

THE EFFECT OF E-COMMERCE ON MALAYSIAN TAX SYSTEM: AN EMPIRICAL EVIDENCE FROM ACADEMICIANS AND MALAYSIAN TAX PRACTITIONERS

Mohd Rizal Palil

*School of Accounting, Faculty Economics and Business,
Universiti Kebangsaan Malaysia, 43600 Bangi, Selangor, Malaysia
Email: mr_palil@pkrisc.cc.ukm.my*

Abstract: The explosion of information technology (IT) nowadays has created new phenomena in shopping activities. Consumers can easily buy products via Internet. Within a minute, the products will be delivered instantly and accurately. This scenario is known as e-commerce. The emergence of e-commerce affects consumers' shopping behavior as well as taxation system. The objective of this research is to reveal the effects of e-commerce upon Malaysian taxation system by emphasizing in scope of charge 'derive and remittance'. Research was conducted through questionnaires of 82 tax practitioners and 22 academicians. The research findings shown that derive and remittance basis is no longer appropriate in e-commerce environment. Scope of charge derives and remittances, which are practicing in Malaysia right now, are unable to maximized e-commerce tax revenue.

Keywords: Malaysian tax system, e-commerce, academicians, tax practitioners, scope of charge

Abstrak: Perkembangan dalam dunia teknologi akhir-akhir ini telah membawa banyak arus perubahan terutamanya dalam aktiviti belanja. Konsumen dapat membeli barang dengan mudah melalui internet. Dalam waktu beberapa menit, barang sampai di tangan konsumen. Skenario demikian dikenal sebagai perdagangan elektronik. Kemunculan perdagangan elektronik mengubah perilaku belanja konsumen serta sistem perpajakan di Malaysia. Tujuan penelitian ini adalah untuk mengetahui efek perdagangan elektronik terhadap sistem perpajakan di Malaysia dengan penekanan pada pengenaan pajak dan hak pemajakan. Penelitian dilakukan dengan menggunakan 82 sample praktisi perpajakan dan 22 akademisi. Hasil penelitian menunjukkan, bahwa praktek pengenaan pajak dalam perdagangan elektronik belum sesuai dengan aturan yang berlaku, sehingga tidak dapat memaksimalkan penerimaan pajak dari perdagangan elektronik.

Kata kunci: sistem perpajakan Malaysia, perdagangan elektronik, akademik, praktisi perpajakan, pengenaan pajak.

If we want to buy an product. No more browsing in boring furniture store or leafing through old-fashioned mail order catalogues. We can do this differently, as benefits the new millennium. What's Amelia doing is an example. Amelia is going

to buy through the web. By several clicks on the mouse, she finds what she is looking for, a fabulous website named *kitchens.com* owned by Kitchen Co. which is operated and managed in Guyana. She quickly enters into electronic conversations with the company's marketing consultants. She answers the questions and e-mails him a copy of her kitchen measurements. He, in turn conveys her wishes to a designer, who works from a beachfront condo in Bermuda. The designer is able to fulfill Amelia's specifications by assessing a mainframe computer in Buenos Aires. A company employee residing in Sydney, Australia where the company had no other business wrote the design software on the computer specifically for this purpose. The Buenos Aires computer is able to do some of the design work itself: it can check Amelia's measurements, compare them to a available material and appliances, make up a list of possibilities within Amelia's budget and check each possibility for safety and durability. The designer in Bermuda can use the options he downloaded from the computer, as well as a database of design options from the same source, to come up with Amelia's dream kitchen.

After obtaining Amelia's electronic approval, the work order then is forwarded to skilled artisans working in the Italian countryside, who serve as consultants while the actual construction of the kitchen itself is performed at the company's factory in Penang, Malaysia, with the appliances supplied from Germany. Finally, after Amelia pays for the order by using her e-money account on the web, the finished kitchen is shipped to her from Malaysia for installation in Boston. For the installation, Amelia also receive a copy of design software, so that she can make last minute changes in case any of the features did not match her vision as they were actually installed.

The above story is just a simple example of electronic commerce transaction out of thousands transactions a day. We can just sit down in front of the computer and buy whatever product we wish to. According to the example given, what's wrong with the transaction? Is there any fraud being done by one of them? Do they crossing outbound without visa and passport? The answer is no.

Actually, Amelia's dream kitchen is the tax administration's nightmare. Consider the taxing jurisdiction that potentially could impose an income tax on Kitchen Co income from Amelia: Guyana (Kitchen Co country of legal residence and the location of its sales force); The United States (Amelia's country of residence and where consumption of the goods take place; Bermuda (where the designer works, Argentina (location of the mainframe that stores the order and participates in the design); Australia (where the software that made the design possible that written); Italy (location of the consultants); Germany (production site for the appliances); and Malaysia (production site for the kitchen).

