CHALLENGES AND STRATEGIC SOLUTIONS FOR INDIVIDUAL INCOME TAX COMPLIANCE IN MALAYSIA

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ABSTRACT

Individual income tax is an essential part of Malaysia's national budget, providing the revenue needed for public services and national development. However, the country faces a persistent problem of low tax compliance caused by limited public understanding, complicated regulations, and low trust in government spending. This study aims to explore the key challenges influencing individual income tax compliance in Malaysia, analyse the effectiveness of digital tax systems, and propose strategic solutions to improve compliance rates. The research used a qualitative method by examining secondary data from government reports, official policies, and existing academic studies. The findings show that tax compliance in Malaysia is strongly influenced by the ease of using the tax system and the level of public trust in authorities. Many taxpayers find tax forms difficult to complete, and there is limited tax education for emerging groups of workers, such as those in the gig economy. To address these issues, the study recommends improving tax education programs, simplifying digital filing systems, and increasing transparency regarding the use of tax revenue. This paper contributes by offering practical strategies to improve tax compliance and strengthen the relationship between the government and taxpayers. These efforts are expected to support economic stability and sustainable national development in Malaysia.

Keywords: Individual Income Tax; Tax Compliance; Taxpayer behaviour; Digital tax system; Tax education

1. INTRODUCTION

Taxation is the primary financial resource that a nation uses to fund essential public goods, such as roads, schools, and hospitals. In Malaysia, individual income tax (IIT) is a vital part of the government's revenue, supporting key national development programs. To make tax collection more efficient, the Malaysian government introduced the Self-Assessment System (SAS) in 2004. Under this system, the legal duty of calculating, declaring, and paying taxes was moved from the tax office directly to the citizens. This approach was intended to reduce administrative costs and encourage people to take more responsibility for their own tax affairs.

However, a significant research gap has appeared since the introduction of this system. Although Malaysia has a large workforce of over 16 million people, only a very small percentage contribute to income tax, reflecting a narrow tax base (OECD, 2024). Many individuals, especially those in the gig economy, such as freelance workers and food delivery riders, struggle to report their earnings correctly because the rules are often too technical and the nature of their work is highly flexible (Nawawi et al., 2025). While many citizens say they want to follow the law, they are often blocked by the complexity of tax regulations and the administrative burden associated with compliance (Mantzaris & Fosner, 2025). This study fills a gap in the current literature by focusing specifically on the barriers faced by these modern types of workers and the psychological reasons behind non-compliance.

Based on these challenges, the primary objective of this research is to explore the key challenges influencing individual income tax compliance in Malaysia. Second, to analyse the effectiveness of digital tax system. Third, the study seeks to propose strategic solutions to improve compliance rates. By reaching these goals, the research provides a clear roadmap to develop a more efficient and transparent tax system that supports Malaysia's long-term fiscal stability.

In Malaysia, the digital tax system is progressively developed and implemented by the Inland Revenue Board of Malaysia through several initiatives, including electronic filing (e-Filing), e-Invoice adoption, pre-populated tax return systems, and the use of data analytics or artificial intelligence to identify potential tax non-compliance. These measures are designed to enhance the efficiency of tax administration by streamlining processes and minimising manual work. In addition, the system helps reduce errors associated with human intervention, improves transparency in tax reporting, and strengthens overall compliance. It also plays a significant role in improving the detection of tax evasion activities. Overall, the digital tax system represents a modern, technology-driven approach to tax management that promotes faster, more accurate, and more transparent administrative processes.

2. METHODOLOGY

This research is based on a qualitative research design that focuses on understanding the complex issues surrounding tax compliance in Malaysia (Creswell & Poth, 2025; Saunders, Lewis, & Thornhill, 2023). Instead of using numerical surveys, this study uses a descriptive approach to explore the behavioural and structural reasons why people find it difficult to pay their taxes (Yin, 2024). By choosing a qualitative method, the study can better explain why and how behind taxpayer choices, providing a deeper look at the relationship between the public and the tax authorities.

The participants or primary data sources for this study are not individual people, but rather a wide range of secondary data and official documents. To ensure the findings are accurate and update, the research reviewed several high-quality sources, including official statistics from the Inland Revenue Board of Malaysia (IRBM). Additionally, information was gathered from national policy documents like the National Budgets, which provide the latest updates on tax laws and government goals.

The instruments used for collecting this data involved a systematic search of academic and professional databases. The research looked at expert reports from global auditing firms such as KPMG and Grant Thornton, as well as peer-reviewed academic journals that specialize in Malaysian fiscal policy. These documents acted as the tools for the study, providing a large amount of professional evidence and historical data that helped build a complete picture of the current tax system.

