

# Introduction of goods service tax gst in malaysia economics essay



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In the new global economy, more companies are operating cross border, and as such are faced with the need to deal effectively with many different taxes, often in many different countries, each with different rates, ruling and application. Coupled with this, the regulatory environment is increasingly challenging. The IMF has been trying to push for all countries to adopt the Goods Service Tax (GST), or also known in certain countries as Value Added Tax (VAT), so as to create a more level playing field amongst trading nations. Direct taxes have in the past been used to camouflage 'protectionism' policy of certain countries. High tariff on certain product like motorcar has prevented healthy competition amongst trading nations. The general populations of that country are left without a choice but to consume the local products, as imported products have become more expensive with the high tariff. Often, because of this, the local products tend to be inferior in quality as there is no real incentive to compete.

Other possible reasons for implementing GST are:

Presently, the average birth rate is 2.2, so it is expected that by 2030, 12% of the population will be above 60 years old, double the current number. The current 15% of the working population paying taxes will therefore reduce, putting a greater burden on a smaller group of people. GST is a broad-based tax that distributes the burden of taxation among a larger section of the population based on consumption.

GST preserve the incentive to work and encourages enterprise as it is not a progressive income tax. The tax rate does not increase according to income level; it is flat at the determined rate.

GST is levied at the production and distribution stages, thereby incorporating a self-policing mechanism that facilitates administration and makes it more difficult to avoid or evade. This further reduces the possibility of revenue loss through understatement of tax evasion.

The GST model implemented in Malaysia is not expected to have cascading, or pyramiding, effect as the tax on a particular good depends upon its final value, and not the number of production and distribution channel it passes through. Furthermore, the output tax to be paid will be offset against the input tax, and there is no GST levied over GST.

GST is expected to provide a more stable source of revenue as consumption is less affected by economic cycles compared to income tax.

GST can be an effective tax on the 'shadow economy', as those involved would consume, and thus pay indirect taxes through GST. It is likely that those involved in such activities would buy luxury goods, which would be subjected to GST.

The government is cutting its operating expenditure for 2010 by 13%. This shows it is aware of the growing deficit that has widened due to the stimulus package. Recently, Fitch rating agency has cut the rating of the ringgit, which may cause imported inflation if it depreciates, and the International Monetary Fund commented that the GST needs to be implemented urgently.

Malaysia's budget 2010 reports on GST; is that, it is currently at the final stage of completing the study on the implementation, where analysts are measuring the social impact of its presence in Malaysia. The Malaysian

government said that it could be possible for them to implement this in the near future. Looking at Malaysia in a broader scale, GST will not only affect big businesses, but small and medium enterprises (SME) as well. Although there were a number of past information saying that a food outlet can only charge GST if it's annual turnover is above RM3 million (3, 000, 000 Ringgit Malaysia), the GST compliance requirements and thresholds has not been officially announced.

If we were to take into account GST's implementation into goods and services, we have to assume that it will happen to all stages of the supply chain; which means from the purchase of raw materials or start-up goods all the way to end-user (consumer ready) products available for sale. Ultimately in a product, GSTs charged to every level are passed on to the next person and ultimately, the consumer.

## 1. 2 Background

In the 2005 Budget, the Malaysian Government announced that the current sales tax and service tax would be replaced with a broad-based consumption tax to be known as the Goods and Services Tax (GST). The tax is based on value added concept and is proposed to be implemented on 1 January 2007. This move was necessary, to improve the government's revenue without affecting the population from the lower income group. Since this tax is based on goods and service consumption, it follows that the rich will be the ones more affected since they tend to consume more. The Prime Minister recently announced that this increase in revenue will be used mainly to finance the

hike in Civil Servants' salary and to finance other infrastructure works for the benefit of the nation at large.

A Tax Review Panel was formed in middle of 2005, and it has come out with a Discussion Paper intended for businesses to understand the basic administrative requirements and procedures when GST is implemented so that they know the impact of GST.

Secondly, the Tax Review Panel invites the business community and other relevant organizations and associations to review the proposal in that paper.

Thirdly, by having a public consultation, it provides an appropriate forum for both the public and private institutions to exchange views with members of the Tax Review Panel so as to understand the rationale behind the proposals initiated.

