Capital Gains Tax

Its Implementation and The Broader Impact Concurrently with Income Tax and RPGT

April 2024

Audit / Tax / Advisory

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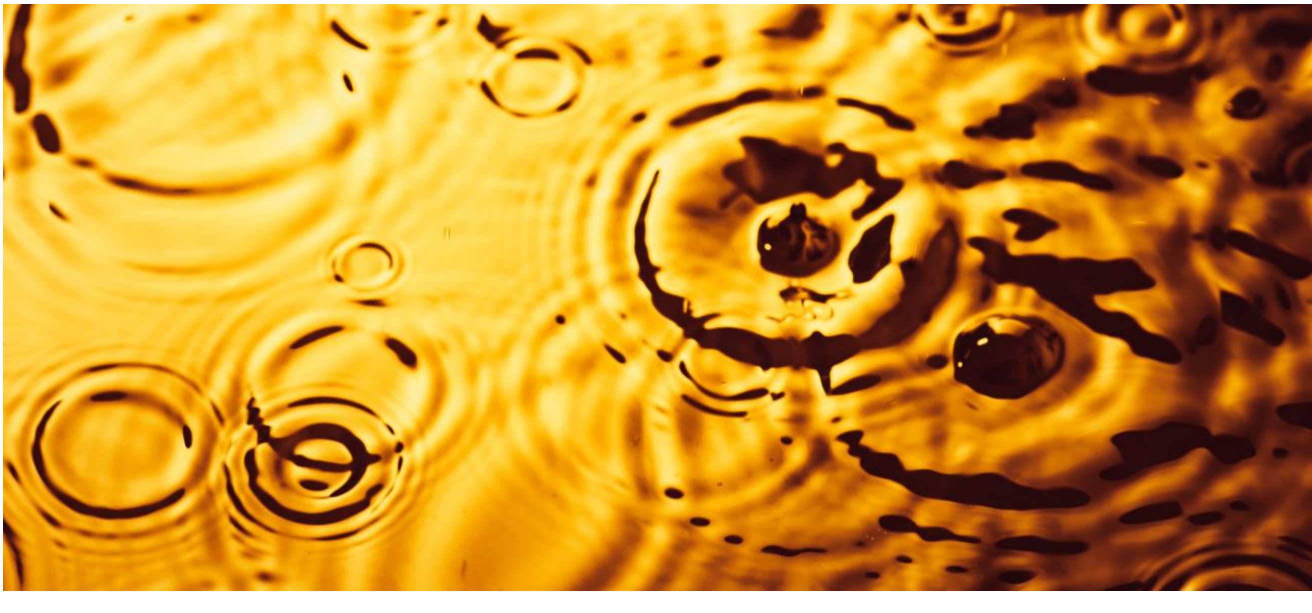
What is Capital Gains Tax?

On 29 December 2023, the Finance (No.2) Act 2023 was published, and with it, the tax laws governing Capital Gains Tax ("CGT") were formally enacted.

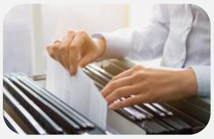
Generally, Malaysia does not impose CGT except on gains arising from the disposal of real property in Malaysia which may be subject to Real Property Gains Tax ("RPGT") at a maximum RPGT rate of 30%.

Country	Headline corporate CGT rate (%)
Thailand	Subject to standard corporate income tax (CIT) rate of 20%
Indonesia	Subject to standard CIT rate of 22%
Vietnam	Subject to standard CIT rate of 20%
Cambodia	Subject to standard CIT rate of 20%
Myanmar	10% for non-oil and gas sector; 40% to 50% for oil and gas sector



Who is affected?

Companies



Trust Bodies

Limited Liability Partnerships (LLP)

Co-Operative Societies

Implementation Dates

Effective date	Types of Capital Assets Affected
1 Jan 2024	Foreign Capital Assets
1 Mar 2024*	• Local Unlisted Shares • Shares Deemed Acquired in Malaysia Pursuant to Section 15C of the ITA (see Page 6)

*The effective date has been deferred to 1 March 2024 with the gazette of Income Tax (Exemption) (No.7) Order 2023.

