

# Tax Residence Status of Investment Holding Companies in Malaysia

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## Introduction

This article examines the law in relation to the determination of corporate tax residence status under the Malaysian Income Tax Act, 1967 (the Act) and issues arising from the development in other jurisdictions and the application of double tax treaties to the concept of corporate residence. The interpretation of concepts relating to corporate residence has not been the subject of much dispute in Malaysia and hence the lack of reported judgments that can be relied on as precedents. As such the developments in other countries are examined to assist in understanding the determination of corporate residence in Malaysia. An investment holding company for the purposes of this article shall be deemed to be a company that does not carry out any business activity but is only in receipt of investment income.

## The Significance of Determining Residence Status

The scope of taxation in Malaysia is largely the territorial basis, i.e., only income that is sourced within Malaysia is subject to tax, except in the case of companies involved in banking, shipping, sea or air transport which are subject to tax on a world scope on their business income. As such, where a resident investment holding company invests offshore, the dividends therefrom are not subject to tax in Malaysia. The offshore income can be credited to an exempt account for the payment of exempt dividends to shareholders. However tax laws of the foreign jurisdictions may be applicable at the source countries of such overseas investment with relevant application of treaty provisions where Malaysia has signed any avoidance of double taxation treaty. For treaty purposes companies may be required to obtain certification confirming their resident status from the Revenue authorities. Under section 8(2) of the Act, where such a determination is made, it shall be presumed that the company is resident in Malaysia for the purposes of this Act for the basis year for every subsequent year of assessment until the contrary is proved. A company which is resident in Malaysia is subject to the provision of Section 108 of the Act, in relation to franking of dividends paid in addition to other responsibilities and privileges.

## The Law

In Malaysia, section 8 of the Act provides for the determination of residence status in respect of companies. The residence status is determined under subsection (1)(b) when the company is carrying on a business or businesses and for any other company under subsection (1)(c) as reproduced:

## 8. Residence: companies and bodies of persons

(1) For the purposes of this Act—

- (a) a Hindu joint family is resident in Malaysia for the basis year for a year of assessment if its manager or karta is resident for that basis year;
- (b) a company or a body of persons (not being a Hindu joint family) carrying on a business or businesses is resident in Malaysia for the basis year for a year of assessment if at any time during that basis year the management and control of its business or of any one of its businesses, as the case may be, are exercised in Malaysia; and
- (c) any other company or body of persons (not being a Hindu joint family) is resident in Malaysia for the basis year for a year of assessment if at any time during that basis year the management and control of its affairs are exercised in Malaysia by its directors or other controlling authority.

### Corporate Residence of Investment Holding Companies

As emphasized above, Section 8 (1)(b) provides for a company 'carrying on a business or businesses' while section 8(1)(c) provides for 'any other company', i.e., a category that would include companies not carrying out business, such as an investment holding company, which will be the subject of examination here. As such any reference to the resident status of an investment holding company should be based on section 8(1)(c). The requirements of this section are based on facts with reference to:

- management and control
- of affairs exercised in Malaysia
- at any time during the basis year
- by its directors or other controlling authority

### Foreign-Owned Malaysian Companies

Where a company is incorporated under the Companies Act, 1965 it is subject to local company law and accounting standards. Incorporation under the Companies Act, 1965 in itself creates many legal obligations and responsibilities for the company in Malaysia. Although incorporation raises a *prima facie* inference that the company is tax resident in Malaysia, the above mentioned requirements will be the determining factors for tax purposes. Such an impression is created as the local company may have directors resident in Malaysia.

### Management and Control

Although the meaning of these expressions has been considered many times by the courts in other countries where the law is similar, it has not been considered in any depth by the Malaysian courts. Foreign cases that defined 'management and control' often dealt with companies carrying out business activities. Although section 8 makes a clear distinction between management and control of a business in subsection 8(1)(b) and

management and control of the affairs of the company in subsection 8(1)(c), decisions of foreign courts rarely make such a distinction (see Thornton's Malaysia Tax Commentaries, 2<sup>nd</sup> Edition). Most of the foreign authorities have been concerned with defining 'central management and control' while the Act refers to only 'management and control'.

