

Performance of the Royal Malaysian Customs Pre-GST Era

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Abstract: This study evaluates the performance of the indirect tax administration in Malaysia based on the international benchmarks by means of document analyses of published and unpublished sources and a survey on tax employees. It is discovered that 13 out of 47 tax administration tasks investigated are below the international benchmarks. Out of the 13 items, 5 items involve tax collection processes while another 8 items involve tax administration capabilities. It is found that the under performances of these 13 items are attributable to lack of resources. The result of the document analyses is further supported by the survey on tax employees which indicates that the main source of employees work stress came from inadequate manpower, materials and other resources. The policy implication of this study is that further resources (both in terms of capital and human resources) should be made available to the Royal Malaysian Customs so that the department can perform its tax administration tasks in an efficient and effective manner.

Key words: Performance measurement, tax administration, indirect tax, customs, Malaysia

INTRODUCTION

The cloud over whether Goods and Services Tax (GST) will be introduced in Malaysia was finally lifted on 25 October, 2013 after the Prime Minister of Malaysia announced the Budget 2014. The idea of introducing GST was first conceived in 2005 but GST's implementation had been deferred subsequently to facilitate public education and consultation. Although, the draft GST bill was read for the first time in Parliament in 2009, the bill has not been passed into legislation and no clear timeline was set as to GST's implementation. The uncertainty as to GST's implementation cast many doubts as to whether Malaysia will have a GST regime and if so, when the GST will be implemented. Many businesses were taking a wait and see approach before taking any steps to prepare for GST's implementation. The budget 2014 announcement ended the speculation and the uncertainties relating to GST's implementation. It is announced that the GST will be implemented in Malaysia with effect from 1 April, 2015 at the rate of 6% and will replace the current sales and service tax regime.

An argument often used against the introduction of GST is the weaknesses of the tax administration. This is a valid concern as GST performance would be poor under a weak administration (Santos, 2002). However, if a tax administration is weak, its strengthening is a priority regardless of what taxes the country has in place. This is because while the tax policy and tax laws create potential

for raising tax revenues, the actual amount of taxes flowing into the government treasury to a large extent, depends on the tax administration (Gill, 2003).

In the developing countries, the tax administration's capacities are constrained by many limitations: "although, tax administration has come a long way in many developing countries over the last three decades, there is still much to be done despite the improvements, there remain areas where good tax policy continues to surrender to tax administration constraints" (Bahl and Bird, 2008). Most governments in the developing countries are faced with the same basic limitations concerning the function of their tax administration: the complexity of fiscal legislation; the degree of non-compliance; a steadily growing workload; the need to improve customer service and reduce costs of tax assessment and collection and the need for efficient and effective management (Hogye, 2000).

Efficient and effective management impact on the overall performance of a tax administration OECD (2008) and World Bank (2003). Silvani and Baer (1997) proposed that the efficiency of a tax administration is best evaluated by looking at its tax collection process. Baurer conducted a comprehensive study on tax administration operations in developing countries and found weaknesses in the tax collection process which cover poor management practices, taxpayer registration, enforcement, operating procedure, taxpayer education, employee training, information technology and

performance evaluation and control. Findings from case studies in India (Das-Gupta *et al.*, 2004), Latin American countries (Lledo *et al.*, 2004) and Indonesia (Brondolo *et al.*, 2008) also supported the above claims. A poor tax administration in terms of raising revenue has serious effect on a country's income (Teera and Hudson, 2004). According to Das-Gupta *et al.* (2004), poor tax collection in developing countries has limited the capacity of their governments to raise revenues for developmental purposes.

In terms of effectiveness of a tax administration, Bird (2003) stated that effective tax administration requires establishing environments in which citizens are induced to comply with tax laws voluntarily. Low tax compliance is a matter of serious concern in many developing countries (Das-Gupta *et al.*, 2004). Cobham (2005) calculated the overall level of tax revenue lost due to non-compliance in developing countries to be equal to roughly US \$385 billion per year. In addition, Christian Aid (2008) estimated the overall tax revenue loss due to tax non-compliance in developing countries was US \$160 billion in 2008. Christian Aid (2009) also reported tax revenue losses due to non-compliance of US \$121.8 billion per year in developing countries during the period of 2005-2007. The above studies have highlighted the need to improve efficiency and effectiveness of tax administrations in developing countries.

