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PREMIER TAX EVENT OF THE YEAR
NATIONAL TAX CONFERENCE
2017

25 & 26 JULY 2017 | KUALA LUMPUR CONVENTION CENTRE

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DAY 2: WEDNESDAY, 26 JULY 2017

TAXATION OF ROYALTIES, SERVICES AND WITHHOLDING TAX ISSUES – DIFFERENT PERSPECTIVES

Speaker: Hazlina Hussain
Director
Dispute Resolution & the Board
Secretariat Department
Inland Revenue Board of Malaysia

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OVERVIEW



1

TAXATION OF ROYALTIES

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TAXATION OF SERVICES

3

WITHOLDING TAX ISSUES

4

**SIGNIFICANT IMPACT ON PUBLIC
RULING AND GUIDELINE**

5

**FEDERAL COURT CASE IN
IRBM VS ALAM MARITIM**

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INTRODUCTION

FINANCE ACT
2017
(Act 785)
W.E.F
17.1.2017

- Critical amendments in the Finance Act 2017 on the ITA includes:
 - Amendment on the Royalty definition
 - Deletion of the proviso to Section 15A

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TAXATION ON ROYALTY

**Amendment to Section 2 of the Income Tax Act 1967
(Act 53)**

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Prior to 17th January 2017

“royalty” includes—

(a) any sums paid as consideration for the use of, or the right to use—

(i) copyrights, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks or tapes for radio or television broadcasting, motion picture films, films or video tapes or other means of reproduction where such films or tapes have been or are to be used or reproduced in Malaysia or other like property or rights;

Current

"royalty" includes any sums paid as consideration for, or derived from-

(a) the use of, or the right to use in respect of, any copyrights, software, artistic or scientific works, patents, designs or models, plans, secret processes or formulae, trademarks or other like property or rights;

Section 4, Finance Act 2017 (Act 785)
w.e.f. 17th January 2017

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Copyright Act 1987 (Act 332)

“7. (1) ~~Subject to this~~ section, the following works shall be eligible for copyright:

- (a) literary works;
- (b) musical works;
- (c) artistic works;
- (d) films;
- (e) sound recordings; and
- (f) broadcasts.”

Copyright Act 1987 (Act 332)

“2. “literary work” includes—

- (a) ...;
- (b) ...;
- (c) ...;
- (d) ...;
- (e) ...;
- (f) ...;
- (g) ...; and
- (h) computer programs,”

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**Onestop Software
Solutions (M) Sdn.
Bhd. & Anor v
Masteritec Sdn Bhd
& Ors**
[2009] 8 MLJ 528

• **Issue** : Whether computer software programs protected by copyright under the Copyright Act 1987.

• **Facts of the case** : QnE Software is an accounting software specially designed for use by a person with minimal accounting background. The objective of the QnE Software is to bypass the in depth knowledge required to manage the financial affairs of a business and the day to day financial administration and reporting of a business.

• **Held** : Computer program is protected as a literary work under the Copyright Act 1987. Under s 3 of the Copyright Act 1987, 'literary work' includes 'computer program'. The case of Creative Purpose Sdn Bhd & Anor v Integrated Trans Corp Sdn Bhd & Ors [1997] 2 MLJ 429 at p 437 affirms that a computer program is a literary work. It comprises source codes which are literary works. A computer program also comprises non-literal elements which are protected under the law.

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Damco Logistic Malaysia Sdn.
Bhd. v KPHDN (2011)MSTC 30.

EDP charges – whether it is “royalty”/ DTA
Malaysia-Denmark

KPHDN v Alcatel-Lucent
Malaysia Sdn Bhd & Anor
(2016) MSTC ¶30-134

Payment to NR for global network for voice,
data and video communication

KPHDN v Thompson Reuters
Global Resources
[2016] 10 MLJ 1

Distribution fee as “royalty” under the ITA

KPHDN v Mudah.my Sdn. Bhd.
[2017] 2 MLJ 197

Payment for Software to NR

Finance Act 2017 (Act 785)

- Amendment to the ITA to broaden the scope of “royalty”

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TAXATION OF SERVICES

**Amendment to Section 15A Income Tax Act 1967 (Act 53)
(DELETION OF THE PROVISIO TO SECTION 15A ITA**

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HISTORICAL BACKGROUND ON SECTION 4A

