International Journal of Advanced Science and Technology
Vol. 28, No. 8s, (2019), pp. 280-288

Is Tax Administration an Obstacle to Firm Performance?

*Nur Hayati Abd Rahman, Ahmad Fadhly Arham, Khairunnisa Abd Samad & Nur Hazwani Mohamad Roseli
Saiyidi Mat Roni

Faculty of Business and Management

Universiti Teknologi MARA

Melaka, Malaysia

School of Business and Law

Edith Cowan University

Australia

Abstract

The roles of firms in driving the economic growth cannot be neglected particularly via their contribution from taxation. However, their performance may be compromised if tax administration is complicated. Instead of boosting the economy, the impacts might turn out to be negative, which create multiplier reaction on the whole economic performance. This issue is relevant to be assessed since it helps the government to formulate better tax administration and public policies to ensure growth and sustainability in the private sector. Hence, this paper is meant to analyze how tax administration in Malaysia affects firm performance. By using responses from 938 firms generated from The World Bank's Enterprise Surveys, descriptive statistics, Spearman correlation and cross-tabulation analyses were conducted. It was found that tax administration does not adversely affect firm performance in Malaysia. Instead, firm performance could be impeded due to other major obstacles such as competitors, business licensing and permits as well as high tax rates. The data used in this paper encompassed to three different sizes of firms namely small, medium and large companies. It does not include micro-enterprises or any non-government organizations. For future research, the inclusion of these two types of firms might be needed. Besides, since tax rate is declared as among the main obstacles in conducting business in Malaysia, its role in affecting firms' performance can also be analyzed.

Keywords: *firm performance; tax administration; tax rate*

1. Introduction

The issues on firm's performance have been widely discussed by researchers around the world. Massive literatures on the antecedents of firm's performance were analyzed from various angles such as working capital management [13], total quality management practices [1], supply chain management [3], types of firm's ownership [15], human capital attributes [10] as well as technology and non-technological innovations [4]. However, literature on how tax administration affects firm's performance is still underdeveloped. This issue is essential since firms' performance is vital in ensuring the growth of an economy particularly from its productivity and efficiency's perspectives. Their full potential can be reaped with the supports from various institutions such as the government. As part of the public sector's initiatives to increase their revenues, taxation is one of the important elements that might affect the firm's performance. However, the recent change of taxation system in Malaysia may complicate the tax administration, hence may change the performance of the firm. For instance, the replacement of Sales and Services Tax (SST) to Goods and Services Tax (GST) by the Malaysia's government on 1st April 2015 leads to changes in tax collection and administration. Besides, the recent change of GST rate from 6% to 0% for all goods and services effective 1st June 2018 may also impact overall firm performance. All changes have to be addressed via change management practices to educate and cultivate new cultures among firms and households. Or else, the impacts might turned out to be negative, which create multiplier reaction on the whole economic performance.

Generally, tax administration consists of a complete process for firms to determine, document and make payments in meeting their tax obligations [8]. It also includes any post-filing procedures that need to be undertaken by the firms such as claiming the GST refund and undergoing tax audit. If the processes are burdensome, the tendency for tax non-compliance is increasing especially among small and medium enterprises (SMEs). One of the reasons might be due to the propensity for the firms to divert their financial resources into something more productive for their business activities rather than handling matters on tax administration. The complexity of tax policy perhaps can be associated with tax administration burden, which in turn lead to higher corruption and lesser investment among players in the private sector. This issue is relevant to be assessed since it reflects the quality of the Malaysian government operations in taxation. For that reason, this paper is meant to analyze how the tax administration in Malaysia affects firm performance. Specifically, it contributes toward answering the following research questions:

- Is tax administration considered as the main obstacle in conducting business in Malaysia?
- What are other main obstacles in conducting business in Malaysia?
- How tax administration correlate with firms' performance?
- To what extent is tax administration associated with different firm's size?

The findings can be used to help the fiscal policy makers to improve the firm performance and business environment based on the complexity of the Malaysia's tax system.

