TaXavvy

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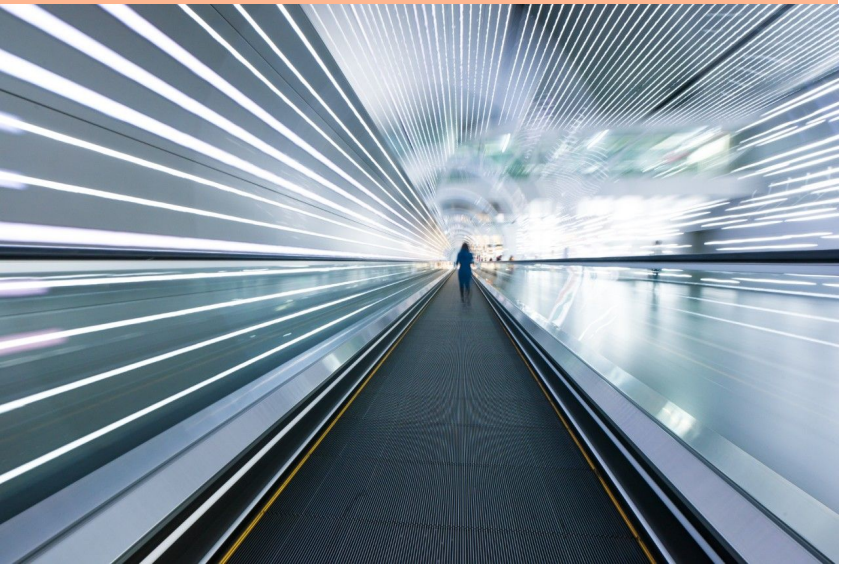
FAQ for implementation of e-Invoice for the construction industry

The Inland Revenue Board (IRB) has issued the FAQ for implementation of e-Invoice for the construction industry.



The following are the salient points:

1. Contractors are defined as per the Income Tax (Construction Contracts) Regulations 2007, which means *a company, an individual, a partnership, a co-operative society, a body of persons, who or which is engaged in or carries on or undertakes or causes to be undertaken construction contracts.*

2. e-Invoices are required to be issued by contractors for charges to subcontractors, including penalties

3. e-Invoice are to be issued for sale of construction materials to a related company. Consolidated e-Invoice is not allowed for sale of construction materials as defined under the Construction Industry Development Act 1994.

4. Main contractors which purchase materials on behalf of the owner will be allowed to continue with their current billing arrangement (where the purchases are included in the progress billing issued to the owner). With the implementation of e-invoice, the progress billing issued to the owner is to be issued via e-Invoice.

5. Issuance of e-Invoice for progress claim:

    - Where certification of work done is not required, e-Invoice is to be issued with progress claim to substantiate the income generated

    - Where certification of work done is required, e-Invoice can be issue upon obtaining the certificate

The FAQ is available on IRB's website www.hasil.gov.my (e-Invoice > Industry Specific Frequently Asked Questions).

Practice Note 3/2023 - Tax Treatment on Copyright and Software Payments by a Distributor and a Reseller to a Non-Resident

The IRB has issued Practice Note 3/2023 - Tax Treatment on Copyright and Software Payments by a Distributor and a Reseller to a Non-Resident (“PN 3/2023”).

PN 3/2023 is available on IRB’s website www.hasil.gov.my (Legislation > Practice Note).

The following are the salient points:

1. IRB issues PN 3/2023 to provide clarification on its treatment for payments made by software distributors / resellers (collectively, “distributors”) to non-residents which do not have a permanent establishment in Malaysia (“NR”). In particular, it sets out whether payments for software made by resident software distributors to the original NR owner of the software constitute royalty under section 2* of the Income Tax Act 1967 (“ITA 1967”) which are subject to withholding tax at the rate of 10% [subject to Double Taxation Agreement (DTA) rates].

   * Extract of the royalty definition in relation to software under section 2 of ITA 1967 for reference:

   "*royalty" includes any sums paid as consideration for, or derived from—*
   …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;...

2. The purchase of software or the use of Apps and content by distributors, regardless of whether the distributor has rights to modify, exploit, distribute, reproduce or make copies, is considered as royalty because ownership of the intellectual property (IP) in the software remains with the NR.

3. Payment by a distributor to the NR owner of the software under the following distribution arrangements are equally treated as royalty payments:

   - Example 1 - The distributor is given the right to make copies of the computer software purchased from the NR for resale to end customers whereby the end customers will purchase copies (by downloading) from the distributor.

