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Indirect Tax Chat

Keeping you updated on the latest news in the Indirect Tax world

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Greetings from Deloitte Malaysia's Indirect Tax team

Greetings readers, and welcome to the December 2020 edition of our Indirect Tax Chat. We hope that you have been keeping safe and well.

Earlier this month, seven indirect tax amendment bills were tabled before the House of Representatives of Parliament, of which six have been passed. These bills once enacted would amend a number of the indirect tax laws impacting sales tax, service tax, and customs and excise duties. The majority of these amendments were not included in any of the earlier Budget 2021 pronouncements. We also anticipate that once these bills are passed into Law, we will also see the accompanying amendments to the Regulations released. Our analysis of key proposed amendments to indirect taxes are covered in a separate alert, which will be released soon. Keep a look out for this and our subsequent alert once the amended Regulations are released.

The Royal Malaysian Customs Department ("RMCD") have indicated that the outstanding GST refund currently stands at RM1.316 billion and involves 48,225 companies and 82,517 applications. This is due to companies' failure to provide proper documents or the correct banking information. As a result, they may not have received notices or letters from the RMCD. We would advise businesses who have yet to receive their GST refunds to check their account in the GST TAP portal for any letters from the RMCD, and to ensure their details are up to date.

The RMCD have also provided a limited amnesty on penalties for disclosures settled before the end of the year. Although initially provided to only companies that have been issued bills of demand, we understand that this concession can be made available to other taxpayers on a case by case basis. You can get more details here.

Separately, here are some recent news that may interest you:

- Deputy Finance Minister II Mohd Shahar Abdullah said in Parliament that the government is looking at reintroducing the GST to raise funds for its coffers. Shahar said the government is currently studying the feasibility of reintroducing the GST and other consumer-based tax models after taking all aspects into consideration, including the weaknesses in the current Sales Tax and Service Tax (SST) and the GST that was implemented in 2015. The study will also cover the effects of reintroducing GST on the economy, cost of living and the cost of goods, including the black economy. Shahar also promised that any new tax model that is implemented would be easy to manage and will not increase the cost of business, while strengthening the nation's fiscal standing, adding that there would be no point increasing government coffers through a tax model that will burden the *rakyat*. For more information, please click here.

We at Deloitte Indirect Tax would like to wish all our readers a Merry Christmas and a Happy New Year. We look forward to seeing all of you next year in the January 2021 edition of our Indirect Tax Chat.

Best regards,
Tan Eng Yew
Indirect Tax Leader

1. Service Tax on Directors' Fees and Allowances

Following our coverage of the RMCD's Service Tax Guide on Professional Services dated 6 October 2020 ("Professional Services Guide") in our November 2020 Chat last month, this article further explores the taxability of fees charged by directors to a company.

Subparagraph 39(viii) of the Professional Services Guide which is about consultancy services states that when a person is appointed as a non-executive director in his personal capacity under a contract for service to provide expert opinion, the director under a contract for service may charge a fee to the company and such fees are subject to service tax.

However, if a person is appointed as a director in the capacity of his post (contract of service) or under employment with the company, it is not subject to service tax. The Professional Services Guide also provides the table below:

Service Tax Treatment On Office Holders/ Directors' Fees

No.	Type of payment	Subject to Service Tax	Not Subject to Service Tax
1.	Directors' remuneration/ fee	√	
2.	Directors' allowances e.g: Meeting allowance, monthly allowance		√
3.	Benefit in kind (BIK)		√
4.	Reimbursement or disbursement		√

A contract of service under subsection 2(1) of the Employment Act 1955 is defined as "any agreement, whether oral or in writing and whether express or implied, whereby one person agrees to employ another as an employee and that other agrees to serve his employer as an employee and includes an apprenticeship contract".

Where a person is employed under a contract of service to be a director of a company, the individual would usually receive salary, emoluments, and other income. The employed individual would not typically send an invoice to the company for his time and services, therefore no service tax is chargeable.

