

MALAYSIA'S GST JOURNEY: PAST, PRESENT AND FUTURE

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Abstract

After Malaysia's two attempts since 2005 to introduce a consumption tax, the Goods and Services Tax Act 2014 was finally passed by the parliament with the tax taking effect from 1 April 2015. This paper concerns an investigation into Malaysia's introduction of the GST. An important reason for the introduction of GST was the recognition of the country's overdependence on the revenues generated from Petronas (Petroleum Nasional Berhad) (Eleventh Malaysia Plan 2016-2020). The timing of its actual implementation coincided with the slump in oil and gas prices over the period mid-2014 to mid-2016. Its' implementation successfully helped the Federal treasury to cushion the impact of lower oil revenue and with little opposition from the public.

To quote the words of the Malaysian Prime Minister,

'GST has been our saviour'. In the light of these developments - Royal Malaysian Customs Department's (RMCD) current and future role in collecting revenue from consumptions taxes becomes more significant.

A significant observation is that the implementation of GST benefitted from the early preparation by RMCD commencing in 2010 which aided with the overall success. During the lead-up time to its implementation, RMCD prepared taxpayers by conducting numerous seminars in major towns and issuing various draft Industry Guides on how GST law is to be applied.

After a year of its implementation, GST registrants exceeded the target of 412,000 by over 20%. The Director General of RMCD has highlighted the acute shortage of GST tax agents as currently there are 2,000 agents but more are needed. As at 30 June 2016, there are over 7,294 GST appeal cases and the numbers highlight the volume of taxpayer grievances. Further, very little are known about the factors and magnitude of GST compliance cost burden imposed on the business taxpayers.

GST law continues to evolve and the changes impact on business transactions. Some businesses struggle to grasp the various aspects of GST thus leading to inefficiency that results in additional GST cost, penalties due to non-compliance and incorrect management of documentation.

This paper highlights concerns related to GST implementation that were never anticipated and explores how they would have an impact on revenue collection. It also investigates business concerns and evaluates broadly whether the tax is regressive in nature.

MALAYSIA'S GST JOURNEY: PAST, PRESENT AND FUTURE

1. Introduction

After Malaysia's two attempts since 2005 to introduce a consumption tax,¹ the Goods and Services Tax (GST) Act 2014² became operational effective from 1 July 2014 and the legislation was implemented with effect from 1 April 2015 (see Table 1). The GST Act provides for the imposition and collection of goods and services tax and on the implementation date, it replaced the Sales Tax Act 1972 and Service Tax Act 1975.³

Table 1: Process of Implementing the Malaysian GST Act 2014⁴

Legislative Process	Date
Goods and Services Tax Bill 2009 was initially tabled for first reading in Parliament. ⁵	16 December 2009
Goods and Services Tax Bill 2014 was once again tabled in Parliament	31 March 2014
Royal Assent for Introduction of Goods and Services Tax Bill 2014	9 June 2014
Goods and Services Tax Act 2014 (Act 762) was Gazetted	19 June 2014
Operational date of Goods and Services Tax Act 2014	1 July 2014
Implementation of GST in Malaysia	1 April 2015

In Malaysia, the GST (or value added tax in the case of the United Kingdom and continental Europe) is generally imposed on goods and services sold at the manufacturing, wholesale and retail stages, as well as at the point of importation but exports are not subject to tax. The treatment of cross border supply have an impact on exports and imports and the implementation process is explored in part 4 of this paper.

¹ Kraal, D. & Kasipillai, J. (2016) "Finally, a Goods and Services Tax for Malaysia: A Comparison to Australia's GST Experience" 31 (2) *Australian Tax Forum* 31(2): 257.

² Reference is made to The *Goods and Services Tax Act 2014* (Laws of Malaysia, Act 762).

³ <http://www.federalgazette.agc.gov.my/> Sales tax was imposed under the Sales tax Act 1972 and the tax rates were either 5% or 10% depending on the goods sold. Service tax was imposed under the Service Tax act 1975 and was taxed at a standard rate of 6% except for credit cards which were taxed at specified rates.

⁴ Kasipillai, J. and Jegan, J. ((2014). Forging ahead with Malaysia's GST Act 2014, *Tax Notes International*: July 28: pp. 321-25.

⁵ The Goods and Services Bill 2009 was subsequently withdrawn for reassessment.

The GST Act 2014 was introduced amid government claims that it would improve the overall economy and enhance efficiency of its tax system.⁶ For many decades, Malaysia has been facing a chronic budget deficit problem. Over a 46-year period from 1970 to 2015, the federal government budget was in deficit in all but five years (1993 to 1997 inclusive of both years). According to Narayanan (2004), deficits are unrelated to economic cycles but the size of the budget deficits have consistently exceeded forecasts since 1999.⁷ Further, a slide in petroleum prices since July 2014 resulting in a sharp drop in petroleum income tax and petroleum-related taxes lead to highly unstable tax revenues with the potential to adversely impact development spending.

In Malaysia, about four million people lodge income tax returns, and only about one million have a net tax liability, hence the GST has an important role to play in budgetary considerations.^{8,9} Further, a vital rationale for the introduction of GST was the recognition of the country's overdependence on the revenues generated from Petronas.¹⁰ Petronas (abbreviated for Petroliam Nasional Berhad), is Malaysia's national oil and gas company and it was founded on 17 August 1974. In 2014, Malaysia's national oil and gas company's contribution was almost 30% of total federal revenue.¹¹ As a result of low oil prices, Petronas' projected contribution to federal revenue is reduced to 13% in 2016. In September 2016, Petronas reported a 96% drop in the second-quarter profit and labelled the oil and gas industry outlook to be gloomy well into 2017.¹²

The timing of GST implementation coincided with the slide in oil and gas prices over the period June 2014 to September 2016. Its' implementation successfully helped the Federal

⁶ An important reason for introducing GST is that it will increase the efficiency with which resources are allocated in the economy. The GST remedies the cascading effects of the sales tax and service tax. Unlike sales tax and service tax, which are collected only at the point of sale to the final consumer, GST revenue is collected throughout the production process.

⁷ Narayanan, S. (2014). The Impact of The Goods and Services Tax (GST) In Malaysia: Lessons From Experiences Elsewhere (A Note), *Singapore Economic Review* 59(02)

⁸ <http://www1.nst.com.my/news/2016/07/157625/gst-and-shadow-economy> (The GST and the shadow economy by Alex Maley, 11 July 2016).

⁹ Given Malaysia's Budget deficits (2010: 7.4%; 2012: 4.5%; 2013: 3.9%, 2014: 3.5% and 2015: 3.2%), the government has since 2010 cut domestic petrol subsidies and relaxed price controls.

¹⁰ Reference is made to the Eleventh Malaysia Plan 2016-2020, Economic Planning Unit, Prime Minister's Department, Putrajaya, Malaysia, 25 May 2015.

¹¹ Petronas contributed MYR16 billion in dividend to the government in 2016, down from MYR26 billion in 2015. Its net profit for July-September 2015 tumbled to MYR1.4 billion ringgit from MYR15.1 billion in the same period in 2014: <http://www.reuters.com/article/us-petronas-results-idUSKCN0T016G20151111>

¹² Pooi. K.C., (2016), Kuala Lumpur, "Malaysia's Petronas Posts 96% Profit Drop on Lower Oil Price", Bloomberg, 22 August, <http://www.bloomberg.com/news/articles/2016-08-22/petronas-posts-96-quarterly-profit-decline-on-lower-oil-prices>

treasury to cushion the impact of lower oil revenue and with little opposition from the public.¹³

To quote the words of the Malaysian Prime Minister:

‘GST has been our saviour’.¹⁴ In the light of these developments, the Royal Malaysian Customs Department’s (RMCD) current and future role in collecting revenue from consumptions taxes becomes more significant.

