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GST for sustainable revenue growth

TRUST IN Resilience

BY JAGDEV SINGH

Over the last few months, the Malaysian government has announced various Madani economy initiatives, allocating funds for wide-ranging areas to benefit targeted groups, including an inclusive housing pilot project, the Malaysian Investment Development Authority's talent development plans and e-tunai credit.

During the 12th Malaysia Plan Mid-Term Review, the expenditure ceiling was raised by RM15 billion to RM415 billion. The increase was to meet the need to finance priority areas for the people's benefit, to improve the quality of management and re-target subsidies to meet the basic needs of the people. While these measures are a step in the right direction to drive inclusive growth, they need to be funded by expanding the government's revenue base in a sustainable manner.

Ahead of Budget 2024, there have been more focused discussions on the government's decision to widen the revenue base, with the Goods and Services Tax (GST) mooted as a possible revenue enhancement measure.

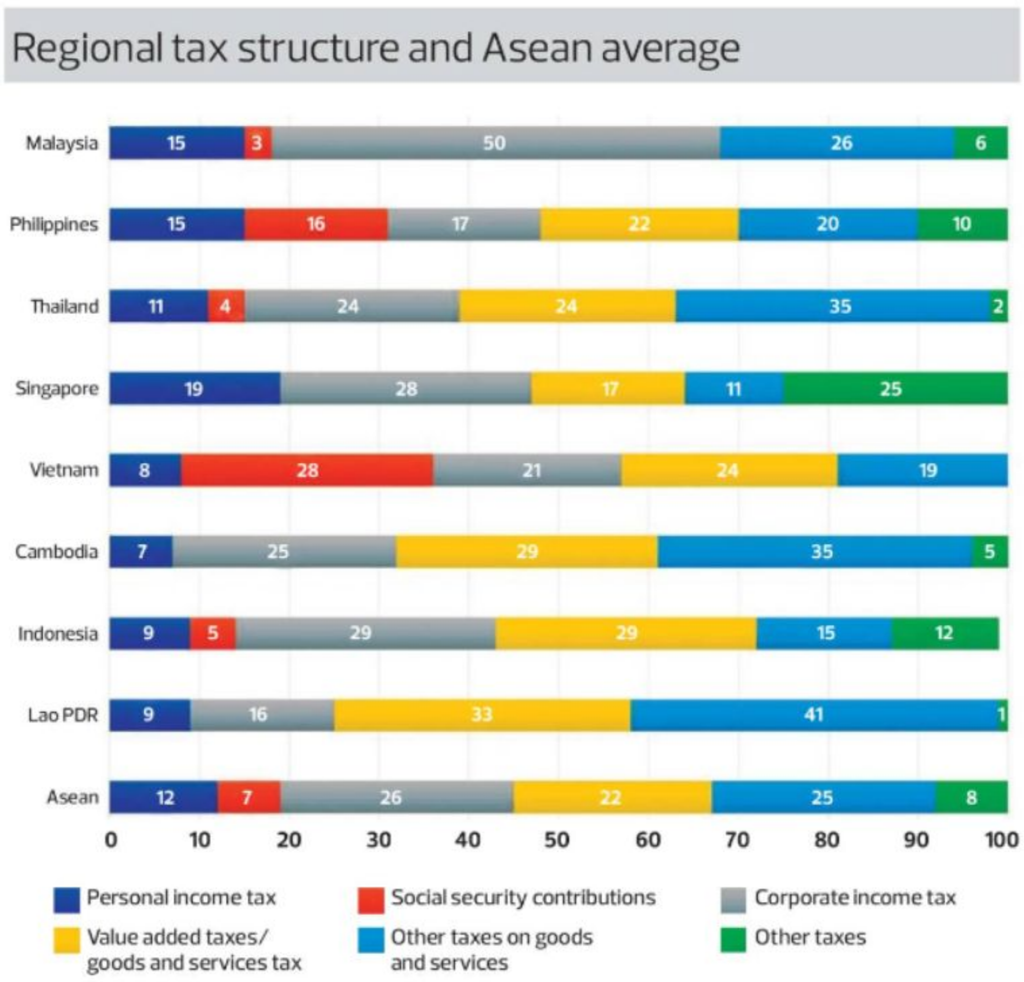
The guessing game continues as to how and when GST can be implemented, bearing in mind the need to ensure that it does not unfairly burden the lower-income groups.

