FACTORS INFLUENCING KNOWLEDGEABLE CONSUMERS' LEVEL OF ACCEPTANCE OF GOODS AND SERVICES TAX

SHALENE KALYANASUNDARAM

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This thesis is dedicated to my Papa, S.K. Sundaram who is my sturdiest pillar of

support and who inspired my interest in GST.

I can never thank you enough.

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ABSTRAK

Pelaksanaan Cukai Barangan dan Perkhidmatan (GST) pada 1 April 2015 adalah satu kejayaan bagi Malaysia. Pelaksanaan GST adalah amat penting untuk menyokong pembangunan negara. Kajian ini telah dibangunkan untuk mengenal pasti faktor-faktor yang mempengaruhi tahap penerimaan GST oleh pengguna menggunakan'Theory of Planned Behavior'. Faktor-faktor yang dikaji termasuk Peraturan kelakuan pematuhan, Persepsi keadilan GST, Aras pengetahuan GST, 'Self-efficacy', Sikap, 'Subjective Norm' dan 'Perceived Behavorial Control'. Borang soal selidik telah diedarkan kepada pelajar-pelajar dalam talian MBA daripada Universiti Sains Malaysia, Universiti KebangsaanMalaysia, Universiti Malaya dan Universiti Putra Malaysia pada Februari 2015. 228 MBA pelajar mengambil bahagian dalam kajian ini dan Smart PLS telah digunakan untuk menguji kesahan dan kebolehpercayaan data dan hipotesis.. Hasil kajian membuat kesimpulan bahawa 6 hipotesis daripada 7 disokong. Tahap penerimaan GST rendah dengan Sikap dan Persepsi Kawalan Tingkahlaku menjadi pengaruh yang penting. Pematuhan Peraturan Kelakuan dan Persepsi GST keadilan adalah 'ántecedent' yang penting kepada Sikap. Self-efficacy dan Tahap pengetahuan GST adalah ántecedent' yang penting kepada 'Perceived Behavorial Control'. Kajian menunjukkan bahawa walaupun tahap pengetahuan GST dipertingkatkan di kalangan pengguna, tahap penerimaan tidak akan bertambah baik tanpa langkah-langkah berkesan yang diambil untuk meningkatkan persepsi mereka terhadap keadilan GST. Di samping itu, pemahaman GST tidak akan mencukupi untuk mempengaruhi penerimaan GST. Pengguna perlu dididik bagaimana untuk menguruskan penggunaan dan kewangan mereka serta diberikan sokongan yang mencukupi dalam tempoh peralihan ini.

ABSTRACT

The implementation of Goods and Services tax (GST) on the 1st of April 2015 is a milestone for Malaysia. The implementation of GST is of vital importance in order to support the development of the nation. This study was developed in order to identify the factors that influence knowledgeable consumers' level of acceptance of GST using the Theory of Planned Behaviour. Factors examined include Rule observance behavior, Perception of fairness of GST, Level of GST knowledge, Self-efficacy, Attitude, Subjective Norm and Perceived Behavioral Control. Questionnaires were distributed online to MBA students of Universiti Sains Malaysia, Universiti Kebangsaan Malaysia, Universiti Malaya and Universiti Putra Malaysia in February 2015. 228 MBA students participated in the study and Smart PLS was used to test the validity and reliability of the data as well as the hypotheses developed. Findings of the study concluded that 6 hypotheses out of 7 were supported. The acceptance level of GST was slightly low with Attitude and Perceived Behavioural Control being significant influencers of the acceptance level. Rule Observance Behaviour and Perception of GST fairness were significant antecedents to Attitude with perception of fairness being the variable with higher weightage. Self-efficacy and Level of GST knowledge were acceptable antecedents to Perceived Behavioral Control with Self-Efficacy carrying the higher weightage of significance. This implies that although the level of GST knowledge is enhanced amongst consumers, level of acceptance will not improve without effective measures taken to enhance their perception of GST fairness. Besides that, the mere understanding of GST will not be sufficient to influence acceptance of GST. Consumers need to be educated on how to manage their consumption and finances as well as be given ample support during this transition period.