An important observation is that the implementation of GST benefitted from the early preparation by RMCD commencing in 2010 which aided with the overall success. During the lead-up time to its implementation, RMCD prepared taxpayers by conducting numerous seminars in cities and major towns as well as issuing various draft Industry Guides on how GST law is to be applied. The accounting profession (including tax agents), industry and IT personnel as well as tax academics were grappling to fully understand and keep abreast with the raft of GST industry guides and subsidiary legislations that followed. Tax professionals enrolled for intensive courses conducted by trained experts and those who cleared the examinations, and after seeking approval from RMCD, became GST tax agents. The names of approved tax agents are listed in the RMCD website and they play a significant role in enhancing GST-compliance.¹⁵ Since the implementation of GST has wide-ranging implications on businesses, taxpayers are also required to prepare a GST-compliant financial system and purchase GST-accounting software.

- **Statutory appointments in Malaysia**

The responsibility to administer indirect taxation, including the implementation of Goods and Services Tax, lies with the Director General of Royal Malaysian Customs Department.¹⁶ The Director General of RMCD is assisted by three deputies who head different portfolios, namely:

¹³ Based on the Budget estimate in 2016, if SST had been retained, collection in 2016 would have been only MYR18 billion compared with GST revenue of MYR39 billion. With the introduction of GST, the Government’s indirect tax revenue share to total revenue is estimated to increase to 25.7% in 2016 from just 17% in 2014.

¹⁴ <http://www.thestar.com.my/news/nation/2015/10/26/najib-gst-malaysia-savior/>. Quoting Malaysian Prime Minister’s Najib Tun Razak speech on 26 October 2016.

¹⁵ http://www.customs.gov.my/en/ip/pages/ip_lta.aspx.

¹⁶ In the United Kingdom, Her Majesty's Revenue and Customs is a non-ministerial department and it is a merger of the Inland Revenue and Customs and Excise departments. In Malaysia, the RMCD and the Inland Revenue Board are separate department that come under the purview of the Ministry of Finance.

- (i) deputy Director General of Customs (Enforcement & Compliance);
- (ii) deputy Director General of Customs (Customs & Internal Taxes); and
- (iii) deputy Director General of Customs (Management).

The enforcement and compliance division of RMCD carry out GST-surveillance tasks and intensive audit activities are yielding a tremendous rise in revenue collections. The government is confident of surpassing the 2016 GST collections target of MYR39 billion.¹⁷

2. Literature review

The literature review is on studies involving the broad-based consumption tax carried out in Malaysia before and after GST implementation. A qualitative study on GST-registered small and medium enterprises (SMEs) was carried out¹⁸ in May to June 2015, that is, during the post-GST era in Malaysia. The study involved a semi-structured face-to-face interview with nine owners of businesses. The study found mixed results on the attitudes and perceptions of the interviewees towards GST. Compliance costs are known to be proportionally higher among SMEs and these entities are often not adequately prepared to accommodate the new tax provision into their existing businesses. The study is significant as it identifies the relationships among the factors that influence the intention and compliance behaviour of GST taxpayers. This study is known to be the first of its kind after the introduction of the GST in Malaysia. The factors identified include the perception of fairness regarding the GST system, GST compliance readiness of businesses and external factors influencing the behavioural intention of taxpayers. The findings of the study highlighted that the degree of support from family members, friends and fellow retailers, known as subjective norms (perceived social influence) significantly determine the behavioural intention of taxpayers. The identification of factors influencing the behavioural intention of taxpayers is crucial because taxpayers could be influenced and nurtured to engage in GST-compliance activities over time.

International evidence often advocate that GST compliance costs are often regressive and this is particularly true in the case of small businesses when compared to large businesses.¹⁹

Hence, to ensure the GST system is an effective and efficient tool for revenue-raising, efforts

¹⁷ <http://www.thestar.com.my/business/business-news/2016/03/10/gst-collection-exceeds-2015-target/>

¹⁸ Yong, M.C., Kasipillai, J, and Sarkar, A. (2016), "Challenges Encountered by SMEs with the Implementation of GST in Malaysia: A Qualitative Study", (Unpublished).

¹⁹ N. Faridy, Freudenberg, B., Sarker, T. and Copp. R (2016) "The Hidden Compliance Cost of VAT: An Exploration of Psychological and Corruption Costs of VAT in a Developing Country" *eJournal of Tax Research*, 14(1): 166-205

need to be directed towards the main objective of gaining trust and confidence among businesses and urge them to comply with GST law as a social obligation.

2.1 Perception of fairness of tax system

From a macro perspective, the public in Malaysia may have initially perceived GST negatively mainly due to its impact on general price level; its regressive nature on lower income households; potential rise in the GST rate over time; and that the GST revenue is used irresponsibly to mitigate problems in wasteful public spending and leakages.²⁰ Hence, the negative perception towards fairness of GST and tax complexity may have an adverse impact on attitudes of the business community thereby increasing non-compliance behaviour.

Krever's 2016 comprehensive VAT legislative volume highlights that in Australia, the GST Act delegates to various Ministers and to the Commissioner of Taxation the power to issue legislative determinations with the force of law on a number of particular issues.²¹ He further highlights that the accelerating pace of changes to the law in Australia has been matched by a growing volume of court and tribunal decisions further exuberating the complex nature of the GST legislation.

The costs of managing a tax system comprises of the costs incurred by taxpayers in complying with their tax obligations but additionally includes the administrative costs for the government machinery to collecting its taxes in an efficient manner.²²

2.2 Empirical findings

In the context of Malaysia, we report on the empirical findings of the "hidden" or "cash" income followed by a study that highlights the impact of GST on household expenditure.

Research findings have shown that the hidden or the cash economy in Malaysia was as high as 8.7 percent of gross domestic product in 1980,²³ thus the cash economy might be seen as

²⁰ Narayanan, S. (2014). The Impact of The Goods and Services Tax (GST) In Malaysia: Lessons From Experiences Elsewhere (A Note) *Singapore Economic Review* 59(02)

²¹ Rick Krever (2016), *GST Legislation PLUS 2016*, Thomson Reuters (Professional) Australia Limited ABN, Sydney.

²² C Evans, 'Taxation compliance and administrative costs: An overview', in M Lang et al (eds) *Tax compliance costs for companies in an enlarged European Community*, Linde Verlag and Kluwer Law International, 2008: 447–68.

²³ Jeyapalan Kasipillai, Jonathon Baldry, and Prasada Rao, "Estimating the Size and Determinants of Hidden Income and Tax Evasion in Malaysia" *Asian Review of Accounting* . 2000: 8 (2): 25-42

normative in Malaysia. In their study, Kasipillai et al. (2000) provided plausible estimates of the size of the hidden economy ranging from a high of 8.7% of Gross National Product in 1980 to a low of 3.7% in 1993. By using calculated average tax rates, the tax evaded for each of the years from 1971 to 1994 was computed, with estimated tax losses between a low of MYR192 million (in 1971) and a peak of MYR1,350 million (in 1984).

