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Place of Business — Tax Implications in Malaysia

It is commonly understood that income derived in Malaysia by a non-resident from another country that has a Double Taxation Agreement (**DTA**) with Malaysia would be taxable here only if the non-resident has a “permanent establishment” based on the provisions of the DTA. In respect of income derived by a non-DTA resident, reference is made to s 12(3) and (4) of the Income Tax Act 1967 (**ITA**) which, in essence, provide that income that is attributable to a “place of business” in Malaysia shall be deemed to be derived from Malaysia and, consequently, taxable in the country.

On 27.5.2020, the Inland Revenue Board (**IRB**) released a set of guidelines (**Guidelines**) on the scope of s 12(3) and (4) of the ITA. The key takeaway points from the Guidelines are as follows.

Physical ‘Place of Business’

The phrase “place of business” covers any premises, facilities or installations used for carrying on the business of a person, regardless whether the premises are used exclusively for that purpose. The “place of business” may be owned or rented. A certain amount of space within a premise is sufficient to constitute “place of business” if the space is at the disposal of the person in question.

The “place of business” must be fixed. There are two critical components to determine whether there is a fixed place of business, namely, the degree of permanency and the geographical point:

- (a) The duration required to establish the degree of permanency would depend on the nature of the business. A short period may suffice if the nature of the business is such that it would only be carried for a short period of time; and
- (b) The geographical point refers to the area in which the

business activities are conducted. The business activities may move between different locations so long as they remain within a single geographical point or are coherent as a single business operation.

Preparatory or auxiliary

A physical place maintained solely for the purpose of carrying on an activity which is preparatory or auxiliary in nature will not render the physical place a “place of business”. However, whether an activity may be regarded as preparatory or auxiliary in nature would depend on the factual circumstances. In general, an activity that is preparatory or auxiliary in nature would have one of the following features:

- (a) it is so remote from the actual realisation of profit of the business that it is difficult to allocate any profit to the physical place in question;
- (b) it does not form an essential and significant part of the business as a whole;
- (c) it is not identical to the general purpose of the whole business; or
- (d) it is carried out during a relatively short period.

An activity that is complementary or is part of a cohesive business operation will not be regarded as preparatory or auxiliary. This is particularly when the activity is carried out by an associated person.

Building site, construction, installation, assembly and supervisory activity

Building site or construction, installation or assembly project, and supervisory activities in connection therewith will be regarded as a “place of business” if the work is carried out for a duration exceeding five months in any 12-month period. In such a situation, the work rendered will be subject to withholding tax under s 107A of the ITA. On the contrary, if the duration is less than five months, withholding tax under s 109B of the ITA will apply.

The duration of work rendered by a person and its associated persons in Malaysia will be aggregated if the work rendered by them are connected with one another. The connection between the work rendered would depend on whether, among others:

- (a) the contracts covering the different activities were concluded with the same person or its associated persons;
- (b) the conclusion of additional contracts with a person is a

logical consequence of an earlier contract previously concluded with the same person or its associated persons;

- (c) the activities would have been covered by a single contract in the absence of tax planning considerations;
- (d) the nature of work involved under the different contracts is the same or similar; and
- (e) the same entities are performing the activities under the different contracts.

Agent as ‘Place of Business’

A person will be deemed to have a “place of business” in Malaysia if it carries out its business activities through an agent who habitually:

- (a) concludes contracts on its behalf or plays the principal role leading to the conclusion of the contracts. The type of contracts covered include those which are binding on the person, and is not limited to only those which are in the name of the person; or
- (b) maintains a stock of goods or merchandise in that place of business of the person from which such person delivers goods or merchandise, or regularly fills orders on behalf of the person. This would be applicable only if the agent also conducts sales-related activities.

The above principle, however, would not apply to an independent agent. An independent agent is someone who does not act exclusively, or almost exclusively, on behalf of a person or its associated persons.

Our comments

It appears that the Guidelines were prepared largely based on Art 5 of the OECD Model Tax Convention (**OECD Convention**) and its commentary, as opposed to the express wording of s 12(3) and (4) of the ITA. For instance:

- (a) The IRB adopted the condition for a “fixed place of business” based on the wording used in Art 5(1) of the OECD Convention despite the absence of the word “fixed” in s 12(3) and (4) of the ITA;
- (b) The IRB excluded activities which are preparatory and auxiliary in nature based on Art 5(4) of the OECD Convention, despite the absence of a similar provision set out in the ITA; and

- (c) The IRB further drew a distinction between an agent and an independent agent based on Art 5(6) of the OECD Convention, even though such distinction was not expressly stated in s 12(3) and (4) of the ITA.

It shall be noted, however, that the IRB did not adopt all the provisions in the OECD Convention in the Guidelines. For example, the IRB did not mention the excluded activities set out in Art 5(4) of the OECD Convention in the Guidelines. The list of excluded activities is also not set out in s 12(3) and (4) of the ITA. Given this, it will be difficult for taxpayers to contend that the excluded activities should similarly be adopted, as the interpretation of the term “place of business” should be based solely on the wording used in the ITA (and not the OECD Convention). It would also be difficult for taxpayers to rely on Art 5(7) of the OECD Convention, which states that the “permanent establishment” of a subsidiary company shall not in itself constitute the “permanent establishment” of the parent company. Likewise, it will be difficult for the IRB to insist on the condition that a physical place may constitute “place of business” regardless whether they are exclusively used for business purposes, or the imposition of the five-month duration in respect of building site, construction, installation, assembly and supervisory activity.

Ultimately, case laws have consistently held that the IRB’s guidelines do not have force in law as they are not part and parcel of our legislative framework. In the event that the Guidelines are used by the IRB to expand the scope of s 12(3) and (4) of the ITA, its decision can be challenged in court.

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