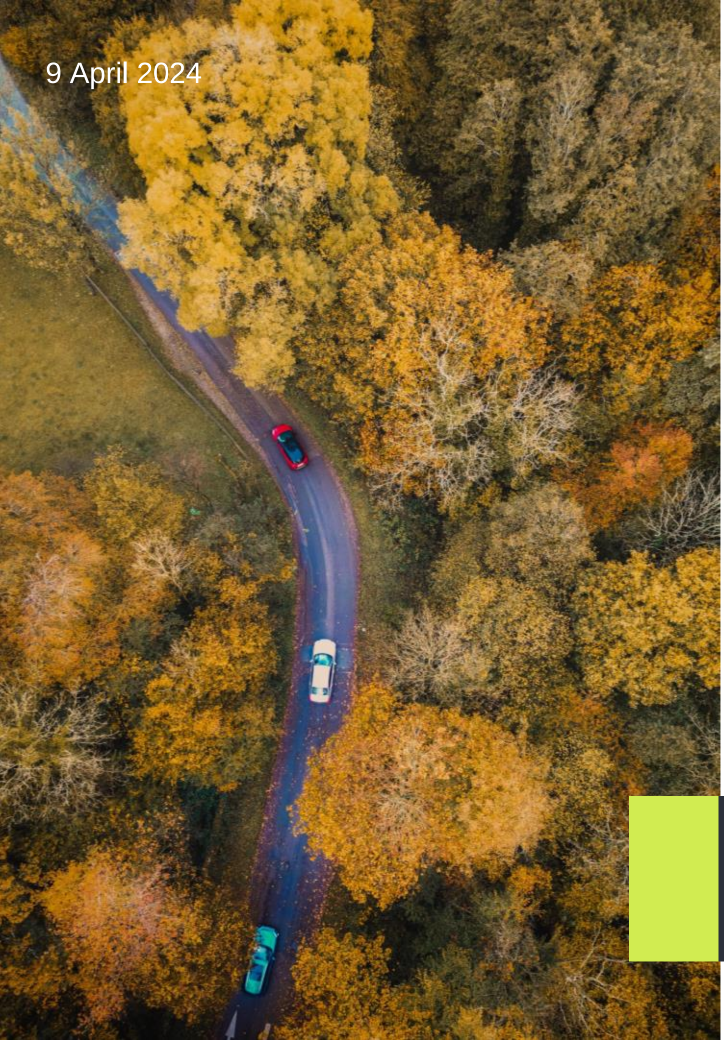
9 April 2024



TaxSnaps

Capital Gains Tax ("CGT") and 'economic substance'!

(Part 2)

Following our earlier TaxSnaps on CGT on 22 February 2024 (click HERE) and 12 March 2024 (click HERE), the Inland Revenue Board of Malaysia ("IRBM") has issued Guidelines recently, in connection with tax treatment on gains from disposal of foreign capital assets received from outside Malaysia.

Let us go through the salient points from the said Guidelines.

continued…

Disposal of capital assets situated outside Malaysia

Chargeable Person and CGT Rate

Gains from the disposal of all types of foreign capital assets received in Malaysia by the following resident chargeable persons are subject to CGT –

- Company
- Limited liability partnership
- Trust body
- Co-operative society

Effective Date : From 1 January 2024

Gains from the disposal of capital assets situated outside Malaysia are considered as taxable income under section 4(aa) of the Income Tax Act 1967 ("ITA") and are subject to the prevailing tax rate. For example, the general prevailing tax rate for company is 24%. However, such gains **must be received in Malaysia** to be taxable.

The recent Guidelines on **Tax Treatment On Gains From The Disposal Of Foreign Capital Assets Received From Outside Malaysia** ("the Guidelines") (click HERE) issued by the IRBM, states that "received in Malaysia" means transferred or brought into Malaysia whether in the form of cash or through electronic funds transfer, or both.

