

THE CORPORATE TAX  
PLANNING LAW  
REVIEW

Editors

Jodi J Schwartz and Swift S O Edgar

THE LAWREVIEWS

THE  
CORPORATE TAX  
PLANNING LAW  
REVIEW

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# PREFACE

We are pleased to present the inaugural edition of *The Corporate Tax Planning Law Review*. This volume contains 20 chapters, each devoted to a different country and providing expert analysis by leading practitioners of the most important aspects of tax planning for multinational corporate groups in that country, with a particular focus on recent developments.

The jurisdictions represented in this volume are diverse and include established major economies (such as the United States, Germany and Korea); EU countries that have become popular destinations for new business organisations and those where multinationals tend to form entities to facilitate local operations or investments; the city-states of Singapore and Monaco; and several nations in the Global South (including Colombia, Venezuela and Malaysia). Echoing this geographical variety, *The Corporate Tax Planning Law Review* describes tax developments worldwide that respond to different challenges in different places. At the same time, many countries share goals of preventing jurisdiction-shopping, protecting against erosion of the tax base, promoting local investment and raising revenues. These complex and at times conflicting goals present opportunities for the well advised and traps for the unwary.

While each chapter discusses issues at the cutting edge of tax law, the authors have contextualised their analyses with sufficient background information to make this volume accessible and useful to both generalists and tax practitioners outside each particular jurisdiction. Although *The Corporate Tax Planning Law Review* is, by its nature, an abbreviated overview, we hope it will at least serve as a workable compass to in-house counsel and outside advisers as they attempt to navigate their clients through the unsteady, and at times uncharted, waters of contemporary corporate tax planning.

We are extremely grateful to the contributors who have assiduously distilled a wealth of expertise to create this volume, and to Gina Mete, Nick Barette, Gavin Jordan and Adam Myers at Law Business Research for their editorial acumen and dedication to this project.

**Jodi J Schwartz and Swift S O Edgar**

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# MALAYSIA

*D P Naban, S Saravana Kumar and Katryne Chia Phei Shan<sup>1</sup>*

## I INTRODUCTION

Amid revelations of a staggering national debt,<sup>2</sup> it comes as no surprise that the announcement of Malaysia's Budget 2019 includes proposals by the government to raise government revenue by reviewing taxation policies.<sup>3</sup> Most of the tax-related proposals announced in the Budget have already been implemented by the Finance Act 2018 (FA 2018), bringing with it tax planning implications for multinational enterprises (MNEs) with the tightening of tax laws and increased scrutiny by the Malaysian tax authority, the Inland Revenue Board of Malaysia (IRB).

In addition to domestic pressures to improve the efficacy of the taxation system, on an international front, Malaysia has also further expressed its commitment in implementing the OECD Base Erosion and Profit Shifting (BEPS) Action Plan, following Malaysia's entry into the OECD Inclusive Framework (IF) on BEPS as an Associate Member in 2017.<sup>4</sup> This commitment means that Malaysia will implement and adhere to the IF 'minimum standards' on preferential tax regimes, tax treaty shopping, country-by-country reporting by MNEs, and tax-related dispute resolution mechanisms. Malaysia has already shown its readiness to follow through on its international obligations, for example, by implementing country-by-country reporting and automatic exchange of information between tax authorities.

In light of this tax climate, businesses may find that tax planning requires more acute consideration of not only their current activities in Malaysia, but also future activities in anticipation of a more rigorous and tax-efficient system.

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1 D P Naban is a senior partner, S Saravana Kumar is a partner and Katryne Chia Phei Shan is an associate at Lee Hishammuddin Allen & Gledhill.

2 National debt still above 1 trillion ringgit, says Guan Eng (22 February 2019) The Star Online, [www.thestar.com.my/news/nation/2019/02/22/national-debt-still-above-rm1-tril-says-guan-eng/](http://www.thestar.com.my/news/nation/2019/02/22/national-debt-still-above-rm1-tril-says-guan-eng/).

3 Budget 2019: Guan Eng's full speech (2 November 2018) The Star Online [www.thestar.com.my/news/nation/2018/11/02/here-is-the-full-speech-by-finance-minister-lim-guan-eng-during-the-tabling-of-budget-2019/](http://www.thestar.com.my/news/nation/2018/11/02/here-is-the-full-speech-by-finance-minister-lim-guan-eng-during-the-tabling-of-budget-2019/).