On the other hand, a contract for service is when the individual is engaged to provide services to the company not in the capacity of an employee. The individual, as a contracted director providing his expert opinion and charging fees to the company, would need to charge an additional 6% service tax for the consultancy services provided.

We understand from the RMCD that only the director's fees are taxable in accordance with section 9 of the Service Tax Act 2018, as the value of taxable service on which service tax is chargeable is the actual value of the taxable service provided. Thus, the value of service should be in the form of money (price) and not in the form of benefits-in-kind (BIK).

If a BIK such as a car is given for use and convenience of the contracted director, the benefit and facility enjoyed is not a service provided by the director. As such, the BIK (car) does not count as part of the value of the director's services.

In the case of allowances, we understand from our discussions with RMCD, if such allowances are given only to selected non-executive directors under a contract for service, then such allowance is subject to service tax, if related to the provision of a taxable service by the director. Where an allowance is provided to all directors (not selective), the allowance is not subject to service tax. For example, if only the chairman of a company who is also not an employee, is provided an allowance for a personal driver, this allowance is subject to service tax when the director submits his invoice to the company. On the other hand, if all non-executive directors receive a meeting allowance and not just the chairman, then this allowance would not subject to service tax.

For reimbursements, if it is purely reimbursed from a third party invoice and no value added service is involved, it is not taxable. Do note that certain conditions as per RMCD's Guide on Disbursement and Reimbursement must be met in order for service tax to not be applicable, such as the director providing the third party invoices as supporting document when sending his own invoice to the company. We covered disbursements and reimbursements in more detail in our September 2020 Chat, which is accessible here.

Deloitte's comments

The Professional Services Guide makes it clear that where a director of a company is employed under an employment contract, no service tax is applicable. On the other hand, where an individual is appointed as a director but is not an employee and is acting as a contractor, the individual would typically charge a fee for his professional services, and these would be subject to service tax. However, where the remuneration also includes allowances or benefits-in-kind, these allowances may or may not be subject to tax depending on how these allowances are allocated to all the directors. We recommend businesses who have directors who are not employees of the firm, to review their position to ensure the right tax treatment is adopted.

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2. Case study: Success in resolving RM6 million RMCD audit dispute on indirect tax exemptions without litigation

We recently assisted a client-taxpayer to favourably resolve a RM6 million bill of demand ("BOD") arising from an RMCD audit on indirect tax exemptions by the Minister of Finance ("MOF").

The case is instructive due to MOF intervention in the RMCD audit to grant 100% remission of the RM6 million BOD, without litigation at Tribunal or High Court and without prejudice to taxpayer's position against indirect tax liability.

Background

Taxpayer's relevant activity was the importation of a certain liquid product for subsequent local sale. The product was subject to indirect taxes *inter alia* excise duty, import GST during the GST era and sales tax post-GST. Besides this activity, the taxpayer also produces the same liquid product at its factory, for sale to the local market and was a duly registered manufacturer for excise and sales tax purposes.

RMCD conducted an audit in 2019 on taxpayer's activity of importation of the liquid product under MOF 'ad-hoc' excise duty exemption (which had commenced circa 2013 and was continuously renewed since then), and a MOF gazette order sales tax exemption under 'item 1, Schedule C' ("C1 sales tax exemption") on raw material for registered manufacturers (since the re-implementation of sales tax in September 2018).

The key RMCD audit finding alleged taxpayer's ineligibility to claim the MOF excise duty exemption between 2016 and 2019 on the imported product for local sale, which triggered the BOD for around RM6 million in indirect taxes, largely comprising excise duty and incremental import GST/import sales tax on the excise duty amount.

Initial 50% chance of success due to ambiguity in MOF excise duty exemptions

Initial taxpayer response to RMCD disputing audit finding

Taxpayer responded to the RMCD audit finding that it was not liable to the indirect taxes due to the MOF excise duty exemption that initially (circa 2013) expressly covered imports of the liquid product, though the renewals of the exemption between 2016-2019 did not expressly state imports and hence were ambiguous.

