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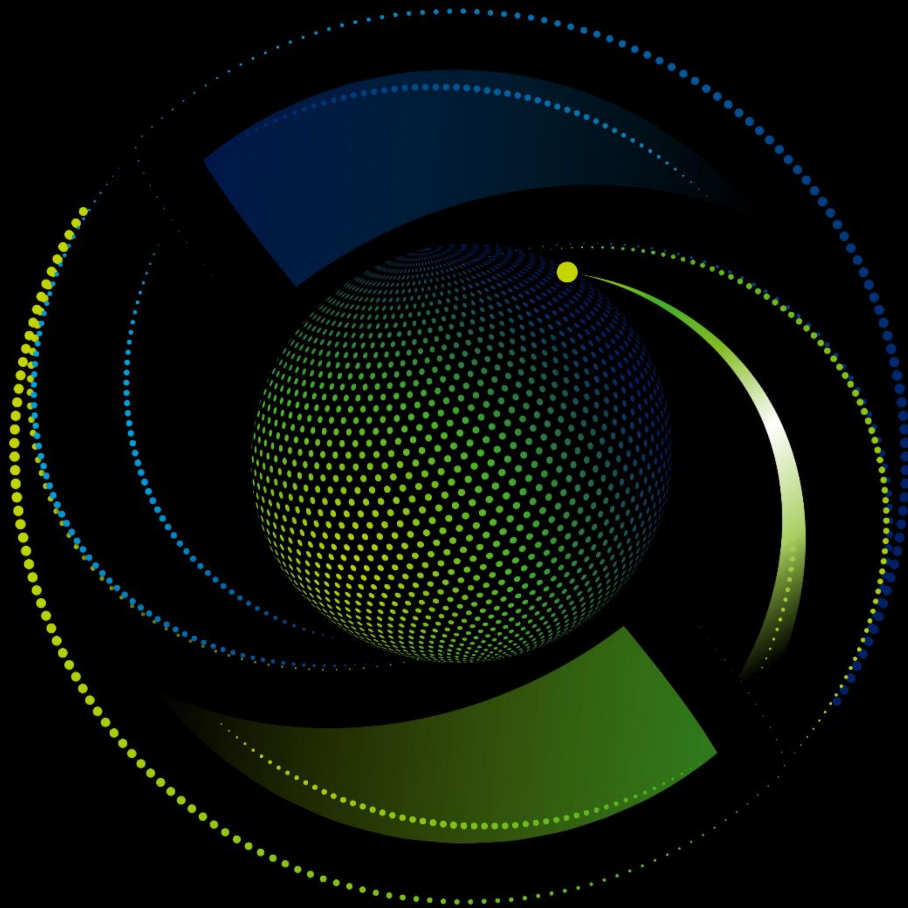

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Indirect Tax Chat

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

May 2022

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Key takeaways:

1. *Unjust enrichment for refunds of overpaid service tax*
2. *Court of Appeal decision on pre-GST era sale of land completed in GST era*

Greetings from Deloitte Malaysia's Indirect Tax team

Greetings readers, and welcome to the May 2022 edition of our Indirect Tax Chat.

This month we discuss the principle of unjust enrichment and its use by the Director General ("DG") of the Royal Malaysian Customs Department ("RMCD") to deny or reduce refunds of overpaid service tax. We also discuss an interesting Court of Appeal decision involving goods and services tax ("GST") and the sale of land.

With the beginning of June, it also means the final month of Phase One of the Special Voluntary Disclosure and Amnesty Program ("VA Program"). As highlighted previously, for those of you who are participating or still deciding, it is important to make a submission as soon as possible to allow the RMCD sufficient time to process the application. The benefits under Phase One will only accrue if full settlement of claim is made by 30 June 2022.

