

CHAPTER 4

SERVICE TAX

4.1. INTRODUCTION

This chapter presents the overview of service tax and the compliance requirements under the service tax legislation. This chapter also reports the findings of the survey carried out.

4.2 OVERVIEW OF THE SERVICE TAX

Service tax was introduced in Malaysia on 1 March 1975 and its operation is governed by the Service Tax Act (STA) 1975. The Service Tax Act 1975 applies throughout Malaysia excluding Langkawi, Labuan, Tioman and the Joint Development Area¹.

4.2.1 CHARGE TO TAX (Section 3, STA)

Service tax is charged and levied in respect of any taxable service provided by any taxable person except for "exported taxable service". Exported taxable service means service provided to a person in a country other than Malaysia.

4.2.2 RATE OF TAX (Section 5, STA)

The rate of service tax as stipulated in the Service Tax (Rate of Tax) Order 1975 is 5%. The tax of 5% is imposed to an organisation's turnover and is not to the net profit. The Minister of Finance may exempt any person or class of persons from payment of the whole or part of the service tax or penalty (Section 6, STA)

¹ Joint Development Area has the meaning assigned thereto to in section 2 of the Malaysia-Thailand Joint Authority Act 1990

4.2.3 PERSON CHARGEABLE TO TAX (Section 7, STA)

Service tax is charged on any taxable person who carries on a business of providing taxable service under the STA. A taxable person means any person who is prescribed to be a taxable person under the STA. A taxable service means any service which is prescribed to be a taxable service under the STA.

4.2.4 LICENSING REQUIREMENTS (Section 8, STA)

Every taxable person who carries on a business of providing taxable service is required to apply for a licence before collecting the service tax. A taxable person is not allowed to carry on such business without possession of the licence. After obtaining a licence, the taxable person will continue to be licensed unless the licensee submits the licensed for cancellation. Every taxable person who is licensed under the STA is required to display the licence in a safe and conspicuous place at his place of business. (Regulation 6, Service Tax Regulations 1975)

4.2.5 SCOPE OF CHARGE

When the Service Tax Act was introduced in 1975, the imposition of service tax was confined to certain services and goods provided or sold in hotels, restaurants, private clubs, health centres and night clubs. The service tax has seen significant expansion in its scope between the years 1992 and 1998. The 1992 budget extended the scope of STA to cover eleven taxable services (earlier referred to as prescribed Professional Establishment). The scope of services covered is accountancy, engineering, law, surveying and valuation, private hospitals, motor vehicle service, forwarding agencies, insurance companies, advertising agencies and consulting firms.

Under the 1993 budget, effective from 1 January 1993, the following four additional services were introduced namely, telecommunication services, security guard services, recreational clubs and real estate agents. Effective from 1 January 1994, private dental clinics, private veterinary clinics, the

provision of parking space for motor vehicles and courier services became subject to service tax.

With effect from 1 January 1998, service tax was further extended to cover employment agencies, companies providing management services (including project management or coordination service) and provision of hire and self drive car hire services. However with effect from 1 January 2003, the service tax on intra group services were abolished. The intra group service means services provided to companies within the same group which include accounting services, legal services, engineering services, architectural services, surveying, real estate agency, valuation and appraisal services, consultancy services and management services. The full list of taxable persons and taxable services as per Second schedule of STA is attached in the Appendix 1.

4.2.6 ANNUAL TURNOVER THRESHOLD

Thresholds are prescribed to determine whether a person carrying on the business of providing taxable services is liable to licensed under the Service Tax Act 1975. The threshold has been set at RM150,000, RM300,000 or RM500,000 depending on the types of service sectors. The service providers should apply for the service tax licence immediately if the annual sales turnover of taxable services reaches the threshold. However there are services like insurance services, telecommunication services and hotels (with more than 25 rooms) which are not subject to any threshold and are required to obtain a licence on day one of operations.