A subsequent study by Marliza Mohamed (2012) highlights that between the years 1980 to 2009, the hidden economy in Malaysia rose from nine percent to 27% of Gross Domestic Product (GDP).²⁴ The researcher used a ratio technique on tax and criminal annual time series enforcement data. According to Marliza, there is a shift in the tax non-compliance mix in the informal (hidden) economy and a rise in ‘fraud’ activities in the illegal economy. Marliza contends the rise in fraud activities highlight the need for more efficient and effective enforcement by tax authorities. She relied on the use of economic statistics from the formal sector to estimate the hidden economy in Malaysia over the 20-year period.

Anecdotal evidence too suggests there are sizeable illegal sectorial activities that evade tax payments to the Government.²⁵ The World Bank has reported that the “hidden or informal economy” constitutes 31% of the Malaysian economy, almost double the percentage in other Asian countries such as Vietnam (15.6%) and Singapore (13%).²⁶

On 20 September 2016, it was reported that goods worth MYR42 million were seized by RMCD officials in the state of Sabah and the goods mainly comprise of liquor and cigarettes.²⁷ Confiscation of these goods including tyres and controlled items such as rice and sugar are very often reported in the media highlighting the prominence of “hidden income” in Malaysia. Hence, concerted efforts are needed by the government to tap on lost revenue from immense “hidden income” activities that exist in Malaysia. The introduction of GST is an effort by the government to trace “non-compliant” activities but more enforcement initiatives are needed to address its root problem.

- **Household expenditure survey**

²⁴ Marliza Mohamed. “Estimating the underground economy from the tax gap: the case of Malaysia” *Malaysian Journal of Economic Studies*, 2012 49 (2): 91-109

²⁵ *The Edge Financial Daily*, May 23, 2015, Kuala Lumpur, www.theedgemarkets.com.

²⁶ Malaysia Economic Monitor: towards a middle-class society (2014) December World Bank report IBRD-IDA Monitor <https://openknowledge.worldbank.org/bitstream/handle/10986/21057/932370WP0P1528010MiddleClassSociety.pdf?sequence=1>

²⁷ The Star newspapers, “Goods worth MYR42 million were seized in Sabah”, 20 September 2016, p. 18

In 2009, Kasipillai and Sinnakkannu investigated the distributive effects of a comprehensive GST on prices of broad groups of commodities and services in Malaysia.²⁸ Base data was compiled from the Household Expenditure Survey (HES), which collates current information on levels and trends of consumption expenditure by households on a comprehensive range of goods and services. A simulation model was developed to determine the effects of the GST on households. Four GST rates, namely 3, 5, 7 and 10 percentile points were considered in the simulation exercise. The findings of this study suggest that the GST is not necessarily a regressive tax and at lower household expenditure levels, it is even found to be fairly progressive. In Malaysia, most essential daily food consumables are controlled items and the ceiling price is set by the Ministry of Domestic Trade, Cooperatives and Consumerism²⁹

2.3 Expanding economies and GST revenue

Among the eight Association of South East Asian Nations (ASEAN), Indonesia was the first country to implement the GST in 1984, followed by the Philippines (1988), Thailand (1992), Singapore (1994), Vietnam (1999), Cambodia (1999), Laos (2009) and lastly, Malaysia (2015). After Malaysia, the Indian sub-continent is the latest country to introduce GST and passed the Goods and Services Tax (GST) Act 2016³⁰ on 3 August 2016. Subsequently, India's President Pranab Mukherjee gave assent to the GST legislation, a major step towards rolling out the new indirect tax regime which is expected to be effective from 1 April 2017. The new GST, which was contemplated over a decade ago, promises in unifying the India's 29 states and 1.3 billion people into a common market for the first time.³¹ The effective GST rate is unclear but a government study has indicated the rate to vary from around 15.5 percent to as high as 26 percent.³² The proponents have claimed that GST is one indirect tax for the whole nation, which will make India one unified common market.

Amongst OECD countries, Mexico relies the most on consumption taxes, raising around 54.5% of their total tax revenue from GST followed by Chile (50.1%) and Turkey (45%).³³

²⁸ Kasipillai, J. and Sinnakkannu (2008), "Distributive Effects of the Introduction of GST in Malaysia" *The International VAT Monitor* 19(5): 359-366.

²⁹ Control of Supplies Act 1961, Malaysia

³⁰ The short title stated in the GST Model is termed as the Central / State Goods and Services Tax Act, 2016

³¹ <http://www.economist.com/news/asia/21703370-tax-overhaul-will-have-welcome-if-unpredictable-consequences-one-nation-one-tax?>

³² <http://timesofindia.indiatimes.com/india/After-Presidents-nod-next-steps-ahead-on-GST/articleshow/54195775.cms> (Retrieved on 9 September 2016)

³³ <http://taxfoundation.org/article/sources-government-revenue-across-oecd-2015>, "Sources of Government Revenue across the OECD, 2015" By Kyle Pomerleau, 30 April 30, 2015.

Japan raises slightly more at 18 percent, followed by Switzerland at 22.9 percent.³⁴ On an annualized basis, Malaysia’s share of GST to Federal revenue in 2015 is around 17% and with an expanding economy this share is expected to grow over the years. According to Malaysia’ Eleventh Malaysia Plan (2016-2020), monthly income increased 20-fold from MYR264 in 1970 to MYR6,214 in 2014, hence there is potential for GST revenue to grow tremendously.

3. Malaysia’s GST story

The Malaysian government had plans to introduce GST in the early 1990s and 2000s but it did not materialize until 2009 when the GST Bill 2009 was first tabled in Parliament on 16 December 2009. However, the political landscape at that time coupled with strong objection from the general public prompted the government to suspend the third reading of the 2009 Bill at the eleventh hour.

As mentioned earlier, the new broad-based consumption tax was implemented on 1 April 2015 and its’ enforcement is regulated by the GST Act 2014 embodying 165 pages with 197 sections. In addition, there are four schedules to the GST Act and the details are highlighted in Table 2.

Table 2: Schedules of the GST Act 2014

Schedules	Title of Schedules
First Schedule	Matters to be treated as a supply of goods or a supply of services
Second Schedule	Matters to be treated as neither a supply of goods nor a supply of services
Third Schedule	Value of supply of goods or services
Fourth Schedule	Non-appealable matters

The first and second schedules cover tax treatment of supply of goods and supply of services. The third schedule explains how “value” of supply of goods or services is determined. The fourth schedule states that the Goods and Services Tax Appeal Tribunal shall not have jurisdiction to hear appeals and they are listed in items (a) to (q).

³⁴ Above n 12

The GST Act must be read together with GST Orders; specific and industry guides; and GST-related regulations (Kasipillai, 2015).³⁵ The GST Act³⁶ states that the tax “shall be charged and levied on (a) any supply of goods and services made in Malaysia, including anything treated as a supply under this Act and (b) any importation of goods into Malaysia”.

Malaysia’s tax architecture has changed significantly after the introduction of GST in April 2015 with greater focus on consumptions taxes (see Table 3) and its proponents have touted it to be a panacea for the Malaysian economy. Indirect taxes as a share of federal government revenue rose gradually from 17% in 2014 to 23.9% in 2015 and 25.7% in 2016.

