Tax hikes essential to fill coffers but may be detrimental to growth

BY **BEN SHANE LIM**

What goodies do you want from the upcoming National Budget? Tax cuts, please.

But tax collection was already down in the first half, and how the government plans to make up for the shortfall is now the elephant in the room. On top of that, the government needs to play a more prominent role in stimulating economic growth.

Against this backdrop, most Malaysians, namely the bottom 40% (B40) and middle 40% (M40) of households in terms of income level, would probably point to the super-rich, who are also known as the Top 20 (T20), and tell the government that they should be the target group for more taxes.

Already, there is speculation about an inheritance tax that targets the estates of the super-wealthy, besides an outright increase in tax rates for the top income brackets.

Besides, there is also talk about the reintroduction of capital gains tax — a move perceived to be detrimental to the capital markets — as well as taxes on luxury goods.

"In Budget 2016, personal income tax was increased to a maximum of 28% (up from 26% previously) for the highest income bracket. This contradicted the expectation that the implementation of GST would be followed by an income tax cut," says Yee Wing Peng, Deloitte's managing director for tax,

He argues that the T20 already pay a relatively high proportion of the country's taxes, especially since the implementation of GST. "This could lead to the rich putting their money elsewhere. In turn, this can stifle investment. On top of that, it makes Malaysia less attractive," he says.

Keep in mind that there was a mild 1% to 3% reduction in tax rates for the lower income brackets in Budget 2014.

However, should the government be taking a Robin Hood-esque approach in policy making and take from the rich to give to the poor?

"I think last year's tax hike for the rich is just a one-off. Another hike this year is too soon. Besides, it simply doesn't raise enough money. The last hike, from 26% to 28%, was expected to raise tax collection by only RM500 million. That's not enough to solve the revenue shortfall," says Peck Boon Soon, head of Asean economics at RHB Research Institute.

Meanwhile, the government will have to be mindful about taxes on luxury goods as that would affect tourism, he notes.

"Things like luxury cars and motorbikes can be taxed, but taxing luxury goods that tourists consume will be counterproductive," he says, stressing the importance of tourism to the economy.

But Lavindran Sandragasu, PwC Taxation Services Malaysia's senior executive director, is of the view that the negative consequences are exaggerated.

"I'm not quite sure if you can call it a Robin Hood approach — it is simply taxing those with the capacity to pay and giving benefits to those who need it," he tells *The Edge*.

Public revenue declined 9.8% year on year to RM96.29 billion, largely due to a fall in income tax collection. This works out to only 42.7% of the annual revenue target of RM225.656 billion for 2016.

The drop on revenue is not due to shrinking petroleum revenue that plagued the previous two budgets after the sharp plunge in crude oil prices. In short, another government income source is being squeezed as the country's economic growth decelerates to 4%, apart from lower oil revenue.

Yee says a reduction in corporate tax can lead to higher tax revenue in the long run

"Corporate tax was projected to grow by 9% y-o-y (in 2016). But for the first half, it contracted 2%. This is a huge problem for government revenue. Corporate tax is the largest contributor to tax revenue at almost RM70 billion, even more than GST," Peck explains.

Furthermore, personal income tax contributions have also been shrinking as companies pay less bonuses, Peck adds.

It is apparent the government cannot afford broad-based tax cuts, but targeted tax relief, for instance, deduction allowances for Employees Provident Fund (EPF) contributions and insurance, and allowance for children, could be an alternative, say tax consultants.

Tax relief is perceived to be more viable compared with cash handouts from a cash-flow perspective.

Likewise, a much-hoped-for reduction in corporate tax is also unlikely, says Lavindran.

"At 24%, Malaysia's corporate tax rate is comparable to other countries in the region. Besides, there are income tax exemptions and reinvestment allowances available," he says.

However, Deloitte's Yee argues that a reduction in corporate tax can lead to higher tax revenue in the long run.

"Lower tax rates mean companies are less likely to avoid or evade. The risk simply isn't worth it. Take Singapore, for example. With a 17% tax rate, if you don't recognise your income there, where can you do it for cheaper?"

The government does not have much room to raise taxes either. Most of the usual targets are already struggling to cope with the last round of tax hikes and additional hikes would only do more harm than good in the long run.

The trouble is that there are not many industries or groups that have the capacity to be taxed further given the unfavourable economic weather.

The past one year has seen some of the most aggressive tax hikes on tobacco and alcohol products in recent time. Taxes on tobacco products were raised by over 40% — the second-highest tax rate in Asean — while alcohol taxes almost doubled, keeping Malaysia's rate the third highest globally.

