SERVICE TAX 2018

GUIDE ON DISBURSEMENT AND REIMBURSEMENT

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This information is intended to provide a general understanding of the relevant treatment under Sales Tax and Services Tax Legislation and aims to provide a better general understanding of taxpayers' tax obligations. It is not intended to comprehensively address all possible tax issues that may arise. While RMCD has taken the initiative to ensure that all information contained in this Guide is correct, the RMCD will not be responsible for any mistakes and inaccuracies that may be contained, or any financial loss or other incurred by individuals using the information from this Guide. All information is current at the time of preparation and is subject to change when necessary.

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INTRODUCTION

1. Service Tax is a consumption tax governed by the Service Tax Act 2018 (the Act) and its subsidiary legislation. The effective date of the Act is 1st September 2018.

2. Service tax is imposed on prescribed services called taxable services, imported taxable service and digital service (with effect from 1 January 2020).

3. A person who provides taxable services exceeding a specified threshold is required to be registered under the Act and is known as a “registered person” who is required to charge service tax on his taxable services made to his customers.

4. The Guide is prepared to assist you in understanding the service tax treatment on disbursement and reimbursement.

5. This Guide applies to a taxable person in any business transaction who has to deal with invoicing, making and receiving payments which include service tax.

6. This Guide discusses the issue of how a taxable person’s recovery of expenses are characterised and what is the method used to determine expenditure incurred by him which can be classified as a disbursement or reimbursement for service tax purposes. There may be three parties (service provider, claimant and customer) involved in reimbursement & disbursement.

TERMINOLOGY

7. For the purpose of service tax, the following words have these meanings in this guide unless the contrary intention appears:

(i) “**Claimant**” means a registered person who recovers expenses he incurred on behalf of the customer;

(ii) “**Customer**” means any person who receives a service directly or indirectly from a service provider through a claimant;

(iii) “**Service Provider**” means a person who provides directly or indirectly, a service to the customer through a claimant;

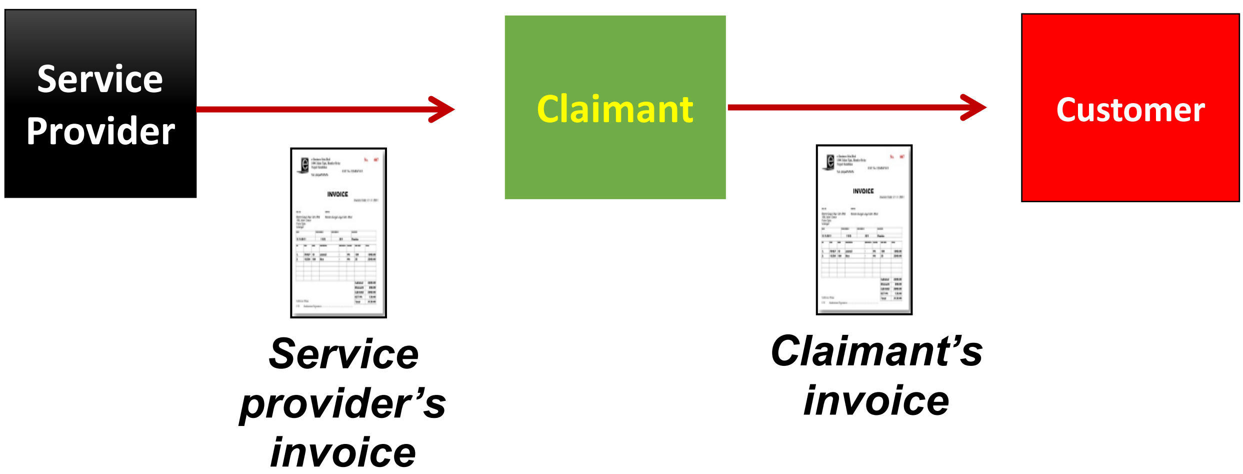
(iv) "**Disbursement**" means the recovery of a payment made on behalf of the customer by a claimant who is acting as an agent;

(v) "**Reimbursement**" means the recovery of an expense from the customer that a claimant incurs as a principal from another party;

(vi) "**Cost**" means the value of taxable service exclusive of service tax (if any) incurred by the claimant;

(vii) "**Primary service**" means the main service provided by a claimant as a principal to the customer.

