

SECTION 2:

FEDERAL GOVERNMENT REVENUE

- Overview
- Revenue in 2019
 - [Feature Article — Tax Reform Committee](#)
- Outlook for 2020
- Conclusion

SECTION 2: FEDERAL GOVERNMENT REVENUE

Overview

The Government will continue to strengthen its revenue management through several reform initiatives, particularly by improving the existing taxation system and enhancing revenue collection as a percentage to GDP. The initiatives will continue to focus on streamlining tax administration and reducing tax leakages, as well as promoting new investments in sustaining economic growth. Furthermore, the Tax Reform Committee (TRC) is reviewing measures to narrow tax gap, improve efficiency and enhance sustainable revenue collection. In this regard, priority reforms are centred on building a larger and consistent revenue base to foster inclusiveness; reviewing existing tax incentives to avoid distortion in resource

allocation, and strengthening overall tax administration as well as compliance to improve the effectiveness of tax collection.

In 2019, the Government has introduced several measures to improve revenue collection and broaden the tax base, which includes the Special Voluntary Disclosure Programme (SVDP), service tax on imported services and departure levy. Over a decade, the Government has reduced its dependency on petroleum-related revenue from 9.2% of GDP in 2009 to around 5% in 2019, indicating a more diversified tax base. Efforts to enhance the revenue base will provide additional fiscal space to increase the efficiency of income redistribution and achieve national socio-economic agenda.

Table 2.1. Federal Government Revenue 2018 – 2020

	RM million			Change (%)			Share (%)		
	2018	2019 ¹	2020 ²	2018	2019 ¹	2020 ²	2018	2019 ¹	2020 ²
Tax revenue	174,061	180,010	189,951	-2.0	3.4	5.5	74.7	68.4	77.7
Direct tax	130,035	135,639	142,676	12.1	4.3	5.2	55.8	51.5	58.4
<i>of which:</i>									
CITA	66,474	70,760	75,510	3.1	6.4	6.7	28.5	26.9	30.9
Individual	32,605	35,224	37,363	12.6	8.0	6.1	14.0	13.4	15.3
PITA	20,082	17,883	17,452	70.7	-10.9	-2.4	8.6	6.8	7.1
Indirect tax	44,026	44,371	47,275	-28.6	0.8	6.5	18.9	16.9	19.3
<i>of which:</i>									
GST/SST	25,680	26,800	28,300	-42.0	4.4	5.6	11.0	10.2	11.6
Excise duties	10,779	10,485	11,000	6.6	-2.7	4.9	4.6	4.0	4.5
Import duty	2,897	2,670	2,800	4.1	-7.8	4.9	1.2	1.0	1.1
Export duty	1,725	1,280	1,300	27.3	-25.8	1.6	0.7	0.5	0.5
Non-tax revenue	58,821	83,290	54,579	37.6	41.6	-34.5	25.3	31.6	22.3
<i>of which:</i>									
Licences and permits	14,027	15,204	15,177	9.8	8.4	-0.2	6.0	5.8	6.2
Investment income	31,889	59,500 ³	28,580	47.4	86.6	-52.0	13.7	22.6	11.7
Total revenue	232,882	263,300	244,530	5.7	13.1	-7.1	100.0	100.0	100.0
Share of GDP (%)	16.1	17.4	15.2						

¹ Revised estimate.

² Budget estimate, excluding 2020 tax measures.

³ Including one-off PETRONAS special dividend of RM30 billion.

Source: Ministry of Finance, Malaysia.

Revenue in 2019

Federal Government revenue in 2019 is anticipated to record a higher growth of 13.1% to RM263.3 billion due to one-off PETRONAS special dividend. However, tax revenue remains the major contributor which constitutes 68.4% of total revenue or 11.9% of GDP, while non-tax revenue represents 31.6% (5.5% of GDP). The revenue collection will be supported by continuous economic growth, coupled with measures initiated by the Government to enhance the revenue base.