4 Malaysia's Commitment in International Tax Standard (11 January 2019) Official Portal of Ministry of Finance [www.treasury.gov.my/index.php/en/tax/malaysia-s-commitment-in-international-tax-standard.html](http://www.treasury.gov.my/index.php/en/tax/malaysia-s-commitment-in-international-tax-standard.html).

## II LOCAL DEVELOPMENTS

### i Entity selection and business operations

The most common forms of business entities are companies (private or public), partnerships, limited liability partnerships and sole proprietorships. For foreign enterprises, business activities can also be carried out through a local branch as opposed to an incorporated local subsidiary.

Under the Malaysian Income Tax Act 1967 (ITA), most of the business entities above are taxable given the non-exhaustive definition of a taxable person under the ITA.<sup>5</sup> However, Malaysia offers a multitude of tax exemptions under the ITA and the Promotion of Investments Act 1986 (PIA), which exempt either the entirety of the income of an entity from tax or income in respect of specific business activities. Tax incentives are also offered in the form of allowances or increased tax deductions.

#### *Entity forms*

For multinational businesses considering establishing a presence in Malaysia, entity selection plays a pivotal role as it will affect the rate of tax payable and tax incentives available.

#### *Sole proprietorships and partnerships*

Sole proprietorships and partnerships are not recognised as 'persons' for income tax purposes. Consequently, the profits and loss of a proprietorship or partnership flow through to the business owners, who are taxed on their individual income at the graduated rates of tax for individuals.<sup>6</sup> In a partnership, each partner is assessed on his or her share of the partnership income.<sup>7</sup>

#### *Companies*

Companies are generally taxed at the corporate rate of 24 per cent.<sup>8</sup> For a company resident and incorporated in Malaysia that has a paid-up ordinary share capital of 2.5 million ringgit or less, income tax is chargeable at a rate of 17 per cent for the first 500,000 ringgit and 24 per cent for every ringgit thereafter.<sup>9</sup>

Locally incorporated and resident companies can enjoy significant tax incentives, most notably in the form of pioneer status and investment tax allowance under the PIA.<sup>10</sup> Companies that are granted pioneer status by participating in a promoted activity or producing a promoted product are allowed tax exemption on 70 per cent of their statutory income for five years.<sup>11</sup> Investment tax allowance, on the other hand, is granted on 60 per cent qualifying capital expenditure incurred for a period of five years, to be utilised against 70 per cent of the statutory income.<sup>12</sup>

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5 See Section 2 ITA on the definition of 'person' and Section 3 ITA.

6 See Paragraph 1, Part I, Schedule 1 ITA.

7 See Section 55 ITA.

8 Paragraph 2, Part I, Schedule 1 ITA.

9 Paragraph 2A, Part I, Schedule 1 ITA. See also Paragraphs 2B and 2C, Part I, Schedule 1 ITA for exceptions.

10 See Section 2 PIA on the definition of 'company' and Section 3 PIA.

11 See Sections 14 and 21B(4) PIA.

12 See Sections 29A(2) and (5) PIA.

Reinvestment allowance (RA) is also available on 60 per cent of the capital expenditure incurred on a factory, a plant or machinery used in Malaysia for the expansion, modernisation, or diversification of a company's business.<sup>13</sup> As all three incentives are mutually exclusive, it may be more advantageous for businesses that qualify for both investment tax allowance and RA to apply for RA as it can be enjoyed for a longer period of 15 years.<sup>14</sup>

#### *Local branches*

Local branches of non-resident entities are generally treated as non-residents for income tax purposes unless it can be established that the management and control of its affairs or businesses is exercised in Malaysia.<sup>15</sup> Branches are taxable at a rate of 24 per cent<sup>16</sup> on income accruing in or derived from Malaysia, which is the same as the tax rate imposed on local incorporated companies.

Given their non-resident status, tax incentives under the ITA and PIA are generally unavailable to local branches. Thus, from a tax perspective, it may be more tax-efficient for foreign enterprises to carry on their business activities in Malaysia by incorporating a local subsidiary rather than by registering a branch.

