



The issue of Assessment Tax Arrears: A Case Study of the Melaka Historic City Council, Malaysia

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ABSTRACT

Objective – The purpose of this paper is to evaluate the relationship between the assessment tax system and tax arrears in Melaka Historic City Council, Malacca, Malaysia. (Local Government)

Methodology/Technique – Method used is quantitative method. With population sample of 484 885 residents (N=484,885) and a sample size of 384 residents (n=384), the instrument used to collect primary data is questionnaire. The data were analysed using Statistical Package for Social Sciences (SPSS) version 21.

Findings – With accuracy $r = .141$, $p < .001$, showed that the relationship was moderate and highly significant. This tells us that the inadequacies in the tax system are one of the contributing factors towards high assessment tax arrears in Melaka Historic City Council.

Novelty – Although the issue of tax arrears in Malaysia is not a new phenomenon, however this paper specifically focuses on the issues of assessment tax at the local level, which in this case refers to the Melaka Historic City Council.

Type of Paper: Empirical

Keywords: Assessment tax; Arrears; Local Government; Local autonomy; Malaysia.

JEL Classification: H2, H20.

1. Introduction

Local government is viewed as a 'system of local administration under local communities that are organized to maintain law and order, provide limited range of social amenities and encourage cooperation and participation (Emezi, 1984).

In many countries, local government can be seen as an important level of government. This is because local government worldwide is a huge service provider. They provide social care, education, environment and housing (Pemberton, S. Et al, 2010). Local government derives its revenue mainly from assessment tax. The assessment tax is a compulsory contribution to be paid by the taxpayer to the local government. Taxpayers refer to the person that resides in one particular area and holds property such as shops, house, hotels and factories (Kuppusamy, 2008). Assessment tax or property tax is generally practiced by countries around the

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world. Almost all the governments around the world rely to some extent on property taxation for their survival (Dzulkarnain, 2011). For instance, the property tax is the main sources of revenue for municipalities in Canada, United States and Australia (Enick Slack, 2002).

Local government occupies the lowest level in the Malaysian government hierarchy. It is a government institution that is given authority to administrate, plan and enforce its assigned responsibilities in a local area. These functions are stated in the Local Government Act 1976 (Act 171), The Town & Country Planning Act, 1976 (Act 172) and The Street, Drainage and Building Act, 1974 (Act 133). Under item 4 in List II of the Ninth Schedule, the Federal Constitution stipulates local government as a subject under the State List. Hence, all local governments fall under the exclusive jurisdiction of the state government (UNESCAP). As stated in the Local Government Act 1976 (Act 171), local government could be referred to as City Council, Municipal Council or District Council.

Local government in Malaysia is to a certain extent vested with the power to create its own revenue sources. Local government's financial autonomy is thus important since it will determine whether local government is able to provide services and development to the residents. In order to provide these services, local government depends heavily on their main income which is the assessment tax. According to part 5, section 39 of the Local Government Act 1976, the assessment tax is the main revenue of local government. Assessment tax is normally used by local government to finance its services such as in providing and building public toilets, drainage, and roads and street lightings. Therefore, the local governments must have enough revenue in order to deliver the services to the community. However, the amount of revenues that is collected by local government is decreasing due to the problem of assessment tax arrears (Pawi, S. et al, 2011).

In a situation where a local government is unable to collect its assessment tax adequately, it may affect its ability to provide the necessary facilities and infrastructure to its residents and thus they may fail to perform their functions effectively. The local government assessment tax rate is determined by the state government. However, the tax rate can vary from one local government to another.

2. Problem Statement

In Malaysia, there has been limited research on the reasons why councils have huge amount of arrears and the factors that determine delay in the assessment tax payment by the tax payers. Even though there are a number of research done on assessment tax arrears in Malaysia, but there are limited study done in Melaka and no study has been done on the Melaka Historic City Council. With regard to the problem of assessment tax arrears in Melaka City Council (MBMB), the records showed that the value of the tax arrears from 1987 until September 2010 amounts to RM 35 million (Utusan online, 2010).

The property tax revenue has declined greatly as a share of all taxes collected in the U.S. It has also declined as a share of U.S. GDP (Hoxby et al., 2012). As in Malaysia, a report by the Inland Revenue Board of Malaysia in 2005 (IRB) showed that the non-compliance behaviour is 'alarming'. This main problem is due to the taxpayers' negative response on tax compliance behaviour (Saad, N, 2010).

