Doing Business in Malaysia

This document describes some of the key commercial and taxation factors that are relevant on setting up a business in Malaysia.

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Background

Country overview

Situated in the centre of Southeast Asia, with a total land area of 330,000 square kilometres, Malaysia is approximately the size of Japan, with a population of about 30.3 million people. The country is made up of two geographical regions, Peninsular Malaysia, which accounts for 40% of the land mass and 80% of the population and the East Malaysian States of Sabah and Sarawak on the island of Borneo, which are separated from the peninsular by 640 kilometres of sea.

Malaysia's political system, as prescribed in the Federal Constitution, is that of a parliamentary democracy based on the Westminster model. Malaysia has a unique constitutional monarchy, the Yang di-Pertuan Agong (The King) being elected to office for five-year terms by a council of hereditary rulers of the nine states.

However, the executive authority of Malaysia is vested in the Prime Minister and his cabinet. The executive and legislative authority is extensive. Under the Constitution, the judiciary is independent of the executive and legislature.

Bahasa Malaysia is the official language of Malaysia. Chinese dialects and English are also widely taught and spoken.

The Malaysia government is committed to nurturing the country into a fully developed industrial, commercial and financial centre, which can boast of a highly sophisticated infrastructure as well as skilled support services. Its philosophy of meritocracy, effective political leadership and stable political environment are conducive to foreign investments.

Choice of Legal Form

The main forms of commercial organizations are the limited company (public and private) formed under the Companies Act 1965, the partnership regulated by the Partnership Act 1961 and Limited Liability Partnership regulated under the Limited Liability Partnerships Act 2012.

Any person intending to carry on a business or maintain a place of business in Malaysia must register a business entity with the Companies Commissions of Malaysia or the Registrar of Businesses.

A business may be carried on in any one of the following forms:

1) By an individual operating as a sole proprietorship registered under the Registrar of Businesses.
2) By two or more (but not more than 20) persons in partnership registered under the Registrar of Businesses.
3) By a locally incorporated company or a foreign company registered under the provision of the Companies Act 1965 with the Companies Commissions of Malaysia.
4) By Limited Liability Partnership (LLP) registered with the Companies Commissions of Malaysia which combines the characteristics of a company and a conventional partnership.

Business firm

A business firm can be registered as a sole-proprietorship firm or a partnership under the Business Registration Act. It is considered as an incorporated body, not a legal entity. A foreign individual or corporation may register a business firm as such, provided that a local manager or agent is appointed. The local manager or agent should be a Malaysian, a permanent resident or an employment pass holder.

A partnership may consist of two or more partners but not more than 20. If it exceeds 20, the partnership must be registered as an incorporated company.

Incorporated company

The Companies Act 1965 is the principal legislation governing companies in Malaysia. The Act provides for three types of companies:

1) A company limited by shares, where the personal liability of its members is limited to the par value of their shares.
2) A company limited by guarantee, where the members guarantee to meet liability up to a nominated amount if the company is wound up.
3) An unlimited company, where there is no limit to the members' liability.

Company limited by shares

The most commonly incorporated company registered in Malaysia is a company limited by shares. The liability of its shareholders is limited to the nominal value of the amount of the shares held by them. Such a company may either be a private or public limited company.

A company having a share capital may be incorporated as a private company if its Memorandum or Articles of Association:

a) restricts the right to transfer its shares;
b) limits the number of its members to 50, excluding employees and some former employees;
c) prohibits any invitation to the public to subscribe for its shares and debentures; and
d) prohibits any invitation to the public to deposit money with the company.

A public limited company may have more than 50 shareholders. Its shares can be offered to the public for subscription and are freely transferable. Such a company must register a prospectus with the Companies Commissions of Malaysia before offering its shares to the public. A company seeking to list on the stock exchange is required to obtain the necessary approval from Bursa Malaysia.

Branch of foreign corporation / representative office

A foreign corporation may opt to establish a branch in Malaysia to conduct its business operations. Before doing so, the foreign corporation must register as a foreign company under the Companies Act 1965 with two or more local resident persons to act as agents.

