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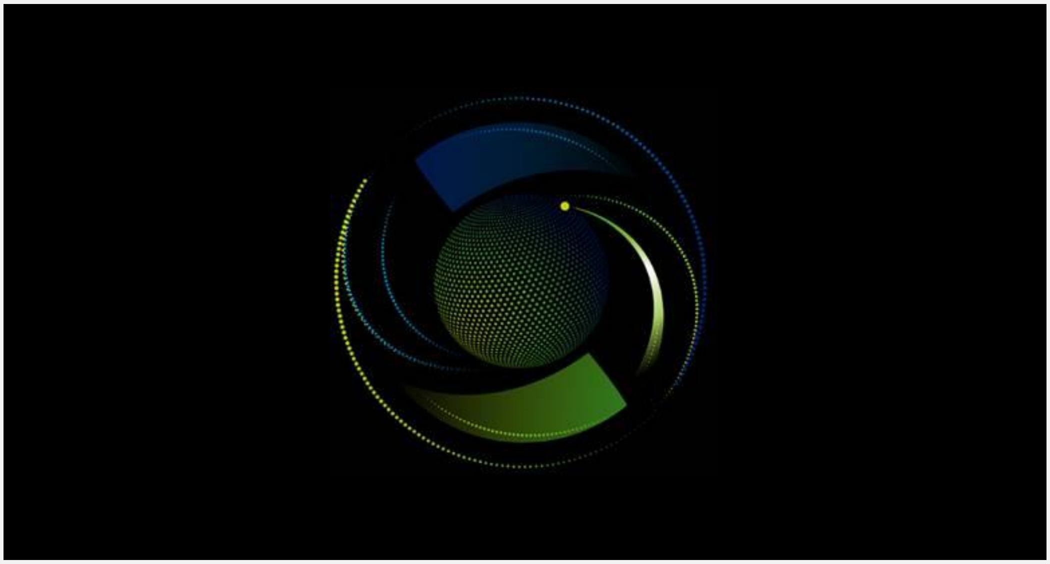

Tax Espresso—Special Alert

Capital Gains Tax in Malaysia - What Do We Know Thus Far? (Part 1)

Introduction

There have been many discussions and talks on the Malaysian capital gains tax ("CGT") over the last one year or so. Finally, CGT has arrived in Malaysia. On 29 December 2023, the Finance (No. 2) Act 2023 was published in the government gazette and came into operation on 30 December 2023. A new Chapter 9 has been introduced in the Income Tax Act 1967 ("the Act") to impose tax on gains or profits from the disposal of capital asset on or after 1 January 2024 (as opposed to 1 March 2024 that was announced earlier). This is to be read together with the Income Tax (Exemption)(No. 7) Order 2023 ("EO").

Our write-up, in the form of Frequently Asked Questions is aimed at providing the readers with the latest overview of the new Malaysian CGT regime. Where relevant, we have provided our commentaries.

As CGT is new, we expect that the Inland Revenue Board (“IRB”) would release the relevant guidelines in due course.

1. Prior to 1 January 2024, did Malaysia impose tax on capital gains?

No, except for Real Property Gains Tax (“RPGT”) which is a tax that is imposed on gains from the disposal of real property situated in Malaysia or shares in a Real Property Company (“RPC”). RPGT is governed under a separate tax law, viz the Real Property Gains Tax Act 1976 (“RPGTA”).

2. In a nutshell, how does RPGT regime (in particular, RPGT on RPC) work?

RPGT is imposed on gains arising from the sale of chargeable asset, i.e. real property located in Malaysia, or shares in an RPC. The RPGT rates on chargeable gain arising from disposal of chargeable asset ranges from 0% to 30%, depending on the holding period and status of the disposer.

An RPC is defined under Paragraph 34A, Schedule 2 of the RPGTA to mean a controlled company which as at 21 October 1988, owns or at any later date, acquires real property (in Malaysia) or shares in an RPC or both, whereby the defined value of real property or shares or both, owned at that date is not less than 75% of the value of its total tangible assets.

A “controlled company” is a company having not more than 50 members and controlled by not more than 5 persons. The “defined value” of a real property refers to the market value of the real property, whilst the ”defined value” of RPC shares refers to the acquisition price of the RPC shares. “Total tangible assets” refers to the aggregate of the defined value of real property and/or RPC shares and the value of other tangible assets. "Real property" for RPGT purposes means any land situated in Malaysia and any interest, option or other right in or over such land.

