The invisible cost of SST

STORIES BY **ESTHER LEE**

More often than not, consumers do not think about the sales or service tax they indirectly incur when purchasing goods from retail stores.

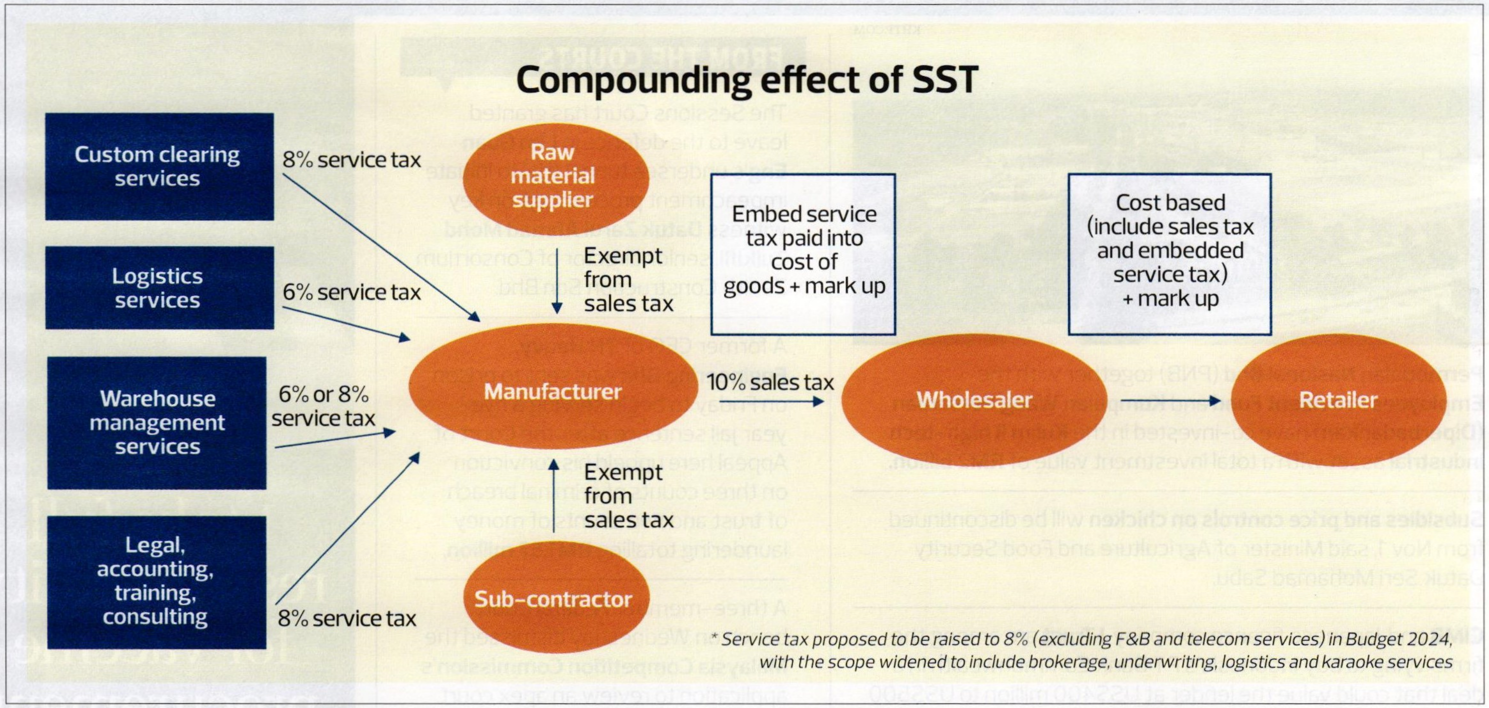
As the portion of the sales or service tax paid earlier on in the supply chain is not reflected in the receipt of the consumer's purchase, it is invisible to the consumer — unless it is a service that the consumer directly incurs, such as having a meal at a restaurant, which attracts a 6% service tax.

