



Tax Espresso – Special Alert

Revised Guidelines issued on Tax Treatment of Foreign Source Income received in Malaysia

Greetings from Deloitte Malaysia Tax Services,

Following the Technical Guidelines (the Guidelines) issued by the Inland Revenue Board of Malaysia (IRBM) on 29 September 2022, [[reported via our Special Alert dated 2 October 2022](#)], in which it explains the application of the tax legislation with respect to the foreign source-income (FSI) received by residents in

Malaysia, as well as the qualifying conditions for the exemption from tax imposed by the Minister of Finance, the IRBM has since imposed an additional qualifying condition for tax exemption on foreign source dividend income received by resident company, resident limited liability partnership (LLP), and resident individual in relation to a conventional partnership business in Malaysia (collectively known as the qualifying person). The IRBM imposes the additional qualifying condition to reflect Malaysia's commitment towards compliance with international tax standards to avoid tax evasion and double non-taxation in accordance with the requirements set by the European Union. With that, the IRBM has issued the following:

- The revised [Technical Guidelines](#) (the revised Guidelines) dated 29 December 2022; and
- [Media release](#) dated 30 December 2022 (available in Bahasa Malaysia only).

Background

The Government of Malaysia implemented the measure to impose tax on the income of residents derived from sources outside Malaysia and received in Malaysia through the Finance Act 2021 which came into operation on 1 January 2022. As a transition measure, the FSI received in Malaysia from 1 January 2022 until 30 June 2022 would be taxed at a 3% rate on a gross basis. Any FSI received in Malaysia from 1 July 2022 would be subject to tax based on the prevailing income tax rate.

However, following the gazette of the Income Tax (Exemption) (No. 5) Order 2022 [[P.U.\(A\) 234/2022](#)] and the Income Tax (Exemption) (No. 6) Order 2022 [[P.U.\(A\) 235/2022](#)], certain FSI received by certain categories of tax residents in Malaysia will continue to be exempted from tax for another 5 years until 31 December 2026 [[refer to our Special Alert dated 20 July 2022](#)]. These orders provide some clarifications on which Malaysian tax resident may qualify for an income tax exemption and conditions that are applicable for an exemption.

Prior to the revised Guidelines, a qualifying person who receives foreign source dividend income in Malaysia is exempted from the payment of income tax from 1 January 2022 until 31 December 2026 if the following qualifying conditions are met:

- (a) the foreign source dividend income has been subjected to tax in the country of origin; and
- (b) the headline tax rate in the country of origin is at least 15%.

Salient points in the revised Guidelines - economic substance requirement as an additional qualifying condition for tax exemption on foreign sourced dividend income

1. A qualifying person who receives foreign source dividend income in Malaysia is now required to comply with the economic substance requirement to be qualified for the tax exemption from 1 January 2022 to 31 December 2026. The introduction of economic substance requirement is to provide clear linkage between the foreign source dividend income received in Malaysia and the actual activities carried out by the qualifying person in Malaysia.
2. A qualifying person shall be deemed to have met the economic substance requirement if it has:
 - (a) employed adequate number of employees with necessary qualifications to carry out the specified economic activities in Malaysia; and
 - (b) incurred adequate amount of operating expenditure for carrying out the specified economic activities in Malaysia.
3. However, as the mode of operation varies from industry to industry, the IRBM is of the view that it is neither feasible nor appropriate to specify any minimum thresholds for the economic substance requirement. Therefore, the economic substance requirement will depend on the facts of each case. The factors that will be considered to ascertain the economic substance include:
 - (a) the number of employees having regard to the nature of the relevant activities, e.g., whether it is in a capital or labour-intensive industry;
 - (b) whether the employees are employed on a full-time or part-time basis; and
 - (c) whether office premises have been used for undertaking the relevant activities, and whether the premises are adequate for such activities.
4. As advised in the media release, qualifying persons who have submitted their Income Tax Return Form (ITRF) to the IRBM on or before 29 December 2022 are required to submit an amended ITRF if the additional qualifying condition, which are economic substance requirements, is not complied with, and no penalties will be imposed on these qualifying persons.

Comment

The introduction of the economic substance requirement as an additional qualifying condition has created an impact on qualifying persons that relied on the conditions stipulated in the Guidelines issued by the IRBM on 29 September 2022. It is hoped that the IRBM will provide further clarification on certain issues which appear to be unclear in the revised Guidelines, among others, are:

- a) The adequacy of economic substance as the level of economic substance requirement for each company is to be determined on a case-to-case basis. While this appears flexible, the adequacy of economic substance may be subject to dispute.

- b) Whether the revised Guidelines apply to the qualifying persons retrospectively, as the IRBM requires qualifying persons that have submitted their ITRF on or before 29 December 2022 to revise their ITRF with no penalties being imposed. If so, whether companies with December year end are required to build the economic substance by 31 December 2022 for the year of assessment (YA) 2022.

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