

DISCORD OR HARMONY DIGITAL SERVICE TAX VS SERVICE TAX ON IMPORTED SERVICES?

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Beginning 1 January 2019, taxable services that are imported into Malaysia would require the recipient of such services to self-account and pay a 6% Service Tax to the Royal Malaysian Customs Department (“RMCD”)¹. In other words, any person in Malaysia (irrespective of whether he is registered for Service Tax or not) has to pay a 6% Service Tax to the RMCD when the following conditions are met:

- The services acquired are prescribed as taxable services in the Service Tax Regulations 2018;
- The services are imported

into Malaysia; and

- The services are used for business purposes.

If by any chance, any of the conditions are not met (e.g. the services were not used for business purposes), the recipient of such service would not be required to account for the 6% Service Tax.

Exactly one (1) year after 1 January 2019, the authorities widened the scope of the Service Tax legislation further to include digital services that are provided in Malaysia. The Service Tax for this new category of taxable services is commonly referred to as the “Digital

Service Tax” which took effect from 1 January 2020². As a result of this tax, a foreign company that has no physical presence in Malaysia may now be liable to register for Service Tax³ in Malaysia under this new system and would have to charge a six per cent (6%) Service Tax on any digital service provided by this foreign company to any consumer in Malaysia.

As of 20 December 2019, an RMCD spokesman said that at least 126 foreign digital service providers including companies like Netflix, Spotify, Google and Airbnb had registered for this Digital Service Tax³



WHAT ARE THE DIFFERENCES BETWEEN THE DIGITAL SERVICE TAX AND SERVICE TAX ON IMPORTED SERVICES?

Before we look into the differences between these two taxes, let us first understand their common features.

Firstly, both the Digital Service Tax and Service Tax on Imported Services relate to taxable services that are acquired from service providers that are not from Malaysia. A company would not need to consider the implications of these two taxes below if the service provider is from Malaysia. Secondly, the taxable services under these two types of taxes are in relation to services that are imported into Malaysia or provided to consumers that reside in Malaysia. An example of a type of taxable service that is not treated as being imported into Malaysia would

Taxable services in Group G of the Service Tax Regulations only



be a hotel stay in a foreign country.

Having gone through the similarities, we shall now analyse the differences between these two taxes. From a policy perspective, the ex-/ previous Finance Minister, Mr. Lim Guan Eng has clarified that the Service Tax on Imported Services is meant to be imposed on services imported by businesses in Malaysia

whilst the Digital Service Tax is meant to be imposed on services imported by consumers⁴.

The policy to impose Service Tax on services imported by businesses is expressed in the Service Tax Act which requires a person not registered for Service Tax to account for the Service Tax on Imported Services only if the services are acquired for the purpose of carrying a business⁵. The Digital Service Tax is, however, meant to tax digital services that are provided to consumers in Malaysia, with the definition of what constitutes a “consumer” being provided in the same Act⁶.

The types of services to be taxed by the two taxes are vastly different from each other. By definition, the self-accounting of the 6% Service Tax is required to be performed by the recipient on the acquisition and importation of all types of services that are prescribed to be taxable in the Regulations⁷. However, the Digital Service Tax is only imposed on taxable digital services that are provided to consumers in Malaysia (as opposed to businesses), with the definition of “digital services” being also provided in the same Act⁸. In other words, the scope of taxable services to be taxed under the Digital Service Tax only represents a subset of the whole set of taxable

Table 01

TYPE OF SERVICES	EXAMPLES OF DIGITAL SERVICE
Software, application and video games	Online licensing of software, updates and add-on website filters, firewalls, provision of mobile applications, etc.
Music, e-book and film	Provision of music, live streaming services, including subscription-based media or membership, etc.
Advertisement and online platform	Offering of online advertising space on intangible media platforms, offering platforms to trade products or services, etc.
Search engines and social networks	Customised search-engine services, etc.
Database and hosting	Website hosting, online data warehousing, file-sharing and cloud storage services, etc.
Internet Based Telecommunication	Cloud-PABX, VOIP Phone, etc.
Online training	Online courses, webinars, etc.
Others	Provision of other digital content like images, text, information and payment processing services, etc.

services that are prescribed in the Regulations.

