A complex tax

Being GST-ready was a challenge for many companies, but the real complexity of the new tax regime has yet to be seen

When Prime Minister Datuk Seri Najib Razak announced the implementation of the Goods and Services Tax (GST) during Budget 2014, he also said some goods and services would be exempted from this broad-based tax to reduce the burden of the poorest segment of society. Essential items, such as livestock, meat and vegetables, would not be taxed.

This measure is aimed at reducing the impact of the new tax regime on low-income families, who spend a larger proportion of their household income on consumables than high-income families.

There are four types of supplies under GST — standard-rated (tax is imposed at each stage of the supply chain), zero-rated (subject to GST of 0%, but any input tax credits can be claimed), exempt-rated (only the output stage — the consumer — is exempt from GST), and those outside the scope of GST.

The different tax treatments are aimed at maintaining the progressive nature of this consumption-based tax. The drawback, however, is they exacerbate the confusion among the general public over what is taxable and what is not.

"The intention [of having tax exemptions] is good. The government wants to look after the rakyat. So, supplies that are tax-exempt and zero-rated are well studied by the tax authorities. But the different tax treatments immediately add to the complexity of the tax regime.

"This is true for countries using GST or Value Added Tax (VAT) all over the world. Furthermore, the list of taxable, tax-exempt and zero-rated supplies are communicated in reports and guidelines. There are limitations in getting the right message across when these words are used," observes Hanita Ahmad, executive director at PricewaterhouseCoopers Taxation Services Sdn Bhd (PwC).

Different tax treatments also add to the complexity of becoming GST-compliant. Tax consultants say many companies, especially SMEs, are still unsure about how GST works and what they need to do in order to be compliant although enforcement of this tax is just around the corner.

"I think large corporations — the listed companies — are mostly ready for GST. They have taken active measures since the government announced the new tax regime and engaged tax consultants and other relevant parties.

"My concern is the small and medium enterprises (SMEs). Small business owners probably don't realise the complexity and far-reaching consequences of the GST regime. Many are rushing now. My guess is that a number of SMEs will not be GST-ready come April 1," says Renuka Bhupalan, managing director at Taxand Malaysia Sdn Bhd.

"There have been many seminars by the Royal Malaysian Customs Department and by tax advisers like us, but business owners still need to know more. This is because the GST regime is really wide.

"Many companies are still upgrading to or implementing GST-compliant software and business owners are still thinking about how to price their products in a way that adheres to the Anti-Profiteering Act and without hurting their current profit margins," says Jack Wong, senior GST adviser at accounting firm Cheng & Co.

The GST mechanism levies tax at every point along the supply chain. Business owners get to claim a tax credit for any tax paid in the production stages. GST-compliant software is used to capture transactions that are affected by this tax. Where possible, the appropriate treatment is automated by the system.

A common misconception among business owners is that the right software is all that is needed to be GST-compliant. But the accounting treatment, use of tax codes and apportionment rules, if used by a business, also need to be understood by employees so as to avoid entering the wrong information into the system.

"We live in a complex world and there is a tendency to want a system that can automate everything. But it is important to know what to do.

"Companies in other countries have not automated their GST-compliant systems to the extent that it has been done here. In the UK, which has had VAT for more than 40 years, a lot of transactions are still manually recorded," says PwC senior consultant Tim Simpson.

Tax consultants and software vendors say training and informed employees are the keys to becoming GST-compliant and filing accurate tax returns. Training and documentation is emphasised to ensure that employees are aware of the impact of what they do and that this knowledge can be passed on to new employees.

"The nitty-gritty of this tax regime caught people by surprise — what is taxable and what the appropriate treatment is. There are no generic best practices that a company can adopt to be compliant.

"Every business is unique and management needs to take ownership of the process even though the finance department has the big responsibility of collating information and producing GST reports. Basically, companies would have done what is called GST-mapping, that is, identifying all the purchases that are made and all the supplies that are provided to customers and the appropriate treatment for each," says Renuka.

"People need to understand how it works — the accounting treatment, tax codes and the very important tax submission documents. An organisation would have documented a process flow chart that covers all the operational transactions and GST impact, if any. The accounting department will need this information," says Wong.

One benefit that can arise from the tedious process of poring over all the business transactions for GST impact is that efficiencies and cost savings can be found.

