Indirect Tax Chat
Keeping you up to date on the latest news in the Indirect Tax world

July 2018
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Key takeaways:

1. GST and SST – what is it all about?
2. Don’t wait and see for SST: What should I be doing now?
Greetings from Deloitte Malaysia’s Indirect Tax team


It was recently announced that the Goods and Services Tax (Repeal) Bill 2018 will be tabled in the Dewan Rakyat for its first reading on 31 July 2018. It was also stated that four other bills will also be tabled on 31 July 2018, namely the Sales Tax Bill 2018, Service Tax Bill 2018, Customs (Amendment) Bill 2018, and Free Zones (Amendment) Bill 2018.

For now, the Minister of Finance Lim Guan Eng has announced that the new SST rate will follow the previous rate where the sales tax rate for goods will be at 5% and 10% and services tax rate for services will be at 6%. It is forecast that the SST will be in full force by 1 September 2018 with the assumption that the proposed Bill can be passed within the period of the first sitting of parliament.

He further mentioned that the estimated collection of the SST would be approximately RM21 billion, where RM4 billion is to be collected within the last quarter of the calendar year of 2018. The whole amount of estimated collection would be only equal to half of the total collection from Goods and Services Tax (‘GST’), which reaped a total of RM42 billion last year in 2017.

The shortfall of RM21 billion collected from GST last year is said to be covered by cutting cost to increase savings where possible and by increasing the efficiency of Government spending.

Other news that may interest you:

- It was reported that the Domestic Trade and Consumer Affairs Minister Saifuddin Nasution stated that the consumers have yet to fully realise and feel the effects the reduce of GST rate since 1 June 2018 due to majority of the prices, appearing to remain the same. A survey was conducted over a 35-day period from 1 June 2018, which includes 417 goods spanning baby items, grocery and non-grocery goods, which showed a price drop ranging between 0.04% and 13%. The drop in prices only affected 30% to 40% of the goods surveyed. The Minister further noted that the majority of the complaints received from consumers are in relation to the price charged for food and beverages at restaurants, dining outlets and food courts where the price remained unchanged or in some cases, increased.

- It was reported by a Reuters poll that Malaysia’s annual inflation rate is likely to drop to 1.3% in June 2018 from 1.8% the previous month in May 2018 due to the withdrawal of the GST regime. Economists are of the opinion that the removal of GST likely reduced inflation in June, despite higher transport and food prices during the Muslim fasting month of Ramadan and subsequent Eid al-Fitr celebrations.

- The Nikkei Asian Review reports that Malaysia is experiencing an increase of capital outflow with the Ringgit currency and stock market negatively impacted as the new government has
not brought forth any new economic policies that inspire investor confidence. The removal of the GST had contributed to the ringgit losing against the US dollar and a further dip in the share market. The recent revelation that government debt was at more than RM1 trillion, which is far higher than previously thought, had added fuel to the fire. Prime Minister Dr Mahathir Mohamad plans to combat this by establishing a new national automaker and a renewed ‘Look East Policy’ by working closely with Indonesia and Japan to strengthen foreign ties.

Please do not hesitate to contact us if you have any queries, comments or require our assistance on any GST matters or the transition to SST.

Kind regards,

Tan Eng Yew
Indirect Tax Country Leader
1. GST and SST – what is it all about?

[A version of this article was published on the New Straits Times on 20th July 2018 and can be found at this link: https://www.nst.com.my/opinion/columnists/2018/07/392556/how-gst-and-sst-work]

There has been plenty of talk recently in relation to the Goods and Services Tax (GST) and the Sales and Service Tax (SST) and what the impact of each is to the public. There is also plenty of information that has been made available to the public through various sources including the social media, in some instances adding to the confusion on how these taxes operate. The purpose of this article is not to lend support to either tax, but to help the public understand how these taxes work and how they apply to the purchase of goods and services, so that the public can be better informed about the issue.