Types of Capital Assets subject to this CGT

Local unlisted shares

Section 15C
- foreign unlisted company shares deemed acquired in Malaysia (see Page 6)

All types of foreign capital assets

Salient Points on the Introduction of CGT

When to file and pay CGT?

- Within 60 days from date of disposal
- One return per disposal
- Penalties for non-filing, late filing, understatement of tax and late payment

Date of disposal

- Date of agreement; or
- Where there is no agreement, the date of completion of the disposal

How to compute CGT?

- Disposal price minus Acquisition price
- Deemed market value can override transaction price or to be used if no transaction price is available
- Foreign capital gains – double tax reliefs are available (if applicable)

CGT Tax Rates

Effective date of acquisition	Types of Capital Assets Affected
Malaysian unlisted company shares acquired before 1 January 2024	10% on gain or 2% on gross proceeds
Malaysian unlisted company shares acquired after 1 January 2024	10% on gain
Foreign sourced capital gains i.e capital gains from disposals of assets held outside Malaysia and acquired at any time in the past	Taxpayer's prevailing tax rate

Key definitions

Some key definitions to take note from the implementation of CGT are as follows:

Terms	Definitions
Capital Asset*	a) movable or immovable property situated outside Malaysia including any rights or interests thereof; or b) movable property situated in Malaysia which is a share of a company incorporated in Malaysia not listed on the stock exchange (including any rights or interests thereof) owned by a company, limited liability partnership, trust body or co-operative society.
Consideration	Consideration in money or money's worth.
Disposal	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.
Shares*	In relation to a company, includes stock other than debenture stock.

Note (*) – Proposed amendments to the definitions pursuant to the Income Tax (Amendment) Bill 2024.

Some key points to take note are the inclusion of reduction of share capital under the definition of "disposal".

In a capital reduction exercise ("CRE"), there is no buyer and seller per se as it is merely a return of capital to the shareholder by extinguishing the company's shares. However, as this type of transaction has been included under the definition of disposal, affected taxpayers need to be aware of their obligation to file CGT returns when implementing a capital reduction exercise.

What is Section 15C of the ITA?

Section 15C of the ITA was introduced as an anti-avoidance provision so that the sale of shares of foreign unlisted companies owning Malaysian real property or owning shares of Malaysian companies which in turn own Malaysian real property would be subject to CGT similar to the disposal of Malaysian unlisted company shares.

Section 15C of the ITA is summarised as follows:

“Shares of a foreign company (FC) are deemed to be acquired from Malaysia if the FC owns either:

a) real estate located in Malaysia; or

b) shares in a Malaysian controlled company provided that the real property (including any right or interest thereof) owned by this controlled company in Malaysia is also not less than 75% of the value of its total tangible assets; or

c) both (a) and (b).

Where the market value of (a), (b) or (c) is more than 75% of the value of its total tangible assets of the FC.”

One would note that the 75% rule above is similar to the one adopted for the ascertainment of Real Property Company (“RPC”) shares under the Real Property Gains Tax Act 1976 (“RPGTA”). Thus, the concept is similar which is to avoid taxpayers from structuring the asset ownership via another company (in this case a FC) in an attempt to avoid CGT.

Are there exemptions available?

In the tabling of the Revised Budget 2024 on 13 October 2024, our Prime Minister and Finance Minister, YAB Dato' Seri Anwar bin Ibrahim had announced that to ensure the smooth implementation of CGT and reduce the cost of doing business, CGT exemption will be given on the following disposals of shares :

a) Initial public offerings (IPO) approved by Bursa Malaysia.

b) Restructuring of shares within the same group of companies.

c) Exemption on foreign sourced capital gains subject to meeting economic substance requirements (refer to Page 8).

