Wong & Partners
MEMBER FIRM OF BAKER & MCKENZIE INTERNATIONAL

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For further information, please contact:

Yvonne Beh
+603 2298 7808
yvonne.beh@wongpartners.com

Tan Yi Lyn
+603 2298 7847
yilyn.tan@wongpartners.com

GST in Malaysia - One Year On

Following numerous delays and postponements since its initial announcement back in 2009, the goods and services tax ("GST") regime was implemented in Malaysia on 1 April 2015.

As we have just passed the 1st anniversary of the introduction of the GST regime, we take stock of some highlights and key issues faced by businesses in the first 12 months of the GST implementation. We will also take a look at some of the potential GST issues to look out for in the coming year.

Facts and Figures

We thought it would be interesting to highlight some key facts and figures gleaned from recent press statements by the Royal Malaysian Customs ("Customs") and Ministry of Finance:

- 406,000 companies have registered for GST as at March 2016
- GST collection for 2015 is estimated to exceed the target of RM 27 billion (total amount not finalised yet due to expected refunds);
- RM 800 million GST refunds are still pending or being processed; Customs expects to raise RM 39 billion from GST for 2016; and
- 1,190 GST-related cases investigated by Customs as at 31 January 2016.

Year in Review: Key Issues / Concerns

As with the rollout of any new tax regime or model, initial teething issues during the implementation stage are to be expected. Similarly, there will be areas of uncertainty in the interpretation and application of the new GST laws which businesses would need to navigate during this period.

We have summarised below some of key issues and concerns which have been at the forefront for businesses in the first 12 months of the GST implementation:

1. Input Tax Credit Refunds

The promptness of GST input tax credit refunds remain at the top of the priority list for most businesses, given its significant impact on cash flow.

Based on the Goods and Services Tax Regulations 2014, input tax credit refunds should be made within 14 working days (or within the time practicable) after the GST return is received by the Director General, for online submissions. Refunds for filings made manually shall be processed within 28 working days.

However, in the first few months following the GST implementation, businesses were plagued with fairly lengthy delays in the refund process, with some input tax credit refunds taking up to 3 months to be processed. The Customs had cited errors in GST return forms and bank account details as some of the reasons for the delay, as well as necessary verifications and reviews conducted by Customs to weed out suspicious or fraudulent claims.

According to Customs, by end 2015, approximately 70% of GST refund claims by companies are processed and refunded within the 14-day period.

From experience, it is not uncommon for Customs to request for further information regarding the input tax refund claim (including requests for supporting documents such as tax invoices, customs declaration forms, etc.) to substantiate the refund claim. Such requests and verification procedures often lengthen the processing time

of the GST refund. It is also observed that companies which are in a refund position for more than 2 or more consecutive taxable periods, would have a higher likelihood of receiving a verification / review notice prior to the approval of its input tax refund claim.

2. Compliance with the Price Control and Anti-Profiteering Act 2011 ("PCAP")

Briefly, the PCAP was passed in an effort to alleviate concerns amongst Malaysian consumers of unreasonable increases in the prices of goods and services following the introduction of the GST regime. Under the PCAP, it is an offence for a person to make an unreasonably high profit from the sale or supply of goods or services in the course of a trade or a business.

In exercising the broad investigative powers under the PCAP, the Ministry of Domestic Trade, Co-operatives and Consumerism ("MDTCC") carried out inspections at business premises on a national level, including investigations to follow up on consumer complaints received from the public. As at 8 March 2016, the MDTCC has issued 2,848 notices under Section 21 of the PCAP, and 209 investigation papers were subsequently opened. At present, 16 cases have been prosecuted and convictions have been handed down by the Sessions Court, whereas 13 other cases have been compounded and 1 case remains outstanding.

Given the higher level of scrutiny by the MDTCC coupled with heightened consumer awareness, any price reviews or changes to the pricing policy should be implemented carefully to ensure that it does not fall foul of the PCAP requirements.