The concept of RPC is not a straightforward one. Even if the current Malaysian real property (including RPC) holding in a company falls below the 75% threshold of the definition of RPC, one cannot conclude that the said company is not an RPC. All these years (but do note the latest case law mentioned below), the RPC status of a company is to be determined at the date of each acquisition/disposal of real property in Malaysia or shares in RPC by the company. If a company acquired land/ building in Malaysia before acquiring other tangible assets, it could instantly breach the 75% threshold and become an RPC at the point of acquisition of the land/ building. This being the case, any shares in that company owned by its shareholders at that time and those issued by that company subsequent to that will become RPC shares unless the shares are acquired at a time when that company has subsequently lost its RPC status.

Having laid down the above traditional view on RPC, it is noteworthy that the IRB has recently uploaded a case report, *AEM Microtronics (M) Sdn Bhd v DGIR (HC)*" on its website. **The taxpayer asserted that the RPC's definition provides that the property's defined value must be computed at the point QEM (the company where its RPC status is in question) acquired the real property and this in line with the aforesaid traditional view. On the other hand, the IRB took the position that the 75% threshold test must also be done at the point of acquisition of QEM by the taxpayer.** To the tax authorities, the definition of RPC provided under the law is clear and unambiguous. Moreover, Paragraph 34A should be read as a whole and not confined to certain words or subparagraphs only.

The issue is whether QEM is an RPC and therefore the gains received by the taxpayer from the disposal of its shares in QEM is a disposal of chargeable asset pursuant to Paragraph 34A, Schedule 2. The Special Commissioner of Income Tax ("SCIT") decided that the defined value of the real property, shares, or both owned by the relevant company, as referred to in the definition of RPC, is determined **at the date of acquisition of the chargeable asset. The High Court upheld the SCIT's decision and dismissed the taxpayer's appeal.**

Deloitte's comments:

The principle laid down in the said case law, in a way, differed significantly from the way Paragraph 34A has been interpreted by taxpayers and tax practitioners since the inception of the RPC law in 1988. If the taxpayer appeals further, the future decision of the Court of Appeal would be crucial in providing a final position. Meanwhile, it is vital for taxpayers to assess their previous RPC assessments and monitor the development of this case law. Interestingly, some of the positions taken by the IRB in this case have been reflected in the new CGT regime.

Generally, RPGT is a not a covered tax under the double tax agreements ("DTAs") and as such, Malaysia would be able to impose RPGT on the non-resident disposer.

For RPGT, both the disposer and acquirer are required to file an RPGT return on the disposal/ acquisition of chargeable asset respectively to the IRB within 60 days from the date of disposal. If the transfer consideration consists wholly or partly of money, the acquirer is required to withhold an amount equal to certain percentage of the total value of the transfer consideration or the entire amount of the money consideration, whichever is lower, and remit the required withholding amount to the IRB within 60 days from the date of disposal.

RPGT intra group exemption under Paragraph 17, Schedule 2 of the RPGTA may apply where the conditions are met.

3. Who is the chargeable person under the new CGT regime?

Company, limited liability partnership, trust body or co-operative society are the chargeable persons under the new CGT regime. Individuals are not subject to CGT but would continue to be subject to the provisions of the RPGTA for disposal of real property or shares in RPC.

4. What types of assets are under the ambit of CGT?

"Capital asset" is defined to mean movable or immovable property including any rights or interests thereof.

For the purposes of CGT, "shares" mean all or any of the following:

a) stock and shares in a company;
b) loan stock and debentures issued by a company or any other corporate body incorporated in Malaysia;
c) a member's interest in a company not limited by shares whether or not it has a share capital;
d) any option or other right in, over or relating to shares as defined in paragraphs (a) to (c).

Based on this definition alone, the scope of CGT is extremely wide. However, as a start, Malaysia's plan is to limit the application of CGT to:

i) Shares in unlisted companies incorporated in Malaysia

ii) Shares of a controlled company incorporated outside Malaysia ("Foreign Company") that owns real property in Malaysia or shares of another controlled company or both

In relation to (ii) above, gains or profits accruing on the disposal of shares of a Foreign Company is deemed to be derived from Malaysia if the defined value of real property situated in Malaysia (including any rights or interest thereof) and/or shares of "another controlled company" owned by the Foreign Company is not less than 75% of the value of its total tangible assets at the date of acquisition of the shares of the Foreign Company. "Another controlled company" would refer to another controlled company that owns real property situated in Malaysia (including right or interest thereof) of which the defined value of the real property situated in Malaysia is at least 75% of the total tangible assets of that controlled company. "Defined value" is the market value of the of the real property or the acquisition price of shares of another controlled company as determined under the new section 15C(2).