Tax revenue is estimated to increase 3.4% to RM180 billion with the share of direct tax and indirect tax constituting 75.4% and 24.6%, respectively. **Direct tax** collection is anticipated to increase by 4.3% to RM135.6 billion contributed mainly by higher individual

and companies income tax (CITA) collection following measures under SVDP, continuous stable wage growth and corporate earnings. Under the SVDP, about 270,000 participants have voluntarily disclosed their undeclared income, and this is expected to raise an additional collection of RM6 billion. This measure has also contributed to the increase in individual and CITA collection to RM35.2 billion and RM70.8 billion, respectively. Meanwhile, services and manufacturing sectors are the largest contributor to CITA. Petroleum income tax (PITA) collection is projected to decline by 10.9% to RM17.9 billion in tandem with expected lower global crude oil prices averaging USD63 per barrel (2018: USD71 per barrel). Stamp duty and real property gains tax (RPGT) are estimated at RM6.3 billion and RM1.6 billion, respectively reflecting higher gain from property market transactions.

Feature Article

Tax Reform Committee

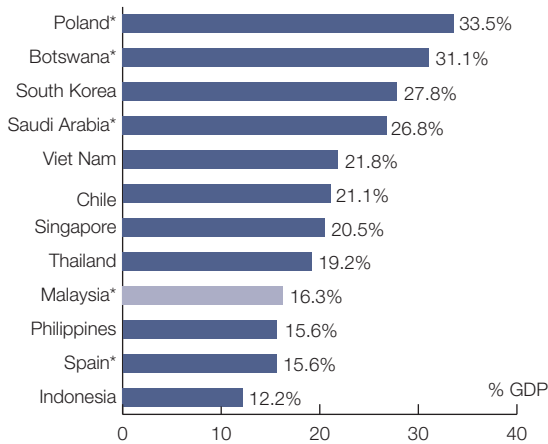
Introduction

The Government has announced the establishment of the Tax Reform Committee (TRC)¹ in September 2018, which comprises of experts and practitioners with vast experience in taxation. The committee aimed to review and propose measures in reforming the taxation system, which among others include streamlining tax incentives, narrowing the tax gap, enhancing tax efficiency as well as broadening and diversifying tax revenue. In carrying out the tasks, the Committee has conducted series of engagement with various stakeholders including government agencies, business communities, trade associations, accounting and tax consultant firms, professional bodies, analysts and rating agencies. The Committee was also involved in reviewing some measures which were announced in the 2019 Budget. These include the introduction of excise duty on sugar-sweetened beverages, the departure levy, service tax on digital services provided by offshore suppliers, review of the Real Property Gains Tax (RPGT) and the stamp duty rates as well as matters related to restriction on the carrying forward of business losses.

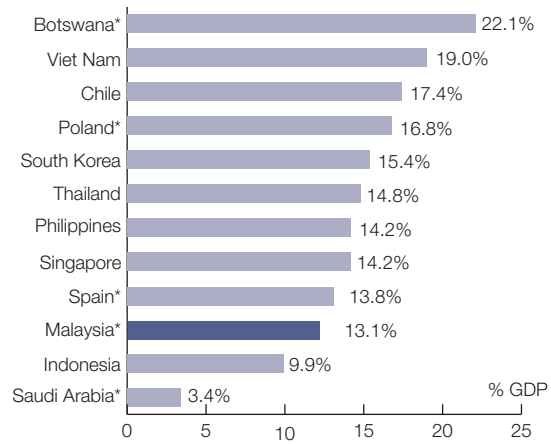
Current Scenario of the Malaysian Tax System

Federal Government's revenue growth has exhibited a declining trend, from an annual average of 10.7% for the period of 2000-2009 to 4.5% in 2010-2018, which lagged nominal GDP growth of 8.1% per annum in 2010-2018 (nominal GDP growth 2000-2009: 8.4%). In terms of percentage to GDP, total revenue recorded 20.9% compared to 19% during the same period. The following graph shows Malaysia's total revenue and tax revenue to GDP growth vis-a-vis selected countries.

¹ Independent committee members are Tan Sri Hasmah Abdullah, Dr. Veerinderjeet Singh, Dato' Chua Tia Guan, Dato' Khodijah Abdullah and Mr. Amardeep Singh.

Figure 1: Total Revenue relative to GDP of Selected Countries, 2017

Note: *Denotes A-rated countries i.e. Malaysia's rating peers.
Source: The World Bank.