A foreign corporation may also operate in Malaysia by establishing a representative office. Such a representative office has no legal corporate status. It cannot engage in any profit making or trading activities nor is it permitted to conclude contracts or open and receive letters of credit.

Principally, it merely serves as a promotional and liaison office of its parent company. Its activities are therefore confined to promotions, market research, liaison and coordination of activities on behalf of its parent company.

Limited liability partnership (LLP)

Limited liability partnership (LLP) is an alternative business set up which combines the characteristics of a private company and a conventional partnership.

LLPs provide limited liability status to their partners and offer the flexibility of internal arrangement through an agreement between the partners. This combination will give entrepreneurs and businesspeople more structure compared to a sole proprietorship or a conventional partnership.

LLPs may be formed by a minimum of two persons (wholly or partly individual or corporate bodies) or any business group to carry on any lawful business with the view to make profit. However, the main targeted groups are:

- Professionals
- Small and medium sized businesses
- Joint ventures
- Venture capitals

Audit Requirements

All companies incorporated and registered under the Companies Act 1965 are required to arrange for their account to be audited by qualified chartered accountants. Such requirement is not imposed on LLP.

Taxation

Income tax

Income tax is levied under the Income Tax Act 1967. The rules for determining taxable income are the same for corporations and individuals except that individuals are entitled to certain personal reliefs and are taxed on graduated rates of tax. The tax treatment for an LLP is similar to that of a company.

Territoriality

The Malaysian income tax system works on a territorial basis. Generally, income accruing in or derived from Malaysia or received in Malaysia from outside Malaysia is subject to tax unless there are special provisions to the contrary made in a double taxation agreement with the country in which the source is derived.

Single tier system

Malaysia has adopted the single tier company income tax system since the year of assessment 2008, where the tax on the profits of a company is a final tax and dividends distributed will be exempted from tax in the hands of shareholders.

Basis of assessment

Income is chargeable to income tax on current year basis. Malaysia is adopting the self-assessment system where taxpayers are obliged to self-assess their taxes and pay the assessment accordingly.

Residence rules

A company is treated as resident in Malaysia if its management and control is exercised in Malaysia. Generally, management and control are taken to be exercised at the place where the directors' meetings are held. An individual generally is treated as a resident for tax purposes if they are physically present in Malaysia for 182 days or more in a year of assessment.

Rate of tax

A Small or Medium Enterprise ("SME") is defined as a company incorporated and resident in Malaysia with a paid-up capital of RM2.5 million ordinary shares or less at the beginning of its basis period for a year of assessment. SMEs are taxed at 19% on their chargeable income for the first RM500,000, and the remaining amount of the chargeable income is taxed at 24%.

However, a company is not considered an SME if:

a) 50% of the paid-up capital, in respect of the company's ordinary shares, is directly or indirectly owned by a related company;

b) 50% of the paid-up capital, in respect of ordinary shares of the related company, is directly or indirectly owned by the company; and

c) 50% of the paid-up capital, in respect of ordinary shares of the company and the related company, is directly or indirectly owned by another company.

"Related company" in this context is defined as a company which has a paid-up capital exceeding RM2.5 million, in respect of ordinary shares, at the beginning of its basis period for a year of assessment.

Companies not defined as SMEs are taxed at 24% on their chargeable income.

For resident individuals, income is taxed at graduated rates ranging from 1% to 28%. Non-resident individuals are taxed at 28% on their chargeable income.

Business income

Income is determined in accordance with generally accepted accounting principles but adjusted in accordance with specific rules in the taxing statute. A partnership is not a separate legal entity; thus, each partner is assessed on his share of partnership income individually, unlike an incorporated company.

Losses

Losses can be carried forward to be set off against a company's future business income from any source, subject to the following conditions:

a) The loss must be on revenue account and incurred in the course of trade;

b) Brought forward losses are only allowed to relieve against the current year business income. Current year business loss can be used to relieve against the business and other sources of income;

c) There is no substantial change in the company's shareholdings.

