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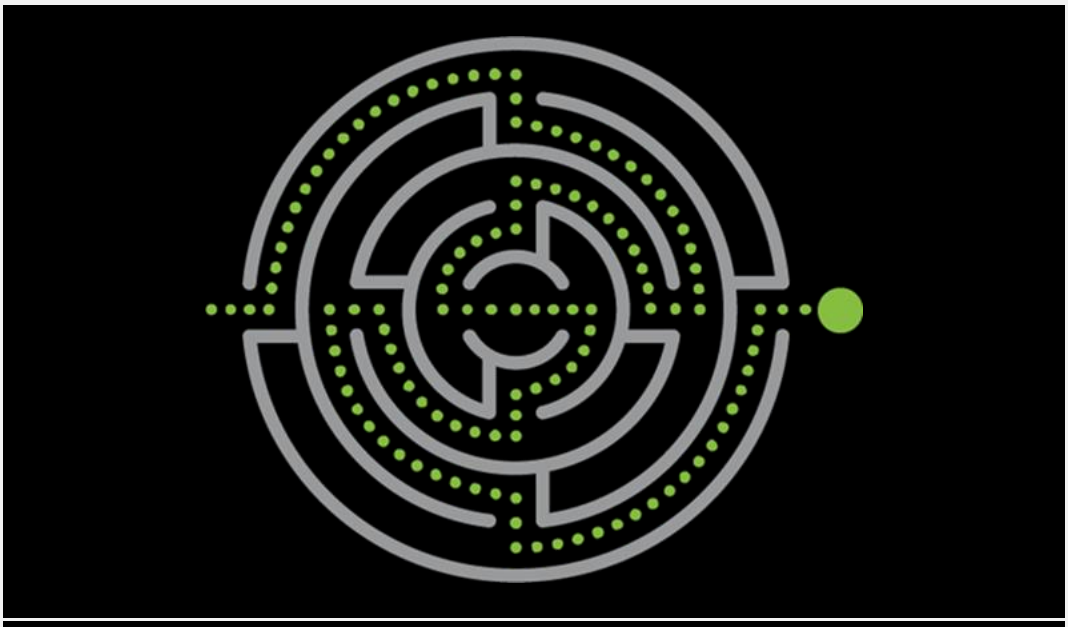

Tax Espresso – Special Alert
Public Ruling No. 11/2018 – Withholding Tax on Special Classes of Income

Public Ruling No. 11/2018 – Withholding Tax on Special Classes of Income (PR 11/2018)

The Inland Revenue Board of Malaysia ("IRBM") has uploaded on its website the PR 11/2018 (issued on 5 December 2018) which supersedes the previous Public Ruling No. 1/2014 – Withholding Tax on Special Classes of Income (last amended on 27 June 2018) [PR 1/2014].

The PR 11/2018 incorporates changes to the tax law via Finance Act 2017, Practice Notes 1/2017, 2/2017 & 3/2017 as well as clarification on current positions taken by the IRBM on certain withholding tax ("WHT") related matters. We expect this PR 11/2018 to be updated to include the relevant changes proposed via the Finance Bill 2018 once the bill is enacted.

Our Commentary

1) Regrossing is no longer required

Effective 5 December 2018 (i.e., date of publication of the PR 11/2018), where WHT on Special Classes of Income is borne by a payer, the WHT is to be computed on the gross amount paid to the non-resident. This means that the payment made to the non-resident need not be regrossed to determine the amount of withholding tax.

2) Imposition of penalty under Section 113(2)

Pursuant to Section 39(1)(j) of the Income Tax Act 1967 (the ITA), if a payer claims a deduction in the income tax return form ("ITRF") for expenses that are subject to WHT whereas the WHT has not been paid or remitted, the DGIR is empowered to impose a penalty under subsection 113(2) of the ITA for incorrect returns. This applies regardless of whether the ITRF has been filed within / after the due date for submission for the relevant year of assessment.

The IRBM has cautioned that a payer would still be penalised under Section 113(2) of the ITA for filing an incorrect return although the tax payable for the year of assessment concerned is "Nil".

