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# Capital Gains Tax: What You Need to Know for Disposal of Shares of Unlisted Companies in Malaysia



Capital gains tax (“CGT”) was introduced into the Malaysian tax regime through amendments to the Income Tax Act 1967 (“ITA”), following the gazetting of the Finance (No. 2) Act 2023 on 29 December 2023. This development has significant implications for how mergers and acquisitions (“M&A”) transactions are conducted in Malaysia.

In this article, we answer the following key questions arising from the introduction of CGT in the context of M&A transactions in Malaysia and in particular, disposal of shares of unlisted companies incorporated in Malaysia.

## 1. What is CGT?

In general, CGT is a type of tax imposed on capital gains derived from disposals of investments.

The new section 4(aa) of the ITA introduces a new class of income on which tax is chargeable under the ITA, namely gains or profits from the disposal of capital assets.

“Capital asset” means:

- (a) moveable or immovable property situated outside Malaysia including any rights or interests thereof; or
- (b) moveable property situated in Malaysia which is a share of a company incorporated in Malaysia not listed on the stock exchange (including any rights or interests thereof) owned by a company<sup>1</sup>, limited liability partnership<sup>2</sup>, trust body<sup>3</sup> or co-operative society<sup>4</sup>(as defined under the ITA).<sup>5</sup>



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“Share” in relation to a company, includes stock other than debenture stock<sup>6</sup>.

Shares of unlisted companies incorporated in Malaysia is one of the classes of capital assets which are subject to CGT.

## 2. Are there any exemptions for disposal of shares of unlisted companies incorporated in Malaysia?

Although the ITA is amended to impose CGT on the disposal of capital assets on or after 1 January 2024, CGT is applicable to disposal of shares of unlisted companies incorporated in Malaysia starting on 1 March 2024. The Income Tax (Exemption) (No. 7) Order 2023 exempts a company, limited liability partnership, trust body or co-operative society from the payment of CGT received from the disposal of shares of unlisted companies incorporated in Malaysia made on or after 1 January 2024 to 29 February 2024.

The Government of Malaysia has indicated, in its Budget 2024 speech, that it will consider exemptions for disposal of shares in connection with approved initial public offering, internal group restructuring and venture capital related investments. However, these proposed exemptions have yet to be incorporated into any legislations as of the date of this article.

## 3. When is the effective date?

In respect of the disposal of shares of unlisted companies incorporated in Malaysia, the effective date for the application of CGT is 1 March 2024 due to the two months’ exemption discussed above.

**4. Who is chargeable with CGT for disposal of shares of unlisted companies incorporated in Malaysia?**

In general, sellers as described below which dispose of shares of unlisted companies incorporated in Malaysia are subject to CGT.

Companies, limited liability partnerships, trust bodies or co-operative societies (as defined under the ITA<sup>7</sup>) which receive gains or profits from the disposal are chargeable with CGT<sup>8</sup>. It should be noted that for the purpose of ITA, a company includes a corporation established outside Malaysia and a business trust<sup>9</sup>.