The RMCD has further clarified that digital services are a service that is to be delivered through information technology medium with minimal or no human intervention from the service provider. For clarity purposes, the following table presents a non-exhaustive list of services that are viewed to be digital services⁹ (refer Table 01).

Another critical difference between the two types of taxes is the manner in which the Service Tax is paid to RMCD upon the acquisition of the taxable services by the consumer or recipient. As mentioned earlier, a foreign service provider of digital services in Malaysia may be liable to register for Service Tax in Malaysia if the registration threshold of RM500,000 is exceeded¹⁰. Once registered, the foreign service provider is expected to impose and charge a 6% Service Tax to the consumers in Malaysia for the digital services provided. In this regard, the recipient or the consumer of such digital services would only have to pay the 6% Service Tax to the foreign service provider. The liability to account and pay the Service Tax to

Table 02

IMPORTED SERVICES	DIGITAL SERVICES TAX
Similarities	
<ul style="list-style-type: none"> Relates to services that are provided to consumers in Malaysia by a foreign service provider. Both are subject to 6% Service Tax. 	
Differences	
<ul style="list-style-type: none"> For business purposes Covers all taxable services Recipient is liable to account and pay the 6% Service Tax to the authorities 	<ul style="list-style-type: none"> For personal consumption Covers only digital services Foreign service provider is liable to account and pay the 6% Service Tax to the authorities

RMCD lies with the foreign service provider and not with the consumer or recipient.

In contrast to the Digital Service Tax, the taxable services that fall within the purview of Service Tax on Imported Services would require the recipient of the taxable service to do a self-accounting of the 6% Service Tax to RMCD. Depending on the registration status, the recipient would have to file a Service Tax return to the RMCD and make the payment for the Service Tax due. Thus in such cases, the liability to account and pay for the Service Tax to RMCD lies with the recipient and

not with the foreign service provider (refer Table 02).

As one will note, the above rules can result in an overlap of Service Tax in certain situations. This is because, generally, the recipient of any imported taxable services (including digital services) bears the responsibility to perform the self-accounting of the 6% Service Tax to RMCD if the foreign service provider is not registered for Service Tax in Malaysia. What would happen if the foreign service provider is registered? Would the same digital service be taxed twice and thereby, create a cascading effect?

EXEMPTIONS PUT IN PLACE TO AVOID DOUBLE TAXATION

“The government is conscious of the issue of rising prices and the cascading effect from double taxation on the consumers in Malaysia”, the Finance Ministry said through the *New Straits Times* on 31 December 2019.

To address the double taxation resulting from services provided by foreign companies in Malaysia, the following exemptions have been put in place:

i. Exemption on digital services - Item 3 of the Exemption Order¹¹

A Foreign Registered Person (“FRP”) means a foreign service provider that is registered for Service



Tax in Malaysia for the provision of digital services in Malaysia. Based on Item 3 in the Exemption Order, any person who, in carrying on his business, acquires the digital service from a FRP would be exempted from the payment of Service Tax on the digital service if the exempted person holds a valid invoice or other document issued by the FRP and the digital service is not used for personal consumption.

The RMCD had published a separate Service Tax Policy No. 7/2020 to clarify that this exemption is referring to the requirement of accounting for Service Tax by the recipient. In other words, the recipient of digital services from a FRP would not be required to account for Imported Services separately once the recipient has been charged with 6% Service Tax on the digital services by the FRP.

