ABOUT THE CONSULTANT EDITOR

Mr. Vincent Josef began his career with the Inland Revenue Board in 1968 and over the next 35 years, he served in various branches, earning himself a wide command of the numerous demands of Malaysian taxation. Prior to his retirement, he was with the Operations Division of the Board Headquarters holding the position of Assistant Director General where his duties included Payment Through Banks and Branch Performance Evaluation.

His taxation expertise includes corporate and business taxation, investigation and monthly tax deductions. He also represented the Director General in both the Subordinate and High Courts in civil suit and prosecution matters. While in the Monthly Tax Deduction Department, Vincent was responsible for overseeing Branch Practice Management, Payroll Audit, Compliance Enforcement, and Employer Education throughout Malaysia.

In addition, Mr. Josef has wide experience in lecturing at IRB events and Malaysian professional institutions and corporations including:

- Chartered Tax Institute of Malaysia
- Malaysian Institute of Accountants
- Malaysian Association of Company Secretaries
- CPA Australia
- MAICSA
- Commerce Clearing House (Malaysia) Sdn Bhd.

With his 49-year presence in taxation, Mr. Vincent Josef manages his own practice providing taxation consultancy services on tax audits and investigation matters and "problem resolution". He has written a book "***Tax Audit and Investigation Guide – Malaysia***" published by CCH Malaysia and also serves as their Consultant Editor in respect of the ***Malaysian Master Tax Guide***, a position he has held for the past several years.

ABOUT THE TECHNICAL ADVISOR

Dr Veerinderjeet Singh is a leading tax specialist in Malaysia. He has extensive experience in the tax profession both as an academician and as a consultant, and has served on the Advisory Board of the National Tax Academy, the Labuan IOFC Tax Consultative Committee, the Technical Resource Group on Investment of the Ministry of International Trade and Industry, and the Working Group on Fiscal Reform under the National Economic Advisory Council which was tasked with formulating the New Economic Model for Malaysia. He is also a member of the Focus Group on Paying Taxes set up by PEMUDAH which is tasked with introducing business efficiency initiatives to make Malaysia a competitive economy.

An accomplished author and tax observer, Dr Veerinderjeet has published over 100 books and articles in local and international tax, law and accounting journals and in local newspapers. He is also a well-sought-after speaker on tax issues in the local and international arenas.

In addition to being the Group Executive Chairman of Axcelasia Inc., (which is the holding entity of Axcelasia Taxand Sdn Bhd, a specialist tax advisory firm and a member of the Taxand global organisation), Dr Veerinderjeet is involved in various professional bodies as a council member and is a past president of the Chartered Tax Institute of Malaysia. He is also the Past Chairman of the International Fiscal Association — Malaysia Branch and is a member of the Commission on Taxation of the International Chamber of Commerce based in Paris.

PREFACE

The *Malaysia Master Tax Guide* is a handy and comprehensive reference on Malaysian tax rules. It is used widely by tax agents, accountants, lawyers, financial advisers, lectures, students and IRB officers alike, and it is often the first port of call for those dealing with tax issues because of its clear and concise approach.

This thirty-fourth edition of the *Malaysia Master Tax Guide* has been updated to reflect the various legislation promulgated and gazetted since 31 January 2016, including:

- the *Finance Act 2017*
- Income Tax Rules
- Income Tax Exemption Orders
- Stamp Duty Exemption Orders
- Stamp Duty Remission Orders
- Real Property Gains Tax Exemption Orders, and
- *Goods and Services Tax Act 2014*.

It also provides information on public rulings that were released up to February 2017, tax proposals and changes announced in the Budget 2017 which were subsequently enacted through the *Finance Act 2017* and the information on Stamp (Amendment) Bill 2016.

The law is stated as at 1 February 2017.

CCH tax editors

February 2017

HIGHLIGHTS OF 2016/2017 TAX CHANGES

HIGHLIGHTS OF 2016/2017 TAX CHANGES

¶100 2017 Budget Proposals and Finance Act 2017

The Budget 2017 was announced on Friday, 21 October 2016, against the background of a challenging economic environment. The Budget theme of *"Ensuring Unity and Economic Growth, Inclusive Prudent Spending, Well-being of the Rakyat"* although largely similar to recent Budget themes, is nonetheless ambitious given the current economic climate in the country and external factors.

Given the need to maintain revenues in view of the impact of reduced petroleum-based revenue, there has been a flurry of tax audit and investigation activity from the Inland Revenue Board (IRB) this year, and we can expect the same from the Royal Malaysian Customs Department. The introduction of Goods and Services Tax (GST) in 2015 has been critical in plugging the deficit from petroleum taxes/revenue, but the tax revenue must continue to grow to be able to achieve a balanced Budget by 2020. Clearly, this must be coupled with measures to stimulate growth and to manage expenditure effectively with minimum leakages.

The Government has projected a 3% fiscal deficit for 2017, a reduction from 3.1% expected this year. Government revenue for 2017 is projected to be RM219.7 billion, while the operating expenditure is RM214.8 billion and development expenditure is RM46 billion. The growth rate is projected to be between 4% to 5% in 2017 compared to 4% to 4.5% this year. From a tax perspective, the targeted revenue for 2017 sees an increase of RM10 billion to RM7 billion from corporate taxes, RM1 billion from personal taxes and RM2 billion from petroleum income tax. That indeed is a very optimistic target given that the collection in 2016 has not met the original targets which had to be scaled down in January 2016 under the re-calibrated Budget.

Highlights of Budget 2017 include the following:

PERSONAL INCOME TAX

1. Tax relief for lifestyle

Currently, in order to inculcate a reading habit, lead a healthy lifestyle and enhance the usage of computers and internet, a tax resident individual is entitled to claim the following reliefs:

(i) Tax relief of up to RM1,000 for the purchase of reading materials (excluding newspapers and banned reading materials)

(ii) Tax relief of up to RM300 for the purchase of sports equipment for sports activities as defined under the *Sports Development Act 1997*, and

CHAPTER 1

INDIVIDUALS

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INDIVIDUALS AS TAXPAYERS

¶1-100 Malaysia-sourced income

Income tax in Malaysia is on a territorial basis. That is to say, tax is chargeable on only income derived from Malaysia. Where the source of derivation of income is outside Malaysia, no liability will arise even if such foreign income is remitted to Malaysia. The exception to this rule is where the income is derived from a business of sea and air undertakings, insurance or banking; such income is taxed on a "worldwide scope" and not just from business activities carried out in Malaysia.

The resident status of an individual has no bearing on his/her scope of liability since the "derived from Malaysia" principle applies to him/her also. His/her resident status determines whether he/she is to be taxed at resident or non-resident rates and whether he/she accordingly is entitled to personal relief and deductions.

Prima facie, the source or originating source of income from employment is the location where the services are rendered, ie where the employment is exercised (see ¶7-202). The place where the contract is signed or the place where the remuneration is paid is not relevant.

Where an employment is exercised partly outside Malaysia, the individual's liability to tax will not be affected if it is established that the employment is substantially exercised in Malaysia or the work done outside Malaysia is an extension of the Malaysian employment, that is "the employee performs outside Malaysia duties incidental to the exercise of employment in Malaysia".

Where an employee is stationed outside Malaysia to perform services there on behalf of his/her Malaysian employer, his/her total remuneration, ie in respect of his/her

services, both in Malaysia and outside Malaysia, will be taxable in Malaysia. Nevertheless, should his/her services outside Malaysia be not related to any employment in Malaysia, there will be no liability to tax on the income earned overseas.

Public Ruling No 1/2011 on "Taxation of Malaysian Employees Seconded Overseas" provides clarification on the tax treatment of employment income derived by employees from Malaysia who are seconded by their employer to perform duties outside Malaysia (including clarification as to what constitutes incidental duties, and guidance on how tax treaties would apply). The principal elements of "secondment" are:

(a) an employee is transferred temporarily by the employer to perform duties elsewhere, and

(b) after the completion of his temporary duties the employee returns to the same employer to continue his employment.

Following the case of *Robson v Dixon* 48 TC 527, the Public Ruling takes the view that the word "incidental" denotes "an activity (here the performance of duties) which does not serve any independent purpose but is carried out in order to further some other purpose".

The reference to "Malaysian employees" described in the Public Ruling is in relation to any employee serving employment in Malaysia. The Public Ruling is effective from YA 2011.

Where an employer outside Malaysia sends his/her employee to Malaysia to render services here, such an employee is taxable here notwithstanding that the employer is overseas or that the employee's remuneration is paid outside Malaysia and not remitted here (see ¶7-210). The liability to tax arises from the fact that the employment is exercised in Malaysia.

Public Ruling No 8/2011 on "Foreign Nationals Working in Malaysia — Tax Treatment" explains how foreign nationals employed in Malaysia are to be taxed, taking into account related issues such as leave pay and duties outside Malaysia which are incidental to the employment in Malaysia. The Public Ruling also examines the impact of Sch 6 para 21 (exempt income) and provides examples of the circumstances under which employment income would be taxable or otherwise. The Public Ruling is effective from YA 2011.

The impact of Sch 6 para 21 is that where a non-resident employee exercises employment in Malaysia for a period or periods totalling not more than 60 days in a basis year or two overlapping years, his income from such employment would not be liable to tax. However, the 60 days would apply for two consecutive years if there is an overlapping period.

Example 1

John works in Malaysia from 1 June 2014 to 23 July 2014.

He would not be liable as his employment is for only 53 days.

Example 2

Sachin works in Malaysia as follows:

	From 1 March 2014 to 29 March 2014	29 days
and	From 1 May 2014 to 26 May 2014	26 days

Sachin would not be liable as the total number of days he was employed in Malaysia was only 55 days.

Example 3

Aarthi works in Malaysia from 1 July 2014 to 25 August 2014	56 days
And from 1 June 2015 to 28 July 2015	58 days

She would not be liable as she did not work in either year for more than 60 days.

Example 4

Chong's periods of employment in Malaysia are:

From 1 April 2014 to 27 April 2014	27 days
From 22 December 2014 to 5 January 2015	14 days
From 20 September 2015 to 18 October 2015	28 days

Chong would be liable as the total number of days he was employed in Malaysia, which includes a period overlapping 2014 and 2015, is more than 60 days.

Public Ruling No 8/2011 mentions, several times, that para 21 and 22 of Sch 6 apply to foreign nationals, suggesting that Malaysian employees, who may be non-resident, cannot enjoy this exemption. This may not be correct as the law itself merely refers to non-resident employees. There obviously could be situations where Malaysians who become non-resident by virtue of being abroad for several years, return to work in Malaysia for a short term not exceeding 60 days.

It must also be borne in mind that the exemption is available only to employees and that the 60-day period refers to the period of employment, not to the number of days the employee may be in Malaysia.

Law: s 3, 13(2), Sch 6 para 21, 28.

¶1-110 Definition of "Malaysia"

"Malaysia" includes the territories of the Federation of Malaysia, the territorial waters of Malaysia and the seabed and subsoil of the territorial waters, and the airspace above such areas, and any area over which Malaysia has sovereign rights to explore and exploit natural resources. Under the *Exclusive Economic Zone Act 1984* the offshore area of Malaysia extends up to 200 nautical miles from the Malaysian coast. The *Income Tax Act 1967* (ITA) would therefore have jurisdiction over persons working offshore within the exclusive economic zone of Malaysia.

