KPMG

Corporate Trends

Turning Knowledge Into Value | Issue 03 / September 2004

Introduction of Value Added Tax - Practical Implementation Issues

In 1992, the then Finance Minister announced during the 1993 Budget that Malaysia would be introducing the Sales and Service Tax (“SST”). The SST is essentially a value added tax (“VAT”) system, and would replace the existing sales tax and service tax structure. Nevertheless, the plans to adopt the SST were eventually deferred.

Recently, the Government announced its intention to gradually reduce the countrys budget deficit. One way in which the Government may do so would be to increase its revenue collection. Given that the VAT system is a broad based taxation system, perhaps the Government may reconsider the introduction of the SST, which is essentially a VAT system, in order to increase its tax collection.

The VAT system is a broad based multi-stage taxation system whereby tax is levied on the amount of value created by each participant of the value chain. Under this system, all goods and services are taxable unless specifically exempted.

In contrast, our current sales tax and service tax system are single-stage tax systems. Sales tax is imposed on all imported and locally manufactured goods whereas service tax is levied on a range of services as prescribed in the Second Schedule to the Service Tax Regulations, 1975.

The conceptual application of a VAT system appears simple and equitable. However, certain practical implications with respect to the implementation of the VAT system may in fact be extensive, complex and politically unpopular. This does not mean that the VAT system should not be introduced because of the potential “problems” or difficulties that could arise. Teething problems and public adverse reaction are inevitable in any change. These can be mitigated by observing other countries handling of their VAT systems and addressing the potential implementation issues proactively. Hence, the Governments handling of change management issues arising from the introduction of the VAT system would be critical.

The Governments reasons for replacing the existing single-stage taxation system with a multi-staged one would be long-term and macro in nature. In other words, if Malaysia is to achieve its vision of becoming a developed nation by the year 2020, the decision to adopt the multi-stage VAT system should help Malaysia become more competitive in the global arena.

The objective of this write up is to create awareness of potential implementation issues so that we can prepare for the introduction of the VAT (if indeed so) more effectively.

IN THIS ISSUE

Political Minefield

The introduction of a VAT system, in spite of it being touted as more equitable, has historically been politically unpopular with the masses. Despite the privilege of learning from the experiences of countries that had introduced the VAT system, the Indian Government, for example, still faced resistance from both businesses and various State Governments when it sought to introduce the VAT system. Resistance to the VAT was evident when the small traders association threatened to go on a two-day nationwide strike to protest the introduction of the VAT[1]. This resistance was despite the fact that the small traders may not even be caught by the ambit of the VAT system given the threshold limit set for registration purposes.

Conceptually, the Government should reduce income taxes and abolish the existing sales and service taxes with the introduction of VAT. Whilst the abolishment of sales and service taxes should be a foregone conclusion, a more pertinent question would be to what extent and how soon will the Government reduce income tax rates to compensate for the introduction of VAT? Ideally, the reduction in income, sales and service taxes should offset the VAT collected. However, in reality, the expected impact of the VAT system would probably be difficult to predict and quantify given its dependence on a variety of non-economic factors.

Further, a decrease in income taxes may not necessarily have much compensatory impact on the poor because the poor would probably not be paying substantial income taxes anyway. On the contrary, the introduction of the VAT may in fact make the poor worse off than they already are at present. The effective tax paid by the poor under the VAT system could be higher than the current taxation system.

The rich, on the other hand, would not only be better placed to enjoy the compensatory effects of the move to the new taxation system, but may also have at their disposal, various tax structures that can help them reduce their effective tax paid. In fact, the prudent rich may get richer. The impact of the VAT is highly dependant on the extravagance of ones consumption pattern (ie. spending habit). A financially savvy and prudent well-off individual is less likely to feel the effects of the VAT compared to another who lives extravagantly.

Hence, the poor may view the VAT system as being capitalist in nature, and as a result, are skeptical of the purported benefits of VAT. It is, therefore, critical that the Government foresees and deals with the potential inequitable effects of VAT upfront and decisively. For instance, basic necessities like staple food items, education and healthcare services must be classified as zero-rated. The Government could also provide subsidies to the poor in the form of housing and food subsidies.

