



Unit trust funds under the spotlight

Recent tax exemptions explained

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KPMG in Malaysia



Overview and Commentary



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Key Message

“Starting 1 January 2024, gains from the realization of certain investments made by unit trusts in Malaysia came under the scope of Capital Gains Tax, but qualifying unit trusts can now enjoy exemptions for the said disposals made until 31 December 2028. Additionally, while foreign sourced income is generally taxable effective from 1 January 2022, unit trusts may now qualify for an exemption on foreign sourced income received in Malaysia from 1 January 2024 until 31 December 2026, provided they meet specific conditions. With these recent exemptions granted, the unit holders would be able to enjoy a higher return on investments made.”

Recent tax exemptions explained



The Finance (No. 2) Act 2023 introduced capital gains tax (“CGT”) on gains from the disposal of certain capital assets, effective 1 January 2024. In addition, since 1 January 2022, unit trusts have also been subject to tax on remittance of foreign sourced income (“FSI”) into Malaysia. The major shift in the tax framework for the unit trust industry has caused concern for the fund managers as well as the unit holders in terms of the return on investments.

Nevertheless, the Finance Minister II Datuk Seri Amir Hamzah Azizan had, on 16 January 2024, announced that unit trusts will be exempted from CGT (for the period from 1 January 2024 to 31 December 2028) and income tax on FSI (for the period from 1 January 2024 to 31 December 2026).

The much-awaited Income Tax (Unit Trust) (Exemption) Order 2024 and the Income Tax (Unit Trust in relation to Income Received in Malaysia from Outside Malaysia) (Exemption) Order 2024 have recently been gazetted to shed light on the prescribed conditions for unit trusts to enjoy the exemptions. Fund managers would need to assess how these changes will affect their return on investments.

Gains from the realization of investments

Before 1 January 2024, unit trusts enjoyed an exemption from income tax on gains from the realization of investment under Section 61(1)(b) of the Income Tax Act, 1967 (“the Act”). However, based on the Finance (No. 2) Act 2023, gains arising from the realization of the following investments will now be taxable under Section 4(aa) as gains or profits from the disposal of capital assets, effective 1 January 2024:-

- a) Unlisted shares of companies incorporated in Malaysia;
- b) Shares of a controlled company incorporated outside Malaysia which owns real property situated in Malaysia or shares of another controlled company, subject to meeting the 75% threshold conditions (“Section 15C shares”); and
- c) Capital assets (e.g. investment) situated outside Malaysia.

For CGT purposes, “disposal” means to sell, convey, transfer, assign, settle or alienate whether by agreement or by force of law and includes a reduction of share capital and purchase by a company of its own shares.

Pursuant to the Income Tax (Unit Trust) (Exemption) Order 2024, a qualifying unit trust resident in Malaysia is exempted from CGT on chargeable income from the disposals related to items (a) and (b) made during the period from 1 January 2024 to 31 December 2028. However, the exemption is not applicable to disposals where the gain or profit is derived from the business of trading in shares. Note that a qualifying unit trust does not include an approved Real Estate Investment Trust (“REIT”) or Property Trust Fund (“PTF”) listed on the Bursa Malaysia.

Where the current disposal of capital assets results in a gain, any unabsorbed losses arising from earlier disposals shall be used to offset the gain from the current disposal in ascertaining the chargeable income which is exempt from CGT. Nevertheless, the carry back of losses is not allowed, i.e. losses that are incurred after realizing a gain, cannot be utilized against that gain, even though both disposals happen in the same Year of Assessment (“YA”). However, any unabsorbed losses can be carried forward for 10 consecutive YAs and be deducted against gains from future disposals.

Notwithstanding the exemption, unit trusts will still need to file CGT returns for disposals within 60 days from the date of disposal for disposals of capital assets made on or after 1 March 2024. There was a blanket exemption from filing of CGT returns for the disposals made from 1 January 2024 to 29 February 2024.

Whereas, for gains from the realization of item (c) above, CGT will apply when it is *received in Malaysia*¹. However, if the unit trust meets the participation exemption requirements or the economic substance requirements outlined in the Income Tax (Unit Trust in relation to Income Received in Malaysia from Outside Malaysia) (Exemption) Order 2024, these gains should be exempted from CGT.