Law: s 2.

¶1-120 Residence of individual

The ITA categorises an individual as:

- a resident, or
- a non-resident,

depending on the duration of his/her physical presence in Malaysia in the relevant years. An individual's residence status is not related to any business or employment he/she may have in Malaysia; it is determined by only his/her stay in Malaysia.

Section 7 of the ITA defines a "resident" thus:

"(1) For the purposes of this Act, an individual is resident in Malaysia for the basis year for a particular year of assessment if—

(a) he is in Malaysia in that basis year for a period or periods amounting in all to one hundred and eighty-two days or more;

(b) he is in Malaysia in that basis year for a period of less than one hundred and eighty-two days and that period is linked by or to another period of one hundred and eighty-two or more consecutive days (hereinafter referred to in this paragraph as such period) throughout which he is in Malaysia in the basis year for the year of assessment immediately preceding that particular year of assessment or in that basis year for the year of assessment immediately following that particular year of assessment:

Provided that any temporary absence from Malaysia is—

(i) connected with his service in Malaysia and owing to service matters or attending conferences or seminars or study abroad;

(ii) owing to ill-health involving himself or a member of his immediate family; and

(iii) in respect of social visits not exceeding fourteen days in the aggregate,

shall be taken to form part of such period or that period as the case may be, if he is in Malaysia immediately prior to and after that temporary absence;

(c) he is in Malaysia in that basis year for a period or periods amounting in all to ninety days or more, having been with respect to each of any three of the basis years for the four years of assessment immediately preceding that particular year of assessment either—

(i) resident in Malaysia within the meaning of this Act for the basis year in question; or

(ii) in Malaysia for a period or periods amounting in all to ninety days or more in the basis year in question; or

(d) he is resident in Malaysia within the meaning of this Act for the basis year for the year of assessment following that particular year of assessment, having been so resident for each of the basis years for the three years of assessment immediately preceding that particular year of assessment.

(1A) For the purposes of subsection (1), an individual shall be deemed to be in Malaysia for a day if he is present in Malaysia for part of that day and in ascertaining the period for which he is in Malaysia during any year, any day (within paragraphs 1(a) and (c) for which he is in Malaysia shall be taken into account whether or not that day forms part of a continuous period of days during which he is in Malaysia.

(1B) Notwithstanding subsection (1), where a person who is a citizen and—

(a) is employed in the public services or service of a statutory authority; and

(b) is not in Malaysia at any day in the basis year for that particular year of assessment by reason of—

(i) having and exercising his employment outside Malaysia; or

(ii) attending any course of study in any institution or professional body outside Malaysia which is fully-sponsored by the employer,

he is deemed to be a resident for the basis year for that particular year of assessment and for any subsequent basis years when he is not in Malaysia."

The primary test set by the above definitions is clearly the quantitative test.

In determining the residence status of a taxpayer, the facts concerning him/her which may need to be examined are those of the relevant basis year, the immediately preceding years or even the following year as the case may be.

There are four sets of circumstances in which an individual acquires the status of a resident in Malaysia. Where he/she does not fall within any of these four categories, he/she is a non-resident.

(i) Section 7(1)(a): In Malaysia for 182 days in a basis year

Where an individual is in Malaysia for a period or periods which in total are 182 days or more, he/she is a resident for that basis year. Part of a day counts as a full day.

Example 1

An individual who arrived in Malaysia for the first time on 2 January 2015 and left on 30 June 2015 is not a resident since the period of his stay covers 180 days only.

Example 2

An individual who arrived in Malaysia on 14 May 2015 and left on 26 November 2015 is a resident since the period of his stay covers 197 days.

Example 3

An individual who arrived for the first time in Malaysia and was here:

from 1 March 2015 to 31 May 2015	(92 days)
from 4 July 2015 to 15 July 2015	(12 days)
from 1 September 2015 to 31 December 2015	(122 days)
	226 days

would be a resident since he was in Malaysia for periods which in total were 182 days or more.

(ii) Section 7(1)(b): In Malaysia for less than 182 days in a basis year

Where an individual is in Malaysia during a particular basis year for a period of less than 182 days but such period is linked to a period of 182 or more consecutive days throughout which he/she is in Malaysia (the qualifying period) in the basis year either immediately preceding or immediately succeeding that particular basis year, the individual will qualify as a resident for that particular basis year. Prior to YA 2002, it was important for an individual to be physically present in Malaysia on 31 December and 1 January of the following year in order to link up the two periods. However, with effect from YA 2002, any absence for these two days can be considered as part of the individual's temporary absences from Malaysia.

Temporary absences from Malaysia are to be treated as forming part of the qualifying period. Temporary absences of an individual include absences:

- connected with his/her services in Malaysia or due to service matters
- connected with attending conferences or seminars or studies abroad
- due to ill health involving himself/herself or members of his/her immediate family, and
- social visits not exceeding 14 days in total.

Example 1

A taxpayer left Malaysia permanently on 30 April 2015. He would be treated as a resident for 2015 (the particular basis year) if he was physically present in Malaysia throughout the period from 2 July 2014 (ie 183 days in 2014) or earlier to 1 January 2015 or later. Even if he had left Malaysia on 1 January 2015, he would be resident for YA 2015 since his stay in 2015 was linked to the period of 182 days or more in 2014.

Example 2

An individual first arrived in Malaysia on 1 July 2014 and left the country permanently on 30 May 2015. However, he was in Singapore from 9 September 2014 to 26 October 2014 to undergo medical treatment.

He would be resident for 2015 since his period of stay was linked to the period of 182 days or more in 2014. His temporary absence from Malaysia for medical treatment would not reduce the number of days that he was deemed to have been in Malaysia.

Example 3

A taxpayer arrived in Malaysia for the first time on 1 November 2014 and left on 16 July 2015. He would be deemed a resident for the basis year 2015 because he was in Malaysia for 197 consecutive days in 2015.

For the basis year 2014, the taxpayer was also resident under s 7(1)(b) since his period of stay was linked to a period of 182 days or more in 2015.

Example 4

A taxpayer arrived in Malaysia on 15 September 2014 and left on 31 March 2015. He would not be deemed a resident for both YA 2014 and YA 2015 despite the fact that the total number of days he was in Malaysia exceeded 183. To be resident under s 7(1)(b), one of the periods must be 182 days or more.

Case law

Ketua Pengarah Hasil Dalam Negeri v Richard Allen Sonnet & Anor (1998) MSTC 3,714 looked at the question of whether a summer vacation amounted to a "social visit" in the context of s 7(1)(b). In this case, the taxpayers were in Malaysia from 1 August 1991 to 18 June 1992 when they left for their summer vacation. They returned to Malaysia on 10 August 1992 (ie after an absence of 52 days). The Revenue treated them as non-residents for the basis year 1991. The taxpayers contended that they were residents in 1991 as their stay in Malaysia in 1991 was linked to their 170-day presence in Malaysia from 1 January 1992 to 18 June 1992, and a 14-day

temporary absence from 19 June 1992 to 2 July 1992. The Revenue contended that, since the taxpayers did not return to Malaysia after the 14th day, proviso (iii) to s 7(1)(b) could not be applied.

The Special Commissioners held that the taxpayers were residents for the year 1991. The High Court stated that the 14 days' absence need not be consecutive, nor does it need be at the beginning, middle or end of the period making up the 182-day period. However, the High Court held that a "summer vacation" is not synonymous with "social visits". Therefore, the taxpayers were held to be non-residents in 1991.

(iii) Section 7(1)(c): In Malaysia for 90 days or more

Where an individual, in a particular basis year, is in Malaysia for 90 days or more, not necessarily consecutive, and in any three out of four immediately preceding basis years he/she was either resident or in Malaysia for 90 days or more, he/she will be deemed resident for the basis year in question.

Example 1

An individual was in Malaysia from:	Residence status:
4 January 2011 to 31 December 2011	362 days — resident (s 7(1)(a))
1 January 2012 to 9 February 2012	40 days — resident (s 7(1)(b))
1 January 2013 to 5 April 2013	95 days — non-resident
1 March 2014 to 30 April 2014	61 days — non-resident
1 February 2015 to 3 June 2015	123 days — resident (s 7(1)(c))

For the basis year 2015, the taxpayer was a resident since his stay was more than 90 days, and in three out of the four immediately preceding years he was resident under s 7(1)(a) and 7(1)(b) and was in Malaysia for more than 90 days in the basis year 2013.

Example 2

An individual was in Malaysia from:	Residence status:
1 June 2012 to 10 September 2012	102 days — non-resident
15 June 2013 to 15 September 2013	93 days — non-resident
15 April 2014 to 15 July 2014	92 days — non-resident
1 January 2015 to 2 June 2015	153 days — resident (s 7(1)(c))

For the basis year 2015, he was resident under s 7(1)(c) since he was in Malaysia for more than 90 days (153 days), and in the three preceding years he was in Malaysia for more than 90 days (s 7(1)(c)(ii)).

(iv) Section 7(1)(d): Not in Malaysia

With reference to a particular basis year, if an individual is resident for the immediate following year and was resident for the three immediate preceding years, then he/she is deemed resident for that particular year even though he/she was not in Malaysia in that year.

Example

An individual was resident in Malaysia for the basis years 2012, 2013, 2014 and 2016. But, during 2015, he was not in Malaysia — not even for a single day. He would nevertheless be deemed resident in Malaysia for 2015.

Section 7(1A) provides that, when determining the residence of an individual, he/she shall be deemed to be in Malaysia for a day if he/she is present in Malaysia for part or parts of that day. It also provides that, in determining the period an individual is in Malaysia during any year, any day (within para (a) and (c) of s 7(1)) for which he/she is in Malaysia shall be taken into account whether or not that day forms part of a continuous period of days during which he/she is in Malaysia.

Section 7(1B), which took effect from YA 2009, deems a citizen of Malaysia to be tax resident in a basis year if he/she is employed in the public services or that of a statutory authority and is not in Malaysia at any day in the basis year due to:

- having and exercising his/her employment outside Malaysia, or
- attending any course of study in any institution or professional body outside Malaysia which is fully sponsored by the employer.

Section 7(1B) was introduced following the discontinuation of non-resident citizen relief with the deletion of s 130. Non-resident citizen relief is no longer applicable with effect from YA 2009.

The Inland Revenue Board (IRB) has issued Public Ruling No 6/2011 on the determination of residence status of individuals where a number of examples are included to show how one can determine residence status in line with s 7 of the ITA.

Law: s 7.

WHO MUST FILE A RETURN?

¶1-200 Residents

An annual return must be filed by all resident individuals who are chargeable to tax. Normally, unmarried individuals with an annual income of RM29,000 or more and married individuals with an annual income of RM38,000 or more may be considered chargeable to tax. This applies to all individuals who qualify as residents, whether or not they are citizens of Malaysia.

Where an individual's relief and deductions exceed his/her total income, he/she is not chargeable to tax and he/she is not therefore obliged to inform the Director General. However, where he/she has received a return form for completion, he/she is required to submit the form to the Director General declaring his/her income and claiming the deductions he/she is entitled to.

Every individual carrying on a trade or a profession, whether on his/her own or in partnership, ought to file a return, whether or not he/she is chargeable to tax. This is because, should a tax loss from a trade or profession be established, it will rank for deduction against income earned in future years (see ¶4-420).

Law: s 77.

