IMA

Tax System in Malaysia

Introduction

Malaysia is a member of the British Commonwealth and its tax system has its roots in the British tax system. The British introduced taxation to the Federation of Malaya (as Malaysia was then known) in 1947, during the British colonial rule with Income Tax Ordinance, 1947. The Ordinance was subsequently repealed with the enactment of the Income Tax Act, 1967, which came into effect on 1 January 1968, and further tax legislation has since been introduced.

The current principal direct taxation legislation consists of the following:

- Income Tax Act, 1967 (ITA), which provides for the imposition and collection of income tax;
- Real Property Gains Tax Act, 1976 (RPGT Act), which is imposed on profits from the disposal of real properties in Malaysia and shares in real property companies (RPC);
- Petroleum (Income Tax) Act, 1967, which is imposed on profits from petroleum operations;
- Promotion of Investment Act, 1986, which provides for tax incentives for persons engaged in promoted industries or activities; and
- Stamp Act, 1949 (Stamp Act), which imposes stamp duty on various instruments.

In Malaysia, the Foreign Investment Committee (FIC) and Securities Commission were established to implement guidelines for the regulation of mergers, acquisitions, and takeovers. The FIC is also responsible for issues involving foreign investment in Malaysia, The regulations formulated for the banking and finance sectors are mainly the responsibility of the Central Bank of Malaysia (Bank Negara). Bank Negara is also responsible for currency flows to and from the country. For mergers and acquisition (M&A) involving parties undertaking manufacturing activities, the approval of the Ministry of International Trade and Industry may be required. Guidance on government policies and procedures can be obtained from the Malaysian Industrial Development Authority (MIDA), which is the government's principal agency for the promotion of the manufacturing and services sectors in Malaysia.

Recent Developments

Malaysia had gradually reduced its corporate tax rates from 27 percent in year of assessment (YA) 2007, to 26 percent in YA 2008, and 25 percent for YA 2009 onwards, in a move to keep Malaysia competitive in the region.

In addition, the following are some of the notable changes introduced by the Malaysian government in the 2009 National Budget, 2009 Mini Budget, and the more recent 2010 Budget. These changes include:

- Reintroduction of real property gains tax (RPGT) at a rate of 5 percent on gains from the disposal of real property in Malaysia and shares in RPCs with effect from 1 January 2010. The 5-percent RPGT will only apply to gains from the disposal is within five years from the date of acquisition.

- Allowing the carry back of losses in YA 2009 and 2010 of up to MYR 100,000 to be set off against the defined aggregate income of the immediate preceding YA (subject to certain conditions).
- The tightening of the conditions for the reinvestment allowance (RA) incentives, as follows:
    - The definitions of the quality project has been restricted to exclude processing activities;
    - Manufacturing activity is given a more specific and clear definition under Schedule 7A of the ITA;
    - The requirement that the company must be in operation for at least 12 months to be eligible to claim RA is extended to at least 36 months;
    - A company purchasing an asset from a related company within the same group where RA has been claimed on that asset is not allowed to claim RA in the same asset; and
    - The provision to clawback RA for assets disposed of within a period of two years from the date of purchase of the asset is extended to five years.
- The dismantling of the 30-percent Bumiputera equity requirement for listed companies, excluding companies in strategic industries such as telecommunications, water, ports, and energy.
- Post-listing fund raising exercises are no longer subject to any equity conditions.
- Increase of foreign shareholding in existing stock brokers and unit trust management companies to 70 percent from 49 percent.
- Foreigners can own 100 percent of fund management companies.
- All property transaction including those between foreigners and non-bumiputeras no longer requires the FIC's approval, apart from transactions that involve a dilution of Bumiputera of government interests for properties valued at MYR 20 million and above.
- The FIC guidelines covering the acquisition of equity stakes, mergers and takeovers are repealed and not replaced with new guidelines.
- Removal of the 30-percent Bumiputera requirement for 27 services sub-sectors including computer and related services, health and social services, tourism, transport, and business services with effect from 22 April 2009.

Asset Purchase or Share Purchase

Generally, in the Malaysian context, M&A transactions are undertaken via the acquisition of shares, or a business (such as asset purchase).

Purchase of Assets

Purchase Price

Generally, the acquisition price is not deductible (that is, capital cost) except for the qualifying cost incurred to acquire assets in an asset purchase deal. Please see below for further details.

Goodwill

For tax purposes, the amount of goodwill written-off or amortized to the income statement of the company is non-deductible on the grounds that the expense is capital in nature.

Depreciation

The ITA contains provisions for granting initial and annual tax depreciation allowances on qualifying capital expenditure incurred in acquiring or constructing industrial buildings (as defined) and qualifying plant and machinery used for the purposes of the taxpayers' business (subject to certain conditions). The main rates of initial and annual allowances are summarized in the following table.