Table 3: Federal Government Revenue, MYR million

	2014	%	2015 (revised estimate)	%	2016 (Budget estimate)	%
Direct Tax	126,743	57.4	116,760	52.5	125,566	55.6
Income Taxes	118,996	53.9	108,362	48.7	116,558	51.6
- Companies	65,240		68,320		74,381	
- Individuals	24,423		28,155		30,266	
- Petroleum	26,956		9,529		9,331	
- Withholding and others	2,377		2,358		2,580	
Others ³⁷	7,747	3.5	8,399	3.8	9,009	4.0
Indirect Tax	37,462	17.0	53,258	23.9	57,987	25.7
Export Duties	1,893	0.9	1,053	0.5	1,012	0.4
- Petroleum	1,577		904		900	
- Others	316		149		112	
Import duties	2,670	1.2	2,727	1.2	2,791	1.2
Excise duties	12,925	5.9	12,168	5.5	12,408	5.5
Sales tax	10,939	5.0	4,784	2.1	-	-
Service tax	6,278	2.8	2,851	1.3	-	-
GST	-	-	27,000	12.1	39,000	17.3
Others	2,757	1.2	2,675	1.2	2,776	1.3
Non-Tax Revenue ³⁸	56,421	25.6	52,437	23.6	42,103	18.7
Total	220,626	100%	222,455	100%	225,656	100%

Source: Ministry of Finance, Economic Report 2015/2016³⁹

³⁵ Kasipillai, J. (2015) A Guide to Goods and Services Tax, McGraw-Hill Education, Shah Alam.

³⁶ Reference is made to s 9, GST Act 2014 which is the charging section and it provides for the chargeability of the tax.

³⁷ Includes revenue from stamp duties and real property gains tax.

³⁸ Includes interest income and returns on investment, licences & services fees, road tax, fines and petroleum royalties.

³⁹ http://www.treasury.gov.my/pdf/ekonomi/er/1516/jp6_2.pdf

3.1 Compensate unfair distributional effect

In implementing the broad-based consumption tax, the Malaysian government introduced numerous measures to compensate for the adverse distributional effects on taxpayers.

Individual income tax rates were reduced by 1 to 3 percent, effective from year of assessment 2015 (the year when the GST is implemented). Co-operative tax rates were reduced by 1 to 2 percent from year of assessment 2015. Corporate income tax rates were lowered by one percentile point from 25 percent to 24 percent, but the reduction is effective from 2016.

Income tax rates for small and medium-size enterprises were reduced from 20 percent to 19 percent effective from year of assessment 2016.

A MYR100 million fund was set aside by the government to provide businesses with an opportunity to send their employees for GST training in 2013 and 2014. A further sum of MYR150 million was used to provide financial assistance to purchase accounting software for small and medium-size enterprises in 2014 and 2015. Traders were prohibited from indiscriminately raising the prices of goods by the enforcement of the Price Control and Anti-Profiteering Act 2011.

3.2 Social safety net

After its' introduction, a well-targeted social safety net in the form of monetary assistance was initiated to compensate poor households.⁴⁰ It was accompanied by a package of measures aimed at mitigating the impact of the new tax. In the 2016 budget announcement, the government allocated MYR5.9 billion to implement the “1 Malaysia People’s Assistance Scheme” and it benefits 4.7 million households and 2.7 million single individuals (2016 Budget announcement).⁴¹ The distributional effect of GST in Malaysia should not be examined in isolation but viewed within the context of a fiscal system comprising of tax and government-expenditure programs.

Economists generally agree the assistance scheme and tax reduction measures would have a limited impact on the middle 40% household income group (M40), hence, the need to ensure

⁴⁰ According to Malaysia’s Economic Transformation Programme Annual Report 2014, households with average monthly incomes of less than MYR760 in Peninsular Malaysia, less than MYR1,050 in Sabah and less than MYR910 in Sarawak are defined as poor. <http://www.thestar.com.my/business/business-news/2015/05/18/measure-of-poverty>.

⁴¹ http://www.bnm.gov.my/files/Budget_Speech_2016.pdf. The allocation for 2014 and 2015 were MYR4.6 billion and MYR5.3 billion respectively

the cash hand-outs reach the target groups.⁴² Given the tight fiscal situation of the nation, the government is not expected to increase the coverage of the 1 Malaysia's Peoples' assistance scheme. Consequently, tax expenditures by widening the income bands applicable to the tax brackets for the M40 group would be an approach to ease the burden of this particular group.

3.3 Impact on consumer spending

Malaysia introduced GST with the objective of reforming the indirect tax system on a revenue-neutral basis. It however turned out that the reform has a revenue-increasing effect⁴³ which suggests the introduction of GST could have a negative effect on consumer prices. This however was not the case as Malaysia faced the lowest inflation figure since April 2015 as prices of food, housing and utilities eased while cost of transport fell. Amid a global slump in oil and gas revenues, consumer prices in Malaysia merely rose 2.1% year-on-year in April of 2016, slowing from a 2.6 percent increase in March and slightly below market estimates of 2.2%.⁴⁴

As mentioned earlier, the mild regressive aspects of the indirect tax are overcome with a gradual reduction of income tax rates in the lower and middle income bands, imposing graduated excise duties on non-essentials and cash disbursement to support the lower income groups.⁴⁵ The GST in Malaysia is also seen as a reformatory move to jumpstart the implementation of an efficient tax administration. After a year of its implementation, GST registrants exceeded the target of 412,000 by over 20%.⁴⁶ The Director General of RMCD has highlighted the acute shortage of GST tax agents as currently there are 2,000 agents but more are needed. As at 31 December 2016, there were over 7,294 GST appeal cases and the numbers highlight the volume of taxpayer grievances.

⁴² Tan Siew Mung, "All that the M40 group needs is less taxes" *The Edge Malaysia* September 12-18, 2016 p. 10.

⁴³ L. Ebrill, M. Keen, J.P. Bodin and V. Summers, "The Allure of the Value Added Tax", *Finance and Development*, A Quarterly Magazine of the IMF, Vol. 39, No. 2, June 2002. Also available at <http://www.imf.org/external/pubs/ft/fandd/2002/06/ebrill.htm> (retrieved on 4 September 2004).

⁴⁴ www.tradingeconomics.com/malaysia/inflation-cpi

⁴⁵ As from 2016, the individual income rates on chargeable income exceeding MYR600,000 has been increased from 25% to 26% and income exceeding MYR 1 million are taxed at 28%.

⁴⁶ Dato Sri Khazali, Director General of RMCD, "Progress on GST Implementation and Future Focus of RMCD" National GST Conference 2016, 31 May, Berjaya Times Square Hotel Kuala Lumpur.

3.4 GST compliance cost

The compliance cost of GST in Malaysia appears to be disproportionately high and constitutes a mild disadvantage that counters its major merits. This is because the number of registered GST business entities is generally very large when compared with a single-stage, transactions-based tax such as sales tax (and service tax as in the case of Malaysia). This problem was partially overcome by having a threshold of MYR500,000 for firms registering for GST purposes. The threshold limit, ideally, should be such that the compliance cost saved matches or exceeds the revenue foregone. Once it is established that the GST-base is concentrated among large business entities, a higher threshold can be recommended.

