

**THE FOURTH IMF-JAPAN HIGH-LEVEL TAX  
CONFERENCE FOR ASIAN COUNTRIES  
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**TAXATION OF MICRO AND SMALL  
BUSINESSES IN MALAYSIA –  
HOW TO DEAL WITH INFORMAL ECONOMY**

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# INTRODUCTION

## Definition

- An informal economy refers to activities and income that are partially or fully outside government regulation, taxation and observation. This type of activity allows employers, paid employees and the self-employed to increase their take-home earnings or reduce their costs by evading taxation and social contributions. (World Bank)

## Why tax informal sector?

- To avoid over taxing formal sector, negative consequences for on competitiveness and growth, undermine social cohesion and fiscal losses.

# ...INTRODUCTION

## **Literature on taxation of micro businesses advocates-**

### **• Good tax design:**

- **wide base**
- **clear, simple and transparent system**
- **separate thresholds for micro-enterprise, enterprises**

### **• Tax base:**

- **presumptive tax based on turnover**
- **cash flow: simple cash receipts and payment basis for micro-business (Ireland)**

### **• Tax administration:**

- **minimise compliance costs and streamline procedures**
- **reduce administrator discretions**
- **encourage voluntary compliance, outreach programmes**



medium

# APPROACH

- 1. Tax Profile and Taxation of Micro and Small Business in Malaysia***
- 2. Understanding Micro and Small Businesses through Economic Profile from the SME Census 2011 produced by SME Corp***
- 3. Moving forward***



# ...DEFINITION

**SME Corporation (an agency established to spur the development of small and medium enterprises in Malaysia):**

Sector	Criteria	Micro Enterprise	Small Enterprise	Medium Enterprise
<b>Manufacturing</b> <b>Manufacturing related services</b> <b>Agro-based Industries</b>	<b>Sales turn over</b>	<b>&lt;RM250,000</b>	<b>RM250,000 – &lt;RM10,000,000</b>	<b>RM10,000,000 - RM25,000,000</b>
	<b>Full time employees</b>	<b>&lt;5</b>	<b>5-50</b>	<b>51-150</b>
<b>Services</b> <b>Primary agriculture</b> <b>ICT</b>	<b>Sales turn over</b>	<b>&lt;RM200,000</b>	<b>RM200,000 – &lt;RM1,000,000</b>	<b>RM1,000,000 – RM5,000,000</b>
	<b>Full time employees</b>	<b>&lt;5</b>	<b>5 - 19</b>	<b>20 - 50</b>

# PROFILE OF SMEs

**SME Census 2011 is a set of survey data collected from registered businesses and firms**

**Exclude smallholders, farmers, households and individuals**

**Census 2011 provide an account on micro, small and medium businesses operating in the formal economy in Malaysia-**

- Total respondents: 662,939**
- Total SMEs: 645,136**
- Total employment: 3,669,259**