Figure 2: Total Tax Revenue to GDP of selected Countries, 2017

The current tax revenue base in Malaysia is narrowed due to generous incentives, availability of various reliefs and reduction in tax rates. As at end-2017, 62.4% out of 1,251,190 companies were registered with Inland Revenue Board (LHDN) of which 7.8% are subjected to tax. Likewise, only 16.5% of 15 million workforces were subject to individual income tax. Despite the Government significantly reducing its dependency on petroleum-related revenue from 41.3% in 2009 to about 23% in 2018, the share is relatively substantial and could expose a risk, particularly when crude oil prices decline.

The World Bank Study in 2015 found Malaysia to be generous in giving out tax incentives. The concern is whether current investment incentives are effective in fulfilling Government objectives. Tax incentive granted to companies is a cost to the Government as it is measured by the amount of tax revenue foregone. Instead, the Government could utilise the revenue foregone for other development projects or lowering fiscal deficit. The incentives are also exposed to abuse resulting in unnecessary revenue loss to the Government. Therefore, it is timely to review the relevance, effectiveness and efficiency of the whole tax incentive structure both in the Promotion of Investments Act 1986 and Income Tax Act 1967.

Furthermore, there is a serious need to address the issue of tax evasion and underreporting of income which undermines the self-assessment system as well as public trust and confidence in the whole taxation system. In addition, the incidence of hidden, informal and hard-to-tax sectors creates an unfair advantage to those compliant taxpayers. Hence, it is crucial to include the tax evaders strategically into the tax net.

An effective taxation system requires establishing an environment in which taxpayers are induced to comply with taxation laws voluntarily, while an efficient tax administration requires the task to be performed at minimum cost to the community. Thus, compliance management is not just about audits, verifications and enforcement, but also about making compliance easy for taxpayers.

TRC Strategic Approach

TRC will focus on achieving the strategic objectives in improving the share of tax revenue-to-GDP and optimising tax revenue based on four pillars as follows:

- Reduce the tax gap, mainly informal and hard-to-tax sectors as well as widening the tax base through digitalisation and effective enforcement activities;
- Reduce tax leakages by reviewing existing tax incentives and legislations;
- Explore new sources of sustainable tax revenue such as digital and environmental tax; and
- Enhance tax administration by reviewing the legislation and simplifying administrative processes and procedures towards improving compliance.

Tax Reform Philosophy

In addressing current issues and challenges under the four pillars of tax reforms, measures will be based on principles of neutrality, equity and simplicity. Neutrality implies that, while the tax system raises revenue, it should not discriminate in favour of, or against, any particular economic sector. The principle of equity is categorised as horizontal equity (equal taxation of equal incomes) and vertical equity (higher taxation of higher incomes). For example, implementation of the departure levy as announced in the 2019 Budget, as well as amendments to the Real Property Gains Tax Act 1976 were based on the principle of vertical equity, where taxpayers contribute according to their ability to pay. This is generally reflected in taxation systems with a progressive income tax rate structure.

In addition, tax legislation, structures and procedures should be clear and simple to make it easier for taxpayers to understand their obligations and rights. The philosophy behind tax simplification is to encourage voluntary compliance. Studies on taxpayer behaviour indicate that improving services such as simplifying reporting, filing and paying taxes; issuing of clear guidelines on a timely basis; and providing assistance to lower compliance costs, is more effective in securing compliance than measures designed to counter non-compliance (Wenzel, 2004).

Another approach to enhance tax compliance is through inculcating responsibilities to pay tax as a national duty of every citizen, which creates a sense of pride for being able to contribute to the nation. These principles will encourage taxpayers, particularly from the informal economy into the tax base and reduce the level of tax evasion and avoidance. Thus, it is timely that the burden of compliance and accountability under both direct and indirect legislations be placed in the hands of the taxpayer.

Furthermore, relevant tax authorities should strive to ensure those who earn or derive taxable income are registered as taxpayers and file appropriate tax returns on a timely basis. The initiatives should encompass continuous education and outreach programmes by the tax agencies to assist potential taxpayers, especially those who have never filed tax returns or maintained proper records of a business, thus facilitating their transition into the tax bracket. In addition, authorities should also continue to undertake specific approach coupled with strong enforcement strategies towards non-compliant taxpayers.

Way forward

Effective tax administration requires establishing an environment or ecosystem in which citizens are encouraged to comply with tax laws voluntarily, while efficient tax administration requires that this task be performed at minimum cost. To continue to collect more tax revenue, the need

for effective enforcement by the tax authorities is an important component. It is timely that tax authorities are transformed into truly service-oriented entities which leverage information technology as well as redesign and streamline existing systems and procedures. The setting up of information gateway of integrated data will enable real-time information sharing and streamline the tax administration system, hence enhancing revenue collection and improving compliance.

