Malaysia Indirect Tax: Special Voluntary Disclosure Program ("SVDP")

Moving forward with a clean slate

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Moving Forward with a Clean Slate

Service Tax is an indirect tax levied on only the prescribed taxable service stipulated under the First Schedule of the Service Tax Regulations 2018. This has perhaps created a general impression that the scope of consumption tax is narrower since the reintroduction of SST 2.0 back in 1 September 2018,as compared to the GST regime.

Nevertheless, it is worth noting that with the gradual fine-tuning of the service tax regime since 1 September 2018, coupled with increased explanations and guidance from the Royal Malaysian Customs Department ("RMCD"), it is very evident now that the "tax net" has been cast much further resulting in more services or transactions being brought under the scope of service tax.

In view of this, we are pleased to share some interesting observations on the issues affecting certain industries. We hope that the taxpayers in these industries will benefit from our sharing, in order to better prepare themselves to take advantage of the proposed Special Voluntary Disclosure Program ("SVDP") that will be administered by the Royal Malaysian Customs Department ("RMCD"), which was mentioned in the Pre Budget Statement published by the Ministry of Finance on 31 August 2021.

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Disclaimer: Please kindly note that our sharing is based on our observations, and is not meant to be representative of entire industries.

Investment holding and management services

Our observation

In general, investment holding companies or management arm companies which have been set up to render corporate and administrative support services, consultancy services, and the sharing of staff to the inter-companies and associate companies.

Often and for most of the time, businesses would have the impression that all the services provided to their subsidiaries can qualify for an intra-group exemption and that there would not be concerns on service tax.

Nonetheless, there are conditions to be in compliance with, when the intra-group exemption facility is applied. The main criteria that the service provider must establish is their ownership and control over the service recipients, where one company possesses controls over another company, directly and indirectly.

There are instances where businesses fail to realize that the intra-group exemption may not be applicable, if the management services are also rendered to associate companies, where they do not possess majority control. In this context, the entire intra-group exemption which has been applied to the full range of management services, not only at the associate companies, but also to the related companies, may be jeopardized.

Our view

It appears that businesses may regard the intra-group exemption as being easy to apply for. However, it is to be noted that without an in-depth analysis on whether the activities being carried are prescribed taxable services for service tax purposes; and scrutinizing the group structure for the level of control; the self-application of the intragroup exemption will be highly risky.

Our thoughts

Failure to fulfill the criteria for intra-group service tax exemptions will result in additional costs, in relation to taxable services provided within the group of companies.

Hence, for companies that provide taxable services (e.g. management services and treasury services) to related companies, their eligibility for intra-group service tax exemption should be re-assessed, in order to gauge potential service tax liabilities and formulate alternative strategies, if necessary.

2 Infrastructure construction and maintenance

Our observation

Are infrastructure construction and maintenance subject to service tax?

In general, infrastructure construction and maintenance services are not subject to service tax, as they do not fall within any of the categories of taxable services under the First Schedule of the Service Tax Regulations 2018. However, it is worth noting that while pure construction and maintenance services are not taxable services, some packaged services may contain elements of taxable services.

An example would be the routine maintenance of roads, where various activities are also involved. For the building of roads or emergency repairs carried out based on the instructions from Jabatan Kerja Raya (Public Works Department), it is considered as a construction service, and hence, not subject to service tax.

In contrast, for the long term maintenance of roads, where the contractor is involved in the monitoring of road conditions, budget preparations, arrangement of logistics and deployment of resources to carry out the maintenance works, it is evident that there is an element of management, embedded in the overall service package. This concept has been confirmed by Royal Malaysian Customs Department ("RMCD") via engagement sessions with the industry, and is stated in the Guide on Management Services dated 4 August 2021 ("the Guide"), where examples no. 6, 7 and 8 illustrate the different kinds of maintenance service packages and their corresponding service tax treatments within the ambit of maintenance management.