Goods and Services Tax

The GST is a multi-stage tax, meaning it is collected at every stage of a supply chain. In simple terms, every business is effectively required to charge and collect the tax on any sales of goods or services they make (unless specifically excluded). However, one of the major misunderstandings with GST is that this means there are several layers of tax on tax. This is not the case, as the business is allowed to claim a credit on any GST they pay on the purchase of goods and services. As an example:

A Raw Materials Supplier sells raw materials to a Manufacturer
GST-exclusive Price: RM10.00
GST@6%: RM0.60
Total Price: RM10.60
[RM0.60 (GST on sale) is paid to Malaysian Customs by the Raw Materials Supplier]

The Manufacturer then uses these raw materials to build a table.
GST-exclusive price: RM50.00
GST@6%: RM3.00
Total Price: RM53.00
[RM3.00 (GST on sale) – RM0.60 (Credit on GST on raw materials) = RM2.40 is paid to Malaysian Customs]

The Manufacturer then sells the table to a Retailer who sells it to the final consumer.
GST-exclusive price: RM100.00
GST@6%: RM6.00
Total Price: RM106.00
[RM6.00 (GST on sale) – RM3.00 (Credit for GST on purchase of table) = RM3.00 paid to Malaysian Customs].
So, in the above example there is a total of RM6 that is collected by Malaysian Customs through the distribution chain. RM0.60 from the Raw Materials Supplier, RM2.40 from the Manufacturer and finally RM3.00 from the Retailer. Importantly, this RM6.00 is equal to what the final consumer actually pays on the purchase of the table, i.e., RM6.00.

So the key points to note are:

- **GST** is a tax on the final consumption/sale of goods and services; but
- **It** is collected at every stage of the supply chain
- **There** is a credit system that allows businesses to offset GST paid on purchases so that there is no ‘double tax’

It is the second of those points that is often highlighted as the reason GST is more transparent and harder to avoid; however, it is also the point that is often confused by consumers.

One final point is that although GST did apply to most goods and services, there were a lot of exemptions and zero-rated items including basic foods, medicines, public transport, taxis etc. So in some cases there was no GST paid by the consumer in the purchase.
Sales and Service Tax

The first thing to clear up is that there is no such thing as Sales and Service Tax. It is Sales Tax and Service Tax, which are two separate taxes. These are not new taxes, and had in fact existed in Malaysia since the 1970s and were only removed in 2015 when the GST was introduced.

Sales Tax

Sales Tax is a single stage tax applying on the importation and manufacturer of certain prescribed goods. It has rates of 5% and 10% and is collected by the Manufacturer or Importer. There is no credit mechanism for tax paid.

If we refer back to our earlier example:

A Raw Materials Supplier sells raw materials to a Manufacturer for RM10.00 [no sales tax is applicable]
The Manufacturer then uses these raw materials to build a table.
Sales Tax-exclusive price: RM50.00
Sales Tax@10%: RM5.00
Total Price: RM55.00

The Manufacturer then sells the table to a Retailer who sells it to the final consumer. As the Retailer cannot claim back the RM5.00 of Sales Tax included in the purchase of the table, this is added to the cost of the purchase and then reflected in the margin.

So, assuming the Retailer decides to maintain a margin of RM50.00 on the sale, the final price sold to the consumer will be RM105.00.

<table>
<thead>
<tr>
<th>Raw Materials Supplier</th>
<th>Manufacturer</th>
<th>Retailer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Raw Materials Supplier sells raw materials to a Manufacturer</td>
<td>Manufacturer uses the raw materials to build a table and sells to the Retailer.</td>
<td>The Retailer sells to the final consumer.</td>
</tr>
<tr>
<td>Price</td>
<td>Sales Tax n/a</td>
<td>RM 10.00</td>
</tr>
<tr>
<td>Sales Tax exclusive price</td>
<td>Sales Tax@10%</td>
<td>RM 50.00</td>
</tr>
<tr>
<td>Total Price to Manufacturer</td>
<td>Sales Tax @ 10%</td>
<td>RM 5.00</td>
</tr>
<tr>
<td>Total Price to Retailer</td>
<td>Total Price to Consumer</td>
<td>RM 55.00</td>
</tr>
<tr>
<td>Price</td>
<td>Price Sales Tax n/a</td>
<td>RM 105.00</td>
</tr>
</tbody>
</table>

