COVER STORY

A NEED TO DE-DEMONISE GST

BY **CINDY YEAP**

The goods and services tax (GST) has been so "successfully demonised" in Malaysia by certain quarters that it is hardly a surprise that Prime Minister Datuk Seri Anwar Ibrahim made no mention of it when tabling Budget 2024 in parliament, which saw Putrajaya tinkering with limited alternatives.

Those harbouring high expectations of much bolder, more definitive strokes being made on subsidy rationalisation and government revenue as part of the Madani Economy framework are coming to terms with the realisation that even the more progressive ones are treading carefully: one needs to stay in power to enact the necessary reforms.

Yet, going by the tight fiscal conditions and growing socioeconomic spending needs as society ages, there is clearly a need to push the envelope. By opting for lesser but politically safer alternatives, Putrajaya is cheating itself of a bigger income stream, which inadvertently does more damage to the economy and people they want to protect, say experts.

Putrajaya is not oblivious to the facts. When tabling Budget 2024, Anwar said Malaysia is among the lowest tax revenue collectors in Asean at just 11.8% of GDP in 2021, not just significantly below the 16.4% in Thailand but also the 12.6% in Singapore, which is known as a low-tax regime. The tax-to-GDP ratio is even higher in Vietnam (18.2%), the Philippines (18.1%) and Cambodia (18%), according to OECD data (see Chart 1).

What the prime minister did not mention was the fact that revenue from value-added tax (VAT) or GST averaged 26% of tax revenue in Asia-Pacific in 2021, being 33% of tax revenue in Laos, 29% of tax revenue in Cambodia and Indonesia, 24% of tax revenue in Thailand and Vietnam, 22% of tax revenue in the Philippines and 17% of tax revenue in Singapore.

Without revenue from VAT/GST, corporate income tax makes up 50% of tax revenue in Malaysia — more than double the average of 18% in Asia-Pacific, 19% in Africa and 9% in OECD countries, OECD data show (see Chart 2).

"There is a reason our neighbours Singapore, Indonesia, Thailand are looking at raising the GST/VAT ... At 24%, Malaysia cannot raise the corporate tax further when the average in the region is 20% ... there is also limited income that can be raised from the top personal income tax bracket because not many people who are already paying personal income tax actually have that level of high income," says an observer.

SUHAIMI YUSUF/THE EDGE

"[GST/VAT] has been so successfully demonised to the point that it has become a four-letter word. But it should not be so. It is not an accident that the world is using [GST/VAT] to expand tax revenue." — Nungsari

PWC

"[It is imperative for Malaysia to] create an ecosystem that reduces the leakages and also reduces the grey economy." — Jagdev

Not now or not ever

If one sees the glass as half full (rather than half empty) however, indications are that a broader consumption tax like GST or VAT is not entirely out of the question.

While GST/VAT was not mentioned in the budget announcement on Oct 13, there was a feature article on the distinctions between the country's consumption tax — the narrower base sales and service tax (SST) versus the broad-based GST/VAT — in the *Fiscal Outlook and Federal Government Revenue Estimate 2024* report, issued in conjunction with the tabling of Budget 2024.

The big difference between SST and GST/VAT is that the SST is less transparent to consumers as the tax may be embedded in the price of goods, causing an overlap or so-called cascading effect, where an item may be taxed more than once. This cascading effect is why some products and services could end up being more expensive for consumers, experts say, even though the bill may not specifically show how much tax consumers are paying because the tax is embedded in the price instead of transparently shown on the receipt to consumers like in the case of GST/VAT.

Contrary to its demonisation, the feature article notes that "the final price may be lower" for consumers under GST/VAT because there is no cascading problem as the cost to business owners can be reduced with input tax credit claims.

At the same time, the article notes that "as the scope of the tax is broader, the GST impact on consumers may be significant. Nevertheless, the additional revenue collection can support economic activities and enhance socioeconomic welfare. Additionally, GST has the capacity to reduce the size of the shadow economy, hence benefiting the economy".

According to tax experts, the single-stage checking under SST means the government loses out on the tax if it is not captured at the level it is imposed versus multiple-level checks under GST .

