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The Longitudinal Study of Measuring Corporate Tax Planning: Evidence from Industrial Product Companies

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Abstract: This paper examines the extent of corporate tax planning undertaken by a sample of 43 Malaysian-listed industrial companies during the period from 2000 to 2020. This longitudinal study covers the period of tax and accounting reform in Malaysia. Descriptive statistics and t-tests were conducted to examine the differences among variables. This paper contributes to the analysis of whether there is a significant difference between corporate tax planning and the impact of tax and accounting reform in the Malaysian environment over the past 20 years. The results show that there is a significant difference between the effective tax rate and the statutory tax rate. This observation suggests that the tax planning strategies adopted by firms have the potential to reduce the amount of tax payable. Further research is needed to identify the factors that have an impact on the remarkable discrepancy between the two variables. The results of this study suggest that firms are using efficient tax planning techniques resulting in significant tax savings.

Keywords: corporate tax planning, effective tax rate, industrial product companies, statutory tax rate, tax incentive.

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INTRODUCTION

Taxation is a key development tool for spurring economic growth. As reported by the Ministry of Finance, the direct tax contributes the highest percentage to the government's revenue. Consequently, the role of taxation in government budgets, particularly within the expenditure section, is of utmost significance (Supriyati & Anggraini, 2021). Recent statistics highlight that, the Malaysian Federal government's revenue is funded by almost 40.90% of the direct tax, in which the corporate tax is part of the direct taxes (Ministry of Finance Malaysia, 2021). Being the primary source of government revenue, corporate tax payable is marked as the duty of every company to strengthen the Malaysian economy. Furthermore, companies must prepare the tax reporting as stipulated in the Income Tax Act 1967. According to Lymer & Oats (2009), taxation is defined as "a compulsory levy, imposed by government or other tax-raising body, on income, expenditure, or capital assets, for which the taxpayer receives nothing in specific return". Hence, the tax authorities need to ensure that the companies do not exploit the loopholes that arise from tax rules and regulations.

Generally, the tax planning should be managed in a legal way for the benefit of the taxpayer in reducing the amount of tax payable but without any violations of tax laws. However, taxpayers can conduct the tax planning illegally to conceal their income by either falsifying returns or under-reported income, known as tax evasion. Investors, policymakers, and researchers share an interest in the phenomenon of corporate tax avoidance and often use effective tax rate (ETR) as a means to evaluate and compare tax liabilities across firms and over time, based on the assumption that low ETRs indicate intentional corporate tax planning (Drake et al., 2020). For many years, corporate tax planning has been an important topic of study in literature. Tax planning is a set of actions performed by a taxpayer to manage the sources of income by minimizing or deferring taxes but within the ambit of tax laws. Tax planning is crucial to both companies and tax authorities. Both parties have different perspectives when dealing with corporate tax planning. Hence, tax planning is the process of organizing one's affairs to reduce the tax burden.

The government offers various tax incentives or even revises its tax structure to attract foreign investors as well as to reduce the burden of the companies by lowering their operating costs (Paun, 2019). From the companies' point of view, they will implement the tax reduction strategies by planning and managing the business transactions that are capable of reducing their chargeable income, thus, lessening the tax liability. However, the aggressive way of corporate tax planning may lead to a potential loss of the government's revenue. In addition, companies also will incur costs in managing their tax affairs. Therefore, they must ensure that the cost associated with it outweighs the benefit as well as avoid any tax offenses (Thomsen & Watrin, 2018) by choosing between the alternatives available to mitigate the risk of violating the laws.

The Income Tax Act 1967 governs income taxes in Malaysia. Section 3 of the Income Tax Act 1976 (Act 53) refers to income that is liable to tax as "subject to and in accordance with this Act, a tax to be known as income tax shall be charged for each year assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia." As discussed earlier, taxation is the pillar of the government's revenue, and thus, a revolution in the tax system is necessary to increase revenue collection and boost economic growth. In Malaysia, two regulatory agencies are responsible for the tax collection: the Inland Revenue Board of Malaysia (IRBM), which deals with direct tax, and the Royal Malaysia Customs Department (RMCD), which deals with indirect tax. The computation of tax liability for a company is shifted from the Official Assessment System (OAS) to the Self-Assessment System (SAS) starting from the year assessment 2001 to create an efficient tax collection system. Following its implementation, Pradnyani & Utthavi (2020) stated that SAS could improve tax compliance since taxpayers are accountable for determining their tax liabilities and ensuring tax reporting and payment timeliness.