Diagram 1: Transaction Flow for Reimbursement and Disbursement



LEGISLATIVE CONTEXT

8. Under section 7 of the Act, service tax shall be charged and levied on:

(a) any taxable service provided in Malaysia by a registered person in carrying on his business; or

(b) any imported taxable service.

9. Under section 9 of the Act, the value of taxable service on which service tax is payable shall be determined based on the actual value of the taxable service provided.

RECOVERY OF EXPENSES AS PRINCIPAL OR AS AGENT

10. In order to determine whether such recovery of expenses is a disbursement or reimbursement the claimant needs to establish whether he acted as a principal or as an agent when he acquired the services from the service provider.

11. The agent and principal relationship may be established in a written contractual agreement between the service provider and the claimant.

12. Written Contractual Agreement

12.1. The service tax treatment to be applied by the claimant will be determined according to the written contractual agreement, where the contractual terms clearly show that the claimant incurred the expense either as an agent, or as a principal.

12.2. If a claimant acquired the services from the service provider as a principal, the claimant's recovery of expenses from the customer will be treated as a service provided to the customer. If a claimant acquired the services from the service provider as an agent for the customer, the claimant's recovery of expenses shall not be treated as a service provided by the claimant.

12.3. In the case where in the written contractual agreement shows clearly that a claimant acquired the services from the service provider acting as an agent but the amount subsequently recovered from the customer is more than the cost or expenses incurred (i.e. with a mark-up), the claimant is treated as a principal and such recovery will be treated as a reimbursement.

13. Contract Does Not Exist or Ambiguous Contract

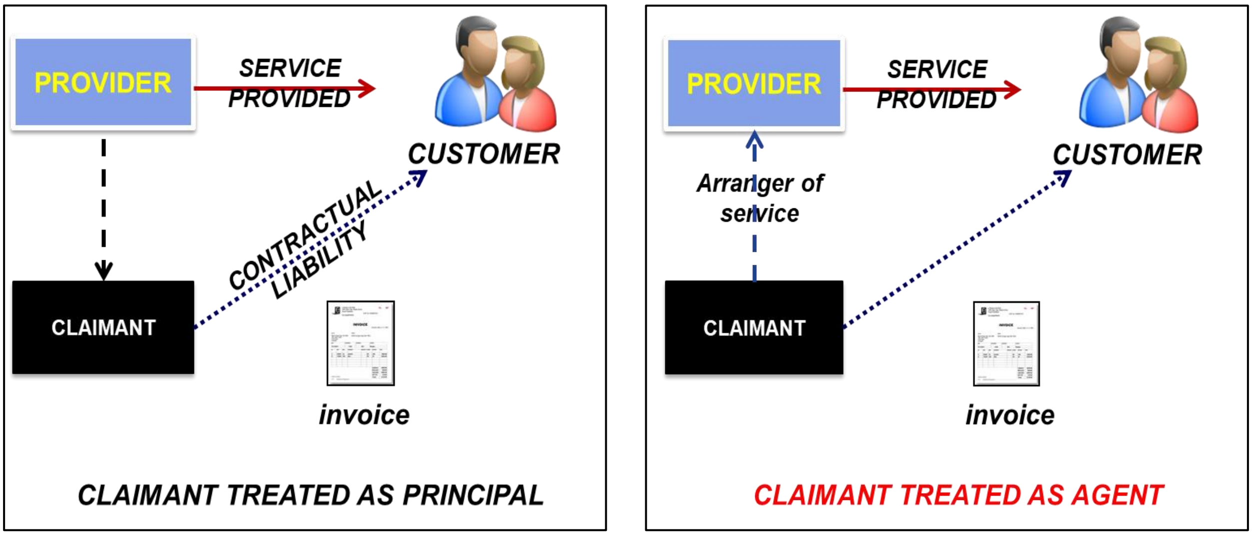
In the event that there is no written agreement between the claimant and customer or there is a written agreement but the contractual relationship cannot be clearly identified, status of the claimant shall be determined according to any of the following rules:

(a) Contractual liability and assumption of responsibilities and risks
(b) Legal obligations to make payment or payment arrangement
(c) Alteration to the nature and value of expenses
(d) Identities of parties and transaction involved