Foreign sourced income

The income tax exemption on FSI *received in Malaysia* by any Malaysian resident person has been revoked with effect from 1 January 2022.

Pursuant to the Income Tax (Unit Trust in relation to Income Received in Malaysia from Outside Malaysia) (Exemption) Order 2024, qualifying unit trusts can be exempted from income tax on gross foreign income *received in Malaysia* from 1 January 2024 to 31 December 2026, subject to meeting the prescribed conditions.

¹ *Received in Malaysia is defined as transferred or brought into Malaysia, whether in the form of cash or through electronic funds transfer; or both.*

“Qualifying unit trust” refers to a unit trust resident in Malaysia managed by a management company licensed by the Securities Commission and has FSI received in Malaysia but excludes an approved REIT or PTF listed on Bursa Malaysia².

To qualify for the exemption, the unit trust must satisfy either:-

➤ Option 1: Participation Exemption Requirements

- a) The gross income of the qualifying unit trust has been subjected to tax of a similar character to income tax under the laws of the originating foreign jurisdiction (i.e. income tax or withholding tax is paid or payable); and
- b) The highest rate of tax (headline tax) of a similar character to income tax under the laws in the originating foreign jurisdiction in which and at that time the FSI arises is not less than 15%.

➤ Option 2: Economic Substance Requirements

The unit trust shall be regarded as having economic substance if the management company of the unit trust has:-

- a) Employed an adequate number of employees in Malaysia; and
- b) Incurred an adequate amount of operating expenditure in Malaysia.

Any expenses in relation to the income exempted shall be disregarded for the purpose of ascertaining the chargeable income of the qualifying unit trust.

Issues to consider and take note

❖ CGT vs FSI Exemption Periods

It is worth noting that, the Finance Minister II has earlier announced that the CGT exemption for unit trusts will be given until 31 December 2028. However, gains from the disposal of foreign capital assets which are remitted into Malaysia, are given exemption under the Income Tax (Unit Trust in relation to Income Received in Malaysia from Outside Malaysia) (Exemption) Order 2024, which expires after 31 December 2026. This mismatch poses a question on whether the exemption period for gains from the realization of foreign capital assets would be extended for another 2 years. Hopefully, there would be further guidance on this in the near future.

❖ Administrative Burden

CGT returns are required to be submitted to the IRB on a transactional basis within the stipulated deadline. As the frequency of realization of investments could be comparably higher for the unit trust industry than other industries, the requirement to adhere to the CGT return filing even during the exemption period may result in administrative burden. To ease the unit trusts' administrative and paperwork burden, it is hoped that the IRB could consider exempting unit trusts from filing CGT returns where the disposal qualifies for exemption or introducing alternative approaches to streamline the process, such as granting qualifying unit trusts the flexibility to file a consolidated CGT return which covers multiple transactions over a specific period. This may significantly reduce the

² Based on the exemption Order, the exemption would also not apply to a unit trust carrying on the business of banking, insurance, sea transport or air transport.

operational burdens associated with compliance, which allows them to focus more on their core investing activities.

❖ **Economic substance requirements**

Currently, there is no established minimum threshold for the economic substance requirement. It would be interesting to see if the IRB would come up with a benchmark for fund management companies to adhere to. The fund management companies may find it useful if the IRB could provide guidance on this matter as it would provide a clearer picture as to what is expected of the fund management company and have greater certainty on whether they comply with the economic substance requirement. The risk of non-compliance with the requirements, which could result in additional taxes and penalties, could arise as what is viewed by the management company as being adequate or reasonable may not be in line with IRB's view or expectations.

It is hoped that the IRB would issue new guidelines on the requirements to meet the economic substance requirements for unit trust or update the existing FSI Guidelines and the Guidelines on the Tax Treatment on Gains received from Disposal of Foreign Capital Assets to give further clarity on the requirements of the Exemption Order for unit trusts.

❖ **FSI remittance**

Unit trusts should take advantage of the income tax exemption period for remitting FSI or gain from disposal of foreign capital assets into Malaysia. Furthermore, the unit trust should also utilize this exemption period to remit its capital gains derived previously as the remittance would not attract any taxes now, subject to meeting the prescribed conditions.

