

SST e-Alert

20 JULY 2018

The Return Of SST

By now, Malaysians would have grown accustomed to the term “sales and services tax” (**SST**) as it has dominated headlines over the past few weeks. During a debate session in Parliament on 18.7.2018, the Finance Minister stated that on a full-year scale, SST collection will be RM21 billion, which is almost half of that collected from the goods and services tax (**GST**) in 2017.

After much intense speculation in respect of the scope and mechanism of the SST, the Royal Malaysian Customs Department (**Customs**) finally shed light on this matter by publishing a draft on 19.7.2018 (Proposed Mechanism). It turns out that the Proposed Mechanism mirrors that of the SST regime pre-April 2015.

In essence, although coined “SST”, both sales tax and services tax are actually governed by separate pieces of legislation, and therefore, the term could be misleading. Although both are single-layer consumption-based taxes, one major difference is that sales tax operates on a negative list, where all goods manufactured or exported to Malaysia are taxable unless exempted. On the contrary, services tax operates on a positive list, where only specific services are taxable.

Four issues concerning sales tax

Based on the information provided by Customs on 19.7.2018, sales tax will be levied on all goods manufactured in Malaysia or imported unless exempted. The persons liable to collect such sales tax will be the manufacturer and the importer, respectively. This is the exact same structure as the previous sales tax regime.

(i) Registration

It is stated in the Proposed Mechanism that “manufacturers of taxable goods are liable to be registered when sales value of taxable goods has exceeded RM500,000.00”.

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The first issue that arises from this statement is whether goods that are listed under the proposed Sales Tax Exemption Order (**Proposed Exemption Order**) are deemed to be “taxable goods”, notwithstanding that they are exempted. Section 2(1) of the previous legislation, i.e. the Sales Tax Act 1972, sheds light on this as it defines “taxable goods” to exclude goods that are exempted.

If this provision is similarly adopted in the new legislation, manufacturers whose goods are exempted will not be required to register. However, as we are certain that the Proposed Exemption Order will be amended continuously in the years to come, where goods could be included in or excluded from the list, manufacturers need to keep a close eye on such amendments.

(ii) Exemptions

One of the clear benefits of GST is that it is simplified, where only a handful of goods or services are zero-rated or exempted respectively. However, the Proposed Exemption Order contains a list of exempted goods that runs up to almost 300 pages and they are classified by tariff codes.

By reverting to the SST regime, businesses will scramble to determine whether goods that they manufacture or import are exempted. We will also revert back to an era where tariff classification becomes imperative, not only from an exemption standpoint, but also for the purposes of identifying the rate of tax. This is on the premise that the Finance Minister has also announced that rates of tax will differ based on product.

Nevertheless, having compared the Proposed Exemption Order and the Exemption Order under the previous sales tax regime, we found that they are roughly 95% the same. In other words, it is status quo for goods that were previously taxable or exempted, save for the following items:

Goods previously exempted but now taxable include:

1. Oils such as soya bean, ground-nut, olive, sunflower seed and mustard oils;
2. Seafood products such as lobster, scallops, mussels, clams, sea cucumbers and sea urchins;
3. Hard rubber;
4. Cellular wood panels, panels, boards, tiles and blocks;

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5. Printing machinery such as printers and fax machines;
6. Laptops, desktop computers, monitors, projectors and hard disk drives;
7. Sound recording devices;
8. Digital cameras; and
9. Wrist watches, video game consoles, pens and lighters.

Goods previously taxable but now exempted:

1. Hot-rolled steel bars and wire rods for producing soldering sticks and rebars; and
2. Hand tools such as hammers, screwdrivers and other household tools.

(iii) Valuation

Sales tax is charged at the point of manufacturing and importation. This is starkly different from the GST regime, which is a multi-layer tax, and ultimately charged at the point of consumption and borne by the end consumer.

Being charged at the point of manufacturing, the issue of whether costs incurred post-manufacturing should be included in the value for sales tax purposes is often debated. In fact, during the previous SST era, it was commonplace for manufacturers to have both a manufacturing and a trading arm, where sales tax was charged on the ex-factory price.

This matter recently received judicial pronouncement by the Court of Appeal and the High Court in *Ketua Pengarah Kastam v X Sdn Bhd*, in which we acted for the taxpayer. In that case, the Director General of Customs had uplifted the value of the goods manufactured by the taxpayer by adding advertising and promotional expenses incurred by another company. The taxpayer successfully argued that valuation for sales tax shall be based on the Sales Tax (Rules of Valuation) Regulations 2002, which prescribes that the value to be used is the transaction value. As the transaction value of goods sold by the taxpayer does not include advertising and promotion expenses, therefore, the same could not be included for the purposes of the computation of sales tax.

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As such, with sales tax back in the picture, we could well see manufacturers reverting to having both a manufacturing and a trading arm, where the value declared for sales tax purposes will be the transaction value of goods sold by the manufacturing to the trading arm. This form of trading was ruled to be valid by the High Court in *Pioneer Technology Sdn Bhd v Royal Malaysian Customs Department*. Although it is legal for businesses to restructure their transactions in such a manner in anticipation of the reintroduction of sales tax, it should be done with utmost caution as there are obviously transfer pricing risks involved.

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(iv) Exemptions for LMW

Another issue that is bound to be a point for discussion will be the availability of exemption of sales tax for licence manufacturers. Previously, holders of licence manufacturing warehouses were exempted from the payment of sales tax for raw materials — provided that 80% of the finished goods was for export. However, based on industry feedback, manufacturers found the need to have perfect records of raw materials usage and K2 Export forms to be an administrative difficulty and extremely cumbersome. As such, a more simplified and uniform system ought to be in place to track raw materials usage.

Conclusion

The Finance Minister had earlier stated that the Bill on sales tax and services tax would be tabled in Parliament in August, with sales and service tax to be implemented starting 1 September 2018. This gives businesses and companies a mere one month to adapt, register and implement the new tax structure. Those potentially affected should immediately take steps to prepare themselves for this transition.

Please contact our tax partners Datuk D P Naban or Mr S Saravana Kumar at tax@lh-ag.com if you have any queries pertaining to SST.

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