Under the SAS regime, taxpayers are responsible to compute their tax amount accurately during the stipulated time (Fauziati & Kassim, 2018). Contrarily, under OAS, the taxpayers must submit the tax returns known as G Form in which the IRB is responsible to make the assessment and compute the liability based on the Income Tax Form. As for the SAS, taxpayers, specifically, the companies, must estimate their tax payment at least 30 days before the beginning of the basis period using Form CP204. The companies need to pay monthly tax estimates and allow the government to collect tax payments on time. Hence, it has helped the tax collection system since the government can use it to finance public expenditure. Taxpayers who fail to comply with the tax regulation and rules will be imposed on the tax penalty. Furthermore, in an attempt to improve tax collection, during the 2019 Budget Presentation, the Special Program for Voluntary Disclosure was announced by the Minister of Finance as a tax reform system to minimize the tax leakages. In a similar vein, Agunbiade & Idebi (2020) argued that broader tax strategy needs to be implemented to increase tax revenue, emphasizing all major drivers of the tax system with economic benefits. Tax reform is necessary to increase the efficiency of tax administration over time, maximize economic and social advantages, and promote equitable tax collecting practices, among other things.

According to Section 2 of the Act, a resident company in Malaysia is a chargeable person and liable to pay income tax according to the statutory tax rate (STR) enacted by the Inland Revenue Board. As depicted in Table 1, the statutory tax rate in Malaysia for resident companies with paid-up capital above RM2.5 million at the beginning of the basis period is reducing from year to year. Like other countries, the STR in Malaysia also shows a gradual reduction. However, the STR does not indicate the actual tax payments since the tax will not be computed based on the earnings before tax. The amount of corporate income taxes paid by businesses is often better represented by the ETR than by the STR (Janský, 2023).

Over the years, numerous tax provisions were introduced during the budget presentation, where the companies were able to strategize their tax affairs by utilizing the tax incentives. The amount of income tax due is calculated based on the chargeable income after applying the tax treatment on the transaction incurred in that basis year. Meanwhile, the companies will pay less than the statutory tax rate since they benefit from tax incentives resulting from income exemption, tax allowances, double deduction, and specific deductions on expenses incurred. Therefore, this study's main aim is to analyze the level of corporate tax planning among industrial products based on public listed companies in Malaysia by investigating whether there is a significant difference between ETR and STR.

Table 1 Statutory Tax Rate in Malaysia for Year Assessment 1998 to 2020

Year Assessment	Tax Rate (%)
1998 - 2006	28
2007	27
2008	26
2009 - 2015	25
2016	24
2017 – 2018	20 - 24
2019 - 2020	24

The main regulatory frameworks that control corporate financial reporting in Malaysia are Companies Act 1965 and Malaysian Financial Reporting Standards (MFRS). The Companies Act of 1965 is then replaced with the Companies Act 2016, which transforms the landscape of Malaysia's financial reporting environment. The company must adhere to the accounting standards and procedures stipulated in the Act to present the financial information to external users. The financial statements are viewed as a primary tool in communicating the company's financial position, particularly to the shareholders.

The new Companies Act 2016 elevates shareholders to be the primary stakeholders and gives them significant influence over managerial decision-making in the company (Janggu et al., 2017). Therefore, with the changing role of the shareholders, it is crucial to investigate the impact on the company's tax affairs in terms of corporate tax planning. Mgammal (2019) stated that reporting tax information to a wide range of stakeholders will improve tax compliance by encouraging the reconciliation of accounting and tax information. This is consistent with the legitimacy theory, which states that in situations where there is a discrepancy between a company's actions and society's expectations, management will take actions that serve society's interests in order to create legitimacy (Isnurhadi et al., 2020). Hence, the business must actively provide the tax information needed by the stakeholders.

In addition, financial statements in Malaysia are prepared in accordance with the Malaysian Financial Reporting Standard (MFRS) framework, which was established by the Malaysian Accounting Standards Board (MASB). In terms of tax disclosure, MFRS 112 which is similar to IFRS 12 was published by MASB that outlines income tax accounting treatment. In particular, the rules specify the disclosures relating tax expenses and accounting profit by reconciling both items and reconciliation of ETR and STR in paragraph 81(c). Such disclosure is needed to comprehend the relationship between effective tax expense and statutory tax expense (Mgammal et al., 2018). Thus, it will enhance the transparency and credibility of financial statements as well as reduce the information asymmetry between the management of the companies and the users of financial statements.

Generally, tax planning is a mechanism implemented that includes a wide range of tax strategies to reduce its income tax liability. This mechanism will determine the company's corporate tax planning effectiveness, representing the actual tax payment, and known as ETR. The difference between the ETR and STR is referred to tax savings. The wider the discrepancy between STR and ETR, the greater the level of tax avoidance (Thomsen & Watrin, 2018). A lower ETR indicates that companies are carrying out their tax planning strategies effectively since they are able to reduce their tax burden. Therefore, taxable income can be exempted by applying numerous tax incentives using tax treatment under the tax rules and regulations.