In Budget 2002, it was proposed to lower the threshold for the imposition of service tax. With effect from 1 January 2002, the threshold of annual sales turnover of RM500,000 was reduced to RM300,000 for the following services:

- Restaurants, bars, snack bars, coffee houses located in hotels having 25 rooms or less;

- Restaurants, bars, snack bars, coffee houses outside hotels, and food courts;
- Private clubs
- Advertising agencies

The threshold from an annual sales turnover of RM300,000 was reduced to RM150,000 for professional and consultancy services provided by accounting, legal ,engineering, architectural, surveyor, and consultancy firms, and companies providing management services including project management and coordination services.

The reduction in the threshold for imposing service tax is in line with the 8th Malaysia Plan, which highlights consumption taxes as a source to increase revenue. Such reduction will strengthen the governments revenue collection whereby many smaller business entities in food and drink, recreational clubs and advertising services will come under the service tax net.

4.3 COMPLIANCE UNDER THE SERVICE TAX LEGISLATION

Once licensed under the Service Tax Act (STA) 1975, the taxable person shall comply with the requirements under the service tax legislation. Such requirements include the followings:

1. To levy or charge service tax and pay service tax on the provision of taxable services. (Section 7 of STA)
2. To display a licence in a conspicuous place. (Regulation 6 of Service Tax Regulation)
3. To issue invoices and receipts to the customers and state separately in the invoices and receipts the amount of service tax payable. The invoices issued shall be in the National language or English. (Section 10 of STA). The invoices shall be in duplicate, printed and serially numbered. (Regulation 8 of Service Tax Regulation). Prior approval in

writing from the Director General of Customs must be obtained if an invoice is produced by computer. (Section 10A of STA). All invoices, receipts, books of accounts and other records to be kept within the principal place of business. (Regulation 9)

4. To submit returns and pay the service tax within 28 days to the Director General of Customs (Section 12 and Section 14 of STA)
5. To keep books of accounts and records with respect to the transactions relating to the provision of taxable services. The books of accounts shall be kept for a period of 6 years. (Section 11 of STA)
6. To surrender or submit the licence when a taxable person ceases business in providing any taxable service. (Regulation 7, Service Tax Regulation)
7. To give the correct information which is required to be given relating to service tax. (Section 23 of STA)

In order to prevent business enterprises from setting up more companies to avoid reaching the threshold, thus avoiding the service tax collection, section 7A of STA empowers the Director General of Customs to direct the various business operated by different persons to be treated as a single business by a single person. That person directed by the Director General is required to apply for the licence within 21 days of such direction.

If a taxable person fails to comply with the above requirements he shall be guilty of an offence against Service Tax Act 1975 and shall be liable on conviction to a fine not exceeding RM5,000 or to imprisonment not exceeding 2 years or to both. However a Customs senior officer may offer a compound to any offence to a maximum of RM5,000.

In order to prevent tax evasion and to ensure the service tax can be recovered from the business enterprise, the following sections of the Service Tax Act 1975 stipulated the measures that can be taken by the Customs authorities.

1. Section 18A empowers the Director General of Customs to issue a certificate to the Director General of Immigration preventing any person from leaving Malaysia unless he has paid the service tax and penalty or provided security for the payment. A notification of the issued certificate would be sent to the business enterprise concerned. The non-receipt of such notification would not deter the Director General of Immigration from exercising the detention.
2. Under section 32, any person who wilfully with intent to evade or to assist any other person to evade service tax like makes a false statement or prepares false books of accounts shall be guilty of an offence against STA and shall be liable on conviction to a fine up to a maximum RM50,000 or to imprisonment for a term not exceeding 3 years or to both. Section 39 permitted the senior officer of Customs to compound any offence up to a maximum RM5,000.
3. If any person is found guilty of an offence under section 29 or section 32, the court will issue a court order compelling the person to pay the service tax and penalty before trial. (Section 40A).
4. Under section 16, where any amount of service tax remains unpaid after the last day on which it was payable:
 - A penalty of 10% will be imposed;
 - If the service tax remains unpaid for every 30 days, a 10% penalty will be imposed to a maximum of 50%.
5. A penalty up to a maximum RM5,000 or to imprisonment of 2 years or both will be imposed to a non taxable person who is charging or collecting service tax. (Section 31)
6. The senior officer of Customs has been given powers to search without warrant (Section 26) and to access any recorded information or computerised data whether stored in a computer or otherwise (Section 26A). Any books, documents or things which may reasonably be believed to have been used to commit any offence against this Act may be seized by the Customs officer. (Section 27)

