



Tax Espresso – Special Alert

Guidelines issued on Tax Treatment of Foreign Source Income received in Malaysia

Greetings from Deloitte Malaysia Tax Services,

On 29 September 2022, the Inland Revenue Board of Malaysia (IRBM) issued the [Technical Guidelines](#) (herein after referred to as the Guidelines) on Tax Treatment of Foreign Source Income (FSI) (*available in Bahasa Malaysia only for now*), to enhance taxpayer's understanding of the IRBM's interpretation and application of the tax legislation with respect to the FSI received by residents in

Malaysia, as well as the qualifying conditions for the exemption from tax that are imposed by the Minister of Finance.

The Government of Malaysia implemented the measure to impose tax on the income of residents derived from sources outside Malaysia and received in Malaysia through the Finance Act 2021 which came into operation on 1 January 2022. As a transition measure, the FSI received in Malaysia from 1 January 2022 until 30 June 2022 would be taxed at a 3% rate on a gross basis. Any FSI received in Malaysia as from 1 July 2022 would be subject to tax based on the prevailing income tax rate.

Period	Tax rate
01.01.2022 – 30.06.2022	3% on the gross amount
01.07.2022 onwards	Prevailing tax rate

However, following the gazette of the Income Tax (Exemption) (No. 5) Order 2022 [[P.U.\(A\) 234/2022](#)] and the Income Tax (Exemption) (No. 6) Order 2022 [[P.U.\(A\) 235/2022](#)], certain FSI received by certain categories of tax residents in Malaysia will continue to be exempted from tax for another 5 years until 31 December 2026 [[refer to our Special Alert dated 20 July 2022](#)]. These orders provide some clarifications on which Malaysian tax resident may qualify for an income tax exemption and conditions that are applicable for an exemption.

The Guidelines, which are issued pursuant to these exemption orders, aim to provide detailed explanation (with illustrative examples) to taxpayers to address their concern regarding the tax implications of FSI received by residents in Malaysia and the scope of exemption.

Salient points

FSI received in Malaysia by tax residents

- Effective 1 January 2022, in general, all types of FSI received in Malaysia by Malaysian tax residents are subject to tax, except for the FSI which is exempted from tax (subject to certain conditions) from 1 January 2022 to 31 December 2026 under P.U.(A) 234/2022 and P.U.(A) 235/2022.
- P.U.(A) 235/2022 which exempts a “qualifying person” from the payment of income tax in respect of gross income of that qualifying person from dividend income does not apply to resident companies carrying on the business of banking, insurance, sea or air transport.
- Expenses or deductions made in connection with the FSI received in Malaysia and subject to tax in Malaysia may be allowed subject to the

provisions under the Income Tax Act 1967 (ITA). Any deductions in relation to the exempt FSI must be disregarded in arriving at the chargeable income of the qualifying individual or qualifying person.

- FSI received in Malaysia that has been subjected to tax, either through the imposition of withholding tax or foreign tax, can claim a bilateral or unilateral tax credit under the provisions of Sections 132 and 133 of the ITA. Tax credit claims for a particular year of assessment (YA) shall be made within 2 years from the end of that YA.
- FSI received in Malaysia for a YA shall be determined by the taxpayer. Where FSI received in Malaysia involves income from more than one YA, then the taxpayer is required to determine the YA of which income is brought into Malaysia.

Foreign source dividend income received in Malaysia by tax residents which is exempted from 1 January 2022 to 31 December 2026

A summary of the scope of exemption from the payment of income tax in respect of gross income of a qualifying person from dividend income, which is received in Malaysia from outside Malaysia, as provided under P.U.(A) 235/2022, is shown below:

Qualifying person	Type of income exempted from tax	Qualifying conditions
<ul style="list-style-type: none"> • Company incorporated or registered under the Companies Act 2016 • Limited liability partnership (LLP) registered under the Limited Liability Partnerships Act 2012 • Individual partner (in relation to a conventional partnership business in Malaysia) 	Dividend*	<ul style="list-style-type: none"> (i) The foreign source dividend income has been subjected to tax in the country of origin ^{Note 1}; and (ii) Headline tax rate in the country of origin is at least 15% ^{Note 2}

*Tax-exempt dividend refers to dividend paid by a foreign company where its operating income has been subjected to foreign tax.

