

GUIDELINES ON THE PROCEDURES TO GIVE EFFECT TO THE 50% TAX REDUCTION ON INCOME DERIVED FROM EXPLORATION AND EXPLOITATION OF PETROLEUM IN THE MALAYSIA – THAILAND JOINT DEVELOPMENT AREA

1. General

The objective of these guidelines is to explain the procedures to give effect to the 50% reduction on income derived from activities directly related to exploration and exploitation of petroleum in the Malaysia-Thailand Joint Development Area.

2. Introduction

The Governments of Malaysia and Thailand have signed a Memorandum of Understanding in 1979 to resolve the issue of overlapping claims in a defined area of the continental shelf of the two countries in the Gulf of Thailand. As was agreed, the Malaysia-Thailand Joint Authority (MTJA) was established for the purpose of administering and managing the activities directly related to exploration and exploitation of natural resources in the joint area which is to be known as the Joint Development Area (JDA) where both countries have sovereignty.

Malaysia and Thailand have also agreed to continuously impose and collect taxes based on the domestic laws of their respective countries in respect of income derived from that area.

- (i) Production Sharing Contractors operating and managing upstream activities will be subject to the Petroleum Income Tax at the following rates:

| | | |
|---|---|-----------------------|
| First 8 years after Petroleum production | - | 0% of taxable income |
| Next 7 years | - | 10% of taxable income |
| Subsequent years | - | 20% of taxable income |

The tax chargeable by each country shall be reduced by 50% thereof and where the tax chargeable for each year by each of the countries exceeds that chargeable by the other country due to varying tax principles, that

excess shall be shared equally by the two governments and shall be adjusted accordingly by MTJA.

- (ii) A national of Malaysia or Thailand employed by the MTJA or JDA shall be taxable only in the state of which he is a resident.
- (iii) Other categories of taxpayers such as the general service contractors and foreign workers who derive income from the JDA shall be taxable according to the domestic laws of both countries and where such income is taxable in both countries, the tax chargeable in each country shall be reduced by an amount equal to 50 thereof.
- (iv) The MTJA shall be exempt from taxation in Malaysia and Thailand.

For the purposes of enforcement, the Petroleum (Income Tax) Act 1967 and the Relied Order of Malaysia-Thailand Double Taxation Agreement 1983 shall be amended whenever necessary.

3. Protocol Amending The Double Taxation Agreement Malaysia-Thailand 1995

Income derived from the JDA is subjected to tax in Malaysia and Thailand. For the purposes of avoiding double taxation on income derived from the JDA, both countries have agreed to reduce the tax chargeable by 50%.

The above arrangement shall apply in accordance with the provision of Articles 7A, 12A, 14A and 20A of the Protocol Amending the Malaysia-Thailand Double Taxation Agreement 1995. The Protocol shall have effect on income of the calendar years or accounting periods beginning on or after the first day of January 1992.

3.1 Articles – Income of Profits From The Joint Development Area

The two categories of taxpayers deriving income or profits from the JDA are as follows:

- (i) Production Sharing Contractors (PSC) – engaged in upstream activities in the JDA.

Income or profits received by them are subject to Petroleum Income Tax Act 1967 (PITA)

- (ii) Other Contractors such as service contractors engaged in downstream activities directly related to exploration and exploitation of petroleum in the JDA. Income or profit derived from such activities is subject to Income Tax Act 1967 (ITA).

3.2 Article 12A – Royalties

“Royalties” means royalties as defined in Article 12 of the Double Taxation Relief Agreement derived from activities in the JDA and charged as a business expense by Production Sharing Contractors or other contractors as mentioned in sub-paragraph 3.1.

3.3 Article 14A – Personal Services in the JDA or with the Joint Authority

Personal services cover the following categories of individuals:

- (i) Nationals of Malaysia or Thailand exercising an employment in the MTJA or in the JDA ;
- (ii) Individuals other than nationals of Malaysia or Thailand exercising an employment with the MTJA or in the JDA; and
- (iii) Individuals performing or carrying out professional services in the JDA.

