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SECTION 2

Federal Government Revenue

Overview

The Government will continue to bolster its revenue and tax management through comprehensive reform initiatives. A well-designed tax system is imperative to generate sustainable revenue for socio-economic agenda, nation building and country competitiveness. The principles of effectiveness, efficiency, equity and progressivity as well as simplicity are vital for the formulation of sound tax policy. These initiatives will emphasise on the optimisation of tax administration; minimise tax leakages and wastages; and facilitate new investments to sustain economic growth. In this regard, priority reforms are centred on building a wider revenue base to foster inclusiveness; rationalising existing tax incentives to avoid distortion in resource allocation; and strengthening tax compliance to improve the efficiency of tax collection with the ultimate goal to increase tax-to-GDP ratio.

Several new measures were introduced in the Budget 2023 to enhance revenue collection and broaden the tax base, specifically through the voluntary disclosure programme under the Inland Revenue Board and the Royal Malaysian Customs Department. These measures also include imposing capital gains tax, excise duty on liquid or gel products containing nicotine used for electronic cigarettes and vapes, as well as widening the scope of sugar sweetened beverages tax. These efforts will create additional fiscal space, thereby facilitating a more efficient income redistribution and the realisation of the national socio-economic agenda.

Revenue in 2023

Federal Government revenue is estimated to grow by 3% to RM303.2 billion or 16.4% of GDP compared to 2022. This revised estimate is higher by 4% or RM11.7 billion compared with the initial forecast of RM291.5 billion on account of higher tax revenue collection. Tax revenue is estimated to increase by 9.7% to RM229 billion or 12.4% of GDP driven by better collection of income taxes; measures announced in the Budget 2023; and continuous administrative efforts to expand the revenue base. Meanwhile, non-tax revenue is projected to record RM74.2 billion or 4% of GDP due to lower proceeds from investment income.

Direct tax is anticipated to increase by 12.7% to RM173 billion mainly driven by continuous corporate profitability, stable employment conditions and sustained wage growth. Companies income tax (CITA) remains the largest contributor to direct tax collection, which is expected to increase by RM16.3 billion to record RM98.4 billion, accounting for 56.8% of the total. The higher CITA is mainly attributable to approximately RM6 billion tax dues from Prosperity Tax for the assessment year of 2022 as well as robust business activities primarily from petroleum-related and banking sectors. Likewise, individual income tax is estimated to surge by 17.6% to RM39.7 billion in line with the revision of individual income tax rate for higher income band between 0.5% and 2%, for income range of RM100,000 to RM1 million as announced in the Budget 2023. However, petroleum income tax (PITA) is forecast to fall by 12.4% to RM20.5 billion in tandem with the expected

TABLE 2.1. *Federal Government Revenue 2022 – 2024*

COMPONENT	RM MILLION			CHANGE (%)			SHARE (%)		
	2022	2023[1]	2024[2]	2022	2023[1]	2024[2]	2022	2023[1]	2024[2]
Tax revenue	**208,765**	**229,020**	**243,620**	***20.2***	***9.7***	***6.4***	***70.9***	***75.5***	***79.2***
Direct tax	153,476	173,020	185,000	*18.0*	*12.7*	*6.9*	*52.1*	*57.0*	*60.1*
of which:									
CITA	82,133	98,435	106,420	*2.9*	*19.8*	*8.1*	*27.9*	*32.5*	*34.6*
Individual	33,776	39,725	42,460	*24.9*	*17.6*	*6.9*	*11.5*	*13.1*	*13.8*
PITA	23,421	20,520	21,750	*102.4*	*-12.4*	*6.0*	*8.0*	*6.8*	*7.1*
Indirect tax	55,289	56,000	58,620	*26.8*	*1.3*	*4.7*	*18.8*	*18.5*	*19.1*
of which:									
SST	31,368	34,200	35,800	*22.5*	*9.0*	*4.7*	*10.7*	*11.3*	*11.6*
Excise duties	12,556	13,100	13,600	*22.6*	*4.3*	*3.8*	*4.2*	*4.3*	*4.4*
Import duty	3,192	3,038	3,200	*20.7*	*-4.8*	*5.3*	*1.1*	*1.0*	*1.0*
Export duty	2,622	1,800	1,900	*27.5*	*-31.4*	*5.6*	*0.9*	*0.6*	*0.6*
Non-tax revenue	**85,592**	**74,180**	**63,980**	***42.5***	***-13.3***	***-13.8***	***29.1***	***24.5***	***20.8***
of which:									
Licences and permits	15,626	15,465	14,611	*47.7*	*-1.0*	*-5.5*	*5.3*	*5.1*	*4.8*
Investment income	58,223	47,775	39,710	*66.3*	*-17.9*	*-16.9*	*19.8*	*15.8*	*12.9*
Total revenue	**294,357**	**303,200**	**307,600**	***25.9***	***3.0***	***1.5***	***100.0***	***100.0***	***100.0***
Share of GDP (%)	***16.4***	***16.4***	***15.6***						