Note 1:

The foreign source dividend income received in Malaysia should either be:
 (A) subjected to income tax or withholding tax in the country of origin; or
 (B) subjected to the underlying tax[^] in the country of origin; or

(C) not subjected to tax in the country of origin as the foreign source dividend income is paid out of underlying profit which is not subjected to tax in the country of origin due to:

- unabsorbed losses or capital allowances;
- capital gains;
- tax regulations under the tax consolidation regime in the country of origin; or
- enjoyed tax incentives in compliance with substantive requirements in the country of origin.

^ Underlying tax refers to an income tax paid or payable in the country of origin related to the underlying profit arising from operating income in the country of origin where the profit after tax is used to pay dividends.

Note 2:

Headline tax rate refers to the highest corporate tax rate in the country of origin in the year when the foreign dividend income is received in the country of origin. The headline tax rate is not necessarily the actual tax rate imposed on the foreign dividend income.

Note 3:

In a situation where the dividend paying company (say Company X) pays dividends to a Malaysian resident company out of dividends received from another company (say Company Y) (either within the country which is the same as Company X or otherwise), the underlying tax paid by Company Y on the dividend paid to Company X cannot be considered as taxes paid or payable by Company X for the purposes of this eligibility requirement of the Malaysian resident company.

FSI received in Malaysia by resident individuals which is exempted from 1 January 2022 to 31 December 2026

All types of FSI (including dividend) received by resident individuals in Malaysia is exempted from the payment of income tax, except a source of income from a Malaysian partnership business that is received in Malaysia from outside Malaysia, as provided under P.U.(A) 234/2022.

The FSI received in Malaysia should either be:

- (A) subjected to income tax or withholding tax in the country of origin; or
- (B) not subjected to tax in the country of origin due to:
 - country of origin's taxation system;
 - individual's income does not reach the taxability threshold in the country of origin;
 - individual's income is given exemption through a tax incentive in the country of origin;

- foreign source dividend income has been subjected to underlying tax; or
- foreign source dividend income is paid out of underlying profit which has not been subjected to tax in the country of origin due to:
 - unabsorbed losses or capital allowances;
 - capital gains;
 - tax regulations under the tax consolidation regime in the country of origin; or
 - enjoyed tax incentives in compliance with substantive requirements in the country of origin.

Exclusion of FSI for the purpose of Cukai Makmur

As you are aware, companies (other than small and medium-sized enterprises) that generate chargeable income exceeding RM100 million in the basis period for YA 2022 are subjected to a special one-off tax known as “*Cukai Makmur*”.
[Note: Under the ITA, the term “small and medium-sized enterprise” generally applies to resident enterprises incorporated in Malaysia that have paid-up capital not exceeding RM2.5 million in respect of ordinary shares at the beginning of the basis period for a YA, that are not part of a group containing a company exceeding this capitalization threshold, and that have gross income from business sources not exceeding RM50 million for the YA.]

The Government of Malaysia gazetted the Income Tax (Exemption) Order 2022 [[P.U.\(A\) 96/2022](#)] to legislate the exclusion of FSI received in Malaysia from outside of Malaysia as from 1 July 2022 from the calculation of “*Cukai Makmur*” for YA 2022. Any chargeable income of the company that remains taxable will be subject to income tax for YA 2022, as the case may be, i.e.:

- Chargeable income in relation to FSI that is received in Malaysia from outside Malaysia and that is exempt from the calculation of “*Cukai Makmur*” will be subject to tax at the prevailing rate of 24%; and
- The remaining chargeable income for YA 2022 will be subject to tax at the following rates:
 - The first RM100 million will be subject to tax at the prevailing rate of 24%; and
 - Income in excess of RM100 million will be subject to the “*Cukai Makmur*” at a 33% rate.

Relevant definitions

“Foreign source income” refers to income from all sources specified under Section 4 of the ITA (which refers to the classes of income on which tax is chargeable) sourced from outside Malaysia, which comprises of:

- (a) gains or profits from a business;

- (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 above; and
- (f) gains or profits not falling under any of the above.

“Income received in Malaysia” refers to income sourced from outside Malaysia that is brought into Malaysia, either via cash or electronic fund transfer.

“Cash” refers to bank notes, coins and cheques.

