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CbCR Notification using Form C, Revised Guidelines on Secretarial Fee and Tax Filing Fee, Latest Gazette Orders, Practice Note 1/2021 on MTD and more

June 2021

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Greetings from Deloitte Malaysia Tax Services

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Inland Revenue Board of Malaysia

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Task	2021 Due Date	
	30 June	**1 July**
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6. Deadline for 2021 CbCR notification for companies with June year-end	√	

1. Country-by-Country Reporting (CbCR) Notification using Form C

On 25 May 2021, the Inland Revenue Board of Malaysia (IRBM) announced on its website that starting from the year of assessment (YA) 2021, constituent entities can now furnish the Country-by-Country Reporting (CbCR) Notification using Form C. For constituent entities filing other forms (i.e. TF, TP, LE, etc.), the existing manner of filing the CbCR Notification letters remains the same, i.e. by using the format (Annex B/C1/C2) released by the IRBM.

Up to YA 2020, the Malaysian constituent entities of a multinational enterprise group (MNE Group) were required to file the CbCR Notification letters to the IRBM for each reporting financial year (for CbCR) by the last date of such reporting financial year. For example, if the reporting financial year-end for CbCR is 30 June 2020, then the CbCR Notification was due by 30 June 2020.

However, starting from YA 2021, those taxpayers filing tax return via **Form C** would need to complete the CbCR Notification template provided within the Form C (see the sample Form C for YA 2021 provided by IRBM, relevant particulars to be completed on Pages 4, 17, 22 and 23 as applicable). Specifically, Deloitte has confirmed the following with the IRBM:

- If the reporting year-end is up to 31 March 2021 (YA 2021), then the CbCR Notification would have already been submitted by 31 March 2021. However, when filing the Form C by 31 October 2021 (statutory deadline*), the relevant constituent entities would still need to complete the CbCR Notification particulars within the Form C for YA 2021.

- If the reporting year-end is 30 June 2021 (YA 2021), then the CbCR Notification would be submitted through the Form C by 31 January 2022 (statutory deadline*). In this case, there is no need to file the physical CbCR Notification letter by 30 June 2021 under the existing manner.

- If the constituent entity is subjected to Labuan Business Activity Tax Act (LBATA) i.e. not filing Form C, then the following applies:

  i. Existing due date to file the CbCR Notification remains the same i.e. on or before the last day of the reporting financial year;

  ii. Labuan constituent entity to continue filing the physical CbCR Notification letter i.e. Annex B (for Labuan ultimate parent entity), Annex C1 (for Labuan constituent entity of Malaysian ultimate/surrogate parent) and Annex C2 (for Labuan constituent entity of foreign ultimate/surrogate parent);

  iii. Previously, the Malaysian MNE Group would submit two CbCR Notification letters under CbCR Rule 6(1)** by reporting entity and under CbCR Rule 6(2)** by non-reporting entity i.e. consolidated CbCR Notification by one constituent entity on behalf of others – following Annex C1]. Now, if there is more than one constituent entity in Labuan subjected to LBATA, then the option to file a single consolidated Notification letter under CbCR Rule 6(2)** through Annex C1 by any one of the Labuan constituent entities continue to remain available; and

  iv. If it is a foreign MNE Group, then all the Labuan constituent entities should continue to file separate CbCR Notification letters following Annex C2.

* Generally, the filing deadline is extended by one month, but this is announced by IRBM separately for each year.

** Income Tax (Country-by-Country Reporting) Rules 2016 [P.U.(A) 357/2016] read together with Income Tax (Country-by-Country Reporting) (Amendment) Rules 2017 [P.U.(A) 416/2017] and Labuan Business Activity Tax (Country-by-Country Reporting) Regulations 2017 [P.U.(A) 409/2017].

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2. Revised guidelines for deducting expenses in relation to secretarial fee and tax filing fee from YA 2020 onwards

The IRBM has issued the above-mentioned Revised Guidelines dated 11 May 2021 (*available in Bahasa Malaysia only*) to supersede the previously issued Guidelines dated 18 September 2020.

The main changes are as follows:

- Addition of Item 2.2 which states that athough the Income Tax (Deduction for Expenses in relation to Secretarial Fee and Tax Filing Fee) Rules 2020 [P.U.(A) 162/2020] has replaced the Income Tax (Deduction for Expenses in relation to Secretarial Fee and Tax Filing Fee) Rules 2014 [P.U.(A) 336/2014], the Revised Guidelines will explain the tax treatment of expenses in relation to secretarial fees and tax filing fees involving the two gazette orders.

