BACKGROUND

The sudden emergence of the Internet has facilitated the communication and exchange of information at an unprecedented level. The term Internet can be traced from the phrase 'Interconnected Networks'. This term (Internet) is, therefore, meant to imply a web of different computer networks that use fixed rules to send and receive information (McKeown and Watson, 1997). Electronic commerce (E-commerce), on the contrary, is any transaction involving the exchange of goods and services between two or more parties using technological tools and techniques.

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This paper is organised as follows. After providing a background to the emergence of the Internet, Section 2 explains some of the concepts and definitions used in this paper. Section 3 examines the tax and legal issues relating to e-commerce. Some recent developments in industrialised countries such as Australia, the UK and the US are covered in this section. Section 4 examines the current developments in Malaysia pertaining to e-commerce, growth of the Multimedia Super Corridor and tax implications on cyber income. The findings of a survey carried out by the authors are reported in Section 5. This survey sought the level of understanding among firms and individuals regarding the practical side of the use of e-commerce. The final section provides some concluding remarks on the potential development of e-commerce in Malaysia.
CONCEPTS AND DEFINITIONS

The Internet is a global information system that is linked together using Internet protocol address. It is a worldwide system between unrelated operators. The Internet can be regarded as part of an Information Highway, which consists of thousands of interconnected logical networks linking millions of computers around the world together through gateways connecting organisations in Asia, Europe, the US and other countries. The two main methods for transporting data across a network are circuit and packet switching. The circuit switching is commonly used to transmit voice while packet switching is meant to transmit data. The Internet is, in fact, a packet switching network. The Transmission Control Protocol/Internet Protocol (TCP/IP) is responsible for splitting a message from the sending computer into packets, numbering and transmitting the packets and subsequently putting them together in the correct sequence at the receiving computer.

The process of determining the path a message will take from the sending to the receiving computer is referred to as 'routing'. It is the responsibility of the IP part of TCP/IP for ascertaining the best route through the network. Messages, however, can be sent from one computer to another only when every server on the Internet is uniquely addressable. The Internet Network Information Centre (InterNIC) manages the assignment of unique IP addresses so that TCP/IP networks in any part of the world can communicate with each other. An IP address is a unique 32-bit number consisting of four groups of decimal numbers in the range of 0 to 255. For example, the IP address for Universiti Utara Malaysia is 161.142.40.29.

A single important application of the Internet is the World Wide Web, often designated as WEB. The WEB is a navigational device, which permits the user to browse through and locate information that is presented in multimedia form available on storage devices known as servers. These servers are physically located within computers. The term used to describe electronic information moving about the WEB is 'bits'. To regulate this activity, it is necessary that revenue authorities will have to tackle new problems in assessing income arising from transactions in a borderless economy. Several emerging economies would rather wait and learn from new developments and experiences from other advanced countries before taking any definite steps to tax cyber income.

It was agreed at the conference of the member countries of Organisation of Economic Co-operation and Development (OECD) that the taxation of goods and services in cyber space should be equal to the taxation of similar physical transactions (OECD, 1998). 27 of the 29 member OECD countries use some form of Value Added Tax (VAT) which averages about 30 per cent of tax revenues in the OECD area. These countries are concerned that the
Internet provides opportunities to evade this tax. Vendors are able to avoid the VAT if they do not have a physical presence in the country where they are selling their goods and services. The problem that the tax authorities have with existing VAT or sales tax systems is that it is almost impossible to identify the venue of the (Internet) seller. Some of the tax and legal issues faced by the developed countries such as Australia, the UK and the US are examined below.

**Australia**

The government introduced the Electronic Transactions Bill 1999 as part of its strategic framework for the development of the information economy and in particular the use in commerce of electronic communications in Australia. The revenue authorities plan to tax consumers, not businesses, on the goods and services sold on the Internet. The tax would be automatically deducted when consumers use their credit cards, or new electronic smart cards, to order products from businesses operating Internet web sites. Taxing the consumer rather than the vendor seems the only solution to the problem in that it is almost impossible to identify the venue of the Internet seller (Australian Accountant, 1998). The technology of the Internet would be used to collect more, not less tax than present systems by using computer software set with individual tax rates for goods and services bought on the Internet. When consumers use their credit cards or smart cards to pay for their purchases, the appropriate tax will be deducted automatically and sent to the appropriate tax authority.