**SME Census as a proxy to understand operations of micro businesses in the informal economy**

# DEFINITION OF SMEs

**Ministry of Finance:**

**Companies with paid-up capital of RM2.5 million and below**





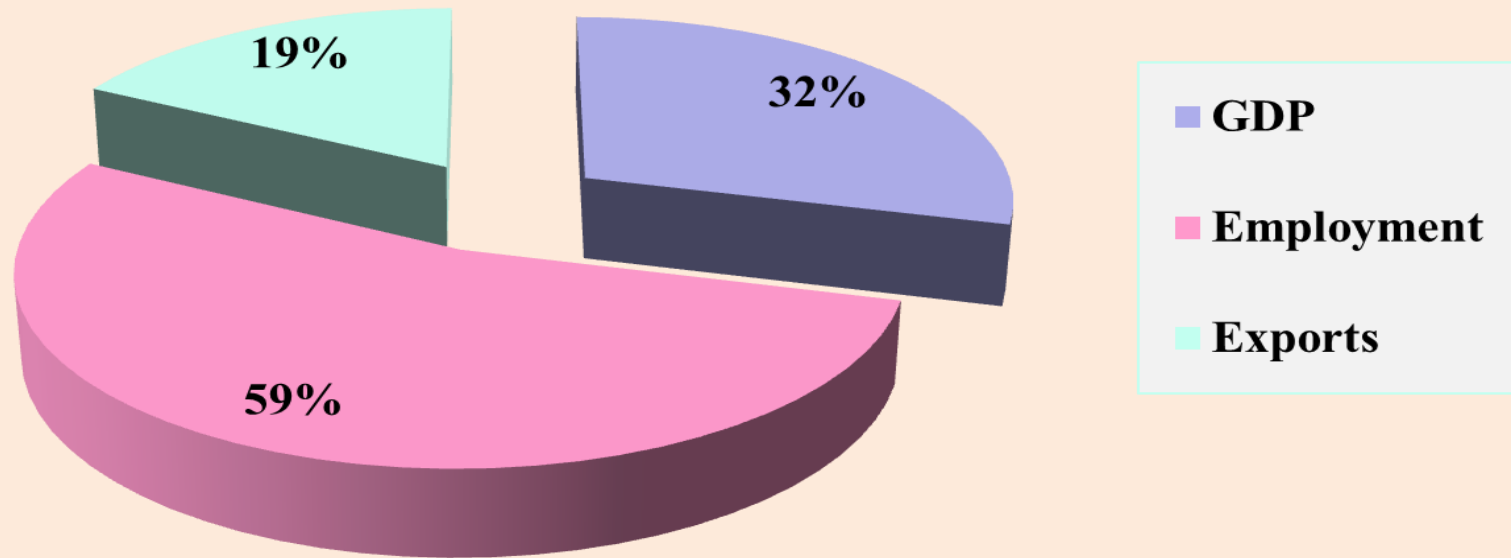
# ...PROFILE

	Micro- Enterprise	Small Enterprise	Medium Enterprise
<b>Total SMEs</b>	<b>77%</b>	<b>20%</b>	<b>3%</b>
<b>Involvement in economic sectors</b>	<b>Services (79.6%)</b> <b>Manufacturing (57.1%)</b> <b>Agriculture (56.3%)</b>	<b>Mining &amp; Quarrying (42.1%)</b> <b>Manufacturing (36.8%)</b> <b>Construction (34.9%)</b>	<b>Mining &amp; Quarrying (38.8%)</b> <b>Construction (20.6%)</b> <b>Agriculture (14.8%)</b>
<b>Total employment</b>	<b>36.5%</b> <b>- Services (91%)</b>	<b>40.1%</b> <b>- Services (68.1%)</b> <b>- Manufacturing (24.5%)</b>	<b>23.4%</b> <b>- Services (45.2%)</b> <b>- Manufacturing (31.5%)</b> <b>- Construction (18.1%)</b>

Source: SME Census 2011



# SMEs IN THE NATIONAL ECONOMY



Source: SME Census 2011

# TAX PROFILE OF SMALL BUSINESSES

## (Micro, Small & Medium Enterprises)

Sector	Year of Assessment	2011
	SMEs	Micro Business/ Sole Proprietors
Wholesale and retail Repair of motor vehicles & motorcycles	25%	1.7%
Construction	14.6%	3%
Manufacturing	11.1%	2%
Agriculture, hunting & forestry	10.2%	6%
Finance & insurance	5.5%	4%
Technical & scientific professional services	5.1%	0%
Land development, rental	1.1%	4.5%
Others	27.1%	78.8%*
<b>Total Tax Paid (RM mil)</b>	<b>15,004</b>	<b>2,308</b>

