

Progressive Taxation in ASEAN: A Review on Personal Income Tax Rates

Shanmugam Munuswamy, Zulkifflee Mohamed

Universiti Tun Abdul Razak

Abstract

The wisdom of progressive taxation is to ensure equity and fairness among tax-payers by increasing tax rates as income increases. Despite its criticism for tax evasion, the progressive tax system has been widely used in several nations including countries in ASEAN. However, the marginal tax rate between different income groups from lower band to upper band grossly varies from one country to another. Similarly, classification of the income groups such as Below 40 (B40), Middle 40 (M40), and Top 20 (T20) depends on average median income of the respective countries. The tax rates within and between groups are based on several factors including the policy of the government. Firstly, this article will shed light on the status of progressivity in the personal tax rates among the countries in ASEAN. Secondly, the paper highlights on the higher marginal tax rates for middle-income group in Malaysia. Thirdly, it will compare the top tax rates of countries in ASEAN. Finally, it will conclude by underlining the necessity of tax cuts for the middle-income group in Malaysia in order for them to sustain their life style after retirement.

Key words: Progressive tax, middle-income, M40, top tax rate, T20, tax structure, Tax rates in ASEAN

1. INTRODUCTION

Taxes are a portion of private wealth, exacted from individuals by the State for the purpose of meeting the expenditure essential to carrying out the functions of government (Armitage Smith, 1907). It is also used as a tool to encourage savings and investments, optimum utilization of available resources, reduction of equality in income and wealth, acceleration of economic growth, and as a control mechanism. A good tax system should be understandable, efficient, and equitable. The rates at which taxes are charged on the income of individuals, business profits or goods and services are called 'Tax Rates' and this is determined by the government based on several factors. Tax rate, however, has significant impact on the tax payers' savings, investment, and life style of its citizens. Hence, it becomes essential for the government to design the tax structure in such a way that its citizens are charged fairly and equitably.

1.1 Methods of Taxation

Taxes are collected either directly (direct tax) or indirectly (indirect tax) from the people. While the direct taxes (Income Tax, Stamp Duty, & Property Tax) are collected directly from the people, the indirect taxes (Sales Tax, Goods and Services Tax, Exercise Duty) are received through goods and services. A tax system can be progressive, proportional, or regressive. In a proportional tax system, higher income individuals pay higher proportion of tax which has been cited as a method to reduce inequality in society. A proportional tax system, every tax payer pays the same proportion of his or her income as tax. On the other hand, in a regressive tax system, individuals with lower income pay a higher proportion of his or her income as tax. Among the three-major tax system, progressive taxation has been widely used by several countries.

* Corresponding author.
E-mail: shanmugam@unirazak.edu.my

2.1 PROGRESSIVE TAX SYSTEM

The supreme wisdom of progressive taxation is to ensure fairness among tax payers. Under this system, the tax rate progresses from low to high and as a result the tax liability increases as the taxable income increases (Sommerfeld et.al, 1992). However, opponents of this tax policy believe that in case of such a tax, the additional revenue generated would not be enough while it may also encourage the rich to further evade taxes. However, it is generally agreed that taxing someone who is earning at a much higher rate is quite justifiable in terms of equity and in accordance with the principles of progressive taxation.

A progressive tax is a tax in which the tax rate increases as the taxable amount increases. Under the system the tax rate progresses from low to high. As a result a taxpayer's average tax is less than the person's marginal tax rate (Becker, 2007). The system attempts to reduce the tax incidence of people with a lower ability to pay and shifts the incidence increasingly to those with a higher ability-to-pay. Diamond, et.al., (2011) advocates that very high earners should be subject to high and rising marginal tax rates on earnings whereas low-income families should be encouraged to work with earnings subsidies, which should then be phased-out with high implicit marginal tax rates. However, critics of progressive taxes argue that it is discriminatory against wealthy people and might lead to tax evasion. Case against progressive tax include that it will not help bring down the income equality. For instance, according to Max Ehrenfreund in 'The Washington Post' (10th July, 2017), South Africa, the country with the world's most progressive taxes has the world's highest income equality. However, despite criticism, it is evident from the literature that several countries across the globe employ progressive tax system as one of the tools to reduce income disparity among the people.