All in all, the timing with which the Government introduces the VAT system would probably play an important role in determining the success of the crossover from the existing taxation system. Therefore, a key question would be Is the VAT system critical to Malaysias competitiveness globally?

Inflationary Pressure

The introduction of the VAT system has historically led to an increase in prices. However, the extent of the inflationary pressure on goods and services would largely depend on the scope, rate, complexity and manner in which the VAT system is introduced.

Ideally, the percentage increase in prices of goods and services should reflect the VAT rate. In practice, however, this is not always the case. The expected increase in the prices of goods and services could lead to profiteering attempts by unscrupulous businesses. Therefore, consumers must be vigilant and adequately informed when comparing prices before and after the introduction of VAT.

[1] http://www.rediff.com/cms/print.jsp?docpath=/money/2003/mar/28vat2.htm

One country that had been successful in controlling the inflationary pressure of VAT is Singapore. When Singapore introduced its equivalent of the VAT called the Goods & Service Tax ("GST") in 1994, the annual inflation rate increased to 3.1%, reflecting the rate of the GST, which was 3%[2]. However, when the GST rate was increased from 3% to 4% in 2003, the annual inflation rate merely increased by 0.5%[3]. This is probably because Singapore was experiencing economic recession between 2002 2003 such that the 1% increase in GST resulted in a less than 1% hike in prices.

The inflationary impact of VAT would in a way depend on the manner in which the VAT system is introduced. Would the Government be introducing one final VAT rate such that there would only be a one-off increase in prices? Or would the Government be introducing an initial low VAT rate, but progressively increasing the rate over a number of years, as in the case of Singapore?

Where the Government introduces only one final VAT rate, then there should only be a one-time hike in prices attributable to the VAT. Consequently, claims by businesses of further increases in prices due to the introduction of VAT would be questionable. Hence, profiteering opportunities may be curbed and it would also be easier for the Government to monitor and manage the inflationary effects of the VAT.

Alternatively, if the Government chooses to progressively increase the VAT rate over time, the Government would then be looking to smoothen the inflationary effect of the VAT over time. Whilst this option could be more difficult to monitor and manage, and could possibly create more profiteering opportunities, these difficulties can be minimized by adopting a simple VAT structure and extensive public education.

Upon the implementation of the VAT system, the VAT rate would be but one of many determinants of Malaysias inflation rate at that point in time. With this in mind, the Government could conduct a comprehensive study of the various determinants of the countrys inflation, assessing how these interact with each other before deciding on the strategy with which the VAT system should be introduced. One should note, however, that the attempt to conclusively predict the behaviour of future prices with the implementation of VAT could be akin to that of predicting the future as a number of the determinants of the countrys inflation rate are beyond the control of the Government, for instance, the movement of the US Dollar and health of the global economy. Nevertheless, the Government should still seek to carefully project the potential inflationary impact of VAT so that it would be more prepared for the extent and nature of the inevitable price hikes. In addition, with greater understanding of the possible impact of VAT, the Government would also be more equipped to customise our VAT system to the countrys needs.

Hence, in anticipation of the inflationary effects of VAT, the Government must be prepared to make concerted efforts to monitor the changes in prices and where necessary, enforce penalties on errant businesses.

Complexity of the VAT System

As mentioned above, the ability of the Government and consumers to identify profiteering attempts could be complicated by the adoption of a complex VAT system, for instance, where there are different VAT rates for various types of goods and services. Hence, it may be more feasible to adopt a simple but broad based VAT structure. In general, countries operating a broad-based single rate system will have fewer definitional problems[4]. For example, in adopting a broad-based single but relatively low rate policy, Japan has avoided unbundling issues arising from the bundling of differently rated goods or services that are sold as a package.

[2] http://singstat.gov.sg/keystats/hist/cpi.html
[3] http://singstat.gov.sg/keystats/hist/cpi.html
[4] OECD paper on the "Implementation Issues for Taxation of Electronic Commerce".

