

Indirect Taxes and Fiscal Sustainability: A Conceptual Revisit of SST and GST in Malaysia

Siti Nur'amalina Syeddin*, Noormahayu Mohd Nasir, Nor Zarina Mohd Salim, Zarul Azhar Nasir, Muhammad Adidinizar Zia Ahmad Kusairee, Hafini Suhana Ithnin

Faculty of Business and Management, Universiti Teknologi MARA Perak Branch, Malaysia

*Corresponding Author

DOI: <https://dx.doi.org/10.47772/IJRISS.2025.909000481>

Received: 10 September 2025; Accepted: 16 September 2025; Published: 15 October 2025

ABSTRACT

This paper conceptualizes the role of indirect taxation in Malaysia by comparing the Goods and Services Tax (GST) and the Sales and Services Tax (SST) within a theoretical and policy framework. Drawing on the principles of taxation, optimal tax theory, and political economy, the study develops a conceptual framework that highlights the interplay between administrative complexity, economic efficiency, revenue generation, and social acceptance. While GST is recognized for its broader base and revenue stability, SST is viewed as simpler and more publicly acceptable, though less efficient in reducing tax distortions. The framework emphasizes the dual perspective of demand and supply, showing how tax design affects both consumer welfare and business competitiveness. Conceptual gaps remain in assessing long-term welfare impacts, comparative regional experiences, and the integration of quantitative and qualitative evidence. Policy implications suggest the need for stable, transparent, and socially responsive tax regimes that balance fiscal sustainability with equity and legitimacy. The study contributes to advancing the discourse on indirect taxation in Malaysia and provides a foundation for future empirical research.

Keywords: Indirect taxes, Consumption taxes, GST, SST, Conceptual framework.

INTRODUCTION

In almost every country, the government's main source of income comes from taxes, whether direct or indirect. Over the years, many governments have started to rely more on indirect taxes—especially those based on consumption—to strengthen their revenue. In Malaysia, taxes also play a central role in funding national development, and a significant portion is collected through indirect taxes such as the Sales and Services Tax (SST) and the Goods and Services Tax (GST). These are known as consumption-based taxes because they are charged when people spend on goods and services. Unlike direct taxes, which are tied to income or profits, consumption-based taxes shift the responsibility to consumers at the point of purchase. Governments prefer this approach because it creates a broader and more reliable source of revenue, particularly in countries like Malaysia where consumer spending continues to grow.

Malaysia has gone through a unique journey when it comes to consumption-based taxation. For many years, the country used the Sales and Services Tax (SST) system. Under SST, a sales tax was charged on certain goods at the manufacturing or import stage, while a service tax applied to specific services. While relatively simple, SST was seen as limited because it only covered a narrower range of goods and services, leaving gaps in tax collection.

In 2015, the government introduced the Goods and Services Tax (GST) to replace SST. GST was designed as a more comprehensive, broad-based consumption tax that applied to most goods and services at every stage of the supply chain, with businesses able to claim input tax credits. The aim was to strengthen government

revenue, reduce tax leakage, and create a fairer system. However, GST faced strong public resistance. Many Malaysians felt the burden of higher living costs, as prices of goods and services seemed to rise after its introduction, even though the tax was supposed to be more efficient.

Due to mounting public pressure and its political sensitivity, the government decided to abolish GST in 2018 and reinstate SST. The new version of SST, often referred to as “SST 2.0,” returned to the older framework of taxing only specific goods and services, though with some adjustments. While SST generates less revenue compared to GST, it was considered more acceptable to the public because it was narrower in scope and less visible in daily spending.

This study takes a conceptual approach to explore how different forms of consumption tax affect Malaysia’s economy, focusing on the country’s shift from the Sales and Services Tax (SST) to the Goods and Services Tax (GST), and then back to SST. These two taxes represent very different designs: SST is narrower and applies only to certain goods and services, while GST is broader and captures value added at almost every stage of production and distribution. Because of these differences, they influence not only how much revenue the government collects, but also how consumers experience prices, how businesses manage costs, and how people view the fairness and acceptability of the tax system.