13.1. Rule 1: Contractual Liability And Assumption Of Responsibilities And Risks

If a claimant has contracted for the acquisition of services in his own name or capacity, a claimant will be treated as acquiring the services from the service provider as a principal. If he is not a party to the contract and merely arranged for the provision of services on behalf of his customer, he is treated as acquiring the services from the service provider as an agent;

Diagram 2: Contractual Liability And Assumption Of Responsibilities And Risks

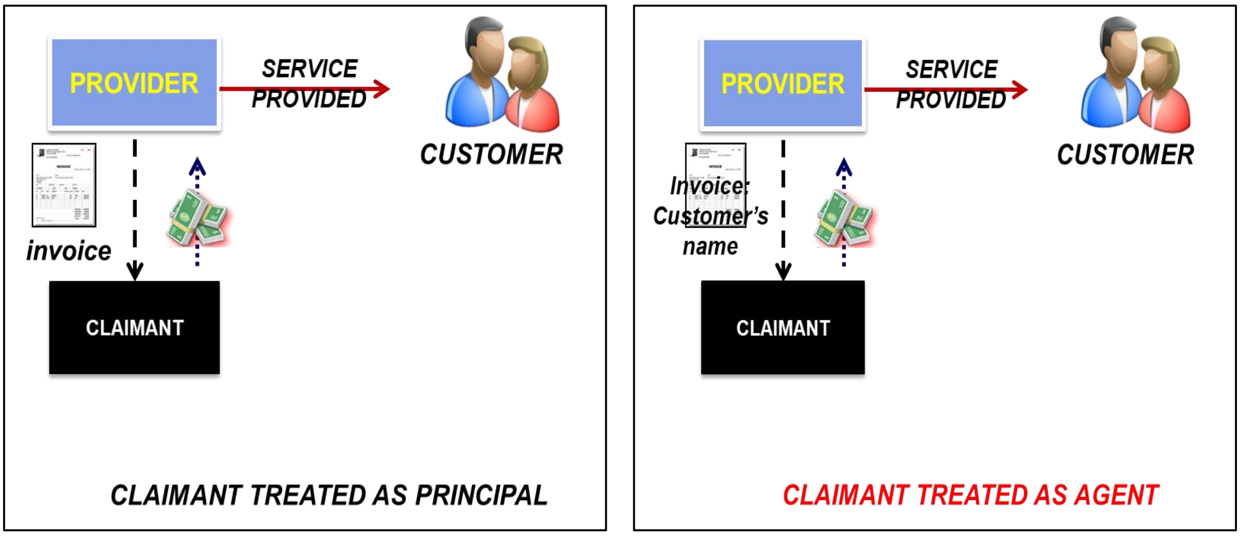


13.2. Rule 2: Legal Obligations To Make Payment Or Payment Arrangement

If a claimant has the legal obligation to make payment to the service provider for the services, the claimant is treated as a principal acquiring the services from the service provider. For example, the service provider's invoice is issued under the claimant's name.

If a claimant does not have the legal obligation to pay for the services but is authorised by his customer to make payment to the service provider on his behalf, the claimant is treated as an agent acquiring the services from service provider. For example, the service provider's invoice is issued under the customer's name;

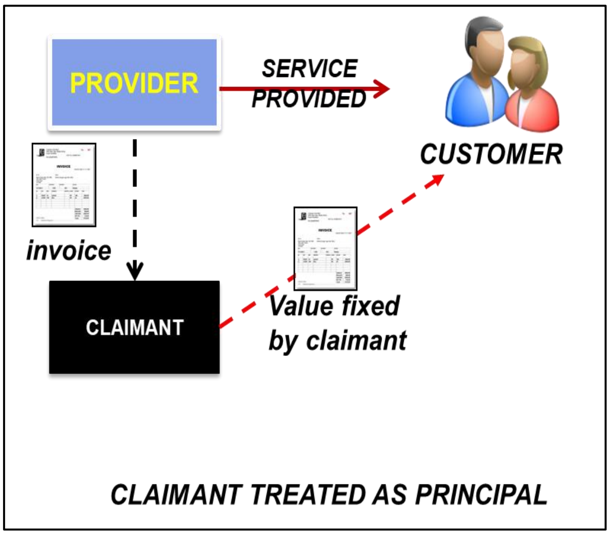
Diagram 3: Legal Obligations To Make Payment Or Payment Arrangement