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

- The Malaysian Automotive Association ("MAA") is appealing to the Government to extend the vehicle sales tax exemption, which effectively ends on 30 June 2022. MAA president Datuk Aishah Ahmad shared that the tax holiday helped to spur and sustain car sales during the course of the pandemic. The MAA is hopeful that the sales tax exemption will be extended until the end of the year, which, on top of being a sales-booster, would also allow automakers to complete their backlog of orders. With less than two months left for the sales tax exemption, Aishah said the local automotive industry could see a jump in sales in May and June. For more information, please click here.

- The Malaysia Budget & Business Hotel Association ("MyBHA") deputy president Sri Ganesh Michiel said the Government needed to help address six key threats in the industry to ensure its long-term viability, of which one is the low service tax registration threshold. MyBHA wanted the government to raise the annual service tax registration threshold for the hotel industry from RM500,000 to RM1.5 million a year, in line with the food and beverage industry. He also mentioned that MyBHA wants an exemption and revision of the service tax on digital services imposed by the online travel agents on hotels. For more information, please click here and here.

We hope that you are keeping safe and well.

Best regards,
Tan Eng Yew
Indirect Tax Leader

1. Unjust enrichment for refunds of overpaid service tax

It is not uncommon for Malaysian service tax registrants to have incorrectly charged service tax to their customers / service recipients in the normal course of business. The scope of service tax can be quite vague, and the interpretation adopted by the RMCD constantly changes. However, once a taxpayer has determined they have overpaid service tax, the process for obtaining the tax refund can be quite complicated. We have recently highlighted that the RMCD have said that credit notes cannot be used to adjust and offset overpaid tax, and a refund can only be claimed through adjusting the original return where the transaction was reported and then seeking a refund.

Practically speaking, we have observed this process to be a lengthy one, and in recent cases we have noted that the RMCD have asked for evidence that the service provider has already refunded the overpaid tax to the service recipient before agreeing to process the refund claim. In this article we examine the powers afforded to the DG under the Service Tax Act 2018 ("STA") in such cases, and whether the practice adopted, in our view, is consistent with it.

The relevant power to pay refunds for overpaid tax is contained in Section 38 of the STA. Subsection 38(1) states that "*any person who – (a) has overpaid or erroneously paid any service tax, surcharge, penalty, fee or other money….may make a claim for refund in the prescribed form*." However, this power to pay refunds is limited by subsection 38(4) which provides that the DG "*may reduce or disallow any refund due in respect of the claim to the extent that the refund would unjustly enrich the person*".

In simple terms, subsection 38(4) gives the power to the DG to limit a refund where he feels that payment of the refund to the person making the claim would receive a benefit over another party. An example of this arising under service tax would be where a service provider is refunded the overpaid tax, but the tax was actually borne by the service recipient, thereby 'unjustly enriching' the service provider. One way the service provider could deal with such a scenario would be to refund the tax amount to the service recipient to ensure there is no unjust enrichment. In practice, it appears this is what the RMCD is seeking to do through asking for evidence that such a refund has been paid. However, there is nothing in subsection 38(4) that requires the amount to be refunded by the service provider to the service recipient before such a claim can be made. It is arguable an agreement between the parties to evidence the intention to refund the money as soon as it is obtained from the RMCD should suffice. As a consequence, it would seem that the RMCD approach is far more onerous than required by the Law and has the potential to create additional cash flow costs for the service provider.

In addition to the scenario covered earlier, there can also be scenarios where the service provider has in fact 'borne' the cost of the tax. We have observed this most recently in the context of landlords of commercial buildings and service charges collected from tenants. There was a brief period in 2021 where the RMCD held the view that service or maintenance charges were subject to tax and as a consequence, many landlords registered for service tax and paid tax to the RMCD. However, due to the economic conditions at the time, many landlords were struggling to collect rent, let alone any additional service tax. As a consequence, many had made the decision to not increase the value of the service charge and the cost of any tax paid to the RMCD was borne by the landlord. So, in such a scenario, where the cost of the tax was not borne by the service recipient, can the DG still hold the view that unjust enrichment would arise if the service recipient is not refunded the money?