An illustrated example provided in the feature article showed how the net tax col-

CONTINUES NEXT PAGE

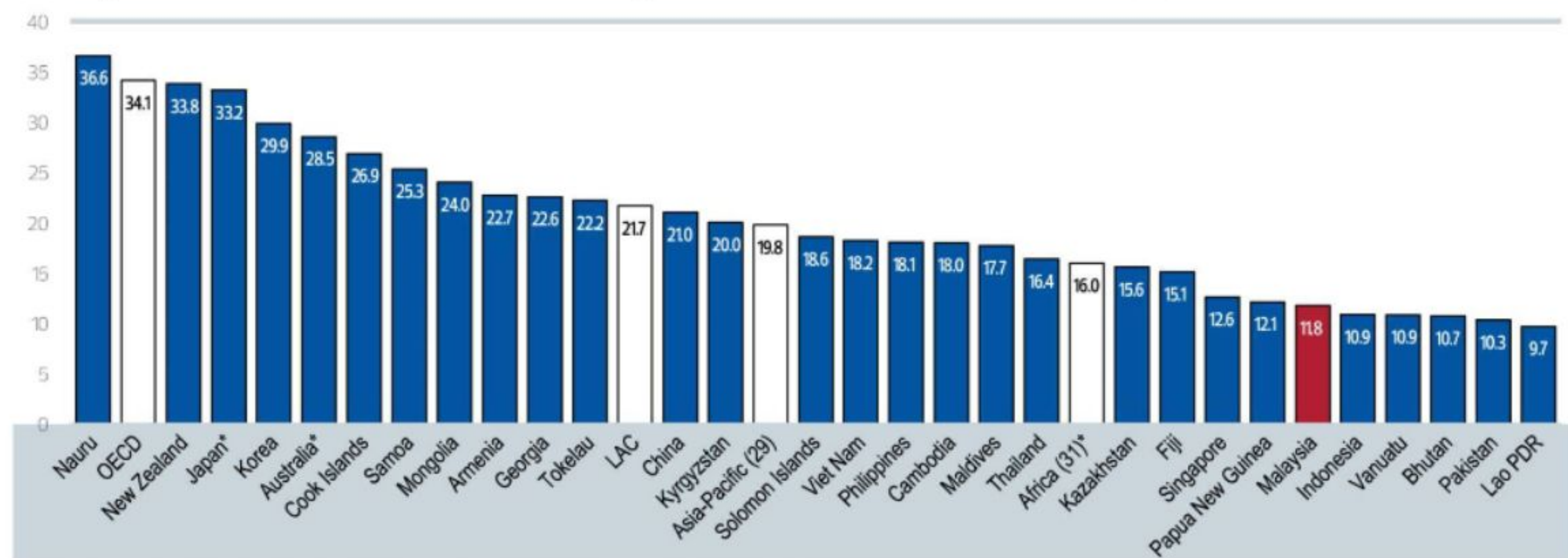
THE EDGE GRAPHICS

COVER STORY

GST often described as a regressive tax, but effects can be negated

CHART 1

Malaysia's tax-to-GDP ratio is among the lowest in Asean in 2021 (%)