As a reference for economic substance-based exemption, Singapore requires an employment of an adequate number of qualified and experienced employees, incurs an adequate amount of business expenditure and requires the key decisions of the company to be made by persons based in Singapore, while Hong Kong requires the employment of an adequate number of qualified employees and incurs an adequate amount of operating expenditure for carrying out specified economic activities in Hong Kong.

Recently on 16 January 2024, Finance Minister II, Datuk Seri Amir Hamzah Azizan announced that the government has agreed for unit trusts to be exempted from CGT from 1 January 2024 to 31 December 2028 and for foreign sourced income ("FSI") to be exempted from 1 January 2024 to 31 December 2026.

As we wait for the guidelines on exemptions to be issued, there are a few questions for which we hope the law would provide clarity:

a) What are the conditions to be imposed to qualify for the exemptions? Will the Government impose similar conditions that it imposes for companies to qualify for the stamp duty reliefs under Section 15 or Section 15A of the Stamp Act,1949?

b) What are the economic substance requirements to qualify for the exemption on foreign sourced capital gains?

Clarity on the conditions would ease the burden of taxpayers to plan for their business as they have to take into account CGT as well as the actual application of the exemption itself.

Exemption on foreign sourced capital gains

The Income Tax (Exemption) (No.3) Order 2024 was published on 4 March 2024 and subsequently the guidelines on the Tax Treatment on Gains From The Disposal of Foreign Capital Assets Received From Outside Malaysia ("the Guidelines") were issued on 27 March 2024.

Generally, gains from the disposal of foreign capital assets disposed on or after 1 January 2024 and received in Malaysia would be subject to foreign sourced capital gains tax.

Some examples of foreign capital assets include:

- Immovable properties – land and buildings situated outside Malaysia.
- Movable properties – plant and machinery, motor vehicles, paintings, etc. that are situated outside Malaysia.
- Intellectual property ("IP") – copyrights, patents, software, etc. that are situated outside Malaysia.
- Shares of a company incorporated outside Malaysia which are not subject to tax in Malaysia based on the provisions of the ITA.

Pursuant to the Income Tax (Exemption) (No.3) Order 2024 and the Guidelines, gains from the disposal of foreign capital assets received in Malaysia will be exempted from CGT from 1 January 2024 until 31 December 2026. The exemption is subject to compliance with the economic substance requirements as follows:

a) Employment of an adequate number of qualified employees to carry out the specified economic activity in Malaysia; and

b) Incur an adequate amount of operating expenditure to carry out the specified economic activity in Malaysia.

The appropriate number of qualified employees and operating expenditure will be based on the facts of the case. Factors that are considered include:

- The type of business activity of the company, i.e. labor-intensive industries would require more employees whilst capital-intensive industries may require less employees;
- Whether the employees work full-time or part-time; and
- Whether the office premises have been used to carry out related activities and are sufficient for those activities.

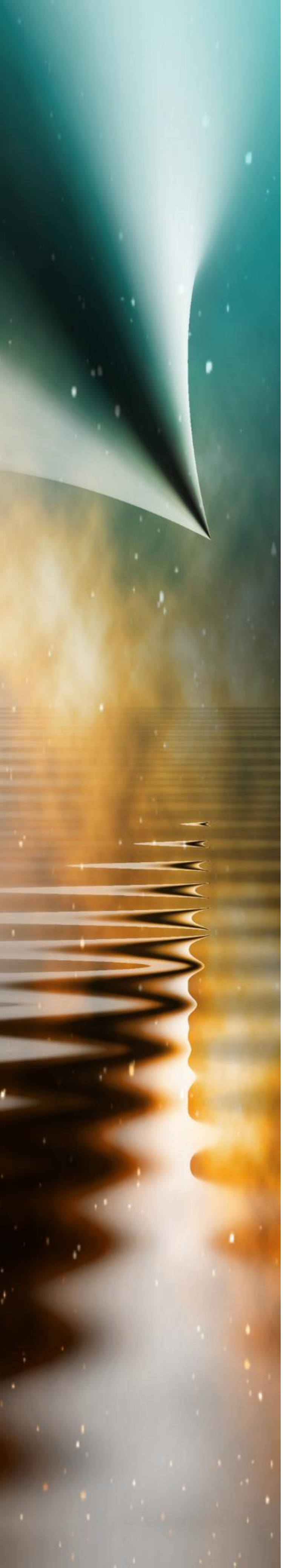
Interactions among CGT, Income Tax and RPGT