3.5 GST audit-blue ocean strategy

The Malaysian RMCD announced its first wave of GST audit - blue ocean strategy covering a 4-month period ending 31 December 2016.⁴⁷ In the first wave, RMCD is targeting to audit 50,000 registered persons out of a total of 420,000 registrants and they are concentrating on retailers and restaurant operators.⁴⁸ As for GST registrants, the taxable period is one month when annual turnover exceeds MYR5 million and is three months when it does not exceed MYR5 million.⁴⁹

According to a RMCD deputy director general, one-third of the firms audited during the first two weeks in September 2016 were facing compliance problems, especially relating to their failure to furnish information accurately in their GST returns.⁵⁰ He was quoted to have mentioned that the majority of the firms which submitted incorrect returns did so due to lack of knowledge, incorrect guidance; and in some instances the revenues declared were relatively low.⁵¹

⁴⁷ Earlier, on 20 June 2016, the compliance management division of RMCD issued the Goods and Services Tax Audit Framework.

⁴⁸ <http://www.1gst.com.my/gst-knowledge-portal/341-gst-audit-customs-blue-ocean-strategy.html>

⁴⁹ See s 40 GST Act 2014 (Laws of Malaysia, Act 762)

⁵⁰ Kong See Hoh, "Firms still struggling with GST returns", newsdesk@thesundaily.com, 14 September 2016. Customs deputy director general quoted in the newspaper is Subramaniam Tholasy.

⁵¹ Section 88 of the GST Act 2014 stipulates that the person would be liable to a fine not exceeding MYR50,000 and/or imprisonment for a term not exceeding three years and a penalty of the amount of tax which has been undercharged.

3.6 Dispute resolution

The GST Appeal Tribunal was established in Malaysia effective from 1 April 2015 to provide taxpayers an avenue to appeal against a decision by the Director General of RMCD.

Taxpayers aggrieved or dissatisfied with a decision of the Director General have two options: (i) apply for review, or (ii) make an appeal to the Tribunal. An appeal is to be filed with the Tribunal against an order passed by the Director General. Aggrieved parties have to exercise their legal remedies within the prescribed time, that is, 30 days from the date the decision was communicated to the taxpayer. Drafting review applications and mediating with the RMCD to settle disputes is costly, time consuming and there is additional psychological impact to the aggrieved parties.⁵²

4. GST Implementation and Concerns that were not Anticipated

This section highlights several significant concerns related to GST implementation that were never anticipated and explores how they would have an impact on revenue collection.

4.1 Concessions and proliferation of tax expenditure

A benchmark VAT intended to tax all consumption in a wholly neutral fashion provides no concessions for goods or services with possible positive externalities and no excessive rates for goods or services with possible negative externalities. Support for the former are provided by direct and tightly targeted subsidies and discouragement of the latter is accomplished through regulation or, if a price mechanism is preferred, by means of tightly targeted excise taxation. In the benchmark VAT, zero-rated supplies are limited to exports where consumption clearly takes place outside the jurisdiction. Deviations from the benchmark VAT are the norm, not the exception. The three most common forms of tax expenditures are designating some supplies as exempt supplies (so they are input taxed, and no VAT is imposed on the supplier's value added), if the goal is to remove all tax from the supply, then zero-rating the supply and reduced rates for particular types of supplies.⁵³

⁵² This is the first time, two taxpayers are charged in court for making fraudulent claims of GST totalling MYR945,123. They could be fined up to a maximum of 20 times the tax amount or would be jailed for up to five years or both: *Deloitte Malaysia Indirect tax, Chat Issue 9* (September): 2016.

⁵³ See s 74 GST Act 2014 that covers the "Flat Rate Scheme".

- **Exemptions and zero-rating**

The key differences between Malaysia and other GST jurisdictions such as Australia, Canada, New Zealand and Singapore are the proliferation of tax expenditures by way of exemptions and zero-rating in the Malaysian system and the varying international cross-border rules. Further, the extent and use of Ministerial discretion in Malaysia is significant and a key point for a paper on introducing a GST in the context of a developing economy. The Malaysian Minister of Finance too is empowered to grant relief and he does so by way of an order in the gazette and it must be laid before the parliament.

4.1.1 Treatment of Cross Border Supply

As for GST administration purposes, a supplier is treated as belonging in Malaysia if there is a business establishment or fixed establishment in Malaysia. A fixed establishment includes a branch or an agency through which a person carries on a business (section 14 GST Act 2014).

The list of exported services that could be zero-rated is provided under the Second Schedule of the GST (Zero-Rated Supply) Order 2014. The supply of exported services is not automatically zero-rated based on the interpretation of sec 17, GST Act 2014. Section 17 GST Act covers zero-rated supplies. There are certain prescribed conditions to be fulfilled in order to be able to zero-rate exported/international services and these services must also be listed in the Zero Rated Order. It is unclear whether an application could be made to the Minister to get certain services to be zero-rated as this is currently not provided in the law.

- **Zero-rating in Singapore**

In Singapore, the wordings in relation to the zero-rating for exports and international services reads:-

Section 21 GST Act 2005 (Revised):

- (1) Subject to this section and sections 21A, 21B and 21C, a supply of goods is zero-rated only if the goods are exported and a supply of services is zero-rated only if the services are international services.

Notwithstanding that, it should be noted that the description of the international services in this instance must also be defined or listed in the Singapore GST Act in order to qualify for

zero-rating. The authors are of the view that most jurisdictions adopt a similar principle for zero-rating of international services so as to ensure that there is a proper control in place. As for goods on the other hand, it will be easier to control and monitor based, for example, on the export declaration form whereas in the case of services, it would be difficult to prove due to the “virtual” nature of the transaction.

In Malaysia, amongst others, businesses could zero-rate the supply of the international services provided the following prescribed conditions are satisfied:-

- (i) Services are supplied under a contract that belongs in another country
- (ii) The services directly benefit the person who is outside Malaysia at the time the services are performed
- (iii) The services are not directly in connection with land or goods in Malaysia.

- **Zero-rating in Australia**

In Australia, the provisions to zero-rate international services are covered in Sections 38-190 of the GST Act 1999.

Illustration of zero-rating international services

Let us consider one other situation where an overseas company hires a Malaysian accountant to advise it on the interpretation and application of our GST law. In determining whether the accountant is making a zero-rated supply, we have to examine the nature of the advice. If the advice is in relation to a potential business that the overseas company intends to set-up in Malaysia, then the fee is zero-rated pursuant to para 12 or 13 or both.⁵⁴ If the advice is regarding an application of GST on land located in Malaysia owned by the overseas company, then the service fee may be argued as being directly in connection with land in Malaysia, thus paragraphs 12 and 13 may not be applicable, hence the fees payable would be standard rated and subject to 6% GST.

It is our view the Malaysian GST law is not on all fours with that of Singapore (and other GST jurisdictions), hence it is cumbersome to export-oriented firms which export services rather than goods. In any case, the practical means

⁵⁴ Reference is made to para 13(a) Goods and Services Tax Act (Zero-rated Supply) Order 2014 (P.U. (A) 272.

implemented in Malaysia can lead to double or involuntary non-taxation, resulting in uncertainties for both businesses and the tax authority.

The key GST provisions of zero-rating international services in Malaysia, Singapore and Australia are presented in Appendix 1.

4.1.2 Concessions for special tax economic zones

Malaysia has uniquely carved special tax economic zones out of the ordinary GST. These zones can be classified into two:

- (i) free zones, and
- (ii) designated zones.

A free zone is a designated, secured area in which commercial and industrial activities are carried out and it is gazetted by the Minister of Finance.⁵⁵ The Free Zone Authority is appointed by the Minister⁵⁶ to manage the zone. A list of FIZs and FCZs are found in the First Schedule of the Free Zones Act 1990.

There are two types of free zones: free industrial zone (FIZ); and free commercial zone (FCZ).