### 1. 3 Problem Statement

The GST was supposed to be implemented in Malaysia in the year 2007; however the government has to defer the move due to critical reviews by certain quarters. After losing four States to the opposition, it has to tread on a careful path in order not to lose more public support. It cannot afford to make any more major mistake in the wake of its dismal performance in the last General Election.

GST is generally known as a tax system which results in regressivity (i. e. people with less pay a greater share of their resources than those with more), in contrast with the ideal aim of progressivity which is generally

sought when implementing a tax. It is sometimes argued that a GST system <https://assignbuster.com/introduction-of-goods-service-tax-gst-in-malaysia-economics-essay/>

does not work in a poor region such as Africa, where most countries have heavy external debt burdens, malnutrition, civil wars and lack of food and medicines which often result in inhuman living conditions. Nevertheless, with the support of the IMF, VAT/GST systems were designed in many African countries to combat or at least alleviate the adverse effect of VAT/GST regressivity by having a list of exemptions and zero-ratings which apply (generally speaking) to basic foodstuffs and other basic necessities.

GST is not always simple to administer, contrary to what the advocates of GST would want countries to believe during the transformation stage. Unless a proper GST administration, supported by modern technology and electronic communication systems can be implemented, GST administration will inevitably be costly for both the Revenue Authorities and the business sector. The output/input mechanism of the GST system, coupled with GST refunds, may provide the ideal opportunity for fraud where corrupt officials and unscrupulous businesses exploit weaknesses in the system. This again results in a defensive attitude from the Revenue Authorities, resulting in bad communication, cash flow and other GST cost.

In 1992, a Free Trade Agreement (FTA) was signed which reduced import tariffs between ASEAN member countries. In the first three years of the FTA, exports amongst the ASEAN countries grew from US\$43 billion to US\$80 billion. In 1997, the leaders of ASEAN adopted the vision to build a stable, prosperous and highly competitive economic region, in which there is a free flow of goods, services and investments, a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities.

The plan is to remove all tariffs for the six more developed countries by 2010 and for all countries by 2015. The summit also progressed the efforts to integrate ASEAN with the much larger economies of Asia- Pacific, specifically China, Japan, South Korea, India, Australia, and New Zealand. China signed a pact to introduce the world's largest free trade zone by 2010, covering almost two billion people. Japan signed a similar agreement to take effect by 2012. India agreed to join in by 2011. Australia and New Zealand have agreed to talks starting next year to free up trade within a decade. The master plan is to have a free trade zone that can compete with the US and EU. In South East Asia, Malaysia remains one of the few countries yet to adopt the GST system, which would indirectly be in the way, if we want to be part of this master plan.

In Malaysia, it was announced that essential goods and services will not be subjected to GST, but fears that GST will spark a chain reaction that will increase the prices of most non-controlled items should not be dismissed. We have seen numerous examples of when there is an increase in a certain commodity; it sparks a price rise in most goods and services. For example, when the petrol price increased to RM2. 70, prices of most goods, foods and services were hiked. But after the petrol price dropped, there has not been a substantial correction in the prices of goods, food and services.

The relevant ministries are powerless to mitigate the situation and curb the necessary inflation. A recent example is on the removal of the subsidy on white bread resulting in price increase of one loaf of bread by 20 to 30 cents.

The Deputy Domestic Trade, Cooperative & Consumer Affairs Minister can only comment that the price adjustment was not necessary, urge traders to <https://assignbuster.com/introduction-of-goods-service-tax-gst-in-malaysia-economics-essay/>

practice corporate social responsibility and call on the consumers to execute their power in hand. All these statements will not effectively curb excessive profiteering and traders taking opportunity to increase the price of goods and service. The public would want to know how the government intends to avoid the similar predicament

## Chapter 2

### 2. 0 What is GST and how does it work?

GST is a consumption tax charged on a wide range of domestic & international products, goods and services. It's a broad-based tax imposed on every level of a product, from raw materials all the way to finished goods. The proposed implementation of GST will replace the current Malaysian service tax and sales tax.

