Malaysia widens withholding tax net

BY **JOYCE GOH**

The scope of the withholding tax — a tax imposed on non-residents for services rendered to Malaysia-based companies — has been widened. It is one of the major tax changes that came into effect on Jan 17 under the Finance Act 2017.

Under the changes, non-residents must pay withholding tax regardless of whether their services to local companies are rendered in Malaysia or abroad. Previously, only services rendered in Malaysia by non-residents were taxed. So, in essence, the withholding tax net has been widened.

"The re-imposition of the withholding tax on offshore services caught many by surprise. Uncertainties might arise as to whether payment for offshore services to a non-resident would still be subject to withholding tax, given that the non-resident would not have a permanent establishment in Malaysia," says Deloitte Malaysia's International Tax partner Tan Hooi Beng.

"In the past, this withholding tax would not arise when [the services] were not rendered in Malaysia, as it was specifically mentioned that no withholding tax would be imposed if services were rendered outside the country. It was very clear in the law. But recently, that provision was removed — so that means most services provided outside the country by a non-resident to Malaysian resident companies are also caught in the withholding tax net."

Asked if the latest withholding tax treatment, which covers services provided onshore and offshore, is similar to other countries, Tan notes that most advanced countries impose a withholding tax on services rendered onshore.

PwC Taxation Services Malaysia senior executive director Jennifer Chang notes that countries that impose withholding tax only on onshore services include South Korea, Singapore and the US.

"Countries such as the UK, France, Germany and Denmark do not have withholding tax for services at all. On the other hand, there are countries in Asia, such as Indonesia and Thailand, where withholding tax is imposed on onshore and offshore services," she says.

"If you look around the world, governments are casting their tax nets wider. For example, the US has introduced new taxes, such as FATCA (The Foreign Account Tax Compliance Act), which requires financial institutions to report on US citizens and withholding tax may be imposed," she says. Even certain countries in the Middle East, such as Kuwait, Bahrain and the United Arab Emirates, are introducing a goods and services tax or value-added tax.

Chang notes that withholding tax in Malaysia used to be imposed on onshore and offshore services but that was changed in 2001, to limit withholding tax to only onshore services.

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Meanwhile, another recent widening of the tax scope is on the treatment of royalty, Tan says.

"This latest change among others, includes the payment for the use of or the right to use software — that is a significant change.

"Looking back at history, payment for the use of copyright is subject to royalty. The word 'software' was never in the law. So now the change is that the word 'software' is added and any payment for the use of software to a non-resident is subject to royalty withholding tax," Tan says.

Nevertheless, he says there could be some relief to corporates and non-residents as Malaysia has a wide treaty network with foreign countries.

"DTAs [double taxation agreements] prevail over local law. So there could be some protection for non-resident companies if there is an exemption to the service and royalty withholding tax under the tax treaties between Malaysia and the country the non-resident company is from," he notes.

While withholding tax is imposed on non-resident companies, local corporations are impacted because they must "withhold tax" from the non-resident and remit it to the Inland Revenue Board. If they do not comply, the local resident company would be penalised.

"Withholding tax is technically imposed on the foreign service provider but the obligation to withhold the tax is on the payer. As the enforcement and penalty is imposed on the payer, it is important for the Malaysian payer to ensure that the withholding tax is deducted and paid correctly and on time. This is because the foreign service provider does not have a business presence in Malaysia," says Chang.

With these latest changes, she advises taxpayers to review cross-border contractual and payment arrangements to assess whether withholding tax applies when making payments to non-residents, particularly in respect of software, intangible property and service fees.

Taxpayers should also determine whether there are avenues to reduce the withholding tax under a specific DTA, she adds.

A tax manager with a listed government-linked company notes that the recent changes in withholding tax, including the changes in treatment of royalty, are major changes that have affected all corporates.

"We will have to look at our contracts with non-resident companies again to ensure that we are compliant so we won't be penalised," the in-house tax manager says.

Speaking from experience, Chang says there could be instances where the non-resident refuses to incur the withholding tax.

"There are some cases where the foreigner says this is the amount I want to receive and I do not want the amount received to suffer any withholding tax. This is where the payer has no choice but to absorb the tax on their behalf. In this case, hiring offshore expertise could be more expensive," she says. E