For the purposes of this Article, an employment exercised in the JDA means an employment with contractors referred to in paragraph 3.1 solely in connection with the exploration and exploitation of petroleum in the JDA.

3.4 Article 20A – Technical Fees

“Technical fees” means technical fees as defined under this Article and is solely in connection with the activities carried out by contractors referred to in paragraph 3.1

4. Activities directly related to exploration and exploitation of petroleum in the JDA

As provided for in the Protocol, where income from the JDA is subject to tax in both Malaysia and Thailand the tax chargeable in each country shall be reduced by 50% provided that the income is derived from activities that are directly related to the exploration and exploitation in the JDA. In view of the difficulty to identify or determine such activities, an “exclusion list” has been prepared by both governments and shall be communicated through Exchange of Letters.

Activities mentioned in the list are activities not directly related to exploration or exploitation. However, not all activities that are not included in the list can be treated as activities that are directly related to exploration or exploitation.

4.1 Exclusion List

- (i) Professional Services provided by accountants, auditors, lawyers and doctors;
- (ii) Maintenance and repairs that are general in nature and do not require specific skills;
- (iii) Catering and support services;
- (iv) Land transportation;
- (v) Insurance;
- (vi) Financial services;
- (vii) Construction, installation or erection of facilities onshore except facilities utilised before the point of sale of petroleum;
- (viii) Any other activities as may be agreed from time to time by the Finance Ministers of Malaysia and Thailand.

(This list will be reviewed from time to time)

5. Tax Treatment

The 5% tax reduction will be effected at the level of the total tax chargeable. Therefore, the elimination of double taxation under Article 23 of the Malaysia/Thailand Double Taxation Agreement is not applicable.

5.1 Business Income

Activities in the JDA as referred to in paragraph 3.1 (ii) are subject to the Income Tax Act 1967 as the case of other business activities. However, the facts of each case must be studied in order to ascertain the nature of business that are carried out in the JDA. This is to ensure that only activities that are directly related to exploration and exploitation are subject to the reduction of 50% tax.

5.1.1 Tax Computation

Problems of tax computation and rebate will not arise where the income is purely JDA related. However, where the source on income is from both activities related and not related to the JDA, then the following points are to be noted:

- (a) the income from both activities is to be treated as being derived from one business source.
- (b) the 50% tax reduction applies only to income related to the JDA. For the purpose of giving the rebate, calculation of tax from the two activities is to be done separately.

Below are some of the examples of tax computations and procedures to give effect to the 50% tax reduction on income received from both the JDA and the Non-JDA.

Example 1

Business Profits arising from the JDA and the non-JDA.

| | <u>JDA</u> | | <u>Non-JDA</u> | |
|---|---|----------------|--|---------------|
| Gross Income | | 400,000 | | 100,000 |
| <u>Deduct</u> | | | | |
| Direct Expenses | 180,000 | | 20,000 | |
| General Expenses | | | | |
| $\frac{400,000}{500,000} \times 100,000$ | <u>80,000</u> | <u>260,000</u> | $\frac{100,000}{500,000} \times 100,000$ | <u>20,000</u> |
| | | | | <u>40,000</u> |
| Adjusted Income | | 140,000 | | 60,000 |
| <u>Deduct</u> | | | | |
| Capital Allowances | | | | |
| $\frac{400,000}{500,000} \times 50,000$ | | <u>40,000</u> | $\frac{100,000}{500,000} \times 50,000$ | <u>10,000</u> |
| | | 100,000 | | 50,000 |
| Total Taxable Income | | = 150,000 | | |
| Tax chargeable on 150,000 @ 30% | | 45,000 | | |
| 50% tax reduction on tax chargeable on income from activities from the JDA: | | | | |
| | $\frac{100,000}{150,000} \times 45,000 \times 50\%$ | = | <u>15,000</u> | |

Example 2

Where losses are incurred from the JDA and profits are made from the Non-JDA but the overall amount shows profits.