For the purposes of determining the acquisition date of shares in a Foreign Company, Section 15C of the Act provides that shares in a Foreign Company are deemed to be acquired:

- On such date that the defined value of real property or shares or both owned by the Foreign Company is at least 75% of its total tangible assets; or
- On the date of acquisition of the shares of the Foreign Company

iii) All types of capital assets situated outside Malaysia (not confined to shares)

Deloitte's comments:

The imposition of CGT on (i) is a way to widen Malaysia's tax base. On (ii), this is nothing new as Malaysia's taxing right is already in existence under Paragraph 34A of the RPGTA since 1988. Finally, on (iii), this is primarily due to the fact that several countries like Malaysia, Hong Kong and Singapore have been requested by the European Union ("EU") to ensure that their tax treatments of foreign-sourced disposal gains are in compliance with the updated EU Foreign Source Income Exemption Guidance by the end of 2023. It appears that the commencement date of 1 January 2024 is key to meeting the EU requirement.

5. What is the effective date?

At this point in writing, the CGT is already in operation. The effective dates are as follows:

a) Shares in unlisted companies incorporated in Malaysia: deferred to **1 March 2024** due to the 2-month exemption as provided under the EO. The disposal of shares shall be made on or after 1 January 2024 to 29 February 2024. The EO does not apply where such gains or profits are considered business income under Section 4(a) of the Act.

b) Shares in foreign incorporated companies deriving value from real property in Malaysia (new Section 15C): **1 January 2024,** but please see answer to Question 12 below where Capital Gains Tax Return Form ("CGTRF") Filing Programme issued by the IRB seems to indicate that the 2-month exemption would also apply to disposal of Section 15C shares even though this was not stated in the EO. Further clarification from the IRB may be required.

c) Capital assets situated outside of Malaysia: **1 January 2024**

In line with the introduction of CGT in Malaysia, the RPGTA has been amended such that acquisitions or disposals of shares in RPC by a company, limited liability partnership, trust body or co-operative society would no longer be subject to RPGT effective 1 January 2024. However, a Labuan entity carrying on a business activity as defined in Section 2B of the Labuan Business Activity Tax Act 1990 would still be subject to RPGT on disposal of shares in an RPC.

Deloitte's comments:

The non-applicability of CGT for a qualified Labuan entity is in line with the objective of promoting Labuan as international financial and business centre including being a regional platform for investments. It goes without saying that proper economic substance of the Labuan entity would be important, not only from the Labuan Business Activity Tax Act, 1990 perspective but also from the tax laws of the country where the investees are.

6. What is the meaning of disposal and how does one determine disposal date?

"Disposal" is defined to mean to sell, convey, transfer, assign, settle or alienate whether by agreement or by force of law and **includes** a reduction of share capital and purchase by a company of its own shares.

Deloitte's comments:

One key issue here is the legal interpretation of the word "include". In this regard, the intention of the Parliament is important. Are reduction of share capital and purchase by a company of its own shares merely examples or are they the complete list? If it is the former, what would be other transactions that may fall within the ambit of disposal? Further clarification from the IRB on this may be necessary to alleviate any uncertainty.

Meanwhile, disposal of capital asset is deemed to take place on the date of the agreement where there is written agreement for the disposal of the capital asset. Where there is no written agreement, the disposal is deemed to take place on the date of completion of the disposal.

Where a contract for the disposal of a capital asset is conditional and the condition is satisfied (by the exercise of a right under an option or otherwise), the acquisition and disposal of the capital asset shall be regarded as taking place at the time the contract was made, unless—

a) the acquisition or disposal requires the approval by the Government or a State Government (of Malaysia), the date of disposal shall be the date of such approval; or

b) the approval referred to in subparagraph (a) is conditional, the date of disposal shall be the date when the last of all such conditions is satisfied.

7. How is the gain being taxed?

Gain/income that is subject to CGT would be treated as a separate non-business source of income of the disposer and the gains on disposal of capital asset cannot be offset against unabsorbed capital allowances from the business source of income.

<u>*CGT rates – Disposal made by a company, limited liability partnership, trust body or co-operative society*</u>

a. <u>For disposal of capital asset situated in Malaysia</u>

Capital Asset Acquisition Date	**CGT Rate**
Before 1 January 2024	i. 10% of chargeable income; or ii. 2% of gross disposal price
From 1 January 2024	10% of chargeable income

b. <u>For disposal of all types of capital assets situated outside Malaysia</u>

At prevailing income tax rate on the chargeable income received in Malaysia from outside Malaysia. The prevailing tax rate for company is currently 24%.

