Have you considered the anti-profiteering regulations?

The rapidity and depth of the COVID-19 crisis was unexpected and it is not over yet. During a virtual meeting held by tax leaders from KPMG member firms recently, more than 1,000 attendees were asked about their current priorities. Besides keeping up to date with business changes and cash preservation, rounding out the top three is compliance.

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> The Price Control and Anti-Profiteering Regulations 2018 applies to all goods and services, not just essential goods which are price controlled.

As the COVID-19 crisis continues in Malaysia, consumers had to reshape their habits with the Movement Control Order (“MCO”) in place. Even with the relaxation of the MCO (also known as Conditional MCO) more Malaysians are staying and eating at home, resulting in the surge in the use of food delivery services and long queues observed at supermarkets, partly amplified by the hoarding impulse driven by the fear of a potential deteriorating situation.

While the increase in consumer demand for essential goods is observed, the MCO has inevitably created supply chain disruptions which also pushed prices upwards for certain goods. Where there is an indiscriminate hike in prices especially on price controlled goods, the government can intervene at any time by implementing price controls to protect the people’s purchasing power, similar to the Maximum Price Scheme which is usually imposed on essential goods during the festive seasons. Amongst others, the government stepped in to set the ceiling price of RM1.50 for a 3-ply face mask as we saw the hike in price to more than 100% due to a shortage in the market.

Since March 2020, the Ministry of Domestic Trade and Consumer Affairs (“MDTCA”) enforcement officers have intensified inspections at business premises of retailers, wholesalers and manufacturers to monitor the supply and prices of essential goods. In addition to keeping a close watch on businesses to ensure adequate supply of essential goods for the people, it was also to ensure that businesses are not taking advantage of the MCO situation to increase prices and the price of controlled goods does not exceed the ceiling price. Having said that, businesses should also take note that even if their goods and services are not within the category of essential goods, the Price Control and Anti-Profiteering (Mechanism to Determine Unreasonably High Profit) Regulations 2018 (“PCAP Regulations”) applies to all goods and services.

Price Adjustments

During the MCO period, a lot of businesses continue to incur operating costs including rental, head office expenses, insurance, and repair and maintenance. Adding to their cash flow pressures are staff costs comprising salaries and wages, allowances and contributions which some businesses had to continue paying after weeks of reduced or zero revenue.

To the extent the market demand allows, some businesses may look into increasing their prices to cushion such increase in costs.

Any price adjustments as a response to the downturn in business activity and significant shifts in consumer demand and behaviour must be managed carefully. Based on the PCAP Regulations, where the mark-up percentage ("MUP") or margin percentage ("MP") of the goods or services exceeds the percentage determined based on the prescribed formula, the business is regarded as making unreasonably high profit (i.e. profiteering). On conviction, any body corporate that commits such offence shall be liable to a fine not exceeding RM500,000 and, for a second or subsequent offence, to a fine not exceeding RM1,000,000 each.

The challenge has always been applying the right formula in determining the MUP or MP permitted under the regulations.

> "The decision whether to increase selling price or hold back requires careful consideration from the price control and anti-profiteering compliance perspective.

Depending on the sales strategies which businesses have, other considerations worth noting on price adjustments are:

Where businesses plan to have promotions in response to the expected slowdown in consumer spending amidst job losses and pay cuts.

The PCAP Regulations recognise that the MUP or MP of the goods or services become distorted during promotional periods and provide for exceptional rules where goods or services are offered at cheap sale price or promotional charges. Businesses should take note of the different rules in applying the formulas.

Where businesses have minimal increase in prices and opted to absorb the remaining increase in costs to protect their market share.

As the formulas prescribed in the PCAP Regulations largely take into account the increment of the MUP or MP of the goods or services in the 3 preceding years in determining whether the business is making unreasonably high profit, a reduction or minimal increase in the current year MUP or MP may translate into a lower MUP or MP permitted in the future years. Below is a simple illustration:-

	1 July 2018	1 July 2019	1 July 2020
MP	10%	13%	11%
2020/ 2019		-2%	
2019/ 2018	3%		
Whichever higher	3%		
Profit is unreasonably high if the MP of this product exceeds **14%** (i.e. 11% + 3%).			

	1 July 2018	1 July 2019	1 July 2020
MP	10%	13%	14%
2020/ 2019		1%	
2019/ 2018	3%		
Whichever higher	3%		
Profit is unreasonably high if the MP of this product exceeds **17%** (i.e. 14% + 3%).			

"New" vs "Same" goods or services

Another apparent shift in business models during the MCO is the switch to e-commerce as a means to prevent cash flow bottlenecks and to maintain competitiveness amidst a changing landscape. As foot traffic has reduced significantly during the MCO, businesses are going online to sell their products and connecting with delivery partners to bundle a variety of offers. Due to challenges posed by the MCO, some businesses are also rolling out new product offerings or repackaging existing ones to suit the market conditions.

From a price control and anti-profiteering perspective, businesses need to consider the implications whether their products would be classified as a new product as a result of the changes to e.g. distribution channels and marketing strategies. Whilst the prescribed formulas are fundamentally based on the MUP or MP of the goods or services in the 3 preceding years in determining whether the business is profiteering, for a new product, a separate set of formulas apply in the absence of historical data. It is therefore crucial for business to assess whether the goods or services offered during this unprecedented time should be regarded as being offered for supply for the first time.

The COVID-19 pandemic coupled with the restrictions imposed under the MCO has undeniably caused supply chain disruptions particularly in raw materials sourcing. Hence, when businesses source for alternatives, are the goods or services offered to be regarded as new?

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> It is important to determine whether the goods or services offered are the same as pre COVID-19 due to the various changes in response to market condition.

Cost Cutting

It is not to our surprise that some businesses are looking into areas where they can reduce or minimise costs by putting in place better resource planning and initiating negotiations with suppliers. The business landscape is unlikely to be the same even after the MCO is lifted and the return to normalcy in terms of economic activities and consumer sentiment before the COVID-19 crisis is difficult to predict at this stage.

Owners of businesses – big, medium and small – need to take necessary measures to position themselves to operate in a new environment and that includes restructuring themselves to improve on operational efficiencies while maintaining fiscal discipline in facing the immediate and anticipated impact of the COVID-19 crisis.

All else being equal, cost cutting would naturally result in a higher profit margin for the business and raise the concern of whether it would be considered profiteering. Again it is worth noting that the PCAP Regulations provide an exception where the profit is not unreasonably high if the MP or MUP exceeds the percentage permitted due to the reduction of cost in the course of or in furtherance of business. Businesses who are recording higher MP or MUP for a particular goods or services should assess whether they can fall under the exception, which otherwise would be an offence and hefty penalty applies.

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> Is improved profitability due to reduction in cost regarded as making unreasonably high profit?

It is expected that the MDTCA enforcement team will continue to be active in carrying out inspections even post MCO. It should be businesses' priority to ensure that measures are taken to comply with the PCAP Regulations at all times.

Should you wish to discuss further on this matter, please do not hesitate to contact us and we would be pleased to assist.

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