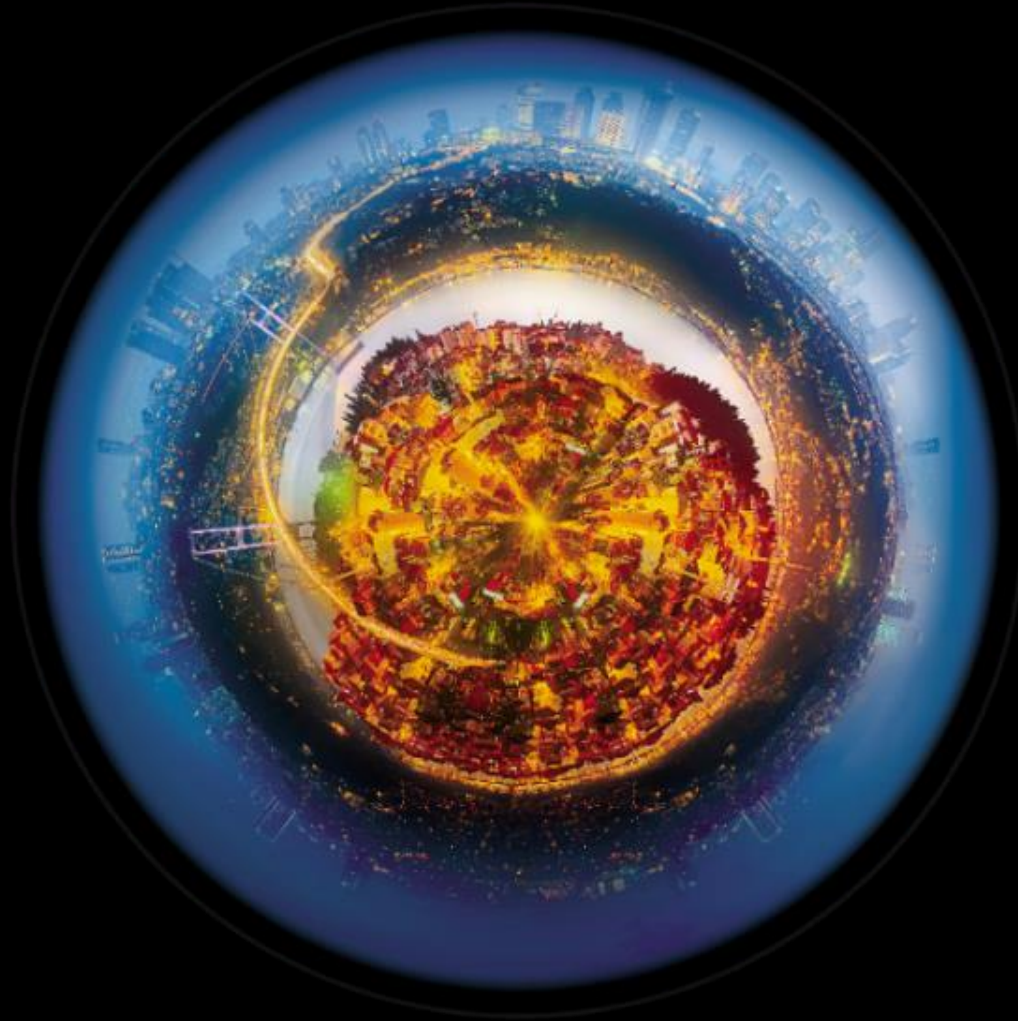


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**Malaysian Dutch Business Council (MDBC)
Burning International Tax Issues**

3 April 2017

Withholding tax

WHT - Introduction

- ❖ Imposed on non-residents deriving income from Malaysia.
- ❖ The payer is responsible for the payment of tax.
- ❖ Withholding tax – method of payment through withholding mechanism.
- ❖ Imposed on:
 - a. Interests.
 - b. Royalties.
 - c. Rental of moveable property.
 - d. Technical service fees/management fees
 - e. Installation fees.

WHT – Special Classes of Income

As per Paragraph 4A(i) of the ITA 1967:

Amount paid in consideration of services rendered by the non-resident person or his employee in connection with –

- a) the use of property or rights belonging to him, or*
- b) the installation or operation of any plant, machinery or other apparatus purchased from him.*

Examples

- ❖ Provision of personnel for advisory or supervisory services;
- ❖ Installation and commissioning services.