In the case of Malaysia, a study on the taxable capacity and revenue potential of the developing countries by Le *et al.* (2008) revealed that Malaysia is one of the 37 developing countries which are in the category of low tax collection level. The tax collection performance, specifically the indirect taxes has also been a concern to the Malaysian Government since 2002, when the revenue body was unable to collect unpaid sales tax of RM75.7 million, services tax of RM46.8 million, customs duties of RM46.7 million and excise duties of RM0.57 million. There was also evidence of an increase in the ratio of tax administrative costs to indirect tax revenue and increases in indirect tax arrears to indirect tax revenue throughout the years from 1991-2001 (Mansor *et al.*, 2005).

Tax collection is a measure to evaluate tax administration performance. In fact, Teera (2003), Von Soest (2006) and James *et al.* (2007) stated that tax revenue collection is the first performance measurement that should be considered. They suggested that tax performance evaluation should focus on raising more tax revenue and that revenue performance constitutes the ultimate goal of any tax administration. This calls attention to identify areas of underperformance in Malaysian indirect tax administration to improve its tax collection.

Thus, the principal aim of this study is to provide an objective evaluation of the performance of the revenue body that administers the indirect taxes in Malaysia, i.e., the Royal Malaysian Customs Department (RMC). The evaluation is based on task performance of RMC in comparison with international benchmarks to identify areas of under performance. Further, evidence regarding RMC performance was gathered through a survey on the tax employees to find out their main source of work stress that can impede their job performance. The evaluation of RMC's performance is important since the department is entrusted with the responsibility of administering the GST that is going to be implemented in this country very soon. The present weaknesses that can be found in the administration of RMC can be learned to improve its performance particularly to ensure that the implementation of GST in Malaysia is successful and achieve its intended purpose of being a transparent, fair and efficient tax regime.

LITERATURE REVIEW

The focus on fiscal policy in general and tax policy in particular has sometimes ignored the importance of the tax administration. Surrey (1975) warned that the concentration on tax policy might lead to insufficient consideration of the aspect of tax administration. He further added that the performance of tax administration must receive far greater attention if the goals of tax policy are to be attained. Teera and Hudson (2004) stated that a poor tax performance in terms of raising revenue could result from either deficiency in tax structure policy or an inefficient and ineffective tax administration. Bird and Oldman (1990) also suggested that the administrative aspect of a tax system is one of the elements that should be given attention in the case of a tax reform for a country.

Bird (2007) stressed the importance of an efficient and effective tax administration for developing countries and expressed his concern about its absence in practice. The best ways for developing countries to respond to challenges of globalisation and trade liberalisation are to broaden their tax base, reduce tax rates and improve tax administration performance. The administrative aspect of a tax system must be given attention because how well a tax administration system performs depends on how well it achieves the goals for which it should be held accountable. An efficient and effective tax administration system would enhance a high level of taxpayer voluntary compliance which in turn would result in a high collection of potential tax revenue (Fischer, 1991). Therefore, measuring the tax administration performance as well as improving it is essential especially for the developing countries.

Table 1: Main tasks of revenue administration requiring analysis

Organisation and management tasks	Operational tasks
Strategy and policy formulation	Registration of taxpayers
Planning, budgeting, resource allocation	Taxpayer services
	Taxpayer education
	Taxpayer assistance
	Facilitation of voluntary compliance
Monitoring and evaluation	Processing of declarations and payments
Coordination	Monitoring of tax with holders and collecting agents
Financial management	Collection of information about taxable transactions
	Collection of information from third parties
	Intelligence operations
	Search and seizure and survey operations to obtain incriminating evidence
Personnel management	Risk analysis and selection of cases for audit and investigation
Information technology management	Audit and investigation
Asset management	Recovery of tax arrears
Internal control	Legal and judicial matters
	Legislation
	Appeals
	Prosecution
Anti-corruption	Code of ethics, disciplinary rules, vigilance and cooperation with external anti-corruption agencies
External relations	Effective interaction with important environmental actors to promote the tax administration objectives; meet external challenges and exploit emerging opportunities offered by the environment

Gill (2003)

Tax administration is associated with how the tax authority discharges the responsibilities and tasks entrusted to them. Task is the defining activity of any organisation, i.e., the basic and inherent tasks to be performed by the organisation and its parts (Nadler, 2006). The performance of this task is one of the primary reasons for the organisation's existence and any analysis from a design perspective has to start with an understanding of the nature of tasks to be performed, anticipated work flow patterns and an assessment of the more complex characteristics of the work. Gill (2003) listed the main tasks of tax administration that require analysis when assessing if a tax administration is performing well or not as reflected in Table 1. The tasks consist of organisation and management as well as operational tasks.

