An Assessment of the Introduction of Goods and Services Tax in Malaysia and its Implications on the Merchant Shipping Sector and Maritime Supply Chain

Margaret Ang Guat Hee and Laksme Khorana
Researchers
Centre for Maritime Economics and Industries (MEI)

Abstract

As plans to introduce Goods and Services Tax (GST) in Malaysia gather momentum, it is important for players in the maritime industry to understand the potential implications of GST on the merchant shipping sector and maritime supply chain. This paper provides a broad overview of GST and assesses its potential impacts on the industry players. It argues that GST would not hamper seaborne trade. Since 95% of Malaysian ships ply internationally, services such as ship agency, navigation, ship handling, as well as ship repair and maintenance will be zero-rated. However, services provided domestically and are not related to international freights will be standard-rated. Cost for standard rated supplies would eventually increase after GST is implemented and will be borne by end users. It is noteworthy that the increase in price will only be a one-off inflation. The paper puts forth a set of policy options to ensure the smooth and successful implementation of the GST while emphasising on the need for the Government to publish the GST regulations and orders soonest possible as well as provide the businesses with guidelines and timelines for the various stages of implementation. In order to remain competitive, industry players should lobby for all shipping activities to be zero-rated and start early in adjusting their business operations and management practices to accommodate the GST. The paper concludes that Malaysia is currently not ready for GST but industry players should, however, allay their fears and be ready to adopt it with an open mindset.

(248 words)

Keywords: Goods and Services Tax (GST), Sales and Services Tax (SST), consumption tax, merchant shipping, maritime supply chain
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Executive Summary

1. Introduction

This executive summary contains the main findings and recommendations of the report entitled, ‘An assessment of the introduction of Goods and Services Tax in Malaysia and its implications on the merchant shipping sector and maritime supply chain’. The key objectives of the study are to provide an overview of the mechanics and dynamics of GST, and to assess its potential impacts that the maritime transport industry players in Malaysia may have to face.

2. Overview of the GST system

The current Sales and Services Tax (SST) will be replaced by GST, which is a consumption tax imposed on the supply of goods and services. In view of the declining reserves of oil and gas, leading to the foreseeable slide in the country’s revenue in the future, the Government plans to widen its income base that includes a new and sustainable source. It is in this context that GST materialises.

Despite opposition to GST, which mainly stems from the fear of rising prices and double taxation, the public has to be mindful that it is a more comprehensive and transparent system compared to SST. This is because it is a broad-based tax that is charged on the value added activities at each stage of the supply chain. Malaysia’s proposed standard GST rate of 4% is actually lower than the current sales tax of 10% and services tax of 5%, which is also among the lowest rates in the world. Businesses can also claim any GST paid on their inputs. Hence, concerns of cascading effects or double taxation from the system can be avoided.

Under the GST system, tax on the supply of goods and services can either be standard-rated, zero-rated or exempted (Table ES-1). In both standard- and zero-rated supplies, GST registrants are allowed to claim input tax credit from the Government on their business inputs for the production of taxable supplies.

<table>
<thead>
<tr>
<th>GST System</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard-rated supplies</td>
<td>4%</td>
</tr>
<tr>
<td>Zero-rated supplies</td>
<td>0%</td>
</tr>
<tr>
<td>Exempted supplies</td>
<td>Not subject to GST</td>
</tr>
</tbody>
</table>

Source: Royal Malaysian Customs (2010)

3. Implications of GST on the shipping sector and supply chain

The potential implications of GST on the merchant shipping sector and maritime supply chain are summarised as follows:

- GST system will affect all individuals and industries however; the extent of its impact varies depending on the type of activities.
- Due to the fact that 95% of Malaysian ships ply internationally, most of the services relating to the shipping sector and supply chains will be zero-rated as they involve exportation of services. These include ship agency services,
navigation services, ship handling services, and ship repair and maintenance services, to name a few.

- On the other hand, domestic shipping services as well as land-based logistics services supply chains that are not related to international freights will be standard-rated. Such services include ship management services, purchase of ships, domestic freight services, domestic ship rental, and certain services provided at ports such as rental of warehouses and machinery, handling of local movement cargoes services, and services that are not connected directly to ship anchored at the ports.

- The cost for standard rated supplies would eventually increase after GST is implemented and will be borne by end users. However, it is noteworthy that the increase in price will only result in a one-off inflation.

- Although the Government would refund tax credits for standard-rated services, local shipping and logistics supply chain companies may lose business opportunities to neighbouring countries where the same services are treated as zero-rated. This is true in the case of ship management services which are treated as zero-rated supply in Singapore and the United Kingdom (UK).

- Even though all shipping services in Singapore and UK are zero-rated, it does not mean that Malaysian companies can benefit from them by engaging their services. The reverse charge mechanism, a provision in the Malaysia’s GST Act, compels companies of imported services to pay GST at Malaysian rates to the Government notwithstanding that no GST has been charged by the foreign countries.

- Table ES-2 summarises the strengths, weaknesses, opportunities and threats (SWOT) of the GST with a focus on its implications to the shipping sector and supply chains.

Table ES-2: SWOT analysis of the GST

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Provides an alternative source of revenue for Government and helps shrink fiscal deficit.</td>
<td>- Involves much more tedious/laborious administration processes compared to SST due to more documentation requirements.</td>
</tr>
<tr>
<td>- Transparent system with built-in mechanism to track defaulters/tax leakages.</td>
<td>- GST treatment on some supply of goods and services is yet to be fully understood by public and businesses.</td>
</tr>
<tr>
<td>- GST rate to be introduced in Malaysia is among the lowest rates in the world.</td>
<td>- Has enterprise-wide effects and GST is not easy to implement.</td>
</tr>
<tr>
<td>- Multi-stage tax system avoids the cascading tax effect.</td>
<td>- Increase cost of doing business in terms of GST preparations.</td>
</tr>
<tr>
<td>- GST not borne by businesses but only consumers.</td>
<td>- Existing long-term contracts will be affected and prices need to be re-negotiated.</td>
</tr>
<tr>
<td>- GST input tax incurred by businesses is claimable as a credit if goods and services provided are taxable supplies.</td>
<td>- Strict and hefty penalties imposed on any errors in filing returns.</td>
</tr>
<tr>
<td>- Businesses are allowed to claim input tax credit on purchases irrespective of whether they have paid suppliers as long as invoices are issued to them.</td>
<td></td>
</tr>
<tr>
<td>Opportunities</td>
<td>Threats</td>
</tr>
<tr>
<td>------------------------------------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>• Can reduce corporate and individual tax rates as GST (4%) replaces SST</td>
<td>• Possibility of rising GST rates after implementation.</td>
</tr>
<tr>
<td>(5% + 10%)</td>
<td>• Profiteers may take advantage of GST by raising prices arbitrarily.</td>
</tr>
<tr>
<td>• Facilitates trade as most of the services supplied by shipping sector and</td>
<td>• May have serious negative cash flow impact on businesses if tax refund mechanism is</td>
</tr>
<tr>
<td>supply chains are zero-rated.</td>
<td>inefficient.</td>
</tr>
<tr>
<td>• Encourages the usage of local ports as most services provided by local</td>
<td>• With the reverse charge mechanism businesses pay GST twice if the country which the</td>
</tr>
<tr>
<td>port operators are zero-rated.</td>
<td>goods and services are imported also charges GST.</td>
</tr>
<tr>
<td>• Provides huge potential to tap on the zero-rated GST treatment as input</td>
<td>• Companies providing ship management services may lose out to foreign companies providing</td>
</tr>
<tr>
<td>tax credit is claimable from the Government even if tax imposed on</td>
<td>such services with zero-rated GST.</td>
</tr>
<tr>
<td>customers is zero.</td>
<td></td>
</tr>
</tbody>
</table>

4. **Issues and challenges of GST implementation in Malaysia**

The proposed implementation of GST has not been smooth despite the Government’s effort in promoting the system. With the implementation being postponed several times since its announcement in 2005, it is not surprising that the public doubts that the new tax system will ever take place. The issues and challenges in implementing the GST are as follows:

i) Lack of collaborative effort between the Government, corporations and individuals.

ii) Strong resistance from the public due to the misconceptions that GST may cause inflation and double taxation.

iii) Lack of detailed information and knowledge on the duties imposed on business operations.

iv) Inadequate or ineffective education and training programmes lead to uncertainty as to what needs to be done to be ready for the GST.

v) High compliance cost to change information technology (IT) and accounting systems discourages the public from embracing the GST.

vi) Lack of confidence in the Royal Malaysian Customs and the Anti-Profiteering and Price Monitoring Council in enforcing the *GST Act*, as well as the *Price Control and Anti-Profiteering Act* effectively.

vii) Lack of clear GST implementation mechanisms. Detailed guidelines for industries with specific time frames for each stage of implementation are not available.

viii) Insufficient time for businesses to carry out the necessary work to gear up to meet the GST requirements.

