Service tax on imported taxable services and digital service tax

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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.

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