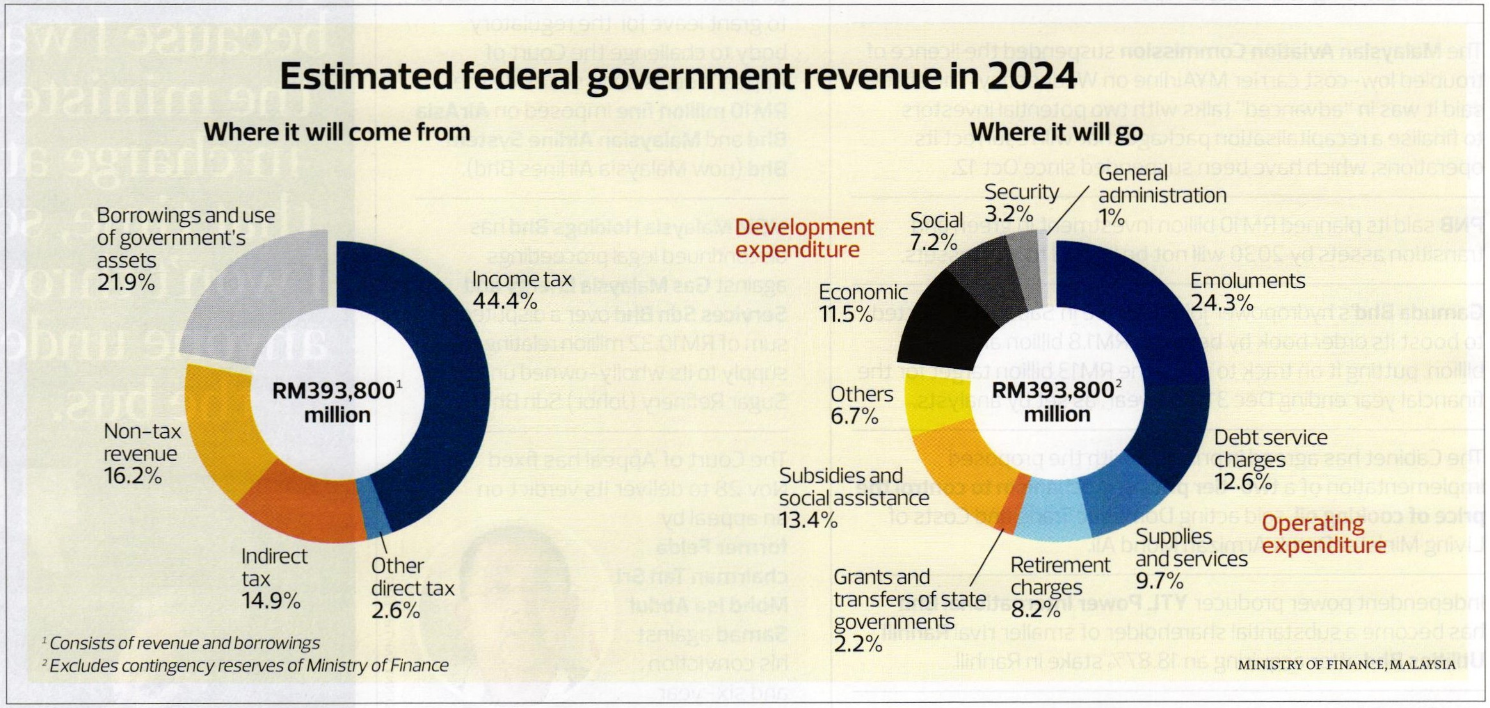
The sales or service tax is a single-stage tax. The sales tax is collected at the manufacturer level at a general rate of 10% while the service tax — the proposed rate of which is 8% commencing in 2024 — is paid by the consumer (be it business or individual).

Being a final tax in nature, meaning that businesses do not get to claim a credit for incurring it, it creates a tax-on-tax effect along the supply chain. The effect is especially apparent in the service tax.

One example of this would be the property developer that incurs various services in order to bring a project to completion. At the very least, it would have to pay service tax on the accounting, IT and architectural services it uses. Unable to claim any input tax, the developer is likely to embed the service tax paid into its pricing for the said project. This essentially means the end-consumer is likely paying for the service tax incurred by the business — meaning higher prices — without realising it.

"Previously, a study was done on a chair manufacturer in Segambut. Chairs attract a sales tax of 10%. It was a fairly simple supply chain where the manufacturer sells its products to the marketing company, which then sells to the distributor and then to the retailer. The effective tax rate was 17.5% — that's the cascading effect," explains PwC indirect tax director Raja Kumaran.





"Even when dealing with non-taxable goods, businesses could have paid service tax on accounting, auditing or some other form of service, which will be a cost to the business. It can be quite significant because every business deals with another taxable person," he points out.

Tax experts call the cascading or compounding effect one of the biggest weaknesses of the current sales and service tax (SST) regime, while the lack of transparency is seen as another downside to the indirect tax regime adopted by Malaysia.

TraTax Sdn Bhd executive director Thenesh Kannaa notes that there are a number of grey areas when it comes to the service tax, which is prescribed based on a list of taxable services.

"For example, warehouse management is listed as a taxable service, but there is an overriding provision that exempts management services related to logistics. There are no published guidelines to clarify when warehouse management is in fact taxable," he observes.

"This leads to unsynchronised compliance until enforcement activity is conducted by the Royal Malaysian Customs Department. This matter should be improved."

He adds that unclear policy goals are evident with the SST regime. He cites the example of a consumer who engages a technician to repair his air-conditioning unit and is not subject to service tax on the repair cost. However, if the consumer enters into an arrangement for proactive maintenance periodically, the maintenance charges are subject to service tax.

