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Goods and Services Tax (GST): A New Tax Reform in Malaysia

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Abstract

The Goods and Services Tax (GST) is becoming one of the most prominent topics in Malaysia. The announcement by the Malaysian Ministry of Finance (MOF) in the Budget 2010 on the implementation of GST had created various reactions from practitioners, academicians, general public and most important businesses. GST is one of the tools that are proposed by the Government to reduce continuous deficit budget in Malaysia. This paper discusses the GST as a new tax reform in Malaysia, and covers several issues in order to enhance the understanding and readiness among Malaysian in adopting GST.

Keywords: Tax reform; GST; budget deficit.

1. Introduction

The introduction of Goods and Services Tax (GST) was first announced in the Budget 2005 in order to replace the existing sales and services tax structure in Malaysia. This new tax reform is projected to be implemented in January 2007. However, the Government has announced on 22 February 2006 that the implementation would be postponed to a later date. Recently in Budget 2010 the Government is currently at the final stage of completing the study on the implementation of GST, particularly to identify the social impact of GST on the *rakyat*.

The implementation of GST will witness that, not only on manufacturing and services sector would be affected, but also include other sectors such as education, health, transport, financial services, agriculture and mining, petroleum, land, property and construction, telecommunication, electricity and water industry. Besides, GST also would be imposed on export services/international services, government, charities, club, association and union.

During the first time GST was announced, there were conflicting views from the masses. However, GST will also provide more income and strengthen our economy in future. According to Former executive director of the Malaysian Institute of Economic Research Prof Datuk Mohamed Ariff Abdul Kareem, who has been one of the most vocal proponents for the implementation of GST in Malaysia, argues, GST is needed not only to raise more revenue for the Government, but also to diversify its sources of income (TheStarOnline, 2010).

This entails issue of readiness among businesses and the view of the general public that GST would become burdensome. It takes too long to discuss and reviewed the benefit of new tax implementation and the most important concern is toward businesses and public, which they prefer the win win-win situation. Datuk Dr Jacob George, president of the Consumers Association of Subang and Shah Alam, (TheStarOnline) for people to accept any new form of tax, the Government has to make strong effort to educate and explain to consumers clearly on how the new tax will benefit them in the long run.It has to give the public confidence that the additional tax they pay to the Government is managed well and used in their best interests.

Moreover, changes are the main difficult things to do without any preparation. According to tax specialist Dr Arjunan Subramaniam, there is always resistance to change, even change for the better. The main challenge is addressing the mindset of taxpayers. They need to be educated on this new method of indirect taxation (TheStarOnline). Besides, the refinement of GST law is one of the most paramount opinions, in the view of practitioners. In addition, the importance of GST is highlighted due to the reason that it is not simply related to tax matter, but it is a comprehensive issue, which could not be taken for granted by society**.**

The purpose of this paper is to explore the GST as a new tax reform in Malaysia. The remainder of this paper is organised as follows: the second section of this paper briefly discusses the reasons of GST in Malaysia. In the third section, general operations of GST are explained. Next, this paper provides deferment issue of GST in Malaysia. The fifth section provides readiness issues of GST. The final section provides some conclusions and recommendations on the topic.

2. Why GST?

In the current environment, there are two Acts that separately govern the goods and services which are known as Sales Tax 1972 (Act 64) and Service Tax 1975 (Act 151). Both taxes were handled by the Royal Malaysian Customs and Excise (the Customs). Sales tax is imposed on a consumer who consumes taxable goods, which is then, collected by business enterprises and accountable to the Customs.

Service tax on the other hand is imposed on a consumer who consumes foods or services for example in places such as hotels, health centres or engages in professional services such as auditing firm and such services listed under Second Schedule Service Tax Regulations 1975. Basically both sales and services tax are single stage tax levied on consumers at the consumption stage. It is known as a single stage tax due to the fact that tax is charged only once, either at the input or output stage (Figure 1).

In contrast to existing sales and services tax, GST or Value Added Tax (VAT) is a multi stage tax. This is due to the payment of tax is made in every stage by the intermediaries in the production and distribution process. In other words GST is imposed at every level of production and distribution chain until the final consumer (Figure 2).

In the pursuit of implementing GST in Malaysia, the Government has established a Tax Review Panel comprising representatives from the public and private sectors. The scope of work of the Tax Review Panel includes formulating concepts, legislation, process and procedure for the GST. As a benchmark the Panel reviewed tax legislations of several countries which include the Goods and Services Tax Act 1985 of New Zealand, Value Added Tax Act 1994 of United Kingdom, Value Added Tax Act 1991 of Republic of South Africa, Goods and Services Tax 1991 of Canada, Goods and Services Tax Act 1993 of Singapore, A New Tax System (Goods and Services Tax) Act 1999 of Australia, Value Added Tax Act 1992 of Thailand, Value Added Tax on Goods and Services and Sales Tax on Luxury Goods 2000 of Indonesia and The Sales Tax Act 1990 of Pakistan.