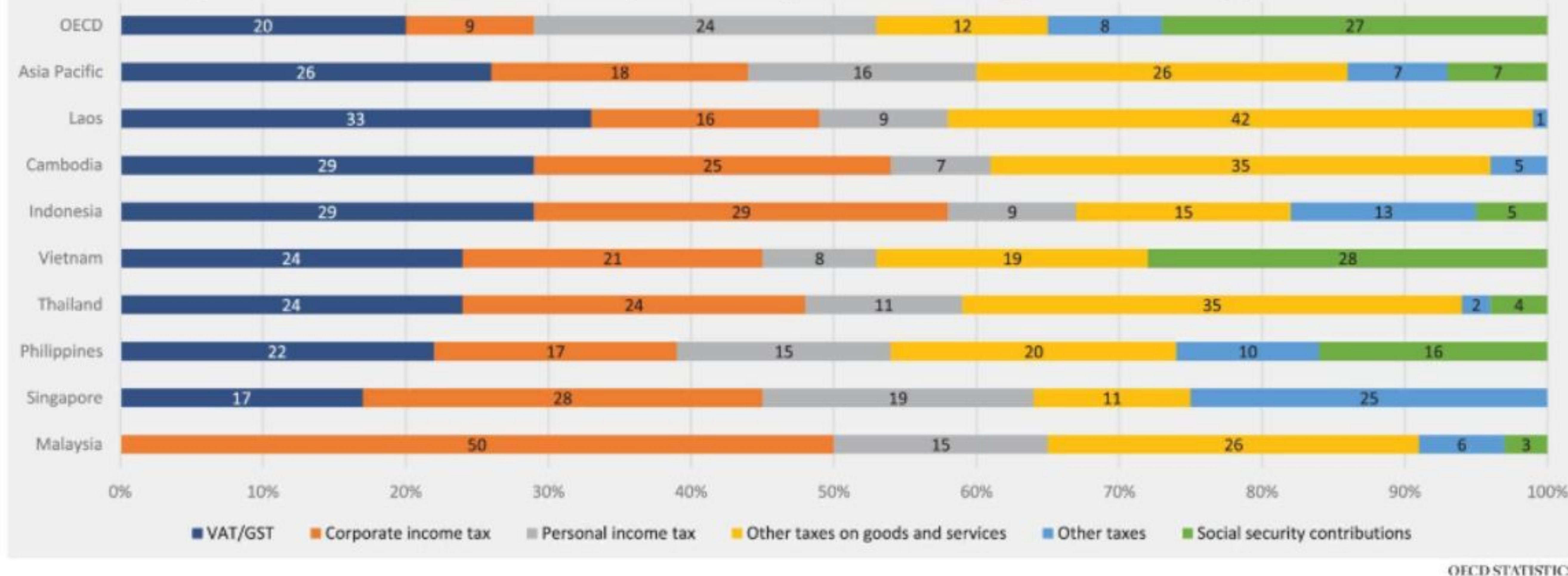


* Data for 2020 is shown for Australia, Japan and Africa (31) average as 2021 data is not available.
Note: The ADB recognises "Kyrgyzstan" as the Kyrgyz Republic"
LAC refers to the average for Latin America and the Caribbean

OECD STATISTICS

CHART 2

How Malaysia's tax structure compares to peers and regional averages



OECD STATISTICS

FIGURE 1

The government's net tax collection is higher under GST without consumers paying a higher price

Features and calculation mechanisms

SALES TAX

GOODS AND SERVICES TAX

MINISTRY OF FINANCE/FISCAL OUTLOOK AND FEDERAL GOVERNMENT REVENUE ESTIMATE 2024 REPORT

FROM PREVIOUS PAGE

lected by the government is only RM5 under the sales tax regime but is 21% higher at RM6.05 under the GST regime. The consumer pays the same price of RM127.05 under both tax regimes. The higher tax collection for the government comes from wholesalers and retailers, which can only lower the amount of tax they pay if they can prove that the manufacturer or wholesaler had paid the tax (see Figure 1).

Reason for cash transfers, zero-rated items

GST is often described as a regressive tax because percentage-wise, the tax makes up a higher proportion of income for those with lower incomes than those with higher incomes.

The rich, who have money to spend and save, would naturally spend a lower proportion of their total income. To illustrate, someone who saves RM300 out of RM1,000 earned, a 6% tax on the RM700 spent means he or she pays RM42 or 4.2% of income on tax, whereas someone who earns only RM100 and saves nothing after expenses would pay RM6 or 6% of income on tax. In short, it is the higher income group that has more income to spend, consumes more goods and services, and pays more taxes in absolute amounts.

> "Regressive effects [of GST/VAT] can be addressed through specific mechanisms, such as targeted subsidies or cash transfers, aimed at mitigating the impact on lower-income individuals."
> — Fiscal Outlook and Federal Government Revenue Estimates 2024 report

More importantly, cash transfers to the lower- and lower-middle-income groups are supposed to cancel out this regressive element, thus making the tax fairer while filling government coffers with more money from people who can afford the tax.

The zero-rating of many essential food items — which is what the lower income group spends most of their income on — is also supposed to shield them from the consumption tax imposed. That is why the word regressive is usually brought up whenever the tax on goods and services is broadened to include items that are consumed by those in the low- and middle-income groups, especially where consumption patterns are likely not changed in response to price increases.

As mentioned in the feature article, "regressive effects can be addressed through specific mechanisms, such as targeted subsidies or cash transfers, aimed at mitigating the impact on lower-income individuals".

If the government is indeed serious about plugging leakages, an economist says the reintroduction of a broad-based consumption tax like VAT or GST "is a question of when, not if" because the "leakage of tax revenue" is smaller with VAT/GST versus SST.

Dr Nungsari Ahmad Radhi, a seasoned economist and former chairman of Khazanah Research Institute, is for the reimplementation of GST or VAT that "must come with appropriately targeted cash transfers".

