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HARMONISING SALES AND SERVICES TAXES: THE BETTER ALTERNATIVE TO REINTRODUCING GST

Tan Sri Yong Poh Kon

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About the Author

Tan Sri Yong Poh Kon is a Member of the Board of Trustees of MIER. He has served on the Boards of Bank Negara and the Malaysian Investment Development Authority (MIDA) and as Co-Chair of PEMUDAH, The Task Force to Facilitate Business. He is a past President of the Federation of Malaysian Manufacturers (FMM) and a past Member of the Economic Council.

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Table of Contents

Acknowledgement 5

Executive Summary 6

1 Background 9

2 The Goods and Services Tax 10

2.1 "Many Countries Have GST" 10

2.2 How Much More Tax Did GST Really Collect? 11

2.3 Will Reintroducing GST Reduce Fiscal Deficit? 13

2.4 GST's Impact on Business Cash Flow 13

2.5 Unintended Effects of GST 14

3 The Sales and Services Tax (SST) 15

3.1 Eliminate Cascading Effect of Taxes 15

3.2 Addressing Tax Refunds and Sales Tax Exemptions 17

3.3 Facilitate and Simplify Customs Enforcement 18

3.4 Specialised Traders to be Considered as "Deemed Manufacturers" 19

4 Building a Harmonised Sales and Service Tax System (HSST) 20

4.1 A Comprehensive Approach to Defining Manufacturing Inputs 20

4.2 The HSST as a Better Alternative to GST 21

5 Concluding Remarks 22

References 23

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Executive Summary

In recent months, there have been many calls for the reintroduction of the GST, leading to statements by the Prime Minister that GST would be reintroduced only after a proper study and the Finance Minister saying that besides new taxes, improving tax administration is also a revenue measure.

The paper will argue that there is a better alternative to reintroducing GST. It will highlight the problems businesses and the Customs Department faced in implementing the GST during the 2 ½ years it was in force. It will also highlight the existing problems of the SST and how the tax can be improved to collect almost the same revenue with far greater efficiency than the GST.

The GST has many drawbacks. Apart from its complexity and problems with a late refund of input tax to industry, it requires a large number, 480,000 GST-paying businesses, to collect RM44 billion. However, this revenue figure includes RM9 billion in outstanding tax refunds, so GST revenue was only RM35 billion.

In contrast, Sales Tax 2.0 is a single-stage tax levied only on manufacturers' gates at a higher rate of 10% and nothing more on downstream sectors such as retail. Together with the 6% service tax, these taxes raised RM28 billion per year. Comparing the SST and GST, there is a smaller difference of RM7 billion rather than the RM16 or 20 billion often quoted. Moreover, only 80,000 companies collect the Sales and Services tax as the distribution, and retail sectors and the vast majority of SMEs are not required to do so. This is much more tax efficient. This means that the 400,000 companies that no longer have to collect and account for GST would have saved RM10 billion, assuming a cost of RM25,000 per annum per company to collect and account for input and output taxes.