[1] OECD paper on the "Implementation Issues for Taxation of Electronic Commerce".
[1] OECD paper on the "Implementation Issues for Taxation of Electronic Commerce".

The Governments Coffers

In deciding to adopt the VAT system, the Government would also need to determine the VAT rate and scope.

Whilst the introduction of VAT would probably be accompanied by a corresponding drop in direct taxes, like income taxes, the extent to which revenue from VAT collections will compensate for the loss of income tax revenue remains unknown until the actual crossover to the new taxation system. The Government would only be able to estimate the set off at best.

As such, careful selection of the VAT rate and definition of its scope would be critical in determining the Governments finances. For instance, if the rate and scope set are too high and wide respectively, the Governments revenue will increase at the expense of the public. Although a wide tax scope would inevitably reduce tax leakages amongst businessmen, this could be discriminatory against wage earners and the poor. Conversely, if the VAT rate is too low and scope too narrow, the Governments revenue could drop, thereby curtailing Government spending on, for instance, education, infrastructure and rural development. As a result, the Government may not be able to fulfill its commitment towards existing and future development projects.

Therefore, the move to the VAT system would require careful determination of the VAT rate and scope in view of its effects on, amongst others, the Governments financial position, public reaction and the ability to reduce tax leakages without penalising the poor.

Tourist Dollar

The Governments recognition of the importance of tourism as a source of revenue for Malaysia is evident from the formation of the Ministry of Tourism recently. One of the objectives of the Ministry is to develop the tourism industry to become a main industry in the country's economy[5]. Various tax incentives have also been introduced by the Government to encourage the growth of the tourism industry in Malaysia. Therefore, the impact of VAT on this sector cannot be taken for granted. Whether perceived or real, the introduction of the VAT could make Malaysia more expensive as a holiday destination.

Although foreign tourists would be entitled to VAT refunds above the set threshold amount, the process of claiming the refund would in itself be troublesome and as such, be perceived as a form of "cost". They would have to religiously collect and redeem their VAT receipts above the threshold amount at the various exit points in Malaysia. Further, purchases made below the threshold amounts would not be eligible for VAT refund.

Therefore, to mitigate the potential adverse impact of VAT on the countrys tourism industry, the threshold amount above which foreign tourists would be eligible for VAT refunds should be carefully set, bearing in mind the added administrative cost to administer the refund mechanism. If the threshold amount is set too low, the cost of administering the refund mechanism may be expensive to the Government. On the other hand, if the threshold is too high, the increased cost of visiting Malaysia could severely affect the tourism industry in Malaysia.

Crossover Issues

Crossover issues would also need to be dealt with effectively. Some potential issues would include: -
At National Level

i. Choosing and Preparing for the Crossover Date

Having decided to adopt the VAT system, the Government would need to choose an appropriate crossover date after which the VAT system would replace the current indirect taxation system. The date set should provide business and individuals sufficient time to prepare for the change to the VAT system. A lead-in time of, say, 18 to 24 months would be required to make the VAT fully operational.

[5] http://www.mocat.gov.my/index.cfm

Public Education

During the lead-in period, public education campaigns would be a good approach to sell as well as to explain the VAT mechanism to the general public via various communication channels. Genuine and concerted effort would have to be made early on in the lead-in period to allay the fears highlighted by various quarters of the economy rather than ignoring the fears till the last minute.

For instance, the Government could set up VAT information booths at public places like shopping centres to inform as well as to answer queries from the general public. Also, a help-desk could also be provided via the internet to provide hassle-free, 24-7 access to VAT information and compliance assistance. Meetings with various business associations could also be organized to facilitate 2-way communication of VAT issues during the lead-in period.

Compliance issues such as when, how and who would file VAT returns should ideally be decided even before the Government announces its VAT plans. These issues should not be constantly reviewed and revised during the lead-in period as this would only lead to confusion amongst businesses.

