New taxes not the only way to increase revenue

BY ESTHER LEE

The Covid-19 pandemic has led to a collapse in government revenue as expenditures skyrocketed in an attempt to contain the outbreak even as the economy deteriorated. With financial numbers looking more dire, are new taxes in the offing?

After nearly 2/3 decades of spending more than it earns, Malaysia now has a fiscal deficit that is projected to balloon to 7% of gross domestic product this year while the debt ceiling may be nudged up to 50% of GDP.

As the economy moves into recovery mode, Putrajaya is anticipating an increase in revenue collection in the second half of 2020 and from 2021.

While the government has assured that new taxes will be implemented only after assessing the potential impact on the retail, Malaysia urgently needs to widen its revenue base so that the fiscal deficit can be lowered and fiscal sustainability ensured.

As Budget 2022 draws nearer, many worry about the introduction of new taxes and what form they may take. Can taxes be introduced without too many negative repercussions?

Given the current economic landscape that is finally inching towards a recovery from the pandemic, most experts do not think new taxes will be introduced in the upcoming budget.

"It may not be the right time to introduce new taxes immediately. Although there are signs of recovery, many businesses are still facing challenges and any new taxes will not go down well with them," says Deloitte Malaysia’s tax leader Sim Kwang Gek.

As Malaysia’s Budget Plan calls for significant funds to be made available for the government and existing tax revenue sources may be hard-pressed to contribute the amount needed, local businesses are also questioning the government’s consideration of new sources of income, he observes.

However, taxes can still attract business and investments, encourage entrepreneurship, foster creativity and job creation and eliminate deadweight costs and red tape that hold back growth.

"Some countries that have successfully implemented tax reforms have noted an increase in their tax-to-GDP ratios by an average of 0.5% a year over a minimum of three years, coupled with economic growth," he stresses.

PwC Malaysia tax leader Jagdev Singh says there is no "perfect time" to introduce new taxes if the purpose is to broaden the existing tax base with a long-term view in mind, rather than as an immediate source of revenue for the government.

"While it is important to develop a framework to widen the country’s tax base for the future, measures can be taken to improve tax compliance for the immediate term, which will go some way in addressing the issue of fiscal sustainability," he adds.

One way sees this happening is through the implementation of a tax identification number (TIN) and the introduction of a special voluntary disclosure programme (SVDP), which can be widened on a targeted basis to cover direct taxes to focus on specific sectors where perceived compliance is low.

Instead of new taxes, Amarjeet says, the government could accelerate the digitisation of the country’s tax administration so that compliance with existing tax rules is made almost automatic.

"Today, to a large extent, the onus is placed on the taxpayer to comply with tax rules and there is still heavy reliance on taxpay

Amarjeet highlights that the shadow economy accounted for 18% of Malaysia’s GDP in 2019. He believes there are many ways for the government to plug the leak, including the use of technology to address areas and players in the shadow economy that will also help restore trust in the system and improve taxpayer morale.

"Digitalisation of the tax administration function, mandatory e-Invoicing and reduction of cash transactions are just a few options that leverage the use of technology to help curb the loss of tax revenue arising from the shadow economy," explains Amarjeet.

In Mexico, the introduction of e-invoicing resulted in a rise in tax revenue of more than 100% and a drop in income tax and VAT evasion rates by 44% and 44% respectively within four to six years.

Capital gains tax debate

A week ago, former finance minister Lim Guan Eng said his party, DAP, is opposed to a proposed capital gains tax, such as a tax, which would also include inheritance tax, would make the country less competitive.

Malaysia does have a capital gains tax regime, but it is limited to the Real Property Gains Tax (RPGT), which was introduced in 1976.

KPMG’s Tai believes there could be merit in introducing a broader capital gains tax. "Currently, the RPGT provision and mechanics on the disposal of shares in real property companies (RPCs) are complex and often difficult to administer in practice. A more simplified capital gains tax on disposal of shares, with simpler mechanics and clear provisions, would be welcomed," he says.

He suggests that the mechanics for capital gains tax be targeted at short-term investors and speculators, who should rightfully pay due respect to the value of tax, while not badly affecting genuine long-term investors.

He explains: "This can be managed if a mechanism similar to that in the RPGT is introduced to reduce the capital gains tax rate after the investments are held for a stipulated period. It will also be necessary to consider allowing deductions for any losses that have been suffered from such activities, to be more equitable. Certain capital gains taxes are also to be considered for retail investors and individuals in the lower-income group."

PwC’s Jagdev points out that in many developed nations, the tax regime has a wider base that reflects a comprehensive means of wealth accumulation covering income arising from physical assets, financial investments as well as gains from the realisation of capital assets.

Even in Southeast Asia, many countries impose a broader base capital gains tax with the exception being Singapore.

Jagdev notes that the initial intention of the RPGT was to prevent speculative gains in real property, as the tax rate depends on the period of ownership.

Nevertheless, from Jan 1, 2019, individuals are subject to a minimum of 5% RPGT for real properties held for more than five years, whereupon, there would be no RPGT payable.

"This would effectively mean that the tax is no longer imposed just to prevent speculative gains but also serves as a form of capital gains tax, albeit on a specific class of asset," says Jagdev.

He adds that it would be inappropriate for the government to consider this from a wider angle to see if the current scope of capital gains should be extended, as well as look into how this tax is widened over time. A higher capital gain rate can be imposed on luxury goods, which should be affordable to the high-income group.

"The perceived regressive nature of GST can be addressed by zero-rating essential items and ensuring that GST collected is channelled to the deserving ones. Strict enforcement is key to ensure no profiteering," she says.

Discussing these issues have to be managed up front to gain the trust of businesses and the public. Many of these can be learnt from our previous experience."