The study highlights four key dimensions—revenue generation, economic efficiency, administrative complexity, and social acceptance—and explains how these shape outcomes for both consumer welfare and business competitiveness. Seen this way, Malaysia’s experience illustrates the trade-offs governments face: GST offers efficiency and stronger revenue, but SST is simpler and enjoys greater public support. Instead of producing numbers, this paper develops a framework to interpret these trade-offs, showing why tax policy is not only an economic issue but also a political one.

THEORETICAL BACKGROUND

This section outlines the theoretical foundations of GST and SST in Malaysia, showing how these taxes are shaped not only by economics but also by questions of fairness, trust, and political legitimacy.

The first principle is the Benefit Principle of Taxation, which holds that people should contribute in proportion to the benefits they receive from public services (Voyiakis, 2025; Shome, 2021). Yet, indirect taxes like GST and SST sit uneasily with this idea. They are levied on what people buy rather than what they earn, meaning the link between benefits received and taxes paid is weak. This raises long-standing concerns about equity (Poh, 2002) and fairness (Jamel et al., 2021; Kendrick, 1939), especially when citizens feel they are paying without seeing enough tangible returns.

Second is the Ability-to-Pay Principle, which argues that taxation should reflect an individual’s financial capacity. As Kendrick (1939) notes, true fairness means asking more from those who can afford it. While GST and SST are relatively easy to administer and provide governments with a wide base of revenue, they are often criticised as regressive. Lower-income households spend a larger share of their income on consumption, meaning these taxes bite harder for those who have the least (Chernick & Reschovsky, 2000). Recent studies (Dalamagas, Leventides & Tantos, 2022) confirm that indirect taxes disproportionately affect lower-income groups, underlining the tension between efficiency and fairness at the heart of these systems.

Third, the Optimal Taxation Theory highlights the need to balance efficiency, revenue, and social welfare. GST, as a value-added tax, fits more closely with this theory by avoiding cascading effects and minimising distortions in trade. Murty (2017) shows how India’s GST was designed to support both revenue generation and redistribution, following Diamond and Mirrlees’ (1971) argument that taxes should avoid punishing production efficiency. By contrast, SST is simpler but less efficient — it targets only certain goods and services, creating distortions in consumer and producer choices. Evidence from Friedman, Lindholm, Barr & Robertson (2021) suggests that sales tax systems can weaken international competitiveness and undermine sustainable revenue, falling short of optimal taxation principles.

Finally, the Political Economy of Taxation reminds us that taxes are never just technical tools — they are deeply political. Malaysia's experience with GST illustrates this clearly: despite its fiscal efficiency, public resistance was strong, fuelled by issues of trust, legitimacy, and perception. As Swan (2016) argues, taxation in developing countries is shaped by political dynamics and global economic pressures, where questions of fairness and acceptance often matter as much as revenue itself.

Taken together, these perspectives show that GST and SST are not simply rival revenue instruments. They represent two competing approaches to balancing efficiency, fairness, and administrative feasibility while navigating the realities of public acceptance. In Malaysia, the choice between them is not merely about technical design, but about building a system that citizens believe is just, transparent, and aligned with their lived experience.

CONCEPTUALISING GST & SST

This section looks at GST and SST not merely as ways for the government to raise money, but as systems that touch everyday life and shape the broader economy. Viewed through four key lenses — revenue, efficiency, administration, and public acceptance — these tax models reveal their deeper impact on both households and businesses. On one side, they influence the prices people pay and the choices they make as consumers; on the other, they affect how firms compete and grow in a challenging marketplace. Framing GST and SST in this way moves the conversation beyond technical details, offering a more balanced and inclusive understanding of what indirect taxation really means for Malaysia's future.

