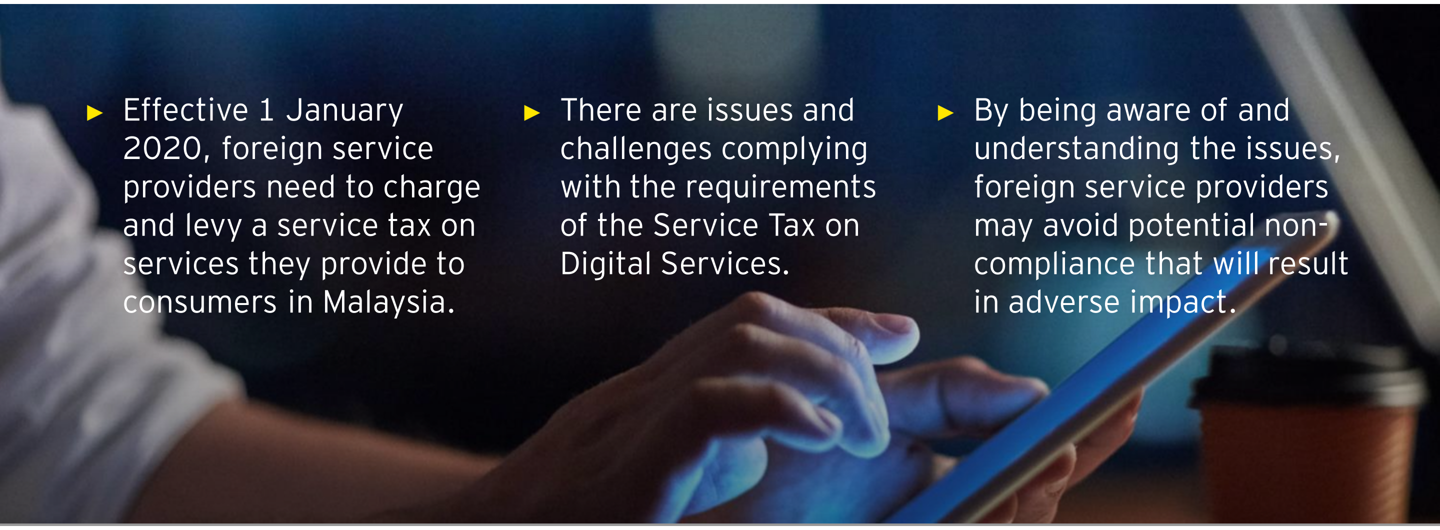
Building a better working world

What foreign digital service providers need to comply with in Malaysia

Foreign providers of digital services to Malaysia should ensure compliance with the Service Tax on Digital Services in Malaysia.



- Effective 1 January 2020, foreign service providers need to charge and levy a service tax on services they provide to consumers in Malaysia.
- There are issues and challenges complying with the requirements of the Service Tax on Digital Services.
- By being aware of and understanding the issues, foreign service providers may avoid potential non-compliance that will result in adverse impact.

Our world today is impacted by rapid advancements in technology and digitalization, with countries and businesses moving towards more efficient and sustainable digital models. The COVID-19 pandemic has also accelerated e-commerce growth across countries in ASEAN, where conducting business transactions over the internet has now become the new norm.

With digitalization, businesses are now able to generate revenue from a wider consumer base, even from those located outside their home country. The widening of market coverage has indirectly led to tax leakages as e-commerce businesses generally do not pay tax in foreign jurisdictions where they do not have a physical business presence.

To address this issue and ensure a level playing field between local and foreign service providers, besides fostering a sustainable business environment, several countries across the globe have implemented a digital tax. In ASEAN, Malaysia, Singapore and Indonesia were the first countries to impose a tax on foreign supplies of digital services starting in the year 2020, in line with global taxation trends.

