Chapter 13
Taxation of Digital Business in Malaysia

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ABSTRACT

Governments across the world are looking at introducing the "digital tax," which will be imposed on technology companies and digital business players. Digital giants like Google, Amazon, Facebook, Apple, and Microsoft are benefiting from the strong growth of digital business. The Malaysian government has announced in the national 2019 budget that a digital tax will be implemented effective January 1, 2020. The rationale of the tax is that both the international and local businesses in the digital sector must pay their fair share of tax. Malaysia has been taxing income from e-commerce, but it has no guidelines on the taxation of income from digital business. Global digital businesses often avoid paying taxes in Malaysia because they have no physical presence in the country. This chapter looks at how Malaysia is reforming its laws and policies to ensure its tax base fully reflects the scale of transactions and profits generated by the digital economy.

INTRODUCTION

Today, digital business is big business. Digital businesses have become a lucrative segment of the economy. Consumers are spending more money online and the growing digital economy has enabled consumers to be familiar with digital products and services. This new digital age has encouraged the emergence of an enormous variety of new products and services, easily accessed online. The digitization of the global economy creates huge economic opportunities and companies are gearing towards digital sources of revenue and digital channels. Digital giants like Google, Amazon, Facebook, Apple, Microsoft and Alibaba (global companies that transact business in the digital space) are benefitting from the strong growth of digital business. The digital platforms providing search engines, social media, virtual marketplaces and online advertising services have transformed lives for the better. However, it is also a challenge for governments to ensure that the tax systems are fair by also taxing income derives from the digital economy. It is not fair that the lucrative digital platform business can avoid paying tax

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while conventional business cannot. Therefore, it is important that tax legislations must keep up with the changing business models as a result of advancing technology in business.

TAXING THE DIGITAL BUSINESS

While digital business platforms generate billions of dollars in revenue, many digital enterprises are not liable to pay tax. In fact, tax evasion in the digital economy has become a growing concern to governments worldwide (Bacache-Beauvallet & Bloch 2018). The advent of the digital economy poses great challenges to the international tax arena. Governments worldwide, including Malaysia, are looking at introducing the “digital tax”, which will be imposed on technology companies and e-commerce players. Tax authorities across the world are reviewing the ways to collect taxes from digital enterprises under the current international rules. The Organisation for Economic Cooperation and Development’s (OECD) view is that the digital economy should be taxed on the same principle that is currently being used to tax traditional businesses. Currently, the international tax law is lagging behind the business models in the digital era.

The reason is international permanent establishment rules are used to determine how much a company should be taxed based on a threshold of its activity in a given country. The concept is mainly based on physical presence such as the existence of offices, factories, warehouses etc. in a country. Based on existing tax rules, these digital companies report their profits in the country where their businesses are based, thereby depriving other countries of potential tax revenue.

The keys to classic business models are of little relevance for Silicon Valley giants like Google, Amazon & others. Today, digital businesses are able to have significant economic or digital presence without necessarily having a substantial physical presence. For instance, in July 2017 the French Government has failed to recover 1.1 billion euros (US$1.3 billion) for years 2005 to 2010 from Google as there was no permanent establishment in France (Reichert 2017). As such, France is pushing for digital tax to be implemented.

There is increasing pressure on governments to ensure that digital business owners pay their fair share of tax. Current taxation concepts for international cases were basically developed for the world in the early 20th century. According to Nellen (2015), tax practitioners are continually facing challenges in both understanding the technology and how tax rules apply. OECD und EU are examining alternative taxation concepts for digital business models. The US government is also keen to find an effective way to tax the new digital economy and is watching EU’s plan closely. The Malaysian government has been studying the possibility of collecting taxes (indirect tax and direct tax) from foreign companies that offer digital services in Malaysia. Malaysia has now confirmed that a digital tax will be coming to the country based a similar model and timeline in Singapore. According to the World Bank Group (2018), tax imposition on the digital economy will allow diversification of the Malaysia’s revenue sources. Currently there is no common action to tackle the taxing of digital business globally and each country is making its own proposals. There is a need for a global solution to the issue of how, what and where to tax income from the digital economy.