A. Tax Structure

When Malaysia shifted from SST to GST in 2015, and then back again to SST in 2018, it was more than just a technical change in tax policy. It was a reminder that taxation is as much about public trust and politics as it is about economics.

On paper, GST is designed to be more efficient and transparent. By taxing at every stage of the supply chain and allowing businesses to claim input credits, it ensures that companies are only taxed on the value they add. This avoids the “tax-on-tax” effect and creates a level playing field across industries. SST, on the other hand, is only applied once — usually at the point of manufacturing, import, or on selected services. While this makes it simpler to administer, it also means hidden layers of tax can build up as goods move along the chain, often pushing up costs for consumers without them noticing.

From a revenue perspective, Malaysia's short experience with GST revealed its strengths. It delivered a broader base and generated more stable income compared to SST, which is narrower and full of exemptions. For a government focused on fiscal sustainability, GST seemed like the smarter option. Yet, as Malaysia's history shows, efficiency and revenue are not enough on their own. Without public acceptance and trust, even the most technically sound tax system cannot last.

For businesses, compliance requirements shaped much of how GST was perceived. Under GST, every company along the supply chain had to register, report, and file on a regular basis. This did help with transparency and reduced the room for tax evasion, but it also meant heavier paperwork — something especially challenging for small and medium enterprises (SMEs). By comparison, SST involves far fewer businesses, so it feels administratively lighter, though it sacrifices some economic efficiency.

For ordinary Malaysians, the experience of GST was even more direct. The tax was printed clearly on every receipt, making people very aware of each ringgit they paid. While economists saw this as a form of transparency, many Malaysians simply felt it as an extra burden on their daily expenses. SST, on the other hand, is “built into” final prices — people still pay the tax, but it's less obvious. That difference in visibility played a big role in shaping public perception and fueled political dissatisfaction.

The switch back from GST to SST in 2018 showed that debates about tax reform are not just about design on paper. Timing, communication, and public trust matter just as much. GST may have been more efficient in theory, but it was introduced at a time when living costs were already rising, which made it deeply unpopular. SST, while less efficient, was seen as lighter on businesses and more politically acceptable.

In the end, the choice between GST and SST comes down to trade-offs. GST is more complex but delivers stronger revenue and clearer transparency. SST is simpler and easier to live with politically, but it is weaker for long-term fiscal sustainability. Malaysia's journey between the two shows that taxes are never just about economics — they are about finding the right balance between efficiency, simplicity, and public acceptance.

B. Key Conceptual Dimensions

Revenue Generation

At the heart of any tax system is its ability to bring in money for the government. This is where GST has the upper hand. Because it taxes every stage of production and distribution — but allows businesses to claim credits for the tax they've already paid — GST casts a wider net and provides more stable revenue. Malaysia saw this during the years GST was in place: collections were stronger and more predictable. SST, by contrast, is narrower. It only applies at the manufacturing, import, or service-provider level, and many items are exempted. While this makes SST feel lighter, it also means the government collects less, which can be a problem when long-term fiscal stability is the goal.

Administrative Complexity

Running a tax system isn't only about collecting money — it's also about how easy or difficult it is to manage. GST is definitely more demanding. Every business along the supply chain has to register, file returns, and keep proper records. For many, especially smaller companies, this felt like a heavy administrative load. The advantage, however, was that GST created a clear paper trail, which closed loopholes and made the system more transparent. SST, by contrast, is much simpler. Only selected manufacturers, importers, or service providers deal with it directly, which means far less paperwork for most businesses. The trade-off is that the government loses visibility over many transactions happening further down the chain.

Economic Efficiency

A well-designed tax system should interfere as little as possible with how people produce, trade, and consume. In this sense, GST has the upper hand. Its input tax credit system ensures that tax is only applied to the actual value added, which prevents the "tax-on-tax" effect. This makes prices under GST more neutral and transparent. SST, by contrast, doesn't have a credit mechanism. As a result, tax can quietly build up at different stages of the supply chain, pushing prices higher than they otherwise would be. Economists often point to this as a weakness, since it creates inefficiencies that distort choices and raise costs in ways consumers don't always notice.

