



ROYAL MALAYSIAN CUSTOMS

GOODS AND SERVICES TAX

**GUIDE
ON
CONSTRUCTION INDUSTRY**

Publication

Date Published: 2 February 2016.

The Guide on Construction Industry revised as at 29 October 2014 is withdrawn and replaced by the Guide on Construction Industry revised as at 2 February 2016.

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INTRODUCTION

1. This industry guide is prepared to assist businesses in understanding matters with regards to GST treatment on Construction Industry. This Guide covers all contractors including self-employed individuals, partners, companies, local authorities and anyone carrying on a business which includes construction operations.

Overview of Goods and Services Tax (GST)

2. GST is a multi-stage tax on domestic consumption. GST is charged on all taxable supplies of goods and services in Malaysia except those specifically exempted. GST is also charged on the importation of goods and services into Malaysia.

3. Payment of tax is made in stages by the intermediaries in the production and distribution process. Although the tax would be paid throughout the production and distribution chain, only the value added at each stage is taxed thus avoiding double taxation.

4. In Malaysia, a person who is registered under the Goods and Services Tax Act 2014 (GSTA) is known as a “registered person”. A registered person is required to charge GST (output tax) on his taxable supply of goods and services made to his customers. He is allowed to claim back any GST incurred on his purchases (input tax) which are inputs to his business. Therefore, the tax itself is not a cost to the intermediaries and does not appear as an expense item in their financial statements.

GENERAL OPERATION OF THE INDUSTRY

5. The key players involved in the construction industry are:

(a) Developer

Acquires land and engages contractors to construct building or structure on the land;

(b) Main Contractor

Engaged by the developer to carry out the construction and he takes full responsibility for the completion of the construction project.

(c) Subcontractor

Engaged by the main contractor to perform portions of the main contractor's work. Subcontractors include specialists such as plumbers, electricians, painters and bricklayers.

6. Under Section F of the MSIC Code 2008, construction services include general construction and specialized construction activities for buildings and civil engineering works. It includes new work, repair, additions and alterations, the erection of pre-fabricated buildings or structures on the site and also construction of a temporary nature. The section encompasses amongst others the following activities:

(a) Construction of buildings

The general construction of all kinds of buildings including residential or non-residential buildings and any other miscellaneous buildings. It also involves any assembly and erection of pre-fabricated constructions on the site.

(b) Construction of civil engineering works

It consists of heavy constructions such as motorways, streets, bridges, tunnels, railways, airfields, harbours and other water projects, irrigations systems, sewerage systems, industrial facilities, pipelines and electrical lines, outdoor sports facilities, etc.

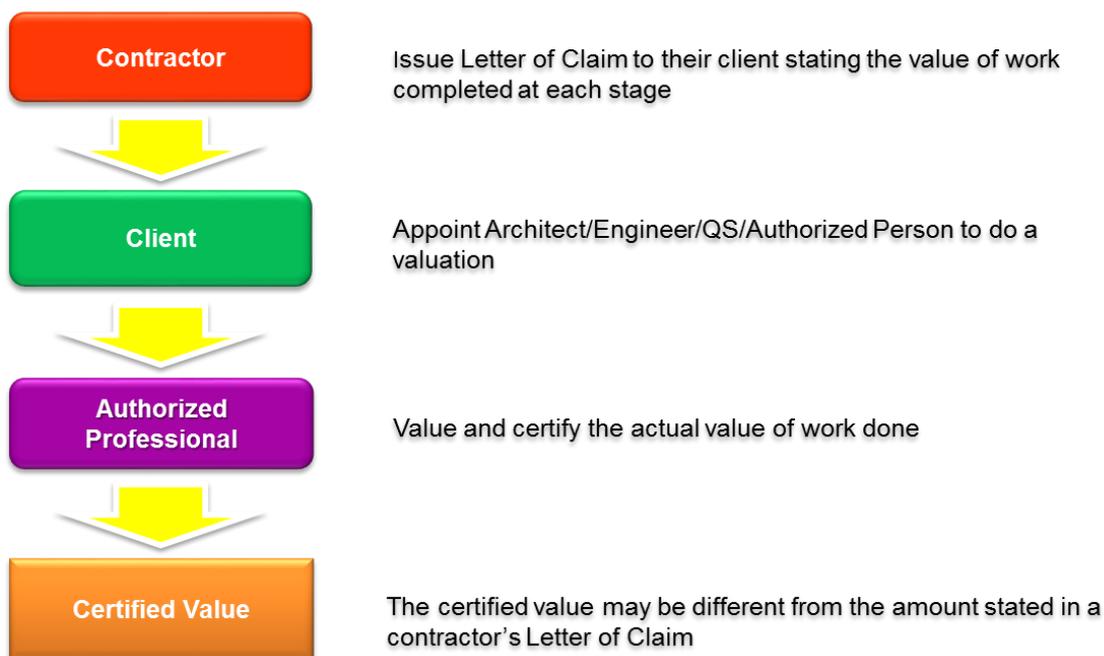
(c) Specialized construction activities

Special trades such as the construction of parts of buildings and civil engineering works without responsibility for the entire project. It includes demolition and site preparation works, electrical, plumbing and installation of all kind of utilities that makes the construction function as such, building completion and finishing works and other specialized construction activities.

7. All construction services performed in Malaysia are subject to GST. Hence, a contractor who is the registered person has to charge GST on the supply of construction services, whether in relation to residential and non-residential properties, in Malaysia.

8. The business flow and issuance of bill under the construction activities is as in the illustration below:

Business flow and issuance of bill under the construction activities



9. The contractor issues a letter of claim which will serve as a bill for payment to the client stating the value of work completed at each stage of the construction. The client will then get either an architect or engineer (or an authorized person) to do a valuation and certify the actual value of work done. This certified amount by the authorized person can be different from the amount stated in the letter of claim issued by the contractor.

Time of Supply

10. Generally, a contractor will issue a letter of claim to the client based on the schedule of progressive payment expressed in the contract or agreement between

parties. This letter of claim will indicate the progress of construction services rendered and the value of the work done.

11. The time of supply is the time at which supplies made by the provider of the construction services is treated as having taken place. However, the rules under Regulation 11 of GST Regulations 2014 (GSTR) will determine when output tax is to be accounted on any considerations to be received.

12. Regulation 11 of the GSTR has identified time of supply is based on two situations:

- (a) Where the construction work does not require the issuance of a certificate in relation to any work done, time of supply for GST is at the earlier of the following:
 - (i) when a tax invoice is issued; or
 - (ii) when a payment (wholly in money) is received

When a contractor issues a letter of claim to the client based on the schedule of progressive payment, the letter of claim must be issued in the form of tax invoice as required under Section 33 of the GSTA and must indicate the amount payable for the service.

- (b) Where the construction work requires the issuance of a certificate in relation to any work done, the certificate is usually issued after the letter of claim has been released by the contractor to the client. Therefore, the time of supply for GST is as follows:
 - (i) when the tax invoice is issued within 21 days after the certificate in relation to any work done is issued, the time of supply is the date of the tax invoice issued.
 - (ii) when the tax invoice is issued after 21 days after the certificate in relation to any work done is issued, the time of supply is the date of the certificate is issued.
 - (iii) when the payment is received or tax invoice is issued before the

certificate in relation to any work done is issued, the time of supply is treated as taken place when the payment is received or tax invoice is issued, whichever is the earlier.