WHT – Special Classes of Income (cont'd)

As per Paragraph 4A(ii) of the ITA 1967:

Amounts paid to NR person in consideration of technical advice, assistance or service rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme

Examples

- ❖ Management or marketing services;
- ❖ Consultancy services;
- ❖ Legal services in connection with a debt or agency department;
- ❖ Inter-company technical service;
- ❖ Specially-tailored training course.

WHT – Special Classes of Income (cont'd)

- ❖ Derivation of special classes of income [Sec15A, ITA 1967]
 - a) Payer - Government, State Government or Local Authority;
 - b) Payer - Resident Person; and
 - c) Payment made charged as an outgoing or expense against any income from Malaysia.
- ❖ Tax rate at 10%
- ❖ Technical fees Article in the respective DTA (Preferential rate will apply)
- ❖ To be eligible for the preferential rate, a letter from the Revenue Authority of the relevant country confirming the resident status of the payee should be submitted.

Payments To Non-resident Contractors – [Sec 107A]

- ❖ Payments by residents to non resident contractors for services under a contract, on the services portion of the contract.
- ❖ Subject to withholding tax of 13% (10% tax in respect of the contractor and 3% tax in respect of the employees of the contractor).
- ❖ To allow the collection at source of tax due by non resident contractors and professionals firms engaged in services under a contract.
- ❖ This tax is not final and will be refunded to the contractor in the following circumstance:
 - a) The 10% withholding tax (on service portion) will be offset against the contractor's own tax liability of the overall contract and any excess will be refunded upon finalisation of the tax affairs of the contractor for that year; and
 - b) The 3% portion will be refunded when the returns of the employees of the contractor have been submitted to the tax authorities and the tax settled.

Re-imposition of Malaysian withholding tax on offshore services:

One step forward, two steps
back?

Re-imposition of Malaysian withholding tax on offshore services:

One step forward, two steps back?

21 October 1983

Sections 4A and 15A were introduced

Payment to non-resident under Sections 4A(i) and 4A(ii) is subject to withholding tax

21 September
2002

Section 15A were amended

Payment to non-resident under Sections 4A(i) and 4A(ii) is subject to withholding tax if **services are performed in Malaysia**

Finance Bill 2016

Payment to non-resident is subject to withholding tax irrespective of where the services are performed

Re-imposition of Malaysian withholding tax on offshore services (cont'd):

One step forward, two steps back?

Issues and challenges

- ❖ **Why re-imposition?**
- ❖ **Determination of effective date:**
 - a) Invoice date?
 - b) Date of service agreement?
 - c) Payment date?
 - d) Date when services were rendered?
- ❖ **Transitional issue:**
 - a) Contract signed earlier

Clarification on new law effective from 17 January 2017

Services rendered on	Services performed	Payment made on	Subject to S109B?
01/12/2016 to 31/12/2016	Outside Malaysia	Dec 2016	No
01/07/2016 to 30/06/2017	Outside Malaysia	July 2017	Yes (from 17/01/2017)
01/07/2016 to 31/10/2016	Outside Malaysia	Feb 2017	No
01/01/2017 to 31/01/2017	Outside Malaysia	Dec 2016	Yes

Value of services performed in or outside Malaysia to be ascertained in a manner that is fair, reasonable and justifiable.

Issues and challenges – Technical Services

Particulars	Malaysian ITA 1967	Malaysia - Singapore DTA	Malaysia - Netherland DTA
Definition	<p>(i) amounts paid in consideration of services rendered by the person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;</p> <p>(ii) amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;...</p>	<p>Payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of a technical, managerial or consultancy nature.</p>	<p>Payments of any kind to any person, other than to an employee of the person making the payments, in consideration for any services of a technical, managerial or consultancy nature.</p>
Rate of withholding tax	10%	5%	8%

Issues and challenges – Technical Services (Cont'd)