¶1-210 Non-residents

A non-resident individual who has a Malaysia-sourced income is, like a resident, required to file a return.

Where a non-resident individual is not physically present in Malaysia, the Director General may appoint a person in Malaysia as an agent of the non-resident. The agent will, in such cases, be required to discharge the obligations of the non-resident. See further ¶12-200.

Law: s 68.

¶1-220 Employees on short-term visits

Non-resident employees who exercise employment in Malaysia for a period or periods which together do not exceed 60 days in a calendar year are exempt from tax and need not file a return, unless they are specifically required to do so by the Director General (see ¶8-370).

Law: Sch 6 para 21, 22.

¶1-230 Married women

A married woman is assessed separately on her income from all sources. As such, the obligation lies on her to submit a return form. However, she may elect for a joint assessment in her husband's name; in which case, only the husband will need to submit a return.

Law: s 45(2).

¶1-240 Children

Where a child has total income that renders him/her liable to tax, he/she will be taxable in the same way as an adult and will need to furnish a return.

If income is passed under any settlement to an individual who is unmarried and under 21 years of age, such income is deemed to be the income of the settlor and not the recipient (see ¶5-520).

Law: s 65, 69.

¶1-250 Employment aboard a ship or aircraft

Pursuant to s 13(2), where employment is exercised aboard a ship or aircraft operated by a person who is resident in Malaysia, income therefrom will be deemed to be derived from Malaysia. As such, should the vessel or aircraft spend most of its time outside Malaysia, the employee will in all likelihood face the additional misfortune of being charged as a non-resident.

To compensate for this predicament, exemption under para 34 of Sch 6 is available to those serving on board a ship under the following circumstances:

- The ship is owned and operated by a person resident in Malaysia.
- The ship is registered under the *Merchant Shipping Ordinance 1952*.
- The ship is a seagoing vessel and not a ferry, barge, tug boat or similar vessel.

Where exemption under the above conditions is to be considered, the following must be noted:

- Exemption is available only in respect of employment aboard a ship and not an aircraft.
- The relevant ship must be both operated and owned by a person resident in Malaysia; liability under s 13(2) befalls those serving on board a ship operated by a resident; he need not also own the ship.

See also ¶12-400ff.

Law: Sch 6 para 34.

WHICH FORM TO USE?

¶1-300 Manual filing

The forms of return for individual taxpayers are Form B/BE and Form M. Form B/BE is used by resident individuals whereas a non-resident individual will use Form M.

Where an individual's income does not include any income from a business source, he/she is required to submit Form BE. Should an individual have a business source, he/she would need to submit Form B. The income an individual may have included income from a partnership, a business, a profession, an employment, dividends, interest and discounts, rents, royalties and premiums, pensions, annuities and other periodical payments, casual earnings and other receipts of an income nature not falling within the above categories (see ¶6-100ff).

A non-resident individual is required to submit Form M and is required to declare only his/her income from Malaysian sources.

An individual should personally sign his/her return. Under the self-assessment regime beginning from YA 2004, no supporting documents need to be submitted to the IRB although they should be kept for a period of seven years for the purposes of tax audits.

Law: s 77, 82, 82A.

¶1-310 Electronic filing

The IRB strongly encourages taxpayers to submit their income tax returns through electronic filing. The forms that can be submitted through this medium are:

- e-C
- e-R
- e-CP 204
- e-BE
- e-B
- e-M, and
- e-P.

Enquiries or requests for assistance on electronic submissions can be made to e_filing@hasil.gov.my.

The IRB's website is at www.hasil.gov.my.

The section also provides that where the above two conditions do not apply the value of the closing stock "shall be taken to be an amount equal to its market value at the time he so ceases and shall be taken to be the value thereof at the end of the relevant period".

If on a cessation of trading the stock is not sold, then in the final accounts the stock in hand should be valued at its market value at the date of cessation (s 35(5)(b)).

Where stock is included with other items as a global sale figure, the total sale price must be allocated among assets and stock so as to arrive at a stock valuation figure which is just and reasonable. If stock is sold for valuable consideration the value to be placed on the stock is the market value at the date of transfer (s 35(5)(c)).

The above rules will apply equally to work in progress.

Thus, where a trader or professional is disposing of a business which includes trading stock or work in progress, the agreed figures for the sale of the stocks and work in progress will represent the closing item of stocks and work in progress of the vendor and the opening ones for the purchaser. If this does not apply, the open market value is taken into account.

The aim of s 35(5) is to prevent tax avoidance by manipulating stock values on the cessation of one operation and the commencement of another.

Accordingly, a Singapore case has held that trading stock, in the form of land, which had not been sold or transferred for valuable consideration when the taxpayer's trade discontinued, had been correctly valued by the Comptroller, under the equivalent to s 35(5), at its market value at the date of transfer (*HC & Anor v CIT*).

Part II of Public Ruling No 4/2006, which is expected to be issued at a later date, will explain the valuation of stock in trade and work in progress relating to specialised industries including construction contracts, property development, banks and financial institutions, professional and service establishments, livestock, agricultural, forest products and mineral ores, and computer software and spare parts.

Law: s 35(5).

CHAPTER 7

WHAT IS INCLUDED IN ASSESSABLE INCOME?

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WHAT IS INCOME?

¶7-050 General — income not defined

The whole object of the *Income Tax Act 1967* (ITA) is to tax income and it is therefore an exercise of utmost importance for a taxpayer to distinguish the nature of a particular receipt or accrual. Money or money's worth to be taxable must not only be received from a specific identifiable source but it must be in the nature of *income* and not in the nature of *capital*. Income receipts normally would have a recurring characteristic whereas capital receipts are of a once-and-for-all-time nature. Thus, one can contend that capital is wealth retained and invested and income is wealth that is transferred and circulated.

"Income" has not been defined in the ITA and the expression has been often described by the courts with reservations. Its meaning is not exhaustive. It has been defined as a gain derived from capital, labour or both combined that is received by the taxpayer for his/her separate use, benefit and disposal (*Eisner v Macomber*). It is not necessarily a recurrent return from a definite source. It may consist of a series of separate receipts, as it does in the case of professional earnings (*Kamalakshya Narain Singh v CIT*). For income tax purposes, income from a business or employment or investment takes its limitation from the words "gains" and "profits". Thus, the tax on a business is a tax on the gains and profits it makes from its entire operations and is not a tax on its gross receipts.

Capital or revenue receipt?

Two identical transactions can yield a capital receipt in one case and an income receipt in another. An accountant who sells his/her car sells it on a capital account, whereas a car dealer who sells a car does it on a revenue account. The latter's receipts are of an income nature. It follows that the status of the recipient in such cases becomes all important.

Generally, the accounting treatment gives support to its nature but cannot be considered conclusive for tax purposes.

Since Malaysia does not cater for tax on capital gains or profits (except on certain properties), once a receipt is evaluated as one of a capital nature, it should be ignored for tax purposes (see ¶17-050ff).

In the case of a trade or business, all receipts which are normally related to the circulating capital or stock in trade of the business are considered of an income nature. Those related to fixed capital are of a capital nature. There are certain tests that can be usefully applied in varying degrees to a transaction in question:

- Does the receipt arise from the carrying on of the trade or business? Thus, if a receipt has little relevance with the business or falls outside the scope of its operations, it cannot give rise to a gain or profit from the trade. This does not, however, mean that the receipt will fall outside the scope of taxation. It may well be taxable under some other heading in s 4 of the ITA.
- Is it a capital or a revenue receipt?
- Are there any provisions in the ITA which require that the receipt in question is to be given special treatment? For example, is it specifically exempted or is it subject to tax at a reduced rate?

Insofar as personal services are concerned, the criteria are different. Briefly, all that flows from an employment will rank as income receipts unless specifically exempted.

Income referred to in tax legislation is taxable income, ie that income which is chargeable to tax under the tax laws of the relevant country.

Income is taxable only when it is received or, as in the case of businesses, when it becomes receivable. Further, tax can only be charged on and paid by the person receiving or entitled to the income. Hence, traders may pay tax on the balance of profits or gains and bring money owed to them into account but ordinary individuals are not assessable and do not pay tax until they get the money because until then it is not part of their income (*IR Commrs v Whitworth Park Coal Co Ltd*).

The concept of income is not *in vacuo*. The income bears its quality as income only if it is received by the taxpayer or it has accrued or has arisen to the taxpayer. It can also be income if it is fictionally deemed to be received by, or is deemed to have accrued or arisen to, a taxpayer.

¶7-055 Income "deemed" to derive from Malaysia

"Deemed to derive" means "deemed by the statutes" to derive. In other words, income in reality is not derived but the ITA requires it to be treated as income derived from Malaysia. Artificial derivements are provided in the Malaysian ITA and broadly fall under five concepts:

- *Artificial place of derivement*

  In such a case, the income is not in reality derived in Malaysia but the ITA requires it to be treated as if it was derived here.

  The fiction in s 15, eg fixes the place of derivement in Malaysia of certain types of interest and royalties.
- *Artificial chargeability of a person*

  Here, the income of someone else may be deemed to be the income of the person sought to be taxed.
- *Artificial year of taxability*

  Here, the income may be deemed to be the income of the previous year, ie the accounting year or year of remittance of offshore income, when actually it may be the income of a different year.
- *Artificial amount of derivement*

  This situation arises where the amount actually derived is artificially reduced. For instance, s 54 states that the profits of a non-resident shipping operation will be 5% of the gross earnings from outward shipments from Malaysia.

¶7-060 Charging section

Section 4 of the ITA is the charging section and sets out six main heading of income that are chargeable to tax:

- profits or gains from a trade, business, profession or vocation (s 4(a))
- profits or gains from personal services — employment (s 4(b))
- dividends, interest and discounts (s 4(c))
- rents, royalties or premiums (s 4(d))
- pension, charge or annuity or other periodical payments (s 4(e))
- gains or profits from other sources (s 4(f)).

For each year of assessment, tax is levied on the total of the income derived under the above headings.

Law: s 4.

¶7-065 Income of a non-resident person

In addition to the main six headings of income indicated in ¶7-060, there is a charging section for non-residents. Section 4A(i) to (iii) provides that income of a non-resident person from the following is chargeable to Malaysian tax:

- any consideration for services rendered by him/her or his/her employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from the non-resident

- any consideration for technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme, and
- rent or other payments made under any agreement or arrangement for the use of any movable property.

For first two categories of income mentioned above, they are deemed to be derived from Malaysia under s 15A if the relevant services were performed in Malaysia; if not, liability to tax would not arise.

Budget 2017

However, s 15A is amended via *Finance Act 2017* so that income under s 4(i) and (ii) would be subject to tax even if the services for which they were paid were not performed in Malaysia.

The Inland Revenue Board (IRB) has expressed the general view that any services involving the imparting or transferring of specialised and expert knowledge will be deemed to be of a "technical" nature.

Services provided by architects, computer programmers and engineers fall squarely within the scope of s 4A of the ITA, although the Revenue has indicated that routine day-to-day administrative work charged by a head office to a branch, or by a holding company to a subsidiary, will not be considered as specialised services. Similarly, fees or commissions paid to non-resident purchasing agents whose services are not specialised or technical in nature would not be included under s 4A of the ITA.

Under the Malaysian–German tax treaty, there is a "Technical Fees" Article. As such, s 4A payments to a resident of Germany which were previously exempted from Malaysian tax under Art 21 of the old DTA is no longer applicable.