3. Voluntary registration for GST

The provisions of the current Goods and Services Tax Act 2014 ("GST Act") provides two mechanisms for GST registration:

(a) mandatory GST registration - a business is required to register for GST if it makes taxable supplies exceeding RM 500,000 (calculated based on the historical method or the future method); or

(b) voluntary GST registration - a business which does not meet the prescribed threshold of RM 500,000, may apply to be registered voluntarily.

Under the voluntary registration mechanism, if the Director General is satisfied that the person (i) is carrying a business; and (ii) makes a taxable supply or intends to make a taxable supply in the course or furtherance of that business, the Director General may register the person for GST.

Customs had clarified, by way of the DG's Decision No. 2/2014 that one of the conditions to qualify for a voluntary registration is that the applicant must make taxable supplies exceeding RM 500,000 within 12 months from the date of application ("Additional Requirement"). This Additional Requirement was subsequently amended in October 2015 so that the applicant is only required to make its first taxable supply within 12 months from the date of application (as opposed to making taxable supplies amounting to RM 500,000 within 12 months).

In practice, the pre-commencement/start-up stage of a business could exceed 12 months, and a taxpayer may have incurred significant GST costs during this phase. For instance, the time frame for the start-up and development stage for persons commencing business in the property development, oil and gas exploration, or manufacturing sector would very likely exceed 12 months.

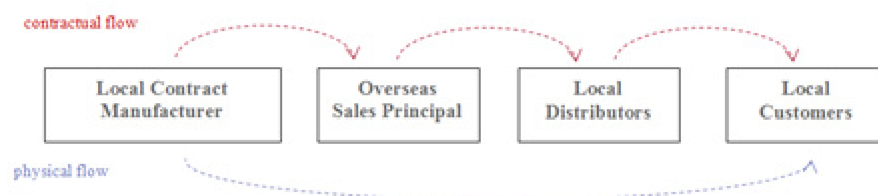
The taxpayer would not be able to claim input tax credits on the GST incurred for services consumed during this period, if it cannot meet the Additional Requirement (i.e., to make its first taxable supply within 12 months) and accordingly does not obtain the approval for a voluntary GST registration. This would result in the GST incurred becoming a business cost, which could impact both operational cash flow, profit margins as well the pricing of the onward supplies.

Therefore, subject to further amendments to the Additional Requirement by Customs, it would be prudent for new businesses commencing operations in Malaysia to consider and structure the development and pre-commencement stage of the operations carefully, to minimise the potential GST leakage to the extent possible.

4. Supply chain restructuring

One of the criteria for GST to be applicable is that the supply of goods or services must be made "in Malaysia". For the context of goods, a supply is regarded as taking place in Malaysia if goods are removed from a place in Malaysia or made available when located in Malaysia. From a practical perspective, we understand that Customs generally regards a supply of goods as taking place in Malaysia, if title/ownership to the goods is transferred when the goods are physically located in Malaysia.

We have seen the place of supply rules give rise to potential GST consequences for multi-national corporations ("MNCs") who carry out manufacturing and trading operations in Malaysia.



It is not uncommon for MNCs to have a supply chain flow that is fairly similar to the illustration above. The finished goods are manufactured in Malaysia by the local contract manufacturer. These finished goods would subsequently be sold by the local contract manufacturer to the overseas sales principal, which would then on-sell the finished goods to local distributors almost immediately (i.e., flash title transfer) for onward distribution to local customers.

In this scenario, the overseas principal would be regarded as making a taxable supply of goods in Malaysia in respect of the sale to the local distributers (since the goods are located in Malaysia when ownership of the goods is transferred). If the value of the supplies exceed RM 500,000, then the overseas sales principal would be required to register and charge GST on the sale of the finished goods.