#### *Labuan company*

In a bid to attract investors and promote the Federal Territory of Labuan as an international offshore financial centre, preferential tax rates are provided under the Labuan Business Activity Tax Act 1990 (LBATA) for companies incorporated under the Labuan Companies Act 1990 undertaking Labuan trading activities such as banking, insurance, trading, management, licensing and shipping operations.<sup>17</sup> Before 1 January 2019, Labuan entities could choose between paying tax at a rate of 3 per cent<sup>18</sup> or a flat rate of 20,000 ringgit per year. However, legislative amendments have now removed the tax ceiling of 20,000 ringgit.<sup>19</sup>

#### *Limited liability partnerships*

Unlike conventional partnerships, limited liability partnerships (LLPs) are recognised as taxable persons for income tax purposes and are taxed at a rate of 24 per cent.<sup>20</sup> Where an LLP has a capital contribution of 2.5 million ringgit or less, the LLP will enjoy a reduced tax rate of 17 per cent for the first 500,000 ringgit of its income and 24 per cent for the remainder.<sup>21</sup> Significantly, profits paid or distributed to partners in an LLP are exempt from tax<sup>22</sup> and no withholding tax is applicable.

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13 Schedule 7A ITA.

14 Paragraph 2, Schedule 7A ITA.

15 Section 8(1)(b) ITA and Paragraph 5.4, Public Ruling No. 5/2011 on the Residence Status of Companies and Bodies of Persons.

16 Paragraph 2(a), Schedule 1 ITA.

17 Section 2 LBATA.

18 Section 4 LBATA.

19 Section 76 FA 2018.

20 Paragraph 2(f), Part I, Schedule 1 ITA.

21 Paragraph 2D, Part I, Schedule 1 ITA.

22 Paragraph 12C, Part I, Schedule 6 ITA.

### ***Domestic income tax***

Malaysia's income tax system is territorial in nature. Income tax is levied on any person's income accruing in or derived from Malaysia,<sup>23</sup> including business gains or profits, employment income, interests, rents and royalties.<sup>24</sup> However, income of a resident company carrying on the business of air or sea transport, banking, or insurance is taxable on a worldwide basis.<sup>25</sup> In respect of dividends, Malaysia operates on a single-tier system where income tax imposed on a company is a final tax and dividends are tax exempt in the hands of shareholders.

Non-resident businesses are taxed on income accruing in or derived from Malaysia if they have permanent establishments in Malaysia. Recent amendments to Section 12 of the ITA have amended the definition of 'place of business' in the ITA to mirror the definition of permanent establishments that is commonly found in all double taxation agreements (DTAs).<sup>26</sup>

### ***International tax***

Malaysia's territorial tax system means that foreign-sourced income is not subject to income tax in Malaysia.<sup>27</sup> In other words, the income of a person derived from sources outside Malaysia and received in Malaysia is tax-exempt.

In determining whether an income is a foreign-sourced income, Malaysian courts have adopted the principle enunciated by the Privy Council in *Hang Seng*.<sup>28</sup> That is, one must see what the taxpayer has done to earn the profit. Thus, if a service is rendered or an activity is engaged in, profit will arise or will be derived from the jurisdiction where the services were rendered or the profit-making activity carried on. In *Cardinal Health*,<sup>29</sup> for example, the High Court held that interest income received in Malaysia arising from a loan provided by a Malaysian company to a company in the Netherlands was foreign-sourced income as the provision of credit occurred in the Netherlands.

Hence, enterprises should consider factors such as the place where an agreement is entered into and the jurisdiction in which personnel carry on commercial activities when structuring their business dealings.

### ***Capitalisation requirements***

Legislation on thin capitalisation was introduced in Malaysia on 1 January 2009,<sup>30</sup> but the Thin Capitalisation Rules for its implementation were never gazetted. With the proposal of Earning Stripping Rules (ESR) by the OECD under its BEPS Action 4 Report on Limitations on Interest Deduction, the legal provision on thin capitalisation was consequently removed with effect from 1 January 2018.<sup>31</sup>

Exactly a year later on 1 January 2019, a new Section 140C of the ITA came into effect to restrict the deductibility of interest expenses between related persons. No deduction is

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23 Section 3 ITA.