In addition, specific crossover issues should also be anticipated and addressed before the actual crossover to the VAT system. Such issues include, situations where a transactions contractual period straddles the period before and after the crossover date as in the case of insurance premiums, and where the costing of goods sold are distorted by stocks purchased before the crossover date, but sold after the crossover date. The Governments decision on how to treat such transactions should be announced before the crossover date, and not after the event, to facilitate a smoother transition to the VAT system.

Impact on the Trading Patterns of Businesses

Businesses are likely to analyse the potential impact of the VAT and in response to the expected impact, may alter their trading patterns just before the crossover date. For instance, businesses may postpone or accelerate certain purchases just prior to the crossover date. They may also consider renegotiating their supply contracts to revise prices to include VAT. Hence, the trade figures reported just before and after the crossover date may not be indicative of the countrys normal trade behaviour.

At Individual Business Level

To Register for VAT Purposes?

Businesses are likely to analyse the potential impact of the VAT and in response to the expected impact, may alter their trading patterns just before the crossover date. For instance, businesses may postpone or accelerate certain purchases just prior to the crossover date. They may also consider renegotiating their supply contracts to revise prices to include VAT. Hence, the trade figures reported just before and after the crossover date may not be indicative of the countrys normal trade behaviour.

ii. Information Systems

Certain relevant software used by businesses would also need to be reprogrammed, upgraded or replaced to cope with the VAT reporting requirements. For instance, a business input and output taxes would need to be tracked for reporting purposes. As for the billing function, a business sales invoices would now need to reflect the VAT charged on taxable supplies separately.

[2] http://singstat.gov.sg/keystats/hist/cpi.html
[3] http://singstat.gov.sg/keystats/hist/cpi.html
[4] OECD paper on the “Implementation Issues for Taxation of Electronic

Who is to Administer the VAT?

In most OECD countries, the VAT is closely integrated with income tax such that the department that deals with income tax would also administer the VAT system (ie. integrated at the country level). Such a move would bring about greater integration of income tax and VAT so as to reduce administrative costs and counter evasion activities.

However, in the United Kingdom, the VAT is kept separate from income tax and administered by the Customs & Excise Department. Whilst in Singapore, GST charged on goods imported into Singapore is collected by the Customs & Excise Department whilst GST charged on goods and services supplied within Singapore is collected by the Comptroller of GST.

At present, the administration of indirect taxes in Malaysia falls under the purview of the Royal Customs & Excise Department. Would the Royal Customs & Excise Department then be administering the VAT? Whatever the administrative arrangement would undoubtedly require careful consideration on the part of the Governments decision-makers.

E-Commerce Transactions

Lastly, the development of e-commerce is a challenge for current tax systems. Ideally, online transactions must comply with the same tax rules as traditional ones so as not to distort competition, whilst at the same time, the tax rules must not discourage the development of Internet business[6].

Typically, electronically supplied services are not bound by geographical boundaries. Whilst this characteristic is widely seen as a positive quality from a business perspective, this very characteristic could also pose practical problems when applying the VAT. With e-commerce, the application of traditional consumption rules that are defined by geographical borders no longer apply.

For instance, until recently, US-based companies offering services such as web hosting, ASP services, sale of downloadable software and upgrades, and sale of electronic books could also service the European Union ("EU") market, from the US. In taking advantage of the borderless nature of e-commerce, these US-based companies could service their European customers from the US without charging VAT for their services rendered. On the other hand, competing EU-based companies would be required to charge VAT for the same services, thereby making them less competitive. This loop-hole has since been addressed. Consequently, US-based service providers would now be required to charge VAT on the value of their services rendered.

Since e-commerce becomes increasingly integral to business today, potential VAT issues arising from such transactions cannot be taken lightly. In enacting the VAT legislation for Malaysia, the Government should seek to anticipate and address potential e-commerce related issues so that our Malaysian-based Internet businesses would not be disadvantaged by the introduction of the VAT.

Conclusion

Should the Government choose to adopt the VAT system, it must be aware that its role does not end with the enactment and announcement of the relevant VAT legislations. On the contrary, the decision to adopt the VAT system is only the beginning of the transition process. Active involvement is necessary to anticipate and tackle the potential implementation issues that will or may arise when introducing the VAT system.

