A Quick Understanding On
Taxability of Foreign Sourced Income
Updated on 17 January 2022
Malaysia adopts a territorial principle of taxation in that only income accruing in or derived from or received in Malaysia from outside Malaysia is subject to income tax in Malaysia pursuant to Section 3 of the Income Tax Act, 1967 ("ITA").

Since 2004 to-date, “income received in Malaysia from outside Malaysia” or foreign sourced income ("FSI") received by Malaysian taxpayers is not taxable due to the availability of tax exemption under Paragraph 28, Schedule 6 of the ITA ("Para 28"). Under this law, exemption is given to any person, other than a resident company carrying on the business of banking, insurance or sea or air transport, in respect of income derived from sources outside Malaysia and received in Malaysia.
On 29 October 2021, it was announced in the Budget 2022 that the exemption under Para 28 will no longer be applicable to tax residents with effect from 1 January 2022. The law was made effective when the Finance Act 2021 was gazetted on 31 December 2021 whereby Para 28 is amended by removing the exemption previously enjoyed by tax residents. Effectively, income tax will be imposed on resident persons in Malaysia on income derived from foreign sources and received in Malaysia with effect from 1 January 2022. Such income will be treated equally vis-à-vis income accruing in or derived from Malaysia and taxable under Section 3 of the ITA.

In summary, the tax treatments for income of a person in Malaysia are depicted as follows:

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<tr>
<th>Income derived from</th>
<th>Income received in</th>
<th>Present</th>
<th>Proposed (Effective 1.1.2022)</th>
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<td>Malaysia</td>
<td>Malaysia from outside Malaysia</td>
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<td>Overseas</td>
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<td>Tax exempted</td>
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MoF’s Announcement on Tax exemption for FSI on 30 December 2021

On 30 December 2021, the Ministry of Finance (“MoF”) had announced that exemption from income tax will be available for a period of five (5) years from 1 January 2022 to 31 December 2026 on certain categories of FSI received by the following groups of tax residents:

• **Individuals** – All categories of foreign sourced income are exempted.

• **Companies** – Foreign sourced dividend income is exempted.

We expect the MoF to give effect to the above income tax exemption vide issuance of a Ministerial exemption order in due course. It is noted that the above income tax exemption will be subject to a set of eligibility requirements which will be detailed out in the guidelines to be issued by the Inland Revenue Board of Malaysia (“IRBM”).

In addition, the MoF has clarified in the same announcement dated 30 December 2021 that the taxable FSI received by companies in the year of assessment 2022 will not be included in the calculation of “chargeable income” of a company for the purposes of Cukai Makmur. Cukai Makmur is a one-off tax imposed at the rate of 33% on companies having chargeable income exceeding RM100 million for the year of assessment 2022.

The latest announcement by the MoF to exempt foreign sourced dividend income for Malaysian corporate tax residents comes in a timely manner to address the administrative complications involved in taxing foreign sourced dividend income. Concurrently, it provided needed relief for Malaysian companies from the additional tax burden on their dividend income received from foreign subsidiaries or foreign investments.

In addition, this exemption helps to put to rest temporarily (at least for the next 5 years) the uncertainties surrounding the reporting of foreign sourced income faced by many Malaysian individual tax residents. Particularly relieved are those caught in the FSI situation and left stranded on the possibility of paying top-up taxes in Malaysia following the initial announcement on 29 October 2021, especially individuals with employment income that had been subject to tax in a foreign country.
Who are affected?

Those categories of FSI received by Malaysian corporate tax residents that are not included in the exemption list announced by the MoF on 30 December 2021 will still be subject to tax in Malaysia, including interest, rent, royalty, etc.
A few of the more common examples are as follows:

- **Companies owning properties outside Malaysia.**
  The rental income generated from their properties and remitted into Malaysia will be subject to tax.