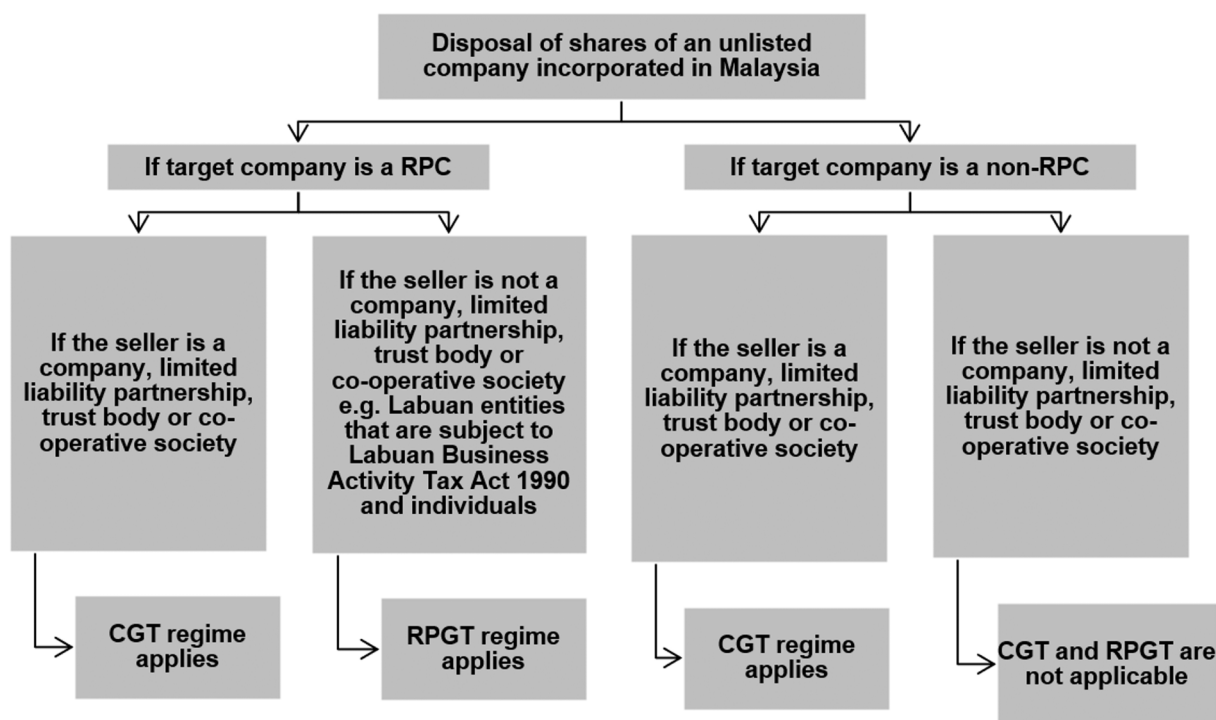
Labuan entities that are subject to Labuan Business Activity Act 1990 and individuals are not subject to CGT but will continue to be subject to real property gains tax (“RPGT”) for disposal of real property or shares in a real property company (“RPC”).<sup>10</sup>

Please refer to question 5 on the application of RPGT and CGT on the various entities.

**5. Whether RPGT or CGT applies for disposal of shares of unlisted companies in Malaysia?**

The following diagram depicts whether RPGT or CGT regime applies depending on:

- whether the target company is a RPC or non-RPC company; and
- whether the seller is a company, limited liability partnership, trust body or co-operative society (as defined under the ITA).



**6. What constitutes disposal for the purpose of CGT?**

For the purpose of CGT, “disposal” means to sell, convey, transfer, assign, settle or alienate whether by agreement or by force of law and includes a reduction of share capital and purchase by a company of its own shares.<sup>11</sup>



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**7. What is the rate of CGT for the disposal of shares of unlisted companies incorporated in Malaysia?**

In relation to disposal of shares of unlisted companies incorporated in Malaysia which was acquired before 1 January 2024

**CGT rate<sup>12</sup>**

10% of chargeable income from the disposal of the shares; or  
2% of gross disposal price of the shares (at the option of the seller)

In relation to disposal of shares of unlisted companies incorporated in Malaysia which was acquired on or after 1 January 2024 10% of chargeable income from the disposal of the shares

10% of chargeable income from the disposal of the shares

**8. What are the filing and payment requirements for CGT?**

Taxpayers or through their tax agents are required to submit CGT return form through e-Filing at the MyTax portal (<https://mytax.hasil.gov.my>) together with the CGT payment within 60 days from the date of disposal of shares in unlisted companies incorporated in Malaysia.<sup>13</sup>

**9. What is the date of disposal?**

The date of disposal for the purpose of submission of CGT return and payment of CGT to the Inland Revenue Board of Malaysia is as follows:

Where there is a written agreement for the disposal and no approval is required from the Government or State Government for the acquisition of disposal

**Date of Disposal**

The date of the agreement.<sup>14</sup>

Where there is a written agreement for the disposal and approval is required from the Government or State Government for the acquisition of disposal

The date of the approval or if the approval is conditional, the date in which the last of all conditions is satisfied.<sup>15</sup>

Where there is no written agreement

The date of the completion of the disposal of the capital asset.<sup>16</sup>

The date of completion means the date on which the ownership is transferred by the seller, or the date on which the whole of the amount of the consideration is received by the seller, whichever is earlier.<sup>17</sup>

## Commentary

The introduction of CGT marks a significant development with notable implications for M&A transactions in Malaysia. Some of the key considerations for disposal of unlisted companies incorporated in Malaysia include:

- whether there is any CGT exemption for disposal of shares of unlisted companies incorporated in Malaysia;
- the pricing of disposals, as sellers will take into consideration the CGT payable when negotiating deals; and
- whether there are any capital losses from previous restructuring exercises which may be utilised.