The rest of the paper is organized as follows. Section II describes the research methodology, followed by empirical studies in section III. Section IV presents and discusses the empirical results while the last section concludes.

2. LITERATURE REVIEW

Firm's performance can be measured by using various dimensions namely profitability, market value, growth, employee satisfaction, customer satisfaction, environmental performance and social performance [11]. With regards to the profitability dimension, few indicators can be utilized in measuring firm's profitability such as return on assets, earnings before tax, return on investment, sales revenue, return on equity as well as economic value added. The rest of this paper is using sales revenue as a measurement of firm's profitability and performance.

The role of firms as a catalyst to economic growth and development cannot be neglected. With the open economic policy, firms regardless of their sizes take advantage in gaining market shares by trying to embrace local and foreign customers via the medium of exports [16]. Given the advancement of technology, market penetration is almost seems to be easier relative to older years. Marketing and sales activities can be done at fingertips without incurring high costs. With the helps from established virtual networks such as Facebook and Instagram, most of the business activities can be done even by small businesses without them having a proper business setup. In previous years, the economy was driven mainly by the contribution of public sector together with medium and large businesses. However, the current scenario shows that small businesses are also performing very well, hence contributing to the national economic growth. With regards to the issue of firms performance, it has been widely discussed by previous literatures. Nevertheless, less attention is given on the major obstacles that might hinder their performance, especially related to tax administration.

In relation to tax administration, the International Monetary Fund (IMF) has developed Tax Administration Quality Index (TAPI) by using four main components of tax administration namely the supports available to access tax information, filing and payment, post-filing processes as well as accountability and transparency [8]. Basically, tax administration comprises of the ease by which the taxpayers obtain information from the tax administration, the number of declarations that need to be filed and paid, the time taken to receive tax refunds, the complexity of the tax audit program in detecting and deterring any inaccurate reporting, as well as the integrity and accountability of the tax administrators. All of these components involve high costs especially if the whole administrative processes are complex in nature. The costs cover the number of time spent in recording tax records, the costs of hiring auditors, accountants and lawyer, together with the costs of paying penalties or bribes to corrupted administrators. The larger the cost, the higher would be the non-compliance behavior among firms. Besides, complex tax administration processes would also reduce firm’s revenues due to the diversion of funds from improving productivity to paying tax administrative costs.

The most critical challenge in tax administration is tax refunds, especially for countries that impose Value Added Tax (VAT) or GST. Normally, the refunds are paid within certain statutory time limits; 30 to 60 days. Based on the research conducted by the International Monetary Fund (IMF), less cases of tax fraud were found in countries that were able to pay back the refunds to the firms within the stipulated time frame [2]. For instance, firms located in Singapore and Canada performed better in enhancing their roles in economic development due to their happiness in tax administration processes particularly when it comes to the amount of tax refunds received and the time taken to receive the refunds. In this case, tax administration was not an obstacle to the firms in those countries. However, there were high tax evasion rate recorded in Africa (not including South Africa) and Asia (not including Singapore) mainly due to complex tax administration. Consequently, these countries were unable to reap the highest earnings from their tax collection as well as from the private sector’s contribution. When the firms started to perceive complex tax administration as an obstacle, their contribution to the nation would be reduced. More fraud cases would emerge.

Combining both subjects into empirical analyses, the European Bank had conducted a research in examining the nexus between these two variables on 1,800 Western Balkans business owners. Firms from six Western Balkans countries were chosen as subject matters namely Albania, Bosnia, Macedonia, Kosovo, Montenegro and Serbia. The analyses were conducted based on the responses from the Business Environment and Enterprise Performance Survey (BEEPS). With the main idea to investigate the biggest obstacles that might hinder firm performance, it was found that tax administration, tax rates and competition from informal sector are the greatest obstacles for firms in the manufacturing sector. However, for firms in the services sector, tax administration is not their concern. Their concerns are more towards corruption and access to finance [7]. The burdensome tax administration especially on the manufacturing firms led to a call for a formation of enhanced and simplified tax administration processes in the Western Balkans countries.