Real property gains tax

Real Property Gains Tax is charged on gains arising from the disposal of real property situated in Malaysia, or interest, options, or other rights in or over such land, as well as the disposal of shares in real property companies at a rate of tax ranging from 0% to 30% as follows:

Disposal	Companies	Individuals (Citizens & Permanent Residents)	Individuals (Non-Citizens)
Within 3 years	30%	30%	30%
In the 4th year	20%	20%	30%
In the 5th year	15%	15%	30%
In the 6th year and subsequent years	5%	0%	5%

Sales tax and service tax

Effective from 1 April 2015 onwards, the sales tax and service tax were abolished and replaced with the Goods and Services Tax ("GST").

Goods and services tax ("GST")

Effective from 1 April 2015, GST of 6% is due on the taxable supply of goods and services utilised for business in Malaysia by a taxable person. GST is also charged on the importation of goods and services.

A taxable supply is a supply which is standard rated or zero rated. Exempt and out of scope supplies are not taxable supplies.

GST is to be levied and charged on the value of the supply.

GST can only be levied and charged if the business is registered under GST. A business is not liable to be registered if its annual turnover of taxable supplies is below RM500,000. Therefore, such businesses cannot charge and collect GST on the supply of goods and services made to their customers. Nevertheless, businesses can apply to be registered voluntarily.

Excise duty

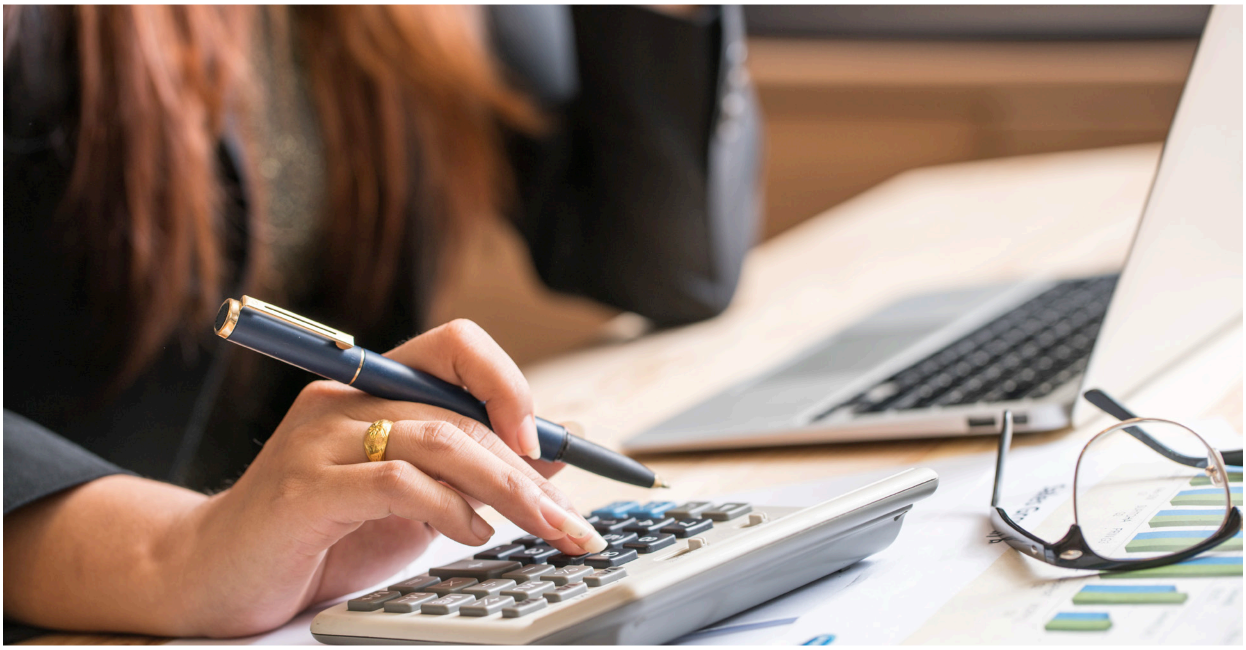
Excise duties are levied on selected products, namely, cigarettes, liquors, playing cards, mahjong tiles, petrol, diesel and motor vehicles.