2.1 Marginal and Effective Tax Rate

A Marginal Tax rate is the percentage of tax applied to income for each tax band in which it qualifies. It is the percentage taken from the next dollar of taxable income above a pre-defined income threshold. However, the Effective Tax rate is the percentage of tax calculated on the amount of tax paid by the gross income of an individual. For instance, if Zam earns a gross income of RM130,000 and his chargeable income i.e., income after eligible deductions, is RM110,000, his marginal tax rate falls under the tax bracket RM100,001 to RM250,000 with a marginal tax rate of 24% (Table 2.1). In this case, the tax liability of Zam is calculated on the tax amount for the income up to taxable amount RM100,000 (RM11,900) plus 24% on RM10,000 (excess over RM100,000) which is RM2,400 making the total tax liability as RM14,300. In this case, the effect tax rate is 11% which is calculated by dividing on the total tax liability by gross income (RM14,300/RM130,000). Though Zam's marginal tax rate is 24%, his effective tax rate is only 11%. Typically, the effective tax rate is always lower than the marginal tax rate.

3. PERSONAL INCOME TAX RATES IN ASEAN

A review on the tax rates of the member countries in ASEAN (Malaysia, Singapore, Thailand, Indonesia, Philippines, Myanmar, Laos, Cambodia, Vietnam, and Brunei) for the Year of Assessment (YA) 2016, it was found that except in Brunei (tax-free country), all the countries were adopting progressive tax system. It was also noticed that the marginal tax rate was 5% in all countries except in Malaysia and Singapore. However, in Malaysia and Singapore, the tax rates for the middle-income group appear to be high. While the underlying philosophy for the increased tax rates in Singapore is not explicit, it has significant impact on the savings and investments for the M40 in Malaysia. The following chart shows the tax structure in Malaysia for the Assessment Year (AY) 2016.

The following charts show the tax rates of the eight ASEAN countries namely, Singapore, Thailand, Philippines, Indonesia, Cambodia, Laos, Vietnam, Myanmar, and Malaysia for the YA 2016. The data pertaining to the tax structure of these countries are taken from their respective country's website.