- Addition of Example 3 which is in relation to claiming of expenditure on secretarial fees and tax filing fees incurred and paid in the same year and involved the application of P.U.(A) 336/2014 and P.U.(A) 162/2020. In this example, the total deduction allowed in the basis period for YA 2020 is RM15,500 comprised of:
  a) secretarial fees in respect of services rendered in YA 2019 but invoiced/charged and paid in YA 2020, where the amount of deduction allowed is limited to RM5,000 pursuant to P.U.(A) 336/2014; and
  b) the remaining RM10,500 is the cumulative amount of tax filing fees invoiced/charged and paid in YA 2020 pursuant to P.U.(A) 162/2020.

- Addition of Example 4 which is in relation to claiming of expenditure on secretarial fees and tax filing fees incurred and paid in the YA 2020 and subsequent YAs pursuant to P.U.(A) 162/2020 only.

Please refer to the Revised Guidelines for full details.

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3. Income Tax (Exemption) (No. 2) 2020 (Amendment) Order 2021 [P.U.(A) 245/2021]

P.U.(A) 245/2021 was gazetted on 31 May 2021 to legislate the proposed extension of application period for the health/medical tourism tax incentive by another 2 years as announced in Budget 2021 by amending **paragraph 4(5)(a)** of the Income Tax (Exemption) (No. 2) Order 2020 [P.U.(A) 141/2020]. The amendment in paragraph 4(5)(a) of P.U.(A) 141/2020 extends the application period to **31 December 2022**.

Other terms and conditions of the health/medical tourism tax incentive stipulated in P.U.(A) 141/2020 remain unchanged. Please refer to the respective Orders for the full details.

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4. Income Tax (Deduction for Training Costs under the Professional Training and Education for Growing Entrepreneurs (PROTÉGÉ-Ready to Work (RTW)) Programme) Rules 2021 [P.U.(A) 228/2021]

P.U.(A) 228/2021 (the Rules) was gazetted on 11 May 2021 and deemed to have come into operation on 11 September 2019.

Deduction
For the purpose of ascertaining an adjusted income of a qualifying company in Malaysia from its business in a basis period for a YA, a double deduction shall be allowed for any outgoings and expenses which were incurred by that qualifying company during that basis period for conducting the Training Programme.

For each Training Programme, the outgoings and expenses allowed for deduction are as follows:

- monthly training allowance of not less than RM1,000 paid to the trainees for a maximum period of 12 months; and

- total expenditure of not more than RM5,000 per trainee incurred for providing training, allowances for food, travelling and accommodation to the trainee and fees paid to a person who has been appointed to conduct soft-skills training under the Training Programme.

The qualified company claiming for the deduction is required to produce a confirmation from the Ministry of Entrepreneur Development and Cooperatives specifying that:

- the Training Programme has been approved and the date of approval begins from 11 September 2019 until 31 December 2025; and

- the implementation of the Training Programme shall commence within 12 months from the date of approval of the Training Programme.

For the purposes of the Rules:

“Trainee” means a Malaysian citizen graduate who is undergoing the Training Programme is unemployed or is under an employment which does not commensurate with his qualification.

"Training Programme" means the Professional Training and Education for Growing Enterpreneurs (PROTÉGÉ-Ready to Work (RTW)) Programme approved by the Ministry of Entrepreneur Development and Cooperatives which is conducted for trainee for 8 to 12 continuous months.

“Qualified company” means a company incorporated in Malaysia under the Companies Act 2016 and approved by the Ministry of Entrepreneur Development and Cooperatives to participate in the Training Programme.

Revocation
The Income Tax (Deduction for Training Costs under Skim Latihan 1Malaysia for Unemployed Graduates) Rules 2013 [P.U.(A) 260/2013] are revoked.

Please refer to the Rules for the full details, including the savings and transitional provisions.

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5. Income Tax (Exemption) (No. 5) Order 2021 [P.U.(A) 209/2021]

P.U.(A) 209/2021 (the Order) was gazetted on 4 May 2021 and comes into operation from the YA 2021 until the YA 2023.

Exemption
The Order exempts a resident fund management company licensed under the Capital Markets and Services Act 2007 (CMSA) or registered with the Securities Commission Malaysia (SC) as a venture capital management corporation or a private equity management corporation from the payment of income tax in a basis period for a YA in respect of the statutory income derived from a business of providing fund management services for Sustainable and Responsible Investment (SRI) Fund in Malaysia.

An exemption granted under the Order shall be subject to the company obtaining annual certification from the SC that the following conditions have been fulfilled namely the company —

(a) provides fund management services for SRI Fund in Malaysia;

(b) incurs annual operating expenditure of at least RM250,000 in Malaysia; and

(c) has at least —

i. in the case of a company licensed under the CMSA, two full-time employees in Malaysia, of which one of the employees holds a Capital Markets Services Representative’s Licence under the CMSA; or

ii. in the case of a company registered with the SC as a venture capital management corporation or a private equity management corporation, two full-time employees in Malaysia, of which one of the employees is a responsible person approved by the SC.

