Malaysia

The Malaysian legal system is based upon common law and, in keeping with such traditions, judicial proceedings are adversarial in nature. Historically, much of Malaysian tax and revenue jurisprudence originated from the British and other Commonwealth jurisdictions. Shearn Delamore & Co explains the rules that apply to taxpayers in Malaysia

Tax authorities

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Revenue legislation and administration

The Federal Constitution provides that tax shall only be levied by or under authority of federal law. This means the general body of tax law is to be found in tax statutes, supplemented by other legislative instruments such as subsidiary legislation and ministerial orders. However, the Director General of Inland Revenue and the Inland Revenue Board (Revenue) are responsible for administrative functions, such as the care and management of direct tax matters. In the exercise of their administrative powers, the Revenue purportedly issued a number of public rulings and guidelines which are, strictly speaking, not legally binding upon taxpayers before the year of assessment (YA) 2007, as public rulings and guidelines issued before January 2007 are given legislative endorsement retrospectively only with effect from YA 2007 onwards. While the Revenue may insist upon applying these public rulings and guidelines, their conduct may be open to challenge particularly in regard to public rulings and guidelines which the Revenue has issued and applied in YA 2006 and previous YAs.

Direct taxes

The Income Tax Act 1967 (ITA) is the principal legislation for taxing income. The general scope encompasses the income of any person accruing in or derived from Malaysia or received in Malaysia from abroad. It is a question of fact as to what constitutes income, that is, gains or profits from a business or employment, dividends, interests, discounts, rents, royalties, premiums, pensions, annuities or other periodical payments, and other gains or profits.

Special provisions govern the taxation of income of, for example, insurance companies, shipping and air transport companies, banks and financial institutions, leasing companies, unit trusts and property trusts.

Malaysian income tax is imposed on a territorial, not worldwide, basis. The prevailing corporate tax rate is 25% with effect from YA 2009 but with applicable tax holidays, incentives, exemptions and concessionary or reduced tax rates, effective tax rates can be significantly reduced. With the abolition of the imputation system, a single-tier tax system has been in force from YA 2008.

Withholding tax

Withholding tax is applicable in Malaysia if a non-resident payee derives, or is deemed to derive, from Malaysia interest, royalty, rent for use of moveable property, contract payments for projects carried out in Malaysia, technical fees and other similar types of fees. The Revenue takes the view that even non-technical service fees would be subject to withholding tax. However, if these technical and non-technical services are performed outside Malaysia, payments for them would not be subject to withholding tax. Under a new legal provision that came into force on January 1 2009, withholding tax may be applicable to miscellaneous income under section 4(f) of the ITA, not being gains or profits falling under section 4(a) to (e).

For the purposes of the ITA, a company is tax resident in Malaysia if it is managed and controlled from Malaysia, meaning that a company is deemed to be tax resident in Malaysia if the board of directors holds at least one board meeting a year in Malaysia to discuss the substantive business affairs of the company.

Business losses and capital allowances

Where deductible business expenses are more than the gross income of the taxpayer's business, the difference, that is, an adjusted loss, can be offset against the adjusted income of the taxpayer's other business sources (if any) or carried forward (indefinitely) for deduction against its business income for future years. Capital allowances for qualifying expenditure would be claimable on the plant and machinery of a business. With effect from YA 2006, accumulated losses and unabsorbed capital allowances of a company cannot be carried forward if there is a change of more than 50% of its shareholdings. However, the Ministry of Finance has clarified that this restriction is only applicable to dormant companies, where there is a change of more than 50% of its direct shareholdings.

Business losses move with the corporate taxpayer. Therefore, in a transfer of assets and liabilities to the purchaser, the seller retains the right to use these losses. Unabsorbed capital allowances of a business, however, may only be carried forward and offset against income from the same business source by the same company. There is only limited group relief in Malaysia whereby a surrendering company (as defined in the ITA) may surrender up to 70% of its adjusted losses to one or more related companies as specified in the ITA.

Limitation period for issuance of assessments

The limitation period for the issuance of assessments is six years from expiry of that YA. However, no time bar applies if there appears to be any form of fraud, wilful default or negligence by the taxpayer.

Anti-avoidance provisions

The Revenue has a general power to invoke anti-avoidance provisions in transactions with little or no commercial purpose, apart from tax avoidance.