7. Any senior officer of Customs may arrest and search without warrant any person whom he may reasonably suspect to have committed an offence against this Act. (Section 28)
8. Rewards may be given to any officer or other person for services rendered in connection with the detection of any offence against this Act. (Section 48)

4.4 STRATEGIES TO CURB NON-COMPLIANCE

Besides all the above measures, which are already legislated in the Act, the Customs authorities also came up with various strategies to curb non-compliance under the Service Tax Act. In the year 2002, the Royal Customs Malaysia had launched the campaign "2B Strategy" which means "Bawa Betul, Bayar Betul". The objectives of the campaign:

1. To increase the collection of indirect taxes up to the amount of RM2 billion in year 2002.
2. To ensure all the duties or taxes paid by exporter, importer or taxable person are correct.
3. To increase the awareness among the clients of the Customs about their responsibility to the country and the importance of paying the correct taxes or duties

Under this campaign, a priority had been given to audit the accounts of big firms or companies. Licensing operation also had been carried out to increase the number of new licensees. All the Customs branches were required to have at least two session meetings or dialogues with the clients through out the campaign period. The number of service tax licensees for the year 2001 and 2002 is shown in the Appendix 1.

In the year 2003, the Director General of Royal Customs reported that the Customs will give more attention in collection of service tax as the war in Iraq

will affect the collection of export duties and import duties. The Royal Customs Malaysia will work closely with the Inland Revenue Board (IRB) to detect those who evade paying the service taxes and frequent operations with the IRB will be carried out through out this year. Starting March 2003, the Customs launched two operations namely "Jejak Restoran" and "Jejak Professional" to detect those service providers who do not comply with the requirements under the Service Tax Act 1975.

To increase the awareness of compliance in service tax among the service providers, the Customs also conducts seminars which will be held through out the year and the information regarding the service tax has been made through the radio, television (Selamat Pagi Malaysia), newspapers, pamphlets, and Royal Customs website. The new strategy that will be taken by the Royal Customs is to get the cooperation from banks in order to identify those who do not comply under the Service Tax Act as most of the restaurants operators do not have proper accounting records.

4.5 PROBLEMS FACED BY THE CUSTOMS

- Lack of awareness and knowledge about the service tax among the service providers. Most of them do not know their responsibilities and the requirements under the Service Tax Act 1975. It is the responsibility of every service provider to comply under the Service Tax Act and they have not to wait until such notification to comply is given by the Customs authorities.

- Lack of participations in the seminars or dialogues conducted by the Customs especially participants from professional services. The reasons might be the busy schedule in their professions and they do not bother to waste their time attending the seminars. Most of them also rely on the Consultancy services for any information related to the Customs. The

professionals also have their own professional body like Bar Council and MIA in which these professional bodies will send their representatives to attend the seminars or dialogues. Therefore it is difficult for Customs to convey the first hand information to them involved in providing the taxable services.

- Lack of enforcement due to the lack of manpower in the Internal Taxes Unit. Thus the inspection on the service providers has been done randomly. In practice, the Customs only focus on the big firms and companies.

In 2001, the Customs reported that the first ranking for under collection in revenue was still for service tax which amounted to RM17 million (including penalty). This was followed by Sales tax (RM 11 million) and then under section 14(2) of Customs Act (RM3.36 million). Most of the uncollected service tax was detected from the Group G of Schedule 2 in which most of them are professional services.