- **Free industrial zones**

A FIZ is a place where manufacturing activities are carried out primarily for export purposes. Generally, all goods that are supplied from a business operating in a FIZ to overseas are zero-rated. However, all goods supplied locally by businesses in the FIZ are subject to GST.

Businesses operating in FIZs are obliged to pay GST on acquisition of goods and services from local suppliers. This applies also to services supplied and consumed within a FIZ (for example forklift rental and storage charges). By default, they are also obliged to pay GST on the importation of goods, but being an export-oriented business, the business may apply for the Approved Trader Scheme (ATS)⁵⁷ to suspend GST on importation. In essence, the

⁵⁵ Reference is made to s 3(1), *Free Zones Act 1990*.

⁵⁶ s 3(2), *Free Zones Act 1990*

⁵⁷ s 71, *GST Act 2014*. Reference is also made to the RMCD Guide on Approved Trade Scheme dated 12 January 2016.

scheme seeks to alleviate the cash flow problems encountered by importers by allowing participants to suspend the payment of GST on the importation of goods. All GST paid on acquisitions and importations can be claimed as credit unless they are specifically blocked or used for making an exempt supply.

- **Free commercial zones (FCZs)**

A FCZ is regarded as a place outside the Principal Customs Area (PCA). The zones are located at ports and airports and outside ports and airports.⁵⁸ No tax is payable on importation of goods from a place outside Malaysia into FCZ (except for goods used in the FCZ for the purpose of commercial or retail trade activities). Where goods are removed from a FCZ to PCA, tax is imposed as though such removal is an imported item. However, if the recipient has an approval under the Approved Trader Scheme (ATS), GST on such removal is suspended. GST is suspended on removal of goods from FCZ to a licensed warehouse and vice versa.

The GST Act 2014 provides that no tax shall be charged on any supply of goods made within the FCZs in relation to approved retail trade activities.⁵⁹ GST, however, is chargeable pursuant to the normal rules on any supply of goods made from PCA to a FCZ, except where the movement of goods is not a supply to FCZ (i.e. movement for the purpose of an outright export).

- **Designated areas**

The islands of Labuan, Langkawi and Tioman are collectively referred to as “designated areas”.⁶⁰ The Singaporean and Australian GST legislations do not have comparable provisions for “designated areas”. Generally, no tax is charged on any taxable supply of goods or service made within or between the designated areas. However, there is no statutory guidance on the interpretation of the terms “within” and “between”. There appears to be a consensus to base the interpretation on physical movements for the case of goods.

⁵⁸ Areas outside ports and airports are Stulang Laut (Johor Bahru), Bukit Kayu Hitam (Kedah), Pengkalan Kubor (Kelantan) and Rantau Panjang (Kelantan).

⁵⁹ The Minister can exercise the power conferred on him by s 56(3) of the GST Act 2014 to relieve the supply of any goods made within FCZs for commercial activities.

⁶⁰ s 2, the GST Act 2014

The general rule is that no GST is charged on any supplies within or between designated areas and on importations into designated areas but the following are exceptions, hence chargeable to GST:⁶¹

- (1) on the supply of petrol, diesel and liquefied petroleum gas within or between the designated areas or the importations of such goods into the designated areas.
- (2) on freight service supplied between designated areas.
- (3) on telecommunication services⁹ supplied within or between designated areas.
- (4) on importation of cement, marble and rubber into Langkawi.
- (5) on the supply of motor vehicle to or within, or importation of motor vehicles into Tioman.

The supply of goods to designated areas from the PCA is zero-rated. Likewise, reverse charge rules do not apply to supplies of imported services into a designated area. In any case, GST is charged on all goods and services supplied within Malaysia by a taxable person whose principal place of business is located in any of the designated areas.

4.1.3 Flat rate scheme

A flat rate scheme (FRS)⁶² is a concession provided by the government to allow a “qualified person” carrying out “prescribed activities” to include a flat rate of 2% in addition to the consideration for any taxable supply of goods made by him to any registered person. This scheme relieves the tax burden of small-scale agricultural-based businesses that are not liable to be GST-registered.

A “qualified person” is one who is not a GST-registered person and is a member of an association or body prescribed in Third Schedule of the GST Regulations

“Prescribed activities” involve the growing of crops or horticulture, livestock farming and fishing including aquaculture.

Under the FRS, a registered person is entitled to a credit for input tax against output tax⁶³ on any taxable supply of goods acquired from the approved person from the prescribed activities equal to the prescribed 2% flat rate addition on the supply.

Illustration of flat rate scheme

⁶¹ Refer to GST Guide on Designated Area dated 11 April 2016.

⁶² s 74 GST Act 2014.

⁶³ s 38 GST Act 2014

Temiang manages a small-scale business and owns a small plot of land in the state of Selangor. Temiang is engaged in livestock farming which is a “prescribed activity”. He is not GST-registered and is a taxable person approved under the “flat rate scheme”. He supplies livestock produce worth RM5,000 without any tax to Lee Traders who are GST registered. The flat rate tax concession given to small scale businesses by the government is 2%.

Temiang invoices Lee Traders RM5,100, inclusive of MYR100 which is the 2% flat-rate addition. Lee Traders pays the bill of RM5,100 and claims the input tax credit of MYR100 for the relevant taxable period.

The flat rate addition of MYR100 is extra income to Temiang and is meant to compensate him for any GST he may have incurred on his acquisitions without being able to claim the input tax credit.

4.2 Administrative matters

The successful implementation of GST in Malaysia went along well with a set of comprehensive and visible compensatory measures which formed the basis for a well-conceived publicity campaign to educate the public on the aims, merits, and distributional implications of the reform. Several months after GST-implementation, it was perceived that compensation payments were not adequately provided to small and medium-sized businesses to get ‘GST Ready’ in its initial stages of implementation.⁶⁴ This view is broadly evident when one-third of the firms audited by the Malaysian Customs during the first two weeks in September 2016 were facing problems, especially relating to businesses’ failure to provide information accurately in their GST returns.

The number of GST registrants by entity as at May 2016 are as follows:

Number of GST Registrants by Entity (as at May 2016)

Types of entity	Total
1. Company	229,319
2. Sole Proprietor	107,894
3. Partnership	58,691

⁶⁴ Yong Mun Ching (2015), “Challenges Encountered by SMEs with the Implementation of GST in Malaysia: A Qualitative Study”, Master thesis, School of Business, Monash University Malaysia (Unpublished)

4.	Professional	6,884
5.	Individual	4,062
6.	Association	2,146
7.	Limited liability partnership	1,748
8.	Other entities	<u>1,971</u>
Total		<u>412,715</u>

Other entities include statutory, local and public authorities. An analysis of the data suggests that:

- (i) 55% of the GST registrants are corporations (Group 1), and
- (ii) 41% are either sole-proprietors, partnerships or individuals (Group 2).

Judging from the GST-audit carried out by Customs officials, the group that complies the least with GST law are from item (ii). As a whole, over 65% of the GST registrants are from the wholesale, retail and manufacturing sectors.

The government might not have anticipated the adverse impact of GST on small businesses. A study was carried by Yong Mun Ching (2016) during the post GST-implementation period on challenges faced by SMEs. The qualitative study was executed over a 3-month period ending September 16, 2015. Her findings suggest that the government should critically assess the magnitude and social impact of closure of small traditional businesses which resulted from their inability to cope with GST regulations. In addition, a more sympathetic approach should be devised to support this alienated group of small traders so that they could continue to make a living in the new tax regime.

