BY **ESTHER LEE**

CAPITAL GAINS TAX:
More than expected

It has been two weeks since the capital gains tax (CGT) took effect, but accountants are still figuring out what to make of it. The accounting industry is busy, with experts from accounting professional bodies coming together to draft a paper that they plan to submit to the Ministry of Finance (MoF) this month, seeking clarification on and confirmation about the proposed tax law.

"It has been a long process for us. The industry had actually been meeting to discuss it even before the draft bill was out," a tax consultant tells *The Edge*.

The months of discussions spent trying to work out the implications of the new tax law are understandable, given that the only kind of CGT that Malaysians are familiar with is the real property gains tax (RPGT).

The CGT is new territory for taxpayers and professionals in the country. Having said that, Malaysia did impose inheritance taxes — a form of a CGT — once under the Estate Duty Enactment 1941, which was repealed on Nov 1, 1991.

What is certainly not helping both taxpayers and the accounting industry is the lack of clarity on the CGT, whose scope has turned out to extend far beyond what was announced in Budget 2024.

Many had understood that the CGT would be imposed only on gains or profits from the disposal of unlisted shares from March 1, 2024.

When the draft Finance (No 2) Bill 2023 — containing the 2024 Budget proposed tax amendments — was tabled, however, the accounting industry was surprised to find that it included a broad category under the new item in Section 4(aa) of the Income Tax Act 1967, which states that gains or profits from the disposal of capital assets would be included as income, with the effective date of the CGT brought forward to Jan 1, 2024.

Those who are subject to the CGT include companies, limited liability partnerships, trust bodies and cooperative societies. Individuals have been excluded.

While the law exempts from income tax gains or profits from the disposal of capital assets situated in Malaysia, it taxes the disposal of unlisted shares in a company incorporated in Malaysia and the disposal of shares under Section 15C, that is, shares in a controlled company incorporated outside Malaysia that owns real property situated in Malaysia or shares in another controlled company.

The rate of tax is 10% of chargeable income for capital assets acquired on or after Jan 1, 2024, while taxpayers can choose to pay either 10% of chargeable income or 2% of gross disposal price for capital assets acquired before Jan 1, 2024.

This domestic component of the CGT will come into effect from March 1, 2024.

The broad new category of Section 4(aa) also means, however, that all types of gains or profit on foreign capital assets, ranging from real property overseas to shares on foreign stock exchanges, will be subject to the new tax. They will be taxed at the prevailing tax rate, which is 24% for companies.

For the accounting industry, the surprise does not end there. Upon reading the definition and new provisions inserted into the Act, the main issues are, for example, the definition of "shares", which includes loan stock and debentures, and the definition of "disposal", which also takes into account capital reduction and share buybacks but is unclear on whether liquidation or winding up would be subject to the CGT.

Tax consultants say there are many aspects of the new tax that require clarification and guidance on how it should be applied. The industry is also waiting upon the exemptions that the government had announced or communicated would be granted — such as the exemption on gains on disposal of shares from initial public offerings approved by Bursa Malaysia, intergroup reorganisation and venture capital companies.

The fund management industry has also been shaken by the CGT. As the law stands, with no further clarification or exemptions, the gains brought back to Malaysia or from unlisted shares in the country will be taxed at prevailing income tax rates, which ultimately means that returns to unit holds will be smaller (see "How the new tax affects unit trust funds investing in bonds, foreign assets" next page).

Some conservative asset management companies have sent circulars to their investors informing them of the additional tax and are making provisions for the net asset value of funds.

It appears, however, that good news may be on the horizon for the asset management industry, which is already in discussions with MoF.

"As announced in Budget 2024, the CGT will not be applied to individuals and listed shares. With that in mind, MoF is looking favourably into the request by the fund management industry in relation to the exemption of unit trusts," an MoF spokesman tells *The Edge*.

