TaXavvy

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IRB's Practice Note 2/2018

A "non-application" or "mutual exclusion" provision is a common feature in exemption orders and income tax rules granting tax incentives. There had been some confusion as to which types of Section 127 exemptions would exclude taxpayers from claiming incentives under specific gazette orders made under the Income Tax Act 1967. The IRB has now issued a practice note to explain and provide clarity on how mutual exclusion by reason of a Section 127 exemption works.

Practice Note 2/2018: Explanation in relation to application of non-application provisions stated in Orders/Rules under the Income Tax Act 1967 ("PN 2/2018") was issued on 1 June 2018.

The non-application provisions are mutual exclusion provisions which restrict a taxpayer from claiming a tax incentive if he is currently enjoying any of the tax incentives listed in the non-application provision of the gazette order. Where Section 127 of the Income Tax Act 1967 (ITA) is included in the mutual exclusion list of a gazette order, the taxpayer therefore cannot make a claim for the incentive offered in the said gazette order.

Scope of "exemption granted under Section 127"

The clarification addresses the common interpretation issue when a non-application provision is broadly expressed as "exemption granted under Section 127" without specifying which (or all) of the following sub-sections under Section 127 is to be covered:

- Section 127(1) [income exempted under Schedule 6 of the ITA],
- Section 127(3)(b) [exemptions made under gazette orders],
- Section 127(3A) [exemptions given directly by the Minister of Finance, usually via a letter to the taxpayer].

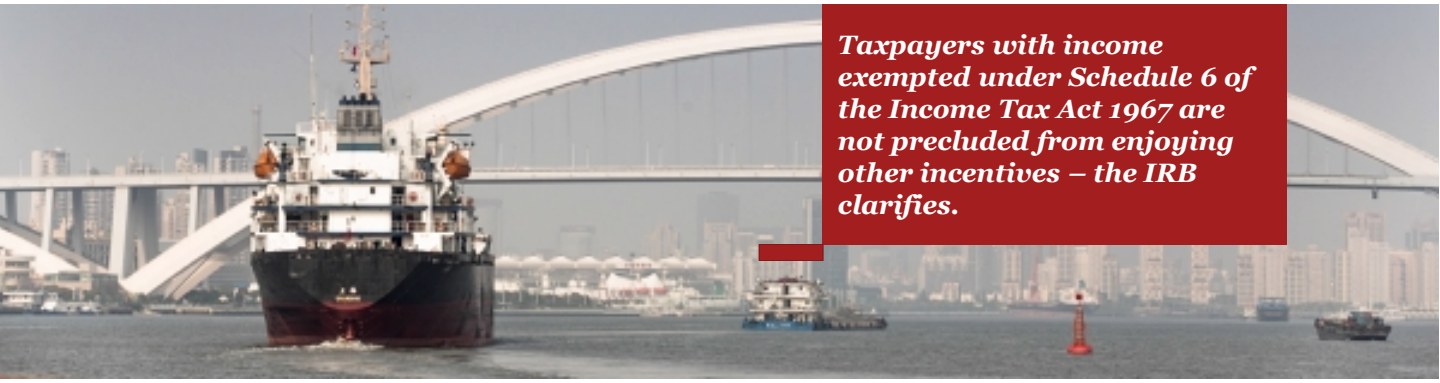
In PN 2/2018, the IRB clarifies that the scope of "exemption granted under Section 127" under a non-application provision covers exemptions granted under the following sub-sections:

- Section 127(3)(b) [exemptions made under gazette orders], and
- Section 127(3A) [exemptions given directly by the Minister of Finance].

This is because the exemptions under the abovementioned sub-sections are specific exemptions granted based on the merits of each case or particular situations. Whereas, the income exemptions under Schedule 6 (section 127(1)) are given on a general basis. Therefore a taxpayer which has income exempted under Schedule 6 is still eligible to enjoy the incentive under any gazette order, subject to the conditions therein, while those granted the specific exemptions under sections 127(3)(b) and 127(3A) would not be.

Our comments

With the above clarification from the IRB, consideration should be given to claim incentives (which may not have been previously claimed where a different interpretation of the mutual exclusion clause above was adopted) in income tax returns.



Taxpayers with income exempted under Schedule 6 of the Income Tax Act 1967 are not precluded from enjoying other incentives – the IRB clarifies.

Public Ruling 1/2014 – Withholding tax on special classes of income

The IRB has recently made amendments to this public ruling, providing certainty on its position with regards to (i) the classification of payments made to non-resident models for photo shoots, and (ii) the re-grossing of payments made to non-residents for the purpose of determining the amount of the withholding tax due where the withholding tax is borne by the payer of such payments.

Payments to non-resident models for photo shoots

Paragraph 8.5(f) and example 12 of *Public Ruling 1/2014 – Withholding tax on special classes of income* ("PR 1/2014"), which previously illustrated that payments made to non-resident models for photo shoots taken in Malaysia were treated as special classes of income under section 4A of the ITA, have been deleted.

A similar example was incorporated by IRB in *Public Ruling 6/2017 – Withholding tax on income of a non-resident public entertainer* ("PR 6/2017"). In example 5 of PR 6/2017, an international supermodel from USA who participated in a fashion show, commercial and photoshoot in Malaysia is considered as a public entertainer, and fees paid to the model is subject to withholding tax under section 109A of the ITA.

Payments made to a non-resident model for photo shoots taken in Malaysia now fall within the scope of payments to a public entertainer, and is subject to withholding tax under section 109A.

Withholding tax borne by payer

Example 25 of PR 1/2014 was amended to reflect the IRB's position with regards to the computation of withholding tax due where the said withholding tax is borne by the payer. Previously, the withholding tax due was computed based on the actual amount paid to the non-resident. Based on IRB's revised example, the amount paid to the non-resident is to be re-grossed to include the withholding tax which is borne by the payer. The withholding tax due is then computed on the re-grossed amount of the payment.

	Original PR 1/2014	Revised PR 1/2014
Gross technical fees paid to non-resident	150,000*	150,000*
Withholding tax payable to IRB	15,000	16,667
Total expense of payer	165,000	166,667
Computation of withholding tax to be withheld		
Amount subjected to withholding tax (i.e. the gross / re-grossed amount).	150,000	$150{,}000 \times {}^{100}/_{90}$ = 166,667
Withholding tax at 10% of gross / re-grossed amount.	15,000	16,667

** Note: Only the gross technical fee paid to non-resident is deductible for tax purposes.*

Re-grossing of payments made to non-residents applies in computing withholding tax borne by payer.

Our comments

It is interesting to note that the IRB's latest position is not in line with the decision in the tax case of EPM Inc. v Ketua Pengarah Hasil Dalam Negeri (2001) MSTC 3306 where it was held that "...there is no basis or provision for grossing up".

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