LIST OF ABBREVIATIONS

ATT	Attitude
AVE	Average Variance Extracted
BR1M	Bantuan Rakyat 1 Malaysia
CBSEM	Covariance-based Structural Equation Modelling
CFA	Confirmatory Factor Analysis
CMB	Common Method Bias
FAQ	Frequently Asked Questions
GST	Goods & Services Tax
ITA	Income Tax Act
LA	Level of Acceptance
LTK	Level of Tax Knowledge
PBC	Perceived Behavorial Control
PLS	Partial Least Squares
PTF	Perception of Tax Fairness
RMCD	Royal Malaysian Customs Department
ROB	Rule Observance Behavior
SE	Self Efficacy
SEM	Structural Equation Modelling
SN	Subjective Norms
SST	Sales & Services Tax
TPB	Theory of Planned Behavior

UM	Universiti Malaya
UKM	Universiti Kebangsaan Malaysia
UPM	Universiti Putra Malaysia
USM	Universiti Sains Malaysia
VAT	Value-Added Tax
VBSEM	Variance-based Structural Equation Modelling

CHAPTER 1

INTRODUCTION

1.0 Introduction

This chapter presents the research framework of the study. It begins with discussing the background of the study and the problem statement followed by research objectives and research question. Definition of key terms of major variables will also be included to enhance understanding of the concepts. The significance of the study is the contribution of the scope of study to both practical and theoretical implications. The scope of study focuses on consumers as the Goods and Services tax being studied is a consumption tax. Manufacturers, retailers and distributors are able to set off the tax they pay against the tax charged to their customers but consumers are unable to claim the GST they pay on their consumption. Towards the end, the chapter will give a brief overview of the remaining chapters in the thesis.

1.1 Background

Malaysian taxation system is divided into two; direct and indirect taxes. Indirect taxes are controlled by the Royal Malaysian Customs Department (RMCD) and consist of four parts; customs duties, excise duty, sales tax and service tax. Direct taxes are administered by the Inland Revenue Board of Malaysia (IRBM). This comprises individual income taxes, corporate taxes, petroleum income taxes, real property gains taxes and stamp duty.

According to Jeyapalan Kasipillai(2005), taxation is a vital economic tool for governments to regulate the economy, to revitalize economic growth through the granting of fiscal incentives and to provide funds for development projects.

Attached in Appendix A is a table which provides information on the federal government revenue obtained from the Economic Report 2013/2014 of Ministry of Finance. According to the report, in 2013, 57.6% of the revenue was in the form of direct taxes while 16.6% was in the form of indirect taxes.

With reference to the second table in the Appendix B, the Economic Report 2013/2014 reports an overall deficit yet again. From the table, it can be seen that Malaysia faces deficits even from 2010. This has accentuated the desperate need for Malaysia to develop a more efficient, effective taxation system which will be able to provide Malaysia with a stable source of revenue.

Since the Sales and Service tax had inherent weaknesses in its system in terms of generating stable revenue, Malaysia was forced to look into the implementation of GST. GST is a broader consumption-based tax which is proven to be able to generate stable revenue for the nation's financial needs. GST is levied on all goods and services except for essential ones which are exempted from tax, or those which are at zero-rated tax for now (Palil & Ibrahim, 2011).

Sales tax is an indirect tax levied on certain imported and locally manufactured goods introduced in 1972. It is also known as manufacturer's tax. It is a single stage

tax and 10% sales tax is charged to manufacturers of locally manufactured goods when goods are sold or for imported goods, at the time when goods are cleared at Customs. Service tax of 6% was introduced in 1975 and is levied on taxable services which include prescribed goods, i.e tobacco as well as professional and consultancy services (Palil & Ibrahim, 2011). The Goods and Services Tax will replace both these taxes at a rate of 6%. It is also categorized into standard-rated, zero-rated and tax-exempt items. It is mandatory and involves all Malaysians nationwide as it is a consumption based tax.

1.2 Problem Statement

Budget 2014 was a milestone budget as the Honourable Prime Minister Dato' Seri Najib Tun Razak announced the implementation of Goods and services tax (GST) on the 1st of April 2015. According to The Star newspaper the Prime Minister in his budget speech stated that the Government had to take bold measures to overcome the weaknesses of the current sales and service tax in order to strengthen the fiscal position of the nation. Thus, after years of detailed and comprehensive studies as well as views of all segments of society including chambers of commerce, investors, economists, academicians, consumer associations and NGOs, the government has decided to implement a fair tax system that benefits all Malaysians, Goods and Services Tax (GST). The GST was publicized at a rate of 6%, higher than what was promised in earlier proposals (Singh 2013). However, this rate is the lowest amongst the ASEAN countries compared with 10% in Indonesia, Vietnam, Cambodia, the Philippines, and Laos and 7% in Singapore and Thailand.

Amongst the main highlights associated with the implementation of GST was that GST will not be implemented on approximately 40 essential goods and services, the Government will be assisting the Rakyat with the GST transition period by providing them with one off cash allowance and a reduction of 1% in individual income tax rates. The Prime Minister also iterated that the GST is vital in assisting the Government to generate revenues in an effective way in order to invest in the development of the country (Lai 2014; New Strait Times, 2014).