High reliance on direct tax increases the vulnerability of revenue collection as it correlates with economic growth and the business cycle. Hence, rebalancing of direct tax toward indirect tax, mainly consumption-based tax does not only broaden the tax revenue base but also enhances tax buoyancy. There is growing global shift from direct to indirect tax as countries strive to boost sustainable tax revenue collection.

Conclusion

The Committee believes that the Government should enhance its effort to strengthen further the revenue stream. Measures to improve the existing tax system, including reviewing tax incentives, streamlining tax administration and exploring sustainable revenue sources are some of the possible options for the Government. Ultimately, the success of bringing in the potential taxpayers into the tax net is a prerequisite for widening the revenue base towards improving fiscal space.

Reference

World Bank. Retrieved on September 18, 2019 from <http://documents.worldbank.org/curated/en/182271468280761125/pdf/359340MY.pdf>.

Wenzel, M, "An Analysis of Norm Processes in Tax Compliance" 2004, *Journal of Economic Psychology*, Vol 25, No. 2.

Addressing The Tax Challenges of the Digital Economy, Chapter 2, page 30 & 31, *Fundamental Principles of Taxation*

Source: Tax Reform Committee.

Indirect tax collection is estimated to rebound marginally by 0.8% to RM44.4 billion contributed by higher Sales Tax and Service Tax (SST) collection. The SST which was originally forecast at RM22 billion in the 2019 Budget, was revised upwards to RM26.8 billion due to better-than-expected collection in the first half of 2019. Of this, sales tax collection is targeted at RM15.5 billion following higher demand on four wheels drive (4WD) and sports utility vehicles (SUV) as well as machines and spare parts. According to the Malaysia Automotive Association (MAA) report, 4WD and SUV vehicles sale for the first half of 2019 increased 77.4% compared to the corresponding period in 2018. In addition, service tax is estimated at RM11.3 billion, primarily contributed by higher demand for food and beverages sector followed by telecommunication and insurance sector.

However, export duty is expected to decline to RM1.3 billion due to lower crude oil price and export volume, in tandem with slowing global

demand growth amid doubts over ongoing trade conflicts. Likewise, excise duties collection is anticipated to decrease 2.7% to RM10.5 billion, following slower demand for Completely-Built-Up (CBU) vehicles and receipts from cigarettes. Excise duty on cigarettes is expected to decline further due to winding down of operations of tobacco companies in Malaysia and lower imports of cigarettes. In the first half of 2019, 3.2 billion cigarette sticks were imported compared to 3.5 billion sticks in corresponding period in 2018. Meanwhile, excise duty on sugar-sweetened beverages are expected at RM100 million since its implementation in July 2019.

In the 2019 Budget, a one-off special dividend of RM30 billion from PETRONAS was announced to partially finance the outstanding income tax and Goods and Services Tax (GST) refunds of RM37 billion. The balance of RM7 billion will be financed through the Federal Government revenue collected during the year. As at end-

August 2019, RM12.5 billion or 69.4% of RM18 billion allocation for outstanding income tax refund has been utilised. For GST, after taking into account the opening balance of RM3.9 billion in the GST Refund Trust Fund (TBBC GST) and the refund provision of RM19 billion in 2019, total funds available for GST refund is RM22.9 billion. As at end-August 2019, 66.4% or RM15.2 billion has been paid for GST claims.

Meanwhile, **non-tax revenue** is expected to increase significantly by 41.6% to RM83.3 billion, largely contributed by higher dividend from PETRONAS totalling RM54 billion, of which RM30 billion is a one-off special dividend. In addition, dividend from Bank Negara Malaysia totalled RM2.5 billion. Proceeds from licences and permits are expected to register RM15.2 billion, an increase of 8.4% mainly contributed by higher receipts from petroleum royalty, motor vehicle licences and levy on foreign workers.

In 2019, **petroleum-related revenue** is forecast at RM81.2 billion, including the one-off special dividend from PETRONAS of RM30 billion. However, after excluding the special dividend, total petroleum-related revenue is estimated to decrease by 6.1% in tandem with lower average crude oil price. In contrast, **non-petroleum revenue** is projected to increase 2.1% to RM182.1 billion following the Government's effort in widening the revenue base through various tax measures.