If VAT is integral to Malaysias ability to compete globally, then perhaps the next critical question to address would be how best to facilitate a smooth transition to the VAT system.

---

[6] *Europe on the Move - Tax Policy in the European Union*

1. What is Value Added Tax (VAT)?

Over the years we have seen the widening of the scope of service tax by the Government through increasing the number of taxable services. The gradual widening of the scope of services would eventually lead to the implementation of a broad based consumption tax in Malaysia, i.e. Value Added Tax or VAT. The Government had indicated in the 1989 Budget its intention to introduce VAT in the near future. In the 1993 Budget, the Government had once again proposed to integrate the existing sales and service taxes into a single broad based tax on consumption to be called the Sales and Service Tax (SST). With the implementation of AFTA and the reduction in the rate of import duty and the Government fiscal policy to improve the budget deficit, will the Government now consider the implementation of VAT?

In Malaysia, the Royal Customs Department is administering the present indirect taxation, such as sales tax and service tax. Therefore, if VAT is introduced, this department would be the logical choice to administer it.

VAT is a tax on consumption. You pay the tax whenever you buy a good or service and the supplier will collect the tax at the point of purchase. For instance, at a VAT rate of 5%, if you pay RM100 for an item, RM100 will go to the supplier and RM5 to the Government as tax. VAT can also be levied on the importation of goods and on the importation of services in certain circumstances.

2. Input Tax Credit

The central feature of a VAT system is the credit mechanism whereby a registered person is able to recover the tax chargeable on supplies made to him for his business purposes. As VAT is a multi-stage tax and is collected at every stage of the production and distribution chain, a registered person will be able to claim credits for VAT paid on the goods and services supplied to him and the importation of any goods by him. The claimable credits are called input tax to him. The total input taxes paid are then deducted from the total output taxes that the taxable person has collected from his sales during the same taxable period, subject to the rules provided in the legislation and regulations made thereunder.

The net VAT amount is the tax figure which the taxable person would either pay to or claim as refund from the proper authorities. If the figure is positive, the net VAT amount is payable to the proper authorities. If it is negative, the amount is claimable as refund from the proper authorities. In order to be able to claim input tax credits, the person must be a taxable persons; the input tax is paid for supplies of goods and services used for making of taxable supplies and the tax invoices or simplified tax invoices for all claimable credits are available when claims are made.

The proper authority may withhold refund due to the taxable person if his VAT returns are not submitted, reasonable queries by the proper authorities are not answered or any tax/penalty for any period is not paid.

3. Supply

The concept of supply is central to the understanding of the workings of VAT. It describes the event which gives rise to when a charge to tax on the supply made takes place, who makes the supply and where the supply takes place. In most of the VAT system, the charging provision for the tax on a supply of goods or services provides that the tax shall be charged and levied on any supply of goods or services made in the country where it is a taxable supply made by a taxable person in the course of furtherance of any business carried on by him and on the importation of goods into the country. “Business” has a wide meaning and includes any trade, profession or vocation and the provision of facilities by a club or society to its members.

4. Types of Supply

Under the VAT system, supply can be classified along several dimensions. Firstly, supply can be classified according to their subject matter, i.e. supply of goods and supply of services. Secondly, supply can be classified according to their taxability, i.e. taxable supply and exempt supply. Finally, the rate of tax is another criteria by which taxable supply is classified. Taxable supply can be subject to tax at zero rate or the prevailing rate under the legislation, i.e. commonly called a standard-rated.

In a VAT system, the VAT is payable on all taxable supply (standard-rated) made in the country by a registrant except an exempt supply. In the case of standard-rated supply, a registrant under a VAT system can claim input tax while an exempt person cannot. A zero-rated supply is a taxable supply but the tax charged is nil or zero. Since zero-rated supply is a taxable supply, a registrant is entitled to claim input tax. Generally, zero-rating is restricted to exports of goods and international services. Hence the paradox that a business which is exempt cannot claim input tax but a business which is taxable can.