Discrepancies between accounting standards and tax laws allow companies to report higher profits in their financial statements than they disclose to tax authorities (Lievia & Herusetya, 2022). The expenses incurred can be claimed as allowable expenses and double deduction expenses, which will reduce their taxable income. Thus, the income tax portion over the income before tax can be minimized significantly. Apart from that, this tax-reducing strategy can increase the company's profit after tax (Jasrial et al., 2018). Recognizing the significance of incentives on the corporate tax planning level, more effort is necessary to investigate the influence of the incentives to effective tax planning. This may be regarded as the company's strategic strategy for lessening its tax liability.

Previous scholars have used different approaches to measure corporate tax planning in their research. These scholarly works often rely on indicators of tax discrepancies, such as differences between accounting and taxable income, to determine the extent of tax aggressiveness. The use of tax havens and ETR are also used as possible indicators. Ftouhi & Ghardallou (2020) and Supriyati & Anggraini (2021) are in consensus that ETR is the most predominant measure in tax planning since it reflects the elements of tax incentives on tax liability. Besides, it provides more detail on the percentage increase in income tax to the income before tax (Tang & Firth, 2011). Therefore, this study uses ETR by dividing current tax expenses by pre-tax income (Fernández-Rodríguez & Martínez-Arias, 2014; Hanlon & Heitzman, 2010; Shafai et al., 2018), and both variables can be evaluated in financial statements.

Given the importance the corporate tax planning on the government's revenue, this study investigates the level of corporate tax planning, particularly among industrial product companies listed in Bursa Malaysia. To date, there is a notable absence of a comprehensive and up-to-date examination of the empirical literature pertaining to corporate ETR (Janský, 2023). Hence, the objective of our study is to make a scholarly contribution to the current body of literature examining the temporal dynamics of ETR of industrial firms in Malaysia over the past 20 years. Our study aims to provide valuable insights into the extent and patterns of tax avoidance in this context. This study extends and contributes to the understanding of the interplay between tax incentives and corporate tax planning, and it is of interest to regulators.

METHODS

The sample of this study is based on the firm's year observation covering the period from 2000 till 2020, which were gathered from Thomson Reuters Datastream. The balanced panel data includes industrial products listed in Bursa Malaysia's public listed companies. First, the data was filtered according to specific industry and years. Next, the relevant financial data used are tax expenses and net profit before tax. Companies with missing financial data, negative values or zero income tax expenses, and companies that incur losses are excluded. Next, the ETR was computed using the ETR measurement, based on the percentage with the tax expense as the numerator and the net profit before tax as the denominator. The initial sample size is 48 firm-years. However, after the data cleaning, the final sample consists of 43 companies with a total of 903 firms-years observations.

RESULTS AND DISCUSSION

Descriptive analysis was conducted to summarize the ETR and STR values. Table 2 exhibits the mean, maximum and minimum values of the variables for the 43 companies. Based on the table, the maximum ETR paid by the company is 91%, whereas the minimum value is 0%, which is much lower than the nominal STR of 24%. In average, the companies paid 20.72%, which is below the mean value of STR of 25.90%. This is similar with prior literature that stated companies reported lower ETR as compared to STR (Zeng, 2018). As indicated by the literature, tax incentives provide the mechanism for companies to minimize their tax burden.

Table 2 Descriptive Statistics

Variable	Min (%)	Max (%)	Mean (%)
ETR	0.00	91.00	20.72
STR	24.00	28.00	25.90

In addition, the t-test was conducted to analyze if there is any significant difference between the mean value of ETR and STR. Thus, the level of tax planning practices is analyzed based on the average score during the investigation period. Based on the result as depicted in Table 3, the level of effective tax rate and statutory tax rate were statistically significant ($p = 0.0000$) among Malaysian industrial product companies that are listed in Bursa Malaysia. Vržina et al. (2020) claimed that the effective tax rate and the statutory tax rate can be highly significant since there is divergence between taxable income and net profit before tax. Furthermore, the statutory tax rate does not reflect the real tax burden by the companies since the computation of tax paid is based on tax reporting instead of financial reporting.

Table 3 T-Test Analysis

Method	df	Value	Probability
t-test	1804	-11.99471	0.0000

Table 4. Mean value of ETR, STR and tax savings from the year 2000 until 2020

Year	ETR (%)	STR (%)	Tax Savings (%)
2000	20	28	8
2001	20	28	8
2002	22	28	6
2003	23	28	5
2004	20	28	8
2005	21	28	7
2006	18	28	10
2007	16	27	11
2008	20	26	6
2009	16	25	9
2010	19	25	6
2011	20	25	5
2012	22	25	3
2013	23	25	2
2014	21	25	4
2015	23	25	2
2016	20	24	4
2017	24	24	0
2018	21	24	3
2019	25	24	-1
2020	23	24	1

Moreover, a comparison of the mean between ETR, STR, and tax savings was conducted to compare the different tax values for the year 2000 until 2020. The ETR results of the current study were compared to the level of STR that the government mandates for companies. A discrepancy between the ETR and the STR would be considered tax planning. The higher the ETR, the lower the tax planning of companies in terms of tax avoidance (Delgado et al., 2023). As shown in Table 4, the result presents on average that companies paid their actual tax (ETR) less than the statutory rate (STR). The positive value of the difference between the two variables implies that companies enjoy tax savings since they pay less tax than what has been enacted by the tax authorities.