Meanwhile, Silvani and Baer (1997) suggested that in order for a tax administration to be efficient, the general strategy of the tax authority should have an integrated approach to the tax collection process as a guiding principle and each elements of the tax collection process are essential to the tax administration strategy. They stated that to achieve a significant improvement in the overall performance of the tax administration, each element in the tax collection process needs to be improved. Researchers elaborated that tax collection process involves: taxpayer registration; tax returns and payments processing; computer operations; detection of stop filers and collection of arrears; delinquent taxpayers; audit; the sanctions and penalty system; taxpayer services and publicity; management and organisation; and personnel.

Basically, the elements in the tax collection process suggested by Silvani and Baer (1997) are the same

elements for the main tasks of revenue administration as proposed by Gill (2003). Hence, this study evaluates the indirect tax administration in Malaysia in terms of the performance of its tax administration tasks.

DOCUMENT STUDY

Document studies were used for the purpose of evaluating the performance of tax administration task at RMC. A total of 47 task items were evaluated based on the general task proposed by Gill (2003) and detailed out by Gallagher (2005). These 47 items were classified according to the following seven categories:

- Enforcement
 - Auditors as percent of tax administration staff
 - Auditors as percent of registered taxpayers
 - Percent of taxpayers subject to annual audit
 - Comprehensive audit plan, type of audit generally used and audit selection criteria
 - Simultaneous or separate audit for different type of taxes
 - Unified domestic and import audits
 - Separation of taxpayers by size or nature
 - Enforcement powers of the tax administration
 - Advance notification of the intention to take enforcement action against the taxpayer
- Payments and collections
 - Electronic payment methods
 - Percent of large taxpayers paying via internet
 - Numbers of stop-filers as percent of registered taxpayers and active taxpayers
 - Average time to detect a stop-filer and procedure to detect stop-filers

- Tax debts as percent of annual tax revenue
- Recovery of tax debt
- Share of fines collected
- Administrative cost as percent of total tax revenue
- Institutions that establish revenue targets
- Automated systems
 - Computerised tax administration functions
 - Interconnectivity between headquarters and local tax offices
 - Data and systems backups
 - Operating taxpayer current account
 - Operating taxpayer registry
 - Automated audit selection
 - Tax declaration entry with automatic error correction
 - Use of external data, exogenous information and third party databases
 - Crossing information among taxes
 - Late or stop-filers system
- Planning and coordinating
 - Planning, monitoring and evaluation systems for tax organisation
 - Coordinate information with ministries and others in the government
- Tax personnel management/human resources
 - Number of taxpayers per tax administration staff
 - Percent of staff in core operational functions
 - Percent of employees with university degrees
 - Ratio of director salaries to that of tax auditors
 - Ratio of average tax administrator's salary to average GDP per capita
 - Existence of administrative career plan and formal retirement plan
 - Specialised training for staff
- Sanctions and penalties
 - Tax administration code
 - Existence of tax fraud law
 - Application of tax fraud felony sanctions
 - Appeals tribunal
 - Type of penalties and late payment interest rates
- Organisation, institutional credibility and public confidence
 - Stability of top-level position
 - Professionalism of top-level staff
 - Tax fraud unit in the tax administration
 - Unit for investigation of internal corruption
 - Internal regulation

The above 47 items for RMC were compared against the international benchmarks as proposed by Gallagher (2005). Comparison data for the benchmarking purpose

was also derived from the report of the World Bank and OECD (2009). The results from the evaluation of these items are summarised in Table 2.

Statistical and explanatory data gathered from various documents and tax officials who held the relevant information were used to examine RMC in performing its tax administration tasks. The measurement of task performance involved analysing 47 items related to tax enforcement, payments and collections system, information technology systems, planning and coordination, tax personnel management, sanctions and penalties and organisational credibility and public confidence. These 47 items were then compared with the international benchmarks from Gallagher (2005) and OECD (2009).

