



INLAND REVENUE BOARD OF MALAYSIA

**TAX TREATMENT ON ROYALTIES
FOR PAYMENT OF SOFTWARE TO
A NON-RESIDENT**

PUBLIC RULING NO. XX/2023

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PUBLIC CONSULTATION DRAFT



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DIRECTOR GENERAL'S PUBLIC RULING

Section 138A of the Income Tax Act 1967 (ITA) provides that the Director General is empowered to make a Public Ruling in relation to the application of any provisions of the ITA.

A Public Ruling is published as a guide for the public and officers of the Inland Revenue Board of Malaysia. It sets out the interpretation of the Director General in respect of the particular tax law and the policy as well as the procedure applicable to it.

The Director General may withdraw this Public Ruling either wholly or in part, by notice of withdrawal or by publication of a new Public Ruling.

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**

PUBLIC CONSULTATION DRAFT

1. Objective

The objective of this Public Ruling (PR) is to explain –

- (a) tax treatment on royalty payments for software, specifically to a non-resident; and
- (b) deduction of tax from royalty payments.

2. Relevant Provisions of the Law

- 2.1 This PR takes into account laws which are in force as at the date this PR is published.
- 2.2 The provisions of the Income Tax Act 1967 (ITA) related to this PR are sections 2, 3, 4A, 7 and 8, subparagraph 6(1)(b)(i), section 15, paragraph 39(1)(f), sections 98, 109, 109B, 109H, subsection 113(2), section 131A, subsection 132(1) and Part II, Schedule 1 of the ITA.
- 2.3 The relevant subsidiary legislations referred to in this PR are:
 - (a) Income Tax (Exemption) Order (No. 4) 2019 [P.U. (A) 147/2019];
 - (b) Income Tax (Exemption) Order (No. 22) 2007 [P.U. (A) 437/2007]; and
 - (c) Income Tax (Exemption) Order (No. 9) 2017 [P.U. (A) 323/2017].

3. Interpretation

The words used in this PR have the following meaning:

- 3.1 “Individual” means a natural person.
- 3.2 “Director General” means Director General of Inland Revenue.
- 3.3 “Person” includes a company, a body of persons, a limited liability partnership and a corporation sole.
- 3.4 “Resident” means resident in Malaysia for the basis year for a year of assessment (YA) by virtue of section 7 and section 8 of the ITA.
- 3.5 “Double Taxation Avoidance Agreement (DTA) and protocols” means an agreement and its protocols entered into between the two governments of two countries to afford relief from double taxation.
- 3.6 “Special Commissioners” means the Special Commissioners of Income Tax-referred to in section 98 of the ITA.

4. Introduction

4.1 The definition of royalty under the provisions of subsection 2(1) of the ITA:

“Royalty” includes any sums paid as consideration for, or derived from –

- (a) 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;
- (b) the use of, or the right to use, tapes for radio or television broadcasting, motion picture films, films or video tapes or other means of reproduction where such films or tapes have been or are to be used or reproduced in Malaysia, or other like property or rights;
- (c) the use of, or the right to use, know-how or information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (d) the reception of, or the right to receive, visual images or sounds, or both, transmitted to the public by –
 - (i) satellite; or
 - (ii) cable, fibre optic or similar technology;
- (e) the use of, or the right to use, visual images or sounds, or both, in connection with television broadcasting or radio broadcasting, transmitted by –
 - (i) satellite; or
 - (ii) cable, fibre optic or similar technology;
- (f) the use of, or the right to use, some or all of the part of the radiofrequency spectrum specified in a relevant licence;
- (g) a total or partial forbearance in respect of –
 - (i) the use of, or the granting of the right to use, any such property or right as is mentioned in paragraph (a) or (b) or any such knowledge, experience or skill as is mentioned in paragraph (c);
 - (ii) the reception of, or the granting of the right to receive, any such visual images or sounds as are mentioned in paragraph (d);

- (iii) the use of, or the granting of the right to use, any such visual images or sounds as are mentioned in paragraph (e); or
 - (iv) the use of, or the granting of the right to use, some or all such part of the spectrum specified in a spectrum licence as is mentioned in paragraph (f); or
 - (h) the alienation of any property, know-how or information mentioned in paragraph (a), (b) or (c) of this definition.
- 4.2 The interpretation of royalties above which is effective from 17.1.2017 further clarifies the definition of royalties as payment for the use or right to use, which includes:
- (a) software;
 - (b) any transmission through satellite;
 - (c) payment preventing the use of right;
 - (d) fee for the use of industrial, commercial and scientific equipment; and
 - (e) the use of radiofrequency spectrum subject to the related licence.
- 4.3 The word “software” has been included in the interpretation of royalty for the purpose of clarity to further define royalty under subsection 2(1) of the ITA. The tax treatment of payment or receipt for royalty is the same before and after the amendment of the Act, where before the amendment, software payments were classified under the category of **copyright** in the interpretation of royalty under subsection 2(1) of the ITA.
- Software is included as copyright because by the definition of copyright under subsection 7(1) of Copyright Act 1987, literary works are eligible for copyright. Section 3 of Copyright Act 1987 defines literary works as including **computer programs**.
- 4.4 Pursuant to paragraph 12.1 in Article 12 OECD Model Tax Convention (MTC) Commentary, software may be described as a program, or series of programs, containing instructions for a computer required either for the operational processes of the computer itself (operational software) or for the accomplishing of other tasks (application software). It can be transferred through a variety of media, for example in writing or electronically, on a magnetic tape or disk, or on a laser disk or CD-ROM. It may be standardised with a wide range of applications or be tailor-made for single users. It can be