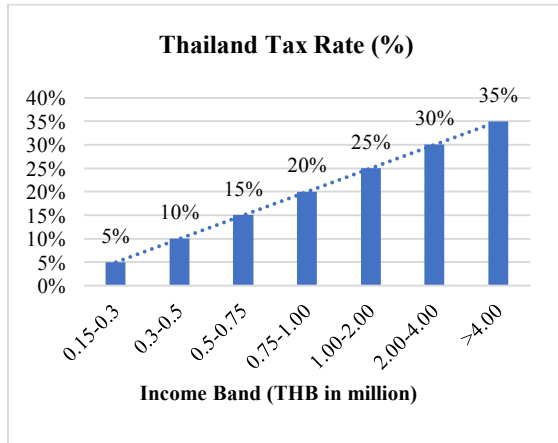


Figure 1

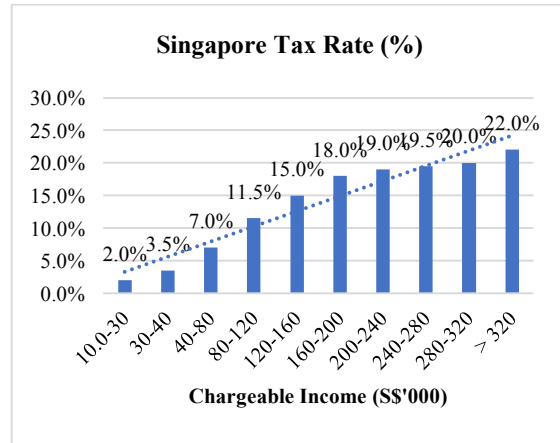


Figure 2

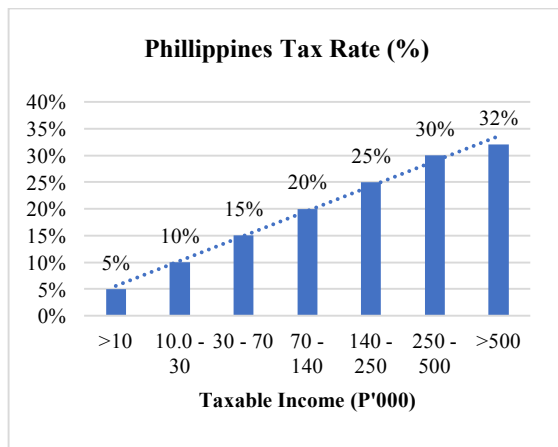


Figure 3

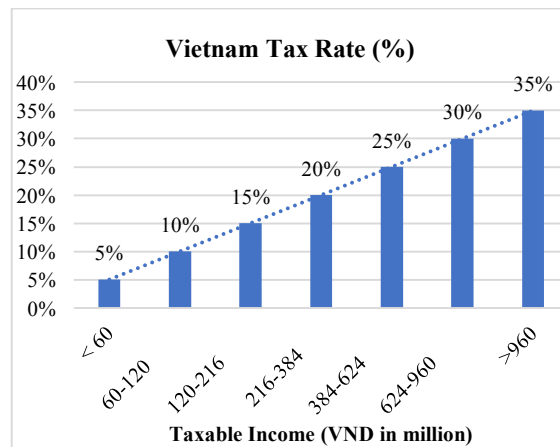


Figure 4

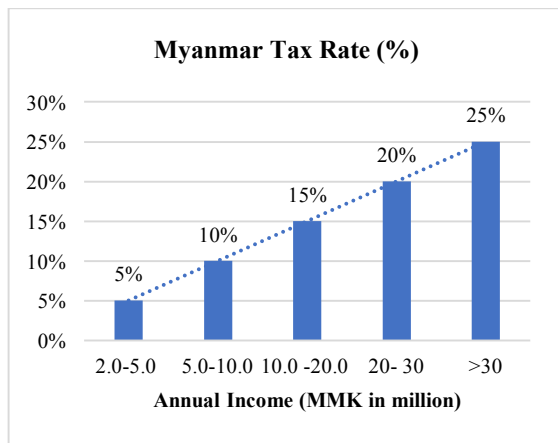


Figure 5

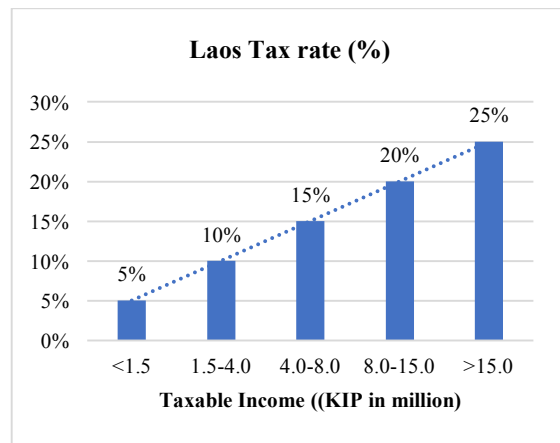


Figure 6

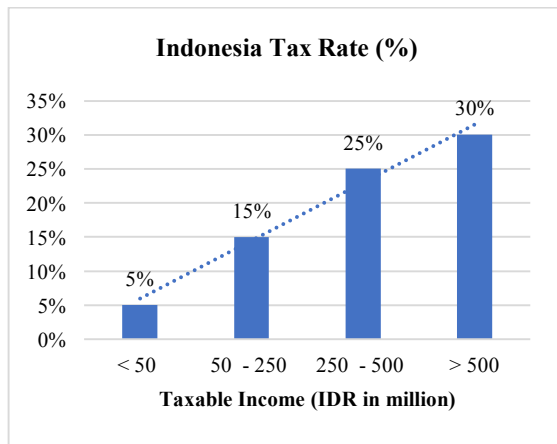


Figure 7

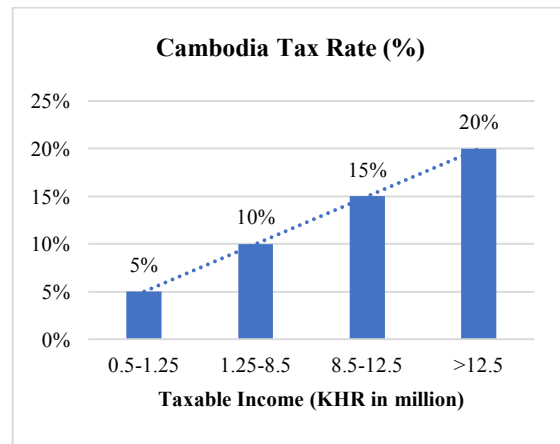


Figure 8

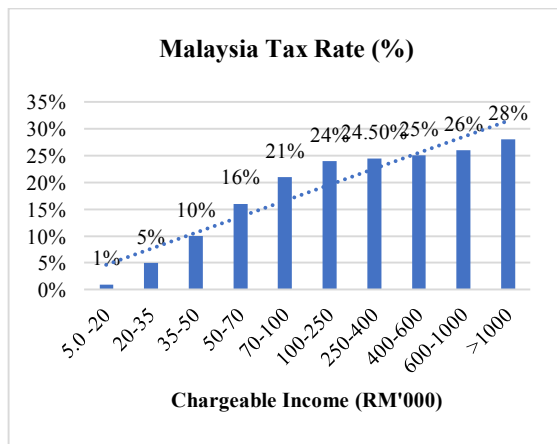


Figure 9

From the above charts, it can be seen that the trend line for all the countries except Malaysia (Figure 9) and Singapore (Figure 1) appears to be perfectly linear demonstrating the progressivity of the tax rates. However, a closer look at the tax rates of Malaysia and Singapore clearly appear to be skewed in the middle of the chart which