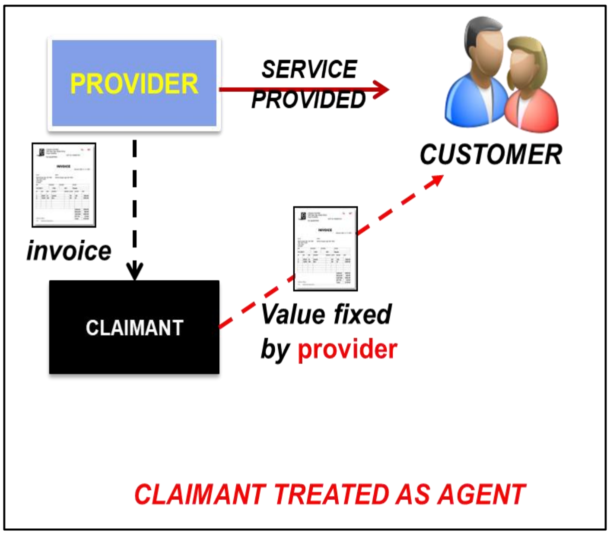


13.3. Rule 3: Alteration To The Nature And Value Of Expenses

If a claimant can alter the nature or value of the services and make a decision on the value of expense to recover, he is treated as a principal. If the claimant is not able to alter the nature or value of services made between the customer and the third party service provider unless he is authorised to do so by the customer, he is treated as an agent;

Diagram 4: Alteration To The Nature And Value Of Expenses

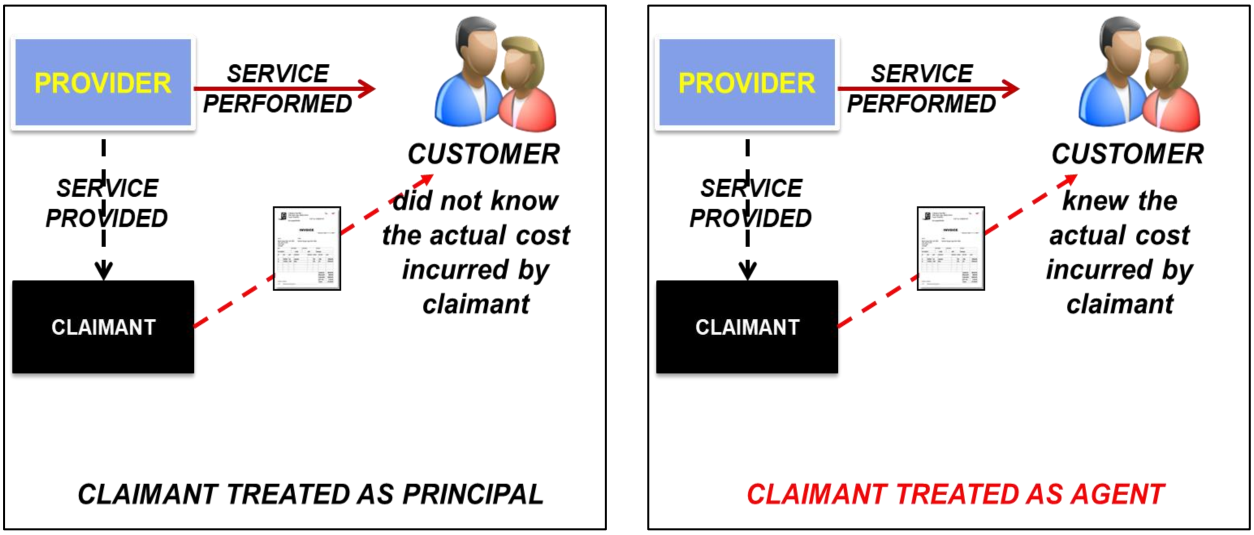




13.4. Rule 4: Identities Of Parties And Transaction Involved

If the claimant is the only party known to the third party service provider and the customer does not know the cost incurred by a claimant on the acquisition of services from the third party service provider, then the claimant is treated acting as a principal. If the third party service provider knows the identity of the customer and the customer knows the exact cost incurred by claimant on the acquisition of services from the third party service provider, then the claimant is treated acting as an agent.