\* 76.6% has no / incorrect code

Source: IRBM

# ECONOMIC PROFILE

•*Based on SME Census 2011:*

1. **Legal structure of SMEs - 71% individual proprietorships, 18.4% private limited companies and 8.5% partnerships**
  - Enterprises operating in the formal economy are incorporated entities. The legal structure excludes micro business proprietors and partnerships from being eligible to claim tax incentives which are available to incorporated entities eg. tax holidays
  - The actual number of enterprises operating in the informal economy cannot be estimated. These enterprises are unregistered and operate on a cash basis

## ...ECONOMIC PROFILE

•Based on SME Census 2011:

2. **Employers make up 18.7% (working proprietors, active business partners and unpaid family workers) compared to 77.7% (2.85 million) full time employees and 3.6% part-timers**
  - Pull factors for informal economy - risk takers, bear unlimited liabilities, handle mostly cash transactions and unpredictable sales and profits
  - Changing nature of operations – employ less locals and more foreign workers who are less monetary demanding and prepared to work longer hours. Employees unlikely to fall into tax net
  - As local entrepreneurs age, they employ foreign helpers or become renters
  - If no contribution made for social security, health insurance and employees provident fund, no need to move into formal economy
  - Requires time and resources to be tax compliant – proper accounts for business, employ tax agent to file returns and provide tax estimates for monthly deduction of self and employees, if eligible.

## ... ECONOMIC PROFILE

•Based on SME Census 2011:

### 3. Financing

(%)	FI	RE	F&R	Others (grants)
<u>Overall</u>	<u>20.3</u>	<u>55.9</u>	<u>14.3</u>	<u>30</u>
M-E	16.2	58.1	15.0	28.8
Small E	30.7	49.6	12.7	33.6
Medium E	47.7	46.4	8.5	35.5

- Micro-enterprises fall below the radar.
- Pull factors to remain in informal economy-
  - limited access to loans from financial institutions (FI)
  - rely heavily on profits/retained earnings (RE) from their business
  - borrow from friends and relatives (F&R)
  - less likely to receive government assistance like grants

# ...ECONOMIC PROFILE

•Based on SME Census 2011:

## 4. Technology - usage of ICT in business operations

- YES: 27% (internet users 67% and non-internet users 23%)
- NO: 73%

IRBM provides 12 on-line facilities for tax payers. Among them are e-registration, e-filing, e-payment, e-updates, e-ledger. IRBM also provides assistance and tax payer education to tax payers and support through out reach programmes.

Micro entrepreneurs must be able to read and write especially in Bahasa Malaysia or English language and ICT inclined.



# ...ECONOMIC PROFILE

## 5. Tax Compliance

- **Study on “Tax compliance costs of Bumiputera Small and Medium Enterprises in Northern Malaysia” for year of assessment 2003 found that tax compliance costs have a significant relation with the paid up capital of enterprises (*Hafizah Abdul Mansor, UTMara Johor, 2008*):**
  - **Smaller Bumiputera enterprises incur more internal tax compliance costs and have a higher percentage of tax compliance costs based on tax revenue**
  - **Bumiputera entrepreneurs lack tax knowledge**
- **With effect from YA 2003, companies with paid up capital less than RM2.5 million is taxed at 20% on chargeable income up to RM500,000 and the balance at prevailing company tax rate of 25%. Policy to further promote domestic investment by SMEs.**
- **Create opportunities for tax planning by large companies.**