We note that MNCS are generally reluctant to register a foreign entity for GST in Malaysia, due to the compliance obligations and requirements that would be attached to a GST registration (including the filing of GST returns, issuance of tax invoices and record keeping requirements). Therefore, the supply chain model may need to be re-considered and/or re-structured to take account of the Malaysian GST consequences and to ensure compliance with the Malaysian GST requirements.

What's next for GST in Malaysia?

1. Increased Audit Activity

As both Customs and businesses settle into the GST regime, it is expected that there will be an increase in audit activity by Customs. The target GST collection for 2016 has been set at RM 39 billion, and Customs has announced that it would be sending its audit team into the field soon as one of the initiatives to meet this target.

Further, during the 2016 Budget recalibration speech made by the Prime Minister in January 2016, one of the new measures to be implemented includes an increase in tax compliance and auditing efforts.

Customs has generally taken the stance that any audits conducted in the 2 years after GST implementation will be "advisory" in nature to help businesses understand their compliance requirements, and penalties will not be imposed for non-compliance. That said, this verbal concession is not codified in law. Therefore, from a legal perspective Customs would still be entitled to impose penalties for any non-compliance discovered in the course of an audit, if it so wishes.

2. GST Automatic Assessments and New Penalties

In October 2015, Customs had announced that automatic tax assessments would be issued to taxpayers who have registered for GST but have failed to submit the

GST returns. The automatic assessments would be calculated based on the annual revenue declared during the application for registration process.

In addition, the GST Act was also amended pursuant to the Budget 2016 announcements to introduce new penalties for the failure to pay GST. Prior to the amendments, the GST Act stipulates that any person who fails to pay GST in accordance with the GST Act would, upon conviction, be liable to a fine of up to RM 50,000 or imprisonment for a term of 3 years, or both.

The amendments introduced the following additional penalties for the failure to pay GST, in instances where no criminal proceedings are commenced by Customs:

(i) GST payment made between day 1 - 30: penalty of 5% on the amount of GST due;

(ii) GST payment made between day 31 - 60: additional penalty of 10% on the amount of GST due;

(iii) GST payment made between day 61 - 90: additional penalty of 10% on the amount of GST due (subject to a maximum penalty of 25%).

Customs has also indicated that the group of businesses which are automatically assessed could be the main focus by Customs' audit division when GST audits commence.

3. Increase in GST rate?

There has also be talk of a potential hike in the GST rate, given the current economic climate and the sustained downturn in crude oil prices.

However, during the 2016 Budget calibration speech in January 2016, the Prime Minister had announced that the current rate of GST will be maintained. Further, the Deputy Finance Minister had also re-iterated in early March 2016 that the government has no plans to review the GST rate.

It appears unlikely that there will be a change in the GST rate in the short term, although it remains to be seen if this position will change if economic conditions do not improve. Malaysia currently has one of the lowest GST rates in the Southeast Asian region, with Indonesia, Cambodia, Vietnam and Laos imposing a 10% GST rate, and Thailand and Singapore imposing GST at 7%.

4. Fine-tuning of GST Regime

As with all new regimes and legislation, there remains many areas of uncertainty in the GST regime. Depending on particular industries and businesses, there are many issues which still need to be ironed out or clarified by Customs in relation to the interpretation of the GST Act and subsidiary legislation, practical implementation of GST obligations, compliance requirements and GST treatment of transactions or supplies.

It is noted that various industries and sectors have been engaging with Customs to lobby for clarification or changes to the relevant GST provisions or treatment. Such lobbying efforts should be intensified, since the flurry of transitioning to GST has ended and the important issues moving forward would be issues of interpretation of the GST Act and regulations as well as GST compliance. Ongoing feedback from industries and businesses are important to ensure that Customs understand the challenges and concerns faced by the relevant industry relating to GST compliance and hopefully, with such feedback, the GST regime and rules can be fine tuned further to enable ease of compliance.

www.wongpartners.com

Wong & Partners
Level 21, Suite 21.01
The Gardens South Tower
Mid Valley City
Lingkaran Syed Putra
59200 Kuala Lumpur

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