Several aspects remain unclear and are subject to further clarification. For instance, it is unclear whether the redemption of redeemable preference shares constitutes disposal for the purpose of CGT. Additionally, the exemptions in respect of internal group restructurings, approved initial public offering and disposals by venture capital companies are still pending formalisation.

It is prudent to continuously monitor the legislative updates on CGT and seek professional advice to ensure that all considerations are taken into account before undertaking disposals of shares of unlisted companies incorporated in Malaysia.

<sup>1</sup> A "company" means a body corporate and includes any body of persons established with a separate legal identity by or under the laws of a territory outside Malaysia and a business trust (section 2 of the ITA)

<sup>2</sup> A "limited liability partnership" means a limited liability partnership registered under the Limited Liability Partnerships Act 2012 (section 2 of the ITA)

<sup>3</sup> A "trust body", in relation to a trust, means the trust body provided for by section 61 of the ITA (section 2 of the ITA)

<sup>4</sup> A "co-operative society" means any co-operative society registered under any written law relating to the registration of co-operative societies in Malaysia (section 2 of the ITA)

<sup>5</sup> Section 2 of the ITA

<sup>6</sup> Section 2 of the ITA and paragraph 3.2(e) of the Guidelines on Capital Gains Tax for Unlisted Shares issued by the Inland Revenue Board of Malaysia with effect on 1 March 2024

<sup>7</sup> Please refer to endnotes 1 to 4.

<sup>8</sup> Section 65D(1) of the ITA

<sup>9</sup> Section 2 of the ITA

<sup>7</sup> Please refer to endnotes 1 to 4.

<sup>8</sup> Section 65D(1) of the ITA

<sup>9</sup> Section 2 of the ITA

<sup>10</sup> A "real property company" means a controlled company which as at 21 October 1988, owns or at any later date, acquires real property (in Malaysia) or shares in an RPC or both, whereby the defined value of real property or shares or both, owned at that date is not less than 75% of the value of its total tangible assets.

"Defined value" means the market value of the real property or the acquisition price of the RPC shares.

"Value of total tangible assets" refers to the aggregate of the defined value of real property and/or RPC shares and the value of other tangible assets.

(Paragraph 34A, Schedule 2 of Real Property Gains Tax Act 1976).

<sup>11</sup> For RPGT purpose, "real property" means any land situated in Malaysia and any interest, option or other right in or over such land. Section 65C of the ITA

<sup>12</sup> Section 6(1)(g) and Part XXI, Schedule 1 of the ITA

<sup>13</sup> Section 77A(1B) of the ITA and CGTRF Submission Guide Notes published by Inland Revenue Board of Malaysia at <https://www.hasil.gov.my/en/forms/cgt-return-form-filing-programme/>

<sup>14</sup> Section 65F(1)(a) of the ITA

<sup>15</sup> Section 65F(4) of the ITA

<sup>16</sup> Section 65F(1)(b) of the ITA

<sup>17</sup> Section 65F(3)(a) of the ITA

*This article is authored by our Partner, Ms Wong Mei Ying and Associate, Ms Ooi Hui Tian. The information in this article is intended only to provide general information and does not constitute any legal opinion or professional advice.*



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# DEPARTING FROM LAST-IN-FIRST-OUT: THE “BEST FIT” PRINCIPLE



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The year 2020 will be remembered as one of the most challenging periods for the airline industry. The enforcement of the travel and border restrictions in many countries during COVID-19 pandemic had drastically reduced the demand for flights, adversely impacting the financial performance of airline companies. According to Malaysian Aviation Commission (**MAVCOM**), Malaysia experienced a massive drop in air travel in the third quarter of 2020 compared to the same period in 2019. Specifically, the number of international passengers reduced by 98.1%, meaning almost no one was flying internationally. Meanwhile, domestic travel also suffered significantly with a 69.3% decrease in domestic passengers.<sup>1</sup>To keep themselves afloat, many airline companies had to make tough decisions to reorganise their business operations and to retrench their employees.