The Customs also identified four factors why there was under collection revenue in service tax.

1. A person who is required to apply for the licence under the section 8 of STA has still not applied for the licence.
2. Service tax deemed payable remained unpaid.
3. Failed to charge, collect and pay the service tax by taxable person providing the taxable service.
4. Collection of service tax by unlicensed taxable person and who do not pay the service tax to Customs.

4.6 FINDINGS FROM THE SURVEY

4.6.1 BACKGROUND OF THE SURVEY

There were 30 service providers selected in this study, which consist of professional services (accountants and lawyers), consultancy services, telecommunications and restaurants. The survey had been carried out for about one month, starting in the middle of March to the middle of April. From the 30 in the sample, 19 of them gave the response over the survey. Table 4.1 shows the number of responses for each type of business

TABLE 4.1 SAMPLE SELECTED IN THE STUDY

Type of business	Sample size	No. of response	Percentage of response	Percentage of response over sample
Accountants	10	5	26.3%	16.67%
Lawyers	7	3	15.8%	10.0%
Consultancy	3	3	15.8%	10.0%
Restaurants	7	5	26.3%	16.67%
Telecommunication	3	3	15.8%	10.0%
TOTAL	30	19	100%	63.33%

4.6.2 PERCEPTIONS ON THE POSSIBLE FACTORS OF NON-COMPLIANCE

Part two of the questionnaire requires the respondents to identify the possible causes of non-compliance in service tax. There are five factors listed in the questions which are, probability of being detected is low, other businesses also do it, complexity of tax law, perception of tax fairness and education and services given to taxpayers. This question used the 5 Point Likert scale ranging from 1= not important to 5= very important. Table 4.2 (a) and 4.2 (b) show the results of statistical testing.

Table 4.2(a) shows there are different views among the service providers regarding the most important factors which contribute to non-compliance.

Telecommunication services and lawyers rank the low probability of being detected as the main factor to non-compliance (mean=4.67). While according to accountants, the complexity of tax law that deter people from fully understanding their responsibility and procedures to comply is the main factor for non-compliance (mean=4.40). Restaurants and consultancy services rank the main factor to non-compliance is due to the lack of education and services given by relevant authorities to make them comply with the law. (mean=3.80 for restaurants and mean=4.67 for consultancy)

Table 4.2(b) ranks the most important factors of non-compliance in general according to their mean value. It shows that the lack of education and services is the main cause for non-compliance (mean=3.84). This means that it is important to educate the public especially the service providers and to give necessary assistance or services regarding the service tax in order to promote compliance. The next important factors are the complexity of tax law (mean=3.79) and the low probability of being detected (mean=3.53).

**TABLE 4.2(a) RESPONDENTS' PERCEPTION OF THE POSSIBLE CAUSES OF
NON-COMPLIANCE**

Type of business		low detection	other businesses also do it	complexity of tax law	fairness of tax system	education and service
telecommunication	Mean	4.67	2.67	4.33	2.33	4.00
	Std. Deviation	.58	.58	.58	1.15	1.00
	N	3	3	3	3	3
accountants	Mean	3.20	2.60	4.40	3.00	4.00
	Std. Deviation	1.64	1.14	.55	1.22	1.00
	N	5	5	5	5	5
lawyers	Mean	2.67	2.67	2.33	4.00	2.67
	Std. Deviation	1.53	.58	1.15	1.00	2.08
	N	3	3	3	3	3
restaurants	Mean	3.20	3.40	3.40	2.80	3.80
	Std. Deviation	1.30	1.82	.89	1.48	1.10
	N	5	5	5	5	5
consultancy	Mean	2.33	2.67	4.33	4.33	4.67
	Std. Deviation	1.15	1.53	1.15	.58	.58
	N	3	3	3	3	3
Total	Mean	3.21	2.84	3.79	3.21	3.84
	Std. Deviation	1.40	1.21	1.08	1.27	1.21
	N	19	19	19	19	19