Type of allowance	Initial Allowance	Annual Allowance
Industrial building	10% of qualifying expenditure	3% of qualifying expenditure
Heavy machinery and motor vehicles	20% of qualifying expenditure	20% of qualifying expenditure
Plant and machinery (general)	20% of qualifying expenditure	14% of qualifying expenditure
Computers and computer related equipment	20% of qualifying expenditure	10% of qualifying expenditure
Office equipment, furniture and fittings, and others	20% of qualifying expenditure	10% of qualifying expenditure

In addition to the above allowances, the ITA allows, among other things:

- A tax deduction for capital expenditure on replacement assets that have a life span of two years or less and are used for the purposes of the taxpayer's business (such as bedding and linen, crockery and glassware cutlery and cooking utensils, and lose tools, among others);
- Accelerated capital allowance on qualifying capital expenditure used for the conservation of energy;
- Accelerated capital allowance for Information and Communication Technology (ICT) equipment (including computers and software)(effective from YA 2009 to YA 2013);
- A capital allowance equal to the amount of that expenditure is given to small value assets with each asset costing not more than MYR1,000 and total capital expenditure in respect of such assets generally being not more than MYR10,000;
- Accelerated capital allowance for security and surveillance equipment (effective from YA 2009 to YA 2014);
- Accelerated capital allowance for plant and machinery acquired between 10 March 2009 to 31 December 2010; and
- Accelerated capital allowance to bus operators for buses acquired from YA 2009 until YA 2011.

There are also separate rates for, among other things, plantations, mining, forestry, agriculture, and hotels.

Balancing allowance or charges may be triggered when a taxpayer disposes of a qualifying capital item (such as industrial buildings, plant, and machinery, among others).

A balancing allowance arises when the market value or the sale price of the asset, whichever is higher, is lower than the asset's residual or tax written-down value. A balancing charge arises when the market value or sale price of asset, whichever is higher, exceeds the asset's residual or tax written-down value. However, the amount of balancing charges to be imposed will be limited to the amount of capital allowance claimed on the asset prior to its disposal. Capital allowances claimed on qualifying assets that are disposed of within two years may be subject to claw-black at the discretion of the Inland Revenue Board (IRB); typically this applies to the disposal of luxury goods.

The provisions on balancing allowances, balancing charges and claw-back will be applicable unless the disposal falls within the controlled transfer provisions in the ITA. In a controlled transfer situation, the assets are deemed to be transferred at their respective residual values such that no balancing charges or allowances will arise

A controlled transfer situation arises when:

- The disposer of the asset is a person over whom the acquirer of the asset has control;
- The acquirer of the asset is a person over whom the disposer of the asset has control;
- Some other person has control over the disposer and the acquirer of the asset;
- The disposal is effected as a result of a plan of reconstruction or amalgamation of companies; or
- The disposal is effected by way of a settlement, or gifts, or by devolution of the property in the asset on death.

In addition to tangible assets, tax deductions are currently available for the cost of acquisition of proprietary rights used for the purposes of the business of a manufacturing company of which at least 70 percent of the issued share capital is Malaysian-owned.

Tax Attributes

The RA incentive is given to resident companies in the manufacturing and agricultural sectors undertaking expansion, modernization, automation, or diversification activities. The rate of RA is 60 percent of q1ualifying capital expenditure. RA is abated or offset against a maximum of 70 percent of statutory income (with effect from YA 1997). Companies that reinvest in Sabah, Sarawak, and designated areas of the Eastern Corridor, as well as those that achieve the level of productivity determined by the Ministry of Finance (MOF) are, however, allowed to use the RA fully against statutory income. Any unused allowance can be carried forward until it is fully used.

To qualify for the allowance, the company must have been in operation for at least 36 months. Companies that are currently enjoying certain other incentives, such as pioneer status or investment tax allowance, will not qualify for RA.

The allowance is granted for a period of 15 consecutive YAs, beginning from the YA in which the capital expenditure was first incurred.

Other tax incentives include pioneer status (an exemption based on statutory income) and investment tax allowance (based on capital expenditure). Both of these incentives are limited to promoted activities or products.

The RA given on a particular asset will be withdrawn if the asset is disposed of within five year from its date of acquisition. Withdrawal applies even though the disposal may be viewed as a controlled transfer for capital allowances purposes. When assets for which RA has been claimed are transferred in a controlled transfer situation, the acquirer is not allowed to claim RA on the same assets.

Controlled transfer situation for the purpose of RA are as follows:

- The acquirer is a person over whom the dispose has control, or vice versa;
- Some other person has control over the acquirer and disposer; or
- The acquisition is effected as a result of a plan of reconstruction or amalgamation of companies.

Currently, there is neither a goods and services tax nor a VAT in Malaysia. Instead, there is an indirect tax framework that consists of the following core taxes/ duties:

- Service tax
- Sales tax
- Import duty
- Export duty
- Excise duty

With respect to the purchase of assets, it is important to determine whether the items purchased (such as machinery, equipment, or raw materials) have been exempted from sales tax, import duty, or excise duty. This is because, where there is such an exemption, the company purchasing the items (such as plant and machinery) must officially inform the Royal Malaysian Customs of the change in ownership.

For the purchasing company to enjoy the tax/duty exemption on the goods purchased, an application must be made to the MOF to inform the MOF of the transfer of ownership and to obtain an approval to extend the tax/duty exemption to the purchasing company.

Where the exemption is granted based on the same grounds as stated previously by the vendor company, the company purchasing the goods must adhere to the same condition attached to the exemption for instance, the machinery, equipment, and raw materials must be used to manufacture the same finished product.

Typically, an asset sale will trigger an obligation on the disposer to cancel or modify existing indirect tax licenses and on the acquirer to apply for new licenses.

It was proposed that with effect from 1 January 2007, goods and services tax (GST) will be introduced in Malaysia to replace sales tax and service tax, but the implementation date has since been postponed. However, the government has recently announced that the introduction of GST is being reconsidered.