Non-application
This Order shall not apply to a company if in the basis period for a YA —

- the company has been granted any incentive under Section 60G of the Income Tax Act 1967 (ITA); or
- the company has been granted any exemption under Paragraph 127(3)(b) or Section 127(3A) of the ITA.

Please refer to the Order for the full details.

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6. Double Taxation Relief (The Government of Ukraine) Order 2021 [P.U.(A) 223/2021]

The Double Taxation Relief (The Government of Ukraine) Order 2021 [P.U.(A) 223/2021] was gazetted on 7 May 2021 and encloses the Double Taxation Avoidance Agreement ("DTAA") between Malaysia and Ukraine signed on 4 August 2016.

The DTAA shall enter into force on the date of receipt of the later of the written notifications by Malaysia and Ukraine to each other on the completion of the procedures required by their respective domestic laws for bringing the DTAA into force. The DTAA will have effect in Malaysia, in respect of Malaysian tax, to tax chargeable for any YA beginning on or after the first day of January in the calendar year following the year in which the DTAA enters into force.

Pursuant to the protocol to the DTAA, in the case of Malaysia, the provisions of the DTAA shall not apply to persons carrying on Labuan business activities under the Labuan Business Activity Tax Act 1990 (LBATA). The term "Labuan business activity" means Labuan business activities as defined under Section 2(1) of the LBATA. Provided that the provisions of the DTAA shall apply to a Labuan entity that has made an irrevocable election to be charged to tax in accordance with the ITA. Such irrevocable election shall be confirmed by the competent authority of Malaysia.

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7. Practice Note 1/2021 on MTD as final tax

The IRBM has recently issued Practice Note 1/2021 (*available in Bahasa Malaysia only*) to clarify on the treatment of Monthly Tax Deduction (MTD) as the final tax for the employment income received by an individual under Section 77C of the ITA, which came into effect from YA 2014. An individual who met the conditions laid out in Section 77C(1) and elected not to file his income tax return form (ITRF) for a YA to the IRBM, the MTD will become his final tax for that YA.

Practice Note 1/2021 explains the conditions to be met by the individual to qualify for the treatment of MTD as final tax. Generally, the following conditions which apply from YA 2014 are:
1. the individual has income only in respect of gains or profits from an employment;
2. the individual must serve under only **one** employer for a **period of 12 months in a YA**;
3. the MTD of the individual is not borne by the employer for that YA;
4. the individual and spouse did not elect for joint assessment for that YA;
5. the MTD is made in accordance with the Income Tax (Deduction from Remuneration) Rules 1994; and
6. the calculation of MTD includes benefits in kind and value of living accommodation.

From YA 2015 onwards, the condition under no. 2 above has been relaxed where the employee must serve under only one employer ***irrespective of the period of employment*** e.g. an individual who just started his employment and the employment is less than 12 months in the YA.

Apart from the above, additional conditions have been imposed for YAs 2015 and 2016 onwards e.g. the MTD takes into account Section 25(1) which provides that the employee's gross income from his employment which is receivable in any YA is taxed in the year it is received and Section 25(6) which provides that gross income for *certain* employees who ceases to be employed in Malaysia and has departed from Malaysia is taxed in the YA in which the individual leaves Malaysia permanently.

The Practice Note also explains the implications under various situations where the individual elects not to submit his ITRF for a YA. It covers situations such as where the taxpayer claims a tax relief or rebate by reducing his MTD via submission of the Form TP1 (Individual Deduction And Rebate Claim Form) to his employer; where the taxpayer is later found to have failed to meet the conditions in Section 77C(1) e.g. the IRBM receives further information on the income of the taxpayer;

and that IRBM may impose penalties on the employee (or his employer) including in the event the employer is found to have under-deducted the employee's MTD. The individual is required to file his ITRF if it is discovered by IRBM that he has failed to meet the conditions under Section 77C(1).

Please refer to the Practice Note 1/2021 for the full details.

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8. Operational Guidelines on Compensation on Late Refund of Overpayment of Tax (Updated)

The IRBM has recently issued an updated Operational Guidelines on Compensation on Late Refund of Overpayment of Tax (GPHDN 2/2021) dated 21 May 2021 (*available in Bahasa Malaysia only*) to supersede the previously issued Guidelines (GPHDN 1/2014) dated 15 May 2014.

The significant changes are as follows:

- Item 2.1(d) – Taxpayers are eligible for compensation on late refund by the IRBM if the ITRF is furnished by the extended due date specified in the Return Form Filing Programme released by the IRBM for the respective year.

