

# The Impact of Online Business on Malaysian Taxation

Morni Hayati Jaafar Sidik<sup>1</sup>

<sup>1</sup>Universiti Kuala Lumpur

## Abstract

Online business has transformed the way of conducting business and have raises several tax issues and problems internationally. Many tax authorities around the world felt that this communication revolution has created new possibilities for tax administrations to improve the efficiency of their operation but also open up new possibilities for tax evasion. They also viewed that the current taxing rules are insufficient to deal with online business. As more Malaysian companies and individuals involve in online business, they will also be exposed to this issue. The purpose of this paper is to study the tax issues and problems raised by the online business transactions from Malaysian perspectives. It also examines at the impact of online business on Malaysian taxation system. Finally, this paper will also discuss some possible solutions for the tax authorities to deal with the challenges posed by the online business.

**Keywords:** *Online Business, Taxation*

## 1. Introduction

With the growth usage of the Internet, a new form of commerce has emerged and known as electronic commerce. This new electronic commerce (e-commerce) or online business is simply defined as business conducted using the Internet as means of communication and transactions. In 2017, retail online business sales worldwide amounted to 2.3 trillion US dollars and e-retail revenues are estimated to escalate to 4.88 trillion US dollars by 2021 [1]. Besides that, according to survey done by [2], total online business market value in Malaysia in 2020, is expected to be worth about four billion U.S. dollars. The rapid growth in the usage of the online business has created challenges for tax administrations worldwide including Malaysia. This is because online business would provide borderless transactions and fundamentally change the way of conducting commercial transactions. This paper, therefore, examines how online business would have impact on the income tax system in Malaysia

## 2. Growth of Online Business in Malaysia

Nowadays, online business plays as an important element of the business world. The term of online business is generally referred to as conducting commercial transactions online and through Internet. This type of business provides a fundamentally new way of conducting commercial transactions as traditional ways of doing business is profoundly changed. This is because the economic distance between producers and consumers will reduce, traditional intermediaries will be replaced, new products and markets will be created, and new relationships will be formed between businesses and consumers and between the different parts of global enterprises. At a click of a key, products, services or information are transferred and delivered to the customers. The process, thus, saves the shopper time, travel expenditure and the chore of lugging goods as with conventional shopping [3]. Online business provides opportunities for price reduction as online

transactions reduce the economic distance between producers and customers. With these benefits, more and more people are using online business.

Like any other country in the world, Malaysia has also take part in this electronic business. Malaysian government through the Multimedia Development Corporation (MDC) has promoted wider use of online business in the country. Online business is just one of many areas under the nation's Multimedia Super Corridor's (MSC) borderless marketing flagship application which will spearhead the growth of the multimedia based service industry in Malaysia. Malaysia is also one of the pioneers within Asian countries to set up a ministry specifically to promote the development of Information and Communication Technology (ICT) and to encourage e-commerce growth with the assistance of several agencies such as Malaysian Communications and Multimedia Commission (MCMC) and MDC [4]

The figures in Table 1 show that online business is growing rapidly in Malaysia. Besides that, 13.9 million people in Malaysia are users of online business in 2016 and expected to increase by 21.4 million in 2022.

## 3. Implication of Online Business to Tax Administrations

The development in the online business poses challenges to the tax systems. From the perspectives of tax administrator, these new communication technologies open up possibilities to improve the tax administration of tax systems but also open up new avenues for tax evasion and avoidance [5]. Tax administration will encounter greater difficulties tracing transactions because of the lack of links between electronic entities and their physical counterparts [6]. For example, [7] stated that online business is a new way for taxpayer to evade tax as they may not register their business and thus giving some impact and challenges for tax authorities to deal with them.

Some other emerging issues resulting from the increase in electronic transactions are stated below. Verification of identity

and residence: With online business, the world has become one big market where taxpayers can establish and operate from an Internet address in any jurisdiction irrespective of their residence or source of income. Thus, the problem with the tax authorities is that online business enables a foreign person to engage in

extensive transactions with customers in other countries without physically entering that country [8].

Obtaining documentation: To obtain information for enforcement purposes will be difficult through online business, especially if the transactions that involve with countries that has no tax treaty.