Transfer Taxes

The stamp duty that would be imposed on the disposal of property) except stock, shares, marketable securities, and accounts receivable or certain book debts) is based on the value of the transaction thereof of the amount of the monetary value of the consideration or the market value of the property, whichever is greater, the rates of stamp duty are as follows:

- MYR 1 on the first MYR100,000
- MYR 2 on any amount in excess of MYR100,000 but nit exceeding MYR500,000
- MYR 3 on any amount in excess of MYR500,000

The rates imposed on other instruments are outlined in the First Schedule of the Stamp Act.

Several kinds of relief are provided in the Stamp Act, including two key reliefs relating to M&A.

Section 15 of the Stamp Act provides relief from stamp duty in connection with a plan for the reconstruction or amalgamation of companies if the following conditions (among others) are met:

- The transferee company must be registered or incorporated in Malaysia, or have increased its capital with a view to the acquisition either of the undertaking of, or of not less than 90 percent of the issued share capital of, any particular existing company.
- Not less than 90 percent of the consideration for the acquisition (other than such part of the consideration relating to the transfer to, or discharge by, the transferee company of liabilities of the existing company) consists of:
  - The issue of shares (when an undertaking is to be acquired) in the transferee company to the existing company or to holders of shares in the existing company; or
  - The issue of shares (when shares are to be acquired) in the transferee company to the holders of shares in the existing company in exchange for the shares held by them in the existing company.

The approval of the collector of stamp duties is required, and there are anti-avoidance provisions under section 15 whereby the stamp duty relief (if granted) may be clawed back under certain circumstances.

Section 15A(2) of the Stamp Act provides relief from stamp duty in the case of a transfer of property between associated companies on any instrument if the collector of stamp duties is satisfied that (among other things):

- The effect thereof is to transfer a beneficial interest in property from one company with limited liability to another company and that the companies in question are associated, that is to say one is the beneficial owner of not less than 90 percent of the issued share capital of the other; or
- A third company with limited liability is the beneficial owner of not less than 90 percent of the issued share capital of each of the companies.

There are also anti-avoidance provisions in section 15A.

The Stamp act empowers the Minister of Finance to exempt specific transactions from stamp duty, but this power is rarely exercised.

Stamp duty exemptions are given to M&A transactions undertaken by companies listed on Bursa Malaysia from 1 January 2008 to 31 December 2010. Such transaction must be approved by the Securities Commission and completed by 31 December 2011.

Purchase of Shares

Incentives: tax incentives are granted to companies that undertake promoted activities. A subsequent change in ownership of a Malaysian company enjoying any tax incentive should not have an impact on tax incentive granted as long as the company continues to carry out the promoted activity granted under the tax incentive.

Notwithstanding, there are instances where the Malaysian tax incentive is granted with equity conditions attached, whether directly or indirectly. In this case, the resulting change in ownership of the company enjoying the incentive may affect the grant of such incentives. As such, it would be advisable to ascertain the tax incentives currently enjoyed by the target Malaysian company and any condition attached to them.

Regulatory: limitations on foreign ownership still apply to some extent to a purchase of shares.

Indirect tax issues: indirect tax issues are of less significance in the context of a share purchase as opposed to an asset purchase. However, in the event that any historic liabilities exist, these remain with the target company notwithstanding the change in ownership.

Tax Indemnities and Warranties

Please refer to the section on Tax Clearances.

Tax Losses

Losses and capital allowances not used in a YA can be carried forward indefinitely, provided the company is not dormant. If the company is dormant, the company has to prove to the satisfaction of the IRB that more than 50 percent of its shareholders on the last day of the basis period in which such losses or capital allowances arose are the same as on the first day of the basis period in which the unabsorbed losses or capital allowance are to be used.

Unused business losses may be set off against income from any business source. However, unused capital allowances may only be set off against income from the same business source in which the capital allowances arose. From YA 2008 to YA 2010, a new provision on the carry-back of tax losses has been introduced in the ITA The carry-back loss relief applies to tax losses from a business source incurred in YA 2009 and YA 2010. The tax losses incurred in these YAs can be carried back to be set off against the defined aggregate income of the immediate preceding YA; an irrevocable election must be made. The total tax losses that can be carried back are up to MYR 100,000 per YA or the defined aggregate income of the preceding YA, if lower,. Certain conditions have to be met to be eligible for the carry back

Crystallization of tax Charges

The advisers to the prospective purchaser may undertake a due diligence review of the books and records of the target company to ascertain the tax position of the target company and to identify potential tax liabilities.

Pre-Sale Dividend

Generally, a company is allowed to pay pre-sale dividends. Please refer later in the chapter for details ion dividend payments.

Malaysia does not impose withholding tax (WHT) on dividend payments.

Transfer Taxes

Transfers of shares in an unlisted Malaysian company would attract stamp duty at the rate of 0.3 percent of the value of shares transferred. Based on the guidelines issued by the Stamp Duty Unit of the IRB on 21 April 2001, the value of shares transferred for stamp duty purposes is the highest value using one of the following measures:

- The par value
- Net tangible assets (NTA)
- A price-earnings multiple or price-earnings ratio
- The actual sale consideration

The transfer of securities on the Central Depository System would not attract ad valorem stamp duties at 0.3 percent; instead, the contract notes may attract stamp duty at 0.1 percent. According to Stamp Duty Remission Order 2003, all contract notes relating to the sale of any shares, stock, or marketable securities listed on the stock market of a stock exchange approved under subsection 8(2) of the Securities Industry Act 1983, are waived on stamp duty in excess of MYR200 calculated at the prescribed rate in item 31 of the First Schedule to the Stamp Act.