For the latest development with effect from 21 September 2002, see ¶12-810.

Law: s 4A.

ASCERTAINMENT OF TAXABLE INCOME

¶7-100 General

The basis or the concept of tax in Malaysia is territorial. In ascertaining the income that is to be subjected to tax, one has to start with the gross income. This means the total amount:

- not of a capital nature
- derived during the year of assessment
- from a source within Malaysia, and
- by any person.

Thus, the following four factors to be considered when determining tax liability are:

(1) *Quality* — If the income is of a capital nature and it does not fall within the taxpayer's gross income.

(2) *Time* — Only those amounts that are physically received by the taxpayer during a particular year of assessment are subject to tax in that year.

(3) *Source* of income — Here, we pose the questions: What did the taxpayer do or suffer to earn the income; and did he/she earn it in Malaysia?

(4) *Incidence* — Here, we need to determine who is the person or legal entity upon whom the liability for tax falls.

In ascertaining the income of a person for the purposes of tax one has to take the gross income and from this make all the qualifying deductions as prescribed in the ITA (see ¶9-050ff). In addition, all income which is exempt from tax is to be excluded (see ¶8-100ff).

Source of income

The Malaysian ITA does not define "source" and consequently each commercial activity has to be carefully examined to determine the source from which income is generated. With Malaysia's taxation concept being territorial, if the originating cause of an income in question is not within the jurisdiction of Malaysia, it falls outside the tax net.

In Malaysia's first landmark case regarding the source of income, ie *Ketua Pengarah Hasil Dalam Negeri v Cardinal Health Malaysia 211 Sdn Bhd* (2011), the Court of Appeal affirmed that interest income derived by the taxpayer from loans made to an overseas entity (in the Netherlands) was foreign-sourced and therefore not subjected to Malaysian income tax. The taxpayer won before the Special Commissioners of Income Tax, the High Court and lastly the Court of Appeal.

At each level, the Malaysian courts and the Special Commissioners affirmed Commonwealth case law, in particular the Privy Council cases *CIR v Hang Seng Bank* (1989) and *CIR v Orion Caribbean Ltd* (1999). Although the Malaysian exemption and the counterpart Hong Kong legislation in *Hang Seng Bank* and *Orion Caribbean* are not identical, the Malaysian courts were persuaded to apply the principles arising from each case, as the present case revolved around the question of what the taxpayer had done to earn the interest income.

The DGIR had argued that the interest income was in fact sourced in Malaysia, as the funds lent were generated from the business activities of the taxpayer in Malaysia and transmitted from the taxpayer's bank account in Malaysia. Applying Lord Bridge's dicta in the *Hang Seng Bank* case, the Court of Appeal affirmed the judgment of the High Court that the source of the interest income was located "where money was lent", and it followed that what had been done to earn the income was the placement of the funds in the Netherlands. Therefore, the interest received by the taxpayer from its related Dutch company was foreign-sourced income and hence exempted from income tax under the Income Tax (Exemption) (No 48) Order 1997.

As the issue of foreign-sourced interest income had never been litigated previously, the case of *Ketua Pengarah Hasil Dalam Negeri v Cardinal Health Malaysia 211 Sdn Bhd* (2011) was crucial in setting an important precedent.

¶7-110 Tax-free income

Technically, there is no such thing as "tax-free income". If an amount is liable, then the appropriate tax has to be paid. Where the receipt of income, eg remuneration, dividends and interest, is tax free (ie borne by the employer in the case of employment), the amount of tax involved must be added to the income and the total would constitute gross income.

¶7-120 Gross income

"Gross income" is referred to as the total income for the basis period derived from all the sources indicated in ¶7-060. Thus, "gross income" refers to a specific source and also to the total from all sources.

Law: s 4, 5(1)(b).

¶7-130 Adjusted income (loss)

After applying all expenses and outgoings incurred wholly and exclusively in producing the gross income and excluding receipts which are not liable, the result is the adjusted income or loss, as the case may be. However, it must be noted that the concept of "loss" applies to a business source only. For any other source, should the allowable expenses exceed the income, the surplus does not constitute a loss, it is simply disregarded for tax purposes.

Law: s 5(1)(c), 33.

¶7-140 Statutory income

Capital allowances as provided in the ITA are then deducted from the adjusted income and the balance is referred to as statutory income. Should the capital allowances exceed the adjusted income, the statutory income would be nil and the surplus capital allowances would be carried forward to the following year. Since capital allowances are applicable to only business sources, adjusted income from non-business sources would also be statutory income.

Law: s 5(1)(d), 42.

¶7-150 Aggregate income

The next step is to apply all unutilised business losses carried forward if any, from earlier basis years which could not be absorbed to the statutory business income, and to add all the non-business sources of income. The residue is referred to as the aggregate income.

Law: s 5(1)(e), 43.

¶7-160 Total income

From the aggregate income are deducted items like the adjusted loss for the basis period (if any), abortive prospective expenses, donations to approved institutions and the Government, group relief (applicable for companies), and carry back losses under s 44B. The balance is total income.

Law: s 44.

¶7-170 Chargeable income

The final step is to deduct personal relief, ie individual, wife and child relief, life assurance, and the other relief and deductions available to an individual. The result

would be chargeable income and to this amount the tax rates relevant to the person concerned are applied. Since companies are not entitled to personal relief, their chargeable income will be the total income.

Law: s 5(1)(f), 46–50.

¶7-180 Calculation of chargeable income

Example

		RM	RM	RM	Section
	Business income (rubber trading)		80,000		24
Less:	Business expenses wholly and exclusively incurred	45,000			33
	Bad and doubtful debts	1,500			34
	Contributions to approved scheme	1,000			34
	Stock adjustments	1,500	(49,000)		35
	Adjusted income (see ¶7-130)			31,000	
Less:	Capital allowances (Sch 3)			(7,500)	
	Statutory income (see ¶7-140)			23,500	42
Less:	Balance of unabsorbed business loss b/forward, say,			(4,500)	43(2)
				19,000	
	Employment		10,000		24
Less:	Rent for accommodation and furniture		(1,000)		38
	Adjusted/statutory employment income			9,000	
	Interest, discounts			7,500	27
	Rents, royalties, premiums			8,500	27
	Pensions, annuities, etc			2,000	27
	Other gains — commission			1,500	28, 29
	Aggregate income (see ¶7-150)			47,500	
Less:	Prospecting expenses	7,000			44(6)
	Donations to the Government and approved institutions	1,000		(8,000)	Sch 4
	Total income (see ¶7-160)			39,500	42
Less:	Personal relief (self, wife, etc)			(16,000)	46, 49
	Chargeable income (see ¶7-170)			23,500	

EMPLOYMENT INCOME OR INCOME FROM PERSONAL SERVICES

¶7-200 What is an employment? — Distinguished from a profession

An employment is an arrangement made for the performance of personal services by an individual. There must be an employer and an employee and the relationship between the two must be one of master and servant. In other words, there must be control by the employer in respect of the manner in which the employee is to conduct his/her work and in the case of the employee there must be an obligation to discharge his/her duties of employment in accordance with the wishes and instructions of the employer.

The distinction between an employment and profession must be clearly understood. A profession involves the making of a series of engagements where service is provided. If therefore the earnings of an individual are the result of a series of engagements and he/she moves from one to another at his/her own will, he/she is considered to be exercising a profession not an employment. Each of an actress's engagements could, thus, not be considered an employment, but was a mere engagement in the course of exercising a profession (*Davies v Braithwaite*). The rewards which a "self-employed" individual receives will form part of his/her business income (s 4(a)). For an individual to be taxed under s 4(b), he/she must be the holder of an "office" or "employment".

Example 1

An accountant, B, who runs his own practice and has his own office and staff, is engaged by a company to formulate an internal audit programme for remuneration of RM3,000 per month. This income of B will not be deemed employment income. It will be income derived from the exercise of a profession.

Example 2

A, a chartered accountant, is the chief accountant of a company and is required by the board of directors to draw up an internal audit programme. In addition to his normal salary, he receives an amount of RM1,000 during the period he is doing this special job. The RM1,000 will be deemed income from employment.

Basically, it is a question of fact whether an individual is "employed" or "is carrying on a profession" and the following questions should be posed:

- Does the taxpayer occupy an office?
- Does the taxpayer undertake an employment?
- Are the services rendered by the taxpayer merely in the course of the exercise of his/her profession?

Contract for services versus contract of service

Where a taxpayer makes a living by undertaking a series of engagements for reward, then none of them will be considered an employment. Each one will be merely a contract for services, entered into in the sense of a whole business or profession. On the other hand, where a taxpayer's working life involves the obtaining of an appointment and staying in it until he/she gets another one, each succeeding contract will be a contract of service — one which has a master-servant relationship. A legal assistant who is employed under a contract of service does not carry on a profession even though he/she performs professional work. The salary paid to him/her while serving as an employee is received from "carrying on an employment" (*KM*). Similarly, a professional public entertainer, who contracted with a hotel to provide floor shows, was employed under a contract of service because her performance was integrated with the hotel's business and therefore she could not have been carrying on a business on her own account. The terms of her contract included the payment of fixed remuneration, stipulations as to the duration of the performance and her appearance, and the prohibition of alternative employment. Accordingly, her income under the contract was employment income and not business income (*DGIR v FY* (1988) 1 MSTC 2,078).

Problems can arise when an individual works for more than one person either concurrently or consecutively. He/she may be a holder of several offices, or be employed by a number of persons; alternatively, his/her work may all be part of one profession which is carried on by him/her. It is essentially a question of fact when one has to consider whether or not an individual is exercising an employment.

Definition of employment

Section 2 of the ITA defines "employment" as:

> "(a) employment in which the relationship of master and servant subsists;
>
> (b) any appointment or office, whether public or not and whether or not that relationship subsists, for which remuneration is payable;"

An employment should also be distinguished from a trade or business (see ¶7-300).

An individual in the full-time employment of a firm carrying on a trade or business, and precluded by the terms of his/her engagement from doing any work for any other firm, is not carrying on a business on his/her own account. On the other hand, an individual who is employed by a number of firms does carry on a trade or business (*Marsh v IR Commrs*).

Law: s 2, 4(a), (b).

¶7-202 What constitutes employment income?

Section 13(1) lays down the general rules as to what constitutes employment income. This income includes:

> "(a) any wages, salary, remuneration, leave pay, fee, commission, bonus, gratuity, perquisite or allowance (whether in money or otherwise) in respect of having or exercising the employment;

(b) an amount equal to the value of the use or enjoyment by the employee of any benefit or amenity (not being a benefit or amenity convertible into money) provided for the employee by or on behalf of his employer excluding—

(i) a benefit or amenity consisting of medical or dental treatment or benefit for child care

(ii) a benefit or amenity consisting of—

(A) leave passages including meals and accommodation for travel within Malaysia not exceeding three times in any calendar year; or

(B) one leave passage for travel between Malaysia and any place outside Malaysia in any calendar year, limited to a maximum of three thousand ringgit:

Provided that the benefit or amenity enjoyed under this subparagraph is confined only to the employee and members of his immediate family.