transferred as an integral part of computer hardware or in an independent form available for use on a variety of hardware.

4.5 In general, there are two (2) main types of software:

(a) Operating System Software

The basic functioning and efficiency of a computer depend solely on its operating system software without which it would not operate. Operating system software is usually inside the computer (the hardware); thus, it is also referred to as bundled software. However, operating system software may also be acquired separately from the hardware.

Examples of operating system software are Microsoft Windows, Apple macOS, and Linux.

(b) Application Software

Application software involves programs for performing specific tasks or applications, such as video games, word processors, graphic designs and learning programs. Unlike system software, which is designed to run the computer's hardware and manage the operating system, the application software is developed to accomplish various needs and purposes of the user.

Examples of application software are Microsoft Word, Microsoft Excel, Outlook Express, and Internet Explorer.

4.6 Means of transmission and form of consideration:

(a) A software program, written in programming language or has been compiled into source code, is considered an intangible intellectual property.

However, unlike other forms of intangible property, it can interact with a physical device, whereas licences, patents, and copyrights merely represent intangible rights. The underlying program typically does not depend on its physical media, in fact, it can be entirely purchased and transferred intangibly (i.e., via the internet network).

For instance, once a program is written, it may be recorded on a disk, copied to another computer's hard drive, or transferred over a network. The purchase of the software is deemed to be purchase of a tangible or intangible property, depending on the characteristics of each transaction.

- (b) There are various forms of consideration for software. It can be in the form of money or in kind which may not require a particular formula, e.g. a lump sum, monthly or yearly payment, based on sales, etc.

However, neither the means of transmission nor the form of consideration should affect the tax characterisation and tax treatment of income derived from software. It is important that the determination is made based on the fundamental economic characteristics of the software, as there may be a transaction in goods, in services or in intellectual property, or in all three combined.

5. Derivation of Royalty Income

- 5.1 The scope of the imposition of income tax in Malaysia is determined under section 3 of the ITA which provides that income tax shall be charged for each year of assessment upon the income of any person accruing in or derived from Malaysia or received in Malaysia from outside Malaysia.
- 5.2 Pursuant to section 15 of the ITA, gross income in respect of royalty shall be deemed to be derived from Malaysia in the following circumstances:
- (a) if responsibility for payment of the interest or royalty lies with the Government, a State Government or a local authority;
 - (b) if responsibility for payment of the royalty in the basis year for a year of assessment lies with a person who is resident for that basis year; or
 - (c) if the royalty is charged as an outgoing or expense against any income accruing in or derived from Malaysia.
- 5.3 Any income in relation to software payments is deemed to be derived from Malaysia if it is associated with any activity in Malaysia, regardless of whether the income is received in Malaysia or otherwise.

6. The Tax Treatment in Relation to Software Payments to a Non-Resident

- 6.1 Payments of software to non-residents who do not have a permanent establishment (where a Double Taxation Avoidance Agreement applies) or where there is no place of business in Malaysia are subject to withholding tax under –
- (a) Section 109 of the ITA, if the payment received is a royalty income under the Act; or
 - (b) Section 109B of the ITA, if the payment received is an income within the scope of paragraph 4A(ii) of the ITA.

6.2 If the non-resident has a permanent establishment or place of business in Malaysia, payment received will be taxed under paragraph 4(a) of the Act.

6.3 The tax treatment in relation to payments of software to non-residents depends on the facts of each particular case. As a guide, the criteria to determine whether a payment to a non-resident constitutes a royalty or service fee are as follows:

(a) Payment that constitutes a royalty and is subject to withholding tax under section 109 of the ITA if:

- (i) the payment is for the purchase or the use of, or the right to use an application by the payer for the purpose of own use.
- (ii) in relation to the software payments, any purchase of application and contents falls under the interpretation of royalty. As long as the intellectual property is still belonging to the original owner of the applications and contents, such purchase, regardless of whether it can be modified (exploit/modification/alteration) or otherwise, still falls under the definition of royalty.

(b) Payment constitutes a service fee and is subject to withholding tax under section 109B of the ITA if:

- (i) it does not involve the purchase or use of an application but merely a provision of service by a non-resident.
- (ii) in relation to the software payment, the provision of service means the service provider develops relevant functions to be used by the user (payer).