For relief with respect to stamp duty and transfer taxes please refer to the previous discussion.

Tax Clearances

It is not possible to obtain a clearance from the IRB (or from the Royal Malaysian Customs) giving assurance that a potential Malaysian target company has no arrears of tax. Therefore, it is usual to include tax indemnities and warranties in the sale agreement. The extent of the indemnities or warranties is subject to negotiation between the vendor and purchaser.

The advisers to the prospective purchaser may undertake a due diligence review of the books and records of the target company to ascertain the tax position of the target company and to identify potential tax liabilities.

Choice of Acquisition Vehicle

Local Holding Company

It has been common for foreign companies to set up Malaysian-resident holding companies to acquire shares or assets in Malaysia. Regardless of where a holding company is incorporated, it is considered a tax-resident in Malaysia if it is managed and controlled in Malaysia. Generally, a company is regarded as being managed and controlled at the place where its directors' meetings are held.

The Malaysian holding company may be set up to serve as a borrowing vehicle to obtain financing for acquisitions of companies. A Malaysian holding company can offset interest costs incurred for financing an investment against the chargeable income derived from that investment. With effect from 1 January 2009, thin-capitalization and transfer pricing provisions have been introduced to the ITA.

Historically, Malaysia has adopted the imputation system of dividend payments, in which the corporate income tax paid by a company on its profits is fully passed on or imputed to the shareholders when a dividend (other than an exempt dividend) is paid. Therefore, the dividend is paid net of tax, but has an imputation tax credit attached. A company receiving taxable dividends from a Malaysian resident company is taxable at the appropriate corporate income tax rate, but is entitled to claim the tax credit attached to the dividend to offset against the resulting tax liability. Therefore, one advantage of using a Malaysian resident holding company to hold shares in a Malaysian resident target company is that is has been possible to claim a refund of tax credits when there is sufficient interest cost to offset the taxable dividend income.

Effective from 1 January 2008 the single-tier system replaced the imputation system. Under the single-tier system, the tax payable by a resident company will constitute a final tax. Dividends paid under the single-tier system will be tax exempt in the hands of shareholders. Transitional provisions have been introduced to allow the imputation system (with some amendments) to be used until 31 December 2013. Under the single-tier system, tax relief can no longer effectively be obtained by offsetting interest expense against dividend income, because dividends will be exempt from tax. Surplus expenses in holding companies, including those listed on Bursa Malaysia, cannot be carried forward.

Issues of interest restriction and allocation can arise when a company has an interest expense and a variety of income-producing and non-income-producing investments (see comments on interest restriction and thin-capitalization).

Foreign-sourced income when received in Malaysia by a resident company [other than a resident company carrying on the business of banking (there are limited exemptions for banking businesses), insurance, shipping, or air transport] is exempt from tax. Hence, it may be advantageous for the Malaysian holding company to hold a foreign investment, as foreign-sourced dividend income (including trading profits from a foreign branch) and gains on the sale of subsidiaries are generally not subject to tax as mentioned above. However, interest costs and other costs attributed to foreign-sourced income incurred by the Malaysian holding company to fund the foreign investment would be wasted. The capital gains arising from the sake of subsidiaries could also form a dividend trap, since capital gains are generally not subject to tax and, therefore, the necessary franking credits may not be available. The dividend trap issue for capital gains is resolved under the single-tier system, because dividends can be paid up provided the company has sufficient distributable reserves.

In relation to thin-capitalization, section 140A (4) of the ITA, which was effective from 1 January 2009, provides that where the value of all financial assistance to an associated person is excessive in comparison to the fixed capital of the recipient of the financial assistance, the interest, finance charge, or other consideration payable on the excessive value shall not be deductible.

An associated person is, based on Section 140A(5) of the ITA, one who has control over the recipient of the financial assistance, one who is controlled by the recipient of the financial assistance, , or one who, together with the recipient of the financial assistance, is controlled by a third person. It should not be assumed that control refers only to shareholding control.

Although Section 140a (4) was technically effective from 1 January 2009, its actual implementation has been deferred.

Non-Resident Intermediate Holding Company

Malaysia has concluded agreements for the avoidance of double taxation (DTA) with the following countries. (Not all have been ratified, however, and not all are comprehensive.):

Albania, Argentina, Australia, Austria, Bahrain, Bangladesh, Belgium, Bosnia, Brunei, Canada, Chile, China, Croatia, Czech Republic, Denmark, Egypt, Fiji, Finland, France, Germany, Hungary, India, Indonesia, Iran, Ireland, Italy, Japan, Jordan, Kazakhstan, Kuwait, Kyrgyz, Lebanon, Luxembourg, Malta, Mauritius, Mongolia, Morocco, Myanmar, Namibia, Netherlands, New Zealand, Norway, Oman< Pakistan, Papua New Guinea, Philippines, Poland, Qatar, Romania, Russia, Saudi Arabia, Senegal, Seychelles, Singapore, Slovak Republic, South Africa, South Korea, Spain, Sri Lanka, Sudan, Sweden, Switzerland, Syria, Taiwan, Thailand, Turkey, United Arab Emirates, United Kingdom, United States, Uzbekistan, Venezuela, Vietnam, Yemen, and Zimbabwe.

