

# SST e-Alert

2 MAY 2019

## Taxing Digital Services — The Service Tax (Amendment) Bill 2019

On 8.4.2019, the Dewan Rakyat passed the Service Tax (Amendment) Bill 2019 (**the Bill**), which, among others, proposes the imposition of service tax on the supply of digital services in Malaysia by foreign service providers. This new “digital service tax”, as it is known, will come into effect on 1 January 2020.

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### Scope Of Service Tax

The Bill inserts a new Section 56A into the Service Tax Act 2018 (**the Act**), which prescribes that service tax shall be charged on any digital service provided by a foreign registered person to any consumer. The elements that must be present for service tax to be chargeable on foreign digital services are:

#### *Foreign registered person*

“Foreign Registered Person” is defined as any foreign service provider registered with the Director General of Customs and Excise (**Director General**) under Section 56C of the Act.

“Foreign service provider” is further defined as any person who is outside Malaysia providing any digital service to a consumer and includes any person who is outside Malaysia operating an online platform for buying and selling goods or providing services (whether or not such person provides any digital services) and who makes transactions for provision of digital services on behalf of any person.

However, not all foreign service providers falling within the above definition are liable to be registered with the Director General under Section 56C of the Act. The liability to register arises when:

“... the total value of the digital services provided in a month and in the 11 months immediately succeeding that month exceeds the total value of RM500,000 (**the Threshold Value**); or

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there is a reasonable ground for believing that the total value of the digital services provided in a month and in the 11 months immediately succeeding that month exceeds the Threshold Value”.

### *Provision of digital services*

Digital service is defined as:

“... any service that is delivered or subscribed over the internet and other electronic network and which cannot be obtained without the use of information technology and where the delivery of the service is essentially automated”.

Examples of digital services on which service tax may be imposed include music and video streaming services such as Netflix and Spotify, listing fees on electronic marketplaces such as App Stores, as well as subscription fees for cloud storage services such as Google Drive.

However, most of the digital service providers in the industry are not tax resident in Malaysia. What the Royal Malaysian Customs Department (**Customs**) is now proposing through the introduction of these clauses is essentially to compel such foreign service providers that operate in Malaysia to register for service tax and, thereafter, start charging and remitting service tax to the government. This is unprecedented for a start, whereby corporations without a permanent establishment in Malaysia are forced to come within the parameters of our tax system.

It remains to be seen as to how effective Customs could enforce this as the definition of digital service is so wide and there are possibly thousands of foreign digital service providers worldwide. It is also impracticable and impossible for Customs to penalise any of these providers that fails to register or violates any provisions of the Act in the future as they are all located in foreign jurisdictions in the first place.

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In dialogue sessions, Customs has intimated that the government may seek to enforce the imposition of service tax on foreign service providers via government-to-government cooperation under the auspices of the Organisation for Economic Co-operation and Development (OECD). Further, there has also been indication that websites of foreign service providers that fail to comply will be blocked, but the effectiveness of such a move remains to be seen.

### Consumer

Clause 3(e) of the Bill inserts into the Act the definition of “consumer” as follows:

“consumer” means any person who fulfils any two of the following:

- (a) makes payment for digital services using credit or debit facility provided by any financial institution or company in Malaysia;
- (b) acquires digital services using an internet protocol address registered in Malaysia or an international mobile phone country code assigned to Malaysia;
- (c) resides in Malaysia;”

Our view is that this clause could potentially be easily abused as it requires consumers to be acquiring digital services through an IP address registered in Malaysia. However, it is common knowledge that internet users can easily use a foreign IP address through a virtual private network (VPN) server. Therefore, it is surprising to see the government limiting themselves in the scope of digital consumers under this Bill.