The principles of unjust enrichment are not unique to Malaysian service tax as similar principles exist globally. In the UK and the European Union, there is an established case law. The UK tax authority, Her Majesty's Revenue and Customs ("HMRC") has even codified the principles adopted in its manual, available here.

At a basic level, the HMRC would not refund overpaid tax if the service provider did not bear the economic burden of the wrongly paid tax but passed it onto customers. However, in making such a decision, the HMRC has indicated it would be a question of fact based on whether the market price had been adjusted due to tax. It also stated that the HMRC would not simply refuse a refund purely on the basis that the service provider refused to make payment of the refund.

In the Malaysian context, we have no equivalent guideline from the DG as to how he determines if a service provider has been 'unjustly enriched'. Unfortunately this has created considerable confusion and angst for taxpayers seeking a refund of overpaid tax. At present, it seems the DG is taking a very subjective approach to this provision and simply requiring all service providers to refund the tax to service recipients, even in cases where the tax has been borne by them. A more practical approach such as we have seen in the UK and EU would be a much more desirable outcome for the parties involved.

For taxpayers that have been denied refunds under such circumstances, there are potential avenues for appeal that must be considered and assessed.

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2. Court of Appeal decision on pre-GST era sale of land completed in GST era

A Court of Appeal ("COA") decision in ***Agro-Mod Industries Sdn Bhd ("Agro-Mod") v Goods and Services Tax Appeal Tribunal and Director General of Customs (Civil Appeal No. W-01(A)-564-09/2019)*** held that GST was not chargeable in a pre-GST era on sale of land completed in GST era (GST era was from 1 April 2015 to 1 September 2018), as: (a) the land was supplied before GST era and (b) alternatively, in any event the supply was GST-exempt agricultural land. The COA decision is contrary to the findings of the High Court ("HC") and the former GST Appeal Tribunal ("GST Tribunal"). Also, there are other local and overseas GST cases which indicate contrary positions from the COA decision, hence making it controversial. We set out our comments based on the available key background facts and decisions of the COA (as published on 2 June 2021 in a newsletter of the law firm which handled the case), and the earlier unreported HC judgment, published in ***[2019] MLJU 1789***.

<u>Background</u>

Agro-Mod entered into a sale and purchase agreement ("SPA") dated 1 August 2013 with Mydin Wholesale Cash and Carry Sdn Bhd ("Mydin") for the sale of a piece of "vacant" land (category of 'land use' in land title: agricultural) in Perak, Malaysia. The executed Memorandum of Transfer ("MOT") for the transfer of the land was delivered to Mydin in 2013. However, the MOT was only dated on 29 April 2014. A deposit was paid by Mydin on 17 April 2014. The land was acquired by Mydin for the purpose of building a hypermarket. As such, the parties agreed as a condition precedent that Agro-Mod would obtain the conversion of 'land use' (in the land title) from "agriculture" to "building", which was duly fulfilled by Agro-Mod. All conditions precedent, including the land conversion, were fulfilled on 30 October 2014, after which the balance purchase price was payable by Mydin within 3 months viz. by 29 January 2015. Mydin delayed the payment but was allowed an extension of time by Agro-Mod to pay the balance purchase price, with 8% late payment interest, for a period till 15 June 2015. Mydin paid the balance purchase price together with the late payment interest on 10 June 2015, and vacant possession of the land was delivered to Mydin on 22 June 2015 i.e., the date the MOT dated 29 April 2014 was registered at the Land Office.

No GST was charged in the transaction by Agro-Mod, and the RMCD subsequently alleged that 6% GST was chargeable and issued a bill of demand accordingly.

Agro-Mod disputed the RMCD's decision.