| | <u>JDA</u> | | <u>Non-JDA</u> | |
|--|---------------|----------------|--|-------------------|
| Gross Income | | 100,000 | | 400,000 = 500,000 |
| <u>Deduct</u> | | | | |
| Direct Expenses | 90,000 | | | 110,000 |
| General Expenses | | | | |
| $\frac{100,000}{500,000} \times 100,000$ | <u>20,000</u> | <u>110,000</u> | $\frac{400,000}{500,000} \times 100,000$ | <u>80,000</u> |
| Adjusted Income | | (10,000) | | 210,000 |
| Aggregate Adjusted Income | | 200,000 | | |
| <u>Deduct</u> | | | | |
| Capital Allowances | | <u>50,000</u> | | |
| Statutory Income/Tax payable | | <u>150,000</u> | | |

In this case, the 50% tax reduction is not granted because there is no tax payable on income from the JDA (the JDA activities incurred losses).

Example 3

Where profits are made from the JDA and losses are made from the Non-JDA but the overall amount shows profits.

| | <u>JDA</u> | <u>Non-JDA</u> |
|---|-----------------|--|
| Gross Income | 400,000 | 100,000 |
| <u>Deduct</u> | | |
| Direct Expenses | 110,000 | <u>90,000</u> |
| General Expenses | | |
| $\frac{400,000}{500,000} \times 100,000$ | 80,000 | $\frac{100,000}{500,000} \times 100,000$ |
| | 190,000 | 20,000 |
| | | <u>110,000</u> |
| Adjusted Income | 210,000 | 10,000 |
| Aggregate Adjusted Income | 200,000 | |
| <u>Deduct</u> | | |
| Capital Allowances | <u>50,000</u> | |
| Statutory Income/Tax payable | <u>150,000</u> | |
| Income Tax on 150,000 @ 30% | = 45,000 | |
| 50% Tax reduction on income tax from the JDA: | | |
| 45,000 x 50% | = <u>22,500</u> | |

Since the activities from the Non -JDA incur losses, the statutory income / taxable income amounting to 150,000 is solely from the JDA activities.

Example 4

Where profits are made from the JDA and losses are incurred from the Non-JDA but the overall amount shows profits. The company also has income from other sources.

Business – Statutory Income
JDA 100,000

| | | |
|------------------------------------|--------|--------------------|
| (Not from the JDA – losses 50,000) | 50,000 | (100,000 – 50,000) |
| Rent | 5,000 | |
| Interest | 5,000 | |

Computation of tax reduction is as follows:

| | |
|----------------|-----------------|
| Business | 50,000 |
| Rent | 5,000 |
| Interest | <u>5,000</u> |
| Taxable Income | 60,000 ===== |

Income Tax in 60,000 @ 30% = 18,000

50% tax reduction:

$$\frac{50,000}{60,000} \times 18,000 \times 50\% = \mathbf{7,500}$$

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Example 5

Where profits are made from both the JDA the Non-JDA sources and losses are incurred from a second business. The company also receives income from other sources.

Business I - Statutory income 150,000 (including income from the JDA 100,000)

| | | |
|-----------------------------|----------|-------|
| Business II - losses | (20,000) | |
| Rent | | 5,000 |
| Interest | | 5,000 |

Computation on 50% tax reduction is as follows:

| | | |
|---|----------|---------------------|
| Business I | | 150,000 |
| Business II - losses | (20,000) | Nil |
| Rent | | 5,000 |
| Interest | | 5,000 |
| | | <hr/> 160,000 <hr/> |
| <u>Deduct</u> | | |
| Losses Sect. 44(2) | (20,000) | |
| Taxable Income | | 140,000 |
| Income Tax on 40,000 @ 30% | = | 42,000 |
| 50% tax reduction : | | |
| $\frac{100,000}{160,000} \times 42,000 \times 50\%$ | = | 13,125 |
| | | ===== |

Example 6

Where profits are made from the JDA and losses are incurred from the Non-JDA but a second business suffer losses. The company also receives income from other sources.

| | | |
|---|----------|--------|
| Business I - [JDA 100,000 and not from the JDA (50,000)] | | 50,000 |
| Business II - losses | (20,000) | Nil |
| Rent | | 5,000 |
| Interest | | 5,000 |