Outlook for 2020

In 2020, the Federal Government's revenue is projected to decline by 7.1% to RM244.5 billion. However, after excluding the one-off special dividend from PETRONAS in the 2019 revised estimates, the revenue is forecast to increase 4.8%. Tax revenue remains the major contributor to the Federal Government revenue with expected total collection of RM189.9 billion.

Tax revenue as a percentage to GDP is forecast to remain stable at 11.8%. The collection from **direct tax** is estimated to increase by 5.2% to RM142.7 billion constituting 75.1% of total tax revenue. The bulk of the increase is primarily attributed to better collection from CITA and individual income tax at RM75.5 billion and

RM37.4 billion, respectively. Higher collection from CITA is primarily contributed by better corporate earnings prospects and continuous efforts in enhancing auditing and tax compliance. At the same time, the Government will consider implementing measures proposed by the TRC in the medium-term, which is aimed at broadening the tax base and reducing the tax gap. Meanwhile, revenue from other direct tax comprising stamp duty, RPGT and other taxes is expected to increase by 7% to RM8.7 billion. The increase in stamp duty and RPGT to RM6.8 billion and RM1.7 billion, respectively are in line with the expected stable property market.

Indirect tax collection is anticipated to increase by 6.5% to RM47.3 billion, mainly contributed by higher collection from SST. In 2020, SST is forecast to register RM28.3 billion or about 1.8% of GDP in consonance with higher consumption, Visit Malaysia 2020 programme and various international events. The Government has set a target of 30 million tourist arrivals and RM100 billion in tourist receipts in 2020. Sales tax collection is projected to increase by 5.4% to RM16.3 billion, primarily contributed by machines and spare parts as well as sales of vehicles. Similarly, service tax is estimated at RM12 billion, largely contributed by higher demand for food and beverages sector followed by telecommunication and insurance sector. Excise duties collection in 2020 is expected to increase 4.9% to RM11 billion due to higher demand for motor vehicles. The MAA anticipates a 2% growth for total industry volume following continuous demand for new model of vehicles and aggressive promotional campaign by automotive companies. Meanwhile, export duty is expected to remain stable at RM1.3 billion.

In the absence of one-off special dividend from PETRONAS, **non-tax revenue** is estimated to decline by 2.4% to RM54.6 billion or 3.4% of GDP. The annual dividend from PETRONAS is projected at RM24 billion. Licences and permits is expected to decline marginally to RM15.2 billion on account of lower proceeds from petroleum royalty in tandem with the lower average crude oil price. However, other major components for licences and permits such as motor vehicles licences and levy on foreign workers are forecast to increase to RM3.4 billion, respectively.

In 2020, **petroleum-related revenue** is expected to register RM50.5 billion in line with the average world crude oil price at USD62 per barrel. Total petroleum-related revenue is estimated to decrease 1.4% as compared to 2019 (excluding one-off special dividend from PETRONAS) following lower crude oil price. However, **non-petroleum revenue** is projected to increase 6.6% to RM194.1 billion consistent with the Government's commitment to diversify revenue through tax reform initiatives. As a percentage to GDP, non-petroleum revenue is expected to remain stable at around 12.1% (2019: 12.0%). The Government will continue to widen non-petroleum revenue to drive a sustainable revenue stream in the medium-term.

Conclusion

The Government will enhance its revenue base, reduce the tax gap and improve tax efficiency to provide a sustainable revenue collection. This will be done through various initiatives, among others by rationalising tax incentives; minimising tax leakages; and enhancing tax compliance through effective auditing. The establishment of TRC will further improve revenue collection by reviewing existing tax system and exploring new sustainable sources. Tax policy enhancement will continue to uphold the principles of neutrality, equity and simplicity towards improving the nation's competitiveness.

