

# ***CHAPTER 6***

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### **POLICY RECOMMENDATIONS AND CONCLUSIONS**

#### **6.1 Policy Recommendations**

Based on the analyses that we have looked at in **Chapter 5**, there are a number of policies that are recommendable to NBD. And these policies shall be presented one by one.

##### **6.1.1 Introduction of the Personal Income Tax**

As shown in **Chapter 4**, NBD has no personal income tax. It follows that in **Chapter 5**, NBD has a zero reliance ratio for personal income tax and therefore zero tax effort. In addition, it is also shown in **Chapter 5** that those NBD ratios for both reliance and effort on personal income tax are differed significantly to other country groups. Moreover, direct tax as we have understood and clearly shown by the conventional model that we have looked at in **Chapter 2**, has lower excess burden of taxation. So based on this and on the analyses that we have performed **Chapter 5**, what the government of NBD can do is ‘simply’ to introduce personal income taxation.

In **Chapter 3**, it is shown that NBD’s inequality indexes measured by Gini coefficients and the Lorenz curve performed by Hj Mohiddin (2002) suggests that households in NBD have are relatively equitable income. But as I have alluded earlier

these results might have been understated because of the reasons I have given in **Chapter 3**. Even if NBD has a relatively equitable income, it is no harm to improve those indexes further. Thus in either direction, we will benefit. To be able to achieve this objective, we are looking at a progressive type of personal income tax, which theoretically could reduce income equality gap.

The per capita GDP also has something to say on this matter. In **Chapter 3**, we have gone through the 'performance' - as I would like to call it - of NBD's per capita GDP for the 11 year period and we have found that the per capita here is relatively higher than those of other countries. We were pretty specific about this through comparison with country groups as well as countries within these groups. With the trend of per capita that seems to be constant at a higher level, or at least for the last 11 years, personal income tax collection would be certainly the way to net revenue and increase our reserve. This in turn, would give us more resources for development purposes. Thus, with such a high per capita GDP, it looks to be appropriate to put personal income taxation into perspective.

In **Chapter 5**, we have seen that the direct tax reliance ratio is very high relative to other country groups, even within individual countries. However, 100% reliance was put onto corporation income tax alone and 0% to personal income tax. This has been discussed quite thoroughly in **Chapter 5**. So by having the 'conventionality' or the characteristics of tax reliance ratios in other country groups that we have found, it is somewhat wise to follow their footsteps and redistribute the reliance between corporation income tax and personal income tax more evenly or at

least, a non zero reliance for the personal income tax. This, not only would ease or take the heat off the corporation income tax, but would further raise income tax revenue, as well as raising the contribution of personal income tax to direct tax.

Taking into consideration of the income inequality matter, as mentioned above, the progressive type of taxation would be the theoretically best option. But one other matter that is more important is the condition of our private sectors. As we have seen in **Chapter 3**, our private sectors are relatively smaller than our public sector. Subsequently, remuneration packages are more attractive in the public sector. The prevailing mindset of the Bruneians of having permanent career only in the public sector makes small and medium enterprise (SME) growth slow. This further deteriorates employment opportunities, which has already been in a reasonably bad state. One policy that could be embarked to counter this quandary is the introduction of personal income tax to the public servants. This tax could be imposed on those who have salary above, say BND \$2,000, and the tax rate would be about, say 5%. This rate would therefore be similar to the existing rate of contribution to Tabung Amanah Pekerja (TAP) and relatively lower than those of the other countries<sup>1</sup>. A rationale for such a lower rate of personal income tax is that to reduce the level of shock and enable the public servants to adjust with their new 'lower' disposable income, who had no first hand experience with such tax. Still, there might be groups that are against this new policy and thus, communications with the public are very important in order to give, officially, the rationale of the tax introduction and its importance to the country. This is vital because income can be considered as a very sensitive matter

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<sup>1</sup>Singapore with 30%, Malaysia with 34%, Indonesia with 35%, Thailand with 37% and Philippines 35% as stated in the Asiaweek, June 08, 1994.

here and thus it needs a delicate approach to make this policy a success. Of course the rate selection must be decided with thorough scrutinization and research. Thus, if such introduction were made possible, we would see perhaps, some percent of our labours going to private sectors. This would, somewhat automatically, help to ease out the problem of unemployment since more people are pushed towards the private sectors. Interestingly, as common sense tells us, the higher the rate of tax in the public sector, the more 'attractive' the private sectors' jobs become and the more Bruneians would look for jobs here. These job seekers may constitute unemployed graduates who have excellence degrees but failed to get jobs in the public sectors and their untapped expertise would then be transferred to the private sectors if the jobs were matched with their skills. Such trend would, in time, helps the growth of the SMEs and therefore the growth of private sectors. Slowly, we might see the movement of job seekers from the public to the private sectors. This obviously would enlighten our economy in terms of diversification policy.