EUROMEDICAL'S
CASE [1983]



FINANCE ACT
1983



FINANCE (No.2)
ACT 2002



1983-2017



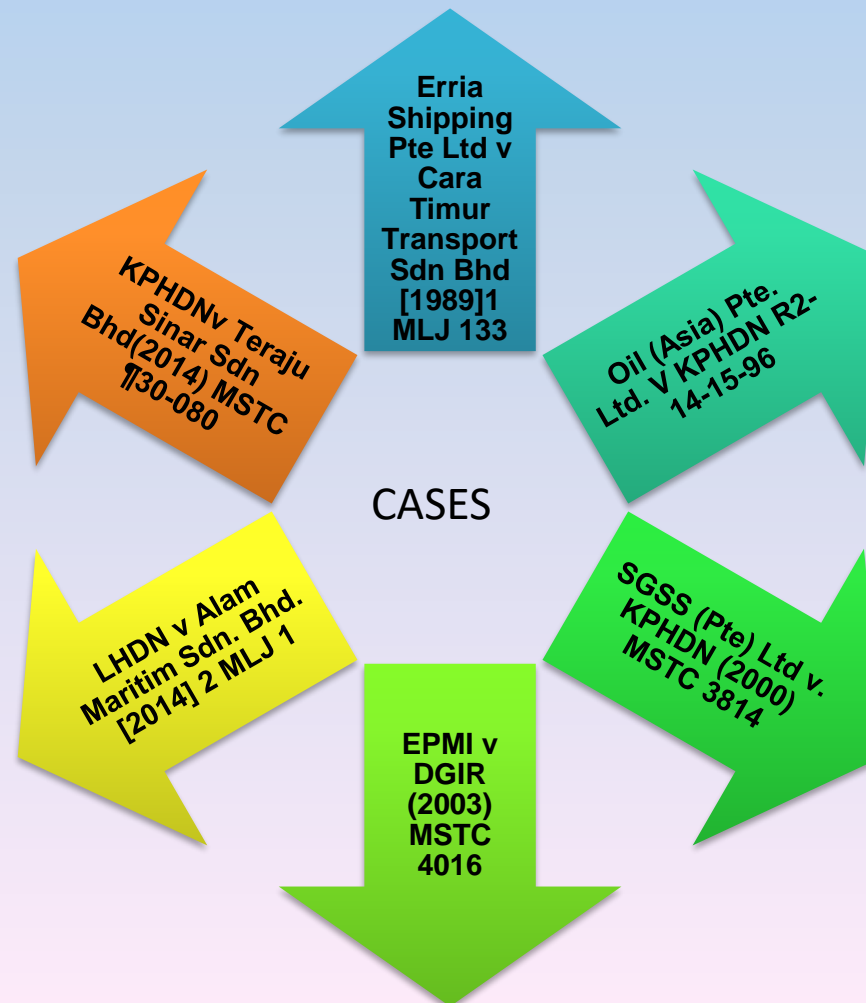
FINANCE ACT
2017

- DGIR v Euromedical Industries Ltd. [1983] CLJ (Rep) 128.
- Introduction of Section 4A/Special Classes of Income by Finance Act 1983 w.e.f. 21.10.1983.
- Insertion of a proviso in Section 15A Income Tax Act 1963
- Section 7. Finance (No.2) Act 2002 (Act 624) w.e.f. 21.9.2002.
- Applies to onshore services.
- Deletion of the Proviso to Section 15A
- Applies to offshore and onshore services.

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HISTORICAL BACKGROUND ON SECTION 4A



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Prior to 17th January 2017

15A Derivation of special classes of income in certain cases

Gross income in respect of-

- (a) amounts paid in consideration of services rendered by a person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;
- (b) amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;
- (c) ...

shall be deemed to be derived from Malaysia-

- (i) ...
- (ii) ...
- (iii) ...

Provided that in respect of paragraphs (a) and (b), this section shall apply to the amount attributable to services which are performed in Malaysia.