The next pressing question is whether companies with overseas assets such as shares on foreign stock exchanges or properties would be subject to the CGT on gains from the disposal of the foreign asset.

EY Malaysia International Tax and Transaction Services (EY) partner Florence Tan says: "We understand that an exemption will be available in respect of remittances that fulfil prescribed economic substance requirements. However, the relevant legislation has not yet been enacted."

Therefore, it is likely that companies that either have disposed of their assets overseas recently or are in the midst of a disposal would choose to hold on to the gains until there is more clarity from MoF. After all, the CGT on gains on the disposal of foreign capital assets is taxable only upon remittance.

With the implementation of the CGT for gains on disposal of domestic unlisted shares from March 1, companies that have been in the midst of capital asset disposals would take the opportunity to complete the exercise before the law comes into effect.

An example is the disposal of a 86.65% stake in Central Cables Bhd that belongs to Plantation Industries and Commodities Minister Datuk Seri Johari Abdul Ghani via his investment vehicle JAG Capital Holdings Sdn Bhd to KUB Malaysia Bhd, whose largest shareholder is also Johari.

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Comparison of CGT on domestic and foreign gains

	DOMESTIC GAINS	FOREIGN GAINS
Type of capital asset taxable	1. Unlisted shares in companies incorporated in Malaysia 2. Shares in foreign companies that derive at least 75% of their value from real property in Malaysia	All capital assets (including shares listed on foreign stock exchanges, debt instruments, real property, machinery, collections)
Effective date	March 1, 2024 (exemption in place for the period Jan 1 to Feb 29, 2024)	Jan 1, 2024
Taxable person (being disposer)	Company, limited liability partnership, trust body, cooperative society	Company, limited liability partnership, trust body, cooperative society
Tax rate	10% of gain; for assets acquired prior to Jan 1, 2024, the taxpayer may choose to pay 2% of the gross disposal value instead of 10% of the gain	Prevailing tax rate; for example, 24% in cases in which the disposer is a non-SME
Time at which tax is required to be paid	60 days from the date of disposal, which is: • The date of agreement; or • The settlement date, if there is no agreement. Further, where a transaction is subject to federal or state government approval, the date of such approval would be the date of disposal.	Based on the time of remittance into Malaysia
Mechanism	A distinct return is required to be filed within 60 days. Payment of tax is due within 60 days from the date of disposal as well.	As part of the annual tax return
Exemptions	• Internal restructuring • Approved IPOs • Venture capital companies	Disposers that meet the economic substance requirements

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Tratax's Thenesh: This liberalisation is timely in addressing the issue of inherent economic double taxation

The revised proposal, which will see the issuance of redeemable convertible preference shares in KUB to JAG instead of ordinary shares as first announced, is now targeted for completion by end-February, instead of the initial announced timeline of the first half of 2024.

Some might stand to benefit

Tax consultants believe one good thing that has come out of the recent tax law amendments is that it would benefit companies disposing of real property company (RPC) shares. An RPC is defined as a controlled company where at least 75% of its total tangible assets comprise real property and/or shares in another RPC.

According to Tratax Sdn Bhd executive director Thenesh Kannaa, the RPGT Act has been amended to ensure that the same gain is not subject to both the CGT and RPGT, particularly in terms of the sale of RPC shares.

He says this means that gains derived by any company from the disposal of RPC shares before or on Dec 31, 2023, are subject to the RPGT. From March 1, 2024, the disposal of RPC shares will be subject only to CGT in cases in which the disposer is a company, limited liability partnership, trust body or cooperative society.

"While the tax rate for the RPGT varies between 10% and 30% of the gain (depending on the tenure of ownership of the asset), the CGT provides for a flat rate of 10%. In addition, for assets acquired prior to Jan 1, 2024, the CGT on future disposals may be limited to 2% of the disposal value.

"This liberalisation is timely in addressing the issue of inherent economic double taxation, where the RPGT was imposed in the past on the disposal of both real property as well as shares in RPCs," says Thenesh.