(iii) a benefit or amenity used by the employee solely in connection with the performance of his duties; and

(iv) a benefit or amenity falling under paragraph (c);

(c) an amount in respect of the use or enjoyment by the employee of living accommodation in Malaysia (including living accommodation in premises occupied by his employer) provided for the employee by or on behalf of the employer rent free or otherwise;

(d) so much of any amount (other than a pension, annuity or periodical payment falling under section 4(e) received by the employee, whether before or after his employment ceases, from a pension or provident fund, scheme or society not approved for the purpose of this Act as would not have been so received if his employer had not made contributions in respect of the employee to the fund, scheme or society or its trustees; and

(e) any amount received by the employee, whether before or after his employment ceases, by way of compensation for loss of the employment, including any amount in respect of—

(i) a covenant entered into by the employee restricting his right after leaving the employment to engage in employment of a similar kind; or

(ii) any agreement or arrangement having the like effect."

Budget 2017

A new s 13(1A) has been introduced whereby any benefit-in-kind (BIK) provided by an employer should include any GST output tax he/she has to bear. Thus, the gross income from employment includes output tax borne by the employer.

In *DM v Ketua Pengarah Hasil Dalam Negeri* (2001) MSTC 3,215, E Sdn Bhd ("the Company") had only two directors being the taxpayer and her husband. The taxpayer was not a service director and did not receive any remuneration from the Company. The Company owned a residential house in which the taxpayer and her husband resided. The house was transferred to them for a consideration of RM1. The Director General of Inland Revenue (DGIR) argued that the taxpayer was an employee under s 2 of the ITA and the transfer of the house was a form of remuneration. The DGIR assessed the difference between the market value of RM730,000 and the consideration of RM1 as a perquisite received by the taxpayer having exercised an employment under s 13(1)(a) of the ITA.

The taxpayer contended that the transfer of the house was not a perquisite in respect of having or exercising an employment as she was not an employee of the company. Her appointment as a director of the Company was merely to fulfil the requirements of the *Companies Act 1965* (CA 1965). On appeal, the Special Commissioners of Income Tax held that the taxpayer was not paid any wage, salary, remuneration, leave pay, fee, commission, bonus, gratuity or allowance within the meaning of s 13(1)(a) of the ITA. No service contract was drawn up between the taxpayer and the company and there was no offer, promise or resolution of any kind to pay the taxpayer any form of remuneration for her services. The taxpayer's appointment as a director was to satisfy the requirement of s 122 of the CA 1965. The consideration of RM1 although seemingly inadequate was sufficient consideration to make the transaction a valid sale and purchase.

"Having or exercising" an employment

The words "having or exercising" the employment in s 13(1)(a) give a wide scope to the taxing of employment income. Thus, if it can be established that some form of remuneration arises from having an employment, not necessarily exercising the employment, it is taxable. For example, during a leave period one does not exercise an employment but one certainly *has* an employment.

When employment income derives from Malaysia

Where an employment is exercised in Malaysia, the source is in Malaysia, ie the income is derived from Malaysia (s 13(2)(a)). In the case of leave pay, if the leave is attributable to the employment exercised in Malaysia the leave pay is deemed to derive from Malaysia (s 13(2)(b)).

Example 1

Smithers, a British citizen, was employed as a teacher in Malaysia from 1 January 2016 to 30 September 2016. His income from employment would be derived from Malaysia and would be taxable here.

Relevant Schedule	Type of allowance	Initial allowance	Annual allowance	Particular feature	Balancing allowance	Balancing charge
Schedule 3	Plant and machinery	20%	See ¶11-695	Must be owned and in use at end of basis period or if sold during the basis period have been in use or owned in basis period. Accelerated allowances are available.	If an initial or annual allowance was given or was able to have been given — the difference between residual expenditure and disposal value (subject to maximum allowances given for balancing charge).	
Schedule 3	Industrial building (Certain types of living accommodation) (Accommodation — approved service projects)	1/10 2/5	3/100 or permitted fraction	Must be owned and in use at end of basis period or if sold during the basis period have been in use or owned in basis period.	If an initial or annual allowance was given in or was able to have been given — the difference between residual expenditure and disposal value (subject to maximum allowances given for balancing charge).	
	(childcare facilities)	–	1/10			
	(schools/educational institutions)					
	(warehouses — storage of goods)					
Schedule 3	Agriculture	–	1/10 1/2	Must be owned and in use at end of basis period or if sold during the basis period have been in use or owned in basis period.	No balancing allowance: allowance for year of assessment in the basis period for which the asset sold is allocated between vendor and purchaser on a time basis.	Government subsidies, etc, are charged fully. Agriculture charge equal to the total allowance given if disposal takes place less than 10 years after expenditure is incurred. Charge can be spread over number of years for which allowances were given.
	(Buildings)	–				
	(Other capital expenditure)	–				
Schedule 3	Forest	–	1/10		On disposal: an allowance of the balance of expenditure unallowed.	On disposal: a charge of the amount of the allowances given. Charge can be spread over years for which allowances were given.
Schedule 2	Mines	–	Fraction of residual expenditure at end of basis period. Fraction is estimated life of mine at beginning of basis period.	Allowance is given in arriving at adjusted income.	Difference between residual expenditure and disposal value to be either a deduction or a sum to be included in arriving at adjusted income of the basis period, as the case may be.	

CHAPTER 12

NON-RESIDENTS AND SPECIAL CASES

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NON-RESIDENT COMPANIES

¶12-100 General

Prior to YA 1995, the remittances of foreign income received by resident companies were subject to tax in Malaysia whereas non-resident companies were only taxable on income accrued or derived from Malaysia. Thus, a non-resident company carrying on a worldwide trade was taxed in Malaysia only on that part of its trade which it carried on in Malaysia. However, from YA 1995 to YA 1997, tax was only charged on income accrued or derived from Malaysia. An exemption order was issued with effect from YA 1998, to grant an exemption from income tax on foreign-sourced income received in Malaysia by a resident company (other than a company carrying on the business of banking, insurance, shipping and air transport).

The residence of a company has been dealt with at ¶2-120 in detail and it need only be mentioned here briefly that, if the control or management of a company is exercised by its directors in Malaysia, it will be deemed resident here. Thus, a foreign company can become resident in Malaysia if its directors hold board meetings regularly here and generally manage and control the company from here.

The double taxation agreements which Malaysia has with several countries resolve the problem to a large extent insofar as the taxation of non-resident companies are concerned. These agreements provide that Malaysia will only tax residents of the contracting countries if they carry on a trade through a permanent establishment in Malaysia (see ¶15-050ff).

Law: Income Tax (Exemption) (No 48) Order 1997.

¶12-110 Tax liability criteria

To attach liability to a non-resident company in Malaysia, it is necessary to establish that it is carrying on a trade or business within Malaysia. A trade carried on with Malaysia will not expose the non-resident to tax here.

Trading with Malaysia or within Malaysia

The question whether a person is carrying on a trade within Malaysia or with Malaysia is to be decided after a review of all the relevant facts (see ¶12-220).

If all that a trader does in any particular country is to solicit orders, he/she cannot reasonably be said to exercise or carry on his/her trade in that country. What is done there is only ancillary to the exercise of his/her trade in the country where he/she buys or makes, stores, and sells his/her goods (*Grainger and Son v Gough*). Thus, the mere seeking or canvassing of orders in Malaysia is not of itself evidence of the carrying on of a trade within Malaysia. If, however, the non-resident extends his/her activities to accepting orders in Malaysia, he/she may be held to be trading within Malaysia.

The courts have over the years indicated that not only is it impossible but often unwise to attempt to provide an exhaustive definition of what is trading within a country. The place where sales or contracts of sale are made is of great importance when it is a merchanting business that is in question. It is not, however, the determining factor if there are other circumstances present that outweigh its importance (*Firestone Tyre & Rubber Co Ltd v Lewellin*).

Guidelines

Two very pertinent factors which provide guidance when determining whether a person is carrying on a trade in Malaysia are:

(1) whether it is the intention of the taxpayer to make a profit in Malaysia and what motivates him/her to carry on trading activities here, and

(2) what is the nature, extent and frequency of his/her activities in Malaysia which give rise to income.

It is really the question of "source of income" which gives rise to the distinction between trading with Malaysia and trading within Malaysia (see ¶12-220). If it is held that trading is being carried on within Malaysia, a tax exposure will arise. Some of the factors the Revenue considers when determining whether or not a person is trading within Malaysia are:

- whether there is a permanent establishment here
- whether there is capital employed in any other way, eg the ownership of property — which can include patent, trademarks or the ownership of trading stock
- whether the taxpayer carries on business operations within Malaysia — eg performing acts under a contract
- the location where contracts are formed
- the location where services are performed, and
- the location where goods pass.

Where none of the above factors is present within Malaysia there can be no income within Malaysia that can become liable to income tax. However, if one or more of these factors exist, jointly or severally, an imputation can be made that a source of income exists in Malaysia and the particular income arising from it falls within the scope of the *Income Tax Act 1967* (ITA).

Distributing profits

In Malaysia, profits may be taxed distributively. This particular area is covered by the provisions of s 12(1) of the ITA which state that the profits which accrue or are derived from outside Malaysia are distinguished from the local profits of the Malaysia business and are not subject to tax. In matters such as these the true question is not whether the profits concerned arise or are derived from a trade or business carried on in Malaysia, but rather, did the operations from which the profits arise or accrue take place in Malaysia?

It is not necessarily the case that, if a company is not carrying on a trade or business in Malaysia it will not be in any way affected by the provisions of s 12(1). It is not an essential prerequisite of liability to tax in Malaysia that a company should actually be carrying on business in Malaysia. The essential test is, is it carrying on any operations in Malaysia (which may only be part of its trade or business) so as to give rise to income which accrues or is derived from those operations? In Malaysia, the question of trading or carrying on a business within Malaysia is only a guide to what is the true question, namely, are operations, which give rise to profits, carried on within the jurisdiction?

What constitutes "trading"

It must be emphasised that the activities which constitute the carrying on of a trade need not necessarily be confined to activities by way of a trade, commerce or manufacture, or for that matter activities relating to the exercise of a profession. They can consist of rendering services to others. Thus, if non-resident companies house their technical staff in Malaysia for providing services (or backup services) in Malaysia the activities of these personnel will constitute the carrying on of a trade by the non-

resident company in Malaysia. The fact that the trading activities are carried on by individuals and not by the foreign company with a fixed place of business in Malaysia is not relevant.

Law: s 3, 12.

¶12-120 Carrying on business in Malaysia

In relation to foreign companies, s 330(1) of the *Companies Act 1965* (CA 1965) states that "carrying on a business" includes establishing or using a share transfer or share registration office or administering, managing or otherwise dealing with a property situated in Malaysia as an agent, legal personal representative, or trustee whether by servants or agents or otherwise.

Section 330(2) excludes a foreign company from being regarded as carrying on a business in Malaysia by reason only that it does any of the following things:

"(a) is or becomes a party to any action or suit or any administrative or arbitration proceeding or effects settlement of an action suit or proceeding or of any claim or dispute;

(b) holds meetings of its directors or shareholders or carries on other activities concerning its internal affairs;

(c) maintains any bank account;

(d) effects any sale through an independent contractor;

(e) solicits or procures any order which becomes a binding contract only if the order is accepted outside Malaysia;

(f) creates evidence of any debt, or creates a charge on movable or immovable property;

(g) secures or collects any of its debts or enforces its rights in regard to any securities relating to those debts;

(h) conducts an isolated transaction that is completed within a period of thirty-one days, but not being one of a number of similar transactions repeated from time to time;

(i) invests any of its funds or holds any property; or

(j) imports goods only temporarily pursuant to the *Customs Act 1967* for the purpose of display, exhibition, demonstration or as trade samples with a view to subsequent re-exportation within a period of three months or within such further period as the Director-General of Customs and Excise may in his discretion allow."