In the UK cases, it has been held that central management and control of a company normally 'abides' at the place where the directors hold their meetings. The residence of individual directors or shareholders or the place of the company's general (i.e. shareholders) meeting are usually irrelevant considerations (see Adrian Shipwright, Textbook on Revenue Law, 1997, pg 556). As such reference to UK cases on corporate residence must be examined with caution as the position in UK itself has changed since 1988. The author has this to say in respect of determining residence status in the UK:

*Previously the place of incorporation of a company did not matter greatly in determining a company's residence in the UK. There is now a distinction to be made between UK and non-UK incorporated companies as to the test of residence to be applied. Since 1988 a UK incorporated company is treated as UK resident by reason of its incorporation in the UK whether or not by other tests it would be resident outside the UK. If a company is incorporated in the UK it is UK resident by reason of that fact. Other companies (i.e., companies incorporated outside the UK) are treated as resident where the 'centre of management and control' of the company is situated. The meaning of the 'centre of management and control' is a matter of case law.*

In most cases where the function of directors has been considered, it has been in relation to 'central management and control' of the business of a company. Most decided cases show conclusively that the statutory control of a company is vested in its directors and that a company is controlled where its directors effectively exercise that control.

It is submitted that 'management and control' is substantially different from 'central management & control' as the former can lead to dual residence depending on the laws on corporate residence in the countries involved. As such the present legislation in Malaysia may lead to dual residence as the requirement for 'central' or 'effective' management and control is not specifically referred in our domestic legislation. As the Act does not make reference to 'central', defining this expression is beyond the scope of this article.

## **‘Management and Control at any Time in the Basis Year & Central Management and Control’**

Since the requirement of section 8 is in reference to management and control ‘at any time during the basis year’, thus management and control in the Malaysian context need not be exercised over the whole basis year in order to establish a corporate residence in Malaysia. Therefore, the holding of a single board of directors’ meeting in Malaysia may lead to the company being resident in Malaysia (see Veerinderjeet Singh, Malaysian Taxation, Administrative & Technical Aspects, 6<sup>th</sup>. Edition at page 296).

The author goes on to say further that:

*“ It must, however, be noted that for the purposes of the Malaysian Act, it is merely necessary to show in the case of a company conducting a number of business, that the management and control of any one of the company’s businesses were at any time in the basis year managed and controlled in Malaysia. There is no need to establish central management and control in Malaysia. Even if central management and control might be exercised outside Malaysia, if it can be shown that there was any meeting of the directors in Malaysia or that at any time in the basis year, the management and control of any business of the company was exercised in Malaysia, then that company would be resident in Malaysia for the basis year.*

The above mentioned opinion was also expressed by the eminent commentary of Leo D Pointon in Revenue Law in Singapore and Malaysia, 2<sup>nd</sup>. Edition, 1993 at page 239:

*“Clearly, the residence provisions in Malaysia, while having a superficial similarity to those in Singapore are significantly different. Unlike SITA, MITA looks to test residence in a basis period which is the preceding year.*

*The Malaysian test is more stringent in two further respects. To the extent that management and control is exercised in the basis year in respect of its business or any one of its businesses, the company will be resident. It will also be resident if management and control is exercised at any time during the basis year. That is, only one directors’ meeting held in Malaysia may be sufficient to render the company resident, even though all their other board meetings are held outside the Federation.”*

In both subsections 8(1)(b) and 8(1)(c), the requirement of control ‘at any time during the basis year’ is mentioned and as such, from the above, the determination of corporate residence can be inferred from a single meeting of the board of directors in Malaysia.

## **Dual Residence and Foreign Linked Companies**

As the Act does not make reference to ‘central management and control’ or ‘effective management on control’ but merely ‘management and control by directors or other controlling authority’, there is a possibility that the company may be resident in more than one jurisdiction. Furthermore there is no single determining factor or universal definition used by all countries and as such dual residence is a real possibility. In the UK, and in the United States, residence is determined by the *situs* of incorporation. The proposition that a company may be resident in two or more countries at the same time was laid down in the case of *Swedish Central Railway Co. Ltd v Thompson* (9 TC 342).

