The Implications of the Move from GST to SST

IN THIS ARTICLE, ABHILAASH SUBRAMANIAM DISCUSSES THE POTENTIAL IMPLICATIONS OF THE MOVE FROM GST TO SST.

Introduction

The much anticipated Sales Tax Act 2018 and the Service Tax Act 2018(commonly referred to as "SST") was rolled out on 1 September 2018, together with their respective subsidiary legislations, to replace the previous Goods and Services Tax Act 2014 ("GST").

GST provided for a multi-staged tax collection system in which every taxable person down the supply chain was taxed when a supply was rendered (output tax), but was allowed to reclaim from the Customs Department any taxes paid to the previous entity along the supply chain (input tax)[1].

GST was therefore very broad based, covering the supply of all prescribed goods or services made in Malaysia and any importation of goods into Malaysia[2].

Sales tax, however, is much more narrow based, being levied only on specific goods manufactured in Malaysia by a registered manufacturer[3] or imported into Malaysia by any person[4]. It was also announced in Parliament by the Minister of Finance that SST will only be imposed on 38% of the Consumer Price Index's basket of goods, compared with 60% under GST[5]. SST was therefore welcomed by the Malaysian public due to the perception that it will be a less burdensome tax on the public.

There are approximately 160 countries in the world that have moved from a single stage type tax system like SST to a multi-stage system like GST in some form or another - many citing that a multi-stage tax system is consistent with a progressive and developed economy.

The reason behind this is that GST is designed to provide a more holistic, transparent and efficient system for the collection of taxes. Malaysia's move of switching back to SST from GST makes it the only country in the world to have done so and may have certain implications as set out below.

Transparency and regulation

During the GST system, there was a delay in receiving input taxes from the Government. Many traders therefore unlawfully increased their prices by incorporating the 6% tax into their supply price, ignoring that input taxes would be refunded by the Government. This was cited as one of the main arguments against GST and in support of SST by the Director General of Customs[6].

However, GST in reality prevented risk and provided a stronger anti-profiteering mechanism compared to SST. For one, GST was a self-policing and self-enforcing system. GST operated on collection in stages whereby each successive taxpayer down the supply chain claimed input tax on purchases and had to account for output tax on subsequent supplies.

Therefore if Company A supplied goods or services to Company B, Company A would know that Company B would be reporting that transaction in order to claim its input tax. This would ensure Company A reported that particular transaction as well. Therefore every entity along the supply chain was effectively self-audited. This made it easier for the Government to monitor tax compliance of every taxable person.

Furthermore, input taxes were only claimable if supported by purchase invoices. This ensured that taxpayers maintained a record of relevant transactions. Therefore, although GST may have been more broad based, it had a trail of invoices that allowed for improved tax compliance, enforcement and transparency.

This, however, does not necessarily occur in a single stage tax system where there is only a single tax point. In fact, it was acknowledged by the Minister of Finance that SST would not be as transparent or as efficient as the previous GST system[7].

It could be said that prices went up during the GST era not necessarily because of the tax system itself but because of delays in receiving input tax refunds resulting in taxpayers unlawfully raising prices. If, in spite of numerous penal provisions in the GST Act and the system of self-regulation, prices were still unlawfully raised, there is no guarantee that the same will not happen under the present system of SST. In fact, the greater lack of transparency and efficiency in the SST system may prove easier for taxpayers to avoid paying taxes and unlawfully raise prices in the long term.

Revenue leakage

There is also the risk of revenue leakage in a single-stage taxation system. With tax collection being generally confined to one stage of the supply chain, the system of natural checks and balances under the GST system would not be present. If a single taxable person succeeds in slipping past paying tax at the tax point, the revenue of the Government will drop accordingly. Under the GST system, even if tax is not collected at one stage, it is collected at other stages such that the drop in government revenue may be somewhat limited.

Cascading effect of taxes

One of the key advantages of the GST system is that it prevented a cascading effect of taxes. SST can potentially raise the price of goods depending on the taxes that are embedded in goods and/or services involved along the supply chain.

Under the GST system, input taxes of a business are claimed back from Customs and offset against the output tax payable by that entity (without matching purchases with the supplies made). Therefore, there is no “tax-on-tax” moving down the supply chain as the input taxes are already claimed from Customs and this is supposed to be accounted for when setting the prices of goods and services moving down the supply chain.

However under SST, there is no system for “claiming back” or offsetting input taxes. Therefore, if there is more than one SST registered entity along the supply chain (for instance more than one taxable manufacturer or a manufacturer and a service provider), it is possible for there to be a tax-on-tax, increasing the price of the final good/service received by the consumer compared to the GST system.

However, the extent to which this may increase the price of goods remains to be seen and may be somewhat mitigated depending on the scope of tax exempt/zero-rated goods.

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Conclusion

It has been reported that businesses in Malaysia have spent almost RM15 billion to implement GST systems that have been in use for less than four years[8]. These include the cost of software, tax recording tools and professional advice. Further costs were also incurred in shifting businesses from being GST to SST compliant.

Although some of these costs may be recoverable, many will end up being sunk costs to businesses. Without the guarantee that prices will go down and with the lesser degree of transparency/regulation and the possibility of revenue leakage with SST, it remains to be seen if Malaysia's bold move of being the only country in the world to move back to SST was the right one.

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[1] See section 38 and 39 of the GST.
[2] See section 9 of the GST
[3] Section 8(1)(a) Sales Tax Act 2018.
[4] Section 8(1)(b) Sales Tax Act 2018.
[5] Penyata Rasmi Dewan Rakyat Parlimen Keempat Belas (Penggal Pertama Mesyuarat Pertama) 19 Julai 2018
[6] www.freemalaysiatoday.com/category/nationa/2018/08/30/customs-department-tells-why-saw-higher-prices/
[7] Penyata Rasmi Dewan Rakyat Parlimen Keempat Belas (Penggal Pertama Mesyuarat Pertama) 19 Julai 2018.
[8] www.theedgemarkets.com/article/state-nation-previous-tax-regime-getsfacelift.