Since the excise duty exemption was under MOF purview, taxpayer had informed RMCD that it would make a representation to MOF to intervene and clarify the ambiguity.

Initial taxpayer representation to MOF to clarify ambiguity in MOF excise duty exemptions

Taxpayer requested MOF to clarify that the excise duty exemption covered the import of the products for local sale during the period 2016-2019, in continuation of the letter and policy behind the initial MOF excise duty exemption in 2013, or, alternatively for MOF remission of the indirect taxes involved (without prejudice to taxpayer's position that it is not liable for the indirect taxes).

One of the key grounds in the representation to MOF was that, taxpayer had submitted monthly reports to MOF/RMCD pursuant to all the MOF excise duty exemptions since the initial one in 2013. The monthly reports to MOF/RMCD clearly stated the quantities of sale of imported products and the renewal of MOF excise duty exemptions were based on these data. As a result of this long-standing practice since 2013, it was argued that

the taxpayer had a legitimate expectation to excise duty exemption on imports of the products for sale between 2016 - 2019. This was despite the ambiguities in the MOF exemption conditions since the beginning - the initial MOF excise duty exemption attached conditions, which *inter alia* stated that the exemption is for imports of the products for use as raw material in manufacturing, and the renewals of MOF exemption during the period 2016 – 2019 attached conditions which *inter alia* stated that excise duty exemption is for products manufactured by the company, and did not state imported products.

Tax exemptions would generally be construed strictly, and hence the ambiguities involved created a risk of 50% chance of success to resolve it in favour of taxpayer.

The turning point - 50% case converted to 100% technical strength – due to subsequent RMCD reply raising new factor of "repacking" imported product not being manufacturing

A fortuitous turning point came in the form of an unexpected RMCD reply to taxpayer's initial response to RMCD audit finding (whilst taxpayer's initial representation to MOF was still pending MOF consideration). RMCD's reply was that the MOF excise duty exemptions only covered raw materials for manufacturing, whereas taxpayer's activity on the imported liquid product is "repacking" (not manufacturing, in RMCD's view) of finished product into smaller containers for sale.

The "repacking issue" for excise duty/C1 sales tax exemption was not raised in the initial RMCD audit finding and hence was not dealt with in taxpayer's initial response/initial representation to RMCD/MOF. (The alleged non-compliance of C1 sales tax exemption was a 'low key' ancillary finding within the RM6 million total sum in the 2019 RMCD audit finding and BOD). The repacking issue revealed linkages between the C1 sales tax exemption and the MOF excise duty exemption, due to the relevant common "manufacturing" definition in both excise and sales tax laws i.e.: *"the conversion by manual or mechanical means of organic or inorganic materials into a new product by changing the size, shape, composition, nature or quality of such materials…"*.

There was clear authority in sales tax law that the *"repacking of bulk goods into smaller packages by a person other than a (sales tax) registered manufacturer*" was exempted from registration. Since the taxpayer was sales tax-registered person for producing the same liquid product at its factory, it was not exempted from registration for the repacking of the imported bulk liquid product into smaller containers. Thus, taxpayer was considered manufacturing for sales tax and clearly entitled to C1 sales tax exemption (the bulk 'finished' product being the relative 'raw material' product for the repacking). Although there is no equivalent exemption from registration under the excise law, the common manufacturing definition with sales tax was compelling enough reason for equal manufacturing treatment of the repacking activity under the excise law, including the MOF excise duty exemption granted under the excise law.

Hence, the taxpayer's case had converted from one of 50% chance of success to one of 100% technical strength, that the taxpayer should be seen as manufacturing (repacking) the imported products for local sale, in line with C1 sales tax exemption and MOF excise duty exemption.