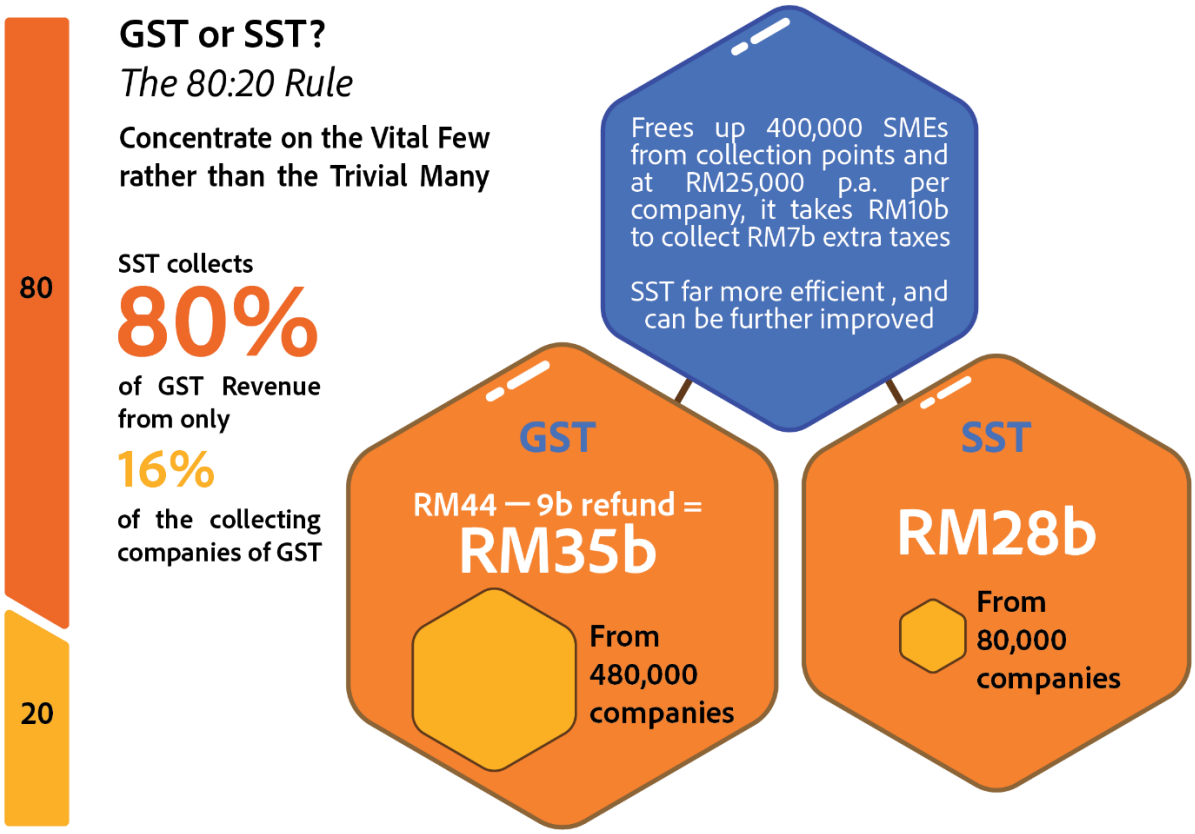

Figure 1 : The taxing 80-20 rule

A major advantage of GST is the avoidance of cascading taxes. This is the reason why many companies are demanding the return of GST despite its complexity and tardy tax refunds; because under the current SST, manufacturers cannot reclaim input taxes charged by service providers and vice versa.

By harmonising sales tax and service tax to function like a single legislation providing similar rights and obligations, businesses registered separately under either law will not have to charge nor pay input tax to each other, and SST will be collected only from end consumers or entities without an SST number. This will lead to a system where there is no longer tax on tax and cascading of taxes, resulting in a more competitive business environment. Customs will also find it easier to enforce the rules as there will be fewer audit points to examine. Smaller businesses will not be burdened by GST. In addition, since there are no input taxes to be collected, the problem of late processing and refund of input taxes no longer exists.

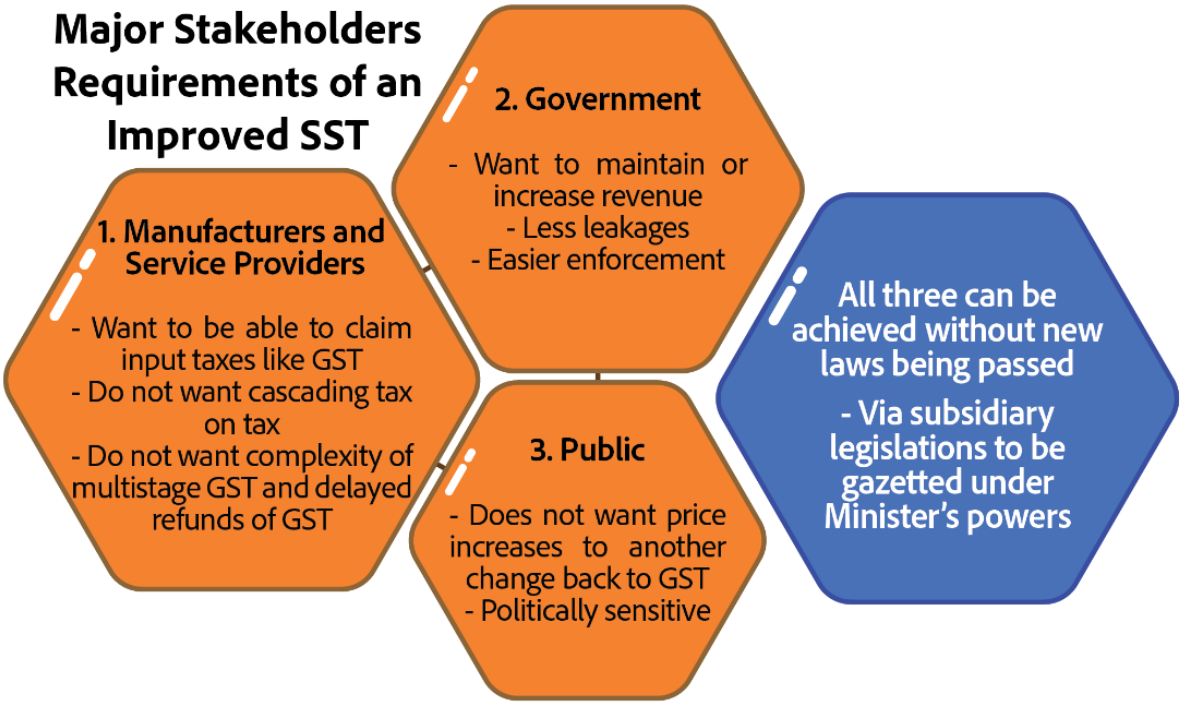

Figure 2: Needs of major stakeholders in the face of a new SST

Initial discussions with former customs officials, tax experts and industry on a harmonised SST system have been positively received. Further engagements with stakeholders will help find the most efficient path to reform the Sales and Service Tax. The proposed reform measures for the harmonised SST can be implemented quickly through subsidiary legislations as a Ministerial initiative without the need to pass new legislation.

1 Background

The Organisation for Economic Co-operation and Development (OECD) 2021 Economic Survey of Malaysia recommended reintroducing the Goods and Services Tax (GST) as part of the post-pandemic medium-term fiscal strategy.[1] All governments want to raise more revenue to meet the demands for operating expenses and development. However, increasing revenue must be based on economic considerations to achieve tax efficiency through the simplest means.

On 6 June 2022, YAB Prime Minister Datuk Seri Ismail Sabri Yaakob emphasised the need to study the negative and positive aspects before reintroducing GST and, if appropriate, the correct timing. We agree there is a need to conduct a study first, preferably by an independent think tank like the MIER involving all relevant stakeholders.