"It is hard to say what is uncovered when a company looks at all its financial transactions. I have seen companies finding processes that are inefficient.

"For example, keeping money in a suspense account instead of recognising it as revenue or sales just because it has always been done that way. In becoming GST-compliant, a business owner looks at all business scenarios and processes, and sometimes sees a better way for things to be done," says Simpson.

Wong recommends that business owners check to see if their accounting department knows how to compile tax returns using the GST-03 report.

"Compiling the GST returns looks simple as it is output tax less input tax. But entries with the wrong tax treatment that go undetected will affect the entire tax return calculation. My advice is to engage a tax consultant to review your GST computations before submitting the GST-03 document to the Customs Department," she says.

Companies should prepare a manual on relevant tax codes to use and adjustment rules to follow. "Computer systems are user-friendlier these days, so a company should focus on getting their employees trained in GST. I believe that every employee in every department should have some knowledge about GST as it will improve their marketability," says Wong.

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PwC's Hanita recommends that companies that have a GST project team to maintain the team for some time after April 1. "All the knowledge about GST and its impact on the business is in this team. Avoid dismantling the team and sending employees back to their previous roles right away.

"Consider keeping the project champion to deal with issues and problems that may emerge as GST is implemented. Also think about how this knowledge and expertise can be passed to other employees. After all, GST is here to stay, but people move on," she says.

The consequences of not being GST-compliant largely depends on the stance taken by the authorities. According to Raja Kumaran, executive director at PwC, the director-general of the Customs Department has said he will be fair but firm when it comes to compliance issues.

"Think of the position he is in. It is very hard to come up with an open statement. If he comes across as too lenient, there is no incentive for companies to get ready," says Raja.

He believes that the director-general will deal with the issue of non-compliance on a case-by-case basis. "An offence is an offence. If something isn't done as it should, then that is an offence. But I think the authorities will look at the steps and intentions of the company in committing this offence.

"Are there efforts to be GST-compliant? Is there an element of fraud? If so, then he will be firm," says Raja.

The penalties imposed on GST-related offences are hefty. For example, failure to submit a tax return will incur a penalty of RM30,000 and/or up to three years' imprisonment.

Companies that are not ready with a GST system and processes are advised to focus their efforts on issuing tax invoices first. "Those that are really not ready should look at collecting their output tax correctly first. Then work on recording input tax. Companies must file a tax return, but they have up to six years to claim input tax," says Raja.

ISSUES IN THE WOODWORK

As businesses struggle with operational and compliance issues, further complexities of the new tax regime are expected to surface in the years to come. One issue tax consultants say is likely to come up is the matter of defining or classifying items, which affects the tax status of the particular items. This occurs when there are two opinions on the exact definition of a particular item for tax purposes

"Once a tax regime has different classifications which affect the tax status, there will be definitional issues. Definitional cases are those that explore what an item really is in order to determine its tax treatment. VAT was introduced in the UK in 1973 and there are new definitional cases in court until today," says Raja.

Simpson cites the Jaffa Cake court case as an example of a definitional issue. Under UK tax rules, most traditional bakery products, such as bread and cake, are VAT-exempt. But a tax of 20% is payable on partly or wholly-coated biscuits, cereal bars and shortbread. In 1991, the producer of Jaffa Cakes, McVitie and Price, were taken to court by the tax authorities for not levying VAT on the sale of this biscuit-size cakes.

In a long-standing, costly dispute, McVitie argued that Jaffa Cakes are cakes and exempt from VAT. The turning point in this case was when McVitie explained that the main difference between biscuits and cakes is that cakes tend to harden when stale whereas biscuits go soft. Since Jaffa Cakes become hard, the judge found them to be cakes and not subject to VAT.

In another tax classification case, Marks & Spencer won a 13-year battle over the tax status of its chocolate-covered teacakes. The retailer took action against the tax authorities for charging VAT on teacakes after wrongly classifying them as biscuits and refusing to return the wrongly charged VAT that had been paid. Marks & Spencer was found to be entitled to a full VAT refund of £3.5 million (RM19.3 million).

"I expect to see definitional cases coming up in the future. This occurs in countries that have implemented GST or VAT all over the world except in places where everything is taxable," says Raja. — *By Elaine Boey*

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