This 100% technical strength was established and articulated by Deloitte at a critical round table discussion ("RTD") with MOF/RMCD and followed up with a subsequent written representation to MOF on the repacking issue raised in RMCD's reply.

Conclusion

The Treasury had to send the case to its Legal Department for analysis and the outcome was a MOF decision to grant the alternative remedy applied for by taxpayer i.e. 100% remission of the RM6 million in indirect taxes (excise duty, import GST and import sales tax).

On the same date as the MOF decision on 100% remission, a separate MOF 'clarification' decision was issued in response to taxpayer's initial representation to MOF, to clarify the ambiguities in the excise duty exemption. The MOF clarification decision stated the excise duty exemption is for products manufactured by the taxpayer, whereas the taxpayer's activity of repacking was not manufacturing but trading, and hence the import of the product was subject to excise duty and sales tax. There was no practical necessity to dispute the MOF 'clarification' decision via judicial review at High Court, due to the MOF decision on 100% remission. Although the MOF clarification decision seemed to be at odds with the technical position of taxpayer, it may be fairly said that the 100% technical strength of taxpayer's case is reflected in the 100% remission.

Nevertheless, this does not mean that the battle on the technical front is lost for the future, since moving forward, the taxpayer could apply to RMCD to confirm and use C1 sales tax exemption for repacking, as repacking was not exempted from sales tax registration due to taxpayer being a sales tax-registered manufacturer (producer). Taxpayer could also apply for suitable excise duty remedy from MOF/RMCD consequent to the MOF clarification decision (e.g. potentially to confirm warehousing of the imported product in the factory without excise duty in accordance with the excise law and to seek MOF excise duty exemption for local removal from the factory after repacking).

Key lessons learnt

1. Considering MOF forum to resolve issues within MOF purview, though issues may be raised in a RMCD audit.
2. Being alert and agile to adapt and respond to RMCD's position(s) that may be clarified and revealed outside the written RMCD audit finding.
3. Where a matter is to be resolved at MOF forum, to consider applying to MOF for alternative remedy of remission without prejudice to taxpayer's position against liability for the indirect taxes.
4. Where 100% remission is granted by MOF, to consider choosing to defer battles on technical positions to the future on go forward basis.
5. As tax exemptions are strictly construed, to seek professional advice to apply for, and to assess that, exemption terms and conditions are compatible with taxpayer's operations and to remedy any shortcomings immediately before any RMCD audit.

Deloitte is well-equipped with technical expertise and experience to advise and assist taxpayers in the above matters. Please feel free to reach out to us to discuss how we can assist you.

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3. Updates from the SST Technical Committee

Following last month's newsletter, this is the second part of our summary on the additional issues raised by the SST Technical Committee along with RMCD's responses from the minutes of Meeting No. 1/2020 dated 13 August 2020. For part one of our summary, please refer to our November 2020 Chat, accessible here.

Clarification on calculating the 'total value of taxable services' in determining 5% threshold for services provided to company outside the group

From 1 January 2020, taxable service provided by a company to any third party or group member shall be taxable if the value of services provided to a third party exceeds 5% of the total value of services provided by the company within 12 months.

RMCD clarified that:

- total value of taxable services to determine the 5% threshold refers to total value of the same taxable services only and not on the combined value of all taxable services provided.
- the 5% must be reviewed at any month within the 12-month period based on future method.
- business can use the past 12-month business transaction data as a basis to determine the percentage.
- if the value is ascertained not to exceed 5%, no tax shall be imposed to the group member. Otherwise, service tax should be charged.

Deloitte's comments

In determining the total value of services for registration purpose, both the value of the same taxable service provided to group members and third parties shall be taken into account. Generally, RMCD is encouraging tax registrants to adopt a more prudent approach and impose service tax on services provided to third parties in advance, should the tax registrant be unsure if the total value of services to third parties meet the threshold requirement. Failure to charge service tax due to breaching of 5% threshold may result in service tax late payment penalty of up to 40%.