24 Section 4 ITA.

25 Paragraph 28, Part I, Schedule 6 ITA.

26 Section 6 FA 2018.

27 Paragraph 28, Part I, Schedule 6 ITA.

28 *Commissioner of Inland Revenue Appellant v. Hang Seng Bank Ltd Respondent* [1991] 1 AC 306.

29 *Ketua Pengarah Hasil Dalam Negeri v. Cardinal Health Malaysia 211 Sdn Bhd* (2011) MSTC 30-034.

30 Then Section 140A(4) ITA.

31 Section 11 Finance (No. 2) Act 2017.

allowed in respect of any interest expense in connection with or on any financial assistance in a controlled transaction granted directly or indirectly to that person that is more than the maximum amount of interest as determined under any rules made under the ITA.

Based on OECD recommendations, interest deductions are predicted to be limited to a fixed percentage (between 10 per cent and 30 per cent) of an entity's earnings before interest, taxes, depreciation and amortisation (EBITDA). As the relevant rules have yet to be issued or gazetted, it remains to be seen what is the maximum amount of interest that is deductible and how the ESR are to be implemented, including whether the ESR would apply only to cross-border related party transactions and whether there would be a *de minimis* threshold.

## ii Common ownership: group structures and intercompany transactions

### *Ownership structure of related parties*

Unlike countries such as Australia and the United States of America, Malaysia does not allow income tax consolidation where wholly owned or majority-owned companies are treated as a single entity for income tax purposes. The ITA does, however, offer group relief for related companies<sup>32</sup> incorporated in and resident in Malaysia in respect of the transfer or surrender of losses.<sup>33</sup>

Under Section 44A of the ITA, a company (the 'surrendering company') could surrender not more than 70 per cent of its adjusted loss in a year of assessment to one or more related companies (the 'claimant company'), with no time limitation. However, from 2019 onwards, group relief is only available to new companies. Losses can only be surrendered immediately after 12 months from the date the company first commences operation and only for three consecutive years of assessment.<sup>34</sup>

While group relief is certainly advantageous, businesses should be aware that where a surrendering company furnishes an incorrect return in respect of the amount of loss surrendered, the company may be liable to a penalty equal to the amount of tax that had been undercharged on the claimant company in consequence of the incorrect information.<sup>35</sup>

### *Domestic intercompany transactions*

In Malaysia, transactions between related domestic companies are subject to the same legislative provisions and rules that govern international intercompany transactions, which are discussed below. Even though there may be no erosion of the Malaysian tax base given that both companies are taxable in Malaysia, pricing manipulation could alter the tax incidence of the related entities by shifting profits between loss-making and profit-making companies. Thus, it would be prudent for groups of companies to maintain proper transfer pricing documentation in respect of their domestic intercompany transactions, especially where there are differences in the tax incentives enjoyed by or rates of tax applicable to the related companies.

Nevertheless, tax benefits are available in the form of exemptions on stamp duty or real property gains tax (RPGT). Relief from stamp duty is available for reconstructions or

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32 See Section 44A(3) ITA for the determination of related companies and the requirements under Section 44A(7) ITA.

33 Section 44A(1) ITA.

34 Section 12 FA 2018.

35 Section 44A(9)(b) ITA.

amalgamations of companies<sup>36</sup> or for the transfer of property between associated companies,<sup>37</sup> subject of course to the fulfilment of certain conditions. Similarly, RPGT relief may be granted where real property is transferred between companies in the same group to bring about greater efficiency in operation or transferred between companies in any scheme of reorganisation, reconstruction or amalgamation.<sup>38</sup>

### ***International intercompany transactions***

Apart from the ESR as described above, Malaysia has implemented transfer pricing legislation in an effort to counter BEPS. Cross-border related party transactions are subject to the transfer pricing provisions in the ITA as well as the Income Tax (Transfer Pricing) Rules 2012 (the TP Rules). Businesses must ensure that their intercompany transactions are priced at arm's length in accordance with traditional transactional methods (comparable uncontrolled price method, resale price method, or cost plus method) or if impractical, transactional profit methods (profit split method or the transactional net margin method).<sup>39</sup> Section 140A of the ITA empowers the IRB to substitute the price in respect of a related party transaction to reflect an arm's-length price of the transaction.

