



Budget 2019 Of Sugar Tax and the Digital Economy

KPMG in Malaysia

2 November 2018



Overview and Commentary

Of Sugar Tax and the Digital Economy

While the 2019 Budget contained a number of proposals, the so called sugar tax and the widening of service tax to include the digital economy had been expected. Malaysia is not alone as many other countries have or are preparing to adopt comparable taxes.

Sugar Tax

Based on statistics, the percentage of the Malaysian population with diabetes had increased from 15.2% in 2011 to 17.5% in 2015. As a measure to curb the upward trend of diabetic patients, the Government has proposed that "sugar sweetened beverages" be added to the list of manufactured goods subject to excise duty which is payable by the manufacturer.

It is proposed that excise duty at the rate of RM0.40 per litre on "sugar sweetened beverages" will be applicable where the sugar content of such beverages is as follows:

- i. Beverages, including carbonated drinks containing added sugar / other sweeteners and other non-alcoholic beverages, containing sugar exceeding 5 grams per 100ml; and

- ii. Fruit and vegetable juices regardless of whether the juices contain added sugar / other sweeteners which contain sugar exceeding 12 grams per 100 ml.

The proposal is effective from 1 April 2019.

Sugar taxes or soda taxes as they are sometimes called, are not unique to Malaysia. For instance in the UK, the sugar tax or levy, introduced in April 2018, applies where the sugar content of drinks exceeds 5 grams per 100 ml. The rate increases where the sugar content exceeds 8 grams per 100 ml. The levy is paid by the manufacturer. A number of other countries including Australia and the Philippines already have a sugar tax.

The effectiveness of a sugar tax as a source of revenue is questionable as manufacturers can reduce the sugar content or in some cases use artificial sweeteners. Rather such moves are more health oriented with the objectives of reducing obesity and tooth decay and in this way reducing the financial burden on the health system. Aligned with this is the suggestion from some quarters that sugar taxes should also apply to confectionary and not just drinks.

Key Highlights

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Introduction of sugar based tax

2

Widening of Service Tax to include the digital economy

3

No Inheritance Tax and no Capital Gains Tax

Digital Economy

The digital economy and the potential missed revenues have been in the taxman's sights for quite some time. It therefore comes as no surprise that Malaysia has announced its intention to widen the scope of service tax which will include non-resident suppliers in the digital economy.

What Are The Concerns With The Digital Economy

At an international level the concerns are centered on non-residents and missed opportunities for tax. Indeed the Organisation for Economic Co-operation and Development ("OECD") under its Base Erosion Profit Shifting initiative identified the "Tax Challenges of the Digital Economy" as its first action plan.

There is a perception that business models used in the digital economy allow non-residents to do significant business with a country without sufficient presence to trigger an income tax liability based on traditional taxing norms. In general, traditional taxing norms, based on Double Taxation Agreements, require a non-resident to have a Permanent Establishment ("PE") in the other country.

Only where there is a PE should business profits be subject to tax. However, the concept of a PE was defined largely in the 1960s, where the emphasis was on a "bricks and mortar" test. The primary direction is whether as an indicator of a PE, the non-resident has a physical business presence in the other country seeking to impose tax.

In contrast, the business models used in the digital economy allow non-resident businesses to have significant presence in a local market in terms of users, without having a physical presence. The use of intangible assets, which could not have been envisaged when the original PE concept was being formulated back in the 1960's, allows scale without mass. There is therefore, a concern that the current definition of PE is unsuited for taxing business models used by non-residents in the digital economy and this results in tax leakages or "double non-taxation".

OECD

The OECD is continuing to look at whether the definition of PE needs to be amended. The OECD is advocating a consensus based approach rather than countries deciding to implement unilateral methods of taxation. However, achieving consensus will take time.

Malaysia

In the National Budget 2019 announcements on 2 November 2018, the Government has proposed that service tax be imposed on taxable services imported into Malaysia and new provisions will be introduced in the Service Tax Act 2018 as follows:

- i. In relation to the importation of services by businesses ("B2B"), the responsibility lies with the recipients of the imported services to account, declare and pay the service tax to the Royal Malaysian Customs Department; and
- ii. In relation to the importation of services by consumers ("B2C"), foreign suppliers of such services provided to consumers in Malaysia are required to register and charge service tax.

The Government has proposed that service tax on imported services will be implemented in the following phases:

- i. B2B effective from 1 January 2019; and
- ii. B2C effective from 1 January 2020.

It is the services falling under (ii) that will have the greatest impact for the digital economy. In particular, the requirement for foreign suppliers to register for Malaysian service tax is likely to attract attention particularly from countries where the major suppliers are based.

At present, regulations or guidelines for the widening of service tax on taxable services supplied by foreign service providers have not been issued. The market will await further details on the threshold at which the imported services will be taxed and how the service tax will be implemented.

While the “Sugar Tax” and “Digital Tax” have been announced, there was speculation as to whether the Government would introduce Capital Gains Tax (“CGT”) and / or Inheritance Tax (“IHT”). At this juncture, the Government has chosen not to introduce either CGT or IHT. These could, however, be introduced in future Budgets and it is therefore worthwhile considering what these taxes might entail.

CGT

CGT is a mechanism used to impose a tax on capital gains. It is a technical tax on the profit from the sale of an asset that has appreciated in value. Capital gains are commonly realised from the sale of stocks, bonds and property and a chargeable disposal could typically include part disposals and the gift of assets. However, there are instances in which exempt transfers could be made. CGT is due when an asset is sold.

There are various ways to compute gains that are to be taxed while inflationary gains should be excluded. Typically, an individual’s liability to CGT is determined by their residence and domicile status as well as the locations of their assets and sources of income.

CGT is found in approximately 30 countries, including Australia and Japan. CGT rates vary from country to country, e.g. 10% (Mexico) to 42% (Denmark).

IHT

IHT, which may also be known as Capital Transfer Tax or Estate Duty, exists in a number of countries, including Japan and South Korea. Indeed Malaysia previously had estate duty although this was repealed in 1991. The essence of IHT is that it is a tax based on transfers of wealth whether these be lifetime transfers or transfers on death. Subject to exemptions, IHT is levied on the value of the property transferred.

Using a global comparison, rates of IHT vary from 4% (Italy) to 55% (Japan). However, a key component is the value threshold at which IHT applies. This is particularly important in times of rising property prices given that for many, the family home is their most valuable asset.

One of the major drawbacks with IHT is that the assets being transferred on which tax is payable may not be liquid. For example, a transfer of a house may attract IHT but in the absence of a sale,

there are no cash proceeds to pay the tax.

Any proposal to introduce capital taxes would no doubt be carefully considered.

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