At this juncture, Malaysia has approximately over 300 foreign service providers resident in China, Europe, Japan, Singapore, United States of America and other countries that have registered for the Malaysian Service Tax on Digital Services (SToDS). Among them are reputable search engine companies, online gaming and software developers, leading online advertisement platform providers and esteemed internet-based telecommunications companies.

Prior to the implementation of the Malaysian SToDS, it was anticipated that SToDS would increase tax revenue by more than RM2.4 billion (approx. USD600 million) a year. However, it was announced that the Malaysian government had only collected RM428.07 million (approx. USD103 million) from foreign service providers in 2020. Notwithstanding this, such a new taxation trend seems to be the right approach to increasing revenue collection for the government.

Sources: EY research, RMCD, media releases

The Malaysian SToDS

Effective 1 January 2020, service tax is to be charged and levied on any digital service provided by a foreign registered party to any consumer in Malaysia.

'Digital service' refers to any service that is delivered or subscribed over the internet or other electronic network, which cannot be obtained without the use of information technology and where the delivery of the service is essentially automated (with minimal or no human intervention from the service provider). Examples of digital services include the provision of software or applications, video games, music, e-books, films, online advertising services or platforms, online search engines and social networks, database and hosting, internet-based telecommunications, and online training courses.

By definition, a 'foreign service provider' is any party outside Malaysia that provides any digital service to a consumer in Malaysia, including any party that operates an online platform for the buying and selling of goods or for providing services (whether or not such party provides any digital services), and that makes transactions for the provision of digital services on behalf of another party.

A 'consumer' refers to any party (whether a business or an individual) that fulfils any two of the following:

a) Makes payments for digital services using a credit or debit facility provided by any financial institution or company in Malaysia
b) Acquires digital services using an internet protocol address registered in Malaysia or an international mobile phone country code assigned to Malaysia
c) Resides in Malaysia

Foreign service providers that provide digital services to consumers resident in Malaysia and have an annual taxable revenue exceeding the registration threshold of RM500,000 (approx. USD120,000) are required to register for the Malaysian SToDS and to impose a service tax at the rate of 6% on the digital services provided.

As a foreign registered party, the individual or business is also required to furnish tax returns on a quarterly basis and remit the service tax due to the Royal Malaysian Customs Department (RMCD) on or before the stipulated deadlines.

Sources: EY research, RMCD, media releases

Common issues faced in SToDS

a) Late registration or failure to register for SToDS

Foreign digital service providers are expected to register for SToDS in Malaysia. However, some may not be aware of the requirement to do so or of the annual revenue threshold for registration (RM500,000 or approx. USD120,000).

Furthermore, as the Malaysian SToDS regime is broad in nature and the scope of digital services is quite extensive, some service providers may misinterpret the legislations and assume that the services they provide do not fall within the ambit of the Malaysian digital service tax and therefore do not register.

To date, there are foreign service providers who were late in submitting their SToDS registration applications and have been required by RMCD to file historical returns as far back as the implementation date, as well as remit late payment penalties.

b) Failing to file and pay SToDS by the statutory deadlines

Foreign registered parties that fail to submit returns and make payments to the RMCD by the statutory deadlines are committing an offence and risk being fined or imprisoned. However, the Malaysian SToDS legislation has been updated to include a provision that grants power to the Director General of RMCD to remit or waive any penalties on late payment of SToDS, on a case-by-case basis.

c) Non-compliance with prescribed conditions for the issuance of documents

There have been instances where the foreign registered party was not aware of the prescribed particulars required to be stated on the invoice, debit note or credit note issued, to be compliant with the Malaysian SToDS requirements.

d) Accounting for SToDS on a payment basis vs. accrual basis

SToDS is due at the time when payment is received for the service provided to the consumer. Where the foreign registered party wishes to account for SToDS on an accrual or invoice basis, it needs to apply to the Director General of RMCD for approval. However, foreign registered parties commonly overlook this requirement for approval of the change to the accounting basis (i.e., from payment basis to accrual basis).

e) SToDS intragroup relief facility

Effective 14 May 2020, the SToDS legislation was updated to include a provision to make available the intragroup relief facility on digital services provided by foreign service providers. Subject to specific conditions, a foreign service provider may utilize the facility to not charge 6% service tax on digital services it provides to related parties in Malaysia.