Particulars	Malaysian ITA 1967	Malaysia - Singapore DTA	Malaysia - Netherland DTA
<p>Taxing right</p>	<p>Both onshore and offshore services are subject to withholding tax in Malaysia.</p>	<p>1. Technical fees derived from one of the Contracting States (M'sia) by a resident of the other Contracting State (SG) who is the beneficial owner thereof may be taxed in the first-mentioned Contracting State (M'sia)...</p> <p>4. Technical fees shall be deemed to arise in a Contracting State (M'sia) when the payer is a <u>resident of that State (M'sia) and the services are performed in that State (M'sia)</u>...</p>	<p>1. Fees for technical services arising in a Contracting State (M'sia) and paid to a resident of the other Contracting State (ND) may be taxed in that other State (ND).</p> <p>2. However, such fees for technical services may also be taxed in the Contracting State (M'sia) in which they arise and according to the laws of that State (M'sia),...</p> <p>6. Fees for technical services shall be deemed to arise in a Contracting State (M'sia) when the payer is a resident of that Contracting State (M'sia).</p>
<p>Claim of double taxation relief</p>	<p>√</p>	<p>√</p>	<p>√</p>

Malaysia – Netherland DTA

Type of income	DTA rate	Malaysian domestic rate
Interest	10%*	15%
Royalty	8%*	10%
Technical service fees	8%*	10%

*The Netherland resident should be beneficial owner of the interest, royalty or technical fees i.e he has the right to use and enjoy the interest, royalty or technical fees, unconstrained by a contractual or legal obligation to pass on the payment received to another person.

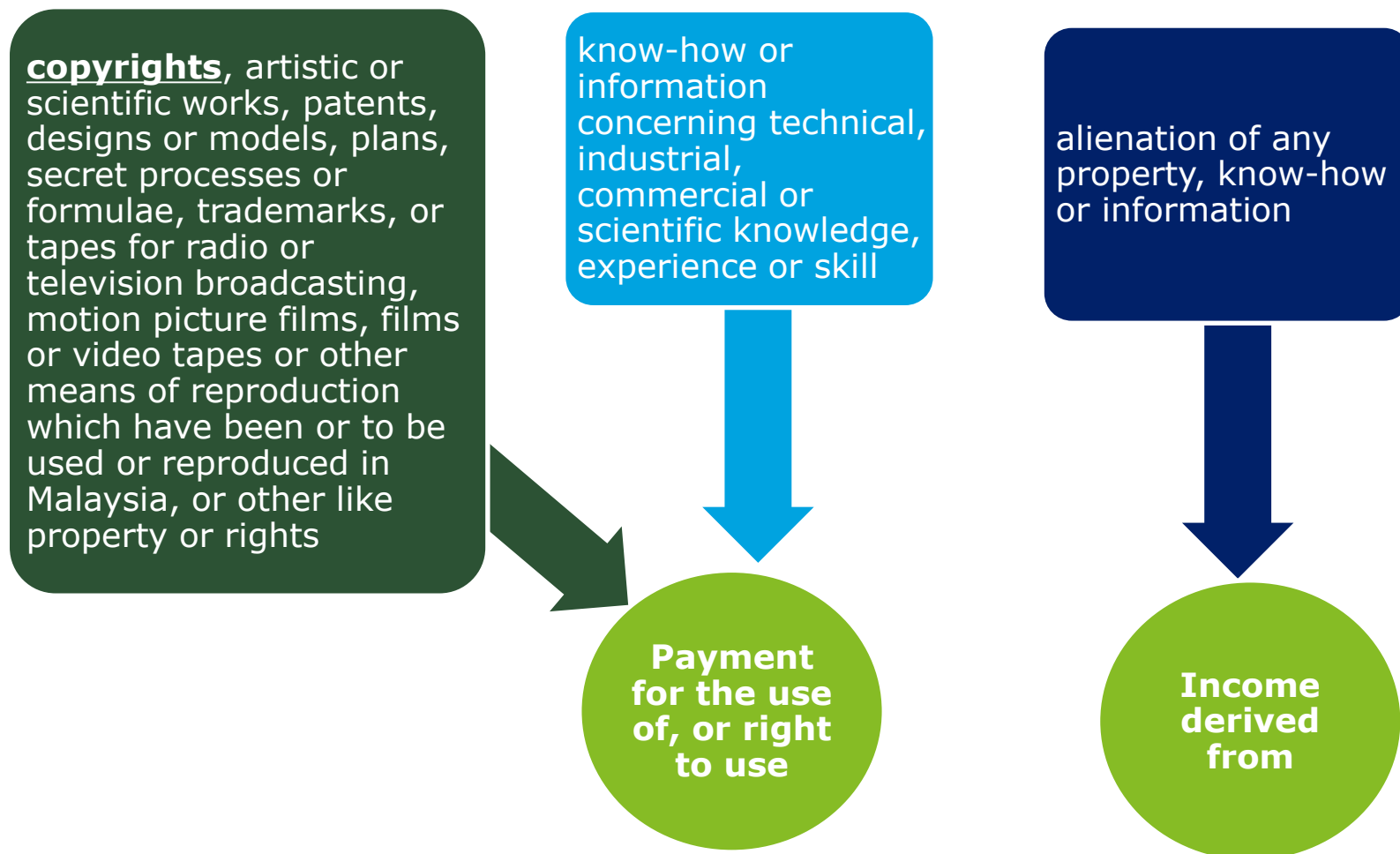
*In case, the payment is made by Malaysian company for interest, royalty or technical service fees to a Netherland company with whom it has a **special relationship** and the payment exceeds the **arm's length price**, then: -