When remitting FSI that includes a mix of capital gains and investment income, it is crucial to differentiate between the types of income being remitted into Malaysia, specifically distinguishing investment income from gains from the realization of investments. This distinction is important for fulfilling the disclosure requirements on the income tax return form for unit trusts. Proper classification will ensure compliance and accurate reporting.

Please note that CGT arising from foreign sourced investments should be reported in the income tax return form. There is no need to submit a separate CGT form.

❖ **Estimated tax payable**

Unit trusts are required to submit an estimated tax payable ("ETP") for each YA. They have three opportunities to revise this estimate, i.e. in the 6th, 9th and 11th month of the basis period for a YA. Previously, when the exemption on FSI was revoked, unit trusts had to accurately estimate its ETP based on the timing of its remittances of FSI into Malaysia to avoid any penalties being imposed for underestimating its tax payable for that relevant YA. This has also led to fluctuations in cashflow as the unit trust had to make instalment payments to the IRB based on their ETP. However, now that the exemption is in place for FSI, unit trusts should find that cashflow management has become a less stressful affair.



Next steps

To fully leverage on the tax savings from the two exemption orders, unit trust funds should consider the following measures to optimize their tax efficiency and navigate potential complexities:

- Determine whether the management company of the unit trust fund meets the economic substance requirements.
- Ensure timely and accurate monitoring / identification of the various FSI for compliance with tax reporting obligations and the fulfillment of the exemption conditions.
- Determine the originating country of the foreign investment income for purposes of bilateral or unilateral relief in cases where the unit trust does not qualify for tax exemption, but the said income is taxable in both Malaysia and the foreign country. Monitor the net tax suffered on the foreign investment income received and gather documentation evidencing the foreign tax suffered to support claims for bilateral or unilateral relief.
- Gather all necessary documentation to substantiate the nature of foreign funds, including details of gains from the realization of investments, the relevant foreign tax suffered and tax relief claimed.
- Consider whether a revision to the ETP would be required.
- Conduct training / briefing for the relevant department or personnel on the requirement and timing of the CGT return filing or engage with tax advisor to obtain the necessary assistance / guidance for the filing of the CGT return.

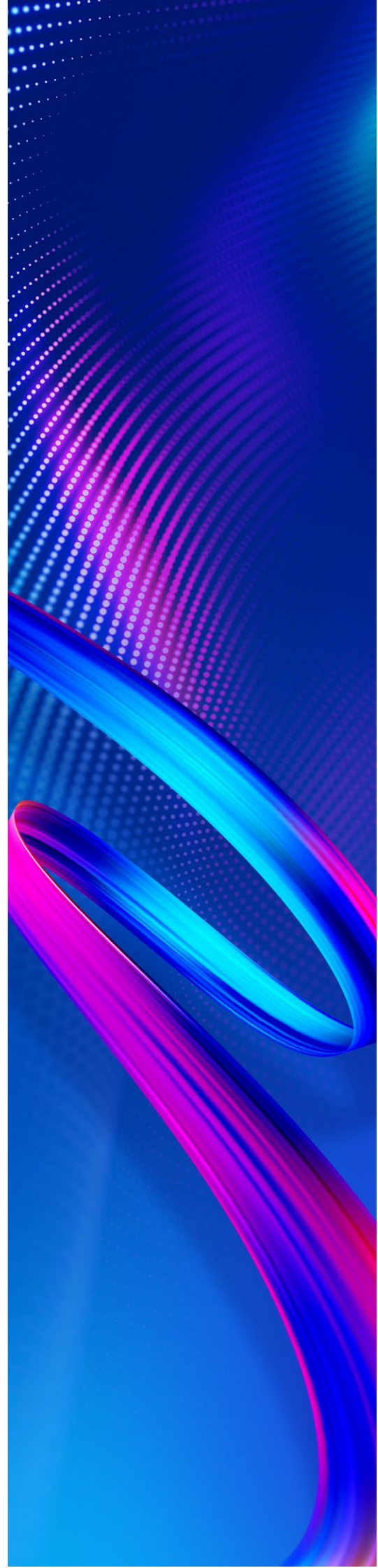
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