In view of issues and challenges listed, Malaysia is not ready to live with GST.
5. **Recommendations**

For the GST to be successfully implemented, the following are our recommendations to prepare maritime industry players for the new tax regime:

i) Designating all shipping-related activities, in particular ship management services, as zero-rated to facilitate competitiveness in Malaysia’s shipping sector. The industry players should lobby with the TRP for ship management services to be zero-rated.

ii) Publishing the GST regulations and orders soonest possible so that industry players can provide inputs and recommendations to further improve them. Therefore, they can understand how GST affects their businesses and better prepare themselves for it.

iii) Providing vigorous education and training programmes without further delay specifically for the merchant shipping players and the maritime supply chain stakeholders.

iv) Extending GST implementation period of 18 months, from the passing of the Bill, to 24-month period with each GST implementation stages clearly stated to allow lead time for businesses to restructure functional areas and modify software systems.

v) Swiftly and strictly enforcing the Price Control and Anti-Profiteering Act in response to complaints on unjustified price increases, Actions include nabbing and penalising unscrupulous businesses.

vi) Reducing compliance cost for businesses by providing financial support through soft loans and incentives at the initial stage of implementation.

vii) Formulating strategic management plans to implement GST at organisational level of companies.

6. **Conclusion**

The study concludes that GST will have minimal impact on the merchant shipping sector and maritime supply chain. Since most services in the shipping industry will be zero-rated, industry players stand to benefit from the system as no GST is imposed on the supplies and are eligible to claim input tax credit. Thus, GST is not a liability to businesses. In fact, GST is an effective solution to redress the concerns of sliding revenue from oil and gas. It is definitely the way forward in tackling the nation’s fiscal deficit situation.

Having said that, Malaysia appears to be not ready to implement the system, mainly due to lack of clear directive from the Government as well as the daunting and costly task of GST preparations that businesses would have to bear. The nation should give the Government a chance to prove that the GST system works by accepting it with an open mindset.
1. Introduction

The Goods and Services Tax (GST) is a tax on final consumption of goods and services supply. It is a multi-stage tax where the government collects tax at various stages along the delivery process of the supply chain. In another words, tax will be imposed on every level of a product, from the purchase of raw materials or start-up goods all the way to finished goods or consumer ready products. Therefore, tax will be levied on all intermediaries throughout the production and distribution chain, such as manufacturers, wholesalers and retailers. This tax will ultimately be borne by final consumers or end users; hence it is not intended to add cost to businesses. In some countries, GST is known as Value Added Tax (VAT). Both are conceptually similar because tax is applicable whenever value is added to goods and services at each level of the supply chain.

There is a pressing need to transform the Malaysia’s tax revenue bases to raise the revenue volume as well as to diversify their revenue sources. Malaysia has had 46 years of fiscal deficit, due to the large government expenditure on stimulus packages aimed at boosting domestic consumption and the economy. Figure 1 shows the fiscal balance from 1970 to 2008. Over this period, fiscal surpluses occurred only in five consecutive years from 1993 to 1997. There is no direct relationship between growth in gross domestic product (GDP) and fiscal balance.

![Figure 1: Federal Government fiscal balance, 1970 - 2008](source: Malaysian Institute of Economic Research (2009))

Currently, Malaysia’s revenue is mostly derived from direct and indirect taxes with the remainder from non-tax revenues. Figure 2 shows the percentage share of the revenue sources in 2008. The Government relies heavily on revenue from the oil & gas (O&G) sector, which accounts for 41% of the total taxes. The corporate and personal taxes respectively comprised 24% and 9% of the total. However, these revenue bases are insufficient to cover the national expenses.

It is envisioned that the oil and gas reserves are bound to deplete in the foreseeable future unless new oil fields are discovered. Besides that, the personal tax is a narrow tax base as only one-tenth of the working population pays income tax. Therefore,
the Government has to resort to other more sustainable avenues\textsuperscript{5}. In line with that, the Government intend to introduce a 4\% goods and services tax in 2011. It is hoped that the GST would boost the national revenue by an additional RM1 billion annually\textsuperscript{6}. The GST system will replace the current Sales and Services Tax (SST).

![Figure 2: Percentage share of Government revenue sources, 2008](image)

Source: Malaysian Institute of Economic Research (2009)

Basically, companies registered in the GST system are required to charge GST on their output of taxable goods and services supplied to customers. The tax charged to the buyer is termed as ‘output tax’ while GST that is incurred for the purchases of goods and services as part of business operations is referred to as ‘input tax’. Companies must pay to the Royal Malaysian Customs (RMC) the tax difference between output and input taxes. On the other hand, if the input tax is more than the output tax, the companies are eligible to claim tax credit from the RMC. Consequently, the cascading effect or double taxation in the system is avoided, and only value that is added to goods and services at each stage is taxed.

Currently, the SST practised in Malaysia is a single-stage tax applicable to selected goods and services. Generally, SST is fixed at 10\% and 5\%, respectively\textsuperscript{7}. Sales tax is imposed on manufacturers licensed under the Sales Tax Act 1972 at the import or manufacturing levels\textsuperscript{8}. Licensed manufacturers\textsuperscript{9} are taxed on their output while manufacturers that are not licensed or exempted from licensing need to pay tax on their inputs. Services tax is applicable to certain prescribed goods\textsuperscript{10} and services\textsuperscript{11}, as well as professional and consultancy services\textsuperscript{12}.

Therefore, SST is embedded in the prices of goods and services in the supply chain. Consumers have been paying SST all this time except that they are not aware of it because these taxes are not shown in the invoice. This is why SST is perceived as a non-transparent tax regime. It is envisioned that the GST will provide a more comprehensive and transparent tax system because GST is a broad-based consumption tax that is charged on transactions at all stages of production of goods and services. Additionally, it has a built-in control mechanism that helps to track down defaulters and minimise tax evasion by traders. The comparison between SST and GST can be briefly summarised in Table 1.
Table 1: Comparison between SST and GST

<table>
<thead>
<tr>
<th></th>
<th>SST</th>
<th>GST</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales tax</td>
<td>= 10%</td>
<td>Proposed standard rate = 4%</td>
</tr>
<tr>
<td>Services tax</td>
<td>= 5%</td>
<td></td>
</tr>
<tr>
<td>Single-staged tax</td>
<td></td>
<td>Multi-staged tax</td>
</tr>
<tr>
<td>Non-transparent tax system</td>
<td></td>
<td>Transparent tax system</td>
</tr>
<tr>
<td>Tax borne by all businesses and individuals</td>
<td></td>
<td>Tax borne only by end users</td>
</tr>
</tbody>
</table>

Malaysia is a nation that relies heavily on seaborne transportation to facilitate much of its trade. As such, it is important for industry players to understand the implications of GST on the shipping sector and the supply chains. Among key areas are the impact of GST on import and export, freight tax, long term contracts, and maritime ancillary services, to name a few. It is imperative that the GST’s economic implications on the supply chains and shipping industry are understood by industry players. This ensures that the industry players and other stakeholders are adequately prepared and have adjusted their operations, conduct and planning to accommodate the GST.

It is within this scenario that this study is undertaken to outline potential impacts and issues arising from the implementation of the GST as well as its possible implications on the maritime transport industry. The scope of this study will only focus on the GST implications in the merchant shipping sector and maritime supply chain which includes all activities that facilitate transportation of goods.

This study aims to provide an overview of the GST by outlining its principles, mechanism and proposed method of implementation in Malaysia. It discusses potential issues and challenges to be faced by players along the maritime supply chain and the merchant shipping sector. The study also attempts to provide recommendations on how industry players can prepare to take on the impacts, and also policy options for the Government to facilitate the smooth implementation of the GST.

2. Problem Statement

As the pace quickens to implement the GST to replace the current SST, it is crucial to understand its implications on the maritime supply chain and merchant shipping sector in the country. Since GST operates as a broad-based tax, it will affect not only carriers, but also all intermediaries along the Maritime supply chain such as freight forwarders, equipment leasing operators, ship and cargo brokers, legal firms and financiers. The extent of the impact of GST on these players needs to be analysed to enable them to prepare for the eventualities arising from the proposed tax regime.

3. Limitation of Study

At the time of this study, the Government has just announced its mulling over the implementation of GST in Malaysia. The draft GST Bill was published for public viewing in January 2010 but specific regulations and orders of the system for
industries are not available. The Government is waiting for the Bill to be passed by the Parliament before publishing them. Therefore, it was a challenge to find information on how GST can affect industry players.

Information provided in this study was mostly obtained through the researchers’ personal communications with the RMC and PricewaterhouseCoopers (PwC). Attempts to interview industry players were futile as most were reluctant to discuss about GST until the Bill has been passed or the regulations and orders are publicised. Consequently, it is impossible to address the industry players’ perspective on this issue in the study.