13. Where a certificate is required, the letter of claim cannot be treated as a tax invoice as required under Section 33 of the GSTA, as only the certificate is held valid to verify the progress of the work done. A contractor who is the registered person should issue a tax invoice to his customer upon certification by the authorized person and he is required to attach the certificate in relation to any work done issued together with his tax invoice to support the value invoiced to the client.

14. In considering the time of supply for construction services which relates to payment received, the consideration for the payment must be wholly in money. The time of supply in Regulation 11 will not trigger if goods or services are received as payment. If the consideration received is in the form of goods or services, then the normal rule for the time of supply of services shall apply i.e. when the services is performed.

Value of Supply

15. The value of a supply is the value on which GST is chargeable. The amount of GST is the value chargeable multiplied by the tax rate. Subject to Section 15 and the Third Schedule of GSTA, the value of supply depends on whether there is a consideration or not. A consideration is any form of payment in money or in kind, including anything which is itself a supply.

16. If the consideration for the supply is in kind (either partly or totally not in monetary form), the consideration has the value of the monetary payment which can be established. This monetary payment will then be used in determining the value of the supply. Please refer the specific Guide on Valuation.

17. Supply of services with no consideration is implied as not a supply. Nevertheless, it is a supply of services if the service is rendered with no consideration to a connected person as stipulated under Paragraph 6 of the First Schedule of GSTA. The value of the supply is the open market value as indicated under Paragraph 1(2) of the Third Schedule of GSTA

18. When a GST registered contractor quotes in any manner the price of his services, it shall be inclusive of GST as required under Section 9(5) of the GSTA. Otherwise, he is required to apply to the Director General for approval if he intends not to quote the price inclusive of GST as required under Section 9(6) and (7) of the same act. If he contravenes the provision, he commits an offence. Please refer to specific Guide on Valuation.

Retention Sum

19. Most of the construction contracts provide a provision to retain part of the amount of consideration (known as “retention sum”) due to the contractor(s). Retention sum is the amount of progress payment which is not paid until the conditions specified in the contract for the payment of such amounts have been met or until defects have been rectified.

20. Construction contracts provide for a contractor to render progress payments as work on a contract progresses where the contractor will be paid, usually after the relevant part of the work has been satisfactorily completed, as certified. Such contract allows the client to withhold a percentage from the payment of each progress payment pending satisfactory completion of the entire contract. This retention amount is a specified amount withheld at each stage of progress payment, and will only be released to the contractor when the customer is satisfied with the work performed. Usually, retention sums are released only after the construction project has been completed or at the expiry of the defect liability period.

21. For GST purposes, a retention sum will be treated as a supply when a payment in respect of such amount is received or a tax invoice for such retention sum is issued by the contractor, whichever is the earlier.

Liquidated and Ascertained Damages

22. Liquidated and Ascertained Damages (LAD) means a fine or compensation imposed to a contractor or supplier who fails to fulfil a contractual obligation as stipulated in the contract. Among the failures to meet contractual obligations that can be subjected to LAD are as follows:

- (a) delay in completing a project that is not in accordance with the schedule specified in the contract; and
- (b) delay to supply or failure to supply or quality of services supplied not according to the specifications in the contract.

23. Failure to deliver the completed construction work within the stipulated time will result in such contractors being liable to pay the client liquidated damages for the period during which the relevant works remain incomplete.

24. Any compensation for poor work done, late delivery penalty, liquidated damages etc. which due to delay in completion of the construction project are normally outside of the scope of GST as they are not a consideration for a supply. This is because the payments are made through an agreement between the parties involved to compensate one party for suffering some inconvenience, loss or damage.

Rectification of Defect

25. Rectification of defect is one of the provisions in the construction contract. It is allowed even after the issuance of Certificate of Practical Completion (CPC) or after the purchaser has taken the possession of the property. Under the contract, the contractor is liable to rectify the defects that appear between the period of CPC is issued and the expiry of the Defect Liability Period (DLP). Hence, such rectification of defect is compensatory in nature, and cannot be treated as taxable supplies.

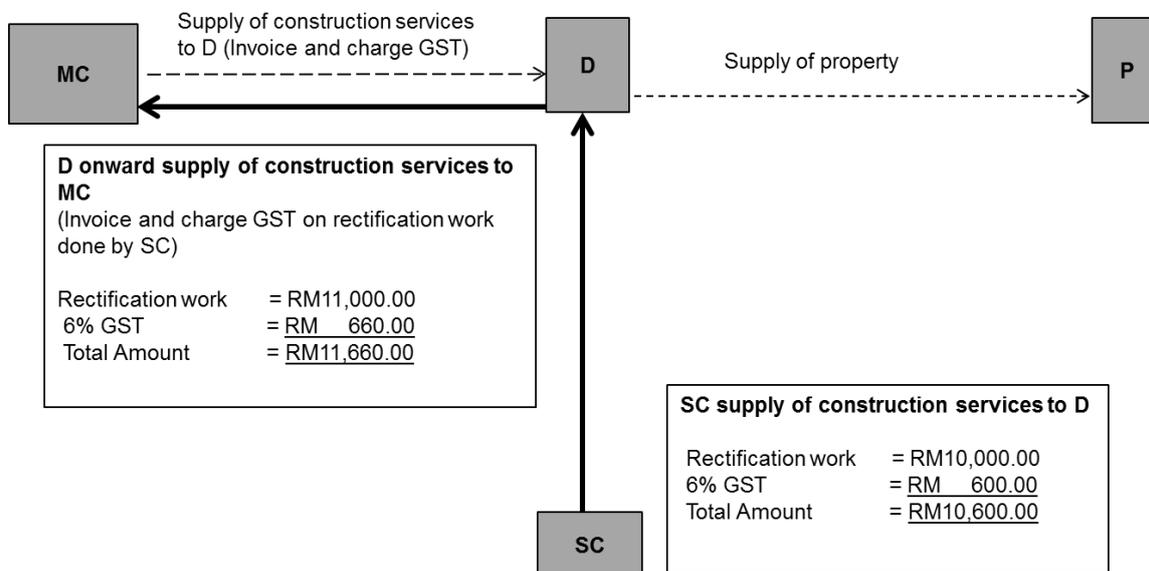
26. However, if the contractor fails to rectify the defects and another contractor is hired by the client to rectify the poor workmanship done, the additional cost incurred may be subjected to GST. If the second contractor is a GST registered person, he will charge GST to the client on the work done. The client will in return recharge the amount (with or without margin added) to the first contractor by deducting the charges from any payment due to the first contractor and this amount is also subjected to GST.

Illustration 1:

The developer ("D") hires another sub-contractor ("SC") to do the rectification. As such, the sub-contractor ("SC") is supplying his construction services to ("D"). If the sub-contractor ("SC") is registered for GST, he has

to charge ("D") GST on the rectification works performed. ("D") then makes the onward supply of the construction services to the main contractor ("MC"). ("D") has to charge ("MC") GST on the said works.