Transfer pricing

Section 141 ITA seeks to prevent profit shifting by a non-resident carrying on a business with a resident over whom it exercises substantial control. In July 2003, the Revenue purportedly issued the Transfer Pricing Guidelines under section 140, the general anti-avoidance provision. Largely based on the OECD Transfer Pricing Guidelines, the guidelines' legality is open to question, even though they are seemingly followed in practice. These guidelines have recently been replaced by the Transfer Pricing Guideline 2012, issued by the Revenue on July 20 2012.

After the proposal in the Budget 2009 to introduce specific transfer pricing legislation in Malaysia, the arm's-length principle has been introduced via section 140A(1) ITA, with effect from January 1 2009. Section 140A(1) also pro-

vides that it would apply subject to any rules prescribed under the ITA. Such rules are only to implement and facilitate the operation of the arm's-length principle, and recently been gazetted as the Income Tax (Transfer Pricing) Rules 2012 PU (A) 132/2012.

Thin-capitalisation legislation was also introduced with effect from January 1 2009 and provides that the portion of interest and finance charge, among other things, in respect of the financial assistance which is excessive, may be disallowed as a deduction. Under section 138C ITA taxpayers may enter into advance pricing arrangements to determine the prices in cross-border transactions with associated persons.

Recently, the Revenue introduced a new Form MNE [1/2011] – *Information on Cross-Border Transactions* as part of the Revenue's measures to monitor cross-border transactions. Among other things, taxpayers would be required to provide information pertaining to their group structure, cross-border related party transactions, particulars of financial assistance with respect to related parties outside Malaysia and confirm whether transfer pricing documentation had been prepared for the relevant year of assessment.

Self-assessment system

With the implementation of the self-assessment system, there has been a corresponding shift towards the use of criminal proceedings under the ITA by the Revenue. The ITA provides for criminal proceedings to be instituted against persons who are alleged to have committed the offences contained in part VIII. Fines, imprisonment and/or penalties may be imposed.

Real property gains tax

There is no general capital gains tax in Malaysia. However, a tax known as real property gains tax (RPGT) is levied on capital gains accruing from the disposal of property and shares in a property company.

For the purposes of the tax, real property is broadly defined as 'any land situated in Malaysia, and any interest, option or other right in or over such land'. This would mean, for instance, that the holding or grant of a lease may amount to an interest in land as a lease is extensively defined in the Real Property Gains Tax Act 1976 (RPGTA).

The tax is imposed on the gain, if any, at a rate between 30% and 5%, depending on how long the property is held for and whether the vendor is a company or Malaysian national or permanent resident.

If the vendor is a company, any disposal made within two years of the date of acquisition of the chargeable asset is taxed at 30%, in the third year at 20%, in the fourth year at 15%, and in the fifth year onwards, at 5%.

In the case of an individual who is not a citizen and not a permanent resident, any disposal made within five years of acquisition of the chargeable asset would be taxed at 30% and after that at 5%.

With effect from January 1 2012, such gains are taxed at 10% for properties held for two years or less, 5% for properties held for more than two years but less than five years, and tax-exempt if held for more than five years.

Stamp duty

Malaysia imposes stamp duty on certain prescribed instruments, defined to include any written document. In a business or asset sale, stamp duty is charged on all instruments conveying the assets, meaning movable or immovable property. It is payable by the purchasers/transferees at these rates:

- 1% on the first RM100,000 ($28,600) of the value of transfer;
- 2% on the value of transfer more than RM100,000 but not more than RM500,000; and
- 3% on the value of transfer more than RM500,000.

With effect from January 1 2009, loan, services and equipment lease agreements, amongst others are also subject to ad valorem stamp duty. However, service agreements executed between September 15 2009 and December 31 2010 are subject to a stamp duty of RM50 under the Stamp Duty (Remission) Order 2009 PU (A) 391/2009 while service agreements executed on or after January 1 2011 are subject to stamp duty at the rate of 0.1% of the sum of money under the Stamp Duty (Remission) (No. 4) Order 2010 PU (A) 476/2010.

Any instrument required to effect transfers of properties and other transactions is subject to stamp duty. There are other rates of stamp duty on other classes of instruments, which are generally lower than the rates above.

Indirect taxes

The Royal Customs and Excise Department Malaysia (Customs) have the care and management of indirect taxes.

