

## UNDERSTANDING AND PREPAREDNESS OF MANUFACTURING COMPANIES TOWARDS THE PROPOSED GOODS AND SERVICE TAX IN MALAYSIA

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### ABSTRACT

*The Malaysian Government announced that the Goods and Services Tax (GST) would replace of Sales and Service Tax on 1 April 2015. The government would implement the GST system once everyone understands and familiar with the system. This study is aimed to discover the understanding and preparedness towards the implementation on the GST among managers in manufacturing companies in Malaysia. Two constructs namely understanding and preparedness were used to measure the GST perceptions. A survey was conducted by using mailed questionnaire to acquire the data from 2,600 managers of manufacturing companies throughout Malaysia. Only 173 responded where two questionnaires were found unusable giving almost 7% response rate. Data were analyzed using descriptive statistics. The reliability and validity tests were also performed on the two constructs. Overall, the results indicated that manufacturing companies in Malaysia have good understanding and well prepared towards the GST. All the items loading in the two constructs except one item (slightly less than 3.0) have mean score of above 3.00. The results of reliability for both constructs had shown the Cronbach alpha value above 0.70. Furthermore, the results of construct validity for both constructs also shown KMO values are more than 0.80. The results of the study provide invaluable inputs for the Government to implement GST to manufacturing companies in Malaysia.*

**Keywords:** Understanding, Preparedness, Goods and Service Tax

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### 1. Introduction

The introduction of a Goods and Services Tax (GST) has been discussed for many years in Malaysia. Present Prime Minister of Malaysia said that the implementation of GST is to help the country overcome deficit in tax revenue as a result of reduction in oil revenue. GST would be introduced structurally to ensure that the new tax would be naturally equal to the current sales and service tax so as not to burden the Malaysian public. GST is a multi-stage tax on domestic consumption. GST is charged on all taxable supplies of goods and services in Malaysia except those specifically exempted. GST is also charged on importation of goods and services into Malaysia. GST aims not to tax the essential and fundamental goods and services as these goods and services would be exempted. The scope of charge on goods and services would be broadened so that the country would not depend solely on one sector to generate income to develop the nation. The collection system would be enhanced to ensure its collection is at its very efficient level. The reason the Malaysian Government proposes to implement GST is to ensure the country's fiscal is on a firmer ground in its quest to be a high income economy in the following decade. According to Grandcolas (2005), GST would be a major source of revenue for a government if it is adopted. In Malaysia, according to the Bank Negara Annual Report, the revenue from sales and service tax comprised 10.6% of the total federal taxes in 2004.

GST will make the current taxation system in Malaysia more comprehensive, efficient, effective, transparent, and business friendly. The abolishment of sales and service tax would make way for GST, which is considered as a more efficient taxation system in terms of cost. Businesses are expected to benefit as the cost of doing business would be lower and the GST is not considered as cost to the business. Furthermore, GST would be able to reduce bureaucratic practices in the management and administration of the tax system that exist in the current sales and service tax. GST would substantially improve the overall tax administration in establishing an integrated tax system and development of modern procedures based on voluntary compliance (Kasipillai & Liew, 2005). In short, if GST is introduced in Malaysia, it will achieve three main criteria of a taxation system: efficiency, equity and tax revenue productivity (Bardai, 1993). GST is viewed as a more structured and transparent form of taxation (Kasipillai & Liew, 2005).

The Malaysian general public is concerned that GST would adversely affect the distribution of their real income. They argued that the implementation of GST should be made at an appropriate time as current cost of living is at very high and the economy is growing at a slower phase. There is also the equity concern as this tax would increase the price of commodities of basic needs which could disproportionate the impact on real income of the poor. Currently the lower income group does not pay tax but when GST is implemented they might pay taxes for the goods and services consumed. The public is concerned with the initial rise in the price of goods and services, as evidenced by several countries that have implemented it.