As such, a non-resident intermediate holding company may be used to fund the Malaysian investment to take advantage of the applicable DTA benefits, such as lower WHT rates on interest.

Local Branch

In Malaysia, both a branch and a subsidiary are generally subject to the same tax filing and payment obligations.

Malaysia does not impose branch profits tax on the remittance of branch profits. Therefore, the profits of a local branch may be freely repatriated back to its head office without attracting further tax liabilities in Malaysia.

However, where profits are repatriated in the form of (among other things) royalties, interest, or payments for management fees, Malaysia WHT would be applicable.

Joint Venture

A joint venture can be either unincorporated or incorporated. If the former, it needs to be determined whether it is a partnership.

A partnership is not taxed as an entity. Tax is instead charged at the partners' level on their share of the adjusted income from the partnership. The divisible income is allocated among the partners according to their profit-sharing formula, and the capital allowances (also allocated according to the profit-sharing formula) are deducted in arriving at the partners' chargeable income. If there is a partnership loss, each partner's share of the loss may be offset against his/her income from other sources.

Choice of Acquisition Funding

The financing of a transaction can be in the form of shares or load notes, cash asset swaps, or a combination of different types of consideration.

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Debt

Where the consideration is in the form of cash, the acquirer may have to raise external borrowings, which may involve a variety of regulatory approvals.

Incidental costs of raising loan finance, such as legal fees, rating fees, and guarantee fees, are viewed as capital and hence are non-deductible (except for certain Islamic financing and asset-backed securitizations).

Borrowings from a non-resident may require exchange control approval.

Malaysia has introduced thin-capitalization legislation effective from 1 January 2009. However, publication of the detailed rules pertaining to the thin-capitalization legislation, including the permitted ratio has been deferred until further notice.

Investment Abroad, ECM Notice 9: ECM 9 imposes the requirement on Malaysian-resident corporations with domestic borrowings to seek prior approval from Bank Negara for overseas investments through conversion of MYR exceeding MYR 50 million per calendar year on a per corporate group basis. The threshold for Malaysian-resident individuals is MYR 1 million per calendar year.

A Malaysian-resident corporation is required to seek prior approval from Bank Negara when the foreign currency borrowings for overseas investment exceed in aggregate MYR 100 million (equivalent) on a corporate group basis.

Malaysian residents with domestic borrowings are free to invest abroad foreign currency funds maintained onshore or offshore. Malaysian resident with no domestic borrowing are also free to invest abroad.

In addition, Malaysian resident would usually be required to repatriate all interest, dividends, profits, and proceeds from the sale of investments to Malaysia as soon as these are received.

Foreign Currency Credit Facilities and Ringgit Credit Facilities from Non-Residents, ECM Notice 10: ECM 10 stipulates that resident companies may obtain foreign currency credit facilities up to MYR 100 million equivalent in aggregate on a per-corporate group basis from licensed onshore banks, licensed merchant banks, and non-residents.

With effect from 28 May 2008, the threshold for foreign currency borrowing of MYR 100 million in aggregate for a resident corporation has been relaxed as follows (amongst others):

A resident company is free to borrow any amount in foreign currency from:

- Its non-resident non-bank parent company;
- Other resident companies within the same corporate group in Malaysia; and
- Licensed onshore banks and licensed international Islamic banks

Under ECM 1 definitions, credit facilities means any advances, loan, trade financing, hire purchase, factoring, leasing facilities, redeemable preferences shares, or similar facility in whatever name or form. This definition excludes the following (among others):

- Operational leasing facilities;

- Factoring facilities without recourse;
- Performance and financial guarantees.

Deductibility of Interest

Deductibility of interest costs is subject to the provision under sections 33(1) and 33(2) of the ITA. A deduction of interest expense may be claimed under section 33(1) when the interest expense is wholly and exclusively incurred in the production of a company's gross income. A company with an ongoing business may claim a deduction on the interest expense pursuant to the same section if it relates to a loan used for the working capital purposes of the company. An investment holding company may claim a deduction on its interest expenses against its investment income pursuant to section 33(1).

However, under the single-tier system (discussed earlier), the interest cost incurred by an investment holding company could be lost as the investment income (that is, dividend income) would be tax-exempt.

The deductibility of the interest expense would be restricted pursuant to section 33(2), when monies borrowed are used directly or indirectly for non-trade purposes (such as investments or loans other than for business purposes). This section applies to companies with ongoing businesses which undertake non-business investments. The interest restricted can only be allocated and set off against the taxable income, if any, derived from the non-business investments or loans to which the monies have been applied, but cannot be set off against business profits. Inefficiencies could arise where these non-trade applications do not produce sufficient taxable income, as the interest expense restricted is then lost or wasted. Therefore, for companies with interest expense and non-trade applications, managing interest restrictions can be a major issue that, if not handled properly, can adversely affect the effective tax rate.

In addition, there are transfer pricing and thin-capitalization issues to consider (please refer to section on Local Holding Company).