Which of these jurisdictions should have the right to tax Kitchen Co income? Firstly, if more than one jurisdiction has the right, how can the income be allocated among them to prevent either multiple taxes or no tax at all? Secondly, what kind of income does Kitchen Co have, and how does the answer to this question relate to the previous one? These kind of problems could arise when economic transactions done through Internet.

From the above story, we could realize how electronic commerce works and affect tax system in various countries. The objective of this paper is to obtain Malaysian academician perspective about the e-commerce effects in various aspects such as scope of charge, residence status, permanent establishment (PE), tax evasion and indirect taxes as well as attempts address the ways in which the rise of e-commerce poses a challenge to traditional concepts of tax regime especially income arise from e-commerce transactions. This paper will starts with the definition and mechanism of e-commerce, the development in Malaysia, literature review, research design, and followed by findings and conclusion.

WHAT IS E-COMMERCE

Electronic commerce or e-commerce has been defined as “the ability to perform transactions involving the exchange of goods or services between two or more parties using electronic tools and techniques” (Yonah 1997). The essential prerequisite for the existence of e-commerce is thus the ability of the parties to communicate with each other by electronic means. Actually, this electronic ability has existed since the rise of the telegraph in the 1830's, and has grown exponentially since the arrival of the telephone in the 1890's by Alexander Graham Bell. Thus, it is well known to anyone who has ordered anything over the telephone (Smart shop, Kayla Beverly Hill etc.), E-commerce is not new. It is therefore, important to begin with the question, what if anything has changed in the way e-commerce was conducted in 1990's, so as to present new challenges to the international tax regime. It is also define as any buying and selling transaction through Internet. Payment can be made through credit card, Stored Valued Cards that is merely a debit card but not link with bank account.

According to US Commerce Department via its report in 1999, The Emerging Digital Economy II, e-commerce is define as a business process which shift the normal transaction into internet or any other medium as long as it is web-based transaction. It is also related with e-business, which is lately widely used by many business entities to enhance their market share. This definition is quite general compared wit Yonah's. Although there are various definition of e-commerce, in order to determine whether the transaction is e-commerce, we can conclude that the main criteria is the transaction is done through Internet regardless the payment and delivery method.

Mechanism of E-Commerce that Impacts Taxation

In e-commerce, there are two types of delivery methods, one through mail method or courier whereas another one is through online method. The problem to tax administrators is the one through online method. For example, Kenneth Wee resides in Kuala Lumpur bought a Peachtree Accounting Software version 10.0 from United Kingdom by downloading online from the particular company. All payment and delivery made through online. In this case, no third party involve such as Courier Company or Customs Department (at Klang Northport). On the other hand, Linda Yoe also resides in Kuala Lumpur bought the same thing, but she wishes to receive the software in compact disc (CD) through courier. If these two situations happen, only Linda Yoe will be taxed by Malaysian tax authority

(i.e. import duty) but not to Kenneth Wee. Meaning that, if you buy a digital product from other country and full settlement is being done through Internet including payment and delivery, you will not be taxed (for the time being). This is the main problem to local tax authorities.

Bear in mind, traditional tax principles were developed in the era where a transaction involves an identifiable party established in a physical location, which deliver goods or services to identifiable customers. Where several jurisdictions are involved, the concept of 'permanent establishment (PE)' used in many tax treaties will typically determined whether or not the operations constitutes a taxable presence in the country concerned. The definition of permanent establishment is based on the premise that there is a fixed and physical presence of a business or operations, usually in the form of an office, assets, employees of dependent agents (Ming 1999). The concept of PE finally resolved the potential conflict of which country has the right to impose tax (please refer Kitchen Co case).

However, with e-commerce, there are often no face-to-face customer relationships, there may be no employees or human intervention, and no identifiable physical location for either the seller or the customer. Therefore, in e-commerce, the analysis of PE becomes less clear. Other examples of e-commerce, which could possibly erode the tax base, are (1) computer software which can be transferred electronically to the user's computer (2) magazines, books and photographs which can be transferred digitally and (3) stocks trading, which do some stocks brokerage firms through the web sites that permit customers to trade share currently offer? (I.e. JF Apex Securities with their website www.apextrade.com).

E-Commerce in Malaysia

Compared with other countries such as Australia, United Kingdom and United States, the rate of development of e-commerce in Malaysia is quite low. Table 1 shows the value of e-commerce transactions for Malaysia, Australia and United States.