Social Acceptance

Even the best-designed tax system cannot survive without public support — and this was where GST stumbled in Malaysia. Because GST appeared clearly on every receipt, people could see exactly how much tax they were paying. At a time when living costs were already climbing, that visibility made GST feel like an extra weight on households. SST, by contrast, is folded into the final price. People still pay the tax, but they don't see it itemised, which makes it easier to accept politically even though it's less efficient. Malaysia's return to SST in 2018 shows that social acceptance can matter more than technical advantages. In the end, a tax system only works if people are willing to live with it..

C. Outcomes

Consumer welfare (demand side)

For consumers, the main concern is always: how much do people really end up paying? Under GST, the system was more transparent because the tax was clearly printed on receipts. In theory, this should have been good for accountability. But in practice, it made people feel the pinch much more directly. Every supermarket run or meal out came with a visible reminder of the tax, reinforcing the idea that GST was driving up the cost of living.

With SST, the tax is built into the final price. Consumers don't see a separate line on their bills, so the burden feels less obvious. That doesn't mean they aren't paying — the cascading effect of SST can quietly push prices higher without people noticing. The difference is as much psychological as it is economic: GST is more efficient but felt heavier, while SST is less efficient but felt lighter on the wallet. In the end, how people perceive their own welfare under each system plays a powerful role in shaping social acceptance and even political outcomes.

Business Competitiveness (supply side)

For businesses, the picture looks quite different. Under GST, companies could claim input tax credits, which meant they weren't taxed over and over again along the supply chain. This was a big advantage for exporters, since it kept Malaysian products more competitive abroad by stripping away hidden taxes. But the downside was the compliance load. Many SMEs struggled with the paperwork, the filing requirements, and the costs of upgrading their systems just to meet GST rules.

SST, on the other hand, is simpler. Only selected businesses — mainly manufacturers, importers, and certain service providers — deal with it directly. This lighter touch makes things easier for most firms, especially smaller ones. The trade-off, though, is the return of the hidden “tax-on-tax” effect, which quietly drives up production costs and eats into competitiveness. Exporters, too, lose out because SST makes it harder to fully remove taxes from goods headed overseas.

In short, GST supports long-term competitiveness through efficiency and transparency, while SST offers short-term relief through simplicity. The trade-off is clear: GST demands more effort from businesses upfront but rewards them with a fairer system, whereas SST feels easier at first but can slowly erode competitiveness over time.

CONCEPTUAL GAPS

Even with all the debates about GST and SST, there are still blind spots in how we understand and study them.

First, there is no integrated comparative model that systematically examines the two tax structures side by side. Most studies focus on either GST or SST in isolation, missing the opportunity to map their similarities and trade-offs within a single framework.

Second, the role of social acceptance as a moderating factor is often underplayed. Malaysia's experience shows that technical efficiency alone is not enough; public trust and political legitimacy can determine whether a tax system survives. Yet, existing analyses tend to treat acceptance as a background issue rather than a central variable.

Third, much of the literature lacks a dual-sided analysis. Consumer welfare (demand side) and business competitiveness (supply side) are often studied separately, but rarely as interconnected outcomes of tax policy. This one-sided view weakens the ability to fully understand how tax structures shape the economy.

Fourth, there is an insufficient focus on welfare outcomes. While revenue generation and administrative efficiency are well-documented, fewer studies ask: How do these systems affect households, affordability, and inequality? Addressing this would bring the discussion closer to the lived realities of taxpayers.

Fifth, the debate is often confined to the Malaysian case, with a lack of international comparison. Since many countries have adopted GST or VAT, comparing Malaysia's dual experience with global practices could yield richer insights on what works, under what conditions.

Finally, existing research suffers from a weak integration of mixed-method approaches. Quantitative studies emphasize revenue and efficiency, while qualitative studies focus on political narratives. Very few attempt to combine these perspectives into a holistic understanding of how tax systems operate in practice.

