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→ Tax Updates

Guidelines on the Application of Subsections 12(3) and 12(4) of the Income Tax Act 1967 (“ITA”) in Determining a Place of Business

The Inland Revenue Board (“IRB”) has issued guidelines to provide clarification on the application of subsection 12(3) and 12(4) of the ITA which was effective as of 28 December 2018.

Sections 12(3) and 12(4) stipulates that a person’s income derived from a business that is attributable to a place of business in Malaysia is deemed to be derived from Malaysia; and spells out the meaning of place of business (“POB”) which is largely based on the definition of a Permanent Establishment (“PE”).

PHYSICAL POB

A POB is explained as a physical place (whether owned or rented) that the non-resident has access to and uses to carry out their business activities. The physical place must also be fixed, i.e. with a certain degree of permanency (duration test); and a specific geographical point (location test). The duration and location tests would depend on the individual facts of each case.

BUILDING SITE, CONSTRUCTION, INSTALLATION, ASSEMBLY AND SUPERVISORY ACTIVITY

A person is only considered to have a POB if they have carried on activities at the site or realized a project for a period or periods exceeding 5 months in aggregate in any 12 months period (“5-months period”).

In determining the duration, the period of activities carried on by a person and those carried on by associated persons in Malaysia shall be aggregated if the activities carried on by associated persons are connected with the activities of the person in question. Different activities will be regarded as connected based on the actual facts and circumstances of the case.

Withholding tax (“WHT”) is to be applied on payments to non-residents in relation to such projects and supervisory activities. WHT under Section 107A, i.e. at the rate of 10 percent + 3 percent will be applicable where the duration exceeds the 5-months period; and WHT under

Section 109B, i.e. at the rate of 10 percent respectively will be applicable where the duration does not exceed the 5-months period.

AGENT AS POB

A non-resident person (principal) may be deemed to have a POB in Malaysia if they have an agent carrying out the following activities in Malaysia on their behalf, provided that the agent is not of an independent status:

- a. habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modifications;
- b. habitually maintains a stock of goods or merchandise in that POB from which such person delivers goods or merchandise; or
- c. regularly fills orders on his behalf.

The types of contracts covered under a. above include those which are in the name of the principal or which are binding on the principal even if those contracts are not in the name of the principal. All facts and circumstances are to be taken into account in determining activities that would constitute a “principal role”. The activities under b. and c. above only create a POB in case the non-resident principal is the agent, also conducting sales related activities.

Independent agents who act for an enterprise in the ordinary course of their business do not constitute a POB of that person. An agent is not considered as independent if he acts exclusively, or almost exclusively, on behalf of one or more associated persons.

PREPARATORY OR AUXILIARY ACTIVITIES

A physical place may not constitute a POB if it is maintained solely for the purpose of carrying on activities of preparatory or auxiliary character. Activities of preparatory or auxiliary nature comprise activities that:

- d. are so remote from the actual realization of profit of the business that it is difficult to allocate any profit to the physical place in question;
 - e. in themselves do not form an essential and significant part of the activity of that business as a whole;
 - f. are not identical to the general purpose of the whole business; or
 - g. are usually carried out during a relatively short period.
- If the preparatory or auxiliary activity forms part of a cohesive business operation that is carried out by the non-resident and their associated persons, that activity is not to be regarded as preparatory or auxiliary.

Practice Note 3/2020 – Determination of Gross Income from Business Sources of Not More Than MYR 50 million of a Company or Limited Liability Partnership (“LLP”)

Under the ITA, companies with paid-up capital of not more than MYR 2.5 million, i.e. Small and Medium Enterprises (“SMEs”), are accorded various preferential tax treatments. With effect from year of assessment (“YA”) 2020, the definition of SME has been tightened and an additional condition, has been allocated, i.e. the taxpayer must have a gross income from a business source not exceeding MYR 50 million for the basis period for that YA.

Practice Note 3/2020 provides clarification on the application of the MYR 50 million threshold. In determining the MYR 50 million threshold, gross income from source(s) consisting of business for the basis period for a YA include:

- in the case of companies/LLP engaged in manufacturing/trading service:
 - income from insurance, indemnity, recoupment, recovery, reimbursements etc., in relation to amounts that are tax deductible;
 - compensation for loss of income;

- debts arising from stock in trade sold, or services rendered or to be rendered, and use of or enjoyment of any property;
- bad debts recovered where deduction has been claimed previously.
- in the case of banks, insurers, developers, contractors, the gross income is also subject to specific provisions or regulations made under the ITA;
- foreign sourced business income;
- business income exempted under tax incentives such as Pioneer Status or Investment Tax Allowance.

Given that this condition requires taxpayers to derive an income from a business source in the first place, unlisted investment holding companies under Section 60F of the ITA and companies/LLPs only having a passive income such as rent and interest, are not eligible for the preferential tax treatments. However, listed investment holding companies under Section 60FA of the Act are eligible as income of a listed investment holding company is deemed as income from a business source.

