



Tax Whiz

Tax highlights from your advisers

Guidelines on tax treatment in relation to income which is received from abroad



KPMG in Malaysia

12 October 2022

Taxation of foreign source income

With the amendment to Paragraph 28, Schedule 6 of the Income Tax Act, 1967 (“the Act”), effective 1 January 2022, the income tax exemption on foreign source income received in Malaysia by a resident person has been repealed. However, the Income Tax (Exemption) (No. 5) Order 2022 and Income Tax (Exemption) (No. 6) Order 2022 provide the following exemptions, for a period of 5 years until 31 December 2026:

Category of Resident Taxpayers	Type of Foreign Income Exempted
Individuals	All classes of income under Section 4 of the Income Tax Act, 1967 (excluding a source of income from a partnership business in Malaysia)
<ul style="list-style-type: none"> Companies incorporated or registered under the Companies Act 2016 Limited Liability Partnerships (“LLPs”) registered under the LLPs Act 2012 Individuals who brought into Malaysia foreign sourced dividends in relation to a partnership business in Malaysia (excluding those carrying on the business of banking, insurance, or sea or air transport)	Dividend income

The following conditions have been imposed in order to enjoy the above exemption:

- The income exempted must have been subjected to tax of a similar character to income tax in the country of origin;
- For foreign dividend income, other than dividends received by an individual, the headline tax rate in the country of origin must be at least 15%; and
- Comply with the conditions indicated in the guidelines issued by the Malaysian Inland Revenue Board (“MIRB”).



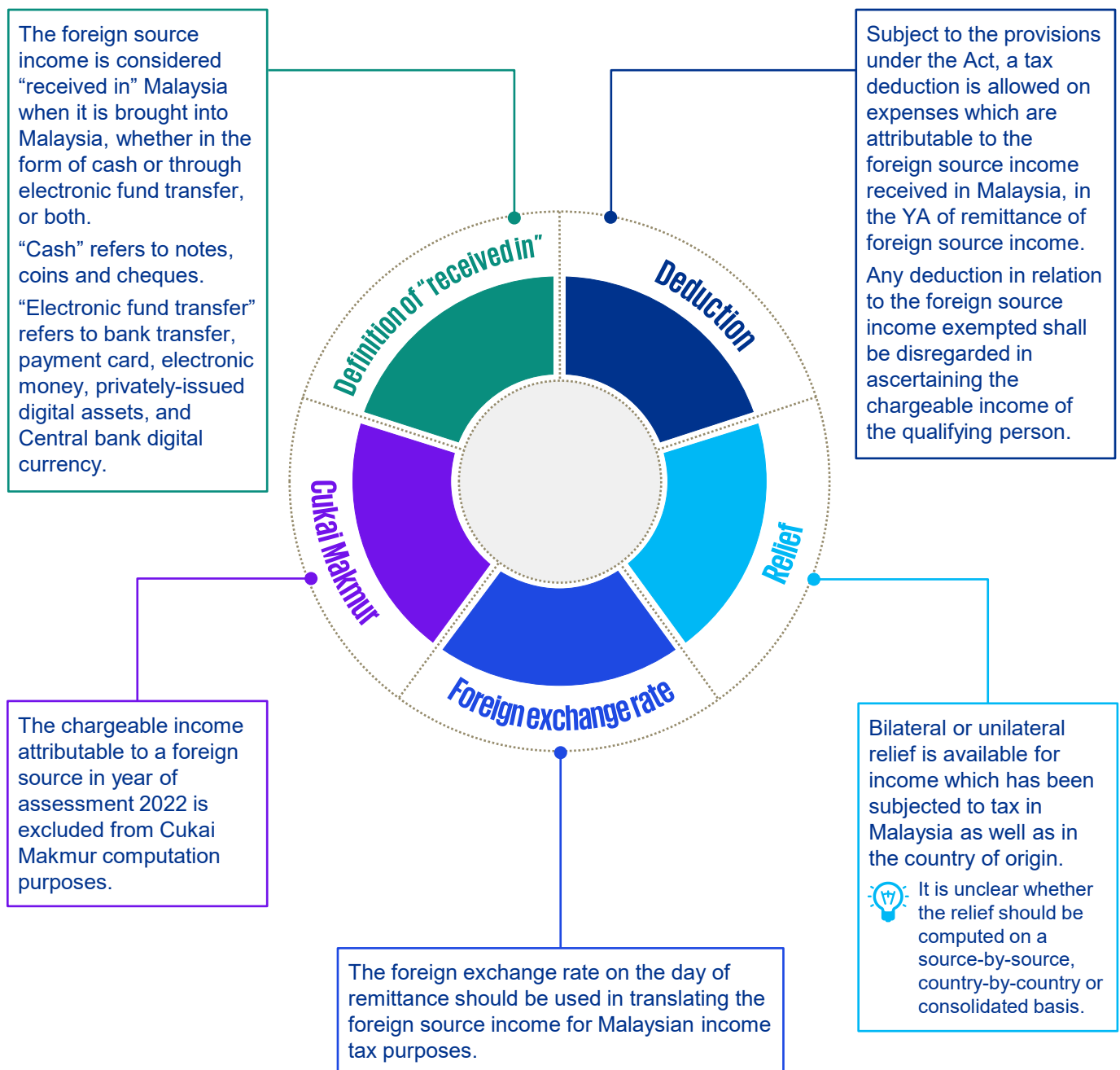
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Guidelines in relation to income which is received from abroad

