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Amendment to the foreign-sourced income exemption order

In brief

The Income Tax (Exemption) (No. 6) Order 2022 (Amendment) Order 2024 (“Amendment Order”) has been gazetted to amend the provisions in the Income Tax (Exemption) (No. 6) Order 2022 (“Principal Order”) which provides tax exemption on foreign-sourced dividend income.

Labuan companies which have made an election to be subject to tax under the Income Tax Act 1967 have now been included into the scope of the exemption. The amendment takes effect retrospectively, from the year of assessment (YA) 2022.

The economic substance requirement has been legislated into the law (this was previously only introduced under the Inland Revenue Board’s guideline). Effective from 1 January 2024, qualifying taxpayers are required to meet either one of the following groups of condition to qualify for the tax exemption:

1. Subject to tax and minimum tax rate of 15%; or
2. Economic substance requirements

In detail

Amendment to the foreign-sourced income exemption order

The Principal Order provides tax exemption on foreign-sourced dividend income received by resident companies, limited liability partnerships and individuals in relation to a partnership business in Malaysia.

The Amendment Order has now been gazetted to amend the provisions in the Principal Order. Highlights are as follows:

A. Inclusion of Labuan companies for the exemption

Companies incorporated under the Labuan Companies Act 1990 (“Labuan companies”) were previously excluded from the scope of the tax exemption.

Under the Principal Order which was issued in 2022, companies which qualify for the tax exemption were specified and limited to companies incorporated or registered under the Companies Act 2016.

The Amendment Order has now included Labuan companies which have made an election to be subject to income tax as persons eligible for the tax exemption. The amendment takes effect retrospectively, from YA 2022.

Comment: This is a welcomed move which puts Labuan companies in equal footing with companies incorporated under the Companies Act 2016.

B. Conditions for exemption for foreign-sourced dividend income

The economic substance requirements (ESR) have now been legislated. The ESR was introduced as an additional mandatory condition for the tax exemption via the Inland Revenue Board's (IRB) Guidelines on Tax Treatment in relation to Income Received from Abroad (Amendment) dated 29 December 2022 ("2022 IRB Guidelines").

Based on the Amendment Order, taxpayers have the option to meet either one of the following groups of conditions to qualify for the tax exemption, with effect from 1 January 2024:

1. Subject to tax and minimum tax rate of 15%; or
2. Economic substance requirements

The above are subject to conditions to be imposed by the Minister via IRB Guidelines (currently the 2022 IRB Guidelines). Key details of the above conditions are:

Subject to tax and minimum tax rate of 15%

- Subject to tax of a similar character to income tax under the law of the territory where the income arises, and
- The minimum headline income tax rate territory where the income arises is not less than 15%

Economic substance requirements

- Employ adequate number of employees with necessary qualifications to carry out the specified economic activities in Malaysia; and
- Incur adequate amount of operating expenditure for carrying out the specified economic activities in Malaysia.

Comment: Amendment to the 2022 IRB Guidelines is expected to follow. Questions include whether the ESR condition under the 2022 IRB Guideline for periods prior to 1 January 2024 will remain mandatory or whether taxpayers will similarly be given the option of meeting either the ESR condition or the Subject to tax and minimum tax rate of 15% condition.

Further background information on the exemption of foreign-sourced dividends can be found in [TaXavvy 13/2022](#) and [TaXavvy 23/2022](#).

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