Automation Equipment Incentives: Investment Allowance and Accelerated Capital Allowance

The amending gazette orders i.e. Income Tax (Exemption) (No. 8) 2017 (Amendment) Order 2020 and Income Tax (Accelerated Capital Allowance) (Automation Equipment) 2017 (Amendment) Rules 2020 have been issued to provide 200 percent of automation capital allowance for the manufacturing sector. The incentives comprise:

- 100 per cent accelerated capital allowances on capital expenditure incurred on automation equipment for a qualifying project;
- Income tax exemption on statutory income from a qualifying project, equivalent to 100 per cent of capital expenditure incurred on automation equipment, to be set-off against 70 per cent of the statutory income.

QUALIFYING PROJECT	ORIGINAL INCENTIVES APPLICABLE TO APPLICATIONS TO MIDA DURING THE PERIOD	EXTENSION OF INCENTIVE FOR APPLICATION TO MIDA
CATEGORY 1: Labor-intensive Industry (Rubber, Plastics, Wood, Furniture and Textile Products)	1 January 2015 – 31 December 2017	31 December 2023
CATEGORY 2: Industries other than Category 1	1 January 2015 – 31 December 2017	31 December 2023

The new condition stipulates that the qualifying company must have been in operation for at least 36 months.

FAQs on Advance Pricing Arrangement ("APA") Treatment due to COVID-19

The IRB has on 16 June 2020 issued FAQs on APA treatment due to the COVID-19 pandemic.

- IRB is not accepting any new APA application from businesses affected by COVID-19 until further notice, as the outcome of the pandemic is still highly uncertain;
- Taxpayers that have an on-going APA being reviewed by the IRB will continue to be reviewed based on the information previously submitted; and the arm's length range and benchmarking analysis of normal economic and market conditions, i.e. pre-COVID;
- Amendments and substantial updates on material changes to on-going applications will not be allowed as the full impact of the pandemic is highly uncertain at this point of time;
- Depending on the facts and circumstances of the case, the term test may be applied in order to take into account the impact of the pandemic on the proposed covered transaction. An Annual Compliance Report ("ACR") will be required to be submitted annually notwithstanding the application of the term test. Any compensating adjustment shall be made at the end of the APA covered period;
- If taxpayers with ongoing APA see that the probability of the impact of the pandemic is significant, they may opt to withdraw from the APA application. Taxpayers may file a new APA application based on the new circumstances at a later stage;
- Taxpayers that have concluded APA are required to comply with all the critical assumptions stated in the APA;
- If taxpayers cannot fulfil the critical assumptions in the APA due to COVID-19, the taxpayer can either revise or apply for the cancellation of the APA;
- Revision of APA must be notified to the IRB within 30 days after becoming aware of the need for a revision due to the economic and business impacts from COVID-19;

- Expired APA can be renewed under similar terms and conditions. Renewals will not be allowed if the critical assumptions in the

expiring APA are no longer valid due to material changes on taxpayers business as a result of the pandemic.

Revisions to Public Rulings and New Public Rulings

PUBLIC RULING NO. 1/2020 – TAX INCENTIVES FOR BIONEXUS STATUS COMPANIES

This Public Ruling replaces Public Ruling 8/2018, incorporating the substantial activities requirements and excluding income from intellectual property (“IP”) rights following the review of tax incentives and recommendations by the Forum on Harmful Tax Practices.

- SUBSTANTIAL ACTIVITIES REQUIREMENTS

To be eligible for the tax incentive, the Bionexus Company (BNX) must have an adequate number of full-time employees and knowledge workers in Malaysia; and incur an adequate amount of annual operating expenditure or investment in fixed assets to carry on a qualifying activity.

Grandfathering rules have been provided for existing companies that enjoy the incentive to commence implementation of the substantial activities requirements.

The date of commencement of the requirement are as follows:

SCENARIO	EFFECTIVE DATE
Exemption granted on or before 16 October 2017	1 July 2021
Carries out new qualifying activity after 16 October 2017	1 January 2019
Exemption granted after 16 October 2017	1 January 2019

- EXCLUSION OF INCOME FROM IP RIGHTS

Royalty and other income derived from IP rights will be excluded for the tax exemption.

The date of commencement of the exclusion are as follows:

SOURCE OF IP INCOME	EFFECTIVE DATE
New IP rights the company owns or is the licensee of the right	1 July 2018
All IP rights the company owns or is the licensee of the right (not included above)	1 July 2021

PUBLIC RULINGS NO. 2/2020 AND NO. 3/2020 – TAX TREATMENT OF STOCK IN TRADE PART 1 & 2 – VALUATION OF STOCK & WITHDRAWAL OF STOCK

Public Rulings No. 2/2020 and 3/2020 replaces Public Ruling No. 4/2006. Both Public Rulings are to be read together.

Public Ruling No. 2/2020 explains the tax treatment for valuation of stock.

The definition of stock in trade comprises anything a business acquires, produces or manufactures, for the purpose of manufacturing, selling at a profit or exchanging. Property of a business is more than just physical things such as land and buildings. It also includes rights and interests that can be owned and have a value such as shares, bonds and marketable securities.

