PENANG INSTITUTE
making ideas work

Penang Institute
(Co. No. 423660A)
10 Brown Road,
10350 Penang,
Malaysia

(604) 228 3306
(604) 226 7042
www.penanginstitute.org
enquiry@penanginstitute.org

Press Statement – 8 November 2013, Penang

by Penang Institute
Dr. Lim Kim Hwa, Fellow, Penang Institute
Miss Ooi Pei Qi, Research Analyst, Penang Institute
limkimhwa@penanginstitute.org/peiqi.ooi@penanginstitute.org

Response to the Minister Dato' Sri Idris Jala's blog-post on 4 November 2013

The Minister in the Prime Minister's Department, Dato' Sri Idris Jala, wrote about the 2014 Budget in his blog on 4 November 2013. There are three points regarding the Goods and Services Tax (GST) which needs to be clarified.

Firstly, the Minister wrote that GST "will tax most those who consume the most, which of course will be the rich". Secondly, the Minister wrote that "the imposition of a 6% GST will have minimal impact on the poor because a range of essential items will be zero-rated and exempted". Thirdly, the Minister also wrote that "the imposition of the GST paves the way for a cut in the corporate and individual income tax" and money saved by the government "will also enable the payment of an increase in direct cash grants to middle and low income group to RM650 under BR1M, the 1Malaysia cash assistance programme."

These three points need to be clarified and expanded further. Whilst measuring the extent of taxation based on the absolute amount of tax paid, as what the Minister has written, is one way; it is not the norm in international practice as it does not measure the burden of taxation relative to the level of income. Indeed, the IRS (the tax administrator in the United States) defines a regressive tax as "a tax that takes a larger percentage of income from low-income groups than from high-income groups" (http://apps.irs.gov/app/understandingTaxes/teacher/whys_thm03_les02.jsp). The similar definition is also adopted by the Macmillan Dictionary and the Collins Dictionary. Hence, a tax is measured relative to income levels to determine the impact of the tax on the rich vs. poor.

Using Bank Negara's estimates of income/expenditure and combining with the latest Household and Expenditure Survey 2009/2010, a study by the Penang Institute took into account the level of income, households' spending pattern and evaluated the burden of GST – being GST paid as a proportion of household income. The detailed study and other information is available on http://www.penanginstitute.org/gst/.

Despite setting essential items like basic food, public transportation, education and healthcare as exempt or zero rated items, the study shows that GST is a regressive tax (i.e. the low and middle income households will bear a higher tax burden than the higher income households).

