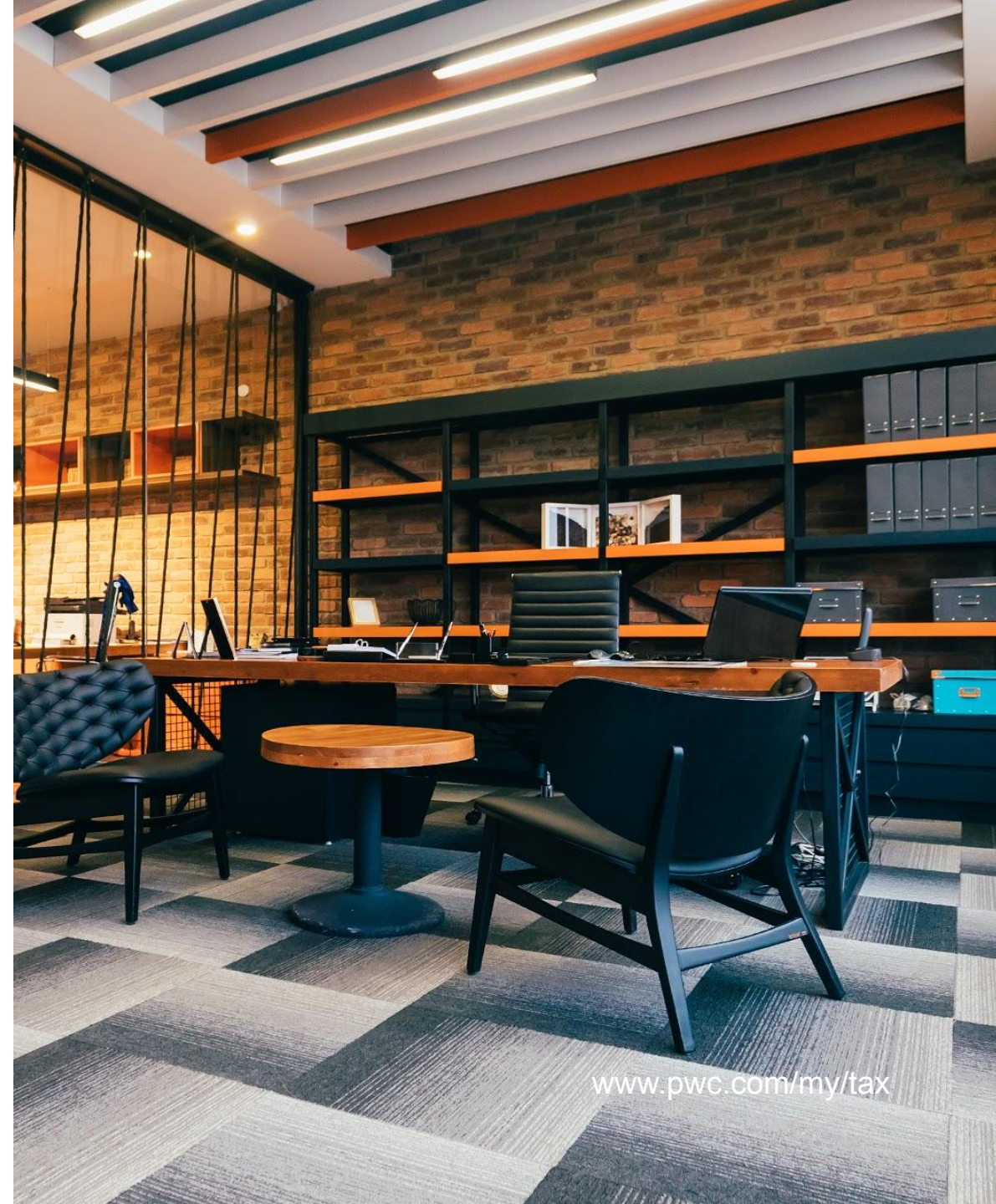




# TaXavvy

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## Guidelines on the Application of Subsections 12(3) and 12(4) of the Income Tax Act 1967 in Determining a Place of Business



## Guidelines on the Application of Subsections 12(3) and 12(4) of the Income Tax Act 1967 in Determining a Place of Business (“Guideline”)

The Guideline dated 21 May 2020 has been issued by the Inland Revenue Board (IRB) to provide guidance on the determination of existence of a place of business in Malaysia.