**TABLE 4.2 (b) GENERAL PERCEPTIONS OF THE IMPORTANT FACTORS THAT
CAUSE NON-COMPLIANCE**

	N	Minimum	Maximum	Mean	Std. Deviation
low detection	19	1	5	3.53	1.39
other business do it	19	1	5	2.84	1.21
complexity of tax law	19	1	5	3.79	1.08
fairness of tax system	19	1	5	3.21	1.27
education and services	19	1	5	3.84	1.21
Valid N (listwise)	19				

4.6.3 PERCEPTIONS ON THE POSSIBLE STRATEGIES TO ENFORCE COMPLIANCE

In the third part of questionnaire, the respondents are required to give their opinion about the best strategy that should be implemented in order to increase the compliance. There are 4 strategies given, increasing audit probability, impose high penalty and sanctions, positive approach and taxpayers' education. The questions also used the 5 Point Likert scale ranging from 1= Strongly Disagree to 5= Strongly Agree

Table 4.2. (c) presents that there are also different views among the service providers as to which are the best measures to promote compliance. Telecommunications, accountants and lawyers agree that increasing audit probability will increase the compliance rate among service providers (mean= 4.67 and 4.20). However restaurants and consultancy services choose the best strategy to increase compliance is by giving enough education and information to service providers (mean=5.00 and 4.67)

From all of the given strategies, it seems that the best strategy to enforce compliance among the service providers is by increasing the audit probability (mean=4.37), which is shown in the table 4.2 (d). This is followed by the second preferred strategy, education and services to the taxpayers (mean=4.00) and then followed by the positive approach taken by Customs (mean=3.89). From the survey, 63.2% of the respondents stated that they do not get enough information or assistance from the Customs regarding the service tax. 73.7% of the respondents also are not aware of any campaign conducted by the Customs.

**TABLE 4.2 (C) RESPONDENTS' PERCEPTION ON THE STRATEGIES TO
ENFORCE COMPLIANCE**

Type of business		High audit prob.	High penalty	Positive approach	Education and service
telecommunication	Mean	4.67	4.00	3.67	4.33
	Std. Deviation	.58	1.00	1.15	.58
	N	3	3	3	3
accountants	Mean	4.20	4.00	4.00	3.60
	Std. Deviation	.84	.71	1.00	1.14
	N	5	5	5	5
lawyers	Mean	4.67	3.00	3.67	2.00
	Std. Deviation	.58	1.73	.58	1.00
	N	3	3	3	3
restaurants	Mean	4.40	4.40	4.80	5.00
	Std. Deviation	.89	.55	.45	.00
	N	5	5	5	5
consultancy	Mean	4.00	3.67	3.00	4.67
	Std. Deviation	1.00	1.15	2.00	.58
	N	3	3	3	3
Total	Mean	4.37	3.89	3.95	4.00
	Std. Deviation	.76	.99	1.13	1.25
	N	19	19	19	19

**TABLE 4.2 (d) GENERAL PERCEPTIONS OF THE STRATEGIES TO ENFORCE
COMPLIANCE**

	N	Minimum	Maximum	Mean	Std. Deviation
High audit prob.	19	3	5	4.37	.76
High penalty	19	2	5	3.89	.99
Positive approach	19	1	5	3.95	1.13
Education and services	19	1	5	4.00	1.25
Valid N (listwise)	19				

4.7 OTHER ISSUES OR COMMENTS REGARDING SERVICE TAX

1. Cost of doing business

The requirement to issue invoices or receipts and to have proper accounting systems (to keep books of accounts and other records) would have an impact on restaurant operators. In practice, most of the restaurants do not have proper accounting systems and in most cases do not issue invoice or receipts to customers. This requirement however would not be so significant in the case of accounting, legal, engineering and management companies as most of these companies already have proper accounting systems.

2. Burden to consumers

Effective 1 January 2002, many companies providing professional services and food and beverage outlets have been charging and levying service tax. The compliance cost would be imputed into the price of taxable services and together with the service tax, be passed to consumers. Consumers regardless of rich or poor would have to pay tax on taxable services consumed.