Apart from that, domestic-owned companies are more likely to regard tax administration as an obstacle than foreign-owned companies [7]. The companies owned by foreigners normally have larger resources and funds as compared to the local companies. Besides, they are facing with less bureaucracy and protocols that will ease tax administration processes and fees. Nonetheless, larger firms are found to view tax administration as a major obstacle to their business performance since they have direct and continuous involvement with tax authorities [5]. Due to the fact that they are not able to escape from paying taxes, some of them have unfavorable interaction with tax authorities.

From the country's perspective, tax administration is an obstacle to firm's growth especially if the firms are located in the countries with higher Gross Domestic Product (GDP). This is due to the cumbersome tax administration bureaucracy that will hinder the growth of firms in developing and emerging countries [6]. The argument is almost consistent with [7] that consider bureaucracy as a cost of tax administration. Nevertheless, as the government in these countries implement e-filing and e-payment to ease overall processes, tax administration is no longer perceived as an obstacle for the firms [6]. Such implementation under e-government with adequate maintenance of ICT infrastructure and cyber security would minimize hassles and ensure data integrity across the nations.

As opposed to the above paragraph, countries that have lesser GDP may also have complex tax administration that would hinder the firm's performance. As an example, firms in Bangladesh perceived their tax system and tax administration as unjust. Due to free-rider problem, firms who do not pay taxes in this country enjoy most of the public goods and services for free. However, the firms that produce more goods and services are being penalized by having to pay more taxes [12]. Due to that sentiment, it distorts honest firms to keep paying taxes to the government by paying bribes. Besides, some of the firms intentionally reduce their production of goods and services in order to avoid paying more taxes. Indirectly, it reduces firms' performance and lesser contribution of the private sector can be generated for the betterment of the society.

In conclusion, tax administration can be considered as one of the obstacles for the firms. Nevertheless, the impacts of the complex tax administration to the firm performance are varying across firms due to different characteristics and geographical location.

3. RESEARCH METHODOLOGY

The responses generated from The World Bank's Enterprise Surveys of approximately 938 firms in Malaysia were used in examining whether the Malaysia's tax administration an obstacle to firm's performance or not. All responses were derived from the survey conducted in March 2015 to May 2017; cover wide samples of manufacturing and services firms in five regions in Malaysia namely central, southern, northern, east coast as well as eastern regions. These firms were categorized into small, medium and large firms. Under those circumstances, stratified random sampling were used in order to generate unbiased estimator for three different levels of stratification namely industry, size and region. It is a sampling method that divides a population into smaller groups that share similar characteristics.

In answering the above research questions, descriptive statistics, Spearman correlation and cross-tabulation analyses were conducted. Generally, descriptive statistics is used to answer the first and second research question, particularly using frequency distribution and percentage. It is useful to make general observations on the main obstacles faced by the firms in doing business in Malaysia. Out of 15 obstacles listed by the World Bank, descriptive statistics can be used to rank the major obstacles faced based on the responses collected from 938 firms. From the results, general observation whether tax administration is a major obstacle can be concluded.

Following to the third research objective, Spearman correlation is adopted in order to determine the strength and direction of the monotonic relationship between tax administration and firm performance. In this regards, Spearman correlation is preferable relative to Pearson correlation because it is capable in examining the strength of two variables monotonically, rather than just linear relationship as in Pearson correlation. Moreover, since it is a non-parametric statistic, there is no requirement that the data must be normally distributed. The correlation strength can be varied from 0.00 – 0.19 (very weak), 0.20 – 0.39 (weak), 0.40 – 0.59 (moderate), 0.60 – 0.79 (strong) and 0.80 – 1.00 (very strong). The extreme result of Pearson correlation is 0 and 1, in which 0 implies no relationship while 1 shows perfect monotonic relationship between two variables.