[1] Revised estimate
[2] Budget estimate, excluding 2024 Budget measures
Source: Ministry of Finance, Malaysia

moderation in global crude oil prices averaging at USD80 per barrel (2022: USD100 per barrel). Stamp duties is expected to grow by 4.5% to RM8.4 billion reflecting higher transaction in property market. In addition, Labuan Offshore Business Activity Tax is projected to increase substantially by 69.6% to RM1.4 billion as a result of better earnings from petroleum-related activities.

Indirect tax is estimated to increase marginally by 1.3% to RM56 billion or 18.5% to total revenue following strong business and consumption activities. Sales tax and service tax (SST) which represent the largest share of indirect tax of 61.1%, is anticipated to expand by 9% to RM34.2 billion, constituting 1.9% of GDP. This reflects sustained expansion in domestic economic activity. Sales tax is projected to improve by 8.3% to RM17.6 billion mainly attributed to favourable outlook in the automotive industry, machines and spare parts as well as resins and plastic materials. Similarly, service tax is estimated to increase by 9.8% to RM16.6 billion contributed by food and beverages followed by telecommunication and insurance sectors. Excise duties are expected to increase by 4.3% to RM13.1 billion mainly driven by anticipated strong demand for motor vehicles, following new model launches and improved industry supply chain. This is also in line with Malaysian Automotive Association's upward revision of the total industry volume for passenger vehicles by 1.7% to about 652,500 units for the year.

Non-tax revenue, accounting for 24.5% of total revenue, is expected to decline by 13.3% to RM74.2 billion as a result of lower investment income receipts. The proceeds from investment income is estimated to record RM47.8 billion, owing to lower dividend receipts from PETRONAS at RM40 billion (2022: RM50 billion) and Bank Negara Malaysia (BNM) at RM2.75 billion (2022: RM5 billion). Furthermore, receipts from licences and permits are expected to record RM15.5 billion (2022: RM15.6 billion) due to lower proceeds from motor vehicle licences and levy on foreign workers which are estimated at RM3 billion and RM3.2 billion, respectively. However, the lower investment income collection is cushioned by higher receipts from petroleum royalty amounting to RM6.8 billion (2022: RM6 billion). In addition, the Government is also projected to receive a special payment of RM3 billion from the Retirement Fund (Incorporated) (KWAP) to partly finance the retirement charges for this year.

In 2023, the share of **petroleum-related revenue** is projected to be lower at 23% of total revenue (2022: 28%) in tandem with lower global crude oil prices and dividend receipt. Meanwhile, the share of **non-petroleum revenue** is estimated to improve to 77% (2022: 72%), increasing by 10.1% to RM233.4 billion (2022: 11.2%; RM211.9 billion). The higher collection from non-petroleum revenue indicates continuous efforts by the Government to reduce reliance on petroleum-related revenue following its depleting resources. In the meantime, other sources of revenue remain fairly diversified. Hence, the Government will enhance its non-petroleum revenue base particularly through the implementation of the recommendations stemming from the tax reform initiative.