The income from this service falls under special classes of income [paragraph 4A(ii) of the ITA].

6.4 In accordance with the explanation in Practice Note No. 1/2018, payments in relation to Digital Advertising are:

(a) Subject to section 109 of the Act, if it is for the purchase or use of (for example) an application (Apps) by the payer allowing him to create his own advertisement campaign; or

(b) Subject to section 109B of the Act, if it does not involve the purchase or use of an Apps but merely for the provision of service by the non-resident. In this case, the payer solely relies on the service provider to deal with all aspects of digital advertising.

- 6.5 The tax treatment in relation to software payments by distributors and resellers to non-residents depends on the facts of each case. In the context of the Double Taxation Avoidance Agreement (DTA), the definition of royalty and permanent establishment may differ. Therefore, reference should be made to the DTA of the contracting country.

7. Software Payments Fall Under the Scope of Royalties

The following are examples of payments that fall under the scope of royalties in accordance with the provisions of subsection 2(1) of the ITA and are subject to withholding tax under section 109 of the ITA:

- (a) Purchase of a laptop with software

Example 1

Syamire & Kamire Associate, a law firm, purchased a Super laptop from Orite Pte. Ltd., a non-resident company, for RM5,000. The cost of the hardware of the computer is RM3,000, while the cost of the software is RM2,000. The basic specification of the software is equipped with a Solid State Drive (SSD).

The cost of software of RM2,000 falls under the definition of royalty.

- (b) Free download of applications and additional software

Example 2

The facts of the case are the same as those in Example 1, Syamire & Kamire Associate had downloaded free software applications from the internet and purchased additional software from a non-resident supplier, Alpha Limited. There is a software purchase agreement that stipulates Syamire & Kamire Associate has no right to exploit, duplicate copies of the software, nor the right to modify, compile or arrange related software.

Tax treatment on the activity of downloading software for free via the internet is not subject to withholding tax as no payment is made, and therefore, there is no issue of royalty.

However, payment for the purchase of additional software from Alpha Limited, regardless of whether the software can be modified or not, is included in the definition of royalty.

- (c) Purchase of software and licensing fees

Example 3

Maju Sdn. Bhd. is a housing developer that uses accounting software to prepare financial reporting. Maju Sdn. Bhd. purchased software from a non-resident company for RM100,000 and paid an annual licensing fee of RM3,000.

Both payments to the software supplier are considered royalties for the use or right to use the software.

- (d) Payment for digital advertising

Example 4

Seri runs an online cosmetics business. Seri uses a social media platform provided by a non-resident company to advertise her products. Seri is allowed to promote and upload advertisements for her products on the platform.

Payment to the non-resident social media provider is considered royalty.

- (e) Change of identity of payer and type of payment

Example 5

Mesra Sdn. Bhd. is an affiliate of Sunshine Pte. Ltd., a non-resident software company, where Mesra Sdn. Bhd. pays an annual fee for the use of licence, software upgrades, and maintenance. In 2023, Mesra Sdn. Bhd. changed its identity from an affiliate to a reseller. Mesra Sdn. Bhd. no longer pays an annual fee to Sunshine Pte. Ltd. but has made payments for the purchase of digital certificates. Mesra Sdn. Bhd. is licensed to distribute digital certificates to end-users. The payment includes the use of Sunshine Pte. Ltd.'s trade name, trademark, and product logo.

Digital certificates are considered computer software products and therefore within the scope of the definition of royalties. The change in identity from an affiliate to a reseller and the change in the method or form of payment do not affect the characterisation and tax treatment of income from the software.

- (f) Access fee for software and ancillary services

Example 6

Oriental Private Limited, a non-resident company, provides access to various channels for its customers to receive financial data that can be used for tracking stock prices, reviewing past performance of the entities, monitoring of specific markets including commodities, bonds, currencies, and others. The data is transmitted from Oriental Private Limited to customers via electronic media. The monthly access fee is RM5,000 and a one-off payment for the cost of installation is RM1,000.

The monthly access fee of RM5,000 is considered royalty.

Meanwhile, the one-off payment of RM1,000 for the cost of installation is classified as special classes of income under section 4A of the ITA and is subject to withholding tax under section 109B of the ITA on the amount relating to services performed in Malaysia.

- (g) Payment for customised software

Example 7

Sinar Berhad signed a contract with Xing Xing Private Ltd., a non-resident company. Xing Xing Private Ltd. will develop, implement, maintain, and operate a XYZ system for Sinar Berhad. Xing Xing Private Ltd. grants a non-exclusive and non-transferable licence to Sinar Berhad to use the XYZ system for internal purposes. The monthly fee payment includes hosting, management, and support for the XYZ system. The payment is based on the number of stores, distributors, and end-users active in that month.

The payment is for the purpose of obtaining the right to use the XYZ software is considered royalty.