Malaysia is the only country to have implemented a Sales Tax since 1972, withdrawn it, introduced GST in 2015 and reverted to the SST in 2018. Having experienced GST and SST, we are better positioned to consider a tax system more appropriate to our needs. The GST's attraction to the government is the RM44 billion raised in 2017, compared to the SST's RM18 billion in 2015 and SST2.0 RM28 billion in 2019. The GST also avoids the cascading of tax-on-tax. It is transparent to consumers on their shopping bills. However, the high compliance cost to cover more than 70% of goods and services and involving 480,000 collection points had led to extensive inflationary pressures on market prices despite generous exemptions and zero-rating.

Consequently, the GST was not popular with the *rakyat.* Businesses were also unhappy over the high cost of tax compliance and refund delays. The GST became a hot election issue during Malaysia's 14th General Election (GE14).

This discussion paper will highlight points that have not been sufficiently aired on GST, which could swing the debate decisively in favour of improving the SST as the far better tax reform. Solutions will be offered to enhance tax efficiency by incorporating desirable attributes of the GST, lowering costs to the public, greater ease of tax compliance, while retaining the SST's simplicity of a single-stage tax. The RM44 billion reported as revenue from GST included RM9 billion of outstanding refunds. This mean the net amount of tax collected per year is only RM35 billion, giving a smaller difference of RM7 billion compared to the SST, and not RM16 billion as commonly quoted.

Furthermore, the SST collection of RM28 billion is collected from only 80,000 companies compared to 480,000 for GST. This is a perfect example of the pareto rule to concentrate on the vital few rather than the trivial many. We get 80% of the revenue from only 16% of companies. The Customs Department need to audit only 80,000 companies, not 480,000.

[1] Insight – OECD recommends that Malaysia reintroduces GST; The Star; August 16, 2021. For a comprehensive review of the Malaysian tax system, see Ariff, M and K.L Yeah (eds.), 2020. *Malaysia's Taxation System: Contemporary Practices, Issues and Future Direction*. Sunway University Press; Kuala Lumpur.

2 The Goods and Services Tax

The primary motivation for reintroducing GST is to raise more revenue through a broad-based consumption tax that covers all sectors of the economy but with generous exemptions, which can now supposedly be supported by targeted aid mechanisms. It is said that the GST will enable better monitoring and prevention of tax evasion. Many countries have already introduced the tax.

Proponents of the GST[2] have also recognised the weaknesses of the tax and have proposed the following improvements as part of the reintroduction package:

- Reduce GST rates to 3 to 4%;
- Zero rate all essential goods and services;
- Maintain the GST registration threshold at RM500,000;
- Minimise refund delays, especially for exporters and businesses with zero-rated supplies, as a long refund period of six to eight months has made GST a cumulative tax burden;
- Introduce interest provisions for late-payments and refunds in the GST legislation to ensure strict compliance with the Client Charter and the integrity of the system;
- Create more efficient schemes to replace the Approved Trader Scheme and Approved Toll Manufacturing Scheme as they are complicated to implement; and
- Ensure that an adequate mechanism is in place to monitor price control and anti-profiteering in the market when the tax system is reintroduced.

We will show that improving the SST is a better alternative to reintroducing the GST to meet the above wish list. Except the unrealistic tax rate of 3 to 4%, all other proposed improvements can be easily achieved through adjustments to the SST, as outlined in Section 5.

2.1 "Many Countries Have GST"

One hundred and sixty countries[3] have adopted GST or Value Added Tax. Yet, open, competitive economies such as the United States and Hong Kong SAR have not adopted the GST even after extensive studies. Each country has different socio-economic or domestic realities to consider when deciding on the best solution. Malaysia's domestic circumstances that make the GST unsuitable are:

- External trade is higher than GDP. Malaysia's trade amounted to 116% of GDP in 2020. In 2017, when GST revenue was RM44 billion, the percentage was even higher at

[2] Reintroduction of GST is welcomed to strengthen economic recovery and growth; Federation of Malaysian Manufacturers; 26 January 2022 & 5 June 2022.

[3] Customs GST website, last updated on 24 January 2014.

133%. This will continue to result in a higher-than-average volume of transactions requiring input tax refunds, which is the Achilles' heel of the GST.

- Only 16% of Malaysia's 15 million working population pay income tax. Reducing income tax rates as a quid pro quo has no impact on the vast majority of the 86% who do not pay income tax. Yet they feel penalised for their consumption because only 545 goods in the consumer price index basket have been exempted from GST compared to 5,445 goods under SST.[4] Despite zero-rating and tax exemptions under GST, prices of goods and services have not come down because the new high compliance costs, including delays in refunds affecting business cash flow, have been passed on to consumers.

  The 16% who pay taxes were not offered a reduced income tax to help increase disposable income. Regardless, they too were affected by the rising cost of living in their consumption of essential and higher-value goods and services.

- Tax inequity between Malaysia's two principal tax systems. Income taxes are progressive, i.e. the rich are taxed more than the poor, while consumption taxes are highly regressive. Raising income tax poses a difficult challenge in maintaining a competitive tax system to attract and retain investment, talent, etc. For the government, taxing consumption is the easier way to raise revenue.