Withholding Tax on Debt and Methods to Reduce or Eliminate

Interest paid or credited to any person who is not a tax resident in Malaysia, other than interest attributable to a business carried on by such person in Malaysia, is generally subject to Malaysian WHY at the rate of 15 percent on the gross amount. The rate of WHT may, however, be reduced by the relevant DTA between Malaysia and the country of residence of the recipient, but request for such exemption must be supported by a certified if residency of the non-resident company. Interest payments to non-resident companies without a place of business in Malaysia in respect of Islamic securities issued in any currency and debentures issued in MYR, other than convertible loan stocks, approved by the Securities Commission or securities issued by the government of Malaysia are exempted from WHT. The following interest paid or credited to a non- resident is also exempted from WHT.

- Interest paid or credited to any individual not resident in Malaysia (other than such interest accruing to a place of business in Malaysia of such an individual) in respect of Islamic securities other than convertible loan stock issued in any currency other than MYR and approved by the Securities Commission and

- Income of a unit trust in respect of interest derived from Malaysia and paid or credited by any bank or financial institution licensed under the Banking and Financial Institution Act, 1989 or the Islamic Banking Act, 1983.

The tax withheld must be remitted to the IRB within one month of the earlier of the paying or crediting of such amount. Failure to remit the WHT to the IRB within the stipulated period will result in the imposition of a penalty of 10 percent of the amount unpaid. In addition the interest expense will be disallowed as a tax deduction until the penalty and the WHT have been settled.

Instead of borrowing directly from an offshore location, it may be possible to arrange funding through Labuan. Interest payments to a Labuan company are not subject to WHT (provided that the recipient is a Malaysia tax-resident). Exchange control approval may be required.

Checklist for Debt Funding

Where a Malaysian company is considering debt funding, following issues among others should be considered:

- Where the debt funding is to be received from a related party, issues relating to thin-capitalization (the issuance of detailed rules on this has been deferred until further notice), transfer pricing (Please see later in the chapter) and deductibility of interest (please see early in the chapter);

- Malaysian WHT on interest paid or credited to a non-resident lender and whether there are ways to minimize or mitigate the impact of WHT (please see early in the chapter); and

- Malaysian exchange controls (please see early in the chapter).

Equity

Companies need to pay registration fees on the amount of their authorized share capital. The registration fee starts from MYR 1,000 for an authorized share capital of MYR 100,000 or less, and increases at a gradual rate up to MYR 70,000 for authorized share capital above MYR 100 million. The registration fee is not deductible for income tax purposes.

For the tax implications of dividend payments, please refer to the discussion under Local Holding Company section.

Hybrids

A commonly used hybrid is the redeemable preference share (RPS). An RPS is usually treated as a form of equity for tax purposes. The use of the RPSs allows for flexibility of redemption, which is generally regarded as a repayment of capital (assuming that this occurs on a one-off basis).

The RPS scan be redeemed either out of profits that would otherwise be available for dividends or out of the proceeds of a fresh issue of shares made for the purposes of the redemption. When the RPSs are redeemed in ways other than from the proceeds of a fresh issue of shares, an amount equal to the nominal value of the shares redeemed has to be transferred out of profits that would otherwise have been available for dividend distribution to a capital redemption reserve (CRR).

The IRB has indicated that RPS distributions will generally not be treated as interest for tax purposes.

Under the purposed single-tier system transitional provisions, dividends on RPSs will not carry tax credits (usually attached to a dividend distribution).

Discounted Securities

Where discounted securities are issued, it would need to be established whether the discount element is in the nature of interest. If this is the case, please refer to the discussions above on debt funding.

Deferred Settlement

Generally, tax relief under the ITA is claimed on an incurred basis. As such, where tax relief is to be claimed under the ITA, it would need to be determined whether the relevant cost has been incurred notwithstanding that the payment of the same is deferred. However, it should be noted that, generally, Malaysian WHT obligations crystallize on the earlier of paying or crediting a non-resident.

Other Considerations

Concerns of the seller

RPGT is a capital gains tax imposed on gains on disposals of real property located in Malaysia or shares in an RPC and is embodied in the RPGT Act. An RPC is a company that owns real property in Malaysia or shares in other RPCs to the extent the value of its real property or shares (in other RPCs) or both, exceeds 75 percent of the total tangible asset value of the company at the relevant time.

Pursuant of the real Property Gains Tax (Exemption) (No 2) Order 2007, the Minister of Finance exempts any person from all provisions of the RPGT Act in respect of any disposal of chargeable assets after 31 March 2007.

However, with effect from 1 January 2010, RPGT at an effective rate of 5 percent will be imposed on gains from the disposal of real property or shares in RPCs. The purchaser is required to withhold 2 percent of the purchase value and remit the amount withheld to the IRB.

Generally, a gain arises when the disposal price exceeds the acquisition price of the real property or the shares in an RPC.

The disposer and acquirer of a chargeable asset must each make a return to the IRB within one month (extended to n60 days with effect from 1 January 2010) of the date of disposal (as defined) in the prescribed form, supported by all the particulars stipulated therein. Where market value of the asset is to be used, a written valuation by a valuer must be submitted.

Exemption: where, with the prior approval of the Director General of the IRB, a chargeable asset is transferred between companies and the transferee company is resident in Malaysia, the Director General shall treat the transfer as one from which no gain or loss arises if one of the following applies.

- The asset is transferred between companies in the same group to bring about greater efficiency for a consideration consisting substantially of shares (that, is not less than 75 percent in shares) and the balance in cash;

- The transfer is a result of a plan of reorganization, reconstruction, or amalgamation; or

- A liquidator of a company distributes the asset and the liquidation of the company was made under a plan of reorganization, reconstruction or amalgamation.