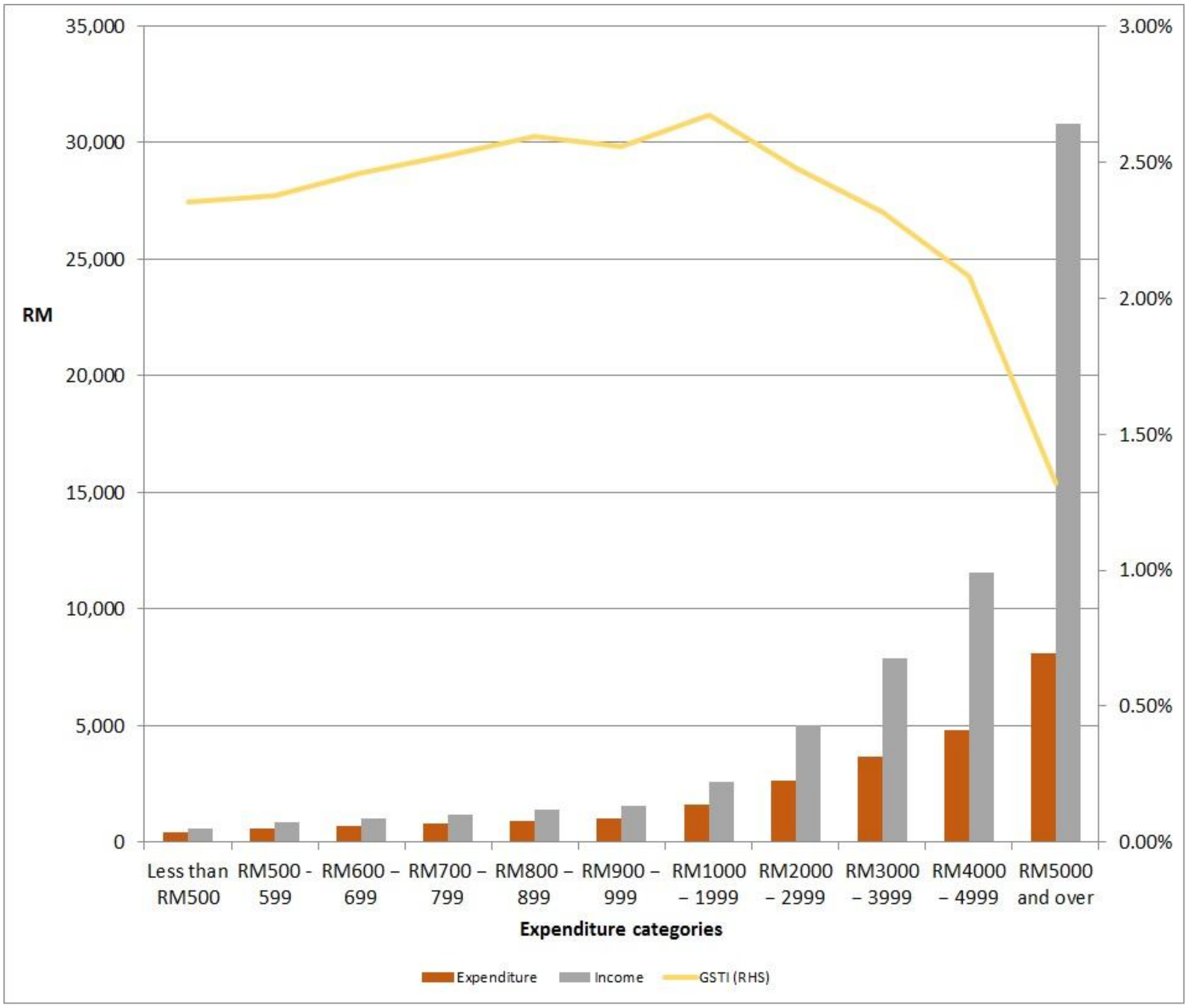
The yellow line in Figure 1 below (measured by the scale on the right hand side) shows that the proportion of income payable as GST (GSTI) is higher for the low and middle income households compared to the highest income households. The worst hit households are those earning about RM 2,500 per month – with GST burden at 2.67% of their income. The lowest income households (with

Penang Institute
(Co. No. 423660A)
10 Brown Road,
10350 Penang,
Malaysia

(604) 228 3306
(604) 226 7042
www.penanginstitute.org
enquiry@penanginstitute.org

average monthly income of RM 605) will pay 2.35% of their income in GST. However, the highest income households (with average monthly income of RM 30,815) will bear only 1.32% GST burden.

Figure 1: The burden of GST as a proportion of income across different monthly income households



Apart from hitting the low to middle income households, we also find that households will pay higher percentage of their income as GST if they are:

