Introduction to the taxation of trusts in Malaysia

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Outline

► What is a trust
► Parties involved in a trust
► Types of trusts
► Why are trusts used
► Examples of countries with estate tax / inheritance tax
► Tax considerations – An overview
► Income tax provisions relevant to trusts
► Special tax exemptions in relation to trusts
► Tax considerations
What is a trust?

“A trust is an **equitable obligation**, binding a person (who is called a **trustee** to deal with the property over which he has control (which is called **trust property**), for the benefit of persons (who are called **beneficiaries** or cestui que trust) of whom he may himself be one, and any of whom may **enforce the obligation**.”

*Source: Underhill, Law of Trusts and Trustees*
Parties involved in a trust

**Settlor**
- Creates the trust via a trust deed
- Transfers his property / asset

**Trust**
- Legal owner of the trust property
- Manages and administers affairs of the trust
- Owes a fiduciary duty to the beneficiaries
- Acts according to the trust deed

**Beneficiaries**
- Beneficial owners of the trust property
- Receive income and / or the property itself at the appointed time
Types of trusts

- Living trusts
- Testamentary trusts
- Revocable trusts
- Irrevocable trusts
- Discretionary trusts
- Non-discretionary trusts
- Unit trusts / REITs
- etc…
Why are trusts used?

1. Avoid probate
2. Help manage affairs
3. Eliminate family feuds
4. To divide assets and properties
5. Tax considerations
6. Flexible distribution
7. Contest resistant
Examples of countries with estate tax / inheritance tax

- 10% - 55%
- 3% - 80%
- 33%
- 0% - 34%
- 5% - 45%
- 7% - 50%
- 10% - 40%
- 10% - 50%
- 10% - 55%
### Tax considerations

#### An overview

The areas of taxation that are generally considered:

<table>
<thead>
<tr>
<th>Types of tax</th>
<th>Applicable to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real Property Gains Tax (RPGT)</td>
<td>Disposal of chargeable assets:</td>
</tr>
<tr>
<td></td>
<td>► Real property; or</td>
</tr>
<tr>
<td></td>
<td>► Shares in Real Property Companies (RPCs)</td>
</tr>
<tr>
<td>Stamp duty</td>
<td>Instruments of transfer</td>
</tr>
<tr>
<td>Goods and Services Tax (GST)</td>
<td>Transfer of assets that are taxable supplies</td>
</tr>
<tr>
<td>Income tax</td>
<td>Income earned by both the trust and beneficiaries</td>
</tr>
</tbody>
</table>
Income tax provisions relevant to trusts

► Section 61 – Trusts generally
  ► Section 61A – Exemption of real estate investment trust or property trust fund

► Section 62 – Discretionary trusts

► Section 63 – Trust annuities
  ► Section 63A – Special deduction for qualifying capital expenditure
  ► Section 63B – Special deduction for expenses (unit trusts)
  ► Section 63C – Special treatment on rent from the letting of real property of a real estate investment trust or property trust fund
  ► Section 63D – Income of a unit trust from the letting of real property is not income from a business

► Section 64 – Estates under administration

► Section 65 – Settlements
Special tax exemptions in relation to trusts

Special tax exemptions given for the transfer of assets to certain trust vehicles:

► Stamp duty exemption:
  ► Instruments of deed of assignment and instruments of transfer of real property to a Real Estate Investment Trust (REIT) or Property Trust Fund (PTF) approved by the Securities Commission

► Real property gains tax (RPGT) exemption:
  ► Disposal of chargeable assets to a Real Estate Investment Trust (REIT) or Property Trust Fund (PTF)
Tax considerations
Settlor \(\rightarrow\) Trust (RPGT)

<table>
<thead>
<tr>
<th>Category (for cases where the disposer is not a company or an individual who is not a citizen or a permanent resident of Malaysia)</th>
<th>Tax rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Disposal within 3 years after date of acquisition</td>
<td>30%</td>
</tr>
<tr>
<td>Disposal in the 4th year after date of acquisition</td>
<td>20%</td>
</tr>
<tr>
<td>Disposal in the 5th year after date of acquisition</td>
<td>15%</td>
</tr>
<tr>
<td>Disposal in the 6th year after date of acquisition or thereafter</td>
<td>0%</td>
</tr>
</tbody>
</table>

Ranging from 0% - 30%, depending on the holding period of the property.