Together, these gaps highlight why a fresh conceptual framework is needed — one that integrates structure, acceptance, welfare, and comparative insights into a more balanced model of GST and SST.

PROPOSED CONCEPTUAL FRAMEWORK

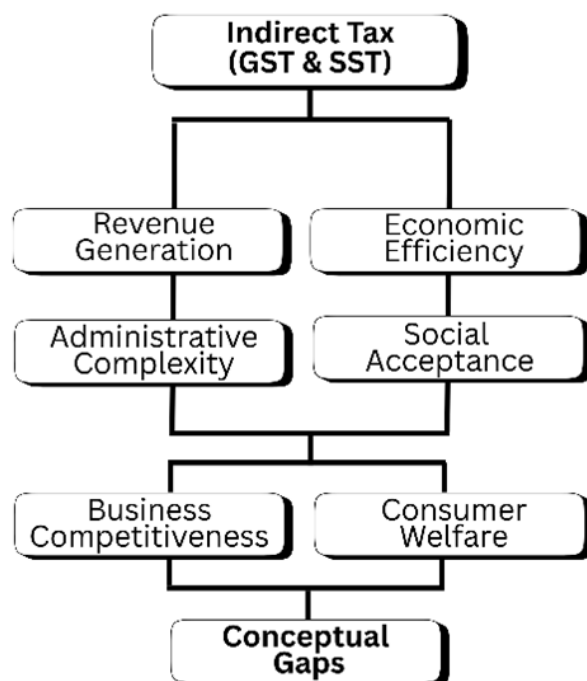


Fig. 1 Conceptual Framework GST & SST

This framework gives us a clearer picture of how GST and SST work as part of Malaysia's indirect tax system. At the very top, both tax structures are placed side by side because they represent two alternative ways the government can raise revenue.

To understand how they function, the framework breaks things down into four main dimensions. First, there is revenue generation, which simply looks at how much money each system can bring into government coffers. Second, economic efficiency considers how smoothly the tax system works without creating too many market distortions. Third, administrative complexity highlights the real-world costs of running and complying with the tax system for both the government and businesses. Finally, social acceptance reminds us that even the most technically sound tax system will not survive if the public does not trust or support it.

These dimensions then flow into two big outcomes. On the business side, taxes can shape competitiveness by affecting costs, compliance pressures, and how firms position themselves in global trade. On the consumer side, taxes matter for welfare — influencing prices, affordability, and people's sense of fairness.

At the bottom of the framework lies an important reminder: there are still conceptual gaps in how GST and SST are studied. We often see studies that look at efficiency or revenue in isolation, but very few that bring together acceptance, welfare, and competitiveness in one model. By recognizing these gaps, the framework shows why a fresh, more integrated perspective is needed to understand Malaysia's experience — and how it can inform future tax reforms.

POLICY IMPLICATION

The framework reminds us that tax reform is not just about filling government coffers. It is about shaping the kind of economy and society people want to live in — one that is fair, efficient, and trusted.

First, while GST has the potential to generate more revenue, numbers alone don't tell the whole story. If compliance costs spiral or ordinary families feel crushed under the weight of taxes, the system will quickly lose its purpose. Protecting low- and middle-income households through smart exemptions or targeted aid is not charity — it is about safeguarding dignity and ensuring no one is left behind.

Second, how taxes are administered matters as much as the rates themselves. A system that is confusing or opaque breeds frustration and mistrust. Investing in digital tools, educating taxpayers, and enforcing rules with fairness sends a powerful signal: the government values people's time, effort, and honesty.

Third, efficiency is about more than technical neatness — it is about giving businesses and workers the confidence to plan their futures. A predictable, transparent tax system reassures investors, encourages innovation, and helps Malaysia compete on the world stage without forcing people to make unfair trade-offs in their daily lives.