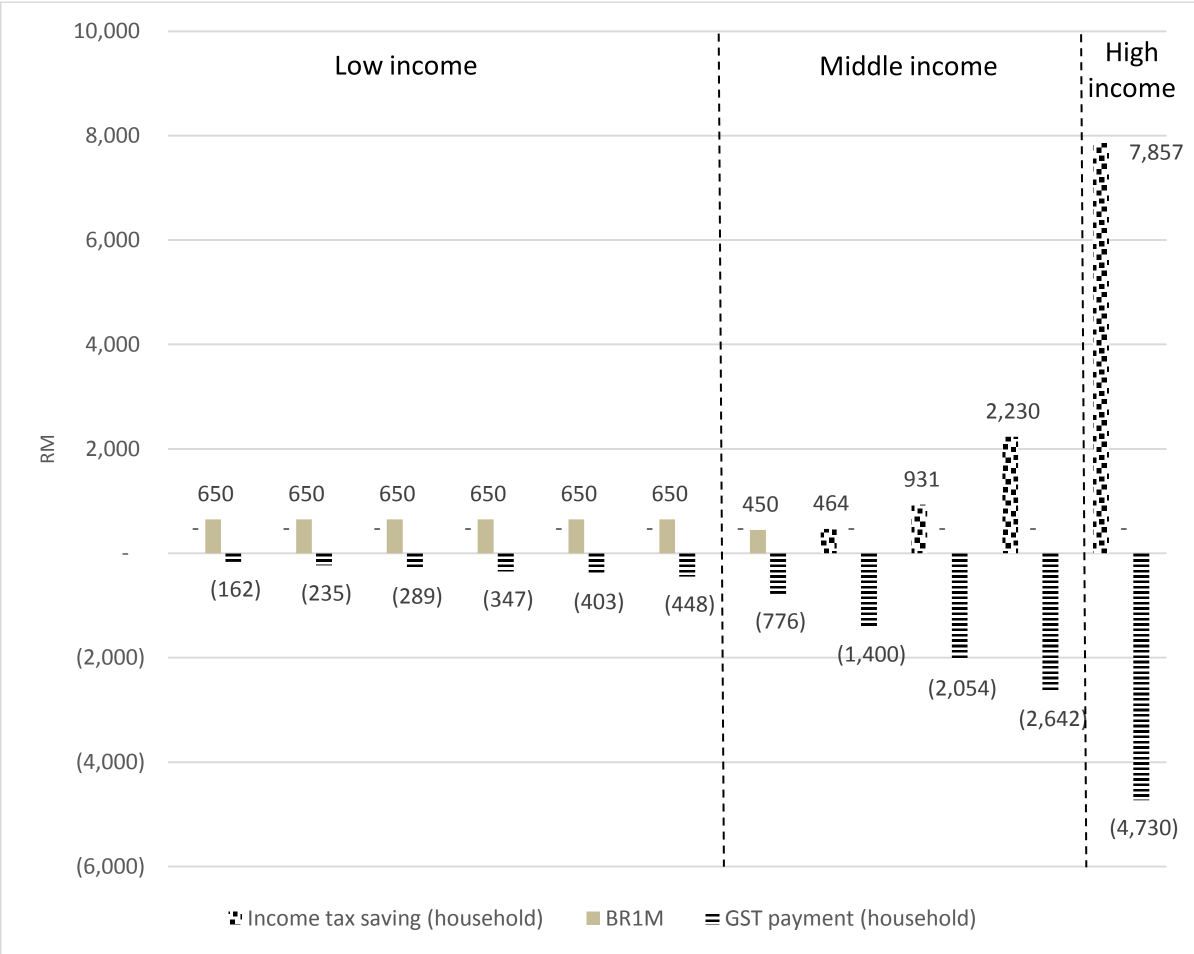
- engaged as technicians, clerical and services workers, farmers and fishermen
- in single person household
- in young households (less than 24 years old)
- Bumiputera-led households
- households residing in Peninsular Malaysia

Penang Institute
(Co. No. 423660A)
10 Brown Road,
10350 Penang,
Malaysia

(604) 228 3306
(604) 226 7042
www.penanginstitute.org
enquiry@penanginstitute.org

In the 2014 Budget, the government also announced income tax rate cuts, the widening of income tax band and a higher BR1M. These measures will be implemented at the same time as GST in 2015. Figure 2 below summarises the cash impact across different income classes, with higher income groups on the right. Figure 2 shows that: 1) income tax payers will benefit from tax savings (dotted bars); 2) low income households will benefit from BR1M (grey solid bars); and 3) everyone pays GST (bars with horizontal lines).

Figure 2: Annual GST payments, BR1M and income tax savings across different household income