The CA 1965 provides that a foreign company must register either if it has a place of business in Malaysia or if it commences to carry on a business in Malaysia (see ¶12-150ff).

Law: s 330 of the *Companies Act 1965*.

¶12-130 Trading activities in Malaysia

Non-resident companies or enterprises which intend to extend their activities to Malaysia can do so in any of the following ways:

- through commercial representatives
- by establishing a branch
- by incorporating a subsidiary
- by granting patent licences to Malaysian enterprises, and
- by rendering technical or other services to Malaysian enterprises.

COMMERCIAL REPRESENTATIVES

¶12-150 Resident representative

A foreign company can function in Malaysia through a resident representative without having to establish a place of business here. Activities through this means are not tantamount to carrying on a business in Malaysia and the foreign company will not therefore be exposed to tax here (see ¶12-120). In such cases the representative is considered to be carrying on an employment here.

There are very definite limitations to the operations the foreign company can carry on through its representative. For instance a representative cannot operate a manufacturing organisation and pay staff and disburse funds received from his/her principal. Nor would the foreign company be able to consign stocks, materials, equipment, etc, to its representative for him/her to effect sales or enter into contracts in Malaysia in its name. If this is done the company would be deemed to be carrying on a business in Malaysia. There is no danger, however, of a tax exposure if the representative merely carries stocks of samples in order to deal with queries from existing and potential customers.

Generally, representatives are located in Malaysia for information gathering and supplying purposes. So long as they confine themselves to such related activities there is no exposure to Malaysian tax. Some of the more common activities carried out are:

- manufacturing surveys
- establishing contacts with suppliers and consumers
- furnishing the head office with marketing feasibility studies of various countries in the region
- providing after sales advice and back up information, and
- generally acting as promotional and liaison contacts between the head office and the manufacturers/consumers in the region.

¶12-160 Representative offices

Foreign corporations in the manufacturing and trading sector, and foreign institutions in the banking sector are allowed to set up representative offices in Malaysia to perform certain activities for their head offices/principal/foreign interests. The setting

up of representative offices in the manufacturing and trading sector requires the approval of the Ministry of International Trade and Industry, while in the banking sector, the approval of Bank Negara is required.

Manufacturing and trading sector

A representative office in the manufacturing and trading sector is permitted to undertake the following activities:

- planning or coordination of business activities
- gathering and analysis of information or feasibility studies relating to investment and business opportunities in Malaysia and the surrounding region
- identifying source of raw materials, components or other industrial products
- research and product development
- acting as a regional coordination centre for the corporation's affiliates, subsidiaries and agents, and
- other activities which will not result directly in actual commercial transactions.

However, a representative office is not permitted to engage in any trading or business activities. It is also not permitted to lease warehousing facilities, or sign business contracts on behalf of the foreign corporation or provide services for a fee, or participate in the daily management of any of its subsidiaries, affiliates or branches in Malaysia.

Banking sector

A "foreign institution" is defined as an institution which carries on any business outside Malaysia, which corresponds, or is similar to a banking business, finance company business, merchant banking business, discount house business, money broking business, building credit business, credit token business, development finance business, factoring business and leasing business.

A representative office in the banking sector is permitted to carry on the following activities:

- the supply of trade and other economic and financial information on Malaysia to overseas interests and *vice versa*
- assisting Malaysian exporters in finding new markets through the services of their international offices and *vice versa*
- assisting foreign interests in establishing joint venture companies in Malaysia, and
- seeking opportunities for its respective bank to provide and to participate in the management and syndication of foreign currency loans to the Malaysian corporations, including identifying Malaysian companies which require offshore financing.

However, a representative office is prohibited from conducting banking or any other form of business in Malaysia.

OTHER REPRESENTATIONS

¶12-170 Service centres

Such centres perform primarily two functions. Firstly, as regional offices, they supervise and coordinate the activities of affiliated companies, agents, distributors and licensees in the region. Secondly, they supply technical aid to the enterprise under their charge.

Notwithstanding this, the Inland Revenue Board (IRB) has recently taken on a stance whereby regional offices providing administrative/accounting services to affiliated companies in the region, are deemed to have a permanent establishment or a base in Malaysia, and taxable on a deemed profit basis (generally at 5% of the total Malaysian expenses).

Where the services extend to the provision of technical services to licensees by stationing technical staff in Malaysia or where the provision of such technical services is the principal activity, a trading within Malaysia label (see ¶12-110) may be attached and consequently an exposure to tax will arise. Sometimes non-resident companies station staff in Malaysia to provide "after-sale" services on a somewhat ad hoc basis. It is considered that where such services involve a charge and/or the maintenance of spare parts in Malaysia, an exposure to tax can arise.

¶12-180 Sales assistance centres

Enterprises with international ramifications tend to provide sales assistance centres wherever feasible and profitable. The main function of such centres is the supervision and support afforded to distributors and agents in that country or region. In addition they provide personnel advice and in some cases technicians where sale of sophisticated equipment is concerned. It is considered that such centres do not expose the foreign enterprise to Malaysian tax as no productive activity is carried on here. This is provided all sales are effected outside Malaysia and the services rendered here are not substantial and not necessary for the conclusion of the business.

AGENTS OF NON-RESIDENTS

¶12-200 Who is an agent?

The ITA does not define an "agent", but generally, this term includes any individual, partnership, company or any other body of persons acting for or on behalf of another person. Thus, a Malaysian subsidiary of a non-resident parent can be deemed an agent of the non-resident parent.

¶12-205 Non-resident's liability

A non-resident person is not chargeable to Malaysian tax unless he/she carries on a trade within Malaysia. If he/she does, the income becomes liable to tax under s 3. Where he/she does not have a fixed place of business here, eg a branch, trading operations would normally be through an agency and he/she would be assessable in the agent's name (s 70(1)).

The Director General is given powers under s 68(1) to appoint any person to be the agent of another person for any specific purpose, such as recovery of tax, or for any or all of the purposes of the ITA. The appointment must be in writing and it may be revoked at any time.

A person appointed as an agent under s 68(1) may, within 30 days of the receipt of the notice, object to the appointment and appeal to the Commissioners against such appointment.

Normally, for purposes of the collection of tax, the Director General will only appoint a person as an agent if such person is in some sort of a fiduciary or quasi-fiduciary relationship with the taxpayer. In other words the agent should be holding moneys belonging to or due to the taxpayer presently or in the future.

Effective from 1 January 2012, where the representative is a person appointed as an agent by the Director General under s 68 of the ITA, the Director General may issue a written notice to the representative to remit the tax or debt due by the principal to the Director General. Section 67(4A) of the ITA indicates that the tax or debt is so payable even if the assessment in respect of the tax due is not issued in the name of the representative. The tax or debt is payable out of the accessible moneys and shall not include moneys held in the custody and control of the representative on behalf of the principal.

The insertion of this provision aims to eliminate disputes between the Director General and the representative on an assessment which is not issued in the name of the representative.

Section 67(6) confers on the agent the right to retain out of the moneys coming into his/her hands so much as from time to time is sufficient to pay the tax charged on the non-resident, with concomitant indemnification for all payments thus made to the Director General.

The agent is not to be convicted or any fine imposed on him/her in connection with any offence committed by the principal and in which the agent had no part.

Law: s 67, 67(4A), 68, 70(1).

¶12-210 Independent agents

Some of the distinguishing features of an independent agent are:

- The principal cannot generally tell an agent how to carry out his/her instructions. The latter is free to carry out the instructions according to his/her own discretion. This is unlike a master who can tell his/her servant what to do and how to do it. A dependent agent would be in a somewhat similar position to that of master and servant.
- An independent agent may sometimes be authorised to make contracts on behalf of the principal.
- An agent is generally paid by commission based on the result he/she is expected to produce by his/her principal.
- Such an agent normally makes an arm's-length charge to any independent third party for the use of his/her services and he/she is taxable in his/her own name.

Under the Malaysian double taxation agreements, an independent agent is not deemed to be a permanent establishment of a non-resident enterprise unless he/she has the authority to conclude contracts in the name of the enterprise. The guidelines concerning the liability of non-residents who operate in a country through agents were provided in *Pommery and Greno v Apthorpe* where a taxpayer working through an agent in England, who obtained orders in England, and caused goods to enter England to English customers, and through whose hands money passed, and through whom all arrangements were made, was held to have been carrying on a trade in England.

¶12-220 Whether trading in Malaysia

It is a question of fact whether a non-resident person is trading *with* Malaysia or *within* Malaysia (see ¶7-050ff and ¶12-110). Where the agent or representative contracts for the sale of goods or for the performance of services in Malaysia and this is done with regularity on behalf of the non-resident, a trade will be deemed to be carried on within the jurisdiction of Malaysia. On the other hand, if an agent in Malaysia is involved merely in the purchase of goods in Malaysia or the soliciting of orders in Malaysia, on behalf of the non-resident, the latter will not be deemed to be trading with Malaysia.

Buying alone will not constitute trading in Malaysia. The principle that selling is the source of profits has been well established in case law. The agent's capacity to contract on behalf of the non-resident is an important determining factor in such cases (see also ¶12-210).

¶12-230 Contracts by non-residents

Contract making by an agent can be of importance when determining whether the principal is trading in a tax jurisdiction. Where an agent contracts with others in Malaysia, on behalf of and so as to bind his/her principals, the latter can be held to be trading in Malaysia through an agency.

Contracting to buy or soliciting to sell in Malaysia is not by itself tantamount to exercising a trade in Malaysia. The place where sales or contracts for sales are made, however, can create tax implications. Further, even if all the sales or contracts of sales are made outside Malaysia the nature of the operations and the methods of dealing here can be determining factors of whether a trade exists.

Where a non-resident trader consigns goods to a Malaysian agent by way of sales and the agent agrees to sell the goods on certain terms regarding price and to account to the non-resident for a proportion of the proceeds of the sale, the non-resident may be deemed to be trading within Malaysia. In this case the agent does not make contracts of sale which bind his/her principal. In the UK, it was held that even where the property in goods passes to the agent under a contract made outside the UK, the principal may be held to be trading within the UK (*Weiss, Biheller & Brooks Ltd v Farmer*).

The prudent non-resident should, as far as it is possible, take steps to make all his/her contracts outside Malaysia. Where a contract is made abroad and the substance of the contract is performed abroad a non-resident cannot be said to be carrying on a

business in Malaysia even if he/she has a presence here or the initial negotiations and costing of the contract are done here. This is on the basis that the profits in substance arise from a binding contract and its actual performance, and not from the negotiation of the contract.

Generally, a contract is made where the act of acceptance takes place. Where a written contract does not exist, acceptance is in the location where services are performed or where the goods are delivered. Thus, where goods are sent to Malaysia, by a non-resident, on a CIF ("cost, insurance and freight") contract the goods are considered as having been delivered in Malaysia. On the other hand, where goods are on an FOB ("free on board") basis, they are considered as having been delivered outside Malaysia, ie delivered at the port of loading.