Citing the tax scenario in Singapore, Pheng and Loi (1994) explained that GST is desirable to be implemented in Singapore due to the following reasons: -

- To reduce reliance on direct taxation
- To sustain a lower corporate tax rate
- To reduce its reliance on personal income taxes due to the problem of Singapore's aging population

In Malaysia, the introduction of GST is aimed at reducing the nation's growing budget deficit whereby it is intended to improve revenue collection. Veerinderjet (2006) argued that, the objective is to have a GST that is comprehensive in scope (that covers a wide or broad base of goods and services) and is effectively implemented so that there is a stable source of national revenue. Overall the introduction of GST in Malaysia is intended to achieve the following:

- To avoid tax cascading, multiple taxation and transfer pricing bias;
- To enhance tax compliance as well as to reduce tax avoidance and tax evasion;
- To implement self-policing, lessen the bureaucratic red tape and to lower the administrative cost;
- To further reduce the cost of doing business by providing tax credit on business inputs and
- To enhance Malaysia's competitiveness and to improve efficiency

3. General Operations of GST

Based on the discussion paper of Tax Review Panel of Ministry of Finance (MOF) (2005), a person who is registered under the GST is required to charge on his output of taxable supply of goods or services made to his customers. He is allowed to claim as credit on any GST incurred on his purchases which are inputs to his business. His customer, if he is also in a business of making taxable supply of goods or services, in turn is allowed to claim a credit on GST paid on his input. Thus, double taxation will be avoided and only the value added at each stage is taxed.

As far as GST rate is concerned, it has yet to be fixed and is sill at discussion level. In Europe, the rate of tax is between 16% and 25% and its GST is more complex and uneven. Basically, there are a few factors considered in determining the rate of tax which include current threshold of sales tax and service tax, number of businesses in Malaysia, exemptions and zero-rating, social and economic considerations and compliances costs as well as comparison with other countries which have implemented the GST or VAT. Table 1 shows the GST/VAT rate in Association of Southeast Asian Nations (ASEAN) countries.

In the GST environment, tax will be imposed in two situations, which are input tax and output tax. Moreover taxable person might fall under one of the three categories of GST rates: standard-rated supplies, zero-rated supplies and exempt supplies. The tax treatments for these different categories are different as explained below.

3.1 Input tax

Input tax is the GST that a taxable person has incurred on the purchases of goods and services in the course or furtherance of his business.

3.2 Output tax

Output tax is the GST that a taxable person charges on his taxable supply goods and services made by him in the course or furtherance of his business.

3.3 Standard-rated supplies

Standard-rated supplies are defined as taxable supply of goods and services, which are subject to a standard rate. The taxable person is eligible to claim input tax credit on his business inputs in making taxable supplies.

3.4 Zero-rated supplies

Zero-rate supplies are taxable supplies which are subject to a zero rate. Although there is no GST to be imposed on these supplies, the taxable person is eligible to claim input tax credit on his business inputs in making taxable supplies.

3.5 Exempt supplies

Exempt supplies are non-taxable supplies that are not subject to GST. Suppliers of exempt supplies are not eligible to claim the GST incurred on his business inputs.

Furthermore, in the case of input tax there is credit, which is eligible to suppliers or intermediaries to claim, known as input tax credit. In other words, he is allowed to claim as credit on any GST incurred on his purchases which are inputs to his business.

The purpose of input tax credits is to remove the tax on business input. According to the Tax Review Panel, the mechanism for input tax credit is as follows: -

- Tax incurred on inputs can be offset against the output tax in the relevant taxable period subject to a time limit 24 months from the data of supply
- Any refund of input tax credit may be offset against future output tax and other unpaid government taxes or duties
- Input tax credit will be refunded within 14 working days for on-line submission and 28 working days for manual submission

However for the refund on the input tax credit, Veerinderjet (2006) mentioned that one just has to refer to the difficulties faced with income tax refunds. He argued businesses just couldn't believe that a refund will be made in so short a time period. In this case, the Government should thinks comprehensively in convincing businesses on the refund matters.

4. Deferment of GST

The implementation of GST was announced in the Budget 2005 and is set to take place on January 2007. The GST is under first strategy of Budget 2005, which is to enhance the effectiveness of government financial management, efficiency of the delivery system and competitiveness. However, on 22 February 2006, the Malaysian Government announced that the implementation of GST would be postponed to a later date.