"The policy rationale is unclear. There are many aspects like this which should be studied and harmonised to influence consumer and industry behaviour in the right direction," says Thenesh.

While the compounding effect is less of an issue for the sales tax as there are facilities available for manufacturers to apply for a tax exemption, it is not without problems either.

PWC

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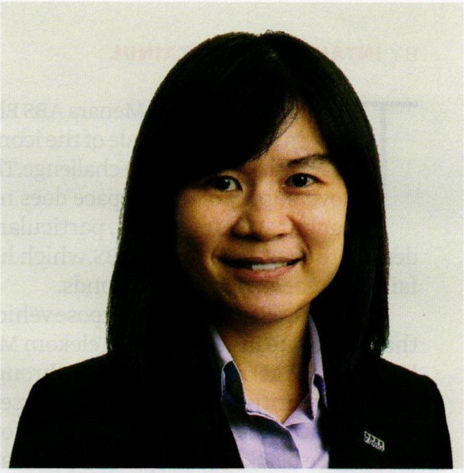

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"There are exemptions available to manufacturers so they do not have to charge each other sales tax, but the manufacturers have to apply and ensure they meet the required conditions, which can be tedious," says KPMG Malaysia indirect tax head Ng Sue Lynn.

Raja says many sub-manufacturers do not make use of the facilities available. Perhaps they are not aware of the facilities or how to apply for them, he muses. "It is also a hassle for smaller businesses with the monthly submissions, where they have to keep track of the raw materials, of what is tax exempt and not. So, they end up not applying for exemptions and they charge manufacturers the sales tax."

8% service tax

During the Budget 2024 announcement, the government proposed to raise the service tax to 8% from 6% currently, except on food and beverages and telecommunications services. It said it expected a RM3 billion increase in revenue from the higher tax rate, but some experts believe the figure could be higher.

With the proposal to raise the service tax to 8% and widen the scope to include brokerage, underwriting, logistics and karaoke services, Ng thinks the actual impact may be more than the increase of two percentage points, from 6% to 8%. "The actual impact could be more than the two percentage point increase, but it would also depend on the complexity of the supply chain."

Currently, only business-to-business transactions between certain professional services are exempted from service tax.

Thenesh opines that with the proposed increase in the service tax rate and wider scope of taxable services, it is crucial for the government to embark on initiatives to harmonise the sales tax regime and service tax regime to allow sales-tax-registered manufacturers to either claim input tax credit or allow tax exemptions on services procured by businesses.

No GST on the cards, what's the solution?

At this juncture, the goods and services tax (GST) does not seem likely to be implemented for many reasons. Apart from being a highly politicised topic, tax experts also believe GST and the subsidy rationalisation efforts the government is embarking on cannot be implemented at the same time as it will result in higher inflation.

"It must be noted that the GST model introduced in 2015 was not a full-blown model as it had too many exemptions. It is recommended that a proper study be conducted for the introduction of a full-blown GST model in line with international standards. Until the economy, people and industry are ready for that, it is suggested to improve the present SST model," says Thenesh.

Ng says the tax base can be widened and the government could relook the SST rate, but relief such as input tax credit should be given to businesses so as not to cause a spike in prices along the supply chain.

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HSST the next best option to GST, says MIER

Last week, Prime Minister Datuk Seri Anwar Ibrahim said the government has no plans to revive the goods and services tax (GST), adding that any changes to tax policies will have to take into account the impact on the economy and the cost of living of the people.

While the news might have disappointed those who were hoping for some definite timeline on the implementation of the consumption tax, others believe that it is the right move at this juncture.

"The reintroduction of GST requires a major overhaul, which comes with upside risks to inflation, primarily from behavioural aspects. Given the present rising cost of living, the government's decision to defer GST implementation is welcomed," says Thenesh Kannaa, executive director of tax advisory TraTax Sdn Bhd.

With GST not likely to be implemented anytime soon, the proposed harmonised sales and service tax (HSST) seems like the next best option in the interim to overcome the shortcomings of the current sales and service tax (SST).

Treasury secretary-general Datuk Johan Mahmood Merican was quoted as saying in October that the government was studying the HSST proposal as well as other proposals. He added that there were many other ways to widen the tax base besides GST.

HSST, a term coined by think tank Malaysian Institute of Economic Research (MIER), seeks to "harmonise" the Sales Tax Act and the Service Tax Act, bringing both taxes into one ecosystem. The proposed HSST functions similarly to the GST system without the hassle of input tax, output tax and claiming refunds.

In a paper titled "Harmonising Malaysia's sales and services taxes — the better alternative to re-introducing the GST" published in 2022, MIER argues for SST to be collected only when the product or service is ready for sale to consumers.