¶12-240 Director General's tests and queries

The following are some of the many factors and questions on which the Director General determines whether or not a non-resident does business within Malaysia:

- Does the agent accept orders in Malaysia on behalf of the non-resident person or does he/she merely transmit the solicited orders to the non-resident for the latter's acceptance abroad?
- Are the goods sent direct to the buyer — ie invoiced to him/her — or are they sent to the agent for delivery to the buyer? In the latter case, it would appear that in the first instance the principal will invoice the agent. This is followed by the agent invoicing the buyer.
- Where are the payments for the goods made, ie direct from the buyer to the overseas seller or from the buyer to the agent and ultimately to the overseas seller?
- Are the goods sent to Malaysia on CIF or FOB terms?
- Does the agent maintain a stock of merchandise in Malaysia belonging to the non-resident, from which he/she makes deliveries in respect of contracted sales?
- What are the terms of the agency agreement? Here the agency contract can provide useful information about the relationship between the principal and his/her Malaysian agent.
- What is the degree of control by the non-resident of the agent in Malaysia, ie pricing, sales, etc?
- Does the non-resident trade in Malaysia through a consignee?

¶12-250 Regular agency

Whether or not a regular agency exists is a question of fact and some of the more important factors that go to determine this are:

- Does the agent act for only one principal or several principals?
- Does the agent act as a sole agent for the non-resident person?
- Is the agent's appointment confined to a specific area in Malaysia or does it cover the whole of Malaysia?

- Has the non-resident principal, by notification in the press or *Government Gazette*, made it known that he/she is appointing an agent in Malaysia? Or does the agent, by notification, hold himself/herself out as the agent for the non-resident person?
- Is the agent merely indenting for supplies or does he/she also place orders for his/her own retailing and wholesaling activities?
- Does the agent get a commission only on orders placed through him/her or by him/her or does he/she get an overriding commission on all orders placed by whosoever from within the jurisdiction he/she is covering?
- Does the agent have the authority to conclude contracts in Malaysia on behalf of the non-resident principal?

¶12-260 Brokers

The position of a broker is somewhat different from that of an agent. Any sales or transactions carried out by a broker in the ordinary course of his/her business do not expose the non-resident buyer or seller to any danger of carrying on a trade within Malaysia.

Usually *bona fide* brokers in Malaysia who transact business on behalf of non-resident persons receive a remuneration in the form of brokerage or commission. Thus, where a non-resident person executes sales or carries out transactions, through a *bona fide* broker in Malaysia, this will not in itself be taken as ground for charging the non-resident to Malaysian tax. In other words, any business between non-residents and *bona fide* agents or brokers will not expose the non-resident to Malaysian tax.

¶12-270 Non-residents trading through consignees

Non-residents who carry on activities in Malaysia through consignees are liable to Malaysian income tax on the profits they derive from sales effected by the Malaysian consignees. This extends to trading in any commodity produced outside or inside Malaysia. Specific exemption is, however, given to those non-residents who trade through consignees in rubber, copra, pepper, tin, tin ore, gambier, sago flour or cloves on the condition that these commodities are produced outside Malaysia (see ¶8-625).

¶12-280 Double taxation agreements

Malaysia's double taxation agreements provide for the concept of a "permanent establishment" (see ¶15-250). Generally, the agreements provide that a person resident in a state which has contracted an agreement with Malaysia will not be deemed to be trading in Malaysia unless he/she has a fixed place of business, ie a permanent establishment, here. From the point of view of the non-resident, whether a company or an individual, it is immaterial if taxes are paid or payable in Malaysia if they can be offset by way of credits in the home country as a consequence of a double taxation agreement. In practice, however, because of the different tax bases existing between countries, each country pursues the objective of collecting all the tax to which it is legally entitled (see further ¶15-050ff).

¶12-290 Non-resident sales agents

Often non-resident sales agents provide services outside Malaysia for the Malaysian exporters and manufacturers. The commissions paid to such non-resident agents for their services are not considered to be taxable here on the grounds that the commissions arise abroad at the location where the services are performed, and not in Malaysia.

FOREIGN BRANCH OR SUBSIDIARY OR JOINT VENTURE

¶12-300 Choice of media

A non-resident has the choice of conducting his/her operations in Malaysia in the form of:

- a branch
- a separate Malaysian company, or
- a joint venture with a Malaysian business organisation or investor.

The form chosen can be largely influenced by the taxation system of the non-resident's home country. If the home country does not tax foreign income, whether earned by a branch or a subsidiary, it should make no difference which he/she chooses. In such cases, foreign income by way of profits or dividends, or for that matter foreign losses, will be disregarded by the home country. Where there is taxation of foreign income in the home country, either when it is earned or when it is remitted, [illegible] consideration has to be given to the laws of the home country and Malaysia before a final choice is made.

Generally speaking, most countries, eg the United States, Japan and Britain, tax foreign income and allow foreign losses although the timing of these may vary. It is therefore considered that where it is expected that a loss will be incurred in the initial period of operations, a branch would be the right choice. As the expectation of profits is justified a local subsidiary should take over.

¶12-310 Tax considerations

The following tax considerations would apply in the exercise of the foreign company's choice of media for operating here:

- whether the home country will tax income which arises in Malaysia
- whether Malaysia taxes income which arises both in and outside Malaysia
- whether losses incurred in Malaysia will be allowed in the home country
- the extent of tax credits provided by both the home country and Malaysia
- whether dividends received from Malaysia, which are already subjected to tax here, would suffer further tax in the home country
- the treatment of differences in the exchange rates between the two countries, and
- the extent of foreign exchange controls in the two countries generally, the tax system, labour laws, and finance regulations in Malaysia.

The method of computing the assessable income and the rate of income tax remains the same for both the branch and subsidiary. In the case of joint ventures, the difference lies in whether the joint venture is an incorporated/equity or unincorporated/non-equity/contractual joint venture. For an incorporated joint venture, the tax rules relevant to companies are applied whereas contractual joint ventures are treated as partnerships for tax purposes and taxed as such (see ¶4-400).

ROYALTIES, TECHNICAL ADVICE AND SERVICES

¶12-320 Patent royalties

If the use of any patent, design, trademark, copyright or similar property is in Malaysia and such property is registered here, the income derived therefrom by a non-resident person is subject to Malaysian tax (see further ¶7-820).

Income arising from the provision of technical services in Malaysia by a non-resident person is also a subject of tax here as the income is deemed to derive from here.

The rate of tax applicable to royalties paid or credited to non-resident persons is 10%. This is, of course, subject to the provisions contained in Malaysian double taxation agreements (see ¶15-520) which provide for reduced rates or exemptions.

¶12-330 Technical services

There are two basic kinds of technical services. The first involves the provision of data including designs, drawings, formulae and related manufacturing instructions. In such cases the foreign company merely sends technical documents prepared outside Malaysia to a Malaysian enterprise and charges a fee for supplying them. In addition to the above, there may be the facility, provided by the foreign company, to train Malaysian technicians in its factories and laboratories overseas. Although none of the above activities are carried out in Malaysia the payments received by the foreign company will be deemed to be derived from Malaysia if these payments are borne directly or indirectly by the Malaysian enterprise or if the payments are deductible against income derived from or accruing in Malaysia (see ¶9-050ff).

The second type of services involve personnel where, in addition to the services stated earlier, expertise is sent to Malaysia by the foreign company. In such cases tax difficulties can arise. It is considered that visits to Malaysia by foreign personnel connected with the provision of technical services involve some activities in Malaysia by the non-resident company. The Director General views such visits as clearly constituting "services rendered" in Malaysia. Where the non-resident company charges a lump sum fee, and for highly specialised services this fee may be substantial, the whole of this fee becomes taxable in Malaysia. (See further ¶7-065.)

Budget 2017:

Section 15A is amended via *Finance Act 2017* so that income derived by a non-resident under s 4A(i) and (ii) will still be subjected to withholding tax even if the relevant services are not rendered in Malaysia.

CHAPTER 15

TAX TREATIES — DOUBLE TAXATION RELIEF

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DOUBLE TAXATION

¶15-050 General

International tax agreements provide an effective solution to the problems of double taxation. Double taxation is primarily the result of connecting factors between the taxation laws of the two relevant countries. The factors could be:

- the residence, domicile or nationality of the taxpayer
- the income — this could be the real or deemed income, and
- the property — usually its location, its character and sometimes its source.

Agreements to eliminate double taxation may be contracted between States which have different levels of economic development or States with similar levels of development. Less developed countries have a different approach towards such agreements from those of developed countries. For example, a less developed country's main concern is for maximum revenue and its concepts of income allocation will differ markedly from those adopted by industrially advanced countries. It is not unusual, therefore, for less developed countries to insist that income arising from casual and incidental activities of sales or executive personnel within their respective tax jurisdiction is a subject of tax. Other developing countries go a step further and claim that if production takes place within their jurisdiction, income should be attributable to them notwithstanding that all the sales are made outside that country. This, they

argue, is on the grounds that there can be no income without production. Then there are those countries which claim that there can be no income without a sale and, consequently, although the goods are produced outside, if the sales take place within their jurisdiction, income arises there. All these problems are resolved, as far as it is practicable, through double taxation agreements.

Generally, agreements between States with different levels of economic development give rise to a capital flow into the developing State and an income flow into the developed State. For example, agreements between Malaysia and Japan or between Malaysia and France give rise to this phenomenon.

Tax neutralisation is effected by systems of tax credits and exemptions provided in double taxation agreements. Complete neutrality is difficult to achieve except in circumstances where the tax structures, tax rates and the rules for allocation in the two Contracting States are identical. To a large extent this neutrality is achieved, eg in the agreement between Singapore and Malaysia.

The primary consideration of all agreements is to promote the elimination of double taxation. Other considerations, particularly with developing countries, are to encourage the inflow of capital and to encourage the growth of trading activities. To achieve the latter considerations, fiscal incentives are given and tax sparing credits sought by such countries.

¶15-060 Definition of double taxation

Double taxation occurs where income derived by a person from a source is brought to charge in more than one tax jurisdiction. Thus, where two countries concurrently impose taxes on the same income in such a way that a taxpayer incurs a heavier tax burden than if he/she were subject to tax in one country only, double taxation is said to have taken place. To relieve the taxpayer in such situations, bilateral agreements are entered into by countries.

International juridical double taxation can arise where:

- a person is subject to tax on his/her worldwide income or capital in both Contracting States
- a person resident in one Contracting State derives income from, or owns capital in, the other Contracting State and both States impose tax on that income or capital, and
- a person not resident in either Contracting State is taxed by both Contracting States on income derived from, or capital owned in, one of the Contracting States, eg a person who has a permanent establishment in one Contracting State through which he/she derives income from the other Contracting State.

¶15-070 The principles of double taxation relief

As a generalisation, a tax treaty does not of itself impose a liability to tax. Rather it regulates a liability which would have otherwise arisen as a result of domestic tax laws of either or both of the Contracting States.

There are three basic principles surrounding double taxation agreements:

(1) A double taxation agreement is primarily one that provides relief in respect of tax where the authorities of the two contracting countries concurrently impose taxes having the same bases and incidence, with the result that a taxpayer incurs a heavier tax burden than if he/she were subject to one tax jurisdiction.

(2) Unless specifically provided, a double taxation agreement does not form part of the domestic law of the contracting countries.

(3) A double taxation agreement cannot impose a tax in the jurisdiction of one of the contracting countries if in that contracting country there are no provisions for the imposition of such a tax. In other words, only the domestic laws govern the imposition of taxes on various types of income.