**Table1:** Online business Revenue in Malaysia 2016 to 2022

YEAR	REVENUE MILLION US\$
2016	884
2017	1076
2018	1309
2019	1578
2020	1878
2021	2200
2022	2531

Sources: Statista, October 2017

The removal of convenient ‘taxing points’: E commerce reduces the economic distance between manufacturers and consumers [9]. With lesser intermediaries, tax administrators are pushed to collect smaller amount of incomes. Offshore banking and tax heaven become more ‘reachable’: With online business, it will become easier for taxpayers to transfer their income offshore to tax havens. Besides that, Internet banking will offer easier accessibility, low transaction costs and a degree of anonymity. All these will result in more difficulties for tax administrators to counter the international tax evasion.

#### 4. Implication

From a tax policy perspective, the main concerns raised by the growth of electronic commerce are whether existing tax policy is sufficient to address any new and existing issues and whether such activities pose a threat to the revenue base through avoidance and evasion. Online business has implication for both the income tax and consumption. This paper, however, will only focus on income tax. The existence of a business by Non-residence Company may be created through the concept of permanent establishment (PE) in the double tax agreements signed between Malaysia and other countries. Basically, a PE is defined as a fixed place of business through which the business of an enterprise is wholly or partly carried on. For example, if a foreign company set up an office in Malaysia, this would result in a PE and the profit received would be taxable under Section 4(a). This PE concept is important as it helps to determine the right of a country to tax the profits of an enterprise that belongs to a different sovereign jurisdiction [10]. The question arise is whether the bases adopted by Malaysian tax law are adequate to address the tax consequences of online business transactions conducted by non-residence companies? Can a server or website adequate to create a PE in online business environment? Apart from that, companies that are resident in Malaysia are taxed on all income derived in Malaysia, while certain types of income such as interest and technical service fees, are subject to tax where they are sourced in Malaysia, regardless of the resident status of the recipient. Nevertheless, resident companies other than banking, insurance, shipping and air transport, that received income in Malaysia from abroad, will be exempted from income tax. A non-resident company is taxed in the same way as a resident company for any profits or gains accrued or derived in Malaysia. However, [11] argued that the source concept is operational and functional if the physical location where goods are traded could be identified. In online business environment, it will be difficult, if not impossible, to track down the physical locations for online business transactions [12]. This raise question whether the bases adopted by Malaysian tax laws are adequate to address the tax consequences from transactions done in the online business

In January 2013, the Inland Revenue Board of Malaysia (IRB) has issued “Guidelines on Taxation of Electronic Commerce”. The

purpose of the guideline is to give some guidance on basic tax issues and income tax treatment with respect to online transactions. The guideline provides that e-commerce businesses will be subjected to the same tax treatment as conventional businesses as suggested by the OECD. This means that all individuals and companies involved in online businesses will also be taxed under the Income Tax Act 1967. The impact of the guideline is significant as it marks the IRB’s attempt to shed light on the complex area of taxation [13]. In other words, it provides taxpayer with a degree of certainty on tax treatment of online transactions in Malaysia. Under Paragraph 5.1 of the guidelines, it says that even though the server and website facilitate the performance of business activities, a server/ website by itself does “not carry any meaning in determining derivation of income.” Income from e-commerce is regarded as derived from Malaysia if the business operations test shows that the business is carried on in Malaysia. Thus, it is subject to income tax. However, in the case where the business operation of a person is carried on outside Malaysia, business income from electronic commerce would not be considered as derived from Malaysia and will not be subject to income tax. In general, the guideline is quite similar to the guideline issued by the Singapore tax authorities. In 2016, IRB has issued a brochure on e-commerce. According to IRB, all payments and benefits received from the carrying on of blogging, advertising and any other activity performed on online, including social media platforms, is considered as a trade or business constitute gains or profits from a trade or a business. Thus, individuals or businesses that sell their products on social media platforms such as Instagram and Facebook must declare their income and file tax returns. Apart from that, the IRB has also collaborated with other government agencies such as the Companies Commission of Malaysia (CCM) and the Royal Malaysian Customs Department (RMC) in their effort to monitor and track the online business operators in Malaysia.

##### 4.1. Recommendation Measures for the Tax Authorities

As discussed above, there are several the issues and problems raised by the online business transactions. The main reason is because the current tax rules may no longer applicable to online business. For example, [14] has commented that the responses by Canada, Australia and the United States and the OECD so far have been limited to reinterpreting existing tax principles in the context of e-commerce. She pointed out that “*In the long run, such an approach is likely to fail because e-commerce is a brand new medium for international business and will require fundamental changes to the international tax system.*” Thus, the cooperation between countries is necessary to enhance the development of an effective tax system for online business and activities.