Companies are also required to maintain contemporaneous transfer pricing documentation setting out, among others, the organisational structure of the business, the nature of the business, the controlled transaction, selection of the transfer pricing method, and comparability, functional and risk analyses.<sup>40</sup> Given that the IRB has seven years to raise an additional assessment,<sup>41</sup> businesses should ensure that their documentation is in order.

In respect of withholding taxes, tax must be withheld on the payment of interest derived from Malaysia to non-residents at a rate of 15 per cent or potentially less if there exists a double taxation treaty between Malaysia and the home country of the non-resident. No withholding tax applies to payments of dividends.

### **iii Third-party transactions**

#### ***Sales of shares or assets for cash***

In general, income tax is not chargeable on income from the sale of shares unless the seller is involved in the business of trading shares. Similarly, there are largely no income tax consequences for the sale of assets as they are not the stock in trade of a business unless the sale involves capital assets for which capital allowances have been granted and the disposal value exceeds the tax written-down value of the assets.<sup>42</sup>

Unlike countries such as the United Kingdom, Malaysia also has no capital gains tax, with the exception of RPGT, which is only applicable to gains from the sale or disposal of real property or shares in a real property company (RPC). An RPC is a controlled company in which real property or shares in another RPC make up at least 75 per cent of its total tangible assets. For companies, RPGT is imposed at a rate of 30 per cent for disposals within three

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36 Section 15 Stamp Act 1949 (SA).

37 Section 15A SA.

38 Paragraph 17, Schedule 2, RPGT Act 1976 (RPGTA).

39 Section 5 TP Rules.

40 Section 4 TP Rules.

41 Section 91(5) ITA.

42 Paragraph 35, Schedule 3 ITA.

years after the date of acquisition of the real property or RPC shares, 20 per cent for disposals in the fourth year, 15 per cent for disposals in the fifth year, and 10 per cent for disposals in the sixth year and thereafter.<sup>43</sup>

The sale of shares or assets will, however, attract stamp duty. Stamp duty on the share transfer instrument is payable at an *ad valorem* rate, calculated on the price or value on the date of transfer. Three ringgit is payable for each 1,000 ringgit or fractional part of 1,000 ringgit.<sup>44</sup> Similarly, *ad valorem* stamp duty is payable on the transfer instrument of any asset.<sup>45</sup>

### ***Tax-free or tax-deferred transactions***

RPGT relief is available where an asset is distributed by a liquidator of a company and the liquidation of the company was made under a scheme of reorganisation, reconstruction or amalgamation.<sup>46</sup>

### ***International considerations***

Under the ITA, withholding tax is imposed on selected cross-border payments to non-residents, including interests,<sup>47</sup> royalties,<sup>48</sup> contract payments in respect of services rendered in Malaysia<sup>49</sup> and special classes of income.<sup>50</sup>

Notably, recent legislative amendments have widened the scope of special classes of income under Section 4A(ii) of the ITA, which provided that income in respect of 'technical advice, assistance or services' rendered by non-residents is subject to tax. The amendments have removed the phrases 'technical' and 'technical management or administration'.<sup>51</sup> Consequently, now any amount paid in consideration of any advice given, or assistance or services rendered in connection with any scientific, industrial or commercial undertaking, venture, project or scheme is subject to income tax. 'Technicality' is no longer required for a service to be taxed under this provision.

In effect, taxes would now have to be withheld and paid for payments made to offshore service providers for any services provided in Malaysia.

## **iv Indirect taxes**

Holding fast to its election promise, the new government has replaced Malaysia's goods and services tax (GST) with sales and services tax (SST), which began on 1 September 2018.<sup>52</sup> Unlike GST, the scope of SST is much narrower and the number of items exempted from SST is 10 times more than that under the GST system.<sup>53</sup>

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43 Part II, Schedule 5 RPGTA.