**United States**

In the UK, the Electronic Commerce Bill was introduced in November 1998. Once the bill is enacted, it will give digital signatures legal force and will create a voluntary licensing system for trusted third parties which offer signature and encryption services. Digital signatures are forgery to prove someone's identity (Singleton, 1999). The UK Electronic Commerce Draft Directive has identified five issues relating to the development of e-commerce. These issues relate to:
- Commercial communications
- Establishment of information service providers
- Liability of intermediaries
- On-line finalisation of contracts
- Implementation

The first issue covers the meaning of 'commercial communication' and makes it subject to specific transparency requirements to enhance consumer confidence trading. In this respect, commercial communications by electronic mail must be easily identifiable. The second issue relates to definition of the place of establishment in line with the principles of the European Union (EU) Treaty and the Court of Justice. A contract at a distance is recognised as a service provided without the parties being simultaneously present. The third covers the liability of intermediaries. It has been proposed to allow a mere conduit exemption for those who are simply intermediaries transmitting information provided by third parties. The fourth area will require member states to amend national laws and to ascertain the moment of the conclusion of a contract. Finally, the fifth issue relates to the implementation and enforcement of a contract in an electronic environment.

**Current Developments in Malaysia**

Although the development of e-commerce is particularly significant in advanced countries such as Australia, the UK and the US, Malaysia is not far behind. There is a nationwide effort in Malaysia towards an electronic environment, with the government actively involved in the business of e-commerce within its own systems (Zurina, 1998).

Since e-commerce has created a borderless business world, laws and regulations have to be adopted and be applicable in a world without boundaries. During the Asia-Pacific Economic Corporation (APEC) Business summit held on 12-18 November 1998 in Kuala Lumpur, the Malaysian government announced that it would award a certification authority license to a private company to provide a digital certification system. Digital certification ensures the security of transactions over the Internet and identification of parties involved in the transactions. Furthermore, the development of e-commerce would expand the markets for businesses, as potential consumers around the globe would be accessible through the Internet. Competition would also be intensified, as consumers would also have more choice, as they would not have to restrict them-
selves to local vendors. An essential ingredient to the growth of e-commerce is a computer network system that is capable of satisfying the requirements of entrepreneurs. Companies need to have an information technology (IT) infrastructure system that is able to cope with the increasing demands of e-commerce. Available data indicate that Malaysian companies having one to 499 employees contributed approximately 47 per cent of the personal computer market locally. In numbers, this accounted for about 200,000 units in 1997 and 240,000 by the end of 1998.

The Basis of Malaysian Taxation

The imposition of income tax in Malaysia depends as much on the establishment of sources and residence as on whether income has been derived, and if so, when and by whom. From an income tax compliance perspective, the question of who derives the income can be ascertained by tracing who owns the investment which generates the income. However, in cases involving transactions via e-commerce, ascertaining who derives specific sales income will be problematic if a history of transactions is not kept. Furthermore, transactions may be made off-shore, making it difficult to enforce third-party information reporting.

The basis year for a year of assessment is the calendar year immediately preceding that year of assessment. Consequently, a basis year is always the 12 months to 31 December. Nevertheless, the Act recognises that business organisations may have accounting year-ends which do not end on 31 December and hence allows the accounting year to be the basis period for income derived from a business source. In contrast, the tax year in Australia runs from 1 July to 30 June whereas in the UK, the year of assessment begins on 6 April.

Scope of Charge

The basis of taxation is the derived scope. The income of an individual is only assessed if it is derived in Malaysia or received in Malaysia from abroad. However, excluded from the scope of taxation. The exception to this rule is when a resident person carries on banking, insurance or air/sea transport operations. In such cases, the resident person carrying on such operations is assessable to tax on worldwide income even though the income is not received in Malaysia.

Significance of Residence Status

The residence status of individuals is determined under Sec. 7 ITA. In general, residence is determined by the number of days an individual is present in Malaysia, that is a quantitative test. This quantitative test determines whether an individual is:

- exempted from remittances of income from abroad; and
- entitled to personal reliefs.

Individual residents are granted personal reliefs and exemptions, including RM5,000 self-relief (RM8,000 w.e.f. Y/A 2000, current year basis), RM3,000 wife relief (if wife is not assessed separately) and child relief of RM800 for each unmarried child not exceeding 18 years of age. A relief on the employee provident fund contribution and life insurance premium up to RM5,000 is also provided for an individual taxpayer.

Exemptions

Tax exemption is provided on a range of income including salaries paid to royal families, allowances to members of parliament, compensation for loss of employment due to ill-health and emoluments of any member of the armed forces of a Commonwealth country.

Retirement gratuities are wholly exempt if the retirement:

- is due to ill health; or
- takes place after the age of 55 or on reaching the compulsory age of retirement from employment and in either case, the employment must be for a period of at least 10 years with the same employer.

Certain interest and dividend incomes are exempt from tax. Finally, employment income of a non-resident individual from the
period, or periods, which do not exceed 60 days in a calendar year, is also exempt.