The following are the allowable reductions/ deductions against the disposal price in arriving at chargeable income/ net gain (would not apply if the disposer elects to be taxed at 2% on gross disposal price):

i) the amount of any expenditure wholly and exclusively incurred on the capital asset at any time after its acquisition by or on behalf of the disposer for the purpose of enhancing or preserving the value of the capital asset, being expenditure reflected in the state or nature of the capital asset at the time of the disposal

ii) the amount of any expenditure wholly and exclusively incurred at any time after the acquisition of the capital asset by the disposer in establishing, preserving or defending its title to, or to a right over, the capital asset

iii) the incidental costs to the disposer in making the disposal

iv) value of the consideration for the acquisition of the capital asset (together with the incidental costs to disposer in making the acquisition)^

^ The acquisition cost is to be reduced by the following:

- any sum received by the disposer by way of compensation for any kind of damage or injury to the asset or for the destruction or dissipation of the asset or for any depreciation or risk of depreciation of the asset

- any sum received by the disposer under a policy of insurance for any kind of damage or injury to or the loss, destruction or depreciation of the asset

- any sum forfeited to the disposer as a deposit made in connection with an intended transfer of the capital asset.

Market value

- The consideration for acquisition or disposal of capital asset is deemed to be equal to the market value of the capital asset as at the time of disposal in several situations e.g. related party transactions. Based on the Finance (No. 2) Act 2023, where the market value of the asset is to be taken for CGT purposes, the market value based on a valuation made by a valuer is required to be provided in the CGT return. In the absence of further details, it is unclear for now whether the IRB would accept market value determined based on the audited accounts of the target company for disposal of shares or if a nominal consideration would be accepted in practice for disposal of unlisted shares in a Malaysian company with net liability position.

Treatment of capital losses

- Capital losses is the excess of acquisition consideration and incidental costs over the disposal consideration. Capital loss may be used to offset against the gains from disposal of other capital assets.

- Any unutilised capital losses can be carried forward up to 10 consecutive years of assessment to be offset against future gains from disposal of capital assets.

8. Is there a CGT exemption?

a) For disposal of unlisted shares in Malaysian incorporated companies

The proposed exemption for disposal of unlisted shares in relation to Initial Public Offering approved by Bursa Malaysia and restructuring within the same group (as announced in Budget 2024) are not stated in the Finance (No. 2) Act 2023. However, it is expected that this will be covered under subsidiary legislation, which has yet to be issued.

b) For disposal of foreign capital assets

The proposed exemption to be given upon remittance of the foreign disposal gain by fulfilling the economic substance requirements (as announced in Budget 2024 Touchpoints) are not stated in the Finance (No. 2) Act 2023 but it is expected that this will be covered under subsidiary legislation.

9. Is there an exemption provided under the relevant DTAs with Malaysia?

Where CGT applies, foreign taxpayers need to assess whether exemption under relevant DTA would be applicable (e.g. where only resident country has the taxing right over such gain). As the CGT rules are new, it is unclear if the exemption under the DTA can be applied automatically or a notification/application to the IRB is required.

Meanwhile, in order to rely on the DTA, it is crucial for the non-resident to demonstrate with sufficient documentary evidence that the proposed structure is driven by commercial reasons/ factors and that obtaining a tax treaty benefit was not one of the principal purposes of the proposed structure unless the granting of the benefit would be in accordance with object and purpose of the tax treaty.

> **Deloitte's comments:**
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> *Each treaty has to be analysed carefully, especially on the article on capital gains which generally gives taxing right to the country where the disposer or alienator is unless the company in question is a land-rich company. **It is crucial to note that the Malaysia-Singapore DTA does not contain the article on capital gains presumably that both countries did not have CGT regime in the past**. It is hoped that both governments would consider including this in the DTA given the significance of investment and economic ties between Malaysia and Singapore.*

Meanwhile, where Malaysian resident disposers suffer CGT in Malaysia as well as foreign tax, foreign tax credit may be available. However, confirmation is required from the IRB on how the foreign CGT paid could fit into the formula in Schedule 7 of the Act.

10. What is the impact of CGT on unit trusts and latest development on CGT and foreign sourced income ("FSI") for unit trusts?

It was announced by Finance Minister II on 16 January 2024 that the government has agreed to exempt the imposition of CGT as well as taxes on FSI on unit trusts. The exemption on CGT is effective from 1 January 2024 until 31 December 2028 while the exemption on FSI takes effect from 1 January 2024 until 31 December 2026. The subsidiary legislation to give effect to the CGT and FSI exemption have yet to be gazetted.

