

18/02/2002

Consultant sees introduction of VAT by 2005

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FULL compliance with free trade regime under the Association of South-East Asian Nations Free Trade Area (Afta) will pressure Malaysia to introduce value-added tax (VAT) by 2005, according to a tax consultant.

Ernst & Young Tax Consultant Sdn Bhd principal Chan Chow Pong said this is to allow the country to offset losses in government tax revenue as a result of complying with tariff cuts under Afta.

He said Malaysia would be ready for the new tax structure by then as the Government has been raising consumption taxes (sales and services) gradually over the years.

"It is highly possible that the goods and services tax (GST) may be introduced by the Government in 2004 or 2005, when the Government has to comply with the cut in import tariff for motor vehicle sector under Afta.

"The GST is now a worldwide trend," Chan told Business Times in Kuala Lumpur.

Tax consultants and economists agree on the need to implement the VAT in the country as it is more efficient and transparent.

The VAT, which is also known as GST, is a broad-based consumption tax which can be introduced at the importer's or manufacturer's level and then extended to the wholesalers and retailers.

The existing sales and services taxes (SST) in Malaysia are levied on and collected from manufacturers, importers and persons who provide taxable services.

Prime Minister Datuk Seri Dr Mahathir Mohamad recently said the Government is studying the possibility of introducing several new taxes to compensate for the loss in revenue due to the cutback in import duties under Afta and World Trade Organisation (WTO).

Import tariffs on a wide range of products within Asean will be reduced by between 0 and 5 per cent under Afta, in a move to liberalise the market among the 10-member grouping. Malaysia, however, had pledged tariff cut for motor vehicle in 2005.

Chan said the Government receives a substantial revenue from the import duties on motor vehicles, which range from 170 per cent and 300 per cent.

As such, he believes the Government is likely to introduce the VAT in 2005 to offset for the loss in revenue when tariffs on motor vehicle sector are reduced in that year.

PriceWaterhouseCoopers executive director Boon Oon Seang said the Government could look at the VAT as a mean to boost revenue through indirect tax.

He, however, could not say when the Government would impose GST. He said the GST has been discussed in Malaysia since 1993.

"The sales and services taxes laws are quite old (Sales Tax Act 1975 and the Service Tax Act 1975) and the authorities have changed the original concept of the taxes with ad-hoc amendments to the laws, resulting in ambiguity in the implementation and administration.

"Furthermore, there is no mechanism to prevent leakages except the human element," Boon said, adding that there is little room for leakages in the VAT as it is self-policing and easier to administer.

Chan said the VAT rate in the country could range from 5 to 7 per cent, which are sufficient for the Government's coffers.

At present, the service tax in Malaysia is 5 per cent, which is applicable to services providers like hotels, restaurants, entertainment

outlets and professional services such as accounting and legal services, based on a minimum annual turnover.

Sales tax ranges from 5 per cent for food preparation, an average of 10 per cent for manufactured goods, 20 per cent for alcoholic drinks and 25 per cent for cigarettes.

Chan said Singapore's GST is 3 per cent, while Thailand's is 7 per cent. The VAT rate in the UK is 17.5 per cent and Sweden is between 20 and 25 per cent.

He said relevant authorities have been gearing themselves up since 1993 and all they need is the amendment of the law and introduction of procedures regarding the VAT.

In addition, the Government has been extending the consumption taxes every year. Starting from January 1 this year, more professional services are included in the groups liable for service tax when the limit of annual turnover of professional service providers like architectural, consulting, legal and engineering firms have been reduced from RM300,000 to RM150,000.

Likewise, the annual sales of food and entertainment outlets have also been reduced from RM500,000 to RM300,000 to be liable for service tax.

"It is a matter of time before the Government implements the VAT. The implementation is made easier as the Royal Customs and Excise Department has computerised its operations," he said.

The department collects excise duties, import and export duties, as well as sales and services taxes.

According to tax experts, the VAT has a built-in system for businesses to claim tax credits on inputs, thus ensuring compliance with registration and collection of tax.

The current SST, meanwhile, involves high administrative cost to ensure compliance and prevents abuse.

The VAT has also become a popular form of indirect tax in both developed and developing countries.

In the South-East Asian region, countries like the Philippines, Singapore and Thailand have already introduced the GST.

Meanwhile, RAM Consultancy Services Sdn Bhd chief operating officer Dr Yeah Kim Leng does not expect the Government to introduce the VAT soon.

While acknowledging the need for the Government to broaden its tax base, he said a lot of paper work are required before the VAT can be introduced.

"It can be administratively difficult because it involves defining different value at each processing stage," he said.

He also said that such a system could lead to inflationary pressure when prices of goods rise under VAT.

Yeah, however, said many countries are joining the pack in implementing the VAT as part of their fiscal policy. "The VAT is more efficient because the tax imposed is based on value-added," he said.

Chan said there may be an inflationary pressure from the implementation of VAT but it is only transitional.

He said experiences from developed countries have shown that local prices increased for the first one to three years of the implementation of the VAT.

"After that, the prices will stabilise when people begin to understand and become well-versed with the system," he said.

Chan added that due to the efficiency and transparency of the VAT, the Government can make an accurate forecast of their revenue from the indirect tax.

The VAT will also make the export prices competitive as it is imposed on goods which are consumed locally.

"This will make our exports slightly cheaper. It may not be significant but it will have an impact, that is some saving elements on goods

exported," he said.

Despite supporting the introduction of VAT in the country, tax consultants and economists agree that the reduction in import duties under Afta will not have significant impact on the government revenue.

For one, the import duties have already been reduced gradually over the years.

Secondly, Malaysia's trade with Asean countries only constitutes about 20 per cent of its international trade. The rest are with non-Asean economies, particularly the US and the European Community.

Moreover, most of the products imported from Asean countries are construction materials, water, food and others which have no import duties.

Yeah pointed out that there is a declining trend in the contribution of import duties to the government revenue.

"The bulk of the government revenue is from direct taxes where their contributions averaged 46.9 per cent between 1995 and 2000," he noted.

Yeah said the fall in government revenue from the cut in import duties under Afta and WTO can be offset by the growth in domestic economy and an increase in trade.

"When there is growth in the economy, the collection from the corporate and individual taxes will increase correspondingly," he said, adding that the increase in trade will also boost government revenue.

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