

## **Tax Reliefs: Hidden Subsidies That Favour The Rich** **MalaysianMirror.com**

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**By Dr Subramaniam Pillay**

In the past couple of years, there has been a lot of talk on subsidy rationalisation i.e. the removal of subsidies for basic items like cooking oil, sugar, flour and petrol. The argument is that it subsidises the poor as well as the rich; it is unfair to provide subsidies for the rich, so we must eliminate the subsidies and let market forces work.

Many of these subsidies help the poor and the rich equally. For example, if a family consumes 5kg of cooking oil per month, they get the same subsidy regardless of their wealth and income. Usually, consumption of basic food items does not increase with increasing wealth and income.

However, there is a large hidden subsidy which favours the rich over the poor that has been conveniently forgotten. And this comes in the form of the various tax reliefs offered to taxpayers. In this week, before the 2012 budget is announced, there have been numerous calls to increase the tax relief for various items including premiums for medical insurance, educational insurance and life insurance.

Tax reliefs are a very regressive form of government subsidies to the taxpayers. The richer the taxpayer, the more subsidy she gets from the government. Thus it is unfair and inequitable.

### **Tax relief for purchase of books**

Let us illustrate this with an example. Currently, there is a tax relief of RM1000 for the purchase of books and magazines that is available to all taxpayers. Ostensibly, this is to encourage the reading habit among Malaysians. A high-income earner who is at the top tax bracket will pay a marginal tax rate of 26 per cent i.e. for every extra ringgit she earns, she will pay 26 sen income tax. On the flip side, every ringgit of tax relief that she claims will reduce her income tax by 26 sen. If she now buys books and magazines worth RM1000 for herself or her children, she can claim the full relief and lower her tax bill by RM260. In other words, this high-income person is getting a government subsidy of RM260 to purchase books.

Now let us take the case of Mr X, the average citizen of Malaysia whose income is so low that he does not pay taxes. (It has been reported that only 1.7m residents have tax files with IRB which means the remaining 12m-15m working adults are either earning too little to pay income tax or evading paying income tax!) If Mr X now buys RM1000 worth of books to improve his and his children's knowledge to enable them to have a better life in the future, he receives no subsidy as he is not entitled to any tax relief.

If Ms Y, a middle income Malaysian has a marginal tax rate of 12 per cent, she will get a subsidy of only RM120 for the RM1000 worth of books she buys. The irony is that it is the families in the lower-income group who need the books more as it will enable them to earn a better income in the future. They need the book subsidy more than the rich. But our tax relief system rewards the rich more than the poor thus widening the income and wealth disparity in this country.

### **Tax relief for medical insurance premiums**

An even more unfair tax relief is the one offered for purchase of medical insurance. Using the same reasoning as above, the government is subsidising the rich with 26 per cent of the cost of the medical insurance premium while the poor will be unable to even think of buying medical

insurance as they cannot afford it. This subsidy should rightly be diverted to the health care budget so that the public sector health care system can do a better job in terms of delivering quality health care on a consistent basis. The beneficiaries of this medical insurance tax relief (or subsidy as it should be correctly labelled) are not only the high-income taxpayers but also the private medical insurance companies and the profit-seeking private hospital sector.

### **Why are tax reliefs popular?**

Given this glaring inequity and unfairness of the tax relief system, why is it popular in many countries? The beneficiaries are well educated and vocal enough to influence politicians to give these reliefs. Industry groups which benefit from these reliefs (e.g. insurance companies, private hospitals, and private education providers) are also powerful lobbies in many countries.

The poor on the other hand are voiceless and their welfare is usually neglected. For example, few top leaders in all segments of our society use public hospitals; in fact many go abroad for medical treatment, so they don't see the need for consistently high quality health care from government hospitals which most Malaysians have no choice but to use.

Another reason is that the subsidy in the form of tax relief is revenue foregone and not visible directly; it is not recorded anywhere in the government's income and expenditure accounts. On the other hand, a subsidy for cooking oil turns up as an expenditure item in the accounts. So when the government thinks of tightening its belt, it tends to focus on how to cut spending and not how to enhance revenue by removing all these indirect subsidies which favour the rich more than the poor. It is also easier to quantify direct subsidies whereas revenue foregone through tax reliefs is more difficult to estimate and is thus less visible.

Given these reasons, it is not going to be easy to get rid of the unjust and massive inequitable subsidy that occurs through tax reliefs in our government budgets.

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