FEATURE ARTICLE

Unravelling the Conundrum of Consumption Taxes: A Closer Look at the Distinctions between the SST and the GST/VAT

Introduction

Taxation serves as the primary source of funding for the government operation to uphold nation-building, which will contribute towards economic stability and social well-being. A well-designed tax system is essential to generate sufficient revenue for infrastructure, healthcare, education, welfare and improved services. Moreover, an efficient tax structure will enhance the nation’s competitiveness, particularly by providing a conducive business environment as well as ensuring convenience to enhance the willingness among taxpayers to pay taxes.

A sound tax system is premised on the principles of neutrality, efficiency, certainty and simplicity, effectiveness and fairness, as well as flexibility in line with international best practices. Based on these principles, Malaysia went through numerous phases of tax reforms over the years to respond to economic shifts, administrative efficiency and global trends. The primary focus of these reforms has been on enhancing revenue collection, minimising tax evasion and avoidance as well as simplifying the tax structure. The most notable tax changes and transformations were the implementation of the Goods and Services Tax (GST) in 2015, followed by the reinstatement of the Sales Tax and Service Tax (SST) in 2018.

The Concept Of Consumption Tax

Consumption taxes, which are categorised as indirect taxes, are imposed on the amount spent on goods and services by individuals and businesses. These taxes are levied onto goods and services and imposed on the consumer through the purchase price. According to the Government Finance Statistics Manual 2014 published by the IMF, taxes on goods and services are payable upon the production, sale, transfer, leasing or delivery of goods; and rendering of services. Thus, depending on the country, consumption taxes terms may include the following:

1. **Sales Tax:**
   A single-stage tax imposed on taxable goods manufactured locally by a registered manufacturer and on taxable goods imported by any person or businesses. The tax rate can vary based on the jurisdiction and the type of goods being sold.

2. **Service Tax:**
   A tax imposed on certain prescribed services rendered by any taxable person or service providers.

3. **Value-Added Tax (VAT)/Goods and Services Tax (GST):**
   A multi-stage tax levied on goods and services at each stage of the supply chain. Registered businesses collect the tax from the sales and deduct the tax paid on purchases incurred at the previous stage, remitting the differences to the government.

4. **Flat-Rate Consumption Tax:**
   This is a straightforward tax applied to all consumption, usually at a fixed rate. It does not differentiate between different types of goods or services and does not involve the complexities of tracking value added.

5. **Excise Taxes:**
   A tax on specific goods, such as alcohol, tobacco and fuel, often considered harmful or subject to specific regulatory considerations.

Revenue from consumption taxes as a share of GDP are relatively stable over time compared with taxes on income. Income taxes are imposed on earnings, whereas consumption taxes zeroes-in on spending patterns and economic activities. In this regard, the imposition of consumption taxes may encourage individuals to save more and subsequently lead to higher capital accumulation within the economy. However, the consumption tax is generally regressive in nature and may burden low-income households as they spend a bigger proportion of their income on consumption as compared to higher income households.

In addressing the regressive impact of the consumption tax, necessary adjustments to the tax designs is essential to ensure the tax burden is equally distributed across various income groups. As such, essential items will be subjected to lower tax rates or exemptions, while luxury goods and non-essential services will be imposed with higher tax rates. This approach ensures a more progressive and socially just tax system.

In addition, the principles of simplicity in consumption tax focus on streamlining tax codes, which eliminates or reduces complex deduction and exemption process associated with income taxes. The simplification will benefit taxpayers, making tax compliance and administration become more straightforward while benefiting government agencies by enhancing tax collection efficiency and reducing administrative burden.

Malaysia's Consumption Tax

Milestone

Malaysia has undergone significant changes in its consumption tax system, experiencing both the single-stage as well as the multi-stage tax systems as follows:

1. **Sales Tax and Service Tax (SST):** A single-stage tax system that has been in place since 1972. SST comprises two independent taxes, governed by separate legislations, namely the Sales Tax Act 1972 [*Act 64*] and the Service Tax Act 1975 [*Act 151*]. Sales tax is generally an ad valorem tax with a rate imposed at 10%. However, certain goods are taxed at 5%, while others are taxed at specific rates or are specifically exempted. Goods that are exempted and taxable at 5% are determined based on the Harmonised Commodity Description & Coding System. Meanwhile, the service tax ad valorem is imposed at 6% for all taxable services including digital services, except for the provision of the charge card or credit card services, which are taxed at a specific rate.

