



## THE TAX POSITION OF COMPANIES LIMITED BY GUARANTEE, FOUNDATIONS AND NON-PROFIT ORGANISATIONS

### Introduction

A business entity in Malaysia is subject to the Income Tax Act 1967 ('ITA 1967') to pay taxes for any income generated through its operations. Pursuant to section 2 of the ITA 1967, most business entities are generally taxable given the wide definition of a taxable person. Nevertheless, Malaysia offers tax exemptions to a certain number of entities which are not for profit in character such as companies limited by guarantee, foundations and non-profit organisations.

### Tax Exemption Provision

The general tax exemption provision is found in section 127 of the ITA 1967. Section 127 provides that any income specified in Part I of Schedule 6 in the ITA 1967 shall be exempt from tax. Some examples in this list of Schedule 6 are the incomes of the Government, State Government, local authority, co-operative society, limited liability partnership, trade unions and others. In particular, paragraph 13 of Schedule 6 specifies that:

- (a) the income of an institution, organisation or fund approved for the purposes of subsection 44(6) so long as the approval remains in force; or
- (b) a religious institution or organisation for charitable purposes, provided such institution or organisation is not operated or conducted primarily for profit and is established in Malaysia exclusively for the purpose of religious worship or the advancement of religion.

In light of that, section 127 is read in conjunction with subsection 44(6) of the ITA 1967. Subsection 44(6) stipulates that the total income of a person shall be deducted by an amount equal to any gift of money made by him to the Government, a State Government, a local authority or an institution or organisation or a fund from the aggregate income of such a person including entities, approved for the purposes of this section by the Director General on the application of the institution or organisation concerned.

Subsection 44(7) of the ITA 1967 further sets out the definitions of certain terms. In regard to institution, the legislation specifies only six categories of institution which would be eligible for the tax exemption status. These categories are as follows:

- (i) a hospital;
- (ii) a public or benevolent institution;
- (iii) a university or other educational institution;
- (iv) a public authority engaged solely in research or other work connected with human diseases;
- (v) a Government-assisted institution engaged in socioeconomic research; or
- (vi) a technical or vocational training institution.

On the other hand, organisation is given a broader scope of meaning in which it is established and maintained exclusively to administer and augment a public or private fund established or held for various purposes. These purposes, as provided in the legislation, range from education, relief of distress, religious worship, promotion of culture or the arts, conservation or protection of animals and environment and others. Above all, there is a caveat on both institution and organisation whereby they shall not be operated or conducted primarily for profit.

### **What Are the Criteria for Tax Exemption?**

There are various criteria that an entity has to satisfy in order to enjoy the benefit of tax exemption under the ITA 1967.

It should be mentioned at the outset that the entity first has to be established in Malaysia and registered as, amongst others, a company limited by guarantee under the Companies Act 2016.[1] A company limited by guarantee is incorporated under the Companies Act 2016 and registered with the Companies Commission of Malaysia (SSM). Alternatively, the entity may take the form of an organisation under the Societies Act 1966 or a body corporate under the Trustees (Incorporation) Act 1952 or under other recognised registrar bodies[2]. In any case, the entity can only seek the approval for tax exemption after the registration or incorporation.

Thereafter, by virtue of sections 127 and 44(6), the eligible entity is entitled to register with the Director General of Inland Revenue Board ('IRB') for an approval to be exempted from tax for its income. Given that the "institution" and "organisation" are loosely defined in subsection 44(6), a company limited by guarantee, foundation or non-profit organisation may fall under this section. For instance, the court in *SBSB v DGIR* [1996] 1 BLJ 271 affirmed that a "foundation is an approved institution within the meaning of the subsection".

Next, the entity shall offer charitable activities as laid out in the aforementioned subsection 44(6). At its core, the objective of the institution or organisation shall not

be making profits. The court in *Syarikat Pendidikan Staffield Bhd v Ketua Pengarah Hasil Dalam Negeri* [2011] 5 CLJ 916 deliberated on the interpretation of “non-profit” and ruled:

*“An organisation should be regarded as being non-profit, where, by its constituent documents or by operation of law (for example a statute governing an organisation), it is prevented from distributing its profits or assets to owners, members or any other individual or group of individuals when it is operating and on winding up...”*[3]

The entity’s income and property shall be “applied solely towards the promotion of the object of the company.”[4] As such, an entity may generate profits from its operations on the premise that profits have to be channelled back to the entity to achieve its objective instead of being paid to stakeholders.

