training, with the hope that a higher coverage is more readily achieved with increase in auditors' level of competency.

Policy Arguments Is the outsourcing of the tax audit a sound public policy? Implementation of the external tax audit is a policy that could potentially affect many taxpayers, therefore factors other than statutory and economic advantages should also be considered. One of the concerns is the privacy and security risk of revealing confidential client information to the third parties. This risk of outsourcing has been discussed by many researchers especially when the core competencies of the firms are outsourced (Selim & Yiannakas 2000; Peursem & Jiang 2008; Power, Bonifazi & Desouza 2004). Once sensitive taxpayer information leaves the confines of the IRBM, there is no guarantee that taxpayer security will not be violated. Taxpayers may not want their information to be sent to a third party, whose work is not directly supervised by IRBM. The confidentiality of material is stated under section 138(1) of the Act as follows:

"Subject to this section, every classified person shall regard and deal with classified material as confidential; and, if he is an official, he shall make and subscribe before the prescribed authority a declaration in the prescribed form that he will do so."

Any return or other document made for the purposes of this Act and relating to the income of the taxpayer, and any information or other matter or thing which comes to the notice of IRBM shall be regarded and dealt as confidential material. The officer who deals with the material has to make a declaration in a prescribed form and subscribe before the prescribed authority that he will regard the material as confidential. If he communicates the material to another person or allows another person to have access to the material, under the law, he shall be guilty of an offence and shall, on conviction, be liable to a fine or imprisonment or both [section 117(1)].

This section of the Act, however, does not prevent any tax agent from handling the tax matters of the taxpayers. The classified person as stated in section 138(1) is further clarified in section 138(5)(c) as 'any person advising or acting for a person who is or may be chargeable to tax, and any employee of a person so acting or advising if he is an employee who in his capacity as such has access to classified material.' In the Tax Agent's Code of Conduct, this section is also acknowledged. Only one clear difference is that the tax agent is normally appointed by the taxpayer himself whilst the external tax auditor most possibly is appointed by the IRBM.

However, operating in a capitalistic society and ultimately profit motivated, statutory protections regulating the outsourcing activity does not guarantee that external auditor will not engage in inappropriate behavior during audit. One of the executive has raised this issue, "…*if the outside auditors run after taxpayers after this,* *who is going to bear the cost between them or between companies*?" Since the external auditor is an independent entity, the control mechanism would become the issue especially on the standardized audit procedures and the integrity of the tax agents. Concern over the control of audit procedures including the varying interpretation of laws and regulation is voiced out by all four executives. The integrity of the tax agents to provide fair treatment to taxpayers is considered as one of the main issues on disagreement to outsource the tax audit function. As evidence in the case of the United States, no amount of deterrents provided by the laws and policy will dissuade all private debt collectors from engaging in taxpayer abuse (Resnick 2005). Besides that, collaboration between the taxpayers with intention to evade tax and the aggressive tax agents would increase the level of tax non-compliance (Murphy 2004). Similarly, a study by Devos (2012) reveals the evidence that tax agents still have a significant influence upon taxpayers' compliance behavior when more than 50 percent of them would retain the services of a tax agent who adopts an aggressive tax position.

TAXPAYERS' AND TAX AGENTS' VIEWS

In total, 75 of 265 tax agents (28.30%) and 30 of 285 companies (10.5%) returned the questionnaires. The small rate is reasonable and comparable to the other taxation research in Malaysia using companies as respondents (Slemrod & Venkatesh 2002; Hijattulah & Pope 2008). The views from respondents are taken on the feasibility to implement tax audit outsourcing, the mechanism on the implementation and the risk and benefits associated with the implementation. Their perceptions on the subjects are based on a 5-point Likert scale.

The results are discussed separately under respondents' characteristics, opinion on tax audit outsourcing and results of regression analysis.

