Why GST is a must

MIERVIEWS

By Mohamed Ariff

On the proposed General Services Tax (GST) there has been a lot of talk but hardly any walk. The Malaysian Government made an announcement in Budget 2005 that it would implement GST in 2007. This, however, did not materialise, as the Government decided to shelve the idea temporarily in the wake of public outcry amid rising prices. There were fears then that GST would unleash the dreaded spectre of inflation.

The main problem surrounding the GST is that it is grossly misunderstood. Those who oppose the GST either do not understand what it is all about or fail to see the big picture.

There is no need to belabour the point that Malaysia lacks fiscal discipline: that it has had 46 years of budget deficit during the last 52 years says it all. A major concern is that the government revenue could not keep pace with the growth of operating and development expenditures of the government. Another cause for concern is the narrowing tax base, with oil and gas accounting for an increasing share of the total.

Thus, there is a need not only to raise more revenue for the government but also to diversify the sources of revenue. There are limits to rate hikes on the existing taxes. In fact, there are compelling reasons why the rates on corporate and personal income taxes should be lowered and not raised.

For one thing, income tax acts as a strong disincentive to work and earn, beyond a certain point, dampening initiatives and efforts, which in turn constrain economic growth. For another, over-dependence on income tax would make the country less attractive to foreign investment and brainpower, especially when its competitors have more liberal income tax regimes.

Malaysia's corporate and personal income tax rates are much higher than its immediate rivals, especially Singapore and Hong Kong. Malaysia's personal income tax rate of 26 per cent is way above Singapore's 15 per cent or Hong Kong's 17 per cent, while its corporate tax rate of 25 per cent is also too high compared to the 17 per cent in Singapore and Hong Kong. This calls for a reduction in tax rates.

The crux of the problem for Malaysia is how to raise tax revenue while reducing the tax rates. Although there have been instances in the past when lower tax rates led to higher tax collection through greater efficiency in tax collection or less tax evasion, significant reductions in tax rates would inevitably entail revenue losses.

The narrow tax base, with oil and gas contributing over 40 per cent of the total, is too risky, not only because the prices of oil and gas are extremely volatile, but also because the country may run out of oil and gas in the foreseeable future.

Thus, it is not difficult to understand why Malaysia badly needs to seek a new source of government revenue. It is in this context that the relevance of GST becomes manifest, although many remain unconvinced that the GST is the answer.

The Value-Added Tax (VAT), a generic term for the GST in the literature, is by no means new, as many countries have successfully adopted it as part of their fiscal strategy. Malaysia, as a latecomer, can benefit from the experiences of countries that have treaded the path before.

First and foremost, there is a need to dispel the wrong perceptions about the GST in the minds of the taxpayers and tax collectors. The GST is essentially a tax on consumption, not production. The tax burden ultimately falls on the consumers and no one else, although it is collected, based on the value-added, at every link along the supply chain.

The GST does not cascade along the production and supply chain, as those who pay the tax on output can claim a full tax credit to offset input taxes. The tax collected by the supplier, after deducting the input tax credit, is remitted to the authority until finally it ends with the consumers who bear the brunt of it, as they cannot claim input tax credit.

The question of suppliers raising their prices at every stage by the amount of the tax therefore does not arise. The tax is just passed on from one link to another until it is borne by the consumers. In other words, the GST does not represent a permanent cost to the businesses.

The impact on the consumer price index (CPI) or inflation will be just one-off. The timing is therefore critical for its introduction. In this sense, now is the right time for it as the CPI is growing negatively, but the machinery unfortunately is not in place. The impact on the CPI can be capped by keeping the GST rate at low levels within 3 to 5 per cent, as shown by other country experiences.

In Malaysia, only one-tenth of the working population pays income tax. To the question of broadening the tax base, the GSP can be an answer. In the case of the poll tax, which forces everyone to pay, the cost of collection will exceed the revenue. In the case of the GST, the suppliers in the supply chain would act as tax collectors for free. No wonder they oppose the GST.

The GST, which penalises consumption, is not regressive, just because the rate is flat for all. The rich would actually be paying a lot more than the poor, as they consume more.

As mentioned earlier, the detractors of the GST either fail to see the big picture or do not understand it. This why the Government must take pains to educate the public on the GST, The Singapore government spent millions on publicity campaign and education programmes, while the Australian government allocated A$500 million to help small businesses understand and prepare for the tax. We should do likewise.

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