Service tax on imported taxable services and digital service tax

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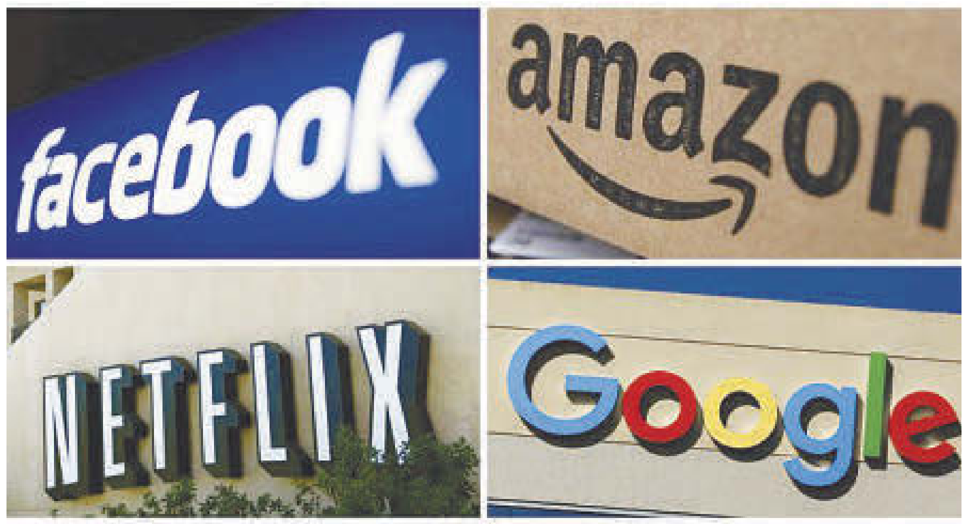
THE ACCOUNTANT'S PERSPECTIVE



– REUTERSPIX

A 6% service tax on imported taxable services (ITS) was imposed with effect from Jan 1, 2019. Another service tax known as the digital service tax (DST) will be coming on Jan 1, 2020. What are these taxes and how will they affect you?

Service tax is a tax imposed on sales of "taxable services", for example, on food and drinks served by restaurants. Taxable services include a long list of professional services but when rendered by overseas providers, it is often exempted from service tax because the service provider is not in Malaysia. To level the playing field, so to speak, the government has decided to impose a 6% service tax on ITS.

This service tax on ITS at 6% should be "accounted for" by a Malaysian business when it purchases "taxable services" from a foreign service provider (FSP). This means that the user should collect the tax from himself and pay it over to the Customs i.e. the user is the tax collector. Being a service tax specifically for businesses, this ITS service tax should not affect non-business consumers.

As an example, if a Malaysian property developer were to engage the services of an American architect at a fee of RM200,000, the developer has to calculate 6% service tax amounting to RM12,000 on this fee and pay this 6% service tax to the Malaysian Customs at the time when it pays the fee to the American architect. The obligation to account for the service tax is on the developer and not on the American architect. The developer may also be liable to deduct withholding tax from the fee but this subject will not be discussed here.

Who actually pays for this service tax? One can argue that the service tax is paid by the Malaysian developer but in reality, it depends on the business environment. In a competitive environment where market prices for architectural services are elastic, the American architect may need to reduce his fees to compete and hence bear the tax.

Again, to level the playing field, the government will expand the scope of service tax on Jan 1, 2020. Known as the DST, the expanded service tax will affect digital services purchased by Malaysian consumers from FSPs. Digital services are basically IT-based electronic services such as those obtained through the Internet and telephone networks and where the delivery of the service is essentially automated.

In a nutshell, all digital services purchased by Malaysian consumers whether they are businesses or non-businesses, will attract a 6% service tax. Common digital services would include Spotify (songs), Netflix (movies), Google (advertising services), mobile apps such as those from Google Play or Apple's App Store, Grab (transport) or Steam (video games).

Hence, from Jan 1, 2020, all FSPs who sell digital services to Malaysian consumers even if they do not have a business setup in Malaysia, have to impose DST on their services and pay this DST to the Malaysian Customs. The mechanism of collection is to require the FSPs to voluntarily register themselves for service tax similar to the present system where the service provider is the tax collection agent. As an example, if the monthly subscription charged by Netflix is presently RM33, the new subscription is RM34.98 (assuming that Netflix does not absorb the service tax) or RM33 (assuming that Netflix absorbs the service tax in which event Netflix will only earn RM31.13). Netflix will be required to register for service tax and pay the tax collected over to the Customs.

The challenging issue facing Customs is enforcement should any of the FSPs fail to comply. The worst situation is when the FSP collects the service tax but does not remit the tax to the Customs. Time will tell what mechanisms are most effective and whether the FSPs will increase their prices to cover this DST.

For the time being, consumers may reconsider whether to buy from FSPs if they are unwilling to pay the DST but local substitutes are similarly subject to service tax anyway. In addition, they are not likely to fall outside the scope of this tax because a "consumer" is defined as one who meets any two out of the three following conditions – he makes payment for the digital services by using a debit card or credit card issued in Malaysia; he receives the digital services through the internet or mobile network; or he resides in Malaysia.

In conclusion, the service tax regime will be extended to several types of services purchased from FSPs. Whether the Customs is able to effectively collect this tax and what is the impact of this service tax on final consumers is left to be seen.