Current

15A Derivation of special classes of income in certain cases

Gross income in respect of-

- (a) amounts paid in consideration of services rendered by a person or his employee in connection with the use of property or rights belonging to, or the installation or operation of any plant, machinery or other apparatus purchased from, such person;
- (b) amounts paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration of any scientific, industrial or commercial undertaking, venture, project or scheme;
- (c) ...

shall be deemed to be derived from Malaysia-

- (i) ...
- (ii) ...
- (iii) ...

???

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- PRACTICE NOTE

[PRACTICE NOTE NO. 1/2017](#)

[PRACTICE NOTE NO. 2/2017](#)

<http://www.hasil.gov.my>

- The PM had announced on 12 July 2017 that Guidelines regarding exemption of withholding tax will be issued by MOF by end of July 2017.

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PRACTICE NOTE NO. 1/2017

For contracts
signed and
performed **after**
17.1.2017

The payments to
non-resident are
subject to
withholding tax

Example 1

Contract period/ Service performance period	Implication
1.2.2017 – 31.1.2019	The payments are subject to withholding tax

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PRACTICE NOTE NO. 1/2017

For contracts signed **before 17.1.2017** and the services are performed outside of Malaysia before and after 17.1.2017.

Example 2:

Contract signed for period 1.12.2016 – 28.2.2017.

Service performance period	Implication
1.12.2016 – 16.1.2017	The payments are not subject to withholding tax
17.1.2017 – 28.2.2017	The payments are subject to withholding tax

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PRACTICE NOTE NO. 1/2017

The payments made after **17.1.2017** for services performed outside of Malaysia **before 17.1.2017**, are not subject to withholding tax.

Example 3:

Service performance period	Payment date	Implication
1.12.2016 – 16.1.2017	28.1.2017	The payments are not subject to withholding tax

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PRACTICE NOTE NO. 1/2017

The **payments** made **before 17.1.2017** for **services** performed outside Malaysia **after 17.1.2017**, are not subject to withholding tax.

Example 4:

Service performance period	Payment date	Implication
17.1.2017 – 28.2.2017	1.12.2016	The payments are not subject to withholding tax

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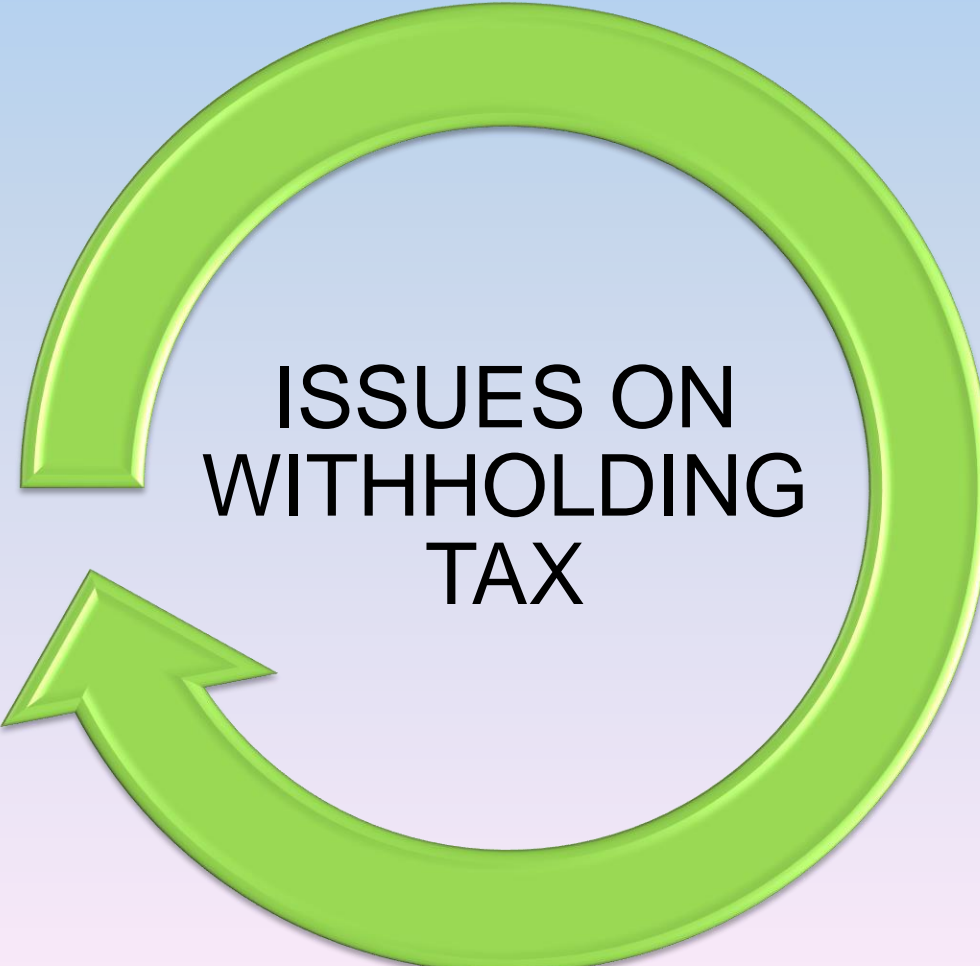
PRACTICE NOTE NO. 1/2017

