CHARTERED TAX INSTITUTE OF MALAYSIA

MEMORANDUM ON

PRICE CONTROL AND ANTI-PROFITEERING LEGISLATION

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Technical Committee – Indirect Tax

Memorandum On Price Control And Anti-Profiteering Legislation

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1. Preamble

The new Section 15(1A) of the Price Control and Anti-Profiteering Act 2011 (PCAPA)(as amended by Act A1464) provides that the mechanism to determine unreasonably high profit includes the Minister of Domestic Trade, Co-operatives and Consumerism (MDTCC) "*determining a certain period during which there shall be no increase in the net profit margin ("NPM") of any goods or services*".

NPM is the ratio of profitability calculated by using net profit divided by sales. NPM is displayed as a percentage and is commonly used to compare the performance of companies (usually in similar industries).

From the slides presented by MDTCC during the 3 October briefing, it appears that the formulae used in determining NPM is in fact Net Profit (NP) in Ringgit Malaysia, which is not in line with the provision under Section 15(1A). Net Profit Amount is not an ideal comparable due to the many limitations and potential problems, some of which are highlighted below. It is noteworthy that companies which maintain the same Net Profit Amount in two periods will most likely have different NPM as a result of different fixed and variable costs components, different production and sales quantities, cost efficiency, etc.

In addition, we notice that pursuant to Section 15(2) of the PCAPA, items such as supplier's cost, supply and demand conditions, geographical and product market, and other matters affecting the prices of goods or charges for services shall be considered in formulating the mechanism. Nevertheless, the formulae used in the slides does not have any room for such adjustments on selling price and cost.

In view of the foregoing and with due respect, we are of the opinion that the formulae should be amended as follows to include the items in red:-

$$\text{NPM} = \frac{\text{SP - (COG + OC - IT) - OT +/-SP Adjustment +/-COG Adjustment +/-OC Adjustment}}{\text{SP - OT +/- SP Adjustment}} \times 100\%$$

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2. Issues Relating to the Proposed Methodology in Determining Profiteering

The Institute supports the Government's pro-active effort to curb profiteering activities with the introduction of GST. Nevertheless, the following potential issues may arise in implementing the proposed anti-profiteering mechanism:-

(i) Variations in Accounting Policies

The methodology used by different companies across various industries in accounting for selling prices, costs and margins will vary in that certain companies may define selling price as net of discount but others may use different definitions. Similarly, cost of goods may be taken into account of stock written off, bad debts, etc. while others may not.

CTIM suggests that, to smoothen the implementation and enhance compliance, the basis of computing NPM per SKU/product should be accepted as long as the provider has adopted the same practice consistently during the prescribed period.

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(ii) Net Profit Margin v Net Profit in Ringgit Malaysia

Prices increase due to inflationary pressures (both local as well as worldwide, which impacts the cost of production, logistics, payroll, etc.). The Anti-Profiteering mechanism focuses on absolute increase in Net Profit Amount rather than increase in NPM or rate of return. Below is an illustration showing lower profit margin (%) as a result of maintaining the absolute Net Profit Amount:

	Pre GST	**Post GST**
Price per SKU	100	104
Cost of Goods excl sales tax	(50)	(54)
Sales Tax	(2)	0
Overhead Costs	(28)	(30)
Total Costs	(80)	(84)
Net Profit per SKU	20	20
NPM	20.0%	19.2%

(iii) Investment in Plant and Machinery

A company that invests in plant and machinery will allocate the related costs across different product lines. When the plant is operating below full capacity, the cost allocated to each SKU is substantial. An increase in production volume will lead to reduction in cost allocated to each SKU, and hence increase in its Net Profit Amount. The issue is more significant to capital intensive industries. The effect is illustrated as follows::

Production volume	@ **100,000 units**	@ **500,000 units**
Sales (per SKU RM100)	10,000,000	50,000,000
Cost of raw materials	(4,000,000)	(20,000,000)
Capital expenditure of 10 million (to be amortised over 5 years)	(2,000,000)	(2,000,000)
Other variable overhead Costs	(2,000,000)	(10,000,000)
Total Costs	(8,000,000)	(32,000,000)
Net Profit Amount	2,000,000	18,000,000
NPA per SKU	***20***	***36***
NPM	***20.0%***	***36.0%***

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(iv) Fixed price pre-GST long term contract that extends to post GST period

The Anti-Profiteering mechanism will have an impact on the businesses entering into long term contracts entered prior to 1 Apr 2015 to supply goods and services commencing from contract date to after 1 April 2015 and businesses which have entered into a long term supply contracts with customers wherein the selling price is fixed, i.e Property, Construction and similar types of contracts. The Net Profit Amount will fluctuate with changes in total costs arising from fluctuation of raw material prices, changes in foreign exchange, improvement in operating efficiency, etc.