Further to the issuance of the Exemption Orders, the MIRB has released the “Guidelines on Tax Treatment in relation to Income which is Received from Abroad” on 29 September 2022.

The above Guidelines explain what constitutes foreign source income and how it would be taxed or exempted in Malaysia, as well as any deductions or relief available. The notable points from the Guidelines are set out as follows:



Conditions for the exemption of foreign dividend income

Foreign dividend income received in Malaysia by companies, LLPs as well as individuals in relation to a partnership business (as defined)

01

The income exempted must have been subjected to tax of a similar character to income tax in the country of origin

- Income tax or withholding tax has been paid / is payable in the country of origin; or
- The foreign dividend has been subjected to underlying tax; or
- The underlying profit, out of which foreign dividends have been distributed, is not subjected to tax due to any of the following reasons:
 - ✓ Unutilised business loss or unabsorbed capital allowance
 - ✓ Capital gains
 - ✓ The tax rules under tax consolidation regime
 - ✓ Enjoyment of tax incentive which complies with the substantive requirements in that country

Underlying tax is the income tax charged in the jurisdiction of the payer company on its profits out of which dividends have been distributed. If the payer company paid the dividend out of a dividend it received from another company, the underlying tax paid by that other company is not to be considered as tax paid or payable by the payer company for the purpose of this condition.

02

The headline tax rate in the country of origin must be at least 15%

- It refers to the highest corporate income tax rate in the country of origin in the year where the foreign dividend income is subject to tax in the country of origin.
- It is not necessarily the actual income tax rate being charged on the foreign dividend income.

Conditions for the exemption of all foreign source income

Foreign source income (which is not from a partnership business) received in Malaysia by resident individuals

01

The income exempted must have been subjected to tax of a similar character to income tax in the country of origin

- Income tax or withholding tax has been paid / is payable in the country of origin; or
- No tax has been charged in the country of origin due to the following reasons:
 - ✓ The foreign income is not subjected to tax under the tax system
 - ✓ The foreign individual income has not reached the minimum threshold to be subjected to tax
 - ✓ The foreign income is exempted due to a tax incentive
 - ✓ The foreign dividend income has been subjected to underlying tax
- The underlying profit, out of which foreign dividends have been distributed, is not subjected to tax due to any of the following reasons:
 - ✓ Unutilised business loss or unabsorbed capital allowance
 - ✓ Capital gains
 - ✓ The tax rules under tax consolidation regime
 - ✓ Enjoyment of tax incentive which complies with the substantive requirements in that country

Underlying tax is the income tax charged in the jurisdiction of the payer company on its profits out of which dividends have been distributed. If the payer company paid the dividend out of a dividend it received from another company, the underlying tax paid by that other company is not to be considered as tax paid or payable by the payer company for the purpose of this condition.

