

Asia Internet Coalition (AIC) Industry Submission on the Inland Revenue Board of Malaysia's draft public ruling on the tax treatment on royalties for payments of software to a non-resident

18 March 2024

To
The Inland Revenue Board (LHDN)
Government of Malaysia

On behalf of the [Asia Internet Coalition](#) (AIC) and its members, we would like to provide our comments and recommendations into the Public Draft Ruling (Ruling) issued by the Inland Revenue Board of Malaysia (IRB) regarding the Tax Treatment On Royalties For Payment Of Software To A Non-Resident. We have provided commentary with regards to our key observations and concerns as well as attached Annex with comments and recommendations in relation to certain examples provided in the Ruling.

Our overarching concern is that the IRB is proposing to take a view that is inconsistent with views taken internationally by other jurisdictions, in relation to software payments, as well as long-standing international best practices. The Ruling adopts an unreasonably broad interpretation of a royalty, which is at odds with views shared globally. The Ruling treats payments for digital services as payments for software falling within the definition of 'royalties' for Malaysian tax purposes.

Further, the Ruling supports that as long as the intellectual property still belongs to the original owner of the software, a payment for the use of the software (regardless of whether the software can be modified or exploited by the user) falls to be treated as a royalty. This is both illogical and incompatible with international tax norms. The widely accepted international tax interpretation of whether software payments are royalties hinges on whether the consideration is made for the **right to use, modify or exploit** the underlying copyright of the software. It is clear from the Ruling that Malaysia is taking a different view here, where the right to use, modify or exploit the software does not feature in the assessment. This poses various concerns and creates compliance hurdles and increased tax costs for both foreign investors and Malaysian consumers.

We explain these views further below followed by **Comments and recommendations in relation to certain examples referenced in the Ruling in the Annex.**

1. Increased tax compliance and costs

- Based on the draft Ruling, the IRB expects Malaysia customers who purchase digital services (e.g. cloud services, streaming services, digital advertising services, etc.) from non-residents to treat these as payments for software and withhold Malaysia royalty withholding taxes. Many other countries do not characterize digital services as software payments subject to withholding tax. By adopting a different characterization and treatment, Malaysia has subject non-residents and Malaysia customers to additional tax burden and costs, otherwise not applicable.
- Under the draft Ruling, payors in Malaysia will be obliged to review all “software payments” to non-residents, even where the payment does not relate to a right to use, modify or exploit the underlying copyright software. This casts a wide net over the types of payments that need to be analyzed from a Malaysian withholding tax perspective, thereby increasing compliance for Malaysian consumers, in particular in comparison to payors in other jurisdictions. Where an incorrect interpretation is adopted by a Malaysian user in the view of the IRB, penalties could be payable by the Malaysian consumer as well as withholding tax.
- The Ruling also leads to increased tax costs for Malaysian customers. Even though non-residents will initially suffer the tax (e.g. through receiving a net payment after the withholding tax is levied), it will likely lead to the non-resident recipient passing on this additional cost to consumers through increased goods/service costs or by introducing gross up clauses in contracts such that the non-resident is ‘made whole’ for the withholding tax suffered. It is likely that non-residents would be restricted from claiming double tax relief in relation to the Malaysia withholding tax suffered due to the differing view taken by Malaysia that the software payment is a royalty.
- The view proposed in the Ruling also creates uncertainty for taxpayers. For example, where a Malaysia resident is paying a non-resident for bundled services, the Ruling creates uncertainty as to how to identify which part of that payment could constitute a royalty. For instance, where a Malaysian consumer is making a payment to a non-resident seller of a smart TV, or for the purchase of a laptop with software, the payment could include a component relating to the purchase of the TV/laptop itself and for software. There will need to be new mechanisms, processes and systems in place to allow the non-resident seller or Malaysian consumer to bifurcate such payments to levy an appropriate amount of withholding tax. Even where that is the case, the approach to bifurcation of the payment could be contested by the Malaysian tax authorities, giving rise to uncertainty for businesses and likely increased disputes.

2. Inconsistent with other jurisdictions views

- As noted above, many countries recognize and respect that payments for digital services are payments for services supplied electronically through the internet. While there may be software utilized in the process, such software is used by the service providers to make these digital services available to the purchasers. The purchasers do not acquire any software in the process and are merely accessing the services provided by the service providers. For example, a customer who pays for cloud services provided by the cloud service provider is merely paying for the storage and compute power offered by the cloud service provider and do not acquire any software or rights to any software.
- Further, even if Malaysia insists on treating digital services as payments for software, the view outlined in the Ruling that software payments made that do not relate to the right to use or exploit software copyright could still be considered software royalties is a view that is out of line with those adopted internationally. This view puts Malaysia on an uneven footing compared to other jurisdictions following international tax norms and OECD guidance where software payments are only considered royalties to the extent there is an element of use or exploitation of the underlying copyright itself, by the payor.
- For example, the Singapore IRAS e-Tax Guide to characterizing software payments¹ provides that a payment for software is a royalty payment only where it allows the payer to commercially exploit the rights. The term 'commercially exploit' includes to be able to reproduce, modify, adapt or prepare derivative work based on the software. It does not, for example, include scenarios where an end-user purchases a software for own use. In this instance, any right obtained by the end-user to use the software will not constitute a royalty payment. This view is consistent with international norms such as the OECD commentary on royalty payments.