Where multinational companies and companies within a group operate with a strong influence from parent or holding companies, the issue of real control or central management and control may be raised. In *Bullock v The Unit Construction Co. Ltd* (38 TC 712), where the parent companies usurped the supervision of their affairs of certain East African subsidiaries, it was held that the subsidiaries were resident in the UK. However in a more recent High Court case: *Wood v Holden* [2005] EWHC 547 (Ch) in UK it was opined that the facts in *Bullock’s* case were exceptional. It was a case in which the local boards stood aside altogether, and the parent company effectively usurped what in theory were the functions of the local boards.

Justice Park had this to say:

*“In the context of a group of companies where matters proceed in a normal way and not in an exceptional way it is to be expected that the parent company will have plans for what it wants its subsidiaries to do, and that the directors of the subsidiaries will ordinarily be willing to go along with the parent company’s wishes. If in those circumstances the subsidiaries were resident for tax purposes wherever the parent company is resident the consequences would, in my view, be unsatisfactory, productive of double taxation clashes between different jurisdictions, and disruptive of national tax systems”.*

There is a difference between, on the one hand, exercising management and control and, on the other hand, being able to influence those who exercise management and control. In the case of an investment holding company or special purpose vehicle companies, their active affairs may be limited. In many cases the acts of such companies though important, tend not to involve much positive outward activity. So the companies do not need frequent and lengthy board meetings.

### Shareholding and Location of Shareholders

The shareholding and location of the shareholders have no relevance to the determination of residence status of an investment holding company under section 8(1)(c), which does not impose any other requirement besides that which are highlighted above. Section 8(1)(c) makes reference to control by 'directors or other controlling authority'. The management and control of companies are usually in accordance with the Articles of Association of companies and usually vests in the hands of the directors unless the facts of a case show that there is another controlling authority. In any case a company is controlled by the directors and not the shareholders (see *Automatic Self-Cleansing Filter Syndicate Co. v Cunninghame* [1906] 2 Ch ).

### Location of Investments Outside Malaysia

The location of investment outside Malaysia is of no relevance in determining residence status under section 8(1)(c), which merely requires the management and control of the affairs of the company to be conducted in Malaysia.

It does not matter where the company's assets are situated. Thus a company with assets in India was resident in the United Kingdom as the board of directors met in the United Kingdom (*Calcutta Jute Mills v Nicholson* (1 TC 83)). Conversely, a company with assets in Egypt was held to be resident there as the directors also met there (*Todd v Egyptian Delta Land and Investment Co. Ltd* (14 TC 119)).

In *De Beers Consolidated Mines, Ltd. v Howe* (5 T.C. 198) a company that operated diamond mines in South Africa was held to be resident in the U.K. because the consideration was 'central management and control' as seen from the location of board of directors' meetings and not the location of business activity. As such, the location of investment has no bearing on the determination of residence status. However these cases are cited only to stress that location of business has no bearing in determining 'central management and control' which is a concept alien to the provisions of the Act which only makes reference to 'management and control', thus enabling the possibility of residence in more than one country.

### Shareholding by Directors

There is no requirement under the Act or the Companies Act, 1965 that necessitates shareholding by directors. In any case in determining residence status, this is an irrelevant factor and does not affect the determination of residence status of an investment holding company. Shareholder control does not in general matter in determining the residence of a company (see *Kodak Ltd v Clarke* [1903] 4 TC 549).

### Distinguishing Statutory Provisions and Common Law Perspective

The basic test that evolved from these cases is the 'central management and control' test. The test seems to have originated in the Court of Exchequer in 1876: *Calcutta Jute Mills Co Ltd v Nicholson* 1 TC 83, and *Cesena Sulphur Co Ltd v Nicholson* 1 TC 88. It was adopted some thirty years later by the House of Lords in what is generally regarded as the seminal authority on the matter: *De Beers Consolidated Mines Ltd v Howe* [1906] AC 455. Lord Loreburn said at page 458:

*"... the principle that a company resides for purposes of income tax where its real business is carried on. ... I regard that as the true rule, and the real business is carried on where the central management and control actually abides."*

Several jurisdictions have now amended their provisions and included other requirements especially for companies not incorporated within the jurisdiction. This has now come to be known as the 'statutory test'. Among the countries that have provisions where incorporation is a criterion are Sweden, UK, the United States of America and Australia. For instance in the case of Australia, the 'statutory test' refers to the requirements in paragraph 6(1) of the ITAA 1936 that a company that is not incorporated in Australia must carry on business in Australia and have its central management and control in Australia in order to be a 'resident of Australia'. It was acknowledged in the ATO's Taxation Ruling (TR 2004/15) that in the early cases in Australia, the relevant provision referred to a person being a 'resident' in a particular place and not whether the company was a 'resident of Australia', which is what the statutory definition is concerned with. Similarly in Malaysia, when defining corporate residence, the statutory provisions should not be equated with the requirements of the common law test of 'central management and control' but only to 'management and control' as there are fundamental differences from adding the adjective 'central'. So will the case be if the adjective 'effective' was added. However it is not denied that these foreign cases have immensely contributed in the interpretation of 'management and control'.