Respondents' Characteristics Majority of tax agents under study have operated for more than 10 years (44%), followed by the agents who are working with firms operated between 6 to 10 years (33.3%) and the rest who work with firms that are less than 5 years (22.7%). While, majority of tax agents have working experience exceeding 10 years (46.7 %), the rest have about 6 to 10 years (38.7%) and 1 to 5 years (14.6%). Additionally, 62.7 percent tax agents are working in small size firm with the number of personnel less than 10 persons and only 1.3 percent respondents are working with firms that have personnel more than 50 persons. At the same time, most tax agents who answer the questionnaires consist of those who are working in firms that have only one partner whether audit partner or tax partner (refer to Table 1).

TABLE 1. Tax agents' background

Item	Number (n = 75)	Percentage
Period of operation (year)		
1-5	17	22.7
6-10	25	33.3
>10	33	44.0
Working experience (year)		
1-5	11	14.6
6-10	29	38.7
>10	35	46.7
Number of employees		
≥ 10	47	62.7
10-20	20	26.7
20-50	7	9.3
>50	1	1.3
Number of audit partners		
0	23	30.7
1	38	50.7
2	11	14.7
3	2	2.7
>3	1	1.3
Number of tax partners		
0	27	36.0
1	30	40.0
2	15	20.0
3	2	2.7
>3	1	1.3

Most tax agents are affiliates to more than one professional bodies whereby Malaysian Institute of Accountants is the professional body that has highest number of members participated in this research (51 persons), followed by Chartered Taxation Institute of Malaysia (43 persons), Association of Certified Accountants (30 persons), Malaysian Association of Tax Accountants (19 persons), Malaysian Institute of Certified Public Accountants and Chartered Institute of Management Accountants (6 persons), Institute of Chartered Secretaries and Administrators (4 persons) and only one person has a membership in Certified Public Accountant of Australia. The tax agents' firms in this study offer various services such as tax field (96.0%), advisory service (61.3%), assurance (52.0%) and other services such as auditing, accounting, and secretarial work (18.6%).

For taxpayers group, 50 percent of the companies participated in this study are parent companies while 50 percent are subsidiaries to parent company listed on Bursa Malaysia. There are 21 of the companies (70.0%) that have annual sales exceeding RM10 million and 5 companies (16.7%) with sales value between RM1 million and RM10 million while the rests have sales less than RM1 million. Majority of the companies (70.0%) have paid-up capital exceeding RM10 million while 86.7 percent of them have between 51 and 150 employees. The number of companies with the experience of being tax audited by IRBM is lower (43.3%) than the SMEs which have never been audited (56.7%). There are also SMEs which not only have been imposed with desk and field audit but also with tax investigation included in the sample. The breakdown on industry for the vs participated in this study is as follows: 53.3 percent in manufacturing industry, 10.0 percent in agriculture industry, trade and communication, 6.7 percent in transport, construction and information technology, and only 3.3 percent in finance, information technology, oil and gas, real estate investment trust, retailing and stock exchange.

Opinion on Tax Audit Outsourcing Generally, both groups of respondents agree that the outsourcing of tax audit works can be implemented in Malaysia. Tax payers have a significantly (p = 0.000) lower level of agreement (means = 2.81) than tax agents (mean = 3.65) (refer to Table 2). Outsourcing of tax audit activity also is able to give benefit to the interested parties in term of job opportunity to accountant firms or tax agent to be competitive in the market to grab opportunity to provide audit services (Cameron et al. 2004). According to Lin (2000), implementation of tax audit outsourced has given benefit to taxpayers by helping them to fulfill their responsibilities. It can save their time and prevent pressure and problems when dealing with the tax authorities. Results of this study indicate that both groups of respondents believe that the implementation of external tax audit does not only benefit them but also present with some elements of risk. For tax agents, external tax audit would give new business opportunity, help them to develop skillful and competent tax auditor, allow knowledge transfer from IRBM and create conducive environment to develop tax experts in the country. On the other hand, the tax agents would face a higher probability of litigation raised by unsatisfied clients or by IRBM if they issue misleading tax reports as a result of being influenced by the clients. The litigation cases would tarnish the image of the agents.

