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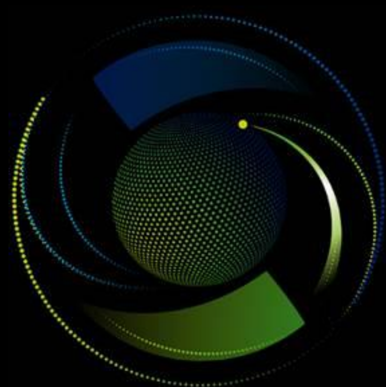

Tax Espresso - Special Alert

Capital Gains Tax in Malaysia (Part 2) – Guidelines for CGT on unlisted shares and CGT Exemption Order on gains from disposal of foreign capital assets received in Malaysia

Introduction

Following the imposition of Capital Gains Tax (CGT) in Malaysia effective from 1 January 2024 via the Finance (No. 2) Act 2023 [*Act 851*], the Inland Revenue Board (IRB) has issued the Guidelines: Capital Gains Tax on Unlisted Shares dated 1 March 2024 (CGT Guidelines) [*Available in Bahasa Malaysia only]*.

Additionally, the Income Tax (Exemption) (No. 3) Order 2024 [*P.U.(A) 75/2024*] (Exemption Order) in relation to the CGT exemption on gains or profits from the disposal of foreign capital assets received in Malaysia, was gazetted on 4 March 2024.

In our recent alert, CGT in Malaysia (Part 1), we provided an overview of CGT in Malaysia with a commentary based on what was known thus far about CGT. In this alert, we are providing an additional commentary based on further details made available in the CGT Guidelines as well as the details of economic substance requirements (ESR) to qualify for a CGT exemption in respect of gains or profits from the disposal of foreign capital assets received in Malaysia pursuant to the Exemption Order.

CGT Guidelines

The CGT Guidelines aim to provide guidance and clarification on the imposition of CGT in respect of gains or profits made by companies, limited liability partnerships, trust bodies, and co-operative societies [including Labuan entities that are subject to tax under the Income Tax Act 1967 (ITA)] (these are chargeable person for CGT as per Paragraph 4 of the CGT Guidelines) from the disposal of:

- shares of a company incorporated in Malaysia not listed on the stock exchange (unlisted shares); and
- shares of a controlled company incorporated outside Malaysia which owns real property situated in Malaysia or shares of another controlled company, subject to meeting the 75% threshold conditions which are deemed to be derived from Malaysia under Section 15C of the ITA (Section 15C shares).

> **Deloitte's comments:**
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> *These CGT Guidelines do not cover the imposition of CGT on gains or profits arising from the disposal of capital assets located outside Malaysia (all types of assets, not limited to shares) upon remittance of such gains or profits into Malaysia (foreign capital assets). Such gains or profits from the disposal of foreign capital assets which comply with the ESR are exempted from CGT pursuant to the Exemption Order as discussed below.*

Key points

1. CGT rates

The CGT rate charged on gains or profits from the disposal of unlisted shares and Section 15C shares is provided under Part XXI, Schedule 1 of the ITA. The CGT rate is determined based on the acquisition date of the unlisted shares and Section 15C shares as shown in the table below:

Acquisition Date of Unlisted Shares and Section 15C Shares	CGT Rate
Before 1 January 2024	• 10% on chargeable income from disposal of unlisted shares and Section 15C shares; or • 2% of gross disposal price
On or after 1 January 2024	10% on chargeable income from disposal of unlisted shares and Section 15C shares

Deloitte's comments:

As highlighted in question 12 of CGT in Malaysia (Part 1), companies, limited liability partnerships, trust bodies, and cooperative societies are exempted from CGT on the disposal of the capital assets mentioned above (i.e. unlisted shares and Section 15C shares) for the period from 1 January 2024 to 29 February 2024, and are not required to file the CGT return form for the disposal of those capital assets during the two-month exemption period. These exemptions were legislated via the Income Tax (Exemption) (No. 7) Order 2023 [P.U.(A) 410/2023] and the Income Tax (Exemption) Order (No. 2) 2024 [P.U.(A) 57/2024].

2. Meaning of shares for the purpose of CGT

Shares which are subject to CGT are shares with the nature of equity, such as ordinary shares, preference shares, redeemable preference shares, convertible bonds or long-term borrowings with the nature of equity. Among others, the characteristics of shares with the nature of equity are:

- The shareholder's right to receive dividend is not fixed;
- The shareholder's interest in the remaining assets ranks after other claimants' claims are resolved in a liquidation;
- The shares have no maturity date;
- The shares carry voting rights.

3. Determination of market value

Disposal price is the amount or value of consideration for the disposal of the capital asset at the time of disposal. The value of consideration for disposal is equivalent to the market value. Market value refers to a price that is reasonable. The criteria to determine whether a price is reasonable include the following:

- The existence of both the disposer and the acquirer;
- The disposer and the acquirer are not related persons;
- The disposal is an arm's length transaction;
- The disposal is not made under coercion;
- Both the disposer and the acquirer have sufficient knowledge.