Despite the implementation of GST being a topic already put forth many years ago, the acceptance level amongst Malaysians is poor as represented by the massive rally organized by a coalition of 89 various parties on May 1 2014. The rally with the theme "GST: Protest Till It's Dropped' was aimed at displaying the protest of citizens against the implementation of GST and enforced the need of the Government to first resolve the issue on the high personal debt level of the nation and minimum wage as well as that the people are currently still adjusting to the hike in petrol prices and other essential goods. (Star Online, 2014)

Moreover, a survey conducted by the Merdeka Centre in May 2014 of 1009 registered voters comprising 60% Malay, 31% Chinese and 9% Indian concluded that 62% of Malaysians are not in favour of GST. The respondents were selected on the basis of random stratified sampling along ethnicity, gender and state of residence in order to obtain results which are generalizable. At the same time, 64% of the respondents indicated that they are not aware of the working of the national economy. To add on, 72% of those with household income less than RM1, 500 and 56% of those with household income between RM1, 501 and RM3,000 do not

understand GST. More than half of those who earn between RM3, 000 and RM5, 000 and 67% of those who have a household income of over RM5, 000 understand the issue.(MerdekaCenter,2015).

Also, 45% of the respondents have indicated that GST is not a fair tax system when in fact more than 160 countries have successfully implemented GST. According to the poll, 62% Malays do not understand GST, while less than half of the Chinese (41%) and Indian (35%) respondents do not understand the issue (MerdekaCenter,2015).The results of the survey are attached in Appendix C. To further corroborate this phenomenon, some of the riot participants who were interviewed by the Star newspaper displayed the same lack of knowledge in the system and high level of uncertainty in its impact to their daily lives.

Previous studies (Nordiana, 2012; Bidin & Shamsudin, 2013; Ramalingam et al., 2014) were focused on the compliance of organizations with GST and their adoption of the GST application systems. Previous studies have also explored the awareness and acceptance levels of consumers (Saira et al., 2010; Palil & Ibrahim, 2011; Shamsuddin et al., 2014; Moomal & Zakarian, 2014). However, in the nation's current scenario, it is vital for the government to understand the causes of the low levels of acceptance. In line with that, this study will delve deeper into factors that are influencing consumers' acceptance of GST using the well-established Theory of Planned Behavior. In order to further understand the factors influencing the consumers' acceptance of GST, antecedent variables to the attitude and perceived behavorial control are examined. The antecedent variables determined were Rule Observance Behaviour, Perception of GST Fairness, Level of GST knowledge and

Self-Efficacy. If these antecedent variables together with the other variables examined in the study (attitude, subjective norm and perceived behavioral control) proved significant, recommendations can be suggested to ensure a more efficient and smooth implementation of GST. This is because the relevant authorities can now identify specific areas for improvement in order to address any acceptance issues amongst the consumers.

The focus of this study is knowledgeable consumers who are currently pursuing their Masters in Business Administration. This is because the Merdeka Center survey had portrayed that there was a higher level of unacceptance amongst private sector employees, self-employed individuals and those involved in business. Moreover, the age groups comprising of those in their twenties and thirties showed a higher level of unacceptance (Merdeka Center, 2015). MBA students will be able to represent the demographics of the Merdeka Center survey who are not accepting GST. MBA students are normally within the above-mentioned age group and majority are employed (Tay, 2001) Moreover, lack of GST acceptance has been associated with lack of knowledge (Borneo Post Online, 2015; Jalil, 2015; GST Malaysia Info,2014) and by choosing MBA students we will be able to put that assumption to test as MBA students are expected to have the required basic knowledge on GST. Thus, for this study, MBA students will represent the consumers in Malaysia.

1.3 Research Objectives

1) To examine the level of acceptance of Goods and Service Tax (GST) amongst consumers.

2) To examine the relationship between the existence of rule observance behavior and attitude of consumer.

3) To examine the relationship between perception of GST fairness and attitude of consumer.

4) To examine the relationship between level of GST knowledge and perceived behavioral control of consumer.

5) To examine the relationship between self-efficacy and the perceived behavioral control of consumer.

6) To examine the relationship between attitude of consumers and their level of acceptance of GST

7) To examine the relationship between subjective norms of consumers and their level of acceptance of GST

8) To examine the relationship between perceived behavioral controls of consumers and their level of acceptance of GST

1.4 Research Questions

1) What is the level of acceptance of GST amongst consumers?

2) What is the relationship between rule observance behavior and attitude of consumer?

3) What is the relationship between perception of GST fairness and attitude of consumer?

4) What is the relationship between the level of GST knowledge of consumers and perceived behavioral control?