means higher tax rates for the middle-income group as compared to the other income groups. As regards the number of tax bands, Malaysia and Singapore have the highest number with 10 each whereas Indonesia and Cambodia have the lowest number with 4 tax bands. Similarly, Thailand, Philippines, and Vietnam have 7 tax bands, and Laos and Myanmar with 5 tax bands.

4. TOP TAX RATES in ASEAN

The following chart shows the top tax rates for the YA 2016 for the ASEAN countries except Brunei.

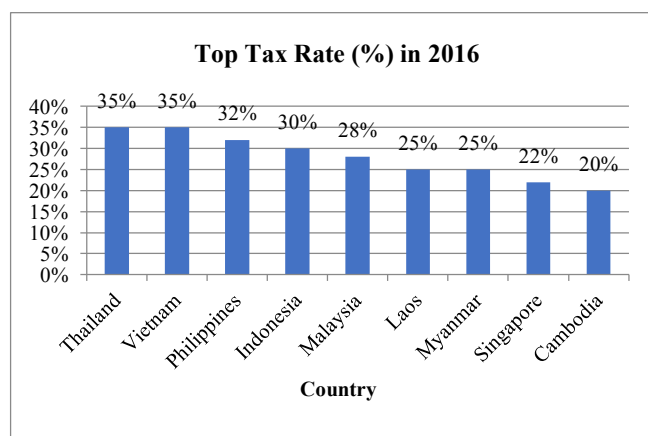


Figure 10

With regards to the tax rate on the upper band (Figure 10), Thailand and Vietnam have the highest tax rate with 35% followed by Philippines and Indonesia with 32% and 30% respectively. While Malaysia's top tax rate is 28%, the remaining four countries have below this rate.