Our thoughts

Service providers, such as roads and toll concessionaires, who are involved in the provision of long-term infrastructure maintenance like building and telecommunication networks maintenance, should consider the relevance of this issue to their business.

If services were rendered but service tax was not charged or remitted to the RMCD, a late penalty of a maximum of 40% is applicable, in addition to the amount of tax that should have been remitted to RMCD.

Hence, providers of infrastructure maintenance services may want to examine the details of the services provided to their customers, in order to identify any elements of management services which may be embedded, and ascertain the basis to determine the correct value for the management service portion.

2 Infrastructure construction and maintenance

Our observation

Is the entire service package subject to service tax?

Once a construction or maintenance service package has been determined to contain elements of management and is thus subject to service tax, the next important step is to ascertain the correct value of the taxable service. In the Guide's example no. 7, it is stated that if the value of the taxable service is not segregated from the other non-taxable portions, the entire service value is subject to service tax.

It is to be noted that in terms of segregating the value of taxable service from the entire service value, proper justifications and grounds have to be deployed to arrive at the proper value of taxable service, as the need to ascertain the correct value of taxable service is provided for under the legislation.

Our thoughts

This exercise is useful for risk management purposes, as the RMCD has commenced service tax audits on maintenance service providers. With such assessments carried out, the business will be able to understand their service tax exposure, formulate the associated risk management strategy, as well as to re-negotiate the pricing with customers, if necessary. Special attention should be given to any historical service tax liability that may arise.

3 Engineering, Procurement, Construction and Commissioning ("EPCC")

Our observation

For pure construction services, there are no service tax implications. However, for a construction service package, which involves multiple stages of works, for example, there may be certain portions of the work that may be subject to service tax.

Packaged construction services

In the construction sector, especially for the construction of specialized facilities or large scale structures, such as sophisticated factories and power plants, it is common for the contractor to provide packaged services involving engineering, procurement, construction and commissioning ("EPCC") with the project owner to build such facilities.

Due to the sophisticated nature of the equipment and machineries built, there are times when the contractor is retained to continue to service and maintain the sophisticated equipment and machineries, due to their in-depth knowledge of the equipment and the facilities.

Depending on the content of the servicing and maintenance package, there may be elements of management service involved, such as the constant monitoring of the performance of the equipment and machinery, and performing periodic checks on the condition. If these services are present in the service package, there is evidence of management service being provided, which may subject the service package to service tax.

Our thoughts

For taxable services that have been rendered but where the service tax was not charged or remitted to the RMCD, a late penalty of a maximum of 40% is applicable, in addition to the amount of tax that should have been remitted to the RMCD.

Similarly, for those transactions where the exemptions are incorrectly applied (be it an intra-group exemption or a B2B exemption), a late penalty of a maximum of 40% is applicable, in addition to the amount of tax that should have been remitted to RMCD.

Therefore, contractors may want to assess the contents of the services provided to their customers, especially for maintenance services rendered after the completion of the project.

For those who are applying for intra-group exemption and B2B exemption, a detailed assessment must be performed to confirm whether all the criteria are met.

3 Engineering, Procurement, Construction and Commissioning ("EPCC")

Our observation

Joint venture ("JV") arrangements

In the construction industry, it is common for contractors to enter into JV arrangements with other parties to form a larger entity for project tendering purposes. Once the JV entity is awarded with the main contract, the individual parties within the JV entity will then provide their services to the JV entity.

For those that provide taxable services (e.g. engineering services, consultancy services, project management services, etc) to the JV entity, some will invoke the intra-group exemption facility provided under para 3 of the First Schedule of the Regulations, and thus do not charge or account for service tax on the taxable services provided to the JV entity.