It is important to know the view or perception of manufacturing sector. Almost all supplies in the manufacturing sector are subjected to GST including sale of finished goods, stocks, capital assets and services rendered to other establishments. As a registered person, a manufacturer is therefore responsible for accounting output tax on their taxable supplies, and on the other hand, is eligible to claim input tax on expenses which they had incurred for the furtherance of their business. For the purpose of GST, the activities carried out by a manufacturer can be categorized as input activities and output activities. Payment of tax is made in stages by the intermediaries in the production and distribution process. Thus, this study attempted to investigate the understanding and preparedness of managers in manufacturing companies toward the proposed implementation of GST in Malaysia.

## 2. Literature Review

### 2.1 Goods and Services Tax

In Malaysia, the Royal Customs under the Ministry of Finance would be the governing body that deals with all matters regarding GST. In other words, the Royal Customs of Malaysia would be the tax authority for GST, which receives remittance, processes refunds, claims on input taxes and other matters related to GST. The GST tax is charged at every production process and the amount collected at each stage is based on the value added at that stage. GST involves the input tax credit method where the differences between GST on sales and GST paid on the inputs are calculated. GST is also known as consumption type where the tax base is private domestic consumption. The current sales tax and service tax (SST) is a single stage tax but GST is a multi-stage tax which is more complex than sales and service tax in terms of its cost of compliance and administration (Kasipillai & Baldry, 2005). The GST is seen as more efficient, economically and more viable than SST, and has compliance advantages too. GST taxes on the value added on product or services in each stage of business in the economy.

An exemption from GST is made based on certain characteristics of businesses, turnover, and specified threshold level. Those who are GST exempted are not eligible for input tax credit claim on their input purchases. If the exemption is based on particular commodities that are not charged with GST then the cost of administration and enforcement would be lower as it is not related to the number of taxpayers. When exemption for GST is given, revenue to the government is sacrificed. The effective rate for GST is thus reduced in the exempted business which violates the efficiency criteria. Many small businesses are insignificant taxpayers and are given exemption is. The determination for exemption would be much more difficult for financial services, gambling, second hand goods and auctions (Kasipillai & Baldry, 2005). Thus a special exemption and rule is needed to sort these difficulties. This is because the exemption effect on GST would reduce the cost of compliance and administration cost which has a major impact on economy efficiency. In most countries that implement GST, businesses and goods and services that are exempted are: financial transactions (life insurance and banking), medical services, charitable activities, sale of newspaper, periodicals and books, sale of agricultural products and food, and small businesses with annual turnover below a certain limit. In Malaysia the proposed exemption are on basic necessities and services such as basic food stuff, residential accommodation, education, health services, public transportation, domestic water and electricity supply up to a certain limit ("GST", 2010).

GST has a self-enforcing element since the input credit is based on invoices. A taxable business can claim with evidence of purchase invoices and needs to maintain the invoices of the transaction made and kept them for tax officers to audit. Proper invoicing by maintaining records enforces GST compliance. Tax evasion is expected to be reduced when GST is implemented since it cannot be easily avoided due to lack of discretionary element. A GST liability is where revenue received from the sales of goods is less the input cost incurred, which means that possibility to avoid zero rated business is minimal. Evasion in GST means that business could understate their revenue and overstate the tax on input cost by falsifying the documents. For them to be able to do requires collusion between businesses. In order to understate revenue the seller must be able to induce the purchaser to accept an invoice less than the actual amount charged for a commodity. If the buyer is a customer, the purchase is made by offering discounts. Collusion incentives would increase evasion in GST (Kasipillai & Baldry, 2005).

GST is intended to make revenue collection more efficient and it is also meant to benefit businesses. GST would able to clear areas of ambiguity in the current distortional sales and service tax regime and create a more transparent system. GST would not be a tax burden for the business community as there is a rebate that could be claimed at each level of the supply chain. A proper planning would in fact reduce the inflation and the national budget could be balanced without any deficit. Singapore was able to reduce the inflation rate to less than 1% in 2005 and Australia has reduced the corporate rate to 30% after one year implementing the GST from 34%. In Malaysia, the proposed GST would have an effect on the compliance level if GST adds an extra cost especially to the business community. If GST is perceived as fair and equitable, it will instill confidence among the taxpayers in Malaysia, and hence result in compliance behavior. Tax fairness refers to a tax system that is reasonable, right and just; and tax equity is where the tax system treats every taxpayer equally. These two elements are important in determining the compliance level or behavior towards GST.