Please note that the above is a very simple example to highlight how the tax works. Businesses these days have complex supply chains and pricing decisions are impacted by a number of factors, of which tax is only one.
**Service Tax**

Service Tax is also a single stage tax and applies at a rate of 6% on services that are in-scope. It also does not have a credit mechanism for any tax paid. A simple example would be a dinner for two at a local restaurant:

**Price of Dinner for 2**: RM50.00
**Service Tax at 6%**: RM3.00
**Total Price**: RM53.00

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### Restaurant

<table>
<thead>
<tr>
<th>Description</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dinner for 2</td>
<td>RM 50.00</td>
</tr>
<tr>
<td><strong>Service Tax @ 6%</strong></td>
<td>RM 3.00</td>
</tr>
<tr>
<td><strong>Total Price to Consumer</strong></td>
<td>RM 53.00</td>
</tr>
</tbody>
</table>

**Am I paying tax twice under SST?**

There has been plenty written about whether consumers will be hit with a 16% tax. This is not correct and is not how these taxes would work. In saying that is possible that a consumer may purchase an item that has been subjected to sales tax and service tax, the scope of these taxes are narrow and there is not that much cross-over. Where that cross-over does happen, the total cost should still not be 16%.

A simple example would be a can of soft drink purchased at a restaurant:

A Manufacturer sells a can of soft drink to a Retailer for RM0.55 (including Sales Tax at 10% of RM0.05)
The Retailer sells the soft drink can to a Restaurant Operator for RM1.00
The restaurant provides the soft drink to a customer as part of a meal for RM3.18 (including service tax at 6% of RM0.18).

The total paid by the customer on the soft drink is RM0.18 + RM0.05 = RM0.23, which roughly works out to be 7.6%. But, we need to stress that two layers of tax only apply in limited circumstances, and the final cost impact is dependent on a number of factors including the profit margin set by the Retailer and the Restaurant Operator.
So the key points to note about SST are:

- Two separate taxes – Sales Tax and Service Tax;
- Not a new tax to Malaysia and was in existence for a long period of time;
- Only collected at one stage of the supply chain and applies to a narrower set of goods and services;
- It is possible for Sales Tax and Service Tax to apply on the same item but only in limited circumstances and it would be wrong to say it is a 16% tax.

As the Sales Tax and Service Tax are single stage taxes only taxing one stage of the supply chain, it keeps more businesses out of the tax net. This can be a good and bad thing. It means that fewer businesses are impacted and need to incur costs to comply, but it also means that it creates opportunities for more businesses to avoid collecting the tax. These are inherent issues in the tax that will hopefully be addressed when it is reintroduced.

**Summary**

At the start of this article, I said my aim was to help you, the reader, to better understand how these two taxes work, and I hope that I have been able to clear some doubts.

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2. Don’t wait and see for SST: What should I be doing now?

Malaysia is going through a historic and unprecedented change with the election of a new ruling Government. Whilst there are many social and economic reforms that the new Government have proposed to introduce, one key tax policy is the abolishment of the Goods and Services Tax and reinstatement of the “SST” regime that preceded it.

The much-talked-about SST in fact refers to two separate taxes, a Sales Tax and a Service Tax. While waiting for more official details of the new taxes, uncertainties in handling may cause businesses to opt to defer the preparation work. However, with such a short expected timeframe to the tax being put into effect, waiting may not be an option.

Without debating in detail the merits of the SST and GST tax systems, for now it is perhaps important to just be aware of some of the key differences between the two systems.

GST is a multi-stage and broad-based consumption tax, casting a wide net over essentially all supplies and importation of goods and services in Malaysia. The most important feature of the multi-stage GST is the input tax credit mechanism, which allows the majority of businesses to claim an offsetting credit or refund of any GST paid on business costs.

The previous sales tax and service tax regimes were firstly much narrower in scope. Sales tax was only imposed on the importation of certain taxable goods or the manufacturer and sale of certain taxable goods. Similarly, service tax was imposed on specifically prescribed taxable services ranging from clubs and restaurants to professional and management services. But critically, both were single stage taxes, meaning there was no credit system for taxes incurred. So unless there were specific exemptions applicable, such as the case for sales tax, the taxes would be a cost to the business.

