

SST e-Alert

24 OCTOBER 2019

Update On Taxation Of Digital Services

Come January 2020, service tax will be imposed in Malaysia on digital services in line with the government's plan to level the playing field for both local and foreign service providers (**FSPs**). With less than three months left till implementation, FSPs are preparing themselves for the challenges that lie ahead. The Royal Malaysian Customs Department (**Customs**) recently issued a Guide on Digital Service Tax (**Guide**) to assist FSPs. This alert highlights some of the key points that FSPs should consider in assessing their liability prior to the implementation.

Key Points And Clarifications

Pursuant to the Service Tax (Amendment) Act 2019 (**the Act**), service tax will be charged on any digital service provided by a foreign registered person to any consumer. As predicted, the provisions of the Act have been worded so broadly that they warrant a series of clarifications by Customs on several matters.

The Guide defines FSPs as foreign businesses or individuals providing digital services to Malaysian consumers by selling digital products directly or indirectly through intermediaries (online platforms). These include online platforms that carry out transactions on behalf of overseas service providers but do issue invoice or any other document under their name.

In order to be a consumer for the same purpose, at least two of the following requirements must be met:

- Makes payment for digital services using a credit or debit facility provided by any financial institution or company in Malaysia.
- Acquires digital services using an internet protocol address registered in Malaysia or an international mobile phone country code assigned to Malaysia.
- Resides in Malaysia.

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These requirements are applicable to both “business to consumer” and “business to business” transactions. Accordingly, Customs may obtain information for the above requirements via the billing address, home address or country selection of consumers.

Registration

FSPs must register as foreign registered providers (**FRPs**) when the total value of digital services provided to consumers in Malaysia exceeds RM500,000 per year. The scope of services extends to those delivered through an information technology medium with either minimal or no human intervention from the service provider. Accordingly, the Guide provides a non-exhaustive list of such services, including software, applications, online platforms, social networks etc.

Importantly, the Guide explains that the value of digital services for a period of 12 months is determined based on either the historical or future method. The former is based on the value of digital services in any month, plus the value of digital services for 11 months immediately before that month. Alternatively, the future method is based on the value of digital services in any month plus the expected value of digital services for the 11 months immediately after that month.

Thus, FSPs that are liable to be registered shall apply for registration no later than the last day of the month following the month in which the threshold exceeded. The effective date of registration is on the first day of the following month after the application was made.

However, an existing FSP that provides digital services to consumers in Malaysia shall apply for registration three months before 1.1.2020, if it expects its total value of digital services from 1.1.2020 and for the next 11 months to exceed RM500,000. In this regard, the determination of the value of digital services will be based on future method only.

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Invoicing

Further, FSPs are required to issue an invoice or documents to consumers in respect of transactions pursuant to section 56G of the Act. Based on Regulation 6 of the Service Tax (Digital Services) Regulations 2019, the invoices/documents shall state:

- the date of the invoice;
- the registration number of the FRP;
- a description sufficient to identify the digital services provided;
- the total amount payable, excluding service tax, the rate of service tax and the total service tax chargeable shown as a separate amount.

FRPs should keep all original records of transactions which may affect their liability to digital service tax. They will have a duty to preserve all records kept for a period of seven years, from the latest date to which the record relates. In cases where the record is in an electronically readable form, the record shall be kept readily accessible and convertible in writing.

Non-compliance

FSPs are also warned that any failure to comply with the digital tax provisions under the Act is an offence subject to penalty. Thus, failure or late application for registration must be avoided. In relation to the digital tax returns, FSPs should avoid late filing and incorrect submissions altogether.

In the event that the FRP fails to pay service tax after the last day on which it is due and payable, it may face a penalty of:

- 10% of the amount of service tax on digital services that remains unpaid for the first 30-day period that the service tax on digital services is not paid wholly or partly after the expiry of the period;

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- An additional penalty of 15% of the amount of service tax on digital services that remains unpaid for the second 30-day period that the service tax on digital services is not paid wholly or partly after the expiry of the period; and
- An additional penalty of 15% of the amount of service tax on digital services that remains unpaid for the third 30-day period that the service tax is not paid wholly or partly after the expiry of the period.

Where payment is received before the effective date of the digital service tax, the FSPs will not be required to charge taxes on any digital services provided. However, if the provision of the services spans beyond 1.1.2020, the part of the services provided on or after the date must be charged to tax. This is provided that the full payment for the services has not been received beforehand.

Ultimately, to avoid delay in registration and unnecessary complications, FSPs are advised to take advantage of the early registration programme, which started on 1 October 2019.

Conclusion

The Malaysian government estimates an increase in tax revenue by more than RM2.4 billion a year once foreign digital service providers register for the 6% service tax. However, with less than three months left before the digital service tax applies, FSPs are facing difficulties in ensuring proper compliance of the law. Although Malaysia's rate of service tax is one of the lowest compared to other countries, FSPs fear that the wider approach lacks in certainty, which may cause them more harm than good.

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More practical difficulties are in regard to the FRP's system configurations and classifications. Essentially, FSPs will have to ensure that each digital transaction is identified correctly to avoid filing of incorrect returns, resulting in failure to remit service tax. Whether or not Customs will be able to collect the service tax effectively is another issue yet to be determined. This is because the interests of both businesses and consumers must be balanced in line with the government's objective of increasing revenue collection.

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