Digital advertising - Scope for taxable person and taxable services

RMCD informed that:

- Effective from 14 May 2020, digital services provided in relation to matters outside Malaysia is exempted from service tax. Item (l) and (m) to Group G to First Schedule of the Service Tax Regulations 2018 have been amended.
- advertising digital services appear under Group G and Group I for the following reasons:
    - Service provider who provides advertising services by using digital method to remain registered under Group I. This would mean that B2B exemption would apply in accordance to the conditions set out for Item 8 to Group I.
    - Service provider who solely provides digital services shall be registered under Group G.

Deloitte's comments

Businesses who provide digital services should refer to the relevant taxable person/taxable service under the service tax regulations and be guided accordingly.

Interpretation of IT Services in relation to trading activity

RMCD has clarified that trading of IT services is part of distribution or reselling. With regards to the inquiry on whether "on behalf of any person" is intended to apply to resellers acting as an agent of the supplier, RMCD clarified that it is to strengthen that distributor/reseller usually referring to a person who sells IT services not owned by them, but on behalf of another person i.e. it shall apply to all resellers/distributors.

Deloitte's comments

There are currently no additional conditions set out in the trading of IT services. Based on RMCD's response, they will update the Guide on IT services accordingly to reflect the latest position.

Clarification on the 'personal consumption' condition for services acquired for business purpose

RMCD has clarified that 'personal consumption' means that a company acquired such taxable services for his own company's use or to be consumed by the company itself. The company will not provide the same services to its client. Therefore, they are not entitled for the exemption.

For documents needed to prove that the services are not for personal consumption, RMCD clarified that an RMCD auditor during the course of an audit would conduct checks on documents used for the business transactions such as invoice, CN/DN or others which clearly describe the transaction.

Deloitte's comments

Based on RMCD's clarification, we understand that the meaning of personal consumption is applicable to scenarios where a service is acquired and not re-supplied, thereby severely limiting the application of this concession. This interpretation is also not consistent with actual commercial practices where the taxable person may acquire various taxable services that would be consumed for the purpose of providing the final service to the customer (which is also taxable). In order to support the single stage tax, RMCD should widen the meaning of personal consumption to reduce the cascading effect of the service tax.

Service tax treatment for online distance learning services

In response to the question on whether "professional training" includes online webinars and conferences accessible from depository of such recorded content, RMCD clarified that "professional training" is confined to training provided by tertiary education institution. RMCD also clarified that "recognized by the relevant authority in such country" is equivalent to the local requirement such as Education Act, MQA or NSDA in Malaysia.

As foreign service providers may have registered before the release of this policy, RMCD also clarified that FRP may apply for deregistration if their service is confirmed to be not taxable by providing relevant supporting documents.

Deloitte's comments

Businesses are advised to verify with the relevant regulatory body on the status of the education institution.

Goods exported to Designated Area (DA), Item 57, Schedule A, Sales Tax (Person Exempted from Payment of Tax) Order 2018

Prior to 6 October 2020, Section 51 and 54 of the Sales Tax Act 2018 specify that taxable goods transported to DA applies as if it is exported to DA. However, RMCD does not allow the goods qualifies for exemption on the grounds that the transport of the goods is not regarded as an export. As a result, the company need to pay tax which will affect SMEs.

Upon receiving feedback from the trade bodies, Item 57, Schedule A of the Exemption Order has been amended to extend the sales tax exemption to cover goods for transport to any DA or SA, effective 6 October 2020 provided that the conditions are met. On this latter point, the conditions to the exemption have also been amended to include the following new conditions:

- the goods shall not be used or carry out any further process after purchased or acquired; and
- the Director General of RMCD may impose any other conditions as he deems fit.

Deloitte's comments

Overall, this amendment provides cash flow relief on these transactions to businesses. The amendment of Item 57 of the relevant sales tax exemption order is consistent with the spirit of sales tax to treat movement of goods from principal customs area to DA and SA as export.

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