Malaysian tax revenue landscape

Tax revenue is, and has been, the largest source of revenue for the federal government for a while now. In 2022, it constituted almost 71% of total revenue. Yet, our tax-to-gross domestic product (GDP) ratio (11.7% in 2022 and 11.8% in 2021) is on the lower end of the spectrum when compared to most of our neighbours as well as the average for Asia-Pacific.

If we were to break this down further, currently, more than 50% of our tax revenue is from taxing corporate profits. As shown in the chart consumption tax makes up a significant percentage of tax revenue among Asean countries and, of late, has been seen as the most pragmatic way of generating revenue growth. Singapore, Indonesia and Thailand have plans to increase their GST/VAT (value-added tax) rates in the coming years.

The noticeable trend in the chart is that GST/VAT contributions generally exceed corporate income taxes. If Malaysia brings



Data extracted from 'Revenue Statistics in Asia and The Pacific 2023', OECD.

back the GST, it would create an opportunity for us to gradually reduce our reliance on corporate income taxes. This could create an opportunity for us to reduce our corporate tax rates to be more competitive vis-à-vis our regional peers.

The case for GST

GST as a broad-based tax on consumption

Individual taxpayers who paid personal taxes in 2022 make up about 8% of the current population. The RM33.8 billion collected from personal taxes in 2022 does not reflect the full fiscal potential of a nation of 33.5 million people, given the low number of individuals who pay taxes.

Since the types of income and capital gains that are subject to tax in Malaysia for individuals are fairly narrow, consumption tax will help to broaden the tax base equitably.

Addressing inefficiencies in the current system

Sales tax and service tax (SST) are two separate taxes and, as such, inherently inefficient as a mechanism to tax consumption. By design, the number of items covered by sales tax has to be a lot lower compared to GST to keep the cascading effect of tax as low as possible. Similarly, only specific services, which in the majority of instances are consumed by the end consumer, are subject to service tax.

Despite this, there remains a cascading effect for certain goods and services that results in a tax on tax, which ultimately gets passed on to the consumer.

In the absence of an input tax mechanism, expanding the scope and coverage of SST would not be effective as it could bring about other unintended consequences.

An avenue that can really move the needle on revenue

While the government has other options in terms of new taxes or even increasing existing taxes, most of these may not make a meaningful contribution to the government coffers. Given the broad base of GST, which is not entirely dependent on corporate profitability, the potential upside can be significant.

A holistic approach to taxes

In the new economic landscape, which has moved away from the traditional employment-based and corporate-driven structures, it is important for the government to have better visibility of the value chain and ensure that the right amount of taxes, both direct and indirect, is being collected. The key feature of GST, which imposes tax at a transactional level, is that it provides transparency, which would automatically result in parts of the shadow economy being brought into the net.

A GST model that could work

Rate

As our starting point is a service tax of 6% that we are all familiar with and an embedded sales tax of 10% on a majority of goods meant for consumption, starting with a GST rate of 6% would be ideal.

There have been calls for a lower rate to start with. However, this would mean that we could be unfairly taxing consumption across the board (including by the T20) at a low rate. This will end up being akin to the current issue we have with subsidies, whereby it is difficult to distinguish between the different income groups. Hence, as discussed below, a strategy of targeted cash transfers would be more appropriate in mitigating the effect of a higher tax rate on the lower-income groups rather than imposing a lower tax rate on everyone.

Scope

Learning from the past, a long list of zero-rated and exempt supplies results in ambiguities and inefficiencies. Hence, in line with the GST strategy adopted in most countries, we ought to keep the carve-outs to a minimum. Coupling this with a more reasonable registration threshold of perhaps RM1 million would also simplify the administration process.

Addressing the elephant in the room

Unfortunately, GST is perceived as regressive and will potentially burden the lower-income groups if not implemented effectively. The additional GST burden on the lower-income groups needs to be compensated for by way of cash transfers that are targeted and regular. This needs to be an integral part of the implementation strategy.

Also, corporates should not be bearing the cost and uncertainties in terms of timely refunds. Hence, ensuring the proper implementation of a fund for GST refunds is critical.

In conclusion, a strong narrative coupled with an extensive education programme is key to an effective rollout of GST. It is important for the rakyat and businesses to appreciate the mechanisms of a consumption tax to dispel the misconception that it has a compounding effect that will result in price hikes. The lower-income groups must feel that they are not bearing any additional burden as the cash transfers will compensate for any increase in costs relating to their daily spending.

Equally essential is price control and anti-profiteering enforcement to keep unscrupulous price increases in check.

As Malaysia charts its growth journey under the Madani economy, a strong revenue base will propel the country towards high-income nation status. We are just one decision away from real progress. E

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