- Cases where taxpayers are not eligible for compensation on late refund include the following:
  (a) Item 3.3 – There is an assessment raised under Sections 90(3), 91, 91A, 92 and 96A of the ITA;
  (b) Item 3.4 – The taxpayer has applied for an extension of time for submission of ITRF, other than the extended due date specified in the Return Form Filing Programme released by the IRBM;
  (c) Item 3.6 – There are audit findings which resulted in taxes or additional taxes to be paid within 90 days from the ITRF's submission due date (if the ITRF is submitted via e-filing) / 120 days from the ITRF's submission due date (if the ITRF is submitted by post or by hand at the IRBM counter).
  (d) Item 3.7 – The excess taxes were not paid according to the tax instalment schedule issued by the IRBM under Sections 107, 107B and 107C of the ITA. Please refer to Example 1.

  Note:
  The following refund cases which were included in the superseded Guidelines (GPHDN 1/2014) as not eligible for compensation on late refund, have been removed:
  i. Item 4(b) – The claim was wrongly made;
  ii. Item 4(f) – There is a mathematical error; and
  iii. Item 4(g) – Failure to pay instalment in accordance with Sections 107, 107B and 107C of the ITA.

- Item 4.2 – Examples 2 and 3 on the calculation of compensation on late refund of overpayment of tax.

- Item 5.1 – If an error was committed by the IRBM (in calculating the compensation for late refund), the IRBM has the right to recover the compensation wrongly paid out without an increase of 10%.

- Item 5.3 – The IRBM will issue a notification letter to the taxpayer on the recovery of compensation on late refund and 10% increase under Section 111D(3)(b) of the ITA (if the error arises because of incorrect information or incorrect return by the taxpayer). The said notification will be delivered to taxpayer by post.

- Item 6 – Disclaimer: The examples in the updated Guidelines are for illustrative purposes only and are not exhaustive.

Please refer to the updated Guidelines (GPHDN 2/2021) for full details.

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9. Guidelines and forms on the application procedures for DGIR's approval for the purpose of Section 44(6) of the ITA in respect of TBSA, TPS and TSUWAS

The IRBM has recently uploaded the Guidelines (dated 28 April 2021) and Forms relating to the application procedures for the approval of the Director General of Inland Revenue (DGIR) for the purpose of Section 44(6) of the ITA in respect of Tabung Pembelian Sekolah Agama (TBSA), Tabung Pembinaan Sekolah (TPS) and Tabung Sumbangan Wang Awam Sekolah (TSUWAS).

The TBSA, TPS and TSUWAS Guidelines cover:

(i) Eligibility criteria and conditions of TBSA, TPS and TSUWAS for the application of approval under Section 44(6);
(ii) Application procedures by the committee of TBSA, TPS and TSUWAS for approval under Section 44(6);
(iii) Responsibilities of the committee of TBSA, TPS and TSUWAS after obtaining approval under Section 44(6);
(iv) Consequences of breach of conditions;
(v) Period of approval and extension on the application made under Section 44(6);
(vi) DGIR's power to approve and to impose conditions; and
(vii) Tax treatment of donors who have donated to TBSA, TPS and TSUWAS approved under Section 44(6).

Please refer to the TBSA Guidelines and Form, TPS Guidelines and Form, and TSUWAS Guidelines and Form for the full details [*Available in Bahasa Malaysia only*].

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10. Public Ruling No. 1/2021: Taxation Of Unit Holders Of Real Estate Investment Trusts / Property Trust Funds

The IRBM has recently issued Public Ruling No. 1/2021: Taxation Of Unit Holders Of Real Estate Investment Trusts / Property Trust Funds (REITs/PTFs) (PR 1/2021) to replace PR 9/2018 (dated 12 October 2018).

The updates and amendments are listed in Paragraph 6 of the PR, mainly to reflect changes made by the Finance Act 2020 which amended Section 5(1A) to the ITA effective from YA 2021 onwards. Pursuant to the amendment, the **withholding tax** deducted from the income distribution by a REIT/PTF listed on Bursa Malaysia which is exempt under Section 61A to its unit holders be treated as the **final tax**. Distribution made by such REIT/PTF to a resident company unit holder for unit trust income derived from Malaysia is not subject to **withholding tax** under Section 109D. Instead, resident company unit holders are subject to tax at the prevailing income tax rates applicable to a company. This is illustrated in the updated Note to Example 2 of the PR 1/2021.

It is to be noted that tax charged on distribution of income which is tax exempt at REIT/PTF level under Section 61A for that YA by a REIT/PTF that is listed on Bursa Malaysia is a final tax where withholding tax under Section 109D applies, as stated in the updated Paragraph 4.2 of the PR.