5) What is the relationship between self-efficacy of a consumer and perceived behavioral control?

6) What is the relationship between attitude of consumers and their level of acceptance of GST?

7) What is the relationship between subjective norms of consumers and their level of acceptance of GST?

8) What is the relationship between perceived behavioral control of consumers and their level of acceptance of GST?

1.5 Definition of Key Terms

1. **Level of Acceptance** refers to the level of intention to accept (Shamsuddin et al., 2014).

2. **Attitude** is an individual's positive and negative feelings about performing a target behavior. The feelings are brought about after evaluations conducted based on beliefs (Fishbein & Ajzen, 1975).

3. **Subjective Norm** is the individual's opinion that those who are important to him/her think that he/she should not perform the behavior in question (Fishbein&Ajzen, 1975).

4. **Perceived behavioral control** is the perceived internal and external constraints on behavior or intention to behave (Taylor & Todd, 1995).

5. **Rule observance behavior** relates to obedience to authority (Trevino, 1986).

6. **Perception of fairness** is the judgement of individuals that something or someone is free of biasness and injustice (Saad, 2010).

7. **Self-efficacy** is an individual's perception of his/her capability to organize and execute courses of action required to accomplish selected types of performances (Bandura, 1986).

8. **Level of GST knowledge** is an individual's technical and general knowledge on the subject matter of GST. (Saad, 2010)

1.6 Significance of Study

Both theoretical and practical implications of the study will be discussed.

1.6.1 Practical Implication

With the Goods and Services Tax finally being implemented, a study of this nature would be imperative for the government in identifying areas at which they should improve in and allocate resources to. This is very crucial especially since according to Deputy Finance Minister Datuk Ahmad Maslan, there is RM250 million budget

allocation to educate the public about GST and to facilitate its implementation (Ian, 2014 ; Malaysian Insider, 2014).

This will therefore enable the Royal Malaysian Customs Department to undertake measures for a smooth and effective transition to the GST system for consumers and the Government as a whole. This includes enhancing their current support system and enforcement measures (Kasipillai, 2013; Tan, 2009; Tan, 2014; Choo, 2014).

Previous studies (Saira et al., 2010; Palil & Ibrahim, 2011) have been conducted on an exploratory mode as the GST implementation was not finalized. Other studies Shamsuddin et al. (2014) and Moomal & Zakarian (2014) studied on the correlation between awareness and acceptance. However, all these studies were not backed up by a theory. Nordiana (2012), Bidin & Shamsudin (2013) and Ramalingam et al. (2014), conducted a study on the compliance with GST and adoption of GST application system of corporate tax collectors. Thus, this study would be the first study to examine the factors that influence the acceptance level of consumers at large amidst the announcement of the confirmed implementation of GST on 1 April 2015.

The key idea to understand here is that with corporate tax payers, their compliance is harped on because under the GST implementation they are required to file in taxes to the Royal Customs on a monthly or quarterly basis. Although they bear expenses on preparing infrastructure and staff to ensure compliance to GST, which is usually a one-off expenditure, it is the consumers who bear the tax burden of GST and corresponding price hikes. The findings of this study will ultimately provide insight

to the Consumers' association on the information they can disseminate to the consumers in order to assist them to accept and adapt to the implementation of GST.

1.6.2 Theoretical Implication

Although the implementation of GST has been decided upon-1 April 2015, however, the acceptance level of consumers is still low. As such, the only issue at hand now is to handle the transition process as smoothly as possible.

For this to be a success, the theory of planned behavior comes in handy to explain the various possible factors to be addressed in order to enhance the acceptance of GST amongst consumers. Previously this theory has been used to study corporate tax payers' compliance to GST (Nordiana, 2012; Bidin & Shamsudin, 2013) but through this research, the theory will be extended to understand the factors that contribute towards the acceptance of GST by consumers. Consumers do not need to comply with the GST but rather just accept it as the tax will already be embedded in prices of goods and service. In this case, the study will examine the consumers' level of acceptance of GST by determining their intention to accept GST because at the time of data collection GST has not been implemented yet.

Hence, this study will test the theory's rigidity in instances where the intention to not behave in a certain way does not enable the respondent to escape from the behavior itself.

Antecedent variables are also used in this study to enhance the explanatory power of the Theory of Planned Behavior. With these antecedent variables, the research will be able to demonstrate very specific key areas for improvement that the government should allocate resources to. The antecedents were Rule Observance Behavior, Perception of GST Fairness, Self-Efficacy and Level of GST Knowledge.

1.7 Organization of the remaining chapters

This research is made up of a total of five chapters in order to present the study in a systematic manner. The next chapter, Chapter two presents an overview of previous literature on the variables put forth. This then leads to the development of the theoretical framework and hypotheses for this study.

