Malaysia’s GST—Just Days Ahead

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As the implementation date draws near for GST in Malaysia, the government is keen not to repeat the mistakes of the sales and service tax regime.

Benjamin Franklin famously said “In this world nothing can be said to be certain, except death and taxes”. What is certain is that the implementation of a new tax, which forces businesses to analyze every product and contract, requires the planning and synchronization of a military marching band.

Introducing GST be one of the most extensive tasks a Malaysian business will undertake in this decade.

I. Wait, We Already Have a GST, Don’t We?

In the mid-70s while the U.K. was busy introducing the VAT as a condition to join the European Economic Community, Malaysia introduced its Sales and Service Tax regimes (“SST”).

In Malaysia today, sales tax at the rate of 5%, 10% and other varying rates, depending on the type of good, is levied on the manufacture and import of goods into Malaysia.

Separate from that, service tax at 6% is imposed on a relatively narrow base of prescribed services, including the provision of services by professional engineers, lawyers, accountants, hotels, restaurants and telecommunication providers. Notably, neither tax allows for recovery of the tax paid by the consumer.

Critics of the SST are quick to point out that the tax remains opaque to the end consumer. Final selling prices have embedded elements of tax. Businesses at the tail end of the supply chain make a margin on tax embedded prices, leading to an eventual effect of tax cascading to the end consumer. Studies by Royal Malaysian Customs have shown that effective SST rates are much higher than those published.

Tax leakages brought about by a bounty of exemptions and smuggling activities have rendered the SST inefficient and unattractive to the government. To a business, implementation of the SST remains a relatively simple task without the need for sleek cutting-edge IT systems. From our experience with certain clients, the calculation and declaration of their liability can be done with pen and paper alone.

Over the past 40 years, the service tax rate has only been revised once, moving one percentage point up from 5% to 6% in 2011. Not much else has changed. However, in 2014 the Malaysian government collected an estimated 13.8 billion ringgit (US$3.8 billion in today’s terms) from both taxes.

April 1, 2015 will mark the repeal of these humble and rather inefficient tax systems in favour of a long overdue goods and services tax (“GST”). The GST has faced multiple postponements since 1989. The Malaysian variant of GST is founded on the principles of the U.K. VAT framework and is similar to the system implemented in neighbouring Singapore in 1994.

As one of the last countries in the ASEAN region to adopt a national value added tax system (countries yet to adopt include Brunei and Myanmar) the government, with consultation from its Tax Review Panel, has gazetted an introductory standard rate of six percent. Once implemented, this standard GST rate of six percent would represent the second lowest in Asia, just one percent higher than the current titleholder, Taiwan.

II. Now or Never

Prime Minister Najib Razak announced the introduction of GST 17 months ahead of its implementation, giving businesses ample time to prepare. Previous discussions mooted by the government were faced with resistance for fear of increased cost of living amongst lower income segments of the public (“rakyat”).

It would appear that some businesses may have dismissed the Prime Minister’s announcement expecting the GST to be postponed once more. However, on December 31, 2014—the deadline for mandatory registration—the government’s estimate of 300,000 registered businesses was exceeded.

III. Remapping Business Processes

Malaysian businesses are now in the midst of procuring and training resources to ensure that there is suf-
IV. Balancing Cost and Benefit

In the 2015 Budget speech delivered in October 2014, Prime Minister Najib spoke of an increase in government revenue from the implementation of GST. His government estimates a 41% increase (5.6 billion ringgit) in collection over the current SST, grossing a total 19.4 billion ringgit over the current 13.8 billion ringgit.

While allowing the government to broaden its revenue base, it has promised that 4.9 billion ringgit of the additional revenue will be channelled to lower income groups via cash assistance programmes. This is in recognition of the increased living costs and regressive effect of the tax. Net increase in government revenue after distribution will only amount to 690 million ringgit.

Costs associated with the implementation of this tax must be considered. In the run up to April 1, private businesses have invested to ensure GST, IT and project management consultants are on hand. Assets have been diverted from usual business activities to focus on implementation.

Given the mandatory registration threshold of just 500,000 ringgit, even medium and small-sized businesses are now required to register for GST. For medium-sized enterprises, the cost of system upgrades can run up rather quickly. For the small enterprise (for example the popular neighbourhood restaurant in downtown Kuala Lumpur), their cash till will be decommissioned to make way for a modern point of sale system. Systems will be set up to semi-automate GST compliance.

What remains to be seen is whether the cost of implementation pushes this segment of the private sector into the red.

Given the above, one must consider if the additional 690 million ringgit revenue per year estimated to be derived from implementation of GST justifies the introduction of the tax.

V. Profiteering from the GST

Petrol and sugar have long been under scrutiny for the subsidies allocated by the government each year. With the government tightening its belt, a subsidy rationalisation scheme has been in place to let market forces play their role.

It is apparent to the Malaysian consumer that—all things being equal—unscrupulous traders may increase the price of a glass of quintessential Malaysian teh tarik (milk tea) by 0.20 ringgit for every 0.20 ringgit reduction in subsidy for a kilogram of sugar.

In light of potential profiteering by businesses and to manage inflationary pressures come April, the Price Control and Anti-Profiteering Act 2011 and its subsequent amendments in late 2014 were brought into force.

The Ministry of Domestic Trade, Cooperative and Consumerism has been empowered to convict and penalize both registered and non-GST-registered traders where they are seen to be profiteering from the introduction of GST over a controlled period.

Spanning 18 months, the control period came into force on January 1 this year. Upon conviction, penalties range from 500,000 ringgit for the first offence to 1 million ringgit for subsequent offences.

VI. On the Other Side of the Fence

One must not discount the fact that the administrator of a broad-based tax like GST has plenty of homework to do to make sure the same mistakes that made the SST inefficient are not repeated.

Internally, officers from Royal Malaysian Customs have been cajoled from their roles in SST enforcement into developing new skills within the GST environment. GST audit trainings are held every so often equipping officers with GST audit experience from Australia and neighbouring Singapore.

While the collection of back taxes and penalties are likely to be incorporated into the key performance indicators ("KPIs") of front line officers, the government is expected to allow businesses a two-year moratorium. Notwithstanding this, GST audits will still be conducted in the first two years to educate and train registered businesses.

Royal Malaysian Customs have made it clear that suspected cases of GST fraud will not be tolerated. Maximum penalties under the GST Act are some of the most punitive around, even in comparison with those imposed by counterparts in the Inland Revenue Board of Malaysia in respect of corporate and personal income tax.

VII. Concluding Remarks

With April 1, 2015 fast approaching, businesses have put their GST implementation projects at the forefront of corporate priority for the financial year 2014/2015. Medium and small-sized enterprises under the GST radar have come to terms with the additional burden of compliance that the GST places on them.

The government and Royal Malaysian Customs are looking forward to a bigger slice of their cake. The rest of us, well, we will be watching the show unfold sipping on our reasonably priced teh tarik for comfort.

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