Other notable changes apart from the above:
- Example 3 has been amended to clarify that income exempted from tax **other than under Section 61A** of the ITA which is received by a REIT and subsequently, is distributed to unit holders continues to be tax exempt at the unit holders' level.
- A note has been added in Paragraph 4.1(ii) of the PR to explain that for the purpose of the PR, 'tax credit' is the portion of the tax paid by the unit trust attributable to the units held by the unit holders which can be utilised by the unit holders to set off against the tax charged on them pursuant to Section 110(9A) of the ITA.

Please refer to PR No. 1/2021 for full details.

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11. Kind Action (M) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (High Court)

Issue:

Whether the taxpayer's application for leave for judicial review (JR) to quash the notices of additional assessment raised by the DGIR for the YAs 2010, 2015 and 2018 that subjected the gains received by the taxpayer from the disposal of plantation lands to tax under the ITA should be granted.

Decision:

The High Court (HC) granted the taxpayer's application for leave for JR, together with an interim stay, with the following grounds of judgement:

Adversely affected

1) Order 52, Rule 2(4) of Rules of Court 2012 (ROC 2012) provides that any person **adversely affected** by a decision of any public authority shall be entitled to make an application for JR; and the Federal Court case in *Malaysian Trade Union Congress & Ors v Menteri Tenaga, Air dan Komunikasi & Anor [2014] 3 MLJ 14* held that this had to do with that person's "real and genuine interest in the subject matter". The cases, amongst others, of *Flextronics Shah Alam Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri [2018] 7 CLJ 487* affirmed that the Courts had to adopt a flexible approach when deciding if and when an applicant was indeed "adversely affected".

2) The taxpayer had submitted that the additional taxes and penalties of RM81 million to be paid in short order by the taxpayer was a clear and unequivocal demonstration of them being "adversely affected" by the decision of the DGIR, both in terms of alleged "grave injustice" and "serious financial prejudice". On the facts and on this point, the HC was satisfied that the taxpayer has a real and genuine interest in the subject matter (i.e. the additional taxes and penalties sought to be imposed upon them) and thus have ostensibly been aggrieved by the decision of the DGIR (which the latter point will be subjected to full ventilation by both sides at the merits stage of these proceedings).

Domestic Remedy

On the DGIR's submission that there exists a domestic remedy for the taxpayer (i.e. Section 99 of the ITA) which precludes the HC from granting leave for JR, the HC held that the existence of a domestic remedy falls to be considered and decided upon at the merits stage of the proceedings and not at the leave stage based on courts authorities in several case laws. It was also held by the Court of Appeal in the case of *Teh Guat Hong v Perbadanan Tabung Pendidikan [2015] 3 AMR 35* that, "It was not necessary to go into the merits of the case at the leave stage because the threshold to establish whether leave should be granted is very low."

Pursuant to the foregoing, the HC granted the taxpayer's application for leave for JR, together with an interim stay.

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12. What is "Other Income"?

Lim Bee Teng, Tan Ann Peng and Karen Lai

Introduction

What is "other income"? Is it defined under the Income Tax Act 1967 ("the Act")? Unfortunately, it isn't. However, this probably makes sense as it is almost impossible to define "other income". From a revenue collection standpoint, this is good because the boundary of "other income" under Section 4(f) is almost unknown. On the flip side, Section 4(f) category may give rise to ambiguity to taxpayers.

Why is it important to understand the scope of Section 4(f)?

Given that Malaysia does not have capital gains tax regime, save for Real Property Gains Tax, it is crucial to determine if a receipt is of income or capital nature. Only the former will be taxable. Income is categorised as follows:

a) gains or profits from a business, for whatever period of time carried on;
b) gains or profits from an employment;
c) dividends, interest or discounts;
d) rents, royalties or premium;
e) pensions, annuities or other periodical payments not falling under any of the foregoing paragraphs;
f) **gains or profits not falling under any of the foregoing paragraphs.**

The biggest challenge here is to determine the types of receipt that would fall under Section 4(f). More often than not, there is a thin line between capital receipt and Section 4(f) income, and this sort of controversy was evident in the following recent Malaysian tax cases:

(a) ABM v Ketua Pengarah Hasil Dalam Negeri (SCIT) – Receipt of money from an individual

In this case, the Special Commissioners of Income Tax ("SCIT") dismissed the taxpayer's appeal on the issue of whether the taxpayer's receipt of money from an individual fell under Section 4(f) of the Act because the taxpayer failed to prove the purpose of the receipt of the money. Therefore, the SCIT decided that the assessment raised by the Director General of Inland Revenue ("DGIR") pursuant to Section 4(f) of the Act was correct and in order, and the taxpayer's appeal was dismissed and the assessment maintained.