2. **Goods and Services Tax (GST):** In April 2015, Malaysia introduced the GST, a broad-based multi-stage consumption tax to replace the existing SST. The tax was governed under the Goods and Services Tax Act 2014 [*Act 762*]. It was aimed at streamlining the tax structure to be more efficient, effective, transparent and business-friendly. The introduction of GST has allowed for the enhancement of revenue collection, reduction of tax evasion and conformity to international best practices. The GST was designed to incorporate several features to make it less regressive at a low standard rate of 6%, which includes the zero-rating of certain supplies of essential items and exempting certain supplies such as education, healthcare, financial services and public transport. Nevertheless, the GST was abolished in May 2018.

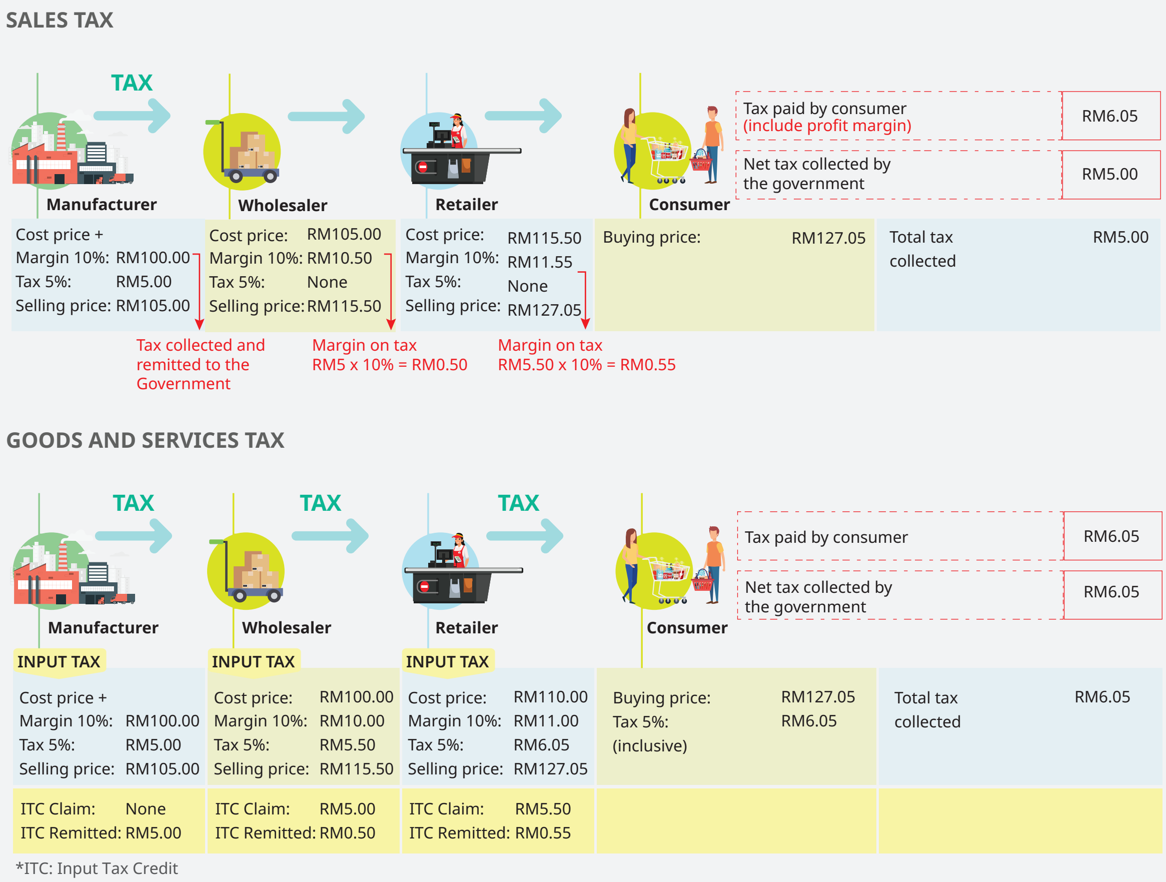
3. **Reintroduction of SST:** The Government has reinstated the SST under the new Sales Tax Act 2018 [*Act 806*] and the Service Tax Act 2018 [*Act 807*] which came into effect on 1 September 2018 to replace GST. The system incorporates enhancements to minimise the inherent weaknesses associated with SST and increase tax efficiency, while maintaining the salient features of the previous SST.