**Opportunities to Evade**

Transactions making use of unaccounted forms of electronic cash provide opportunities for income tax non-compliance. Levels of income tax compliance would depend on the opportunity to evade and the likelihood of detecting taxpayers' omitted income. Under Internet payment systems, the temptation to dishonesty becomes harder to resist as there is little likelihood of the taxpayer's deceit being traced (Reed, 1996).

The Malaysian Government has provided several incentives to encourage the growth of multimedia companies (Kasipillai, 1998). For instance, companies that are granted MSC-status are eligible for a package of financial and non-financial incentives. Financial incentives include zero income tax for a maximum period of ten years or a 100 per cent investment tax allowance on new investments made in MSC designated zones. Non-financial incentives include unrestricted employment of foreign knowledge workers, freedom to source capital globally and freedom of ownership.

**Legislative Support**

The Malaysian government has legislated the necessary laws to provide support to the MSC. In this respect, several pieces of multi-specific legislation have been passed in Parliament and they include:

- The Digital Signature Act 1997 which governs electronic signatures.
- The Computer Crimes Act 1997 which outlaws the fraudulent use of computers and unauthorised access to and modification of the contents of computers.
- The Electronic Government Act 1997 which regulates communication within the public sector. This Act also enhances communication between the public and private sectors.
- The Multimedia Convergence Act 1997 which streamlines communication, information and broadcasting services.
- The Telemedicine Act 1997 allows for the promotion of medical services.
- The Intellectual Property Protection Act 1998 which protects copyright laws.

Although the above legislations were prompted by the establishment of the MSC, it is of general application throughout Malaysia. Moreover, the Electronic Government Act provides a mechanism for business and the community to voluntarily choose electronic communications when dealing with government agencies. These legislations will facilitate the development of electronic commerce in Malaysia by removing a number of existing legal obstacles to the use of electronic communications.

**SURVEY QUESTIONNAIRE**

A n exploratory survey was carried out by the authors (Kasipillai & Razak, 1998) to seek an understanding of the practical side of the use of e-commerce in Malaysia. The survey was confined to the northern region of Penin-

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3 Companies approved by the Multimedia Development Corporation (MDC) will be granted Multimedia Super Corridor (MSC) status.

4 The Multimedia Development Corporation envisions a 20-year time-frame for the full implementation and execution of the MSC.

5 'Seed capital' is funding for businesses which have not commenced operation but have complete prototypes. These businesses are striving to acquire financing for full-scale commercial operations.
Survey Findings

The findings of the survey suggested that most consumers and retailers are aware of the use of the Internet for purposes of commerce. However, only four firms surveyed (eight per cent) marketed their products using the Internet. Two of these firms (four per cent) were from the services sector, while the other two firms were from the manufacturing sector. Except for one firm, all the other firms were in operation between two to eight years. A single firm was in operation for over 30 years, suggesting that new firms are more prepared to use the Internet to market their products compared to traditionally established firms.

The questionnaire also solicited information on the possible reasons for firms not using the Internet to market their products. Some of the respondents provided 26 per cent of the firms do not have trained personnel to manage Internet transactions.

CONCLUDING REMARKS

The use of the Internet as an alternative way of transacting commercial deals provides new opportunities for businesses to increase their trade through e-commerce. Consumers too would be able to access goods and services at minimal cost worldwide.

Current tax laws and regulations, however, are not able to keep pace with the sudden change in the manner businesses are transacted via Internet. It would also be extremely difficult for the revenue authorities, acting independently of each other, to succeed in handling compliance issues that arise from e-commerce. There is a pressing need for tax authorities worldwide to collaborate in developing standards, exchanging data and developing a uniform tax policy. One other issue is allocation of taxing rights on income arising from e-commerce among the countries concerned.

Tax administrators and policy-makers, however, have now begun to review existing tax legislations to ascertain whether they are able to cope with new approaches to carry out businesses. Recent developments suggest some moves by governments to introduce new legislations to smoothen the manner of trading on the Internet.

For example, in the UK, the Electronic Commerce Bill was introduced to formulate rules for commercial transactions via the Internet.
office has released a report on tax and the Internet. This report is meant to guide the business community and taxpayers in trading on the Internet while preserving the nations' tax base (Australian Accountant, 1997). The Malaysian government too has legislated several multi-specific legislations to provide support to the Multimedia Super Corridor. More changes to tax law provisions are expected to be introduced to cope with the anticipated growth of e-commerce.

**REFERENCES**


http://www.mdc.com.my


"Where there's a will, there's a way...
But where there's a will, there's also an inheritance tax."

~ Author Unknown ~