Computation on 50% tax reduction is as follows:

| | | |
|---|----------|--------------------|
| Business I | | 50,000 |
| Business II - losses | (20,000) | Nil |
| Rent | | 5,000 |
| Interest | | 5,000 |
| | | <hr/> 60,000 <hr/> |
| <u>Deduct</u> | | |
| Losses Sect. 44(2) | | (20,000) |
| Taxable Income | | <hr/> 40,000 <hr/> |
| Income Tax on 40,000 @ 30% | = | 12,000 |
| 50% tax reduction: | | |
| $\frac{50,000}{60,000} \times 12,000 \times 50\%$ | = | 5,000 |

5.1.2 Expenses

Where a business carries out activities both inside and outside the JDA, the general expenses incurred may be allocated on a gross profit basis. In case where direct expenses incurred in the JDA could be ascertained, the expenses incurred would be allowed in full. Taxpayers are advised to keep a separate profit and loss account in order to facilitate tax computation.

5.1.3 Section 108 Account

The provisions of Section 108 are apply. Since income from the JDA and the Non-JDA are being assessed as one source, the maintenance of a separate account for the purpose of Section 108 is not necessary.

5.2 Employment Income of Malaysian or Thailand nationals

Any remuneration derived by Malaysian or Thai nationals in the JDA is subject to tax in the country where the recipient is resident. The resident status of the recipient will be determined in accordance with the laws of the respective countries. Where the recipient is a resident of both countries, then his status shall be determined in accordance with the “tie-breaker rule.” (Article 4, Malaysia / Thailand Double Taxation Agreement).

5.3 Employment and professional income received by non-nationals

Any remuneration or professional income derived by non-nationals in respect of employment or professional services exercised in the JDA may be taxable in both countries. The 50% reduction of tax is to be effected at the level of tax chargeable. In determining resident status, information such as traveling details, address and identity card number of the individual can be used as a basis.

- 5.4 Withholding Tax:**
- royalties
 - technical fees
 - contract payments relating to contract services

There is no specific form to be used for the purpose of granting the 50% tax reduction. The tax reduction will be made at the time of payment by the payer on condition that complete evidence in respect of his activities in the JDA could be furnished to IRB.

The taxpayer may forward the application to the Collections Branch for approval.

6. Income Tax Return Form

No special forms will be issued for the purpose of reporting income from the JDA. The normal procedure for filing income tax return applies.

7. Schedular Tax Deduction (STD)

The STD applies even if the workers only work in Malaysia on a short-term basis. Employers are not allowed to reduce the tax on STD by 50%. The taxpayers may apply to stop the STD on receipt of the notice of assessment.

8. Management of Files

Where possible, the assessment files of non-resident taxpayers will be dealt with the Non-Resident Branch in Kuala Lumpur. However, for the convenience of taxpayers living outside Kuala Lumpur, the branch office nearest to where the taxpayers live can maintain their assessment files. Meanwhile, the assessment files of resident taxpayers will be maintained by the respective branches concerned.

9. Procedure for claiming the 50% tax reduction

Taxpayers are required to produce sufficient evidence in respect of income from the JDA before the 50% reduction can be accorded. Evidence and documents, such as the contract agreement for contractors carrying out activities in the JDA, including individuals exercising employment with or providing services to the contractors may be used as a proof for this purpose. Further clarification can be obtained from:

(i) The Technical Division

On matters concerning the implementation of the 50% tax reduction on income from the JDA.

(ii) The International Tax Division

On matters concerning the interpretation of the Protocol Amending the Malaysia/Thailand Double Taxation Agreement.

MTJA will from time to time submit a list of contractors and individual involved with the activities in the JDA. This information will be extended to the various IRB branches to enable them to identify the activities in the JDA for the purpose of giving effect to the 50% tax reduction.

10. Article 26 – Exchange of Information

Article 26 of the Malaysia/Thailand Double Taxation Agreement is applicable for the purpose of obtaining information in respect of activities in the JDA.

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