Based on the observation, the tax savings keep on decreasing starting from the year 2005, when the STR is decreased to 25%. The average ETR has fallen dramatically during this time span resulting from lower STR, and the finding is consistent with the studies by Dyreng et al., (2017) and Dias & Reis (2018). In addition, there is a negative value of tax saving during year 2019, which suggests that, the organization will have to pay more taxes and thus will have higher tax burden (Amidu et al., 2019).

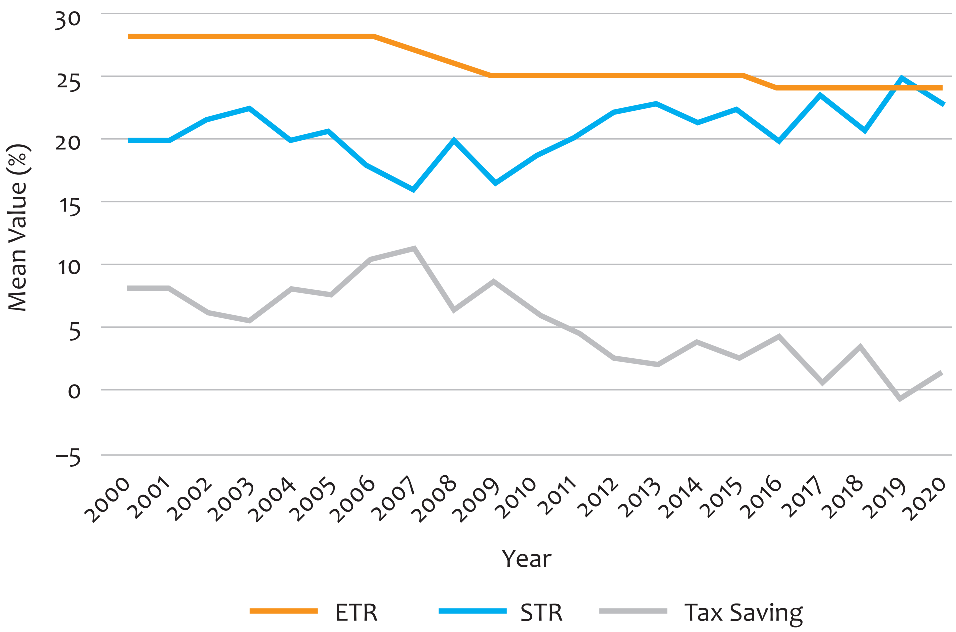

Figure 1 The trend of tax planning for the year 2000 - 2020

Tax planning trend for the companies during the year 2000 until 2020 is illustrated in Figure 1. The data revealed that Malaysian industrial product companies, on average, pay less for their corporate tax obligations. This is due to various tax incentives that can reduce the effective tax rate to levels substantially below the statutory rate (Vržina et al., 2020) which in line with agency theory. According to the principles of agency theory, managers are responsible for protecting the interests of shareholders by seeking to maximize the total value of the firm (Jensen & Meckling, 1976). Agency theory typically examines conflicts of interest between a firm's management and its shareholders. In the context of tax aggressiveness, management might use aggressive tax planning strategies to enhance firm value, which benefits shareholders. However, these strategies also carry risks, such as penalties and reputational damage, which could harm shareholders' interests. In conclusion, the tax planning measures indicate that the companies conducted effective tax planning strategies, thus enabling them to reduce their tax liabilities.

CONCLUSION

Overall, it is evident that industrial product companies in Malaysia have conducted tax planning strategies to lower their tax payables. Tax incentives appear to be one indicator that the companies enjoy tax savings by claiming the incentives available to them to reduce their taxable income and thus pay less tax. In addition, the actual tax paid by the companies, which is a proxy by ETR, has a significant difference with the STR enacted by the government. Policy implications generally depend on the results of this paper. They may include recommendations to improve corporate governance practices or the need for more transparency and disclosure in tax reporting to mitigate the aggressiveness of tax reporting. This paper contributes to the existing knowledge by increasing the understanding of tax reporting practices within the perspective of industrial products in the developing countries, where the industrial sector plays a crucial role in contributing to economic growth. Thus, future research is needed to explore the factors that influence corporate tax planning and to comprehend the potential impact of these factors on the ETR in corporations.

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