Bilateral or unilateral relief

Where the same income is subject to both Malaysian and foreign tax, a tax credit in the form of bilateral relief under a Double Tax Agreement (“DTA”) or unilateral relief under the domestic law (if there is no available DTA or if the DTA does not contain such relief Article) may be given on such income to eliminate or minimize double taxation.

Determining the Malaysian Tax Charged on the Foreign Source Income

The relief article of the relevant DTA or Schedule 7 of the Act shall be referred to in computing the bilateral or unilateral relief. Generally, the bilateral or unilateral credit allowed shall not exceed the total amount of Malaysian tax charged on that foreign income.

- a) For taxable foreign source income received in Malaysia within the first half of year 2022, the Malaysian tax payable, in computing bilateral or unilateral relief, would be 3% of gross amount remitted.
- b) For taxable foreign source income received in Malaysia on or after 1 July 2022, the attributable Malaysian tax payable should be determined using the general formula as follows:

Foreign income (statutory income)			Malaysian tax payable before bilateral / unilateral credit
	X		
Total income			

The “total income” and the “Malaysian tax payable before bilateral / unilateral credit” should exclude the amount relating to foreign source income received in Malaysia during the first half of year 2022.



Foreign source income derived in more than one YA is received in Malaysia

The taxpayer is required to determine the YA the foreign source income received in Malaysia is related to. The following will need to be matched with that particular foreign source income:

- a) the foreign tax suffered for bilateral / unilateral relief claim; and
- b) the attributable expenses incurred for tax deduction claim.

The burden of proof is on the taxpayer in the event of a tax audit.

What's next?



Tax Impact on Change of Law

Review the tax impact on remittance of any taxable foreign source income from outside Malaysia into Malaysia, including foreign investment structures. This is particularly important for revising the estimated tax payable for a year of assessment to avoid any underestimation penalty.



Supporting Documentation

Get ready all the supporting documentation to substantiate the nature of foreign funds, i.e. capital or revenue, the relevant foreign tax suffered (including the underlying tax) / the reason why no foreign tax is suffered and tax relief claimed.



Accounting System

Make sure that your accounting system can cater for the required tax information, including:

- Date of remittance of foreign funds
- Foreign exchange rate on the day of remittance
- Source countries where the foreign income was derived for relief claim purposes
- Expenses attributable to the remitted foreign income (refer next page for practical issues)



Engage Professionals

Seek advice or engage with tax professionals to assist in reviewing your tax position.

Practical issues in claiming deduction on expenses and reliefs



It can be administratively burdensome to taxpayers in collating information on foreign tax suffered and expenses attributable to foreign source income received in Malaysia, particularly if the foreign source income was derived several years back.

Illustration

Company A was incorporated in Malaysia. Since year 2010, Company A took out a loan from a Malaysian bank for the purpose of on-lending to its subsidiary company in Japan. Company A has never remitted the interest income accrued over the years (totalling RM1 million) into Malaysia and no tax deduction has been claimed on the said interest expenses.

With the need of additional funds for its operations in Malaysia, Company A decided to remit part of its interest income, amounting to RM500,000 out of the RM1 million into Malaysia on 1 August 2022.

With the repeal of the income tax exemption on foreign source income received in Malaysia by a resident person effective from YA 2022, Company A is required to bring the interest income to tax. Based on the MIRB's Guidelines, Company A is required to determine:

1. The YA(s) the RM500,000 is related to

Company A has decided to remit the interest income derived from YA 2010 until YA 2018.

2. The amount of interest expenses incurred attributable to RM500,000

No supporting documents for interest expenses incurred from YA 2010 until YA 2014, as all the records have been destroyed as the statutory period to keep and retain records of 7 years has lapsed. Where such records are available, it would need to be determined which years interest expenses should be set off against the interest income.

3. Bilateral relief

The subsidiary company was not able to provide all the relevant foreign withholding tax receipts as some were lost.

As a result, without the necessary supporting documentation, Company A had lost part of the income tax deduction and relief, which could otherwise have been claimed.

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