Reasonable and appropriate share valuation methods [(e.g., the net tangible asset (NTA) based on the company's financial statements] can be used in determining the market value of a share. The formula to calculate the value of shares based on the NTA method are as follows:

- NTA Value = Total Assets – Non-Tangible Assets – Total Liabilities
- NTA / Share = NTA / Total Number of Shares Issued

The value of consideration for an acquisition or disposal is deemed to be the market value of the capital asset at the time of disposal in the following circumstances:

- The acquisition or disposal of the capital asset is not at arm's length or by way of gift;
- The acquisition or disposal of the whole or part of the capital asset is for a consideration that cannot be valued;
- If the disposer acquires the capital asset as a trustee (for creditors of any person) for the payment of debt, or the disposer transfers a capital asset as a trustee (for creditors of any person) for payment of debt due to the creditor;
- The capital asset is taken into account as a trading stock;
- The acquisition or disposal of the capital asset in a business transfer transaction is made with a lump sum consideration;
- The acquisition or disposal of the capital asset is between connected persons.

The Director General of Inland Revenue (DGIR) may determine the market value of the capital asset in the following circumstances:

- The parties to the transaction cannot reach an agreement on the market value of the capital asset;
- The disposal involves only one party;
- The DGIR is of the opinion that the market value as agreed by the parties is incorrect (e.g., in circumstances where the disposal involves related companies where the disposer is controlled by the acquirer or vice versa).

4. Section 15C shares and performance of 75% threshold test

Section 15C shares are shares in foreign-incorporated companies deriving value from real property in Malaysia. Any gains or profits accrued on the disposal of shares of a foreign company are deemed to be derived from Malaysia. These gains or profits are subject to CGT if the defined value of real property situated in Malaysia and/or shares of another controlled company owned by the foreign company is no less than 75% of the value of its total tangible assets at the acquisition date of the foreign company's shares.

The 75% threshold test is based on the defined value of shares or real property owned by the relevant company. Based on the CGT Guidelines,

- the "defined value" of a real property refers to the market value of the real property;
- the "defined value" of shares of another controlled company refers to the acquisition price of shares of another controlled company as determined under Section 15C(4).

The 75% threshold test to determine whether the shares of the relevant company constitute Section 15C shares is to be made **only** when the controlled company incorporated outside Malaysia acquires real property situated in Malaysia or shares in another company pursuant to Section 15C(2) of the ITA. Please refer to Example 9 of the CGT Guideline for guidance.

Shares in a company are no longer Section 15C shares when the defined value of shares becomes less than 75% of the value of its total tangible assets due to the disposal of real property or shares in another controlled company or both.

The disposal of shares in a real property company under Paragraph 34A, Schedule 2 of the Real Property Gains Tax Act 1976 (RPC shares) acquired prior to 1 January 2024 will also be subject to CGT. This treatment is in line with the introduction of Paragraph 34A(5A), Schedule 2 of the Real Property Gains Tax Act 1976 which provides that acquisitions or disposals of shares in an RPC by a company, limited liability partnership, trust body, or cooperative society will no longer be subject to real property gains tax, effective as from 1 January 2024.

5. Bilateral tax credit

A person who has been subjected to foreign tax in respect of the gains or profits from the disposal of capital assets may claim a bilateral tax credit under Section 132 of the ITA. The bilateral tax credit claim is subject to the provisions of the relevant tax treaties.

Income Tax (Exemption) (No. 3) Order 2024 [*P.U.(A) 75/2024*] (Exemption Order)

Exemption

From 1 January 2024, CGT has been charged on gains or profits remitted into Malaysia from capital assets located outside Malaysia (foreign capital asset). With the Exemption Order gazetted on 4 March 2024, any gains or profits from the disposal of foreign capital assets received in Malaysia by companies, limited liability partnerships, trust bodies, and co-operative societies resident in Malaysia, which comply with the economic substance requirements (ESR), are exempted from CGT from **1 January 2024 to 31 December 2026**.

The ESR condition is subject to compliance with the conditions imposed by the Minister as specified in the guidelines, which is to be issued by the DGIR. The ESR for the CGT exemption includes the following:

(a) employ an adequate number of employees in Malaysia; and
(b) incur an adequate amount of operating expenditures in Malaysia.

Any deduction in relation to the gains or profits exempted from CGT shall be disregarded for the purpose of ascertaining the chargeable income of the company, limited liability partnership, trust body, and co-operative society.

Gains or profits from disposal of intellectual property rights

Any gains or profits from the disposal of intellectual property rights shall be disregarded from the CGT exemption, provided that the companies, limited liability partnerships, trust bodies and co-operative societies are the owner or licensee of the intellectual property rights.

"Intellectual property rights" means any rights arising from a patent, utility innovation and discovery, copyright, trademark and service mark, industrial design, layout-design of integrated circuit, secret processes or formulae and know-how, geographical indication and the grant of protection of a plant variety, or other similar rights, whether or not registered or registrable.

Non-application

This Exemption Order shall not apply to a person carrying on the business of banking, insurance, sea transport, or air transport.

Please refer to the CGT Guidelines dated 1 March 2024 and *P.U.(A) 75/2024* for full details.

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