- Informal economy and "last mile" problem comprising businesses with revenue of less than RM500,000. The GST system is caught in a tussle between easing the cost burden on consumers and helping small businesses. Tax exemptions and zero-rating to relieve high consumption taxes for the B40s and B60s have led to complications in recording, audit and refunds, increasing overall business costs. The tax exemptions have also resulted in a significant informal economy and businesses with revenue of less than RM500,000 being unable to offset input taxes against any output taxes since they do not pay output taxes. They can only pass on the costs to customers or fold up.

Expanding the scope of GST zero-rating to cover the same number of items as SST in the CPI basket could worsen domestic realities and business sustainability due to the high cost of tax compliance. Since a comprehensive zero-rating is highly desirable and already included in the SST, do we need to reintroduce the GST? Why not directly improve the SST?

2.2 How Much More Tax Did GST Really Collect?

Correcting the misconception that the GST collected far more taxes than the SST is imperative. The RM44 billion is the gross tax collection before deducting refunds of RM9 billion per year. The net tax collected per fiscal year under the GST was only RM35 billion. The SST2.0 revenue

[4] Customs (former) Director-General Dato' Sri T. Subromaniam, *The Diplomat;* October 16, 2018

in the first year was RM28 billion. The difference in revenue collection is RM7 billion, not RM16 billion.

- GST advocates have proposed reintroducing GST at 3 to 4% to reduce the cost of doing business and prices for consumers. The low tax rates will not achieve the government's goal of raising tax revenue as it means a collection of RM17 billion to RM23 billion, which is lower than the current SST2.0 with all the complications of the GST, defeating the purpose of reintroducing the tax.

- Even more alarming is that the "extra" tax revenue of RM7 billion under GST came at a significant cost to tax efficiency. Huge additional overheads were incurred in compliance costs due to the following:

  - The GST required an additional 400,000 companies, big and small, across many levels in every sector of the economy as tax collection points; and

  - Detailed records of input and output taxes had to be kept for tax compliance. Each collection point or firm had to hire additional staff and tax advisors and invest in accounting systems to handle the onerous record keeping. A conservative estimate is that each firm would have incurred at least RM25,000 per year in GST compliance costs. Multiplied by 400,000 firms, that is RM10 billion in additional costs for businesses to collect the additional RM7 billion in revenue. The single-stage Sales Tax at the manufacturer level has helped reduce tax compliance costs and administrative burdens, especially for SMEs.[5]

  The government, especially Customs, would also have additional expenses for auditing 400,000 more collection points; additional man-hours for verifying voluminous records of inventories and sales, input and output taxes and refunds; and detailed audits. Government overheads and tax compliance costs are ultimately borne by the *rakyat*. This supports the public claim that prices have increased under the GST.

- The government is recovering lost revenue from leakages. The Finance Minister has indicated that RM5 billion in lost revenue could be recovered just by eliminating tax losses due to smuggling of high-duty goods such as cigarettes. This is a far better strategy than reintroducing the GST.

Advocates of GST have called for mechanisms to monitor price control and anti-profiteering in the market to improve GST. Tax compliance costs and tax efficiency also need to be monitored and improved. These are regulatory costs with much larger impacts, which are more burdensome and beyond the control of businesses. We should demand simpler tax administration under the SST rather than expose ourselves to high compliance costs again under the GST.

[5] In: Siti Nur Amalina et al., 2021. Measuring the impacts of GST and SST on the cost of production in Malaysia: An input-output price model analysis. *Journal of Business and Social Development*, Vol 9 No 1; March 2021

2.3 Will Reintroducing GST Reduce Fiscal Deficit?

Total federal debt as of June 2021 stood at RM958 billion or 63.6% of GDP. To bring the debt level down to 55%, *ceteris paribus*, the GST would need to be able to raise an additional RM139 billion on top of the RM35 billion collected in 2017. This is an unrealistic expectation, especially when GST advocates have proposed reintroducing the tax at 3 to 4%. It is more practical to reduce deficits by cutting unnecessary operating expenditures.

Besides, higher tax revenues do not necessarily lead to a reduction in government debt. Malaysia's debt had increased even after the introduction of the GST. In 2016, the federal government's debt was RM630.5 billion and climbed to RM686.8 billion in 2017.[6] There may be valid factors contributing to the rising debt, but higher tax revenues alone will not reduce the debt level.

Tax reforms are more effective. Tax experts and think tanks have cautioned that the GST is not a "magic bullet" that could solve fiscal problems. The solution is tax reforms in terms of tax structure and administration to facilitate compliance, and more effective enforcement to ensure a more progressive tax system.[7]

As a business community, we should advocate tax reform, improved tax administration and tax efficiency as priority revenue measures, starting with SST. The reintroduction of the GST will not be able to ensure a reduction in budget deficits or the national debt.

2.4 GST's Impact on Business Cash Flow

GST has not only increased overheads but also weakened the cash flow of businesses by delaying refunds. Although the GST Act promised refunds within 14 days, disputes over input and output tax compliance and interpretations over tax-exempt and non-exempt inputs led to delays of up to three years.

As of 31 May 2018, the government owed 121,429 firms, including GLCs such as Petronas and Tenaga Nasional Berhad, with about RM19.4 billion in refunds.[8] The difficulties of claiming tax refunds are certainly greater for thousands of SMEs operating on low profit margins and without a dedicated tax accounting team to advocate for the refunds that are rightfully theirs.