Rectification Work By Subcontractor Appointed By Client



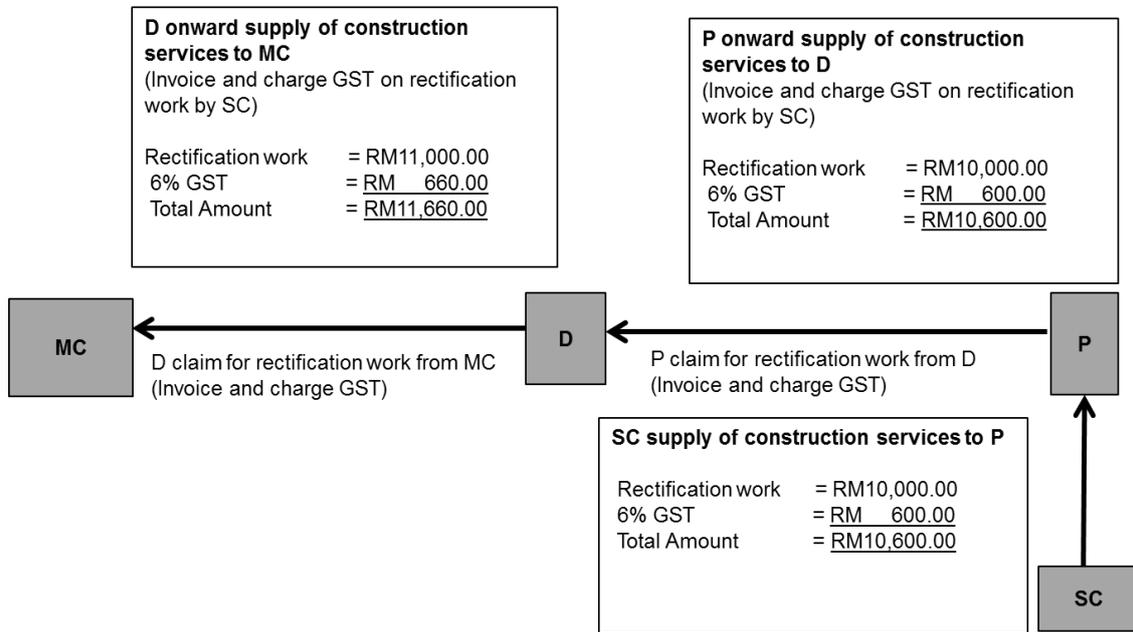
27. In another scenario, there could be separate contracts involving parties in relation to rectification works to be done; firstly a contract of construction work between the developer and the contractor and secondly, another contract to supply the building between the developer and the purchaser. If there is any rectification works undertaken by the purchaser by engaging his own contractor, he may recover such cost from the developer. If the purchaser is a GST registered person, such recovery of cost is subject to GST. In return, the developer may recharge the amount (with or without margin added) to the first contractor by deducting the charges from any payment due to the first contractor and this amount is also subjected to GST.

Illustration 2:

If the purchaser ("P") hires his own sub-contractor ("SC") to rectify the defects, there is a supply from the purchaser ("P") to the developer ("D") because the purchaser ("P") is making good the defects that should have been done by ("D"). If the purchaser ("P") is registered for GST, he has to charge ("D") the GST on the cost of the rectification works carried out by his

subcontractor ("SC"). "D" will in turn onward supply this construction service to the main contractor ("MC") and charge him GST accordingly. Please refer to Q26 for details.

Rectification Work By Subcontractor Appointed By Purchaser



FREQUENTLY ASKED QUESTIONS

Registration

Q1. Who is liable to be registered?

A1. All contractors and sub-contractors in the construction industry, whether they are companies, partnerships or self-employed individuals are liable to be registered if their annual turnover involving taxable supplies exceeds the prescribed GST threshold in the past 12 months or within the future 12 months.

Q2. If my annual turnover of taxable supplies does not exceed the GST threshold, can I apply to be registered?

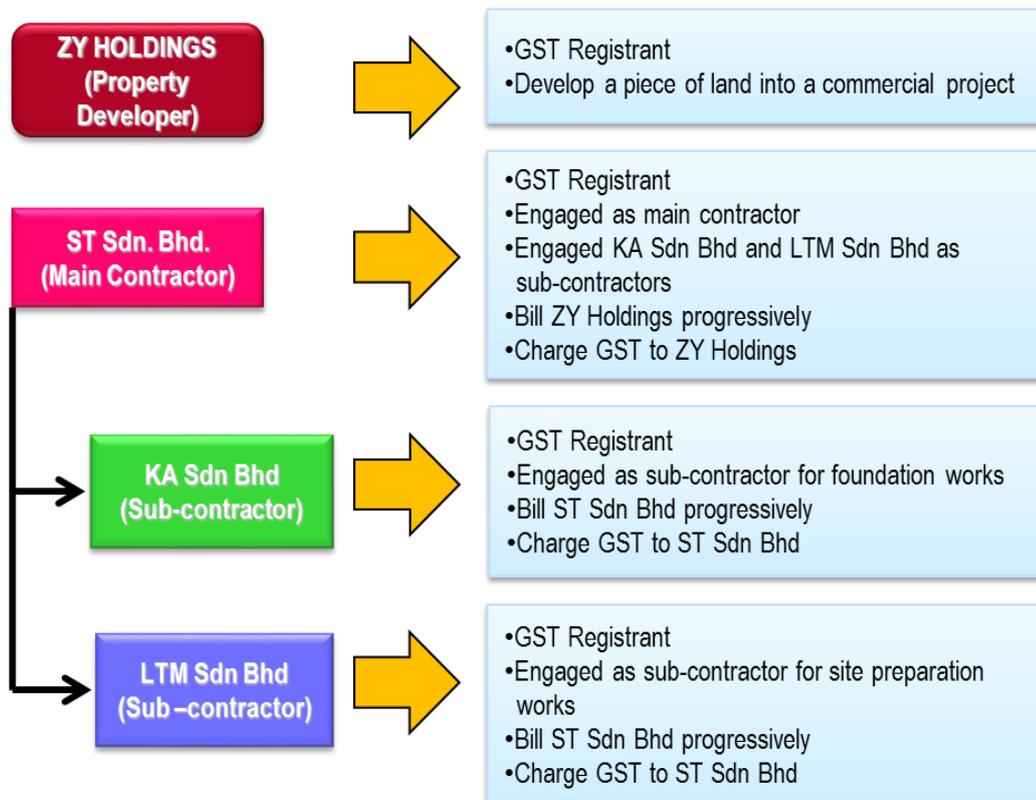
A2. You may apply for voluntary registration, but once registered you must remain registered for a minimum of two years.

Taxable Supplies

Q3. What supplies are subject to GST in the construction industry?

A3. Construction services are standard rated supply. All types of construction services including construction of residential houses or agricultural buildings are subject to GST.