### Location of Directors

Where the Board of Directors includes foreign based directors, it is not uncommon to have meetings in more than one jurisdiction. Furthermore with the use of modern technology such as video conferencing, e-mail, and internet, and changed business practices (such as those of dual listed companies) it is possible to participate in management from anywhere in the world with the use of these technologies (and the efficiencies they provide). Where can then 'management and control' be pin-pointed?

# TAX RESIDENCE STATUS...

Some jurisdictions focus on where the participants contributing to the high level decisions are located rather than where the electronic facilities are based. Unless there is difficulty in making this judgment, then other factors such as the location of the initiating secretariat will feature in the decision making. One such instance may be when there is an equal number of local and foreign based directors attending a "meeting". In the context of the Malaysian legislation, which provides for such management and control to be exercised at any time in the basis period, then a minimum of one board meeting initiated in Malaysia will suffice.

## Fiscal Domicile Article in Avoidance of Double Taxation Treaties

Where the issue of dual residence is confronted among treaty partners, the Article on Fiscal Domicile (Article 3 or 4 in Malaysian Treaties) is resorted to. The OECD Model provides the following:

*"Where by reason of paragraph 1, a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated"*

The 'effective management test' can conjure a different meaning and connotation as compared to 'management and control' or 'central management and control'. As such it is possible for a subsidiary of a multi-national company to have management and control in Malaysia where the Board of Directors meetings are held and effective management and control in another jurisdiction where the holding company is located and from where the Board's decisions are influenced.

Malaysia has adopted the OECD position in several treaties such as that with France (Paragraph 3 of Article 4), Australia (Paragraph 4 of Article 4), Belgium (Paragraph 3 of Article 4), and India (Paragraph 3 of Article 4) to name a few. However in the case of Sweden, the following was adopted:

*"3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to settle the question by mutual agreement"*.

This is not surprising, as pointed out above, the situs of incorporation is an important determinant in the Swedish provisions. The mutual agreement provision is also

adopted in the Pakistan, Thailand, and the 2005 South Africa treaties (not effective yet). However a combination of "effective management" criterion and "mutual agreement" way is adopted in several treaties such as that with South Korea and China. It is also interesting to note a different provision in the case of paragraph 3, of Article 3 in the New Zealand treaty:

*(3) Where, by reason of the provisions of paragraph (1) of this Article, a person other than an individual is both a New Zealand resident and a Malaysian resident it shall, for the purposes of this Agreement, be treated solely as a New Zealand resident if the centre of its administrative or practical management is situated in New Zealand and solely as a Malaysian resident if the centre of its administrative or practical management is situated in Malaysia whether or not any person outside New Zealand or Malaysia, as the case may be, exercises or is capable of exercising any overriding control of it or of its policy or affairs in any way whatsoever.*

Yet again as highlighted above, different criteria appear to be used in this treaty. These are just several such examples on how the domestic legislation envisaged in section 8 can be modified by treaty provisions. The treaty provisions are resorted to only if the parties (Malaysian authorities and the treaty partner) agree that the question of dual residence arises. However, if for any reason, residence status is denied by any jurisdiction, then the right to invoke treaty provisions as a contracting state becomes questionable.

## Conclusion

Section 8(1)(c) must be interpreted from a statutory perspective and foreign case laws that relate to business activity must be examined with circumspect when applied to the context of an investment holding company. Factors other than those envisioned in the section are irrelevant except where it relates to the interpretation of 'management and control of affairs at any time in the basis period'. The direction of the legislation in other countries indicates that the location of incorporation is given great importance. A locally incorporated company should not be denied tax residence status if the company fulfills the requirements of section 8(1)(c) and nothing more.

## Author's Profile

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