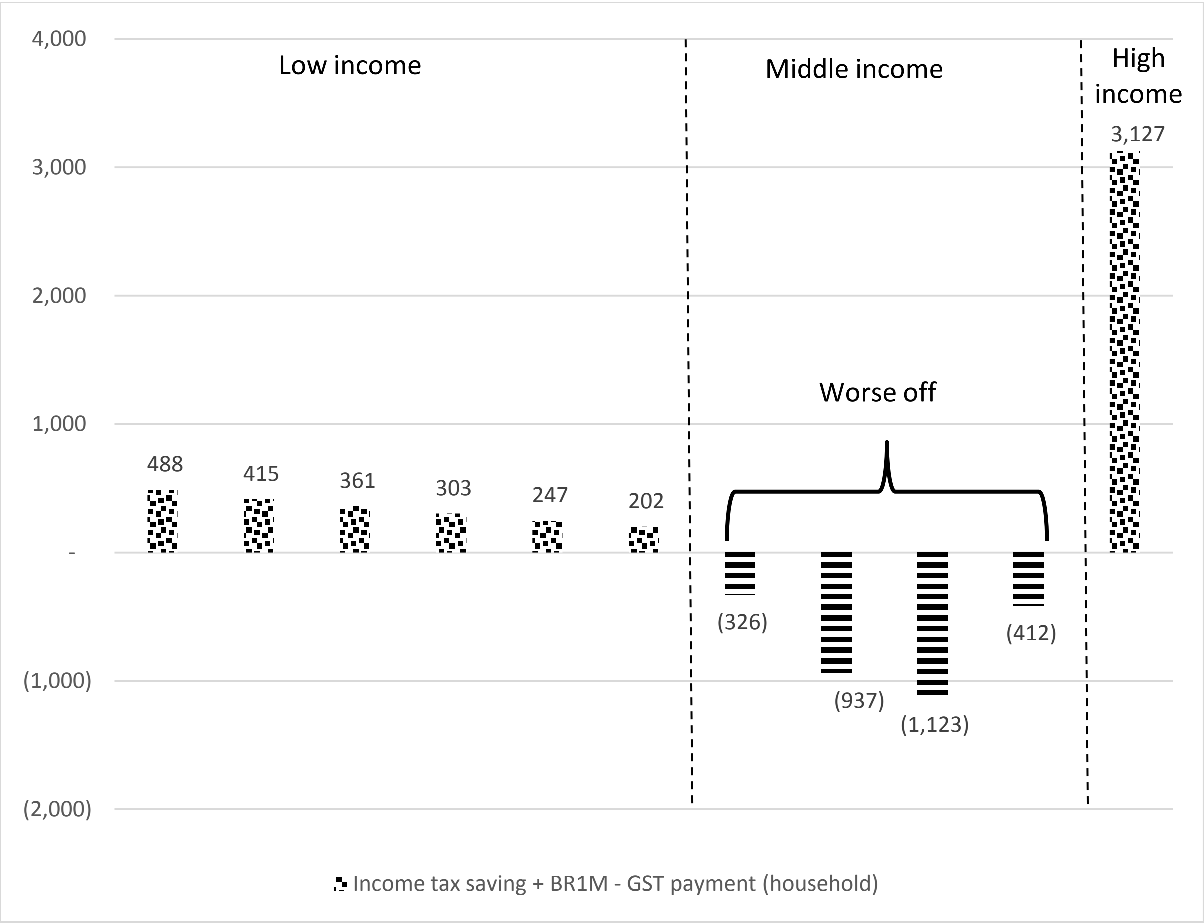
PENANG INSTITUTE
making ideas work

Penang Institute
(Co. No. 423660A)
10 Brown Road,
10350 Penang,
Malaysia

(604) 228 3306
(604) 226 7042
www.penanginstitute.org
enquiry@penanginstitute.org

Combining these measures, Figure 3 below shows that: 1) low income households are better off by RM 202 to RM 488 – primarily from BR1M; 2) highest income households who earn on average about RM 370,000 per annum will benefit with extra cash of RM 3,127 per year – mainly from savings in income tax; but 3) middle income households will suffer cash outflow of up to RM 1,123 per year – due to GST payments exceeding income tax savings. These middle income households have current annual income between RM 30,000 to RM 150,000.

Figure 3: Net effect of BR1M plus income tax savings minus GST payment as per Budget



To conclude, the three points to be highlighted to the Minister are:

1) a tax is usually benchmarked against the level of income to measure the impact of a tax on the rich vs. poor;

PENANG INSTITUTE
making ideas work

Penang Institute
(Co. No. 423660A)
10 Brown Road,
10350 Penang,
Malaysia

(604) 228 3306
(604) 226 7042
www.penanginstitute.org
enquiry@penanginstitute.org

2) despite setting essential items like basic food, public transportation, education and healthcare as exempt or zero rated items, GST is a regressive tax where the low and middle income households will pay higher GST as a proportion of their income; and

3) combining GST with the measures announced in the Budget (BR1M, income tax band widening and tax cuts), the net effect for the middle income households, who tend to have current annual income between RM 30,000 to RM 150,000, is cash outflow. This indicates that the 2014 Budget is unfavourable to these middle income households.