Comparison between SST and GST

Features	SST	GST
Theoretical base	• Single-stage tax levied at any one level in the value chain. Sales tax is imposed at manufacturing level and imports. Service tax is imposed when any taxable service is provided by a taxable person. • Applies to specific goods and services, often with varying tax rates for different categories. • Narrower tax base.	• Multi-stage tax levied on goods and services at each stage of the supply chain. • Broad-based consumption tax imposed on value-added of goods or services at each stage of the production and distribution chain. • The tax does not constitute as a cost to business as the tax on input is claimable.

Features	SST	GST
Tax rate	• Sales Tax: 10% • Other rate: 0%, 5% • Service Tax: 6%	• Standard rate: 6% • Other rate: 0%
Cascading effect	Cascading effect happens when the tax element is embedded into the cost at each successive stage in the supply chain. At the same time, the overlapping of two separate tax systems, causing a cascading effect where an item may be taxed twice.	No cascading effect as tax on input is recoverable and not embedded in the cost.
Relief for exports	Exports are not taxed, yet a cascading effect may increase cost of exports.	All exports is zero-rated, allowing for the identification of hidden consumption taxes which are eligible for rebates.
Transparency	Less transparent to consumers as the tax may be embedded in the price of goods and services.	More transparent to consumers as the tax is explicitly shown in the final price of goods and services.
Impact on Consumers	Sales tax is only charged at the manufacturer's level, which is indirectly compounded along the distribution chain and added to the tax element and the cost of product sold.	Cost to business owners can be reduced as businesses can claim input tax credits from the Government. Hence, final price may be lower since it is not impacted by tax cascading effect.
Revenue Generation	SST might generate less revenue due to its narrower tax base.	GST has the potential to generate more revenue with a broader tax base.
Tax Evasion and Compliance	SST is only imposed on certain goods and services, therefore classification of the taxable status of an item or service may contribute to compliance issues, leading to tax evasion.	Self-policing mechanism in GST can encourage better compliance and reduce tax evasion.
Economic Impact	As the scope of tax is limited, SST may not pose a significant impact on consumers.	As the scope of tax is broader, the GST impact on consumers may be significant. Nevertheless, the additional revenue collection can support economic activities and enhance socio-economic welfare. Additionally, GST has the capacity to reduce the size of shadow economy, hence benefitting the economy.
Red tape for tax free materials	Registered manufacturers are required to apply for exemption certificate to acquire tax free materials.	GST is self-policing and taxable persons may offset any input tax credit incurred against output tax liability.

FIGURE 1. *Features and Calculation Mechanisms*



Source: Ministry of Finance, Malaysia

Challenges and Best Practices of Consumption Taxes

The adoption of a consumption tax system offers numerous advantages, including promoting savings and streamlining tax administration. However, similar to other taxation model, consumption taxes also have its own challenges. Hence, it is essential to understand and address these challenges in order to reap the benefits, while mitigating potential pitfalls. The key challenges and best practices associated with the implementation of consumption taxes, among others, are as follows:

Challenges:

1. **Tax evasion and avoidance**: Consumption taxes are susceptible to evasion and avoidance, especially in cases where there are complex rules, regulatory loopholes or inadequate enforcement mechanisms.