However, foreign service providers may overlook the prescribed conditions required to fully enjoy the said facility, resulting in non-compliance with the tax legislations and under-payment of SToDS.

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Being aware of the SToDS issues encountered by other similar businesses may help a business avoid such challenges and potential adverse impact.

Yeoh Cheng Guan
Partner and Malaysia Indirect Tax Leader
Ernst & Young Tax Consultants Sdn Bhd

Sources: EY research, RMCD, media releases

How to ensure compliance

It can indeed be a challenge for foreign businesses to keep abreast of the ever-changing indirect tax legislations in multiple jurisdictions.

With the implementation of SToDS in Malaysia effective 2020, foreign service providers should re-evaluate the digital services they provide to consumers in Malaysia and urgently perform an assessment to determine whether their services fall within the digital service scope in Malaysia.

They should also analyze the impact of local tax legislation developments and changes on their business operations, and consider whether to restructure their existing business model to mitigate tax exposure.

Foreign providers of digital services to Malaysia should keep abreast of local tax legislation developments and regularly perform an assessment of their operations to ensure compliance with local legislations and avoid potential hefty penalties and reputational damage.

The authors

Yeoh Cheng Guan
Partner and Malaysia Indirect Tax Leader, Ernst & Young Tax Consultants Sdn Bhd

Cheng Guan has over 22 years of tax experience, of which five years were spent in corporate income tax compliance and advisory before he moved to indirect tax. He serves a wide range of local and multinational clients, mainly in the automotive, financial services and consumer products sectors. Cheng Guan provides advisory and compliance services on indirect tax matters covering service tax, sales tax, excise duty, customs import/export, free zones, licensed manufacturing warehouses and duty exemption facilities.

Germaine SL Ong
Senior Manager, Indirect Tax, Ernst & Young Tax Consultants Sdn Bhd

Germaine has over 13 years of tax experience, of which six years were spent in corporate and individual income tax compliance and advisory before she moved to indirect tax. She serves a wide range of local and multinational clients, mainly in the manufacturing, property development, construction, consumer products and oil and gas industries Germaine provides advisory and compliance services on indirect tax matters covering service tax, sales tax, goods and services tax, customs and global trade.

Sources: EY research, RMCD, media releases

Have questions on Indirect Tax matters?

We would be pleased to arrange a discussion with you.

Please contact a member of the EY Indirect Tax team for a non-obligatory meeting, where we can explore your specific concerns.

EY Indirect Tax leadership team

Yeoh Cheng Guan
Partner and Malaysia Indirect Tax Leader, Ernst & Young Tax Consultants Sdn Bhd
+603 7495 8408
cheng-guan.yeoh@my.ey.com

Jalbir Singh Riar
Partner, Ernst & Young Tax Consultants Sdn Bhd
+603 7495 8329
jalbir.singh-riar@my.ey.com

Lindsey Cruickshanks
Director, Ernst & Young Tax Consultants Sdn Bhd
+603 7495 8440
lindsey.cruickshanks@my.ey.com

EY Indirect Tax contacts

Germaine SL Ong
+604 688 1908
germaine-sl.ong@my.ey.com

Aljo Barias
+603 7495 8558
aljo.barias@my.ey.com

Poh Ai Yeen
+603 7495 8353
ai.yeen.poh@my.ey.com

Lee Siew Chian
+603 7495 8504
siew.chian.lee@my.ey.com

Stephen Nguoi
+6082 752 654
stephen.nguoi@my.ey.com

Aaron Kong
+6082 752 653
aaron.kong@my.ey.com

Wong Jen Shaun
+603 7495 8502
jen.shaun.wong@my.ey.com

Sheila Suppiah
+603 7495 8468
sheila.suppiah@my.ey.com

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