However, the Director general shall not give such prior approval for the transfer or distribution of an asset under the last two categories above unless he/she is satisfied that such an asset is transferred to implement a plan that is in compliance with government's policy on capital participation in industry. Under these approved transfers, the date of acquisition of the chargeable asset by the transferee is deemed to be the original date of acquisition of the chargeable asset by the transferor. However, there are various anti-avoidance provisions.

The RPGT Act empowers the Minister of Finance to exempt specific transactions from RPGT, but this power is rarely exercised in practice.

Group Relief/Consolidation

The concept of grouping for tax purpose in Malaysia was first introduced for selected industries, such as forest plantations and rubber plantations, and selected products in the manufacturing sector, such as biotechnology, nanotechnology, optic, and phonics, as well as certain food products. With effect from YA 2006, group relief has been extended to companies in other industries. A company resident and incorporated in Malaysia may now surrender not more than 70 percent of its adjusted loss for the basic period to one or more related companies' resident and incorporated in Malaysia. However, to qualify for this treatment, there must be at least 70 percent common ownership through Malaysian companies. There are various restrictions on how tax losses can be transferred and these include definitions of group as well as the requirement for common year ends. Companies enjoying certain tax incentives are also ineligible.

Transfer Pricing

Transfer pricing is an issue of concern to taxpayers in Malaysia in the context of related-party transactions.

In July 2003, the IRB issued formal transfer pricing guidelines (Guidelines). The Guidelines broadly follow the arm's-length principles established under the Organization for economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Generally, the Guideline prescribe that all transactions between associated parties should be on an arm's-length basis.

The Guidelines cover transactions between:

- associated enterprises within a multinational group where one enterprise is subject to tax in Malaysia and the other enterprise is located overseas; and
- associated companies within Malaysia

The scope of the Guidelines includes transactions involving lending and borrowing money.

To enhance certainly on pricing issues for inter-company transactions, the government has introduced an advance pricing arrangement (APA) mechanism. The APA provides a mechanism to predetermine prices of goods and services to be transacted between a company and its associated companies for a specified period. APAs would offer considerable security in terms of transfer pricing although the timeframe to negotiate and agree the APA would need to be considered.

With effect from 1 January 2009, the Director General of the IRB has been accorded the power, under section 140A of the ITA, to adjust the transfer price of transactions between associated persons when he/she is of the opinion that the transfer price is not at arm's length. With these extended powers, it is anticipated that the IRB will increase its focus on transfer pricing. It has therefore become increasingly important for taxpayers to ensure that the pricing of goods and services with associated persons is demonstrably at arm's length. Taxpayers must ensure that they have sufficient contemporaneous to substantiate this. The MOF is expected to issue rules pursuant to section 140A of the ITA.

Dual residency

Based on the ITA, regardless of where a holding company is incorporated, it is considered a tax-resident in Malaysia if it is managed and controlled in Malaysia. Generally, a company is regarded as being managed and controlled at the place where its directors' meetings are held.

It may also be possible that a foreign company may be viewed as a tax-resident in the jurisdiction of its incorporation.

Based on the aforementioned information, a foreign company may be a tax-resident of Malaysia and its jurisdiction of incorporation (where the relevant conditions are met).

Issues arising due to a company having dual residency may be resolved by an applicable DTA, where relevant.

Foreign Investment of a Local Target Company

Generally, Malaysian companies are allowed to undertake foreign investments (however, please see the comments on ECM 9).

As mentioned previously, foreign-sourced income when received in Malaysia by a resident company [other than a resident company carrying on the business of banking (there are limited exemptions for banking businesses), insurance, shipping or air transport] is exempt from tax. However, the non-deductibility of costs attributable to foreign-sourced income would need to be considered.

Tax Neutral Reorganizations or Mergers

Malaysia does not have a capital gains tax regime except for RPGT which applies to transactions relating to land and shares in RPCs where such transactions are not subject to the ITA.

In respect top reorganizations or mergers, the Malaysian tax regime provides for limited exemptions in the following scenarios:

- Where the transfer of assets, for which capital allowances (that is, tax depreciation) have been claimed, fall within the controlled transfer provisions in the ITA. In these circumstances, the assets are deemed to be transferred as their respective tax residual values such that no balancing charges or allowance will arise.
- Where the transfer of assets or shares fall within Sections 15 or 15A of the Stamp Act, and meets the relevant conditions therein, the transaction will be relieved from stamp duty.
- In addition to the above, the Minister of Finance is empowered to exempt specific transactions from stamp duty, but this power is rarely exercised.
- Specific exemptions from specific types of taxes (such as income tax, stamp duty, and RPGT) may be issued by the government from time to time by way of statutory orders.
- In relation to RPGT, where, with the prior approval of the Director General of the IRB, a chargeable asset is transferred between companies and the transferee company is resident in Malaysia, the Director General shall treat the transfer as one form which no gain or loss arises if one of the following applies:
    - The assets is transferred between companies in the same group to bring about greater efficiency in operation for a consideration consisting substantially of shares (that is, not less than 75 percent in shares) and the balance in cash;
    - The transfer is a result of a plan of reorganization, reconstruction, or amalgamation; or
    - A liquidator of a company distributes the asset and the liquidation of the company was made under a plan of reorganisation, reconstruction or amalgamation.