The illustration below shows the supply of the construction services:



Example 1:

A property developer, ZY Holdings acquired a piece of land in Kuala Lumpur to be developed into commercial properties. He engaged a main contractor, ST Sdn. Bhd. to be fully in charge of the project. As the main contractor, ST Sdn. Bhd. engaged subcontractor KA Sdn. Bhd. for site preparation work and subcontractor LTM Sdn. Bhd. for foundation work on such project.

KA Sdn. Bhd. and LTM Sdn. Bhd. as the subcontractors billed ST Sdn. Bhd. progressively for their work done. As both are registered under GST Act, they will have to charge GST on the amounts billed to ST Sdn. Bhd. for the work performed.

ST Sdn. Bhd. bills ZY Holdings progressively for the work done for the whole project. Upon certification by ZY Holdings' architect, ST Sdn. Bhd. will bill ZY Holdings for the agreed amount of work done. GST is chargeable on all these amounts if ST Sdn. Bhd. is a person registered under Section 20 of GSTA.

Q4. What charges are subject to GST in the construction industry?

A4. The charges which are subjected to GST include the value of all works and materials permanently incorporated in or affixed on the site of the building or construction project, and any other movable goods that the contractor may charge to the customer.

Example 2:

KLM Sdn. Bhd. awarded a contract to DEF Construction Sdn. Bhd. to build a commercial building. Under the contract agreement, the value of construction services including the value of materials and work done is RM60,000.

The total amount of GST chargeable is RM3,600 (RM60,000 X 6%).

However, if the contractor gives to the customer movable furniture and charges him separately over and above the contracted amount, this charge is also subject to GST. If he charges the customer RM2,000, he also has to charge GST of RM120 (RM2,000 X 6%).

Time of Supply and Accounting Period

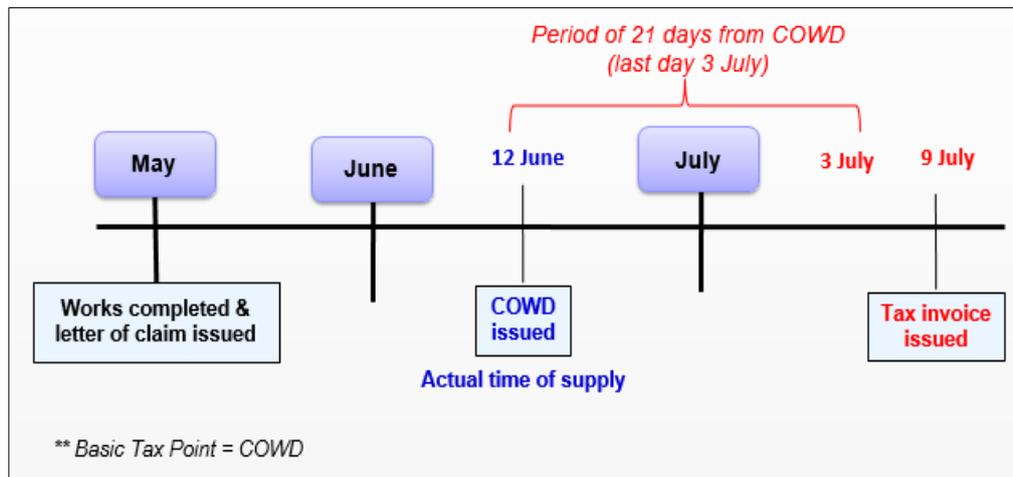
Q5. When do I have to account for GST?

(a) If the issuance of certificate is not required

Assuming you are on a monthly taxable period, if you issue a tax invoice on 15 June and receive a payment for that invoice later on 3 July, you have to account for GST in your June GST return since the tax invoice is earlier than the payment received. However, if you receive the payment earlier than the issuance of the tax invoice e.g. on 25 May, then you have to account your GST in the May GST return. Refer Regulation 11(a) of GSTR.

(b) If the issuance of certificate is required

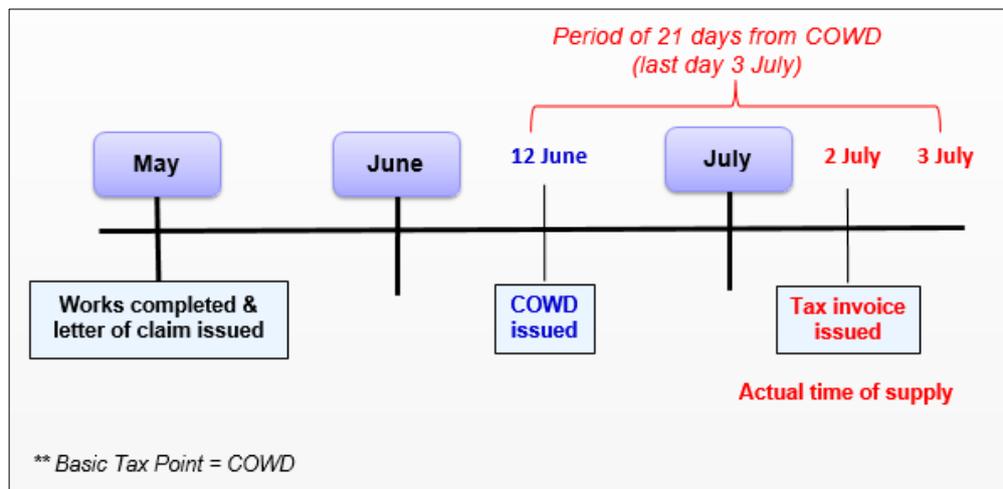
Assuming you is on a monthly taxable period:



Scenario 1:

- Certificate of work done (COWD) issued on 12 June
- Tax invoice issued on 9 July (more than 21 days after COWD)

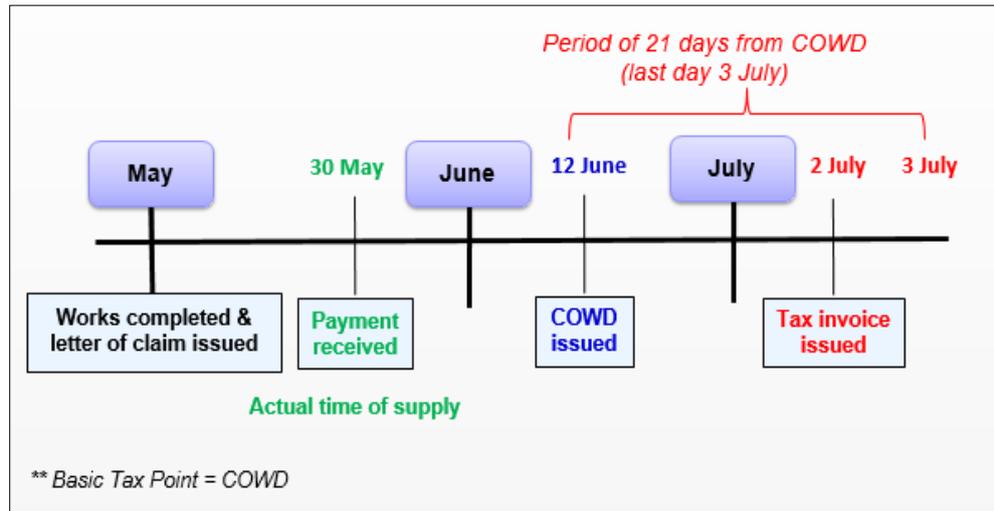
Therefore, GST has to be accounted in June GST return (based on the date of the certificate is issued). Refer Regulation 11(b) of GSTR.



