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The GST-SST conundrum

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This is the final article in a series of eight written by various members of the Chartered Tax Institute of Malaysia's (CTIM) GST-SST Transformations Working Group (TWG). The voluntary group was set up by CTIM to support the government on the nation's transition from the Goods and Services Tax (GST) to the Sales and Services Tax (SST) and comprises indirect tax practitioners from professional accounting and legal firms to commercial businesses.

The urgent need to replace GST with SST is a consequence of the country's 14th general election held on May 9. It is one of the key promises made in the Pakatan Harapan manifesto and has to be honoured, for better or for worse. It is evident that the people are more concerned about the rising cost of living and consumer prices than about which of the two tax systems is more efficient.

This article discusses some of the lessons learnt from GST and the previous consumption tax at a macro level and also highlights the implications of SST for businesses and the people.

At the time of writing, the Royal Malaysian Customs Department (RMCD) had issued an outline of its proposals for SST to the Ministry of Finance, together with some frequently asked questions. The GST bill has yet to be tabled in parliament but is expected to be made available for its first reading by Aug 7.

Shift from income tax to broad-based consumption tax

The global trend in recent years has been to shift the source of tax revenue from income tax to a broad-based consumption tax, and in 2014, the previous government decided that it was the right time to follow suit. Proponents of GST argued that a consumption tax was fairer as the burden of tax would be more evenly distributed than income tax, which impacted a relatively small proportion of the population. Moreover, most of the expenditure of the poor was on basic necessities, which were zero-rated. Even so, the majority of the people felt that the Malaysian GST system was regressive and unfair to the middle and lower-income groups.

What went wrong with GST in Malaysia?

Tax professionals believe that GST is a far more superior and efficient multi-stage consumption tax system, from a revenue collection point of view, than the more primitive single-stage consumption tax system. GST is designed to be broad-based and transparent, and a tax for consumers, not businesses. So, what went wrong with GST in Malaysia?

Although the non-taxation of businesses was the understanding of GST communicated to businesses before its implementation, this was not really the case. Malaysia chose to implement a complicated GST system, where there were so many exempted and zero-rated items that it resulted in complex rules and higher compliance cost to businesses. The GST refund process became a constant struggle for RMCD, which added to the financing cost of businesses. To add to the disappointment of many businesses, the widely expected two-year amnesty or hand-holding period to educate the public was almost non-existent. Instead, GST audit teams were actively deployed and strict enforcement of the legislation was practised.

The "exempt" category was one of the main causes of additional burden to consumers as GST was invariably passed on to consumers via higher prices. It was also the exempt category that resulted in high administrative costs, especially when computation of partial exemption, capital goods adjustment and/or longer period adjustment required a higher level of proficiency from in-house GST practitioners and consultants.

Many businesses involved in projects with long gestation periods, such as infrastructure or property development, were disadvantaged by the long delay in the refund of input tax credits. It was best practice for RMCD to not refund input tax until output tax was collected. As a result, many businesses ended up incurring interest cost to finance the GST input tax on purchases, which went against the true spirit of GST and led to price increases.

Although GST may have been originally proposed with the noble intention of addressing the potential future deficit from Malaysia's depleting oil revenue, it unfortunately ended up being perceived by some as merely a collection tool implemented by the previous government to compensate for the leakages in its coffers. It was this perception that led to the demise of GST post-GE14.

SST and how it has evolved

The weaknesses of the old consumption tax model may be summarised as:

- The cascading and double-tax effect of the single-stage tax system;
- The high percentage of non-compliance; and
- The inefficient manual accounting system.

The switch to GST in April 2015 largely eliminated these weaknesses and some modifications could be made to SST to avoid these same problems.

The outline of the SST system unveiled by RMCD on July 19 showed some positive improvements, considering the very short time frame for implementation. What is certain is that Malaysia cannot afford to implement SST later than the proposed Sept 1 because any delay would cost the government over RM1.75 billion a month. RMCD's proposals were issued promptly with little opportunity to consult professional bodies, and there were no elaborate modifications to the previous model.