For transfers under the second and third bulleted item, the scheme concerned must ne in compliance with the government's policy on capital participation in industry. Approval is at the discretion of the IRB. There are various conditions which must be met.

The RPGT Act empowers the Minister of Finance to exempt specific transactions from RPGT. However, in practice this is rarely exercised.

Comparison of Asset and Share Purchases

Advantage of Asset Purchases

- The purchase price of qualifying assets(or a proportion) may be depreciated for tax purposes in the form of capital allowances
- Liabilities and business risks of the vendor company will not be transferred
- It is possible to acquire only certain parts of a business
- Interest incurred to fund the acquisition of plant, equipment, and other assets that will be used in the trade or business is generally tax deductible
- Acquirer company may claim RA, if it has incurred qualifying capital expenditure for the purposes of a qualifying project and has been in operation for at least 36 months. Where the asset is disposed of within a period of five years from the date of purchase of the asset, the RA claimed by the disposer will be clawed back. In addition, the assets for which the RA has been claimed are acquired under a controlled transfer situation where the

transferor has previously claimed RA, the acquirer is not allowed to claim RA on the same assets.

- Acquirer company may be able to claim new incentives, where applicable.

Disadvantages of Assets Purchases

- Possible claw back of capital allowance claimed by the vendor in the form of a balancing charge.
- Possible claw back of RA, if the qualifying asset is disposed of within five years from the date of acquisition.
- Higher stamp duties on the transfer of certain assets
- The benefits of any losses or unused tax attributes remain in the vendor company.
- The benefits of incentives remain in the vendor company.
- There could be a need to cancel and apple for various indirect tax licenses.

Advantages of Share Purchases

- No capital allowance or balancing charges claw-backs on vendor and no withdrawal of RA.
- Purchaser may be able to use and benefit from unused tax attributes, tax incentives and franking account balances of the target company.
- Lower stamp duties payable on the transfer of shares compared with other physical assets.
- Target company may continue to enjoy tax incentive.

Disadvantages of Share Purchases

- Purchaser may acquire historic ax and other liabilities.
- No deduction or depreciation allowances (capital allowances) are available for the purchase cost of shares.
- There is no re-basing of the underlying assets.
- Purchaser may not be able to use the unused tax losses or capital allowances available in the target company where there is a substantial change in shareholders. However, this only applies to dormant companies.
- Interest incurred to fund the acquisition of shares would be subject to interest restriction.

Withholding Tax Rate Chart

The following chart contains the withholding tax rates that are applicable to dividends, interest and royalty payments by Malaysian companies to non-residents under the tax treaties currently in force. However, Malaysia does not impose any withholding tax on dividends under domestic law. The rates provided below are maximum withholding rates should Malaysia impose a withholding tax on dividends in the future.

The rate information and footnotes contains in this table are from the recent 2011 Budget announcement.

Country	Dividends		Interest[1] (%)	Royalties (%)
	Individuals, Companies (%)	Qualifying Companies (%)		
Albania	15	5	10	10
Armenia	0	0	15	10/15
Australia	0	0	15	10
Austria	0	0	15	10/15
Azerbaijan	0	0	15	10/15
Bahrain	5	5	5	8
Bangladesh	0	0	15	10
Belarus	0	0	15	10/15
Belgium	15	15	10	10
Canada	0	0	15	10
China (People's Rep.)	0	0	10	10
Chile	15	5	15	10
Croatia	10	5	10	10
Czech Republic	0	0	12	10
Denmark	0	0	15	10
Egypt	0	0	15	10
Fiji	15	15	15	10
Finland	0	0	15	10
France	0	0	15	10
Georgia	0	0	15	10/15
Germany	0	0	15	10
Hungary	0	0	15	10
India	10	10	10	10
Indonesia	0	0	15	10
Ireland	10	10	10	8
Italy	10	10	15	10
Japan	15	5	10	10
Jordan	10	10	15	10
Kazakhstan	10	10	10	10
Korea (Rep.)	0	0	15	10/15
Kuwait	0	0	10	10/15

Kyrgyzstan	0	0	10	10
Lebanon	5	5	10	8
Luxembourg	10	5	10	8
Malta	0	0	15	10
Mauritius	15	5	15	10
Moldova	0	0	15	10/15
Mongolia	10	10	10	10
Morocco	10	5	10	10
Myanmar	10	10	10	10
Namibia	10	5	10	5
Netherlands	0	0	10	8
New Zealand	15	15	15	10
Norway	0	0	15	0
Pakistan	0	0	15	10
Papua New Guinea	0	0	15	10
Philippines	0	0	15	10
Poland	0	0	15	10
Romania	0	0	15	10
Russia	0	0	15	10
Seychelles	10	10	10	10
Singapore	10	5	10	8
South Africa	10	5	10	5
Spain	5	0	10	7
Sri Lanka	0	0	10	10
Sudan	10	10	10	10
Sweden	0	0	10	8
Switzerland	15	5	10	10
Syria	10	5	10	10
Taiwan	0	0	15	10
Tajikistan	0	0	15	10/15
Thailand	0	0	15	10
Turkey	15	10	15	10
Ukraine	0	0	15	15
United Arab Emirates	0	0	5	10
United Kingdom	10	5	10	8
Uzbekistan	10	10	10	10
Vietnam	10	10	10	10