Malaysia seeks to tax income which accrues or is derived here or which is remitted here. It does not tax income on a world basis. Accordingly, resident companies of Malaysia will only be faced with double taxation when their overseas income is liable to tax in Malaysia. This is essentially only in respect of insurance, banking, sea and air undertakings. To claim relief under the double taxation agreements which Malaysia has contracted, the following conditions have to be satisfied:

- the claimant must be a resident of Malaysia
- the income must be such that it is a subject of tax in Malaysia; for example, capital gains made in overseas territories need not be taxable income in Malaysia if the recipient is not a dealer in the subject which gives rise to the gains
- the income must be remitted or deemed to be remitted into Malaysia, and
- tax has been paid or is payable on the income in the foreign country.

The "world-income scope" applies only to resident persons who carry on a business of sea and air transport or a business of banking or insurance. The question of remittances of income into Malaysia does not therefore arise in their case.

Law: s 54(2), 60B.

TAX TREATIES AND DOMESTIC LAW

¶15-100 Parameters of tax treaties and domestic law

A tax treaty is designed and intended to diverge from domestic law, the intent being to change the domestic law on both sides. If this is not done there would not be any need for a treaty. It is, therefore, important that this fact be kept in mind when interpreting a tax treaty. Treaty negotiators deliberately agree to change domestic law for the purpose of alleviating double taxation and preventing tax evasion.

It is generally accepted that where there is a conflict between the provisions in a tax treaty and the provisions in the domestic law, the former will rule the roost. There is, however, one exception to this proposition. This is when an internal tax law is enacted and a provision is specifically made for this law to precede the provisions of the tax treaty.

Three matters of considerable importance need to be clearly understood:

- A tax treaty is one that primarily provides relief where tax is imposed on the same income by the domestic laws in the Contracting States.
- A tax treaty does not form part of the domestic tax laws of the Contracting States.
- A tax treaty cannot impose a tax if the domestic tax laws of a Contracting State do not provide for the imposition of the tax. That is to say, only the domestic tax laws can impose taxes on different types of income.

See also ¶15-070.

¶15-120 Necessary characteristics of a tax treaty

The four necessary characteristics of a tax treaty are:

(1) **It must be in writing**

Since tax treaties affect not only the rights of the sovereign States which enter into them but also the rights and obligations of the individual subjects of these States, the terms of the treaty must be capable of publication for the ultimate benefit of individual subjects. However, under international law, treaties can be oral. Under the United Nations Charter, it is necessary to register with the Secretary-General all treaties entered into by members of that organisation. An oral treaty would not qualify under the provision of the Charter.

(2) **It must be an agreement between entities with national status**

This is because only sovereign States have the powers to enter into binding treaties with other States. The status of colonial territories is that they must rely upon their protecting power to negotiate on their behalf.

(3) **It must be governed by international law**

This is important because only under the framework of international law can difficulties and disagreements be resolved.

(4) **It must create a legal obligation upon the respective Contracting States**

A treaty must intend to create a legal obligation. That is to say, once it has been signed the States agree to observe the provisions of the treaty.

MALAYSIAN DOUBLE TAXATION AGREEMENTS

¶15-150 Development of Malaysian treaties

The development of international trade and industrialisation is emphasised by the number of treaties entered into by Malaysia. Section 132 empowers the Minister of Finance to make provisions, by Order (done by notification in the *Government Gazette*), for the granting of relief in respect of double taxation. Such an Order specifies the country with which an agreement has been reached and provides for the prevention or mitigation of double taxation and the rendering of reciprocal assistance in the administration and collection of taxes.

The Malaysian relief or credit pattern adopted in its agreements is a sophisticated combination of territorial taxation (as opposed to global taxation) and exemption of foreign income unless remitted into Malaysia. It is neutral in the sense that it does not interfere with the other country's tax policies. This pattern is as ideal as a tax system can be for a country whose national economy depends largely on its international business activities.

The Minister has the power under s 154 to make rules which *inter alia*, touch on double taxation. The Budget 2016 proposals include one empowering the Minister to make rules for implementing or facilitating mutual administrative assistance arrangements.

As at 14 October 2016 (per Inland Revenue Board's (IRB's) website viewed on 4 January 2017), the status of Malaysian DTAs is as follows:

Effective DTAs

- Albania
- Argentina
- Australia
- Austria
- Bahrain
- Bangladesh
- Belgium
- Bosnia and Herzegovina
- Brunei
- Canada
- Chile
- China
- Croatia
- Czech Republic
- Denmark
- Egypt
- Fiji
- Finland
- France
- Germany
- Hong Kong
- Hungary
- India
- Indonesia
- Iran
- Ireland
- Italy
- Japan
- Jordan
- Kazakhstan
- Korea
- Kuwait
- Kyrgyz
- Laos
- Lebanon
- Luxembourg
- Malta
- Mauritius
- Mongolia
- Morocco
- Myanmar
- Namibia
- Netherlands
- New Zealand
- Norway
- Pakistan
- Papua New Guinea
- Philippines
- Poland
- Qatar
- Romania
- Russia
- San Marino
- Saudi Arabia

- Seychelles
- Singapore
- South Africa
- Spain
- Sri Lanka
- Sudan
- Sweden
- Switzerland
- Syria
- Thailand
- Turkey
- Turkmenistan
- United Arab Emirates
- United Kingdom
- United States of America
- Uzbekistan
- Venezuela
- Vietnam
- Zimbabwe

Taiwan

Taiwan Economic and Cultural Office

PU (A) 201 (1998)
PU (A) 202(1998)

Gazetted DTAs (not yet entered into force)

Belgium (Protocol)	24 May 2010
Indonesia (EOI Protocol)	19 July 2012
Kuwait (EOI Protocol)	26 August 2010
New Zealand (EOI Protocol)	8 September 2015
Poland 20114	23 June 2014
Senegal	25 May 2010
Seychelles (EOI Protocol)	26 August 2010
Slovak Republic	30 October 2015
Turkey (EOI Protocol)	21 April 2010

Concluded DTAs

Oman	13 April 2000
Yemen	28 August 2006
Canada (New Agreement)	12 January 2010
South Korea	13 January 2011
Ukraine	18 October 2012
Denmark (New Agreement)	13 December 2012
Barbados	8 February 2013
Fiji	11 December 2014
Belarus	13 March 2015

DTAs under negotiation

- Azerbaijan
- Brazil
- Cyprus
- Finland (New Agreement)
- Kenya
- Lesotho
- Mexico
- Norway (New Agreement)
- Portugal
- Russia (New Agreement)
- Tunisia
- Uruguay
- China (New Agreement)
- Nepal

Effective TIEA

Bermuda (TIEA)	28 December 2012

TIEAs under negotiation

- The Bahamas
- Guernsey
- Liberia

Source: www.hasil.gov.my.

Further developments of treaties

With the single-tier tax system on dividends being fully applicable with effect from 1 January 2014, such income would no longer feature in the question of double taxation since it would not be liable to tax in Malaysia.

In the summaries stated below, any reference to dividends would reflect the position only up till 31 December 2013.

Australia

The first Protocol to the agreement with Australia which was gazetted on 21 October 1999 was ratified on 27 June 2000. Malaysian tax will not be applicable on any payment for services (including consultancy services) to an Australian enterprise, unless the services are rendered in Malaysia and continued for periods of more than three months within any 12-month period, thus resulting in a permanent establishment in Malaysia. In the absence of a permanent establishment, withholding tax under s 109B of the Act will not be applicable.

A second Protocol amending the agreement between Malaysia and Australia for the avoidance of double taxation as amended by the first Protocol on 2 August 1999 was gazetted on 29 May 2003 under the Double Taxation Relief (The Government of Australia) Order 2003 and ratified on 25 June 2003. The agreement as amended by the second Protocol is effective in Malaysia from 1 January 2004.

The third Protocol to the income tax treaty of 20 August 1980 (as amended by the two earlier Protocols) that relates to the exchange of information was signed on 24 February 2010, and it entered into force on 8 August 2011.

Bahrain

The Double Taxation Relief (The Government of the Kingdom of Bahrain) (Amendment) Order 2011 is a Protocol to the tax treaty between Malaysia and Bahrain which has inserted a new Art 27A (Exchange of Information) in line with international commitments. The Protocol shall enter into force on the date that the contracting states through diplomatic channels notify the other of the completion of the procedures required by their laws for the bringing into force of this Protocol, and its provisions shall have effect 30 days after the date of the later notification.

The amending Protocol entered into force on 20 February 2012 and generally applies from 21 March 2012.

Belgium

Belgium and Malaysia have signed an amending Protocol to the tax treaty of 24 October 1973 on 18 December 2009. The Protocol amends the withholding tax rates as follows:

- Dividends — 10%
- Royalties — 10%
- Interest — 10%
- Technical fees — 10%.

Bermuda

The Exchange of Information (The Government of Bermuda) Order 2012 provides arrangements for exchanging information that is foreseeably relevant in relation to Malaysian tax and Bermudian tax.

The OECD has categorised Malaysia as a nation that has substantially met the internationally agreed tax standards for the exchange of information (ie Malaysia has been moved into the OECD's "white list" from the previous "grey list"). This reclassification was due to the fact that Malaysia has signed tax treaties/Protocols to enhance some of the existing treaties by adopting the exchange of information standards which the OECD has encouraged jurisdictions to adopt. Malaysia has recently signed Protocols in respect of the DTAs with Australia, Bahrain, France, Ireland, Belgium, Kuwait, the Netherlands, Seychelles, Japan, Turkey and the United Kingdom.

Brunei

The treaty between Malaysia and Brunei has been gazetted by the Double Taxation Relief (The Government of His Majesty the Sultan and Yang Di-Pertuan of Brunei Darussalam) Order 2010. The DTA entered into force on 17 June 2010. It is effective for the year of assessment beginning on or after 1 January 2011 in respect of income tax and withholding tax, and beginning on or after 1 January 2012 in respect of petroleum income tax.

The withholding tax rates will be as follows:

- Dividends — 10%
- Royalties — 10%
- Interest — 10%
- Technical fees — 10%.

Croatia

The new DTA with Croatia provides for a reduced rate of 10% for interest.

Denmark

A Protocol to amend the DTA between Malaysia and Denmark was gazetted on 13 May 2004, although it is awaiting ratification. The definition of "royalties" now includes payments received in consideration for "the rendering of any services or assistance of a technical, managerial or consultancy nature".

Germany

The new tax treaty between Malaysia and Germany was signed on 23 February 2010 and entered into force on 21 December 2010. The new treaty is effective from 1 January 2011 for income tax and 1 January 2012 for petroleum income tax. The new tax treaty has replaced the old treaty of 8 April 1977. The withholding tax rates under the new treaty are as follows:

- Dividends — 15%
- Royalties — 7%
- Interest — 10%
- Technical fees — 7%.

It should be noted that the provisions of the earlier tax treaty did not allow Malaysia to impose any withholding tax on technical fees. The new treaty has obviously changed this position but allows for a lower withholding tax rate than the domestic rate of 10%. Likewise, the withholding tax rate for royalties is also reduced. A further important matter is the exclusion of Labuan companies falling within the scope of the LBATA from enjoying the treaty benefits.

Guernsey

It has been reported that negotiations are under way for an exchange of information agreement between Guernsey and Malaysia.