Literature on GST is also scarce in most book stores in the country. Given the short duration to complete this study, it was not possible to purchase any GST publications online even though they are available in other countries. In this respect, comparison of GST practices with other countries is limited in this study.

Although the Ministry of Domestic Trade, Cooperative and Consumerism (MDTCC), and the Ministry of Finance (MOF), through the Price Monitoring Council (PMC), have been working on the Price Control and Anti-Profiteering Act\textsuperscript{13}, no information on this has been disclosed. In this respect, it was difficult for the study to gauge the efficiency and effectiveness of the enforcement measures.

4. Literature Review

Various reports in the local media have mentioned of the Government’s plan to implement the GST legislation in 2011. Several parties have expressed concern over the potential adverse impacts that GST may have on the lower and middle income earners especially in the food, healthcare and apparel sectors. King (1998) argued that GST shifts the burden of taxation even more from the rich to the poor as low income earners would have to pay a higher proportion of their income on spending compared to the high income earners. This makes GST a regressive tax system which is similar to all consumption taxes. Moffatt (n.d.) also shared the same view and questioned if the burden of the taxes is shared equally by everyone.

Although, Moffatt (n.d.) acknowledged that taxation is essential to generate the revenues for the government to finance their activities, he feared that GST would harm the economy as taxes are imposed to discourage certain activities or behaviours\textsuperscript{14}. This would mean that GST may cause a disincentive for the consumers to spend and therefore, leads to damage to the economy. He mentioned that there is a cost to economy for every types of tax.

The Malaysian Institute of Economic Research (MIER) reported that Malaysia lacks fiscal discipline as it has 46 years of budget deficit. Moreover, the current narrow tax base, with oil and gas contributing about 40% of the total, is too risky because the country may run out of oil and gas in the near future. Metcalf (1995) commented that there are two ways in reducing fiscal deficit. This can be done by cutting expenditures or increasing taxes. However, he stressed that the question in tackling the deficit is not whether the nation should raise tax, but rather which tax should be raised. In that context, Both MIER and Metcalf concluded that GST/VAT would be a more attractive solution to reduce fiscal deficits as it broadens the tax revenue base.

Ariff (2009) stated that the GST does not cascade along the production and supply chain, as those who pay tax on output can claim a full tax credit to offset input taxes.
The tax collected by the supplier, after deducting the input tax credit, is remitted to the authority with the consumers bearing the brunt of it, as they cannot claim input tax credit. The GST is essentially a tax on consumption, not production. The tax is just passed on from one link to another until it is borne by the final consumers. In other words, the GST does not represent a permanent cost to the businesses. He argued that the impact on the consumer price index (CPI) or inflation will be just one-off. The GST also has a self-policing mechanism that discourages evasion, unlike in a retail sales tax system or an income tax system where it would be relatively easier to evade.

Dissents have argued that the GST would unleash the dreaded spectre of inflation. There is the risk that businesses may increase prices because they think that all costs of inputs have increased (Personal Money, April 2010). However, the current SST is an indirect tax system which King (1998) claimed is irrational since tax is imposed entirely on goods but not all services. He said tax should not only be payable on washing machines but also laundries, as well as on televisions and video recorders but also on going to the movies. This also applies to services provided by the maritime transport industry where not all are subjected to SST. Unfortunately, limited literature is available on how GST will affect the maritime transport industry, which is at the forefront among service activities that facilitate the nation’s trade.

5. GST Implementation in Malaysia

5.1 Background of GST in Malaysia

Table 2 provides the chronology of announcements and decisions by the Government on GST implementation. The GST was first announced in the 2005 Budget\(^\text{15}\). The Government set a target for its implementation on 1 January, 2007. However, it was announced on 22 February, 2006 that the implementation is deferred to allow lead time for businesses to prepare and adjust to potential changes in business processes, development of software and training of personnel\(^\text{16}\). Later in his Budget 2010 speech on 23 October, 2009\(^\text{17}\), the Prime Minister Datuk Seri Najib Tun Razak said the study on the implementation of GST is near completion, and the GST Bill was tabled for first reading in the Parliament on 16 December, 2009\(^\text{18}\).

<table>
<thead>
<tr>
<th>Year</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>First announcement of the proposed introduction of GST</td>
</tr>
<tr>
<td>22 February 2006</td>
<td>Deferred the implementation of GST</td>
</tr>
<tr>
<td>23 October 2009</td>
<td>The Government is at the final stage of completing the study on the implementation of GST</td>
</tr>
<tr>
<td>24 November 2009</td>
<td>Announcement of the GST Bill to be tabled for first reading</td>
</tr>
<tr>
<td>16 December 2009</td>
<td>First reading of the GST Bill</td>
</tr>
<tr>
<td>March 2010</td>
<td>Planned second reading of the GST Bill has been postponed until further notice</td>
</tr>
<tr>
<td>6 May 2010</td>
<td>Announcement that GST will be implemented after the Price Control and Anti-Profitteering Act is ready</td>
</tr>
</tbody>
</table>

Source: Royal Malaysian Customs (2010)
The second reading of the Bill was initially scheduled for March 2010 but it was later postponed until further notice\(^\text{19}\). The reason for the postponement is to allow the Government to get feedback from the public on GST. Recently, the Deputy Finance Minister Datuk Seri Awang Adek Hussin announced that GST will be implemented only after the *Price Control and Anti-Profiteering Act*\(^\text{21}\) is implemented. This Act is similar to the *United States Antitrust Law* and the *European Union Competition Law*. The MDTCC, together with MOF, are drafting the Anti-Profiteering Bill. Since the passing of this Bill has not been decided, the actual timing of GST implementation cannot be determined as well. Nevertheless, GST system is targeted to be implemented 18 months after the passing of the GST Bill\(^\text{22}\).

5.2 Proposed GST System

Under the GST system, tax on the supply of goods and services can either be standard-rated, zero-rated or exempted (Table 3). It is important to identify the types of supply being provided because of the input tax credit mechanism.

<table>
<thead>
<tr>
<th>GST System</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Standard-Rated Supplies</td>
<td>4%</td>
</tr>
<tr>
<td>Zero-Rated Supplies</td>
<td>0%</td>
</tr>
<tr>
<td>Exempted Supplies</td>
<td>Not subject to GST</td>
</tr>
</tbody>
</table>

*Source: Royal Malaysian Customs (2010)*

In this system, standard-rated and zero-rated supplies are taxable with standard-rated supplies to be subjected to a 4% tax while zero-rated supplies will be taxable at a GST rate of zero. Examples of zero-rated supplies are the export of services or goods to boost Malaysia’scompetitiveness abroad, and basic necessities such as agro-food products to provide some GST relief to the final consumers. GST registrants of the mentioned will be allowed to claim input tax credit from the Government on their business inputs required for the production of taxable supplies.

A supply is non-taxable if it is an exempted supply and also if it is out of scope. Exempted supplies are not subject to GST and hence, input tax credit is not recoverable. It is embedded in cost. Its main objective is to reduce the tax burden on the final consumers. In February, the Government announced that up to 40 basic goods and services will be exempted from GST. Examples of exempted supplies are basic foodstuff, the sale and rental of residential properties, certain financing activities provided by banks, education and public transport. Supplier of these services cannot recover their input tax. In the case of out-of-scope, supplies are not subject to GST, but input tax credit maybe recoverable. An example of out-of-scope supply is the licensing and permits issued by statutory body and local authority.

With GST, although goods and services are taxable at every stage of the production delivery process, it is only chargeable on the value added goods and services. Additionally, all intermediaries along the supply chain are eligible to claim input tax credit from the Government. So long as there is input and output tax flow along the delivery process, the GST offsets. Therefore, the cascading effect of GST or double taxation is avoided. As GST is a consumption tax on imported goods and on supplies...
of goods and services in Malaysia, other than those exempted or zero-rated, final consumers would have to pay the 4% tax rate on the total value added of the goods and services.

5.3 GST Implementation Strategies

i. Basic Principles of GST

GST entails two important principles, one of which is the ‘place of supply’. This concept states that GST is only applicable if the supply is from Malaysia. Supplies can be further segregated into goods perspective and services perspective. The law states that for purposes of goods, the general rule is, if the goods originate from Malaysia to a place in Malaysia, it is subject to GST where the standard rate applies. If the supply of goods originates from Malaysia to a destination outside of Malaysia, it is also a taxable supply and it is called a zero rate supply. Fundamentally, the rule is to look at where the good originates. In the rule for services, the supply of service shall be deemed as have originated from or made in Malaysia if the supplier is in Malaysia. This is called the ‘supply belonging concept’.