Malaysia takes the stand that it has the right to impose withholding tax under section 109B on payment for services to the resident of the other Contracting State, irrespective of whether the services are performed in Malaysia or outside Malaysia. **However under certain DTAA's between Malaysia and Contracting States, Malaysia's right to tax is restricted as follows:**

Contracting State	Implication
Singapore	Payment for services performed outside Malaysia are not subject to withholding tax.
Spain	
Australia	Payments for services are not subject to withholding tax.
Turkmenistan	

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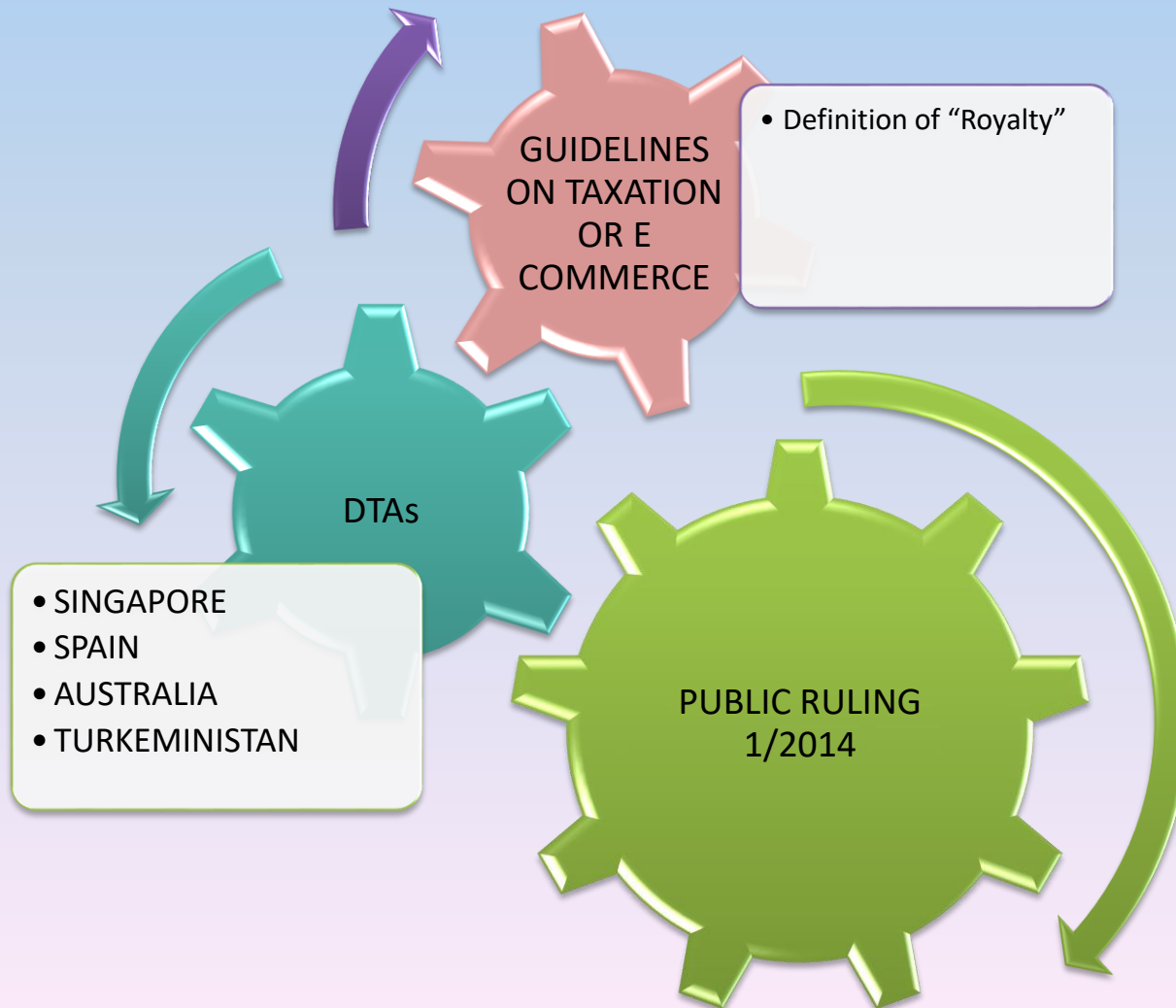