[6] Why the GST became Malaysia's public enemy number one; Li Xirui, Research Assistant, China-ASEAN Research Institute, Guangxi University, PRC; ASEAN Beat, The Diplomat; October 16, 2018

[7] GST, not a magic bullet, says tax expert; MalaysiaNow; September 29, 2021

A more progressive tax system – a prerequisite for reintroducing the GST; Dr Rais Hussin & Jason Loh Seong Wei, EMIR Research; Letter to The Star; September 7, 2021

[8] YB Lim Guan Eng, Parliament in early August 2018

While we understand the need for due diligence to weed out fraud and the challenges Customs faces in processing thousands of claims, the delays in refunds have been frustrating for businesses. Hence, the industry's call to minimise delays and pay interest on late payments and refunds. Tax refunds are considered the Achilles heel of GST. For exporting companies, there is no output tax to offset against input tax paid earlier as exports are zero-rated.

One of the main advantages of a single-stage tax like the SST is that licenced manufacturers do not have to pay input taxes upfront. There is no reason to quibble over the refund of input taxes, except for exempt products, and even for that, we have proposed a solution.

2.5 Unintended Effects of GST

Another key point of contention is exempt goods and services. The government has rightly exempted certain services and products from GST in its quest for social equity. For example, education and health services and certain goods like sports goods and diapers. But while the finished product or service has been exempted, the inputs used to produce it are strangely not exempt from tax as is the case with other products subject to sales tax.

Exempt institutions such as educational institutes, which do not charge GST or Service Tax, could not claim input tax on the goods and services purchased and had to pass on the cost to consumers. Manufacturers of tax-exempt products cannot claim input tax on components and have to include it in the cost of the final product to consumers. This anomaly has contributed to higher prices for goods and services for consumers.

Another unintended result is that a fully imported, tax-exempt product is cheaper than a locally manufactured one because input tax is charged on the latter's components, while the imported product (along with the components in the product) is fully tax-exempt. This contradicts the Made in Malaysia policy of promoting and supporting locally manufactured goods and services.

It was a challenge for Customs officials to check the inventory of inputs from manufacturers producing both exempt and taxable products. Customs had to vet thousands of bills of materials and components and decide whether the segregation of inputs for taxable and non-taxable items was done correctly.

To illustrate, a factory manufacturing taxable air conditioners and sales tax-exempt dehumidifiers has many common inputs such as electric motors, switches, nuts and bolts, cooling coils, paint, metal sheets, etc. Each item had to be accounted for separately because the inputs for the exempt dehumidifiers were taxable but those for the air conditioners were not.

3 The Sales and Services Tax (SST)

The government introduced the sales tax on 29 February 1972 as it was a simple, single-tier tax levied only at the level of manufacturers' output. All manufacturers could purchase inputs free of sales tax by filling out Form CJ-5. A separate service tax was introduced on 1 March 1975. These two taxes were maintained for more than 40 years until 2015.

In 2018, after GE14, the then government reverted to Sales and Service Tax or SST2.0 and set 10% as sales tax at the factory level. A higher tax rate of 10% levied only at the manufacturer level removed the burden of tax collection on distributors, warehousing and thousands of large and small retailers. Overnight, 400,000 businesses were freed from the onerous obligation of collecting GST. The SST also removed the need to collect and refund large amounts of input tax, eliminating cash flow constraints and delayed refunds, as well as the workload of Customs in monitoring refunds.

In contrast, GST is levied at the rate of 6% on each unit of value-added provided by all segments of the value chain, i.e. manufacturing, distribution, warehousing and retail, with additional complications in accounting, upfront payments of input tax and claiming refunds.

We can improve the current SST system to mitigate its shortcomings. A major drawback of the current SST is the cascading of taxes on taxes between service providers and between the service and manufacturing sectors. Unlike GST, where input tax can be deducted from output tax payable or theoretically recovered from the government, SST does not provide relief from output tax levied on the manufacturing sector and vice versa.

A sales tax is levied on the supply of food, which a service provider, such as a hotel, charges the consumer a Service Tax in addition to the sales tax already levied. Conversely, services such as logistics, advertising, legal and auditing companies charge a service tax on to manufacturers who charge a sales tax on top of these taxes when they sell their products. This tax on taxes makes our industries and services less competitive and increases the final cost to consumers. The tax on taxes must be removed from the SST2.0.

3.1 Eliminate Cascading Effect of Taxes

Sales and Service taxes should not be implemented in silo to avoid cascading taxes. The two Acts should be harmonised so that any business with a sales tax or service tax registration number does not have to charge each other. Dato' Sri T. Subromaniam even came out with a name during informal talks in 2019 - a Harmonised Sales and Service Tax (HSST).

The HSST should work as a GST but without the cumbersome process of booking an input tax all along the value chain, accounting for it as a credit against output tax and remitting the difference to the government or sometimes claiming a refund from the government.

To avoid the complex intermediate input tax accounting and payments under GST, sales or service tax under HSST should be imposed only once when a product or service is sold to the final consumer or a business with no tax registration number. A manufacturer can purchase all its inputs free of sales tax or receive invoices on fees free of service tax for consultancy, legal services, advertising, freight forwarding etc., by quoting his sales tax number.

A hotel that charges service tax to its customers can now purchase all inputs free of sales or service taxes by quoting its service tax number, thus avoiding the effect of tax on tax. A beer manufacturer will sell its beer without sales tax to the hotel, which will charge its customer service tax on the beer along with its markup and overheads. The tax is paid only once.