Customs duty

Customs duties are levied upon specified goods imported into, or exported from, Malaysia and are to be paid by the importer or exporter, as the case may be. The relevant rates are set out in the Customs Duties Order 2007 PU (A) 441/2007 whereas valuation of the goods would be in accordance with the Customs (Rules of Valuation) Regulations 1999 PU (A) 507/1999 giving effect to the WTO Valuation – WTO Guidelines.

Excise duty

Excise duties are levied upon specified goods manufactured in or imported into Malaysia.

Sales tax

Sales tax is charged and levied at rates ranging from 5% to 15% on all taxable goods that are:

- manufactured in Malaysia and sold, used or disposed of, by any person who is, or is required to be, licensed under the Sales Tax Act 1972; or
- imported into Malaysia by any person for home consumption.

Service tax

Service tax is payable on any taxable service provided by any taxable person, that is, a person carrying on the business of providing such taxable service. The rate of tax was increased from 5% to 6% with effect from January 1 2011.

Goods and services tax (GST)

The implementation of a GST in Malaysia was proposed in the 2005 Budget to replace sales tax and service tax. The taxation review panel regards GST as a replacement tax. Accordingly, sales tax and service tax will be abolished once GST is implemented.

The GST Bill 2009 was first tabled in Parliament on December 19 2009 and has charging provisions similar to the UK VAT Act and the Singapore GST Act. GST is an inclusionary and broad-based consumption tax. The rate is expected to be set at 4%. No date has yet been fixed for its implementation.

Tax reliefs and incentives

Malaysia has an aggressive and progressive approach towards the grant of special tax incentives, such as pioneer status, an investment tax allowance and a reinvestment allowance, to attract foreign direct investments. There are also many promoted activities, products and areas such as free zones, Iskandar Development Region, Northern Corridor Economic Region, East Coast Economic Region, Sabah Development Corridor, Sarawak Corridor of Renewable Energy and the Multimedia Super Corridor.

Malaysia has concluded a wide-ranging network of double taxation treaties with numerous jurisdictions for the prevention of double taxation of income and fiscal evasion.

Labuan

Though part of Malaysia, the federal territory of Labuan has specific laws which are only applicable there. They were introduced in 1990 to promote Labuan as an international business and financial centre. Relevant laws include the Labuan Companies Act 1990, Labuan Business Activity Tax Act 1990 (LOBATA), Labuan Financial Services and Securities Act 2010, Labuan Foundations Act 2010 and Labuan Limited Partnerships and Limited Liability Partnerships Act 2010.

Pursuant to LOBATA, a Labuan company carrying on Labuan trading activities enjoys a lower tax rate of 3% or alternatively, may elect to pay a flat tax of RM20,000 ($6,660) regardless of its income level. Income from Labuan non-trading activities carried on in Labuan would not be charged to tax. With effect from YA 2009, a Labuan company may elect to be taxed on its Labuan business activity under the ITA instead of LOBATA.

Tax exemption is given for dividends received from a Labuan company out of income derived from a Labuan business activity or income exempt from tax. Labuan companies are also exempt from having to withhold tax on royalties, interest and fees for technical advice, assistance or services paid to non-residents. Labuan also has other incentives and special rules.

With effect from January 1 2009, Labuan companies are also exempted from withholding tax obligations on gains or profits falling under paragraph 4(f) of the ITA, i.e. miscellaneous income, paid to non-residents.

The preferential tax rate of 3% and other incentives and exemptions previously only available to Labuan companies have been extended to other Labuan entities, including Labuan foundations, Labuan Islamic foundations and partnerships, Labuan limited partnerships and limited liability partnerships, Labuan trusts, Labuan Islamic trusts and Labuan financial institutions.

Judicial remedies

Malaysian taxpayers are increasingly prepared to challenge the Revenue and Customs. Malaysian courts have taken a robust and objective approach to adjudicating tax disputes. Taxpayers have won a substantial number of them.

A taxpayer may challenge the Revenue's assessment by lodging a notice of appeal (Form Q) within 30 days of the disputed assessment. The Special Commissioners of Income Tax would hear the appeal, with further rights of appeal being available to both parties to the High Court and thereafter, to the Court of Appeal. The High Court also has original jurisdiction to hear tax disputes which have proceeded through an application for judicial review or for declaratory relief. Appeals lie to the Court of Appeal and, with leave, to the Federal Court.

Taxation review panel

The minister of finance has set up a taxation review panel to review all Malaysian revenue legislation with a view to updating and, if necessary, consolidating it.

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