

The hidden costs of abolishing GST



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May 9, 2018 will be etched in Malaysian history as a political turning point, with the first-ever change in government since Independence. Pakatan Harapan won the election on the back of a manifesto that contains a number of promises, one of which is the abolishing of the unpopular Goods and Services Tax (GST). It is not unusual for manifestos to promise the repeal of laws or abolishment of taxes, but the government's swiftness in zero-rating GST in less than 30 days demonstrates its determination to do away with the tax.

The government has stated that the zero-rating of GST is an interim measure and it ultimately intends to repeal all existing GST legislation. But one should be aware that the laws cannot be repealed without careful consideration of a number of issues. The GST legislation was drafted

with perpetual continuity in mind and there are no inherent provisions that cater for its removal. There are complex rules that are applied on equally complex supply chains and transactions. A sudden removal without having due regard to these potential complications will present cliff-edge situations that may be inequitable for businesses, taxpayers and the government.

Transitional issues

The immediate transitional issues will relate to transactions that occur over a period that covers both the current imposition of GST as well as post-GST. Certain transactions, especially those involving advance payments or billings and unbilled deliveries or services, may straddle the date when the remaining GST legislation is repealed. Technically, there are provisions in the GST legislation to determine what is known as "time of supply", which may be applied to determine if a particular transaction is subject to GST. Nonetheless, the interpretation of such legislation is challenging and ordinary people are likely to need guidance and assistance.

The zero-rating of GST alleviates the collection and payment of GST in such situations as neither period will require the charging or payment of the tax. Some quarters may then overly simplify matters and see the removal of the tax legislation as being academic. While this may hold

some truth from a buyer's perspective, GST registrants could find themselves facing issues relating to documentation and compliance, such as the issuance of tax invoices and reporting GST returns.

One such complexity presents itself when there are subsequent adjustments required in the post-GST era to current GST-applicable transactions. It is unclear how a GST registrant in the post-GST era would issue credit notes and debit notes relating to tax invoices that charged GST. The GST legislation should ideally be repealed with savings and transitional provisions addressing such situations as well as the reporting and compliance requirements.

Currently, GST registrants who utilise capital assets to produce a mix of taxable and exempt supplies are permitted to claim a proportionate GST relating to the capital assets as their input tax claim. However, due to the enduring nature of capital assets, GST registrants are required to make adjustments over a period of time to their input tax claims to reflect the usage in producing taxable supplies. These adjustments can last for up to 10 years and they will be curtailed when GST is repealed. Savings and transitional provisions may require a final adjustment to address this. Unfortunately, the inability to make future adjustments may be unfavourable for selected GST registrants who may have to forgo a portion of their GST input tax

claimable in future adjustments.

It is a practice in certain industries, such as construction, to retain a portion of the contract sum for claims, such as for defects. The retained portion, commonly known as the retention sum, is often billable months, if not years, after the completion of the contract or project. The GST treatment for the retention sum will follow the treatment of the amount billed earlier. However, if the retention sum is only billable in the future after the GST legislation has been repealed and the amount billed earlier was GST-chargeable, the contractor will be in a peculiar position in which he needs to bill the retention sum with GST but there is no longer any applicable GST legislation to enable him to do so.

This circumstance also represents a loss of GST revenue to the government if the client of the contractor is not entitled to claim this GST as input tax credit. Conversely, if the client is in a position to claim the GST as input tax credit, his ability to claim it is also in question as the GST legislation has been repealed.

The right to claim input tax credits is also at risk in other circumstances. One of them involves industries with long gestation periods such as power generation and oil and gas exploration. The company is only liable to register for GST at a much later date when it begins to issue invoices. In practice, these companies are often

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not allowed to register despite incurring millions of ringgit in GST. They are often told to register for GST only after they have commenced issuing invoices for sales and seek approval to claim the accumulated GST. Notwithstanding the need to finance the accumulated GST during the gestation period, these companies are now faced with the possibility that they will never be able to claim the accumulated GST.

GST input tax is currently claimable if the claim is made within six years. Clearly, the GST incurred in April 2015 — when the tax was implemented — should still be claimable well into 2021 if the GST legislation is not repealed. The abolishing of GST will reduce the timeframe to claim the input tax, effectively depriving GST registrants of such claims in the future. GST registrants need to ensure that they have claimed any claimable input tax before the GST legislation is repealed or the claims may be forfeited.

Apart from these input tax claims that may be lost, a GST registrant may also be deprived of reclaiming the GST that they have remitted for tax invoices that they are unable to collect. Presently, a GST registrant will provisionally remit to the Royal Malaysian Customs Department the GST in the tax invoices he issues, pending collection from his clients or customers. If the clients or customers are proven to be insolvent or have not paid the tax invoices after a period of six months, the GST registrant will typically recover the remitted GST as bad debt relief and the clients or customers have to correspondingly repay the related input tax credit that they may have claimed. The six-month period may expire only after the GST legislation is repealed and the right to claim bad debt relief will be in limbo. If this is not addressed in the savings and transitional provisions, the forgone bad debt relief will pose as a cost to a GST registrant while the clients or customers get away with the benefit of having claimed input tax credit when they did not pay their dues.

GST will manifest itself as a cost of doing business under these circumstances, against the ideals of GST where it should never be a cost of doing business as businesses are not the consumers. If GST becomes a cost of doing business, there is a distinct likelihood that it will be passed to consumers. This will work against the objective of removing GST in order to lower the price of goods and services.

Contractual issues

Many contracts have incorporated GST without taking into consideration its possible abolishment or the reintroduction of sales and services tax (SST). Consequently, the effectiveness of these contracts might be undermined. Amendments may have to be made or supplementary contracts may have to be signed, all of which would incur additional legal cost. At the very least, the parties have to devote time to negotiating new terms to avoid an impasse.

Recovery of GST, audits and penalties

The rights of GST registrants have always been highlighted but one must not forget that the government is also a stakeholder. We should also consider how the government can recover unpaid GST and penalise offenders after the GST legislation is repealed. There are several ways to achieve this. First, the savings and transitional

provisions may empower the government to recover any GST and continue to impose any applicable penalties. However, it takes time to draft such provisions and a better way would be to repeal the GST legislation while preserving the relevant sections dealing with these matters.

Aside from preserving the government's rights to recovery and penalty, a final audit on GST registrants before repealing the GST legislation has been bandied about as a potential measure to ensure closure. This is easier said than done as the number of GST registrants reportedly numbered 465,000 at the beginning of the year. There are limited resources to complete such a formidable undertaking and it will take thinking out of the box to accomplish.

Right of appeal

Equally important to preserving the government's rights to recovery and to penalise defaulters are the GST registrants' rights to challenge any such assertion. The GST registrants must be accorded the right to defend themselves and escalate any dispute for review in the judicial system. Similar to preserving the government's rights, the relevant existing legislation may also be preserved or new provisions can be incorporated into the savings and transitional provisions.

Conclusion

Clearly the abolishing of GST is not a simple matter and it should not be taken lightly. There are various factors to

be considered lest GST becomes a cost of doing business that might be passed on to consumers. A hasty removal of the tax is risky and given the current contentment with zero-rated GST, a concurrent application of zero-rated GST and SST may be a viable solution to mitigate any potential problems. The compliance requirements of GST need to be reduced in order to avoid being an administrative burden for businesses. Nonetheless, the government is adamant on keeping its promise to abolish the tax. We wait with bated breath. E

Alan Chung is a member of the CTIM GST-SST Transformation Working Group



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