3. Application for de licensing

When an annual sales turnover falls below the threshold (RM150,000 or RM300,000) in a year, a taxable person has to apply for delicensing before ceasing collection of service tax. The problem is when a taxable person applies for delicensing, the basic principle of natural justice does not seem to apply. The tax department no longer takes the monthly statements for the past years for granted. A taxable person has to prove that the accounts are in order. In this situation, a taxable person is "presumed guilty until proven innocent". Thus, it is believed that a considerable number of the gratuitous service tax collectors will elect to carry on collecting the tax, merely to avert the cumbersome process of complying with the requirements for delicensing.

4. Lack of awareness and information about the service tax as well as the functions of the Customs. Certain people do not purposely evade the service tax but they are not aware of the compliance requirements under the Service Tax Act. Some of them do not know why they need to pay the service tax and the purpose of such tax to the country.

4.8 RECOMMENDATIONS

- **Education and services**

Findings from the survey show that most of the respondents agree that the important reason of non-compliance is due to lack of education and services given to the taxpayer. And it seems the imposition of higher penalty and sanctions are not preferred measures to curb non-compliance. Thus the government should take proactive measures to educate people about service tax and its implications for compliance under the service tax legislation. It has been suggested that the syllabus of Indirect Taxes should be taught either in the secondary school or university level so that the people at least have a basic knowledge of such taxes. One should know that it is a responsibility of each service providers to comply under the service tax regulations (e.g to apply for the licence for collecting service tax when they reach the threshold) and they do not have to wait until such notification is given by the Customs. Once they are found not complying under service tax legislation, they shall be guilty of an offence against the Act.

- **Compliance efforts should be coordinated**

The campaign on service tax must be an on going exercise. Every year, the Customs must come up with the schedule of events and this must be made known to the public. It is also suggested that Customs should work closely with the Inland Revenue Board (IRB) in order to promote the awareness of service tax. A copy of the brochure or pamphlet can be sent to all taxpayers together

with the tax forms as one way to inform and educate the people about the service tax.

- Cooperation from the public

In order to curb non-compliance in service tax like collecting the tax by unauthorized tax collectors, the Customs should get cooperation from the public so that it is easier to identify those service providers. Most of the service providers (especially restaurants operators) do not display the licence as a tax collector, thus the customers are not assured whether they are entitled to collect service tax or not. In this case, it is suggested that the customers should have a right not to pay the service tax if such service providers fail to prove that they are entitled to collect the service tax.

- Assistance and facilities

The profession or trade is rendering invaluable service to the government by way of collecting service tax on behalf of the government. It is only fair and reasonable that the government should as far as possible facilitate collection of the service tax, causing little or no inconvenience to the parties concerned. The relevant authority ought to provide whatever assistance and facilities available to any trade or profession collecting the service tax gratuitously on behalf of the government. There is no legal justification at all for making it difficult for any business or profession to collect the service tax for the government since it is a gratuitous service.

- Personnel issue

There is a need to increase a highly skilled manpower in the Customs organisation. On going training should be provided to all the workforce which also include customer service training so that they have a better understanding system of tax administration.

- **Public relations**

There should be a better publicity about how the tax system works, how taxpayers benefit by complying and how the Customs authorities deal with abuses of the tax system.

- **Positive approach**

There is a need to devise way to recognise compliant behaviour and to reward those who pay tax on time. The government may consider either to give material rewards or verbal rewards like a letter thanking them for their compliance.

- **Inculcate in citizens a sense of responsibility towards taxes**

Citizens need to understand and accept their responsibility of compliance. The purpose of collecting service tax and the importance to the country must be communicated clearly to the public so that misperceptions about the tax can be avoided.

4.9 CONCLUSION

This chapter discusses the findings from the survey as well as the recommendations to enforce compliance in service tax. The next chapter presents the issue of non-compliance in customs duties.