Smaller restaurants that do not have a tax number will have to be invoiced by the manufacturer for the sales tax. The restaurants will build in the sales tax in their prices as they cannot charge service tax to their customers. The government revenue is collected from the manufacturer and not from the restaurant.

A garment manufacturer issues an invoice for 10,000 shirts and charges a department store chain a one-time 10% sales tax. The department stores chain has no sales or service tax number, it will add the tax to its margin and sell the 10,000 shirts to customers without any further tax. Customs only need to audit that one invoice and not 10,000 individual receipts.

Consultants like architects, lawyers and accountants do not charge service tax to each other or to the manufacturers but only to the final consumers who do not have a sales or service tax number. When these consultants provide services to the manufacturers, their fees become a cost to the manufacturers and HSST at the rate of 10% is eventually charged on the output of the manufacturers, including the fees of the consultants, without any service tax. Similarly, the products purchased by the service providers are included in the final cost of services, so they are levied service tax.

Customs has already recognised the problem of tax-on-tax. It has created bubbles for service providers in the advertising industry, where copywriters and layout graphic artists or photographers do not charge each other service tax. Service tax is charged when the final advertisement is sent to the advertiser. This bubble concept needs to be extended to all service sectors and manufacturing.

BOX 1: Treatment of Service Tax in the Advertising Industry

An advertising agency will suggest the best combination of media, including placement and sale of advertising space, advertising method, design, graphics, photography, etc.
The communication platform for advertising can be print media, outdoor advertising, digital signage and ground graphics, mobile advertising via SMS, MMS, etc., television, radio or online. These platforms are services offered by media owners.
The value of advertising services is based on the actual selling price charged to the advertiser, including all costs for typesetting, formatting, printing and the necessary technology to fit the advertisement into any communication medium.
From September 1, 2018, service tax at the rate of 6% will be levied on the supply of services prescribed in Group 1 of the First Schedule to the Service Tax Regulations 2018. Media owners or advertising agencies who are registered persons and provide these specified services will have to levy service tax on the actual price paid or paid by the advertisers.
In the Association of Accredited Advertising Agents Malaysia (4As Malaysia) Annual Report 2019 - 2020, it was updated that under the Service Tax (Persons Exempted from Payment of Tax) Order 2018, there is no double taxation for taxpayers registered under Item 8, Group I of the First Schedule of the Service Tax Regulations 2018. Registered members are exempted from payment of service tax within the industry. Service tax is levied only at the time of billing to the advertiser, the ultimate consumer.

3.2 Addressing Tax Refunds and Sales Tax Exemptions

Since no input tax is payable under HSST, the problem of delayed refunds is eliminated. This is the most important advantage of HSST for manufacturers and Customs. Also, fraud through excess input tax, whether in the form of credits or refunds, will no longer exist. Customs will no longer have to decide whether to accept claims for input tax refunds amounting to millions of Ringgit, as there will no longer be any input tax to be paid that can be offset or refunded. This allows resources to be concentrated on auditing output taxes.

On the issue of tax exemption is given on the final product or service but not on the inputs, the HSST should make a policy change to extend the tax exemption backwards to the inputs as well. The difficulties manufacturers face in producing taxable and exempt goods under the GST as described in 4.5 above are also present in the current SST2.0 and should be rectified. There could be a slight decline in tax revenue, which can be offset by better overall tax efficiency. Any tax shortfall in the future could be offset by a slight increase in the service tax rate to 8% or eventually at par with the 10% sales tax rate.