This exemption appears to be consistent with the government's policy to ensure that the digital services acquired by the recipient for business purposes are not taxed twice i.e., by the FRP and by the self-accounting mechanism of Imported Services. Nevertheless, it would still cost the recipient an additional 6% Service Tax to be paid to the FRP.

ii. Exemption on digital services - Service Tax Policy No. 3/2020

Notwithstanding the abovementioned exemption, the RMCD has published a separate Service Tax Policy No. 3/2020 that allows for the claiming of a refund resulting from the acquisition of digital services provided by the FRP. Based on this Service Tax Policy, the following conditions have been imposed by the RMCD:

- The person claiming the refund is a registered person for Service Tax;
- The person who acquires the digital service also provides



the same digital service to its customer;

- The payment of Service Tax has been made to the FRP.

Based on the mechanism in this Service Tax Policy, it would mean that the FRP is still required to charge Service Tax on the digital services provided. Subsequently, the person who acquires the digital services would have to make payment in full to the FRP and should then claim the Service Tax charged by and paid to the FRP as a refund from the RCMD. The approved refund would be used to set off against the Service Tax due and payable by the recipient.

Expectedly, to enjoy this refund facility, the recipient of such digital services would have to charge and impose Service Tax when the same digital services are provided to the recipient's customers. The mechanism under this Policy would also be consistent with the government's initiative to avoid double taxation for the same supply of digital services as the services go through the distribution chain.

This refund facility is essentially different from the earlier Item 3 exemption where the recipient is indeed consuming the digital services

provided by the FRP itself whilst, the mechanism under Policy 3/2020 is for the case where the recipient is further distributing the digital services provided by the FRP.

iii. Exemption on other imported services - Item 4 of the Exemption Order

Effective 1 January 2020, another exemption from Service Tax is available for IT services that are imported by a registered person. Based on Item 4 of the Exemption Order¹², a registered person that provides IT services would be exempted from accounting for Service Tax on Imported Services if the following conditions are met:

- The exempted person is a registered person for Service Tax;
- The acquired IT service is identical to the IT service distributed or sold by the exempted person; and
- The taxable IT service is not for personal consumption.

Based on the conditions prescribed, this Item 4 exemption appears to be made only available to registered IT service providers in Malaysia that would distribute the

imported IT services to its customers in Malaysia. Similar to the above exemptions, such exemption would be consistent with the government's efforts to eliminate the cascading effect of having Service Tax being imposed more than once for the same or identical services. However, this particular exemption would not be available to a person that is not registered for Service Tax in Malaysia.

iv. Exemption on imported services - Service Tax Policy No 2/2020

In order to accommodate similar exemptions for other types of taxable services, the Minister of Finance has granted a separate exemption through the publication of the Service Tax Policy No. 2/2020 by the RMCD.

As stated in this Policy 2/2020, a registered person is exempted from accounting and paying the Service Tax on Imported Services if the following conditions are met:

- The exempted person is registered for Service Tax;
- The exempted person provides the same services

as the imported services acquired to its customers;

- The imported services are for the furtherance of business and not for personal consumption; and
- The exempted person has made payment to the foreign provider for the imported services.

The exemption granted by the Minister of Finance under this Policy No 2/2020 is only applicable to professional taxable services prescribed under Group G [excluding item (j) and item (k)] and advertising services under Item 8 of Group I of the Regulations¹³.

It is worthwhile to note that this particular exemption is not included in the gazetted Exemption Order¹⁴ that we have discussed previously. This would imply that the exemption in Policy 2/2020 was granted by the Minister of Finance through the power conferred on the Minister under subsection 34(3)(a) of the Service Tax Act 2018.

Whilst the Item 4 exemption is granted to imported IT services only, the exemption provided in this

Policy 2/2020 covers a wider range of taxable services. The exempted services in this Policy 2/2020 are similar to those exempted services for the business-to-business exemption that have been previously introduced and implemented since the beginning of the Year 2019¹⁵.

v. Intra-group exemption for Imported Services

Another form of exemption that would be available for consideration would be the exemption on selected imported taxable services acquired from a foreign provider that is within the same group of companies¹⁶. This particular exemption took effect on 1 January 2019 and is only applicable for selected taxable services in Group G in the First Schedule of the Service Tax Regulations 2018.