Scenario 2:

- Certificate of work done (COWD) issued on 12 June
- Tax invoice issued on 2 July (within 21 days after COWD)

Therefore, GST has to be accounted in July GST return (based on the date of the invoice is issued). Refer Regulation 11(c) of GSTR.



Scenario 3:

- Certificate of work done (COWD) issued on 12 June
- Tax invoice issued on 2 July (within 21 days after COWD)
- Payment received on 30 May

Therefore, GST has to be accounted in May GST return (based on the date of payment received). Refer Regulation 11(c) of GSTR.

Q6. When do I have to submit GST payment to Customs?

A6. GST payment should be submitted on or before the last day of the month subsequent to the taxable period. If you are on a monthly taxable period, the last date to submit a June GST return and its payment is on the last day of July. If you are on a quarterly taxable period, the last date to submit an April-June GST return and its payment is on the last day of July.

Place of Supply

Q7. If I have a construction business established outside Malaysia, do I have to account for GST?

- A7. No. If the business is established outside Malaysia, the supply made outside Malaysia is considered as out of scope.

Example 3:

X, a foreign contractor registered outside Malaysia provides construction services in Singapore. The supplies provided by X are regarded as out of scope and is not subject to Malaysian GST.

- Q8. I am a contractor who established in Kuala Lumpur and provides construction services on the islands of Langkawi, Tioman or Labuan. Do I have to account for GST?**

- A8. Any contractor who established in Malaysia (excluding Designated Areas (DAs) which are Langkawi, Tioman or Labuan) and make any construction services in the DAs are subjected to GST.

On the other hand, a contractor who established in the DAs and supply construction services in Malaysia (exclude DAs) is required to charge and account for GST if the supply exceeded the prescribed threshold.

Supply of construction services between or within DAs is not subject to GST.

- Q9. If I am registered in Malaysia and provide construction services outside Malaysia, is the supply subject to GST?**

- A9. Yes, this type of supply is a taxable supply but it is zero-rated. You charge your customer the GST at zero-rates percent, and you are eligible to claim input tax for all supplies related to such construction services.

Example 4:

Y, a local contractor provides contract works outside Malaysia. The value of the contract works is RM100,000. The GST to be charged is zero. In the course of providing the above the contract works, Y incurred input tax in the form of materials to be used or incorporated into the contract works. The value of the materials is RM50,000 and the GST incurred was RM3,000 (RM50,000 X 6%). Y is eligible to claim the

RM3,000 as his input tax.

Progress Payment

Q10. When and how do I account for GST for progressive payment contracts which involve the issuance of the certificate in relation to any work done?

A10. GST has to be accounted for after the end of each successive progressive payment schedule and after you received the certificate in relation to any work done (progress certificate) from the architect, engineer or surveyor who values the amount of construction work done. For further information on how to determine your time of supply, please refer to Paragraph 13 of this guide.

Example 5:

A contractor, AB Sdn. Bhd. enters into a construction contract to construct a project for BC Sdn. Bhd. Such construction contract entered by both parties allows BC Sdn. Bhd. to withhold 5% from the payment of each progress billings pending satisfactory completion of the entire contract as a retention sum. It also stipulates that the work is scheduled for 4 successive intervals and the estimated value of the contract work is as follows:

Date of claim	Estimated Value by contractor	Certified Value	Accumulated Certified Value
1 st interval (31 March 2016)	RM40,000.00	RM30,000.00	RM30,000.00
2 nd interval (30 June 2016)	RM100,000.00	RM90,000.00	RM120,000.00
3 rd interval (30 Sept 2016)	RM160,000.00	RM150,000.00	RM270,000.00
4 th interval (31 Dec 2016)	RM300,000.00	RM300,000.00	RM570,000.00

AB Sdn. Bhd. issues the letter of claim for the respective dates and amounts as above.

The architect issues such progress certificate after each interval period as follows:

Progress Payment – 1st interim certificate

Value of material and works	=	RM30,000.00
Less: Retention sum (RM30,000 X 5%)		(RM1,500.00)
Amount Paid		RM28,500.00

Progress Payment – 2nd interim certificate

Value of material and works	=	RM120,000.00
Less: Retention sum (RM120,000 X 5%)		(RM6,000.00)
Less: 1st interim certificate		(RM28,500.00)
Amount Paid		RM85,500.00

Progress Payment – 3rd interim certificate

Value of material and works	=	RM270,000.00
Less: Retention sum (RM270,000 X 5%)		(RM13,500.00)
Less: 1st interim certificate		(RM28,500.00)
2nd interim certificate		(RM85,500.00)
Amount Paid		RM142,500.00

Progress Payment – 4th interim certificate

Value of material and works	=	RM570,000.00
Less: Retention sum (RM570,000 X 5%)		(RM28,500.00)
Less: 1st interim certificate		(RM28,500.00)

<i>2nd interim certificate</i>	<i>(RM85,500.00)</i>
<i>3rd interim certificate</i>	<i>(RM142,500.00)</i>
Amount Paid	RM285,000.00

The contractor, AB Sdn. Bhd. received the respective amounts as follows and has to account GST accordingly:

1st interval

<i>Payment received</i>	=	<i>RM28,500.00</i>
<i>Invoiced issued</i>		<i>12 April 2016</i>
<i>GST (RM28,500.00 X 6%)</i>		<i>RM1,710.00</i>

2nd interval

<i>Payment received</i>	=	<i>RM85,500.00</i>
<i>Invoiced issued</i>		<i>18 July 2016</i>
<i>GST (RM85,500.00 X 6%)</i>		<i>RM5,130.00</i>

3rd interval

<i>Payment received</i>	=	<i>RM142,500.00</i>
<i>Invoiced issued</i>		<i>16 October 2016</i>
<i>GST (RM142,500.00 X 6%)</i>		<i>RM8,550.00</i>

4th interval

<i>Payment received</i>	=	<i>RM285,000.00</i>
<i>Invoiced issued</i>		<i>31 January 2017</i>
<i>GST (RM285,000.00 X 6%)</i>		<i>RM17,100.00</i>

The contractor accounts for GST based on the date the payment is received. In the above example, the contractor AB Sdn. Bhd. has to account for GST on the values and dates as stated above, that is account

for GST of RM1,710.00 on 12 April 2016 for the first interval, account GST of RM5,310.00 on 18 July 2012 for the second interval, and so on.

Q11. How do I account for the GST if my client has paid less than the amount stated in the letter of claim?

A11. If you issue a tax invoice equivalent to the amount as stated in the letter of claim prior to the issuance of the certificate of work done (COWD), GST shall be accounted for according to the tax invoice.

However, if the client later pays the contractor based on the amount of COWD, which is less than the amount in the tax invoice, you may issue a credit note and make an adjustment in the GST return of the relevant taxable period. In this scenario, the contractor shall reduce the amount of output tax and the client shall reduce the input tax declared in his return for the taxable period in which the credit note was issued.