Broadly, GST works by offsetting GST paid on purchases (input tax) against GST due on sales or supplies made (output tax). This is referred to as the credit offset mechanism. The multi tier stages of tax helps to ensure that GST paid by businesses for purchases does not end up being a permanent cost. However, the consumer ultimately bears the burden of the tax.

Conceptually, GST is imposed on the value added to goods or services by each separate processor in the production and distribution chain.

This can be seen in the simple illustration below.

### 2. 1 SOME CONCERN ABOUT THE INTRODUCTION OF GST.



There were some concerns that Malaysians could suffer even more with the introduction of the Goods and Services Tax (GST). GST-driven inflation would be a calamity that the struggling lower-income group could do without.

The GST Bill was tabled in Parliament at the end of the Budget sitting that ended on 17 December 2009. At its first reading, the bill was just mentioned, but there was no explanation of the bill or any debate. The second reading is when the bill is open for debate and proposed amendments. This may come as early as March 2010 for the GST Bill. Once approved, the new tax can be implemented as early as 2011.

The table below lists the government's tax revenue for 2008 which contributed RM112.9 billion or 70 per cent of total government revenue.

#### Government Tax Revenue in 2008

Personal Income Tax	RM 15.0 bil
Company Tax	RM 37.7 bil
Petroleum Tax	RM 24.2 bil
Export and import duties	RM 5.4 bil
Excise duties	RM 10.7 bil
Sales and Services Tax	RM 11.7 bil

As shown in the table, the biggest source of tax revenue is company tax, which at 26 per cent of declared profits, currently brings in RM37.7 billion

into government coffers. Petroleum tax makes up the second biggest tax item while the tax levied on the 1.5 million individuals who are now currently paying personal income taxes in Malaysia makes up the third biggest. All these taxes are deemed progressive for they tax the richest individuals and the companies that are making profits. Progressive taxes do not burden the poorer sectors of society. Progressive taxes tend to equal out income differences between the rich and the poor in society.

It was argued that regressive tax regimes, on the other hand, burden the poor. Sales taxes are generally regressive as they tax consumption and not income. But sales tax in Malaysia has different rates for different types of goods and the government can make them less regressive by levying sales taxes exclusively on goods that are consumed by the richer sectors of society such as expensive cars, big houses, overseas travel, expensive restaurants and other luxury items.

The Goods and Services Tax, however, is perceived to be even more regressive for it is levied at a flat rate on a very wide range of products including many items that the poorer people need to buy. It might lead to a rise in prices and would definitely hit the poorest the hardest. As in most countries with the GST in place, a reduction of corporate tax and personal tax will follow suit. This then, is seen as the real reason that the GST is being brought in - to make Malaysia more "business friendly" by cutting corporate tax (which has already been reduced markedly from the 40 per cent level in 1988 to its current 26 per cent).

## 2. 2 LACK OF INFORMATION AND CONFUSION ON GST.

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The piecemeal release of information is creating great concern among the people and in the business sector. For example;

Will the authorities furnish an extensive list of item that will be charged GST, and what will be exempted?

If a product, like rice or chicken is exempted, does the exemption apply across the board regardless of the form of the product? For example, is cooked rice or cut, frozen or marinated chicken also exempted?

What is the difference between exempt and zero-rated GST?

Will there be any reduction in personal and corporate tax?

What changes will be made to the sales and service tax?

There is a perception that as GST is a multistage tax, it would result in higher effective tax rate than 4%. As GST is very technical, most people are unaware how it will impact them.

When will the GST rate be reviewed?

Recent media statement on its impact did not improve opinion on the introduction of GST. It is reported that under the sales and services tax system, the burden on the poor is 2.38%, but under the GST it will be 2.17%. For the higher income group, the tax burden will be reduced from 13% to 2.74%, according to the Finance Ministry. The overall savings for households will be between RM14.52 and RM346.92 yearly. This clearly contradicts other statement from politicians, and the public perception, that

the GST will be inflationary. But as no further details are provided on how the savings are arrived at, public sentiment remains negative on GST.

