GST – A boost to SMEs?

Small and Medium Enterprises ("SMEs") have often been labelled the backbone of any industrialised economy. In Penang, parts, components and services produced by SMEs are essential and critical ingredients to the success of many multinational companies ("MNCs") who have made Penang their manufacturing home.

While MNCs investing in Penang have always found our Free Zone and Licensed Manufacturing Warehouse ("LMW") facilities advantageous and business friendly for their export oriented business, SMEs have often faced challenges securing similar benefits for their sales tax exemptions and facilities. This has often led to increased administrative efforts on the part of the SMEs or increased indirect tax costs to their business.

The goods and services tax ("GST") proposed to replace the current sales and services tax ("SST") will be effective 1 April 2015. The proposed GST will be a welcomed relief to SMEs as it has been proven in more than 160 countries to be a more efficient, effective, transparent and business friendly tax.

SO HOW DOES THE PROPOSED GST BENEFIT SMES?

Input tax credit mechanism

Being a broad-based consumption tax, GST will be levied and collected at each stage of the production and distribution supply chain. The tax levied and collected is known as output tax whereas the tax incurred by businesses on the inputs used in the making of their taxable supplies is known as input tax.

The input tax credit mechanism within the GST system allows businesses to claim back their input tax incurred in the making of their taxable supplies. The input tax claimable is to be netted off against the output tax levied and collected by the businesses on the taxable supplies that they make. Any excess of input tax over output tax will be refunded by the Royal Malaysian Customs (i.e. 14 days for e-filing or 28 days for manual filing).

This transparent and business friendly input tax credit mechanism under GST augurs well for SMEs who have often faced challenges securing sales tax exemptions or other drawback facilities. With this input tax credit mechanism, all SMEs will now be able to achieve tax free status for the inputs used in the making of their taxable supplies.

In addition, the input tax credit mechanism will also "flush out" any SST which are incurred by intermediaries within the supply chain and embedded within the SMEs' business costs. In particular, service tax presently imposed at 6% on prescribed services consumed by SMEs in the course of their business will now be eliminated under the GST system.

See table below for a comparison of the current SST and the proposed GST.

Today's SST		Tomorrow's GST
Sales Tax	Service Tax	
• Ad valorem (5%-10%) & specific rates (dependent on products) • Single stage tax at manufacturer's sales • No input tax credit	• 6% (no tax on imported services) • Single stage tax on prescribed services • No input tax credit	• 6% (unless exempt or zero rated. Tax on imported services) • Multi-stage & broad based consumption tax • Recoverable input tax credit
Cost to the business		Tax neutral * *except to businesses that provides exempt supply

Benefits from cost reduction

The combined effect of input tax credit claim and elimination of embedded SST under GST is likely to lead to elimination or lowering of the incidence of SST costs to SMEs. Let us now examine the benefits that SMEs can derive from the elimination or lowering of SST costs under the GST system.

1. Improve export competitiveness

As a measure to maintain Malaysia's competitiveness in the international market, all exports from Malaysia under the GST regime will be zero-rated. Zero rated exports means that exporters will be able to claim input tax credit on all input tax incurred in the making of exported supplies.

While MNCs in Penang form the largest group of exporters to the local economy, SMEs, in their supporting roles, provide significant inputs and value add to MNCs in their exports. With the potential of SST costs eliminated or lowered under GST, SMEs could improve their support and value add to MNCs to further enhance the competitiveness of Malaysia's exports. This in turn could generate additional business opportunities for Malaysia.

2. Lower costs of business supplies including capital assets

The elimination or lowering of SST costs to business intermediaries in the supply chain via the efficient and transparent nature of GST embodied around its input tax credit mechanism can result in lower costs of business supplies to SMEs. This could include cost of capital assets as GST paid on capital assets used in the business will be claimable as input tax credit.

Hence, with GST, SMEs could look to their business vendors and suppliers for a potential lowering of costs for business supplies, including the supply of capital assets.

3. Preferred GST registered suppliers

Only businesses with annual sales turnover of RM500,000 or more are required to register for GST. However, businesses with lower annual sales turnover can also volunteer to be registered for GST purposes. But, once registered, a business must remain registered for a period of at least 2 years.

The benefits of SMEs registering for GST purposes are varied. Besides being entitled to claim back GST incurred on the inputs used in the making of their taxable supplies, SMEs would be able to position themselves as preferred GST registered suppliers to MNCs who are looking at optimising their input tax claims. Under the GST system, only GST registered person are permitted to issue GST tax invoices to their customers for the input tax credit claim purposes. In this regard, GST registered SMEs could be preferred suppliers to MNCs who look towards optimising their business costs in Malaysia as a means of staying competitive in their business.

Improving governance

A successful implementation of GST will require SMEs to put in place proper processes and operating procedures throughout their business organisation. This is to ensure that the business not only imposes and levies GST on its taxable supplies correctly, but also claims back only input tax that it is eligible to claim and which can be supported with proper documentation.

This necessity to have in place proper processes and operating procedures for GST will undoubtedly provide SMEs with an opportunity to implement or improve on their existing business governance matters. Such improvements are expected to bring long lasting benefits.

Government assistance

The preparation for GST readiness is not an easy or simple process. It requires SMEs' commitment of time and resources to prepare and implement the processes and procedures that are compatible with the GST technical requirements. Towards this end, SMEs will appreciate that the Government has outlined financial assistance and incentives to assist SMEs in their GST implementation. These include:

1. Expenses incurred for GST-related training of employees in accounting and ICT will be given further tax deduction in years of assessment 2014 and 2015;

2. A training grant of RM100 million will be provided to businesses that send their employees for GST training in 2013 and 2014; and

3. Financial assistance of RM150 million will be provided to SMEs for purchase of accounting software in 2014 and 2015.

Conclusion

In conclusion, it is my view that the implementation of GST in Malaysia has the potential to provide a boost to SMEs. With less than 15 months away from 1 April 2015, SMEs in Penang should take advantage of the time frame given to prepare for GST implementation through early planning and capitalise on the benefits it offers.

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