- (h) Payment of distributor fees

Example 8

Ayu Sdn. Bhd. engages in purchasing computer software from Star Pte. Ltd., a non-resident company, and distributing the computer software to customers in Malaysia. Ayu Sdn. Bhd. signed an Authorised Distributor Agreement with Star Pte. Ltd. The software licence fee is charged based on the number of users, and the price is determined according to Star Pte. Ltd.'s price list from time to time.

Payment for computer software is considered royalty. This is in line with the definition of royalty under subsection 2(1) of the ITA, which states “the use of, or right to use copyright and software.” Although Ayu Sdn. Bhd. does not have the right to exploit or make any modifications to the software, Star Pte. Ltd. still owns the intellectual property rights to the computer software.

- (i) The DTA rate is in accordance to the country of residence of the actual beneficial owner

Example 9

Sinaran Sdn. Bhd. signed an agreement with Guang Ming Pte. Ltd., a company based in Hong Kong, and Gamma Ltd., a company based in Taiwan.

Guang Ming Pte. Ltd. sells Smart TVs with pre-installed content and applications provided by Gamma Ltd. to Sinaran Sdn. Bhd.

Guang Ming Pte. Ltd. designs and provides hardware and firmware software that is compatible with the pre-installed content and applications provided by Gamma Ltd.

Gamma Ltd. provides pre-installed content and applications on the smart TV. In addition, Gamma Ltd. operates an app store and provides it to smart TV users. Both Guang Ming Pte. Ltd. and Gamma Ltd. provide their respective services separately to Sinaran Sdn. Bhd.

Sinaran Sdn. Bhd. makes payments to Guang Ming Pte. Ltd., including payments for licences and rights to use the applications supplied by Gamma Ltd.

The portion of the payment involving licences and rights to use the applications is considered royalty. The tax rate is 10% [referring to P.U. (A) 201/1998]. Although the payment is made directly to Guang Ming Pte. Ltd., which is based in Hong Kong, the DTA rate between Malaysia and Hong Kong is not applicable because the actual licensor and owner of the beneficial royalty is Gamma Ltd., which is a tax resident in Taiwan.

- (j) Payment of maintenance charges

Example 10

Maju Sdn. Bhd. signed an agreement with Osaka Corporation, a non-resident company. Payments to Osaka Corporation include initial licensing fees and annual maintenance fees for the ABC software and OPQ system.

ABC is a three-dimensional (3D) design software. The designs will be stored in the OPQ system after being approved by Osaka Corporation.

Maju Sdn. Bhd. paid the initial licensing fees and annual fees based on the usage to Osaka Corporation.

The payment for the initial licensing fee and annual maintenance fee based on the usage is construed as payment for the right to use the software. Therefore, it is considered as royalty.

- (k) Payment for cloud-based services

Example 11

Nora Sdn. Bhd., a software developer company has entered into an agreement with Beta Ltd., a non-resident company which provides cloud-based services. Nora Sdn. Bhd. is provided with services including storage, data transfer, database, and Application Programming Interface (API), from Beta Ltd.

The payment is classified as royalty.

- (l) Perpetual licence fee and subscription fee

Example 12

Pelangi Berhad made a payment of RM200,000 for the purchase of software inclusive of a one-time payment perpetual licensing fee, for its right to use the software forever. In addition, it has to pay an annual subscription fee of RM5,000 for the software licence, access to support services, and new versions of the software. All payments are made to Sunset Limited, a non-resident company.

Both the perpetual licensing fee of RM200,000 and the annual subscription fee of RM5,000 are considered royalties.

- (m) Subscription fee for assessment report

Example 13

Summer Sdn. Bhd. purchased and subscribed to an online psychometric assessment report from a non-resident company, Delta & Co., which holds the copyright. This assessment is used by Summer Sdn. Bhd. for the recruitment of new staff. The psychometrics assessment and interpretive report are generated from questionnaires answered by the candidates for the purpose of understanding their individual personalities.

The subscription fee for psychometric assessment report is a royalty as the payment is for the use, or the right to use, any copyright. According to subsection 7(1) of the Copyright Act 1987, literary works are eligible for copyright. While, section 3 of the same Act defines literary works includes “letters, reports, and memoranda as well as computer programs.”

- (n) Payment for digital learning system

Example 14

For the purpose of enhancing the engagement of online class attendees, a local university has subscribed to an online or digital learning tool known as Fun Learning from a non-resident company. Fun Learning is a game-based interactive classroom system that allows facilitators to create quizzes, discussions, and surveys that can be played by the students in real-time.

The subscription fee for the right to use and the usage of the Fun Learning software is within the definition of royalty.

- (o) Purchase of digital products

Example 15

Moonlight Enterprise makes payments to non-residents to obtain copyrighted digital products. These digital products include online music downloads, music videos, movies, e-books, video games, ringtones, logos, and other similar products. Moonlight Enterprise is not granted commercial rights or the right to exploit these digital products.

The payment for the purchase and use of digital products falls under the definition of royalty regardless of whether Moonlight Enterprise is given commercial rights or the right to exploit the digital products.