Diagram 5: Identities Of Parties And Transaction Involved



SERVICE TAX TREATMENT ON DISBURSEMENT

14. The recovery of cost by the claimant incurring the cost while acting as an agent is treated as disbursement. A disbursement does not constitute providing taxable services and hence is not subject to service tax. Recoveries of cost paid to service providers or on behalf of the customer will be treated as disbursement if the claimant fulfils all the following criteria:

(a) The customer knew the services is made by the service provider and not by the claimant;
(b) The exact amount is claimed from the customer and the claimant shall not alter the nature of the services or add on the value of the services; and
(c) The copy of invoice from the service provider is attached together with the invoice issued by the claimant to the customer as a supporting document.

15. Subject to the rules in para 13, in the case where an invoice is issued by the service provider to a customer through an agent (claimant), the service shall be deemed as to be made by the service provider to a customer not by an agent (claimant). Such recovery of expenses by an agent (claimant) will be treated as a disbursement for service tax purpose if recovery of the payment is incurred by him on behalf of the customer in order to discharge the customer's payment obligation.

Example 1
Ali (i.e.the client) is legally required to obtain a permit from the Road Transport Department and used the service of a registered person to act on his behalf. The permit is issued by such relevant authority in Ali's name. Therefore, the issuance of the permit is made by that relevant authority to Ali and not to the registered person (i.e. the claimant). When the registered person pays for the permit it is acting as a paying agent for its client. Therefore, the amount paid by the client to the registered person for the permit is a disbursement and not subject to service tax.

16. If payment received from a customer includes additional charges, mark-up or margin, such payment (i.e. full amount) will be regarded as a provision of service and subject to service tax if it relates to any taxable services provided. A claimant is treated acting as a principal because he can alter and change the value of the original service

(i.e. service by third party service provider). This recovery will be subject to service tax.

17. If the criteria in para 14 are fulfilled, service tax shall be charged based on the excess portion. If the primary service provided by the claimant is not a taxable service, the determination of whether it is a disbursement or reimbursement is no longer relevant.

SERVICE TAX TREATMENT ON REIMBURSEMENT

18. Service tax treatment on recovery of expenses are as follows:

17.1. If the claimant pays the expenses as an agent, the recovery of expenses does not constitute a provision of service and hence will not be subject to service tax.

Example 2
A guest at a hotel requires a taxi and asked the hotel to arrange a taxi for him. The hotel will charge the taxi fare in the hotel's bill. The taxi fare is not subject to service tax even though it is billed together with the accomodation charges, provided it is separately itemised in the bill.

Example 3
A guest at a hotel ordered pizza from a pizza delivery restaurant outside the hotel. The guest requested the front desk hotel to pay on his behalf. The hotel will recover the pizza costs without any mark-up together with the hotel accomodation charges by attaching the restaurant's invoice together with the hotel's bill. The hotel is acting as an agent to the guest. The pizza charges are treated as disbursement and not subject to service tax.

Example 4
A guest at a hotel requested the front desk to order pizza from a pizza delivery restaurant outside the hotel. The guest also requested the front desk hotel to pay on his behalf. The hotel will recover the pizza costs with mark-up together with the hotel accomodation charges. The

hotel is acting as a principal. The hotel is no longer treated acting as an agent because it did not fulfill Rule 3 in para 13. The pizza charges are treated as the value of service and it is subject to service tax.

Example 5

In relation to Example 4, if the hotel attached the restaurant's invoice together with his invoice to the customer, only the mark-up will be subject to service tax provided it is separately itemised in the hotel's bill.

17.2. If the claimant incurred the expenses as a principal, the recovery of the expenses from the customer will be subject to service tax. If payment received from a customer includes mark-up, such mark-up will be treated as a separate service and will be subject to service tax.

Example 6

The guest requested the front desk hotel for pizza. Since the hotel did not provide pizza in his menu, the hotel will order from a pizza delivery restaurant. The hotel recovered the pizza costs together with the hotel accomodation charges. The hotel is acting as a principal to the guest. The pizza charges are treated as a service by the hotel and it is subject to service tax.

19. Reimbursement is ancillary to a primary service if such recovery form part of the overall price the claimant charged to his customer. The service tax treatment for the recovery of the expenses will generally follow that of the primary service.

