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LHAG update

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Taxing Digital Services — Updates from Customs

Last week, senior associate Jason Tan Jia Xin, from the firm's Tax, SST & Customs Practice, attended a closed-door briefing on digital service tax organised by the Royal Malaysian Customs Department (**Customs**) for the American Malaysian Chamber of Commerce.

Customs has reiterated that the commencement date for foreign service providers to register remains as 1.10.2019, while the implementation date is on 1.1.2020. It is understood that the Customs guidelines on this matter will be issued soon.

Digital Service

Under the Service Tax Act 2018, "digital service" is defined as:

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

In essence, for a service to fall within the definition, it needs to fulfil all of the following criteria:

- it is first and foremost a service;
- delivered or subscribed over the internet;
- cannot be obtained without the use of information technology; and
- the delivery of the service is essentially automated.

Customs' Position

During the briefing, Customs clarified that the scope of "digital services" covered under the definition will include (in a non-exhaustive fashion):

- software, applications and video games;
- online licensing of software, updates and add-on websites;
- music, e-books and films;
- advertising and online platforms;
- search engines and social networks;
- database and hosting: file sharing, cloud sharing, website hosting and online data warehousing;

- telecommunications;
- online learning courses; and
- payment processing services.

Our Preliminary View

Customs appears to presume that all transfer of software over the internet is a transfer of "*service*" and, therefore, liable to digital service tax. However, globally, this remains a thorny issue whereby courts from different jurisdictions are tasked to determine whether such transfer constitutes a transfer of a good or service. Accordingly, Customs' position is open to challenge as the transfer of software might not even satisfy the first limb of the definition of a "*digital service*", i.e. that it is in essence a "service" and not a form of "*good*". This issue could potentially end up in our courts in the future.

The other concern is that some of the items stated above can still be obtained even "*without the use of information technology*", such as software or video games in physical copies or films sold and marketed in physical copies. Hence, there could be many items listed above that do not actually fall within the definition of "digital service" and, therefore, subject to challenge.

Another concern revolves around the last limb of the definition of "digital service", i.e. "*that the delivery of the service is essentially automated*". There are various types of services that may not be completely automated, such as online advertising, whereby the service provider would still need to render some manual services in providing the advertising. Another example would be online training and learning courses, whereby there will be trainers or coaches who provide "live" lessons. There is a high possibility that Customs and the foreign service providers might not reach a consensus in the future.

It was highlighted by Customs that there will not be intra-group relief of service tax for digital services. In other words, service tax will be chargeable for an intra-group digital service transaction whereby the recipient of the same is a Malaysian consumer. This clearly contradicts the government's intention of creating parity through the introduction of service tax on digital services.

If you have any queries pertaining to digital service tax matters, including making representation to Customs and the Ministry of Finance, please contact our partners **Datuk D P Naban** or **S Saravana Kumar** from the Tax, SST & Customs Practice at **tax@lh-ag.com**

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