- (i) excess payment will be denied deduction and
- (ii) treaty rate is applicable to the amount which is at arm's length.

Redefinition of royalty: Alignment with international practice?

Redefinition of “royalty”

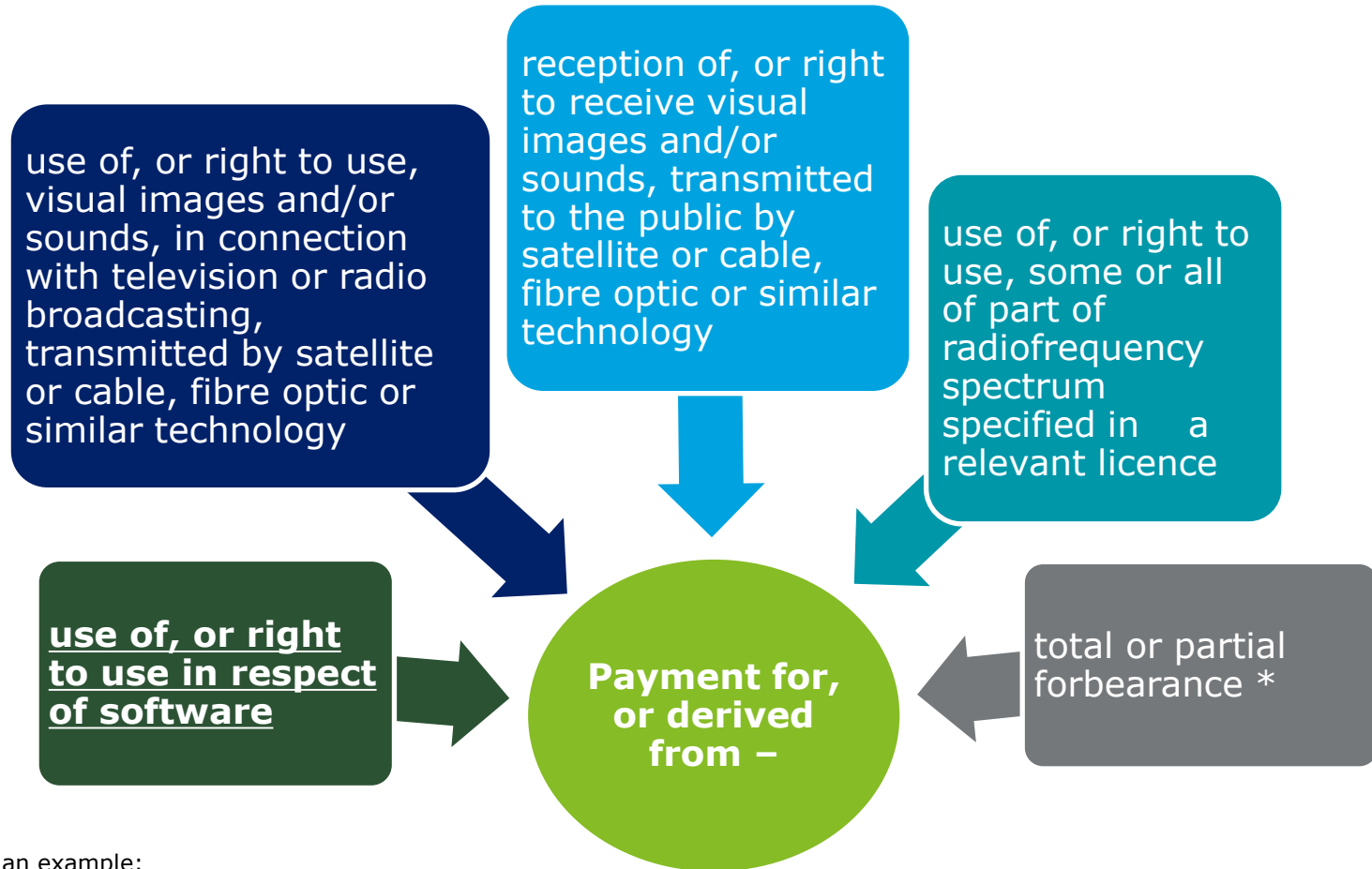
Existing Section 2, Income Tax Act 1967



Redefinition of "royalty" (cont'd)