44 Item 32(b), Schedule 1 SA.

45 See Item 32(a), Schedule 1 SA for the stamp duty rates.

46 Paragraph 17, Schedule 2 RPGTA.

47 Section 109 ITA.

48 *ibid.*

49 Section 107A ITA.

50 Section 109B ITA.

51 Section 5 FA 2018.

52 The GST Act 2014 was repealed by the Goods and Services Tax (Repeal) Act 2018.

53 Above n 3.

Sales tax is charged on taxable goods that are manufactured in Malaysia by a registered manufacturer and sold, used, or disposed of by him or her, or imported into Malaysia.<sup>54</sup> Manufactured goods that are exported would not be subject to sales tax. Unlike under the GST regime, there is no system of input tax or output tax.

Service tax is imposed on specific prescribed services provided in Malaysia by a registered person carrying on his or her business<sup>55</sup> at a rate of 6 per cent.<sup>56</sup> Services subject to service tax include the operation of hotels and restaurants, betting and gaming, professional and consultancy services, and IT services.<sup>57</sup> Unlike under the GST regime, any service tax incurred is not recoverable and would thus be a business cost, albeit deductible for income tax purposes. From 1 January 2019 onwards, registered service tax companies enjoy exemptions on specific business-to-business service tax.<sup>58</sup>

### III INTERNATIONAL DEVELOPMENTS AND LOCAL RESPONSES

#### i OECD-G20 BEPS initiative

Malaysia has been proactive in implementing various recommendations of the OECD on BEPS, beginning with the introduction of transfer pricing legislation in 2012, followed by legislation on country-by-country reporting and the common reporting standard for the automatic exchange of information in 2016.

The Income Tax (Country-by-Country Reporting) Rules 2016 (the CbCr Rules) are consistent with the OECD's recommendations outlined in Action 13 of its BEPS initiative. These rules apply to multinational corporation (MNC) groups where their ultimate holding company is incorporated and resident in Malaysia, the group has a total consolidated group revenue of at least 3 billion ringgit in the financial year preceding the reporting financial year, and their constituent entities have cross-border transactions with its other constituent entities.<sup>59</sup> An MNC group must include in its report aggregate information on, among others, revenue, income tax paid, number of employees, and tangible assets for each jurisdiction the group operates in and identify each constituent entity of the group.<sup>60</sup>

Besides compulsory reporting by MNCs, Malaysia has enacted the Income Tax (Automatic Exchange of Financial Account Information) Rules 2016 compelling Malaysian financial institutions to collect and report to the IRB financial information of non-residents. The IRB in turn will exchange this information with participating foreign tax authorities in the non-residents' home countries, thus reducing opportunities for offshore tax evasion. As of 19 January 2019, there are 63 reportable jurisdictions, including Australia, China, Switzerland and the United Kingdom.<sup>61</sup>

Most recently, Malaysia has begun to address its tax incentives that have been identified by the Forum on Harmful Tax Practices for evaluation, in accordance with BEPS Action 5. For example, with effect from 1 January 2019, the LBATA has been amended to

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54 Section 8 Sales Tax Act 2018

55 Section 8 Service Tax Act 2018.

56 Service Tax (Rate of Tax) Order 2018.

57 First Schedule, Service Tax Regulations 2018.

58 See Item 3, Service Tax (Persons Exempted from Payment of Tax) Order 2018.

59 Rule 2 CbCR Rules 2016.

60 Rule 4, CbCR Rules 2016.

61 The IRB Common Reporting Standard List of Reportable Jurisdictions.

remove ring-fencing on Labuan business activity.<sup>62</sup> Labuan business activity was previously ring-fenced by excluding transactions between a Labuan entity and a resident (Malaysian natural person or business) and transactions in Malaysian currency.

## ii EU proposals on taxation of the digital economy

The Malaysian government has recently announced its intention to introduce a digital tax with effect from 1 January 2020,<sup>63</sup> making it the second south-east Asian nation, after Singapore, to establish such a tax. Foreign service providers of online services will be required to register with the Royal Malaysian Customs, and charge and remit the relevant service tax on digital transactions, including the downloading of software, music, video or digital advertising. For example, foreign service providers such as Netflix and Spotify would be required to register and remit service tax.<sup>64</sup> Given the challenges of cross-border enforcement, it remains to be seen how the proposed digital tax will be implemented in practice in Malaysia.