4.3 Customs staffing and need for tax agents

GST law continues to evolve and amendments to the legislation impact business transactions. Some businesses struggle to grasp the various aspects of GST thus leading to inefficiency that results in additional GST cost, penalties due to non-compliance and incorrect management of documentation. There needs to be a constant flow of information to the tax-paying public, including tax professionals so as to avoid mistrust in the interpretation of rules and regulations. Further, the level of knowledge and practical application of rules and regulations among tax professionals have to be continuously enhanced with the support of RMCD staff. Misinterpretation of specific GST law has to be minimised and there should be avenues for

quality checks. The government has to ensure that GST law is consistently applied by all RMCD branches with minimal variances in the application of the rules and regulations among them. Currently, there are over 60 Industry guides and 16 Specific guides and the numbers keep growing but it is unclear the extent to which these subsidiary legislations are applied uniformly across all branch offices.

The Director General of RMCD too has highlighted the acute shortage of GST tax agents as currently there are 2,000 agents but over 5,000 is needed, a shortfall of 150%.⁶⁵

4.4 Need for consultative GST design

A number of grey areas have surfaced upon amendments made to Malaysian 2015 GST legislation and these include the manner in which exports are zero-rated, changes to rules dealing with imported services and carrying forward of unutilised input tax credit.

Currently, there is a GST Technical Committee that comprises of professional bodies and trade chambers, without a representative from the Ministry of Finance, and they meet once in three months to discuss specific technical issues but they seem to be ineffective. A formal consultation process is needed with external stakeholders such as industry associations, government agencies and professional tax bodies potentially impacted by proposed changes to GST policy and drafting of GST law. In a nutshell, it is crucial that consultation takes place with industry before (and not after) GST positions are made.

Setting-up a consultative GST design process will not in itself ensure the required improvements unless it is accompanied by a change in the mind-set of the policy makers.

4.5 Challenges raised by digital imports

There is ample growth in cross-border trade of digital services and intangibles but little or no amount of GST is levied due to the complexity of enforcing payment of tax on such supplies. There are two scenarios: one is the taxing rights to supplier jurisdiction and the other is when the supplier jurisdiction may not impose GST.

⁶⁵ Kishore, K. (2016), "Customs looking for more tax advisors for GST", Promotional portal, Ministry of Domestic Trade, Co-operatives and Consumerism, 2 October: <http://kpdnkk.bernama.com/featuresEn.php?id=1059919>

Digital supplies imported by registered businesses

While all VAT/GST systems impose VAT on imported goods (usually subject to a low value threshold), for practical and historical reason VAT has only been on services and intangible goods acquired by registered businesses. The mechanism used to collect the tax, a reverse charge that transfers the tax liability from supplier to customer system, is largely redundant for registered purchasers that will use the acquisition in the course of making taxable supplies as the tax liability is simultaneously offset by an input tax credit. For this reason, some jurisdictions only apply the reverse charge rule to registered businesses making exempt-supplies or supplies that otherwise do not attract input tax credits.

Malaysia has followed the broad reverse charge model, imposing the tax liability on all registered businesses that import services or intangible goods, including those that will be entitled to an offsetting input tax credit.⁶⁶

Digital supplies imported by unregistered consumers

It is almost universally understood that a reverse charge regime can only be applied to registered enterprises. Remarkably, however, the Malaysian law goes even further and imposes an apparent tax liability on unregistered business customers receiving imported services and intangible property.⁶⁷ The apparent liability has no practical impact as tax authorities have little means of tracing the imports or collecting tax from unregistered customers other than relying on information from the Inland Revenue Board or Companies Commission of Malaysia.

The solution adopted by a number of major economies is to require foreign suppliers of services or intangible property to register in the customers' jurisdiction where the value of supplies exceeds a specified threshold. In some cases, the liability is transferred to an internet platform that acts as an agent for a large number of smaller retailers. Malaysian authorities are well aware of the both the risk to revenue and the competitive distortions if services and intangible property which are imported directly by final consumers are untaxed while the same supplies made by domestic providers are subject to tax. However, to date no solutions have been proposed.

⁶⁶ s 11(1) and (2) GST Act 2014.

⁶⁷ s 11(3) GST Act 2014.

Low value imports of goods

Although in theory, it was always possible to order goods from abroad via catalogues, mail and later fax, the internet has opened the door to simple purchases either directly from foreign retailers or via a retail platform serving small suppliers. All jurisdictions have grappled with the question of how to impose VAT on low value imported goods sent by post or courier. For low value goods, the cost of collecting tax inevitably exceeds the amount of tax collected. To address the problem, a low value import threshold is common and Malaysia has set the limit as MYR500 per consignment.⁶⁸ Further, advanced economies supplement this with rules to require foreign suppliers to register when the total value of their shipments exceeds the registration threshold but to-date, Malaysia does not have such a regulation.

4.6 Voluntary GST Registration

It is not realistic to expect taxable supplies to be made within a period of 12 months under all circumstances as businesses may need to register for GST due to various commercial reasons. Experiences from other countries show that businesses, particularly the SMEs, who supply goods and services to large multinationals, are required to be GST registrants, otherwise they lose their business to multinationals.

Likewise, hotel operators, mining companies, oil and gas companies, property developers, and plantations need heavy initial outlay and they too have a long gestation period exceeding 12 months. Consequently, there is a need for voluntary registration to address the complex nature of business requirements.⁶⁹

The GST legislation makes it clear that commencing a business is treated as being done in the course or furtherance of that business⁷⁰. Read literally, the DG of RMCD has a discretion to register if the person satisfies him the taxpayer is carrying on a business. The authors are of the view when the DG of RMCD is satisfied a business is carried out, there should be no discretion to refuse registration, irrespective of the threshold limit.

4.7 Interpretation of “GST Inclusive Price”

⁶⁸ For reference, Singapore's limit is SGD400 and in Australia the limit is AUD1,000.

⁶⁹ Refer s 24, GST Act 2014

⁷⁰ Refer s 3(3) GST Act 2014

The display of GST inclusive price” by retailers is covered under sec 9(5) GST Act 2014. This provision is meant to ensure consumers are not disadvantaged and to avoid unscrupulous businesses taking advantage of the public. The DG of RMCD has indicated that all prices must be quoted inclusive of GST and (the GST component) must be shown as a separate item. The authors are of the view that in bilateral agreements, the parties involved can agree to a GST exclusive price and this can be reflected without the need to obtain prior approval from RMCD. Hence, we gather the director general’s decision is restrictive as it allows the prices to be displayed exclusive of GST only if the supply is made to a registered person. In respect of contractual bilateral transactions, the supplier should be permitted to display prices exclusive of GST.

4.8 Refunds

The Malaysian government was not prepared for the large amounts of refunds that needs to be repaid to GST-registrants within 14 days if GST returns are filed electronically or 28 working days when done manually.⁷¹ This timeline is difficult for RMCD to meet due to concerns about the validity of the claims and the usual mind-set of a tax officer to carry out a tax audit before the refund application is approved. According to the newspaper report⁷², we quote:

“Businesses entering the second month of paying their goods and services tax (GST) bills after its implementation on April 1, 2015 are being told upon submitting their claims to RMCD that a full audit on their accounts must be undertaken before their claims on input tax could be released”.