It is noted from the case report that the taxpayer had received money amounting to RM750,000 from an individual which money was allegedly intended to be used as a fund to generate business opportunities for a company. The DGIR did not accept the taxpayer's reasons as the money had been used to purchase assets in the name of the taxpayer and the taxpayer's wife. Therefore, the money received had been assessed as other income under Section 4(f) of the Act. Section 4(f) of the Act is a catch all provision for the receipt of revenue that does not fall under any of the provisions of Sections 4(a) to 4(e) of the Act. Income that can be assessed under Section 4(f) of the Act, among others, involves miscellaneous or casual and isolated receipts, i.e. receipts obtained occasionally or by chance, even if they arise not from the normal activities by the taxpayer.

(b) Mohd Zainuri Bin Mohd Idrus v Ketua Pengarah Hasil Dalam Negeri (High Court) [2020] MLJU 1555] – Windfall

The High Court has held that the phrase "gains or profits not falling under any of the foregoing paragraphs" in Section 4(f) of the Act is very wide and it is a "catch all" provision that would include the taxpayer's windfall of RM30,000,000 arising from the Settlement Agreement. Therefore, the RM30,000,000 received by the taxpayer is income under Section 4(f) of the Act, upon which tax is chargeable.

(c) Keysight Technologies Malaysia Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri (High Court) [(2018) MSTC 30-150] - Transfer / sale of technical know-how

In this case, the High Court held that the taxpayer's application for leave to commence judicial review was premature and should thereby be dismissed, as the taxpayer should have proceeded with the appeal process statutorily provided by the Act. Among others, the taxpayer applied for an order of certiorari for the purpose of it being quashed, the decision of the IRB dated 9.6.2017 that the sale of the marketing and manufacturing intangibles ("Intellectual Property Rights") by the taxpayer is revenue, and not capital in nature. Based on the facts of the case, the DGIR has decided that the transfer of the technical know-how is revenue in nature and subjected to tax under on Section 4(f) of the Act, and rejected the taxpayer's appeal on the ground this technical know-how is an outright sale which is capital in nature. The change in the structure of the company from full fledge manufacturer to contract manufacturer does not make an impact on the derivation of income of the company as the company was still using such technical know-how in their manufacturing processes.

In view of this, the DGIR was of the view the manufacturing process with the use of these technical know-how (which now belong to its related company) remained as usual, the income received from the transfer / sale of technical know-how is revenue in nature and subject to tax under Section 4(f) of the Act.

The decision in Keysight is critical and would have far-reaching effect because the traditional position is that this kind of receipt is not taxable. After all, Malaysia has always been known as a jurisdiction that does not impose exit tax.

Capital allowance and unabsorbed business losses would not be available for set off against "other income" and this is another reason as to why proper income categorisation is crucial.

Guidance

Whilst the scope under Section 4(f) of the Act remains unclear and controversial, one can make reference to the Public Ruling No. 1/2010 – "Withholding Tax on Income under Paragraph 4(f)" ("the PR") issued by the Inland Revenue Board ("IRB") which explains the withholding tax treatment on Section 4(f) income. As a guide, the PR provided that the following criteria can be considered to determine if a payment made to a non-resident ("NR") falls under Section 4(f) of the Act:

(a) the payment is revenue and not capital in nature;
(b) the payment is not income that falls under Sections 4(a) to 4(e) and Section 4A of the Act;
(c) the payment received by a NR person is in the nature of a miscellaneous income. Such income is often casual in nature. Casual income means an occasional income, which is received outside the ordinary course of trade or vocation;
(d) the payment is for an isolated transaction; and
(e) there is an absence of repetition of transactions to indicate the commercial nature of the transaction.

An income received may be chargeable to tax under Section 4(f) of the Act regardless of whether the payment made is in cash or in-kind. A casual income is one which arise to a person from an activity which is outside his ordinary trade or vocation, but which nevertheless is a profit or income item accruing to him. Casual income could be a Section 4(f) income if it is revenue in nature and does not fall under Sections 4(a) to 4(e) and Section 4A of the Act. A “one off” income received by a person for a casual or occasional transaction does not automatically mean that it is a Section 4(f) income. Consideration should be given as to whether the “one off” income of the person for an isolated transaction could be classified as a business income. Some of the factors that could be considered to determine if it is a business income are as follows:

(a) whether the “one off” income is for an isolated transaction which marks the beginning of an ongoing business. If there is an intention to continue to pursue that line of business, the single business transaction may constitute the first transaction of an ongoing business; or

(b) whether in the absence of repetition of transactions, a business may exist because of the commercial nature of the service rendered or arrangement made.

Examples of casual income include commissions, guarantee fees , brokerage fees, introduction fees, fees for the occasional hosting as the master of ceremony, fees for the occasional newspaper articles, or the giving of ad-hoc lectures, are all casual but nevertheless income in nature.