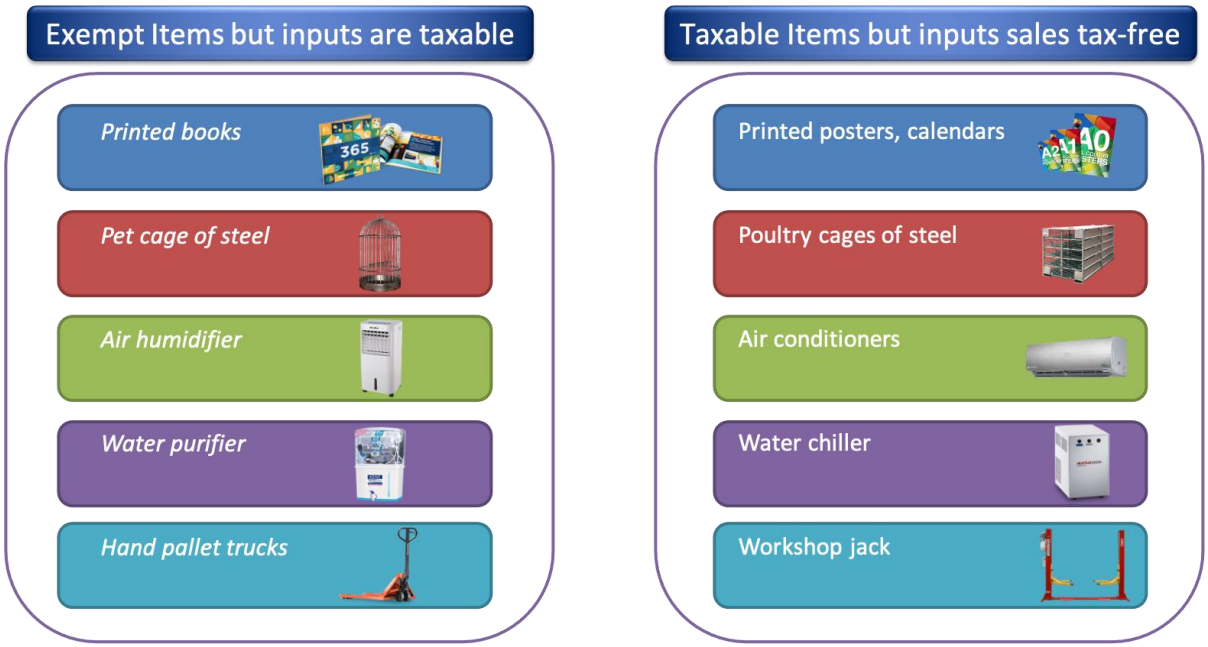

Figure 3: Inventory accounting complications for the manufacturer making both taxable and exempt products

This policy change of not taxing inputs of exempt goods will benefit many stakeholders:

- Manufacturers will compete on a more level playing field against tax-exempt imported products. The procurement and recording of raw materials and components for a manufacturer producing both taxable and non-taxable products; will be immensely simplified as there is no longer a need to keep separate inventory accounting of the same components used for making similar products and avoid the difficulties in navigating Schedules A, B and C of the Sales Tax Act.

- Tax-exempt service providers like the education and health service providers will have lower costs of inputs, and the public will enjoy lower prices for exempt services.

- The government fulfils the original intention of providing tax-exempt services to lower the burden of essential services on the citizens.

3.3 Facilitate and Simplify Customs Enforcement

Customs enforcement resources will be freed from monitoring and analysing stocks and inputs and will focus entirely on the output stage of manufacturers and service providers. The audit process will focus on output invoices for taxable goods and services issued in the following manner:

- If the invoices do not show the customer's sales or service tax registration number, then sales or service tax must be collected and paid to the government.

- If the invoices show the customer's sales or service tax registration number, no tax is levied. Random checks to verify that the customer exists and that he/she has been invoiced for goods/services with the relevant invoice number on that day will make manufacturers or service providers fall in line. Severe penalties should be imposed for invoices issued with fictitious customer tax numbers.

Spot checks on a customer with an SST number who has legitimately received goods without SST must show that it is a bona fide business that has issued its own invoices and charged output HSST. This is to flush out businesses set up only to buy goods or services for friends and family without HSST and have not issued output invoices of their own. Repeated discrepancies will be punished with heavy penalties.

3.4 Specialised Traders to be Considered as "Deemed Manufacturers"

There are import and trading companies that supply manufacturers. Under GST, tax is suspended on imported goods through the Approved Trader Scheme (ATS) and Approved Toll Manufacturer Scheme (ATMS). Trading companies that buy goods from manufacturers and export them can also claim back the input tax paid.

However, under SST, manufacturers have faced difficulties in claiming refunds for sales tax charged on goods supplied by trading companies that had paid sales tax at the time of import. To circumvent this problem, these trading companies should be able to apply for a sales tax number and register as a "deemed manufacturer". The trading company can then import components and materials free of sales tax like a manufacturer and supply the goods without tax to registered manufacturers but charge sales tax to those who do not have a number.

Conversely, a trading company specialising in exports can also obtain a "deemed manufacturer" sales tax number so that a manufacturer can supply these specialised export trading companies free of sales tax. These trading companies can export the products without paying sales tax, i.e. sales-tax-free end-to-end. However, if they sell the products on the domestic market to customers who do not have a sales tax number, the trading company has to charge sales tax to these customers and pay it to Customs.

Advocates of the GST have also called for improvements to create more efficient schemes for traders to replace the complicated ATS and ATMS, both of which are difficult to implement. The HSST is the simpler solution, as explained above.

4 Building a Harmonised Sales and Service Tax System (HSST)

4.1 A Comprehensive Approach to Defining Manufacturing Inputs

The fundamental principle for improvements to simplify tax collection under the HSST system is that all inputs should be free of sales tax for any company with a sales tax or service tax number. The system should not chase sales tax revenue at the beginning of the value chain by collecting input tax just because it is obvious. Instead, the system should allow all inputs to accumulate in a manufacturer or service provider without input taxes and ultimately the product or service is taxed only once at the output stage when all costs are already priced into the product.

The fact that all registered businesses can purchase their inputs tax-free does not mean that no tax is levied, only that the tax is levied only when the product or service is ready for sale to consumers.

To work seamlessly, we must maintain the principle that all inputs are exempt from input tax once a product or service is exempt from SST. This would enormously simplify the administration of HSST for the private sector and Customs authorities.

An economic or tax modelling exercise will determine how much revenue is lost by granting input tax exemptions on exempt products and services and abolishing the tax on taxes, and how much more can be collected by increasing the Service Tax rate from the current 6% to 8% or 10%. In any case, it should not be a policy to impose a tax on tax in the economy.

Below is a chart summarising the output taxes of the HSST, where all inputs are exempt from tax for all registered manufacturers and service providers. Control points are significantly reduced, and enforcement efforts can only focus on the few output points (in red) where the final output sales/service tax is levied.