Income Tax (Exemption) (No. 3) Order 2024 and the Guidelines

CGT exemption is available on gains from the disposal of capital assets situated outside Malaysia which is received in Malaysia. The exemption shall include the following conditions (in addition to other conditions as specified in the Guidelines) –

- employ an adequate number of employees in Malaysia; and
- incur an adequate amount of operating expenditures in Malaysia.

Exemption Period : From 1 January 2024 to 31 December 2026

The Guidelines provide more information on the above economic substance requirements as follows –

- employ adequate number of employees **with necessary qualifications to carry out the specified economic activities*** in Malaysia; and
- incur adequate amount of operating expenditure **for carrying out the specified economic activities*** in Malaysia.

** Specified economic activities means -*

- *Investment holding entity*
  - *Holding and managing its equity participation in other entities; OR making necessary strategic decisions in respect of any assets the entity acquires, holds or disposes of; and managing and bearing principal risks in respect of such assets.*
- *Other than investment holding entity*
  - *In the case of chargeable persons carrying out a trade, profession or business in Malaysia, it refers to the business operations carried out.*

Disposal of capital assets situated outside Malaysia

Income Tax (Exemption) (No. 3) Order 2024 and the Guidelines *(cont'd)*

The Guidelines goes on to state that due to the different operating methods between industries, the determination of any minimum threshold value for the appropriate economic substance requirements would be based on the facts of a case.

Factors to be considered will include the following –

- the number of employees, by considering the type of activity involved;
- whether the employee is full-time or part-time; and
- whether the office premises have been used to carry out the related activities; and are sufficient for those activities.

Service Director

A service director who is employed based on a contract of service can be considered as an employee.

Outsourcing of specified economic activities

Outsourcing of specified economic activities to an outsourcing entity is permissible if conditions are met as follows –

- The specified economic activities are carried out in Malaysia;
- The taxpayer implements sufficient monitoring and control;
- The outsourcing entity is generally expected to charge the taxpayer (subject to the transfer pricing rules) for the specified economic activities carried out;
- The number of employees and operating expenses incurred by the outsourcing entity is equivalent to the level of specified economic activities carried out; and
- There is no double counting if the outsourcing entity provides services to more than one taxpayer.

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Disposal of capital assets situated outside Malaysia

Other selective points from the Guidelines

- Gains from the disposal of foreign capital assets received in Malaysia that are subject to CGT refer to the **disposal of foreign capital assets that occur on or after 1 January 2024**.
- The following are examples of foreign capital assets situated outside Malaysia –
    - Immovable and movable properties that are physically situated outside Malaysia.
    - Intellectual property rights situated outside Malaysia.
    - Shares issued by a company incorporated outside Malaysia, etc.
- In determining the gains from the disposal of foreign capital assets that are subject to CGT, expenses wholly and exclusively incurred for the acquisition and disposal of capital assets are allowable as provided for under the provisions of section 65E of the ITA.
- Bilateral or unilateral tax credit is available under the provisions of sections 132 and 133 of the ITA for gains from the disposal of foreign capital assets received in Malaysia that are also chargeable to tax outside Malaysia.
    - The resident chargeable person must keep records that foreign tax has been imposed on that particular income, if claiming such tax credits.
    - Any claim for tax credits in a year of assessment ("YA") must be made in writing to the Director General of Inland Revenue not more than 2 years after the end of that YA.
- Tax reporting and record keeping–
    - Gains from the disposal of foreign capital assets received in Malaysia in the basis period for a YA must be **reported in the Income Tax Return Form**.
    - Taxpayer must report and keep records for the following –
        a. type and amount of foreign income;
        b. country where the income arises;
        c. amount of tax imposed by the foreign country; and
        d. any information to be determined other than the above (a) to (c).

Let us be of assistance to you

Do reach out to our team of tax experts for a discussion. As CGT is new in Malaysia, our team at Baker Tilly Malaysia would be able to provide professional advice on certain areas of CGT that require further analysis. For example, it would be advisable to study the CGT impact before remittance into Malaysia of foreign-sourced capital gains arising from disposal of all types of capital assets situated outside Malaysia.

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