Retrenchment is often a controversial process due to the need to strike a balance between the competing rights of the employers to run and reorganise its business and the rights of the employees to enjoy security of tenure. Traditionally, the Last-In-First-Out (LIFO) principle has been used in such scenarios to determine which employees to be let go first. However, these unprecedented challenges have forced the companies to rethink and sometimes deviate from this principle. This can be observed from an airline’s recent cases, where the airline opted for a “best fit” selection criteria instead of LIFO principle during its retrenchment exercise.

<sup>1</sup>Malaysian Aviation Commission, Waypoint Report: December 2020 (MAVCOM 2020) <https://www.mavcom.my/wp-content/uploads/2020/12/201208-MAVCOM-Waypoint-Report-December-2020.pdf> accessed 18 June 2024.

## **What is LIFO principle?**

The LIFO principle is a method used in retrenchment exercises in a redundancy situation to determine which employees should depart based on their length of service. This principle is designed to afford a healthy safeguard against discrimination of the employees in retrenchment exercises<sup>2</sup> by ensuring that the most junior employees are retrenched before the more senior ones in the same category. However, the LIFO principle does not apply to cases where there is only one person in a particular position or category that has been identified as redundant.<sup>3</sup>

The LIFO principle comes from the Code of Conduct for Industrial Harmony (“**Code**”), but it is not a strict law. Clause 22(b) of the Code states that employers should select employees for retrenchment based on objective criteria, with the length of service being one such criterion. Thus, the LIFO principle is only one of these criteria that employers are encouraged to consider when making retrenchment decisions.<sup>4</sup> However, any departure from the LIFO principle must be justified with acceptable or valid reasoning. Otherwise, preferential treatment of junior employees over senior ones can indicate a lack of bona fides in the retrenchment exercise.<sup>5</sup>

Case law reveals that the LIFO principle is traditionally favoured due to its simplicity and the perceived fairness. It retains employees based on their loyalty towards their employers regardless of age, gender, race, colour, or nationality. This approach also helps to maintain transparency, which is essential to ensure procedural fairness in retrenchment exercises.

## **“Best fit” policy: was it fair?**

In a recent Industrial Court case, the Claimant alleged that an airline (“the Company”) had wrongfully dismissed him by adopting the “best fit” policy in the Company’s retrenchment exercise. The Claimant, a co-pilot with 16 years of service without accident, argued that adherence to the LIFO principle would have preserved his position, questioning the fairness

<sup>2</sup> *Dynacraft Industries Sdn Bhd v Kamaruddin bin Kana Mohd Sharif & Ors* [2012] 4 ILJ 334

<sup>3</sup> *First Allied Corporation Bhd v Lum Siak Kee* [1996] 2 ILR 1628

<sup>4</sup> *Supreme Corporation Bhd v. Doreen Daniel & Ong Kheng Liat* [1987] 2 ILR 522

<sup>5</sup> *Tan Hong Yak v Nixdorf Computer (M) Sdn Bhd* [1997] MELR 347



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of his redundancy while foreign pilots remained employed.

The Company defended its position by highlighting the severe financial difficulties it faced due to the global economic changes in the Asia Pacific region and the COVID-19 pandemic. As a result, the Company had no choice but to undergo a business alignment exercise to maintain a lean and efficient operations team of crews and pilots, i.e. to retain only a core team of “best fit” employees. The company justified its “best fit” approach by reviewing the performance ratings and disciplinary records of the pilots including the Claimant, since 2016. Despite his 16 years of service, the Claimant’s past ratings of “Must Improve” in 2016 and “Need Improvement” in 2019 had compelled the Company to proceed with the retrenchment.

Considering the Company’s intention for the business alignment exercise to retain the “best fit” employees during the COVID-19 pandemic to mitigate financial adversity, the Industrial Court held that the Company was justified in deviating from the LIFO principle when deciding to retrench the Claimant. The



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Industrial Court noted that selecting employees for retrenchment based on work locations, special skills/ qualifications, performance ratings and disciplinary records was justified to depart from the LIFO principle for the Company to achieve its objective in the face of a financial crisis.

Further, retrenchment exercises should always be guided by objective performance and business needs, not nationality. Whilst recognising the "Foreign Worker, First Out" Policy, it applies only when both local and foreign workers possess equal qualifications and competence. Prioritising local workers over more competent foreign workers can harm the company's overall performance and productivity.