Many articles have been published in recent weeks that examine the differences between GST and SST. Ultimately, SST is projected to collect a lower revenue of RM21 billion per annum compared with RM43 billion by GST. In theory, this means an additional RM22 billion of cash is being "given back" to the people. The question is, will all this effort to return RM22 billion to the people be felt and appreciated by them?

SST legislation

SST will be administered under two separate tax legislation — the Sales Tax Act 2018 and the Service Tax Act 2018. The sales tax will be chargeable either upon the importation of goods or upon the sale of goods by manufacturers. Certain goods and manufacturing activities shall be exempted from the sales tax via the Sales Tax (Goods Exempted From Sales Tax) Order 2018 and Sales Tax (Person Exempted from Sales Tax) Order 2018, as proposed by RMCD.

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Under SST, price reductions should be expected mainly for items that are not imported or manufactured

Although the scope of the sales tax appears to be much narrower than that of GST, we should not expect reductions in the prices of many essential items that were zero-rated under GST. Price reductions should be expected mainly for items that are not imported or manufactured.

A new wider definition of the term "manufacturing" has been proposed, which defines it as "a conversion of materials by manual or mechanical means into a new product by changing the size, shape, composition, nature or quality of such materials and includes the assembly of parts into a piece of machinery or other products". However, the term would generally exclude the installation of machinery or equipment for the purpose of construction. In relation to the petroleum industry, it has been proposed that "manufacturing" would include any process of separation, purification, conversion, refining and blending. Other activities that have been proposed to be exempted from SST registration come under tailors, jewellers and opticians.

In view of the broad definition of "manufacturing", greater clarity is needed for taxpayers to be certain about the type of activities that are excluded. Therefore, one of RMCD's priorities should be to issue a more comprehensive exemption list for manufacturers in advance so that potential SST registrants have sufficient time to prepare.

To avoid confusion, it would also be important for RMCD to clarify any difference in the definition and interpretation of "manufacturing" from the old consumption tax regime.

Sales tax shall be an ad valorem tax at 10%, 5%, exempt or at a specific rate. Special rules would apply to supplies made for or within designated areas (that is Labuan, Langkawi and Tioman) or special areas (free zone, licensed warehouse, joint development area and so forth). Drawback facilities should also be available in relation to any sales tax paid in respect of taxable goods exported. Sales tax exemptions on goods and on persons would be available under the proposed Sales Tax (Goods Exempted from Sales Tax) Order 2018 and Sales Tax (Person Exempted from Sales Tax) Order 2018 respectively.

Service tax, on the other hand, is chargeable on any provision of taxable services made in the course of the furtherance of any business by a taxable person in Malaysia. It shall not be chargeable on imported or exported services. RMCD has proposed service tax at a fixed rate of 6% except for a specific rate of RM25 for the provision of credit cards.

Clarity on the scope and list of taxable services is also key to understanding the effects of service tax on consumers. RMCD has provided an exhaustive list of taxable services (see Figure 1), which is similar to the list under the old consumption tax regime except for the proposed inclusion of domestic travel and wider interpretation of the provision of food and beverages to be extended to cover hawkers and food trucks. Service tax is chargeable on the provision of electricity of more than 600kWh based on the actual value of taxable service provided.

The service tax proposal excludes provision for group relief. The rationale for this is not known as the decision would unfortunately discriminate against groups of companies that have centralised services for operational efficiency. We hope that the government will reconsider this and whether a provision for group relief similar to the one in the old consumption tax regime could be proposed.

SST registration process

For the sake of simplicity, the proposed registration threshold for SST shall be standardised at RM500,000 per annum for both sales tax and service tax. Based on this threshold, RMCD estimates that the number of SST registrants would be just over 100,400. This means that the number of SST registrants would be less than a quarter of the number of GST registrants.

The registration process would be electronic and manufacturers who are GST registrants and who meet the sales tax registration criteria would be automatically registered as Registered Manufacturers for Sales Tax. Likewise, service providers who are GST registrants and who meet the registration criteria would be automatically registered for service tax.

