Service tax imposed on utility bills sparks retailers' concerns

BY **ESTHER LEE**

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Many tenants in shopping malls have received an unexpected 6% service tax on utility bills since July 1

The service tax on rental and leasing services, which include any other services that form part of the rental or lease agreement, is causing concern among retailers.

The Royal Malaysian Customs Department's (RMCD) guidelines on rental and leasing services that were issued in May have added to their worries, with retailers saying they were taken by surprise that even utilities, such as electricity and water, paid to the mall management are now subject to the 6% service tax.

"We were shocked. We were not aware of the guidelines until the shopping mall management issued a circular to us in early July stating that we would have to pay a 6% tax on utility bills," Malaysia Retail Chain Association (MRCA) vice-president and chief of food and beverage (F&B) division Valerie Choo tells *The Edge*.

In an Aug 1 statement, the MRCA called on the government to defer and review its decision to extend the service tax to electricity, water, chilled water supply and other recoverable utilities and ancillary charges paid by commercial tenants through mall management.

Notably, electricity and water supplied to commercial consumers are not taxable services under the service tax regime. This means utilities such as Tenaga Nasional Bhd (KL:TENAGA) and Pengurusan Air Selangor Sdn Bhd do not impose service tax on the supply of electricity or water to commercial users, says PwC Malaysia tax director Geeta Balakrishnan.

The complication arises because of the way commercial tenants receive their utility bills. Many retailers do not pay for the utilities directly. Instead, the mall management pays for the utilities and recovers the costs from tenants under the tenancy agreement.

According to KPMG head of indirect tax Ng Sue Lyn, the broad scope of the rental and leasing provision, which includes any other services that form part of the rental or lease agreement, means those recovered utility charges are now subject to the 6% service tax. "From a technical perspective, service tax is imposed only once, that is, on the taxable rental service (including utilities) provided by the mall management to the tenant.

"However, the concern is whether utilities for commercial buildings, which are not intended to be subject to service tax and are consumed directly by the tenant, should be subject to service tax just by virtue of the contracting and billing arrangement. Hopefully, the authorities can take this into consideration."

Geetha points out that where rent is charged as a single package that includes utilities, upkeep and related services, those elements may be treated as part of one taxable rental service because they are not economically separable from the rental.

However, tax treatments are less clear in situations where landlords merely recover the exact amount charged by the utility based on metered consumption. In these cases, the question is whether the landlord is providing a separate taxable service or simply facilitating the payment, she adds.

"Recent guidance appears to suggest that the tax outcome depends on the billing and settlement arrangement. Broadly, where the utilities are included in the landlord's bill, the recovery may be subject to service tax. Where they are not included in the landlord's bill, the recovery may not be subject to service tax," says Geetha.

Given the variety of commercial and billing arrangements in practice, clearer guidance on the underlying principles would help businesses understand their obligations and apply the rules consistently, she adds.

Retailers have been pushing for that clarity. MRCA said in June that eight major trade associations had jointly submitted a memorandum to the RMCD requesting a dialogue on the issue. More than a month later, they are still waiting for a response.

For businesses, the concern is not simply the additional 6% tax on an individual utility bill but what it means across an entire retail network.

MRCA's Choo says retailers, depending on the subsector they are in and the size of the store, typically incur monthly electricity bills of more than RM1,000 and could go up to RM10,000.

While the 6% service tax on a RM1,000 bill may seem insignificant when viewed in isolation, the impact could be substantial for those with multiple stores across the country.

"It really depends on the size and number of outlets. But just imagine if it's a retail chain with hundreds of stores, it could come up to quite a significant sum," she adds.

Choo opines that F&B operators would feel the biggest pinch from the additional tax burden because they consume considerably more electricity and water than many other retailers.

PwC's Geetha notes that the effect may be more pronounced for smaller retailers who often operate on tight margins. "Having said that, businesses of all sizes — large, medium and small — may have limited flexibility to absorb an unexpected increase in occupancy-related costs, particularly where the change is introduced suddenly.

"Depending on the contractual arrangements, the additional cost may affect profitability, cash flow or pricing decisions. Where there has been a change in interpretation or clarification that produces a materially different tax outcome, businesses may experience it commercially as a significant policy change, regardless of how it is characterised from a technical perspective."

Whether those higher costs will eventually be passed on to consumers remains uncertain.

Choo believes many retailers simply cannot afford to raise prices in the current environment. "Most of them might not do it because there is no room for them to increase prices. Certain players may do it if they are already facing thin margins," she says.

She adds that the recent months have been stressful for retailers as they are already contending with weaker consumer sentiment, changing spending habits and steadily rising operating costs. Another tax, even one that appears relatively modest on paper, risks adding to pressures that many businesses are struggling to absorb.

"We hope the government listens to our pain points. The service tax [on utility bills] will add to the government's coffers but it could come at the expense of other things. Businesses pay taxes, but if we don't do well, there will be less tax paid eventually," says Choo. E

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