



Taxing the Digital Economy

By Marcus Tan

The word “digital” was greatly emphasised in the recent Malaysian budget 2020 announcement. As part of its strategies to accelerate the digital economy, the government is committed towards digital transformation in building digital infrastructure, digital companies, digital champions as well as providing digital stimulus on grants and



incentives. Additionally, the government has reiterated its decision in taxing the digital economy by way of implementing a service tax regime on digital services provided by foreign service providers effective from 1 January 2020.

The primary factor that spurred the interest and implementation of the said taxation of digital services can be attributed to the prolificacy of digital-based services offered by

businesses to consumers, which in turn is seen to create an unlevel playing field between on-line and off-line businesses. Malaysia is also committed to the Organisation for Economic Cooperation and Development (“OECD”)’s initiatives to counter the shifting of tax bases in countries around the world, amongst others, in addressing the tax challenges of the digital economy under the Base Erosion and Profit Shifting (“BEPS”) project.



Tax Challenges of Digitalisation

In this increasingly digital age, the above phenomenon is just the tip of the iceberg. Digitalisation of the global economy has disrupted the existing tax systems around the world, resulting in digitalised businesses not being taxed, or not taxed sufficiently, in the countries where their users and consumers are located by virtue of not having attributable physical presence in those countries. What this means is that our present international tax systems which adopt the double taxation avoidance principle only require a non-resident company to be taxed on its business profits in a jurisdiction in which it has a permanent establishment ("PE") or some form of physical business presence. The digitalisation of businesses has strained the applicability of this rule as companies can increasingly do business with customers in a jurisdiction without having any semblance of a physical presence or attributable business in that jurisdiction.

As the OECD is still working on a multilateral solution for digital taxation, a growing number of countries are taking unilateral measures to address the above challenges of taxing the digital economy. One example is that of France which voted to introduce a 3% tax in July 2019 aimed at taxing around 30 'big-tech' companies including Facebook, Amazon and Google. The said tax applies to firms with annual revenues of more than 750 million euros arising from digital activities, including 25 million euros arising from France.

In Malaysia, the implementation of a service tax regime as mentioned

above would require foreign service providers to be registered with the Royal Malaysian Customs Department ("RMCD") if their total value of digital services provided to consumers in Malaysia have exceeded the annual prescribed threshold of RM500,000. In this regard, a 6% service tax is to be accounted for at the time when payment is received by the foreign registered service providers and to be remitted to the RMCD by way of filing of their service tax returns in Malaysia. Over and above the said service tax, Malaysia also has a withholding tax regime that applies to non-resident companies undertaking e-commerce transactions under various business models such as online trading and services, Apps stores, online advertising, cloud computing, online payment gateways and services, and digital currency transactions.

Whilst the above has a common goal to tax the digital economy, you will notice the varying approaches being taken, the former being a French corporate tax of 3% whilst the latter example is in the form of a Malaysian consumption tax and expansion of the withholding tax regime to these new digital services provided by non-resident companies. Until a new international consensus and agreement on digital taxation is reached, there is currently no "internationally accepted" approach to ensure taxpayers fulfil their tax obligations under the digital era.

Embracing Taxation in the Digital Age

Digitalised businesses may unwittingly end up running afoul of the tax laws if they are uncertain or

facing difficulties in ensuring compliance with any new laws being introduced to tax the digital economy across jurisdictions. It is inevitable for these businesses to consider the additional tax risks that comes with the increasingly digital age.

The final point to be made is concerning the impact of pricing of tangibles, intangibles and services in a digitalised and borderless world. Supply chains have been drastically revamped with digitalisation, and the manner in which goods and services are procured and delivered creates totally new dimensions in where and how margins are earned along the supply chain in a transfer pricing context. The impact of this will be evidenced in the growing number of transfer pricing disputes as well as cross-border indirect tax arguments over customs and import duties.

In conclusion, these are challenging but exciting times for tax professionals as they work with their clients to overcome a fresh set of issues brought about by the digital age and the structuring of businesses and operations in a coherent and efficient manner. The pitfalls of not paying heed to tax issues and rules across jurisdictions are numerous and expensive too, with the potential of double taxation, ever-increasing tax penalties for non-compliance, and tax litigation costs as the result.

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