The Guideline is available on the IRB’s website [www.hasil.gov.my](http://www.hasil.gov.my) (Legislation > Technical Guidelines)



### Background

Under double tax agreements (DTAs) concluded by Malaysia with its treaty partners, a non-resident of a treaty partner which derives business profits from Malaysia is generally subject to Malaysian income tax only if the non-resident has a permanent establishment (PE) in Malaysia and such profits are attributable to that PE. The definition of PE includes a fixed place of business through which the business of the non-resident is wholly or partly carried on.

A practical implication of a non-resident having a PE in Malaysia is the need to file a Malaysian income tax return in respect of business profits attributable to the PE.

Although the PE requirement was not written into the domestic law, i.e. the Income Tax Act 1967 (Act), the IRB had in practice accorded similar treatment to non-residents from countries which have not concluded a DTA with Malaysia (“non-DTA countries”). The IRB had generally required non-residents from non-DTA countries to file Malaysian income tax return only if the business profits relate to a business presence (similar to a PE) in Malaysia.

Effective from 28 December 2018, Sections 12(3) and 12(4) were introduced into the Act. Section 12(3) sets out that income of a person from a business that is attributable to a place of business in Malaysia is deemed to be derived from Malaysia from the business. Section 12(4) spells out the meaning of place of business (POB), which is largely based on the PE definition but written more liberally and is therefore subject to a wider interpretation.

**Section 12(4)**

POB includes:

- (a) a place of management;
- (b) a branch;
- (c) an office;
- (d) a factory;
- (e) a workshop;
- (f) a warehouse;
- (g) a building site, or a construction, an installation or an assembly project;
- (h) a farm or plantation; and
- (i) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources,

and without prejudice to the generality of the foregoing, a person shall be deemed to have a POB in Malaysia if that person:

- (i) carries on supervisory activities in connection with a building or work site, or a construction, an installation or an assembly project; or
- (ii) has another person acting on his behalf who:
  - (A) habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification;
  - (B) habitually maintains a stock of goods or merchandise in that place of business from which such person delivers goods or merchandise; or
  - (C) regularly fills orders on his behalf.

## The Guideline

The IRB's Guideline focuses on the definition of POB under Section 12(4). Key matters covered are:

- General characteristic of a POB
- Building site, construction, installation, assembly projects, and related supervisory activities
- POB created by agents
- Preparatory or auxiliary activities
- Cohesive business operations
- Example of a Malaysian integrated warehouse

### General characteristic of a POB

A POB is explained as a physical place (whether owned or rented) that the non-resident has access to use to carry out its business activities. The physical place must also be fixed, i.e. it should have:

- a certain degree of permanency (duration test); and
- a specific geographical point (location test).

The duration and location tests are to be viewed in the context of each specific case. For example, a mine constitutes a single place even though the business activities may move from one location to another in a very large mine as it constitutes a single geographical and commercial unit for the mining business (Example 3). Likewise, a physical place which exists for a very short period of time may still be considered as a POB because the nature of the business is such that it will only be carried on for that short period of time.

### Building site, construction, installation, assembly projects (collectively "Projects"), and related supervisory activities

A duration threshold is to be applied before the Projects or related supervisory activities is considered as a POB. A person is only considered to have a POB if it has carried on activities at the site or project for a period or periods exceeding 5 months in aggregate in any 12 month-period ("5-month period").

The Guideline also briefly states the withholding tax (WHT) provision which is to be applied to payments to non-residents in relation to the above Projects and related supervisory activities:

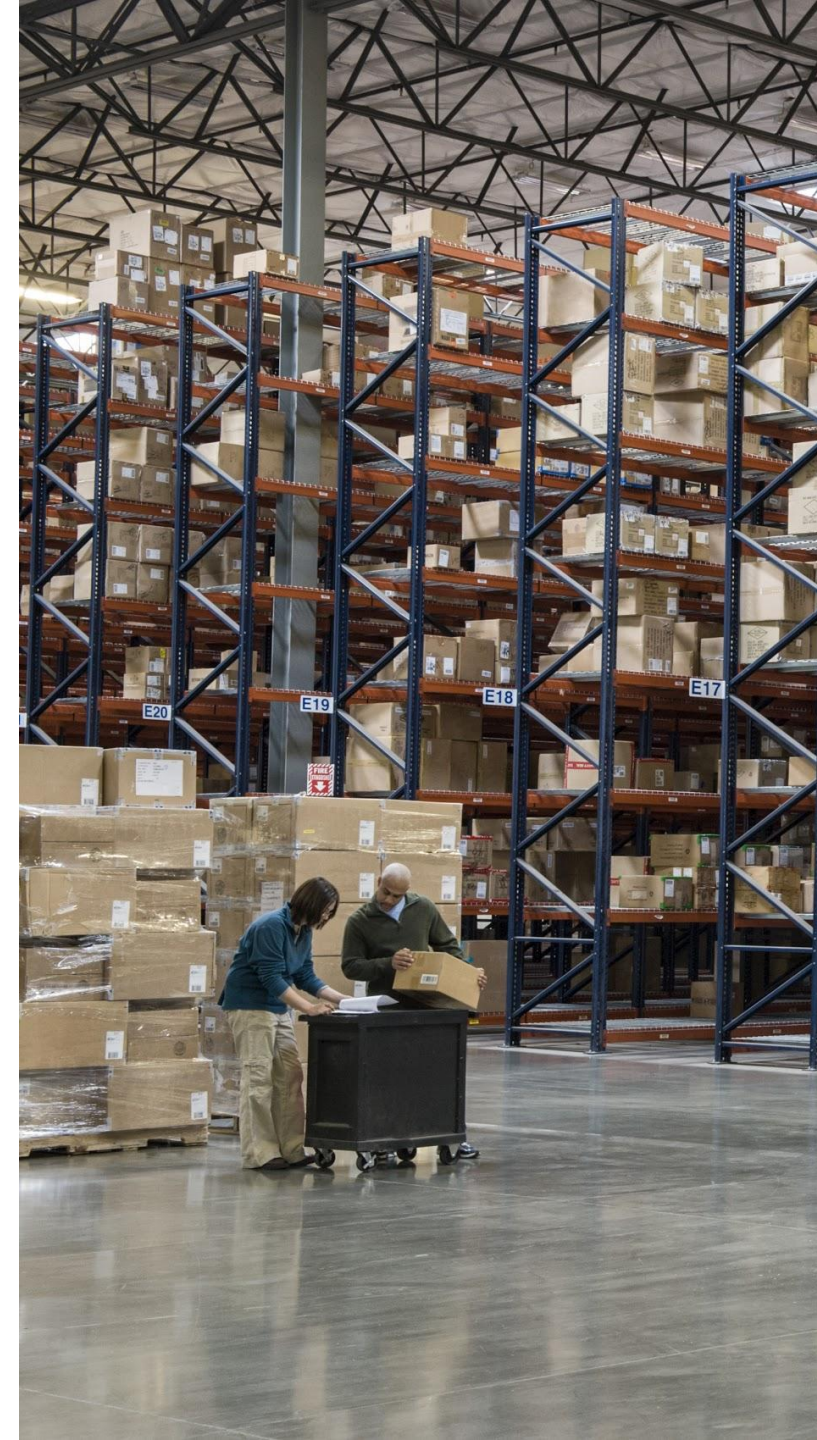
- Where the duration exceeds the 5-month period - Section 107A WHT (at the rate of 10% + 3%)
- Where the duration does not exceed the 5-month period - Section 109B WHT, where applicable (at the rate of 10%)

### POB created by agents

A non-resident principal is deemed to have a POB in Malaysia if it has an agent who carries out certain activities in Malaysia on its behalf, provided that the agent is not of an independent status.

Activities of agent under Section 12(4)	Salient points
(A) Habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification	<ul style="list-style-type: none"> <li>• The types of contracts covered include those which are in the name of the principal or which are binding on the principal even if those contracts are not in the name of the principal.</li> <li>• All facts and circumstances are to be taken into account in determining activities that would constitute “principal role”. Example includes meeting with customers to promote and give explanation on products and negotiations with customers (see Example 8).</li> </ul>
(B) Habitually maintains a stock of goods or merchandise in that place of business from which such person delivers goods or merchandise	<ul style="list-style-type: none"> <li>• These activities only create a POB for the non-resident principal if the agent also conducts sales related activities</li> </ul>
(C) Regularly fills orders on his behalf.	