Table 1. E-commerce Transactions (US\$)

Countries	1998	1999	2000
Malaysia (a)	18.01 mil.	58.89 mil.	164.15 mil.
Australia (b)	123.2 mil.	180.6 mil	1.2 bil.
United states (c)	25 bil.	75 bil.	250 bil

Sources:

(a) International Data Corporation, 1999

(b) Australian Bureau of Statistics, Household Use of Information Technology Report 1998

(c) Forrester Research Report 1998

Table 2 shows the number of revenue collected by Malaysian companies and tax loss projection for the period of 1997 to 2004.

As we can see from the tables above, e-commerce development in Malaysia is getting bigger from year to year. From tax administrator perspectives, the growth

seems to be a silent killer of our national tax revenue. According to Table 2, in the year 2003, Malaysia will approximately lose around US\$98.16 millions or RM392.62 millions in tax collection. This figure will increase tremendously by 68% in 2004, or RM659.27 millions.

Table 2. E-commerce Revenue and Tax Loss Projection in Malaysia (1997–2004) (US\$mil.)

Year	Revenue	Tax Loss Projection**	Loss Increment
1997	6.31	0.32	185%
1998	18.01	0.86	227%
1999	58.89	2.80	179%
2000*	164.15	7.80	260%
2001*	426.72	20.26	133%
2002*	993.68	47.20	108%
2003*	2,066.40	98.16	68%
2004*	3,469.85	164.82	

* projections

** Based on assumption 5% tax rate

Source: Malaysian Business, April 1, 2000

Scope of charge is defined as a limit to tax certain income in a particular country (Barjoyai 1987). Currently, Malaysia is practicing scope of charge 'derive and remittance'. It means that all incomes derive in Malaysia and any income derives outside Malaysia but remitted into Malaysia is subject to Malaysian tax. This scope is applicable to residence only (Income Tax Act 1967). Kasipillai & Razak (2000) and Ming (1999) perceived that derive and remittance is no longer capable to cope with explosion of information technology especially in e-commerce. The implementation of this scope of charge will increase tax evasion among e-commerce doers because the tax administrator could not identified the location of the doers and the doers them selves.

The derive and remittance scope of charge is actually linked with residence status. For example, if a person does not reside in Malaysia in that particular basis year, income remitted from outside Malaysia into Malaysia would not subject to tax. It is also a big issue in e-commerce. One of the main attribute of e-commerce is implicit transaction and 'ghost' doers (Goolsbee & Zittrain 1999; Fox et al. 1997; Frieden & Porter 1996 and Hellerstein 1997a). In Malaysia, Section 7, Income Tax Act 1967, governs determination of residence status. Residence status permit special privileges such as progressive tax rate, personal relief and other tax incentives. Determination of residence status become difficult or almost could not be identified in e-commerce transaction (McClintock 2000; Mc Lure 1999 and Australian Tax Office 1997). Therefore, tax administrator could not simply impose tax to the doers due to inability to trace them accurately.

Besides that, there are many negative impacts in e-commerce (tax aspects especially). The most significant impact is reduction in tax collection in United States (Andrew 1999). He suggested that e-commerce transaction should be taxed because it will eventually reduce state tax revenue. In US, in order to impose tax on e-commerce, a special committee has been established in 1997 to analyze

effectively the impacts and come up with practical and realistic solutions. In 1998, a special act named Internet Tax Freedom Act 1998 (ITFA) has been approved by US law. This act developed by certified public accountants (CPA) and tax experts as an initial input to tax e-commerce, not the way to tax e-commerce in overall.

Goolsbee (1999) discussed the cost and benefit of taxing e-commerce. He emphasized on tax losses, rivalry among retailers and compliance cost by using Optimal tax theory. His research findings show that, for the time being (1999), the tax loss suffered by US government is still at reasonable level. He also found that (1) taxing e-commerce will increase a little tax revenue for couple years ahead and (2) cost of taxing e-commerce is very high in term of software development.

HYPOTHESES

The main objective of the research is to evaluate the appropriateness of using 'derive and remittance' scope of charge in e-commerce environment. The following hypotheses are developed in order to achieved the objective:

H₁ = 'Derive and remittance' scope of charge is no longer appropriate in e-commerce environment in Malaysia.