**Is the "best fit" policy a new trend?**

The "best fit" policy, prominently used by the Company during the COVID-19 pandemic, represents a notable shift in how some companies approach retrenchment. The Company underwent business restructuring, including retrenchments, downsizing its fleet, and shutting down some of its international operations as part of an effort to weather through the financial hardship during the COVID-19 pandemic. This restructuring led to a series of legal cases brought by affected employees against the Company.

Nevertheless, based on case law, the Industrial Court has consistently upheld the Company's "best fit" policy as a fair and pragmatic approach given the unprecedented challenges posed by the pandemic. This new trend reflects the flexibility within the industrial relations landscape in times of economic crisis and underscores the importance of applying objective criteria in retrenchment exercises.

**Implications of the Recent Decisions**

The Industrial Court's decisions to uphold the Company's deviation from the LIFO principle in favour of a "best fit" policy has significant implications for both employers and employees. It sets a legal precedent allowing companies to prioritise experience, performance, skills, and overall fit over tenure during retrenchment, potentially leading more companies to adopt similar approach in times of economic and financial crisis. This can enhance operational efficiency by retaining employees who are best suited to meet their current business needs.

However, the potential negative impact on employees who lose their jobs during times of uncertainties should not be overlooked. There must be a balance between the competing rights of the employers and employees. Whilst employers can choose to depart from LIFO and adopt their own criteria, it also means that the selection criteria are subject to further evaluation by the court. Therefore, employers are advised to ensure that transparent and fair procedures are implemented and well-documented during retrenchment exercises. Consequently, companies may need to revisit their retrenchment policies to ensure decisions are justified and balanced between operational needs and fair treatment of employees.



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# THE POWER OF DESIGN:

## A BEGINNER'S GUIDE TO INDUSTRIAL DESIGN IN MALAYSIA



Industrial design, although a pivotal component of intellectual property (“IP”), often flies under the radar when compared to more familiar forms of IP such as patents, trademarks and copyrights. In Malaysia, this disparity is particularly obvious from the application and registration or grant statistics issued by the Intellectual Property Corporation of Malaysia (“MyIPO”)<sup>1</sup>, with industrial design receiving less attention from the general public.

This article serves as a 101 to understanding industrial design in Malaysia.

### **What is “Industrial Design”?**

Industrial designs, as defined and governed by the Industrial Designs Act 1996 (“Act”), are features of shape, configuration, pattern or ornament applied to an article through industrial processes or means. These features are intended to appeal to and be judged by the eye in the finished article. It is important to note that industrial designs do not include:

- a method or principle of construction;
- features of shape or configuration of an article which are dictated solely by the function which the article has to perform. In simpler terms, this exclusion applies when an article is shaped in a specific way in order for the article to work properly; and
- features of shape or configuration which are dependent upon the appearance of another article of which the article in question is intended by the designer to form an integral part.

### **Registrable Design**

An industrial design is not registerable unless it is ‘new’. What then is considered ‘new’? An industrial design for which registration is sought is not ‘new’ if, before the priority date of the application to register the design, the design was disclosed to the public anywhere in Malaysia or elsewhere, or the design was covered by a different applicant’s application for registration filed in Malaysia with an earlier priority date.

A design will not be deemed to have been disclosed to the public if it appeared in an official exhibition or it has been unlawfully disclosed by a person other than the applicant or his predecessor in title within the period of six (6) months preceding the application filing date. Further, for an industrial design to be ‘new’, it must be substantially different from an existing design and not differ from the existing design only in immaterial details or in features commonly used in the relevant trade. Slight modifications do not make a design ‘new’.

Industrial designs that are contrary to public order or morality will also not be registrable.

### **Who Owns The Design?**

The author of an industrial design is generally considered the original owner. However, if the design is created under a commission, the person commissioning it is deemed the original owner, unless otherwise agreed. Similarly, if an employee creates the design during his/her employment, the employer is regarded as the original owner, subject to any contrary agreement. In cases where a design is generated by a computer with no human author, the person who made the necessary arrangements for its creation is considered the author.

A registered industrial design is a personal property capable of assignment, transmission or being dealt with by operation of law.