## iii Tax treaties

As at 29 January 2019, Malaysia has entered into DTAs with 74 countries.<sup>65</sup> These DTAs are recognised and given legal effect under the ITA.<sup>66</sup> Notably, Section 132 of the ITA provides that the arrangements under the DTAs shall have effect notwithstanding anything in any written law. In other words, in the event of a conflict between a DTA and the provisions of the ITA, the former will prevail and this principle has been repeatedly confirmed by the Malaysian courts.<sup>67</sup>

However, the Federal Court in *Alam Maritim*<sup>68</sup> held that the taxpayer was precluded from relief under the Malaysia–Singapore DTA as the disputed payments fell within Section 4A of the ITA, which created a special class of income under which the taxpayer’s income should be taxed in Malaysia. This decision was nevertheless recently distinguished by the High Court in *Orange Rederiet Aps*<sup>69</sup> where the court held that the Malaysia–Denmark DTA here had been ratified subsequent to the enactment of Section 4A and must have clearly been intended by Parliament to take precedence.

## Notable typical or model provisions

While Malaysia is not a member of the OECD, most of Malaysia’s DTAs largely mirror the provisions of the OECD Model Tax Convention on Income and Capital, including the definition of permanent establishment. Given that Malaysia does not impose withholding

62 Section 72 FA 2018.

63 Above n 3.

64 Digital tax only on services, not on transactions (22 November 2018) The News Straits Times [www.nst.com.my/business/2018/11/433592/digital-tax-only-services-not-transactions](http://www.nst.com.my/business/2018/11/433592/digital-tax-only-services-not-transactions).

65 Double Taxation Agreement (29 January 2019) [www.hasil.gov.my/bt\\_goindex.php?bt\\_kump=5&bt\\_skum=5&bt\\_posi=4&bt\\_unit=1&bt\\_sequ=1](http://www.hasil.gov.my/bt_goindex.php?bt_kump=5&bt_skum=5&bt_posi=4&bt_unit=1&bt_sequ=1).

66 Section 132 ITA.

67 See *Director General of Inland Revenue v. Euromedical Industries Ltd* [1983] CLJ (Rep) 128; *Damco Logistics Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* (2011) MSTC 30-033; and *Maersk Malaysia Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* (2013) MSTC 10-046.

68 *Lembaga Hasil Dalam Negeri Malaysia v. Alam Maritim Sdn Bhd* [2014] 3 CLJ 421.

69 *Orange Rederiet Aps v. Ketua Pengarah Hasil Dalam Negeri* (Judicial Review Application No. WA-25-75-03/2017).

tax on dividends, Malaysia's DTAs also reflect this tax-exempt position. DTAs generally do lower the withholding tax rates set out in the ITA, but rarely significantly. For example, most of Malaysia's DTAs prescribe a withholding tax rate for interest payments at 15 per cent (the rate in the ITA) or 10 per cent.<sup>70</sup>

### ***Recent changes to and outlook for treaty network***

On 24 January 2018, Malaysia signed the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). Instead of renegotiating each of Malaysia's DTAs individually, the MLI enables signatories such as Malaysia to incorporate treaty-related measures to counter BEPS into its existing DTAs. Accordingly, a new Section 132C of the ITA was subsequently enacted to give effect to Malaysia's international tax obligations under the MLI.<sup>71</sup> Malaysia has yet to ratify the MLI, meaning that its MLI position provided at the time of signing could differ from its definitive position upon ratification.

## **IV RECENT CASES**

### **i Perceived abuses**

Malaysian courts have recognised the permissibility of tax mitigation to minimise the incidence of tax, however, transactions or business structures should not fall within the ambit of a tax avoidance scheme under Section 140 of the ITA.<sup>72</sup> If the dominant purpose of a transaction has no commercial purpose, that transaction will be disregarded or varied on the basis of tax avoidance by the IRB.<sup>73</sup>

In *Syarikat Ibraco-Peremba*,<sup>74</sup> the taxpayer had concocted a series of elaborate transactions to avoid paying income tax on the profits made from the sale of a land it developed. The taxpayer was a property development company. Profits arising from the sale of developed properties would be treated as the taxpayer's business income and subject to income tax. On the advice of its tax consultant, the taxpayer first incorporated a subsidiary company and after selling the lands to the subsidiary, entered into a contract with it to develop the lands. Upon completion of the project, the taxpayer then sold its shares in the subsidiary company to a related company and the subsidiary company subsequently sold the developed lands to third parties. The subsidiary and related companies were then wound up.