Withholding tax (“WHT”) on Other Income and Special Classes of Income

Certain payments made to non-residents would be subject to WHT. This includes payment that fall within the category of “other income” under Section 4(f) as well as special classes of income under Section 4A. Section 4(f) income must not be an income that falls under Sections 4(a) to 4(e) and Section 4A of the Act. Special classes of income under Section 4A covers the following:

i. Amounts paid in consideration of services rendered by the person or his 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, such person;

ii. Amounts paid in consideration of any advice given, or assistance or services rendered in connection with the management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme; or

iii. Rent or other payments made under any agreement or arrangement for the use of any moveable property.

It is clear that Section 4A prevails over Section 4, which includes 4(f) income. In that sense, once an income falls within the ambit of Section 4A and is deemed to be derived from Malaysia, the payment would be subject to WHT at 10% (or reduced rate subject to tax treaty consideration).

Special classes of income shall be deemed to be derived from Malaysia if:
(a) the responsibility for the payment lies with the Government, a State Government or a local authority;
(b) the responsibility for the payment lies with a person who is resident in Malaysia for that basis year; or
(c) the payment is charged as an outgoing or expense in the accounts of a business carried on in Malaysia.

For Section 4A (i) and (ii) income to be subject to Malaysian withholding tax, services must be rendered in Malaysia but this is not necessary for other income under Section 4(f). Hence, this is also another reason as to why proper income categorisation is key.

According to the IRB’s Minutes of Dialogue and Responses to Joint Memorandum on Issues Arising from 2019 Budget Speech & Finance Bill 2018 dated 30 November 2018, the IRB has responded that in the context of a Double Tax Agreement (“DTA”), Section 4A income is not a business income. Thus, Section 4A of the Act should be applicable even though a NR is not carrying on business through a permanent establishment (“PE”) in Malaysia.

In short, the “No PE, no tax on busines profits” protection under the DTA cannot be applied to Section 4A income. The IRB is also of the view that in the absence of Technical Fees Article, the Other Income Article in the DTA may be invoked. Most treaties allow Malaysia (some exceptions such as Germany and Turkmenistan DTAs) to impose WHT on “other income” but the real issue is whether Article on Other Income is correctly used.

Conclusion

In summary, there is no bright line test on the determination of "other income" under Section 4(f) and this is particularly so when that particular receipt could also be argued as capital receipt. This will be dependent on the facts and circumstances of the case.

Capital receipt is not taxable. Different sources of income would be accorded different tax treatments. For instance, capital allowance can only be claimed against business income. Only business losses could be carried forward. As for income which is subject to tax as "other income" under Section 4(f) of the Act, no claim for capital allowance would be available. Losses (i.e. excess of deductible expense over the gross income under Section 4(f)) cannot be carried forward. Unabsorbed business losses from other business sources cannot be used to set off against "other income". There would also be WHT implication if the income received by a NR is Section 4(f) income instead of business income. Section 4(f) income received by a NR would be subject to WHT of 10% regardless of the locality of services. There is no reduced rate available under the DTAs.

The authors are senior managers with Deloitte and the above views are solely theirs. They wish to express their appreciation to Carol Eng and Julia Leong for their input.

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13. A Closer Look at the Public Ruling on Withholding Tax on Special Classes of Income

Yap Tee Chong, Chuah Kie Shiuan, Yap Wei Yee

Introduction

Nothing is certain in life except for death and taxes. But, how certain are you that you are paying the correct amount of taxes? The Malaysian Income Tax Act 1967 ("the Act") is the statute that governs Malaysian income tax matters. At times, tax disputes would arise due to different interpretation by the taxpayers and the Malaysian Inland Revenue Board ("IRB"). To assist taxpayers, public rulings ("PRs") are issued by the IRB from time to time, setting out the interpretation of the Director General of Inland Revenue ("DGIR") on specific areas of tax law. In this article, we share our thoughts on one of the most widely used PR, namely the Public Ruling 10/2019 ("PR10/2019") - Withholding Tax ("WHT") on Special Classes of Income.

Tax Deduction on Cash Basis?

Certain payments made to non-residents (e.g. onshore service fees, royalty, interest, rental of movable property etc.) would attract WHT. The WHT has to be remitted to the IRB within one month after paying or crediting the payments to non-residents.

Paragraph 14.3 of the PR 10/2019 provides the following:-

> *"Where the withholding tax is not due for payment and no payment or crediting is made to the non-resident payee on or before the due date of submission of the Income Tax Return Form, **regardless of the withholding tax has been paid or remitted to the Director General of Inland Revenue**, a deduction is not allowable under paragraph 39(1)(j) of the Income Tax Act 1967 "*

Prior to the issuance of PR 10/2019, it is a known practice that a deduction could be claimed if the payer remits the applicable WHT to the IRB voluntarily (on the basis that other deduction rules are met). However, the latest position taken by the IRB seems to suggest that the amount due to the non-resident would also need to be paid or credited prior to the filing of the tax return for the year of assessment in which the expense relates to.