The findings identified key problems in task performance of RMC which were below the international benchmarks. From the findings as shown in Table 2, it was discovered that 13 out of 47 items that showed a divergence from the international benchmarks are related to enforcement (1 item), payment and collection (4 items), information system (2 items), tax personnel management (4 items), sanction and penalty (1 item), organisation, institutional credibility and public confidence (1 item).

Specifically, the aspects of tax administration which were less efficient as compared to the international benchmarks are:

- Existence of a large variety of laws
- Incomplete and not up to date taxpayer registry
- High percentage of stop-filers as compared to registered and active taxpayers
- Low share of fines collected
- Manual audit selection
- Too low administrative cost as compared to total tax revenue
- Unavailability of tax payment via the internet or electronic filing
- Large number of taxpayers per tax administrators
- Small number of tax administrators performing core operational functions
- Small number of tax auditors as compared to tax administrators
- Low percentage of tax administrators with university degrees
- Moderate professionalism of the tax administrators
- Low tax administrators' salary as compared to GDP per capita

Basically, the above items can be classified into two main categories, i.e., tax collection process (items 1-5) and tax administration capabilities (items 6-13). The

Table 2: Royal Malaysian Customs in comparison with international benchmarks

Items evaluated	International benchmarks	Royal Malaysian Customs
Auditors per tax administrators	16-40%	7.20%
Auditors per registered taxpayers	-	1:411
Percent of taxpayers subject to annual audit	1-10%	1.38%
Comprehensive audit plan, type of audit and audit selection criteria	Yes	Yes
Simultaneous or separate audit for different type of taxes	Simultaneous	Simultaneous
Unified domestic and import audits	Trend	Trend
Separation of taxpayers by size or nature	Yes	Yes
Enforcement powers of the tax administration	Broad	Broad
Advance notification of intention to take enforcement action	Yes	Yes
Electronic payment methods	Yes	Yes
Percent of large taxpayers paying via internet	100%	n.a.
Numbers of stop-filers as percent of active taxpayers	5%	13.38%
Average time to detect stop-filer and procedure to detect stop-filer	Minimum	Minimum
Tax debt as percent of annual tax revenue	5%	1.54%
Recovery of tax debt	33-50%	32%
Share of fines collected	80%	70.90%
Administrative cost as percent of total tax revenue	0.75-1%	0.26%
Institutions that establishes revenue targets	Ministry	Ministry
Computerised tax administration functions	Yes	Yes
Interconnectivity between headquarter and local tax offices	Yes	Yes
Data and systems backups	Yes	Yes
Operating taxpayer current account	Yes	Yes
Clean and operating taxpayer registry	Yes	Limited
Automated audit selection	Yes	No
Tax declaration entry with automatic error correction	Yes	Yes
Use of external data, information and databases	Yes	Yes
Crossing information among taxes	Yes	Yes
Late or stop-filer system	Yes	Yes
Planning, monitoring and evaluation system	Yes	Yes
Coordinate information with ministries and other departments	Yes	Yes
Number of taxpayers per tax administration staff	150-250:1	104:1
Percent of staff in non-core operational functions	20%	40%
Percent of employees with university degrees	70%	29.70%
Ratio of director salaries to the tax auditors	2:1	3.2:1
Ratio of tax administrator's salary to average GDP per capita	2:1	0.15:1
Existence of administrative career plan and formal retirement plan	Yes	Yes
Specialised training for staff	Yes	Yes
Tax administration code	Single code	Variety of laws
Existence of tax fraud law	Yes	Yes
Application of tax fraud felony sanctions	Little	Little
Appeals tribunal	Yes	Yes
Penalties and late payment interest rates	Yes	Yes
Stability of top-level person	Fixed appointment	Fixed appointment
Professionalism of top-level staff	Excellent	Good
Tax fraud unit in the tax administration	Yes	Yes
Unit for investigation of internal corruption	Yes	Yes
Internal regulation	Yes	Yes
Various documents from RMC		

weaknesses in tax collection process and capabilities can deter a tax administration from achieving its organisational strategies. Studies have shown that some 90% of managers fail to implement and deliver their organisation's strategies and the key reason for strategic failure is that an organisation's processes and capabilities are not aligned with its strategies (Neely *et al.*, 2007). In this case, performance measurement plays a crucial role by allowing managers to track whether or not the right processes and capabilities are in place and to communicate which processes and capabilities matter to achieve an organisation's strategies. The finding of this study shows that the weaknesses in the processes and capabilities at RMC are due to insufficient resources made available to the department. These flaws are in terms of lack of staff,

lack of staff with specialised skills, logistic problems and insufficient budget allocation for administration purposes, specifically for information technology development and infrastructure.

