

SST e-Alert

13 JUNE 2019

Sales Tax Exemption For Registered Manufacturers

Lately, several registered manufacturers have been issued bills of demand for underpaid sales tax by the Director General of Customs (**DG**). Customs has alleged that the manufacturers' raw materials, components or packaging materials do not qualify for sales exemption despite obtaining the sales tax exemption certificate.

The Exemption Order

Section 8 of the Sales Tax Act 2018 (**STA**) prescribes the imposition of sales tax on taxable goods manufactured in or imported into Malaysia, unless the goods are exempted from sales tax.

Among others, this exemption covers raw materials, component and packaging materials acquired by a registered manufacturer to manufacture finished goods (see Column 4, Item 1 of Schedule C of the Sales Tax (Persons Exempted from Payment of Tax) Order 2018 (**Exemption Order**)).

The conditions for this exemption under the Exemption Order are:

- the goods approved by the DG.
- the goods are imported or purchased from another registered manufacturer or a warehouse licensed under Section 65 or licensed manufacturing warehouse under Section 65A of the Customs Act;
- the goods shall be used solely in the manufacturing of finished goods of the registered manufacturer;
- the registered manufacturer shall pay the sales tax on any goods that cannot be accounted for; and
- any other conditions the DG deems fit to impose.

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The DG's Position

According to the DG, in order for a registered manufacturer to qualify for sales tax exemption, the raw materials, component and packaging materials must be used solely in the manufacturing of taxable goods. The registered manufacturer is not allowed to use these materials to manufacture any exempted goods.

Paragraph 6 of the Customs' Guide on Sales Tax Exemption under the Exemption Order (as at 24.4.2019) states:

Conditions for exemption under Item 1 and 2, Schedule C, Sales Tax (Persons Exempted from Payment of Tax) 2018 are:

- (i) The goods are approved by the Director General;*
- (ii) The goods are imported or purchased from a registered manufacturer or a licensed warehouse under section 65 or licensed manufacturing warehouse under section 65A of the Customs Act 1967;*
- (iii) The goods shall be used solely in the manufacturing of taxable finished goods; and*
- (iv) The approved person shall pay sales tax on any goods that cannot be accounted for.*

The Customs' Guide restricts the exemption of raw materials, components and packaging materials to those used solely in the manufacturing of "taxable finished goods". In contrast, Condition (c), Column 4, Item 1 of Schedule C of the Exemption Order merely requires the registered manufacturer to use them in the manufacturing of "finished goods" instead of "taxable finished goods" as required by the Customs in the Guide.

Practical Difficulties

Due to this rigid condition, a registered manufacturer would be required to segregate the raw materials, component and packaging materials purchased for the manufacturing of taxable and non-taxable products. This would create unnecessary administrative burden and cause inconvenience to a registered manufacturer in his manufacturing process as the manufacturer would not be allowed to utilise his materials freely.

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Clearly, the DG has failed to appreciate the practical difficulties of a registered manufacturer who manufactures both taxable and non-taxable goods to keep track of the actual usage of his raw materials, components and packaging materials. This is especially if the materials are used across the board to manufacture several different types of taxable and non-taxable products.

Our View

The conditions for a registered manufacturer to be entitled for sales tax exemption have been explicitly provided in Column 4, Item 1, Schedule C of the Exemption Order. If a registered manufacturer has fulfilled all these conditions, he should be entitled to the sales tax exemption.

The DG would be acting erroneously in restricting the sales tax exemption to raw materials, components and packaging materials that are used solely for the purposes of manufacturing taxable finished goods. There is no legal basis for the DG to impose such restriction through the Guide. Our view finds support from the decisions in *Multi-Purpose Holdings* and *Metacorp*, where it was ruled that the internal policy, circular and procedure of a taxing authority have no force in law.

The purpose of an Exemption Order is to exempt one from the payment of sales tax. In this regard, based on the clear reading of the Exemption Order, the registered manufacturer is not required to use the exempted goods acquired solely in the manufacturing of taxable goods. The term used in the Exemption Order is “finished goods”, which can refer to either taxable or non-taxable goods, and should not be artificially restricted to taxable goods only. Although there is a separate condition which states any other condition the DG deems fit to impose, such condition cannot be imposed arbitrarily and retrospectively through the Guide so as to defeat the very purpose of the Exemption Order.

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Remedy For Aggrieved Taxpayer

A registered manufacturer who is aggrieved by a bill of demand in relation to this matter may make an application for the bill of demand to be reviewed by the DG within the prescribed time frame. Alternatively, an appeal can also be lodged with the Customs Appeal Tribunal.

If the sales tax amount demanded is substantial, the DG had acted arbitrarily and the aggrieved manufacturer has no financial capacity to settle the demanded sales tax, then judicial review could be explored as an option.

For queries pertaining to sales tax, including on challenging the bills of demand issued by the DG, please contact our partners from the Tax, SST & Customs Practice, **Datuk D P Naban** or **S Saravana Kumar** at tax@lh-ag.com

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