

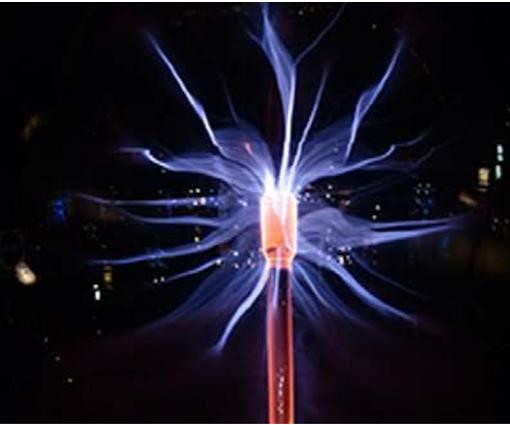


# Budget 2019

## SST 2.0, Digital Tax and Excise

KPMG in Malaysia

2 November 2018



# Overview and Commentary

## Budget 2019 – SST 2.0, Digital Tax and Excise

### Imported Services and Digital Tax

With growing e-commerce fueled by technology advancements, the Government is taking steps to tax cross-border content sold to Malaysian buyers that are delivered in digital form.

This move to tax the digital economy is in line with the intention of other countries and it is a bold move as Malaysia will be among the early adopters.

At present, the coverage of Service Tax is “restrictive” and only applicable on local service providers who provide prescribed taxable services in Malaysia. The legislation, however, does not extend to cover overseas service providers who could be providing the same services in Malaysia and yet, not subject to Service Tax – which causes the local players to be less competitive.

Recognizing the uneven playing field, the Government has proposed that Service Tax shall also be applicable on taxable services that are procured from overseas service providers, regardless whether it is involving business-to-business (“B2B”) or business-to-consumer (“B2C”) transactions.

The key difference between the two types of transactions (whether B2B or B2C) would be the party that is obliged to comply with the Service Tax legislation; recipient to do self-accounting (if the recipient is a business) or overseas service provider to be registered for Service Tax in Malaysia (if the recipient is the end consumer).

It is to be noted that this proposal shall be implemented at two different effective dates – 1 January 2019 for B2B transactions and 1 January 2020 for B2C transactions.

Whilst the Service Tax coverage can be extended to include overseas service providers, compliance and enforcement could be a challenge, especially where the overseas service providers do not have any presence in Malaysia and such services can be provided remotely or practically anywhere around the world.

### B2B Service Tax Exemption

Opponents of Service Tax often criticise its effects on tax cascading and hence price increases, as tax is imposed on top of tax in the absence of a credit system.

For instance, a Service Tax registered lawyer provides legal services to a Service Tax registered consultant and charges 6% Service Tax on its fee (RM100 + 6%). The consultant’s fee to its client is RM200, so he adds the amount invoiced by the lawyer (RM106) to its invoice to its client and charges 6% Service Tax on the total fee (RM306 + 6%). In this case, the total Service Tax collected by the Government is RM24.36 (RM406 X 6%), which is an effective rate of 8.12% (RM24.36/RM300). This would mean Service Tax is charged twice on the legal services and the clients pays a 6% Service Tax on the Service Tax charged by the lawyer.

To eliminate the tax cascading effect, it is proposed that specific taxable services provided by a registered person to another registered person be exempted from Service Tax, effective 1 January 2019.

This should help in preventing inflationary prices resulting from the above tax cascading effect and hopefully it will make the local service providers more competitive.

It would be interesting to see the group of services that qualify for the above exemption and the conditions to fulfill.

### Credit System for Sales Tax Deduction

Currently, if a registered manufacturer acquires raw materials, components or packaging materials for its manufacturing activities from an importer, unlike those purchased from another registered manufacturer, there is no Sales Tax exemption available for the first-mentioned registered manufacturer on the acquisition of materials. In such a case, this could potentially result in compounded taxation as the importer would have incurred Sales Tax on the importation of materials and this would likely be passed on to the registered manufacturer. This will increase the costs to the registered manufacturer who will then charge Sales Tax on its taxable goods, on top of the Sales Tax incurred on the acquisition of materials from the importer, and the roll-over effect could increase the costs of the product to the end-consumer.

To prevent the compounded taxation and decrease the cost of doing business, it is proposed that a credit system for Sales Tax deduction be introduced for small registered manufacturers who acquire “*input pembuatan*” or products for their manufacturing activities from importers instead of from other registered manufacturers.

This proposal is effective 1 January 2019. While the proposal is good news to small registered manufacturers, there are still some uncertainties in relation to the proposal, some of which we have set out below:

1. Who are the “small” registered manufacturers who will qualify for the credit system?
2. What are the “*input pembuatan*” or “products” acquired from the importers which will qualify under the credit system?
3. We note that a credit system was available under the previous Sales Tax regime, where a Sales Tax deduction up to a certain percentage of the total value of goods purchased from a non-registered person will be allowed, provided the prescribed conditions were met and prior approval was obtained from the Director General of the Royal Malaysian Customs Department. Will the proposed credit system be similar to the previous credit system?

4. Who are the “importers”? Does it cover manufacturing inputs from traders who are not importers (who purchased the goods from local licensed manufacturers)?

It is hoped that with better clarity on the proposal including the mechanism in which the credit system for Sales Tax deduction will be introduced, this could assist small registered manufacturers in managing their cost of acquisition of materials from importers and thus decreasing their cost of doing business.

### Soda/ Sugar Tax

In line with the Government initiative to promote healthier lifestyle, Malaysia introduces excise duty at 40 cents per litre on two group of beverages, following a number of other countries that had already done so or in the process of doing so.

This proposal takes effect on 1 April 2019 and the two groups of beverages are non-alcoholic beverages (if sugar exceeds 5gm per 100ml) and fruits/ vegetables juices (if sugar exceeds 12gm per 100ml).

As observed in other countries, the impact of the Soda Tax is uncertain as producers may incorporate sugar substitutes into their products to avoid paying increased tax.

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