

e-CIRCULAR TO MEMBERS

CHARTERED TAX INSTITUTE OF MALAYSIA (225750-T)

e-CTIM TECH 33/2013

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TO ALL MEMBERS

TECHNICAL

Direct Taxation

[GUIDELINES ON TAXATION OF ELECTRONIC COMMERCE](#)

The above guidelines, dated 1 January 2013, were uploaded on the website of the Inland Revenue Board (IRB) of Malaysia on 11 March 2013.

The following are some salient points from the guidelines.

Introduction (Para 1)

Among the points made are the following:

- The guidelines seek to provide some guidance on basic tax issues and income tax treatment in respect of electronic commerce (e-commerce);
- The above is based on the provisions of the Income Tax Act 1967 (ITA) and other relevant legislation;
- The IRB adopts the principle of neutrality where e-commerce and conventional businesses are subject to the same tax treatment.

Terminology (Para 2)

“E-commerce” is defined as “any commercial transactions conducted through electronic networks including the provision of information, promotion, marketing, supply, order or delivery of goods or services though payment and delivery relating to such transactions may be conducted off-line”.

Other terms defined are “server” and “website”.

Scope of charge

Para 3 states the general scope of charge of the income tax laws of Malaysia while para 4 discusses the scope of tax liability for a business under the law. The main points are:

- In general, income of a person accruing in or derived from Malaysia is subject to income tax in Malaysia.
- Where business operations are carried on in Malaysia, the income attributable to those business operations is deemed to be derived from Malaysia. The scope and extent of business operations in Malaysia is a determinant factor in considering whether income is derived from Malaysia.
- In the context of e-commerce, some determinant business activities that may be considered include sourcing of content, procurement of goods, promotions, advertisement, selling, updating and maintaining of website, uploading and downloading of contents, etc.
- In cases where a Double Taxation Agreement (DTA) is applicable, determination of Malaysia's taxing right over the business income is based on the Permanent Establishment (PE) concept.

Treatment of server and website (Para 5)

Para 5.1 states that although the server and website facilitate the performance of business activities, a server/website by itself, does "not carry any meaning in determining derivation of income." Income from e-commerce is regarded as derived from Malaysia if the business operations test shows that the business is carried on in Malaysia.

Para 5.2 provides 3 examples of situations where income from e-commerce is deemed to be derived from Malaysia even though the company (in each example) conducts business through a website which is hosted on a server located outside Malaysia.

Business models of e-commerce

Para 6 examines various business models of e-commerce with varying assumptions, in each case, stating in conclusion, the IRB's position on whether or not business income is deemed to be derived from Malaysia. These positions are summarized in a table which is appended as an Attachment to the Guidelines.

The table is shown below:

	Business operations		Website Hosted		e-Commerce Income Deemed Derived from Malaysia? (Example ref)
	In Malaysia	Overseas	In Malaysia	Overseas	
R E S I D E N T	√		√		Yes (6.1)
	√			√	Yes(6.2)
	√	Branch		√	No (6.3) - Income of the company from operations in Malaysia taxable in Malaysia whilst income derived from sales via the website that are attributable to the business operations of the branch outside Malaysia not deemed to be derived from Malaysia
		√	√		No (6.4)
		√		√	No (6.5)
N O N R E S I D E N T	√		√		Yes (6.6)
	√			√	Yes (6.7)
		√	√		No (6.8)
	Branch	√		√	Yes. Income including e-commerce income that are attributable to the business operations of the branch in Malaysian (6.9)
	Branch	√	√		No. Whilst income from the branch liable to tax in Malaysia (6.10)
<ul style="list-style-type: none"> · Business – either manufacturing / trading / services · Products – either tangible / intangible 					

- Website – identify /queries / order / payment / online delivery
- Tangible products – deliver by normal physical channel
- Business activities include sourcing of contents / procurement of goods / promotion and advertisement / selling / arranging for delivery of products / maintaining website.

Withholding tax on royalty (Para 7)

Para 7 discusses issues arising in cases where income from e-commerce of a non-resident is deemed not to be derived from Malaysia because business operations are not carried out in Malaysia. If payments to non-residents are in the nature of royalty and deemed to be derived from Malaysia, they are subject to withholding tax.

Para 7.2.1 to 7.2.3 provide examples of the following types of payments falling within the definition of 'royalty' in the ITA:

<u>Paragraph</u>	<u>Type of payment</u>
7.2.1	<p>Payment for the use of, or the right to use copyrights of intangible products (with examples);</p> <p>In this example, a distinction is made between payments for the use of, or the right to use, copyrights (royalty), and payment for the purchase of the product (not royalty income).</p>
7.2.2	<p>Payment for the use of or the right to use know-how (intangible products).</p> <p>In this example, a distinction is made between a contract for the supply of knowhow (royalty) and a contract for the provision of services (technical fee);</p>
7.2.3	<p>Payment for the use of, or the right to use information concerning technical, industrial, commercial or scientific knowledge, experience or skill.</p>

Issues of double taxation and tax treaties (Para 8)

Double taxation relief is available for a person whose income from e-commerce is subject to tax, both in Malaysia and a foreign country, in accordance with the provisions of the ITA and the relevant DTA.

Para 8.3 cites the following relief provisions:

- In the absence of a DTA, a unilateral tax credit is allowed under S133 of the ITA, in accordance with Schedule 7 of the ITA;
- Where a DTA is available, bilateral credit is allowed under S132 of the ITA, in accordance with Schedule 7 of the ITA, and subject to the terms and provisions stipulated in the relevant DTA.

Para 8.4 discusses the PE concept upon which the allocation of taxing rights over business income between countries which are partners to a DTA, is based. The following matters are discussed:

<u>Paragraph</u>	<u>Subject</u>
8.4.2	Definition of PE and conditions for a PE;
8.4.3	Implication if server constitutes a PE in Malaysia; (i.e. income arising from e-commerce through the server will be considered as derived from Malaysia.)
8.4.4	When would server constitute a PE, according to Organisation for Economic Cooperation and Development (OECD) Commentary <i>"...a server...can only constitute a PE of the business if the activities conducted through the server are not regarded as preparatory or auxiliary."</i>
8.4.5	Examples of activities that would generally be regarded as auxiliary.
8.4.6	The general view – <i>"...is that computer equipment, such as a server, could constitute a PE where the functions performed at the server represent a significant and essential part of the enterprise's business activities."</i>

The full text of the guidelines is available at the [IRB website](#).