Furthermore, the court discussed at length on the nature of charitable purposes and the activities being carried out therein. Notably, the court gave weight to the entity’s Memorandum of Association in the course of delivering the judgment. The court stated that:

*“...a charitable organisation can conduct non-inherently charitable activities so long as the clear and exclusive purpose is to raise funds to deploy in ways that are charitable. The characterisation of an organisation will therefore be determined by an enquiry into the organisation’s activities as set out in a constitution or memorandum and the legal constraint under which the directors work.”*[5]

In this case, the court appreciated that, “by the constitution of the company, the operating surplus from the operations of the company cannot by law be distributed or applied for the benefit of individuals or commercial companies”.[6] The court lastly added that the tax exemption status of non-profit organisations was not lost[7] while they conducted business enterprise in order to achieve their objectives.

In other words, the entity is allowed to make profits even through non-charitable activities so long as the profits are used in pursuit of the entity’s mission. The activities set out in the entity’s constitution would be inquired to dictate as to whether the entity has charitable purposes. In fact, the significant factor[8] raised by the court was whether any individual who was engaged in managing the organisation had derived benefits from the profits received by the organisation. Nevertheless, the founder or the board members may receive reimbursement of expenses[9] except for remuneration or benefits from the institution or organisation.

The other criteria[10] to be observed is that, in establishing the Board of Trustees, at least 50% of the members of the Board of Trustees must comprise individuals who are not related to the institution or organisation and founder. The entity also has to be in operation for at least two years prior to applying for the exemption. In addition, the entity is required to submit its audited financial statement to the IRB on an annual basis.

Once the approval is granted, the IRB will issue the tax-exemption status to the entity. There are several conditions<sup>[11]</sup> to which the entity has to adhere for the sake of maintaining the approval. Notably, while the approval remains in force, the entity has to continue its operation not primarily for profits. Besides, at least 50% of the income generated in the previous year must be spent in the following year for activities to reach the entity's purpose.

### **Breach of Conditions**

In the event that the entity is found in breach of any condition imposed, the Director General may exercise his discretion to revoke the approval. For instance, in 2019, the IRB withdrew the tax-exemption status of the National Kidney Foundation in Malaysia following an audit carried out by the IRB.<sup>[12]</sup> The withdrawal was grounded on non-compliance with subsection 44(6) of the ITA 1967 in terms of procedural matters and accounting structure. Accordingly, it is recommended that the audit requirements shall be complied with at all time.

### **Summary**

In arriving to this conclusion, it is highlighted that a company limited by guarantee or foundation or non-profit organisation is eligible for tax exemption under the ITA 1967. However, there are various criteria imposed on the entity to successfully obtain the tax-exemption status. Fundamentally, the entity should be established and operated for charitable objects and not primarily for profits. Notwithstanding that, one can infer from the cases that the entity is also free to carry out non-charitable activities which bring profits so long as the profits are utilised for the entity's charitable objectives. It is stressed that the party managing the entity should not see these criteria merely as a box-ticking exercise as the criteria should be strictly observed at all time. It can be gleaned from the instance of National Kidney Foundation that the IRB is always entitled to exercise its discretion to revoke the tax-exemption status once a non-compliance with the conditions of approval is found.

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1. Guidelines for Approval of Director General of Inland Revenue under subsection 44(6) of the Income Tax Act 1967 [http://lampiran1.hasil.gov.my/pdf/pdfam/GP\\_44\\_6\\_06022020\\_2.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/GP_44_6_06022020_2.pdf)
2. Guidelines for Approval of Director General of Inland Revenue under subsection 44(6) of the Income Tax Act 1967 [http://lampiran1.hasil.gov.my/pdf/pdfam/GP\\_44\\_6\\_06022020\\_2.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/GP_44_6_06022020_2.pdf)
3. [2011] 5 CLJ 916 paragraph 29
4. [2011] 5 CLJ 916 paragraph 28
5. [2011] 5 CLJ 916 paragraph 26
6. [2011] 5 CLJ 916 paragraph 30
7. [2011] 5 CLJ 916 paragraph 27
8. [2011] 5 CLJ 916 paragraph 27
9. Guidelines for Approval of Director General of Inland Revenue under subsection 44(6) of the Income Tax Act 1967 [http://lampiran1.hasil.gov.my/pdf/pdfam/GP\\_44\\_6\\_06022020\\_2.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/GP_44_6_06022020_2.pdf)

10. Guidelines for Approval of Director General of Inland Revenue under subsection 44(6) of the Income Tax Act 1967 [http://lampiran1.hasil.gov.my/pdf/pdfam/GP\\_44\\_6\\_06022020\\_2.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/GP_44_6_06022020_2.pdf)

11. Guidelines for Approval of Director General of Inland Revenue under subsection 44(6) of the Income Tax Act 1967 [http://lampiran1.hasil.gov.my/pdf/pdfam/GP\\_44\\_6\\_06022020\\_2.pdf](http://lampiran1.hasil.gov.my/pdf/pdfam/GP_44_6_06022020_2.pdf)

12. <https://www.malaysiakini.com/news/491357>

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