Leveraging GST technology and database is an excellent way for the government to address the issue of low compliance levels seen under the old consumption tax regime. GST registrants who meet the registration criteria but who are not registered by Sept 1 would need to apply for registration within 30 days of the commencement date. Just like for GST, businesses that are below the RM500,000 threshold would have the option to voluntarily register for SST.

Accounting period/submission of returns/payment

RMCD's proposal is for sales tax and service tax returns to be submitted bimonthly, which is welcomed as this should result in easier administration for compliance compared with monthly filing. The submission deadline shall be no later than the last day of the following month after the end of the taxable period. SST returns must be submitted electronically or by post to the SST processing centre; manu-

FIGURE 1

❑ Hotel	❑ Accounting	❑ Motor vehicle service or repair
❑ Insurance and Takaful	❑ Surveying	❑ Courier
❑ Service of food and beverage preparation	❑ Architectural	❑ Hire and drive car
❑ Club	❑ Valuer	❑ Advertising
❑ Gaming	❑ Engineering	❑ Domestic flight except Rural Air Services
❑ Telecommunication	❑ Consultancy	❑ Credit or charge card
❑ Pay-TV	❑ Employment agency	❑ IT services
❑ Forwarding agents	❑ Security	❑ Electricity
❑ Legal	❑ Management services	
	❑ Parking	

al submissions over the counter will not be accepted. Similarly, payment of SST shall be made electronically or by post (cheque or bank draft) to the SST processing centre.

RMCD has proposed that sales tax shall be accounted for on an accrual basis whereas service tax shall be on a payment basis. This inconsistency may result in challenges in the configuration of certain accounting systems. Therefore, RMCD should consider providing options to taxpayers for ease of compliance.

Late payment penalty

Similar to GST, the maximum penalty for late payment shall be 40% after 90 days (10% for the first 30 days, 15% for the second 30 days and 15% for the third 30 days).

Conclusion

In view of the short time frame and the many SST implementation issues to resolve, it would be good if the tax authorities could focus on the key priorities over the next few weeks.

TWG is a voluntary group of tax professionals set up under CTIM, specially to support the government on the transition from GST to SST. The professional bodies have offered to assist the government to review the draft SST legislation from a technical standpoint and it is hoped that the Ministry of Finance will take up this offer before the SST legislation is tabled in parliament on Aug 7.

The issue of non-compliance under the old consumption tax regime was largely resolved under the GST regime, where there was enhanced transparency, greater efficiency and self-compliance. It would then make sense for the new SST system to leverage the information technology system, databases and best practices under the GST system. Automatic registration, electronic registration and electronic payment are excellent proposals by RMCD.

As discussed above, further clarification from RMCD on taxable supplies and taxable persons would be another key priority area, given the extensive list of exemptions and interpretation of the wider definition of "manufacturing". Given that SST has a much narrower base than GST and the number of registrants is expected to fall to 100,408, a thorough understanding of the scope of SST would be vital for compliance preparation.

Businesses used to the GST system would soon realise that input tax credits would no longer be available under the new system. This would, in some cases, result in a cascade and a double tax. This means businesses will have to turn to the available exemptions so that there will hopefully be no need to increase prices. For instance, whenever SST results in higher prices than under GST, this may be highlighted to the government for consideration. After all, the main objective of abolishing GST is to reduce prices. Furthermore, any price increases may attract the attention of the Ministry of Domestic Trade, Co-operatives and Consumerism, which has the task of enforcing price control under the anti-profiteering law wherever there is profiteering.

In the interest of promoting operational efficiency within a corporate group, the government should also consider introducing group relief under SST. It would seem wrong for any tax system to discriminate against businesses that chose to organise their affairs to operate in a more efficient manner.

Finally, if the government is serious about ensuring that Malaysia is a competitive location for foreign direct investment, then it would have to ensure that the SST system enables it to continue on its current path of reductions in direct taxes; further modifications would have to be made to the SST system. As Malaysia approaches its goal of becoming a high-income nation, its revenue collection from consumption tax would need to become more relevant. E

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