He notes that the RPGT on the disposal of real property still remains at 10% to 30%, and the amendment to the RPGT Act is only in relation to gains arising from the disposal of shares in RPCs.

Going by the tax rates alone, the CGT's flat rate of 10% on the disposal of RPC shares after March 1 is definitely a boon for companies thinking of disposing of such shares.

"The fact that it is currently at the rate of 10% also means, however, that it can be increased in the future. If you look at other countries — such as Japan, South Korea, Thailand and Vietnam — the CGT rate is similar to corporate income tax. The only country that is similar to our model (where CGT is lower) is Myanmar.

"I wouldn't be surprised if the rate moves once the CGT matures," says KPMG Malaysia head of tax Soh Lian Seng.

Interestingly, from Jan 1 to Feb 29, there appears to be a period in which the RPGT Act will not apply to the sale of RPC shares while they are also exempted from the CGT.

While some call it an unintended consequence of bringing RPC transactions into the Income Tax Act under the CGT, others think it might be time for property-rich companies

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'No real rush by property-rich companies to restructure at this time'

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to streamline their asset-holding structure without RPGT or CGT exposure.

Soh notes: "It is possible that property developer companies will have more to gain because they usually would hold properties such as development land through their unlisted subsidiaries. If they intend to dispose of these properties within the next two months, the gains or profits would not be subject to the RPGT and also be exempt from the CGT.

"If property developer companies begin, however, to trade their unlisted investments and the activities become an adventure in the nature of trade, the gains or profits from the disposal of such investments will fall under Section 4(a) business income and will be taxed at the prevailing income tax rate (the CGT does not apply)."

Thenesh says while this issue has been much talked about by property-rich companies, he has seen no actual rush to restructure during this period.

Compliance with EU Code of Conduct ... and more

Many believe Malaysia's move to implement CGT is a result of being placed on the European Union (EU) Code of Conduct's grey list, which identified the country as having a "harmful" foreign source income exemption regime. Singapore and Hong Kong are also on the list.

"The CGT regimes in Singapore and Hong Kong are limited to foreign-sourced disposal gains and do not include 'indirect transfers' within the scope of the CGT," says EY's Tan.

While Singapore and Hong Kong limit the CGT to foreign-sourced disposal gains, Malaysia has included the CGT on domestic gains in the form of gains on unlisted shares and indirect transfers, on top of foreign-sourced disposal gains.

Some say this move could be in response to the country's need for additional revenue, given its fiscal constraints.

"If the intention was to comply to get out of the grey list, then we would probably just do what Hong Kong and Singapore have done and not include the domestic CGT," says a tax consultant.

Apart from Malaysia's obvious inclusion of the domestic CGT, which differs from Singapore and Hong Kong, Tan says both Singapore and Hong Kong make various exemptions available, covering financial institutions, taxpayers enjoying tax exemptions or concessionary tax rates, and disposers that meet certain economic substance requirements.

"Based on the Budget 2024 announcement, the proposed exemptions in respect of the Malaysian CGT are expected to cover disposals of shares as part of an approved initial public offering and intragroup restructuring exercises, but these have not yet been legislated," notes Tan.

Furthermore, tax consultants lament the lack of guidelines provided to assist in understanding and applying the CGT law.

"Detailed guidelines have been released by the tax authorities in Singapore and Hong Kong in respect of the application of their respective CGT provisions. It is expected that the Malaysian Inland Revenue Board will be issuing guidelines in due course," adds Tan.

For now, everyone is making do with whatever is available on the Act, but it has undoubtedly made certain business decisions more complicated in the meantime.

Will clarity be given soon? Taxpayers certainly hope so. ■

KPMG

KPMG Malaysia's Soh: It is possible that property developer companies will have more to gain

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EY's Tan: Malaysia has included the CGT on domestic gains in the form of gains on unlisted shares and indirect transfers