Figure 2.1. Petroleum-Related and Non-Petroleum Revenue
(% of total revenue)

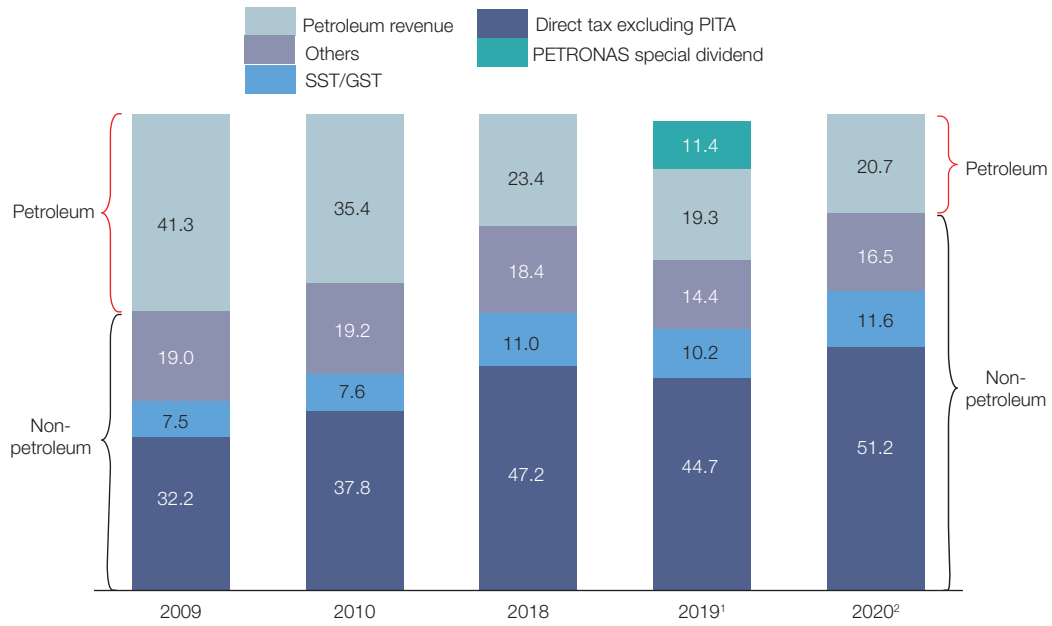
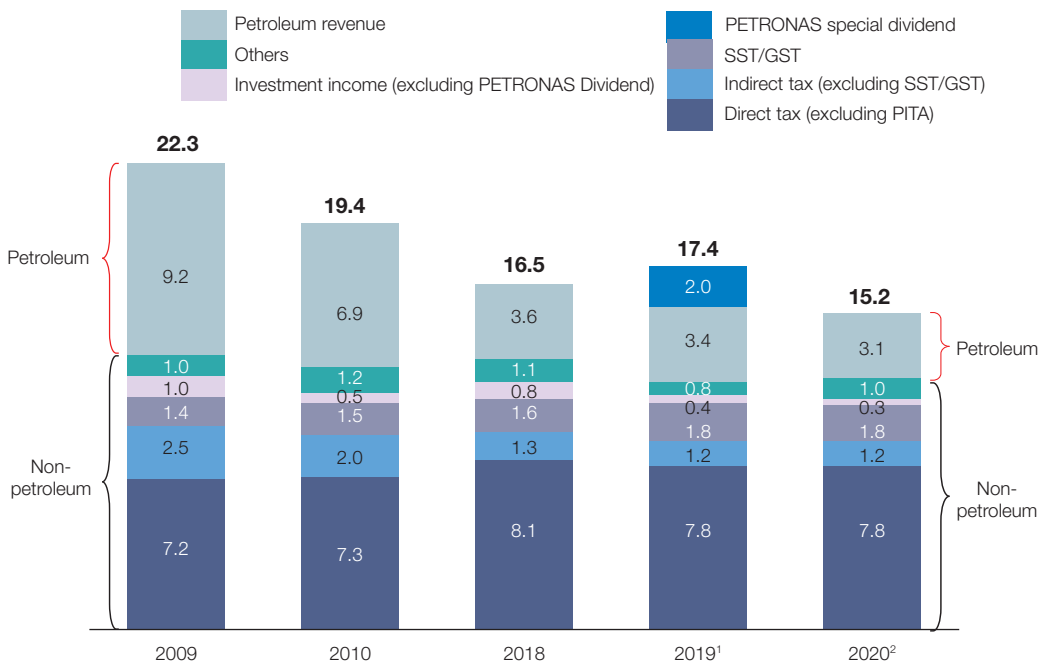


Figure 2.2. Revenue as Percentage to GDP



¹Revised estimate.

²Budget estimate, excluding 2020 tax measures.

Source: Ministry of Finance, Malaysia.