5. PERSONAL INCOME TAX RATES IN MALAYSIA

The following table (Table 1) under Section 5.1 shows the personal income tax structure of Malaysia for the YA 2016. It can be observed from the table that there are 10 tax brackets starting with the lower band of RM5,000 to RM20,000 and the upper band of RM1,000,000 and above carrying a tax rate of 1% and 28% respectively.

5.1 Tax Rates for Middle-Income and High-Income Group

The middle-income group in Malaysia, falls between the monthly income of RM3860 (annual income RM46,320) and RM 8319 (annual income RM99,828) as reported in the web site: <https://www.imoney.my/articles/middle-class-malaysia>. Referring to the table below (Table 1), the middle-income group lies within the tax band between RM20,001 to RM35,000 and RM70,000 to RM100,000 carrying tax rates of 5% and 21% respectively. There are 4 tax brackets to the middle-income group for the chargeable income RM80,000 (RM100,000 – RM20,000). Interestingly, there are 5 tax band for the high-income group for the chargeable income RM900,000 (RM1,000,000 – RM100,000). It can also be noted from the table below that the tax rate for the M40 increases from 5% to 21% in four tax bands. However, for the T20 income group, the tax rate increases from 21% to 28% in 5 tax bands. In other words, the marginal tax for M40 is 16% (21% - 5%) whereas it is 7% (28% - 21%) for the T20 group. Thus, the marginal tax rate increases by more than 300% within the middle-income group whereas it is only about 30% for the high-income group.

Table 1. Malaysia Personal Income Tax Rate for YA 2016

Chargeable Income	Calculations (RM)	Marginal Tax Rate %	Tax Amount (RM)	Total Tax Liability (RM)	Effective Tax Rate (%)
0 - 5,000	On the First 2,500	0	0		0
5,001 - 20,000	On the First 5,000		0		
	Next 15,000	1	150	150	0.4
20,001 - 35,000	On the First 20,000		150		
	Next 15,000	5	750	900	1.8
35,001 - 50,000	On the First 35,000		900		
	Next 15,000	10	1,500	2,400	3.7
50,001 - 70,000	On the First 50,000		2,400		
	Next 20,000	16	3,200	5,600	6.6
70,001 - 100,000	On the First 70,000		5,600		
	Next 30,000	21	6,300	11,900	10.3
100,001 - 250,000	On the First 100,000		11,900		
	Next 150,000	24	36,000	47,900	18.1
250,001 - 400,000	On the First 250,000		47,900		
	Next 150,000	24.5	36,750	84,650	20.4
400,001 - 600,000	On the First 400,000		84,650		
	Next 200,000	25	50,000	134,650	21.9
600,001 - 1,000,000	On the First 600,000		134,650		
	Next 400,000	26	104,000	238,650	23.5
Exceeding 1,000,000	On the First 1,000,000		238,650		
	Next ringgit	28		

Source: http://www.hasil.gov.my/bt_goindex.php?bt_kump=5&bt_skum=1&bt_posi=2&bt_unit=5000&bt_sequ=11&bt_lgv=2

5.2 Savings and Investment of Middle-Income People

According to Khazanah Research Institute report 2016, (<http://www.krinstute.org>), about three out of four EPF (Employees Provident Fund) members (76%) earn less than RM3,000 per month, and nearly 90% earn less than RM5,000 per month. This is consistent with data from the Salaries and Wages Survey Report published by DOS (Department of Statistics, Malaysia), which states that the median wage in Malaysia in 2015 was RM1,600. In other words, half of Malaysian workers earned less than this amount per month. In 2014, the savings of the bottom 71.5% constituted a meagre 2.4% of total savings, while the savings of the top 0.2% was 3.7 times more than this figure at 8.8% 13. In 2012, the savings of the bottom 73.7% consisted of 3.2% of total savings compared to the top 0.2% whose savings was equal to 7.7% of the entire savings. In 2014, active EPF members in the 51 – 55 age group, who are on the brink of retirement and would have their careers' worth of savings, had on average RM159,952 each (Table 6). But this is distorted by the richest 1.6%, or 6,413 members, who have an average of

RM1.6m in savings (2012: RM1.4m). If these members are excluded, then the average savings for this age group would be RM137,605 (2012: RM118,538). However, the bottom 13.5% has average savings of only RM5,621 (2012: RM3,787) and the next 6.5%, an average of RM9,585 (2012: RM7,384). In other words, about one in five members nearing retirement has less than RM10,000 in savings.