Example 6:

You issued a tax invoice for services performed amounting to RM80,000 based on your letter of claim and account for the GST. However, the amount that should be due to you based on the client's certificate was estimated to be RM70,000. In this situation, you may issue a credit note for the difference of RM10,000 and make an adjustment in the GST return accordingly.

Payment Not In the Form of Money

Q12. How do I account for the GST when payment is not in the form of money?

A12. You have to account for the GST based on the open market value of the consideration received.

Example 7:

You provide construction services valued at RM5,000. In return, your client gives you furniture. The open market value of the furniture is

RM5,200. You account GST based on RM5,200 (GST inclusive) in the following manner:

$$GST = RM5,200 \times \frac{6}{106}$$

$$GST = RM294.34$$

Input Tax Credit

Q13. Can I claim input tax for the services related to the supply of construction project? For example, professional services of architects.

A13. Yes, you can claim input tax on services incidental to the construction project regardless whether the project is residential housing or commercial building. This is because all construction services are standard rated. However, if you are a developer of residential properties and supply such construction services on such project, you cannot claim input tax because the supply of residential house is an exempt supply.

Q14. Can I claim input tax credit on landscaping work constructed on the residential property which is required by Planning Authorities?

A14. Yes, you can claim input tax credit because the inputs are attributable to a taxable supply. All construction services done in Malaysia are subject to GST, regardless of whether such services is in relation to residential or non-residential properties and such services may include landscaping services constructed by the contractors. GST will be imposed on the supply of such services at the standard rate even though residential properties are exempt supplies.

Q15. Can I claim input tax on built-in furniture supplied together with the construction of the building?

A15. Yes, if you are a contractor you can claim input tax if the built-in furniture is supplied by you in the course of the construction project. Any furniture and fittings that are supplied together with the construction of the building are subject to GST.

Contra Payment or Counter Supplies.

Q16. I provide construction services to a landowner who in return (after completion) leases the land and building to me for a period of 5 years. Can I contra the payment of the construction services with the lease payment? When do I have to account for GST?

A16. No, there are 2 supplies involved; the supply of construction services from the contractor to the landowner and the second supply is the leasing services made by the landowner to the contractor.

The contractor has to account GST on his construction services based on the consideration he received i.e. the open market value of the 5 years lease of the land and building. The time to account GST is when the lease is given to the contractor.

On the other hand, the landowner has to account for the leasing services based on the consideration he received i.e the open market value of the construction services. Since the 'payment' for the lease is the completed building, the time of supply of the leasing services is upon the completion of the construction by the contractor.

Both the landowner (if taxable person) and the contractor should issue a tax invoice for the gross value of the supply made to each other and account the GST accordingly. It is incorrect to contra the payment of the construction services with the lease payment. The contractor as GST registrant has to charge the landowner the GST for the supply of construction services and account it as the output tax which in return the landowner can recover as input tax credit. The landowner, on the other hand also has to charge GST to the contractor for the leasing services and account it as his output tax which in return the contractor may recover it as his input tax.

Q17. I provide construction services to a landowner who in return gives to me 20 units of the commercial building. How and when do the landowner and I have to account for GST?

A17. As a contractor, you have to account for GST on the open market value of the 20 units of the commercial building. The time to account is when the building was given or made available to you. The landowner (if GST registered) would account for GST on the open market value of the construction services provided by you. The landowner has to account for GST when the construction services are completed.

Q18. The client purchased and supplied the contractor with building materials and workers. Can the contractor deduct the value charges for these supplies from the value of progressive payments due to him?

A18. No, there are two separate supplies in this instance; the supply of building materials and workers from the developer to the contractor and the second supply made by the contractor to the client for the construction services. Both the client and contractor should issue a tax invoice for the gross value of the supply made to each other and account the GST accordingly. Hence, it is incorrect for the contractor to charge and account the output tax based on the net amount paid by the developer being the net value of construction services against the cost of the building materials and workers wages. The client (developer) as a GST registrant has to charge the contractor the GST for the supply of building materials and workers which the contractor can recover as input tax credit.

Q19. In relation to the question above, how should the client and contractor account for the GST?

A19. Assuming the developer, DK Sdn. Bhd. supplies building material and workers amounting to RM50,000 to his contractor ZH and the progressive payment due for ZH's construction services to DK is RM100,000

(a) On the part of the client (developer):

DK Sdn. Bhd. has to issue ZH a tax invoice of RM40,000 and account for GST amounting RM2,400 (RM 40,000 X 6%).

(b) On the part of the contractor:

ZH has to issue tax invoice of RM100,000 to DK Sdn. Bhd. and account for the output tax of RM6,000 (RM100,000 X 6%). ZH may recover the GST of RM 2,400 as his input tax.

Construction Works Relating To Exempt Properties.

Q20. Supplies in a form of sale, lease or rental of residential properties are exempted from GST. Does it mean that all construction works related to such residential properties, being an exempt supply, are exempted from GST too?

A20. No. All construction services are subject to GST, irrespective of the types of property where the construction works are carried out. Construction works related to residential properties will also be standard rated even though residential properties are exempt supplies.

Retention Amount

Q21. The construction contract allows the client such as the developer or an individual to withhold a percentage from the payment of each progress payment pending satisfactory completion of the entire contract. Is this withholding or the retention amount subjected to GST?

A21. The retention amount is not subjected to GST until the money is released to the contractor. The amount of the progress billings, excluding retention money, has to be accounted for GST based on the date the payment is received as stated in the construction contract entered. For retention amount/sum, the contractor has to account for GST after he received the money. Normally, construction contracts which have been agreed by both parties normally provide for a contractor to render, from time to time, progress billings as work progresses. Such contracts also normally stipulate that the contractor be paid, usually after the relevant part of the work has been satisfactorily completed, as certified by the client, the client's architect or engineer. It may also require the client to withhold a percentage from the payment of each progress billings pending satisfactory completion of the entire contract. The retention money/sum

withheld is not paid to the contractor until the conditions for the payment of the money or sum as specified in the contract are met.

Example 8:

A contractor BB Sdn. Bhd. enters into an agreement to construct a project for BC Sdn. Bhd. and the project cost is RM84,000. The construction contract entered by both parties allow BC Sdn. Bhd. to withhold 5% from the payment of each progress billings pending satisfactory completion of the entire contract as a retention sum. It also stipulates that the work is scheduled for 2 successive intervals. In his billing BB Sdn. Bhd. will have to account for GST as follows:

Progress Payment - 1st interim certificate

Value of material and works	=	RM30,000.00
Less: Retention sum (RM30,000 X 5%)		(RM1,500.00)
Amount Paid		RM28,500.00
GST (RM28,500 X 6%)		RM1,710.00

Progress Payment – 2nd interim certificate

Value of material and works	=	RM84,000.00
Less: Retention sum (RM84,000 X 5%)		(RM4,200.00)
Less: 1st interim certificate		(RM28,500.00)
Amount Paid		RM51,300.00
GST (RM51,300 X 6%)		RM3,078.00
Total retention sum		RM5,700.00
GST on retention money/sum		RM342.00

Q22. When do I have to account GST for the retention sum?