"[GST/VAT] has been so successfully demonised to the point that it has become a four-letter word. But it should not be so. It is not an accident that the world is using [GST/VAT] to expand tax revenue. Malaysia's revenue side lacks buoyancy — it is too narrow, too dependent on Petronas ... Reimplementing GST/VAT will remove the grey areas and generate additional revenue that the government coffers sorely need," he says, noting that Malaysia needs to reverse the decline in its tax revenue as a percentage of GDP to be able to invest more for future generations and expand the social safety net (see "PFFR a firm step towards reform" on Page 40).

"We need to solve our problems and not leave [four-letter-word] finances to our future generation," Nungsari tells *The Edge* on the sidelines of The Path Towards Greater Prosperity for Malaysia symposium in Putrajaya, organised by Universiti Malaya's Social Wellbeing Research Centre.

Rather than provide a one-off cash transfer, like what was done when GST was implemented in 2015, the government can utilise the PADU system as well as shared data from the Inland Revenue Board and Royal Malaysian Customs Department to provide multiple cash transfers to targeted groups when reimplementing GST/VAT to counter the regressive elements as well expand the tax net, says a seasoned observer.

"You cannot just give a RM300 one-off cash transfer because I incur the tax every day. So, you must have a sustained cash transfer programme and you must narrate it well," he adds.

Jagdev Singh, tax leader at PwC Malaysia, reckons that it is imperative for Malaysia to "create an ecosystem that reduces the leakages and also reduces the grey economy", acknowledging initiatives by tax authorities like e-invoicing and the issuance of the tax identification number (TIN) as "important steps" towards greater tax transparency. He, for one, reckons that Malaysia "must invest time and resources to analyse the data" to close tax gaps as that could potentially "be more powerful than introducing new taxes".

Jagdev is also for the reimplementation of GST/VAT, at a level that is consistent with the prevailing consumption tax regime.

"[The introduction of a broader consumption tax] at a lower rate is a subsidy for the rich," he says, pointing out that a lower GST/VAT rate would mean those paying 6% SST at Michelin-starred restaurants would now be paying a lower tax if GST/VAT is reintroduced at lower than the prevailing 6% to help the man in the street have meals at, say, Kentucky Fried Chicken.

"Let [the Michelin-starred restaurant patron] pay and use the money for cash transfers," he adds, noting that the government has said it is taking a "phased approach" to reforms that are necessary for sustained outcomes.

"Although we should be prudent in undertaking any kind of reform, bolder, more wide-reaching measures are required to actually move the needle in revenue generation, absent more significant cost-saving measures such as a holistic subsidy rationalisation exercise. Careful implementation of bolder measures is feasible, provided initiatives are in place to minimise the impact on lower-income groups. Increased allocations of specific and targeted handouts should be considered to alleviate the impact from the increased cost of living, alongside more sustainable measures to move the B40 up the social ladder," Jagdev writes in our Forum pages this week (see "Tax reforms for sustained outcomes" on Page 41).

Here's the regression

As one tax expert aptly points out, Malaysia is "probably the only country in the world" to go back (read: regress) to the narrower base SST in September 2018, three months after zero-rating the GST that was implemented on April 1, 2015, after a prolonged delay.

Even back in 2015 — eight years ago — Indonesia was 31 years ahead (having implemented VAT in 1984); Thailand was 23 years ahead (having implemented VAT in 1992); Singapore was 21 years ahead (having implemented GST in 1994); the Philippines was 17 years ahead (having implemented VAT in 1998); Vietnam was 16 years ahead (having implemented VAT in 1999); and Laos was six years ahead (having implemented VAT in 2009).

Except for Singapore, six other Asean members that have implemented VAT have much lower GDP per capita than Malaysia today. Apart from Brunei and Myanmar, Malaysia is the only country in Southeast Asia without a broad-based consumption tax.

Malaysia has lost decades compared with many of its neighbours, which have hugely benefited from a broader consumption tax regime. The continued demonisation of GST/VAT will only lose the country more precious revenue that could be redirected to help targeted groups once the right systems are in place. Only the shadow economy benefits if the current leakages in the tax system is not plugged. It is time for a new narrative, one that will bring better outcomes for the people. E

Read also interview with Treasury secretary-general Datuk Johan Mahmood Merican on Page 10

Scan the QR code to read 'Correcting the flawed narrative that made low income a GST hurdle for Malaysia but not six Asean peers'