__Poon Yew Hoe__, Council Member, The Malaysian Institute of Certified Public Accountants (MICPA) and Tax Partner of Crowe Malaysia

WARRANTS WATCH

Episodic week for Hang Seng Index warrants

LAST week saw a lower turnover in the Malaysian warrants market compared to the previous week, partly due to the shorter trading week. Total warrants turnover came up to RM388.7 million for the week or RM97.2 million on average per day, lower than the average of RM111.7 million in the previous week. However, warrants turnover on Tuesday and Wednesday skyrocketed in view of the increased volatility in the Hang Seng Index (HSI); turnover for warrants over the HSI was RM326.1 million, comprising 83.9% of overall turnover.

Last Monday, the Malaysian market was closed in view of the replacement holiday for Awal Muharram. The HSI futures fell 0.6% over Monday and Tuesday to close at 25,468 points. However, on Wednesday, the futures surged 4.0% or 1,008 points to 26,476 points on the back of the withdrawal of the controversial extradition bill that had sparked months of protests. On this day alone, bearish investors net bought 21.1 million units of put warrant HSI-H6P as the warrant price fell 51.4%. Put warrants move in an opposite direction to their underlying, meaning they will decrease in value as the underlying increases. Investors should note that HSI-H6P, with an exercise level of 24,800, expires soon on Sept 27 and its last trading date is on Sept 25. Investors should take note that the decay in the time value of warrants will speed up closer to expiry, meaning the warrant will lose value quicker over time even if the underlying remains at the same level.

On Thursday, the Hong Kong futures market (on which the HSI futures are listed) experienced connectivity issues from about 9.45am and was suspended from 2pm onwards, meaning the issuers of HSI warrants would not be able to make markets for HSI warrants. Nonetheless, the HSI futures resumed trading on Friday, and finished the week at 26,642 points, 4.0% higher week-on-week (w-o-w).

The put warrant HSI-H6S was the top traded warrant for the week, clocking in 302.9 million units in total. Bearish investors net bought 22.4 million units of this warrant over last week as the warrant bid price fell 45.7% w-o-w to close at 22 sen last Friday. As at Friday, this warrant has an effective gearing of 15.4 times, meaning it moves 15.4% for every 1% change in the underlying.

Top warrants by volume traded

Warrant name	Volume (million)	Issuer	Exercise level	Expiry date
HSI-H6S	302.9	Macquarie	25,200	30 Oct 2019
HSI-C7F	183.9	Macquarie	27,400	30 Dec 2019
HSI-H6P	136.2	Macquarie	24,800	27 Sep 2019
HSI-H8E	130.3	Macquarie	24,600	30 Dec 2019
HSI-C7E	116.8	Macquarie	29,200	30 Dec 2019

To view the full list of structured warrants available on Bursa Malaysia, visit malaysiawarrants.com.my.

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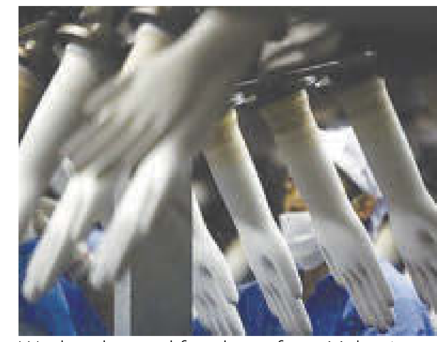

Weaker demand for gloves from Malaysia partly due to increase in China glove imports into the US. – *REUTERSPIX*

Worst likely over for rubber glove sector

PETALING JAYA: The worst is over and growth is likely to resume in the coming quarters as glove manufacturers indicated that they have started to increase selling prices to pass on the incremental costs, according to Affin Hwang Capital.

In the second quarter (Q2) of the year, overall earnings for the sector have fallen short of both consensus and the research house's expectation.

The sector saw earnings contract 11.5% year-on-year (yoy) in Q2, a similar situation in the previous quarter.

The performance for 1H19 was also less than satisfactory, as earnings fell short of both the market and Affin Hwang's expectations, delivering only 40% of both consensus and its full-year forecasts.

"The miss was attributed to lower sales volume (Hartalega) and margin compression for its latex glove product (Top Glove). Post-revisions, we are forecasting a 6.7% yoy sector earnings growth in 2019," it said.

Despite the weak set of results, Affin Hwang maintained its "neutral" call on the sector.

"Malaysia manufacturers are acting more rationally to prevent an all-out price war, as they are willing to delay or cut capacity to maintain selling prices," it said in a research note.

It believes that the weaker demand for gloves from Malaysia was partly due to an increase in China glove imports into the US, as buyers stock up in anticipation of the tariff hike.

The research house believes that there are a few challenges limiting the glove manufacturers' ability to raise their selling price, namely the value perception between latex gloves and nitrile gloves, overcapacity in the latex glove space and the time lag (around 30-45 days) in price-setting.

In addition, the management of both Top Glove and Supermax have commented that one of the main contributing factors for the low margin during the quarter was the sharp increase in latex cost, which they were not able to pass on fully through selling price increases.

Average latex prices were up by 15% quarter-on-quarter in Q2.

"However, we believe that pressure to hike latex glove selling prices has eased, as the latex price has fallen by 13% to RM437.6 per kg from the peak in 2Q19," said the research house.

Affin Hwang noted that as the US-China trade tension intensifies, the ringgit has weakened against the US dollar to 4.2203 from 4.1940 in May.

"If the ringgit continues to weaken from current levels, margins for rubber glove manufacturers will no doubt benefit," it said.

The research house estimated that for glove manufacturers under its coverage, every 1% depreciation in the ringgit, net profit will increase by 0.3-0.8% in 2019, and vice versa.

Its top picks for the sector are Kossan and Supermax for its undemanding valuation and higher-than-industry growth rates.

"These stocks are currently trading at around their historical averages, hence we believe there is more upside due to their strong earnings growth."