Governments will have to implement methods which will allow taxpayers to comply with their taxpaying duties. Thus, there is a need for tax authorities to develop sound techniques to detect tax evasion with the use of technologies. Software and electronic

tracking systems will continually be developed to assist governments in their taxing challenges in the world of online business [15].

## 5. Conclusion

Online presents new challenge for tax administrators not only in Malaysia but also in other countries. The challenge is for the tax authorities to develop a system of taxation that is equitable to the public, governments, and the business communities without hindrance to the development of the electronic commerce. Thus, the cooperation between countries is necessary to enhance the development of an effective tax system in the cyberspace.

## References

- [1] Ahmad, S. Z., Abu Bakar, A. R., Faziharudean, T. M. and Mohamad Zaki, K. A. An empirical study of factors affecting e-commerce adoption among small and medium-sized enterprises in a developing country: Evidence from Malaysia. *Information Technology for Development*. doi:10.1080/02681102.2014.899961. [Taylor & Francis Online], [Google Scholar], (2014).
- [2] Omodero, C. O., & Ogbonnaya, A. K. Corporate Tax and Profitability of Deposit Money Banks in Nigeria. *Journal of Accounting, Business and Finance Research*, 3(2), 47-55, (2018).
- [3] Nkuah, J. K., Frederick, A. K., & Asamoah, K. The Correlation between Accounting Systems of Small and Micro Enterprises and Tax Revenue Assessment in Ghana. *Journal of Education and e-Learning Research*, 2(1), 1-12, (2015).
- [4] Wireko-Manu, F. D., & Amamoo, C. Comparative Studies on Proximate and Some Mineral Composition of Selected Local Rice Varieties and Imported Rice Brands in Ghana. *Agriculture and Food Sciences Research*, 4(1), 1-7, (2017).
- [5] Handley, H. An Introduction to online business in Malaysia. Retrieved February 28, 2018, from aseanbriefing: <https://www.aseanbriefing.com/news/2016/12/16/an-introduction-to-online-business-in-malaysia.html>, (2016).
- [6] Ho, D., Mak A. & Wong, B. Assurance of functionality of tax in the e-business world: the Hong Kong experience. *Managerial Auditing Journal*. 16(6), 339-346. (2001).
- [7] Isabel, M. I. Internet Taxation: Which Side Are You On?. Retrieved on July 29, 2001 <http://www.powerhomebiz.com/vol4/internet-taxation.htm>, (2000).
- [8] Kasipillai, J and Razak, A.S. Tax Considerations Involving Electronic Commerce. *Tax Nasional*, June, 44-50, (2000).
- [9] Kelly, T. E. When Does Online business create a PE? *Tax Advisor*. 31(5), 306-309, (2000).
- [10] Li, J. E-commerce tax policy in Australia, Canada and the United States, *UNSW Law Journal*, Vol 23(2), 313-328, (2000).
- [11] ANYANWU, F. A., ANANWUDE, A. C., & OKOYE, N. T. Exchange Rate Policy and Nigeria's Economic Growth: A Granger Causality Impact Assessment. *International Journal of Applied Economics, Finance and Accounting*, 1(1), 1-13, (2017).
- [12] Nyarko, I. K., Agbemava, E., & Bediako, A. K. Effectiveness and Usefulness of Personal Tax Reliefs: A Study of Ghana Revenue Authority's Domestic Tax Division. *Asian Journal of Economics and Empirical Research*, 3(1), 59-70, (2016).
- [13] Chiang, C., & Hsu, H. L. Incorporating Pollution Taxes and/or Subsidies into Master Planning in Semiconductor Foundry Plants. *International Journal of Management and Sustainability*, 6(1), 8-22, (2017).
- [14] Zandi, G., & Elwahi, A. S. M. Tax Compliance Audit: The Perspectives of Tax Auditors in Malaysia. *Asian Development Policy Review*, 4(4), 143-149, (2016).
- [15] Ayenew, W. Determinants of tax revenue in Ethiopia (Johansen cointegration approach). *International Journal of Business, Economics and Management*, 3(6), 69-84, (2016).