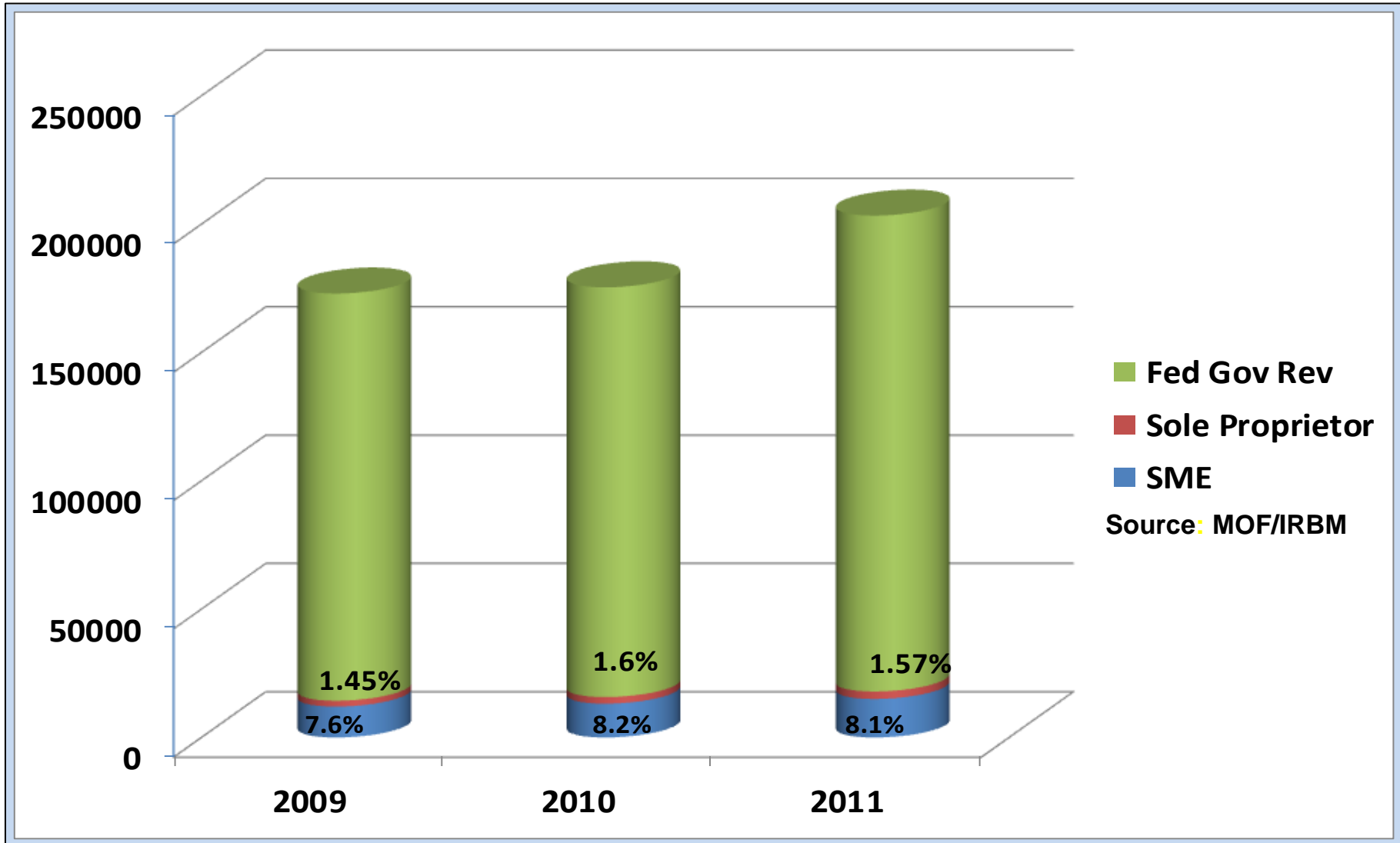
# TAXING MICRO BUSINESSES IN MALAYSIA

## *POLICY - Why tax micro businesses?*

**Income Tax Act 1967: gains or profits from a business are subject to tax**

- 1. Micro business includes sole proprietors, self employed, partnerships eg. sundry business, direct selling, stalls, clinics, law firms, writers and actors, remisiers, agriculture and farming**
- 2. No preferential tax rate**
- 3. Subject to scale rates as in personal income tax**
- 4. Eligible for deduction on expenses incurred in the production of income such as allowable business expenses, export allowance and double deductions but exclude personal expenses, purchase of personal assets and initial expenses**
- 5. Eligible for financing from RM1,000 to RM50,000 for use as working capital based on viability of business and solely on creditworthiness of borrower**

