VEERINDERJEET SINGH

Comment

A blueprint for tax sustainability

Run-up to Belanjawan 2025 MALAYSIA MADANI

THE tax revenue base of Malaysia is extremely narrow with around 15% of the workforce being subject to income tax and around 20% of registered companies paying income taxes.

This puts into focus the extremely narrow base from which the government tries to extract its tax revenue. In addition, oil-related revenues still generate around 25% of the total revenue of the government.

The personal tax base is affected by higher chargeable income exempt thresholds as well as the granting of too many personal reliefs.

As part of political expediency, we keep increasing reliefs.

However, when only around 15% of individuals are paying income taxes, why do we need to keep increasing reliefs when such "benefits" only impact 15% of the population?

As for the corporate income tax rate, it will be a challenge to lower it under current economic circumstances until the tax revenue to gross domestic product or GDP ratio improves with various changes or reforms to the tax structure.

The government does face some serious constraints and the issue of tax evasion and under-reporting of income needs substantial focus as the hidden and informal sectors have not been contributing towards the tax revenue of the country.

A robust fiscal framework (over say a five-to-10-year time frame) to outline the way forward is what we need.

Possible broad reform approaches

A suggested reform focus could logically be in the following areas:

> Increase in tax effort (reducing the tax gap) via enhancing compliance and strengthening enforcement, widening coverage to encompass the informal/hidden sector, reducing tax evasion and continuing to aggressively promote voluntary tax compliance.

> Reform the tax structure by increasing the shift to indirect taxes (broaden the coverage of the existing consumption taxes and increase the tax rate as dictated by condition and need).

> Streamline the tax incentive regime by instituting a formal process of review on the use of incentives and their effectiveness, simplifying the tax incentives legislation, and ensuring a level playing field and equal access for both domestic and foreign investors.

> Technology deployment, database and information sharing by developing integrated databases and systems with inter-agency information sharing which require a national database centre, as well as deploying artificial intelligence and data analytics to strengthen tax administration.

Malaysia thus needs to:

> Introduce a strategic plan on the direction forward in respect of developing and improving the sources of tax revenue especially since oil reserves (from which petroleum income tax and royalties are generated) are dwindling.

> Review the legislative framework holistically to simplify current provisions and to remove archaic ones.

> Keep tabs on improvements in the tax legislation in the region and other parts of the world. Make proactive suggestions to reform and enhance the current structure so that we are in step with worldwide developments.

Measures to address the long-standing budget deficit need to move into a higher gear. This has been suggested by many commentators and some of the measures are listed below:

> Effective revenue and public expenditure management. Controlling expenditure will be challenging in view of the various commitments that the government has made in terms of various development projects, as well as the fact that curbing the rise in operating expenditure is difficult due to the "locked-in" nature of these expenses.

To address the shadow economy, the government should look into encouraging e-payments and reduce cash usage for transactions above a certain limit.

Nevertheless, government contracts could be made more effective with clear transparent open tenders and clear anti-corruption parameters across all agencies.

> Subsidy rationalisation should be continued with vigour. The need to continue to focus on targeted subsidies for the low income and the poor is imperative.

The granting of subsidies which are not being applied in the manner intended must also be eradicated.

Thus, the efficiency of public transfers has to be re-examined as transfers cannot be done without equal contribution of the recipients.

Our people must be trained to fend for themselves and not continue to rely on handouts from the government.

> A very robust and clear public relations policy needs to be implemented by the government to ensure its accountability as the public needs to be kept informed on a timely basis.

Issues will not go away but will simmer and boil over at some time and this can be counter-productive to the nation.

Informal sector

The small business sector/informal sector must be brought into the tax net – a low presumptive tax should be introduced that will make it simpler and easier to file tax returns so that compliance costs will be low.

Such a tax can be imposed on total sales made in a year so that full accounting records are not needed. To address the shadow economy, the government should look into encouraging e-payments and reduce cash usage for transactions above a certain limit.

Presumptive tax regimes (also known as simplified tax regimes) aim at encouraging tax compliance and business formalisation by reducing tax compliance costs and by levying lower tax rates as compared to the standard tax system.

These regimes usually target micro and small businesses and levy tax on a presumed tax base that intends to approximate taxable income by indirect means.

Hence, they can be particularly relevant where actual taxable income is difficult to assess accurately. These regimes are present in many tax systems and differ widely in their design dimensions.

The OECD Taxation Working Paper No. 59 (2023) presents an analytical framework that allows for the systematic characterisation of presumptive regimes.

The paper also mentions some of the key design questions worthy of receiving closer attention in the future and concludes with a series of best practices for the design and administration of presumptive tax regimes.

As a step to further reduce the size of the underground economy, a communication strategy needs to be formulated to

> SEE PAGE 8

Ensuring that tax incentives are tied to strict KPIs/conditions

> FROM PAGE 5

remind all that receipts must be issued for all payments and must be serially numbered and the need for a tax identification number will also further assist in curtailing tax leakages.

This should dovetail with the fact that the tax agencies are more approachable and business friendly agencies as well as the fact that a public communication strategy must be in place to show how the tax revenue of the nation is utilised for the people's benefit.

We want the citizens to appreciate that tax revenue is well-spent and there will be accountability by all ministries in their spending to ensure that the benefits filter down to the citizens.

The e-invoicing initiative is a solid start to push compliance and with that, the tax agencies can collect what is due once e-invoicing is fully implemented in a few years.

Of course, tax revenue is also lost via smuggling-enhanced enforcement and investigation activities must continue, and the agencies must work harder to curtail smuggling of taxable goods/under-declaration of imported values more holistically and comprehensively.

Reduce tax leakages

We should only grant incentives to desired sectors/type of investment and remove all other incentives, eg, double deductions, accelerated allowances, etc.

We have started to use the corporate tax rate as the incentive, that is imposing a 5% or 10% rate instead of granting total exemption.

We must ensure that tax incentives are tied to strict key performance indicators or KPIs/conditions.

Further, we must withdraw incentives if there is non-compliance with the relevant conditions.

We have to cut down the agencies involved in granting/approving tax incentives.

From the investors' perspective, having only one go-to government agency managing tax incentives avoids confusion and simplifies the compliance process.

Some other aspects should be considered:

> Reinvestment allowance should be reviewed so that its scope is restricted.

> Limit or remove exemptions in real property gains tax (RPGT)/stamp duty/other tax legislation.

> Ensure that the use of discretionary powers by the Inland Revenue Board or the Minister of Finance is subject to clear internal criteria so as to limit any possible abuse.

> Remove the concept of Designated Area or Special Area in respect of indirect taxes so as to eliminate abuse.

Thus, Malaysia needs to move to a tax incentive system that is simple, transparent, automatic and easy to enforce, and one that removes uncertainty.

Dr Veerinderjeet Singh is senior adviser on tax policy at KPMG in Malaysia, and a past president of CTIM, MIA and Micpa.

The views expressed here are the writer's own.

Note: This is the first of a two-part series, of which the second part will appear tomorrow.