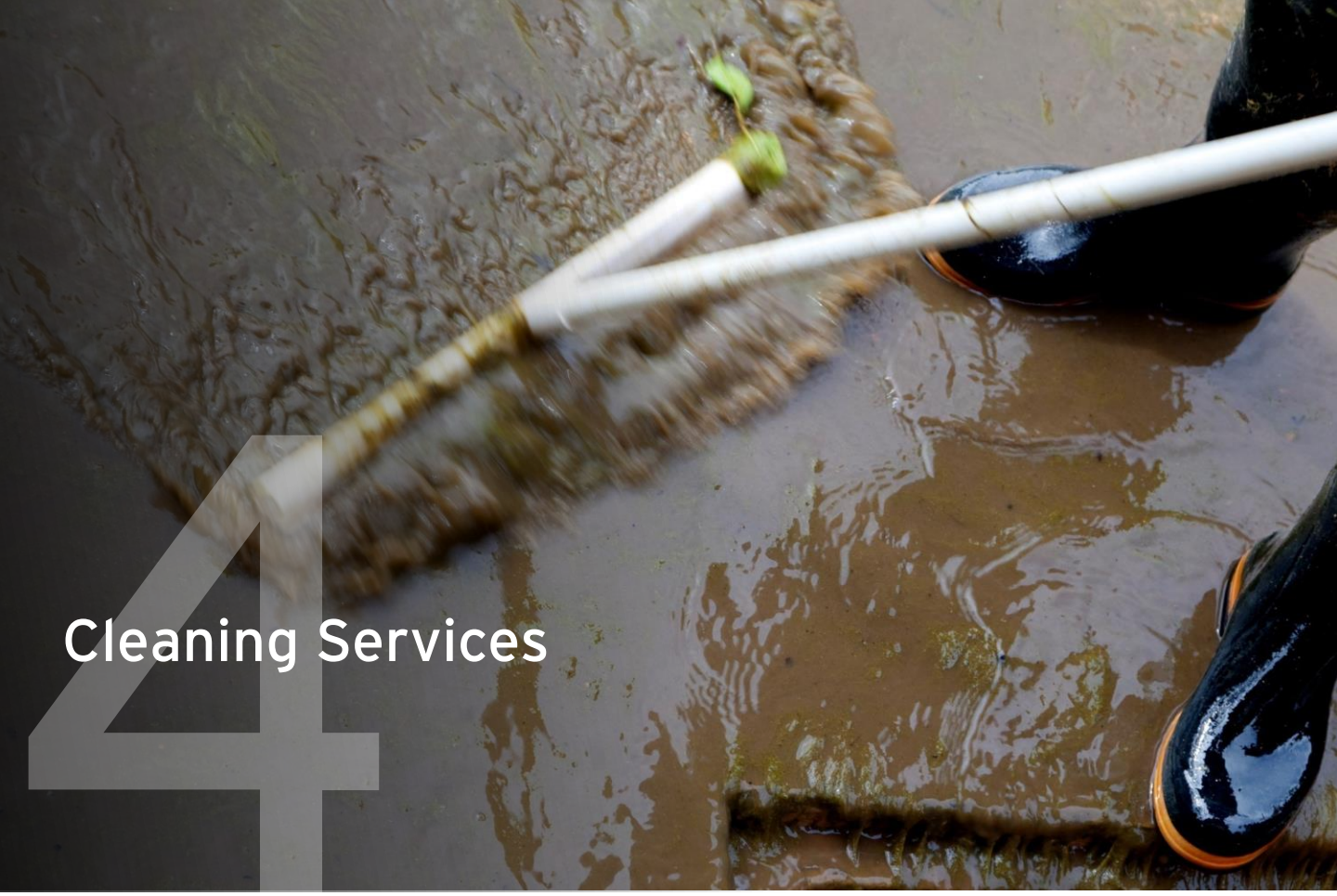
However, it is worth noting that in order for intra-group exemption to apply, all the criteria must be met. The shareholding structure of the JV entity may be evenly split with no party having a clear control of the board of directors, and this may become an issue for intra-group service tax exemption purposes.