Independent agent refers to a person who acts for a non-resident principal in the ordinary course of its business. An agent is not considered as independent if it acts exclusively, or almost exclusively, on behalf of one or more associated persons.



## Preparatory or auxiliary activities

Whilst POB is explained as a physical place that the non-resident has access to use to carry out its business activities, the activities should not be too remote from the business operations. An activity which is preparatory or auxiliary refers to an activity that is carried out at a physical place but is by itself not sufficient to constitute a POB. Subject to the cohesive business operation test, activities of preparatory or auxiliary in nature include the following characters, that they are:

- so remote from the actual realisation of profit of the business that it is difficult to allocate any profit to the physical place in question;
- by themselves do not form an essential and significant part of the activity of that business as a whole;
- not identical to the general purpose of the whole business; or
- usually carried out during a relatively short period.

## Cohesive business operations

The determination that an activity by itself is preparatory or auxiliary in nature alone does not necessarily mean that the activity does not constitute a POB for the non-resident. The determination is not to be made in isolation but is to be viewed within the context of the overall activities carried out by the non-resident and its associated persons in Malaysia. If the preparatory or auxiliary activity forms part of a cohesive business operation that is carried out by the non-resident and its associated persons, that activity is not to be regarded as preparatory or auxiliary.

In Example 5 of the Guideline, storing activities at a warehouse owned by a non-resident is not regarded as preparatory or auxiliary as it is connected to the overall business of selling the same goods by the non-resident and its subsidiary in Malaysia.



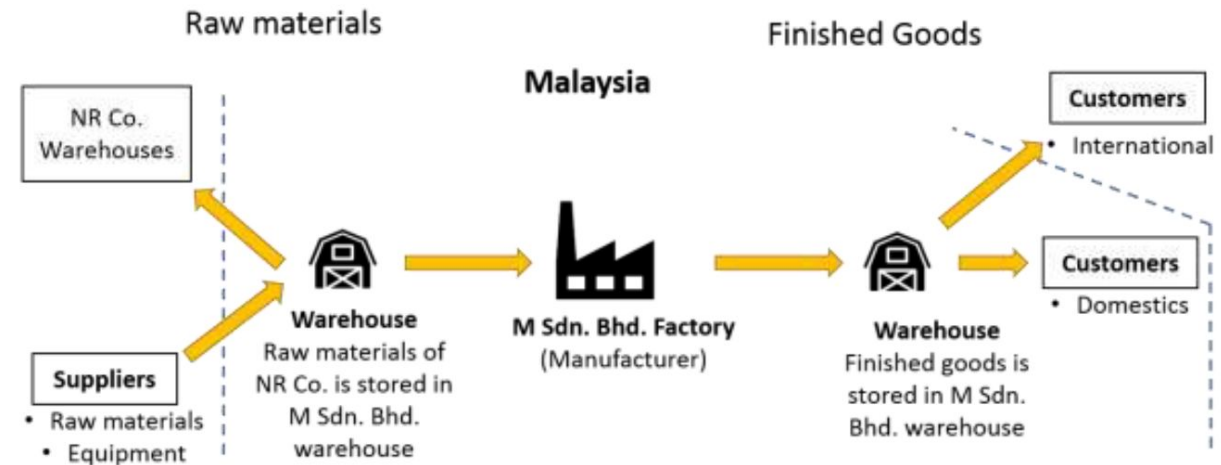
## Example of a Malaysian integrated warehouse

Example 9 illustrates the application of some of the key requirements of a POB under the Guideline as follows:

### Salient points from the business model

<b>Toll manufacturing</b>	<ul style="list-style-type: none"> <li>NR Co is a non-resident and the principal and ultimate holding company of M Sdn Bhd.</li> <li>M Sdn Bhd acts as a toll manufacturer for NR Co in Malaysia.</li> </ul>
<b>Warehousing activities</b>	<ul style="list-style-type: none"> <li>M Sdn Bhd also provides warehousing services to NR Co. The services are provided from two private bonded warehouses which are owned and managed by M Sdn Bhd from which raw materials and finished goods belonging to NR Co are received, stored and delivered, based on orders received from NR Co.</li> <li>NR Co's personnel are not involved in the warehouse operations and do not have unrestricted access to the warehouse.</li> <li>The warehouse in Malaysia also supports regional returned shipments and warranty replacement program for regional customers.</li> </ul>
<b>Marketing activities</b>	<ul style="list-style-type: none"> <li>NR Co has a sales representative office in Malaysia. However, its activity is limited to marketing to new or existing customers and is not authorised to sign contracts.</li> </ul>

### Diagram: Business flow



### Does NR Co have a POB in Malaysia?

- NR Co does not have access to use the warehouse. Therefore, the warehouses by themselves do not constitute NR Co's POB.
- However, the overall activities which comprise warehousing, manufacturing, marketing activities, form complementary functions that are part of a cohesive business operation. Therefore, NR Co would have a POB in Malaysia.

## Our comments

1. Although the POB definition under Section 12(4) is largely based on the PE definition under Malaysian DTAs, the definition is written more liberally as compared to the PE definition. The Courts have also been guided by commentaries to model tax conventions and case laws relating to PEs (“PE principles”) in determining whether a PE exists. These PE principles are not found in the definition of POB under Section 12(4). As a result, the scope of POB based on a words in Section 12(4) is wider than the scope of PE in general.
2. The Guideline has adopted some of the key PE principles in providing the much needed parameters to limit the scope of the widely defined POB. Ideally, they should be written into the Act for certainty from a law standpoint.
3. Building site, construction, installation, assembly projects (“projects”), and related supervisory activities - The 5-month period adopted by the Guideline is a departure from most Malaysian DTAs where a 6-month period is commonly set.
4. Creation of POB by agents - The exclusion of agents of independent status is in line with the the dependent agent PE (DAPE) provisions found in most Malaysian DTAs.
5. Preparatory or auxiliary activities - The Guideline stops short of providing a list of examples of activities which are preparatory or auxiliary (commonly referred to as the “negative list” in the PE definition under DTAs).
6. Cohesive business operation (also known as the anti-fragmentation rules) - The Guideline emphasises on the need to consider the overall business activities of the non-resident and its related company in Malaysia rather than viewing each activity in isolation.
7. The Guideline is forward looking as it adopts some features from the Multilateral Instrument (“MLI”) to implement treaty related measures under the OECD’s BEPS Project in relation to:
  - Preparatory and auxiliary activities
  - Anti-fragmentation rules
  - Definition of independent agent

The above MLI features generally expand the scope of the PE definition. Whilst the adoption of these features bodes well for consistency between the determination of PE and POB for non-residents from DTA countries and non-DTA countries respectively (Malaysia is a signatory of the MLI), they are not currently applicable to Malaysian DTAs as the MLI is pending ratification. Until then, the early adoption of these MLI features in the Guideline would mean that a more stringent rule is imposed to non-residents from non-DTA countries as compared to those from DTA countries.

8. Pursuant to Section 12(3), business income which is attributable to a POB [as defined under Section 12(4)] will be deemed to be derived from Malaysia, and hence subject to tax in Malaysia. Whilst the Guideline deals with the definition of POB, it does not address income attribution.



# Restructuring for Resilience: Tax considerations

The economic uncertainties precipitated by COVID-19 are impacting organisations in significant ways, with its effects being felt in almost every facet of business. Status quo may no longer be an option and organisations are exploring strategies to remain robust and competitive under the new normal.

*Are you thinking of restructuring your group to remain resilient during these unprecedented times and emerge with a much stronger footing?*

With any proposed restructuring, there are relevant tax considerations which need to be addressed, be it exploring ways on how the transactional tax cost arising can be managed as well as ensuring that the structure adopted moving forward is tax efficient.

With this in mind, we are pleased to invite you to our **complimentary** tax webinar which will touch upon the following:

Operational &  
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Common tax  
implications

Tax  
optimisation  
avenues

What should  
you consider  
next



## Complimentary Webinar

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10am - 11am

Live via Webex (link to be shared upon  
registration)

**Register here:**

<https://forms.gle/VPeiohVC6QeVdmmX6>

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