<u>GST Tribunal and HC decisions</u>

The GST Tribunal dismissed Agro-Mod's appeal, and ruled in favour of the RMCD that 6% GST was chargeable on the sale of the land. This was then affirmed by the HC based on the following grounds, summarised below:

- There is no issue of retrospectivity, as the transitional provision in section 188(1), GST Act 2014 ("GST Act") specifically caters for a supply made under an agreement for a period or progressively over a period, and the period commences before the GST effective date (1 April 2015) and ends after the GST effective date, where GST would be chargeable on the proportion of the supply on or after the GST effective date, similar to Agro-Mod's land transaction with Mydin;
- The "time of supply" of the land is when the land was "made available" in accordance with section 11(2)(b), GST Act. This occurred when vacant possession was delivered to Mydin on 22 June 2015 after

the balance purchase price was paid by Mydin on 10 June 2015 during the GST effective date, and indefeasible title was obtained by Mydin; and
- The land was intended to be used for the building of Mydin's hypermarket and therefore not an exempt supply of land intended to be used for agricultural purposes, under paragraph 1(1), First Schedule to the Goods and Services Tax (Exempt Supply) Order 2014 ("Exempt Supply Order"). This provision states that the supply of land *"used or intended to be used to the extent of it being used or intended to be used for … agricultural purposes",* would constitute an exempt supply and hence not chargeable to 6% GST.

<u>COA decision contrary to HC and GST Tribunal</u>

The COA overturned the HC decision and held that the land was *"made available"* (under section 11(2)(b), GST Act) when the *"MOT was delivered to Mydin"* (on signing of the SPA in 2013). Therefore, the time of supply of the land was before the GST effective date of 1 April 2015, hence the supply of the land was not chargeable to 6% GST. In so ruling, the COA held that section 188(1), GST Act would have no relevance to this case, as no progressive or periodic supplies would be made in a sale of a merely vacant piece of land.

The COA also held in the alternative that, in any event, the land supplied was 'agricultural land', which is a GST-exempt supply under paragraph 1(1), First Schedule to the Exempt Supply Order, thus not chargeable to 6% GST.

<u>*Deloitte's comments*</u>

There is no further appeal against the COA decision, as the decision at first instance was made by a tribunal (i.e., the GST Tribunal). This makes the COA decision final and binding upon lower courts and tribunals in similar GST cases (unless another case is taken up at first instance by the HC, e.g., via a judicial review action against the Minister of Finance of the RMCD, where the final appeal would lie to the Federal Court with the leave of the Federal Court).

As it stands, the Agro-Mod case seems controversial for several reasons.

First, both the HC and the COA decisions do not seem to consider the special time of supply rule for land transactions, where the consideration is payable periodically or from time to time, under section 11(9)(a), GST Act read with regulation 4(1), GST Regulations 2014 ("GST Regulations").

Section 11(9)(a), GST Act empowers the Minister of Finance to prescribe the time of supply for the *"supply of goods … for a consideration the whole or part of which is determined or payable periodically, or from time to time, or at the end of any period"*. Pursuant to this power, the Minister of Finance made regulation 4(1), GST Regulations, which provides that, where *"…the whole or part of the consideration for the transfer of land is payable periodically or from time to time, such goods shall be treated as separately and successively supplied at the time part of the consideration is received or the tax invoice relating to the transfer of land is issued, whichever is the earlier"*.

In the present case, there seems to be more than one payment in the SPA for the sale of the land, i.e., the deposit paid on 17 November 2014 and balance purchase price together with late payment interest, paid on 10 June 2015. (Under the definition of "consideration" in the GST Act, a deposit is not treated as payment under the GST Act unless it has been applied by the supplier as consideration, which apparently has been done by Agro-Mod in this case. Based on overseas case law on Value Added Tax or "VAT", late-payment interest would broadly be

treated as part of the consideration for the underlying supply i.e, the land in this case, rather than a GST-exempt provision of credit for which interest is charged.)