Chapter three consists of the research methodology, research design, data collection methods and data measurement methods that will be employed for this study.

Chapter four presents the findings of this study where the goodness of the data used is confirmed and the hypotheses developed are tested.

The final chapter, Chapter 5 will discuss the implications of the findings, practical and theoretical applications of this study, limitations of the study, future research suggestions and the conclusion.

CHAPTER 2

LITERATURE REVIEW

2.0 Introduction

This chapter aims to examine all existing literature on the content, theory and latent variables of this study as well as the relationships being examined in relation to Goods and Services Tax which will be implemented come 1st April 2015.This will then lead to the formation of the theoretical framework and the development of the hypotheses.

2.1 Malaysian Taxation

The British colonialism introduced taxes into the Federation of Malaya in 1947 which has resulted in the taxation system in Malaysia today (Singh, 1999). At first, the Income Tax Ordinance 1947 was gazetted as the fundamental act yet this was accordingly changed and replaced by Income Tax Act 1967 (ITA) with effect from January 1, 1968. At that time, ITA combined the three acts of income taxation in particular Sabah Income Ordinance 195633, Sarawak Inland Revenue Ordinance 196034 and Income Tax Ordinance 194735. As of now, ITA 1967 is the fundamental act to administer direct taxes in Malaysia including individual and corporate income tax (Palil, 2010).

The Lembaga Hasil Dalam Negeri or the Inland Revenue Board (IRB) is the tax authority which oversees the operationalization of direct taxes in Malaysia. Other than ITA, the IRB are also accountable for supervision, assessment, collection and enforcement of petroleum taxes, real property gain taxes and stamp duties. The indirect taxation system is controlled by the Royal Malaysian Customs (RMC). This includes customs duties, excise duty, sales tax and service tax (Palil, 2010).

2.2 Consumers

In previous research, (Nordiana, 2012; Bidin & Shamsudin, 2013; Ramalingam et al., 2014) their scope of study was on industrial taxpayers such as manufacturers, retailers and distributors. The focus was on businesses that were registered under GST compliance. In this study, the scope of study is on consumers, individuals who consume goods with taxes already embedded in the pricing. Thus, the matter of non-compliance or evasion does not exist in this context. In this study, MBA students will be representing the consumers as majority of them are within the age group and employment status highlighted in the Merdeka Center Survey of those who had a higher percentage of not accepting GST.

An in-depth discussion of GST in the following component will highlight the very fact that although GST will be charged at different stages, in the end the burden will be on the consumer (Voon, 2013). The implementation of GST will have quite a significant impact on consumers especially since according to the Report on Household Expenditure by the Department of Statistics Malaysia, average monthly expenditure per household has increased from RM 1,161 in 2004 up to RM 2,190 in

2010. Even without GST implemented, consumers are facing an increase in expenditure by 89% over 6 years. Thus, it is vital to study the perceptions and acceptance of GST by these Malaysian consumers and the factors that are influencing their perceptions.

Moreover, according to Bank Negara, Personal/Household Debt is standing at an alarming rate of 83% of Gross Domestic Product of the nation compared to a 70% in 2009 and the debt to household income ratio is standing at an alarming 140% (Joseph, 2013). Additional statistics creates more concern over this implementation of GST. The increase in GDP of 5.1% in 2012 is less than half of the growth of household debt of 12% in 2012, indicating severe unsustainability (Joseph, 2013). Consumers are already high in debt pre-GST and it is worrying to imagine the impact on consumers' post-GST, where prices of goods and services are expected to increase.

Hence, with the undertaking of this study, the reasons for knowledgeable consumers accepting or not accepting GST can be determined and consequently influence the channeling of resources towards customizing assistance and support for the consumers in the most effective way.

2.3 GST

Goods and Services Tax or GST is a tax on consumption based on a value-added concept. In a nutshell, the more you consume the more tax you pay. Unlike the present sales tax or service tax which is a single stage tax, GST is a multi-stage tax. The tax is not a cost to the intermediaries since they are able to claim back GST incurred in their business operations. GST is imposed on goods and services at every stage in the supply chain including situations in which the good or service is imported. It is not a new tax but instead is a tax to replace the current Sales Tax and Service Tax (SST). GST is also known as VAT, Value-Added Tax in certain countries (RMCD, 2013)