2. **Regressivity**: Consumption taxes are deemed to be regressive as the same rate is imposed on the goods purchased, irrespective of the purchasers' income levels.

3. **Complexity**: Consumption tax system's design and implementation may create complexity for businesses, taxpayers and tax authorities, particularly if the system contains multiple tax rates or exemptions.

4. **Administrative burden**: Consumption taxes implementation requires efficient tax administration processes that facilitates registration, reporting and auditing. However, the increase in administrative cost will burden both taxpayers and tax authorities.

5. **Tax incentives and exemptions**: Consumption taxes can be used to mitigate the impact of higher prices on essential goods and services through incentives, reduced rates and tax exemptions. However, these actions could create market distortions, which consequently affect the overall economy.

6. **Cross-border transactions**: Consumption taxes in the case of cross-border trade taxation can be complex due to variations in tax regimes, risk of tax evasion and the need for reciprocal arrangements.

7. **Transition period**: Consumption tax system's introduction or replacement poses transitional challenges, including the requirements of new compliance, systems and practices.

Best Practices:

1. **Broad-base and low rate**: A broad-base tax combined with low and uniform tax rates could minimise market distortions and tax evasion.

2. **Simplified structure**: A simple tax structure which has fewer rates and exemptions, can enhance compliance and ease administrative burden.

3. **Effective infrastructure**: A robust and efficient infrastructure facilitates the communication between taxpayers and authorities, making tax administration and reporting more efficient and effective.

4. **Robust enforcement:** Tax evasion can be deterred by strengthening enforcement mechanisms, such as auditing capabilities and penalties for non-compliance.

5. **Clear communication:** Educating taxpayers and businesses about the tax system, the obligations and current development is crucial for smooth implementation and compliance.

6. **Mitigating regressivity:** Regressive effects can be addressed through specific mechanisms, such as targeted subsidies or cash transfers, aimed at mitigating the impact on lower-income individuals.

7. **Regular review and update:** Tax policy effectiveness is contingent upon continuous review of the tax system to adapt to changing economic conditions and address emerging challenges.

8. **Transparency**: Transparent reporting and effective communication on tax policies, rates and revenue utilisation can enhance public trust and compliance.

9. **Stakeholder engagement**: Engagement with various stakeholders, such as businesses, trade associations and tax experts can offer valuable insights for the development and improvement in the tax system.

Conclusion

Consumption taxes play a crucial role in complementing income taxes. An effective consumption tax policy has the potential to enhance the overall tax system that is economically efficient and socially equitable. The assessment on consumption taxes, specifically SST and GST, offers a profound understanding of Malaysia's tax landscape which exhibit a variety of options in the tax implementation and administration in fulfilling the targeted policy objectives.

The SST, characterised by its narrower scope that concentrates on specific goods and services, serves as a subtle strategy in consumption tax. On the other hand, the GST model broadens the tax base; enhances compliance and transparency; improves efficiency and business-friendliness; and mobilises efficient revenue collection. Despite the differences in structures, both the SST and GST offer an important fiscal tool for the country to fund government's programmes and projects for the benefit of the people. The choice between SST and GST hinges on the nation's economic goals, administrative capabilities and the need to achieve an optimal balance between revenue generation and the promotion of fairness and equity among the rakyat.

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Outlook for 2024

Federal Government revenue in 2024 is anticipated to record a marginal growth of 1.5% to RM307.6 billion in line with better economic prospects. Tax revenue remains as the major contributor which constitutes 79.2% of total revenue or 12.3% of GDP, while non-tax revenue represents 20.8% (3.2% of GDP). The revenue collection will be supported by robust economic growth, coupled with measures initiated to further enhance the revenue mobilisation through broadening the tax base as well as improving tax compliance and transparency. Furthermore, several measures will be implemented, among others the introduction of Capital Gains Tax for the disposal of unlisted shares by companies and e-invoicing.