In **Chapter 2**, we talked about the advantages of having an income elastic tax system. The first of such advantage is serving as stabilizer in the economy. Since we have shown in **Chapter 5** that our corporation income tax and therefore direct tax is income elastic with 1.17. Thus, in the case of boom in the economy, the tax yield would increase and automatically lead to increase in budget surplus or a decrease in budget deficits. This process will restrain a rise in demand and check inflationary pressures. Though NBD have had no experiences in high inflation, but it is wise to keep inflation in check, especially during boom time. Another equally important agenda is what a flexible tax could do in a depression. In this case, as have been

mentioned earlier, the tax yield would decrease. This will automatically lead to a drop in budget surplus and a rise in budget deficit. Such an automatic decline in tax revenue acts to curve deflationary pressures. This situation is even remote than that of inflation appearances. Nevertheless, like the saying, it is better safe than sorry. Therefore, the existence of an elastic income tax system in NBD would provide some sort of cushion for both inflationary and deflationary pressures.

The income elasticity of direct tax of 1.17 would mean a good thing, as what Lye T.K. (1970) have stated. But as we have seen in Chapter 5, this figure is contributed by corporation income tax alone. Thus, if we would introduce personal income tax, this figure could be improved further. However, this needs further elaboration to eliminate confusion. In Chapter 2, we have looked at the definitions of both income elasticity and buoyancy elasticity of tax revenue. We know that income elasticity of tax revenue takes into account of the discretionary changes of tax bases and rates whilst buoyancy elasticity of tax revenue disregards the discretionary changes on tax rates and bases. In our model, there are no changes in the bases and rates of corporation taxes as well as the estate duty. This means that the buoyancy elasticity of direct taxes is equal with its income elasticity. If we were to introduce personal income taxation into the tax system, we would consider this as a discretionary change for direct taxes. Thus, when the buoyancy elasticity of direct tax is much higher than its income elasticity, the introduction of personal income tax would therefore be beneficial.

Talking about the appealing features and effects of the income elasticity of a tax system is not complete, especially if the government were to introduce new type tax, without taking buoyancy elasticity into account. However, no changes of direct taxes were made for the past 37 years and thus both the buoyancy and income elasticities of direct taxes are equal, as have been alluded above. Thus, whether such proposed introduction of personal income tax would actually increase income elasticity of direct tax, remained to be seen.

The introduction of personal income taxation for NBD can be primarily obliged to increase revenue. This could be done through maintaining the rate for the corporation income tax and in introduce the new tax. This would inevitably raise revenue. If the government felt that corporation income tax would hurt the private sectors, and in the effort to increase private sectors contribution to the economy, reducing this type of direct tax would have an economic appeal. Then, personal income tax would be introduced to compensate the anticipated fall in revenue of direct tax, hence maintaining its previous level. These are the two options that the government would have if they were to pursue for the introduction of personal income tax.

In Chapter 2, we looked in a rather detail manner to how taxation effects the economy. In theory, if we introduce tax or increase the bases or rates of taxes, this would reduce consumption - either via the direct or indirect taxes - and GDP would fall. However, if this tax were used primarily for funding government expenditures,

the reduction in consumption could possibly be compensated, hence maintaining the attractiveness of tax.

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Having discussed all the appealing features and effects that personal income taxation would have, if NBD were to incorporate this type of tax into the existing tax structure that we have looked at in **Chapter 4**, it is ultimately up to the government to decide whether such policy is applicable. It is also important to consider how the Bruneians feel about the new policy and the relevant departments under the ministry of finance must make them fully understand through talks and forums. These activities must be delicately and carefully dealt with since we are dealing with a sensitive matter.

#### **6.1.2 The Introduction of Indirect Taxes**

Besides personal income tax, some types of indirect taxes do have their significance for improvement or introduction. It is expected that these types of taxes will face fewer opposition to from the people because of their 'indirectivity' nature. These taxes are discussed below.

##### **Value Added Tax**

As we have seen in **Chapter 4** and **5**, NBD does not have V.A.T tax. This means that we have zero indexes for both the tax reliance and tax effort ratios. Other



country groups exhibit non-zero indexes for both ratios. This means that there are plenty of spaces for V.A.T. taxes.

In the ground of revenue, this type of tax can be used to generate extra revenue to the government. Though the magnitude may be somewhat smaller than that of the personal income tax that we have looked at earlier, it would still be appropriate to introduce this type of tax here because of a number of reasons.

Theoretically, this type of tax carries with it – as those of other indirect taxes – an excess burden of taxation, which is greater than that of direct tax. Nevertheless, with zero tax reliance and tax effort ratios, it would be reasonable to introduce V.A.T. tax.