Financial management determines the effectiveness and efficiency of local government operations. Local governments provide a wide range of services to the community such as waste disposal, recreation parks, sewerage and town planning. In most parts of the world, these functions may only be offered when a proper administration of assessment tax is observed. According to Lowery 1985; MacManus 1995b (as stated in Mark et al (2003), local governments worldwide are particularly concerned about the growing resistance to pay tax. Pawi, S. (2011) found that the collection of assessment tax is decreasing across the board in many types of councils in Malaysia and this has affected the quality of services provided by local government.

Kuppusamy and Mangaleswari (2006) in their study showed that the arrears in assessment tax proved to be one of the main issues faced by many local authorities. They found that in between 1996 and 2000 about 15 percent to 25 percent of the tax revenue of municipal and district councils remained uncollected. Lack of enforcement in collection of taxes was also an issue. Research done by Asmah and Emelin (2003) cited in Norli and Asmah (2006) also found that uncollected revenue such as tax arrears was one of the problems faced

by many local councils. This is supported by Pawi, S. et al (2011) where they found that the property tax collection in Malaysia is unsatisfactory and the amount of revenue collected is decreasing due to the serious problem of assessment tax arrears.

According to the Economic Report of the Ministry of Finance as stated in Pawi, S. et al (2011), the revenue of tax performance in local government throughout the country showed a worrying decline. It decreased from 11.7 percent in 2007 to 0.3 percent in 2008. The implication of tax reduction resulted in the deficit spending of RM75 million in 2007 and RM1179 million in 2008. Furthermore, majority of Malaysian local government collect less than 60 percent of the total tax estimated (Pawi, S. et al, 2011).

Even though local government receive grants from Federal and State government as stated in Article 156 of the Federal Constitution and is able to collect revenue from its activities such as imposing fine, rental and fees, however local government still faces financial difficulties in providing its services. Many services have been found to be inadequately performed or not carried at all (Phang Siew Nooi, 1997). Mohamad Shafori Isamil et al (2006) suggested that local councils have to innovate their modes of collecting payment from taxpayers in order to ensure effectiveness of tax collection.

Henceforth, the purpose of this study is to look at the issues of assessment tax arrears in Malaysian local authorities specifically Melaka Historic City Council. This study will also evaluate the relationship between the tax system and tax arrears.

3. The Importance of Assessment Tax Collection

Property taxation is becoming increasingly important in local government as more and more responsibilities are being devolved from central to local governance units. This is because taxes on property are the single most important source of locally raised revenue in many parts of the world and often seen as reliable revenue for local governments (McGuire, 2001; Sullivan, et al, 1995; Dillinger, 1992). The tax is also an important source of locally raised revenue in developing countries because the other major revenue sources such as sales and income tax bases are being exploited by the central government, leaving local governments to rely on property tax (Bahl, 1979).

In recent years Mc Cluskey (2000) has observed an international trend of increasing demand for public services and specifically those provided by local governments. Subsequently the growing need for revenue to finance local services has resulted in an increase in the number of countries that levy taxes on real property (Sullivan, et al., 1995). It is also argued that the increased interest in property tax is due to a growing interest in local autonomy (Sullivan, et al., 1995). Thus property tax has the potential to yield large sums that can promote efficient fiscal decision making (Oates, 2001), and subsequently enhance local autonomy.

Taxation is crucial fiscal tools to govern the country. Property taxes have a long history in the U.S. and have traditionally been used by local governments to fund local public goods, such as schools, policing, fire protection services, recreational facilities, and local roads and transportation (Hoxby et al, 2012). As in Malaysia, the property tax or assessment tax is a local tax levied on all property holdings, including shops, factories, residential, agriculture situated within the Council's area of jurisdiction (www.malaysia.gov.my).