- (p) Software subscription for online meetings

Example 16

Easy Bhd. subscribes to a software for online meeting from a non-resident software and application owner. Easy Bhd. can generate links on online meetings together with meeting notifications that allow participants to access online meetings.

The payment made by Easy Bhd. for the use, or right to use the software and applications constitutes a royalty payment to non-resident.

- (q) Subscription fee for digital platform

Example 17

Sri Ayu runs online sales of its products through Eh-Bay digital platform owned by a non-resident company. Sri Ayu is charged a monthly subscription fee of USD 20.50. The subscription fee is related to the right to use the Eh-Bay application.

Under subsection 2(1) of the ITA, the monthly subscription fee falls under the category of payment for the use of, or right to use of software is considered as a royalty.

- (r) Other payments

Example 18

Empire Sdn. Bhd. makes payments to non-resident suppliers for the following services:

- (i) Subscription fees for an online news portal that allows users to search for information and download information from the portal.
- (ii) Subscription fees for digital tools, e-learning platforms or library content and e-books.
- (iii) Registration fees for online courses or training programs, conferences, workshops, and seminars.
- (iv) Web-based applications (such as pigeonhole) for real-time Q&A sessions during meetings, seminars, or conferences where questions from participants can be filtered and displayed by the user. Users can also submit answers through the same application.

All payments to non-resident suppliers as mentioned above are included under the definition of royalties.

- (s) Payment for additional charges for professional membership fee

Example 19

Winter Berhad pays an annual membership fee to a non-resident professional body. The basic professional membership fee is offered together with complimentary access to the professional body's e-library.

The entire professional membership fee is not a royalty and is not subject to Withholding Tax.

However, if Winter Berhad, having become a member, pays other subscription fees and additional charges to access online information and learning databases, these payments are considered royalties.

8. Payments Constituting Service Fees and are Subject to Withholding Tax under Section 109B of the ITA

Payment of software to a non-resident which is neither involved in the purchase nor usage of an application but merely as provision of service by the non-resident is not considered as royalties.

The provision of service means the service provider develops relevant functions to be used by the payer.

The income derived from such service falls under special classes of income [paragraph 4A(ii) of the ITA] and is subject to withholding tax under section 109B of the ITA. However, services provided outside of Malaysia are exempted from tax effective 6 September 2017 through the Income Tax (Exemption) Order (No. 9) 2017 [P.U. (A) 323/2017].

- (a) Transaction fees for service

Example 20

The facts of the case are as in Example 17 above. As per the agreement signed between Sri Ayu and Eh-Bay, Sri Ayu is also required to pay transaction fees related to the services provided by Eh-Bay. The transaction fee charged is 5% on each successful transaction.

The transaction fee received by Eh-Bay for the services provided is a special classes of income under paragraph 4A(ii) of the ITA.

- (b) Service fee for e-payment gateway

Example 21

A non-resident charges a fee for e-payment gateway services to merchants by providing a link to the e-payment gateway on the merchant's website, enabling customers to access and make online payments to the merchant.

Such payment is not considered as royalties and is not subject to withholding tax under section 109 of the ITA. It is a special classes of income under paragraph 4A(ii) of the ITA.

- (c) Payment of fee for technical support

Example 22

Murni Berhad makes a payment of fee for technical support to ST Pte. Ltd., a non-resident company for an accounting system implemented outside of Malaysia. ST Pte. Ltd. is the parent company of Murni Berhad.

This payment is a fee charged to Murni Berhad by ST Pte. Ltd. for technical support in help desk service.

The payment to ST Pte. Ltd. for its accounting system is considered a special classes of income under paragraph 4A(ii) of the ITA.

- (d) Fee for online examination platform

Example 23

Mawar University uses an online platform to conduct the examination program. The online platform is managed and maintained by the non-resident who will upload the examination papers for candidates to answer online. The examination answer scripts are marked and graded online by the examiners.

The payment made to the non-resident is not considered as royalties. It is a special classes of income under paragraph 4A(ii) of the ITA.

- (e) Payment for the use of online ticket booking and vehicle rental service platforms

Example 24

SP Ltd., a non-resident company, provides online services for airline ticket booking and vehicle rentals through a single platform. Customers can book airline tickets and vehicle rentals and make payments through this platform.

Golden Airline, an airline company in Malaysia, uses the ticketing booking service platform, while Azrul & Jharul Enterprise, a partnership in Malaysia, uses the vehicle rental service platform provided by SP Ltd.

After deducting the fees or commissions from the airline ticket booking and vehicle rental reservations, SP Ltd. will release the balance to Golden Airline and Azrul & Jharul Enterprise.

The fees or commissions received by SP Ltd. are special classes of income under paragraph 4A(ii) of the ITA.