Fourth, public acceptance is where everything stands or falls. Malaysia's past has shown that even the "best-designed" systems collapse when people believe they are unfair or politically manipulated. Trust is fragile — it must be earned through open communication, genuine participation, and by proving that every ringgit collected comes back to the people in better services and opportunities.

Finally, reform must balance two sides of the same coin: protecting the consumer who worries about the cost of living and supporting the business owner striving to grow in a competitive market. A just tax system lifts both households and firms, giving them the strength to move forward together.

In the end, a tax system is more than a fiscal tool. It is a social contract. For Malaysia, the challenge is not only technical but deeply human — building a system that people believe in, that includes everyone, and that can stand strong for generations to come.

CONCLUSION

This paper has sought to reframe the debate on GST and SST, moving beyond narrow fiscal numbers toward a more human and integrated understanding of indirect taxation. By looking at revenue generation, economic efficiency, administrative complexity, and social acceptance together, the framework reminds us that tax reform is not simply about designing a system on paper — it is about shaping how people experience fairness, trust, and opportunity in their daily lives.

The analysis shows that indirect taxes cut across two vital fronts: the purchasing power of households and the competitiveness of businesses. To focus on one while neglecting the other is to risk creating tensions that weaken both economic resilience and public confidence. Taxation, then, must be understood as a delicate balancing act — a negotiation of trade-offs between fiscal needs, economic strength, and social wellbeing.

At the same time, this study highlights how much remains unexplored. Current debates often stop short at technical comparisons, overlooking deeper issues of legitimacy, acceptance, and international learning. Filling

these gaps opens the door to a richer and more honest conversation — one that acknowledges taxation not just as an economic instrument, but as a lived experience that touches every citizen and business.

The central insight is clear: a tax system's legitimacy is as important as its efficiency. For Malaysia, the way forward is not to frame GST and SST as a technical choice between two competing models, but to build a system that people believe in — one that is fair, transparent, and trusted. Such a system would not only secure the revenues needed to run the state but would also renew the social contract, giving Malaysians confidence that their contributions are building a more inclusive and sustainable future.

REFERENCES

1. Voyiakis, E. (2025). The moral force of the benefit principle. *Economics and Philosophy*.
2. Shome, P. (2021). *Equity Effects of Taxation*.
3. Jamel, N.E., Hamid, N.A., Azizan, S., Arshad, R., Othman, R.D., Sanusi, S., & Zawawi, S.N. (2021). Analysing SST 2.0 Tax Burden through the Element of Principle of Good Tax Policy. 12th GLOBAL CONFERENCE ON BUSINESS AND SOCIAL SCIENCES.
4. Poh, E.H. (2002). Broad-Based Consumption Tax Reform: The Economics and Politics of Its Equity Implications.
5. Kendrick, M. S. (1939). The ability-to-pay theory of taxation. *The American Economic Review*, 92-101.. The ability-to-pay theory of taxation. *The American Economic Review*, 92-101.
6. Chernick, H., & Reschovsky, A. (2000). Yes! Consumption taxes are regressive. *Challenge*, 43(5), 60-91.
7. Dalamagas, B., Leventides, J., & Tantos, S. (2022). Equity-efficiency dilemma and tax harmonization. *Central European Economic Journal*, 9(56), 342-353.
8. Murty, S. (2017). Lessons from optimal taxation theory for the GST and beyond (No. 17-07). Centre for International Trade and Development, Jawaharlal Nehru University, New Delhi, India.
9. Diamond, P. and J. Mirrlees (1971). Optimal Taxation and Public Production I: Production Efficiency *The American Economic Review* 61, 8-27.
10. Friedman, K. A., Lindholm, D. L., Barr, R., & Robertson, D. D. (2021). *A Global Perspective on US State Sales Tax Systems as a Revenue Source: Inefficient, Ineffective, and Obsolete*. Washington, DC: State Tax Research Institute.
11. Swank, D. (2016). The new political economy of taxation in the developing world. *Review of International Political Economy*, 23(2), 185–207.