Taxes are an important revenue source for any government. Assessment tax is the main sources of revenue for municipalities in Canada, United States and Australia (Enick Slack, 2002). In China, they do not depend much on the financial grant of the Federal government, but on local taxes. China derived its local taxes from income, licence plates and real estates. In Japan, there is an interesting inverse relationship between revenue collection and expenditure with the strong belief that local government is the corner stone of democracy and the level of government closest to the people. Therefore, it should get greater shares of revenue to meet their needs. In Indonesia, the local government received its revenues from hotels, properties, restaurant bills and entertainment and enterprises owned by local government. In the U.S. over 95 percent of property taxes are collected by local government's municipalities. However, the degree to which local governments depend on property taxes varies from state to state. In Alabama, the property taxes make up only 20 percent of local revenue while in the New England states, property taxes make up more than 80 percent of local revenue (Hoxby

et al, 2012). As for Malaysia, assessment tax is one of the main sources of revenue for local government accounting for 70 to 80 percent of its total revenue, with licenses, rentals, grants, parking compounds and development charges its other sources of finance (Dzulkarnain, 2011).

4. Discussions

This section presents the analysis of primary and secondary data. The primary data refers to the analysis of the questionnaires distributed to the residents in Melaka Historic City Council, Malaysia. While the secondary data present the results obtained from the Melaka Historic City Council.

4.1 An evaluation of Assessment tax arrears of local government in Malaysia

The problem of local tax arrears is not a new issue. According to the Mayor of the Alor Setar City Council, Datuk Mat Noh Ahmad, only 73 percent of the taxpayers settle their arrears in full or in instalments. Until July 2011, the council managed to collect an average of 67 percent which is RM25000 after invent seizure operation from April until Jun 2011 on 143 holdings, and a total of 87 businesses and 56 residential premises were fined. It shows that there are still a number of individuals who did not respond to the actions taken by the council. In the case of the Alor Setar council, strict enforcement on their part has helped to reduce the amount of arrears. Thus it is a good approach taken by the council when they decided to take court action in accordance with Act 171 of the Local Government Act (1976) on the business that refused to pay tax. Shah Alam City Council (MBSA) followed suit by seizure operations to those with arrears of more than RM2000 and exceeded five-year debt (BeritaHarian online, September 1st, 2011). In addition, according to the Mayor of Kuala Lumpur City Hall, Datuk Seri Ahmad Phesal Talib the private companies owed the bulk of the unpaid arrears, amounting to millions of ringgit. In addition, delinquency is also prevalent amongst GLCs (government-linked companies). A religious council also owes Kuala Lumpur City Hall some RM651, 000 in unpaid taxes while a rail operator and utility company owe about RM433, 000 and RM317, 000 respectively.

The above shows that in order to deal with the attitude of the taxpayers, the local councils need to disseminate information regarding the urgency to pay assessment tax. The citizens should be equipped with the tax knowledge and should be able to understand why they need to pay the assessment tax. Other than that, the councils have suggested that there should be programs such as "Open day" for the customers. This is to increase citizen trust on the council. When the citizens have trust in the council they will be obliged to comply with the law and pay their assessment tax.

From the researcher's personal observation, many of the councils now have their own website, and provide adequate information on assessment tax to the public. However, the council should know that not every citizen has access to the internet, therefore printed paraphernalia such as flyers, brochures that give information on assessment tax, the tax rate and methods of payment should also be distributed to the residents, so that they may see the councils to collect assessment tax.

Other than that, for the tax system / structure which refers to the tax administration by the local council, it is suggested that the councils should find some ways on how to reach their taxpayers. This is because there are several cases where the councils are unable to reach the residents, and the letter is not delivered to the homeowner on time or not at all. For an example, for those houses that are rented out to other parties, most tenants do not care about the assessment bills that are sent to the house. They do not pass the bills to the respective house's owners. Thus the house owners do not pay on time. There are also some cases of transfers of ownership of property that are not reported to local authorities. The Valuation department sends out the assessment bills with the old property's owner name. The new property's owner refused to pay rates with the excuse that the bill does not state his or her name.

4.2 Results

Table 1. Respondent's Profile

Demography	Frequency	Percentage
Gender		
Male	117	35.5
Female	213	64.5
Age (years old)		
18-28	45	12.5
29-39	110	33.3
40-50	87	26.4
51-61	46	13.9
Race		
Malays	182	55.2
Chinese	73	22.1
Indian	48	14.5
Others	27	8.2
Education		
Secondary school	275	83.3
Higher learning institution	55	16.7

Table 1 shows the respondents' frequency distribution according to gender, age and race. Most of the respondents are female that is 64.5% compared to 39.5% male respondents. The respondents are also from various age groups, most are from 29-39 years group which is at 33.3% followed by 40-50 years at 26.4%, 51-61 years at 13.9% and 18-28 years at 12.5%. There are three major races involved in this study which are the Malays, Chinese and Indian. The frequency is 55.2% are Malays, 22.1% are Chinese, 14.5 are Indian and 8.2% other races. Majority of the respondents were from the secondary school, which were 275 taxpayers or 83.3 percent from the total number of respondents while the respondents from higher learning institution were 16.7 %.