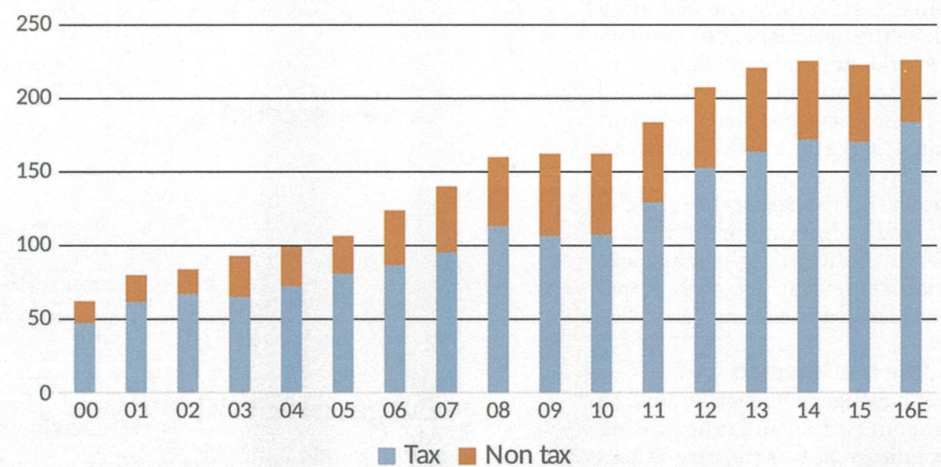
"Raising sin taxes too far just drives smuggling or the black market. We've seen illicit the cigarette market share rise to over 50%, for example. I don't think the government will be able to raise taxes against tobacco or alcohol in the coming budget," says PwC Taxation Services Malaysia's executive director and head of indirect tax, Raja Kumaran.

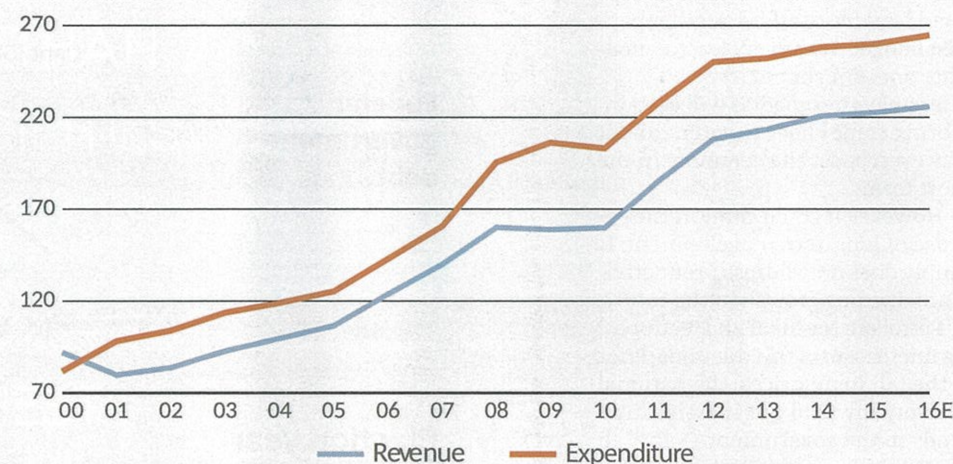
"But they could increase taxes on the gaming industry."

Just like the other sin taxes, Raja cautions that any hike would have to be carefully executed or it could drive business to illegal gaming operators that do not pay any tax at all.

One area where the government can enhance revenue is reversing the zero-rating or tax-exempt status for certain items under GST.

MOF, BNM





MOHD IZWAN MOHD NAZAM/THE EDGE

Raja hopes to see the removal of the requirement that a business generate revenue within 12 months of registering for GST

"We have one of the most convoluted and complicated GST systems in the world with thousands of items zero rated or exempted. Many of these do not benefit the B40 and M40 as much as they do the T20," says Yee.

Raja echoes this sentiment.

"One area that the government can roll back is the exemption for RON95 petrol. It is like a subsidy that everyone enjoys; more so the rich. A more effective measure is to give targeted subsidies to the groups that need it," he says.

While it may seem that the government does not have much room to manoeuvre, tax consultants anticipate Budget 2017 to announce lots of adjustments to the GST.

An increase in the GST rate is highly likely, tax consultants and economists agree.

"Our GST system is only 1½ years old. There are still lots of teething issues that need to be worked out. Australia, for example, has had to make over 200 amendments to its GST Act and ours is more complicated. I expect the government to legislate a number of changes to synchronise the law with decisions made by the director general," Raja says.

Some of the amendments could effectively reduce unnecessary friction with no loss of revenue for the government.

One major change Raja hopes to see is the removal of the requirement that a business generate revenue within 12 months of registering for GST.

"A business needs to register if it wants to claim input tax credits. But take the developer of a mall or hotel, for example, or an infrastructure company. Revenue may take up to five years to come in. In the meantime, being unregistered means none of the input tax credits can be claimed. This is a deterrent to businesses," he explains.

The restriction is to prevent shell companies that do not generate output tax from abusing input tax refunds from Customs.

However, Customs should take a case-by-case approach as opposed to a blanket 12-month requirement, Raja says. "At the very least, if Customs doesn't want to give refunds for input tax, it should allow the business to register and claim the credits once revenue operations start."

Another amendment he anticipates is the inclusion of GST offences under the purview of the Anti-Money Laundering Act (AMLA).

"Previously, sales and service taxes were under the AMLA, but GST isn't," he explains. ∎