TABLE 2. Agreement for tax audit outsourcing, benefits and risks

Item	Tax agents		Company	
	Mean	Std. dev.	Mean	Std. dev.
Agreement for tax audit outsourcing*	3.65	0.503	2.81	0.842
Benefits of outsourcing of tax audit	3.64	0.540	3.45	0.858
Risks of outsourcing of tax audit	3.53	0.752	3.78	0.697

Note: *Significant at 0.00

Engaging external auditor has benefited the taxpayers in the following areas. They perceive that it would increase their voluntary compliance, improve their tax knowledge, avoid future penalty by IRBM, and enable them to focus their resources for tax and business planning. However, they would face the risk of being re-audited by IRBM if external tax auditor fails to perform tax audit as required by IRBM, their information would be disclosed to unrelated third party, incur additional compliance cost and might be fined by IRBM due to incompetence tax auditor.

Both taxpayers and tax agents agree that outsourcing should be implemented when the IRBM has limited resources to perform tax audit, the number of companies has increased, IRBM has no longer works for the interest of taxpayers and the non-compliance and evasion has increased amongst companies' taxpayers. However, there are significant differences on the agreement between the two groups on three issues. Tax agents agree that outsourcing should be implemented when the number of companies being audited by IRBM is small (t = -2.050, p = 0.033) and tax audit that has been carried out by IRBM is not effective to curb non-compliance (t = 3.595, p = 0.000), while the companies' taxpayers disagree with the statements. Tax agents also believe that outsourcing should be implemented when the tax audit activities as performed by IRBM are not effective to curb the non-compliance behaviors of the tax payers (refer to Table 3).

TABLE 3. Reasons for outsourcing tax audit

Reasons	Tax agents		Company	
	Mean	Std. dev.	Mean	Std. dev.
IRBM has limited resources to implement tax audit	3.31	0.870	3.17	1.262
Increase of non-compliance amongst companies' taxpayers*	3.61	0.820	3.20	1.031
Increase in the number of companies' taxpayers	3.27	0.759	3.20	1.095
The number of companies have been audited is small*	3.28	0.781	2.90	1.029
Minimum cost of tax audit	3.13	0.741	2.97	1.377
Taxpayers believe that IRBM is not acted for their interest	3.39	0.733	3.53	1.167
Tax audit by IRBM is not effective to curb non-compliance*	3.07	0.890	2.37	0.928

Note: *Significant at 0.05

The taxpayers' disagreement to be audited by external auditor when only a small number of them being audited and the current audit work is ineffective indirectly prove that the intention of non-compliance may be alleviated by the increase in tax audit as taxpayers tend to report high taxable income when the probability of audit is also high (Pentland & Carlile 1996; Alm et al. 1992; Beck et al. 1991; Collins & Plumlee 1991). Both groups of respondents perceive that the implementation at the early stage should be based on voluntary basis and providing incentive would be helpful to increase acceptance of the external audit.

On the issue of cost of audit that are much discussed by the tax executives interviewed, taxpayers disagree with the outsourcing works if they have to incur the cost but would agree to bear the expense if it is accompanied with a tax deduction on the amount. They show a high level of agreement if the cost is borne by the tax authority. The tax agents tend to agree regardless of who bear the cost since they themselves would definitely not be burdened by the cost of audit. The different levels of agreements between both groups of respondents are significant (refer to Table 4).