The second basic principle of GST is the ‘time of supply’ rule. This rule, which provides for a 21-day period between transactions, is important because it determines the point of time in which companies have to account for GST. The time of supply is at one of the following transactions and examples are provided below to illustrate the application of the rule.

i. When services are performed (basic tax point)
ii. Issuance of tax invoice (actual tax point)
iii. Receipt of payment

If a tax invoice is issued within 21 days from when services are performed and no payment is received, the date of the invoice is taken as the time of supply. The significance of this rule is shown in the following example. Assuming a company performs a service on 29 January, which is known as the ‘basic tax point’, and the company’s system raised the invoice only on 8 February, which is the ‘actual tax point’. Since the company issues the invoice within 21 days (allowable period), the time of supply is 8 February. Given this date, the company has until the end of following month, i.e. 31 March, to account for this GST with the RMC even though it performed the service in January.

However, for some of the company’s systems, the cut off date is at the third week of each month. For that reason, the company can only issue the invoice on 21 February from when the service is performed. As the company raises the tax invoice after the allowable period (within 21 days), the time of supply will go back to the basic tax point, which means that the company effectively has to account for this GST one month after January, which is the last day of February. Unless the company re-programme its system, which is purely relying on invoice date, it will probably presume that it has to account for this in March.

ii. Imposition and Scope of Tax

Companies are liable to register for GST if they make taxable supplies of goods and services in Malaysia, and if their business taxable annual turnover exceeds the prescribed threshold of RM500,000. They can claim the input taxes paid on purchases of intermediate goods or services against the GST charged on the final
goods or services that they sell. Companies with an annual turnover below the threshold have an option not to register, or they can also apply for voluntary registration to take advantage of the input tax credit. Once registered, they must remain in the GST system for at least two years.

Taxable turnover includes standard-rated supplies, zero-rated supplies and deemed supplies such as private use. It excludes exempted supplies, sale of capital assets, imported services, and designated areas such as the islands of Tioman, Labuan and Langkawi, as well as out-of-scope supplies.

The liability to register is determined by the historical turnover based on the turnover of the current month and the preceding 11 months, or the future turnover based on the turnover of the current month and the next 11 months. Companies are required to apply for registration within 28 days from the end of the relevant month. The effective date of registration will be on the first day of the following month. For example, a company that applies on 15 January will be effectively registered on 1 February. Companies must pre-register three months before the implementation of GST.

In certain circumstances where companies cease to fulfil the required conditions, deregistration occurs. Mandatory deregistration arises when the business ceases, requiring a notification within 30 days after the termination of business.

For the filing of returns, a taxable period will be determined at the time when the GST registration is approved. The GST returns and payments must be submitted not later than the last day of the month following the end of the taxable period. For businesses with an annual turnover exceeding RM5 million, returns are to be submitted on a monthly basis. If the businesses annual turnover does not exceed RM5 million, submissions are done on a quarterly basis. Also, there are special cases where submissions can be on a six months basis. By default, this is the final timeline.

Tax invoices must be issued by any registered person who makes taxable supplies within 21 days after the time of supply. All particulars related to the transaction must be shown in the tax invoice in order for businesses to claim input tax credit. If companies file their returns electronically, the Government will refund within 14 working days. However, if filing is done manually, refund will be made within 28 working days. Hence, electronic filing is encouraged. Based on the draft Bill, the refund period will be provided by law, which means that if the Government fails to pay the companies between 14 and 28 days, they are in breach of the GST Act therefore, allowing the companies to take up an action against the Government to recover damages as a result of the delay which may ultimately lead to the Government being sued.

Unlike the current SST, the GST has a mechanism called the input tax credit. With input tax credit, businesses are allowed to claim from the Government any tax incurred on payments to creditors. Businesses collect tax on all their taxable sales, which is the difference between the amount charged to consumers and the costs incurred by the businesses. If output tax or tax charged to customers for a particular period is greater than input tax, then businesses have to pay tax to the RMC. On the reversal, if in that particular month, businesses incur a substantial input tax on their capital expenditures, it will be refunded by the Government.

Figure 3 illustrates a scenario provided by a senior executive of PwC, where an oil and gas (O&G) company engages a ship liner company to transport its petroleum products to other countries. In today's nature of business, most operations are outsourced to third parties. Similarly, the ship owner would hire a ship management
company to run its ship throughout the delivery process. Since the service is a taxable supply, the ship management company will charge the vessel owner RM100, assuming that is the sale value, plus the GST rate of 4%, which amounts to RM104 (see Item 1 of Figure 3). If the ship management company has no other input cost, this RM4 is the output tax for the company which has to be paid to the RMC.

For supplying the vessel, the ship owner then adds RM300 to the price of ship management service and charges RM400 (see Item 2 of Figure 3). On top of that, the vessel owner will also charge RM16 as GST. However, the vessel owner only needs to pay RM12 to the RMC in this case. This is because the vessel owner already has an input tax of RM4 that is paid to the ship management company (the supplier) and will be collecting RM16 from the O&G company.

The advantage of this GST system is that even though the vessel owner has not paid the RM4 to the ship management company, vessel owner can still claim input tax credit of RM4 from the RMC so long as the tax invoice is obtained from the ship management company. The disadvantage of the system is that even if the O&G company has not paid the vessel owner in this period, the vessel owner has to take this into account when filing its tax return. Therefore, it is essential to analyse the impact of GST on the vessel owner. Credit control becomes a major process that should be examined because it implies how soon the vessel owner gets back the RM16 so that it can minimise GST as a cost to its operations.

The importance of credit control process can be compared to the Enterprise Resource Planning (ERP), a tool to manage supply chain, which assists companies in executing the processes required for proper supply chain management. In this context, the earlier the companies receive the GST invoice, the earlier they can claim
from the RMC the input tax credit even though they have not paid the output tax to the suppliers yet. In this way, GST affects the company’s sales side as well as the procurement side. Credit control on GST may not necessarily lie in the hands of the accounts department alone. It may be incumbent upon sales and procurement division to ensure the retrieval of input tax credit from the purchases, and the proper record of tax invoices. As a result, various departments of a company have to be involved in the credit control process to avoid gaps in the implementation process of GST.

iii. Transitional Provisions

The Government also mentioned that they want to give transitional provision for stocks or goods that businesses bought before GST is implemented. For example, if the GST is implemented in July and companies may have purchased something in June where they have paid Sales Tax, the Bill states that the companies can claim for refunds if they can show the sales tax invoice. In the event where companies do not have a sales tax invoice for taxable goods bought from a trader, they are allowed to get 20% back. In order to do that, the companies must have an audit certification if goods value exceeds RM10,000. This claim must be made within six months. The Government will refund the companies by instalment within two years.

The Bill also mentioned that if companies have entered into a contract that will stand after GST implementation, and if this contract is non-reviewable, then companies can zero-rate the goods and services supplies of that contract even though it is otherwise subject to GST. Companies are given until five years after GST is implemented to review the contract. In this context, companies need to look into all existing contracts and determine which contracts will still be valid after GST is implemented, and whether the contract has a review clause. If the contract is reviewable, then it automatically becomes a standard-rated contract.

iv. Offences and Penalties

The GST Act provides that a fine not exceeding RM50,000 per return will be imposed on companies that forget to report a single return or unintentionally omitting any information in that return. Therefore, even though net tax impact may be zero, technically, the Government can impose a fine on companies if they fail to report it.

6. Potential Impacts of GST and Their Assessment

6.1 The Implications on Shipping Sector and Supply Chains

So far, specific details of the GST for the shipping sector and supply chains are not available from open sources. However, discussion between the Ministry of Finance’s Tax Review Panel (TRP) and industry players are in progress. Basically, all services relating to shipping sector and supply chains are taxable supplies, either at standard-rated or zero-rated. The stakeholders of the related industries who will be affected by the GST system are:

- Ship Liners/Owners
- Port Operators
- Shipping Agents
- Freight Forwarders
- Hauliers
- Shipbuilders
<table>
<thead>
<tr>
<th>Type of Services</th>
<th>Proposed GST Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ship liners / owners</strong></td>
<td></td>
</tr>
<tr>
<td>Freight – Domestic</td>
<td>Standard-rated</td>
</tr>
<tr>
<td>– International</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>Lease – Domestic</td>
<td>Standard-rated</td>
</tr>
<tr>
<td>– International</td>
<td>Zero-rated</td>
</tr>
<tr>
<td><strong>Port operators</strong></td>
<td></td>
</tr>
<tr>
<td>Navigation services</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>(pilotage, tug boat, towage)</td>
<td></td>
</tr>
<tr>
<td>Ship handling services</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>(port/harbour dues, wharfage, berthing/unberthing, mooring, waste collection, fire and security, survey – SOLAS30, MARPOL31)</td>
<td></td>
</tr>
<tr>
<td>Cargo handling services</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>(loading/unloading, stevedoring, RORO32 discharging, repair to damage cargo, sorting/stuffing/strapping, extra movement charges, carpenter services, reefer container services)</td>
<td></td>
</tr>
<tr>
<td>Other related services</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>(fumigation, salvage, etc.)</td>
<td></td>
</tr>
<tr>
<td>Warehouses</td>
<td></td>
</tr>
<tr>
<td>Rental</td>
<td>Standard-rated</td>
</tr>
<tr>
<td>Storage – Domestic cargo</td>
<td>Standard-rated</td>
</tr>
<tr>
<td>– International cargo</td>
<td>Zero-rated</td>
</tr>
<tr>
<td><strong>Shipping agents</strong></td>
<td></td>
</tr>
<tr>
<td>Classification, repair &amp; maintenance, cleaning, chandler (ship store)</td>
<td>Zero-rated</td>
</tr>
<tr>
<td><strong>Freight forwarders</strong></td>
<td></td>
</tr>
<tr>
<td>Domestic freight</td>
<td>Standard-rated</td>
</tr>
<tr>
<td>International freight or part thereof</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>(Service supplied by the same supplier)</td>
<td></td>
</tr>
<tr>
<td><strong>Hauliers</strong></td>
<td></td>
</tr>
<tr>
<td>Local movement of cargo</td>
<td>Standard-rated</td>
</tr>
<tr>
<td><strong>Shipbuilders</strong></td>
<td></td>
</tr>
<tr>
<td>Build and supply ships locally</td>
<td>Standard-rated</td>
</tr>
<tr>
<td>Build and supply ships for export</td>
<td>Zero-rated</td>
</tr>
<tr>
<td>Imported purchases (ship, equipment and machinery) relieved by Approved Trader Scheme</td>
<td>Standard-rated</td>
</tr>
<tr>
<td><strong>Others (service providers)</strong></td>
<td></td>
</tr>
<tr>
<td>Services not connected directly to ships anchored at the ports (e.g. cleaning services, security services, &amp; supply of utilities at ports)</td>
<td>Standard-rated</td>
</tr>
<tr>
<td>Ship management services</td>
<td>Standard-rated</td>
</tr>
</tbody>
</table>

*Source: Royal Malaysian Customs (2010)*
Table 4 shows the proposed GST treatment based on the type of services in shipping sector and supply chains. Due to the fact that 95% of the Malaysian ships ply internationally, most of the services relating to the shipping sector and supply chains are zero-rated\(^33\). These include ship agency services, navigation services, ship handling services, and ship repair and maintenance services, to name a few. The primary rational for zero-rating these activities is to ensure that GST does not impede international trade. By doing so, the Government also hopes that it will encourage more usage and investment in local ports for them to remain globally competitive.

In transporting goods, freight services will be zero-rated if goods were transported outside of Malaysia. Likewise, services to transport goods into Malaysia are also zero-rated. The domestic leg of any of the international freight services including ancillary services such as loading and unloading from a place in Malaysia to outside Malaysia will also be zero-rated. For example, if a shipping company is transporting goods from Penang Port (PEN) to Port Klang (PKG), and then ship out to other countries, the PEN-PKG leg of transport will be a zero-rated supply. Such GST treatment is only applicable if the transportation of goods is taken out of Malaysia in a single journey by the same ship liner.

Some services provided domestically are deemed as standard-rate as the ‘place of supply’ rule applies. For example, freight for domestic cargo, chartering of ships in Malaysian waters, rental of warehouses by port operators, storage of domestic cargo in warehouses, ship management services, and other services that are not directly connected to ships anchored at the ports.

GST treatment for the freight forwarders varies depending on the destination of shipment as well as the role of the forwarders. Again, the ‘place of supply’ rule applies to the destination of shipments arranged by freight forwarders. The service of arranging cargo movement to a domestic destination is standard-rated. Freight forwarding services for international shipments, for example, shipment of cargo from Hong Kong to Japan are zero-rated. However, international shipments from Malaysia to other countries and vice-versa also depend on the role of the freight forwarders. Some forwarding agents like DHL, FedEx, TNT and UPS may act as carriers and will provide door-to-door service. Such forwarders are responsible for movement of cargoes from the customer or sender to the final destination or receiver. In this case, GST is zero-rated. If the land-based and sea-based transportation of cargoes is performed by different logistics companies, then the land-based service will be treated as standard-rated while the sea-based service is zero-rated.

In facilitating trade, the supply of ships also applies a similar concept to transportation of goods by ship liners. Ships built in Malaysia and supplied to customers based in Malaysia are subject to GST standard rate. If ships are built in Malaysia and delivered to customers outside of Malaysia, then zero-rate GST applies. On the other hand, importation of ships, equipment or machinery is monitored under the Approved Trader Scheme (ATS)\(^{34}\). Imported purchases are subject to standard-rate GST and import duties. Under the ATS, companies are given a longer period to pay GST. This provision for deferred payment is meant to address companies’ cash flow problems upfront. Hence, companies can pay the GST later instead of at the time goods are imported. For rental or charter of ships in Malaysia, the service will be standard-rated and if it is for international use, GST is zero-rated.

Rental of warehouses is part of service provided by port operators. As this service does not directly connect to ships anchored at the port, it is therefore treated as standard-rated GST. However, GST treatment for storage of goods in the warehouse
depends on where the goods originated. International cargoes are treated as zero-rated GST while domestic cargoes are standard-rated GST.

Some companies have operations or businesses based in Labuan. The proposed GST Act specifically deals with this circumstance by referring to Labuan as a designated area\textsuperscript{35}. In line with that, Labuan is regarded as outside of Malaysia. However, the place of supply concept still holds. A majority of businesses in Labuan supply goods and services to oil rigs and fields within the 200 nautical mile (NM) radius of Malaysian waters. This supply is deemed as importation of goods and services into Malaysia and therefore, is taxable at standard rate. If any supplies are made further than the 200nm radius, that service actually becomes an exported service and is taxable at zero rate. On the other hand, any supply of goods and services, with the exception of freight services, made within Labuan is disregarded for tax purposes.

Not listed in Table 4 are the OSV services. These activities are not being defined in the Merchant Shipping Ordinance 1952 and hence, GST treatments for the OSV services were not mentioned. On these services or any services that are not listed in the GST regulations and orders, the RMC and PwC advised industry players to apply the place of supply rule. For example, OSV service provided by local O&G companies in foreign waters – GST is not applicable as it is perceived as an export service. However, O&G companies are cautioned to take note of GST or VAT regulations in the importing countries. The O&G companies would still have to pay GST to the Governments of the importing countries but not in Malaysia.

6.2 Comparison of Malaysia’s GST System with Other Countries

Since its introduction in 1948, 143 countries worldwide have implemented GST or VAT as part of their tax systems to date\textsuperscript{36}. GST has been implemented in Canada, Australia, New Zealand, Pakistan, and Singapore among others while the European Union (EU), South Africa, Mexico, India, South Korea, and Thailand, to name a few, have used VAT. Only three Southeast Asian countries – Malaysia, Brunei and Myanmar – do not practise this taxation system\textsuperscript{37}.

\textbf{Figure 4: GST rates of selected countries}
\textit{Source: World-Wide Tax (Adopted by authors) (2010)}
GST rates vary across countries\(^3^8\) (Figure 4). Malaysia has proposed GST rate at 4%, which is lower than the current SST rate which is ranged between 5% and 10%. The proposed GST rate is also among the lowest in the world. The highest standard GST rate implemented is 25% in some EU countries such as Denmark, Hungary, and Sweden. Within the Southeast Asian countries, the Philippines and Indonesia have the highest GST rates of 12% and 10%, respectively. GST rates for Thailand and Singapore are 7% while Vietnam is 5%.

GST rates can be revised after implementation. For example, GST was introduced in Singapore in 1994 at 3% but later increased to 4% in 2003, 5% in 2004, and was raised again to 7% in 2007\(^3^9\). Additionally, the Singapore Government decided on the 3% rate because Singapore did not have any SST on goods and services prior to GST. The lower rate was to appease the masses and to allow them to adjust to the implementation of GST.