**ISSUES ON
WITHHOLDING
TAX**

- Scope of section 4A
- Technical or Non-Technical services
- Grossing Up
- Impact of the amendments to DTAs on payment of “Royalty” and “services” to Non Resident

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ITA	DTA Malaysia & Singapore	DTA Malaysia & Japan
Royalty	<p style="text-align: center;">Art. 12(3)</p> <p>“3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, and films or tapes for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information (know-how) concerning industrial, commercial or scientific experience.”</p>	<p style="text-align: center;">Art. 12(3)</p> <p>“3. The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including software, cinematograph films and films or tapes for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience, as well as receipts from a bare boat charter of ships or aircraft (other than those dealt with in Article 8).”</p>

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ITA	DTA Malaysia & Singapore	DTA Malaysia & Spain
Sections 4A, 15A and 109B	<p style="text-align: center;">Art. 13</p> <p>“2. The term “technical fees” as used in this Article means payments of any kind to any person, other than to an employee of the person making payments, in consideration for any services of a technical, managerial or consultancy nature.</p> <p>4. Technical fees shall be deemed to arise in a Contracting State when the payer is a resident of that State and the services are performed in that State. ...”</p>	<p style="text-align: center;">Art. 12(1)</p> <p>“1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.</p> <p>7. Fees for technical services shall be deemed to arise in a Contracting State when services are rendered in that State.”</p>

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Erria Shipping Pte
Ltd v Cara Timur
Transport Sdn Bhd
[1989]1 MLJ 133

- Summary judgment application
- The defendant sought to plead in its defence that only S\$17,844.17 was owing to the plaintiff as S\$9,518.33 was paid to the Inland Revenue Department as withholding tax pursuant to s 109B of the Income Tax Act 1967 ('the Act').
- Held : the commission payable is not technical advice rendered under section 109B(1)(b) of the ITA. Even if it extends to “assistance or services” non-technical in nature, there is no evidence that the amount claimed is “in connection with technical management or administration.

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SGSS (Pte) Ltd v.
DGIR (2000) MSTC
3814

- Payment for services rendered by NR in 1984 and 1985.
- High Court decided that the Special Commissioners had failed to interpret the contract to determine the nature of the relationship between the parties.
- The contract did not indicate that the taxpayer was exercising “management, control or supervision: within the exclusionary meaning of “income or profits” under Article 11(1)(I) of the DTA Malaysia-Singapore.

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LHDNM v ALAM
MARITIM SDN. BHD.
[2014] 2 MLJ 1

- Landmark case on Section 4A of the ITA
 - Section 4A is a good law.
 - Regardless of the prominence of the DTA, we must also not lose sight of the fact that the charging law is the Act, and not the DTA.
 - The DTA is merely the mechanism to eliminate double taxation or to grant relief, and has no jurisdiction as regards the imposition or creation of tax. (*Walter Wright (Singapore) Pte Ltd v Director General of Inland Revenue* [1990] 3 MLJ 186)



“In short, effect is given to the clear terms; if he falls under the Act then he must be taxed. Otherwise he is freed of any tax...”

Per Suriyadi FCJ in LHDNM v Alam Maritim Sdn. Bhd. [2014] 2 MLJ 1