## CHAPTER 3

### EXPECTED IMPACT OF GST

#### 3. 1 Impact on the people in the street.

Generally, the public is concerned that the introduction of GST will hit their wallets directly. In an initial assessment, as the GST is expected to be lower than service tax, the bill for a restaurant meal will be 1% lower as the service tax rate is 5% and GST is 4%. For other services liable to service tax, a GST rate lower than service tax should result in a slight decrease in charges if the cost of the other components in providing the service remain the same.

On goods that attract sales tax, the current rate seems higher than the proposed GST, hence there might be a reduction if there is no further adjustment. Current rates are as follows;

- Fruits, certain foodstuff and building materials (5%)
- General goods, including motor vehicle (10%)
- Liquor and alcoholic drinks (20%)
- Cigarette and cheroots (25%)

For hawkers; even though they do not have a turnover of RM500, 000 yearly, so are not required collect GST, the material procured, for example, noodles,

fish balls, processed meat, chicken, equipments for the stall may be subjected to GST, resulting in price hike. But without detailed knowledge or mapping, or even information on the duties charged, the people are uncertain whether the prices of goods and services will remain stagnant, increase or decrease.

### 3. 2 IMPACT ON BUSINESSES.

The implementation of GST is expected to impact business in the following manner:

Compliance costs are expected to be incurred as there is requirement to track the input tax and output tax to determine refund or tax to be submitted. Even though some Malaysian companies are already paying sales tax or service tax, there was no input tax to be monitored and accounted for to offset against output tax.

Business process and procurement need to be mapped out, especially with respect to suppliers and promotional items. For example, a new car attract GST, but items provided for free during promotion – like sports rims or a GPS system – may not be eligible for an input tax claim. Likewise the corporate souvenirs and hampers given out by businesses may not be eligible. The procurement department should start detailing the sales tax or the existing tax paid for their items used a raw material. As the GST is expected to be lower than most current indirect tax, there should be some potential cost savings. This is also to avoid being overcharged by supplier that intends to add the GST over the existing price of its supplies after sales tax, there should be some potential cost saving.

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Human resource factor: New staff may need to be employed to ensure a business is compliant and conversant with the GST requirement. As most staff have not been exposed to GST, training needs to be conducted.

Accounting system and account payable: The business would require an appropriate accounting system to keep track of the GST amounts. Most systems could be upgraded, and it is important to notify software vendors to test run the data to avoid any potential complication.

Cash flow management: Businesses should be aware that output GST may have to be settled before settlement of sales invoices by customer.

Meanwhile, payables on which input tax has been claimed but remains unpaid after six months have to be accounted as output tax and are to be reclaimed as input tax only after payment is made. Businesses are concerned about the timeliness of the refund process as delays would result in a higher working capital cost.

In addition, businesses that have thin margins are worried about the speed of the refund for input tax, especially if the business is mainly exported-oriented and procure its raw material locally.

### 3. 3 OTHER IMPACTS:

The expected impact on corporate and income taxes are as published in the news recently. Deputy Finance Minister Chor Chee Heung quoted that Malaysia will see a gradual reduction in its corporate and income tax rates once the proposed Goods and Services Tax (GST) is in place by mid-2011.

He does not think that there was a timeline for achieving this reduction in corporate and income taxes, as this is a long-term objective of the government. Once the GST come into play, it will be a broad based tax and the trend is, once GST is implemented, corporate and income taxes will gradually be reduced.

Chor also disclosed that businesses related to services such as those in the food and transportation sectors, would be exempted from the proposed GST. He gave assurance that the cost of living and lifestyle of the people would not increase or be affected with the implementation of a GST.

He also added that the implementation of GST would not cause inflation. Once the GST is in, the service tax and sales tax (now imposed) would be abolished. Both taxes are quite high at 10 per cent and five per cent respectively. The GST at four per cent is considered very low.

Meanwhile, the Finance Ministry's Tax Review Panel Chairman, Ms. Kamariah Hussain, said there would be revenue gains of about 1. 0 Billion Ringgit for the government with the GST implementation.

She explained that the introduction of the GST was part of an overall tax reform in the country. With the GST, the government would have a better mix of revenue, and not be too dependent on income tax and petroleum income.