Therefore, the consideration for the supply of the land in Agro-Mod is arguably payable progressively or periodically, which should support the applicability of the similarly worded transitional provision for 'progressive or periodic supplies' in section 188(1), GST Act. On this basis, the payment of the deposit in Agro-Mod before the GST era should not be chargeable to 6% GST, but GST would be chargeable on the payment of the balance purchase price on 10 June 2015 together with late payment interest.

Secondly, it follows that the general time of supply provision in section 11(2)(b), GST Act is not applicable for land transactions where the consideration is payable periodically or from time to time. However, even if section 11(2)(b), GST Act is applicable, there is a GST case law from Australia i.e., ***Central Equity Limited v Commissioner of Taxation (2011) 214 FCR 255***, where it was held by the Australian Federal Court that, a supply of land would be *"made available"* at the *"time of substantive performance, being the time at which the recipient obtains that which was bargained for"*, in other words *"… obtained any real or practical ability to use the … [real property] interests …"*, which would be at "s*ettlement"* (Australian land law terminology essentially meaning '*delivery of vacant possession',* which is the term used in the Malaysian context). As the delivery of vacant possession of the land in Agro-Mod's case took place on 22 June 2015, this could potentially trigger the applicability of section 183, GST Act, whereby any payment made before the GST's effective date (e.g. the deposit paid on 17 November 2014) for a supply that will be made on or after the GST effective date (on delivery of vacant possession on 22 June 2015 in this case), would be deemed to be made on the GST effective date of 1 April 2015. Hence, the entire consideration (including deposit paid pre-GST era) would be chargeable to 6% GST. Such a draconian result could rightly be avoided, if, as indicated earlier, section 188(1), GST Act (which is similar to the special time of supply rule for land in regulation 4(1), GST Regulations) is applied and not section 183, GST Act (read with the general time of supply of "made available" in section 11(2)(b), GST Act).

Lastly, in determining that the status of the land in Agro-Mod's case is agricultural or non-agricultural (commercial) land, both the HC and COA do not seem to consider that the GST exemption in para 1(1), First Schedule, Exempt Supply Order is for (actual) use of the land for agricultural purposes, instead of category of 'land use' as "agriculture" (in land title). In Agro-Mod's case, the land transferred to Mydin was factually "vacant" land (i.e. not used yet for agricultural purposes). In another case of ***SFSB v Menteri Kewangan & Anor*** **("SFSB's case", 11 September 2020**), the HC has allowed an application for judicial review by SFSB to quash the decision of the Minister of Finance/Director General of the RMCD on the basis that the land in that case was actually used by the vendor (SFSB's supplier) for agricultural purpose, i.e., estate land used for oil palm plantations. The HC in SFSB's case decided that the use of the land or intention as to use of the land would have to be determined at the time of supply, a point also not considered by the HC and COA in Agro-Mod's case. Applying this test in SFSB's case, at the time of supply of the GST-era proportion of the 'progressive or periodic' supply of the vacant land, as represented by the balance purchase price together with the late payment interest paid on 22 June 2015, there was no actual use of the land for agricultural purposes, as the land was vacant land. However, at that time there was clearly an intention for the land to be used for the 'non-agricultural' (commercial) purpose of building a Mydin hypermarket, which would support the HC's decision in Agro-Mod's case as to the taxable treatment of the land, rather than the COA's decision that the land is GST-exempt. (The HC decision in Agro-Mod would still be wrong on the point of the entire consideration being chargeable to GST, instead of excluding the deposit, for reasons explained in the second point, above.)

In view of the above controversies, it is hoped that a similar case may be brought at first instance via judicial review to the HC, and appealed up to the Federal Court, for the COA decision in Agro-Mod to be revisited. As there are talks of reintroducing GST in the future, the Government could make things clearer in GST 2.0 to reflect the above comments, so as to avoid confusion in any land transactions spanning the implementation of GST 2.0.

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