RESEARCH METHODOLOGY

This research is an exploratory study. Respondents come from two groups. First group comes from all academicians in higher learning institute in Malaysia including Akademi Percukaian Malaysia who is teach tax courses. The second group is tax practitioners who are registered with Malaysian Institute of Certified Public Accountants (MICPA) working in 155 accounting firms in Kuala Lumpur and Klang Valley. Rationale of choosing them as respondents is because they have extensive knowledge in Malaysian tax situation so that the information given is reliable. Fallan (1999) said that knowledge in specific area will enable them to answer the questionnaires analytically and accurately. Sum of 340 questionnaires were distributed, 40 for academicians and 300 for tax practitioners by using mail. Out of that figure, 22 (55%) academicians and 82 (27.3%) tax practitioners replied. All questionnaires replied are usable. The questionnaires were divided into three sections. First section contains respondents' background such as knowledge of e-commerce, educational background and gender. Section two concentrates on the effect of e-commerce on Malaysian tax systems and section three contains suggestion to deal with e-commerce. Data were analyzed by using SPSS ver. 10.0.

ANALYSIS AND DISCUSSION

Table 3 shows the academic qualification of the respondents. 90.1% or 22 academicians have postgraduate qualification whereas 52.4% or 43 tax practitioners have professional qualification. Table 4 shows the length of experience in tax environment. For academicians, most of them are more than 5-year experience. Only 34.1% or 28 tax practitioners have so. Table 5 shows the main result of the research. 61% or 63 of the respondents perceived that the existence of e-commerce has created a tax loophole especially in Malaysian scope of charge context.

Table 3. Academic qualification

Qualification	Academicians	Tax practitioners
Ph.D	7	0
Masters	13	8
Professional	2	43
Bachelor	0	18
Diploma	0	9
Other	0	4
Total	22	82

Table 4. Experience in tax environment

Duration	Academicians	Tax practitioners
> 10 years	4	13
8 - 10 years	3	3
5 - 7 years	6	12
2 - 4 years	7	27
< 2 years	2	27
Total	22	82

Table 5. The impact on scope of charge

Variables	Agree?	ACA	TP	Total	min	χ^2	p
V ₁	Y	18	45	60.6%	3.62	5.27	0.022*
	N	4	37	39.4%			
V ₂	Y	18	47	62.5%	3.59	4.44	0.035*
	N	4	35	37.5%			
V ₃	Y	16	42	55.8%	3.52	3.25	0.071
	N	6	40	44.2%			
V ₄	Y	18	45	60.6%	3.56	5.27	0.022*
	N	4	37	39.4%			

*Significant at p = 0.05

Whearas;

ACA - Academicians

TP - Tax practitioners

V₁ - E-commerce creates big tax loopholes

V₂ - certain income excludes from tax net

V₃ - derive and remittance is inappropriate in e-commerce

V₄ - Implementation worldwide scope of chare is better in e-commerce

As for now, the usage of derive and remittance basis makes some of the income generated from e-commerce transaction are excluded from current tax net. This statements supported by 62.5% or 65 respondents. Therefore, derive and remittance basis is inappropriate in e-commerce environment. 55.8% or 58 respondents perceived that current scope of charge should be revised to a better coverage scope such as worldwide basis. 60.6% or 63 respondents support this. For Chi Square test, all variables are significant at $p = 0.05$ ($V_1 = 0.022$, $V_2 = 0.035$ and $V_4 = 0.022$) unless for V_3 , $p = 0.071$. It implies that there were no different ideas among two groups of respondents.

CONCLUSION

According to the findings, Malaysian tax practitioners and academicians feel that the current scope of charge is no longer suitable in order to cope with new information technology explosion, especially in e-commerce transaction. They proposed to revise the current tax legislation so that it can be used to tax the virtual transaction accurately. Therefore, the respondents suggest to shift from 'derive and remittance' basis to 'worldwide' basis.

Based on worldwide basis, all income arise around the world will be taxed by regardless where the income is derived. In Malaysia for instance, the implementation of derive and remittance scope of charge since year assessment 1974 (before that, worldwide basis) has been successfully achieved. Collection of revenue is always increasing year by year. But, as e-commerce becomes a new phenomenon in people behavior, some of income could not successfully include in tax net if derive and remittance basis is used. For the time being, e-commerce transactions do not subject to tax in any country although many foreign researchers and tax administrators afraid with the impacts.

The problems raised by taxation of e-commerce are profound. Efforts to resolve them through modification and addition existing Malaysian tax structure, as confined by federal constitutional restraints are hopefully to meet with much success. If there is to be a sound resolution of these problems, it will have to come from a uniform legislative approach. Hopefully, federal and industry will be able to build on their important point of agreement, iron out their major point of disagreement, and forge a workable solution to many of the problems of taxing electronic commerce. Therefore, in order to cope with e-commerce tax problem, one of the alternatives is by using worldwide basis, so that all cross border income could be taxed.

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