In order to support the result from the document study on the issue of insufficient resources, a survey on tax employees at RMC was conducted. Specifically, the survey focused on tax employees' work stress as explained in survey on tax employees.

SURVEY ON TAX EMPLOYEES

The survey on tax employees focused on work stress as occupationally-induced stress is a major problem for both individuals within an organisation and for the

organisation itself (Leong *et al.*, 1996). Stress is seen as an undesirable phenomenon which is brought about by inadequate coping with environmental sources of stressors associated with a particular job for example, work overload, role conflict/ambiguity, poor working conditions which results in negative mental and physical health consequences (Cooper and Payne, 1988). Stress at work can contribute to an employee’s poor job performance.

In this study, tax employees’ work stress was measured based on the criterion introduced by Rizzo *et al.* (1970) and adopted by Chang (2008). The tax employees were selected based on the proportionate stratified random sampling method. On the merits of stratified sampling, Sarantakos (2005) noted that such samples are employed when there is a need to represent all groups of the target population in the sample. In this sense, the method is very economical and offers a high degree of representativeness. In addition, some degree of stratification is relatively simple to accomplish and it usually is a desirable feature of a sample design.

In determining the sample size, Sekaran (2003) provided a table that generalised scientific guidelines for sample size decisions. Based on the table by Sekaran (2003), the appropriate sample size for this study was 248. Assuming a response rate of around 80%, 315 questionnaires were distributed to the tax employees to get an effective sample size of approximately 248. Table 3 shows the sampling procedure employed in this study.

The questionnaire survey sought to identify the perceptions of the tax employees of RMC regarding the source of stress in their job and workplace. A total of 315 questionnaires were distributed to the tax employees.

Examination of the response rate shows that it is excellent. This is consistent with Sekaran (2003) who suggested that personally administered questionnaires could yield almost a 100% response rate. The response rate for the survey on the tax employees and the details of the sample are summarised in Table 4.

The finding of the survey is shown in Table 5. It is based on the strength of the tax employees’ agreement with the questions relating to stress. The stress items are stated in negative statements where agreement with the statement indicates the respondents’ agreement with the existence of stress element in performing their tasks. Table 5 presents the summary of statistics showing the strengths of the tax employees’ agreement towards the existence of stress for the total sample in this study. The items with the largest agreements shown by the respondents in the sample are:

Table 3: Proportionate stratified random sampling

Department	No. of staff	No. of staff selected	Actual sampling fraction
Customs	171	80	0.4678
Internal taxes	197	80	0.4060
Technical services	122	60	0.4918
Management	127	60	0.4724
Preventive	80	35	0.4375
Total	697	315	0.4519

RMC staff database

Table 4: Tax employees survey (response rate)

Response rate	Employees
Sample selected	315
Questionnaires distributed	315
Questionnaires returned	288
Response rate (%)	91.4
Usable responses	250