### Table 5: Gross national income (per capita) for selected countries

<table>
<thead>
<tr>
<th>GST Countries</th>
<th>Per Capita Income (US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>$35,474.10</td>
</tr>
<tr>
<td>Norway</td>
<td>$35,053.30</td>
</tr>
<tr>
<td>Denmark</td>
<td>$30,191.50</td>
</tr>
<tr>
<td>Sweden</td>
<td>$25,105.50</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>$24,486.70</td>
</tr>
<tr>
<td>Germany</td>
<td>$23,534.80</td>
</tr>
<tr>
<td>Canada</td>
<td>$20,789.50</td>
</tr>
<tr>
<td>Singapore</td>
<td>$20,066.00</td>
</tr>
<tr>
<td>Italy</td>
<td>$19,276.10</td>
</tr>
<tr>
<td>Australia</td>
<td>$19,213.50</td>
</tr>
<tr>
<td>Hungary</td>
<td>$4,912.72</td>
</tr>
<tr>
<td>Malaysia</td>
<td>$3,311.76</td>
</tr>
<tr>
<td>South Africa</td>
<td>$2,751.22</td>
</tr>
<tr>
<td>Thailand</td>
<td>$1,838.41</td>
</tr>
<tr>
<td>Philippines</td>
<td>$920.19</td>
</tr>
<tr>
<td>China</td>
<td>$865.03</td>
</tr>
<tr>
<td>Indonesia</td>
<td>$599.24</td>
</tr>
<tr>
<td>India</td>
<td>$441.56</td>
</tr>
<tr>
<td>Vietnam</td>
<td>$392.19</td>
</tr>
</tbody>
</table>

Source: NationMaster.com (Adopted by authors) (2010)

GST is not only implemented in developed countries with high per capita income. Developing countries with low per capita income such as China, India, the Philippines, Vietnam and Indonesia have higher GST rates compared to some developed countries such as Japan, Canada and Australia. Table 5 shows the gross national income (GNI) per capita for selected countries with GST system. India’s per capita income is only $442 but its GST rate of 12.5% is even higher than those of developed countries. Although Japan is one the world’s highest income earning countries with $35,474 per capita, its GST rate of 5% is among the lowest in the world. The only high GNI countries that have implemented high GST rates are Norway, Denmark and Sweden. Vietnam and Indonesia, with their respective per capita income of $392 and $599, have the same GST rate as Australia which has a per capita income of $19,214. Therefore, there is no correlation between GNI per capita and GST rates. GST is not only for the rich and developed countries.
Table 6 compares the GST treatment of related services in the shipping sector with Singapore and the United Kingdom (UK). For Malaysia, related shipping services such as shipping agency, navigation, ship handling, repair and maintenance are zero-rated regardless of where the supply is. However, ship management services are not specified in the GST Act. According to the Tax Review Panel, ship management services provided from Malaysia are not specialised services compared to navigation, ship handling, as well as repair and maintenance services. Ship management services are seen as a routine type of service and therefore do not require preferential treatment. Consequently, TRP deemed that ship management services should be taxed and be treated as standard rated GST. It is noteworthy that by standard rating the ship management services the competitiveness of this service sector may be hampered. Local ship management will lose businesses to neighbouring countries where the service is zero-rated.

Table 6: Comparison of GST treatment in shipping sector of selected countries

<table>
<thead>
<tr>
<th>Types of Services</th>
<th>Malaysia</th>
<th>Singapore</th>
<th>United Kingdom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ship Management</td>
<td>Standard rated</td>
<td>Zero rated</td>
<td>Zero rating for qualifying ships$^{40}$</td>
</tr>
<tr>
<td>Services</td>
<td></td>
<td>(regardless of foreign or local customer)</td>
<td></td>
</tr>
<tr>
<td>Ship Agency Services</td>
<td>Zero rated</td>
<td>Zero rated</td>
<td>Zero rated</td>
</tr>
<tr>
<td>Navigation Services</td>
<td>Zero rated</td>
<td>Zero rated</td>
<td>Zero rated</td>
</tr>
<tr>
<td>Ship Handling Services</td>
<td>Zero rated</td>
<td>Zero rated</td>
<td>Zero rated</td>
</tr>
<tr>
<td>Repair and Maintenance</td>
<td>Zero rated</td>
<td>Zero rated</td>
<td>Zero rated</td>
</tr>
</tbody>
</table>

Source: PricewaterhouseCoopers (2010)

For Singapore and the UK, their Governments have treated all shipping activities as zero-rated GST. They disregard the 'place of supply' concept. This includes the charter of ships. The UK says for the purpose of ship supply, it will be treated as zero-rated with a few conditions attached. The conditions apply when a customer takes possession to enter into a charter agreement where the service is zero-rated only if the ship gross tonnage is not less than 15 tonnes and is not for recreation and pleasure usage. Therefore, if a Malaysian company charters a bare boat from the UK, it is treated as zero-rated service. However, in the UK charter agreement, services for transport of passengers, accommodation, entertainment, catering and education provided onboard ships are subject to the standard rate.

Although all shipping services in Singapore and the UK are zero-rated, it does not mean that Malaysian companies can benefit from them by engaging their services. For example, if a Malaysian company engages ship management services from Singapore to mend their ships, Singapore’s GST charge will be zero-rated. There is a provision in the GST Act which refers to a reverse charge mechanism$^{41}$. The mechanism is introduced to place Malaysian suppliers on the same footing as foreign-based service providers. The Malaysian Government recognised that countries like Singapore and the UK are also promoting export services, Malaysia will be at a disadvantage if no mechanism is in place to equalise the GST impact on the domestic shipping industry. Therefore, the reverse charge mechanism works by
compelling the company of imported services to pay GST at Malaysian rates to the RMC notwithstanding that no GST has been charged by the foreign countries.

6.3 SWOT Analysis of GST

Based on the discussions covered in the sections above, the strengths, weaknesses, opportunities and threats (SWOT) of the GST with a focus on its implications to the shipping sector and supply chains are summarised in Table 7.

The SWOT analysis shows that GST provides more strengths than weaknesses to businesses in the merchant shipping sector and maritime supply chain. This is mainly due to the fact that it is a transparent and multi-stage system, and it does not represent a permanent cost to the businesses as input tax credit is claimable. Moreover, ample opportunities can be reaped from GST as most supplies are treated as zero rates. Businesses can benefit from the zero-rated GST treatment of supplies by claiming input tax credit from the Government while consumers would gain from the GST system by paying a lower tax rate compared to SST. However, there are many threats and weaknesses which businesses and consumers would have to overcome for example, the tedious and costly GST preparations and the risk of profiteering behaviour by unscrupulous traders.

Table 7: SWOT Analysis of the GST

<table>
<thead>
<tr>
<th>Strengths</th>
<th>Weaknesses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Good source of revenue for Government and help shrink fiscal deficit.</td>
<td>Much more tedious/laborious administration process compared to SST due to more documentation requirements.</td>
</tr>
<tr>
<td>Transparent system with built-in mechanism to track defaulters/tax leakages.</td>
<td>GST treatment on some supply of goods and services is not fully understood by public and businesses.</td>
</tr>
<tr>
<td>GST rate is among the lowest rates in the world.</td>
<td>Has enterprise-wide effects and GST is not easy to implement.</td>
</tr>
<tr>
<td>Multi-stage tax system avoids the cascading tax effect.</td>
<td>Increase cost of doing business in terms of GST preparations.</td>
</tr>
<tr>
<td>GST not borne by businesses but only final consumers.</td>
<td>Existing long-term contracts will be affected and prices need to be re-negotiated.</td>
</tr>
<tr>
<td>GST input tax incurred by businesses is claimable as a credit if goods and services provided are taxable supplies.</td>
<td>Strict and hefty penalties imposed on any errors in filing returns.</td>
</tr>
<tr>
<td>Businesses are allowed to claim input tax credit on purchases irrespective of whether they have paid suppliers as long as invoices are issued to them.</td>
<td></td>
</tr>
</tbody>
</table>

Table: SWOT Analysis of the GST
### Opportunities

| Can reduce corporate and individual tax rates as GST (4%) replaces SST (5% + 10%) |
| FACilitates trade as most of the services supplied by shipping sector and supply chains are zero-rated. |
| Encourages the usage of ports as most services provided by port operators are zero-rated. |
| Provides huge potential to tap on the zero-rated GST treatment as input tax credit is claimable from the Government even if tax imposed on customers is zero. |

### Threats

| Possibility of rising GST rates after implementation. |
| Profiteers may take advantage of GST by raising prices arbitrarily. |
| May have serious negative cash flow impact on businesses if tax refund mechanism is inefficient. |
| With the reverse charge mechanism businesses pay GST twice if the country which the goods and services are imported also charges GST. |
| Companies providing ship management services may lose out to foreign companies providing such services with zero-rated GST. |

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7. **Issues and Challenges of GST Implementation in Malaysia**

Although the GST Bill has been developed, its implementation has not been all smooth sailing. The idea was first mooted in 2005 but it has been postponed several times since then. The Bill which was supposed to be tabled at the Parliament end of March, 2010 has been postponed until further notice. Many opined that Malaysia is not ready for GST implementation at this stage\(^42\). The issues and challenges of GST implementation are listed below in no particular order of importance:

i. **No Collective Effort Among Corporations, Individuals and the Government**

GST implementation has been postponed several times since its announcement in 2005. The reason for the delay is primarily due to the lack of collaborative effort between the Government, corporations and individuals. The individuals and corporate bodies claimed that the Government proposed the GST policy without public consultation\(^43\). However, prior to the announcement; the TRP tried to approach all stakeholders to seek their inputs and recommendations in developing the GST Bill\(^44\). The RMC informed that the public were not cooperative in providing inputs at that time. Consequently, when the Government reintroduced the GST in late 2009, there was a public outcry.

ii. **Strong Resistance from the Public**

The proposed GST system provoked strong opposition from the nation. Most people are reluctant to change to the new tax system because of the misconception that GST is inflationary and have cascading effect/double taxation which will affect their livelihood. They are also worried that the Government will progressively raise the GST rate over the years after its
implementation. **Table 8** shows the GST rate at the enforcement point and the current rate, illustrating the change in GST rates of 10 countries. For instance, Denmark’s VAT started at 9% and has increased considerably to 25%. Following that are the UK’s VAT which grew from 8% to 17.5%, Germany’s from 10% to 19% and Italy’s from 12% to 20%. Other countries that follow similar practice of increasing the rates after implementation are Sweden, France, Spain, Singapore, Japan and Switzerland, to name a few. These are just a few of the main grousers on GST from the public.