Transfer of real property

Settlor

Trust

Beneficiaries
Tax considerations
Settlor ‡ Trust (Stamp duty)

Tax treatment

Stamp duty

► Generally chargeable with stamp duty as a conveyance or transfer on sale

Transfer of real property

► Ad valorem stamp duty up to 3% on the execution of the instrument of transfer, computed on the higher of the sales consideration or the market value

<table>
<thead>
<tr>
<th>Value</th>
<th>Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>The first RM100,000</td>
<td>1%</td>
</tr>
<tr>
<td>Next RM400,000</td>
<td>2%</td>
</tr>
<tr>
<td>Balance in excess of RM500,000</td>
<td>3%</td>
</tr>
</tbody>
</table>

*Effective 1 January 2018 – the stamp duty rate for value in excess of RM1,000,000 shall be 4%
Tax considerations
Settlor \( \rightarrow \) Trust (Stamp duty)

**Settlor**

Transfer of real property / asset

**Trust**

**Tax treatment**

**Stamp duty**

Transfer of shares

- 0.3% on the execution of the instrument of transfer, computed on the higher of consideration or value of shares

**Beneficiaries**
Tax considerations
Trust ➔ Beneficiaries (RPGT)

Tax treatment
Real Property Gains Tax (RPGT)

Transfer to beneficiaries
► The transfer of real property by the trustee to the beneficiaries should not be subject to RPGT because there is no change in the beneficial ownership of the property

Disposal to third parties
► The trustee should be assessable and chargeable with the tax in respect of any chargeable gains accruing on the disposal of any chargeable assets of the trust
Tax considerations
Trust → Beneficiaries (Stamp duty)

Tax treatment

Stamp duty

- Nominal stamp duty should be chargeable for a transfer by the trustee to beneficiaries

Transfer of real property / asset

Settlor

Trust

Beneficiaries
Tax considerations
Settlor ➔ Trust ➔ Beneficiaries (GST)

Transfer of property / asset

Settlor

Transfer from settlor to trust
► GST will be chargeable on a taxable supply if the settlor is a taxable person. Normal GST rules apply

► Transfer of real property
  ► Commercial – standard rate at 6%
  ► Agricultural / residential – exempt supply

► Transfer of shares
  ► Exempt supply

Trust

Beneficiaries

Transfer from trust to beneficiaries
► Q: Is there a supply?
Tax considerations
Income tax – Trust

Income tax

Trust body
- The trust body shall be treated as a separate person for income tax purposes
- Income of the trust body of a trust shall be assessed and charged to tax separately from the income of a beneficiary
- The income from any source forming part of the property of the trust shall be treated as the income of the trust body
- Rate of income tax is 24% for both a resident and non-resident trust
- If a trust is non-resident, withholding tax provisions may be applicable to income derived by the trust
A trust body shall be regarded as resident for the basis year for a year of assessment if, but only if, any trustee member of that body is resident for that basis year:

Provided that where –

- The trust was created outside Malaysia by a person or persons who were not citizens;
- The income for that trust body for that basis year is wholly derived from outside Malaysia;
- The trust is administered for the whole of that basis year outside Malaysia; and
- At least one-half of the number of the member trustees are not resident in Malaysia for that basis year,

that trust body shall not be regarded as resident in Malaysia for that basis year.
Tax considerations
Income tax – Beneficiaries

Income tax

Beneficiaries

► Deemed to have a source of income in relation to the trust

► Where the beneficiary is entitled to income from the trust, the beneficiary is generally subject to income tax on his share of the **total income** from the trust
Tax considerations

Income tax – Beneficiaries

Income from the trust

Settlor

Trust

Beneficiaries

Tax treatment

Income tax

Beneficiaries

- The tax chargeable on the chargeable income of the trust body (or a proportion thereof) is available as a tax credit to the beneficiary

- Individual beneficiaries are subject to the following tax rates:
  - Resident individuals – scaled rates from 0% - 28%
  - Non-resident individuals – flat rate of 28%
### Income tax computation – example

<table>
<thead>
<tr>
<th>Example</th>
<th>RM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total income / chargeable income</td>
<td>100,000</td>
</tr>
<tr>
<td>(Less): Income tax payable @ 24%¹ (payable by the trust body)</td>
<td>(24,000)</td>
</tr>
<tr>
<td>Net income after tax (to be distributed equally)</td>
<td>76,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Distribution to the beneficiaries²</th>
<th>Beneficiary A</th>
<th>Beneficiary B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Received net distribution (76%)</td>
<td>38,000</td>
<td>38,000</td>
</tr>
<tr>
<td>Assessed at gross distribution (100%)</td>
<td>50,000</td>
<td>50,000</td>
</tr>
<tr>
<td>(Less): Personal relief</td>
<td>(9,000)</td>
<td>(9,000)</td>
</tr>
<tr>
<td>Chargeable income</td>
<td>41,000</td>
<td>41,000</td>
</tr>
<tr>
<td>Income tax payable</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>(Less): Section 110 set-off</td>
<td>(12,000)</td>
<td>(12,000)</td>
</tr>
<tr>
<td>Tax refund</td>
<td>(10,500)</td>
<td>(10,500)</td>
</tr>
</tbody>
</table>

¹ Note 1 – w.e.f. YA2016
² Note 2 – Beneficiaries are Malaysian tax-resident individuals
Thank you
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