Survey on tax employees

Table 5: Summary statistics of work stress as perceived by tax employees

Q	SI	Stress Items (SI)	Frequency (%)					Mean (SD)	Rank
			1	2	3	4	5		
10	S10	I receive many assignments without the manpower to complete them within the deadlines	13 (5.2%)	67 (26.8%)	60 (24.0%)	69 (27.6%)	41 (16.4%)	3.23 (1.17)	1
9	S9	I receive many assignments without adequate resources and materials to execute them	27 (10.8%)	66 (26.4%)	25 (10.0%)	89 (35.6%)	43 (17.2%)	3.22 (1.30)	2
6	S6	I do not feel certain how I will be evaluated for a raise or promotion	33 (13.2%)	114 (45.6%)	14 (5.6%)	62 (24.8%)	27 (10.8%)	2.74 (1.27)	3
2	S2	There is a lack of policies and guidelines to help me	38 (15.2%)	97 (38.8%)	46 (18.4%)	60 (24.0%)	9 (3.6%)	2.62 (1.11)	4
1	S1	I do not have enough time to complete my work	47 (18.8%)	99 (39.6%)	36 (14.4%)	51 (20.4%)	17 (6.8%)	2.57 (1.20)	5
8	S8	I receive assignments that are not within my training, capability and job descriptions	41 (16.4%)	112 (44.8%)	32 (12.8%)	46 (18.4%)	19 (7.6%)	2.56 (1.19)	6
7	S7	I feel that I work under incompatible policies and guidelines	47 (18.8%)	109 (43.6%)	27 (10.8%)	43 (17.2%)	24 (9.6%)	2.55 (1.25)	7
4	S4	I receive incompatible orders from two or more colleagues	59 (23.6%)	115 (46.0%)	19 (7.6%)	30 (12.0%)	27 (10.8%)	2.40 (1.27)	8
5	S5	I have to work under vague directives or orders	62 (24.8%)	112 (44.8%)	20 (8.0%)	42 (16.8%)	14 (5.6%)	2.34 (1.18)	9
3	S3	There are no clear, planned goals and objectives for my job	121 (48.4%)	84 (33.6%)	18 (7.2%)	25 (10.0%)	2 (0.8%)	1.81 (1.00)	10

Survey on tax employees

- S10: I receive many assignments without the manpower to complete them within the deadlines (Mean = 3.23, SD = 1.17)
- S9: I receive many assignments without adequate resources and materials to execute them (Mean = 3.22, SD = 1.30)

Table 5 shows that generally the tax employees perceived that they receive many assignments without the manpower to complete them within the deadlines and they receive many assignments without adequate resources and materials to execute them. The existence of stress was related to the issue of inadequate human resources, especially in performing core operational tax administration functions such as auditing.

Low motivation and morale, decrease in performance, high turnover and sick-leave, accidents, low quality products and services, poor internal communication and conflicts are related, directly or indirectly to stress and they have an effect on overall organisational efficiency and effectiveness. Severe job stress results in dysfunctional and decreasing commitment and productivity and has both physiological and behavioural effects leading to poor job performance. This in turn can affect the implementation of an organisation's strategic goals and objectives.

The finding from the survey on tax employees further supported the issue of resources at RMC. The result shows that the tax employees' main source of work stress came from inadequate manpower, materials and other resources.

CONCLUSION

This study examined how the indirect tax administrators in Malaysia perform their tasks and how efficient is the RMC as compared to the international benchmarks. The results of this study show that there are some weaknesses at RMC with regards to tax collection process and tax administration capabilities which could affect the overall tax administration performance. The finding from the comparison with the international standards shows that most of the items which are below the international benchmarks relate to the issue of insufficient capital and human resources. Further, evidence on the significance of the issue is derived from the survey on the tax employees which revealed that the main source of their work stress came from inadequate manpower, materials and other resources.

The finding for Malaysia is in line with previous studies concerning the issue of resources. The scarcity of resources is still impinging upon the tax administration

performance in most developing countries. A study by Brondolo *et al.* (2008) for example, found that the tax authority in Indonesia experienced serious staffing problems specifically in the key functions of strategic planning, audit and taxpayer services. The Indonesian tax authority also suffered a problem of outdated information technology systems. The same problem with information technology is also faced by the tax authority in Egypt where the current systems do not yet meet the needs of the modern customs administration (Crandal and Bodin, 2005). The problems regarding staffing and information technology are also experienced by the Latin American countries (Lledo *et al.*, 2004) and Croatia (Ott, 1998). Another study in India (Das-Gupta *et al.*, 1992) revealed that poor use of information collected by the central intelligence branch, ineffectiveness of surveys of business premises, absence of an adequate system of taxpayer identification numbers, absence of an adequate system of third-party information collection and deficiencies in the record keeping system could be solved if appropriate systems and technology are available.

Reflecting on the issue of resources, a tax administration must have adequate resources in terms of manpower, infrastructure and an appropriate organisational structure in order to achieve an efficient and effective tax administration system. Therefore, Malaysian government needs to assist RMC in improving the 13 areas which have been identified as underperformed in comparison with the international benchmarks by providing the department with the much needed resources. This will enable RMC to improve the quality of its task performance in an efficient and effective manner.

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