2.3.1 Reasons for implementing GST

The key reason for many countries adopting GST/VAT is the inefficiency of the current tax system in financially supporting the development of the nation's economy. The same scenario occurred here in Malaysia and the Ministry of Finance has studied and confirmed that the implementation of GST can overcome the various weaknesses under the current Sales & Service Tax system. These weaknesses include tax compounding and cascading, transfer pricing and reliefs on certain goods (RMCD, 2013).
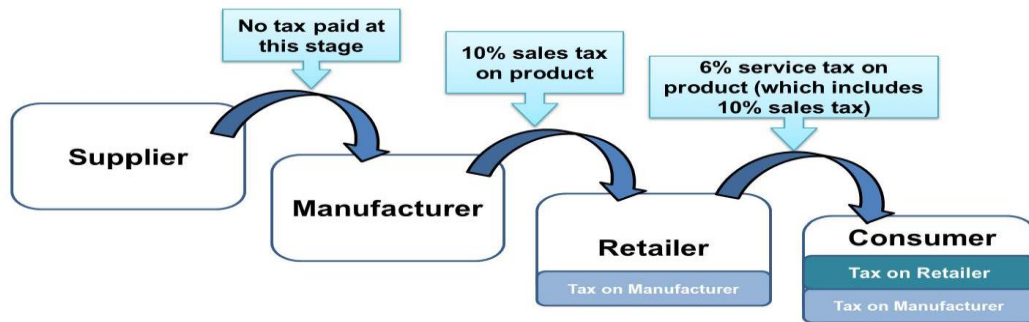
Figure 2.1: Cascading effect -Sales & Service tax (RMCD, 2013)
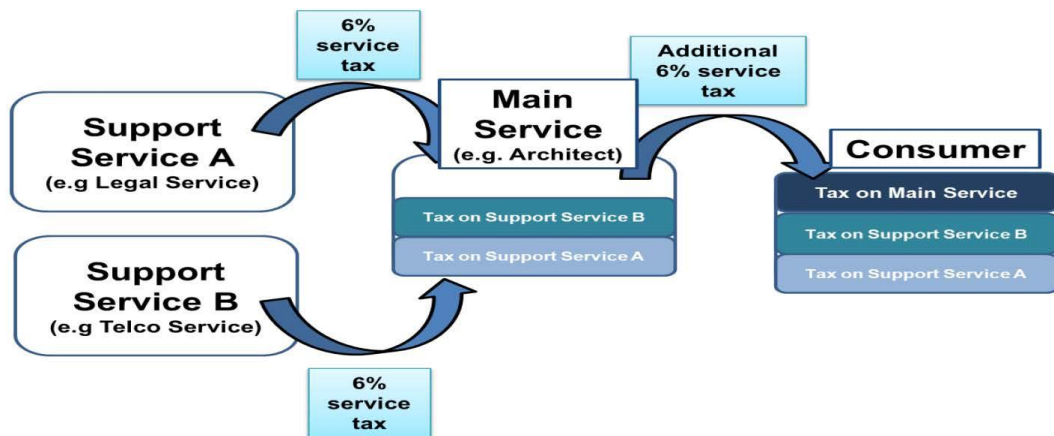
Figure 2.2: Cascading effect - Service tax (RMCD, 2013)

In 1990, direct taxes contributed to 35.2% of the nation's revenue whilst indirect taxes contribute to 36.7%. The contributions of both categories of taxes were equal but trade liberalization policies were amended causing major inequality in the contribution of direct and indirect taxes. This was clearly depicted in 2012 when the contribution from direct tax was 56.4% and indirect tax 17.2%. At this point of time, Malaysia relies profoundly on direct taxes and petroleum revenues, a situation which economic experts do not recommend. According to these experts, over-dependence on only certain taxes will have an adverse effect on the nation's financial position. Hence, to eliminate these adverse effects this is an appropriate time for the Government to engage in an overall tax reform and implement GST. (RMCD, 2013)

GST was introduced by the government in the 2005 budget but postponed to a later date. Following that, the GST Bill was tabled for the First Reading in the Dewan Rakyat in December 2009 but in 2010 the implementation was postponed again. However, the implementation of GST is inevitable to support the nation's long term economic growth and the pressure was on the government to ensure a smooth transition to GST. In order to do this, the Government has to take into account the welfare and concerns of the society as a whole so that it is well-received (RMCD, 2013).

With this in mind, the Government had undertaken social impact studies of the implementation of GST. To ease the tax burden on the consumers, certain goods and services which are indispensable to the low and middle income group have been proposed not to be subjected to GST. To add on, basic items such as poultry, rice, flour, meat, vegetable, sugar, flour, cooking oil, residential and agricultural properties, health services and education will not be subjected to GST (RMCD, 2013).