   - Example 2 - The distributor is not given the right to make copies of the computer software purchased from the NR for resale to end customers.

4. The IRB states that, where there is a DTA with the respective countries, reference should be made to the DTA of the respective contracting countries. In other words, where the definition of royalty under DTA differs from the definition under section 2 of ITA 1967, the DTA definition would prevail.

PwC comment

No explanation nor example is given on when DTA definition is considered to prevail over the royalty definition under section 2 of ITA 1967. The royalty definition under Malaysian DTAs (DTA definition) generally does not expressly spell out whether software distribution arrangement is within the scope of the definition. Example of items which are specifically excluded or exempted include industrial royalties approved by the Government. In view that PN 3/2023 does not provide an update on the IRB's general view on whether DTA definition excludes software related payments made by distributors, clarification is required from the IRB whether such exclusion is limited only to payments covered under specified exclusion such as industrial royalties approved by the Government. For reference, below is an example of definition of royalty under Malaysian DTA based on the Malaysian-India DTA:*

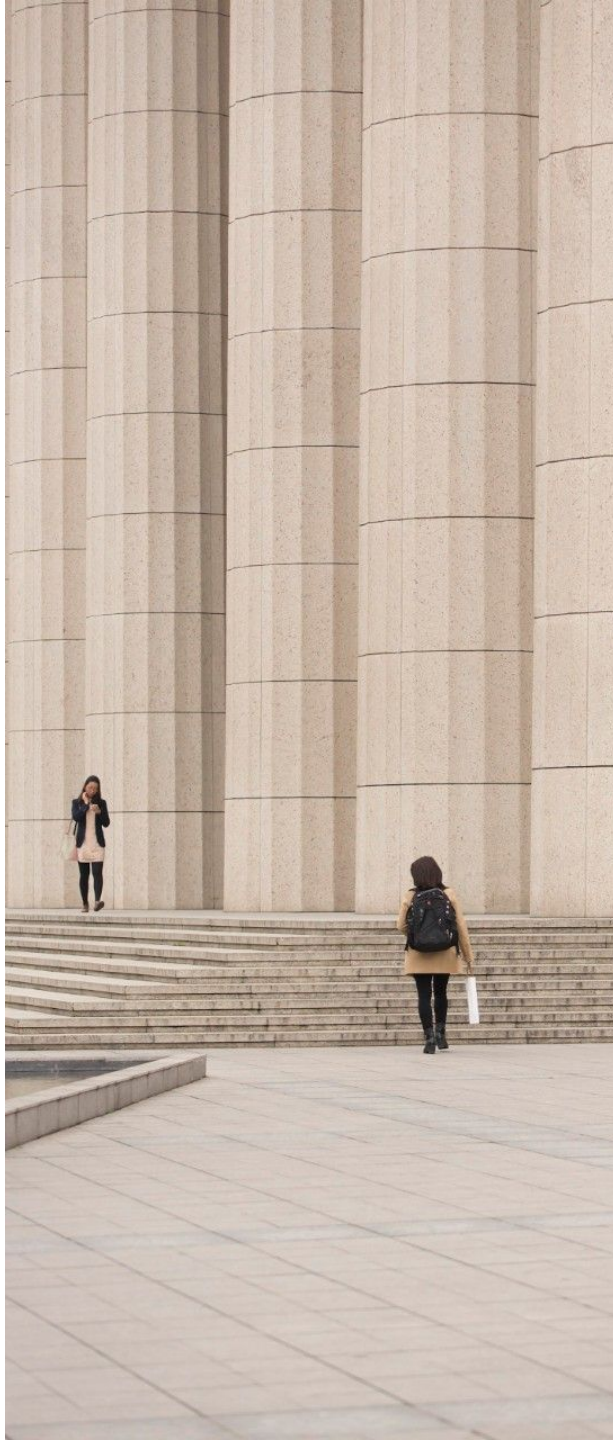
> "The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films or films or tapes used for television or radio broadcasting, any patent, trade 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."

** For reference only. The specific DTA that is applicable for each situation should be examined to determine the tax treatment.*

Summary

- The IRB has communicated its position / treatment on payments made by software distributors to NR IP owners of the software and considers distribution arrangements, whether or not there is right to reproduce / make copies, to constitute "right to use" software. PN 3/2023 however does not discuss nor make any distinction between "right to use" from a trade arrangement or purchase of copyrighted items.

- Affected taxpayers would be required to assess the implications arising from PN 3/2023 including its impact to existing and future arrangements.



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