“Electronic fund transfer” refers to bank transfer (i.e., credit or debit transfer, payment via card (i.e., debit card, credit card and charge card), electronic money (e-money), privately issued digital assets (i.e., crypto-assets, stable coins) as well as Central Bank digital currency (CBDC).

Comments

1. The removal of tax exemption on most FSI effective from 1 January 2022 has created an impact on qualifying persons that receive FSI in Malaysia, which in the past was exempted by virtue of Paragraph 28 of Schedule 6 to the ITA. As noted above, resident individuals are exempted on all types of FSI received in Malaysia except a source of income from a Malaysian partnership business that is received in Malaysia from outside Malaysia. Meanwhile, resident companies, LLPs and individual partners (in relation to conventional partnership business in Malaysia) are exempted on foreign dividend income only, their FSI other than dividend income will be subject to tax in Malaysia. Taxpayers are advised to revisit and revise their estimate of tax payable (i.e. CP204A) for YA 2022 if necessary. In a situation where a company has missed the last chance to submit a revision in the 9th month of the basis period for YA 2022, the company should attempt to appeal to the IRBM for a concession to submit a revision following the release of the Guidelines.
2. For example, Labuan entities incorporated under the Labuan Companies Act 1990 that have made an irrevocable election to be taxed under the ITA and trust bodies will be among the persons unable to qualify for the exemptions under the terms specified in the orders. With the enacted orders in place, a Labuan entity or a trust body that holds investments in foreign countries is subject to Malaysian income tax at the prevailing rate of 24% as from 1 July 2022 (any FSI received in Malaysia from 1 January 2022 until 30 June 2022 would be taxed at a 3% rate on a gross basis) on the dividend income it receives in Malaysia in respect of the investments held outside Malaysia (capital gains are not taxable in Malaysia under the ITA). However, double

taxation relief may be available to reduce the Malaysian tax payable in respect of the foreign tax incurred: if there is an applicable tax treaty between Malaysia and the jurisdiction in which the income arises, bilateral relief may be available under the treaty and Malaysian domestic law; if there is no applicable tax treaty, unilateral relief may be available under Malaysian domestic law.

3. With that being said, qualifying persons that expect to receive FSI either through investments placed abroad or to meet their commercial requirements locally, are advised to stay vigilant and ensure proper records of all FSI received in Malaysia are retained for at least seven years, so that they are able to provide such records to the IRBM in the event of a tax audit or upon request (the record retention period as required by the ITA is seven years, while the time bar for assessment of tax is five years for general cases and seven years for cases involving related-party transactions). In cases where the FSI received is pooled together with domestic source of income, which is common for businesses that use the same bank account, the burden lies on taxpayer to distinguish the source of income between foreign and domestic as well as to determine the nature of the FSI received (i.e., capital or revenue in nature).
4. In future, taxpayers that intend to undertake investment opportunities abroad are advised to take note of the potential tax implications in Malaysia that may arise from such opportunities. To minimize such implications, taxpayers are advised to undertake appropriate tax planning measures before deciding to embark on such potential investment opportunities. Besides, taxpayers should also consider tax planning measures on current investments placed abroad to ensure such investments are managed in the most tax efficient manner.
5. It is a norm for companies to provide intercompany loan to its related entities within a group of companies. Apart from adhering to transfer pricing rules, companies that expect to receive interest income from its related entities outside Malaysia on intercompany loans provided, are encouraged to undertake appropriate measures such as debt restructuring exercises or rescheduling of repayments to minimize tax implications on interest income remitted into Malaysia.
6. It is hoped that the IRBM will provide further clarification on certain issues which appear to be unclear in the Guidelines, among others are:
 - a) Clarification is required on the treatment of the foreign source income derived by a permanent establishment (PE) of a Malaysian resident company. A sample computation of the tax treatment thereon in Malaysia would be helpful.

- b) Whether the IRBM's position on the treatment of underlying tax paid as mentioned in Note 3 above (i.e. underlying tax paid by an investee company abroad is disregarded and the dividend income received by the Malaysian resident company from its foreign intermediary holding company is not tax -exempted) is applicable to dividend income received by a resident individual in Malaysia.
- c) The IRBM's position on the treatment of underlying tax paid as mentioned in Note 3 above may give rise to a double taxation. It is hoped the Ministry of Finance can consider revisiting this aspect. In the meantime, taxpayers that are affected should review their group structure accordingly.

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