### **3. Methodology**

#### **3.1 Population and Sample**

The population of the study was manufacturing companies in Malaysia. Therefore, the unit of

analysis for the study consists of managers of manufacturing companies who are members with Federation of Malaysian Manufacturer (FMM). The lists of the manufacturing companies were obtained from FMM Directory of Malaysian Industries (2013). Thus, the sampling frame of the study was from FMM directories. According to the directories, there are more than 2,600 manufacturing in all over the country in Malaysia. Roscoe (1975, as cited in Sekaran, 1992) suggests that for most research sample sizes more than 30 and less than 500 are appropriate. Since a mail survey approach was used, 2,600 questionnaires were mailed to the manufacturing companies' manager throughout the country in order to compensate for the inherent disadvantage of low return rates associated with a mail survey.

### 3.2 Research Instrument

This research adapts the instrument used by Hanefah, Kasipillai, Bardai (1995) and Zainol, Munusamy, Abdul Jabbar (2012) with some modification to suit the current environment. The modification is done because the respondent in their studies were the general public. This study focuses on managers of manufacturing companies about the perception on the proposed GST in Malaysia. The questionnaire is divided into three parts where Part I consists of 5 items to measure the understanding construct, Part II consists of 8 items to measure the preparedness construct and Part III consists of companies profile.

### 3.3 Data Analysis

Data on the demographic variable and the two main constructs gathered were analyzed using descriptive statistics. Reliability and validity tests were also conducted on the two constructs. The mean scores were used to determine the scores of the attributes. Cronbach's alpha was employed to test the reliability of the instrument. The validity of the instrument was ascertained based on the factor analysis.

## 4. Results

### 4.1 Descriptive Statistics

A total 2,600 questionnaires were mailed to companies' manager throughout Malaysia to respond to the survey. Within a month, 173 questionnaires were returned, out of which two were not usable because the respondents failed to complete fully all the parts in the questionnaire. Thus the final sample size was 171, giving a response rate of 6.6%, which is considered acceptable in a mail survey.

### 4.2 General Information

All questionnaires were received from all zones in Malaysia (northern, central, south, and east). The highest response rate comes from central (32%), followed by south (28.5%), northern (25%), and east (14.5%). Respondent in the manufacturing companies with the Finance manager position received the highest response rate of 30.1%. This followed by Director (25%), others (21%), Accountant 14%, and General Manager 9.5%.

### 4.3 Test of Reliability and Validity

The result of reliability test for the two constructs indicates that all the two constructs have achieved a good level of reliability. The cronbach alpha value for general perception and probable area of difficulties were is above 0.70. Hair, Anderson, Tatham, Black (1998) an alpha value of 0.60 is acceptable in exploratory studies. As such these constructs have achieved better value than the acceptable level of reliability. The factor analysis is used to determine the validity of the constructs. This analysis method is also used to determine the adequacy of the samples for the research with

the KMO (Kaiser-Meyer-Olkin) value. KMO measures the sampling adequacy which should be greater than 0.50 for a satisfactory factor analysis. All the two constructs have KMO value above 0.80 which is achieved the satisfactory level. Bartlett's Test of Sphericity tests whether the correlation matrix is an identity matrix, which would indicate that the factor model is inappropriate. The Bartlett's Test of Sphericity shows all the constructs are significant at 0.000 which means the correlation matrix is not an identity matrix thus the factor model is appropriate.

#### 4.4 Understanding towards GST

Table 1 indicates the mean score of 5 items used to measure the understanding variables on GST of manufacturing companies' manager. Overall, the variable indicates that all statements on managers' understanding on GST shown a mean score above 3.00. The highest mean score of 4.00 was reported for the statement that companies agree that they understand that GST is a consumption tax. This followed by the statement that understand that GST is transaction based taxation, understand that GST is a stage by stage taxation, understand that in GST the collection and payment is on self-assessment basis, understand that the input tax credit is means of passing GST liability along the production/supply chain.