There are many factors involved in the deferment of GST and one of foremost is the readiness issue among small and medium-sized enterprises. Many businesses are coming to the realization that GST preparation is complex and will have a profound impact on financial reporting and strategic decisions in many areas of business including business planning, pricing and competitive positions.

In addition, even though GST is not yet to be implemented, businesses projected to have higher initial costs especially for establishment an effective information system and knowledgeable teamwork for GST operation. In conjunction to that matter, Veerinderjet (2006) has noted that one of the logical reasons of GST deferment is readiness among enforcement agencies itself i.e. Malaysia Royal Customs and Excises. This will include computerization, electronic filing facilities, educational activities and training of Customs officers in auditing techniques, etc.

5. Readiness Issues of GST

Factors that need to be considered when implementing GST are presented in Figure 3:

5.1 Communications

The knowledge and expertise for GST implementation need to be spread out from the top management to all staffs in each department. This is because they need to understand how GST will affect the performance of company. Moreover, every company needs to execute seminar, training and course in order to be quality companies and aware for GST conformity. Once deciding to implement GST, company as a business community also needs to re-assess their approach towards the management of GST whether their staffs can cope with this new operation of GST.

5.2 Accounting and Finance Graduates

Future graduates need to be prepared with sufficient and broaden knowledge in order to ensure company readiness in implementing GST since this is a new issue in Malaysian Indirect Taxation. They need to understand the whole processes that involve suppliers, customers and government. In addition, they should also understand the reason of GST implementation compared with Sales Tax. Actually, the successful introduction of GST is depends on education at all levels of community and not only graduates.

5.3 Roles of Tax Authority

In this new tax reform, tax authority need to play important roles to enforce GST in order to ensure their level of understanding. They need to give training and motivate each company in case to encourage them to implement GST. In addition, sufficient consultation on relevant GST issues for respective industries need to be given. Then, the authority needs as well to be compassionate when meting punishment for mistakes made by taxpayers in order to encourage them at the beginning of GST implementation.

5.4 Cash Flow Management

In implementing GST, cash flow for each company will be affected because they need to pay more to each of the supplier for the taxable charges and price mark up. Thus, most of the company needs to ensure a good level of cash flow in daily operation.

5.5 Pricing setting up

In preparing GST, management of company needs to really understand how to setting up price for goods or services because every path of supplying item from suppliers is taxable. They need to know the taxable amount and the margin for each part to ensure they will receive sufficient profit at the end of manufacturing goods or supplying their services. This is because once GST is implementing, business will raise the price of their goods and services

5.6 Developing Information Technology

Developing a new system is one of important preparation for GST and will involve in computerized accounting system in order to have accurate financial reporting. This is because every taxable percentage needs to be charged for every single path of manufacturing or servicing. Most of previous accounting system is not ready with GST modification thus we need to modify, revamp or to do significant changes.

Hence, the role of developing a new system is play by both of company and system developer because they need to have a good system in order to comply with GST obligations. The survey and research need to be done before any system can be adjusted to be GST compliant. Furthermore, the cost-benefit impact need to be analyzed whether to purchase a new system or make changes on current system. However, at the beginning they need to understand the process of GST to make sure the level of readiness to implement a new system.

5.7 Manage Human Resource

More human resources need to have by both companies and tax authority. In company, they need more resources in order to refurbish overall operation of manufacturing or servicing especially when they need to handle a new system of GST. So, company need to take prompt action to enhance staff knowledge and expertise in handling any GST case. Moreover, the tax authority must recruit more new staff to be GST personnel or help-desk to provide the relevant fundamental information in order to assist taxpayers in preparing for GST.

Conclusion

Today, GST is an important issue in Malaysia and it is believed that it will boost tax consumption revenue. Thus, in ensuring the smooth implementation of GST, all parties must be well prepared and give full commitment towards it. The public should not solely rely on the Government only i.e. the Customs in ensuring its success but the responsibility is especially for the businesses. Perhaps, by continuously reducing the corporate tax from 28% to 26% in the year 2008 which has been mentioned in the Budget 2007, it will gives a comfortable room to businesses to commit towards GST.

Most important, any weaknesses that are identified during the initial implementation of GST should be improved and reengineered in order to create ‘win-win situation’ to all parties involved. As a conclusion, GST would enable to strengthen the Malaysia’s economy and enhance the public quality of life.