- (f) Payment for internet network connection

Example 25

Union Ltd. is a financial network provider company based in Shanghai, China. Union Ltd. provides banking card payment services in China. Anggerik Company has a joint venture with Union Ltd. through an ATM service network partnership. This internet network access enables information regarding banking activities to be channelled to Union Ltd. Union Ltd. charges Anggerik Company for the internet network connection provided.

The payment made is for provision of services and is not considered as royalty. It is a special classes of income under paragraph 4A(ii) of the ITA.

9. Advance Payments and Deposits

- 9.1 Advance payments and non-refundable deposits paid to a non-resident payee for the purchase or the use of software form part of the gross income of a contract and constitute royalty payment.

The advance payment or non-refundable deposit made are purely for the future use of the software and form part of the gross amount payable for charges of usage. Therefore, this payment is subject to withholding tax under section 109, ITA.

- 9.2 On the other hand, deposits paid upon signing of an agreement of which the deposits can subsequently be retrieved, do not form part of the gross income of a contract.

10. Deduction of Tax

- 10.1 Income tax shall be charged for each year of assessment on the income of a non-resident person chargeable to tax on royalty payments derived from Malaysia, at the rate of 10% on the gross amount as provided in Part II, Schedule 1 of the ITA.

- (a) Withholding tax borne by payee

Example 26

Tulip Pte. Ltd., a non-resident company, charged a subscription fee for software usage rights to Cempaka Sdn. Bhd., valued at RM200,000. Cempaka Sdn. Bhd.'s financial year ended on 31 December. Tulip Pte. Ltd. issued an invoice dated 15.5.2023 to Cempaka Sdn. Bhd. for the use of the software. Cempaka Sdn. Bhd. paid the subscription fee to Tulip Pte. Ltd. on 10.6.2023.

The gross amount paid to Tulip Pte. Ltd. is a royalty payment and subject to withholding tax at the rate of 10% under section 109 of the ITA.

Computation of Withholding Tax

	RM
Payment of software subscription fees	200,000
Less:	
Withholding Tax (10%)	20,000
Payment due to Tulip Pte. Ltd.	180,000

Cempaka Sdn. Bhd. should remit the withholding tax deducted of RM20,000 to Director General of Inland Revenue (DGIR) within one month after the payment has been paid or credited to Tulip Pte. Ltd., which is on or before 10.7.2023. The amount of software usage subscription fees that can be allowed in computing the adjusted income of Cempaka Sdn. Bhd. for the year of assessment 2023 is RM200,000.

- (b) Withholding tax borne by payer

Example 27

The facts are the same as those in Example 26, except that Cempaka Sdn. Bhd. contracted to pay the full amount of the subscription fee of RM200,000 to Tulip Pte. Ltd. Cempaka Sdn. Bhd. also undertakes to bear and pay withholding tax to DGIR within the stipulated period.

For the financial year ended 31.12.2023, Cempaka Sdn. Bhd. claimed the following as an expense in its profit and loss account.

	RM
Payment of software subscription fees to Tulip Pte. Ltd.	200,000
Add:	
Withholding Tax paid to DGIR	20,000
Amount claimed in the profit and loss account	220,000

Only the software subscription fee of RM200,000.00 is deductible in computing the adjusted business income of Cempaka Sdn. Bhd. for the year of assessment 2023. The withholding tax (tax of Tulip Pte. Ltd.) borne by Cempaka Sdn. Bhd. is not an allowable expense being not wholly and exclusively incurred in the production of its gross income.

10.2 For purposes of determining the amount of withholding tax where payment to a non-resident is made in non-ringgit currency, the equivalent Ringgit Malaysia (RM) value has to be calculated at the time payment is made at the:

- (a) prevailing foreign exchange rate on the date the payment is made (the rate would be reflected in the telegraphic transfer);
- (b) rate published in the official portal of IRBM; or
- (c) rate published by Bank Negara Malaysia.

The withholding tax is to be computed based on the amount in RM on the date payment is made to the non-resident.

10.3 Withholding tax under section 109 of the ITA is a final tax. However, if a non-resident payee has income from other sources other than royalty, he is required to file an Income Tax Return Form (ITRF). The royalty income may be included in the ITRF, in this case the income will be subject to tax at the rate of 10% and a set-off under section 110 of the ITA will be given for the withholding tax paid in computing his tax payable for a year of assessment [paragraph 109(3)(a) of the ITA].

11. Remittance of Tax Deducted

11.1 A payer, normally a person carrying on a business in Malaysia, is responsible for deducting and remitting the withholding tax payment under section 109 of the ITA to the DGIR and pay the net amount to the non-resident payee. The payer must pay the withholding tax so deducted to the DGIR within one month after paying or crediting the recipient.

11.2 The methods of submission of Form CP 37 and payment of withholding tax

(a) e-WHT

Having all payment information duly completed, the taxpayer may choose a payment channel via ByrHASIL, selected bank services or at the counter of the Revenue Management Centre (RMC) by using the Bill Number provided on the slip. If the payment is made through a local bank which is an agent-bank of IRBM, it is recommended to make the payment via ByrHASIL and selected bank services. The payment through bank transaction slip is considered as proof of payment, the original receipt will not be issued.