The Court of Appeal held that the taxpayer clearly obtained the tax advice for the primary purpose of ordering the transactions in a manner to minimise tax. Although Section 140 did not explicitly state that the IRB has the power to disregard a series of transactions, as opposed to a single transaction, in looking at tax avoidance schemes that comprised a number of specific transactions, the genuineness or otherwise of each individual step or transaction need not be looked at from each individual step or transaction but had to be looked at as a whole.

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70 <http://lampiran1.hasil.gov.my/pdf/pdfam/DoubleTaxationAgreementRates.pdf>

71 Section 9 Income Tax (Amendment) Act 2018.

72 See *Sabah Berjaya Sdn Bhd v. Ketua Pengarah Jabatan Hasil Dalam Negeri* [1999] 3 MLJ 145.

73 See *Syarikat Ibraco-Peremba Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* (2014) MSTC 30-084, *SBP Sdn Bhd v. Director General of Inland Revenue* (1988) 1 MSTC 2,053, and *Labad Datu Timber Sdn Bhd v. Director General of Inland Revenue* [1981] 2 MLJ 97.

74 *Syarikat Ibraco-Peremba Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* (2014) MSTC 30-084.

Thus, taxpayers should be ready to demonstrate that any series of transactions that they enter into are not merely for tax-saving purposes.

## ii Recent successful tax-efficient transactions

In *Ensko Gerudi*,<sup>75</sup> the taxpayer had been providing offshore drilling services to the petroleum industry in Malaysia for 18 years. The taxpayer, however, does not own any drilling rigs. It would enter into a leasing agreement on a bareboat charter basis with a rig owner within the Ensko Group. One of the rig owners then decided to incorporate a Labuan company to facilitate easier business dealings for the taxpayer. Pursuant to the approvals granted by the Labuan Offshore Financial Services Authority and Bank Negara Malaysia, the taxpayer entered into an agreement with the Labuan company for the leasing of rigs. Unlike previous transactions of the taxpayer to lease the drilling rigs, the payments made to the Labuan company did not attract withholding tax. The IRB in imposing Section 140 of the ITA contended that, among others, the Labuan company had no economic or commercial substance and that the purpose of the transaction was to benefit from the tax incentives provided.

The High Court in deciding in favour of the taxpayer held that there was nothing artificial about the payments and the transactions were within the meaning and scope of the arrangements contemplated by the government in openly offering incentives. The ultimate question was whether the impugned arrangement viewed in a commercially and economically realistic way makes use of the specific provision in a manner that was consistent with Parliament's intention. The High Court recognised that taxpayers have the freedom to structure transactions to their best tax advantage.

Hence, in light of *Syarikat Ibraco-Peremba* and *Ensko Gerudi*, businesses should ensure that their business structures and transactions fulfil the requirements of the law and that there are genuine commercial reasons behind the transactions or arrangement.

## V OUTLOOK AND CONCLUSIONS

Malaysia's Finance Minister recently announced that the Inland Revenue Board of Malaysia will raise its income tax collection target to more than 150 billion ringgit for 2019,<sup>76</sup> a target that is bolstered by the introduction of the IRB's Special Program for Voluntary Disclosure from 3 November 2018 to 30 June 2019. As can be surmised from the recent legislative amendments highlighted above, Malaysia is keen to reduce any tax leakages from profit shifting as well as domestic tax inefficiencies. In light of this tax environment, MNEs and taxpayers are encouraged to seek legal advice when conducting tax planning to ensure proper compliance with the new legislation, while managing tax risks at the same time.

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75 *Ensko Gerudi (M) Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* (unreported).

76 IRB to raise income tax collection target to above RM150b in 2019 (1 March 2019) The Edge Markets [www.theedgemarkets.com/article/irb-raise-income-tax-collection-target-above-rm150b-2019](http://www.theedgemarkets.com/article/irb-raise-income-tax-collection-target-above-rm150b-2019).

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