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SECTION 109DA INCOME TAX ACT 1967 (ITA) AND RETAIL MONEY MARKET FUNDS: GROSS OR NET — WHAT IS THE CORRECT WITHHOLDING TAX BASE?

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Background

The tax treatment of Retail Money Market Funds (**RMMFs**) in Malaysia has undergone significant changes over the past decade, largely driven by the tax exemption granted to unit trust funds investing in money market instruments. Historically, a non-individual investor deriving interest income directly from money market instruments would be subject to tax. However, where the same investment is made through a unit trust structure, the income may be exempt at the fund level, with distributions to investors correspondingly exempt.

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The introduction of Section 109DA of the Income Tax Act 1967 (**ITA**) in 2022 sought to address this disparity by imposing withholding tax on distributions from RMMFs to non-individual investors. The central controversy that has since arisen concerns the determination of the amount on which withholding tax is properly chargeable under Section 109DA — namely, whether it is the gross distribution or the net distribution. The Inland Revenue Board (**IRB**) has issued Practice Note 1/2026[1] to publicly state its administrative position on the matter, following several audits of RMMFs.

At the outset, it ought to be observed that Practice Note 1/2026 is not a Public Ruling issued pursuant to Section 138A of the ITA, nor does it constitute guidelines issued under Section 134A. It reflects the IRBM's administrative position but does not itself amend the legislation or conclusively determine its proper interpretation. A taxpayer may therefore, after obtaining advice and having regard to the attendant audit and litigation risks, take a different position that it considers better supported by the statutory language and relevant authorities.

IRB's Position

In summary, Practice Note 1/2026 takes the position that withholding tax under Section 109DA of the ITA is to be imposed on the gross amount of income attributable to the unit holder, as reflected in Column (1) of the distribution statement, rather than the net amount actually distributed.

The IRB's position **appears to** rest on the following grounds:

- Section 61(1A) of the ITA provides that a unit holder is to be assessed on an amount determined by reference to the unit holder's share of the total income of the unit trust fund that is distributed to the unit holder;

- the expression "total income" in Section 61(1A) is interpreted by the IRB as referring to the fund's gross income (in this context, interest income exempt under paragraph 35A of Schedule 6 to the ITA); and

- Section 109DA, read with Part XIX of Schedule 1 to the ITA, imposes withholding tax at the rate of 24% of the gross amount of interest income distributed by an RMMF to non-individual unit holders, notwithstanding the fund-level exemption under paragraph 35A of Schedule 6 to the ITA.

[1] Practice Note No. 1/2026 'Explanation on Tax Treatment for Reporting Income Based on Profit Distribution Vouchers of Retail Money Market Funds' (RMMF), accessible here: https://www.hasil.gov.my/wp-content/uploads/practice-note-no-1-2026-tax-treatment-for-reporting-income-based-on-profit-distribution-vouchers-of-rmmf.pdf

Analysis and Our View

At the outset, it is necessary to identify the governing principles of statutory interpretation. It is well established that tax legislation is to be strictly construed. However, “strictly” in this context does not mean in favour of the revenue — it means strictly in accordance with the actual words of the statute, without extension or implication. Applying those principles, there are, in our view, reasonable grounds to question whether the IRB’s position as set out in Practice Note 1/2026 is correct as a matter of law.

1. **First**, a critical distinction may be drawn between income that is “attributable” to a unit holder and income that is “distributed” to that unit holder. Income attributable represents the unit holder's proportionate share of the fund’s gross income. However, this is not necessarily the same as the amount available for distribution, as the fund necessarily incurs operating expenses in generating that income. Section 109DA expressly applies to income “distributed or credited”, and it is accordingly arguable that the relevant tax base ought to be the amount actually distributed, rather than the gross income attributable to the unit holder.

2. **Second**, Section 61(1A) and Section 109DA may arguably be said to serve distinct functions and ought not to be conflated. Section 61(1A) governs the computation of income to be assessed in the hands of the unit holder, by reference to the fund's total income. Section 109DA, in contrast, governs the mechanism of withholding tax, which is triggered on amounts paid or credited to the investor. These provisions arguably operate at different stages of the tax framework, and it may not be appropriate to use the former to determine the tax base for the purposes of the latter.

3. **Third**, the IRB’s interpretation may produce an economic distortion that is arguably not consistent with legislative intent. Imposing withholding tax on the gross income attributable — rather than the net amount distributed — would result in taxation on amounts that the investor does not economically receive. This is further compounded by the fact that the investor is not entitled to claim a deduction for the underlying expenses incurred by the fund, as those expenses are not incurred by the investor directly. Consequently, the result may be an effective over-taxation of the investment return, which is arguably inconsistent with fundamental tax principles and may undermine neutrality between direct and indirect investment in money market instruments.

Our Conclusion

For the reasons set out above, it is our view that there are reasonable grounds to question whether the IRB's interpretation of Section 109DA is correct as a matter of law.

A more defensible interpretation, in our view, is that withholding tax under Section 109DA ought to apply to the amount actually distributed or credited to the investor, which is consistent with both the language of the provision and the general principles governing withholding tax regimes.

The IRB's approach — which effectively subjects gross income attributable to the unit holder, rather than the net amount distributed, to withholding tax — may produce manifest economic distortions, and may be difficult to reconcile with the foundational principles of income tax law. There remain reasonable grounds for an alternative interpretation based on the statutory wording. Until judicial guidance is available, the appropriate withholding tax base under Section 109DA may remain a matter of legitimate controversy.

Taxpayers who have deducted and remitted withholding tax on the gross attributable amount in reliance on Practice Note 1/2026 should be mindful that the Practice Note does not carry the force of law and that the correct legal position may ultimately be determined differently by the courts. Taxpayers who wish to adopt a position consistent with the analysis set out above should nonetheless be prepared for the possibility of an audit challenge by the IRB and are strongly advised to seek specific legal advice before doing so.

This publication was co-authored by **Jason Tan Jia Xin** and **Chris Toh Pei Roo** of LHAG's Tax, Customs and Trade Practice Group, together with **Mark Chan**, Group Tax Leader of Folks DFK Group.

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