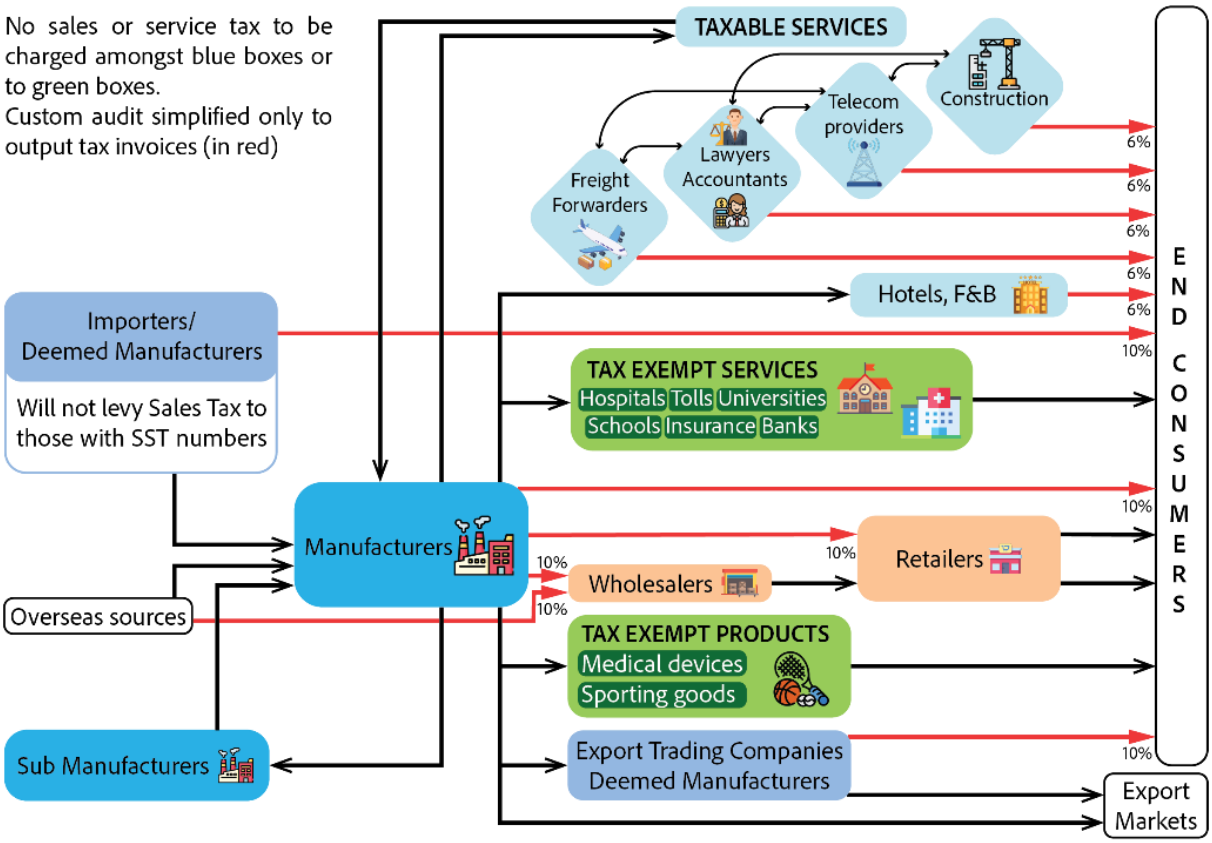

Figure 4: Defining the placement of tax in the manufacturing line

4.2 The HSST as a Better Alternative to GST

The proposed HSST can be implemented with the current sales tax rate of 10% and service tax rate of 6%. Complete harmonisation may be considered by using a single 10% HSST rate for goods and services at a later stage after due study is conducted.

Like all tax systems, the HSST will not be perfect. There is still a risk of leakages through fraud and under-reporting. The solution lies in the automated matching of output invoices with customer records, sample auditing and heavy penalties for defaulters and fraudsters.

The benefits and advantages of the HSST far outweigh its disadvantages. The HSST will be far more tax-efficient and will affect only the most important sectors of the economy. Only 80,000 enterprises will be required to collect RM28 billion, as opposed to the GST's 480,000 firms under the GST, which had been required to collect RM35 billion.

The HSST follows the classic 80:20 rule, whereby 80% of tax revenue is collected from only 20% of GST-paying business enterprises in the country. This eliminates the unproductive compliance costs of RM10 billion imposed on the economy.

As the economy grows, tax revenues will increase accordingly. The merits and simplicity of the single-stage HSST are a good and practical alternative to the GST. It can be introduced relatively quickly in the country.

5 Concluding Remarks

The paper hopes to stimulate an active discussion with all relevant stakeholders and, in particular, to convince the proponents of the GST that the right way forward is to improve the far simpler SST system into a more efficient and business-friendly tax by addressing all its shortcomings through the HSST.

Improvements in the HSST, such as exemption of taxes on inputs and harmonisation of the two separate Sales and Service Tax Acts, can be quickly implemented through administrative measures and gazetted as subsidiary regulations via Ministerial powers to strengthen and ensure economic recovery.

The necessary measures that need to be taken in the future include:

- Undertake an independent study to assist the government, especially Customs, on medium to long-term tax reform;
- Track, measure and improve the efficiency of tax collection;
- Monitor and study compliance costs and mitigate their impact on the cost of doing business and market prices;
- Assess the impact of broadening the tax base on tax collection, costs and prices; and
- Identify additional improvements, including the appropriate tax rate and timing for harmonising the sales and service tax.

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Malaysian Institute of Economic Research
JKR606, Jalan Bukit Petaling
50768 Kuala Lumpur

www.mier.org.my

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