An integral part of the HSST model is that businesses with a registered SST number must be exempted from paying sales tax for its inputs and from paying service tax on the services it receives from other service providers.

By exempting the tax levied between registered businesses, it will also work in eliminating the cascading effect that takes place between service providers as well as between the service and manufacturing sectors.

"The system should allow all inputs to accumulate in a manufacturer or service provider without input taxes and ultimately, the product or service is taxed only once at the output stage when all costs are already priced into the product," said MIER.

Royal Selangor International Sdn Bhd chairman Tan Sri Yong Poh Kon, who is also a member of the board of trustees at MIER, is a strong proponent of the HSST system. Notably, he is also the author of the MIER report on HSST.

"The Customs Department does recognise the cascading effect of SST and it has done something about this for the advertising industry and for certain professional services where they are exempted from payment of service tax within the industry. So, the thing to do now is to expand it to other services as well," he tells *The Edge*.

"The manufacturing sector already has its own bubble, where the inputs are free of sales tax. So, if we harmonise the two sectors into one big bubble, all SST-registered businesses

PATRICK GOH/THE EDGE

Royal Selangor's Yong: The Customs Department does recognise the cascading effect of SST and it has done something about this for the advertising industry and for certain professional services where they are exempted from payment of service tax within the industry

can buy their inputs free of tax and charge tax only on non-registered customers."

Speaking from a business point of view, Yong says if the government is able to provide the exemption of input taxes for SST registered businesses, he believes the business community would rather work with HSST than GST because of the simplicity.

Another notable benefit of the HSST, says MIER, is that it will ease the administrative burden for customs enforcement as they would only need to look into the final output where sales or service tax is levied instead of monitoring and analysing stocks and inputs.

Undeniably, exempting SST on businesses-to-business transactions would result in some loss of revenue for the government.

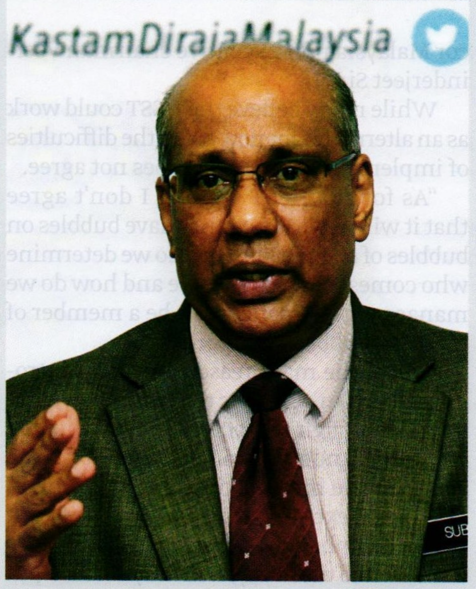
"The harmonised SST will create a slight loss in revenue, but it can be compensated by widening the service tax to other sectors using the negative list where only passenger transport, margin-based financial services and education should be exempted. For goods, the taxing point can be maintained at import and manufacturing level," says non-resident senior fellow of MIER Datuk Seri Subramaniam Tholasy, who adds that having a single tax rate for goods and services is also favourable because it will be able to help cut some leakages that might happen and prevent misclassification and value shifting between goods and services.

The MIER study is proposing a single tax rate of 10% for both sales and service tax.

Subromaniam, who was director-general of the Royal Malaysian Customs Department and a key figure in the implementation of GST in 2015, points out how under the GST regime, services made up 65% of GST revenue while goods accounted for 35% — whereas under the current SST regime, the scope of service tax is very small compared with GST. He adds that in most cases, service tax is imposed on final consumption, hence it is akin to GST. In the Budget 2024 announcement, it was proposed to widen the service tax scope to include brokerage, underwriting, logistics and karaoke services.

"Assuming there is a harmonised rate of 8% for sales tax and service tax, and the service tax is expanded to include services that were similarly taxed under GST, there is a potential of RM10 billion in additional revenue after exempting the business-to-business transactions," he says.

SUHAIMI YUSUF/THE EDGE



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Subromaniam believes GST is the more efficient tax system, but HSST is something the government can consider as an alternative if it is unable to implement GST at this juncture. "If we were to go back to the old model of GST where many items were zero-rated, then there is no point in implementing GST," he adds.

KPMG indirect tax head Ng Sue Lynn opines that while the proposed HSST has a positive intent to address the issue of tax-on-tax, she believes that it could raise some concerns if it is implemented as an intermediary measure pending GST.

"It cannot be just a short-term measure. If we keep changing the tax regime, it is not good for investors' confidence. And if it is only for the interim before GST is implemented, then there will also be transitional rules to consider as the mechanisms are different.

"Ultimately, there needs to be a long-term plan on this," she says.