A22. You have to account for GST after you receive the amount of retention sum, or when you issue an invoice related to the retention sum, whichever is the earlier.

Example 9:

Based on Example 10, the retention amount is RM5,700 exclusive of GST. You must account for GST of RM342 (RM5,700 X 6%) after you received that amount from your client, or when you issue an invoice for the retention sum.

Q23. When can my client claim input tax on retention sum?

A23. When the retention sum is released to you and you issue him a tax invoice, or when you issue him a receipt of payment.

Damages and Out of Court Settlement

Q24. What is GST treatment for damages and out of court settlements?

A24. Damages and out of court settlements which are paid for the breach of warranty or delays in completion of a contract, are compensatory in nature. Hence, such settlements cannot be treated as taxable supply and GST need not be charged for such recovery. However, GST is chargeable for settlements that are payments for taxable supplies made.

Liquidated Damages

Q25. Are liquidated damages such as delay in completion of work subject to GST?

A25. No, liquidated damages due to delay in completion of the construction project are not subject to GST.

Example 10:

The Main contractor, AMC Sdn. Bhd., did not complete the building project by the stipulated completion date stated in its contract with its developer, DEC Pemaju Perumahan. It is required to pay liquidated damages to the DEC Pemaju Perumahan at a rate of RM3,000 per calendar day (including Sundays and public holidays) for every day

where the completion of the project is delayed. Such liquidated damages are not subject to GST as it is compensatory in nature.

Rectification of Defect

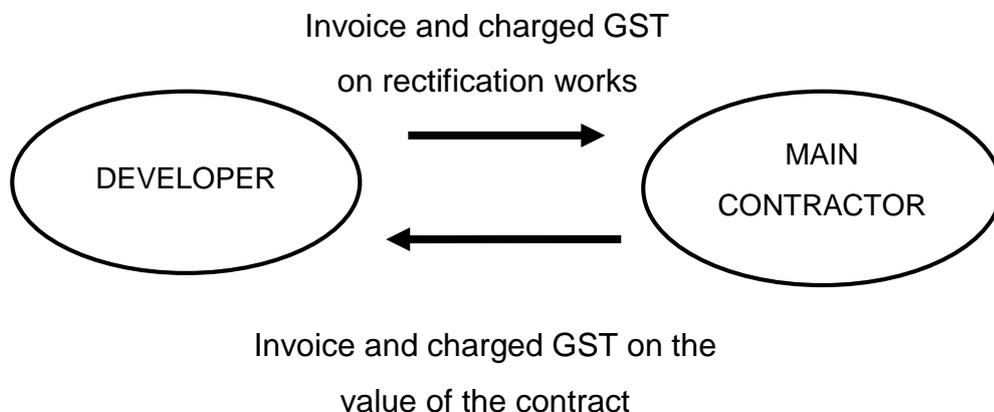
Q26. Under the contract, the main contractor is required to carry out rectification works during the defect liability period. However, since the main contractor did not want to rectify this defect, another contractor is hired by a client to rectify the poor workmanship done by the main contractor and, as a result, the additional cost is incurred. What is the GST treatment on this?

A26. The client can recover the amount for rectification of defect in two ways:

- (a) Deduct the cost of rectification work from the retention sum.

Such supplies will be treated as two separate supplies. One supply is from the main contractor for completing the entire job (though not entirely to the client's satisfaction) on the full value of the contract (including the retention sum).

Another supply is from the client to the main contractor for the full value of the rectification works because the client is making good the defects that should have been done by the main contractor.



- (b) Claim payment from the main contractor.

The client may go to court to seek payment from the main contractor for the rectification cost, or this may be agreed by an out-of-court settlement. Such payment is subject to GST as it is in relation to taxable supplies made from the client to the main contractor for making good the defects which should have been rectified by the main contractor. The main contractor should still charge the client GST on the full value of its supply, and the client should charge the main contractor GST for the rectification works, similar to (a).

Q27. What is the GST treatment if the compensation only relates to the poor work done and does not involve any rectification works?

- A27. If no rectification work is going to be carried out and the client is only claiming compensation from the main contractor for the poor work done, such compensation is not subject to GST as there is no supply made. The main contractor will still have to bill the client for the full value of the contract including the retention sum.

Please refer to Paragraph 19 to 21 of this Guide.

Tender, Liquidated Damages and Contract Deposits

Q28. Are tender and contract deposits subject to GST?

- A28. (a) The deposit for payment of tender documents is subject to GST because it involves the supply of goods.
- (b) No GST is payable if the deposit serves as a security to ensure the contractor proceeds with the contract or to ensure that the contractor carries out all the obligations detailed in the contract.
- (c) Yes, if a deposit is intended to be used to offset against the future payments (partly or fully) once the supply has been made, GST is chargeable on such a deposit.

Example 11:

A property developer, DZ Sdn. Bhd., calls for main contractors to tender for a large scale project in Puchong. Interested tenderers have to purchase the tender documents containing details of the project (e.g., plans, specifications, schedule of quantities) for a fee of RM250. This fee is non-refundable and is subject to GST as it is a sale of tender documents. GST should be charged on this supply.

DZ Sdn. Bhd. then awards the building contract to the main contractor, MS Sdn. Bhd. MS Sdn. Bhd. is required to submit a security deposit in the form of a banker's guarantee of 5% of the contract sum for non-performance. This deposit will be refunded upon the completion of the contract. This security deposit is not subject to GST as there is no supply made.

Since this is a large-scale project, DZ Sdn. Bhd. is required to give MS Sdn. Bhd. an advance payment (akin to a deposit) which will be used to offset against future progress payments. GST should be charged on this advance payment.

Bad Debts

Q29. What will happen if my customer does not pay me after I have issued tax invoice after completion of work?

A29. You can claim bad debts relief on the GST output tax paid in respect of taxable supplies. The GST portion of the bad debt can be recovered subject to certain conditions:

- (a) The tax is already paid;
- (b) You have not received any payment 6 months after the supply has been made, or the debtor has become insolvent; and
- (c) Sufficient efforts have been made by you to recover the debt.

Q30. Do I have to make a formal claim to recover GST due to bad debts?

A30. No, you only need to make an adjustment by increasing your input tax in your GST return after you have satisfied all the conditions for bad debt relief.

Q31. What happen if my customer pays me back the bad debt after I have claimed bad debt relief?

A31. You have to make an adjustment by increasing your output tax in your GST return.

Supply of Workers or Services of Personnel from Overseas

Q32. What is the GST treatment if I were to employ workers or services of personnel from overseas?

A32. The treatment is as follows:

- (a) If the foreign worker works for you under a contract of employment, it is not subject to GST.

Example 12:

DEF Sdn. Bhd. is a registrant and hires foreign workers under a contract of employment to work in their company. This supply of foreign worker is not subjected to GST.