(b) Payment Counter of the Revenue Management Centre (RMC)

If the payment is made through the RMC counter, the taxpayer is encouraged to provide complete payment information so that a bill number can be generated, and a payment slip be printed using e-WHT platform (<https://mytax.hasil.gov.my/>). The e-WHT payment slip must be submitted when making the payment. If the taxpayer chooses to fill in Form CP37 manually, the form must be submitted together with the payment. The accepted modes of payments are by cash and via bank draft.

RMC Information:

STATE	ADDRESS
Peninsular Malaysia	Lembaga Hasil Dalam Negeri Malaysia Pusat Bayaran Kuala Lumpur Tingkat Bawah & 15, Blok 8A Kompleks Pejabat Kerajaan Jalan Tuanku Abdul Halim, Karung Berkunci 11061 50990 Kuala Lumpur
Sabah & Federal Territory of Labuan	Lembaga Hasil Dalam Negeri Malaysia Pusat Bayaran Kota Kinabalu Tingkat Bawah, 3 & 4 Menara Hasil Jalan Tuanku Abdul Rahman 88600 Kota Kinabalu
Sarawak	Lembaga Hasil Dalam Negeri Malaysia Cawangan Kuching Pusat Bayaran Kuching Unit Operasi Kutipan Cukai Aras 1, Wisma Hasil No 1, Jalan Padungan 93100 Kuching

(c) e-TT System

The taxpayer is required to provide complete payment information and a generated VA number using e-TT to facilitate payment made via Telegraphic Transfer (TT)/Interbank Transfer Giro (IBG)/Electronic Fund Transfer (EFT) from the taxpayer's account to the IRBM's account. This service is provided to a taxpayer who does not have a bank account in Malaysia or bank account holder who is not a member of FPX.

12. Consequences of Not Deducting and Remitting Tax

- 12.1 Where a payer fails to deduct and remit any amount of withholding tax due to the DGIR under subsection 109(1) of the ITA, that amount which he fails to pay shall be increased by 10% of the amount of withholding tax which he fails to pay and the total sum shall be a debt due from him to the Government and shall be payable to the DGIR [subsection 109(2) of the ITA].

Example 28

Silver Sdn. Bhd. failed to deduct and remit tax of RM5,000 due and payable on 30.4.2023, on a payment of RM50,000 chargeable to tax on royalty payments to Rainbow Ltd., a non-resident company. That sum which Silver Sdn. Bhd. failed to pay shall be increased by RM500 (10% × RM5,000). The total sum of RM5,500 shall be a debt due to the Government.

- 12.2 Where the payment in respect of royalty income is subject to withholding tax under section 109 of the ITA and the payer fails to deduct and remit the tax to the DGIR in accordance with subsection 109(1) of the ITA, such payment will be disallowed as an expense in the computation of the adjusted income from any source of the payer [paragraph 39(1)(f) of the ITA]. However, if the payer subsequently pays the withholding tax together with the increased amount (as stated in paragraph 13.1), that royalty payment made to the non-resident can be subsequently allowed as a deduction [proviso to paragraph 39(1)(f) of the ITA].

Although the expenses are incurred under subsection 33(1) of the ITA, a deduction is not allowable under paragraph 39(1)(f) of the ITA if the withholding tax is not paid or remitted to the DGIR.

- 12.3 Effective 1.1.2011, for year of assessment 2011 and subsequent years of assessment, in addition to the late payment penalty mentioned in paragraph 12.1 above, where –

- (a) the withholding tax deduction is made or paid after the due date for the furnishing of an ITRF for a year of assessment that relates to the payment of royalty income; and
- (b) a deduction for expenses related to such payment is made in the ITRF furnished or claimed on the information given to the DGIR in arriving at the adjusted income of the payer

the tax or amount so paid shall not prejudice the imposition of penalty under subsection 113(2) of the ITA [proviso to paragraph 39(1)(f) of the ITA].

In other words, if a payer claims a deduction in the ITRF for expenses that are subject to withholding tax whereas the withholding tax has not been paid or remitted, the DGIR is empowered to impose a penalty under subsection 113(2) of the ITA for incorrect returns. This applies regardless of whether the ITRF has been filed within or after the due date for submission for the relevant year of assessment.

Where the withholding tax is not due for payment and no payment or crediting is made to the non-resident payee on or before the due date of submission of the ITRF, regardless of the withholding tax has been paid or remitted to the DGIR, a deduction is not allowable under paragraph 39(1)(f) of the ITA.

13. Application for Relief Other Than in Respect of Error or Mistake under Section 131A of the ITA

Effective 1.1.2017, a payer who has furnished to the DGIR a ITRF for a year of assessment and has paid tax for that year of assessment may file an application for relief if the payer alleges that the assessment relating to that year of assessment is excessive. The assessment is said to be excessive where a deduction is not allowed in respect of payment not due to be paid under subsection 109 of the ITA on the day the ITRF is furnished. The payer may make an application in writing to the DGIR within one year after the end of the year the payment is made.