The value of opening stock in trade at the beginning of the basis period (unless it is commencement), must be the value which has been placed on the closing stock at the end of the immediate preceding basis period.

The value of closing stock in trade at the end of a basis period is (a) the market value at the end of that period; or (b) if a business elects that the stock is physically tangible, an amount equal to the total cost of acquiring that item and including the cost of bringing it to its condition and location at that time. However, for any item of stock in trade consisting of immovable properties, stocks, shares or marketable securities, the value of these items at the end of the relevant basis period is the lowered by an amount equal to its cost or market value.

The basis of valuation of stock in trade for tax purposes is the market value of an inventory that is equal to the fair value or estimated selling price. Net realizable value is not acceptable.

Public Ruling No. 3/2020 explains the tax treatment of withdrawal of stock for own use.

SCENARIO	TAX TREATMENT OF STOCK
Stock in trade withdrawn for use in a different business activity	Treated as if a transaction of sale or purchase at market value has taken place
Reclassification from trading to capital or vice versa due to a change of intention of business	At market value
Stock in trade withdrawn for other reason than on requisition or compulsory acquisition or in a similar manner	At market value at the time of withdrawal

Where the stock in trade is withdrawn for a consideration consisting of property together with a debt or/and any such sum in cash, the market value of that stock in trade can be reduced by the amount of debt or sum; or the amount of the debt and sum. The amount of debt would be a trade debt and is taxable when stock in trade is withdrawn, the cash sum would be taxable when it is received and the balance would be taxed at the time the stock is withdrawn.

Where gains or profits from a business would include amounts receivable arising from stock in trade parted by an element of compulsion, the amount receivable would constitute gross income of the business in the year when the stock in trade was compulsorily acquired.

PUBLIC RULING NO. 4/2020 – TAX TREATMENT OF ANY SUM RECEIVED AND A DEBT OWING THAT ARISES IN RESPECT OF SERVICES TO BE RENDERED

This is a new public ruling that outlines the tax treatment of amounts received or debts owing for services to be rendered, bringing the public ruling up to date with the current legislation.

Debt means a debt in liquidated sum whether or not due; or due and payable. A debt owing to a person and any sum received by a person, notwithstanding that there is no debt owing to the person that arises in respect of services to be rendered is to be treated as gross income of the person from a business for the relevant period.

No debt is owing to the relevant person in respect of such services means that a debt owing to the person has not arisen as the liability to pay in respect of such services has not arisen yet.

Deposits for any service received by a service provider upon the signing of an agreement where the deposits are refundable upon completion of the services do not form part of the gross income of the service provider's business. For example, security deposit and refundable deposit. However, deposits that are forfeited would be part

of the gross income of the service provider's business.

LABUAN ENTITIES CARRYING ON PURE EQUITY HOLDING ACTIVITY – FULL TIME EMPLOYEES REQUIREMENT

The Labuan Business Activity Tax (Exemption) Order 2020 has been gazetted on 2 June 2020 and exempts Labuan entities carrying on pure equity holding from the requirements to have an adequate number to full time employees in Labuan. The exemption takes effect retrospectively from 1 January 2019.

Pure equity holding companies are defined as Labuan entities that hold participations and earn only dividends and capital gains. A pure equity holding company will still be regarded as having a pure equity holding activity if it derives interest income from the placing of dividend monies or proceeds from disposal of shares, in financial institutions which does not constitute commercial activity.

STAMP DUTY EXEMPTION FOR RESTRUCTURING OR RESCHEDULING OF A BUSINESS LOAN OR FINANCING

The Stamp Duty (Exemption) (No.2) Order 2020 has been gazetted with effect from 1 March 2020 and provides stamp duty exemption on an instrument of loan or a financing agreement relating to the restructuring or rescheduling of a business loan or financing between a borrower and a financial institution, executed on or after 1 March 2020 but not later than 30 December 2020.

The application for exemption is to be accompanied by a letter of offer from the financial institution for the restructuring or rescheduling of the loan or financing arrangement

"Restructuring or rescheduling" means any modification made to the existing repayment terms and conditions of the loan or financing pursuant to a concession provided by the financial

institution due to the inability of the borrower or customer to comply with the existing repayment schedule consequent to deteriorating financial conditions.

We hope that this comprehensive review has provided you with a more thorough insight on what is to come, and its implications on you and your business in Malaysia.

CONTACT FOR FURTHER INFORMATION:



Priya Selvanathan
T +60 3 2276 2755
priya.selvanathan@roedl.com

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Publisher:

Roedl Consulting Sdn Bhd
Unit 18-12, Menara Q Sentral
No. 2A, Jalan Stesen Sentral 2
Kuala Lumpur Sentral 50470
Rödl & Partner

Responsible for the content:

Priya Selvanathan
priya.selvanathan@roedl.com

Layout:

Priya Selvanathan
priya.selvanathan@roedl.com

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