The collection from **direct tax** is estimated to increase by 6.9% to RM185 billion or 75.9% of total tax revenue. The bulk of the increase is primarily attributed to continuous higher collection from CITA and individual income tax at RM106.4 billion and RM42.5 billion, respectively. The increment in CITA is primarily contributed by better corporate earnings prospects and continuous efforts in enhancing audit and tax compliance. Similarly, individual income tax is projected to increase by 6.9% in tandem with better outlook in unemployment rate and annual wage growth. Likewise, PITA is expected to record a stable collection at RM21.7 billion on account of steady average crude oil prices averaging at USD85 per barrel. On the other hand, revenue from other direct tax comprising stamp duty and real property gains tax is expected to register RM8.6 billion and RM0.8 billion, respectively, in line with better property market outlook.

Indirect tax collection is anticipated to increase by 4.7% to RM58.6 billion, mainly contributed by higher collection from SST. In 2024, SST is forecast to register RM35.8 billion or 1.8% of GDP in consonance with higher consumption as well as optimism surrounding consumer and business sentiments. Sales tax collection is projected to increase by 4% to RM18.3 billion, primarily contributed by machines and spare parts. Similarly, service tax is estimated at RM17.5 billion, on the back of higher demand for food and beverages followed by telecommunication and insurance sectors. Excise duties collection is estimated to grow by 3.8% to RM13.6 billion on account of higher imported cigarettes, measures introduced such as imposing excise duty on liquid or gel products containing nicotine used for electronic cigarettes and vapes as well as widening the scope of sugar sweetened beverages tax as well as stable outlook in the automotive industry.

Non-tax revenue is estimated to decline by 13.8% to RM64 billion or 3.2% of GDP due to lower proceeds from investment income. The annual dividend from PETRONAS is projected to be lower at RM32 billion while BNM is forecast to contribute a higher amount at RM3 billion. Meanwhile, a total of RM1 billion is expected from KWAP as a contribution to partly finance the retirement charges. In addition, licences and permits is expected to register RM14.6 billion mainly contributed by petroleum royalties amounting to RM5.6 billion followed by levy on foreign workers (RM3.3 billion) and motor vehicle licences (RM3.1 billion).

Petroleum-related revenue is anticipated to be lower at RM61.8 billion or 3.1% of GDP, compared with RM69.8 billion or 3.8% in 2023 mainly due to lower PETRONAS dividend despite the forecast higher average crude oil price. Meanwhile, **non-petroleum revenue** with a share of 80% is envisaged to increase by 5.3% to RM245.8 billion, reflecting better revenue diversification on the back of a favourable economic outlook. Moving forward, the Government will continue to ensure sustainable non-petroleum revenue generation in order to finance expenditure commitments, particularly in providing better infrastructure and social welfare for the public.

Conclusion

The Government remains committed in fortifying its revenue base, narrowing the tax gap and enhancing tax efficiency, with the overarching goal of establishing a sustainable revenue collection framework. This objective will be pursued through a diversified array of initiatives, including but not limited to the optimisation of tax incentives, the reduction of tax losses, and the augmentation of tax compliance through effective audit processes. In addition, efforts will be intensified to enhance revenue mobilisation and tax transparency through the implementation of the Medium-Term Revenue Strategy and tax expenditure reporting.