# CONTRIBUTION OF MICRO BUSINESS TO FEDERAL GOVERNMENT REVENUE



# DEALING WITH MICRO BUSINESSES IN THE INFORMAL ECONOMY

1. **Focus of the Inland Revenue Board of Malaysia**
  - registration, filing, declaration and payment
  
2. **Segmentation of economic zones**
  - identify new business activities & owners
  - identify those without Income Tax Reference Number and new tax payers
  - surveillance on unregistered businesses
  - premise visits to visit new/old/high potential business areas
  - identify potential audit cases
  
3. **Verification and enforcement**
  - surveillance to detect unregistered businesses
  - information gathering via third parties, mass media, internet
  - cooperate with other government agencies
  - research and understand industries
  - desk and field audits

## ...In Informal Economy

### 4. Tax payer education and outreach program

- conduct workshop and seminars on business record keeping, accounts, tax computation and tax payment
- provide advisory service on record keeping, laws and regulations
- set up one stop service center at all IRBM branches

### 5. Data matching on asset acquisitions and tax payer data base

- compile “enterprise taxpayers profile” arising from stamp duty paid on property acquisition transactions, motor vehicle insurance renewals from insurance companies
- matching above with registered tax file and those earning assets not in tandem with declared income
- new vehicle registrations from the Road Transport Department

## **...In Informal Economy**

### **6. On-line services for new and registered tax payers-**

- \* e-ledger: tax payer to check personal details, transactions and current tax position**
- \* e- registration: individuals or companies to apply for tax file no.**
- \* e- filing: by individuals, tax agents, companies**
- \* e- payment: tax payer pays tax via financial process exchange**
- \* e- update: tax payer update info**
- \* e-data: employer to upload text files**
- \* e-PCB: employer who does not own a computerised payment system to record employee info, tax installments and tax payments**
- \* calculator: online calculation of monthly tax installment**
- \* e-SPC: certification that tax is paid in full**
- \* SMS: register mobile phone to access IRBM's application**
- \* STAMP: e- payment of stamp duties**

# MOVING FORWARD

## **HOW TO TAX MICRO BUSINESSES IN THE INFORMAL SECTOR?**

### **1. Policy perspective-**

- i. Low contribution to total revenue ie less than 1.6% to total Government revenue and 2.1% to total tax revenue in YA 2011. Should resources be actively directed at micro business?***
- ii. Adopt common definition for micro and small businesses for purpose of data collection***
- iii. Shared information among government agencies to identify unregistered tax filers***
- iv. Broaden indicators for net worth of business entrepreneurs in the informal economy to include purchase of luxury motor vehicles from second hand car importers, personal insurance policies with high monetary value, memberships in trade associations (eg. Ghana) and golf clubs***

# MOVING FORWARD

## **2. Tax administration perspective –**

- i. Push factors for micro business to migrate from informal economy into formal economy eg. income tax statement is required for application for bank loan and hire purchase, application for tax incentives and government grants and assistance***
- ii. Facilitate rather than regulate tax compliance***
  - simplify filing rules eg. tax estimates, monthly deductions, revisions and tax returns***
  - low tax thresholds for new and genuine micro-businesses***
  - tax filing based on minimal information***
  - not required to use service of tax agents***
  - reduce punitive impact of penalties***
  - choice of alternative tax base combined with special tax regime eg. receipts from cost of sales, cash flow, turnover***
  - reward voluntary registration by new businesses***
- iii. Enhance basic ICT skills and access to on-line services***



# CONCLUSION

***Taxing micro and small business enterprises in the informal economy is a balancing act-***

- \* A tax regime that is too restrict will discourage the development of entrepreneurial spirit and drive enterprises underground***
- \* A tax regime that offers preferential treatments will discourage micro business from growing big and move into the formal economy***



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**(THANK YOU)**

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