Import duty

Import duties are levied on many imported goods. Under the ASEAN Common Effective Preferential Tariff (CEPT), import duties imposed on most goods from ASEAN countries may be reduced to 0-5%.

Transfer pricing rules

The transfer pricing guidelines adopted in Malaysia are largely based on the governing standard for transfer pricing which is the arm's length principle as set out under the Organization for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines. Henceforth, all methodologies and supporting rationale will be based on these principles.



Allowances

Depreciation / Capital allowances

Accounting depreciation is not recognized as a tax-deductible expense. For income tax purposes, the company will be given a tax allowance on qualifying expenditure incurred on plant, machinery or other fixed assets computed in accordance with rates provided by the taxation authorities.

Tax incentives

There are various tax incentives available and these take the form of approved pioneer status, double deductions, accelerated capital allowances, investment allowances, and various other incentives for export, expansion, warehousing and servicing, international consultancy services, research and development, pioneer service, venture capital, principal hub incentives, etc. These incentives may be accorded in the form of double deduction of qualifying expenditure incurred, exemption of tax, or reduced rate of tax on income.

Such incentives, introduced by the Government to stimulate the economy, assist in the development of certain areas of economy, encourage exports of manufactured goods and qualifying services, and promote regionalization, etc.

These incentives are administered under the Promotion of Investments Act 1986 and Income Tax Act 1967.

Employment

Generally, Malaysians work eight hours a day or 48 hours a week. The Employment Act governs the terms and conditions of employment and stipulates the rights and obligations of employers and employees. The Act applies to employees earning not more than RM2,000 a month (1 April 2012).

Employees provident fund act 1991 (EPF)

The EPF provides for a compulsory contributory provident fund which is payable to employees in full on reaching the age of 55, or earlier in the case of incapacity or upon permanently departure from Malaysia. Both the employer and employee are required to contribute to the EPF at 13% and 11% (respectively) of the employees' monthly wages. Self-employed persons, expatriates and domestic servants are exempted from compulsory contribution. They can, however, choose to contribute to the fund.

Employees' social security act 1969

The Social Security Organization (SOCSO) administers the Employment Injury Insurance Scheme and the Invalidity Pension Scheme, as provided under the Employees' Social Security Act 1969.

All establishments employing workers (who are Malaysian or permanent resident) earning wages not exceeding RM4,000 a month are required to insure their workers under the two social security schemes.

Human resources development act 1992

The Human Resources Development Fund (HRDF) operates based on a levy/grant system. Employers who have paid the Human Resources Development levy will qualify for training grants from the HRDF to defray or subsidize training costs for their Malaysian employees.

Withholding Taxes

The general requirement is that where payments (interest, royalty, contract payments, management fees, technical fees, rental of moveable properties, other gains or profits) are made by a Malaysian tax resident to a non-tax resident, the payer is required to:

a) withhold tax at prevailing rate of tax (unless specifically exempt or to be withheld at reduced rate of withholding tax as provided under the relevant tax treaty);

b) give notice of deduction to the taxation authorities in writing in the relevant prescribed form; and

c) pay the amount withheld to the income tax authorities.

The tax withheld must be paid within 1 month from date of payment or crediting, otherwise penalties will be imposed.

This document is provided by Folks DFK & Co., Malaysia as a general overview of matters to be considered when setting up an overseas business in Malaysia. It is essential to take advice on specific issues. No liability can be accepted for any action taken or not taken arising from the information provided in this publication.

If you are setting up a business in Malaysia, the members of DFK International can help you to achieve this efficiently. You will receive practical advice on business issues, tailored to meet your objectives, from experienced business advisers.

For further information on the services available from the DFK member firms in Malaysia please see overleaf:

Last updated October 2017

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