2.3.2 Significance of GST

GST is a more transparent, competent, effective and less bureaucratic taxation system. The double taxation phenomenon under the Sales & Services Tax regime is eliminated with GST in place. From a business point of view, they are able to reduce costs as they now can claim back the GST incurred which was not possible under the SST regime. A company which back then had to absorb the sales and service taxes

paid can now claim the GST paid from the Customs. The net effect is definitely a reduction in costs for these companies (RMCD, 2013).

Exportation of goods and services are not subjected to GST which will in return ensure Malaysian exports are competitive in the global market. Consequently, this will improve the Gross Domestic Product of the nation (News Strait Times, 2015) With GST in place, shadow economy activities such as illegal trading, black money and tax evasion can be curbed. (Schneider & Frey, 2000 ; MalayMail Online, 2015)

2.3.3 Mechanism of GST

The mechanism of GST can be examined from the consumers' and businesses' point of view.

(a) Business

GST is charged on the supply of goods and services made in Malaysia and on the imports of goods and services into Malaysia. GST is charged on the selling price of the goods or services and only the GST amount will be forwarded to the Government. The GST value is representative of the **value added to the goods or services** at each level of the supply chain. The value added is the value added to a raw material or purchases before selling the new or improved product or service. To operationalize this, GST adopts a **credit offset mechanism** whereby GST charged on the output of the business is offset against the GST paid on the goods or services acquired as inputs by the business. Along these lines, a company will be charged GST by its suppliers and simultaneously, the company will charge GST to its

customers. GST charged on output is called output tax and GST incurred on purchase is called input tax. This offsetting mechanism is to guarantee GST paid by businesses are recoverable leading to a reduction is cost. Most importantly, this ensures there's no double taxation and the net tax effect on the end consumer is only 6%. (RMCD, 2013)
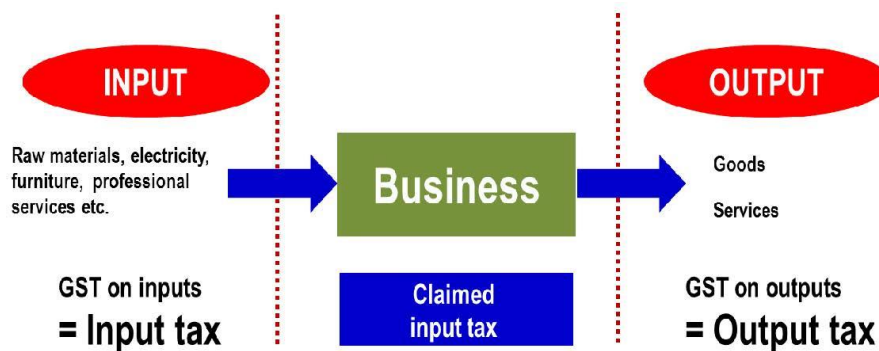

Diagram 2.3: Input and output tax (RMCD, 2013)

(b) Consumers

GST-registered businesses will collect GST from consumers on the goods and services purchased. There are three types of supplies listed under GST which are(**Examples are derived from Royal Malaysian Customs Guide on Supply under GST**):

(i) Standard rated supplies are taxable supplies of goods and services which are subject to a positive rate of 6%. Examples of these supplies are sales of commercial properties, vehicles, accessories and packaged food items.

(ii) Zero rated supplies are taxable supplies which are subject to a zero rate.

Examples of zero-rated supply are fresh vegetables, live animals, books and exports of goods and services. Businesses dealing with zero-rated supplies are still able to claim the input taxes incurred.

(iii) Exempt supplies are non-taxable supplies which are not subject to GST. However, the GST paid on input by the businesses cannot be claimed as tax credit. Examples of exempt supply of services are domestic transportation of passengers for mass public transports, private education and private health services. Examples of exempt supplies of goods are residential properties, land for agricultural and land for general use.