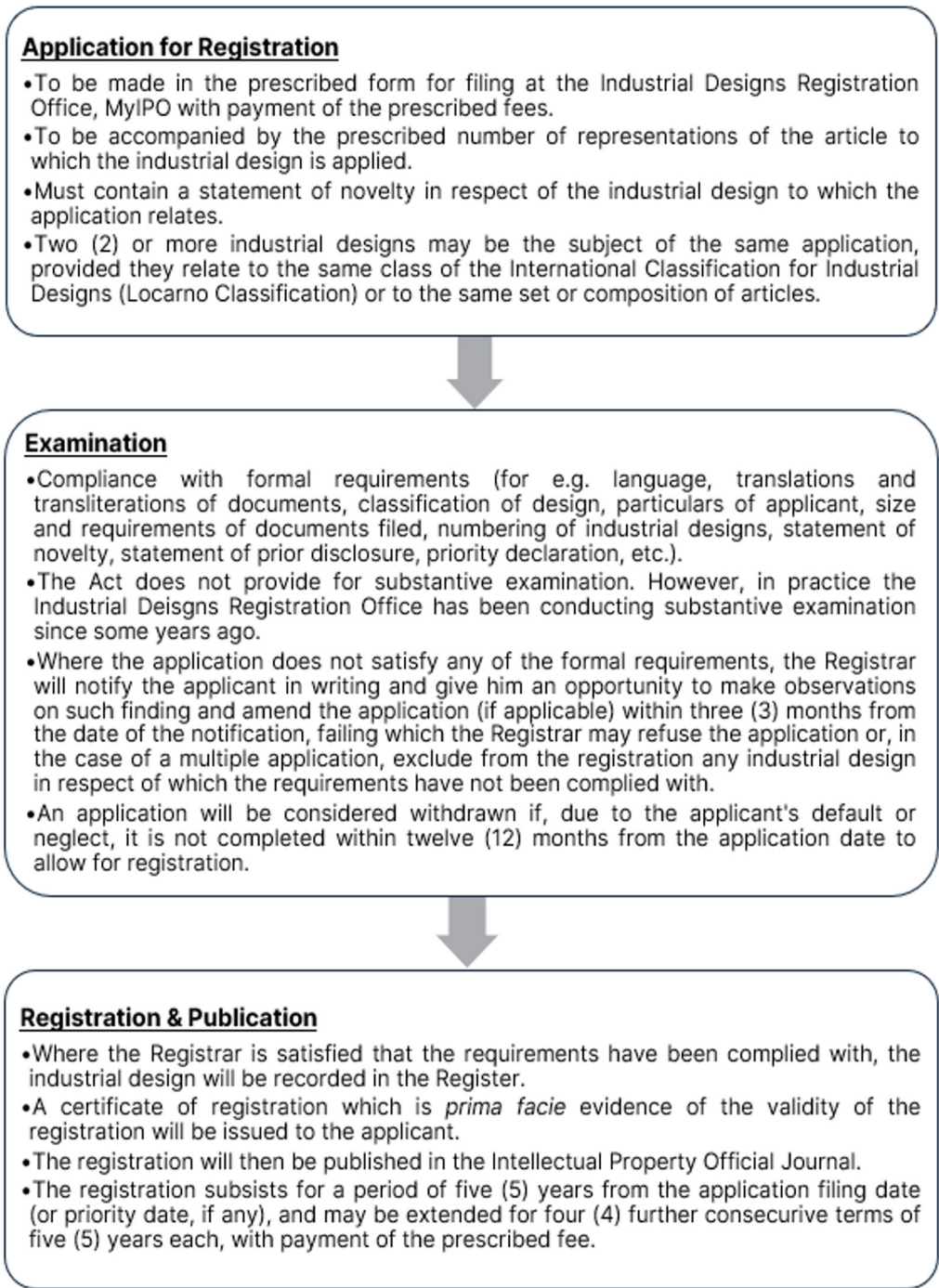
### **Why Is It Important To Register A Design?**

The owner of a registered industrial design enjoys the exclusive right to make or import for sale or hire, or for use for the purposes of any trade or business, or to sell, hire or to offer or expose for sale

or hire, any article to which the registered industrial design has been applied.

The original owner of an industrial design, as defined above, is entitled to make an application for the registration of the industrial design.

Below is a flowchart briefly outlining the process of an industrial design registration:



<sup>1</sup> <https://www.myipo.gov.my/en/statistic-application-registration/#toggle-id-1>



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