### Table 8: Comparison of GST/VAT between Original and Current Rates

<table>
<thead>
<tr>
<th>Country</th>
<th>Original Rate (%)</th>
<th>Current Rate (%)</th>
<th>Difference (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>9.0</td>
<td>25.0</td>
<td>+16.0</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>8.0</td>
<td>17.5</td>
<td>+9.5</td>
</tr>
<tr>
<td>Germany</td>
<td>10.0</td>
<td>19.0</td>
<td>+9.0</td>
</tr>
<tr>
<td>Italy</td>
<td>12.0</td>
<td>20.0</td>
<td>+8.0</td>
</tr>
<tr>
<td>Sweden</td>
<td>17.7</td>
<td>25.0</td>
<td>+7.3</td>
</tr>
<tr>
<td>France</td>
<td>13.6</td>
<td>19.6</td>
<td>+6.0</td>
</tr>
<tr>
<td>Spain</td>
<td>12.0</td>
<td>16.0</td>
<td>+4.0</td>
</tr>
<tr>
<td>Singapore</td>
<td>3.0</td>
<td>7.0</td>
<td>+4.0</td>
</tr>
<tr>
<td>Japan</td>
<td>3.0</td>
<td>5.0</td>
<td>+2.0</td>
</tr>
<tr>
<td>Switzerland</td>
<td>6.5</td>
<td>7.6</td>
<td>+1.1</td>
</tr>
</tbody>
</table>

*Source: The Wall Street Journal (adopted by authors) (2010)*

### iii. Lack of Information on GST

Despite the RMC having organised roadshows to educate and raise awareness among the masses on GST, most are still confused about it. This is further compounded by the Government’s decision to release the details of regulations and orders after the Bill is enacted. Due to the lack of detailed information and knowledge on the duties imposed on their business operations, the masses are uncertain as to what has to be done. This, coupled with the severe negative sentiments against the implementation of GST resulted in most businesses stalling their preparations to adopt the GST.

### iv. Inadequate Training/Education Programmes for the Public

In so far, the Government has not given any training to the people as they are busy campaigning and promoting the GST. Only some private organisations, namely PwC and Federation of Malaysian Manufacturers (FMM), took the initiative to provide advice and consultations to the industry players on how to prepare for GST. Clearly, comprehensive training programmes are lacking currently. The Government needs to design and carry out these programmes to assist and guide organisations in preparing for GST as it has an enterprise-wide effect. All functional areas of a business will be affected by GST (Figure 5).

Employees including data entry clerks have to be adequately trained on the GST requirements. The figures reported by them must be accurate and in the right currencies. Erroneous reports submitted to the RMC will result in the organisations being slapped with hefty penalties. Hence, it is vital that
comprehensive training is provided early to ensure that the employees are competent to handle GST when it is implemented.

Figure 5: Enterprise-Wide Impacts from GST
Source: PricewaterhouseCoopers (Adopted by Authors) (2010)

v. Information Technology (IT) and Accounting Systems

In order to take into account the GST system, organisations need to reassess their entire business processes, structures and relationships. Accounting systems have to be modified and new IT software installed for GST compliance. These changes incur costs and are therefore, liabilities to the organisations. Smaller businesses may not be able to afford such a change. Unless the Government can affirm that GST will definitely be implemented, organisations will not go full swing in tweaking their computer systems to meet the GST requirements.

vi. Effectiveness of Enforcement Measures are Questionable

In addressing inflationary pressures and curbing excessive profiteering, the Government will be introducing the Price Control and Anti-Profiteering Act and establishing the Price Monitoring Council (PMC). Under the purview of the MDTCC, the anti-profiteering legislation aims to deter traders from taking advantage of the GST to raise prices and increase profits. However, the practicality of the legislation is questionable. According to Jamaluddin (2010), the enactment of the Anti-Profiteering Act is only good on paper and based on past practices in Malaysia, effectiveness of enforcing the legislation is discouraging. The authorities have to act swiftly in response to complaints.
about unjustified price increases by catching and penalising unscrupulous businesses. Otherwise, without strict enforcement, profiteering activities will persist and eventually lead to inflation.

vii. Lack of Clear GST Implementation Mechanisms

Currently, TRP at the MOF is set to look into matters pertaining to GST such as to study the general impact of GST, gather feedback from the public, plan the implementation process as well as identify and resolve operational problems of GST. However, apart from the briefing roadshows and the talk about setting up of the Anti-Profiteering Act, not much is mentioned about the approach the Government would take in helping the nation to prepare themselves for GST. Plans to train and assist the organisations and individuals were only vaguely stated. Detailed guidelines for various industries with specific time frames for each stage of implementation are not available.

viii. Insufficient Time for Preparation

Upon passing the Bill, the Government plans to give organisations an 18-month period to prepare for the necessary changes in their businesses and accounting processes. However, this period may not be sufficient for the industry to conduct the preparatory works to comply with the GST requirements. According to Dennis Lin of BDO Australia partner, it takes more than two years for corporations and individuals to accept the new tax regime. FMM president Tan Sri Mustafa Mansur also shared the same sentiment.

8. Policy Options and Recommendations Towards Smooth Implementation of GST in Malaysia

Based on the issues outlined above, the following set of recommendations is put forth to facilitate the smooth and successful implementation of GST. They are:

i. Designate All Shipping-Related Activities as Zero-Rated

Although ship management services are not considered as specialised services, other countries have zero-rated such services. Following the GST treatment of shipping services in Singapore and the UK where all activities are zero-rated, the Malaysian GST should also zero-rate the ship management services. Shipping industry players should lobby to the TRP for equivalent treatment of this service. Otherwise, Malaysia will lose its competitiveness and profitability. It is an important service provided to shipping sector because it is common trend now for ship liners to outsource this service to third parties to help manage their ships. Similar to the aviation and coach industries, aircraft or coach owners do not operate the vehicles themselves. By not taking this service as specialised service reflects the ignorance of the Government on the complexity of the shipping sector. Ship management is a specialised skilled service as ship managers need to know how best to operate the ship at the lowest cost and shortest time possible in delivering goods.
ii. **Publish the Draft GST Regulations and Orders**

Government should not wait for the GST Bill to be enacted before making the regulations and orders available to the public. By publishing the regulations and orders early, industry players can give inputs and recommendations to further improve them. Having this information available can also make industry players understand how GST affects their businesses and therefore, better prepare themselves for it.

iii. **Provide Extensive Education and Training Programmes**

The responsibility of educating and training the public should not be limited to the MOF only. Other Government authorities such as MDTCC and the Ministry of International Trade and Industries (MITI) can also play an important role in assisting enforcement, briefing organisations, and helping the public to comply with the GST. Through the Malaysian Logistics Council, the Government can provide training and education workshops specifically for the merchant shipping players and the maritime supply chain stakeholders. Extensive publicity and training programmes should be launched and the task should be shared by various governmental departments. This would also expedite the process of GST implementation as well as convincing the public to accept the system.

iv. **Give Longer Time for GST Implementation**

A 24-month period should be given to the organisations to prepare for GST. The Government should also provide a detailed time frame on the implementation of the various stages to better guide the organisations in their preparation to adopt the GST. Knowing the Malaysian culture of procrastination, businesses may wait until the deadline draws near before scrambling to meet the GST requirements. Therefore, specific timelines should be given to the implementation processes such as registration; organisational restructuring; IT and accounting systems set up; and so forth to assist them in meeting the 24-month deadline.

v. **Introduce Swift and Strict Enforcement Measures**

The RMC and PMC must be strict and swift in curbing tax fraud activities and controlling the hike in prices of goods and services. Doing so would help address some of the concerns raised in the previous section and boost public confidence in the Government as well as the GST system.

vi. **Reduce Compliance Cost for Businesses**

To encourage organisations and individuals to adjust their business operations to meet the GST requirements, the Government should provide financial support through soft loans and incentives at the initial stage of implementation.

vii. **Formulate Strategic Plans to Implement GST**

At the organisational level, businesses need to look at the implementation process early by identifying key issues and on how to implement the GST. Therefore, it is imperative that the higher management liaise with all the
functional areas to identify and understand the potential issues that may arise within each area. Having analysed the issues, companies can make business policy decisions and develop strategic plans for GST implementation. For example, informing the clients of the changes in the service fee rates, which include GST, may be part of the strategic plan. Decision to educate and train employees on GST is also another move companies have to make as part of their implementation process. Once strategic management plans have been drawn up, companies can proceed to systematically implement the GST.