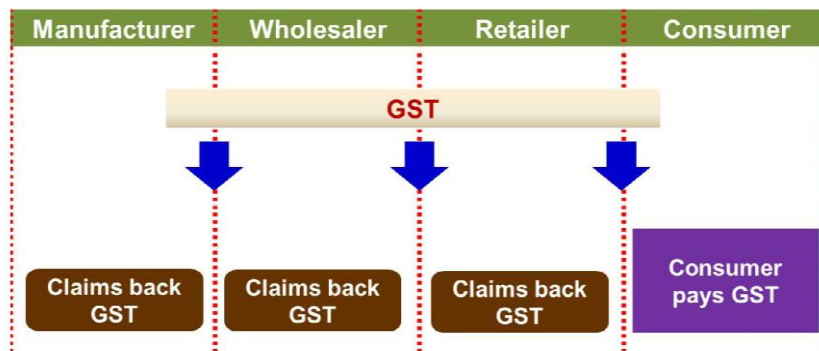Below is an illustration showing how GST works:
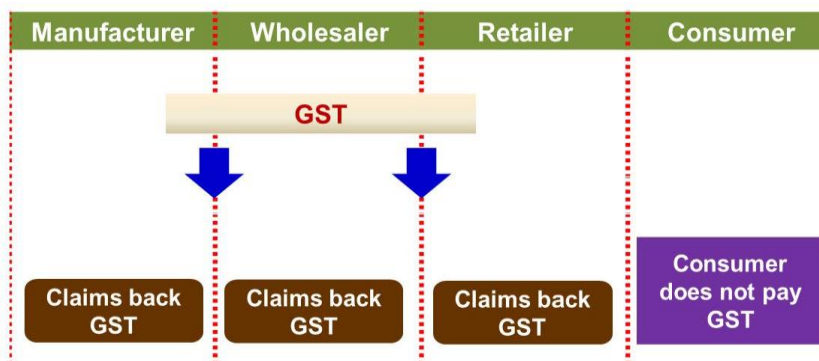

Diagram 2.4: Standard rated supply (RMCD, 2013)

Diagram 2.5: Zero-rated supply (RMCD, 2013)
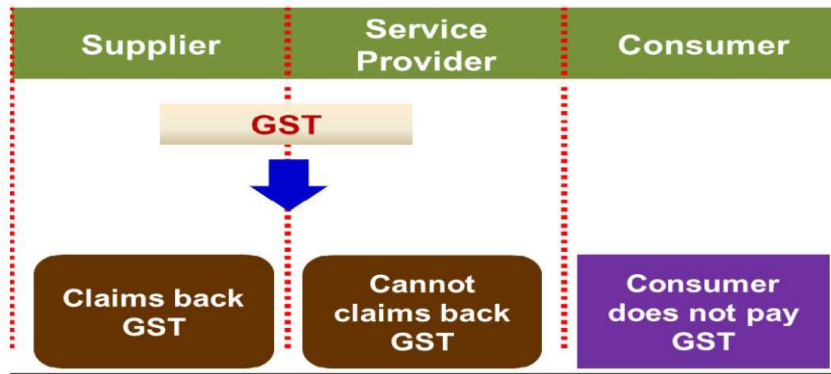
Diagram 2.6 : Exempt supply (RMCD, 2013)

Although GST is imposed at every stage of the supply chain, businesses can claim the GST incurred on inputs. Such mechanism implies that the end consumer only pays GST at the rate of 6% and not 24%.

Diagram 2.7: GST Mechanism- standard rated (RMCD, 2013)

Hence, for consumers patronizing zero-rated and exempt-rated products, there would not be any tax burden unlike purchasing a standard rated product. However, delving

deeper, the consumer should understand that producers of exempt rated goods and services cannot claim back their incurred input GST and will have no choice but to channel the cost to the consumers by increasing prices. For example, a private education institute will have to pay their suppliers GST for purchases of infrastructure and maintenance services but will not be able to claim this GST expense from the customs as their service is considered an exempt rated service. However, the institute is now incurring higher costs than pre-GST implementation and will have to increase their selling prices as well to cover the costs incurred.

An equally important point to understand is that GST, if well-implemented should not result in increase of prices of **all** standard-rated products and services**.** With the discussions below, an understanding can be obtained on the three main implications of standard-rated GST on consumers.

Scenario 1:
10% SALES TAX abolished, 6% GST implemented

The sales tax of 10% is a business to business transaction and this tax burden is usually embedded in the final pricing to end consumers. With the implementation of GST, consumers should end **up paying less** because a product manufactured or imported now is subject to 6% GST rather than 10% Sales Tax.

Scenario 2:

6% SERVICE TAX abolished, 6% GST implemented

While most consumers don't experience the direct effect of the 10% Sales Tax, most of them would have paid for the 6% Service Tax. In the scenario of consumers engaging in service for which they were previously charged 6%, the implementation of GST will not impose any price increase on items. **Consumers will be paying the same.**

Scenario 3:

No Service or Sales Tax previously, GST 6% implemented

As GST is a broad-based taxation system, more sectors of the economy are covered as compared to under the SST regime such as the paper and printing industry, food preparation industry, medical and educational equipment industry as well as repackaging industry. (Customs Guide Book,2003) Unless the goods or services are zero-rated, prices of goods not previously covered under SST will now be affected. **Consumers will have to pay a higher price.**

2.3.4 GST rates in the ASEAN countries

The GST rate of 6% suggested is the lowest in comparison to our neighboring countries. Although Singapore initially introduced GST at 3% but the current GST rate is 7%.