4.9 Hike in GST rate

⁷¹ GST Regulations 2014

⁷² Late GST refunds a headache, <http://www.thestar.com.my/metro/smebiz/news/2015/07/06/late-gst-refunds-a-headache/>, The Star Online, Kuala Lumpur, 6 July 2015

The Malaysian government has given an assurance that there will be no increase in the GST rate for 2017.⁷³ When comparing with our neighbour, the Singapore Government introduced GST in 1994 at a low rate of 3% together with a high threshold limit of SGD1 million (SGD1 = MYR3.0) and made a pledge that it would not increase the GST rate for 5 years.⁷⁴ The GST rate was only increased after 8 years and 9 months, effective from 1 January 2003, from 3% to 4%. Twelve months later, that is, from 1 January 2004, the GST rate rose to 5% and from 1 July 2007 to 7%⁷⁵ (see Table 4 for details).

Table 4: GST rate increase (Singapore)

Effective from	Tax rate (%)
1 April 1994	3
1 January 2003	4
1 January 2004	5
1 July 2007 onwards	7

GST is a robust tax and if the tax authorities expect to raise more revenue in a buoyant economy and without impinging on its' popularity, there is a likelihood that the Malaysian government would increase the rate in the near distant future.⁷⁶ A decision to hike the rate would be likely after the 14th Malaysian general election scheduled to take place on or before 24 August 2018.

5 Conclusion

Malaysia's economy was in need of a radical overhaul, including tax reform, with a system excessively dependent on income tax (including petroleum income tax) and inefficient indirect taxes such as sales tax and service tax. The timely introduction of GST in Malaysia has proved to be broadly successful in terms of increasing tax revenues as well as expanding the tax base, nevertheless there is evidence to suggest pitfalls exist in the interpretation and application of law. There is general consensus that the Malaysian GST structure is among the most complex in the region and it is particularly due to its lengthy list of exemptions and

⁷³ New Straits Times Online (2016), No increase in GST percentage for 2017, 16 October. www.nst.com.my/news/2016/08/164198/no-increase-gst-percentage-2017

⁷⁴ International Monetary Fund (IMF), Washington D.C., Occasional Paper (February, 1995), Singapore: A Case Study in Rapid Development, Edited by Bercuson, K.

⁷⁵ Kasipillai, J. and Sharma, S (2014), Implementing GST in Malaysia: Some Comparisons with Singapore's Experience, *Tax Notes International*: March 31: 1213-17

⁷⁶ New Zealand implemented GST in 1985 and since its enactment, no Government has reduced its scope; instead the rate has increased twice (from 1 July 1989 to 12.5% and from 1 October 2010 to 15%).

zero-rated items.⁷⁷ According to a news report⁷⁸, the proliferation of zero-rated and exempt goods and services were necessary for the government to pre-empt a public backlash against the introduction of GST in Malaysia. With greater acceptance of the consumption tax, concerted efforts made to demonstrate accountability, prudence and transparency, there is room for cutting back the exempted and zero-rated items and making the tax legislation simpler for greater compliance. Remedial measures have to be taken to address the poor GST knowledge particularly among small business-owners and increase the number of qualified and experienced GST agents.

Studies on GST have prominently highlighted psychological and corruption costs eroding the tax base and this is evident in the case of Bangladesh.⁷⁹ Anecdotal evidence suggest that the gap between potential GST revenue and actual GST revenue in Malaysia is around 40 per cent and there is room for the gap to rise.

There should be continuous initiatives by policy-makers to ensure the GST system is an effective tool for revenue-raising, hence measures have to be directed towards gaining trust and confidence of taxpayers and encourage them to comply with the law and pay the correct amount of GST as a social obligation.

Ultimately, a significant way to expand Malaysia's GST collection is to nurture a healthy economy – an economy that will generate more consumer spending, increase firms' profitability and accelerate property development. The initiatives will contribute more revenue for the government, hence the emphasis is to strive for companies to grow through rigorous entrepreneurship, innovation and internationalisation.

⁷⁷ The Edge Malaysia, Chua Sue-Ann (2016) "Finding money for Budget 2017", 19 September

⁷⁸ Above n. 46

⁷⁹ Faridy, Freudenberg, Sarker and Copp, above n 19

Key provisions in Malaysia, Singapore & Australia to zero-rate international services

Malaysia	Singapore	Australia
<p>Para 12 of Second Schedule, GST (Zero Rated Supply) Order 2014 [P.U. (A) 272/2014]</p> <ul style="list-style-type: none"> □ Satisfy <i>all</i> conditions below: <ul style="list-style-type: none"> ■ There is a contract pursuant to which the supply in question is made ■ Such contract must be with a person (“customer”) who belongs in a country other than Malaysia ■ The service must <i>directly benefit</i> a person (“beneficiary”) who belongs in a country other than Malaysia ■ The beneficiary must be outside Malaysia when the service is performed □ The followings are expressly excluded from the para 12: <ul style="list-style-type: none"> ■ Any service comprising promulgation of an advertisement or the right to do so. ■ Any service which are supplied <i>directly in connection</i> with: <ul style="list-style-type: none"> ■ Land situated in Malaysia or any improvement to such land; ■ Goods which are in Malaysia at the time the services are performed; or ■ Capital market products traded in Malaysia or 	<p>s 21 GST Act 1993</p> <p>s 21(3)(j) Subject to sections (4B) and (4C), services supplied:</p> <ul style="list-style-type: none"> (i) under a contract with a person who belongs in a country outside Singapore; and (ii) which directly benefit a person who belongs in a country other than Singapore and who is outside Singapore at the time the services are performed; <p>s 21 (4B) The services referred to in sections (3)(e), (f), (g) and (j) shall not include any services comprising either of or both:</p> <ul style="list-style-type: none"> (a) the supply of a right to promulgate an advertisement by means of any medium of communication; and (b) the promulgation of an advertisement by means of any medium of communication. <p>s 21 (4C) The services referred to in subsection (3)(j) shall not include any services which are supplied directly in connection with —</p> <ul style="list-style-type: none"> (a) land or any 	<p>ss 38-190 GST Act 1999, item 3</p> <p>a supply:</p> <ul style="list-style-type: none"> (a) that is made to a recipient who is not in Australia when the thing supplied is done; and (b) the effective use or enjoyment of which takes place outside Australia; other than a supply of work physically performed on goods situated in Australia when the thing supplied is done, or a supply directly connected with real property situated in Australia.

<p>insurance contracts where the coverage relates to risk in Malaysia</p>	<p>(b) improvement thereto situated inside Singapore; or goods situated inside Singapore at the time the services are performed, other than goods referred to in s (3)(g).</p>	
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In each of the three countries namely, Malaysia, Singapore and Australia, there is more than one provision that deals with zero-rating as there are several types of international services. There are also similarities in many other provisions, for example, para 16 of the Malaysian order is similar to s 21(3)(i) in Singapore, and para 4 is similar to s 21(3)(a). Further, para 9 in Malaysia is similar to ss 38-187 of the Australian GST Act.

The main difference is that, in Australia and Singapore, the zero-rating provisions are in the respective GST legislations (which probably means that any change has to go through parliament) whereas in Malaysia, it is provided for in the PU Order (subsidiary legislation).

Although the amendments to the PU Order are within the powers of the Malaysian Minister of Finance, there are three instances, including changes to zero-rated supply order, where Parliament must pass a resolution within 120 days to confirm the Minister's decision as provided in s 17(5) of the GST Act 2014.