Finally, in examining the degree of tax administration based on firm's size, cross tabulation analysis is conducted to understand how they are related. Basically, cross tabulation or so called as contingency table analysis is a joint frequency distribution based on two or more categorical variables. It can be analyzed by using chi-square statistics with the purpose to examine whether the variables are statistically independent or not. In this case, the degree of tax administration which is represented by the tax officials visits, audit and inspection is further analyzed based on firms' size. The rationale is to examine whether there is different degree of tax administration from small, medium and large companies in Malaysia.

The answers for the above questions are vital in helping the public sector to formulate better tax administration and public policies to ensure growth and sustainability in the private sector. Consistent with the vision of Malaysia's government to achieve a status of high income nation by 2020, the roles of firms must be strengthened since they have potential as a catalyst to sustain high economic growth and development. If the business regulation and environment are not supportive, the economic transformation agenda may not be achieved at the optimum level.

4. FINDINGS AND ANALYSIS

938 firms in Malaysia have participated in the survey conducted by the World Bank. They can be categorized into three different sizes namely small (employ 5 to 19 employees), medium (employ 20 to 99 employees) and large (employ 100 or more employees). Based on the descriptive statistics, the number of firms and its sales revenue based on firm's size are shown in table I.

TABLE I. FIRMS' CHARACTERISTICS AND ITS SALES REVENUES

Firm's Size	**Firms**		**Total Annual Sales**	
	N	***%***	***RM***	***%***
Small	359	38.3%	RM 822 million	25%
Medium	302	32.2%	RM 1,091 million	33%
Large	277	29.5%	RM 1,419 million	42%
Total	**938**	**100%**	**RM 3,332 million**	**100%**

In this paper, total annual sales revenue is used as a measure of firm performance. Even though the number of large firms is the lowest as compared to small and medium firms, its annual sales revenue was the highest in 2015 to 2017. It consists of 42% of the total annual sales of all firms in Malaysia regardless of its size. Its contribution to the national economic development is comprehensive and can be regarded as one of the main engines for economic growth. Any obstacles that might hinder their performances should be tackled in early stage in order to collect fruitful returns later.

In dealing with the first and second research questions, the World Bank had listed 15 possible obstacles that might be faced by the firms in doing businesses particularly in Malaysia [14]. One of the elements listed is tax administration, followed by [2] access to finance, [3] access to land, [4] business permits and licensing, [5] corruption, [6] courts, [7] crime, theft and disorder, [8] customs and trade regulations, [9] electricity, [10] inadequate educated workforce, [11] political instability, [12] practices of competitors in the informal sector, [13] tax rates, [14] transportation, and [15] labor regulations. Table II shows the results from the surveys conducted on the obstacles faced by the firms in Malaysia from the most to the least.

TABLE II. MAJOR OBSTACLES IN DOING BUSINESS

No.	**Obstacles**	**N**	**Percentage**
1	Competitors	201	21.4%
2	Business licensing and permits	109	11.6%
3	Tax rates	99	10.6%
4	Political instability	83	8.8%
5	Customs and trade regulations	66	7%
6	Labor regulations	64	6.8%
7	Corruption	60	6.4%
8	**Tax administration**	**50**	**5.3%**
9	Transportation	48	5.1%
10	Electricity	40	4.3%
11	Access to land	36	3.8%
12	Access to finance	29	3.1%
13	Courts	15	1.6%
14	Crime, theft and disorder	14	1.5%
15	Inadequate educated workforce	6	0.6%
16	Others	18	1.9%
Total		**938**	**100%**

The findings shown in the above table illustrates that tax administration is not a major obstacle for the firms in Malaysia. Out of 938 firms, only 50 firms (5.3%) declared that tax administration is really a major obstacle. Consistent with previous literature [2], firms are happy with the ease of filing, claiming and obtaining tax refunds in a timely manner. Since the processes were made simpler, then the tax administration is not regarded as the major obstacles in conducting businesses in Malaysia.