New definition - coming into operation of Finance Act 2016

- Additional items



Australian example:

* E.g. 1. Payment for the owner of an industrial process / technology acquired so as not to make the industrial process / technology available to any other person.

E.g. 2. Payment to prevent another person obtaining a dealer franchise.

Redefinition of “royalty” (Cont’d)

Payment for software – The saga continues

Existing local law	Proposed local law	MY-SG DTA	MY-JP DTA
Any sums paid as consideration for the use of, or the right to use (i) <u>copyright</u>	Any sum paid as consideration for, or derived from (a) The use of, or the right to use in respect of any copyrights, <u>software</u> ,	Payments of any kind received as a consideration for the use of, or the right to use, any <u>copyright</u>	Payments of any kind received as a consideration for <u>the use of, or the right to use, any copyright</u> of literary, artistic or scientific work including <u>software</u>

- Copyright vs copyrighted item
- OECD’s position – Commentaries on Article 12
- Non-member’s position – Malaysia’s position on commentaries to Article 12 (i.e. license fees for rights to distribute software constitutes royalty)

Redefinition of “royalty”

Payment for software – The saga continues

- Comparison between countries

Countries	Australia (OECD Member)	Denmark (OECD Member)	France (OECD Member)	Germany (OECD Member)	Japan (OECD Member)	Philippines (Non-OECD Member)	Singapore (Non-OECD Member)
Does the definition of royalty under the income tax legislation specially include payment for use or the right to use software?	No	No	No	No	No	No	No
Does the income tax legislation differentiate “use of copyright” (i.e. royalty, hence subject to WHT) from “use of copyrighted item” (i.e. non royalty, hence not subject to WHT)?	Yes	N/A (No WHT on software at all)	N/A (No WHT on software at all)	Yes	Yes	Yes	Yes
Does payment for the use of software or the right to use software fall under the definition of royalty?	Yes, but only if there is an element of commercial exploitation (e.g. reproduction, modification, etc.)	No	No	Yes, but only on non-standard software	Yes, but only if there is an element of commercial exploitation	Yes, but only if there is an element of commercial exploitation	Yes, but only if there is an element of commercial exploitation

Penalty and Key impacts of the amendment of withholding tax provision

Offences and Penalties - ITA 1967

Provision of the Tax Laws	Penalty charge and rate
Incorrect tax returns Subsection 113(1)/ Subsection 113(2)	<ul style="list-style-type: none"> • Conviction, fine RM1,000 to RM10,000; • Conviction, special penalty 200% of the tax undercharged; • No conviction, penalty 100% of the tax undercharged.
Wilful Evasion Section 114	<ul style="list-style-type: none"> • Conviction, fine RM1,000 to RM20,000 or imprisonment up to 3 years or both; • Conviction, special penalty 300% of the tax undercharged.
Failure to keep Records Section 119A	<ul style="list-style-type: none"> • Conviction, fine RM300 to RM10,000 or imprisonment up to 1 year or both. • The chargeable income of the company may be determined according to the best judgement of the Director General.
10% Penalty Section 107A(2), 109(2), 109B(2), 109F(2)	<ul style="list-style-type: none"> • When the payer fails to remit the withholding tax to the DG within one month after payment, the amount which he fails to pay shall be increased by 10% penalty based on the amount which he failed to pay.

Key impacts of the amendment of withholding tax provision from the Finance Act 2017

- Application for withholding tax exemption?
- Short time window for preparation – 30 days?
- Training and getting the staff ready to handle withholding tax administration and compliance matters;
- Planning and understand the withholding tax rates for types of payment to non-resident (countries with DTA and without DTA, type of payment);
- Review of current contract with non-residents;
- Pricing negotiations / strategy;
- Cash flow impact; and
- System change/configuration to identify and flag payment which is subjected to withholding tax.



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