Table 2. APA style correlation table

APA styled correlation table			
Construct variables	1	2	3
Tax system./structure	.379**	1	.141**
Tax arrears	.181**	.141**	1

Table 2 shows the results for the tax system/ structure and tax arrears relationship, with accuracy $r = .141$, $p < .001$, which showed that the relationship was moderate and highly significant. The finding shows that the inadequacy in the tax system is a contributing factor towards arrears in assessment tax in Melaka Historic City Council. For instance, the council tax administration is inefficient to handle delinquent taxpayers. The enforcement on errant taxpayers is still not effectively carried out and there are lack of rewards and incentives given to taxpayers. What the council needs to do after several initiatives have been offered to reward the taxpayers is to carry out seizure of moveable assets from properties of owners who refused to pay their assessment taxes. S. Azmi & Yee, (2003) also found the tax system as the main factor contributing to assessment in tax arrears. They stated that poor tax administration resulted in poor monitoring, delayed revenue collection and substantial revenue arrears. Kuppusamy S. & Mangaleswari S. (2006) found similar results whereby the local government was seen to have poor administrative and enforcement systems that resulted in poor monitoring and delay in revenue collection.

The findings were also supported by other researchers in Malaysia such as Pawi S. et al (2011) who found that the property tax arrears crisis in Malaysia is due to weaknesses in local government financial management. The weaknesses in its financial management also contribute to local government's poor performance and lackadaisical attitude in collecting taxes. Moreover, findings in Melaka Historic City Council also are concurrent with the findings by Aziz, A.A. & Talib, N. A (2006). In their study they found out that the management of assessment tax collection for other states such as Selangor and Perak is weak. The same situation was faced by local government in Tanzania, where political intervention and weak management led to the problem of tax valuation and tax enforcement (Fjeldstad, H.O. 2004). In America, the citizens expect the government to be more responsive. In Ghana, the issue of property records are not up to date (Elias, D.K 2010). Therefore, it can be concluded that the tax system has a positive relationship with assessment tax arrears.

Furthermore, this study found that the tax system is weak in the council studied above. It is further suggested that the councils need to find various avenues on how to reach their taxpayers. Other issues are the attitudes of the taxpayers themselves who either resist paying their tax or avoid contact by the local authority.

From the study, it showed that the councils should be utterly concerned with the tax arrears issues because this issue is not a new phenomenon. Until recently, even though the Melaka Historic City Council have taken many initiatives and efforts to collect the arrears but their efforts were not fruitful. Therefore, it is now time for the councils to come out with initiatives to attract taxpayers to pay their tax and the same time identify and implement more effective approaches to increase compliance behaviour. It is therefore, suggested that the issue of assessment tax arrears can be resolved by Melaka Historic City Council by determining the best means to reach the public, to inform them and to attract them to pay their assessment tax. The Melaka Historic City Council also can use rewards method to attract the taxpayers to pay their assessment tax.

5. Conclusion

Study findings reveal that property tax generate very low levels of revenue when measured against the potential. This is a result of inadequacies in administration of the tax. Property tax coverage is low as large proportions of the property tax base are not valued and less revenue is collected from rateable properties captured in the property tax database

The findings also show that the property tax administrators are trying hard to work within the difficult conditions, as the support from the Municipal authorities is not sufficient enough to facilitate the whole property tax administration undertaking. For instance lack of or inadequate property information is a critical problem confronting property tax systems in the Melaka case study above.

The study further observes inadequacies of non-supportive relationship among the key actors in property taxation. Property taxpayers express resistance to paying their tax bills on account of not receiving their bills on time or not receiving them at all. The observed deficiencies with the property taxation system call for the urgent attention of the relevant municipal authorities if the property tax is to achieve its full potential.

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