Nevertheless, the firms' performance could be impeded due to other major obstacles such as competitors, business licensing and permits as well as high tax rates. Due to the technological advancement, new firms can easily enter the market with a very low cost. With the support of IT infrastructure, huge network of suppliers worldwide can also be built in seconds. Consequently, competition becomes fiercer among all market players. Hence, it is no doubt to declare fierce competition as the main obstacle to firm performance. Moreover, business licensing and permits fall the second major obstacle after competitors. Therefore, to further boost the firm performance, the process of obtaining business licensing and permits shall also be eased. Besides, the firms should equip themselves with skills required in the era of industrial revolution. It is highly needed as to minimize the impact of competition and gain market shares.

In answering whether tax administration hinder firm's performance, Spearman correlation was used. For this purpose, annual sales were used as a proxy of firms' performance. Based on table III, the finding illustrates that there is a significant positive correlation between these two variables. This result is consistent with the descriptive analysis as tabulated in table II. Even though tax administration is not the major obstacle in conducting business, but still 5.3% of the firms regard it as an obstacle. Although the correlation is weak, it is significant in explaining its association with the firms' annual sales performance. Hence, if the obstacle in administering tax is improved, the firms in Malaysia can improve their sales performance as well. Consistent with the research conducted by the International Monetary Fund (IMF), tax administration is not an obstacle for firms in Singapore and Canada [2]. Firms in these countries are happy with tax administration processes particularly when it comes to tax refunds since the processes are easy to be conducted and the refunds can be received in shorter period of time. Looking from Malaysia's perspective, tax refunds can be submitted online and the refunds can be received within 14 to 28 working days [9].

TABLE III. CORRELATION BETWEEN TAX ADMINISTRATION AND FIRMS' PERFORMANCE

	Annual Sales	**Tax Administration**
Annual Sales	1	0.254 [0.0000***]
Tax Administration	0.254 [0.0000***]	1

One of the elements in tax administration is tax officials' visits and inspection [8]. Out of 938 firms, 51 firms responded that they were unsure whether they have been visited and inspected by tax officials or not. The remaining 887 firms' responses were analyzed by using cross-tabulation analysis as shown in table IV.

TABLE IV. CROSS-TABULATION RESULTS BASED ON FIRMS' SIZE

		Firms' Size			**Total**
		Small	**Medium**	**Large**	
Visited, audited and inspected by tax officials	*Yes*	68 (19%)	75 (27%)	79 (31%)	222
	No	282 (81%)	207 (73%)	176 (69%)	665

As stated in table IV, the possibilities of being audited and inspected by tax officials are higher for large firms relative to firms with small and medium sizes. This might be due to the actions conducted by Custom officers to ensure tax compliance among large companies in Malaysia. Since they are among the players in the private sector that helps in boosting Malaysia's economy, their contribution to the government in terms of tax payment should not be neglected. However, for small and medium companies, the visits and inspection conducted are mainly to educate and create awareness on tax compliance.

5. CONCLUSION AND RECOMMENDATION

In achieving a status of developed nation, both public and private sectors should play significant roles in ensuring the accomplishment of the mission. Sole reliance on the public sector is insufficient due to their responsibilities in maximizing the welfare of the citizen. Hence, the contribution from the private sector is needed especially in terms of funding various national expenditures. It can be in the forms of investment as well as taxation. However, if tax administration is complex, there will be non-compliant cases that will reduce the amount of tax collected. It will also significantly affect the firms' performance. Therefore, in ensuring a winning situation between both public and private sectors, tax administration should be eased and improved, or else the sales performance especially among larger firms will be reduced. Apart from that, the roles of small firms should not be neglected even though their sales revenues were the lowest. This is because they are among the major business players in Malaysia's business environment. Tax incentives shall be given as a medium for them to sustain in the long-run, hence boosting the economic growth.