Another key requirement that the same taxable service provided to third parties must not be more than 5% of the total value of taxable services of the service provider. The failure to meet any of the criteria will render the exemption void, and service tax liability will arise.

Some parties within the JV entity will invoke the B2B exemption under the Service Tax (Persons Exempted From Payment of Tax) Order 2018. One of the key requirements for this exemption is that the same kind of taxable service that is being exempted must be provided onwards to the end recipient. In actual practice, we have noted incidents where the Customs audit officers disputed the B2B exemption applied, based on the concept the same service is not being supplied onwards, due to the fact that the service code (in the SST-02 return) of the service provider is not the same as that of the service recipient's.

Our thoughts

These exercises are useful for risk management purposes, and will enable businesses to understand their potential service tax exposure and historical service tax liability, in order to formulate the associated risk management strategy, as well as re-negotiate pricing with customers, if necessary.



4 Cleaning Services

Our observation

'Cleaning', by definition, is the act of removing dirt or unwanted substances using manual, chemical or mechanical means. This has left a wide room for interpretation on what constitutes cleaning services. For instance, the following scenarios may be considered as 'cleaning services', and therefore, are subject to service tax :

1. **Land clearing** for a development project other than for religious, educational, residential or agricultural purposes.
2. **Cleaning of specialized tools, equipment and devices:** The provision of cleaning services for specialized tools, equipment and devices, e.g. medical equipment and apparatus, oil-and-gas related equipment.
3. **Public amenities cleansing:** Removal of pollutants or spills from seas or river, removal of sludge from industry refining processes, cleansing of public areas, etc.
4. **Ship hull and aircraft cleaning services:** Hull cleaning services for the removal of biological roughness or marine fouling; and aircraft cleaning services including exterior and interior cleaning.
5. **Disinfection and sanitization services:** Disinfection and sanitization services for containers, cargoes, buildings and public areas.

Our thoughts

For taxable services that have been rendered but where the service tax was not charged or remitted to RMCD, a late penalty of a maximum of 40% is applicable, in addition to the amount of tax that should have been remitted to RMCD.

Hence, it is important for providers of these services to examine the details of the services provided to their customers, in order to determine their service tax exposure and formulate risk mitigation and management strategies.

It is also worthwhile for service providers to look into possible strategies to form a basis to determine the value of the portion of service subject to service tax, if necessary.

5 Port operators

Our observation

With the introduction of warehousing management services under the Service Tax legislation and guidelines issued by the RMCD, it is to be noted that any person who renders warehousing management services (including handling, loading and unloading, sorting, consolidation and de-consolidation, labelling, inventory control, pick and pack, and security) are required to register and account for service tax on the taxable services provided.

Ports normally have warehouses and godowns and form part of the facilities and services that they provide to their clients. Other than warehouse and storage services, port operators also provide other ancillary services such as handling, loading and unloading and the storing of goods and cargo at the warehouses, which may come under the scope of service tax.

Ports operators with storage tanks and bulking facilities for refined products (i.e. crude oil and crude palm oil) are likely to be seen as providers of warehousing management services.

Our view

Pursuant to Section 53 of the Service Tax Act 2018, if taxable services, including warehousing management services, are provided by port operators located in Special Areas (i.e. Free Zones or Licensed Warehouses), they will be excluded from being levied a 6% Service Tax.

As for port operators who are not located in the Special Areas, there may be service tax liability on the above-mentioned warehousing management service.

Our thoughts

For taxable services that have been rendered but where a service tax was not charged or remitted to RMCD, a late penalty of a maximum of 40% is applicable, in addition to the amount of tax that should have been remitted to RMCD.

Therefore, it is important for port operators who are not located within free zones to look into the services provided to their customers, in order to determine their service tax exposure and formulate risk mitigation and management strategies.

Port operators may also look into the viability of applying to be gazetted as Free Zones, or change their warehouses and storage facilities into Licensed Warehouses.

