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## **THE VIRTUAL GOLD MINE: TAXING ELECTRONIC COMMERCE**

### **The Future Today**

The digital marketplace has steadily grown in popularity over the last couple of years. As of January 2020, Malaysia's 6% digital service tax was implemented to levy taxes on popular online services like Netflix and Spotify. However, the “new normal” arising from the outbreak of COVID-19 has driven more transactions online and there is plenty of untapped revenue to be taxed. The Malaysian e-commerce market is projected to reach US\$4.46 billion (approximately RM18.7 billion) in 2020 and revenue is expected to show an annual growth rate of 16.0% by 2024.

On 13th May 2019, the Inland Revenue Board of Malaysia (“**the Revenue**” or “**IRB**”) updated their Guidelines On Taxation of Electronic Commerce Transactions (“**the Guidelines**”) which is a public statement of how the Revenue views the issue.

Electronic Commerce Transactions (“**e-CT**”) are defined in the Guidelines as follows:

*“any sale or purchase of goods or services, conducted over any networks by methods specifically designed for the purpose of receiving or placing of orders. The goods or services are ordered by those methods, but the payment and the ultimate delivery of the goods or services do not have to be conducted online. An e-CT can be between enterprises, households, individuals, governments, and other public or private organisations.”*

At the time of writing, there are no specific taxing provisions for e-CTs and the IRB has taken the approach of taxing these transactions in the same way as traditional transactions.

### **The Guidelines**

The Guidelines cover the taxability of e-CT income that falls into one of three classes: Business; Section 4A Special Classes of Income; and, Royalty.

As mentioned above, the approach taken by the IRB is to tax these classes of income just like traditional transactions, however the defining feature of e-CTs is that trade can be done online and involve goods, services and persons from across the world. This poses a problem for territorial tax systems like ours. **Specifically, where is the income accrued in or derived from?**

Section 3 of the Income Tax Act 1967 (“ITA”) states that:

*“...a tax to be known as income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia.”*

This is fairly straightforward in the case of local transactions. A local seller selling an item in Malaysia would clearly have accrued income in Malaysia, whether or not the transaction is an e-CT. However, the transaction becomes more difficult when the e-CT involves the sale of goods and services overseas. Can the income be said to be accrued in or derived from Malaysia?

The Revenue attempts to answer this in their guidelines with the following:

*“4.2 Any income in relation to e-CT is deemed to be derived from Malaysia if it is associated to any activities in Malaysia regardless of whether that income is received in Malaysia or otherwise.”*

It is unclear what is meant by “associated to any activities in Malaysia” and unfortunately, they provide no examples of this in the Guidelines. Furthermore, this statement is much wider than the ITA provides as seen in Section 3 above.

The courts addressed the question of where income accrues in the Hong Kong case of Commissioner of Inland Revenue v Hang Seng Bank Ltd where Lord Bridge sitting with the Privy Council opined:

*“The question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. **The broad guiding principle, attested by many authorities, is that one looks to see what the taxpayer has done to earn the profit in question. If he has rendered a service or engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on.** But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and reselling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected.”*  
(Emphasis added)

This was adopted by the KL High Court in the case of Ketua Pengarah Hasil Dalam Negeri v Cardinal Health Malaysia 211 Sdn Bhd. In this case, the taxpayer had earned interest income on an inter-group lending arrangement with another group company in The Netherlands. The Special Commissioners of Income Tax (“**SCIT**”) found that the interest income was sourced from outside of Malaysia as neither the

agreement entered into between the taxpayer and the borrower company nor the provision of credit were made in Malaysia. The respondent lent the monies to the borrower company in The Netherlands. This decision was upheld by the Courts. Thus, we see that the law essentially looks at where the profit making activity was carried on, which is a matter of fact to be decided on a case-to-case basis.

On top of that, there are a number of deeming provisions within the ITA which provide certain situations where the income will be deemed to have derived from Malaysia. Businesses conducting their trade online and with overseas partners should be particularly aware of section 12 of the ITA, which provides a number of circumstances in which income may be deemed to be accrued in Malaysia. For example, overseas businesses with a place of business in Malaysia may still have their income deemed to be derived from Malaysia.

## **Conclusion**

The taxation of e-commerce is still an area of law that needs to be developed and refined. In an age where business can be conducted by anyone, with anyone, anywhere in the world, the territorial basis for tax will need to adapt to the rise of e-CTs.

Businesses in Malaysia that have moved online should ensure that they take into account the nature of their business to determine where the profit-making activity is carried on. Nevertheless, this is a question of fact for determination before the SCIT.

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