- (b) If you further supply the foreign workers under your employment to another company, then GST is chargeable

Example 13:

ABC Sdn. Bhd. is a contractor that has a pool of foreign workers. XYZ Sdn. Bhd. requires workers in his construction industry. ABC Sdn. Bhd. provides foreign workers to XYZ Sdn. Bhd. in return for payment. Therefore ABC Sdn. Bhd. should charge GST when they provide foreign workers to XYZ Sdn. Bhd.

- (c) If a foreign consultant does work for you but is not under your contract of employment, you have to account for GST by reverse charge mechanism. Under this mechanism, the GST liability shifts from the

supplier to the recipient if the recipient's fixed or business establishment or his usual place of residence is in Malaysia. Hence, as the recipient of the services, the contractor is liable to account GST on the supply made for the purpose of any business.

When such contractor receives a supply of imported services for the purpose of business, he is treated as if he is making and receiving the supply. Since he is treated as making a supply, he is required to account GST on the supply of imported services as his output tax. Since, construction services is a taxable supply, the contractor is entitled to claim the GST incurred as his input tax and have to declare both input tax and output tax in his GST return. The contractor as the recipient of the services is liable to pay the tax not later than the last day of the month following after the end of his taxable period where the payment for the supply of imported services is made to the supplier.

Example 14:

KK Sdn. Bhd. hires a foreign consultant in building a bridge. Payment to the foreign consultant will be subject to GST. KK Sdn. Bhd. has to account for it by reverse charge mechanism. Reverse charge mechanism will shift the GST liability from the supplier to the recipient. Thus, when KK Sdn. Bhd. receives a supply of imported services (foreign consultant) for the purpose of business i.e. to construct a bridge, he is treated as if he is making and receiving the supply of consultancy services. Since he is treated as making a supply, he is required to account GST on the supply of imported services as his output tax. As construction services is a taxable supply, KK Sdn. Bhd. is entitled to claim the GST incurred as his input tax.

Contracts

Q33. Are contracts signed which span the transitional period (pre and post-GST implementation date) liable for GST?

A33. The value of contract works performed before GST implementation is not subject to GST. However, the value of contract works performed after GST implementation date will be subjected to GST.

Q34. What are the consequences if I do not a make a provision to include the element of GST in my contract?

A34. Failure to include the GST provision may result in the contractor if he is registered under GST, unable to recover the GST from the client.

Transitional Provisions

Q35. I bought goods that were subject to sales tax and I still have these goods in my trading stocks on 1 April 2015. Can I be refunded for the amount of sales tax paid on those goods?

A35. If you are registered under GST, you can claim a special refund of sales tax paid on those goods provided you have documentation such as invoices and customs documentation to show sales tax have been paid.

Q36. What is the GST treatment on progress payment on any construction contract made before 1 April 2015?

A36. Generally, GST is only payable on any supply of goods or services to the extent that it is made on or after 1 April 2015. Basically, the value of work and materials permanently incorporated in or affixed on the construction site before 1 April 2015 will not be subject to GST. In order to determine whether the performance of the service is subject to GST or not, a contractor is required to value all works and materials permanently incorporated in or affixed on the construction site of the building or civil engineering work at the beginning of 1 April 2015.

This value must be determined on or before the end of the first taxable period after 1 April 2015. Such valuation must be certified by an authorized person e.g. registered engineers, architects or quantity surveyors as in Question 37. In the case where, the value of the supply after 1 April 2015 exceeds the value certified, then GST will be chargeable on the exceeded amount (apply GST on the margin). Whereas, if the value of the supply after 1 April 2015 is less than

the certified value, no GST is chargeable on such amount. However, if the taxable person fails to comply on the certified value within the specified time, GST will not be charged on the margin but on the full value of the supply.

Q37. How do I calculate GST on the value of construction work for a project that straddles between two periods that is before and after GST implementation?

A37. There are 2 situations:

- (a) For projects which require the issuance of the certificate in relation to any work done.

You must apportion the value of construction works pre and post-GST. GST is only chargeable for construction work done after GST implementation. A recognized person such as engineer and architect has to verify the value and amount of work and the materials permanently incorporated or affixed on the site of the building or civil engineering work for the period prior to the commencement of GST.

Example 15:

KLM Sdn. Bhd. has a contract above RM1,000,000 with JKL Sdn. Bhd. to build a commercial building. The contract is scheduled to begin on 1 May 2014. Under the contract of agreement, KLM Sdn. Bhd. will receive payment inclusive of GST based on monthly progress billing. On 15 April 2015, the architect does the valuation and certifies the value of work done till 31 March 2015 is RM1,000,000. After completion of the project on 15 July 2015, KLM Sdn. Bhd. lodges a claim amounting to RM1,100,000. GST due is based on RM100,000 (RM1,100,000 – RM1,000,000) for the construction work done after GST implementation.

$$\text{GST} = \text{RM}100,000 \times 6\% = \text{RM}6,000$$

- (b) For projects which do not require the issuance of the certificate in relation to any work done.

For contract which does not require certification by the architect or engineer as a recognized person, you have to apportion the value of work done before and after the commencement of GST. You have to account for GST for the value of work done after the period of commencement of GST.

Example 16:

TJK has a contract with an individual to build a residential building. The contract is scheduled to begin on 15 March 2015. Under the contract of agreement, TJK will receive payment on completion of work. Upon completion of the project on 14 July 2015, TJK lodges a claim amounting to RM42,000. GST due is based on RM34,615 (RM42,000 X 75/91) for the construction work done after GST implementation.

$$\text{GST} = \text{RM}34,615.00 \times 6\% = \text{RM}2,076.00$$

Total number of days undertaken for project = 91 days

Construction work done after GST = 75 days.

Q38. What is the GST treatment on Retention amount that straddles between two periods that is before and after GST implementation?

A38. Where such retention amount under a construction contract relates to a supply of construction services made before 1 April 2015, such retention amount is not subject to GST. However, if such amounts relate to a supply made after 1 April 2015, it shall be subject to GST.

Example 17:

A contractor makes a supply of services from 1 December 2014 to 31 May 2015. A sum of RM48,000 is retained for the satisfactory performance of the construction work. Since part of services are performed before 1 April 2015 (four months) and part of it is performed after 1 April 2015 (two months), the amount of GST payable on the retention sum is:

$$RM48,000 \times 2 / 6 \times [6/106] = RM905.66$$

Please refer to the GST Guide on Transitional Rules for further details about the transitional issues.

Other Issues

Q39. I am a nominated subcontractor and a GST registrant who was appointed by the client to carry out a specified portion of the construction project. Although I am being engaged by the main contractor, but I received my payment directly from the client. How do I have to account for the GST?

A39. A GST registered person who makes a taxable supply is required to issue a tax invoice to the recipient of the supply regardless of how or from whom he received the payment. In this case, the nominated subcontractor will bill the main contractor progressively for his work done. He has to issue a tax invoice for his supply and account for the GST. The main contractor later will bill the client for his total amount of work done, issue a tax invoice and account for the GST accordingly.

INQUIRY

1. For any inquiries for this guide please contact :

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FURTHER ASSISTANCE AND INFORMATION ON GST

2. Further information can be obtained from:

(a) GST Website : www.gst.customs.gov.my

(b) Customs Call Centre:

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