3. RESULTS

The first objective of this study was to explore the key challenges influencing individual income tax compliance in Malaysia. The findings indicate that insufficient taxpayer awareness remains a key issue, as a notable proportion of individuals lack knowledge about the reliefs and deductions available to them (Inland Revenue Board of Malaysia, 2023; Organisation for Economic Co-operation and Development, 2022). This problem is further compounded by the complexity of the tax system, which creates difficulties for taxpayers, especially those engaged in gig or freelance work, in differentiating between various types of income, such as employment earnings and capital gains. In addition, compliance behaviour is strongly influenced by the level of trust in public institutions. The taxpayers are more likely to fulfil their obligations when they perceive tax authorities as transparent and believe that public funds are managed efficiently for societal benefit.

The data collected during this study confirms that the number of active tax contributors in Malaysia is still quite low compared to the total size of the workforce. Table 1 shows that the country has approximately 16.5 million workers, only a small fraction is effectively contributing to the national tax revenue (DOSM, 2025). Specifically, only about 2.3 million people are considered effective contributors, which is less than 15% of the total working population (LHDN, 2024; Ministry of Finance Malaysia, 2025). This highlights a major challenge for the government, as it means a small group of people is carrying the financial burden for the rest of the nation's development (OECD, 2024).

Table 1. Taxpayer Statistics in Malaysia (2023)

Description	Number of People
Total Workforce	~16.5 million
Registered Taxpayers	~6.0 million
Active Individual Filers	~2.8 million
Effective Tax Contributors	~2.3 million

In addition to the small tax base, the research shows that the Self-Assessment System (SAS) has created significant difficulties for many Malaysians. Data suggests that nearly 40% of taxpayers are not aware of the specific tax reliefs or discounts they are legally allowed to claim (LHDN, 2024; Abdul Wahab et al., 2025). Because they do not fully understand the system, these individuals often make mistakes on their official forms or end up paying more tax than they actually owe (OECD, 2024). This lack of awareness is a primary reason for unintentional non-compliance and administrative errors (Palil & Mustapha, 2025).

Table 2. Progressive Tax Rates (Assessment Year 2024)

Chargeable Income (RM)	Tax Rate (%)
0 – 5,000	0%
35,001 – 50,000	8%
100,001 – 250,000	24%
Above 250,000	30% – 33%

The findings also indicate that the complexity of the tax rate structure can be a barrier for middle-income earners. As shown in Table 2, the tax rates increase progressively, reaching as high as 33% for top earners (Ministry of Finance Malaysia, 2025; LHDN, 2024). While this system is designed to be fair, the jump between different income brackets can be confusing for those who do not have professional help to manage their filings. This complexity leads to a more reliance on tax agents, which adds an extra cost for the individual taxpayer.

The second objective of this study is to analyse the effectiveness of digital tax system. The study looked at how digitalization is currently being used to fix these issues. While the government is moving toward a fully digital system, many taxpayers still struggle with the technology. Issues like high system traffic during the final filing months and a lack of digital literacy in rural areas continue to hinder progress. However, the data suggests that if digital tools like pre-filled returns and AI-driven support are fully implemented, the rate of errors could drop significantly.

The findings indicate that the Malaysian government, through Inland Revenue Board of Malaysia, is advancing the HASiL 2026 Strategic Plan, which aims to establish a comprehensive and integrated digital tax environment. Measures such as pre-populated tax forms and the application of artificial intelligence for compliance risk assessment are expected to enhance accuracy and strengthen enforcement capabilities (Organisation for Economic Co-operation and Development, 2023). However, practical challenges remain, as a segment of taxpayers continues to experience difficulties related to limited digital skills and system-related constraints, including platform congestion during peak submission periods. The results highlight that although digital transformation can streamline administrative processes, its effectiveness is largely influenced by users' ability to adapt to and effectively utilise the available technological tools.