Example 7

Total Event Sdn Bhd (TESB) has appointed MyWorld Event Sdn Bhd (MyWorld) to manage an international exhibition in Malaysia. MyWorld needs to provide a venue, booths, catering, handling, and security services. MyWorld does not have its own catering and security services, so MyWorld uses third-party service providers.

Third parties will charge the following charges to MyWorld.

Service	**Amount (RM)**
1) *Catering*	*20,000*
2) *Security*	*10,000*
Total	***30,000***

MyWorld then charges the following to its customers on all services provided including catering and security services obtained from third parties. MyWorld also attached invoices from third parties that clearly state the true cost of catering and security services.

Service	**Amount (RM)**
1) *Rental of venue*	*30,000*
2) *Booth*	*20,000*
3) *Catering*	*25,000 (markup 5,000)*
4) *Handling*	*5,000*
5) *Security*	*12,000 (markup 2,000)*
Total amount	*92,000*
Cost from third parties provider	*(30,000)*
Services from MyWorld	***62,000***

MyWorld as a registered person will charge service tax on RM62,000. This is because by attaching the invoice from the third parties to the customer, the value of RM62,000 is considered to be the actual value of services provided by MyWorld to TESB.

Example 8

A lawyer from XYZ Associates provides legal advice to a local client relating to acquisition of property in Thailand. XYZ seeks counsel with a Thailand law firm Thai & Partner who provided the necessary information concerning Thailand law and business regulations. XYZ includes Thai & Partner's counsel fees in its billing to the client.

XYZ contracts directly with Thai & Partner and works with the latter to obtain the required information in order to perform its legal services to the client. Therefore, XYZ is the principal in acquiring the services from Thai & Partner. The subsequent recovery of overseas counsel fees by XYZ from its local client is a reimbursement. The counsel fee recovered forms part of XYZ's legal services to the local client but is not subject to service tax since it is related to matters outside Malaysia.

EXPLANATION ON OTHER COST RECOVERIES

20. Sometimes the recovery of cost is termed as out of pocket expenses (OPE) which form part and parcel of the service provided. In circumstances where the contract does not specifically state about OPE, OPE related costs are treated as part of the value of the taxable service by the service provider.

Example 9

NH Accounting Sdn Bhd is providing audit report services. In providing the services, the company will charge professional fees and miscellaneous fees. Under the miscellaneous fees it covers the travelling, photocopy, printing and other out of pocket costs which will be charged to the customer. These charges are not considered as neither reimbursement nor disbursement. These charges are part and parcel of the services provided and it relates to the provision of taxable service.

21. However, OPE which is charged separately is not a taxable service provided by the claimant to his customers if it fulfills all of the conditions below:

a) it is stated in the contract that the customer will bear the OPE costs;
b) It is paid on a back to back basis (without any mark-up); and
c) the claimant provides the supporting documents when making the claim from the customer.

Example 10

KAT Sdn Bhd provides consultancy services to KREM O&G Sdn Bhd. Based on the contract, KAT will issue an invoice for professional fees and OPE. KREM as per contract, agreed to pay the OPE such as taxi fares, meals and accomodation on back-to-back basis with supporting documents. The professional fees are subject to service tax, while the OPE charged by KAT are not subject to service tax.

Example 11

TAK Sdn Bhd provides consultancy services to MREK Sdn Bhd. TAK will issue an invoice for professional fees and OPE such as air fare, meals and accomodation on back-to-back basis with supporting documents. Both the professional fees and OPE are subject to service tax because there is no contract between both parties.

Example 12

ATK Sdn Bhd provides consultancy services to REM Sdn Bhd. Based on the contract, ATK will issue an invoice for professional fees and OPE. REM as per contract, agreed to pay the OPE such as transportation fares, stationeries and printing on back-to-back basis with supporting documents. However ATK failed to provide OPE supporting documents on the claims. Both the professional fees and OPE are subject to service tax.

INQUIRY

For any inquiries for this guide please contact:

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FURTHER ASSISTANCE AND INFORMATION ON SST

Further information on SST can be obtained from :

(i) SST website : https://mysst.customs.gov.my

(ii) Customs Call Center

- Tel : 03-7806 7200 / 1-300-888-500
- Fax : 03-7806 7599
- Email: ccc@customs.gov.my