The rate of service tax was 6%, the same as the current GST rate. Sales tax rates were based broadly on types of goods and mainly 10%, with limited goods at 5% and some specific volume-based rates.

In the absence of any certainty in the law at this point, there are, however, some critical areas that should be looked at urgently.

Will I need to charge the new tax?

The first concern, of course, is assessing if your business will be subject to the new sales and/or service tax. The Government has indicated that there could be a widening of the previous SST base of taxable goods and services. This at least provides a good indication that the sales tax and service tax legislation that was in place immediately before GST, will be a reliable starting point to determine if you will be subject to the new taxes.

The process may not be straightforward. Determining if a good is subject to sales tax, for example, requires knowledge of the correct tariff code classification of the specific good. The tax treatment could vary for similar goods but with slight variations in their classification.

There are also certain categories of services that may be open to interpretation as to whether they would be subject to service tax. As an example, though construction services were not
subject to service tax, depending on the nature of the contracts and the parties involved, all or parts of the services could be taxable under the category of management services. Potential contracts that could be brought into scope could be Engineering, Procurement, Construction and Commissioning (“EPCC”) contracts or other turnkey contracts.

**Sales tax exemptions for manufacturers**

Manufacturers previously relied heavily on sales tax exemptions. The exemptions were granted for raw materials and plant and machinery used in the production of taxable goods, and were critical to managing the cost of production.

The exemptions were not automatic and needed to be applied for and pre-approved by the relevant authorities, and was granted in respect of specific quantities of raw materials or specifically identifiable plant and machinery, which were to be acquired over a specified time period. Eligibility for the exemptions, and the application and approval processes, may also vary depending on whether or not the manufacturers’ finished goods were subject to sales tax.

The timeframe from the release of the relevant legislation, to the time the sales tax will be implemented, will be short if the 1 September 2018 deadline is to be met. In this small window, manufacturers will need to determine if their finished products are subject to tax, assess the impact of sales tax if any on their cost of raw materials, plant and machinery, determine quantities to be purchased or imported over the next year, then prepare, submit and pursue an approval for the exemption before the start date of the tax.

Not having the exemption in place on day one of the new tax could prove costly in the form of sales tax incurred with no avenue for recovery of the tax.

**The impact to the cost of business**

There will no longer be any input tax credits available. Sales tax or service tax incurred will be a cost of business. Except for the sales tax exemptions available to manufacturers, there will not likely be any exemption facilities granted.

Procurement plans, operational and financial budgets will very likely need to be re-examined to factor in the additional cost. More critically, what will the impact of any increase in costs on the profit margins and the selling price of the products of the business be?

Bear in mind also that the impact on profit margins and pricing is tied to the Anti-Profiteering rules and regulations, which are expected to be diligently enforced in the transition to the new tax. The application of these rules can be taken up as the subject of a separate discussion due to their lengthiness and complexity.

**Contracts**

Contracts, whether already in force or in the various stages of negotiation, will need to factor in the impact of the new taxes on the contractual costings and pricings. Contracts negotiated based on GST considerations, would not have accounted for GST as a cost. This same consideration cannot apply for sales tax or service tax.

For example, for a construction contract, the cost of building materials, construction machinery, architectural or engineering services would now be subject to tax that would not be recoverable.
A manufacturing company considering a large capital expenditure on the upgrade of a plant, would need certainty that a sales tax exemption on the plant and machinery can be obtained.

Another consideration is whether there are appropriate clauses under the contract to allow the business to charge the new sales or service tax on the products or services to be supplied under the contract. Failing which, the taxes may end up having to be absorbed by the business.

The imposition of the new taxes could impact the whole structure and financial viability of a project and an urgent and critical examination of these contracts is necessary.

No doubt, there will be plenty to do once the law and relevant regulations are made available. However, here are a few immediate and critical areas that businesses can act on immediately. A wait-and-see approach may prove costly as businesses could find themselves in a position without sufficient resources to make the required changes to systems and processes.

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![Larry James Sta Maria](image)

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