In terms of implementation, this type of tax may prove to be easier and less complicated than that of the personal income tax. Unlike the personal income tax, where people - at least generally - cannot avoid paying, with indirect tax such as V.A.T, they can. As a result, people would obviously prefer to have V.A.T rather than the direct taxes. Therefore, it is expected that there would be less pronounce opposition against its introduction.

### **International Trade Taxes**

With the commitment towards ASEAN AFTA, and with the abolishment of export tax, it seems that we have no space for improvement in international trade

taxes. The only option that we may have is to maintain the tax on imports at its highest rate within its agreed upon rates, which is between 0% to 5%. This policy may save some revenue from simply disappearing without benefiting NBD's economy. However, there are still hundreds of commodities that are not yet taxed and this could give us one other option besides the one that we have now.

An appropriate strategy would be to find those commodities that are produced here in NBD that are competitors with those of imported commodities. Though the magnitude of the effect of import tax as an instrument for protection may be reduced, it is still better than when we do not have any protection at all. To maximize the protection effect of the domestic industries, it is wise to put the rate of tax of similar commodities from other countries at 5%.

In the recent years, the government of NBD is more concern for the health of the population. This is evident in the increase of the rates of cigarette and tobacco in 1994. The commitment with ASEAN AFTA today, may conflict with this idea. Thus, the best we can do is to charge 5% duty to these 'hazardous' commodities.

## **Licenses**

Increase Licenses bases, for example introducing license to pets such as dogs and cats. One of the reasons for this is to ensure animal rights are being practiced and in addition giving the government extra money to provide veterinary services to these domesticated animals (Look for the number of animals per households). Giving extra

money is in fact very important in economic sense in all circumstances. The availability of such licenses would reduce government's costs of giving free veterinary services and thus government could therefore use the existing revenue for other important socio, politic and of course, economic agendas. Moreover, this may make veterinary services more efficient in the sense that it has their own 'fund' for the services it provides. The seemingly large number of stray dogs and cats wondering around the city street and in the suburban areas can create problems. Diseases such as skin diseases and 'mad dog disease' which commonly infecting these dogs can be dangerous to humans. The increasing threats of these common illnesses among stray dogs can be reduced through capturing, quarantining, providing medical attention, so on and so forth. Cats though looked to be of less threats to humans than dogs, can in fact be more dangerous to humans since these cats can easily be picked up on the roads, in the bin, and other insecure and uncertain places and bring them home. Adopting these stray cats can easily transfer their skin diseases especially to small kids that love to play with these cute and small animals.

## **Toll**

The introduction of toll may also have some significance. Not only will it generate extra revenue to the government, but it will also provide a good network for delivering general government information to the public, through flyers and leaflets. At the moment, there is only one toll booth in NBD and it is located in Kuala Belait (see Map of NBD in **Diagram 3.1**). The government may also set up other facilities right next to the toll collection area and these can include, small shops, refilling

station, restaurants and other public amenities. The funds for these small businesses may come from the collection of the toll itself.

## **6.2 Conclusion**

This thesis attempts to look into the structure and the performance of taxation in NBD. Since there are not many works done on this subject, it is therefore essential that this detail study on the tax performance to be undertaken. Besides computing the tax performance indicators for NBD in **Chapter 5**, the detail tax system is described in **Chapter 4**. This includes how taxation is operated in NBD, who administer them, the procedure of payment of tax, and several other concepts important in the tax system. This should provide us the clear picture of taxation system in NBD. In **Chapter 3**, we have looked at the current economic condition in NBD and this is to ensure that NBD do need to give attention to taxation. The high per capita income, the fluctuation of oil prices, the unhealthy condition of the private sector, the level of unemployment are all conducive for tax introduction. The performance indicators computed for NBD in **Chapter 5** is the core of this research. The performance indicators such as the tax reliance ratio, tax effort ratio, direct-indirect tax ratio, tax burden and the buoyancy and income elasticity are performed here. The results give us the basis for the policy recommendation in **Chapter 6**. However, this is not the end of the story. In **Chapter 2**, we looked at the theory of taxation and in **Chapter 3** we looked at the current economic condition of NBD. Thus, based on **Chapter 2**, **Chapter 3**, **Chapter 4** and **Chapter 5**, policy recommendations for taxation are suggested. It is recommended that NBD needs to introduce personal income taxation.

Our economic condition, its theoretical aspects and the performance suggest that it must be put into perspective. This is the most attractive tax policy recommendation because all the elements are favorable for its introduction. This does not mean that indirect taxes are left out of the picture altogether. The introduction of V.A.T tax, new licenses and other feasible indirect taxes may give NBD extra revenue.