**Table 1:** Understanding on GST (n=171)

Item	Min	Max	Mean	Std. Deviation
1. Does your company understand that GST is a consumption tax?	1	5	4.0100	.77453
2. Does your company understand that GST is transaction based taxation?	1	5	3.9701	.80567
3. Does your company understand that GST is a stage by stage taxation?	1	5	3.8905	.82338
4. Does your company understand that the input tax credit is means of passing GST liability along the production/supply chain?	1	5	3.6617	.86312
5. Does your company understand that in GST the collection and payment is on self-assessment basis?	1	5	3.7512	.92618

#### 4.5 Preparedness on GST

Table 2 shows the respondents perceived the preparedness towards GST system. Overall, all managers of the companies perceived that the all statements on the variable shown a mean score above 3.00. The statement about that your company's agrees that business operation would have some changes when GST is implemented (4.33) is the highest score statement in relation to the proposed GST. The companies agreed that GST would affect your company's business cash flow ranked the second highest (4.16). The third ranking is the statement relation to the companies agrees that your company's cost of compliance cost would increase with introduction of GST (4.14). Other areas about the preparedness are shown in table 2.

**Table 2:** Preparedness on GST (n=171)

Item	Min	Max	Mean	Std. Deviation
1. Does your company agree that your company's business operation would have some changes when GST is implemented?	2	4	4.3333	0.75290
2. Does your company agree that there might some sort of potential impact of your company's business if GST is implemented?	1	5	4.0050	.83365
3. Does your company agree that GST would affect your company's business cash flow?	2	5	4.1642	.79869
4. Does your company agree that your company's would incur initial capital outlays (new equipment) for GST?	1	5	3.8010	.90565
5. Does your company agree that your company needs to re price their goods and services since GST is imposed on the inputs?	1	5	3.7662	.94871
6. Does your company agree that GST would have an impact on company's staff training?	1	5	3.8408	.82130
7. Does your company agree that your company's cost of compliance cost would increase with introduction of GST?	1	5	4.1393	0.79994
8. Does your company agree that your company need to review accounting system once GST is implemented?	1	5	4.1144	.80737

## 5. Discussion and Conclusion

The aim of this study was to explore the understanding and preparedness towards the implementation on the GST among managers in manufacturing companies in Malaysia. Results of the study indicate most of the manufacturing company's managers have a positive perception towards the understanding and preparedness on GST.

In general, this study found that the manufacturing company's managers indicated a positive perception towards the implementation of the proposed GST. This indication has a good sign for the government. This finding supported previous study conducted by Porcano and Price (1992), Christensen, Weihrich and Gerbing (1994) and Wartick (1994) which agreed that taxpayers with more tax knowledge would have a positive view about tax system. In order to enhance a positive perception among taxpayers, the government has continually provided information and education relating to GST. This is because a positive perception toward GST would encourage better GST compliance. Previous studies also have shown that perception or attitude has a significant impact on

compliance (Jackson & Milliron, 1986).

In order to assist business preparation toward accepting and complying with the new tax system, Government should develop a strategic approach to deal with the GST implementation. It is proposed that government agencies should aggressively promote GST to be more positive towards GST. For example government agencies such as the Royal Customs Department have to provide more training programs for taxpayers. assist taxpayers such as lack of GST knowledge among clients, the increased burden of documentation for record keeping, the need to upgrade the computerized system, getting refund from tax authority, enhancing the accounting system to accommodate for GST, clarity of goods and services that are taxable, maintaining records for clients, understanding the GST legislation, dealing with tax authority, and cooperation from clients. Besides that, the government needs to give incentive or subsidy to business community for initial cost (e.g. cost of GST software) such as by giving double deduction for allowable expenses. The government needs to take necessary action to enhance compliance when GST is to be implemented. In this context, by enhancing knowledge, the taxpayers would be more understand and prepare toward the implementation of GST. Knowledge is the most important part of implementing the tax. A high level of tax knowledge would help increase the level of tax compliance (Crane & Nourzad, 1990; Hanefah, 1996; Natrah, Muzainah & Idawati, 2003).

This study also has a limitation. The findings of this study were limited to manufacturing company's managers only. This study suggests that further studies could extent to widen scope by taking into consideration others business communities such as sole proprietor and partnerships and salaried group to get better insight into their perception towards GST. Besides that, there need for a continuing research to further examine the extent of the on-going compliance burden on business communities.

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