3. Economic growth and other concerns

- The above leads to reduced attractiveness of Malaysia to foreign investment. Particularly given Malaysia would be seen as an outlier to neighboring and wider jurisdictions and that there would be increased costs for doing business in Malaysia compared to other countries. The Ruling will likely discourage foreign investment, in particular from technology businesses who may currently favor neighboring jurisdictions in place of Malaysia, for cost and administrative

¹ IRAS e-tax guide on Rights-Based Approach for Characterising Software Payments and Payments for the Use of or the Right to Use Information and Digitised Goods published on Jul 15 2022: [etaxguides_cit_rights-based-approach_2013-02-08.pdf](https://www.iras.gov.sg/etaxguides_cit_rights-based-approach_2013-02-08.pdf) ([iras.gov.sg](https://www.iras.gov.sg))

reasons. This will in turn disadvantage Malaysian consumers who will be restricted in terms of access to latest technologies.

- The unilateral position taken by Malaysia in the Ruling comes at a time when global efforts are being made to coordinate and centralize complex areas of international taxation. This coordination brings many benefits to businesses and tax administrations – for example, less risk of double taxation, aligned views internationally and less uncertainty. It seems out of sync for Malaysia to publish a view that is out of line with internationally adopted best practices at such a time and indicates Malaysia is a country that is not encapsulating of a tax system that is making progressive steps to align global taxation systems.

The AIC stands ready to engage in constructive dialogue and provide input to support the development of a regulatory framework that benefits all stakeholders. Should you have any questions, please do not hesitate to contact me directly at Secretariat@aicasia.org or at +65 8739 1490.

Thank you for your time and consideration.



Sincerely,
Jeff Paine
Managing Director
Asia Internet Coalition (AIC)

Annex: Comments and recommendations in relation to certain examples referenced in the Ruling

Example/Commentary per the Ruling	Our observations	Our recommendations
The commentary at paragraph 4.3 of the Ruling states the following (emphasis added): <i>“The word ‘software’ has been included in the interpretation of royalty for the purpose of clarity to</i>	This commentary extract supports the notion that payments for the use of software are royalties only where they constitute payments for the use of copyright . It is widely accepted as international	We strongly recommend that the IRB revise its Ruling to align its view on copyright royalties to those adopted internationally, meaning that a software payment is subject to royalty withholding tax only

Example/Commentary per the Ruling	Our observations	Our recommendations
<p><i>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.”</i></p>	<p>best practice that, for withholding tax purposes, there is no use of copyright where a payment is simply made for the use of the software (with no use/exploitation/modification available for the underlying copyright). Malaysia’s Ruling is not aligned to this widely accepted view.</p>	<p>where that payment relates to the right to use, modify or exploit the underlying copyright of the software.</p>
<p>Paragraph 7, Example 4 of the Ruling states (emphasis added): “<i>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.”</i></p>	<p>In scenarios where customers use social media platforms to advertise their products/services, the user is paying for the advertising space (i.e. they are paying for a service). There is limited ability for that user to otherwise use/modify/exploit the software application/copyright. Similar to historic advertising models, a customer would purchase the advertising space (e.g. on television/a billboard etc.) and provide the advertisement content to the supplier. Such a payment would typically be considered a services payment. Although the mode of advertisements through social media platforms may be different, the underlying principles of</p>	<p>We strongly recommend that the IRB clarifies that payments for digital advertising (such as through the use of social media platforms) are payments for services and not royalties, in line with views adopted internationally.</p>

Example/Commentary per the Ruling	Our observations	Our recommendations
	historic advertising models, and the characterization of the payment, remains the same.	
<p>Paragraph 7, Example 11 of the Ruling states (emphasis added): “<i>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.”</i></p>	<p>Payments for cloud transactions relate to payments for storage and processing customer data. These payments are therefore, in substance, services and not royalties. Again, the end user cannot use, modify or exploit the underlying copyright of the software. It is instead paying for the use of a digital service (e.g. to store data). The commonly adopted view internationally is that such cloud based payments are payments for services.</p>	<p>We strongly recommend that Malaysia clarifies that cloud transactions are payments for services, in line with internationally adopted best practices.</p>
<p>Paragraph 7, Example 17 of the Ruling states (emphasis added): “<i>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</i></p>	<p>The subscription fee in this instance is more akin to a service fee. Again, in such instances there is generally no permission for the user to use or exploit the underlying software copyright and instead, the payment is made for access to the digital platform as a means to sell products/services. Comparable historic (non-digital) services include subscribing to an agency as a means to provide certain services. Users would do this to have access to a wider and</p>	<p>We strongly recommend that this example is either removed or updated to reflect that such payments should generally be considered service payments and not royalties.</p>

Example/Commentary per the Ruling	Our observations	Our recommendations
<i>of software is considered as a royalty.”</i>	readily available customer base. Changing the mode of service to a digital form does not generally change the character of the payment from a service to a royalty.	