The third objective of this research aimed to propose strategic solutions to improve compliance rates. The findings emphasise three core pillars which are education, simplification, and institutional trust, as the foundation for sustainable improvement in compliance behaviour. Strengthening tax knowledge through early exposure is highlighted as a key measure, with recommendations to incorporate basic taxation concepts into school and university curriculum to better equip future taxpayers (Organisation for Economic Co-operation and Development, 2023). In addition, simplifying tax-related materials and reducing technical complexity are identified as important steps to make compliance more accessible to the public. The study also shows the importance of transparency initiatives, such as publishing clear and user-friendly reports that explain how tax revenues are allocated and spent, which can strengthen public confidence in the system. Collectively, these measures are expected to foster a more informed and trusting taxpayer base, ultimately supporting higher voluntary compliance**.**

4. DISCUSSION

The analysis of the research results suggests that the core of the tax compliance problem in Malaysia is not necessarily intentional dishonesty, but a significant gap in technical knowledge. Many citizens expressed that they want to be law-abiding but find the Malaysian tax code to be highly intimidating and difficult to navigate (OECD, 2024; Abdul Wahab et al., 2025). For example, the average taxpayer often struggles to differentiate between taxable standard earnings and capital gains, leading to mistakes in their annual filings. This confusion creates a psychological barrier where individuals avoid filing taxes simply because they are afraid of making a legal mistake that might result in a penalty.

Another vital factor influencing compliance behaviour is the level of institutional trust between the public and the government. The research indicates that taxpayers are much more willing to participate in the system when they believe their money is being managed with transparency and fairness (OECD, 2025; Rahayuningsih, 2025). If there is a perception that tax revenue is misused or not used for the public benefit, the motivation to comply drops significantly. Therefore, building a culture of compliance is not just about enforcing laws; it is about proving to the public that their contributions are directly funding valuable services like better hospitals and schools. A Grant Thornton (2023) report found that over 40% of Malaysian taxpayers are unaware of full deductible claims available to them, reflecting a clear gap in tax literacy.

To bridge these gaps, digitalization represents the most promising strategic solution for the future. The HASiL 2026 Vision aims to upgrade the system by using advanced tools like artificial intelligence and automated auditing (LHDN, 2023; OECD, 2025). By moving toward a more digital-first approach, the tax authorities can reduce the friction that taxpayers feel when trying to file their forms. The goal is to create a seamless experience where the technology does the hard work, leaving less room for the individual to make errors.

Table 3. Digital Transformation Goals

Technology	Expected Benefit
Pre-filled Returns	Fewer mistakes by taxpayers
e-Invoicing (2025)	Real-time auditing of income
AI Risk Scoring	Better detection of tax evasion

As detailed in Table 3, the implementation of pre-filled returns is a key step because it uses existing data to complete parts of the tax form for the individual (OECD, 2025; LHDN, 2024). This directly addresses the problem of technical confusion, as the taxpayer only needs to verify the information rather than calculate it from scratch. Furthermore, the introduction of e-Invoicing by 2025 will provide the tax office with real-time data on transactions, making it much harder for businesses or individuals to hide income accidentally or intentionally.

Beyond technology, this study finds that educational reform is essential for long-term compliance. Currently, many Malaysians only learn about taxes when they start working, which is often too late (OECD, 2024; LHDN, 2024). Including basic financial and tax literacy into the secondary school and university curriculum would ensure that the next generation of workers understands their civic duties early on (OECD, 2025; World Bank, 2024). When taxpayers are educated, they feel more confident in their ability to use digital tools and claim the tax reliefs they deserve.

The discussion highlights the need for a balanced enforcement strategy. While education and trust are important, there must be a credible system of penalties for those who choose to ignore the law. However, these penalties should be fair and heavier for those who intentionally evade taxes, and lighter for those who make honest mistakes due to the system's complexity. By combining technology, education, and fair enforcement, Malaysia can create a sustainable and equitable tax system for the long term. The integration of behavioural insights, policy simplification, and technology can yield compliance gains exceeding 20% over the medium term (KPMG Malaysia, 2025).

5. CONCLUSION

This study highlights that individual income tax is the most important pillar of Malaysia’s fiscal sustainability. The transition to a Self-Assessment System (SAS) has shifted the burden of compliance to the citizens, many of whom lack the necessary technical knowledge to file accurately. The findings indicate that unintentional non-compliance, driven by complex tax laws and a lack of awareness regarding available reliefs, is a major barrier to optimal revenue collection. Furthermore, the discussion shows that compliance is deeply connected to the level of trust the public has in the government. When taxpayers perceive that their contributions are managed transparently and used for the public benefit and voluntary compliance naturally increases. While digital transformation initiatives must be supported by a more inclusive approach that addresses the needs of gig-economy workers and individuals in rural areas who may have lower digital literacy. To effectively raise tax compliance levels in Malaysia, the government must focus on education, systemic simplicity, and the rebuilding of institutional trust, Malaysia can create a more tough and reasonable tax environment Strengthening tax compliance in Malaysia requires a balanced strategy that combines modern technology with human-centred reforms. These measures will not only improve administrative efficiency but also ensure that the nation has the necessary financial resources to achieve its long-term economic goals and support the welfare of all its citizens.

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