### Registration Of Foreign Service Providers

A foreign service provider is liable to be registered where the actual total value of digital services provided over 12 months exceeds the Threshold Value, or where there are reasonable grounds for believing that the total value of digital services provided over 12 months would exceed the Threshold Value. As far as registration is concerned, Part IV of the Act does not apply to foreign registered persons. Instead, Clause 51 of the Bill and

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the proposed Section 51C have provided for the timeline for registration as follows:

- *Where such liability to register arises before the proposed provisions come into effect*

The liability to register arises where there are reasonable grounds for believing that the total value of all digital services provided in the month of the coming into operation of the proposed provision and 11 months immediately succeeding that month will exceed the Threshold Value. In such a situation, an application for registration has to be made three months before the date of coming into operation of the proposed provisions, i.e. before 1.10.2019.

Hence, existing foreign service providers already providing digital services to Malaysian consumers will have to look at their revenue projection for the next few months to gauge whether the total value of the digital services provided since February 2019 will exceed RM500,000 by the end of January 2020. If this is the case, such foreign service providers are expected to make an application for registration before 1.10.2019.

- *Where such liability to register arises after the proposed provisions come into effect*

An application to register has to be made not later than the last day of the month following the month in which liability to register is triggered.

### **Taxable Period And Payment Of Service Tax**

Unlike other taxable services where the taxable period is two months ending on the last day of any month of any calendar year, the taxable period for a foreign registered person shall be three months ending on the last day of any month of any calendar year.

The returns have to be furnished and the service tax has to be paid before the last day of the month following the end of the taxable period. Failure to do so would amount to an offence which, upon conviction, would attract a fine not exceeding RM50,000 or to imprisonment for a term not exceeding three years, or both.

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Alternatively, if payment of service tax is not made before the stipulated deadline and no prosecution is instituted, a penalty will be imposed in the following manner, at the same rate as the penalty imposed for other taxable services:

Period	Penalty
First thirty-day period	10% penalty on the amount of service tax that remains unpaid
Second thirty-day period	Additional 15% penalty on the amount of service tax that remains unpaid
Third thirty-day period	Additional 15% penalty on the amount of service tax that remains unpaid

### Issuance Of Invoice

Clause 56G of the Bill proposes that every foreign registered person has to issue an invoice or a document containing the prescribed particulars to a consumer in respect of the transaction. The invoice may be issued electronically or in paper form.

### Our Observation

The imposition of service tax on foreign digital services will not only affect foreign companies providing digital services to Malaysian consumers, but also local firms that subscribe to such digital services provided by foreign companies in the course of their operations. As a result, it might increase the costs borne by such companies in subscribing to such foreign digital services. This is particularly the case when the term “digital services” has been defined so widely that common online services used by businesses such as online software, online marketing services and others are all highly likely to fall within the scope.

In terms of the operation of the Bill, there have been no rulings or guidance issued by Customs to date, even though there are several points in the Bill that remain to be clarified, such as the wide definition of “digital services”. Further, while the Threshold Value is expressed in Ringgit Malaysia and the payment of service tax is to be done in Ringgit Malaysia, digital services provided by foreign service providers are most likely charged in foreign currency. In this regard, the Bill is silent on the conversion mechanism of foreign currency to Ringgit Malaysia, though one may look at the Service Tax General Guide published by Customs for guidance.

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Paragraph 60(viii) of the guide provides that any amount stated in a foreign currency in an invoice is also required to be expressed in Ringgit Malaysia based on the selling rate of exchange prevailing in Malaysia at the time the taxable service is provided.

Given that the new provisions are due to come into effect in January 2020, foreign service providers will need to start considering whether they are providing digital services within the definition of the new provisions and whether they are liable to be registered. In these circumstances, foreign digital service providers should seek proper consultation from their tax solicitors, especially in the early stages of the implementation of the new proposed provisions, in order to preserve their rights.

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For queries on matters pertaining to the law of digital and technology-related matters including FinTech, please contact our Corporate Practice partner, **Raphael Tay Choon Tien** ([rtt@lh-ag.com](mailto:rtt@lh-ag.com)).

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