Where the WHT is not due for payment and no payment or crediting is made to the non-resident payee on or before the due date of submission of the ITRF, a deduction is not allowable under Section 39(1)(j) of the ITA as the WHT is not paid or remitted to the DGIR.

3) Services rendered in connection with royalties

It should be noted that the IRBM has given its view that any services provided in connection with the use of property or rights belonging to the non-resident person that falls under the scope of royalties would fall under the scope of Special Classes of Income [i.e., Section 4A(i) of the ITA].

4) Removal of concession to exempt payment of head office expenses from WHT

With the removal of the concessionary exemption given by the IRBM in the superseded PR 1/2014, the allocation of head office expenses for ordinary day to day or routine administration expenses would fall within the scope of Special Classes of Income subject to WHT even though such payment is in no way related to the performance of any specialised service.

This removal reflects the interpretation adopted by the IRBM that the WHT applies to payments for non-technical assistance as well as non-technical services, and that it is irrelevant whether the service is in connection with technical management or administration.

5) Testing and Calibration services subject to WHT

Similar to item 4 above, the IRBM has changed its interpretation and gives its view in Example 12 of the PR 11/2018 that fees for providing testing, measurement and calibration services would fall within the scope of Special Classes of Income [i.e., Section 4A(ii)] and subject to WHT.

In Example 12, the IRBM does not make a distinction whether the testing services are for the provision of test results on finished products to meet required standards which do not involve technical advice or consultation.

6) Fees other than freight charges are subject to WHT

Whilst maintaining its interpretation that freight charges paid to non-residents in respect of shipment of goods are not payments for the use of a moveable property within the scope of Section 4A(iii) of the ITA hence not subject to

WHT, IRBM has clarified that fees other than freight charges such as handling fees and agency service fees would fall under the scope of Special Classes of Income under Section 4A(ii) of the ITA and subject to WHT.

7) Advance payments and non-refundable deposits for technical services to be rendered

It is the position taken by the IRBM that even though the services are yet to be performed, the advance payment or non-refundable deposit made are purely for the services which will be performed and form part of the gross amount payable for the services.

Please note any advance payment or deposit paid upon the signing of an agreement for technical services, which are refundable upon completion of the service do not form part of the gross income of a contract.

8) Income received from an approved MSC status company

It is noted that the IRBM has not included in the PR 11/2018 the exemption from WHT on payments received by a non-resident company for providing technical advice or technical services to an approved MSC status company as defined in the Income Tax (Exemption) (No. 13) Order 2005. The exemption is effective from 1 October 2002.

We understand that the above exemption has been withdrawn but there is no revocation of such exemption order as at to-date.

9) WHT on late payment penalty charged by the non-resident payee

Pursuant to Section 4B of the ITA, the late payment penalty which is payable to the non-resident would be considered as interest income under Section 4(c) of the ITA hence the WHT provision under Section 109 of the ITA is applicable. In cases where Double Taxation Agreement ("DTA") applies and it is mentioned in the DTA that penalty charges for late payment shall not be regarded as interest for the purpose of the DTA, then the DTA prevails

over the ITA and no WHT is applicable on such penalty charges.

Nevertheless, any penalty charges for late payment would not be a deductible expense under Section 33(1) of the ITA.

10) Payment to non-resident in non-ringgit currency

IRBM has advised that WHT is to be computed based on the amount in Ringgit Malaysia (RM) on the date payment is made to the non-resident. The equivalent RM value has to be calculated at the time payment is made based on:

a) prevailing foreign exchange ("Forex") rate reflected in the telegraphic transfer;
b) Forex rate published in the official portal of the IRBM; or
c) BNM published Forex rate.

11) Application of Article on "Other Income" or "Income Not Expressly Mentioned" in the DTA

It is the current position taken by the IRBM that in the absence of a Technical Fee / Fee for Technical Services Article in the DTA signed by Malaysia, the Other Income / Income Not Expressly Mentioned Article is applicable to provide Malaysia the taxing right.

The above position may be challenged by the non-resident payee who is a resident of the other contracting state which has signed the DTA with Malaysia.

For any queries or assistance, please speak to your usual Deloitte contact or Tan Hooi Beng (International Tax Leader) at hooitan@deloitte.com.

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