Currently, there are two taxes which may be applicable on the disposal of real property in Malaysia and on RPC shares i.e., income tax and real property gains tax (“RPGT”). Depending on the circumstances of each case, the disposal of real property in Malaysia and RPC shares could be taxed under income tax or RPGT. However, now that CGT has been implemented, we summarise below how a disposal of real property in Malaysia and RPC shares could be taxed in Malaysia.

Tax	Summary
Income Tax	Generally, a taxpayer could be taxed under income tax on the disposal of real property in Malaysia and on RPC shares if the said disposal is the business activity of the taxpayer or the disposal has been conducted as an adventure in the nature of trade. A test to determine whether the said disposal is conducted as an adventure in the nature of trade would be the badges of trade which are as follows: • Profit-seeking motive • Frequency of transactions • Length of Ownership • Nature of Asset • Source of Finance • Method of Acquisition • Expertise and Knowledge • Way the sale was carried out • Existence of similar trading transaction or interest
Real Property Gains Tax	• An individual taxpayer disposing of real property in Malaysia and RPC shares would be subject to RPGT. • A company, an LLP, a trust body or a co-operative society disposing of real property in Malaysia would be subject to RPGT. • Effective 1 January 2024, a company, an LLP, a trust body or a co-operative society disposing of RPC shares would no longer be subject to RPGT because such disposals would be subject to CGT (see below).
CGT	• Effective 1 March 2024*, a company, an LLP, a trust body or a co-operative society disposing of Malaysian unlisted company shares would be subject to CGT. • Effective 1 January 2024, a company, an LLP, a trust body or a co-operative society disposing of foreign capital assets would be subject to CGT.

*The effective date for CGT implementation on the disposal of Malaysian unlisted company shares has been deferred to 1 March 2024 with the gazette of Income Tax (Exemption) (No.7) Order 2023.

Based on the summary above, one would note that there is a two (2)-month period between 1 January 2024 and 29 February 2024 whereby a disposal of RPC shares could potentially not be subject to either RPGT or CGT.



What should companies do?

Businesses should proactively review their group's corporate plans in the coming years and assess whether there are any opportunities for restructuring of the group's corporate structure, divestment of companies or undertaking of any other corporate exercises that may involve the disposal or transfer of unlisted shares, shares deemed acquired in Malaysia under Section 15C of the ITA or foreign capital assets.

How Crowe Can Assist You

In addition to reviewing the group's corporate plans and highlight transactions that may be impacted by CGT, we will also provide insights on the potential tax implications such as:

- To determine whether the disposal or transfer of capital assets is taxable under income tax, RPGT or CGT.
- To comment on the potential impact of RPGT or CGT, where applicable.
- To highlight other potential tax implications, i.e. stamp duty, etc.
- To recommend tax efficient methods to meet the group's objectives.

Summary

In the past, the disposal of real property has always been a point of contention for certain taxpayers whether it should be taxed under income tax or RPGT.

With the implementation of CGT, a third type of tax has been added into the mix. Depending on the class of taxpayers and the circumstances of the case, the disposal of RPC shares may be subject to either income tax, RPGT or CGT.

More than ever, it is important to ensure that any gains or income earned should be subject to the appropriate type of tax.

If your business is bracing for the impact of Capital Gains Tax and navigating the complexities of Malaysia's evolving tax landscape, we understand the challenges you may face. Whether you need assistance in strategizing, compliance, or understanding the intricacies of these tax changes, we are here to help. Please feel free to reach out to us, and our expert team will be glad to provide tailored guidance and support for your specific needs. Together, let's ensure your business thrives in this dynamic fiscal environment. Get in touch with us today to embark on a proactive approach to financial success.

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