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Figure 1: Tax Treatment of Single Stage Tax

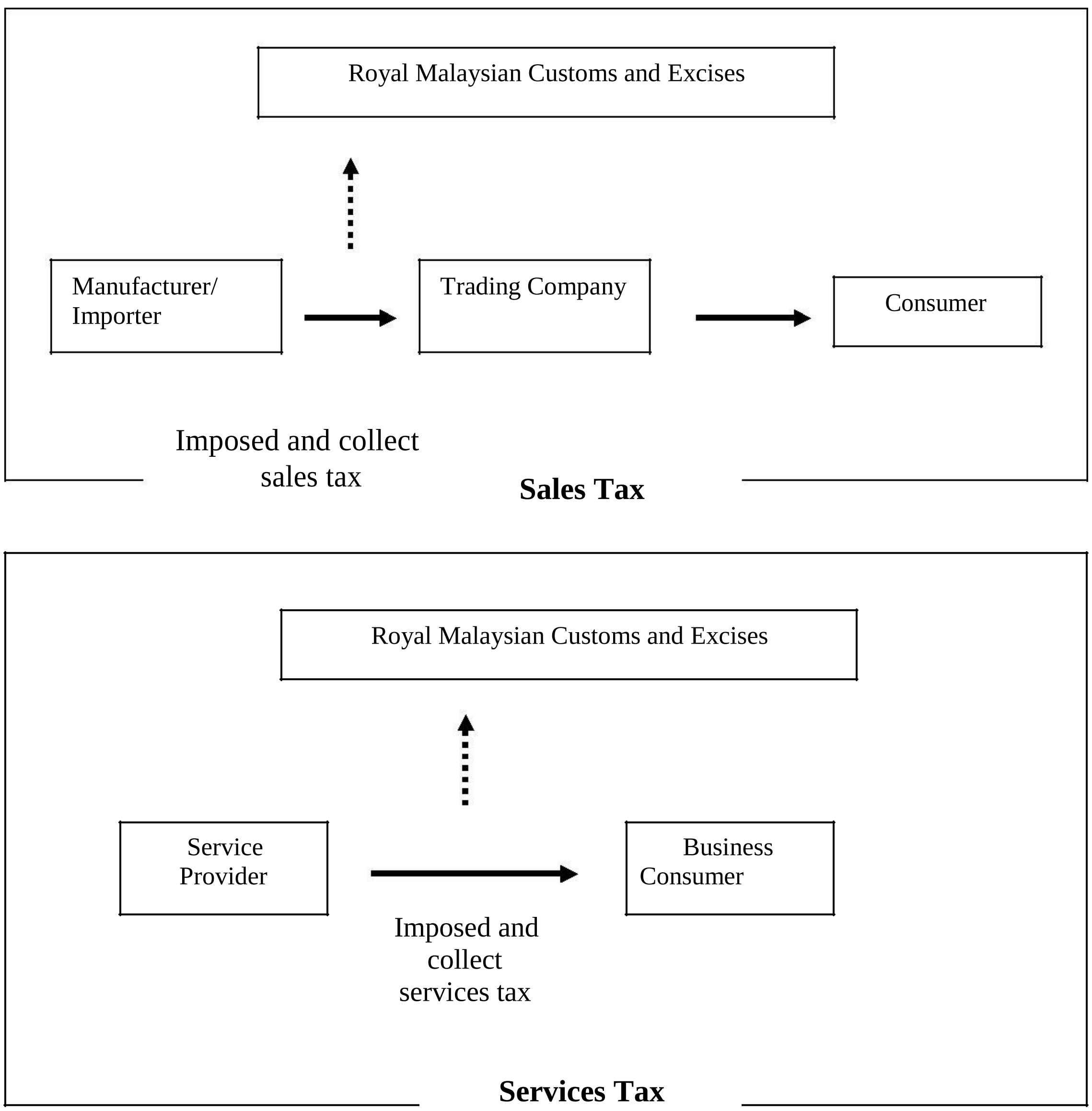

Figure 2: Tax Treatment of Multi Stage Tax

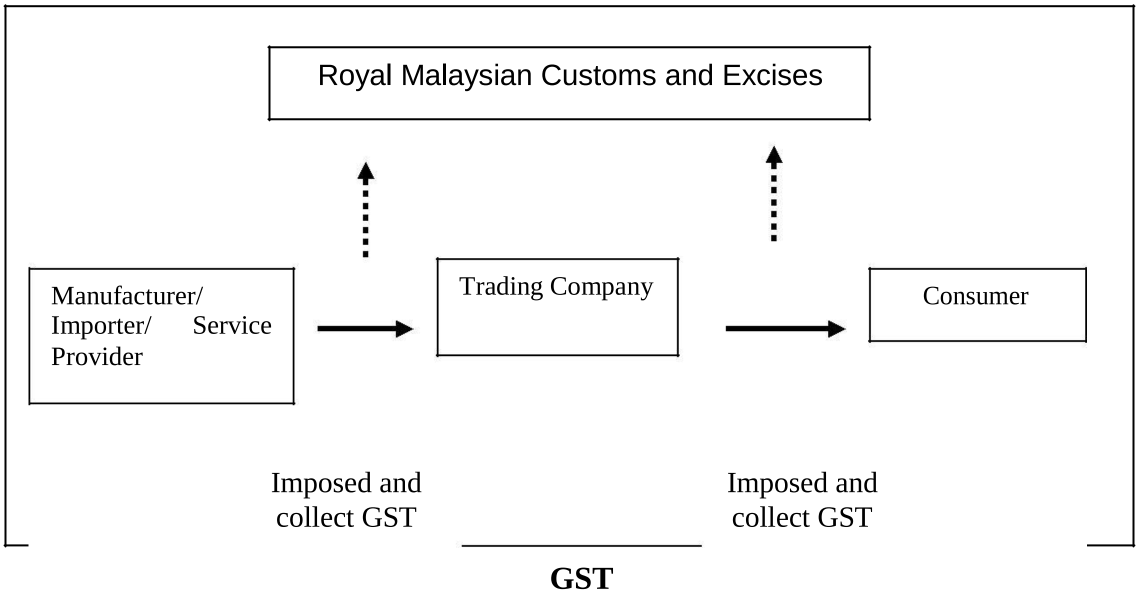

Figure 3: Readiness issues of GST

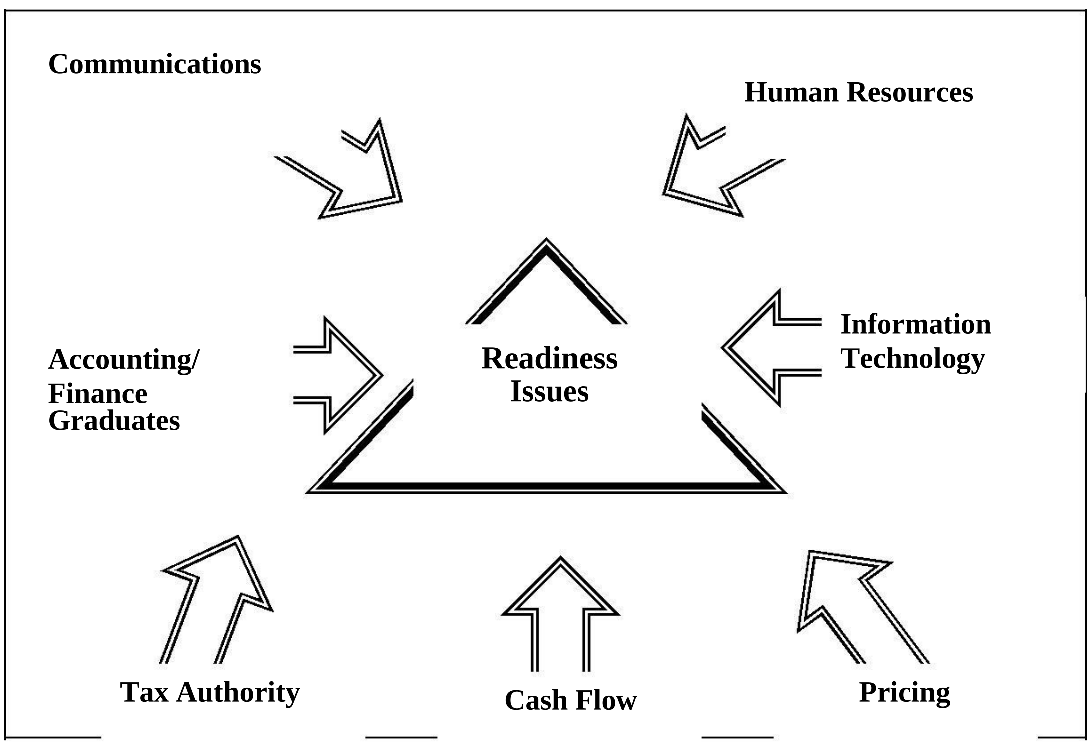

Table 1: GST/VAT rates in ASEAN countries

Country	Date Introduced	Current rate %	Poverty Rate (%)
Cambodia	1999	10	30.1
Indonesia	1985	10	14.2
Philippines	1998	12	32.9
Singapore	1994	7	0.00
Thailand	1992	7	8.5
Vietnam	1999	10	13.5

Source: Asian Development Bank as of 31 Dec 2009