Malaysia is fast becoming an ageing nation, as a result of longer life expectancies and falling fertility rates. Providing income security for the elderly and reducing financial pressure on the healthcare system are among the key concerns in the near future. Population ageing, and rising food costs highlighted in this report. Safeguarding the well-being of Malaysian households will require significant structural measures. Though the government is keen on extending relief measures for M40, not all criteria are applicable to the entire group of M40. Only certain reliefs can be availed by a few people while others are not. Thus, the increased tax rates for the M40 are likely to leave a little or no balance depriving opportunity for long-term investment. While the progressive taxation could not bring down inequality in the income distribution per se, the reduced tax rates to M40 might create opportunity for long-term investment to support retired life.

6. CONCLUSION

The primary objective of progressive taxation is to ensure fairness and equity. In a progressive tax system, the marginal tax rate increases gradually from the lower band to the uppermost band. Countries in ASEAN follow the progressive tax principle and the marginal tax rates are found to be gradually increasing except in Singapore and Malaysia. However, in Singapore and Malaysia, the marginal tax rates at the middle representing the middle-income group are appears to be deviating from the trend. While the deviation is not significant in Singapore, the Malaysian tax structure clearly shows higher tax rates for the middle-income group deviating from the principle of progressivity. On the other hand, the marginal tax rates for the high-income group appears to be lower as compared to its peer in ASEAN. Tax cuts for the middle-income group will certainly help them to overcome the challenges of raising cost of goods and services as well as create an opportunity for long-term investment.

REFERENCES

- Armitage Smith (1907), *Principles and Methods of Taxation*, John Murry, London, Page 1
- Becker, Gary S. & Murphy, Kevin M. (2007). *"The Upside of Income Inequality"*. *American Enterprise Institute*. Retrieved Jan 8, 2014.
- Diamond, Peter, and Emmanuel Saez. (2011). "The Case for a Progressive Tax: From Basic Research to Policy Recommendations." *Journal of Economic Perspectives*, 25(4): 165-90.
- Sommerfeld et.al., (1992) *Concepts of Taxation*, Dryden Press: Fort Worth, TX
- Wanniskin Jude (1978), 'Taxes, Revenues and the "Laffer Curve"', *The Public Interest*, No.50 page 5 - 7.
- <https://www.iras.gov.sg/irashome/Individuals/Locals/Working-Out-Your-Taxes/Income-Tax-Rates/>
- <http://www.rd.go.th/publish/6045.0.html>
- <https://www.bir.gov.ph/index.php/tax-information/income-tax.html>
- <https://home.kpmg.com/xx/en/home/insights/2011/12/vietnam-income-tax.html>
- <http://www.mof.gov.mm/en/content/internal-revenue-department>
- <https://home.kpmg.com/content/dam/kpmg/pdf/2016/08/country-tax-profile-laos.pdf>
- <https://www.pwc.com/id/en/pocket-tax-book/english/ptb-2017.pdf>
- <http://www.tax.gov.kh/en/btos.php>
- http://www.hasil.gov.my/bt_goindex.php?bt_kump=5&bt_skum=1&bt_posi=2&bt_unit=5000&bt_sequ=11&bt_lgv=2
- <http://www.krinststitute.org/>
- <https://brandongaille.com/8-progressive-tax-system-pros-and-cons/>
- https://www.washingtonpost.com/news/wonk/wp/2017/07/16/what-american-liberals-could-learn-from-south-africa/?utm_term=.14b01bece09b
- <https://data.worldbank.org/data-catalog/GDP-ranking-table> (updated July 2017)
- <https://www.imoney.my/articles/middle-class-malaysia>.