Example 29

Seesaw Sdn. Bhd. which closes its financial accounts on 31st December each year did not claim royalty expense payable to Seesaw Ltd. for the YA 2023 because the royalty and withholding tax were paid on 30.9.2024. The company may apply for relief under section 131A of the ITA to amend the assessment for the YA 2023 before 31.12.2025.

14. Appeal by Payer on Payment of Withholding Tax under Section 109H of the ITA

Effective 1.1.2013, a payer who is liable to make payment of withholding tax under section 109B of the ITA may appeal to the Special Commissioners if the basis is that the withholding tax payment is not liable to be paid under the ITA. The appeal has to be made within 30 days from the date the amount is due to be made to the DGIR.

However, an appeal cannot be made by the payer under the following circumstances:

- (a) the non-resident person has filed an appeal to the Special Commissioners in relation to the royalty payment to which the withholding tax relates;
- (b) the royalty payment to the non-resident has been disallowed as a deduction under section 39 of the ITA in arriving at the adjusted income of the payer; or
- (c) the withholding tax due has not been paid to the DGIR by the payer.

15. Double Taxation Avoidance Agreement (DTA)

Malaysia has entered into agreements with a number of countries for the avoidance of double taxation and prevention of fiscal evasion.

15.1 Where a DTA has been signed with a particular country, the DTA would generally include a Royalty Article which provides that royalty derived or arising from Malaysia may be taxed in Malaysia (i.e., subject to withholding tax in Malaysia). The DTA may provide for preferential rates of withholding tax on royalty income. To be eligible for the preferential rate, a written confirmation in the form of a letter or certificate from the revenue authority of the relevant country confirming the resident status of the payee has to be submitted together with the Form CP37 when making withholding tax payment.

15.2 Where Malaysia has not entered into a DTA or there is a limited DTA with a particular country, the domestic tax laws of Malaysia shall prevail.

15.3 Under the DTA provision, if the same income is taxed in both countries (Malaysia and a treaty country), the taxpayer (non-resident) may claim tax relief known as bilateral credit in the country where he is resident.

However, if the withholding tax is borne by the payer (Malaysian resident) instead of the non-resident, then the bilateral credit cannot be claimed by the non-resident.

16. Withholding Tax Exemption on Royalty

There are several exemptions granted on royalty income received by non-residents namely:

16.1 Effective from 1.3.2019, withholding tax exemption is provided under Income Tax (Exemption) Order (No. 4) 2019 [P.U. (A) 147/2019] on payments received by a non-resident from an end user who is an individual resident in Malaysia, who purchases software or acquires any right to use the software for personal usage and not for usage in his business.

(a) Payment for downloading applications by individuals for personal use

Example 30

Ms. Shidah has downloaded Korean and Indian drama applications from various websites for her personal use. These downloads can be obtained for free and may also be subject to charges by certain websites.

The payment charged to enable the use of the downloaded applications is considered as a royalty payment and is subject to withholding tax under section 109 of the ITA.

However, with effect from 1 March 2019, an exemption from withholding tax is provided for, under the Income Tax (Exemption) (No. 4) 2019 [P.U. (A) 147/2019].

(b) Payment for the purchase of software by individuals for personal use

Example 31

Asman is an employee of a company in Malaysia. He bought a computer, including the software from a company in Singapore for personal use to facilitate his work tasks.

The payment made for the purchase or use of the software is considered as royalty payment and subject to withholding tax under section 109 of the ITA. However, the payment is exempted from withholding tax effective from 1.3.2019 under P.U. (A) 147/2019 because Asman is a resident in Malaysia using the software for personal use.

- 16.2 The royalty received from an offshore company by a non-resident or another offshore company is exempted from withholding tax according to the Income Tax (Exemption) Order (No. 22) 2007 [P.U. (A) 437/2007].
- 16.3 There are provisions under DTA between Malaysia and certain countries which provide the exemption of royalty from being taxed in the country where the royalty is derived. For instance, DTAs between Malaysia and Norway, New Zealand, Netherlands and Australia. However, the exemption applies only if such royalty is approved by the Minister of Finance.

In most DTAs, Approved Industrial Royalties shall be exempted from tax. Approved industrial royalties has been defined to mean royalty which has been:

- (a) approved and certified by the Minister of Finance;
- (b) for the purpose of promoting industrial development in Malaysia; and
- (c) payable by a company which is engaged in activities in the sector of:
 - (i) manufacturing, assembling and processing;
 - (ii) construction, civil engineering or ship building; or
 - (iii) electricity, hydraulic powers, gas, water supply

17. Disclaimer

The examples in this PR are for illustration purposes only and are not exhaustive.

**Director General of Inland Revenue,
Inland Revenue Board of Malaysia.**