The IRB's position on "cash" basis is an interesting one because the general rule for deduction under Section 33 of the Act provides that any expenditure incurred wholly and exclusively in the production of income is allowable as a deduction from the gross income unless it is specifically prohibited under Section 39 of the Act.

It's important to note that Section 39 disallows a claim if the relevant WHT plus penalty on payment to NRs are not remitted. However, we are of the view that the issue of WHT would not arise if the NR has not been paid or credited (e.g. inter-company set off). An expense could still have been incurred (i.e. when legal liability to pay has arisen) but this does not trigger WHT in the absence of actual payment or crediting. We agree that abuse could arise, especially in the case of inter-company dealings where a deduction has been taken, but the amount remains unpaid for years. There are several provisions in the Act that IRB could use to deal with this situation.

Dry lease vs Wet lease

Paragraph 8 of the PR 10/2019 provides that payment to the non-resident lessor for the lease of a ship/aircraft, whether bare boat (dry lease) or with crew (wet lease), are subject to WHT at the rate of 10% on the gross receipt. This is on the basis that those payments would fall within the meaning of rent or other payments made under any agreement for use of moveable property.

Whilst the payment for bare charter would fall squarely within this category, it may be possible to argue that wet lease income is part of sea/air transportation income of the non-resident. Under most tax treaties, income from the international air/sea transportation will not be subject to Malaysian tax.

Other Income Article – Weapon for all seasons?

Another observation is on Paragraph 18 the PR 10/2019, where it is stated that in the absence of Fees for Technical Services Article, the Other Income / Income Not Expressly Mentioned Article would be applicable. Essentially, the position taken is that Section 4A income is not a business income. Thus, Section 4A of the Act should be applicable even though a NR is not carrying on business through a permanent establishment ("PE") in Malaysia. In short, the "No PE, no tax on busines profits" protection under the DTA cannot be applied to Section 4A income. Most treaties allow Malaysia (some exceptions such as Germany and Turkmenistan DTAs) to impose WHT on "other income" but the real issue is whether the Other Income Article is correctly used.

It appears to us that the position under the PR is that Section 4A prevails over the tax treaty or alternatively, Section 4A income could not be a business income under the tax treaty. In our view, Section 132 of the Act, which essentially provides that DTA prevails over ITA, cannot be brushed away just like that. It should prevail over any other provisions in the ITA.

Section 132 is the basis of tax treaty. On the treaty front, one may contend that business income is not defined. Hence, business income under the domestic tax law of the source country, namely ITA, which excludes Section 4A income from business income, should kick in. This view would be over simplistic and is one that does not take into account the objective of the tax treaty.

There would be situations where the context otherwise requires for international meaning to be used, rather than domestic tax law, when defining a term. Many courts have recognised the existence and the application of an international tax meaning that is not derived from the domestic law of the contracting states, but that is obtained by referring to alternative sources.

In reality, most advanced countries construe a tax treaty liberally. If narrow interpretation is adopted, this would give a result at odds with the intention of the treaty. In such cases, a broader interpretation will usually be allowed. After all, this is consistent with Article 31 of the Vienna Convention on the Law of Treaties ("VCLT"). We are fully aware that Article 31(4) of the VCLT provides that a special meaning shall be given to a term if it is established that the parties so intended.

In this regard, we reiterate that the tax treaty provides that there would be situations where the context requires for international meaning to be used as opposed to the meaning under the ITA. The crux is that the treaties are international agreements which are entered in good faith, as endorsed by VCLT and, unlike the domestic law, does not warrant a literal interpretation. Therefore, while interpreting a treaty, a broader interpretation should be applied.

Conclusion

Even though we are guided by PRs that are issued by the IRB, there are several areas in PRs that could be subject to further debate. Clearly, taxpayers must analyse these areas carefully and adopt a robust technical position that could hold water in case of court litigation.

The authors are senior managers with Deloitte and the above views are solely theirs. They wish to express their appreciation to Kelvin Yee and Joseph Teoh for their input.

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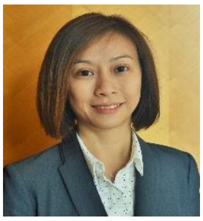
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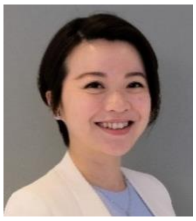
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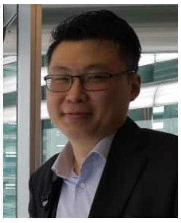
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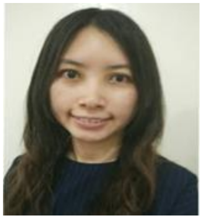

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