11. How would the gain that arises from the disposal of unlisted shares of an RPC incorporated in Malaysia from 1 January 2024 to 29 February 2024 be dealt with?

When the amendment to the RPGTA and the EO are read in parallel, it appears that gains or profits received from the disposal of unlisted shares of an RPC incorporated in Malaysia from 1 January 2024 to 29 February 2024 are subject to neither RPGT nor CGT in Malaysia. At issue here is intent policy of the government in this respect. Further clarification from the IRB on this may be necessary to alleviate any uncertainty. It is also important to consider the general anti-avoidance rules in any group restructuring within the 2 months exemption period.

12. What are the tax filing and payment procedures of CGT?

- A return in the prescribed form for the disposal of capital asset shall be submitted to the IRB (vide e-filing) together with the CGT payment within 60 days from the date of the disposal. Based on the Finance (No.2) Act 2023, it appears that the CGT filing requirement would also apply to a foreign disposer company without business presence in Malaysia (pending from the IRB administrative details on CGT filing).

- For disposal of foreign capital asset, it is unclear for now on whether the CGT return is also to be submitted within 60 days from the date of the disposal even though technically CGT on income/gain from disposal of foreign capital asset would only be triggered upon remittance of the income / gain into Malaysia. There is a possibility for this type of disposal to be declared in the annual corporate tax return. Further clarification from the IRB on this may be necessary to alleviate any uncertainty.

CGT Return Form Filing Programme

- The IRB has uploaded the Capital Gains Tax Return Form ("CGTRF") Filing Programme for disposal with effect from 1 March 2024 on 15 January 2024 on its website. The CGTRF Filing Programme applies to company, limited liability partnership, trust body and co-operative society which receives gains or profits from the disposal of capital asset consisting of:

  a) shares of unlisted companies incorporated in Malaysia; or

  b) shares of a controlled company incorporated outside Malaysia which owns real property situated in Malaysia or shares of another controlled company or both ("Section 15C shares").

- Labuan entities (Labuan Company, Labuan Limited Liability Partnership, Labuan Foundation and Trust) that elect or subject to tax under the Act are subject to the imposition of CGT.

- Company, limited liability partnership, trust body and co-operative society are exempted from CGT for the disposal of the abovementioned capital assets for the period of 1 January 2024 to 29 February 2024 and are not required to file the CGTRF for the disposal of that capital assets within the 2-month period.

- Based on CGTRF Filing Programme, it would appear that the 2-month exemption would also apply to disposal of Section 15C shares even though this was not stated in the EO. Further clarification from the IRB may be required.

- Taxpayer is required to file the CGTRF and pay the CGT for the disposal of the above-mentioned capital assets effective from 1 March 2024 within 60 days from the date of disposal.

- CGTRF and Explanatory Notes can be downloaded from the IRB's website from 31 January 2024 for reference purposes. The e-Filing System for taxpayers and tax agents will be available from 1 March 2024.

13. Is the CGT a covered tax for Pillar Two Global Minimum Tax's purpose?

CGT could fulfill the definition of Covered Tax but the gain arising from the sale of shares must be part of the GloBE income. The gain is excluded from GloBE income calculation if a Multinational Enterprise group owns 10% or more of the ownership interest in an entity. If the gain is excluded, then the CGT should not be forming part of the numerator (i.e. the Covered Tax).

14. How would corporate exercise be affected?

One should take into account the CGT implications in corporate exercise. For example, the following factors may be relevant for merger and acquisition exercise that involves a Malaysian target company:

- CGT implication at exit level for direct disposal of shares in unlisted companies incorporated in Malaysia.

- Availability of DTA exemption – choice of holding company location to hold shares in Malaysian target company.

- Sufficient documentary evidence to demonstrate that the proposed structure is driven by commercial reasons/factors and that obtaining a tax treaty benefit was not one of the principal purposes of the proposed structure.

- Potential application of Section 15C if the exit is at foreign holding company level.

It is also important to ascertain other transactions that could fall within the meaning of disposal, apart from capital reduction and share buy-back. Given that CGT applies to all types of capital assets situated outside of Malaysia (not confined to shares), it is also crucial to determine the situs of non-share assets such an intellectual property, debtors, goodwill etc.

Stay tuned for Part 2 as we will be providing our commentaries once the details of CGT exemption in respect disposal of unlisted shares in relation to Initial Public Offering approved by Bursa Malaysia and restructuring within the same group as well as economic substance requirements for disposal of foreign capital assets are available.

Get in touch

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