TABLE 4. Who should bear the cost of tax audit

Item	Tax agents		Company	
	Mean	Std. dev.	Mean	Std. dev.
IRBM*	3.27	1.004	4.10	1.125
Taxpayers*	2.79	0.990	1.97	1.098
Taxpayers with tax deduction**	3.61	0.914	3.10	1.242

Note: *Significant at 0.00 and **significant at 0.05

Regression Analysis This study hypothesizes that benefits derived from tax audit outsourcing will give rise to a favorable opinion of the implementation of the external tax audit to be exercised in Malaysia. This study uses multiple regression to test the relationship between the favorable opinion on tax audit outsourcing with it effects. Prior to multiple regressions testing, the data on possibility of tax audit outsourcing, risks and benefits of outsourcing for both respondents were tested for reliability and suitability for multiple regressions test.

The results show that there is positive relationship between benefits of outsourcing and their favorable opinion of tax audit outsourcing for both respondents groups. The results suggest that the more benefits gained by the respondents, the favorable their opinion of tax audit outsourcing. In term of risk, the regression produced contrast result for both groups of respondents in which for tax agent, risks have positive and significant relationship with a feasibility of tax audit outsourcing; whilst for taxpayers, risk has an insignificant positive relationship with their opinion on tax audit outsourcing implementation (see Table 5).

TABLE 5. Results of multiple regressions

	Tax agents		Taxpayers	
Variables	B	Sig. P	β	Sig. p
Benefits (χ_1)	0.422	0.000*	0.814	0.000*
Risks (χ_2)	0.284	0.006*	0.037	0.744

Note: R^2 for tax agents = 0.550, R^2 for taxpayers = 0.812, and *significant at 0.05

From the results we can conclude that tax agents are willing to accept the implementation of tax audit outsourcing regardless of the benefits and risks of the arrangement. Similarly, taxpayers agree to accept the implementation of tax audit outsourcing because of the benefits that they could gain from the arrangements.

CONCLUSION

This paper discusses the possibility of outsourcing the federal tax audit works from the views of its stakeholders namely tax authority, taxpayers and tax agents in Malaysia. Tax audit outsourcing is considered as an alternative for IRBM to increase its tax collection and maintain its revenue without introducing or implementing new taxes. It might also reduce tax evasion and noncompliance by exercising more tax audit activities through engaging the external auditors.

In general, the opinion of the tax authorities does not favor the outsourcing of tax audit. The concerns are mostly on the securing of the national assets as well as protecting and securing the taxpayers' rights especially on the confidentiality of their information. The risks of the taxpayers being exploited by the external tax auditors also form part of the tax authorities' concerns. Moreover, all of the executives agree that tax audit activities should be used moderately and mainly to promote voluntary compliance and to increase trust on the tax office.

The finding from the questionnaire indicates that tax agents and taxpayers believe that it is feasible to outsource federal tax audit in Malaysia, recognizing the benefits that could be gained from it. For tax agents, they believe that while federal tax audit outsourcing has benefits and risks but they hold favorable opinion on its implementation in Malaysia. This is justifiable considering the new service would generate income to their practice. Meanwhile, for corporate taxpayers, federal tax audit outsourcing is acceptable given the benefits. Therefore, it can be concluded that the idea to implement the federal tax audit outsourcing cannot be simply rejected and should be opened for further discussion. Both the respondents groups in this study represent two major stakeholders in implementation of the tax audit outsourcing, and thus carry considerable weight in the decision on whether to implement the tax audit outsourcing. As such, identified benefits have becoming a consideration to most organizations to use outsourcing services.

This study provides an alternative strategy to the tax authority to secure government revenue through outsourcing of tax audit to independent auditors without having to invest in other assets or personnel. This approach is also expected to reduce the workload of the tax authorities and may assist firms in meeting their tax obligation.

This study however has its limitations. The low response rate particularly for the taxpayers group may prevent findings from this study to be generalized to the population of taxpayers in Malaysia. Another limitation is the lack of reference related to federal tax audit outsourcing resulting in the researchers unable to deeply understand the practice of federal tax audit outsourcing and rely on other literature such as outsourcing literature. Future research on feasibility of federal tax audit outsourcing implementation should be conducted incorporating the views of the tax authorities and corporate taxpayers from the large private companies or public listed companies to obtain more complete views on the matter.

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