Similar to the commonly known intra-group exemption, this particular exemption works the same way but is specifically for services that are provided by foreign-related companies of the recipient. In the event a local Malaysian company acquires the selected taxable services from a foreign company that qualifies to be treated as being within the same group of companies as the Malaysian company, the local Malaysian company is not required to account for and pay the Service Tax on the Imported Service.

CONCLUSION

It may seem a bit confusing to certain companies in understanding the different types of exemptions that are now available from 1 January 2020 onwards. Each of the available exemptions have been designed to fit a specific business model or trade arrangement. Hence, businesses should take note of the different requirements and conditions for each of these exemptions before using any of these exemptions.

From these available exemptions, it is noted that the government is indeed





trying to minimise the occurrence of double taxation or the cascading effect of the Service Tax for the same supply of taxable services as it goes through the distribution chain. What remains clear is that a 6% Service Tax would eventually be imposed and levied for the provision of any taxable service in Malaysia irrespective of whether the taxable service originated from a foreign provider or from a local provider.

Quoting Richard Record, the World Bank leading economist for Malaysia who commented in *The Sun* daily on 14 October 2019, “*The implementation of the Digital Service Tax in Malaysia is the right move towards helping the government increase its revenue base from the Sales and Service Tax*”.

Thus, Malaysia can be seen as moving in the right direction with the implementation of this new Digital Service Tax. However, how efficient or successful will this new tax be? How will the RMCD ensure that all FRPs register and comply with Malaysia’s new Digital Service Tax?

Google Malaysia was quoted in a report in *The Star* on 2 December 2019 as saying, “We always comply with the tax laws in every country we operate in, and we continue doing so as tax laws evolve.” The report also has stated that Google has confirmed that the 6%

Service Tax will be applicable on G Suite services. The tax will be charged on user purchases and reflected under Billing & Payments.

“Facebook also said it would be charging the 6% digital service tax for its advertisements in Malaysia, while PlayStation Store said it would apply the tax on purchasable items and subscriptions on their platform. Other companies, such as Netflix and Spotify, have yet to announce whether they will absorb the tax or charge it to their users,” as reported on 30 December 2019 in *The Star*.

Taking all these tech giants as an example, it is hoped that companies will come forward and start complying with this new Digital Service Tax because of the possible reputational risk that they may face for not complying.

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Disclaimer: This article does not seek to address all Service Tax issues associated with the Digital Service Tax and imported services including the relevant exemptions. All views expressed herein are purely the personal opinion of the authors.

- ¹ Section 7 of the Service Tax Act 2018.
- ² This is with reference to the Malaysian Service Tax only and is not to be mistaken with other corporate taxes, VAT or GST globally that may have similar names.
- ³ *The Star* on 30 December 2019.
- ⁴ In the News Straits Times written by Bernama on 2 November 2018.
- ⁵ Subsection 26A(1) of the Service Tax Act 2018
- ⁶ Subsection 2(1) of the Service Tax Act 2018 (amended from Service Tax (Amendment) Act 2019)
- ⁷ First Schedule of the Service Tax Regulations 2018
- ⁸ Subsection 2(1) of the Service Tax Act 2018 (amended from Service Tax (Amendment) Act 2019)
- ⁹ Guide on Digital Services (dated 20 August 2019)
- ¹⁰ Section 56B of the Service Tax Act 2019
- ¹¹ Item 3 in Schedule of Service Tax (Person Exempted From Payment of Service Tax) Order 2018
- ¹² Item 4 in the Schedule of Service Tax (Person Exempted From Payment of Service Tax) Order 2018
- ¹³ First Schedule of the Service Tax Regulations 2018
- ¹⁴ Service Tax (Persons Exempted from Payment of Tax) Order 2018
- ¹⁵ Item 1 and Item 2 in the Schedule of Service Tax (Persons Exempted from Payment of Tax) Order 2018
- ¹⁶ Paragraph 3A in the First Schedule of the Service Tax Regulations 2018