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

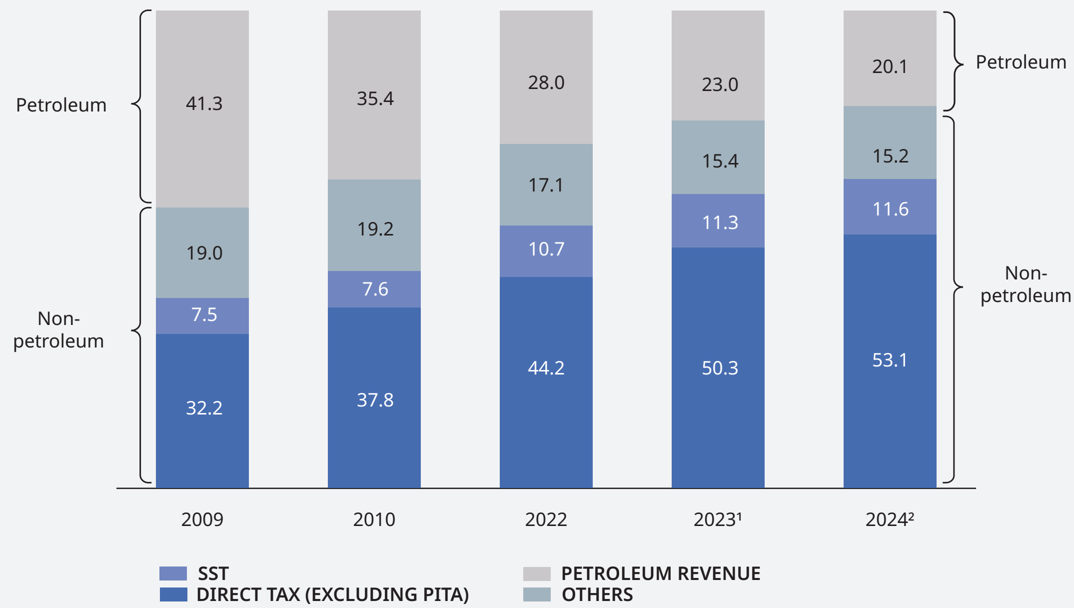
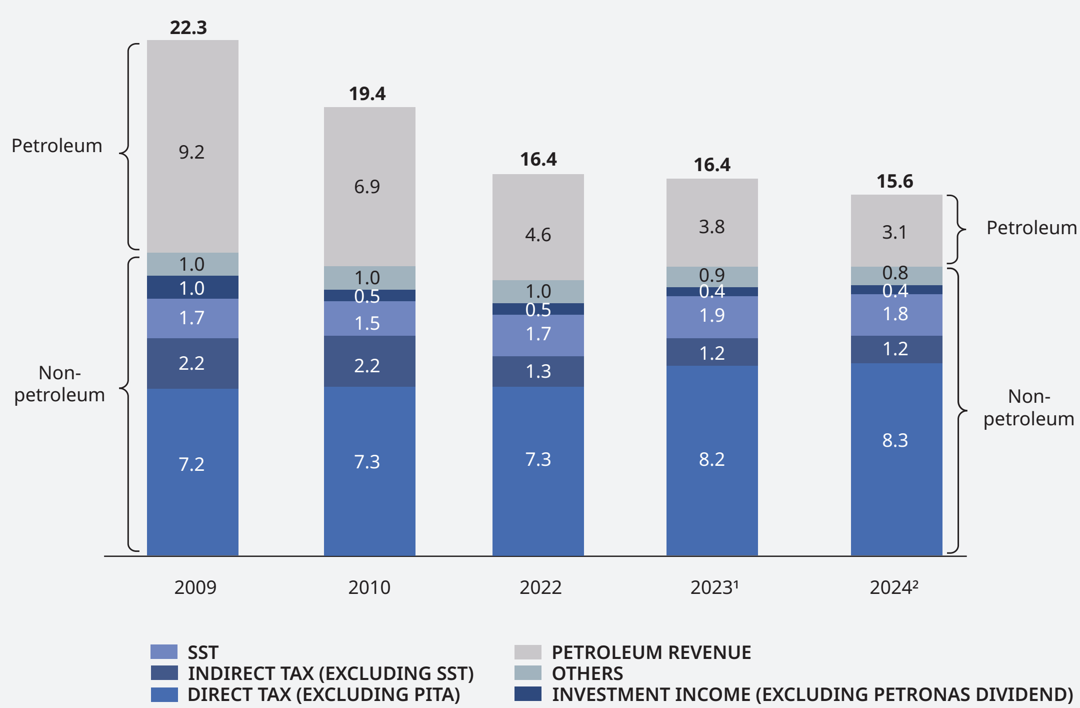


FIGURE 2.2. *Revenue as Percentage of GDP (% of GDP)*



[1] Revised estimate
[2] Budget estimate, excluding Budget 2024 measures

Source: Ministry of Finance, Malaysia