6 Hotel operators

Our observation

Service tax exemption for hotel operators

It is to be noted that the current service tax exemption for hotel operators will be ending on 31 December 2021, as stipulated in the Service Tax Policy 2/2021, if no further extension is announced by the government.

In the Service Tax Policy 2/2021, it was clearly stipulated that the service tax exemption is only on the accommodation service provided. Further to that, it is worthy to note that an amendment was made on 23 August 2021 to the Service Tax Policy 2/2021 to further clarify that for hotels taking part in COVID-19 quarantine programs, out of the RM 150 charged to every customer, RM 45 is for meals and RM 5 is for laundry service.

Hence, the RM 45 and RM 5 for meals and laundry services respectively. are subject to service tax, as these are not accommodation services in nature.

Deposits and booking fees

Deposits and booking fees received subject to service tax when they are part of the payment. If the payment is received as a collateral, it is not subject to service tax.

Depending on the nature of deposits and booking fees received, if the service tax is accounted for late, a late payment penalty may be imposed, if the issue is uncovered in the event of an audit by RMCD.

Our thoughts

For hotels participating as quarantine hotels, careful assessment must be performed to ensure that the service tax has been properly accounted for on the meals and laundry services.

Hotel operators may consider performing a review on free rooms to identify those that are for private use (and hence, subject to service tax).

For deposits and booking fees, hotel operators may consider reviewing documentation to confirm their nature when they are first received, in order to ensure that the service tax is correctly accounted for in a timely manner.

If there is any under-accounting or late accounting of service tax, proper actions should be taken to rectify the errors in order to mitigate the risks of incurring late payment penalties.

7 Services acquired from overseas vendors

Our observation

It is to be noted that for imported services, only taxable services stipulated under the First Schedule of the Service Tax Regulations 2018 are subject to service tax.

For certain taxable services, such as legal, accounting, engineering and valuation services, if the taxable services being imported are in relation to goods and land situated outside Malaysia, or if the subject matters relates to a country outside Malaysia, it is not subject to service tax.

At the same time, intra-group exemption for service tax purposes is also available for imported taxable services.

It is also to be noted that there are cases where some companies have an erroneous idea that once they have accounted for the withholding tax, they are no longer required to account for the service tax on imported taxable services that they acquired. This is not compliant with service tax legislations.

Our thoughts

For imported services, it is advisable for companies to perform a detailed review and assessment on all their imported services (taking into account the exemptions available), in order to ensure that the service tax is correctly accounted for and ensure that there has not been any over- or under- accounting of the service tax).

For companies that acquired taxable services in order to deliver services that are subject to service tax, it is worthwhile to explore whether the B2B service tax exemption is applicable, in order to achieve cost savings.

Hence, detailed assessments are to be done to ensure eligibility for exemption, and as a basis to undergo the RMCD's audit on this matter.

8 Business-to-Business ("B2B") service tax exemption

Our observation

The B2B service tax exemption was made available from 1 January 2019 onwards, and it was introduced to mitigate the tax cascading effect brought about by service tax.

This exemption is only applicable to taxable services in Group G in the First Schedule of the Service Tax Regulations 2018 , i.e. professional services other than employment services and the provision of guards or security services, advertising services, digital services which are acquired from foreign registered persons, where the service tax is already paid, and IT services acquired from outside Malaysia.

The main criteria for this exemption to be applied are:

- Both the service provider and the recipient of the service are registered for service tax.
- The same taxable service is being provided onwards by the service recipient to another recipient, who do not qualify for exemption on digital services.

We note that there may still be businesses that are not fully aware of this exemption, especially when it comes to a packaged service involving multiple taxable services being acquired.

Our thoughts

It is the duty of the service recipient to substantiate that all criteria are met, because the exemption is for a person to be exempted from paying service tax, rather than exempted from charging service tax.

Hence, detailed assessments are to be done to ensure eligibility for the exemption, and as a basis to undergo RMCD's audit on this matter.

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 concern.

EY Indirect Tax leadership team

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