Exempt supply is supply other than taxable supply, therefore is not liable for VAT. In most countries that implemented VAT, exempt supply is kept to a minimum. This is to maximize the tax base, minimize distortion for businesses and to keep administration of the tax simpler. However, exemption is unavoidable and it is included to avoid problems where it is difficult to identify the value added within a business transaction and on the grounds of meritorious and regressivity.

Supply which do not fall within the charging provision of a VAT system or is disregarded for VAT purposes is often referred to as out-of-scope supply and VAT is not chargeable on the supply. Therefore, if a taxable supply is not made in the country, not made by a taxable person or not made in the course or furtherance of any business carried out by the taxable person, no tax is chargeable on the supply which is outside the scope of the VAT legislation. For example, although an employee is making a supply of labour to his employer, he is not doing so in the course or furtherance of any business carried on by him. As such that supply does not fall within the scope of the charging provision under the VAT legislation.

5. Place of Supply

The general principles of VAT is that VAT is chargeable on the supply of goods or services made in the country or imported into the country. Since goods are tangible, it is possible to identify the place where the supply of goods originates. Under the VAT system, for the supply of goods, if the supply is made outside the country, VAT will not be charged on the supply. However, upon their entry into the country, the goods will be charged VAT as imports at the point of importation and VAT is colleted by the proper authorities.

On the other hand, a supply of services are intangible by nature. Therefore, it is not possible to objectively identify its place of origin. Generally, for VAT purposes, the place where a service is supplied shall be deemed to be where the supplier “belongs”. A supply of services shall be treated as made in the country if the supplier belongs in that country. If the supplier has a business establishment or fixed establishment only in the country, he will then belong in that country. However, even if the supplier does not have any business establishment, he will belong in the country if his usual place of residence is in that country. These are the basic rules governing the place of supply involving services.

6. Time of Supply

The time of supply of goods or services is important because it determines when the taxable person should charge VAT on the supply made. It represents the point in time in relation to the supply at which the liability to account for tax arises. Generally, in most cases under the VAT system, the supply is treated as taking place at the earliest of the following events – (1) when the goods are removed or are made available, or the services are performed; (2) when the supplier issues a tax invoice for the supply; and (3) when the supplier receives payment for that supply. The exception is that if the supplier issues a tax invoice within certain days after the event in (1), the time of supply may be the date of the invoice. These are the basic tax points in determining the time of supply.

In a VAT system, if the supply is on sale and return terms, the time of supply can be the earliest of the following events – (1) the date when the supply is known; (2) 12 months after removal of the goods; and (3) the tax invoice date. The exception is that if the supplier issues a tax invoice within certain days e.g. 14 days after the event in (1) or (2), whichever is the earlier, then the time of supply is the date of this tax invoice.

7. Value of Supply

Under a VAT system, VAT is charged on the value of the supply of goods or services whenever the time of supply is recognized. Generally for a supply to fall within the scope of VAT, it must not only be made by a taxable person in the course or furtherance of business but also be made for a consideration. Therefore, if the supply is for a consideration, the value of supply on which VAT is due is on the price the taxable person charges his customer. The value of the supply can be for a consideration in either money or the open market price of the supply. If the value is not for a consideration or is for a consideration not wholly consisting of money, the value of the supply is the market value. Basically, the market value is the VAT-exclusive price that the goods or services would fetch at the time they are supplied between two unrelated persons

8. Who may register for VAT

Any person who makes a supply of goods or services whose annual turnover exceeds the stipulated threshold, is required to register with the proper authorities. A person can apply for voluntary registration even if the annual turnover does not exceed the stipulated threshold. However, the approval of such registration is at the discretion of the proper authorities. Once registered, the registrant would have the same obligations as any other taxable person.

A “person” is the basic entity required to be registered. If generally you are liable for registration, you are known as a taxable person. A taxable person can be defined to include a sole proprietor, a partnership, a company, a club, a society, an association, a management corporation, a non-profit organization, a statutory board or government body.

Taxable supplies would include standard-rated and zero-rated supplies. It would exclude exempt and out-of-scope supplies.