- **Companies that received in Malaysia foreign sourced royalty income.**

- **Companies providing loans to a foreign party.**
  The foreign interest income received in Malaysia will be subject to tax.

- **Unit trust funds having investments in foreign assets.**
  The foreign interest income received in Malaysia will be subject to Malaysian tax.
Double Tax Relief on Foreign Tax Suffered

Where a Malaysian corporate tax resident has suffered foreign tax on the FSI, the taxpayer is given bilateral or unilateral tax credit relief against the Malaysian tax payable on the same FSI. Bilateral relief is given under Section 132 of the ITA when the foreign country has a double tax agreement with Malaysia (e.g Singapore, Indonesia, Japan, China, Australia, South Africa, United Kingdom, France, etc.).

On the other hand, unilateral relief is given under Section 133 of the ITA when there is no double tax agreement between Malaysia and the foreign country (e.g British Virgin Islands, Taiwan, United States of America, etc.). While full relief may be possible under a double tax agreement, the final amount is calculated based on a prescribed formula and relief is only given up to the maximum of the Malaysian tax suffered.

As for unilateral tax relief, the foreign tax recognized is automatically halved. In addition, in order to claim the said tax relief in the tax returns, the Malaysian corporate tax resident is required to substantiate the amount of tax paid in overseas with the relevant supporting documents from the tax authorities in the foreign country.

What are not taxable?

The provisions will only affect gains that are “income” in nature. On this note, foreign sourced gains that are “capital” in nature will not be subject to tax. Foreign sourced capital gains should include proceeds from the disposal of foreign stocks, foreign properties, foreign assets, foreign currencies, foreign investment papers, etc if these assets had been held as long-term investments.

As to whether the gains are “income” or “capital” in nature, the onus of proof lies with the Malaysian tax resident based on the facts and circumstances giving rise to the gains. If the remittances are found to be income in nature instead of capital as claimed by the taxpayers, the same shall be subject to income tax.
The implementation of the above legislation is staggered into the following 2 timelines, depending on the timing of remittance of foreign sourced income into Malaysia:

a. During the period from 1 January to 30 June 2022 (6 months) – FSI remitted shall be taxed at a fixed rate of 3% on the gross amount of income remitted as announced by the IRBM in their PKPP (below).

b. On or after 1 July 2022 – FSI remitted shall be taxed at the prevailing tax rate applicable to tax residents on the statutory income (i.e. gross FSI less expenses attributable to the FSI).

On 16 November 2021, the IRBM announced a Special Income Remittance Programme (Program Khas Peremitan Pendapatan or PKPP) which will take place between 1 January 2022 and 30 June 2022. Subject to certain terms and conditions, the FSI remitted during the PKPP period will be taxed at 3% on the gross income.

FSI remitted under the PKPP will be accepted in good faith by the IRBM as the IRBM will not conduct any audit or investigation on the taxpayer. In addition, the IRBM will not impose any penalty on FSI remitted during the PKPP period.

Any FSI remitted into Malaysia after the expiry of PKPP, i.e. after 30 June 2022, will be taxed at the prevailing tax rates.

The introduction of PKPP aims to provide a longer time frame for Malaysian corporate tax residents to transition into the full FSI regime.

With the low tax rate of 3% and the less stringent measures in verifying the validity of the FSI, it is anticipated that Malaysian corporates are likely to consider bringing in their taxable FSI into the country during the 6 months’ window before this concession ends on 30 June 2022.
Actions required from tax resident companies

In view of the changes in tax treatment on FSI, Malaysian corporate taxpayers should consider the following action points to navigate through the new tax landscape going forward:

- Review the Malaysian tax impact on remittance of any taxable FSI from outside Malaysia to Malaysia.
- Consider participating in the Program Khas Peremitan Pendapatan (PKPP).
- Review the cross border inter-company loans within the group of companies.

If assistance is needed

If you need any assistance on your FSI or on the PKPP mentioned above, please do not hesitate to contact us.

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