CTIM is of the view that the operation of the PCAPA should not affect such businesses due to operation of external factors, which are outside their control. Guidelines should be issued to give relief to these business groups.

3. Other Implementation Issues

(i) Numerous product lines

Retailers and wholesalers which have numerous product lines will face compliance issues and should be given sufficient time and support to assist in their implementation.

(ii) Changes to accounting system

Currently most businesses do not keep NPM on product basis but gross margin is tracked instead. This requirement will compel companies to change their reporting to provide NPM on product basis. This will require changes to their accounting systems that will incur additional cost and time.

(iii) Setting basis of allocation

It is important to note that setting the basis of allocation of overhead costs for each and every goods and services provided to arrive at the NPM would be very difficult and costly, especially for companies which deals with many product lines with many multiple SKUs. While direct costs are easily attributable to the individual SKU, common or indirect costs such as staff costs, rental, depreciation, professional fees etc will be very challenging to allocate to SKU level and will require an acceptable allocation key and the formulation of new management agreements in compliance with transfer pricing rules.

(iv) Businesses with seasonal fluctuations

For businesses with seasonal fluctuations, the NPM computations should take into consideration the timing of expenses. For instance, the business may have a few peak periods, such as Ramadan, Chinese New Year, Mid-Autumn Festival, and Christmas/New Year. Advertising & promotions expenses will be incurred in the months prior to and during the peak period.

4. Professional and consultancy services

The bulk of professional and consultancy services are priced based on individual expertise, the complexity of the assignment, the nature of the advice and time taken to prepare the advice, etc. It is very subjective and is impossible to maintain a fixed amount of NP for consultancy services rendered.

CTIM recommends that the professional and consultancy services sectors be excluded from PCAPA.

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5. Clarifications Sought

In addition, the Institute would like to seek clarification on the following:

(a) Whether PCAPA and the Regulations apply to all Goods and Services across the board or are there any exceptions ?

(b) Certain companies adopt bundled SKU, particularly in the fast moving consumer products, how would the NPM be determined?

(c) In industry where the business entered into contract prior to 1 Apr 2015 to supply goods and services commencing after 1 April 2015 and businesses which have entered into a long term supply contract with customers wherein the selling price is fixed, how is the NPM calculated?

(d) S. 53A(2) requires records to be kept for "a period of seven years from the latest date to which record relates". We would like to seek clarification on "the latest date to which the record relates".

(e) Where a business does not want to claim sales tax refund or Input Tax Credit (ITC), will it be required to calculate the NPM by taking into account the notional refund and ITC?

(f) Where traders adopt marketing strategies such as "loss leader" strategy, promotion discounts, bulk incentives, etc. and sold the products at very competitive prices or even lower than the costs of goods, how would the Anti-Profiteering mechanism operate?

(g) Where there is an unexpected gain resulting in a substantial increase in NPM after implementation of GST, for example, an palm oil refiner gains from the fall in prices of palm oil, how would the Anti-Profiteering mechanism operate?

(h) What is the definition of subsequent offence? It is unclear whether the provision to limit penalty to RM500,000 [S.18(a)] is applicable on KSU basis or on a body corporate basis?

6. Recommendations

The Institute recommends that the following measures be considered for incorporation in the proposed regulations.

(a) Scope of PCAPA Application

Since the intention of the PCAPA is to curb unreasonably high profit margin as a result of GST introduction, it is suggested that increase in NPM as a result of commercial fluctuations and justification will not fall within the ambit of PCAPA and this principle should be incorporated in the proposed regulations.

(b) Allowance for NPM variations

The purpose of the anti-profiteering mechanism under Section 15 of the PCAPA is to determine "unreasonably" high profit and not merely an increase in the NPM. Hence, in comparing the NPM for the two periods, the Institute is of the opinion that an allowance or buffer (say 10% to 30%) should be given and incorporated into the prescribed regulations. For instance, an increase in NPM of 10% would be acceptable and will not fall within the ambit of an unreasonably high NPM.

(c) Initiation by Complaints

The Institute suggests that the investigation be initiated by complaints and go through a process in which businesses are granted the right to be heard and defend themselves before the legal proceedings is initiated or compound is imposed.

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