

CAPITAL GAINS TAX: ITS IMPLEMENTATION AND THE BROADER IMPACT CONCURRENTLY WITH INCOME TAX AND RPGT

Michael Cheah Liat Sheng

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.

Before the enactment of the CGT laws, Malaysia did not impose CGT except on gains arising from the disposal of real property in Malaysia and Real Property

Company (RPC) shares which may be subjected to Real Property Gains Tax (RPGT) at a maximum RPGT rate of 30%.



What is Capital Gains Tax?

Generally, CGT is a tax levied on capital gains accruing from disposals of investments, i.e. shares, bonds, cryptocurrencies, precious metals, real properties, etc. The tax will be levied at the point of disposal of the investments.

Although CGT in general covers a wide group of assets, the CGT introduced in Malaysia will only be imposed on capital gains from the disposal of Malaysian unlisted shares and foreign capital assets where the gains are remitted into Malaysia.

As a comparison, some ASEAN countries that have already implemented CGT and their respective tax rates are as follows:

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?

CGT is imposed on a selected category of taxpayers, namely companies, trust bodies, limited liability partnerships (LLP) and co-operative societies.

It is an important point to note that individuals are not impacted by CGT.

Implementation Dates

In line with Malaysia's commitment to align with international tax standards on taxation of foreign income, CGT had been introduced to be effective from 1 January 2024 but an exemption was subsequently

gazetted for the disposal of local capital assets. The implementation dates are as follows:

EFFECTIVE DATE	TYPES OF CAPITAL ASSETS AFFECTED
1 Jan 2024	Foreign Capital Assets
1 Mar 2024*	<ul style="list-style-type: none"> Malaysian Unlisted Shares Shares Deemed Acquired in Malaysia Pursuant to S. 15C of the Income Tax Act 1967 (ITA 1967)

**The effective date has been deferred to 1 March 2024 with the gazette of Income Tax (Exemption) (No. 7) Order 2023 and Income Tax (Exemption) (No. 2) Order 2024.*

Types of Capital Assets subject to CGT

CGT will be imposed on gains on disposal of both local and foreign capital assets. For local capital assets, CGT is only imposed on the disposal of Malaysian unlisted shares and foreign unlisted shares deemed acquired in Malaysia under S. 15C of the ITA 1967. S. 15C of the ITA 1967 is covered in detail below.

Whereas for foreign capital assets, the disposal of all types of foreign capital assets

are subject to CGT. This may include listed or unlisted shares, real properties, vehicles, paintings, any other types of moveable or immovable assets and intellectual properties owned overseas by a Malaysian resident.

Salient Points on the Introduction of CGT

When to file and pay CGT?

CGT return has to be filed and any CGT payable has to be paid within 60 days from the date of disposal of the Malaysian unlisted shares or shares deemed acquired in Malaysia pursuant to S. 15C of the ITA 1967. For each disposal of a Malaysian capital asset, CGT return has to be filed electronically with the Inland Revenue Board of Malaysia (HASiL).

Whereas, for disposal of foreign capital assets where the gains are remitted into Malaysia, the CGT is to be declared in the taxpayer's annual income tax returns.

Date of disposal?

Similar to RPGT, the date of disposal for CGT will be the date of agreement or where there is no agreement, the date of completion of the disposal. The date of completion of the disposal may be the date of transfer of ownership or the date when the full consideration has been received, whichever is earlier.



Where the disposal is subject to government's or state government's approval, then the date when such approval is received shall be the date of disposal.

How to compute the capital gains?

Generally, capital gains is computed by taking the disposal price less incidental costs minus the acquisition price plus incidental costs.

However, in certain circumstances the deemed market value can override the disposal price or to be used if no disposal price is available.

CGT Rates

EFFECTIVE DATE OF ACQUISITION	TAX RATE OF CHARGEABLE PERSON
Malaysian unlisted company shares acquired before 1 January 2024	10% on chargeable income or 2% on gross proceeds
Malaysian unlisted company shares acquired after 1 January 2024	10% on chargeable income
Foreign sourced capital gains i.e. capital gains from disposals of assets held outside Malaysia	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 (*) – Amendments to the definitions pursuant to the Income Tax (Amendment) Act 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 S. 15C of the ITA 1967?

S. 15C of the ITA 1967 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 companies which in turn own Malaysian real property would be subject to CGT similar to the disposal of Malaysian unlisted company shares.

S. 15C of the ITA 1967 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 75% or more 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 RPC shares under the Real Property Gains Tax Act 1976. 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 Budget 2024 on 13 October 2023, 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.

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 to be issued with respect to the exemptions for approved IPOs or restructuring of shares within the same group of companies, 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?
- (b) Will the government impose similar conditions that it imposes for companies to qualify for the stamp duty reliefs under S. 15 or S. 15A of the Stamp Act 1949?

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 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 1967.

Pursuant to the Income Tax (Exemption) (No.3) Order 2024 and the Guidelines, gains from the disposal of foreign capital assets received in Malaysia by companies, trust bodies, LLPs and co-operative societies 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. labour-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 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: <ul style="list-style-type: none">• Profit-seeking motive• Frequency of transactions• Length of ownership• Nature of asset• Source of finance• Method of acquisition• Expertise and knowledge• Way of carrying out the sale• Existence of similar trading transaction or interest.
RPGT	<ul style="list-style-type: none">• 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	<ul style="list-style-type: none">• 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. However, exemption may be applicable as mentioned above.

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 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 S. 15C of the ITA 1967 or foreign capital assets.

In addition to reviewing the group's corporate plans and transactions that may be impacted by CGT, potential tax implications such as the following should be considered:

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

Conclusion

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.

Disclaimer: This article does not seek to address all tax issues associated with capital gains tax and all views expressed are purely the personal opinions of the author.

Michael Cheah Liat Sheng is an Associate Director, Crowe KL Tax Sdn Bhd. He can be contacted at michael.cheah@crowe.my.