Second Finance Minister, Ahmad Husni Hanadzlah had indicated that while the GST would replace the existing sales and services taxes, it would not put

pressure on prices and to ease the burden of consumers, staple foods such as rice, sugar, cooking oil and flour would be exempted from it.

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### 3. 3. 1 IMPACT OF GST ON SMALL MEDIUM ENTERPRISE (SME).

SMEs form the backbone of the business activities of a nation. Other than encouraging the growth of new industries such as tourism and biotechnology-based industries, the Government (2004 Budget Proposals) too has singled out SMEs to spearhead domestic growth.

However, there is a group of ‘ unhappy’ people representing non-governmental organizations (NGOs) and the public who have expressed their non-approval for the introduction of the proposed GST. Their main argument is that GST favours the rich and burdens the poor at large. Their contention is that “ it will burden the people and contribute to the widening gap between the rich and the poor, not to mention the rise in the inflation rate”.

However, tax practitioner, Beh Tok Koay is of the opinion that “ perhaps this small group lacks an understanding of the whole system of GST. It is supposed to be broadbased and will replace the service and sales tax system, and this in turn will help to reduce income tax rates”. There could be two GST rates: a lower rate for SMEs and a higher rate for large enterprises. Imposing two GST rates is, however, difficult to administer as they provide ample room for tax avoidance and increase compliance cost. Lowering the compliance cost of GST would ease the burden of SMEs. If there is convincing data to show that the compliance cost of SMEs are lower if the accounts are computerized, then the Government could provide software packages to the <https://assignbuster.com/introduction-of-goods-service-tax-gst-in-malaysia-economics-essay/>



licensees to enable them to correctly compute GST. Free training and seminars including visits should be extended to SMEs to enable them to have a better understanding of the compliance requirements. One other option is to exempt small businesses from GST altogether but such a decision too has its drawbacks.

The Government has to analyze the revenue gain as compared to the compliance cost before making a decision to determine the threshold limit. With the two-year window period before GST is in force, all of us have a role to play in contributing towards the development of a better broad-based consumption tax system which ultimately would help reduce the rates of income tax. No doubt, everyone especially the SMEs will eagerly await the final introduction of the GST system and the extent of the expected income tax rate cuts.

The business community, NGO and charity organization are concerned about the ability of the authorities to implement GST smoothly. Australia, for example, had to bring in foreign experts to help in rollout of GST. It would undermine investor confidence if the GST is not implemented in a structured manner with minimal hiccup.

Burdening the poor and those economically vulnerable: Some 32% of the household in Malaysia have an income under RM2, 000 per month. The introduction of GST without the necessary revamp of subsidies will result in a heavier financial burden on poor and low-income families. Families with an income below RM2, 000 a month do not have to pay personal income tax. With GST, things that are not basic necessities - toys, processed food, can

food, packet drinks, and so on, could increase existing inflationary pressures. The ongoing restructuring of the subsidy will also create the tension, discomfort and dissatisfaction as people eligible for subsidy could unintentionally be left out as the government establishes and tries to refine its method of distribution.

## CHAPTER 4

### 4. 0 CONCLUSION

GST is unavoidable. It will just be a matter of time when it will be implemented. It may not be a perfect system, but has worked well as a revenue base for other countries. Malaysia's problem may lie more in public education, implementation and enforcement.

To move forward, Malaysia has to conform to the free trade vision of ASEAN and cannot lag behind the other countries. As of today, apart from Malaysia, only Myanmar and Brunei has yet to implement the GST. GST modernises the tax system by addressing tax evasion committed by free riders who want every benefit but refuse to pay for it, or rather have others to pay for them. GST will certainly be a good platform to increase the Government's revenue. Concerns of it being regressive can be overcome by careful and prudent classifications of zero rated supplies and exempt supplies for essential items as against standard supplies for non essential and luxury items.

One good point of starting late is the ability to learn from the mistakes of others. The government has to be fully transparent in the implementation of the proposed GST.

In this borderless world, news and knowledge cannot be curbed. The masses are getting more intelligent and informed. It will not be prudent for the government of the day not to move forward towards a more modern tax system. Rather than blind opposition, critics should provide examples and lessons learnt from the weaknesses of other nations in the implementation of GST or VAT.