9. Conclusion

It is for the benefit of the country that the Government is mulling over replacing the SST with GST. As the oil and gas reserves are depleting, GST is an effective solution to redress the concerns of sliding revenue from oils and gas. GST, as a broad-based consumption tax system, generates more revenue thus reducing financial deficits and aids the country in recovering from the economic recession. Many countries, even less developed countries, have successfully adopted GST/VAT as part of their fiscal strategy for decades. Therefore, GST is not only for advanced countries but also for developing countries as well. Hence, it is high time for Malaysia to implement the system. Otherwise, the country will lose its projected additional annual revenue of RM1 billion. However, some questioned if it is worth going through the tedious administrative processes for an additional RM1 billion per year.

It is undeniable that the GST system will affect all individuals and industries. However, the extent of its impact varies depending on the type of activities. In the maritime sector, it does not have much impact on shipping industry as most international trade activities are zero-rated. The rationale for this is to maintain competitiveness of the seaborne trade in Malaysia. Since most services in the shipping industry are zero-rated, the industry players stand to benefit from the system as no GST is imposed on the supplies. Yet, they are eligible to claim input tax credit. These services include navigation services, ship handling services, repair and maintenance services, and ship agency services.

However, not all shipping services are classified as zero-rated supplies. Standard GST rate is applicable to domestic trade activities and land-based logistics services supply chain. Such services are ship management services, purchase of ships, domestic freight services, domestic ship rental, and certain services provided at ports such as rental of warehouses and machinery, handling of local movement cargoes services, and services that are not connected directly to ships anchored at the ports. Although the Government refund tax credits for standard-rated services, local shipping and logistics supply chain companies may lose business opportunities to neighbouring countries where the same services are treated as zero-rated. This is true in the ship management services which are treated as zero-rated supply in Singapore. To facilitate competitiveness in Malaysia’s shipping sector, the players should approach TRP and lobby for ship management services to be zero-rated.

By not zero-rating the ship management services also implies that the GST system is not in line with Malaysia’s New Economic Model (NEM)\(^4\), where one of the eight Strategic Reform Initiatives (SRIs) is aimed at creating a competitive economy. For other SRIs under the NEM, GST would fulfil the criteria of fiscal sustainability as it is a broad-based consumption tax. It also enhances workforce skills with the adoption of advance accounting and IT systems. This will lead to the advent of Malaysia’s knowledge-based infrastructure.
With the implementation being postponed several times since 2005, it is not surprising that the public is not taking the Government seriously. Additionally, the misconceptions that GST may cause inflation and double taxation lead to strong opposition from the public. This indicates that the public do not fully understand the GST, and that, the education and training programmes are inadequate or ineffective. Many are still unsure of what needs to be done to be ready for the GST. This coupled with the high cost of switching to compliant IT and accounting systems further discouraged the public from embracing the GST. Taking all that into account, Malaysia is not ready to live under the GST law.

For the successful implementation of GST, the Government should publish the GST regulations and orders as well as provide vigorous education and training without further delay. Besides the MOF, other ministries and governmental organisations should collaborate and be responsible for accelerating the GST implementation. The Government, RMC and PMC should be resolute and swift in enforcing the GST law. Since businesses need time to restructure functional areas, modify IT and accounting systems, as well as to inform clients of the change in pricing system, the Government should provide 24 months instead of the decided 18 months with the timeline for each GST implementation stages clearly stated. Organisations can then formulate internal strategic plans to implement GST based on that specified timeline.

In conclusion, GST will have minimal impact on the merchant shipping sector and maritime supply chain. Besides treating most of the services as zero-rated, businesses are allowed to claim from RMC any GST paid on their inputs. Thus, GST is not a liability to businesses, and cascading effect or double taxation can be avoided in the system. GST is definitely the way forward in tackling the nation’s fiscal deficit situation. Even though it is a broad-based tax regime, the nation stands to benefit from it by paying a lower tax rate than SST. However, Malaysia is currently not ready to implement the system. This is mainly due to lack of clear directive from the Government as well as the daunting and costly task of GST preparations that businesses would have to bear. It is hoped that the recommendations will spur all those involved to take the necessary actions to ensure the smooth implementation of the GST. The nation should give the Government a chance to prove that the GST system works by accepting it with an open mindset.

10. Recommendations for Further Studies

The actual implications of GST are not fully comprehended since the regulations and orders on the system are not published. Once the GST Act including its regulations and orders, together with the Price Control and Anti-Profiteering Act are released for public viewing, a secondary study should be undertaken to reassess its impacts and evaluate the effectiveness and efficiency of the enforcement of both laws. Additionally, this study mostly compared GST practices in the maritime sector with Singapore and the UK. Future studies should be on the best practices of leading maritime nations, assessing the GST implementation and effect on shipping and supply chain activities. This allows Malaysia to learn from the successes and failures of other countries in their implementation strategies and mechanisms of GST as well as the incentives and support by the various Governments. The further studies should also compare the revenue generated by the shipping sector and supply chain GST against the SST.
Acknowledgement

The authors would like to express their thanks to the officials from the Royal Malaysian Customs for their valuable assistance and information on the GST model and its implication on the shipping industry. They are Senior Assistant Director of Customs I Mdm Chin Jek Bin; Senior Assistant Director of Customs II Mr Aziz Abdul Aziz bin Mohd Nor; and Assistant Director of Customs Mdm Maria binti Madel. Also, special thanks to the Pricewaterhouse Coopers Malaysia tax consultants – Senior Executive Directors Mdm Theresa Lim and Mr Wan Heng Choon; as well as Mdm Hanita Ahmad – for sharing their insights and knowledge on the effect of GST on the offshore supply vessel (OSV) sector.

Endnotes

2 Direct tax revenues include corporate tax, personal income tax, petroleum tax, stamp duties, and others.
3 Indirect tax revenues include excise duties, sales tax, service tax, export duties, import duties and others.
6 Announcement made by the Malaysia’s Second Finance Minister, Husni Hanadzlah in December 2009.
9 Companies with a sales turnover of less than RM100,000 and companies with Licensed Manufacturing Warehouse (LMW) status are exempted from this licensing requirement. However, companies with a sales turnover of less than RM100,000 have to apply for a certificate of exemption from licensing. Sales tax is generally at 10%. However, raw materials and machinery for use in the manufacture of taxable goods are eligible for exemption from the tax, while inputs for selected non-taxable products are also exempted. Certain non-essential foodstuffs and building materials are taxed at 5%, general goods at 10%, liquor at 20% and cigarettes at 25%.
10 Prescribed goods such as food, drinks and tobacco.
11 Services in terms of provision of rooms for lodging and premises for meetings, conventions, and cultural and fashion shows; health services, and provision of accommodation and food by private hospitals.
13 See Section 5.1 and Section 7 (vi) for further details on the Price Control and Anti-Profiteering Act.
High taxes are imposed on cigarettes as a measure to deter people from taking up smoking. Similarly, high taxes on gasoline to encourage consumers to use less fossil fuel.


Ibid.


In order to subdue public’s fear that prices of goods may increase unjustly because of the GST, the Government decided to introduce the Price Control and Anti-Profiteering Act to prevent profiteering by traders.


United States Antitrust Act and the European Union Competition Law prohibit anti-competitive or monopolistic behaviour and regulate the unfair business practices.


Ibid.


Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

Ibid.

The International Convention for the Safety of Life at Sea, 1974

The International Convention for the Prevention of Pollution of Ships

Roll-on/Roll-off vessels

Discussion with Mdm Maria Madel and Mr Abdul Aziz Mohd Nor on March 31, 2010 at RMC, Putrajaya


Ibid.

A ‘qualifying ship’ is defined as any ship of a gross tonnage of not less than 15 tonnes; and which is neither designed nor adapted for use for recreation or pleasure.


Chua, T.Y. (b). (2010, February 8). Improving the implementation of GST. *The Edge Malaysia*. pp. 61-62


Chua, T.Y. (b). (2010, February 8). Improving the implementation of GST. *The Edge Malaysia*. pp. 61-62


The NEM which was announced by the Prime Minister of Malaysia aims at re-energising the private sector, developing quality workforce and reducing dependency on foreign labour, creating a competitive domestic economy, strengthening of the public sector, carrying out transparent and market-friendly affirmative action, building knowledge-base infrastructures, enhancing the sources of growth, and ensuring sustainability of growth.
References


Madel, M., & Nor, A. (2010, March 31). *Discussion on GST with the Royal Malaysian Customs* (M. Ang, & L. Khorana, Interviewers)