In deciding whether you have to be registered for VAT, you would have to consider your past or anticipated taxable supplies turnover. You are liable to register if at the end of any month, the total value of taxable supplies you made in the past 12 months or a period of less than 12 months has exceeded the required registration threshold. For the purpose of registration, the turnover figure includes the value of standard-rated and zero-rated supplies but excludes the value of exempt and out-of-scope supplies.

VAT legislation may also allow businesses making out-of-scope supplies to apply for voluntary registration if you make certain out-of-scope supplies provided that (1) you have a business establishment in the country or if your usual place of residence is in that country; (2) you make or intend to make taxable supplies; and (3) you are carrying on a business and make or intend to make supplies outside the country which would be taxable supplies if made in the country or supplies within a bonded warehouse scheme.

You may apply for exemption from registration if you make or intend to make only zero-rated supplies, even if your turnover exceeds the stipulated threshold. If you are granted exemption, you will not be able to claim the input tax you pay on your purchases of goods or services for your business.

9. Accounting for VAT

A taxable person is required to issue a **tax invoice** when he makes a supply of goods or services in the course or furtherance of business. An invoice is given to the recipient to notify him of his obligation to make payment for the supply he receives. A tax invoice is a document containing certain information about the supply of goods or services which the recipient uses to claim input tax paid on his purchases. When you make input tax claims in the VAT return, you must have tax invoices or some other documents acceptable by the proper authorities to support the claims. You need not send the invoices or documents to the proper authorities, but they must be available for inspection when required.

10. Taxable Period and VAT Returns

In a VAT system, a taxable person is required to submit returns and account for VAT to the proper authorities at regular intervals. This is known as taxable period. In a VAT system the normal period is two months. However, certain countries provide a shorter period of one month for certain businesses. This would enable the taxable person to claim input tax credit earlier and would also ensure a steady inflow of revenue to the Government. A longer taxable period of three months would benefit small businesses as they do not have to submit tax return and account for VAT often and thus reducing compliance cost.

11. Are we ready for VAT?

The implementation of VAT would have significant higher administrative costs to the administrator in implementing the legislation and compliance costs incurred by businesses in meeting the requirements imposed under the new tax regime. A business registered as a taxable person would have to meet certain obligations. For example, in order to complete a tax return and correctly account for the tax, businesses would have to issue tax invoices for the sales to their customers, keep invoices received in respect of their purchases from its customers and to maintain a daily record of the value of sales and purchases. From such records, the taxable person will be able to determine the tax payable to or refund from the tax authorities.

In this situation, this would create an extra cost especially to the small businesses to maintain such records. Consequently, under the VAT system one way to deal with such businesses is to exempt them entirely from VAT.

In practise, the implementation of a VAT system would involve some sensitive initiatives on the part of the authorities to educate businesses and the general public about a new tax and to react with understanding to the concern of the taxpayers. These are issues concerning registration, educating the businesses about VAT, the transitional treatment of inventories, capital goods, contract prices, instalment payment and continuous supplies that must be dealt with before the changeover to VAT.

Publicity is important to explain the tax regime to counter expectations of high compliance costs among businesses and to counter fears of inevitable price increase and inflationary pressures. Without an intensive publicity campaign, there is the danger of hostility towards VAT due to the public’s perceptions. Therefore, it is fundamental that the private sector individuals and groups with vested interest are consulted and encouraged to contribute to its development in order for VAT to be successfully implemented.

Contact us

Khoo Chin Guan
Tel. +603 20953388
chinguankhoo@kpmg.com.my

Loke Yee Lin
Tel. +603 20953388
lyloke@kpmg.com.my

Raja Kumaran
Tel. +603 20953388
srajakumaran@kpmg.com.my

Aminudin Saidin
Tel. +603 20953388
asaidin@kpmg.com.my

Wisma KPMG Jalan Dungun Damansara Heights 50490 Kuala Lumpur
Telephone: 03 20953388 Facsimile: 03 20950971

This article has been reprinted with the permission from the Star Biz 04/09/04