Even though tax administration is not the major obstacle among firms in Malaysia, the government should really look at the tax system in general, particularly on the tax rate. Reformation on the tax rate might be needed because it falls under the top three of major obstacles in doing businesses in Malaysia. On top of that, there is a need for further investigation especially on the major obstacles in conducting business in Malaysia starting from 2018 onwards. Due to a change of government administration, different policies are taking place. For example, the GST is downgraded from 6% to 0% tax for all goods and services. The level of tax administration may also face few changes in-line with the industrial revolution.

The data used in this paper encompassed to three different sizes of firms namely small, medium and large companies. It does not include micro-enterprises or any non-government organizations. For future research, the inclusion of these two types of firms might be needed. Besides, since tax rate is declared as among the main obstacles in conducting business in Malaysia, its role in affecting firms' performance can also be analyzed.

Acknowledgments

This work was supported in part by Ministry of Higher Education (MoHE) Malaysia under Fundamental Research Grant Scheme (FRGS) No. FRGS/1/2016/SS01/UITM/03/7.

References

[1] A.P. Anil and K.P. Satish, "Investigating the relationship between TQM practices and irm's performance: A conceptual framework for Indian organizations," Procedia Technology, vol. 24, pp. 554-561, 2016.

[2] K.O. Baer, "What international experience can tell us about the potential challenges of administering a US VAT," National Tax Journal, vol. 66, no. 2, pp. 447-478, 2013.

[3] K. Foerstl, H. Franke and F. Zimmermann, "Mediation effects in the purchasing and supply management (PSM) practice-performance link: Findings from a meta-analytical structural equation model," Journal of Purchasing and Supply Management, vol. 22, no. 4, pp. 351-366, 2016.

[4] C. Geldes, C. Felzensztein and J. Palacios-Fenech, "Technological and non-technological innovations, performance and propensity to innovate across industries: The case of an emerging economy," Industrial Marketing Management, vol. 61, pp. 55-66, 2016.

[5] R.K. Goel, U. Mazhar, M.A. Nelson and R. Ram, "Government decentralization and international government performance," CESifo Working Paper, no. 6013, 2016.

[6] A.Kochanova, Z. Hasnain and B. Larson, "Does e-government improve government capacity? Evidence from tax administration and public procurement," World Bank Group, 2016.

[7] Kresic, J. Milatovic and P. Sanfey, "Firm performance and obstacles to doing business in the Western Balkans: Evidence from the BEEPS," European Bank, 2017.

[8] E.A. Norris, F. Misch, D. Cleary and M. Khwaia, "Tax administration and firm performance: New data and evidence for emerging market and developing economies," IMF Working Paper, Fiscal Affairs Department, 2017.

[9] Royal Malaysian Customs Department, "Claiming GST refunds," retrieved from http://gst.customs.gov.my/en/ib/Pages/ib_clm.aspx, 2017.

[10] A.Samagaio and R. Rodrigues, "Human capital and performance in young audit firms," Journal of Business Research, vol. 69, no. 11, pp. 5354-5359, 2016.

[11] J.B. Santos and L.A.L. Brito, "Toward a subjective measurement model for firm performance," Brazil Administration Review," vol. 9, pp. 95-117, 2012.

[12] M.S. Sarkar, M. Nodee, M. Musleh and S.M.S. Reza, "VAT reform in Bangladesh: Perspectives on tax morale," International Journal of Business and Management Study, vol. 2, no. 2, pp. 289-293, 2015.

[13] H.P. Singh, S. Kumar and S. Colombage, "Working capital management and firm profitability: A meta-analysis," Qualitative Research in Financial Markets, vol. 9, no. 1, 2017.
[14] The World Bank, "Malaysia Enterprise Survey", The World Bank, 2017.
[15] K.T. Wang and G. Shailer, "Does ownership identity matter? A meta-analysis of research on firm financial performance in relation to government versus private ownership," A Journal of Accounting, Finance and Business Studies, 2017.
[16] S. Munjal, I. Requejo and S.K. Kundu, "Offshore outsorcing and firm performance: Moderating effects of size, growth and slack resources," Journal of Business Research, 2017.